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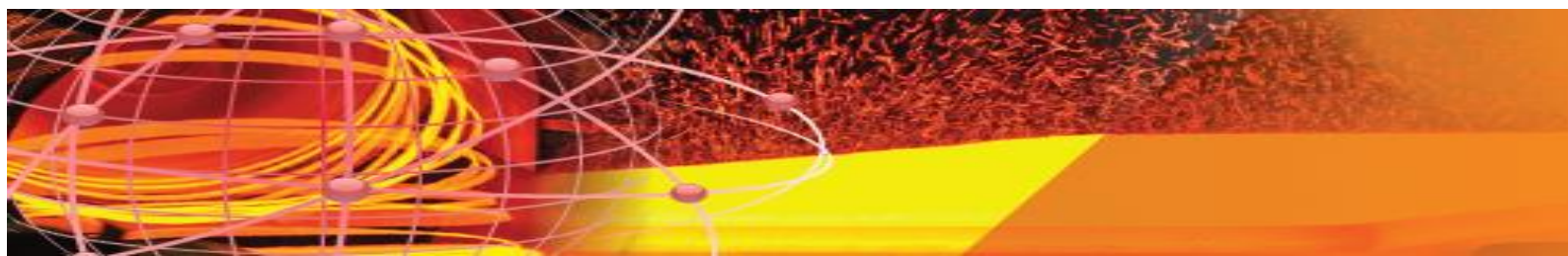
Excess Capacity and Structural Adjustment in the Steel Sector

18 April 2016, Brussels, Belgium

BACKGROUND NOTE NO. 1

LATEST GLOBAL STEEL MARKET DEVELOPMENTS

This background document on **Latest Global Steel Market Developments** overviews current trends in the world steel market. It serves as background information for the discussions under Session 1, *The Current Situation: Global Steel Market, Capacity and Trade Developments*.



Economic background

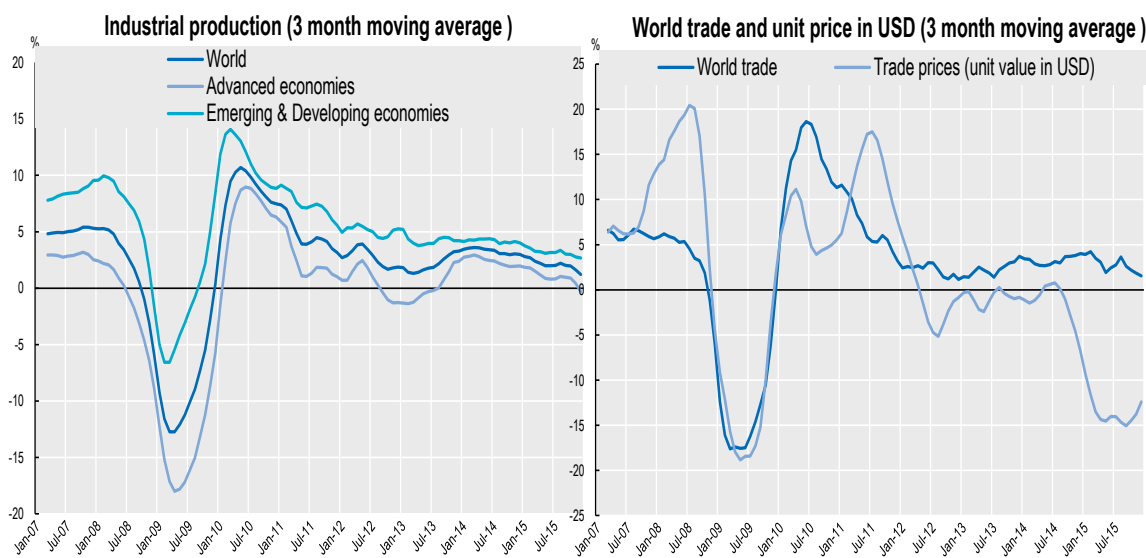
The outlook for the steel sector has weakened further in recent months, in line with deteriorating economic growth prospects. In February 2016, the OECD lowered its forecasts for world economic growth in 2016 and 2017, in light of disappointing economic data as well as recent weakness and volatility in global financial markets in both advanced and emerging economies (OECD, 2016). Global GDP growth in 2016 is now expected to remain at the same rate as 2015, at 3%, the lowest rates of growth observed over the past five years and well below long-run averages. World GDP growth is expected to pick up marginally to 3.3% in 2017.

In the advanced economies, investment and productivity growth is subdued, constraining the momentum of economic recovery in those countries. Growth in the emerging economies continues to slow, with lower commodity prices and a tightening of financial conditions contributing to sharp corrections in demand.

The sluggish pace of global economic growth has been reflected in weak trade and industrial production growth, and has contributed to falling commodity prices (see the figure below). The contraction in imports by China and other emerging market economies has led to weaker export demand for advanced economies, reducing economic growth in many OECD countries. Falling commodity prices should support consumption in commodity-consuming economies but are expected to restrain investment and add to financial pressures in commodity-producing economies.

Sluggish GDP growth is weighing on industrial production and trade

% change from one year earlier



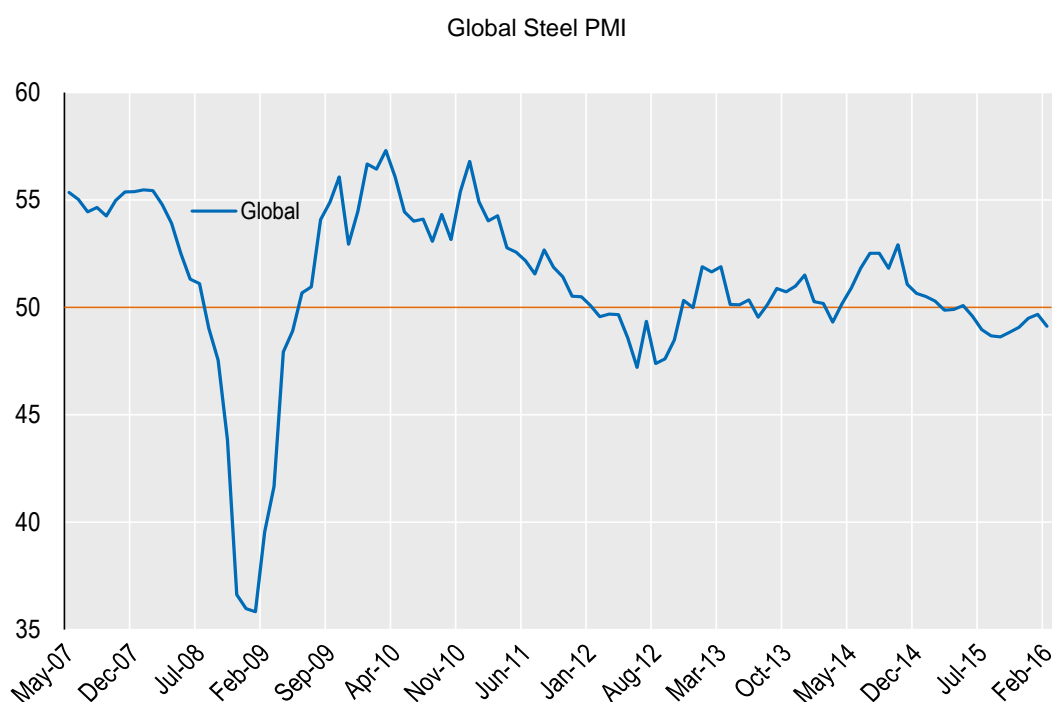
Source: Netherlands Bureau for Economic Policy Analysis (CPB).

Steel market sentiment has deteriorated

Steel market sentiment has deteriorated in the past several months, in line with the general downturn in the global market. Purchasers of steel are wary of increasing their inventories, amidst rapidly falling prices of steel, and many economic indicators that are linked to steel demand, such as manufacturing activity and fixed investment, have either fallen or their growth has slowed in many economies.

The global Steel Purchasing Managers' Index (PMI), an indicator of general sentiment, has been trending down since mid-2014. The sentiment indicator has been below the threshold reading of 50 (that separates contraction from expansion) since March 2015, as shown in the figure below.

Steel market sentiment remains weak

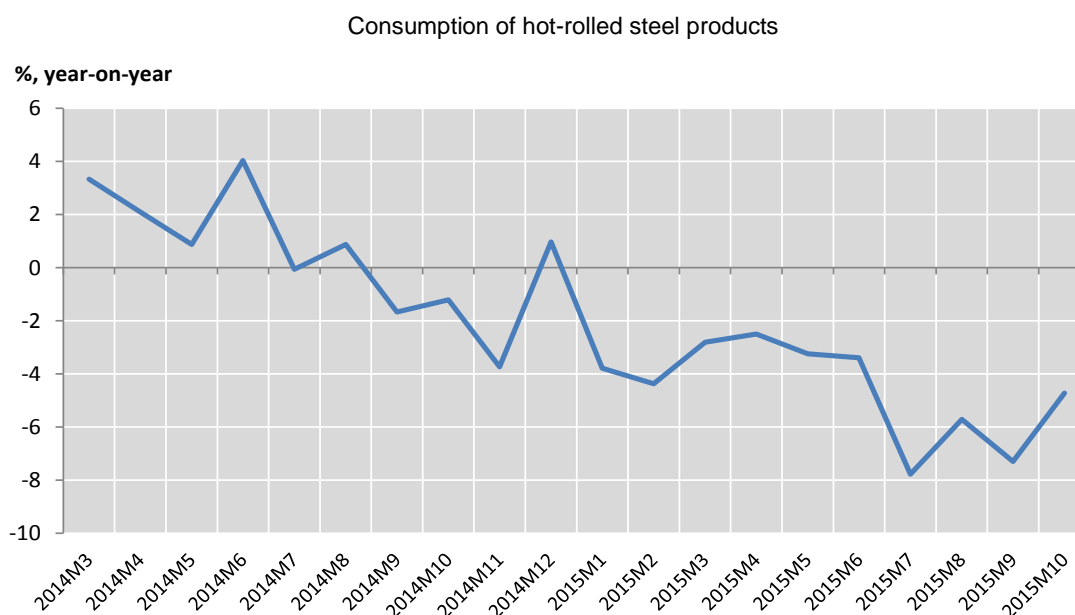


Source: Markit Economics.

Steel consumption continues to decrease

Monthly steel consumption figures have been declining for major steel-consuming economies during the course of 2015. The figure below presents the year-on-year per cent change in the combined consumption of hot-rolled products for eight of the world's largest steel-consuming economies in Asia, the CIS region, Europe, North America, and South America, which together account for approximately 72% of global steel demand. The data suggest a strong deceleration in consumption growth during 2014, with growth turning negative in the final quarter of 2014 and the downturn gathering momentum during 2015. In the first ten months of 2015, the monthly consumption indicator for the major steel-consuming economies declined by slightly more than 4% in year-on-year terms, as shown below.

Steel consumption is declining by more than 4% in major economies



Note: Combined consumption of the following economies: Brazil, China, Germany, India, Japan, Korea, Russia and the United States.
Source: ISSB.

Steel production is contracting in almost all regions

Growth in world crude steel production has decelerated significantly in the past three years. Following growth of 5.8% in 2013 (to 1.65 billion tonnes), production growth slowed to 1.2% in 2014 and then declined by 2.8% in 2015. In the first two months of 2016, global crude steel production declined by an even greater 5.2%, compared to the corresponding time period one year earlier. The decline is widespread, with steel production falling in almost all regions of the world, as shown in the table below.

Almost all regions are experiencing sharp falls in crude steel production

	Level, thousand mmt			% change, year-on-year		
	2015	Jan-16	Feb-16	2015	Jan-16	Feb-16
EU	166,090	13,428	13,081	-1.9	-7.6	-6.3
Other Europe	33,991	2,785	2,587	-6.1	0.3	3.8
CIS	101,353	8,142	8,154	-4.3	-5.2	2.8
North America	110,668	9,274	8,809	-8.7	-7.6	1.7
South America	43,895	3,251	3,180	-2.5	-14.6	-9.4
Africa	13,988	1,142	912	-1.8	-14.9	-26.0
Middle East	26,938	2,061	2,175	-3.9	-11.3	-7.1
Asia	1,096,163	87,175	81,085	-2.2	-6.9	-3.4
Oceania	5,717	466	429	4.6	-6.3	-7.7
World	1,598,804	127,724	120,412	-2.9	-7.1	-3.3

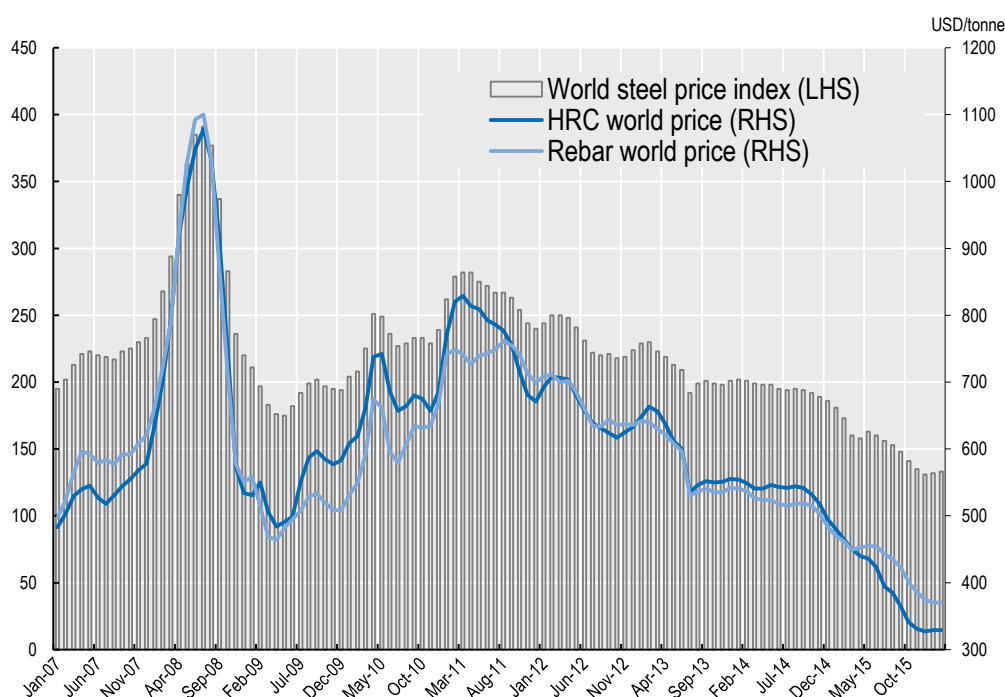
Source: World Steel Association.

Steel prices are down sharply

The combined effect of weakening global steel demand, growing imports in many economies, and decreases in steelmaking costs has led to a very sharp decline in steel prices since the latter part of 2014. The world steel price index, which has been trending downwards since the second quarter of 2011, fell to 133 points in February 2016, down 23% from its level in February 2015. World hot-rolled coil (HRC) prices have fallen 29% and rebar prices 20% compared to their levels a year ago. In February 2016, the world average HRC price stood at USD 329 (down from USD 465 in February 2015) and the world rebar price at USD 370 per tonne (down from USD 462 in February 2015).

Steel prices are down sharply

World steel prices (latest month February 2016)



Source: Platts Steel Business Briefing.

Profitability of the steel industry

The profitability of the steel industry has also come under intense pressure. Profit reports across steel companies illustrate a sector that is clearly underperforming most other industries. According to data issued by Damodaran, the average pre-tax operating margin of 732 publically trade steel companies during 2015 was -1.88%, well below the 6.11% average operating margin for the world's 41 889 publicly traded firms.¹ The statistical data also show the steel sector's profitability ranking relative to all sectors in given economies. Globally, steel's average operating margin was ranked 91st out of 94 listed industries. If only manufacturing firms are included, steel is ranked amongst the least profitable industries.

¹. Additional information available at: <http://pages.stern.nyu.edu/~adamodar/>. (accessed on 18 March 2016)

The steel market outlook: demand weakness

The three-year period from 2014 to 2016 is expected to be characterised by exceptionally slow global steel demand growth. According to the October 2015 forecasts of the World Steel Association, world steel demand is projected to have declined in 2015 for the first time since 2009. Global finished apparent steel use is forecast to decline by 1.7% to 1 513.4 million metric tonnes (mmt) in 2015, before increasing modestly by 0.7% to 1 523.4 mmt in 2016 (see the table below). The previous forecasts, released in April 2015, had indicated positive demand growth of 0.5% and 1.4% in 2015 and 2016, respectively. The downward revisions reflect a steeper demand contraction in China than was previously anticipated and a significantly weaker outlook for the CIS economies, South America and many developed countries.

Table 2. Latest forecasts for regional apparent steel use by the World Steel Association

Millions of tonnes of finished steel

	2014		2015 (f)		2016 (f)	
	Volume	% change	Volume	% change	Volume	% change
Europe Union (28)	148.0	5.0	149.8	1.3	153.1	2.2
Other Europe	36.9	0.1	40.1	8.6	40.6	1.3
CIS	56.1	-4.6	49.9	-10.9	49.9	0.0
NAFTA	144.8	11.4	140.8	-2.7	143.7	2.1
Central and South America	48.8	-4.7	45.2	-7.3	46.1	2.0
Africa	36.6	3.6	38.5	5.1	40.9	6.2
Middle East	51.9	4.5	53.9	4.0	56.3	4.3
Asia and Oceania	1016.8	-0.9	995.1	-2.1	992.8	-0.2
World	1539.9	0.7	1513.4	-1.7	1523.4	0.7

Source: Worldsteel (2015).

Concluding remarks and issues for discussion

In summary, the outlook for the steel market has weakened significantly, due to cyclical factors associated with sluggish global economic activity and industry-specific structural problems such as overcapacity. It appears that adjustment pressures are growing significantly and will have to be worked out in the coming years. There are many ways in which the industry can adjust, but one possible near-term scenario involves further price and profitability declines, further falls in production, resulting in low capacity utilisation rates across the board, and possibly plant closures. There will be growing social and human costs associated with the current market downturn, and governments should prepare effective programmes to help steel workers, who are laid off in the process, adapt to these changes.

- How have recent market developments altered the outlook for steel demand in 2016 and 2017?
- Is the current demand slowdown temporary or does it reflect structural factors such as economies' passing their peak steel intensity?
- How can the industry's profitability return to more sustainable levels?

References

OECD (2016), "OECD Economic Outlook, Interim Report February 2016", OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/eco_outlook-v2015-sup2-en.

Worldsteel (2015), "Short Range Outlook 2015-2016", the World Steel Association, Available at: <https://www.worldsteel.org/media-centre/press-releases/2015/worldsteel-Short-Range-Outlook-2015-2016.html>.