Steel Stumbles as Chinese Demand Cools

Shanghai steel futures languished near a record low amid cooling Chinese demand, putting more pressure on raw material iron ore that is only a tad off a seven-year trough.

A global glut of iron ore at a time of shrinking steel demand in top market China has caused iron ore prices to fall 38 per cent this year, on course for a third consecutive annual decline.

This has led to deep cost cuts for iron ore producers, both big and small, including mid-cap Australian miner BC Iron which incurred a net loss of A$158.5 million (US$114.07 million) in the year to June.

"Given the price of iron ore, reality needed to be addressed and acted upon. There was no point in building a current and future strategy on hope," BC Iron Chairman Anthony Kiernan said at the company's shareholders' meeting.

Based on annual pricing that preceded the current spot-based system, July's $44.10 mark was the lowest since 2005, according to data compiled by Goldman Sachs.

"Sentiment in the spot iron ore market was negative, with talk of rising output at iron ore miners flooding the market as steel mills start to shut production," TSI said in a note.

China's steel output dropped 2.2 per cent in January-October, while demand fell nearly 6 per cent during the period.

The bleak market has also forced closures among many of China's steel producers that have been hit by losses as the world's No. 2 economy heads for its slowest growth in 25 years.

Entry of Chinese Companies Stirs Excitement

The rise in the number of big China steel players investing in Malaysia via joint ventures or acquiring stakes in local steel mill companies has stirred up much excitement in the lackluster steel sector.

The China investors are interested in local steel millers that have secured iron ore concessionaires from the various state governments.

A notable investment is the RM1.8bil integrated steel mill complex in Kemaman, Terengganu under Eastern Steel, a joint venture between local steel pipe maker Hiap Teck Venture Bhd and China's Shougang Group, a global Fortune 500 company.

Alliance Steel (M) Sdn Bhd, a wholly-owned Malaysian subsidiary of China's Guangxi Beibu Gulf Iron and Steel Investment Co. Ltd, is set to invest RM4.2bil in an integrated steel mill for production of high carbon steel and H-shape steel in Kuantan.

Financially troubled Perwaja Holdings Bhd has also found a new partner in China's Tianjin Zhiyuan Investment Group Co. Ltd.

According to a Lion Group spokesperson, Chinese steel mills' involvement, whether "directly or indirectly", does not augur well for the domestic steel players.

"Given that almost all of them are state-owned and financed by their nation's huge reserves, these steel millers have deep pockets and will likely muscle the existing domestic players out of the market.

For example, Alliance Steel has been approved with a huge capacity of 3.5 million tonnes per year and would likely to produce the same products manufactured by the domestic steel mills, says the spokesperson.

Meanwhile, Southern Steel Bhd group managing director Chow Chong Long says that the China steel players are largely state-owned and many are incurring huge losses in China.

"I don't see any changes in the short to medium term as long as the dumping of cheap low-end steel from China continues.

"The China steel players, setting up mills or investing in Malaysia, cannot survive with the cheap steel exports flooding the local market," explains Chow. "They will not have the funds to complete their projects in Malaysia, while making huge losses in their home country as well as in Malaysia.

"This is already happening in among some joint ventures in Malaysia," says Chow.

Furthermore, China steel players that have shown interest or have already started to invest in Malaysia are not investing or producing high-end products.

"They are basically commodity steel products which will worsen the overcapacity and under-utilized production situation in Malaysia and the region.

Hence, the entry of big China steel players is unlikely to bring any positive changes in the domestic steel industry in the short, medium and long-term.

He says that players in Malaysia must continue to upgrade and improve on their efficiencies and should not rely on foreign investors to increase capacity.

"They must incorporate low energy and environment-friendly technologies," adds Chow.

For Southern Steel, the steel group is embarking on hot-coil roll production which is cost-effective while incorporating automation.

However, for the local steel industry to seriously venture into high value-added products, the participation of foreign steel players either via joint-ventures or foreign owned should be encouraged.

"Only this can bring about a positive change in the local steel industry landscape," adds Chow.