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China's green steel reform – A 5-year delay in its implementation

When watching the 2022 Beijing Winter Olympic games, audiences might notice the gigantic furnaces and cooling towers sitting right next to the snow-covered ski ramps. This rather unique venue, which is one of Beijing's urban renewal projects that had been transformed from a decommissioned steel factory, highlights China's historical efforts in fighting air pollution. During the past decade or so, China took the approach of relocating highly polluting industries out of its major economic hubs to lower-tier cities where environmental regulations are relatively loose, particularly around the 2008 Beijing Summer Olympic games when the government wanted to show a "bluer sky and clearer water" to audiences globally.

With Beijing increasingly tightening its grip on environmental regulations, especially after its announcement on carbon peak and carbon neutrality targets, the old window-dressing approach of relocating factories elsewhere is no longer viewed as viable by the regulators. Recently, the Chinese Ministry of Industry and Information Technology (MIIT), the National Development and Reform Commission (NDRC) and the Ministry of Ecology and Environment (MEE) jointly delivered the [Guiding Opinions](#) on Promoting High-Quality Development of the Iron and Steel Industry. The policy reiterates tight control over steel production capacity expansion and sets goals of an 80% ultra-low emissions steel production and 10% water usage reduction by 2025.

Steelmaking is China's second-largest carbon emitter after thermal power generation. It accounts for 15% of the country's annual carbon emissions. As the country is currently undergoing major reforms in its power sector for renewable transition, it is rather obvious that steelmaking becomes the next targeted sector to achieve emission reduction.

Slash carbon emission from steelmaking is not only an environmental decision, but a business one as well. With the EU's Carbon Border Adjustment Mechanism (CBAM) expected to kickstart its pilot phase in 2023 and to be formally launched in 2026, unless the Chinese steelmakers manage to reduce their emissions substantially, the world's largest steel exporters would soon find their products no longer price competitive in the European market due to the add-on carbon tax.

In fact, the decarbonisation pressure faced by the sector is nothing new to steelmakers in China. Since 2019, NDRC and MEE have been urging the sector to implement ultra-low emissions retrofitting, a process that consists in upgrading all manufacturing processes (including raw material mining, sintering, pelletizing, coking, ironmaking, steelmaking, steel rolling, power supply and transportation, etc.) involved and tightly managing emissions from each respective source.

As of December 2021, only 15% of the country's steel production capacity has completed such a retrofit with another 50% currently undergoing the process, leaving another 15% unaccounted for to reach the 80% target set by the regulators. Mainly due to technological and financial constraints, privately-owned smaller steelmakers have shown reluctance in upgrading their manufacturing facilities, particularly after China's crackdown on its property sector in late 2021.

Lately, the steel sector has been under pressure due to spiking energy and raw materials prices paired with weakening demand from the property sector. In 2021, crude steel production in China decreased by 3% YoY to 1.03 billion tons, the first yearly production decline since 2015 when the industry experienced its first wave of supply-side consolidation.

To achieve carbon reduction while addressing difficulties faced by the industry, the Guiding Opinions has shown more flexibilities and relaxations in a number of areas compared to its consultation draft issued in early 2021, most notably by delaying the deadline for carbon peak of the industry from 2025 to 2030. The policy also loses other stipulations from the older draft by removing multiple technical KPIs and industry concentration targets. Instead, it has adopted a more general goal of "largely increase industry concentration", leaving more time and flexibility for implementation.

In our view, this kind of scale-back from previous ambitious targets is not surprising. Particularly after a series of power outages across China in 2021, the regulators have come to acknowledge the challenges of implementing "energy dual-control" and thus adopted a more flexible approach to avoid "campaign-style" carbon reduction initiatives. With the policies gradually shifting from "absolute reduction" to "stable and smooth transitioning" towards a greener economy, we believe that the long-term targets of carbon peak and carbon neutrality remain attainable given more fine-tuned policy guidance.

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