Global prices to prop domestic steel despite near-term demand taper: Icra

India’s steel consumption growth is expected to moderate sequentially in the near term due to a surge in the number of new Covid cases in March 2021 and increasing mobility restrictions.

However, the extent of moderation is too early to estimate, given that vaccination drive is ongoing and the fact that the lockdowns being announced are not as severe as witnessed in Q1 FY2021, said ratings agency Icra today.

Despite the possibility of demand moderation, Icra expects domestic steel prices to remain elevated on the back of favourable international price trends.

In terms of demand trends, it is to be noted that contraction in domestic steel consumption has been much lower at 9.9 per cent in 11M FY2021 compared to a 19.6 per cent drop witnessed during 8M FY2021 on the back of a sharp pullback in demand during December 2020 and January 2021.

Buoyancy in international steel prices kept domestic steelmakers' export volumes high in February 2021 with a year-on-year (y-o-y) and month-on-month (m-o-m) growth of 15 per cent and 25 per cent respectively, a trend, which Icra expects to continue in March 2021 as well.

However, steel demand in February 2021 reported a m-o-m decline of 7.6 per cent as elevated steel prices kept some of the end-users in wait and watch mode.

"Given the elevated Chinese export HRC price level of $768 per tonne and a recent spurt in ocean freight rates, landed price of imported steel from China is 10 per cent costlier compared to domestic HRC prices. As a result, even if the domestic steel consumption moderates in the coming months, we do not expect domestic steel prices to fall drastically from the current levels," the report quoted Jayanta Roy, senior vice-president & group head, corporate sector ratings at Icra as saying.

With respect to international trends, despite second or third wave of Covid-19 hitting many key steel consuming geographies in recent months, with a crude steel production growth of 6.8 per cent in January 2021, China continued to drive the world steel production growth and kept it in a positive territory at 4.8 per cent.

Notwithstanding a moderation in economic activities in February 2021 due to Lunar New Year Holidays and new cases of Covid-19, China has been able to regain its growth momentum in March 2021 and is expected to witness a healthy domestic demand in the coming months.

On the raw material scenario, domestic iron ore supplies continue to remain tight with only ten of the nineteen mines that were recently auctioned in Odisha having started production till February 2021. Consequently, domestic iron ore prices remain elevated.

In this context, The Mines and Minerals (Development and Regulation) Amendment Bill, 2021, which allows merchant sale of upto 50 per cent of the annual production by captive iron ore mines owners, remains a positive.

However, Icra expects the ore supply tightness to prolong for the next 6-9 months, as merchant ore supplies fails to catch up with healthy steel production, and captive miners requiring some time to mobilise resources to ramp-up production following the recently promulgated Bill becoming an Act.

On the coking coal side, steelmakers are expected to witness consumption costs decline sequentially, which, along with better steel realisations, can help lift operating profit margins by around 230 basis points sequentially in Q4 FY2021.

Icra expects the operating profitability of the industry in Q4 FY2021 to improve further to around 32.4 per cent due to an Rs 8,000 per tonne increase in average steel prices during the quarter.

In line with operating margin trends, the industry's interest coverage increased on a q-o-q basis to 6.6 time in Q3 FY2021 from 4.0 times in Q2 FY2021 (2.3 times in Q3 FY2020) and is expected to sequentially improve to over 8 times in Q4 FY2021.

Steel Consumption