

Steel Market Report: October 2011

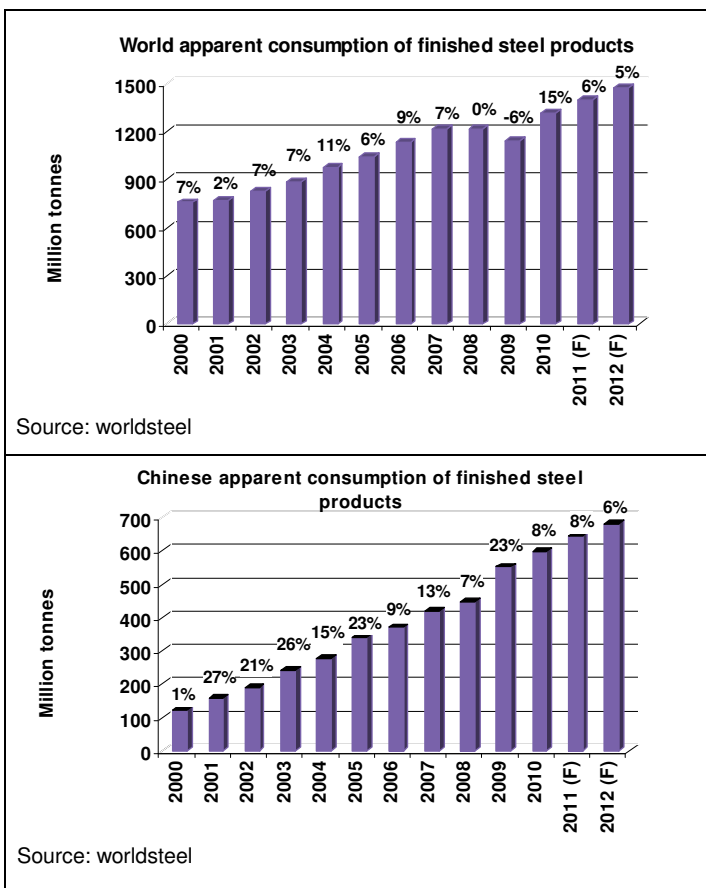
Summary

The latest World Steel Association demand forecasts predict continued robust growth in world apparent steel consumption.

In Europe, manufacturing output has continued to grow, whereas construction activity remains poor. However, uncertainty about future economic prospects and an earlier import-fuelled increase in inventories have resulted in a short term drop in orders and consequent price weakness for some products. These trends are expected to reverse early next year.

Raw material prices are currently stable, but at very high levels. The pressure on steelmakers' costs is thus unremitting.

Steel demand outlook



World steel demand

After recovering strongly in 2010, global apparent steel demand growth in 2011 and 2012 is predicted in the World Steel Association's latest forecasts to be slightly below the long term trend, but nevertheless robust, at 6% and 5% respectively.

Chinese demand

Chinese demand for steel boomed during the recession, and was the main driver for the surge in raw material prices.

Worldsteel in its October forecasts has revised upwards its forecasts for China. Although the boom has ended, Chinese demand growth is forecast to continue above the world average.

China currently consumes 46% and produces 47% of the world's steel.

After showing strong growth in 2010 (as we emerged from recession), demand in the **developed world** and the CIS is predicted to have slowed to more sustainable levels in 2011. A further slow down is now forecast for 2012, although growth is expected to remain positive. Even so, it is predicted that the EU, USA and Japan will still not have returned to pre-recession demand levels.

It is the developing world that will continue to be the main driver of growth. Even though Chinese growth is forecast to slow somewhat, the sheer size of this market means that China will add 40

million tonnes to world demand next year – equivalent to the whole of the German market. Other “non-western” countries are also growing rapidly, with double-digit growth forecast for Kazakhstan, Brazil, Colombia, Venezuela, Morocco, Saudi Arabia, Indonesia and Vietnam.

Apparent steel demand by region

	Consumption: million tonnes				Growth rates		
	2009	2010	2011 (F)	2012 (F)	2010	2011 (F)	2012 (F)
EU 27	120	145	155	159	21.1%	7.0%	2.5%
Other Europe	24	30	33	35	24.0%	11.3%	5.7%
CIS	36	49	56	60	34.5%	14.4%	7.5%
NAFTA	84	111	121	127	32.8%	9.0%	4.9%
Central & South America	34	46	48	52	35.2%	4.7%	9.9%
Africa	27	25	21	24	-8.9%	-12.7%	11.0%
Middle East	42	48	50	54	14.6%	5.0%	7.9%
Asia & Oceania	775	861	914	963	11.1%	6.2%	5.4%
<i>of which China</i>	<i>551</i>	<i>598</i>	<i>643</i>	<i>682</i>	<i>8.5%</i>	<i>7.5%</i>	<i>6.0%</i>
TOTAL WORLD	1,140	1,312	1,398	1,474	15.1%	6.5%	5.4%

Source: worldsteel

European market

Eurofer (our European steel federation) has again revised upwards its EU demand forecast for 2011 as a whole. Growth is predicted to have been strong in 2011 (above 5%) in all major steel consuming sectors other than construction, domestic appliances and shipbuilding (the latter two showing negative growth). Weighted average output across all consuming sectors for 2011 is forecast at +5.9%.

Consumer sector activity is expected to grow across all sectors next year, but at generally more subdued levels, ranging from +0.9% for shipbuilding to +3.4% for mechanical engineering. The weighted average growth is forecast at +2.6%.

However, it is the quarterly progression in consuming sector output that has been the main concern. Weighted average growth will have fallen in each quarter in 2011, with the decline continuing into Q1 2012 before beginning to recover in Q2.

Translated into steel demand, the quarter on quarter decline in growth is detailed in the following table. The drop in European manufacturing activity combined with rising import levels (see below) has triggered a stock draw in the current quarter which is expected to continue into the first half of 2012. Eurofer are then forecasting a stock build in the second half of 2012.

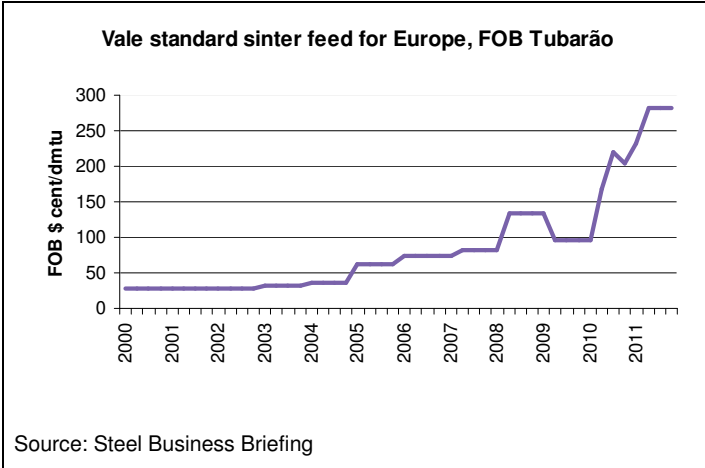
EU steel demand

	Year-on-year % change	
	Real demand	Apparent demand
Year 2010	+4.8%	+22.2%
Q1 2011	+13.8%	+16.5%
Q2 2011	+7.6%	+11.4%
Q3 2011	+2.3%	+3.5%
Q4 2011	+1.7%	-1.6%
Year 2011	+6.1%	+7.5%
Q1 2012	+0.6%	-3.1%
Q2 2012	+1.9%	+0.5%
Q3 2012	+2.4%	+4.0%
Q4 2012	+3.2%	+7.7%
Year 2012	+2.0%	+2.8%

Source: Eurofer

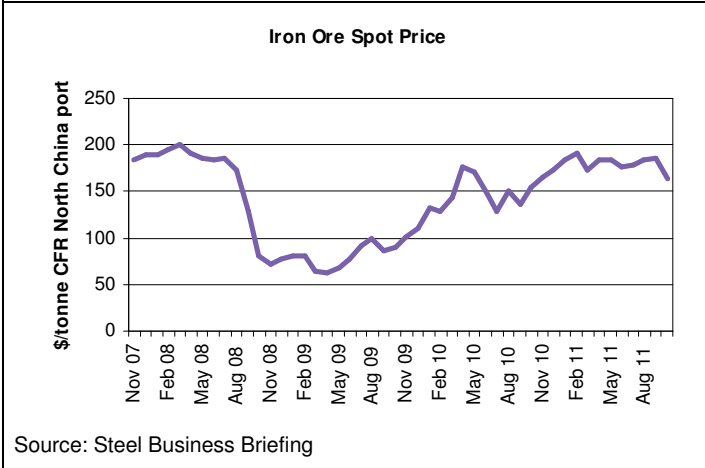
Raw material prices

The growth in world steel production, and in particular the sheer scale of China's appetite for raw materials, continues to exert a strong influence on raw material prices.



Iron ore – contract prices

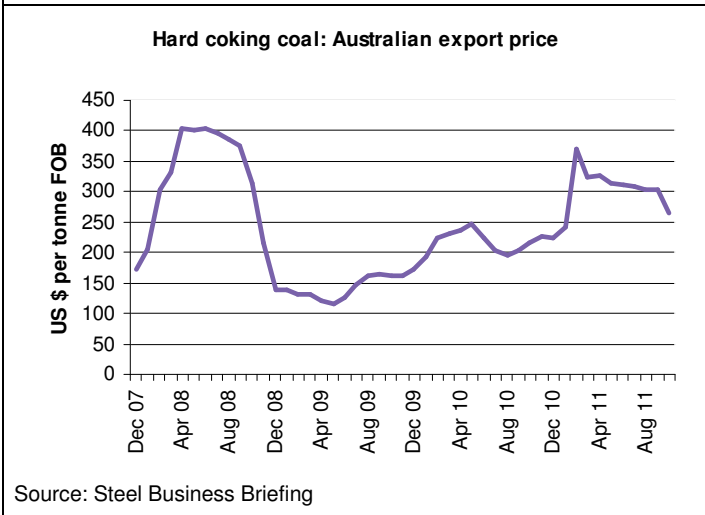
Last year the principal miners ended the annual benchmark price contract system, which had ensured price predictability for the industry's key raw material, and imposed index-linked quarterly prices. As a result, ore prices rose by 112% in 2010, and by a further 38% in the first two quarters of 2011. Since then however, prices have reached a plateau, with no further increases in the last two quarters of 2011.



Iron ore – spot prices

The new quarterly contract price is derived from the preceding quarter's spot price for exports from India to China, lagged by one month. Thus, if the quarterly indexation system survives, the Q1 2012 price will be based on the average daily spot price in September to November.

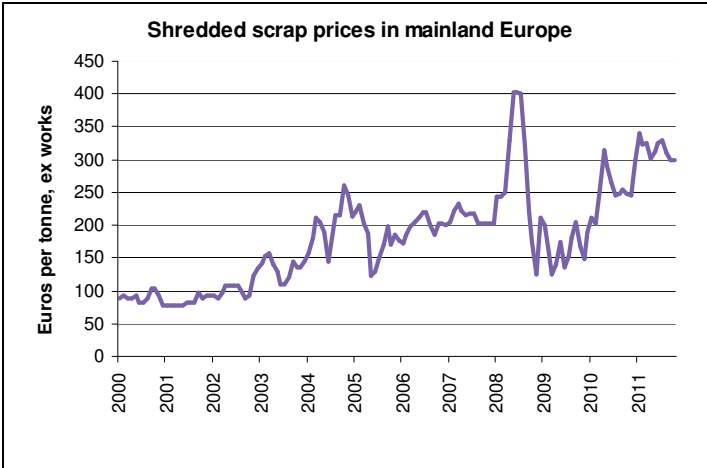
Spot prices fell back somewhat in October, but it is too early to predict the Q1 price.



Coking coal

Coking coal prices shot up in the early months of the year in reaction to the Queensland floods, nearly reaching the all-time peak established in 2008.

Since then, prices have slowly but consistently fallen back, although remaining at historically high levels.

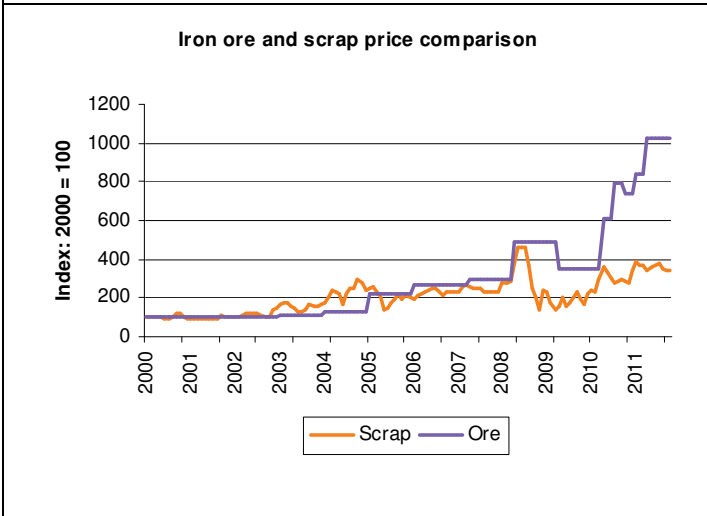


Source: Steel Business Briefing

Scrap

After the volatility experienced in 2010, scrap prices have shown greater stability this year. Scrap peaked in January at €340 per tonne, and since then prices have been fluctuating between €300 and €330.

On average, scrap this year has been 24% more expensive than the average for 2010.



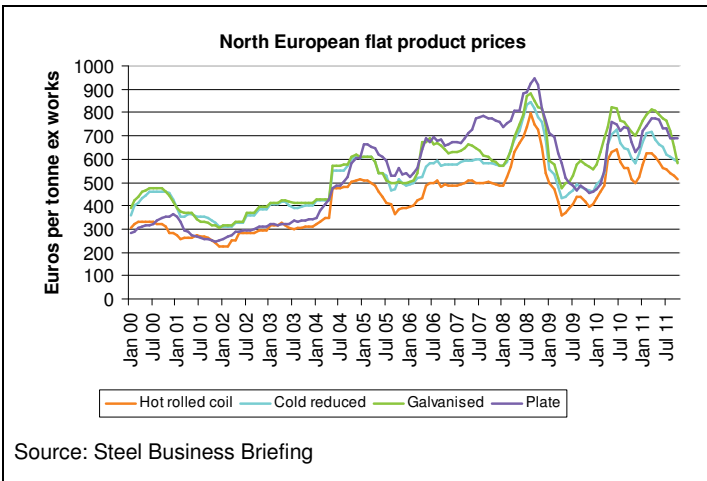
Index derived from Steel Business Briefing data

Iron ore/scrap relativities

Traditionally, iron ore and scrap prices tended to move in tandem. The spectacular hikes in iron ore prices commencing April 2010 resulted in a very wide divergence opening up between the two. This remains very wide. Ore is now **relatively** a far more expensive source of Fe input than scrap.

We continue to predict that this imbalance (together with EU climate change policy) will encourage integrated steel producers to maximise the volumes of scrap they use, thereby putting upward pressure on scrap prices in the longer term.

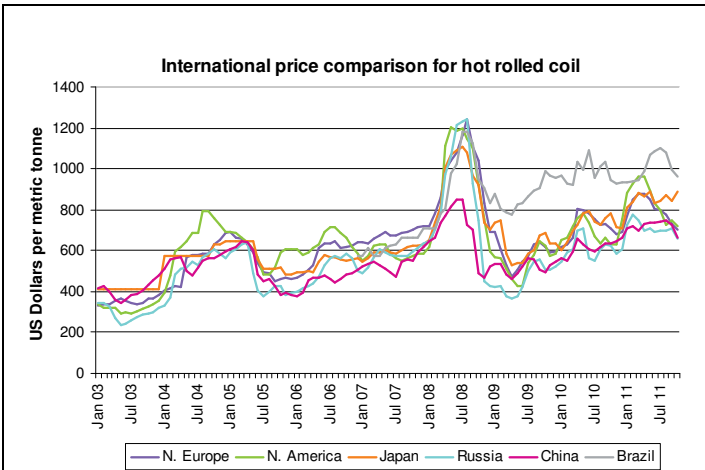
Steel product prices



Source: Steel Business Briefing

Flat products

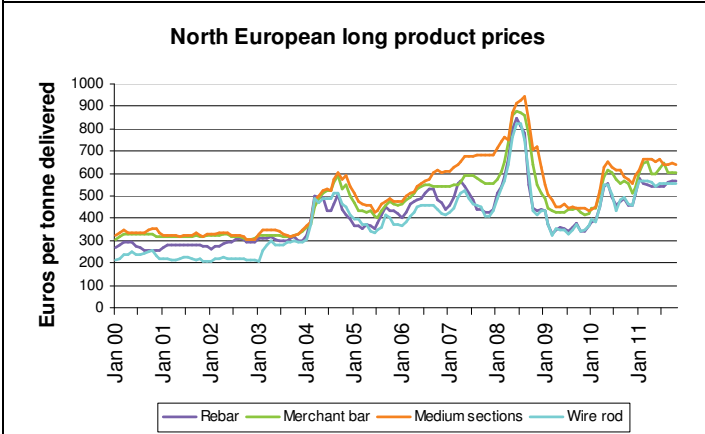
Average European flat product prices peaked in March 2011 (reaching the same level as the previous peak in June 2010). Since then, they have fallen back – a reflection of the progressive slow down in steel demand growth over the same period, combined with increased import penetration.



Source: Steel Business Briefing

N. Europe domestic - ex works
 N. America domestic - FOB Mid-west mill
 Japan domestic (Tokyo Steel) - FOT
 Russia Black Sea export - FOB
 China domestic - Shanghai
 Brazil domestic - delivered

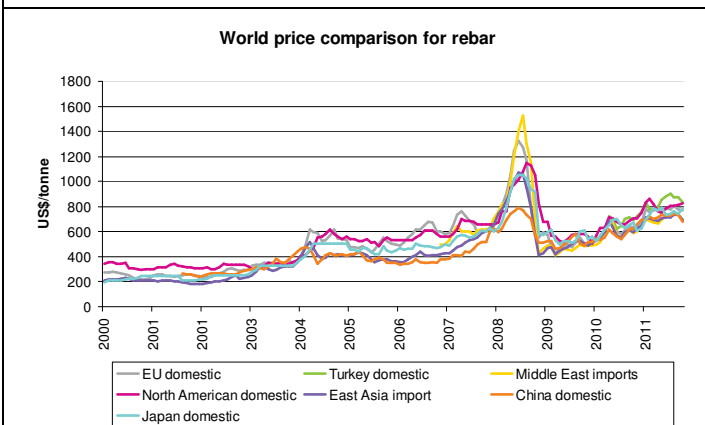
Ignoring Brazil, where prices remain aberrantly high, price trends for the benchmark product, hot rolled coil, in most other major producing areas are broadly similar to European trends and are at roughly similar levels. The notable exception has been Japan, where prices have held up.



Source: Steel Business Briefing

Long products

After rising by 23% on average between November 2010 and February 2011, European long products prices have generally held up robustly since then. The exception is merchant bar, where prices have been somewhat more volatile.

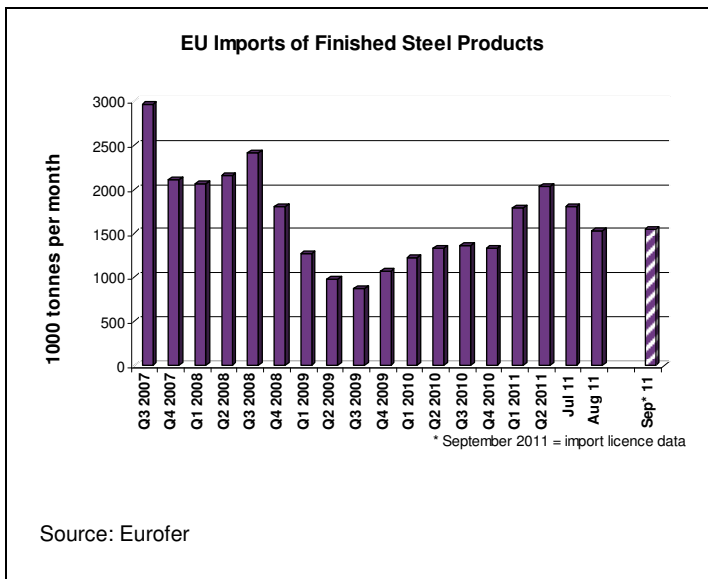


Source: Steel Business Briefing

EU domestic – delivered
 Turkey domestic – ex stock (incl. 18% VAT)
 Middle East imports – CFR Gulf States port
 North American domestic – ex mill US Mid West
 East Asia import – CFR
 China domestic – Shanghai (incl. 17% VAT)
 Japan domestic – (Tokyo Steel) CIF

Prices for reinforcing bar in all major consuming markets remain closely clustered together and continue to trend upwards from the recessionary lows in early 2009.

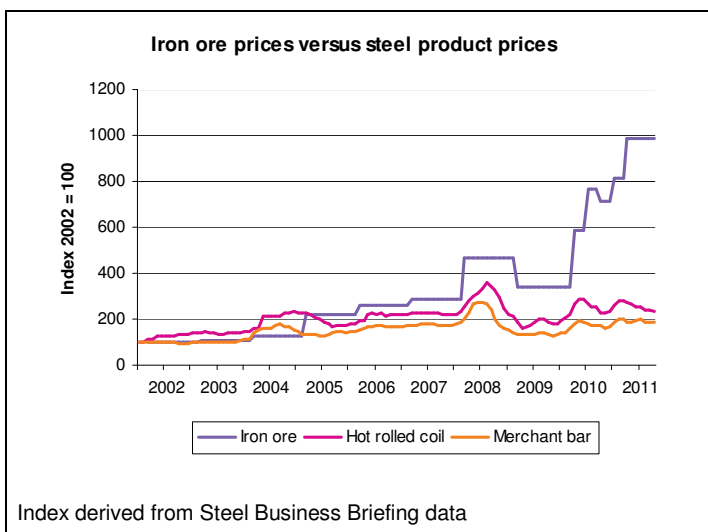
Import activity



After two years of subdued activity, imports into the EU rose rapidly in the first half of the year: Q2 2011 imports were 53% above Q4 2010 levels. This import surge was almost entirely concentrated in flat products, and was the cause of the excess stock build and consequent relative price weakening in those products. It is notable that in long products, prices have been more stable, despite the weakness of construction markets, because of the continuing low import volumes.

Since Q2, import volumes into the EU have started declining, and based on the latest import licence data this trend is expected to continue.

Cost/price squeeze

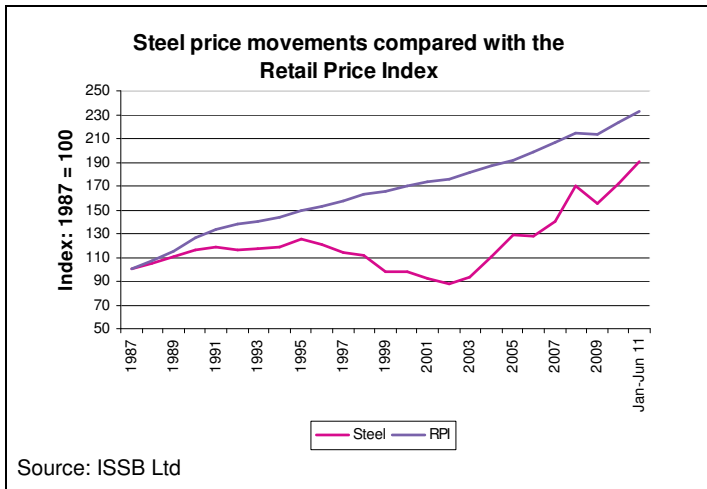


Despite the standstill in iron ore prices in the last two quarters, the cost-price squeeze suffered by steel producers has continued to worsen.

Iron ore prices have risen by 670% since the start of the surge in 2005. Hot rolled coil by contrast is currently selling in Europe at just 3% above early 2005 levels.

The imperative for steel companies will be to push up their sale prices as soon as market conditions permit.

UK steel prices compared with general inflation



Despite the price increases earlier this year, as of June steel on average remained good value for money compared with UK prices in general. Since that time, with the falls in flat product prices, and with UK inflation still running high, the differential will have widened.

Note: All prices used in this report were extracted from data published by Steel Business Briefing on its website on 28th October 2011.

28 October 2011