

# Coal Rally Ending as China Shuns Imports, Opens Mines (Update3)

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China's unprecedented appetite for imported coal is about to be sated, jeopardizing a five-month rally in prices by adding to a global surplus of the fuel used in power plants from Perth to Chicago.

After importing a record 48 million tons in the first six months, China is opening mines idled by worker deaths this year following safety upgrades in a bid to bolster economic growth. Huadian Power International Corp. expects China's largest coal-mining province, Shanxi, to boost output by 60 percent in the second half of the year. That would mean an increase of 150 million metric tons, almost twice what Germany burns annually.

With little need to buy coal outside the country, prices may tumble, falling as much as 7 percent in Europe alone, Barclays Capital says. China's purchases will plunge 33 percent between June 30 and Dec. 31, based on the median estimate of four analysts surveyed by Bloomberg.

"In the first half, China really supported the market and put a pretty firm floor under the thermal-coal price because it was sucking in so many imports," said Andrew Harrington, an analyst at Patersons Securities Ltd. in Sydney. "It's difficult to be confident that it will continue at such a rate."

China's July coal imports fell 13 percent to 13.9 million tons from 16 million tons in June, a record high, customs data show today. Demand from China, which uses coal to generate about 80 percent of its electricity, helped ease a global supply glut that sent U.S. inventories to an 18-year high.

## Earnings Hit

A retreat in prices may curb profit at Xstrata Plc, the mining company that is the biggest shipper of coal for power stations, said Nick Hatch, an analyst at ING Groep NV in London. Coal was the biggest contributor to operating earnings last year for Zug, Switzerland-based Xstrata, which boosted output of the mineral by 11 percent in the first half.

"If China stops importing as much coal, it clearly may mean lower coal prices in the seaborne market, and that could have an impact on earnings," said Hatch, who has a "buy" rating on Xstrata and mining companies Rio Tinto Group and Anglo American Plc, which also produce coal.

Claire Divver, a spokeswoman for Xstrata, declined to comment. Murray Houston, the general manager for the company's South African coal unit, said on Aug. 13 that shipments to China will increase "due to a tight domestic market."

Six-month supply contracts signed by Chinese buyers in February and March are expiring and aren't likely to be renewed at the same amounts as global costs remain high and as domestic supplies rise, said Huang Teng, the general manager of Beijing LT Consultant Ltd., a coal consultant based in the capital city.

## China Prices

Chinese provinces are accelerating the expansion of coal mines, the China Coal Transport and Distribution Association said in a statement on its Web site today. The reopening of small mines in regions including Shanxi will increase supplies and put pressure on prices. The benchmark price at Qinhuangdao port was unchanged for a third week at 570 yuan (\$83.44) a ton on Aug. 24, according to the government-backed association.

Coal futures for September delivery at Rotterdam, the benchmark for Europe, have risen 39 percent to \$72 a ton on Aug. 21 from this year's low of \$51.75 on March 12. Prices rebounded from a 35 percent decline last year, when the recession slowed demand for electricity. Supplies for delivery in January are trading 7.6 percent higher than the September contract.

### **Shrinking Premium**

That premium for delivery early next year may shrink because China won't be buying as much of the world's surplus, said Amrita Sen, a commodity analyst at Barclays Capital in London. Coal delivered at Rotterdam will fall to an average of \$67.20 a ton from \$72 in the first six months, she said.

"China has been a key factor in providing a floor to prices and any softening in Chinese buying will pressure coal," Sen said. "We will see a softening on a month-on-month basis in Chinese coal imports."

Prices of coal shipped from South Africa's Richard's Bay, which exports to Europe and Asia, posted a second straight drop last week. Export prices at the port fell 10 cents, or 0.2 percent, to an average of \$64 a metric ton in the week ended Aug. 21, according to McCloskey Group Ltd.

An end to the global recession may trim the surplus. China has spent 4 trillion yuan in a stimulus package designed to support its economy. The world's third-largest economy grew 7.9 percent in the second quarter from a year earlier after expanding at the slowest pace in almost a decade the previous three months, the statistics bureau said July 16.

### **'Extraordinary' Measures**

"Price momentum and volume momentum are so strong, it's difficult to see why the price should go down," said Eugen Weinberg, a senior commodity analyst at Commerzbank AG in Frankfurt. "Measures to initiate demand are extraordinary."

Drax Group Plc, the owner of western Europe's biggest coal-fed power plant, has no plans to sell its surplus inventories of the fuel because the North Yorkshire, U.K.-based company expects the value of the commodity to increase.

"We see the coal market rising," Chief Executive Officer Dorothy Thompson said on an Aug. 4 conference call with reporters. "It does not make sense to sell coal now."

China, the world's largest producer and consumer of coal, ordered the closure of almost all 10,000 of the country's small pits during the Spring Festival in January, and plans to open some were delayed following a deadly accident in February.

An explosion at a shaft in Shanxi killed 74 and injured as many as 114 miners, leading to more intense safety checks. Small mines that account for about 25 percent of China's production were told to merge and those deemed unsafe were closed.

### **Most Deadly**

The nation's coal mines are the most deadly in the world, with 3,770 workers killed in 2007, more than 100 times the number of fatalities in the U.S., the second-largest producer, according to government data. Suppliers kept old pits open, ignoring safety rules and forgoing routine checks, to meet surging demand from the world's fastest-growing major economy.

The mine closures and lower prices led to an increase in purchases from overseas. Imports surged to 16 million tons in June, bringing the first-half total to 48 million, according to customs data. Thermal coal futures in Newcastle, Australia, the world's largest coal port, have rallied 22 percent from a low in March to \$72.90 a ton on Aug. 21, according to ICE Futures.

While most of the world's output is used near where it is mined, export prices are determined by the remaining 16 percent bought and sold internationally, data from the London-based World Coal Institute show. Thermal coal used in power plants accounts for 92 percent of global production and 72 percent of international trade, according to the U.S. Energy Department. The rest is mostly used in steelmaking.

### **Safety Checks**

After completing safety checks and consolidating small pits that had an annual capacity of 300,000 tons or less, the province of Shanxi is accelerating the pace of mine openings to revive the worst-performing provincial economy in China. The region's gross domestic product contracted 4.4 percent in the first half, according to government data.

"The province started approving restructuring plans in April and the process of consolidating mines has started," said David Fang, the director of the international department at the China Coal Transport and Distribution Association. "Small mines are reopening gradually."

Of the 10,000 small mines in China, about 2,598 are in Shanxi, according to the China Daily newspaper. Output in Shanxi may rise to 400 million tons in the second half from 250 million tons in the first six months, said Chen Jianhua, the president of Huadian Power, the fourth-largest Hong Kong-listed Chinese electricity generator. Chen expects Shanxi production to reach 650 million tons in 2009.

China produced 2.6 billion tons last year, according to the national bureau of statistics, which compiles data for the government. China is likely to cut imports by 33 percent in the second half of the year to 32 million tons, according to four analysts and industry officials in a Bloomberg survey.

### **Swelling Supplies**

Reduced demand may swell global supplies that ballooned during the recession. Stockpiles held by electricity generators in the U.K., Europe's biggest importer of coal, rose 68 percent in May from a year earlier to 17.4 million tons, the most since at least 1995, government data show.

“Europeans are fully stocked, but not reselling because they fear higher prices with an Asia-led economic recovery,” said Emmanuel Fages, a Paris-based commodities analyst at Orbeo. “The cost of carry for storing coal is cheaper than buying the coal for later delivery.”

### **U.S. Inventories**

In the U.S., inventories jumped 15 percent in the first four months of the year, compared with a 1.1 percent gain in 2008 and 2.4 percent in 2007, Department of Energy data show. Stockpiles at the end of last year totaled 199.2 million short tons (180.7 million metric tons), the highest since 1991.

Global supply of internationally traded thermal coal is forecast at 633 million tons next year, exceeding demand by 14 million tons, according to forecasts from Macquarie Group Ltd., Australia’s largest investment bank.

The rapid increase in Chinese coal output may upset the calculations of producers in other countries, including the U.S., where exports rose 38 percent last year.

St. Louis-based Peabody Energy Corp. sold 16 percent of its coal production outside the U.S. last year, regulatory filings show. The company’s sales outside the U.S. climbed 30 percent to 40.3 million tons, outpacing total sales growth of 8.2 percent to 255.5 million.

“China has been an indirect market” for the U.S., said James M. Rollyson, an energy analyst at Raymond James Financial Inc. “It’s soaked up capacity from Australia, so it kind of makes waves into other markets.”

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