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PROCUREMENT UPDATE

JULY 2022

FLUX-ED

Steel markets are certainly fluid at present, to use some steel terminology in "flux" with a number "additives" causing a volatile market melt, making references to "volatility" in the past almost appear to have been lightly used.

These are turbulent times. The Russia invasion of Ukraine has dealt a major shock to commodity markets, altering global patterns of trade, production and consumption which is likely to increase price volatility, keeping prices historically high through to 2024.

All eyes are on China and how quickly it will recover from its COVID-induced slump, and on how long the Russia/Ukraine conflict will continue and what ramifications it will have on the global economy.

Meanwhile, domestically watchful eyes are monitoring escalating inflation, interest rates and the declining New Zealand dollar with increasing concern, due to the flow on effect to confidence levels, incomes and subsequent growth rates or decline.

Amongst all this, increasing costs of transportation continue to be felt in the price of finished goods in all sectors, with steel and stainless products being no exception.

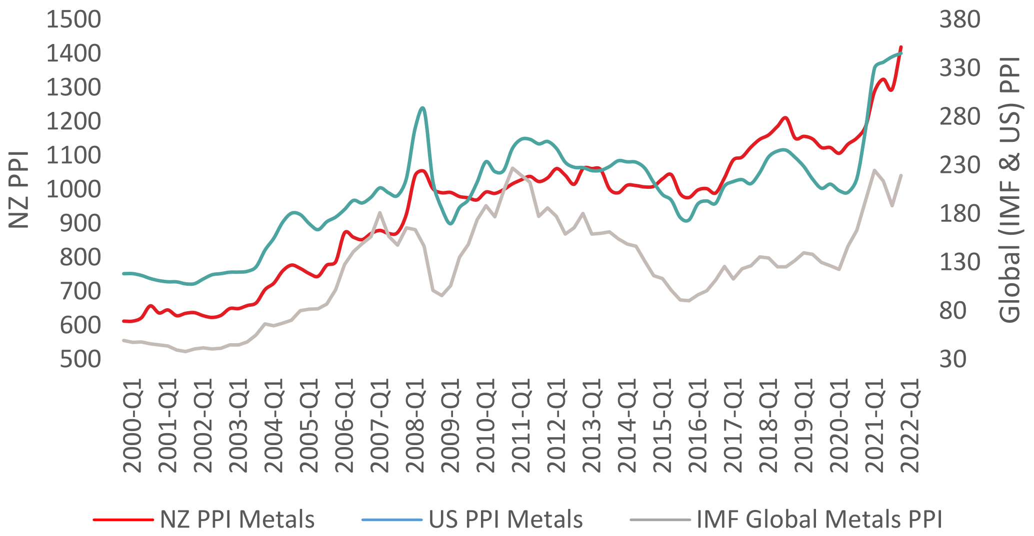
When mixing in already higher than historical inventories from a cost and volume perspective industry wide there are a number of additives "in the melt" which could increase the price spreads typically seen in the market and the magnitude of their adjustments.

Making for an unparalleled trading environment where daily "change" is the new norm.

Russia invading Ukraine has created significant anxiety on many fronts, which is testing global financial and commodity markets. The flow on financial effects have affected currency values globally adding additional pressure on (already high) domestic inflation and volatile elements into finished product prices.

In metal markets basic economics prevail, everything comes down to supply and demand, market forces are cyclical. Traditionally after a period of strong demand, the steel supply builds up with mills gearing up capacity, and prices reduce. In more extreme cycles prices escalate so high that "people" stop buying, causing prices to drop or even plummet, leading to a surge in demand once again. So where are we in this latest price "super" cycle? Likely more than halfway through if the past is anything to go by.

Producers Price Index - Metals

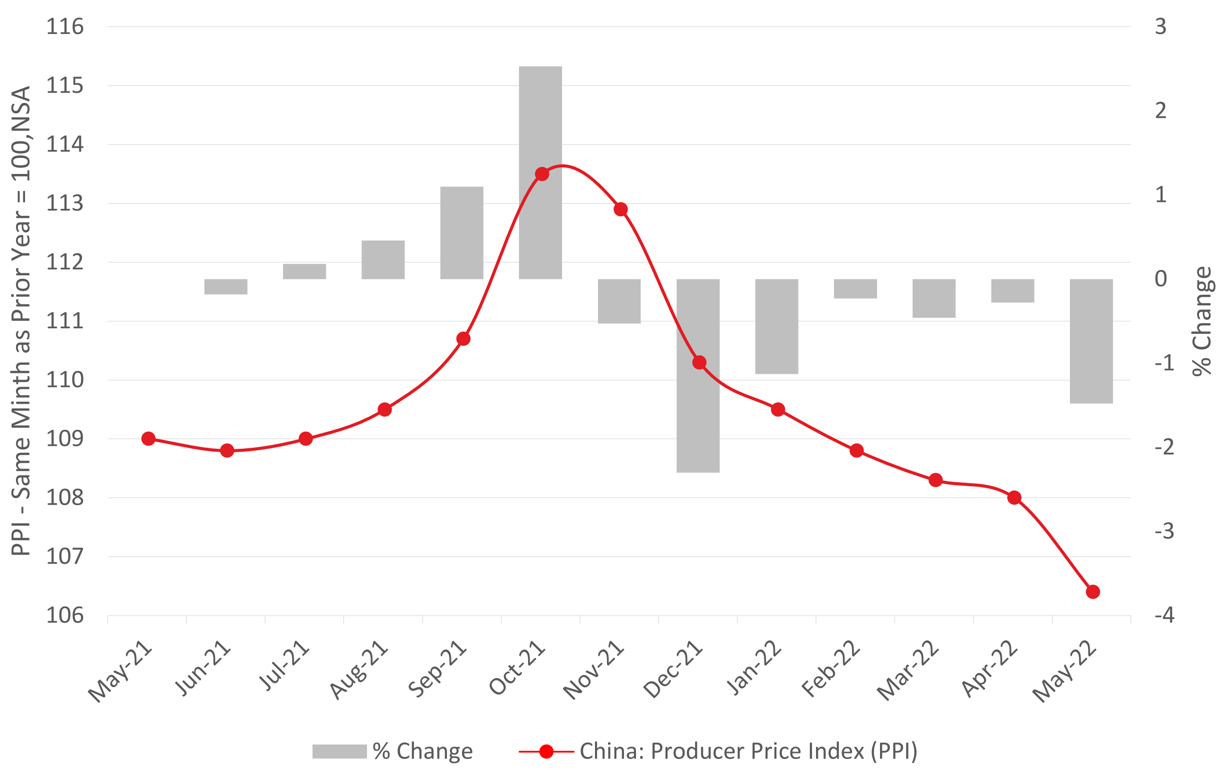


Source Data: Stats NZ & US Federal Reserve Economic Data & IMF

In the last 5-year super cycle (2003 – 2007) there were volatile quarterly dips and bounces reflected in Producer Price Indexes globally prior to a quarterly slide in growth. It took an extraordinary event in the form of the credit crisis to send all markets into a turmoil. This time around drastic steel price deflation is not likely. Only twice in 50 years have we experienced massive cost deflation, the recession years of 2009 and 2010. That was at a time when demand (volume) and jobs dropped by around a third. A situation which was not bought on with the onset of high inflation rates alone.

The outbreak of COVID in mainland China with its subsequent lockdowns during March to May has acted like a release value for some of the supply and price pressures experienced since late 2020, as shown by the drop in China's Producer's Price Index below.

China - Producer Price Index



Source: Moody's Analytics

China's producer prices peaked in late 2021 and are beginning to moderate. Economists are forecasting a 6.5% rise in factory prices in May from a year earlier, down from 8% in April. That's a promising development for relief in inflation worldwide. In addition, lower container freight rates and improving supplier delivery times in purchasing managers indexes point to easing bottlenecks that should curb price pressures later this year.[1]

Chinese mills went into their lockdown highly geared, operating at 90% capacity to meet seemingly insatiable demand for steel domestically and globally - their highest rate in 13 months. During their lockdown mills slowly accumulated steel and stainless product, in COVID 'closed-loop' production "bubbles", increasing output over May by 3% particularly in flat rolled products where most mills have geared up capacity. Consequently, inventory levels are 12% higher compared with last year and may take months to fall to the median levels of the past five years.[2] A situation more preferable to Chinese mills than taking 6 months to restart a blast furnace to 90% capacity, especially if a bounce back like other COVID "locked down" economies China's quarterly consumption of crude steel according to S&P Global Commodity Insights falling 14%, Chinese mills increased export volumes 50% which has dropped price levels in recent weeks across Asia.

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Despite recent weeks events there remains plenty of the underlying supply issues mentioned in prior 'Procurement Updates' which are likely to maintain steel and stainless prices at elevated levels, after a quarter of settling – now that China has largely resumed normal operations:

- Supply chains remain slow to recover. Vessel delays are still high historically, and product order backlogs continue to congest manufacturing hubs, vessels, and ports globally, keeping costs high and building in demurrage as a part of BAU prices.
- High demand and production of pig iron globally means demand for iron ore is solid.
- Iron ore inventory at China's major ports has been trending down since the Chinese Lunar New Year holidays.
- Iron ore prices are hovering between $120 and $180 USD a tonne across the quarter, compared with prices of as low as $30 to $40 USD a tonne during the 2012-2016 slump.
- World crude steel production for the 64 countries reporting to the World Steel Association was 169.5 million tonnes (Mt) in May 2022, a 3.5% decrease compared to May 2021. With Asia and Oceania experiencing a 6.5% decline in steel production Jan 21 – May 22.[3] While steel demand is expected to continue to grow, albeit marginally in 2022, as detailed further below.
- If steel prices continue to fall sharply with mill losses extending, the Chinese government is expected to set exact numbers for production cuts - like what OPEC did when COVID was at its height in 2020-2021.
- The World Steel Association ranks Russia as the 5th and the Ukraine as the 13th largest steel producers in the world, with their supply mainly removed from the market this will continue to have an impact given world steel demand is expected to increase 0.4% in 2022 and 2.2% in 2023.
- Global growth is expected to finish around 2.9% for 2022 and spark up to circa 4% in 2023 as inflation eases in many regions. In East Asia and Pacific, growth is projected to decelerate to 4.4% in 2022 before increasing to 5.2% in 2023.[4] Growth levels which remain above global averages and rates at which regional steel production will struggle to meet.
- According to the JPMorgan Global PMI™ (compiled by S&P Global), the global economy expanded for a 23rd straight month in May and accelerated for the first time in three months. Generally, manufacturing Purchasing Managers' Indexes (PMIs) are seen as a gauge of flat rolled steel and stainless prices. It appears based on this data that global manufacturing activity and flat rolled pricing is not likely to start on a downward trajectory as of yet.
- Supply shortages of metallurgical coal continue. EU planning to introduce a full import ban of low-priced Russian coal from August 2022, on top of already-tight global supply, with coal supplies coming from more remote locations and coal being bulky and expensive to transport. Coking coal prices are unlikely to continue their drop and may in fact soar further.
- Increased coke prices also affect pricing of iron ore. Prices for different qualities of iron ore products depend upon their iron content as well as their chemical and physical composition (lumps versus fines versus pellets). Lower-quality iron ores require more energy to reduce, leading to higher coke rates in the blast furnace. This increases the cost of finished steel production and likewise, likely it's price.
- While Russia coking coal accounts for a smaller share (12%) of coking coal supply, Russian PCI (Pulverized Coal Injection) accounts for nearly 30% global PCI imports. The ban of Russian PCI will leave a significant supply gap likely filled by, the higher priced Australian PCI,given it is the dominant exporter of PCI. The PCI market currently remains tight with little capacity and Asian buyers are also looking to replace Russian volume. PCI prices are therefore expected to remain high in the coming months.[5]
- The Chinese government has released 33 stimulus measures to boost infrastructure, non-residential construction, and residential building. These measures include a US$396 billion tax relief package, easing of purchase/sales restrictions, lower down payments, and a two-basis point drop of mortgage rates. A cut in the reserve rate requirement for banks which will also release $80 billion of long-term liquidity. In addition, a US $120 billion line of credit has been provided for infrastructure projects. Furthermore, the Chinese state has issued US $44.8 billion worth of railway construction bonds. State agencies like China Energy Investment Corp will build 11 power projects worth US $12.8 billion and the National Energy Administration will invest US

$4.3 billion in solar power projects. The auto market will also benefit from US $8.9 billion worth of reduced taxes on cars and US $13.4 billion of commercial truck loans by government owed car makers. Chinese local authorities are planning to handout billions of yuan in shopping vouchers and subsidies for large ticket items like appliances to shore up retail consumption.[6] This was one of the measures used by the Trump and Biden administrations to fuel rapid consumer demand and quick economic growth in the US - as part of the US $5 trillion the US spent on pandemic relief in 2020 and 2021.In summary the Chinese are re-embarking on their now traditional formula of massive public sector stimulus to jump start their economy.

- In the United States their US $1.9 trillion fiscal stimulus package remains in place. The global economic outlook released by the International Monetary Fund showed that America's economy is expected to expand by 3.7% this year, faster than the roughly 2% trend that prevailed before the pandemic and the 3.3% average expected across advanced economies this year.[7]
- India the second largest steel producer (111 million tonnes) in the world (1/10th the size of China) imposed export tariffs on steel, coal and iron and other steel-making raw materials on 22nd May 2022. Among them, an export tariff of 15% has been levied on carbon steel products like flat-rolled steel and bar. The iron ore export tax has also increased to 50%. All in a bid to reduce the impact of supply shortfalls on domestic manufacturers, as local steel makers chased higher priced export opportunities caused by the impact of the cessation of Russian and Ukraine supply.[8]
- Labour market disruptions from the pandemic – has shocked labour supply among advanced economies, the impact has been relatively larger in the United States, where participation is about 1.5% lower than before the pandemic (about 4 million fewer workers). The employment shortfall will likely persist moving forward and contribute significantly to inflationary pressure due to higher wages pushing up costs and keeping steel market prices high globally.[9]
- Longevity of the Russian-Ukraine conflict looks increasing likely. Russia has built a significant cushion of reserves (US $634.1 billion, representing a US $44.1 billion increase over the past year) and has cut down its exposure to foreign creditors and with their debt at 19.3% of GDP, very low levels by international standards.[10] Russia is well positioned for a protracted conflict. Even if peace is reached in Ukraine by the end of the year, markets are likely to price in political risks for key metal aligned commodities. Futures markets anticipate oil prices to remain elevated for years. There is also a massive rebuild at some stage to consider, unparalleled in Europe since WWII and likely to absorb vast quantities of steel. If Europe's access to Russian energy is not resolved, steel will be pulled from further afield markets.
- The World Bank in their recent 'Commodity Markets Outlook' advised that they expect energy prices to rise more than 50% in 2022 before easing in 2023 and 2024. Non-energy prices, including agriculture and metals, are projected to remain well above their most recent five-year average. In the event of a prolonged war, or additional sanctions on Russia, prices could be even higher and more volatile than currently projected.[11]
- In our last 'Procurement Update' a correlation was established between global oil and finished steel prices. The World Bank also summarised in their Commodity Outlook that Brent crude oil is expected to average US $100 a barrel in 2022. Even at these elevated prices OPEC sees global growth continuing (at reduced levels) and are forecasting increased consumption across 2022-23 of 2 million barrels per day in 2022.[12]
- Commodity hedge funds have been attracting more investment than at any time in the last decade, enticed by red-hot inflation and a futures market offering big profits. Commodity futures in energy and industrial metals traditionally have the most favourable hedging properties during times of high inflation. If inflation remains high, steel feedstock commodities will likely remain the same, if this trend continues, holding up finished product prices. Risk has however amplified in the last week, as speculators shifted trade positions in US Crude oil and a range of industrial metals futures and commodity markets have shifted down significantly from their peaks earlier this year – with rising interest rates increasing investor fears of the likelihood of U.S. and global recession.
- Steel industry downstream inventories are presently heavy as businesses rushed to restock due to the outbreak of the Russian-Ukrainian war. Demand on distributors and likewise mills remains subdued and will likely remain so in the near-term, reducing intake of opportunistic lower priced Asian mill offers, keeping average inventory prices elevated. Many major Chinese steel mills have recently announced a roll over June prices to

July, signalling the bottoming-out and recovery of Chinese steel product markets. Factors which will keep supporting market prices at overall historical highs.

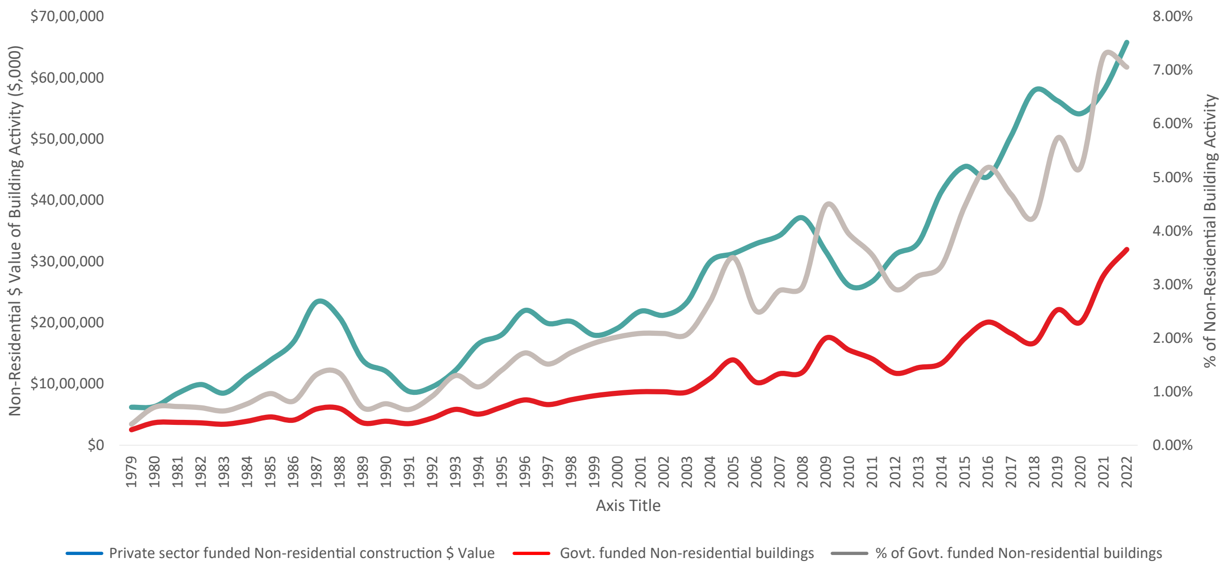
- South Korea serves as a good barometer of worldwide demand, with its manufacturing capability ranging from microchips to displays, refined oil products and steel. The diversity of destinations for its overseas shipments also means its trade performance is something of a heat map for global economic activity. As a result, the increase in daily shipments by 15% in April out of Korea from a year earlier, with a 26.4% gain into the US and a 7.4%[13] increase to the EU, is a positive sign that the global economy is not set for a recessive slide just yet.
- Fitch Ratings expect that the cost of raw materials (iron ore and coal) will remain high and steel prices are too remain "fairly high" in 2022 because of geopolitical tensions and state-mandated measures to reduce carbon emissions – mainly output cuts.[14]
- The cost of decarbonization in the steel industry is also yet to be realised because the programmes, methods and technology is in its infancy. Carbon-free steel refers to the production of one metric tonne of steel that emits less than 0.5 mt of CO^2, which means steelmakers using blast furnaces will need to cut their carbon emissions by over 80% to meet carbon-free steel standards. For instance, blast furnaces using biomass, zero-carbon electricity and CCUS (Carbon Capture, Use and Storage) technology could reduce emissions in pig iron production by close to 80%. Current estimates suggest this would increase the manufacturing cost of steel by US $150/tonne. While hot metal production at DRI (Direct Reduced Iron) plants using green hydrogen as reducing gas could cut CO^2 emission by almost 100%, but the costs will likely be around US $425/tonne higher than a conventional iron-making process. Alternately, DRI plants, using coal, zero-carbon electricity and CCUS, will reduce the CO^2 emission by close to 100%, but the cost could be over US $400/tonne higher.[15] In general NZD landed cost terms for a "Cost Plus" industry, de-carbonization will in the future bring some large cost implications, considerations, but hopefully no consternation.

On the domestic front.

- The cost of transporting goods to New Zealand doubled in the year to December 2021. This has also filtered through into CPI inflation, which rose to 6.9% in December 2021.[16] These costs have accumulated against warehouse inventories and will likely keep ex-stock prices high.
- The supply shock of the Russian invasion of Ukraine on food is only just starting to be realised globally and locally. Global dairy supply is currently very tight, due to combination of bad weather, high feed, and other key input costs such as fertilizer and fuel is constraining production of powder products (3.2% below last year). This has triggered a 2.5% increase in dairy prices. Despite a dip in recent days, prices on the Global Dairy Trade Auction are currently 28% higher than a year ago, ~ 38% higher than the 5-year average, their highest level since 2014.[17] On 6 July Synlait hiked its expected payout for the 2022/23 season by 50c, taking it to $9.50 (KgMS). An injection of "white gold" into the economy should provide not only a positive "trickle down" effect but may hopefully trigger a new round of capital investment by the dairy companies requiring both stainless and carbon steel.
- With exports to China growing 21% over 2021, driven by dairy (up 7%), meat (up 8%), wood (up 22%), machinery (up 15%) coupled with a softer NZ dollar, which has fallen to 19-month lows against many major currencies[18] – it is again welcomed stimulus for growth to our local economy and a trend set to continue – provided geo-political tensions do not boil over.
- From a related perspective, the NZ Performance on Manufacturing Index (PMI) – sub-index for new orders remained in positive territory (53, 55 is the historical average).[19] Despite the shutdown in China and the resulting shipping chaos globally it has caused, impacting inwards receipt of components and outwards shipping of finished products, along with COVID absences in workplaces hamstringing businesses operating to full capacity.
- Building consents in general remain at historical highs (factoring in seasonality), despite shortages of materials and labour becoming a handbrake on how quickly projects can either be completed or started. If any lulls in activity do eventuate, it is more likely these are due to planning and material delays.

- Capacity constraints will likely limit the extent of further rises from the existing elevated levels. Inflation fears with interest rate escalation will possibly postpone project starts, but this may only extend planning timelines and the pipeline of work. Project demand should continue to firm, especially once all sectors of the economy become fully active (tourism and hospitality). With so many projects in train, building activity should continue to rise over the coming months, with some commentary expecting it to continue for "the next few years."[20] Unprecedentedly high consents for multi-level townhouses are nearly at the same number of consents as stand-alone houses. This is a favourable trend in terms of increased steel usage.

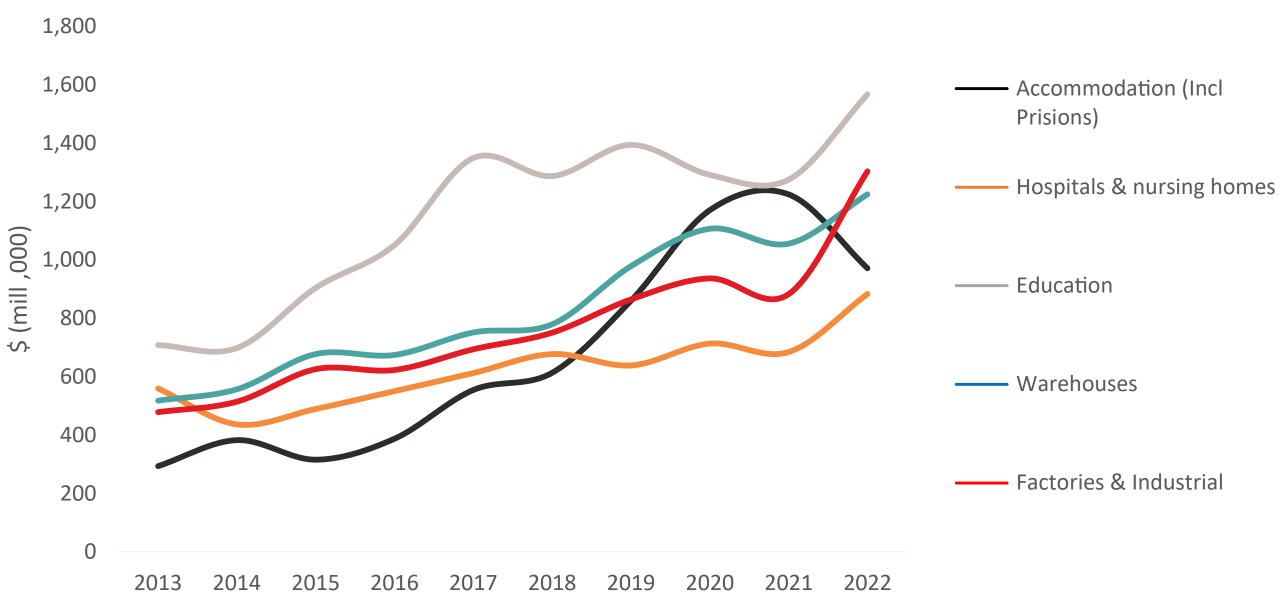
Non-residential Building Consents by Funding Sector



Source Data: Stats NZ

- Whilst the outlook across some segments in non-residential construction is mixed i.e. offices, more importantly for our industry, the overall trend is both very positive and robust, due to the large increase in construction value and the proportion of which is government funded.

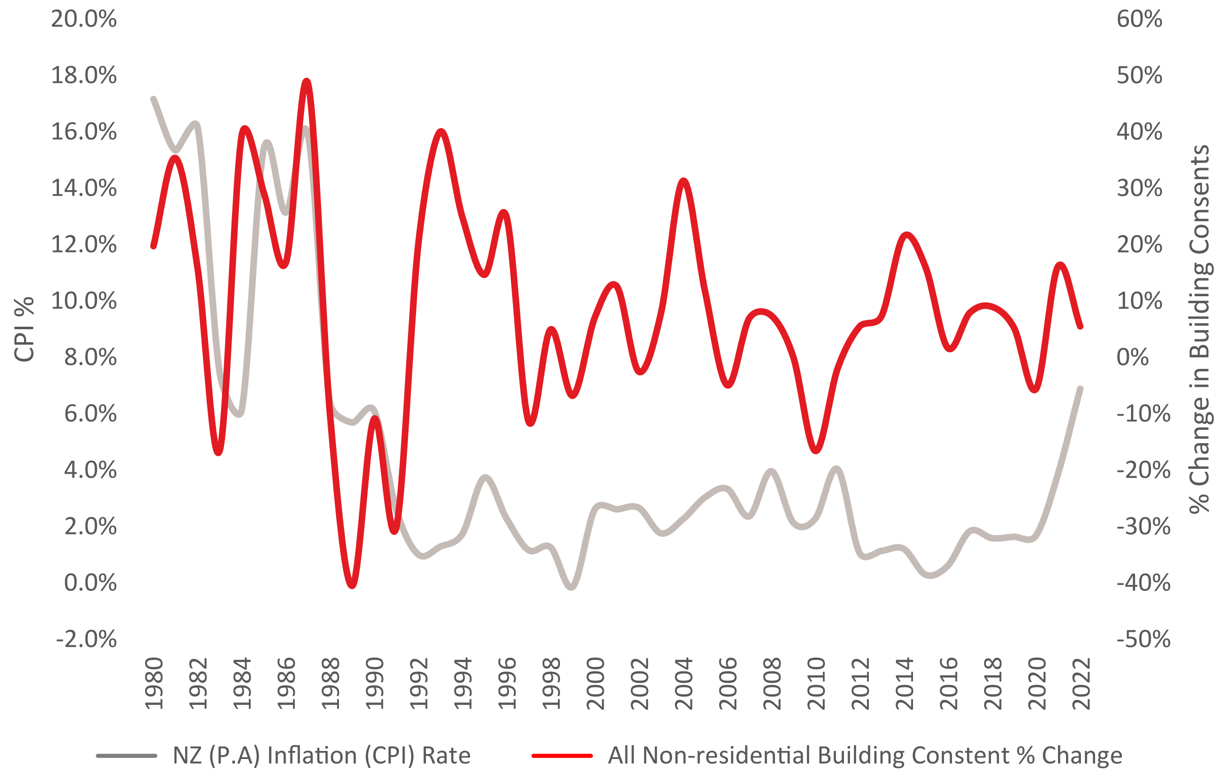
Value of Non-Residential Building Work Put in Place by Type



Source Data: Stats NZ

- Private sector funding has increased the continued popularity in 'big-box' retail and warehousing facilities to manage the on-line retail boom and "just in case" inventory requirements across all industries. Requirements for new food processing and management facilities have also boosted consents. While public sector spend is going into hospitals, education, prisons, and infrastructure projects – all in all both above graphs indicate a collapse in building activity is neither likely nor imminent.
- Other encouraging news, Infometrics recently updated it's 'Infrastructure Pipeline Profile (IPP)' (29 June 2022) predicting a massive $172b spend on infrastructure over next decade – 56% increase on the last decade. Their analysis found almost all infrastructure types are expected to see a sizable boost in investment over the next 10 years, with a large proportion expected to go to roading (44.2%) and around 19% of the total investment expected across water supply, wastewater, and stormwater.
- Whilst high inflationary fears are neither healthy for the economy nor ideal planning environments, the non-residential construction sector has operated with strong activity levels for prolonged periods with high inflation before external market shocks triggered tumbles as shown below.

NZ Non-Residential Building Consent v P.A. Inflation (CPI)

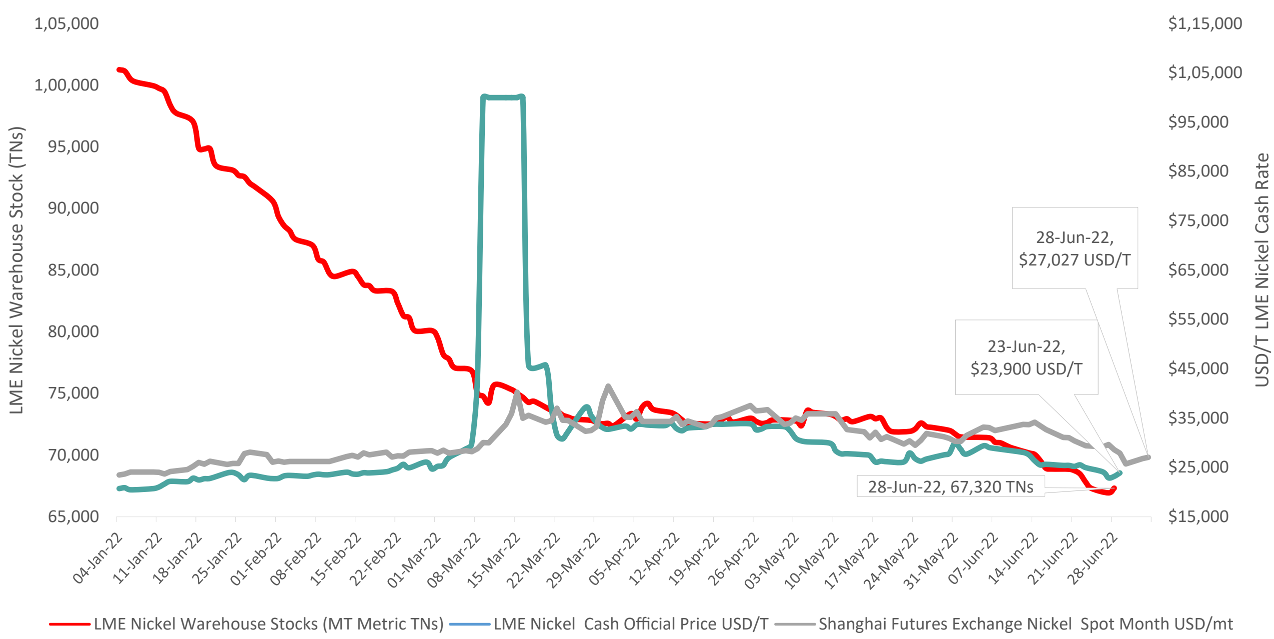


Source Data: Stats NZ

In summary the global and local economy is in a state of "flux", meaning increasing quarterly volatility is likely to prevail, which will likely keep steel and stainless finished product prices at higher than historical levels for the foreseeable future (12 – 24 months). At which point a slide is expected as increasing levels of inflation aided by wage growth and continued business capacity issues, starts to choke real productivity and growth. Unless an external shock like China invading Taiwan eventuates – then an end of cycle slowing in demand and pricing could be possible.

NICKEL

LME Nickel Price & Warehouse Stocks v. SHFE Nickel Price



Source: Argus Media

Three factors have contributed to Nickel's price drop on both the LME (London Metal Exchange) and SHFE (Shanghai Futures Exchange), back to where it was trading before the Russian - Ukraine conflict.

Firstly, China, the producer of influence, manufacturing 56% of all stainless steel, which constitutes 70% of nickel demand, experienced a drop in second quarter production due to weaker demand (-31.6%), particularly from the automotive (EV) sector and ongoing logistics disruptions a result of the April - May lockdown in Shanghai.[19] The second factor has been continued shipments by Russia's Norilsk Nickel, which remains unsanctioned and accounts for 11% of the world's Nickel supply. Thirdly, Indonesia which supplies 40% of global nickel requirements has ramped up output 38.2% in the first two months of 2022 and moved into production of high-grade nickel for battery manufacture.[21]

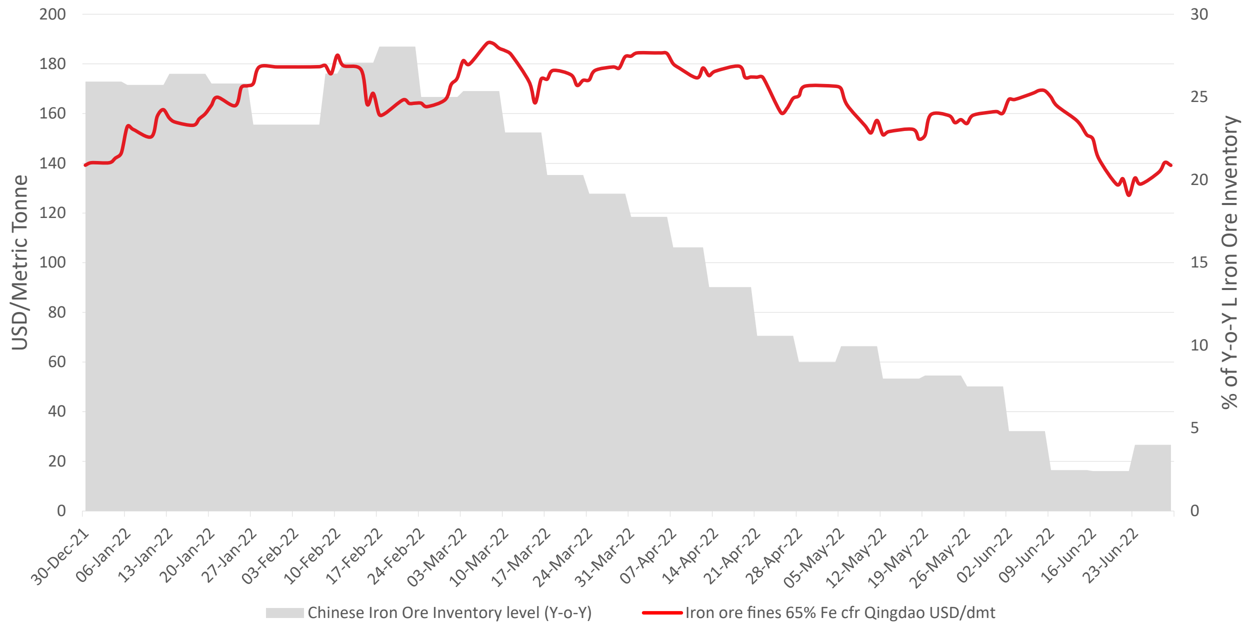
The drop in nickel due to stainless steel demand has partially been offset by the fast-rising off take from the electric vehicle (EV) battery sector. Goldman Sachs forecasts nickel usage in the EV battery sector to increase by 62% this year and by another 26% to 358,000 tonnes in 2023. Adamas Intelligence estimates that 18,610 tonnes of nickel were deployed onto roads globally in the form of batteries in new electric vehicles in March, a 50% increase on March 2021.[22]

As a result, analysis by the International Nickel Study Group expects market usage to grow another 8.6% this year, exceeding the 3.0 million tonne mark for the first time ever. With tax rebates for EV purchases in China set to continue and the issuing of vouchers for appliance purchases – nickel demand and prices will likely bounce back during the third quarter of the year.

At this present point, on the back the back of poor domestic demand in China, Chinese export volumes for stainless steel have increased circa 33%, lowering mill offers in recent weeks to relieve themselves of the inventory they have stockpiled over April and May, putting pressure on regional Asian prices.

IRON ORE

Chinese Iron Ore Spot Pricing & Inventory



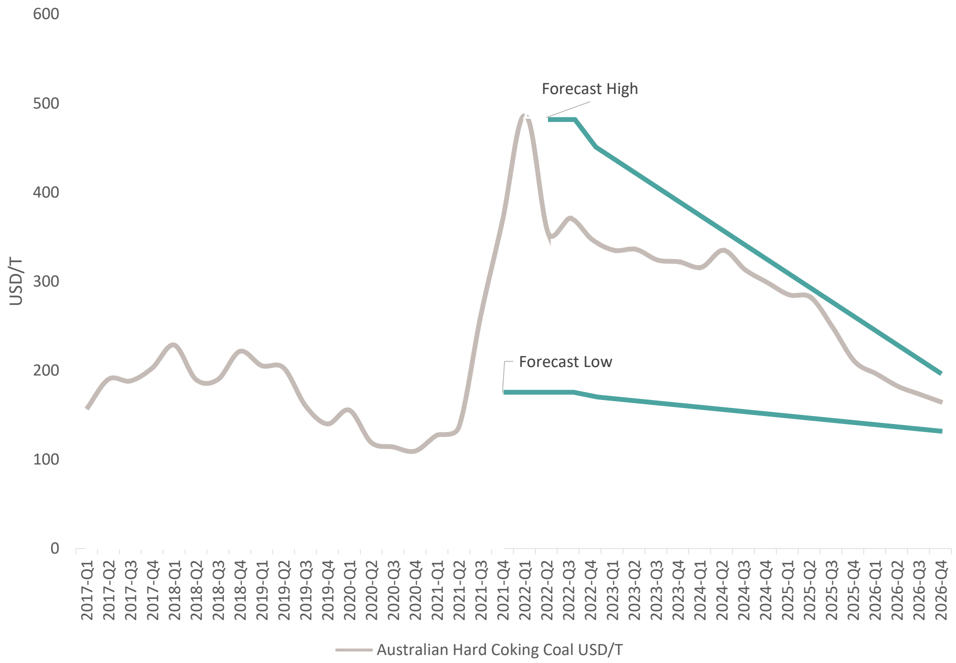
Source Data: MacroMicro & Argus Media

Iron ore inventories in China have been slowly consumed by mills over recent months with fewer vessel arrivals due to the disruptions and subdued demand caused by Omicron lockdowns. Port tonnages are 1.17 million tonnes down compared to the same period last year. Because of a slow resumption of normal demand patterns for finished product and high inventories, more blast furnaces have been put under maintenance programmes, so the demand for new iron ore deliveries has dropped significantly as a result. Iron ore prices have therefore faced pressure in recent months but are showing signs of recovery in recent days. A robust recovery in China's steel production on strong infrastructure spending should drive more price upside by the third quarter.

Longer term - steel demand has grown roughly at the same pace as the global economy, and if a compound annual growth rate of 2.5% is assumed, steel consumption will have more than doubled by 2050. The iron ore industry needs to add 100 million tonnes of new capacity every year just to replace mines that are depleting.[23] The major miners are only investing enough to replace depleting mines and junior producers are not aiming to add much more than relatively small volumes, due to planned decarbonisation within steel mill programmes, this could firm iron ore at higher price levels in the future.

COKING COAL

Metallurgical & Pulverised Coal Injection (PCI) grade USD/MT



Source Data: Argus Media & KPMG

Poor weather in China and demand has seen a sharp adjustment to coking coal pricing over May. The COVID lockdown and the spread in value between domestic and overseas offers of metallurgical (coking) coal, means imports have been limited, affecting both domestic and import price offers. China and India have also reportedly been buying cheap coking coal from Russia as other nations move to ban deliveries due to the war in Ukraine – reducing transactions in the indexes above.[24] China alone imported 1.37 million tonnes of Russian coal in April, a 48% increase on April 2021.[25]

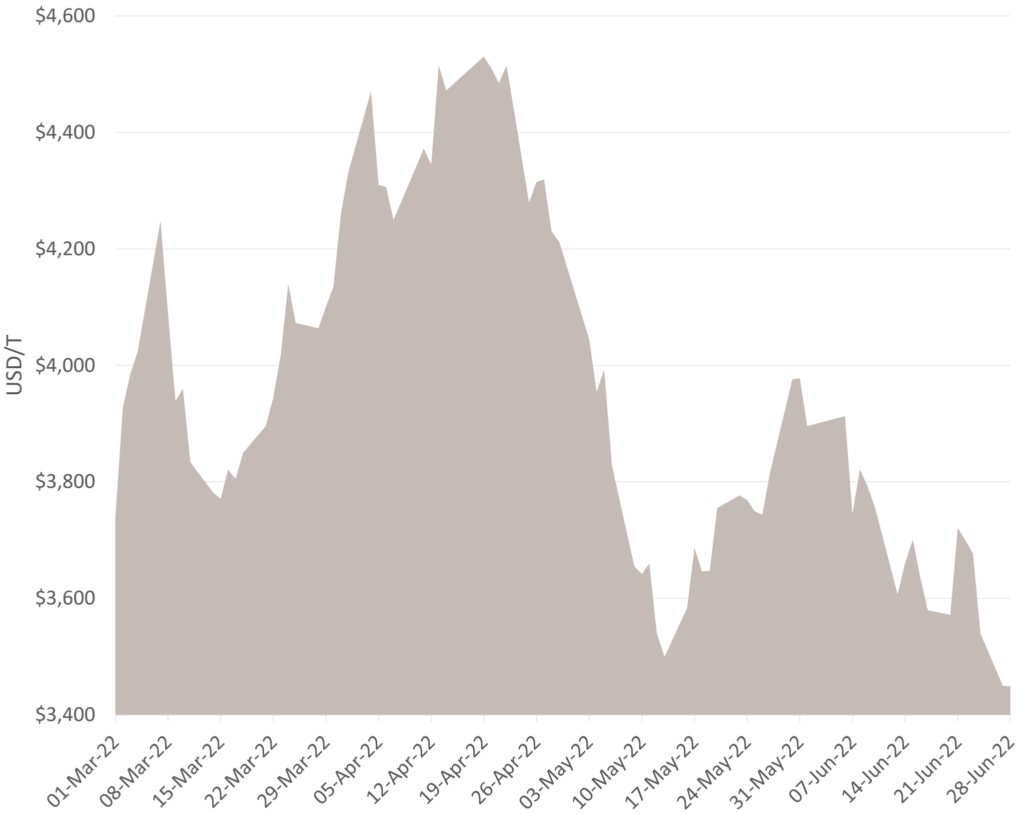
Due to weak market demand and sentiment in coal futures markets, coupled with falling steel prices, some steel companies in Tangshan and surrounding areas have begun to overhaul and reduce operations of their blast furnaces as burning their higher priced coal inventory is putting increasing pressure on margins. Argus Media comment that from the end of June to July, it is estimated that a total of 22 blast furnaces in Tangshan and surrounding areas are scheduled to be put under maintenance, halting production.

More coal is also being sort from non-traditional sources, in response to the spike in pricing and the Ukrainian conflict, Indonesia coal shipments for example are at record highs. All actions which will reduce coal price offers and market indexes in the coming months.

With steel demand set to increase and banks not keen to finance investments into new mines due to government decarbonisation programmes – coal supply will remain tight. Prices should recover in coming quarters with most forecasts out to 2025 at the upper end of the range before sliding back to pre-COVID levels in 2026 – though a wide spread exists between the possible market high and low. Given up to 40% of finished steel prices can be attributed to the coking coal price, it could well be a good indication of how pricing will track in the future.

ZINC

LME Zinc Cash Official Price USD/mt

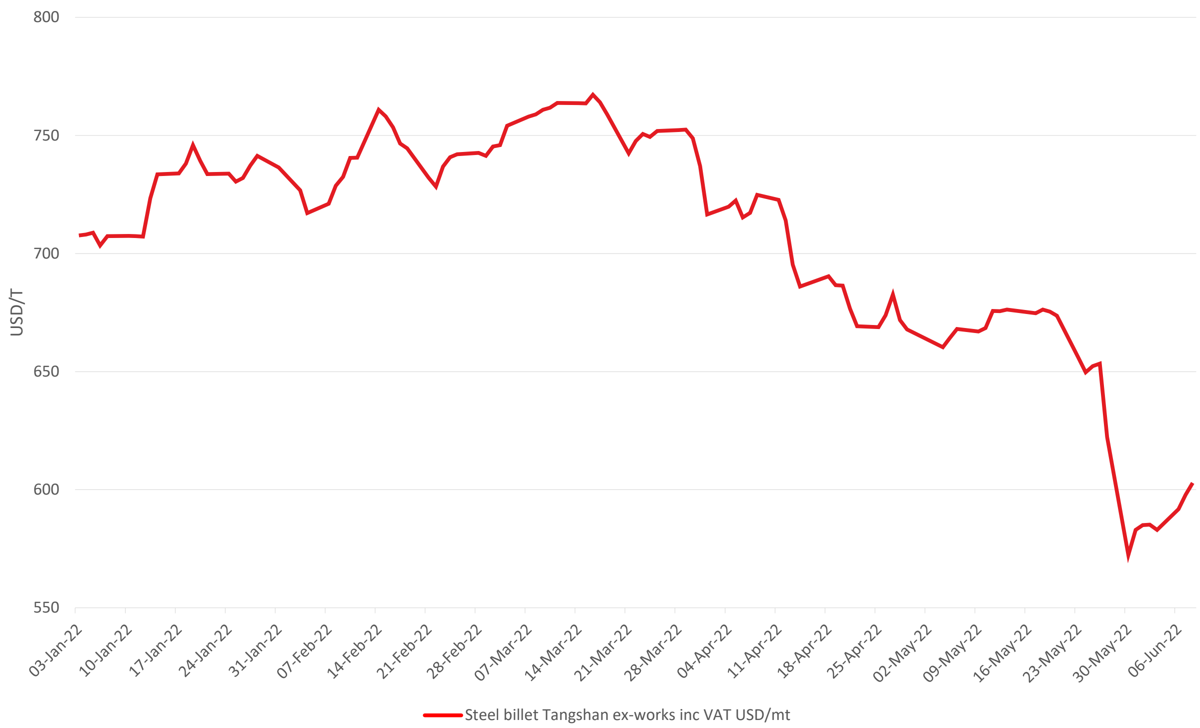


Source: Argus Media

The fluctuation in the LME (London Metal Exchange) Zinc price in recent months is an example of just how much "flux" or volatility there is in the metals market at present. Zinc has come off its lofty peak in April caused by supply concerns due to the conflict in Ukraine and has proceeded to spike up and down as concerns linger over falling LME inventories and possible reductions in smelter output, because of high energy prices. Just where prices will go in the next few weeks or months is any one's guess.

SEMI FINISHED STEEL

Chinese (Tangshan) Steel Billet Price

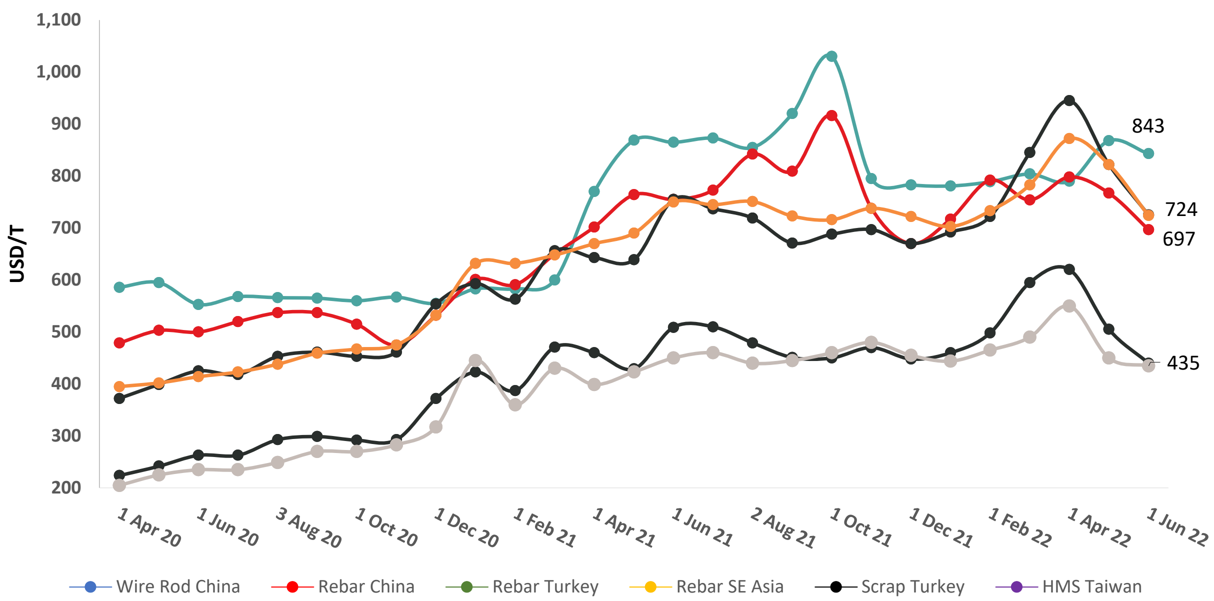


Source: Argus Media

The drop in the Chinese steel billet price illustrates well the interruptions and impact of lockdowns on the Chinese economy and subsequent demand for steel (feedstock) commodities and steel products. While the uptick in price in recent days shows the propensity for the Chinese market to bounce back from lockdowns on the back of government stimulus programmes and inventories thinning out.

FINISHED PRODUCT INDICES

Long Products - Construction Steels



Source: ASN & Argus Media

The weakening in the Taiwanese scrap price in June has come about mainly due to healthy scrap inventory levels coupled with underwhelming demand and sales of finished products. In addition, large Taiwanese steelmakers face a surge of up to 15% in energy bills depending on their consumption rate from 1 July. In the face of these conditions, Taiwanese steelmakers' look set to cut production by 5 – 15%.[26]

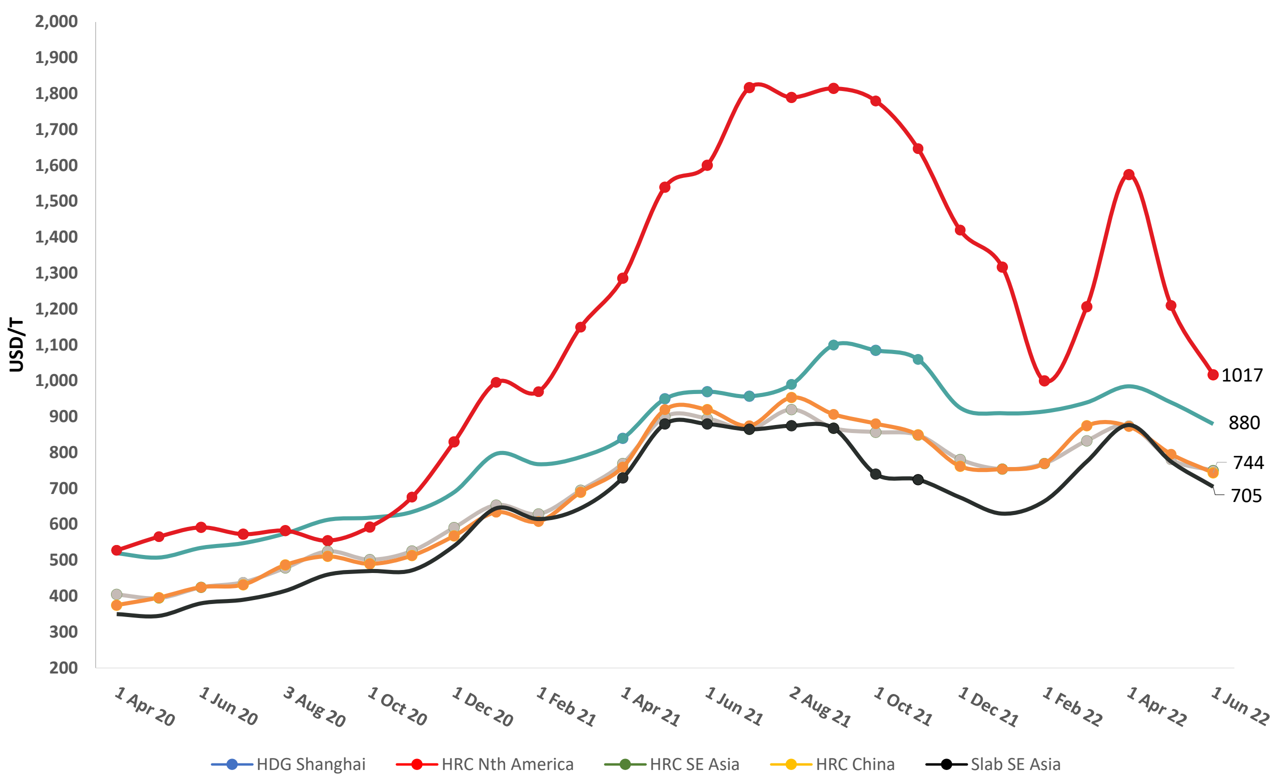
Elsewhere – long product prices, particularly reinforcing bar (rebar) have suffered due to tepid demand on the back of market concerns over the influence of inflation on price levels and interest rates, effecting business construction intentions. There are also healthy inventories downstream as many participants brought product ahead of time to lock in prices and safeguard supply.

In China, inventories held by steel mills increased to over 20 million tonnes by May, up 25% compared to the same time in 2021, according to data from China's Iron and Steel Industry Association. The higher volume of inventories held by mills points to significantly lower sales in China in January to April. Many mills in China have now geared down to 70% capacity levels. As previously stated, 22 blast furnaces were on maintenance from 15 June, reducing hot metal output by 68,800 tonnes/day. There are 11 electric arc furnaces (EAF) on maintenance during the same period, cutting crude steel output by 29,000 t/d. Output cuts at 14 rolling lines that are under maintenance also reduced finished steel output by 21,400 t/d.[27] The mills hope that the production cuts will rebalance supply towards recent softer demand levels. They can only hope that construction activity picks up, to pass on these rising operating costs, rather than take the margin hit themselves – many rebar mills are reportedly back to or below breakeven levels.

On a more positive note, the government funded building programmes announced during the various pandemic breakouts are only starting to get momentum now in many economies. In the US total construction starts rose 3% in April to a seasonally adjusted annual rate of $945.8 billion, according to Dodge Construction Network. Non-residential building starts rose 6%.

S&P Global believes that China's post-Omicron infrastructure stimulus programme will increase steel rebar demand in the China's construction sector over the second half of 2022 settling pricing at levels more reminiscent of historical highs rather than back at the extraordinary peaks seen in the last 12 months.

Flat Products - Manufacturing Steels



Source: ASN & Argus Media

Flat rolled product pricing dipped in May and June with reduced consumption by Chinese manufacturers due to decreased demand for goods domestically from the lockdown-driven downturn and internationally as increasing inflation bites into consumer's disposable incomes.

The PMI, published by the National Bureau of Statistics which is a key indicator of China's major flat steel consumption sectors, due to the mix of businesses surveyed, recorded a positive result (50.2) for June – reflecting a rebound in demand, productivity, and likely future pricing of flat rolled (sheet & plate) products in coming quarters.

SHIPPING

The Russian invasion of Ukraine and the return of COVID lockdowns in China has caused renewed disruption to trade and global shipping. Consequently, supply chain problems are expected to endure and be endured through 2022.

The Chinese lockdowns in various cities from late March through to June accentuated all the issues seen post COVID in supply chains. Blank sailings on vessel schedules, port closures, missed port calls, tight vessel capacity, shipment delays, labour shortages, cartage (trucking) availability issues, warehouse / wharf congestion at ports of origin, container shortages and increased shipment costs.

Several additional factors are now adding to the mix and "flux" within the supply chain environment adding a lot of fluidity and cost, mainly:

- The Russia invasion of Ukraine has increased the cost of shipping freight. Bunker prices make up a significant part of total operational cost in shipping. The fuel bill can easily exceed half of the total operating costs for larger vessels. Fuel prices are trading at double the 10-year averages for heavy sulphur fuel oil (HSFO) and have approached 2008 highs for marine fuel.
- Fuel prices are not the only factor increasing overall shipping costs: the Russia and Ukraine conflict has spurred insurers to hike premiums to between 1% and 5% of the value of the ship compared to pre-conflict levels of 0.25%.[28]
- Lack of Warehouse Space. Ship operators have diligently purchased new containers to address the lack of containers that grew out of the COVID pandemic. Ship operators are now moving eight million more containers than before the pandemic. This increase in containers has led to a shortage in warehouse space to store the containers and inventory, further slowing the movement of goods along supply chains.[29]
- Shipping Industry Issues. Between 2011 and 2018, three shipping alliances increased their share of the shipping container market from 29% to 80%. This has changed the competitive landscape and bargaining positions, making it easier for shippers to increase prices dramatically. With a record high cargo backlog and a limited fleet orderbook in 2022, shipping rates are likely to remain at an elevated level for quite some time, albeit lower than the recent peak – unless geo-political tensions in Asia-Pacific increase.[30]
- Trucking Industry Challenges. The trucking industry is highly cyclical in nature and appears to be plagued globally and locally by a shortage of drivers and equipment – all creating capacity constraints. When combined with spiralling FAF rates – carrier costs continue to increase.

At an operational level however conditions as shown below in the 'Ocean Timeliness Indicator' for cargo readiness out of China are improving. While the graph only shows a four-week average, the index does provide a sense as to whether bottlenecks early in the journey are declining or rising. Analysis by Sea-Intelligence also illustrates that there has been a significant improvement in the number of container ships waiting at port for berths, since between January and April the percentage of the global fleet unavailable due to delays fell from 13.8% to 10.5%. It appears the worst of late 2021 congestion may have passed, but things have yet to return to pre-pandemic levels.

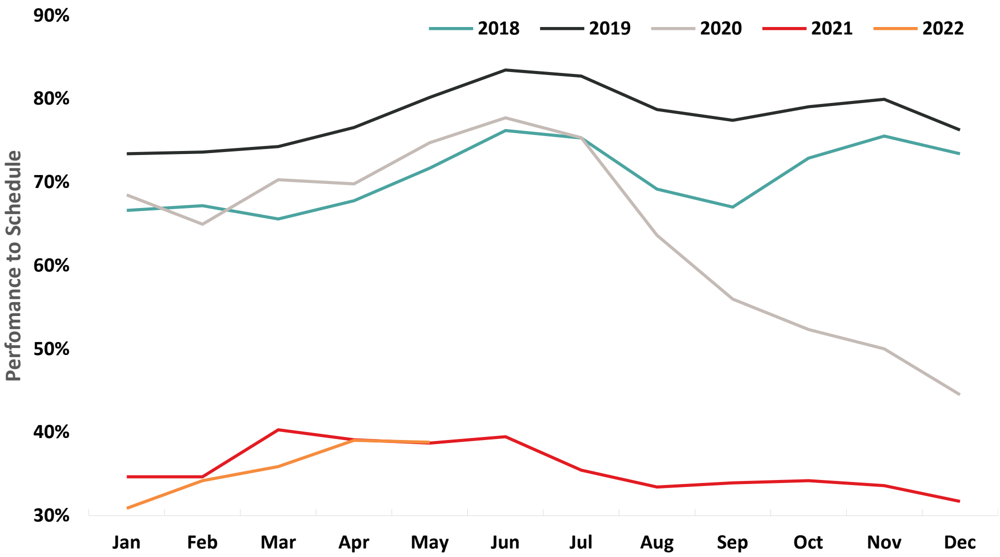
CARGO READY TO ORIGIN PORT DEPARTURE

Transpacific Eastbound (China to U.S.) by Date of Completion

Source: Flexport

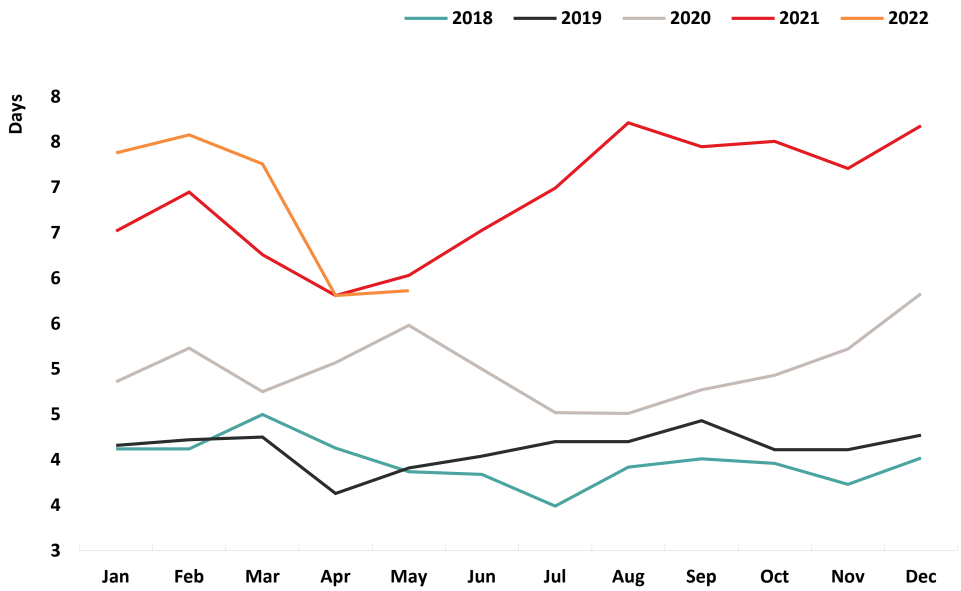
As a result, both schedule reliability is improving and as is vessel arrival date integrity, but again not back to pre-pandemic levels, as the below shows.

Vessel Global Schedule Reliability



Source: Sea-Intelligence

Global Average Delays for Late Vessel Arrivals



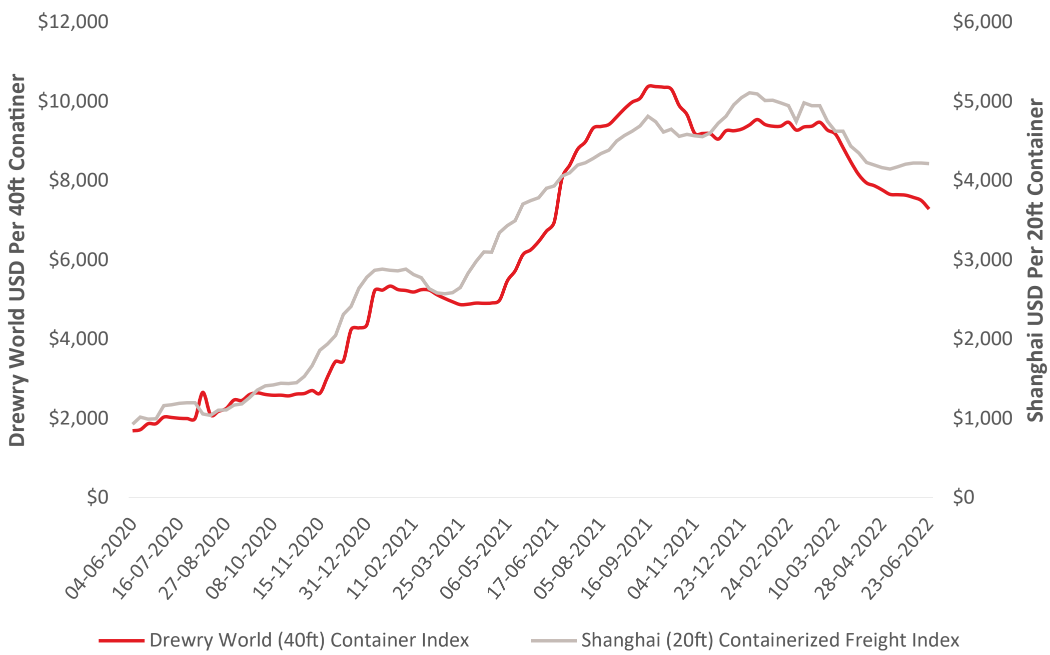
Source: Sea-Intelligence

From a situational perspective the break-bulk and container market balance is expected to remain stable in 2022, while freight rates may face correction depending on how market demand fares.

Although there has been a wave of new vessel orders the majority are for container ships and less than 5% of the current fleet size as new capacity will come online in 2022. All in all, fleet expansion will remain limited across shipping segments in 2022 so this won't derail the markets from the supply side.[31]

In respect to capacity considerations. The strong container market is starting to show signs of weakness with falling consumer demand as spending shifts to services with the COVID protocol removal and building retail inventories. Market expectations are that demand for capacity will decline if prices continue to escalate, and transportation costs rise. Uncertainty is clearly there as reflected in the container rate indexes with a 12.6% drop in the Shanghai Containerized Freight and Drewry Indexes since early November 2021. Rates are also slowing on the time charter market, an important indicator of breakbulk shipping costs. However, early indications are that the reopening of the Chinese market, rates are starting to rebound.

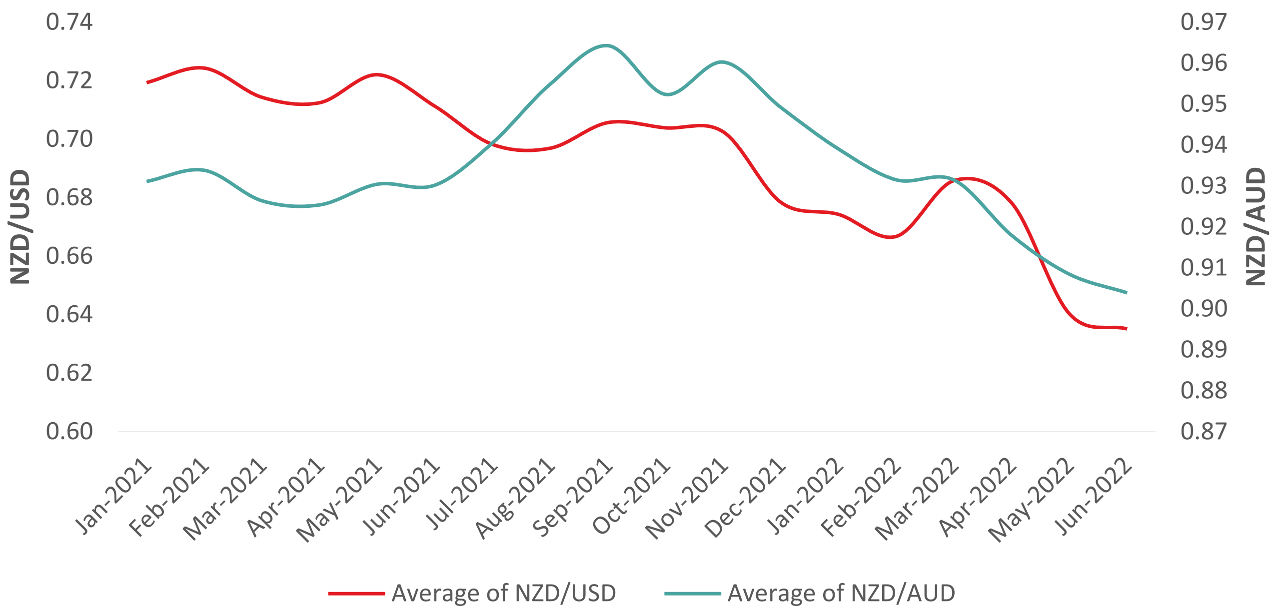
Drewry World (40ft) & Shanghai Containerized (20ft) Freight Index



Source Data: Drewry Multipurpose Forecaster & MacroMicro

FOREIGN EXCHANGE (FX)

Foreign Exchange Rates NZD-AUD-USD



Source Data: RBNZ (Reserve Bank of New Zealand)

The NZD has slipped back and is stabilising against the USD at 0.617 (around 13% decline from recent highs) at the time of writing – lower than it has been for some time, with some forecasters picking the Kiwi to fall lower into the 56c – 60c range. The combination of ongoing concerns over the global ramifications of the Ukraine invasion on key commodity supply and prices is increasing inflationary fears. With expectations that disposable incomes may drop, impacting consumer spending, strangling growth, or otherwise will be fuelled by an upwards wage-price spiral, the US Federal Reserve has begun to tighten monetary policy. As a result markets have become risk adverse and investor confidence fragile. Investors have responded by retreating to more “safe-haven assets” such as the US dollar, depreciating the NZD relative to the USD. This has increased the landed price of imported goods such as steel and stainless, pressuring profit margins.

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

The current conditions both within and outside of New Zealand are likely to continue. Volatile global commodity markets for energy, oil and steel feedstocks are expected to continue to remain at higher than historical levels. Turbulent feedstock prices are likely to impact finished product prices with greater frequency and magnitude given their historical highs and the "flux" conditions caused by the number of changing variables or "additives" in the market melt!.

Price offers from steel mill suppliers will be more changeable depending on their different dynamics within each of the product markets. Increases are still being passed through from steel mills and are exacerbated by a rapid fall in the NZD strength.

If history is anything to go by, we will likely be operating at these elevated price levels where prices will likely fluctuate (depending on how China performs) for a while yet. Assuming no new geo-political conflicts, prices are likely to eventually soften during 2024 as inflationary pressures impact demand, and put a cap on commodity prices and shipping rates.

Steel & Tube will be increasingly vigilant to these market amendments to ensure we maintain continuity of supply and retain business in the face of these changing and challenging conditions.

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

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