

World Steel Dynamics (WSD) is a leading steel information service in Englewood Cliffs, N.J. 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. To submit your questions for WSD, e-mail [WSD@aist.org](mailto:WSD@aist.org).



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## Q: When is the world export price for hot rolled band forecast to rally?

A: WSD thinks that the hot rolled band price on the world export market is poised to rally at least 10% in the fourth quarter of 2007 from the Aug. 27, 2007, SteelBenchmarker™ figure of \$555 per tonne, FOB the port of export. If so, this would be the fifth consecutive time since 2001 that the HRB price has bottomed out at a higher price than the prior low and also at a level well above the mills' marginal cost to make the product. (Note: The last pricing "death spiral" occurred in late 2001 when the HRB price, at just \$175 per tonne, FOB the port of export, fell to a level below the marginal cost of many mills except principally for the Russians and other CIS producers. See Table 1.)

## Q: Are hot rolled band prices going to be up the remainder of 2007?

A: Three reasons why the answer may be "yes" include the following:

1. Notwithstanding recent and growing "sub-prime" loan problems in a number of countries, the global economy – and, therefore, steel demand – seems likely to continue to grow at a good pace in the remainder of 2007. Any development that tends to diminish economic excesses, as seems to be the case when it comes to revealing the extent of worrisome sub-prime loan portfolios, should be a factor adding to the long-term economic potential. (Note: This

author had never even heard the phrase "sub-prime loans," at least in the way it is being used at present, until about a month ago.)

2. The supply of hot rolled band on the world export market seems likely to lessen in the next six months as: (a) the Chinese mills are forced to dampen their offerings due to governmental quantitative (export license) restraints, and (b) the U.S. mills reduce their offerings as they obtain better prices in the home market.
3. Marketplace psychology may be turning to the favor of the steel mills. Their customers are sensing, for both good reasons and bad, that now is the time to buy ahead at the current price rather than hold off to buy at a cheaper price.

## Q: Will the international hot-rolled band price rally include a "volcanic" price eruption?

A: We place the odds at 40% that the HRB price will surge to new highs – let's say \$700 per tonne, FOB the port of export – versus the prior highs of about \$625 per tonne in September 2004 and \$596 per tonne in March 2007. We place the odds at 40% because: (a) we don't see a major shortfall of global steelmaking capacity; (b) the Chinese government might lift its export constraints, as some expect, if the world price is so lofty; and (c) global economic growth might slow down in 2008 after four years of 4.9%+ GDP expansions.

**Table 1: Hot Rolled Band Pricing Bottoms on the World Market**

| Date           | FOB the port of export (\$) |                             |
|----------------|-----------------------------|-----------------------------|
| Feb. 1974      | 186                         |                             |
| Aug. 1975      | 251                         |                             |
| June 1994      | 300                         |                             |
| Feb. 1996      | 225                         |                             |
| Dec. 1998      | 185                         |                             |
| Dec. 2001      | 175                         | Third consecutive decrease  |
| June 2003      | 250                         |                             |
| July 2005      | 390                         |                             |
| Jan. 2006      | 420                         |                             |
| Dec. 2006      | 502                         |                             |
| Sept. 2007 (e) | 550                         | Fifth consecutive increase? |

Source: Steel PriceTrack from 1974 to January 2006. SteelBenchmarker™ from April 2006.

## Q: What role will steel scrap prices play?

A: The extent that world export product prices rise volcanically in the next six months may be a direct function of the price of steel scrap. The higher the price of scrap, the more buyers will rush to place orders in advance because they know higher steel prices follow scrap prices.

The price of obsolete steel scrap is difficult to predict because it is the most marginal of all steelmakers' commodities. It is the item bought last. Currently, the price is quite high. The price of #1 heavy melting steel scrap in the United States in late August was about \$255 per gross ton, which compares to the brief low of \$80 per ton in December 2001 and the brief high of \$308 per ton in March 2007.

From a statistical point of view, WSD has been offering the proof since 1994 that there will not be a sufficient supply of obsolete steel scrap at a reasonable price level if global steel demand grows at a fairly moderate rate – i.e., 2.5% or more per annum. However, readers should be aware that this analysis is subject to a problem called “the tyranny of large numbers.”

- The derivation of the demand for obsolete steel scrap is based on the global metallics requirement (steel scrap, pig iron and steel scrap substitutes) for the steel and foundry industries of about 1.6 billion tonnes at present. From this we subtract the production of pig iron, the production of steel scrap substitutes, and the estimated generation of home scrap and new scrap.
- The derivation of the size of, and the future growth rate for, the obsolete scrap reservoir is based on our assessment of obsolete steel scrap requirements and recovery rates in 56 countries 10–40 years ago.

There is a sizable margin for error when calculating the final supply/demand balance figure because it is the result of the subtraction of two huge numbers from one another.

## Q: Fixed asset investment has been the driver of steel's success. Will that continue?

A: We say yes. From a macro point of view, the main reason for the better performance in recent years of steel prices, and steel company profits, has been the enormous growth of global steel demand. In turn, much of the increase in steel demand is due to rising fixed asset investment globally. Of course, the higher the rate of global GDP growth, the greater the need for more fixed asset investment (and the more the need for more savings, largely in the form of enterprise profits, since savings = investment).

In its latest forecast as of April 2007, the International Monetary Fund (IMF) indicates that in only two countries/

regions of the world – the United States and Africa – is fixed asset investment forecast to decline as a share of GDP in 2007 and 2008.

- For the United States, the ratio of investment to GDP is forecast to fall to 18.9% in 2008 versus 19.0% in 2007 and 20.0% in 2006.
- For Africa, the ratio of investment to GDP is forecast to fall to 22.9% in 2008 versus 24.0% in 2007 and 22.6% in 2006.
- For the Western Hemisphere, the ratio of investment to GDP is forecast to rise to 21.1% in 2008 versus 20.7% in 2007 and 20.0% in 2006.
- For China, fixed asset investment (using the IMF definition for it) to GDP may rise to about 44.3% of GDP in 2008 (WSD interpretation of the data) versus 43.2% in 2007 and 42.3% in 2006.
- For the world, the fixed asset investment to GDP ratio rises to 23.5% in 2008 versus 23.1% in 2007 and 22.8% in 2006.

Global constant GDP is forecast by the IMF to rise 4.9% in 2007 versus 5.4% in 2006, 4.9% in 2005, 5.3% in 2004 and 4.0% in 2003. Estimated growth in global constant GDP is 4.9% for 2008.

## Q: What should we most expect for the future?

A: We live in an era in which the unexpected should be expected. We've yet to anticipate all the new patterns of events that will be occurring in the “new continuum” for the steel industry. As one large exporter recently pointed out to WSD, “It's crazy out there.”

It seems fair to ask the question, “Wouldn't the steel industry be in a shortage condition today were it not for surging Chinese exports?” WSD's answer is “yes.”

For example, the resiliency of hot rolled band pricing on the world market in the past six months is really quite amazing when considering that Chinese steel output in July was up 14.6% year-on-year to 485.7 million tonnes annualized, and that Chinese exports of all products including semis were up 29% year-on-year to about 85 million tonnes annualized. Chinese exports of steel flat products in June were up about 25% year-on-year to about 31 million tonnes annualized.

– Peter F. Marcus, managing partner, World Steel Dynamics, pmarcus@worldsteeldynamics.com, (201) 503-0902

– Becky E. Hites, managing director, World Steel Dynamics, bhites@worldsteeldynamics.com, (201) 503-0935

**Do you have a question for World Steel Dynamics?**

**Submit it today to [WSD@aist.org](mailto:WSD@aist.org).**