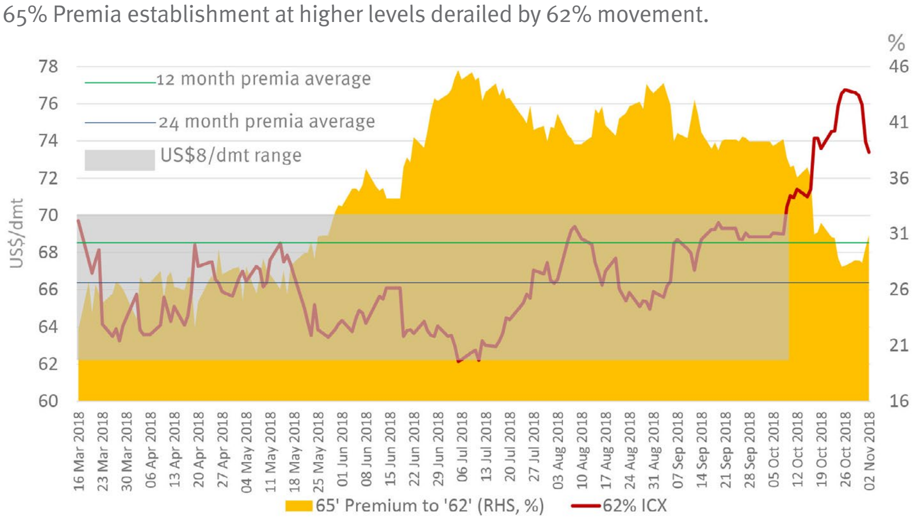
October was an atypical month in recent steel market activity. Iron ore prices got a shot in the arm and coking coal sneaked up to a high point, although not universally. Steel prices and margins fell, scrap remained topsy-turvy and futures exchanges saw divergent performance for their products.

Margins on the wane: coking coal on the up.

It's been an interesting time for the breakout to occur...Chinese steel mill margins have been on a tear over this year, solidifying a run of gains that have been appreciating since December 2016. That ran into reverse during this month.

The beast is loose!

Iron ore unshackles itself from 145 range-bound days. Increasingly established predictability in 62% pricing has been negative for derivative volumes.
65% Premia establishment at higher levels derailed by 62% movement.



The 65% gap is down, but not out.

A few notable things happened over the course of the month. Firstly, iron ore (previously known as something of a "beast" for volatility) slipped its cage. It's been stuck in that place for more than half a year, so on its own this would be notable.

Secondly, the 65% grade premium (which has been building again over 62%) has been returned closer to its 12-month average. Its last 'bull run' lasted ~four months trough-peak, in 2017.

Thirdly, Argus ICX was offered for the first time in spot trade against a premium 62% iron ore grade at GlobalORE, with bids repeating thereafter!

To be sure, it is not just iron ore that is pushing up at overall mill costs: Australian coking coal prices just hit their highest level since February 2018. And yet, this is an issue that will actually hurt international margins more. Subscribers checking domestic Chinese coking coal prices in US$ terms will notice that prices actually fell over October. China sources most of its metallurgical coal requirements from domestic sources, so rising Australian prices matter less in the scheme of Chinese profitability.

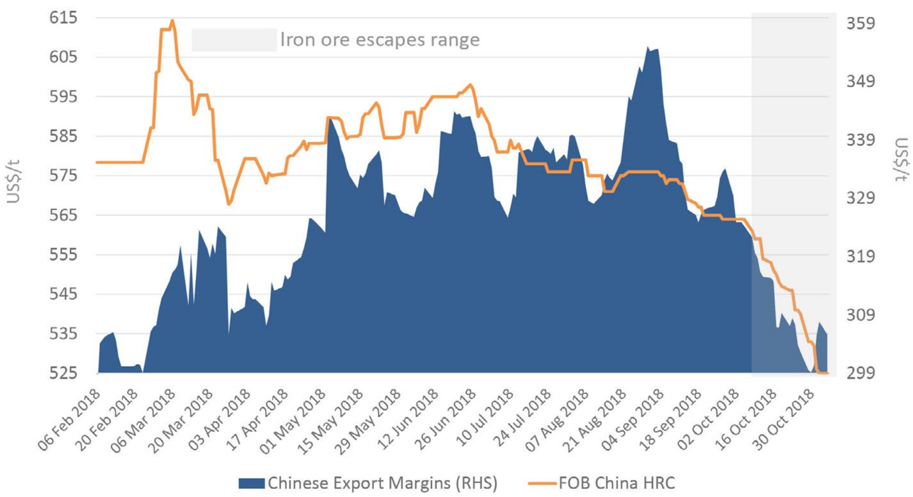
White as a sheet

What does matter is domestic steel prices. With China no longer incentivising exports and balancing supply and demand, export prices look a lot more like domestic prices. Rebar prices fell over October but remain above their 2018 average. Pain seemed more localized to the flat markets. Monthly average HRC FOB China prices swooned -4.7% month-on-month to US$551/t, but spot prices fell lower, to US$525/t as of the 5th of November.

However, that is more a reflection of weak Chinese demand than any sudden interest in sharpening export prices:

A challenging time for China's mills to digest cost push

Rise in iron ore prices occurred just as indicative Chinese steel export prices fell sharply i.e. margin shrink not just cost-led; albeit rebar has been more stable.



they are not exporting much, as Black Sea sellers are offering delivered HRC cheaper than FOB China prices.

Bulk scrap's premium evaporated some time back. It's not returned.

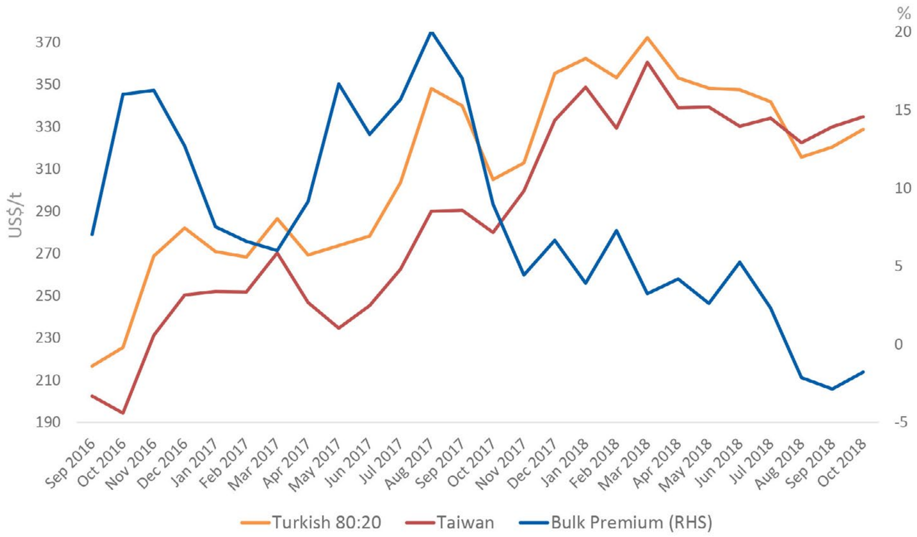
Back in August, we mentioned that Bulk scrap's premium to containerized ('boxed') scrap had evaporated.

By the end of October, it remains absent. The reason this is remarkable is that it is simply not easy to source large quantities of ferrous scrap. That is the reason the bulk scrap industry is relatively consolidated: it costs money to operate at scale, as well as deep pockets to sustain full-vessel trades that can easily top US$20 million per trade.

That scale does not seem to be being rewarded much at present. Taiwanese producers are contending with high-priced feedstocks and falling steel prices, reducing their demand. At the same time, Turkish producers have had margins crimped as they place tonnes anywhere but the US, with offer levels below FOB China. It's therefore an unusual time to compare this pair: Taiwanese boxed demand has been subdued, but so has Turkey's, exacerbating the divergence from norm. So perhaps it is a localized phenomenon.

Scrap premium: still underwater

Maintaining uniform clean scrap quality in 50,000 tonne+ quantities is harder than doing so for several 20t (container) parcels. It once commanded a premium.



Indian, Bangladeshi and Pakistani containerized shred markets, for example, have continued to price in a punchy premium to the Turkish bulk market. However, they seem to be shrinking. Over Q3, the Nhava Sheva price was at an average US$35/t premium to Turkish prices. By mid-October they had hit US$24.6/t and over the first week of November, they had fallen to US$19.3/t.

Trading Places

Over at the exchanges, the darlings of yesteryear have not been performing as well as they did yesteryear. In this area, October yielded few surprises.

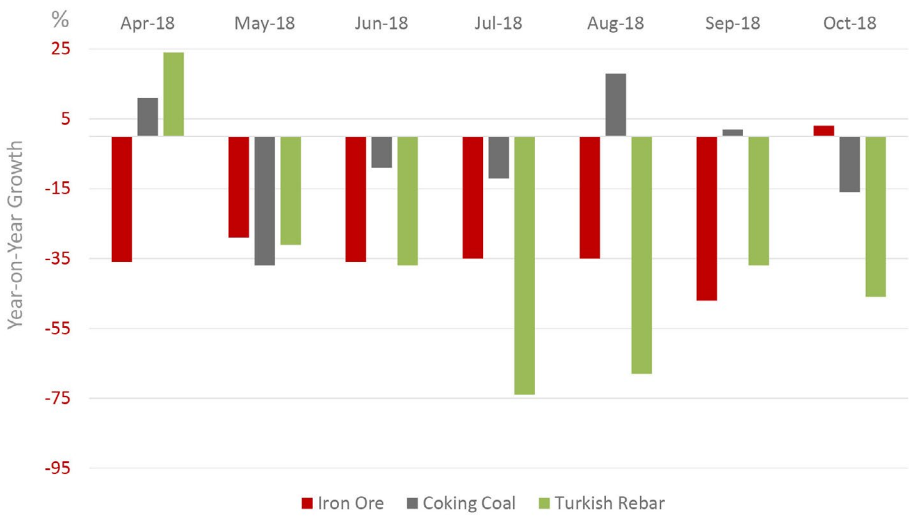
Some commodities seem in something of a rut. Ore volumes have endured an annus horriblis with 12 months of (mainly) falls averaging -27.8% year on year, but as bad as -50%. Price volatility provided some respite this month, as hedgers flocked to lock-in higher levels and others covered positions.

After a barnstorming performance last year, 2018 has proven something of a damp squib for coking coal. There's been a number of reasons underlying that for that covered here, but volatility isn't one.

Rebar volumes have had a tough time since May, but perhaps that is a reflection of how good 2017's volumes were, or Turkish scrap sucking in liquidity due to tight correlations with rebar. Either way, October saw scrap volumes being 7 times larger than rebar volumes at the same exchange. In context, that is actually a better performance than September (19 times) or August (23 times).

Some derivative volume groups pressured since Q2...

Iron ore broke an 8 month losing streak (volumes wise): 3% up, y-on-y. CME accounted for 67% of that rise, as volatility saw volumes rise 1000%+ m-on-m.



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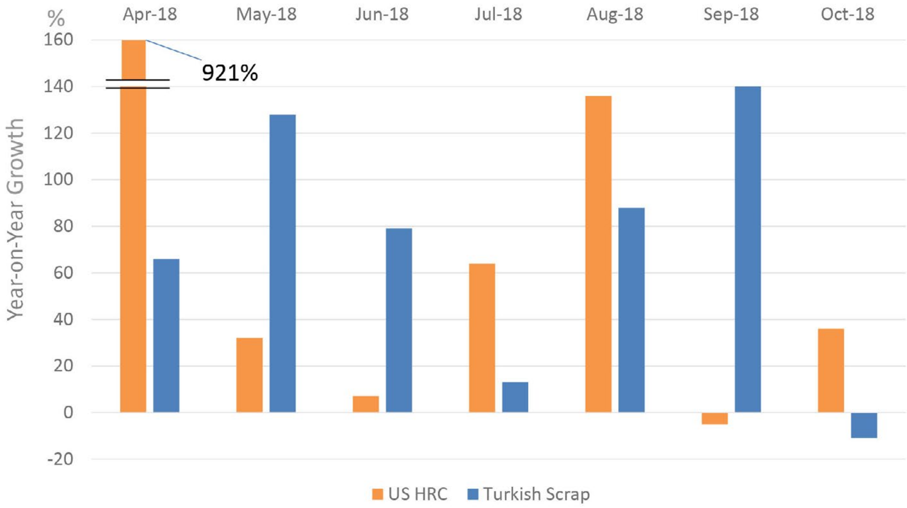
By contrast, other contracts are performing very well indeed. The Turkish scrap contract is a study in contrasts with the rebar contract, whilst the US HRC contract is growing fast. It will trade much more than 50% greater volume than any prior year in 2018.

As the world's oldest extant steel futures contract celebrates its tenth birthday, its health bodes well for new steel contracts launching next year.

...Whilst some are thriving

Trump's trade war catalyzes 'Old Boy' HRC's volumes.
'New kid' scrap continues to perform strongly.



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