

IRON ORE PRICES

Steeled for a downturn

The recent multiyear climb in iron ore prices, which has delivered attractive returns for investors in companies like BHP Billiton and Rio Tinto, is widely expected to reverse, or at least track sideways, for the next five years.

SA is one of the world's biggest exporters of iron ore.

Weaker prices will reflect imbalances in supply rather than demand. Plans made several years ago to expand production are coming to fruition, and analysts suggest quantities may be more than the market can absorb, especially if China's economic growth is slower than expected. Its 2012 GDP growth of 7,8% was the lowest in 13 years.

But the outlook for iron ore's biggest customer, steelmaking, may be improving. ArcelorMittal SA CEO Nonkululeko Nyembezi-Heita told the Gibbs Forum in Johannesburg last week that by 2014 the global steel industry may start to emerge from the deep downturn that began in 2008.

She said capacity was expanded to meet demand before 2008, which meant the industry was in structural oversupply during the recession. Overcapacity has been difficult to eliminate because the industry is fragmented and steel is regarded as a strategic asset by most governments. The situation has been made worse by China's incentives to grow its own steelmaking industry, so that country now makes almost half the world's steel.

Unable to raise prices because of oversupply and weak demand, steelmakers have been squeezed by the rising costs of main inputs: scrap metal, iron ore and coking coal. Iron ore prices have become volatile after the move away from benchmark pricing to spot and short-term contract pricing in 2010, and this has made it difficult for steelmakers to plan, Nyembezi-Heita said.

Last September iron ore prices plunged to US\$87/t but recovered to around \$137/t last week, a level they are not expected to sustain. McKinsey & Co partner Diedrik Tas, in a presentation at the Mining Indaba in February, said September's price dip was caused by

 **IMPROVING OUTLOOK**

Global apparent steel consumption growth forecast 2012 vs 2013



* Russia & former Soviet states

SOURCE: ARCELORMITTAL

supply and demand imbalances in China, which last year absorbed 744 Mt of the world's 1,2bn t seaborne iron ore supply.

Bloomberg reported investment bank Morgan Stanley is forecasting that seaborne iron ore supply will rise 9,1% this year but demand only 8,3%, as Australian producers export more and China's demand slows. This will result in a surplus next year, which will widen until at least 2018.

Australia's Bureau of Resources & Energy Economics is more bullish in the short term, based on a boost to iron ore prices in the first quarter of this year from new infrastructure projects unveiled in China. It says world steel consumption will rise about 3% this year to 1,6bn t and by an average rate of 3% each year to 2018, to 1,8bn t.

Yet in the longer term, the bureau forecasts that spot iron ore prices will continue falling every year until 2018 to around \$90/t, in response to moderating demand, especially in China, and substantial supply increases.

London-based stockbroker Liberum Capital doubts if the iron ore glut will materialise to the extent most forecasters suggest. It says supply will exceed offtake in 2014 and 2015 but the major producers can delay expansions, which will account for 71% of new growth over the next four years, if prices are un-

Nonkululeko Nyembezi-Heita

Global steel industry may emerge from downturn by 2014

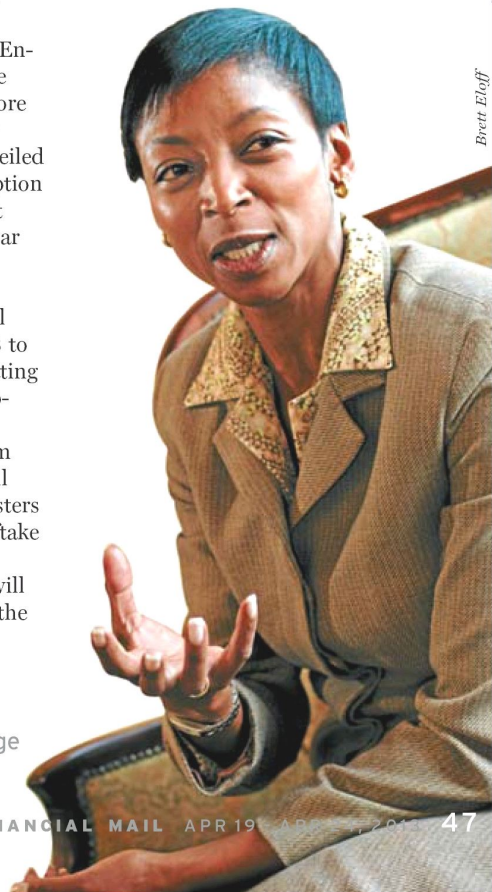
favourable. The big three producers (BHP Billiton, Rio Tinto and Vale) dominate the market because of the high capital cost of new projects.

Liberum's research shows Rio Tinto, BHP Billiton and Anglo American's profits are substantially exposed to iron ore and their recent share price falls are anticipating future weakness in the price.

Despite a mixed outlook for iron ore, Rio Tinto is disposing of its Queensland coal, Pacific aluminium and diamond interests, while retaining its huge iron ore interests in the Pilbara region of Australia.

"You have to question the strategy behind a number of these decisions," London stockbroker Numis says in a note. "Are the reasons behind diversification enshrined by previous generations of Rio Tinto's (and other mining houses') management teams an old lesson that needs to be re-learned?"

Charlotte Mathews



Brett Elloff