

## Goliath in the glass house: worse than a bull in a China shop

Picture this: The steel industry of each country lives in its own glass house. Everything is visible — there are no secrets. Goliath, who is representative of the Chinese steel industry’s unprecedented threat to the viability of the non-Chinese steel companies, is circling the houses.

What’s the necessary action for the non-Chinese steel mills to prevent Goliath from entering the houses and destroying them? The needed action is to build a massive cast-iron gate that keeps Goliath on the outside.

One might say that, in this new world, protection against offshore steel deliveries is the trump card.

This evolving steel industry structure is not a happy one for some players:

- The Chinese and other sizable steel-exporting countries will be facing import restraints in a growing number of countries, which will greatly reduce their deliveries (Tables 1 and 2). Yes, protectionism reduces trade.
- Steel-exporting mills delivering only a small portion of their product to affiliated steel-consuming units will find it very difficult to sustain exports, and they will suffer from a lower-value-added export mix than if they had downstream affiliated outlets.
- Steel mills located at deep water ports in the Pacific Basin — there are about 26 of them — will remain in a very



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WSD’s steel experience, steel database and availability of steel statistics are the principles for performing steel forecasts, studies and analysis for international clients. WSD seeks to understand how the “pricing power” of steel companies the world over will be impacted by changes in the steel industry’s structure. The views and opinions expressed in this article are solely those of World Steel Dynamics and not necessarily those of AIST.

Table 1

*China Exports of Steel Products by Country (million metric tons) Source: China Customs Statistics*

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Y-to-Y
Total Exports	20.50	44.12	62.64	59.18	24.58	42.45	48.98	55.60	62.44	93.93	112.40	19.7%
South Korea	5.53	8.82	11.60	13.95	5.56	8.44	9.99	9.90	9.73	12.97	13.49	4.0%
United States	2.38	5.40	4.14	5.02	1.05	1.01	1.57	1.98	2.24	3.47	2.42	-30.3%
Italy	0.52	2.97	3.31	2.65	0.41	1.31	1.19	0.77	0.75	1.54	2.73	77.3%
Vietnam	0.87	1.72	3.37	2.74	1.47	2.42	1.86	2.52	3.86	6.63	10.15	53.1%
Spain	0.20	1.68	2.36	1.17	0.26	0.62	0.70	0.64	0.58	1.02	1.40	37.3%
India	0.42	1.57	2.87	1.95	1.18	3.38	2.60	2.25	1.65	3.81	4.76	24.9%
Belgium	0.23	1.33	2.57	1.88	0.29	0.75	1.58	1.00	0.97	1.53	2.15	40.5%
Hong Kong	1.50	2.04	2.12	1.62	0.52	0.95	0.92	1.66	2.05	2.61	2.71	3.8%
Iran	0.18	0.52	3.14	0.95	0.59	0.56	0.70	0.81	0.89	1.49	2.11	41.6%
Singapore	0.79	1.58	2.16	1.82	0.66	1.05	1.53	2.38	2.93	3.21	3.23	0.6%
Total 10	12.60	27.63	37.64	33.75	11.99	20.49	22.64	23.91	25.65	38.28	45.15	17.9%
% of total export	61	63	60	57	49	48	46	43	41	41	40	—



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Table 2

China's Steel Products Real Consumption (million metric tons) Source: WSD estimates

	2000	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016e
Total Output*	131.5	376.0	466.0	564.0	582.0	694.3	796.3	881.3	951.9	1,086.9	1,125.6	1,123.5	1,058.0
+ Imported	16.0	27.2	18.9	18.0	17.0	21.0	16.4	15.6	14.1	14.7	14.4	12.8	13.0
- Exported	6.2	27.7	52.1	71.0	61.0	24.0	42.4	48.9	55.5	62.3	93.8	112.4	85.0
- Double counting	11.5	38.6	69.8	91.0	100.0	156.3	194.3	221.0	264.5	321.3	351.5	367.8	356.2
Consumption	129.8	337.0	363.0	420.0	438.0	535.0	576.0	627.0	646.0	718.0	694.7	656.1	629.8
Y-to-Y chg %		17.0	7.7	15.7	4.3	22.1	7.7	8.9	3.0	11.1	-3.2	-5.6	-4.0

\*Reported by China Customs Statistics and includes double counting (including imported hot rolled band or cold rolled coil to be galvanized or painted).

competitive exporting environment. For example, a new US\$11 billion 6 million-metric-ton-per-year steel plant in Vietnam is starting up with no good market for the higher-end products that can be produced by its state-of-the-art hot strip

mill. It also has no ownership of downstream steel processing entities in Vietnam or elsewhere. The profit outlook for this mill, which may face interest expenses of more than US\$100/metric ton, is quite a challenge.

### World price: the key driver of international steel profitability

#### What about the future?

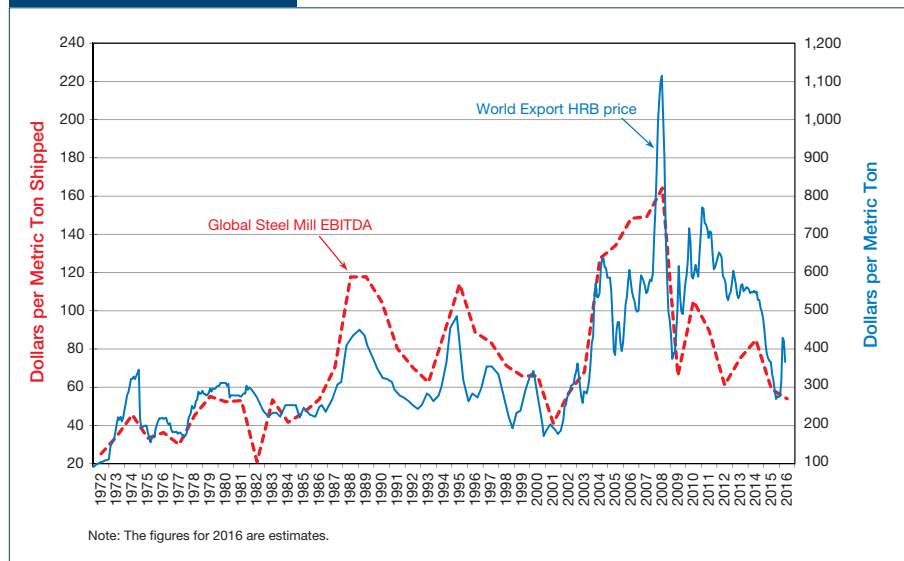
At least since the early 1970s, the evidence has been persuasive that the world export price for hot rolled band is the key indicator of global steel mills' profitability. When the export price is high, the domestic steel mill gets a better price in its home market because, otherwise, it will boost its exports. When the export price is low, the domestic mill has much-reduced exporting opportunities and, as well, is likely to be confronted with low-priced foreign steel in its home market.

This situation is about to change because of the incredibly low hot rolled band export price that prevailed at the end of 2015 (Fig. 1). At that time, the Chinese mills were offering to export hot rolled band at about US\$75/metric ton below the marginal cost of their median-cost mill. Concurrently, many leading international steel mills decided to cut their price close to the Chinese mills' price, delivered to the offshore customer. Why? They no longer could tolerate a further sizable decline in their share of world export deliveries even though this might

continue to drive down the world price — which it did — and, this drove them into a condition of “financial calamity.”

Looking ahead, might the world export price be a less potent profit driver? WSD suspects the answer, at least

Figure 1



World hot rolled band price vs. global steel mill EBITDA. Source: WSD's Financial Dynamics of International Steelmakers reports published annually since 1982.

statistically speaking (looking after the fact), is “probably not.” Although, a rising number of steel mills have cajoled their governments into providing them with significant import protection reflecting: (a) the damage caused by the collapse of the world export price late last year; and (b) the prospect that the global steel industry is facing more than a decade of significant oversupply as Chinese steel demand seems likely to decline at least 100 million metric tons in the next decade.

Steel mills have the potential to generate a good profit margin even when the world export price is depressed in countries where the mills have created a “fortress” condition with regards to domestic steel versus foreign steel and the number of suppliers is not so substantial (not

the case in China and perhaps not the case in Western Europe).

What does WSD conclude? For the steel mills, protectionism and mercantilism are great and free/fair trade is bad. Is this good or bad for the country? That’s another subject. In 1971, this writer joined Mitchell Hutchins, a well-regarded Wall Street research boutique. In the office next to me was Larry Ross, the top-ranked paper analyst in the country. He said, “Do you know that what’s good for the steel industry is bad for the country?”

Please note that, in Fig. 1, the scale is 12-to-1 for the export price per metric ton and major international mills’ EBITDA per metric ton. Hence, there’s a one-to-one relationship between the figures.

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