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July 19, 2007

# Recent Issues - -
# An Update

Many of the matters that we have addressed in recent letters have been evolving, and we thought that you might be interested in those new developments.

- China. In most of our looks at China, the story has been one of growth, growth and more growth. Indeed, the country's Gross Domestic Product grew 11% in 2006, a rate not seen since the Chinese economy was much smaller. Hand in hand with this growth have been huge international trade surpluses, fueled by exports of food, clothing, appliances, machinery and equipment.

  However, for the first time, serious problems have cast some doubt about the future in store for Chinese exports. Tainted seafood and pet food, poisonous toothpaste, fake drugs, lead paint in toys and a variety of similarly defective exported products have put foreign consumers on guard. Large importers, like Wal-Mart, must be concerned about customer acceptance and must be looking for alternative suppliers. Already, some producers and sellers are advertising "China Free".

  The Chinese seem at last to be concerned about these developments. The recent execution of the head of their food and drug administration was no doubt intended to send a message. However, the problem is rooted in the very structure of the Chinese government. It appears that the writ of Beijing does not run to many of the provincial and local authorities, where a culture of bribery and corruption continues. Thus, whether executions will get the message across is uncertain; certainly, efforts to stem piracy of intellectual property have not shown much progress.

  The bottom line is that China looks to be encountering some new bumps on the export highway and may not always have everything to itself.

- Subprime Lending. In our letter last March, we presented some facts about the subprime mortgage problem. We noted then that the holders of interests in bundled mortgages (largely pension funds and other institutional investors) do not revalue them on a daily basis, but await periodic ratings by a rating service, like Moody's and Standard and Poor. That shoe has now dropped, as raters have announced their intention to downvalue those packages of mortgages. The markets fell sharply on that news.

  Economists continue to warn about the longer term effects of the subprime debacle. Bear Stearns (they of the rose colored glasses on the impending collapse) announced that they would put $3.2 billion into one of their bundled mortgage vehicles, but later reduced the amount to a mere $1.6 billion. General Electric has announced that they are getting out of the subprime market entirely.

- Trade Talks. June 30 came and went without renewal of the President's "fast track" authority, so another nail has been driven into the coffin of the Doha Round of multilateral trade negotiations. As we have been reporting, those talks have limped from crisis to crisis, never quite dying, but not truly alive. What happens next to this zombie is still not certain, but don't expect a magic potion to revive it.

  One note on the fast track authority: That legislation permits the President to negotiate a trade deal and then send it to the Congress for an up or down vote. The expiration of the authority does not cut off the President's deal-making powers, but it does mean that any agreement he makes will be subject to amendment as it proceeds through the legislative process. As a practical matter, fast track is essential to a multilateral trade pact, structured as it is on a very intricate web of quid pro quos that would unravel if modified.

  Other, bilateral, trade agreements may make it through Congress this year. The Administration has negotiated such deals with four countries – Peru, Panama, Colombia and South Korea. The Democrats in Congress have agreed to enact the former two in return for the Administration accepting the need for undertakings in the agreements on labor and environmental issues. The deal with Korea has been faulted for lacking effective commitments on auto imports and may not see the light of day. The Colombian agreement is mired in concerns whether that country is taking effective steps to stop paramilitary violence inflicted on peasants and labor representatives.

Here are some specific data on input costs:

- Scrap and Pig Iron. Both #1 dealer bundles and #1 busheling (Chicago) were essentially unchanged this month, at $298 and $300 per mt, respectively. The spot price for Brazilian pig iron (cif New Orleans) showed a change for the first time in five months, dropping $15 to $360 per mt.

- Natural Gas. Despite the recent increases in gasoline prices, the NYMEX contract price for natural gas sunk by over 20%, dropping from $8.10 to $6.64 per mcf. That's its lowest price since January, 2007, breaking an upward trend over the months since then.

- Exchange Rates. The dollar has continued to sink. Currently, the euro is worth $1.38, up 4 cents; the pound is at $2.04, up 5 cents; and the Canadian dollar is at 96¢, up 2 cents. Each of these numbers are at levels not seen in decades or, in the case of the euro, ever.

As is our custom, we shall be posting this letter on our web site, www.coreysteel.com, and on the international site, www.steelonthenet.com. Let us have your comments and suggestions.