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HANDS-ON CHINA REPORT
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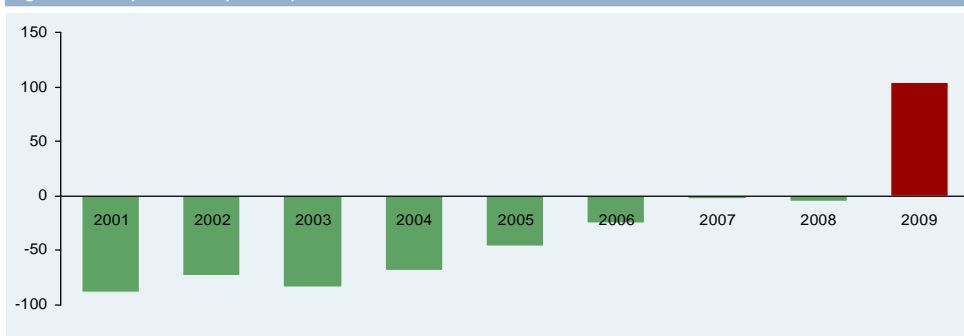
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China's Coal Imports Surged Fourfold in January

Following a year of remarkable growth in Chinese coal imports (see Figure 1), China's January import volumes remained near record levels, increasing by 437.5% YoY to 16.1 million tons. Sequentially, imports were down 1.9% from December's record level, while *net* imports remained stable at approximately 14 million tons.

With energy demand continuing to expand rapidly, transport difficulties and mine consolidation still constraining supply, and government policy increasingly inclined towards conserving domestic reserves, we expect China to remain a net importer of coal in the years ahead. Although China's monthly coal trade may vacillate according to seasonal conditions and price fluctuations, the long-term trend is clearly one of a higher reliance on imports. China's Ministry of Finance has temporarily lowered import tariffs on coal in 2010 to help achieve further supply diversification as economic growth gathers pace in 2010.

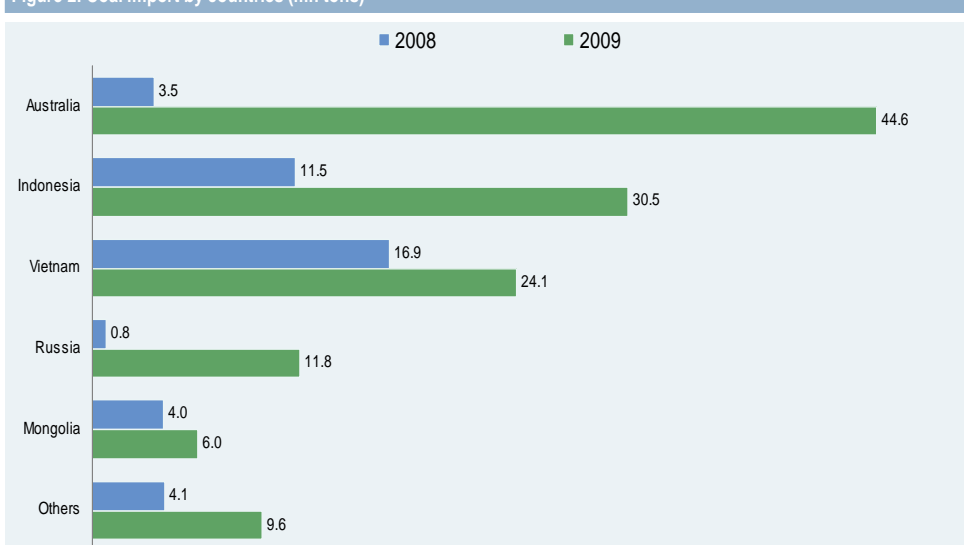
Figure 1: Net Import of Coal (mn tons)



Source: CEIC

■ **Beneficiaries of higher coal imports.** China's transition to a net-importer of coal will primarily benefit regional coal exporters (see Figure 2) and dry bulk shipping lines positioned to fulfill China's seaborne coal demand. Indeed, Chinese coal demand may serve to ease some concern about the impact of excess capacity on the dry bulk industry.

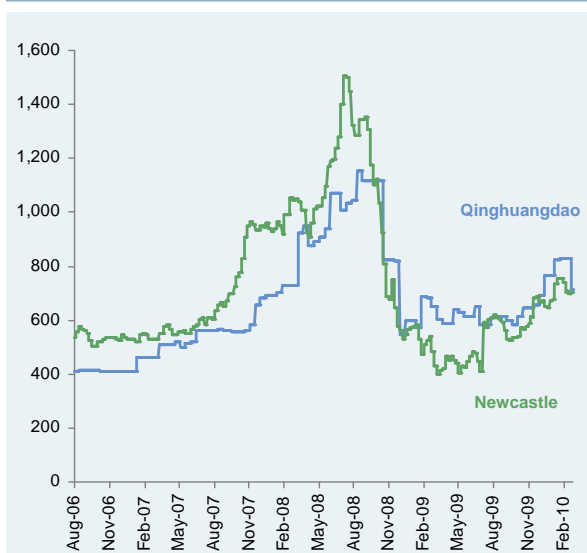
Figure 2: Coal import by countries (mn tons)



Source: CEIC

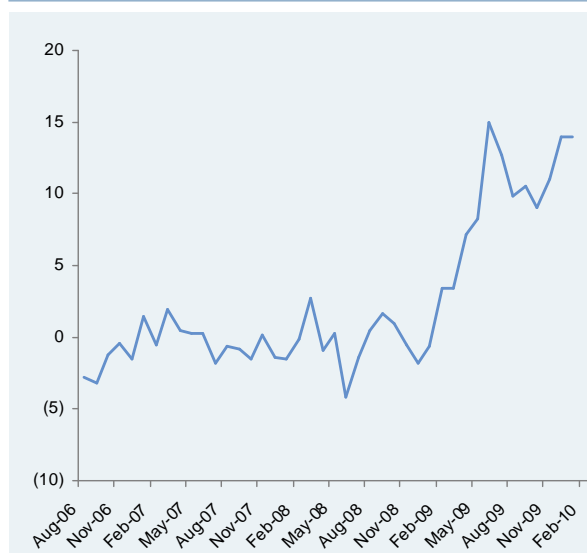
- **After severe winter disruptions, spot coal prices are moderating.** China's domestic coal supply situation has improved since late January, when the Chinese Railway Ministry ordered railway operators to prioritize shipments to regions affected by coal shortages. During the 20-day campaign that ended on Jan 30, 61.6mt of coal was reportedly transported, contributing to a recovery in power plants' coal inventory from 7.9 days in mid-January to 14 days as of mid-February. Moreover, warmer weather in February, coupled with a decline in electricity consumption due to the Chinese New Year holiday has resulted in a drop in coal demand. Subsequently coal prices at Qinhuangdao port declined for three consecutive weeks, with prices for coal with calorific value of 5500 Kcal/Kg dropping to RMB720-730/ton, down 5.2% during the last 2 weeks according to CCTD (see Figure 3).

Figure 3a: Qinhuangdao & Newcastle thermal coal spot prices (RMB/ton)



Source: CEIC, Bloomberg

Figure 3b: Net imports of coal (mn tons)



According to forecasts by the Development Research Center of the State Council, China's coal consumption is expected to grow by 5% in 2010 (from ~3 billion tons in 2009), with consumption growth skewed to the first half. Demand for thermal coal is set to moderate following the peak winter season, and with power producers' inventory levels recovering, the upside for domestic thermal spot prices is likely to be capped in the near-term. In contrast, demand for metallurgical coal should strengthen in the coming months as construction enters peak season with warming weather.

- **Pace of mine consolidation remains a swing factor in 2010.** The pace of resumption in output from Shanxi (China's largest coal producing province) following last year's aggressive campaign of mine consolidation will be a crucial factor behind this year's domestic supply picture. Other major coal producing provinces, such as Henan, plan to push forward with their own industry consolidation plans in 2010 (in Henan's case the plan is to merge mines with an annual production capacity <300,000 tons and limit future approvals to mines with an annual output capacity of at least 450,000 tons). China's National Energy Administration recently forecast that consolidation plans across several provinces this year may bring China's domestic coal production growth rate down to 5%, compared with 12.7% in 2009.

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