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## **WHEN WILL DEMAND PICK UP?**

Since the beginning of the year, sales of steel products have undoubtedly slackened, but the question has been for how long? For many, the downturn was a temporary matter, and shipments would pick up, once inventories were worked off. Others saw the fall off in sales to be more lasting, perhaps into next year.

There were some signs last month that the pessimists may be right:

- Total shipments of steel products in April were down by 7.6% from March and 6.5% below April, 2004.
- In May, the *American Metal Market* reported that wire rod prices had declined due to high inventories and lower demand. Since the beginning of the year, prices had fallen between 4% and 12% for various product grades. Anecdotal comments from producers in various sections of the country attributed the declines, in one way or another, to market softness. Earlier reports described the same situation for flat rolled products.
- Mittal Steel recently announced that it would extend the shutdown of its Weirton blast furnace from the previously announced ten days to from eight to ten weeks. Mittal Steel had previously idled its West Side plant in Cleveland. Market conditions were blamed for the measures.
- Steel Dynamics, Inc. and Stelco, Inc. reduced earnings projections for the second quarter due to declining demand. One suspects that many other companies have found themselves to be overly optimistic in this regard.

There is no sure answer, of course, to the question when will demand pick up. But, given the import levels, the continuing inventory levels held by producers and customers and the uncertainties in the overall economy, it is hard to believe that a strong rebound will materialize in the second half of 2005. (I have often stated in these letters my discomfort with making market predictions; perhaps that is due to my record for accuracy. *Caveat lector.*)

You will recall the information in previous letters about the state (Mississippi) and federal (Labor Department) grants, loans and guaranties (about \$150 million in the aggregate) provided to the new SteelCorr mill. It now turns out, as reported in the *AMM*, that the Russian steel producer Severstal will be providing at least 75% (about \$500 million) in financing the facility, which will be called SeverCorr. Coincidentally, the report in the *AMM* appeared the same day as another story about protests from the American Iron and Steel Institute and the Steel Manufacturers Association against a planned loan by the World Bank's International Finance Corporation to an Indian steel producer. The IFC loan would be at commercial rates *i.e.*, at rates presumably higher than the rates that SeverCorr will be charged on government and government-guaranteed loans. And the next day the *AMM* reported the ringing endorsement by the president of Mittal Steel USA for a zero tolerance of government subsidies. One must ask whether this zero tolerance, like charity, shouldn't begin at home.

Turning to some specifics:

- Scrap. What goes up.... Scrap prices continued to tumble last month. Number 1 dealer bundles fell by \$70 to \$145 mt. Number 1 busheling (Chicago) declined by \$59 to \$151 mt. These prices are about the same level as during the first half of 2003, before the huge run-ups thereafter. The collapse could make U.S. scrap more attractive to foreign buyers, but many in the market talk more about whether prices have bottomed than about any strengthening in the near future.
- Pig Iron. After resisting the effects of the decline in scrap prices for several months, Brazilian pig iron (spot price, New Orleans) dropped \$55 to \$250 per mt in May.
- Ocean Freight. The Baltic Capesize Index declined in May from 3224, or by about 60% since last December/January. This index, too, is near the levels of the first half of 2003.
- Natural Gas. The Nymex contract price was up slightly from last month to \$6.80 mcf. This price continues to reflect the current market for crude oil. One ominous note was the report of efforts by natural gas producing countries to create an OPEC style cartel.
- Exchange Rates. The dollar made substantial gains last month against the euro (\$1.29 to \$1.22) and the pound (\$1.91 to \$1.81). This improvement appears to be more due to the political problems in Europe than to any significant improvement in the U.S. economy. The dollar actually weakened slightly against the Canadian dollar, which is now worth 80¢.

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