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The rubber economy after COVID /19 with a special focus on China

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Summary:

Three parts that I intend to cover in this report is the review of the rubber prices after the outbreak of COVID 19; the impact on the domestic rubber supply and the shrunk demand.

On April 8, Wuhan the capital of Hubei province, China is open to the outside world again. Although people are still reeling from the loss of loved ones and cautious against COVID 19, life must go on. In the first part, we make a briefly review of the rubber prices after the outbreak of COVID 19.

The second part let's deal with the domestic supply. We believe the domestic supply is less affected compared with the demand. This is because firstly we are still in the off season of the rubber cutting. Secondly, China already has a rubber stock of nearly 2 million tons. The decrease of importation will have a limited contribution to relieve the pressure of domestic high stock.

The third part we deal with the demand. Under the spread of the COVID/19, the pressure on the tire industry is unprecedented. The pressure is mainly reflected in two aspects: domestic market and exports. We will go deeper from these two aspects.



1. Introduction – the review of the rubber prices after the outbreak of COVID 19

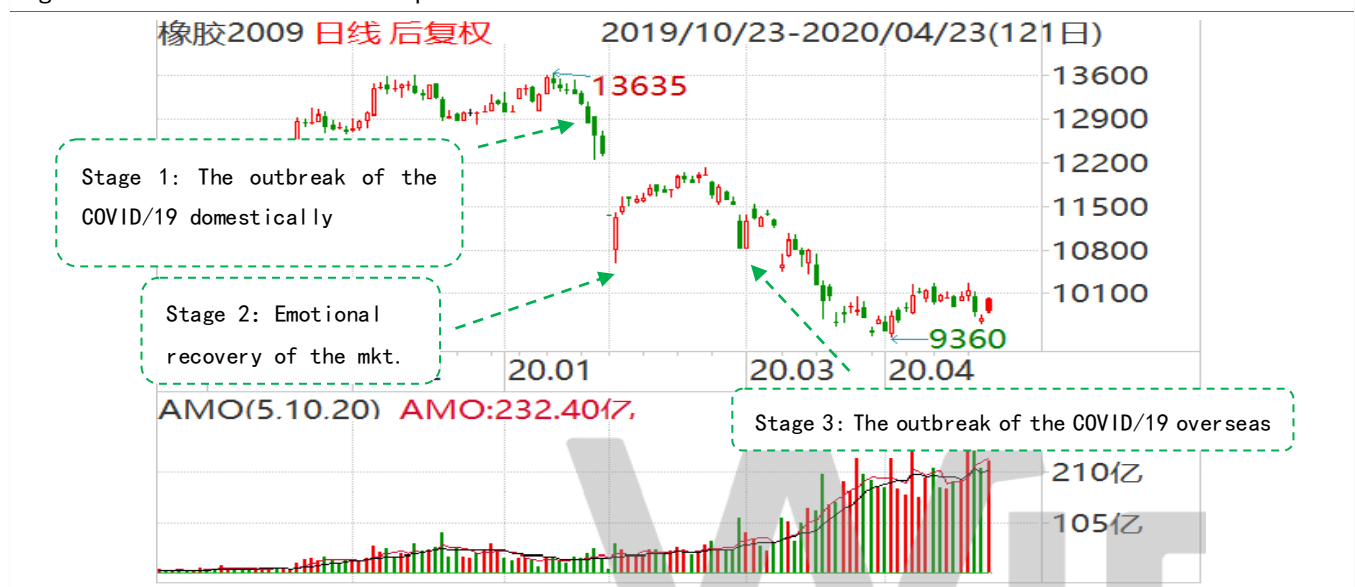
On April 8, Wuhan the capital of Hubei province, China is open to the outside world again. Although people are still reeling from the loss of loved ones and cautious against COVID 19, life must go on and there's plenty to look forward to.

If we looked back, the impact of the pandemic can roughly divide into three stages. The first stage was from one week before Chinese spring festival, cases of infection had been reported and on January 23, the decision to seal off Wuhan, a city of 11 million, added to the confusion and fear to the financial market. During this period, the rubber price in Shanghai futures market declined dramatically. The Chinese capital market closed down due to the traditional holidays. On Feb. 3rd, the market opened again and pessimism thickened. Rubber futures price sealed at the down limit at the close.

The second stage began just one day after, the rubber prices appeared to have bottomed out and slightly rebounded with oversell. Investors came to realize China is making efforts to hasten the comprehensive recovery in work and life, solve difficulties and problems during the process and limit the economic shock caused by the pandemic. Local governments created the conditions for work and production resumption while improving pandemic prevention measures according to their local conditions. Great support also is provided to industries facing difficulties such as motor industry. The belief that the pandemic can be under control and the resetting life and economic activities usher in a period of improved sentiment that support prices heading into 12000. But it didn't last long.

The third stage began in late Feb. and has lasted until now, which has witnessed another slump of the rubber futures price. The spread of COVID-19 worldwide caused growing concerns. The spread of COVID-19 worldwide seemed inevitable. Besides, due to the outbreak of COVID-19, the global demand for energy has decreased sharply. Although the slump in the oil price didn't have a direct impact on natural rubber, it does transmit from the butadiene to the synthetic rubber, which is a substitute for natural rubber. This time, investors were not as confident as of the domestic outbreak. If the spread of COVID-19 continues globally for a longer time, the drag on economic growth will be much more severe.

Figure1: SHFE rubber futures price



Source: Wind., GTJA futures Research Institute for Industrial Service

Figure2: the cumulative confirmed cases in China and worldwide

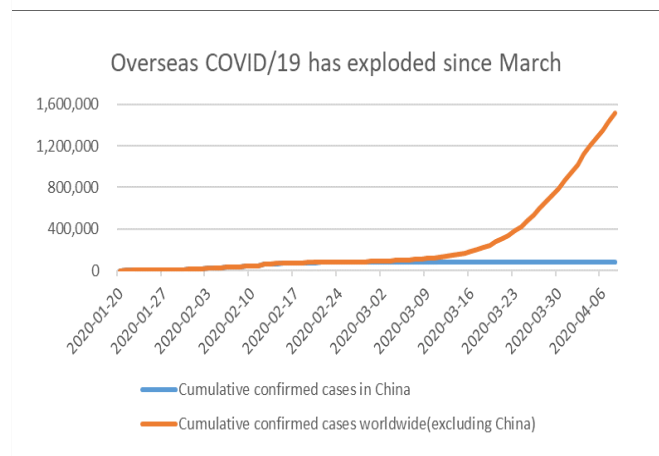
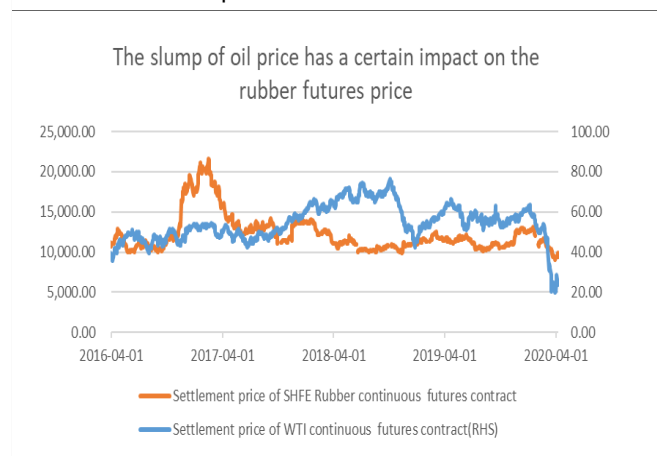


Figure 3: the interaction of the WTI oil price and rubber futures price



Source: Wind., GTJA futures Research Institute for Industrial Service

2. Domestic supply was less affected

We believe the domestic supply is less affected compared with the demand. This is because firstly we are still in the off season of the rubber cutting. Secondly, China already has a rubber stock of nearly 2 million tons. The decrease of importation will have a limited contribution to relieve the pressure of domestic high stock. In the following article, we will introduce the recent situation of rubber production in Yunnan and Hainan Province, the pandemic impact on world supply chain and domestic rubber supply.

2.1 Domestic cutting period will be delayed

These two pictures are maps of rubber plantation in Hainan and Yunnan Province (Figure 4、5). Red, orange and beige areas represent different grades of rubber estate. In both Hainan and Yunnan rubber production area, at present, the growth of rubber trees is not good. Some production areas have problems with Leaf Fall Disease. There is the possibility of secondary defoliation, and even some production areas have powdery mildew. It may take some time for new leaves to grow. The cutting expectation this year is not optimistic. It is expected that the large-scale cutting period will be delayed to the middle of May. It is difficult for the processing plant to purchase a large number of raw materials in a short period of time.

Besides, Yunnan continues to suffer from the drought. The spring is unusual dry and the rainfall is below average. According to Xinhua News Agency it perhaps the worst drought situation in Yunnan for the past 10 years. And according to data from the Yunnan Provincial Department of Water Resources, as of April 15, there were 100 rivers in Yunnan, 180 reservoirs dried up, and 140 electromechanical wells had insufficient water. The storage capacity of the reservoir is 6.11 billion cubic meters which is 10% less than the same period last year. Judging from the current drought and its impact, this year's drought is the worst in 10 years. Considering the bioclimatic conditions after waiting for the fallen leaves to recover, the decision to opening of large-scale cutting will be more cautious for the locals.

Figure 4 Grade of rubber garden in Hainan

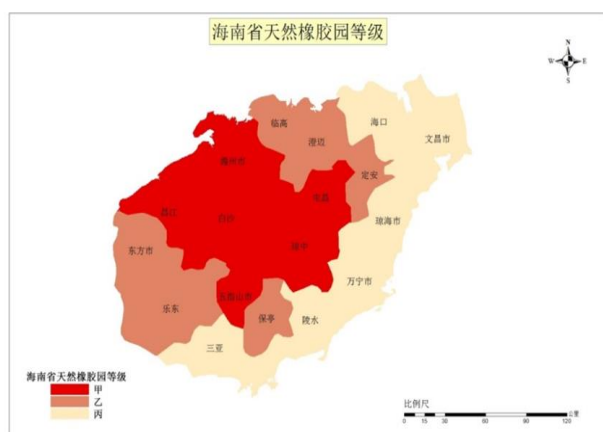
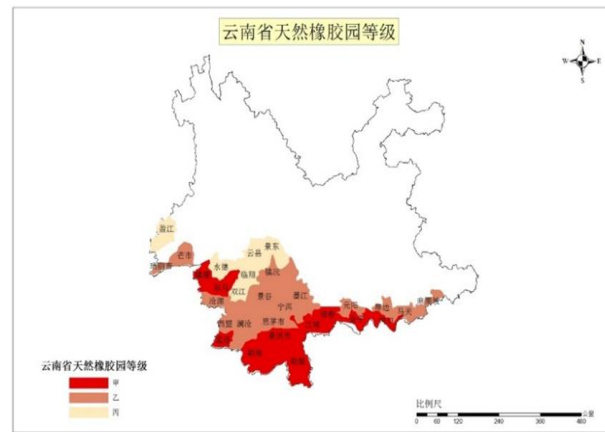


Figure 5 Grade of rubber garden in Yunnan



Source: public info., GTJA futures Research Institute for Industrial Service

2.2 The pandemic impact on world supply chain

Figure 6-9 I put here shows the accumulated number of confirmed cases and the new confirmed cases daily reported of four main rubber imported counties to China. The key thing I want to highlight is current world economic operation may be interrupted by the pandemic. There is still a significant impact on ocean and air transportation, considerable congestion at ports and a decline in container volume. And we still need to track the spread of the COVID/19 in Southeast Asia.

Figure 6 Thailand

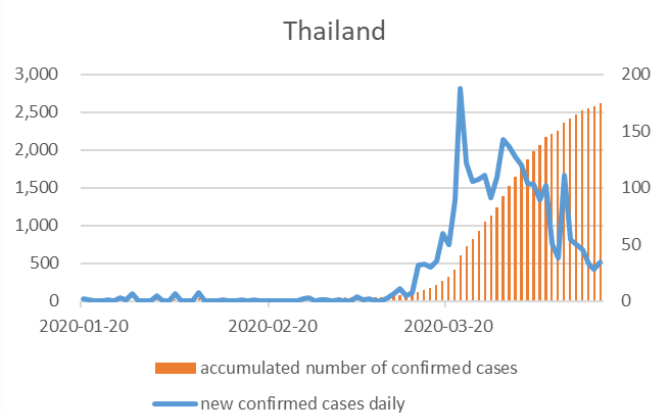
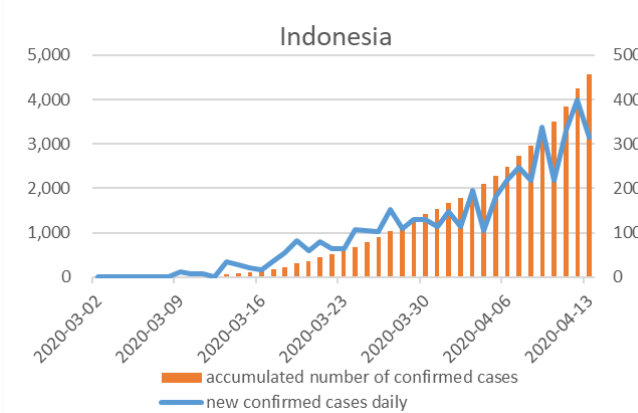


Figure 7 Indonesia



Source: Wind., GTJA futures Research Institute for Industrial Service

Figure 8 Malaysia

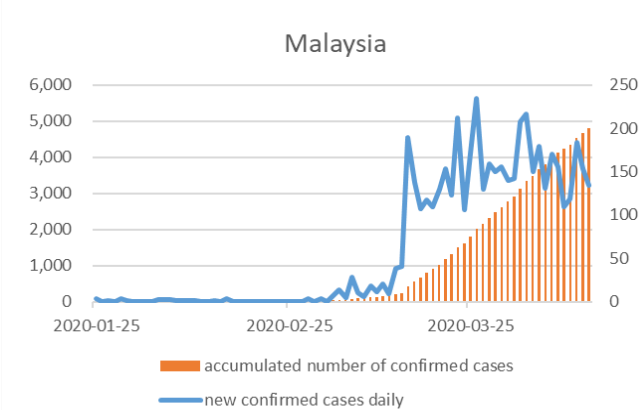
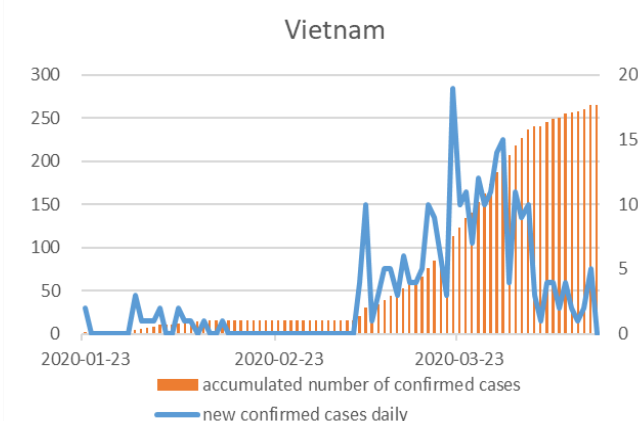


Figure 9 Vietnam



Source: Wind., GTJA futures Research Institute for Industrial Service

Figure 10-13 show monthly exports of four counties. As you can see, in Feb and March, the exports of Thailand and Indonesia declines obviously. Exports of Malaysia remains the same with last year, but at a historical low. In contrast, Vietnam's rubber exports are more stable. At present, many countries have declared a state of emergency, introduced a series of measures to close the country, block the city, restrict port operations and citizen's freedom activities. Although rubber can still be shipped to all parts of the world, the impact on the entire logistics and supply chain is great.

Figure 10 Thailand

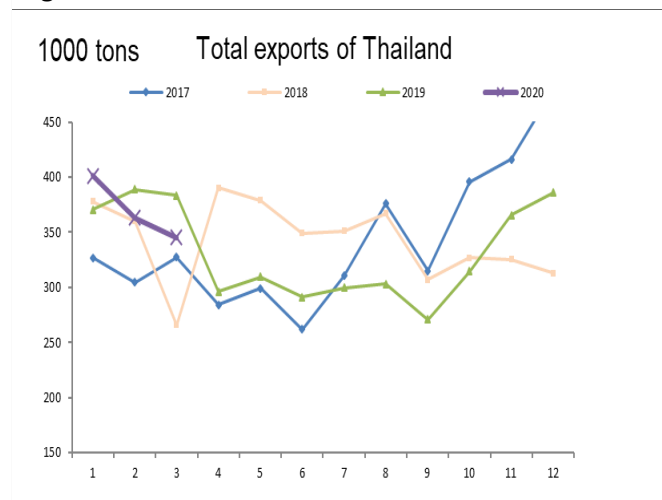
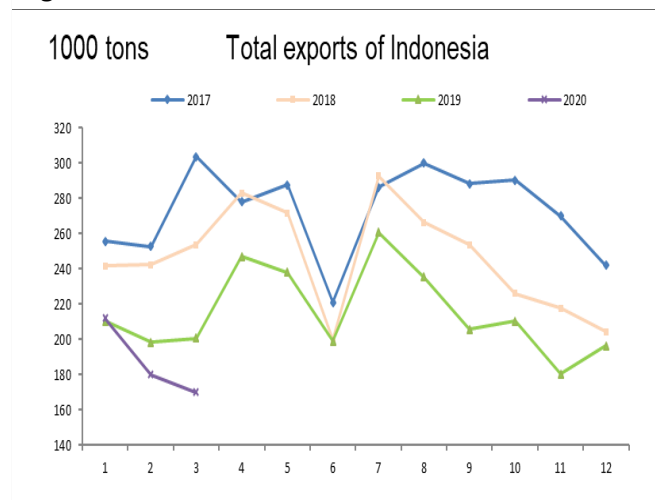


Figure 11 Indonesia



Source: Wind., GTJA futures Research Institute for Industrial Service

Figure 12 Malaysia

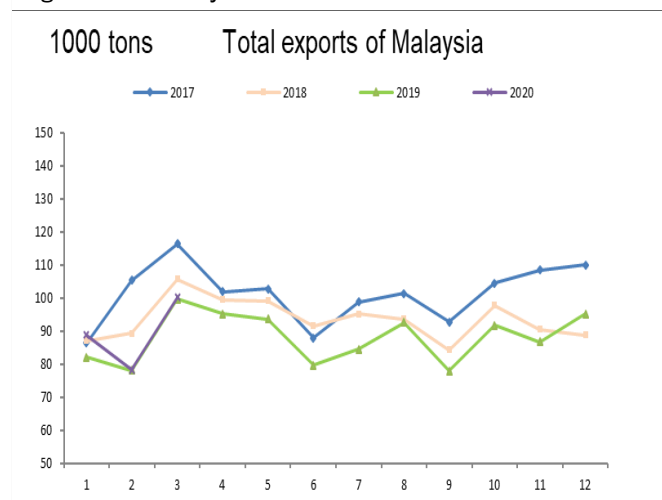
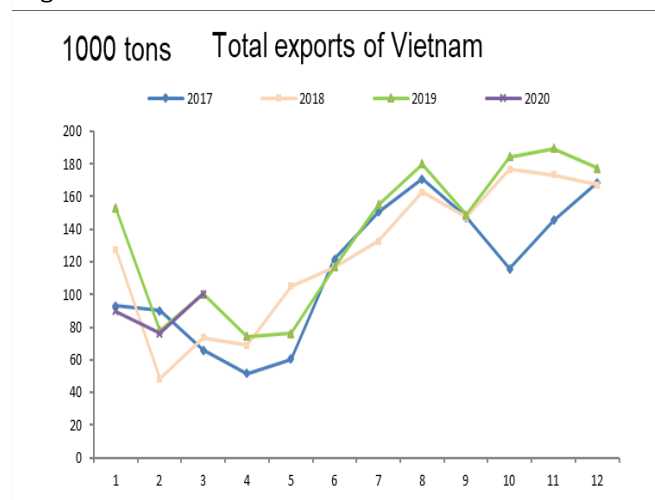


Figure 13 Vietnam



Source: Wind., GTJA futures Research Institute for Industrial Service

2.3 Qingdao area is still in the stock accumulation stage

China already has a rubber stock of nearly 2 million tons, As of Mar 10th, the inventory of 23 general warehouses in Qingdao was 607.4 thousand tons, an increase of 16.2 thousand tons from the previous week; the inventory of 18 bonded warehouses in Qingdao was 194.1 thousand tons, an increase of 5.215 thousand tons from the previous week; the total stock in Qingdao area is more than 801.6thousand tons, increased 2.75% on a weekly basis.

It can be seen that the Qingdao area is still in the stock accumulation stage, and the downstream procurement demand has not increased significantly. Therefore, the decrease of importation will have a limited contribution to relieve the pressure of domestic high stock. So we don't have a very strong sense of the contraction of supply. But it doesn't mean it doesn't exist. We still should pay attention to the bioclimatic condition in production area and track COVID 19's impact on the world supply chain.



3. The pandemic hit the market and the demand shrank significantly

Under the spread of the COVID/19, the pressure on the tire industry is unprecedented. The pressure is mainly reflected in two aspects: domestic market and exports. The domestic demand for tire products is suppressed in the first quarter as I will show you the data in the later part. With the domestic demand not yet fully recovered, the outbreak of pandemic overseas increased the uncertainty on demand. The shrinking of overseas demand for tires hurts China's exportation of tires. Under the drastic changes in the external environment, perhaps we need to look more or expect more at the domestic market in the second quarter. At present, the pandemic is still quickly spreading in America and Europe, which is the biggest risk factor for the global rubber demand. We are still trying to strike a balance between epidemic prevention and economic development.

3.1 The outbreak led to poor February data

The outbreak of the pandemic led to poor February data for the tire market. As you can see from the graph representing (Figure 14、15), in Feb, the Chinese OE (original equipment) tire mkt for passenger vehicle declines 78% on a yearly basis, while the RE (replace equipment) tire mkt declines 60 percent. And for the first two months, the decline would be 45 and 32 percent respectively.

Figure 14 Feb. YoY% of Passenger Vehicle Tyre

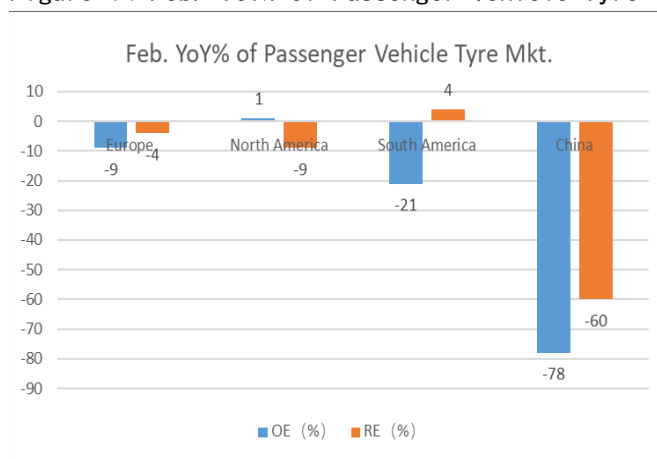
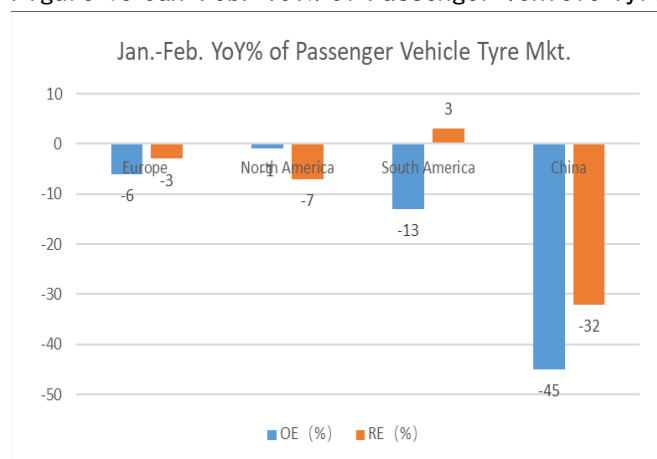


Figure 15 Jan-Feb. YoY% of Passenger Vehicle Tyre



Source: public info., GTJA futures Research Institute for Industrial Service

3.2 Domestic demand is recovering, but there is still a large gap

Now although more tire manufacturers have started their production recently, there is still a large gap for the capacity utilization rate compared with the same period of previous years. As you can see in Figure 16、17 in early April, the capacity utilization rate of PCR is 61.2%, which is 10.3% lower than last year. And the capacity utilization rate of TBR is 63.37%, which is 12.41% lower than last year.

According to statistics from monitoring of tire production enterprises, the total output of PCR tires in China in March was 38.164 million, a year-on-year decrease of 15.51%. From January to March, the cumulative output of China's PCR tires was 80.082 million, slipped 25.8% from the year before. China's total output of TBR tires was 10.21 million in March, a year-on-year decrease of 12.15%. From January to March, the cumulative output of China's TBR tires was 20.995 million, slipped 26.2% from the year before. As we can observe, the decrease is narrowed in March, but still has not been restored to a positive value.

Figure 16 Capacity utilization trend of PCR

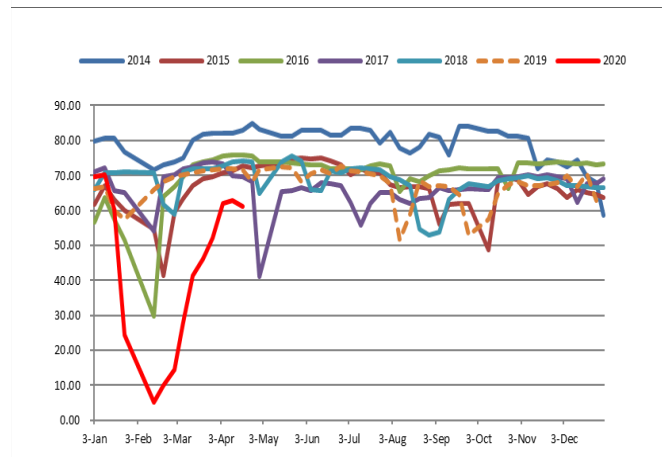
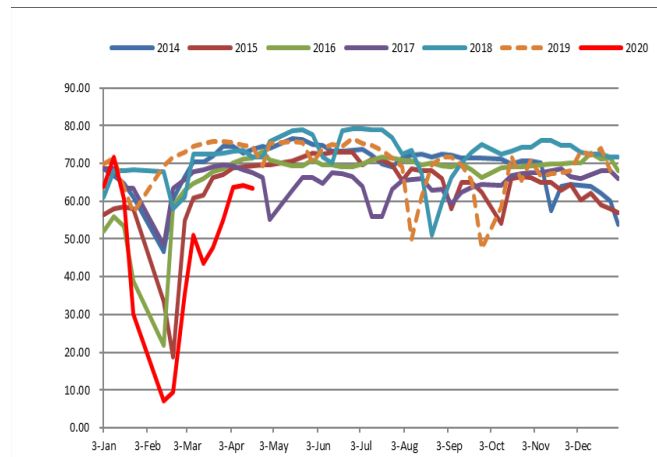


Figure 17 Capacity utilization trend of TBR



Source: Wind., GTJA futures Research Institute for Industrial Service

Q1 was a difficult quarter for the Chinese motor industry, with the sales and production volume of automobile were down over 40% on a yearly basis. I would like to highlight that commercial vehicle which had been driving demand for natural rubber over the last quarter, reported less declines relative to passenger vehicle. This doesn't come as a surprise, as people would defer purchasing decisions foreseen that the economic slowdown and decrease in future earnings. Although the pandemic has made a great impact on the automobile industry, there are some differences in the subdivisions.

Figure18: The Sales and Production of Automobile in Q1

		2020/03	MoM(%)	YoY(%)	2020/01-03	2020/01-03 YoY(%)
Sales	Automobile	143	361.1	-43.3	367.2	-42.4
	Passenger Vehicle	104.3	365.8	-48.4	287.7	-45.4
	Commercial Vehicle	38.8	348.9	-22.6	79.4	-28.4
Production	Automobile	142.2	398.9	-44.5	347.4	-45.2
	Passenger Vehicle	104.9	437.9	-49.9	268.4	-48.7
	Commercial Vehicle	37.3	319.1	-20.3	79	-28.7

Source: public info., GTJA futures Research Institute for Industrial Service

Figure 19、20 shows the monthly sales and production data of heavy truck in China from 2013 to 2020. The Sales of heavy trucks in Jan. increased 18% on a YoY basis. But hit the bottom in Feb (slipped more than 50% from the year before). The sales are already showing some signs of bottoming. In Mar. the sales rebound, but still lower than the previous year. The volume of production almost stepped the same pace with the sales.

In our opinion, the growth rate of heavy truck sales and production has touched the lowest point in Feb. With the foreseeable stimulus policies, the sales and production volume of heavy truck in China for the 2020 will still beyond 1million.



Figure 19 The Sales of Heavy Truck

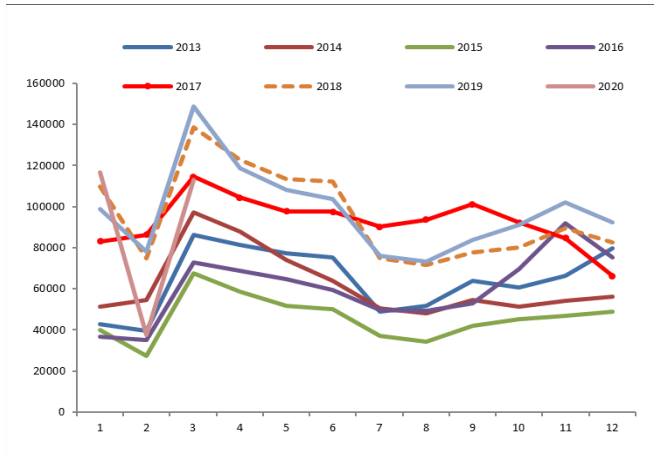
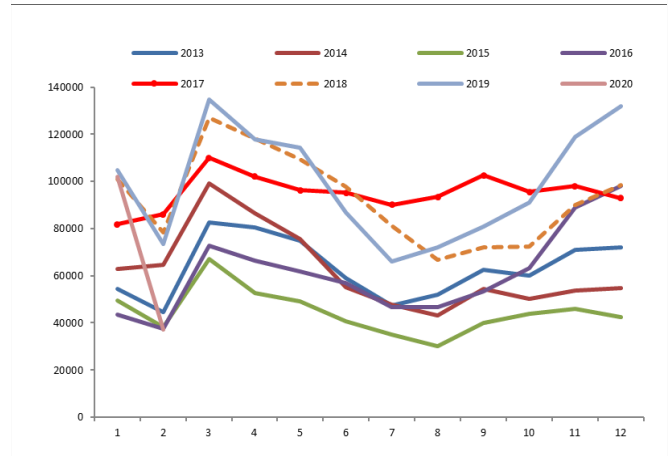


Figure 20 The Production of Heavy Truck



Source: public info., GTJA futures Research Institute for Industrial Service

3.3 The greatest negative impact is from the overseas mkt.

As the domestic demand for rubber gradually recovers, the greatest negative impact is from the overseas mkt. More countries prevent the pandemic from spreading through strict control of transportation, thus causing a significant decline in the demand for tires. As you can see from Figure 21, China's tire exports account for about 40% of total sales. The industry's dependence on exports is very high. The poor export situation can directly affect the benefits of the whole industry. According to the cumulative number of confirmed cases on April 15, the top 12 countries account for 31.6% of China's light vehicle tires exportation and 17.2% of China's commercial vehicle tires exportation (Figure 22). Through a survey we found that export orders decline substantially in April. Some factories told us the decline is more than a half.

Figure 21 Ratio of dependence on export

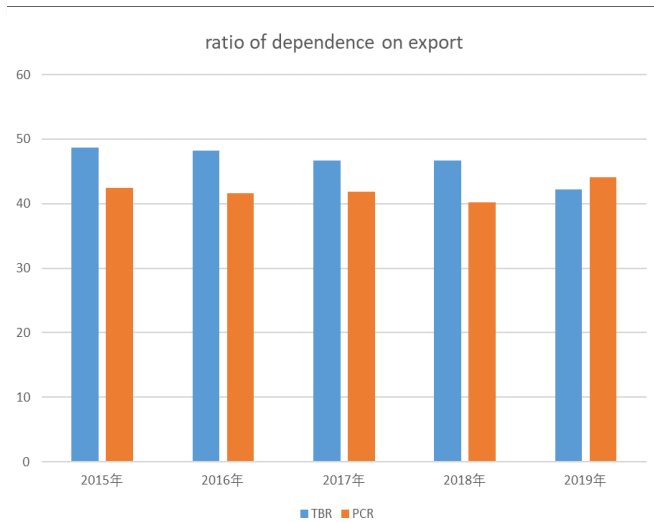


Figure 22 China's exportation of tires hurts

key zone	40111000 (%)	40112000 (%)
US	2.6	8.3
Spain	2.7	0.4
Italy	2.6	0.3
France	2.6	0.3
Germany	3.9	0.6
Britain	8.3	0.8
Iran	0.3	3
Turkey	0.4	0.4
Belgium	1.5	0.3
Netherlands	3.2	0.5
Canada	3.4	2.3
Switzerland	0.1	0

Source: public info., GTJA futures Research Institute for Industrial Service

4. Summary: it may need a long time to restore

What rubber mkt roadmap is most likely? A V shape recovery? U-shape recovery or a L-shape recovery? An old Chinese proverb says in every crisis, there is opportunity. When written Chinese, the word crisis is composed of two characters, one represents danger, and the other represents opportunity.

In my point of view, the market is a very smart pricing mechanism, reflected the mood sentiment and perception of most investors. For now, the rubber price has reflected most of the bad news,



but it may need a long time perhaps longer than you imagine to restore because the pandemic is not like a light just to turn on or off and the recovery of social, economic order and consumer' s confidence needs more time.



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