High Contractual Prices to Hit Indian Iron Ore Exporters

- Steelworld Research Team

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Worsening US economic crisis has led to global steel companies pruning their capacity thereby, lower forecast of iron ore consumption this year. This is evident from the latest data collated by the Federation of Indian Minerals Industries (FIMI) which states that iron ore exports from India till December 15, 2008 declined over 13 percent despite huge price decline in steelmaking raw materials. According to Labour Department, the US job losses last year were the most since 1945. Additionally, the federal budget deficit is expected to hit $1.18 trillion this year as the government spends billions on industry bailouts and tax cuts. Consequently, the US government has pledged more than $8.5 trillion as of November 25 for the bailout package to companies and help the country recover from an economic recession. The recently elected president Barack Obama has also favored an additional stimulus package of at least $775 billion.

Low Iron Ore Exports from India

The latest FIMI data indicates iron ore exports plunged to 55.8 million tons between April 1 - December 15 of the current fiscal as compared to 64.38 million tons in the

In a Nutshell (In Lakh Tons)			
	Total exports between Apr 1 - Dec 15		
Name of the ports	2007-08	2008-09	%change
Belekeri	20.34	9.63	-52.65
Chennai	72.69	53.38	-26.56
Ennore	15.21	7.61	-49.97
Haldia	64.89	53.78	-17.12
Hazira	0.49	2.16	340.82
Kakinada	26.26	15.69	-40.25
Karwar	8.54	9.77	14.40
Krishnapatnam	8.39	36.00	329.08
Mormugao	212.43	204.60	-3.69
New Mangalore	58.55	44.66	-23.72
Paradip	81.95	74.02	-9.68
Redi	2.27	1.05	-53.74
Vizag	62.76	45.73	-27.14
Total	643.77	558.07	-13.31

corresponding period last year. Shipment, however, witnessed a marginal decline of 3.81 percent to 5 million tons during the first fortnight of December from 5.2 million tons in the same period last year. Indian iron ore exporters took off the season slowly late October. But, orders intensified as steel mills in China, that were closed last year due to environmental hazards for Olympic Games, started operations gradually. Still, India's exports of iron ore to China will be difficult to achieve the last year's level.

Total shipment from Mormugao port in Goa during the first fortnight of December showed a drastic decline of over 27.18 percent to 20.84 million tons as against 28.62 million tons in the same period last year. Goan exporters ship mainly Karnataka- and Goa-origin low grade iron ore to Chinese steel mills, said Glenn Kalavampara, Secretary of Goa Mineral Ore Exporters' Association (GMOEA). Haresh Melwani, CEO, H L Nathurmal & Co, one of the leading iron ore miners and exporters from Goa attributed the decline in exports to three major factors namely: frequent changes in exports levy on fines and lumps (the two grades of iron ore below and above 64 percent of iron content respectively), slowdown in Chinese demand and buyers lenience towards Australia and Brazil because of favourable government policy. He also forecast about 25 percent decline of exports of state-origin iron ore from Goa to the tune of 20 million tons this financial year from 26 million tons last year. Similarly, both Karnataka- and Goa-origin iron ore exports may also fall to the level of 30 million tons as compared to 40 million tons last financial year, Melwani added.

China's Back to Basic

Chinese steel mills are wrestling to negotiate iron ore price from the three global mining major; Brazil's Vale and Anglo, Australian BHP Biliton and Rio Tinto that extracted hefty price rises in the past few years. The first salvo, which China fired as ore price negotiations for the season starting April 2009 began early this month, must have wracked the nerves of the triumvirate of miners. Favouring the price rise, China Iron and Steel Association (CISA) secretary general Shan Shanghua said, "Since steel prices have sunk to 1994-levels in the wake of global financial crisis and demand fall, iron ore prices should be calibrated accordingly". However, the argument that ore prices should stay in alignment with steel prices is unarguable. As 1.6 unit of ore will be used for making one unit of steel, the mineral is the single biggest element in the metal's production cost. Incidentally, the benchmark grade iron ore contract price has advanced from $24.40 a ton in 1994 to over $90 a ton now.

Chinese importers, according to Sharma, are now buying fines from India at spot prices ranging from $50 - $60 a ton. At this stage, no one will risk forecasting where iron ore spot prices will be a quarter or two hence as steel mills everywhere are cutting production so that inventories at their end don't rise, said Sharma. China, which over the last few years has been stepping up ore procurement from India to reduce its dependence on the likes of Vale, BHP and Rio. Sharma is confident that China will step up ore procurement after months of lull, now that India has done away with duty on ore fine exports. China shared over 88 percent in India's iron ore exports of 104.27 million tons in 2007-08. The country largely buys fines from India for which there is still little local use in the absence of sufficient pelletisation capacity. As China produced 489 million tons of crude steel last year, it had to import about

380 million tons of ore to supplement domestic raisings. At the beginning of this year, the forecast was Chinese ore import requirements will rise to 410 million tons. This, however, may not be the case as many Chinese mills have cut production in response to shrinking demand for steel, particularly from construction and auto sectors. Significantly, China had the biggest share of the international iron trade of 822 million tons in 2007, a rise of 8.1 percent over 2006. And this will remain unchanged in future, a steel analyst said.

Negotiation of Australian Ore

Chinese imports of Australian iron ore have moderated since the infrastructure development for Beijing Olympic completed by the first half of 2008. The whole iron ore price issue is looked at in Australia through the prism of the 2008 settlement, which pushed an 80 percent jump in price to approximately USD 144 per ton from USD 80 per ton. Spot iron ore prices into China have steadied at around the levels of early 2007, in US dollar terms, which means it is worth well above that in Australian dollars. Every event in the iron ore market since then has looked like a trip downhill, but in fact it's been a correction from was the absurdly high aberration of the 2008-09 contract prices that run from April 2008 for a year. Most expectations for the contracts in 2009-10 are for a number closer to USD 100 per ton but that is still a significant improvement on the 2007-08 price of around USD 80 per ton. There are numerous issues clouding the iron ore export story, most particularly the widely reported situation in November and December of 2008 when a number of Chinese iron ore importers chose not to send ships to Australia to pick up cargoes, either because their stockpiles were full or they had difficulty obtaining letters of credit to pay for the cargoes because of the economic uncertainty surrounding the industry.

Crude Steel Production Down

Meanwhile, the data released by World Steel Association (WSA) states grim past for global crude steel production which declined 19 percent year-on-year (YoY) and 10 percent on month-on-month (MoM) to 89 million tons in November 2008. November production was 23 percent lower than the average monthly production during January-August 2008. Production cut has been steepest in CIS region because its main producing countries Russia and Ukraine are dependent on exports. Production declined 24-27 percent YoY for Netherlands and UK in November 2008. November production was 32 percent lower than the average production during January-August 2008. This is in line with the production cuts announced by Corus. The production of these two countries is dominated by Corus. Chinese production too declined 12 percent YoY and 2 percent MoM to 35.2 million tons and was 19 percent lower than the average production during January-August 2008.

In order to align with sharp decline in demand, the steel industry has been able to achieve sharp production cuts in such a short span of time due to higher level of consolidation and high variable costs (owing to high raw material prices). This has been helpful in preventing pile-up of inventories. According to reports, the inventories in USA and China are at normal levels, which are reflected in recovery of buying there and little better prices.

Capacity utilization rate of US steel industry has fallen to below 50 percent, lowest since 1995. Nucor has raised steel prices for January 2009, as supply/demand situation has tightened due to production cuts and end of de-stocking. Supply/demand situation in China too is better than a month ago due to production cuts and end of de-stocking, which is reflected in small price recovery.

Domestic Steel Companies Margin under Pressure

The margins of steel producers will be under severe pressure in the second half of 2009 due to high cost of coking coal (US$300-350 per ton). Coking coal prices too are likely to correct sharply in 2009 due to sharp drop in steel production. Coke demand has weakened drastically and prices have fallen further to US$315 per ton (peak of US$760 per ton) fob (Chinese ports) recently.

According to industry sources, the domestic demand for long products and semis have picked up, which is reflected in prices. After falling to Rs 25,000 per ton (excluding taxes), prices of TMT bars and other long products have recovered to Rs 31,000 per ton (peak prices of Rs 40,000 per ton).

Currently, capacity utilization of Ispat Industries is 30 percent, JSW Steel and Essar Steel is 60-70 percent each, and Bhushan Steel is 50 percent. SAIL and Tata steel have not announced production cuts but they have brought forward repairs. Tata Steel's November production of 570,000 tons was the highest ever despite three of its smaller blast furnaces under relining. Though JSW Steel announced production cut of 20 percent, actual production rates have been worse in November 2008. Start up of new blast furnace has been further postponed until recovery of market conditions. The company held inventories of 92,000 tons of saleable steel, which has not reduced much despite production cuts. JSW Steel is committed to its expansion to 7 million tons per annum, which has pending capex of Rs 300 crore. However, it has put on hold further expansion to 10 million ton per annum at a capital expenditure of Rs 5500 crore, while Rs 1500 has been spent so far. Net debt is around Rs 13600 crore.

Indian government restored import duty of 5 percent to deter cheaper imports, though industry along with steel ministry had been lobbying for 10 percent duty. Duty entitlement passbook scheme (DEPB) benefits on re-export too have been restored. Also, export duties of 15 percent on pig iron, semis, and long productions were withdrawn few weeks ago. This marks the complete roll-back of fiscal measures taken during 2008 to curb extreme volatility of steel prices in the domestic market. HRC imports have been restricted to end use only. As a result, imports by traders have become difficult.

Outlook

Despite higher estimated contract price for 2009, the iron ore sector is likely to face a tough time ahead on economic uncertainty. Price negotiations for iron ore are set to be even tougher in 2009 as steel makers, facing a global slowdown in demand, are looking to reverse some of the past six years of continuous price increases for their inputs. Contractual iron ore prices, which take effect for a year from April 1st 2009, are influenced by settlements between the Asian steel makers and the world's biggest iron ore producers: Rio Tinto, BHP Biliton and Companhia Vale do Rio Doce. Kumba Iron Ore and Assmang follow the same price trends as the major global producers, although they negotiate separately with their customers. As per an estimate, annual contract iron ore prices were likely to fall by 20-40 percent in 2009 and steel demand would not recover until the second half of the year.

Though, steel prices are set to start recovering in the next few months, boosted by governments' economic stimulus packages and cutbacks in production, after halving since July 2008, yet the impact on iron ore price would be seen only towards the end of the current year. The indicative iron ore spot prices had risen 24 per cent from a three year low on October 31, 2008.