2002 IFA PRODUCTION AND INTERNATIONAL TRADE CONFERENCE

Fairmont Le Château Frontenac – Quebec City (Canada)
16-18 October 2002

CHINA'S FERTILIZER MARKET AFTER WTO

by

Hongwei (Harry) YANG
US Chem Resources (SINOCHEM)
USA

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1. CHINA'S WTO COMMITMENTS ON FERTILIZER

China became an official member of the World Trade Organization on December 11, 2001. The WTO protocol dictates that the Chinese government will abolish the fixed quota administration on all fertilizer imports, and replace it with the tariff rate quota (TRQ) system. The TRQ system covers DAP, Urea and NPK, with initial import quota of 5.4 million, 1.3 million and 2.7 million metric tonnes (Mt), respectively. The in-quota tariff is 4%, while the out-of-quota tariff is 50%. The import of MOP and all other fertilizers will be administered by the automatic permit system.

In addition, the Chinese government also agrees to open the fertilizer wholesale and retail business within five years after her accession. Meanwhile, the agreement makes it clear that fertilizer import is administered through state trading, and Sinochem is designated as one of the two state-trading companies. Except for products prescribed for non-state trading in the protocol, the import of all the other fertilizers must be executed through the state-trading companies.

2. CHINA'S FERTILIZER IMPORT AND EXPORT DURING JANUARY-AUGUST 2002

2.1 Fertilizer Import

2002 has witnessed a sharp increase in China's fertilizer import. Total import during January-August 2002 reached 12.25 Mt, up by 63% over the same period of 2001. Specifically, the import of nitrogen fertilizers was 1.39 Mt, including 0.77 Mt of urea and 0.62 Mt of ammonium nitrate ; the import of DAP was 3.56 Mt, up by 64%, the largest increase among all the fertilizers ; the import of NPK was 1.75 Mt, up by 30% ; and the import of MOP was 5.21 Mt, up by 39%. (See the following Table)

China's Fertilizer Import During January-August 2002 (in Mt)

	Jan-Aug 2002	Jan-Aug 2001	Increase by %
Total	12.25	7.53	63%
DAP	3.56	2.17	64%
NPK	1.75	1.35	30%
UREA	0.77	0	-
AN	0.62	0	-
KCl	5.21	3.74	39%

The sharp rise in fertilizer import can be attributed to the following factors :

1. The single issuance of the whole year's TRQs made it possible for concentrated deliveries ;
2. Sufficient rainfall and favorable weather conditions in some of the farming areas in first half of 2002 led to increased fertilizer demand and import ;
3. The increased permit quantity led some importers to overestimate actual demand and sharply increase fertilizer import, especially DAP.

2.2 Fertilizer Export

China's fertilizer export during January-August 2002 was 1.53 Mt, down by 16% from the same period of last year. Urea export was 0.3 Mt, down by 65%. DAP export was 0.25 Mt, down by 28%. This shows that the Chinese fertilizer industry still lacks competitiveness internationally. (See Table below)

China's Fertilizer Export During January-August 2002 (in Mt)

	Jan-Aug 2002	Jan-Aug 2001	Increase by %
Total	1.53	1.83	-16%
DAP	0.25	0.35	-28%
NPK	0.08	0.09	-11%
UREA	0.3	0.85	-65%
AN	0.6	0.02	133%
KCl	0.24	0.16	51%

3. <u>CHINA'S FERTILIZER PRODUCTION DURING JANUARY-AUGUST 2002</u>

3.1 Fertilizer Production

2002 has witnessed rapid growth in China's fertilizer production.

During January-August 2002, China's fertilizer output totaled 23.92 Mt (nutrient tonnes, same below), up by 11.88% over the same period of 2001. The output of nitrogen fertilizers was 18.33 Mt , up by 11.73% ; phosphates 5.13 Mt, up by 14% ; and potash fertilizers up slightly to 0.46 Mt. (See Table below)

China's Fertilizer Output During January-August 2002 (in Mt)

	Jan-Aug 2002	**Increase in % over 2001**	**Estimated annual output in 2002**	**Total output in 2001**
Total	23.92	11.88%	36.00	33.35
N	18.33	11.73%	27.28	25.26
of which UREA	10.53.	9.17%		
P_2O_5	51.31	13.72%	8.00	7.39
K_2O	0.46	4.93%	0.72	0.70

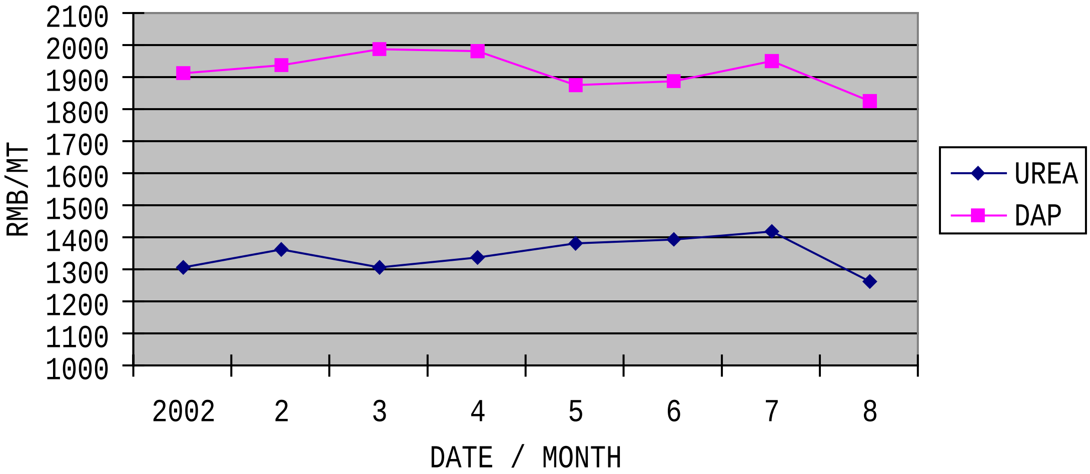
In the first half of 2002, China's domestic fertilizer production and sales boomed for some time. Domestically manufactured urea was selling well, which was rarely seen in the past few years. Domestically manufactured DAP also gained widespread recognition, and rose significantly in both production and sales.

However, compared with the previous years, fertilizer production cost in China also went up due to tight supply of energy resources (coal) and increased cost of raw materials (phosphate rock, ammonia, sulphur, and natural gas).

Therefore, the overall Chinese fertilizer industry for the year will show little improvement in their bottom line even with the increase in sale prices.

3.2 Price Changes

In 2002 fertilizer prices fluctuated in a wide range in the Chinese market. The national average retail prices of urea and DAP during January-August 2002 is shown in the following chart :



The price curve shows the obvious correlation between urea and DAP prices and the peak and off-peak application seasons. The market for the second half of 2002 is less than promising.

3.3 Market Characteristics

The 2002 Chinese fertilizer market has the following characteristics :

First half 2002 : both production and sales flourished, and fertilizer imports jumped. Plenty of rainfall and favorable weather conditions in many of the farming areas led to an upsurge in fertilizer demand, which consequently stimulated fertilizer production.

Second half 2002 : demand will shrink and competition will intensify. During the Autumn season, severe drought in some areas has lowered fertilizer demand, but at the same time both import and domestic production kept growing. This will certainly lead to intensified competition. For instance, China’s annual consumption of DAP is approximately 5.0 Mt product. 2002 domestic DAP production will exceed 2.50 Mt, and DAP import during January-August alone has already reached 3.56 Mt. It is certain that DAP supply far exceeds demand.

4. OUTLOOK ON THE CHINESE FERTILIZER MARKET

After China's accession into the WTO, the fertilizer industry, like all other industries, will be increasingly integrated into the world economy, and we expect to see the following developments :

4.1 Steady but Slow Growth in Fertilizer Demand in the Next 2-3 Years

China's fertilizer consumption in 2001 totaled 38.41 Mt (nutrient tonnes), and is estimated to reach approximately 42.0 Mt in 2005, growing at an annualized rate of 2.5%. (See Table below)

China's Fertilizer Consumption by Year (in Mt)

Year	1999	2000	2001	2002 (estimated)	2005 (estimated)	Annual increase by % during 2002-05
Total Consumption	**36.837**	**37.082**	**38.41**	**39.50**	**42.00**	**2.5%**
N	24.471	24.455	25.476	26.30	28.00	
P2O5	8.909	8.365	8.888	9.00	9.50	
K2O	3.457	4.262	4.046	4.20	4.50	

4.2 Nitrogen Production To Remain Steady While Phosphates and Potash Production To Increase Sharply During the Next 2-3 Years

We estimate that by 2005 China's phosphates production will exceed 9.00 Mt (P_2O_5), and potash production will reach 1.20 Mt (in terms of K_2O) as the 1.0 Mt (MOP) project goes into operation at the Qinghai Salt-Lake Potash Co. Ltd.

4.3 Globalization of the Fertilizer Industry and Acceleration of Fertilizer Exports

In South-East Asia, China's geographical advantage will give the country an edge in fertilizer exports.

4.4 Structural Realignment of the Fertilizer Industry Will Speed Up

In the near future, a number of large competitive conglomerates will emerge in the Chinese fertilizer industry.

4.5 Market Competition Will Intensify

Fertilizer marketing and distribution channels will become more integrated and centralized. A fertilizer network system, represented by Sinochem, combining network marketing, logistical management and agrichemical services will take shape.