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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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Rebar is the "king of spades" in China; in the U.S., it's a lowly "three of clubs"

In 2014, apparent rebar consumption in China, at 215 million metric tons, was 27 times the U.S. figure, at 7.83 million metric tons (Figure 1). This year, apparent rebar consumption in China may decline by 12.5 million metric tons to 204 million metric tons and be flat in the U.S.; however, the Chinese figure is still 26 times that of the U.S.

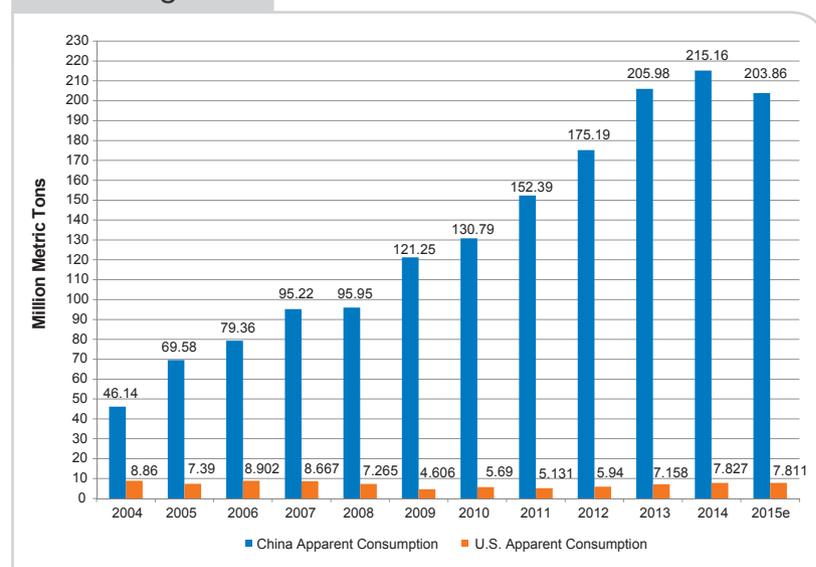
The reason for the disparity is that fixed asset investment (FAI) in China, after adjustments, accounts for about 50% of gross domestic product (GDP), with the steel intensity of the economy being remarkably high when FAI is at such a high level.

In 2004, Chinese apparent rebar demand was at 46 million metric tons compared to 8.86 million metric tons for the U.S. — or 5.2 times the U.S. figure.

What do these figures demonstrate? To WSD, they demonstrate, among other things, the validity of the "Capital Fundamentalism" economic theory, which postulates that fixed asset spending drives the growth of an economy. There are exceptions, of course, such as the amazing growth of the service sector in India to 55% of GDP from about 38% a decade ago due to the power of the Information Revolution.

China's surge in FAI has been enabled in good part because of the low interest rates available to manufacturing and construction companies when borrowing from the country's government-owned banks. One of the consequences of this policy was to keep interest rates on deposits unnaturally depressed, which held down household spending as a share of GDP.

Figure 1



China vs. U.S. apparent rebar consumption (2004–2015). Source: WSD estimates.

China is now in a condition in which the government — even though, theoretically speaking, it is determined to boost household spending as a share of GDP — is once again turning to infrastructure projects as a means to bootstrap the economy. It's more difficult to have as big an impact as in the past, however, because: (a) the housing sector in the country is seriously overbuilt; (b) municipalities are already burdened in most cases with

excessive debt; and (c) many of the manufacturing and construction companies are overextended on a financial basis.

If adjusted FAI were to zoom to 58% of GDP in the next two years, this means that Chinese steel demand will be higher than forecast and that the potential fallback in demand is even more substantial.

Currency wars: exchange rate roulette reverberating in the steel casino

The steel industry, being a derived-demand industry, is always impacted by macroeconomic developments. This time around, it's being driven for better or worse, depending on one's perspective, by the following:

- Competitive currency devaluations.
- Widening protectionism.
- A shift of mercantilism to the U.S. from China.
- Slowing FAI, especially in energy-related projects that are so important to the steel industry because they are so steel-intensive.

Regarding implications of the first item above, the Chinese steel mills, starting last year, began to sharply boost their export offerings at far lower prices. Coincidentally, the Russian ruble weakened greatly, which permitted the Russian steelmakers, with their reduced costs due to a weaker currency and their own iron ore and coking coal mines, to battle the Chinese on the world market. In August 2015, Chinese exports amounted to about 120 million metric tons annually versus 41–47 million metric tons per year in 2010–2011, which compares to the global export market of about 365 million metric tons per annum. Russian exports are now running at an annual rate of about 26 million metric tons, about unchanged from 2014.

Turkish exports are about flat at 16 million metric tons annualized compared to 2014. They are benefitting from

a weaker currency and lower steel scrap prices. Brazil exports, however, have increased to an annualized rate of 13 million metric tons from 7.5 million metric tons in 2014, reflecting lower demand at home and a much weakened currency.

In recent months, a number of the steel mills at coastal locations in the Pacific Basin have joined the fray because, with high fixed costs and fairly high export ratios, they could not afford the sharp increase in fixed costs per metric ton that comes with lower deliveries.

As of this writing, the world export price for hot rolled band, relative to the mills' costs, is probably, by far, the lowest it has ever been.

The South Korean won versus the U.S. dollar has held steady in recent years, which is very tough on the South Korean steelmakers if they are selling to Japan because their products may be priced in Japanese yen (which is down so sharply versus the Korean won).

The Chinese RMB has been fairly strong despite the recent 2–3% weakening. For China, after taking into account the 10–15% wage increases that have occurred every year in the past decade, it's now clear that, besides slower economic growth in a number of markets they are serving, manufactured products are often less attractive to foreign buyers because the price is up so much.

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