Why have metallurgical coal prices fallen even as iron ore has soared?
Coking coal’s decline was so severe this year, that benchmarks briefly fell below iron ore

- After nine full months, the daily average PHCC benchmark fell 29.7% year on year to $137/t.
- By contrast, the daily average 62% Fe fines benchmark, also imported in China, rose 5.6% to $100/t.

Source: Fastmarkets
Not surprisingly, Chinese ore miners have had another great year; coal miners one to forget!

- Rising prices have helped Chinese iron ore miners increase their profits by 31.3% this year.
- By contrast, coal mining & washing profits are down 30.0%.
- Unsurprisingly, steelmakers are also struggling; profits fell 23.1% bringing margins down to just 3.1% from an already poor 4.0% in 2019.
Arguably, Chinese steelmakers have been better off than their foreign peers…

Source: Fastmarkets Steel Tracker. Note: Hot metal proxies are lagged two months for EU and Chinese spreads; prime scrap lagged one month to calculate US spread
... thanks to an enduring steel demand surge which has contrasted with a collapse in the rest of the world.

- Steel demand appeared to rise by as much as 9.0% year on year through the first nine months in China, accelerating from the 8.1% growth we recorded at the same time one year ago.

- The rest of the world, by contrast, has seen demand fall by 15.9%, compared to just a 0.3% decline one year ago.

Source: WSA, NBS, Fastmarkets
Given the strong demand in China, uncertain but increasingly important iron ore import volumes have exacerbated the price trend.

- Last year and to a lesser extent in 2020, supply-side concerns in the seaborne market have caused prices to spike.
- We see this as an inverse relationship between Chinese imports as a share of Chinese demand, and the price.
- A few years earlier, the opposite happened as a surplus of seaborne imports lead to a price collapse.

Source: Fastmarkets
While China’s dependency on imported iron ore is increasing, for coking coal it is relatively limited.

- As Chinese demand keeps growing, the country’s exposure to the seaborne market remains high, supporting prices which are less exposed to weaker markets elsewhere.

- For coking coal by contrast, seaborne exposure to a strong Chinese market is limited and so suppliers are more dependent on weaker markets elsewhere.

Source: Steelhome, Fastmarkets
...consequently coking coal prices are more dependent on weaker, more volatile markets

Source: JISF, VWStahl, AcoBrasil, NBS
And even in strong China, where demand is rising, steelmakers have been attempting to reduce their coke & coking coal intensity

- Official statistics from the NBS in China reveal that coke rates and underlying coke consumption fell over recent years, even as iron and steel production increased.

- The spectacular rise in iron production since 2017, however, suggests that coke consumption must have increased at steelmakers even if the coke rate fell further.

- This year, however, just as net imports of iron ore rose more than 10%, net imports of coking coal fell more than 10%, suggesting why prices have moved in different directions this year.

Source: NBS
Is the semblance of recovery already over?
The big story in coal recently has been in China, where the government asked steel mills to avoid importing Australian coal.

Alternative suppliers are believed to be short on material and shipping times so long, that buyers’ only option for fresh deliveries this year is to make local enquiries.

This is as the government reportedly planned: to support the domestic mining industry.

Source: Steelhome citing China Customs. Data refer to Chinese coking coal imports in first 8 months of 2020
Unsurprisingly, Chinese domestic prices are rising **BUT** at seaborne suppliers’ expense…

The immediate impact of the “verbal” agreement not to import Australian coal has been…

…Rises in local coal prices of roughly $5/t…

…Reductions in seaborne coal prices of close to $20/t

Source: Fastmarkets. Data compiled on a weekly average basis.
• China’s decision to “raise the drawbridge” on Australian coal has negatively impacted spot prices and puts predicted price rises under threat.

• In our so-called “verbal impact” scenario where neither offers nor bids can be meaningful, prices are likely to be paralysed until trade is allowed to resume (next year).

• Given no change to our fundamental view, however, we expect prices in Q1 will catch up with our forecasts.
... though an inevitable demand rally should pull prices higher again in the first quarter

Year-on-year changes in non-China markets in Q1

Quarter-on-quarter changes in non-China markets in Q1

Quarter-on-quarter changes in Q1 in China; year-on-year changes are higher at 5.5% given effects of COVID in early 2020
Can the longer-term outlook live up to post-crisis targets?
Can we expect a demand surge next year, as in 2010?

- At the last recession in 2009, non-China demand fell by 22%, the partial recovery the following year amounted to 20%. Including China the recovery amounted to 11%, following a 2% fall in 2009.

- The EU and the Americas rose as much as 30% in 2010, following particularly sharp recessions. Only India rose more quickly but from a smaller base.

Source: WSA
The 2021 recovery is predicted to be as dramatic as what was experienced in 2010…

According to Oxford Economics data, the key steel using sectors from construction through automotive industries fell by 7.8% in 2009 before reviving 8.2% the following year.

The automotive recovery was particularly sharp, from -12.6%, automotive output surged 26.0% in 2010!

This time around, a similar 7.2% fall is predicted in end-user activity this year before an 8.3% revival is forecast next year.

Again leading the recovery will be the automotive industry, dominated by ironmaking and coke consuming integrated steel mills.

After falling 21.2% this year, far worse than in 2009, the recovery is expected to reach 19.1% next year.

Source: Oxford Economics, Fastmarkets. Note: SWIP is a steel weighted industrial production index.
And with a demand surge, what could happen to prices?

- At the last recession in 2009, coking coal prices fell by 34% to $165/tonne fob Australia. The following year, in light of an 11% revival in demand, prices rose 29% to reach $213/tonne. They rose a further 40% in 2011!

- As in 2009, the PHCC benchmark has fallen hard so far this year (30% in first 9 months).

- Assuming it were to recover next year at the speed it did in 2010, we can expect a nominal gain of $34/t.

Source: WSA