

China may miss price recovery in Q4

The worst seems to be over for steel prices, which have been spiraling downwards since last summer. De-stocking, both in the form of producers cutting output and consumers running down inventories, is widely expected to get over by the fourth quarter of 2005. This, coupled with rising oil and energy prices, which will add to production costs, should keep the price of steel buoyant until the end of the year. Hurricane Katrina, which has caused flooding in New Orleans, limiting the supply and distribution of raw materials like scrap steel and liquid hydrogen, will also give steel prices a boost, but that would take some time.

Recently, Arcelor, the world's second-largest steel maker, said that it was aiming to raise steel prices in the fourth quarter as steel stocks held by clients had mostly returned to normal levels. A year ago, prices doubled from 2003 because the market created a real shortage by building inventories on concern of an

anticipated tightness in supply due to heavy Chinese consumption, said a Tokyo-based metals trader. But the price increased on speculation, not real demand, and so it led to a glut in the market and a fall in prices. Western steel producers responded by announcing production cuts of almost five million tonnes for the second and third quarters of this year.



“Having been fairly disciplined in cutting steel production, western producers now seem fairly confident the worst has passed in the steel market, and that prices may stabilize and even improve,” said JP Morgan’s metals analyst Jon Bergtheil. In the past two months, most investment houses, from Credit Suisse First Boston and Morgan Stanley to Merrill Lynch and Goldman Sachs, have raised their view of the steel industry. Analysts are now predicting prices will average \$460-\$480 a metric ton this month and over \$500/ton in October, up from close to \$400/ton in August.

Japanese steel makers benefit from auto industry, China demand

Japan’s top three steel makers raised their net profit forecasts the back of rising prices due to strong demand from the automotive and

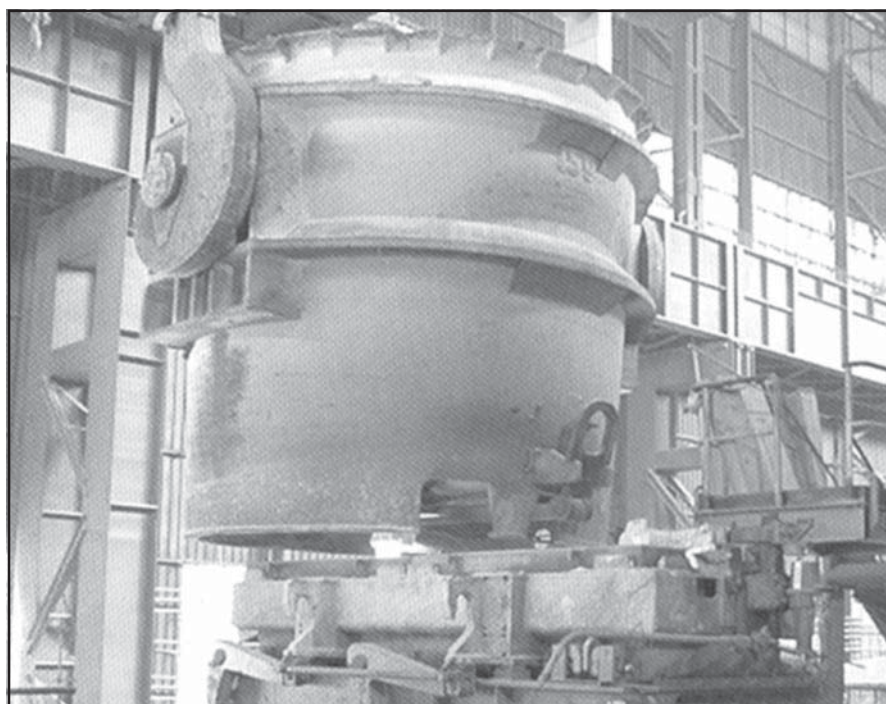
shipbuilding industries. Nippon Steel Corp., the world's third-largest steel maker, upped its forecast for the first fiscal half ending September from Y130 billion to Y180 billion, and raised estimates for the full fiscal year ending March 2006 from Y265 billion to Y310 billion. JFE Holdings Inc. revised up its fiscal half-year outlook from Y140 billion to Y150 billion but left its full-year forecast unchanged at Y290 billion because of the government's temporary suspension of its engineering unit's participation in public works tenders. Sumitomo Metal Industries Ltd. raised its profit outlook for the first half of the fiscal year from Y45 billion to Y72 billion, and for the full year from Y120 billion to Y143 billion.

Analysts said that Japanese steel makers had another reason to cheer in China's consistently strong demand for high-end steel. China still lacks sufficient capacity to meet domestic demand for higher grade steel, which should support higher prices for these products. Japanese steel makers have a large focus on high-end steel. At Nippon Steel Corp. for example, about three-quarters of production is high-quality steel for the auto and

shipbuilding industries.

China unlikely to see similar recovery

In China, however, high inventory levels and a continued increase in output will limit steel's upside potential in the domestic market. The



capacity for steel production in China is expected to reach 490 million tonnes by the end of next year, according to the China Iron and Steel Association, while analysts were earlier expecting capacity to expand more modestly, to 420 million tonnes. Steel production this year is forecast to reach 322 million tonnes, up 17% from 2004, despite China's recently implemented national steel policy, which encourages industry consolidation rather than rapid

expansion in capacity.

Analysts point to recent price cuts by China's Baoshan Iron & Steel Co. as an indication the steel market in China is unlikely to recover despite a revival in global steel prices. Baosteel had held off dropping prices in the third quarter thanks to its strong order book

for higher-quality products, and was hoping the market would turn the corner in the fourth quarter to allow it to rollover prices, but it was forced to play catch-up with other market players who earlier cut prices to secure orders. The listed arm of China's largest steel maker, Shanghai Baosteel Group,

said recently that it expects Chinese steel prices to head lower in the second half of the year and slashed prices for its products by up to 17%.

