Mining Boom or Bust (An Investors Perspective)

Dymphna: Welcome everyone to iloverealestate.tv and great to have you guys on board. What I want to talk about today is all of this very very negative stuff going in the media at the moment. You know, "the mining boom is busted" and "China is going down the tube", and "Greece is going down the tube", and "Italy is going down the tube" and what else, I think America, well it's already down the tube and unlikely to be able to climb out of the tube for a long time. My goodness, it's all gloom and doom.

What I actually want to talk about first up is the fact that we need to understand the media angle. Now this is not a derogative comment by any stretch of the imagination. I mean from a purely idealistic perspective, the media is there to report the facts and inform people and they have this wonderful noble job to do, but the business side - and I am an accountant and I am economist and perhaps little cynical - but the business side of the media is about selling-advertising. Let's face it, the only way to sell advertising to get readers, or listeners, or viewers. whichever kind of media we happened to be talking about, and in order to do that, we need to be sensationalistic and really hone in the bad news. I guess this is because bad news sells and good news doesn't basically.

That being said, what I'd like to do is set some of the records straight on what's actually going on with respect to property, the property in Australia and in particular property in some of the mining-related areas.

Now in order to understand what's going on in the resource sector, what we first of all need to do is understand the ore bodies and how they interrelate around the world. Just before I get on to that, let me just make a few comments regarding things like Europe, as an example.

Alright, what's goes on in Europe from a GDP perspective or "Gross Domestic Product" perspective has actually very little impact on what goes on here in Australia from a housing perspective. I'm not making any comment about the stock market or how much it jumps around and has these little jitters and whatever else - I have no interest in that. What I'm talking about here is the property market and in order to have an effect on the property market, what we really talking about is the monetary system. We're talking about the balance of trade that Australia has with the international markets. Where our currency sits and therefore, where our interest rates sit, inflation, and all of those other factors, jobs mainly. This is because all of those bigger factors that I just talked about, what they affect is jobs. Jobs affect housing, housing affects investors, so that's kind of a chain of command, if you like, that I'm going to address.

Let's start with Europe. Regardless what might happen over there – Australia trades very little with Europe. On top of that, we also have a balance of trade that has not really been affected by what's going on in Europe one iota.

The main effect that is going to come out of Europe, and what happens over there, is the monetary policy and we need to understand what that actually does. I mean if Europe's over there propping itself up and doing all of its little dances inside the Euro itself, what that means basically for us, is that there's less money on the international monetary market. What that means is that there is less supplied - just as in any demand and supply curve - when there's less supply, the price goes up.

When we're talking about the price of money, we're talking about the wholesale price at which our Australian banks borrow and then re-lend to us here in Australia. So it causes a loosening or a contracting of our monetary policy here in Australia. All that being said, yes what goes on in Europe will mean that there will be less money on the open market for international borrowing which includes our banks. But what it also means is that all the Reserve Bank equivalents all around the world, what they then try and do is adjust their levels so that it has a less of an impact internally within their shores.

Now, Australia's wholesale rate runs at around perhaps three and a half percent at the moment, so the Reserve Bank of Australia has a lot of cushion to be able to lower that wholesale rate in order to cushion any effect by the higher price of funds on an international basis, so compare that to a country like Japan or America for that matter. Both of those countries have a wholesale rate of about half a percent. Now seriously, half a percent leaves those Reserve Banks (they are not called that in the other countries), nowhere to go. There is no cushioning effect as there is nothing that they can do to ease the effect of a tighter monetary policy. From an Australian perspective, yes it has a minor impact from a monetary availability markets but when it really comes down to it, the Reserve Bank of Australia has plenty of room to cushion the effect. Actually what we're doing because interest rates are so high, we actually have the other effect of more money coming in on an overnight basis and short-term lending and things like that to be able to be re-lent within Australia potentially. For this reason we're getting a lot of international money coming in from a capital safe haven perspective.

Okay, so now let's have a look at the United States. Whilst we do have a balance of trade with the United States, it's interesting to consider the last few years and how our balance of trade with the United States has actually been affected by the GFC. Now you would think that with the GFC going on in America, our exports to America would have significantly gone down.

No, they haven't – in fact they haven't changed on one iota. The levels of trade going through the United States are the same as what they've been prior to the GFC, so even though they have gone through one the worst recessions it's had in the last 70 years, it really hasn't affected Australia and our impact, our interaction with America. There again, how does that affect our Australian property market? Very little, very little.

Let's talk about Asia. Well the two fastest growing countries in the world are China and India. Neither of them are interdependent on each other which means that they both move in their own cycles and neither is influenced by the other to any large extent; however, both countries have a major influence on Australia because we are the resource bowl of Asia. I mean we are Asia, we are located in Asia, we deal with Asia and we are the closest quarry pit. We are the closest food bowl. We are closest trading partner of all the raw materials to go into Asia where they can use all of their cheap labor force and lower cost of living and all of those other things to produce secondary items.

So there's a little bit of talk in media about the fact that in places like China or India will be affected by Europe and the United States because they won't be buying as much from China or India. Well let's also look at the internal growth in both countries. The urbanisation that's going on in China and

India separate from each other is absolutely in massive. Do you know how many cars? What percentage of the Chinese population actually drive cars? At the moment, it's a little over 2% and the expectation is that over the next five years, they want to get it up to 5% and over the next, I think it was 7 to 8 years, they wanted to get it up to 10%. Now that's a lot of cars. That's a lot of electricity, where they're going to need our coal. That's a lot of ore or LNG, or a it's a lot of steel and iron ore from us to make those cars. Those are just cars.

Let me give you some statistics here. It was announced as late as last week that China has just launched 1trillion Yuan, which is their currency which equates to in Australia Dollars. About a $152.5billion package on the 55 infrastructure projects. That's a lot of money and it's a lot of development, a lot of steel, and a lot of electricity, and all of those things that are needed to make that happen. The infrastructure projects are actually announced ranged from everything from subways, to highways, to government buildings and all of that kind of stuff, so it's a lot of money that is going to be poured out there. On top of that, we've also seen that the inventory stock piles particularly in iron ore that the Chinese steel mills were actually running up over the last few months has pretty much depleted now which again is going to push up the price for coking coal, even though the commodity prices right now are in a bit of a low. What we're going to see is the dollars start to pick up as those inventories start to diminish and they are diminishing.

The Chinese is already also closing 625 of their coal mines in China due to safety concerns. Now that may only be a temporary measure but again, what it means is that we're going to see a much greater demand for our coal whether that's coking coal or brown coal. Now coking coal is the type of coal that's used to make steel and brown coal is the coal that is used to fire power stations.

It's interesting even when you start even looking at the economic reports. I'm not a big believer in some of the reports that have come out by the banks because they quite often get it wrong but it was interesting to read that ANZ released some figures in the last few weeks that they expect to see the coking coal prices back up to $175 a tonne because at the moment, it's down close to $100 by the end of this year and by the middle of next year, being 2013, they expect to see it over $200 a tonne. As I say, I read a lot of this economic data and even though they do get it wrong quite a bit, it was interesting to see that these particular statistics were backed up by some American coal mining statistics that came out and these statistics that have been commissioned by major coal industry groups in America to try and work out, how they should be spending their money and what projects should go ahead and things like that. This information has been used to make major decisions, so you think, if ever the money has gone into to preparing things. They're actually saying that they expect the coking coal prices to recover to $215 a tonne by the middle of 2013. Now all of that is very good for Australia. It's very good for the whole industry when we talk about coal but resources generally. I'll get on to the respective ore bodies in a minute but I just want to point out another thing to you that when we talked about America or the stimulus package that are going on over there.

See America can't change their reserve rates because they're already down to half a percent, so there's no movement there to go. They can't increase demand, internal demand and capacity by importing, bringing in more immigrants because they're already at capacity and they've got massive unemployment and our employment figures are very low in comparison, so the only opportunity to stimulate the economy over there is actually to print money and that's exactly what they're doing. They're going through the third phase of printing money at the moment and they're actually printing about $US40billion dollars a month. Can you believe that? That's a lot of money to be printing, isn't it?

That will mean a probably a decrease in the US dollar to some extent but traditionally whenever you look at the US dollar going down or any instability coming out of the US, what it means is that all prices go up because the money flows to what is deemed to be a safe haven and guess what, Australia is seen to be quarry pit of the world of the world basically. So again, an increase in pricing all ore bodies will mean much greater time ahead for all of the real estate that flows on from any of the mining industry.

We're not just talking the mining towns, we're talking the regional towns that are a flow on for everything from bread, milk, and taxi services etc., that surround the mining areas right through to the ports. Then, because a lot of these places particularly in WA are predominantly fly in-fly out, it brings more money back to wherever those people live. So it really is being spread around Australia actually quite well, some areas more than others obviously but we're starting to see that flow on affect really getting some legs right around Australia. There are some weak points but it's good times ahead, certainly nothing to be concerned about when you start reading the stuff in the newspaper. Remember, what I did say in the beginning about the fact that they need a sensationalistic headline, it's simply to get a reader or a viewer or a listener in order to be able to sell advertising and that's how they make money without selling advertising, they don't exist, so call me cynical as I said but that's the reality of it.

Let's talk about ore bodies. When it comes to ore bodies, you really need to understand how the ore bodies work and the projects that are already underway around all of these ore bodies. I guess the major media concern over whats happened in the last three to six months have been things like, in Queensland, the new state government has started to imposed coal taxes and mining taxes on the majors. We've got the Federal Mining Tax. We've got the Carbon Tax. How many more taxes do we actually need? I guess what you have to understand is that a lot of the reports and even the posturing, if you like, that's going on at a mining company level, there's some other things playing behind the scenes. One is industrial relations, the other is a bit of a political show of feathers against all of these taxes and other bits and pieces and none of that's going to change. It's been going on for a 100 years, so it's not going to change – you have read through the figures to really understand what's going on.

Let's talk coal for starters and really when we talk coal, the major states that are affected are Queensland first and then to a lesser extent, New South Wales. Even if we look at the figures that come out of the Queensland alone, there is about a 104 coal operations around Australia and there is 60 of those that are in Queensland, so when you take into account the announcements by BHP that they're closing three of them, when you put that into perspective - there are 60 in Queensland and they're closing three and the three that they're closing were all ones that were tipped for imminent closure anyway.

They were the ones that were less productive and less profitable and all research was getting to that non-profitable figure, so it's to be expected really. When we look from a job loss perspective, for Queensland, the announcements total job losses of about 1,300 people. In Queensland alone and these are only 2011 figures (I'm sorry I haven't got the more up-to-date figures) but in 2011 and this is a lot more now, there were 27,000 people employed in the Queensland Mining Industry. So if we take off 1,300, it's less than 5%. So the overall impact is not great yet the media blew it up to be that the whole industry was going to pot - gloom and doom forever.

You also have got to remember that there have been mines that have been opened up in the last three years as well and all of those mines that have opened up just in the last three years, they employ another 2,000 construction workers and some 1,200 operational workers, so the figures are really the favour of good times ahead not the other way around.

In fact, if you look at five years ago, the coal mining industry in Queensland alone employed 18,200 workers. Today or 2011 at least, we employed 27,600 to be precise. So yes it has increased, it has actually increased since those figures were released but that's a 52% increase in the last five years. That fact is that the world will still need coal whether it would for coking coal to make steel or whether it would be the brown coal to fire a power stations and when you look at the overall numbers and volume of contracts and requirements around the world, our volume is going to increase over the next 20 years, not decrease.

If you look at India for example, in the last year, they built 24 new coal-fired power stations and the expectation is that next year they've already got into planning, another 35 that are going to be built. Now that's 35 new plants, 24 this year, that's a lot of coal for a lot of years to come. China is operating 75 coal-fired power stations and within the US is some 600 coal-fired power stations, just to give you some dynamics.

We don't sell much to the US because they have got their own, so you look at the country, the size of China and the number of people there, compared to, America for instance, and they've got 600 over there and China with much less - 75 or whatever I said - that really shows you the capacity of China to expand as it urbanises and the push is definitely for coal-fired power stations at least, at least for the next 10 years probably 20, even though yes you do have the green movement that talks about alternate energies and I'm all for it. The volume is just not going to be there, the ability to be able to convert across to an alternative source. Quickly enough, it's just not going to be there in the next, I would say at least 10, probably 20 years.

The other energy source which is quite major and will be a major influence in the future is going to be LNG or liquefied natural gas and again, Queensland is the big winner there. New South Wales is in there as well and so too is WA. A lot of the LNG for WA is offshore which means that the royalties don't make it to the local area but it goes to the federal government. Still from an export perspective, it's a fabulous thing for the country. Let's just have a look at some of the projects that are underway and the expectations for those projects over the next few years when we start talking LNG.

I'm very excited about LNG and all of the runoff towns and all of the infrastructure towns and everything else that supports any of the LNG projects because what we're going to be seeing is it will be at least the third biggest exporter for Australia within very short space of time.

The other thing I absolutely love about LNG is that the contracts are actually locked in for 20 years, so we've got contracts with places like Japan and Korea and countries all through Asia or in China, India and all the rest as well but we have contracts with them that are locked in and they span over the next 20 years. It's Australia who now has to deliver and when you look at the volumes that Australia has to deliver just to fulfill those contracts, it's enormous. The capacity, the operations and the wells, and the people, and the employment, and all of those other things and the housing that all of these people have to go into is going to have a major impact on anything that is associated with any towns, that are associated with LNG.

When you look at volumes in places like the Surat Basin and the drilling that goes on there and the Surat isn't the only place where LNG is very prominent. A lot of New South Wales is going to have some major flow on effect and so too in and around the Karratha area or over there and most of that as well in WA. But just in the Surat Basin alone, there are $63billion worth of LNG projects current under construction throughout the Surat Basin. Now that's a lot of money to be poured into once small area and everything else that needs, from a job's perspective.

When we looked at an ore body, the size, volume and the impact of iron ore and what it has on the Australian economy is massive, not just for the Pilbara. The GDP (Gross Domestic Product) of the Pilbara Area alone is greater than 125 countries around the world including New Zealand, isn't that amazing? The Pilbara Area has a GDP greater than New Zealand. Now that surely speaks volumes for the size and the strength of iron ore and what it means to Australia. When you start looking at iron ore, WA walks all over everywhere else. There's minor deposits in other places but the Pilbara Area really is the big winner there. Whilst BHP again has come out and talked about the closure of the Port Hedland expansion, the deferring of the Port Hedland expansion, whilst that may have an impact from a media perspective , what we're really seeing is that the volumes to be put out Port Hedland alone are actually scheduled to increase.

When you look at BHP, Fortesque, Hancock, Atlas, they will have plans to not only reach the targets of this year, and through Port Hedland alone, they exported 247 metric tonne out of Port Hedland, so as a port area, that's a lot of work. Having been there quite a few times myself, you see the ships lined up waiting to come into the port to take the iron ore away. You've got trains, trains that are literally kilometres and kilometres long but the major companies I mentioned there before, they have plans to see what's not being export out of Port Hedland - 247 metric tonnes increased to 495 metric tonnes over the next five years. That's over a 100% increase, so regardless of whether they going to ship it out of existing port facilities or whether it's going to be an expansion, even if they only get half of that the volumes have to increase because they have the contracts and that's what we have to fulfill. Look at the requirements and demands coming out of particularly just the

Asian region. You're starting to see major flow on effects from a housing perspective. The Chinese steel production is expected to increase by 40% through to 2025 simply taking up that urbanisation of China internally. Nothing to do with exports to Europe or America or anywhere else, that's just internal urbanisation and it's the Pilbara that underpins that, so your major cities, your port towns, you're simply not going to see them pull back even the towns where most of the processing is unlike Newman and places like that. They're still going to remain strong for a very long time and whilst you may see some minor movements in employment and things like that, it's going to be redirected into other areas rather than being cut completely. It's just a movement amongst the industry itself and the Pilbara whilst its large area, it's all drive by the same economic forces.

What we are going to see that will have a direct impact on housing and housing prices in the Pilbara is more to do with the financing industry than anything else. It's not about jobs or exports or any of the things that you would think on that what the media is reporting on. What actually is going to affect prices generally, is house prices in the Pilbara, it's house prices in the Surat Basin, the Bowen Basin, the port towns, the runoff towns, everywhere that actually has the ability to be able to get funding for projects in those areas. The bank in particular - they've got a little bit of the jitters - they've got a reason to pull back and be a little more conservative which didn't take much of reason, so you are going to see a lot of the projects will actually be stalled for a while until confidence comes back and that alone will mean that supply won't be getting out onto the market and easily and freely.

You're going to see a tightening of supply, demand is going to go up, not down, so what's going to happen, is prices will go up - rents will go up. You're going to see a little bit of a lull but I can tell you now, those investors that hang on these areas are going to be the winners. Those who have short-term rental problems in some areas right now, if you can hang on, you're going to do much better.

The prices will stabilise in some areas but in other areas, they'll actually increase particularly in some of the stronger port towns and also in the runoff towns and some of the mine site towns as well. Those who haven't gone through massive increases yet, so it's good time ahead basically. Stop listening to fear mongering, look at the core figures and just have a look at the volumes and the contracts in place for the volumes that is going to be required over the next number of years. For the major ore bodies being iron ore, coal, and LNG; particularly LNG, you start to have to look at the tonnages to go out of the ports and the expectation for increase there.

There was recent study commissioned by the Queensland Resource Council which identified the potential for a three-fold increase this decade in coal output in Queensland alone and that's being multiplied right around the country. In New South Wales and in WA, I mean the losers are going to be the other states. They're going to be in Victoria because it's heavily manufacturing. It's going to be South Australia unfortunately because of the stigma around uranium and the Olympic Dam the fact that the Olympic Dam is going on expansion, it was not going as planned and that's a bad thing for South Australia because it would have made a massive difference down there. But that's a uranium as opposed to iron ore or coal and really is to be expected.

This commission that was put out by the Queensland Resource Council, it was resulting in increases in export shipments from 210 million tonnes last year, that's 2011 to just over 700 million tonnes by 2020. So from 210 million tonnes exported last calendar, it's expected to increase by 2020 to 700 million tonnes. That's huge and even though the future expansion of places like Abbots Point and even Dudgeon Point for that matter, that sheer volume of tonnes going out of there, they're going to need more resources, they're going to need more ports whether the government is going to pay for it or whether the actual companies themselves are going for it is a different story. I think that's really what's being played out behind the scenes.

I love figures and when you actually chart some of this stuff and even if commodity prices dropped by 50%, when you take into account the increase in volume to meet the supply, it will actually mean that our profitabilities will go up, not down by 50% drop in commodity prices. Now that says a lot for the future of the mining industry generally and even though we had a few projects canned with BHP, well there will mines that were going to close anyway.

The Port Hedland expansion is going to increase capacity, they're going to increase efficiency and productivity before the expansion goes ahead, that's basically what it means. There are 98 projects that have been committed to right around Australia and predominantly in Queensland, New South Wales, and WA but there are 98 projects that have already been approved, commissioned, and are definitely proceeding. The money has been set aside – worth $260.8billion - so the minor closures of non-profitable mines that was announced in the media, when you put it into perspective with those kind of projects. What that means for jobs, what it means for demand, house prices, rental yields - it's good times ahead. So stop panicking, stop being a worry wart and if you can hang on, or if you can get in now, there is some really good rises ahead as well as increases in yields.

It's important to understand what kinds of properties to buy because there is a lot of stuff out there where the money has already been made and you're going to sit back and probably not get great returns for a while, so it's important to get yourself educated, so you really know how to maximise your yields, undercut the marketers, and get in there and really make some major profits in the industry that are going to go on for decades to come.

So guys, that's it from me. Great to talk to you again and I hope that it really puts your mind at ease with respect to what's going on around the place and all those little stats in there. Listen to it a couple of times because you will really get some great information about the flow on effect into the housing industry of the resource sector and I hope to see you again very soon at one of the three-day intensives where I can really show you what to do, what to buy, exactly where to go, and how to come in $50-60,000 below everybody else and have a yield somewhere between 20 to 40% higher than anybody else. That's the name of the game. It's not just about buying anything, it's about buying the right thing in the right area.

So guys, that's it for me. Great to talk to you and I'll be back again to talk to you very soon on something completely different. Bye for now.