

Hard times will come soon for Ukrainian iron and steel producers

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The last panel session held by the balance committee of the mining and metallurgy complex of Ukraine in Dnepropetrovsk, on October 10, breathed gloom and disappointment. The industry coordinators unanimously claimed that the domestic steelmakers enter a rather difficult period.

The reason for such claims became the deficit of coke that emerged this summer, which already in September forced the companies to cut the average daily output of cast iron by 500 thousand tonnes as against this August. By the end of the month the drop in the output amounted to 169 thousand tonnes. The most who suffered from coke deficit became Dniprovsk Dzerzhinsky Iron and Steel, which obtained by 18 thousand tonnes less than required, Mariupol Illich Iron and Steel – 1.1 thousand tonnes and Arcelor Mittal Kryvy Rih – 1 thousand tonne.

Vasyliy Kharakhulakh, the CEO of Metallurgpom association, specified the reason for coke deficit: an increased demand for coking coal on the part of the Russian steelmakers, which do not let their Ukrainian peers to buy it in amounts that our steel kings are willing to. Anatoly Starovoit, the CEO of Ukrkoks association, said that another reason is the accident at Ulianovskaya mine (Kemerov region, Russia) owned by Yuzhkuzbassugol OJSC, which consequences have not been eliminated until now. Taking into consideration that Yuzhkuzbassugol output amounts to about 16% of the Russian coking coal total output, it is not a surprise that the price for the Russian coal in the conditions of the current deficit will grow. Despite the fact that presently, the coke price has already reached almost \$300/tonne, Mr Kharakhulakh made a disappointing forecast for steelmakers saying that by the next year the price will exceed the current figures, and in 2008, the coke price will add another 20%. One should also take into account that approximately a 50% gas price rise should be expected as well. These facts make the steelmakers choose between two evils: either increase their losses or limit themselves to the minimum possible output. It is quite understandable that steelmakers choose the second option.

The steel output cut by the domestic steel companies has also unpleasantly surprised the iron-ore producers, which at the request of the steelmakers have been constantly increasing their production. Thus, for nine months of 2007, the ore-dressing companies and mines produced by 2.865mn tonnes of iron-ore more than in the comparable period of the last year. Now, the miners do not know what to do, as the perspectives of the domestic primary market for the next year are very unclear, and signing of long-term export contracts may result in a deficit of not only coke but the iron ore as well. Therefore, the mining companies are facing two options: either to cut prices for key inputs (which will be unlikely taking into account the alignment of forces in the iron-ore market) or cut the output.

This month, the negotiations on 2008-2009 financial year prices between the largest suppliers and consumers of iron ore will be commenced, and the parties will exchange with their respective preliminary requests. More specifically, it will be the iron-ore producers that will put forward their

requests due to their stronger positions in these negotiations, as the global iron-ore markets start experiencing a deficit, which will last till 2010, as minimum.

Australian-based BHP Billiton and Rio Tinto have already put forward to their Chinese clients an “innovative” proposal on introduction of a premium on the price for their raw materials that will compensate the difference in costs for the ore delivery from Brazil and Australia. Presently, the FOB prices for iron ore from different countries are practically the same, but in Chinese seaports the price for raw materials of the Brazilian origin is by \$30-40% higher than for the Australian ones.

At the same time, the proposal made by the Australians has nothing to do with the long-lasting hopes of ore importers: to set during negotiations a fixed price on CIF and not FOB basis, so as the exporters pay for the cost of delivery. BHP Billiton and Rio Tinto are willing to increase asymmetrically the price for key inputs delivered by them: according to the preliminary estimates they expect to raise prices by 20 p.p. more than the Brazilian-based companies. If there plans are materialized, the Brazilian ore will cost by about 30% more next year, and the Australian – by 50%.

Thus, the steelmaking companies, which have no iron-ore assets of their own, will face the hard times in the nearest future.

Source: UFC Capital