Feature Articles

No major new mines coming on stream and growing demand from emerging markets mean a shortfall is on the way.

Slowdown seen by analysts as only delaying inevitable rough shortfall

The global financial slowdown may make the idea of a shortage of rough diamonds seem laughable, but analysts agree it has only been delayed.

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It's not an issue that creates an immediate problem, due to the fall in demand in the past year for diamond jewellery, but nonetheless it has been playing heavily on the minds of many in the diamond industry. It also may seem an odd question to bring up at a time when the Western world is looking, at best, at a slow recovery from the financial turmoil of the past 15 months. But is the diamond trade heading for a shortfall in rough diamond supply?

The basis for the calculation is that few new significant mines have come on stream in recent years, meaning that when the economic slowdown comes to an end and sales return to their multi-year levels, supply will be approximately in line with demand levels. But add to the mix the growing demand from emerging markets such as China, India and the Gulf, and it becomes clear that demand quite possibly is not going to be sufficient to keep up with demand. That inevitably means that prices are set to rise substantially, but will it also present an opportunity for manufacturers of synthetic diamonds to enter the market on a big scale?

As far as supply is concerned, the last major mine was discovered 15 years ago, and among those that are scheduled to come on line, preparations are taking longer than planned. Even if a diamond deposit was found today, it would not come on line until 2015 at the earliest, said RBC Capital Markets analyst Des Kilalea. Diamond mining is a hugely expensive business, he said, and finding deposits and proving their commercial viability can take several years, as well as tens or even hundreds of millions of dollars.

The world's diamond mining is concentrated in a few areas which are not very hospitable. These include Canada's frigid North West Territories, and Russia's equally frigid Far East. Meanwhile, deposits are to be found in a range of African countries, some – Zimbabwe for instance – in which the level of good governance and transparency is questionable, at best.

The business of bringing a diamond mine on stream is a slow process. Botswana's Orapa mine is on the surface and yet took four years to develop, Kilalea said. Meanwhile, the Jwaneng mine, also in Botswana and of the size needed to overcome the future supply shortfall, took 10 years to move from discovery to production, while the Venetia operation in South Africa took 12 years. In Canada, the Ekati mine took 10 years to find and seven to prove and build, while Diavik took even longer. Even the ice road to the mines – which is only open for just seven weeks a year – cost $20 million to build. In Angola, BHP Billiton spent $50 million along with Petra for no result, while the Democratic Republic of Congo has absorbed millions of exploration budget dollars, Kilalea explained.

The four largest producers – De Beers, Alrosa, Rio Tinto and BHP Billiton – account for 90 percent of total output, while smaller players include Harry Winston Diamond Corp, Petra Diamonds, and Gem Diamonds. "A host of mid-tier and juniors kick in the rest; they are small and often not well financed," Kilalea said. Of the more than 100 firms involved in diamond mining, fewer than 20 have "meaningful production," he added.

The source of the problem, it appears to be, is that despite investments of hundreds of millions of dollars in global exploration, the diamond industry has thus far failed to discover sufficient commercial diamond deposits to replace existing finite mines. Consequently, production is projected to remain essentially flat for at least the next decade. Even the new mines coming on stream will not make up for the shortfall as older mines become depleted, Kilalea said. The Argyle mine in Australia that used to produce 30 million carats is now down to half that amount.

James Allan, principal of Johannesburg-based corporate finance and advisory firm, James Allan and Associates, said the development of a huge new mining capacity is essential. He says that new diamond mines equivalent to the annual output of leading diamond producer Botswana are needed to balance the gap expected by in diamond supply and demand. Botswana produces well over 30 million carats of diamonds annually and is the world’s leading supplier in volume terms.

Is there evidence that more diamonds will be needed in the coming years? IN 2006 India's Gems and Jewellery Export Promotion Council commissioned a report from the KPMG management consulting group that showed a shortfall of diamonds was likely in the coming decade. The main conclusions of “The Global Gems and Jewellery: Vision 2015: Transforming for Growth,” were that global jewellery sales could grow at 4.6 percent year-on-year to reach $185 billion in 2010 and $230 billion in 2015. That compares with the current level of annual global sales of around $150 billion. Even more startlingly, the report said, with collective action sales could grow to $280 billion by 2015, with India and China together emerging as the equivalent to the U.S. market which accounts for around 31 percent of global sales.

De Beers Managing Director Gareth Penny also believes that demand will outstrip production of rough stones due to the lack of major new diamond discoveries in recent years and rising demand in emerging economies. “There are no major new mines as of now," Penny said at a De Beers Town Hall meeting in 2009. "So if you look at the supply and demand relationship over the next few years, demand should outrun supply.” He said rising demand from large markets in China and India, and increasing diamond jewellery purchases in Russia, the Gulf and South America were behind the forecast rise in demand.

Diamond industry analyst Ken Gassman is not so convinced, however, that rising natural diamond prices will inevitably lead to constantly rising prices. “Assuming that diamond prices are determined by supply and demand, prices will rise until the market can no longer tolerate further price increases,” Gassman said. “At that point, consumers will look for diamond substitutes, including synthetic diamonds, moissanite, and other look-alike gemstones.”

Allan, however, does not believe the natural diamond industry has reason to be concerned that the shortage of rough will present manufacturers of synthetics with an opportunity to enter the market in a large-scale way. Although there is a place for synthetic stones in the jewellery industry, the limiting factor is the industry’s capacity to produce, and it simply is not producing enough diamonds, he explained.

For the moment, the diamond industry appears to be confident that non-natural stones are not going to play an increasing role in the business. As one senior member of the Antwerp diamond trade said, "It is clear that supply will not keep up with demand once we are over the effect of the financial crisis and the economic recovery gathers pace. The result of that will, of course, be rising prices for diamond jewellery sold at retail. However, can one really see a man proposing with a non-natural diamond? Would a woman really accept that their love be symbolised by something grown in a laboratory? I cannot believe that would be the case."

The forecast supply shortfall argument was made before the financial crisis that struck in the fourth quarter of 2008. Although rough prices have risen sharply since mid-2009, polished prices have not moved anywhere near as much and demand remains fairly subdued, particularly in the world's most important jewellery market, the United States. Does that invalidate the supply shortage claim or has it just been pushed back a while?

For his part Gassman believes the economic downturn has simply delayed the inevitable diamond shortfall by a couple of years. He thinks the effect of the financial downturn on the jewellery market has been overstated and that there are already signs that consumers in the United States are returning to jewellery buying.

"Firstly, you cannot turn around the love affair of the human race over the past 50,000 years with jewellery making and buying," Gassman said. "Secondly, I do not believe that Americans are going to almost overnight simply become disconnected from their cultural affinity for spending. I think I was a lone voice predicting that Christmas jewellery sales would show a rise. I am absolutely convinced that there was a rise of at least 2.8 percent although we won't know the exact figures for 60 days or so.

"The economic dislocation of 2008-09 is already recovering, and we will see consumers returning to their pre-recession spending habits. The downturn will not derail the human affinity for precious stones and metals. It must be remembered that the U.S. market is culturally born to spend. I believe the shortfall has been delayed by around two years, meaning it is five to seven years away, but it will come."