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Steelmaking raw materials turning into modest surplus: BHP

- **We highlight relevant read-across for Indian ferrous players from BHP's Economic and Commodity Outlook and FY24 (ending Jun) results**
- **BHP expects modest global steel production growth and modest surplus in global iron ore and coking coal supply through CY25**
- **Pace of stabilisation of China's property sector and addressing of steel capacity surplus in China are two key swing factors for the sector**

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Soft backdrop: From a soft commodity demand backdrop, BHP is cautiously optimistic about bottoming out of real estate in China over CY25 and notes steady growth in several commodity-intensive segments like conventional infrastructure, zero- and low-emission technologies, machinery, automotive and shipbuilding.

Medium-term volatility in commodity markets: BHP expects small-to-mild surplus for a number of commodities over next couple of years, leading to volatility in prices.

Modest growth in global steel production: BHP expects a small improvement over CY24-CY25, with growth led by India and Southeast Asia and some recovery in developed regions. While BHP expects China's steel production to ease in CY24, it reiterates production plateau of above 1bn tonnes to continue over the mid-2020s.

Era of adjustment for steel-making raw materials: BHP highlights several drivers that could potentially influence steel value chain trade flows – (a) decline in China's steel production, (b) growth in India's steel production, (c) new low-cost iron ore supply, (d) operational uncertainties of coking coal supply, and (e) decarbonisation.

Soft iron ore price outlook: BHP anticipates the iron ore surplus to increase through CY25 and sees the cost support level at US$ 80-100/t on a 62% Fe CFR basis. Persisting surplus could lead to the exit of some high-cost suppliers over time.

Soft coking coal price outlook: Despite continuing operational challenges, BHP expects the seaborne coking coal market to be in a mild surplus in CY25 whereas the supply of higher quality coals to be relatively tight.

Wild cards: BHP flags pace of stabilisation of China's property sector and the government's approach to regulating steel production as large swing factors.

Read-across for ferrous players: We have a neutral stance on Indian ferrous players with stocks largely pricing in future volume growth. BHP's outlook ties in with our view of (a) cap on steel margins until steel capacity surplus is addressed in China and (b) easing of iron ore and coking coal prices over the next two years.

Economic outlook

Economic backdrop

Steady global economic outlook: BHP expects global economic growth to be slightly above 3% annually for CY24 and CY25, similar to last year. However, it highlights its diverging outlooks across major economies, with developed economies facing less of a drag from higher interest rates, China experiencing an uneven recovery among its end-use sectors, and India likely to continue as the fastest-growing major economy.

Soft commodity demand: While demand for commodities has been soft in developed economies, BHP expects demand to recover across the Organisation for Economic Co-operation and Development (OECD). While China is on track to meet CY24 macroeconomic growth targets, its property sector is a drag on commodity demand.

China's uneven recovery: While acknowledging weakness in the property market, the company highlights steady growth in several segments important to commodity demand – like conventional infrastructure, zero and low emission technologies, machinery, automotive and shipbuilding. BHP also flags a steady recovery in export-oriented sectors, with the "New Three" of solar, electric vehicles (EVs) and batteries expanding rapidly.

- **Real-estate to bottom out in CY25:** BHP is cautiously optimistic that the shift and more recent fiscal and monetary stimulus will lead to a bottoming of the sector in CY25, first for housing sales and then for construction activity. BHP notes that the policy on destocking excess housing supply is a decisive policy pivot.
- **Reducing linkage to building and construction:** BHP notes that the share of the building construction sector reduced to slightly over 20% of steel consumption this year, and has been overtaken by machinery and equipment.

Long-term outlook remains strong: BHP expects population growth, urbanisation, the infrastructure of decarbonisation, capital stock replacement and rising living standards to continue to drive demand for steel, non-ferrous metals, and fertilisers for decades to come.

Volatility to persist in commodity markets

Medium-term volatility: BHP expects a small-to-mild surplus for a number of commodities over the next couple of years. This will lead to continued volatility in commodity markets over the next 18 months.

Era of adjustment for steel-making raw materials: BHP expects steel-making raw materials to enter an era of adjustment. BHP expects the following drivers to have an influence on steel value chain trade flows – (a) conclusion of China's crude steel plateau phase, (b) India's rapid steel capacity growth, (c) new entrants in iron ore seaborne trade, (d) uncertain operational performance in steelmaking coal, and (e) the complexities that will come with greater efforts to decarbonise.

Steel outlook

Modest growth in global steel production: BHP expects a small improvement in global steel production over CY24-CY25 with growth led by India and Southeast Asia, and some recovery in developed regions.

China's production to continue at plateau level across the mid-2020s: BHP expects Chinese blast furnace run-rates to ease in CY24 due to pressure from subdued steel margins and the potential for policy-driven production controls. The company reiterates its view of China steel production remaining above 1bn tonnes across the mid-2020s. However, with increasing use of recycled scrap, this could lead to a decline in pig-iron production, in turn leading to a decline in demand for coking coal. However, this decline could be offset by rise in pig iron production from developing Asia.

Difficult to displace blast furnace technology: BHP's analysis suggests that blast furnace (BF) iron making, which depends on coke made from steelmaking coal, is unlikely to be displaced at scale by emergent technologies for decades. BHP's argument hinges partly on the sheer size of the existing stock of BF-BOF capacity (70% of global capacity today) and the still quite young BF capacities in China – the major producer, but also on the large amount of new BF capacity expected to come online in India and Southeast Asia in the coming decade.

Iron ore outlook

Modest surplus over medium term: The surplus in global iron ore markets has increased with Chinese port inventories at an elevated level of 150mt by Jun'24. BHP anticipates the surplus will rise further over the balance of CY24 and into CY25 as supply is likely to continue to outpace demand. Supply is likely to grow, particularly from major low-cost iron ore producers, while iron ore consumption is likely to experience a modest decline, according to BHP.

Soft iron ore price outlook: Iron ore prices declined over Jan-Jun'24 and traded in the range of US$100-120/t. BHP expects iron ore to enter an era of adjustment.

Cost support levels: BHP expects a real-time cost support level of US$80-100/t on a 62% Fe CFR basis. In case surplus persists in the market, some high-cost suppliers could exit over time.

BHP reckons three differentiated envelopes of supply contributing to a relatively dense shield of support: (a) higher-cost juniors in Australia, Brazil and other regions, (b) the shoulder of the Chinese domestic mine cost curve, and (c) lower grade Indian exports. BHP estimates the cost support level at above US$ 90/t for over 130mt-140mt of supply and US$ 80-90/t for a further 30mt-40mt of supply.

Wild cards: BHP flags two drivers as large swing factors**:** (a) pace of stabilisation of the property sector in China, and (b) the government's approach to regulating steel production.

Long-term supply outlook: BHP flags the following new sources of supplies – (a) higher-grade supply from the Simandou project in Guinea, with the first tonnes likely in the middle of this decade, (b) additional supplies from majors, including BHP, (c) ambitions of the Chinese domestic iron ore industry to increase production.

BHP specific inputs:

- **Jul'24-Jun'25: target range-bound production:** BHP's guidance suggests range-bound production with -2% to +2% YoY growth implied by 255mt-265.5mt production target (equivalent of 282mt-294mt at 100%).
- **Modest growth expected in medium term:** BHP aims to grow iron ore production above 305mt (100% basis) from the 282mt-294mt target over Jul-Jun'25. Growth is likely to be driven by creep production growth at its Western Australia Iron Ore (WAIO) operations.
- **Studying feasibility of long-term growth:** BHP is assessing options to grow production from WAIO up to 330mtpa and aims to complete these studies in CY25.
- **Ramping up capex:** BHP plans to increase capex on iron ore to US$ 2.5bn in FY25 from US$ 2.1bn annually in FY23 and FY24. BHP notes capex inflation in resources sector in Western Australia, and is guiding for increase in annual sustaining capex spend from ~US$ 5.50/t to ~US$ 6.50/t.

Coking coal outlook

Price outlook: BHP expects the price of coking coal to remain soft on a mild surplus in CY25.

Slight surplus in CY25: BHP expects seaborne supply in the steelmaking coal market to experience a mild surplus in CY25 and relative tightness in the supply of higher-quality coals. The expectation of mild surplus is despite operational challenges that have remained a regular feature of the market. BHP flags the availability of land borne imports into China and operational recovery of Chinese domestic mines as key uncertainties for supply.

Demand to improve gradually over CY25: BHP sees continuing strong momentum in India's demand and gradual recovery in OECD's demand with a gradual pickup in their steel industries. BHP also notes China's reducing dependence on the seaborne market with a significant increase in landborne imports from Mongolia (CY23 imports rose to 54mt, up almost 60% from CY19 levels).

BHP-specific inputs:

- **Flat production target for FY25:** BHP's guidance for Jul'24-Jun'25 (FY25) at 33mt-38mt (100% basis) does not suggest a material improvement in coking coal production with BHP planning to focus on improving supply chain stability. While BHP notes signs of improvement in stability, BHP still highlights that it will take time to recover (**refer note for details**).
- **Growth potential in the medium term:** While BHP aims to improve production to 43mt-45mt over the next five years, the recovery is likely to be after its operations reach a sustainable inventory level and the stripping ratio normalises.

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