

Lower Crude Oil Price to Weigh on Gulf Steel Industry

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Falling crude oil prices may affect the economy of the Gulf region badly and steel industry is not immune to it. A number of scheduled projects including some of Indian majors like the Steel Authority of India (SAIL) and Rashtriya Ispat Nigam Ltd. (RINL) may extend their deadlines for commencing commercial production on their respective projects due to steep fall in steel demand global. The ongoing worry over China economic growth may create renewed supply pressure on steel mills. Since, steel mills in the Gulf region face acute raw material shortage, their overall productivity may get affected severely.

Warning from International Monetary Fund (IMF)

In its latest forecast, the IMF said that the six-member Gulf Co-operation Council (GCC) will see gross domestic product growth slow from 3.25 per cent this year to 2.75 per cent next year. Council members average fiscal deficits are expected to reach 13 per cent of GDP this year, with the region's largest economy, Saudi Arabia, facing a deficit of 21.6 per cent in 2015 and 19.4 per cent in 2016. The projections were made by the IMF based on estimates of average oil prices at \$52 a barrel in 2015, down from \$110 a barrel in the first half of 2014, gradually increasing to \$63 a barrel by the end of the decade. Most Gulf countries fiscal measures are unlikely to achieve balanced budgets in the medium term, the fund warned. All regional exporters apart from Kuwait, Qatar and the United Arab Emirates are on course to run out of financial reserves within five years, it noted, adding that GCC states need to rebuild surpluses to deal with future oil shocks. But it expected states across the wider region to continue to raise debt levels to slow the rate of reserve depletion. Saudi Arabia, Oman, Bahrain, Iraq and Yemen have issued debt to cover the fiscal shortfall, with debt issuance expected to cover 22 per cent of GCC deficit-financing needs this year. To balance their budgets, Middle Eastern countries would have to reduce spending by 12-13 per cent of GDP over the year, the IMF warned.

Positive Attitude, Negative Headwind

In fact, falling oil prices may prove the best medicine for economies in the Arab world, rebalancing growth towards countries struggling to recover from the Arab Spring uprisings without doing major damage to the oil exporters of the Gulf. The price of Brent crude has sunk by nearly \$20 from its June peak to as low as \$96 a barrel in recent weeks, its lowest level since mid-2012. Behind the drop is soft economic data from top consumers such as China; a plentiful supply outlook points to further price declines in the next two years. By the end of the first week of January, however, it is hovering around \$32 a barrel. It is potentially the biggest shift for the Gulf Arab economies since the global financial crisis five years ago. But the huge financial reserves that they have built since then mean they are likely to cope fairly comfortably with cheaper oil.

Meanwhile, cheaper oil would be very good news for weak Arab economies that are still struggling to recover from the political fallout of the region's 2011 revolutions and the economic slump in Europe, which widened their external deficits. Interestingly, Egypt, Morocco, Tunisia, Jordan and Lebanon would enjoy a \$4 billion annual reduction in their combined import bills for every \$10 fall in the oil price on a sustained basis. Since 2011, the Gulf Arab countries have scrambled to protect geopolitical stability in the region by providing tens of billions of dollars of aid to keep the weak economies afloat, particularly Egypt. An era of cheaper oil could reduce the need for the Gulf to provide this aid - in effect, the oil market would be transferring wealth to the poorer countries through lower prices, rather than Gulf governments transferring it through loans and grants.

Steel Industry in Arab Region

There are 67 steel plants in the Arab region and the demand for steel is rising at 5-6% every year. It is predicted that half of the world steel could be produced in Arab countries. However, this may depend

on how well they can keep up with worldwide developments in the industry as well as consolidations and mergers. With oil-exporting countries within the GCC aiming to diversify their economies, steel demand from downstream industries is expected to expand in the region for a long run. Many projects have been announced recently in the Middle East, often with the objective to reduce import dependency. However, these developments have led to concerns that the industry's expansion might lead to over-supply issues in the region, particularly in the square billet market. Steelmaking is predominantly EAF-based, and the preferred feedstock is DRI, owing to plentiful (and thus relatively low priced) natural gas availability in the region.¹³ DRI is generally expected to remain a major feedstock in EAF steelmaking, and the EAF process, in turn, is expected to continue to play a dominant role in steelmaking route in the region.

Major Projects Taking Place in the Middle East:

Iran aims to expand its steelmaking capacity to 55 million tpy by 2025 (Reuters, 2014). Most new plants will be based on the DRI-EAF route. The country has significant resources of iron ore deposits and low-cost natural gas, and these factors are affecting the choice of raw materials used to produce steel in Iran. Although eight new steelworks have been under construction by state-owned IMIDRO since 2006, and numerous projects have been announced, a number of projects were put on hold because of financing constraints caused by economic sanctions.¹⁴ Currently, Middle East Mines Industries Development Holding Company (MIDHCO) is involved in three greenfield projects in the country: Butia Steel Company (BISCO), Sirjan Iranian Steel Company (SISCO) and Zarand Iron & Steel Company (ZISCO).

Meanwhile, falling crude oil prices coupled with economic sanctions has led to the drop in Iran oil revenues resulting into the government was forced to cut its construction budget which has significantly reduced demand in the steel market since the country's main projects in various sectors, including oil, gas, and construction, were being conducted by the government. Over 8.2 million tons of crude steel was produced in Iran during the first half of the current Iranian fiscal year, a fall of 1.8 percent year-on-year. Iran crude steel output reached 16.33 million metric tonnes in 2014, with country being the 14th major crude steel



producer in the world. Chinese producers are dumping steel products on overseas markets, that is, not just selling them cheaply, taking advantage of their lower production costs, but actually selling products at a loss to destroy the steel industry in other countries, he remarked, adding that this had forced these countries to resort to an anti-dumping steel import tax increase. China was supplying the market, which was already suffering the effects of stagnation due to the surplus output of 100 million tonnes from 2014, at low prices.

In Oman, growing steel demand (driven by construction activity) is encouraging domestic producers to increase their capacities and is attracting new investors to the steel industry. Scrap consumption is expected to grow due to capacity expansion projects, while some companies plan to install DRI modules because domestic scrap collectors may not be able to supply enough material for several years. An example of capacity expansion projects can be found in Jindal Shadeed Iron and Steel project, which involves a 2 million tpy EAF steelmaking complex, including a DRI module. Sun Metals and Moon Iron & Steel (MISCO) also plan to install EAF facilities.

Saudi Arabia is currently experiencing fast-growing demand for electricity driven by population growth and industrial development (NOREF, 2013). Although a shortage in natural gas allocation and electricity generation capacity has delayed the launch of a number of steelworks in the country, many EAF projects are currently underway to balance billet imports. For example, Saudi Iron & Steel Company, the largest integrated steelmaker in the Middle East, started trial runs at its sixth electric arc furnace of 1 million tpy in February 2014. Also, Arkan Steel and Al Atoun Steel are building EAF-based plants.

Major steel mills in the Gulf region has reduced their operating capacity due to weak demand and falling oil prices resulting into overall

infrastructure spend in the region. For instance, Foulath company Bahrain Steel's pelletising output is up 40 per cent in 2014, but the overall plant utilisation remained low in 2015 as raw material supplies from its two main Brazil sources continued to be hampered because of force majeure events. However, the company (formerly known as GIIC) has a promising outlook for the next two years and conditions could be favourable for ramping up production by more than 80 per cent in 2015 and reaching its full annual capacity of 11 million tonnes in 2016. The prospect of value addition in the future appears as one that would be worth exploring

Better Prospects Await Bahrain Steel

In all, Bahrain Steel is becoming prosperous. The year 2015 is estimated to have ended with 9 million tonnes of output. The incremental production will mainly be supplied to Bahrain Steel's traditional customers in the region, where the pellet demand remains strong and the superior quality of its products is widely recognized. The expected good year in 2015 will overflow into 2016 with the prospect that in the latter year Bahrain Steel will produce at full capacity, 11 million tonnes. Bahrain Steel has two pelletising plants, one of five million tonnes annually and operating since 1984 and the other of six million tonnes (potentially seven million tonnes) and running since 2010. Ahead of reaching full capacity in 2016, Bahrain Steel has classified its customers in four broad groups. In 2016, when Bahrain Steel hits its nameplate capacity, there will be the temptation to think of a capacity expansion. But that will not be as easy as it sounds. For one, there is the issue of dedicated gas supplies, which have to be substantial, as an expansion of such a kind involves upgrading by another five or six million tonnes annually. On the other hand, issues related to demand growth pattern and consistency as well as reliability in high-grade raw materials come to the fore.