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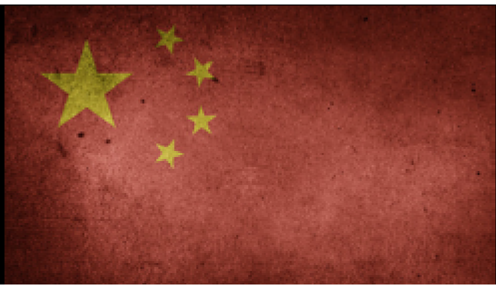
Analysis: Will China's potash contract end the bull run?



With first offers by MOP suppliers to China's consortium of buyers underway, the market begins its annual ritual of guessing if China will settle this year, when it will if it does, and for how much.

Last year, suppliers settled for $230/t, $11/t more than the headline price of $219/t cfr agreed in 2016 for standard MOP.

This year, suppliers want more, and they are likely to get it.

Ahead of formal talks, the general view seems to be that the suppliers have the better initial bargaining position, and China may have to accept uncomfortable increases for its standard MOP requirements, after two years of successful negotiating.

Suppliers argue that spot prices are up significantly since the last contract was settled, as are freight rates and demand — all of which is true — so the contract price has to go up accordingly.

But the consortium of Chinese buyers — which includes state-owned Sinochem fertilizer arm Sinofert, China National Agricultural Means of Production Group (CNAMPGC) and state-owned CNOOC — may be looking further into the future at the raft of new capacity coming onstream, and be tempted to bet on a drop in prices later this year.

Suppliers are offering lower prices if the consortium buys early, but as of late-March, have not been successful with the incentive. If suppliers are keen to settle early, it may indicate that they also view a period of lower pricing on the horizon, as Eurochem enters the export market, and K+S' Bethune mine in Canada ramps up exports.

New capacity in 2017-18

Company/Project	Location	Commissioning date	± Capacity '000 t/yr KCL*	Notes
Turkmenkhimiya	Garlyk, Turkmenistan	1 April 2017	1,400	Test MOP production began in February 2017. 10,000t was sold via the state commodity and raw materials on 3 July for $120/t fca Magdanly with payment in advance.
K+S, Bethune	Bethune SK, Canada	2Q 2017	2,860	First tonnes of marketable potash produced in June 2017. K+S aimed to produce 500,000t of white potash in 2017.
Eurochem, Usolskiy	Palashersk, Russia	May 2018	3,700	Two-phase development. Commissioning of 2.3mn t/yr phase one had been expected in late 2017, followed by 1.4mn t/yr second phase. Eurochem plans to produce 450,000t in 2018 at Usolskiy.
Mosaic, K3	Esterhazy SK, Canada	2017	7,000	First significant volumes of potash being produced, as of late February 2018, following K3 expansion at Mosaic's Esterhazy facility. The company expects to produce 50,000t of potash from the K3 project this year.
Eurochem, VolgaKaliy	Kotelnikovo, Russia	Summer 2018	4,600	Two-phase development. First production from 2.3mn t/yr phase one expected in summer 2018, followed by 2.3mn t/yr second phase. All facilities to be fully commissioned by 2020. Production in 2018 is projected at 130,000-140,000t.

**total capacity once all phases complete*

New capacity impact on potash market

Argus expects the raft of new production capacity from Canada and Russia to erode recent price gains that began back in summer 2016. But the extent to which prices will fall depends on how suppliers react to Eurochem, and K+S' new Bethune mine, both of which require strong sales while ramping up to full output.

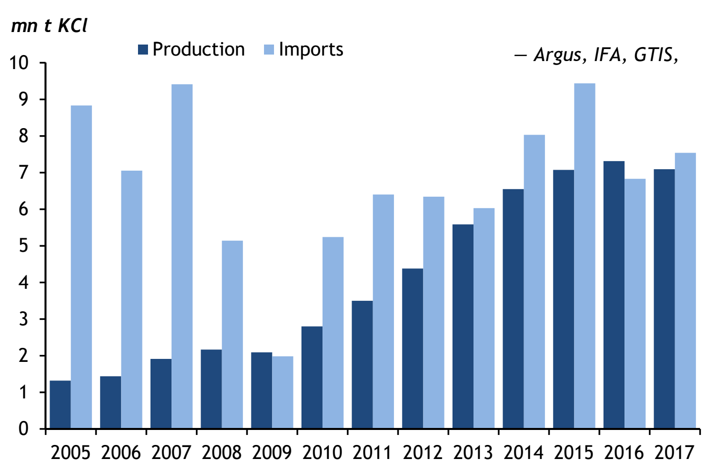
If output from the three new mines is aggressively targeted towards key destinations by undercutting existing prices — and more established companies refuse to cut production — it is conceivable that prices could ultimately dip back to the low $200s/t fob again, until such time as demand increases to catch up with oversupply. But prices are more likely to dip slightly in the short term, with no sharp falls forecast.

Argus expects K+S to produce 1.5mn-1.7mn t from its Canadian operations this year, and while some of this supply will be offset by the winding down of output from its German mines, one of which is scheduled to close by the end of this year, the net gain in production will need to find an outlet.

Eurochem needs to build up buyers for its MOP eventually. But its new potash output will serve its own needs before any of its product hits the international spot markets, so the impact of the initial output is limited. The firm needed to source 850,000-1mn t/yr of MOP and SOP for its requirements as of summer 2017. And it intends to produce more than 590,000t this year from its two new mines, Usolskiy, and Volgakaliy.

China will be looking at the potential 2.3mn t of extra production heading for export compared with 2017, and weighing up the impact on prices.

China KCl production and imports 2005-latest



Some have wondered if China will sit out the contract altogether this year, opting to rely on its port stocks of 2.3mn t, domestic MOP production of around 7mn-8mn t and the roughly 270,000t t railed from Uralkali since July last year.

But it will not satisfy the 14mn-16mn t/yr that China requires, so *Argus* sees little chance of a roll-over, and expects the settlement in July - the same month that China settled in last year and in 2016 - unless it sees no price drop ahead of its potash requirements for application season, in which case it could settle during the second quarter.

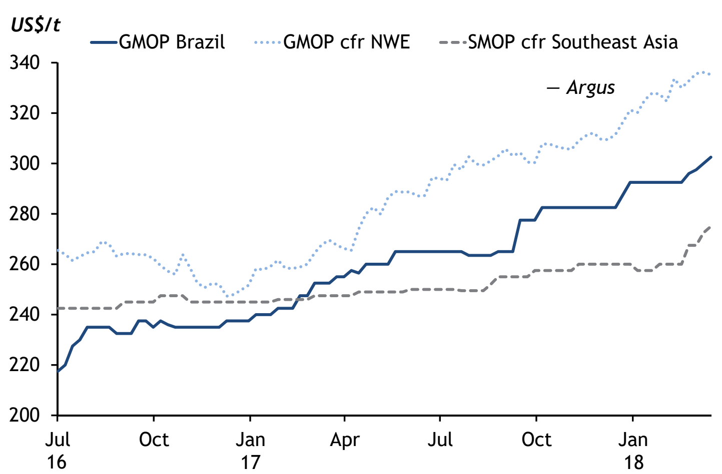
As for the price, the market has wide-ranging forecasts, from as low as a $10/t increase, up to $55/t. But *Argus* expects a $20-30/t increase to the headline level.

Spot up, freight up, demand up

Suppliers have cited several key factors in determining the price that China should settle at.

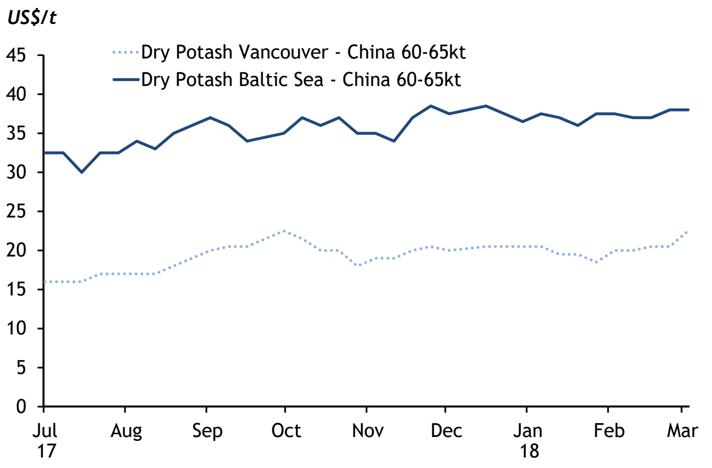
Firstly, spot rates are up. Granular MOP in Brazil and Europe has gone up by $30-45/t and €10-25/t, respectively, since China settled in July 2017 compared with late-March 2018. Standard MOP in southeast Asia has risen by $30-45/t to $270-280/t cfr.

Key CFR granular and standard MOP spot prices



Second, suppliers have endured freight price increases in the last 12 months, which adds to their costs. The Dry potash Baltic Sea to China (60,000-65,000t) *Argus* freight rate was at $33/t when China settled its 2017 MOP contract, and is now at $38/t, up by 17pc in less than a year. And freight from Vancouver to China on the same vessel size was $16/t in July last year, but has risen around 30pc as of late-march, or $4.50/t.

Vancouver-China & Baltic-China freight rates



Thirdly, the supply/demand balance continues to favour MOP sellers. Potash demand was strong last year, and shows few signs of slowing down this year, other than for seasonal lulls. Canpotex told the markets in mid-March that it is fully committed until July. SQM is sold out until the end of the year. And Uralkali said it is also struggling to match supply with demand, all of which may prompt the Chinese consortium to consider the potential risk to food security if supply becomes tighter.

Purchasing power and new capacity

China may accept some of these points as a reason to endure a price hike. But it remains the most powerful group buyer globally because it buys the most potash in any single deal. China settled in 2016 when prices hit multi-year lows, and also managed to negotiate only a modest price increase the following year.

This year, it may be banking on a change in the spot market supply/demand balance hitting prices before it settles.

If it does not foresee a drop in prices this year, *Argus* expects the consortium to react by settling early, at some point in the second quarter.

With new capacity threatening to upset the market, China could favour a wait-and-see approach, even at the risk of higher prices, if it views the suppliers as capable of meeting its requirements despite claims of very tight supply.

Suppliers' 2H17 China MOP contract quantities	*'000t*
Suppliers	**Contracted**
Uralkali*	600
BPC	1,300
Canpotex	1,400
ICL	925
APC	700
K+S*	140
Total	**5,065**

**Quantity not confirmed*

It is clear that prices have risen, and China will have to lift the contract levels to be more in line with global spot market. Whatever the quantities it buys relative to last year's 5mnt, and whenever the contract is eventually signed, the result will be a strong indicator of how China sees future potash prices. If it buys early, it is either because it sees prices going up, or it sees suppliers' repeated calls of tight supply as more than just a bargaining position.

If it hasn't settled by July, it is a strong indicator that it senses a change in the rising MOP market this year, and it is waiting to see if suppliers will waver on the potential end to rising prices brought about by growing new production entering the global export market from Russia and Canada.