

## Iron ore

# Volatility forecast with end of price benchmark

## Record volumes of seaborne iron ore sold in spot market

Michelle Wiese Bockmann

THE 40-year benchmark pricing system that underpins sales of iron ore shipments — a key driver of bulk carrier freight rates — is “not sustainable”, according to investment bank Barclays Capital.

The bank has joined a growing number of analysts who believe the contract price-setting system for iron ore is obsolete.

“We expect the annual iron ore benchmark contract system to significantly change over the next few years,” Barclays Capital said in an industry overview of the iron ore industry, published last month.

“Our expectation is that contracts will become shorter in duration, perhaps quarterly or even monthly, with prices pegged to spot prices and/or prices of an increasingly liquid futures market.

“We also expect the spot market to become more liquid as Vale, Rio Tinto and BHP Billiton sell more of their production in the spot market.”

Brazil's Vale, the world's largest iron ore producer, disclosed last week that it sold 70% of its iron ore on a cost, insurance and freight basis last quarter. Most of this would comprise spot sales.

Last month BHP Billiton negotiated to

sell 30% of its production on a quarterly, spot or index-based price this year, and just 23% on a contract basis.

This is a huge departure from the benchmark system, in which traditionally all seaborne iron ore has been sold at prices agreed annually between producers and steel mills.

This sets the scene for volatile spot iron ore prices, higher inventories of iron ore held by steel mills and higher realised prices for miners, the Barclays Capital report said.

It also referred to the three miners that control 70% of global seaborne iron ore trade — estimated at 249m tonnes in 2009 — as an “oligopoly”.

BHP Billiton, Vale and Rio Tinto “can in essence control the price by limiting production”, the report said.

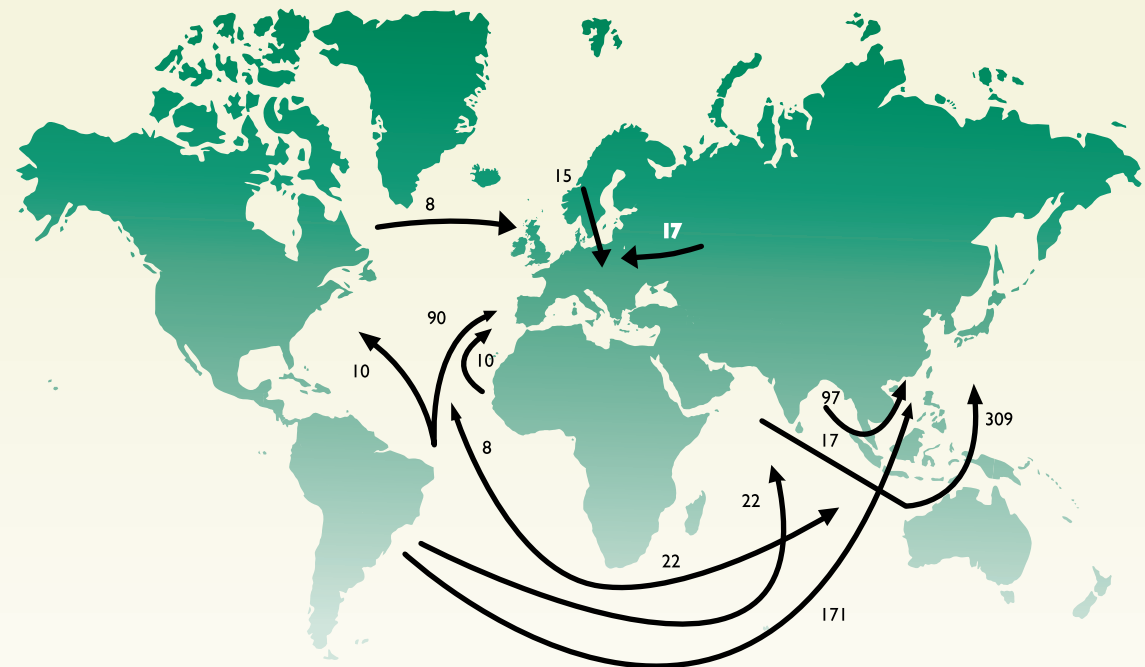
The increased uncertainty in iron ore pricing will increase freight rate volatility, a key executive from the world's largest operators of bulk carriers, Chinese government-owned Cosco, forecast last month.

Barclays said global steel production would fall 16% in 2009, rebound 10% in 2010 and grow a further 11% in 2011 and 2012.

Up to 200m tonnes of idled, high-cost Chinese iron ore mining capacity could come online to meet local demand.

This would limit price growth, the report said. Prices would remain at \$60-\$100 per tonne, it added. The current spot price from India to China is \$105.

## Iron ore trade 2008E



### Data in million tonnes

#### Seaborne market (2008) 849

Exporter Companies		% of total
Vale	240	28%
Rio Tinto	188	22%
BHP Billiton	138	16%
Kumba	25	3%
Other	258	30%

#### Exporter Countries

		% of total
Australia	326	38%
Brazil	292	34%
India	97	11%
South Africa	31	4%
Other	103	12%

#### Importer Countries

		% of total
China	444	52%
Europe	148	17%
Japan	136	16%
South Korea	47	6%
Other	74	9%

Source: IISI, AME, Bloomberg, BHP Billiton, Rio Tinto, Vale, Barclays Capital Equity Research estimates

## Steel recovery to revive idle coking coal mines

ABOUT 20% of global coking coal capacity idled in late 2008 is expected to come back online over the next year as steel production recovers, writes Michelle Wiese Bockmann.

“Based on our analysis, including discussions with coal buyers in China, we believe that China will be a growing net importer of coking coal in the

years ahead,” says a Barclays Capital industry overview.

“This is one reason for our positive view on coking coal prices for the next three to five years.”

Barclays said limited coking coal reserves were held by a few producers, constraining production as demand rises.

“For this reason we believe that prices for the highest-quality coking coal will remain elevated for a substantial period,” the report said.

Contract prices are expected to exceed \$200 per tonne for 2010 and 2011. Coking coal is used in blast furnace steel production, with production exceeding 516m tonnes in 2008.