THE STEEL INDEX
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MAY 2011

TSI Iron Ore Monthly Review - May 2011

Summary

- Australian share of the seaborne spot market grows as Indian and Brazilian export volumes decrease.
- Chinese crude steel production equalled record highs in May, reaching 1.98mt/day (11-20 May).
- Chinese steel inventories were drawn down by 23% to 14.6mt from the YTD high of 18.9mt (4 March).
- China's PBOC raised the DRRR (18 May) for the fifth time this year by a further 50 bp to 21%.
- China facing summer power shortages caused by severe drought, high coal prices and strong demand.

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Prices

- TSI 62% Fe reference price opened May at US$182.60/dry metric tonne, hitting a monthly high of US$183.30/dmt on May 4th, before falling by US$13.50/dmt to finish the month at US$169.80, a month-long low.
- For index-linked contracts employing a 'lagged quarter' (Q-1M lag) price discovery mechanism, indicative Q3 (Jul-Sep) prices based on TSI's 2% Al indices are as follows:
  - FOB West Australia 62% Fe at US$170.61/dmt, a 1.8% decrease q-o-q.
  - FOB Brazil 66% Fe at US$182.83/dmt, a 1.6% decrease q-o-q.
- For Vale customers with min 5% change triggers in their index-linked contracts, this implies Q3 prices unchanged from Q2.

TSI Iron Ore Spot Reference Prices (US$/dry metric tonne)

Series	Notes	May Average		QTD Average (µ)		Q-1M Average (α)	
			m-o-m		q-o-q		q-o-q
62% Fe*		177.10	-1.2%	178.12	-0.1%	174.82	-1.9%
58% Fe*		155.96	+0.3%	155.72	+1.7%	152.40	+1.2%
62% Fe˝	Low alumina (2% Al)	180.41	-1.2%	181.43	+0.1%	178.13	-1.6%
63.5/63% Fe˝		183.81	-1.2%	184.83	-0.3%	181.54	-2.2%

Indicative FOB Spot Prices (US$/dry metric tonne)^

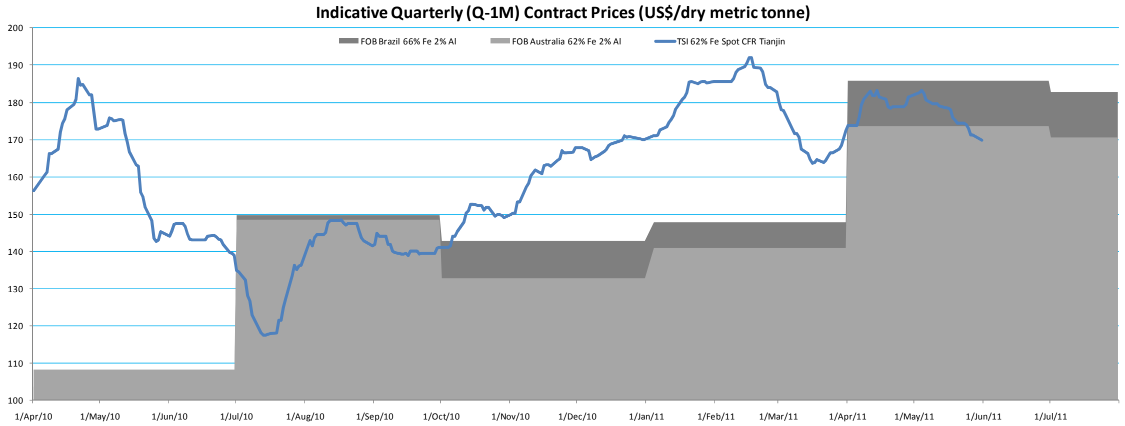
Pricing Point	Fe and Al Content	May Average		QTD Average (µ)		Q-1M Average (α)	
			m-o-m		q-o-q		q-o-q
FOB W. Australia	62% Fe, 2% Al	172.96	-1.1%	173.86	-0.3%	170.61	-1.8%
FOB Brazil	66% Fe, 2% Al	183.29	-1.1%	184.25	-0.1%	182.83	-1.6%

*CFRFO Tianjin port ˝CFRFO Qingdao port (µ)Calendar quarter: Apr, May & Jun. (α)Lagged quarter: Mar, Apr & May.

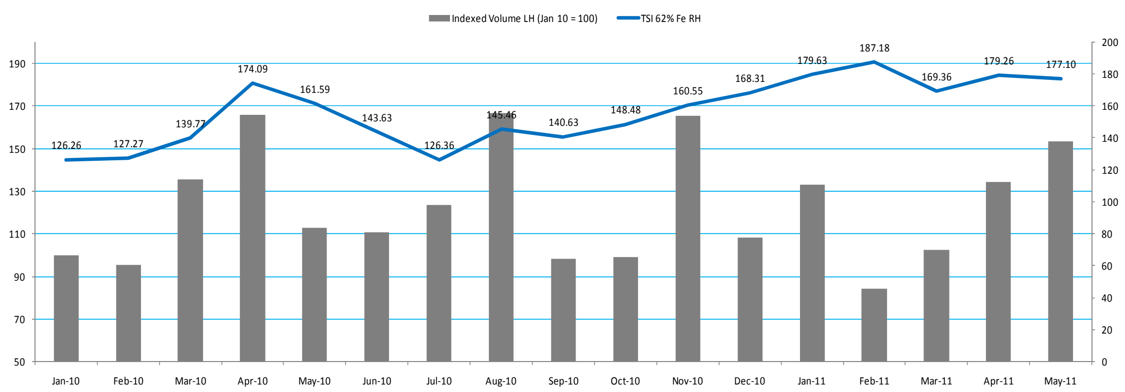
^Basis: TSI 62% Fe, low alumina (2% Al) series. FOB prices derived as net-backs using average Baltic C3 and C5 rates

Fe adjustment coefficient per 1% Fe = US$5.50/dmt for range 61-64% Fe and US$8.00/dmt for range 56-59% Fe during May

Indicative Quarterly (Q-1M) Contract Prices (US$/dry metric tonne)



Indexed TSI Iron Ore Spot Volumes & TSI 62% Fe Monthly Average Prices (US$/dry metric tonne)



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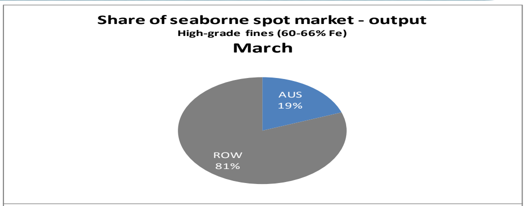
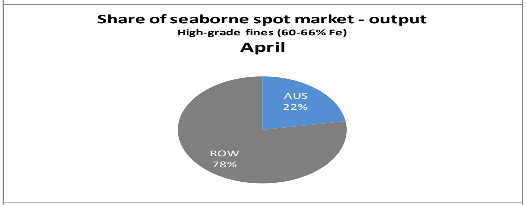
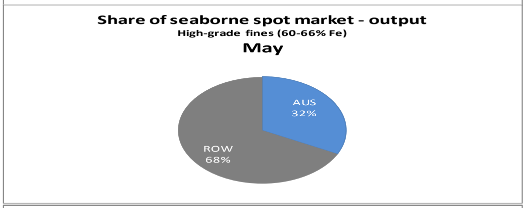
Supply

- Analysis recently carried out by TSI shows the proportion of Australian ore in the seaborne spot market increasing, while volumes of Indian and Brazilian ore in the market have fallen (see right).
- Australia origin ore has gone from 19%, as a percentage of the total seaborne spot market, to 32% between the end of March and the end of May.
- Factors behind this include:

  - Output at mining in operations in the Pilbara, Western Australia, have bounced back after weather disruptions at the start of the year.
  - Operations owned and operated by Rio Tinto and FMG were particularly badly affected by cyclones Carlos and Diana, and as a consequence suffered output losses in Q1 (as reported in April's review).
  - Australian miners, chief amongst them BHP Billiton, have increased spot market commitments in light of reduced demand from Japan post-quake. Demand from European buyers has also come off slightly over the past month but for reasons of geography and logistics this has had a lesser affect on the seaborne spot market.
  - Brazilian iron ore exports to China fell by a surprising 28% m-o-m, April to May. According to market sources, Q1 weather-induced output reductions were still impacting landed China volumes throughout May. The recovery in the Atlantic freight market over the last two to three weeks may also have been a factor.
  - Volumes from India continue to diminish, with actions to limit exports from Odisha (Orissa) threatened alongside continued limitations ex Karnataka.
  - The State of Odisha has suspended 20 exporters from shipping through Paradip port. The suspensions have been handed down over alleged reporting irregularities.
  - Exporters continue to experience difficulties moving material from Karnataka. Traders report severe bureaucratic delays.
  - A recent TSI study shows cost support, ex east coast India, at US$160-165/dmt CFR China, 62% Fe equivalent.

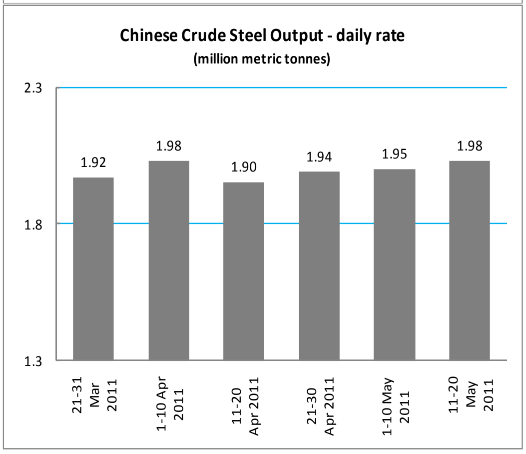


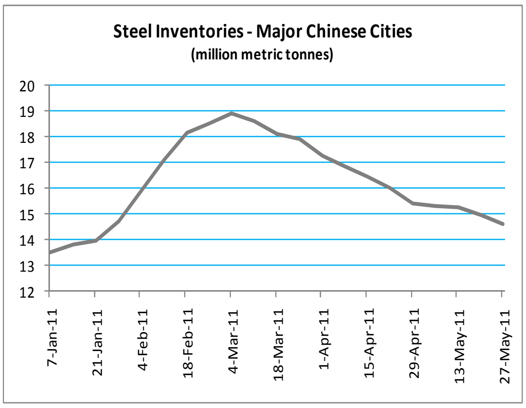


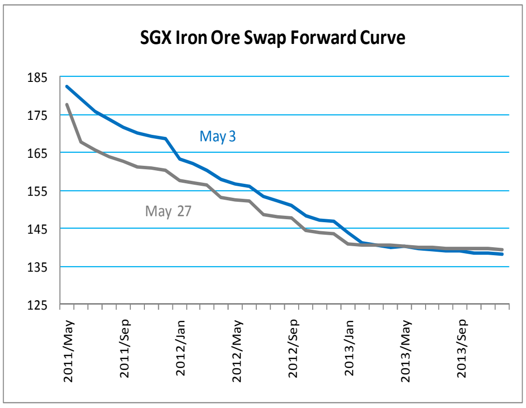


Demand

- Despite demand for imported iron ore in China weakening m-o-m, as evidenced by rising stock piles at ports (up 10.7% to 92.45m tonnes), Chinese production of crude steel continues apace. The period 11-20 May saw crude steel production daily run rates equal record highs at 1.98mt/d (see chart right).
- With trader-held steel inventories being drawn down in the face of increased crude steel production, end user demand appears strong; inventories down 5.3% m-o-m (see right).
- Construction continues to underpin steel demand in China, long products inventories having fallen far faster than those of flat products over the last two months.
- Short-term, the demand picture looks relatively robust, but consumption from the construction sector is seasonal and we would expect offtake to weaken as temperatures rise and work slows.
- The seasonal downturn in demand could be exacerbated this year by increased energy costs and power outages. China's latest severe drought, which has reduced hydroelectric power output, and firm domestic coal prices are pressurizing power production margins, just as energy intensive air-conditioning units are being switched on all over China.
- In response, and to increase power output, China's National Development and Reform Commission (NDRC) has raised power prices for industrial plants by RMB 20 (US$3.10) per 1,000 kilowatt-hours.
- The NDRC has so far left residential power rates unchanged, but fears persist that rising energy costs will eventually spill over to hurt consumers, fuelling already high inflation.
- The People's Bank of China (PBOC) continued its attempts to tackle rising inflation and cool the economy in May, adjusting the deposit reserve requirement ratio (DRRR) upward for the fifth time this year.
- The PBOC lifted the DRRR by 50 basis points to 21% on May 18th, having already lifted the reserve ratio by 50 bp on four occasions this year: January 20th, February 24th, March 25th and April 21st.







Derivatives

- Iron ore swaps (IOS) experienced a rollercoaster month in May, stated Kerry Deal, Senior FFA & IOS Broker at Clarksons Securities.
- "While swaps prices started the month in heavy backwardation to the roaring spot market, buyers took the reins and drove the market up. By mid-month price levels had been hit by the general sell-off in commodities that accompanied increasing fears about a slowdown in China," reported Deal.
- Despite sentiment taking a turn for the worse, "volumes remained extremely healthy, with an increasing number of Chinese participants coming to the market," Deal added.
- Cleared IOS volumes hit a record high in May, with 1 million tonnes traded in the first week of the month alone. Total volumes for the month are expected to exceed 3.5 million tonnes, with a nominal value of over US$600m, when official statistics from all exchanges and clearing houses are released later this week.
- The volume of iron ore swaps cleared on the Singapore Exchange (SGX) alone, all basis TSI, exceeded 3.45mt in May, with open interest hitting 5,600 lots - both new monthly records.

Next Month…

- Demand from the construction sector in China traditionally slows in the summer months. Construction has underpinned steel consumption in China for the past two to three months; offtake from the auto sector has been flat.
- Power shortages are expected to bite from next month, unless moves to raise the price industrial plants pay for electricity are applied to the rest of the economy. Any move towards widespread electricity hikes will add further upward pressure to inflation.
- Analysts expect another 25 bp rise in the benchmark one-year depositing and lending rates during the coming Dragon Boat Festival holidays (June 4-6), in a further effort to curb rising inflation.
- Fears of slowdown in China mount. Moves by the government to tame domestic growth will have greater impact on the global recovery from next month, when QE2 stimulus draws to a close in the United States. Concerns over European debt persist.

Would you like to speak to a TSI expert about how to use TSI's iron ore data to your advantage? If so, please choose from a contact below!

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TSI Iron Ore Index

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Sources: MySteel (Steel Inventories), CISA (Crude Steel Output)