

Client: Prosperity Minerals
Source: Metal Bulletin (Main)
Date: 16 March 2009
Page: 22
Circulation: 6264
Size: 406cm2
AVE: 1835.12

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Iron and steel

In depth

Unsettled 'I think it may just be that the benchmark this year never happens'

Benchmark iron ore settlement 'may not happen' as outlook remains uncertain

LONDON
BY JANA MARAIS

A benchmark settlement for annual iron ore contracts may not be reached this year, with producers and mills opting instead to trade on the spot market due to the uncertain outlook for steel and iron ore demand, analysts told MB.

"I think it may just be that the benchmark this year never happens," one London-based analyst said. "I'd say the chances of that is 25-33%."

"Steel companies have a lot of iron ore inventory; there is no urgency to settle. BHP wants the benchmark to fade away. It might just happen by default this year, rather than as a conscious decision," he continued.

BHP Billiton, the third-largest exporter of iron ore, stopped signing new contracts with customers under the old benchmark system last year and has been steadily increasing its participation in the spot market. The miner is a vocal supporter of a move to more spot-based pricing.

At the very least the uncertainty in the market is likely to lead to record-long negotiations this year, with Rio Tinto, the second largest exporter, saying it will wait for more economic stability and governments' stimulus packages to kick in before it settles annual prices. Vale, in first place, said it will wait for its competitors to first settle prices, while the decline in spot prices will ensure that Chinese steel mills are not in a hurry to

settle quickly either, a second analyst said.

Chinese customs statistics published last week showed a 43.15% month-on-month and 22% year-on-year increase in iron ore imports in February, but analysts said this could include bookings made in January before the Chinese new year, and that it doesn't reflect the weakening seen in the market in the latter part of the month.

"The second half of February was much weaker than the first half, and we expect to see much weaker data in March," one told MB.

"If [spot] prices continue to head down, Chinese mills may feel they want to draw out negotiations even longer. It may depend a little bit on how things develop in the global economy and the spot market," the analyst said.

Spot prices, which have rallied since the lows seen in October, started weakening again in the latter part of February and have continued to decline.

"There is not a lot of visibility," a third analyst said, adding that conditions may not stabilise sufficiently before the end of the year for any parties to settle. Instead, players may decide to continue trading at spot, or fix prices on a different basis, for example monthly.

"The main reason for both sides not to have a settlement now is that it would be better to wait

until [the outlook] is clearer, so they would not miss an opportunity of getting better pricing," said Sandy Chim, director of Prosperity Minerals, an iron ore and cement trading company in China.

With the current market characterised by an irrelevant benchmark price and spot trade seen as the interim market norm, there is no rush from either side to settle, Chim said.

A Brazil-based analyst agreed, saying it might be that prices are only settled under the benchmark system for the latter part of the new contract year, which will end in March 2010.

"We are in a very delicate moment and I do not believe that a change in the current situation will be in everybody's interest. I believe that negotiations should continue and should be finalized, even if only for half of this year," the analyst said.

While a benchmark settlement is not expected anytime soon, if at all this year, sources said it should not be discarded yet.

"There is a merit of a benchmark price in a relatively more stable environment as it has been for decades. I think when things become clearer and stabilized, the market will go back to the benchmark system as it does provide stability of trade and order in the market," Chim said.

"The Chinese like having these contracts. BHP is always keen to try and move away from the

benchmark and contract agreements to a more spot-based system, but the Chinese are very much resisting that. They're very much against a move away from the benchmark system, not only this year, but forever. It may be that discussions will take even longer this year, but when they do reach an agreement, it will be backdated to April as always," the second analyst said.

Another source said market players will not get rid of the benchmark system in the medium term. "Whether they settle much later, or only for the last six months, or whatever other possibility they chose... it will remain in place. I think they will settle later rather than sooner; there is a wide difference between what the Japanese and Chinese mills want and what the producers think are reasonable," the source said.

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**No talk: steel benchmark
settlement thrown in doubt**

