



# Iron & Steel Outlook – March 2007

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## Summary – iron ore prices reach new record in 2007, but set to decline in 2008

- **Chinese producers settle for price rise in 2007:** China's Baosteel agreed to a 9.5 per cent rise to contract iron ore prices for the 2007 financial year – reflecting the continued tightness in iron ore availability.
- Major producers in both Australia and Brazil are expanding production capacity in 2007. CVRD, Rio Tinto and BHP Billiton have projects scheduled to commence in this year, as does Fortescue Metals Group – however delays in the latter appear likely.
- **Prices tipped to fall in 2008...:** The expanded production capacity in both Australia and Brazil, combined with slowing growth in global steel output, is expected to push the global iron ore market into surplus in late 2007. As a result contract prices for iron ore are forecast to fall by around 10 per cent in 2008.
- **...but upside risk remains:** However, our forecast is predicated on sufficient growth in supply to push the iron ore market into surplus. The potential for project delays and moves to withdraw Indian iron ore exports add upside risk to this price forecast.
- **Steel demand remains firm:** Global steel consumption is forecast to increase by around 5.2 per cent in 2007 – with China underpinning this growth.
- China's steel demand continues to grow – driven by growth in the country's construction, infrastructure and manufacturing sectors – with consumption set to increase by around 10 per cent.
- Indian steel consumption is also set to increase by around 10 per cent in 2007, while restocking in the US auto industry may provide support for steel consumption.
- **Steel production remains driven by China...:** Global steel production is forecast to increase by around 5 per cent in 2007 to reach 1280 million tonnes.
- China remains the main driver of growth – with global output excluding China forecast to increase by just 1.9 per cent.
- China's steel production is forecast to increase by 12 per cent in 2007 – down from over 20 per cent in 2006 – to reach 470 million tonnes.
- **...building trade tensions elsewhere:** The spectacular growth of steel production in China has raised the ire of international competitors – with the United States launching action against China in the World Trade Organisation.
- At the recent National People's Congress, China's Premier committed to closing 35 million tonnes of annual steel making capacity, as well as around 30 million tonnes of outdated iron making capacity.
- However, poor adherence to these orders, as well as the commissioning of new projects, may delay a return to trade balance.

### Iron & steel prices

	2004	2005	2006	2007	2008
Steel <sup>1</sup>	655	585	612	635	555
Iron ore <sup>2</sup>	46.7	80.0	95.2	104.3	93.9

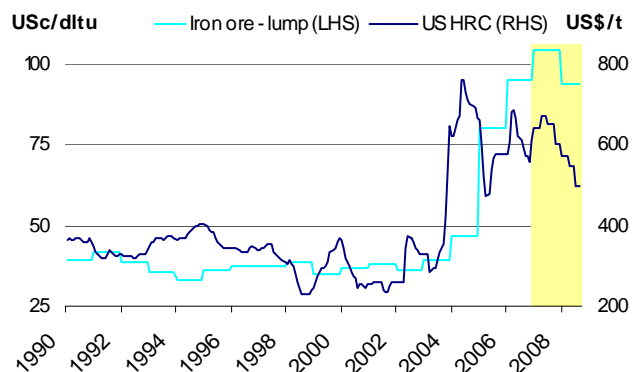
1. Hot rolled coil, United States import, US\$/t

2. Negotiated Japanese contract price, Brockman lump, USc/dltu

### Iron & steel prices: Iron ore to new price record in '07 but lower in '08...

Chinese steel producers wasted little time in settling iron ore contracts for the 2007 financial year. In stark contrast to the protracted negotiations of 2006 (which lasted six months), major producer Baosteel agreed to a 9.5 per cent increase in ore prices with Brazil's CVRD in mid December. This result was broadly in line with our forecasts for a 10 per cent increase.

### Iron and steel prices to drift lower in 2008, but remain historically high



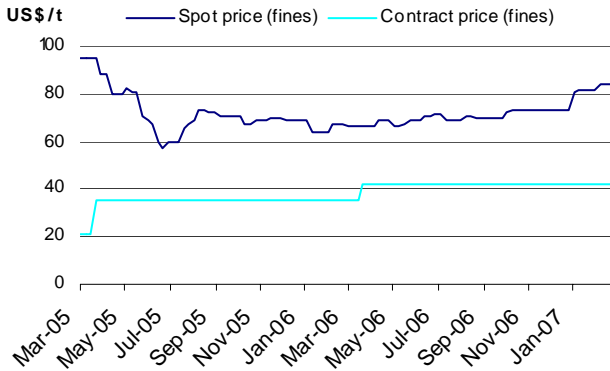
Source: Datastream, ABARE, NAB Group Economics

Despite growth in seaborne availability – with expansions to export capacity in both Australia and Brazil – surging demand from steel producers, primarily in China, has maintained a tight market balance. The major iron ore producers – CVRD, Rio Tinto and BHP Billiton, who together control around three quarters of global iron ore trade – added around 39 million tonnes of additional production in 2006.

Global steel production increased by 48 million tonnes – equivalent to an increase in iron ore consumption of around 70 million tonnes. Much of the shortfall in seaborne iron ore was made up by high cost Chinese or Indian ore.

Indian iron ore producers have benefited in recent years from high prices in the limited spot market – with prices in early 2005 almost five times benchmark contract levels. However, the imposition of an iron ore export tax – equivalent to around US\$6.77 a tonne (SBB) – as well as calls for export caps may reduce the availability of spot ore.

**Spot prices higher as India imposes export tax**



Source: Datastream, Metal Bulletin, ABARE

In 2007, the major iron ore producers are set to increase output by over 50 million tonnes – with Brazilian ore dominating growth. In line with expectations of more moderate growth in steel output, the iron ore market should return to a modest surplus prior to 2008 contract settlements. As a result, our forecast for iron ore prices is unchanged, with benchmark Brockman lump forecast to fall by 10 per cent in 2008 to US 93.9 cents a dry long ton unit.

However, the potential for delays to new developments, and lower Indian exports, presents upside risk to this forecast.

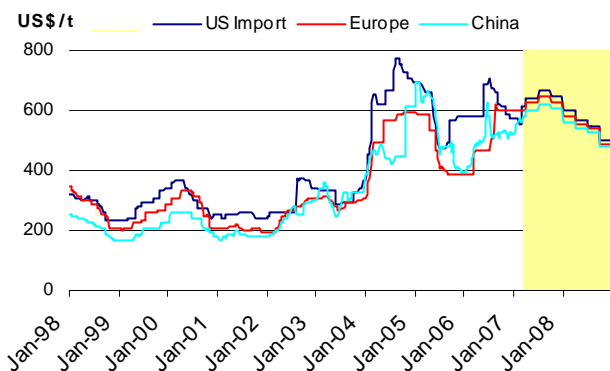
**...while steel prices hold firm**

Global hot rolled coil prices have started the year firmly, if below levels of mid-2006. Demand conditions appear supportive – particularly for the first half of the year, with a modest period of destocking in the United States and Japan coming to an end.

For the first two months of 2007, US import hot rolled coil prices averaged US\$565 a tonne, down around 2.4 per cent year on year. However, since the start of March, prices have moved back above US\$600 a tonne (Metal Bulletin).

Steel makers should weather the higher cost of iron ore with lower energy costs – reflecting the 16 per cent fall in hard coking coal prices for the 2007 Japanese financial year.

**Steel prices to retreat in 2008**



Source: Datastream, NAB Group Economics

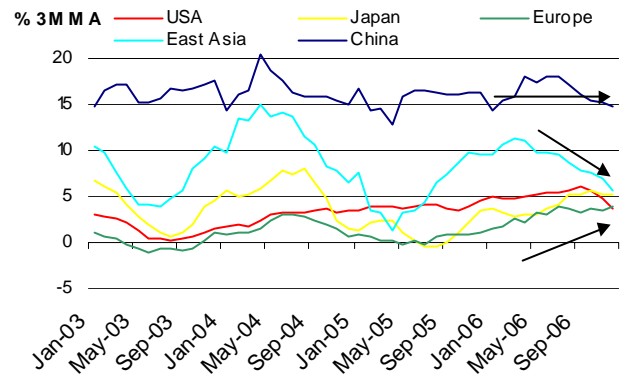
With higher demand across the first half of 2007 – following stock adjustments – steel prices are forecast to trend marginally higher across the year, before resuming a downward trend that will continue across 2008. In 2007, US

import hot rolled coil is forecast to average US\$636 a tonne, a year on year increase of 3.5 per cent.

**The demand side: China continues to lead the way**

The global economy is set to expand by around 4.2 per cent in 2007, with China's economic development providing the catalyst. While China's growth is expected to slow marginally – down from 10.7 per cent in 2006 to 9.9 per cent this year – this will continue to underpin global steel demand.

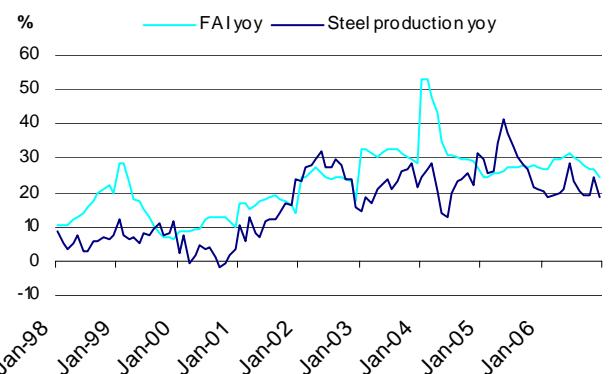
**China's industrial production powers on, with gains in other regions offsetting East Asia**



Source: Datastream

The International Iron & Steel Institute forecasts global finished steel demand to increase by 5.2 per cent in 2007 to reach 1179 million tonnes (IISI). China remains the key growth market – as the country's manufacturing, construction and infrastructure developments drive demand. Industrial production growth averaged around 16 per cent in 2006, though has slowed from mid-year peaks. Similarly, fixed asset investment has moderated, but remains strong, averaging over 28 per cent (CEIC).

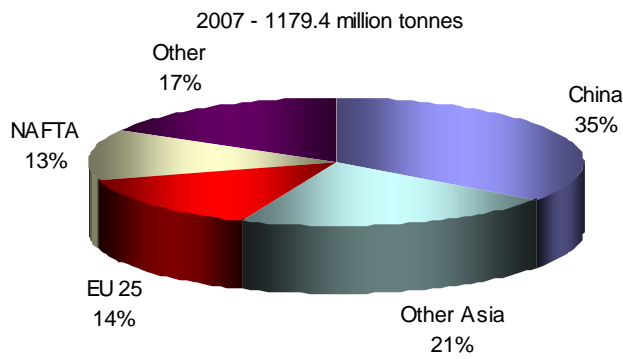
**Fixed investments underpin Chinese steel demand**



Source: CEIC

China's finished steel consumption is forecast to increase by 10.4 per cent in 2007 to 413 million tonnes (IISI). Other Asian economies are likely to record growth, with Indian consumption increasing by 9.1 per cent to 46 million tonnes and other Asia (including Japan) increasing by 2.8 per cent to 203 million tonnes (IISI).

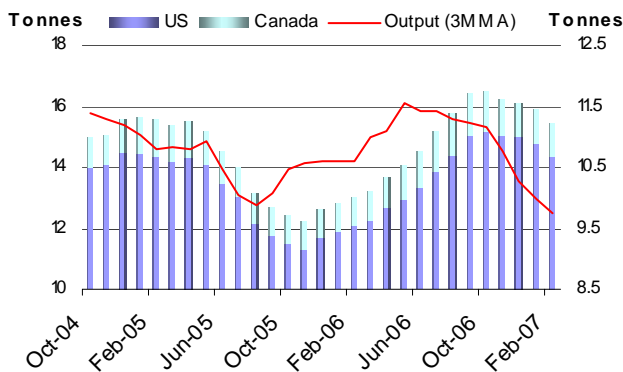
**China dominates global steel consumption**



Source: IISI

While economic conditions are worsening in North America, a period of heavy destocking in the auto industry has come to an end, and may support increased consumption in the short term. US steel mills pre-emptively cut production in late 2006, helping to reverse the upward trend in steel inventories.

**Production cuts reverse North American steel stocks**



Source: MSCI

**The supply side: China's steel growth raises trade tensions...**

In 2006, global steel production increased by 7.9 per cent to reach 1219 million tonnes (IISI). However, excluding China, the growth rate was more moderate, at just 2.2 per cent.

China's steel production surged by 21 per cent in 2006, to total 421 million tonnes (IISI). The government's measures to slow growth in the steel sector have so far had minimal impact – despite higher interest rates, borrowing limits and reduced tax incentives.

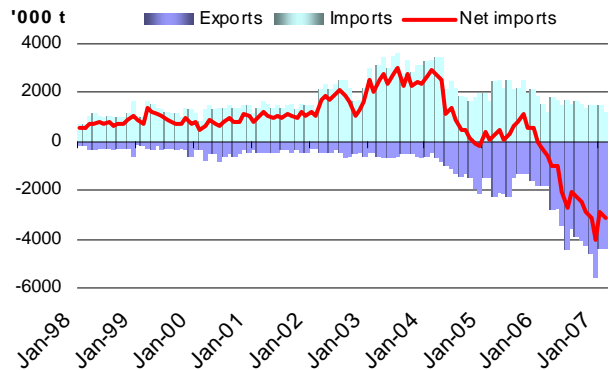
At the recent National People's Congress, China's Premier committed to closing 35 million tonnes of annual steel making capacity, as well as around 30 million tonnes of outdated iron making capacity. The National Development and Reform Commission had previously targeted 26 steel mills in Hebei province – China's largest steel producing region – for closure, yet this capacity represents just over 10 per cent of the target (3.71 million tonnes a year).

The urgency for action in controlling China's rampant steel sector has been heightened by action in the World Trade Organisation in February. The United States has accused

China's government of nine subsidy programs that violate WTO rules, distorting trade in favour of Chinese steel producers. In response, China has removed an initiative that allows large exporters to access discounted finance.

China's steel trade position has shifted notably since early 2006, when the country became a sustained net exporter for the first time. In 2006, China exported around 25 million tonnes more than it imported. While the central government has promised closures, poor adherence to these orders, as well as the commissioning of new projects, may delay a return to a balanced trade position.

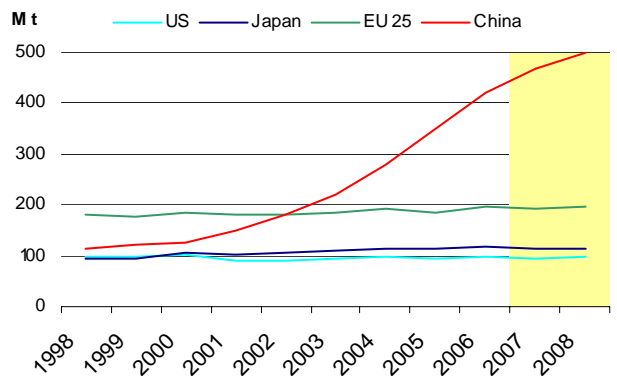
**China's unfettered production drives export growth**



Source: CEIC, NAB Group Economics

Despite attempts to reign in steel production, China's output is forecast to increase by around 12 per cent in 2007 to reach 470 million tonnes. Excluding China, global production is forecast to increase at a modest 1.9 per cent – with Indian output forecast to increase by almost 10 per cent. Global steel production is forecast to reach 1280 million tonnes, an increase of 5.2 per cent.

**China's steel output dwarfs other major producers**



Source: IISI, NAB Group Economics

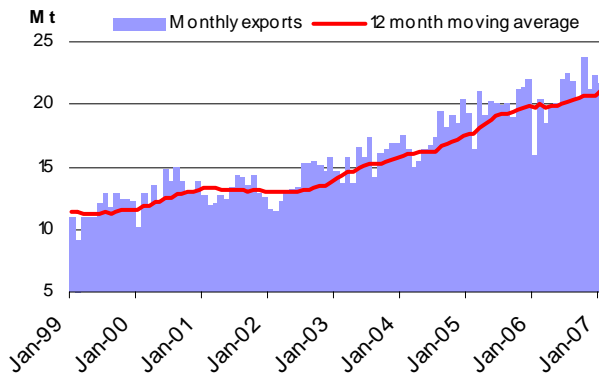
**...as iron majors step up growth**

Australia's iron ore exports increased by just 3.9 per cent in 2006, to total 248 million tonnes. Severe cyclone disruptions partially account for the moderate growth, while delays in new developments has hampered higher output.

Expansions to mine, rail and port capacity is set to increase Australia's supply of seaborne iron ore. A number of new projects are scheduled to commence in late 2007 – including expansions to Rio Tinto's Yandicoogina mine and

BHP Billiton's Mining Area C (as part of the Rapid Growth Project 3).

### Australian iron ore exports trend higher as producers struggle to expand



Source: ABS

Fortescue Metals Group's Cloud Break iron ore project is also scheduled to commence in late 2007, however shortages of mining equipment and development delays – particularly related to recent Tropical Cyclone George – may slow this project.

Brazil's CVRD has also expanded production capacity – with output rising by around 28 million tonnes in 2006. Expansion of the massive Carajás mine to 85 million tonnes of annual capacity helped to support this growth. This year, the mine will be further expanded to 100 million tonnes a year.

CVRD plans to increase iron ore output to 300 million tonnes in 2007, with expansion plans to allow output of between 320-340 million tonnes a year by 2009.

Producers in both major regions continue to face rising development costs – impacted by higher labour, capital and oil costs – as miners across the resources sector attempt to expand production.

### Major iron ore developments Western Australia

Company	Project	New capacity	Completion
Rio Tinto	Yandicoogina expansion	16 Mt	Late 2007
Rio Tinto	Hope Downs	22 Mt	2008
BHP Billiton	Rapid Growth Project 3	20 Mt	Late 2007
FMG	Cloud Break	45 Mt	Late 2007*

\* Official start up time, delays to development are likely

### Brazil

Company	Project	New capacity	Completion
CVRD	Carajás	15 Mt	2007-08
CVRD	Fabrica	5 Mt	2007
CVRD	Fazendao	14 Mt	2007

Note: depletion of existing mines could reduce existing capacity by up to 20 Mt over 2006 and 2007

Source: ABARE, BHP Billiton, Rio Tinto, CVRD

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