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Carbon tax may dent steel sector's recovery

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MALAYSIA'S commitment to decarbonisation is taking shape, with the government confirming that a carbon tax will be introduced in 2026.

While this presents an opportunity for Malaysia to price carbon and reduce emissions, investors are concerned about its potential impact on Malaysian export competitiveness.

Prime Minister Datuk Seri Anwar Ibrahim recently gave the reassurance that the carbon tax will be implemented in a realistic manner, aiming not to deter investors.

However, beneath this assurance lies a more complex reality for Malaysia's heavy industries, particularly the steel sector.

The proposed carbon tax, set to target the iron, steel and energy sectors by 2026, could eventually expand to other critical sectors, including those already under the European Union's Carbon Border Adjustment Mechanism, such as cement, aluminium, fertilisers, electricity and hydrogen.

This expansion aligns with international frameworks regulating these sectors.

The complexity arises from the fact that Malaysia's steel manufacturers are among the highest emitters of greenhouse gases, primarily due to their reliance on fossil-fuel-powered blast furnaces and energy-intensive production processes.

This positions the sector as a natural target for a carbon pricing regime aimed at driving industry players toward sustainability.

Final details of the tax, such as the price per tonne of carbon dioxide, scope and thresholds are yet to be released.

It is clear, however, that the tax will significantly affect major steel players in Malaysia, with financial and operational ramifications, as noted by TA Securities Research analyst Raymond Ng Ing Yeow.

"The added tax burden could increase operating costs, particularly for those with high emissions intensity and legacy infrastructure," he tells *StarBiz 7*.

However, he says it will be difficult to quantify the exact financial impact, as details on the carbon tax structure and computational methodology have not been disclosed yet.

"Those with stronger balance sheets and prior investments in cleaner technologies will be better positioned to weather the transition," he adds.

Surely, the impact will not be uniform across all steel players.

Companies such as Ann Joo Resources Bhd and Malaysia Steel Works (KL) Bhd, which operate integrated steel plants with higher carbon intensity, are expected to bear the brunt of the new levy.

These firms are particularly exposed if the tax structure penalises direct emissions from upstream production processes.

Companies like CSC Steel Holdings Bhd, which focus on downstream cold-rolled operations with inherently lower emissions, may not be so badly hit although they won't be entirely insulated.

The carbon tax could raise input costs across the supply chain. What complicates the outlook is the sector's already precarious financial situation.

- Steel players facing cash flow constraints and operating with outdated, emissions-heavy facilities are likely to bear the brunt

- Most listed steel counters are already trading at depressed multiples due to prolonged demand weakness and subdued average selling prices

Steel makers in Malaysia already face multiple headwinds, including low average selling prices due to global oversupply, weak domestic demand, and cheap imports from China.

In such an environment, passing on the carbon tax burden to customers would be extremely difficult.

As Ng points out, producers will have to absorb most of the cost in the near term, eroding already thin profit margins.

"Although carbon tax may further pressure razor-thin margins, we foresee limited downside to current valuations.

"Most listed steel counters are already trading at depressed multiples due to prolonged demand weakness and subdued average selling prices.

"The carbon tax, however, could signal a protracted earnings recovery cycle, given the added capex burden for facility upgrades and the structural shift required to meet sustainability compliance," he explains.

He believes that steel players are not in a position to pass on the additional cost to end-customers, at least in the near term.

"We anticipate that the tax burden will largely be absorbed by producers initially.

Over time, if cost pressures persist and margins remain suppressed, we do not rule out production optimisation strategies, including partial relocation to cheaper areas or investment in cleaner, more efficient facilities," he adds.

Catalyst for change

This anticipated margin squeeze could be a catalyst for change.

The tax is intended not just as a punitive measure, but also an incentive for companies to transition to cleaner operations.

"Carbon taxation is intended to encourage sustainable, environmentally friendly practices.

This could lead to a strategic pivot towards renewable energy, but it may take some time.

"As steel manufacturing is inherently power-intensive, current green energy solutions may not be reliable and scaled enough to support industrial operations in the near future," says Ng.

The more forward-looking players are expected to accelerate investments in low-carbon technologies such as electric arc furnaces, carbon capture systems, and renewable energy integration.

However, such investments require capital, time and technological adaptation – factors that not all steel makers are in a position to manage quickly.

Moreover, while there is long-term potential for these initiatives to improve competitiveness and reduce exposure to future carbon costs, the upfront capital expenditure means earnings recovery could take years.

Investor sentiment will also evolve as the carbon tax takes effect.

While most steel stocks on Bursa Malaysia already trade at low valuation multiples due to cyclical weakness, the tax could become a tipping point for environmental, social and governance-conscious capital.

Investors, especially those with environmental mandates, are expected to increasingly favour companies that demonstrate tangible progress in reducing their emissions footprint.

Steel makers that invest early in compliance and sustainability may enjoy valuation premiums, better financing access, and new business opportunities linked to green supply chains.

Regionally, Malaysia is not in uncharted waters.

Singapore was the first South-East Asian country to implement a carbon tax in 2019, initially set at S$5 per tonne of emissions, with plans to increase it to S$80 by 2030.

Oil giant, Shell recently exited its refinery business in Singapore, having paid more than S$25mil in carbon tax, impacting its businesses.

Indonesia introduced a modest carbon tax in 2022, focusing on coal-fired power plants with plans to expand it into a broader emissions trading framework.

Thailand approved a draft ministerial regulation in January to integrate carbon tax, a carbon pricing mechanism on oil and oil products, under the Excise Tax Act.

This regulation aims to fulfill Thailand's national targets to achieve carbon neutrality by 2050 and net zero greenhouse gas emissions by 2065.

Compared to these peers, Malaysia's 2026 target gives industries more time to prepare, though the absence of policy clarity could cause inertia or sub-optimal investment decisions in the interim.

The success or failure of Malaysia's carbon tax will ultimately depend on design and implementation.

A pricing structure that is too aggressive could undermine industrial competitiveness and risk production flight to countries with weaker environmental regulations.

Conversely, a tax set too low may fail to meaningfully reduce emissions or stimulate green innovation.

The country's pledge for a sector-specific, phased rollout offers a degree of reassurance, but what industry really needs now is clarity on pricing, timelines, reporting obligations and incentives for early adopters.