Challenging Times are here to Stay

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The Steel Trade has seen tumultuous times in the last few years. Starting with the extremely challenging markets in the late 90's to a boom that took place in 2008 and the subsequent crash. Though initially, markets had appeared to settle between the years 2010 to 2013, the last year has seen a dramatic change in the global steel scenario. Iron Ore Prices have crashed, the price of Steel has reacted similarly and China has started to export more than 100 million tons annually.Unfortunately for Steel Producers in the rest of the world, this has led to increased competition and a compression of margins. Many steel producers are in a bad financial position and are hoping that prices will improve. Unfortunately, market improvement is unlikely for a number reasons that point to a structural change.

To understand the scenario, we have to look to China as the driver of the changes. From the year 2000 to 2014, steel consumption growth in China was averaging at over 10% per annum. Consumption grew from a base of approximately 200 million tons to over 700 million tons annually. In the late 90's before the rise of China's rapid steel production and consumption, steel prices were in inflation adjusted terms the cheapest they had ever been. The CIS countries after the fall of the Soviet Union were eager to export hard commodities for cash and there were no legacy costs to contend with for the new Steel Plant owners. A maturing of the CIS based producers coupled with the strong demand from China led to prices increasing on a yearly basis till 2008. In 2008 Steel suffered from speculative demand that led to new highs that are not likely to be ever repeated. The subsequent crash was caused both by excessive speculation and the financial crisis. China reacted to the financial crisis by unleashing a tremendous fiscal stimulus and has since the repeatedly undertaken similar actions to keep economic growth strong. No doubt, they were hoping that once the rest of the world recovered, they would be able to slack of on their stimulus and export their excess production in all sectors to a newly growing world economy. The rest of the world economies have in fact not recovered from the crisis and are still resolving their issues.There are four reasons to suspect that for the foreseeable future steel markets are going to remain challenging and producer margins will remain compressed.

Firstly, there will be an oversupply situation for iron ore for many years to come. The ravenous appetite for iron ore from China led to extremely high prices for a commodity that had been singularly uninteresting for centuries. Iron oxide is the most common element available in the earth's crust and it is not logical to have such high prices for such an abundant commodity. Due to the rapid increase in iron ore demand from China, prices of iron ore rose significantly. With such high prices and the consequent margins enjoyed by iron ore miners, iron ore mining became a highly profitable business. This unleashed a horde of new iron ore mining projects that based the feasibility studies on a projected consumption and production of more than a billion tons of steel in China and prices remaining in the above 150 US Dollar range CIF China. As we are acutely aware today iron ore has dropped to 50 – 60 Dollar Range CIF China and there is still plenty availability and many supply projects that are still in the completion stage. It is unlikely the Chinese iron ore imports will increase enough to impact prices significantly despite the closure of many high cost mines within China and the subsequent drop in domestic production.

This leads to the second reason as to why steel prices are unlikely to rise. Steel consumption in China has flat lined. A massive fixed investment boom the like of which the world has never seen drove Chinese steel consumption. China decided to urbanize and to urbanize fast. In the last 15 years China has built to the kind of infrastructure it took the United States more than 40 years to build. Granted there is still much to do in China, but the rate of investment has been astonishing and it would be safe to say that there is less to do in the next 15 years than in the last to bring China's infrastructure to first world status. At present long product consumption in China is more that 80% of market. In the developed world long products constitute, in most countries, less than 50 % of the demand. It is very likely that long product demand in China is going to drop in the next few years. In fact current evidence suggests that this trend is already underway. For flat product consumption to grow enough to even replace let alone outpace the drop in long product consumption, China would have to turn each and every individual of their population into an "American Consumer". That is highly unlikely to happen. China may continue to grow or may stagnate. However, it is not likely that either outcome would affect the fortunes of steel producers positively.

Thirdly, Chinese GDP is falling and it has been a long time habit of the Chinese government to target GDP growth as the most important parameter of Chinese domestic policy. GDP growth targets and the investment boom they inspired have led to lifting hundreds of millions of the Chinese population out of poverty and farms into middle class urban workers. It has inspired a productivity boom in China and China has become a factory to the world. With this model of growth now ceasing to inspire the growth it had previously, the government is seeking avenues to at least avert contractions in the Chinese economy. When steel consumption falls or stabilizes as it has done in China. How do you keep growing the steel industry or at least prevent it from shrinking? The answer of course is to export the excess. Since 2011 Chinese net exports have grown from a marginal 20 – 30 million tons per annum to more than 100 million tons per annum. The Chinese export more than any other country produces. Japan as the second biggest producer only make 110 million tons, China will likely export 120 million tons this year. If the Chinese continue to insist on exporting their excess steel due to falling domestic demand, there is no way for price pressures to be relieved in the steel industry. Countries may adopt temporary anti-dumping measures but the global effect of these exports will not allow any country to shield their industries in the long term. In other words you cannot anti-dump everybody in a Free Trade World.

Fourthly, there is no evident demand scenario that would be able to soak up the excess capacity in China or the rest of the world that may act as a pressure relief valve on this scenario. Europe is teetering on the brink of recession. The U.S.A has had an anemic recovery. Africa and South America are unlikely to grow for decades due to lack of political will and cohesiveness. The Middle East is either mired in war, sanctions or simply not big enough as in the case of the GCC countries to make a difference. In Asia, many of the economies are highly dependent on Chinese demand and/or the domestic economy is weak for a variety of reasons including China displacing their production capacities in almost every sphere. The only country that had the population and lack of infrastructure that would be a possible candidate to soak up excess global steel production is India. However, nobody thinks that this is going to happen in the short to medium term. Hence, oversupply is a condition that is going to remain globally unless the Chinese government acts unilaterally, and as explained above, due to domestic growth constraints, they are unlikely to do that.

That leaves Steel Producers globally in a very uncomfortable situation. We are forced to face a difficult situation that may not have any resolution for some time to come. The question of course is how to adjust to such conditions. Different countries have adopted different measures, such as anti-dumping a strengthening of non – tariff barriers etc. For the MENA and especially GCC markets, it is unlikely that any government is going to impose anti-dumping tariffs. The institutions are simply not designed for such measures and there is a lack of political interest to protect local producers. Countries such as Egypt have taken a few half measures, but inflation fears a general lack of knowledge about the effects of commodity dumping on local industry will conspire to prevent further tariff barriers on Chinese imports of steel. Local producers in the GCC have been somewhat fortunate that their main product Rebar for Construction has not been affected directly by Chinese exports. The lack of local acceptance for the quality assurance and also long lead times plus local availability has prevented the Chinese producers from penetrating this market significantly. What should producers do to survive?

In our opinion, producers need to be aware of the increased competition and continue to support their local markets with reasonable prices and good service and quality. This would prevent them from losing market share to the Chinese import threats. Many of the producers have lowered their prices but not to a necessary extant to ward of the threat of imports. Further, even though it is unlikely that local governments will extend tariff barriers to help the local mills. The local mills should continue to apply pressure to the regional governments on anti dumping issues.