Minimum Import Price to Benefit Some, to Pinch Others

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Steel industry in India has been bleeding for the last couple of years due to cheap import from China, Russia, Japan and South Korea and other major producing countries. At a time when steel industry is facing acute shortage of demand from local sources due to lack of new investment in infrastructure, a slowdown in global economy prompted major world producers to dump into India.

As a consequence, Indian user industries started importing cheap steel products on massive scale. Since steel mills did not exercise production cuts in sync with demand, India underwent a steel supply glut.

Following global fall in steel prices, mills in India also cut their product prices resulting into their margins squeezed to unprofitable level. Most steel mills incurred massive losses in the last several quarters. Their market capitalization eroded to multi year low. Then, steel mills across the country approached the government for protection. After anti dumping duty levied few months ago which resulted into little change in the import situation, the government decided to levy minimum import price (MIP) to prevent cheap imports.

MIP Levy

The government early February imposed an MIP ranging from US$341-752 per tonne on 173 steel products to provide relief to local steel makers hurt by an increase in cheap imports. Steel industry is grappling with headwinds of subdued demand, excess supply and pricing pressure driven by surge in imports at predatory pricing. Applicable for six months from the date of notification i.e. February 5, 2016, or until further orders, whichever is earlier, the MIP expires on August 5. Industry sources explain that the notification covers over 80% of the total steel imports with price (CIF) in the range of US$445 750/ton. MIP will not be applicable on imports under the advance authorisation scheme and high-grade pipes used for pipeline transportation systems in the petroleum and natural gas industry. The notification said imports/shipment contracts (under Letter of Credit) entered into before February 5 is also exempted from the MIP conditions. Prior to it, the government levied safeguard duty (SGD) of 20% on hot-rolled coils (HRC) of width greater than 600 mm in September 2015, and hiked import duty on steel twice by 2.5% points each in June and August 2015.

The MIP is likely to provide an interim relief to urgently address the crisis faced by the steel industry, said the government. The government will continue to work on other measures which are more sustainable to reduce dumping of low priced imports. The notified MIP for steel products is 54-70% higher than spot export prices from China. Following imposition of MIP, steel industry has pinned hope on revival of Indian steel sector. In an interview, Sajjan Jindal, chairman and managing director of JSW Steel, said that more relief measures may possibly be announced in the budget 2016. Moreover, the steel sector is hopeful that the country's economy should grow by 8-8.5 per cent, which would help the industry to revive. The industry will have to wait and watch for its impact on the entire steel sector.

Meanwhile, the imposition of MIP has given the domestic steel manufacturers room to raise prices by US$75-200/ton depending on product categories. However, the steel manufacturers would not be able to pass on the full impact as increase in prices in the long products category would be also curtailed by lower scrap prices (scrap has not been included in the list of products under MIP). In the flat product category, demand remains subdued and hence customers would resist the large hike in prices.

IMMEDIATE PROTECTION MINIMUM IMPORT PRICE LEVIED ON STEEL	
MAJOR PRODUCTS	**PRICE (US $/TONE)**
Hot Rolled (Flats, Plates, Strips, Bars And Rods)	445-500
Semi-Finished Products (Iron, Alloys etc.)	341-362
Cold Rolled Steel	560
Coated Flat Rolled Steel Products	643–752
Bars & Rods Products	451

Its impact would be positive on Indian steel producers. The imposition of MIP along with the safeguard duty imposed by the government would help steel mills to raise prices upto 20 per cent assuming steel prices remain unchanged in the international markets. Since, experts believe, steel prices have bottomed out in global markets; a revival would provide bell weather for steel mills to raise their products prices proportionately in domestic markets as well.

But, price hike would be in a phased manner and would be quite lower initially than the landed price through imports. The increase in domestic steel making capacity would also curtail the increase in steel prices in the domestic market. However, flat products account for ~90% of Indian imports and major increases in imports over the last year has been in this category, As a result, flat product manufacturers would benefit more from this move as compared to long products. The imposition of MIP would not only help the domestic steel manufacturers to raise prices, but would also lead to higher sales volume. Cheap steel imports over the past two years resulted in sharp decline in domestic steel prices and eroded profitability of Indian steel makers. For the first nine months of the current financial year, steel imports were higher by 29% year on year, whereas domestic consumption grew by a mere 4.4% year on year. In FY16, of the total steel demand roughly 10-12 million tonnes is expected to be met by imports. But protectionist measure by the government would substitute imports through increase in domestic steel manufacturing capacity and higher utilisation levels.

Impact on Domestic Steel Industry

Steel import in India is likely to decline substantially in FY 2016-17 on the back of imposition of MIP, a recent report from the rating agency ICRA said. With the MIP covering almost the entire spectrum of steel products, which accounted for 87% and 98% of India' s total steel imports in FY15 and April-November of FY16, its impact on curbing imports is likely to be more effective than import duty hikes. These earlier measures of anti dumping duty however failed to have any material impact on reducing imports which, even after the imposition of SGD, continued to increase in Q3 FY16 as well, growing by 11.6% year on year (yoy), and 3.13% in December quarter. The MIP regime is expected to improve the margins and capacity utilisations of stronger domestic steel players. However, the extent of margin improvement is unlikely to be sustained over the medium term, given the likely demand-supply mismatch in the domestic industry at current demand growth rates, expectation of weak steel prices in international markets and a limited validity period of six months initially for MIP. Meanwhile, a strong recovery of domestic demand conditions would be critical for a sustainable improvement in the credit profile of domestic steel players. Domestic HRC and CRC prices will therefore recover in the coming months. However, the extent of rise will not be as sharp as the current price differential between import offers and MIP, which is $130-200 per tonne. The quantum of increase, however, would be much lower, in the range of $40-50/MT. The key factors that will temper the extent of increase of domestic prices will be large domestic surplus capacity, with domestic mills currently operating at an utilisation rate of 75%, and 10-15 million tonne per annum of fresh capacity currently at advanced stage of commissioning. The large integrated players having stronger financial profile to take this as an opportunity to moderately increase prices, and grab a greater market share from their weaker competitors to ensure better capacity utilisation at their plants. Operating profit margins for domestic blast furnace players after MIP will improve by around 5% as compared to levels registered in the first week of February. While there could be an improvement in debt protection metrics in FY17 from current levels following the imposition of MIP, they would still remain weak in absolute terms.

Steel Mills Raise Prices

Immediately after imposition of a minimum import price (MIP) on a range of steel products, leading domestic primary steel producers such as JSW Steel, Essar Steel and Jindal Steel & Power have raised product prices by up to four per cent effective February 8. Some of these companies have hinted at gradual but marginal price hike going forward. Sajjan Jindal – led JSW Steel raised is basic steel products prices by 4 per cent for both flats and longs. Confirming the development, Seshagiri Rao, managing director and group chief financial officer, said, "We have raised prices by less than 4 per cent in the retail segment for both flat as well as long steel products. Since we are in long-term contracts with OEM (Original Equipment Manufacturers), it's not possible to raise prices for these customers."

Following the move, Jindal Steel and Power also raised its products' prices albeit marginally. Domestic steel companies had been selling products at distressed prices owing to cheap imports that flooded the market.

Steel prices in India had fallen by over Rs 8,000 per tonne over the last year, severely impacting the operations of steel companies. Though the government has fixed MIP at $445 per tonne for hot-rolled, keeping in mind interests of customers, we have increased prices by 4-5 per cent only, said a spokesperson of Essar Steel.

In a recent report, Fitch said that MIP will allow domestic producers to raise product prices for most products by $50-$70 a tonne from current levels. The rating agency says because of weak domestic demand, capacity utilisation is unlikely to improve significantly. Hence, additional price increase, if any, would

BREATHER FOR DOMESTIC PRODUCERS					
PRODUCTS	MIP ($/TONNE)	IMPORT DUTY (%)	LANDED COST POST MIP (RS/TONE)	CURRENT PRICE (RS /TONE)	DISCOUNT OVER MIP (%)
Hot Rolled Coil	445	12.5	34,800	25,200	27.6
Cold Rolled Coil	560	12.5	43,800	28,500	34.9
Ingots/Billets	362	10	27,800	18,500	33.5
Bars & Wire Rods	449	10	34,300	24,000	30.0

be similar to the current levels (4-5 percent) but spread out over the next three months. Consequently, Fitch expects profitability of steel producers to remain weak compared with FY15 level. "We believe that further steel price increases and a significant improvement in steel producers' profitability will depend on a strong revival in domestic demand growth," the report states. The agency continues to consider the increased government spending on infrastructure to be the key catalyst for acceleration in Indian steel consumption growth, which was at 4.7 per cent in the first nine months of FY16. This followed weak demand from key end-user industries, such as real estate. Globally, supply continues to outstrip demand. The recent announcement by China, the world's largest steel producer, that it would cut its steel production by 100-150 million tonnes fails to adequately address concerns. China's capacity is close to 1.2 billion tonnes, with an output of around 800 million tonnes in 2015.

Contrasting Views

Cautioning the imposition of MIP on steel products will lead to further erosion in engineering exports, Engineering Exports Promotion Council (EEPC) India sought from the government a compensatory mechanism to make up for the increased raw material price which the distressed exporters, mostly in the small and medium enterprise (SME) segments will be made to bear, following big protection given to the large steel manufacturers. "The introduction of the Minimum Import Price on steel products will raise the cost of raw materials for engineering products by about 6-10 per cent depending upon the nature product. This will have a serious debilitating impact on engineering exports which have already declined by a huge 15 per cent in the first nine months of the current fiscal," said T S Bhasin, Chairman of EEPC India.

Segments like auto and auto parts, industrial and electrical machinery, products of MSME sector, which in any case have low margins and are facing cut throat competition will face sudden escalation in raw material price, giving a further jolt to the exporters. Moreover, the move will have an inflationary impact on the entire manufacturing sector and leakages of money as all import invoices will be at MIP now. "The Government must provide steel at global competitive prices and EEPC India requests the Government to provide a compensatory mechanism for higher steel prices that the MIP entails on domestic prices, he said. "A new International Price Reimbursement Scheme (IPRS) should be immediately introduced", he said. Bhasin said, the safeguard duties should be removed and not extended further as the MIP has already been fixed. It may be mentioned that the Advance Authorisation route is not used by the MSME sector and has many limitations. Hence unless a price reimbursement mechanism is worked out for engineering exporters, there will be no revival of exports in the next six months, the EEPC chief cautioned.

Echoing similar view, Process Plant and Machinery Association of India (PPMAI) and apex body representing the Process Plant Manufacturers in the country have written to Prime Minister Narendra Modi against excessive protectionism including imposition of MIP being given to the steel sector in the country. Process Plant and Machinery manufacturers which include major companies like Larsen & Toubro (L&T), Godrej, Thermax, Praj Industries, Aker Solutions, Toyo Engineering., ThyssenKrupp Industrial Solutions (India). (UHDE), Ion Exchange and BGR Energy Systems have strongly objected and expressed serious concern at perpetual protectionist environment being created excessively in favour of steel sector in the country without consulting the capital goods and industry sector. "India is in the process of globalizing its manufacturing base through establishment of Capital Equipment and downstream industries in medium and small medium enterprises (MSME) to generate employment as well as boost 'Make in India' vision through competitiveness of Indian products. However, government must also be understood that this goal is endangered if our industrial and trade policies are based on narrow perspectives of Protectionism for one individual industry. India should not be seen as a protectionist nation with unpredictable policies," said V. P Ramachandran, Secretary, Process Plant and Machinery Association of India (PPMAI).

"If steel industry including stainless steel is favoured with so much of excessive protectionism including curb on imports with anti dumping duties and additional safe guard duties and latest MIP in this competitive world, it will end up as a burden on the economy and scare away investors in other productive Capital Equipment as well as downstream MSME areas which have the potential to run efficiently and grow without support and develop export markets and most importantly generate employment for the youth in our nation," said Ramachandran.

Government has already provided enough protection to steel industry through high imports duties, Rupee devaluation by over 50% and trade barriers such as anti-dumping or safeguard duties. In a deregulated environmental government is taking away capital good industries right to access the required quality of raw materials and intermediates at competitive prices. Why only steel sector alone which is about 80 -90 per cent family owned business in the country is being taken care of and that too at the prospect of killing the downstream capital goods & MSME sector who are the backbone to 'Make in India' theme.

The recent proposal by Government to impose MIP for steel products without discussing with all the stake holders will further create confusion if arbitrary price is fixed and will hit domestic industry if asked to follow prices.

Conclusion

Of the large domestic steel producers, JSW Steel would benefit the most on account of higher share of flat products and rising steel capacity. Steel Authority of India Ltd (SAIL) too would also be a major beneficiary as share of exports is quite minimal. However, higher share of long products limit the benefit for SAIL. With international operations accounting for 60% of overall revenues for Tata Steel, the impact would be least amongst the large three producers.