Economic recovery to keep Middle East steel industry afloat

- Steelworld Research Team

The rippling affect of global economic slowdown in the beginning of the year followed by signs of recovery during the mid and Asian-economies led turnaround towards the mid made a difficult year for steel industry in the Middle East in 2009.

Construction sector in the UAE witnessed a massive drop in costs during the past 12 months. Prices of most materials dropped by more than half compared to 2008. Producers and distributors experienced a difficult year as reduced cost coupled with falling demand led to severe drop in revenues. Many of them had to cut their production by more than 50 percent and send several staff on mass leave in order to reduce operational cost. The UAE market experienced oversupply of steel in the beginning of the year and therefore, producers had to cut production, in an effort to curb excess supply in the market. By the last quarter of 2009 imports had drastically reduced.

Apparently, local producers did not cut production in the region despite dwindling demand scenario. Since, the local supply was enough to meet the severe decline in demand, imports of steel products mainly used in construction sector hit the most. However, analysts believe that the year 2010 will bring three cheers for them due to indications of global economic recovery. Producers had to severely reduce their profit margins in order to discourage further imports. Prices during the H1 of 2009 remained fluctuating. The year started with rebar prices at US $485 in January from US $460 in December, increasing to US $510 in February before falling to the lowest price of US $420 in March. Rebar prices again moved up in April to US $455 and increasing further to US $495 in May and falling again to US $455 in June.

In the third quarter rebar prices turned around to shot past US $500 per ton for the first time since February last year and had reached the highest since November 2008. Industry analysts however felt the increase could be temporary as there has not

been enough evidence of real growing demand which proved later in the year.

Rapid changes

The rapid changes taking place during the last few months have certainly had a destabilising effect on the steel markets, and by extension on other industries too; the price of steel billets fell from US$1200 per ton down to US$270 per ton. This is also applicable to the scrap prices and the prices of some other finished products. With the continued recession facing the steel sector as a result of declining demand in most markets, and available cash liquidity decreasing, forecasting what the state of this industry will be over the next few months is very difficult and is one of the great challenges facing the steel markets' not only at the level of the Middle East, but also at the world level.

According to the monthly statistics released by the Turkish Automotive Manufacturers' Association, in December 2009 Turkey's motor vehicle output totaled 95,389 units increasing by 143 percent Y-o-Y and up by 24.38 percent over the month of November. In December, Turkey's passenger car output totaled 48,917 units up 139 percent, its commercial vehicle production reached 44,853 units up 149 percent while tractor production amounted to 1,619 units up 94 percent all compared to December 2008.

In 2009, the country's motor vehicle output totaled 884,466 units, decreasing by 25 percent Y-o-Y. Also in 2009, Turkey's total passenger car output declined by 18 percent to 510,931 units, its commercial vehicle production slid by 32 percent to 358,674, while the tractor output of Turkish producers decreased by 40 percent to 14,861 units all compared to the previous year. The overall production capacity utilization rate of the Turkish automotive industry in December was 73 percent while the rate was 57 percent for the whole of the year.

However, signs of an improvement in the steel industry have begun to appear in a number of markets. Steel consumption in one of the biggest Arab markets, Egypt, has seen strong growth during the first quarter of this year, achieving an increase of 21 percent during 2008 compared with 2007. Consumption of long steel products reached five million tons in 2008 against 4.1 million tons in 2007. Also, the steel imports in the markets of the region have been elevated during the first quarter of this year compared with the same period in 2008. The level of imports from Turkey in March 2009 was one million tons. The markets of the Middle East are the largest steel products importers, with a figure exceeding 30 million tons throughout the whole of 2008, according to international statistics.

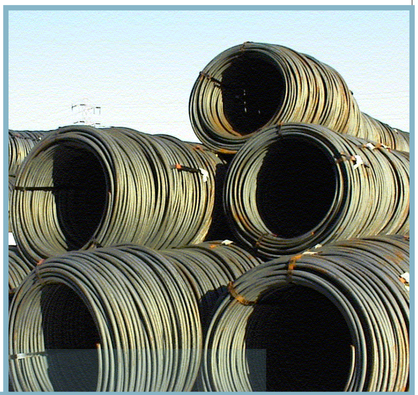
Unsaturated markets

Based on this reality and not on prediction or forecasts, it may be said that the steel markets in the Middle East have great potential reinforced by the available need and the fact that most steel markets are still unsaturated. The average per capita consumption of steel products is still less than the world consumption average, with some limited exceptions in some countries of the Middle East region. This potential is also reinforced by the fact that the economic growth rate, despite being affected by the global economic crisis with levels expected to be the lowest for many years, is still in the positive side, on contrast to many economies of developed countries where growth is expected to be negative.

An insight into the coming period can be glimpsed seen in the intention of many companies to go ahead with the implementation of their projects in spite of the crisis conditions. Some companies also see this crisis as a good opportunity to acquire other projects or to carry out some merger operations with similar companies. Steel industry in the Middle East has been undergoing rapid expansion over the last few years to meet the needs of a fast-expanding construction sector.

Dubai World crash

Dubai World, which rocked global markets on November 25, 2009 when it announced it would seek a debt standstill on US $26 billion, staved off US $4.1 billion Islamic bond defaults by Nakheel after it got US $10 billion bailout from Abu Dhabi. Now, it is moving to present its restructuring plans to creditors. Dubai World disappointed creditors in December by making little



progress in its intention to request a formal standstill but said that it would pitch a proposal soon.

What is interesting about the development of the Middle East steel industry during the last few years is the speed at which it has grown over the last eight years. The growth rate of this industry in the Middle East was second only to China in world terms. This acceleration is evident in the number of new projects that have been set up, between the expansion of existing mills. The start up of new facilities, over one hundred new projects have been initiated, which has increased the production volume and made it much easier for producers to respond to the needs of the domestic markets, in particular, in the field of long products production, the growth of which has been driven in large part by the construction sector.

In recent years, this rapid growth has imposed certain challenges on producers for one thing, they need to consolidate their position as producers and improve their ability to compete and continually develop. There is also the external challenge posed by the nature of a market such as the Middle East, which is considered one of the most open and attractive world markets for a number of big international players. Perhaps the biggest challenge for local producers has been the number of companies trying to enter the market at a time when weak demand means the field has become too narrow to accommodate a large number of competitors, each of whom is trying to gain market share.

Economic conditions

Without doubt, the economic conditions that have hit the construction sector have been a big shock for steel producers, who have gone from experiencing strong demand for their products to a downturn in a matter of months. However, what makes the markets of the Middle East better able to get out of this shock in a shorter time is the fact that steel is a key need for most countries of the Middle East, and considered a necessity rather than a luxury. This reality reflects the growing demand for popular, middle-income housing developments, while the demand for luxurious or welfare housing has declined. The biggest proportion of steel products go to satisfy growing demand in the housing and infrastructure sectors, which are sectors supported by the governments and directly connected with the social and living situation of people.

The development of the steel industry in the region has been connected with the recent surge in economic prosperity followed by the crash of Dubai World. For instance, much of the revenues resulting from high oil prices in recent years have been directed towards investing in and setting up steel projects. Improvements in the price of steel have also encouraged investment in this sector. In addition, the industry has had a guaranteed return, and its export capabilities as well as its ability to satisfy the increasing needs of domestic markets, mean it has been a very attractive investment.

Nevertheless, the steel industry in the region is relatively nascent, and therefore more vulnerable to crises. Many of the new players who entered into the industry in the last few years are not accustomed to or familiar with the cycles of this industry, and the upwards and downwards conditions through which it usually passes over certain periods of time intervals that have become increasingly short in recent years. Perhaps the clearest indication of the impact of this crisis on the region's steel industry is the slowing down of the implementation of certain projects, the postponement of some and the canceling of others. Projects in the public sector were less affected than those in the private sector.

Regional outlook

With high stockpiles, particularly in the UAE, and slackening demand, steel prices are expected to remain subdued in the range of $500 a ton. This would be a third of what they were at their peak in mid-2008, but a slight increase on their recent lows recorded in November 2008, according to a recent report. With the Middle East being a major importer of semi-finished products and current global steel demand weak, the region is likely to become a focus for international steel suppliers, with the prospect of dumping returning. If this occurs,

governments are likely to re-impose custom duties on steel imports in an attempt to protect local manufacturing, although such moves will do little to bolster prices.

According to Middle East Steel 2009, the longer-term outlook for the Middle East steel market is more promising. Given an expected rebound in the oil price in 2010, fuelling economic growth and capital investment, steel demand is set to rise over the next five years. Major, government-backed players in the regional steel industry appear to be well insulated from the effects of the global slowdown. However, the smaller, private sector firms, especially in the downstream arena, look vulnerable to a prolonged economic downturn, raising the possibility that there may be some much-needed consolidation in the industry.

The global downturn and the lack of available project finance have put the brakes on regional expansion projects, particularly in the downstream sector. In the upstream sector both Bahrain-based holding company Foulath and Brazil's Vale (formerly CVRD), which are planning major investments across the region, maintain that their projects will proceed despite the difficult trading conditions. If implemented, the projects will take regional pelletising capacity up to 68 million tons per year by 2013. The slowdown will have a major impact on Iran's much-publicised plans to quadruple steel production over the next five years, which were already in trouble due to a lack of finance and bureaucracy prior to the onset of the credit crunch. However, a growing issue for the regional steel industry going forward will be the availability of competitively-priced gas feedstock. With competition for limited supplies intensifying from the regional oil and utilities sectors, new gas allocations are likely to cost much more than in the past, when steel producers could count on a gas price below $1 a million BTU.

UAE imports to remain stagnant this year

Analysts forecast the United Arab Emirates steel demand to match the level of 2009 during the current year with more than USD 40 billion still projected to be spent on construction projects despite the debt troubles at Dubai World. Dubai World is the leading player but there are also a lot of other players in Dubai and the United Arab Emirates construction markets. Turkey exported 2.2 million tons Dubai in 2009. Turkey accounts for about 90 percent of the UAE steel imports. The UAE is forecast to import about 2.4 million tons of steel in 2009, or 41 percent of its forecast steel demand of 5.9 million tons for the year.

Demand stabilises

Recession in Middle East market continues as the impact of global economic recovery to have a ripple affect after two-three months. Demand for flat steel products stabilized in recent days. According to reports, cost of Russian hot rolled steel in Turkey, Iran and other countries of the region makes averagely US $550-560 per ton for delivery in January and February, cold rolled steel for US $630-640 per ton. Ukrainian companies offer hot rolled steel for US $515-540 per ton, but cold rolled coils go on the same level with Russian material.

Egyptian companies have put March quotations for hot rolled coils for Middle East countries at the level of US $585-590 per ton FOB. Experts agree that while the Q1 of 2010 demand for flat steel in Middle East will be relatively low and even further hopes placed only on Turkey.

However, situation in the regional long product market is even more cheerless. By some estimates, rebar consumption in UAE in 2009 has reduced more than twice in comparison with the previous year, considerable recession is observed also in other countries of Gulf region, except Iraq only. The perspectives for the H1 of 2010 are rather unclear.

During recent weeks the local prices for rebar in Middle East countries remained relatively stable in the first fortnight of the current year. In UAE local companies offer it for US $490-500 per ton delivered, in other countries which are large importers of rebar the prices are varying between US $520-550 per ton from a steel yard. However, Turkish companies have raised their local and export prices for rebar approximately by US $10 per ton.