

Russian steel regains pre-crisis level, Brazil struggles inflation

- Steelworld Research Team

Growing risk aversion and the worsening of the sovereign debt crisis in the euro region led steel industry in Brazil and Russia to press a pause button on the speed it had caught post-2008 economic crisis. Since renewed threat has been witnessed from small European countries including Greece, Turkey, Spain etc. where steel industry in Brazil and Russia was closely linked with, many companies, therefore, in these two countries halted their organic and inorganic spreads for uncertainty while others are cautiously moving ahead. Many fear that stringent regulations will push the steel-making industry out of Europe and North America into Brazil, Russia and India.

CSN calls off listing of iron ore unit

Severe economic crisis has led Brazilian steelmaker CSN to put off the long-awaited listing of its iron ore unit, which the company had planned for the first half of this year. Investors have been waiting for the initial public offering of the group's mining assets since at least 2007. But in recent months, Chief Executive Benjamin Steinbruch, who set a deadline of June 2010 for the IPO, said any offering should include parts of the group's logistics unit. CSN could raise up to US\$ 3.5 billion by selling shares of the unit, which could include the Casa de Pedra mine, the Namisa iron ore unit, and some railways and logistics assets linked to the mines. Problems over including Namisa may also be holding up the IPO. CSN is Brazil's largest diversified steel group, with interests in mining, logistics, cement and steelmaking. Now, IPO is estimated to be floated by the end of 2010. By selling shares in the mining unit, Steinbruch could help CSN fetch a better value for its business and raise money for acquisitions outside Brazil. The break-up of the conglomerate, which was born after the privatisation of steelmaker CSN in 1994, signals Steinbruch's belief that flexibility could help all the CSN units capture market share and attain cost efficiency more rapidly.

But the plans have been marred by the debt crisis affecting Greece, Spain and

other countries in the euro zone. The fiscal woes have rattled financial markets since mid-February, and investors worry that austerity measures dictated by a European Union bailout plan could stifle global growth. Risk-taking is suffering as a result, hampering demand for new IPOs such as CSN's iron ore unit. To make matters more difficult for the group, the IPO could compete with the massive US\$ 25 billion share sale by oil behemoth Petrobras, Brazil's biggest company by market value. State-controlled Banco do Brasil is also attempting to sell up to US\$ 5.5 billion in stock by the end of this month. Petrobras' offering is expected to be the largest in the world this year and one of the biggest in history. Lackluster appetite for new share offerings in Brazil has been a constant this year, though five of the

seven IPOs held in 2010 were priced below their original range.

Brazil may cut duties on steel imports

Brazil plans to reduce duties on steel imports in a bid to contain inflation after wholesale prices rose the most in two years. Inflation has been running above the government's 4.5 percent target since January, as the fastest growth in 15 years raises concern that Latin America's biggest economy may be overheating. Brazil's broadest measure of inflation, the IGP-M index, rose 2.21 percent from last month, the highest reading since 2003, led up by prices of iron-ore and wholesale goods. The Finance Ministry, however, could not divulge proposal to cut import duty on steel which is currently hovering around 14 percent. Steel mills,



meanwhile, are resisting efforts by iron-ore suppliers including Rio de Janeiro-based Vale SA to raise third-quarter contract prices after steel prices fell 10 percent from an 18-month high on April 15. Vale, the world's biggest supplier of iron ore, won a 90 percent price increase for April quarter contracts after it dropped a 40-year custom of setting annual prices. Abrupt tax moves, either up or down, could have serious consequences mainly for competitiveness and for Brazil's position in the world, and therefore; should be analysed with great caution, experts believe. Higher interest rates, the withdrawal of fiscal stimulus tax cuts and the financial crisis in the euro region will all help to cool the economy. Mantega said gross domestic product will expand 6 -6.5 percent this year.

Interest rates rise

The central bank, led by President Henrique Meirelles, raised the benchmark interest rate for a second straight meeting on June 9. Policy makers said in a one-sentence statement they lifted the overnight rate to 10.25 percent from 9.5 percent to bring inflation back to target. Economists expect the Selic to reach 12 percent by January. The government of Brazil is cutting spending by 10 billion reais (US\$ 5.54 billion) to help cool the economy before the interest rates take hold. GDP surged 9 percent in the first quarter from the year-earlier period, the most since 1995, the government said. Faster economic growth has prompted analysts to forecast consumer prices will stay above the government's target this year and next. Annual growth of 9 percent is not sustainable, even though Latin America's No. 1 economy has the potential to grow faster than in the past, said Carlos Langoni, a former Brazilian Central Bank President.

The US\$ 1.6 trillion economy has the conditions to keep growing at an annual pace between five percent and six percent. Across Brazil, companies are struggling to keep up with demand that's been rising as unemployment hovers near a record low 6.8 percent,



salaries rise and the 30 million Brazilians who have left poverty since Lula took office in 2003 increase spending.

Russia's steel industry in pre-crisis level

Russian steel has regained its pre-crisis role as a big supplier to domestic clients, but a still sluggish construction sector and looming regulation could slow the industry's recovery. Domestic steel sales, which were about 19 percent below export volumes in 2009, were a priority for Russian steelmakers before the crisis since high demand forced buyers to pay a premium. So far this year, domestic sales have outstripped exports by 7 percent, although they were 41 percent more than exports in 2007, the last full year before the downturn, Citigroup analyst Daniel Yakub said. Factors such as the low number of new building starts have reduced demand and prices for key materials such as rebar. Unless the market turns back to stronger demand, the domestic premium is unlikely to materialise. Steel mills in Russia, the world's third-largest producer, returned to full capacity in the second half of 2009 thanks largely to foreign demand for its low cost steel. The export surge was a mixed blessing for Russian steel since it sold more semi-finished steel abroad and less value-added output at home. The domestic market is for more finished products,

while exports are semi-finished billet, slab or low quality steel, such as HRC (hot rolled coil). Russian steel makers make more money on the domestic market because they sell higher-margin finished products.

Construction steel products such as rebar are the key to domestic demand recovery, since the sector accounted for 56 percent of domestic volumes in 2008, according to analysts at Bank of America Merrill Lynch. At the start of the second quarter demand from builders was rebounding from last year's lows. Demand on the domestic market for construction steel is expected to rise between 8-10 percent compared to last year. Steel consumption by the construction sector is still only 70 percent of pre-crisis levels. Analysts, however, believe that to go to pre-crisis demand levels, a stability is required in global macro environment, oil prices, and more government action to fight local corruption that are major impediments to the growth in the building sector.

Small price hike in automotive steel possible

Profit margins could also fall after Prime Minister Vladimir Putin last month met with leading mill owners to force smaller price hikes for automotive steel. Putin called planned increases of up to 30 percent "inexplicable" and served notice that raising prices further threatens the

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recovery in domestic manufacturing. Analysts said price controls are unlikely to affect construction steel products, as they will fall mainly on sales to state-owned auto makers, machine builders and the railways. Price control probably relates more to machine building and pipe manufacturers. Construction is much more diversified and less state exposed. Ironically, overall domestic steel prices could be heading lower regardless of any government intervention because global steel prices have declined sharply in recent weeks. The problem is the global market, and global sentiment is very negative right now, an analyst said.

Steel output up

The World Steel Association (WSA) reported that the global production of crude steel rose 35.7 percent in April 2010 YoY, with a total monthly

production of 122 million tons. China's domination continued with a 27 percent rise at 55.4 million tons. Brazil reported an output of 2.7 million tons (+56.6 percent), while Russia reported an output of 5.6 million tons (+28.9 percent). Meanwhile, Russian Railways reported that during the January–April 2010 period, railway shipments of steel products increased by 20.8 percent YoY to 23.7 million tons, while manganese and iron ore shipments rose by 15.6 percent YoY, to 32.4 million tons. Analysing the World Steel report, commodity trader Balli Steel said that Brazil, Russia, India and China (BRIC) nations are driving the worldwide steel market while emerging economies and established markets struggle to keep up. Statistics show that the four nations accounted for 58 percent of the global steel production in 2009 – industrialisation and economic growth in each of the four being the chief

drivers. Although India is still a net importer of steel, Russia and China are now net exporters. Brazil has a more or less balanced steel trade. CEO Nasser Alaghband of Balli Steel commented, The BRIC countries are often referred to as emerging markets, but in terms of steel they have become the world's primary markets. This rapid growth over the past decade has largely been driven by China and has coincided with a decline in steel production from many of the more established world economies. More advanced countries are saturated with the types of infrastructure projects which generate large scale steel demand, whilst smaller emerging economies do not have the capital or access to credit required to invest.



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