HD China ills become WA's malady
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LP Iron ore producers, and the WA economy, need to prepare for more sluggish demand from China if the findings of a major investment bank are accurate.

CHINA officially has 23 provinces, but Australia is emerging as the 24th, thanks to its strong economic ties with the Asian powerhouse.

TD Very few Australians would welcome the description of our country as a Chinese province, pointing to vast political and social differences between the two countries.

From an economic perspective, however, there is a mountain of evidence to support the mischievous tag of 24th province, a description that will grow with each controversial move by Chinese investors to buy Australian assets.

The likely sale to Chinese interests of the Kidman pastoral stations, which are spread across northern Australia, has the potential to be a flash point, just as the recent powdered milk crisis stirred resentment as Chinese buyers snapped-up vast quantities of a popular infant formula for shipping home.

Learning to live with a giant and increasingly wealthy neighbour is potentially the biggest challenged Australia has faced in a generation, because while there are disagreeable aspects to the relationship, there is also the undeniable reliance of the Australian economy on China.

What happens in China flows directly into the Australian economy thanks to the increasing trade ties, and that connection adds a touch of credibility to the '24th province' description.

It is clear that the health of the Australian economy is becoming ever more closely tied to that of China; a variation of an old saying about the US economy and the way it dominates events in Canada: "When the US sneezes, Canada catches a cold".

Australian academic institutions are good at studying China, but are yet to fully understand that what happens there will quite quickly affect events here.

Investment banks, driven by the smell of money, are quicker off the mark, with Morgan Stanley last week joining the rush of bankers touring China to get an accurate reading of that country's economy and what Australia can expect from the changes.

After a week of meeting government and private-sector leaders, Morgan Stanley formed a view that China is struggling to manage the economic slowdown that has followed two decades of breakneck expansion - and that's not good news for Australia.

Steel production is the Chinese industry with the closest connections to Western Australia, via the extensive use of Pilbara iron ore in Chinese blast furnaces.

What Morgan Stanley noticed in China was an accelerating contraction in steel production, with producers hanging on and hoping their competitors will close first.

Steel-making capacity cuts have been slow, so far, but deeper cuts are expected in the New Year, which is a direct pointer to what's likely to happen to the price of iron ore.

"From the degree of bearishness of the steelmakers in Tangshan, it is clear that many are worried about their jobs and are already taking pay cuts," Morgan Stanley wrote in a research note dated November 16.

"The (steel-making) industry expects another round of producers will be forced out around the Chinese New Year period."

There are a few bright spots in China, with railway building a national priority. Overall, however, the picture is one of a difficult business environment in raw materials and finished product.

"Many domestic industries (such as steel and property development) are quite unprofitable," Morgan Stanley wrote.

Discussions with business and government leaders about the prospect of a fresh economic stimulus package similar to that which sparked a revival in 2009 were not positive.

"Unemployment remains the key benchmark to watch as a trigger point for the government," the bank said.

What a week traveling through China demonstrated to the Morgan Stanley tour group is that the Chinese economy continues to slow, with growth likely to slip from the current 6.9 per cent a year to 6.5 per cent, a number that is high by Australian standards but a big change for China, which had become used to annual growth of 10 per cent, and more.

The outlook is not encouraging for WA's important iron ore industry, despite high-cost Chinese ore being forced out of the market.

An iron ore expert with the specialist metal trading firm Umetal told the Morgan Stanley group that Chinese steel production was likely to fall by 3 per cent in 2016.

"Consensus is for iron ore to drop to $US40 per dry tonne. This (price) could materialise around Chinese New Year," the bank wrote.

"Steel mills can no longer get new financing from banks, but mills are delaying payments to upstream suppliers such as iron ore and metallurgical coal mines to generate credit."

China, it seems, has started to sneeze and it would be wise to assume that Australia is at risk of catching a cold.

Nickel in a pickle

IRON ore is not the only WA industry feeling the pressure of China's slowdown. Nickel mines are also under increasing pressure, thanks to a rock-bottom price that has slipped alarmingly close to the $US4 mark, a level at which most mines are losing money.

The plight of the nickel industry was explored in this column a month ago in a story headed 'Nickel producers in the drop zone'.

Back then, the nickel price was $US4.60 a pound with a favourable exchange rate lifting the Australian-dollar price to $A6.50/lb.

Earlier this week, the nickel price fell to $US4.19, with the US70 cents exchange rate producing a local price of $5.98 - a fall of 8 per cent in a month, and taking the fall over the past 12 months to 44 per cent.

Conditions in nickel are now so tough that hefty production cuts seem certain, with five of the world's biggest nickel producers facing the prospect of being mothballed until the price recovers.

The five facing the prospect of closure, according to investment bank Credit Suisse are: Goro on the Pacific island of New Caledonia; BHP Billiton's Nickel West (WA); Minara Resources' Murrin Murrin (WA); First Quantum Minerals' Ravensthorpe (WA); and the Yabulu nickel smelter in Queensland, owned by controversial politician, Clive Palmer.

Gas dump

A FINAL gloomy word, this time on liquefied natural gas, which is facing the imminent collapse of its spot (short term) price thanks to a previously unnoticed factor - a flood of uncontracted 'commissioning' LNG.

While most LNG is sold on long-term contracts at a reasonable price, commissioning gas, which is produced in the early start-up phase of a project, is unprotected and sold into an oversupplied market. The problem with this arrangement is that commissioning can take months; in the case of the new Curtis Island project in Queensland it took five months and dumped 1.5 million tonnes of LNG onto the spot market.

With six more LNG projects to follow, including Gorgon and Wheatstone in WA, commissioning gas could have a serious effect on the LNG market.

IN i22 : Primary Metals | i221 : Iron/Steel/Ferroalloys | ibasicm : Basic Materials/Resources

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