STEEL OUTLOOK : To Remain Hottest In 2008

Steel is likely to remain the hottest commodity in 2008 with prices set to remain firm throughout the year. An unprecedented rise in raw materials including iron ore, coal, Ferro-alloys etc. is expected to keep the prices up. Most importantly, demand is expected to strengthen substantially even at higher price for infrastructure development for the preparation of Olympic Games 2008 in China and Commonwealth Games 2010 in India. Amid almost a mandate on steel prices firming up substantially in 2008, experts are divided on the extent of surge because of economic, geo-political and demand factors.

In an interview with a private TV channel, J Mehra of Essar Steel Holdings and Seshagiri Rao of JSW Steel, projected the price to go up by 15-20 per cent next year while Nitin Johari, CFO, Bhushan Steel, expects prices to go up by 10 per cent. Mehra and Rao argued that the current spate of price rise in raw materials should be passed on directly to consumers and therefore, a 15-20 per cent rise can be foreseen. But, an estimated a slowdown in demand in the second half may bring down the extent of rise in the first half.

Demand to go Beyond Olympic

Dr. S K Gupta, Director of Jindal Steel, too is circumspect on the extent of price rise in 2008. He feels, “till Olympic Games 2008 gets over, the demand from China, which controls 35 per cent of world production, will continue.” Although its slowdown in demand is less likely, the price rise in raw materials may not reflect that in raw materials. US economy has started signally a recovery and therefore, steel demand is likely to renew from the country. In the last 2-3 years, steel producers have made very good margins that is expected to be squeezed in 2008 because the amount of rise in input cost is unlikely to be passed on to the customers. However, growing demand of steel for domestic infrastructure boom is projected to be met through brownfield and greenfield expansions and imports. The year 2008 is likely to witness a total expansion of 4-5 million tonnes to take the total production/demand up to 51 million tonnes. In the international market, today, steel prices are quoted in the range of $640-650 per tonne which is likely to hit $700 per tonne in 2008. But, this level will remain unsustainable. Steel price will slip to the present level immediately after hitting the psychological barrier. Rupee appreciation, however, may create an imbalance between domestic product and import prices.

Meanwhile, iron ore which has almost trebled in 4-5 years will firm up by 35-40 per cent in 2008. Presently, long term contracts for iron ore is being signed at $140-150 per tonne. India is likely to remain a net importer and exporter of all kinds of steel including crude steel and specialised steel, in the next few years since the domestic industry will meet their commitment abroad. Simultaneously, the internal demand will be met by imports. Of late, Indian steel industry has started importing cold rolled steel. Therefore, the interest of domestic industry should be protected by levying at least 10 per cent differential duty on imports. Cheap imports are likely to plague the domestic industry if the current import duty of 5 per cent is not raised at least up to 15 per cent. Presently, the industry pays 5 per cent import duty on hot rolled (HR) and cold rolled (CR) steel which the industry feels is minimal.

The Mineral Policy Impact

The government may soon adopt a new mineral policy, which will result in higher mineral prices. Today, India has a specific rate of duty per tonne. Iron ore actually as a commodity has different grades and is sold at spot prices. To administer this ad valorem duty that the government is trying to impose, there will be very big administrative hassles, which will lead to a lot of litigations. So what has been told to the government is that there is no issue on increase or a review in the royalty rates. But by keeping it, ad valorem is going to lead to a lot of administrative hassles. Royalty increase is unlikely to prompt steel companies to increase their prices because there are enough margins available there.

Demand to Accelerate

The steel demand is likely to accelerate in 2008. The iron ore prices will be up 30-50% this year. The current landed cost of hot rolled coil is at USD 700/tonne, Dr. S K Gupta informed. Around 30-50% rise in long-term prices in 2008 is foreseen. In the beginning of 2008, there will certainly be a price push up. It is backed up basically by the cost-push. There has been an increase in the cost of production by over USD 100. There would certainly be a pressure. In terms of the demand, it is likely to be as good as we have witnessed in 2007. Experts expect 2008 to be as good in terms of demand as we have seen in 2007. The prices all over the world are showing a sign of moving up. The prices have moved up in the US market; the Chinese market has gone up by about a USD 100.

The increase in raw material price does not necessarily mean that steel price would go up with a flat rate across all sectors. But, the industry will have to go up and some amount of cost absorptions would have to be done through improved efficiencies of the processes. Today, the positive thing for the steel sector is that the demand is quite strong. Even in 2008, it is expected that the demand will go up by 6.8%, which will translate to 80 million tonnes. So, the acceleration in demand growth is much stronger in the year 2008 relative to 2007. Cost-push, of course, is there quite strongly in the year 2008, taking into account the current spot prices of iron ore and coal. Therefore, there is a certainty that prices will go up next year. But if we assume that the iron ore prices will go up between 30-50%, similarly the coal prices will also go up by around USD 30. As far as the long-term is concerned in the next year, it will translate to between USD 75-125 - the increase in the cost-push to the steel industry. If it has to be passed on to the consumer, then the prices have to go up, at least 15-24%, which is the range in which the prices have to go up. Experts expect, taking into account the kind of demand growth in the market and the cost-push, the prices can go up next year.

Technically the demand in the US is going to go up because their inventories have substantially come down in the last one-year. They have been using lot of inventory and they would be compelled to buy more. So technically that demand, which may not be exactly the consumption; would push up the price part of it, and it is already been seen in the US market. The inventories in the European markets have also dropped considerably and they will have to start buying again in the beginning of next year.

Export Duty Rise a Good Sign

The recent increase in duties on export of products - is again a positive factor because first eleven months of the last calendar year, the total exports from China is 64 million tonnes. So, that will significantly get reduced. The increase – mostly will get pronounced in the first half of next year itself.

Today, the industry is seeing almost the landed cost of HR Coils is more than USD 700 here. So taking even at the current exchange rate, there is a gap between the domestic prices and the landed cost of import of HR Coils. Therefore, it can be increased as far as the local prices are concerned.

In India, there is a likely growth of 12-13%, this year it will be almost same - that is what we have witnessed in 2007. There would be some deduction in the imports into India because bulk of these imports was taken out of China and China is not likely to be a big exporter going forward. There will be a drop in that. The industry has seen it now in November itself, compared to May that there is a drop in the exports out of China. Therefore, there will certainly be a big pull on the demand side in India. There is a growth, which is taking place on the brownfield, which we expect by 2010, the present capacity on the big 4-5 is likely to double. So, the Indian growing demand would certainly be met with from the brownfield expansion, which are being undertaken by the major five excluding greenfield at this point in time.

Preferred Options

Worldwide visibility and backward integration both the things are equally important because there is likelihood, as the industry projects, the world demand by 2011-2012 may go up by about by 0.5 (half a billion) tonnes. That means from the present production level of 1.2 billion, it may move upto 1.6-1.7 billion tonnes. Missing one may result into miss out in terms of the production capacity creation. But to be competitive and to make sure that the investments are viable, the upward integration and backward integration would be equally important. They will have to go hand in hand now. In the current circumstances, there is a huge gap between the long-term price and the spot price. Based on that, the expectation is that it will be in the range of between 30-50% increases in the long-term price, which is expected in the year 2008.

Goldman Views

US steel prices may rise more quickly than anticipated to $600 a ton, or 10 percent higher than current levels, as supplies decline, Goldman Sachs Group Inc. said. Hot-rolled coil, used in

automobile manufacturing, may reach $600 before the end of March and could have "more upside beyond that level," Goldman analysts including Aldo Mazzaferro wrote in an investor note. The investment bank said its previous forecast that steel would reach that price by the second quarter was "suddenly too conservative."

ArcelorMittal, the world's largest steelmaker, is charging $120 a ton more for steel for delivery in March compared with December, while AK Steel Holding Corp. has boosted prices $100 a ton since the end of December. U.S. steel prices, about $544 a ton in December, are the lowest in the world and rising freight costs will deter imports, Goldman said. Steel buyers should feel more than a little uneasiness as they approach the seasonally stronger spring and find that they have little inventory, cannot get enough allocation at the domestic mills and must wait a long time and pay even higher prices for the scarce imports. The U.S. imports steel because domestic producers make about 100 million tons a year, 30 million tons less than the nation uses annually.

Low Inventories

Industry executives including Nucor Corp. Chief Executive Officer, Dan DiMicco, predict that steel prices and earnings this year may withstand slowing U.S. economic growth. Steel inventories fell to the lowest in a decade in November and U.S. imports declined 33 percent that month as lower prices and higher costs prompted steelmakers to sell to other regions. Hot-rolled steel sheet rose to a seven-month high in December, as producers passed along higher costs for iron ore and energy.

Falling inventories and imports will keep U.S. steel prices from being harmed by a "mild"' recession this year, Lou Schorsch, the Head of ArcelorMittal's flat-rolled business in the Americas, said in an interview. U.S. steel prices have "never been at this severe a discount to global pricing," Goldman said. Steel on average costs $100 a ton less in the U.S. than in Europe, while current U.S. prices are also about $80 a ton less than Chinese export prices. Freight costs, which have risen, add as much as another $140 to the cost of this material if delivered to Texas, according to Goldman.

Relative Prices

US prices need to rise to $700 a ton and above to become "attractive relative to global levels," the company said, arguing prices will probably gain even in a recession. "Essentially, the U.S. is about 30 percent short of supplying its market in a normal year, and if there were a 5 percent decline in steel demand (typical for a mild recession) the U.S. would still be short and have the same requirement of raising prices to a level that would attract the necessary imports." Nucor, the second-largest U.S.-based steel company, is Goldman's top steel company pick, in part because the company's high dividend and "attractive" valuation may reassure investors even if the U.S. suffers a recession this year, the firm said. Goldman also recommends Reliance Steel & Aluminum Co. and Olympic Steel Inc.

The Projection by Credit Suisse

Benchmark hot rolled coil steel may climb to as much as $900 a metric ton by the end of 2008 because of limited supply, a weaker dollar and rising costs, Credit Suisse Group said. Prices have ``remained stable'' in the export market even as demand growth outside of China has declined in the past 18 months, Michael Shillaker, an analyst at Credit Suisse in London, wrote today in a research note. This shows that the global market is "supply constrained," he said. Outside of China, the world's biggest consumer of steel, demand has rebounded and is currently growing at a rate of 6.5 percent a year, driven by the Middle East, Africa and Russia, Shillaker added.

The dollar has dropped 13 percent against the euro in the past 12 months as the U.S. Federal Reserve cut borrowing costs three times since mid-September 2007. Prices for coking coal and iron ore, ingredients in steelmaking, have surged. Hot rolled coil used to make cars and in construction, fetches 590 euros ($878) a ton in Antwerp, according to Metal Bulletin data. The price has increased 13 percent in the past 12 months. U.S. steel imports dropped about 11 percent in December compared to November as the weaker dollar made foreign- produced steel more expensive for domestic buyers, the American Iron and Steel Institute said. Global steel demand would rise up to 1.46 billion tons in 2011, led by China and Russia, U.K. consulting company MEPS (International) Ltd. said. The world steel demand may go up by 0.5 billion tonnes tonnes by 2011-12. This means from the present level of 1.2 billion tonnes, the total output may go up to 1.6-17 billion tonnes.