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THE GLOBAL FINANCIAL CRISIS AND MANAGEMENT IN THE METALLURGICAL INDUSTRY OF UKRAINE

Declining of business activity of global consumers of metallurgy products is considered in the article, also it describes the negative results of metallurgy industry of Ukraine. There were defined the problems of management in the conditions of production decline in MMC and the appearance of crisis situation on the metallurgy market.

1. INTRODUCTION

Apparently metallurgy, one of the main branches of the Ukrainian economy, is gradually recovering from the crisis. It can be proved by the fact that the prices have stabilized. For example, in November steel sheets were worth USD 400-420 per tone, rebar and rolled products USD 320-340 per tone. In August-October the market was off and the prices were declining, sometimes by USD 50-60 per week. However, nowadays we may conclude that the metal sector can grow in the second quarter of 2009 [10].

Metallurgy, that is steel works, metal works and plants, was the first Ukrainian branch of the economy influenced by the global financial crisis. The majority of the steelmakers traditionally deliver the lion's share of the produced metal abroad, as the domestic market is not capable of consuming the full volumes of output. The technical facilities of Ukrainian plants surpass domestic consuming capacity. And it also should be mentioned that the principal buyers of Ukrainian metallurgical production are metal traders, which since August have stopped purchasing Ukrainian steel due to the prices (USD 1000-1200 per tone) and recession of demand of the ultimate buyers. So August was the start of the dead season of the branch.

Traders accumulated tones of steel in stock and refused to buy Ukrainian products at the existent price, while producers refused to reduce the prices due to high net cost. Consequently, companies with big storage facilities had an advantage; they were able to not have to halt the production (so they won't face the complicated technological problem of its renewal.) For example, up to November Metinvest produced slabs, square billet and rolled steel in almost the same amount as before the "crisis." But, at the same time, Zaporizhstal, Alchevsk and Ilyich had to shut part of their production facilities in

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September-November. However, in November, Metinvest also had to reduce volumes of output: there was already no place where the production could be stocked. Yenakiyevo Steel & Iron Works has reduced metal release by 23 percent, Azovstal Steel & Iron Works by 47 percent. Makeyevka metallurgical plant at all stopped producing pig-iron.

Orders for the Ukrainian steel production began to appear in the first decade of November, 2008. Small Ukrainian building companies started buying small lots of rebar. In November some plants offered buyers a discount (10-15 percent). And by the end of November, traders which work in the markets of the Near East and Asia have also increased their business activity.

The occurrence of buyers may be explained by the fact that the prices of Ukrainian steel have been reduced a great extent. In November the steel price stabilized at the USD 350-420 level due to the lowering of net costs. At that time, traders from the Eastern countries fill up their stocks at the expense of cheaper Ukrainian rolled products, thereby allowing our steelmakers to load capacities in the conditions of global recession in demand [12].

It can’t be omitted that prices on the freight market have also changed greatly (lowered by USD 30-50, they are now at prices of approximately USD 40 per tone), which helps to activate purchases made by foreign traders. In comparison with China, Ukraine has an advantage in the metals sector. The Chinese policy of protectionism has resulted in a backlash of making the prices on the domestic market too high for the majority of consumers. Moreover, a lot of small Chinese steel producers substantially reduced the level of their output. In such conditions, Ukraine has a good chance to fill undersaturated Chinese steel markets.

There is no exact data about the volumes of the rolled products which have been already exported to China during the last month. But still Ukraine may construe the very fact of exporting steel to China as a positive notion, as in 2007, for example, there was nothing exported at all. Ukrainian metallurgy has not reached the lowest point yet. In November, steel output was 14 percent lower when compared with the October rate, to 1.6 million tones.

In December-January steel production, most likely, will fall to 1.4 million tones per month as a result of traditional winter decrease in business activity. But in February 2009 production could increase to 1.6 million tones, and from April up to the end of the year the possible growth of volumes of output have been estimated at 1.7-2 million tones per month. The activation of sale is expected due to new building projects in the Near East and North Africa in the second quarter of 2009 [11].

The management of large industrial complexes based on centralization is also inflexible, centralized resources allocation under the command-administrative system. In general, such enterprises are non-competitive in the market system. That’s why among the modern conditions within the reforms, implemented in transitive economy, the processes of transformation of such industrial giants through creating the system of small and medium business and also the systems of regional level support acquire great actuality. Such projects have special actuality for Left-bank Ukraine with more than 50% industrial production of the country. The latest American publications note that many mega-corporations, created by means of fusion, have serious problems. This confirms the necessity of examination and implantation of industrial transformation methods and forms based on West experience and standards.

There are great quality of publications, dedicated to enterprises transformations, creating and work of small and medium business, functioning of enterprises alliances.

Several recent papers have argued that organizational forms, mechanisms and procedures of enterprise transformation, is open to question and far from clear and complete. The interrelations between organization of business and value of development economies and a firms within them is of increasing importance of as emerging markets around the world look to the developed markets to decide how to set up their own economic and business - system , working in conditions of high uncertain market degree.

2. RESULTS

The national economic system is integrated into the world economy closely enough to be involved in the global processes. The eroded macro-stability of international markets could not but impact internal developments in Ukraine [10, 12] – Figs. 1, 2, 3.

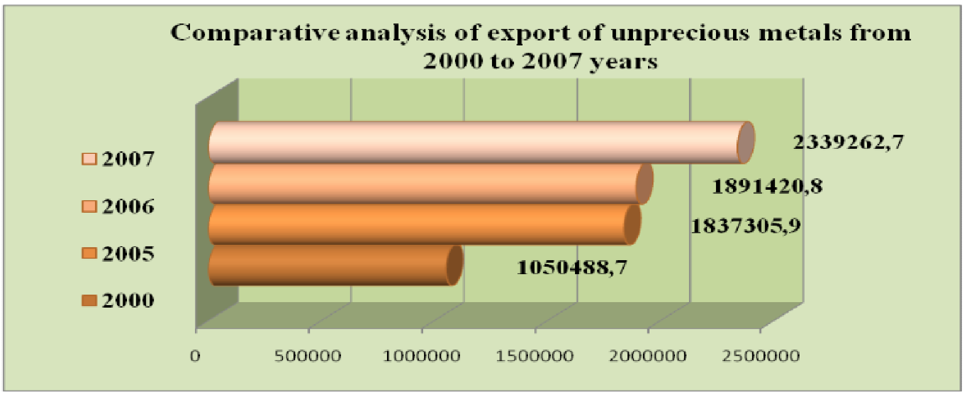

Fig. 1. Comparative analysis of export of unprecious metals from 2000 to 2007 years

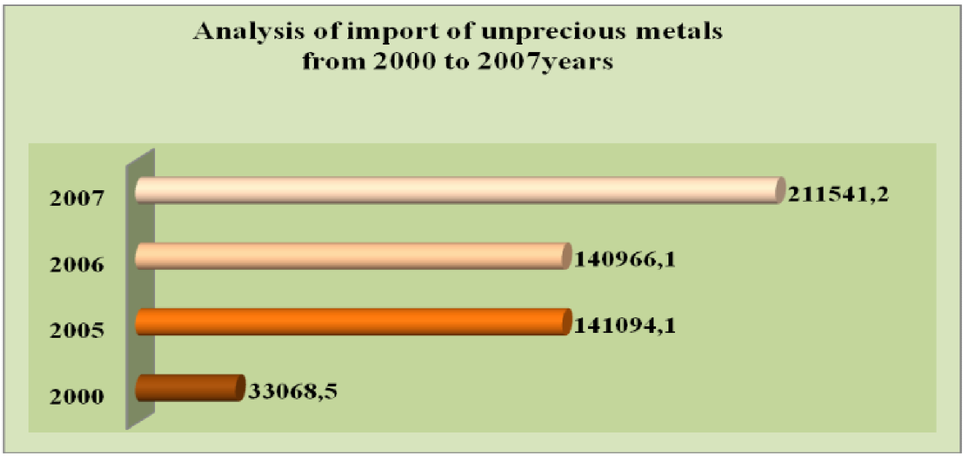

Fig. 2. Analysis of import of unprecious metals from 2000 to 2007 years

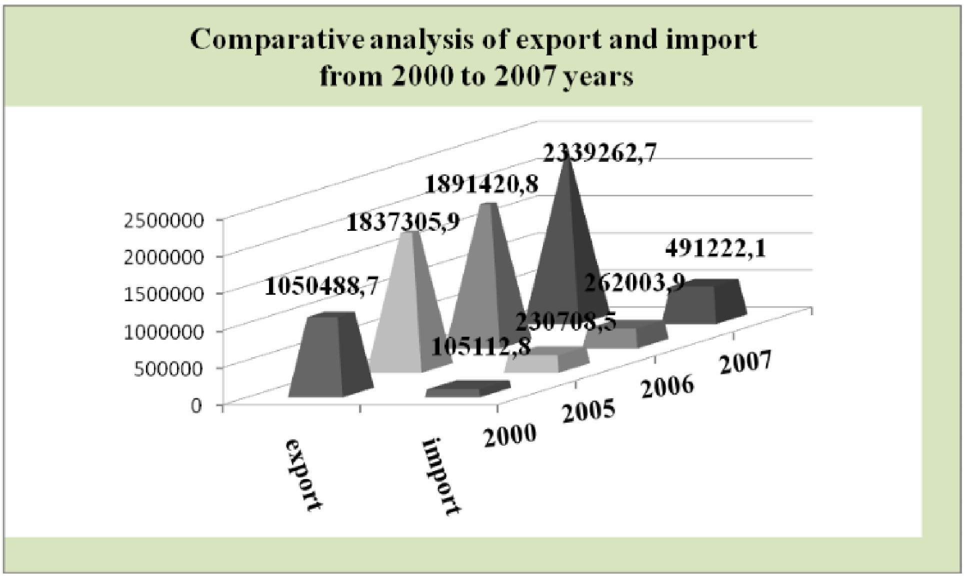

Fig. 3. Comparative analysis of export and import from 2005 to 2007 years

The global financial crisis of 2007-2008, as any other, has been unfolding in several waves. We have survived the first two without big losses, although not without mistakes. The first wave rose in 2007, when stock indices of the world's leading banks and financial institutions went down. Under the circumstances, risk capital looking for stable yet high-profitability markets moved from developed to emerging markets, which continued to show high growth rates and profitability. According to financial experts, the risk to profitability ratio in those emerging markets was fairly attractive. As a result, stock markets in respective countries grew in 2007, China and Ukraine being leaders of such growth. The inflow of credits was also substantial: in 2007, Ukrainian economy borrowed USD 24.3 billion in middle- and long-term credits.

The second wave started in early 2008, when the ongoing fall in the world stock markets re-directed cash flows from one class of assets to another, in particular to commodities and energy resources. These assets became more marketable, and commodity prices soared up. In January-July, average metal prices in eight regions of the world rose by 81%; "Brent" oil price rose by 32%. By the time first favorable forecasts appeared as to the global gross grain harvest in 2008/2009 marketing year, wheat prices (USA, FOB) for 2007/2008 marketing year had grown by 79%, on average.

Ukraine's economy responded to the above challenges in the following way. The overall inflationary background intensified. Inflationary spiral, set spinning in 2007, has been in motion in 2008. Political instability affected economy. Over the first eight months of 2008, industrial manufacturers' prices grew by 36.5%, especially in such sectors as mining of mineral resources (except for fuel-and-energy ones) by 70.4%; metallurgy and metal works by 68.1%, coke production by 64.3%; and the chemical industry by 55.9%. All of these sectors are oriented towards foreign markets or towards servicing export-oriented production.

The convergence factor (resulting from openness of the Ukrainian economy to global trends, e.g. to the 2008 consumer price rise in most countries of the world) also accelerated inflation processes in the domestic consumer markets. In September CPI amounted to 101.1% (in January-September it amounted to 116.1%), but it was much less than in 2006 and 2007, when it grew by 2.0% and 2.2%, respectively. So in general, in Q3 Ukraine had the lowest rate of price rise in the last four years – as low as 0.5%. The overall inflation was driven, first and foremost, by rising prices (tariffs) for services [11].

The second wave of the global financial crises set off ripples in the Ukrainian stock market. The PFTS index lost 43.5% in the first seven months of 2008, primarily due to the withdrawal of some foreign investors (the so-called 'jobbers") from Ukrainian, as well as from the global, markets and to political instability in Ukraine.

The third wave of the global financial crisis is going on right now. It has already caused a series of bankruptcies of the world's leading financial companies and financial crisis rollover to the real economy sector, drop in demand on global markets and, as a result, plummeting commodity prices and stagnation of leading economies. In August-September, average metal prices in eight regions of the world fell by 18.3%, and oil prices fell by 26.5% (Fig. 4).

The Ukrainian economy has not yet felt the consequences of the third wave in full. At this juncture, it is hard to estimate their severity and duration, but some impact has been obvious [11].

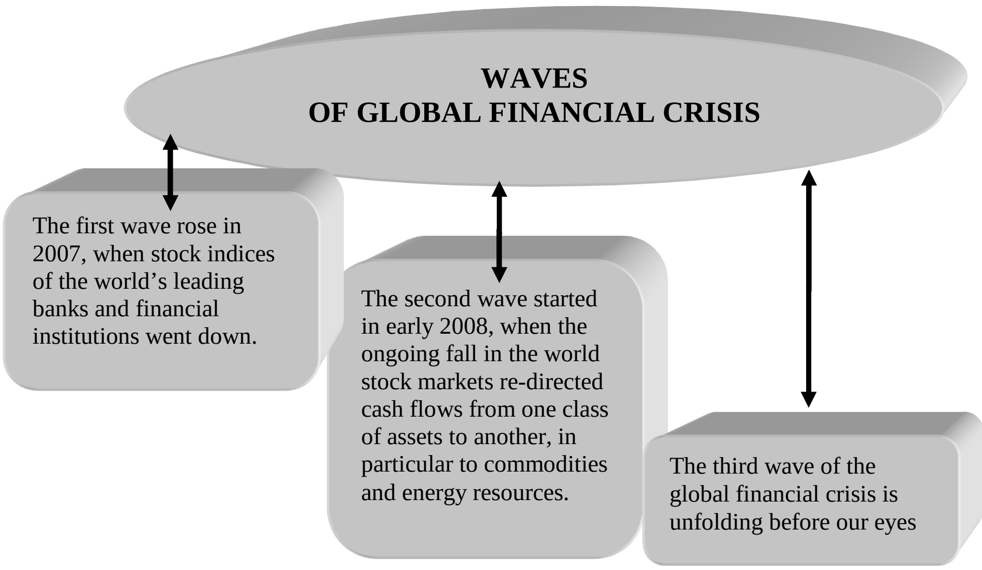

Fig. 4. Waves of global financial crisis

Thus, in August, for the first time since October 2002, industrial production decreased by 0.5% , in particular in metallurgy – by 8.6%, the chemical industry – by 9.1%, and coke production and oil refining – by 4.9% (Fig. 5).

In other words, a set of external shocks, coupled with the export-oriented companies' strategy geared towards searching out niches in foreign markets while underestimating domestic ones, slowed growth, which, in the first eight months of 2008, was as low as 2% in metallurgy and 3.5% in the chemical industry. In general, rates of industrial production growth fell to 6.3% in the first eight months of 2008. Devaluation processes became manifest in the currency market, and in September foreign currency reserves reduced by USD 0.6 billion. Negative inflation expectations contributed to the overall turmoil. A negative balance of sale/purchase of cash foreign currency by the population amounted to USD 1,321 million.

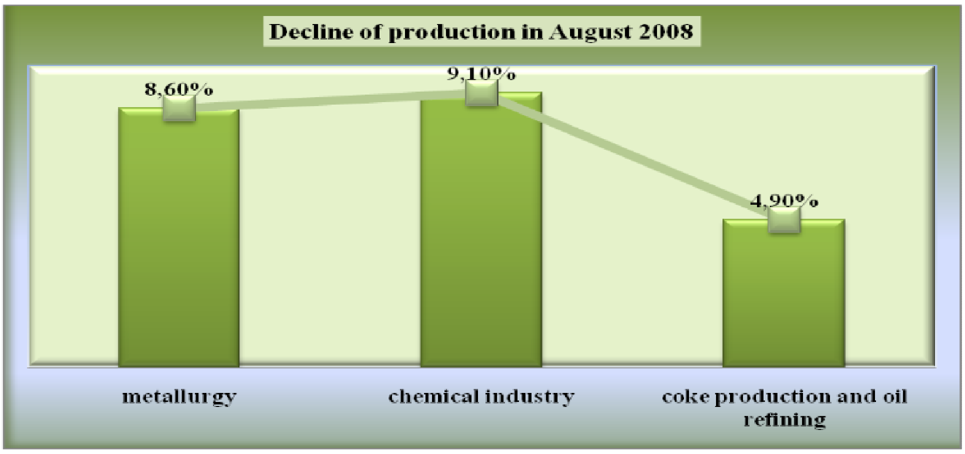

Fig. 5. Decline of production in August 2008

The third wave of global financial crisis forced governments in the world's largest economies to revise their policy vis-a-vis financial markets. In particular, the governments of the USA, the UK, Germany, Russia, the Benelux States and other countries decided to support some of the troubled financial institutions. Investors expect the government of Ukraine to take similar measures. However, the drivers of mortgage and financial crises in the USA and other developed economies and those forming potential negative tendencies in Ukraine's economy are different.

In order to find solutions allowing for mitigation of the influence of the global crisis on the Ukrainian economy, we should analyze the most likely channels of this influence. As matters stand, the channel relating to global stock markets is not the most powerful and painful for Ukraine's economy. Of course, it puts certain pressure on the currency market as the risk (speculative) capital flows out, but it will hardly affect the development of the real economy sector in Ukraine. For one thing, the organized stock market is underdeveloped – only 4.66% of all transactions take place on it. For another thing, foreign investors and other sources of funding, including stock market funds, account for as little as 5-7% of all investments. There are other channels of influence, more deeply-felt by the Ukrainian economy.

The first channel is foreign trade. Widespread financial problems have already undermined demand in the international markets. Recession in the world's leading economies will be accompanied by the decreasing investment demand and poorer dynamics of construction. This, in turn, will continue to drive down prices for metallurgy and machine building products.

Since the Ukrainian economy is highly dependent on exports making up more than 47% of the country's GDP, the above trends in the global markets will be harmful for the development of export-oriented sectors, with subsequent repercussions on industries relying on exports directly and indirectly.

The second channel is the banking system. The penetration of foreign capital into Ukraine's financial institutions is considerable. The financial sector is one of the national leaders in attracting foreign direct investments (19% of total accumulated foreign capital). The share of foreign capital in the banking sector amounts to 37.2% of total capital, which exceeds the threshold of economic security established at 30%; in the insurance sector it approaches the threshold value, currently constituting 28.1% [10, 11].

Given the large share of transnational financial corporations on the Ukrainian banking sector, the global financial crisis could have an indirect adverse impact if mother companies suffer great losses or have liquidity problems.

In this context, it is noteworthy that investments and development of Ukrainian manufacturing companies hinge more on lending than on the stock market: 16% of investments in fixed assets are funded from loans. The most credit-dependent sectors are agriculture, construction, processing industries, including the chemical and petrochemical industry, the food industry, coke production and oil refining.

The third channel of influence is debt. In June 2008, gross foreign debt made up 59.9% of GDP at USD 100.06 billion. Almost 85% of this debt was that of the private sector. According to IMF data, the maximum limit of foreign debt for low and middle income countries is set at 49.7% of GDP; once this limit is exceeded, the probability of financial crisis increases to 70%.

Deteriorating liquidity in global financial markets could slow up lending to the Ukrainian economy. As a result, Ukrainian borrowers will have difficulty refinancing their credit liabilities in external markets.

Furthermore, the share of short-term capital in foreign debt is large (28.2% as of late June 2008). Over the first six months of 2008, the ratio of short-term foreign debt coverage with reserves fell by 15% to 1.258. This capital, in the event of its sudden outflow could contribute to destabilization of the national currency exchange rate.

In order to prevent dramatic devaluation, the National Bank of Ukraine will have to sell hard currency from its reserves. And yet, it will be a difficult task to achieve. Under the circumstances, GDP growth could slow down to 2.5-3%, CPI will go beyond 20% [11].

It is not about mere situation modeling, other things being equal. Nor is it about analyzing scenarios based on the "what if" principle. Since the 1998 crisis, the national economy has become much more integrated into international financial markets; its structure and development characteristics have changed significantly. Today economic growth is determined by domestic potential, rather than external factors. Households' consumer demand is growing rapidly, together with investments in renovation of fixed assets and introduction of modern technologies. Ukraine has become an international market player. In light of the escalating global financial crisis, the government and National Bank have taken a number of measures allowing for the reduction of the risk of its profound destructive influence. They include a package of anti-inflation initiatives, steps to enhance banking sector stability and to minimize the impact of the global financial crisis on Ukraine's economy. In early 2008, the National Bank passed a resolution toughening requirements to calculating the banks' regulatory capital adequacy (long-term asset transactions with time of floatation exceeding the time of funding should be additionally risk adjusted at 50% rate and so on), which enabled banks to adjust and improve their position.

The Government and National Bank of Ukraine constantly monitors the inflationary developments because of their significant social effects. And in July the Government had managed achieve negative price development.

However, as I had mentioned above, in August, drastic change in trends of development had taken place.

New statistical data, published during that period, spoke for the fact that economic situation in a number of European countries, as well as in the USA, had been affected adversely.

GDP had grown less considerably in Estonia (by -0.8%), Italy (by -0.3%), Ireland (by -0.5), Germany (by -0.5%), France and Lithuania (by -0.5%) (II quarter, 2008, to I quarter, 2008).

In July to August, in some countries of EU-27 decrease in construction industry output had been observed. In particular, in August as against July such a decrease had made: in Bulgaria (-4.7%), Czech Republic (-0.4%), France (-0.7%), the Netherlands (-1.7%), Poland (-1.8%), Portugal (-6.6), Slovenia (-4.9%). In general, as for EU-27, seasonally adjusted decrease in August as against July had made -0.2%.

Against the background of drop in output, the problem of unemployment had become strained, as well. Generally, in August, 2008, in EU-25 countries, the level of unemployment had grown by 7%, as against 6.9%, in July. In Estonia the level of unemployment had made 11.3%, in France – 8.0%, in Slovakia – 9.9% and in Hungary – 7.9%. Even now the anchor companies of the world, engaged in construction, metallurgical, chemical and other industries, predict employment layoffs [12].

As a result of recession processes that had affected the world markets the slump of prices had begun in the markets of raw materials, being very important for less developed countries, including Ukraine.

In August to September, 2008, the average price of metal in 8 regions of the world had grown less by 18.3%, while the price of oil had decreased by 26.5%.

Ukraine has just entered those processes, duration and intensity of which is hardly to be estimated, at present. So what had happened?

In August to September, 2008, for the first time since October, 2002, cut-back in industrial production as against relevant month, 2007, is observed. The most dramatic drop in production is observed in export-oriented sectors of economy.

For example, in September, 2008, as against September, 2007, the volume of drop in metallurgical industry production had made 17%, while that of chemical and petrochemical industries had made 2.1%. Cut-back in production of those industries had entailed a drop in production of coke and petroleum derivatives – by 22.3%, mining operations (except for those relating to fuel and power resources extraction) – by 2.3%. In general, industrial output had grown less by 4.5%.

In other words, as a result of implementation of the strategies, focused on preferred search for niches in the foreign market and underestimation of domestic market capacity, low-diversified export-oriented sectors of economy are affected, at present, by a number of foreign challenges resulting in production cut-back.

According to the results of 9 months, 2008, after metallurgical industry output growth, the volume of drop in its production had made 0.03%, while the volume of chemical industry production had grown less by 0.5%. In general, according to the results of 9 months, 2008, the rates of industrial output growth had gone down to 5.1%.

In addition, for the purposes of objectivity, it should be noted that food-processing industry, focused on domestic market, had been adversely affected this year, as well. Industrial output of this sector of economy grows less each month during last quarter, entailing considerable deceleration of cumulative rates of development: in January to September, 2008, food-processing industry output had grown by 3.3% (as against 4.4% in January to August, and 5.5% in January to July).

Furthermore, this year, owing to extremely high prices in the world markets, our exporters had realized a large volume of profit. In metallurgical industry, the volume of profit had grown by 36.3%, while the profit, realized by chemical and petrochemical industries, had increased in 2.7 times. Moreover, those industries are able to finance their capital outlays at their own expense. In other words, their investment/profit ratio is far less than one. Of course, drop in demand and decrease in prices in the world markets will have an adverse effect on financial position of the enterprises. According to estimates of the Ministry of Economic Affairs, if August-to-September trends of metallurgical and chemical industry development last to the end of the year:

- metallurgical industry will lose UAH 7 to 8 billion during the next 4 months, and, following the results of the year, the level of its profitability growth will make 14.5%, as against 36%, observed in January to August, 2008,
- chemical industry will lose UAH 1.7 to 2.3 billion, and, following the results of the year, the level of its profitability growth will make 90%, as against 170%, observed in January to August, 2008.

3. CONCLUSOON

For the purpose of minimization of adverse effects of the world financial crisis on Ukraine we need:

First of all, expedient to revise state budgets for 2008 to 2009, increase the volume of state capital expenditures and expand domestic investment demand, as well as the demand for constructional services and goods, being not in demand in the foreign markets (such as metal products).

What is meant here is increase in volume of budget expenses for the construction of already planned state-financed infrastructural facilities and acquisition of affordable housing by making use of tender procedures, together with minimization of prices for housing and, at the same time, completion of half-constructed facilities.

As a result of abovementioned arrangements, the output of building industry will grow, metallurgical sector will be focused on domestic market and the number of half-constructed facilities will grow less.

The second of all, stock market stabilization. Need to expedient to expand stock market instruments, and, at the same time, tighten control over professional stock market participants, in order to prevent market fragmentation and manipulation of prices.

It is practical to formulate minimum criteria with regard to volume of trade in securities and gross amount of authorized capital to be applied to trade institutors, which will provide grounds for the licensing of trade institution activities.

The third major direction is minimization of adverse social effects and attainment of consensus between social actors.

We need to consultations with social actors representatives with regard to introduction of coordinated arrangements, focused on prevention of unemployment growth, observed in other countries of the world.

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МИРОВОЙ ФИНАНСОВЫЙ КРИЗИС И МЕНЕДЖМЕНТ В МЕТАЛЛОПРОДУКЦИИ УКРАИНЫ

Аннотация

Рассматривается снижение деловой активности мировых потребителей металлопродукции, и их негативное отражение в показателях работы металлургических предприятий Украины, задачи менеджмента при снижении производства продукции в горнометаллургическом комплексе и возникновении кризисной ситуации на рынке металла в целом.

Ключевые слова: Мировой финансовый кризис, управление, сравнительный анализ, металлургия, экспорт, импорт, цены

GLOBALNY KRYZYS FINANSOWY A MANAGEMENT W HUTNICTWIE UKRAINY

Streszczenie

Rozpatrzono obniżenie aktywności biznesowej światowych nabywców produkcji hutnictwa oraz negatywne odzwierciedlenie tych procesów we wskaźnikach przedsiębiorstw hutniczych Ukrainy. Określono zadania managementu w warunkach zmniejszenia produkcji w hutniczo-górniczym przemyśle i powstania sytuacji kryzysowej na tym rynku.

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