Steel at the limits of its resilience

On the situation facing the steel industry in Germany and Europe

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The steel economy: cautious optimism about 2014

The steel industry finds itself in a difficult economic and structural position at the start of 2014. In quantity terms, the situation in Germany remained relatively stable last year **(Fig. 1)**. The crude steel production of 42.6 million tonnes achieved in 2013 was even roughly the same as that achieved during the previous year (42.7 million tonnes). On the other hand, production fell last year in all the other steel-producing regions except Asia.

Reduced sales prices combined with still relatively high raw material costs have led to a difficult economic situation. This has also put the steel industry in Germany under strong pressure to adapt.

We expect economic conditions to improve slightly in 2014 **(Fig. 2)**. This is supported, firstly, by the continuing global economic recovery which is, this time, led by the industrialised nations in particular. Economic indicators in the Eurozone are also positive, in Germany as well as in the problematic southern countries.

Export-oriented steel processors are profiting from rising international demand **(Fig. 3)**. The economic data in the automotive industry, in particular, have recently been satisfactory: incoming orders and confidence indicators are noticeably improving. In addition, car production rose 11 per cent in January year-on-year. The construction industry has started the year with healthy order books, thanks to the residential segment. The restrained orders situation in machine construction, however, shows that there has still not been a really broad recovery across the sectors.

The positive starting conditions for the steel economy in 2014 also include the relatively low level of stocks held by dealers and processors **(Fig. 4)**. While stocks in the distribution sector rose slightly at the end of last year – against the usual seasonal trend – and the inventory range increased somewhat, they were still clearly below the long-term average.

The improved incoming orders situation at steel processors could therefore rapidly be reflected in rising demand for steel. The fundamental economic trend in the steel industry itself is also oriented slightly upwards **(Fig. 5)**:

- Crude steel production rose 2 per cent in January, having already grown by a strong 7 per cent during the fourth quarter.
- The volume of orders received also increased at the start of the year: at almost 3.5 million tonnes, orders in January rose to a 24-month high. Though orders fell by 4 per cent during the fourth quarter last year.

This shows that the recovery process is still fragile. Demand from the non-European area, in particular, is currently being afflicted by the worsened exchange rate relationships between the dollar, yen and the currencies of important threshold nations.

Overall, the mood in the steel industry remains characterised by cautious optimism. The latest economic survey on the steel industry by the Munich-based ifo Institute for Economic Research also points in this direction **(Fig. 6)**. While the current business outlook is still seen as unsatisfactory, most of the companies surveyed believe that this will improve during the coming months. The business climate has therefore brightened during recent months and is considerably better than at the start of 2013.

Against this background, the assessment we made in November last year remains valid **(Fig. 7)**. We expect that the market supply of rolled steel products will rise by 4 per cent in 2014. Crude steel production may rise slightly to 43.0 million tonnes.

When assessing the economic situation it is also necessary to take into account existing structural problems. These include, firstly, that the recovery in Europe is taking place from an extremely low level. The market supply with rolled steel will rise in 2014 and 2015 by 3 per cent each to 146 million tonnes and 150 million tonnes respectively, according to the European steel association Eurofer **(Fig. 8)**. This is slightly better than was still expected in October, but is a recovery in very small increments.

At the end of the forecast period market supply would still be about 25 per cent below the pre-crisis level. Moreover, the regional discrepancies may persist. Germany's market will regain momentum more quickly in 2014 than that of Spain or Italy. Meanwhile stagnation has become apparent in France. Overall, the gap between Germany and the other major steel markets in Europe may increase again this year.

As a consequence of this development in demand there will also initially be little change in the striking imbalance between supply and demand. There is no doubt that the steel industry in Europe is in crisis. The duration and depth of the crisis is difficult to estimate. The development of an EU Action Plan for the steel industry by the Enterprise Commissioner is not unfounded. The restructuring must, however, be carried out by the companies themselves and in response to market forces. There is absolutely no occasion for state interventions.

It is vital to ensure that the consolidation is not achieved by setting the wrong political course, whether in Brussels or Berlin, at the cost of competitive structures in Europe. The EU Action Plan was correct. We welcome the fact that the EU Parliament has made it clear during recent weeks how important the steel industry is, and how greatly it has been affected by energy and environmental policy.

Energy and climate policy: a decisive year for the steel industry

For some years now, the steel industry in Germany has been demanding an energy and climate policy that takes industrial interests more into account. An incorrectly structured energy transition in Germany is a threat for the country as an industrial location. The rapid rise in the levy resulting from the Renewable Energy Sources Act (EEG) has led to electricity prices in Germany reaching record levels **(Fig. 9)**. In an EU comparison it can be seen that the costs for electricity from renewable energies has risen by far the most in Germany in recent years. Almost half of the electricity price in Germany can now be traced back to decisions made by politicians and the state.

In order to ensure that the energy transition can succeed without harming Germany as an industrial location, relief from unilateral energy-policy burdens such as the EEG levy is essential for energy-intensive industries. It is therefore impossible to understand why the Commission has its sights set on initiating a state aid investigation procedure against the industrial relief offered to offset the EEG levy.

The steel industry in Germany alone would face a burden of at least one billion euros a year if the special equalisation scheme for offsetting EEG costs was forbidden **(Fig. 10)**. Internationally competitive production would be unthinkable were such a scenario to come to pass.

The hardship provision is intended to offset burdens that other competitors do not have to face. It is not a subsidy, but only serves to provide a level playing field regarding competition with other European member states. Without such hardship provision an ambitious project like the energy transition would not stand a chance.

The steel industry will participate in the state aid investigation with a position paper, and use all legal means to rebut the subsidy charge. It is to be welcomed that the German government is fundamentally in favour of continuing this system.

In addition, however, the EU Commission must recognise the central important of the relief for industrial value creation not just in Germany, but also for Europe. It must not restrict the leeway for such instruments.

In Germany there is evidently a political consensus to oppose the Brussels state aid investigation procedure in the interest of the industrial location. But even this commitment to the energy-intensive industries in Germany is showing signs of cracking. At the closed meeting in Meseberg, the government decided on the main points of an EEG reform – which would have serious effects on the steel industry and its efforts to increase energy efficiency **(Fig. 11)**.

The planned charge for industrial plants generating their own electricity already leads to extra EEG costs for the steel industry of about 100 million euros a year for existing power stations. Renewable energies enjoy a natural protection of trust. But industry, which generates electricity efficiently in a process-dependent energy circulatory system, is denied this.

Electricity generation from blast furnace gases is part of the steel industry's efficient energy utilisation system. It also helps reduce greenhouse gas emissions. The steel industry has been using this system for decades, and introduced and expanded it for ecological and efficiency reasons long before the Renewable Energy Sources Act (EEG) was conceived. The planned far-reaching charge on new industrial power stations for generating a plant's own electricity would also enormously impair the financial efficiency of this electricity generation from blast furnace gases, so common in the steel industry, as well as other forms of residual energy exploitation. This would hinder future investments. An investment in a new blast furnace gas power station with annual generation of 1 terawatt-hour would, if the German government had its way, be burdened with additional costs of about 43 million euros a year. In this regard, the main points of the EEG reform require urgent realignment. I hope that the special features of the steel industry are recognised when a new draft bill is presented.

The new Economics and Energy Minister pointed out a couple of weeks ago that "individual interests" do not represent "the common good". This is indeed correct. But to derive from this that the interests of the steel industry in retaining the relief in the EEG reform is one of these individual interests falls short of the mark. Retaining industrial value creation in Germany is indeed in the interests of our entire economy.

Sectors like the steel industry are basis industries at the start of the industrial value creation chains, and are the foundation of a business model that has made Germany strong. How fundamental the steel industry is for the industrial core of Germany can be seen from an analysis of foreign trade flows **(Fig. 12)**. More than half of Germany's exported goods involve steel-intensive goods, i.e. sectors in which the proportion of steel deliveries is over 10 per cent of the total preliminary work. These include, above all, the automotive industry, metal goods and machine construction.

These are precisely the sectors that face particular international competition and are successful in it. They generated a foreign trade surplus of 245 billion euros last year, compared with 330 billion euros from industry as a whole. In other words: 75 per cent of Germany's export surplus was produced in sectors that rely on innovative, high-performance steels.

Summary

The steel industry in Germany will see a slight recovery in 2014 but will also have to operate within a continuing difficult market environment. It reacted early on to the current market turbulence. The fruits of these painful efforts, however, are in danger of being nullified by cost increases caused by energy policy-related decisions. Further adaptations will be necessary if the conditions faced by the steel industry in the location of Germany deteriorate further. Those who thus weaken the domestic steel industry also threaten the medium-term competitiveness of the German business model.