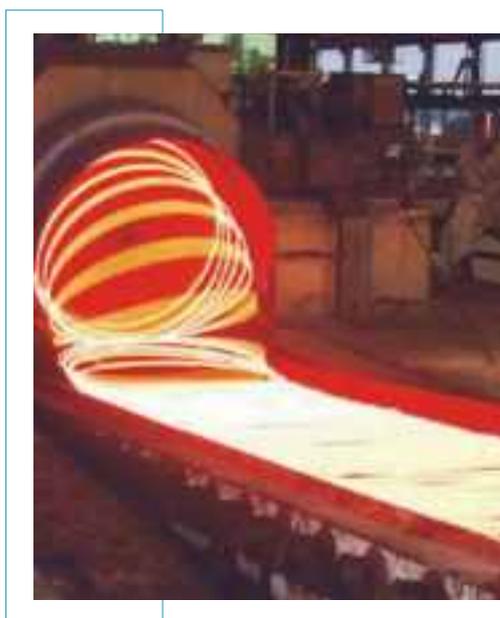




Consolidation in Chinese steel industry

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Consolidation in Chinese steel industry looms large with the government's decision to small and medium size mills with less than one million tons of production capacity. With the major aim to reduce greenhouse emissions, the world's largest steel producer and consumer has drafted new regulation. According to an estimate around two-third of existing steel do not comply with new regulations. Over and above, the government has also ordered to close 16.91 million tons of outdated capacity by the end of February. Under new regulations, small steel mills in China require environment-friendly equipment to be installed alongwith steel mills with innovative technologies. The upgradation of all mini and medium steel mills would entail an investment of millions of dollars which these mills can not afford neither they would get government support for the same.

Mills closure brings uncertainty

Traders, generally still optimistic, are wondering what impact China's new plans for the iron and steel industry would have on the market. Despite government fears that production levels were unsustainable, China, the world's largest emitter of greenhouse gases, set new environmental and power standards for steelmakers and threatened closures to curb pollution and overcapacity. Plants should cap sewage discharge at 2 cubic meters and sulfur dioxide emission at 1.8 kilograms for every ton of steel made, according to draft regulations. China, the world's largest steelmaking nation, has rejected almost \$29 billion of industrial projects this year and is planning measures to close plants to curb pollution.

A severe steel oversupply is overwhelming demand created by the government's stimulus, depressing profits for larger mills including Baoshan Iron & Steel Co. Amid the global downturn, China's share of world steel output reached 48 percent in the first ten months, up from 37 percent last year, and the government has finally issued new measures aimed at curbing the sector.

Steel output of China, the world's biggest producer and consumer, witnessed a rebound in November at 62.95 million tons, a rise of 46.4 percent from a year ago. Total output in the previous month was recorded at 62.44 million tons. Steel exports from the country also gained 6 percent in November from the previous month to 2.85 million tons. Crude steel output jumped 37.4 percent to 47.3 million tons last month from a year ago. Still, that's lower than the 51.7 million ton output in October. Output in the first eleven months was 518 million tons, up 12.1 percent compared to 2008. Crude steel production may rise to 570 million tons this year, with net product exports of 1 million tons. China's \$586 billion stimulus spending has helped industrial manufacturers to recover from the worst economic crisis since the great depression.

Anti dumping duty on US, Russian steel imports

The country has levied provisional duties on some US and Russian imports following anti-dumping and subsidy investigations, escalating a trade spat started in

September. Flat-rolled electrical steel products from steelmakers including AK Steel Holding Corp., OAO Novolipetsk Steel and Allegheny Ludlum Corp., would attract duties of as much as 25 percent. The steel is used to make power transformers. China is striking back after the US, the European Union and other countries assessed tariffs and filed complaints about Chinese steel and commodity products to the World Trade Organisation this year. U.S. and Russia last year exported a combined \$602 million of the targeted steel products to China. The tariffs come after U.S. President Barack Obama in a visit to Beijing last month pledged with China President Hu Jintao to work on easing trade frictions. Obama imposed tariffs on Chinese tires in September, and the U.S. later levied duties on some Chinese steel pipes. The two countries have \$409 billion in annual two-way trade.

US steel products will face two duties, one for subsidies and the other for dumping while Russian companies will only pay tariffs for anti-dumping. This is the first time China has conducted an anti-subsidy and anti-dumping investigation. The imports have hurt the Chinese steel industry. Disputes between China and its trading partners are escalating as the worst economic crisis since the Great Depression spurred countries to protect jobs. China protested U.S. duties of as much as 99 percent on \$3.2 billion of Chinese steel pipe exports on November 6, and announced the start of an anti-dumping probe into American carmakers. The Chinese commerce ministry in October made a preliminary ruling that US, European, Russian and Taiwanese chemical companies had dumped nylon fibers at below-cost prices in the Chinese market. Nylon is used to make textiles and toothbrushes.

Affect on US, Russia mills

China's move to slap punitive tariffs on grain-oriented electrical steel is the latest chapter in a simmering trade row between the Asian giant and the United States, and could also hit Russia's main supplier of the product. China found that US dumping margins on the steel product were 10.7 percent to 25 percent and that the subsidy rate was 11.7 percent to 12.0 percent. The dumping margin on the Russian version of the steel product was 4.6 percent to 25 percent. In October, the US Commerce Department leveled preliminary anti-dumping duties ranging up to 99 percent on \$2.63 billion in Chinese-made oil well pipes in the biggest US trade action to date against China.

Grain-oriented electrical steel, a high-value, specialised product used in transformers, motors and power generators, makes up only a tiny proportion of total steel production in Russia, the world's No. 4 steel-producing country. It is also known as transformer steel. Novolipetsk Steel, or NLMK, is the only major producer of this particular steel product in Russia. The company, however, denied it was dumping steel and said it is already paying a preliminary tariff of 4.6 percent on transformer steel exports while the Chinese investigation continues. Through end-September NLMK produced 98,000 tons of transformer steel, and exported roughly 83,000 tons,

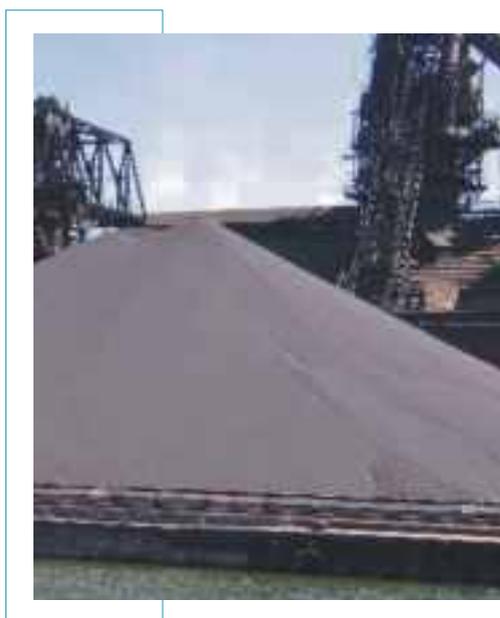


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sending 13 percent of this amount to China. NLMK expects to produce a total of about 10.5 million tons of steel this year, matching last year's level.

No bank credit to small mills

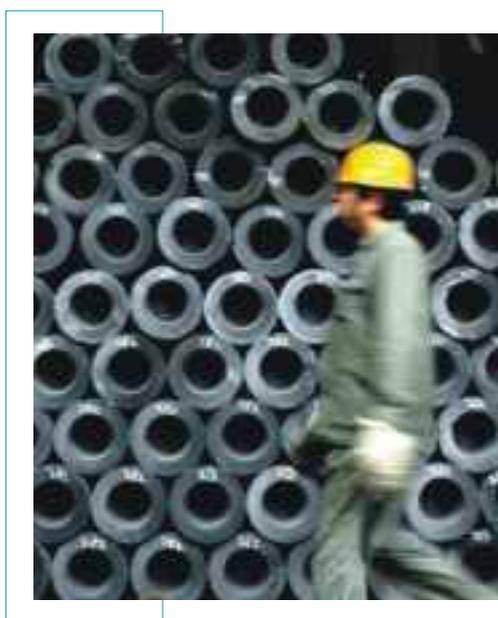
Chinese government has asked banks not to give credit support and government departments must not issue iron ore import permits and supply the steelmaking ingredient to mills failing to meet the new requirements, the environment ministry said in the proposal open for public comments. Steel plants should cap energy consumption of blast furnaces at 411 kilograms coal equivalent and fresh water use at 6 tons for each ton of steel they produce. The ministry also proposed that carbon steel mills should have a minimum production capacity of 1 million tons, and specialised makers have a capacity of at least 500,000 tons. Crude steel production in China may rise 14 percent to 570 million tons this year. The nation's steel capacity may have reached 700 millions or higher, the government sources said. China is planning measures to close plants in steel, aluminum, cement, coke, paper, glass and utility industries.

Sight on iron ore

Falling iron ore spot prices and shipments into China could signal a push by the world's biggest buyer of the steel-making raw material to position itself for an early settlement to 2010 contract talks. But with the spot market still some 30 percent above 2009 contracts on a freight-adjusted basis and the global economy on the mend, miners are in a strong position ahead of what are often acrimonious and drawn-out contract talks. Delays in settling 2009 term contracts - which, formally at least, are still under discussion, but in practice are the same as the 33 percent cut won by South Korean and Japanese steelmakers - cost chief negotiator China Iron and Steel Association a huge amount of bargaining power as demand revived and the country's growth remained strong. The seaborne iron ore trade is a high stakes business worth more than \$80 billion a year, dominated by Brazil's Vale and the big Anglo-Australians Rio Tinto and BHP Billiton on the mining side and China, the world's biggest iron ore consumer, on the other. Spot iron ore prices have fallen 6.5 percent from three-month highs struck in late November, but forecasts are still for miners to win hefty price hikes of between 10 and 30 percent next year as steel demand rises with economic growth. Iron ore prices in China have retreated to \$98.10 this week from \$104.6, price data from the Steel Index shows. China's steelmakers could be scaling back spot purchases and instead relying on stockpiles as part of a scheme to bolster the country's bargaining position. Between September 11 and November 20, the latest data available, Chinese port stocks fell 5 million tons to 68.87 million tons, around 5 percent of monthly consumption. Certainly data on iron ore fixtures shows a slowdown in vessels bound for China. Vessel bookings from Australia, the biggest iron ore seller to China, fell by more than half in November, to 26, from 56 in October. The number of



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bookings from China's other main supplier, Brazil, also fell last month, and while the ASX data only captures a portion of the trade, it suggests a slowdown in spot purchases after a surge in September.

India can play a big role

Since long term contracts for iron ore procurement is yet to be signed, spot market can play a big role in selling of steelmaking raw material. India can play a crucial role as most of over 100 million tons of exports goes through spot dealings on current prevailing price. Hence, India can bridge the gap between demand and supply mismatch of iron ore in China. The failure to resolve annual price talks in 2009 may also mean spot prices play the pivotal role in the 2010 negotiations as the starting point for discussions rather than the previous year's settlement. Lead mining negotiators in Australia and Brazil refuse to discuss details of their talks until they are wrapped up. This year, Nomura expects contract iron ore prices to rise 30 percent, followed by another 10 percent hike next year, and predicts a supply deficit will emerge in 2010 because of strong steel production growth in China. That is higher than the hike of roughly 20 percent RBC Capital Markets sees in 2010-2011 before a price rollover in 2011-2012.

Meanwhile, iron ore imports by China rose 12 percent in November as steelmakers increased production to meet demand from makers of cars and appliances. Imports of the steelmaking ingredient were 51.1 million tons as compared with 45.5 million tons in October and a record 64.6 million tons in September. Steelmakers and traders are increasing shipments on expectations that prices will gain next year because of the global economic recovery. China may import 70 percent of its iron ore needs this year, up from 50 percent last year. Contract prices for iron ore may rise 15 percent to 20 percent next year to the second-highest on record. Cash prices for Australian iron ore delivered to China have surged 41 percent this year amid rising demand and higher freight costs. The price of 62 percent content ore delivered to Tianjin port was \$100.90 a tonne recently. Rio Tinto Group, the world's No. 2 iron ore exporter, rose 0.5 percent to close at A\$70.18 in Sydney trading. BHP Billiton Ltd., the third-biggest supplier, gained 1.4 percent to A\$40.50. Imported iron ore inventories at China's major ports stayed almost flat by the end of November 11, rising by less than half a percent to reach 65.92 million tons. Ore from India edged higher by 280,000 tons to finish at 12.35 million tons, while Australian ore rose 380,000 tons to 22.43 million tons. Iron ore originating in Brazil fell by 80,000 tons to 18.92 million tons. The price of imported ore, as on date, is still 23.3 percent higher than the same period of last year. China imported 51.07 million tons of iron ore in November, up 12.3 percent month on month, and produced a record 86.781 million tons from its domestic mines, 3.5 percent more than October.