Developments in the Iron Ore Market

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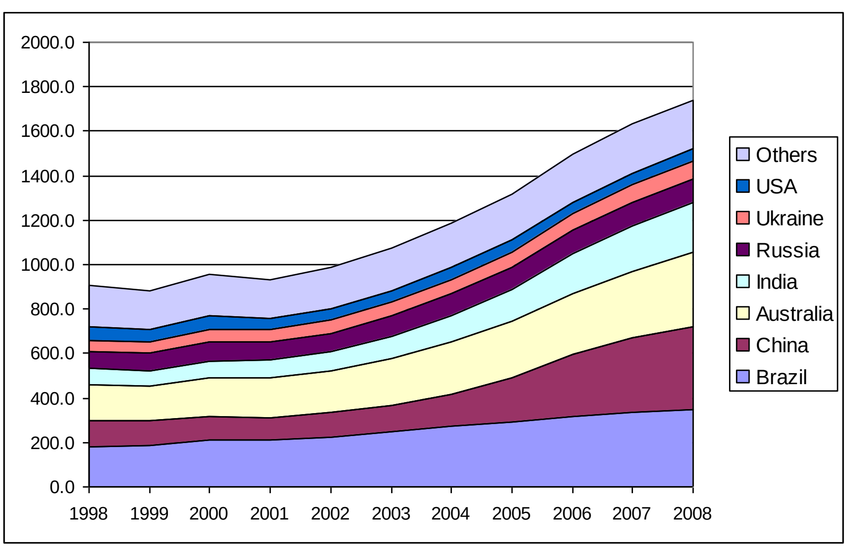
Outline of presentation

- Evolution of production and trade flows
- Industry concentration
- Price developments and the future of the pricing system for iron ore
- Impact of falling demand – production cutbacks, project delays and cancellations
- Supply-demand balance: Medium term outlook

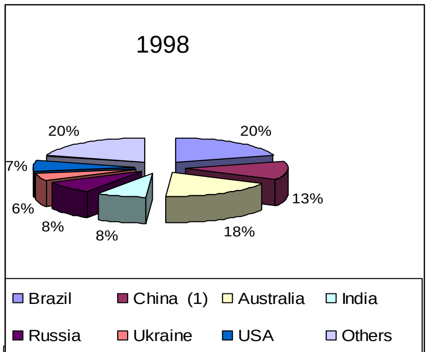
UNCTAD (United Nations Conference on Trade and Development) Iron Ore Trust Fund

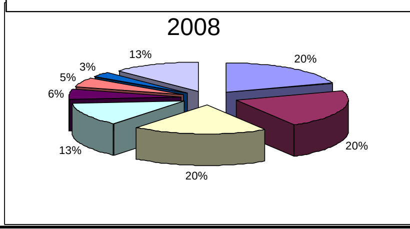
- In existence since 1987, since 2002 in cooperation with the Raw Materials Group of Sweden
- Two annual publications
  - Iron Ore Market Review in May
  - Iron Ore Statistics in September
- Financed by contributions from Australia, Brazil, Canada, Sweden and the United States and by sales of publications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

Global iron ore production grew at an average annual rate of 8 % 1998-2008



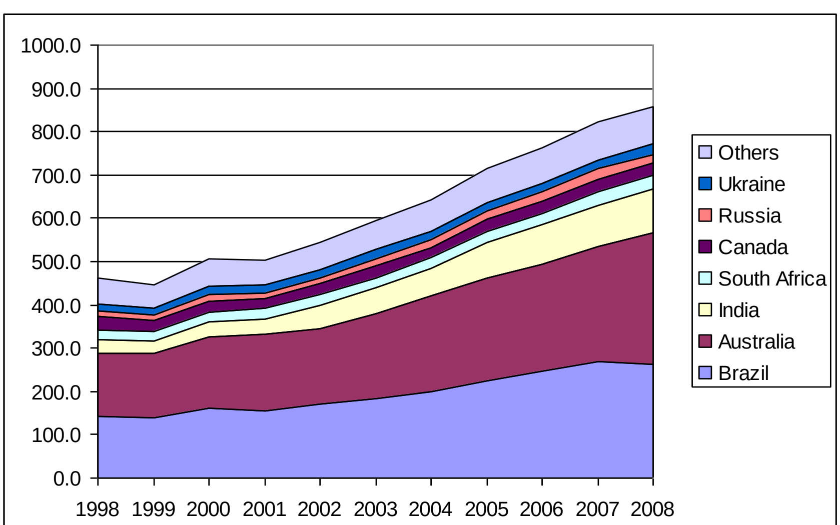
Production has become more concentrated





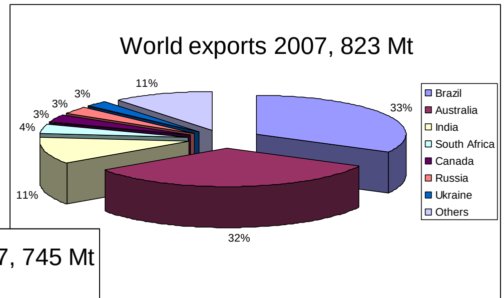
- China's production increased at an annual rate of 12 % 1998-2008, and it is now the world's largest iron ore producer, based on low grade deposits, low degree of mechanization and high operating costs
- The four largest producers accounted for 59 % in 1998, for 73 % in 2008
- Figures for 2008 are uncertain, since it is seldom known exactly when announced production costs are implemented –and sometimes cuts are not announced

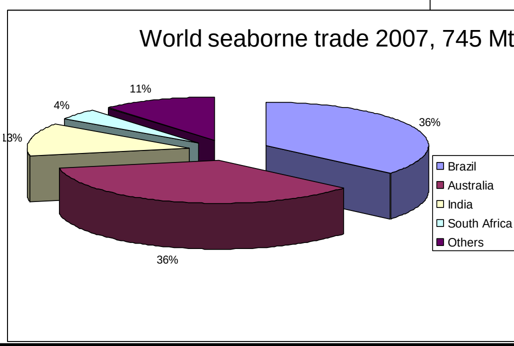
Global iron ore exports grew at an average annual rate of 6.3 % 1998-2008



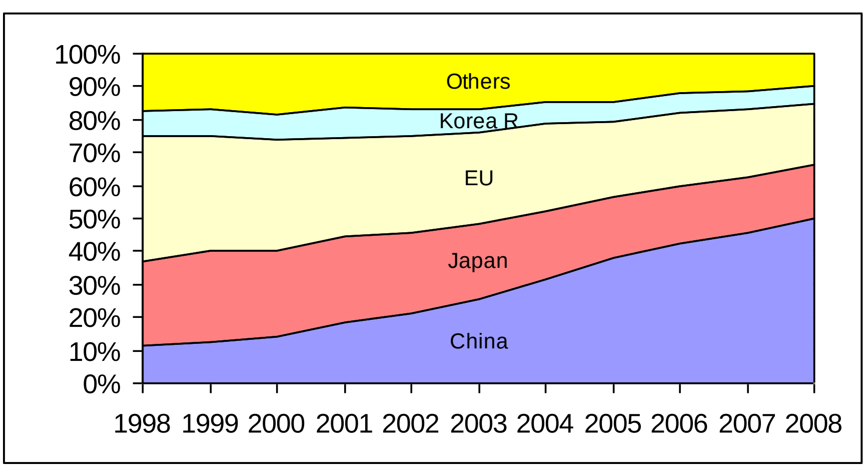
World exports are dominated by Australia and Brazil

Concentration has been growing, due to high barriers to entry in terms of infrastructure investment

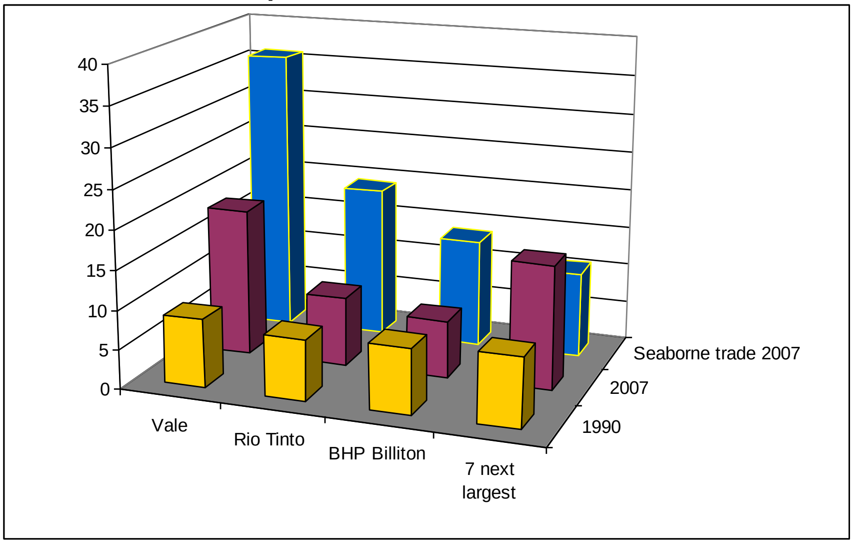




Imports 1998-2008, per cent

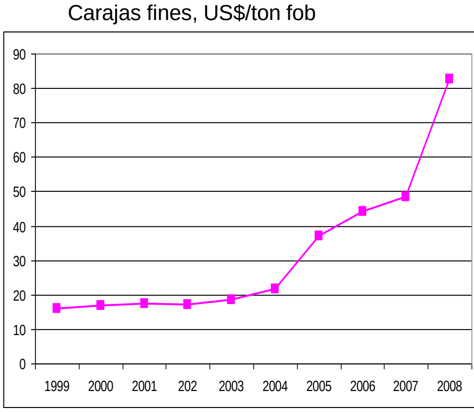


Corporate concentration: share of world production and seaborne trade, %

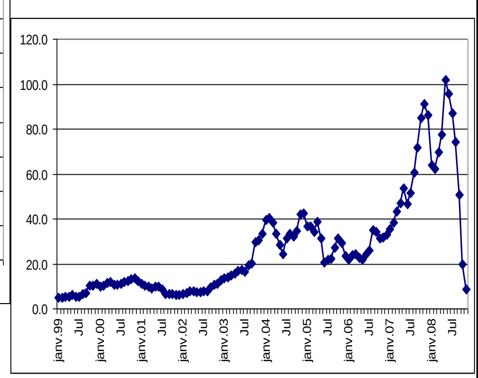


Prices and freight rates

Carajas fines, US$/ton fob



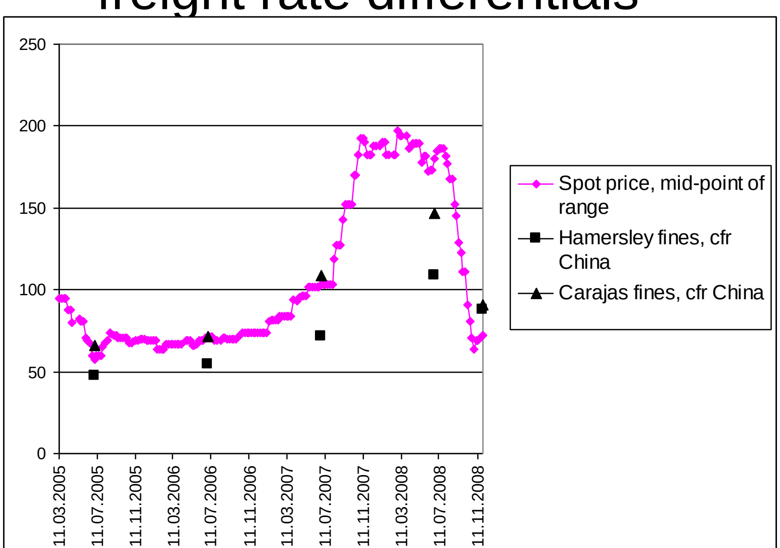
Spot freight rate Brazil-China/Japan, US$/ton



The iron ore pricing system

- Challenges
  - Large freight rate fluctuations
  - No longer any consensus around consideration of freight costs
  - Concerns about concentrated supply
  - Growing and critical importance of spot market
  - Trend towards vertical integration
  - Reduced availability of information
- Innovations
  - Australian freight premium
  - Large producers selling part of production on spot market
  - More frequent price changes in contracts
  - Metal Bulletin Iron Ore Index

Benchmark prices, spot prices and freight rate differentials



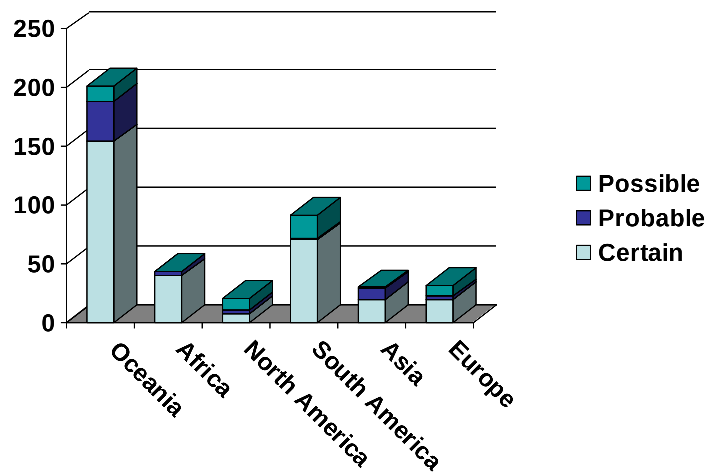
The iron ore pricing system, tentative conclusions

- The benchmark pricing system is no longer the only one available
- But it is convenient and therefore not likely to be abandoned completely or quickly
- The flexibility offered by spot prices, the ability to change price more frequently and the possibility of hedging argue in the favour of other systems
- Conclusion: The benchmark pricing systems and alternatives may co-exist for a considerable time

Impact of falling demand

- Crude steel output declined by 3.6 per cent in September and by 12.4 per cent in October
- Rio Tinto and Vale have both announced that they are cutting production by 10 per cent
- BHP Billiton has stated that it does not plan any cutbacks
- Producers in other countries are also reducing production, in some cases rather precipitously
- The big unknown: the viability of Chinese production
- Changes in investment pipeline

Iron ore projects 2008-2010
Projection February 2008



What has happened since February?

- If steel production is assumed to decline by 5 % in 2009 and 2010 sees growth of 3 %, the iron ore surplus capacity in 2010 (only projects considered to be certain) could be 300-400 million tons, or about 20 % of 2008 production
- Almost no announcements about cancelled projects – sponsors are still hopeful
- 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 infrastructure costs are likely to be cancelled first

Supply-demand balance

- 2009 and 2010 will mark a sharp break in the trend of ever in creasing iron ore production and trade, with no volume growth in 2009 and very low growth in 2010
- With spot prices in China having fallen to less than US$ 70/ton and a large supply overhang developing, it will be difficult for producers to avoid a reduction in the iron ore price
- But the spot price may provide a floor for contract prices, since freight rates are likely to remain low
- Winners: the largest producers, who have the financial resilience to ride out a period of slack demand and who will be able to use the lull in the market to pursue their expansion
- Losers: Chinese miners?
- The market will return to fast growth eventually, probably in 2011, since the structural factors – strong growth in Asia and in other developing regions – are unchanged. When it does, the large producers are likely to have strengthened their market shares

THANK YOU!

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