Developments in the Iron Ore Market

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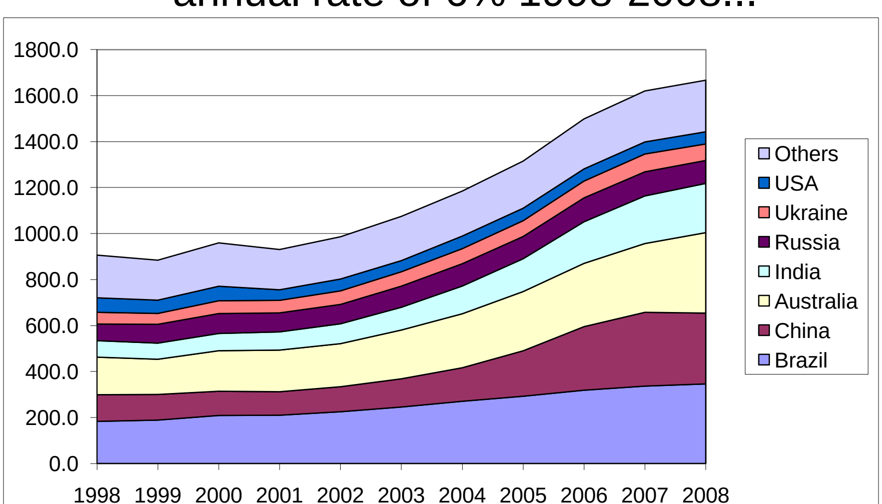
Outline of presentation

- Iron ore in 2008
- Outlook for 2009
- The medium term outlook
- The future of the pricing system for iron ore

UNCTAD (United Nations Conference on Trade and Development) Iron Ore Trust Fund

- In existence since 1987, since 2002 in cooperation with the Raw Materials Group of Sweden
- Two annual publications
  - Iron Ore Market Review in May/June
  - Iron Ore Statistics in September
- Financed by contributions from Australia, Brazil, Canada, Sweden and the United States and by sales of publications
- Contact ironore@unctad.org for information

Global iron ore production grew at an average annual rate of 6% 1998-2008...



Source: UNCTAD Iron Ore Trust Fund

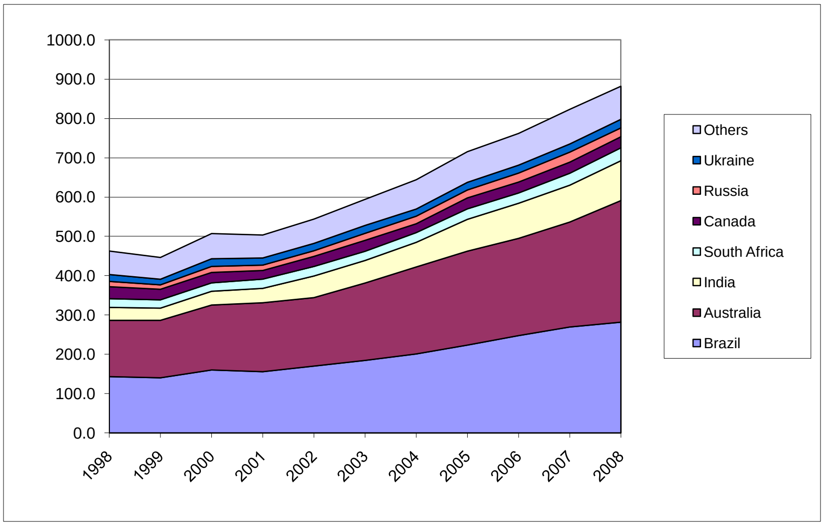
…but the increase was only 1 % in 2008

	Prod 2008, Mton	Change, %	
Brazil	346.0	2.8	
China	308.0	-4.0	?
Australia	349.8	17.0	
India	214.0	3.4	
Russia	99.9	-4.9	
Ukraine	71.7	-7.4	
USA	53.0	1.1	
World	1666.9	1.0	

The Chinese question mark

- Reported production in China was 784 Mtons, corresponding to 230 Mtons Fe if grades were unchanged
- 468 Mtons Fe in iron ore were needed for steel production and imports were 280 Mtons Fe (at 63 %)
- This means only 188 Mtons of domestic production were needed
- Three possible explanations for the discrepancy
  - There was a stock build-up of 42 Mtons Fe, or 143 Mtons run of mine ore
  - Average ore grades fell from 29,5 to 24 % Fe
  - Production was incorrectly reported
- We choose to assume that there was some stock build-up , possibly a slight fall in grades, but mainly inaccuracies in reporting

Global iron ore exports grew at an average annual rate of 6.7 % 1998-2008...

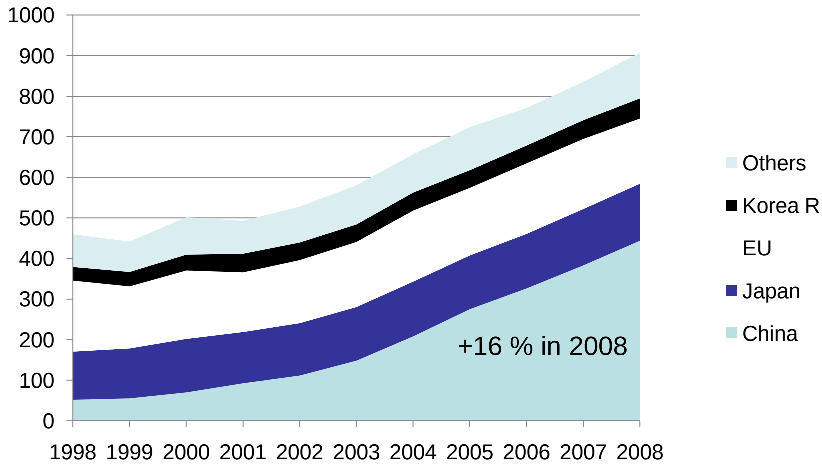


Source: UNCTAD Iron Ore Trust Fund

…and increased by 7% in 2008

	Exports 2008, Mton	Change, %
Brazil	269,4	4,5
Australia	266,9	15,9
India	93,7	8,2
South Africa	30,3	8,0
Canada	28,3	-0,4
Russia	25,5	-11,7
Ukraine	20,7	5,4
World	823,0	7,1

Imports 1998-2008, per cent



Source: UNCTAD Iron Ore Trust Fund

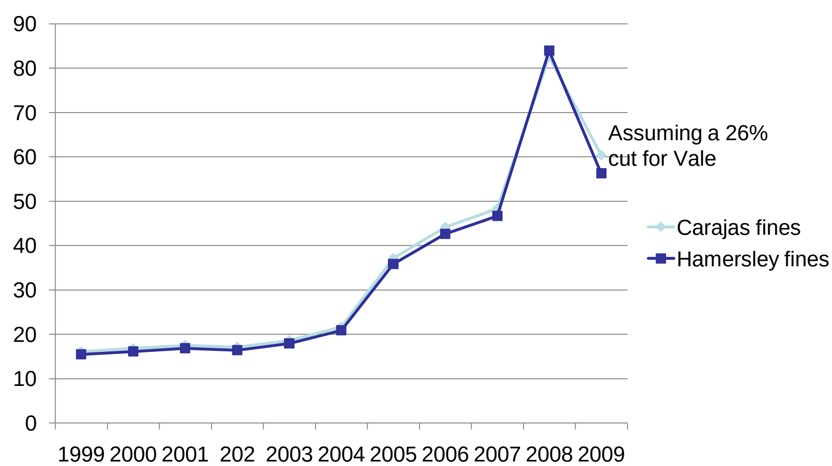
Outlook for 2009

- World crude steel output will fall considerably in 2009, the uncertain factor is the strength of the recovery in emerging economies
- The fall in iron ore demand will be proportionately larger than the fall in steel output
- The largest production cuts are coming in North America and Europe and in China

The 2009 price negotiations

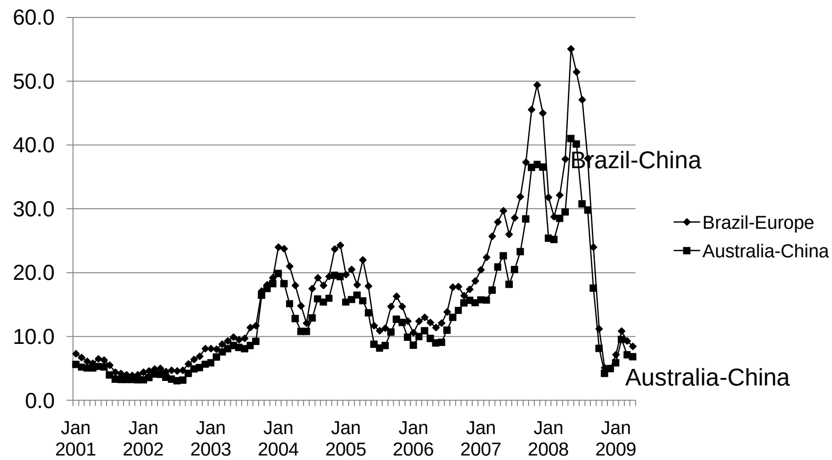
- Rio Tinto agreed on a 33 % price cut for fines with Nippon Steel on 26 May, and with other buyers since
- Chinese steel companies have registered their disagreement and ask for larger cut
- Vale has been reported to be willing to settle for a 26 % cut

Contract prices, 1999-2009, US$/ton fob



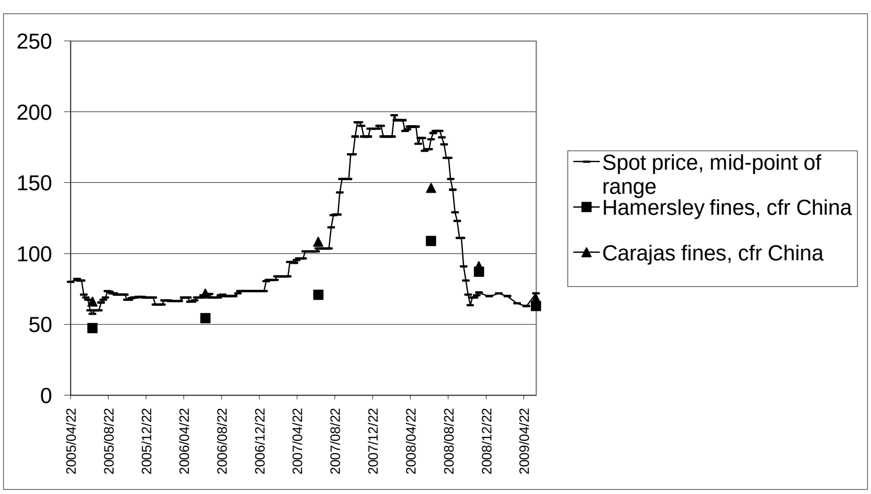
Source: UNCTAD Iron Ore Trust Fund

Iron ore freight rates, 1999-April 2009, US$/ton



Sources: Drewry, SSY

Benchmark prices, spot prices and freight rate differentials 2005-2009, US$/ton



Sources: UNCTAD Iron Ore Trust Fund, TEX Report, Metal Bulletin

Reflections

- Rio Tinto has accepted a 20 % cut in Australian dollars
- Vale declares that it is prepared to accept an 8.5 % cut in Reais
- Chinese steel mills may have to content themselves with a 42% reduction in the landed price of Australian ore and a 54% reduction for Australian ore
- These numbers imply that the settlement between Rio Tinto and Nippon Steel is stable

Medium term supply-demand outlook

- 2009 and 2010 will mark a sharp break in the trend of ever increasing iron ore production and trade, with volumes declining in 2009 and growing by very little in 2010
- There will be considerable iron ore surplus capacity in 2010 – the project pipeline for 2009-2011 contained more than 300 Mtons in late 2008
- Producers are very discreet about their plans: Project cancellations and postponements already known would reduce the surplus by 50 to 70 million tons
- Conclusion: many more investment projects will be cancelled
- The market will return to fast growth eventually, probably in 2011, since the underlying structural factors – strong growth in Asia and in other developing regions – are mainly unchanged. When it does, the large producers are likely to have strengthened their grip on the market

The investment pipeline

- Announcements about cancelled projects are only being made now – sponsors have hoped for a turn in the market or for better credit conditions
- Finance for new projects is almost impossible to find
- Projects already well under-way will be completed but will not come into full production yet
- The large producers have the capability to wait for the market to improve, the smaller ones depend on sales revenue to pay off loans
- Projects with high expensive infrastructure will be cancelled first
- Winners: the largest producers, who can ride out a period of slack demand
- Losers: Chinese miners and sponsors of greenfield projects

The iron ore pricing system, tentative conclusions (1)

- The benchmark pricing system is no longer the only one available
- The flexibility offered by spot prices and the possibility of hedging argue in favour of other systems
- But the benchmark system is convenient and therefore not likely to be abandoned completely or quickly

The iron ore pricing system, tentative conclusions (2) Alternatives

- Benchmark pricing, but with more frequent (quarterly?) renegotiations
  - Favoured by Chinese steel mills
  - Would prices be transparent?
- Spot deals
  - Large producers are moving in this direction
- Producer prices
  - Nobody has raised this as an alternative - yet
- Index based prices
  - Preferred by some large producers
  - Reliability and validity of index?
  - Makes hedging easier

The iron ore pricing system, tentative conclusions (3)

- The benchmark pricing systems and alternatives may co-exist for a considerable time, but the trend is towards more flexibility, with hedging possibilities providing some of the attraction
- However, a market dominated by spot deals could easily become uncompetitive and raise barriers to new entrants
- For quality reasons, steel mills need long term contracts, which should have transparent price provisions
- This implies either a recognized reference price or something very much like the benchmark system

THANK YOU!

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