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Steelmakers Eye Big Increase in Raw-Material Costs

By ALEX MACDONALD

LONDON—Steel consumers should brace themselves for the onset of much higher steel prices in coming months as steelmakers conclude annual negotiations with miners that may result in steelmaking raw material prices rising by 70% or more in 2010, a large steelmaker said.

"In the final negotiations...the increase that we are faced with is bringing the benchmark price close to the [current] spot price," for both coking coal and iron ore, the person at a large steelmaker said.

He said steelmakers will likely have to accept iron ore prices that are 70% to 80% higher than last year's benchmark prices and coking coal prices that are 80% to 100% higher than last year's benchmark prices.

"We definitely feel that our negotiation room to get to a much lower price...is not very likely. The iron ore sellers are shifting more volume to spot market. They tell us they don't want to go for an annual contract. The longest period they want to give is [around] a quarter," he said.

Paul O'Malley, chief executive at Australia's largest steelmaker, [BlueScope Steel Ltd.](#), said he expects iron ore contract prices could jump 60% or more in this year's round of negotiations.

Industry analysts at the high end of market consensus were eyeing 40% and 55% price increases for iron ore and coking coal, respectively, according to a Dow Jones Newswires survey of 19 analysts carried out in January.

Gordon Moffat, Secretary General for Eurofer, the European steel body that represents steelmakers such as the world's largest steelmaker [ArcelorMittal](#), [ThyssenKrupp AG](#), and Corus, the European arm of India-based [Tata Steel Ltd.](#), said a potential near doubling in raw material prices is "something that is definitely on the table. It's a possibility."

"Customers have not yet realized the impact that this will have on them," Mr. Moffat said. "We need to make it clear that it will have a huge impact on our cost level and that it will have a huge impact on steel prices." Mr. Moffat added.

He said that a 40% price rise in raw materials now appeared to be a conservative figure for the steel industry.

Steelmakers will have to pass on the higher raw materials costs to their customers in order to maintain healthy operating margins at a time when many steelmakers are still struggling to recover from last year's economic downturn, which caused key steel customers in the automotive, appliance and construction industries to pare back orders. Steel demand is beginning to recover, largely driven by the emerging markets, but steelmakers are still mired by excess production capacity and weak demand particularly in developed markets such as the U.S. and Europe.

Steel prices may have to rise by a minimum \$160 a ton for hot-rolled coil from April 1 to cover the higher costs, the person said. In Europe, prices for hot rolled coil could rise to EUR550 a metric ton from EUR400 a metric ton in the fourth quarter of 2009 in order to cover costs.

The price rise "is not demand driven, it is cost driven," he said.

The world's largest steelmakers in Asia and Europe are currently locked in annual price negotiations with the world's largest iron-ore miners—Brazil's [Vale SA](#), and Anglo-Australian miners [Rio Tinto PLC](#) and [BHP Billiton Ltd.](#)—in order to determine prices for iron ore and coking coal that would take effect for from the start of the fiscal year beginning April 1, 2010.

The negotiations usually set raw material prices for the rest of the steel industry although for the first time last year, Chinese steelmakers and the miners were unable to settle upon an annual benchmark price. The two parties agreed on a provisional price based on a 33% cut in benchmark prices with Japanese steelmakers.

Iron ore miners such as BHP and Vale have indicated to steelmakers that they expect prices to rise sharply due to burgeoning demand from emerging markets such as China, the world's largest steel consumer, and the fact that large iron ore miners are operating near 100% of their available capacity. They have also indicated that they want to move away from an annual price benchmarking system to shorter-price contracts based on spot prices.

BHP declined to comment on the price rise but confirmed previous comments that it was in favor of a shorter-term pricing system that took into account spot prices. Rio Tinto and Vale weren't available to comment on price rises, although Vale's head of ferrous metals, Tito Martins, previously said he expects customers who want a benchmark price to pay close to the spot market price.

Spot prices for iron ore fines of 62% ferrous content delivered into China have more than doubled to \$131.20 a dry metric ton compared to \$59.10 a dry metric ton in March 2009, according to The Steel Index. The price includes freight and insurance costs. Excluding freight and insurance costs, the price would be tantamount to about \$110/ton, 83% higher than benchmark iron ore price of about \$60/ton in 2009.

Meanwhile, spot prices for coking coal are hovering at \$200-\$250 a dry metric ton compared to the 2009 benchmark coking-coal price of about \$129/ton, free on board, the person at the large steelmaker said.

The steep price rises are largely due to the fact that steel demand is expected to rise above pre-crisis levels to a record high in 2010, largely due to strong demand in emerging markets such as Brazil, India, and China, according to steel consultancy MEPS International Ltd.

Customers in developed countries such as the U.S. and Europe are also expected to place more steel orders, partly due to depleted inventories and slight pickup in end-user demand, but they are more likely to feel the pinch from rising steel prices because the U.S. and Europe are still facing a fragile economic recovery compared to emerging markets where growth is robust, the person said.

"The key message (is)...customers and the steel industry have to get used to this new reality," the person at the large steelmaker said.

Eurofer's Moffat also said the price rises are an indication that pricing power in the iron ore market is too concentrated in the hands of the top three miners. Vale, Rio Tinto and BHP accounted for nearly 70% of the 2008 iron ore trade that was shipped overseas.

Moffat called upon the European Commission's antitrust authorities and other relevant competition authorities to take note of the steep price rises as another reason to oppose the proposed production joint venture between BHP and Rio Tinto. Both miners want to merge their mining operations in the Pilbara region of Western Australia, but said they would continue to run their marketing operations independently of each other and the joint venture. Moffat urged

regulators to oppose the joint venture on the grounds that it will concentrate the top three miners' pricing power even further.

Raw material prices are already forecast to remain high beyond 2010 since miners have shelved many of their expansion projects during the recession and are only now beginning to restart their expansion programs. A production joint venture will likely entail joint coordination of investment and expansion activities which could adversely affect capacity growth in the iron ore market, Moffat said. It would also give both companies the same cost base from which to negotiate future iron ore sales.

BHP and Rio said the joint venture would enable BHP and Rio Tinto to deliver more ore to the market faster and at lower cost by unlocking the synergies between their two businesses. The companies expect to generate \$10 billion in savings by combining operations.

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