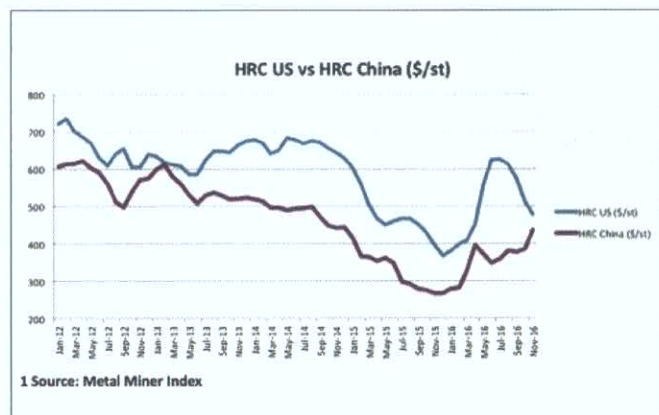


STEEL - GRASPING AT STRAWS



Riz Shaban
 Director of Gulf Region
 Lucky Group

Steel is the second largest industry in the world after oil and gas, according to Reuters, with a global turnover estimated at \$900 billion; but it is an industry weighed down by sluggish demand and chronic oversupply. This chronic oversupply, mainly sourced from China, has significantly affected US-based steel products, trampling its price by 20 to 30 percent since it hit its summer peak. North American producers have had to shut down production lines, and consequently its raw feed of steel scrap has also suffered. As a follow-up to Donald Trump's victory, a steep commodity price surge has boosted commodities and sent the Dow Jones US Steel Index to its highest level in two years, but these are gradually self-correcting to a more appropriate price level. Platts quotes export rebar to have increased 25 percent to \$407.5 per metric ton FOB since the beginning of the year, while import HMS I/II (80:20) has risen 36 percent to \$253 per metric ton CFR.



Trump trumps the commodity market

Though Trump's surprise election has stumped many investors, his repeatedly voiced intentions to implement a \$1 trillion infrastructure stimulus package and higher trade

protectionist measures have made its mark. Though the market is now self-correcting from the surge, what remains to be seen is how much of his policy rhetoric translates into actuality.

Morgan Stanley remains exceptionally positive, with a bullish forecast for the steel industry and anticipating Trump's policies to pull the steel market out of its slump that has kept it down since 2008. It believes these policies will dually add demand to the domestic industry by 20 percent annually in the first five years and curb Chinese import supply.

A Trump stimulus program could encourage higher commodity demand and employment, but critics voice concerns over a deepening fiscal deficit, rising inflation and higher interest rates, states Reuters. Furthermore, Goldman Sachs underlines that the program is unlikely to create ripples in the global steel market as the US only demands 7 percent of the world's steel. Nevertheless, the stagnant domestic usage of commodities since the 1970s within the US is likely to see an upsurge if the stimulus plan follows through.

Protectionist trade measures could work either positively or negatively for the steel market depending on which effect plays out stronger. On the one hand, steel companies demand better protection from alleged Chinese dumping of their excess steel, rendering US steel products less cost-effective. Already, the Wall Street Journal (WSJ) highlights, US has recently imposed varying tariffs up to 266 percent on selected steel products from China, plummeting Chinese steel imports by more than half in just under a year.

On the other hand, tariff barriers applied on other Chinese products could possibly boost US dollar strength as lower commodity demand sends ripples across global currencies, says Reuters. Additionally, restricting imports of Chinese metal into the US will most likely wash up the excess metal onto the rest of the world. China will take time down-scaling their production level, during which the excess supply will place

immense pressure on global metal prices. It is also unclear whether trade restrictions will be imposed on materials needed to be imported for Trump's infrastructural plan.

Pricier raw materials push up steel price

Iron ore, a raw material used in steel production, hit an irrational three-year high in mid-November. China, in a bid to stimulate the economy, unfurled a slew of high-level credit and expedited infrastructural spending, part of which overflowed into the commodity market. This sudden surge of speculative investors boosted iron ore price by nearly 50 percent over just a few weeks.

Iron ore is now gradually stabilising in the Chinese market given the weak steel price in China and amid concerns that Chinese regulators would further curb the overheated market, using measures like hiking transaction fees and deposit requirements. These measures, explains WSJ, effectively dampen commodity price as it reduces market liquidity.

In an effort to curtail pollution and excess industrial capacity of coal, China reduced work hours for coal workers and shut a number of coal mines. The price of coal, which typically accounts for about 20 percent of steel production cost, rocketed to almost triple what it was at the beginning of the year, sending Chinese mills scrambling for alternative raw materials for steel production, namely high-grade iron ore. Until now, iron ore stockpiles at Chinese ports were at a two-year high of 108 million tons. The Commonwealth Bank of Australia predicts iron ore price will continue to remain high at \$60 per ton for the rest of the year supported by fresh demand, while coal price will remain high due to tight supply.

On the other side of the world, iron ore in the US increased by five percent to \$74 per ton after Trump's victory speech restated his international trade rhetoric, nearly doubling the price from what it was at the beginning of the year. However, this is perceived as a clear overstretch as US only accounts for four percent of the world's seaborne iron ore, says CNBC, compared to China's 70 percent. Even if an infrastructural boost would translate into more imported iron ore, it would only translate into 9 million additional tons or an average 0.5 percent additional iron ore demand.

China's changing steel market

China released a four-year development plan for the iron and steel industries, reports the China Daily, part of which incorporates a consolidation of the steel industry to improve efficiency, target higher-quality product range and an overall reduction in crude steel capacity by 150 million tons to less than 1 billion tons by 2020. This will help mitigate the weak steel demand and chronic overcapacity in the global market.

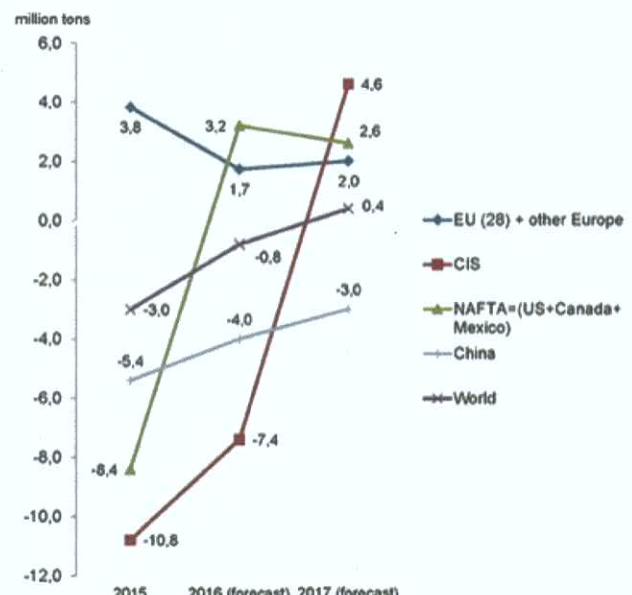
Though China has met its production cut target early this year of 45 million tons, it is yet a challenge to reduce production as steel mills earn at least 100 yuan per ton

profit, explains an analyst from Sublime China Information Group. The profit margins can potentially double if mills use steel scrap as raw material, potentially increasing demand for steel scrap imports. At the moment, due to the pricier raw material, several mills have preponed their 'maintenance' schedule, a euphemism some say for shutting down selected production lines.

Conclusion

China is undergoing a level of infrastructural stimulus with the approval of 15 fixed-asset investment projects totalling 218.8 billion yuan, reports Reuters. The country's factory activity expanded at its fastest pace in two years to 51.2 on the Purchasing Manager's Index (PMI). It seems the global market may see some support from China, in terms of its determination to cut excess capacity in the steel sector as well as its infrastructural spending. The momentum of this will be carried on by the US next year with Trump's stimulus plan. China's regulation in restricting the coal industry will in turn benefit both iron ore and steel scrap demand as alternative raw feed for steel producers. China will only have to ensure that the property sector does not cool off immediately which could send panic ripples across the country and the globe. Finally, we can only wait to see how Trump's trade policies emerge and its impact on the wider global scale. ☒

Steel Demand Forecasts by regions



Source: World Steel Association's Short Range Outlook

www.luckygroup.com

Disclaimer: This report has been prepared solely for information purposes, using publicly-accessible sources that are believed to be accurate and reliable at the time of publishing. Lucky Group accepts no liability whatsoever for any loss or damage resulting from the use of information or opinions expressed in the report.

Sources: AG Metal Miner, China Daily, CNBC, Platts, Recycling Today, Reuters, Wall Street Journal.