The destruction of steel demand because of the coronavirus has some positives

Steel in an "Age of Management"

Everyone in the steel business is well aware that steel production in 2020 could decline 10% and that steel export prices may drop to "death spiral" levels — i.e., to, or below, the marginal cost of the median-cost steel mill. Yet, there are some countervailing forces to be considered:

1. Severe downturns usually set the stage for longer recoveries. For example, after the financial crisis in the fourth quarter of 2008 — initiated by the Lehman Bros. bankruptcy on 15 September 2008 — the global economy started to recover about mid-2009 with the expansion lasting through 2019. WSD expects another long recovery when the coronavirus-related global recession ends. As was the case in 2008 and 2009, a number of excesses in the system, some not detected, are being purged by the power of the "invisible hand" — i.e., price allocates resource.
2. Low interest and inflation rates are probably here to stay — perhaps to 2025. If so, they are a positive for global growth. Huge funds are circulating the world looking for attractive new investment opportunities. However, because not enough high-returning investments are available on a risk-adjusted basis, there's been a massive inflow of funds into governmental treasury securities. Hence, these massive circulating funds are not promoting excessive global growth and inflation (best defined as "too much money chasing too few goods").
3. Steel industry M&A activity will be huge; and, beneficial to a number of the players. It will be adding to the "economic rent" of the stronger companies. China's Baowu is in the process of becoming a 200-million-metric-ton-per-year producer. In the Pacific Basin, size is power.
4. Steel's "Age of Protectionism" will become even more potent. More trade suits on more products will be filed.
5. Steelmaking capacity rationalization will be substantial. Look for: (a) plant closings; (b) consolidation of output at lower-cost plants; and (c) more ways for a facility to be integrated with the output of other plants as multi-plant steel companies proliferate.
6. Greenfield steel plant investments will be delayed and/or less frequently embarked upon. Promoters will have lessened confidence in the supply/demand outlook and more difficulty in funding the new units.
7. The rising number of liquid steel futures curves, outside of China, will permit steel mills, steel scrap processors, middleman companies and others to "efficiently" hedge the steel price risk — i.e., at low cost. One of the potential positives with regard to this development may be an increase in the enterprise value of some steel companies as investors sense that earnings volatility is lessened because of the success in price hedging.

is a leading steel information service in Englewood Cliffs, N.J., USA

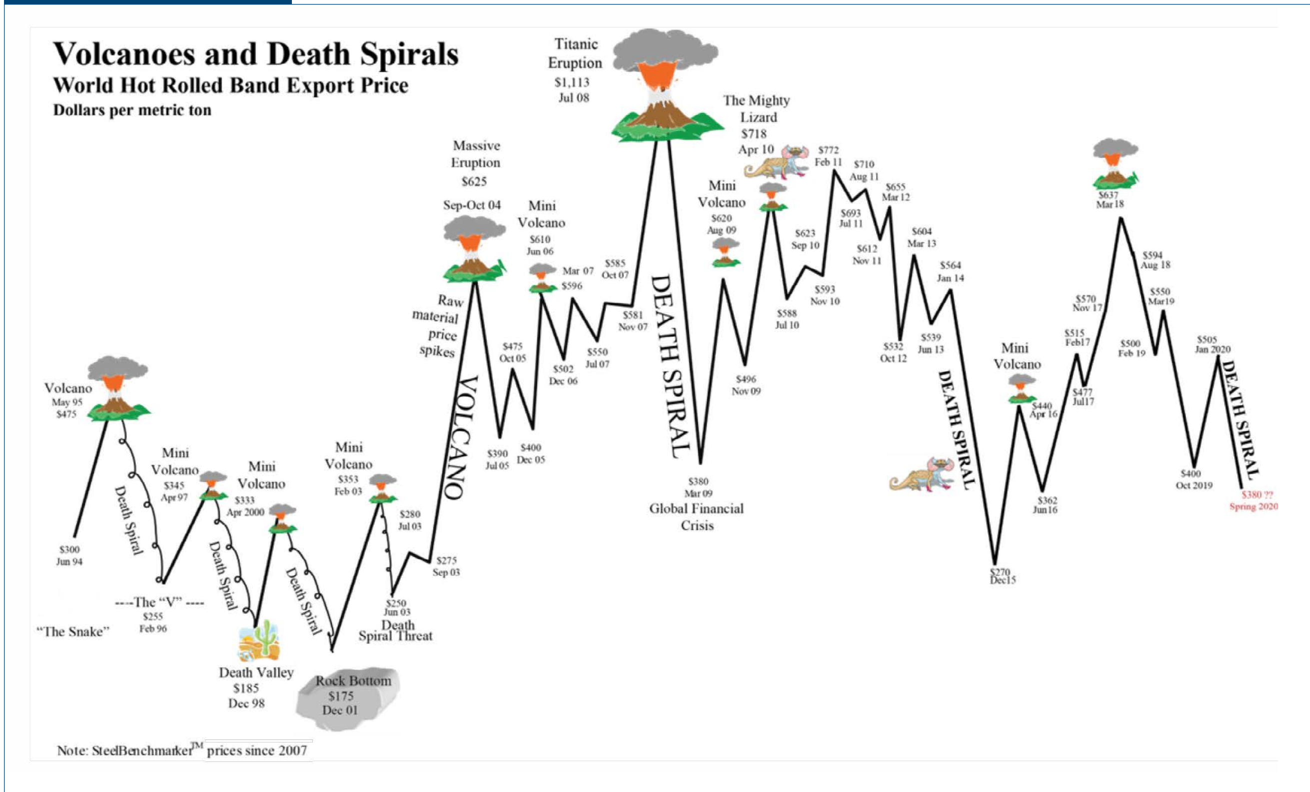
WSD's steel experience, steel database and availability of steel statistics are the principles for performing steel forecasts, studies and analysis for international clients. WSD seeks to understand how the "pricing power" of steel companies the world over will be impacted by changes in the steel industry's structure. The views and opinions expressed in this article are solely those of World Steel Dynamics and not necessarily those of AIST.

Authors

Peter Marcus (left)
managing partner,
World Steel Dynamics
pmarcus@worldsteeldynamics.com
+1.201.503.0902

John Villa (right)
research strategist,
World Steel Dynamics
jvilla@worldsteeldynamics.com
+1.201.503.0911

Figure 1



The steel cost roller coaster. Source: WSD's World Cost Curve for Flat-Rolled Sheet and SteelBenchmarker™.

8. Inflation in steelmakers' operating costs may be nil in the next five years. Factors at work may include: (a) lower prices for steelmakers' raw materials; (b) cost reduction efforts; (c) consolidating output at the lowest cost plants; and (d) lessened worker negotiating power. Regarding the last item, workers' bargaining power is reduced because they are more fungible and replaceable — by machines making ever better usage of advances in artificial intelligence.

Steel is a derived demand industry dependent on activity levers in its customers' industries. And, as well, the companies have high fixed costs and high capital intensity. Hence, there is an abundance of opportunity for management to take actions to improve their company's "economic rent."

This report includes forward-looking statements that are based on current expectations about future events and are subject to uncertainties and factors relating to operations and the business environment, all of which are difficult to predict. Although WSD believes that the expectations reflected in its forward-looking statements are reasonable, they can be affected by inaccurate assumptions made or by known or unknown risks and uncertainties, including, among other things, changes in prices, shifts in demand, variations in supply, movements in international currency, developments in technology, actions by governments and/or other factors. ✦