

WORKING TOWARD GOOD POLICY FROM NEW GOVERNMENT

BY MICHAEL ROCHE - CHIEF EXECUTIVE



The March quarter has been significant for the Queensland resource sector with the election of a new state government, speculation around federal and state tax increases, a visit from UNESCO, and increasing concerns about project viability as a result of rising input costs.

The 24 March election result was the most extraordinary in the nation's history.

With a likely 67 seat majority, Queenslanders have placed an unprecedented level of faith in a new Premier and a new LNP government.

With the rest of the business community, the Queensland resource sector is looking forward to Premier Newman and his LNP team promoting good policy to enable the sector to capitalise on the generational opportunities that await.

In particular, the QRC is working hard to capitalise on the relationship building of the past three years to ensure a close working partnership with the Premier and key ministers, including:

- Deputy Premier and Minister for State Development, Infrastructure and Planning, Jeff Seeney
- Treasurer and Minister for Trade, Tim Nicholls
- Minister for Natural Resources and Mines, Andrew Cripps
- Minister for Energy and Water Supply, Mark McArdle
- Minister for Education, Training and Employment, John-Paul Langbroek
- Minister for Environment and Heritage Protection, Andrew Powell.

As signalled in our CEO Sentiment Index (page 4), a significant challenge for the new government will be to help industry stem

the considerable increase in current and new project input costs.

Across the board, the sector is seeing unsustainable increases in the costs of labour, consumables and compliance stemming from shortages in certain equipment, an increasing array of inefficient and duplicating government regulation and a lack of skilled labour.

The Magic Pudding is Back

In our September 2011 edition I wrote of the magic pudding syndrome besetting governments in Australia – where they want to believe they can keep taking another slice of the resource sector 'pudding' without any harmful consequences.

Egged on by the Greens, speculation is rife that the federal government wants to remove the fuel tax credits for off-road diesel use and is also contemplating a range of other measures at the resource sector's expense to fund the push for a budget surplus.

Net of the very minor transitional assistance, the combination of the \$23 a tonne carbon tax from 1 July and the removal of the sector's remaining 32 cent fuel tax credit would see more than \$1 billion in additional tax placed on the Queensland resource sector per annum.

Nor is it helpful when our new state government muses that it might increase coal royalties if the MRRT dividend to the state falls short of the mark. Memo Queensland Government: the best way to grow royalty revenue is to grow the sector.

UNESCO visit

The recent UNESCO mission to Queensland attracted considerable domestic and global media. Just as newsworthy, but not reported, has been the sector's proactive response to concerns about an increase in activity in and around the Great Barrier Reef.

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- QRC CEO Sentiment Index



In a meeting with the UNESCO delegation in Mackay, the QRC reinforced the sector's sharing of community concerns about the need to preserve the globally iconic reef.

We were able to demonstrate that current state and federal regulatory processes governing resources, port and shipping activities are among the most robust in the world and Australia's record is such that there is no correlation between increases in shipping movements and environmental risks.

Resource industry initiatives such as the BHP Billiton, GVK Hancock, Adani and North Queensland Bulk Ports Corporation's cumulative environmental impact assessment of an expanded Abbot Point port facility was cited as an example of world-leading practice.

Feature article

Our feature article this quarter is an extract from a recent paper by Dr Ed Shann titled - Mining and related sectors are bigger than you think. (See next page).

KEY INDICATORS

QRC PRODUCTION INDEX

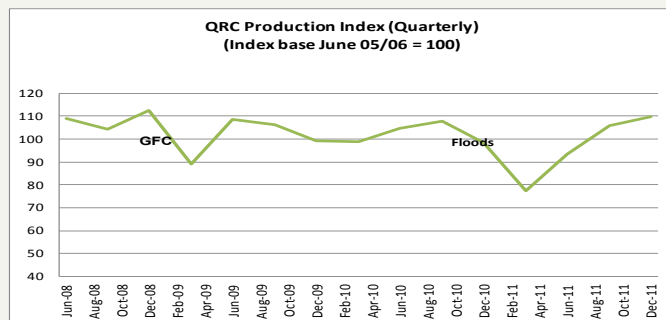
The QRC production index is a composite weighted index that tracks percentage increases and decreases in the total production of Queensland bauxite, alumina, aluminium, coal (all saleable), copper, gold, lead, silver, zinc, oil and gas quarter to quarter.

The index at the end of the December 2011 quarter (latest available data) reached 110 index points, 4 percent higher than the previous September quarter (June 2006=100). At 110 index points, the sector is just shy of the December 2008 peak of 112 points reached just before the Global Financial Crisis (GFC). Positively, 110 is also the second highest production score recorded since the QRC started the index in June 2006.

Encouraging increases in thermal and metallurgical coal production underpinned the increase in the production index with minor rises in bauxite, lead, silver and zinc also recorded. Gold and aluminium production was constant from the previous quarter while copper was down.

Shipments from Queensland coal terminals in the December 2011 quarter were 44 million tonnes, up 2.6 Mt or 6 percent on the September quarter figure.

While a positive result, the coal sector remains demand-constrained because of ongoing uncertainty over a weak European economy and volatile Chinese markets as well as supply constrained largely as a result of industrial action (BMA operations), major maintenance at a number of ports and recent wet weather events.



QRC VALUE OF PRODUCTION INDEX

Comprising the same basket of goods as the QRC production index, the QRC value of production index combines domestic production and average global benchmark prices to track percentage increases and decreases in the Queensland resource sector's total value of production.

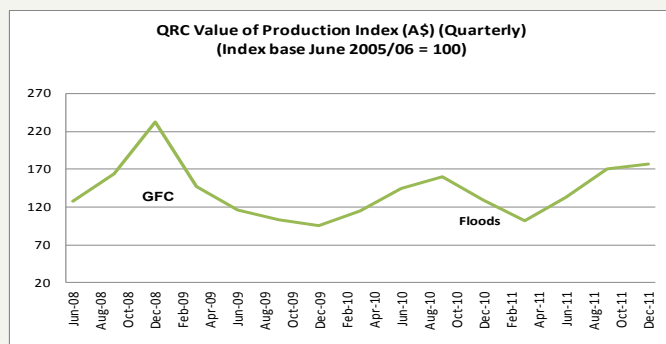
At the end of the December 2011 quarter (latest available data) the index reached 176 index points, 6 percent higher than the previous September quarter (June 2006=100).

In aggregate terms this is an increase of \$500 million in revenue from the September quarter (A\$12.4 billion to A\$12.9 billion). The coal sector currently represents A\$10.2 billion or 70 percent of total resource revenues.

The increase in revenues was due primarily to an increase in coal export tonnages. Metallurgical coal prices weakened slightly during the December quarter to average A\$262/t. QRC notes that Queensland metallurgical coal producers for the April-June quarter have been winning FOB headline prices in the low US\$200/t range.

The metalliferous sector (copper, gold, lead, silver and zinc) experienced a reduction in revenues with a continued softening in prices owing to the strength of the Australian dollar, weakening global demand and relatively flat levels of domestic production.

In what is a positive for Queensland's energy exporters, India is proposing to scrap its 5 percent customs import duty on thermal coal for a period of two years to help ease the financial burden on power generators.



STATE OF THE SECTOR

Finance Minister, Pranab Mukherjee foreshadowed the move in 2012-2013 budget proposals presented in March to the Parliament of India.

The abolition of import duty on thermal coal should provide some immediate relief to power generators struggling to make a profit due to the high cost of raw materials, especially imported coal.

Other fuels such as natural gas and LNG will also be exempt from import tariffs. The exemption, once passed by Parliament, will run for two years until 31 March 2014.

MINING AND RELATED SECTORS ARE BIGGER THAN YOU THINK

BY ED SHANN*

The Federal Treasury and the Reserve Bank of Australia (RBA) use different methodologies to produce radically different estimates of the size of mining and related sectors.

The Reserve Bank estimate is clearly too low, as it excludes mining output for the domestic market and mining service exports and investment.

Treasury estimates that the mining sector, including metals manufacturing, will account for 12.3 percent of total Australian real output in 2011-12 and is similar in size to the decade to 2002-03. While iron ore and coal output rose strongly in the last decade, oil output declined.

The strongest growth has been in mining-related production, which covers manufacturing, construction and service firms that contribute to mining output and investment.

Referred to here as mining services, this sector has doubled from 4 percent of output in the decade to 2002-03 to an expected 8.4 percent in 2011-12. Mining services output is growing rapidly at 15-20 percent a year and Treasury estimates that on the back of the mining investment boom it will expand from 6.7 percent of the economy in 2010-11 to 9.4 percent in 2012-13. Yet some commentators continue to think of the mining sector as relatively small.

On Budget forecasts, Treasury concludes that over the three years to 2012-13 the mining sector will grow annually at 5 percent and mining-related sectors at over 20 percent on the back of the investment boom. By contrast, the non-mining sectors comprise 75 percent of the economy, but are growing annually at only 1 percent.

Mining companies demand high-quality competitive inputs. This has created many leading-edge mining service firms that invest in research and development, enabling them to export and compete offshore.

The rapid growth in mining services reflects the surge in

mining investment, increased contracting out to specialist providers by mining firms and the growth of sizeable Australian mining service firms that are diversifying internationally by both exporting and producing offshore.

Mining service industry growth has been customer driven and public policy has not played an important role. The success of mining services reflects the demand of mining itself for competitive inputs if it is to compete in world markets.

While the construction side of mining services will decline when mining investment peaks, mining output will rise and boost mining service firms involved in contract mining and maintenance.

There are 122 firms listed on the Australian Securities Exchange (ASX) with substantial mining service revenue of \$86 billion in 2010-11 and with expected revenue growth of 17 percent in 2011-12 based on sharebroker forecasts.

These firms are growing rapidly and 20 of the top 150 ASX firms by market capitalisation have substantial mining service revenue. On one estimate, they generate export revenue of around \$9 billion.

Because these firms are not identified as a sector by the Australian Bureau of Statistics or the ASX, their importance and rapid growth is often overlooked. They represent a cluster of internationally competitive Australian firms in construction, engineering, drilling, manufacturing, logistics and services that produce often high technology products and high value-added services.

In conventional treatment the expanding mining sector is associated with a contraction in existing tradeable industries like manufacturing and agriculture, while the non-tradeable services sector also expands.

Yet the rapid growth in mining services currently under way generates increased demand in several manufacturing sub-sectors.

Explosives is recorded in chemicals; rail wagons in transport equipment; high technology mining equipment for drilling and excavation in machinery and equipment manufacturing; fabrication in metal manufacturing; and off-site homes in prefabricated building manufacturing. Just the listed firms in these industries have revenue of \$15.5 billion, though not all is produced in Australia.

So some manufacturers benefit from the mining boom, even if others are squeezed by the higher Australian dollar.

Substantial parts of construction, transport and power are also mining-related and some firms do better than the sector average by tapping into the mining boom.

Irrespective of the ownership of mining companies, nearly two thirds of mining revenue is spent on labour, goods and

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service inputs, tax and royalties, while mining profits are being used at present to finance additional investment.

** Dr Ed Shann worked in the Departments of Treasury and Prime Minister and Cabinet in the 1970s and 1980s and was a Director of Access Economics in the 1990s. His PhD from Cambridge was on 'The effects of a mining boom'. This extract is from an MCA policy monograph entitled: Maximising growth in a mining boom available in full at <www.minerals.org.au>.*

QRC CEO SENTIMENT INDEX

The QRC CEO Sentiment Index is a survey of the QRC's full member company chief executives.

These companies cover the majority of mining, minerals processing, contracting, exploration, electricity generation and oil and gas extraction activity in Queensland.

Issues that will 'strongly' adversely impact operations over the next 12 months (score 60-79) in order:

1 High input costs (75) = combination of a high Australian dollar, increasingly scarce inputs such as labour and consumables, and increased regulatory compliance costs is leading to substantial increases in delays and operating and construction costs.

2 Global macroeconomy (74) = The European slowdown and Chinese volatility is affecting resources demand and capital availability.

3 Uncertain and/or poor regulation (includes taxes and royalties) (69) = concern over state and federal regulations that impose unnecessary costs and restrictions on projects and developments. The mooted removal of the sector's access to fuel tax credits is also of significant concern.

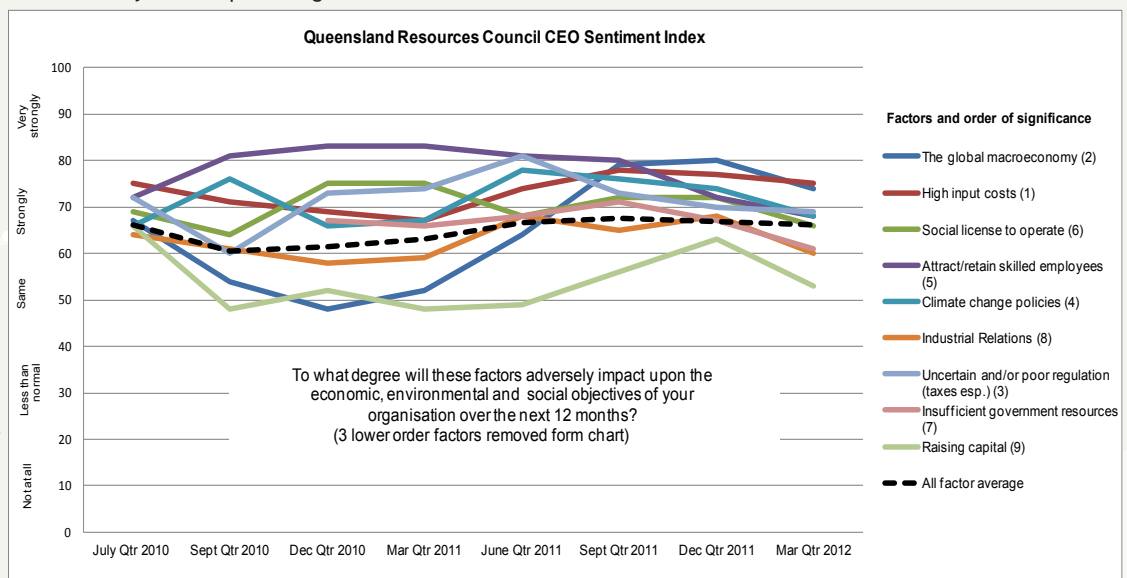
4 Climate change policies (68) = concerns that the Clean Energy Act will place Australia far ahead of competitors on global cost curves, and without adequate transitional assistance, the risk of driving investment offshore. Concern also about impact on industry from higher electricity costs and the stymieing of new baseload generation capacity.

5 Attraction and retention of skilled employees (68) = intense competition for skilled labour in certain occupational categories with salaries being pushed to unsustainable levels. CEOs indicate that engineers and skilled professionals in particular are in very short supply and may undermine the state's capacity to deliver projects.

6 Social licence to operate pressures (66) = concern that governments are responding to issues that are not factually based.

7 Insufficient government resources (61) = concern that approvals processes are hamstrung by a lack of qualified government staff.

8 Industrial relations (60) = concern over potential for sustained, significant increases in industrial disputation based on the flexibilities afforded to bargaining agents under the Fair Work Act.



QRC PROFILE

The Queensland Resources Council is the peak representative body for more than 200 companies with interests in the state's minerals and energy sector. The QRC's 91 full-member companies comprise explorers, miners, contractors, mineral processors, oil and gas producers and electricity generators. QRC service companies cover the gamut of professional services provided to the resources sector in the four corners of Queensland.

Written and prepared by the QRC. The data for this publication is sourced from a number of public sources—notably the Australian Bureau of Agricultural and Resource Economics and the Australian Bureau of Statistics. For more information, contact the QRC on (07) 3295 9560 or www.qrc.org.au