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PREDICTIONS OR PARADOXES?

Last month, I commented that it looked as if input costs would remain steady in 2005. Of course, it didn't take long for me to be proven wrong – scrap prices (which had been moderating somewhat) dropped almost 25% in a single month. Similarly, the costs of pig iron and ocean freight fell significantly. The details are set out below, but the basic message is that any sure predictions about trade in steel products or raw materials should be viewed with a good deal of skepticism. Nonetheless, we offer you a few more pieces of information that could affect the future:

- Brazilian iron ore producer CVRD is asking its customers for a 90% increase for 2005. This demand prompted the European Confederation of Steel Producers (EUROFER) to go public for the first time, labeling the increase as "unreasonable"; Europe's producers get about 50% of their iron ore from Brazil, and CVRD dominates that market. Brazilian automakers have also complained, saying that the proposed increase would raise steel prices by 15%. Among the reasons for the increased price may be increased iron ore demand in China and the start up of a CVRD/Nucor pig iron plant in Brazil with a 360,000 mt output.

- Prices for carbon flat rolled products have remained steady over the past months, even though inventories have expanded due to late buying in anticipation of January price hikes that did not materialize. Service centers held 4.2 months' supply in December, compared to 3.6 months in November. One buyer believed that this kind of oversupply situation would normally have resulted in price declines of 25 – 30%; he credited the steadiness in prices to recent industry consolidation. If he is correct, consolidation may indeed be bringing some price stability to the industry.

- Steel imports grew by 54% in 2004, to 32.3 million mt. Hot rolled sheet was up by 83% and wire rod by 74%. China was a net exporter in November and December, 2004.

Faced with these and other factors, it is not surprising that prognosticators are suggesting increases and decreases in steel demand and prices. We shall see.

Turning to some specifics:

- Scrap. As noted, there was a very large price break in January. Number 1 dealer bundles were off $81 per mt to $290, and #1 busheling (Chicago) fell $90 to $280 per mt. Some reasons for the decline may be the use of lower quality scrap grades, imported pig iron and direct reduced iron, whose prices had been significantly below prime grade scrap. Prices for the lower grade, shredded scrap and #1 heavy melt have not declined significantly (these grades largely satisfy the export market, which is expected to grow in coming months). Therefore, because the traditional price differentials between high and low grades have been restored, we may have seen the end to the price slides in the prime grades.

- Pig Iron. The spot price for Brazilian pig iron (CIF New Orleans) fell (likely in sympathy to the scrap declines) from $350 to $305, or about 13%. In response, Brazilian producers are holding off from the market for 60 days to force prices up. They have full orders through May and won't take more until March, so their tactic may be successful.

- Ocean Freight. The Baltic Capesize Index fell sharply in early February, from 8458 a month before to 5930, or 30%. This decline may reflect somewhat the disruptions caused by the tsunami, but the index is still way above the 3000 range that obtained during the first half of 2003.

- Natural Gas. The Nymex contract price (Henry Hub, LA) firmed to $6.32 in early February, after declining 34% over the prior two months.

- Exchange Rates. Here again, there has been some relief for the weak dollar. As of February 13, 2005, the Euro had declined to $1.286, the pound to $1.867 and the Canadian dollar to 80.8¢.

- Pricing. In view of the cross currents noted above, it is not surprising that there was little news on pricing for steel products during the last month. Nucor announced a $20 per ton increase in some bar products, but simultaneously cut its surcharge by a like amount – the effect is to convert a "temporary" price increase into a "permanent" one. Whether those terms have any meaning is open to question. Last month, the New York Mercantile Exchange stated that the steel industry is not ready for futures trading due to a "lack of fungibility in transaction obligations." Do tell.

We ask for your comments and suggestions on our monthly letters. As usual, we are posting this letter on our website www.coreysteel.com and it can also be found on the UK site www.steelonthenet.com.