

Steel Producers Ready for Price Hike

- Steelworld Research Team



Iron ore, the main raw material used to make steel, contributes around 10 per cent of steel prices. Remaining 90 per cent is shared by other raw materials such as coking coal, fuel oil and last but not the least transportation. Despite, all other factors have leaped heavily in the past to make steel unbearable, the proportionate increase in iron ore prices created huge noises among all government, steel producers and consumers. While discussing the avoidance of price rise with ministers recently, steel producers blamed iron ore as the reason to price rise especially when abundance of this raw material is available in India and abroad.

Today, Indian iron ore suppliers are signing long term contracts for the price between \$90-100 per tonne against the steel price at Rs 51,000 per tonne. Last year, the infrastructural demand for Beijing Olympics, scheduled in August 2008, created huge demand for steel and thereby, iron ore while skyrocketed this raw material to the level at \$175-180 per tonne. But, since this short term demand ends, iron ore prices normalized to the current level which is not only sustainable but also affordable.

The price of iron ore is rising so fast that major miners in India, Australia and Brazil, the three iron ore exporting countries, prefer to sell more output in spot markets than to sign long term contracts. Rio and BHP want to break away from the rigid benchmarking system of previous years and sell more ore at spot prices, a market that barely existed a few years ago. At present the spot price is more than twice the benchmark level. BHP and Rio

are also introducing hybrid contracts for buyers, which include some ore sold at the benchmark and some sold at the spot price.

Brazil raises price 65 per cent for Japanese & Korean supplies. Meanwhile, Japanese and South Korean steel mills have agreed to a 65 per cent increase, the sixth annual increase in a row, in iron ore prices from Brazil in the industry's first major deal for this year, which will set a benchmark for prices at a level painful for steel makers. Nippon Steel said that the company and Posco of South Korea had agreed to pay the Brazilian mining giant Vale \$78.90 a tonne for Itabira fine ore in the year starting April 1, 2008. Term iron ore prices had been widely expected to rise by at least 50 per cent, after spot prices soared to record high levels in 2007 and demand from Chinese steel mills showed no signs of abating. The price for a specific calendar term for iron ore has risen fivefold since 2001.

However, an average price increase for the supply from Australia has been forecast at \$66.40 per tonne for 2008 prices of iron ore benchmark shipments from Australia represents a 30 increase compared to \$51.47 in 2007. Sustained high demand from China's

steelmakers, who are said to be raising production 15 per cent, is credited for the expected price increase. Mining companies and customers are scheduled to begin annual price negotiations in October for shipments starting in April. Goldman Sachs had observed earlier that the demand would outstrip supply for years, resulting in price increases until 2010. Merrill Lynch analysts in a report published recently, said low inventories at China's ports and supply shortages could push prices higher by more than 50 per cent in 2008. HSBC expects price increases of 40 per cent in Australia and 30 per cent in Brazil. India follows the price moves in these two countries with some geographical advantages for supplies to China.

Chinese Doubles the Price

Global inflation fears deepened as Chinese steelmakers agreed to a record increase in annual iron ore prices in a move likely to



boost the cost of cars, machinery, white goods and buildings. Chinese millers agreed to pay Anglo-Australian miner Rio Tinto up to 96.5 per cent more for their ore supplies this year, the largest ever annual increase and well above the

9.5 per cent increase paid last year. The rise suggests that demand for commodities from emerging economies remains strong, in spite of the US slowdown, fuelling fears that global inflation will continue to rise. The rise – an average 85 per cent – surpasses the record increase of 71.5 per cent agreed in 2005. Rio Tinto and Chinese steel enterprises have cooperated for a long time and both parties believe that they would benefit from the long-term stability and common development between upstream and downstream. Chinese steel enterprises support Rio Tinto's further effort to expand investment and increase production, in order to meet market demand. Rio's agreement marks an unprecedented divergence in the annual price rises for Australian and Brazilian ore. Traditionally, Vale of Brazil would negotiate a price and Rio and BHP Billiton would agree later to a similar increase. However, Vale's agreement earlier this year for a price increase of between 65 per cent and 71 per cent was disregarded by its Australian rivals, which in turn demanded a higher increase, arguing their proximity to China reduced ore shipping costs.

China may Rationalize Steel Output

Depending solely on imports of iron ore, China, the world's largest steel producer and consumer, may rationalize steel production further in coming days as frequent price increase made the market unpredictable. The country, imports almost half



of the world's seaborne iron ore, making it the largest iron ore consumer in the world, but it has become a price-taker of late – perhaps because it waited too long to negotiate with major suppliers. This situation

could have been anticipated, because iron ore was in such demand globally, but analysts feel that higher costs might actually help rationalize the Chinese steel industry by pricing some smaller firms with obsolete technology out of business. According to recent reports, half a dozen of small steel mills around Beijing have already shut down their operations considering environmental concerns for the forthcoming Olympic Games.

After Brazilian mining conglomerate Vale hammered out 2008 benchmark prices for iron ore fines with Japanese and Republic of Korea (ROK) steel makers, Baosteel Group, China's largest steel maker, agreed on the price for fiscal 2008, accepting the Brazilian miner's price hikes that ranged from 65 per cent to 71 per cent compared with 2007. That's how benchmark pricing generally works for the international iron ore market: one group of buyers accepts a new range of prices, which then become the norm for the global industry, an analyst said. Last year, it was Baosteel that set the benchmark with Vale. This year, other East Asian steel makers were eager to make a deal quickly, at least partly because some iron ore sellers started talking about 'more flexible' terms, meaning quarterly or even monthly re-pricing.

Hardening Bargaining

China's steel needs have soared, driven by rapid urbanization and many large infrastructure projects. According to the China Iron and Steel Association (CISA), world iron ore seaborne trade in 2007 amounted to 805 million tonnes, of which 383 million tonnes were shipped to China, up 17.4 per cent year-on-year. Since China joined the international pricing negotiations in 2004, the price has risen every year. Price negotiations for 2004 ended with an 18.62 per cent increase, followed by a 71.5 per cent rise in 2005 and a 19 per cent increase in 2006. In 2006, the country was the world's first major steel producer to settle with three mining firms – Vale, Rio Tinto and BHP Billiton – agreeing to a relatively modest hike of 9.5 per cent





for the year starting April 2007. That was the smallest price rise in the years since China joined the world price negotiations. But this year, China lost the opportunity to set the benchmark price while waiting for the

decline and lost the opportunity to Japanese steel makers that reportedly rushed to wrap up the talks before the Chinese and signing the deal with huge price escalation

According to a Chinese buyer, the gap between term prices and spot prices of iron ore in 2006 wasn't as wide as in 2007, resulting in a relatively modest price hike. Steel makers were satisfied with the outcome, although iron ore producers considered it unfair. Soaring spot prices in 2007 changed the equation and pushed up the term prices for 2008. With demand for iron ore soaring, global miners' production has surged. Vale boosted its 2007 iron ore production by 12 per cent, for example, and Rio Tinto turned out 9 per cent more ore. With high global steel prices and surging profits for its producers, growing by 30 per cent year-on-year, miners are up in arm to share their wealth.

Imminent Consolidation

Rising iron ore prices substantially may force smaller steel

mills to accept a dramatic squeeze in margin which would gradually make them unviable or merge with the large ones. Therefore, a consolidation is imminent in steel industry in visible future. Although, steel mills term the iron ore price hike as "expected" yet, thousands of smaller mills globally could be affected if the pricing agreement leads to higher spot prices, hastening consolidation in the steel industry. Smaller mills buy iron ore on the spot market and are unable to lock in prices by annual contract. However, the affect on large mills could be limited as they face no problems while passing on the raw materials price increase on



to steel consumers. But, basically selling in spot market or to companies with long term contract, small mills may run out of business as contracts with long term suppliers.

Domestic Spot Prices Surge 10 Percent

After Orissa Mining Corporation's latest quarterly tender on for sale of iron ore during July to September 2008, the market prices of iron ore in Orissa are expected to surge by Rs 500 per tonne.

Product	Grade	Size	30-Jun	1-Jul	Change	%
Iron ore - BF	Fe 65%	10-40	5000	5500	500	10.0%
Iron ore - Sponge	Fe 63%	5-18	6100	6600	500	8.2%

Prices of Rio Tinto

	US cents per dry metric tonne unit	
	2007	2008
Pilbara Blend Fines/Yandicoogina Fines	80.42	144.66
Pilbara Blend Lump	102.64	201.69

Export restrictions

India restricted exports through imposition of 15 per cent ad valorem duty on shipment of iron ore with the view to increase domestic supplies and thereby, control inflation partly. The move is likely to make the procurement costly for steel mills as export price also move in tandem with domestic one. Thus, India's iron ore exports are likely to remain on firm ground this fiscal year, despite main buyer China imposing price caps on imports from some countries. The industry is estimating the total shipment to decline 20 per cent to 80 million from around 100 million tonnes

last year. India exported a total of about 76 million tonnes of iron ore last financial year, or an eighth of the total world iron ore trade of 605 million tonnes. The cap on Australian ore has been set at \$54 a tonne, including cost and freight, and \$70 for Brazilian ore - roughly the same levels as 2005 term contracts on a free-on-board basis. India's iron ore reserves are estimated at 24 billion tonnes, of which a major portion has a rich iron content of about 65 per cent. In comparison, Brazil's iron ore is about 66 per cent iron.