

**IMnI 41st Annual Conference**

# China's New Macro Policy Strategy: A Steel Industry Perspective

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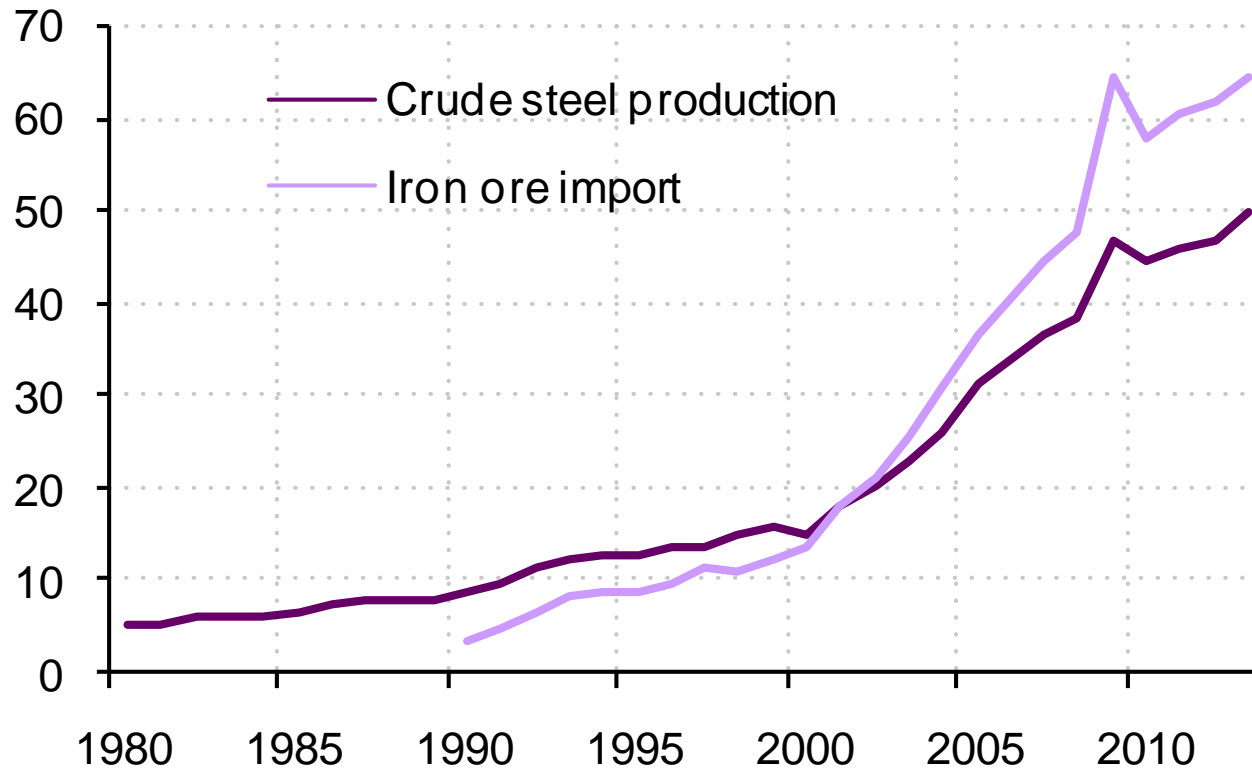
# Agenda

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- ◆ Driving factors of China's steel industry
- ◆ China's new macro policy strategy and its implication on the steel industry
- ◆ Conclusion

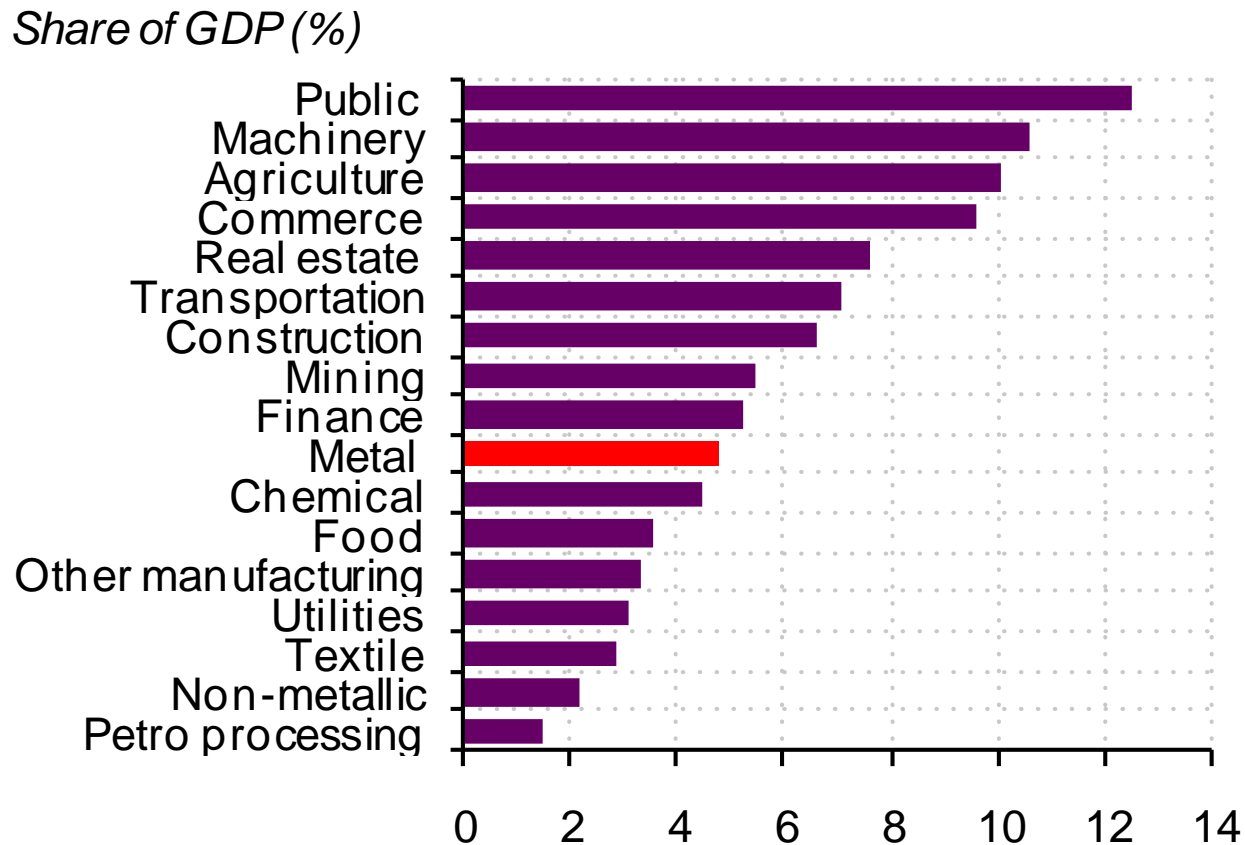
# China plays a dominant role in the global steel industry

China's share in the world (%)



Source: Wind

# In China, metal industry stands in the middle amongst 17 major industries in terms of share of GDP



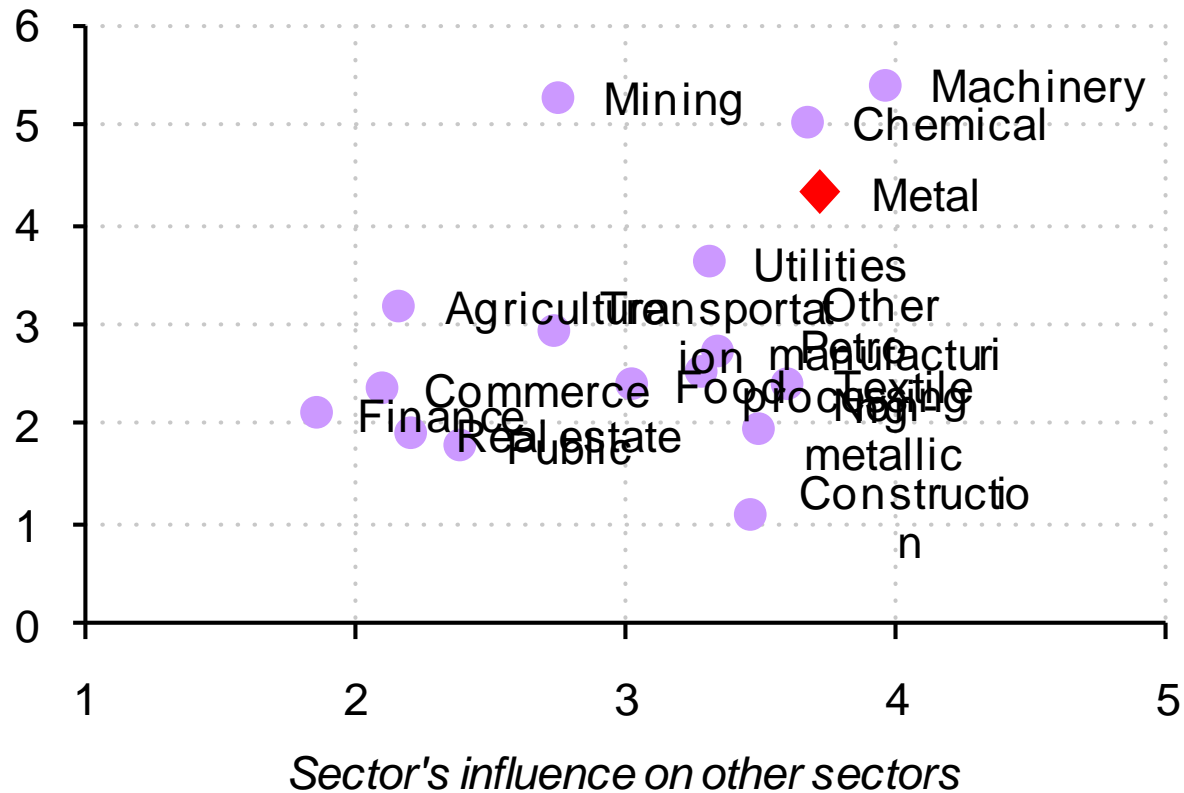
Note: Ferrous metal accounts for about 60% of the metal industry.

Source: Wind

# Metal industry in China is highly cyclical, as it has both strong influence and reaction to other sectors

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*Sector's reaction to other sectors*

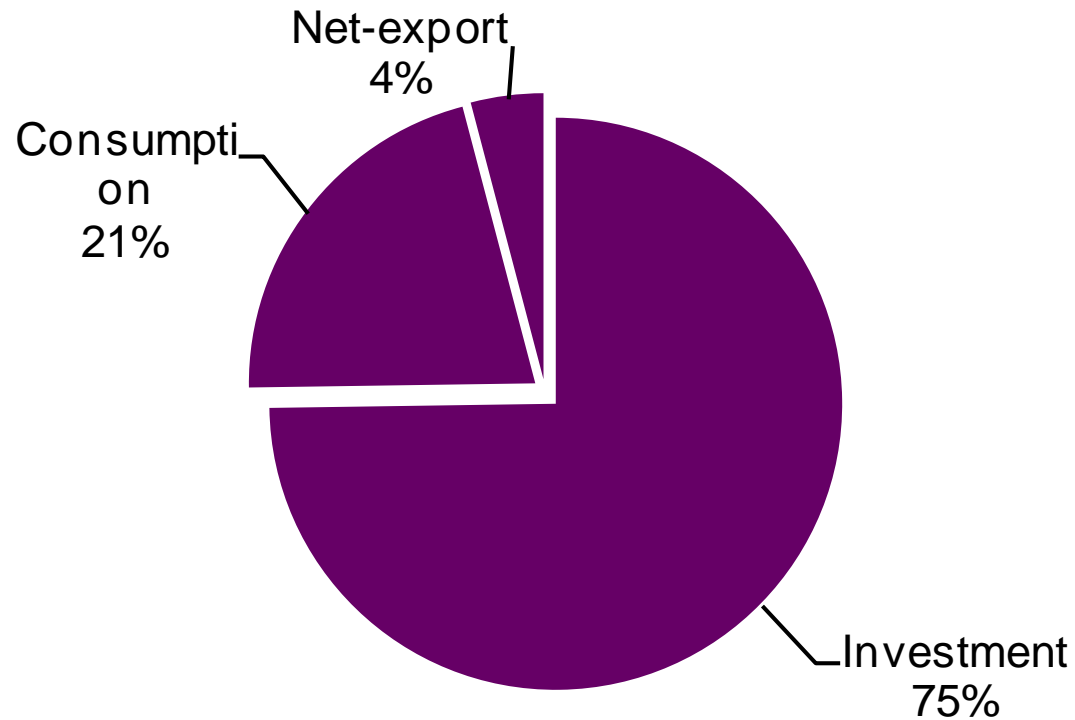


Source: Wind

# 3/4 of final demand for metal in China comes from investment

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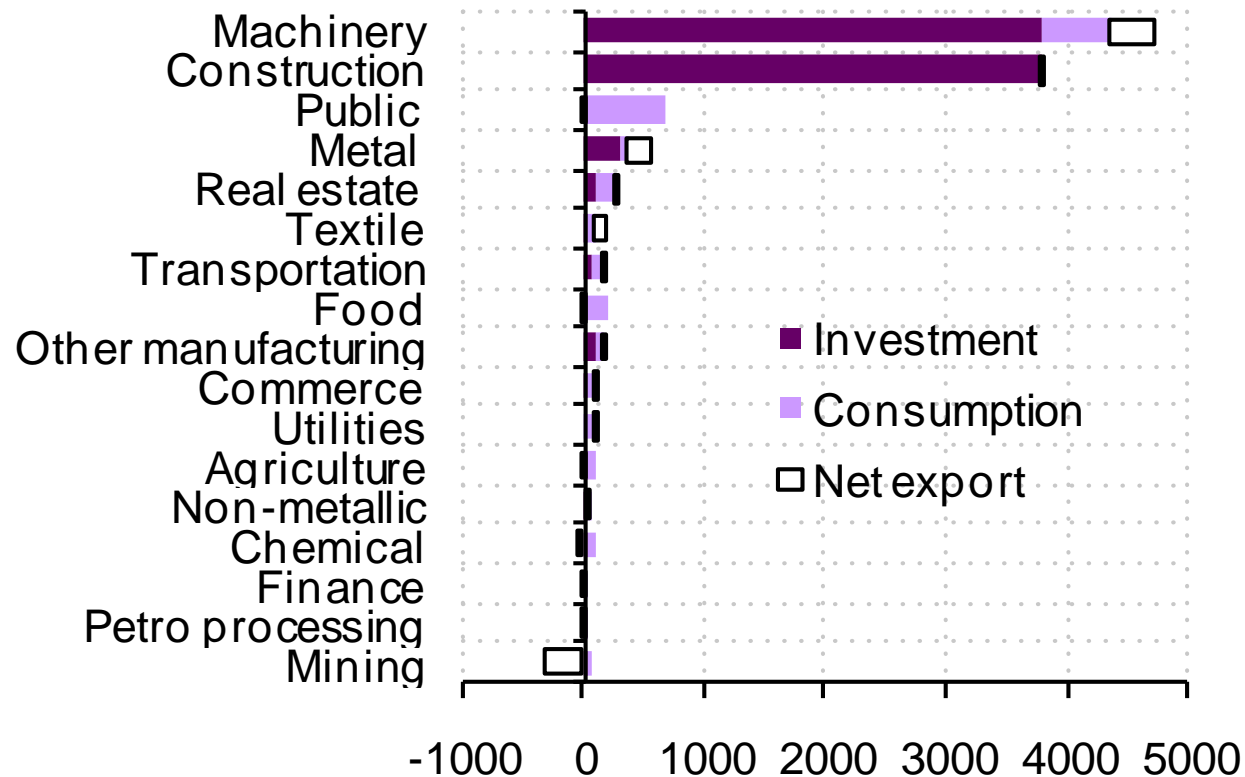
*Composition of final demand of the metal sector (%)*



Note: Data is estimated with China `s input-output table in 2010.  
Source: Wind

# Investment in machinery and construction constitutes the lion's share of metal industry's final demand

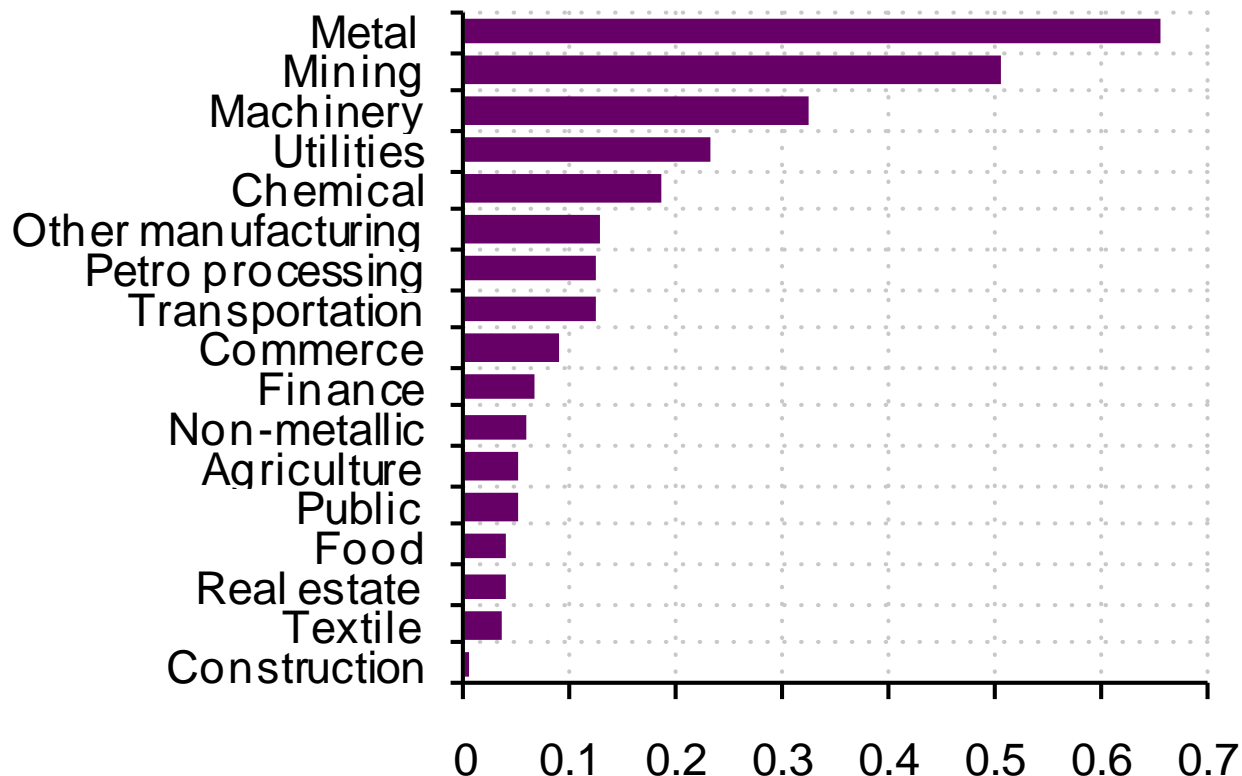
Contribution to metal output (RMB bn)



Note: Data is estimated with China's input-output table in 2010.  
Source: Wind

# The metal industry has strong spillover effects on sectors such as metal, mining, machinery, and utilities

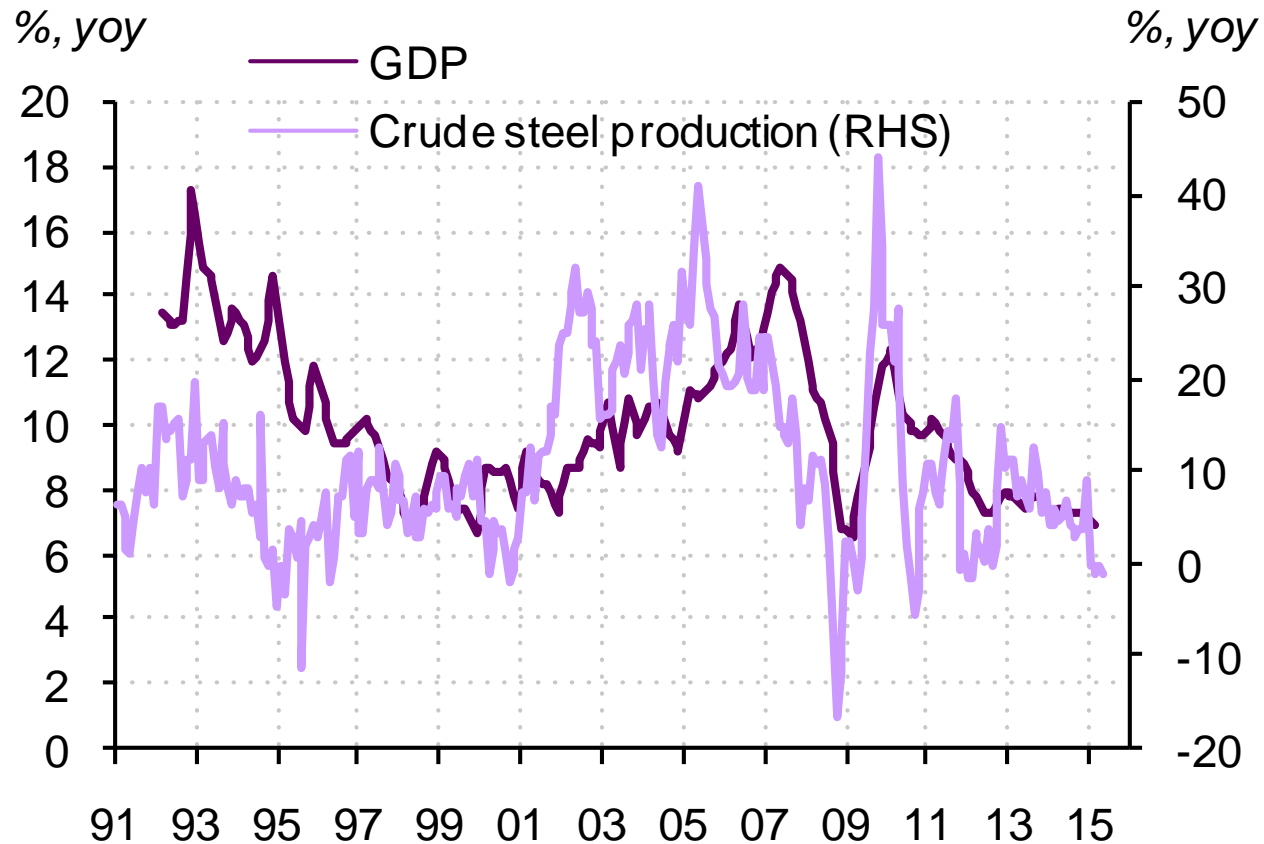
*Influence of 1 yuan metal output on other sectors (yuan)*



Note: Data is estimated with China 's input-output table in 2010.  
Source: Wind



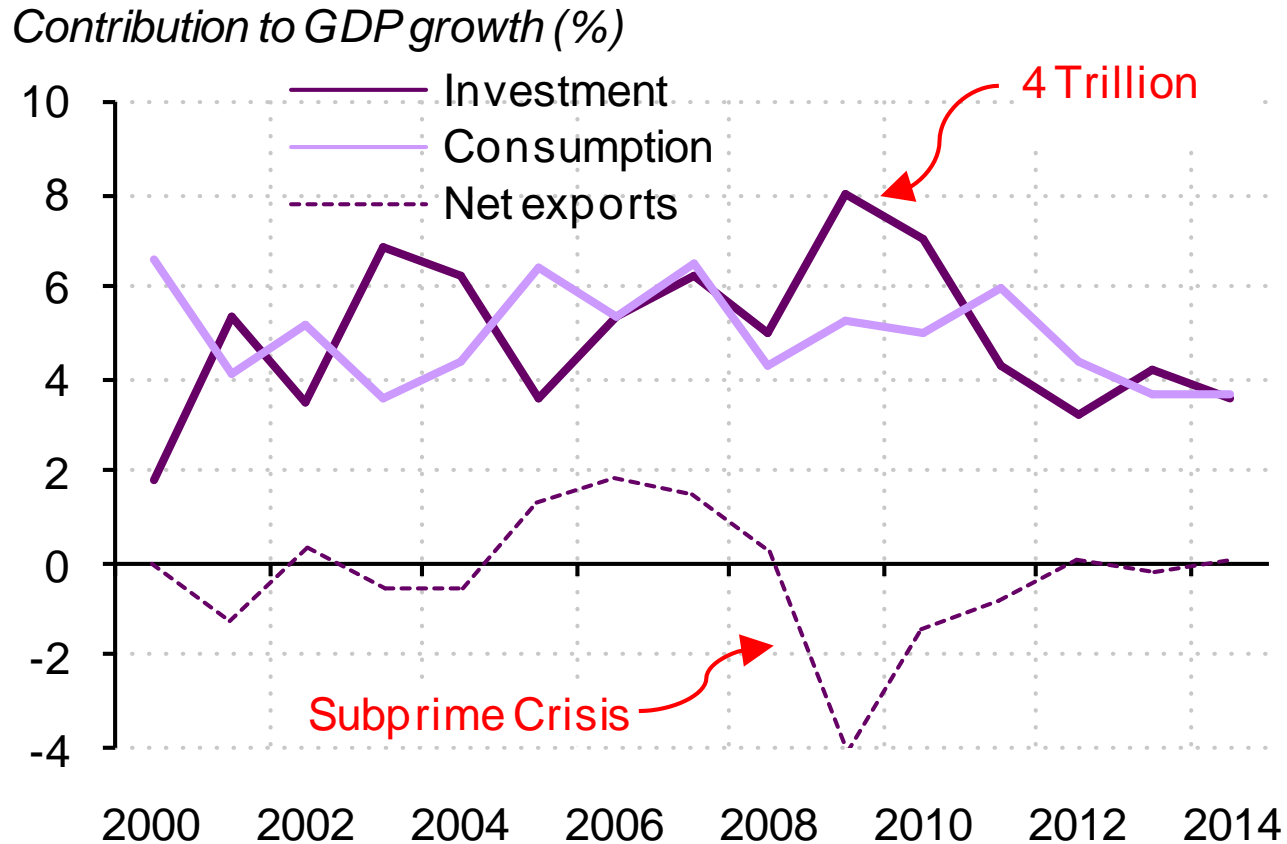
# Steel production in China is highly cyclical



Source: Wind

# After the Subprime Crisis, China has to more heavily rely on domestic investment rather than exports to sustain its economic growth

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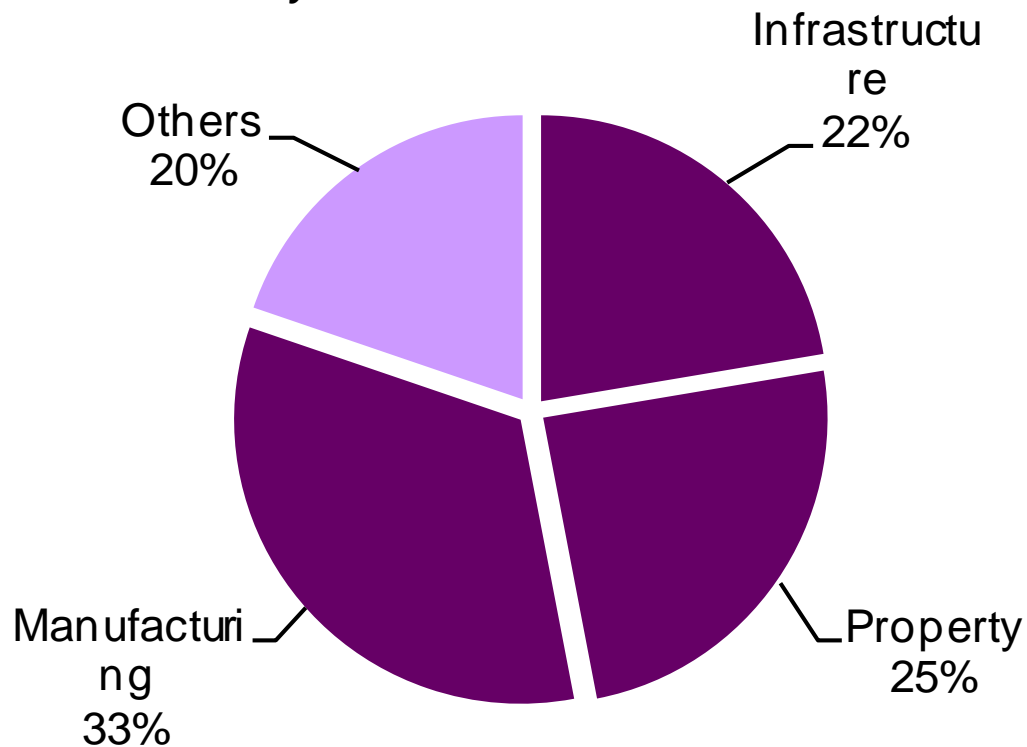


Source: Wind

# China's investment consists of 3 main parts: infrastructure, property, and manufacturing

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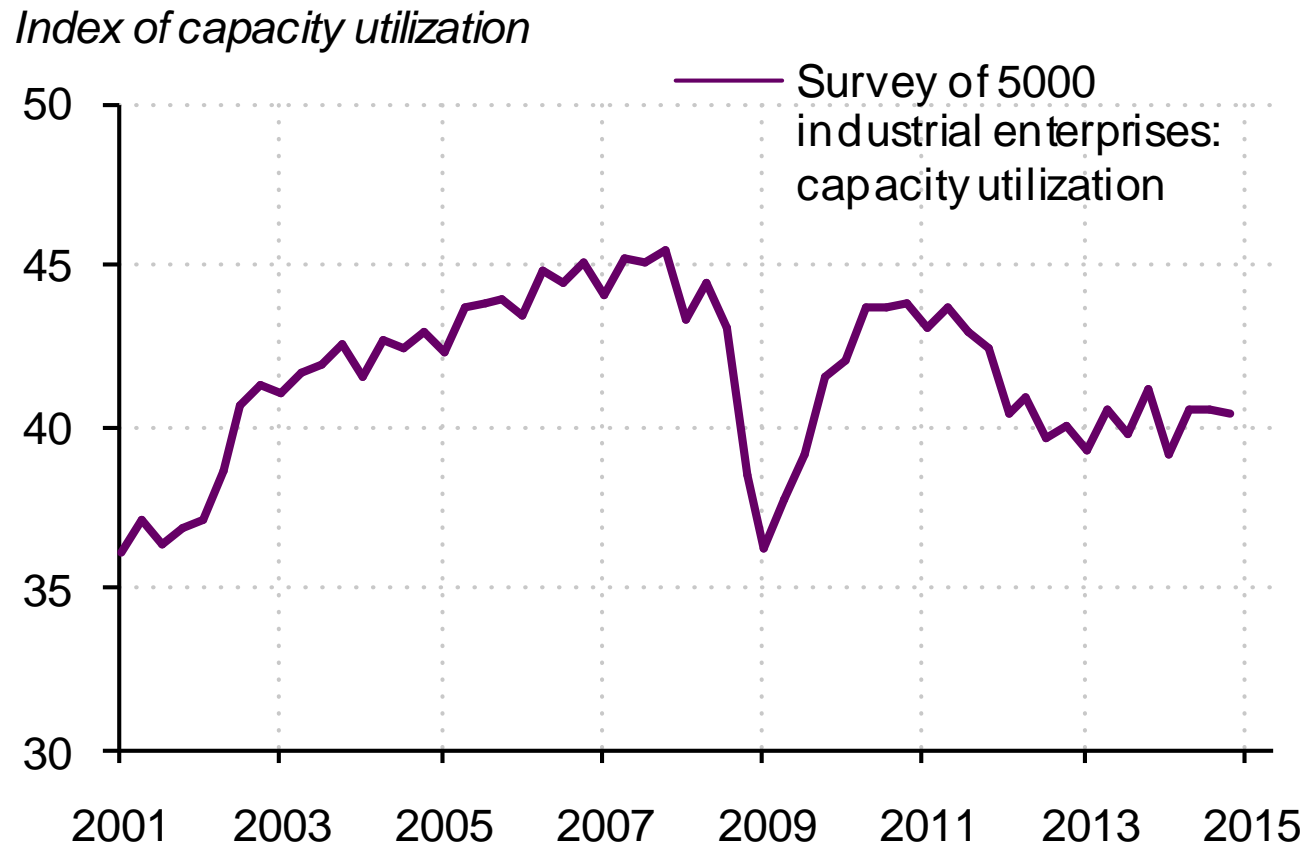
*Composition of FAI in year 2014*



Source: Wind

# Capacity utilization of China's industrial sector has fallen as a result of massive over-capacity

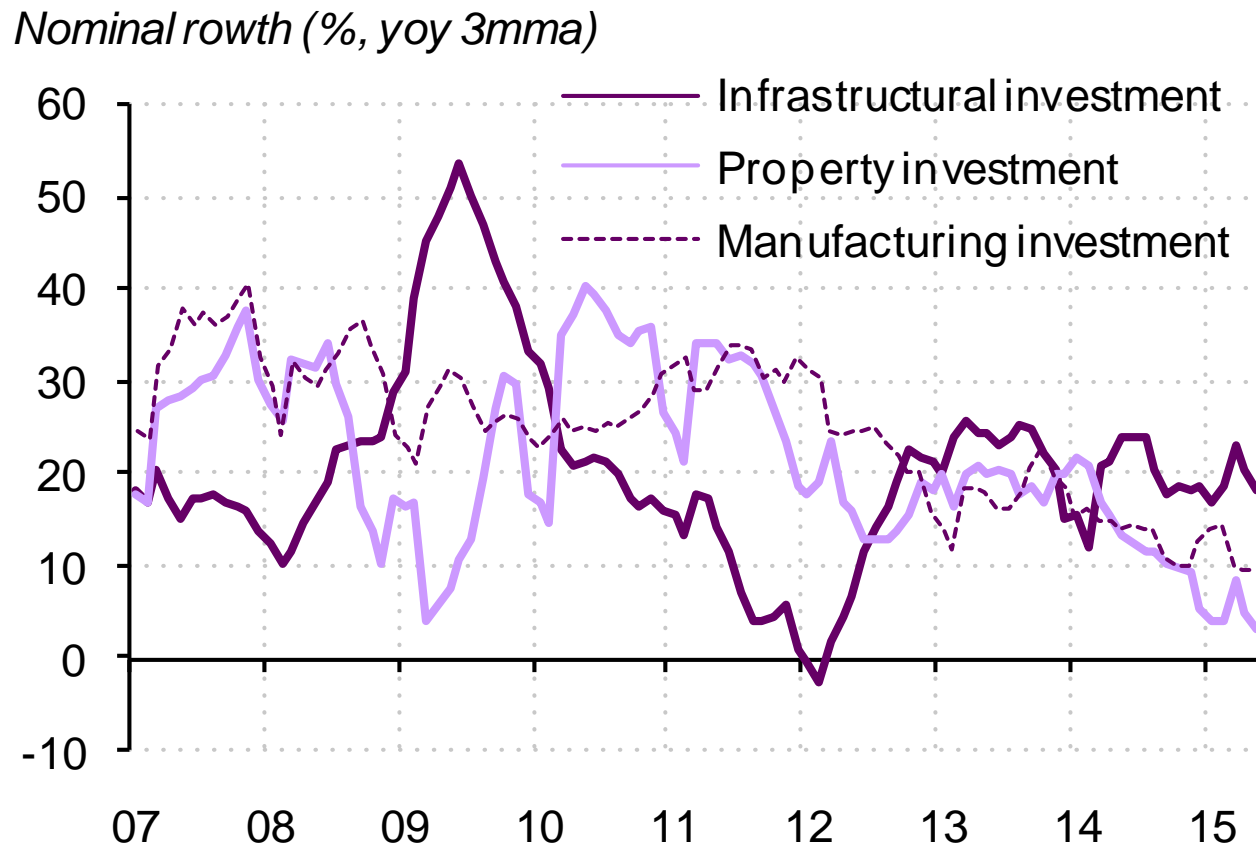
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Source: Wind

# Infrastructure and property investment have become main engines of China's investment

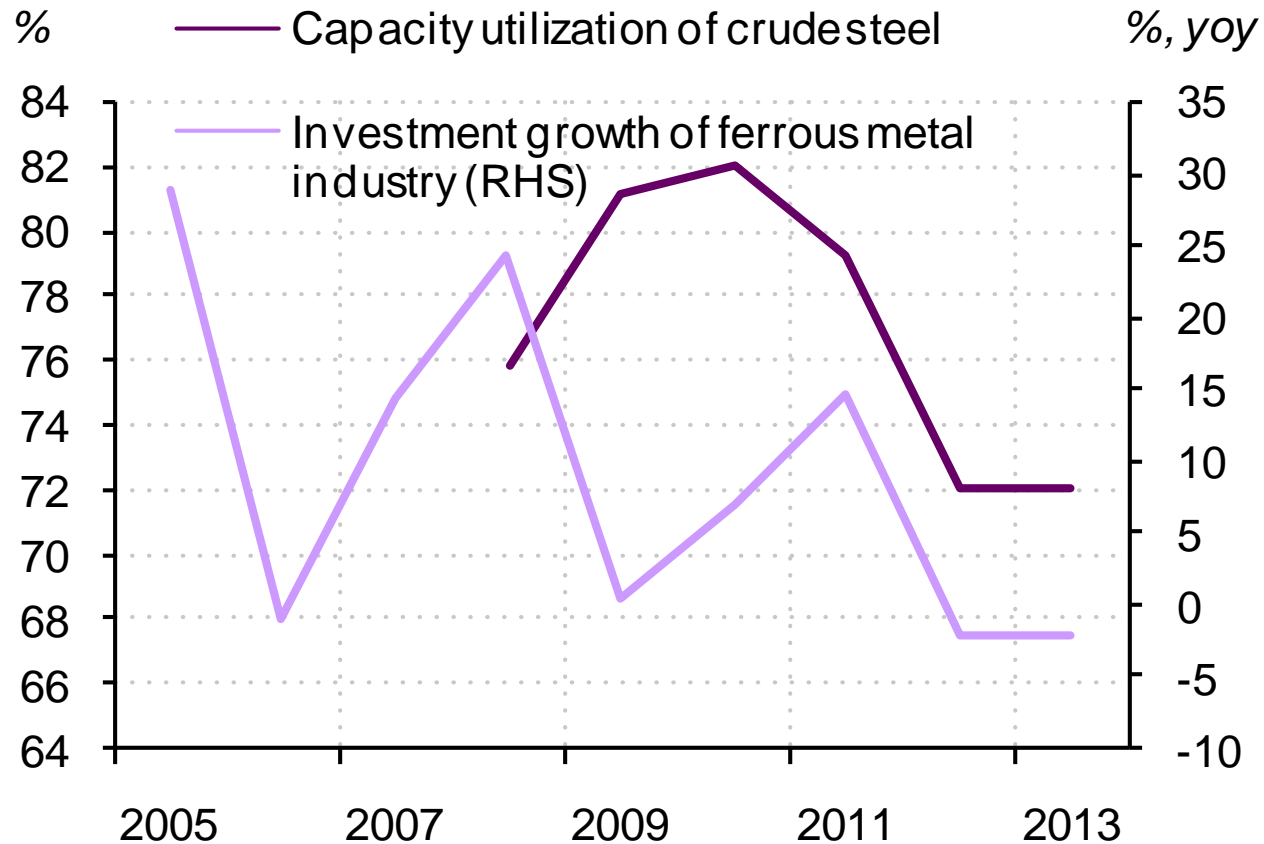
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Source: Wind

# Over-capacity problem in steel industry in China is particularly serious, leading to weak sectorial investment growth

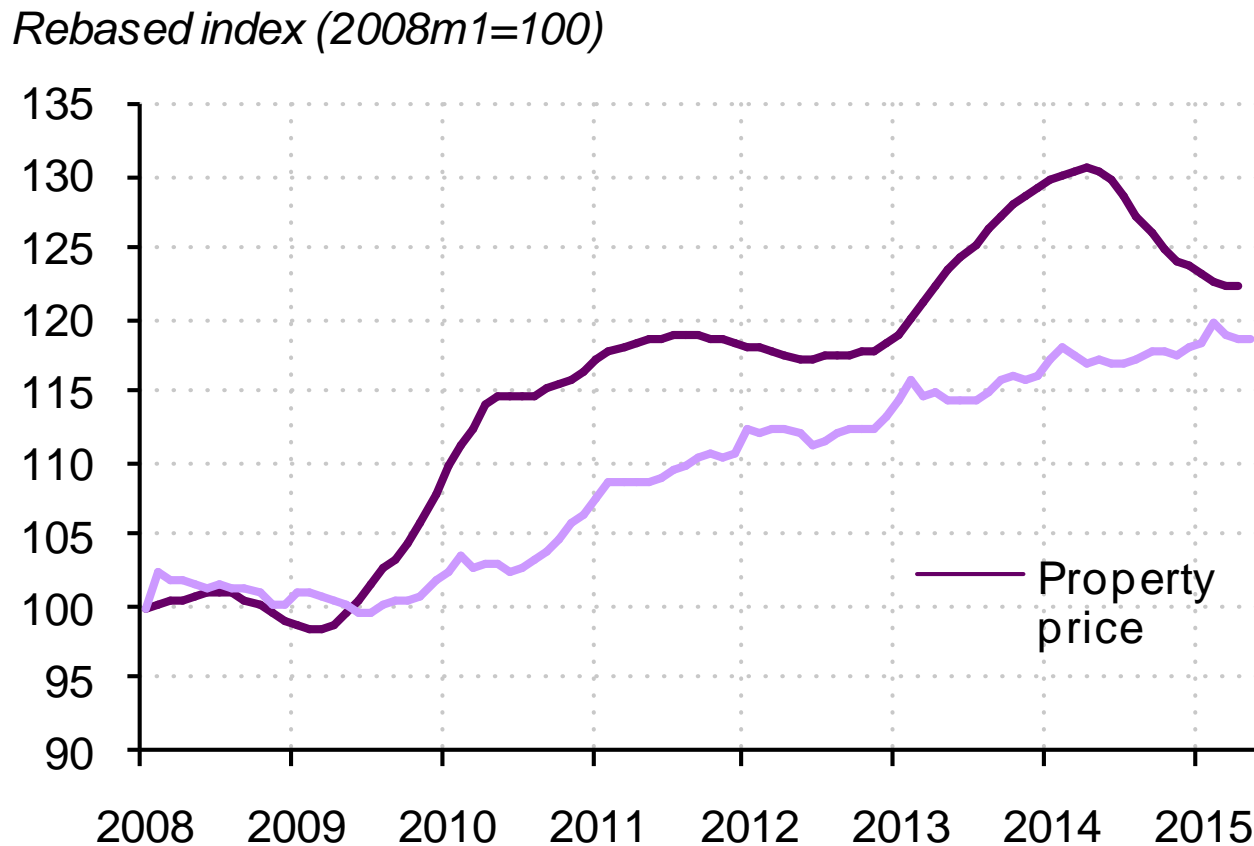
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Source: Wind

# Fast growing property price after the Subprime Crisis has led to tightened property control policies in recent years

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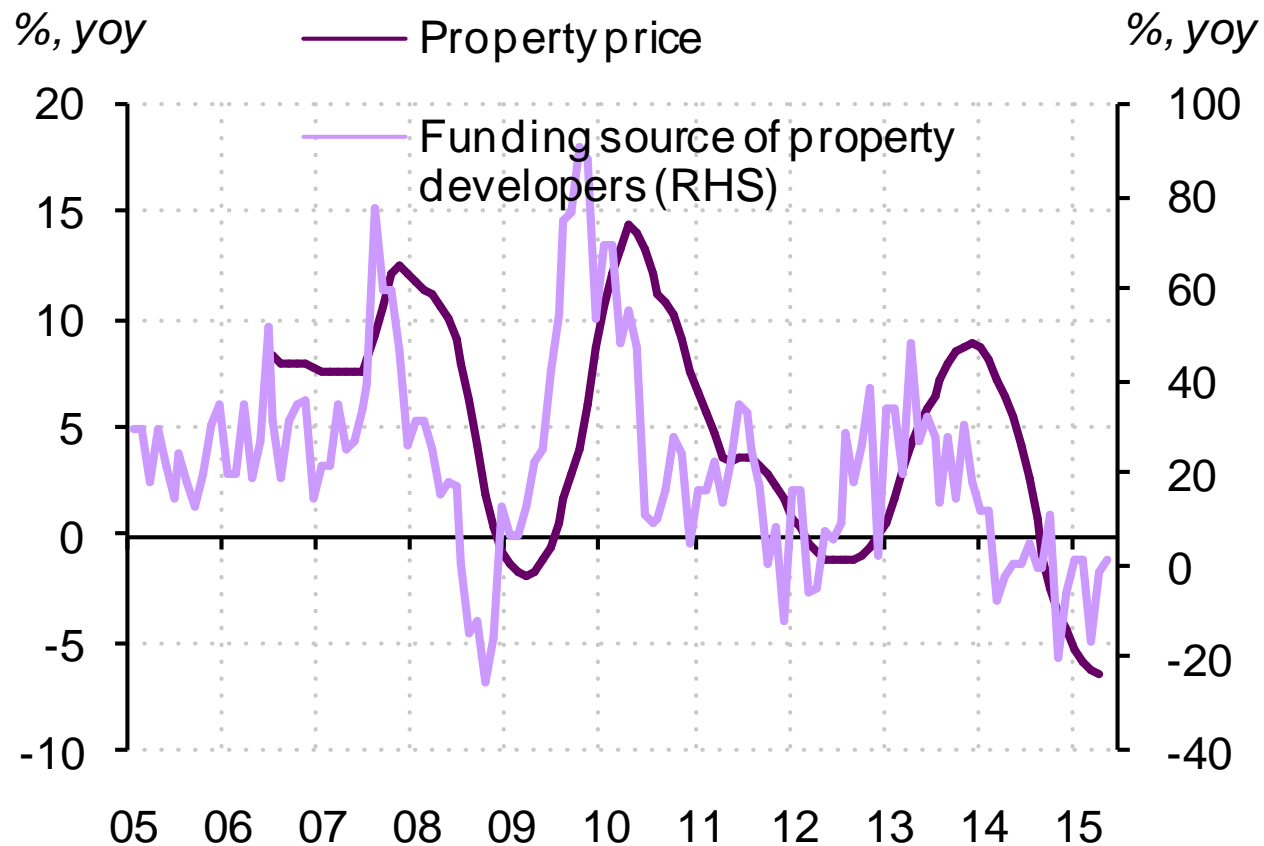


Source: Wind



# Funding source of property developers has been tightened significantly

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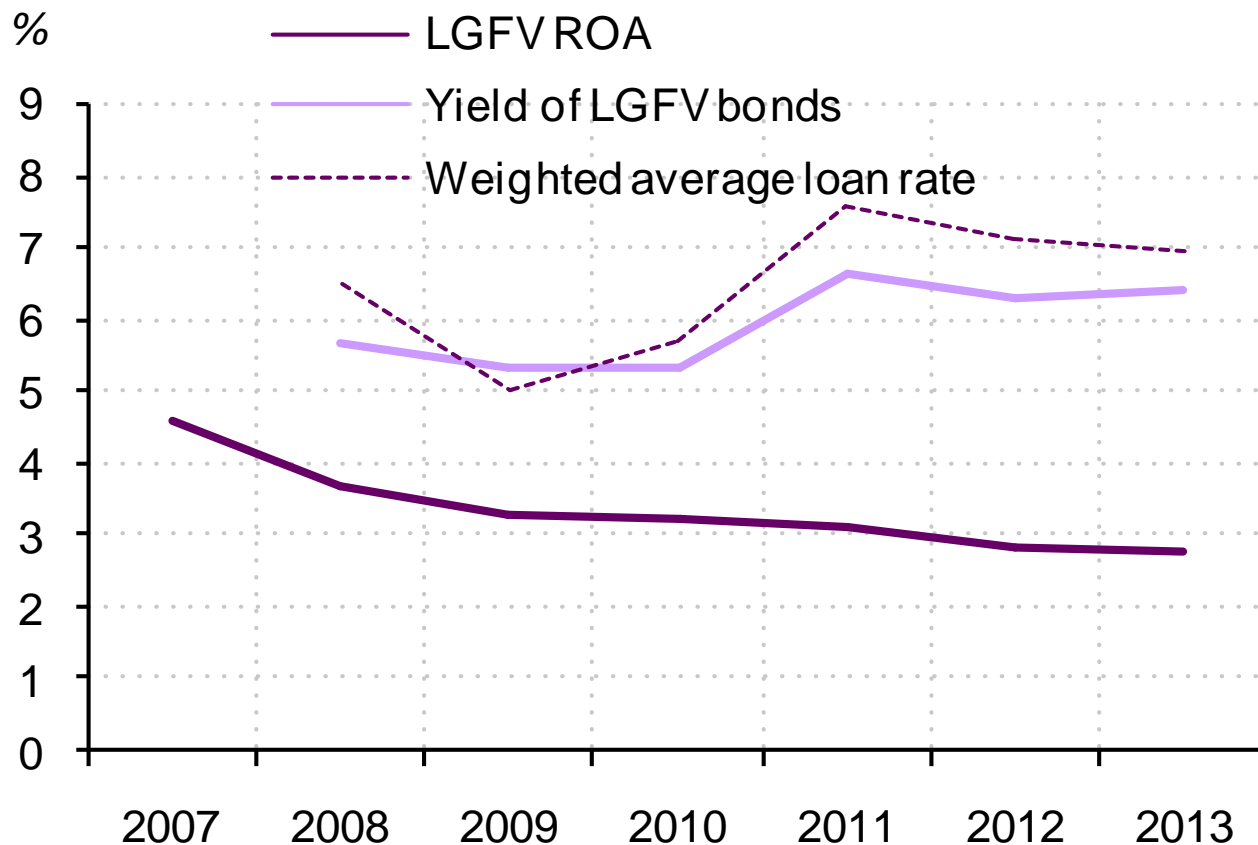


Source: Wind





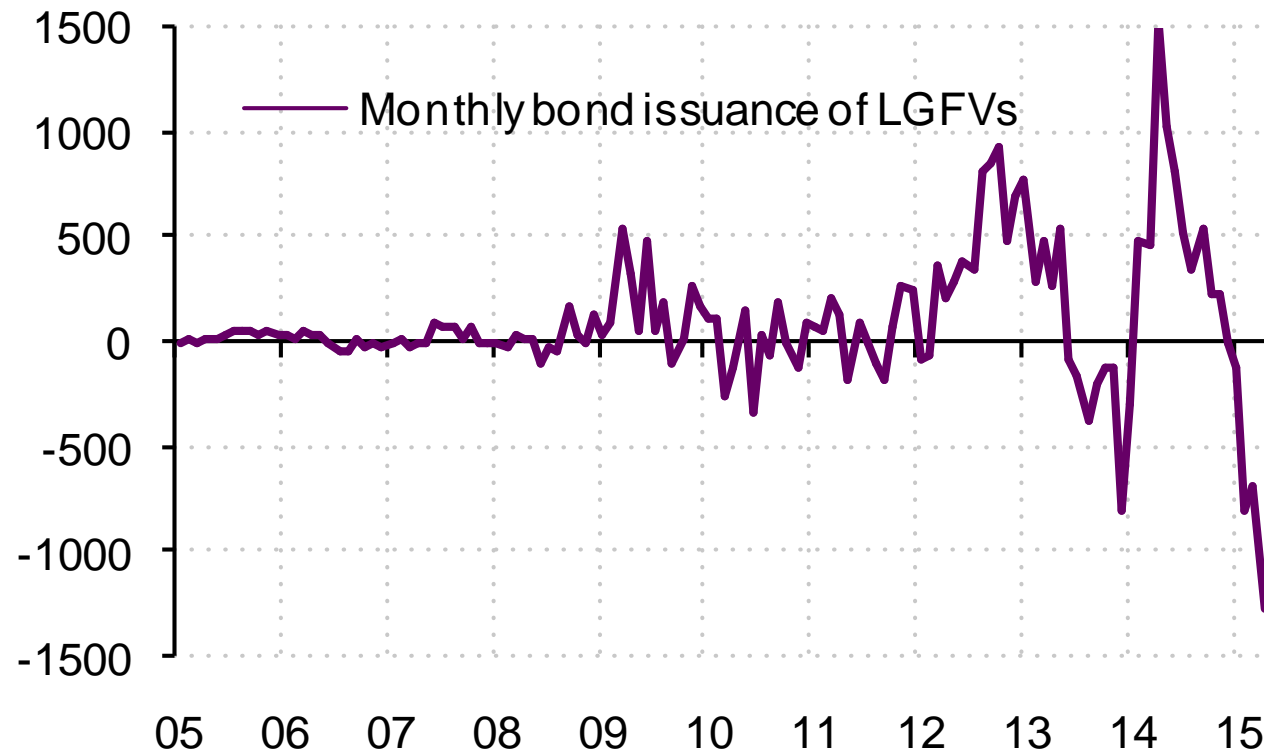
# Infrastructure investment has led to debt problem as ROA of LGFVs falls short of their funding costs,



Source: Wind

# Funding source of LGFVs has also been tightened as local government debt problem exacerbated

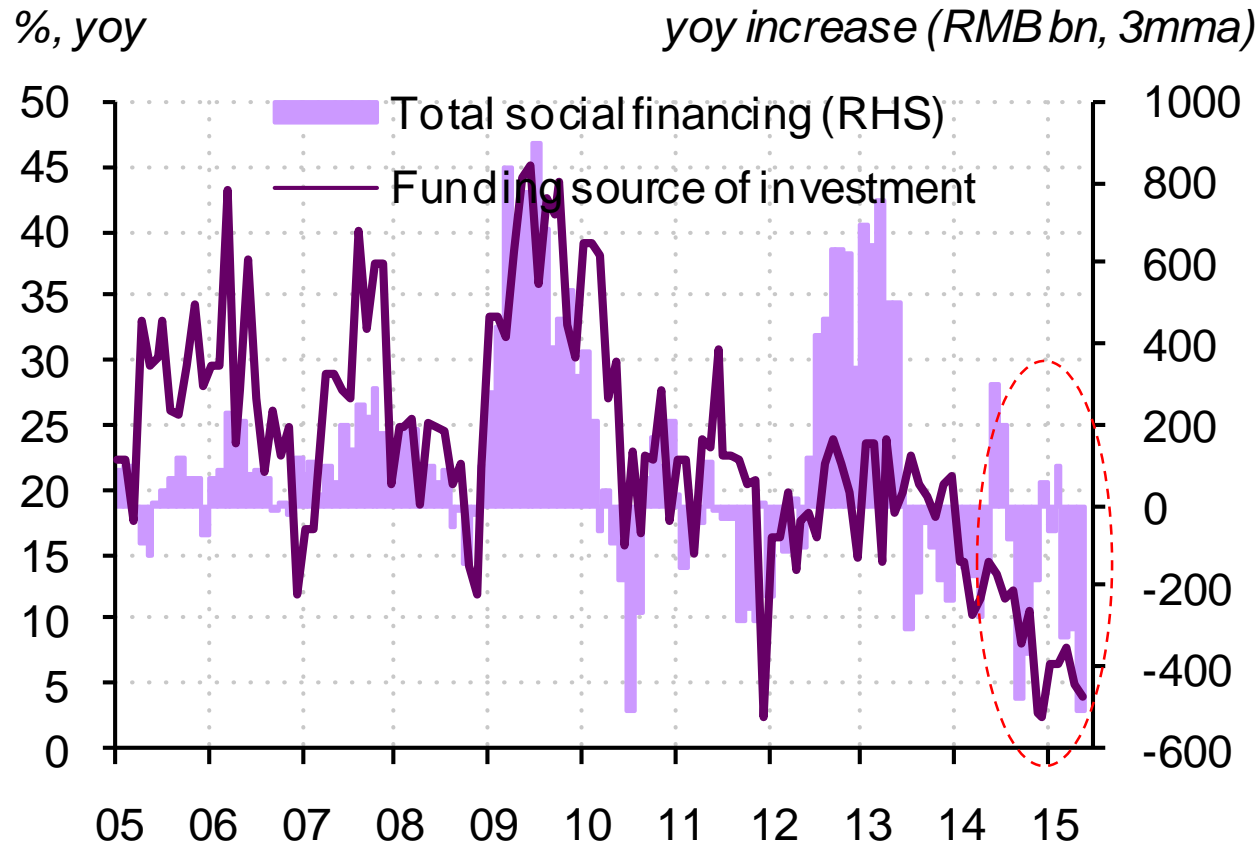
yoy increase (100 mn RMB)



Source: Wind

With funding source of LGFVs and property developers tightened, growth of total social financing has declined, resulting in credit crunch in the real economy

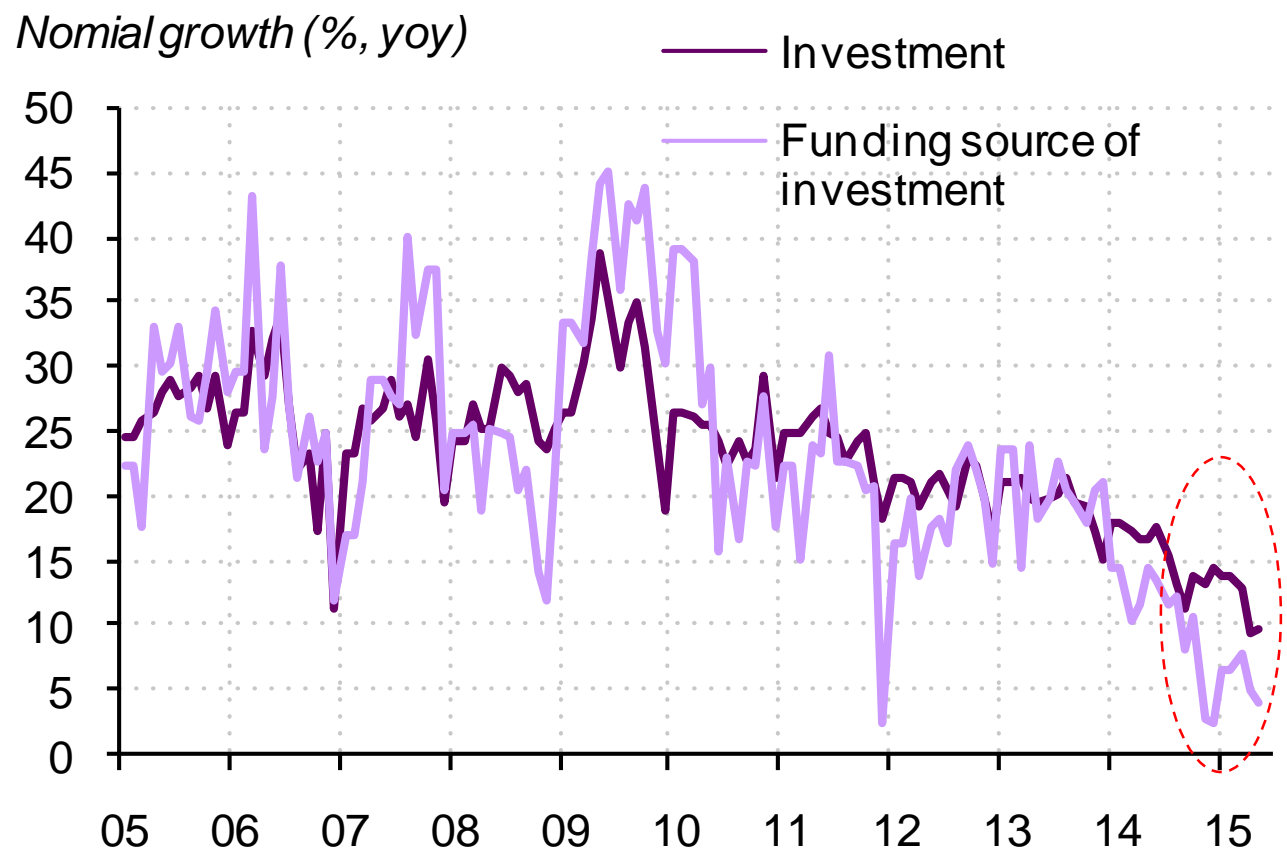
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Source: Wind

# Funding source growth of investment has fallen short of investment growth for more than a year, dragging down investment growth

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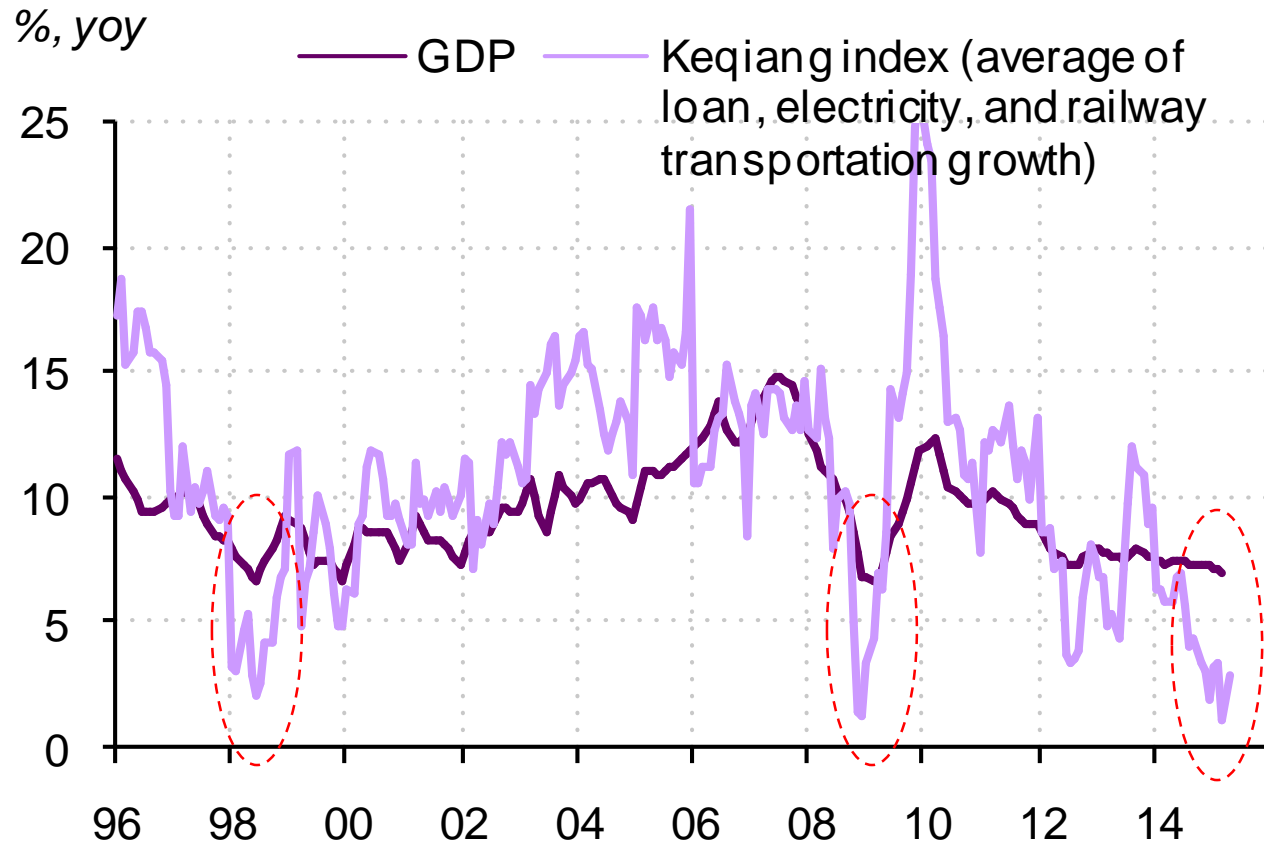


Source: Wind



# GDP growth in China has slowed to a new low since the Subprime Crisis, while growth of real economic activity had a much sharper fall

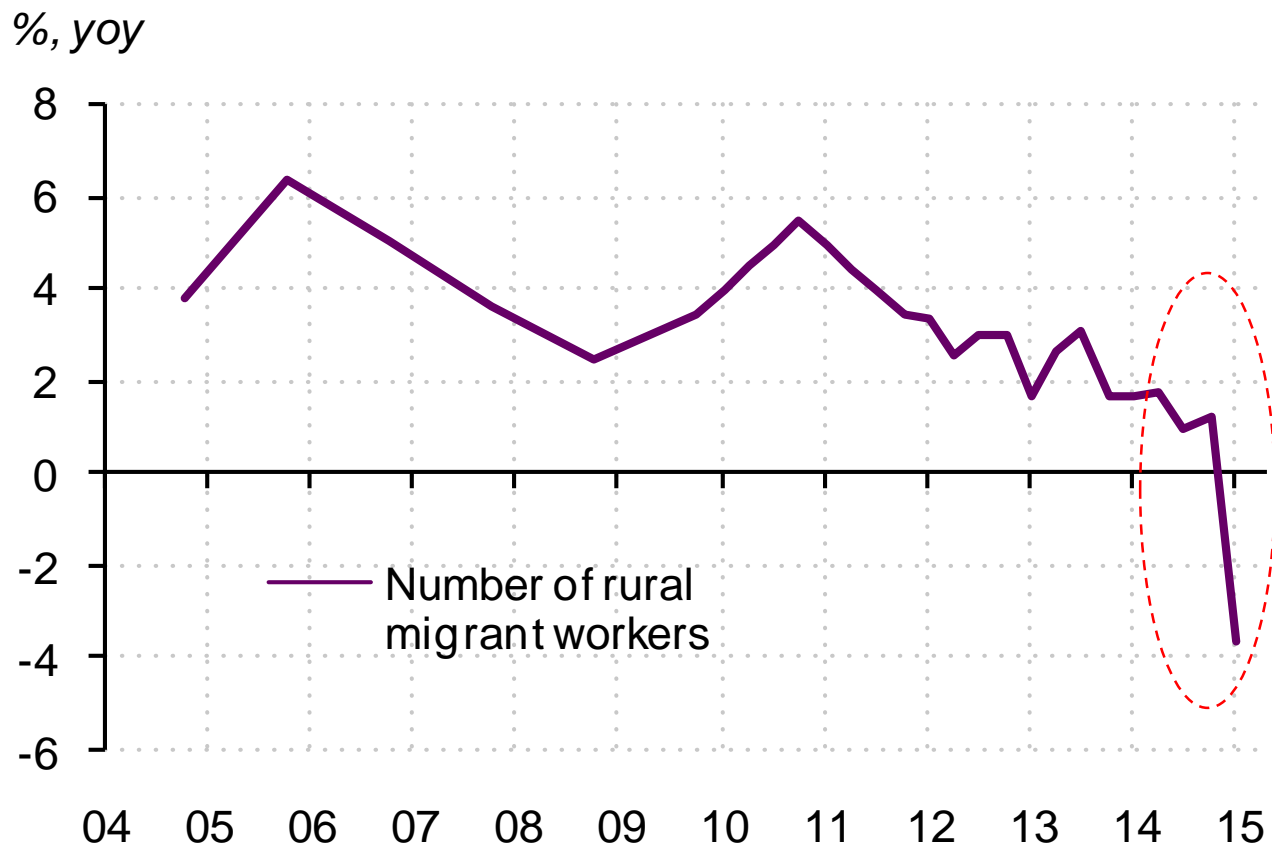
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Source: Wind

# Number of rural migrant workers fell in Q1 2015 for the first time in recent years

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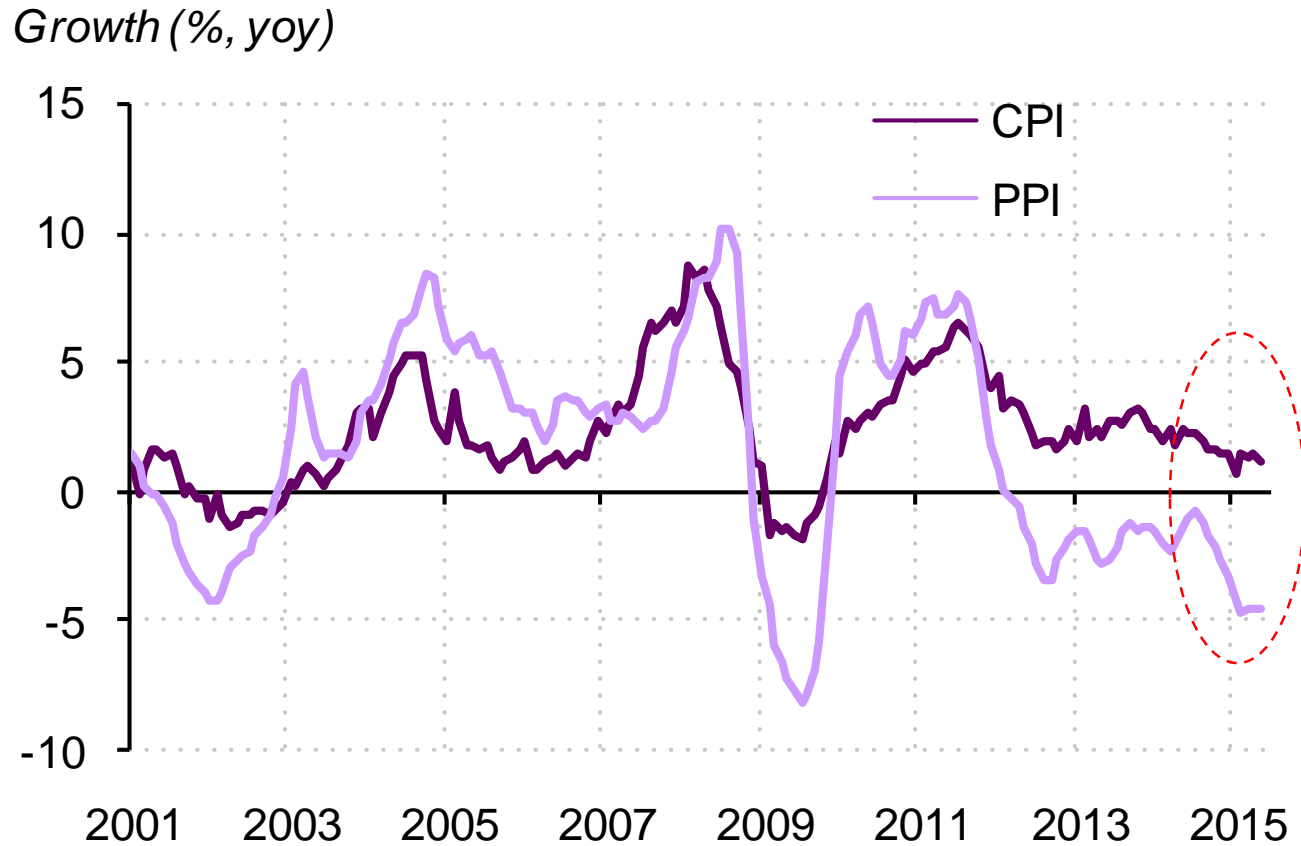
Note: Data before year 2012 is annual data. Data since 2012 is quarterly data.

Source: Wind, CEIC



# Deflationary pressures have risen

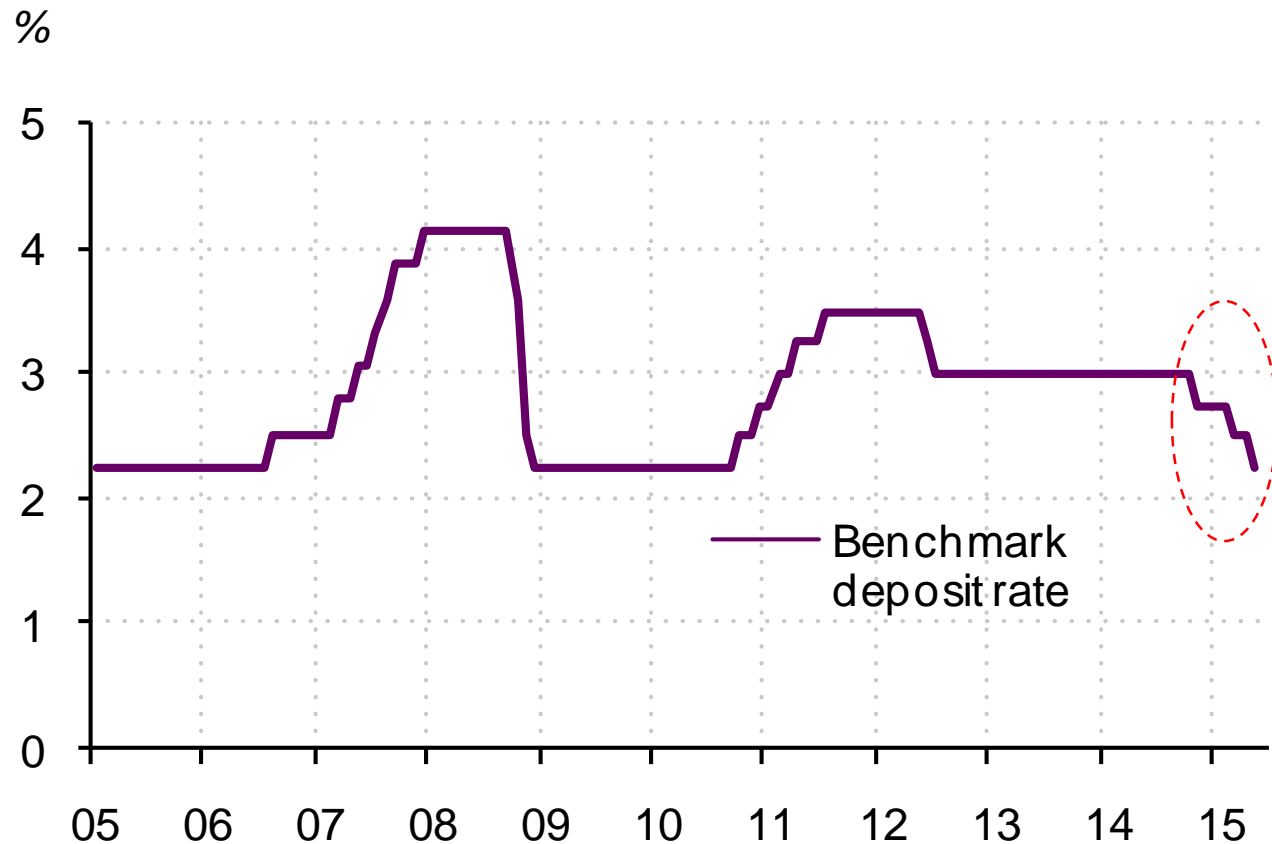
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Source: Wind

Macro policy stance has shifted to pro-growth stance once again, with benchmark interest rate cut 3 times in a row in the past 3 quarters

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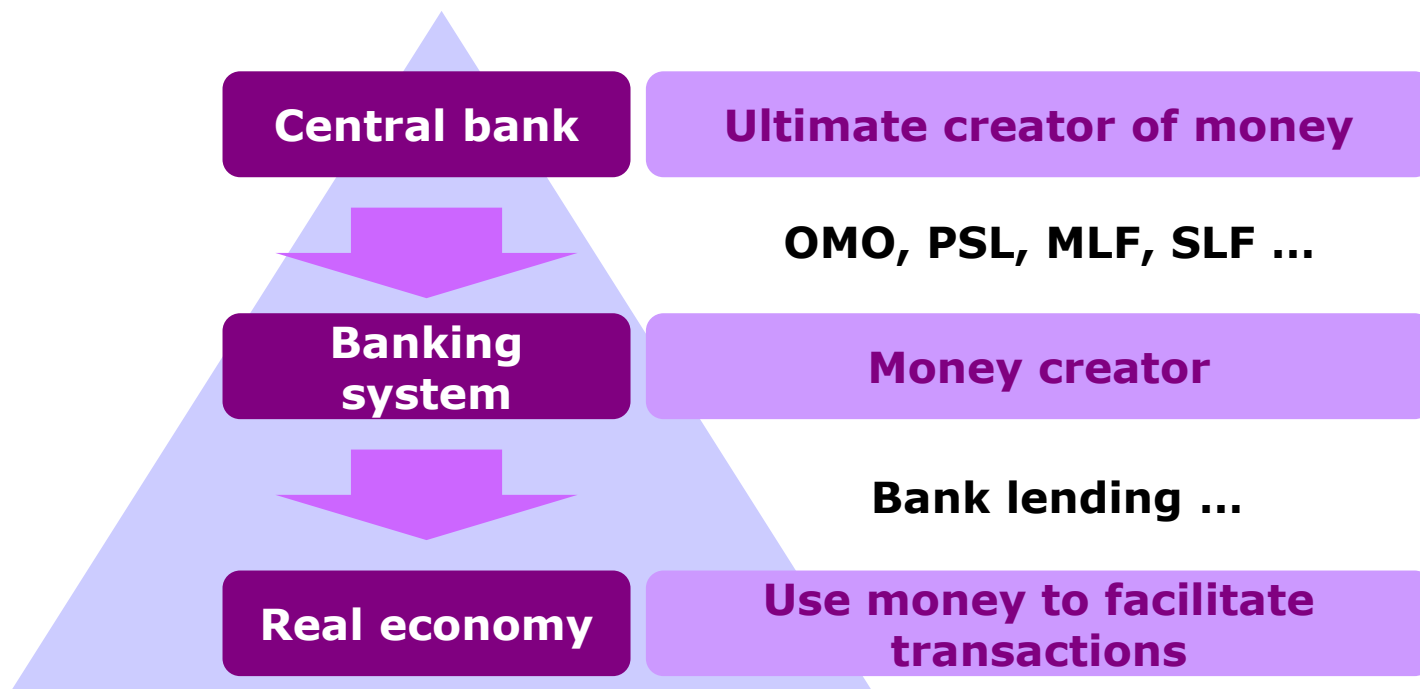


Source: Wind



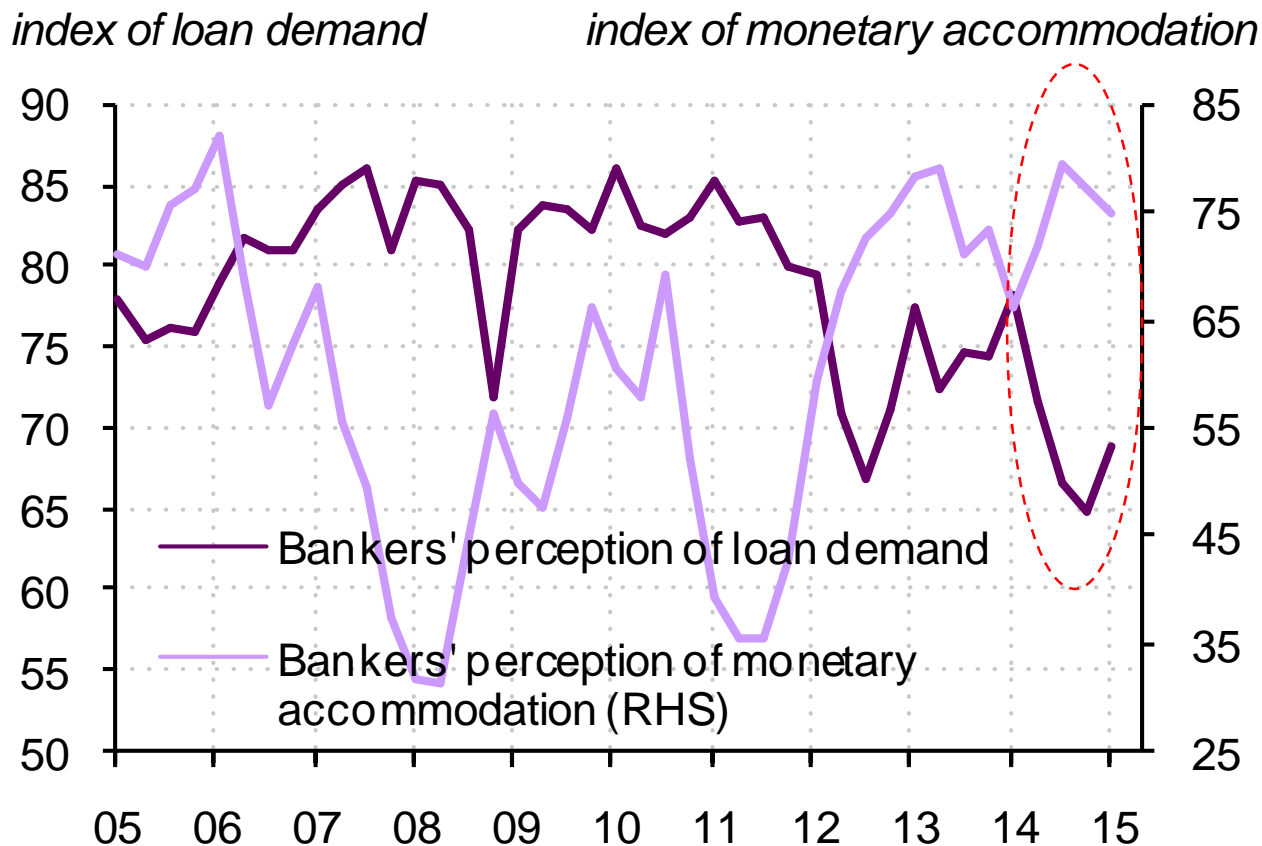
# Credit crunch in the real economy and excessive liquidity in the financial markets – two sides of one coin

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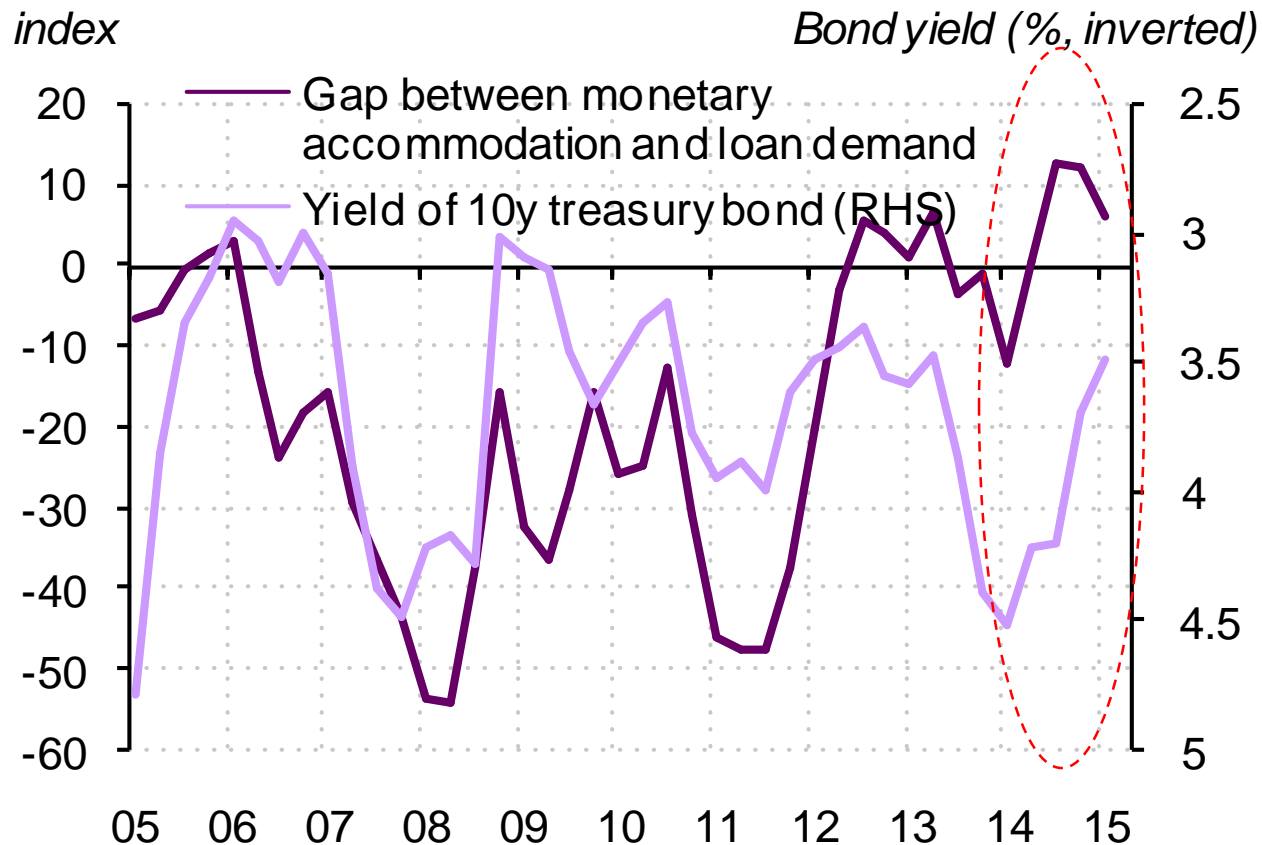
# Monetary transmission channel towards the real economy has largely been blocked since 2H 2014.....

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Source: Wind

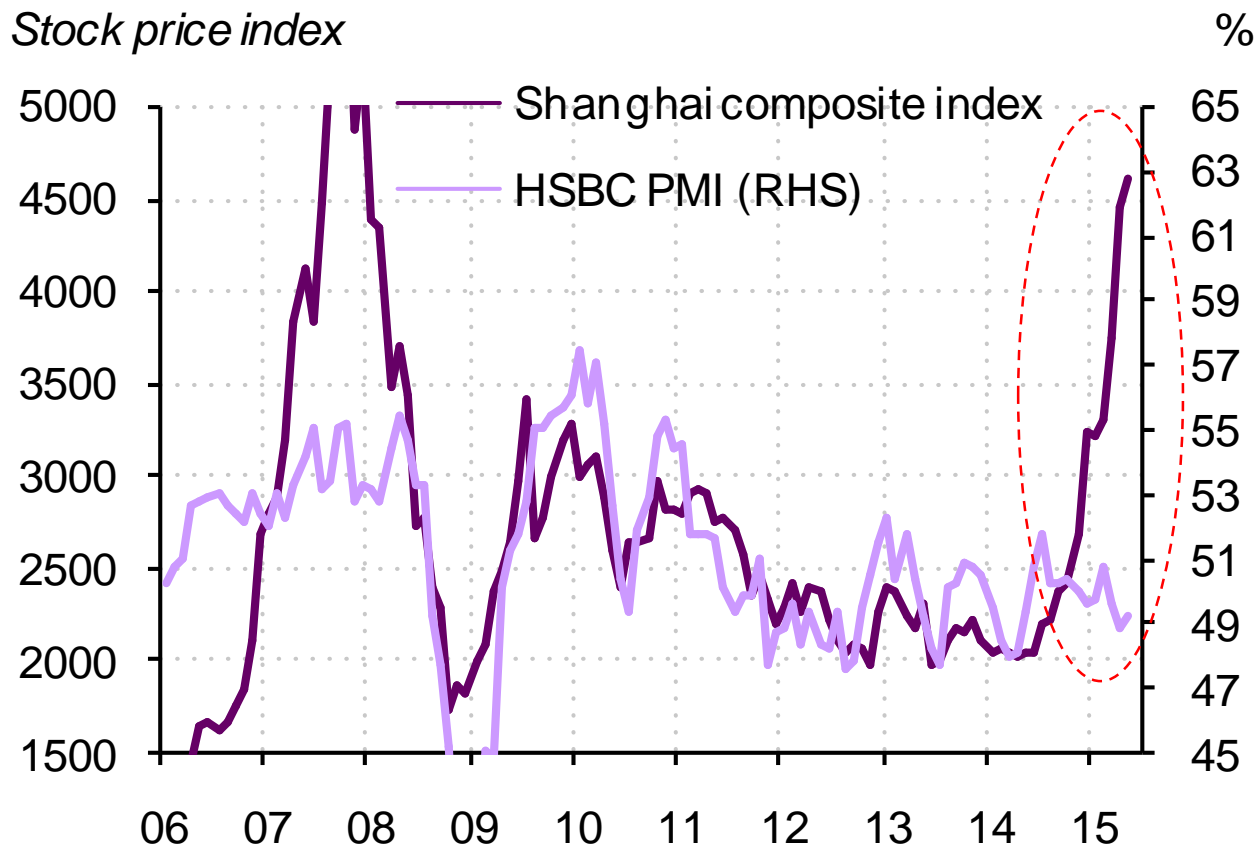
..... leading to excessive liquidity in the banking system, and therefore inflated financial prices



Source: Wind

# The bullish stock market in recent quarters stands in sharp contrast to the weak macro economy

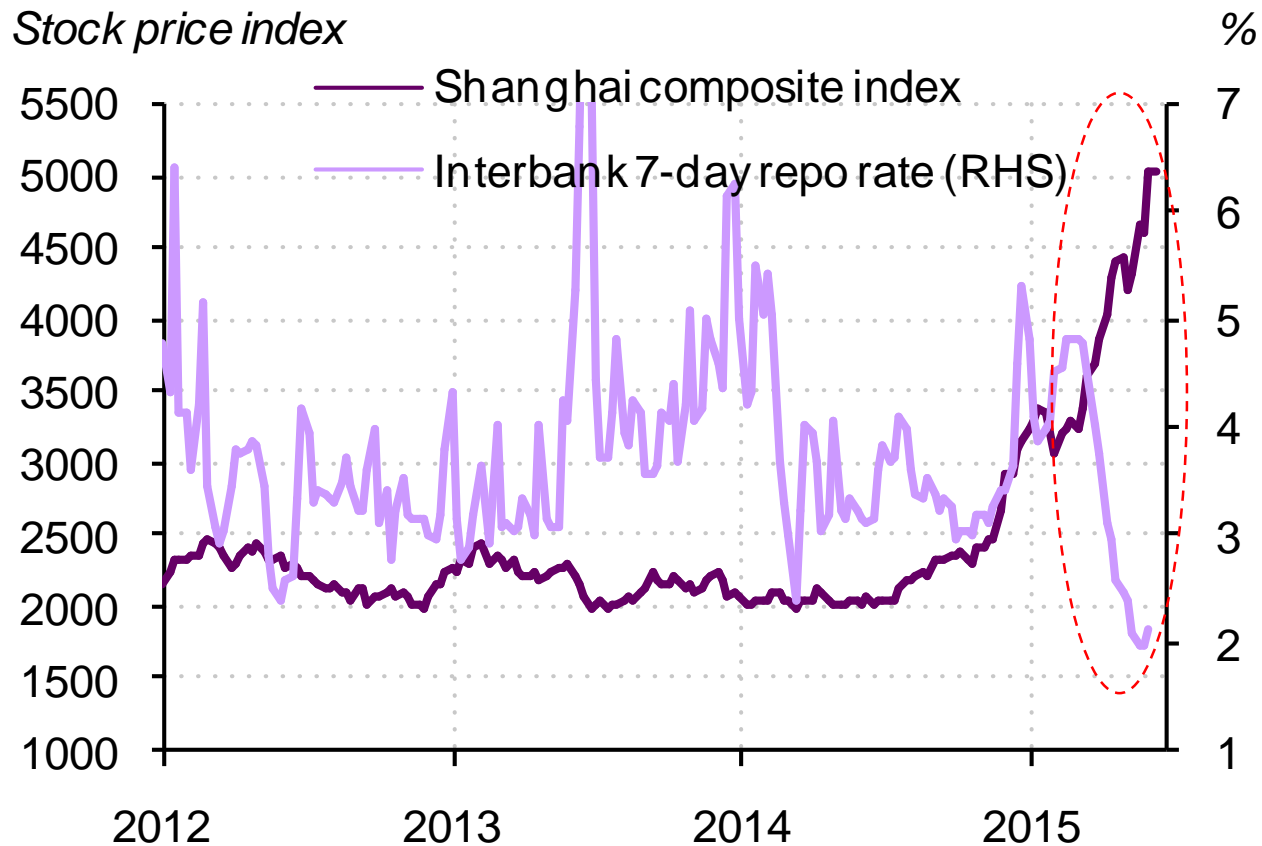
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Source: Wind

# Stock price bubble and weakened economic growth momentum are now reinforcing each other

June 2015



Source: Wind

## Conclusion: Weak economic growth and booming financial market

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- ◆ China's new senior leaders are reluctant to use real estate and infrastructure investment to stabilize economic growth
  - Financing of real estate and infrastructure is constrained
  - Economic growth slows down due to credit crunch
  
- ◆ Into the bubble age
  - Bank lending channel towards the real economy is paralyzed
  - Credit crunch in the real economy vs. excessive liquidity in financial markets
  - Vicious cycle between the financial asset bubble and weakening growth momentum
  
- ◆ Steel industry will continue to face headwind of over-capacity and weak demand

# Thank you

Dr. Gao Xu is the Chief Economist of China Everbright Securities Co. Ltd. He is also a part-time research fellow of Peking University, and a member of the China Chief Economist Forum. He is also a columnist for *Wall Street Journal* and *Caixin*. Before joining Everbright in 2011, Gao worked with the UBS as a senior economist. Prior to that, he was an economist with the World Bank. He also spent 2 years with the IMF first as a research assistant and then as a part-time economist. Gao holds a Ph.D. in economics from Peking University, and Master and Bachelor degrees in Engineering from Southwest Jiaotong University.