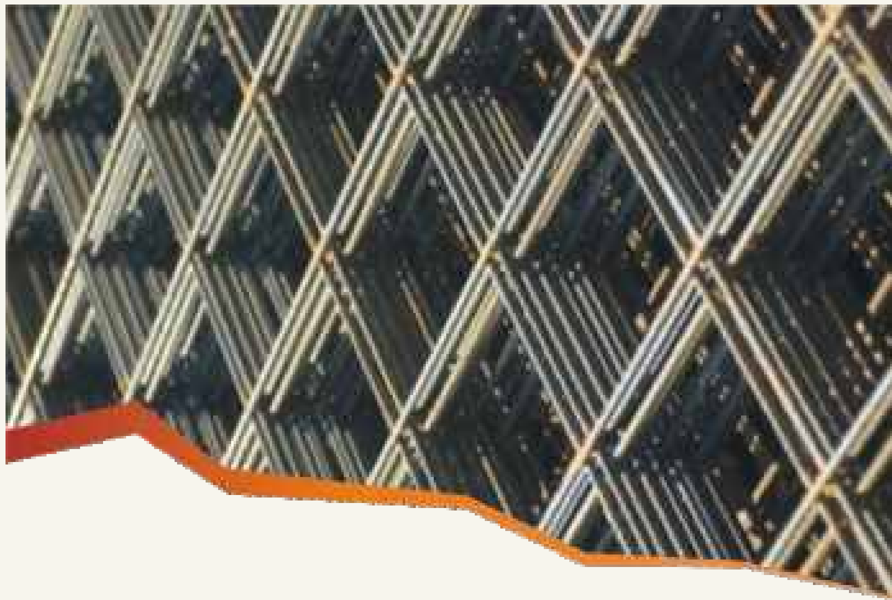
Gulf Steel Industry :
Struggling to Cope with Global Economic Slowdown

- Steelworld Research Team

> "The slowdown in construction across the Gulf could lead to a slump in demand for steel"

Global economic slowdown has hit steel industry in the Gulf region badly. In the region, oil driven boom imports were expected to fall 20 percent this year, as billions of dollars of construction projects were put on hold or delayed. As a result, steel demand in the region is expected to fall over 35 percent this year turning it as an uneven market for steel exporters after the slump in real estate crushed demand even more steeply than on the global market. Gulf imports are expected to fall to 18 million tons this year from 22.5 million tons in 2008.

The slowdown in construction across the Gulf could lead to a slump in demand for steel, an industry expert said. The Dubai Multi Commodities Centre (DMCC) estimated that steel consumption in the region could drop to 9 million tons this year, down from about 14 million tons in 2008. Demand is set to come off with announced slowdowns – less on-site consumption occurring per active project, stoppages of active projects, and less building project starts. Construction in parts of the region has slowed with projects delayed or even cancelled. A report by the research firm Proleads stated that $582 billion worth of projects in the UAE are now on hold. But, this is not indicative of the entire region as countries like Abu Dhabi and Qatar are continuing to see growth. The construction industry accounted for more than 80 percent of the Gulf steel demand.



Stabilising Demand in UAE

Demand for steel in the United Arab Emirates (UAE) has fallen 40 percent so far on the year 2009 due to the slowdown in the construction sector but for now, demand seems to have stabilised. UAE steel demand is expected to fall to about 3.5 million tons in 2009 from around 5.5 million tons in 2008. In 2009, Abu Dhabi is showing strong demand, but demand in Dubai is down. Meanwhile, looking at the favourable orders from Dubai, Abu Dhabi-based Emirates Steel Industries (ESI), a wholly owned government factory, is planning to double its production capacity by 2014 to 6 million tons a year either through acquisitions or setting up greenfield projects. The company claims to have a competitive cost structure which allows it to displace imports. Till now, it has spent Dh8 billion in building ESI's phases I and II. There will be an additional Dh10 billion investment by ESI by 2014 to either build new capacity or to acquire a new facility that would take its annual capacity to the targeted capacity of 6 million tons by that year. Today, the company's annual capacity stands at 2 million tons a year and current targeted annual capacity is 3 million tons which the company targets to achieve by 2011.

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In the largest Arab economy, Saudi Arabia, demand this year was expected to drop to 5.1 million tons from 7.2 million in 2008. Saudi Arabia has witnessed a 26 percent drop in automobile manufacturing and a drop of 22 percent in construction which lead the drop in steel demand. As per report, cheap steel flooding in from Europe and Turkey as a result of weakening currencies could be a further blow for the Gulf steel market.

Meanwhile, hundreds of billions of dollars of construction projects have been put on hold in the Gulf Arab state since the financial crisis curbed property investment. The near $100 (Dh367) fall in oil prices from last July's peak has brought an end to an economic boom in the world's top oil exporting region. The neighbouring emirate of Dubai is the location of many of the UAE's delayed construction projects. Abu Dhabi leads the UAE, holds over 90 percent of the country's oil wealth and has felt the impact of the financial crisis and global slowdown less than Dubai.

Weaker Risk Appetite

The construction sector makes up the bulk of steel demand in the Gulf and an infrastructure boom fuelled by record oil prices has slowed due to lower energy prices and tighter credit conditions. A key factor for the slowdown in construction in the Middle East has been the rising cost of project and trade financing as banks display a weaker appetite for risk. According to an analyst, fortunes have shifted drastically since the financial crisis deepened in the second half of 2008. Companies have slashed thousands of jobs and USD 583 billion worth of building projects in the UAE federation have been put on hold.

Globally, the automotive industry and construction are the main consumers of the USD 800 billion market. Estimates for consumption in 2009 varied from 9 million tons to 13 million tons in Gulf States, down from about 14 million tons in 2008. Lack of demand has boosted inventories in the region over the past five months, with some analysts putting them at around 2 million tons. "While the cost of money interest rates in most

economies is down, regionally it remains relatively high. This is particularly the case in the construction and real estate sectors, where lenders' concerns on the financial health of the sectors and their borrowers translate into significant risk premiums being applied," an analyst said.

Arab governments have adopted a series of measures to thaw frozen credit markets to help spur corporate borrowing and boost waning investor confidence. Saudi and the UAE cut interest rates in January, but the move has done little to boost the ability of construction firms to source the money needed to buy steel and other materials, despite falling commodity prices. Steel rebar prices are now pegged below USD 500 a ton, down from the peak of around USD 1,200 a ton seen in the Q4 of 2008.

Subdued Market in 2009

Steel prices in UAE are likely to remain subdued in 2009 due to high stockpiles, slackening demand that will lead to the metal trading in the range of $500 a ton. At $500 a ton, the prices 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 the recent Research and Markets report, Middle East Steel 2009, 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. 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.

Middle East Steel 2009 reports that 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 Brazils 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 (t/y) 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.

The report warns, however, that "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."

This report provides a comprehensive review of the sector in the GCC since 2005 and assesses the outlook for one of the regions most dynamic industries up to 2015. In addition to providing in-depth analysis of supply

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and demand, projected investment levels, the role of the private sector and the technology of wastewater treatment, the report gives a country-by-country overview of the wastewater sector for Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE by emirate, with detailed tables, charts, graphs and maps.

Rebar demand to Decline 30%

Demand for reinforcement steel used in construction, or rebar, in the Gulf Arab region is expected to fall by at least 30 percent in 2009, according to the latest estimates by Qatar Steel. “The demand will start declining and the decline will be in the range 30 percent for 2009 considering the (global) financial problems and falling oil prices,” he said. Infrastructure and construction demand had pushed rebar prices to above $1,500 per ton in July. Falling demand since then has pushed them to around $500 per ton currently. The mills in this region have to consider cutting production. They have to consider the worst-case scenario to cut their costs. There was a strong correlation between the oil and steel prices as energy sector revenue had helped finance the construction boom in the oil-exporting region. About $850 billion will be spent on construction projects in the next 3-5 years. But the high level of stocks at the ports, warehouses and the yards of the steel mills was a major issue. Rebar stock levels in the region were around 1 million tons, lower than the 2 million tons they had estimated in October. However, rebar prices are likely to edge up in 2009.

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Threat from Aluminium

A collapse in steel demand from the ailing auto sector may be foremost on steelmakers' minds at the moment, but rising government fuel standards are the greater cause for alarm as aluminium and magnesium steal market share. While the auto industry consumes only about 6 percent of the world's crude steel production, mills have long counted on steady growth in car sales to generate new business - growth that may now be in doubt as aluminium and other super-light materials replace steel to help meet tougher environmental regulations. The threat became more apparent as U.S. President Barack Obama introduced the most aggressive proposal yet to boost US auto fuel economy standards, which would encourage automakers to invest in fuel-saving technology. Under the new standards, US passenger vehicles and light trucks must raise fuel efficiency by five percent yearly to an average 35.5 miles per gallon (6.62 litres/100 kilometres) by 2016. The current law requires a similar gain by 2020. To achieve weight-saving and improve fuel efficiency, it's inevitable to replace steel to lighter materials, as steel accounts for around 50-60 percent of total vehicle weight. The incentives are clear: fuel efficiency usually rises by 5-10 percent for every 10 percent reduction in vehicle weight, and per-vehicle steel consumption is well over one ton. That can be a big blow to already reeling steelmakers, such as Nippon Steel, POSCO and AK Steel, which count auto firms as a major client and face reduced demand as auto output falls by as much as 20 percent this year. Already automakers are increasingly stripping off sheets of steel in favour of lighter and more stylish materials, such as aluminium, magnesium, titanium, plastics and carbon fibre.