Office and Plant:
2800 South 61st Court
Cicero, Illinois 60804-3091

(708) 735-8000
(800) 323-2750

Mailing Address:
P.O. Box 5137
Chicago, Illinois 60680-5137

Facsimile:
(708) 735-8100

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MIXED MESSAGES

Last month, my letter suggested that conditions in China had taken a new turn, and that the result of this factor might be an alleviation of pressure on the prices for the raw materials that go into steel-making. The effects of this kind of development are never in the short term, especially in a country like China. However, there has been a tightening of credit, particularly affecting the "overheated" sectors of the economy. No longer are marginal borrowers eligible for interest rates in the neighborhood of 5%; instead they will be forced to borrow at the non-official rates in the high teens.

The result of these measures so far has been a sharp reduction in inflation, which, of course, means that the prices for most raw materials have not continued to skyrocket, as in previous months. Two so-called overheated elements of the economy are the construction and automotive sectors, and a sharp curtailment of lending there has softened the demand for steel building materials and for cars, particularly those made in China. As a result, the pressure on steel making should also go down.

There are still areas where demand grows very fast. The sale of new electric appliances in recent years has caused huge increases in the demand for electricity, particularly as the weather heats up. Thus, coal continues in increasing demand, as do the rail cars that carry it. High coal prices mean high coke prices, and, despite the declines in the cost of pig iron, ferro alloys, scrap and iron ore in China, coke prices remain strong and increasing.

As I said, where these developments will lead in the long run is very uncertain. The Chinese could decide at any time to relax credit and bring back many problems for those who must compete for steel-making raw materials. For the present, we have seen the following developments in the cost factors affecting steel prices in the United States:

- Scrap and Pig Iron. Prices for #1 Dealer Bundles and #1 Busheling (Chicago) reversed a three-month slide and rose from $240 to $250 per ton, by the end of May. The spot price for Brazilian pig iron dropped again in June to $250, an $87 decline in just two months. However, reports out of Brazil suggest that they, like the Chinese, are facing a domestic shortage of steel production (taking into account that some 40% of Brazilian steel is exported).

- Coke. Shortages of coke are affecting steel production world-wide. US Steel is reportedly considering reducing output because of low coke availability, due in some part to problems at the Pinnacle coal mine in West Virginia. Arcelor is reported to be curbing steel production by 5% this year due to the high price it has had to pay for the coke it does not produce in-house – spot market prices for Chinese coke are running $400-$440, compared with $120 last year and $80 the year before. The EU is using the threat of a trade case under the WTO to pressure China to end their export controls on coke.

- Ocean Freight Rates. The bottom has dropped out, with rates sliding to $35 per ton in May, the lowest for over 18 months.

- Natural Gas. We all know what has happened to the price of gas at the pump, and, not surprisingly, natural gas has followed suit. After three months of decline, the Nymex price increased in April and jumped in May. We are back very close to the high of $6.90 mcf that was reached last January.

- Surcharges. Surcharges for increased costs are now a jumble with general price increases, and different producers have taken very different approaches. The transitory nature of raw materials cost increases thus makes some steel price increases uncertain over the long run. For example, we have seen reports that Nucor will be lowering its surcharge by $25 and will increase its base price by $20. ISG is said to be increasing its plate prices by $50 and Ivaco is supposedly increased wire rod pricing by $40.

- Imports. April 2004 imports were 2.209 million mt, compared with 1.661 million mt the previous April. The increase is a product of increased demand, the end of the Section 201 tariffs, easing of ocean rates and the relaxation of Chinese demand. Nonetheless, the dollar is a good deal weaker than a year ago, so the cost factors may be evening out. The Institute for Supply Management's April survey showed that 58% of buyers reported increased contacts by foreign suppliers; at the same time 96% of the buyers said that foreign pricing was at or above domestic.

As you can see, the domestic steel situation is as full of mixed messages as the general economy. We at Corey claim to have no crystal ball, but it does look pretty certain that we shall continue to be uncertain for a number of months in the future. We would, as usual, be very interested in your thoughts on these matters. Also as is customary, we are posting this letter on our web site – www.coreysteel.com.

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