

# Global downturn begins to puncture Australian mining boom

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Since July, definite signs have emerged that Australia's mining boom, a major factor in the country's much touted economic growth during the past decade, has started to crumble under the weight of the world economic slowdown. Mineral export prices have begun to turn. The London Metal Exchange Index of six base metals, including copper, zinc and nickel, fell more than 20 percent from a peak of 4,400 in March to 3,400 in early August.

As a result, the Australian dollar has tumbled. After rising to near parity with the weakening US dollar in the first half of this year, it has become one of the world's weakest currencies in recent weeks, falling well over 10 percent against the greenback.

While fluctuations in metal prices are certainly affected by speculative flows, the latest downturn is, at bottom, an expression of the markets' reaction to what some financial commentators have called a "tidal shift" in the world economy. With the exception of China and India, all the major markets for Australian mineral and energy exports are now contracting or on the brink of recession: Japan, the US, Britain and the Euro zone.

While China, which last year overtook Japan as Australia's largest trading partner, is still growing, its growth has slowed from 11.5 percent last year to less than 10 percent this year, and is expected to drop to 9 percent next year. An even sharper slowdown could be ahead, because about one-third of China's growth is estimated to come from exports.

Over the past seven years, the Australian mining sector, has benefited from an extraordinary surge in world prices for coal, iron ore, base metals and natural gas. The Reserve Bank of Australia (RBA) Index of Commodity Prices rose by more than 250 percent between 2002-03 and mid-2008, reversing a long period of falling or stagnating prices.

Some of the key rises were even greater. Thermal coal rose fivefold, from \$US25 per tonne in 2000 to \$125 in the first half of 2008 (January to May); hard coking coal from \$40 a tonne to \$300; and iron ore from 27 US cents per dry metric tonne to 133. The World Bank's natural gas index rose to 266.87 in the first half of 2008, from 100 in 2000.

In some cases, these increases are still accelerating. Prices for manganese, a key component in steel and iron production, have more than trebled since June 2007, largely because of a "drought" in manganese supplies, with no new mines on the near-term horizon.

Under contracts signed with Chinese steel manufacturers earlier this year, the coal and iron ore prices will remain at their stratospheric levels for another 12 months. In a June speech to a Canadian business summit, RBA governor Glenn Stevens boasted that iron ore and thermal coal prices would approximately double this year, while those for metallurgical coal would treble. He gloated that China was still "running hot", whereas Canada's main export market, the US, was "very weak".

As a result, Stevens said, Australia's terms of trade would rise by 20 percent in 2008, taking the total increase since 2002 to nearly 70 percent. He estimated the rise in real domestic income as about 13 percent of GDP, commenting, "We are talking real money here!"

In other words, an extra \$A130 billion has flowed into corporate coffers and government tax revenues over the past six years. On the surface, the bonanza is still continuing. Over the past two weeks, the two biggest part-Australian-owned mining giants, BHP-Billiton and Rio Tinto, have announced record profits—\$A17.7 billion in a year for BHP and \$8 billion over six months for Rio.

Since June, however, spot prices for iron ore and coal

have started to fall, along with steel. Iron ore landed in China has fallen from \$US200 a tonne to \$155; thermal coal at port in Australia from nearly \$200 a tonne to \$155, and steel is down 10 percent. Chinese steel production is still growing, but much more slowly. Indian prices are also falling.

Even as Stevens was speaking, it was already apparent that prices for other mining exports—freely-traded base metals—had turned downward. Between March and July, the RBA's base metals index fell almost 16 percent in \$A terms and 12.5 percent in US dollars. Some metals have plunged more sharply—zinc is down 37 percent since the start of March, and lead almost 50 percent.

Nickel rose as high as \$US50,000 per tonne in May 2007, but it has since fallen almost two-thirds to \$18,000. Gold hit an all-time peak of \$1,032 an ounce in March and was trading at \$965 in mid-July but has since dropped below \$775. Copper has fallen almost 20 percent from \$8,950 a tonne on July 2 to \$7,335.

Particular factors have affected some of these movements. In the case of nickel, for instance, new mines have opened, stainless steel production has been cut massively and China has been substituting domestically produced low-grade nickel pig iron for refined nickel. More fundamentally, however, the falls express the verdict of the markets on decreasing global demand.

“Sentiment in commodity markets has swung heavily negative in the past month,” ANZ Bank senior commodity strategist Mark Pervan wrote in a note to clients this month. “The extent and speed of the declines has prompted us to downgrade our 2008-2010 prices forecasts.” The ANZ warned that the price fall had not ended. It expects the price of iron ore, Australia's principal export to China, will tumble 10 percent in 2009 and again in 2010. Nickel is set to fall by another quarter this year, then 9 percent in 2009 and a further 19 percent in 2010.

Job losses are another early indicator of the turnaround. Although workers are still flooding into iron ore and coal mining areas, lured by the prospect of high wages, jobs have begun to be axed in other mines.

The lead, zinc and silver mine at Broken Hill in western New South Wales, is sacking more than 450 workers, or almost two-thirds of the workforce. Last month, Minara Resources retrenched nearly 200

workers from its Murrin Murrin nickel operation in Western Australia and Crescent Gold is said to have laid-off about 150 workers when it suspended operations at its Laverton mine in Western Australia. In June, CBH Resources dismissed 220 workers, almost 40 percent of its workforce, at the Endeavour silver, lead and zinc mine near Cobar in central NSW.

Given the dependence of all these sectors on China's continuing growth, any fall off in Chinese demand will ever more sharply expose the Australian economy's vulnerability to the global slump, belying claims that it has “de-coupled” from the financial crisis in the US because of the expansion of Chinese and other Asian markets.

The puncturing of the mining boom will have serious implications for the entire economy, not only by slashing jobs, consumer spending and government tax revenue, but also by further undermining debt-laden investment firms and financial institutions, including the major banks.

Commentators have begun voicing fears of severe economic dislocation. “Commodity booms end ugly, they always do, and there has never been an exception,” Access Economics director Chris Richardson told the *Australian* last week, warning: “The commodity markets are more central to Australian national income than either credit markets or share markets.”



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