GFMS METALS CONSULTING

STEEL MARKET FORECAST BRIEFING

Analysis of the global flat product and raw materials markets

North America , Europe , Asia , Emerging Markets — December , 2005

STEEL MARKET BRIEFING Table of contents

GFMS-MC Steel price indices (December 2005) (Jan 03 = 100)

	Index	MoM	YoY
Scrap	166	(3.2%)	(9.8%)
Slab	135	(1.9%)	(35.0%)
Plate	171	(3.3%)	(30.8%)
HR	143	(2.4%)	(27.5%)
CR	134	(1.5%)	(25.1%)
HDG	139	(0.4%)	(18.9%)

Published by:
GFMS Metals Consulting Ltd
Hedges House, 153-155 Regent Street
London W1B 4JE, UK
Tel +44 (0) 20 7478 1777
Fax: +44 (0) 20 7478 1779
neil.buxton@gfms-metalsconsulting.com
www.gfms-metalsconsulting.com

Contributors:
Neil Buxton, Philip Klapwijk, Paul Walker, Peter Roberts, Shoaib Ur Rehman

Winners and Losers for 2006

As a publication that forecasts steel prices for 12-months forward on a rolling basis, we reach our full-year price forecasts for 2006 this month. After correctly forecasting the sharp downturn in prices through 2005 while others were forecasting a continued strong performance, we again appear to be taking a contrary view to other forecasters. The consensus appears to be broadly negative for steel prices in 2006, with slight weakness in the first half followed by a major downturn in the second half of the year.

Our quarterly view is as follows:

Q1 US prices fall back marginally under pressure from imports, while European prices solidify gains. Asian and emerging market prices hit bottom. Emergence of AD actions with Chinese and potentially CIS suppliers targeted.

Q2 Iron ore price increases facilitate stability in US and EU and Japan, and accelerate a supply response in China. Asian economies see end of stock accumulation and Chinese output growth decelerating.

Q3 Return to Asian buying reduces low-priced material offers and prices gain some traction globally.

Q4 Economic weakness in North America and rising inventory and supply from new and expanding sources leads to some price weakness.

STEEL MARKET FORECAST BRIEFING

This is the most comprehensive and cost-effective source of analysis on the flat-product steel and steelmaking raw materials sector. The report combines in-depth analysis of the latest trends and monthly price forecasts for the next year. The structure is unique as you can subscribe just to the regions that affect your business. This approach, and by passing on the savings of electronic transmission to the customer, enables you to make massive savings compared to other newsletters that cover the sector.

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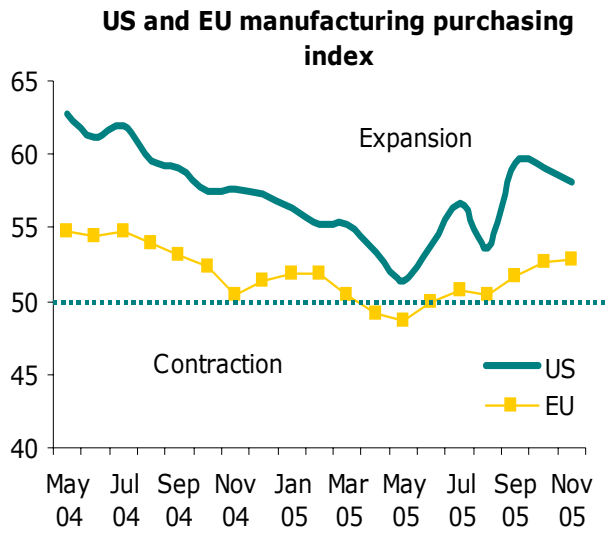
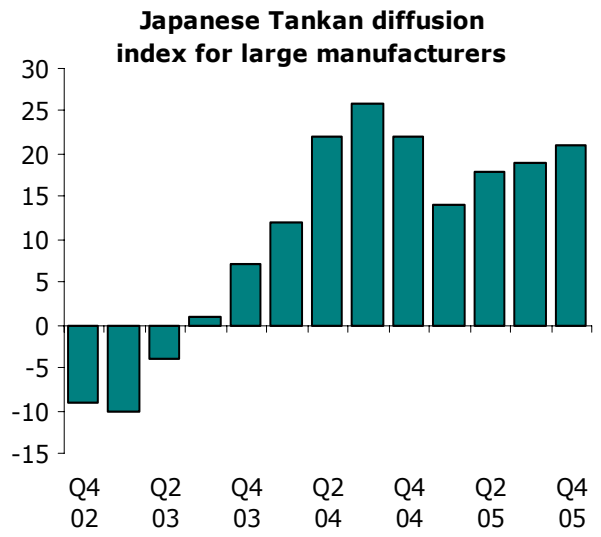


Source: ISM, NTC



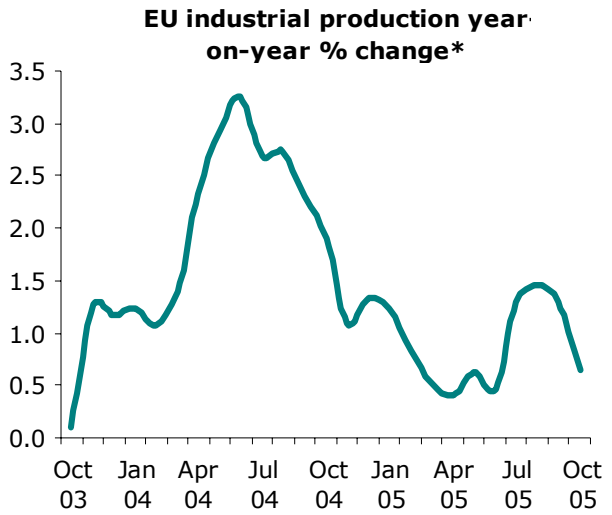
Source: BoJ, GFMS-MC

As prices were extremely high in the first half of 2005, full year prices will be lower than in 2005. We are forecasting average (US/metric tonne) HR coil prices of $561/tonne, $516/tonne, $455/tonne and $404/tonne in North America, Europe, Asian import and CIS export respectively. This is a fall of between 7-10% compared to 2005.

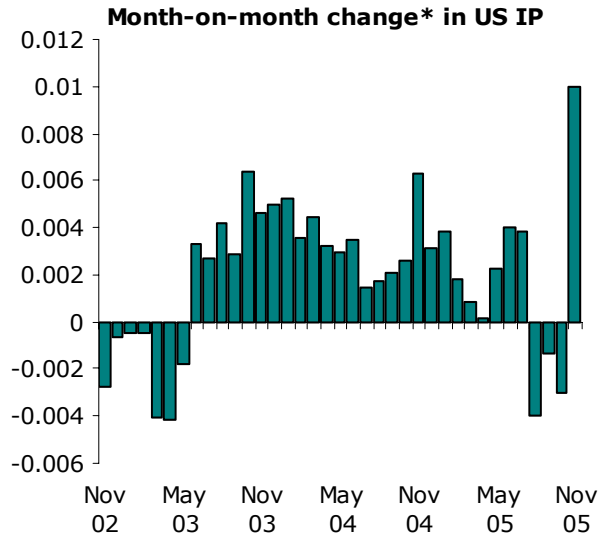
With scrap prices averaging no change, coal prices down by up to 10% and ore prices up by 15%, the clear winners will be integrated steel mills with access to their own iron ore. However, across the industry as a whole, steel mill profitability will be down. In an addendum however, much of the additional supply will be of commodity coil, and with demand from higher-value sectors such as oil and gas, automotive and white goods, suppliers to these sectors will be more price-secure. Higher ore prices may perversely result in a quicker steel industry response as a higher cost structure

It is our view that the steel market in 2006 will be finely balanced between supply and demand. The volatility will come from China, and prices may go up if there is substantial further consolidation, government action to taken to reduce exports and there is a slowdown in supply growth with demand remaining strong. If that is the case, then second half global steel prices could go higher. Our base case scenario sees a deceleration of Chinese supply growth, but if that fails to appear and Chinese prices continue to fall and material is exported, then we could see further price erosion in the second half. However, our view is that prices are more likely to rise sharply than fall sharply and price risk is skewed to the upside.

As average costs go up, then the supply-side response to steel price weakness increases. In Q3 of 2005, there was a dramatic supply response in North America as prices hit around $450/tonne. A significant part of the industry began to lose money. If costs go up an average of 5% this year, that break-even is raised to $475/tonne. With the



Source: Eurostat. GFMS-MC *3-month



Source: Economy.com, GFMS-MC *3-month aver.

consolidated North American industry and a strong AD position, we do not see prices going below this in North America. A similar position will be in place for emerging market suppliers in the Ukraine and China at around $370/tonne, although the supply response may not be as quick.

ECONOMIC BRIEFING

OECD LEI accelerates

In a confirmation of a strengthening economic outlook in global economies, the OECD LEI 6 month rate of change accelerated in October and historic numbers were revised upwards. Growth is likely to be broad-based through 2006 based on these numbers. In particular, the Euro-zone appears to be moving out of its torpor, although this region has disappointed in the past, and latest data is weak. In addition, Japan appears to be moving ahead quickly. This is offsetting slightly disappointing North American numbers.

German IP adds to positive short-term environment…

We have been forecasting an upturn in German IP based on strong forward-looking indicators for the past month. October IP grew 1.1% month-on-month and 3.8% year-on-year. The outlook was also boosted by a strong new manufacturing order number – up 2.0% month-on-month in October and following the 2.9% month-on-month gain in September. Year-on-year gains since June 2005 have been running at 5-10%, predominantly thanks to strong export orders. Rising German retail sales added to the optimism and pushed domestic orders higher as well. The ZEW index of business sentiment leapt to 61.6 in December from 38.7 as uncertainty about economic and political policy diminishes. This helped push up the IFO index to a five and a half year high and should drive German industrial output up in Q1.

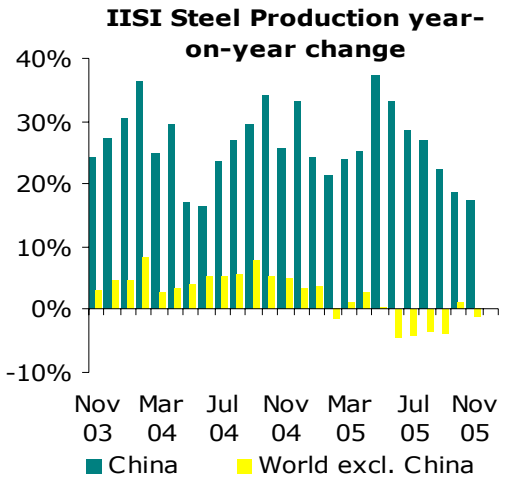
…but weakness elsewhere in the EU

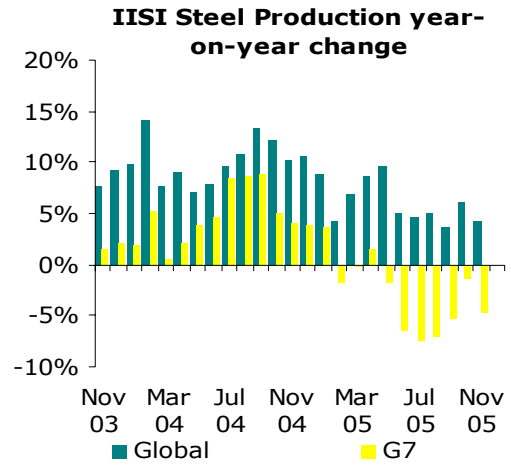
However, a strong German performance was not enough to offset weakness in the rest of Europe, with French, Spanish and Italian data particularly disappointing. Weakness in these markets pushed down Euro-zone IP by 0.8% month-on-month – and barely higher on year-on-year terms. After a promising upturn during the summer, it appears as if the EU has not been able to rise out of its torpor. This puts a dampener on our expectations of a price improvement in Q1 next year. Automotive sales in November in the EU15 were down 2.7% year-on-year – the second successive fall in demand, boding poorly for automotive output in Q1 next year.

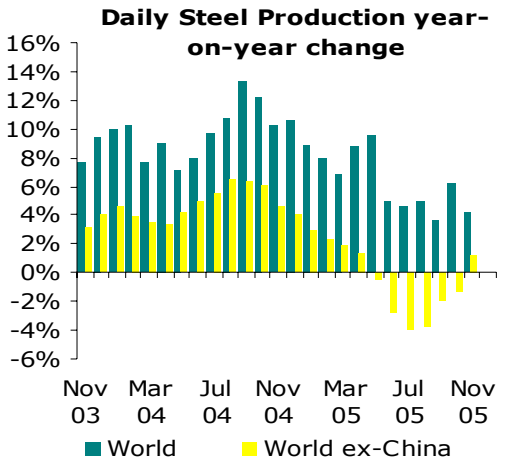
Purchasing managers' indices

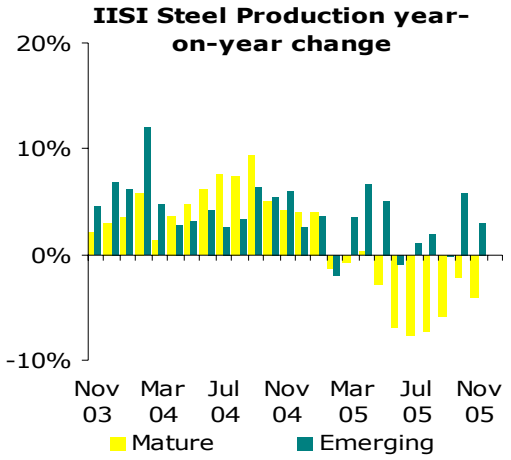
In the USA, the ISM index fell to 58.1 in November – still on track for a positive outlook for manufacturing activity into Q1. In Europe, the Euro-zone manufacturing purchasing managers' index supplied by NTC Research did move higher in November – up to 52.8 on a seasonally adjusted basis but the US index remains substantially ahead of European levels suggesting higher absolute industrial production growth going forward. In November, US IP moved up 0.7% month-on-month after two months' impacted by hurricanes and the consequent bounce-back. The higher PMI European number should suggest stronger industrial output going forward, but the linkage between the PMI and IP has weakened this year.

In Japan, the Tankan index for large manufacturers rose to 21 for Q4 – further evidence of an improvement in the Japanese market outlook. This should feed through to steel-intensive capital expenditure early into 2005.









US housing's final fling?

Despite widespread expectations of a downturn in US construction, the residential sector continues to perform well. However, we may be witnessing the final throes. Construction rates were up 5.3% month-on-month and remained above 2m units on an annualised level, and permits too stayed above the 2m level. However, mortgage approval rates are declining and sales of existing homes are falling. A developing glut – particularly in multi-unit facilities - could trigger a downturn in 2006, although the boost from reconstruction in the South may absorb some of the downturn.

Metronomic Chinese IP

Coming in at an increase of 16.6% year-on-year growth, November was another month of strong performance. Of even greater interest is the news that a thorough review of the Chinese economy suggests that it has been significantly underestimated, primarily through lacking full coverage of the service sector. Although this does result in some scepticism regarding the IP numbers that we follow, it is probably overall a positive for the steel sector. The concern was that the high level of capital investment as a proportion of GDP was unsustainable. However, as GDP is now bigger, that proportion is smaller and falls into historical norms. This should also benefit domestic sales of flat steel, rather than being dependent on the export market for manufactures. A forecast increase of 13% in retail sales for 2005 demonstrates the rising domestic wealth with the knock-on impact on demand for appliances and automobiles.

Crude up 4.1% in November

IISI crude steel production rose 4.1% year-on-year in November. While output in China rose 17.4% year-on-year, production in the world outside China fell 1.2%. After seeing declines for most of the year, central European output began to rise as Polish, Czech and Hungarian output rose after facility modernisation increased. Western European supply discipline (particularly in Germany and France) kept the EU25 number down as a whole however – down 4.0%. CIS output was also higher year-on-year for the second successive month – improved domestic demand is behind the increase. NAFTA output remains down year-on-year with US market discipline and supply problems behind the cuts. Latin American output continues to decline, with weak Brazilian output the primary reason. Lower South African output due to maintenance cut overall African output and with Mittal South Africa undertaking wide-ranging maintenance in 2006 with sinter and blast furnace relines, output could be volatile here for some time. Ezz, Mittal Annaba and higher Lisco output is likely to drive output up again in the near future however. Middle Eastern output was also up driven by Iran and supported by Saudi Arabia. We expect this to continue through 2006.

It is Asia where most growth is coming from. Indian output was up 19.2% year-on-year – even faster than China, albeit from a base that is only 10% of China's. This more than offset year-on-year falls in output in South Korea, Japan and Taiwan.

NORTH AMERICAN STEEL MARKET FORECAST BRIEFING

Flat product pricing holds for now

While there has been weakness in West Coast pricing that we noted in our previous update, there has yet to be any major price downturn in the Midwest as yet. We have been forecasting this, but strong economic data and low inventories appear to have offset the lower import prices being offered, which have yet to arrive in significant volumes. For Q1 however, we are forecasting rising domestic crude supply, and even faster growth in finished product output thanks to rising semis imports. We continue to believe that imports will arrive and undermine pricing, but it may not now be until Q1.

Supply has been restricted in Q4

A number of factors have combined to restrict flat rolled supply in North America, and raw steel production has remained below the 2m tpy mark through the first half of December (see chart on page 7). The biggest factor has been the delay at US Steel in bringing on the revamped Gary furnace, which may not now take place until the New Year. In addition in the last month, Stelco of Canada has reduced availability of HR coil as it takes down its operations for an extended maintenance and upgrade, while we understand that spot availability out of Dofasco has been limited due to operational difficulties.

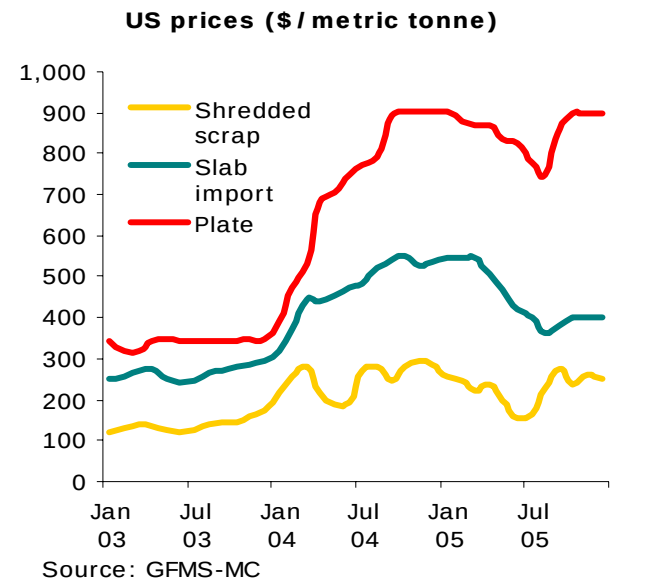
This has helped keep prices steady at $560/ton ($617/tonne) in the Midwest on an ex-mill basis. CR coil has also been steady at $630/ton ($695/tonne), while HDG has pushed out to $680/ton ($750/tonne).

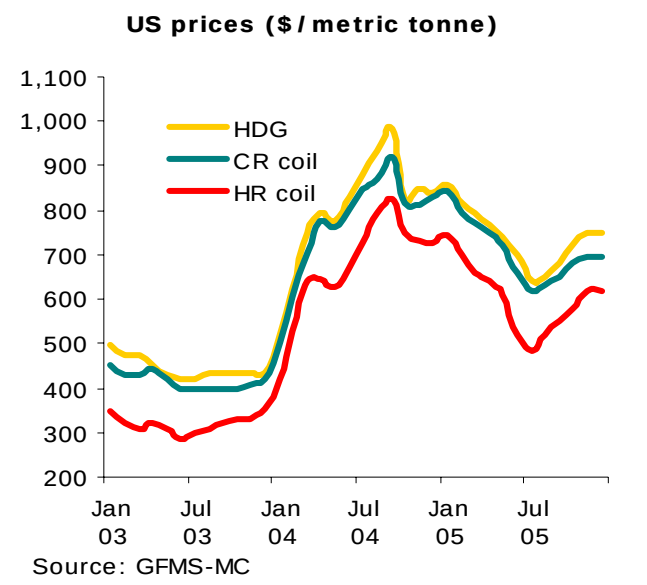
US semis demand rises

With a spread of close to $200/tonne in terms of imported slab versus the domestic HR coil price (and an even greater margin for plate) it is no surprise that imports of semis are rising. Total semis imports in October were provisionally pegged at 726,231 tons according to the Census Bureau compared to 430,763 tons in September – a 68.6% increase and up 15.2% year-on-year. As the chart on page 6 shows, even on a 3-month average basis, imports of semis are on a rising trend. This suggests that while crude steel operating rates remain low, finishing rates could be rising, as US mills take advantage of lower-cost imported semis rather than producing their own crude steel. This is of some concern, suggesting that supply of finished products will be increasing in the near future. The additional 300,000 tons of semis imported this month is the equivalent of 75,000 tons extra of raw steel output per week, which would take utilisation rates up to over 88% if it were produced domestically.

Mittal Mexico cuts output

As we forecast in our September report, Mittal Mexico has been forced to cut output due to natural gas prices and due to lower slab prices. Quarterly capacity is rated at 930,000 tonnes, but production is now running at around 650,000 tonnes per quarter. The current gas price paid by the mill is $9/mBtu. Slab exports are therefore down by around 70,000 tpm – much of which was going to North America on the spot market. This is of benefit to the Brazilian and CIS suppliers who have been struggling to shift volume to slackening Asian markets. Together with a reduction in Chinese exports and rising demand from North America and this could signal a slight improvement in the outlook for slab prices as supply is reduced. While slab prices for Asia will remain in the doldrums, we are forecasting that US slab import prices will rise through Q1 2006 – up to $400/ton ($440/tonne) by Q2.





NAFTA Steel Production & Forecasts (000 tonnes)

	2004	Q1 05	Q2 05	Q3 05	Q4 05	2005	Q1 06	Q2 06	Q3 06	Q4 06	2006
Canada	**16,459**	4,039	4,000	3,667	3,954	**15,660**	3,922	3,988	4,000	4,100	**16,010**
USA	**98,522**	24,945	24,103	22,805	24,128	**95,981**	23,855	24,050	24,250	24,500	**96,655**
Mexico	**16,720**	4,223	4,170	4,268	4,258	**16,919**	4,251	4,200	4,250	4,300	**17,001**
Total NAFTA	**131,701**	**33,207**	**32,273**	**30,740**	**32,340**	**128,560**	**32,028**	**32,238**	**32,500**	**32,900**	**129,666**
YoY % change	***7.6%***	***3.5%***	***(1.7%)***	***(8.2%)***	***(2.9%)***	***(2.4%)***	***(3.6%)***	***(0.1%)***	***5.7%***	***1.7%***	***0.9%***

Source: IISI, GFMS-MC

Finished product supply should rise in Q1

Domestic supply will rise in Q1 2006. This will be due to:

- Higher output from the US Steel, Gary plant, while the end of industrial action at Gerdau will also lead to higher raw steel output.
- Rising semis imports will result in an increase in finished product output.
- Rising imports from orders seen in Q4 will land in North America (see chart on buying practices).

Import offers are even more competitive

We understand that importers have dropped offers of flat product sales by an even greater amount in the last few weeks in an attempt to encourage sales into North America, and widen the difference between domestic and landed import prices. Prices range from below $480/tonne cif Gulf port for HR coil from emerging market producers to $520/tonne from European mills. A widespread recognition that Asian prices are unlikely to bounce back and the possibility that the window for exporting into the USA may be closing, are stimulating activity. Buyers are also reporting strong interest in Indian HDG material in thinner gauges as opposed to Turkish or other emerging suppliers.

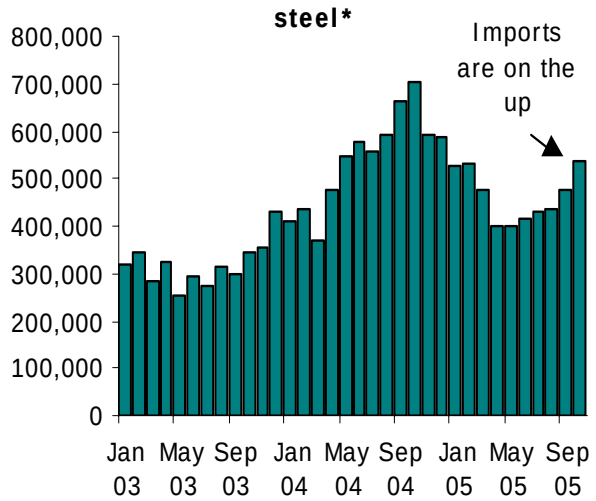
Few plate imports seen

In the past, we have noted that US plate producers have been able to increase plate prices thanks to the difficulty of landing imports into a protected market. We note that Ipsco has raised its base price by $20/ton for January, although the transaction price will be impacted by the raw material surcharge, which will probably fall, and no other producers have announced increases. In terms of imports, while some is arriving e.g. from Malaysia and Australia as well as regular supply from South Korea, it has as yet had no depressing impact on overall prices. Domestic prices remain at $800/ton ($881/tonne). Lead times are a minimum of 6-8 weeks.

Q1 price forecasts

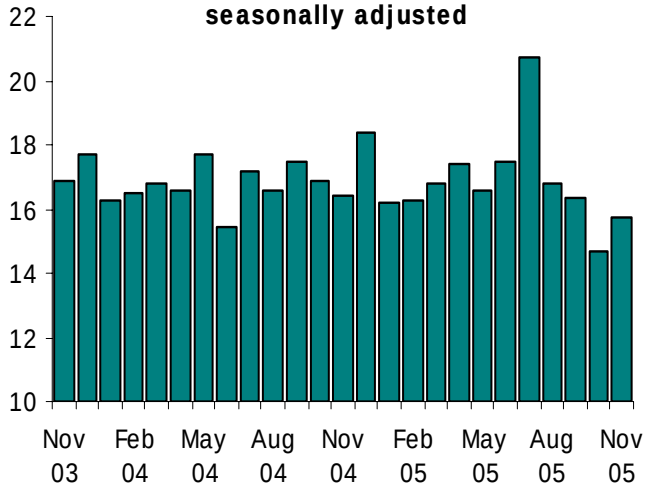
We are forecasting that Q1 HR coil prices in North America will drop to $520/ton ($573/tonne), while CR coil will drop to $600/ton ($661/tonne) and HDG to $630/ton ($695/tonne). We are forecasting that plate on the other hand, will suffer only a very mild fall in transaction prices and remain around $800/ton ($880/tonne) as weaker scrap prices (see below) in the quarter push down transaction prices.

US imports of semi-finished carbon steel*

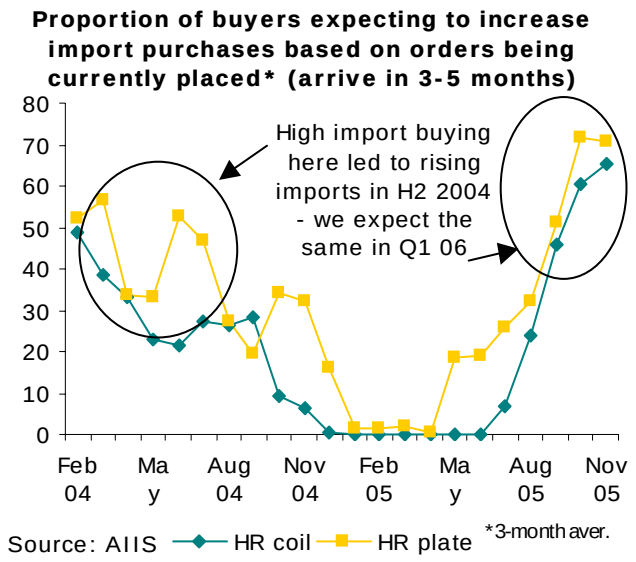


Source: Census Bureau, GFMS-MC *3-month

Annualised US auto sales (m vehicles) - seasonally adjusted



Source: GFMS-MC, Autodata



Scrap price outlook

Last month, we had forecast a rollover to mild increase if there were any disruptions in supply. In fact, there were no disruptions, export demand was weaker-than-expected and output has failed to climb in the expected manner. As a result in December, scrap prices fell slightly – down $5-15/ton for most grades.

January is typically a relatively quiet month for scrap and some dealers are expecting a further weakening in prices. We are however more bullish for January as we feel that the number of upward drivers outweigh the number of downward trends. On the bullish side:

- Steel production is expected to be higher.
- Export shipments could improve on the East Coast as Turkey is active in this market at the moment and will probably continue to be so through Q1 as CIS supply is restricted and EU prices go higher.
- Weather could disrupt supply of scrap in the Midwest.
- Transportation issues (low rail car availability and high river and road freight charges) continue to dog suppliers.
- Seasonal shutdowns at automakers & other steel-intensive users may limit arisings.

On the bearish side:

- Exports to Asian destinations are likely to be slow.
- Holiday shipments to steel mills are slow therefore scrap builds in yards.
- Steel mill shutdowns over the holidays will lead to lower demand.

The key factor in our view is the stock situation at steel mills. If mills are well-stocked, we expect a roll-over, but there is the potential for prices to spike again.

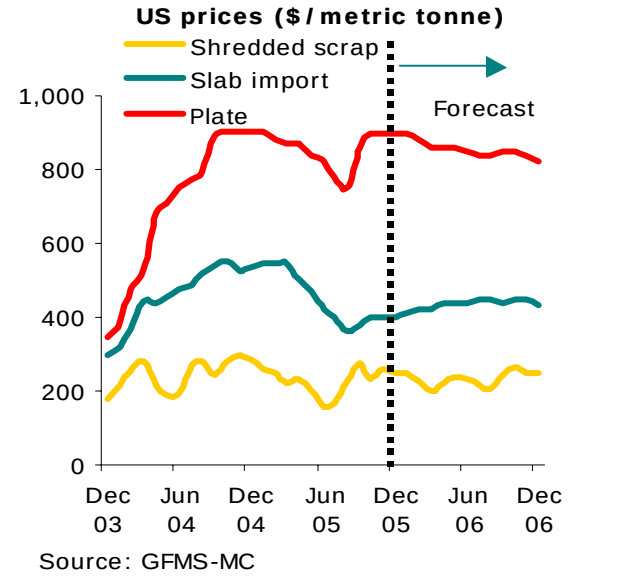
However, later in the first quarter, ferrous scrap prices will come under pressure as steel prices fall from rising domestic and international supply. Plentiful supply as winter ends and industrial production remains strong (plus hurricane scrap enters the system) leads us to suggest some erosion in scrap prices later in the quarter.

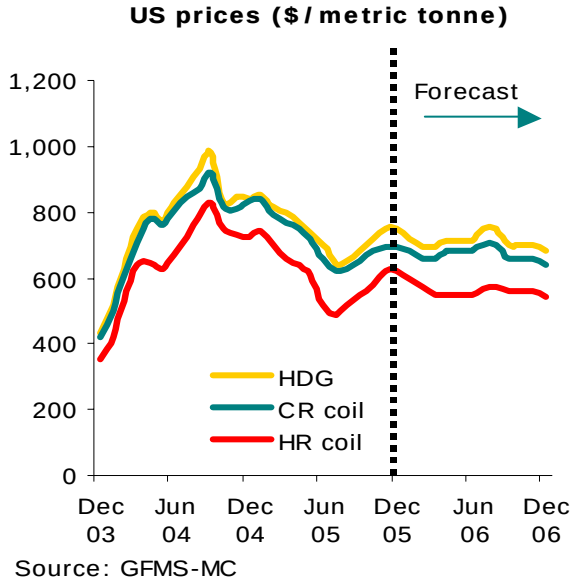
Car to SUV switch may hurt US steel consumption

While not entirely stunning, US auto sales did bounce back in November to a reasonably strong 15.7m vehicles on a seasonally adjusted annual rate – up from 14.7m in October. Perhaps more importantly, SUV and truck sales bounced back to 53% of sales from the 51% level seen in September and October. Even this is well down from the peaks above 60%.

This weakness particularly hurts domestic manufacturers, GM and Ford, and they continued their disappointing performance in November, although it was not enough for the carmakers to cut overall production plans for early next year. GM is in fact going to boost Q1 production by 6% year-on-year, while Ford will drop its output levels by 2.5% year-on-year.

However, GM truck output will rise by just 4.5% and Ford truck output will be cut by 12.3% year-on-year (as car output for Ford rises strongly). Combined car production is forecast for 825,000 units compared to 734,000 in Q1 2005. Combined truck output is forecast to fall to 1.31m units compared to 1.357m in Q1 2005. Particularly hard-hit will be the extremely large SUVs. Based on the





assumption that a car contains approximately 1,200lbs of steel, while an SUV/truck contains 2,000lbs, then the combined steel demand of Ford and GM will be actually be down 1.4% year-on-year in Q1 despite the nominally higher build rates.

Impact of a Delphi strike?

We consider this relatively unlikely, but it is a possibility. The company is the biggest parts supplier to GM and a strike would probably result in a shutdown of GM output and may lead to reduced output at other automakers – some have even suggested that the plans for higher GM output is in fact an attempt to increase inventory in order to reduce the impact on GM sales. For steel mills, a Delphi/GM shutdown would result in substantially higher steel availability – US Steel, Mittal, Stelco and AK Steel are the biggest flat product suppliers. If these mills looked to offload that steel onto the general market, this would quickly depress prices.

US steel prices (US $/metric tonne[1])

	Ferrous scrap [1]	*yoy % change*	Slab import [2]	*yoy % change*	Plate [3]	*yoy % change*	HR [3]	*yoy % change*	CR [3]	*yoy % change*	HDG [3]	*yoy % change*
Dec-05	250	*(12%)*	400	*(25%)*	900	*(0%)*	620	*(15%)*	695	*(16%)*	750	*(10%)*
Jan-06	250	*(3%)*	410	*(25%)*	900	*(0%)*	600	*(19%)*	680	*(19%)*	720	*(16%)*
Feb-06	225	*(9%)*	420	*(23%)*	880	*(0%)*	575	*(18%)*	660	*(17%)*	695	*(15%)*
Mar-06	200	*(10%)*	420	*(23%)*	860	*(1%)*	550	*(17%)*	660	*(14%)*	695	*(13%)*
Apr-06	220	*(6%)*	440	*(13%)*	860	*(1%)*	550	*(14%)*	680	*(9%)*	715	*(7%)*
May-06	240	*20%*	440	*(6%)*	860	*3%*	550	*(10%)*	680	*(6%)*	715	*(3%)*
Jun-06	235	*52%*	440	*5%*	850	*3%*	550	*6%*	680	*3%*	715	*2%*
Jul-06	215	*30%*	450	*13%*	840	*8%*	565	*16%*	700	*13%*	750	*17%*
Aug-06	205	*(9%)*	450	*25%*	840	*12%*	575	*11%*	700	*11%*	750	*15%*
Sep-06	245	*(11%)*	440	*16%*	850	*(1%)*	560	*2%*	660	*2%*	700	*3%*
Oct-06	265	*13%*	450	*13%*	850	*(6%)*	560	*(3%)*	660	*(3%)*	700	*(3%)*
Nov-06	250	*(4%)*	450	*13%*	840	*(7%)*	560	*(10%)*	660	*(5%)*	700	*(7%)*
Dec-06	251	*0%*	430	*8%*	820	*(9%)*	540	*(13%)*	640	*(8%)*	680	*(9%)*
2003 ave.	**138**		**265**		**339**		**319**		**415**		**445**	
2004 ave.	**251**	***81%***	**472**	***78%***	**725**	***114%***	**674**	***111%***	**771**	***86%***	**800**	***80%***
2005 ave.	**227**	***(9%)***	**448**	***(5%)***	**856**	***18%***	**604**	***(10%)***	**709**	***(8%)***	**738**	***(8%)***
2006 ave.	**233**	***3%***	**437**	***(2%)***	**854**	***(0%)***	**561**	***(7%)***	**672**	***(5%)***	**711**	***(4%)***

[1] shredded ex-yard Midwest in $/long ton [2] cif Gulf port [3] ex-mill Midwest
Source: GFMS-MC

EUROPEAN STEEL MARKET FORECAST BRIEFING

After a number of weeks when consumers and traders appeared to be widely forecasting further weakness in the steel market, the last week or so appears to have seen a widespread acceptance that strip prices will go up in Q1.

We hold to our November forecast of an average €15/tonne increase in European sales in Q1 2006 compared to Q4 2005, although we have no doubt that it will be hard-fought, and will rely on continued supply restraint.

We were cautious last month that EU mills had appeared to take their foot off the brake as EU crude supply was broadly flat year-on-year in October. November data however saw EU15 production fall 5.4% year-on-year with the major declines in output being recorded in France and Germany (down 4.5% and 10.4% respectively). Dutch and Belgian output was also down sharply year-on-year. This eases our concern that excessive domestic supply could engender any nascent price recovery. With the exception of Germany, we are forecasting another year-on-year fall in output in December.

Spanish consumers accept price increase

We understand Spanish consumers are going to pay at least €10/tonne ($12/tonne) more for their Q1 contracts. This includes the large tubular industry in Spain that typically price on a quarterly contract basis. This would take HR coil in Spain from domestic suppliers to around €395/tonne ($466/tonne) with CR coil at €485/tonne ($572/tonne) and HDG just €10/tonne ($12/tonne) higher. However, even this €10/tonne premium is reasonable compared to the parity that existed for much of Q4 and the discounted levels that were seen in Q3.

Imports remain a threat in Spain...

The increase is coming about despite a weakness in import prices. Chinese, Bulgarian and Libyan prices for HR coil are now down to €340/tonne ($400/tonne) cif, with Russian and Thai offers only marginally higher. They are not as yet pushing down domestic prices, as distributor stocks are relatively low and most offers are now not realistically for arrival until the end of Q1. With the difference of just €50/tonne ($59/tonne), it is not attractive as yet to take the risk.

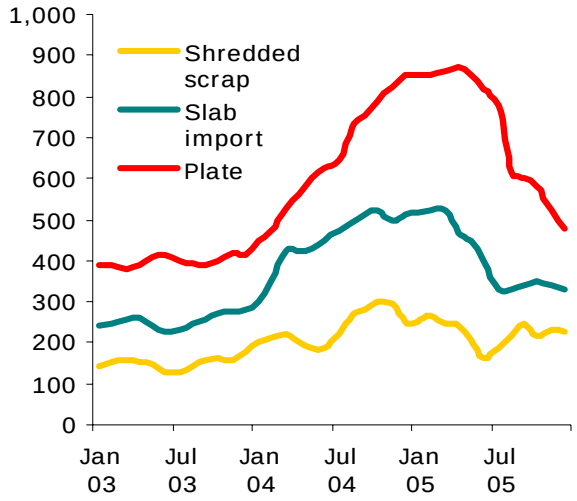
...and Italy

We noted last month that Italian buyers had re-entered the import market and were active and would be interested in prices below €350/tonne ($413/tonne). In fact, we understand that a price for a large shipment of Chinese HR coil was as low as €327/tonne ($385/tonne) cif.

Germany remains a strong EU market

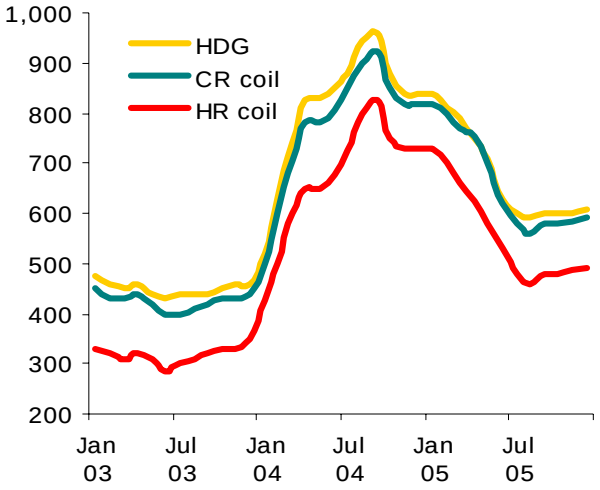
Germany is one of the stronger European markets at present for coil sales, and this was reflected in the early price hikes announced by TKS and Salzgitter. HR coil prices are steady at €400/tonne and will rise by €10-15/tonne in January. Limited import availability, rising capital expenditure and strong exports will keep demand from domestic suppliers at high levels, particularly in galvanized where TKS facilities remain out of commission. With business confidence at reasonably high levels, resistance to price increases will be relatively muted in our view. We also understand that lead times for steel deliveries in Germany are beginning to be pushed out beyond six weeks in a reflection of a tightening market. While some cheap Chinese and Indian material is arriving at Antwerp and being sold on through Germany, it is of relatively limited volumes and is not putting any major dampener on prices.

EU prices ($/metric tonne)



Source: GFMS-MC

EU prices ($/metric tonne)



Source: GFMS-MC

EU Steel Production & Forecasts (000 tonnes)

	2004	Q1 05	Q2 05	Q3 05	Q4 05	2005	Q1 06	Q2 06	Q3 06	Q4 06	2006
France	**20,769**	5,115	5,038	4,358	4,900	**19,411**	4,900	5,000	4,800	5,100	**19,800**
Germany	**46,374**	11,660	11,247	10,423	11,000	**44,330**	11,000	11,550	11,200	11,500	**45,250**
Italy	**28,437**	7,568	7,445	6,433	7,300	**28,746**	7,300	7,500	6,800	7,300	**28,900**
Spain	**17,684**	4,600	4,700	3,949	4,000	**17,249**	4,300	4,500	4,100	4,700	**17,600**
UK	**13,758**	3,240	3,536	3,155	3,500	**13,431**	3,600	3,500	3,200	3,300	**13,600**
Other EU 15	**41,293**	10,688	10,042	9,224	9,800	**39,754**	10,200	10,400	9,800	10,200	**40,600**
Total EU 15	**168,315**	**42,871**	**42,008**	**37,542**	**40,500**	**162,921**	**41,300**	**42,450**	**39,900**	**42,100**	**165,750**
	5.2%	***2.4%***	***(3.6%)***	***(6.9%)***	***(4.9%)***	***(3.2%)***	***(3.7%)***	***1.1%***	***6.3%***	***4.0%***	***1.7%***
Poland	**10,592**	2,248	2,017	1,958	2,100	**8,323**	2,200	2,400	2,250	2,350	**9,200**
Czech	**7,032**	1,680	1,484	1,425	1,500	**6,089**	1,550	1,650	1,700	1,750	**6,650**
Other EU 10	**7,837**	1,924	1,933	1,643	1,850	**7,350**	2,000	2,050	1,950	2,050	**8,050**
Total EU 10	**25,461**	**5,852**	**5,434**	**5,026**	**5,450**	**21,762**	**5,750**	**6,100**	**5,900**	**6,150**	**23,900**
	9.9%	***(9.2%)***	***(17.3%)***	***(21.3%)***	***(10.0%)***	***(14.5%)***	***(1.7%)***	***12.3%***	***17.4%***	***12.8%***	***9.8%***
Total EU 25	**193,776**	**48,723**	**47,442**	**42,568**	**45,950**	**184,683**	**47,050**	**48,550**	**45,800**	**48,250**	**189,650**
	5.8%	***0.9%***	***(5.4%)***	***(8.9%)***	***(5.5%)***	***(4.7%)***	***(3.4%)***	***2.3%***	***7.6%***	***5.0%***	***2.7%***

Source: IISI, GFMS-MC

The only concern on the demand side is potentially weaker automotive sales. These have fallen in the last two months, after rising through Q3. Although German sales have remained high, German automakers remain heavily dependent on the export market. For now however, machinery orders remain high and capital expenditure is forecast to be strong.

Arcelor yet to confirm Q1 pricing

While holding out for an increase in flat product pricing, Arcelor has yet to specify how much. We therefore only assume that orders for Q1 are now being taken at the prevailing Q4 price, given that order books for January are now open. This will be of some concern to other European steelmakers, given Arcelor's position as the leading EU steelmaker and, in recent times, the most "price-reactive" producer. It is concerned that imports are disrupting the market and that big buyers may be leaving buying very late in order to see how the market will develop and put downward pressure on prices. Service centres are running down inventory to end the year "capital-light", but an improved economic environment should see them ordering at higher price levels in Q1. We believe that Arcelor is applying different pricing to different markets at present, but over the whole of the quarter expect to see prices move higher across Europe.

France weakest major EU market

French industrial production has been relatively weak in the second half of 2005, and this has led to France being one of the weaker EU markets for strip products. With no major improvement in the economy expected in Q1, price increases may be more hard-fought here than in Germany. Buyers are reporting that they can often obtain material from stock rather than waiting for a rolling schedule availability.

Improving market may assist iron ore suppliers

The mirror-view of the increasing confidence of European steel mills will be the fact that they will be tempted to accept a modest increase in iron ore prices as contracts are likely to be agreed in Q1. With Japanese and European buyers setting the benchmark, the improved market in these two economies bodes well for higher ore prices in 2006.

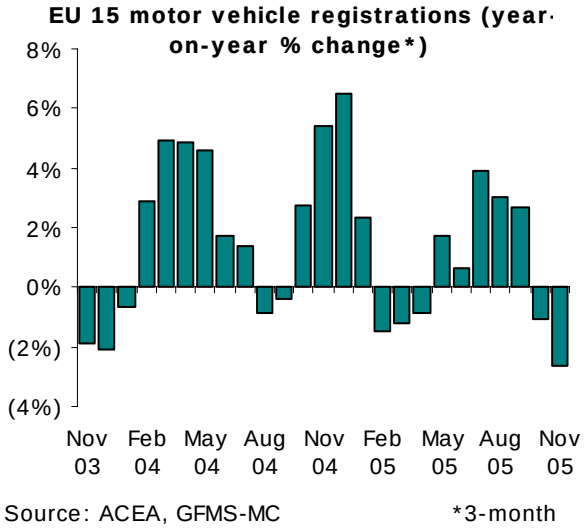
Ferrous scrap broadly flat in December

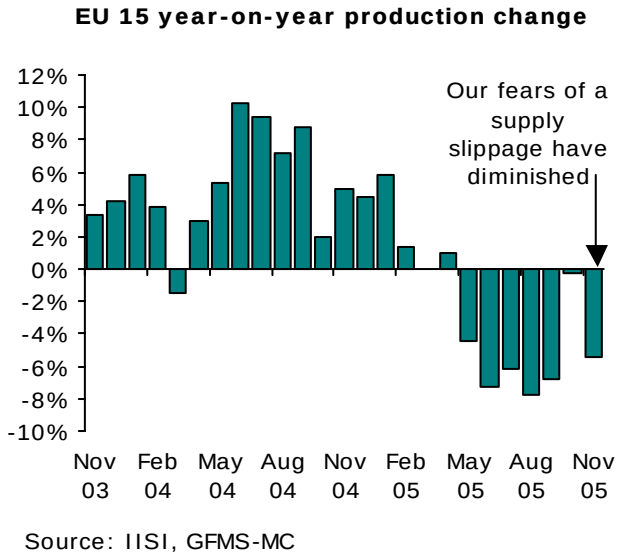
The contrasting fortunes of different European steel industries were reflected in the subtle changes in the EU scrap market in December. German prices for example were up by around €5/tonne in the month as improved mill sentiment encouraged higher orders. A number of mills have decided not to cut output over the holiday period and therefore were forced to order additional material. French mills on the other hand saw weaker expectations and a drop of up to €5/tonne, and construction-oriented EAFs may close for an extended period. Italian and Spanish mills were broadly flat with little change in prices.

With German shredded prices up to €190/tonne ($225/tonne) internal EU prices are more attractive for once than export prices to Turkey, which instead is absorbing US supplies. Rotterdam exports have been more limited this month, although there is some drawing in from northern France and Benelux sources with sales to India and Pakistan being undertaken instead.

Arcelor gets part of Erdemir

Arcelor's run of misses appears to have ended. After bidding and failing to obtain control of Erdemir, Krivorozhstal and possibly Dofasco, it appears to have been selected as Oyak's international partner to run





Erdemir. In what will mean that Arcelor will effectively own just less than 25% of Erdemir, Arcelor and Oyak will be 49%/51% partners in a new company that will control Oyak's 46.22% share of Erdemir.

Central European supply to increase in 2006

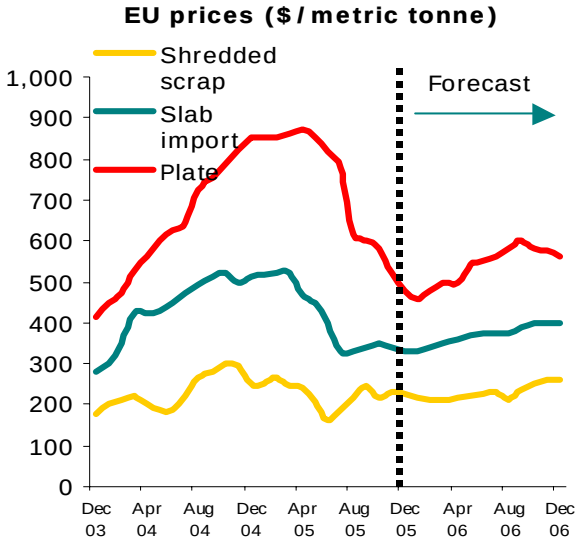
While certainly one of the more dynamic regions of demand growth, we believe that regional supply of flat products in central Europe will rise quickly in 2006.

- US Steel Kosice will be limited to further sales into the EU15 of an additional 2% over 2005 levels due to the accession agreement signed by Slovakia in 2004. As such, any increase in output will be sold locally.
- US Steel Serbia started its second blast furnace in June and after a slow ramp-up will operate at a much higher level in 2006. The majority of additional output will probably be in the form of HR coil given the 2.4m tpy HR capacity and the 0.9m tpy CR capacity.
- Mittal Poland continues to undertake developments. Although an additional blast furnace was brought back on-stream at the former Katowice works, the new continuous slab caster will not be on-stream until the end of 2006 at around the same time that the new 3m tpy HR mill at Cracow will be finished. The end of 2006 will see one of the two CR lines at Cracow also shut, although GFMS-MC believes that the company may announce a new CR and HDG

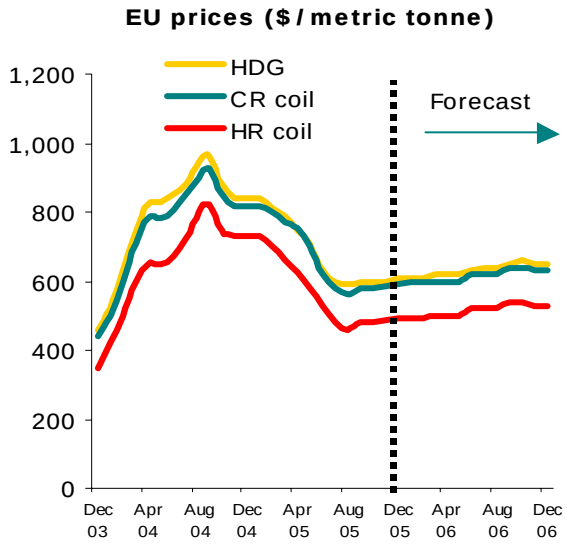
EU steel prices (US $/metric tonne[1])

	Ferrous scrap [1]	*yoy % change*	Slab import [2]	*yoy % change*	Plate [3]	*yoy % change*	HR [3]	*yoy % change*	CR [3]	*yoy % change*	HDG [3]	*yoy % change*
Dec-05	225	*(11%)*	330	*(35%)*	480	*(44%)*	490	*(33%)*	590	*(28%)*	610	*(27%)*
Jan-06	215	*(14%)*	330	*(36%)*	460	*(46%)*	495	*(32%)*	595	*(27%)*	610	*(27%)*
Feb-06	210	*(21%)*	340	*(35%)*	480	*(44%)*	495	*(29%)*	595	*(26%)*	610	*(25%)*
Mar-06	210	*(15%)*	350	*(33%)*	500	*(42%)*	500	*(24%)*	600	*(22%)*	620	*(22%)*
Apr-06	215	*(10%)*	360	*(23%)*	500	*(43%)*	500	*(20%)*	600	*(21%)*	620	*(17%)*
May-06	220	*7%*	370	*(18%)*	540	*(36%)*	500	*(14%)*	600	*(14%)*	620	*(13%)*
Jun-06	225	*36%*	375	*(6%)*	550	*(33%)*	520	*(2%)*	620	*0%*	630	*0%*
Jul-06	230	*24%*	375	*14%*	560	*(28%)*	520	*8%*	620	*7%*	640	*7%*
Aug-06	210	*(2%)*	375	*14%*	580	*(6%)*	520	*13%*	620	*11%*	640	*8%*
Sep-06	235	*(4%)*	390	*15%*	600	*0%*	540	*13%*	640	*10%*	650	*8%*
Oct-06	250	*16%*	400	*14%*	580	*0%*	540	*13%*	640	*10%*	660	*10%*
Nov-06	260	*13%*	400	*18%*	575	*11%*	530	*9%*	630	*8%*	650	*8%*
Dec-06	260	*16%*	400	*21%*	560	*17%*	530	*8%*	630	*7%*	650	*7%*
2003 ave.	**152**		**252**		**400**		**318**		**425**		**450**	
2004 ave.	**235**	***55%***	**449**	***78%***	**652**	***63%***	**672**	***111%***	**778**	***83%***	**812**	***80%***
2005 ave.	**224**	***(5%)***	**408**	***(9%)***	**723**	***11%***	**558**	***(17%)***	**662**	***(15%)***	**678**	***(17%)***
2006 ave.	**228**	***2%***	**372**	***(9%)***	**540**	***(25%)***	**516**	***(8%)***	**616**	***(7%)***	**633**	***(7%)***

[1] shredded cif average EU mill [2] cif major port [3] ex-mill
All prices are an average of a range of prices that are present in the market, and exclude grade and finishing extras
Source: GFMS-MC



Source: GFMS-MC



Source: GFMS-MC

facility for automotive sheet will be built there. For 2006 therefore, HR coil supply will continue to be limited and subject to downtimes in Poland. This will make it an attractive market to sell into. By 2007 however the revamped Mittal operations should be able to grab an extended market share, particularly if the steel is certified for automotive and white goods markets.

- Mittal Skopje in Macedonia (a HR and finishing facility) will also run at full capacity with slab supplied from the expanded former Katowice works – a slight increase on sales in 2005 are expected.

- In Hungary the former Dunaferr works owned by IUD and Duferco has completed the upgrade to the coke facility that saw crude output reduced over Q3. Output is expected to be at full capacity in 2006. However the group has yet to specify when it plans to complete the intended expansion of the HR and finishing facilities that will drive output substantially higher.

- The new owner of Vitkovice of the Czech Republic (Evraz Group) is investing in facilities at the plant that may see it offering coiled plate of thinner dimensions rather than just quarto-plate.

- Mittal Galati in Romania completed the modernisation of blast furnaces in September 2005. The company now plans to run the facility at the full 5m tpy – up around 400,000 tpy from previously.

We therefore believe that additional HR coil supply from local producers will be as much as 1.5m tonnes, and little of that additional material will be converted to further finished products. Finally the region is likely to be targeted by EU suppliers of higher-quality material for the expanding automotive and white goods industries, which cannot easily be supplied by local producers. Voest-Alpine, TKS and Arcelor are committed to expanding distribution in the region and these companies often have arrangements with the consuming groups in western Europe that have facilities in central Europe.

We therefore believe that commodity strip pricing in central Europe next year could be severe despite the upturn in demand and the region may see a return to a substantial discount to EU15 prices. However, as higher-quality material will be in greater demand, a wider margin could appear between HR suppliers and CR and HDG markets may be less affected.

ASIAN STEEL MARKET FORECAST BRIEFING

Posco cuts domestic prices again

Posco has been forced to cut its prices for Q1 HR coil and other flat products in an attempt to counter the threat of cheap imports. Commodity HR coil will be cut by 70,000 won/tonne ($69/tonne) to 480,000 won/tonne ($471/tonne), with minimill HR coil from Gwangyang down to 450,000 won/tonne ($442/tonne). This 16% cut will still leave Posco prices above imported Chinese levels that are as low as $400/tonne cif Korea, although other regional suppliers' imports tend to range between $400-440/tonne.

This brings Posco domestic prices back in line with international prices, which as we have noted over the last couple of months have been forced much lower as Asian demand has plummeted. South Korean exporters are selling at around $460/tonne fob for HR coil.

CR coil is also down heavily to 580,000 won/tonne ($570/tonne) for commercial qualities. Posco is trying at present to differentiate between commodity supply and higher-grade material (automotive and white-goods as well as API or other specialty grades).

In the short term, there appears to be little respite to falling Asian prices, with continued over-supply and high inventories dogging the region. Chinese coil is being exported for as low as $360/tonne fob.

Chinese prices remain under pressure

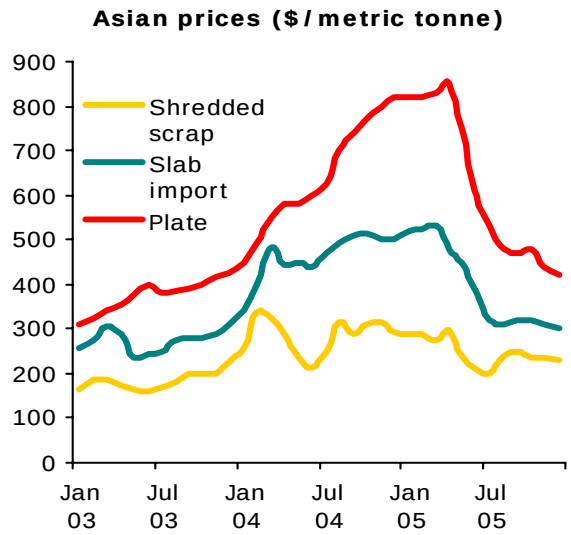
Prices for thick HR coil have not moved down much in the last month, but have also not moved either. However, we have seen the erosion of premiums that have existed over this base thickness. Most obviously has been the reduction in the CR to HR premium. Earlier in the year that premium was up to RMB2,000/tonne (over $200/tonne), but has been sliding steadily and now stands at just RMB800/tonne ($85/tonne) – only marginally higher than processing costs. As HR coil prices plunged and the market was in over-supply, CR output accelerated. This was due to rising capacity, but also included factors such as stainless CR re-rollers moving to carbon steel as the stainless CR market was over-supplied.

Until recently, thinner HR coil had also held its price better, but rising supply of this product thanks to new operations and its higher price has led to this price advantage being eroded in the last few weeks as well. We also note that the internal price differences within China have also been eroded in the last few weeks, with material for example flowing away from the very depressed prices seen in Shanghai to higher prices seen in Tianjin. However, the excess of material has now pushed down Tianjin prices.

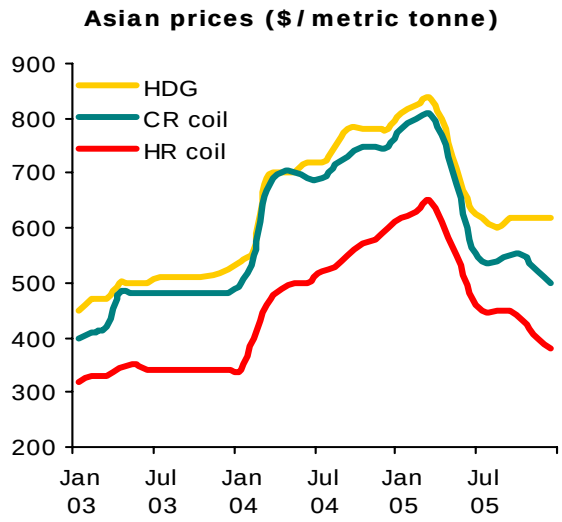
Profits now under pressure

According to statistics, industry profit growth has unsurprisingly slowed – to an 11.2% year-on-year for the first ten months of the year. However, profit growth in the first nine months was 20.5% higher year-on-year and was 36.1% higher year-on-year in the first half of 2005 (for state-owned mills). This suggests that the state-owned Chinese steel industry is now losing money as a whole.

The problem is that they have probably built up capital reserves over the last two years, and probably have access to bank loans from friendly local bankers in order to maintain working capital. With the widespread understanding that survival in the current cycle will lead to a strong position in the expected consolidation phase, we expect that desperation for market share will not lead to any significant cutback.



Source: GFMS-MC



Source: GFMS-MC

Asian Steel Production & Forecasts (000 tonnes)

	2004	Q1 05	Q2 05	Q3 05	Q4 05	2005	Q1 06	Q2 06	Q3 06	Q4 06	2006
India	**32,626**	8,861	9,506	10,100	10,000	**38,467**	10,500	11,000	11,400	12,000	**44,900**
Japan	**112,717**	27,763	28,972	28,000	27,600	**112,335**	28,000	28,400	27,400	28,200	**112,000**
South Korea	**47,523**	11,788	11,934	11,850	12,000	**47,572**	12,000	12,400	12,200	12,450	**49,050**
Taiwan	**19,569**	4,930	4,955	4,850	4,650	**19,385**	4,650	4,800	4,800	4,900	**19,150**
China	**279,038**	77,445	86,363	89,500	91,500	**344,808**	94,100	96,500	97,300	99,500	**387,400**
Total Asia	**491,473**	**130,787**	**141,730**	**144,300**	**145,750**	**562,567**	**149,250**	**153,100**	**153,100**	**157,050**	**612,500**
YoY % change	***15.1%***	***13.5%***	***19.9%***	***16.4%***	***8.7%***	***14.5%***	***14.1%***	***8.0%***	***6.1%***	***7.8%***	***8.9%***
Australia	**7,416**	1,909	1,936	1,944	1,878	**7,667**	1,900	1,950	1,900	1,900	**7,650**
New Zealand	**883**	201	223	225	220	**869**	220	220	220	220	**880**
Total Australasia	**8,299**	**2,110**	**2,159**	**2,169**	**2,098**	**8,536**	**2,120**	**2,170**	**2,120**	**2,120**	**8,530**
YoY % change	***(1.1%)***	***(3.5%)***	***3.6%***	***6.6%***	***5.2%***	***2.9%***	***0.5%***	***0.5%***	***(2.3%)***	***1.0%***	***(0.1%)***

Source: IISI, GFMS-MC

Therefore we do not see any short-term alleviation of flat product prices in China. Export offers continue to come down, although volumes remain limited as quality concerns remain for buyers. However, some are undoubtedly likely to be tempted and better-known mills should be able to maintain sales.

Chinese consolidation is taking place

The most recent Chinese government policy called for consolidation of the steel industry into a much smaller group of large players. Explicitly, it called for the emergence of two 30m tpy steelmakers. Since then, there have been a number of announcements that have resulted in the emergence of larger players. The table on Page 15 highlights the emergence of some 10m tpy capacity producers. In our view, there will be substantially more mergers over the next 12-18 months and the Chinese will in fact have 3-4 companies at that time with a capacity of more than 30m tpy. Interestingly the Top 3 producers already have an approximate market share of 17% - and higher in terms of flat products.

The merger of Angang and Bengang to form Anben is the most ambitious of the projects to date. The company will have a 25m tpy capacity by the time the merger is confirmed and with relatively good access to ore within Liaoning Province, the group is low-cost in Chinese terms. However, it remains to be seen how much the individual managers will give up and work together. Raw material procurement, foreign trade, back-office accounting and possibly technology will be easier to integrate, but the presence of local authority ownership may preclude aggressive cost-cutting. In addition, senior management suggest that they intend to pursue bolt-on acquisitions in the north-east of China (Jinan, Laiwu, Dalian and Baotou have been suggested).

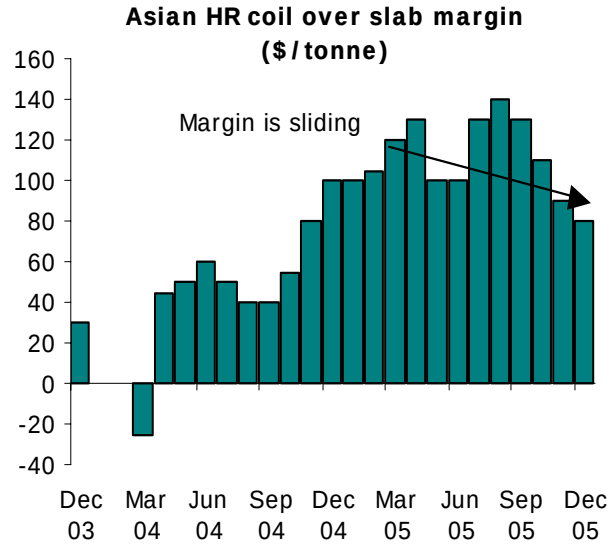
The most recent was Wuhan's acquisition of Liugang, with which it plans to further expand capacity with a 10m tpy planned Greenfield mill in Fangchenggang in Guangxi. This marks a geographic stretch for Wuhan given the distances between the two. It follows Wuhan's majority control of the Echeng Group.

Other notable consolidations have a much greater regional feel about them with the Handan-led and Tangshan-led mergers in Hebei orchestrated by the provincial government with the explicit aim of concentrating ownership in two major companies. The Jilin-led deal was also brought about as a direct result of the provincial ownership, although this is particularly interesting as Severstal is reported to be close to this company.

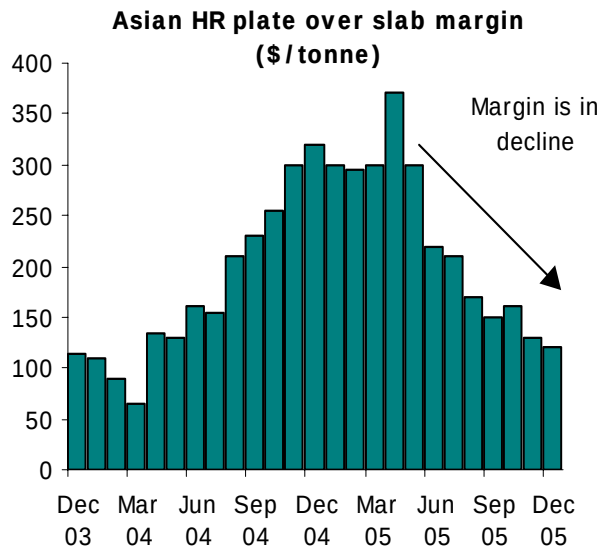
We would expect that the leading groups (Wuhan, Anben and potentially Shougang, Pangang, Kunming, Maangang) will act as regional consolidators picking up regional players who are part of the provincial state system. There will also be the merger of secondary players in an attempt to gain scale quickly. The integration of privately-owned groups into this predominantly state sector will be more difficult and we expect that these will evolve separately for now.

Are mergers a reflection of weakness?

We re-iterate our view on the Chinese steel industry that the next 2-3 years will be a bitter struggle for survival. It is our view that the majority of the industry is medium-sized and is therefore vulnerable to difficulties in securing raw materials, technology and most importantly political influence. Bulking up allows the producer in effect a license not to fail. Orchestrating steel industry mergers with different cultures is difficult – witness the British-Dutch conflict that still exists within Corus more than five years after its merger. In China, where the drive for merger is often political, we question whether the bulked-up industry will be any more rational or successful than the sum of its parts.



Source: GFMS-MC



Source: GFMS-MC

Asian suppliers continue to offload to non-regional markets

For the last six weeks, we have noted that Asian sales of HR coil have been undertaken by Japanese and South Korean and Taiwanese suppliers to non-Asian destinations in a spreading of the Asian price weakness. Excess coil is being offered via traders in an effort to reduce internal stocks. This is reflected in offers of Japanese material to the Middle East at $475/tonne cif for HR coil and below this for other quality suppliers. This material is being picked up by regional buyers and is adding to pressure on European suppliers that are also trying to maintain tightness in their local markets by exporting. The US market is also attractive. Although Chinese material cannot directly go to the USA due to AD restrictions, Taiwanese and South Korean and Indian material is being sold in larger amounts, with smaller volumes from Thailand and Malaysia.

Slab conversion under pressure

The falling HR coil price is beginning to put pressure on slab re-rollers in the region. While they have plentiful supply on hand, they are aware of falling HR coil prices and are therefore looking to secure slab at even lower prices and lower their average purchase costs. We understand that CIS exports to south-east Asia are now as low as $305/tonne cif. Brazilian prices are higher, but there are fewer buyers. Chinese prices are as low as $300/tonne fob, but most have limited capacity to sell at any lower level due to their cost structure.

Korean consumption of flat products to grow in 2006

Korean steel industry association (KOSA) forecasts a 1.1% increase in total steel consumption for South Korea in 2006. However, flat products (particularly HDG and plate) will grow faster. The group forecast that production of finished products will increase from 54.7m tonnes to 55.9m tonnes – an increase of 2.2%. This is approximately in line with our forecast of growth in crude steel production of 3.1% (primarily due to rising output by INI for their flat product operations). The KOSA analysis is based on falling imports of construction products and rising exports, and strong growth in automotive, shipbuilding and manufacturing sectors.

Asian scrap prices are flat to down

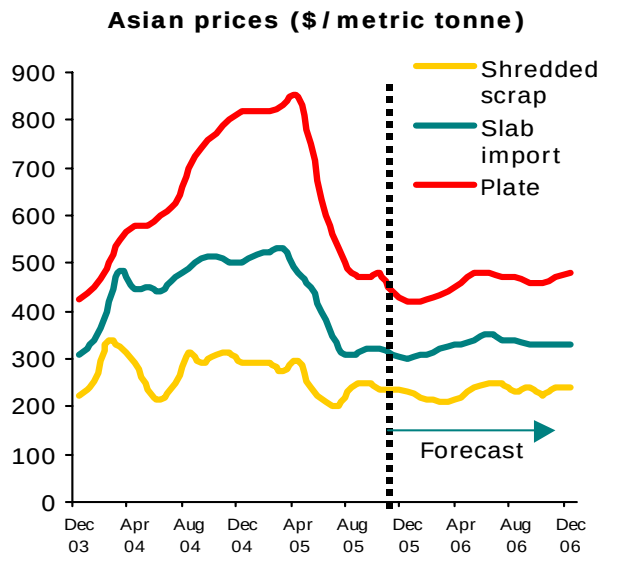
With steel prices generally depressed, steel mills are being aggressive on price for scrap purchases. INI of South Korea booked Japanese H2 at $218/tonne fob. Some Venezuelan HBI is being bought, but at $190/tonne

Recent mergers in the Chinese steel industry

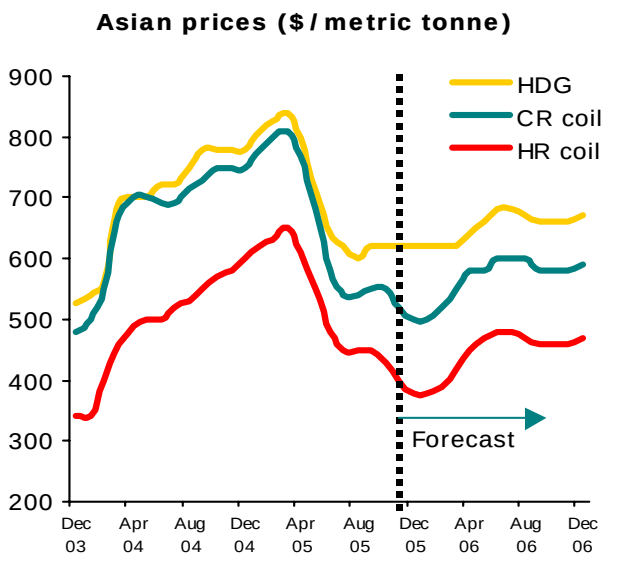
	Company	Capacity (m tpy)	Company	Capacity (m tpy)	Company	Combined	Market share*
Dec-05	Wuhan	10.0	Liugang & Echeng	8.0	Wugang Liugang	18.0	5%
Nov-05	Tangshang	9.0	Xuangang & Chenggang	7.0	Tangshang	16.0	4%
Nov-05	Tonghua	2.5	Jilin Ferro-alloys & Jilin Jianlong	2.0	Tonggang	4.5	1%
Aug-05	Anshan	17.0	Benxi	7.0	Anben	24.0	6%
Jun-05	Handan	7.5	Shijiazhuang & Xingtai	5.0	Handan	12.5	3%
	Baosteel	25.0				25.0	6%

*Based on current capacity of 400m tpy of crude

Source: GFMS-MC



Source: GFMS-MC



Source: GFMS-MC

fob translates to $235/tonne cif North Asia. Japanese domestic scrap prices are down around 1,000/tonne ($8.50/tonne) over the month, while Chinese buyers of US material are reluctant to go above $230/tonne cif. With no major expansion in demand expected into Q1, we expect that Asian scrap prices will be flat to down over the next month.

Asian steel prices (US $/metric tonne[1])

	Ferrous scrap [1]	*yoy % change*	Slab import [2]	*yoy % change*	Plate [3]	*yoy % change*	HR [3]	*yoy % change*	CR [3]	*yoy % change*	HDG [3]	*yoy % change*
Dec-05	230	*(22%)*	300	*(40%)*	420	*(49%)*	380	*(37%)*	500	*(33%)*	620	*(21%)*
Jan-06	220	*(24%)*	310	*(40%)*	420	*(49%)*	380	*(39%)*	500	*(36%)*	620	*(23%)*
Feb-06	215	*(26%)*	315	*(40%)*	430	*(48%)*	390	*(38%)*	520	*(35%)*	620	*(25%)*
Mar-06	210	*(24%)*	325	*(39%)*	440	*(47%)*	420	*(35%)*	550	*(32%)*	620	*(26%)*
Apr-06	220	*(25%)*	330	*(31%)*	460	*(46%)*	450	*(26%)*	580	*(25%)*	640	*(20%)*
May-06	240	*0%*	340	*(24%)*	480	*(36%)*	470	*(15%)*	580	*(15%)*	660	*(7%)*
Jun-06	250	*19%*	350	*(8%)*	480	*(20%)*	480	*0%*	600	*3%*	680	*6%*
Jul-06	250	*25%*	340	*6%*	470	*(11%)*	480	*7%*	600	*11%*	680	*10%*
Aug-06	230	*(4%)*	340	*10%*	470	*(2%)*	470	*4%*	600	*11%*	670	*12%*
Sep-06	240	*(4%)*	330	*3%*	460	*(2%)*	460	*2%*	580	*5%*	660	*6%*
Oct-06	225	*(4%)*	330	*3%*	460	*(4%)*	460	*7%*	580	*5%*	660	*6%*
Nov-06	240	*2%*	330	*6%*	470	*7%*	460	*15%*	580	*12%*	660	*6%*
Dec-06	240	*4%*	331	*10%*	480	*14%*	470	*24%*	590	*18%*	670	*8%*
2003 ave.	**184**		**274**		**375**		**338**		**463**		**498**	
2004 ave.	**286**	***55%***	**462**	***69%***	**642**	***71%***	**503**	***49%***	**683**	***48%***	**708**	***42%***
2005 ave.	**249**	***(13%)***	**397**	***(14%)***	**624**	***(3%)***	**508**	***1%***	**635**	***(7%)***	**694**	***(2%)***
2006 ave.	**231**	***(7%)***	**331**	***(17%)***	**460**	***(26%)***	**449**	***(12%)***	**572**	***(10%)***	**653**	***(6%)***

[1] shredded cif Korea [2] cif major port ex-CIS [3] cif major port

All prices are an average of a range of prices that are present in the market, and exclude grade and finishing extras

All finished steel prices are prime, non-CIS sources (e.g. Japan, S. Korea, Taiwan)

Source: GFMS-MC

EMERGING ECONOMIES STEEL MARKET FORECAST BRIEFING

Prices for export continue to struggle for emerging market suppliers on widespread Asian weakness. We see little chance of that improving prior to Chinese New Year. Domestic demand in most emerging markets however is in the main holding up and although there is some price erosion from imports, total offtake volumes remain high and the markets are in varying stages of the stock cycle. In South Africa for example, destocking was completed by the end of Q3 and domestic sales volumes have moved higher through Q4 and into Q1. In Brazil meanwhile, the domestic market remains over-stocked and price weakness is growing, although we expect some relief via exports over Q4 and Q1 which will facilitate an improved domestic environment. In India, high import levels do not seem to be having any major impact on domestic production volumes and offtake remains strong. Domestic prices are higher than imports, and early mutterings about AD action will not ease the downward pressure.

In Russia, the end of the construction season is dampening offtake to some extent, but an improved tube market is keeping HR coil mainly at home (November pipe output was up 29% year-on-year) and prices are only dipping marginally and remain far more attractive than exports. Ukraine and Kazakhstan are much more dependent on Asian and Middle Eastern sales and are finding life more difficult. In the Middle East the very strong construction and oil markets are keeping domestic suppliers busy.

Ukrainian prices suffer

With little contract business, Ukrainian exporters are almost totally dependent on the spot market and need to sell out every month. With such limited buying in the last few weeks as Asian stocks are high, Ukrainian prices have slipped to as low as $330/tonne fob. This translates to a $370/tonne cif price. However, there is little take-up at the present with Asian buyers instead taking up offers of re-exported coil from China that has been available as low as $350-360/tonne.

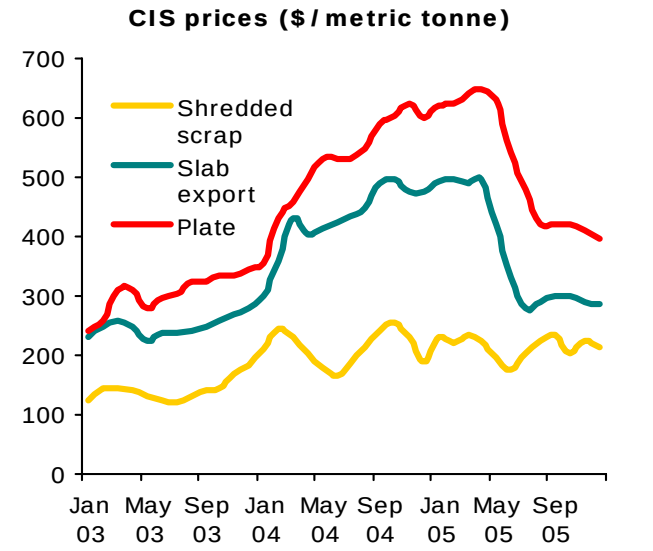
Even Russian producers with less HR coil to sell have had to cut to $360/tonne fob Black Sea. Romanian and Eastern Europeans are trying to hold their coil at $400/tonne fob, but are finding few buyers.

CR prices are being bid down to very low levels for Asian destinations – as low as $400/tonne fob, but demand was sufficient from Western Europe and the USA for Russian suppliers to maintain prices around $500/tonne fob, although Ukrainian dropped to $475/tonne fob.

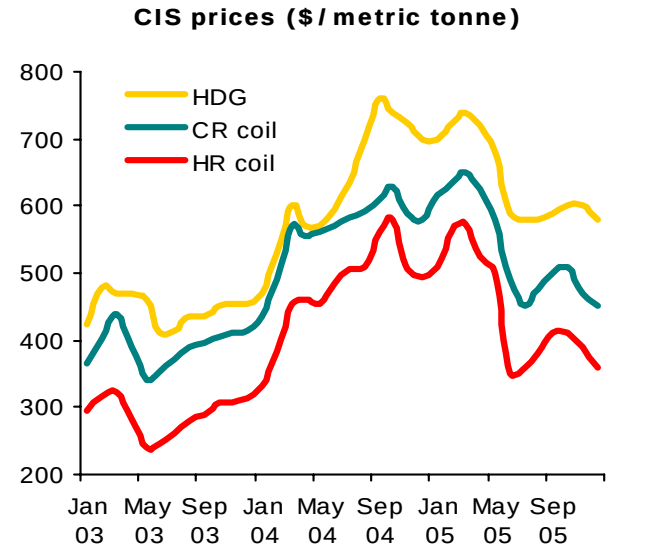
We suggest that there may be longer-than-usual shutdowns for maintenance at CIS suppliers over the holiday period as they try to reduce stock levels held by themselves and also try and boost the market for January sales, which they hope will be slightly brighter. Our view is that this is unlikely to be the case, and any upturn for emerging market prices will not come before Chinese New Year in February.

Russian domestic preference should hold

While prices to North American and Western European markets may hold steady through Q1, there is unlikely to be any major relief in Asia. Average prices are therefore unlikely to move up. This will incentivise producers to sell to the domestic market where prices will probably remain high, albeit on a slightly downward trend. As the chart highlights, Russian domestic prices have been at a premium over export prices (for HR coil) for most of the second half of the year.



Source: GFMS-MC



Source: GFMS-MC

Emerging Producers Steel Production & Forecasts (000 tonnes)

	2004	Q1 05	Q2 05	Q3 05	Q4 05	2005	Q1 06	Q2 06	Q3 06	Q4 06	2006
Turkey	**20,486**	4,869	5,230	5,374	5,200	**20,673**	4,900	5,200	5,400	5,350	**20,850**
Other Europe	**7,814**	2,008	2,000	1,921	2,200	**8,129**	2,300	2,500	2,500	2,600	**9,900**
Total Other Europe	**28,300**	**6,877**	**7,230**	**7,295**	**7,400**	**28,802**	**7,200**	**7,700**	**7,900**	**7,950**	**30,750**
Russia	**64,289**	16,062	16,038	15,778	16,000	**63,878**	16,650	16,800	17,000	17,200	**67,650**
Ukraine	**38,738**	9,728	9,306	9,233	9,400	**37,667**	9,450	9,600	9,800	9,700	**38,550**
Other CIS	**8,710**	1,746	2,093	2,070	2,150	**8,059**	2,250	2,350	2,300	2,200	**9,100**
Total CIS	**111,737**	**27,536**	**27,437**	**27,081**	**27,550**	**109,604**	**28,350**	**28,750**	**29,100**	**29,100**	**115,300**
Brazil	**32,909**	7,940	7,992	7,720	7,900	**31,552**	7,900	8,000	8,000	8,200	**32,100**
Other Central & S. America	**14,272**	3,623	3,893	3,850	3,750	**15,116**	3,780	4,000	3,950	4,050	**15,780**
Total Central & S. America	**47,181**	**11,563**	**11,885**	**11,412**	**11,650**	**46,510**	**11,680**	**12,000**	**11,950**	**12,250**	**47,880**
Africa	**16,564**	**4,309**	**4,613**	**4,412**	**4,600**	**17,934**	**4,900**	**5,000**	**5,100**	**5,150**	**20,150**
Middle East	**13,671**	**3,577**	**3,684**	**3,666**	**3,800**	**14,727**	**4,000**	**4,200**	**4,400**	**4,600**	**17,200**
Total emerging	**217,453**	**53,862**	**54,849**	**53,866**	**55,000**	**217,577**	**56,130**	**57,650**	**58,450**	**59,050**	**231,280**
	6.0%	***1.1%***	***1.6%***	***(2.8%)***	***0.3%***	***0.1%***	***4.2%***	***5.1%***	***8.5%***	***7.4%***	***6.3%***

Source: IISI, GFMS-MC

We see no reason why this trend will not hold through for 2006. However, the key strategic change in 2006 will be the development of the Russian galvanized sector. While the Russians are now importing from sources outside the CIS in order to satisfy domestic demand, the arrival of Severgal – due for commercial ramp up in Q1 with a capacity of 400,000 tpy (some of which will be utilized in a new 200,000 tpy paint line) will result in easier supply. There is however unlikely to be any major return to exports until later in 2006 as the winter season leads to reduced demand again.

Middle Eastern markets awash with commodity coil

With Asian supply increasingly present as well as multiple offers from Mediterranean and CIS suppliers, Middle Eastern prices have continued to move downwards in the last few weeks. Moreover, buyers continue to hold off large-scale purchases in the expectation of further price weakness. Rising imports has pushed down domestic Iranian HR coil prices below $400/tonne ex-mill for thicker gauges. However, CR has been holding up better, and Iran is one of the better import markets for CR from the CIS. Japanese and Korean material is arriving at below $475/tonne cif for prime material and Mediterranean and Black Sea suppliers (Egypt, Bulgaria, Romania, Libya & CIS) are struggling to get over $420/tonne delivered. Turkey remains a reasonable market for imports, but export prices in the last few weeks have fallen as Turkish mills are forced to compete with regional suppliers for sales.

Domestic-focused mills such as Hadeed in Saudi Arabia are busy however with offtake to domestic pipe mills, which are an increasingly important part of their market. Prices are being eroded but remain high and profitable in this sector as API grades are less-impacted by weakness in commodity coil.

Turkish scrap booking accelerates

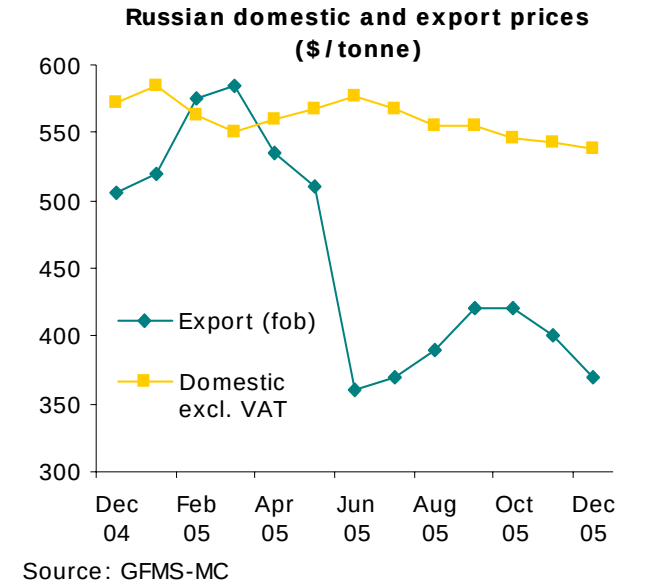
Turkish buyers appear to be buying significant amounts in the run-up to Christmas with reports of purchases from Rotterdam, the UK, USA and the CIS at around $210/tonne cif Turkey for A3 equivalents. It therefore appears that Turkey has been able to order a significant amount of its requirements for early 2006 without disturbing the market to a large extent.

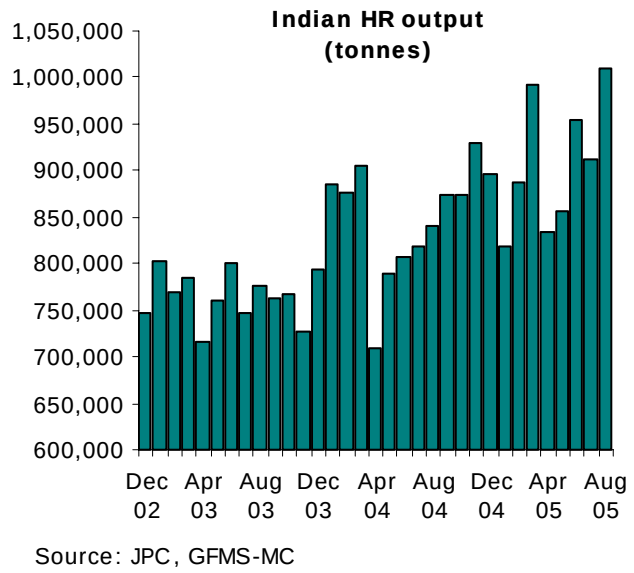
The 18% VAT tax on Russian ferrous scrap sales is due to be lifted in January. In the short term, this is not expected to result in any major changes to export markets (where VAT was exempt), although its impact on the Russian domestic market is as yet uncertain. Domestic Russian A3 prices are around $160/tonne (excluding VAT) depending on location. However, domestic steel mills will now not have to pay the 18% VAT on top.

India breaks through 1m tpm

Latest Indian production data for August 2005 indicates that production of HR coil rose to more than 1m tpm for the first time. Indian crude steel production growth has also been phenomenal – rising 16.6% year-on-year for the first eleven months of 2005. HR coil output has in fact lagged this growth – increasing just 9.5% year-on-year over the first eight months of 2005.

Domestic flat rolled prices however have been flat to downwards over the last month. As we noted last month, aggressive offers from Chinese suppliers as well as CIS mills are keeping cif import prices low – below $400/tonne, which in turn is putting downward pressure on domestic prices. Chinese and Ukrainian prices are as low as $360/tonne cif. Domestic mills are hoping to keep prices at Rs21,000/tonne ($465/tonne) – a factor which is not being helped by the appreciation of the rupee against the dollar. There are also mutterings of anti-dumping





action against CIS and Chinese imports, but this will not alleviate the price pressure in the short-term. For now therefore, imports will continue to arrive, although as we note above, it appears to be having little impact on domestic industry output.

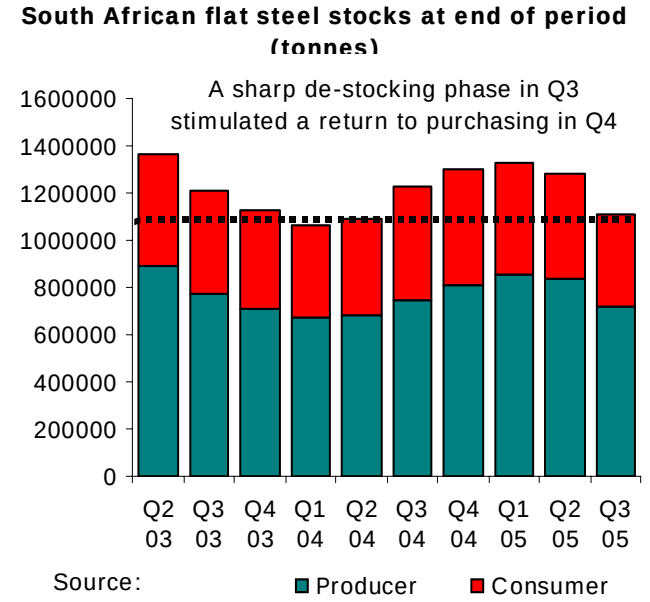
South African galvanized supply under pressure

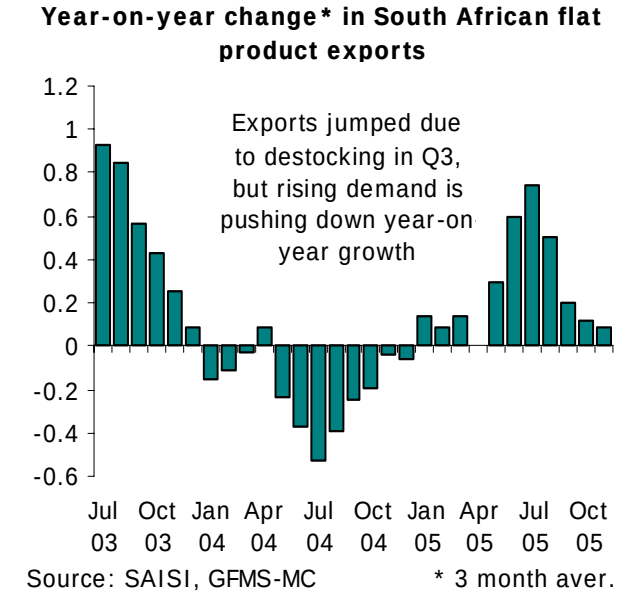
Dominant South African producer Mittal Steel reduced its coated sales in October as it undertook maintenance. However, this followed a de-stocking period during Q3 and the lack of availability combined with re-stocking and the acceleration in the construction sector has resulted in shortages and customer allocations for much of Q4 that is only now being caught back up with. Coated stocks were already at multi-year lows in September 2005 after dropping by 40,000 tonnes in Q4 (based on SAISI data).

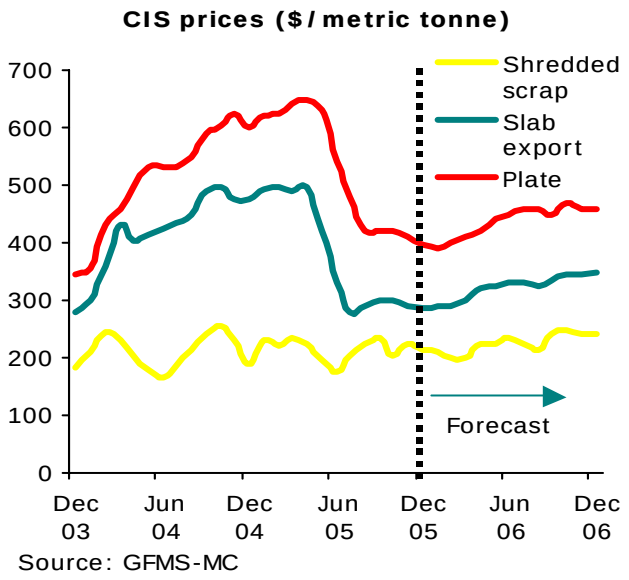
The tightness of the domestic market and the expected continued strong demand from the construction and automotive sectors in the medium term is stimulating suppliers to examine the potential for a new HDG line. Indian sales to South Africa have been rising in 2005, with the thin-gauge product particularly attractive to the construction market. Meanwhile Safil Investments is reportedly examining the potential for a CR and galvalume plant for supply to the local construction sector. It would probably source low-cost HR coil from the CIS or possibly Asian suppliers.

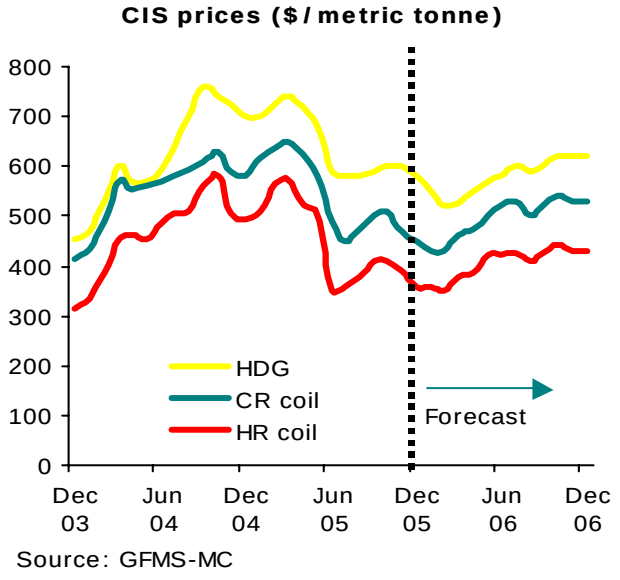
However it is not just in galvanized that the South African market is tightening. Rising exports in Q3 allowed producers to maintain output while stocks were worked off. Strong demand in Q4 is being accelerated by restocking, which is bringing down export volumes.

Into Q1 next year, we do not expect to see any major slowdown in demand, and stocks are expected to remain at reasonably low levels, which will limit any slowdown.









Mittal is relining its blast furnace at Vanderbijlpark in the second half of 2006, which will increase capacity by approximately 500,000 tpy, and this could facilitate a higher throughput on rolling facilities and the potential expansion of flat output.

Rising Real will further facilitate exports

We noted last month that Brazilian exports were on the rise, and latest data confirms this trend. October flat exports of 370,800 tonnes were up 138% year-on-year. The recent depreciation of the real against the US dollar – down almost 10% could make exports even more attractive. This will facilitate the existing trends of rising capacity, improved access to US markets and higher US market prices. Rising exports should help balance the domestic market, where stocks remain high. Prices are under threat however from rising imports that are allowed in duty-free. Large volume domestic sales of HR coil are now available for around $475/tonne ex-mill, although CR remains solidly above $620/tonne. List prices are higher from Brazilian suppliers, but are being widely discounted.

Asian price weakness spreads

We have noted in the past couple of months that low prices in Asia have been spreading to emerging markets – particularly impacting CIS suppliers. However, we understand now that Chinese material is landing in Latin America and bringing down regional prices there. Chinese medium plate is landing in Latin America at $450/tonne cif (Chile, Venezuela and Argentina). This is despite local tariffs for non-regional imports. This is undercutting local suppliers (particularly the Brazilians) by up to $100/tonne. We believe that HR coil is likely to follow and could arrive as low as $420/tonne cif.

Emerging steel prices (US $/metric tonne[1])

	Ferrous scrap [1]	*yoy % change*	Slab export [2]	*yoy % change*	Plate [2]	*yoy % change*	HR [2]	*yoy % change*	CR [2]	*yoy % change*	HDG [2]	*yoy % change*
Dec-05	215	*13%*	285	*(40%)*	395	*(34%)*	360	*(27%)*	450	*(22%)*	580	*(17%)*
Jan-06	210	*(9%)*	290	*(41%)*	390	*(37%)*	360	*(29%)*	430	*(30%)*	550	*(21%)*
Feb-06	200	*(9%)*	290	*(41%)*	400	*(36%)*	350	*(38%)*	430	*(32%)*	520	*(28%)*
Mar-06	200	*(15%)*	300	*(39%)*	410	*(36%)*	380	*(34%)*	460	*(29%)*	525	*(29%)*
Apr-06	225	*0%*	320	*(35%)*	420	*(35%)*	385	*(27%)*	475	*(24%)*	550	*(24%)*
May-06	225	*15%*	325	*(23%)*	440	*(30%)*	420	*(16%)*	500	*(14%)*	570	*(16%)*
Jun-06	235	*34%*	330	*0%*	450	*(17%)*	420	*20%*	520	*6%*	580	*(2%)*
Jul-06	225	*10%*	330	*18%*	460	*(4%)*	425	*18%*	530	*18%*	600	*3%*
Aug-06	215	*(4%)*	325	*12%*	460	*10%*	410	*8%*	500	*5%*	590	*2%*
Sep-06	240	*2%*	335	*12%*	450	*7%*	425	*4%*	520	*4%*	600	*2%*
Oct-06	250	*22%*	345	*15%*	470	*12%*	440	*7%*	540	*6%*	620	*3%*
Nov-06	240	*7%*	345	*19%*	460	*12%*	430	*10%*	530	*13%*	620	*3%*
Dec-06	240	*12%*	350	*23%*	460	*16%*	430	*19%*	530	*18%*	620	*7%*
2003 ave.	**142**		**249**		**305**		**288**		**389**		**447**	
2004 ave.	**213**	***50%***	**430**	***73%***	**525**	***72%***	**477**	***66%***	**564**	***45%***	**633**	***42%***
2005 ave.	**216**	***2%***	**372**	***(13%)***	**521**	***(1%)***	**445**	***(7%)***	**538**	***(5%)***	**640**	***1%***
2006 ave.	**224**	***4%***	**321**	***(14%)***	**437**	***(16%)***	**404**	***(9%)***	**494**	***(8%)***	**575**	***(10%)***

[1] A3 fob Black Sea [2] fob Black Sea (incl. Russian, Kazakh & Ukraine)
All prices are an average of a range of prices that are present in the market, and exclude grade and finishing extras
Source: GFMS-MC

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Post:
GFMS Metals Consulting ltd,
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London, W1B 4JE, UK

Sales Team:
+44 (0)20 7478 1750
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