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THE STEEL MARKET SITUATION

SPRING 1998

CANADA

Industry Canada

Metals and Minerals Processing Branch

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The General Steel Market

General Economic Overview

In February 1998, the real Gross Domestic Product (GDP) increased by 0.9% and was 3.4% higher than in February 1997. The rate has fluctuated quite dramatically since the beginning of 1997 — ranging from a low of -0.86% in January 1998 to a high of 1.10% in December 1997. In 1997, real GDP grew by 3.91% compared to 1.55% in 1996 and 1.85% in 1995. Private sector forecasts now anticipate real GDP growth of 2.9% in 1998 and 2.8% in 1999.

In April 1998, the Consumer Price Index (CPI), a measure of inflation in the economy, was 0.1% lower than in March and 0.8% higher than in April 1997. Analysts expect that the rate for the remainder of 1998 will rise to about 1.8% by December In 1997, the CPI rose 1.6% and private sector forecasters expect it to rise by 1.8% in

1998 and 2.0% in 1999.

The unemployment rate was 8.4% in April 1998 compared to 9.5% in April 1997. The unemployment rate had been trending down from a high of 10% in November 1996 and in April 1998 it fell 0.1% point from a month earlier. In 1997, the unemployment rate averaged 9.2 down from 9.7% in 1996. Private sector forecasters anticipate it should average 8.7% in 1998 and 8.3% in 1999.

The prime rate charged by banks on loans was 6.50% as of May 19, 1998. The rate has been rising since September 1997 when it stood at 4.75%, its lowest level in decades. Despite this increase, the Canadian prime rate remains significantly below the U.S. prime rate of 8.50%. In 1997, the prime rate averaged 4.96%, down from 6.06% in 1996 and 8.65% in 1995. Private sector forecasters anticipate the prime rate to average 6.58% in 1998 and 6.75% in 1999.

The average value of the Canadian dollar, expressed in U.S. funds, was $0.6899 as of May 19, 1998. However, this is up from its record low of $0.6810 in January 1998. In May 1997, the dollar had a value of $0.7244. For all of 1997, the average value of the Canadian dollar was $0.7223, down from $0.7334 in 1995. Private sector forecasters are expecting the exchange rate to continue to weaken from past annual averages to $0.707 in 1998 and $0.716 in 1999.

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The Canadian Steel Market

Employment, hourly and salaried, at primary iron and steel producers was 33,384 for the first 2 months of 1998, up 2.12% from 32,691 for the same period in 1997. For all of 1997, industry employment was 33,403, basically unchanged from the 1996 level of 33,483.

For the first 4 months of 1998, liquid steel production increased 8.7% to 5.438 million tonnes (MT) over the same period in 1997. During the first 2 months of 1998, total shipments increased 1.0% to 2.357 MT and domestic shipments increased 1.7% to 1.922 MT compared to a year earlier. In the first 2 months of 1998, liquid steel production was 2.628 MT.

Overall steel demand in 1997 was excellent. At least one analyst described demand in Canada and the U.S. as being at its highest level in 25 years. After several years of increased imports of semi-finished steel, their levels are again returning to more normal levels. These imports peaked at almost 1,482,000 tonnes in 1995 before declining to about 1,054,000 tonnes in 1996 and about 822,000 tonnes in 1997. For the first 2 months of 1998, such imports totalled about 20,000 tonnes compared to 26,000 tonnes for the same period a year earlier.

In 1997, apparent domestic consumption (ADC) was up 19.5% over the 1996 level and up 73% from the last low point in 1991. Given the very strong steel market in Canada, import volumes surged 58.4% in 1997 and import penetration levels increased by 33% to 37% of ADC. In fact, in 1997 import volumes and penetration figures are the highest ever recorded. Total imports amounted to 6.331 MT and were up strongly from the United States (to 3.250 MT), Asia (to .271 MT), Central and South America (to .854 MT) and Eastern and Central Europe and the former USSR (to .672 MT). About the only region from which imports declined was the European Union where they totalled .963 MT, down 20.5% from 1996 levels.

Imports from the U.S. grew by 58.4% in 1997 and were at record levels, accounting for 21.1% of A.D.C. up from 16.6% in 1996 and the previous annual high of 17.5% in 1995 Imports from Central and Eastern Europe and the former USSR increased by 205% in 1997, with imports from Russia increasing by 172% to .516 MT in 1997. In fact in 1997 Russia was the second largest exporter of steel to Canada after the U.S. Last year Russian steel accounted for about 8.7% of all Canadian steel imports by volume and 4.5% of all such imports by value and represented about 3.6% of Canada's total A.D.C. of steel products. Most of these imports were concentrated in a few product categories: hot rolled sheet, cold rolled sheet, cut plate and H sections. The Slovak Republic also emerged as a large exporter to Canada in 1997, particularly of cold rolled sheet and hot rolled sheet.

In the first 2 months of 1998, total imports were .958 MT, up 16.7% from the same period in 1997. Imports from the U.S. were up 19.3% to .587 MT while those from Central and Eastern Europe and the former USSR were down by 35.9% to .053 MT and imports from Russia down 61.5% to .022 MT.

For the first 2 months of 1998 compared to the same period in 1997, steel shipments have increased for motor vehicles and parts (up 5.2%), for rail cars and locomotives (up 108.1%), for miscellaneous stamping and coating (up 6.0%), industrial packaging material (up 11.9%) and pipes and tubes (up 27.1%). However, steel shipments have decreased service centres (down 10.9%), for steel fabrication (down 5.0%), contractors' products (down 7.0%) and natural resources and extractive industries (down 19.5%).

The economic growth in Canada continues to be export led with the automotive sector being a key one. In 1997, Canadian motor vehicle production increased 10.36% over 1996 levels to 2.408 million units. Motor vehicle sales in 1997 were 18.3% ahead of their pace in 1996 and totalled about 1.424 million units. For the first three months of 1998, production is down .71% (to .636 million units) from the same period in 1997 while sales for the first four months of 1998 totalled .425 million units — up 1.5% over the same period in 1997. Sales are being aided by manufacturers' incentives — often averaging from $1,500 to $2,000 per vehicle and the availability of low or even zero percent financing (in the minivan sector).

In the Canadian construction sector, activity, as measured by the value of building permits issued for residential and non-residential construction, increased by 19.4% in 1997 compared to 1996. In the first 3 months of 1998, the value of such permits increased by 16.8% over the same period in 1997. In 1998, the value of non-residential building permits increased by 50.1% during this period and the value of residential permits decreased by 1.8% over the comparable period in 1997. That year, housing starts totalled 148,300 up from only 112,600 units in 1995 and down from 153,900 in 1994. As of April 1998, seasonally adjusted housing starts were 146,600 compared to 143,300 a year earlier. Forecasts for housing starts in 1998 are for about 160,000 units.

For Canada's three largest steelmakers (primarily integrated producers), 1997 saw total revenues increase by 5.2% (to $7.481 billion) while net income increased by 7.9% (to $354.1 million) compared to the results for these same firms one year earlier. In the first quarter of 1998, for these same three firms, total revenues increased by 7.1% (to $1.919 billion) while net income fell by 18.7% (to $72 million). Despite the fall in profitability, the average revenue per ton shipped by these firms increased to $688 in the first quarter of 1998 from $675 in the first quarter of 1997. The value for the first quarter of 1998 is marginally higher than that for these firms for all of 1997 ($682). The increasing revenue per ton shipped reflects the price increases that the industry has managed to realize in a strong market. Additional increases ranging from $25 to $35 per ton have been announced for plate, hot rolled, cold rolled and galvanized sheet products. They were scheduled to come into effect April 1, 1998.

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Outlook for the Balance of 1998

The steel market is expected to remain strong for the remainder of 1998. However, is based on continued strong demand for the first half of the year followed by a slackening of demand in the second half. It is anticipated that for all of 1998, overall demand is to remain at about the 1997 level. In 1998, automotive production is anticipated to rise marginally and in the pipe and tube sector record drilling activity and the approval of several major large diameter pipeline projects is expected to maintain strong steel demand in this sector in 1998. Given a strong steel market in Canada, import levels are expected to historically high levels in 1998.

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The O.C.T.G. Market

For 1998, drilling activity is expected to slow considerably from the exceptional levels reached in 1997. The Canadian Association of Oilwell Drilling Contractors (CAODC) predicts that 13,700 wells will be drilled in 1998, down from 16,484 in 1997. The figure for 1998 is down from a fall forecast by the CAODC for 16,600 wells. The reduced number of wells now being called for reflects lower commodity prices and a focus on cost-structure reduction in the industry.

About 60% of the wells to be drilled in 1998 will be looking for natural gas. This is a major turnaround from recent years when about 60% of such wells were looking for light and heavy oil. The increased activity in the gas sector is due to the increasing integration between Chicago and the Alberta market.

According to the Oil and Gas Journal, in 1998 Canada has 2,300 miles of (oil and gas) pipelines from 102 to 813 mm (4 to 32") and larger in diameter to complete with about 50% of that amount in the 559 to 813 mm (22 to 32") range. For projects to be completed in 1999 or later, Canada has about another 6,700 miles of pipeline, almost 80% of which is 559 mm (22") and larger and 52% of which 813 mm (32") and larger.

In April 1998, drill rig utilization rates dropped significantly, as is normal due to spring breakup.

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Outlook for the Balance of 1998

Drilling levels are expected to remain relatively strong in 1998. While activity levels will be down significantly from 1997 levels, they will remain above 1996 levels. It should be noted that except for 1997, 1996 was the best year that the industry has ever had.

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The Specialty Steel Market

In the specialty steel long products market, while some markets have been enjoying buoyant current demand (aerospace and related industries) in 1998 other markets (e.g. mining industry) have been experiencing difficulties due to reduced demand and a period of adjustment in global markets.

Overall demand for 1998 is expected to show modest growth. However, imports and import penetration levels continue to grow in volume terms and at price levels that are now at their lowest in many quarters. The Canadian industry contends that this is the result of underutilized productive capacity among many foreign producers which results in low priced products being exported to other markets, like Canada.

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Outlook for the Balance of 1998

The current strong demand in markets like aerospace and related industries is expected to continue for the rest of 1998. Similarly there is no indication that depressed markets such as in the mining industry will recover before the end of the year. As regards import volumes and price levels, the current trends are expected to continue for the remainder of the year.

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Agreement Overview

In order to foster the competitiveness of Canadian industry and increase the domestic stock of scientific and technological knowledge, Canada has negotiated the Agreement for Scientific and Technological Co-operation between Canada and the European Union

The Agreement with the European Union (EU) will give Canadian companies, universities and research institutes the opportunity to join with European partners in research and technological development (RTD) projects under the European Union's RTD programs

The Agreement will enhance opportunities for Canadian organizations to participate in leading-edge R&D, to facilitate the development of results that conform with EU technical standards and to establish good research linkages that have the potential for downstream commercial opportunity to participate in complementary Canadian R&D projects

The Agreement is expected to be interpreted broadly and to encompass a wide range of research areas The potential areas of co-operation listed in the Agreement are

- agriculture (including fisheries)
- medical and health research
- non-nuclear energy
- environment (including earth observation)
- forestry
- information technologies
- communication technologies
- telematics for economic and social development
- mineral processing

The Canadian companies and institutions expected to take an interest in these developments are those for whom R&D is a critical component of their business

Both sides have agreed to establish a Joint Science and Technology Co-operation Committee to oversee the operation of the Agreement, and to allow for discussion on adding new areas of co-operation