China's energy crisis will rock the whole world Country's power failure looms over Europe's own crisis - but there may be a silver lining AMBROSE EVANS-PRITCHARD28 September 2021 â€¢ 12:43pm

The time-honoured cure for high energy prices is high energy prices. Demand wilts.

It is happening in front of our eyes with breath-taking speed in China, the elephant in the global energy boat. Chinese coal stocks are down to 18 daysâ€™ cover, deemed dangerously low by Beijing. It has long been the nightmare of Communist Party planners that the US might weaponise Chinaâ€™s dependency on fuel imports in a crisis.

State-run China Energy News said thermal coal inventories at power plants are critically low. â€œWe are looking for coal everywhere, but no matter how high the price is, it is not easy to find,â€ said one utility.

Plants cannot pass on the surging cost - hitting $300 a tonne in places, up fourfold in a year - and are losing money on a systemic scale. One producer said his plant is losing a dime on every kilowatt of power. Banks are pulling credit lines.

Regions accounting for 70pc of Chinese GDP are rationing power to industrial users, and in some cases have halted operations altogether.

Large parts of north-east China are facing power cuts for several hours each day, hitting traffic lights and cell phone masts. Yicai Global warned of power outages and water shortages until next March.

Guangdong in the south is to halt the use of lifts in office blocks below the third floor. Air conditioners should not be set lower than 26 degrees at businesses and households. Electricity is being rationed for cranes at the port of Tianjin.

Dozens of plants processing soybeans, feed and vegetable oil have been suspended. The steel, cement, aluminium and chemical sectors are under restrictive orders to varying degrees, facing staggered production to avoid peak hours.

Several large firms in the Zhejiang textile hub have been shut until the end of this month. Others are facing de facto triage based on relative energy use.

â€œWith market attention now laser-focused on Evergrande and Beijingâ€™s unprecedented curbs on the property sector, another major supply-side shock may have been underestimated or even missed,â€ said Ting Lu, China strategist at Nomura.

The Japanese bank expects Chinaâ€™s economy to contract by 0.2pc this quarter and barely eke out any growth over the rest of the year. That is a double-dip recession with Chinese characteristics.

It is puzzling that global markets have been so insouciant about a power crisis in Asiaâ€™s anchor economy. The slowdown is happening just as fiscal stimulus fades in Europe and America, and as Western central banks start to tighten in the face of incipient stagflation and a rapidly rising misery index.

What can possibly go wrong in global equity markets still at nosebleed P/E ratios?

While this column does not give investment advice, as a personal precaution I have liquidated most of my modest salarymanâ€™s portfolio and intend to ride out the early autumn with 80pc in cash until risk and reward come back into plausible alignment.

Nor am I buying Anglo-Saxon or eurozone â€œsafe-havenâ€   bonds, given rising structural deficits and the imminent retreat of the chief buyers amid so much debt issuance. The auction of two-year US Treasuries last night was a shocker, the worst cover ratio since December 2008.

Talk of a Chinese â€œLehman Momentâ€   as developer Evergrande collapses with $309bn of debts has obscured the greater danger. Xi Jinping has deliberately precipitated a crunch in Chinaâ€™s encephalitic property sector via his Three Red Lines, deeming a purge necessary to safeguard social order and prevent the further misallocation of resources.

Construction accounts for a quarter of Chinese GDP and half of the worldâ€™s diggers, cranes, and cement mixing. It diverts funds from the green, hi-tech, robotics, AI, cloud computing, and advanced semiconductors sectors, where the struggle for superpower mastery is really taking place.

â€œBeijingâ€™s determination to suppress the whole property sector, not the fallout of Evergrande, is what represents the major near-term risk to Chinaâ€™s growth and financial stability,â€   said Ting Lu. Land sales were down 64pc in August from a year earlier. They are the leading indicator of the building industry.

You could say that Xi has brought forward a denouement bound to happen because Chinaâ€™s workforce is shrinking by three million a year, marriages have fallen by a third in seven years, household formation has slowed, and rural migration has all but ended.

Buyers will be progressively scarcer, rendering the developer model of pre-selling homes to cover past costs a slow-motion Ponzi scheme.

The property squeeze is compounded by a parallel squeeze on carbon. Xi has promised peak CO_2 emissions by 2030, a 25pc cut per unit of GDP by 2025, and a 3pc cut in energy intensity this year.

He knows that China is paying a high credibility price for foot-dragging as Europe and the US launch green deals (nobody can hide behind Trump any longer), and may soon face a carbon border tax in its top markets if it is not careful.

Energy-saving edicts are raining down. Party cadres have been mobilised to pursue CO_2 crimes, and are reportedly doing so with the zeal of the Cultural Revolution. The state planner (NDRC) says 20 Chinese provinces have failed to meet this yearâ€™s goals on cutting energy intensity.

Nomura says nine have received â€œLevel 1 warningsâ€ , including Guangdong and Jiangsu, 35pc of Chinaâ€™s economy between them. Woe betide the Party officials responsible.

The steel, cement, and aluminium industries face production caps by the industry ministry (MIIT). They stole part of their allowance over the first half, and must cut back this half to compensate. That means drastic falls in steel output. It has already begun and is hammering iron ore prices, along with miners such as Vale and BHP Billiton.

Chinaâ€™s energy crunch is happening for much the same reasons as in Europe. Covid upset the rhythms of the global fuel market. The weather was extreme: drought hit hydro-power, and the hot summer boosted air conditioning. The result was an explosion in demand for coal and gas.

The cost of liquefied natural gas in Shanghai reached $26 MBBtu, luring away shipments that would otherwise have gone to Europe to replenish depleted inventories. China is now the worldâ€™s biggest LNG importer.

In August it bought 6.4m tonnes, compared to 4.9m in Europe and Turkey combined (ICIS data). Put another way, Britainâ€™s gas crisis is a function of Chinaâ€™s industrial cycle.

Yuriy Vitrenko, Ukraineâ€™s gas and pipeline chief, told me over the weekend that demand destruction is already working its brutal cure and that global gas prices have probably peaked. That might seem hard to believe with storage so perilously low. The futures market for UK contracts show prices continuing to rise in seasonal contango, hitting 187p per therm in January.

But markets roll over when you least expect. I donâ€™t wish to pick on Goldman Sachs, and agree that depressed investment in upstream oil and gas implies a fossil supercycle in the early 2020s. But I watch with a jaundiced eye as the bank raises its crude oil forecast to $90 this year, in part citing gas to oil switching for power plants.

Goldman issued its infamous $200 call for crude in 2008 at the exact top of the price spike. We now know that core Europe was already in recession by then and that Americaâ€™s subprime debacle was nearing its climax, with giant pillars of Fannie Mae and Freddie Mac already crumbling.

If China is slowing as hard as doubters suspect, it will do the world a big favour and head off a political crisis in Europe and the UK this winter.

No elected government can easily survive loss of control over energy security. Nor should it. It may also head off a backlash against net zero policies at a delicate moment in the transition, before the benefits of cheaper post-fossil energy become self-evident, and there is no looking back.

So unless you are a climate denialist, raise a glass to Xi Jinping.