Flat Steel Products One Year Forecast

February 2010

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EXECUTIVE SUMMARY

- *Our forecast of expected market strength through Q1 was certainly justified in January as global prices rose sharply. Led by raw materials, which were up more than 10% month-on-month, the GFMS global average HR coil price in January hit $600/tonne – its highest since the end of the financial crisis in Q2 2009.*

- *In our update, we highlighted the strong start to the year and suggested that there were limited further gains to be made. Indeed, prices came off peaks in China and the rest of Asia late in January. This was due to fears of monetary tightening in China and concerns over Chinese demand, which triggered Asian buyers to hold off further purchasing prior to the Lunar New Year holiday period. In turn, this dampened excessive hopes of emerging steel producers.*

- *Yet from an Asian perspective, we believe that this is a short-term correction. We believe that the Chinese economy has enough short-term momentum to absorb high levels of steel production beyond the holiday period and through the first half. We expect prices to bounce back from a brief decline to push higher through Q2. The initial tightening does however confirm our view that the second half of 2010 could be much tougher.*

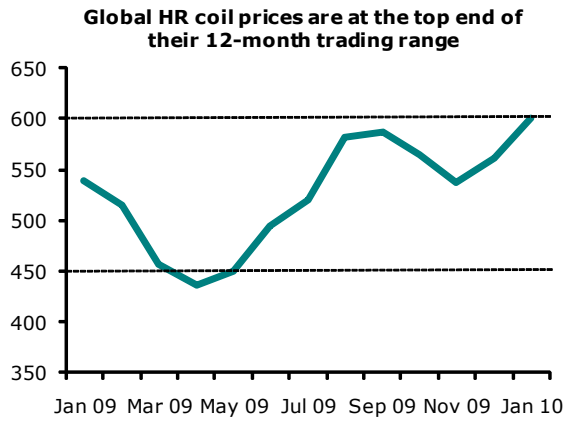
- *Mature markets in Europe and North America have lagged Asia during the upturn for the last nine months, so there remains strength in these markets. However, finished product pricing has been particularly strong in North America, where these raw material gains have been passed on to a market where there is a major lack of inventory. Our concern is that these price gains may be unsustainable into Q2 as additional supply will weigh on a market where demand remains lackluster. Price gains in Europe have lagged, but are finally moving up and given price strength elsewhere, mills here will be able to follow up global prices into Q2.*

- *Fundamentally, we have not changed our view of pricing strength through Q1 underpinned by rising raw materials, with some softness in Q2 as excess supply becomes a factor, in a still weak demand environment. By the second half of the year, we will see if our concern on China is justified.*

GFMS Steel Price Indices January 2010 (Jan 03=100)

	Index	MoM	YoY	Global ave.
Scrap	248	15.5%	31.0%	344
Slab	204	10.6%	26.3%	498
Plate	192	6.5%	(15.8%)	615
HR	186	6.9%	11.4%	600
CR	165	7.0%	10.0%	686
HDG	164	7.7%	7.7%	755

Average Global HR Coil Prices



Global Crude Steel Production and Forecasts (000 tonnes)

	2007	2008	Q3 09	Q4 09	2009	Q1 10	Q2 10	Q3 10	Q4 10	2010	% change
China	489,862	497,859	153,734	146,673	566,420	140,000	155,000	148,000	135,000	578,000	2.0%
Other Asia	243,678	248,059	54,756	59,377	208,375	61,200	62,700	63,550	63,250	250,700	20.3%
EU15	174,780	165,723	28,704	34,541	114,998	37,650	40,350	35,550	38,700	152,250	32.4%
CIS	123,857	112,934	25,531	26,586	96,188	26,200	28,450	26,000	25,100	105,750	9.9%
NAFTA	131,245	123,899	21,957	24,388	80,879	26,600	29,000	27,550	29,950	113,100	39.8%
C & S America	49,576	49,030	10,944	11,487	38,605	11,770	12,080	12,150	12,450	48,450	25.5%
Other Europe	30,115	31,397	7,728	7,759	28,652	7,400	7,800	8,050	7,700	30,950	8.0%
EU12	35,057	31,218	6,028	5,994	21,815	6,900	7,600	6,800	7,500	28,800	32.0%
Middle East	15,726	15,938	4,102	4,100	16,575	4,200	4,400	4,150	4,400	17,150	3.5%
Africa	18,659	16,916	3,676	3,750	14,540	3,900	4,100	4,000	4,250	16,250	11.8%
Australasia	8,751	8,602	1,691	2,095	6,092	2,140	2,145	1,985	2,095	8,365	37.3%
Global total	1,321,306	1,301,575	318,851	326,750	1,193,139	327,960	353,625	337,785	330,395	1,349,765	
Year-on-year % ch.	8.3%	(1.5%)	(5.4%)	21.4%	(8.3%)	24.6%	24.3%	5.9%	1.1%	13.1%	

ALTERNATIVE SCENARIOS

We remain confident of our shorter-term outlook, but note that the outlook for the second half is more speculative. Overall, we have a 60% confidence in our core outlook.

Upside scenario

The major upside is that the global economy accelerates more aggressively than expected, enabling China to resume sustainable growth without further stimulus. In turn, that will drive additional re-stocking through the supply chain that was severely decimated. This will push prices higher through to at least Q3 with HR coil prices breaking through $700/tonne on average. We ascribe a 25% probability to this.

Downside scenario

A double-dip recession, where economies are unable to generate self-sustaining growth as stimuli are withdrawn, remains a possibility. While prices would rise in Q1, the peak would be early in Q2 and prices would test cyclical lows early in Q3 with little respite in Q4. We ascribe a 15% probability to this.

CRUDE STEEL BRIEFING

Final 2009 data for crude steel production is now in. According to WSA data, total global steel production fell 8.3% year-on-year and 22.0% excluding China. In our January 2009 report, we forecast a decline of 6.2% and a decline of 10.4% excluding China. While we were correct in our forecast of falling global demand, but Chinese growth, we under-estimated both. We think that this is a truly amazing feat that steel production in half of the world could grow so strongly, while collapsing by unprecedented levels in the other half. To us, it underlines that steel is a regional business, although global in scope. It also makes it possible that China could have a disastrous year and the rest of the world a very positive one, which is to some extent is what we envision taking place this year. In regional terms, we have the following analysis for 2009:

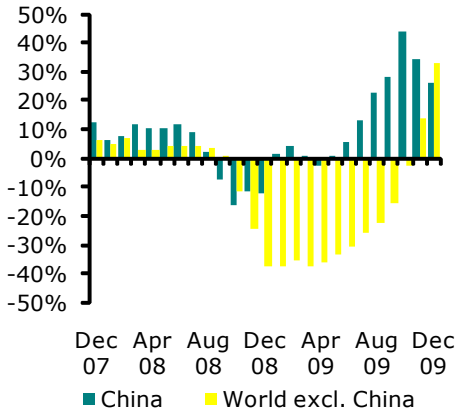
- NAFTA output was down 34.7% year-on-year, although was up 13.1% year-on-year in Q4. Canadian output was down by 44% as US Steel operations were down for most of the year and are still not back, and Gerdau Ameristeel operations were hit by strike action. Mexican output was down 19.3%.

- EU27 output was down by a similar 30.5%, but the bounceback in Q4 was a more muted 6.8% year-on-year improvement. The decline was fairly evenly distributed across the whole of Europe, with Italy and Belgium seeing the biggest decline of major producers. No major producer saw output fell less than 25% year-on-year across the region.

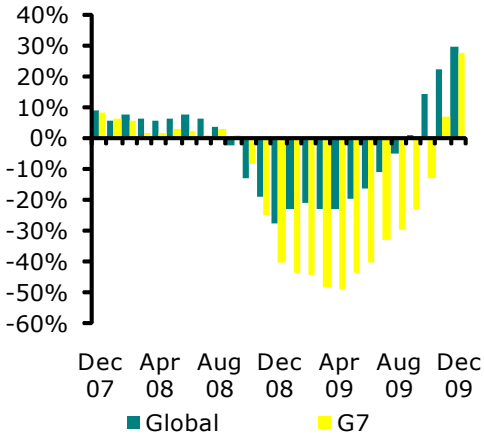
- Chinese output was up 13.8% year-on-year and at 566m tonnes, it accounted for an astonishing 47% of global output (and given that net exports were just 6m tonnes, virtually the same amount of global demand). India also eked out some production gains – up 2.0% on the year, although it could be higher as the WSA included a lot of estimated data this year for India. While Japanese and Taiwanese output was down 26% and 22% respectively, South Korean output was down just 9.2% year-on-year thanks to new capacity coming on-stream and a relatively strong demand performance.

- In emerging markets, Turkish output was down just 6.2% - an astonishing performance achieved in our view by the sacrifice of profitability in long product markets, but also highlighting capacity changes. CIS producers saw output fall 14.8% year-on-year, but 22.3% down on 2008 production levels. It was the first time since 2002 that CIS output had been less than 100m tonnes. Latin American output was down 21% year-on-year, African output was down 14%, but the Middle East eked out a small gain of 4.0% (and in fact was more than this given that the WSA does not cover UAE or other producing countries).

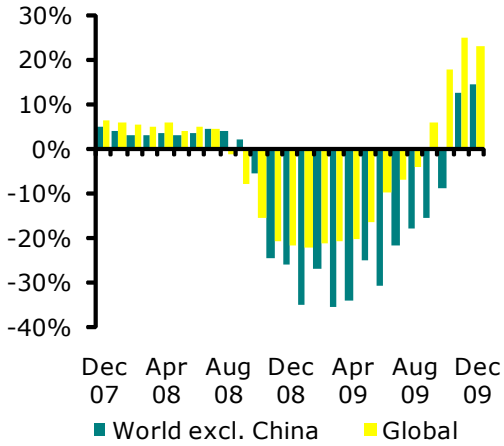
IISI Steel Production (y-o-y % change)



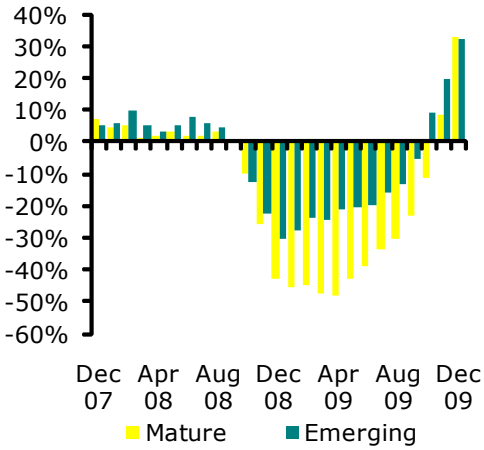
IISI Steel Production (y-o-y % change)



Daily Rate Steel Production (y-o-y % change)



IISI Steel Production (y-o-y % change)



ECONOMIC INDICATORS

US data

- University of Michigan US consumer confidence inched up in January to 74.4. It remains at the top end of the recent range, but well below previous peaks. As this is linked closely to automotive sales, we do not expect a sharp pick-up in this market in the near term. January automotive sales were a disappointing 10.7m units on an annualized basis according to preliminary data – down from December's 11.3m units.

- The ISM Purchasing Managers Index (PMI) rose more sharply than expected – up to 58.4 from 54.9 – to its highest level since 2004. This is extremely positive for flat steel consumption. The issue of whether this is driven by re-stocking or fundamentally stronger demand will play out over the next quarter. If it stays in the 55+ range well into Q2, we may have to upwardly review our demand outlook.

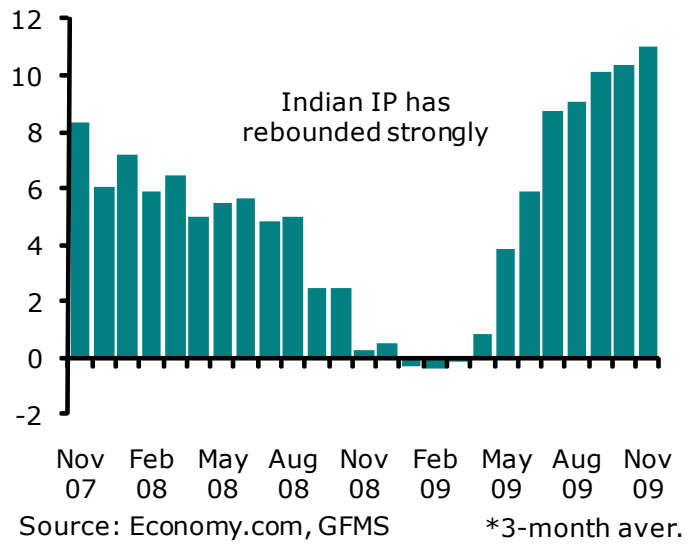
- Construction expenditure however remains downbeat. It fell 1.2% month-on-month in December and remains down 10% year-on-year. November was revised downwards as well. Public construction expenditure remains disappointing having fallen month-on-month for five successive months, and stimulus expenditure still does not remain a factor in the economy.

Main Economic Indicators

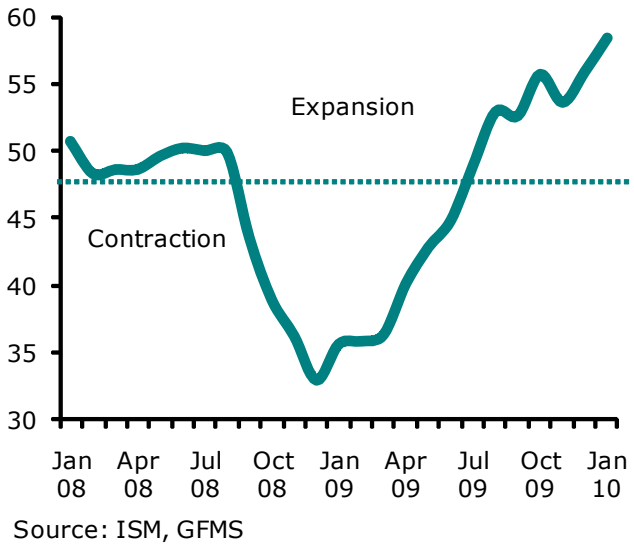
	Apr-09	May-09	Jun-09	Jul-09	Aug-09	Sep-09	Oct-09	Nov-09	Dec-09	Jan-10
Manufacturing PMI										
Eurozone	36.8	40.7	42.6	46.3	48.2	49.3	50.7	51.2	51.6	52.4
USA	40.1	42.8	44.8	48.9	52.9	52.6	55.7	53.6	54.9	58.4
China	50.1	51.2	51.8	52.8	55.1	55.0	55.4	55.7	56.2	57.4
Japan	41.4	46.6	48.2	50.4	53.6	54.5	54.3	52.3	53.8	52.5
OECD Composite Leading Indicators										
OECD	93.6	94.9	96.3	97.7	99.0	100.3	101.4	102.3		
Euro zone	94.7	96.2	97.8	99.4	100.9	102.3	103.5	104.6		
France	97.3	98.6	99.9	101.3	102.6	104.0	105.3	106.5		
Germany	91.3	93.1	95.2	97.3	99.3	101.0	102.5	103.9		
UK	96.0	97.1	98.5	100.1	101.7	103.2	104.5	105.7		
USA	92.1	93.3	94.7	96.1	97.5	98.7	99.8	100.9		
NAFTA	92.6	93.8	95.3	96.7	98.1	99.4	100.5	101.5		
Japan	92.2	93.3	94.6	96.1	97.4	98.8	100.0	101.2		
Brazil	96.9	97.1	97.4	98.0	98.6	99.3	100.1	100.9		
China	94.9	96.3	97.7	98.8	99.6	100.1	100.3	100.5		
India	95.8	96.9	97.8	98.5	99.0	99.2	99.3	99.4		
Russia	88.0	89.3	91.0	92.7	94.3	95.7	96.9	98.0		
Industrial Production (m-o-m)										
Euro-zone	-0.5	1.1	1.0	0.4	1.2	0.3	-0.3	1.0		
Germany	-3.0	4.9	1.3	-1.1	1.7	3.3	-1.8	0.7		
France	-1.4	2.4	0.2	0.6	2.9	-1.2	-0.6	1.2		
Italy	1.2	0.0	0.0	2.1	6.0	-4.9	0.6	0.2		
UK	0.1	-0.8	0.6	0.3	-2.6	1.3	0.0	0.3		
USA	-0.6	-1.1	-0.5	1.2	1.3	0.6	0.2	0.6	0.6	
Japan	5.9	5.7	2.3	2.1	1.6	2.1	0.5	2.2	2.2	
South Korea (y-o-y)	-8.2	-9.0	-1.1	0.7	1.0	11.0	0.3	17.9	33.9	
Brazil	1.2	1.4	0.5	2.2	1.2	1.7	2.3	-0.2		
China (y-o-y)	7.3	8.9	10.7	10.8	12.3	13.9	16.1	19.2	18.5	
India	-10.9	4.2	3.8	-0.1	1.0	2.6	-3.7	3.0		
Consumer/Business Confidence indicators										
Eurozone Economic Sentiment	67.3	70.2	78.3	80.8	84.8	86.7	89.6	91.9	94.1	95.7
USA Consumer Confidence	40.8	54.8	49.3	47.4	54.5	53.4	48.7	50.6	53.6	55.9
Japan Consumer Confidence	32.4	35.7	37.6	39.4	40.1	40.5	40.5	39.5	37.6	
Brazil Consumer Confidence	97.6	102.1	106.4	108.4	110.3	111.5	114.5	115.5	114.1	116.4
China Consumer Confidence	86.1	86.7	86.5	87.5	88.0	88.1	88.5	88.6		

Source: OECD, National Statistics, Dismal Scientist & GFMS

Indian Industrial Production (y-o-y % change)



Institute of Supply Management, PMI (manufacturing)



EU data

- Eurozone IP rose 1% month-on-month in November – 7.1% down year-on-year. This is a stronger-than-expected performance, but follows a month-on-month decline in October. Forward looking purchasing managers indices suggest continued month-on-month gains, but subject to volatility.

- Business confidence in the eurozone is now at its highest level since June 2008, although the rate of growth is slowing. Nevertheless, this is positive for economic growth in the EU, although there remain significant differences between core economies in Germany and France and peripherals in Spain, Portugal, Greece or Ireland.

Asian data

- Thai manufacturing rose 35.7% year-on-year in December and 10.4% month-on-month, highlighting the impressive year-on-year gains being made in Asian consumption. Internal and external demand is supportive, with the potential for further gains through the first half on improving business confidence.

- Japanese IP expanded strongly late in Q4 as a 2.2% month-on-month expansion in November was followed by the same in December. It is now finally above year-on-year levels, and has been growing for five successive months.

Emerging data

- Indian IP rose 11.7% year-on-year in November. This strong performance will accelerate in the next few months as favourable year-on-year comparisons are made. The Indian economy is now one of the strongest in the world.

North America

Recent developments

- ***Scrap prices rose in January and are set to stay at elevated levels through February. This has driven prices higher as marginal providers of sheet – the minimills – have to add this straight on. HR coil prices have risen to a minimum of $600/ton, while plate prices have also risen in line with scrap.***

- ***Low inventories and an improving demand environment have meant that distributors and consumers have had to order material, thus extending lead times. However, shipments from distributors were lower than we expected in Q4 and inventories rose during that period. This suggests that an extended period of higher orders from distributors is unlikely without a major uptick in shipments out of distributors i.e. a sharp increase in demand.***

- ***Nevertheless, higher order levels (and higher prices offering improved profitability) have encouraged suppliers to bring back capacity. The announcement of three BFs back on stream in Q1 at US Steel, ArcelorMittal and Severstal Warren highlights that output will be significantly higher in Q2. The capacity is equivalent to 10-15% of total US supply, although not all will be fully utilized.***

Market outlook

- ***In our January report, we forecast a sharp increase in prices over Q1 and that has not changed. We also forecast that capacity would come back and output would rise, and this would drive raw material prices higher, and this has been the case.***

- ***We continue to believe that there is insufficient demand to support the sharply higher output levels expected and pricing will begin to fade through Q2. Mills may look to make further price announcements in February, but without a sustained hike in scrap, prices are unlikely to stick at much above $620-630/ton for more than a short period.***

- ***Imports are also set to increase in Q2 as a gap opened up between international prices and domestic price levels, further adding to excess supply.***

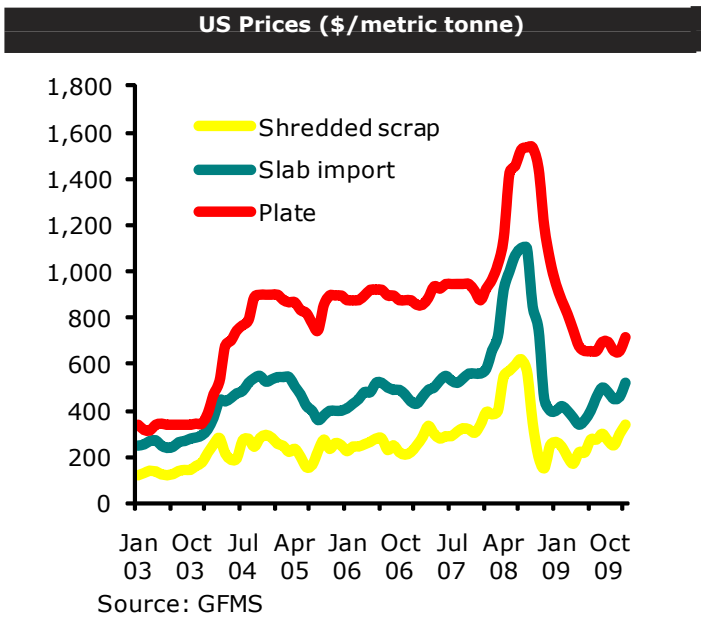
- ***Mills may actually end up producing less-than-expected through the latter half of Q2 and into Q3, thus pushing down scrap prices at that point, but also bringing the market back into balance again.***

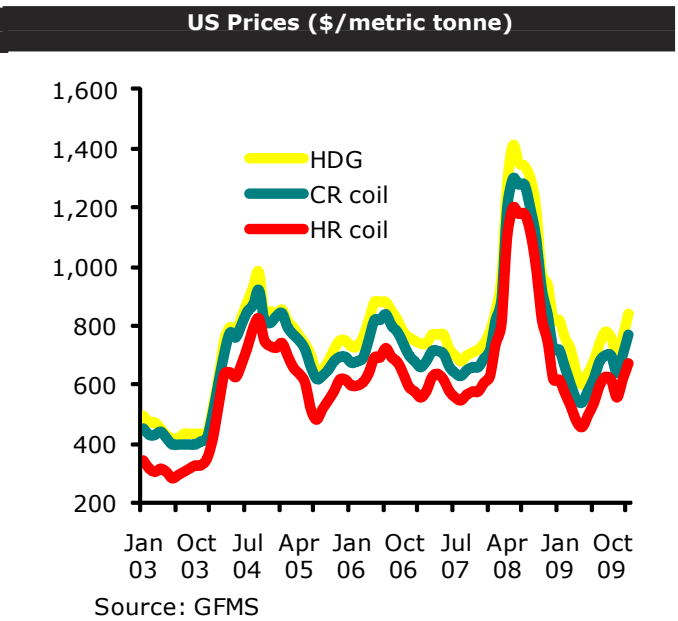
US Steel Prices (US$/metric tonne)

	Ferrous scrap [1]	yoy % change	Slab import [2]	yoy % change	Plate [3]	yoy % change	HR [3]	yoy % change	CR [3]	yoy % change	HDG [3]	yoy % change
Jan-10	340	28%	520	30%	720	(24%)	675	9%	770	7%	840	2%
Feb-10	340	39%	520	24%	750	(15%)	675	17%	770	17%	830	9%
Mar-10	330	65%	550	38%	750	(9%)	660	25%	760	27%	820	14%
Apr-10	320	88%	550	49%	750	0%	650	35%	750	36%	810	27%
May-10	300	36%	550	62%	730	7%	640	39%	740	37%	800	33%
Jun-10	300	36%	530	47%	720	9%	620	24%	720	24%	780	22%
Jul-10	330	20%	510	28%	750	14%	650	20%	730	18%	790	16%
Aug-10	350	27%	510	11%	780	18%	660	10%	740	9%	800	8%
Sep-10	320	7%	500	0%	750	7%	640	2%	720	3%	780	0%
Oct-10	300	11%	480	0%	720	3%	620	0%	700	0%	760	0%
Nov-10	280	12%	460	2%	700	6%	580	4%	660	3%	720	3%
Dec-10	260	(13%)	450	(2%)	680	3%	560	(10%)	640	(9%)	700	(8%)
Jan-11	290	(15%)	450	(13%)	680	(6%)	560	(17%)	640	(17%)	700	(17%)
2003 ave.	**138**		**265**		**339**		**319**		**415**		**445**	
2004 ave.	**251**	**81%**	**472**	**78%**	**725**	**114%**	**674**	**111%**	**771**	**86%**	**800**	**80%**
2005 ave.	**227**	**(9%)**	**448**	**(5%)**	**856**	**18%**	**604**	**(10%)**	**709**	**(8%)**	**738**	**(8%)**
2006 ave.	**244**	**7%**	**473**	**6%**	**896**	**5%**	**646**	**7%**	**748**	**5%**	**803**	**9%**
2007 ave.	**303**	**24%**	**519**	**10%**	**919**	**3%**	**588**	**(9%)**	**672**	**(10%)**	**730**	**(9%)**
2008 ave.	**421**	**39%**	**800**	**54%**	**1,273**	**39%**	**929**	**58%**	**1,022**	**52%**	**1,100**	**51%**
2009 ave.	**249**	**(41%)**	**420**	**(48%)**	**732**	**(43%)**	**561**	**(40%)**	**641**	**(37%)**	**717**	**(35%)**
2010 ave.	**314**	**26%**	**511**	**22%**	**733**	**0%**	**636**	**13%**	**725**	**13%**	**786**	**10%**

[1] shredded ex-yard Midwest in $/long ton [2] cif Gulf port [3] ex-mill Midwest

Source: GFMS





Scrap up $40-45/ton in January and flat(ish) in February

Broker prices for sales of shredded scrap (and most other grades) were up $40-45/l.ton depending on location in early January. This took them to around $330-340/tonne Midwest. The same factors driving prices higher remained largely in place in January.

- Higher order levels for steel products encouraging producers to purchase more scrap and boost inventory
- Still weak industrial output levels limiting scrap availability
- Low collection rates and disruption to deliveries due to winter weather
- High export demand in January pushed up prices sharply – particularly in Asia, but less so in Turkey/ Europe – but this faded in February

The weakness in export markets in February pushed down some prices on the East Coast and this has depressed obsolete scrap in particular, as Midwest brokers were able to sell less-than-expected to export brokers, and some material flowed back to the Midwest. However, re-starts and higher sheet order levels pushed mills to continue purchasing and we expect prices to end up flattish over the month.

However, higher purchasing from mills is unlikely to be in place for three months and the winter weather and collection rates will also improve. Moreover, higher automotive output and industrial production should ease supplies of prompt scrap. As such, we are forecasting that prices are now at their peak or so with some weakness in the market in Q2. The extent of the weakness will depend on local and international steel demand at that point.

Mills follow

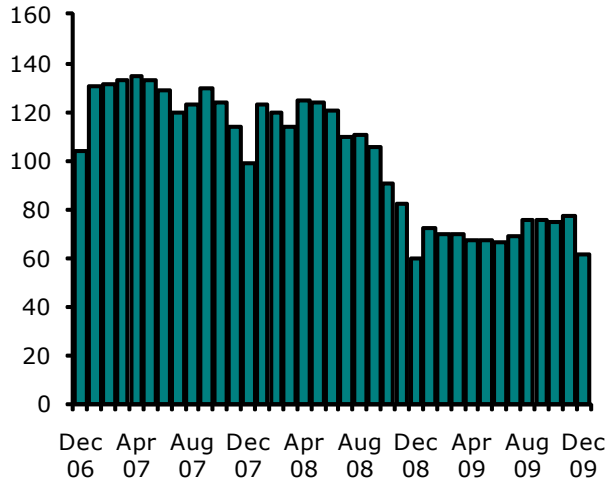
Once again, AK Steel was the first to push prices up on the movement on scrap – announcing a $60/ton increase with immediate effect in the first week of January. This raised prices to $620/ton for HR coil and others followed with $40/ton or $60/ton increases – largely depending on their previous price level. Minimills tended to just add the increased scrap price and settled at around $610/ton ($670/tonne), while other integrateds are quoting as high as $630/ton ($695/tonne), and some of these raised prices by a little more than the increase in scrap (which is not a huge factor for integrateds anyway). Downstream products have been raised in line, and mills are also indicating that they are pushing for higher extras pricing in products such as HDG as they seek to recoup margins.

However, mills have actually settled HR coil pricing at closer to $600-620/ton through most of the month. This indicates to us that although the market is steady, there are still companies that are seeking to use price as a market share tool and are willing to be aggressive on pricing. This suggests that further price gains are unlikely and mills will do well to hold prices at $600/ton or so through February, unless there are further upward moves in scrap.

Lead times extend

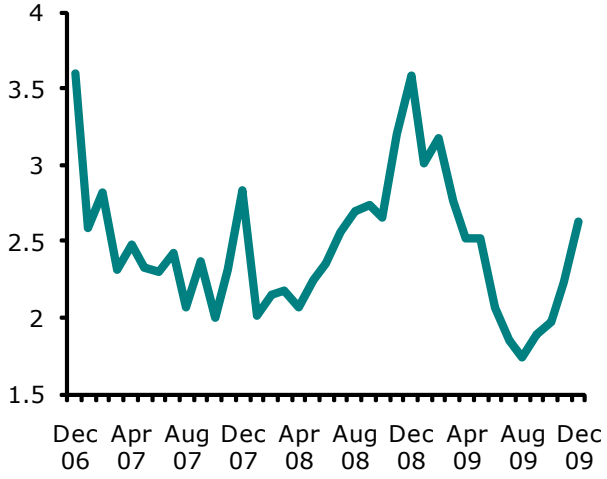
Lead times are out for minimills through to March (around 6-8 weeks) and automotive orders at integrateds are now out to April (8-10 weeks). Moreover, some deliveries are

Carbon flat rolled daily shipments (000 tons)



Source: MSCI, GFMS

Carbon Flat Rolled Inventory (months' consumption)



Source: MSCI, GFMS

coming late, which is keeping the market tight in certain products or forcing consumers to pay more for immediate delivery. Nevertheless, as the higher order levels from mid-December and through January are delivered in February and March, we expect that distributors may be more cautious on additional purchasing. Mills may seek to use this to announce a further increase – maybe $20-40/ton – in the short term, but in our view, this may not hold without a further increase in scrap.

December inventory data disappointing for mills

We highlighted last month that the tight state of affairs in inventory. That is forcing distributors to purchase material as lead times are pushed out as buyers look to secure lower-priced material. Most mills are now out at least 8 weeks for HR coil with sales made through March and into April. This is giving the mills pricing power as lead times now exceed inventory held at distributors (when measured in terms of weeks' consumption). This is allowing them to enforce extras and push out margins somewhat, although minimills are not as yet able to do that.

In fact, it appears as if inventory at distributors rose for the fourth successive month in December, on the back of really weak shipment data. December daily shipments were the lowest in 2009, although marginally up on December 2008.

Flat rolled inventories were up 250,000 tons or nearly 8% month-on-month. This took the number of months' shipments up to 2.6. This is really very disappointing. We expected shipments from distributors to pick up in Q4 on the back of improved PMI numbers that turned positive in September. In fact, there were only marginal improvements in shipment volumes.

Unless shipments out of distributors pick up a considerable amount in Q1, then the need for distributors to replenish inventories will disappear by Q2, order levels and lead times will drop and mills will begin to discount again. In fact, this is what we expect to happen.

Demand environment improving

We have argued that automotive shipments and appliance shipments will be stronger in 2009 and 2010. This month, Whirlpool indicated that North American unit shipments of its products will be up 2-4% this year. We think that this is conservative, and US shipments could be up 5-10% year-on-year.

Automotive sales numbers in January were a disappointing 10.7m units on an annualized basis compared to 11.3m units in December. Nevertheless, this is still up 6% year-on-year, and we expect automotive production to be up 10% year-on-year.

NAFTA Steel Production & Forecasts (000 tonnes)

	2007	2008	Q3 09	Q4 09	2009	Q1 10	Q2 10	Q3 10	Q4 10	2010
Canada	**15,757**	**15,613**	2,210	2,635	**8,725**	2,800	3,000	2,750	3,100	**11,650**
USA	**98,182**	**91,157**	16,364	17,510	**58,331**	20,000	22,000	20,700	22,500	**85,200**
Mexico	**17,306**	**17,129**	3,383	4,243	**13,823**	3,800	4,000	4,100	4,350	**16,250**
Total NAFTA	**131,245**	**123,899**	**21,957**	**24,388**	**80,879**	**26,600**	**29,000**	**27,550**	**29,950**	**113,100**
YoY % change	***0.8%***	***(5.6%)***	***(35.1%)***	***13.1%***	***(34.7%)***	***60.2%***	***61.8%***	***25.5%***	***22.8%***	***39.8%***

Source: WSA, GFMS

Overall manufacturing data is also positive as the ISM PMI jumped an impressive amount to 58.4 indicating that industry expects to improve inventories in the short term, which should translate to higher order levels.

The downside remains construction markets, which should show some seasonal improvement, but many larger projects remain reluctant to commit.

Supply picking up

The increase in orders is resulting in mills bringing back capacity:

- US Steel is bringing back its large No14 furnace at Gary in February/March after maintenance – on its return, 90% of US Steel capacity will be running, albeit not necessarily at full tilt. Lake Erie remains closed due to a labour dispute, but even here there has been some movement to return.
- ArcelorMittal is bringing back its largest furnace at Indiana Harbour by the end of March.
- Severstal Warren is coming back on line at the end of Q1 as well along with some downstream Wheeling facilities.

The increase in capacity is equivalent to around 7-8m tpy of slab, which is 10-12% of the US total and a significant addition to supply, although it may not all run immediately at full capacity. However, we expect sheet availability in Q2 to be sharply higher and these higher offers will ease tightness in the market.

Import potential open up

The spread between US prices and those in the rest of the world theoretically opens the US up for imports. However, buyers remain uncertain as to the strength of the upturn and order levels are therefore somewhat low. However, we expect that to turn up. Quality import HR coil out of Latin America or Europe or SE Asia ordered in January can be landed into the US market at around $600-620/tonne late in Q1, which is not far off domestic lead times and around $60-80/tonne below in price. This may arrive just as there is less need to re-fill inventories and domestic output is accelerating.

Plate moves higher

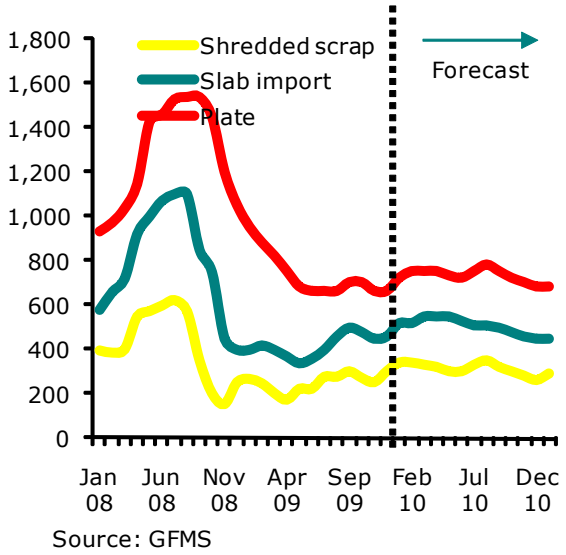
While demand is stagnant, the increase in scrap prices has been so great that buyers have accepted mill increases in prices. Ex-mill prices in February are being pushed up to around $680/ton – up $100/ton since mid-November in line with higher ferrous scrap prices. Mills have been

US Market Data (000 short tons)

		2007	2008	Aug-09	Sep-09	Oct-09	Nov-09
HR coil	**Shipments**	19,335	17,858	1,073	1,161	1,306	1,154
	Imports	2,408	2,557	134	164	184	199
	Exports	1,088	1,026	61	162	122	90
	Net AC	20,655	19,389	1,147	1,163	1,369	1,263
CR coil	**Shipments**	11,334	10,931	680	686	696	665
	Imports	1,201	915	81	97	96	97
	Exports	522	594	49	67	85	66
	Net AC	12,013	11,252	711	716	707	696
HDG	**Shipments**	15,283	13,557	694	859	934	808
	Imports	1,827	1,588	59	84	91	74
	Exports	894	871	80	88	88	89
	Net AC	16,216	14,274	673	855	937	794
Cut plate	**Shipments**	6,858	7,006	432	405	423	397
	Imports	916	728	27	42	47	32
	Exports	1,024	1,212	72	76	72	73
	Net AC	6,750	6,522	387	371	398	
Coiled plate	**Shipments**	3,991	3,418	341	353	319	259
	Imports	856	1,025	63	64	83	41
	Exports	512	1,007	78	99	107	94
	Net AC	4,335	3,436	326	319	295	206
Total*	**Shipments**	56,801	52,770	3,220	3,464	3,679	3,283
	Imports	7,208	6,813	365	451	501	444
	Exports	4,040	4,710	340	491	474	412
	Net AC	59,969	54,873	3,245	3,425	3,705	2,959

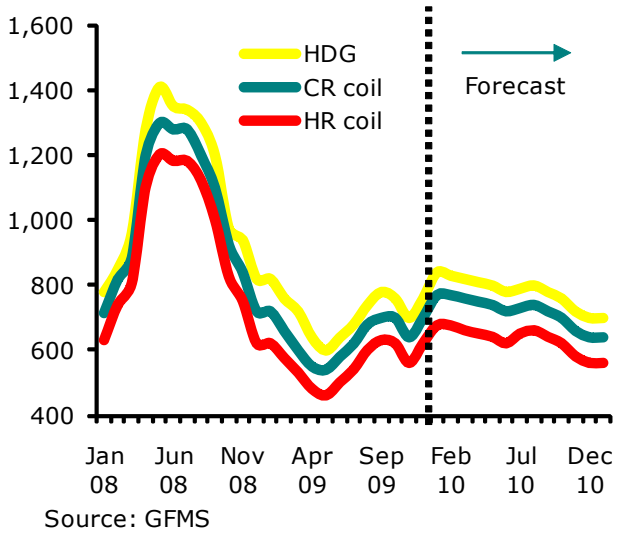
Source: AISI, GFMS
*Total only reflects named products and not all flat steel products i.e. Tinmill, narrow strip, ELG

US Forecast Prices ($/metric tonne)



Source: GFMS

US Forecast Prices ($/metric tonne)



Source: GFMS

raising list prices by an even greater amount – by around $160/ton or so – but consumers appear reluctant to pay any more than the increase in scrap prices. We continue to suggest that prices will drift back down when scrap prices turn back down, as demand in construction and LD oil and gas pipe remains weak, although there has been some improvement in general manufacturing demand.

ALTERNATIVE SCENARIOS

Base case scenario

We remain comfortable with our unchanged short and medium term price forecasts and allocate a 65% probability to this.

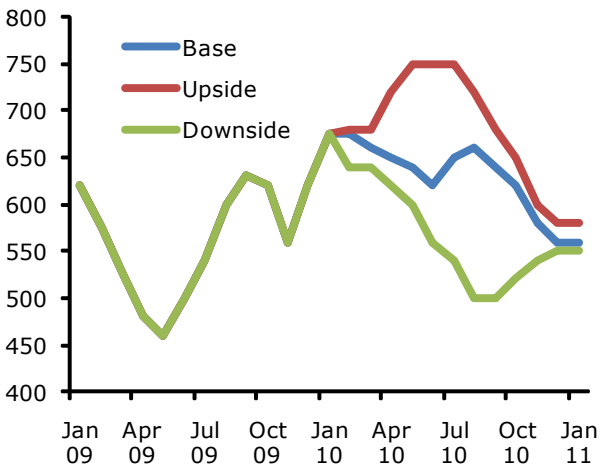
Upside scenario

There is the possibility that demand will be stronger than we expect and consequently steel mills will struggle to keep up with increased demand. Prices will push up significantly higher than our $660/tonne expectation at the end of Q1 up above $750/tonne through Q2 and extend margins. However, this improved economic environment would probably bring up interest rates much more quickly than in our base case, depressing local demand and pull in additional imports. We would still therefore expect prices to trend downwards by Q4. We allocate a 15% chance of this occurring.

Downside scenario

We are expecting a positive demand environment for manufacturing, but less so for construction. Should this not be the case then the current upturn is likely to peak at lower levels and prices will spend the majority of the year trading in a lower band - $470-550/ton. We allocate a 20% probability of this.

US HR coil price forecasts ($/tonne)



Source: GFMS

Europe

Recent developments

- ***The recent price increases are in line with our expectations. Northern European mills have sold out Q1 at €400/tonne ex-works, and are now looking for €450/tonne for Q2. Spot prices in southern and Central Europe were €400-420/tonne in January and mills are now looking for €440/tonne and above for February sales.***

- ***Import prices and offers remain elevated at around €430-440/tonne cif. Most domestic consumers thus prefer to buy domestic material with shorter lead times and more reliable relationships. However, some traders may have taken position cargoes at or below this price to bring in for Q2 and higher prices.***

- ***Rising global prices (and a weaker euro) are helping EU mills get more for their coil, but we continue to argue that the EU market is not strong enough to price above international levels. Under a rising price environment, lead times are extending. Evidence of re-stocking is anecdotal and there has been some improvement in manufacturing PMI numbers, but the outlook for fundamental demand remains weak in terms of automotive and manufacturing output, while the construction outlook remains depressed.***

- ***Utilisation rates at furnaces in operation have risen and a host of operations are looking to re-start through Q1 and into Q2, which will increase supply.***

Market outlook

- ***Northern EU mills have yet to release their prices for Q2 and are likely to announce in mid-February. We expect that they will try for €450/tonne ex-works for HR coil. Whether they get it will depend on international prices. Assuming they stay where they are, and the euro continues to weaken somewhat, then this number is a strong possibility.***

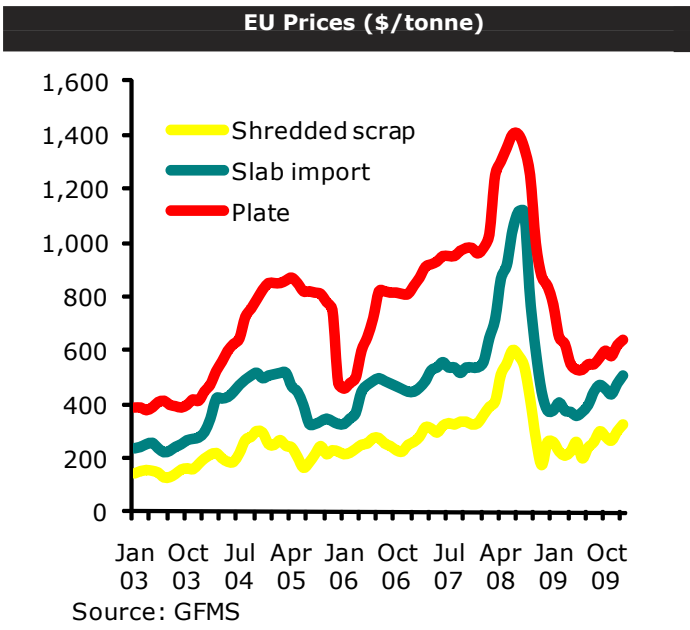
- ***Southern European prices could get to that level sooner with strength through February. However, we are cautious of further gains as ferrous scrap prices appear to be peaking.***

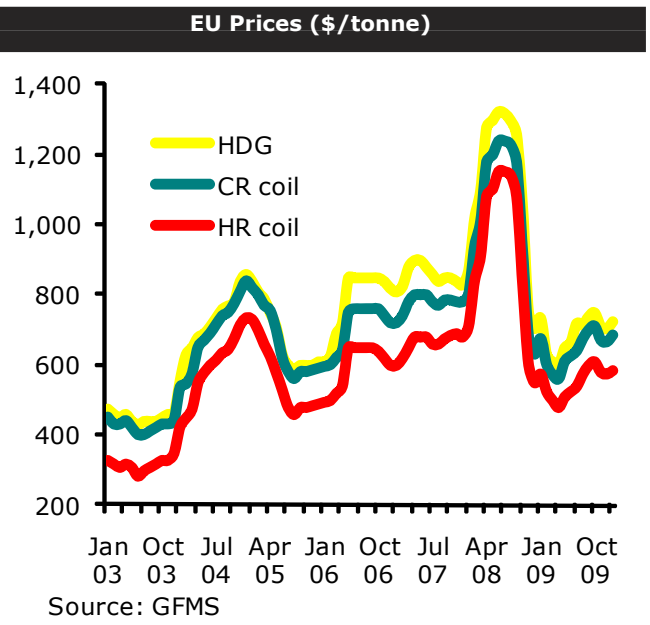
- ***Higher prices and better orders are encouraging mills to bring back capacity. This runs the risk of consequent over-supply of steel later in the year as the outlook for demand has not improved.***

EU Steel Prices (US $/metric tonne)

	Ferrous scrap [1]	yoy % change	Slab import [2]	yoy % change	Plate [3]	yoy % change	HR [3]	yoy % change	CR [3]	yoy % change	HDG [3]	yoy % change
Jan-10	325	25%	510	34%	640	(17%)	585	2%	685	1%	725	(1%)
Feb-10	330	47%	520	27%	650	0%	620	18%	720	20%	760	21%
Mar-10	350	67%	520	37%	680	9%	625	25%	725	27%	765	25%
Apr-10	350	56%	550	47%	700	27%	640	33%	740	32%	780	30%
May-10	350	35%	550	53%	720	36%	650	27%	750	23%	790	22%
Jun-10	320	60%	550	47%	720	36%	630	20%	730	17%	770	16%
Jul-10	300	25%	530	33%	700	27%	610	13%	710	11%	750	4%
Aug-10	300	15%	500	11%	700	27%	600	4%	700	4%	740	3%
Sep-10	280	(7%)	500	5%	680	18%	600	0%	700	0%	740	0%
Oct-10	275	(2%)	480	4%	660	10%	590	(3%)	690	(3%)	730	(3%)
Nov-10	265	0%	460	5%	640	10%	580	0%	680	1%	720	1%
Dec-10	260	(13%)	450	(6%)	620	0%	560	(3%)	660	(1%)	700	(1%)
Jan-11	260	(20%)	450	(12%)	600	(6%)	560	(4%)	660	(4%)	700	(3%)
2003 ave.	**152**		**252**		**400**		**318**		**425**		**450**	
2004 ave.	**235**	***55%***	**449**	***78%***	**652**	***63%***	**592**	***86%***	**691**	***63%***	**722**	***60%***
2005 ave.	**224**	***(5%)***	**408**	***(9%)***	**796**	***22%***	**558**	***(6%)***	**662**	***(4%)***	**678**	***(6%)***
2006 ave.	**244**	***9%***	**443**	***9%***	**692**	***(13%)***	**597**	***7%***	**705**	***7%***	**784**	***16%***
2007 ave.	**313**	***28%***	**521**	***18%***	**934**	***35%***	**663**	***11%***	**777**	***10%***	**855**	***9%***
2008 ave.	**423**	***35%***	**770**	***48%***	**1,169**	***25%***	**928**	***40%***	**1,021**	***31%***	**1,107**	***29%***
2009 ave.	**252**	***(40%)***	**415**	***(46%)***	**594**	***(49%)***	**550**	***(41%)***	**642**	***(37%)***	**686**	***(38%)***
2010 ave.	**309**	***22%***	**510**	***23%***	**676**	***14%***	**608**	***11%***	**708**	***10%***	**748**	***9%***

[1] shredded cif average EU mill [2] cif major port [3] ex-mill
All prices are an average of a range of prices that are present in the market, and exclude grade and finishing extras
Source: GFMS





Northern European mills sell out Q1

By the end of January, Northern European mills have largely sold out of Q1 HR coil at a minimum of €400/tonne ex-works. CR coil was around €480/tonne and HDG base at €500/tonne ex-works. Producers view this as a strong performance, and in the context of Q4, they are correct.

However, while they are likely to push for higher Q2 prices, we believe that the mills are unlikely to publicly announce this yet. While EU imports are at low levels, we believe that mills will not wish to publicise the exact increase for fear of attracting material. Privately, they may be looking for as much as €450/tonne ex-works for HR coil, €530/tonne for CR coil and €550/tonne for HDG, but the price will depend to some extent on the outlook in late February. In the meantime, they will try to squeeze spot prices higher by limiting availability. They could go even higher initially to gauge the market, but we expect them to be able to get in the region of €440-450/tonne ex-works.

Much will depend on distributors and inventory levels. As always, this remains a black hole in terms of accurate data, but the EASSC's most recent statements suggest that inventories remain elevated in terms of the level of consumption. Nevertheless, we do believe that ordering has increased from EU distributors, as it must do to even keep inventories flat rather than de-stocking.

However, we also recognize that fundamental demand is weak. In Italy, Fiat has reduced automotive production on the back of lower sales as subsidies are withdrawn. While the manufacturing PMI rose again in Europe in January, it remains below global levels.

EU Steel Production & Forecasts (000 tonnes)

	2007	2008	Q3 09	Q4 09	2009	Q1 10	Q2 10	Q3 10	Q4 10	2010
France	**19,247**	**17,879**	3,200	3,781	**12,836**	4,100	4,300	4,000	4,200	**16,600**
Germany	**48,551**	**45,833**	8,821	10,016	**32,671**	10,750	11,300	10,500	11,000	**43,550**
Italy	**31,866**	**30,503**	4,218	5,563	**19,502**	7,000	7,500	5,500	6,500	**26,500**
Spain	**18,658**	**17,613**	3,124	3,696	**13,361**	3,800	4,000	3,600	4,200	**15,600**
UK	**14,508**	**13,470**	2,508	3,049	**9,903**	3,000	3,250	2,750	3,000	**12,000**
Other EU 15	**41,950**	**40,425**	6,833	8,436	**26,725**	9,000	10,000	9,200	9,800	**38,000**
Total EU 15	**174,780**	**165,723**	**28,704**	**34,541**	**114,998**	**37,650**	**40,350**	**35,550**	**38,700**	**152,250**
	1.5%	***(5.2%)***	***(31.8%)***	***5.9%***	***(30.6%)***	***47.3%***	***54.1%***	***23.9%***	***12.0%***	***32.4%***
Poland	**10,630**	**9,750**	2,052	1,984	**7,209**	2,400	2,650	2,400	2,750	**10,200**
Czech	**7,056**	**6,388**	1,298	1,252	**4,596**	1,500	1,600	1,400	1,500	**6,000**
Romania	**6,315**	**5,219**	535	800	**2,445**	850	950	1,000	1,000	**3,800**
Other EU 12	**11,056**	**9,861**	2,143	1,958	**7,565**	2,150	2,400	2,000	2,250	**8,800**
Total EU 12	**35,057**	**31,218**	**6,028**	**5,994**	**21,815**	**6,900**	**7,600**	**6,800**	**7,500**	**28,800**
	8.8%	***(11.0%)***	***(27.9%)***	***12.4%***	***(30.1%)***	***48.7%***	***47.5%***	***12.8%***	***25.1%***	***32.0%***
Total EU 27	**209,837**	**196,941**	**34,732**	**40,535**	**136,813**	**44,550**	**47,950**	**42,350**	**46,200**	**181,050**
	2.7%	***(6.1%)***	***(31.2%)***	***6.8%***	***(30.5%)***	***47.5%***	***53.0%***	***21.9%***	***14.0%***	***32.3%***

Source: WSA, GFMS

Production coming back on-line

EU mills are actively bringing back furnaces over Q1, which should improve product availability in Q2.

- US Steel Europe will operate all five of its EU furnaces from February, as it brings back one in Slovakia.
- TKS is bringing back the second Huttenwerke Krupp Mannesmannn (HKM) furnace as it requires more slab in February. It is operating all its furnaces at Duisberg.
- ArcelorMittal brought back its third blast furnace at Dunkirk in late January, although will take down one at Fos for maintenance. Its third furnace at Ostrava is due to return in May, although it is keeping furnaces offline in Romania and Poland.
- Meanwhile, Salzgitter in Germany is running 2 out of 3 furnaces at high utilization levels and is now considering the third for Q3.
- Riva in Italy is bringing back some supply, as it restarts more coke capacity and slab casting, and is now operating at 75% of pig iron capacity, and may restart its final blast furnace in the first half.

Southern European prices accelerate

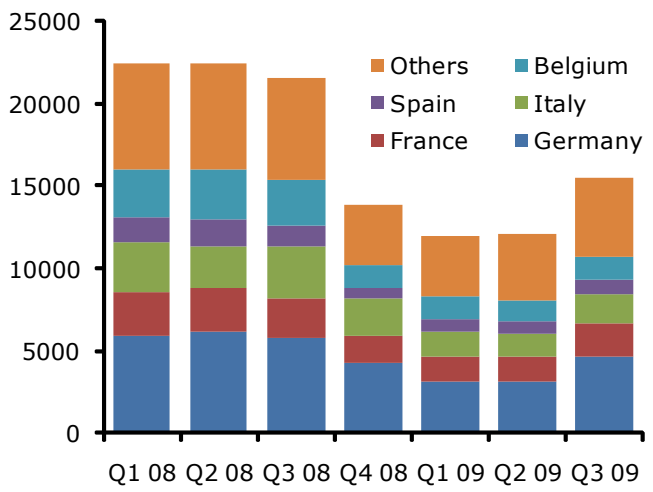
On the back of rising import prices, higher raw materials and limited short-term availability, southern EU mills were able to slowly get prices back up to the €400/tonne ex-works and above level in January. In Italy, that is the price that Riva sold at and as its lead time extends, it is adding more in February – probably in the region of €440/tonne and trying to remain at or above this level into March. January Central European prices – also set on a monthly basis – rose for February production to €400-420/tonne ex-works or more, and this was largely accepted. However, mills have pushed aggressively for sales of March production in early February – quoting €450/tonne, in what we believe is a test-run for western European consumers. Consumers are initially reluctant to pay, and mills are negotiating somewhat – offering delivery included for example to popular locations.

Imports not a factor…yet

With imports now largely quoted at €420/tonne cif southern Europe or above for delivery for March, there is no incentive for a consumer to book now for Q1 deliveries, but depending on the severity of the increase, some consumers may wish to procure material now for Q2. Ukrainian HR coil is around €425/tonne cif, with Libyan at €430/tonne cif into Italy. Egyptian and Turkish base prices are now in excess of €440/tonne. Some traders may have booked cargoes earlier that could arrive in Q2, but volumes are likely to be limited.

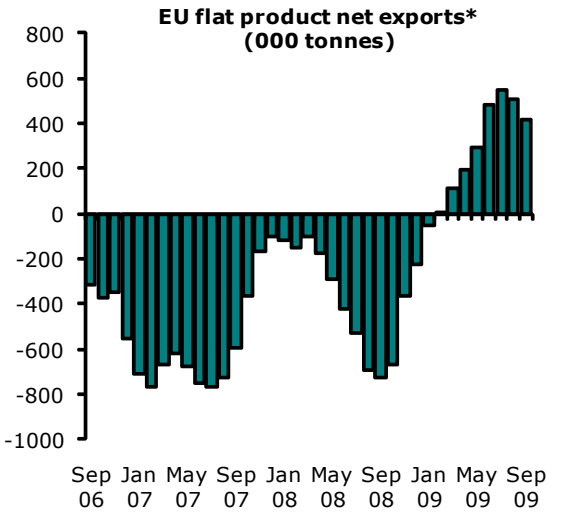
Should prices stay this level, the EU mills should be able to achieve the €450/tonne that they are looking for in Q2. Our concern however is that international prices may drop away on weaker raw material prices, particularly if a weaker Chinese market begins to depress Asian prices, which in turn seek sales into Europe. For now, EU domestic consumers prefer to stick with domestic material, but remain price sensitive.

EU HR coil output by major countries (000 tonnes)



Source: GFMS

EU flat product net exports* (000 tonnes)



Source: Eurofer

*3-month aver.

Selected EU27 Production Data

		Q1 08	Q2 08	Q3 08	Q4 08	Q1 09	Q2 09	Q3 09
HR coil	**Germany**	5,922	6,143	5,825	4,327	3,125	3,099	4,678
	France	2,651	2,709	2,391	1,539	1,576	1,567	1,980
	Italy	3,047	2,489	3,060	2,318	1,410	1,331	1,812
	Spain	1,496	1,573	1,345	672	805	757	854
	Belgium	2,865	3,040	2,702	1,375	1,384	1,272	1,407
	Others	6,497	6,537	6,264	3,567	3,663	4,037	4,723
	Total	**22,478**	**22,491**	**21,587**	**13,798**	**11,963**	**12,063**	**15,554**
HR plate	**Germany**	1,058	1,029	937	848	847	659	643
	Italy	844	911	786	525	622	528	571
	Romania	808	662	626	318	301	199	268
	Others	1,820	1,822	1,616	1,531	1,168	951	860
	Total	**4,530**	**4,424**	**3,965**	**3,222**	**2,938**	**2,337**	**2,342**

Source: Various, GFMS

Plate moves in line with slab and international prices

Plate demand remains poor, but prices are rising on higher import offers and rising slab prices. As with coil products, we believe that producers are unlikely to be able to make sustained price increases above international levels and will be forced to mark to market as well as selling only limited volumes. Many EU re-rollers produced at only around 50-60% of 2008 production in 2009, and volumes are as yet not picking up in the same way that coil is improving.

Spot prices remain in the €425-450/tonne ex-works range for S235 in southern Europe, with central European mills offering that price to Germany on a cif basis.

ALTERNATIVE SCENARIOS

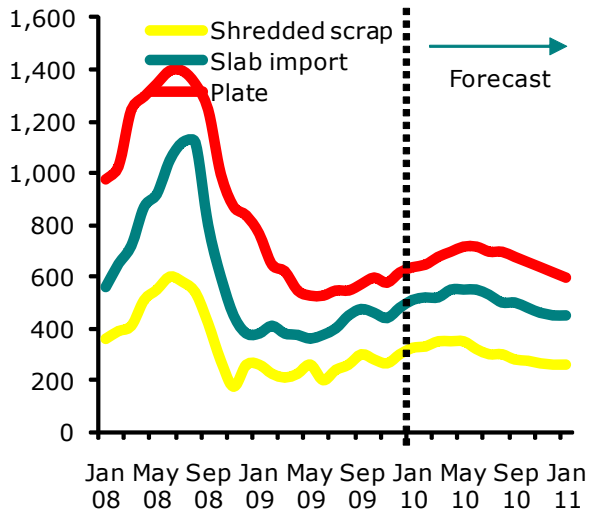
Base case – 55% confidence

We see no reason for a major improvement in pricing given such an anaemic demand environment. Any gains will be achieved via pricing to international levels. With the slightly weaker euro, we have upped the level that we believe mills may be able to achieve early in Q2 to around €450/tonne, but believe that further gains from this level are unlikely.

Upside potential – 20% possibility

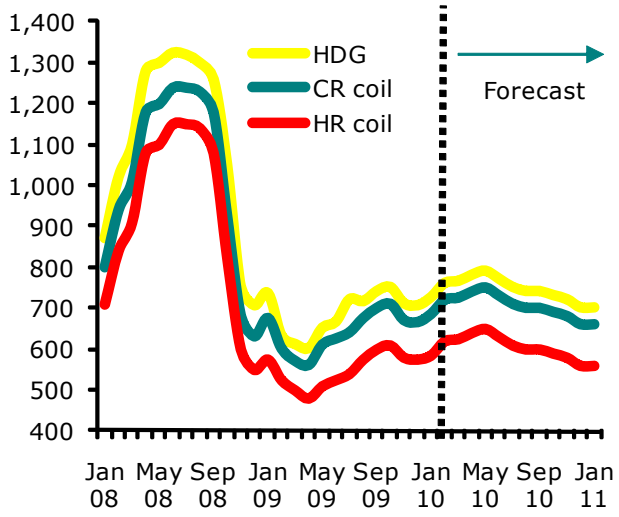
The key potential for the upside is re-stocking, which we consider minimal under our base case, given higher absolute levels than in North America. Nevertheless, should demand surprise even slightly on the upside, then

EU Forecast Prices ($/tonne)

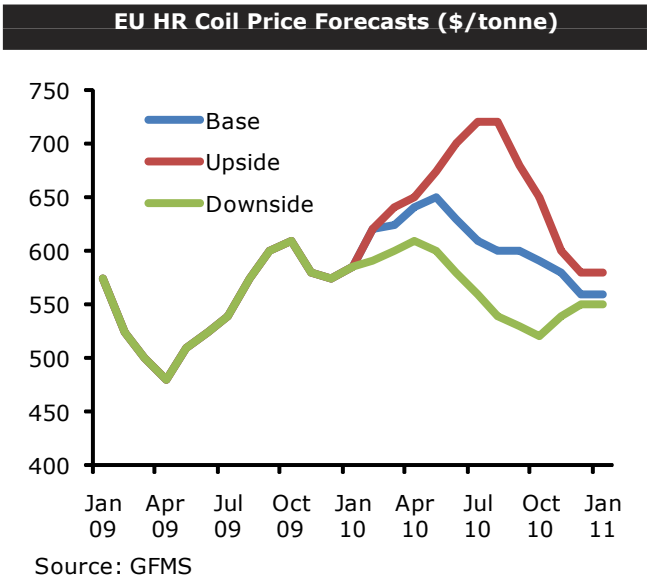


Source: GFMS

EU Forecast Prices ($/tonne)



Source: GFMS



inventory re-stocking would probably be required. Even here however, we do not believe that prices would be pushed up significantly above international levels, but prices would remain elevated through Q2 and into Q3, and the trade balance would probably revert to a deficit.

Downside potential – 25% possibility

We perceive a poorer scenario as more possible. Over-supply would be the primary cause, driving down prices earlier in Q2 and to lower levels. Lower Asian prices and lower import offers could also be a factor here.

ASIA

Recent developments

- ***After moving higher through the first half of January, indications that the government was seeking to move its bias to tightening put a lid on spot steel prices and pushed down raw material (iron ore and scrap) prices in the second half of the month.***

- ***Regional prices followed suit, with prices rising in the region of $600/tonne cif SE Asia for non-Chinese regional suppliers in mid-month, before dropping off in the latter week or so on Chinese concerns and falling raw material prices.***

- ***Most Asian markets are showing some strength, with Indonesia and Philippines in particular being active. On the other hand, Vietnam and Thailand remain relative laggards.***

Market outlook

- ***The regional market is likely to move sideways prior to the Chinese New Year celebrations, both within China and in the wider Asian region. In China, high steel inventories may limit price gains in the short term, but we believe that the economy is retaining momentum on the physical side, which should keep consumption rates elevated through the remainder of Q1 and into Q2.***

- ***Regional markets are also likely to trend water over the next fortnight, with some downward pressure on spot prices, underpinned by weaker raw material pricing. However, assuming China exits as we expect, prices are likely to return to around $600/ tonne cif SE Asia for HR coil through March and into Q2.***

Asian Steel Prices (US $/metric tonne)

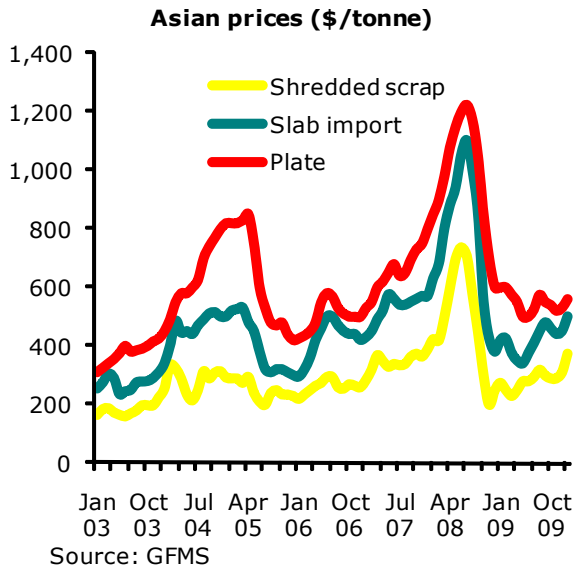
	Ferrous scrap [1]	*yoy % change*	Slab import [2]	*yoy % change*	Plate [3]	*yoy % change*	HR [3]	*yoy % change*	CR [3]	*yoy % change*	HDG [3]	*yoy % change*
Jan-10	375	*36%*	500	*19%*	560	*(7%)*	580	*9%*	640	*8%*	725	*21%*
Feb-10	360	*44%*	520	*22%*	560	*(7%)*	570	*12%*	640	*12%*	720	*22%*
Mar-10	360	*57%*	530	*41%*	580	*1%*	580	*32%*	650	*30%*	730	*30%*
Apr-10	375	*50%*	550	*57%*	600	*9%*	600	*46%*	670	*43%*	750	*44%*
May-10	380	*36%*	550	*62%*	620	*24%*	620	*41%*	690	*38%*	770	*38%*
Jun-10	350	*25%*	540	*44%*	640	*28%*	620	*24%*	690	*23%*	770	*26%*
Jul-10	340	*15%*	520	*27%*	620	*18%*	600	*15%*	670	*16%*	750	*15%*
Aug-10	330	*3%*	500	*11%*	600	*4%*	580	*(3%)*	650	*(2%)*	710	*0%*
Sep-10	300	*0%*	480	*0%*	580	*5%*	540	*(4%)*	600	*(3%)*	660	*(1%)*
Oct-10	290	*0%*	460	*0%*	560	*4%*	520	*2%*	580	*(3%)*	630	*(6%)*
Nov-10	270	*(7%)*	440	*0%*	520	*0%*	500	*(6%)*	560	*(7%)*	610	*(10%)*
Dec-10	260	*(16%)*	420	*(7%)*	500	*(6%)*	500	*(7%)*	560	*(8%)*	610	*(10%)*
Jan-11	270	*(28%)*	420	*(16%)*	500	*(11%)*	500	*(14%)*	560	*(13%)*	610	*(16%)*
2003 ave.	184		274		375		338		463		498	
2004 ave.	286	*55%*	462	*69%*	642	*71%*	503	*49%*	683	*48%*	708	*42%*
2005 ave.	249	*(13%)*	397	*(14%)*	624	*(3%)*	508	*1%*	635	*(7%)*	694	*(2%)*
2006 ave.	262	*5%*	423	*7%*	503	*(19%)*	494	*(3%)*	601	*(5%)*	715	*3%*
2007 ave.	347	*32%*	530	*25%*	658	*31%*	598	*21%*	659	*10%*	725	*1%*
2008 ave.	490	*41%*	774	*46%*	980	*49%*	848	*42%*	899	*36%*	943	*30%*
2009 ave.	281	*(43%)*	415	*(46%)*	547	*(44%)*	508	*(40%)*	572	*(36%)*	625	*(34%)*
2010 ave.	333	*18%*	501	*21%*	578	*6%*	568	*12%*	633	*11%*	703	*12%*

[1] shredded cif Korea [2] cif major port ex-CIS [3] cif major port

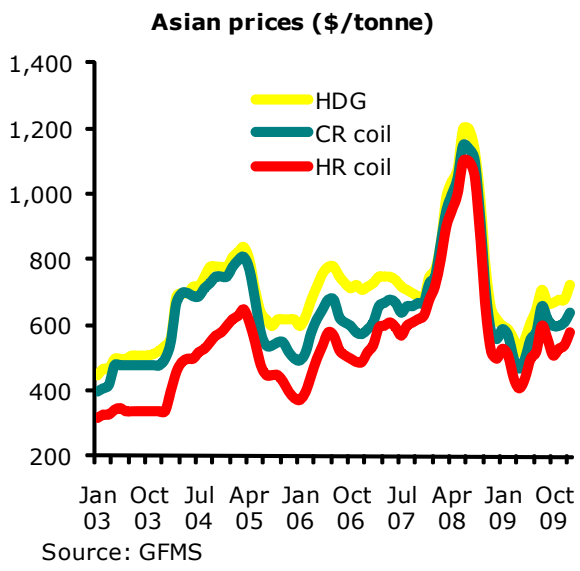
All prices are an average of a range of prices that are present in the market, and exclude grade and finishing extras

Source: GFMS

Asian Prices ($/tonne)



Asian Prices ($/tonne)



Chinese tightening – is it relevant?

In our view, China remains the number one concern for the steel market in 2010, just as it was the strongest part of 2009. In our update, we noted that the Chinese government had started its monetary tightening with the increase in the bank deposit ratio. This small move however was overtaken by a central edict for banks to stop lending with immediate effect. While the overall credit target for 2010 remains in effect, the central bank appears to have taken fright at the rate of lending and the impact on inflation. Certainly it appears as if the bias is likely to tend towards tightening through the year.

The relevance is the fact that bank loans and credit are largely going into capital investment and construction that account for around 70% of Chinese steel consumption and over 50% of flat steel consumption. The level of loan disbursement and strength of the economy means that we suggest that first half steel will hold up strongly. In addition, rising exports are pushing the manufacturing sector forward, while stimulus such as rebates for automotive and white goods sales are also pushing up manufacturing activity. The Chinese PMI rose again in January according to HSBC – up to 57.4 from 56.1.

The concern remains however is that if inflation continues to be a factor, then the government will tighten further and that we are now at the turning point. This will bring down construction activity in the medium-term and has the potential (although this is not our base case) to turn into a rout. Simply the fear of this pushed down spot prices after it was announced, and as we argued in our update, we believe that this was the key reason that Baosteel rolled over February prices rather than push them up as others had done.

Chinese prices may stabilize through New Year

Strip prices over January have continued their steady increase with a few minor fluctuations. By mid-month, prices stood at RMB3,850/tonne ($485/tonne ex-VAT). Yet after raising prices for January and indicating earlier in the month that they planned to raise them again in February, market leader Baosteel surprised the market by rolling over pricing for the next month and others such as Shagang followed suit. In our view, this reflects a more sober assessment of the market, and puts Baosteel more in line with market prices rather than being far ahead.

The holiday season in China can lead to disruption. As the chart on Page A3 highlights, Chinese flat inventory jumped over the New Year in 2009 and has not come down since. Indeed, it has been on a rising trend over the last couple of months, particularly in HR coil, where inventories are now double their level a year ago. While consumption is higher, further inventory accumulation could cause some disruption. With prices unlikely to move up in February, Baosteel is indicating that there is less need to accumulate (cheaper) inventory prior to the holiday and thus hoping to avoid pricing instability in late February.

Nevertheless, even if inventories end up higher after the New Year, we believe that the Chinese industry has

Asian Steel Production & Forecasts (000 tonnes)

	2007	2008	Q3 09	Q4 09	2009	Q1 10	Q2 10	Q3 10	Q4 10	2010
India	**51,511**	**55,063**	14,160	14,691	**56,149**	15,500	16,500	17,500	19,000	**68,500**
Japan	**120,196**	**118,744**	24,236	26,610	**87,524**	27,500	27,000	26,000	24,000	**104,500**
South Korea	**51,377**	**53,767**	12,680	13,266	**48,797**	13,500	14,200	14,800	15,000	**57,500**
Taiwan	**20,594**	**20,485**	3,680	4,810	**15,905**	4,700	5,000	5,250	5,250	**20,200**
China	**489,862**	**497,859**	153,734	146,673	**566,420**	140,000	155,000	148,000	135,000	**578,000**
Total Asia	**733,540**	**745,918**	**208,490**	**206,050**	**774,795**	**201,200**	**217,700**	**211,550**	**198,250**	**828,700**
YoY % change	***12.8%***	***1.7%***	***9.6%***	***24.2%***	***3.9%***	***16.8%***	***15.8%***	***1.5%***	***(3.8%)***	***7.0%***
Australia	**7,906**	**7,797**	1,499	1,900	**5,318**	1,950	1,950	1,800	1,900	**7,600**
New Zealand	**845**	**805**	192	195	**774**	190	195	185	195	**765**
Total Australasia	**8,751**	**8,602**	**1,691**	**2,095**	**6,092**	**2,140**	**2,145**	**1,985**	**2,095**	**8,365**
YoY % change	***0.1%***	***(1.7%)***	***(22.5%)***	***14.2%***	***(29.2%)***	***86.1%***	***85.6%***	***17.4%***	***0.0%***	***37.3%***

Source: IISI, GFMS

sufficient demand strength and momentum to maintain high consumption levels after the New Year. That period also typically coincides with an upturn in order levels as seasonal demand strengthens. We therefore believe that prices could push up again in late February with continued strength through the remainder of Q1 and into Q2.

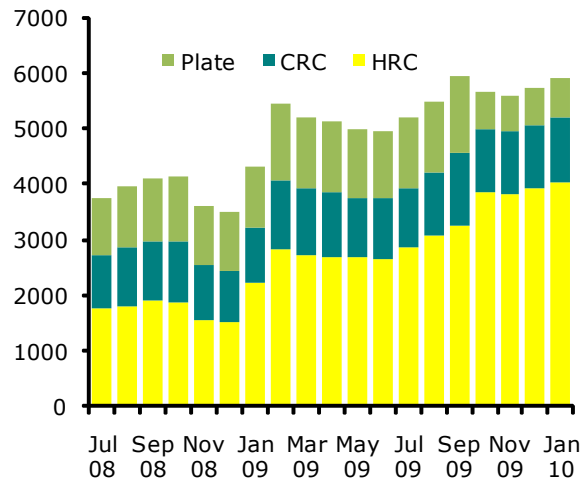
That may push up export prices, which have dipped somewhat as producers offered more to offshore markets in late January. HDG for example dropped to $720/tonne fob for 1mm HDG with 120g coating.

Regional demand slackens after strong start to the year

As Chinese export prices rose to more than $550/tonne fob in mid-January, and most producers asking $560-570/tonne fob, regional providers also upped prices during January. Taiwanese suppliers sought as much as $580/tonne fob, with the most ambitious regional providers seeking $600/tonne fob for March deliveries. Buying was fairly active from most countries at the beginning of January and pricing was supported by rising raw material prices. Iron ore and coking coal prices went to peaks of $140/tonne cif China and closer to $200/tonne cif China in mid-month and ferrous scrap was sold as high as $370-380/tonne cif. Stronger countries included Philippines and Indonesia, while Thailand and Vietnam were on the slow side.

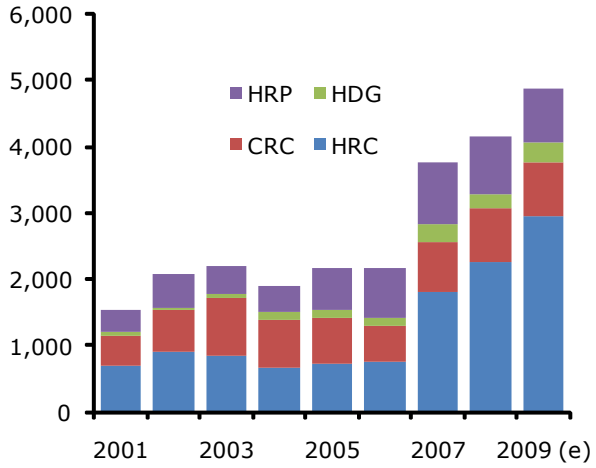
However, regional pricing drifted lower later in the month and into early February as buyers dropped off in the second half of January having secured much of their Q1 requirements. In our view, the stalling Chinese market altered sentiment, while some weakness in iron ore and ferrous scrap pricing reminded producers that raw materials are at the high end of recent price ranges and further gains are unlikely to be significant. Higher Chinese availability and more aggressive orders as they dropped prices below $550/tonne fob put some downward pressure on regional prices at the end of the month, but many regional producers preferred to hold prices at their elevated levels and seek to ship outside the region or wait until after the Chinese holidays before cutting deals. We place our January regional cif SE Asia price at $580/tonne.

Flat Steel inventories held at distributors in major Chinese cities (000 tonnes)



Source: MIIT, GFMS

Vietnamese imports of flat products (000 tonnes)



Chinese Flat Rolled Market (000 tonnes)

		2007	2008	Q4 2008	Q1 2009	Q2 2009	Q3 2009	Q4 2009	Oct-09	Nov-09	Dec-09
HR coil	**Output**	125,713	135,204	28,840	33,086	39,564	45,180	46,024	14,912	14,955	16,157
	Imports	2,417	1,896	361	799	1,626	1,311	744	318	178	249
	Exports	11,091	10,812	1,428	433	348	916	2,212	607	756	849
	AC	**117,039**	**126,288**	**27,773**	**33,452**	**40,842**	**45,575**	**44,557**	**14,624**	**14,376**	**15,556**
CR coil	**Output**	38,941	40,211	8,477	8,802	10,928	12,016	13,080	4,061	4,403	4,617
	Imports	4,678	4,121	695	735	1,383	1,559	1,332	494	412	425
	Exports	3,258	3,482	660	126	125	303	536	169	168	199
	AC	**40,360**	**40,850**	**8,513**	**9,411**	**12,186**	**13,272**	**13,877**	**4,387**	**4,647**	**4,843**
HDG	**Output**	17,995	17,390	3,671	3,645	4,610	5,395	5,761	1,821	1,906	2,034
	Imports	17,995	17,390	672	475	541	809	810	262	239	309
	Exports	3,850	2,900	545	192	158	373	720	203	205	312
	AC	**32,139**	**31,879**	**3,798**	**3,928**	**4,994**	**5,831**	**5,851**	**1,880**	**1,940**	**2,031**
HR plate	**Output**	51,928	58,777	13,049	12,393	14,456	15,139	15,694	5,092	5,264	5,338
	Imports	1,207	1,265	310	287	308	343	245	79	79	87
	Exports	8,010	7,949	1,392	869	485	897	999	293	325	381
	AC	**45,125**	**52,093**	**11,968**	**11,811**	**14,280**	**14,584**	**14,940**	**4,878**	**5,018**	**5,044**

Source: CISA, GFMS

Vietnam re-adjusts

Vietnam has been one of the weaker regional markets in Q1 after being an active buyer through 2009. We estimate that total imports rose to almost 5m tonnes of strip products in 2009. In the short-term however, domestic economic adjustment has drastically reduced trading activity and there have been some limited re-export deals available.

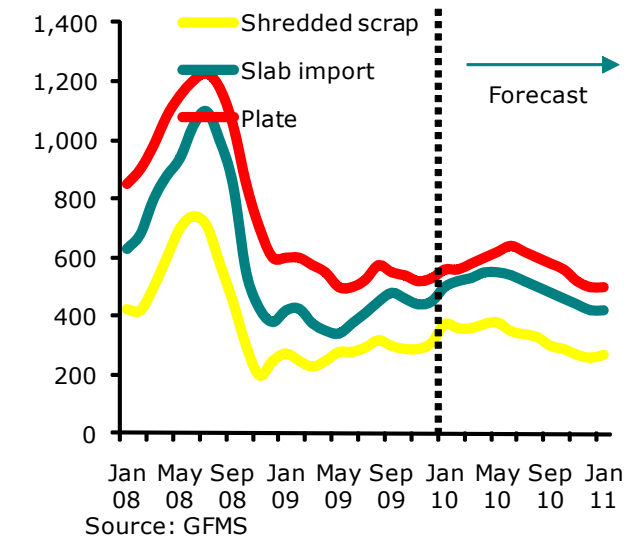
The largest import product is HR coil, with Posco starting a 1.2m tpy CR coil line in 2009, bringing CR coil capacity to over 2m tpy as well as HR coil demand. There are numerous projects for HR coil capacity, but the latest is a Vietnam Steel Company (VSC) joint-venture with Danieli (20%), which we believe replaces the Essar project, but would be reliant on import slab.

Flat until after Lunar New Year

The Chinese market in our view is unlikely to provide much support until the second half of February and with many Asian buyers active early in the year, we see little need for them to purchase again as well. We expect prices to therefore drift lower in the first half of February as buyers continue the wait-and-see attitude.

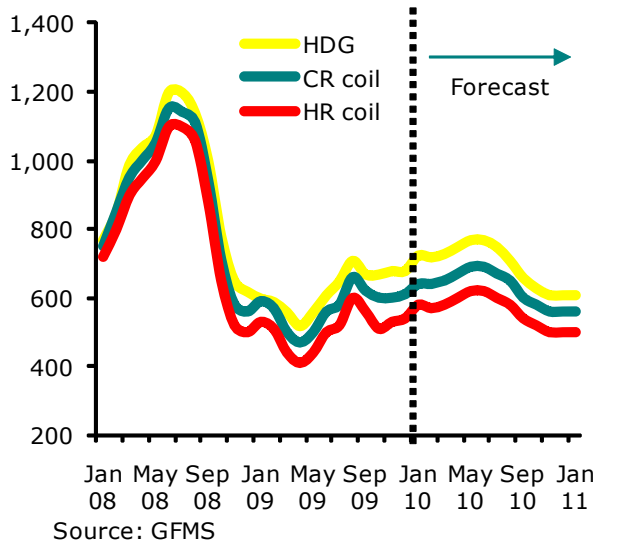
Our view is that there is enough sustained momentum in the physical Chinese economy to maintain demand at higher levels through the remainder of Q1 and into Q2. This should prevent inventories from accumulating to excessive levels and will keep mills busy and they in return may keep buying raw materials, keeping these prices elevated. As Chinese prices recover, there will be limited export availability and consequently we expect regional prices to tick back up again – back to the $600/tonne cif SE Asia level, which we consider towards the top end of our expected trading range for the year.

Asian Forecast Prices ($/tonne)

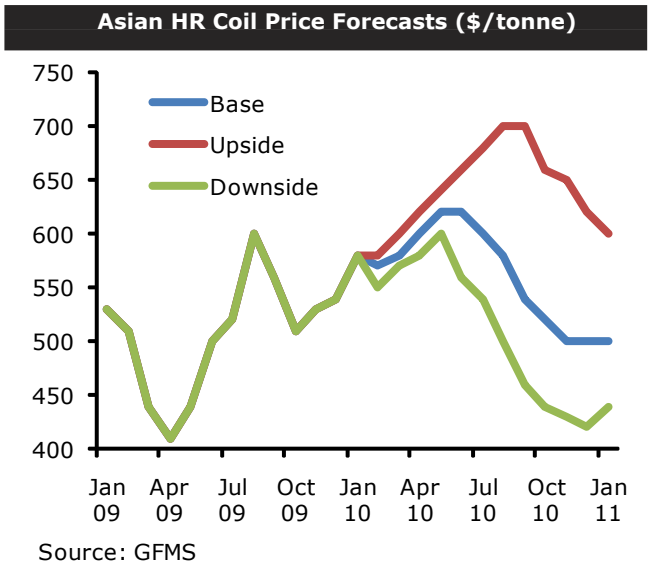


Source: GFMS

Asian Forecast Prices ($/tonne)



Source: GFMS



ALTERNATIVE SCENARIOS

Base case

While we are very confident of our short-term outlook, our forecast weakness in Chinese demand in the second half of the year is a contrarian call. We place our confidence at 50%.

Upside scenario

Betting against the Chinese growth story has not been a successful call over the last decade, but we would argue that the current imbalances are now stretched. Nevertheless, the Chinese government attempts to rein in investment expenditure by reducing credit without a collapse in steel demand could be successful. If so, then Chinese steel demand will grow faster than we expect – keeping raw material and finished steel prices high and Chinese steel at home. This will allow prices to maintain growth during the second half of the year to a higher peak – perhaps $700/tonne cif SE Asia in Q3. We place a 35% likelihood of this development.

Downside scenario

We are forecasting only a slowing of Chinese growth in the first half of the year and only a slight downturn in Chinese demand in the second. A more spectacular bubble bursting would see demand drop much faster, price falls even greater and more aggressive export volumes, possibly enhanced by increased export VAT reductions. This could see prices hit new lows of $400/tonne fob China. We place this at only a 15% likelihood.

EMERGING MARKETS

Recent developments

- ***Emerging market prices have risen quickly over December and January as tight markets have meant that consumers are willing to pay significantly more to receive marginal material with short lead times. Emerging market consumption has also played a part with strong demand in markets such as India and Brazil, meaning that export availability has been reduced, and also resulting in rising imports to those markets.***

- ***While CIS demand remains muted, cutbacks in output in Q4 reduced material availability and induced competitive bidding for export volumes early in the year. However, mills did not have it all their own way. Chinese offers late in the month into SE Asia and the Gulf were below CIS prices and they were forced to adjust. Core CIS markets such as Turkey, the UAE and southern Europe continue to take significantly less than in the past, so the market remains vulnerable to excess supply and they have been forced to compete into Asia again.***

Market outlook

- ***Weakness in Asia in the first half of the month may result in short-term discounting for emerging producers, although they may be able to ship more product into mature economies of Europe and North America given rising prices there, although this will depend on market access, and CIS mills may struggle.***

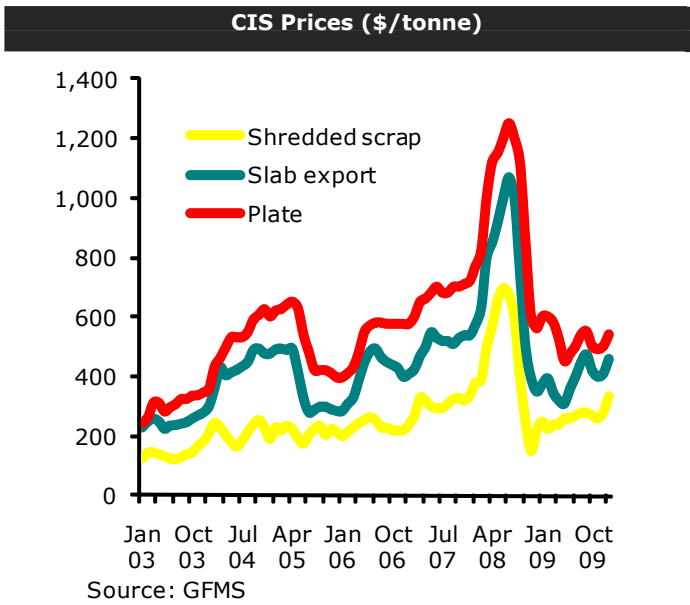
- ***India and Brazil (and indeed Latin America) are likely to remain active buyers of coil as domestic demand remains strong. This will limit export activity and they will try to retain elevated prices through any short-term price dip. On the other hand, domestic demand in the CIS and in the Gulf outside of Saudi and Iran, continues to be weak, with buyers adopting a wait-and-see attitude and actively price shopping.***

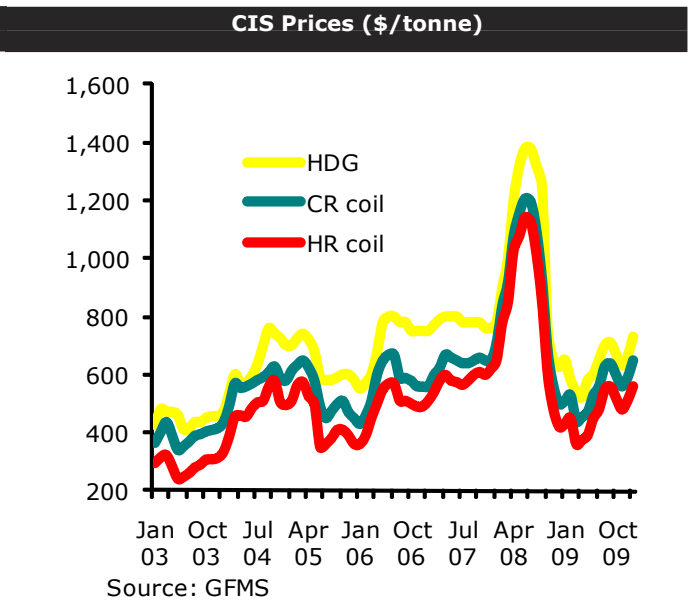
- ***By March and into Q2, we expect an improving Asian price environment to allow producers to push up prices again, but markets remain vulnerable to over-supply, so pricing cycles this year may be very short.***

Emerging Steel Prices (US $/metric tonne)

	Ferrous scrap [1]	yoy % change	Slab export [2]	yoy % change	Plate [2]	yoy % change	HR [2]	yoy % change	CR [2]	yoy % change	HDG [2]	yoy % change
Jan-10	335	34%	460	23%	540	(10%)	560	30%	650	27%	730	12%
Feb-10	320	42%	480	22%	550	(8%)	550	22%	630	19%	700	21%
Mar-10	330	38%	490	42%	575	(1%)	570	58%	650	48%	720	33%
Apr-10	350	46%	510	59%	580	10%	580	55%	660	45%	730	40%
May-10	330	27%	510	65%	590	31%	600	54%	680	45%	750	29%
Jun-10	300	15%	500	39%	600	26%	580	29%	660	25%	730	22%
Jul-10	300	11%	480	20%	600	20%	570	19%	650	16%	720	11%
Aug-10	280	0%	460	2%	600	11%	550	0%	630	0%	700	0%
Sep-10	265	(5%)	440	(7%)	580	5%	530	(5%)	610	(5%)	680	(4%)
Oct-10	260	(4%)	420	0%	560	12%	510	(2%)	590	(2%)	660	(1%)
Nov-10	250	(4%)	400	0%	550	12%	490	2%	570	2%	640	2%
Dec-10	235	(16%)	380	(7%)	530	6%	460	(10%)	540	(8%)	610	(8%)
Jan-11	230	(31%)	380	(17%)	530	(2%)	460	(18%)	540	(17%)	610	(16%)
2003 ave.	142		249		305		288		389		447	
2004 ave.	213	50%	430	73%	525	72%	477	66%	564	45%	633	42%
2005 ave.	216	2%	372	(13%)	521	(1%)	445	(7%)	538	(5%)	640	1%
2006 ave.	232	8%	411	10%	525	1%	491	10%	573	7%	715	12%
2007 ave.	306	32%	504	23%	671	28%	580	18%	638	11%	779	9%
2008 ave.	458	50%	737	46%	970	45%	836	44%	908	42%	1,046	34%
2009 ave.	258	(44%)	385	(48%)	532	(45%)	457	(45%)	537	(41%)	620	(41%)
2010 ave.	295	15%	457	19%	566	6%	543	19%	624	16%	695	12%

[1] A3 fob Black Sea [2] fob Black Sea (incl. Russian, Kazakh & Ukraine)
All prices are an average of a range of prices that are present in the market, and exclude grade and finishing extras
Source: GFMS





Middle East on the up

HR coil in Saudi was sold at $615/tonne ex-works for March and $630/tonne for April, but it is widely expected that Hadeed will raise prices for May delivery on the back of solid orders from tubular mills and construction applications. The company is quoting around $650/tonne cif Gulf for exports, but this is attracting little interest given lower prices elsewhere.

Domestic prices in Egypt are on the increase as well as an aggressive pricing policy from Ezz has kept imports out and inventories tight. It raised prices by E£200/tonne to E£3,300/tonne ($590/tonne ex-VAT) effective 1st February. This still puts it below import prices allowing it to effectively dominate its domestic market. Sales are from the ANSDK site in Alexandria, but it is expected to restart its Suez-based Ezz Flat Steel site in February or March. It is likely to focus on exports, allowing ANSDK to focus on domestic sales. This runs the risk of excess supply, but with EFS now capable of producing billet as well as HR coil, we expect HR coil output to be lower than the 1.2m tpy capacity, and the company will probably run the mill at reduced capacity initially.

Egyptian export sales are primarily to the Middle East (Saudi) with lower volumes into southern Europe, although we believe that the US is now an attractively-priced market. With Hadeed in Saudi only capable of going down to 1.3-1.4mm, gauges below that enter the market duty-free, and Ezz can supply this to local tubemakers in particular, although Saldanha of South Africa and Sahaviriya of Thailand are competitive in this market as well at around $700-730/tonne cif.

Even UAE buying picked up slightly early in the year as buyers finally accepted higher CIS or Asian prices and secured material now in order to avoid further increases later. There is now limited availability of import offers below $600/tonne cif for arrival in Q1, although Chinese offers of below that for April arrival disrupted the market and caused buyers to back away. Despite weakness late in the month, Mobarakeh of Iran sold its export tender for March production at an average of $585/tonne fob.

CIS prices raised

CIS producers were able to get increases of $30-60/tonne for February rollings depending on source and destination. Ukrainian Black Sea suppliers were initially more cautious, pushing prices to around $520-540/tonne fob. However, as MMK has pushed prices closer to $580/tonne fob, and Severstal and NLMK are in the region of $600/tonne fob, the Ukrainians were able to raise prices to around $550/tonne fob in the second half of the month, although the Russians were not able to get all the prices they wanted. There was some interest from Turkey, the Gulf, India and smaller Asian markets. However, by the end of the month, Chinese prices were offered at around $570/tonne cif SE Asia or $590/tonne cif Gulf, which put some downward pressure on CIS exporters, and MMK made some sales at around $560/tonne fob. Chinese CR coil sales were also very aggressive into Asian markets as low as $610-620/tonne cif, which undercut MMK prices of $620/tonne fob.

Modest uptick in Turkish activity

Turkish domestic prices for HR coil are around $600/tonne ex-distributor after Erdemir raised its ex-works price to $570/tonne in late January. There are some export offers out of Turkey at around $580-590/tonne fob, but there is limited interest from European or Middle Eastern buyers. There has been a modest improvement in demand from automotive and appliance manufacturing, although domestically-oriented consumer goods remain weak and construction activity remains low. Shipbuilding demand remains very poor.

Latin American buying active

Central and South American buyers have been active over the last month securing imports to feed growing demand.

Emerging Producers Steel Production & Forecasts (000 tonnes)									
	2007	2008	Q3 09	Q4 09	2009	Q1 10	Q2 10	Q3 10	Q4 10
Turkey	**25,513**	**26,792**	6,761	6,606	**25,135**	6,250	6,600	7,000	6,500
Other Europe	**4,602**	**4,605**	967	1,153	**3,517**	1,150	1,200	1,050	1,200
Total Other Europe	**30,115**	**31,397**	**7,728**	**7,759**	**28,652**	**7,400**	**7,800**	**8,050**	**7,700**
Russia	**72,492**	**67,864**	15,457	16,509	**58,766**	16,200	17,500	16,000	15,500
Ukraine	**42,596**	**37,043**	8,058	8,077	**29,750**	8,000	8,800	8,000	7,600
Other CIS	**8,769**	**8,027**	2,016	2,000	**7,672**	2,000	2,150	2,000	2,000
Total CIS	**123,857**	**112,934**	**25,531**	**26,586**	**96,188**	**26,200**	**28,450**	**26,000**	**25,100**
Brazil	**33,787**	**33,664**	7,889	8,053	**26,509**	8,250	8,500	8,900	9,200
Other Central & S. America	**15,789**	**15,366**	3,055	3,434	**12,096**	3,520	3,580	3,250	3,250
Total Central & S. America	**49,576**	**49,030**	**10,944**	**11,487**	**38,605**	**11,770**	**12,080**	**12,150**	**12,450**
Africa	**18,659**	**16,916**	**3,676**	**3,750**	**14,540**	**3,900**	**4,100**	**4,000**	**4,250**
Middle East	**15,726**	**15,938**	**4,102**	**4,100**	**16,575**	**4,200**	**4,400**	**4,150**	**4,400**
Total emerging	**237,933**	**226,215**	**51,981**	**53,682**	**194,560**	**53,470**	**56,830**	**54,350**	**53,900**
	5.4%	***(4.9%)***	***(14.2%)***	***28.0%***	***(14.0%)***	***24.5%***	***23.7%***	***4.6%***	***0.4%***

Source: IISI, GFMS

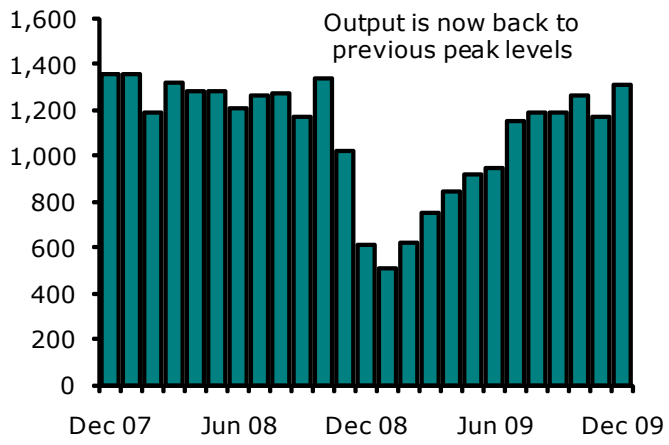
Chinese material in particular has been supplied with HDG sold this month at around $760/tonne cif to Brazil. Brazilian output in December was back up to previous peak levels – finally recovered from a 15-month downturn. Usiminas is bringing back its last idled furnace shortly. Yet flat exports are coming off their peak in Q3 and imports are rising again, highlighting that apparent consumption is now rising quickly, although it still remains below its absolute peak. While local prices remain elevated and imports are rising, we expect mills to seek higher prices in Q2.

Other Latin American markets are active buyers, with Columbian and Ecuadorian buyers forced to seek alternatives as shipments from Sidor have been disrupted due to energy shortages. They have turned to Brazilian and non-regional supply to replace volumes.

Slab sales limited

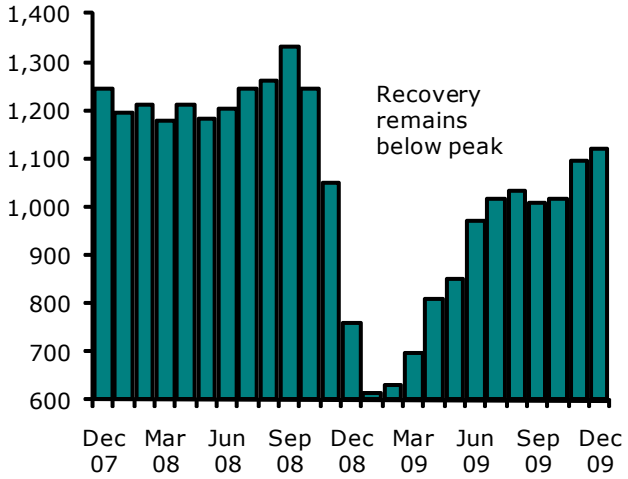
High finished product output in Brazil plus operating problems at Sidor mean that slab availability is limited (in fact Sidor may have to buy slab). ArcelorMittal is ramping up output at its Tubarao operations in Brazil and we believe Gerdau Acominas is the only other seller. Usiminas-Cosipa and CSN are still ramping up their crude operations and preferring to roll product rather than ship slab. Ahmsa and Siderar Ternium sell more limited volumes, but we understand that these are not active at the moment. That is allowing prices to be raised aggressively. ArcelorMittal is quoting up to $500/tonne fob for Q2 slab sales (there is no Q1 availability). For US mills, where prices are north of $660/tonne ex-works out of CSI or the Midwest, this is eminently do-able, although for Asian coil buyers a cif price of $550/tonne is unworkable given HR coil is less than $600/tonne fob. However, plate buyers and North and South American buyers may allow Tubarao to avoid the Asian market for now, leaving it to CIS mills. CIS mills are also looking for higher prices, but at around $460/tonne fob for Q2 sales, we consider it likely that they will dominate Asian business.

Brazilian flat product output (000 tonnes)



Source: IBS

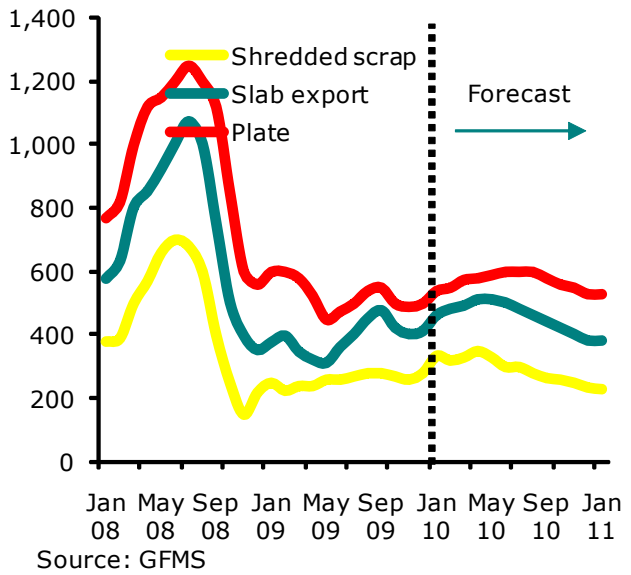
Brazilian apparent consumption* (000 tonnes)



Source: IBS, GFMS

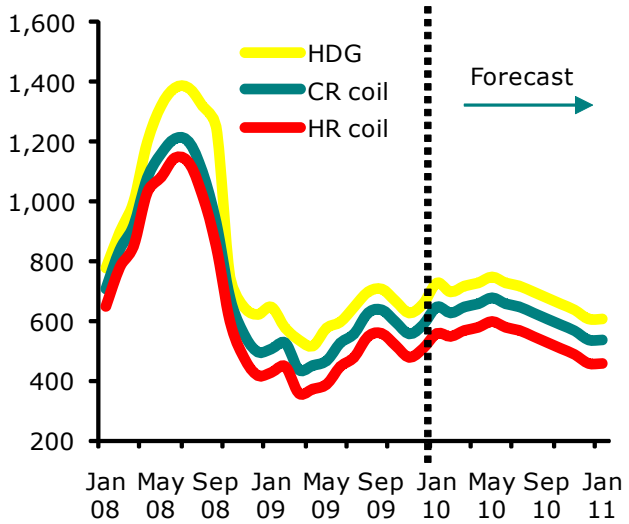
*3-month average

CIS Forecast Prices ($/tonne)



Source: GFMS

CIS Forecast Prices ($/tonne)



Source: GFMS

Indian HR coil prices up

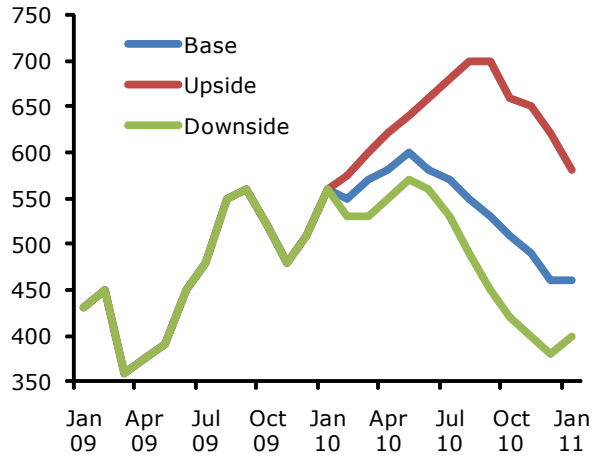
On the back of strong domestic demand, quickly rising domestic raw materials and higher international prices, Indian HR coil producers have raised prices by Rs1,000/tonne in January to Rs30,000/tonne ($650/tonne) with a similar amount expected in February. Downstream products have increased by up to double that thanks to strong demand.

Market vulnerable to short-term correction

The summary of above activity appears bullish, but we remain cautious. Emerging market prices did dip at the end of January as more aggressive Chinese export offers appeared and the market was not tight enough to sustain the higher prices and continued purchasing.

Buyers in many emerging markets were active in January and are now in a wait-and-see mood. This may result in producers seeking to rollover prices in February for March rollings, but struggling to do so. We expect to see competitive offers in the first half of the month result in a slight price decline.

CIS HR Coil Price Forecasts ($/tonne)



Source: GFMS

Q2 outlook still positive

While we believe that mature markets may correct in Q2, we expect some strength in Asian pricing and demand and a continued upturn in global activity to benefit emerging producers at this time, keeping domestic demand strong and increasing purchasing activity by most consumers.

ALTERNATIVE SCENARIOS

Base case

We continue believe that emerging market suppliers will be able to take advantage of the upswing in global prices and demand in the first half of the year – assisted by strong Chinese demand and relatively low exports, although potentially vulnerable to a short-term correction The second half may be more difficult and CIS mills in particular may struggle as domestic demand is expected to remain weak. We have a 50% probability on this outlook – in line with our expectations in Asia.

Upside scenario

Should China continue to grow and not slow as we expect in H2 (it may even draw in additional coil at that point), then emerging mills can continue to ramp up supply and prices through Q3 to higher levels. Prices could continue to rise through Q2 and Q3 to as much as $700/tonne fob. We place a 30% likelihood on this trend.

Downside scenario

Demand in Europe and the US remains weak. A correction in China would lead to rising exports and depressed prices pushing down emerging market prices quickly. They would respond with aggressive price cuts in an attempt to maintain market share. We place a 20% likelihood on this development.