Ferrous

Prices edge higher in June

The Far East has raised its scrap purchasing prices by more than US$ 15 per tonne; for example, at the end of May, South Korea has been buying HMS I at US$ 279.50 per tonne cfr, which equates to around US$ 240 fob. China is also making a reluctant return to the import market. Re-entering the market in late May, Turkish buyers have paid up to US$ 280 per tonne cfr for 80/20 HMS I/II for June delivery. Sea freight rates for scrap going from the USA to Turkey are US$ 25-27 per tonne; from Rotterdam and UK ports to Turkey, rates are around US$ 20-22 per tonne. At the time of writing, fob Rotterdam prices have risen to US$ 255-260 per tonne for 80/20 HMS I/II scrap, to US$ 260-265 for shredded, and to US$ 250-255 for the 60/40 I/II mix. According to feedback from the latest BIR Convention in Beijing, the scrap trade is generally expecting further price increases in June.

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Having gambled on lower scrap prices in the second quarter of this year, Turkey backed the wrong horse and has had no choice but to implement significant purchasing price increases for June/July deliveries. European exporters - followed somewhat later by their US East Coast counterparts - simply refused to sell the HMS I/II mix for prices around US$ 260 per tonne cfr which Turkish mills had offered for May and even June deliveries.

Exporters could mount a range of arguments for refusing to sell even now. For example, they could point to fairly good EU demand for scrap at prices better than those obtainable from Turkey; and to the fact that they have been able to send major volumes of scrap to the USA. Furthermore, EU exporters witnessed increases of US$ 40-50 per tonne in world prices of pig iron and HBI/DRI during May. Producers justified these increases by pointing to ever-rising energy prices, a steadily weakening US dollar, and to the likelihood of increased iron ore prices. Indeed, German steel giant Thyssen Krupp agreed to a 19% increase in Brazilian and Australian iron ore prices last month. This new level was rapidly accepted by virtually all other ore importers, with the exception of China.

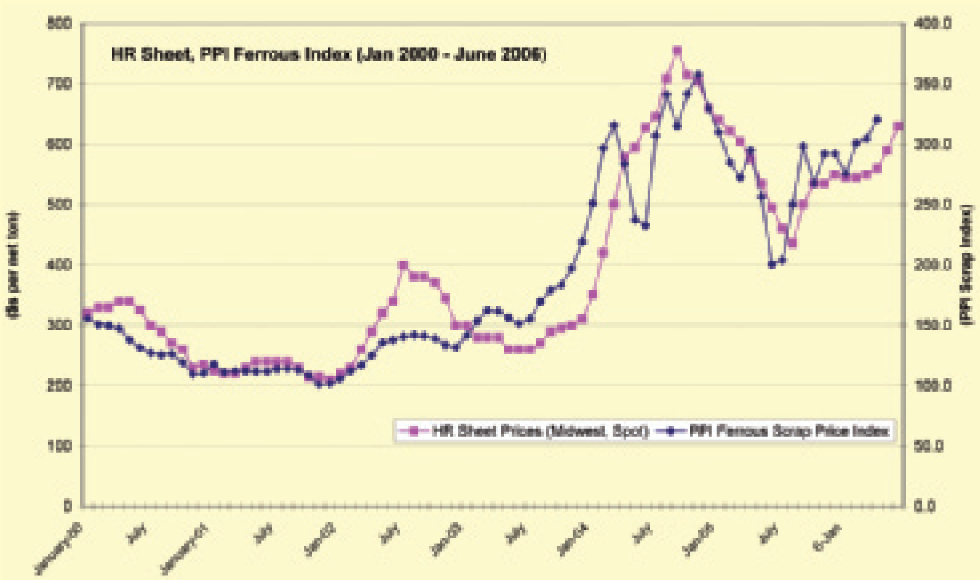
Other arguments for an increase in scrap prices include: the tight supply of industrial scrap; an increase in the US Composite Price for HMS I to US$ 240.50 in the final week of May; and a third consecutive rise in the 'Automobile Factory Bundles' price. The AMM monthly AFB index rose to US$ 352 per tonne for June. In addition, EU and US scrap exporters could point to dwindling scrap exports from the Ukraine as a result of low local arisings and fairly good domestic demand. Ukrainian exports fell from 2.5 million tonnes in 2004 to 1.3 million last year, and a further fall to as little as 900 000 tonnes is predicted for this year.

With these arguments in mind, Turkish mills had no choice but to increase prices for US and EU scrap to over US$ 280 per tonne c&f for 80/20 HMS I/II for June/July delivery. It has become obvious that ferrous scrap exports from Europe to Turkey are caught in a currency bottleneck due to the appreciation of the Euro on the foreign exchange markets.

EU scrap exporters have also stressed that this year's 5%-plus decline in the value of the US dollar has reduced the yield on a tonne of scrap by some US$ 7 per tonne. US and EU scrap exporters also argue that steel, pig iron and DRI/HBI prices are rising faster than those of scrap. In fact, prices for hot rolled and cold rolled coil rose more than US$ 50 per tonne in the first three months of this year for delivery into the third quarter.

China and South Korea find themselves in a similar situation to Turkey. Both countries had abstained from the scrap import market during April and the first half of May in anticipation that steel overproduction would force scrap prices lower in the second quarter of this year. Chinese and Korean imports fell by, respectively, 27% and 16.7% when comparing the first three months of 2005 and 2006. In fact, these Asian buyers were offering similar cfr prices to Turkey, ie around US$ 260 per tonne. However, deep-sea freight costs to the Far East from the EU and the US East Coast were around US$ 45 per tonne - more than double the US$ 20 per tonne for shipments to Turkey. Given these very low offers for c&f deliveries to the Far East, EU and US East Coast exporters were unable to sell their scrap to China and South Korea, thus leaving India as virtually the only Asian market of interest. The c&f prices paid by India were higher than those obtainable in East Asia.

U.S. Hot Rolled Coil prices



'Scrap' magazine's monthly Midwest spot market prices for hot rolled steel through April are here matched against the Bureau of Labor's monthly ferrous scrap price index. The May hot rolled coil price was placed at US$ 590 per tonne while the June price was estimated at US$ 630. The graph shows that, at US$ 315 per tonne delivered for June, prices of automobile bundles have closely followed steel price trends between January 2000 and May 2006.

These circumstances left US West Coast exporters in an awkward position as prohibitive deep-sea freight costs to Turkey via the Panama Canal forced them to sell to China and South Korea, albeit at much lower fob prices than US East Coast and EU exporters could obtain by exporting to Mediterranean buyers. The lower left price graph on page 41 depicting US West Coast and East Coast export prices for HMS I illustrates the exceptional case of US East Coast exporters' fob prices being higher than those applying to the US West Coast. Russian A-3 scrap, a good HMS I quality, has recently been sold for US$ 283 per tonne c&f South Korea and US$ 286 per tonne cfr Taiwan. With the market at least US$ 10-20 per tonne higher than a few weeks earlier, China had to abandon its policy of paying no more than the April price of US$ 260-270 c&f Chinese ports, which equates to US$ 230 per tonne fob US West Coast and to an even lower amount for European exporters.

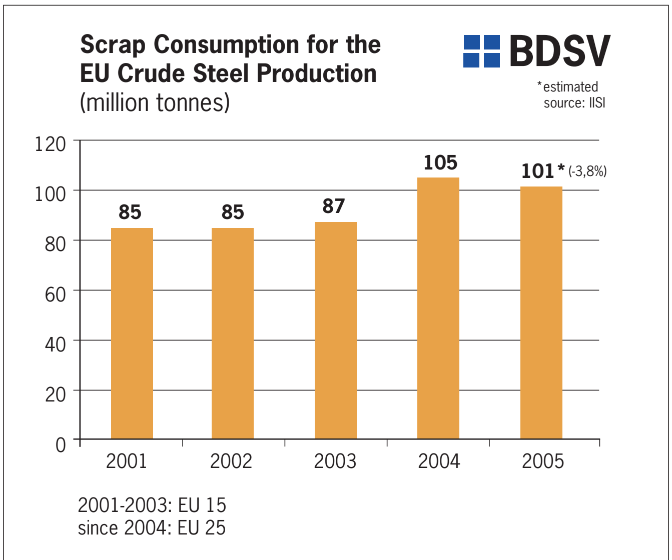
China's average integrated scrap consumption of 179 kg per tonne of steel is no lower than in most Western World countries but is still 17% below the figure for 2003. Last year, in-works scrap consumption accounted for around 35% of the country's total steel supply. China's domestic scrap consumption is due to rise 7.4% this year to 68 million tonnes, the latest BIR Convention in Beijing was informed. Although domestic scrap collection is also set to rise, the country will still need to import at least 10 million tonnes of scrap this year - roughly the same as in 2005 (10.14 million tonnes) and 2004 (10.23 million tonnes).

In the final week of May, US company Hugo Neu set a new benchmark by securing a price of US$ 279.50 per tonne c&f for a large tonnage of HMS I material to be delivered in June/July to the large Hyundai steelworks in South Korea. This represented the highest price achieved since April 2005 when c&f prices for HMS I scrap reached US$ 290 per tonne before slumping.

Japan exported 7.5 million tonnes of scrap last year, with 3.49 million tonnes going to China, 3 million tonnes to South Korea and 900 000 tonnes to Taiwan. Japan's overseas shipments could hit 10 million tonnes this year, bringing the country's exports to around the same level as those of USA and Russia.

Competing commodities

It has finally emerged that iron ore price will increase by 19% this year. An agreement was struck on May 15 between Thyssen Krupp



Steel and CVRD of Brazil, and this lead was duly followed by Europe's major iron ore purchasers - Corus, Arcelor and Mittal - as well as by the major Japanese mills, Posco of South Korea, and by Taiwan. The price of Carajas fines has now been settled at around US$ 77 per DMTU (dry metric tonne units) fob Brazil. Negotiating through its leading steel mill Baosteel, China has so far refused to pay this price but is likely to have to accept the same level as the rest of the world.

China has always been a leading participant in negotiations with the world's leading trio of iron ore producers, namely CVRD of Brazil, and Rio Tinto and BHP Billiton of Australia. Accounting for 43% of the world iron ore trade, China has deemed any advance on last year's 71.5% price hike to be unacceptable. Nevertheless, China is one of the few ore importing countries to produce more iron ore domestically than it has to import; domestic production reached 480 million tonnes last year and is expected to increase to 525 million tonnes in 2006. China imported 275 million tonnes of iron ore last year but will need to raise this total to around 300 million in the current year. Imports in the first quarter of 2006 amounted to 80 million tonnes.

Although freight rates for iron ore fell slightly in May, they differ widely depending on the destination. The Chinese are certainly at a disadvantage as they had to pay a rate of around US$ 21 per tonne for shipments from Brazil - even for a bulk cargo of 150 000 tonnes. The freight rate for a similar tonnage shipped to Rotterdam, for instance, is around US$ 11.50 per tonne. The best buy for the Chinese mills is from Australia, from where they have to pay around US$ 9.50 per tonne plus a few surcharges for domestic transportation. But China relies on higher-quality Brazilian iron ore for blending with their poorer domestic material which has a lower iron content and a larger proportion of impurities.

Japan's steel mills have calculated that the 19% iron ore increase will add around US$ 30 per tonne to their finished product prices.

Pig iron and HBI/DRI prices shot up at least US$ 30-40 per tonne in mid-May. Brazil has only very small volumes of pig iron available for export owing to a major loss of production caused by heavy rainfall and hence a major loss of indispensable charcoal supply. The weather has led to blocked railways and roads, as well as to the idling of some furnaces over the past month. As a result, there is currently a two- to three-month backlog of Brazilian iron ore deliveries. Brazil is currently asking for at least US$ 320-325 per tonne fob for their available reduced iron ore production while underlining that prices will rise even higher in June/July. Offers into the USA are now around US$ 360 per tonne cif, and are up to US$ 10 higher into Asia. Meanwhile, Italy has had to pay US$ 350 cfr for their much-needed pig iron supplies from Eastern Europe.

HBI sales into Europe and the USA have fetched a remarkable US$ 305 per tonne fob Venezuela given that prices had been hovering around European steel scrap price levels for the previous six months.

International trade in DRI/HBI has increased rapidly over recent years to reach 56 million tonnes in 2005, a total which includes just over 21 million tonnes of HBI.

More iron ore needed

Last year, output of iron ore increased by 11% from 1.184 billion tonnes to 1.32 billion tonnes. Australia and Brazil raised their iron ore production by 12% and 8% respectively, but far more spectacular increases were recorded in China (36%) and India (21%). Global sea-borne iron ore exports climbed last year to 718 million tonnes from 450 million tonnes in 2004, and are predicted to reach 825 million tonnes in 2008.

Spectacular rise in steel prices

World steel production climbed a further 6% in the first four months of this year. Once again, practically the whole increase is attributable to China where output grew 18% to 126.3 million tonnes. Other scrap importing countries also recorded higher steel production levels: Turkey's steel production jumped 9.8% and India's by an amazing 20.9%. Despite a 2.6% increase in Italian production, EU steel output as a whole fell 0.6%, mainly due to a spectacular 21% slump in Spain. South Korea's steel production edged 1.3% lower in the first four months of the year whereas US output gained 2.1% to reach 32.7 million tonnes. Year-on-year, Chinese exports of finished steel have increased by 26.3% while imports fell by the same percentage.

The 19% iron ore increase has pushed up steel prices - but to a far greater extent than anticipated. For instance, section prices in the UK increased by the equivalent of US$ 75 per tonne in May and further growth is expected over the coming months. Some EU export prices for hot rolled coils went as high as US$ 600 per tonne at the start of June, with cold rolled coil at over US$ 700. Further price increases are anticipated.

In the USA, hot rolled coil prices are in the region of US$ 620-630 per tonne while rebars are attracting US$ 530 on an ex-works basis. Steel mills believe the market will readily accept higher prices because demand

for steel is strong while stocks of both flat and long products are reportedly low. Furthermore, the US dollar is very weak and energy prices are constantly on the increase.

The scrap trade is always most interested in long steel prices - such as those for sections, rebars and debars - because these are manufactured mainly in mini-mills' electric arc furnaces. In North America, these prices have risen by more than US$ 40 per tonne to their highest level in 30 years. CIS and Turkish debar was sold at US$ 530-550 per tonne fob for delivery in the Mediterranean region during the last week of May - up from US$ 490 in the previous week. All these prices have more than doubled since the final quarter of 2005.

But there is a danger that, if the US and European steel mills allow their domestic prices to rise too high, imports will resume at a high level. EU steel imports in the first quarter of this year were a sizeable 2.27 million tonnes per month. Cautious importers have expressed concern over what they see as an inevitable slide in the latter part of the year. In the first four months of 2006, US imports of flat and long steel jumped to 11.3 million tonnes - 27% more than in the same period of 2005.

Conclusion

Steel and scrap prices are continuing on an upward trend despite many producers and consumers warning of potentially severe falls in the fourth quarter. Scrap and steel prices appear set to remain firm in June due to the recent rise in iron ore prices and continuing good demand for nearly all types of steel. Furthermore, higher domestic steel consumption within CIS countries may leave lower volumes available for export, while Chinese demand for steel is likely to remain high given preparations for the 2012 Olympic Games in Beijing.

Now that pig iron and DRI/HBI prices are once again outstripping those for scrap by some distance, steel mills will have to buy more of the latter. If the US dollar remains weak in relation to the Euro, pound sterling and the Yen, this will be another argument in favour of maintaining steel and scrap prices at comparatively high levels. A reaction to these price increases would seem unlikely before the autumn. □