SKILLINGS
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According to the Chinese Ministry of Transportation, China imported 51 million metric tons of iron ore in March, up 43% over March 2008. In February, China imported 46.74 Mt. Iron ore. Stocks in China's major ports rose 2% to 74 Mt in the week ending April 10, Chinica Shipbrokers Ltd., said in a report.

There has been an increase in demand from China for iron ore and other metals, despite the global economic crisis, Fabio Barbosa, CFO of Vale, Rio de Janeiro, Brazil, was quoted as saying in *Reuters.*

Barbosa said shrinking stocks in China, the world's largest importer of iron ore, had helped demand, but he added that there was still considerable uncertainty over global demand.

"It seems that there is a sign of recovery, of improvement, and in the case of China, it's more pronounced," Barbosa said during a seminar. "It is not visible in the global scene but in the case of China, it certainly is."

Barbosa said that it was important for the mining sector that the North American economy return to growth, as it represented a quarter of the world's demand for iron ore and other metals.

"We are in a hiatus period for growth, an adjustment period, but the trend for improvement in the long term is clear," he said.

The increase in Chinese iron ore imports in the past few months is the result of increased activity from steel mills, Steel Guru said. Traders expected downstream steel consumption will rise with the numerous stimulus plans, as well as cheaper iron ore import prices. Steel Guru said the high volume of iron ore imports suggests that steel mills and iron ore traders were over-optimistic following the rebound of the Chinese steel market from the end of October 2008 to January 2009. It takes several months before shipments arrive at ports after purchase agreements are made.

Also, some steel mills and traders have continued to import iron ore despite high stockpiles because they are honoring long-term contracts of affreightment with shipping companies, *Steel Guru* said.

Fake demand
On April 13, Liang Shuhe, China's vice chairman at the Commerce Ministry's trade department, said his country's iron ore imports increased in February and March because there was a "fake demand" brought on by stockpiling. Liang said imports would likely fall over the rest of this year. Most of the world's rebounding commodities exports are being dumped on stockpiles in China and are not being consumed, according to *The Age.*

In response to the "fake demand" at the beginning of the year, China's steel mills and traders made the mistake of increasing their orders for iron ore, leading to record imports in February and March, he said.

"In February, some of my foreign contacts told me that China's steel market wasn't doing badly... but (the increase in demand) was actually a sign of weakness," Liang said.

China's exports of steel products, at 1.67 Mt, were down by 60% from the previous March.

"When steel output capacity falls later in the year, the demand for iron ore will also fall," Liang said.

Port congestion stockpiles
Chinese port stocks rose by 10 Mt, or 15% since February, the *Sydney Morning Herald* said. Chinese steel mills have record-size iron ore stockpiles, which would seem to be to their advantage in negotiation.

In mid-April, port congestion at major Chinese ports was extremely heavy, according to Reuters, with vessels waiting up to two weeks to discharge at Qigdao and Rizhao, two of China's major ports in eastern China on the Yellow Sea.

China's domestic resources
MetalMiner, an industry resource and trade service, said that low spot iron ore prices are forcing many of China's 150,000 domestic low-grade iron ore miners out of business. Domestic iron ore producers typically meet 40% of China's requirements, but production has been down 70% since the market collapsed in October, making China's steel industry increasingly reliant on imports. Andrew Simpson, chairman of Western Australian junior, Territory Resources, said that the cost of domestic production in China would be a key determining factor on the final price settled in annual contract talks between the major miners and steel mills, according to *The Australian.*

"I am getting two to three inquiries a week from China about securing long-term contracts because there is that anticipation that a percentage of domestic production will stop," he said.

"The general consensus is at least 50% of domestic producers in China, at the current spot prices, are under water, so even today a little company like Territory is being inundated with people from China wanting to write long-term contracts," Simpson said.

Unlike China's small domestic producers, which are losing money at $60 per metric ton, the Big Three (BHP, Rio Tinto and Vale) could afford the price to drop lower and still remain profitable; their average cost price is said to be $24.7 per metric ton, according to Maquerie Bank.

Effects of China's stimulus
Mining Daily said China's $585 billion stimulus package is helping prompt a surge in lending in the first three months of 2009. "The overall national economy showed positive changes, with better performance than expected," China's National Bureau of Statistics said in a statement distributed before a news conference. Fat Prophets resource analyst Gavin Wend said the better than expected increase in China's GDP was a positive sign for the future of Australia's iron ore prices.

"The iron ore demand indications coming out of China certainly during the most recent month of March indicate the steel industry there is starting to crank up again," Wend said.

The *Sydney Morning Herald* reported that BHP Billiton and Fortescue Metals exported a combined 13.1 Mt of iron ore from Western Australia in March, up from 12.2 Mt the previous month.

Port Hedland Port Authority statistics released on April 20 show shipments to China increased to 9.1 Mt in March, up from 8.2 Mt in February.

Some have said that China is taking advantage of the low shipping costs, stockpiling iron ore, and holding off on construction projects until the new, assumed lower, price is settled.

With its huge stimulus package, China will have to begin development of significant infrastructure to deal with its population growth and allay possible massive civil unrest.

Development of such infrastructure is consistent with China's record iron ore imports in March.

The big three
Deutsche Bank said Rio Tinto's quarterly production figures showed a 4 Mt increase in its exports in March to 15.2 Mt.

''Rio is back in the chase for market share,'' said a Peter O'Connor, a Deutsche analyst. "We also sense that the iron ore business unit has a reasonably high degree of confidence in the sales order book for the balance of 2009.'"

Brazil's Vale also has increased its shipments to China since conditions have weakened in the European market. Citi said Vale was attempting to lock in market share gains for future years by selling iron ore at spot prices. It was reported to be selling iron ore at a 20% discount to 2008 benchmark prices on April 20.

BHP Billiton Ltd. warned that market conditions are expected to remain uncertain after reporting a drop in fiscal third-quarter iron-ore production.

*Bloomberg New*s reported April 22 that BHP Billiton said more of its iron ore customers are requesting deferrals on long-term contracts, forcing it to sell its product into the spot market at lower prices. Given the difficult conditions, BHP said that all of its businesses will remain under review.

The company's bearish comments may have come as a disappointment to some investors, since global commodities and equities markets have shown tentative signs of recovery since early March.

Unlike its peers in the global iron ore arena, like Rio Tinto Ltd. and Brazil's Vale, BHP has yet to announce any significant cuts in iron ore production, despite falling demand.

BHP said its iron ore production in the three months to March 31 fell 1% to 28.19 Mt. from the same quarter last year. For the nine months to March 31, production rose by 6% to 87.37 million tons, which is a record year-to-date figure.

Total iron ore exports from Brazil rose to 22 Mt in March from 15 Mt in February.

While miners have yet to settle a benchmark price, Rio Tinto is believed to be shipping ore at a 20% discount to this year's benchmark price and Fortescue at a 30% discount until the new benchmark price is set.

Analysts are predicting a 35% to 40% fall in the iron ore price from last year's record highs.

"The market could actually tolerate a 60% cut in contract prices, but what we can do?" said an iron ore trader based in Anhui in China. "The big three miners are effectively a monopoly, and I think they will hold out for a 30% cut."

Industry experts expect BHP Billiton will settle the benchmark price this year because Vale, which has been the traditional price setter, has indicated it will let its Australian rivals take the lead. Last year, it settled first and ended up with a lower price when the two Australian miners held out for more money. Rio Tinto's controversial deal with Chinalco means it is unlikely to set the price, Australia's *Business Day* said.

According to *Metal Bulletin,* spot prices in China fell to US$62.50 per metric ton during one recent week, dropping below the previous week's $63.50, the same price that was registered in October 2008, when Chinese demand slowed. This means that producers will want to wait because new lows in spot prices mean that negotiations could be extended.

Mark Pervan, ANZ Bank commodity specialist, said the iron ore producers "would have hoped [the market] hadn't hit fresh lows. They might now try and hope they can see a pick-up in real demand and that may not come through until maybe June or July, so this could protract negotiations."

Pervan said the produces would now have to play a waiting game because while there had been some small signs, improvements hadn't been reflected in the spot market.

James Wainscott, CEO of AK Steel Holding Corp., said the price of iron ore could be cut by more than half this year because of low demand caused by the global economic downturn, according to *Reuters.*

"Prices have tripled in the last three years, and demand is now less than it was three years ago, so it's reasonable that cost increases should go away," Wainscott said on a conference call with Wall Street analysts.

"The shoe is on the other foot now, and we should see upwards of a 50% reduction in iron ore prices for 2009," he said.

AK Steel, which reported a first-quarter loss that was less than expected, said it expected to benefit from lower operating and raw material costs in the second quarter.

Mutiny among the Chinese

According to the *Sydney Morning Herald (SMH)*, Shan Shanghua, head of the China iron & Steel Association (CISA), assigned, for the first time, his personal representative to the annual iron ore price talks. The CISA representative initially was seated behind Baosteel's Ding Shouhu and was there in an advisory role. "This year, CISA is claiming they are the leader and Baosteel is only assisting," one industry observer said.

"Baosteel seems to be frustrated."SMH added, "The new CISA negotiator has threatened to unite the whole Chinese steel industry into an import cartel for the common purpose of forcing this year's benchmark price."

They are said to have bypassed Vale and BHP and focused on Rio Tinto and mining juniors they see as vulnerable and more likely to agree to a lower price under pressure. But some say that price would not hold.

The Benchmark System

At a recent mining conference in Perth, the Western Australian capital of the country's iron ore industry, delegates were asked to put their hands up if they thought the current system of annual iron ore negotiations would still exist in five years. Very few hands were raised, a *Financial Times* article said.

The benchmark system has been in place since the 1960s. In former years, the lead role was played by the Japanese mills.

But after 50 years, this annual ritual is looking endangered because the spot market, which was seen as marginal only three years ago, is rapidly gaining in importance.

"Within the next five years, we will see a shift away from the current benchmark system," says Jim Lennon, a commodities analyst at Macquarie bank in London, echoing a view that is quickly gaining support within the industry.

The annual price negotiations have a great influence in the global economy as the cost of iron ore filters down into steel prices and ultimately into goods such as cars and washing machines, *Financial Times* said. A move away from the annual benchmark prices to spot or hybrid contracts could lead to more volatile prices for steel and other goods.

The 2009-2010 contracts will likely deliver the first drop in prices after six consecutive years of increases.

The move away from benchmark pricing is unlikely to be sudden, *Financial Times* said, or lead to the complete disappearance of the benchmark in the short term.