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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Q: Given the rapid increase in Chinese steel capacity and the mills' proclivity to export, should one conclude that the "game is over" for the non-Chinese steel industry? Is it only matter of time before the Chinese steel industry brings down all others?

A: WSD's answer to the above questions is "no." Here are the reasons:

The Chinese government is starting to take ever-stronger actions to dampen exports. For example, as of Dec. 15, 2006, a 10 percent export tax was placed on exports of billet and slab. Prior to that date, there was no tax, and in April 2005, there was a tax credit of 13 percent. It appears that Chinese exports of billet and slab will be declining in the future.

For steel sheet products, the current export tax credit is in the 8–11 percent range. Given the surge in exports, a reduction and/or elimination of the credit seems likely by the spring of 2007, in WSD's opinion.

The Chinese trade surplus in all products is so massive that the Chinese RMB is likely to appreciate sharply in the years ahead. In the last two months of 2006, its trade surplus ran at an annual rate of about $285 billion, or about 11 percent of GDP. The surplus may rise even further in 2007, given the ever-improving quality of Chinese goods. If the currency rises sharply, Chinese steelmakers' costs will continue to rise, since about 80 percent of their expenses are denominated in the home currency.

Anti-dumping and countervailing duty suits will be filed by offshore steel mills if the Chinese sustain their exports. (Note: In a countervailing duty suit, the claim is that the Chinese steel industry is subsidized by the government.) Some argue that, because steel is such a visible commodity, Chinese officials will take actions to avoid trade conflicts in steel. For example, some observers think that a quota system may be worked out on exports to Europe.

In steel sheet products, all the major steel mills except for one are government owned. Hence, it is no problem for the central and/or provincial governments to communicate with the managements of the companies, if needed, for them to restrain exports.

Steel company profitability is important to the cities in which the steel mills are located because they provide such sizable funds for the support of the community ($25 per metric ton shipped, in some cases). Hence, actions that help the industry to obtain better prices are likely, in WSD's opinion.

China's steel exports will probably peak in early 2007 and then decline. This level of export may not be matched for years to come.

Steel sheet pricing patterns in almost all countries, in part due to the industry's concentration, seem to be less adverse for the steel mills than is the case in China. Hence, the Chinese steel sheet mills are in a period of concentration and increased communication among one another to try to change their pricing behavior patterns.

Starting as soon as 2008, it is likely that some of the major Chinese mills will merge with their larger offshore competitors. Especially in Asia, the greater the size of a company, the greater its influence.

The Chinese steel sheet mills may suffer another pricing "death spiral" — i.e., the price drops to marginal cost — in 2007 or 2008. This would be the second one since late 2005. Periods of shake-out lead to accelerating restructuring efforts.

– *Peter F. Marcus*, managing partner
World Steel Dynamics

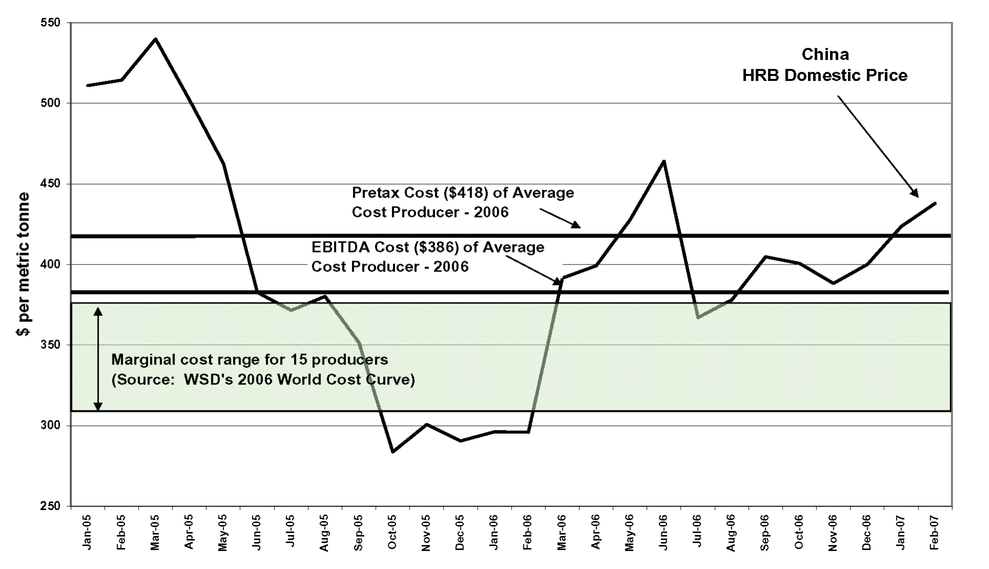

Figure 1 — Chinese "death spiral" track (hot rolled band 4.75 mm thick home-market price, dollars per metric ton).

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