Sharp increase in coking coal prices to reduce steel spreads by Rs.4,000 per tonne

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Majority of the global commodities have been rallying since the abatement of the first wave of covid-19 pandemic from Q2FY21 amid unprecedented liquidity in the global markets and monetary and fiscal stimulus from various central banks and governments. Besides the liquidity factor, supply-side constraints and recovery in demand especially from China has also been contributing to the rally in the commodities like steel, aluminium, zinc, copper, iron ore, etc. However, there has been one commodity, viz., coking coal, which did not follow the general trend of rally in commodities primarily due to the ban imposed by China on Dragon's coking coal imports from Australia amid the ongoing geopolitical tensions between China and Australia. The same has hugely impacted the global demand-supply dynamics as China is the largest producer, consumer, and importer of coking coal, while Australia is its largest exporter. Consequently, there has been an excess supply of Australian coking coal as it did not find enough buyers thereby keeping the prices weak during FY21, a period in which many other global commodities rallied to multi-year highs.

Historically, metallurgical coal has been one of the most volatile commodities and hence it has been a major pain point for Indian steel producers as seaborne coking coal prices and finished steel realizations do not necessarily move in tandem thereby impacting the spreads. India has limited reserves and production of coking coal and domestically produced coking coal is of inferior quality due to high ash and moisture content. Hence, the domestic steel industry is highly dependent on imports for its hard coking coal requirements, with approximately 85% of India's total coking coal requirements being fulfilled through imports. Out of India's total coking coal imports, nearly 70% is imported from Australia, while the remaining is imported from the other countries such as USA, Canada, Russia, Mozambique, South Africa, etc. Since India is self-sufficient for its iron ore requirements, Indian integrated steel players have benefitted hugely from a regime of lower Australian premium coking coal prices and decadal high steel and iron ore prices globally in the recent times.

On the other hand, China has increased its coking coal imports from other nations such as North America, Canada, and Mongolia, which has, over a period, created an overall deficit in coking coal supplies ex-Australia. As a result, Australian exports have moved in to replace the deficit in North America and have got redirected to other markets such as South Korea, Taiwan, and Japan, thereby pushing spot coking coal prices to above USD 200 per tonne in July 2021 from an average of nearly USD 120 per tonne in FY21. This sharp increase in spot coking coal prices, if sustained, is expected to result in a decline in the spreads of integrated steel producers by nearly Rs.4,000 a tonne, ceteris paribus. However, some of the large integrated steel producers have entered short-term supply contracts at lower prices prevalent in early 2021 which may provide some cushion against sharp jump in coking coal prices. Moreover, impact of higher seaborne coking coal prices would be fully visible in Q3FY22 earnings as steel players keep some inventories which would have been bought at lower prices. While the adverse impact of higher coking coal prices on margins of integrated steel producers is inevitable, sustained high steel prices are expected to support the margins and keep the overall profitability at healthy levels especially for flat steel products which have witnessed the highest jump in realizations in the current upcycle.

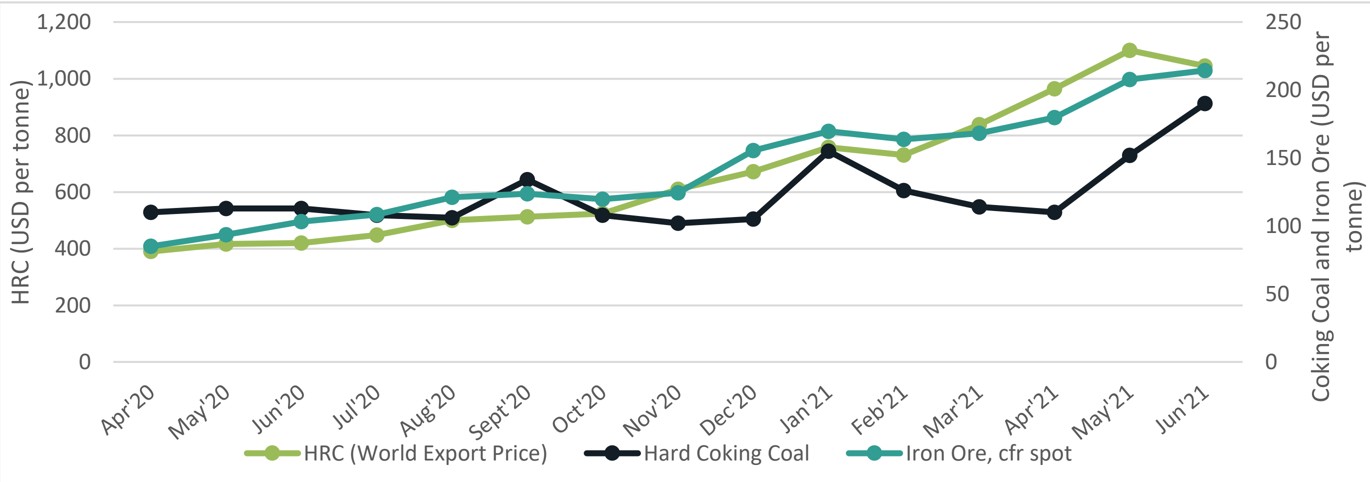

Exhibit 1: Iron ore, coking coal and hot rolled coil (HRC) prices (Source: World Bank, Steel Insights and Steel Benchmarker)

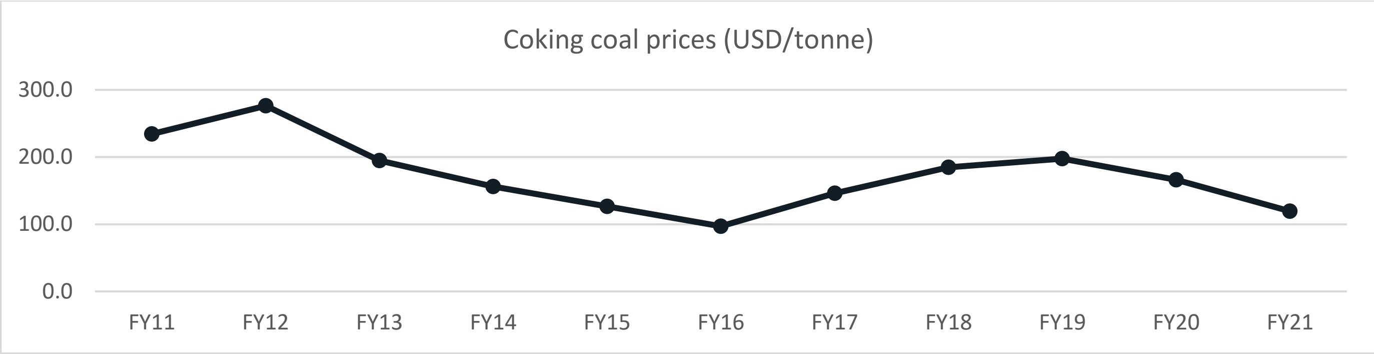

Exhibit 2: Multiyear volatile trend in coking coal prices (Source: CMIE)

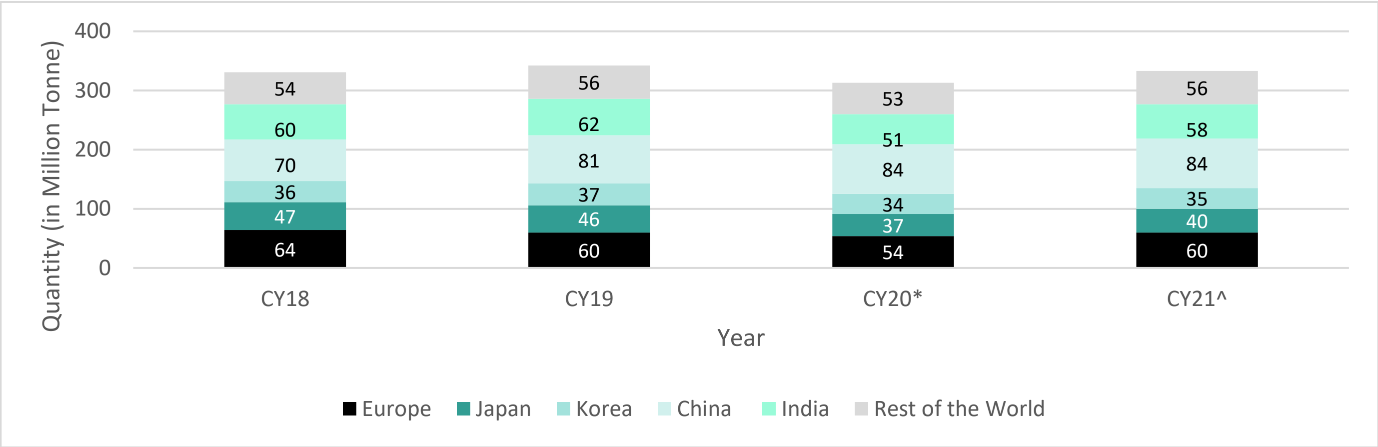

Exhibit 3: Country-wise imports of coking coal (Source: International Energy Agency)

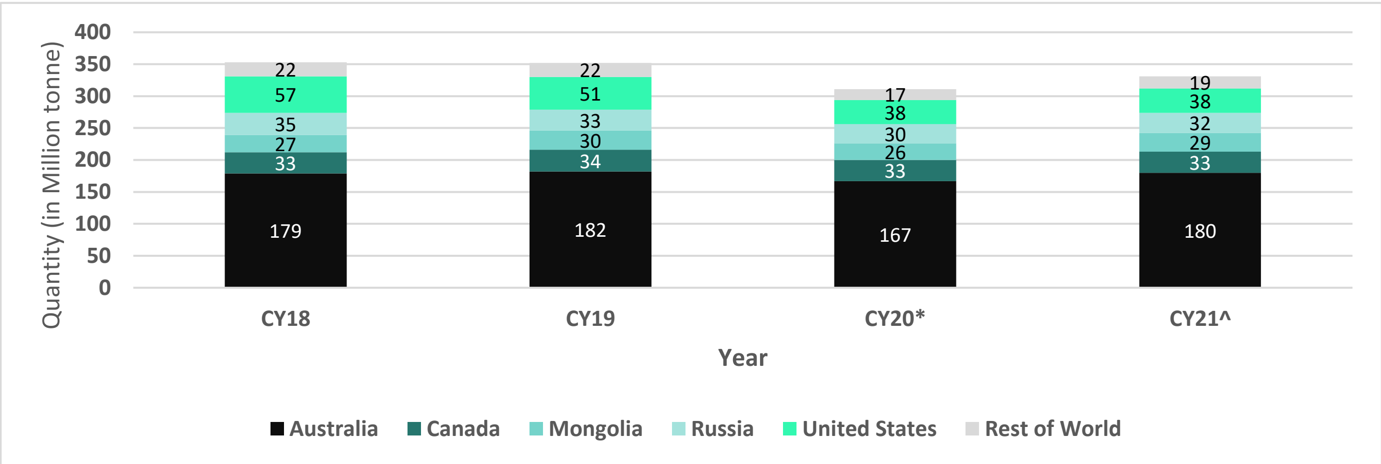

Exhibit 4: Country-wise exports of coking coal (Source: International Energy Agency)

*Estimated; ^Forecasted

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