Keynote Address

Brisbane Mining Club

Grand Ballroom, Brisbane's Tattersall's Club

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"Positioning for the Cycles"

Mitchell H Hooke

May I acknowledge the traditional owners of Meanjin (Brisbane) the Turrbal Aboriginal Nation, and pay my respects to their elders and ancestors……………….

Chairman of the Brisbane Mining Club, Mr Andrew Vigar, Director Robin Vigar, Manager Sally Levis, .. ….distinguished guests

It does feel a little strange to be addressing you today without the authority and intellectual resources of my former position with the Minerals Council of Australia.

That might raise expectations among some that I will speak more freely unrestricted by the responsibilities of that high office. But if that was your expectation you may be disappointed—if anything I will be more guarded for fear I enjoin a debate I am less equipped for, and more to the point, I have no intention of being one of those painful has-beens who continually pontificate from the sidelines as they struggle with RDS-- relevance deprivation syndrome.

Indeed, had I not accepted your kind invitation nearly 12 months ago I am sure I would have declined it in my new post-MCA life.

That said, you have asked me to reflect upon my experiences and observations of nearly 25 years as a CEO in Canberra spanning the agriculture, food and grocery, and minerals industries, but especially so the last 12 years with the MCA.

In 1967, as just a young boy, I recall standing in the severely drought affected paddocks of my parents property in the Western District of Victoria – and I could not comprehend that I would ever again see those paddocks lush in rye grass and clover. Years later after the drought and the paddocks had recovered, I couldn't really reconcile just how bad it was during the drought.

This rather stark childhood experience has proved to be an accurate metaphor, at least for me, for how, generally, as individuals and collectively as society we move through the socio economic vicissitudes of life and the cyclical nature of our respective industries and company's commercial circumstances.

And yet, to step back and reflect on the incredible changes over the last 3 decades of just my own professional career, the inescapable conclusion is that the cyclicality to our circumstances is around a longer term run of enduring change.

…. changes in societies' attitudes and expectations, changes in nations' construct of institutional, social and economic public policies, and changes in peoples personal circumstances and quality of life.

The underlying fundamental driver of this enduring structural change has been the consistent and persistent embrace of the market.

Enduring open market policies across the globe have transformed:

- societies attitudes, expectations of governance and regulation, --from the common denominator of the collective doctrine to the aspirations of the individual
- societies demands for sustainable development —uncompromising demands of our sector for improved social and environmental stewardship of the communities and people and environmental assets under our care
- developed and developing countries' economies alike-- from highly regulated protected and rigid to more open market oriented, deregulated and globally integrated
- global trade and commerce--, globalised and integrated to the point where capital, product and services markets, companies and their industrial activity, capital and human resources and knowledge, are increasingly borderless , and
- global economic growth and the alleviation of poverty – half the world's economies are going through an industrial revolution and circa 1.5 billion people have been lifted from poverty in the last 20 years

There is no turning this tide of structural change—it is part of the furniture so to speak.

And it has so profoundly defined our minerals industry's prospects and modus *operandi*.

Growth in our industry is directly correlated with the socio-economic development of the emerging economies – both in demand for our products and competitiveness for global custom – for access to minerals resources, capital, human resources, and access to markets.

The global economic re-weighting, driven by the twin forces or urbanisation and industrialisation, will continue for at least the next decade.

There is little transiency in this shifting emphasis in global socio-economic and industrial strategic endeavour, the like of which the world had not seen since the industrial revolutions of the 19th Century.

The super cycle of growth has well and truly transcended the industry's traditional boom bust commodity cycles to a "new normal" growth trajectory.

Our industry has similarly restructured – globally integrated and rationalised to the point where the localised roots of each of our companies' origins are invariably masked and certainly any patriotic loyalties.

And, the industry's fundamental commitment to the global pursuit of sustainable development is no passing fad. Both a regulatory and a social license to operate are conjoined, just as are the environmental, social and financial dividends of our industrial endeavour now profoundly interdependent.

There is no question that markets and governments' policies move in cycles.

But this inherent cyclicality is really only in the volatility around the longer term growth trajectory as markets invariably correct as they overshoot either side of the demand and supply axis-- often overcorrecting, exacerbating the inherent volatility.

So too in public policy…..policy makers, and elements of society, periodically, attempt to shape the market, to intervene on a policy platform that is more ideologically bent than founded in rational economics or sound science, or simply to play a destructive role in undermining the market in its allocation of the basic factors of productivity – labour, land and capital.

But this is rarely sustainable if it fails to capture the imprimatur of the market— populists causes will only endure if they are truly sustainable in the market-- even environmental activists know that end of pipe remedies to environmental causes are eventually failures.

My upfront take home message is that there is more substance in the fundamentals of this global structural adjustment and its underlying impact on demand and supply of minerals resources than there is risk in the cyclical volatility – notwithstanding the rather dramatic fall in minerals commodity prices through 2012-13.

There's nothing particularly prophetic in all this you say…

….true…. and yet for all the minerals industry's acknowledgment that ours is a cyclical business with long lived assets and commercial horizons, our understanding and embrace of open market policies and the current global structural adjustment, and knowing that we are vulnerable to the whimsical nature of politicians and NGO protest movements …………, managing these cycles, appears at least to me, to be an underlying fault line in the industry's development.

Generally, -- there are always exceptions!-- the sector tends to be more reactive than proactive in following the cycles in the product and capital markets, the court of public opinion, and the vagaries of public policy, tending to be reliant on the next spin of the cycle for its ultimate salvation.

We appear to be victims of my metaphorical droughted/lush paddock scenario– where we seem somewhat captured by the circumstances of the immediate without sufficient regard for the longer run underlying fundamentals ---and at times we are excessively myopic for an industry whose impacts are broad indeed

In this we tend to reinforce both positive and negative sentiment to the point where markets overcorrect beyond the natural order of things, thereby exacerbating the inherent volatility.

We have tended to be too sporadic:

- in opex and capex performance responding to the short term drivers of the equity markets.
- in social stewardship and environmental management, derogating that stewardship to the so called soft issues of non-core business, until they become immediate impediments to operations,
- in actively publically positioning our industry until the politics of envy and class warfare threaten its very basis ,and
- at times, in our advocacy of public policies where the short term commercial benefits outweigh the longer term costs of prostituting the principle that public policy should not be pursued as a point of competitive differentiation in the market

The legacies of which are structural deficiencies in our operating platform – persistent capacity constraints, inflated costs structure, poor multi- factor productivity, and an erosion in our social and regulatory licences – the product of which is a loss of competitiveness, profitability and investment—and ultimately lost opportunities.

The impact today is acute ---- as access to resources narrows, product and capital markets tighten, as societies' expectations intensify, as governments' regulatory and fiscal demands increase, as emerging resource rich economies bring on new supply….and in countering a renewed assault on parts of the industry's social licence to operate.

And I suggest that an increasing sophistication in getting ahead of the cycle is going to become far more acute in defining competitive strength.

Many of the previous determinants to supply competitiveness are being “commoditised “ i.e. not as great a differentiator in the market, such as sovereign risk, access to technology, skills, capital and product markets, infrastructure etc.

….and emerging resource rich economies have come into the market more prominently, more enduringly and more competitively.

Let me expand on each of the cycles I've referred to :

- the market
- the industry's social licence to operate, and
- public policies

The market….. *yesterday*…..

The industry emerged from the parlous circumstances of 80's and 90's “drought” with a highly globally competitive costs structure having emphasised capacity utilisation over capacity building, but necessarily traded the benefits to customers in lower commodity prices in a fiercely competitive market.

But, the relative capital strike of that period left the industry with capacity constraints to supply growth.

Capacity constraints became the new key determinant of competitiveness as the industry struggled to gear supply to meet the burgeoning demands of a rampant China and other Asian, Latin American and Central European developing economies.

But even then the industry hesitated.

It simply didn't believe then the remarkable minerals demand projections of the developments in China on the back of their accession to the World Trade Organisation in 2001, and other emerging economies following suit.

This hesitation simply exacerbated the supply deficit.

It was only once the demand cycle moved into full swing did the industry get serious.

There was a mad scramble for resources, an unprecedented surge in investment in new projects and the building of inventories.

But in the process, the industry squandered its costs and productivity competitiveness. Between 2006 – 2012:

- operating costs all but doubled. Worse still our rate of increase is nearly twice that of the globe in coal and base metals and more than twice for iron ore.
- Australian operations pushed into the higher end of the global cost curve, even before factoring in declining ore grades.
- capital intensity (capital costs per unit of output) reached unprecedented and uncompetitive levels, and
- multi-factor productivity dropped significantly even when corrected for the lag effects of investment and resource depletion (lower grades and depth).

Some of this was the market's natural order of things --- costs increased in the drive for production, simply because costs always rise to revenues when there is still profitable margin in it… and labour costs were founded more in a combination of the political and market pressures of capacity to pay than market driven productivity offsets.

Some pressures were government induced--- for example, the draconian restrictive impositions of the 2009 Fair Work Act reforms bit hard, and, governments went after a greater cut either through increased royalties which adds significantly to project costs, or as rent taxes which prospectively destroys project value, and certainly eroded investor confidence.

But some of it was self-inflicted ---that the industry went after supply capacity with its ears laid back was also in part in response to the real or perceived drivers of the debt and equity markets—keen to differentiate their investment portfolios on the strength of a company's global reach -- its size, geographic and product diversification and project pipeline.

As companies sought mergers and acquisitions for growth, rationalisation and consolidation pushed organic growth to a backseat—and so too did the industry appear to dispense with the criteria companies have traditionally adopted in making investment decisions ---- that in project NPV calculations discounted cash returns are based on the long-run equilibrium of marginal costs of production.

And yet none that I recall contested that the dramatic increase in commodity prices was well in excess of the long run marginal costs, yet plenty of pipeline projects would not have stacked up on a longer term prognosis.

The Market … *today***….**

I suspect few would contest that a significant part of the industry's predicament and central focus today has much to do with redressing the adverse legacies of yesterday, and in the "not unreasonable expectation" that the next spin of the cycle will be the industry's next point of salvation.

But "the spin" this time is not on the demand side.

That we have entered a new phase of supply competitiveness is clear.

But to suggest this is because the growth in demand for our products is abating is to misread the underlying fundamentals to both demand and supply.

The global growth outlook has strengthened on the back of improvements in some advanced economies—notably the USA and Japan--and the emerging economies relatively high GDP growth is well supported and off an ever increasing base.

China and India are understandably the focus as their GDP growth rates ease. But I would point out that when China was growing at 10% - 12% it was the 15th largest economy in the world -- and now, growing at between 7- 7.5% off the 2nd largest economy in the world.

Commonwealth Bank research indicates that China's GDP growth rate could drop to 6.9% this year and only 4.9% by 2020 to generate the same absolute growth as the average of 11% in the "boom" years from 2003 to 2012.

Per capita incomes and minerals and energy intensities in the emerging economies have a long way to run.

As they approach the point of saturation where demand for raw commodities is insensitive to changes in consumer purchasing power, demand growth will increase at a decreasing rate—but don't confuse deceleration in growth with contraction in demand.

The emerging economies are not materially, if at all, diverging from their path of socio-economic reforms to their political systems, institutions and governance, and open market-oriented economic and regulatory policies.

And although the concept of the emerging bipolar global economy, has tempered somewhat as advanced economies recover and some emerging economies are struggling, the concept holds true in the general sense.

The emerging economies are increasingly decoupled from the dire economic circumstances of the West, particularly the Eurozone, who are struggling under the weight of debt, toxic assets, weak underlying fundamentals, reform inertia, a culture of state dependency and social entitlements and the real risk of deflation.

When you consider the magnitude of change, you'd have to conclude that the emerging economies have been managing well a quadrella of challenges – inflation, population growth, normalisation of monetary policy, and rebalancing growth to consumption from FDI and export led growth.

So too, the "Asia factory" phenomenon of intra-Asian trade and investment deepens as these economies become more "continental" and bolstered by regional savings, increasingly fund its own growth becoming less reliant on the traditional markets of the West. Already Shanghai is growing to rival New York as a financial centre. China's debt markets are forecast to grow from around $US4 trillion last year to around $US 27 trillion by 2030.

There are competing sentiments among commentators and international capital markets as to whether China's current financial growing pains see it destined for a hard landing or not.

Again perspective is a pretty good barometer.

China’s leaders have declared that:

- they recognise the imperative, even the urgency, for continued market reforms
- they want a modest downturn in GDP growth as they work through the rebalancing of their economy to greater reliance on consumption than investment for growth -- which in-turn entails increasing household earnings as they shift from lower paid to higher wage products and services, and a greater returns on savings.
- they are not disposed to a “misallocation of capital” through further stimulus of inefficient state owned corporations, and
- they appear not fazed by the emergence of shadow banking (less regulated financial institutions) which is less than a third of their total banking system, rather reports indicate they working to appreciate how best to allow this to happen, as they liberalise their banks.

Added to which, as Peter Sands writing in the Financial Times points out, China’s savings are high, hence they are not dependent on foreign creditors, and their borrowings have been for investment not consumption.

While many consider China’s debt to GDP ratio at 213% is high, China is well positioned to recapitalise their banks just as the USA and the Eurozone have recently. Indeed, they are confident in their brand of state capitalism’s triumph over open market capitalism.

And they are well engaged in counter-cyclical investment strategies, emboldened by significant stores of capital in sovereign wealth funds, and driven by the imperatives of food and resource security.

And what impact the antagonistic activists on minerals demand?

….very little in the long run of things. I’ve long observed these groups shift their focus from one fad to another in the pursuit of popular patronage than pursuing lasting improvements to their self-proclaimed causes.

I mean no untoward offence in this, rather as a dispassionate critique, as their efforts often properly hold industries like ours to account.

As I said earlier, unless their case stacks up to rigorous scrutiny and the disciplines of the market it will dissipate over time, even though they can cause some disquiet in the short term.

For example…..

…nuclear energy was making significant headway until the calamity of Fukushima and so it will again when the realities of energy security at affordable prices become the overriding demandeur, and the modern technology advances of nuclear reactors are more readily apparent.

In the same vein, the current attacks on the coal industry will peter out over time – reconciling the twin policy imperatives of managing climate change with access to affordable energy and taking some 1.5 billion people out of energy poverty, will ultimately prevail over those who mount campaigns against coal from the comfort of their coal-fired electric homes.

And the relentless drive for salvation in renewable energy is rather naïve and grossly misleading. Does anybody seriously think the global economy can sustain the current and projected rate of subsidisation of renewables -$US 100B today and projected to hit $4.2 T over the next 20 years - without any tangible environmental dividend,…. let alone contemplate a material substitution of coal fuels that currently account for 30% of the world’s primary energy consumption and forecast to still be about 25% by 2035.

… the antagonists would be better off focussing their attention on the breakthrough technologies for all forms of energy – fossil fuels, nuclear and renewables – for there should be little contest the world is going to need all sources if it is to meet future energy demand.

So, if you accept this view that minerals demand is fundamentally not going anywhere differently anytime soon…. the real play is on the supply side.

No surprise that the inevitable market correction [on the supply side] caught up with and currently exceeds demand.

.. but it was the speed with which emerging resource-rich nations’ geared supply that caught the market by surprise.

Supply elasticity will be the key determinant of the extent of the downside cyclical volatility in commodity prices and the speed to recovery to more closely approximate the long run marginal costs of production – for they are surely well south of that now in most commodities.

I said earlier that it was "not unreasonable" that there were some expectations that salvation - at least in creating shareholder value – lay in the next spin of the cycle.

I say "not unreasonable" because corrections on the supply side will be more elastic than many commentators would have you believe.

From a period of relative supply in-elasticity constrained by capacity constraints in the run up, I suggest the flipside to this on the way down will be more elastic in reducing supply as commodity prices have retreated.

My optimism on supply corrections is somewhat qualified by the structural constraints of take or pay contracts especially in coal, the volume imperative for revenue growth, and the capital cost over-hang of new infrastructure investment and new projects. That said there are movements in the market that are cause for optimism, with coal to date being the exception. (ref. Appendix of notes)

The market ---*austerity counter-cyclical tension….*

The accent on drivers of value have necessarily shifted from the price led growth of the last decade to production volume and margin protection, improving operating costs, productivity and capital expenditure…..

The industry is well into austerity measures as companies strive:

- to restore costs competitiveness, realise volumes and to strengthen balance sheets
- to increase returns to shareholders and rebuild investor confidence – who were patient through the capital intensive investment phase; and
- to redress the structural deterioration in multi-factor productivity .

The challenge of remedying the deficiencies from yesterday's activities for tomorrow's growth is a tension between the short term austerity drive to rebuild cash competitiveness and the imperative for counter cyclical positioning for future growth when the supply side of the market corrects.

But I put it to you …..

… if this rather unrelenting austerity focus becomes more akin to foetal position-like behaviour than a careful positioning on the cycle

… the industry could again find itself dragging on the cycle, rather than pre-empting it.—again visiting structural deficiencies in its capacity for growth.

The drive for cash flow and dividend returns to satiate investor demands for yield tends to militate against counter-cyclical investment opportunities to capitalise on the inevitable market correction.

Increased capital discipline in both its allocation and management is moderating, if not curtailing, investment in sustaining capital and in new capacity. Many greenfield expansions have been "deprioritised ".

Project management has become as much about which projects to cut temporarily or permanently as it is to improve their performance

This is reinforcing the risk averse climate in debt and equity markets already spooked by the market correction, and antipathetic to increasing investment in resources, impatient with the industry's performance and looking in a different direction for return on investment.

Access to capital, particularly for small to mid-caps and especially start-ups, has become the dominant capacity constraint. Sources of new capital (as distinct from retained earnings) are increasingly confined to the state-owned enterprises and sovereign wealth funds, reverse takeovers/mergers, and the emerging play of private equity.

Sovereign risk management is taking on a new dimension of blanket discrimination in favour of OECD countries, notwithstanding the considerable progress in economic and institutional reforms of the resource rich emerging economies.

Expenditure on asset accumulation, exploration and technical and systems innovation have invariably joined the ranks of discretionary expenditure.

Reserves and resources replenishment has similarly given ground to the imperative of increased cash flow.

Those who appear to be managing the austerity and counter-cyclical mix well, are focussed on getting ahead of the cycle – when the inevitable supply correction occurs-- and supply capacity constraints prove more enduring, more structural, than the cyclical volatility might suggest.

These are companies with strong balance sheets, an appetite for investing against the cyclical flow, and the capability for top line project management - looking to be better positioned for the anticipated supply shortages as the market corrects.

They are:

- pursuing asset build and or replenishment by maintaining exploration expenditure and/or in acquiring cheaper stranded or stressed assets
- focussing on the opportunities in strategic and applied technological innovation – to build value in systems innovation in exploration, production and processing, transport and in product differentiation and/or product arbitrage, and
- placing greater strategic accent on shaping price side revenues – in moves to integrate production and marketing, even to trading for real time market intelligence in managing supply onto the market for price effect, for product differentiation and for better intelligence on competing assets.

The industry's social licence to operate…

The 1990's was also a pretty ordinary period in the industry's relationship with the communities in which it operates and in particular indigenous communities.

The Australian minerals industry was in conflict on so many fronts that the wagons were closing in ever diminishing circles.

The industry was under siege from communities increasingly disenfranchised from its activities and alienated by its performance.

The industry's failings were various and varied across the globe – they were not hostage to any country or province, to any company or project, nor to any ore body or commodity.

But there was no contest to the consistency of structural deficiencies in our industry across the globe, often given vent by high public profile failings – in workplace fatalities and injuries, fouling of waters, air and surrounding lands, tailings dam breaches, adverse environmental and social legacies, abandoned or orphaned mines, bitter community unrest and social conflict, bribery and corruption.

The industry was lost in the logic of its own self-importance, and in its frustration that Australians did not appreciate its economic significance, worse still, were not eternally grateful for it.

To add insult to the industry's indignation, it was popularly dismissed in the IT boom of the 90's as "traditional, old economy", and largely superfluous to Australia's socio-economic prospects.

The industry's counter back then was to run advertising campaigns promoting its economic worth to the nation, on the misguided assumption that if only the community "saw the light" all would be well.

Quite simply, the minerals industry was at serious risk of losing its social licence – the unwritten social contract between the communities in which it operated, and indeed, the Australian community more broadly.

The industry's reaction then has become the contemporary industry's defining epiphany – its commitment to the global pursuit of sustainable development.

The product of which has been a remarkable transformation in the industry's *modus operandi* and recovery in its standing within local and wider communities. Even our harshest critics acknowledge this progress.

Though, why did the industry not see the whirlpool until just before it nearly engulfed it?

How could the industry let itself get into such a state of affairs before it reacted, again off the back foot?

And are we at risk of eroding some of that hard won ground as elements of our commitments to key principles of community engagement slip below our own standards -- where we might have failed to uphold commitments, where we have tended to, or perceived to, take communities for granted, or where we might have fudged the creating of shared value where there is shared risk.

And so the cycle of loss of confidence and threat to our social licence comes around, for want of preparation and commitment.

On the public policy front….

The last time we had a commodities boom in the 1970s, the Australian economy had all the hallmarks of the European Union today.

Australia was an inflexible, rigid economy, mired in regulatory control, enterprise stifled by bureaucracy, state owned enterprises, a culture of state dependency and entitlement, and antipathy towards business and economic development.

The 1970s mining boom ended in tears for Australia – double digit inflation, interest rates and unemployment.

In the intervening period, as I indicated at the outset, the global socio-economic orientation shifted profoundly to open markets and to individual enterprise and initiative, both in culture and structure.

In Australia, just as in other reforming economies, the whole point of the Hawke-Howard reform era in Australian economic policy was to improve the economy's flexibility, supply side capacity and adaptability, where labour and capital move to where they are used most productively in those industries that we do best.

And yet through the course of successive Labor Governments from 2007, during a period of minerals resources led strongest terms of trade in 150 years and vastly improved national prosperity and living standards, there has been

- an unashamedly regressive shift in economic policy towards the redistributive than the productive side of the economy,
- an emerging protectionist sentiment notably in workplace arrangements, excessive and soft regulation, new taxes without tangible dividend, industries assistance, and an antipathy towards foreign investment, foreign skills and foreign enterprise.
- and as we all know only too well, governments went after a greater cut either through increased royalties which adds significantly to project costs, or as rent taxes which prospectively destroys project value, and certainly eroded investor confidence.

In effectively denying the virtues of the preceding decades of open market reforms, the Australian economy is in structural deficit in just about every key economic indicator.

And all this, the product of a national complacency and economic reform inertia, even backsliding, born of a false sense of security aided and abetted by the politics of envy and class warfare.

To its great credit the minerals industry, in the main, stayed the course of market oriented economic reforms, arguing for more not less.

Rather than being distracted by claims about Dutch disease, or two-speed economy or that the so called 'boom' is more a threat than an opportunity for Australia coming at the expense of other parts of the economy, the MCA stressed

- that the Australian economy's structural tensions created by the rapid expansion of high productive mining can be eased by policies designed to lift the speed limits at which Australia's economy can grow—open market access to foreign capital, to skilled workers and to material inputs principal among them.
- that Australia simply cannot afford to wait for the traditional spur of economic crisis to provide the impulse for further economic reforms – even though one might reasonably conclude that we are already in that space, there is not yet an apparent universal reform imperative the like of which so defined the Hawke-Keating-Howard reform era.
- that we must dispense with the politics of envy in favour of a platform of mutual respect and mutual dependency. There can be no greater 'beacon on the hill' than the remarkable transformation in the mining industry's relationship with Indigenous Australians, and
- critically, that the reform imperative must be transitional and incremental, not revolutionary, if it is to be sustainable …….

But there are always exceptions – some more prospectively damaging than others—a few come to mind where the principle of not allowing public policy to become a key point of competitive differentiation in the internal market, stood to be compromised for narrow commercial benefit.

Parts of the industry's initial approach to climate change management policy was classically defensive – to the point where it was head in the sand stuff and we lost opportunities to better shape the policy response.

The Howard led Ralph reforms of business taxation proposal to trade depreciation tax preferences for a reduction in company tax rates became mired in a tug of war between company's variations on capital intensity rather than key principles of tax reform.

The debate over Part IIIA access to the Pilbara railways was another classic where those with prospective commercial gain became proponents of third party access to another companies infrastructure that was never a privatised State Owned entity, nor access is absolutely essential to competition as subsequent developments bear testament.

The super profits tax debate nearly went even further into the realms of the ridiculous with industry breakaway proposals that starting base asset valuations be double the written down book value as a means of redressing the inequities of retrospectivity where those with longer term assets would be disadvantaged compared to later entrants.

Added to which they proposed that the point of ore valuation not be Run of Mine pad, but rather further downstream – now that would have really compromised the design objectives of a resource rent tax, and widened the commodity coverage significantly giving those who derive value add from downstream processing a real belting.

And more lately we are witness to the self-proclaimed expert commentary of those who were barely bystanders to the mining tax policy machinations declaring that the industry was poorly served by the negotiated outcome.

I often cherish the cheer squad of enthusiasts in the grandstands who have never played the main game, but in this case there can be no entertaining the proposition that the MCA should have continued with its mining tax advertising campaign with the singular purpose of attempting to bring down a Government and run the gauntlet of a Greens - Labour alliance in the Senate.

The MCA properly determined to work with the government of the day for the best policy outcome and leave the politics of governance to the people of Australia. Those who wished it otherwise have their own motives and are quite unfazed in who they damage to achieve them.

In conclusion…….

I suspect after this down load you don't want one – but if I am permitted to leave you with a take home message:

– it is that market sentiment has overshot the underlying fundamentals in this cyclical correction to the longer term trajectory of growth

.-- there is more substance for growth in the "new normal" of this remarkable global structural adjustment, than there is risks in its volatility, but some of that higher risk volatility is self-inflicted and some inflicted by policy makers – both of which are within our purvey to remedy.

.. and I suggest that in our quest for continuous improvement, we might do better by being more proactive than reactive in positioning for the cyclical volatility, for what is a long run business of converting natural endowment into enduring societal capital.

Mitchell H Hooke

10th April 2014

Appendix

On supply elasticity, current indications are grounds for some optimism, even if not universally so.

- Copper production disruptions continue against long term projections of refined copper consumption increasing by circa 60% by 2025. World class discoveries are extremely rare, reserves and head grades are declining in existing operations, and of the recent crop of ”mega projects” few look like coming into production in the near term. Copper inventories (stockpiles) that had built quickly through 2012-2013 are being drawn down to around the 5 year average.
- Nickel is responding to concerns about supplies from Indonesia, facing new restrictions on exports of unprocessed ore, and Russia.
- Zinc is on the precipice of an identity crisis--demand will increase as agricultural production intensifies in emerging countries, as cars in emerging economies step up to the zinc coating phase of rust protection, and galvanising steel reaches new per capita intensities—coinciding with the material run down of existing mines and little prospect of new mines emerging – of the 5 principal new projects, only 2 are big and are in Iran and Russia.
- Bauxite is likely to come under pressure in the near term as China seeks supplies as its refining and smelting capacity continues to outstrip local supply and inventories run down.
- Iron ore is more a function of demand as supply increases from both traditional and so-called emerging producers—and near term demand is, according to one CEO of the majors, expected to support a price in the order of $US110 – $US125/T.
- Production restraint is clearly evident in gold. As one CEO put it - ‘returns will drive production, not the other way around’. Gold producers are closing high cost marginal mines – and there’s a few of them! Gold prices are understandably highly volatile in the current environment of speculation about central banks (US and Japan in particular) future quantitative easing and what prospects investors reinvesting as a hedge against inflation
- Thermal coal supply correction is proving stubborn in the face of dramatic falls in prices—Indonesia and Columbia are continuing to grow exports, as is Australia. Indonesia recanted on its decision to cap exports at 400 million tonnes. As a relative newcomer to the stage Columbia appears intent on staying increasing its exports by 15MT to around 90MT. And Australian producers are dogged by the structural constraints of take or pay contracts, the volume imperative for revenue growth, economies of scale and improved productivity, and the capital cost over-hang of new infrastructure investment and new projects.
  On the flip side as global supply constraints become more acute - as new producing countries Mozambique and Mongolia miss production targets and as mine closures/project deferrals in USA, Mongolia, China, Australia, and Canada start to bite, some consider thermal coal may short within 12 – 18 months as demand, projected to increase at circa 5.2% CAGR, outstrips new supply.
  And a “watch this space” is the Supreme Court challenge to the EPA’s decision in September last year to regulate limits on emissions from coal fired power stations to about 500kgs / MWh which is not possible even with ultra-supercritical plants without CCS. If this decision is overturned coal comes back into competitive calculations with gas prices north of $3-4/GJ.
- And on met coal – even though the current outlook is not much better than thermal, large met coal deposits are relatively scarce - and China and India are short quality met coal – but this is complicated by the regional “ community social benefits” of steel mills overriding the commercial needs for quality product and competitiveness.