

SectorVector

Reading the topical trends

October 2021

Iron ore forks

Global prices slide, less so domestic

Iron ore prices plummet, domestic less steeply than imported

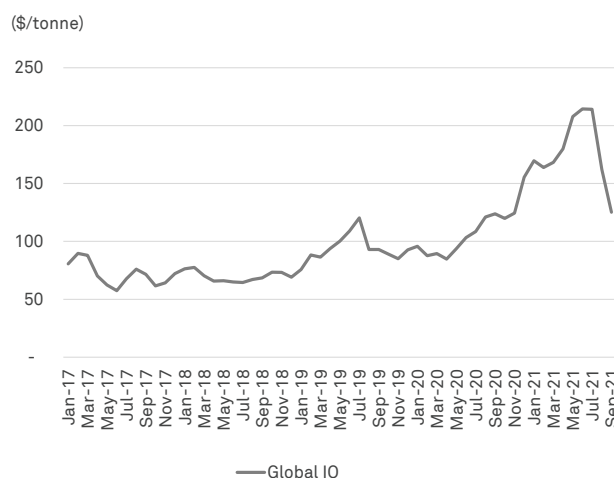
In June this year, global iron ore prices averaged a 10-year high \$214 per tonne, having risen a whopping 60% in a span of six months from the end-2020 level.

Three months on, with China cutting its steel output and issuing stricter production cuts, the prices have corrected sharply to \$125 per tonne as of October first week.

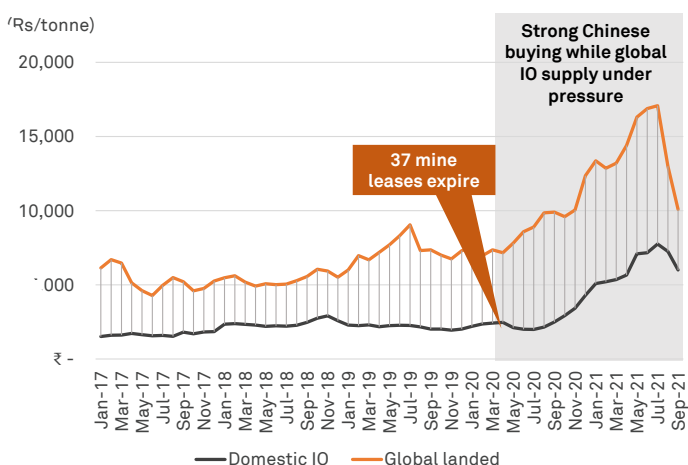
And there is more bad news for iron ore producers. The current run rate shows China had already produced 68-70% of its 2020 steel output by August, portending a slower pace of production and, hence, lower demand for iron ore, through the remainder of the year.

Indeed, despite the tight market resulting from supply disruptions in Brazil (accounting for 20% Chinese imports), iron ore prices are expected to average \$150-165 per tonne in 2021 because of tepid demand from China for the rest of the year and souring of its trade relations with Canberra (accounting for 60% Chinese imports).

Iron ore prices hit 10-year high in June 2021 and have plunged



Price differential between landed and domestic ore narrows



IO: Iron ore
Source: National Mineral Development Corporation, CRISIL Research

Domestic prices have mirrored the global trajectory, peaking at Rs 7,787 per tonne in July, as strong export demand and dwindling inventories at mines **tightened supply in the country**. Prices started to slide in August, and as of October first week have corrected 28%.

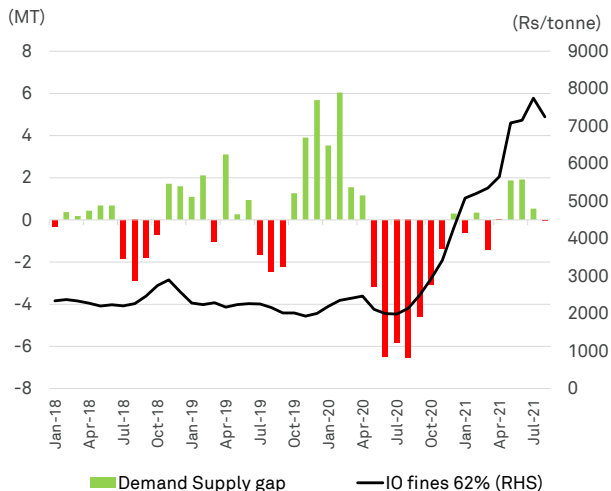
That said, the fall in domestic prices has been less steep compared with the global slide, and this has narrowed the price differential with landed prices. The gap halved in September compared with January. In fact, on the west coast, domestic and imported prices were nearly on a par in the last week of September.

Domestic supply to stay tight due to delayed operation of auctioned mines

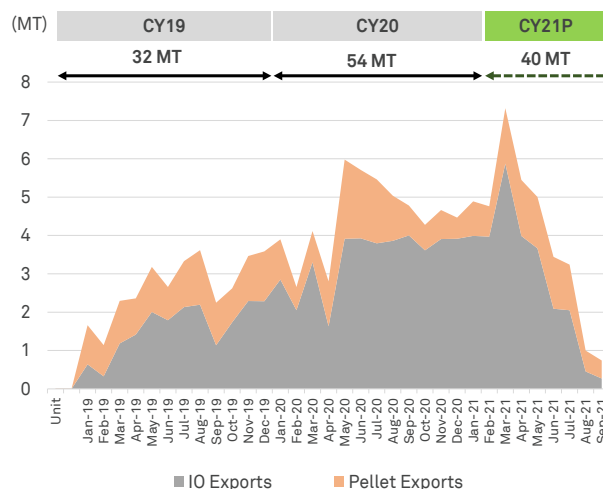
The domestic iron ore market is facing a supply crunch as expiry of leases on 37 operational mines [40-45 million tonne (MT) equivalent] in March 2020 coincided with a nationwide lockdown to control the spread of Covid-19. Consequently, iron ore output fell 40% on-year the following month, and miners whose leases had expired rushed to export their inventories to benefit from the steep rise in global iron ore prices.

Iron ore exports from India surged to 54 MT in 2020, and another 36 MT in the first nine months of 2021, with 83% of exported fines/lumps being low-grade (lower than 58% Fe).

Domestic merchant demand outstripped supply for months due to high exports



Exports soared despite shortage in domestic market



Source: Directorate General of Foreign Trade, CRISIL Research

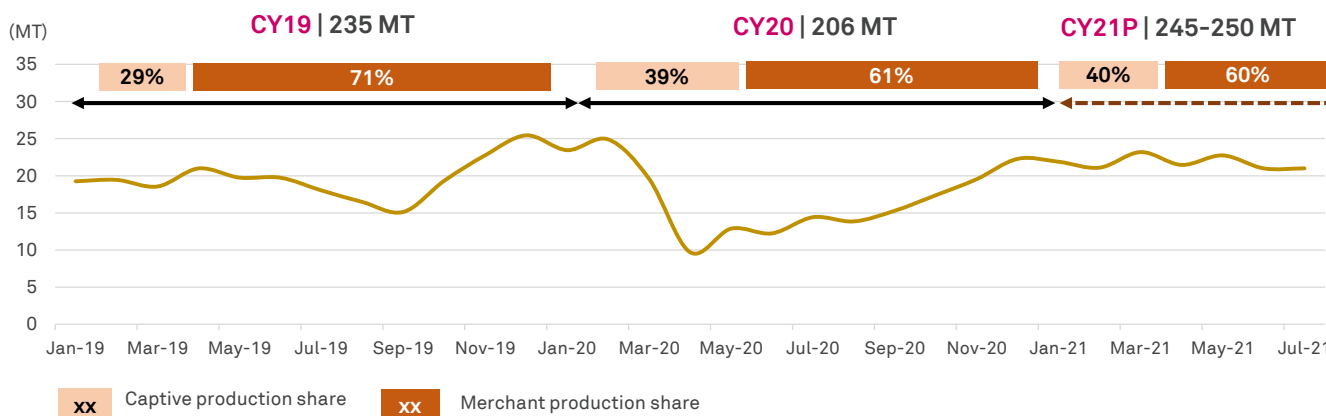
That said, as demand in the international market slows and global prices continue to correct, we project exports to total 40 MT in 2021, i.e. only 4 MT more over the next three months.

On the supply side, domestic output has been ramped up with some of the auctioned mines becoming operational. Owing to minimum dispatch rules, a more uniform monthly throughput is

expected for the rest of this year. Hence, for 2021, iron ore production is forecast at 245-250 MT.

But only ~60% of this is seen being produced by merchant miners, compared with 71% in 2019, thereby creating tightness in merchant market. The ratio will get further skewed towards captive producers as they ramp-up production from recently awarded mines, and continue to bid aggressively in future auctions as well.

Share of captive in iron ore production on the rise on healthy ramp-up by newly integrated players



P: Projected
Source: CRISIL Research

Of the 19 mines auctioned by the Odisha government in March 2020, though, **only 12 are operational** (~75% of the auctioned amount), as:

- Three mines (44 MT reserves) were surrendered as the winning bidders found it unsustainable
- Two mines (158 MT reserves) are in a limbo, with the lessees contemplating surrendering these
- Two mines (268 MT reserves) were transferred to Odisha Mining Corporation as the respective lessees refused to execute their lease deed

To stabilise supply of iron ore in the country, the mines auctioned in 2020 were required to maintain a minimum level of dispatch every month. But the auctioned mines produced ~70% of their total dispatch target. Also, in many cases, while production

exceeded the target, the lessee was unable to dispatch as much. The Odisha mining directorate has issued ~10 notices to lessees at the end of their first year of production for the shortfall in dispatch, and directed them to pay a penalty.

In March 2021, Lok Sabha passed the Mining and Minerals (Development and Regulation) Amendment Bill 2021, allowing captive mines to sell 50% of their output in merchant markets after requirements of the attached plant are met. In this new regime, **16 iron ore mines holding 1,028 MT reserves will be auctioned through end of 2021, of which only four are operational and the remaining 12 non-operational/ virgin mines.**

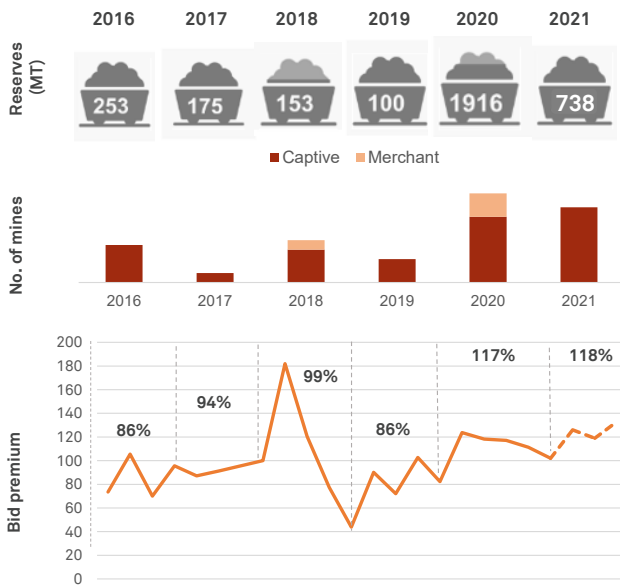
Given that the virgin mines will take at least 4-6 years to commission, **domestic supply will stay tight, thereby limiting any free fall in domestic iron ore prices.**

Iron ore auctions to stay hot and high on premiums

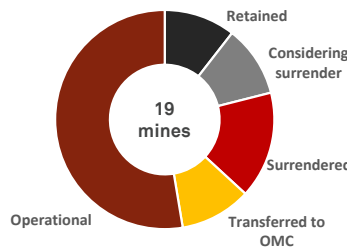
In March 2020, 19 mines were auctioned by the Odisha government, with total iron ore reserves of 1.9 billion tonne. The auction saw 86 companies participate aggressively, which led to premiums reaching 154% of the reserve price.

The mines that have gone under the hammer have seen a repeat of last year's auctions, with seven of the nine mines won by captive steelmakers at average bid premiums of 118%, which is set to alter the cost landscape for them owing to elevated iron ore prices in the medium term.

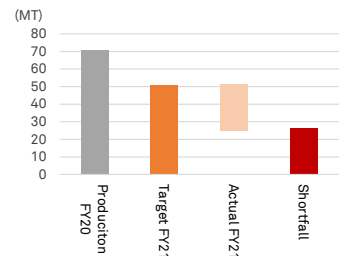
Auctions by year



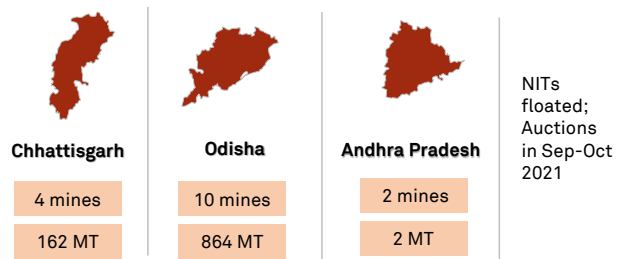
Status of 19 mines auctioned in 2020



Shortfall in target production of 19 auctioned mines



Upcoming auctions in 2021



NIT: Notice Inviting Tender

Note: Bid premium refers to weighted average premium based on reserves. 2021 bid premiums include nine mines auctioned so far.

Source: Ministry of Mines, CRISIL Research

In the long term, there is a need for faster unlocking of iron ore reserves as iron ore production from operational mines will deplete for 90 of the 120+ operating mines in India by the 2040s. Fast depleting operational reserves amid a growing demand scenario has compelled the government to ease policy distinction, such as abolishing captive/merchant distinction, easing mining lease transfer,

and expediting approvals for virgin blocks. Such policy measures will continue to play a critical role in unlocking more reserves and resources to meet the growing ore demand in the nation, which will see demand rise 4-5% on-year over the long term.

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