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Impressions of the International Iron and Steel Institute's 41st annual conference, held in Berlin Oct. 7-9

The conference attendance included steel companies and groups from China, Russia and the Ukraine, in addition to the "normal" Western world companies.

The mood at the meeting was positive, which was not surprising given the many favorable developments for steel companies in recent years, despite rising raw material costs.

The IISI annual meetings provide a great opportunity for steel company managements to get to know one another better. Virtually all the industry leaders participate in the meeting. (Note: In addition, steel is one of the rare industries in which there are regular Organisation for Economic Co-operation and Development meetings in Paris, at which the governments from steel-producing countries engage in an active dialogue with one another.)

One highlight of the conference was a speech by Dr. Angela Merkel, chancellor of Germany, who stressed the importance of the German steel industry, why the steel industry globally must have a substantial research and development effort in order to continually improve its product, and why Germany must maintain policies that make it attractive for investment by many industries.

Key themes of the conference

Following are seven items discussed at length by members of the IISI that seemed important:

1. The outlook for global steel demand growth continues to be spectacular. The IISI published highlights of its latest apparent steel demand survey based on input from steel company economists in 32 countries. For 2007, global apparent steel demand is forecast to rise by 6.9%. For 2008, the figure is a rise of 6.8%. Noteworthy elements of the forecast included: (a) a decline of apparent demand in the United States in 2007, followed by a rise in 2008; and (b) surging demand in the BRIC countries, which are Brazil, Russia, India and China (Table 1).

- Most of the steel industry people this writer spoke to did not think that the subprime debt crisis was having a sizable near-term negative affect on steel demand. (Note: The negative impact, if there is one, could be felt in early 2008, since a number of new projects may be delayed.)
- Mr. B. Muthuraman, managing director of Tata Steel, said that steel is in the midst of a growth mode similar to that from 1945 to the early 1980s, when steel demand grew about 6.5% per year.

2. The steel industry must begin to attract high-caliber young people, unlike the situation in the past few decades, in which the opposite was the case. In many countries, there are not enough qualified people graduating from universities. Employees need to be treated well – i.e., like customers.

3. The steel industry accounts for about 3% of the global emissions of greenhouse gas – i.e., CO₂ that is generated by burning coal, oil and natural gas. Much of the steel industry emissions occur during the production of liquid pig iron. The reduction in CO₂ emissions per tonne of steel has been huge in the past 15 years – apparently about 20% in some countries – due to: (a) the rising share of continuous casting to total steel output (leading to a sharp rise in the liquid steel to steel product yield); (b) the sizeable rise in EAF steel output (in part due to ultralow-cost steel scrap prices, which is no longer the case); and (c) the elimination of highly energy-inefficient plants in many countries – especially China in recent years.

The IISI, with its "sustainability" initiatives, has been doing yeoman's work to make steel companies look more appealing to outside observers. It has encouraged steel companies to combat pollution, make plants safer and more efficient, and reduce greenhouse gas emissions. Steel company managements are far more socially responsible than a decade ago. It seems that the industry is becoming a group of tree-huggers.

Unanswered questions: If the earth grows warmer due to the increased emission of greenhouse gases, how much more vegetation growth could be created due to a warmer climate and how much more CO₂ might be consumed by this vegetation? If a 2.0 million tonne/year blast furnace consumes 1.35 million tonnes of coking coal and other fuels per year, how does this compare to the fuel used each year by: (a) a city of 1 million people, (b) 50,000 cars, and (c) a 2.0 million tonne/year EAF steelmaking plant after adjusting for the fuels burned to supply it with electricity?

4. The Chinese steel industry is a huge threat to the non-Chinese industry for a variety reasons, including: a) it is government owned, (b) it is expanding so rapidly and (c) its exports have surged in the past year. Many of the non-Chinese executives at the meeting seemed to be uneasy with the concept that the Chinese government would be able to control steel exports. (Note: The presence of Chinese steel industry executives at the IISI conference, including some appointed by the government to head their companies, is an important plus for the non-Chinese steel industry because it indicates a willingness on the part of the Chinese to be good corporate citizens in the global steel community rather than be an adverse isolationist force. All the Chinese executives this writer spoke to at the meeting seem convinced that the government would be imposing more severe steel export restrictions. One executive, for example, expects the export tax surcharge on billet and slab will be raised to 30-35% from the current figure of 15%.)

5. Steel product quality will continue to improve sharply in the future, which comes on top of enormous improvements in the past 20 years. The steel company managements seemed to be viewing steel as an increasingly strong and lightweight engineered material that will displace other materials, especially in the construction sector. (Note: Nevertheless, a warning was given to the steel companies by the chairman of

Table 1 — IISI 2007–2008 Apparent Steel Use Outlook and Historic Figures

	Million tonnes					% change			
	2000	2005	2006	2007e	2008e	2006	2007e	2008e	2000–2008
World	844.9	1030.2	1120.9	1197.7	1278.6	8.8%	6.9%	6.8%	6.1%
EU-27	180.3	166.0	184.9	192.2	195.0	11.4%	3.9%	1.5%	1.1%
Germany	42.1	36.2	38.4	40.3	40.9	6.1%	5.0%	1.5%	-0.4%
Italy	32.5	31.6	36.6	36.7	37.3	15.8%	0.3%	1.6%	2.0%
Poland	8.4	8.4	10.6	12.2	12.9	26.2%	15.1%	5.7%	6.3%
CIS	38.9	42.3	50.0	59.8	65.2	18.1%	19.6%	9.0%	7.6%
Russia	29.4	30.4	35.8	44.7	48.9	17.7%	25.0%	9.3%	7.5%
Ukraine	5.5	7.3	8.6	10.0	10.9	16.9%	16.9%	9.0%	10.2%
Other Europe	23.1	24.5	27.2	29.3	31.0	11.0%	7.7%	5.8%	4.3%
Turkey	13.4	18.6	21.3	23.4	24.9	14.7%	10.2%	6.2%	9.3%
NAFTA	172.9	139.6	155.7	148.1	153.9	11.5%	-4.9%	3.9%	-1.6%
Canada	19.8	16.2	17.3	16.3	16.8	6.9%	-6.1%	3.2%	-2.3%
Mexico	19.8	16.1	18.0	18.7	19.7	11.8%	4.1%	5.3%	-0.1%
USA	133.3	107.3	120.4	113.1	117.5	12.2%	-6.0%	3.8%	-1.8%
C&S America	33.5	31.8	35.6	39.5	41.6	11.8%	11.0%	5.3%	3.1%
Brazil	17.5	16.8	18.5	21.4	22.5	10.1%	15.7%	5.1%	3.7%
Argentina	3.4	3.7	4.5	4.5	4.8	20.6%	0.2%	6.6%	5.2%
Africa	16.9	20.7	23.1	25.1	27.5	11.4%	8.7%	9.6%	7.2%
Egypt	4.7	4.8	4.7	5.2	5.7	-3.0%	10.7%	10.0%	3.0%
South Africa	4.5	4.6	6.0	6.4	7.1	29.1%	6.2%	11.8%	6.8%
Middle East	21.3	33.9	37.2	40.4	43.4	9.8%	8.6%	7.4%	10.7%
Iran	10.3	16.1	17.9	19.1	20.8	11.1%	7.0%	8.5%	10.5%
Saudi Arabia	4.2	5.8	6.7	7.5	8.2	15.5%	11.9%	9.3%	10.2%
Asia	350.9	571.8	607.2	663.2	721.1	6.2%	9.2%	8.7%	10.8%
China	138.1	328.1	357.4	398.1	443.8	8.9%	11.4%	11.5%	18.1%
India	30.2	41.4	46.1	52.4	58.6	11.4%	13.7%	11.8%	9.9%
Japan	79.6	78.0	79.0	80.2	80.5	1.3%	1.5%	0.4%	0.2%
South Korea	40.0	47.1	49.6	54.1	55.7	5.3%	9.1%	3.0%	4.9%
Taiwan, China	25.3	19.9	19.8	20.8	21.5	-0.5%	4.9%	3.5%	-2.3%
ASEAN-5	25.5	37.3	35.4	37.5	40.5	-5.0%	6.0%	7.9%	6.9%
Indonesia	5.3	7.2	6.2	6.6	6.9	-13.7%	5.0%	5.0%	3.8%
Malaysia	6.8	7.3	6.8	7.3	8.1	-7.0%	8.0%	10.0%	2.6%
Phillippines	3.3	3.1	3.1	3.3	3.5	2.1%	5.0%	5.0%	0.6%
Thailand	7.2	14.1	13.4	14.0	14.9	-5.1%	4.0%	7.0%	11.0%
Vietnam	2.9	5.5	5.8	6.4	7.2	5.3%	10.0%	12.0%	13.6%
Oceania	7.1	8.0	7.9	8.2	8.0	-1.0%	4.3%	-2.4%	1.7%
China	138.1	328.1	357.4	398.1	443.8	8.9%	11.4%	11.5%	18.1%
All but China	706.8	702.1	763.6	799.6	834.8	8.8%	4.7%	4.4%	2.4%
BRIC	215.2	416.7	457.8	516.6	573.8	9.8%	12.9%	11.1%	15.0%
All but BRIC	629.7	613.5	663.2	681.1	704.8	8.1%	2.7%	3.5%	1.6%
% of world apparent steel use									
China	16%	32%	32%	33%	35%				
BRIC	25%	40%	41%	43%	45%				
BRI	9%	9%	9%	10%	10%				

Notes: BRIC includes Brazil, Russia, India and China. e = estimate.

Source: International Iron and Steel Institute.

Volkswagen, who said that his company is engineering a very small car with no steel body.)

6. Steel cost inflation in 2008 will be huge. The steel company managements seemed resigned to a sizable rise in international iron ore prices in 2008 (perhaps 20%, if not more) and coking coal prices (perhaps 30%). (Note: Even in 2007, costs have escalated more than expected. This writer learned from a Chinese steel company that its current operating cost to produce hot rolled band is about \$405 per tonne.)

7. Steel's technological revolution continues to advance at a rapid pace. Salzgitter AG described its new Belt Strip Technology process, whereby a continuous caster feeds liquid

steel to an intensively cooled revolving belt. The 15-mm-thick strip is then directly hot rolled. While a relatively low-volume process, Belt Strip Technology permits the production of critical grades of steel, including those with high strength and high ductility.

Musings: If the IISI's 6.8% growth forecast for apparent steel demand is correct, 2008 will likely be a boom year for steel — including tight raw material supply/demand balances, surging steelmakers costs and even higher steel product prices. Such an unsustainable condition could be the precursor of negative developments for the steel industry in 2009, if not by the summer of 2008. Once there are substantial steel price hikes, it is only a matter of time before steel buyers seek to unload inventory in order to beat the feared drop in steel prices.

Another worry is that the surge in steelmakers' costs may be a signal that costs will also be rising in a host of other industries, which would contribute to rising global inflation and higher interest rates.

Rising global inflation may create a condition in which steel demand stagnates. Let's not forget that the surge in global fixed asset investment, which has been the key to the extraordinary rise in steel demand since 2000, has been based in good part on rising enterprise profits (which are an important component of global savings). Enterprise profits (savings) are far more cyclical as a share of GDP than household or governmental savings. Rising inflation and lower demand growth are likely to put a crimp into corporate profits globally.

Inflation in steel prices is a frightening thing to government economists. The 1959 Ekstein-Fromm report, "Steel and the Post-War Inflation," erroneously blamed about 40% of the post-war inflation in the U.S. economy on the steel industry because higher-priced steel was used in a variety of industrial products that also appeared in the wholesale price index. In the 1962 Kennedy-Blough confrontation, President Kennedy assailed Roger Blough, the chairman of U. S. Steel, over a 3% (\$6 per ton) steel price increase. The basis for his thinking came from Otto Eckstein, an influential economist who went on to be a member of the President's Council of Economic Advisors from 1964 to 1969. Eckstein's views, in turn, were

an extension of the work of 1930s economist Gardiner Means, who claimed, in this doctrine of administered prices, that concentrated – i.e., oligopolistic – industries were a negative for the economy because, in these industries, prices are not responsive to market conditions.

WSD's orientation in recent years has been to uncover reasons why improved conditions for the steel industry were sustainable. We tended to emphasize opportunity rather than risks. We think now is the time to concentrate more on risks.

It was quite unbelievable to this observer that, during the publicly held portions of the IISI conference, there were no warnings to those in the audience of the looming threat of overcapacity due to surging capacity in China and the massive rise in capital spending on new steel plants outside of China.

Being a tree hugger is great; we all need to worry about the environment. Taking actions now to survive and remain fiscally healthy when the competitive environment gets tougher is even more important. If not, who will be left to hug the trees? ♦

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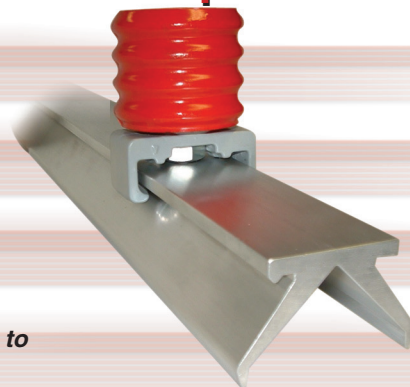
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