Metals & Mining

Straight out of the Blast Furnace: Week 4, July 2024

LatAm Metals & Mining

Main takeaways on China:

(i) Macroeconomics: On July 21, China **cut its LPRs**. The 1-Y LPR was reduced to 3.35% (-0.10p.p.), and the 5-Y LPR also fell to 3.85% (-0.10p.p.); **(ii)** The 7-day reverse REPO were also cut to 1.7% (-0.10p.p.); **(iii)** Since mid-May, the PBoC has allowed provincial governments to set mortgage rates freely, leading to a mismatch with 5-Y LPR. Therefore, we believe that 5-Y LPR was reduced for that reason; **(iv)** The cut in the 7-day reverse REPO rate is likely to further ease funding costs, helping to alleviate pressure on commercial banks' net interest margins (NII) amid the LPR adjustments; **(v) More cuts ahead?** We anticipate a -0.10p.p. reduction in the reserve requirement ratio (RRR) still in 3Q24; **(vi)** We believe in a **deliberate reduction** of the **RMB/USD** to counter **tax measures on Chinese products**; **(vii)** Consumer confidence is at its lowest levels since 2016; **(viii)** China initiated its **3rd plenary**. So far, key highlights include social housing and a fiscal rebalancing between central and local governments; **(ix) Real Estate:** Changes in mortgage rates are not expected to have lasting effects; **(x)** The mortgage rate for second homes dropped more significantly to 3.9% (-1p.p vs. 2023), indicating a shift towards more lenient regulations; **(xii)** Local governments are releasing subsidized credit for commercial banks to lend to developers. However, we understand that credit support to whitelists may not reduce the inventory of unfinished houses; **(xiii)** Credit lines are not a guarantee of funding release. For example, Country Garden secured support for only ¥1.7bn (~US$233mn) in financing vs. ¥604bn (~US$83bn) of unfinished houses; **(xiv) Iron Ore:** Prices fell further, as anticipated, with the 62% Fe spot closing at US$104.2/t (-4.5% w/w). September futures contracts on Dalian (DCE) slowed to US$110/t (-3.8% w/w)**; (xv)** Port inventories halted last week's decline and rose again, reaching 131.4Mt (+0.98% w/w). If mining majors **do not maintain a higher gap between production and sales in 3Q24** and shipments continue at this strong pace with still weak domestic consumption, **the spot iron ore price tends to approach ~US$95/t**; **(xvi) Steel:** Chinese BFs mills recorded a **recovery in capacity utilization**, rising to **89.2%** (+0.50p.p w/w); **(xvii)** Rebar production hit its lowest level in the last 3M, with mills increasingly shifting production to flat steels; **(xviii)** HRC output remains at satisfactory levels, driven by exports. We identified a reduction of 83.5% (-1.14p.p w/w), but still well above the 2023 level (+5.12p.p y/y).

We present another edition of our **weekly Metals & Mining report (Vale, CMIN, Gerdau, CSN and Usiminas)**, covering **week 4 of July 2024**. This report is based on data collected over the **week prior the publication**, specifically from **July 13-19**. We continue to give updates on important indicators for monitoring **steel supply and demand fundamentals in China**, and consequently, **iron ore in the seaborne system**. We also highlight the **chapter on Brazil**, showing the dynamics of the **domestic steel premium** for both long and flat steel references vs. imported prices.

Analysts

Igor Guedes
+55 (11) 99464-8234
igor.guedes@genial.com.vc

Rafael Chamadoira
+55 (11) 99464-8236
rafael.chamadoira@genial.com.vc

Iago Souza
+55 (11) 99464-8235
iago.souza@genial.com.vc

Companies

VALE US Equity
Buy

Price: US$ 10.70 (24-Jul-2024)
Target Price 12M: US$ 14.50 (NYSE)

VALE3 BZ Equity
Target Price 12M: R$ 78.50 (B3)

CMIN3 BZ Equity
Buy

Price: R$ 4.98 (24-Jul-2024)
Target Price 12M: R$ 6.00

GGBR4 BZ Equity
Buy

Price: R$ 17.82 (24-Jul-2024)
Target Price 12M: R$ 23.40

CSNA3 BZ Equity
Neutral

Price: R$ 11.96 (24-Jul-2024)
Target Price 12M: R$ 15.50

USIM5 BZ Equity
Neutral

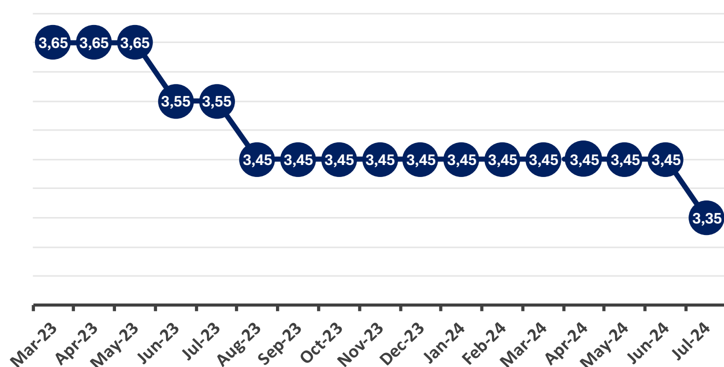
Price: R$ 8.07 (24-Jul-2024)
Target Price 12M: R$ 8.70

China

Macroeconomics

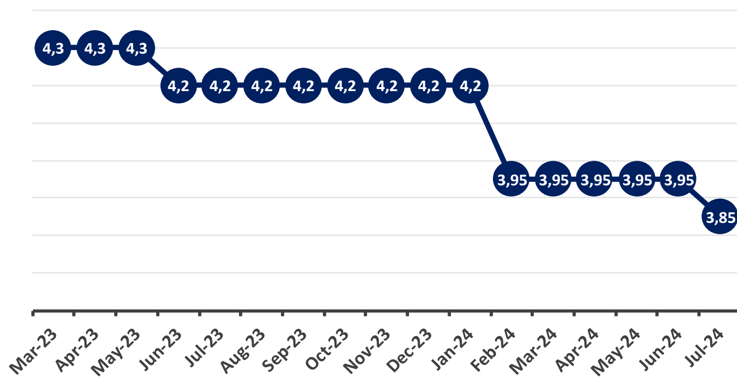
The big news of the week: China cuts interest rates. At the beginning of this week, on July 21, China cut its benchmark loan prime rates (LPRs) after a surprising reduction in the main policy rate used by the People's Bank of China (PBoC). The 1-year LPR was reduced to 3.35% (-0.10p.p.), and the 5-Y LPR also fell to 3.85% (-0.10p.p.). Consensus expectations were for rates to remain unchanged, although we had noted in our week 4 June report that inflation data still indicated potential cuts by the PBoC, and that a less contractionary monetary policy should be adopted in 2H24. This can be seen in the attached report (Straight out of the Blast Furnace: Week 3, July 2024).

Graph 1. LPR 1-Year (%)



Source: Bloomberg, Genial Investimentos

Graph 2. LPR 5-Years (%)



Source: Bloomberg, Genial Investimentos

The 1-Y LPR affects most new and existing loans related to the economy's underlying goods and services, while the 5-Y rate impacts mortgage prices. The 7-day reverse repo rates were also cut to 1.7% (-0.10p.p.). This rate is used by the PBoC to remunerate the purchase of securities from commercial banks through bidding, with an agreement to sell them back to the secondary market in the future.

Our take on macroeconomics

This week, we observed the PBoC implementing the first cut in the 7-day reverse repo rates and the second cut in the LPR, reducing both the 5-Y and 1-Y LPRs. The 5-Y LPR had already been cut by -0.25p.p in February, while the PBoC kept the 1-Y LPR unchanged at that time. This decision comes after a disappointing GDP growth rate in 2Q24, reaching 4.7% y/y (-0.4p.p vs. consensus), with a significant sequential growth slowdown compared to 1Q24. Credit growth weakened, especially in the corporate and real estate sectors, due to worsening economic sentiment. We understand that the recent downgrade of both LPR references aims to stimulate corporate credit demand and stabilize the real estate market.

The decision to cut both LPRs is correlated with the mortgage easing implemented in April. Since mid-April, the PBoC has allowed provincial governments to set mortgage rates independently, leading to a divergence between the 5-Y LPR, usually correlated with mortgage rates, and the actual rates offered for real estate loans over the past 30 days (which were below the 5-Y LPR). Therefore, we believe the 5-Y LPR was reduced for that reason, even though we only expected a cut in the 1-Y LPR. By doing so, the PBoC appears to have realigned the correlation between mortgage rates and the LPR.

If the PBoC wasn't cutting rates despite having monetary policy room, what would have changed? Since April, commercial banks have been prevented from offering deposit rates above a specific limit, reducing their funding costs for liabilities. The 7-day reverse REPO rate cut, announced along with the LPR cuts, is expected to further ease wholesale funding costs for banks, alleviating pressure on their net interest margins (NII) amidst LPR adjustments. This was one reason why, despite weak inflation, the PBoC had not previously accelerated the LPR cuts. By addressing the negative impact on commercial banks' NII, the PBoC has found opportunities to reduce the LPRs.

More cuts ahead? We believe so... In response to growth challenges from the current slowdown in real estate and with very low CPI data, we anticipated last week that there would be monetary and credit policy easing throughout 2H24. We had also indicated in April that the 1-Y LPR could be cut to 3.35% in June. We were off by one month, as the reduction occurred in July. Besides the cuts observed this week, we consider a -0.10p.p. reduction in the reserve requirement ratio (RRR) likely in 3Q24. However, beyond **(i)** concerns about banks' net interest margins (NII), as mentioned above, there is the issue of **(ii)** the stability of the RMB/USD exchange rate, both factors that constrain the potential for further rate cuts.

Deliberate Reduction of the RMB/USD Exchange Rate to Combat Tariffs on Chinese Products. We believe the Chinese government aims to maintain flexibility in the RMB/USD exchange rate to address potential future economic vulnerabilities and external shocks, such as a possible 60% tariff from the U.S. We anticipate a cut in the FED rates in October, following the revision of Payroll data (consensus is for September). In our view, this should help alleviate depreciation pressure on the RMB, potentially allowing for more domestic rate cuts. However, if a 60% tariff is imposed on Chinese imports by the U.S. in 2025-2026, more aggressive rate cuts by the PBoC might only be justified if the Chinese central government decides to deliberately devalue the RMB/USD exchange rate.

Further monetary policy easing for commercial banks. The PBoC has also eased operational requirements for medium-term lending facility (MLF) rates for commercial banks, allowing collateral exemptions if these banks intend to sell central government bonds (CGBs). This decision aims to increase the scale of tradable securities and alleviate supply pressures in the bond market. The PBoC had previously announced plans to borrow 10-Y CGBs from the primary market, enabling short selling and potentially increasing long-term yields. Currently, the yield on 10-Y CGBs remains low (below 2.3%).

Policy updates and market sentiment

Structural changes and salary reductions. Considering the pressured net interest margin (NII) of commercial banks, recent salary cuts in China's financial sector reflect a significant shift in previously lucrative roles, driven by the "common prosperity" initiative. Average hiring salaries in 38 major cities fell by -1% y/y in 4Q23, a stark contrast to the +13% y/y growth seen in 4Q21. Although there was a slight recovery in 1H24, the trend suggests broader salary reductions could extend to other sectors due to high unemployment and low consumer confidence in the economy, which is likely to continue squeezing some business margins. We estimate that discretionary retail spending fell at the steepest sequential pace since the lockdowns in April 2022, when China was under the Zero-covid policy. This could pressure small and medium-sized enterprises to cut salaries further.

Consumer confidence at lowest levels since 2016. Consumer confidence in income and employment remains weak, with indices hovering around pandemic lows of 47-45% in 1H24. This is significantly below the more optimistic levels seen a year ago (1H23) following the end of the zero-Covid policy and the reopening of economic activities. Historically, confidence in income and employment has fallen to its lowest level since 1Q16, when GDP growth slowed to 6.7%, the slowest quarterly pace in seven years. However, a turnaround was triggered by ¥3.3 trillion (~US$455bn) in public investments in the real estate market during 2016-17, which inflated house prices at the time. Conversely, we do not see the current real estate incentives boosting the confidence indicator this time around.

Carbon market in China celebrates 3 years. China's carbon trading market has shown stable performance, with a total of 465Mt in carbon emission allowances traded and a total value of ~¥27bn (~US$3.7bn) as of July 15. Marking its third anniversary, the national carbon emission trading system, launched on July 16, 2021, covers 5.1Bt in annual carbon dioxide emissions, representing over 40% of the country's total emissions, according to the Ministry of Ecology and Environment (MEE).

Our take on policy updates and market sentiment

Increase in US Tariffs by 60% on Chinese Imports. A 60% increase in US tariffs, expected in 1H25, poses a negative risk to China's economy, potentially reducing GDP growth. If the US implements these tariffs without retaliation from China and despite some trade diversion, macroeconomic policy adjustments are anticipated. As previously mentioned, we believe it is likely that fiscal policy will take the lead, while monetary policy may be slightly eased, although full quantitative easing or a zero-interest rate is not expected. As we have previously noted, we believe the Chinese central government might deliberately devalue the RMB/USD exchange rate by up to 10%. This could mitigate the negative impact on GDP in a scenario where domestic consumption does not improve, but China continues redirecting factory overcapacity to global export markets.

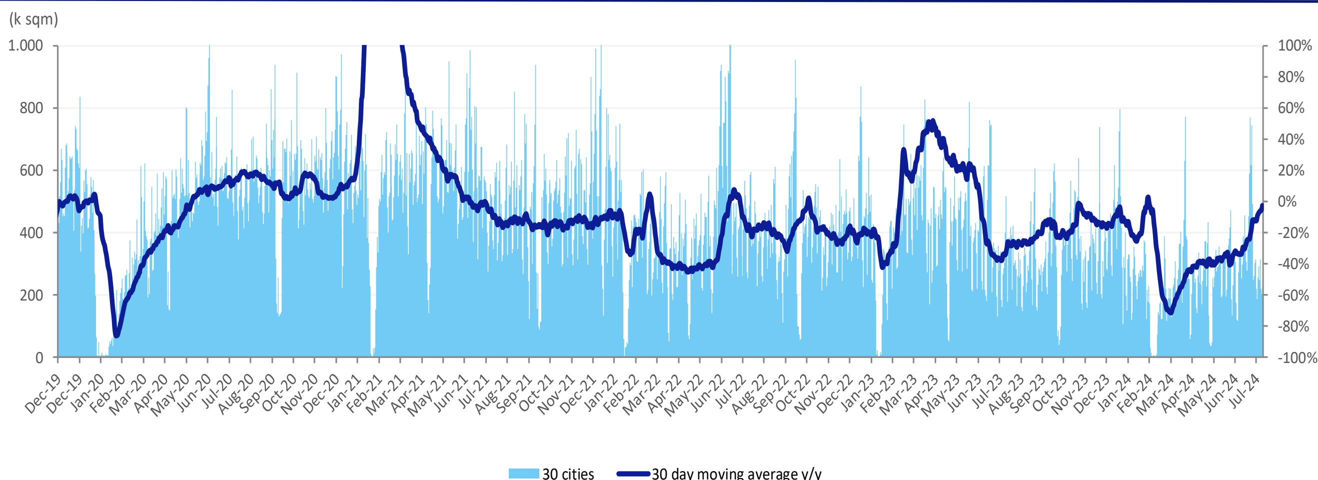
What are the updates on the 3rd Plenary Session of the Chinese Communist Party? The Communist Party of China (CPC) began its third plenary session on Monday, July 21. The plenary is an important meeting held approximately every 5 years to define long-term social and economic policies. This session, the third since the 2022 party congress, will focus on a key document aimed at deepening reforms and advancing modernization. The series of meetings will conclude on Thursday, July 25.

So far, President Xi Jinping has emphasized long-term goals, equal access to production factors, and fair competition, with a focus on high-quality development and innovation. The main areas of reform include **(i)** urbanization (through social housing, further explored in the real estate market section of this report), **(ii)** Improvements in social welfare, and **(iii)** a rebalanced fiscal relationship between central and local governments, shifting tax collection from producers to consumers to increase local government revenue. Nevertheless, without further details on the purchase of unsold property stock, market sentiment remains negative, and the interest rate cuts (LPRs) have not yet boosted investor confidence, despite being surprisingly implemented according to consensus.

Real Estate

Improvement in Tier I city sales likely to be short-lived. There is no doubt that data show the easing of mortgage rules in May is having a positive impact on Tier I cities. In June, state-owned developers reported a +54% y/y increase in primary home sales, while solvent private developers saw up to +24% y/y. However, we believe this situation is temporary due to the continued negative sentiment among buyers and structural challenges within the sector. The gains are influenced by seasonal factors (historically, mid-year sales tend to show increased appetite). We consider a reasonable duration for this sales boost to be ~90-days from early June. We do not foresee the trend persisting much beyond this period.

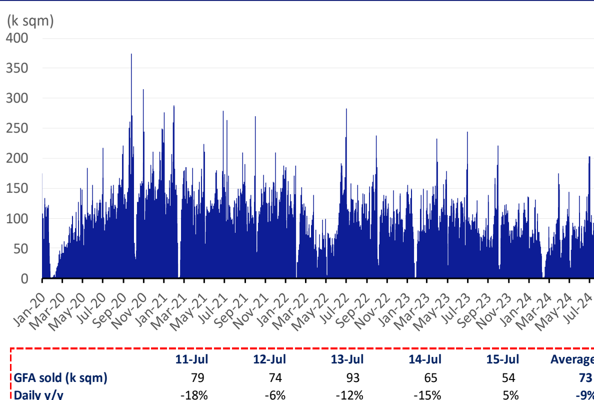
Graph 3. Daily sales of primary housing (30 major cities)



	2-Jul-24	3-Jul-24	4-Jul-24	5-Jul-24	6-Jul-24	7-Jul-24	8-Jul-24	9-Jul-24	10-Jul-24	11-Jul-24	12-Jul-24	13-Jul-24	14-Jul-24	15-Jul-24	Average
GFA sold (k sqm)	249	261	304	314	219	190	258	276	293	249	313	221	203	229	256
Daily y/y	-14%	-29%	-13%	-8%	-37%	-2%	97%	-23%	5%	-22%	4%	-35%	10%	41%	
30d MA y/y	-11%	-12%	-12%	-11%	-12%	-12%	-9%	-8%	-7%	-7%	-6%	-6%	-5%	-3%	

Source: Wind, Genial Investimentos

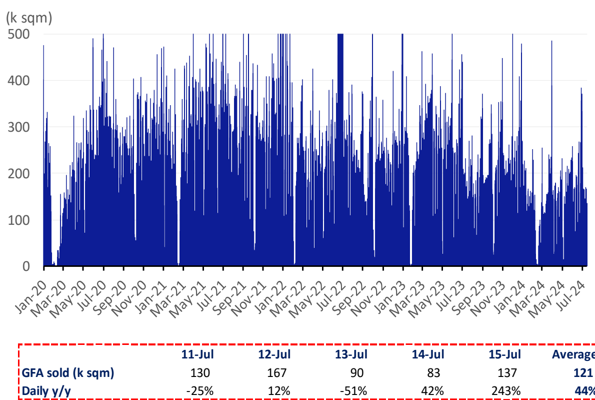
Graph 4. Daily sales of primary housing GFA (Tier 1)



	11-Jul	12-Jul	13-Jul	14-Jul	15-Jul	Average
GFA sold (k sqm)	79	74	93	65	54	73
Daily y/y	-18%	-6%	-12%	-15%	5%	-9%

Source: Wind, Genial Investimentos

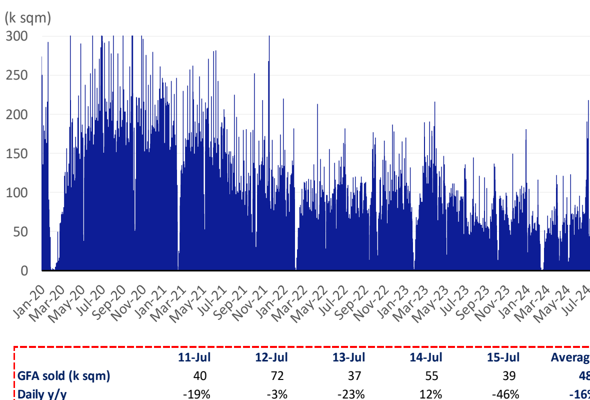
Graph 5. Daily sales of primary housing GFA (Tier 2)



	11-Jul	12-Jul	13-Jul	14-Jul	15-Jul	Average
GFA sold (k sqm)	130	167	90	83	137	121
Daily y/y	-25%	12%	-51%	42%	243%	44%

Source: Wind, Genial Investimentos

Graph 6. Daily sales of primary housing GFA (Tier 3)

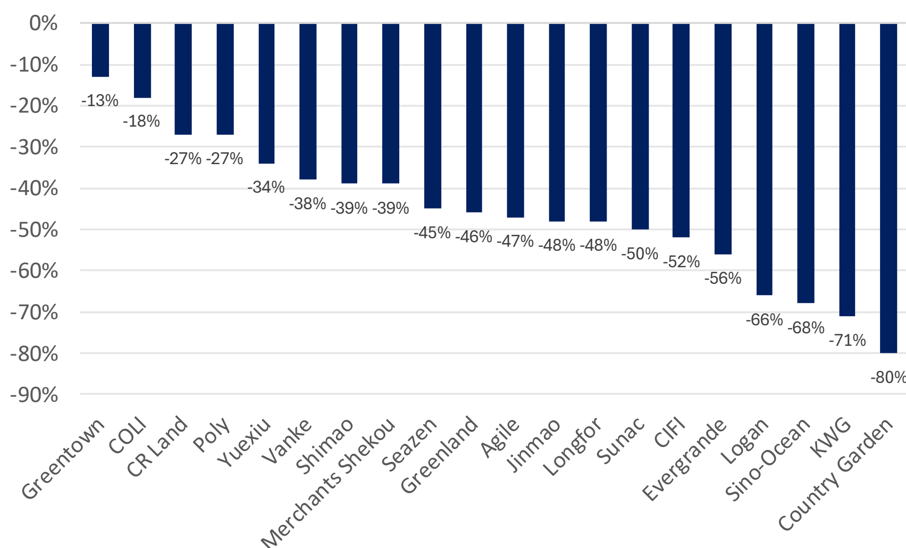


	11-Jul	12-Jul	13-Jul	14-Jul	15-Jul	Average
GFA sold (k sqm)	40	72	37	55	39	48
Daily y/y	-19%	-3%	-23%	12%	-46%	-16%

Source: Wind, Genial Investimentos

Negative sentiment among buyers still prevails. Homeowners in Guangzhou have begun halting mortgage payments on a project with 160 pre-sold units. This action highlights the ineffectiveness of existing whitelist policies designed to ensure housing completion, potentially leading to an increase in secondary home sales and a decline in pre-sales for defaulting developers like Country Garden, Shimao, and R&F. Homeowners of the Guangzhou Shenglong Jinsheng Real Estate project, pre-sold in 2022 with a delivery forecast for June, have notified 5 banks of their decision to stop mortgage payments due to delays. Despite a new round of stimulus measures introduced since mid-May, which have indeed improved primary sales in Tier I cities, we believe it is unlikely that Country Garden's contracted sales will recover from a -80% y/y decline in 1H24, given its focus on low-tier cities.

Graph 7. Contracted sales growth: 1H24 vs. 1H23 (y/y %)

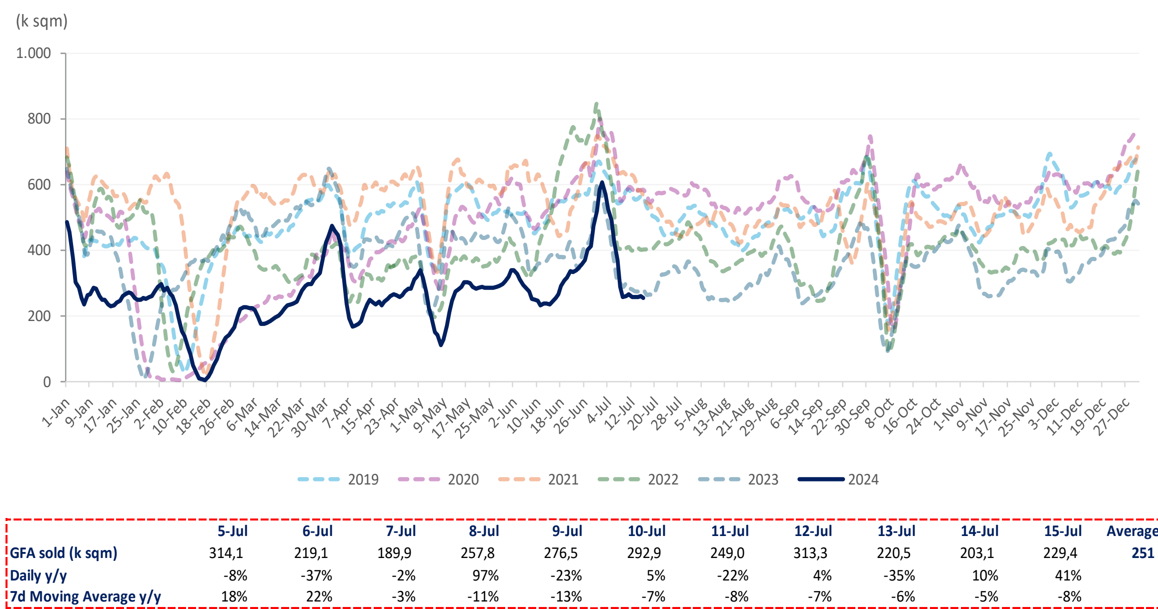


Source: Bloomberg, Genial Investimentos

Why are stimulus unlikely to solve the problems facing real estate developers? We believe that buyers are increasingly focused on completed homes or the secondary market, leaving developers still facing hurdles for new launches. According to our perception, the main barriers to a sustainable recovery include: **(i)** discouraging job prospects, **(ii)** economic uncertainty, and **(iii)** unfavorable trends in residential property prices. Additionally, the situation is compounded by structural issues such as **(iv)** the demographic crisis and **(v)** the oversupply of housing. This combination of factors suggests that the balance between supply and demand in China's real estate market will take some time to stabilize, as we have been signaling since 2022. We understand that the overall picture shows such dysfunction that it could take nearly a decade to reverse. The area sold improved to 229k sqm (+12.8% w/w), but the 7-day moving average still shows a contraction of -8% y/y (-3p.p. w/w).

Beijing was one of the last major cities to embrace the relaxation. Beijing reduced payment requirements by -10p.p, to 20% for first buyers and 35% for second homes in urban areas, with a drop of -5p.p (or 30% in non-urban areas), in line with easing measures in other Tier I cities. This follows the central government's plan to tackle the housing crisis. Although Beijing's rules now favor families with 2 plus+ children, skepticism persists due to the PBoC's minimal funding (which seems to us to be an obstacle, as we commented last week) and the slow progress of the social housing programs being tested. For example, despite similar measures, primary sales of new homes in Shanghai rose by only +8% in the first 23 days of June, far from ideal to compensate for the total of the 70 largest cities reaching a contraction of -9% y/y in the weekly analysis.

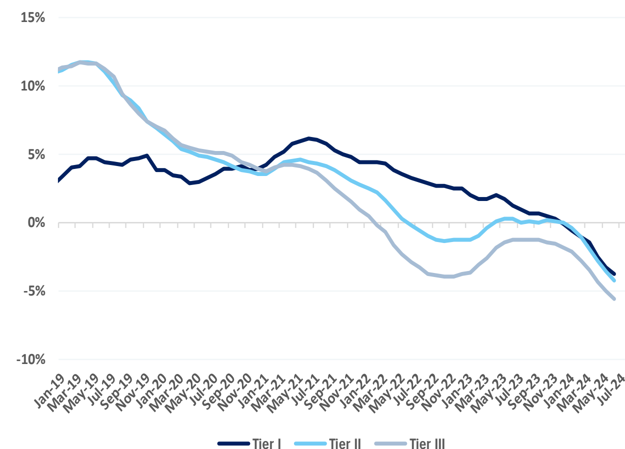
Graph 8. Daily primary housing GFA sales (30 major cities / 7 days Moving Average)



	5-Jul	6-Jul	7-Jul	8-Jul	9-Jul	10-Jul	11-Jul	12-Jul	13-Jul	14-Jul	15-Jul	Average
GFA sold (k sqm)	314,1	219,1	189,9	257,8	276,5	292,9	249,0	313,3	220,5	203,1	229,4	251
Daily y/y	-8%	-37%	-2%	97%	-23%	5%	-22%	4%	-35%	10%	41%	
7d Moving Average y/y	18%	22%	-3%	-11%	-13%	-7%	-8%	-7%	-6%	-5%	-8%	

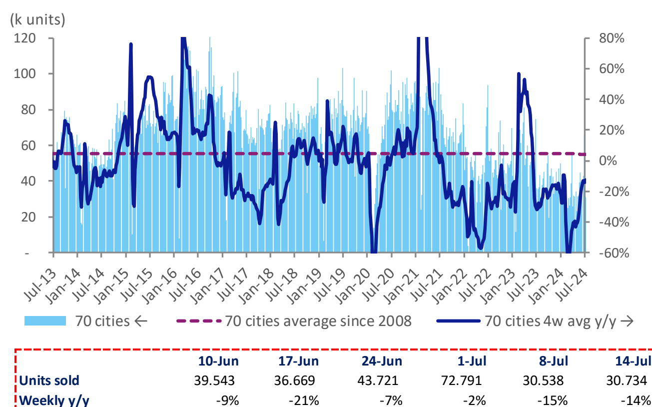
Source: Wind, Genial Investimentos

Graph 9. Price of newly built housing (by Tier)



Source: Bloomberg, Genial Investimentos

Graph 10. Weekly primary housing sales (70 major cities)



	10-Jun	17-Jun	24-Jun	1-Jul	8-Jul	14-Jul
Units sold	39.543	36.669	43.721	72.791	30.538	30.734
Weekly y/y	-9%	-21%	-7%	-2%	-15%	-14%

Source: CRIC, CREIS, Genial Investimentos

Unemployment remains strong, especially among youth, who are typically first buyers. It seems that, despite official unemployment figures showing a reduction to 5% in May (vs. 5.7% at the end of 2022) and remaining stable in June, growing anxiety over employment will continue to dampen consumer confidence. Youth unemployment, although it fell to 13.2% in June (-1 p.p. m/m vs. May), remains at very high levels. It is crucial to understand that for the sector to cool down real estate bubble characteristics, first buyer penetration would need to increase. However, the primary age group struggling with job searches are young people, who are typically those looking to buy their first home. Therefore, the decline in employment sentiment in China threatens to undermine the potential recovery in home sales, despite stimulus efforts. The number of verified job seekers increased by +38% y/y in 1H24.

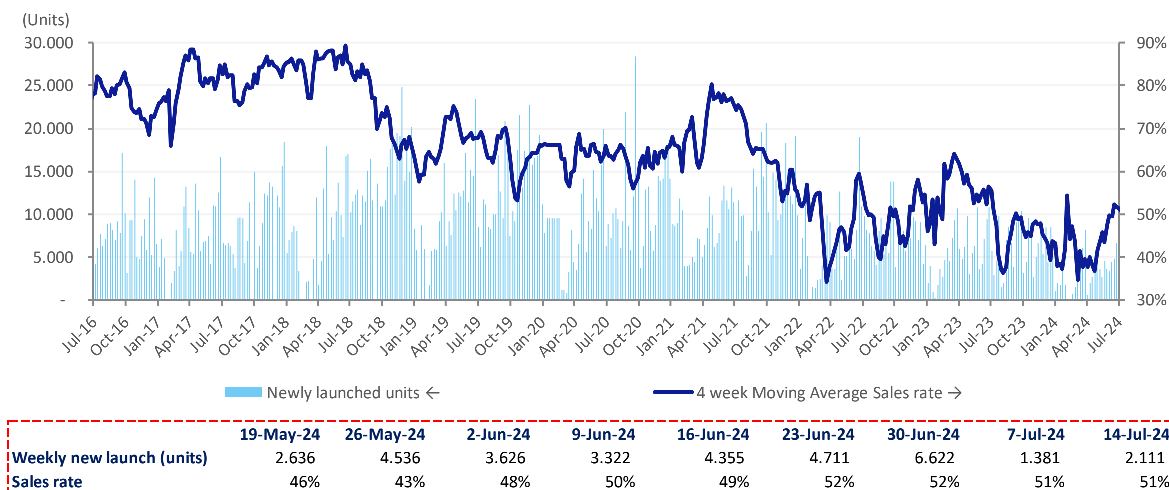
Changes in mortgage rates likely to have no lasting impact. The mortgage rate for first-time homebuyers in China dropped to a record low of 3.45%, the lowest since 2009, following relaxations in May. However, the decrease remains modest at -0.64 p.p. since the beginning of 2023. In contrast, the mortgage rate for second homes fell more significantly, reaching 3.9% (-1 p.p. vs. 2023), indicating a shift towards more lenient regulations on real estate speculation. In other words, the relaxations now extend to buyers who are not first-time purchasers. Despite these reductions, we believe that expectations of housing price declines continue to dampen demand. Previous rate cuts, **(i)** -1.65 p.p. over 15M between 2021 and 2022 and **(ii)** -0.23 p.p. in 2023, have done little to alleviate the current decline in sales, raising doubts about the potential impact of a -0.41 p.p. reduction in 1H24.

End of the "Housing is for Living, not speculation" discourse. Regulatory adjustments may be occurring in response to ongoing challenges in home sales, as evidenced by a narrower gap between mortgage rates for second and first homes since May. The gap has decreased to 0.45 p.p., down from 0.91 p.p. in previous months. Meanwhile, cities such as Hangzhou and Chengdu have started to lift restrictions on home purchases, reflecting a shift towards stimulating the real estate market and the economy, rather than strictly adhering to the principle that housing is primarily for living, not for speculation a slogan introduced by President Xi Jinping's administration in 2019. Since the removal of the "housing is for living, not for speculation" slogan from Premier Li Qiang's employment/payroll activity report in May this year, we have sensed that the government would begin to relax measures beyond first buyers, as we have anticipated in other sector reports.

Temporary increase in sales for major cities at the expense of smaller cities. The latest round of mortgage rate cuts in May, along with lower down payment requirements, may boost real estate transaction volumes in major cities from June to August (approximately 90 days, as previously noted), supporting KE Holdings' commission revenue. Mortgage rates for first homes have decreased to 3.15% in Foshan, 3.25% in Suzhou, Nanjing, and Wuhan, and 3.5% in Shanghai and Shenzhen, reaching higher-tier Tier II cities beyond just Tier I cities. Concerns about the non-completion of pre-sold homes suggest that the stimulus effect is likely to be more apparent in secondary market transactions than in new home sales contracted by developers. Primary home sales in the 70 largest cities continued to decelerate, ending the week at 30.7k units (-14% y/y).

As previously noted, measures targeting tier I and upper-tier II cities may redirect demand from tier III and low-tier II cities. country garden is least exposed to these larger cities, with only 8% of its landbank in such areas, while Evergrande, Seazen, and Agile have 16% to 20%. Therefore, recent stimulus policies may have limited impact on increasing home sales for private developers facing tighter balance sheets. Yuexiu and COLI, both state-owned, are more exposed to Tier I and upper-Tier II cities, with 74% and 59% of their land banks, respectively. Longfor has 37%, and Vanke has 33%.

Graph 11. Weekly housing launches and sales rate (9 major cities)



	19-May-24	26-May-24	2-Jun-24	9-Jun-24	16-Jun-24	23-Jun-24	30-Jun-24	7-Jul-24	14-Jul-24
Weekly new launch (units)	2.636	4.536	3.626	3.322	4.355	4.711	6.622	1.381	2.111
Sales rate	46%	43%	48%	50%	49%	52%	52%	51%	51%

Note: The 9 major cities analised are Guangzhou, Shanghai, Shenzhen, Chengdu, Chongqing, Hangzhou, Nanjing, Wuhan and Suzhou.

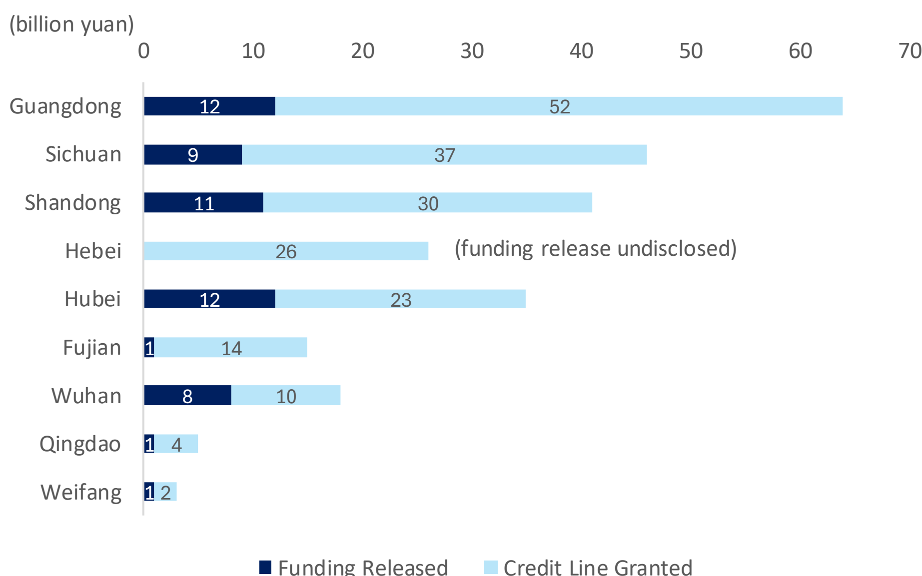
Source: CREIS, Genial Investimentos

Local governments are providing subsidized credit for commercial banks to lend to developers. Most of the financial support for meeting Whitelists, which prioritize completing housing projects, is manifesting as extensions of existing loans, allowing projects to continue construction and minimize delays. Local governments have been authorized by the PBoC to release credit lines for developers to finance unfinished projects. In other words, while the government is subsidizing the credit, the risk of default remains with the bank that issues the loan. Channel checks with private builders indicate that new loan applications generally require additional collateral, typically from a new phase of the project, posing challenges for developers facing cash flow tightness.

Credit support for whitelists may not reduce the stock of unfinished homes. According to our analysis, the focus of Chinese commercial banks on lending for housing projects on Whitelists is unlikely to generate a substantial volume of additional loans, even if governments are willing to subsidize credit. This may do little to reduce the number of unfinished homes. Whitelists imply a total financing need of ~¥1.4 trillion (~US$194bn), representing ~1% of China's GDP. Since the risk of default remains with the bank, commercial banks are advancing credit to developers very slowly, as they are reluctant to lend resources. For example, Country Garden, one of the top 3 private developers, secured support for only ¥1.7bn (~US$233mn) of financing versus ¥604b (~US$83bn) of unfinished homes, representing less than 1% of its total portfolio.

Credit lines are not a guarantee of financing disbursement. As of March, credit lines totaling ¥469bn were allocated to 1,979 projects on Whitelists. Six provinces, including Guangdong and Sichuan, reported ¥182bn (~US$25bn) in bank credit lines. However, having access to these credit lines does not guarantee that the funds will be disbursed, as discussed earlier. For example, Country Garden had ~¥300bn (~US$40bn) in credit lines in 2022, while its total debt was ¥271bn (~US$37bn) at the end of the year. Despite this, the developer missed a payment on a US$15.4mn offshore bond in October 2023, correlating with a significant drop in sales of -71% y/y in 1H24 vs. -34% y/y in 1H23. This situation suggests that banks may withhold assistance when a developer's cash flow deteriorates.

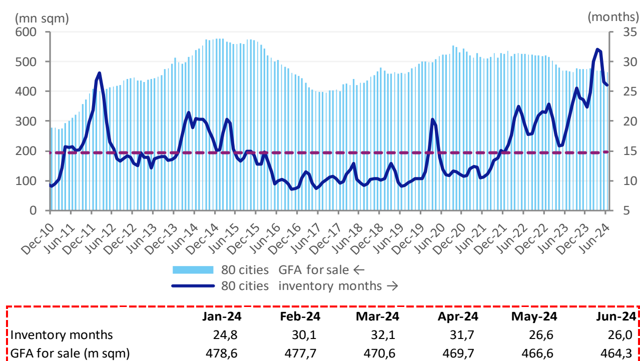
Graph 12. Credit line granted vs. funding released



Source: Bloomberg Genial Investimentos

Financing challenges for developers persist. In April, 1,247 projects on the Whitelists secured loans totaling ¥155bn (~US$20bn). However, loans from local governments to private developers decreased by -6% y/y in March, following a -10% y/y drop in January and February. The share of local government loans in the overall financing sources for developers fell to 15% (-4 p.p. m/m), indicating continued financing challenges despite the introduction of Whitelists at the end of January. Our analysis suggests that Chinese banks' support for developers to address the issue of unfinished homes may be insufficient, with recent financing of ¥2.3bn (~US$315mn) representing only 0.3% of the total value of these homes. Besides the example of Country Garden, Shimao received only ¥68mn out of the ¥366mn requested by April for its 28 projects included in local government Whitelists. The banks' caution in extending further loans to the struggling real estate sector indicates that developers need to rely more on their own resources, even with subsidized credit.

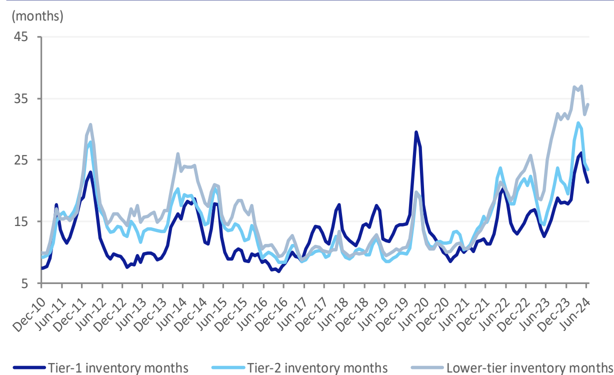
Graph 13. Inventory months (80 major cities)



	Jan-24	Feb-24	Mar-24	Apr-24	May-24	Jun-24
Inventory months	24,8	30,1	32,1	31,7	26,6	26,0
GFA for sale (m sqm)	478,6	477,7	470,6	469,7	466,6	464,3

Source: CRIC, Genial Investimentos

Graph 14. Inventory months (By city tier)



Source: CRIC, Genial Investimentos

Months of new home inventory, even with a slight reduction, remain 3x higher than before the bubble burst. Currently, new home inventory in China is taking three times longer to be absorbed by the market compared to 2016-21, marking the longest duration in 14 years. The inventory across 80 monitored cities is equivalent to an average of 31 months of sales, the highest since data collection began in 2010. This oversupply suggests that the real estate market slowdown may take longer to stabilize, with home prices likely continuing to fall, hindering sales recovery. Tier I cities need 23 months to clear inventory without any new launches, while Tier II cities would take 25 months and Tier III cities, 35 months. Additionally, 28 cities, representing 35% of monitored cities, face a potential halt in land sales due to new home inventories exceeding 36 months of sales. Among these, 21% are Tier II cities and 79% are Tier III, with only five cities having inventory absorption periods of less than 12 months.

3rd Plenary Session: What were the announcements related to the real estate market? At the beginning of this week, on July 21, the Chinese central government announced reforms from the Third Plenary Session focusing on urbanization and housing policies. Key points include **(i)** Urbanization initiatives will aim to equalize the benefits of migrant workers with those of city residents and protect the land use rights of farmers moving to urban areas. **(ii)** Proposed agrarian reforms will allow farmers to monetize their rural land rights. Our understanding is that these measures may have a positive impact on housing demand in the long term, depending on effective implementation. We have consistently argued, since the report we published on social housing last December, that this could be a way for China to continue increasing its urbanization rate in the coming years if the policy is well implemented. This report can be found attached (link).

Updates on the social housing program. During the recent announcements, the Chinese government provided more details about increasing the construction of rental housing within the social housing package to meet the needs of the working class. Local governments will gain autonomy in regulating the real estate market, including the ability to remove restrictions on home purchases. Other reforms will target the real estate development financing model, the pre-sale system, and taxation. Although reforming the pre-sale system is seen as necessary to protect buyers' rights, we believe its implementation may not be timely due to the current market weakness.

Steel and Iron Ore

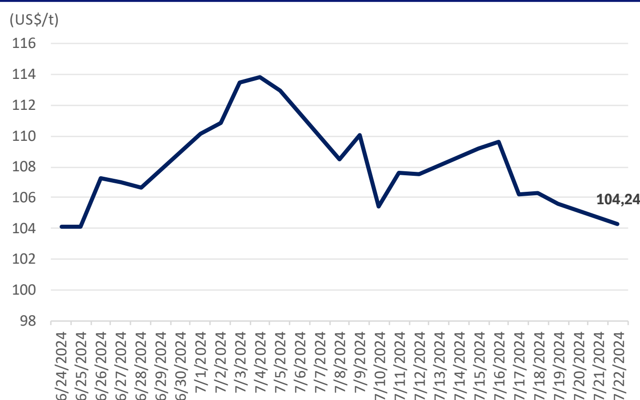
Steel: contrary to our expectations, billet prices declined again. The prices of Tangshan billets recorded a weekly drop, measured between July 15-19, influenced by the fall in rebar futures prices. Despite a slight reduction in billet production and increased demand from rerollers, the fundamentals of the semi-finished steel market remained weaker. On July 21, the price of Tangshan square billet fell -0.9% w/w to ¥3,270/t (~US$450/t), including a 13% VAT.

Inputs: scrap prices continue to decelerate, but coke stocks decline. In the week ending July 19, the national composite price of steel scrap hit a 3-month low, decelerating to ¥2,766/t (~US$380/t), reflecting a -0.8% w/w drop. We attribute this reduction primarily to the weakening of the finished steel market in electric arc furnace mills. Additionally, the production of coke oven coal has also decreased, with the execution rate falling -3.08 p.p. w/w to an average of 66.4%.

Production in major coal mining areas was temporarily halted due to a political meeting in Beijing. Consequently, processed coke production fell to 553.5Kt/day (-1.1% w/w). The price of metallurgical coke traded during the week experienced a slight decline of -0.2% w/w, reaching ¥1,682/t (~US$232/t). Stocks of coke from independent producers dropped to 352.1Kt (-0.8% w/w), hitting the lowest level in 3 years. We understand this decline is a result of consistent coke purchases by blast furnace mills to meet production needs, given the high utilization rates for flat steels.

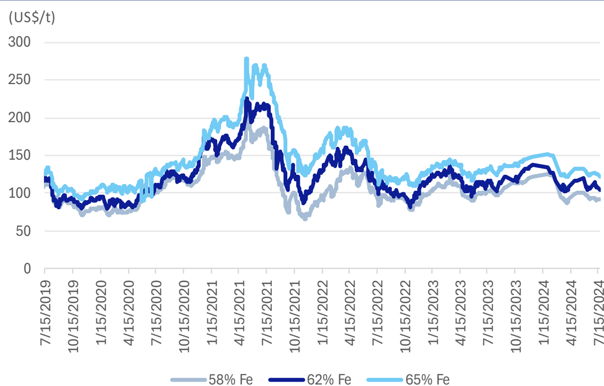
Iron ore: prices fall further, as anticipated. Iron ore prices continued to decline throughout the past week, with the spot price for the 62% Fe benchmark closing at US$104.2/t (-4.5% w/w), reflecting a persistent symptom of weak domestic steel demand. September futures contracts on the Dalian Commodity Exchange (DCE) slowed to US$110/t (-3.8% w/w). However, while we believe a rebound is unlikely, iron ore prices may at least remain within a stable range this week, supported by still robust production rates at flat steel mills, primarily linked to durable goods for export. On the other hand, the steel market continues to be hindered by seasonal calm in demand, with interest in purchasing finished steel, particularly construction steel, remaining quite low due to the weakening real estate market.

Graph 15. 30 Days Iron ore prices (Spot - S&P Platts)



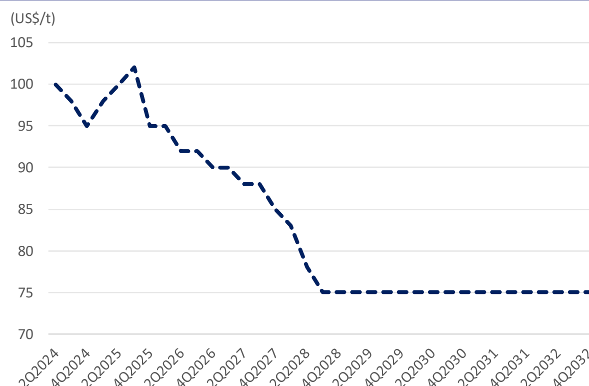
Source: S&P Platts, Genial Investimentos

Graph 16. Iron ore price (Spot - S&P Platts)



Source: S&P Platts, Genial Investimentos

Graph 17. Iron ore price (Genial Est. 24-32E)

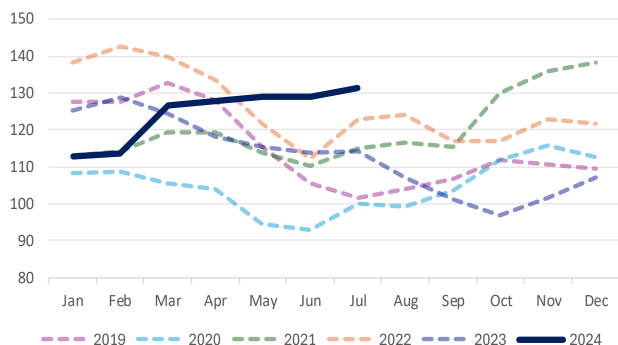


Source: CRIC, Genial Investimentos

Iron ore: port inventory interrupt last week's decline and rise again. Port stocks of iron ore at ~30 ports monitored in China rose to 131.4Mt (+0.98% w/w). According to our analysis, this weekly increase in stocks (the largest since mid-April 2022) continues due to strong shipment flows from Brazilian and Australian miners. As noted in our Earnings Preview for Vale 2Q24, attached (Vale 2Q24 Preview), if mining majors maintain this strong operational performance in shipments, iron ore prices are likely to decline further.

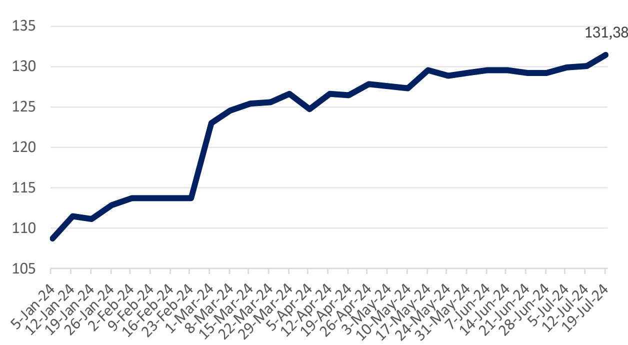
For prices to show any lasting resilience, inventory would need to decrease the current port stocks are increasingly diverging from the levels of the past 5 years. Seasonally, the 2Hs are more favorable for production due to drier weather in Brazil. If miners do not maintain a significant gap between production and sales in 3Q24, and if shipments continue at this strong pace with domestic consumption remaining weak, spot iron ore prices are likely to fall below the US$100/t level, testing the ~US$95/t barrier in 4Q24. This aligns with our projection, which has been the most pessimistic compared to consensus since the beginning of the year.

Graph 18. Iron ore port inventory vs. 5Y (Mt)



Source: Bloomberg, Genial Investimentos

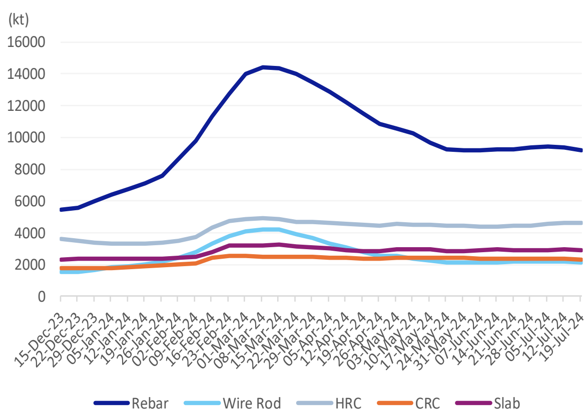
Graph 19. Iron ore port inventory 2024 (Mt)



Source: Bloomberg, Genial Investimentos

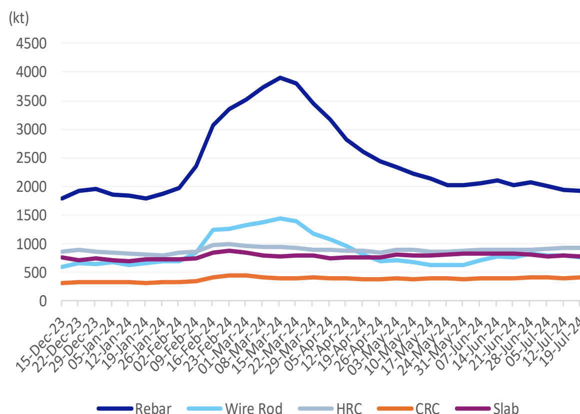
Steel: Inventory at both traders and mills decline. Steel stocks within Chinese mills decreased for the third consecutive week. Between July 12-19, total inventories of the five main steel products (rebar, wire rod, HRC, cold-rolled coils, and plates) fell to 4.8 Mt (-1.1% y/y), according to the mills we monitor. Our analysis suggests that the main reason for the decline is reduced steel production, as many mills conducted maintenance or slightly cut back output. In a related trend, retail and trader steel inventory in China also fell -1.1% w/w, after six weeks of increases. This decrease reflects a slight recovery in demand from developers, particularly state-owned ones with land banks in Tier I cities. These developers are benefiting from a temporary sales boost due to mortgage easing and have expanded their pace of ongoing projects as weather conditions improved (moving out of the rainy months of June/July). This has led to some replenishment needs on construction sites and a slight improvement in local market sentiment.

Graph 20. Steel mills inventory (130 major cities)



Source: My Steel, Genial Investimentos

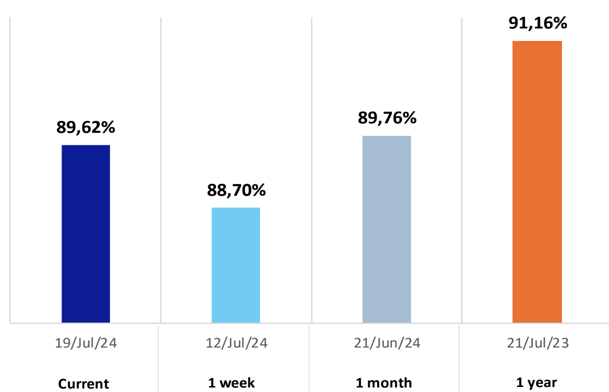
Graph 21. Traders' steel inventory (130 major cities)



Source: My Steel, Genial Investimentos

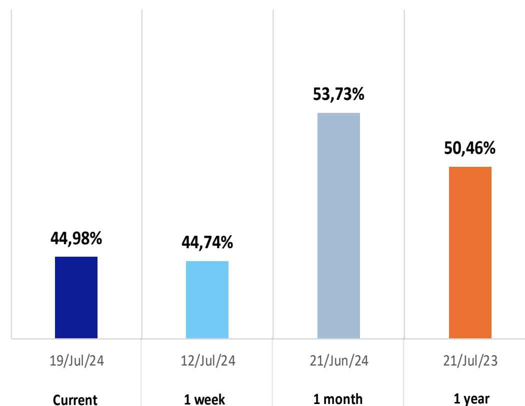
Steel: Blast furnace utilization rate resumes upward trend. Chinese blast furnaces (BF) recorded a recovery in capacity utilization, rising to 89.2% (+0.50 p.p. y/y), ending a three-week decline. According to our findings, some furnaces that were idle have been restarted, although many mills continue to face negative margins. Hot metal production was 2.4 Mt/day (+0.57% y/y). The production of steel from electric arc furnaces (EAF) also showed a slight improvement after four consecutive weeks of decline, with a marginal increase in the utilization rate, closing on July 19 at 44.9% (+0.24 p.p. y/y), as some mills completed their maintenance schedules. However, we note that overall production remains weak. Our view is that mills are reluctant to increase operating hours to boost output due to minimal improvements in profits (which remain negative), as they aim to capture these slight gains amidst successive declines in scrap prices providing input relief. The average loss was -¥174/t (or -US$24/t).

Graph 22. BF capacity % (weighted average)



Source: My Steel, Genial Investimentos

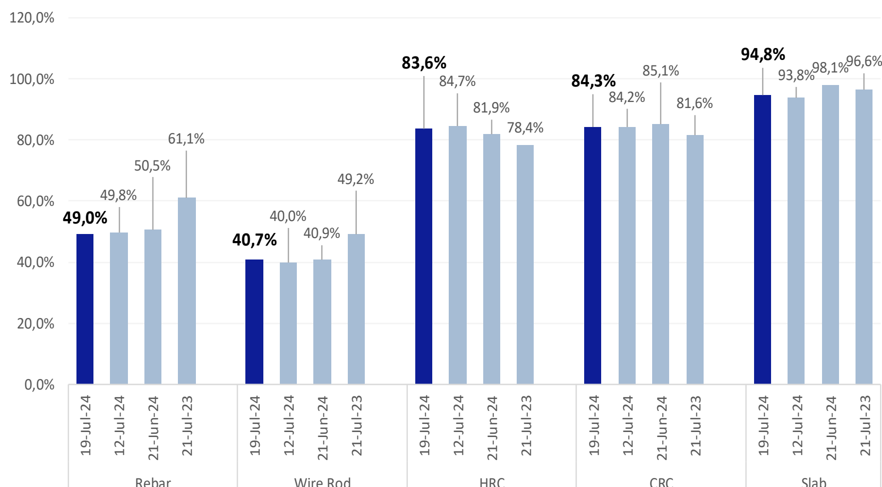
Graph 23. EAF capacity % (weighted average)



Source: My Steel, Genial Investimentos

Steel: Rebar production hits lowest level in 3M. Rebar production in Chinese mills declined for the third consecutive week, ending the past week at 2.2 Mt (-1.7% w/w), reaching the lowest level in almost 3M. This figure represents a significant drop of -19.8% y/y (same week vs. 2023). The decrease in production affected both integrated mills and mini mills, with all regions except southwest and northern China reporting reductions. Demand for residential construction, a key segment for long products, still presents many uncertainties, even with the beginning of the departure from the rainy season, which had been hindering steel loading on construction sites.

Graph 24. Blast-furnace capacity utilization (by product)



Source: My Steel, Genial Investimentos

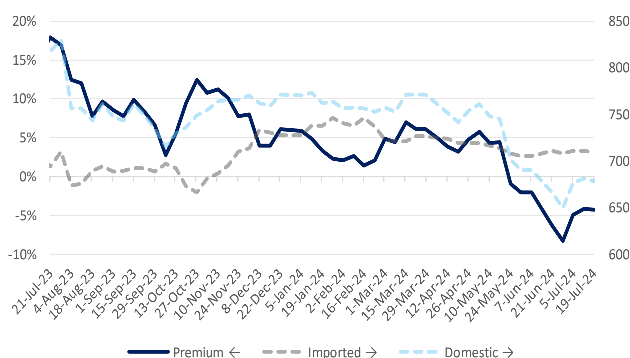
Steel: HRC output remains at a good level. We understand that the decline in rebar production mainly occurred in eastern China, particularly in Jiangsu Province, where some mills halted operations or shifted production from rebar to flat steel products in an attempt to achieve better returns, as anticipated in last week's report. Therefore, mills producing Hot Rolled Coil (HRC) continue to maintain satisfactory output levels, driven by downstream demand related to the export of durable goods. The utilization rate was 83.5% (-1.14 p.p. w/w), showing a weekly slowdown but still well above the 2023 level (+5.12 p.p. y/y).

Brazil

Brazilian Steel: Sequencing of rebar price increases. After an initially challenging fortnight of negotiations, Brazilian rebar prices have risen again, this time by +2.7% w/w with the completion of several July contracts. Overall, prices increased by +4.8% in July, reaching R$3,800/t (~US$678/t), within the range of R$3,650-3,950/t, according to S&P Platts. This price still reflects a negative premium of -4.3% compared to imported steel. We note that the latest price adjustment fell short of the +8% increase targeted by Brazilian mills but was in line with market expectations (between 4-5%).

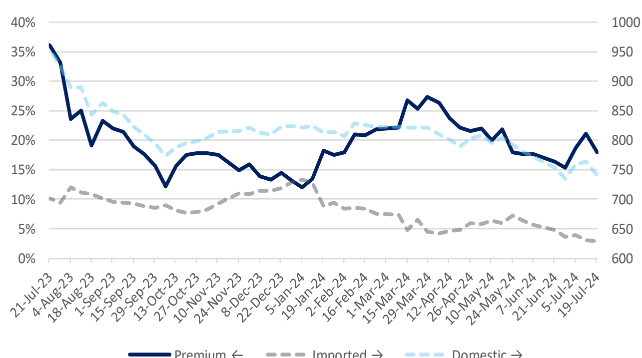
Looking ahead, we believe that major long steel producers (including Gerdau) will attempt another round of increases for August (+6-8%). However, we assess that achieving this, particularly at such a magnitude, will be challenging due to low visibility on the ability to accommodate new hikes, given the current demand for housing construction remains heavily reliant on low-income projects under the Minha Casa, Minha Vida (MCMV) program.

Graph 25. Premium on Rebar (Brazil vs. imported)



Source: S&P Platts, Genial Investimentos

Graph 26. Premium on HRC (Brazil vs. imported)



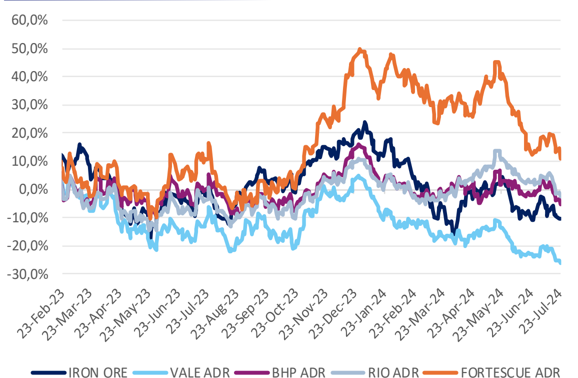
Source: S&P Platts, Genial Investimentos

Brazilian Steel: Imported HRC price from China drops, but premium softens slightly. As discussed, China's hot-rolled coil (HRC) output remains significantly higher compared to the same period last year, supported by the industry's interest in redirecting installed capacity from durable goods to global markets. Despite imminent risks of taxation on Chinese products, HRC blast furnace utilization rates have been rising, driven by a shift from long steel to flat products due to less strained margins.

Consequently, the offloading of unused raw steel and non-rolled material will likely continue, even with the quota system implemented by the Brazilian Ministry of Commerce (MDIC). As a result, the price of Chinese imports arriving in Brazil has decreased to US$500/t (-0.4% w/w). However, the USD/BRL exchange rate has risen, more than offsetting the effect and increasing the cost of imports at Brazilian ports. With domestic HRC prices stable at R$4,150/t, within the R$4,000-4,300/t range calculated by S&P Platts, the parity premium closed the week at +17.9% (-3.1p.p w/w).

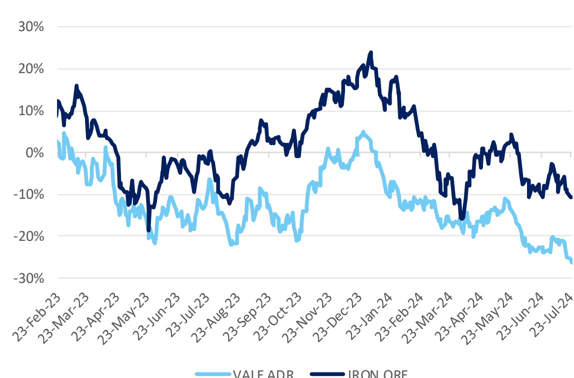
Key data to keep up with on companies' side

Graph 27. Mining majors (since Jan/23)



Source: Bloomberg, Genial Investimentos

Graph 28. Vale's ADRs vs. iron ore discount



Source: Bloomberg, Genial Investimentos

Table 1. Short position

Company	Ticker	Lending Interest Ratio	Change in LI Ratio	Float (%)
Vale	VALE3	9,4	-1,8	4,0
CMIN	CMIN3	13,8	-2,4	19,6
Gerdau	GGBR4	11,2	2,9	4,8
Usiminas	USIM5	7,6	3,3	8,6
CSN	CSNA3	17,5	4,1	7,3

Appendix: Vale

Figure 1. Vale – Income Statement in US$ Millions (Genial Est. 2024-2029)

Income Statement	2024E	2025E	2026E	2027E	2028E	2029E
Net Revenue	**39.856**	**44.580**	**43.639**	**45.540**	**46.582**	**50.303**
(-) COGS	(25.001)	(27.973)	(28.162)	(29.333)	(30.901)	(33.368)
Gross Profit	**14.855**	**16.607**	**15.477**	**16.207**	**15.681**	**16.935**
(-) Expenses	(3.109)	(3.578)	(3.354)	(3.000)	(2.698)	(2.915)
Adjusted EBITDA	**14.914**	**16.284**	**15.617**	**16.866**	**16.819**	**18.022**
(-) D&A	(3.139)	(3.314)	(3.488)	(3.664)	(3.847)	(4.022)
EBIT	**11.774**	**12.970**	**12.129**	**13.202**	**12.971**	**14.000**
(+/-) Financial Result	(2.359)	(2.063)	(2.007)	(2.022)	(1.983)	(2.040)
(-) Taxes	(1.482)	(1.653)	(1.521)	(1.702)	(1.679)	(1.846)
Net income	**7.934**	**9.254**	**8.601**	**9.478**	**9.310**	**10.114**
Profitability						
Net margin (%)	19,91%	20,76%	19,71%	20,81%	19,99%	20,11%

Figure 2. Vale– Cash Flow in US$ Millions (Genial Est. 2024-2029)

Cash Flow (FCFF)	2024E	2025E	2026E	2027E	2028E	2029E
Net Revenue	**39.856**	**44.580**	**43.639**	**45.540**	**46.582**	**50.303**
(-) COGS	(25.001)	(27.973)	(28.162)	(29.333)	(30.901)	(33.368)
Adjusted EBITDA	**14.914**	**16.284**	**15.617**	**16.866**	**16.819**	**18.022**
Adjusted EBIT	**11.774**	**12.970**	**12.129**	**13.202**	**12.971**	**14.000**
(-) Taxes	(1.482)	(1.653)	(1.521)	(1.702)	(1.679)	(1.846)
(+) D&A	3.139	3.314	3.488	3.664	3.847	4.022
(+/-) Brumadinho and Samarco	(716)	(2.070)	(1.750)	(1.279)	(1.117)	(826)
(+/-) Δ WK	1.517	569	847	(393)	(244)	(463)
(-) Capex	(6.758)	(6.778)	(6.778)	(7.319)	(7.319)	(7.319)
FCFF	**7.475**	**6.352**	**6.416**	**6.173**	**6.459**	**7.568**

Appendix: CMIN

Figure 1. CMIN – Income Statement in R$ Millions (Genial Est. 2024-2028)

Income Statement	2024E	2025E	2026E	2027E	2028E
Net Revenue	**13.366**	**16.842**	**19.948**	**20.607**	**16.959**
(-) Cash COGS	(7.635)	(8.548)	(10.263)	(11.133)	(10.455)
Gross Profit	**4.149**	**6.427**	**7.516**	**6.999**	**3.724**
(-) SG&A and others	(1.702)	(2.114)	(2.452)	(2.456)	(1.928)
Adjusted EBITDA	**4.253**	**6.540**	**7.715**	**7.527**	**4.942**
(-) D&A	(1.582)	(1.867)	(2.169)	(2.475)	(2.780)
EBIT	**2.297**	**4.163**	**4.914**	**4.394**	**1.647**
(+/-) Financial Result	(1.087)	(993)	(911)	(934)	(1.002)
(-) Taxes	(377)	(989)	(1.248)	(1.079)	(201)
Net income	**832**	**2.181**	**2.755**	**2.381**	**444**
Profitability					
Net margin (%)	6,23%	12,95%	13,81%	11,55%	2,62%

Figure 2. CMIN – Cash Flow in R$ Millions (Genial Est. 2024-2028)

Cash Flow (FCFF)	2024E	2025E	2026E	2027E	2028E
Net Revenue	**13.366**	**16.842**	**19.948**	**20.607**	**16.959**
(-) COGS	(7.635)	(8.548)	(10.263)	(11.133)	(10.455)
Adjusted EBITDA	**4.253**	**6.540**	**7.715**	**7.527**	**4.942**
EBIT	**2.297**	**4.163**	**4.914**	**4.394**	**1.647**
(-) Taxes	(377)	(989)	(1.248)	(1.079)	(201)
(+) D&A	1.582	1.867	2.169	2.475	2.780
(+/-) Δ WK	254	(110)	23	146	290
(-) Capex	(1.589)	(2.681)	(3.867)	(5.411)	(5.480)
FCFF	**2.166**	**2.249**	**1.991**	**525**	**(964)**

Appendix: Gerdau

Figure 1. Gerdau – Income Statement in R$ Millions (Genial Est. 2024-2028)

Income Statement	2024E	2025E	2026E	2027E	2028E
Net Revenue	**65.957**	**66.628**	**67.907**	**69.433**	**71.736**
(-) COGS	(56.697)	(55.257)	(54.833)	(55.976)	(56.782)
Gross Profit	**9.261**	**11.371**	**13.074**	**13.458**	**14.954**
(-) Expenses	(1.875)	(1.777)	(1.802)	(1.823)	(1.871)
Adjusted EBITDA	**10.615**	**14.122**	**15.989**	**16.449**	**18.253**
(-) D&A	(3.230)	(3.569)	(3.900)	(4.197)	(4.464)
EBIT	**7.714**	**10.258**	**11.947**	**12.323**	**13.795**
(+/-) Financial Result	(1.041)	(1.067)	(880)	(711)	(780)
(-) Taxes	(1.127)	(1.807)	(2.153)	(2.218)	(2.510)
Net income	**5.545**	**7.384**	**8.914**	**9.394**	**10.505**
Profitability					
Net margin (%)	8,41%	11,08%	13,13%	13,53%	14,64%

Figure 2. Gerdau– Cash Flow in R$ Millions (Genial Est. 2024-2028)

Cash Flow (FCFF)	2024E	2025E	2026E	2027E	2028E
Net Revenue	**65.957**	**66.628**	**67.907**	**69.433**	**71.736**
(-) COGS	(56.697)	(55.257)	(54.833)	(55.976)	(56.782)
Adjusted EBITDA	**10.615**	**14.122**	**15.989**	**16.449**	**18.253**
EBIT	**7.714**	**10.258**	**11.947**	**12.323**	**13.795**
(-) Taxes	(1.127)	(1.807)	(2.153)	(2.218)	(2.510)
(+) D&A	3.230	3.569	3.900	4.197	4.464
(+/-) Δ WK	(822)	220	(430)	(474)	(212)
(-) Capex	(5.998)	(6.063)	(6.130)	(6.198)	(6.267)
FCFF	**2.997**	**6.177**	**7.135**	**7.631**	**9.270**

Appendix: CSN

Figure 1. CSN – Income Statement in R$ Millions (Genial Est. 2024-2028)

Income Statement	2024E	2025E	2026E	2027E	2028E
Net Revenue	**45.901**	**53.974**	**59.329**	**59.891**	**60.646**
(-) COGS	(29.066)	(30.548)	(31.526)	(33.403)	(33.448)
Gross Profit	**16.835**	**23.426**	**27.803**	**26.488**	**27.198**
(-) SG&A and others	(5.478)	(5.584)	(5.350)	(4.796)	(4.089)
EBITDA	**11.358**	**17.842**	**22.453**	**21.692**	**23.109**
(+/-) Financial Result	(3.127)	(3.761)	(4.309)	(4.288)	(4.245)
EBT	**4.059**	**9.247**	**12.846**	**11.730**	**12.786**
(-) Taxes	(1.618)	(3.144)	(4.368)	(3.988)	(4.347)
Net Income	**2.441**	**6.103**	**8.479**	**7.742**	**8.439**
Profitability					
Net Margin (%)	5,32%	11,31%	14,29%	12,93%	13,92%

Figure 2. CSN – Cash Flow in R$ Millions (Genial Est. 2024-2028)

Cash Flow	2024E	2025E	2026E	2027E	2028E
Net Revenue	**45.901**	**53.974**	**59.329**	**59.891**	**60.646**
(-) COGS	(29.066)	(30.548)	(31.526)	(33.403)	(33.448)
Adjusted EBITDA	**11.358**	**17.842**	**22.453**	**21.692**	**23.109**
EBIT	**7.186**	**13.008**	**17.155**	**16.018**	**17.031**
(-) Taxes	(1.618)	(3.144)	(4.368)	(3.988)	(4.347)
(+) D&A	4.172	4.834	5.298	5.674	6.078
(+/-) Δ WK	19	(689)	(236)	(298)	(78)
(-) Capex	(5.452)	(6.142)	(6.113)	(5.586)	(5.629)
FCFF	**4.306**	**7.867**	**11.737**	**11.819**	**13.055**

Appendix: Usiminas

Figure 1. Usiminas – Income Statement in R$ Millions (Genial Est. 2024-2028)

Income Statement	2024E	2025E	2026E	2027E	2028E
Net Revenue	**26.690**	**26.956**	**27.619**	**27.985**	**27.707**
(-) COGS	(24.033)	(23.371)	(23.699)	(24.035)	(23.603)
Gross Profit	**2.657**	**3.585**	**3.921**	**3.949**	**4.104**
(-) Expenses	(1.105)	(1.301)	(1.445)	(1.365)	(1.324)
Adjusted EBITDA	**2.590**	**3.377**	**3.626**	**3.834**	**3.769**
(-) D&A	(1.038)	(1.093)	(1.150)	(1.250)	(990)
EBIT	**1.552**	**2.284**	**2.476**	**2.585**	**2.779**
(+/-) Financial Result	545	391	469	746	837
(-) Taxes	(319)	(402)	(441)	(497)	(538)
Net income	**1.885**	**2.380**	**2.611**	**2.941**	**3.185**
Profitability					
Net margin (%)	7,06%	8,83%	9,45%	10,51%	11,50%

Figure 2. Usiminas– Cash Flow in R$ Millions (Genial Est. 2024-2028)

Cash Flow (FCFF)	2024E	2025E	2026E	2027E	2028E
Net Revenue	**26.690**	**26.956**	**27.619**	**27.985**	**27.707**
(-) COGS	(24.033)	(23.371)	(23.699)	(24.035)	(23.603)
Adjusted EBITDA	**2.590**	**3.377**	**3.626**	**3.834**	**3.769**
EBIT	**1.552**	**2.284**	**2.476**	**2.585**	**2.779**
(-) Taxes	(319)	(402)	(441)	(497)	(538)
(+) D&A	1.038	1.093	1.150	1.250	990
(+/-) Δ WK	978	20	(188)	(18)	158
(-) Capex	(1.813)	(1.559)	(2.573)	(2.058)	(1.955)
FCFF	**1.436**	**1.435**	**425**	**1.261**	**1.434**

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