European Steel Producers on Output Cut Spree

- Steelworld Research Team

The American economic crisis storm arisen out of hurricanes followed by the bankruptcy of Lehman Brothers and buy-out of Meryll Lynch, has affected US dollar reliance economies. Importantly, those economies that were largely dependent upon exports to America crashed thereby, intervening respective local governments to pump huge money into system to increase liquidity.

US government started bailing out with a sum of $700 billion followed by the EU with in excess of 500 billion euros. India was quick to follow with fresh infusion of Rs 25000 crore despite the government's denial of any huge repercussion of American economy's fallout. But, worse to mention was the steel sector especially in the Europe. As steel producers located in European region were largely dependent upon exports to America, the slackening demand hampered their sentiment resulting into lower sales to the latter. Infrastructure in European region is said to reach a saturation level. Therefore, steel producers in these regions look for their sales to the American countries and growing economies in Asia so that their revenue remains intact.

Production Cuts

Meanwhile, amid signs of deteriorating demand in America on housing sector slump, European steelmakers are preparing production cuts by the end of the year in the face of a deeper-than-expected economic slump, although German companies are likely to cope better than their rivals with weaker demand. The

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The steel market is set to weaken in 2009, resulting in lower volumes and profit for producers, and most “significant projects” will continue as a result of the recent market turmoil and recessionary expectations, we're increasingly cautious about the industry during the next year or so. Spending on expansion projects and consolidation in the steel industry will continue as companies look to diversify their operations, cut costs and become more flexible.

OAO Severstal, Russia's largest steelmaker, is planning to cut output as much as 30 percent, showing the global financial crisis is eroding industrial demand. Severstal joins Posco, Asia's largest maker of stainless steel, and Voestalpine AG, Austria's biggest steelmaker, in signaling cuts in planned output this week as demand for cars and buildings weakens and banks holdup project financing. The company may delay plans to build a 5 billion-euro ($6.8 billion) steel plant on the Black Sea coast as it reviews the project's financing. Goldman Sachs Group Inc. cut its 2009 steel price forecast 29 percent. The impact was largely attributed to steel mills in China, the world's biggest producers, that are cutting demand for iron ore and asking miners to postpone deliveries because of slower sales and a lack of credit. OAO Magnitogorsk Iron & Steel, the third-largest Russian producer, announced the 18 per cent reduction in October output from the monthly average.

ArcelorMittal and ThyssenKrupp Hide Possibility Publicly

ArcelorMittal, the world's largest steel maker, last month signalled its readiness to slash output by up to 15 percent as prices fall and demand softens faster than forecast. The company said despite the global crisis it expected an improvement in profitability in the second half of the year. Analysts, however, say that the sector is set to benefit from this willingness to cut output rather than compete on prices. Companies are showing a high willingness, such as ArcelorMittal and ThyssenKrupp, Germany's biggest steelmaker, to cut production to meet falling demand. ThyssenKrupp said in private it would be willing to cut production, and publicly they say they do not see the need yet, according to analysts.

ArcelorMittal proposes to extend production cuts at its Kazakh unit and keep about 4,000 workers on leave until October end in response to low demand. ArcelorMittal Temirtau had said that it would cut daily production by 30 percent to 7,000 metric tons for two weeks and put 4,200 workers on leave. The company hoped to resume output as soon as demand rebounds. ArcelorMittal Chief Executive Officer Lakshmi Mittal told Kazakh Prime Minister Karim Masimov on Oct. 3 that temporary production cuts won't derail his plan to double steel output at the company's Kazakh unit by 2014. ArcelorMittal plans to spend $7 billion expanding output at Temirtau to 10 million metric tons a year.

Black Sea free-on-board (fob) prices for long steel, mainly used in construction, have tumbled to around $700 a tonne, from above $1,250 a tonne in late June. Spot prices have been falling for the past four to six weeks, with scrap - an important indicator for long steel products - roughly halved in Europe to around $300 per tonne.

Euro Realities

Euro zone manufacturing activity in September fell to a near seven-year low. Markit PMI showed contractions in France, Italy and Spain were sharper than that seen in Germany. The downturn in order books hit producers of capital goods the hardest. German carmakers have begun cutting production but analysts said the output cut is not as severe as those made by rivals in the region and is a stabilising factor for German steelmakers. Under a hard-landing scenario of uncertainty over short-term demand and a weakening economic environment, Goldman Sachs said it assumed demand and production would be cut by 10 percent in the 27 states in the EU but did not give a timeframe. It said that while estimated fourth-quarter prices were looking to roll over flat on end-third quarter levels, An industry check indicates that production cuts are already planned for 4Q to prevent a large increase in inventories and excess pressure on spot prices. Corus, Europe's second-biggest steelmaker owned by India's Tata Steel, said it would act as needed.

Germany's Salzgitter declined comment on its plans but its CEO Wolfgang Leese had earlier said the steel industry would not escape the impact of the financial crisis but his company would not particularly suffer because of its rather lower exposure to the car industry. Finnish steelmaker Outokumpu said it cut production in line with the demand in the third quarter and repeated that it expected third-quarter volumes to be below the level of the previous quarter partly due to demand weakness. The German Steel Trading Federation has said new orders for January-August were 12 percent better than last year but the latest survey by research institute IFO showed steelmakers have become more cautious in their expectations.

Uncertain Demand

A cloudier macroeconomic climate, brought about by the financial market turmoil, has depressed steel stocks as investors are concerned tightening credit conditions will hit consumer demand. Given the financial market crisis, it is not possible to estimate right now how worldwide demand for steel would develop (going forward). It would be negligent to suggest the credit crisis would have no impact on the industry but many companies have not yet experienced any weakness in demand. Billet in the global market almost halved $600 per ton now from $1200 per ton few months ago. Primary steel producers contribute about 52 million tonnes of the total consumption of 55 million tonnes while the remaining 3 million tonnes is met through imports. According to Joint Plant Committee (JPC) sources, India’s steel production shot up by 3.6 per cent while actual consumption perked up by 9.3 per cent thus widening a production - consumption gap.

Conclusion

Traditionally, steel producers beat the demand slump through production cuts in a cyclic 3-4 years. But, this time economic crisis is deepening. Economists estimate that more number of crisis layers are yet to open thereby, worsening global economic scenario. As steel demand is closely linked with infrastructure which ultimately mirrors the economies, steel uses may fall further on deepening crisis. Therefore, the future of steel looks gloomy at least for the next 2-3 years. After that the existing inventories especially in China and CIS region may exhaust and supply may oversee the demand. However, on rising cost of production amid increasing prices of raw materials may not affect the steel prices immensely.

Analysis of cost of production and earning value of global companies ($/ton)

Company	Cost of production	Earning value/ tonne
SeverStal	450	2574
Tata Steel	460	556
Maanshan	540	515
SAIL	560	694
Posco	680	1170
US Steel	710	1119
Nucor	760	1068
Arcelormittal	760	1548
Thyssenkrupp	762	2562
Corus	850	NA
JSW Steel	NA	803

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