
Iron ore price negotiation - What next

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Reuters reported that China claimed victory in iron ore negotiations last week when it sealed a deal with upstart Australian miner Fortescue Metals Group for iron ore supply in the H2 of 2009. But the real deal and agreement between the Chinese industry and top global miners Rio Tinto, BHP Billiton and Vale may still be a long way off.

The confrontational iron ore negotiations have soured relations with Australia, which hit a nadir when China cancelled a high level diplomatic visit to Australia following a visit to Australia by exiled Uighur activist Mr Rebiya Kadeer.

Below are scenarios for how the iron ore standoff may play out

1. No official annual iron ore deal with China

A public concession by the Chinese will look like a retreat after the China Iron & Steel Association staked its reputation on getting a better deal than that obtained by other Asian mills.

CISA intransigence caused the Chinese mills to break rank and sign interim deals with the miners that could well be renewed and extended piecemeal through the end of the fiscal year. Signing a deal now may not be in miners' interests either, unless they expect spot markets to retreat from the summer high.

BHP Billiton has argued to shareholders and customers that the annual pricing system caused it and Rio to lose out on billions of dollars in the last five years as spot prices stayed stubbornly above term prices. Last month it announced a rising proportion of sales on a spot and index basis, in part reflecting the stalemate in annual talks.

The counter argument that the inflexible annual price benefits the seller in a bear market was proven wrong in 2008, when Chinese customers who signed term deals at the peak of the market simply defaulted and resourced cargoes from the spot market after prices crashed.

In previous years, when Baosteel represented the industry, CISA officials quietly griped that the deals reached weren't good enough. More market oriented steel mills and trading companies bitterly complained that CISA and government interference hampered them from getting the best commercial deal possible.

2. A grudging deal is reached

After months of insisting it was the sole representative of the Chinese industry in the talks, CISA said that Baosteel was the representative and CISA only the organizer. That may allow Baosteel to quietly reach a deal with the miners for the rest of the year, rescuing the benchmark pricing system and taking the brunt of any public criticism.

With spot prices well above term prices an annual deal is unlikely to be on better terms than the 33% discount achieved by other Asian mills.

Miners may even insist on a higher price that better reflects the current spot market although that would leave little incentive for their Chinese customers to sign. They would also further antagonize the Chinese industry their largest clients.

3 Mr Stern Hu stands trial

The fight between CISA and the mills, and the Chinese industry and Australian miners raised China-Australia tensions when four Rio Tinto executives were detained in early July.

Mr Stern Hu an Australian citizen and his three Chinese colleagues were formally arrested this month, and charged with bribery and stealing commercial secrets. The more serious charge of stealing state secrets did not appear on the arrest sheet.

China is likely to continue to stick to the law in prosecuting this case to show that the original detentions were not arbitrary. The four were formally arrested after the precise period legally set for initial investigation.

The current state of investigation could continue for one month with the possibility of extending for a second month before

moving to trial. The process is unlikely to be aborted. If he is convicted, Mr Stern Hu may only serve a portion of his sentence if China wishes to toss a favour to Australia.

No diplomatic leverage will help the other three, who are Chinese citizens.

4. Fallout plagues steel industry delays reforms

At least one senior Chinese official, Mr Tan Yixin was also formally arrested and Chinese media have reported the detention of a second official at Laiwu Iron and Steel Group. Other steel executives have been questioned by investigators ferreting out whether Rio Tinto improperly paid anyone as it collected its detailed information on the Chinese steel industry.

In a teleconference with Australian media, Fortescue chief executive Mr Andrew Forrest said that 100 people in China had been caught up in the investigation.

Executives stung by the investigation will likely become cautious. That may hinder the Chinese industry from becoming more professional in trading and hedging but it could also restrain a widespread culture of leaks by industry and government insiders.

(Sourced from Reuters)

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