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HD **Why are iron ore prices falling so quickly? Big Three producers are flooding the market to put pressure on Chinese competition**

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Iron ore mines are to Australia what the oil sands are to Canada. The Aussie iron ore business is enormous, capital intensive, profitable and has an insatiable customer – China – just as the oil sands can depend on the United States to consume almost all of its output.

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The Aussie and Canadian industries share another trait: falling prices.

The value of both iron ore and oil is plummeting. But the similarities end there. Oil is falling because of excess supply and waning demand in the Western world, in good part because zombie Europe is on the verge of a new recession. But global demand for iron ore is still climbing, if at a somewhat slower pace than last year. So why are iron ore prices falling, and why are they falling so much faster than oil?

The price for iron ore in China, the world's biggest consumer of the material used to make steel for everything from office towers to dishwashers, is down about 30 per cent this year (compared to a 20-per-cent drop for oil). The spot price for iron is off about 40 per cent, though it bounced back a few bucks this week to reach $83 (U.S.) a tonne.

Iron ore is falling even though Chinese demand for steel is up about 5 per cent year on year, while demand for imported iron ore is up 15 per cent or so, outpacing import demand in 2013. On Tuesday, official data showed that Chinese iron-ore imports were up 17 per cent in the first nine months of the year over the same period a year earlier.

So obviously the problem is not a collapse in demand. The culprit instead is the surging iron ore output of the Big Three – BHP Billiton Ltd. and Rio Tinto Group, the Anglo-Australian mining giants, and Brazil's Vale SA. They are responding to prices by ramping up iron ore production to unheard of levels. Since 2011 alone, Aussie iron ore output has climbed by 150-million tonnes a year.

Are they suicidal? On the contrary, they seem happy to flood the market in the hopes of making life difficult for the high-cost producers in China and elsewhere, though you would never get to them to admit to such unsporting behaviour.

Michael Komesaroff of Urandaline Investments, an Australian consultancy that covers China's capital-intensive industries, thinks a "battle of attrition" is under way, one that will not go in favour of China's own iron ore industry. In a recent note he said the "culprit is a struggle to the death between the triumvirate of global miners with their big low-cost mines, and China's beleaguered high-cost producers. Both sides have kept supply growth at full tilt even as demand decelerates."

The Chinese iron ore mines are expensive because their average iron content has fallen to about 22 per cent from 50 per cent in 2003. That means more time, energy and water is needed to upgrade it before it can be made into steel in the blast furnaces.

So far, the Chinese iron ore producers have resisted closing, perhaps in the belief that the price will soar back over $100 a tonne, or perhaps for fear that once they go through the expense of closing, they would be unable to afford to reopen. Local politics, of course, is probably playing a role because local employment is at **stake**. How long can the **Chinese iron ore** mines hold out? Komesaroff thinks they might call it quits after two years and shut permanently, after which prices should rebound. Investors, so far, seem to be buying into the strategy. The six-month fall in the share prices of Rio Tinto (down 4 per cent) and BHP Billiton (down 11 per cent), is well less than the fall in the **iron ore** price.

The strategy could backfire, of course. The **Chinese** mines could consolidate and keep going at a loss. Or investors in the Big Three could lose patience and demand lower output to push the price back up. Neither seems likely. Low cost producers win in the end. It just may take a while.

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