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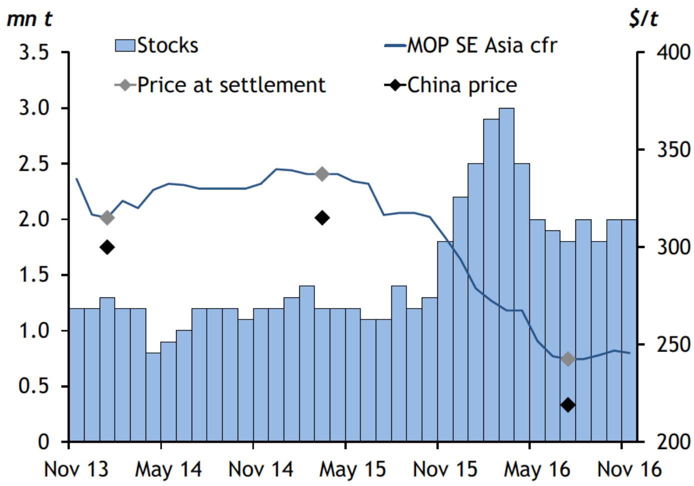
Potash market mulls China's contract options for 2017

Potash suppliers have recently turned their attention to the next China contract settlement, as steady prices and recovering demand have alleviated some tensions in the final months of 2016. Uncertainty remains as to what China's purchasing strategy will be this time around, and market participants have numerous views on how and when Chinese consortiums will choose to buy their requirements for the year.

China could be tempted to settle early, if the price is right. But given its success in achieving such comparatively low rates for 2016, it could well elect to test suppliers' resolve by delaying any talks until they are compelled to accept a lower price to secure a deal.

This year, China elected to hold off signing contracts until later than usual, possibly because stocks were higher than they were when contracts were agreed in 2015 and 2014, and MOP prices were still in decline.

China settlement



Five months on, it would appear that China timed its 2016 purchasing well, as potash prices have since recovered, and its stocks are depleting, but at a manageable rate.

For the next contract, initial indications are that suppliers would be keen to settle early in order to create market confidence and be able to plan production requirements for the rest of the year, assuming that Indian contracts are also signed relatively quickly.

China will draw on a number of variables to decide when to agree supply deals. Normally the current price and price expectations factor in heavily, as do current stock levels, demand requirements for the year, domestic production levels, domestic VAT policy, and the volumes of MOP that are railed to China by Russian firm Uralkali.

China has always demanded a significant discount to spot potash prices, and it managed to secure headline contract prices at discounts to southeast Asian standard MOP prices of $15/t in 2014, $22.50/t in 2015 and $23.50/t this year. Assuming that southeast Asian prices remain steady at a midpoint of $245/t cfr, and assuming that China negotiates a similar discount this time around, the price would be around $225/t cfr.

Demand

Stocks rose to just over a two-year high of 2.9mn t in February 2016, and have only declined to around 2.2mn t as of late January, still significantly higher than the 1.3mn t and 1.2mn t held in stock for the 2014 and 2015 contract signings, respectively.

Higher stocks give China the chance to delay signing seaborne contacts, so it can pick its moment based on price and price expectations rather than any immediate demand requirements.

Overall KCL imports — sent by rail and sea — to China in January-October show imports are already down by nearly 30pc from a year earlier to around 4.95mn t. If that percentage remains unchanged in the final two months of 2016, imports for the year will be down to 5.62mn t. Global seaborne imports of KCL to China have dipped by over 37pc in January-October compared with the same period a year earlier, to 3.79mn t.

But imports of MOP by rail from Russia have risen by nearly 8pc in January-October compared with a year earlier, to nearly 1.1mn t, so domestic supply is being topped up regularly.

In addition, China is cutting its corn planting in the "sickle" area by at least 50mn Mu (33,300 km²) by 2020, to 100mn Mu. Low yields and crop prices this year have meant that farmers may also have less money for fertilizers in 2017.

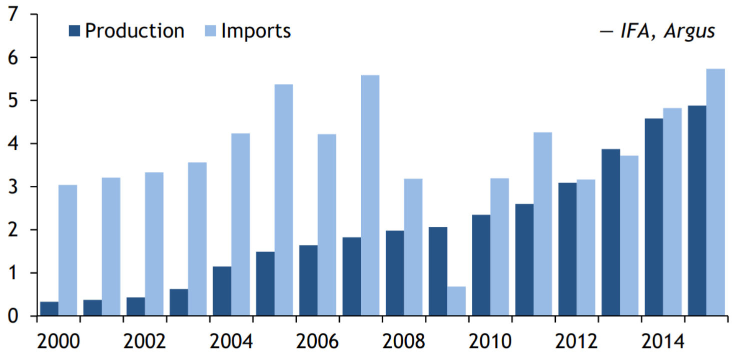
These factors all contribute to an expected fall in demand over the next few years, meaning that suppliers will have to fight to keep their eroding share of seaborne sales to China, potentially by undercutting other suppliers, and so reducing any chance of a significant price hike on this year's $219/t cfr.

Becoming self-sufficient

As its demand for potash has grown in recent years, China has made great efforts to develop its own resources to reduce its dependence on imports. As a result, deliveries from the domestic industry have risen to 3.5mn-4mn t/yr of K_2O — around 5.74mn-6.56mn t of KCL — and now account for around half of total supply in China, compared with around 10pc at the start of the 2000s.

China has been looking to invest in potash reserves abroad, especially since the middle of the last decade, when the escalation of potash exporters' prices revealed the weak position of the big importers. Capital for investment is available from the big national banks, notably China Development Bank, which has been associated with several projects. Countries targeted by China include Canada, Belarus, Kazakhstan, Laos and the Democratic Republic of Congo.

Chinese K_2O production and imports



There is, as yet, no Chinese capital investment in the York Potash polyhalite project of UK firm Sirius Minerals. But Sirius has signed take-or-pay agreements with Huaken and Yunnan Dian Huang, totalling 1.5mn t/yr, and initial agreements with Sino-Agri, Jiangsu Luling and Sichuan AMPC.

These moves to open up new supply channels will not affect the 2017 contract deals, but existing suppliers will be acutely aware of these factors in the coming years. But for now, China remains dependent on foreign producers, and those producers equally as dependent on Chinese demand.

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