China and Brazil prepare for arm-wrestle over global prices
Kevin Morrison

Global steelmakers face an anxious few weeks as they await the outcome of the annual price negotiations that will determine how much their iron ore supplies will cost in the year from next April.

This year is the first time that China has led the talks on behalf of the steel industry - a role previously taken by Japan.

It is a natural switchover now that China has overtaken Japan as the world's largest steel producer and become the world's largest importer of iron ore.

China muscled in on the talks - for the year ending March 2007 - but its negotiating tactics were heavy-handed.

Beijing insisted at the outset that its steel producers would not pay higher iron ore prices.

But eventually it capitulated and fell into line with the rest of the industry and accepted the 19 per cent price rise.

Chinese steel industry executives said on the sidelines of the CRU steelmaking raw materials conference in Beijing last week that negotiations would be different this year.

For a start, the two sides are not as far apart as last year.

The Chinese, led by Baosteel, China's largest steel producer, and Sinosteel and Minmetals, the steel traders, are reported to be seeking a 5 to 10 per cent fall in prices whereas Brazil's Companhia Vale do Rio Doce (CVRD), the world's largest iron ore producer, is looking for a20 to 25 per cent rise.

A year ago, China sought a20 per cent cut in prices and CVRD a 40 per cent increase.

But the gap between the two sides is still significant and negotiations are unlikely to be concluded by the year-end.

Whatever the price agreement made, it will be accepted by the industry, whether they are Japanese or European steel mills or Australian iron ore producers. Wiktor Bielski, managing director mining at Morgan Stanley, said estimated steel demand was the key to determining iron ore prices.

But iron ore supplies were also a factor. "The indications are that iron ore markets will remain very tight next year, which will lead to a further price increase," said Mr Bielski.

Jim Lennon, executive director commodities research at Macquarie Bank, said current spot prices for iron ore, and another strong increase in Chinese steel production next year, suggested iron ore prices would rise again. "I think we are going to see tight iron ore markets until 2010," he added.

Analysts forecast a price rise of about 10 per cent for 2007-08, less than this year's increase and much lower than the 71.5 per cent gain in 2004-05. If prices do increase as expected, it will be the fifth year in a row that iron ore prices have risen, a sequence that has not occurred since 1977-1982 when prices rose for six years in a row.

Mr Bielski said growth in Chinese steel output would slow from 27 per cent in 2005 to 20 per cent this year and 10 per cent next year, meaning output of 470m tonnes in 2007, against 425m in 2006 and 353m last year.

This growth in production has turned China from a net impor- ter of steel to the world's largest exporter in the past two years.

This year, China is expected to export more than 40m tonnes.

But, next year, the figure may drop to 30m tonnes, according to Chinese steel executives, as domestic demand outpaces production growth.

Greater steel output means more demand for imported iron ore - even though China's domestic iron ore production has risen sharply. The country is expected to produce 560m tonnes of iron ore this year and 680m tonnes next year.

China is expected to import 400m tonnes of ore next year, up from 330m tonnes of iron ore in 2006. Most of this increase is expected to come from Brazil.

This will have a knock-on effect in freight markets because bulk carriers will have longer voyage times, reducing vessel availability elsewhere in a market that is already tighten- ing. The Baltic dry freight index - an indicator for bulk carriers that carry iron ore, coal and steel- has doubled since late January to more than 4,200 points.

So not only are Chinese steel producers facing higher iron ore prices, they are also facing higher transport costs.

One respite may come in the form of lower coking coal costs.

Mr Lennon said BHP Billiton had already indicated that it planned to reduce coking coal contract prices for the 2007-08 year by 10 per cent to about $102 to $104 a tonne.

Fonte: Financial Times, London, dec 14 2006. Stock Markets & Currencies, p. 30.