Metal Bulletin Research

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Whitepaper

MBR's Outlook for 2015

Metal Bulletin Research summarise their outlooks for the metal market by sector

next

Metal Bulletin Research's Outlook for 2015

In this one-off whitepaper, Metal Bulletin Research (MBR), the forecasting division of Metal Bulletin, summarise their outlooks for the metal market by sector:

Steel

Steel Raw Materials

Tube & Pipe

Non-Ferrous

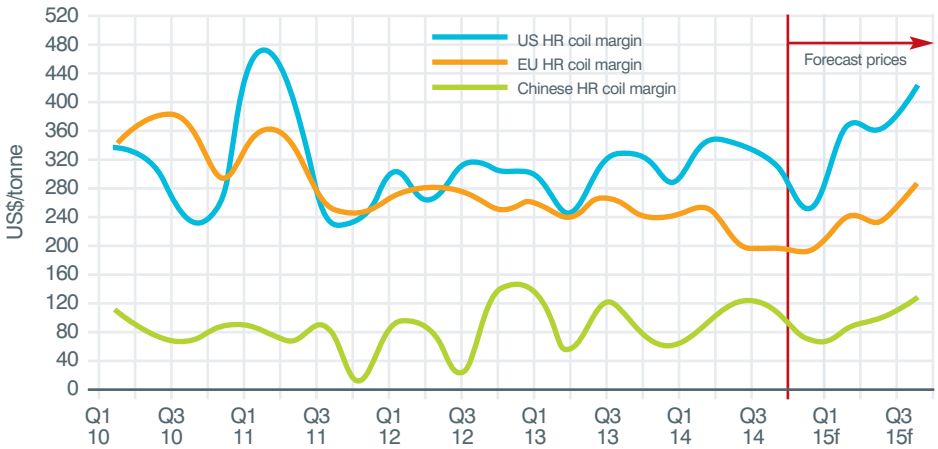
next

Global Steel Outlook

Steel producers' margins should rise with improving demand

Last year, Metal Bulletin Research's core expectations that operating margins would rise at the world's steelmakers given a likely improvement in apparent demand conditions proved largely correct, even if they struggled to beat a growth rate of 2%. Margins rose strongly in the USA, even as US producers saw the negative effect on sales of their aggressive, more consolidated pricing policies. Cheaper imports invariably increased their market share or import penetration and especially for cold-rolled (CR) coil, much to the relief of Asian and latterly even European exporters whose demand at home was not so impressive. Indeed Chinese apparent steel demand actually fell last year and by over 3% by our own estimations, and along with it prices of most steel products. Again, however, margins at steelmakers improved. A 50% rise in finished steel exports clearly helped mills maintain high and efficient operating rates at their plants though the margin gains were mainly a result of the sharp fall in Chinese raw materials costs, given an unusual battle between the now numerous and larger iron ore producers competing for Chinese demand. Margins failed to meet our expectations in European long products, despite slightly better demand conditions but this related more to increasing competition from Turkish and Chinese exporters keen to branch away from their core but often disappointing domestic and export markets. European exports, meanwhile, were also hampered by competition from CIS-based suppliers whose currencies fell even more sharply against the US dollar, boosting their competitiveness. While this year has started with the remnants of destocking in the more active markets of China and the USA and sentiment has clearly weakened for many important steel using industries, and especially tube & pipe, one of the largest consumers of hot-rolled flat products, our overall outlook continues to improve. Indeed construction, by a distance the most important steel-using industry, is still predicted to have the biggest growth year since before the recession, driven by a surge in the USA and gathering momentum in much of Europe and the rest of the world. Manufacturing activity, more important than construction in the mature markets such as Japan, is also expected to remain firm, which suggests that most flat as well as long products demand should revive. Clearly improving demand for steel should support prices and drive demand growth for raw materials, but as with last year, it is the outlook for raw material supply that will determine their price direction. Overall it should be another year for steelmakers to further boost, or in most cases recover, their margins.

HR coil margins over scrap* in key producing market ($/tonne)



Source: Steel Tracker. Note: * New arising scrap in USA and EU but hot metal in China

North American Steel Outlook

US HR prices for 2015 forecast to be well below recent annual averages

The downward pricing correction in US sheet prices that began late in the third quarter persisted through December, and if anything is gaining pace as the weeks progress. After averaging $620-650/ton in November, HR prices slid throughout December, averaging $600-620/ton for the month. Early 2015 has seen further weakness, with HR prices sliding to below $500/ton in early March. CR prices have shown a similar trend, drifting to around $700-720/ton in mid-January $620/ton in early March, down from an average of $740/ton in December.

The outlook for prices at present is clearly negative, reflecting short domestic mill lead times, elevated inventories, high imports, a strong US dollar, falling raw material prices, declining energy prices, and in turn, reduced demand for steel from the energy sector. There are also uplifting factors in the market, though these are for now overwhelmed by the downward factors. The US economy is rising at an impressive pace, as reflected in the latest upward revision to third-quarter GDP. Declining oil and gas prices, while reducing demand for steel from the energy sector, are also reducing steel mills' production costs, and are driving higher demand for large steel-intensive SUVs as buyers see prices at the gas pump declining. Lower fuel prices will also boost consumer spending during 2015, with estimates that US consumers will save $50-75bn this year on fuel relative to 2014, or around $550-750 per household.

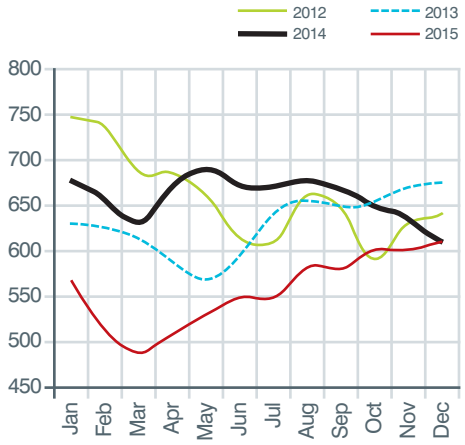
While we expect depressing price factors to outweigh uplifting influences in the near term, with downward pressure on prices likely to persist through much of the first quarter, we equally believe that at some point, a supply-side shock will trigger a pricing rebound. We cannot forecast the timing of this development precisely, given the 'shock' element, however, we believe this event could be triggered by a variety of factors, for example, severe winter weather, as we saw last year, unplanned mill outages, or the filing of an anti-dumping case against CR and/or other sheet products. Again, the timing and the exact nature of the trigger is unknown, but as we have seen in past pricing cycles, actual or perceived disruptions to supply generally enable domestic steelmakers to quickly regain pricing power and reinstate upward pricing momentum.

While we expect the downward spiral in flat product prices will continue for the next several weeks, prices likely have at most only a further $20-30/ton to decline before bottoming out. March/April is our target for a potential price recovery, as domestic mill production cuts help prices to find a floor before the first quarter draws to a close.

For 2015, we are forecasting average annual domestic HR prices at around $590/ton, marking the lowest average pricing level of this decade. While the outlook initially could be perceived as quite gloomy, we believe lower costs this year will help mills maintain reasonable margins despite the finished product price decline relative to the recent past.

Prices could undershoot our forecasts in the absence of any domestic steel production cutbacks or other supply-side disruptions, as well as a decision by steelmakers not to pursue any trade action this year. We believe prices could overshoot our forecasts if there is a sudden rebound in Chinese iron ore demand, and steel production and consumption within that nation, triggering higher raw material costs globally. An array of US anti-dumping case filings and/or significant supply-side disruptions could also send prices well above our base-case forecasts for 2015.

US domestic HR price comparison 2012-2015f ($/ton)

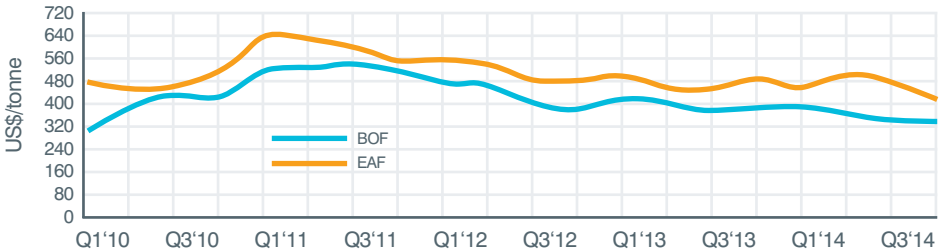


Global Steelmaking Costs Outlook

2014 proved to be a rather volatile year for steelmaking costs and the related business decisions that steel producers made. In Europe, in particular, but as far afield as China and even the comparatively robust USA, plants continued to be idled and even shut down amid a low demand and low steel price environment and Eurofer, the body which represents European steel producers, revealed just how small the region's production capacity would become in the next few years unless the EC sorted out its comparatively high, and they argued, unfair energy costs; at least before oil and related natural gas costs fell towards the end of the year. Our steel cost service revealed, however, that even in the first half, steel producers not only in Europe but across the world had a comparatively good year and this was thanks largely to the most important element in steelmaking costs: that of raw materials.

Frankly through no obvious prudence of their own, at least during 2014, steel producers were able to benefit from an unprecedented battle, largely among Australian, and to a lesser extent Chinese and Brazilian suppliers of iron ore, for Chinese demand. Though Chinese demand increased, mainly because of a recovery in steel demand in Chinese steel export markets, the growth was dwarfed by iron ore supply and the resulting collapse in iron ore prices, of around 50%, proved far sharper than the related steel price declines. Indeed according to our own steel and steelmaking raw material indices, 2014 effectively put an end to the previous six-year trend of raw materials outperforming steel. The beauty for many steel producers, was the index system, such as at Bluescope Steel in Australia, where the month-on-month change in iron ore prices in China was directly applied to their own purchases. Other mills still operating two-three month rolling averages also benefited directly as iron ore prices collapsed. By product, however, our steel cost service also revealed the clear distinction in performance between different traded steels. Unsurprisingly, given the impact of iron ore, merchant pig iron producers had the most to benefit in 2014 as they successfully avoiding dropping prices until later in the year. In our Q3 2014 report, their margin on sales peaked over 50%, far higher than any steel product downstream. Nevertheless, downstream steels also managed to retain their value, as the underlying demand growth for consumer durables such as cars and washing machines accelerated through the mature steel markets and remained firm, at least when compared to construction steels, in emerging markets such as China. Packaging industries also provided a persistently high margin for the world's tinmill producers. For the construction steel products, such as for bar, rod, and plate, where the mills are often more scrap and pig iron dependent, margins were understandably squeezed by comparison though innovative techniques to reduce exposure to scrap and roll billets produced in China and the CIS at certain times ensured that bar mills were generally profitable. This year, we believe scrap and pig iron suppliers will respond to the competitive threats offered by their rivals whilst at the same time, our latest forecasts suggest construction steel demand will rise at its fastest pace in more than a decade, not so much in China but in the USA and farther afield. 2015 could thus be another volatile year but at the outset there are prospects that long products producers can catch their flat-rolled rivals.

Average operating costs to produce one tonne of steel by process ($/tonne)



Source: Steel Cost Service

Global Steelmaking Capacity and Expenditure Outlook

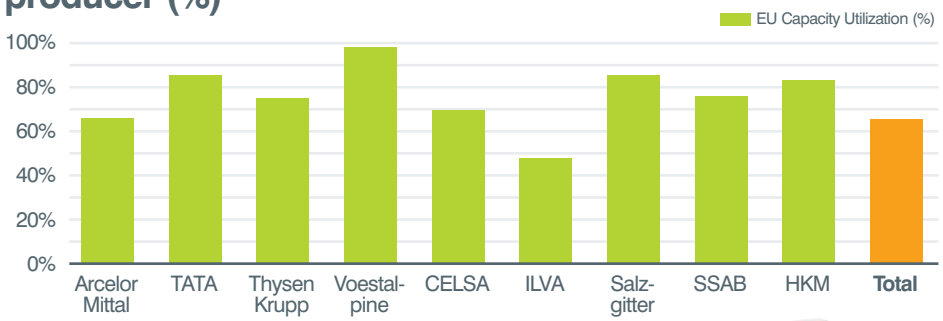
Steelmaking capacity continues to surge

One of the more unusual developments being witnessed in global steelmaking capacity is that for all the highly publicized closures of crude capacity over recent years, particularly in mature markets such as at US Steel Hamilton's works in Canada or at Outokumpu's Krefeld works in Germany, we continue to find that overall, it is still rising year after year, and by a rapid degree. According to the World Steel Association (WSA), global steelmaking capacity utilization, among the 65 reporting countries, slipped to the lowest levels all year at just 72.7% points in December 2014. Though the capacity data was not published at the same time, this rate implies an annualized capacity of 2.16bn tonnes today. In 2013 , the WSA believes that the equivalent capacity utilization figure was much higher at 75.1%, which we can calculate as generating an annualized capacity figure of 2.09bn tonnes. So while steel output may be stabilizing year-over-year, having only risen by a provisional 1.1% (by just 0.9% in China and by 1.4% elsewhere), available steelmaking capacity has increased by closer to 3.5%; as much as 72.3m tonnes. To be fair to the world's steelmaking investors, MBR had predicted that steel production would rise by about that speed this year, expecting Chinese demand merely to slowdown, rather than retreat as it has done, if only temporarily. Nevertheless, this is certainly not the first time that steelmaking capacity has been rising faster than production. Indeed in 2012, capacity had reached an annualized total of 1.98bn tonnes by December of that year, effectively showing that global steelmaking capacity rose by close to 113.2m tonnes last year when production, over the same period, had risen by just 68.5m tonnes. The point being made here is that while the net additions to steelmaking capacity are retreating (from 113m to 73m), they are not falling nearly quickly enough and the gap between capacity and production growth is widening rapidly from 1.6 in 2013 to 2.8 times production in 2014.

So will the world's steel industry try to do something about it?

Well, given that the battle to supply raw materials has become even more intense than the battle to supply the world's steel, the agenda to reduce the "oversupply" has become a little more muted of late as producers find that their profitability is on the rise. Isolated examples aside, we can all acknowledge that low utilizations, such as those in Europe see chart, are a recipe for poor prices and clearly if, as we expect, the battle for raw materials begins to diminish as only the most profitable players survive, steelmakers will need to take more control of their own profligacy. This is clearly still a long-term development for them as next year, according to our latest Steel Capacity and Capital Expenditure database, we have identified a gross addition of 119.440M tonnes coming on stream and over 100M tonnes more through the following three years. Though less than half of this will be available to producers, given different start up and ramp up times – it takes a full year to reach full capacity – it is hardly conducive to bringing tightness to a market, where the demand outlook, though improving, has its increasing share of downside risks.

Crude steel capacity utilization in Europe by leading producer (%)



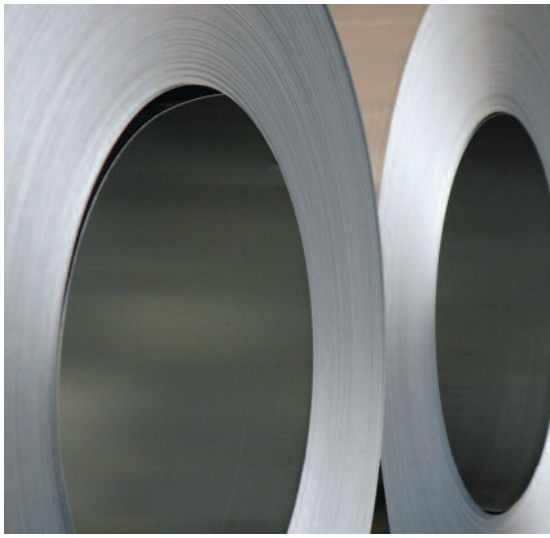
Global Tinplate Outlook

This year has seen tinplate mills in industrialized countries adjusting to the size and form of their mature domestic markets and to the loss of exports markets they enjoyed before the development of tinning capacity in consuming areas where markets are still growing. The predominantly integrated tin mills of the USA and the EU have rationalized and modernized capacity and after years of declining output their markets are in better balance. Prices should stabilize in 2015.

Japan still has substantial tinplate capacity; South Korea and Taiwan rather less; China's capacity is large and growing. There are two main sources of downward pressure on prices in the market in eastern Asia: overall excess capacity and the low prices offered by non-integrated mills that buy re-roll HR coil which they double reduce for substrate. They serve the lower grade end of the market but their low prices influence other tinplate prices. Baoshan Steel, China's biggest tinplate producer, has tried and failed to control these non-integrated suppliers; these will continue to pose a threat to full cost tinplate prices, especially in a year when coil prices are likely to be weak, as they will be in 2015.

Asia also has several stand-alone tinning lines, that buy ready substrate "black plate" or "loam" plate; they usually support higher prices. Some were established in tin mining countries such as Thailand, Malaysia and Indonesia in order to maximize income from local mineral resources. Most obtain substrate from Japan. The prices they bid for loam plate reflect their competition with imports, including competition with priced Chinese non-integrated mills but they have a degree of protection.

It is common for peaks in demand for high grade food quality tinplate to coincide with major harvests, industrial scale fishing seasons and so on. Extra orders in China are generated by demand for fancy gift boxes before Lunar New Year, but excess supply will make it unlikely for prices to rise in the coming quarter. Agribusiness and fishing industry demand are likely to support firm prices in the middle of the year, but prices are likely to fall in the later months.



Global Stainless Steel Outlook

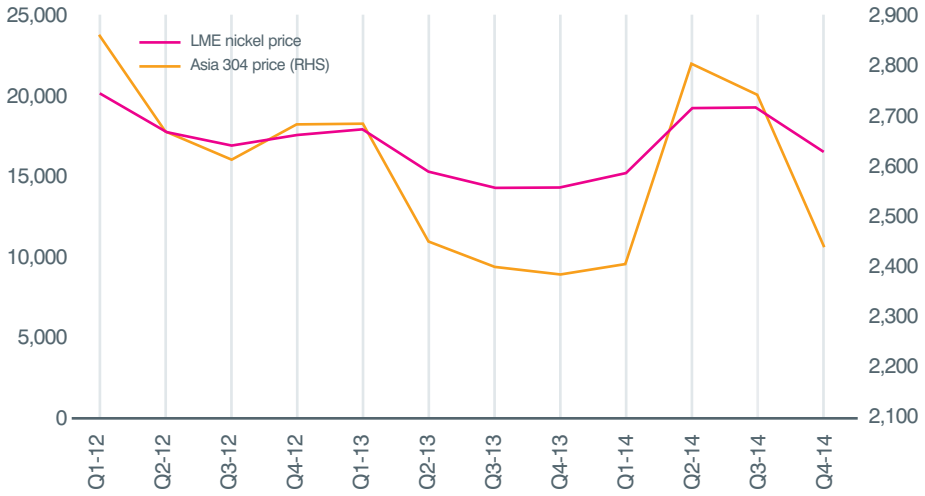
Any outlook for grade 304 stainless steel must incorporate a view on nickel prices. As such, with MBR expecting average nickel prices to head up toward $20,000/tonne this year (up from an average of around $17,000/tonne during 2014), we would expect average prices of grade 304 stainless steel to increase as well.

Outside of this obvious impetus for prices, stainless steel producers worldwide should benefit from tighter supply/demand fundamentals. Capacity cutbacks will continue apace in Europe, with the region's largest producer, Outokumpu, set to close its 800,000 tonne facility in Bochum, Germany during the second half of next year. Elsewhere, US demand strength will help producers there to maintain higher capacity utilization rates.

The wildcard of course remains China. Consumption growth here is set to slow in the coming years, as indeed it has done during 2014. Over the last 12 months, Chinese producers have resorted to shipping their excess material elsewhere, leading to an increase in China's net export position of almost 80% when compared with 2013. This has understandably caused tensions, particularly with the EU, who may impose anti-dumping duties on Chinese material at some point during 2015. This may be the key factor in determining whether the world's stainless steel producers will increase their price-setting power on grade 304 products during 2015, or whether they will continue to remain at the whim of the nickel market.

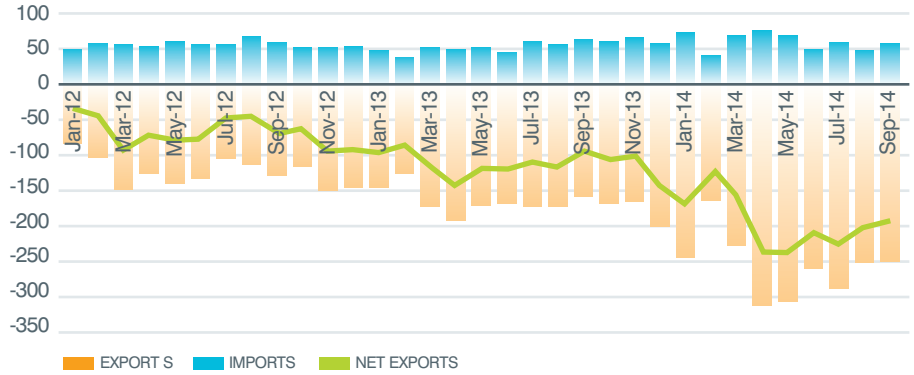
LME nickel price vs. Asia 304 price ($/tonne)

Despite falls toward the end of 2014, MBR expects nickel prices to move higher during 2015



Source: MBR

Chinese stainless steel trade data ('000 tonnes)

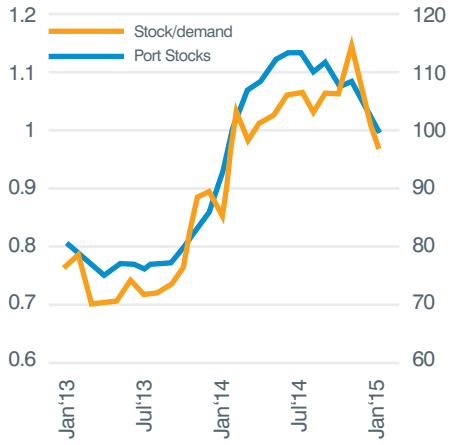


Global Iron Ore & Coking Coal Outlook

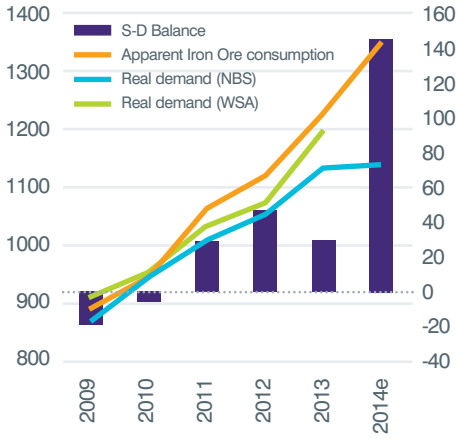
MBR expects that iron ore prices will remain at comparatively low levels throughout 2015, as Chinese demand, which is the destination for close to 70% of seaborne supply, is predicted to slow. In fact, China's pig iron production may have peaked in 2014 although early indications from CISA-member mills, who consume the vast majority of China's iron ore, reveal that production has actually accelerated on a year-on-year basis though the outlook is not so promising seeing as finished steel production has been stabilising at the same time. Chinese steel demand has been decelerating rapidly since 2013 and though export growth has continued to support Chinese steel production and resulting iron ore demand, we highly doubt that this situation can continue. The Chinese government seems particularly determined to restrict the exports of long products and has reduced the preferential tax rebates associated with them, which is bound to restrict volumes in the short term. While some end-user demand indicators are outperforming expectations – Chinese automotive production rose by more than 11% in January – we accept the predictions of the Chinese institute CAAM and independent forecasters, the OEF, that such momentum cannot continue; not least as increasing numbers of metropolitan areas look to encourage public transport and reduce urban pollution caused by increasing automotive use. We expect Chinese manufacturing demand to slow, though not outright decline as the latest PMI statistics have suggested so far and so inevitably the best demand conditions for iron ore and metallurgical coke are to be found in the rest of the world, even though actual consumption outside China trails China by a distance. Global economic growth is predicted to accelerate this year and with it the industries which drive steel consumption but iron ore and coke's particular dependence on China damages the outlook for the sector, especially as China's scrap consumption, albeit from a comparatively low level – it's smaller than Europe's – is further impacting Chinese demand for iron.

Nevertheless, iron ore supply is something the market can worry less about in 2015. Unlike 2014, when more than 160M tpy of new capacity flooded the market, boosting surplus stocks in China (see chart), 2015 will witness a milder net increase in supply. On one hand, though major suppliers are pressing on with their expansion plans, the pace is a lot slower and volume much smaller; on the other, more displacement will be seen in 2015 that includes high-cost seaborne supply from junior miners and Chinese domestic supply. And thus while muted, prices should find support and in our view move comfortably above their current levels.

Chinese port stocks vs. Chinese port stock/ demand ratio, months of demand on hand



China's iron ore supply/demand balance (RHS), Mtonnes



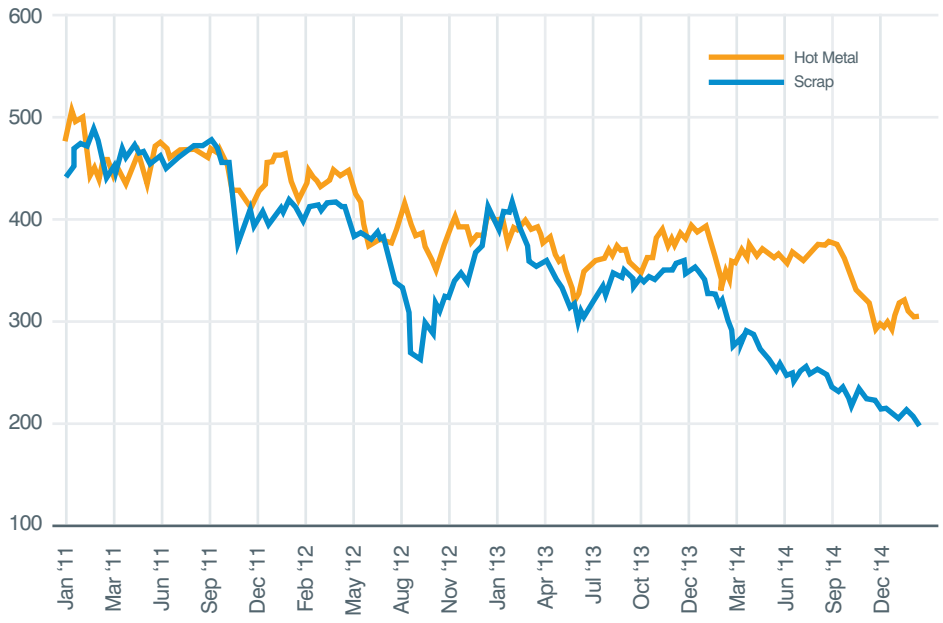
Global Steel Scrap & Metallics Outlook

MBR anticipates that international scrap and metallics benchmarks will be prone to marked downside risks through 2015, as comparatively high supply availability will be exacerbated by at least initially slack demand. We believe scrap and metallics prices are currently overvalued compared to alternative steelmaking raw materials costs in major consuming markets, even after the dramatic falls recorded in early February. As a result, MBR expects electric arc furnace steel producers, in particular, will continue to battle for heavy discounts on scrap, merchant pig iron and DRI/HBI costs to improve their competitiveness.

Hot metal production costs have become more competitive over the past year, given that iron ore prices have slipped to around $62/t, CFR Qingdao, in early February, compared to $140/t at the end of 2013. In fact, the value of an iron unit in iron ore fines versus the equivalent in scrap has deviated away from its long-term mean. If we assume that scrap is a substitutable form of pure iron (produced via blast furnaces), the long-term average value of an iron unit in scrap has been 1.95x that in iron ore and just under 2.10x since 2010 (see chart). This ratio currently stands at up to 2.8x in Asia; suggesting scrap prices are overvalued compared to current iron ore pricing levels. Indeed, this high value has already supported the strong growth in (non-China) Asian integrated (BOF-route) production and the decline in mini-mills (EAF-route) output over the past year. It has prompted some minimills to re-roll blast furnace produced billet or slab rather than melting relatively expensive scrap to be more competitive.

While US minimills had more than enough demand last year to increase production – integrated output by contrast fell – a strengthening US dollar threatens more competition this year. Mini-mills are dropping steel prices frequently to protect market share and scrap suppliers, struggling with the dollar to be competitive abroad, have slashed prices to support their consumers' margins. We believe US scrap-intensive electric arc furnaces will face further competition from abroad and expect local integrated producers to have another challenging year from some of these lower-cost semi-finished and finished steel producers but so long as hot metal costs rise, scrap demand and prices may soon find support.

Hot metal vs. scrap costs in Asia (US$/tonne)



Global Ferro-Alloys Outlook

Ferro-silicon supply is tighter than for most other ferro-alloys, lending support to prices. In addition to reduced Chinese and Brazilian supply, several European producers have been affected by energy and environmental issues in recent months. Reduced supply will continue to support the ferro-silicon market in early 2015, with the northern hemisphere winter leading to further supply restrictions in the near term. European ferro-silicon prices are expected to trade in a narrow range in the short to medium term in line with subdued demand from steelmakers cautioned on erratic currency movements in the euro/dollar rate, while political stability worries persist in Ukraine and the Middle East. European demand seems satisfied for melt rates in the next few months, while the recent slump in the Russian rouble means replacement costs for Russian ferro-silicon look to be good value. Inflows of Russian material will likely be a factor in the USA as well. The dismissal of the US anti-dumping case against Russian and Venezuelan imports will see resumed shipments of ferro-silicon from these nations to the USA in the near term, but we do not expect this to disrupt the market given underlying supply tightness and expectations of further growth in US steel demand during 2015. In China, steel production has continued to increase since November but demand is showing no signs of recovery, and ferro-silicon prices are set to linger at low levels.

There are no indications that the upward momentum in global silicon metal prices will reverse in the near term. In fact, supply shortages are expected to become more pronounced as the northern hemisphere winter season progresses. Chinese output will be negatively affected by rising power costs, while we will also see European producers take outages, such as Ferroatlantica's normal first-quarter furnace closures in France. Demand from the automotive sector, particularly in North America, shows no sign of slowing, and will continue to prop up demand for aluminium alloys, and in turn, silicon metal. Demand from the solar industry also remains buoyant, with reports of shortages due to strong polysilicon demand. Chemical sector demand is also rising, however, this is one area that could be vulnerable given declining oil prices. Oil-based products and silicon-based silicones products compete in numerous chemical industry applications, and declining oil prices versus rising silicon prices could prompt some shifting away from silicones towards oil-based products, dampening demand for silicon metal. We have not yet heard that this shift is occurring, but it is a potential trend to watch.

Ferro-manganese, and to a lesser extent silico-manganese, markets have proved disappointing over the past year, as ample supply has overwhelmed less than impressive growth in crude steel output. We expect this supply-demand imbalance to continue to impede manganese alloy prices during 2015. Manganese alloy prices are poised for further declines in the near term due to muted demand from domestic steelmakers across Europe. The biggest exporter to Europe recently has been South Africa, where suppliers have been selling aggressively. The weakening rand is making South African exports increasingly competitive in Europe. Moreover, there has been no interruption of supply from Ukraine amid the political and security unrest in the eastern part of the country, with Ukrainian manganese alloy output in fact rising in 2014. A weakening euro coupled with the potential for duties against imports of Indian silico-manganese should create an environment in Europe in which prices can rise. The practice is different to the theory though, as prices look likely to hold steady at best, and at worst, fall even further. Chinese manganese alloy markets are struggling amid sufficient stocks and weak demand from steelmakers. US steelmakers are struggling with a slip in demand for their finished products and increased import competition, prompting steel mills to reduce operating rates.

The early-year restocking of raw materials at Europe's stainless steel mills has either come too late or is too feeble in its magnitude for the world's major ferro-chrome smelters. Recent weeks have seen South African ferro-chrome producers give in to demands by Europe's stainless mills to reduce the quarterly charge chrome contract price for the first quarter of 2015. First-quarter contract prices have been agreed down $0.07/lb to $1.08/lb, the lowest level in five years. With ferro-chrome smelters offering ever-larger discounts on contract prices, contract buyers are now receiving material at price levels similar to those seen on the Chinese spot market, at $0.80/lb. This Chinese spot price has stabilised, however, and MBR believes it will be difficult for a large number of ferro-chrome producers to make money much below this level. Further price falls are likely to be limited, unless discounts are reduced. Indeed, if discounts were removed entirely, the contract price could still fall significantly.

The nickel market is at an interesting juncture where the supply outlook is set to get increasingly bullish later this year and for a few years to come. The root of the tightness comes from Indonesia's ban on ore exports just over a year ago, but due to the ban being well telegraphed the Chinese stockpiled and the Philippines added capacity. These actions have delayed the impact of the Indonesian supply cuts as Philippine ores have been blended with the higher grade Indonesian ores that were stockpiled at Chinese ports ahead of the ban. However, the essential Indonesian ore stockpile is running down and, once depleted, falling output of nickel units from NPI production in China will need to be replaced with other types of nickel, including LME-grade material. Considering some 450kt of nickel units have come from NPI in recent years, the gap from lower NPI production is likely to be significant over the next few years. We think the market will start to get bullish when the upward trend in LME stocks turns into a downward trend. Nickel prices have remained volatile in recent weeks, and have now returned to the upper levels of the base area where they were trading before last year's March-May ballistic rally. Having eroded all of last year's gains, it does suggest that last year's enthusiasm has now been washed out of the market, resetting sentiment more in line with the current fundamentals. These have weakened given how much metal has come out of China following the Qingdao port scandal, as seen by the rise in LME stocks. That said, while the current fundamentals might be far from bullish, the future fundamentals still look set to tighten, so it will now be a case of when the market starts to anticipate this.

The molybdenum market has not had a good start to the year as far as pricing is concerned. There has been general weakness in most markets, with prices for ferro-molybdenum in Europe dropping to below $20/kg. The market is incredibly quiet, with very little trade taking place. MBR sees no reason for this to change in the near term. There could well be a widening gap between bids and offers as trading activity slows down, and buyers and sellers struggle to see eye to eye. The US market began the year with prices rising 2% initially, but these prices too have now slipped to below $10/lb. We expect prices to hold steady at these levels in the short term. Any pricing gains during 2015 will only return prices to levels justified by the underlying supply-demand balance. With new molybdenum supply coming onstream, the

Global Ferro-Alloys Outlook (continued)

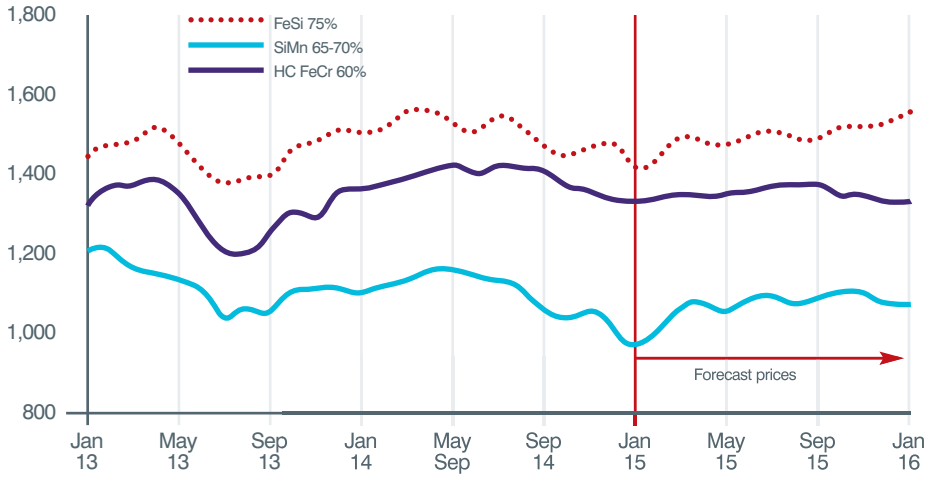
market will trend to over-supply for the foreseeable future, dampening prices this year.

Ferro-vanadium traders have noted an inconsistent trading pattern in recent weeks in Europe and consequently have difficulty in taking a position for any business outlook in the coming weeks and months. European ferro-vanadium prices resumed losses in January, with the bulk of business easing to around $21/kg, with a handful of smaller lots trading 5-10 cents either side of that range. Short-term indicators appear bearish, while some sources have noted an increase in offers of material from several smaller Chinese producers. Chinese 80%-grade ferro-vanadium export prices have fallen sharply in January due to slow demand and a similar trend in the domestic market. Export prices are likely to fall further as that trend looks set to persist, while production costs have also been getting cheaper and the RMB has been weakening versus the dollar. Chinese vanadium is in surplus supply as domestic producers have been producing at a substantial rate despite weakening demand. The US ferro-vanadium market has been steady, hemmed between tight supplies and slow demand for nearby delivery. Spot market buying should be slow right through February after destocking in December, while steelmakers appear content to use their raw material stocks for the time being. A shortage of nearby supplies, with producers well sold in quarterly contracts, has ensured that availability is tightly controlled, and as such is supporting prices.

European ferro-tungsten prices have continued their retreat again this month, following stock liquidation and reduced demand from steelmakers in recent weeks. The market may be bottoming out, however, after a recent improvement in Chinese concentrate prices, although dealer caution is stymieing activity. In China there has been slow business in early 2015, prompting some producers to halt production. We understand several producers in Hunan province have received no new orders so far this year and will shut down early for the Chinese New Year Holiday between 18-24 February.

The Chinese government announced in January that export duties on rare earths will be cancelled on 2 May 2015, with the same expected for tungsten as China intends to comply with WTO rules. The current export duty on ferro-tungsten is 20%. If the export duty is removed, foreign shipment levels should recover and illegal trading should thin to virtually nothing. A slowdown in economic activity in China, added to the arrival of the Hemerdon tungsten project in southwest England and smaller tailings operations, particularly in Australia, should cap tungsten prices in 2015.

Historical and forecast European ferro-alloy prices ($/tonne)



Global Industrial & Structural Tube & Pipe Outlook

Industrial and Structural tube and pipe markets mixed outlook in 2015

A struggling economic outlook in both China and Europe is weighing down on the outlook for industrial and structural tubes demand here into 2015. Major over-capacities in the European market remains a further driver to prevent significant recoveries in this market into 2015.

There are some brighter spots, with demand for precision seamless and welded tubes from the automotive markets likely to hold-up in 2015. Indeed, the benefits of exceptionally low oil prices could eventually work through the system to the end-user prompting rising consumer spending in the EU. In turn, this could see automotive and industrial output potentially start to trend-upwards later into the year. There remains though a number of political events in 2015 which could stifle demand improvements in the precision markets.

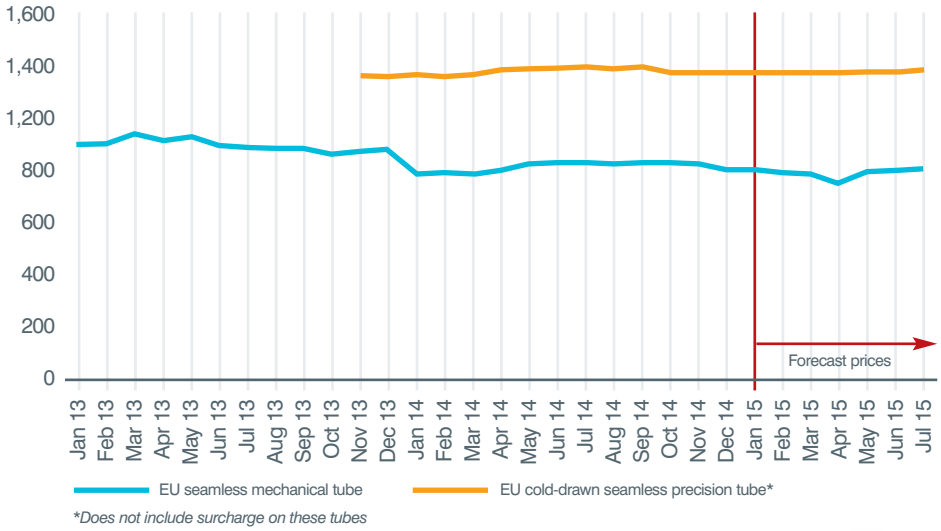
Some respite to local European industrial and structural producers could come if the dollar continues to strengthen against the Euro making it difficult for a number of tubular imports from countries such as Turkey to remain competitive in Europe. The rapidly falling currencies to the East in Russia and the Ukraine are though cause for concern in the EU and this could contradict the benefit of a strengthening US dollar as Russian and Ukrainian industrial and structural tube producers see the EU market as attractive even with import duties in place.

In the USA, consumers are already benefitting from lower oil prices resulting in rising confidence and spending. Automotive purchases will continue to drive manufacturing output gains as consumers relieve pent up car demand while fuel efficiency becomes less of a concern in the decision-making process. The strong dollar, however, will limit manufacturers' ability to export and provide competition on the home market for sales.

Output, and ultimately mechanical tubing demand, could be constrained. Import penetration in the tubing market will likely grow as well, offsetting at least part of the domestic shipment gains from rising demand.

Construction tubing demand still lags that of mechanical tubing demand, although the steady growth experienced late last year is expected to continue through 2015. Again, import competition will put a lid on price appreciation.

EU seamless drawn and non-drawn mechanical pipe prices (€/tonne)



*Does not include surcharge on these tubes

Global Welded Linepipe & OCTG Outlook

Global linepipe momentum may slow in 2015

By mid-2014, the global large-diameter linepipe markets were showing signs of growth following more than a year of weak demand. In North America, demand for natural gas infrastructure especially in the eastern USA, and Mid-Continent oil pipelines have been the main growth drivers here. With the awarding of the Rover, Sabal Trail, Dakotas, Sandpiper, Lone Star pipeline supply contracts, among others, in recent months, domestic capacity is filling creating an opening for import competition in this market. Indeed, lead times for North American large-diameter linepipe producers are now stretching out well into 2015 with some mills taking orders for 2016 delivery.

The collapse in oil prices have created concern amid producers to this market, however, as some projects could be delayed or cancelled altogether. MBR believes that the natural gas lines will likely avoid the fallout given that this infrastructure was far overdue and will eliminate bottlenecks in the northeast which caused severe price spikes in gas supplies last winter. Oil and CO2 pipelines, however, could face tighter scrutiny under current price conditions. MBR has heard that Enterprise Products Partners' North Dakota to Cushing, Oklahoma project has been cancelled. The pipeline faced competition as well as lack of interest due to low oil prices and was unable to secure the needed commitments from shippers. Meanwhile, rail, which is more flexible to varying demand than pipeline investment, will remain a viable alternative for oil transport, especially for Bakken crude oil.

CO2, which is used for enhanced oil recovery (EOR) in mature wells, could see a demand shift as oil from EOR wells is deemed unprofitable and this production is suspended. CO2 pipelines, therefore, have the potential to be delayed under sustained low oil prices.

Nevertheless, MBR forecasts that linepipe pricing in the region will fail to register significant gains this year as producers compete for available projects to sustain them over any near-term slowdowns in activity. The level of import competition will be determined by activity on the home markets, such as the EU.

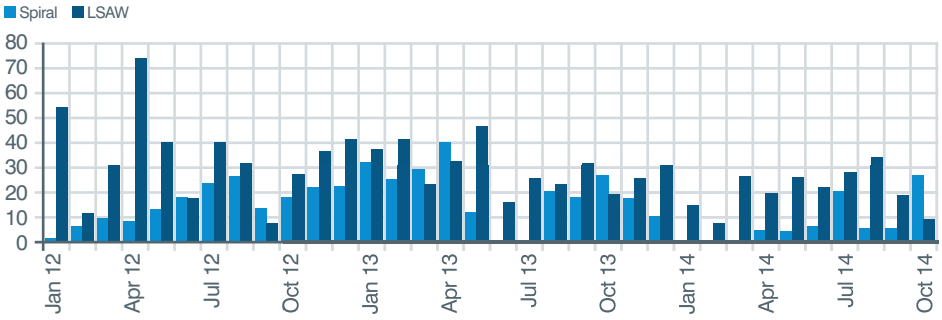
Indeed, pipeline planning and construction activity also picked up in the EU, China and CIS into the second half of 2014.

By the fourth quarter of 2014, Russian mills' utilization rates soared as they produced pipe to supply to three major projects:

South Corridor, Power of Siberia and South Stream. Meanwhile, EU and Asian producers vied for tenders to supply pipe to the TAP/TANAP projects, with significant tonnage going to Chinese suppliers as well as Turkish consortia.

Nevertheless, there is now uncertainty in the progress of the South Stream project as the project has been cancelled by the Russian government and pipe production indefinitely suspended. MBR believes that the uncertainty over Russian pipelines across the Black Sea could support other dormant projects moving ahead, such as the East Mediterranean pipeline, and GALSI. Any spare capacity here, however, will continue to look to other markets, namely North America for potential supply opportunities, especially given the dollar's strength.

US large-diameter (over 16" OD) **linepipe imports** ('000 tonnes)



Global Seamless OCTG & Linepipe Outlook

Tube and pipe markets facing a 2015 correction

2015 is shaping up to be a tough year for the seamless OCTG and linepipe markets. For the past five years or so, these markets were some of the strongest in the steel industry, but are now facing headwinds at the start of the year.

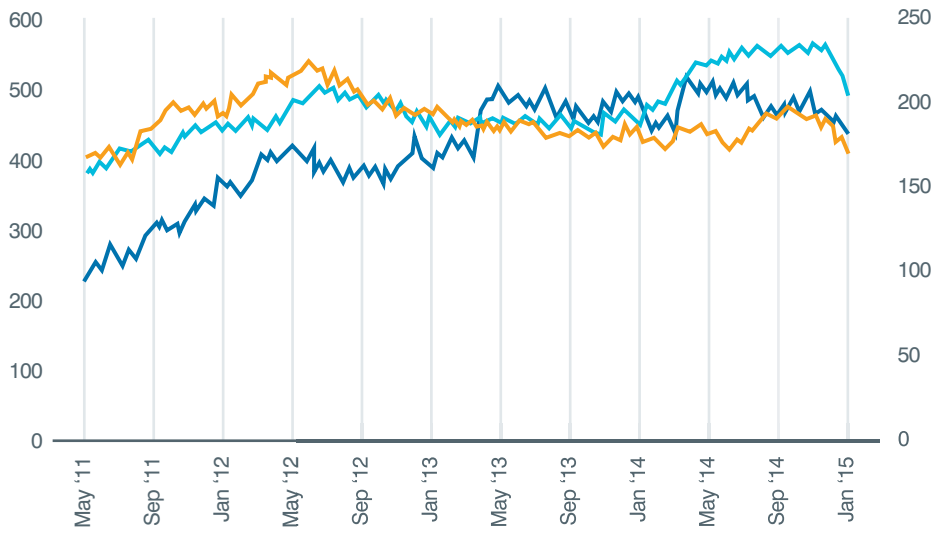
Much of the change in outlook toward a weaker position this year is the result of falling oil prices. Global crude oil prices are down about $45/bbl year-over-year, after falling through much of second half of 2014 on the back of rising production in the USA as well as globally, and slower than expected demand growth in Asia and the EU. US oil output and rig counts remained relatively steady into December as drillers maintained operating budgets. Rig counts are now falling sharply as marginal high-cost producers leave the market. Overall oil production is likely to continue to grow – although at a slower rate than expected – in the first quarter as the larger operators move production to lower-cost holdings.

Nevertheless, OCTG purchasing is already affected, and inventory holdings are now a concern. US distributors will look to control stocks to avoid an oversupply in the market. Seamless mills are being idled as a result of the cut in demand and prices are under pressure. The falloff in drilling will also lead to cuts in linepipe demand and prices here will also be affected.

The problems are not just constrained to North America, other OCTG markets in the world are seeing demand falling noticeably from the high-cost production offshore fields and unconventional drilling areas such as the North Sea, West Africa and South America. Even in regions like the Middle East, where extraction costs are much lower, such has been the speed and size of the drop in the oil price that National Oil Companies here are now thought to be examining their OCTG supply chains. MBR expects that as a result, OCTG prices could be pushed down into the second half of this year.

While the energy markets are difficult to predict, oil prices are not expected to recover until the second half of the year. Meanwhile, it is assumed that oil production growth will be constrained in North America, but there will be no collapse in output in the time period. Operators will maintain steep cost cutting programs which will continue to put pressure on OCTG and linepipe prices. Seamless market share will also take a hit as a result of the cost cutting as ERW supply becomes accepted into previously seamless-only applications. Prices will likely average lower than in 2014.

US oil rig count – selected basins (units)



Source: Baker Hughes and MBR

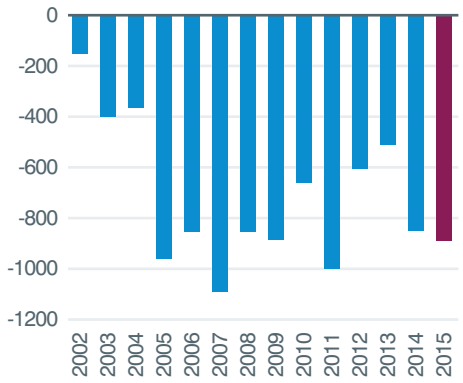
Global Base Metals Outlook

Copper

Low prices have disconnected from tight fundamentals

The steep fall in copper prices this at the start of this year mirrors declines in oil and iron ore, among others, in that each market has descended to, or even beyond, 5-year lows. But that's where the similarity ends. Oil and iron ore are very oversupplied markets, but copper is not. Indeed, it has been our view for a while that, fundamentally, copper is not in a bad shape at all. And, if anything, the outlook is getting tighter. In fact, we have recently revised our supply-demand balance to show a small deficit this year, as we believe demand remains fairly resilient and sub-$6,000/tonne prices will see Chinese SRB stockpiling more metal. Meanwhile, the supply side is on course underperform significantly, with 2015 already well on the way to being a record year in terms of supply disruptions. There has been a pick-up in capacity closures, operational difficulties and other unplanned disruptions, average grades are still falling, investments continue to be scaled back, the risk of labour disputes has grown, there remain processing bottlenecks and scrap collection in an already tight secondary market is likely to be reduced further. So while we have lowered our Q1 price forecast to accommodate the recent wash-out, our view is that prices have become disconnected from the underlying fundamentals, which is not sustainable. Therefore, we are still looking for copper to end this year comfortably above the Q1 lows and well on the way to recovering the losses inflicted since mid-2014.

A record year in the making for copper mine disruptions



Lead

The dark horse

Like copper, lead is another market that has underperformed its fundamentals. Exchange stocks are low relative to consumption, destocking in China has left inventories lean there, and supply and demand are roughly balanced overall. In addition, there is now more talk of production cuts and the lower prices are also likely to start making it more difficult for secondary producers to get scrap. So, as with copper, there is a case for lead pricing to improve during this year, and that is our baseline assumption. But the other thing that is so noteworthy about lead is its quietness. For some time, there has been very little action on stocks, spreads are benign, premiums are lifeless, LME turnover and open interest have shrunk drastically, and prices have gone from a premium over zinc to a deep discount. Interest needs to return to this market and, when it does, we think it has a significant rerating to undergo. It may even turn out to be the top performer this year, potentially overshadowing more obvious consensus top picks, like nickel and zinc.

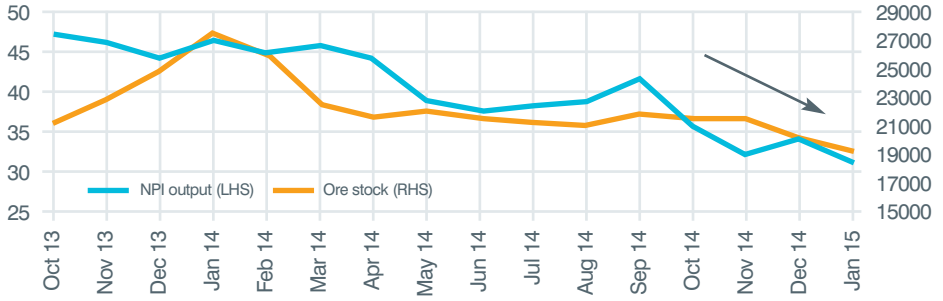
Biggest potential upside of all the base metals

Nickel

Deficit delayed, but still coming

The nickel market got too bullish too soon in 2014. Chinese NPI producers proved to be more resilient and resourceful than they were initially given credit for, Philippine miners produced more ore at higher average grades than previously expected, and the Qingdao scandal triggered the mobilisation of an enormous tonnage of previously invisible inventory from China to LME warehouses. In the end, the fundamentals didn't improve anywhere near as much as the nickel bulls had hoped they would. But they are still improving and 2015 is when some degree of tightening up should belatedly start to be felt. The thing is, visible nickel stocks are much higher now than a year ago, the demand-side is less robust and investors already burnt from sell-off in nickel and other commodity markets over the past 6-9 months will be wary about getting too bullish again. Nickel prices will probably remain volatile in the short term given broader issues but, once the dust settles, falling NPI production and the end to the relentless LME stock build should lay the foundation for a sustainable improvement in prices this year, and next. The recovery may not set in until Q2 at the earliest or, more likely, even later in the year, but it is coming. We are modelling a global market in balance at worst this year, and in a clear deficit in 2016.

Chinese NPI production now in retreat



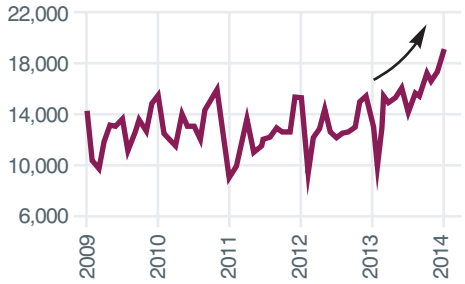
Tin

Chinese supply surge has damaged the fundamentals

All eyes in the tin market will be on China, Indonesia and Myanmar this year to see how crucial supply-side issues pan out. There is the potential for production to accelerate further in China, fuelled by the continued emergence of Myanmar as a major and seemingly increasingly reliable source of concentrate, while there is the potential for Indonesian supply to be further constrained by the government's trade policy tinkering.

Overall, we are neutral on tin's fundamental outlook in the short to medium term. But maintain a bullish longer term view given structural supply shortages that the emergence of Myanmar does not fully compensate for. If demand is anywhere decent this year, we think a global supply deficit is certainly a possibility in the tin market, but with frailties on the economic growth front in most key regions this has begun to feel more like a best case scenario, and recent revisions to our base case see the market recording a small surplus. This should keep the upside to prices in check, but we still see Q1 as the low point of the year with scope to recoup much of last year's losses as 2015 progresses.

Chinese production is accelerating

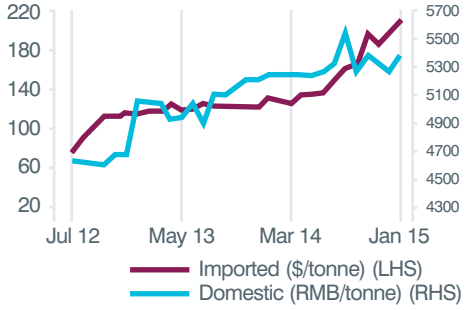


Zinc

We are not strong believers in the zinc bull story

Like nickel, the zinc market is waiting for the fundamentals to tighten. The expectation of tightness was priced in by last year's rally up to $2,400/tonne, but the closure of the giant Century mine in Australia is the key event in the bull story now and that closure will not happen until later this year. It remains to be seen how much effect it, and the closure of other mines, will really have on the concentrate market and ultimately the refined market. Our view has been that the supply gap the zinc bulls are looking for won't be a big deal. As it is, both concentrate and metal remain comfortably supplied at the moment, as evidenced respectively by strong TCs and soft physical premiums. The January sell-off took zinc back almost as far as the $2,000/tonne level, so effectively it has followed nickel's path, as we feared – rallying prematurely on future supply concerns, waiting for some months for the fundamentals to catch up, then giving back virtually all of its gains as bulls lost patience. We expect prices to recover modestly over the course of this year, and we also expect another annual supply deficit on paper. But we still find it hard to get too excited about zinc's outlook yet.

Rising TCs warn there's no concentrate shortage yet



Global Aluminium Outlook

MBR forecasts that the global aluminium market will remain in deficit for 2015, although the deficit should narrow from 2014's level. We are now forecasting a year-on-year growth rate of 7.4% for global aluminium production in 2015, or a 3.83Mt increase in absolute terms. Most of this increase will come from China where we forecast output to increase by 9.1%, while rest of the world (ROW) production is expected to increase by 5.7%. The total deficit is expected to be just 161kt, although this will be split into a surplus of 1.144Mt in China and a ROW deficit of 1.305Mt.

The global economy remains riddled with uncertainties, but nevertheless our base-case view is for an accelerating trend and we remain confident that aluminium demand is set to show another year of expansive growth, with 5.8% forecast. In fact not since 2009 has aluminium demand contracted, and MBR estimates that by the end of last year global aluminium demand was 50% (or 17.7Mt) higher than it was during the 2009 downturn. Of this total, 11.3Mt of additional demand has taken place in China, leaving a more modest (but still substantial) 6.3Mt of additional demand in the ROW.

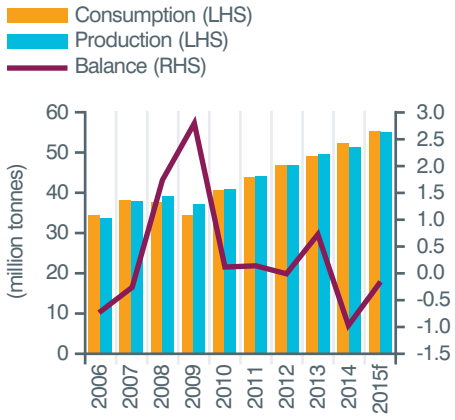
But while demand growth will remain on track overall, there are certainly some major headwinds in some regions which are likely to keep Q1 2015 buying activity lean at best - our major concern is European aluminium demand growth prospects (with a forecast of only 1.6% growth in 2015); only slightly above GDP.

Another hot topic is the trend in aluminium premiums. We believe the implementation of the LME's new warehousing rules is expected to have a relatively significant impact on premiums as queues for physical metal are forced lower.

After the new load-out rates are implemented, affected warehouses are likely to experience a significant increase in the required load-out rate.

In addition, with the market expecting US interest rates to start rising this year, the profitability of financing deals might begin to be undermined. This combination of new warehousing rules and a less favourable environment for financing deals might increase the availability of metal and put downward pressure on regional premiums.

Global supply demand balance



Aluminium premium