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A Critical Juncture on the Path Forward

In the old days (this was just a few years ago but seems like forever now), it used to be the case that the market quieted down in the summer, as buying objectives were largely met earlier in the year, and other issues were not so pressing that they could not be put off until another time. Now, instead of coasting along, the market is heading into a critical juncture, with considerable market activity as well as consideration of issues that really can't be put off too far into the future, a future that now includes the likely ordering of new reactors.

Uranium – The best example of this is in the current uranium market. During 2005, utilities entered into a quarter of a billion pounds of long-term commitments. As discussed on the market page and shown in a chart there, they are on a pace to do that again this year. The problem is that much of this contracting has yet to be completed (there are 40 million pounds of long-term contract commitments currently being sought), and it must be undertaken in a market where not only price is rising, but there are reports that some producers are essentially sold out over certain delivery periods.

As long-term contracting takes place, two things necessarily occur. First, unfilled requirements on the part of utilities decline, as they have done to a considerable extent over the past two years. (Unfilled uranium requirements decline for other reasons besides new contracting – they can decline as utilities lower tails assays and adopt more efficient fuel designs – but new contracting is the primary way.) The other thing that happens is that uncommitted production decreases. In the end, it is the relative balance between unfilled requirements and uncommitted production that matters. Unfilled uranium requirements could be very low – as they are for some years, but if uncommitted production is lower still, price could be propelled to even higher levels.

Of course, this is what has been happening recently with the massive amount of long-term contracting that has taken place. Unfilled requirements are shrinking but so has uncommitted production. It's almost as if there's a contest to see which goes to zero first. In this respect, the market is very much like a race between supply and demand, one that demand is currently winning in the sense that supplies are struggling to keep up, and as a result, price is being pushed ever higher.

Enrichment – The same dynamics more or less apply to the enrichment market, where price has been increasing and some enrichers are also reported to be sold out for certain delivery years. In some ways, supply is more handicapped in enrichment than in uranium, as Tenex is being kept out of the race or only allowed to participate to a limited extent. Enrichment prices have been increasing and enrichers have limited the extent to which utilities can select lower tails assays, which does not help alleviate the supply/demand situation in uranium.

The Search for First Cores – While problematic enough to begin with, this supply/demand picture is further complicated by fuel needs associated with first cores. First cores not only add demand but quite a bit of it, and can exhibit somewhat of a random nature in terms of their occurrence, and thus are not neatly spread out over time. And, while the actual start of the reactor may not be until ten years into the future, the first core must be procured and loaded before the reactor comes on line, and even before this, utilities want to be assured that supplies exist for the first cores, so the market is being tested now.

Government Actions – Into this mix, the U.S. Government is looking to dispose of its uranium stocks and potentially negotiate a quota whereby some Russian commercial SWU can enter the U.S. market, two additional factors that can change the supply/demand balance, perhaps for better or perhaps for worse.

In one sense, the government is damned if it does and damned if it doesn't with respect to making more supplies available to the market. On the one hand, if it fails to take steps to make supplies available, this could adversely impact new reactor orders, as utilities search for material to meet their first core needs. On the other hand, if sales are done in such a way to disrupt the market, this could take the incentive away from companies that are seeking to expand production, and this would also jeopardize the future expansion of nuclear power.

These are more than abstract concerns. The government has interjected inventory supplies into the market before by means of the HEU deal and the transfer of inventories to USEC as part of the latter's privatization. While the HEU deal certainly was a positive development from the standpoint of nonproliferation, it did contribute to the depression of the uranium price and production from which the market and industry is now trying to recover.

Inventory Disposition – While the inventory disposition in question is not as large as the ones previously, it still can have a large impact depending on how and at what rate DOE decides to sell uranium. If it sells a relatively large amount of uranium into a spot market characterized by little demand, then it can have a large impact on price and production, especially if this were to trigger other inventory selling by hedge funds and traders. In this fast-moving market, what appears to be open demand may disappear given the ongoing long-term contracting that is taking place. And, if the supply/demand situation were to worsen later resulting in shortfalls of supply, DOE may not have sufficient stocks of uranium to counter these shortfalls if it has already disposed of much of its inventory.

Russian SWU Imports – With respect to additional sales of Russian commercial SWU, the government in effect has already made a decision to limit these sales, and thus this supply is not available to utilities at a time when they are considering new reactor builds. It is clear that the government wants to encourage domestic investment in enrichment and believes that keeping Russia out of the market serves this end. However, the need for utilities to arrange for supplies for pending first cores in the near future, before the fate of domestic production is known, means that the government and industry no longer have the luxury of waiting for the requisite production to potentially develop. Or, to look at this in another way, if supply choices are limited, as they are currently, it is less likely that utilities will be convinced that sufficient supplies will be available to meet future needs.

Next Steps – Given the fragile nature of the market and the supply challenges the industry faces, it is good that DOE is requesting comments from the industry with respect to its uranium disposition plans. Along these lines, the U.S. government in general may also find it beneficial to take industry input when it comes to the question of allowing the sale of Russian commercial SWU in the U.S. market. These issues need to be examined from a number of perspectives, and here the input of a cross-section of market participants is vital.

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