UK Steel

Analysis of steel price developments – summer 2008

In March 2008, UK Steel issued a paper summarising developments in the global steel market and the implications for steel prices in the UK.

Since that report, steel prices worldwide have continued to rise rapidly. The present report therefore updates the earlier data. Its objective is to explain the underlying causes of these price trends; and to reassure UK steel consumers that it is a global phenomenon: overseas consumers are equally affected by these developments.

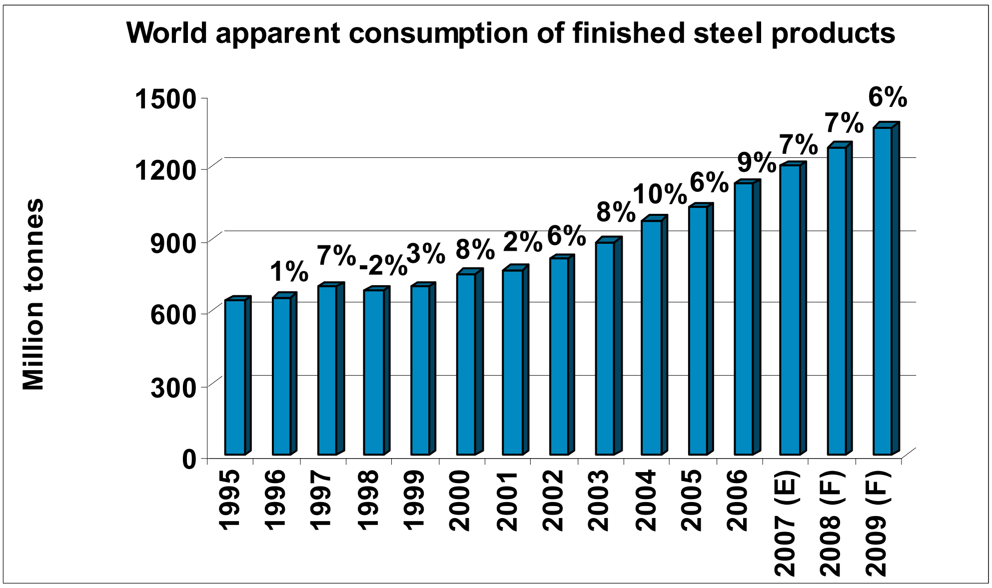
Executive summary

Global steel demand continues to show strong growth – particularly in a number of key newly industrialising countries. This in turn is putting pressure on the supply of steelmaking raw materials, resulting in rapid price increases – most notably for coking coal and iron ore, the two principal raw materials for steelmaking. Together with escalating freight and energy costs, these developments are in turn forcing steel producers around the world to raise their prices.

The UK and EU steel market is no exception to this global trend. All producers are rapidly raising their prices as they seek to recover the cost increases. UK Steel's members understand the impact on UK steel consumers. However, this is a global phenomenon, and UK consumers' foreign competitors will be similarly affected. Furthermore, as this paper also demonstrates, steel prices still remain historically low in real terms.

Steel consumption

World steel consumption has continued to grow at historically high rates, and this trend is forecast by the International Iron and Steel Institute (IISI) to continue. The following graph is based on IISI forecasts produced in March 2008.



Source: International Iron and Steel Institute

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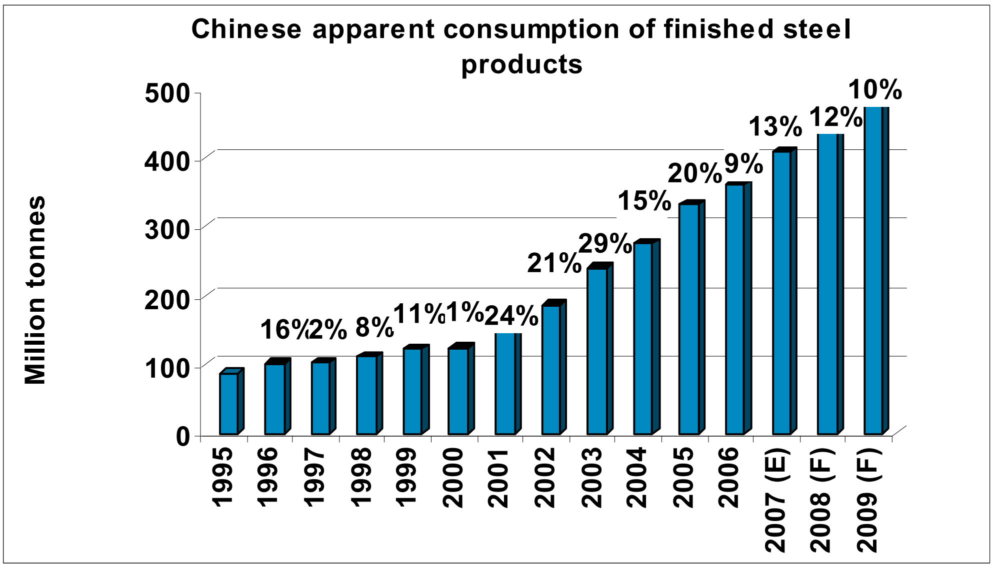
China continues in volume terms to be the main driver of this growth.

Although Chinese demand growth has abated somewhat from the peaks reached in the early years of the decade, it is still rising at nearly double the global average rate. China is forecast to consume 35% of the world's steel this year, compared with only 15% in 1995.



Source: International Iron and Steel Institute

However it is not just China: many other countries and regions also continue to show strong growth. Russia, Argentina, Brazil, Peru, Saudi Arabia, China, Indonesia and Vietnam are all predicted to enjoy double digit growth this year, as in Europe are Poland, Romania and Serbia. For the so-called BRIC (Brazil, Russia, India and China) countries in total, growth is forecast at 11%. While the EU is forecast to be more subdued in 2008, this follows a relatively strong performance in 2006 and 2007. Demand is also forecast to pick up in the USA this year, after the sharp drop experienced in 2007.

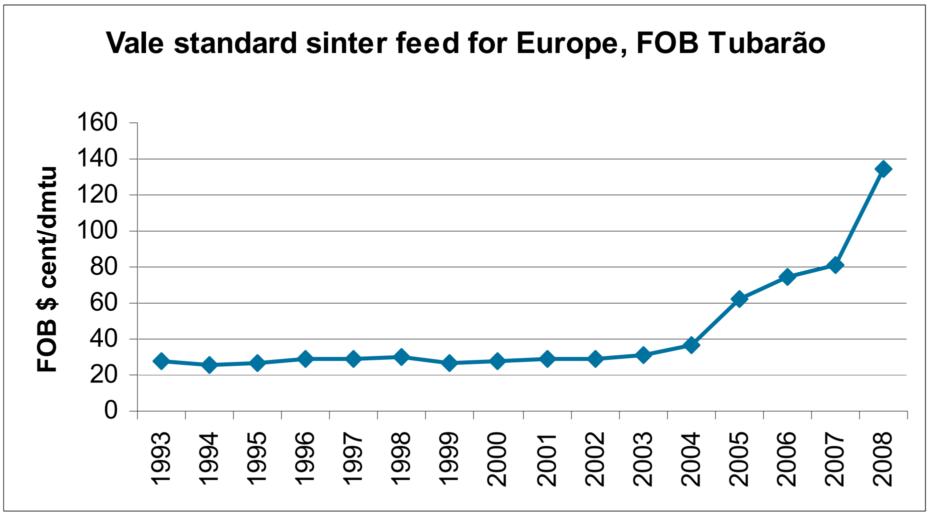
Table 1: Forecast steel consumption in 2008 compared with 2007.

	2008 Forecast		
	Million tonnes	% change over 2007	Share of world total
EU27	195.3	+1.6%	15.2%
Other Europe	33.1	+6.0%	2.6%
CIS	60.5	+8.9%	4.7%
NAFTA	144.2	+1.9%	11.3%
Central & South America	44.6	+8.9%	3.5%
Africa	26.8	+5.9%	2.1%
Middle East	49.2	+11.1%	3.8%
China	455.1	+11.5%	35.5%
India	55.3	+8.9%	4.3%
Japan & Korea	137.3	+1.8%	10.7%
Other Asia	71.9	+5.6%	5.6%
Oceania	8.8	+2.0%	0.7%
WORLD TOTAL	1,282.1	+6.7%	100.0%

Source: IISI

Input costs
The constantly increasing demand for steel is in turn causing tight supply of, and pushing up the price for most steelmaking raw materials, at the same time as most other costs are continuing to rise.

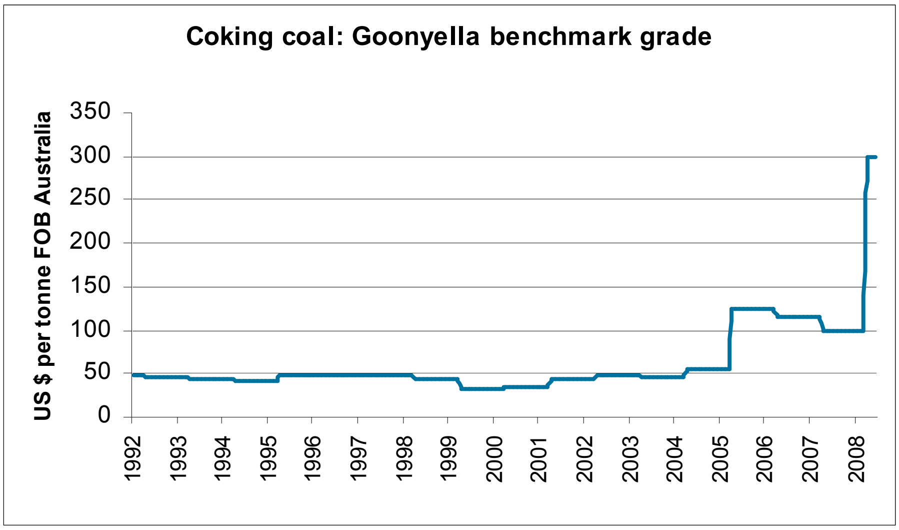
- **Iron ore**
  Iron ore is sold on an annual contract basis. After a couple of more subdued years, the 2008 contract price rose by 65%. Since 2004 iron ore prices have increased by nearly 300%.



Source: Steel Business Briefing

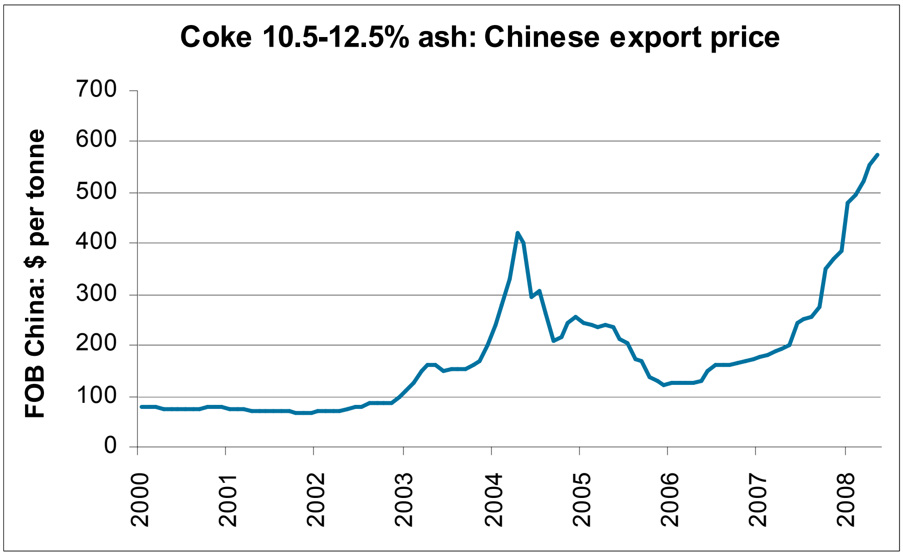
The world iron ore industry is highly concentrated with the top three suppliers (BHP Billiton, Vale and Rio Tinto) accounting for around 75% of the market. Steelmakers have warned that a successful takeover of Rio Tinto by BHP Billiton would increase the market power of the iron ore miners still further, creating in effect a duopoly, and Eurofer has asked the European Commission to block the merger. If however it went ahead, the merger would put further upward pressure on ore prices in the future.

- **Coking coal**
  The recently concluded 2008 settlement for coking coal resulted in a staggering **200% price increase**. This has arisen primarily because of flooding in Australia earlier in the year creating supply shortages.



Source: Industry reference prices/Corus

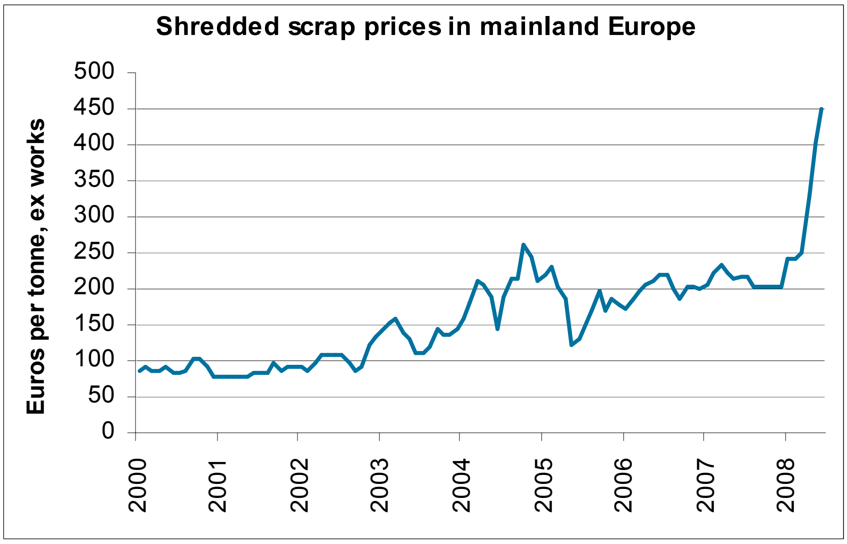
- **Coke**
  Unsurprisingly, prices for internationally-traded coke have also started soaring again. The EU steel industry is not self-sufficient in coke, and relies on imports to meet shortfalls in domestic production.



Source: Steel Business Briefing

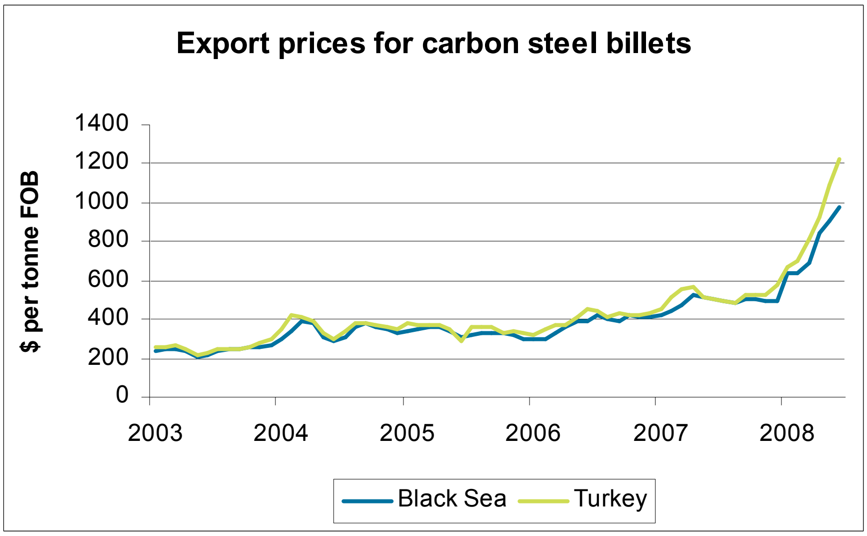
- **Scrap**
  Scrap prices in recent years have tended to be volatile, but the price surge experienced since the beginning of the year is unprecedented. UK scrap prices, which are influenced by export markets and thus driven by the strong demand for scrap from third country steel-producing markets, have risen by 75% since March. Prices in mainland European markets rose by 80% over the same period.

  Prices of light long products, such as rebar, merchant bar and mesh quality wire rod, are heavily influenced by the price of scrap.



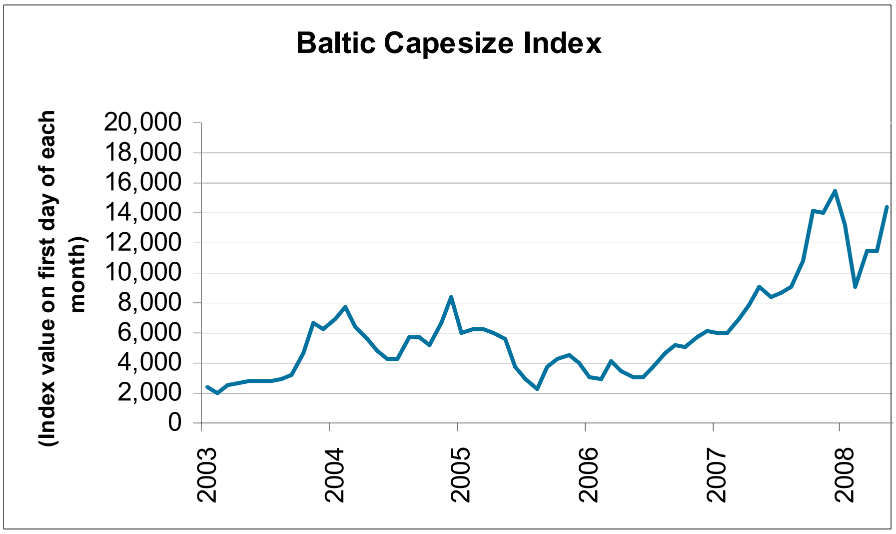
Source: Steel Business Briefing

- **Other feedstock**
  Unsurprisingly, these cost increases have also fed through to semi-processed feedstock. World billet prices for example have surged, impacting on UK re-rollers of merchant bars, regardless of whether they source from within the UK or from overseas.

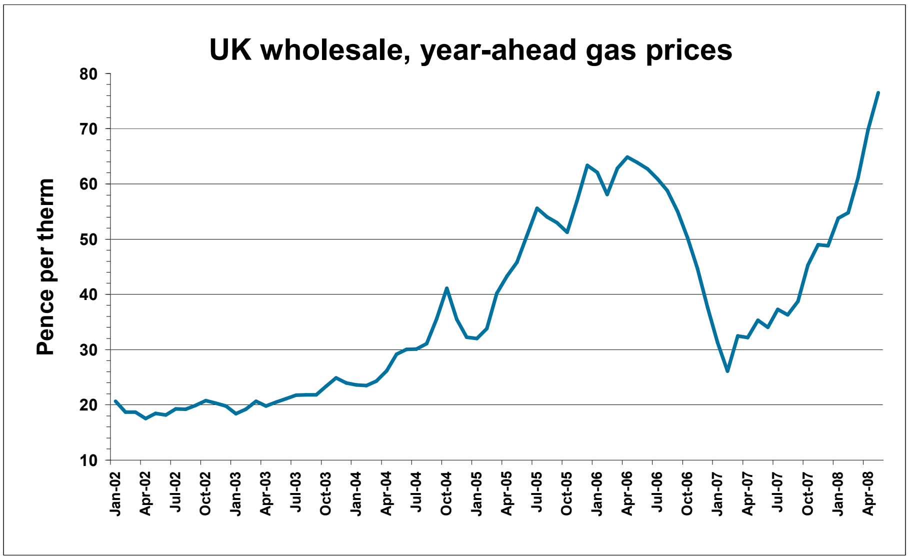


Source: Steel Business Briefing

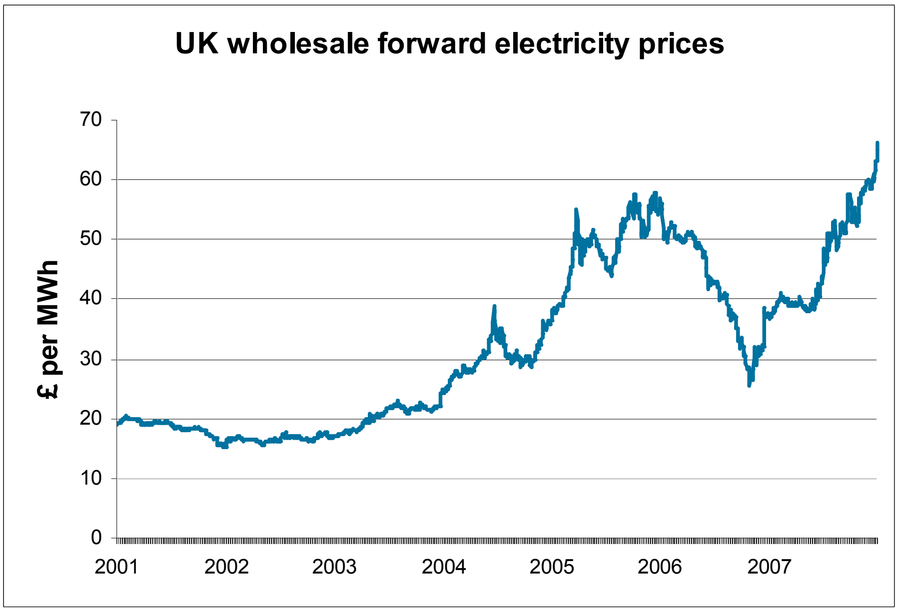
- **Shipping**
  Driven by a shortage of vessels, shipping costs have escalated dramatically. By December 2007, one-year time charter rates were 250% higher than the 2006 average. Rates slipped back in the new year, but have been rising in recent months. The following index shows the increased cost of shipping steelmaking raw materials.



- **Energy costs**
  Like the rest of UK manufacturing, the steel industry has been experiencing high energy prices. As an energy intensive industry, this has had a far greater impact on steelmaking costs than for many other sectors. Forward prices for both gas and electricity are showing worryingly high increases, with the UK gas and electricity prices once again outstripping those of our main Continental competitors.



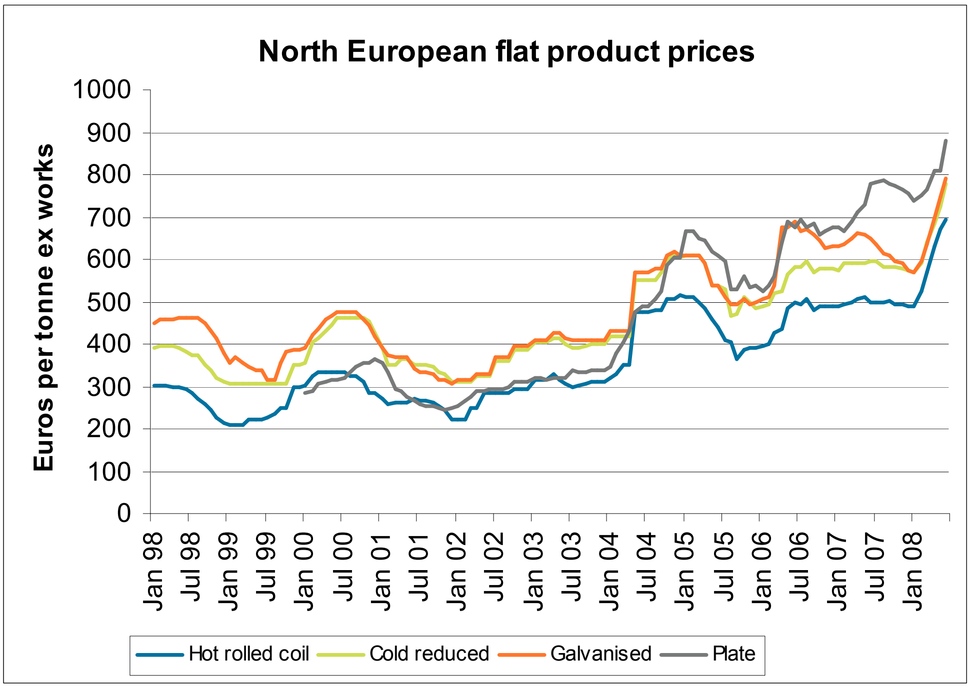
Source: Energy Intensive Users Group



Source: Corus

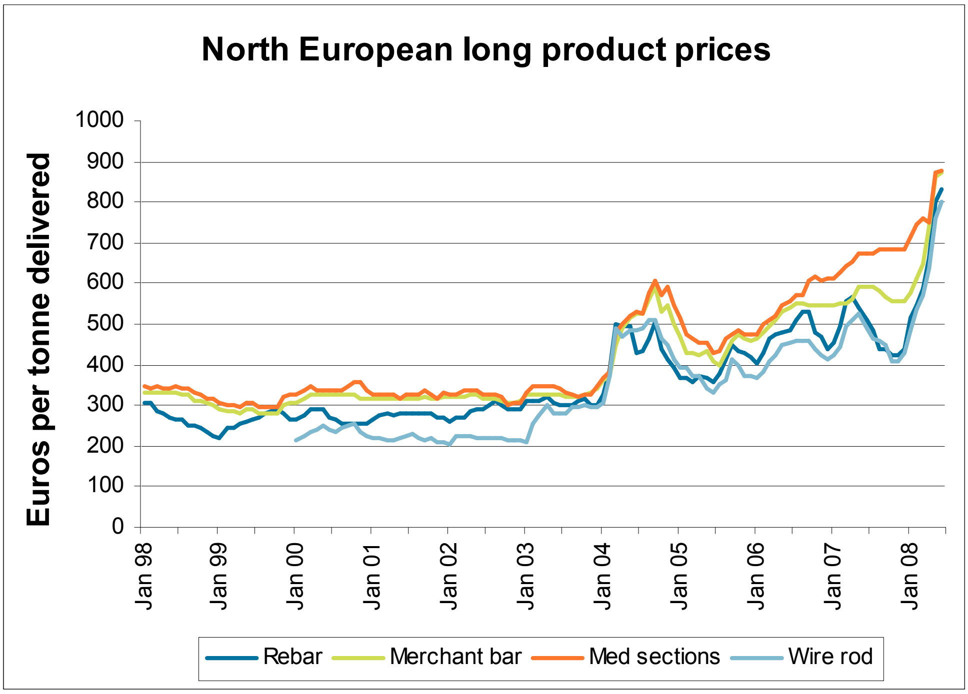
Impact on steel prices
In the light of these developments, steelmakers and re-rollers have had no choice but to seek to recoup their higher input costs through price increases. The following graphs show transaction prices as recorded by the independent steel industry journal, Steel Business Briefing.

After nearly two years of being more or less stable, prices for strip mill products started rising in February, and are currently **39% up** on average since the beginning of the year.



Source: Steel Business Briefing

Long product prices in Europe have been more volatile, because of the strong link to scrap prices. On average, light long product prices have **risen by 60%** since December. Within this however, reinforcing bar and mesh quality wire rod prices have been at a far faster rate – at nearly 90% – reflecting tight market conditions. All four long products monitored have now reached record high levels – most notably for medium sections.



Source: Steel Business Briefing

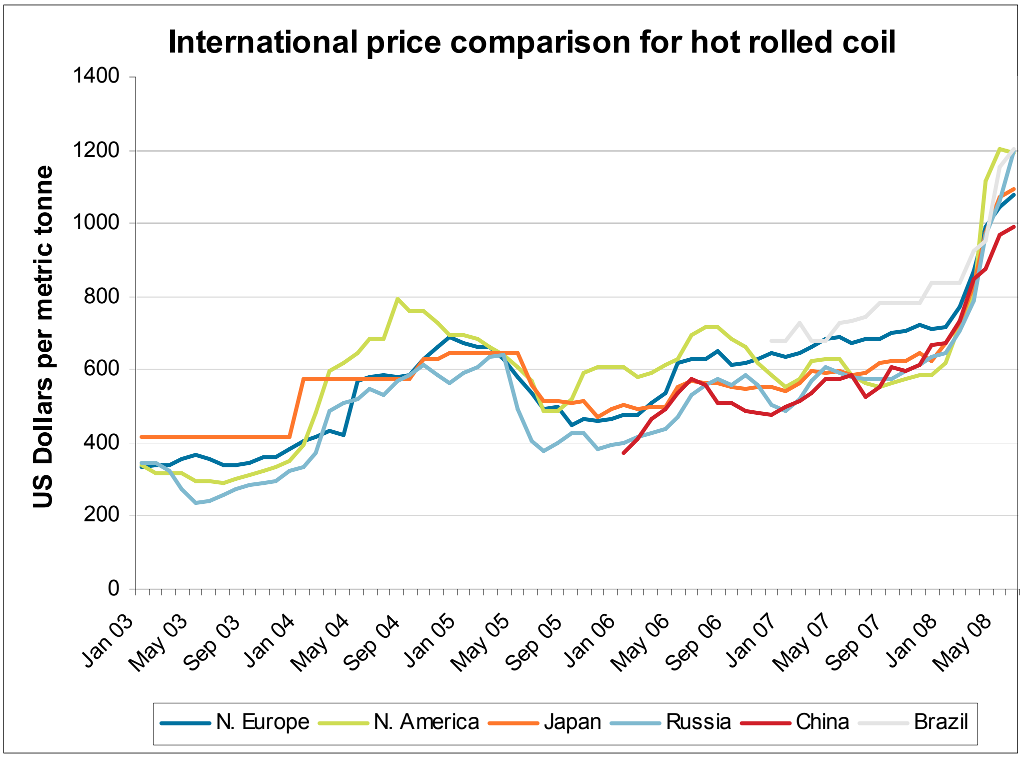
The above graphs show prices as recorded in the market through to June 2008. The recent coking coal price settlement and surging scrap prices have, amongst other things, forced steel companies to announce a series of further price increases for the July to September Quarter. The following table lists a selection of recent announcements by major EU producers and/or press reports of their pricing intentions.

Table 2: Recent announcements and reports of further price increases

Date of announcement	**Company**	**Product**	**Detail of increase**
2 May	Salzgitter	Flat products	+ €130 per tonne in Q3
19 May	ArcelorMittal	Flat products	Raw material surcharge of €160 per tonne from 1 July.
19 May	ThyssenKrupp	Flat products	€120 - €130 per tonne for Q3
21 May	Corus Strip Products	Strip products	Mainland Europe prices to increase by minimum of €130 per tonne from 1 July.
28 May	Corus Construction & Industrial	Plate	+ £60 per tonne from 29 June
		Structural sections	+ £90 per tonne from 3 August

International dimension
As previously stressed, the upwards pressure on steel prices is part of a global phenomenon. It is driven by the global growth in demand; and the increases in iron ore, coking coal, shipping and energy prices affect all steel producers regardless of their location[1]. Thus steel prices are moving in parallel in all the main regional markets.

The following graph tracks price movements around the world for the benchmark product hot rolled coil.



Source: [Steel Business Briefing]

Notes:
North European prices are the same as those used in graph 11, i.e. ex works for domestic shipment, converted into US dollars.
North America: Domestic price FOB mid-west mill.
Japan: Domestic price FOT.
Russia: Export price, FOB Black Sea port.
China: Export price, FOB Shanghai.
Brazil: Domestic price, delivered.

It will be noted that, not only are the trends identical throughout the world, but, with the exception of Chinese FOB export prices, hot rolled coil prices in all markets are currently clustered in the $1,050 to $1,200 range.

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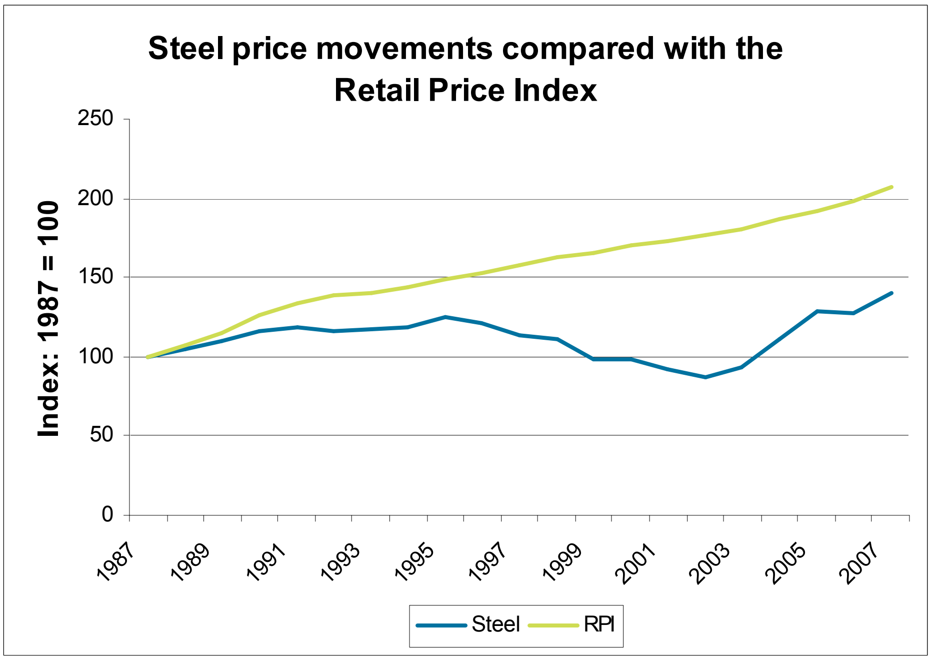
[1] The main exception to this statement relates to steel companies who are backwardly integrated, with their own ore or coal resources. Because the increases in world ore and coal prices are not related to cost increases, backwardly integrated steel companies have been able to take advantage of the increases in steel product prices by greatly increasing their profit margins. This does not apply to Western European producers (although ArcelorMittal does have access to iron ore at several of its non-EU plants).

Steel is still good value
Over the past two decades, steel prices constantly declined in real terms. Indeed, after eight successive years of absolute price reductions, steel prices only started picking up in 2003. The following graph plots the prices of a basket of steel products in the UK compared with the retail price index in the period 1997 to 2007. While this graph does not reflect the recent price increases, it should be noted that in 2007 steel remained 32% cheaper in real terms than it was in 1987.



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