UK Steel

Report on steel market developments

October 2009

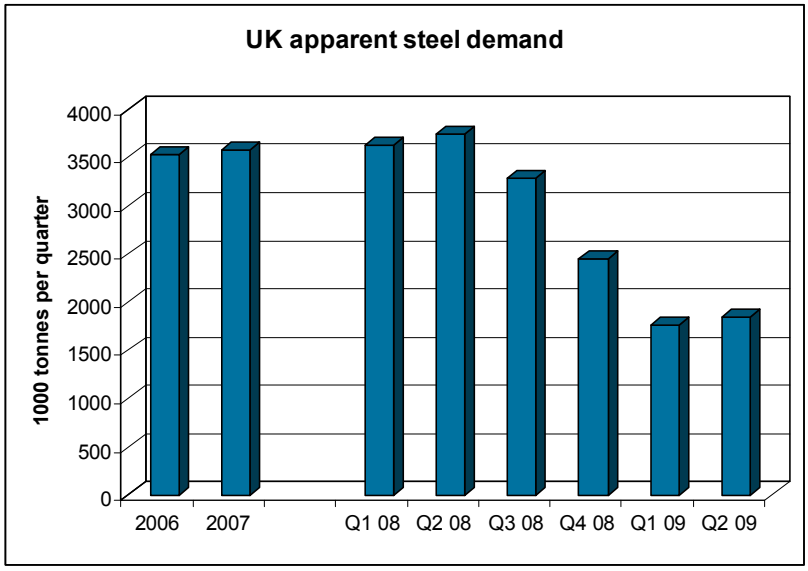
Summary

Customers have been raising concerns about steel shortages on the UK market, particularly affecting flat products. This paper examines the causes of these shortages, and concludes that they are expected to be resolved within the next few weeks.

The paper also analyses recent market developments more generally and the factors influencing steel price increases.

UK steel demand and output

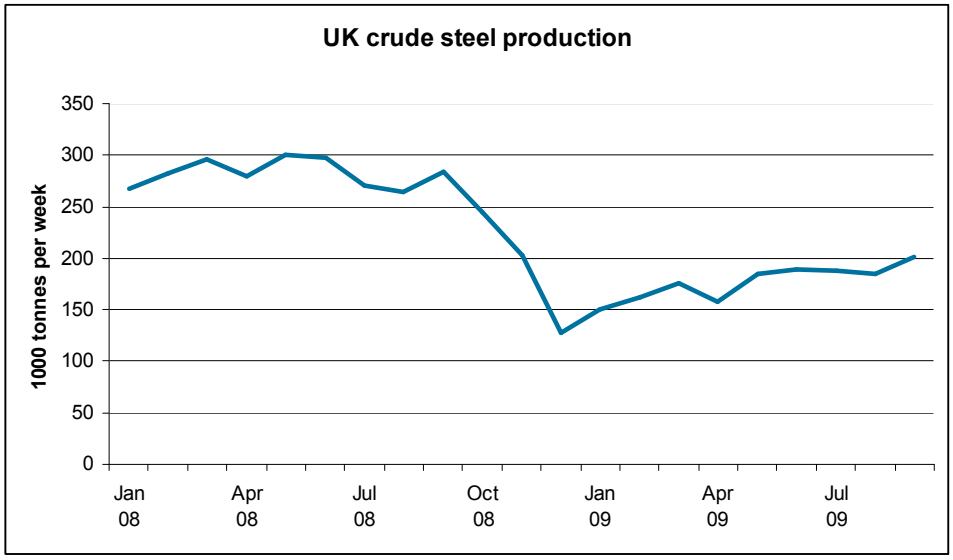
As prices rose during the spring and early summer of 2008, excess stocks built up in supply chains. As it became clear that the world economy was entering a recession, consumers and stockholders started liquidating these stocks, resulting in an unprecedented collapse in demand. In the nine months from Q2 2008 to Q1 2009, UK demand for steel fell by 53%. This de-stocking continued well into 2009, ending mid-way through Q2.



Source: ISSB Ltd

UK producers responded rapidly, trying to match supply to the market's needs by taking extended shutdowns, reducing shift levels and mothballing plant. In the specific case of flat products, Corus mothballed the Llanwern hot strip mill and one of the two blast furnaces at Port Talbot.

INVESTOR IN PEOPLE



Source: ISSB Ltd

This pattern has been repeated in every major steel producing country in the world, with the notable exceptions of India and China. In the period January to August 2009, global steel production minus China was down by 32.4% compared with the 39.0% cut suffered in the UK.

As steel demand started picking up in Europe in the early summer, steel producers started to bring idled capacity back into operation. One problem is that blast furnaces are relatively inflexible. Increases in steel capacity therefore can only be introduced in large increments. Producers therefore need to be reasonably assured that decisions to restart mothballed plant are underpinned by sustainable increases in demand.

Nevertheless, a significant amount of capacity has been brought back into operation around Europe. Based on press reports, at least 11 blast furnaces either have been or are planned to be relit, amounting to over 15 million tonnes of additional capacity, including furnaces at the following locations:

Company	**Location**	**Date of re-lighting**
ArcelorMittal	Ghent	July
	Florange	August
	Gijon	September
	Bremen	September
	Fos-sur-Mer	Q4
Corus	IJmuiden	July
	Port Talbot	October
Riva	Taranto	September
SSAB	Oxelösund	August
ThyssenKrupp	Duisburg	November – under consideration
U S Steel	Kosice	September
Voestalpine	Linz	September

Specifically in the UK, Corus is currently in the process of relighting its idled furnace at Port Talbot, with a capacity of 2.2 million tonnes per year. Prior to this it reopened the hot strip mill at Llanwern in September.

One further issue is that furnaces can not be brought back into full operation instantaneously. It typically takes around two weeks between re-lighting a blast furnace and its output approaching full operational capacity. Furthermore, adaptations will also be needed both upstream and downstream, which are technically complex and can lead to additional delays. This has meant that some of the restarts in Continental Europe have been slower at delivering output increases than planned.

Nevertheless, it is expected that a significant increase in strip mill product output will have been achieved in the UK by November.

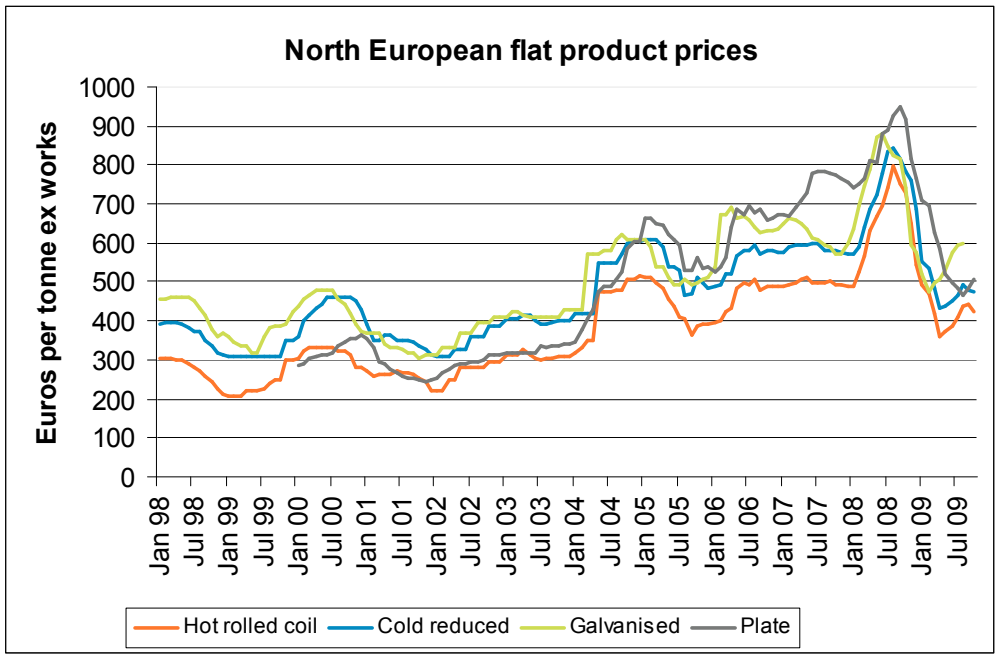
The above applies mainly to flat products, the vast bulk of which in Europe are produced using the blast furnace/basic oxygen steelmaking process route. The majority of (but by no means all) long products are produced using the electric arc furnace route[1], which is more flexible.

Steel price developments

As demand slowly picked up, steel producers have been able also gradually to recoup some of the immense price cuts suffered during the slump.

Flat products

The following graph shows developments in flat product prices in Northern Europe.

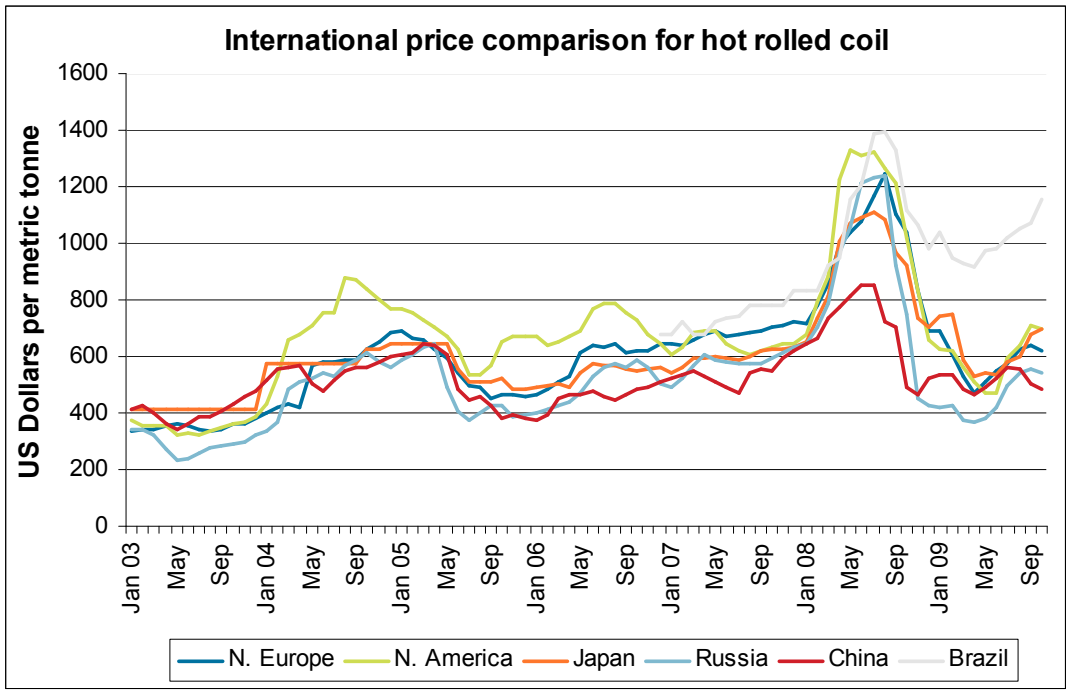


Source: Steel Business Briefing

[1] This is less true in the UK than in other countries. Here, a large volume of billets for re-rolling, wire rod for wire drawing and heavy sections for example is produced from the blast furnace/basic oxygen route.

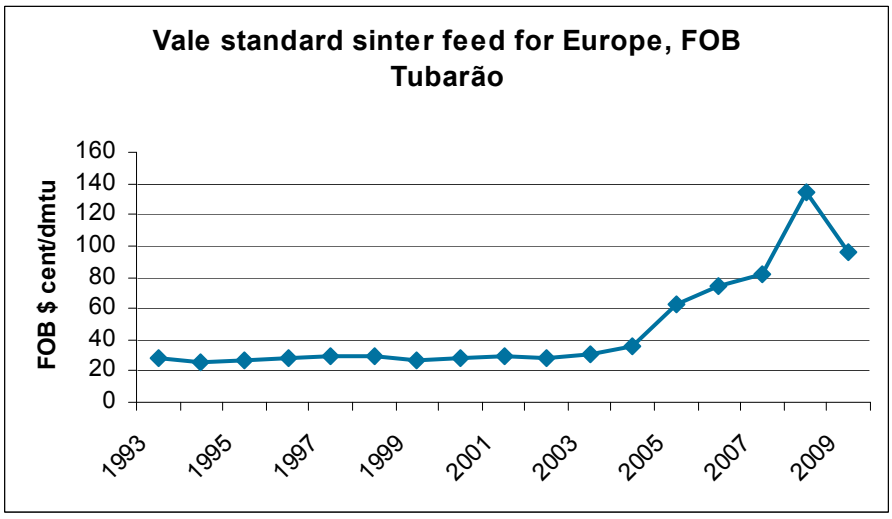
It will be noted that prices have not yet returned to the pre-surge levels of 2006 and 2007.

The same is true of steel prices globally. Taking hot rolled coil as representative of trends in strip mill products generally, developments in major producing regions have been as follows:



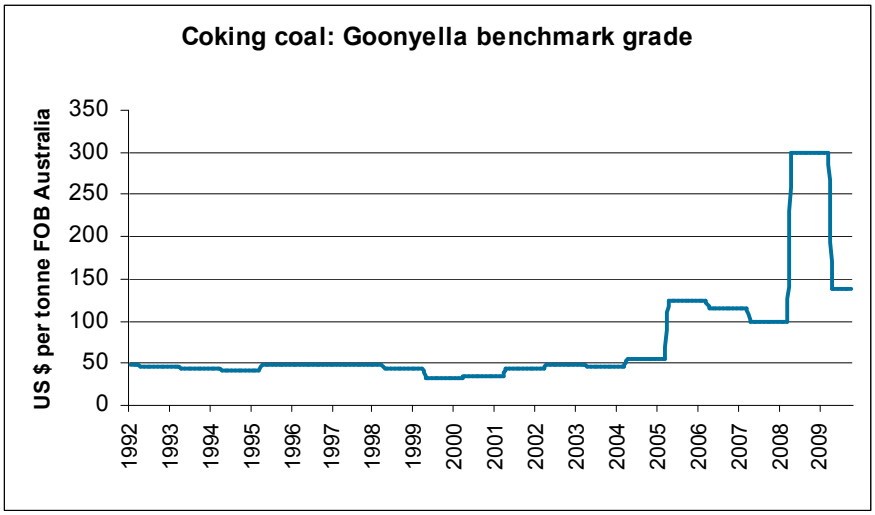
Source: Steel Business Briefing

One issue for blast furnace based steel producers is that raw material prices have not fallen to the same extent as steel product prices. This is accounted for largely by China's continuing to increase output. It particularly affects iron ore, where the 2009 annual contract price only fell by 28% following a 133% increase in 2008. This compares with an average 47% drop in flat product prices between August 2008 and May 2009.



Source: Steel Business Briefing

Coking coal prices also remain above 2007 levels.

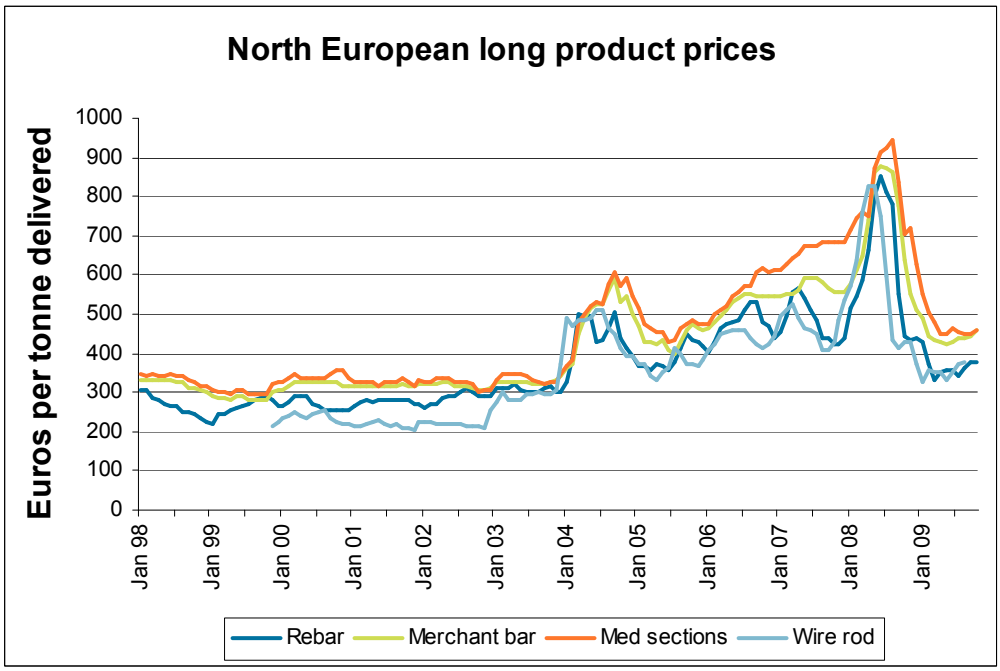


Source: Steel Business Briefing

Steel companies have therefore seen a considerable shrinking in their margins, which they will be seeking to recoup as market conditions allow.

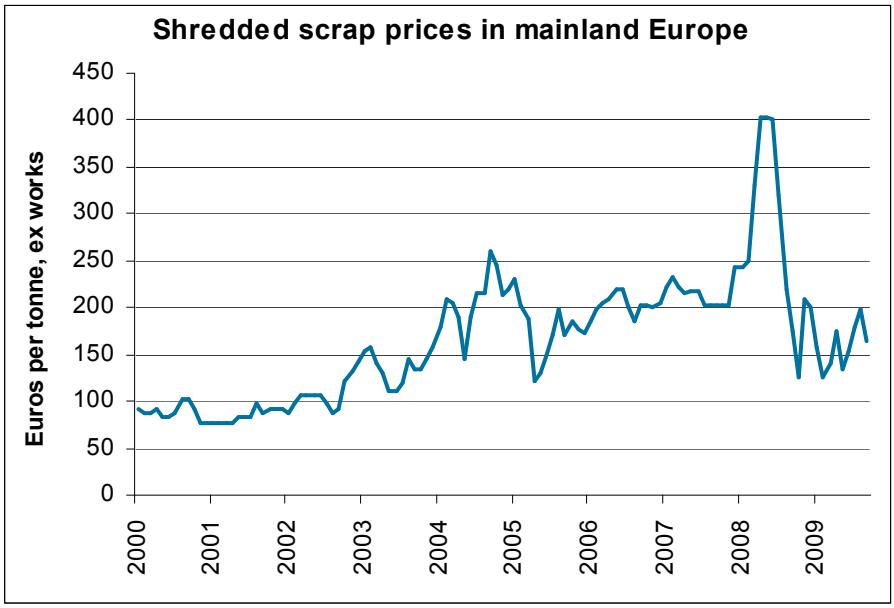
Long products

Despite modest improvements since early summer, European long product prices generally are languishing at around mid-2005 levels. They fell by 55% on average between June 2008 and March 2009, and have currently only recovered by 7%.



Source: Steel Business Briefing

The primary raw material for long products made by the electric arc furnace process is scrap. Scrap prices have continued to be volatile this year.



Source: Steel Business Briefing

Future outlook

The World Steel Association this month published its short range outlook for global steel demand, predicting a strong improvement in 2010 from this year's depressed levels, with the strongest growth coming from the developed countries, which had shown the sharpest falls.

	Million tonnes			**2010 c.f.**
	2008	**2009**	**2010**	**2009**
EU 27	181.3	122.3	137.4	+12.4%
Other Europe	25.3	20.8	23.8	+14.4%
CIS	48.9	33.9	36.6	+8.2%
NAFTA	129.0	82.8	96.9	+17.1%
Central & South America	44.3	33.5	36.7	+9.7%
Africa	26.2	26.3	29.3	+11.4%
Middle East	43.1	38.8	42.9	+10.6%
Asia and Oceania	709.0	745.5	801.9	+7.6%
World	**1,207.0**	**1,103.7**	**1,205.6**	**+9.2%**

Conclusions

1. Any steel shortages currently appearing on the market are temporary, and have been due to the difficulties inherent in bringing large increments of capacity back on stream to match fluctuations in demand.
2. Market conditions, and accordingly steel prices, while improved from earlier in the year, remain poor in historical terms.

3. Despite this, steel raw material prices have not fallen to the same degree as steel product prices, and steel companies will need to recover these costs through price increases as and when market conditions permit.

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