INTERNATIONAL UNCERTAINTY

AT BIR'S SPRING CONVENTION IN OSLO, SPEAKERS EXPLORED "ONGOING CHALLENGES" TO GLOBAL SCRAP MARKETS, INCLUDING UNCERTAIN ECONOMIC RECOVERY IN THE UNITED STATES AND EUROPE AS WELL AS TIGHT SUPPLIES OF SOME SECONDARY MATERIALS.

BY ROBERT J. GARINO

Picturesque Oslo, Norway, provided a scenic backdrop for a somewhat somber spring convention for the Bureau of International Recycling (BIR) (Brussels). Despite an upbeat appraisal of the global scrap situation earlier this year, one nonferrous speaker noted, the current business outlook had darkened by the time of the May meeting. The economic situation in the United States also seemed uncertain, especially for ferrous consumption, another speaker stressed.

Beyond market reports, the Oslo convention was notable for marking two firsts: One was the election of BIR's first Italian president, Fernando Duranti of Leghe & Metalli International Srl (Milan), who succeeds two-term president Barry Hunter of Hunter-BenMet Associates L.L.C. (New York City). In addition, the conference included BIR's first full-day symposium devoted exclusively to aluminum.

NEGATIVES FOR NONFERROUS

Nonferrous markets face a "morose" macroeconomic outlook that has darkened compared with a more optimistic view just a few months before, noted Marc Natan of Malco S.A. (Le Pré Saint Gervais, France).

Several factors contributed to this negative view, including the recent declines in global metal production and consumption, SARS and its impact on China's growth, economic recessions in Germany and France, declines in U.S. gross domestic product, and the rapid depreciation of the U.S. dollar, Natan explained.

Another speaker, Björn Grufman of M.V. Metallvärden AB (Stockholm, Sweden), added that the common thread among the major Western economies was one of "uncertainty" about the near-term business climate as well as prospects for recovery.

Bob Stein of Alter Trading Corp. (Grand Rapids, Mich.) spoke about trade with China—specifically, the real and perceived threats of U.S. scrap exports to China to the traditional flow of nonferrous scrap from U.S. processors to domestic consumers. In his view, China's "intense buying" is "destroying the traditional relationships among dealers in the U.S. as well as to the consumers." Stein explained that buyers from China are achieving market penetration at the expense of the wholesale scrap dealers, whose prices may no longer provide a benchmark for establishing prices, thus fueling the competitive fire. The net result, he concluded, is a loss of domestic outlets for scrap as domestic consumers are being priced out of the market.

Despite China's unfair trade advantage, "arbitrary dictates of foreign interests" against the Chinese aren't the solution, Stein warned. Instead, "appropriate trade action" should be taken against

Fernando Duranti

Marc Natan

Bob Stein

China "in accordance with international law and not by means of unilateral imposition of protectionist policies," he recommended. Looking ahead, however, Stein sees China evolving as a more responsible buyer—most likely as a result of discussions with trade groups and legal actions brought against it by aggrieved consumers.

Looking ahead, Stein sees the strong international flow of nonferrous metals, at least from North America, continuing for many years to come. Those who can survive and who understand how to do business in a drastically changed environment will do well, he said. "The challenge," he stressed, "will be to look at our businesses and understand that business as it was done in the past needs to remain in the past."


Robert Philip


Sandro Giuliani


Barry Hunter

A 'SLUGGISH' FERROUS FUTURE?

At the ferrous division meeting, Robert Philip of Schnitzer Steel Industries Inc. (Portland, Ore.) characterized the U.S. economy as "sluggish" in terms of steel consumption. As evidence, he noted that commercial and industrial construction activity is still slow, while public infrastructure spending also remains in doubt. Moreover, scrap export markets are "cooling off" as exporters react to lower prices and rising ocean freight rates, he said.

Regarding the West Coast market in particular, Philip noted that higher product prices "appear to be holding," as are volumes. While price increases announced months ago are just now coming into effect, higher scrap and energy costs will likely keep margins at bay, he predicted.

As for domestic scrap prices in the near term, Philip recommended watching the interplay between global scrap buyers and the domestic mills as they hedge their inventories and attempt to keep scrap away from the export docks.

Sun Jiansheng of the China Association of Metal Scrap Utilization (CAMSU) (Beijing) provided a comprehensive report on Chinese steel scrap consumption for 2002 and 2003. As he reported, last year's steel output reached a record 181.5 million mt, of which 28.2 million mt (about 16 percent) was produced by electric-arc furnaces. To meet this production, Chinese steel mills consumed 22.1 million mt of ferrous scrap.

China imported a total of 7.85 million mt of scrap last year, along with 1.3 million mt of HBI, Sun said, noting that only 5.34 million mt of that total was used to produce raw steel. The remaining material was rerolled or used in nonmetallurgical applications. China's main global scrap suppliers in 2002 were the United States (2.307 million mt), Japan (1.748 million mt), and Kazakhstan (1.286 million mt).

This year, China's steel output increased 18 percent in the first quarter, said Sun. At that rate, China could end up producing 27 million mt more steel in 2003 than in 2002. Should this forecast prove correct, China would need an additional 4.66 million mt of scrap to meet its production needs, he noted.

Ferrous scrap is expected to remain in short supply, however, due to factors in the Russian, Ukrainian, and U.S. markets, according to CAMSU, which stated that China "cannot expect an export increase [from the United States] in 2003." In addition, scrap prices will likely "maintain at a high level." The association was encouraged, though, by the growing supply of scrap within China, where purchased domestic ferrous scrap should surpass 27 million mt this year.

UNCERTAINTY FOR STAINLESS AND SPECIAL ALLOYS

The global economy is "still experiencing a phase of uncertainty" and so far has been unable to emerge from its protracted slowdown, noted Sandro Giuliani of Giuliani Metalli Sas (Milan). He warned, however, that stainless markets have yet to feel the full weight of the economic "crisis" that has persisted over the past three years.

All over Europe, Giuliani said, the same three factors are affecting stainless steel scrap:

- low scrap collections and inadequate supplies of high-nickel-content scrap;
- export restrictions and changes in trade patterns; and
- longer end-use product life cycles, which delays the recycling timetable.

It would take a strong economic recovery to increase scrap supplies and widen the margins at the dealer level, Giuliani stated, but that "does not seem to be around the corner."

Hunter-BenMet's Barry Hunter echoed many of Giuliani's comments as he took a closer look at the U.S. market. Third-quarter mill order books continue to reflect the downtrend in consumer spending, Hunter said, while a corresponding decline in industrial production is reflected in the concern over scrap availability. At the same time, declining domestic demand is being met by aggressive buying by offshore producers.

Because of this, the domestic dealer business and pricing accurately reflects the international nature of the business, Hunter explained, with

buyers and sellers emphasizing volumes in order to participate in customer blend supply programs. This emphasis also manifests itself in "little or no margin when wholesalers compete for the base 18/8 grades." Ultimately, this will lead to smaller mill suppliers having to determine if they're supporting the correct or logical market when offering their scrap, Hunter concluded.

ALL ABOUT ALUMINIUM

BIR's full-day symposium on aluminum, called "Aluminium Sustainability—The Gate to the Future," offered more than 15 formal presentations and several videos. Speakers discussed regional and global fundamentals, macroeconomic influences, metal-sorting techniques and analysis, as well as risk management. Not surprisingly, the event paid particular attention to global scrap supply issues and China's influence on the world commodity markets.

Harvey Rosen of Alpert & Alpert Iron & Metal Inc. (Los Angeles) discussed the state of the U.S. secondary aluminum smelting industry. The most significant factor affecting the industry in the past 12 months, he said, has been a severe shortage of scrap, which can be directly attributed to the overall decline in U.S. manufacturing.

Rosen also highlighted several contributing factors that influence the generation of industrial scrap, including product economization, miniaturization, and manufacturing efficiencies. These factors have resulted in a scrap market that's in critically short supply, with price pressures increased by strong export demand, particularly from China, Rosen explained. As lower grades of scrap are exported, the remaining material becomes less available to domestic consumers, he said.

These problems were exacerbated by an unusually heavy winter in the U.S. Midwest and East, making the collection of obsolete scrap more difficult than during a "normal" winter, Rosen pointed out. Consequently, prompt and obsolete scrap prices have increased at a faster rate than alloy prices, squeezing secondary margins. The scrap shortfall has had the additional effect of limiting production at some U.S. smelters, he noted.

Turning his focus on China, Rosen said that some economists and metal market analysts see dangers to the Chinese economy from the SARS virus, especially since China is both a major producer and consumer of base and precious metals. If SARS negatively affects China's exports and consumption, Chinese manufacturers may be forced to limit their inventories, which rose sharply in the first two months of this year, Rosen explained. With this in mind, "we must consider the remainder of 2003 as a year of ongoing challenges," he concluded.

The current European scrap supply situation is also an ongoing challenge, said Roland Scharf-Bergmann of VAW-IMCO Guss und Recycling GmbH (Grevenbroich, Germany). The European market for aluminum scrap—earmarked for foundry, slab, and billet consumption—requires 4.8 million mt annually (excluding home scrap), he noted, but such scrap is currently in short supply for several reasons, including:

- increasing "closed-loop" arrangements between recyclers and generators that are keeping supply off the open market;
- globalization factors that have added to regional shortages;
- export duties;
- increased demand from China;
- longer product service life and increased manufacturing efficiencies; and
- the fact that relatively high aluminum recycling rates already exist.

Though collectively these factors have reduced the aboveground supply of secondary material, scrap shortages are "essential and natural" over time and tend to be self-regulating as more primary material is used in place of scrap, Scharf-Bergmann said. While the current supply shortfall is more pronounced than expected, the overall reduction isn't "dramatic," he maintained. At the same time, however, China has the potential "to cause significant market disruption."

Hedging Aluminum. Other presenters at BIR's aluminum symposium explored ways to manage price risk using the LME to hedge metal positions.

In particular, Michael Lion of Sims Group Ltd./Lion Consulting Inc. (Malibu, Calif.) asserted that the connection between the LME and aluminum scrap may be far more tenuous than some believe. Still, there does seem to be a "fairly consistent harmonious affinity between the movement of the LME prime contract and grades of scrap that are typically a raw material feedstock for the mills of primary alloy producers," he said.


Michael Lion

Hedging with lower grades of scrap is another story, he said, stating that "the relationship of secondary grades of scrap to their LME benchmarks are, to put it kindly, far more uneven."

Lion also noted that, "as far as secondary consuming grades of scrap are concerned, the connec-

tion between scrap and the LME is far more tentative." He remained "skeptical of the relationship" and described it as characterized by random uncontrollable variables. Moreover, the lack of any consistent affinity between scrap and the LME is likely to continue for the near future, he said.

In Lion's view, would-be hedgers should first examine potential negative factors such as market backwardations and option fees. Ultimately, though, "the burgeoning development of the China scrap market" is the greatest determinant and likely deterrent to any consistency in secondary scrap price links to the LME, he said. China is "the X factor in scrap pricing influences" and has made the dynamics of pricing increasingly opaque, Lion concluded.

Robert J. Garino is director of commodities for ISRI.

The most significant factor affecting the U.S. aluminum smelting industry in the past 12 months has been a severe shortage of scrap.