TransitionAsia
ACCELERATING EAST ASIAN CORPORATE CLIMATE ACTION

PUBLIC POLICY AND PRIVATE FINANCE: 5 THINGS TO FOLLOW IN JAPANESE STEEL FINANCE IN THE NEXT 12 MONTHS

1. HISTORY REPEATS ITSELF. THE G7'S FOCUS WILL SOON SHIFT TO UNABATED COAL IN IRON AND STEELMAKING.

2021 was a pivotal year for coal power and climate finance. South Korea, followed by the G7 agreed to "take concrete steps towards an absolute end to new direct government support for unabated international thermal coal power generation by the end of 2021, including through Official Development Assistance, export finance, investment, and financial and trade promotion support." This had a major impact on the three Japanese "mega banks" financing of coal power projects, especially in Southeast Asia.

China followed suit. At the UN General Assembly in September 2021, China announced it would support green energy development and stop building coal-fired power stations abroad. Three days later, the Bank of China pledged to end funding for overseas coal power and coal mining projects.

Following the same pattern, the steel decarbonisation agenda has been rising to the surface at the last three G7 meetings in Germany, Japan and Italy and although the focus has been on the standards, definitions and demand side to date, lobbyists remain convinced that the direction of travel is a call to phase out the finance and build of unabated coal in iron and steelmaking capacity, especially next year in Canada.

Table 1: G7 ironmaking capacity pipeline (ttpa)

Country	Total capacity	Announced	Construction	Operating	Phasing out
Canada	13,264	2,500	-	4,050	4,998
France	17,400	6,500	-	5,600	5,300
Germany	42,327	9,350	-	3,200	29,047
Italy	11,500	2,000	-	2,000	-
Japan	92,824	-	50	72,658	8,580
United Kingdom	10,170	-	-	-	7,770
United States	47,212	6,000	-	30,396	2,090

Source: Global Steel Plant Tracker, April 2024

We understand that Japan has been pushing against the G7 Industrial Decarbonisation Agenda (IDA) and its Climate Club on different topics but we also believe that Japan has a unique opportunity in the case of iron and steelmaking: with declining production of steel in Japan, no iron making capacity announced (and very little in construction), little competition overseas for steel finance and no stranded assets resulting from such a policy, Japan could be open to climate diplomacy focused on the industry.

2024/5 probability : **Medium** Impact: **High**

2. IS METALLURGICAL COAL NEXT FOR BANK ESG POLICIES? JAPANESE BANKS ARE EXPOSED.

The three Japanese mega banks that had the most to lose from the end of coal power finance are also exposed to the iron and steelmaking supply chain. That is, the financing of metallurgical coal mining.

According to the Banking on Climate Chaos report, Mitsubishi UFJ is in the top 10 banks for financing metallurgical coal mining and SMBC and Mizuho are in the top 20. Their investments totalled USD 258m in 2023 and just over USD 3bn for 2016-2023. More broadly, Japanese banks make up four of the top five financiers of metallurgical coal expansion outside China. Overall, Japanese banks "provided more than 29 percent of banking support to companies developing such coal supplies excluding China between January 2016 and June 2023."

We believe metallurgical coal exclusions will start to proliferate as a result of ESG concerns and this will impact steel companies and their financiers. La Banque Postale, Société Générale, BNP Paribas, CaixaBank, Cathay United Bank, Lloyds Banking Group, Macquarie, HSBC, and Westpac have such policies. And steelmakers are in the firing line.

Recently Nippon Steel has been considering new metallurgical coal mine investments because of high coal prices and energy security concerns. It has metallurgical coal mining interests in Australia and Canada. We wonder when exclusion policies in metallurgical coal finance might catch up with these unsustainable plans for expansion.

2024/5 probability : **Low** Impact: **High**

3. WHAT IS GREEN STEEL? DEFINITIONS AND STANDARDS TO UNLOCK FINANCE AND TRADE ARE ON THE HORIZON.

By the time COP29 has finished in Azerbaijan in November 2024, we anticipate alignment on green steel standards. COP28 saw the agreement of broad principles led by the WTO: "The Principles call for establishing common methodologies on measuring greenhouse gas emissions within the iron and steel sector in order to accelerate the transition to near-zero emissions."

Key benchmarks like The ResponsibleSteel International Production Standard V2.1 were launched in May 2024, while The Global Steel Climate Council's standard came out last August. We understand that the IEA and the Industrial deep decarbonisation initiative of the United Nations Industrial Development Organization (UNIDO) will lead a discussion on harmonised standards as the latter develops "a globally recognised target for the public procurement of green steel and cement" in which there will be sufficient give and take between all of these organisations to get alignment. The view of organisations like ResponsibleSteel is that it will be a confidence boost and stimulus to the financing of a range of green steel projects and trade.

As an example in Japan's context, the Japanese government has recently approved a bill allowing a tax credit (a de facto subsidy) of up to JPY 20,000 (USD 130) per tonne of low-carbon steel production to steelmakers. However, the classification of green steel products eligible for support is to be defined in the coming months, and should be done so in a clear way so that producers can be aware and fully incentivised to tap into the benefit. By the end of this year, the question "what is green steel?" might have a short(er) answer.

2024/5 probability: **High** Impact: **Medium**

4. WHAT DO YOU GET FOR USD 500M? GREEN STEEL SUBSIDIES GROWING FAST.

We support Japanese steelmakers in their call for subsidies. Nippon Steel, "Japan's biggest steelmaker, is calling on Tokyo to provide at least 2 trillion yen (USD 17.3 billion) in subsidies over almost three decades to meet net zero carbon targets as it seeks to stay competitive against China and other global rivals. Nippon Steel needs the money to compete on "equal footing," according to Hideo Suzuki, the managing executive officer overseeing its net zero initiative."

There is a clear international trend here in the last 18 months. In the US, Cleveland Cliffs received USD 500m in March 2024 from the US Department of Energy for H2-DRI-EMF capacity where it will fund the transition of an existing blast furnace to a 2.5mtpa "Hydrogen Ready" Direct Reduced Iron (DRI) Plant and two 120 MW Electric Melting Furnaces (EMF)". The subsidy is 38% of the project cost. In the UK, Tata Steel received USD640m in September 2023 to replace two blast furnaces at Port Talbot in the UK with one electric arc furnace. The subsidy is 40% of the project cost. In Spain, ArcelorMittal received USD500m in February 2023 from the EU for a new renewable hydrogen-based direct reduced iron plant in Gijón. Alongside a new electric arc furnace (EAF), the plant will substitute the current blast furnace. The subsidy is 46% of the project cost. Importantly, all these projects had timetables, production targets and credible technology pathways.

In Japan, the government also provides significant amounts of subsidies for the steel sector at ¥449.9bn (or USD 2.9bn). The green steel funding is divided between two different types of steel technology: hydrogen (H2) in a blast furnace (also known as COURSE50) and DRI-EAF primary steelmaking. But in contrast to the examples above, we believe much of this support is flawed, as the former is essentially upgrading a blast furnace with hydrogen use and carbon capture and storage (CCS) rather than true low-carbon steel production.

Nevertheless, there is a generous USD 854m for H2-DRI and EAF technology that can reduce emissions intensity by over 90% compared to conventional blast furnaces. It is crucial that Japanese government funding is directed towards high-impact decarbonisation. Indeed, as the subsidy debate grows and more public finance flows, we believe subsidies or tax credits should come with the strict condition that the subsidy is tied to standards for low-carbon steel with deadlines for operation and targets for production, like the international case studies above.

Like other markets, this is also about moving existing subsidies from "brown" to "green". It is not strictly about the availability of finance. For example, the massive investment of USD 5bn in the ArcelorMittal/Nippon Steel joint venture at the Hazira steelworks, a greenfield BF-BOF investment by JBIC and Japanese mega banks, should be the last of its kind and public and private finance should be following the trend in the case studies above to green steel.

2024/5 probabilty: **High** Impact: **High**

5. INVESTORS ARE ENGAGING. STEEL COMPANIES HAVE TO RESPOND WITH COMMITMENTS AND AMBITION.

Japan's steel industry is increasingly gaining attention from large institutional investors that are looking to decarbonise their portfolios. Some of the largest steel companies in the world are in China, but climate disclosure and opportunities for shareholders to engage companies are nearly non-existent. Alternatively, Japan's policies on disclosure and stewardship are some of the best in the region, and shareholder engagement on climate is a growing trend. Since 2020, when Mizuho Bank became the first listed company to have a climate-related shareholder resolution filed, momentum has only increased, including on Japanese utility J-POWER, first in 2022 and then in subsequent years.

Scrutiny on the decarbonisation strategies of JFE and Nippon Steel in the 2022 and 2023 Annual General Meeting (AGM) seasons, respectively, led to JFE committing to periodic reviews of its climate practices alongside stakeholders and Nippon Steel committing to producing studies on how to shift steelmaking from BFs to EAFs. These initially "friendly" engagement approaches have since escalated, demonstrating the commitment of a range of international and Japanese actors, culminating with this months AGMs. The filing of three shareholder proposals on Nippon Steel, all of which received support of over 20% from shareholders marked the first climate-related shareholder proposal on a steel company in Asia. Additionally, leading proxy advisor ISS is understood to have supported all three of the shareholder proposals in their sustainability advice (and two of the three in their general advice), providing further insight into investor sentiment. Investors are now engaging steel companies successfully. Will 2025 be the tipping point for shareholder action in Japan?

2024/5 probability: **Medium** Impact: **High**