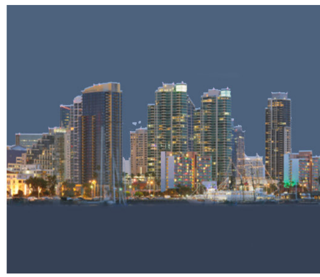
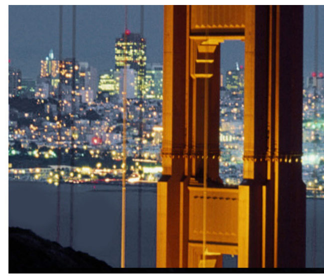
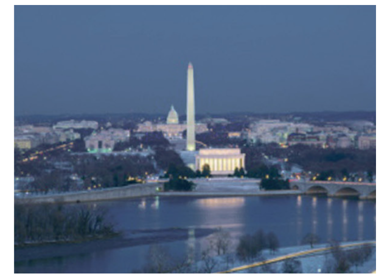

THE BROAD DIMENSION

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The Steel Market

Steve Sacks & Sam Evison

Gone are the days when steel was a relatively stable commodity. For decades, a swing in steel prices meant a change of a few pennies a pound in rebar pricing spread over weeks rather than days. This is no longer the case – price changes are now much more volatile.

Following a sustained decline, the construction market has been dormant for some time, with material costs / unit rates remaining relatively stable for most trades. The exceptions have been trades linked to commodity materials such as copper and steel.

The in-place unit rate for conventional structural steel framing is now above $4,000/ton (up approx. 20% in the last 12 months) and it is possible that this trend will continue through 2012 with no immediate sign of these increases flattening out.

It is safe to assume that the only predictable thing about the steel market in the near future will be continued price volatility.

The current global supply and demand forces for steel have meant that price swings are more pronounced and frequent with no sign of this trend changing anytime soon. Commodity price volatility appears to be the new reality for the construction industry. This is a trend to which the industry will need to adapt as we approach what people hope to be a sustained recovery in business activity.

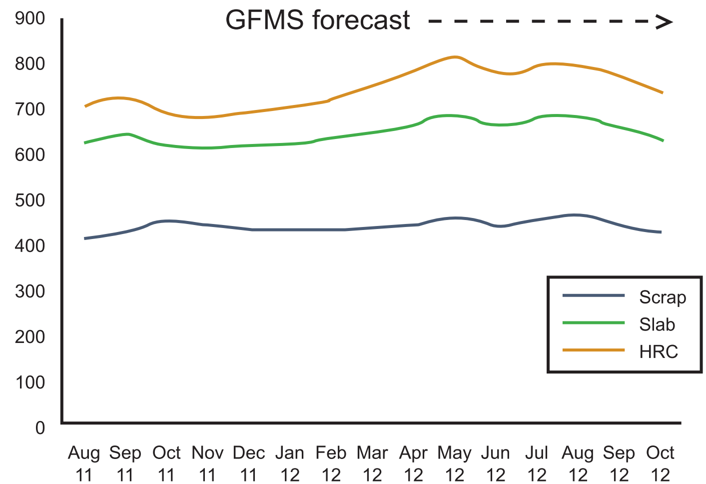
Signs of this new trend in volatility for steel pricing became evident back in 2010 - in mid-November of that year carbon

steel sheet pricing shot up 27 per cent in a five week period. Scrap steel prices also increased rapidly, with steel mills that produce rebar scrambling to increase their prices fast enough to cover their rising input costs. Overall, rebar pricing increased 25-30 per cent over that very short period of time, and the same factors resulted in a corresponding increase in price for structural steel shapes. This general trend continued through 2011.

GFMS Ltd., a leading independent precious metals consultancy that specializes in market research, states that they expect to see increased cyclical volatility as a persistent condition in the market – the current recovery in steel prices could continue over the course of this year and next, but prices could equally fall back to the lows of 2010 as well. The problem for anyone buying steel products is timing – buying early may avoid delays related to mill rolling schedules, but the decision is difficult if short term market trends are unclear - will steel be more or less expensive in 12 months?

Historic pricing trends indicate that from 2003-2008 the duration of the average pricing cycle ran around one year, with a minimum cycle of 10 months. Before 2003 pricing cycles ran 18 to 36 months or more. Steel prices have experienced meaningfully increased volatility in the past 18 – 24 months with a new trend appearing which has two intact cycles within that time. The period from November 2010 until early to mid 2011 saw a 30-percent up cycle and was followed by a 20% down cycle during the third quarter of 2011, the calendar year for 2011 ended part way through another up cycle resulting in a 20% annual increase. The same up cycle has steadily continued until now. Does this suggest that the steel market may be close to starting a down cycle which would see prices drop at some point during the 2nd half of 2012?

Global Steel Mill Price Forecast – Q2 & 3, 2012



World prices - scrap, steel slab, hot rolled coil (GFMS, 2012)

The principal reason why this market volatility is likely to persist in the future is the empty supply chain. Inventories at the mill, distributor and consumer levels normally cushion the market for small swings in steel demand, seasonal swings, supply chain disruptions and other nominal increases / declines in orders. However the supply pipeline has been effectively empty for an extended time now, and some capacity has also been lost during the recession. This means that lead times for production of specific steel products still exist, and increases in demand cannot be instantaneously satisfied. This pricing environment indicates that if you need high quality steel installed by high quality contractors with a short lead time then there is a premium involved, if in fact the schedule is realistic.

This situation may currently be more evident in the Bay Area market than on a wider geographic basis, but as steel sub-contractors refill their order books (or hold capacity for future work) this increases the upward pressure on costs for future projects. With UCSF Mission Bay Hospital, San Francisco General Hospital and the Transbay Transit Center all under construction, and plans in the pipeline for a new San Francisco 49ers stadium, San Jose Earthquakes stadium and a new Apple Headquarters, much of the capacity within the steel sub-contractor sector will be absorbed.

These large projects will tie-up the larger sub-contractors capable of such work, leaving medium sized projects in an unfavorable bidding climate, with limited bid competition and many of the best subs absent from the pool of available

bidders. Limited competition will of course also allow bid prices to rise.

Given the probability that most if not all of these larger projects will go ahead, likely with overlapping schedules, it is prudent to assume that the underlying upward trend in prices for steel products will continue in the short to medium term.

What about foreign steel?

In theory the freedom to import foreign steel should have a moderating influence on domestic prices. In practice there are a number of issues that dampen this effect. In the past the steel industry has been successful in lobbying for tariffs on imported steel, although these are typically applied selectively - for instance, from March 2002 to December 2003 the Bush Administration placed an 8% - 30% tariff on selected imported steel products, but there was no tariff on structural steel shapes, and only a 15% tariff on imported rebar. These tariffs were ultimately removed due to international pressure and the threat of retaliatory tariffs on US exports.

The use of foreign sourced steel is precluded in public works funded with federal money by the 'Buy American' clauses in federal contracts.

Use of foreign steel also introduces the question of certification and quality control, particularly where raw material is being fabricated into finished products overseas.

So while foreign steel mills may provide a source of raw material, they don't necessarily provide a quick easy solution for all projects.

What about out-of-state sources?

Out of State steel fabricators provide a source of additional capacity, and/or expertize to the Bay Area construction industry. Depending on the state of their local market, they may introduce an increased level of competitiveness to an otherwise overheated Bay Area market. They also introduce potential complexities to a project based on their distance from the project site, additional transportation time and costs, and potentially the need to partner with local erectors.

Tablets at Work

At one time you would walk into a meeting and see laptops open all around the conference room table. Nowadays you are likely to see at least as many iPads or iPad-lookalikes as you'll see laptops. The light-weight, instant-on feature, and the wireless connectivity makes tablets an ideal substitute for laptops in many situations, but they do have some limitations.

It has been said that tablets are consumers of data, rather than creators of it, and there is a good deal of truth in that. While the on-screen keyboard works well enough for the hunt-and-peck typist, it lacks the feel of a real keyboard for touch-typists. And transferring data to and from a tablet is easy if, when you connect it to a PC or Mac, it pops up as a USB drive, but if you need a special app, such as iTunes, to transfer data then the process become a bit more involved and off-putting.

Regarding business apps, if all you use regularly are office apps like Word and Excel, then the tablet may well come with the needed software, or it is readily downloadable, and possibly free. But if you have need of specialist applications, then there are a number of issues to address.

With the variety of mobile operating systems in use today, the simplest way to develop a specialist app for use on any tablet is to develop it as a Web application that can be used in the tablet's browser. The problems with that approach is that (1) an Internet connection has to be available, and (2)

the application cannot make use of special features on the tablet, such as GPS or the camera.

You can develop an application that runs directly on the tablet, and that therefore could use features such as the camera, but then you either need to limit the type of tablet, or adapt the application for a variety of operating systems and specific implementations on particular machines. With the growing implementation of the BYOD (bring-your-own-device) idea, any special application might need to be tailored for many different devices.

There are already some tablet devices that run versions of Windows, but the advent of Windows 8 will undoubtedly increase the number. Microsoft has always had a larger focus on business than Apple has, so the proportion of tablets around the conference room table is likely to increase substantially in the near future.

Beware – Cliffs Ahead

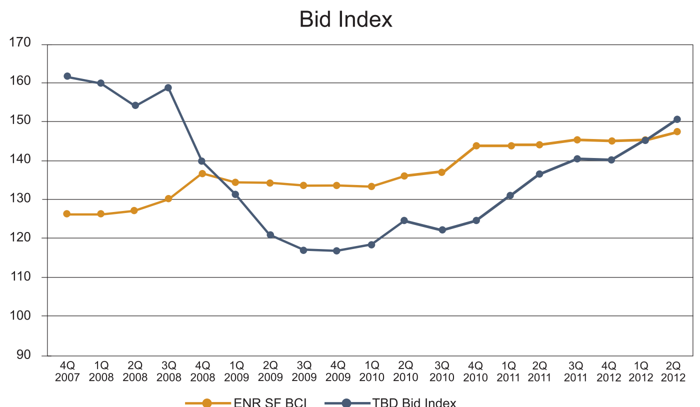
Geoff Canham, Editor

It was two years ago, in our 2010 Q3 newsletter that we wrote about the economic problems associated with Greece, and those problems have not gone away. Indeed, with the political changes that have occurred there, the problems have only compounded. But while Greece may be the chief headline grabber in Europe, it is far from the only one, with Spain and Italy following close on Greece's heels, and France, with its change in leadership, is grabbing more of the headlines as well. And next year, Germany Prime Minister Angela Merkel faces national elections too.

So the problems of the Euro appear to be coming to a head, and the time for kicking the problem further down the street may be coming to an end. In essence, the problems with the Euro stem from having a single currency that is being used by many different countries, each with its own economic and political systems, with varying productivity levels, and no easy way of adjusting the currency's value between nations. Back when they had separate currencies, as Greece became non-competitive it could have devalued its currency, making its goods and services more attractive to other nations. That cannot happen now. The members of the Eurozone cannot now use their currency as a tool for managing their economy.

What we are left with is the option for Greece to opt out of the Euro (and no one seems to be sure how that would work, or even if 'work' is the right word to use), or to have the more productive nations (primarily German) support the less productive ones (and that does not sit well with Germany). The real solution is the integration of monetary and fiscal policies throughout the Eurozone, but that takes away sovereignty from individual nations, which is unpalatable to most people. The idea of using austerity to bring the nations back in line is being questioned by many, especially those who are directly impacted by it. Exactly what the long-term solution to the problem is remains to be seen, but in the meantime the uncertainty is rattling the markets, and creating a business atmosphere where investment is seen as more risky. Uncertainty and recovery may not be totally incompatible, but they do not fit well together.

The problems of Greece and the Euro constitute one cliff we have to look out for, but there is another one, specifically the one that gave us the heading for our article.



Here in the U.S., the recovery may be slowing down, but generally it is still moving in the right direction at present. But the debt issue is still out there, and unless the politicians can agree on an alternative plan for addressing the problem, massive government spending cuts will be automatically triggered, raising the specter of austerity here. As the result of the battle in Congress that led to S&P downgrading the US credit rating, come January 1, 2013, if Congress has not agreed an alternative method for controlling the US debt, then $7 trillion in tax increases and spending cuts, spread over 10 years, will automatically spring into effect. Federal Reserve Chairman, Ben Bernanke, described that as a 'fiscal cliff', and expressed fears that it would result in the U.S. being pushed back into recession. We can hope that the politicians at least come up with a last-minute compromise – a cliff hanger – as they did last time. Is it too much to hope that they could agree on a solution before the last minute?

Meanwhile, we chug alone and hope we are not heading for a cliff edge.

Newsletter designed by Katie Levine of Vallance, Inc.