INSG Insight

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The Ongoing Economic Crisis and Nickel

Introduction

This report, the eight in the series of INSG Insight briefing reports, is intended to provide members with information on the impact of the economic crisis on the metals industries. In addition to this current Insight and earlier briefing papers, the secretariat has organized presentations on this topic as part of the regular Study Group meetings. The topic of the economic crisis will be discussed at the October 2009 meetings of INSG, as well as in a Joint Seminar on 7 October, entitled "Post-crisis Metals: What will be different?". The information in this Insight is intended to aid in those discussions.

Economic background

The IMF has described the current economic situation as a, "recession unprecedented in the post–World War II era", and in July projected that global output will contract by 1.4 percent this year.

The current economic crisis began in 2007 in the U.S. with a financial crisis as the housing bubble collapsed. The financial crisis soon led to a recession in the real economy as lending tightened and capital became increasingly hard to come by, and uncertainty grew about future demand. This uncertainty contributed to a sharp decline in production of manufactured goods and a fall in global trade. The worldwide economic crisis has been described as the most severe since the Great Depression of the 1930's. According to the World Bank, the level of industrial production in rich countries has dropped by 15 percent since August 2008, and that in developing countries, excluding China, by 10 percent.

Economic activity in high-income and developing countries alike fell abruptly in the final quarter of 2008 and in the first quarter of 2009. Unemployment is on the rise, and poverty is set to increase in developing economies, bringing with it a substantial deterioration in conditions for the world's poor and most vulnerable.

The latest IMF World Economic Outlook figures (July 2009) forecast global GDP will contract by 1.4 percent in 2009 and expand by 2.5 percent in 2010. However, the downturn has hit the advanced economies hardest, and their collective GDP is expected to fall 3.8 percent in 2009, and return to a weak growth rate of only 0.6 percent in 2010. Developing countries, in contrast, are projected to see growth of 1.5 percent in 2009 and 4.7 percent in 2010. China and India are the main drivers of this growth, with projected 2009 GDP growth of 7.5 percent and 5.4 respectively.

Africa and the Middle East are projected to grow only slowly, at 1.8 percent and 2.0 percent respectively. Mexico and Russia on the other hand are expected to see large declines in GDP, of -7.3 percent and -6.5 percent respectively.

The recession has meant not only a drop in GDP but also a sharp drop in international trade. The World Trade Organization projects a fall of 9% in global trade in 2009 the biggest such contraction since World War II. Advanced economies are projected to see larger falls in trade than the developing economies.

The World Bank notes that in high-income countries consumer demand and manufacturing orders have already improved or are improving, although for the moment available data do not show a similar turnaround in investment demand. These normal drivers of cyclical recovery will be amplified as monetary and fiscal stimulus measures kick in during the second half of 2009—boosting consumer and investment demand directly through government expenditure and transfers, and indirectly through very low interest rates. However, the expected recovery is projected to be much less vigorous than normal. The large overhang of devalued assets and nonperforming loans will limit the extent to which the banking sector is able to finance new investment and consumer spending.

The Chinese stimulus package – lessons for others?

In the current economic crisis, the Chinese economy stands out as the one major economy which seems to have evaded the crisis. Some observers have speculated that the strength in the Chinese economy will help pull the rest of the world out of recession.

In November 2008, shortly before the G-20 financial meeting, China launched a stimulus program of US $586 billion, equivalent to14 percent of China's annual GDP, with spending to be spread over two years. As a percentage of GDP, the Chinese package is larger than the stimulus package of countries such as the U.S. or the European countries.

The main goal of the stimulus package is to maintain a pace of growth of China's GDP at, or near, 8 percent (also referred to as "bao ba" or "preserve eight") by focusing on ten sectors of the Chinese economy: transportation, rural infrastructure, environment, finance, earthquake reconstruction, taxes, housing, health and education, incomes and industry. The program is designed to immediately bolster domestic confidence, thereby offsetting the downturn in exports. The impact of the Chinese stimulus goes beyond China through the effect on trade. It is expected that the plan will have the strongest impact in countries that are China's biggest suppliers of goods, including Japan, Taiwan and South Korea.

The initial impression is that the stimulus plan is succeeding. China's economy is the fastest growing among the world's major economies. China's GDP grew by 6.1 percent in the first quarter of 2009, according to the Chinese National Bureau of Statistics. For the full year, the International Monetary Fund (IMF) projects that China's GDP will grow by 7.5 percent in 2009 and by 8.5 percent in 2010. The plan was seen as a way to provide a cushion to growth domestically and to provide support for its trading partners. Merrill Lynch & Co. said expansion would have cooled to 5 percent without the program down from 9.5 percent in 2008.

For the first six months of 2009, Morgan Stanley estimated that 88 per cent of GDP growth in China was fueled by investment in infrastructure projects. Industries such as railways, construction, cement, steel and other metals are seeing the impact of the stimulus measures. These industries are connected with the rest of the world through the imports of raw materials, including nonferrous metals.

Is the approach taken by China a possible model for other countries? The situation in China is somewhat different from that in developed countries. The Chinese stimulus measures are in part an effort to move China away from an export driven economy and toward an economy driven more by domestic consumption. China has huge requirements for domestic infrastructure development and meeting these needs will demand tremendous amounts of nonferrous metals. The table below contrasts the existing infrastructure in the U.S. with that in China, and demonstrates the unmet demands that exist in China. In building infrastructure China will require substantial quantities of nonferrous metals.

China's Infrastructure Requirements

China compared to the USA

	USA	CHINA
Per million people		
Motorways (km)	21,862	1,080
Roads (km)	14,157	242
Railways (km)	780	54
Per 000 km^2		
Motorways (km)	699	150
Roads (km)	453	34
Railways (km)	25	8

Nickel imports to China surged in the first half of 2009. For the January to June 2009 period, refined metal imports were up by nearly 80 percent on a year-on-year basis. . The table below provides a more detailed breakdown of changes in imports and exports of lead, zinc and nickel.

Other metals followed a similar pattern during the first half of 2009. Chinese imports of copper, molybdenum and aluminium were also up strongly.

Chinese Metal Trade, January- June 2009

(Unit: metric tonnes; concentrates by metal content)

	Imports		Exports	
	Jan.-June	% Change from 2008	Jan.-June	% Change from 2008
Lead refined	136,000	1600.0	8,000	-75.0
Zinc refined	480,000	595.6	6,000	-85.3
Nickel refined	116,459	78.96	2,497	-20.34
alloy	3,544	579.73	-	-

Source: ILZSG and China Economic Information Center

In July, China's nonferrous metal imports began to recede. Copper imports fell for the first time in six months, to 406,612 tons, representing a drop of 15% on the month. Imports of aluminum and products were 222,858 tons, 37 percent less than

June, customs data showed. Perhaps not coincidentally, new lending by Chinese banks declined 77% in July as well. As metal imports showed declines, the Chinese stock market also slowed its advance. By early August, the Shanghai market had doubled from its low at the end of 2008. However, by mid-August it seemed the market had paused, and on 17 August the Shanghai Composite index dropped 5.8 percent in one day, its largest daily decline in 2009.

What conclusions can be drawn from the Chinese actions to stimulate their economy? It is perhaps too early to say whether the Chinese stimulus measures have set the groundwork for a period of sustained economic growth. The data available does not provide a clear cut answer.

For example, one piece of information that seems to run counter to the general trend is the information on electricity use. As the crisis grew in 2008 electricity used by industry dropped, reflecting the drop in demand for exports. In the first half of 2009, industrial value-added rose a robust 7 percent, while total electricity usage by industry fell 5.9 percent. The National Bureau of Statistics claimed this was due to efficiency gains; however, the reality appears more complex.

Most electricity use is concentrated in high energy users in China. Electric power consumption by small and medium enterprises (SMEs) plunged 48.9 percent year-on-year in the first half, against a 5.9 percent industry-wide drop. While SMEs do not account for a large percent of industry electric use, they do employ a huge number of workers. These companies were more exposed to the economic downturn, causing them to cut output more sharply than larger enterprises. The stimulus measures may, therefore, be boosting output by large firms while failing to provide support for SMEs and overall employment.

China has also announced that, as part of its response to the economic crisis, the nonferrous metals sector will be re-organized. The intention is that 600,000 tonnes of obsolete lead smelting capacity and 400,000 tonnes of zinc smelting capacity will be shut down. At the same time, it is intended that the metals industry will be consolidated so that 60 percent of lead and zinc output will be controlled by the top 10 producers.

Nickel – closures and re-openings

As the economic crisis unfolded, there was a surge of announcements regarding mine and smelter closures and cutbacks. In February, INSG provided information to members in an Insight briefing paper (number 4) on the supply side response to the financial crisis by the nickel industry. At the time of the February report, there were 19 announced closures and cutbacks at existing operations, 15 new projects which had been delayed or stretched out and six projects which had been cancelled or indefinitely delayed. With the recovery of nickel prices in the first half of 2009, several projects have been reactivated.

The Joint Study Groups' Seminar in October will include a discussion of the post-crisis outlook for non-ferrous metals. In addition, INSG will provide updated information on new nickel mine openings, closures and projects in the next edition of the Nickel Directory.

Impact of crisis on exploration, investment and junior companies

Investment in new mining projects trended downward through 2008 as metal prices declined. According to the Stockholm-based Raw Materials Group, in the first half of 2008 101 new projects were launched at a total cost of $50 billion, in the third quarter the figure dropped to 34 projects costing $17 billion and by the last quarter to 23 projects at a total cost of $14 billion. In relative terms the situation is still far from the most recent low point reached in 2002 of $11 billion and 65 projects recorded for the entire year.

Merger and Acquisition (M&A) activity also contracted as metals prices collapsed as can be expected since there is a strong correlation between M&A activity and metal prices. M&A activity peaked at about US $ 140 billion in 2006, declined to roughly $100 billion in 2007 and dropped further to $ 80 billion in 2008.

The uncertainties created by the crisis were reflected in the situation for junior mining companies. The smaller companies depend on access to capital markets to grow. The crisis reduced access to credit and capital markets. However, by the middle of 2009, the situation seemed to be improving. The Ernst & Young Mining eye index which tracks 20 mining companies on the London AIM, provides an indication of market sentiment for junior miners. The index had dropped 75 percent over the course of 2008. However, in the first quarter of 2009 the index rose by 29 percent and then by a further 4 percent in the second quarter. This still leaves the index 57 percent below its record high of March 2008. Ernst and Young noted that raising equity capital “remains a steep challenge” and share prices continue to be volatile. The junior miners on the AIM reportedly raised £147 million in secondary fundraising in the first quarter of 2009 compared to £295 million in the first quarter of 2008.

Conclusions

The trend in the world economic crisis appears to have passed an inflection point, and conditions are no longer deteriorating. The huge Chinese stimulus package has had the effect of boosting imports of nonferrous metals into China and thereby helped the recovery of metals prices globally. It is not clear if imports to China will continue at their current levels. The financial markets suffered declines as the economic crisis unfolded and investment in mining projects fell. However, by the middle of 2009 it appeared that the situation was improving and junior mining companies were able to access capital markets, although not at the same levels as in 2008.

The INSG secretariat will continue to monitor developments related to the economic crisis and their impact on the nickel industry, and will bring any issues of importance to the attention of member countries either through briefing notes or at upcoming Study Group meetings.

Comments or Questions

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