
Iron ore price negotiations - China seeks a new mechanism

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People's Daily Online reported that China's steel industry signed a high profile price cut agreement with Australia's Fortescue Metals Group Ltd avoiding Rio Tinto and BHP Billiton.

This shows China intention to break the traditional negotiation model, so as to weaken the influence of the three iron ore giants. It also shows the willingness of the China Iron and Steel Association to conduct negotiations and establish a pricing model based on a balance of interests.

Annual iron ore price negotiations date back to 1981. Following negotiations and consultation between iron ore suppliers and consumers both sides jointly decide iron ore prices within the coming fiscal year. Over the years, three main iron ore suppliers have developed in the world.

1. Rio Tinto
2. BHP Billiton
2. Vale

It is a strange phenomenon that China's steel industry, a major buyer consuming over 90% of the incremental volume of iron ore in the international shipping market has completely given pricing power to suppliers. It was not long ago that the Rio Tinto spy gate incident exposed the tip of the iceberg.

The agreement with FMG has not only made market insiders reconsider the possibility of concluding an agreement with the three major iron ore suppliers, but also indicated that the CISA still prefers to reach long term price agreements with suppliers.

The negotiation result publicly announced by the CISA has reminded the three major iron ore suppliers that reasonable prices should be established on the basis of a balance of each party's interests. This may promote the Chinese side and Rio Tinto as well as BHP Billiton to reach an agreement as soon as possible.

However, whether a result acceptable to both sides can be achieved still depends on the outcome of the game. The agreement between FMG and China also indicated that the future iron ore negotiation mechanism will be subtly changed. This will play a positive role in the transformation of both iron ore negotiations and the iron ore pricing mechanism.

(Sourced from People's Daily Online)

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