



STEEL CONFIDENTIAL

Local market outlook

Domestically Australia has had near 20 years of uninterrupted growth and may be experiencing the greatest investment boom for over 50 years in the Resource sector but the rest of our economy is clearly turning sour. The Queensland floods have demonstrated how unforeseen events can knock our growth down by 1% to 2% and add to inflation by way of reduced coal exports and high cost “bananas”. Steel demand created by the resource sector continues to be supplied from offshore in prefabricated form and underlying demand is still weak. One exception however seems to be QT plate with imports for the first half of 2011 reaching 29,000 tonnes compared to 35,000 tonnes for the whole of last year. Underlying demand for most carbon steel products however remains weak as demonstrated by the ABS release of data on “steel drivers” such as residential building approvals which are down 15% for the half year to June and non-residential construction activity, whilst it improved marginally in June, was still in decline for the six months to June 2011.

Imports of Carbon Steel Flat products in the Bluescope* product range (*excluding tin coated) for the 2nd quarter declined 25% compared to 1st quarter 2011, whereas imports of Onesteel’s mill products increased 68% on 1st quarter volumes being mainly ReBar and MBQ bars which increased from 55kt in 1st Q to 101kt in 2nd Q.

Onesteel ramped up its Whyalla blast furnace to normal operating levels end of

July after it was down for a reline since 7 May 2011. The 8 week downtime caused a loss of 175 kt production, is estimated to have cost \$65 million in construction and commissioning but is expected to prolong the life of the blast furnace beyond year 2020.

Comment

Australia is one of the very few western economies that could, and should, reduce its interest rates to stimulate the broader, non resource sectors of our economy and regardless of one’s personal view on carbon emissions, climate control etc., surely the preferred option is that now is not the time the Australian economy needs to deal with and calculate another tax on industry, business and consumers. One stark reality on this proposed carbon tax, apart from how Canberra is going to police its accounting which can only create another “giant” Canberra bureaucracy, is that for blast furnace steel makers the only known reductant is coking coal and that process produces around two tonnes of carbon emissions for every one tonne of steel produced.

World Steel Assoc. (WSA) forecasts

WSA recently reported that global steel growth increased 13.2% in year 2010 to 1283 million tonnes and its outlook for this year is further growth of 5.95% to around 1359 million tonnes led by increased Chinese consumption of 5% to 605 million tonnes. The WSA also sees continued global growth in year 2012 of around 6% with steel consumption in

the emerging and developing economies will be 38% higher than in year 2007. Conversely the forecast steel use in the developed countries will still be 14% below their 2007 levels.

These forecasts however would not have factored in the Japanese natural disaster and could not have considered the more recent economic challenges of rising inflation, appreciating currencies and sovereign debt facing major global players.

Major producer forecasting demand increase

In a July 28 briefing the world’s biggest steel producer, Arcelormittal, was forecasting global apparent steel consumption would increase by 7–7.5% in 2011 mainly led by an expected increase in Chinese domestic consumption of around 8.5% due mainly to strong demand for construction steels.

India and Brazil were also experiencing strong demand for construction steels but the reality is that overall apparent global demand for second quarter 2011, excluding China, contracted from 9% in the first quarter to 2%. Since then of course we have experienced the US debacle.

China's Steel output up

For the first half of 2011 China produced 350 million tonnes of crude steel, being an increase of some 9.6% on last year but China's second biggest steel producer, Baosteel, has reportedly cut its production by 5% since June because of weaker downstream demand with the manufacturing sector contracting to its lowest level for two years and if, as has been reported, there is to be a tightening in electricity supply during the second half there may be no immediate improvement in China manufacturing. Central and Southern China are experiencing severe drought which is affecting the supply of hydro power for industry. HRC prices therefore are said to have peaked with slowing demand being compounded by rising stock inventories. There is also an uncertain international market with the more recent expectation being that China will now export less in the second half of 2011 although following three months of lower volume exports they rebounded in July causing the Ministry of Information & Technology to forecast a 5% increase on 2011 exports to 45 million tonnes. The current consensus is for year 2011 crude steel output to still increase by some 80 million tonnes, or around 12%, on year 2010 to 707 million tonnes because of the expected higher domestic consumption of construction steels. Refer Fig. 1 for 2010 crude steel outputs.

Figure 1
Global Crude Steel production
'000 tonnes – Year 2010

Country	tonnes	Producer	tonnes
China	626.7	Arcelormittal	98.2
Japan	109.6	Hegang	44.8
USA	80.5	Baosteel	37.0
India	68.3	POSCO	35.4
Russia	66.9	Nippon	35.0
Australia	7.2	JFE	31.1
Other	454.3	Other	1132.0
TOTAL	1413.5	TOTAL	1413.5

Figure 3
Steel Material Input Price Indicators – China

INPUT MATERIAL	US\$ per Tonne
Steel Make Pig Iron	573 inc 17% VAT
Iron ORE Fines – 62%	176 CFR ex Australia
Coking Coal – 64 mid volat.	270 CFR ex Australia
Scrap-HMS – 80:20	487 CFR East Asia

The Government of China plans to fund construction of affordable housing for some 10 million low income families commencing November 2011 and this alone is anticipated to increase domestic demand for construction steels by some 30 million tonnes.

Global Economic Scene could cause further slowing in steel demand

On balance it appears Steel users in the two major overseas markets are adopting a wait and see approach as economic uncertainty and price volatility continue to dominate market sentiment. Integrated Steel producers, particularly in China, continue to have rising raw material prices and thus higher production costs but this is not being reflected in their market prices which dipped on reaction to the US downgrade and any further reductions in price will result in their selling at a loss. Raw materials for China HRC producers are said to account for 75% of the ex-mill cost to make and operating margins for HRC producers, excluding interest and depreciation charges, are around 3%. The more value added producers like Baosteel are doing better with operating margins at around 6% and EAF steel makers are also faring better due to scrap prices remaining relatively stable and because construction activity, compared to manufacturing, is generally better. Refer Fig. 3.

Japan is back on track after first half steel production was down 6.2% and is recovering from the March natural

disaster but domestic steel markets in the World's two largest economies are giving conflicting and confusing signals in terms of real steel demand. In the US the general consensus appears to be that because of dips in the critical manufacturing and housing sectors, flat products demand is exactly that, flat; and long products, being mainly construction steels, are not faring any better. The exception may be the long products market in China where yet to commence social housing projects, urbanisation of tier 2 and 3 cities and major water conservation projects are said to have caused the prices of scrap and rebar to increase but the flat product market sector is expected to experience ongoing slower demand in the second half of 2011. Japan's major concern is that its appreciating currency is making exports less competitive although steel exports are cushioned to some extent by its system of long term contracts with transplant operations. Last year the US\$ was worth 90 Yen compared to "today's" 75 Yen and the Bank of Japan's recent intervention had an adverse affect on the Aussie Dollar against the US\$. Also because of the March earthquake Japan's motor vehicle production and exports were down 29.2% and 20.8% respectively.

With the recovery under way Japan's Ministry of Economy, Trade & Industry has said third quarter steel output for ordinary steels is now expected to increase 5.1% to around 19 million tonnes. South Korean mills are also increasing production.

