

The Steel Pricing Vortex: How To Escape It?

The Old World — Opt for Oligopolistic Pricing Power When the Occasion Arises

The steel industry was an assemblage of companies whose profitability was driven ultimately by the hot rolled band (HRB) price on the world market. Only when the export price was high did most steelmakers have the “pricing power” to pass on their costs. The best profitability occurred when the export price was spiking to a sizable premium; but, this was a “short” age (Fig. 1).

Conversely, during periods of crisis when the hot rolled export price was extremely depressed, industry

concentration was fostered by a sharp rise in merger and acquisition activity and plant closings. Increased concentration boosted the mills’ pricing power.

This traditional approach to analyzing the industry is no longer working. In the current crisis, the steel industry is “dis-integrating.” Many multi-plant steel companies are selling off some of their plants, often at a bargain price. The number of independent steel mill competitors vying for the market is rising.

The New World — Protection and Mercantilism Is the Steel Mills’ Friend

In the fourth quarter of 2015, given the Chinese steel mills’ willingness to export HRB at a price 15% below the marginal cost of the average-cost Chinese mill, and a rising number of mills elsewhere opting to match the Chinese price because they could not

tolerate a further loss of business on the world market, steel mills in many cases have entered a “financial calamity” condition in which losses are destroying their balance sheets. In desperation, the non-Chinese mills in many cases ran to their governments asking them to



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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.

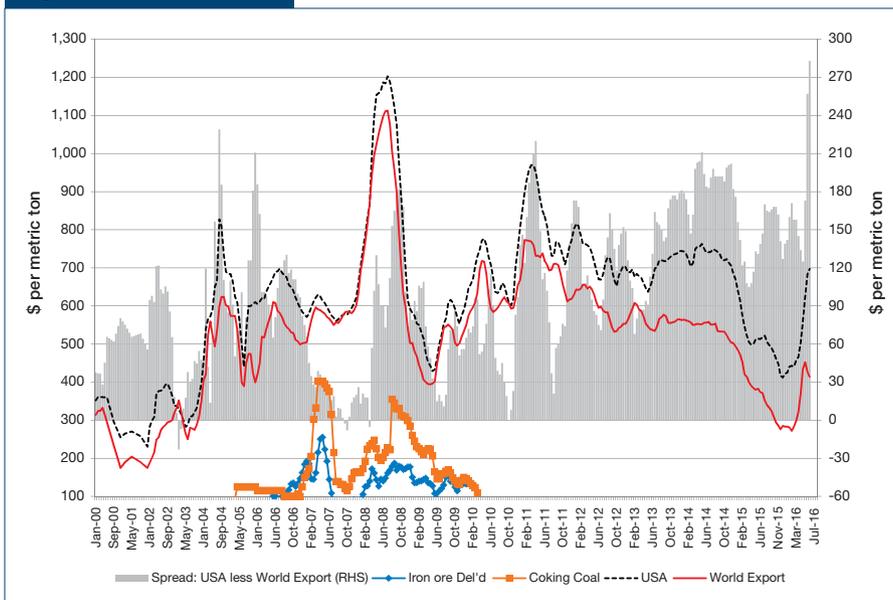


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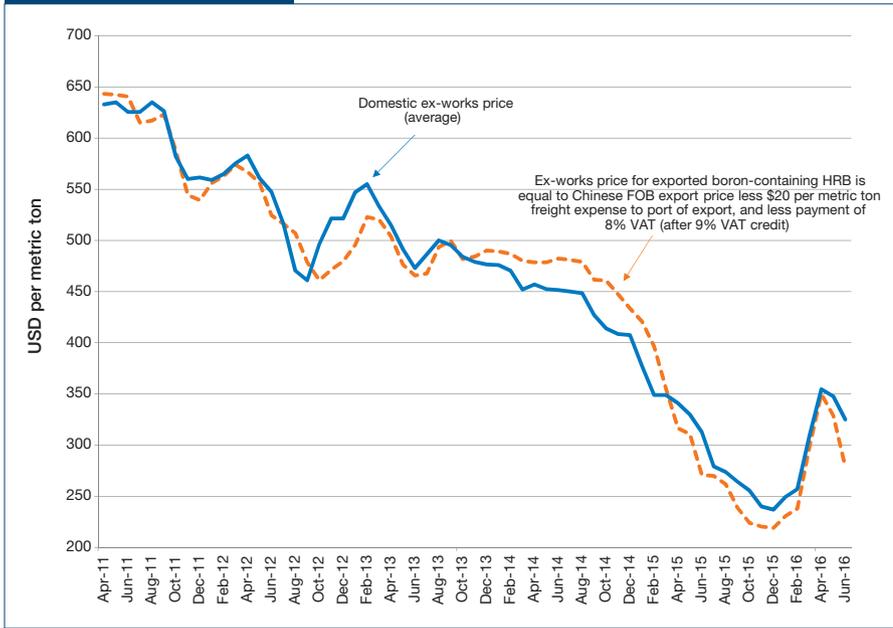
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Figure 1



U.S. hot rolled band price versus world export price and spread. Source: WSD estimates and SteelBenchmarker.™

Figure 2



Chinese ex-works hot rolled band export price vs. domestic ex-works price. Source: WSD’s WCC for Flat Rolled Sheet and SteelBenchmarker.™

enforce the trade laws and take other actions to diminish the impact of the Chinese steel mills’ exporting armada. For once, governments listened.

We’ve now witnessed an unprecedented avalanche of trade suits against steel exporting mills in China and elsewhere. These trade suits, no doubt, will: (a) diminish world steel trade; (b) drive down the Chinese mills’ exports; and (c) cause heightened price competition in non-restrained markets.

Protection and mercantilism have become the steel mills’ friend. Steel mills in countries with strong import barriers and not so many domestic competitors will

increasingly display respectable profits even when the world steel market is slack. This circumstance is extraordinarily evident in the United States in late June 2016 as a “Fortress America” situation.

The result of steel trade suits is permitting the domestic HRB price to hold at about US\$700/metric ton compared to: (a) the Chinese mills’ domestic ex-works HRB price of about US\$325/metric ton; and (b) HRB export price, FOB the port of export, that starts at a low of about US\$330/metric ton for the Chinese mills (and, in a few cases for mills in other countries, still about US\$400/metric ton). The Chinese ex-works export price is now only about US\$300/metric ton (before payment of the 8% VAT) (Fig. 2).

With Chinese and non-Chinese steel production in June 2016 fairly well sustained by the run-up in prices in home markets and the

world market in January to April 2016, WSD now expects that the HRB export price by late summer to be almost as low, on a cost-adjusted basis, as it was in the fourth quarter of 2015.

The Chinese steel mills are particularly in trouble because: (a) their steel production annualized may drop by late summer to 750 million metric tons from a peak of about 850 million metric tons in April–May 2016; (b) their exports will fall back; and (c) the domestic market is so “competitive,” with about 92 wide hot strip mills vying for business, that the mills in most cases have found it impossible to separate their home and export price realizations.

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