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#206, Elite Complex B,
Chinggis Avenue 14, 1st khoroo
Sukhbaatar district
Ulaanbaatar,
Mongolia

Any inquiries for more information, any feedback, suggestions or comments that you would like share with us are welcomed as always. Please contact us at:

Email: staff@frontier.mn
(T) 976-7011-9999
(F) 976-7011-1991

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Iron ore market outlook

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China's steel consumption dropped 0.3 per cent to 500 million tonnes in the first eight months of 2014. This decline in China's steel consumption marks the first time demand has shrunk since 2000. The main reason of this decline is China's focus on growth on consumption and away from investment that has fuelled years of massive expansion in China's steel sector. Xiaoqi Wang, vice chairman of the China Iron and Steel Association said: "From now, domestic steel output and consumption won't rise along with economic growth."

With iron ore prices at five-year lows, the big miners have expected high-cost Chinese producers to be displaced by cheaper foreign supplies and imports to China in the first 11 months of 2014, rose by 13.4 percent to 846 million tonnes. Australia estimated that China's total imports of iron ore will rise to 973 million tons in 2015 from 938 million tons in 2014.

World iron ore trade outlook in 2015 (metric ton)

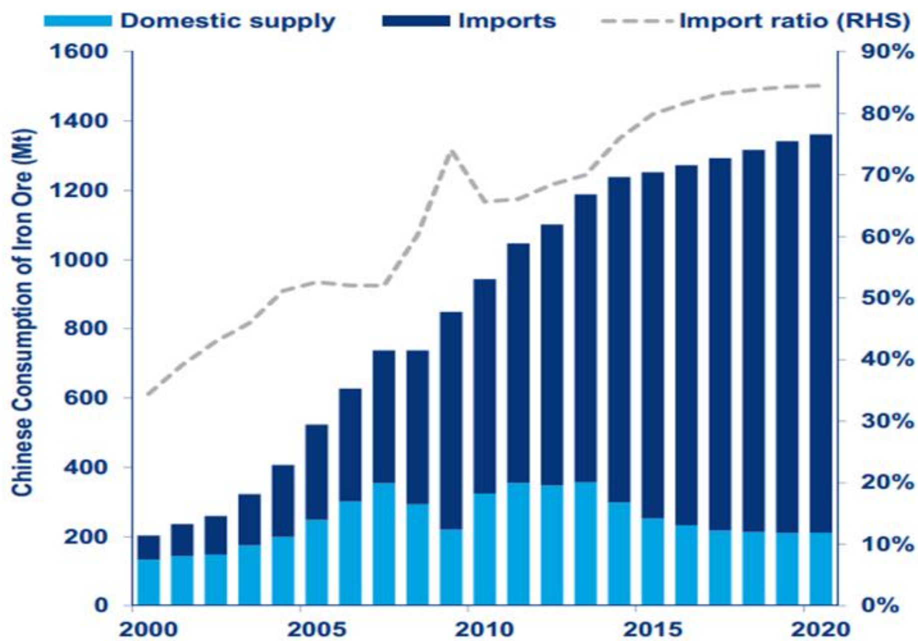
World iron ore trade (metric ton)	2012	2013	2014 f	2015 f	% change
Iron ore imports					
European Union 28	121	128	125	123	–1.6
Japan	131	136	137	138	0.4
China	745	820	938	973	3.7
South Korea	66	63	63	64	1.3
Iron ore exports					
Australia	492	579	718	766	6.6
Brazil	327	330	362	388	7.0
India (net exports)	16	9	– 3	– 2	–19.9
Canada	35	36	34	29	–15.0
South Africa	54	48	46	43	–5.8

Source: Bureau of Resource and Energy Economics of Australia

China Metallurgical Industrial Planning and Research Institute forecasted that China's demand for iron ore is expected to touch 1.157 billion tons in 2015, a 1.67% year-on-year increase. The institute also predicted that 77.5% of China's iron ore demand in 2014 will depend on imports and the imports in 2015 will continue to grow, reaching 80% of the total demand given the further decline in imported iron ore prices.

Wood Mackenzie also suggest that Chinese iron ore import dependence will increase to 85% by 2020. As Australian iron ore production expansions mostly target China, domestic supply will be squeezed out.

Iron ore consumption trend of China



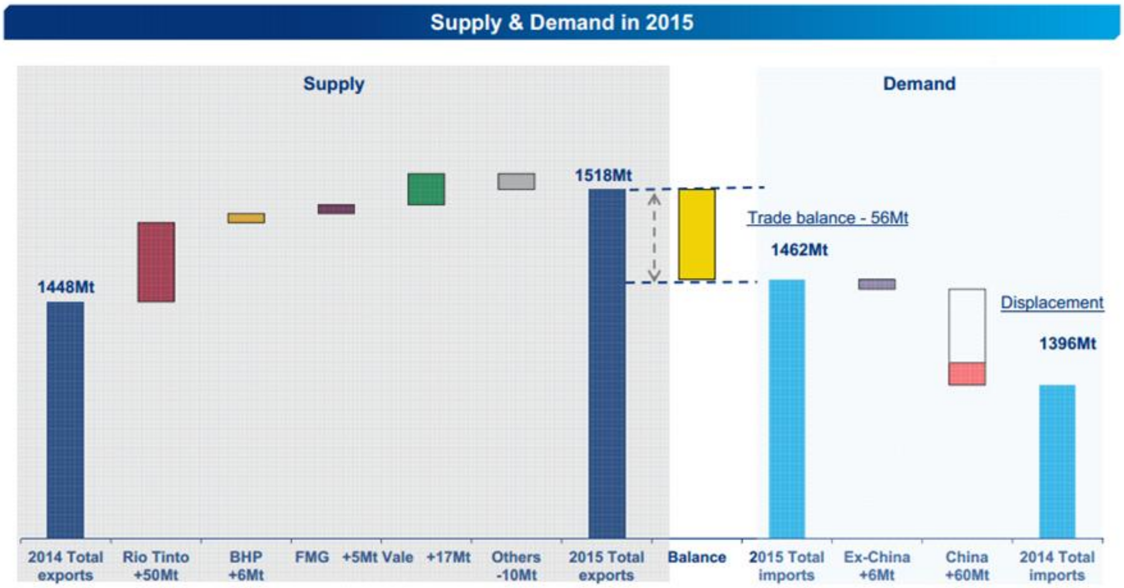
Source: Wood Mackenzie

One of the highlight in the world steel market in 2014 was India's iron ore import, which jumped to record 5 million tonnes in April to October, Reuters informed. Gathering momentum in Indian imports should absorb some of the global surplus of iron ore and help stabilize prices that have been hammered by slowing demand from top buyer China. But analysts warned that shipments to India, a country that holds vast reserves of iron ore, would not wholly make up for the drop in Chinese appetite or fuel a sharp rebound in global prices from their lowest since 2009.

On the supply side, giant iron ore producers however still see that China's iron ore demand to be resilient. Rio Tinto Group, BHP Billiton Ltd. (BHP) and Vale SA (VALE5) have expanded output in 2014 and planning to expand their production in 2015, pushing the market into more oversupply. For example Rio Tinto, which has charted a capacity expansion plan from its current 290 million tons to 360 million tons by mid-2015, has low iron ore costs of around $40 a ton, according to Andrew Harding, chief executive of the company's iron ore business.

Global output of iron ore will exceed demand by 52 million tons in 2014 and 163 million tons in 2015, according to Goldman Sachs Group Inc. Wood Mackenzie also suggest that iron ore export will exceed the import, but by lesser amount, 56 million tonnes in 2015.

Supply and demand of iron ore in 2015



Source: Wood Mackenzie

Oversupply of the market push the price of the raw material to five year low. Australia, the largest exporter of iron ore, has been impacted as miners pull out of the country or shutter projects. The lack of investor confidence has dragged the Australian dollar down.

However oweHXlow-cost mines in Australia and Brazil are expected to continue to expand global supply. All of the world's giant iron ore producers, which includes Vale, Rio Tinto and also BHP Billiton, has spent approximately about 120 billion dollars, since the year 2011 increasing the production of iron ore at a recording speed. In the long run, they are still expected to increase their production. JPMorgan stated that an additional 341 million tons of capacity will be added over the next five years by Rio, Vale, BHP, Fortescue Metals Group Ltd. (FMG) and Hancock Prospecting Pty's Roy Hill Holdings.

The world's top iron ore producer, Vale, is targeting to raise its annual output to 453 million tonnes by 2018 from 306 million tonnes in 2013. Second-ranked Rio Tinto agrees, saying long-term fundamentals remain strong. "We expect Chinese growth in steel consumption per capita to continue out as far as 2030. Rio Tinto's assessment remains that China will reach around 1 billion tonnes of crude steel demand by 2030," said Alan Smith, Asia president for Rio Tinto Iron Ore. These giant producers' optimistic prospect is supported by the news that China's National Development & Reform Commission (NDRC) has approved 43 infrastructure projects since Oct. 1, including 8 large projects on Dec. 22 and 23, with investment totaling 234.6 billion yuan.

Mongolia has exported 5.5 tonnes of iron ore to China in the first eleven month of 2014. The total value of exported iron ore was over 400 million USD and average value is calculated around 72USD per tonne. Mongolia is estimating to export 5 million tonnes of iron ore to China in 2015. Such small scale iron ore production will be pressured by the price decline in 2015 and competition from other giant producers with low production cost.

Iron ore price outlook for 2015

Iron ore will average $67 a ton in 2015, 24 percent less than previously forecast, and $65 in 2016, down 23 percent, JPMorgan Chase & Co. said. Department of Industry of Australia sees the commodity averaging $60 a ton in 2015 compared with a $94 forecast in September 2014, as surging output in the world's top exporter outpaces Chinese demand growth.

The market needs to absorb a surplus of about 110 million tons in 2015, almost double the 60 million tons in 2014, Goldman Sachs Group Inc. estimated in October. The bank forecasts a price of $80 in 2015.

"Price fall of 2014 reflects the competitive expansion in Australia, a shift that is sidelining high-cost producers," Morgan Stanley said in an report in December. The bank cut its 2015 price outlook by 9 percent to $79 a ton and the 2016 forecast by 14 percent to $75 a ton, ranking iron ore as the least-preferred metal after gold on a 12-month view.

Vale Chief Executive Officer Murilo Ferreira on other hand sees that prices to return to an average $85 to $90 in 2015 as high-cost mines shut.

Summary of iron ore price forecast for 2015 (USD/per ton)

	Morgan Stanley	**Citi Group**	**JP Morgan &Chase**	**Department of Industry, Australia**	**Goldman Sach's**	**Vale**	**Average**
Iron ore price	79	65	67	60	80	85	72.6

Summary

As experienced in other commodity market, steel and iron ore market hardly hit by oversupply and slower demand in 2014. Chinese steel consumption shrank for the first time in 14 years and the price of iron ore plunged to the 5 year low. The decline in prices is squeezing producers, prompting mining companies to cut jobs and drive down costs. However, the giant producers of iron ore are not likely to cut their production in 2015 due to the low production cost. They expect that Chinese steel consumption still can increase at the modest 1- 1.5 percent in 2015, therefore iron ore import also could increase. SMM has informed that steel industry of China is still dependent of iron ore import.

Although the average price outlook of iron ore in 2015 is around 70 USD/per tonne, the price could fall even more, closer to 60USD/tonne at some point of 2015, given a further supply additions expected from major producers well in excess of demand. We see iron ore market to be bearish for the next 12 months.

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FRONTIER Securities
#206, Elite Complex B,
Chinggis Avenue 14, 1st khoroo
Sukhbaatar district
Ulaanbaatar,
Mongolia

Tel: +976 7011 9999
Fax: +976 7011 1991
Email: staff@frontier.mn
Web site: www.frontier.mn