China capitulates as steel mills threaten to break ranks

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The Sydney Morning Herald reported that China tough talking steel association has buckled to criticism from its members and the reality of China's economic recovery signalling that it is ready to accept a smaller cut in the benchmark iron ore price than it had previously said was possible.

Respected media outlets, including Caijing magazine and Shanghai Security News reported that the China Iron & Steel Association has decided to accept a settlement smaller than the 40% it previously demanded. But the association was not yet willing to go as low as the 33% benchmark contract already agreed with steel mills in Japan, Korea and Taiwan

A source familiar with the association's discussions said "It is a decision that has been made. They just need some excuse to do it they have been so strong for such a long time they need a higher spot price to accept."

The iron ore spot market price has been rising as mills and traders grow more confident that China economic recovery is on track. Recently the purchasing managers index which financial markets currently regard as the most important Chinese economic indicator pushed further into expansion territory. The CLSA purchasing managers index rose to 51.8 in June from 51.2 in May pushing it above the survey historical average of 51.7.

The official purchasing manager index compiled separately by China's National Bureau of Statistics rose to 53.2 in June signalling a fourth consecutive month of economic expansion. Both surveys showed export orders were expanding for the first time this year.

Separate figures showed electricity output in mid June had bounced and passenger vehicle sales rose 21.2% in the first five months of 2009 from the same period a year earlier. Iron ore negotiators however are conscious that steel and iron ore demand tends to soften in the Chinese summer heat as construction work slows.

Mr Xu Zhongbo the chief executive of Beijing Metal Consulting said the China Iron & Steel Association would not accept a 33% price cut but predicted there would be a compromise in September. He said that "The two sides need time to cool down to see which direction the world economy is heading."

He added that steel mills would be punished if they broke ranks with the association to set their own contracts. Nevertheless, media reports yesterday indicated the association's price-setting authority is fraying as mills pay more for iron ore on the spot market than they would if their industry association had accepted Rio Tinto long standing offer.

Many of the hundreds of smaller and privately owned mills that are not members of the China Steel & Iron Association will be happy to see the end of the benchmark system, which they say allows big and state owned mills to profiteer by buying benchmark ore cheaply and on selling to them at steep mark ups.

(Source: The Sydney Morning Herald)