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China steel glut may take nine months to clear, pressuring iron ore: ANZ

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A Chinese steel inventory overhang that has cut spot demand for iron ore and forced prices to their lowest levels since November 2009 may take as long as nine months to unwind, leaving it up to iron ore producers to cut output to shore up prices, ANZ Bank said Tuesday.

The unwinding of excess steel supply may take six to nine months to complete and a drop in China steel prices points to slower demand from heavy industry and continued production by loss-making steel capacity, the bank said in a report led by analyst Mark Pervan.

"This will continue to weigh on [iron ore] prices until at least October, and potentially beyond," according to Pervan, ANZ's head of commodity strategy.

"In our view, iron ore prices below \$100/dmt [CFR China] look oversold, with close to 50% of Chinese iron ore supply losing money. But we are unlikely to see the market bounce back until mine supply starts to wind down in the coming months."

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The bank said it is "highly likely" to downgrade short-term iron prices by an average of 15%. "The health of the real estate market will remain the key demand driver for the iron ore market in the short term ... while demand remains weak, the established price floor at \$120/dmt could fall to \$100-110/dmt."

"The market will remain difficult in the coming month, with steel mills slowing output for holidays in first week of October," it added.

ANZ said it sees a strong correlation in a 1:2 ratio between steel prices and iron ore, citing an 18% decline in Chinese rebar prices since May and a 33% drop in iron ore prices over the same period.

Chinese steel mills are not responding to market signals of falling prices and are operating at near-record highs, with the industry dominated by state-owned mills that are "very much" motivated by political and social drivers, including employment and provincial tax revenues," it said.

This risked supply overhang into the seasonally stronger fourth quarter, it added.

ANZ stressed going into December there is unlikely to be much impact from policy tools as China's government heads into a political