

Auto sector to drive flat steel demand

- Steelworld Research Team



The Indian steel sector has been one of the best performers due to a lack of surplus capacity and a strong rebound in demand. This has enabled Indian steel companies to operate at full capacity utilisation and to enjoy a higher domestic premium. In addition, Indian companies are more integrated with captive iron ore, making them low-cost producers. Indian steel demand is back to a 7-8 percent growth rate, recovering from flat growth in last financial year. The prime driver of steel demand has been the construction sector, driven by both housing and infrastructure. Steel demand has also been aided by the recent recovery in auto demand. With a GDP forecast of 8 percent for financial year 2011 and the government's renewed focus on infrastructure, analysts believe that demand recovery will gather momentum.

Indian steel demand has recovered after the slump in September-October due to the sudden cash crunch. Long steel demand has been the major driver, as construction-led demand from both infrastructure and rural housing has been very steady. Due to the slightly weaker monsoon season, experts expect rural housing to slow down slightly. However, urban housing seems to be picking up with lower interest rates, a drop in real estate prices and a better business outlook. The auto sector has been in recovery mode, as companies resumed production following good sales growth for two-wheelers and cars.

India's steel demand is estimated to grow by 2 percent this year to 53.5 million tons due to improved post economic downturn consumption from

automobile and construction sectors, the two promising industries with great futures ahead. The economic indicators of industrial production and manufacturing sector have bottomed out and an improvement going ahead can not be ruled out as the country's economy is set to record a GDP growth of 6 percent a marginal decline from 6.4 per cent forecast earlier.

Steel demand is primarily driven by the construction and automotive segments. The demand for long products, mainly bars and rods, is expected to grow strongly as 57.7 percent of the total planned investment, according to the eleventh five year plan, is towards electricity, telecommunication and railways. In addition, a demand revival in the automobiles and home appliances segments would drive the demand for flat products as well. Flat steel demand has already picked up from automotive segment with waiting period of all cars and commercial vehicles increasing significantly.

Table: 1. Steel consumption - product wise

Product type	Percentage share
Bars and rods	43
Hot rolled coils	26
Cold rolled coils	12
Structurals	10
Galvanised steel	6
Rails	3

Revival in demand from auto sector

A pick-up in commercial vehicle sales reflects improving industrial activities. De-growth in sales of commercial vehicles has slowed down in the past four months, reflective of an upturn in industrial activity. The demand for these vehicles have hit a bottom in the third quarter of the last fiscal and now, is only expected to



pick up, going forward. Vehicle sales recorded a sharp slump in the third quarter of 2008-09 as they declined by 10.4 percent as compared to last year. However, sales showed de-growth of 6 percent in January 2009 and recorded a strong growth of 10 percent in February 2009, 8.2 percent in April 2009 and 11.1 percent in May 2009. Going forward, the twin benefits of softening interest rates and falling inflation is further likely to boost loan availability for households and enterprises, therefore providing a push to vehicle demand. Studies show that steel accounts for 55.5 percent of the total weight of a vehicle, which is a key demand driver for the metal.

Power sector - massive investments on the cards

According to a recent report by Standard Chartered on steel sector, 1 Mw of power capacity addition needs 1.3 ton of steel. Hence, steel demand is expected to be driven by strong infrastructure spending in power and railway sectors which together would account for 45.1 percent of the total infrastructure spending in the eleventh five year plan. As per the plan, capacity addition of 78,577 Mw has been proposed for the power sector entailing an investment of more than Rs 6, 66,500 crore. The total planned investment stands at Rs 20, 56,100 crore.

Table:2. Investments in the eleventh five year plan

Sectors	Percentage share
Electricity	32.4
Roads & bridges	15.3
Telecommunications	12.6
Railways	12.7
Irrigation (including watershed)	12.3
Water supply and sanitation	6.99
Ports	4.28
Airports	1.51
Shortage	1.09
Gas	0.82
Total	100

Source: Ministry of Finance

Consumer durables on rise

Index of consumer durables segment has seen a sharp revival in production post December 2008. In the month of April 2009 it recorded a growth of 16.9 percent for the fourth

consecutive month. Index of consumer durables production reported a drop of 4.2 percent in December 2008. A revival in the sales, therefore, is expected for consumer durables to drive the demand for flat products in future. Further, since the Indian economy is driven more by domestic demand, it is likely to be supported by easing interest rate and lower inflation.

The index of industrial production which has recorded negative to zero growth post December 2008 is likely to improve. IIP numbers for April 2009 have already shown signs of revival, recording a growth of 1.4 percent after de-growing by 0.7 percent and 0.8 percent in February and March respectively. Since, demand for steel is strongly co-related to industrial growth, particularly the manufacturing sector, steel demand may deliver growth. In FY09 as index of industrial production for manufacturing increased by 2.3 per cent compared to 9 per cent in FY08 steel consumption declined by 0.5 per cent in financial year 2009 compared to 11.4 per cent growth recorded in the previous year. The growth in steel consumption in the past has been led by the growth in industrial production and the manufacturing sector in particular. Industrial production over the last 14 years grew at a compounded rate of 6.8 percent and manufacturing sector grew at 7.3 percent. The demand for steel has grown in tandem at 7.6 percent during the same period. Steel demand is more a function of industrial production than GDP. This is more so as India remains a service led economy where services account for more than 50 percent of GDP.

Enhanced capacities to help offset imports

India's steel imports are distributed among four major categories of steel products which include HR coils/strips (39.1%), plates (16.9%) and CR coils (12.4%), the report said. Exports of steel include mainly two products



Outlook



GP/GC sheets and semis which together account for almost 50% of the total exports. Both Tata Steel and JSW Steel would, therefore, be in a position to offset these imports through their increased production capacity of 1.8 million tons and 2.8 million tons which was commissioned in the last financial year.

Substitution effect

Steel scrap on the one hand cuts the steel mills costs and on the other, it exerts price pressure on the producers of pig iron and sponge iron for third party sale. Lower scrap prices provide an important cost advantage to mini sheet mills which produce hot-rolled band through the electric arc furnace (EAF) route since it can be used as a substitute for pig iron and sponge iron. Globally (excluding China) more than 50 percent of steel is manufactured through the EAF route. However, due to a sharp production cut globally, analysts do not expect to see an upturn in the price of steel scrap, which was in short supply till recently. Weaker Korean won, Brazilian real and Russian ruble have provided an edge to major players like Posco, Severstal and Novolipetsk through a much lower cost of production in dollar terms. Since CIS countries, Korea and Brazil have cut down production by 33.5 percent, 22.9 per cent and 42.1 percent respectively, any demand upturn would be faced with higher production due to their cost competitiveness compared to other global players. These three countries contributed 25 percent of the total steel production (excluding China) as on March 2009.

Meanwhile, steel mills, globally, are operating with lower capacity. Therefore, the year 2009-10 is likely to be a tough year for steel consuming sectors. Capacity utilisation as on March 2009 stood at 70.4 per cent compared to an average of 95.1 per cent in 2007 and 89.5 per cent in 2008. Hence, any upturn in demand will be met by sufficient supply and will, in

turn, offset any sharp price increase. A decline in input costs and weaker foreign currencies against the US dollar would further put pressure on prices even as steel mills aggressively contest for volumes to offset their fixed costs.

Good prospects ahead

Flat steel producers, however, are encouraged with demand picking up. JSW Steel Ltd. (JSW) is the largest private steel maker in India with an installed capacity of 7.8 million tons post commissioning of India's largest blast furnace of 2.8 million tons in February 2009. The company has the most modern steel plant with latest technologies for both upstream and downstream processes. It is one of the lowest cost producers in the Indian markets on operational parameters excluding backward integration in terms of iron ore and coking coal. The company's product range is highly skewed towards flat products as the slab manufacturing capacity stands at 5.3 million tons. JSW is an integrated player with limited backward integration in terms of captive iron ore mine. The company currently procures 2 million tons of iron ore from its own mine, 2.5 million tons from NMDC at a contracted price and the balance through spot purchases. In terms of coking coal with the commissioning of new coke oven batteries, the company is expected to be 100 percent self reliant in terms of coke. Coking coal is imported from Australia on a long-term contract.

The public sector Steel Authority of India Ltd (SAIL) is the largest integrated steel producer with a diverse product mix. The company has five integrated steel plants and three specialty steel plants with a crude steel production capacity of 14 million tons. It is self sufficient in terms of iron ore with its own captive iron ore mines but is dependent upon Coal India Ltd. and imports for its coking coal requirement. SAIL achieved saleable steel production of 12.5mt with best ever production of

Table: 3 Change in product mix (percent)

Product	2009	2012(estimated)
Semi finished steel	19	0
Pipes	1	1
Plates	21	16
Rounds / bars	10	24
Coated products	3	5
CR coils / sheets	9	10
Structurals	6	15
Railway materials	8	7
HR coils / sheets	23	22

Source: SAIL

value added products at 3.7 million tons recording an increase of 11 percent. Further, production of crude steel production through energy efficient concast route was highest ever at 66 percent with production of 8.2 million tons. SAIL reduced coke

consumption to 521 kgs/ton of crude steel in FY09 compared to 533 kgs/ton of crude steel. Moreover, increased production through the concast route has helped the company reduce its specific energy consumption from 6.95 Gcals/tonne of crude steel in financial year 2008 to 6.76 Gcals/tonne of crude steel.

Tata Steel Ltd is the world's sixth largest steel company with an existing annual crude steel production capacity of 30 million. Post acquisition of Corus, Nat Steel Asia and Tata Steel Thailand, the company has expanded its global reach with

operations in Europe, South East Asia and India. The Indian operation currently has a production capacity of 6.8 million tons and its subsidiary in Thailand has a capacity of 1.7 million tons for long products. Nat Steel Asia and Corus have production capacities of 2 million tons and 20 million tons respectively. The company's Indian operations of 6.8 million tons are fully integrated with captive iron ore mines satisfying 100 percent of its requirement whereas in terms of coking coal, it has captive mines satisfying 60 percent of its requirement.

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