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At the Mercy of the Mills — The Continuing Chronicle of Steel Increases & Surcharges by Kelli Gabel

The cost of steel in the United States is on the rise. Are you in the dark about what factors caused the increase and how it will affect you in the coming months?

Looking much like the 1973-74 worldwide steel shortage, increases in steel prices sold in the United States are once again touching us right in our backyard.

The steel industry has been in a constant state of change since the Bush administration imposed tariffs on imported steel in 2001. After the tariffs were lifted in December 2003, steel consumers expected prices to plummet; instead, prices have escalated 30 to 60 percent in most cases and as much as 200 percent for some specialty products. On top of the escalating cost of steel, many steel suppliers are imposing an additional surcharge on each ton of steel purchased.

As prices continue to rise and surcharges are added, steel consumers have begun to stockpile supplies and explore other ways to offset rising expenses, realizing that they can no longer absorb these rapid cost increases. This has and will continue to cause uncertainty and business disruption for distributors, buyers and contractors down the supply chain.

SURCHARGES & INCREASES

The Bush administration's steel tariffs caused connector plate manufacturers to see average steel cost increases of over 30 percent during 2002 and 2003. Now in 2004, domestic steel makers' price increases are currently averaging $50 to $60 more per ton than 2003 prices on all shipments—another 30 percent.

As previously indicated, steel surcharges are being added by most steel makers to help offset the high costs. This has been averaging $90 to $100 per ton on all shipments. Larger companies have been challenging these added costs, but small to medium size firms without as much purchasing clout are more vulnerable and have no option but to absorb the surcharges and pass on as much as possible to their customers.

To add insult to injury, some steelmakers have recently announced that the price of material will be determined at time of shipment, which means that the price quoted at the time of order may change the day it is shipped. This just compounds business uncertainty.

Consumers say paying market prices for steel right now is like buying lobster at market prices at a restaurant in Jamestown, North Dakota—well, sort of.

REASONS FOR INCREASES

China's Hunger for Steel. One of the main reasons for this calamity is China. China is now the world's leading consumer of steel; in fact, it is consuming so much that the country has to import steel, according to the industry newspaper American Metal Market. To put this in perspective, China consumes twice as much steel as the United States. Their red-hot economy and building boom has led it to use 36 percent of the world's total steel consumption, of which 50 percent is imported, according to China's National Bureau of Statistics. In 2002, China's steel consumption rose 38 million tons, the equivalent to total steel usage in Mexico and Canada combined. To sustain this demand, China is more willing to pay top dollar for steel, which means prices soar. Additionally, India, Japan and Russia are experiencing growth in their economies, and as a result are also consuming more steel.

This increased activity has driven up the price of scrap metal—one of the key ingredients in new steel production for the mini-mills. About half of all domestic steel producers rely completely on scrap for their production. As the international scrap market heats up and world steel mills buy up scrap steel to meet the heavy worldwide demand for steel, less and less is available for U.S. steel makers, creating a serious shortage.

Rising Costs of Natural Gas and Other Natural Resources. Energy prices have remained elevated, making the energy-intensive process of making steel more expensive.

Falling Dollar. The U.S. dollar has been falling in value for months. This makes scrap steel less expensive for foreign mills to buy and recycle, further attracting Asian buyers. It also creates costlier imports into the U.S. and prompts foreign steel makers to sell to China, Russia, Japan and India.

In effect, this has limited the purchasing power of domestic steel consumers and has actually safeguarded the rising prices of U.S. steel makers, allowing them to implement surcharges. Essentially, there is no current domestic price competition from foreign sources.

Freight Costs. Since China's economy overall is super heated and there seems to be no end in sight for their hunger for steel, a large percentage of available ships are being used to serve this market. This has resulted in ocean shipping rates more than doubling in recent months, making the import of steel by U.S. buyers from foreign mills even more costly.

Recovering U.S. Economy. With historical highs in housing starts and low interest rates, home building and remodeling have been on the rise. This is creating a large demand for building materials domestically, many of which have sheet steel components, such as most appliances.

Consolidation Among U.S. Steelmakers. The domestic steel industry has consolidated significantly in the past two years. Many smaller steel makers have filed for chapter 11 and have been purchased by larger companies, resulting in reduced production capacity.

Analysts have suggested that some steel companies may be taking advantage of the situation by adding surcharges aimed at creating a crisis mentality and making up for many years of losses.

Coal Mine Fire. A coal mine fire in West Virginia in 2003 caused a lower U.S. output of coke, a substance made from coal that is used in making steel.

CONTINUED UNCERTAINTY IN THE NEAR TERM

As U.S. steel makers continue to increase prices, implement surcharges, run short on raw materials, and curtail production, the problem will only escalate. Some steel makers are even telling steel consumers they cannot meet order fulfillment.

With such uncertainty in the marketplace and inability to absorb the price increases, the expectation will be that price increases will have to be passed onto all customers and that uncertainty in steel pricing will be the norm for the foreseeable future. No one really knows how long the situation with persist, but some analysts predict that steel prices will not subside until the second half of 2004 or early 2005.

SBC HOME PAGE

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