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Vale SA (ADR)

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Analysts remain cautious on the outlook for iron ore, in spite of ongoing positive supply-demand dynamics

According to analysis undertaken by broker Liberum, the mining sector hit highs in the first week of April that hasn't been seen since early in 2011.

It is an interesting move in a market that has been obsessing over the likely economic weakness in the global economy in the near-term future, and it comes largely on the back of positive sentiment over the price of iron ore.

READ: Iron ore market tightness set to remain as Vale's woes in Brazil continue
How much this positivity is actually justified by the fundamentals is another matter though, and Liberum continues to remain distinctly cautious.

To be sure, Liberum has erred too much on the side of caution in recent months when it comes to iron ore, and it's not as if the market doesn't have some encouraging data to wrap its positivity around.

But it's a fine balance. Following the tailings dam disaster at Brumadinho in Brazil earlier this year, disruptions to the iron ore supply from Vale S.A.(NYSE:VALE), one of the biggest mining companies in the world, turned out to be greater than anticipated.

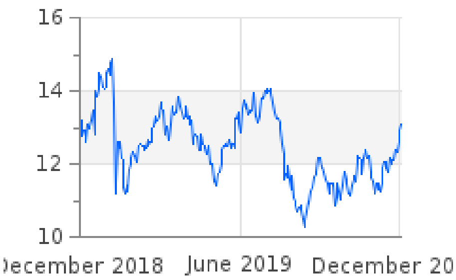
Or at least, greater than most Western analysts anticipated. In China, iron ore buyers immediately started stockpiling in anticipation of a supply squeeze, and they were right to. Vale was forced by Brazilian regulators to cut back supply to a greater degree than had been expected, and that news, combined with the heavy spree that China's buyers had already been on, created a tightness in the market unseen for several years.

At one point, it was thought that supply from Vale would be curtailed by as much as 93mln tonnes this year, but more recent estimates put the shortfall at closer to 44mln tonnes.

Price: 13.06

Market Cap: $66.98 billion

1 Year Share Price Graph



Share Information

Code:		VALE
Listing:		NYSE
52 week	**High**	**Low**
	15.45	**10.2**
Sector:		**Mining**
Website:		**www.vale.com**

Company Synopsis:
Vale is a global mining company headquartered in Brazil, with a workforce of over 100,000 employees. The company is produces iron ore, nickel, coal, aluminum, potassium, copper, manganese and a range of other metals.

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That's still significant, and is one good reason why investors in mining equities remain relatively bullish.

Another is that recent manufacturing PMI numbers from China have come in on the upside, upsetting the continuing narrative of an ongoing slowdown in Chinese growth. The PMI numbers have reminded investors that even if growth is slowing, it's still growth and the consequent demand for raw materials will have to be met from somewhere.

How much the large miners, the likes of BHP Group PLC (LON:BHP), Rio Tinto (LON:RIO), Anglo American (LON:AAL) and Vale are in a position to meet this demand is an open question. It's a small paradox that because they may struggle to supply stock to China, their share prices are actually going up. Iron ore will be scarcer, which means the price is likely to stay high, which in turn means greater profits for the big four from existing operations.

How long this dynamic will last isn't clear, but it's unlikely to be for too long. The gloomier prognosis about the global economy hasn't gone away, and at some point, Vale will be able to get its production levels back up to where it wants them.

And it's worth noting too, that while Vale's production may drop, it has an estimated 80mln tonne stockpile that it can draw on should it so wish. It's with that in mind that analysts at RBC argue that the company may actually end up shipping more product into the seaborne trade than last year.

Overall RBC remains cautious about Vale as a potential investment. The shares have risen in line with the higher iron ore price, but with a normalisation of supply, the broker argues, the focus could likely turn to the longer-term regulatory fallout from the Brumadinho disaster.

That could end up having a real drag on the share price, especially in the context of, say, a US$60 or US$50 iron ore price.

"We continue to see the iron ore market in a general balance with slowing consumption in Europe, China and now wider Asia," writes RBC.

"The potential for returning Chinese domestic iron ore is likely to impact prices once full impacts from the tragedy are assessed. There may be one last upwards move in prices should any further non-Vale Brazilian supply get taken out of the market, but we see this speculation as already in the price."

READ: Vale delivers on 2018 profits but slashes iron ore sales estimates after January dam collapse
Liberum takes a slightly different view on the seaborne trade, but the overall assessment is broadly similar.

"We are still cautious on iron ore prices for the rest of 2019 based on our view of negative Chinese steel production and only a 19mln tonne decline in seaborne supply," the broker wrote.

"Chinese port stocks of iron ore added 1mt on Friday, with still no physical signs of tightness in the iron ore market."

It all means that investors can make a little hay in the miners while the sun is currently shining, but longer term, the money is likely to drain away. That in turn bodes ill for the revival of the once-buoyant junior iron ore market, which may now have to wait for the next economic cycle to get underway before real activity can get underway again.

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