JUNE 2021

PROCUREMENT UPDATE

steel&tube

STEEL YOURSELF!

Internationally steel prices have reached levels not seen since 2008 – the full impact of these increases and their associated supply chain costs have yet to flow through into our market due to extended manufacturing lead-times and shipping delays.

What this means is that domestic market prices are likely to continue to increase for the shorter term and are likely to fluctuate within a narrow range at elevated levels for the medium term.

Are steel prices finally reaching a peak? That is not yet clear, but price gains have certainly started to slow. How much higher can steel prices possibly rise? When will the price peak? Global fundamentals and indicators seem to suggest that steel prices are likely to remain elevated for an extended period. One thing is certain – the longer the trend, with geo-political involvement, and global pandemic conditions still prevalent, there is likely to be greater volatility.

Much has happened in recent weeks in the steel and the stainless steel commodities and finished product markets. Prices soared higher to record levels across the globe – particularly China, fuelled by speculation in the futures markets.

China's steel output hit an all-time high in April pushing production figures for the quarter up 15.6%[1]. Mills ramped up to 90% capacity levels despite China's government targeting to reduce industry capacity by 5% in 2021 to cut carbon emissions and stem increasing commodity prices[3].

In order to meet these targets and despite increasing demand and high prices the State Council had ordered steelmakers in Tangshan in North China's Hebei province to cut output by 30-50%. To put this directive in perspective, Tangshan produced 144 million tonnes of steel last year (~50% flat rolled products), accounting for 13.5% of China's total output, 45% more than produced by the world's second largest steelmaker, India.[2]

The production cuts in Tangshan instead pushed up Chinese domestic steel prices through March, April and May – as China's businesses battled for supply to meet continuing growth in the construction, infrastructure and manufacturing sectors.

As a further measure to shore up domestic supply, slow the growth of carbon emissions and secure more steel resources domestically – China removed its' 13% export tax rebate for 146 steel products and cut tariffs for ferrous / semi-finished steel imports effective 1st May. This move resulted in a 13% increase in Asia-Pacific market prices.

Though China accounts for circa. 30% of global manufacturing and 50% of steel product manufacturing[4], surging steel prices are a global story. Producers outside of China are scrambling to keep pace. Earlier this month, ArcelorMittal lifted its steel prices for the 12th time since November, taking a tonne of Hot Rolled Coil (HRC) in Europe to €1050 – up by more than 80%.[5] With US HRC prices now $1,815 USD/T (up over 200% in 12 months) and trending higher, they remain attractive export markets for Chinese mills. The next step for China to retain steel domestically and dampen demand for steel making commodities is rumoured to be an export tax, which will again have an immediate impact on Asia-Pacific prices.

However, over the past week, iron ore and steel prices dropped back following China's highest authority, the State Council, issuing warnings and calling for stability in bulk commodity prices. Any cooling commodity prices will likely only have a temporary affect on finished steel prices unless Chinese authorities take steps to curb consumption to reduce production. This would however impact China's economic recovery. With about 139 million small, micro-sized and individually run businesses, contributing to the majority of GDP growth, tax revenue and jobs in China, the Chinese Government announced last week that they would increase support for privately run businesses — including financing to cope with rising raw material prices.[6]

The above move by the State Council is important as China's Producer Price Index (PPI) looks like it will reach its highest point for the year in the second quarter. A margin squeeze could result if fabricators, manufacturers and builders, can't pass on the rapid and large price increases onto end users or access enough funds to secure the higher cost materials to operate, let alone gear up to meet demand.

In an attempt to manage these factors, China's local authorities have slowed the scale and pace of debt sales to finance infrastructure projects this year. However with around USD $30 billion invested in Q1 of 2021, steel demand in China should remain strong – particularly from the housing and infrastructure sectors which account for about two-thirds of China's steel demand.[7] Considering also that China's urbanisation levels are currently around 50% compared to a level of around 80% in Western countries[8] – a lot of development remains. China will likely to continue growing steel production up to its planned peak in 2025.

Structurally therefore, the market demand for iron ore has gone up and will continue to by hundreds of millions of tonnes, while supply has only gone up only by tens of millions of tonnes in recent years. With Brazilian ore producer Vale struggling to ramp up its ore production and China in trade dispute with Australia – iron ore supply will remain tight.

Elsewhere, global supply of steel is constrained with demand continuing to outpace capacity recovery from Covid response reductions. There was little buffer in steel and downstream sector inventories after the Covid lockdowns. The sudden surge in demand once economies reopened has been so strong that safety stocks have rapidly depleted. Even if this demand surge fades, restocking is likely to keep steel markets tight, a timeline extended by delays from vessel rotations, equipment shortages, chaos at trans-shipment hubs and a resurgence of Covid-19 in the Asia-Pacific region.

So, although there is a certain amount of fear and speculation feeding into steel market pricing at present, there is a greater fear of not being able to secure the logistics and the product needed with supplier allocations becoming more prevalent – it is much more expensive to idle a business.

The supply shortage of semiconductor chips globally is currently negatively impacting vehicle production and demand for steel, however the auto industry accounts for less than a tenth of total steel demand. The U.S. economy is on the verge of a massive fiscal stimulus boost and Europe's economy starting to reopen as its vaccination rollout gets into gear, unleashing a massive amount of pent up spend. World demand for steel seems solid.

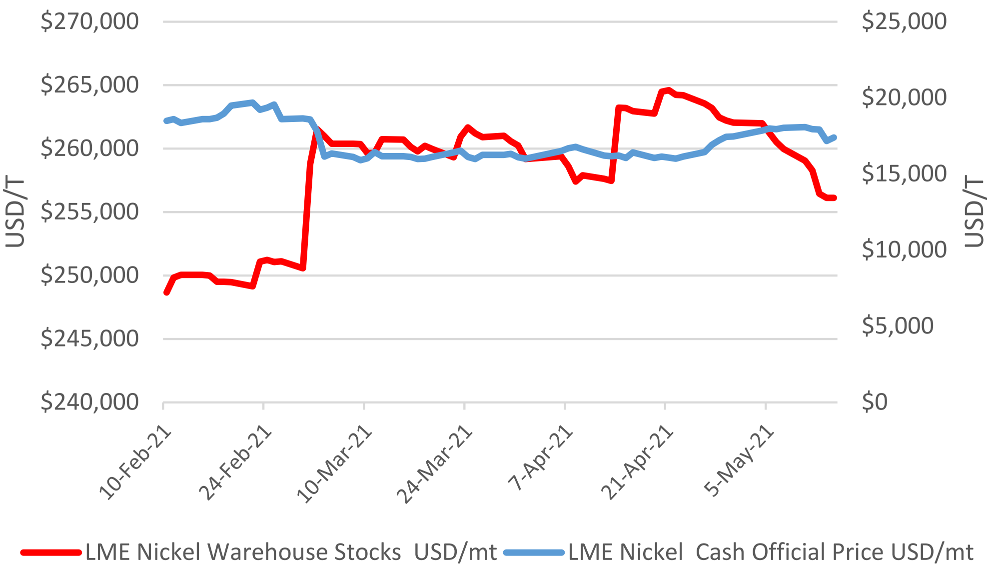
In June, it therefore appears unlikely international steel market pricing will trend down, but prices are likely to fluctuate within a limited range as the conditions within raw material and geo-political factors become more complex and volatile. This increased volatility will possibly result in some softening in the price trend for iron ore fines, though this would need to extend over a number of months before it transfers into steel product prices. In addition new mill capacity won't affect the international market until early 2022 and only unless total market demand wanes, so elevated pricing levels may be here for a while.

STAINLESS STEEL

Stainless steel market demand was initially more heavily impacted globally by the disruptions caused by repeated lockdowns to mitigate the spread of COVID-19 than the carbon steel product markets. With the negative consequences heavily felt in the hospitality and downstream food and beverage sectors. Large downturns for the aviation sector and initially the automotive sector, reduced demand for stainless steel, nickel alloys and castings respectively.[9]

As the US dollar has steadily weakened in May against other currencies, LME prices have increased. Coupled with a rebound in market activity - leaving manufacturers, in the automotive (incl. EV's), white goods and agricultural segments (due to increasing commodity prices), short of material and parts to maintain their production schedules – increasing demand and reducing Nickel stocks.

LME Nickel Price & Warehouse Stocks



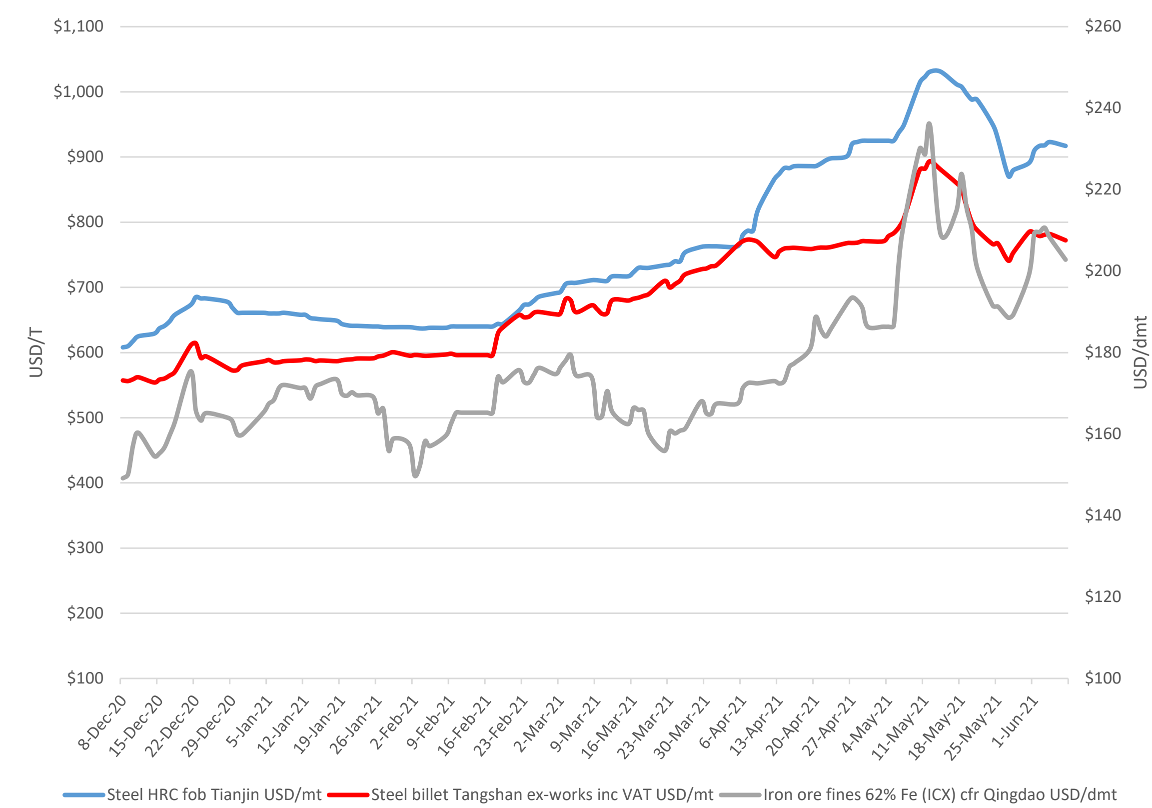
Source: Argus Media

CARBON STEEL – RAW MATERIALS

Booming finished steel prices globally, fuelled by steel futures in China, supercharged rallies of benchmark commodity prices, iron ore and HMS 80:20 Scrap - as downsized mills (due to years of overcapacity and the COVID economic scare) met capacity limits.

IRON ORE

Chinese Iron Ore Price Trend v Steel HRC & Billet



Source: Argus Media

Iron ore prices skyrocketed in May up 20% above their 2011 record, led by soaring Chinese steel product future prices and in particular Tangshan billet which rose to a 13 year high with news of further output reductions for environmental reasons boosting the already hot market. Steel demand in China and likewise crude steel production has grown by 30% over the past five years, growing the gap between demand and supply for iron ore.[10]

Over the last two weeks, the price of iron ore has settled back to around $200 USD/T after Chinese authorities threatened to temper commodity inflation and speculation through market regulation. There is doubt that this current crackdown on speculation will have much of an effect on the price of iron ore over the months ahead. Especially with declining steel stocks and robust demand encouraging Chinese mills to increase output even as they digest the impact of the removal of steel export tax rebates, increasing emission reduction policies and potentially adding export tariffs.[11]

Though global iron ore production is expected to increase by 5.1% in 2021, that increase should be generally absorbed by strong demand for steel as the construction boom takes place around the world with many Governments planning to build their countries out of the pandemic's economic woes.

As it stands the dramatic increase in iron ore price appears a classic case of supply and demand. China relies on just two countries -- Brazil and Australia -- for 80% of its iron ore imports. Brazil's ore production was significantly curbed in 2019 after the Samarco dam collapse cut its production forecasts until 2023. It has then spent the past 12 months crippled by Covid-19, further hampering its production. Separately, China's escalating trade dispute with Australia and the potential for supply disruptions have added another element of risk to a market already concerned about the traditional seasonal weather trends in both WA and Brazil in the coming months.

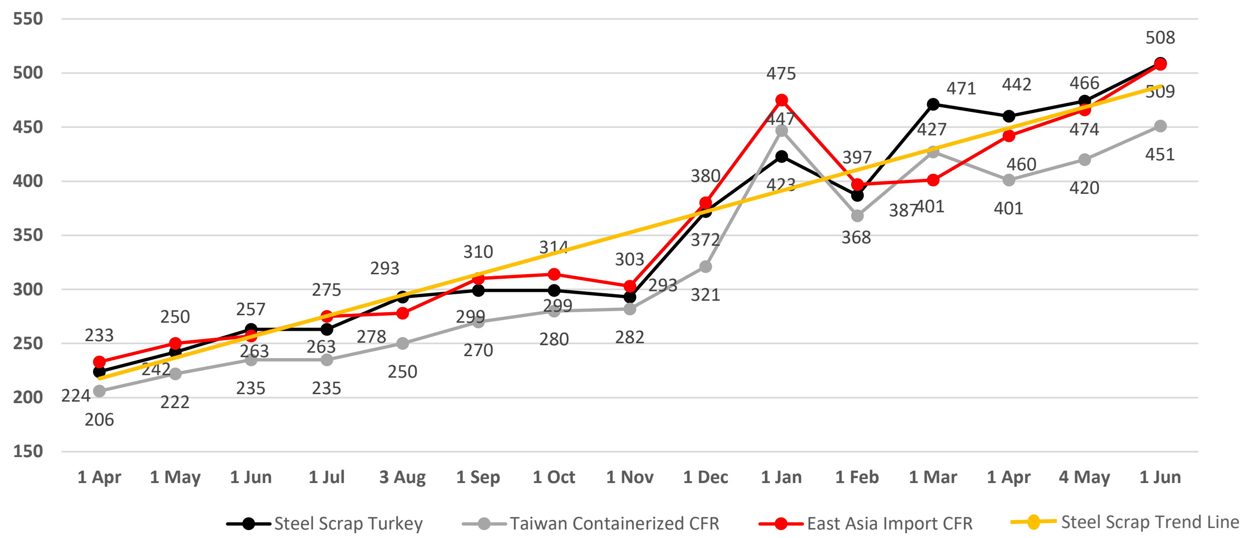
As a result of heightened risks, China has turned to secondary iron ore producers in India, spiking their exports by 66% in recent months, despite India's iron ore production falling sharply because of Covid-19. This spike has shortened ore supply in the Indian domestic market by around 70 million tonnes for manufacturers like Tata, prompting calls for an export ban on (Indian) ore.

Essentially, investment in new iron ore mines has not kept pace with iron ore demand. Typically you need a price of around $100 USD/T plus to incentivise new mine investment. A price point fleetingly hit once in the last 5 years and reached again in June 2020. A new mine takes 5-10 years to get to production after capital commitment. In the short to medium term it appears that there is little that major iron ore companies can do to free up supply and release the price pressure in the market.

At present based on the current demand scenario for iron ore, it seems unlikely that the supply imbalance is likely to change or that benchmark prices will dramatically reduce in the next 12-24 months. The best proof of the underlying demand strength is in the port-side iron ore market in China, which exists to help steel mills get their hands on ore quickly. Reportedly, the port-side market remains $10 USD/T ahead of the seaborne market, indicating that mills remain nervous about being caught short due to lingering supply threats.[12]

SCRAP STEEL

Scrap Metal Prices - HMS 1/2 80:20



Source: ASN – June 2021

International scrap prices pushed marginally higher on moderate activity after heavy trading in recent months due to a lack of scrap availability and some negative market sentiment.

Scrap pricing late April and into May was driven predominantly by Japanese ferrous scrap export pricing, due to strong demand from Asian steelmakers chasing productivity to supply semi-finished steel to the Chinese market.

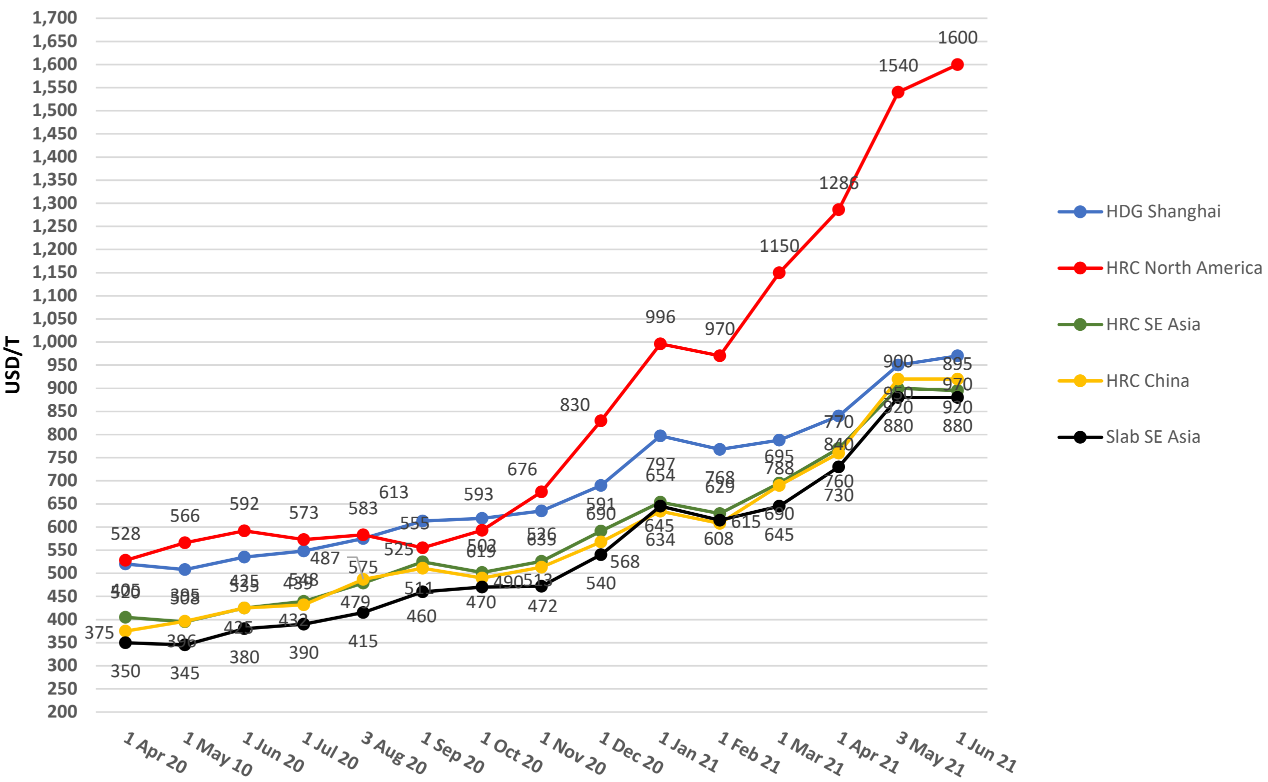
Overall the markets have seen reduced activity in recent weeks due to Chinese prices for ferrous scrap abruptly falling in line with their finished steel prices on the back of Chinese premier Li Keqiang's call for control of soaring commodity prices mid-May. This prompted Chinese mills to quickly cut scrap prices. China however only re-entered the international scrap market in a major way late last year given its targets to reduce carbon emissions and replace 20% of its steelmaking capacity with EAF mills by 2025, increasing its scrap consumption ratio to 30%.

MARKET INDICES

Already high product and market prices took a boost on 1st May in Asia-Pacific markets as China announced removal of its 13% VAT Export Rebate for 146 steel and stainless products – more specifically; HRC, hot-rolled sheet, plate, rebar, wire rod, colour-coated steel and cold-rolled sheet with 0.5-3.0mm and below 0.5mm thickness. It also cancelled rebates on round bar and sections, stainless steel products with width above 600mm, seamless steel pipe, steel strips with 600-880mm thickness and galvanised corrugated sheets. It made no changes to rebates for duties on exported cold-rolled coil and hot-dip galvanised steel.[13]

In its semi-annual Commodity Markets Outlook, the World Bank forecast metal prices to increase 30% and remain close to these levels throughout 2021. Some products such as Pipe and Hollows (RHS/SHS) have exceeded 50% on the back of international Hot-Rolled Coil price increases. This globalised price expectation by the World Bank does not take into account Asia-Pacific dynamics such as the 13% increase resulting from the Chinese Export Rebate removal as stated above or the increased costs of our extended supply chain into our local market.[14]

Flat Products - Manufacturing Steels

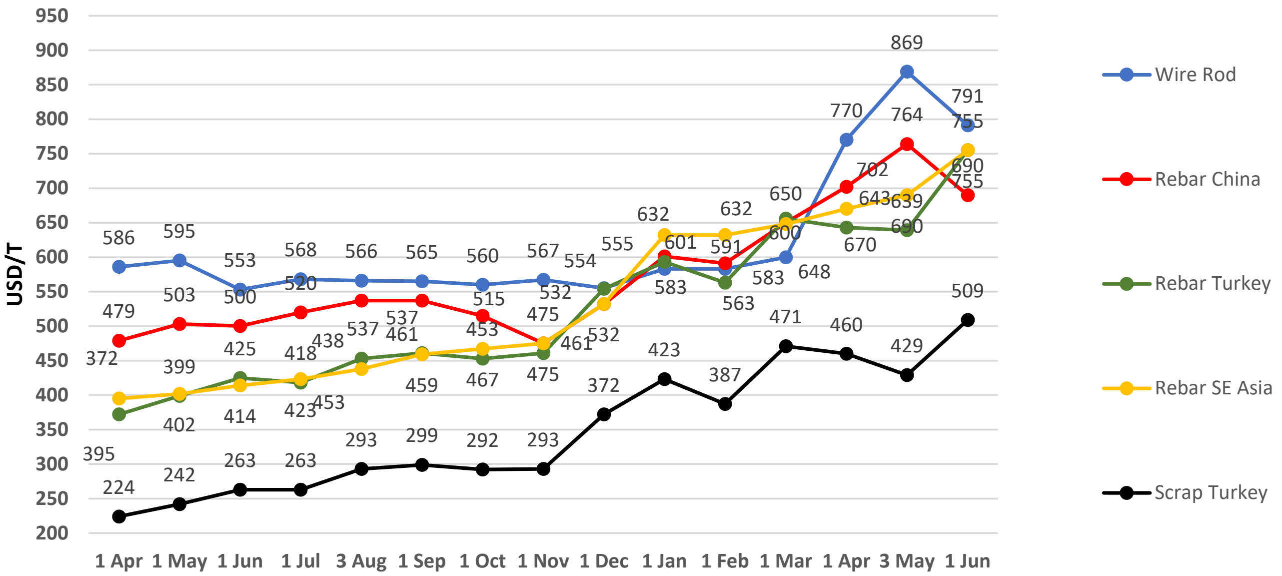


Source: ASN June-21

Prices for hot rolled coil (HRC) - used in automotive, home appliances, shipping containers and machinery manufacturing have climbed globally over 50% in the past six months before flattening in recent weeks as China announced its intention to scrutinize and potentially regulate market prices.

While in the Europe and the US flat steel consumption and prices have boomed since the second half of last year, the latter increasing over 200% due to the market being artificially constrained under Trumps 232 (25%) tariff and continues to trend higher.

Long Products - Construction Steels



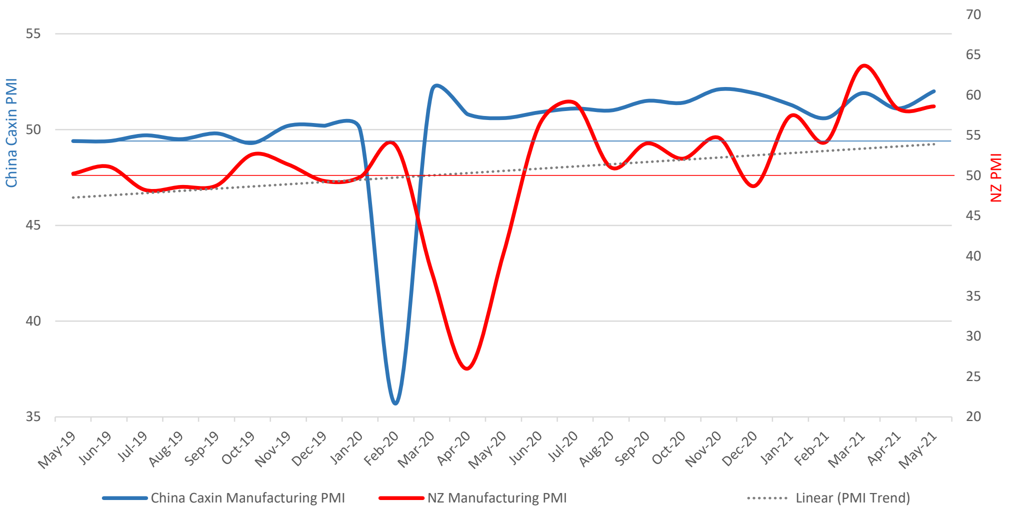
Source: ASN June 21

Demand in the global long steel product market continued to increase, and particularly demand in developed economies as stimulus programmes on infrastructure continued to push the market up. At the same time as international supply tightened even further.

Demand in the EU remains strong, but the market is short of steel. In the US, demand is up, but to ensure supply is far more difficult. Domestic mills are full. Imports are uncompetitive, even harder to ship, with more delays at double or triple the costs. Prices are at historic highs, and fabricators have maximised their credit limits as prices double on most items.

China rebar prices were being led in the same direct by the steel futures markets. Once China's highest authority the State Council issued warnings, ex-warehouse prices for rebar fell by 18.6% below the price of benchmark Tangshan billet. This moved some rebar mills' margins down to breakeven.[15] With robust demand forecast medium term beyond their normal seasonality – prices are however expected to recover ground once sentiment settles and regulator intentions are clarified.

Manufacturing (PMI) Index Trends



Sources: Caxin & Business NZ

In China the 'Manufacturing Purchasing Managers' Index (PMI) is a barometer macroeconomic health in the economy measuring the performance of 430 private industrial companies across five weightings – New Orders, Output, Employment, Supplier Delivery Times and Stock of Items Purchased. A reading above 50 indicates expansion.

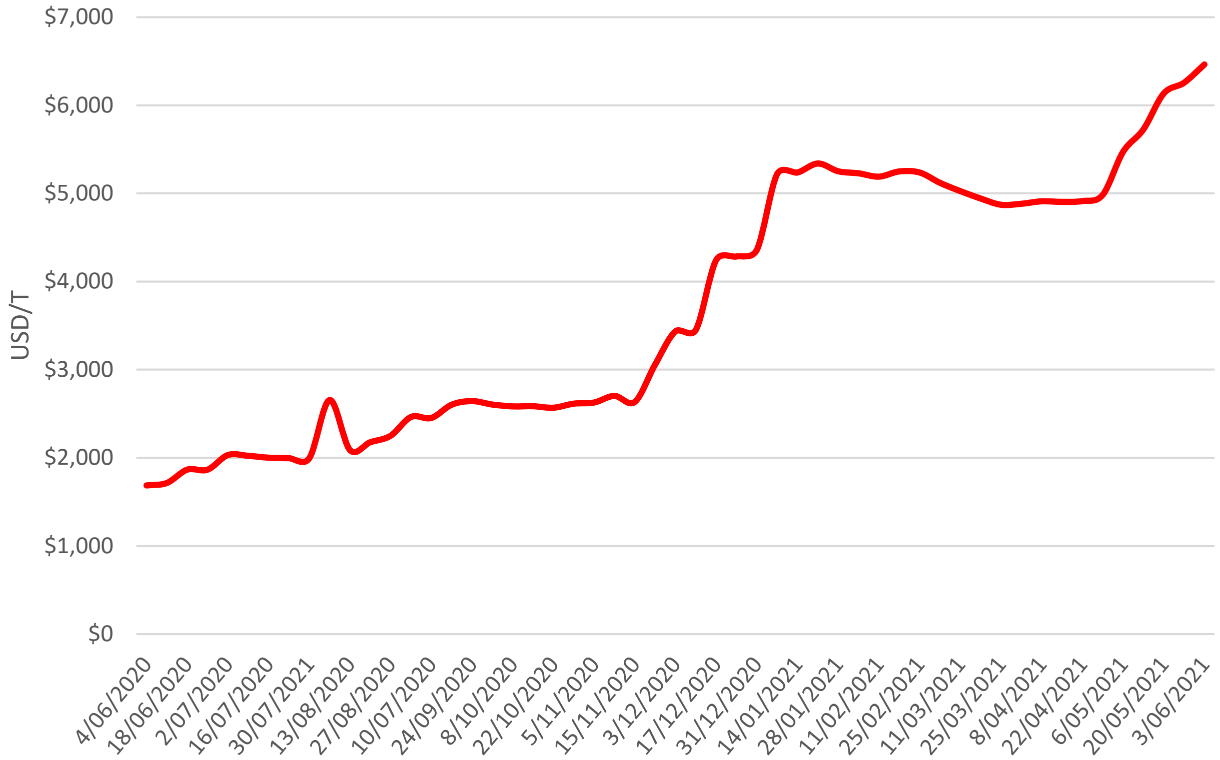
The index rose in May for a second month in a row to a five-month high of 52.0, the highest mark so far this year, despite surging raw material prices as demand recovered.

Domestic and overseas demand surged last month. New orders rose the most since December 2020, export order growth was at a six-month high, and output continued to rise. Also, buying activity increased solidly, amid sustained improvement in customer demand. In the meantime, employment was broadly unchanged while backlogs of work rose for the third month in a row. That led to a further increase in production, but a shortage of raw materials at high prices and transport costs impacted results. Overall the 12-month outlook for service sector activity remained strongly positive midway through the second quarter, with optimism linked to expectations of firmer client demand domestically and abroad.[16]

Overall, based on present global market conditions and indicators suggest high prices are likely be sustained for some time, supported by infrastructure-heavy global stimulus plans. The largest by far will of course be US President Joe Biden's $2 trillion "once in a generation" infrastructure plan, which would involve fixing 30,000 km of roads and 10,000 bridges.[17]

SHIPPING

Drewry World Container Index (USD per 40ft Container)



Source: Drewry

Unfortunately high shipping cost are getting sealed into contracts for the next 12 months so are therefore here to stay – in the medium term at least.

The higher shipping costs have been sparked by a combination of factors internationally and domestically, including soaring demand, container shortages, saturated ports, Covid protocols, too few ships and rotations, dockworkers and truckers. The problems are too broad to be remedied by any short-term fix and are creating ripple effects across supply chains globally.

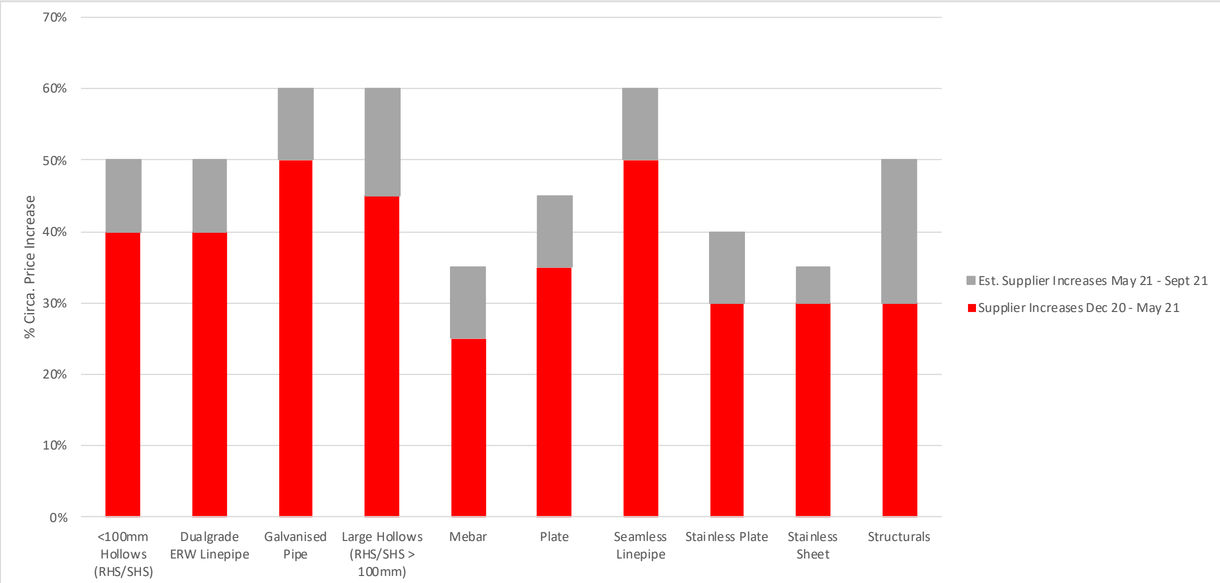
The recent Suez Canal blockage put pay to any optimism that the interim period in 2021 could clear container backlogs.

WHAT DOES THIS MEAN FOR STEEL & TUBE AND OUR CUSTOMERS?

There remains a significant lag in the higher priced product from international suppliers landing and being fully being passed on into the market.

In addition there remains a shortfall in supply of both steel making raw materials and finished steel products, exacerbated by similar dynamics within our extended supply chain. The net result is that our supply partners continue to advise us of further price increases meaning that local prices will continue to increase for the shorter term and look set to stay elevated for the medium term. As evidenced by the graph below:

Product Price Increase Chart



Source: Steel & Tube

Steel & Tube have therefore recently announced a further range of price increases effective for July and August which will need to be applied across a range of key categories - but not restricted to those shown above or referenced in our increase letter given our extensive range.

As a preeminent distributor, Steel & Tube are well serviced through our long standing supply and logistics partnerships to be able to position us in a leading position. Steel & Tube has New Zealand's widest inventory of steel, stainless and allied products – available nationwide, to support your business requirements.

With increasing demand in this supply constrained market for steel products, the best course of action remains to plan ahead as best as possible, expect the unexpected.

Prepared for Steel & Tube by Brendan Smith, National Manager, Carbon Steel & Stainless

Sources Notes:

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7. Bloomberg – 'China Is Already Tapering Stimulus With Drop in Bond Sales' – 27 April 2021
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10. S&P Global Platts – 'Fundamentals support strong iron ore prices in 2021' – 4 May 2021
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