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A PICTURE IS TAKING SHAPE

As I reflect on my earlier letters, I am struck by the number of references to China. As I have learned more about the massive effects of China on today's world steel market (and on the general world economy), I think of how the United States must appear to people in other lands – huge consumption, economically powerful, a battleship in the fleet of nations.

This month's report is full of items that reinforce that view:

- China's increasing demand for oil has become a large element of the run up of world price's, recently over $54 per barrel. Suggestions that prices may ease are tied to a predicted relaxation of Chinese demand.

- China became the fourth largest automobile producer in 2003 and will make 6 million units to pass Germany in 2006 and take third place.

- From January to August, China produced 147 million tons of raw steel and 162 million tons of finished product. These numbers represent year on year increases of more than 20%. (To compare, U.S. raw steel production through August was 69 million tons, a year on year increase of 5%.)

- China's industrial output in August was 16% higher than the same month in 2003. There is now some question whether the efforts of the government to cool off the economy will have much effect, since major raw materials, like steel, remain in short supply.

- China is reportedly encouraging its steel producers to consolidate into four or five companies, each with a capacity of 40 million tons. In today's world, those companies would be four of the top five or six producers in the world.

- China remains, overall, a poor country. However, the sheer numbers involved make it one of the world's largest middle class economies. By putting just one of four of its citizens into the middle class (by our definition), China would have more people so situated than the entire population of the U.S.

Some of the above factors are reflected in the cost specifics we have been reviewing on a monthly basis:

- Scrap. The prices for #1 Dealer Bundles and #1 Busheling (Chicago), which had fallen back a bit last month, have taken a $40 plus leap to a new record of $415 per mt. Exports have slowed, but scrap processors may be holding back in anticipation of the usual October and November buying by mills meeting their winter consumption needs. U.S. scrap prices are among the highest in the world, but increased demand could spur exports and result in even higher prices.

- Pig Iron. Not surprisingly, pig iron prices have followed scrap up the ladder and are now at $350 for a tonne of Brazilian material cif New Orleans. These prices should not be going down soon, because most suppliers are sold out for the year.

- Ocean Rates. We are using a new index here, the Baltic Capesize (don't ask me what it means, but it seems to have international credibility). As of October 1, 2001, the index stood at 1,076. By February 4, 2004, due in large part to Chinese demand for imports, it hit 7,800! It has eased since then, but last month started to rise again and now stands at 4,600. One side effect of these rates is that ship breaking has declined. With today's high prices, a "Capesize" vessel of 22,000 tons contains about $9 million worth of scrap. That amount can be made in two to three voyages with today's freight rates. Of course, those relationships also contribute to higher scrap prices.

- Natural Gas. With oil over $50, one would expect natural gas prices to rise, and they have not disappointed. The September price, you will remember, was a fairly low $4.95 per mcf. By the beginning of October, the price had increased by 36% to $6.75. Winter conditions could cause greater rises.

- Imports. There are mixed signals here. The Metal Service Center Institute reports that hot band prices decreased in September as a result of increased imports and also that more of their members (81%) were seeing foreign prices more than 5% below domestic. On the other hand, Brazilian producers are expected to export 8-10% less this year than last, because of domestic demand. Also, China is receiving higher prices for its exported billets, partially due to the increased demand for rebar. Finally, the dollar has declined a bit against the Euro, the pound and the Canadian dollar.

Many of you have written very kind comments on these letters. I know that you have many sources for the information we provide, so we try to put it into a useful format. If you have any suggestions for improving our output, please let us know. As usual, this letter will be published on our website: www.coreysteel.com.