

**Q1 2014**

**[www.businessmonitor.com](http://www.businessmonitor.com)**

# **IRAN**

## **METALS REPORT**

INCLUDES 5-YEAR FORECASTS TO 2017



**ISSN 2040-6827**

Published by: Business Monitor International



# Iran Metals Report Q1 2014

INCLUDES 5-YEAR FORECASTS TO 2017

---

## Part of BMI's Industry Report & Forecasts Series

Published by: **Business Monitor International**

Copy deadline: October 2013

**Business Monitor International**  
Senator House  
85 Queen Victoria Street  
London  
EC4V 4AB  
United Kingdom  
Tel: +44 (0) 20 7248 0468  
Fax: +44 (0) 20 7248 0467  
Email: [subs@businessmonitor.com](mailto:subs@businessmonitor.com)  
Web: <http://www.businessmonitor.com>

© 2013 **Business Monitor International**  
All rights reserved.

All information contained in this publication is copyrighted in the name of **Business Monitor International**, and as such no part of this publication may be reproduced, repackaged, redistributed, resold in whole or in any part, or used in any form or by any means graphic, electronic or mechanical, including photocopying, recording, taping, or by information storage or retrieval, or by any other means, without the express written consent of the publisher.

### DISCLAIMER

All information contained in this publication has been researched and compiled from sources believed to be accurate and reliable at the time of publishing. However, in view of the natural scope for human and/or mechanical error, either at source or during production, **Business Monitor International** accepts no liability whatsoever for any loss or damage resulting from errors, inaccuracies or omissions affecting any part of the publication. All information is provided without warranty, and **Business Monitor International** makes no representation of warranty of any kind as to the accuracy or completeness of any information hereto contained.



# CONTENTS

<b>BMI Industry View .....</b>	<b>5</b>
<b>SWOT .....</b>	<b>7</b>
<b>Industry Forecast .....</b>	<b>8</b>
<i>Steel: Modest Growth Despite Sanctions .....</i>	8
<i>Table: Iran - Steel Production Forecasts ('000 tonnes, unless stated otherwise) .....</i>	11
<i>Table: Iran - Steel Production Historic Data ('000 tonnes, unless stated) .....</i>	12
<b>Regulatory Development .....</b>	<b>13</b>
<i>Tax Regime .....</i>	13
<i>Table: Iran - Political Overview .....</i>	14
<b>Commodities Forecast .....</b>	<b>15</b>
<i>Steel Price Forecast .....</i>	15
<i>Table: BMI Steel Forecast .....</i>	15
<i>Table: Steel Forecast .....</i>	23
<i>Commodities Forecast .....</i>	24
<i>Iron Ore: Rally To Fade In Q413 .....</i>	25
<i>Steel: Supply Glut To Endure .....</i>	26
<i>Aluminium: Surge Gives Way .....</i>	27
<i>Copper: Weak Outlook .....</i>	28
<i>Lead: Short-Term Weakness .....</i>	29
<i>Nickel: Still The Laggard .....</i>	30
<i>Zinc: Still A Surplus Market .....</i>	33
<i>Table: Select Commodities - Performance And BMI Forecasts .....</i>	34
<i>Table: Global Commodities Strategy .....</i>	35
<b>Competitive Landscape .....</b>	<b>36</b>
<i>Little Room For Newcomers As Sanctions Bite .....</i>	36
<i>Table: Production &amp; Sales By Producer (2012) .....</i>	36
<i>Table: Largest Listed Metal Producers In Middle East .....</i>	39
<b>Company Profile .....</b>	<b>40</b>
<i>Mobarakeh Steel Company .....</i>	40
<b>Methodology .....</b>	<b>42</b>
<i>Cross Checks .....</i>	42

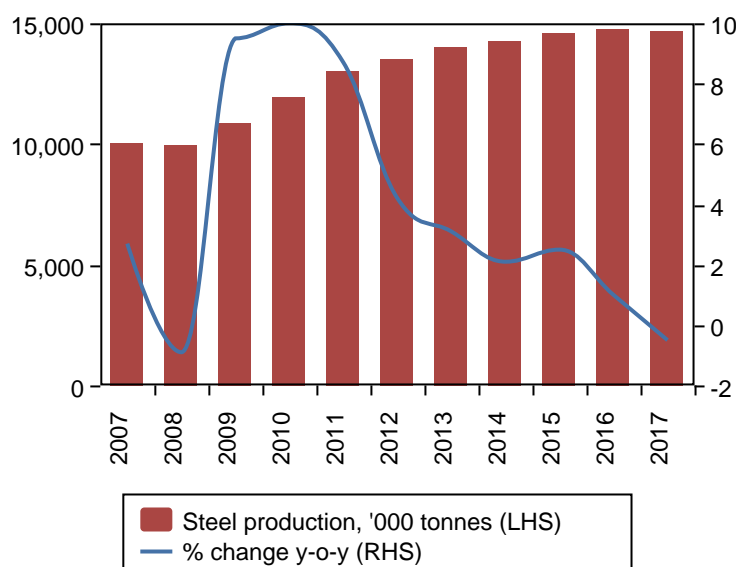
## BMI Industry View

The outlook for Iran's steel sector remains poor; however, there are a few signs of light given the election of Hassan Rouhani and possible moderation in tone towards the West. On the whole, however, we are far from sanguine given our bearish outlook for steel prices and the fact that any rapprochement with the West, if indeed it happens, will be drawn out and not have a significant impact in the near term. We note with scepticism, Iran's plans to increase its steel capacity from 20mn tonnes per annum (mntpa) to 55mntpa by 2025, as well as a tripling of aluminium smelter capacity to 1.5mntpa.

While a cut in external trade has impacted negatively on the steel industry, isolation has ensured that imports have also been restricted. However, domestic industrial deficiencies in certain market segments mean that Iran will struggle to meet its own needs in spite of declining consumption. Crude steel output rose 11.1% year-on-year (y-o-y) to 13.27mn tonnes in the first 11 months of 2012, representing one of the strongest growth rates in the world, rivalling Turkey's.

### Growth To Slow

Iran - Steel Output



Source: BMI, WSA

Nevertheless, due to infrastructural problems and a lack of billet and rebar capacity, the country is still dependent on imports to serve the market, mostly from Turkey. Meanwhile, growth in the manufacturing of steel products has slowed markedly, with existing crude steel capacities unable to sufficiently supply to downstream industries and therefore exacerbating the dependence on imported supplies. Weak points remain, with flats demand coming under pressure as automotive output suffers from declining domestic demand. Over the medium term Iran will be reliant on exports at a time when it is becoming harder to sell on external markets.

Iranian trade has been affected by international sanctions, with the country having to manoeuvre strategically to meet domestic demand and maintain the robust production growth seen a few years ago. Iranian steel production grew by 10.0% and 8.7% in 2010 and 2011, and **BMI** forecasts that growth will remain robust in Iranian steel production; however, this will begin to slow down from 2014 until the end of our forecast period in 2017.

The country's political situation has affected many of its trade dynamics and the negative impact on imports and exports of steel has meant that the domestic industry has had to find a way to ensure that demand is met by ramping up production and clearing stockpiles to make room for imported steel.

Prior to the intensifying international sanctions imposed on Iran, the nation would rely on a significant amount of exports to other Arabian countries in the Gulf region; however, companies in the Arabian Gulf have simultaneously been expanding their capacities rampantly off the back of sustained demand in the region. This has meant that steel prices in Iran have been heading downwards as companies seek to offload their steel stockpiles by selling at a lower price.

Outlooks for metals-intensive sectors - specifically construction, infrastructure and automotives - are all in negative growth territory, meaning further obstacles for growth in the Iranian metals industry.

# SWOT

## Iran Metals Industry SWOT

### Strengths

- Self-sufficiency strategies forced by tight trading rules following intensifying international sanctions have allowed continued functioning.
- Significant iron ore mining industry offers a degree of vertical integration in the steel sector.
- The election of Hassan Rouhani could precede a more moderate line to foreign investors which would benefit the steel industry.

### Weaknesses

- Exports severely weakened and have little prospect for recovery, owing to sanctions.
- Sanctions discouraging outside business investment or partnerships with foreign companies that might improve capacity and efficiency.

### Opportunities

- Observer status on World Trade Organization gives the opportunity for Iran to implement strategies learned from member countries.
- Political rapprochement by Turkey can deepen ties with one of the fastest-growing economies in the world.

### Threats

- Export growth hampered by capacity expansion and investments in Gulf metals industries.
- Capital flight is likely to continue owing to high inflation and currency depreciation.
- We remain bearish on the outlook for steel prices and do not expect a recovery in the near term.

## Industry Forecast

### Steel: Modest Growth Despite Sanctions

***BMI View:** The Iranian steel industry has proven to be remarkably resilient in the face of attempts by Western powers to isolate it from external trade. While a cut in external trade has impacted negatively on the steel industry, isolation has ensured that imports have also been restricted. Domestic industrial deficiencies in certain market segments mean that Iran will struggle to meet all its own needs in spite of declining consumption.*

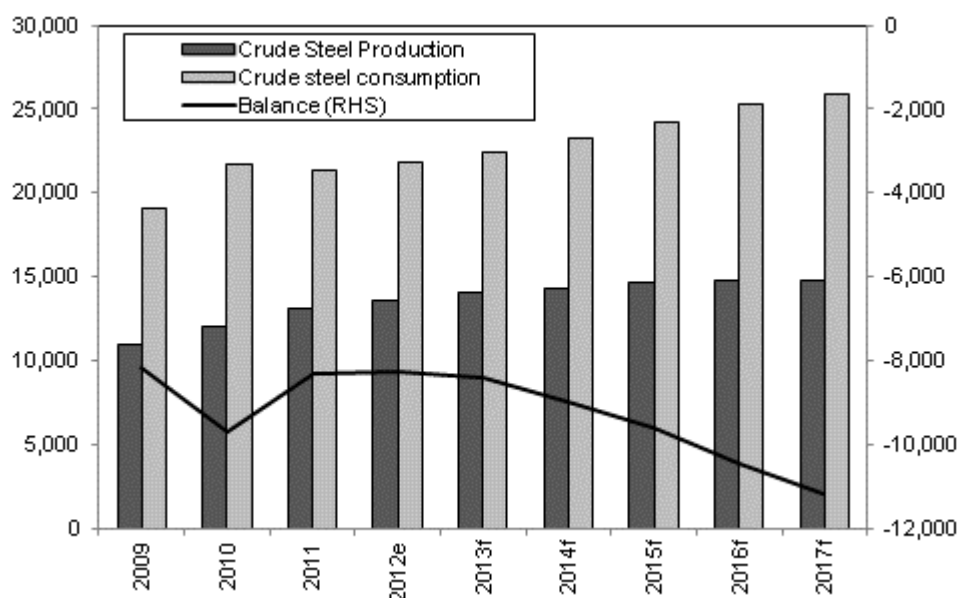
We expect to see a slower but still strong steel production growth rate for Iran over the next five years. However, we forecast growth to begin dwindling from 2014 and will continue to do so until the end of our forecast period in 2017. In 2017, we expect steel production to contract by 0.5%, as we see the short-term strength of the Iranian steel industry breaking down slowly, with the effects of international sanctions becoming ever more clear and unavoidable.

We see a relatively stable Iranian steel industry as the country moves to battle the effects of international sanctions and become self-sufficient. Progress has been made in trade liberalisation efforts, with bans on the import of certain products removed, tariffs lowered and all import quotas on cars eliminated. Iran currently has observer status at the WTO and has a stated policy goal of gaining access, which it hopes to achieve within five to six years. However, such a timetable is optimistic, as Iran is facing stiff opposition from the US and other key bilateral partners in light of the continuing concerns over its nuclear programme. In effect, WTO talks have been halted for political reasons. Iran has 13 import tariff bands with tariff rates ranging from 4% to 174%. A gradual reduction of tariffs has brought the simple average tariff rate down to 22.6%, from 27% in 2003-2004.



## Steel Going Strong Despite Sanctions

Iran - Steel Production, Consumption & Balance (kt)



Source: BMI, WSA

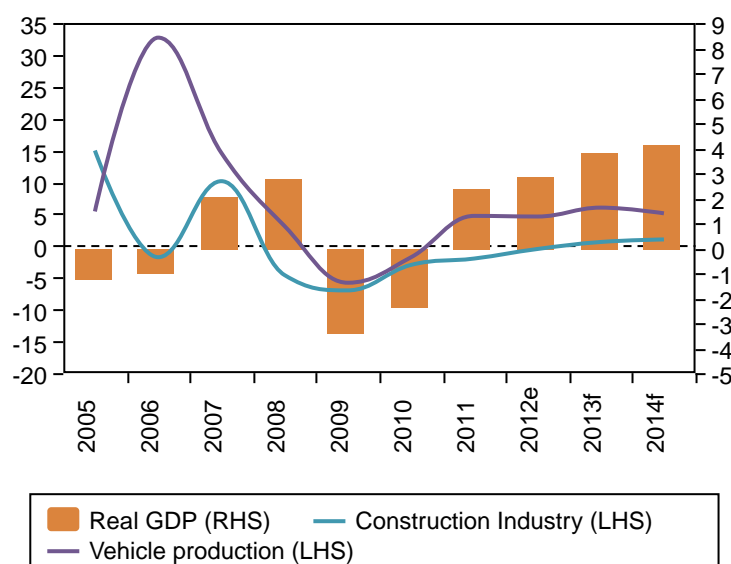
The government has implemented reforms in its foreign trade regime, lifting the ban on automobiles. However, several imports - specifically of alcohol, pork, certain media and luxury goods - are still prohibited. An *ad valorem* commercial benefit tax applies to most imports, ranging from 5% to 375%. Customs duties for chemicals, metals and medical equipment are set at 10%; food, minerals, leather, paper and machinery at 15%; and electronic machinery at 25%.

Export growth is being undermined by strong growth in Middle Eastern capacities, as well as the ongoing economic sanctions regime. Operating rates can only be raised through market diversification, a process that has been severely curtailed by the sanctions regime imposed by the US and the UN. Market growth is particularly limited in the metals-intensive automobiles and construction segments where investment has been restricted. Even with strong export growth, the moderation in domestic consumption means that metal processing plants are operating well below nameplate capacity. However, in the latter part of 2012 Iranian carmaker **Iran Khodro Industrial Group** (IKCO) announced that it plans to increase its daily production to 2,800 cars by March 20 2013. The carmaker also plans to produce 1.2mn cars by the end of 2016, of which 50% will be exported to international markets. IKCO plans to market the **Peugeot** Pars and Peugeot

405 pick-up trucks, powered by its own TU5 engine, by the end of 2012, and Automatic Tondar 90 (Logan) by H113.

## Growth To Pick Up

Iran - Real Growth y-o-y Across Sectors



Source: BMI, UN, IVMA

The Iranian government was to finalise its Comprehensive Steel Plan in 2013, which is due to point the way towards self-sufficiency in steel products and increase exports. The focus will be on private sector investment, particularly in the mining sector in order to improve iron ore availability. The objective is to raise Iran's steelmaking capacity from 20 million tonnes per annum (mntpa) in 2012 to 55mntpa by 2025, with an interim objective of 48mntpa by 2015.

Iran's medium-term self-sufficiency in billet depends on securing financing for 10-12 meltshops currently under construction that have a combined capacity of 4-5mntpa. At least four of these are being spearheaded by the private sector. With financing and hard currency in short supply as a direct result of international sanctions, **BMI** expresses grave doubts about Iran's ability to meet these targets.

The sanctions regime will affect Iran's ability to export and attract investment, which will be crucial to realising the government's long-term goals for steelmaking. We forecast steel production to contract by

0.5% in 2017 to reach 14.7mnt, with growth in output to be increasingly devoted to the domestic market with external trade, both in terms of exports and imports, likely to dwindle under a prolonged sanctions regime. If planned capacity increases come into effect, we anticipate diminishing capacity utilisation as exports decline and the domestic market fails to absorb output growth. Low capacity utilisation will undermine the profitability of the Iranian steel industry, as well as potential market instability. Moreover, the domestic industry is unable to satisfy the country's needs due in part to the technological problems caused by lack of investment and expertise that would come with the involvement of global majors.

Nevertheless, there is still promise from projects being agreed and planned for the future, such as that agreed between China and Iran, and will help sustain **BMI**'s forecast for sustained steel production growth over our medium-term outlook (2013-2017).

The Chinese government has made an offer to build a new freight rail line in Iran, according to Engineering News-Record. The freight line is aimed at allowing continuous rail transport of goods from China, through the Middle East, to Europe. The project is expected to cost US\$2.0bn, starting in Tehran and running to Khosravi on the Iraqi border.

The line will also offer a passenger service. Iran's minister responsible for transport is reported to have invited bids to construct the line. That said, we saw some setbacks within the China-Iran relationship when the Asian giant pulled out of the development of phase 11 of the US\$4.7bn South Pars gas field.

**Table: Iran - Steel Production Forecasts ('000 tonnes, unless stated otherwise)**

	2009	2010	2011	2012e	2013f	2014f	2015f	2016f	2017f
Crude Steel Production	10,908	11,995	13,040	13,588	14,009	14,303	14,661	14,807	14,733
- % Change y-o-y	9.5	10.0	8.7	4.2	3.1	2.1	2.5	1.0	-0.5
Apparent crude steel use	19,097	21,720	21,379	21,849	22,417	23,269	24,247	25,289	25,896
- % Change y-o-y	15.6	13.7	-1.6	2.2	2.6	3.8	4.2	4.3	2.4

e/f = estimate/forecast. Source: BMI, WSA

**Table: Iran - Steel Production Historic Data ('000 tonnes, unless stated)**

	2003	2004	2005	2006	2007	2008	2009	2010
Crude Steel Production	na	8,682	9,404	9,789	10,051	9,964	10,908	11,995
CCS	7,869	8,682	9,404	9,789	10,051	9,964	10,908	11,995
Hot rolled products	7,996	8,009	9,252	9,205	9,309	8,835	9,687	10,743
Heavy sections	1,887	1,628	1,645	1,620	1,910	1,704	1,836	2,042
Light sections	82.0	41.0	43.0	27.0	17.0	21.0	19.7	18.4
Concrete reinforcing bars	2,499	2,507	3,000	2,817	3,256	3,269	3,583	4,175
Tube and tube fittings	28.0	35.0	44.0	26.0	24.0	26.0	22.5	21.6
Exports	1,237	1,400	1,500	2,000	582	450	131	297
Exports (US\$bn)	0.0	0.0	0.7	0.7	0.4	0.3	0.6	0.7
Imports	8,680	7,913	8,431	7,566	12,246	7,914	8,035	9,238
Imports (US\$bn)	0.0	0.0	4.6	4.8	7.9	7.0	6.5	6.7
Imports of scrap	35	310	104	42	42	85	6	3

Source: BMI, WSA

## Regulatory Development

Iran's metals sector will remain highly challenging to new investment as sanctions and an uptick in political risk take hold. Whilst there has been some reform of the tax regime, corruption remains a key issue and it is likely that little will be done to tackle this impediment to investment.

**Corruption:** Iran scored a dismal 28.0 in Transparency International's Corruption Perceptions Index 2012, ranking 133rd out of 176 countries measured. After falling every year from 2002 to 2009, when it was 1.8, Iran's score in the index edged up slightly in 2010. With newspapers and news agencies tightly controlled and censored, there is little information available from inside the country on the level of corruption; independent estimates, such as Transparency International's index, remain the best indicators.

## Tax Regime

The tax regime has undergone substantial reform, with a flat corporate tax rate as opposed to the old, progressive corporate tax system. Resident companies enjoy a corporate tax rate of 10% on taxable income, with the remainder taxed according to a progressive scale ranging from 12% to 54% according to their income. The authorities are planning to curb tax exemptions.

The flat corporate tax rate is 25%, down from a previous cap of 54%. According to the tax code, the taxable income of companies or non-resident persons operating in sectors including construction, technical installations, transport, preparation of construction and installation drawings, surveying, supervising and technical calculations is limited to just 12%.

**Table: Iran - Political Overview**

	Islamic Republic based on the 1979 Constitution
	Supreme Leader - life-term (elected by Assembly of Experts)
System of Government	President - four-year terms, eligible for a second term and third non-consecutive term
	Parliament (Majlis) - 290 members elected for four-year terms
	Assembly of Experts - 86 clerics elected by direct public vote to eight-year terms
Head of State	Supreme Leader Ayatollah Ali Khamenei
Head of Government	President Hassan Rouhani
Last Election	Parliamentary - March 2 2012
	Presidential - June 12 2009
Next Election	Parliamentary - 2017
	Presidential - June 2013
	Mohammad Bagher Ghalibaf (Mayor of Tehran)
	Ali Larijani (speaker of parliament)
Key Figures	Ayatollah Mohammad Reza Mahdavi Kani (Chairman of the Assembly of Experts)
Main Political Coalitions	Ultra-conservatives: Generally Pro-Khamenei. This faction is led by Ayatollah Mesbah Yazdi, an ultra-conservative displaying a staunch anti-Western rhetoric.
	Moderate conservatives: Anti-Ahmadinejad coalition, important members include Ali Larijani, Mohammad Bagher Ghalibaf and Mohsen Rezaii, support moderate economic and political reforms but still favour current policy formation.
	Reformists: Made up of a number of factions with varying views, largely anti-government, favour political freedoms and more open policy formation.
Current Parliamentary Make-Up	Conservatives - 143 seats (53.5%), Reformists - 59 seats (26.2%), Independents - 9 seats (4%), Minority Religions - 14 seats (6.2%)
Ongoing Disputes	US and EU (economic sanctions), UN (four resolutions against nuclear enrichment), Israel, UAE (Lesser and Greater Tunb), Azerbaijan and Turkmenistan (Caspian Sea borders)
Key Relations/Treaties	WTO, Organisation of the Islamic Conference, increasing economic and political relations with Iraq, limited relations with GCC and member countries, strong alliances with Syria. Increasing relations with China.
BMI Short-Term Political Risk Rating	41.7
BMI Structural Political Risk Rating	50.2

Source: BMI

# Commodities Forecast

## Steel Price Forecast

Table: BMI Steel Forecast

	Spot	Short-term	2013	2014	2015	2016	2017
US\$/tonne, average	702	-	710	700	695	700	705

Source: BMI, Bloomberg, June 24

### Short-Term Outlook

We expect steel prices to head modestly higher as the US economic recovery becomes increasingly entrenched and sets the stage for improving downstream demand. Nonetheless, prices are unlikely to make substantive gains over the course of 2013 as signs of an incipient slowdown in China gather pace.

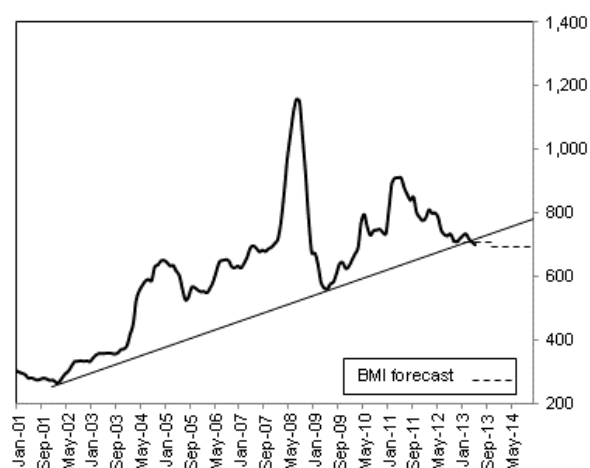
### Core View

We remain bearish on steel and forecast prices to average US\$710/tonne and US\$700/tonne in 2013 and 2014, respectively. The decline in steel prices over the past quarter had been more aggressive than we initially anticipated, forcing us to revise down our outlook from the previous projections of US\$730/tonne in 2013 and US\$720/tonne in 2014.

The global steel market will remain mired in significant overcapacity, sluggish demand and weak margins over coming years. While low prices will be necessary to incentivise a gradual rebalancing, this process will be derailed by dynamics in the Chinese steel market. Specifically, efforts to consolidate the industry will be sidelined repeatedly due to artificial support and persistent subsidies from local and state governments. Surplus Chinese supply will continue to seep into global markets, as illustrated by European, Asian and

### More Weakness Ahead

MEPS Carbon Steel Product Composite Price (US\$/tonne)

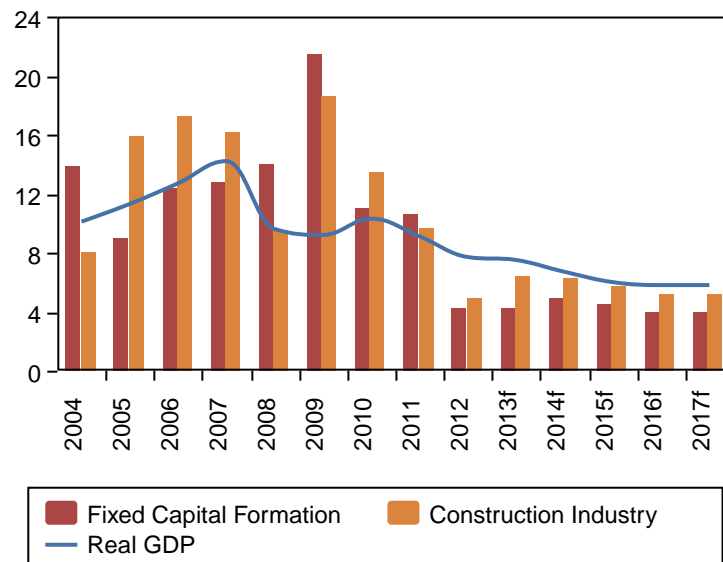


Source: BMI, MEPS

North American markets turning the screw on China over its alleged dumping of cheap steel products abroad.

## Chinese Rebalancing To Drag On Steel Prices

China - Select Economic Indicators (real growth, % y-o-y)



f = BMI forecast. Source: BMI, National Bureau of Statistics, China Statistical Yearbook

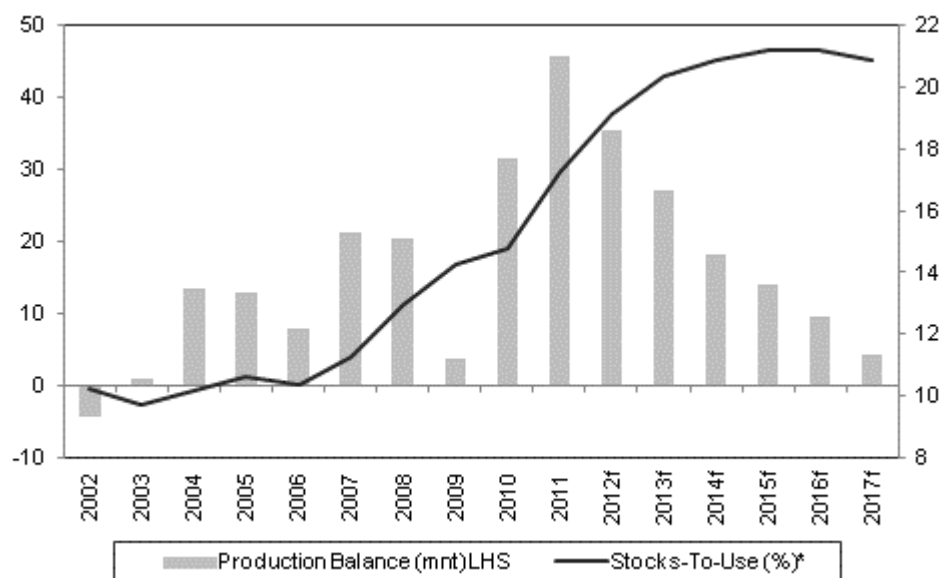
### All About China Slowdown

Our subdued expectations for steel prices are largely predicated on our downbeat view of the Chinese economy. As we forecast, China's growth bounce has proven superficial and signs of an imminent slowdown in economic activity are underway. Our forecast for Chinese real GDP growth to reach 7.5% in 2013 places us below the Bloomberg consensus estimate of 7.7%.



## Sustained Glut To Limit Gains

Global Crude Steel Production Balance And Stocks-To-Use



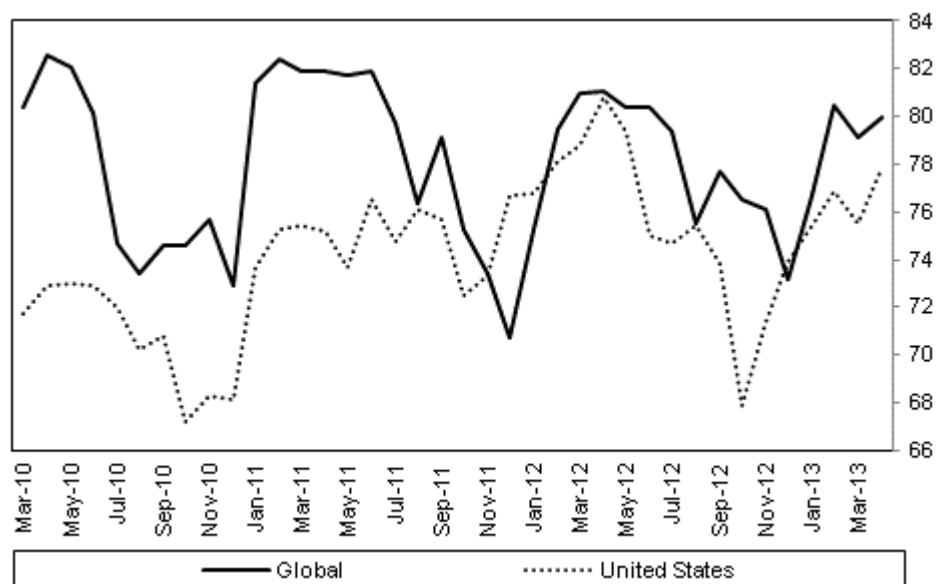
NB Stocks have been calculated using 2000 as a base year (= 100mnt); f = forecast. Source: BMI, WSA

### Overcapacity Here To Stay

In our view, both global production and consumption growth will slow compared with historical rates and the crude steel market will remain in surplus over the next five years. The size of the surplus will steadily decline as production comes offline faster than demand, reaching 4.4mnt (mn tonnes) in 2017. We expect the global stocks-to-use ratio to rise over our forecast period before starting to taper off from 2016.

## Steel Operating Below Capacity

Steel Capacity Utilisation (%)

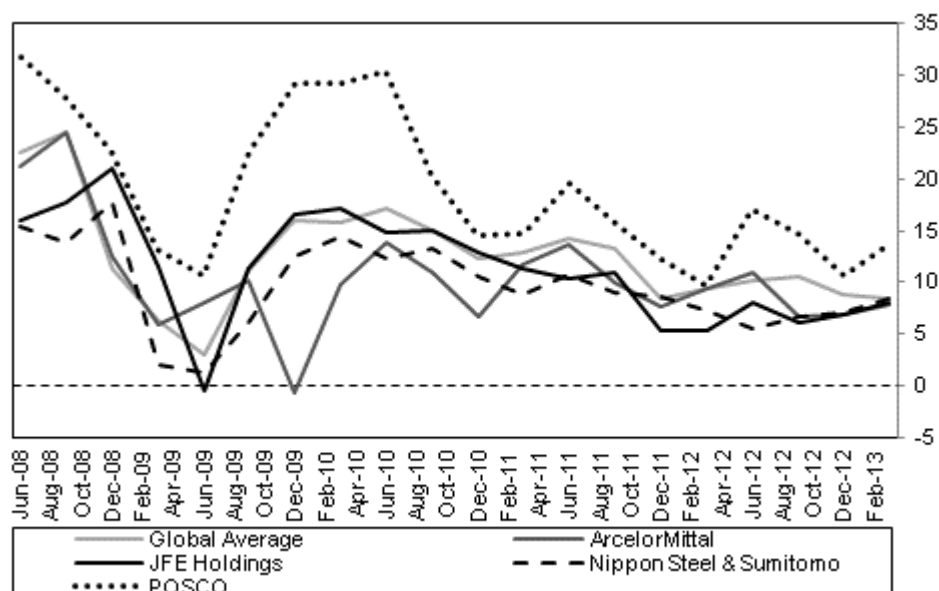


Source: BMI, Bloomberg

While China's steel production is running at record levels, it is estimated that only around 80% of the country's production capacity is being used. This situation is similar to many steel sectors in Europe and North America, where government intervention threatens to circumvent the process of consolidation in an oversupplied industry for the sake of political expediency. The rising tide of steel protectionism around the world reinforces our conviction that the consolidation of the global steel market will be a slow and painstaking process as many steel mills are caught in an unsustainable growth trap.

## Steel Glut Hits Margins

Global - Select Steel Producers (EBITDA margin %)



Source: BMI, Bloomberg

### Consumption: No More Boom Years

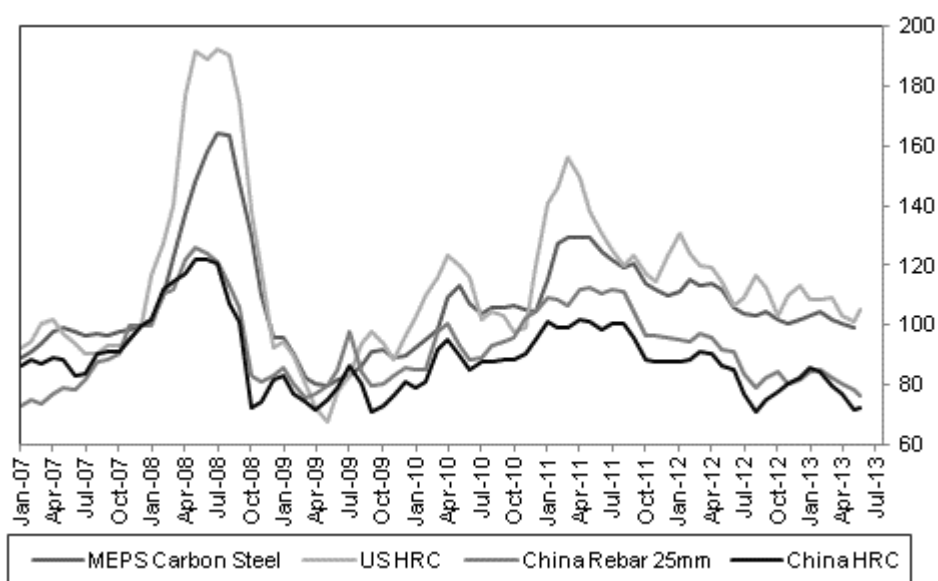
We expect weak demand to remain the key driver of overcapacity and low prices in coming quarters. The uninspiring economic picture in major steel-consuming countries such as Japan and eurozone members suggests a sustained downtrend in prices is almost inevitable. Economic uncertainty and widespread austerity will see steel demand recover only modestly in 2013 after contracting in 2012. That said, the increasingly constructive outlook of the US residential sector is one bright spot and apparent steel use in the country will continue a modest expansion.

Most importantly, the rebalancing of the Chinese economy away from fixed-asset investment and towards private consumption will significantly reduce steel demand. China is the world's largest consumer of the metal, accounting for more than 40% of global demand. While previous infrastructure investment programmes have created rapacious demand for steel products, we believe further forms of stimulus measures from the central government will offer only modest respite for the ailing steel sector.

China's growing credit dependence and the subsequent diminishing impact of stimulus measures will limit the government's ability to support the steel sector, especially when inflationary pressures are on the rise. China's new leaders have explicitly stated their intention to rein in blind investment in order to prevent overcapacity and economic overheating, as the recent demise of **Suntech Power** highlighted.

### Worst Is Yet To Come

Select Steel Contracts (US\$/tonne)



Source: BMI, Bloomberg

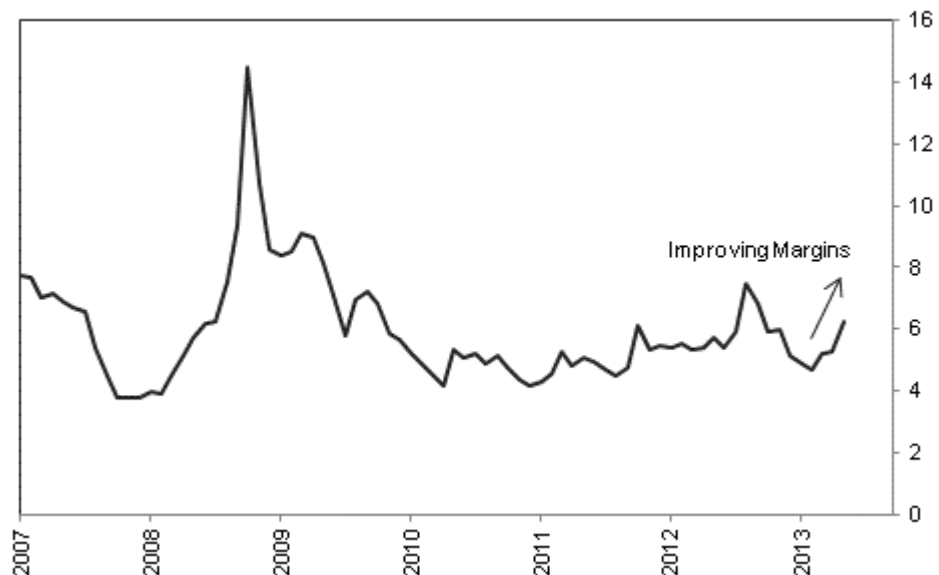
A series of new emission standards will be imposed on Chinese steel mills as part of a growing effort to mitigate environmental pollution. Additionally, a large number of Chinese banks are slashing loans to debt-laden steel traders in the face of rising bad debts and a slowing domestic economy. This will have cascading effects on the steel sector, given that more than 90% of Chinese steel mills rely on traders to sell their products.

### Production Cutbacks To Occur Slowly

Production growth will remain weak in the coming quarters on the back of tepid demand and low prices. We believe the recent improvement in smelter margins as a result of falling iron ore prices will fail to combat the overall weakness in the steel sector. We forecast global steel production growth of 2.4% in 2013, a marked slowdown from the average annual growth rate of 5.6% over the past decade.

### Modest Respite Despite Improving Margins

Price Ratio: MEPS Steel Price/Iron Ore Import Price



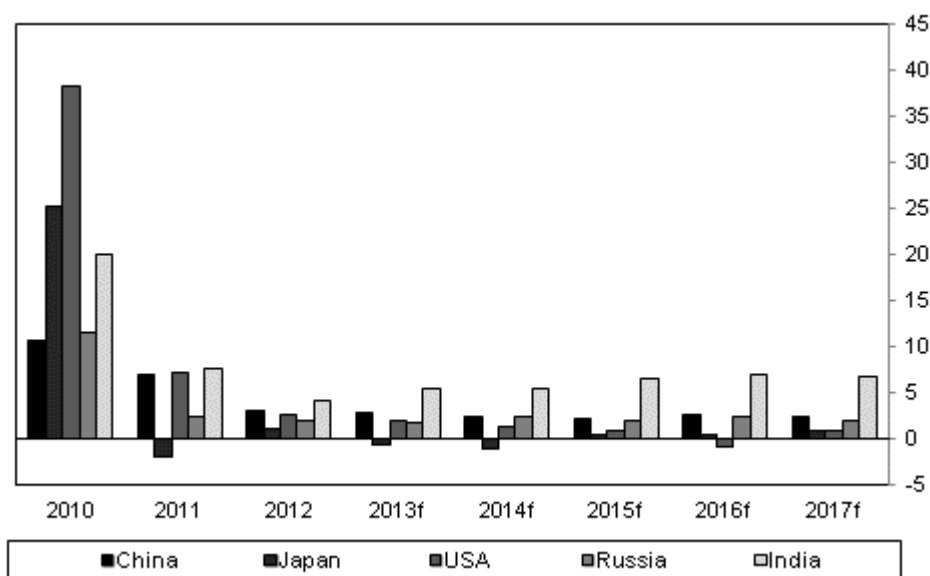
---

Source: BMI, Bloomberg

The EU has led the global production slowdown and will remain a drag on output growth as plant mothballing and shutdowns continue. Europe is home to some of the world's highest-cost steel production and as we do not expect a recovery in steel prices, wafer thin and negative margins will cause closures and production cutbacks.

## Consolidation Will Be Slow

Select Countries - Steel Production Growth (% y-o-y)



*f = BMI forecast. Source: BMI, WSA.*

Similarly, consolidation of the Chinese steel sector will be primarily driven by the deterioration in margins that has made production unprofitable at many smaller, inefficient mills. However, output will not collapse as concerns over maintaining employment will continue to take precedence and constrict the government's ability to deliver potentially painful economic and political reforms.

### Risks To Price Outlook

The risks to our price outlook are fairly even. We will continue to keep a close eye on the latest developments surrounding China's planned decision to scrap the decade-old import licensing system for iron ore. The move would eliminate middlemen in the market and allow Chinese steel mills to purchase iron ore directly from miners. The subsequent lowering of input costs may prompt the bloated steel sector to churn out more steel and impose downward pressure on prices.

On the upside, demand from China's property sector may prove more resilient than we anticipate and stem the decline in prices. Despite the fresh round of cooling measures introduced in March, house prices across

70 major Chinese cities are still rising as the lack of investment options prompt many domestic investors to channel credit into real estate in search of quick returns. While not our core view, the Chinese government could decide against providing yet more liquidity to embattled steelmakers in the near future. This would allow a painful unravelling of the steel sector and significantly reduce the amount of steel overhang plaguing the market.

**Table: Steel Forecast**

	2009	2010	2011	2012	2013f	2014f	2015f	2016f	2017f
Price, average	612	733	854	757	710	700	695	700	705
Production, mnt	1,220	1,417	1,500	1,531	1,568	1,606	1,645	1,686	1,728
Consumption, mnt	1,216	1,386	1,455	1,496	1,541	1,588	1,631	1,676	1,723
Inventories, mnt	174	205	251	286	313	331	345	355	360
Stocks to use, %	14.3	14.8	17.2	19.1	20.3	20.9	21.2	21.2	20.9
Stocks to use, weeks	7.4	7.7	9.0	9.9	10.6	10.9	11.0	11.0	10.8

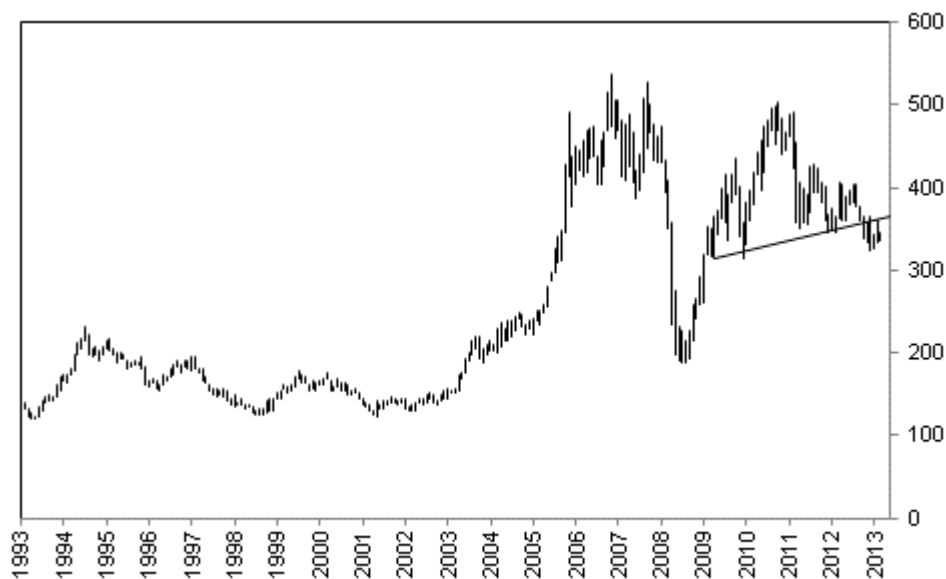
*f = BMI forecast. Source: BMI, WSA*

## Commodities Forecast

- The US Federal Reserve (Fed)'s surprise decision to delay tapering of asset purchases (QE3) has improved the short-term outlook for most commodity prices, including industrial metals.
- Looking into 2014, though, we remain bearish on key metals such as copper, iron ore and steel on a medium-term basis, and our forecasts are generally below Bloomberg consensus. We expect a relapse in Chinese economic growth by Q413 and a continued slowdown in coming years.
- The proposed reform of the London Metal Exchange (LME) warehousing system aimed at reducing significant delivery queues presents a downside risk to even our own relatively bearish price forecasts, particularly for aluminium.
- We initiated a bearish iron ore view in early September and despite the wildcard thrown by the Fed, we expect a significant decline over coming quarters. Iron ore will be the metal most exposed to a slowdown in Chinese fixed asset investment.
- Tin and lead prices will outperform other metals over coming quarters due to supply disruption and resilient demand, respectively. In other markets, improving supply (copper, iron ore) or elevated stockpiles (aluminium, zinc, steel) will undermine price performance.

### Boom Years Behind Us

S&P GSCI Industrial Metals Index (monthly chart)



Source: BMI, Bloomberg

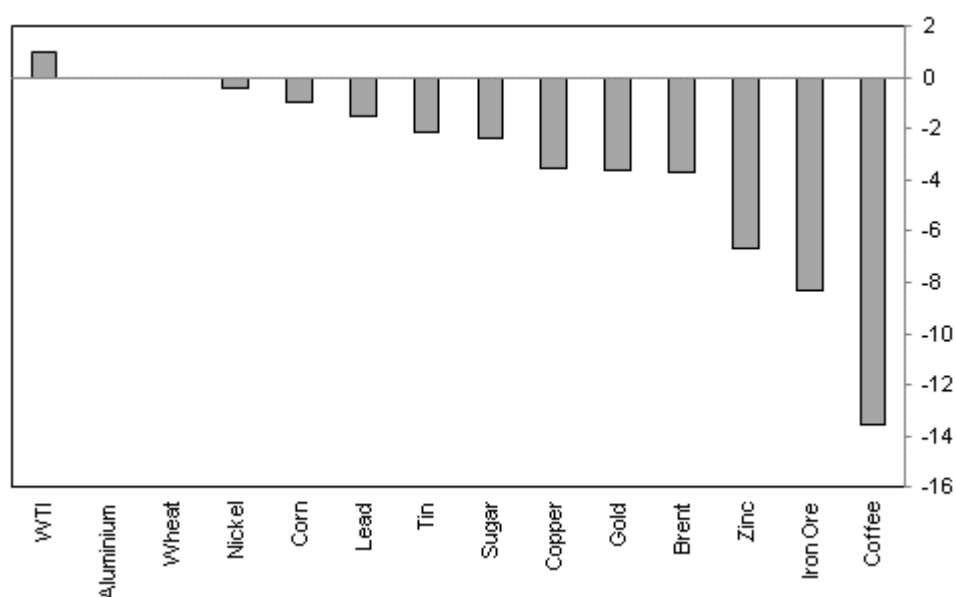


## Iron Ore: Rally To Fade In Q413

The rally in iron ore prices of recent months has limited room to run. China's latest round of stimulus package has once again greased the country's economic wheels, but our core view remains that any growth bounce will be fleeting, and that China's structural downturn will come back into focus in 2014.

### Comfortable Below Consensus

2014 Average Price Forecasts - BMI % Difference From Bloomberg Consensus

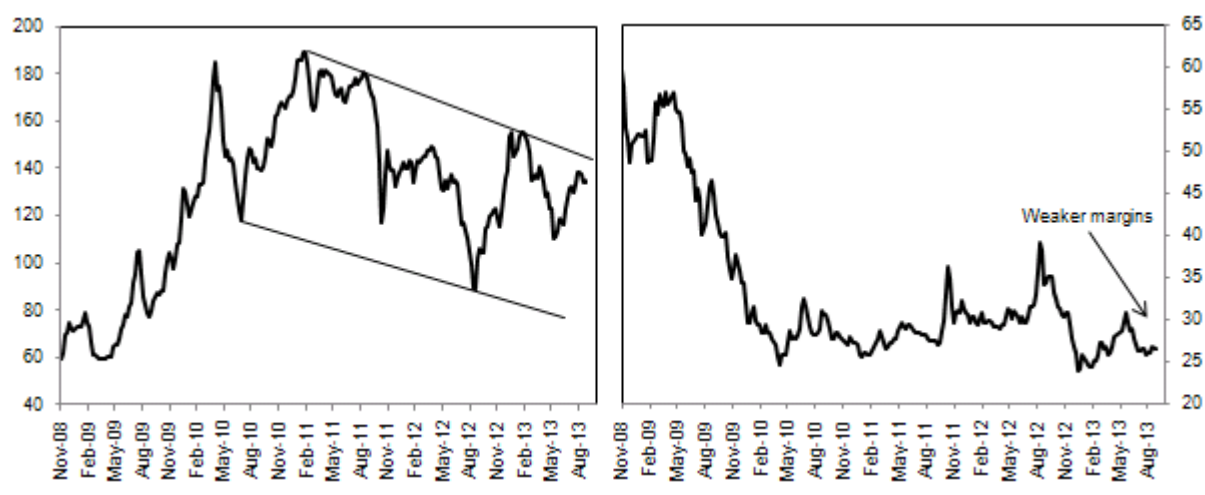


NB A negative number implies that BMI forecast is below consensus. Source: BMI, Bloomberg

We have re-initiated a bearish iron ore view in our commodities strategy table. We see room for iron ore prices to reach US\$110/tonne by the end of 2013, around 18% below current levels. Apart from a glut of new iron ore supply in H213, a combination of weak margins and government pressure are set to limit the rebound in Chinese steel production, which expanded by 12.9% year-on-year (y-o-y) in August 2013.

## Rally On Borrowed Time

China - Iron ore Import Price (US\$/tonne, LHS) And Price Ratio (steel rebar/iron ore, RHS)



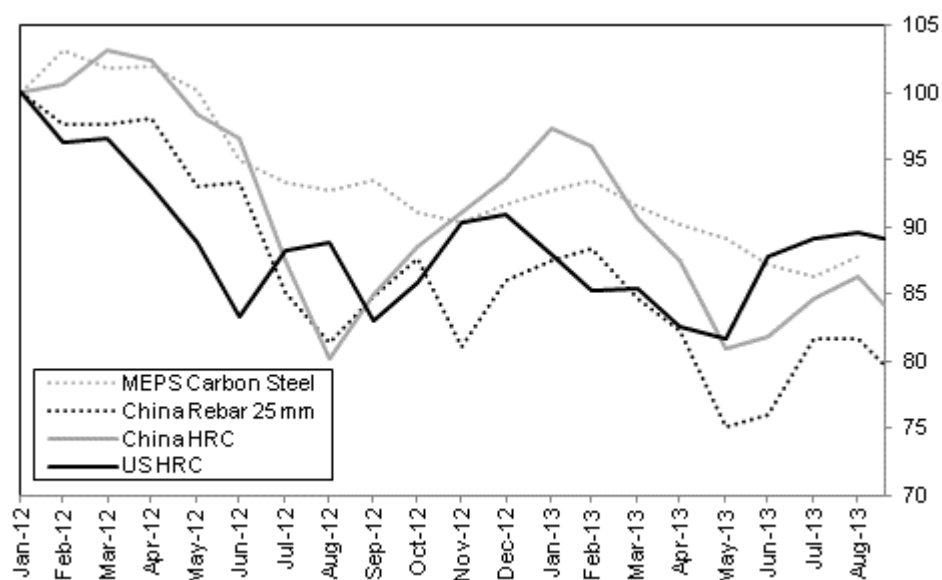
NB China iron ore import price, 62% grade (US\$/dry metric tonne, CFR). Source: BMI, Bloomberg.

## Steel: Supply Glut To Endure

We remain bearish on steel and forecast the MEPS carbon steel index to average US\$710/tonne and US\$700/tonne in 2013 and 2014, respectively. The global steel market will remain mired in significant overcapacity, sluggish demand and weak margins.

## Supply Glut Weighing On Prices

### Select Steel Contracts, Rebased



NB January 31 2012 = 100. Source: BMI, Bloomberg

Despite promising signs of economic recovery in the US, there have been no developments to suggest significant strengthening of global demand for steel. Surplus Chinese supply will continue to seep into global markets, as we have seen recently a strong uptick in Chinese steel exports. We expect rebalancing of the Chinese steel sector to be a protracted process, as the authorities remain reluctant to close down loss-making steel mills for fear of the repercussions on employment.

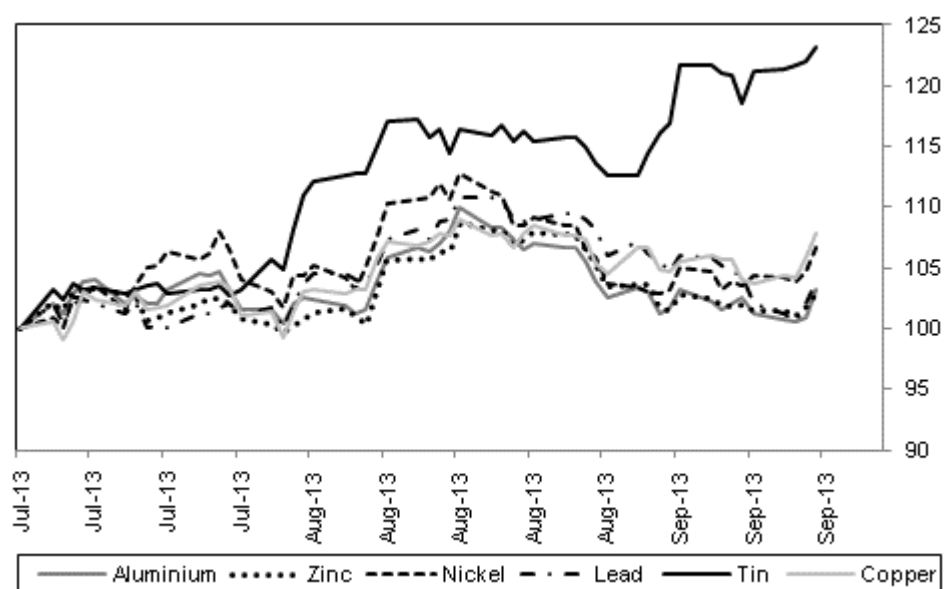
### Aluminium: Surge Gives Way

We expect aluminium prices to remain constrained in coming quarters and note downside risks to our forecast average of US\$2,000/tonne for 2014. Our expectation that aluminium's July and early-August rally would be pared back has proved correct, with prices falling below US\$1,800/tonne by mid-September. The aluminium industry will continue to suffer from a mismatch between supply and demand, with the former outpacing the latter. This is despite production cuts by major developed market producers. **Alcoa** cut capacity in Brazil in August, and will likely announce further cuts. LME inventories have come down slightly, though remain at record highs, which will weigh on prices. This is particularly the case given the

potential for reform of the LME warehouse system to result in a ramp up of aluminium supply from stockpiles in coming months.

## Tin Outperformance Playing Out

Select LME Metal Prices, Rebased



NB July 1 2013 = 100. Source: BMI, Bloomberg

## Copper: Weak Outlook

We expect the multi-quarter downtrend in copper prices to hold. Copper's bounce following the Fed's decision to push back tapering should be relatively short lived. Though positive Chinese economic data contributed to price increases in August, renewed concerns regarding economic growth appear to be weighing on prices. We also believe further Chinese fiscal stimulus will pale compared to that of 2009, potentially providing only a temporary and minimal bounce in prices. Mine supply growth and inventories remain strong, leading us to maintain our forecast for a slight market surplus through 2013. Going into 2014, we forecast prices to average US\$6,800/tonne next year.

## Prices Coming Back Down

Three-Month LME Copper (US\$/tonne, weekly chart)



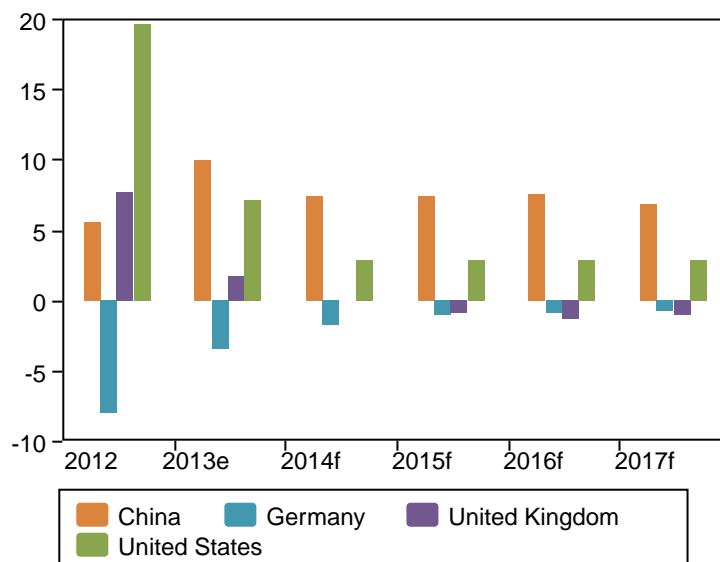
Source: BMI, Bloomberg

## Lead: Short-Term Weakness

We do not expect lead prices to rally significantly. Despite a steady decline in LME lead inventories and lead prices outperforming the other industrial metals since the beginning of 2013, inventories reported a strong uptick in mid-September. The surge in lead inventories can largely be attributed to the surprise appearance of 50,450 tonnes of lead at warehouses in Vlissingen, operated by **Pacorini**, which is owned by **Glencore Xstrata**. It is possible more lead stock could appear in a similar manner, adding downside risk to lead prices. Headwinds for prices will mount in Q413 as the structural deceleration in China's economy gains traction.

## Autos Growth To Provide Support

Selected Countries - Vehicle Production (% change y-o-y)



e/f = BMI estimate/forecast. Source: BMI, OICA, CAAM

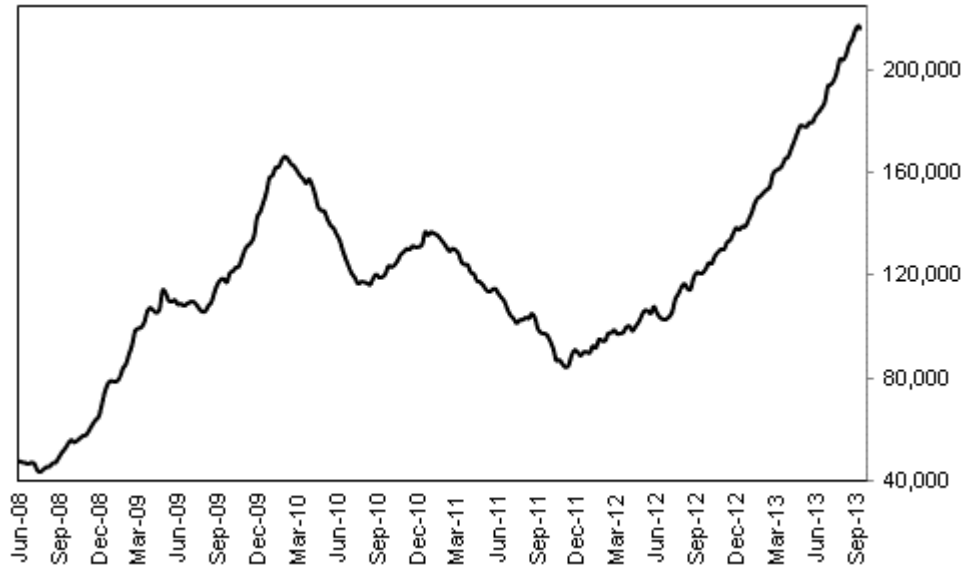
In the medium term, we expect lead prices to continue a modest secular uptrend, with prices averaging US \$2,250/tonne in 2014. Our below-consensus price forecast is largely predicated on our downbeat macro view on China. Nonetheless, demand for lead will be less affected than other industrial metals, due to its primary usage in the production of lead-acid batteries for the autos sector, the demand for which we expect to continue growing. We expect lead to remain a strong performer in the industrial metals complex as China rebalances its economy away from fixed asset investment and towards private consumption.

## Nickel: Still The Laggard

Nickel's continuous poor performance and weak fundamentals recently led us to downgrade our price forecast for 2014 to US\$15,000/tonne. We warned of an imminent downgrade given the metal's deteriorating performance. Nine months into 2013 nickel remains the worst performer in the base metals complex.

## Still Growing

Nickel - LME Inventories (metric tonnes)



Source: BMI, Bloomberg

LME inventories remain at the highest in years, reflecting both solid mine supply and weak demand growth. Chinese nickel pig iron (NPI) production, which uses lower-quality nickel grades, is putting pressure on refined nickel prices. Weak steel demand growth in the developed world is weighing on prices and production of stainless steel, which uses nickel.

## Still Falling

Three-Month LME Nickel (US\$/tonne, weekly chart)



Source: BMI, Bloomberg

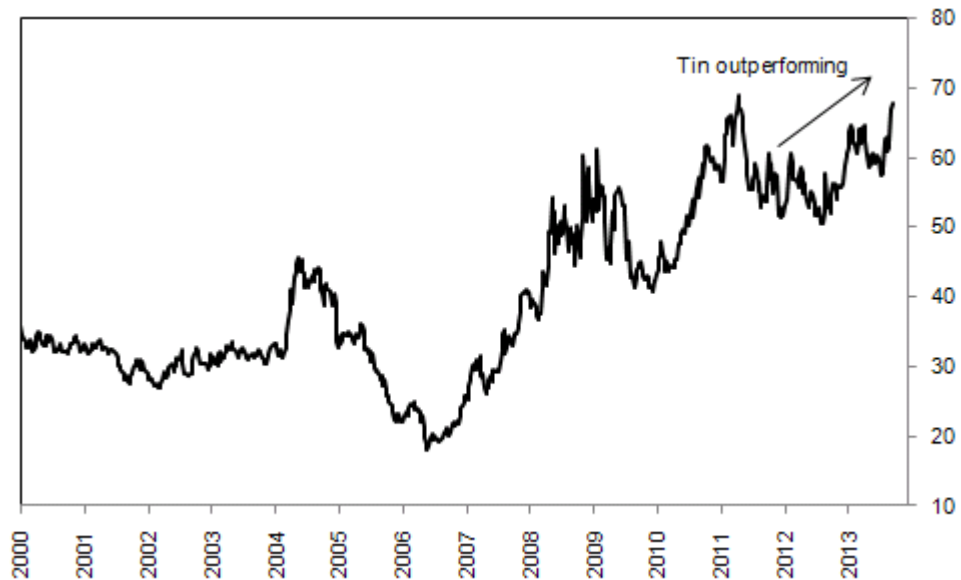
### Tin: Outperformance To Continue

We expect tin to remain an outperformer in the industrial metals complex in coming quarters. Tin's primary use in the electronics sector will bolster demand even as the downshift in the Chinese economy gains traction. Supply disruption and continued price-supportive action from Indonesia will continue to support prices over the medium term. We forecast the market to tighten significantly as consumption generally outstrips production. The global stocks-to-use ratio should decline to 6.2% by 2014 compared to a 10-year average of 9.4% after five consecutive annual deficits. In line with our view, three-month tin has broken above resistance at US\$22,500/tonne and is currently trading at US\$22,875/tonne.



## Uptrend Intact

Price Ratio: Tin/S&P GSCI Industrial Metals Index



Source: BMI, Bloomberg

## Zinc: Still A Surplus Market

We believe zinc may re-test support in the US\$1,800-1,850/tonne area. As with other base metals, strong mine output and an elevated stocks-to-use ratio will leave markets well supplied and in surplus through 2014. The majority of zinc is used for the galvanisation of steel, thus making the metal vulnerable to still weak global steel demand growth. Our bearish outlook on Chinese steel production growth in particular leads us to expect the metal to average US\$1,950/tonne in 2014, below Bloomberg consensus.

## Range-Bound

Three-Month LME Zinc (US\$/tonne, weekly chart)



Source: BMI, Bloomberg

Table: Select Commodities - Performance And BMI Forecasts

Commodity	Unit	Spot price	Year-to-date % change	1-year % change	2012, average	Year-to-date, average	2013, BMI average	2014, BMI average
Aluminium	US\$/tonne	1,839	-11.3	-14.1	2,052	1,916	1,900	2,000
Copper	US\$/tonne	7,350	-7.3	-12.0	7,953	7,417	7,300	6,800
Gold	US\$/oz	1,368	-18.4	-22.7	1,669	1,459	1,425	1,250
Iron ore	US\$/tonne	132	-9.1	20.2	128	135	120	105
Lead	US\$/tonne	2,124	-8.8	-6.5	2,074	2,165	2,200	2,250
Nickel	US\$/tonne	14,240	-16.5	-19.8	17,591	15,512	16,000	15,000
Palladium	US\$/oz	701	-0.3	5.2	645	726	na	na
Platinum	US\$/oz	1,470	-4.5	-10.4	1,553	1,520	na	na
Silver	US\$/oz	22.93	-24.0	-33.6	31.15	24.86	na	na
Steel (MEPS Carbon Steel)	US\$/tonne	691	-4.2	-5.3	755	707	710	700
Tin	US\$/tonne	23,320	-0.3	9.1	21,100	22,047	22,000	22,500

## Select Commodities - Performance And BMI Forecasts - Continued

Commodity	Unit	Spot price	Year-to-date % change	1-year % change	2012, average	Year-to-date, average	2013, BMI average	2014, BMI average
Zinc	US\$/tonne	1,917	-7.8	-9.7	1,965	1,944	2,000	1,950

na = not available. Source: BMI, Bloomberg

## Table: Global Commodities Strategy

	Entry date	Entry level	Gain/(loss)	Rationale
<b>Agriculture</b>				
Bearish rough rice (front-month CBOT)	29-Aug-13	16.65	5.77%	Thailand will release its stocks and scrap its subsidy policy, very well-supplied global market.
<b>Energy</b>				
-	-	-	-	-
<b>Metals</b>				
Bearish iron ore (SGX third-month swap)	05-Sep-2013	129.1	3.05%	Chinese demand to resume slowdown, supply to improve
Bullish platinum (spot) vs gold (spot)	29-May-2013	1.055	1.84%	Supply disruption in South Africa, growing autos use to support platinum prices. Bearish gold.

NB As of September 19. Returns do not take into account roll yield, unless stated otherwise. Source: BMI, Bloomberg

## Competitive Landscape

### Little Room For Newcomers As Sanctions Bite

Iran's relatively low level of per capita steel production demonstrates its great potential. It is also the only country in the Gulf region with the resources to become self-sufficient in steel production and is the only country in the Middle East that is not heavily dependent on iron ore imports, with domestic reserves estimated at 4.5bn tonnes, located in five main deposits. The country also has large coal reserves, which can be utilised by the steel industry, as well as the third-largest gas reserves after Russia and Qatar, representing an important source of energy for electricity generation. The downside is that steel has to compete with other industrial sectors - such as water desalination, petrochemicals and aluminium - for electricity supplies. Furthermore, sanctions on the country, which we do not expect to be lifted for the foreseeable future, will deter investment.

Iran has seen a high level of import growth since 1994, when domestic supply first outstripped demand. The government is attempting to boost production, largely in crude steel, but its target for 2012 of 15mn tonnes (mnt) was missed by nearly 2mnt, and the industry typically operates at just 50-60% of capacity.

**Mobarakeh Steel Company** represents around 47% of the market, followed by **Khuzestan Steel Company** (23%), **Esfahan Steel Company** (20%) and the **Iranian National Steel Industries Group** (10%). Mobarakeh Steel dominates exports and is heavily exposed to external markets, while **Esfahan Steel** and **National Iranian** are oriented towards domestic markets. Mobarakeh Steel was aiming to reach 10 million tonnes per annum (mntpa) of capacity by end-2012 and is planning a 700,000tpa continuous strip processing plant, with facilities including an EAF, a thin slab caster and a hot rolling line at the Saba steel plant. The crude steel production capacities of Mobarakeh Steel, Saba, as well as the Hormozgan plants were expected to rise by 7.5mnt, 1.5mnt and 1.5mnt respectively by end-2012.

**Table: Production & Sales By Producer (2012)**

Producer	% crude output	% semi-finished and finished output	% domestic sales by tonnage	% domestic sales by value	% exports by tonnage	% exports by value
Mobarakeh Steel	47	47	37	41	54	57
Khuzestan Steel	23	na	18	14	42	38
Esfahan Steel	20	25	23	27	3	4
National Iranian Steel	10	28	23	18	1	1

na = not available/applicable. Source: BMI estimates

While long steel output growth is lagging behind flat steel, there are dynamic segments within the Iranian steel industry. In 2011, **Isfahan Steel** completed the IRR300bn (US\$28.0mn) renovation of its first blast furnace, which has a production capacity of 800,000tpa; its two other furnaces each have a capacity of 1.4mntpa. However, it had no effect on Iran's overall steel output figure, and Isfahan Steel reported that its semi-finished steel output was down 3% year-on-year (y-o-y) in the first eleven months of the current Iranian year (to July 21 2013). The **Bardsir Steel** plant in Kerman province, a project owned by a holding company belonging to Iran's **Bank Pasargad**, is expected to come into operation in early 2013, comprising a 1mntpa DRI unit and a 1mntpa melt shop; although progress is reportedly slow, it looks likely to meet its deadline. Nevertheless, growth in capacity without corresponding growth in domestic demand and exports will simply lead to higher levels of surplus capacity.

By 2016, aluminium and copper production capacities are set to rise by 400,000tpa each, according to the government. This will push aluminium capacity to over 900,000tpa and copper capacity to over 600,000tpa. **BMI** believes the industry will fall well short of its targets, however, owing in large part to the effects of sanctions. Even in the absence of new sanctions, the financing, expertise and infrastructure would not be sufficient to achieve the aspirations of the steel industry, with some projects set to see lengthy delays. Individual steelmakers are, nevertheless, retaining overly optimistic forecasts.

Renewed efforts to privatise Iranian metal producers have only been partly successful. In 2011, IMIDRO announced plans to sell four new steelworks under construction to the private sector. Each of the steelworks, which consists of a DRI module, as well as a steel meltshop and billet caster, has a capacity of about 1mntpa of crude steel. The facilities, which will all be sold by tender, include **Bafgh Steel** in Yazd and in Kerman, **Sabzevaer Steel** in Khorasan and **Shadegan Steel** in Khuzestan.

### **International Sanctions**

The UN approved a fourth round of sanctions on Iran in 2010, including restrictions on financial transactions, a tighter arms embargo and the authority to seize cargo suspected of being used for Iranian nuclear or missile programmes. These were followed by yet more sanctions approved by the US Congress, which will force 'banks, insurers, energy firms and others to choose: trade with Iran and you will be barred from business with the United States.' Tougher sanctions mean trade finance is even harder to obtain when dealing with Iran, forcing the country to seek more difficult and innovative ways to bypass the sanctions or demand cash upfront. As trade comes to a halt, Iran will have less money to fund growth in its metals

industry. Moreover, given that a significant amount of new metals output was to be exported, the sanctions will cut into output growth and limit production activity.

Iran's trade with Asia in semi-finished and finished products is unlikely to be immediately affected by the tougher UN sanctions regime relating to the country's nuclear programme and further sanctions by the US and EU, although it is likely to be affected by overcapacity in China. However, increased political risk associated with sanctions will dampen future capacity growth in the sector, since Iran will find it more difficult to secure partners and financial backing for any project. Even without the sanctions regime, the investment climate is challenging owing in large part to the regulatory processes and restrictions.

Increased international isolation exacerbates the problem, with sanctions making payment and shipping processes for Iranian cargoes more complex, although some banks and shipping companies had been excluded from the list of restricted firms. For example, the **Bank of China** has stopped accepting letters of credit for Iranian cargoes, though Iranian suppliers can still get letters of credit through other Chinese banks. However, Iranian cargoes traded by Japanese and Korean trading houses are likely to be affected as these countries seek to adjust to the new sanctions and protect their US and EU markets. Given that they handle a significant bulk of Iranian exports to China, this development will restrict trade movements.

## Developments

The government is aiming to establish plants across the country, with a focus on generating jobs in underdeveloped provinces. As with most large-scale industrial projects in Iran, the objectives are political in that they are aimed at securing support among the poor, while sidelining more practical issues regarding infrastructure and access to markets and raw materials. Due to poor transport links in the country, it often remains more profitable to import steel products than to transport them internally from main production areas to more economically advanced provinces in the north of the country.

Crude steelmaking capacity continues to be ramped up at other new projects. Construction of the Oghlid Steel plant formally started in 2011. The plant is expected to have capacities of 1.1mntpa of pellets, 800,000tpa of sponge iron and 1.5mntpa of steel billet. The project is expected to be completed by 2014 at a cost of about IRR8.3trn (US\$700mn). **Sirjin Steel** is building a IRR3.5trn (US\$330mn) second phase in Kerman province with a DRI capacity of 1mntpa, which was due to be completed by end-2013. Kerman is also the location chosen for a possible new steel plant, with capacity of 1.5mntpa of billets and slabs. Part state-owned **Zarand Steel** has a contract with a consortium of contractors, including Iran-based **Ghaem**

**Reza** and China's **Sino Steel**, for the construction of a EUR513mn blast furnace plant, which is due for completion by 2013. Most output will be consumed domestically.

An Iranian consortium of 10 private sector rolling mills is constructing the 1.5mntpa Negin Kalij-e-Fars steel billet plant. The plant site is located near Khaf city, close to the Sangan iron ore mine in Khorasan Razavi province and is scheduled for completion by 2013. Kermanshah Steel is building a blast furnace which will have a capacity of 400,000tpa and was due to be completed by 2012, according to reports from July 2009. However, it was evident by late-2012 that the plant was not progressing as planned and would not be completed until 2013 at the earliest. Kermanshah Steel, located near Kermanshah city in Kermanshah province, operates a rolling mill with a capacity of 150,000tpa, which began operations in 2004 and exports most of its output to neighbouring Iraq.

**Table: Largest Listed Metal Producers In Middle East**

Company	Country	Market Cap (US\$m)	Revenue (US\$m)	Net Income (US\$m)	Profit Margin (%)	PE Ratio	PB Ratio
Egyptian Iron & Steel	EGYPT	651	307	-67	-21.8	na	128.9
Ezz Steel	EGYPT	785	3,262	1.4	0.0	645.2	1.2
Saudi Arabian Mining	SAUDI ARABIA	7,251	1,487	291	19.6	27.3	1.5
Arabian Pipes	SAUDI ARABIA	230	181	-6.8	-3.7	na	1.3
EL Ezz Aldekhela Steel Alexandria	EGYPT	936	2,413	101	4.2	9.5	2.1
United Wire Factories	SAUDI ARABIA	420	268	31	11.5	13.7	3.8
Aluminium Bahrain BSC	BAHRAIN	2,002	1,972	256	13.0	6.5	0.9
Saudi Steel Pipe	SAUDI ARABIA	370	194	14	7.4	23.6	1.7
Kuwait Foundry	KUWAIT	217	7.8	3.9	49.9	197.4	1.2
National Metal Manufacturing & Casting	SAUDI ARABIA	266	107	1.6	1.5	166.6	2.8
Egypt Aluminium	EGYPT	255	751	19	2.6	na	0.5

na = not available/applicable. Source: BMI, Bloomberg

## Company Profile

### Mobarakeh Steel Company

---

#### Strengths

- Mobarakeh is Iran's largest steel producer and should benefit from the Iranian government's ambitions infrastructure plans.
- The company benefits from subsidised energy costs which help keep output expenses relatively low.

#### Weaknesses

- Sanctions will remain in place for sometime which will restrict the company's ability to export.
- We hold a bearish outlook on the country and do not expect the economy to pick up significantly anytime soon.

#### Opportunities

- Any significant rapprochement between the US and Iran would bode very well for the company's outlook.

#### Threats

- Political risks in Iran will remain high for the foreseeable future.
- 

#### Company Overview

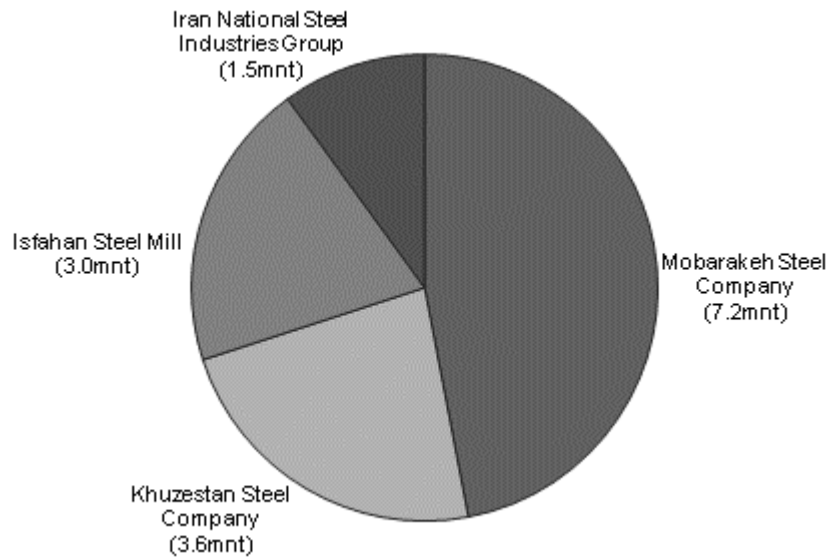
Mobarakeh Steel Company is located 65km south west of Esfahan, near the city of Mobarakeh. It is Iran's largest steelmaker, having begun operations in 1993. The company produces 7.2mntpa, with an additional four ladle furnaces coming on-stream.

The complex's steelmaking and continuous casting plant has eight electric arc furnaces, which use scrap for 15% of feedstock. The plant also has four ladle furnaces. It has four continuous slab casting machines, with slab production capacity currently at 5.4mntpa. The complex also produces HRC and CRC, pickled coils, narrow strip coil, tinplate sheet, galvanised coil, pre-painted coil and slab.



## Little Change Ahead

### Iran - Largest Steel Producers, 2012



---

Source: BMI, Ministry of Mines Iran

Mobarakeh Steel is aiming to reach 10mntpa of capacity in 2014. The company receives its iron ore from mines in Golgohar and Chadermaloo (Kerman and Yazd provinces) which is converted to pellets in the pelletizing plant (diameters: 8-10 mm). In 2009, it began an expansion project to add an extra 1.2mntpa of crude steel capacity and take its overall capacity to 5.4mntpa within a year of commissioning. It is also constructing three DRI modules with a total capacity of 4.5mntpa, while its Shahid Kharazi steelmaking project will create an extra 2.2mntpa of crude steel capacity. It is also constructing another compact strip processing plant that will have a capacity of 700,000tpa.

## Methodology

BMI's industry forecasts are generated using the best-practice techniques of multiple regression analysis, using a combination of industry indicators, as well as country-specific, regional and global macroeconomic variables that have statistically-significant explanatory power in explaining past movements in industry-specific indicators. The indicators use varies from industry to industry, and from country to country within each industry, depending on the structure of supply and demand

When forecasting for some of our industry sub-component variables, however, using a variable's own history is often the most desirable method of analysis. Such single-variable analysis is called univariate modelling. We use the most common and versatile form of univariate models: the autoregressive moving average model (ARMA).

In some cases, ARMA techniques are inappropriate because there is insufficient historic data or data quality is poor. In such cases, we use either traditional decomposition methods or smoothing methods as a basis for analysis and forecasting.

Human intervention plays a necessary and desirable part of all our industry forecasting techniques. Intimate knowledge of the data and industry ensures we spot structural breaks, anomalous data, turning points and seasonal features where a purely mechanical forecasting process would not.

## Cross Checks

Whenever possible, we compare government and/or third-party agency projections with the reported spending and capacity expansion plans of the companies operating in each individual country. Where there are discrepancies, we use company-specific data as physical spending patterns ultimately determine capacity and supply capability. Similarly, we compare capacity expansion plans and demand projections to check the chemicals balance of each country. Where the data suggest imports or exports, we check that necessary capacity exists or that the required investment in infrastructure is taking place.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.