

Global Iron Ore Market – A Perspective

Global steel industry recovered remarkably well after 2008 financial turmoil, thanks to China. China produced about 50 million tons of crude steel every month since mid-2009. The demand came largely from infrastructure, automobile and construction sectors. As per latest estimate, China's production in 2010 will rise by 10.9% YoY to 630 million tons while consumption will increase by 7.8% YoY to 610 million tons. As a result, it is estimated that imports of iron ore will touch around 650 millions tons this year. But here comes the real problem. China is eying to maintain growth at a sustainable rate of 9% and at the same time trying to control the infrastructure cost. Steel is the single largest commodity to achieve this goal and it is absolutely necessary to find iron ore price mechanism, which would provide stability minus the volatility.

The Price Curve:-

Iron ore prices rose sharply with massive demand thrust from China since July 2009. Spot prices of 62% Fe, CFR China port rose from \$76.4/dmt from middle of 2009 to \$186.5/dmt in March 2010. Central banks in developed countries showed the urgency to revive the economy and injected huge liquidity into the market. Though it helped in recovery, the 'induced' demand faded suddenly in the second quarter of this year led by Chinese slowdown concern and partly by European debt crisis. The question is what triggered the Chinese growth concern and subsequent fall of iron ore prices.

Change of pricing mechanism -

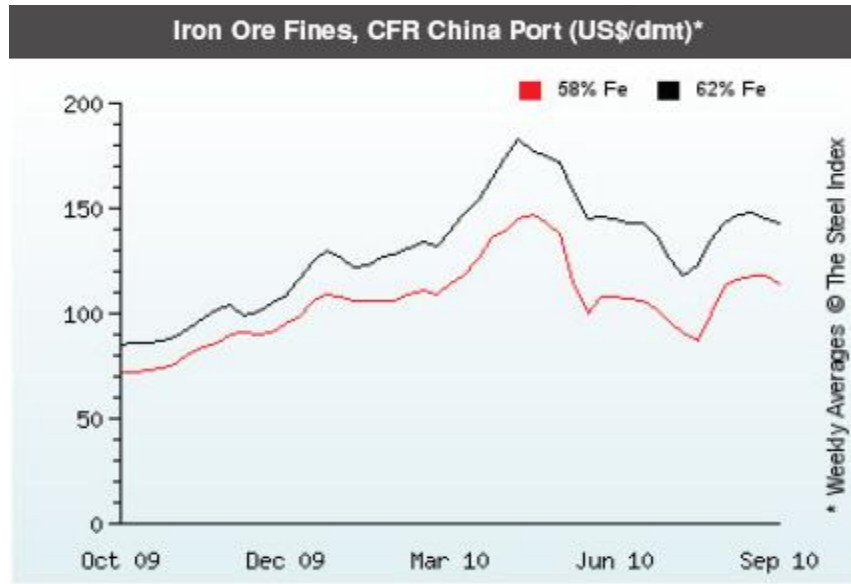
As indicated earlier, growth in Chinese economy is sustained by robust internal growth in infrastructure, real estate and manufacturing sectors, which helped China to retain dominant position in global exports. Growth in steel demand closely tracks growth in the economy. This is the reason the Chinese government tried hard to control the domestic steel market including ore and even decided not to import any ore from 'big trio', Rio Tinto, Vale Group and BHP Billiton, for two months and relied on domestic production. However, this effort failed as domestic production of iron ore could not meet the demand of industry. What actually caused China's worry was the rising ore price post changes in price fixing mechanism from yearly to quarterly. It increased the production cost of steel, which ultimately increased the infrastructure and property cost to an economy which was growing at an average rate of 11% and only opened the fear of hyper-inflation and subsequent overheating.

The concern of overheating economy and inflation compelled the Chinese authorities to curb the property market. They increased the cash reserve ratio for the banks to meet this goal from the beginning of second quarter this year. This created suspicion that demand for steel and other metals will shrink. This impacted iron ore prices, and caused it to fall from the high of \$186.5/dmt to \$130/dmt in the second quarter.

The Price Paradigm

Prices are still struggling as steel production dropped in China by more than 4 percent compared with last year. The volatility of ore prices has been increasing and Chinese

steel makers are finding it difficult to price ore on quarterly basis. The industry is looking for a paradigm shift to control the price volatility.



Iron ore supplies from India affected

Union Minister of Steel Mr. Virbhadr Singh strongly advocated in a recent CII meet that there is a need for banning exports of iron ore. He was emphasizing the need of banning iron ore export in order to conserve the natural resources for future demand of domestic steel industry. He echoed the same when Karnataka government banned 10 ports from exporting iron ore in order to crackdown illegal mining. Karnataka contributes a quarter of India's total iron ore shipments. Government increased export tax on iron ore lumps from 10% to 15% in April and levied 5% duty on iron ore fines last December. Further increase in taxes cannot be ruled out. India is the third largest supplier of iron ore with an annual export of about 150 million dmt, of which about 90 million dmt goes to China. Banning of export may create a 'temporary' setback in the Chinese market and may induce volatility in iron ore prices.

Global economy fear pressurizing ore prices:-

Economic situation is not comfortable globally and world is watching closely the development of Chinese economy along with Asia. It is not easy to predict how Chinese economy would shape for the rest of the year, but indication suggests that growth would be sluggish compared to previous years. This indication is reflected recently in a Japanese move as steelmakers of Japan have agreed with Rio Tinto, the iron ore giant, to import iron ore at a discount of 13% over the previous quarter during October to December. It means that iron ore will be priced around \$130/dmt during the last quarter of this year. Japanese steelmakers have accepted this price as they are anticipating the demand for steel products to decline in China.