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# REVIEWING THE PAST

Over the past months, we have commented on many economic and policy issues of importance to the domestic steel industry. There have been a number of developments on these issues, and we thought you would be interested in some updates.

- The U.S. Economy. At the beginning of 2005, we thought that the only certainty on the economy was uncertainty. That prediction holds up, but the causes of the uncertainty have changed somewhat. We still have high foreign trade imbalances, modest increases in GDP and steadily improving employment. The huge budget deficit remains, but the problem is now the cost of Katrina and Rita recovery rather than further tax cuts and a Social Security fix (that problem, of course, remains to be addressed).

- State and Local Subsidies to Manufacturers. We have reported on the benefits being provided to a new plant in Mississippi. Formerly known as "SteelCorr", the company recently confirmed that Russian producer Severstal will be putting up $200 million for an 80% share of the venture, which is to be called "SeverCorr". The state of Mississippi and the US Department of Labor are offering loans, grants and guarantees for well over $100 million to the project, which is projected to cost $880 million. Last month, the U.S. Supreme Court agreed to hear a challenge to an Ohio tax incentive awarded to DaimlerChrysler to build an assembly plant in Toledo. The question will be whether giving breaks to selected companies amounts to unconstitutional discriminatory taxation. The Court should decide the case by mid 2006.

- Trade Negotiations. A couple of months ago, we reviewed the difficulties encountered by the Bush Administration in getting approval of the Central American Free Trade Agreement (CAFTA) and suggested that the problem might have been deep rooted concerns about the continued validity of the economic theories underlying our free trade policies. These matters are now being tested on a broader stage – the multilateral trade talks sponsored by the World Trade Organization, known as the "Doha Round". These talks have had a rocky road – they were supposed to be kicked off at a meeting in Seattle in 1999, which was marred by street rioting; they finally started in 2001, but were almost derailed by a lack of progress at a meeting in Cancun in 2003. The principal issue is agriculture, but the debate illustrates some of the conceptual problems that arise across the board. Agriculture enjoys political power in both the U.S. and EU, and changes will cause serious disputes and problems for elected officials. The talks will reach a new testing point at a ministerial meeting in Hong Kong in December. All sides are gearing up for a very difficult meeting, whose success is by no means guaranteed. Failure of the Doha Round would be unprecedented in the post-WW II era, with very profound ramifications for the future of cooperation on international trade.

- Energy. Our monthly reviews of input costs include natural gas, and you have ridden that roller coaster along with the rest of us. The hurricanes have illuminated several aspects of our energy situation, chiefly refinery under capacity, but many others were affecting prices well before. For a long time, the U.S. has been consuming oil and gas in sharp disproportion to the relative size of our population and our economy. By and large, we have been able to meet our needs at world prices that were kept down, mainly because there was enough oil to satisfy world demand. That has now changed, probably permanently, as a result of increased demand from the growing economies of China and India. Forty dollar oil is certainly a thing of the past, and fifty dollar is probably the same, simply because there isn't enough to go around at those prices. We in the U.S. have been pretty good at enhancing our energy efficiency except in one area – automobiles. After years of zero improvement in average mileage we are stuck with a fleet of gas guzzlers. Things will change over time, but meanwhile manufacturing, petrochemical producers, householders, hospitals, retailers and every other user of energy will be paying for our automotive extravagance.

As expected, the hurricanes have had diverse effects on steel input costs:

- Scrap and Pig Iron. The clean up of buildings, vehicles, etc., plus efforts by affected scrap yards to dispose of inventories to permit repairs are expected to produce large volumes of scrap over the coming months. The recent run-up in scrap prices was reversed in September, with #1 dealer bundles falling $60 to $230 per mt and #1 busheling (Chicago) slipping a like amount to $235. Brazilian pig iron was also off slightly (by $8) to $255 per mt (cif New Orleans). The Port of New Orleans has been shipping steel and other metals since mid September.

- Ocean Freight. The Baltic Capesize Index was up again in early October, to just under 4,000. This is well below the levels of 2004 through April, 2005, but the trend has been upward.

- Natural and Other Gases. No surprise here, but still very unwelcome news. The Nymex contract price jumped almost $3 to $13.86 per mcf. That is more than double the June 2005 price. Hurricane Katrina took down about 50% of the hydrogen used by US steel producers in annealing processes. The hydrogen shortages could affect up to 30% of finished steel capacity.

- Exchange Rates. Despite the economic bad news here, the dollar has strengthened. As this is being written, the euro is worth $1.19 (4¢ less than last month), and the pound is at $1.75 (a drop of 6¢). The Canadian dollar is unchanged at 85¢.

We shall, of course, be posting this letter on our website, www.coreysteel.com and it can also be found at www.steelonthenet.com. We are always interested in hearing your thoughts on these letters, particularly how they might be improved by making them more useful to you.