

McCoy Bolt Works, Inc.

Steel Economics – The Second Perfect Storm?

October 22, 2007

Summary of Articles from Bibliography (listed at end)

U.S. economic growth will at some point start escalating again, either sooner due to Federal Reserve easing interest rates, or later as the Housing correction is completed. At that point, steel prices will undoubtedly increase. If economic growth escalates rapidly, special bar quality (SBQ) steel prices could create a second “Perfect Storm”. SBQ steel is used primarily in high stress fastening applications, such as large truck suspension fastening. Some base SBQ price increases were already announced. The second “Perfect Storm” is a reference to a repeat of the escalation experienced in 2004, when steel prices doubled over the course of one year.

For just over two years SBQ prices, both absolute and fluctuations, were driven entirely by scrap prices, particularly #1 Busheling, which is a high grade of industrial scrap. The scrap market is like any commodity in that prices are a function of supply and demand, both direct and through alternatives. All steel inputs (iron ore, pig iron, and scrap) are inter-related because they are inter-changeable for the large integrated steel producers, and to some extent for the electric-arc furnace producers (also labeled “mini-mills”, EAF produces SBQ). The following factors will affect scrap prices, and therefore finished steel prices, over the upcoming couple of years.

- Diminished manufacturing in the U.S. lowers the amount of high grade scrap supply
- Low value of the dollar in global market encourages scrap exports
- Iron-ore producers are seeking a 50% price increase in current contract negotiations, after a 9.5% increase last year
- Increasing pig iron prices are prompting integrated steel mills to turn to ferrous scrap as a substitute
- EAF steel producers are integrating backwards to better control raw materials supply
- New SBQ capacity (Nucor, Steel Dynamics) will increase demand for #1 Busheling

While SBQ steel is a niche market, all finished steel prices are inter-related to the degree that steel mills have alternative product capability with furnaces. For example, a bar products manufacturer can change production between merchant quality products (rebar in construction), industrial quality products (manufacturing), and SBQ, depending on the relative prices and profitability in those markets. Furthermore, the U.S. economy over the past 25 years became a net importer of steel. Import prices therefore have a great impact on the total U.S. steel price level. In addition to input costs, the following factors will affect finished steel prices over the upcoming couple of years.

- Low value of the dollar in global market drives up import prices, because prices are higher in other parts of the world
- Low value of the dollar encourages finished steel exports
- China is beginning to restrict incentives for Chinese steel producers to export
- Various U.S. regulations either restricting steel imports, or increasing import prices through tariffs remain in place
- General economic demand will increase while effective capacity (domestic and import) is constrained
- New SBQ capacity will moderate prices to some degree

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