PROCUREMENT UPDATE

NOVEMBER 2022

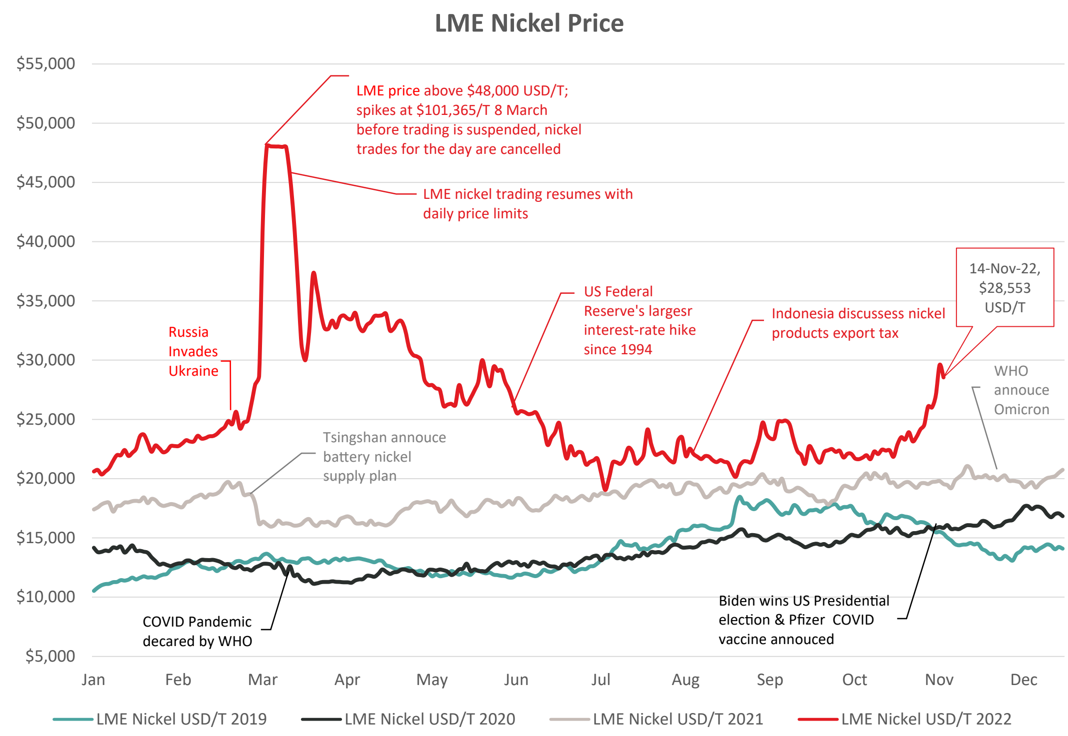
MARKET SUMMARY

Soaring inflation rates, surging interest rates, the war in Ukraine and its impact on energy supply and prices are raising the spectre of recession in Europe, the US and elsewhere. Meanwhile China's strict COVID-19 containment policies have wreaked havoc within China's economy, choking economic growth in the region and reducing Chinese steel demand by 4%.[1] China has pumped trillions of yuan into stimulus programmes and time will tell whether it is able to resume its normal growth trajectory in 2023 after achieving minimal growth by China's standards in 2022.

For mills, the need to fill capacity has seen peak prices descend, despite input costs not abating. This scenario, on top of eroding demand, has already caused a wave of capacity curtailments. Recent steel price declines have potentially reached their bottom and could possibly see some incremental increases from current levels as supply adjustments are made.

Meanwhile, the slowdown in industrial output (Purchasing Managers Index rates) and freight has already been underway for at least the last 3-6 months in most countries, with substantially dropping sea freight orders and rates – an indicator for forward-looking economic conditions. WTO (World Trade Organisation) economists now predict global trade volume growth of 3.5% in 2022. For 2023, however, they foresee a 1.0% increase – down sharply from the previous estimate of 3.4%.[2] The WSA (World Steel Association) has downgraded steel demand in 2022 by 2.3% and predicted 2023 growth will be 1% instead of 2.2% based on infrastructure spend. This means that whatever price movements take effect across 2023 will likely be closer to historical increases.[3]

Nickle

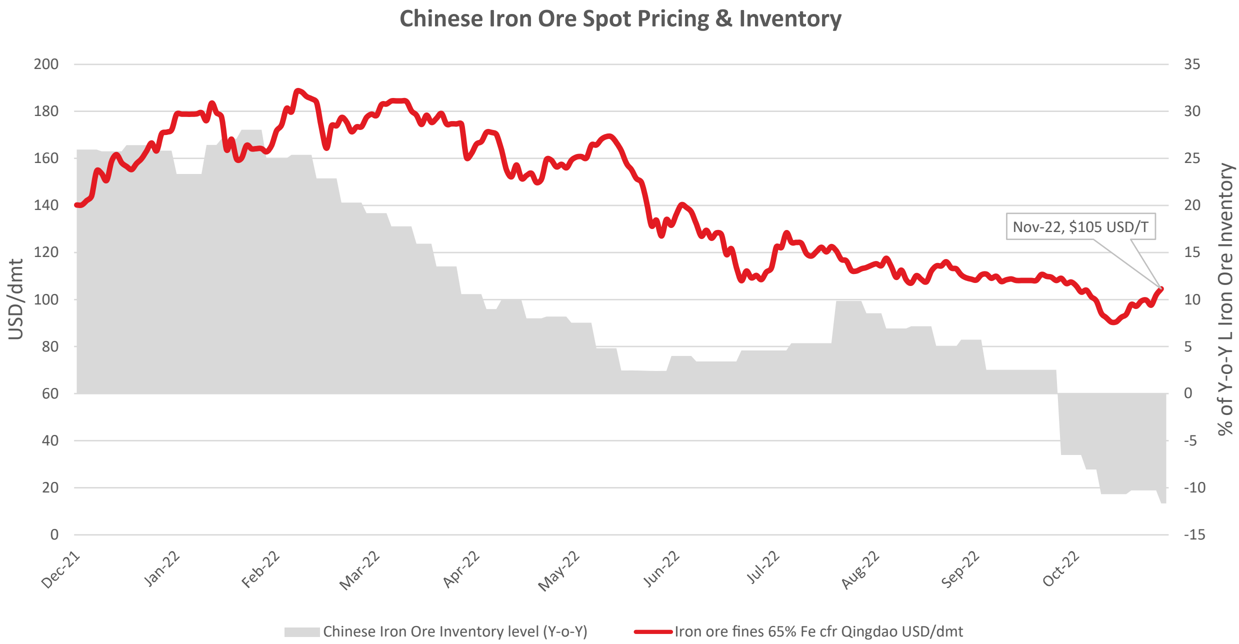


Source: Concept from S&P Global – adapted by author using data by Argus Media

World nickel usage has grown steadily since 2009. 70% of nickel usage in 2021 went into manufacturing finished stainless steel; however, demand for electric vehicle batteries surpassed 11% market share in 2021 and is growing significantly.[4] With this strong base demand, prices of stainless steel and other related commodities overseas have started to arrest their recent decline and are now again trending (slightly) upwards.

As above, "fickle" Nickel has become increasingly volatile over 2022. World events are promptly reflected in price movements benchmarked against prior years. As such, demand for Nickel was expected to soften due to headwinds from monetary tightening and risks of recession. In recent months, however, the Nickel price has firmed and is trending upwards. This has seen several analysts including Fitch Solutions and Trading Economics setting an estimated price range between $24,000 to $28,000 USD/T over the next 12 months. As such, it is unlikely stainless pricing will return to pre-COVID levels in the immediate future.

Iron Ore

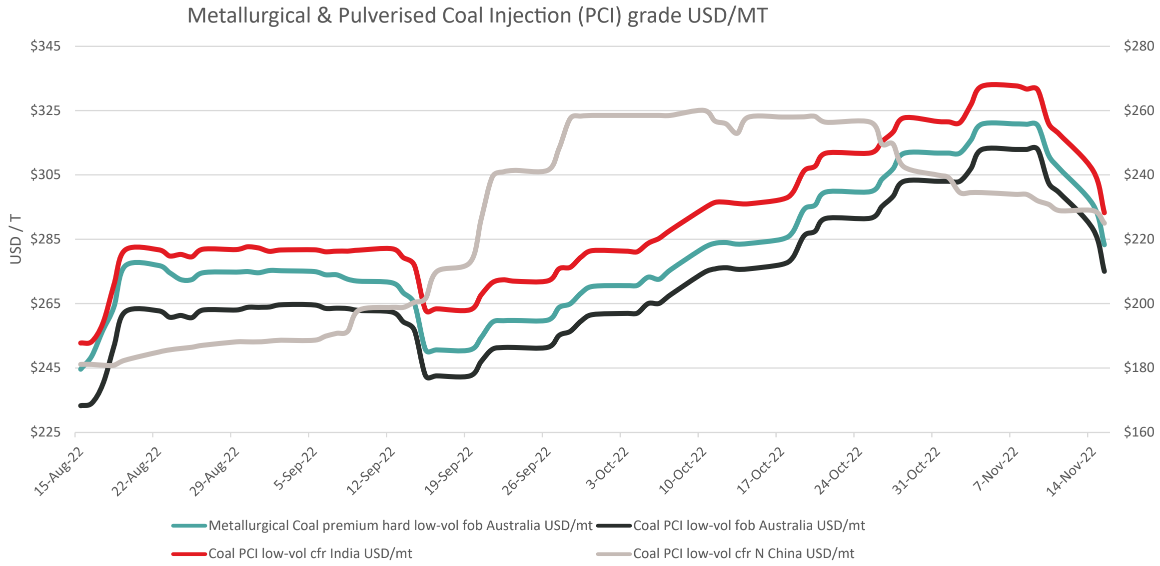


Source: MacroMicro & Argus Media

China accounts for nearly 50% of steel production, over 85% of this is from integrated BOS (iron ore) furnaces. Chinese demand has a strong bearing on iron ore prices. The Caixin Manufacturing PMI (Purchasing Manager's Index) therefore is a good indicator of factors influencing current and future pricing. The PMI for China's manufacturing sector came in at 49.2 in October, down from 50.1 in September, according to data from the China's National Bureau of Statistics. Reportedly the sporadic and scattered COVID-19 outbreaks across China weighed on the October reading. Another cause for the decline is a contraction in energy-intensive industries, such as steel manufacture, with the sub-reading at 48.8, down from 50.6 in September.[5]

As above, ore inventories are still depleting, supporting an uptick in prices due to restocking to support baseline manufacturing rates. Reuters also reported that Chinese steel mills stepped up utilisation rates during September, typically the start of China's peak construction season, and are expecting demand to pick up and government stimulus measures to boost infrastructure activity. October saw a rout in prices on concerns about weakening steel demand domestically (in China) due to COVID-19 curbs and a property sector downturn. Iron ore prices regained some strength in November.

Coking Coal



Source: Argus Media

The major miners in Australia (who produce 70% of the worlds metallurgical coal) have just released their Q1 FY23 (July-September) results and the overall production of coking coal for the quarter has recorded a considerable fall. Issues such as weather-related supply disruptions coupled with labour shortages have adversely impacted production – reducing supply and increasing recent price offers. Such cost increases are squeezing mill margins as finished product prices slide. It is estimated nearly 30% of Chinese steel capacity is being produced below breakeven points, precipitating production cuts, equivalent to 62 million tonnes of finished product.[6]

STEEL PRODUCT INDICES

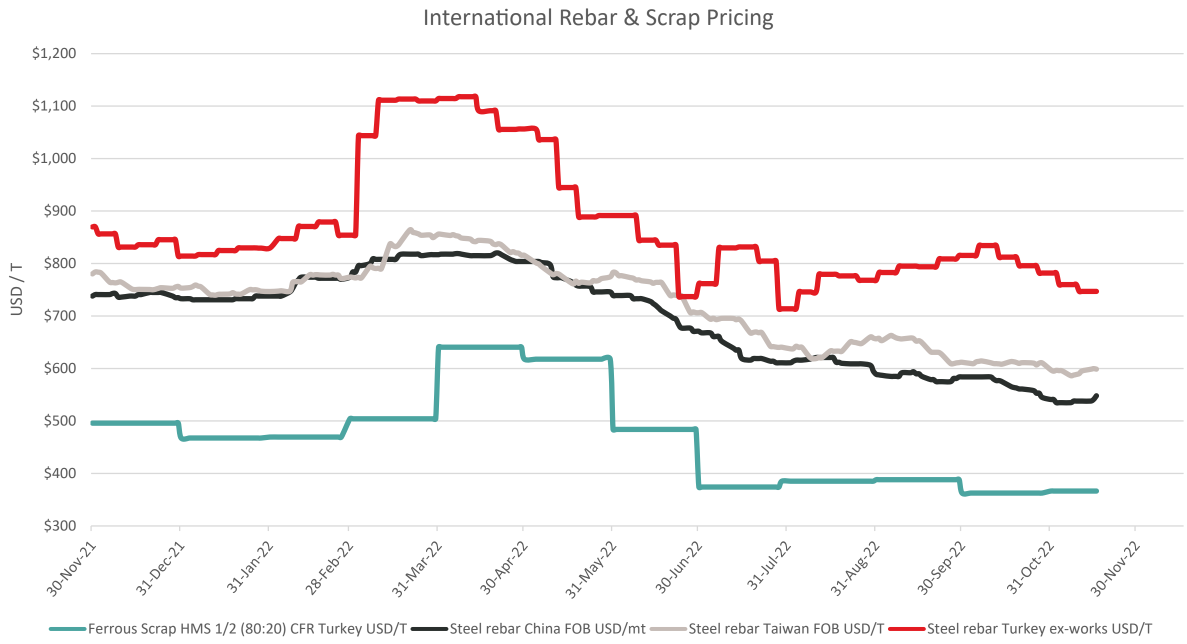
Scrap, Billet, CRC & HRC

Prices of scrap steel, billet, hot rolled steel and cold rolled steel show almost identical movements and have a high correlation – hence the following graph focusing on the most critical market for our region, China.

Source Concept MacroMicro – adapted by author, data Argus Media

China's domestic scrap steel finished product flat rolled prices have started to move up in recent weeks as expectations grow that China could relax COVID-19 restrictions and mills replenish feedstocks at low pricing in anticipation of a spike in demand. Especially with mills in some regions being asked to restrict production because of pollution warnings from authorities. Scrap prices had previously been weak predominantly due to soft demand by the manufacturing sector for flat rolled products.

Long Products – Rebar - Construction Steels



Source Argus Media

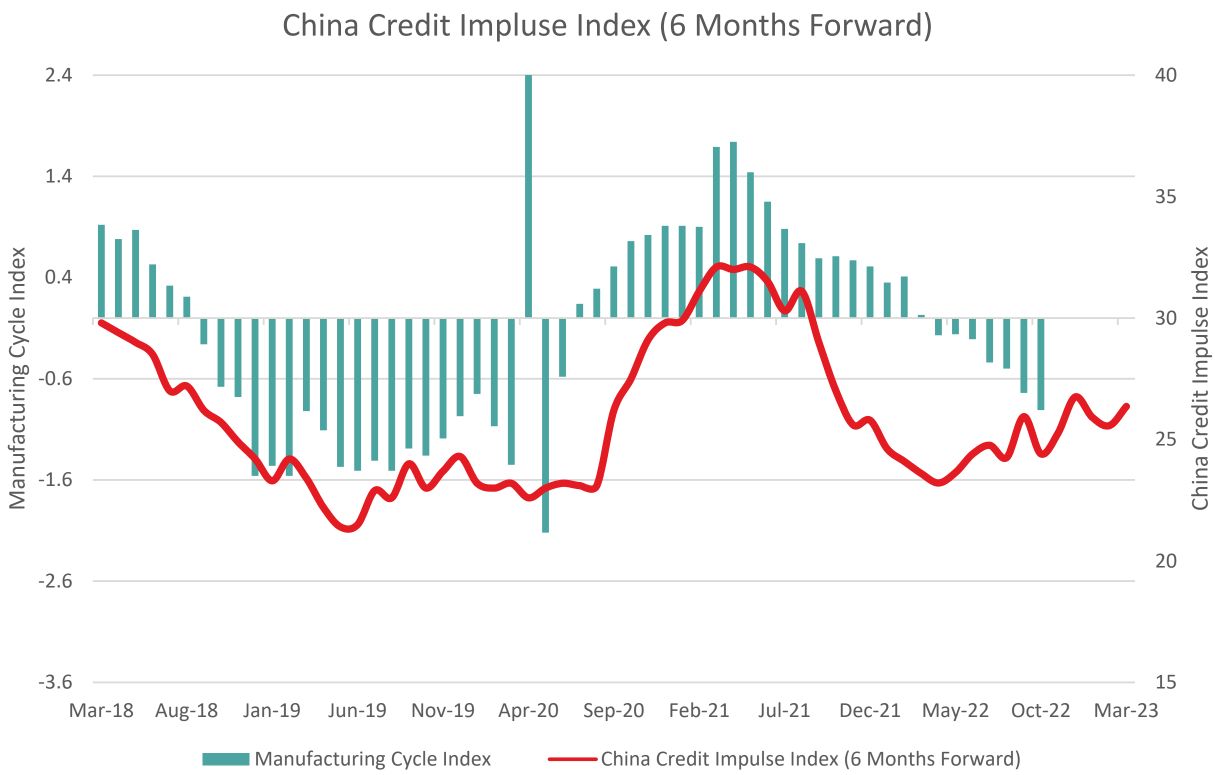
Steel rebar futures and finished product prices started to increase at the start of November, rebounding from a $2^{1/2}$ year low in October after Chinese officials emphasised that China will keep its property market stable and remained committed to pro-growth strategies, through government funded lines of credit and state interest infrastructure projects, a situation being mirrored in many Asia-Pacific countries.

Europe on the other hand, with the combination of rising interest rates, high inflation and uncertainty regarding a worsening recession, has seen construction activity drop. Mills have cut production, but this has yet to affect (Turkish) prices so far, likely due to demand being so low. The potential for surging energy costs and market commentary that international scrap prices are going to increase soon has made European mills resistant to further price falls.

Market Indexes

PMI results globally in the majority of international markets have moved into a period of contraction after a slowdown in global economic activity continued for the third consecutive month. The Global HIS Markit PMI, from being at a high of 56 in May 2021, has now slipped below 50 points (above 50 signals a positive outlook and likely sector expansion). As noted earlier, a continued reduction in international tradeflows in the face of mounting economic, inflationary and geo-political pressures, is lowering business optimism to its lowest level globally in 28 months – international steel markets are not immune.

There does seem to be some positive news on the horizon. The graph below – 'China Credit Impulse Index' – is a leading indicator of the global manufacturing industry. According to historical evidence, the China Credit Impulse Index leads the manufacturing cycle by 6 to 12 months. The Chinese government's stimulus plans, which are freeing up credit within China, are showing some signs of sparking a recovery in manufacturing activity and therefore flat rolled product demand. The earlier graph (Scrap, Billet, CRC & HRC) is hinting at the early signs of this recovery.



Source: MarcoMicro

Shipping

The worsening economic conditions and full inventories globally has put pressure on container shippers, where the fall in demand has forced a significant reduction in container rates. The container shipping indexes such as Drewry, have now fallen more than 40% since the end of January, although freight costs are still more than double compared with October 2019, before the pandemic.[7]

With sea freight cargo reducing by nearly 20% globally on prior months, shippers are cancelling as many as 50% of sailings to rebalance vessel capacity to demand and stabilise rates.[8] This scenario may replicate for our region as volumes drop, causing future delivery disruptions should blank sailings increase. In general, import demand for the Asia Pacific – Oceania region is reportedly flat for Australia and NZ is stable. This has kept sailing schedules intact and maintained pressure on ports. The 'Drewry Oceania Port Throughput Index' has, however, climbed 10.4% MoM to 152.3 points in August 2022, up 12.5% YoY, which indicates that the movement of cargo off wharf and overall product lead times are improving.[9]

It is worth noting that as sea freight is generally inelastic, it has proved to be a reliable indicator of forward economic activity – it will be interesting to see whether the recent 20% reduction in shipping activity will be reflected elsewhere in the economy.

Foreign Exchange (FX)

The strong appreciation of the US dollar (to all currencies) since Feb-22 with the start of the Ukraine conflict appears to have come to an end. US inflation looks like it has peaked and with their economy slowing, the Federal Reserve has started to signal a pause on the rapid increases in interest rates to tighten monetary policy.

Over the course of 2022, the depreciating NZD (to the USD) has contributed to increasing steel landed prices and offset any decreases in recent months of international steel prices beginning to trend down. This however is set to change due to the recent depreciation of the US dollar and the ongoing movement in finished steel prices and freight rates. At the time of writing the NZD USD is still almost 12% weaker than it was a year ago so the appreciation would need to be significant to return to 2021 levels.

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

With inflation yet to peak in NZ and the RBNZ likely to tighten monetary policy further, the NZD has the potential to appreciate further versus the USD. This may put pressure on the landed cost of steel although it will remain to be seen whether the appreciation of the NZD will be maintained. The possible counter to this is moderate recovery of steel feedstock commodities and finished product prices ex-Asia which are in their infancy and likely to influence landed product prices midway through 2023. Stainless steel prices are likely to trend upwards in the medium term with the recent Nickel price recovery.

What is apparent is that product availability is no longer an immediate concern and there are a plethora of economic factors impacting the outcomes for businesses at present which has removed some of the price volatility from the market. Where supplier pricing does adjust, these movements are expected to be less universal in nature than what we have recently experienced and instead more reflective of the specific cost elements being realised to ensure competitive pricing is maintained.

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

Sources:

1. World Steel – 'Global steel demand downgraded, to drop 2.3% in 2022' – 19 October 2022
2. World Trade Organisation – 'Trade growth to slow sharply in 2023 as global economy faces strong headwinds' – 5 October 2022
3. World Steel – 'Global steel demand downgraded, to drop 2.3% in 2022' – 19 October 2022
4. Stainless Steel World – 'The world nickel market in 2022 – return to surplus expected' – June 2022
5. Reuters – 'China's Oct factory activity shrinks as COVID curbs hit output, demand – Caixin PMI' – 1 November 2022
6. Business Standard – 'Don't see further steel price correction' – 23 October 2022
7. CNBC – 'Ocean freight orders are signalling a big drop in consumer demand' – 3 October 2022
8. Reuters – 'Global manufactured freight has started to fall' – 20 October 2022
9. Drewry – 'Port Throughput Indices' – October 2022

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