Industrial Metals Monitor

Steel prices rise with iron determination

22 February 2018

- Base metal prices fall on stock market shock, but steel prices continue to rise without interruption
- Demand for base metals will exceed production in 2018, pushing prices higher
- Iron ore prices will remain high in the near term, but we see a decline in the course of 2018

Economic fundamentals remain auspicious
The global economic outlook remains robust, despite China continuing its policy to cool lending growth. This could prompt a stronger deceleration of economic growth in China, but there is no question of this so far. The economic expansion continues, as is reflected in the volume of industrial factory orders. Order volumes are picking up in Germany, the US and also China. In Germany, purchasing manager indexes (PMI) have even reached record high levels. Worldwide construction activity is also on the rise. Other economic indicators, too, contain no signals of an imminent deterioration. According to ABN AMRO, the recent decline in equity markets and slump in investor sentiment do not reflect economic reality: the global economy is still fundamentally in good shape.

Base metal prices sink deep in the red in early February
The losses in the equity markets in February – sparked by investor concerns over rising inflation and interest rates – sent shock waves through base metal markets. The average base metal price – a weighted average of aluminium, copper, nickel and zinc prices – plunged more than 5% within six days in early February. Calm returned on the seventh day, allowing fundamental trends in the base metal markets to regain the upper hand. Prices rebounded to continue the upward trend initiated early this year. This volatility signals that investors are on a knife edge and ready to shed positions over the slightest suspicion of an economic shock. The ferrous markets remained a picture of calm and took no notice of the stock market shock. The reduction in steel capacity in China is gathering pace and bringing the market more into balance. As a result, prices of e.g. plate steel are rising.

Pressure from overcapacity is receding in the steel sector
Ferrous metal markets have seen prices rise this year, despite persistent overcapacity. Ferrous metal prices are benefiting from steel capacity restrictions in China combined with sustained solid demand for steel. The Chinese authorities’ initiatives to curb steel capacity seem to be bearing fruit. Global steel prices jumped almost 8%, while the prices of raw materials for manufacturing steel (iron ore and coking coal) made gains of, respectively, 2.6% and 5.4%. Supply also remains ample in these markets, but a surge in demand from China – ahead of the Chinese New Year celebrations in February – gave prices an impulse. Aluminium and copper prices came under the strongest pressure from the stock market turmoil. By comparison, nickel and zinc only suffered limited price losses. Base metal prices tend to be much more volatile due to the significantly stronger speculative element in these markets.
Scrap prices follow refined metal price trend
The long-term direction of base metal scrap prices broadly tracks the price trends for refined base metals. But the trends do not move exactly in parallel. The scrap markets have their own dynamics, as is visible in the price trend of zinc scrap. Supply volume and quality are key price determinants in the scrap market. China also plays a key role in the various scrap markets and China’s imports of copper scrap are set to fall sharply this year due to tighter environmental restrictions. As copper scrap processing is an energy-intensive activity, the number of copper scrap import permits has been strongly reduced for environmental reasons and the permits that have been issued are for much lower import volumes. This measure will strongly dampen demand for copper scrap and imports of alternatives – such as blister cooper – will rise strongly.

Fundamentals remain favourable in base metal markets
Fundamentals remain an important indicator of the long-term price trends in the base metal markets. The future supply and demand balance is a key price driver. The short- and medium-term price trends, in turn, are strongly influenced by sentiment, oil price & currency movements and cyclical factors, such as economic growth and monetary policy. This year, demand for base metals will exceed production, resulting in upward price pressure. The supply shortfall will persist in 2019, but with one exception: zinc will show a surplus, although the volume will be relatively low. Stock levels will also continue to support prices in the coming years, as stocks in weeks of consumption terms continue to shrink. In 2018, aluminium stocks will even sink to their pre-crisis (2008-2009) level.

Demand for steel remains robust
In China, capacity utilisation rates in the steel industry stabilised in the second half of 2017. Plate steel stocks rose sharply while volumes traded in the market declined. As a result, the global steel price fell. The tide has been turning since November 2017, with traded volumes rising again. The European steel sector is receiving a boost from reviving activity in the construction sector. Although steel construction is relatively limited in Europe, the sector remains an important customer for steel and steel products. The price of ferrous scrap has risen sharply since the start of this year, in parallel with the price trends of crude steel. The good mood in the steel markets also trickled through to the scrap markets. Steel factories will be inclined to pass on the increased prices for crude material. We see the price of steel in Europe remaining high in the first quarter, which is typically a strong period for demand. The US intends to impose additional import restrictions on the import of steel from countries in the EU, but also from Canada, Russia, China, South Africa, South Korea and Vietnam. As soon as these restrictions come into effect, possible countermeasures from these exporting countries are not unthinkable.

Chinese iron ore imports spiked in early 2018
Chinese iron ore imports were under pressure in late 2017 as stocks accumulated at ports and steel factories. In January, however, iron ore imports soared by 9% annualised. The early-year surge was due to steel factories stocking up on iron ore to ensure they had sufficient supplies to restart production immediately after the Chinese New Year holiday period. This kept the iron ore price high. The first quarter may bring further price increases due to the wet season in Australia, which causes flooding in mines and infrastructure disruptions. The supply of ore may decrease as a result. Apart from iron ore, this scenario also influences the supply of coking coal. For 2018 we expect that prices of the raw materials used to manufacture steel will fall. Reduced steel capacity in China combined with high availability will depress prices for iron ore and coking coal.
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