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The international diamond business: the role of southern African producers in change and consolidation

Bristow, J.W.[1]

[1]Global Diamond Network, P O Box 11946, Hatfield, RSA 0028; jwbdia@mweb.co.za

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Until recently the international diamond market was one of the few commodity sectors relatively unaffected by the rout in mineral commodity prices. However downward pressures on polished prices, and a disconnect between high rough prices and soft polished prices came to the fore in 2015.

Since the early 2000's the view was that rough diamonds were becoming progressively scarcer due to the absence of major new discoveries, old mines going underground (eg. Argyle, Canadian, Russian and South African mines) with concomitant production declines, and that demand polished was growing in response to China's booming economy, with help from India. Rough, and polished prices, were expected to show strong price appreciation as demand outstripped supply.

Contrary to the above scenario, the international diamond business encountered headwinds with sharp falls in rough prices in 2015, and slowing demand for polished. Long term analysis of diamond prices shows that in real terms rough prices have yielded a small long term gain of about 10%, whereas real polished prices are down about 30% over a 66 year historical period [1].

Rough prices have shown stronger gains than polished prices since the introduction of the Supplier of Choice (SOC) in 2003, and 2008 global financial crisis, due to easy credit rather than declining supply. Diamantaires in the pipeline midstream pursuing rough and building inventories to sustain cutting and polishing factories ran up considerable debt, about $16 bn in 2013, $14 bn in 2015.

With credit now reduced due to the key Antwerp Diamond Bank exiting the industry and other banks reducing liquidity to the diamond sector, primarily Indian midstream Diamantaires overloaded with debt can no longer sustain high rough prices. In addition China's stock market volatility and losses in 2015 and 2016, Yuan devaluation in 2015, $1 trillion of Chinese capital flight to early 2016, a debt bubble of $28 trillion, and the international oil rout, demand for polished diamonds and diamond jewellery from this key market driver softened during 2015.

Bankruptcies, cutting factory closures, and job losses have occurred in all main centres of the midstream diamond business including India, Botswana, South Africa, and Belgium during 2015 and this situation is likely to prevail into 2016.

Other factors impacting the diamond business are increasing polished diamond recycling, emergence of high quality polished synthetic grown gemstone diamonds, changing consumer trends in the tech-savy Millennials, and related Brand competition.

In terms of rough prices a similar situation will persist in 2016 with softening in rough prices mirroring 2015 price declines. Market headwinds will persist into 2017. Producers with strong balance sheets, no debt, established production profiles and cost management will gain in the ongoing market conditions. Likewise cutting and polishing businesses will need to significantly reduce debt and revise business strategies. Overall restructuring and consolidation will lead to a stronger, more flexible, and differentiated business. Coloured diamonds and exceptional gemstones will continue to attract top dollar prices. The role of southern African countries, particularly Botswana (alongside Russia and Canada), will be discussed in the re-balancing and long term health of the international business.

References:

[1] Kilalea D and Hatch R (2016) Diamond Digest RBC Capital Markets:12 pp