

Floods are watershed for Asian economies

Lloyd's List, Thursday 27 January 2011,

BACKWASH from the floods which ravaged Australia in late December and early January is now rippling through the global coal trade like a tsunami.

Ships were sitting off the largest coal port in the world, the combined Dalrymple Bay Coal Terminal and port of Hay Point, Australia. Ships-in-wait, double their normal queue, were said to be costing about \$1.4m per day as of January 10. Countries that rely heavily upon Australian coal exports such as China, Japan, and South Korea were scrambling to find new supplies. Millions of tonnes of coal production meant for export to Asia were halted.

The pain will be spread for both coking coal, used in steel production, and thermal coal for electricity generation. Inflation fears around the globe, considered to be emanating largely from China and India's growth, may get revised upward for sectors that depend on coal, like steelmaking and electricity. There will also be the resulting inflationary knock on effects from their input into other products and services. Australia's Gladstone port has lost about \$1bn in exports according to Michael Roche, chief executive of the Queensland Resources Council, because of rail line disruptions.

Australia has become a leader in producing high-quality coking coal. It produces more than 40% of the global seaborne trade, second only to Indonesia, and half of global exports overall. Long-term pricing for coking coal was pushed to \$225 per tonne for the first quarter 2011, with analysts predicting prices up to \$270 in the second quarter. One manager at Shanghai-based Shasteel expected prices to rise to \$337.50 per tonne after the floods.

India is taking note too. India's Steel Authority agreed to pay \$225 per tonne to suppliers, which is 74% more than it paid in the year ended March 31. Pretty soon that may be low-balling it.

Australia is also the second-largest exporter of thermal coal. This has pushed thermal coal spot prices to rise as well. Utilities from South Korea and Japan were reported to be scrambling, with one of China's top coal producers, China Shenhua Energy, selling thermal coal at \$142 per tonne on a free onboard basis.

China is said to have decent stockpiles of thermal coal available domestically. But China

was a net coal importer in 2009. Citigroup analysts expect China to import 200m tonnes, for a 60% increase over 2010.

Despite China's intentions to reduce coal usage by 4%-5% in its 12th five-year plan, forecasts reflect varied opinions. Analysts from HSBC forecast that China will double its generation capacity from the current 900 GW to 1,800 GW by 2020. The head of the National Energy Administration Zhang Guobang said China's generating capacity was already 950 GW at the end of 2010. A general manager of the State Grid Corp of China, Liu Zhenhua, expects growth in generation capacity of 52% over the next five years and 22% for the following five years. The International Energy Association forecast: "Over the next 15 years, China is projected to add generating capacity equivalent to the current total installed capacity of the US."

As the realities of Beijing's green agenda shapes up in 2011, nuclear and hydropower generation are proving to be the most likely low-carbon forms that will take larger market share from coal's reign. Recently there were reports of China's coal giants ramping up investment in their coals-to-chemicals (and coal-to-liquids) sector. These efforts are to replace other fossil fuels sources and chemicals. If China needs coal to replace liquid fuels like oil and its derivative products, even more coal may be needed. Inflation inside China has not lead to energy consumption reductions just yet.

The business that Australia loses to Africa, North America and Indonesia may be short term as higher transportation costs add to consumer prices. Helen Lau, a coal analyst at Hong Kong's UOB Kay Hian, expects a six-week period before prices and shipments return to more normal levels, at worst three months.

Recent natural disasters, including the floods in Australia, the tsunami in India, and the hurricanes in the Gulf of Mexico, all speak to the vulnerability of natural resources supply chains. We all have incentives to co-operate in sustaining our way of life today and tomorrow. There are real opportunities to develop progressive, forward-looking policies and strategies that support principles of good global citizenship and resource utilisation. Hardships always bring opportunities.

Before the floods arrived, Australia was one of the bright spots in developed world economies. The resource-rich states of Queensland and Western Australia didn't blink at the downturn that many others faced. Investment plans will be altered. Of the \$122bn the private sector planned to spend over the financial year to mid-2011, mining was to account for half of it.

Australia's misfortune may well encourage importing countries to diversify their markets. However, Australia has all of the developed world attributes that make it a good trading partner over the long haul — the rule of law, a modern economy that implies certain standards, and an overall stable political environment.

The floods and their impact do beg the question: can growth in Asia continue as forecast? On environmental and resource fronts, at some point continued growth places strains on these systems. We saw this with the Chinese rare earth metals flare up, and the reality of starting new supply chains. In order to diversify sourcing of rare earth metals (in particular neodymium used in batteries for hybrid cars) from China, Japan's Toyota just announced it would develop motors that did not use them, rather than pay escalating costs from a restrictive supplier. In December, China announced a 67% increase in export tariffs on the metal and has declared new limits on exports this year.

That is why I place my bets on continued innovation as we learn how to do more with less. Innovations in technology, as in the case of Japan shifting to induction motors for its electric cars, and in our processes will become more important. Those that can adapt and innovate in this sustainability space will survive, possibly thrive, and endure.