

Upside for coal, but it's likely to be limited

Thermal coal prices have traded down to more than a decade low this year, given the large scale industry shutdowns during the peak of lockdowns and a weak global gas market only added to the pressure. We expect prices to strengthen next year, but much will depend on policy from China. Longer-term prospects are still negative



Coming back from the lows

The thermal coal market has struggled this year, with API2 coal prices trading below US\$40/t at one stage, while Newcastle coal broke below US\$50/t towards the end of the summer. Lower industrial activity would have weighed on coal demand earlier in the year, while a weak natural gas market, would have supported the coal-to-gas switch. In Europe, stronger carbon prices would have only further supported this move, so putting additional pressure on coal prices.

Coal's share in the energy mix in Europe will likely continue to decline in the years ahead

Looking ahead, carbon prices will only make coal more expensive as a feedstock for power generators in Europe. The EU Emission trading system, which is set to enter its fourth phase in 2021, will see the supply cap declining at a quicker rate. This suggests that coal's share in the energy mix in Europe will likely continue to decline in the years ahead, and given the diverging longer-term trends we are seeing with demand in Europe and Asia, the spread between Newcastle/API2 should widen.

Across all regions, we saw reduced power demand as a result of Covid-19 lockdowns. In China, back in March, power generation fell by 4.6% YoY, while in the US, power generation bottomed in April, with it falling by around 7% YoY. In Europe, electricity generation in the EU27 also made its recent lows in April, with generation falling by more than 12% YoY.

As countries recover, we have seen an improvement in power generation. For example, in China, power generation in September grew by 4.6% YoY. In Europe, while power generation has recovered from the lows seen earlier in the year, the latest Eurostat data shows that generation was still down around 1.6% YoY in August. Similarly for the US, electricity generation is yet to return to pre-Covid-19 levels, with it still being down by around 7% in September.

The second wave of the pandemic has made the recovery more challenging, but moving into 2021, we expect power generation to continue to recover as more economies re-open, which should be supportive of input fuels.

Chinese demand prospects

Despite Covid-19, China was able to maintain strong coal imports over the first half of the year, with inflows still growing year-on-year.

However, as we have moved through the year, cumulative imports started to fall behind last year, with a crackdown on Australian coal flows not helping. Over the first 10 months of 2020, coal imports into China totalled a little more than 253mt, down around 8% YoY. Looking ahead, a stronger LNG market should offer some support to thermal coal prices.

The deterioration in the relationship between China and Australia hasn't helped Newcastle coal prices; China was reportedly banning Australian coal imports along with a number of other commodities. This is more likely to lead to a change in trade flows, rather than an absolute reduction in volumes.

In fact, a strong domestic Chinese market should be supportive of seaborne prices, with the government likely to take action to ensure adequate supplies. Domestic prices are above CNY600/t, the upper end of a range that the government would like to keep prices below. Action the government could take includes increasing domestic output or allowing for further imports. The latter would obviously be constructive for seaborne prices. Already, the government recently increased the import quota for thermal coal this year by 20mt. While Australia may not benefit from this additional quota, this is likely to benefit Indonesia and Russia.

India's self sufficiency target

Following the coronavirus disruptions to supply chains and economies, there has been a growing push for more self-sufficiency by some countries.

India has always wanted to reduce its reliance on coal imports and over the years had plans to

boost domestic coal output to reduce import dependence. However, state producer, Coal India has generally fallen short of its production targets. In FY19/20 the country produced a little over 729mt of coal, yet still needed to import almost 250mt over the period to meet domestic needs.

It will take some time for India to boost coal output, following the opening up of the industry to the private sector

This year, the government has liberalised the sector, allowing the commercial mining of coal in the hope that this will drive production growth and reduce the country's reliance on coal imports. The government has set a target to be self-sufficient by 2024, which might be a tough target to reach though given that India's power demand continues to grow, and so far it seems that interest in the mines that the government will auction has been limited. The government plans to auction 38 mines, yet have only received bids for 23. Furthermore, the government will likely find it difficult to attract foreign investment in coal mines, given the general shift we are seeing around the globe.

Clearly, it will take some time for India to boost coal output, following the opening up of the industry to the private sector. Therefore Indian coal imports are likely to see robust growth next year, driven by a rebound in economic growth over 2021.

Longer term demand prospects increasingly bearish

Covid-19 has also put a renewed emphasis on environment and sustainability, with carbon emissions having fallen as a result of the lockdowns. However this is temporary, and as the global economy recovers, carbon emissions will increase once again. Many see Covid-19 as an opportunity for countries to turn to a greener path, by ensuring that stimulus goes towards green projects.

Many see Covid-19 as an opportunity for countries to turn to an even greener path

We have already seen big shifts in the energy mix in Europe and the US over the last few years. In Europe coal is playing a less important role in the energy mix, whilst lower carbon fuels and renewables continue to grow. In the US, an abundance of natural gas has helped to reduce coal demand from the power sector.

Asia remains a key growth market for thermal coal, and policies such as those in India suggest that coal demand in the region is likely to continue growing in the years ahead. However, we are starting to see more focus in Asia on reducing carbon emissions post Covid-19. In recent months China, Japan and South Korea have announced long term plans to become carbon neutral. While these target dates are still far off, these foundations are important, if they want to reach their ambitious carbon neutral targets.

Coal plays a large part in the power mix for these countries and it is difficult to see them

become carbon neutral without starting to reduce their demand for coal in the future.

ING forecasts

	1Q21	2Q21	3Q21	4Q21	FY21
API2 coal (US\$/t)	60	55	56	60	58
Newcastle coal (US\$/t)	67	60	61	70	65

Source: ING Research

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