NIKKEI

HD **Iron ore miners wonder who will crumble first**

WC 1,474 words

PD 22 September 2014

SN Nikkei Report

SC NKRP

LA English

LP

MICHAEL SAINSBURY, Contributing writer

BANGKOK -- Iron ore prices are down almost 40% this year, and many miners hope it has hit bottom. But recent events show that their problems may only get worse. Some weaker players are already failing, and experts forecast years of over-supply caused by faltering growth in China, the commodity's biggest market.

TD

Iron ore began 2014 at $135 per metric ton. The benchmark price closed at $81.70 per ton on Sept. 19, a low last seen in October 2009, according to The Steel Index, published by Platt's. This came at the end of a roller-coaster week that started with a price bounce of more than $3 per ton, which proved a false dawn as the commodity soon began to fall anew. With business in China slowing ahead of the weeklong Oct. 1 National Day holiday period, only the brave are prepared to bet that this is the bottom.

In recent weeks, collapsing iron ore prices have forced two small Australian miners, Western Desert Resources and Termite Resources, into administration. Mining executives said more failures are likely to follow, with suppliers of mining services also under pressure in the market.

Murilo Ferreira, president and chief executive of Brazil's Vale, the world's biggest iron ore producer, told The Nikkei in early September that prices would rebound to $95-$100 per ton by year-end. However, analysts say that any significant revival depends on whether Chinese steel mills would proceed with their traditional end-of-year restocking.

Bump unlikely

Most think that any substantial increase in the benchmark price is likely to be unsustainable into 2015. An industry consensus is emerging that next year's average price will be below $100 per ton for the first time since 2009, with no significant rebound from that level expected in the medium to long term.

"We have reduced our forecasts by between 5% (and) 20% for the 2014-2019 period, with an average 2015 expectation of $92 per ton," analysts at investment bank Macquarie said in a client note, predicting annual average prices in the $85 to $95 per ton range through to 2020.

Goldman Sachs, in a recent report titled "The End of the Iron Age" forecast average prices at $80 per ton for 2015. "The price decline has been dramatic, but a weak demand outlook in China and the structural nature of the surplus make a recovery unlikely," wrote analysts Christian Lelong and Amy Cai. "In our view, iron ore has already transitioned to an exploitation phase where the commodity prices are typically subject to the deflationary pressure of mining productivity and the depreciation of commodity currencies."

Other analysts believe Vale might be wrong about an uptick in demand, arguing that producers have created a self-inflicted margin squeeze by increasing production amid falling prices as they sought to maximize market share.

"Steel mills have told me that they are unlikely to restock at the levels we have seen in previous years during the northern winter," said Tim Murray, managing partner of Beijing-based financial research group J Capital Research, who toured Chinese steelmakers and miners in early September.

Port inventories stubbornly remain at historic highs and there is unease in the market that unsold cargo arriving in China could be piling up, leaving miners at the mercy of discount hunters as they struggle to keep their balance sheets in check.

Key signs look dire

According to Murray, the surge in supply comes amid deteriorating economic growth in China, which consumes about 60% of the world's iron ore, nearly two-thirds of that in housing and infrastructure construction.

China's hurting real estate sector is also exacerbating problems for most iron ore producers. On Sept. 13, data from China's National Bureau of Statistics showed that housing sales declined by 0.9% in August compared with July, the fourth consecutive monthly decline. Prices fell in 74 of 100 major cities surveyed by the China Real Estate Index System, despite moves by dozens of local authorities to ease purchase restrictions imposed several years ago to try to take pressure off the nation's housing bubble.

The three key metrics that Chinese Premier Li Keqiang has said he considers more closely than other statistics are all in decline, prompting some observers to suggest that China could be heading for a recession. Electricity consumption was down 2% for August, compared to the same month last year. Rail freight volume has fallen every month this year compared with the same period last year. Total social financing, seen as the best overall measure of credit growth as it includes bond issuance and shadow banking, was 957.4 billion yuan ($155.9 billion), which missed the 1.135 trillion yuan consensus estimate of economists surveyed by Bloomberg. China's banks, meanwhile, remain reluctant to lend, said analysts.

"The full range of data pertaining to the month of August had a very similar flavor to that of July," said Huw Mackay, China economist at Sydney-based Westpac bank. "That flavor is bitter, and unexpectedly so."

None of this is good news for China's steelmaking sector, or for the miners that supply it with ore. While falling iron ore prices have provided some relief for steelmakers, analysts tracking Chinese domestic demand at Macquarie said they expected steel output to fall for the next three months.

The world's biggest miners have added tens of millions of tons to their output this year, while trimming their own costs, in an attempt to force higher-cost producers -- particularly those in China -- out of the market.

Macquarie's analysis suggests that 2014 seaborne supply from the top five miners -- Vale, Australia's Rio Tinto, BHP Billiton and Fortescue Metals Group, and Anglo American of the U.K. -- is likely to be 86 million tons higher than their aggregated September 2013 forecasts.

As seen in the recent Australian failures, the supply surge has affected some smaller miners. Murray estimated that about 20% of Chinese iron ore production was closed in the first six months of the year, while Macquarie said that the iron ore market was "in the midst of a transition without precedent in recent commodity history."

In March, investment bank UBS published estimates of break-even points for Australian iron ore miners. The lowest were Rio Tinto and BHP Billiton at $43 and $45 per ton, with Fortescue at $72 and Atlas Iron at $82. However, both Fortescue and Atlas receive discounts to the benchmark price of at least 10% because their ore is of lower quality. This means Atlas is now losing money, and Fortescue's plans for debt repayments will be in question if the price fails to rise significantly. Grange Resources and Gindalbie Metals, backed by the Chinese steelmaker Ansteel, are among others now losing money, according to analysts.

Murray warns of a broader problem: the absence of a floor in the market price due to the twin impact of rising supply and falling demand in China.

For Australia, the impact of sliding prices for iron ore -- as well as for its second-largest export of coal -- on the overall economy remains unclear, but with China accounting for more than 30% of Australia's total exports, the portents are increasingly gloomy. Ratings agency Moody's Investors Services recently warned that plunging iron ore prices would have a widespread impact on Australian companies, hitting not just small and medium-sized miners but also directly reliant sectors such as engineering services and the country's already struggling airlines.

Overall, iron ore production is set to outpace demand growth over the next two to three years. While "weaklings" will fall by the wayside, the big three Australian miners still have tens of millions of tons to go before reaching their expanded production targets. Meanwhile, Anglo American's $8.8 billion

Brazilian Minas-Rio project is still in start-up mode, and Vale has just gained environmental approvals for a $20 billion expansion of 90 million tons per annum.

Vale plans to increase its production from 310 million tons this year to 450 million tons in 2018. Vale has the lowest production costs per ton in the global sector, and which analysts estimate at about $12 per ton cheaper than Rio Tinto, the sector's second most efficient producer.

Even so, rapidly falling margins may force Vale and other big miners to slow production growth, or even cut output, if Chinese producers remain in business. "We think ore can only stop falling if and when higher-cost mines start closing, and this will not happen overnight," Credit Suisse analysts said in a Sept. 9 report.

To industry observers, that means the likelihood is growing that one or more of the big five may yet be forced to fold.

CO wesde : Western Desert Resources Limited

IN i211 : Metal Ore Mining | i22 : Primary Metals | i221 : Iron/Steel/Ferroalloys | i2111 : Iron Ore Mining | imet : Mining/Quarrying | ibasicm : Basic Materials/Resources

NS reqrmm : Suggested Reading Metals/Mining | redit : Selection of Top Stories/Trends/Analysis | reqr : Suggested Reading Industry News

RE china : China | austr : Australia | apacz : Asia Pacific | asiaz : Asia | ausnz : Australia/Oceania | bric : BRIC Countries | chinaz : Greater China | devgcoz : Emerging Market Countries | dvpcoz : Developing Economies | easiaz : Eastern Asia

IPC EG001000

PUB Nikkei Digital Media Inc.

AN Document NKRP000020140922ea9m00031

