Ask WORLD STEEL DYNAMICS

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.***

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Steel's Brave New World

Q: What is your macroeconomic outlook for the steel industry in 2008?

A: There has been a profound change for the better in the steel industry since 2003 from the viewpoint of steel companies, their workers, those selling raw materials to the industry and steel mill equipment manufacturers (due to the surge in orders). In contrast, it has been a time of shock and dismay for steel buyers because steel prices have risen greatly. During this period, WSD observed several industry trends highlighted below:

- 2003 was Steel's "Age of Discontinuity."
- The current pattern of events is no longer similar to those in the past (the Old Continuum).
- The Age of Discontinuity was a period of transition to the New Continuum.
- WSD is now placing more emphasis on the risks for the steel companies in 2008.

The steel industry entered a "New Continuum" in 2004 that may prove to be highly favorable to integrated non-Chinese steel mills in the next few years. Looking ahead beyond the next few years, the New Continuum should also favor the Chinese steel mills.

The favorable steel industry outlook in the New Continuum is expected to be a function of:

- Strong global steel demand growth.
- Steel's Age of Metallics remaining in place.
- The ever-increasing concentration of the steel sheet producing industry.
- The failure of Chinese steel overcapacity to wreck the improved competitive environment for steel companies outside China.

Q: What is your microeconomic outlook for the steel industry in 2008?

A: Global apparent steel demand in 2008 may grow at a far slower rate than in recent years. The culprit — the global economy — seems destined to expand far more slowly due to:

- The aftershock of the sub-prime lending crisis.
- Maybe slower growth of China because of more restrictive economic policies to combat inflation.
- The inflationary impact of high oil prices (including less consumer spending).
- Some liquidation of inventories and/or slower accumulation of inventories by manufacturing companies in many countries after four years of heady 5%-per-year global economic growth.

The downturn of the housing markets in the United States, Japan and parts of the European Union is a significant concern.

The New Continuum might also be called "Steel's New Profit Age." Pricing "death spirals" — i.e., prices falling to the mills' marginal cost — are expected to be less frequent (although swings in the direction of prices will probably be more frequent). The companies are expected to be more profitable than previously during periods of weak steel demand — in part because of faster production cutbacks when demand falls that cause prices to fall less sharply (although still substantially). WSD thinks that a higher proportion of the steel cycle than that in the Old Continuum will be devoted to good and boom times for the companies in contrast to shake-out, bad and average times.

The expectation of improved steel industry profits is tied to the following four assumptions:

1. Good global steel demand growth. The improved demand outlook is closely tied to faster global GDP growth, which is probably the result of the "information revolution" that is sweeping the world. The information revolution discovers pockets of unused capacity, permits cost cuts, enables gains in product quality, permits plants to be built faster and cheaper, and increases price competition (thereby holding down inflation). Because of faster global GDP growth, fixed asset investment (construction and capital spending) growth has also been more substantial, which is great for steel demand. WSD is forecasting a 4.5% per annum growth rate to 2015.

2. The "Age of Steelmakers' Metallics" remains in place. The obsolete steel scrap reservoir that is, on average, 10–40 years old may grow at a far slower rate in the next 10 years than the probable increases in the demand for obsolete steel scrap. In fact, high metallics prices may prove to be a constraint to supply additions, which probably is a good thing, since the global steel industry has entered a period of excessive capital spending. Today, it pays to be integrated, especially to own one's raw materials.

3. Further steel industry concentration. The evidence is persuasive that, the fewer the producers, the more "pricing power" is in the hands of the producers. Many steel companies in recent years have had what WSD calls "the urge to merge." As a result, in today's period of mergers and acquisitions, which can also be called a "merger mania," some steel companies have been acquired at a price well in excess of their replacement value. What about the Chinese? WSD expects that Chinese steel companies will begin merging with their non-Chinese competitors within a few years.

4. Oversupply of steel in China does not destroy the pricing environment for steel companies elsewhere. Overcapacity to produce steel in China is likely to become quite evident in 2008. However, we also expect that the Chinese government will restrain exports, which means that the industry's oversupply problem will be encapsulated in the country. Looking ahead five years, positive developments for steelmakers outside China are expected to include:

- Rising Chinese mills' production costs due to a strong currency.
- Sizable concentration in the Chinese sheet-producing industry.
- Governmental export constraints.
- The leading Chinese companies merge with their offshore competitors.

(Note: Unlike the case for finished steel products, WSD thinks that non-Chinese manufacturers of steel-containing goods in the future will be increasingly threatened by rising exports of these goods by Chinese manufacturers.)

Q: How will the development of a steel futures market impact the outlook?

A: Once there is a highly liquid forward price curve for selected steel products, the steel mills and their customers will be able to lock in spreads on these and related products.

The SteelBenchmarker™ benchmark pricing system has become quite robust (i.e., many inputs and it is not able to be manipulated) in certain steel products and is enjoying growing usage as a "peg" to set monthly or quarterly prices between buyers and sellers.

WSD believes that the development of steel futures trading would be a win for the steel mills (perhaps the biggest win), steel middleman companies and steel users.

Q: What does this all mean for steel company profits in 2008?

A: The steel mills' profit outlook for 2008 is up in the air. In order to get upstream – i.e., to obtain higher profits – the mills may need to swim against a persistent downstream current. Spot hot rolled band pricing is currently about flat in a number of countries, weakening in the European Union and also declining on the world export market. Even so, the mills' costs are sure to rise substantially in 2008. ✦

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Do you have a question for World Steel Dynamics?
Submit it today to WSD@aist.org.