



Dynamic steel market faces new challenges

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2007: year of peaks

The steel industry achieved several peaks in 2007:

Crude steel production will probably be 48.6 million tonnes, the greatest quantity since reunification (**Figure 1**). Imports and exports may also reach high points. **Turnover** will grow again for the fifth time in a row and thereby probably exceed EUR 45 million for the first time (**Figure 2**). Average growth in turnover has been almost 20 per cent since 2003, compared with 8 per cent in the period from 1995 to 2002.

The global steel market is also currently in an extraordinarily strong condition. Worldwide demand will grow by 6.8 per cent both this year and next year (**Figure 3**). The 2007 record for world crude steel production, about 1.32 bn. tonnes, will be broken again in 2008 (**Figure 4**). The steel situation is improving again in all major regions of the world, like in the years 2000, 2004 and 2006. China, India, Brazil and Russia will achieve the highest growth rates. The steel industry in the United States will also grow again this year.

Growth rates in Europe are also noteworthy: the EU steel market will have grown by 23 million tonnes since 2004, from 172 million tonnes to a predicted 195 million tonnes in 2008. Around a third of this growth is taking place in the German market. Only in China and the CIS were the increases greater during the same period, and roughly equal in India. In Japan and NAFTA, on the other hand, the rise was just four million tonnes. Whereby this purely quantitative consideration does not take into account that more steel products can be manufactured from a single tonne of steel today than was possible 30 or 40 years ago. In other words: more functions can be fulfilled with the same amount of steel because lighter construction is possible with high- to ultrahigh-strength steels. This trend is especially marked on the strongly innovative European market.

The current situation on the German steel market

Following the breathtaking development during the first nine months of this year, the boom is now no longer as dynamic as before. Both deliveries and orders received went down in summer compared to the previous year, with orders even falling by more than 11 per cent. **(Figure 5)**. The business climate index for the steel industry of the Munich-based German Institute for Economic Research (ifo) has also eased in recent months, though it is still slightly positive.

The current slow down on the steel market is only temporary. The strongly increased imports, particularly from China, have led to excessive stock levels throughout Europe. These stocks are currently being reduced – a process that will continue until the end of the year. Steel demand will probably recover in early 2008, also because there will then be the usual seasonal inventory replenishments .

Prospects for 2008: conditions exist for boom to continue

We are confident that the coming year will be another good one for the steel industry in Germany. The basis for this remains the robust condition of the steel industry's customers.

- Ø Only a moderate softening in the upward drive is detectable in **mechanical engineering**, responsible for about 10 per cent of steel demand **(Figure 6)**. There was double-digit growth in the orders received during the period from June to August, compared to the anyway very high value of the same period in the previous year. The backlog of orders as a sector average is about six months. A strong steel demand can be expected from this industrial sector until well into 2008. The demand for machines for generating, transporting and

converting energy has never been greater. This will continue for several years.

- Ø **Vehicle construction** is doing much better than expected, despite the serious obstacles of increased value-added tax and a weak dollar (**Figure 7**). This success is due to extraordinarily strong exports and highly dynamic growth in the area of commercial vehicles. Moreover, the domestic market may also recover further during 2008, with rising real incomes in Germany.

- Ø The heterogenous development in the **building sector** is currently the only cause for concern (**Figure 8**). While steel-intensive non residential construction remains strong, there will be hardly any stimulus for steel demand from residential construction for the foreseeable future – as indicated by falling new orders, permissions and construction starts

The economic position of the steel-processing sector will certainly not be as dynamic in 2008 as it was during 2006 and 2007 (**Figure 9**). It does, however, have a solid foundation as all our major customer sectors show increasing steel demand. In Europe, too, it can be expected that the growth in production in the steel-using sectors in 2008 may well be about twice as strong as the average between 2000 and 2005, as recently forecast by the Economic Committee of Eurofer, the European steel association.

Risks have increased significantly

Steel's economic situation remains at a high level. But the risks facing the general economy, as well as the steel markets, have increased considerably:

- Ø The steel industry in Germany is the railway's largest customer. Given the current boom in its economy, the steel industry urgently needs every goods wagon, every locomotive and every engine driver. A longer lasting **strike in goods transport** would therefore hit the steel

companies hard. Over 80 million tonnes are transported by rail annually **(Figure 10)**. This is more than half of all the goods transported by the steel industry. The significance of rail freight traffic for providing an assured supply of raw materials is just as great as for transporting finished products. Due to the extraordinarily high demand for transport, the freight carriers of importance for the steel industry – the railways, inland waterway traffic and road transport – are often already operating near their capacity limits.

- Ø **Massive raw material price rises** will yet again be a matter of concern in the coming year. The opening up of new sources of raw materials and the provision of additional cargo space have been insufficient to keep up with the growth of the steel industry worldwide, headed by China. Although negotiations with the ore suppliers have not even started yet, double-digit price rises are already spreading. Appeals for restraint must be made to the three largest suppliers of iron ore. 48 per cent profits on sales should really be enough. The fact is that fine ore and coking coal prices have more than doubled since 2003. In the case of scrap, prices have risen by more than 80 per cent. The freight rates for iron ore have actually increased by about 175 per cent **(Figure 11)**. This, too, will be a challenge for the value-creation chain.
- Ø The **exchange rate** of the euro against the dollar has risen 20 per cent since July 2006 alone. This imbalance is already beginning to exert the first dampening effects on the steel economy, because the expensive euro is a problem for exports, and particularly for steel-dependent exporting sectors. Thus exports to countries outside the EU have decreased by 6 per cent so far this year, and collapsed entirely in August – falling 30 per cent.
- Ø The strong euro makes **imports** cheaper. The development of imports continues to cause strain, particularly because of imports from China. Since the end of 2005, the EU has been transformed from a net

exporter of steel to a net importer. The numbers are quite critical: the EU's steel foreign trade deficit with China during the first eight months of this year reached almost 21 million tonnes, when extrapolated for the year.

- Ø The **antidumping cases** brought against the imports of galvanised sheet from China and stainless cold rolled sheet from China, Taiwan and South Korea, which Eurofer presented to the European Commission on 29 October 2007, are necessary and logical, given the threat posed by imports. In the EU, the defendant countries market both these products via the steel trade or steel service centres.

Criteria that principally involve sensitive confidential corporate data play a decisive role in antidumping cases. These include, for example, price developments, profits, production costs or sales quantities. This is why only a few basic facts can be revealed for this legal action:

- China first became a noteworthy supplier of galvanised sheet to the EU in 2005 and sold 178,000 tonnes. It will increase exports to the EU to almost 1.9 million tonnes in 2007 (**Figure 12**).
- The situation for stainless cold rolled sheet from China is similar, with a delivery quantity of 7,000 tonnes in 2005 and a probable increase to 167,000 tonnes this year. South Korea and Taiwan show a similar development (**Figure 13**).
- China, Taiwan and South Korea are accused of dumping margins of up to 40 per cent for exports to the EU. The dumping margin is the extent to which the actual export prices are lower than domestic market prices or the production costs in the exporting country (or a comparable one).

- Unfair prices of this extent are principally possible because China subsidises its state-owned steel companies, resulting in massive overcapacities there.
- Standards that are usual for us, for example in environmental protection or regarding fair competition, are lacking or ignored at the old plants in China. So while filters are legally required for a blast furnace in China, they are frequently switched off to save money (**Figure 14**). The older coking plants also pollute the environment (**Figure 15**).
- The Chinese government and the steel association have repeatedly provided assurances that unprofitable and environmentally polluting coking plants and blast furnaces would be closed down. But evidently the central government has been unable to assert itself against the provincial governments. Thus the many outmoded, small blast furnaces in China alone pump out about 430 million tonnes of CO₂ into the atmosphere every year. This is 100 million tonnes more CO₂ than if the same quantity of pig iron had been produced by modern European blast furnaces.
- The export offensive that has been made possible using unfair prices leads to a considerable loss of market share for producers in the EU, as well as falling orders and reduced capacity utilisation. There have already been shutdowns to prevent overproduction. Investment decisions that were made years ago are now being called into question. Moreover, we are beginning to see overstocking at the trading warehouses, caused by speculative purchases of imported material.
- China will probably increase its capacity for galvanised sheet again by 12.5 million tonnes by the end of 2009. This rise alone is equivalent to 42 per cent of the production capacity in existence in the EU (30 million tonnes), and thus about half Europe's total demand.

- The situation for stainless cold rolled sheet is even more blatant: China plans to increase its capacity to 4 million tonnes by 2010. This is actually equivalent to 80 per cent of the capacity of EU producers (5 million tonnes), and thus about the level of demand in the EU. Taiwan and South Korea are also expanding their capacities.
- The existing overcapacities in China are increasingly putting the relationship between supply and demand there out of balance, and exerting export pressure. Whereby South Korea and Taiwan are being squeezed on the Asian markets – so that exports from these countries are increasingly being diverted to the EU market at an extraordinarily high rate. This is particularly attractive because the EU has a robust steel economy with a strong euro and there are no trade barriers, such as import duties or non-tariff import obstacles.
- In the case of these two products from China, there are neither export duties nor has the repayment of value-added tax on exports been completely abolished (though it has been repealed for a range of other rolled steel products).

All efforts by the European Commission to find a political solution with China, in particular, have failed. Trade-related legal action is no protectionism. It is the instrument expressly permitted by the World Trade Organisation (WTO) for restoring fair trading practices. It therefore represents a necessary corrective to open markets. It is not a matter of screening the EU market from these imports. It thus follows that:

- Fairly traded steel exports from the countries in question, and from all other third countries that are members of the WTO, will continue to freely reach the European market. They therefore contribute towards a continuous supply for the trade and steel users.

- In view of the sufficient capacities in the EU and worldwide, these antidumping cases will not lead to any shortages. The overall effects of any antidumping duties will therefore be minimal for the users of these products in the EU.

According to EU antidumping legislation, the European Commission must decide within 45 days of receipt of the complaint whether it will initiate an antidumping process. The preliminary measures can go into force 60 days later, at the earliest, e.g. in the form of preliminary antidumping duties. It will therefore presumably take about three months for duties to come into force. The affected countries, namely China, South Korea and Taiwan, can take legal action against these duties at the WTO. This would, however, only be possible if the European Commission were to infringe the conditions for antidumping processes agreed in the WTO. We believe that this can be ruled out. Eurofer is currently examining whether additional antidumping complaints should be brought against other products, in particular those from China.

Energy and climatic policy

Whether the boom in the steel industry will continue is also dependent on political support – in the form of a growth-oriented economic and industrial policy. Above all, the steel industry is reliant upon conditions that lead to competitive energy prices. These do not currently exist. In a comparison of the price of electricity for industry in EU member states, Germany is still in third place after Italy and Ireland. The steel industry welcomes the suggestion by RWE's new head, Dr. Jürgen Grossmann, to work out a joint "**Energy pact for Germany**" – if this would better take into account the needs of energy-intensive industries. As a major consumer of energy, the steel industry would be pleased to meet representatives of the energy sector, industry and politics. If, in this regard, there is talk of a new understanding of "give and take", the fact that the energy-intensive sectors have already "given" a lot should also be borne in mind.

The steel companies in Germany are combating – within the framework of the revision of the **Renewable Energy Sources Act** (RE Act) – the “RE Act levy” that the new RE Act would impose on electricity that a company itself produces. This involves the draft by the Federal Environmental Ministry for amending the RE Act. The integrated steelworks use the electricity they themselves generate from the process gases produced during iron and steel production. This amounts to the considerable sum of 8.1 terawatt-hours per year, and corresponds to about 35 per cent of the total electricity consumed by the steel industry. If this environmentally sensible use of process gases were, in effect, taxed by the RE Act levy this would result in additional costs of almost EUR 100 million per year (**Figure 16**). 68.9 per cent of crude steel production in Germany (equivalent to 33 million tonnes) would be affected. Germany’s cabinet is to approve this change in the law on 5 December – despite the fact that it is ecologically counterproductive because the recycling of process gases leads to energy savings and greater energy efficiency. The incentive for building more plants to exploit dome gases would be considerably reduced.

The integrated **energy and climate programme**, which the German government is to present on the 5 December, is particularly important for the future development of energy costs. A comprehensive package of legislation is being prepared for it. Many measures are aimed at private consumers. But industry is also affected, for example by the use of renewable energies for heating residential and commercial buildings, and amendments to the Renewable Energy Sources Act. A new report initiated by the Federal Environment Agency claims that implementation of the measures agreed during the private session in Meseberg – for an almost 40 per cent reduction in greenhouse gases – would bring about long-term savings of EUR 5 billion a year by 2020. This statement is incomprehensible – the advisors estimate the extra costs for electricity from renewable sources in 2020 at only EUR 1.3 billion. A study by the Energy Environment Forecast Analysis (EEFA) research institute, commissioned by the steel industry and the other energy-intensive

industries, reaches completely different conclusions: the net cost would be almost EUR 7 billion per year for an expansion of renewable energy to at least 25 per cent in 2020. Sticking to the policy of opting out of nuclear energy would result in total economic costs of EUR 175 billion.

The Federation of German Industries (BDI) and the German Steel Federation (WVStahl) jointly authorised McKinsey to produce a study paper assessing in detail the costs contributed by 300 individual measures for reducing greenhouse gases. The study provides a practical picture. It concludes that a reduction in emissions of just 26 per cent would be economically possible by 2020 if Germany opted out of nuclear energy. In contrast, aiming for a reduction of 40 per cent would cost many billion euros – and these calculations do not even include the subsidies for renewable energies. Which is why the steel industry is appealing to the government not to go overboard in its climate protection commitments for 2020.

For the steel industry, the McKinsey study shows only minor potentials for lowering emissions, because the use of fossil fuels in blast furnaces and steelworks in Germany has now reached a minimum in technical process terms. Nevertheless, the steel industry is meeting its responsibility for climate protection. But wherever additional potentials are still available, the costs are often so great that implementation is not economically feasible at present, and cannot be financed in international competition. The incentives must be set at the right levels in order to be able to exploit such potentials. Ever-increasing burdens imposed by emission trading or the costs of the RE Act are also the wrong route – and only damage the industry's international competitiveness.

With regard to **emission trading**, the European steel companies now have an opportunity to correct the structural mistakes for the period until 2012. The EU Commission will announce a proposal on 8 January 2008 for this purpose. The steel industry has designed a trading system for steel that is oriented upon technical benchmarks, and would discard wrongly directed incentives that would merely result in production being relocated to countries outside Europe.

EU Commissioner Günter Verheugen, Minister for Economic Affairs Michael Glos, and even Environment Minister Sigmar Gabriel have recognised the advantages of this proposed system for climate protection. The intentions in Brussels are nevertheless worrying. If emission certificates are no longer issued free-of-charge and all auctioned instead, steel production in Germany and Europe would no longer be competitive. The steel industry hopes that the members of the EU Commission will come to their senses and make realistic proposals, and that the German government will start opposing these plans now with all its power, and stand up for Germany as an industrial location. The massive price rises in electricity brought about by emission trading must not be permitted to become a fixed feature beyond 2012.

Summary:

The basic conditions for a continuing positive steel economy exist. The current slowing and increasingly visible economic risks show, however, that the boom on the steel market is not self-perpetuating. The body politic must put in place conditions that do not constrain the industry's good economic development.

STAHL 2007

The occasion for today's press conference is the STAHL 2007 annual meeting, which has achieved another new record with over 4,000 registrations. The topic "Competition for the future" is evidently of interest to many who want to know today what they can expect tomorrow. I would like to refer in particular to a few highlights:

- The lack of specialist employees is currently the foremost barrier to innovation in the companies in Germany. One of the "Talks about Steel" is on the topic "Competition for talent". At 10.00 a.m. on Thursday, Prof. Karl-Ulrich Köhler, a member of the Executive Board of ThyssenKrupp and Chairman of the Executive Board of ThyssenKrupp Steel, will report on the school and university marketing carried out by ThyssenKrupp Steel.

- Dr. Hartmut Mehdorn, head of Deutsche Bahn, will give a talk on “Integrated mobility, logistics chains and Deutsche Bahn’s strategy,” at 2.30 p.m. on Thursday. In view of the threatened strike in goods traffic, this topic has become more topical than could have been imagined.
- The substantial worldwide rise in crude steel demand has above all been met by pig iron as an input stock. In view of the major investments in new blast furnaces, the question arises of whether there could be overcapacities of pig iron in the near future. Together with the Steel Institute VDEh, Dr. Peter Schmöle from ThyssenKrupp Steel has calculated how pig iron demand will develop to 2010. He will discuss this at 3.30 p.m. on Thursday.
- Highly developed technology and innovative power are the decisive strengths of industry in Germany and Europe. How can the industry maintain its top position and increase its knowledge advantage? In this regard, the Federal Research Minister, Dr. Annette Schavan, will speak on the government’s high-tech strategy. Michel Wurth, member of the Executive Board of ArcelorMittal and Chairman of the European Steel Technology Platform (ESTEP), answers the question from the point of view of the steel industry. He reports on European steel research and its influence on competitiveness and sustainability.