CRITICAL STRATEGIC METALS

Volume 2 - Issue #1 January ~ 2011

Your monthly guide to the latest information on the world's strategic metals

2010 – The Year Strategic Metals Began to Shine

Iron & Steel

One of the most talked about events in the iron & steel industry in 2010 was perhaps the proposed, and later cancelled, $116 billion Pilbara iron ore joint venture between global mining giants Rio Tinto and BHP Billiton. In June 2009, the two companies proposed a merger of their iron ore facilities in Western Australia. They signed a binding agreement in December 2009 to merge their operations and thereby save over $10 billion per year, per company. However, the proposed joint venture attracted more than its fair share of market speculation and opposition from the global steel industry. About 16 months later, in view of the diminishing possibility of obtaining the necessary approvals, the two companies decided to call off the proposal. The decision to withdraw the proposal was not unexpected given the opposition to the deal from steel makers, investors and regulators. In fact, the decision to cancel was welcomed by the global steel industry.

Portfolio Manager Ric Ronge of Pengana Capital said, "The writing was on the wall for quite some time with antitrust issues. There were headwinds and enough rumors to take away any surprises from investors." The success of the proposal would have obscured Vale, the world's leading producer of iron ore, besides creating a price upheaval in the market.

Rare Earth Metals

China's role in the global rare earth industry cannot be ignored. The country accounts for almost 97% of the world's rare earth supply and at 60%, is one of the largest consumers as well. While rare earths are not as "rare" as they are projected to be, there is a growing demand-supply gap because of a dearth of any other major supplying nation. China's imposition of export quotas on several rare earth metals, on the grounds that it needs the higher quantities for its clean energy and high-tech sectors, is squeezing an already starved market.

China has been trying to restructure its rare earth mining sector, which has for long been prone to smuggling and illegal practices. In 2006, the government stopped issuing any new mining licenses and since September this year, the government has been actively encouraging domestic acquisitions and mergers. China's restrictive supply policies have however been extensively criticized by Japan, several European nations and the United States, all of which claim that China has violated the World Trade Organization (WTO) rules. The situation reached a head when China apparently imposed a de facto ban on the export of rare earth shipments to Japan.

As nations scramble to find alternative sources of rare earths, China's tightening export quotas have inadvertently benefited a few non-Chinese players. US-based Molycorp, Inc. (MCP), which owns the Mountain Pass deposit in California – the largest deposit of rare earth minerals outside China – announced in late 2010 that it would reopen its mines within 2012. The announcement was enough to double MCP's share prices. The company's annual production plans range from 20,000 tonnes to 40,000 tonnes.

In spite of the new production announcements, the primary market concern is the short and medium term supply since large-scale production is unlikely to begin before 2015–16.

Molybdenum

In 2009, Chinese molybdenum companies aggressively went about buying molybdenum from various nations and also funded mining operations in many countries. China built a molybdenum stockpile over 2009 and early 2010. The stock building worked to China's advantage as molybdenum prices gradually crept up and within that period, the nation switched from being an exporter to an importer and back to an exporter in Q2 of 2010. In fact, China's moves are helping drive the momentum of the global molybdenum market. China's robust economy during the 2009–10 period pushed the demand for steel even as other nations struggled to regain stability, and that in turn drove the molybdenum and manganese markets – two critical ingredients of the steel industry.

Manganese

The manganese market has been on a steady growth phase post the global economic downturn. Exploration and development projects are on the rise to take advantage of this growth. However, leading manganese-producing nation South Africa failed to make any major investment plans and is now having to wait in the sidelines as nations such as China, also a market leader, cashes in on the growing demand. In October 2010, West African nation Gabon joined hands with China's CITIC Dameng to mine over 26 million tonnes of manganese over the next 25 years from Gabon's M'Bembele mine.

Magnesium

Magnesium consumption saw a gradual rise too after facing a slump in demand post 2008. China has always been a leading player in the magnesium market but Chinese players have failed to generate sufficient confidence in the market forcing global consumers to look elsewhere for reliable suppliers. China's magnesium prices have, however, been falling steadily over the last month due to a slow demand but consumption is expected to grow by about 6% over the next few years.

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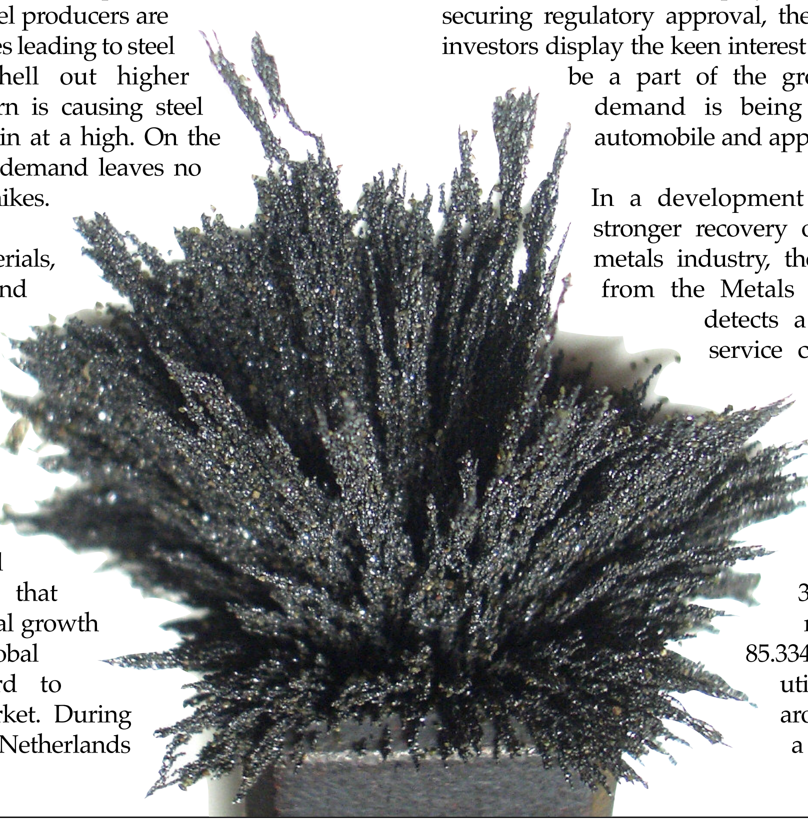
Steel Volume Set to Grow in 2011

World Steel Association (worldsteel) data states that the total crude steel produced by its 66 member countries during November 2010 was 114 million tonnes, which is 5.1% higher YoY. The first 11 months of the year saw a total crude steel production of 1.28 billion metric tonnes, a growth of 16.2% YoY. In Asia, China's YoY crude steel production in November rose by 4.8% to reach 50.2 million tonnes, while India's production rose by 3.15% YoY to reach 5.56 million tonnes. November production in the US went up by 13% YoY to reach 6.5 million tonnes while that of Brazil fell by 2.8% YoY to reach 2.6 million tonnes.

China's steel market is strangely stable with no significant change in recent times despite several contradictory situations. Winter demand is on the decline while production cost is still high. Inventory levels are at comfortable levels and are not causing any undue pressure on the market. Meanwhile, leading steel producers are continuing to raise prices leading to steel traders having to shell out higher amounts, which in turn is causing steel product prices to remain at a high. On the other hand, the lower demand leaves no room for further price hikes.



Easy access to raw materials, low cost manpower and the expectations of a high growth rate in India's steel industry over the next decade has been attracting many global steel and steel allied companies to invest in the Indian steel sector. Analysts opine that with an expected annual growth rate of 8–10%, few global companies can afford to ignore the Indian market. During the year, ArcelorMittal Netherlands BV bought a 35% stake in Uttam Galva Steels Limited, UK-based Stemcor Holdings Limited bought a 10% stake in Ispat Industries Limited, and Japan-based JFE Steel Corporation bought a 14.99% stake in India's third largest steel maker by volume, JSW Steel Limited. More recently, South Korea-based GS Global Corporation has agreed to buy a stake worth $5 million in Steel Strips Wheels Limited, which recently sold a 5.9% stake to Japan-based Sumitomo Metal Industries Limited.

South Korea's Posco plans to set up a new steel plant in India in partnership with the state run Steel Authority of India Limited (SAIL). ArcelorMittal also announced three projects in India, one each in Jharkhand, Karnataka and Orissa. Iron ore producer NMDC Limited has joined hands with Russia's OAO Severstal to build a steel plant in Karnataka. Although most of the announced projects are in various stages of securing regulatory approval, the number and size of the investors display the keen interest of major global players to be a part of the growth story. India's steel demand is being largely driven by the automobile and appliances sectors.

In a development that perhaps signals a stronger recovery of the US and Canadian metals industry, the Metals Activity Report from the Metals Service Center Institute detects a robust rise in the YoY service center shipments of steel products from the US (+28.4%) and Canada (+19.5%). Further, mid-December statistics show that the domestic steel production in the US during 2010 rose by 38.8% YoY, from 61.525 million tonnes last year to 85.334 tonnes this year. Capacity utilization in 2010 has been around 70.2% against 51.5% a year ago.

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Strategic Metal Supplies Will Tighten in 2011

According to the World Steel Association, global steel demand in 2011 is expected to fall to 5.3% but in terms of volume, demand will still reach a record breaking 1.34 billion tonnes. As maturing economies continue to struggle to regain their foothold after the global economic downturn, the emerging BRIC (Brazil, Russia, India, China) nations are expected to dominate the demand curve, with India and China at the forefront.

In 2011, China expects domestic steel consumption to grow by 8–9% and reach 650 million tonnes, while 2012 may see a production of 680 million tonnes. India too is expected to witness domestic steel demand rise by 9–10% during 2010–11. Demand is expected to be driven once again by the automobile, consumer durables and infrastructure sectors. Indian steel makers are finalizing expansion plans to take advantage of this growing market. With rising demand in both nations, the raw material market (coal and iron ore) is expected to see sharp rises in demand too.

After 4 decades of practicing an annual pricing mode, iron ore pricing methods changed to a quarterly one in 2010. The new price for Q1 of 2011 will be based on the average spot prices in September, October and November. Although the new model has the support of the three leading mining companies, many steel companies prefer to maintain the old annual model, which was more stable and predictable. Meanwhile, leading iron ore consumer, China, has begun exploring for more iron ore resources. With the number of invested mines and captive mines on the rise, the market expects iron ore supplies to exceed demand by 2012 instead of the earlier forecast of 2015.

Molybdenum in 2011 appears to share a mixed forecast. China's steel demand, and consequently that of molybdenum, is expected to rise but since molybdenum inventories are already high in China, large-scale imports are unlikely to be required. However, outside China, long-term contracts are already being signed as buyers fear shortness in the supply of molybdenum oxide later in the year due to limited increase in production capacity.

Further, China is likely to classify the metal as a "national mining resource" and play the "rare earth" card with molybdenum as well. By controlling mining and building a stockpile once again, China may cause molybdenum prices to double in the near future.

China is a market leader in the manganese market as well but quality being a prickly issue, South Africa still enjoys the leading position in the global market. In fact South Africa expects to produce 13 million tonnes per year of manganese ore by 2020 and out of that, export about 11 million tonnes per year. Speaking about a new railway line that will transport iron, nickel, and manganese to the port town of San Pedro in Ivory Coast, Mines and Energy Minister Augustin Comoe said, "The west is overflowing with nickel, manganese and iron. Construction of the railway will begin in 2014 and we're looking to transport about 22 million metric tons of minerals a year." Ivory Coast's mining story in expected to create waves in 2011.

In the rare earth market, China's Ministry of Commerce denied October media reports that stated a 30% reduction in export quotas in 2011. Wang Jian, a Vice Minister of Commerce, assured the global market, "I believe China will see no large rise or fall in rare earth exports next year." The quota system will however, undoubtedly remain intact. Spokesman Yao Jian of China's Ministry of Commerce said, "To protect the environment and natural resources, China will stick to the quota system to manage rare earth exports next year, and quotas will also decline."

In addition to a tighter export quota, China's Ministry of Finance has announced that it will increase export taxes on select rare earth metals such as dysprosium, neodymium, terbium and lanthanum, from the existing 0–15% up to 25%. According to Peng Bo, an analyst at Guosen Securities Co., "The government simply wants the same tax standard to apply to all key rare earth elements of which it wants to control shipments." The new taxes will be effective from January 1, 2011. The government also intends to limit the production and exploitation of the metals to ensure sustainable development as per WTO policies.