Thermal coal

Kate Penney

The thermal coal market continues to be plagued by oversupply despite announced reductions in capacity worldwide. Spot prices will also be affected by forecast weakness in China's imports because of reduced economic activity, higher hydropower output and measures to support the domestic industry.

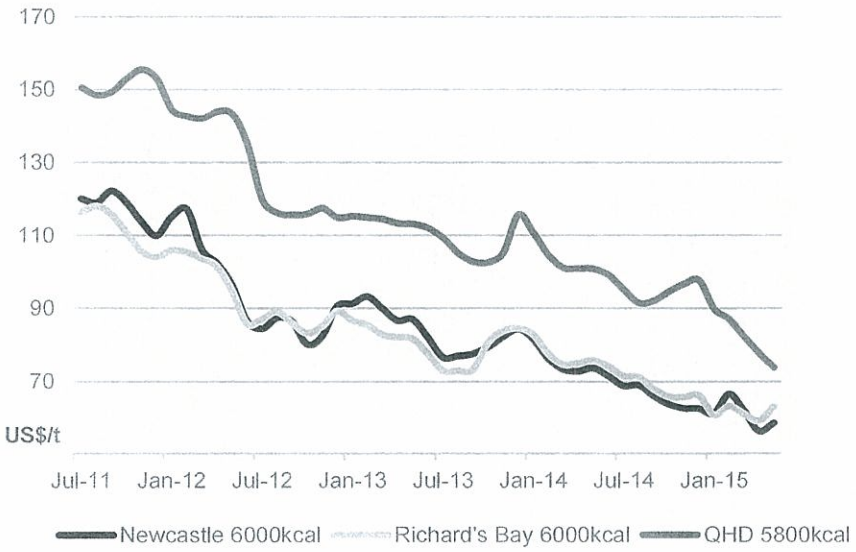
Prices

Thermal coal prices continued on a downward trajectory in the first half of 2015 in response to surplus supply and lower import demand from China. Newcastle free on board prices began 2015 at around US$62 a tonne and declined progressively to around US$54 a tonne in mid-April. Prices have since recovered to around US$60 a tonne.

Many producers have struggled to remain viable in an environment of lower prices. However, the supply response has been delayed because of limitations to changing infrastructure supply services, the depreciation of the US dollar relative to the currencies of other major producers, and lower energy prices. After a period of sustained low prices, some companies are beginning to announce their intention to cut production. Despite this, there has not been a sufficient reduction in capacity to reduce the supply overhang. As such, spot prices are expected to remain under pressure over the remainder of 2015 and into 2016.

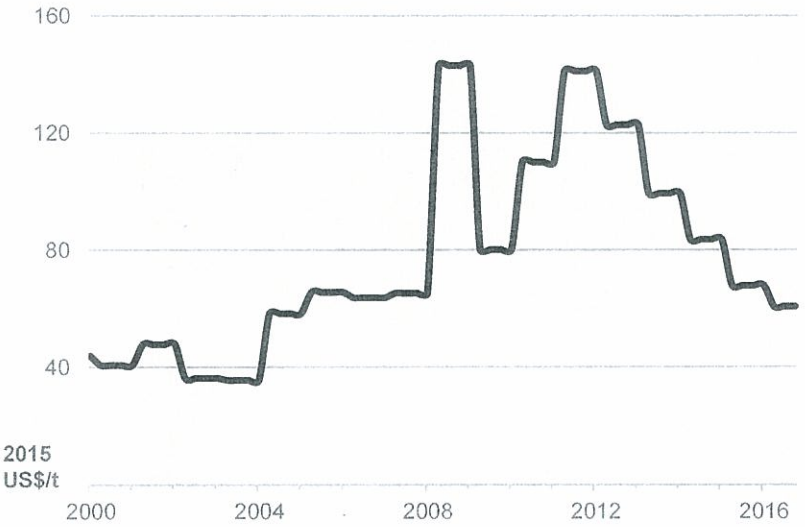
Benchmark prices for the Japanese Fiscal Year 2015 (JFY, April 2015 to March 2016) settled at US$67.80, a strong premium over the prevailing spot price of US$57 a tonne at the time of settlement. Although the benchmark price was 17 per cent lower than JFY 2014, the depreciation of the Australian dollar meant that the price received by Australian producers was around $1 a tonne higher. Benchmark prices for JFY 2016 are forecast to settle at 9 per cent lower at around US$62 a tonne, underpinned by continued oversupply and an assumed depreciation of the Australian dollar.

Figure 5.1: Thermal coal spot prices



Source: Bloomberg.

Figure 5.2: JFY thermal coal prices



World trade

World trade in thermal coal is forecast to decline by 4.6 per cent to 1010 million tonnes in 2015, reflecting a forecast decline in China's imports. World trade is forecast to increase by 2.6 per cent to 1036 million tonnes in 2016, supported by growth in imports into India.

Imports

China

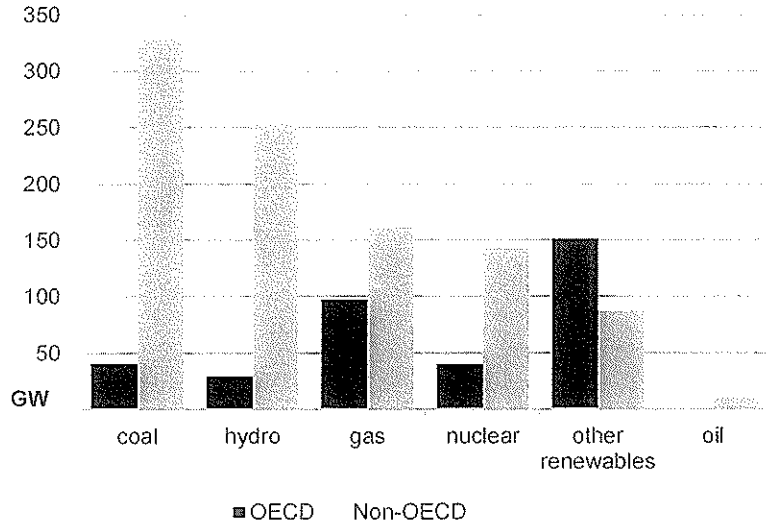
The Chinese Government has announced a series of measures targeting the use of coal in an attempt to improve air quality, particularly in highly populated cities. While this will slow the growth in China's coal use, coal will remain an important part of the energy mix with 96.2 gigawatts of coal-fired capacity under construction or approved (almost twice Australia's total installed capacity across all energy types). In early 2015, China's coal consumption has been affected by reduced economic activity and continued strength in hydroelectric output. In the first five months of 2015, hydroelectric generation increased by 14 per cent year-on-year, while thermal generation declined by 0.7 per cent.

Coal production in China continued to decline in the first half of 2015 in response to weaker demand, lower prices and government directives. Chinese state-owned producers have been encouraged to reduce output as part of efforts to stabilise domestic coal prices. Shenhua, China's largest coal company has committed to reduce its output by 34 million tonnes in 2015 to 273 million tonnes.

China's imports of thermal coal declined by 32 per cent to 54 million tonnes in the first four months of 2015 because of lower thermal generation and increased use of domestically-sourced coal following the introduction of measures to support the domestic industry. The China National Coal Association estimates that 90 per cent of their members' production is unprofitable at current prices.

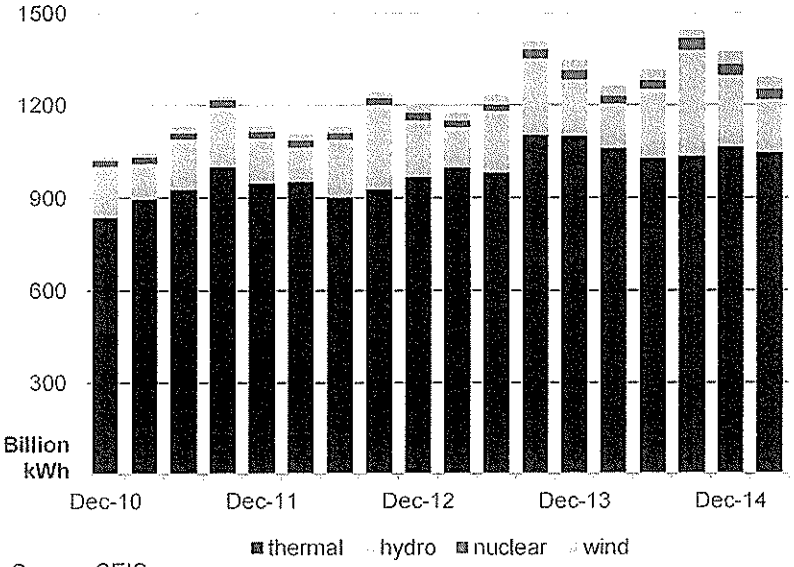
Over the remainder of 2015 and in 2016, China's import growth will continue to be challenged by slowing economic growth, strong hydroelectric output and measures to support the domestic industry.

Figure 5.3: World electricity capacity under construction or approved



Source: Enerdata, www.enerdata.net.

Figure 5.4: China's quarterly electricity generation



Source: CEIC.

China's imports are forecast to decline by 31 per cent to 157 million tonnes in 2015, before recovering slightly to 160 million tonnes in 2016.

India

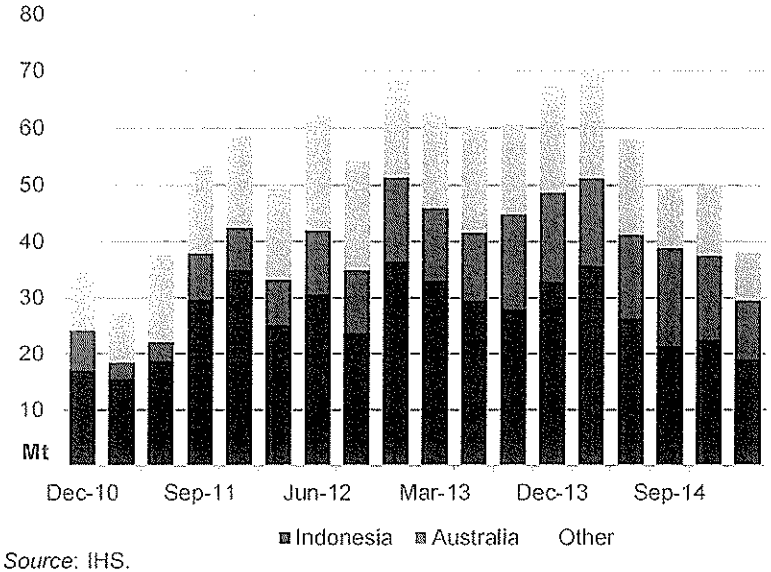
India has around 113 gigawatts of new coal-fired capacity under construction or approved. These investments form the backbone of the Indian Government's plan to improve electricity access and stimulate economic growth. India's coal production has not kept pace with the rapid increase in its demand associated with the expansion of coal-fired capacity, contributing to a rise in imports over the past few years. Coal India Limited, the largest coal producer in India, has been successful in increasing production in early 2015. However, growth in production is not expected to be sufficient to meet demand in the short term.

In early 2015, India's coal imports were mostly of high energy coal that can be blended with lower quality domestic coal to meet power plant specifications. This affected the volume of imports from Indonesia, India's primary source of coal. India's thermal coal imports in 2015 are forecast to increase by 11 per cent to 174 million tonnes, overtaking China as the world's largest importer of thermal coal. In 2016, imports are forecast to increase by a further 8 per cent to 188 million tonnes.

Japan

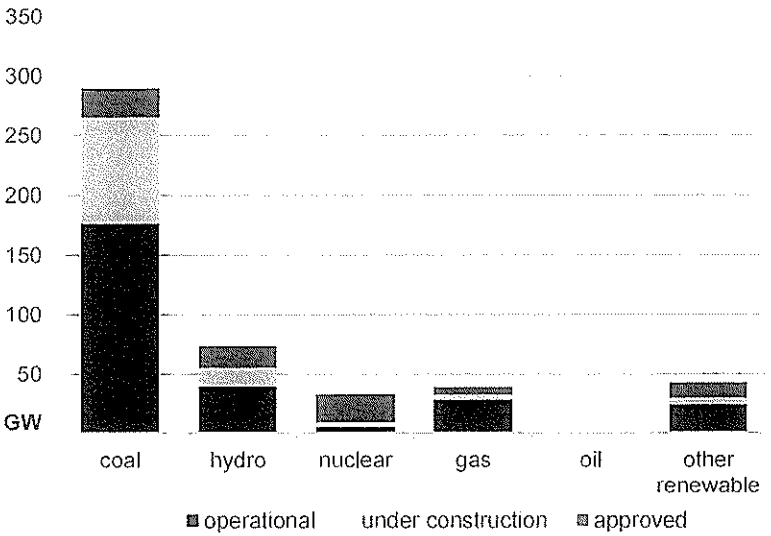
Japan's imports of thermal coal in early 2015 continued to be supported by the absence of nuclear power. In May the Japanese Government released a draft plan for Japan's energy mix by 2030, which indicated a continued role for nuclear power over the medium to longer term. Under the plan, nuclear power is expected to account for 20–22 per cent of the energy mix, gas 27 per cent, coal 26 per cent, renewables 22-24 per cent and oil 3 per cent. Although a few reactors have received approval to restart from the Nuclear Regulatory Authority, there still remains uncertainty over the timing of restarts in the short term which is likely to support Japan's coal imports. Japan's thermal coal imports are forecast to increase by 2.8 per cent in 2015 to 148 million tonnes before declining to 145 million tonnes in 2016.

Figure 5.5: China's quarterly coal imports by source



Source: IHS.

Figure 5.6: India's electricity generating capacity >50MW



Source: Enerdata, www.enerdata.net.

South Korea

South Korea's Seventh Power Generation Master Plan is under development and will provide some guidance on the future structure of South Korea's electricity generation mix. There has been some shift in sentiment away from coal-fired generation because of concerns over emissions near highly populated cities. Four plants with a combined capacity of 3.7 gigawatts have been delayed or cancelled. Nonetheless, the remaining investment in new coal-fired capacity indicates South Korea's total coal-fired capacity is likely to expand.

From 1 July, the import tax on coal in South Korea will be increased by around US$4.40. The tax increase is likely to reduce the competitiveness of low energy content coal, such as that from Indonesia. South Korea's thermal coal imports are forecast to increase by 2.0 per cent in 2015 and 2016 to 100 million tonnes and 102 million tonnes, respectively.

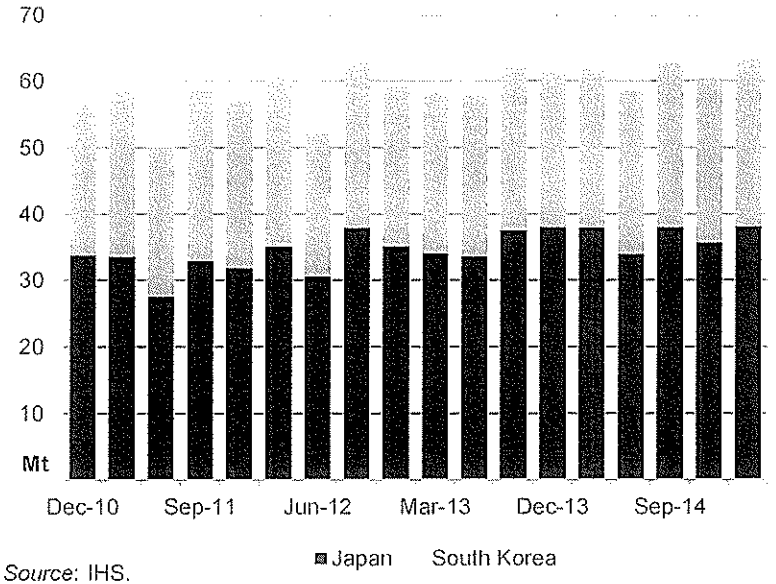
Exports

Indonesia

Indonesian producers have struggled to remain viable in the face of lower prices and reduced import demand in key export markets. The cost of production for many producers is denominated in US dollars and the strengthening US dollar has contributed to deteriorating competitiveness. There are indications that some small to mid-size producers are starting to reduce output in response to reduced profitability. Output was also affected by heavy rainfall in early 2015. Reflecting this, Indonesia's production was reported to have declined by 21 per cent in the March quarter to 97 million tonnes.

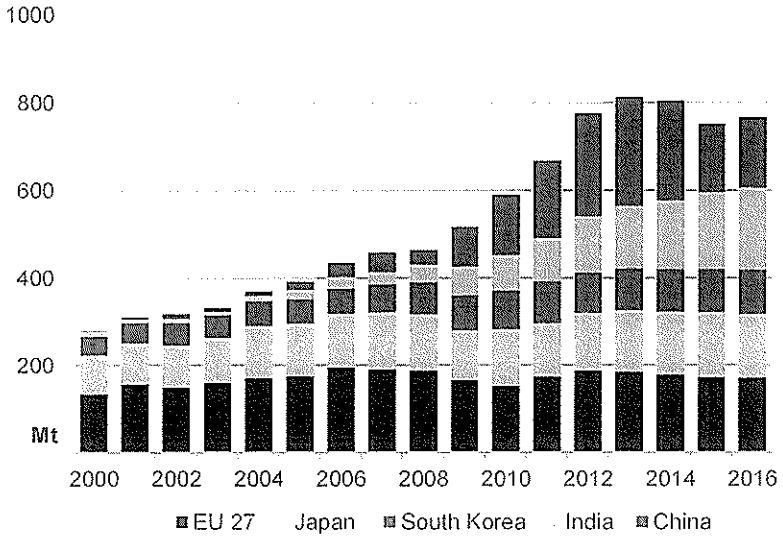
The Indonesian Government has announced its intentions to begin to consolidate the coal industry. They will begin by reviewing coal mines without 'clear certification'. It is estimated that more than 40 per cent of 10 000 licences issued do not comply with government rules, including payment of administration fees and royalties, and could be revoked.

Figure 5.7: Japan and South Korea's quarterly imports



Source: IHS.

Figure 5.8: Major thermal coal importers



Source: IEA.

Indonesia has been adversely affected by lower demand in China and India as they favour higher energy coal from other sources. Lower demand, combined with lower production, tighter regulation of exports and increased domestic use are expected to contribute to lower exports in 2015 and 2016. Indonesia's exports of thermal coal are forecast to decline to 405 million tonnes and 403 million tonnes in 2015 and 2016, respectively.

Colombia

In the March quarter, Colombia's coal production declined by 5 per cent year-on-year to 23 million tonnes because of labour disputes and transport limitations. The introduction of a night time rail restriction on the Fenoco coal railway to reduce noise pollution has affected the operations of three major coal mines: Drummond, Prodeco and Colombia Natural Resources. Accordingly, the Colombian Government has revised its 2015 production forecast to 87 million tonnes. Colombia's exports of thermal coal are forecast to decline by 4.2 per cent to 68 million tonnes in 2015 and then recover by 10 per cent to 75 million tonnes in 2016.

Australia

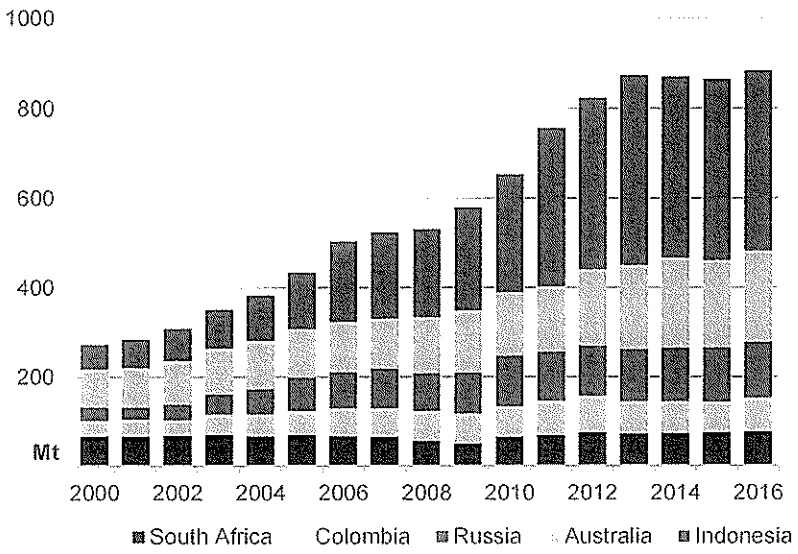
Exploration

Australia's coal exploration expenditure in the March quarter was around $44 million, down 44 per cent on the December quarter and 57 per cent on the March quarter 2014. Low coal prices and persistent oversupply continued to reduce the incentive to invest in coal exploration.

Production

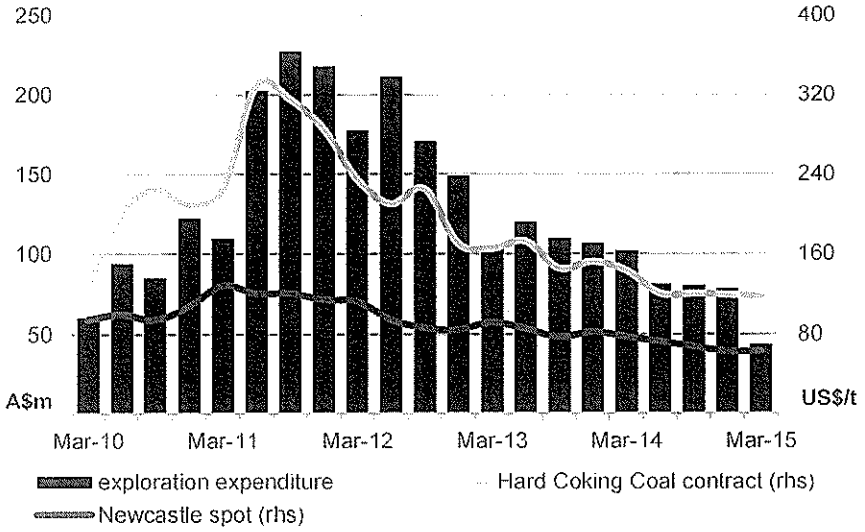
Australia's thermal coal production is estimated to have declined by 0.7 per cent to 246 million tonnes in 2014-15 as announced reductions in capacity more than offset higher production from recently completed projects. In February, Glencore announced its intention to reduce output at its Australian operations by 15 million tonnes in 2015. In 2015-16, Australia's thermal coal production is forecast to increase by 1.4 per cent to 249 million tonnes.

Figure 5.9: Major thermal coal exporters



Source: IEA.

Figure 5.10: Australia's coal exploration expenditure



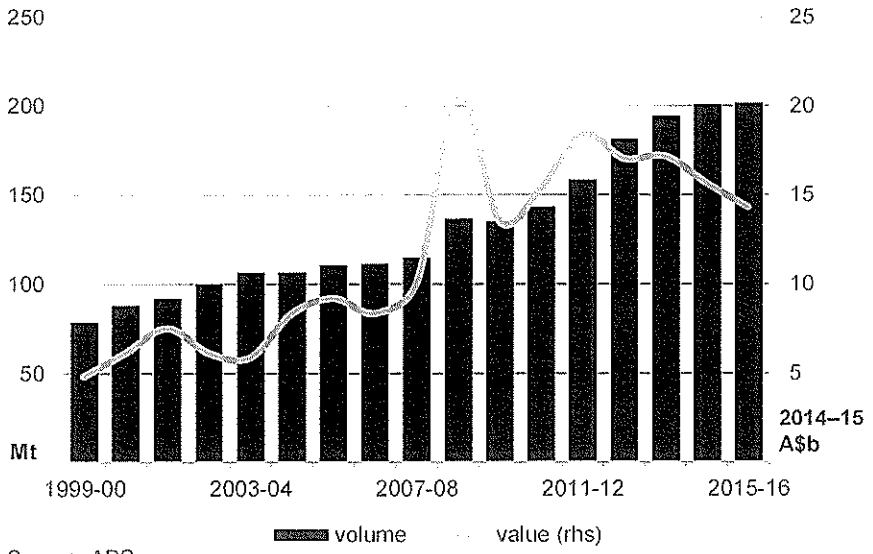
Sources: ABS; Bloomberg.

Exports

Although the current operating environment has been more challenging for Australian coal producers, Australia's thermal coal exports remained resilient. Demand for Australian coal in key markets including Japan, South Korea and Chinese Taipei remained relatively steady during 2014-15. As a result, Australia's exports of thermal coal increased by 3.2 per cent to 201 million tonnes in 2014-15. Despite higher volumes, the value of these exports declined by an estimated 7 per cent to $15.6 billion because of lower prices.

In 2015-16, Australia's thermal coal exports are forecast to increase by 0.4 per cent to 202 million tonnes. Earnings from thermal coal exports are forecast to decline by 6 per cent to $14.6 billion as forecast lower prices more than offset higher volumes and an assumed depreciating Australian dollar.

Figure 5.11: Australia's thermal coal exports



Source: ABS.

Table 5.1: Thermal coal outlook

	unit	2014	2015 f	2016 f	% change
World					
Contract prices b					
– nominal	US$/t	82	68	62	–8.6
– real c	US$/t	84	68	61	–10.6
Coal trade	Mt	1 058	1 010	1 036	2.6
Imports					
Asia	Mt	762	718	738	2.8
China	Mt	229	157	160	1.9
Chinese Taipei	Mt	61	62	62	0.5
India	Mt	157	174	188	8.1
Japan	Mt	144	148	145	–2.0
South Korea	Mt	98	100	102	2.0
Europe	Mt	228	222	224	1.2
European Union 27	Mt	178	172	171	–0.6
other Europe	Mt	50	50	53	7.3
Exports					
Australia	Mt	201	195	205	4.8
Colombia	Mt	71	68	75	10.3
Indonesia	Mt	406	405	403	–0.6
Russia	Mt	120	122	125	2.5
South Africa	Mt	74	75	77	2.7
United States	Mt	31	25	23	–8.0
		2013–14	**2014–15 f**	**2015–16 f**	
Australia					
Production	Mt	247.8	246.1	249.4	1.4
Export volume	Mt	194.6	200.8	201.7	0.4
– nominal value	A$m	16 705	15 621	14 631	–6.3
– real value d	A$m	17 156	15 621	14 274	–8.6

b Japanese Fiscal Year (JFY), starting April 1, fob Australia basis. Australia–Japan average contract price assessment for steaming coal with a calorific value of 6700 kcal/kg gross air dried. c In current JFY US dollars. d In current financial year Australian dollars. f forecast.
Sources: ABS; IEA; Coal Services Pty Ltd; Queensland Department of Natural Resources and Mines.