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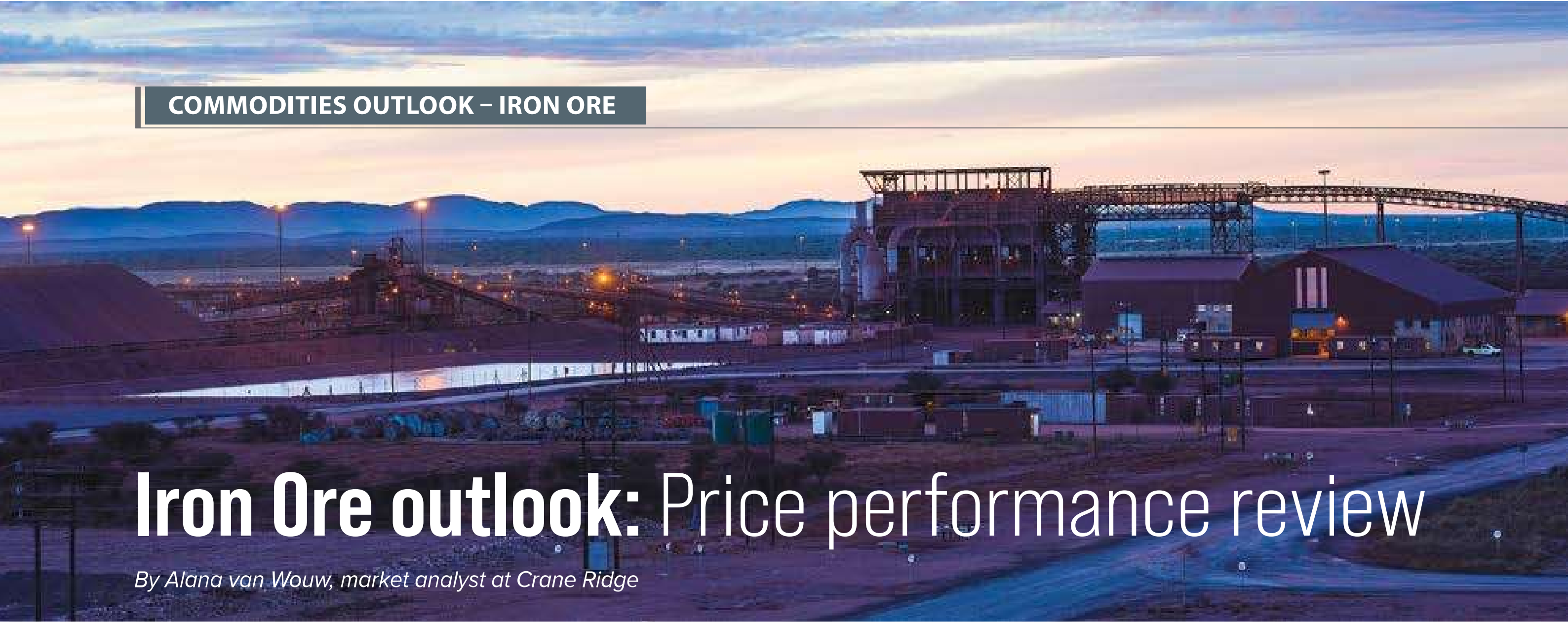


Iron Ore outlook: Price performance review

By Alana van Wouw, market analyst at Crane Ridge

Iron ore mining requires substantial capital investments.

Prices have fallen more than 50% from a peak in July 2022 - this on the back of challenges associated with China's property market and policy tightening by central banks in the US, which could result in further US dollar strength.

The iron ore price is currently in the midst of a deflating bubble as metal prices face macroeconomic headwinds, with headlines dominated by interest rate hikes and energy supply concerns.

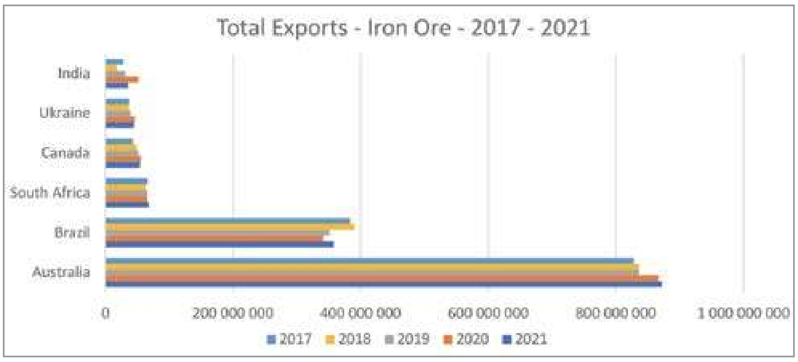
Iron ore extended its route to the lowest level in over two years amid mounting concerns over global steel demand.

Prices have fallen more than 50% from a peak in July 2022 - this on the back of challenges associated with China's property market and policy tightening by central banks in the US, which could result in further US dollar strength. Historically this inversely correlates to the iron ore price. Such strength deflation is like the iron ore price bubbles that took place in the global financial crisis of 2008, and from May 2021 during the pandemic.

Iron Ore outlook: Demand and supply dynamics

Ranked 1 in 2021 – Australia Export Outlook: In the Resources and Energy Quarterly June 2022 report, Australia cut its forecast for the country's iron ore exports for 2022 to 894 mt, down from March's forecast of 919 mt, according to Australia's industry ministry. The revised forecast represented a 2.5% increase year-on-year. The lower export forecast for 2022 was because major Australian producers continued to face persistent supply and labour shortages, which were compounded by the Covid-19 border restrictions that were in place until March this year.

Ranked 2 in 2021 – Brazil Export Outlook: After a disappointing first half of the year, Brazilian iron ore export volumes are showing signs of improvement. Total shipments from the world's second-largest iron ore exporter over the first half of the year stand at 167.7 m tonnes. While this represents a 13% increase on shipments over the same period in 2020, and a 2% increase on those in 2019, these two years were themselves very poor reference points. The former saw exports slashed by poor weather and Covid-19 related disruptions while, during the latter, the Brumadinho disaster temporarily restricted output and severely throttled the flow of cargoes to the water. Compared to the first six months of 2018, YTD shipments from Brazil come in 8% lower.



Ranked 3 in 2021 – South Africa Export Outlook: Turmoil in South Africa has impacted iron-ore exports as ongoing political instability seems to be never-ending, starting with the KwaZulu-Natal protests that emerged in opposition to the jailing of former president Jacob Zuma, and followed by the disruptions (two week strikes) at Transnet-managed ports in South Africa. The next issue facing iron ore exports from South Africa is rail constraints. Morgan Stanley noted that the mismatch between mine capacity and rail constraints would lead to "a resizing of mining operations, which would come into focus during 2023". This could have a direct impact on South Africa's export ability.

Ranked 4 in 2021 – Canada Export Outlook: In 2020, the Canadian steel industry exported 6.9 million tonnes of semi-finished steel products. Canada exported 55.3 million tonnes of iron ore valued at $3.0 billion in 2020, down from 52.2 million tonnes in 2019. Iron ore pellets accounted for 29% of the volume, but 77% of the value. Concentrates accounted for the remaining 71% of the volume and 23% of the value.

Ranked 5 in 2021 – Ukraine Export Outlook: Like other commodities, iron ore was not spared the impact of Russia's invasion of Ukraine. The ongoing war has hampered iron ore shipments from the country; Ukraine was the world's fourth-largest exporter of iron ore, second-largest exporter of pig iron or crude iron and third-largest exporter of semi-finished steel.

Iron ore is expected to endure declining prices and moderate demand from China over the next few years. Despite growth in China and continued growth in global production, global oversupply will likely affect the industry once again, forcing global iron ore prices to decline and constraining revenue growth. Furthermore, volatile steel demand and price trends will make it difficult for operators in the industry to secure long-term contracts.

Iron Ore outlook: Factors to watch for

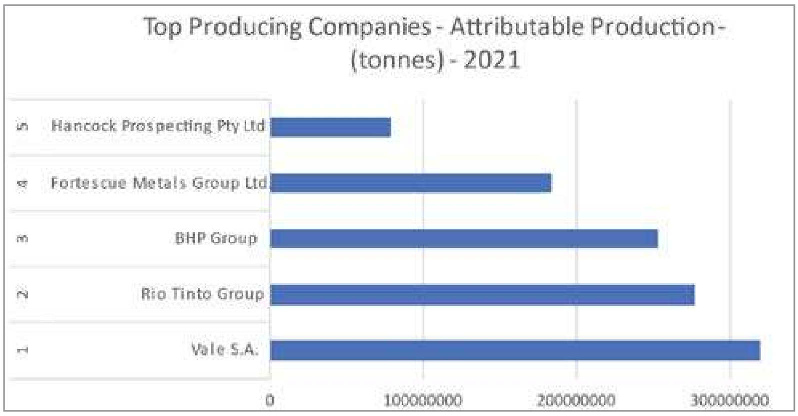
Below are a few challenges in the Iron Ore Industry that we need to watch out for:

- Increasing use of recycled steel - an increasing tendency of manufacturers resorting to using recycled steel has halted the growth of this market. The Spend Edge report on Global Iron Ore Category – Procurement Market Intelligence Report states that around 37% of the global steel production is recycled steel, which is influencing the demand for iron ore.
- Antidumping of steel – governments of various countries in North America and the APAC regions have enacted laws that pertain to the imposition of anti-dumping duties on steel products, and consequently, steel and iron ore export have been hampered. China has faced a significant blow as a result of these laws as it is the biggest importer of iron ore.
- Huge capital requirements: Iron ore mining requires substantial capital investments due to energy-intensive nature of the extraction process. So, to set a lower iron ore price, suppliers need substantial production to achieve economy of scale. Such large capital requirements and investments act as a major growth constraint for this market.
- Land in developing countries: Acquiring land from local communities for mining in developing countries is a long and complicated process with a further growth constraint being that around 70% of the mining sites are in regions where water stress affects the supply of iron ore.

Iron Ore ESG outlook:

COP26's carbon-market agreements could hit Australian miners within the next five years, as reported by numerous analysts. The world's nations reached an agreement on a framework for carbon markets under Article 6 of the Paris Agreement, which analysts expect will free transition capital and raise carbon prices. "Global agreement on carbon mechanisms will unleash market forces, but also increase transition risk," says Credit Suisse in its recent COP26 Watch.

While Article 6 does not have direct implications for voluntary carbon markets, the internationally transferred mitigation outcomes (ITMOs) and the new market-based mechanisms are likely to reduce the pool of available offsets in the voluntary market, pressuring prices.



The EU and US also agreed to a deal to abolish tariffs and restrict access to products that do not meet carbon intensity levels.

With higher carbon prices and the CBAM connection, "Agreement on the rule book should see strong growth in the coverage of emissions trading schemes and the voluntary market: in our view, the foundations of a global carbon price have been put in place," says Credit Suisse in its COP26 Watch. Credit Suisse expects this will result in sharply higher carbon prices and transition risk and estimates the resulting average Carbon Earnings at Risk (CEAR) for miners will increase from 14% to 102%. Bloomberg Green reports Europe's carbon price almost tripled in 2021, and the cost of permits has risen more than 140% this year – a move that favours gas over coal.

The EU's Emissions Trading System is pricing carbon at EUR60 in preparation for the introduction of the carbon border adjustment mechanism (CBAM), which is expected to have a significant impact on Australia's resource companies over the next five years, particularly on iron ore and metallurgical coal exporters, the CBAM applies to steel, aluminium, ammonia, cement, and electricity.

Analysts say that, on a direct basis, the effect of CBAM will not be too bad on Australian iron ore and metallurgical coal exporters, but if the EU extends the tax to upstream products, the risk for Australia will be significant, not to mention the CBAM's effect on Chinese exports is likely to significantly decrease iron ore and met-coal demand within the next five years, aligned with China's recently published green taxonomy. ■

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