



Queensland floods - Impact on Global Commodity Markets

“Mining and agriculture - Queensland’s top export industries”

Queensland’s share

...of Australia’s economy

19%

...of global coking coal exports

56%

...of Australia’s fruit and vegetable production

28%

Australia’s Outlook

GDP rise in 2010-11

4.25%

Reconstruction cost

\$19.7bn

Summary

Australia is suffering from the severe economic impact of the worst floods in Queensland in almost 40 years. Its coal exports have been especially hit hard. Australia is the world's largest coal exporter; it accounts for about 56% of global coal exports. Almost a third of the world's coking coal comes from the Bowen Basin in Queensland.

The torrential rains affected about 30,000 properties in Queensland. They led to the closure of coal mines, disrupted rail transportation, damaged crops, and slowed industrial output.

Flooding in Queensland

The eastern states of Australia witnessed heavy rainfall during H2 2010 and early 2011 due to the development of a La Nina weather pattern and Cyclone Tasha in December. Queensland, including Brisbane, was most affected, although there was flooding in parts of Victoria and New South Wales as well.

As a result of the recent cyclone and floods, there could be a fall of 7,000 million dollars worth of coal and agricultural product exports.

Impact on Commodities

- ▶ The recent flooding in Eastern Australia is expected to reduce agriculture production by USD 500-600 million metric tons this year. The production of vegetables, fruits, cotton, grain sorghum, and some winter crops as likely to be severely affected.
- ▶ The floods swamped the mines in the state of Queensland, halting operations that produce 35% of Australia's estimated 259 million metric tons of exportable coal.

Economic Impact

Commodities make up a large part of Australia's USD 1 trillion economy. Queensland accounts for approximately 19% of Australia's economic output. The floods devastated huge areas of the country, which may take many years to rebuild and is likely to have a significant impact on the economy. It is estimated that the cost of cleanup and rebuilding will total as much as USD 19.7 billion.

"The reconstruction effort is looking set to be larger and larger and could make a significant contribution to growth as early as the second quarter," said Michael Workman, senior economist at Commonwealth Bank.

Australia's GDP is expected to grow at 4.25% this year. However, its GDP is projected to contract by about 1% in the current quarter because of weather damage and the fall in coal and agriculture production. The effect of the floods is likely to be felt most during H1 2011.

However, Australia's GDP is expected to rise during Q2 2011 due to rebuilding.

Economists at Bank of America/Merrill Lynch (BoAML) have reduced their 2011 GDP growth forecast to 3.3% from 3.0% and hiked their CPI forecast to 3.5% from 3.1%.

According to the latest labor reports released by the Australia Bureau of Statistics, 24,000 jobs were created in the month of January 2011. In Queensland, the jobless rate fell to 5.6% in January from 6% in December 2010.

"This is a pretty healthy labor market and it's getting tighter and we are getting pretty close to full employment," said Senior Economist Su Lin Ong of RBC Capital Markets.

Mining

- ▶ The northeastern region produces about 80% of the country's coking coal.
- ▶ The areas affected by floods account for 40-45% of global exports of coking coal, which is the key raw material for steel making.
- ▶ The prices of coking coal increased as the result of the disruption and are expected to average about USD 260 per metric ton in 2011.

The floods severely affected the coal mining industry and have impacted about 40 mines in Queensland. Most companies declared force majeure on contracts, as the floods forced them to halt production and resulted in logistical problems. It is estimated that this disruption could remove over 5% of coking coal from the global market this year.



More than 15 million metric tons of coal is typically shipped every week. However, many shipments were lost during the floods in December. Abbot Point, Dalrymple Bay, Hay Point, and RG Tanna are some of the major export terminals that were affected.



The BDI, which tracks the international shipping rates of various dry bulk cargoes, dropped by 20 points to 1,064 points on February 2, 2011. This decline was the first drop by a large margin in the last two years. The Capsize Index, BACI, fell by 1.74%, indicating that there was a fall in the rate of capsizes, which are typically used for bulk iron ore and coking coal transportation. This decline was primarily due to weather related problems in Australia and other parts of the world.

Companies Affected

The major companies that were affected by the floods were Anglo American, Aquila Resources, Macarthur Coal, Rio Tinto, BHP, Peabody, Wesfarmers, and Xstrata. Together, they have lost USD 2.33 billion in sales. In addition, production stoppages resulted in about USD 608 million a week in lost revenue.

Countries Affected

The key buyers of coal from Queensland (i.e. Japan and Europe, followed by India, Korea, and Taiwan) were indirectly affected by the floods. Some of these countries have started to investigate base material supplies from other regions in order to overcome supply shortages.

Countries	Coal Imports from Australia
Japan	80%
Taiwan	80%
South Korea	63%
India	37%

Impact on Coal Prices

- ▶ The floods are expected to propel coking coal prices to an average of about USD 260 per metric ton in 2011, which is about 25% more than the expected annual increase in coking coal prices. As a result, the cost of steel products, like HR and CR coils, is likely to increase. In addition, the hike in coking coal prices is expected to support the price hike of other raw materials used as substitutes for steel making, such as ferrous scrap and pig iron.
- ▶ The supply shortage of coking coal in Q2 2011 is likely to result in about a 8-10% rise in global coking coal prices compared to Q1 2011. This price rise is expected to be passed on to end users in time.
- ▶ The prices of global HRC and CRC are expected to increase by about 5-6% in Q2 2011, about 1-2% higher than the expected price of flat products for the quarter.
- ▶ The flooding in Queensland has had an indirect impact on the prices of iron ore, another major raw material used for steelmaking. The floods affected freight charges. As a result, FOB based prices for iron ore are gaining more importance. The impact of the floods on the supply of iron ore is projected to be low, as there are few ores in the flood affected region.
- ▶ The profitability of non-integrated steelmakers is likely to be affected in Q2 2011 due to the high cost of production.

Impact on Aluminum Prices

- ▶ Severe flooding in Queensland caused the Rio Tinto Group, the third largest mining company, to declare force majeure on the January 13, 2011 for its aluminium supplies from its Alcan unit's Boyne Smelters Ltd, the largest aluminium smelter in Australia.
- ▶ The floods cut off rail and road access between Gladstone and Brisbane. However, the force majeure was terminated by the company on January 20, 2011. An extended force majeure at the Boyne smelter unit could have driven up aluminum, prices which were already on the rise. However, this effect was prevented as the force majeure was cancelled.
- ▶ The floods and cyclone disrupted the weather and caused the smelting of aluminium to be stopped. The port of Brisbane (from where millions of tons of aluminium are exported) was closed until flood related currents subsided.

Impact on the Indian Steel Market

Coking coal accounts for about 45% of the raw material cost for steel manufacturers in India. Rising coal prices are expected to affect the profit margins of these producers and support an increase in iron ore prices. The effect of coal prices is expected to have an impact when steel makers sign a contract with mining companies for Q2 2011. The steel prices in India are expected to increase by USD 20-30 per metric ton in current quarter.

Australia is likely to impact the profit margins of Indian steel companies in the fiscal third quarter. This trend has already started with companies like SAIL and JSW Steel. The markets have already shown signs of a fall in profits for most steel stocks, including Steel, Bhushan and Uttam Galva Steel.

Agriculture

- ▶ Queensland supplies 28% of Australia's fruit and vegetables. It also produces 95% of the country's annual sugar crop.
- ▶ Australia is the leading exporter of sugar in the global market



The floods caused widespread damage across many agricultural industries, including food, crops, and livestock. The area affected accounts for about 33% of the country's sugar cane production. Food prices have been rising due to supply disruptions in Russia, Pakistan, and now Australia. The supply of wheat and cotton are already at critical levels. The exports of Australia's wheat, sugar, and cotton are expected to be hit by the floods. Due to the floods, sugar prices climbed to a 30-year high across the world. Losses from sugar cane are estimated to reach USD 505 million.

Conclusion

The recent floods resulted in substantial damage to the Australian economy, which could force the government to make difficult decisions about rebuilding Queensland. Cyclone Tasha, a category 5 cyclone, was the most powerful to hit Australia in 100 years. Losses are estimated to total USD 3.54 billion, of which the agriculture and mining industries will face losses of USD 2.03 billion. The tourism industry is projected to suffer USD 1 billion in losses as well. Queensland's top export industries are expected to take months to recover from the impact of the floods.

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