中國通 J.P. Morgan's Hands-On China Series
Views you can use

HANDS-ON CHINA REPORT
April 14, 2010

Jing Ulrich
Managing Director, Chairman,
China Equities, J.P. Morgan
+852 2800 8635
jing.l.ulrich@jpmorgan.com

China's Q1 Commodity Imports Soar on Robust Demand

China's commodity imports surpassed market expectations in March, with the increase in both prices and quantities of imported raw materials contributing toward the country's first monthly trade deficit since April 2004. As Table 1 shows, imports of most major industrial commodities, with the exception of aluminum, experienced robust growth in the first quarter of 2010. These surprisingly strong figures go against previous market expectations that import levels would moderate due to high costs and elevated stockpiles.

Table 1: Summary of commodity imports

	Units (tons)	Mar	Feb	1Q10	YoY%	MoM%	1Q YoY%
Iron ore and concentrates	mn	59.0	49.4	155.0	13.3%	19.5%	17.8%
Unwrought Copper & Products	th	456.0	322.3	1070.4	21.6%	41.5%	14.2%
Copper Waste & Scrap	th	360.0	280.0	977.4	9.3%	28.6%	33.5%
Unwrought Aluminum & Products	th	95.1	64.4	257.0	-35.4%	47.7%	-2.5%
Aluminum waste & Scrap	th	250.0	170.0	673.4	67.6%	47.1%	99.7%
Crude oil	mn bpd	4.98	4.85	4.62	28.9%	2.8%	39.2%

Source: CEIC, China Custioms Bureau

- **Copper:** Import levels for unwrought copper & copper products rose by 41.5% MoM while scrap copper imports rose by 28.6%. Expectations that elevated stockpiles would dampen imports have not been realized in the face of strong end-demand and periodic arbitrage buying. The LME-SHFE arbitrage window opened again in late January, encouraging orders that most likely arrived in March. The tightening of scrap copper import regulations may also have encouraged importers to bring in more shipments before April 1.

- **Iron Ore:** Imports rose 13.3% YoY (19.5% MoM) to 59 million tons in March. In 1Q10, China imported 155 million tons of iron ore (+17.8% from 1Q09), as the country's steel production remained close to the 3Q09 peak level of ~1.65 million tons/day during the first two months of the year. Fundamental demand for the steelmaking ingredient remains strong, as seen in the strong pace of construction activity, auto manufacturing, and a gradual recovery in exports.

- **Crude Oil:** Imports climbed to 4.98 million bpd in March, just shy of the record 5.03 million bpd level recorded in December 2009. Robust car sales, buoyant industrial activity and recovering freight volumes have substantially boosted demand.

Copper

Copper imports reached a nine-month high in March, even as stockpiles in Shanghai Futures Exchange warehouses rose to a record level of 169,538 tons midway through the month. Customs data show that imports of unwrought copper and copper products rose 41.5% above February's level, while imports of scrap copper rose 28.6% MoM, bringing import volumes to 456,240 tons and 360,000 tons, respectively. The increases in the imports by value were 43.6% and 44.3%, respectively, indicating that the sequential price increase for scrap copper has been sharper. In the first quarter of the year, unwrought copper and copper product imports amounted to 1.07 million tons, up by 14.2% YoY, while scrap copper imports increased by 33.5% to 977,443 tons.

We believe there are several reasons for the resilience in copper imports – which defies earlier expectations of moderating import growth in the face of elevated stockpiles and USD7000-8000/ton LME spot prices.

- As Figure 1 shows, the opening of an arbitrage window in late January encouraged more overseas orders, which likely arrived at Chinese ports in March. According to an analyst cited by *Metal Bulletin*, import buying continued after the window closed in February, with traders anticipating strong demand and prices in 2010. According to a Reuters report, metals traders estimated that copper in bonded warehouses in Shanghai approached 200,000 tons in early April (twice February's level), as importers were unwilling to sell at lower prices on the domestic market.

Figure 1: Shanghai & LME copper prices (RMB/ton, including VAT on imports)

Source: CEIC, Bloomberg

- Energy infrastructure investment by the government remains strong in 2010. The first two months of 2010 saw a 6.6% increase in fixed asset investments for electricity and heating purposes. Given that nearly half of copper use in China can be attributed to energy infrastructure, this increase is substantial in terms of copper demand. Refrigerator production, the second biggest source of copper demand, saw very strong growth in February (ranging from 12 – 25% YoY growth across sub-categories) compared to 2009 (see Figure 2a and 2b).

Figure 2a: Refined Copper Demand by Sector in 2009 (Top 3 in Blue)

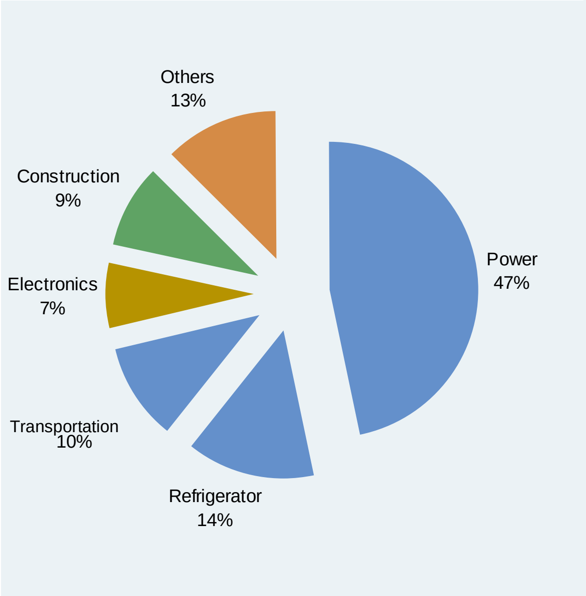
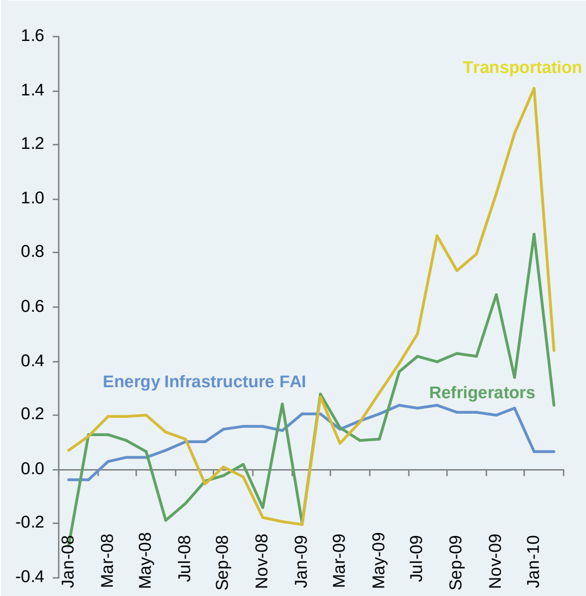


Figure 2b: Year-on-year Growth of Top 3 Copper Consuming Sectors *



Source: Antaike, CEIC, *January and February spikes are due to Chinese New Year being on different months in 2009 and 2010

- Copper inflows may have been boosted in March by importers trying to bring in more shipments before new customs regulations took effect on April 1st. The new rules impose more stringent requirements for specifying copper content, making it more difficult for importers to reduce their tax burden by under-reporting the metal content of scrap. Scrap imports may moderate in April, but copper imports overall will be underpinned by very strong demand.

Although a return to record levels of import growth appears unlikely, imports are expected to stay at relatively healthy levels this year, with bigger volumes booked on long-term contracts. The head of Xstrata's copper division recently projected that China's copper demand will rise between 6 and 10 percent in 2010, compared to a 2-3 percent expansion in global demand.

Iron ore

China's iron ore imports rose 13.3% YoY (19.5% MoM) to 59 million tons in March (see Figure 3a). In 1Q10, China imported 155 million tons of iron ore (+17.8% from 1Q09), as the country's steel production remained close to the 3Q09 peak level of ~1.65 million tons/day in Jan-Feb.

Fundamental demand for the steelmaking ingredient remains sound, as seen in the strong pace of construction activity, auto manufacturing, and a gradual recovery in exports. Meanwhile, improving global demand and relatively tight supply conditions have fueled a sharp rise in seaborne iron ore prices, which have increased by more than 50% since the beginning of the year and by 170% in the last 12 months.

- Crude steel production growth of 27.5% and 24.6% in January and February, respectively, was, supported by 31.1% YoY growth in real estate FAI and 28.6% growth in spending on infrastructure investment. Chinese auto sales rose to a record 1.7 million units in March, while exports grew 24.3% YoY.

- Rising global prices have encouraged domestic miners to boost iron ore output. Chinese iron ore production reached a record level of 88.2 million tons in December, and rose 17.9% YoY in Jan-Feb (Figure 4b). The China Iron and Steel Association expects domestic production will reach 1 billion tons in 2010, compared to ~880 million tons of production in 2009. This would amount to a 14.3% increase in domestic output over last year's level.

Figure 3a: Monthly iron ore imports (mn tons)

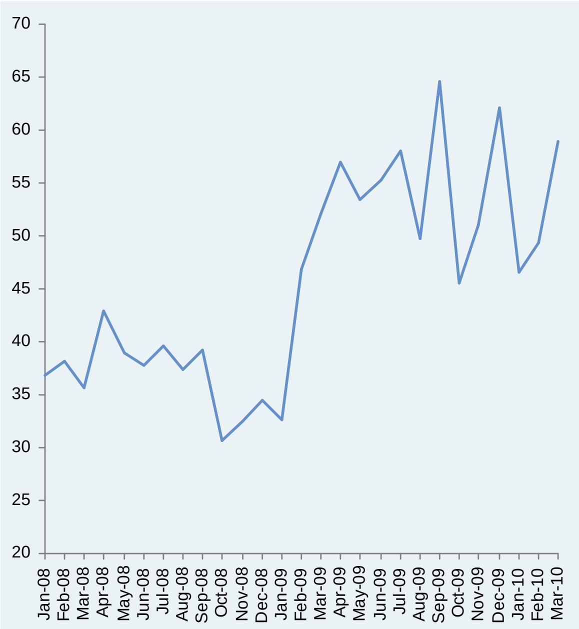
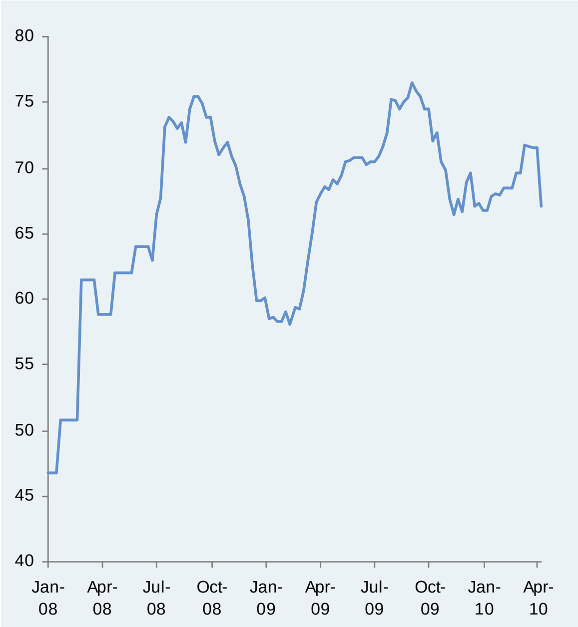


Figure 3b: Iron ore inventory at ports (mn tons)



Source: CEIC, Bloomberg

- With Vale and BHP having secured a 90-100% price increase in new quarterly iron ore contracts with some Japanese mills (Figure 4a), the Chinese steel industry reportedly continues to press for a "China model" in contract negotiations and is resisting the shift to quarterly pricing. Some Chinese producers have reportedly shifted entirely to sourcing from domestic iron ore suppliers. According to J.P. Morgan Analyst Nathan Zibilich, the estimated increase in iron ore and met coal prices could push steel production costs up by 34%, making it difficult for steel producers to fully pass on the increase to consumers.

Figure 4a: Iron ore prices spot vs. contract* (CFR, USD/ton)

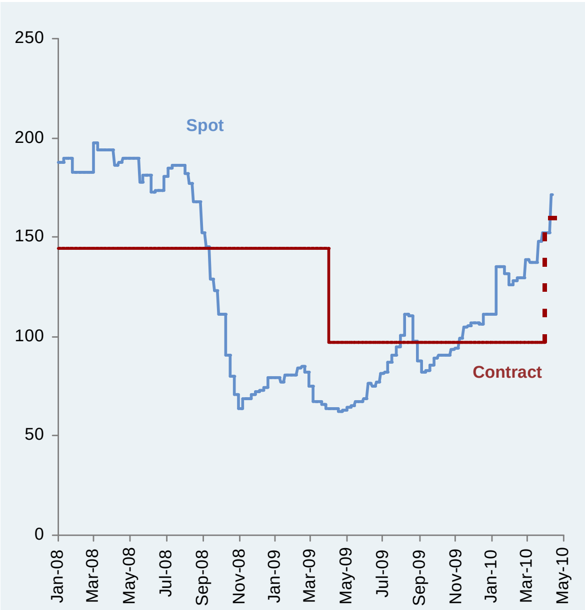
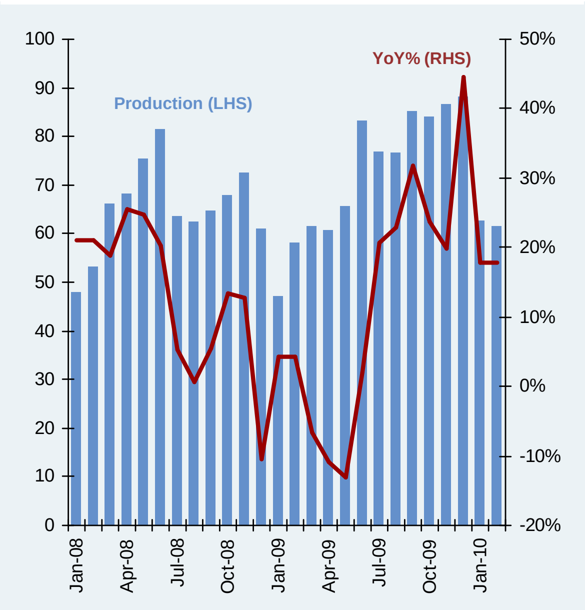


Figure 4b: Production of iron ore (mn tons)



Source: Bloomberg, J.P. Morgan estimates *2009 rate based on Japanese benchmark, 2010 assumes 65% increase

Crude oil

China's crude oil imports climbed to 4.98 million bpd in March, just shy of the record 5.03 million bpd level recorded in December 2009. Crude oil imports rose 39% YoY in the first quarter, but the value of imports rose 149.8%, reflecting the recent steep rise in crude prices. The Chinese government has raised retail prices of diesel and gasoline to prevent the narrowing of refinery margins.

Strong growth in demand and relatively flat domestic crude oil production are contributing to a widening gap that must be met by imports. Robust car sales and buoyant industrial activity have fueled the recent increase in oil consumption. Although China's automobile fuel efficiency standards are very stringent by global standards, the large number of new cars purchased each year adds considerable weight to fuel demand (Figure 5a). According to estimates by a Sinopec representative, the net addition to China's total auto fleet last year generated an extra 20 million tons in annual crude oil demand (equivalent to the total level of imports in March). Meanwhile, as a result of the export recovery and resilient domestic consumption, highway freight volumes rose by 23.1% YoY in the first 2 months of the year, compared to a rise of 13.6% YoY in 2009. J.P. Morgan analyst Lawrence Eagles forecasts China's oil demand will grow by 5.8% and 4.6% in 2010e and 2011e, respectively.

The amount of annual imports increased to over 50% of total annual consumption for the first time in 2009. China Oil, Gas & Petrochemicals (CHINA OGP), a petroleum intelligence provider affiliated with Xinhua News Agency estimates that China's crude oil imports may rise by 15% this year.

Figure 5a: Car Sales in China (th units)

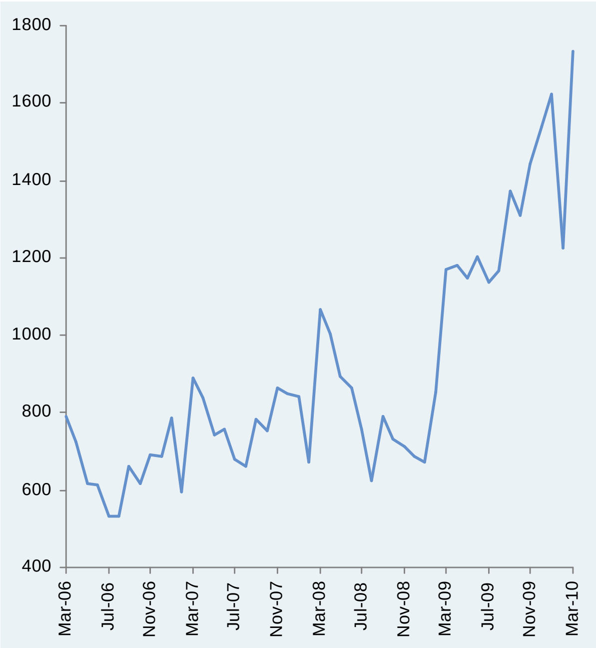
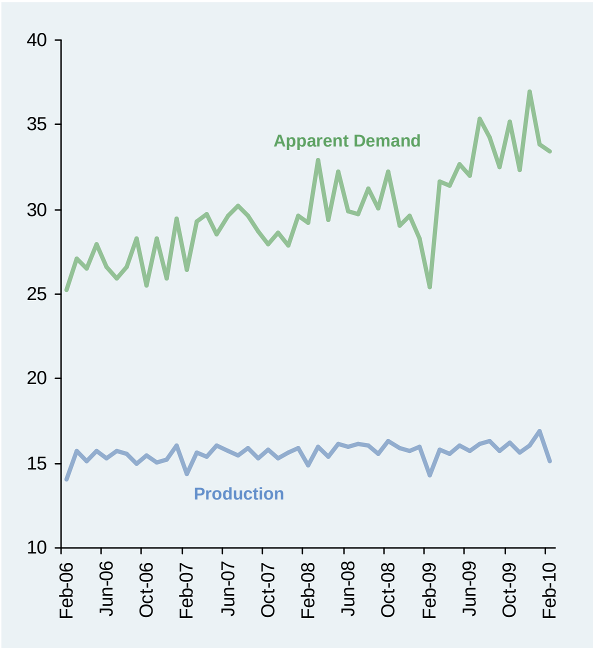


Figure 5b: Apparent Demand and Production of Crude Oil (mn tons)



Source: CEIC

Disclaimer