

## **Developments in the Russian steel industry**

Market Report at the 66<sup>th</sup> Session of the OECD Steel Committee Meeting

8 June 2009

Anton Bazulev

Executive Vice-President, RSPP Steel Committee

Mr. Chairman, dear Colleagues,

As I am a first-time attendee of OECD Steel Committee meeting, I unfortunately don't have with me the report that can provide the same level of momentum cut on the Russian steel industry, that however is very similar in trends, I would like to use this opportunity to share with you a more broad observation of the Russian steel industry and the ways forward.

During the last industry cycle Russian steel industry has undergone considerable changes. Favorable conditions in global steel market were coupled by substantial economic growth in Russia. These factors determined the trends in development of the sector which involved increase in investments aimed at upgrading steel mills, construction of new facilities to fill the gap in production of high value-added products, enhancing energy efficiency, productivity and industrial safety, reducing the environmental impact.

The main achievements during this development are:

Due to substantial investments in development of basic oxygen furnace (BOF) and electric arc furnace facilities the share of open-hearth furnace production reduced by 25% from 26% to current 18% and keeps declining. We expect it to fall to 3-4% by 2015.

Also since 2001 the output of finished products kept rising, especially in segments where Russian producers could not meet the demand of domestic consumers. The output of flat galvanized sheet increased by 80%, tempered rebar – 10-fold, seamless pipes – by 33%, hot-rolled wide thick plate – by 100%. Total consumption of finished steel products in Russia increased from 27 to 34 million tonnes, or by 31%.

All major Russian companies focused on vertical integration with raw material assets, ensuring full or partial raw material self-sufficiency and reduction of operational costs. Many of them also have made substantial progress in downstream integration in Russia and abroad seeking additional advantages and synergies. Today Russian steel companies have a substantial stake in steel industry of a number of countries of the world. This allowed Russian steel industry to actively participate in steel production cycle on the world level.

At the same time, Russian steel production grew rather slowly, by 16% during 2001 - 2008, while in China it increased during the same period by 232%, in India - by 100%. It is explained largely by relatively low steel consumption in Russia and difficulties accessing export markets, both natural and regulatory. Moreover, the growth of new capacities was coupled by closures of inefficient ones. In 2008 the production at 6 major Russian companies accounted for 75% of the country's total steel output.

Modern and efficient kind of steel production, electric arc furnace, has also evolved in Russia. In developed economies the share of EAF steelmaking increases due to rising resources of obsolete scrap, proximity to end-users as well as need for more flexible approach to steel output in line with market fluctuations. Today Russian electrical steelmaking already accounts for 19 million tons per year, which means a 125% growth since 2001. By the year 2015 we expect the share of EAF production to reach 35% of consumption.

During the last 8 years Russian steel companies invested more than USD 24 bn in development and upgrading of production, focusing on increasing efficiency and developing new products. The investments increased along with the rise in their profits and strengthening of their positions in the Russian and global markets.

At the same time Russia is in no way isolated from steel imports. On the contrary, fed by dynamic rise in steel consumption the level of Russian steel imports keeps at a very high level - 19% of national consumption, which is much higher than in the EU - 8%, or China -6%. Moreover, due to high level of imports of finished steel goods, Russia purchases annually the equivalent of around 5 million tonnes of steel in finished goods, which accounts for 15% of total domestic steel consumption. We may say that Russia is not only a major global steel producer and exporter, but also a major market for world steel companies.

As to Russian steel exports, during the last 8 years it did not undergo substantial changes, remaining at the level of 25-30 m. tons per year. It is important to note that Russia is mainly an exporter of semi-finished products which are used in other countries for downstream production of finished products, pipes and other goods. In 2008 in either way semi-finished goods accounted for around 70% of Russian steel exports. Thus, Russia is an active player in global division of labor, supplying to other countries products which bring added value not only to Russian suppliers but also to its partners in global role-sharing.

Thus we may conclude that during the past 7-8 years Russian steel industry enjoyed a steady development on the basis of good production base, sufficiency in major raw materials, internal investment activities, new technologies, in conditions of tough competition in the domestic and global markets.

After the outbreak of the crisis Russian steel mills showed high flexibility and ability to adapt to new conditions. From November 2008 to February 2009, at least 11 Russian blast furnaces were temporarily stopped to cope with the fall in demand. Also 8 coking batteries were shut down, which accounts to 10% of total capacity. Capacity utilization rate of major companies declined to 50-60%. Some of the least effective companies faced serious difficulties. At the same time, leading companies which account for more than 85% of national crude steel production now, partially restoring output and sales volumes, reduced stocks. However we expect the total steel output this year to fall by at least 20%.

Even in case of unfavorable scenario in the global economy in the coming years, we can expect further development of Russian steel industry aimed at lowering production costs, higher energy and raw materials efficiency, strengthening vertical integration and developing new products. Starts of new equipment are scheduled at many Russian mills in

the nearest future, which include blast furnaces (BFs) and electric arc furnaces (EAFs), pulverized coal injection units, rolling mills, hot-dip galvanized units, restructuring and substituting inefficient capacities.

At the same time, the landscape of global steel industry has changed dramatically.

During the past several years China has emerged as an absolute global leader in steel production and a major factor influencing the global steel prices, being both the largest market for world steel trade first, and then becoming one of the biggest suppliers of steel to the global market. Recently we witnessed the considerable efforts of the Chinese Government to change the trends of development of its national steel industry. The influence of the Chinese regulating authorities on further development of the global steel industry is difficult to overestimate. Active Intergovernmental dialog is of the utmost importance in this context.

Consolidation in the iron ore mining sector, that is continuing for the past several years, along with exhausting traditional raw material resources in many countries, are placing many global steel producers in conditions when their added value is re-distributed in favour of mining and transportation companies. This issue requires thorough attention of the industry and the Governments.

The efforts for restructuring and closure of ineffective capacities in the recent years cannot be admitted as sufficient and effective; we will see the proof to this in the operational results of many steel companies this year. During the past several years of favorable market conditions restructuring moved to the background, and in many cases was even replaced with support of inefficient capacities. This situation should be changed urgently. And there is very important that it is changed not by an outbreak of protectionism but by real support for restructuring and shutdown of inefficient capacities. The ways of this restructuring should be urgently addressed on the international level. And a considerable portion of stimulus measures, allocated by the Governments should be directed to the support of this restructuring.

In conclusion we believe it is currently extremely essential to enhance the intergovernmental dialogue on steel industry and resume the search for effective ways for the sector out of the crisis. In this connection the OECD Steel Committee can become one of the key instruments. We are ready for an open discussion with all the participants of this forum on ways to activate the OECD mechanisms to address these issues.

Thank you for your attention.