INSIDE METALS

Thursday, July 18, 2013

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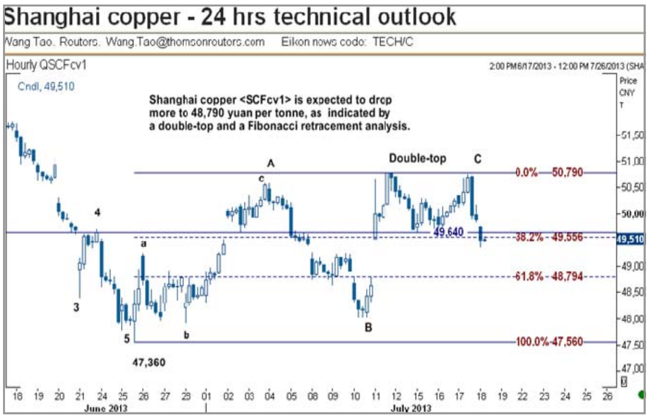

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COLUMN-BHP, Rio gamble on iron ore, but they've stacked the deck

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Andy Home is a Reuters columnist. The opinions expressed are his own

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TODAY’S MARKETS

BASE METALS: London copper eased to a one-week low after U.S. Federal Reserve Chairman Ben Bernanke reaffirmed plans to curtail bond-buying by the end of the year, raising concerns that investors may cut their holdings of commodities.

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PRECIOUS METALS: Gold inched up after falling more than 1 percent in the previous session, but the metal was still under pressure as investors eye an eventual pullback in the U.S. Federal Reserve's stimulus programme.

"We should still expect bond buying to be scaled, but maybe not that soon," said Joyce Liu, an investment analyst at Phillip Futures in Singapore.

FOREX: The dollar rose after remarks from Federal Reserve Chairman Ben Bernanke kept intact expectations that the Fed would be first among the major central banks to move away from ultra-loose monetary policy.

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FEATURE

COLUMN-BHP, Rio gamble on iron ore, but they've stacked the deck

By Clyde Russell

LAUNCESTON, Australia, July 18 (Reuters) - Ramping up output in the face of an expected easing in demand growth may seem like an odd tactic for a miner, but it's exactly what Rio Tinto and BHP Billiton are doing in iron ore.

The world's second- and third-ranked producers both said this week that their expansion plans are on track, notwithstanding the expected slowdown in China, which buys about two-thirds of global seaborne iron ore supply.

But there is method in the seeming madness of increasing production when the demand outlook is less than rosy.

Both Rio and BHP are effectively betting that their low-cost operations in Australia will be able to dominate the market, squeezing out both Chinese domestic production and higher-cost mines elsewhere in Australia and around the globe.

They are also betting that the fears of a slowdown in Chinese demand growth are being overstated, and that import volumes will remain healthy.

While these may look like risky assumptions for the two Anglo-Australian mining giants, they stand a good chance of being correct.

The cost of production for both Rio and BHP is around $50 a tonne, meaning a profit of more than $80 at the prevailing Asian spot price of $130.40.

Even if iron ore does fall sharply in the second half of the year on the back of slowing demand growth in China, BHP and Rio would likely be the last profitable producers standing.

And there aren't too many analysts tipping a decline similar to what happened in the third quarter of last year, when spot prices plummeted by more than 20 percent to reach a three-year low of $86.90 a tonne in early September.

The consensus is centred around levels between $110-$120 a tonne, with downside risks.

If this does prove accurate it means that Rio and BHP are making the right decision to chase volumes, as they will still be making bigger margins than their competitors.

The iron ore market in China, and indeed globally, is also dissimilar to other bulk commodities such as copper and crude oil insofar as there is very little capacity, or willingness, to build large inventories.

Miners, traders and steel mills all work on relatively tight inventories, meaning that supply tends to adjust to demand more quickly than in some other commodity markets.

In times of oversupply, this means output tends to be cut and past experience suggests that the first to be idled are high-cost, low-grade Chinese mines, and the last are BHP and Rio's Western Australian mines, as well as those of Brazil's Vale .

It's also worth looking at what is the likely scenario for Chinese iron ore demand for the rest of 2013.

Imports in the first half were 384.3 million tonnes, a 5.1 percent gain over the same period in 2012.

The median forecast of analysts in a Reuters poll published July 4 was for imports to total 786 million tonnes for the full year.

This means that 401.7 million tonnes would have to be imported in the second half, which hardly sounds like a slowdown at all, in fact it's more like an acceleration.

The most bearish forecast was for iron ore imports of 736 million tonnes in 2013, just below the record 744 million reached in 2012.

Even if this pessimistic assessment turns out to be the most accurate, Rio and BHP would still likely to be able to sell their increased production because they could afford to undercut their global rivals and Chinese miners.

BHP produced a record 187 million tonnes of iron ore in the fiscal year ended June and by December it plans to be running at an annual capacity of 220 million tonnes.

Rio mined 66 million tonnes in the three months to June, on track to meet its 2013 guidance of 265 million tonnes. It said this week that it would lift its annual production capacity to 290 million tonnes by the end of September and to 360 million by the end of 2014.

These capacity expansions come with big price tags, with Rio spending an estimated $5 billion on its projects.

It's the combination of huge capital expenditure and inability to get below BHP and Rio on the cost curve that may ruin other iron ore projects.

Among those are billionaire Gina Rinehart's $10 billion Roy Hill project in Western Australia, which is still trying to secure debt financing and Anglo American's over-cost and delayed Minas-Rio mine in Brazil.

Ultimately, what appears to be a gamble by BHP and Rio isn't so much of a risk, because they are playing with the cards stacked in their favour.

Disclosure: At the time of publication Clyde Russell owned shares in BHP Billiton and Rio Tinto as an investor in a fund. He may also own other shares mentioned as an investor in a fund.

--Clyde Russell is a Reuters market analyst. The views expressed are his own.--

GENERAL NEWS

Metals warehousers plan rent rises to make up for shorter queues

By Susan Thomas

LONDON, July 17 (Reuters) - Companies owning warehouses plan steep rises in storage charges to recoup lost income if the London Metal Exchange (LME) makes them shorten queues for its clients to withdraw metals such as aluminium, industry sources say.

The LME, the world's biggest marketplace for industrial metals also including copper and zinc, on July 1 proposed an overhaul of the global warehousing system it oversees.

If implemented after consultation over coming months, the change will help industrial clients but curb profits for the banks and trade houses that own warehouses.

At stake for the warehouse owners are rental incomes that in some cases total hundreds of millions of dollars a year.

"The warehouse companies are looking at their options, and one of the options is to increase rents substantially," said one warehousing source, without giving an amount.

Several companies with warehouses registered by the LME, including Glencore-owned Pacorini, Trafigura's NEMS and Goldman Sachs' Metro, have found a lucrative business in building up big stocks, charging rent for storage and delivering metal out of storage only at a limited rate.

Metal users can queue for up to a year to get material they have bought via the LME, paying warehouse owners full-price rent while they wait, and have called for action by the exchange.

The LME can demand faster delivery out of sheds but cannot limit rent increases as any such move would be deemed as price fixing by the European Union and therefore anti-competitive.

This warehousing controversy has been so toxic it endangered the $2.2 billion takeover of the LME by Hong Kong Exchanges and Clearing Ltd , agreed last year.

Failure to resolve the issue could lead to a loss of business to sheds outside the system of LME-registered storage that guarantees metal quality and helps maintain the exchange's position as a reliable source of metal at a market price.

The LME proposal links the minimum rate at which a warehouse with big stockpiles and long wait times - more than 100 days - is required to load out material to the rate at which it brings in new metal. Only five of 36 LME-registered locations around the globe have queues of more than 100 days.

In Detroit, for example, where Goldman's Metro warehousing company dominates, the wait for aluminium is 469 calendar days.

At 48 cents per tonne the queue is worth around $220 million, excluding other charges, according to Reuters calculations. With a queue of 100 days, and at the same rent, that income would plunge by more than 60 percent.

A second warehousing source also said a big rent rise was possible if the proposal in its current form came into effect. However, he thought the proposal would probably be watered down.

Pacorini does not comment to media. A Trafigura spokeswoman said the firm was participating in the consultation and gave no further comment. Metro was not immediately available to comment.

For warehouse operators to fully counteract the decline in rental income this way, the daily fee would have to rise to $2.21 per tonne, a near four-fold increase in rents from current listed levels, Barclays said in a research note.

DELISTED WAREHOUSING

"We do not expect such a degree of rent hikes, but warehouse operators will inevitably lobby for a more substantive year-to-year increase than is usually seen in listed LME warehouse rents," Barclays said.

Rents for LME aluminium, the most widely stored metal, have risen almost 50 percent to a median 47 cents per tonne since 2007/2008, according to Reuters calculations.

They jumped as much as 10 percent for some metals last year to offset an earlier LME attempt to cut queues via new higher load-out rates.

Warehouse companies set their rents independently of each other, taking into account inflation, economic conditions and LME rule changes among other factors. They submit rent proposals to the LME by Dec. 1 every year and these take effect in April. While the LME can ask warehouse companies to justify their new prices, it cannot force any changes.

"That's illegal," LME Chief Operating Officer Diarmuid O'Hegarty said at a media briefing. "We cannot control who owns warehouse companies, we cannot control rents, and we cannot control delivery out charges."

O'Hegarty added the three-month consultation would hopefully flush out some of the potential consequences of the proposal, such as steep rent rises.

"The LME will have a new problem and it won't be the queue problem any more. The rent issue will need to be dealt with by a regulator," said a U.S.-based metals trader.

"The EU has said the LME has no right to determine rents. But they were increased 6 percent last year in a deflationary environment."

U.S. anti-trust lawyer Robert Bernstein, a partner at New York-based Eaton & Van Winkle LLP, said non-LME rents are much cheaper, so any big rate rises would spur more storage outside the LME system.

"This may be a boon for delisted warehousing," Bernstein said.

And Deutsche Bank said this week there is a danger LME storage could price itself out of the market, "ultimately leading to a breakdown of the price-finding function that the exchange performs".

GENERAL NEWS *(Continued)*

Miner Boliden looks at cost cuts as metals prices weigh

STOCKHOLM, July 17 (Reuters) - Swedish miner and smelter Boliden said it would look at cutting costs and investments as falling metals prices and maintenance outages pushed it to a small second quarter loss.

However, earnings stripped of the hit of the falling value of metals it holds in inventory were stronger than expected and Boliden shares were up 5.3 percent by 1045 GMT, outpacing a 1.7 percent gain in the European Basic Resources index.

Slow global growth and a weakening outlook for the world's No.2 economy China has softened demand for metals this year.

Boliden, whose share has lost more than a quarter of its value this year, said lower metals prices and maintenance outages had reduced its result by more than 700 million Swedish crowns ($106.36 million) compared to the first quarter.

"While we are obviously hoping for an improvement, we are also preparing for a worsening scenario by reviewing our costs and investments," CEO Lennart Evrell said in a statement.

The company added that ongoing expansion of production at its Garpenberg zinc mine and Kokkola zinc smelter would not be affected.

The benchmark three-month London Metal Exchange zinc stood at $1,863 a tonne on Wednesday, down around 10 percent from the start of the year. Three-month copper is down around 12 percent.

Boliden's operating loss was 59 million crowns ($8.96 million) in the quarter against a forecast for a profit of 61.4 million in a Reuters poll and a 795 million profit in the year ago quarter.

Excluding the impact of a revaluation of process inventories, the picture was slightly brighter with earnings falling to 370 million crowns from a year-ago 956 million, just above the 294 million seen by analysts.

TRADING PLACES

LME scheme not enough to end warehouse logjam -Japan aluminium body

TOKYO, July 17 (Reuters) - The London Metal Exchange's (LME) proposals to tackle the long queues that end-users face to obtain aluminium from warehouses is unlikely to resolve the problem, the chairman of the Japan Aluminium Association said on Wednesday.

On a separate issue, Shigenori Yamauchi also said Japan does not need a new so-called national project, in which government and companies collaborate to secure aluminium supplies, once an existing contract with Indonesia expires in October.

Companies running warehouses registered by the LME, the world's biggest industrial metals marketplace, have been making money by building up stocks and charging for storage, while they deliver metal at a limited rate to holders of LME contracts.

Over the past four years manufacturers needing metal have also increasingly struggled to get supplies as they compete with banks and trading houses, which hold huge stockpiles as collateral for finance deals.

The LME proposed a major overhaul of its metals storage system on July 1 that, if implemented, would aim to reduce queues in places where they are longest and help address the complaints of industrial companies. It also launched a three-month consultation process.

"This is a good step toward easing the problem, but people in the industry see that it won't be enough," Yamauchi told reporters.

"Manufactures want aluminium prices to reflect purely demand and supply, instead of sleeping inventories," said Yamauchi, who is also president of Sumitomo Light Metal Industries Ltd , Japan's No.2 producer of aluminium rolled products.

The artificial shortages created by financial buyers have pushed to record highs the premiums above the LME price that have to be paid to obtain physical metal, even though the market is in chronic surplus.

"The LME plan may help put pricing mechanisms on a more healthy footing, but alone it is unlikely to have a big influence," Yamauchi said. Many warehouses in the global network overseen by the LME are run by banks as well as by trading houses.

A U.S. Senate committee will hold a hearing next week on whether banks should control physical storage for commodities, signalling that lawmakers may be toughening their stance on the lucrative business for giant Wall Street firms.

NATIONAL PROJECT

Indonesia's government is in talks to buy out the Japanese majority owners of aluminium producer PT Inalum, to generate more revenue and reduce foreign ownership in the sector, and it has indicated that an extension is unlikely.

Nippon Asahan Aluminium, a consortium of 12 Japanese firms, holds about 59 percent of PT Inalum, while the Indonesian state owns the rest.

Yamauchi said availability of aluminium had changed and supplies could now be bought all over the world.

"In the long term, demand is expected to grow and supply may become tight. Therefore it is important to secure stable sources," he said. "But I don't think now is the time to invest huge energy to make a new national project."

PT Inalum's smelter in North Sumatra produced 251,000 tonnes of aluminium ingots in 2011 and 253,271 tonnes in 2010.

MARKET NEWS

Norsk Hydro sees solid demand ahead as Q2 tops forecast

OSLO, July 18 (Reuters) - Norsk Hydro , one of the world's biggest aluminium makers, said it expected solid demand growth and weak prices this year as it reported a smaller-than-expected drop in April-June core earnings.

Its primary metals unit outperformed expectations in the quarter, compensating for increasing losses in the Bauxite and Alumina division, that was hit by a power outage at its Brazilian Alunorte refinery in addition to low prices.

Hydro repeated on Thursday that it sees global primary aluminium demand, excluding China, up by 2-4 percent his year, after hitting a low in 2012.

Global aluminium production has continued to rise despite prices falling to levels not seen in four years. LME aluminium stayed below $2,000 per tonne during the second quarter.

The Norwegian firm's underlying operating profit fell to 518 million crowns ($86.30 million) from 531 million crowns in the year-ago period, beating expectations for 401 million crowns seen by analysts.

Hydro said it had sold forward around 50 percent of its expected primary aluminium production for the third quarter of 2013 at a price level of around $1,850 per tonne, excluding volumes from its Qatalum plant in Qatar.

LME prices have fallen some 13 percent this year to just above $1,800 per tonne while average daily production outside China at about 70,000 tonnes per day is largely unchanged from last year, according to data from the International Aluminium Institute.

Meanwhile, production in China - the world's biggest aluminium producer - has continued to rise.

Anglo American copper output climbs in Q2, iron ore dips

LONDON, July 18 (Reuters) - Global miner Anglo American posted a better than expected 14 percent rise in copper production in the second quarter, a bright spot in an otherwise tough quarter for the group which saw key earner iron ore dip.

The miner said iron ore production from its Kumba Iron Ore unit fell 1 percent to 11.3 million tonnes - against expectations of a small increase - as its Sishen mine continues to recover from the impact of a crippling strike at the end of 2012.

Platinum, a unit whose troubles have been a focus for Anglo and its investors, saw production edge 2 percent higher to 594,000 ounces.

Anglo's new chief executive Mark Cutifani is expected to update the market next week on his strategic vision for the group after a review set to take in trouble areas like platinum and Brazilian iron ore. Anglo reports half-year earnings on July 26.

ArcelorMittal abandons dormant Indian project

By Krishna N Das

NEW DELHI, July 17 (Reuters) - ArcelorMittal , the world's top steelmaker, said it would scrap a planned steel plant in India due to delays in acquiring land and an iron ore mine, obstacles that have also caused South Korea's POSCO to abandon plans.

The decision to scrap the planned 12 million-tonnes-a-year (MTA) plant in the eastern state of Odisha, comes a day after the world's fifth biggest steelmaker, POSCO, said it was ditching a 6 MTA plant in the southern Karnataka state because of delays in receiving iron ore mining rights and opposition from residents which had held back land acquisition.

The failed projects will be a blow to India's federal government, which on Tuesday relaxed foreign investment rules to draw in funds needed to turn around slowing economic growth and support a weak rupee.

ArcelorMittal India and China Chief Executive Vijay Bhatnagar said the company's other two projects in mineral-rich states of Jharkhand and Karnataka were making "steady progress" and it would continue to pursue them.

The Jharkhand plant is expected to have an annual capacity of 12 million tonnes, while the one in Karnataka is expected to have capacity of 6 million tonnes.

"The delays relating to land acquisition and allocation of captive iron ore blocks means (the Odisha) project is no longer viable," Bhatnagar said.

POSCO said on Tuesday that it would focus on its main steel project for a 12 MTA plant in Odisha.

An Odisha government official said ArcelorMittal had not deposited the required 10 percent value of the 8,000 acres of land it wanted.

"Despite repeated reminders from the state authorities, the company did not deposit the required charges," said Vishal Kumar Dev, chairman of the Industrial Infrastructure Development Corp of Odisha, the agency that facilitates industrial investment.

"The project was dormant for the past two years," he added.

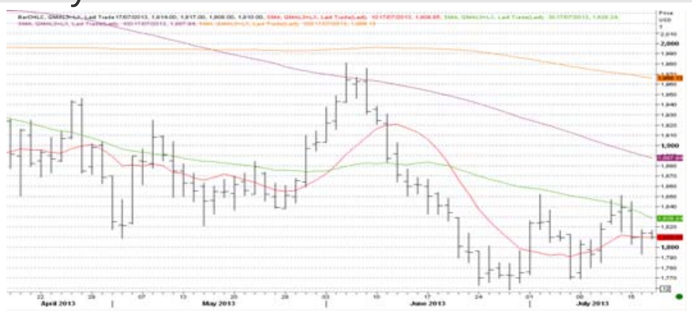
ArcelorMittal spokesman Ritesh Sinha declined to comment on the deposit but Bhatnagar said in a statement the company had invested "considerable resources into the project" over the past seven years.

Industry executives have estimated it costs about $1 billion to set up a plant in India of 1 million tonnes.

"I don't think many people had factored in them continuing with the (Odisha) project," said Neil Sampat, analyst at Nomura in London. Although ArcelorMittal is pulling out of Odisha, its rival POSCO is expected to get an iron ore exploration licence for its planned $12 billion plant in the state, two government officials told Reuters last week.

ANALYTIC CHARTS *(Click on the charts for full-size image)*

Daily LME Aluminium 3-months



Daily LME Copper 3-months

Daily LME Nickel 3-months

Daily LME Zinc 3-months

Daily LME Lead 3-months

Daily LME Tin 3-months

Daily LME Alloy 3-months

Daily LME Nasaac 3-months

MARKET REVIEW

METALS-Copper hits one-week low on Fed stimulus pull-back plans

By Melanie Burton

SINGAPORE, July 18 (Reuters) - London copper eased to a one-week low after U.S. Federal Reserve Chairman Ben Bernanke reaffirmed plans to curtail bond-buying by the end of the year, raising concerns that investors may cut their holdings of commodities.

Bernanke said on Wednesday the U.S. central bank expects to start scaling back its massive bond purchase program later this year, but he left open the option of changing that plan if the economic outlook shifted.

"He is reminding the market that tapering is going to start before the end of the year but that timing is going to be data dependent, so there will be more focus around that which could create more volatility in metals markets," said Natalie Rampono, analyst at ANZ in Melbourne.

"Until the Fed actually starts tapering, we won't see any huge declines... but for copper, prices are already quite low so if anything we could see short-covering rallies in the near term," she added.

Easy-money policies of central banks since the global financial crisis have boosted liquidity, supporting copper and other commodities.

Three-month copper on the London Metal Exchange inched down to $6,866, the lowest since July 10, before paring losses to trade flat at $6,890 a tonne by 0256 GMT after a drop of 1.5 percent in the previous session.

Copper prices have traded in a $6,600-$7,050 a tonne range in the past month, struggling to gain momentum above $7,000 given sluggish growth in top consumer China and summer holidays across much of Europe.

The most-traded November copper contract on the Shanghai Futures Exchange fell 1.4 percent to 49,540 yuan ($8,100) a tonne.

U.S. housing starts and permits for future home construction unexpectedly fell in June, but the decline in activity was likely to be short-lived against the backdrop of bullish sentiment among home builders.

Premiums for copper in China have steadied around $170-$190 a tonne, according to China price provider Shmet, from as high as $210 in late June, while local physical copper has begun trading again at a small premium against the front-month ShFE contract from discounts since late June.

A fitful China growth outlook is also weighing on copper's demand prospects.

China's Premier Li Keqiang urged caution about rushing to change economic policy to try to revive the country's sputtering growth, but he also signalled Beijing was prepared to take action if the economy slips too far.

PRECIOUS-Gold ticks up, Fed keeps up pressure with stimulus view

By Lewa Pardomuan

SINGAPORE, July 18 (Reuters) - Gold inched up after falling more than 1 percent in the previous session, but the metal was still under pressure as investors eye an eventual pullback in the U.S. Federal Reserve's stimulus programme.

Bullion has slipped more than 20 percent this year, losing its safe-haven appeal after the U.S. central bank signalled it would look to rein in its $85 billion in monthly asset purchases later this year and halt stimulus altogether by mid-2014.

The Fed's three quantitative easing schemes have buoyed prices of gold and other commodities. Fed Chairman Ben Bernanke said on Wednesday the central bank still expects to start scaling back bond purchases later this year, but he left open the option of changing that plan if needed.

Gold hit a high of $1,278.86 an ounce and stood at $1,275.61 by 0641 GMT, little changed from Wednesday. Prices were well below an all time high around $1,920 in 2011.

"We should still expect bond buying to be scaled, but maybe not that soon," said Joyce Liu, an investment analyst at Phillip Futures in Singapore.

"We expect to see more downside in gold. I am looking for gold to break below the July 12 low around $1,267 an ounce."

Bernanke will testify before the Senate Banking Committee later on Thursday, but is likely to stick to the theme laid out on Wednesday.

U.S. gold futures were at $1,274.70 an ounce, down

$2.80.

Gold's recent weakness attracted buying in the physical sector, keeping premiums for gold bars steady in Singapore at $2.50 to $3 an ounce to spot London prices. .

But demand from top consumer India has been muted after the government raised its import duty and stopped consignment imports, cutting imports by 81 percent in June.

Bullion is second only to crude oil in India's import bill, which the government wants to cut back to ease the current account deficit and help the weak rupee back on its feet.

"There's some buying, although I wouldn't say the quantity is big. Gold hasn't really fallen a lot anyway," said a physical dealer in Singapore.

"Hong Kong is still doing well, with premiums at $3.50 to $5 because of demand from China."

Physical deliveries from the Shanghai Gold Exchange in the first half of 2013 exceeded total deliveries for all of last year, in the latest sign that demand in China is surging to levels that could take it past India as the No. 1 buyer of gold this year.

In other markets, Asian shares fell as concerns over financing available to property developers weighed on Chinese markets.

MARKET REVIEW *(Continued)*

FOREX-Dollar rises after Bernanke comments, seen staying firm

By Masayuki Kitano

SINGAPORE, July 18 (Reuters) - The dollar rose after remarks from Federal Reserve Chairman Ben Bernanke kept intact expectations that the Fed would be first among the major central banks to move away from ultra-loose monetary policy.

Bernanke, in testimony to Congress on Wednesday, said the Fed still expects to start scaling back its massive bond purchase programme later this year, but he left open the option of altering that plan if the economic outlook changes.

Hiroshi Maeba, head of FX trading Japan for UBS in Tokyo, said he expected the dollar to head higher gradually, given the divergent monetary policy outlook for the United States and other countries.

"But if you ask whether there will be a sudden move higher in the dollar in the near term, I don't see anything that could have that kind of an impact," Maeba said.

The dollar index, which tracks the greenback's performance against a currency basket, edged up 0.2 percent to 82.860, staying above a three-week low of 82.342 set on Wednesday.

Bernanke will testify before the Senate Banking Committee later on Thursday, but is seen likely to stick to the themes put before the House Financial Services Committee.

The euro slipped 0.2 percent to $1.3097 , while the Australian dollar fell 0.6 percent to $0.9177 .

A U.S.-based currency trader sounded a note of caution over about the dollar's outlook, saying some appreciation had already been priced in.

"Any back-stepping by the Fed will cause big waves," the trader added.

The dollar rose 0.5 percent to 100.10 yen .

The greenback is likely to get a lift once the Fed starts tapering its bond buying programme, said Daisuke Karakama, market economist at Mizuho Bank in Tokyo.

"I don't know if it will be September or October, but once the reduction of QE (quantitative easing) starts, U.S. yields will head higher and we may even start to see a clear rise in short-term yields," he said.

Later this year, the dollar may test a 4-1/2 year high of 103.74 yen set back in May, although a rise to 104.00 yen seems unlikely, Karakama said.

One event risk for the yen is Japan's upper house elections on Sunday. Recent opinion polls keep Prime Minister Shinzo Abe's ruling bloc on track for a big win.

That outcome would give Abe more freedom to push forward his agenda to revive the economy through aggressive monetary easing, hefty government spending and structural reform.

While the yen might slip on Monday if Abe's ruling bloc gains a large majority in the upper house as expected, a sustained bout of yen-selling on such an outcome seems unlikely, market players said.

(Inside Metals is compiled by Pradip Kakoti in Bangalore)