

CHINA STEEL BRIEFING

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Solid Conditions for Chinese Steel Price Recovery in 2H September

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Highlights

As Growell predicted **long** product prices made a **slight recovery** while **flat** product prices continued a **modest decline** during the past two weeks, with fundamentals of supply and demand remaining almost unchanged.

Current **downward trend** in China's steel prices will **continue** for a **one-month** period. Growell expects market prices will **recover in 2H September or early October**. Reasons are:

1. Growell's statistics show that growth rate of effective capacity for HR and CR will slow significantly in Q4.
2. Demand is likely to pick up in late September or early October, based on the analysis of historical production data for the automobile and home appliance industries.
3. Wide price spread between China and global market in early July could result in more export deliveries in Q4.

Baosteel's Q4 prices may be **reduced by 5-10% from Q3 levels**, from people familiar with this matter. However, Growell predicts Baosteel will **likely maintain** its Q3 prices through Q4.

News & Analysis

- To Hold or Drop Prices? A Question For Baosteel
- Demand from Automobile and Home Appliance will Recover While Capacity Growth Slows Down in Q4
- VAT Refund Rate Reduction Has Limited Impact on Export Profits
- DeBar and Wire Rod – Decreasing Supply and Weak Demand
- Hot Rolled – Supply Increased Due to Export Reduction
- Cold Rolled – Continuously Declining Prices in Q3
- M&H Plate – Increased Targeted Maintenance Offsetting Incremental Capacity
- Galvanized – Stable Prices in August, Mild Increases in September

Spot Market Price Changes

(unit: USD/mt)

Product	Aug 18	Aug 11	Change	% WoW	Equivalent FOB Price	Baosteel August Price (ex-works)
DeBar (HRB335 Φ16-25mm)	374	373	1	0.2%	364	na
Wire Rod (Q235 Φ6.5mm)	401	399	2	0.5%	389	na
HR (Q235/SS400 4.5-7.5mm*1500*C)	447	450	-4	-0.8%	430	577
CR (SPCC/ST12 1.0mm*1250*2500)	585	591	-6	-1.0%	555	701
Medium & Heavy Plate (Q235B 20mm)	439	439	0	0%	422	629
GI (ST02Z 1.0mm*1000*C)	690	690	0	0%	650	738

Note: All prices include 17% VAT and are per tonne, unless otherwise stated.

Data Source: Growell Research

Growell Research & Consulting (Shanghai) Co., Ltd.

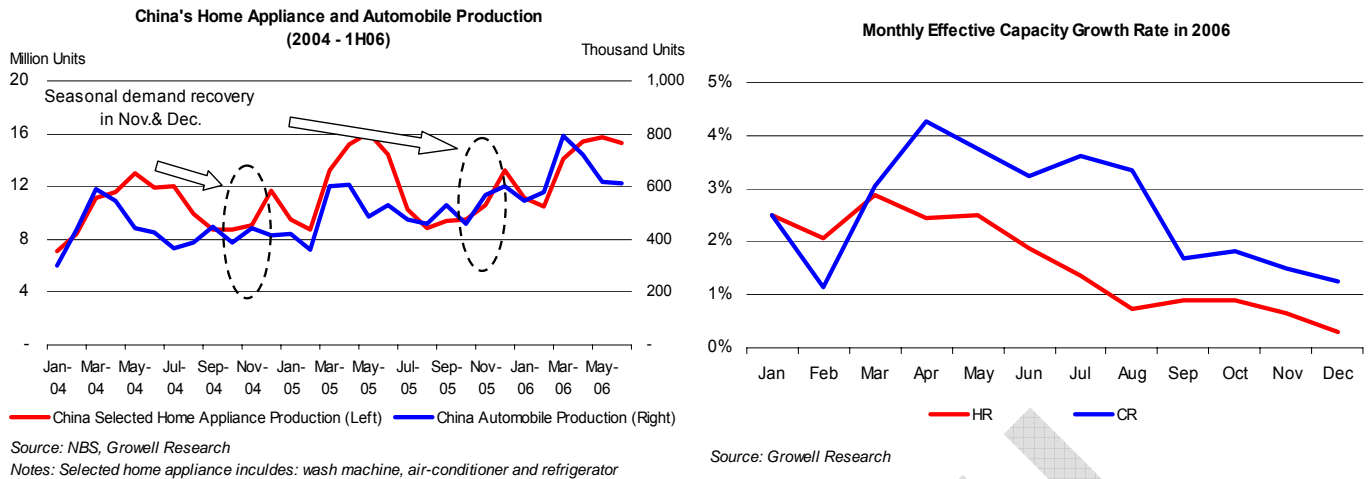
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Solid Conditions for Chinese Steel Price Recovery in 2H September

● Demand from Automobile and Home Appliance will Recover While Capacity Growth Slows in Q4



Growell expects market prices will continue to slide for another month before a rebound beginning 2H September or early October.

Reasons are:

1. Supply: Sufficient capacity of long products will ensure that outputs can match demand. Outputs of flat products will grow since newly built plants are achieving full operating rates. Growell statistics show that growths of effective capacity of HR and CR will slow in Q4, relieving the supply surplus pressure.
2. Demand: Automobile and household appliance industries will undergo a second seasonal peak of production during November and December. Since the purchase of raw material leads production by 1-2 months, steel demand from these two industries can recover from 2H September to early October. Additional new construction projects will also break earth after the July-August off-season despite unfavorable macro-control policy.

Thus, Growell anticipates that market prices will rebound starting in 2H September or early October on the back of stronger demand and slower growth in supply.

● VAT Refund Rate Reduction Has Limited Impact on Export Profits

	Steel Products	Ex-works Price	Corresponding Export Price	Current Export Price	Export Margin	Change in Margin (USD/mt)	% Change in Margin
		(RMB/mt) (incl. VAT)	(USD/mt) (FOB) (ex-VAT)	(USD/mt) (FOB) (ex-VAT)	(over domestic sales)		
VAT Refund Rate 11%	DeBar (HRB400 Φ16-25mm)	3,100	376	400	24	na	na
	Wire Rod (6.5mm)	3,200	387	420	33	na	na
	HRC (4.0*1500*C)	3,600	433	500	67	na	na
	CRC (1.0mm*1250*C)	4,800	569	590	21	na	na
	M & H Plate (20mm)	3,500	421	520	99	na	na
	GI (1.0mm*1000*C)	5,500	648	800	152	na	na
VAT Refund Rate 8%	DeBar (HRB400 Φ16-25mm)	3,100	386	400	14	-10	-26%
	Wire Rod (6.5mm)	3,200	398	420	22	-10	-31%
	HRC (4.0*1500*C)	3,600	444	500	56	-12	-17%
	CRC (1.0mm*1250*C)	4,800	584	590	6	-14	-26%
	M & H Plate (20mm)	3,500	433	520	87	-11	-12%
	GI (1.0mm*1000*C)	5,500	665	800	135	-18	-12%

The export VAT refund rate is expected to be reduced in textile, steel, metallurgy and machinery industries. Export VAT refund rate of finished steel (some high end products are excluded) will be decreased from 11% to 8%, taking effect within one month.

Growell statistics show that the 3% reduction in export VAT refund will not have significant impact on export profits. The reduction in export VAT refund will bring additional costs of about USD10/mt for long products and USD10-20/mt for flat products. Given the thin profit margins for domestic sales, exports are still the more profitable choice.

Due to the considerable spread between global and domestic prices, higher export prices from China could still be accepted by overseas buyers.

● To Hold or Drop Prices? A Question for Baosteel.

Solid Conditions for Chinese Steel Price Recovery in 2H September

Baosteel's Q4 prices could be reduced by 5-10% from Q3 level, from people familiar with this matter.

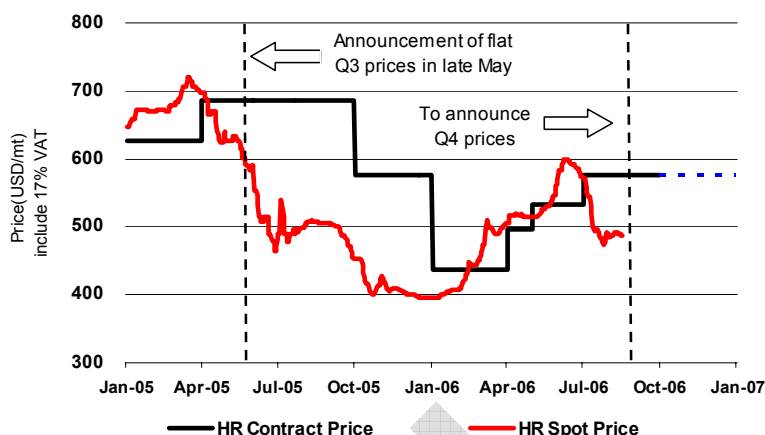
- HR down by RMB200-300/mt (USD25-38/mt), VAT excluded, roughly 5-8%.
- CR down by RMB500/mt (USD63/mt), VAT excluded, roughly 10%.
- M&H Plate will maintain September price.

Growell predicts Baosteel will likely maintain its Q3 prices through Q4. Reasons are:

1. Market prices may recover in early Q4 which will match Baosteel's flat Q4 prices.
2. Recent market prices are stabilizing, so Baosteel, the benchmark price provider in the market, would not upset the market and frustrate market players' confidence by reducing Q4 prices.
3. This present pricing scenario is similar to that of 2Q05, when Baosteel maintained its Q2 prices through Q3.

4. Baosteel has been reviewing and modifying its quarterly prices on a monthly basis, if necessary, since April 2006. Prices can be lowered in November and December to match market prices.

Baosteel HR Contract Price and China's Spot Price (Jan. 2005 - Sep. 2006)



Data Source: Growell Research

DeBar and Wire Rod - Decreasing Supply and Weak Demand

Review

Domestic market prices rose moderately during the past two weeks due to stable demand and mild shrinkage of inventory. The Debar price is at USD374/mt, up USD1/mt WoW, or 0.2%. The Wire Rod price is at USD401/mt, up USD2/mt WoW, or 0.5%.

Forecast

1 Short-term: DeBar and Wire Rod prices should remain stable until late August.

1.1 Supply:

1.1.1 Expected production in 2H August will decrease from 1H August as Debar steel mills conduct unscheduled maintenance.

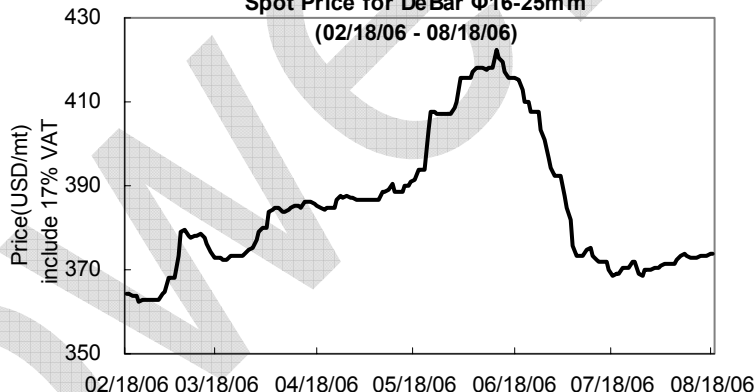
1.1.2 Exports in August will remained relatively unchanged from July as export growth has been moderated.

1.2 Demand: Demand from the construction industry is still weak due to August seasonal low and macro-control policy. This also reflects a lack of new building projects breaking earth.

1.3 Cost: With slim profit margins, integrated mills began to cut production in order to stabilize market prices. Mini mills have shut down production since they can not afford the price rise in Billet.

1.4 Market sentiment: Traders are likely to undersell goods at the end of August due to the pressure of prepayment to steel mills.

Spot Price for DeBar Φ16-25m (02/18/06 - 08/18/06)



Data Source: Growell Research

Hot Rolled – Supply Increased Due to Export Reduction

Review

Market prices slid during the past two weeks. The HR price is at USD447/mt, down USD3/mt WoW, or 0.8%.

Forecast

1 Short-term: The market price will continue to decline but at a slower pace over the next two weeks.

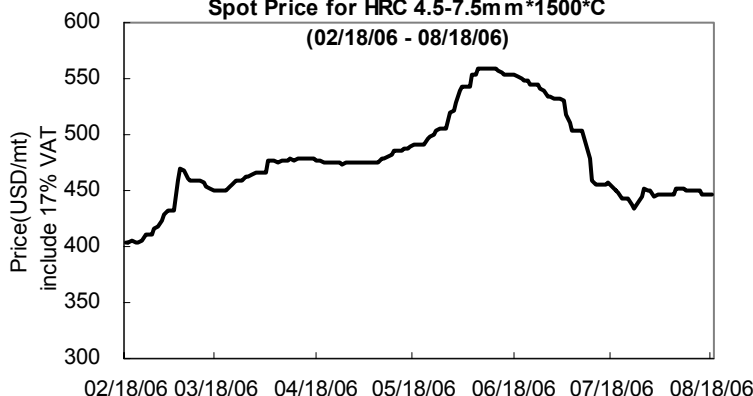
1.1 Supply:

1.1.1 Growell statistics show that planned quantity (for direct sales, not rerolling) of 27 key steel mills will be 3.6mnt in August, up by 2.2% from July.

1.1.2 According to Growell's primary research, major steel mills plan to export 538.5kt in August, down 59.1% from July.

1.2 Demand: Steel structure, agricultural machinery, and automobile industries are in seasonal off-peak period.

Spot Price for HRC 4.5-7.5mm*1500°C (02/18/06 - 08/18/06)



Data Source: Growell Research

Solid Conditions for Chinese Steel Price Recovery in 2H September

- 1.3 Cost: HR market price is currently around USD438/mt while cost is at USD375-400/mt. Growell believes the price is unlikely to decrease sharply.
- 1.4 Market sentiment:
 - 1.4.1 Wuhan Iron & Steel offered rebate of USD25/mt to its distributors and also lowered ex-works price for September delivery by USD25/mt. Benxi Iron & Steel decreased September price by USD88/mt, indicating pessimistic outlook for the future.
 - 1.4.2 Baosteel is expected to lower HR price for Q4 delivery by 5% (USD25-38/mt) from Q3. However, Growell anticipated that Baosteel is likely to maintain the Q3 price through Q4.

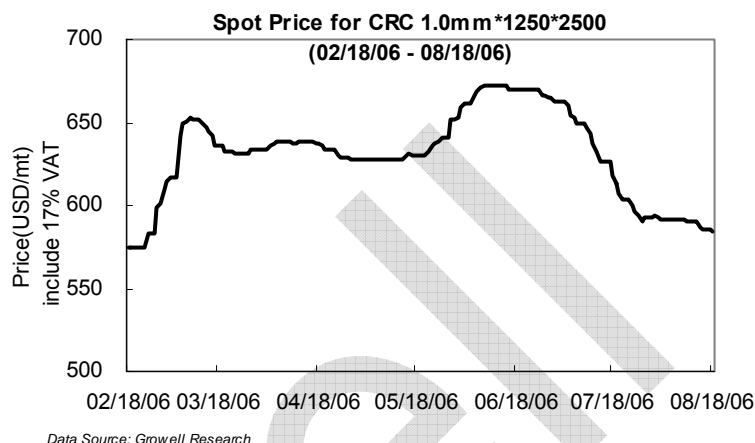
● **Cold Rolled – Continuously Declining Prices in Q3**

Review

CR prices decreased marginally due to stable HR prices and mild growth in inventory. The CR price is at USD585/mt, down USD6/mt WoW, or 1.0%.

Forecast

- 1 Short-term: The price will decline gradually in August due to increasing supply from steel mills and weak demand.
- 2 Mid-term: A decrease in Q3 prices is expected
 - 2.1 Supply: Growell statistics show that domestic capacity expansion will maintain high growth in August.
 - 2.2 Demand: Demand is sluggish as household appliance and automobile industries experience their seasonal production slowdown.
 - 2.3 Cost: The profit margin is currently large at a market price of USD594/mt, with CR cost between USD 500-525/mt.
 - 2.4 Market sentiment:
 - 2.4.1 From unconfirmed sources, Baosteel will decrease Q4 prices of major steel products by 5% from Q3, CR down by USD63/mt.
 - 2.4.2 Wuhan Iron & Steel offered rebate of USD25/mt to its distributors. Benxi Iron & Steel has lowered September price by USD63/mt, negatively affecting traders' confidence.
 - 2.4.3 The reasonable spread between HR and CR prices should be USD100-125/mt. CR prices will continue to decrease as the current spread is as wide as USD156/mt.



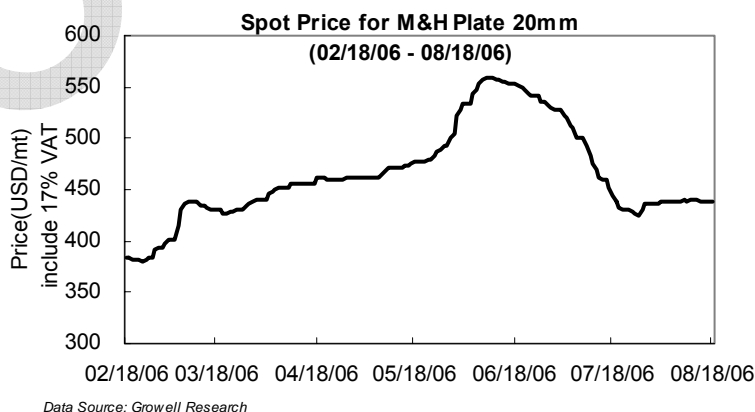
● **Medium and Heavy Plate – Increased Targeted Maintenance Offsetting Incremental Capacity**

Review

Domestic market prices were stable with fewer transactions in 1H August. The Medium and Heavy Plate price remains at USD439/mt.

Forecast

- 1 Short-term: Prices should be stable in late August due to low levels of inventory but weak demand.
- 2 Mid-term: Prices should remain stable in September.
 - 2.1 Supply: Linfen Iron & Steel, Minmetals Yingkou Medium Plate and Jiuquan Steel Group will shut down the production lines for maintenance from August to early September. New production lines of Handan Iron & Steel, Hebei Puyang Iron & Steel and Jiangsu Feida Group have already achieved full operating rates and aggregate production will remain stable in August.
 - 2.2 Demand: Demand is beginning to rebound as downstream industries gradually increase operations due to better weather conditions.
 - 2.3 Market Sentiment: Baosteel is expected to announce Q4 heavy plate price in late August remaining unchanged through September.



● **Galvanized – Stable Trend in August and Mild Increase in September**

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Review

During the past two weeks, GI market price stabilized at USD680-701/mt. The GI price remains at USD690/mt.

Forecast

1 Short-term: Prices will remain low through late August.

1.1 Supply:

1.1.1 Tangshan Hengtong began to cut its production in order to reduce inventories.

1.1.2 Steel mills' planned exports decreased in August compared with July.

1.2 Demand: Downstream demand is weak as construction, household appliance, and automobile industries will experience seasonal shrinks in August.

1.3 Cost: Market prices are close to or slightly lower than costs. Domestic zinc ingot stabilized at USD3,500/mt, and HR stays at USD438/mt, giving robust support to GI market prices.

1.4 Market sentiment: Benxi Iron & Steel canceled its rebate plan for August delivery in order to stabilize market confidence.

2 Mid-term: Prices will inch up in September.

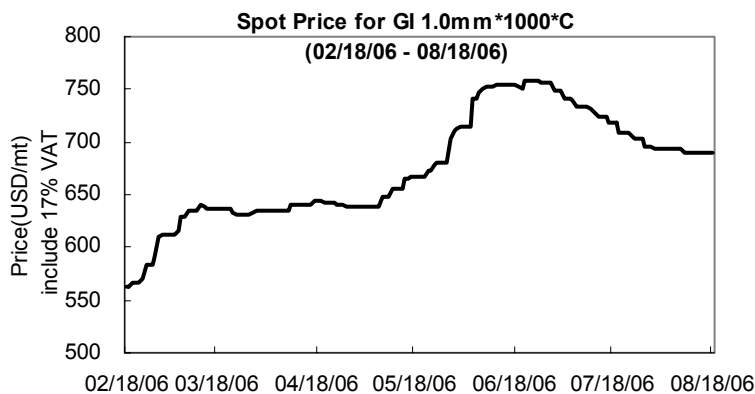
2.1 Supply:

2.1.1 Domestic supply will increase due to fewer export contracts in September.

2.1.2 Private steel mills are either shutting down production lines or operating at low rates.

2.2 Demand: Growell believes downstream demand will pick up as construction, household appliance and automobile industries experience their peak production season during September and October.

2.3 Cost: State-owned and private steel mills are operating with meager profits.



Data Source: Growell Research

