Steel Market Update: As Foreign Imports Surge, U.S. Steelmakers Launch Trade War

By **Benjamin Durfee** and **Tucker Randle**

So far, 2016 has been something of a disaster for commodity markets. A worldwide surplus of commodities has driven returns for raw materials to the lowest level since 1999, as measured by the Bloomberg Commodity Index. And steel has been among the hardest hit commodities. Although there are several factors contributing to the pronounced decline in steel prices, the main problem is that the world produces too much of it. With global excess capacity around 400 million tonnes to 700 million tonnes relative to total global demand estimated at 1.513 billion tonnes this year, according to a forecast from the World Steel Association, foreign steelmakers have had to look abroad for new markets to sell their steel, exerting downward pressure on prices. The current economic climate has made the U.S. a magnet for steel imports, resulting in imports capturing a record 29.6% share of the domestic market in 2015. This surge, which has been gaining momentum since 2011, has exacerbated trade frictions and prompted domestic steelmakers to call for punitive tariffs on foreign steel imports.

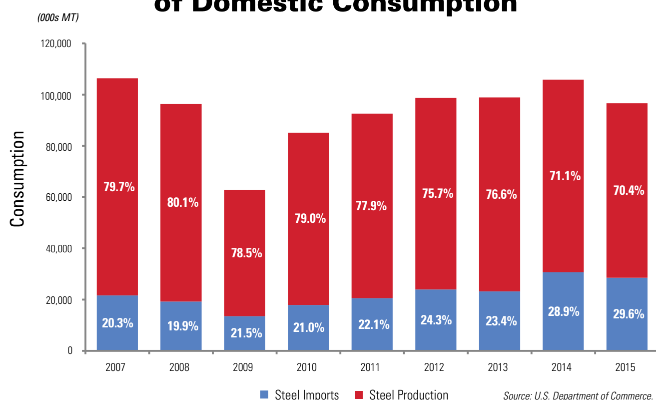
While governments are permitted to invoke anti-dumping laws under the rules of the World Trade Organization, the U.S. government's trade policy has always been a highly politicized affair, especially when pertaining to the steel industry. Rather than insert ourselves into a political debate, the purpose of this article is to identify some of the main economic drivers supporting an increase of imported steel and provide an overview of how recent protectionist legislation has affected the domestic steel market.

Foreign Imports Gain Market Share

Elements of the United States' manufacturing industry have historically depended heavily on raw material imports. Imports of rare earth metals and iron ore are critical to keeping the U.S. economy moving, and domestic producers alone – whether due to supply or capacity constraints – can't meet total demand for these commodities. Steel is certainly no exception. Dating back to 1999, annual steel consumption in the U.S. has exceeded total domestic production by an average of 22.9%, representing foreign imports' critical role in maintaining the supply/demand balance for steel in the country.

The flow of steel imports into the U.S. is closely correlated to the spread between domestic and foreign steel pricing. Service centers, which are among the largest consumers of steel in the country, justify purchasing foreign supply if the spread is wide enough to offset the transportation cost and longer lead times.

U.S. Steel Imports as a Share of Domestic Consumption



The preceding chart depicts annual net steel imports and total U.S. steel production since 2007. The recent surge of imports above historical levels points to the difference in pricing between domestic and foreign steel. This structural change was most evident in 2014, when U.S. steel consumption increased by 6.5%. That same year, foreign imports jumped 24.4% year over year while production growth for U.S. steelmakers remained flat. As a result, steel imports grabbed a record 28.9% share of the U.S. market in 2014 – a milestone that was surpassed again in 2015.

Why Are Steel Imports Increasing Market Share?

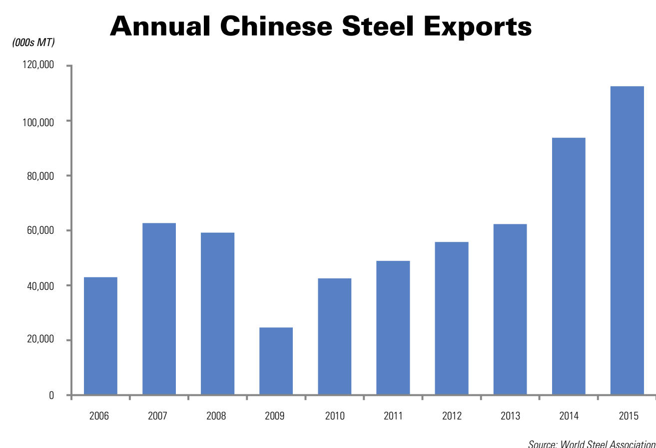
The collapse in global steel prices over the past two years may help explain why the U.S. has been an increasingly attractive market for foreign imports.

The U.S. price of hot-rolled steel coil – the benchmark steel product used to make everything from cars to washing machines – declined by 54.7% last year to $364 per metric ton (MT). Since year-end 2015, prices have made a modest rally, hitting $402 per MT on February 1, 2016, according to Bloomberg daily price data. As imported steel prices have declined, domestic steelmakers have been forced to compete with cheaper imports, although the spread between domestic and foreign prices has continued. There are several factors driving the global price weakness for steel.

First, a global oversupply of steel has put downward pressure on prices. It's a safe bet that if the global steel market is in a state of flux, the first place to look for an explanation is the world's largest producer, China. Since 1990, Chinese annual steel output has expanded at a compound annual growth rate of 11.5%, fueled by robust industrialization and accelerated urbanization. Contemporaneous with the rise of its steel production capacity, China's global market share has increased. According to the World Steel Association, the country's share of global crude steel production rose from 12.7% in 1995 to 49.5% in 2015.

However, when looking at the latest crude steel output data, a disturbing trend is emerging: Steel demand in China is falling as economic growth slows. In 2015, although China's crude steel production declined for the first time since 1991 as local demand dropped and producers remained under pressure from overcapacity, production continued to far exceed domestic demand. Although local regulators have announced aggressive measures to address overcapacity, recent production cutbacks have not outpaced falling demand, leaving the domestic market saturated. As a result, Chinese producers have chosen to ship excess capacity overseas. In 2015, total steel exports from the country reached an all-time high of 112.5 million tonnes,

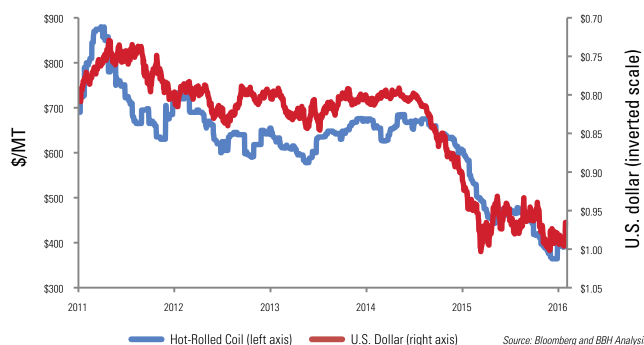
representing a 44.6% increase over a two-year period, based on data from China's government export agency. To put that in perspective, China's steel exports are now 1.5 times larger than total U.S. production in 2015. This trend is also consistent in other major steel producing countries like India and South Korea, where excess capacity continues to ship overseas even though it may not be profitable.



Second, recent appreciation of the U.S. dollar is affecting steel prices. Although the greenback no longer has an official link to the price of gold, or any other commodity, a strong (inverse) correlation still exists between commodity prices and the dollar's value. As the dollar strengthens, it makes dollar-denominated commodities – like steel – more expensive for consumers using other currencies. This typically weighs on demand, as import prices of commodities become more expensive in local currency terms. For example, if the dollar increased by 20% against the euro, an unchanged steel price would look 20% more expensive to a German manufacturer. If that happened, consumers in Germany would buy less steel, which could push down the price.

As the nearby graph shows, U.S. dollar appreciation can also encourage foreign producers to boost exports as goods become more competitive relative to their competitors. Generating sales in U.S. dollars, foreign producers are afforded more leeway to lower prices due to the fact that a larger proportion of their costs are denominated in local currency. This is what economists mean when they describe a stronger dollar as the perfect environment for foreign producers to "export deflation."

Hot-Rolled Coil vs. U.S. Dollar (Inverted)



U.S. Producers Protest Higher Imports

The acceleration of foreign imports into the U.S. market during the second half of 2014 and in 2015 has been followed by strong protest from the domestic steel industry. Although politicians regularly promote the U.S. as the most open market worldwide, it also wields the power to act aggressively against "unfair" trade practices by foreign companies or governments. To ensure a "level playing field," the government commonly relies on protectionist tariffs known as anti-dumping and countervailing duty laws. Anti-dumping duties aim to prevent foreign imports from being sold in the U.S. at "less than fair value," or "dumped," whereas countervailing duties seek to tax imported goods that benefit from subsidies provided by foreign governments. Interestingly, the number of anti-dumping cases initiated by the steel industry has far outpaced any other domestic business. Since 1990, there have been 580 preliminary U.S. anti-dumping hearings, of which 217 pertained to imposing duties on steel products.

In response to the recent surge of steel imports, the U.S. has been swift to initiate anti-dumping investigations across a broad spectrum of product categories. In 2015, the number of new steel-related dumping preliminary hearings considered by the U.S. was 46, which accounted for 45.1% of the total cases filed that year.

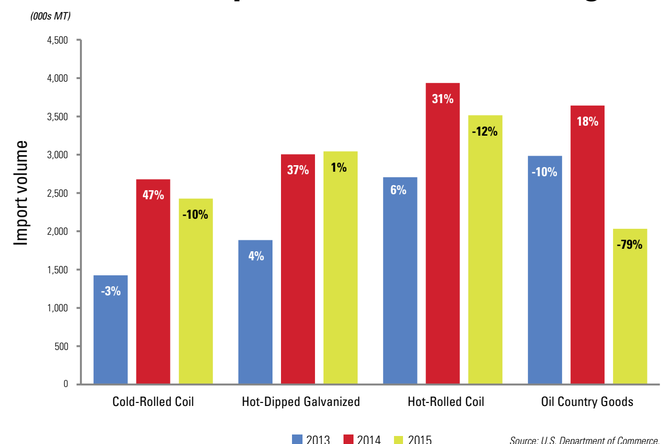
One of the more significant trade cases filed in 2015 pertains to corrosion-resistant steel products imports. This product category – which includes steel sheet that has been coated with zinc, aluminum or any of several zinc-aluminum alloys, such as cold-rolled or galvanized coils – represents 19.4% of steel sold in the U.S. market in volume terms. In June 2015, six U.S. steelmakers filed anti-dumping and countervailing duty petitions with the U.S. International Trade Commission (USITC) and Department of Commerce (DOC) concerning imports of corrosion-resistant steel products from five countries. In the filing, the steelmakers allege that corrosion-resistant steel from China, India, Italy and South Korea was likely being dumped in the U.S. at less than fair value and that those producers likely benefit from a range of countervailing subsidies provided by their respective governments.

Witness testimony during the preliminary phase of the anti-dumping investigation, which was hosted by the USITC, highlights the contrasting views of tariffs on corrōsion-resistant products from the perspective of both domestic and foreign producers.

To summarize, the petitioners representing the domestic industry argued that despite a market with U.S. demand increasing and the domestic industry having significant available capacity, the surge has "idled U.S. mills, led to layoffs, and has damaged the production, sales, profits, and market share of the U.S. industry." This statement seeks to support the claim that imports have threatened the U.S. industry with "material injury," which is necessary to prove in order for the DOC to initiate the establishment of anti-dumping tariffs.

The respondents, which included representatives of foreign steel mills and importers from the six countries named in the petition, struck a decidedly different tone. While they acknowledged that imports have risen across all segments of corrosion-resistant products, they argued that the increases reflect strong demand growth in the U.S. and that supply constraints in the domestic industry require purchasers to diversify with foreign sources. For certain product categories, there is a substantial shortfall of domestic supply – and in some cases, no availability from the domestic industry – which requires foreign steel imports to fill the vacuum. Finally, they argued that corrosion-resistant steel products prices declined as a result of the collapse in raw material prices, including scrap, iron ore and hot-rolled coil, which is the primary feedstock for such products.

U.S. Steel Imports Year-over-Year Change



The preliminary determinations rendered by the DOC announced that corrosion-resistant steel imports would be subject to both countervailing and anti-dumping duties. The countervailing and anti-dumping duties, which are not necessarily aggregated, range from 0% for Taiwan to a punitive 255.8% for China and must be posted in the form of a deposit at the time of import.

The DOC is expected to issue its final ruling in this trade case in the second quarter of 2016.

Trade Tariffs for Corrosion-Resistant Steel Products

COUNTRY	ANTI-DUMPING DUTY	COUNTERVAILING TARIFF
China	235.66%	255.80%
India	6.92%	7.71%
Italy	3.11%	13.04%
South Korea	3.51%	1.37%

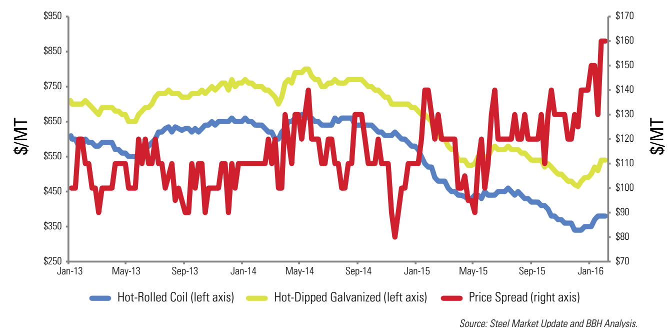
Source: United States Federal Register and Department of Commerce.

While anti-dumping duties are designed to protect domestic industries by achieving a level playing field, their effect can be negative for U.S. consumers. Ultimately, these laws drive up the cost of imported products, eventually resulting in consumers paying higher prices for domestically produced goods.

Since the initial June 2015 filing of anti-dumping and countervailing duty petitions, the flow of corrosion-resistant steel into the U.S. has slowed considerably. According to the American Iron and Steel Institute, net imports of hot-dipped galvanized steel fell 39.3% in fourth quarter 2015 compared with the same period in 2014. The year-over-year decline of hot-dipped galvanized imports has been similar to net flows of other corrosion-resistant products. The price of hot-dipped galvanized in the U.S. has reacted in kind. As illustrated in the nearby chart, the differential between hot-dipped galvanized and hot-rolled coil has increased to its widest level in more than seven years. The premium for hot-dipped galvanized has risen from $110 per MT to $160 per MT over the past six months.

Hot-dipped galvanized prices typically track closely to hot-rolled coil because the latter is the primary feedstock for production, so the fact that the price of the former is rising more rapidly suggests that anti-dumping duties have accomplished their goal of restricting imports and stabilizing prices.

Hot-Rolled Coil vs. Hot-Dipped Galvanized Prices



Source: Steel Market Update and BBH Analysis.

Conclusion

For many U.S. steel buyers, it has become cheaper to purchase imported products from Asia than from domestic mills in, for example, Ohio. Several factors have prompted the recent surge of imports, but increased exports from emerging markets and a strong U.S. dollar have had the biggest influence. As a consequence, steel prices have declined to levels not seen since 2002. While the introduction of anti-dumping duties in the U.S. has offered some price stability, any positive momentum in the price will hinge on emerging markets, like China, reducing domestic steel production capacity to align with current market demand.

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