

A regional perspective Global metals outlook

A three-part series on the future of the global metals industry



In response to the current economic downturn, governments around the world are taking extraordinary measures to stimulate local economies. From incentives to encourage consumer spending on automobiles to massive infrastructure programs, many of these measures hold the potential to significantly impact the global metals industry. But will these actions jump-start local economies and in turn revive the global metals market? To find out, Deloitte Touche Tohmatsu's ("Deloitte") Global Manufacturing Industry Group turned to a panel of metals industry leaders from Deloitte member firms around the globe, including in China, Brazil, Europe, Japan, India, Russia, South Korea, and the United States. Here's what they had to say.

Outlook at a glance

- Benefits from stimulus measures will not be seen until the second half of 2009, at the earliest.
- China's stimulus package seen as holding much potential to impact global demand.
- Demand is still growing in certain emerging markets and these areas could lead the recovery.

Q: What will the government stimulus efforts in the United States mean for the metals industry?

Nick: In the United States, the infrastructure plan that's been discussed is going to help some of the long steel producers, but very little of the spend will come in 2009. I don't think it's really going to help many flat rolled steel producers. Also, we need to be mindful of the rhetoric about protectionism, because I think that's a major mistake.

Dick: To Nick's point, the U.S. stimulus package and its infrastructure spending appears to hold

a beneficial impact for long steel producers, although I don't know how significant it will be. I'm not sure if it will take them back to normal market conditions. But the flat roll steel producers are still heavily dependent on nonresidential construction and the automotive industry. From these market standpoints, the two things that have to happen are some stability for the automotive original equipment manufacturers (OEMs) and a return to normalcy for the credit markets to support more commercial construction.

Q: What is the view of the stimulus packages in Europe and their impact?

Jeff: The “Buy American” provisions are getting a lot of press in the U.S., but in fact, they are not much different than what exists today. There is potentially some negative reaction, but it’s not of particular consequence to anyone who is importing from, for instance, Europe or Brazil or other places. More important is how significant the slow-down in Europe has been in certain areas, particularly given the previous boom in projects that consumed significant amounts of long products—and even flat for that matter—in the construction area. To some degree, those areas that were extremely volatile during the growth time, have now become very volatile in the slow-down. There are various measures in Europe to spur construction and infrastructure—about US\$13 billion is planned in France to modernize rail and for energy grids¹ and even more in Germany—around US\$18 billion over two years for roads and schools. And then there are the EU-wide actions—about US\$260 billion for things like trans-European transport and promoting green cars².

Are Japan and Korea taking any special measures?

Tezuka-san: The Japanese government has not yet made any concrete economic stimulus plans that would specifically increase production in the metals industry. But increased access to credit may slow down the economic downturn and possibly foster a recovery of the economy by supporting companies suffering from a shortage of cash flow. It also may support recovery by helping companies that have plans to acquire other companies or to invest in research and development (R&D)—which could help increase production capacity mainly in foreign countries, such as an investment in Brazil or Thailand.

Heewon: The South Korean stimulus package mainly focuses on social infrastructure development—such as roads, schools, and hospitals. Though the package could influence the metals industry—it did include some measures aimed at supporting construction³—I would not expect a very strong impact overall.

What about in the BRIC markets?

Fernando: The Brazilian government’s efforts to stimulate the infrastructure, civil construction, and transportation sectors are expected to have a positive impact on the metals industry. And with major orders for new shipping vessels, Brazilian ship plate demand is expected to remain stable between 2009 and 2010. The government has also announced plans to build one million houses by 2010 to reactivate the domestic construction sector and create more jobs⁴, which should have a positive impact on the metals sector. Interest rate and federal tax cuts also have encouraged the banks to approve more credit and made products like cars much cheaper. In January, for instance, Brazilian domestic car sales actually increased slightly by 1.5 percent from December 2008 because prices dropped due to government stimulus⁵.

Mark: In Russia, many commentators are using the phrase “state” capitalism. There’s been a lot of input from the state. But it’s yet to emerge whether the government will take a stake in the steel companies as it has in other industries, although it’s increasingly likely. There’s also talk of a continued high level of infrastructure projects—but one wonders with

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— Claude Martin

Claude: And yet there doesn’t seem to be anything that’s going to really change or improve demand in the first half of 2009, regardless of what happens. China is different, and I know there is underlying demand there.

budget deficits the way they are, if that will happen. The government is also talking of buying up inventory in a strategic move to bolster the industry. But in terms of the overall picture, one gets a sense of a bottoming out certainly in this quarter or the next quarter. If one looks at the stock market this year, steel is one of the few sectors that is actually picking up. Clearly this has to be sustained, and as yet levels are nowhere near Q1 and 2 of 2008. So, in Russia, there's a slightly different take than the rest and maybe even a hint of optimism. In the second half of this year, then, we should see maybe a little bit of relief, but it really does depend on how the stimulus packages proceed. The big issue here is going to be the Chinese stimulus package.

Kumar: The stimulus package is unlikely to be large in India given budget deficits. It is around 12 percent at present, including remittances and subsidies, and it is unlikely that there will be any more announcements. General elections are scheduled for April-May 2009, so this means the out-going government may not be able to make any big policy announcements before then. And while the stimulus packages announced so far have provided capital funds to government-owned infrastructure companies, their ability to implement projects early is questionable.

John: In China, there is a belief that the government incentives or the stimulus will benefit the industry—but that probably it will take some time to kick in. There are ten stimulus plans and four out of the ten are related to steel, either directly or indirectly—automotive, ship-building and manufacturing equipment plans. But then, any of these will probably take six to nine months to really impact production and sector profitability. So probably, we would be talking about Q3, Q4 before we can really see how it would impact the industry.

Q: So, the group is agreeing that the various stimulus packages will take some time to jump-start economies, and we may not see any immediate effects?

John: I do agree with that view. Although we're talking about quite a large amount of stimulus, because of the size of the industry and, in China, the

large number of smaller steel distributors and players, I would say the effect would not be as quick or as dramatic as people might want to see.

Claude: The misnomer here is saying "jump start." This is going to be a much longer, rolling start.

Kumar: The steel sector, which has been among the industries hit by a slide in commodity prices, feels that the package is too late to revive demand in the economy and that there will be a considerable time lag for the planned outlay to percolate as benefits to other real sectors. A revival of the sector is likely to be more on account of natural demand growth than to the direct impact of the stimulus package, at least in the near future.

“The stimulus package is unlikely to be large in India given budget deficits.”

— K. Kumar

Q: Could more be done? Is there talk in the market about things that were missing in some of these packages?

Dick: So much of the speed and extent of the recovery depends on two things—consumer confidence and the willingness to go out and spend money and, consequently, the availability of credit. And the credit markets don't seem to be all that thrilled with the stimulus package they're seeing in the United States I'm curious whether that's true in China.

John: The Chinese government is putting effort into trying to encourage spending in the automotive sector, a lot of incentives for reductions of prices, taxes, and things to encourage the production of more cost-effective green automobiles for the middle class. We've yet to see how that will work out. But, for example, in the automotive sector, last year China still had growth of nearly 7 percent, although significantly less compared to the 21 percent in



2007⁶. People believe that for 2009 there will still be growth in the automotive sector because of demand as well as the incentives the government is kicking in. Another positive sign was that bank lending was up 19 percent in December compared to 16 percent in November⁷.

Tezuka-san: The markets in Japan have had a somewhat negative impression of the government's stimulus efforts. They are expecting the government to make and implement clear and concrete policies in such categories as social infrastructure, new industries and technologies—including environment and healthcare. There is some help from the government with auto, however. There will be tax exemptions when people buy cars that are kind to the environment. I think this policy would encourage people to buy new cars if the price of cars that are good for the environment went down. This would likely have a positive effect on the metals industry in Japan.

Q: What are people saying in Russia? Is there much happening to stimulate auto, for example, as a means of spurring consumers?

Mark: No. Auto sales are down. But recently I saw an interesting point on Chinese cars: about 20 in every thousand people own cars there versus around 450 in the West⁸. So there is a gap to be filled sooner or later in China. And I wouldn't be surprised if that statistic is pretty much the same in Russia. Although, if you traveled on the roads in Moscow, you'd never believe it. So no good news from the stimulus side, but the demand is there, I think, eventually.

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— John Hung

Q: Is anything planned to stimulate demand in India or in Korea? How do things look there?

Kumar: The Indian government's infrastructure finance company has been authorized to raise US\$8 billion of tax-free bonds that can support public-private partnership projects up to US\$20 billion. A separate package of home loans is expected to boost the real estate industry—construction accounts for 60 percent of steel consumption in India⁹. A cut in fuel prices should also drive the demand for automobiles. However, the stimulus efforts have yielded very little to the steel sector and there will be only marginal direct benefits, if any, to the large steel players.

Heewon: Considering the supply chain, steel demand in South Korea is very much connected to auto parts demand. Effective political measures could affect auto and related industries positively—but I'm afraid that the measures the government is taking will not spur auto sales.

Q: What about in Brazil?

Fernando: There is a general feeling that much more will be needed to stimulate demand here. Mainly that a massive reduction in interest rates is required, as Brazilian interest rates are still one of the highest in the world.

Q: Do you think that the downturn for the metals industry in your particular country could perhaps make it more competitive?

Nick: The most important thing that's going to happen is the marginal players in China will go away. The contraction is going to bode well long-term for the global steel industry and take a lot of excess capacity—obsolete, bad capacity—out of the system. I think that's going to be the biggest move and it's going to be in China. And this will likely affect the entire global steel economy.

Q: What do others think? What are you hearing in terms of the implications for competition in your market?

Tezuka-san: As for the steel industry in Japan, most electric furnace steel companies are relatively small. So I think they should consider expanding their scale through mergers and acquisitions (M&A) to keep their competitiveness. As for blast furnace producers they also should consider further integration because it is said that the Chinese government is leading Chinese steel companies to expand their scale through M&A. This could be a huge risk if Japanese steel makers do nothing.

Heewon: The downturn will change the market in South Korea—it will be more competitive. China is a factor as well. China-made steel has encroached upon the Korean steel market for the past several years. If the Chinese stimulus package helps marginal companies—that would be out of the market without artificial measures—it will have some negative impact.

Mark: From the Russian side, companies have been pretty sharp in taking a lot of the costs out. As I said before, the state is helping them. There is word in the market that some of the big players are near to being technically bankrupt, but whether they will actually be allowed to go bankrupt is doubtful. They will get a bail-out as opposed to a kick-start. But when the cost of production is higher than the cost of product, then there's clearly going to be fall-out.

John: For China, what we are seeing now is actually as Tezuka-san pointed out, the acceleration of consolidation in the industry. The state-owned companies are being forced to merge even faster. I must say, I still don't see a lot of bankruptcy or things like that for smaller mills, though. But the larger steel companies are all merging. They're also actively acquiring resources and assets overseas. Actually, in the last 12 months, there have been quite a few things happening in China.

Q: What protectionist measures might we see and will this be a good thing or bad thing for the industry?

Tim: From the point of view of the customers of the steel industry, which are mainly the companies that I deal with, they're extremely concerned about this

“The contraction is going to bode well long-term for the global steel industry and take a lot of excess capacity—obsolete, bad capacity—out of the system.”

— Nick Sowar

“Buy American” talk. There's going to be trade barriers established all over the world in response. They're going to make it very difficult for the customers of steel, even beyond auto, to effectively do business.

Nick: There are a number of companies that are absolutely global and there'll be repercussions for them.

Tezuka-san: I think it could be a danger to the Japanese market, because Japanese steel makers have to find opportunities to grow in foreign developing countries—there is a limitation to growth in domestic demand here.

Q: Switching gears, is there a view that emerging markets somehow might lead the recovery?

Mark: I guess in terms of demographics and socioeconomic factors, one still sees an emerging middle class in countries that are still industrializing. Some fundamentals would need to be in place for increased demand, though, such as higher levels of employment and increased credit to increase demand for products such as autos. Now, that's clearly still happening in China, and I guess in other parts of Asia—and, to a lesser extent, in Russia. So that could indicate that a demand-led recovery could come out of one of these places. Remember also that individual debt levels certainly in Russia are nowhere

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— Heewon Kang

near that of the West. Unfortunately, business is generally leveraged in terms of borrowing to a higher degree than most places. The previous commodity price-driven boom perpetuated the high growth strategies of some of the leading business oligarchs, hence state intervention now.

Fernando: I believe that emerging markets will have a relevant role in the world economy recovery but not lead it. There are still enormous internal problems to be solved in most BRIC countries.

“From the Russian side, companies have been pretty sharp in taking a lot of the costs out.”
— Mark Wainwright

Dick: I know that one factor in many of the developing countries is if they’ve taken on a lot of debt over the last decade based on strong commodities prices. I believe it was Argentina that I was looking at that’s going through a crisis—they had taken on a lot of debt and now commodities prices can’t support it. They are likely going to face significant write-downs now on both their currency and their obligations, which can’t mean good things for economic growth, at least for the next three to five years. Some of these countries might be crushed by the debt they have that can’t be supported now by lower commodities prices — as Mark notes.

Q: What do you think will indicate a recovery in your market?

Heewon: There are some signs now—a major South Korean steel maker has already announced that the

company will focus on M&A activities this year. But it doesn’t mean that stimulus spending necessarily gave rise to the opportunity.

Jeff: I agree. I think that while the stimulus packages and the talk of infrastructure could be helpful, the consumer beginning to spend again, whether that’s on automobiles or whatever the category may be, is really the thing that’s required for the recovery to commence.

Eddy: Well, I’m not completely sure about that, because while you’re solving a problem now with the stimulus packages, you’re creating a huge problem in all of these countries for the future with the huge debt that needs to be paid up. So solving it now could mean that five or ten years from now you really have to deal with another problem.

Mark: I guess in Russia we have painted a slightly more optimistic picture, but it’s still clearly demand that we need. But one wonders what the inventory position is like in the markets that have the potential for demand. Those inventories are dropping really quickly, which doesn’t seem right in light of all that we’ve heard. But if they are dropping, even to a lesser extent, then the natural demand, diminished as it is, is going to start up a recovery.

John: I see the recovery probably relying on two key factors. The auto industry needs to recover and the global economic environment needs to improve. At the moment, the government stimulus packages are helping to increase infrastructure spending and that probably will moderate weakening global demand. The industry in China will consolidate much faster and become more competitive through restructuring and technology upgrades. So maybe emerging out of this in two or three years, China will be a much stronger player in the global market.

“From the point of view of the customers of the steel industry, they’re extremely concerned about this “Buy American” talk.”
— Tim Hanley

Stimulus packages by key countries (in US\$)

| Country | China ¹ | India ² | Japan ³ | South Korea ⁴ | USA ⁵ | Brazil ⁶ | France ⁷ | Germany ⁸ | United Kingdom ⁹ | Russia ¹⁰ |
|------------------------------------|---|---|---|--|---|--|--|--|--|---|
| Stimulus package | <ul style="list-style-type: none"> Nov '08: \$586 billion Jan '09: supporting package | <ul style="list-style-type: none"> Dec '08: \$4 billion Feb '09: \$4 billion | <ul style="list-style-type: none"> Aug '08: \$120 billion Oct '08: \$51 billion Jan '09: \$250 billion | <ul style="list-style-type: none"> Oct '08: \$130 billion Oct '08: \$11 billion | <ul style="list-style-type: none"> Feb '08: \$168 billion Sep '08: \$700 billion Dec '08: \$23 billion Jan '09: \$787 billion | <ul style="list-style-type: none"> Jan '07: \$3.1 billion 2008: increased to \$5.05 billion by 2011 Dec '08: 3.6 billion Jan '09: \$91.4 billion | <ul style="list-style-type: none"> Dec '08: 33 billion 2009: \$14.7 billion | Jan '09: \$62.5 billion | <ul style="list-style-type: none"> Nov '08: \$30 billion \$4.5 billion in addition to above | Nov '08: \$200 billion |
| Infrastructure/construction | <ul style="list-style-type: none"> \$29.2 billion: fixed-asset investment projects Increased spending on rural infrastructure: roads, power grids, water supply \$300 billion: infrastructure construction | <ul style="list-style-type: none"> \$6 billion: infrastructure \$8 billion: India infrastructure finance company to raise funds | \$100 billion | \$3.3 billion: roads, schools, hospitals, universities | <ul style="list-style-type: none"> \$61 billion: infrastructure \$16 billion: public housing \$61 billion: local school districts and modernization \$31 billion: federal building construction and repair \$6 billion: weatherizing homes | \$221.4 billion: transport, energy | <ul style="list-style-type: none"> \$13.4 billion: public investment in 2009 \$2 billion: special housing aid | \$23.5 billion | \$4.5 billion | |
| Other measures | <ul style="list-style-type: none"> Encourage exports by implementing "moderately flexible export tax policies" Expedite investment in transportation | Home loan at 8.5% up to \$40,000 for borrowers | | | <ul style="list-style-type: none"> \$32 billion: direct spending and loan guarantees for new electricity transmission and grid improvements. \$20 billion+: renewable energy tax cuts | | | \$130 billion: "credit and guarantee fund" for struggling industries | | Provide credits to India and China for purchasing its machinery and equipment |
| Automobile sector | <ul style="list-style-type: none"> Lower purchase tax Subsidize farmers' purchase and replacement of light cargo vehicles Promote large-scale manufacturing of electric cars and components | <ul style="list-style-type: none"> Government allowed to replace vehicles Fleet operators can depreciate vehicles by 50% bought after January 2009 | | | <ul style="list-style-type: none"> \$17.4 billion in short-term loans for GM and Chrysler \$6 billion for GM financing arm | Taxes reduced on new cars and light commercial vehicles with engine size less than 2.0 litres | <ul style="list-style-type: none"> \$1,300 for car buyers Refinancing facilities for captive credit subsidiaries of car manufacturers Help auto companies refinance R&D and restructure | <ul style="list-style-type: none"> \$2.35 billion: environmental bonuses \$650 million: innovative propulsion technologies | <ul style="list-style-type: none"> \$3-4 billion in loan support Car financing arms to get credits | |
| Metal sector | | <ul style="list-style-type: none"> Reduced levy on iron lump exports Withdrawal of duty exceptions on TMT imports Exemption from basic customs duty on zinc and ferro alloys Withdrawal of export duty on iron ore fines Reduced export duty on iron | | | | | | | | |
| Tax benefits | Increased export VAT rebate hikes | <ul style="list-style-type: none"> Ceiling for interest rate on export credit reduced 2% interest subvention to exporters Reduction of central VAT | Special benefits to households: \$600 per family of four | <ul style="list-style-type: none"> \$2 billion in tax reductions Tax relief on equity sales tax extended | <ul style="list-style-type: none"> \$120 billion in tax benefits 50% of eligible investment to be deducted when depreciation incurred Small business expensing benefits | <ul style="list-style-type: none"> \$3.1 billion in tax benefits in 2007, rising to 4.9 billion by 2011 Tax exemption level on PCs increased | | \$11.7 billion in tax benefits | VAT reduced | Cut in profit tax |

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