Metal Expert

Russia Tubes and Pipes Forecast

Tubes and pipes for oil-gas industry, building and machine-building

QUARTERLY REPORT

AUGUST, 2020

metalexpert.com

EXECUTIVE SUMMARY

The first half of 2020 registered a drop in Russia's economy due to quarantine measures introduced against the COVID-19 spread. On top of the lockdown, the country's budget was hurt by a slump in oil prices and the consequent necessity to reduce drilling and extraction as stipulated by the OPEC+ deal to rebalance demand and supply in the global market.

Specifically, investments in drilling and commissioning of new wells will be limited in the forecast period. Negative environment in the gas market affected financial performance of gas producers, which challenges investment activity under modernization programmes and full-scale performance of repairs on pipeline infrastructure. At the same time, given the President's order, there is a possibility of faster regional gas infrastructure development; however, unless construction of new gas trunk pipelines begins, purchases of small, medium and large diameter pipes are unlikely to increase. The construction market will post a drop in both the housing and infrastructure segments in 2020 and a compensating rise within the two subsequent years.

Pipe consumption will start recovering next year; however, reaching the 2019 level will become possible no sooner than 2022-2023 provided adequate measures supporting consuming industries. That, in turn, will depend more on an increase in prices for energy supply as the main source of the country's export revenues to fund state programmes.

Capacity utilization will decrease in all pipe segments by a total of 17% in 2020. Meanwhile, effective contracts with oil and gas companies prevent the seamless pipe segment from slumping. Amid toughened competition in the market for small and medium diameter welded pipes, **the scale of production** and the volume of available liquidity to build HR feedstock inventories in the period of local price minimums are the basic factors to maintain production activity. Smaller companies continue utilizing their capacity by concluding tolling agreements, which gives them minimum profitability. Overall, **sales margin** in the segment for small and medium diameter welded pipes will be hovering around lows within the eighteen coming months.

CONTENT

CONSUMPTION FORECAST

Obligations under the OPEC+ extraction reduction deal, low prices for energy resources and consequently budget deficiency will be the main factors to exert an adverse impact on steel consumption in the forecast period. A drop in housing commissioning is aggravated by a fall in people's income, while the non-residential sector suffers postponement of projects and a decrease in investments due to a drop in budget revenues. Slower drilling and consequently shorter funding in the oil and gas sector will lead to lower pipe consumption. Without a launch of new projects, repairs of operational infrastructure will be too little to make up for the drop in pipe product sales.

Over 2020-2021, pipe consumption will fall by 11-18% from 2019.

* – LDP and line pipes in total

Key indicators of investment activity

	Jan-Mar 2019	Jan-Mar 2020	Y-o-Y	
			change	change, %
Gross capital accumulation in GDP*, RUB billion	**3,818**	**3,887**	68.7	1.8%
capital investments into all companies	2,855	2,889	34.3	1.2%
incl. capital investments into large and medium-sized companies	*2,204*	*2,264*	*59.5*	*2.7%*
incl. capital investments which are not registered with direct statistical methods	*651*	*626*	*–25.2*	*–3.9%*

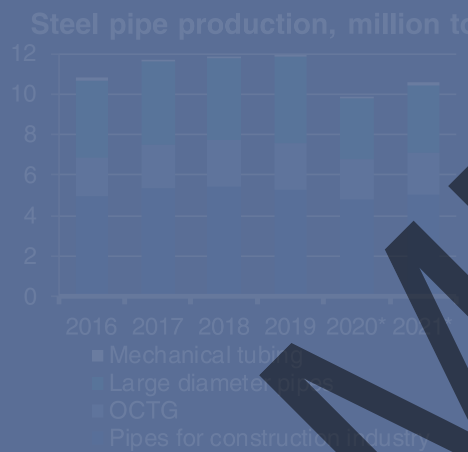
Source: Russian Federal State Statistics Service
** – in 2019 prices*

Besides general global conditions, another factor exerting a considerable impact on Russia's economy is the dynamics of the OPEC+ deal implementation. The agreement has already resulted in much worse results in the extractive industry compared to the processing sector. VEB believes **Russia's GDP** growth will slow down by 5% on the epidemic and by another 1.4-1.5% on a drop in oil prices. With the growth potential being 2% before the crisis, the decrease will be some 4.5% in 2020, and this estimate is the basis for Metal Expert. In 2021, the growth will be 3.4-3.5% unless the OPEC+ contract schedule is revised.

SUPPLY FORECAST

Metal Expert sees no reasons for pipe demand to stay as strong as before in the Russian market in the forecast period, considering an inevitable drop in budget revenues on a slump in oil and gas prices. Export destinations experience a similar situation amid steadily negative conditions in the global oil and gas market and a largely slow recovery of economies in the post-pandemic period.

Pipe business merging is underway, while capacity utilization is still supported by cooperation under tolling agreements. Pipe supply will drop by 17.5% in 2020 and recover by 6.8% in 2021.



OPERATING CAPACITIES

In Q2, welded pipe output expectedly fell amid quarantine restrictions and suspension of production activity – by 12% quarter-on-quarter and by 13.5% year-on-year to 1.199,2 million t. Domestic shipments amounted to some 1.097 million t (down 9.1%; down 12.9%), exports – 102,200 t (down 38.8%; down 19.1%).

PRICE FORECAST

Business activity started recovering in the Russian market for standard welded pipes by the end of Q2 owing to seasonality and quarantine-based deferred demand. Pipe makers managed to get out of the red in April-May thanks to a surge in feedstock prices, yet their margin got little above the break-even point. The producers were supported by peak demand from traders as restrained supply of thin HRC led to a shortage of small-sized pipes.

In July, prices for 57-108 mm welded pipes (GOST 10705) rose by an average of 2.6% relative to the start of the preceding quarter, with the trend continuing in August (up 3-5%). Mills will decide on their further pricing policy depending on feedstock availability in the domestic market as well as under pressure of descending demand in the construction sector. However, they will fail to completely make up for reduced profitability registered in the first half-year, even provided favourable market developments in autumn and a rise in the margin.

Considering an increase in pipe output under tolling agreements and steadily tough rivalry (mills' pipe sales at prices below feedstock costs), the pipe production margin will be heading for minimum in the forecast period. Average welded pipe prices will be within RUB 37,900-44,700/t (with VAT, EXW) in 2020.

RAW MATERIAL AND HR STEEL PRICE FORECAST

China' steel production rose by 2.2% year-on-year in the first half of 2020, hitting its record average daily output in June (3.05 million t). As a result, steadily strong demand in China (even when on strict lockdown) supports **iron ore prices**. Another factor in favour of the prices was limited supply, mainly from Brazil. Quotes of iron ore fines (Fe 62% CFR China) from Australia rose to $120/t at the beginning of August, up from $98-100/t a month before. Low contract prices for **concentrate** in Russia in H1 will lead to a decrease in the average annual index to RUB 5,100/t over 2020 (down 7% y-o-y), with the H2 level to reach RUB 5,400/t. In 2021, driven down by global market developments, the prices will continue dropping to come to RUB 4,000/t. Anticipating a decrease of Russia's domestic free market capacity, Metal Expert expects the average annual price for **pellets** at some RUB 5,800/t this year (down 14% from 2019) and at RUB 4,800/t in 2021.

CIS TUBES AND PIPES FORECAST

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