Steel Industry in Inflation -A Review

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Introduction

Inflation and the consequent slowdown of the global economy have a severe impact on the steel industry. As recession spreads across the world, steel demand, production and prices are falling, revealing a clear depression for the steel industry. The recessionary pattern in global steel market has revealed its impacts on the factor markets as well. Demand for key raw materials for steel such as iron ore, ferrous scrap and coal has declined. As a result of production cuts, labour demand has also weakened and major layoffs have been announced.

It needs to be kept in mind that steel is critical to global infrastructure. The demand for steel is created by construction and infrastructure development, all kinds of appliances, ships and automobiles, as well as the production of coal, natural gas, electricity, and raw minerals. The low domestic demand situation prevailing in the steel industry is further expected to lead to changes in trade policy in many economies, by encouragement to exports to support domestic producers. The slowdown in output growth has hampered the

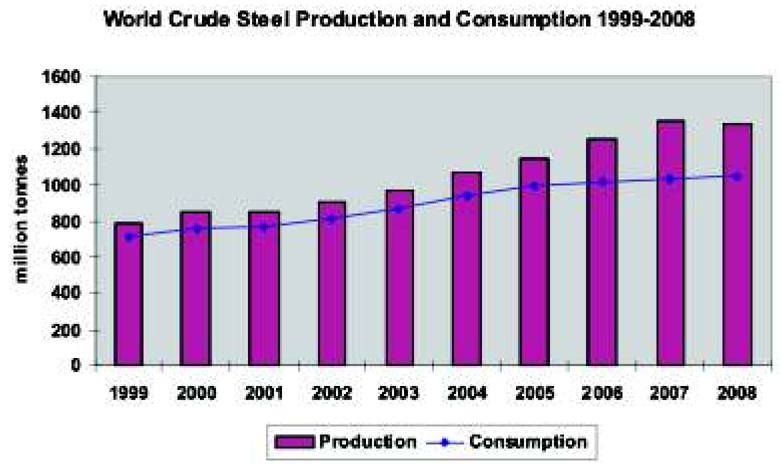

Figure1: World Crude Steel Production and Consumption of Finished Steel (in million tons)

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growth of this sector. Essentially, the steel industry has tremendous forward and backward linkages in terms of income and employment generation, the growth of an economy is very closely related to the quantity of steel consumed by it. Historically, the global steel industry, apart from being subjected to cyclical ups and downs of demand and prices, has suffered from structural deficiencies of large unutilized capacity and high degree of fragmentation. The slowdown in output growth has hampered the growth of this sector. In March 2009, India was the only country which registered a positive growth in steel production, while major economies like the US, Japan, Europe and even China went southward – with negative growth. This performance is commendable from the Indian perspective, despite automobile, capital goods and industrial productions receiving a setback in recent months due to global downturn. Yet, the question remains how far the Indian steel industry will be able to sustain its growth. The challenge looms large in the wake of lower domestic demands and fall in global need for steel and iron ore.

Global Scenario

Figure 1 represents the trends in the growth of the crude steel production and consumption in the world. Total production of Crude steel in the world was 1329.7 million tons in 2008 as compared with 788.7 million tons in 1999 with an average annual growth rate of 7 percent per annum. World crude steel production reached 1,329.7 million tons in 2008 a decrease of 1.2 percent as compared to 2007.Steel production declined in nearly all the major steel producing countries and regions including the EU, North America, South America and the CIS in 2008. Approximately 90 percent of the global steel demand during the past five years has taken place in the emerging or developing nations of the world mainly in industrialization and infrastructure. This growth in finished steel consumption is based on two key factors. Firstly, apparent consumption growth over the last five years was above the level of real demand. The talk of shortages of raw materials has even prompted buyers to carry higher stock levels than previously considered necessary. Low interest rates have made this exercise much less painful than in the past. Secondly, China and its emergence as a growing

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economic power has transformed the world steel scenario. For the steel industry, it brought about a greater balance in the demand-supply equation. However, over the past 10 years, China till now is the world's biggest steel producer with an annual steel output exceeding 100 million tons, a position held since 1999. This growth of steel demand in China has been averaging 10 percent annually on a compound basis, with the per capita steel consumption of 300 kg per annum. China's crude steel production in 2008 reached 502 million tons, an increase of 2.6 percent on 2007, its production volume has more than doubled within five years, from 222 million tons in 2002. China's share of world steel production continued to grow in 2008 producing 38 percent of world total crude steel. Asia produced 770 million tons of crude steel in 2008, 58 percent of world total steel production, 1.9 percent growth over 2007. The EU-27 produced 199 million tons of crude steel in 2008 recording a decrease of 5.3 percent compared to 2007. In 2008, steel production in North America also decreased by 5.5 percent over 2007. The US produced 91 million tons of crude steel, a decrease of 6.8 percent. Overall, the CIS showed a decrease of 8.1 percent in 2008.

Table 1: World steel prices

World Steel Prices US $/ton	Hot Rolled Steel Coil	Hot Rolled Steel Plate	Cold Rolled Steel Coil	Steel Wire Rod	Medium Steel Sections
Nov 2007	615	833	688	584	853
Dec 2007	630	837	705	598	859
Jan 2008	639	847	716	621	871
Feb 2008	699	887	772	687	905
Mar 2008	800	978	890	758	970
Apr 2008	915	1065	985	852	1042
May 2008	998	1160	1080	920	1105
Jun 2008	1073	1225	1144	1005	1184
Jul 2008	1099	1307	1186	1067	1234
Aug 2008	1093	1300	1179	1062	1227
Sep 2008	973	1243	1046	977	1154
Oct 2008	865	1150	940	811	1045
Nov 2008	716	1000	802	676	898
Dec 2008	565	901	659	609	780

Note: Steel price information last updated on 1st Mar 2009.
Source: MEPS Steel Prices On-line.

In the last 6 months, steel manufacturers have cut production to maintain prices, but the prices are still low as the global economic downturn stunted demand. Service centers, which usually run higher stockpiles, are having difficulty selling steel they bought at higher prices and lowered inventories as demand faded. According to the survey conducted by Michelle Applebaum Research, 65 percent of respondents said inventory levels in March stood at less than two months supply. That was up from 56 percent in February. The number of respondents who described their inventory levels as too high when compared with demand fell from 69 percent in February to 47 percent in March. But 71 percent of respondents reported they will lower inventories in the coming months, only a slight decline from 75 percent in February. For the steel industry, 41 percent expect a slowdown compared with 56 percent in February. The economic downturn continues to take a toll on businesses, however, as 47 percent reported customers paying less promptly than 3 months ago, up from 38 percent in February and the highest level in five and a half years.

Steel demand in all countries is linked to fixed capital investment, which in turn is highly dependent on capital availability. Tighter credit conditions will reduce construction activities and other related projects. Lower confidence also has a strong impact on the spending on durables such as automobiles, appliances and other steel-intensive goods. As a consequence of the global economic meltdown, construction activities and capital investment are slowing down in emerging economies. The investment in the real estate industry is showing signs of slowing and housing prices are dropping in many major cities

Price Outlook

Steel prices have fluctuated especialy wildly in 2008, following the major macroeconomic trends of rapid inflation during the first half of the year and then financial crisis and recession. During November 2008 industrial production in G7 economies fell by 6.9 percent year on year – the largest decline since the deep recession of 1975. In China, GDP growth in 4th quarter of 2008 was reported to be just 6.8 percent implying a quarter on quarter fall in economic activity of up to 1.7 percent. Much of this slowdown was brought about by policies designed to reduce perceived overheating in the property market. Since the middle of last year, there has been a stream of new government initiatives designed to improve sentiment amongst potential home buyers. Interest rates and deposit ratios have been cut to improve affordability and the conditions on second mortgages have been eased substantially or virtually abandoned.

The high input costs of raw materials resulted in recession in the steel industry, though infrastructure development drove demand for steel. Iron ore prices have increased by 85 per cent in last year, while coking coal prices rose by 200 per cent. The global steel industry also faced pressure on their margins from the rise in costs, but these increases were absorbed by the market through steel price hikes. While iron prices remain stuck at these high levels, steel prices constantly changed according to supply and demand and depending on the type of steel product. Steel prices have fluctuated especially wildly in 2008, following the major macroeconomic trends of rapid inflation during the first half of the

year and then financial crisis and recession.

After peaking in July/ August 2008, slowdown in global demand for steel nosedived during September 2008 which led to a dramatic drop in steel prices and there was no sign of any

Table 2: Steelmaking Raw Material and Input Costs

Year/ Month	Thermal Coal $/tonne	Coking Coal $/ton	Iron Ore C/dmtu	Natural Gas $/1000m3	Steel Scrap $/tonne
2007 Jan	55	94.3	84.7	302	264-270
2007 Feb	56.7		84.7	302	280-285
2007 Mar	59.3		84.7	302	295-310
2007 Apr	60.1	94.6	84.7	281.9	315-320
2007 May	60		84.7	281.9	295-305
2007 Jun	66		84.7	281.9	295-300
2007 Jul	72.1	95.1	84.7	280.4	280-290
2007 Aug	74.3		84.7	280.4	275-285
2007 Sept	73.3		84.7	280.4	280-290
2007 Oct	80.2	97.8	84.7	308.2	275-280
2007 Nov	90.6		84.7	308.2	280-290
2007 Dec	97.5		84.7	308.2	295-310
2008 Jan	98.3	106.1	140.6	369.7	385-400
2008 Feb	141.4		140.6	369.7	390-405
2008 Mar	126.7		140.6	369.7	490-510
2008 Apr	131.8	113.9	140.6	428.4	510-530
2008 May	142.7		140.6	428.4	570-580
2008 Jun	171.2		140.6	428.4	635-660
2008 Jul	192.9	122	140.6	517	630-640
2008 Aud	169.7		140.6	517	385-390
2008 Sept	160.7		140.6	517	240-245
2008 Oct	115.7	129.1	140.6	576.7	220-225
2008 Nov	98.8		140.6	576.7	205-210
2008 Dec	84.3		140.6	576.7	230-235
2009 Jan	85.7	n/a	140.6	576.7	270-275
2009 Feb	80.8		140.6	520.9	200-205
2009 Mar	65.4		140.6	412.9	195-200
2009 Apr	68.1	n/a	n/a	309.6	200-210

Source: steelonthenet.com

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improvement to the end of the year. Most of it is reflected on the performance of the steel stocks in the market. Even if one discounts for the negative speculation and undue and exaggerated fear that is pulling all stocks down, the steel company stocks have been hit by specific and genuine concerns. As a result of static high iron prices and falling steel prices, many steelmakers are getting squeezed and even shutting down. While most of the world's industries are experiencing similar readjustments to falling prices, the rigid nature of iron prices makes the impact all the greater on the steel industry. Some small- and medium-sized businesses, as well as firms that are overextended, will not be able to continue manufacturing steel. Bigger steel companies whose finances are secure will find advantages over their competitors and might benefit from the chaos. As the global economy contracts, a transitional period of mergers, acquisitions, occasional bankruptcies and overall consolidation will likely ensue.

Conclusion

The world economy has slowed much more rapidly than had been expected in the middle of last year leading to a significant deterioration in the near term outlook for commodity markets. A transformation in the global iron and steel industry will have geopolitical consequences because it will affect those economies that import high volumes of iron while export lots of crude steel or steel products, such as China, Japan and Ukraine. Most notably in Ukraine, where steel is a driving force behind the economy and where the balance of power between Russia and the West is at stake, and in China, where the steel industry contributes to growth and employment and thus to social stability. Other countries, from Brazil to India, also will feel repercussions as they attempt to maintain growth and stability amid the global recession. A sustained recovery in demand is not expected until next year and there are risks that 2010 could be weak as well - for example due to the possibility of further financial shocks to the economic system or delayed implementation of stimulus packages. On the supply side, the recent fall-off in commodity prices and reduced availability of credit are leading to production cuts and to the abandonment or delay of many projects. This is expected to support the eventual recovery in markets. But the expectation that development in emerging markets will generate underlying strength in metals and minerals demand over the long term remains broadly unchanged.