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China's newly commissioned iron and steel capacity add to supply pressure

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HIGHLIGHTS

August-October period sees large capacity additions

Next 14 months to add 259 mil mt of new capacity

Hebei province may launch winter output cuts around mid-Nov

Oversupply seen persisting on new capacity launches

China's steel production continues to show a modest decline despite steelmakers facing poor profit margins, on the back of new pig iron and crude steel capacity launched in recent months, while a lack of any large-scale output cuts is failing to add pressure on production.

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Northern China, home to large steelmakers, could see winter output cuts from mid-November, especially in the Hebei steel hub, market sources said.

But these curbs are expected to remain smaller than the previous year, they added.

Steelmakers in China typically are ordered to reduce production during the winter to cut back on pollution.

Setting a bearish tone for steel prices, there are also several new pig iron and crude steelmaking facilities coming online, which could partly offset the impact of any government-mandated output cuts for 2022 and 2023, according to sources.

"I'm afraid steel production will remain high this winter compared with subdued demand, so any price uptick in the rest of 2022 may be limited, unless more stimulus packages are announced," a market participant in eastern China said.

Rising pig iron and steelmaking capacity

During August-October, China commissioned about 6.4 million mt/year of new blast furnaces and 4.8 million mt/year of crude steel making capacity through capacity swaps, S&P Global Commodity Insights calculations showed.

Because some of the replaced facilities were already closed during 2017-2020, these newly commissioned facilities will in theory lead to a net increase of 2.5 million mt/year of pig iron and 3 million mt/year of crude steel capacity for 2022, according to the calculations based on industry data.

In the first 10 months of 2022, a total of 28.8 million mt/year of new pig iron making capacity and 23.1 million mt/year of crude steel making capacity were brought on stream in China through capacity swaps, leading to a net increase of 8.3 million mt/year pig iron and 6 million mt/year crude steel capacity for 2022.

Although poor steel profit margins have recently forced some mills in the Shanxi and Shaanxi provinces to trim production, these newly commissioned facilities have partly offset the cuts in China's overall steel output.

Some mill sources in northern and eastern China also said that with these newly-added capacity and most mills still refusing to cut production despite current losses, China's crude steel output in October and so far November might stay almost the same as in September.

China's daily crude steel output in September was about 7% higher on the month and 17.6% higher on the year, according to China's National Bureau of Statistics.

On Nov. 3, amid languishing steel demand and bearish market outlook, the Chinese domestic rebar and hot rolled coil sales profit margins fell to minus \$33/mt and minus \$46/mt, respectively, S&P Global data showed.

Though some mill sources S&P Global talked to expected Hebei to launch winter output cuts around mid-November, which could ease the supply glut and support steel prices.

Oversupply may persist

However, with China's debt-laden property sector and sluggish domestic consumption unlikely to generate much incremental steel demand for 2023, the Chinese steel market may remain under oversupply pressure for a longer term, especially as more iron and steel making facilities will keep coming on stream, according to sources.

For the rest of 2022 and whole 2023, Chinese steel makers plan to bring a total of 116 million mt/year of new pig iron capacity and 143 million mt/year of new crude steel capacity on stream through capacity swap mechanism, according to an analysis of industry data.

Although net capacity growth will be minimal for these swaps, these new facilities will be generally more efficient and greener than their replaced ones, and thus any government-mandated output cuts for the purpose of environmental protection or decarbonization would have less impact on their production.

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New York agencies install energy storage system for peak shaving, power price arbitrage

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HIGHLIGHTS

System features increased safety measures

Goal is for wider urban area deployment

The New York Power Authority is using a first-of-its-kind lithium-ion battery energy storage system to provide electricity peak shaving capabilities as part of a demonstration project that stores lower cost energy and delivers it during high demand periods when power prices are higher, Cadenza's CEO said in Feb. 17.

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NYPA and the New York State Energy Research and Development Authority selected the high-safety, lithium-ion "superCell technology" developed by Cadenza Innovation partially due to the system's safety measures that prevent fires, said Christina Lampe-Onnerud, also Cadenza's founder said in video interview.

The 50-kW/250-kWh system went through NYSERDA's study phase and it was determined that the safety issue was important, Lampe-Onnerud said. Specifically, the system is designed to prevent the spreading of a "thermal runaway event," which results from internal short circuits that could lead to a fire.

Committed to eliminating the "potential risk of thermal propagation" which can lead to fires and explosions, Cadenza's US Department of Defense-tested supercell has a patented design that helps to "bolster utility grid resilience and power a range of uses in the commercial and industrial market and other key sectors," according to a Feb. 16 statement issued by the state agencies and the company.

"Notably, by packaging components to lower costs and increase safety, the supercell is designed to reduce the need for additional, high-cost fire safety protection and mitigation systems – resulting in improved energy density and supporting the advancement of the Li-ion battery industry," the statement said.

The **energy storage** system has been deployed immediately adjacent to NYPA's White Plains, New York, offices and the goal is for the installation to serve as a model for integrating "low-cost, safe, high-performance renewable energy resources into the grid," especially in urban areas, that can be replicated at other businesses throughout New York State and beyond, according to the statement.

The technology was designed by Connecticut-based Cadenza Innovation in collaboration with Hitachi Energy.

Peak shaving capability

The project is expected to demonstrate its **peak power demand shaving** function that reduces the peak electricity load of a typical commercial building.

"The unit is reducing peak loads at the Power Authority's main offices, smoothing electricity network operations and showing a safety advantage by demonstrating a reduction in the potential of thermal runaway," Justin Driscoll, NYPA's acting president and CEO, said in the statement.

"Our goal is to demonstrate whether this unit will provide energy storage and power quality services on a scale that can meet commercial, industrial and network demands at buildings that are similar to ours," Driscoll said.

Peak shaving reduces a building's maximum power demand thus reducing the associated utility peak demand charge. This can result in cost reductions for site owners, primarily by arbitrage, which involves storing lower cost energy absorbed at time periods of lower power demand and delivering that energy at time periods of higher cost due to higher power demand, the statement said.

The pilot project will also help advance New York State's climate and clean energy goals, including Governor Kathy Hochul's plans for the State to achieve 6 GW of energy storage capacity by 2030.

The state's Climate Leadership and Community Protection Act mandates 70% renewable energy by 2030 and 100% zero-emission electricity by 2040, with Governor Hochul recently proposing an expansion of New York's energy storage programs to double the goal to 6 GW by 2030, which represents at least 20% of the state's peak electricity load, according to the statement.



The New York Independent System Operator forecasts that total energy storage nameplate capacity will surpass 6 GW in 2032.

Cadenza's Lampe-Onnerud said the company is in discussions to set up US manufacturing operations. Asked how the recent lithium price increase has impacted the company's plans, Lampe-Onnerud said she has been in the battery industry for 20 years and commodity price fluctuations are "nothing new."

Lithium carbonate CIF North Asia prices assessed by S&P Global Commodity Insights were trading at \$69,800/mt Feb. 16, down from a high of just over \$78,000/mt in November 2022. Lithium prices had not traded above \$40,000/mt until January 2022.

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Changing places: Shifting participation and growing intervention in LNG markets

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LNG **trade flows, pricing bases and relative values** all showed significant upheaval during 2022. Market share among companies changed markedly, too, while **market intervention** from previously hands-off administrations may have the longest-running impact.

The companies that stood to gain most immediately from changes in market dynamics during 2022 were those that had significant offtake via long-term contracts priced against non-LNG-based prices. Invoice values based on these formulas worked out cheaper than where LNG prices settled.

US Gulf Coast LNG liquefaction project developers reaped the greatest benefit from 2022's situation: they signed 51 mt/year worth of LNG sales and purchase agreements versus just 21.75 mt/year in 2021, according to S&P Global Commodity Insights data. US-origin accounted for about 75% of all SPAs in 2022. This enabled many of these projects to get within touching distance of a final investment decision, when just a year prior it seemed unlikely they would gain industry support.

Returning focus to the short-term beneficiaries of 2022's market changes though, here are some numbers: **Platts Northwest Europe** price benchmark, which reflects delivered-ex-ship LNG prices into the suddenly gas-starved region, averaged \$32.738/MMBtu.

Averaging the final day settlement price of Henry Hub¹, multiplying by 115%, adding an assumed take-or-pay (often called liquefaction) fee of \$2.75/MMBtu and the average Platts USGC-NWE LNG carrier freight route cost, the total is \$12.59/MMBtu during 2022. Platts is part of S&P Global Commodity Insights.



This means, on average, long-term offtakers of USGC LNG could achieve a 160% profit margin for loading their long-term contract cargoes from the US and selling them delivered-ex-ship, or DES, Northwest Europe. USGC-

NWE is used as the trade route in the example because the US supplied NWE with 31 million mt out of the 71 million mt imported to the region in 2022 – easily the largest exporting country to Northwest Europe.

While the strategy of using non-LNG-based benchmark as the pricing basis of long-term contracts to supply the LNG spot market was highly profitable in 2022, it is one with associated risks. These risks were realized for buyers in 2020, when 175 cargoes of US LNG were cancelled by offtakers, which would have amounted to some \$1.684 billion being paid to US LNG producers by offtakers to not take delivery of these cargoes.

Having access to highly economic long-term offtake in 2022 meant that offtakers, many of whom were portfolio players as most merchant traders remain relatively light on long-term offtake in LNG, also took a larger spot market share. The three largest LNG portfolio players' cumulative \$100 billion plus profits for 2022 would certainly have been aided in part by the above phenomenon.

Portfolio players' increased market share can be demonstrated looking at participation figures in Platts APAC Market-on-Close assessment process. As seen below, portfolio players increased their share of activity to 59% in 2022 versus 17% in 2021, while merchant traders saw their share reduce to 25% from 64%.



Merchant traders struggled to maintain their position in the market not only due to a lack of offtake volumes. High flat prices and swinging margin requirements from futures exchanges constrained their activity. These factors are all changing in favor of increased participation from merchant traders, the largest of whom expanded credit facilities when flat prices were higher and now have extra financing firepower.

While companies' market share can change relatively fluidly, policymakers in many geographies have traditionally been cautious in making large market interventions quickly. 2022 saw major changes in this regard: a trend of de-liberalization in wholesale gas and power markets emerged. The European Union, South Korea and Australia all imposed price cap legislation on parts or whole of these markets.

Vocal calls for a price cap began in Europe in September after the most extraordinary day on its wholesale markets: Aug. 26, 2022, when power and gas prices spiked to never-before-seen levels. French month-ahead power reached Eur768/MWh (\$766/MWh using the exchange rate at the time) while Dutch TTF hit Eur319.975/MWh.



This day shook European energy ministries, and a steadily growing stream of support for full-scale market intervention followed in the last few months of 2022, resulting in the Market Correction Mechanism (MCM) being agreed Dec. 19, 2022, which could mean Dutch TTF exchange-traded futures in the EU are price capped in 2023. While these discussions were going on, similar policies were being mulled in South Korea on the power market and Australia on gas.

These policies mostly have limited duration and market observers have questioned whether the EU gas price cap, which comes into effect Feb. 15, will be triggered as it is reliant on several factors occurring simultaneously, but a precedent has been set in some of the most liberal-leaning gas and power markets for governments to intervene, and for free marketers this move towards illiberalism is a cause for concern. There is the potential for a rebound effect on LNG cargo markets due to their clear link with downstream markets.

Beyond the direct impact of the market intervention and the ripple effect on other markets, as one of the early adopters of gas and power market liberalization the European Union had sought in recent years to influence other markets to adopt similarly liberal policies; the strength of this position will have been severely diluted after the implementation of the MCM.

The interventions are likely to have further implications for market participation: already in Europe there has been concern that market activity will move **off-exchange into the over-the-counter market**, and this fear has encouraged some to create **"insurance" markets** outside the EU.

¹Bullet settles are common in the US natural gas market and have been deployed in the US FOB long-term market, too, removing price risk for the LNG exporter.

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