Iron Ore’s Towering Rally Set to Roll Into 2021 as Mills Protest
2020-12-16 07:04:02.851 GMT

By Krystal Chia and James Attwood
(Bloomberg) -- Iron ore’s dizzying demand surge has made it the world’s best performing commodity this year, and prices could stay elevated for months to come.
The rally has been almost two years in the making, after a mine disaster in Brazil shuttered a significant chunk of output in the world’s no. 2 producer. It’s a supply shock that came as Australia’s mining giants kept production in check, happy to take higher prices rather than rush to raise output.
In the second half of this year, faltering supply has met a surge in demand. China, the dominant consumer, is spending heavily on construction to rescue an economy that cratered in the wake of the pandemic. The country’s steel production this year is on track to top 1 billion tons for the first time.
The benchmark spot price hit a nine-year best last week, while futures markets in Singapore and Dalian, which began trading in 2013, saw all-time highs. Forecasters predict a shortage of the crucial steel input to persist next year.
The gains have prompted China’s steel industry to call for government intervention, complaining that speculation rather than fundamentals are driving prices. The Dalian exchange has tried to rein in speculators by toughening trading terms.
Further action by regulators could blow more froth off the market, but it wouldn’t solve the imbalance between supply and demand.
“China has been incredibly strong,” said CRU Group senior analyst Erik Hedborg, adding that the country now accounts for 77% of the world’s seaborne iron ore demand, the most ever.
“When iron ore inventories are already this low in China, mills become very sensitive to negative supply news.”
On Wednesday, futures pushed higher again, with the most-active contract gaining as much as 1.2% to $155.15 a ton in Singapore. The rally’s been so strong that prices have registered only a single drop in December.

Vale Slides

Once the biggest iron ore miner in the world, Brazil’s Vale SA fell back to second spot last year after the devastating tailings dam collapse that killed about 270 people and triggered an overhaul of its waste storage facilities.

Vale is still about 100 million tons short of meeting the 400 million tons in output promised prior to the Brumadinho dam disaster. The recovery has been slower than expected, depriving the market of much-needed ore. Like its Australian rivals -- Rio Tinto Group, BHP Group and Fortescue Metals Group Ltd. -- Vale has prioritized value over volume. With current prices above $150 a ton and mining costs as low as $12 a ton, it's an approach that has reaped rich rewards.

Click here to read about why iron ore probably won't get tangled up in the trade row between Beijing and Canberra

Shares in Fortescue, a pure-play iron ore miner, have doubled this year after doing the same in 2019. Even Vale's stock is up over 50% in the second half as robust prices have offset operational concerns. Steel mill profits, meanwhile, have been cushioned by a surge in the price of the alloy to feed the construction boom.

Earlier this month, Vale gave another lift to prices by cutting its production target this year and providing 2021 guidance that trailed expectations to the tune of 20 million tons, according to Bloomberg Intelligence analyst Andrew Cosgrove. The shortfall will come at a precarious time as iron ore demand outside China begins to revive from the pandemic.

Further out, potential bull factors for the mineral include the regulatory response to Rio Tinto's destruction of an Aboriginal heritage site, which may check miners' growth plans for the ore-rich Pilbara. More immediately, there's cyclone season to contend with, and its habit of shutting in Australian supply in the early months of the year.

"Vale is the first company that we have visibility on guidance for 2021," Cosgrove said. "An equally sizable wild card is when we start to get guidance from Australian miners."

Vale's head of iron ore, Marcello Spinelli, said the company has taken a conservative approach for its 2021 target, suggesting it could surprise on the upside depending on how much the La Nina weather pattern disrupts operations and how quickly production permits are granted.

Pandemic Recovery

Spinelli and other executives have asked for patience as Vale ramps up its capacity to 350 million tons by the end of next year and 400 million tons by end-2022. Its longer-term goal is to reach 450 millions tons of capacity to provide a buffer that would increase its ability to meet market needs and minimize any operational setbacks.

“I am very skeptical that Vale is going to go back to levels that we saw in 2019, pre-Brumadinho, until at least 2025,” said Macquarie Group commodity strategist Serafino Capoferri. The miner’s move away from tailings dams -- the type of structure involved in the disaster -- is a major change for the company and could leave supply more vulnerable to bad weather. And while current prices have spurred some response from junior miners globally, new investments typically won’t start producing for years, he said.

On the demand side, China’s fiscal splurge will probably moderate next year as it completes its V-shaped recovery from the pandemic. But it also needs to ensure a steady start to its latest five-year plan, which means that stimulus won’t be reined in completely.

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Bank	2021 market balance	Benchmark spot iron ore price forecasts
		1Q: $128/ton
		2Q: $140
		3Q: $115
Goldman Sachs	-27m tons	4Q: $105
		1Q: $125
		2Q: $120
		3Q: $100
Morgan Stanley	-35m tons	4Q: $95
		1H: $114
UBS	-9m tons	2H: $106

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Fortescue Metals expects the steel industry’s momentum to extend into 2021 and for stockpiles held at ports to decline to near 100 million tons in the first quarter. Anything less than that figure would be the lowest since 2016. Banks, meanwhile, are broadly in agreement that iron ore will remain in deficit next year, and that prices will stay elevated.

So, what could upset the predictions? Morgan Stanley points to the possible resumption of steel scrap imports in the New Year, which have dwindled due to China's environmental proscriptions on waste. And if China retools more of its production to using scrap, it could significantly cut its reliance on iron ore over the longer haul.

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