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Steel slumps

Steel markets struggle as the global economy takes a downturn.

Dan Sandoval JULY 9, 2012

The global steel industry has hit a rough patch. Throughout the supply chain, various indicators show that, after a modest improvement during the first few months of 2012, prices have tumbled, and in some cases quite significantly. Ferrous scrap prices dropped by more than $50 per ton through most regions of the United States in May and June. Pricing may continue to decline in the near term, sources say.

The United States is not the only region of the world that has seen a sharp tumble in finished steel and ferrous scrap prices. Asia, especially China, is seeing slowing economic growth, and Europe is seeing its economy contract, reducing demand for finished steel.

Jarek Mlodziejewski with The Steel Index, which has offices in Pittsburgh, London, Shanghai and Singapore, says there is another factor contributing to the sharp correction in global ferrous scrap prices this spring. “The unseasonably warm weather in the United States and, up until the last week of January, in Europe, had been partially to blame for the lack of price momentum in January. Scrap yards throughout Europe and the U.S. stocked up on material in anticipation of a sharp price hike as experienced last year,” Mlodziejewski says. “It seems that they were the architects of their own downfall, as scrap continued to flow into yards, unhindered by the weather. Bearish sentiment followed, with mills pointing to large stockpiles as bargaining tools to start pushing the price down.”

U.S. mill utilization was nearing 80 percent, and subsequent steel service center and stamping plant activity began filling the domestic market with prime scrap material, he says. With pricing falling on that higher-yield scrap, it put pressure on obsolete scrap prices.

“In the last few weeks of May in some U.S. cities, you could buy prime scrap at only a few dollars above that of obsolete,” Mlodziejewski says. “While you would think that this would have the steel mills champing at the bit with such a fantastic deal, in practicality it is very difficult to change your charge that you use for your melt at the EAF (electric arc furnace). We then had a huge drop at the beginning of June in the U.S. domestic market, with participants reporting very good flows into the local yards.”

A report from the steel consulting group Steel Market Intelligence (SMI), headquartered in Chicago, points instead to weak global steel demand and falling iron ore prices as driving declines in ferrous scrap.

In the report SMI President Michelle Applebaum writes, “We expect sheet prices to continue to decline, as global overproduction and weakening demand, along with waning confidence in both Europe and China, are driving ‘fear’ increasingly back into the steel market.”

Narrower margins

The most recent indicator of the problems facing the U.S. steel industry has been Sparrow Point, Md.-based RG Steel. The fourth largest flat-rolled steel producer in the United States filed for bankruptcy protection and announced plans to idle all three of its steel mills. It also is seeking a buyer for the plants. The filing comes after the company acquired the assets from Severstal in 2011.

John Goodwin, CEO of RG Steel says, “Despite the company’s aggressive cost-reduction efforts, significant improvements in its cost structure and substantial investment capital, the company has been unable to overcome the impact of the continued deterioration of the market and the inability of the industry to sustain a meaningful recovery.”

Another steel industry executive points to the surge in steel imports as a factor affecting his company’s performance in 2012.

Dan DiMicco, CEO of Nucor Steel, Charlotte, N.C., says, “Our lower performance in the second quarter of 2012 is mainly due to a surge in imports, particularly rebar, plate and sheet steel, which began at the end of 2011 and has continued through the first half of 2012.

“Although the U.S. market continues to show stable to slightly improving demand for steel, this surge in imports has undercut seasonal pricing momentum that is normally experienced early in the calendar year,” DiMicco continues. “In addition, U.S. markets are also being negatively impacted by the influence of new domestic supply that ramped up production in 2011 and a combination of political and economic uncertainty in global markets that is beginning to affect steel buyer confidence.”

In its recent quarterly report, Schnitzer Steel, a Portland, Ore.-based steel mill and scrap metal recycling company, states that global demand for recycled metals has remained soft and a tepid U.S. economic recovery, together with lower than normal spring scrap flows, have contributed to tighter supplies. As a result, the company’s margins are being compressed from the prior quarter, as a slight increase in average gross ferrous selling prices has been more than offset by higher raw material and freight costs.

The slump in the U.S. market comes after a fairly healthy first half of the year, says Mike Locker with the consulting firm Locker Associates, New York.

Recent figures show that in the middle of June, spot iron ore prices dropped to their weakest level since late February 2012, giving up early 2012 gains to trade down nearly 2 percent year to date as a Chinese slowdown threatens to curb steel output further, some sources indicate.

The sharp drop in ferrous scrap prices may not be the last for 2012. A raft of analysts, consultants and steel industry observers are forecasting further difficulties in the global steel industry through the end of 2012. This fairly negative assessment is a far cry from earlier this year, when many of these same analysts were forecasting modest improvements in the steel market.

Changing landscape

What changed between early in 2012 and the middle of June is the global economy, brought on by the continued economic problems in Europe. The conflagration in Europe, which initially began with Greece, has since spread to Spain and Italy and is threatening to expand to other parts of the euro zone.

Earlier in 2012 market watchers had expected finance ministers to put together an economic package to stave off debt problems. However, moving into the middle of the year, it appears that a rescue plan still has not been developed. Peter Fish with the U.K.-based steel consulting firm Meps says that as of early June banks are tightening credit.

Manufacturers, Fish says, “are only buying steel for their immediate needs. Prices could go down.”

He adds, “There is a serious lack of confidence. And, with a lack of confidence, no one is investing in infrastructure projects. Manufacturers are worrying. It is keeping everything tight.”

In response to slumping steel markets, some of the large steel producers in Europe, including ArcelorMittal and ThyssenKrupp, have been slashing their production.

One source says that prices for some finished grades of steel have fallen to such a low level that steel mills are practically at a break-even level between production costs and selling prices.

In addition to cutting production, some European steel producers are shifting their production to make higher-end, niche products for the aerospace, oil and auto industries.

European steelmakers also have been exporting more finished steel to the United States. The stronger U.S. dollar has made it less expensive to ship material from Europe to the United States.

The American Iron & Steel Institute (AISI) says preliminary Census Bureau data show that annualized total and finished steel imports into the United States are up 22 percent from 2011's figures.

Reasons for optimism

Although European markets look grim in the short term, a report by the European Steel Association (EUROFER), Brussels, points to a moderately optimistic future, though difficulty is predicted in the short term. EUROFER states, "Rather than signaling a marked rebound, the recent trend in the indicators is more consistent with stabilization in economic fundamentals after months of weakening; this could pave the way for a cautious recovery later this year."

In light of fears of more problems in the steel sector, EUROFER adds, "Credit availability staying tight, still low economic sentiment levels and continued high uncertainties in combination with the negative impact of stringent austerity measures synchronously applied by most peripheral and core euro zone countries will act as a drag on domestic demand in the EU."

Europe may be the source of much of the concern regarding the global economy (and the steel industry in particular), but other regions also are struggling. China, the largest steel producer in the world, is seeing its robust economic growth slowing, though it is still growing at high single-digit levels, Fish says. "We expect crude steel production in China to grow by 8 percent."

As challenging as the market is, Meps says it expects to see further price erosion this summer in light of a seasonal slowdown in the market, though there is the potential for a temporary price recovery in September, as customers may need to replenish their inventories. However, market activity is likely to stay low for the remainder of 2012.

Despite the problems in Europe and the slowdown in China, the steel industry in the Middle East has remained fairly stable. This region has been on a construction spree, which has resulted in the increased need for steel, especially from Turkey.

Locker says steel markets in Brazil may have slowed a bit but are showing signs of improvement. Mexico also has been a healthy market for steel. Russia also has boosted its steel operations.

Although the U.S. market is showing strain, the domestic steel industry has been able to work through the pain because of bright spots in some end markets, notably the transportation sector.

The oil industry, which had been enjoying fairly healthy growth in the first half of this year, may be seeing some slowdown. A scrap metal recycler says one of his steel mill customers is reporting a slowdown in orders for tube steel, a product typically used by the oil industry. If this sector slows in combination with the difficult construction industry, greater problems may be in store for the U.S. steel industry in the second half of the year.

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