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June 22, 2007

Indirect Steel Imports - - The Hidden Millstone

In several of our past letters, we have discussed imports of steel products (particularly cold finished steel bar) and the effects of those imports on our company and our customers. In examining those matters, it is fairly easy to develop statistics that can show trends and permit projections about possible future problems. Those statistics are provided by the U.S. Customs Service and by companies reporting their shipments to the American Iron and Steel Institute ("AISI").

But those numbers hardly tell the full story. Anecdotally, we hear about companies, some our own customers, who have seen their markets shrink as a result of imports. Those companies very often are suppliers of screw machine products to appliance makers, automotive manufacturers and farm and construction equipment producers. They have witnessed a decline in their sales either because their customers are buying components from abroad or have lost sales to imports of competing finished products. There is another aspect to the problem: some companies, faced with import competition, decide to move their production abroad or simply close up shop.

In each of these cases, it is hard to determine with strict accuracy the extent of the effects of imports on the particular domestic industry. For example, given the huge variety of screw machine products that are made, no import statistics can capture the number or value of foreign made parts being sold in this country. It is possible to make estimates of sales lost to imported finished products, like cars and appliances, but these, perforce, tell only part of the story.

The AISI has made an effort to determine the extent and effects of these so-called "indirect imports" of steel. Their report, covering the years 1999-2005, examines the steel content of finished product imports in eight major consumer markets, including automotive, machinery, appliances, construction and domestic and commercial equipment. It makes no attempt to quantify imports of steel parts or components. The results are sobering.

In 2005, the steel content of the eight covered finished products amounted to 36.9 million tons. (By comparison, the quantity of steel products directly imported that year was 29.1 million tons.) Subtracting the steel content of U.S. exports of the same finished products, we experienced net steel content imports of 16.9 million tons, worth about \$184 billion added to our trade deficit.

One element of the indirect import picture actually improved during the period covered by the AISI study: The indirect steel trade deficit in the automotive sector was 8.8 million tons in 2005, about 20% less than in 2002. The change resulted from the establishment of U.S. production facilities by foreign automakers, principally the Japanese and Korean companies. Those facilities rely principally on U.S. produced steel. However, this silver cloud had the usual gray lining – China. In 2005, the indirect steel trade deficit with China was 4.6 million tons, up from 1.6 million tons in 1999. And, given the course of Chinese exports to the U.S. since 2005, it is more than likely that the indirect steel trade deficit has gone up sharply. (Direct steel imports from China went from 2.3 million tons in 2005 to 5.4 million tons last year.)

Where does this leave U.S. producers? For makers of steel mill products, it is the old story of addressing measurable increases of foreign steel coming into the market. Where those imports are unfairly traded, U.S. law provides some remedies. But producers of downstream steel products – screw machine products, forgings, etc. – the task is made more difficult by the lack of statistics that can show just what is happening. Some things those producers and their trade associations might consider are developing their own internal data bases relying on anecdotal market information and seeking the aid of the Customs Service to provide more detail about the imports of their products.

Turning to this month's specifics:

- Scrap and Pig Iron. After a couple of months of decline, scrap prices rebounded a bit in June. Number 1 dealer bundles and #1 busheling were at \$295 and \$300 per metric ton, respectively, about 4% above last month. For the fourth month in a row, the spot price for Brazilian pig iron (cif New Orleans) was \$375 per mt.
- Natural Gas. In recent months, the NYMEX contract price has been edging upwards and is now at \$8.10 per mcf. Just last January, it was at \$6.25 per mcf, and the current level is the highest since the spike that occurred in the last half of 2005. Short of a recession, there is no indication that the prices are due to moderate significantly in the foreseeable future.

- Exchange Rates. At this writing, the euro is trading at \$1.34, the same as last month, and the pound is at \$1.99, up a penny. The Canadian dollar is now worth 94¢, a level not seen since the early 1970s.

As always, we are interested in having your feedback on these letters and the subjects that interest you. This letter will be posted on our web site www.coreysteel.com and on the international site, www.steelonthenet.com.