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AMMA RESOURCE INDUSTRY Market Outlook

Summer 2015/16 edition

Contents

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Introduction

Welcome to the Summer 2015/6 edition of the AMMA Resource Industry Market Outlook

2015 has been another challenging year for the resource industry. While for some this period has seen some light starting to emerge at the end of the tunnel, for most it has been a year of adversity and recalibration that we all will remember and learn from.

This quarterly report from Australia's national resource industry employer group, AMMA, provides members with a regular dedicated update on investment, economic and financial matters impacting the Australian resource industry.

It is fitting that this final edition for 2015 provides a year in review and forecasts as to what lies ahead in 2016 and beyond.

Since the previous edition in September, new and updated data has been released on:

- Commodity prices;
- Exploration expenditure;
- Capital expenditure;
- The valuation of major resource projects in Australia's investment pipeline;
- Business and investor confidence; and
- International policies announced that will impact Australia's resource industry.

Figure 1: 2016 - Forecast commodity prices by commodity in USD

Source 1: Averaged prices from World Bank pink sheets, Office of the Chief Economist, Economist Intelligence Unit, AMMA Analysis; Source 2: UBS, LME, Reuters, Barchart

2016 - Forecast commodity prices by commodity in USD

2 December 2015 commodity prices in USD

Commodity	2016 - Forecast	2 December 2015
Copper ($/mt)	$5,588	$4,642
Iron ore 62% Fe, CFR China	$55.58	$42.24
Zinc ($/mt)	$2,201	$1,556
Crude oil avg, spot ($/bbl)	$54.11	$41.50
Aluminium ($/mt)	$1,761	$1,441
Gold ($/toz)	$1,161	$1,067
Natural gas Japan ($/mmbtu)	$11.40	$7.30
Thermal coal ($/t), 6,700 kcal/kg, FOB	$62.00	$52.75 ($/t 6,300) kcal/kg, FOB
Metallurgical coal ($/t), HCC, FOB	$96.50	$72.00

The AMMA Resource Industry Market Outlook outlines key developments and their likely impacts on the industry. It also provides valuable data and insights to assist organisational strategies to plan for cyclical and structural swings in the market.

Given the breadth of AMMA's membership across Australia's resource industry, this diverse publication covers developments relating to mining, hydrocarbons, transport, infrastructure, engineering and associated service and support sectors.

As has been the case throughout 2015, this edition comes as the resource industry continues to digest the unexpected severity of the recent investment and commodity price down-swing, coupled with persistent and growing market volatility and uncertainty.

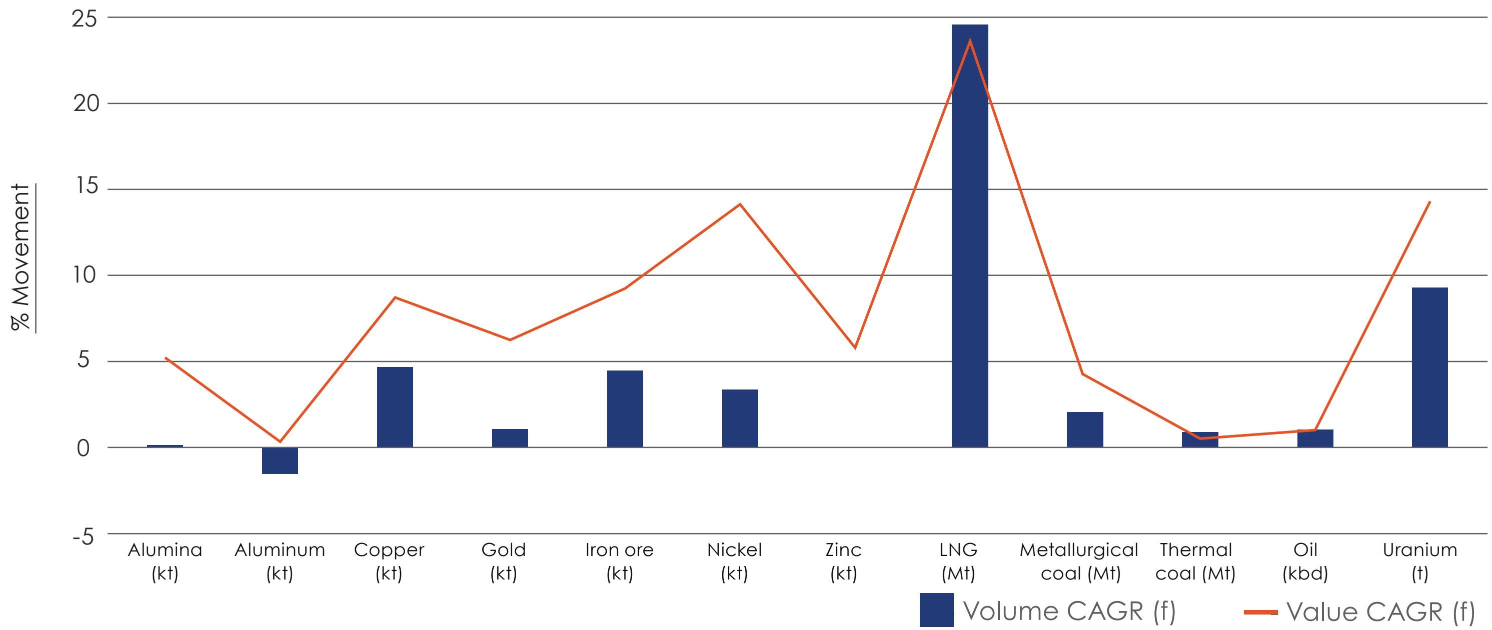
Summary

Expect a turbulent year ahead, but there are signs of recovery

Throughout 2015 there has been continued commentary about the "mining boom" being over. While this may make media headlines, such commentary is exaggerated and can be misleading. According to the Office of the Chief Economist, for all commodities with the exception of alumina and zinc, it is forecast that over the next five years compound annual growth volume rates will increase, and that the value derived from each export commodity will also increase even if commodity prices remain suppressed. If the mining boom were genuinely over, there would be no growth and no potential. So while the recent commodity price boom may have run its course, the mining boom has not.

Figure 2: Australia's 2014-15 to 2019-20 compund annual growth rates per commodity (CAGR)

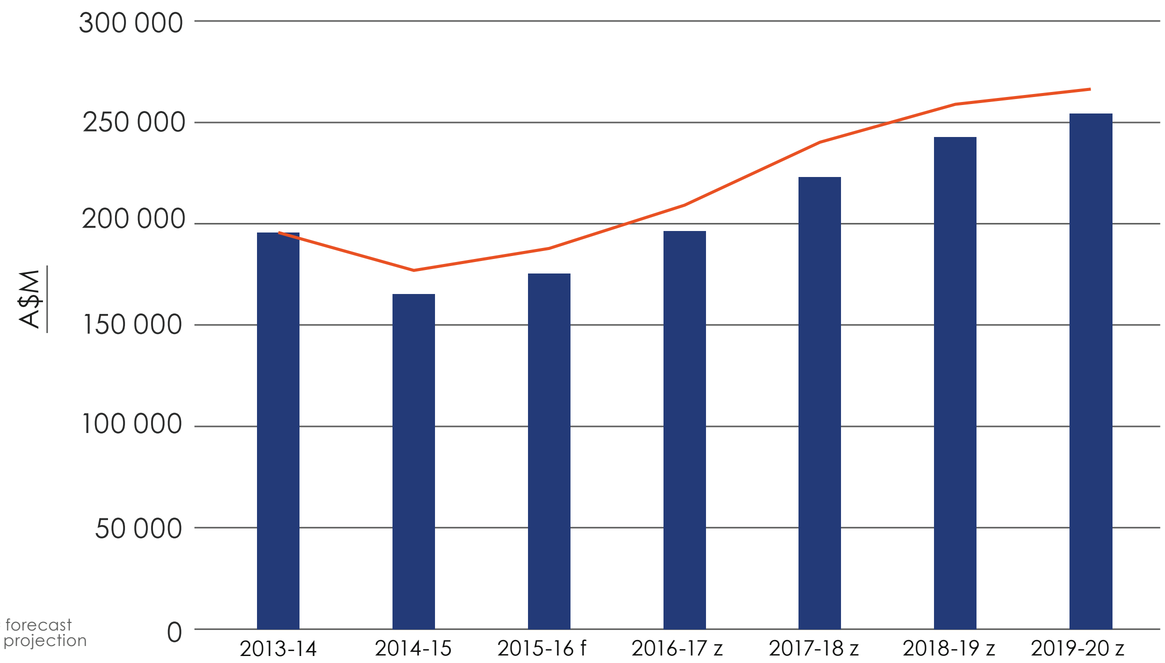
Source: http://www.industry.gov.au/Office-of-the-Chief-Economist/Publications/Pages/Resources-and-energy-quarterly.aspx#



Resource earnings downgraded

Figure 3: Biannual change of Australia's resource and energy projected export earnings

Source: http://www.industry.gov.au/Office-of-the-Chief-Economist/Publications/Pages/Resources-and-energy-quarterly.aspx#



f = forecast
z= projection

	2013-14	2014-15	2015-16 f	2016-17 z	2017-18 z	2018-19 z	2019-20 z
Resource and energy (Sept 2015)	195 001	171 953	176 421	196 988	226 150	244 816	256 031
Resource and energy (Mar 2015)	195 002	178 927	189 953	212 996	242 506	257 238	267 380

Even though there are mounting signs of medium term recovery for the industry, the current economic and resource climate remains volatile.

Since AMMA's previous Market Outlook, revised projections have been released on resource and energy export earnings. This data shows that in the past 6 months (April to September 2015), the value of Australia's forecast 2015-16 resource and energy export earnings were downgraded by $13.5bn (from $189.9bn to $176.4bn). For 2015-16 to 2019-20, the cumulative amount revenue downgrade rose to $69.6bn.

The most significant revisions for 2015-16 to 2019-20 are as follows:

Figure 4: Volume increase and decrease %

Source: http://www.industry.gov.au/Office-of-the-Chief-Economist/Publications/Pages/Resources-and-energy-quarterly.aspx#

Volume (see figure 5)	Volume (see figure 6)
3.61% increase in uranium volume growth	6.28% increase in nickel value growth
2.52% increase in LNG volume growth	5.75% increase in iron ore value growth
2.69% decrease in zinc volume growth	4.87% decrease in zinc value growth
1.80% decrease in iron ore volume growth	1.01% decrease in thermal coal value growth

Figure 5: Biannual change of Australia's projected 2019-20 compound annual **volume** growth rates per commodity

Source: http://www.industry.gov.au/Office-of-the-Chief-Economist/Publications/Pages/Resources-and-energy-quarterly.aspx#

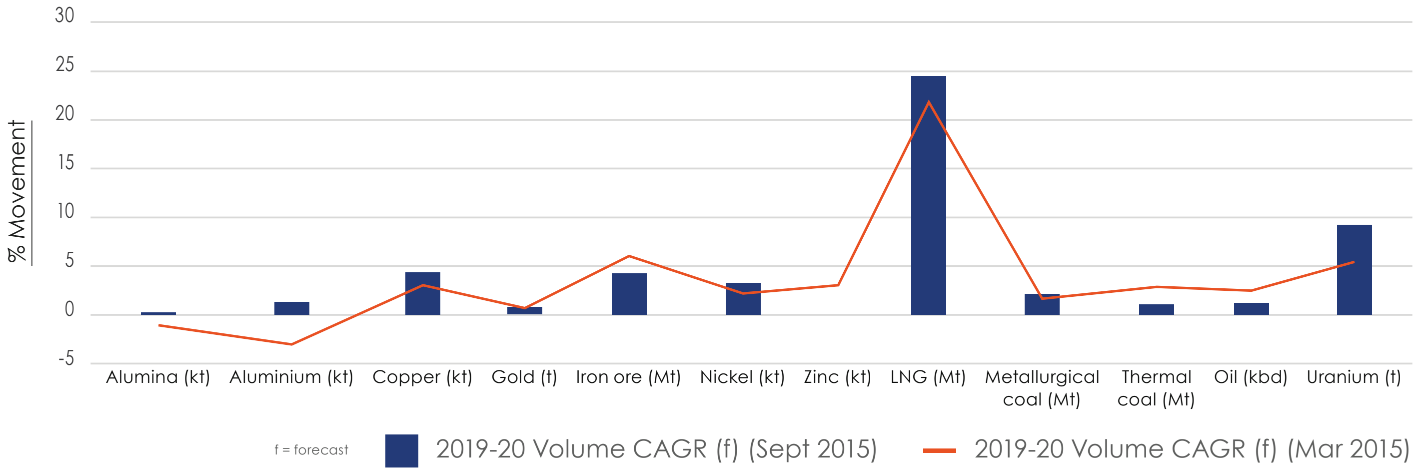
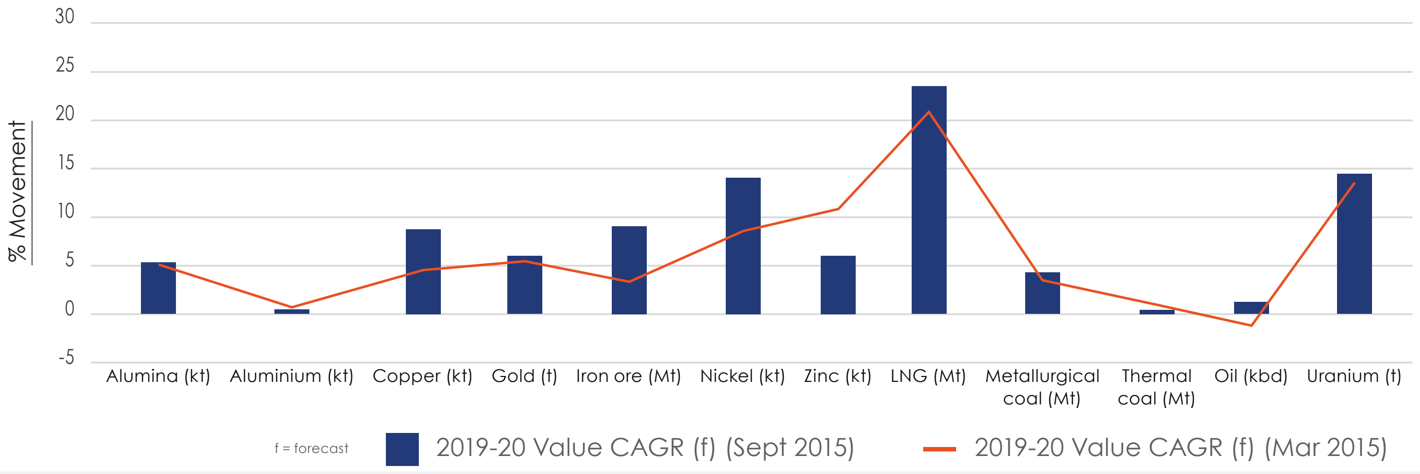


Figure 6: Biannual change of Australia's projected 2019-20 compound annual **value** growth rates per commodity

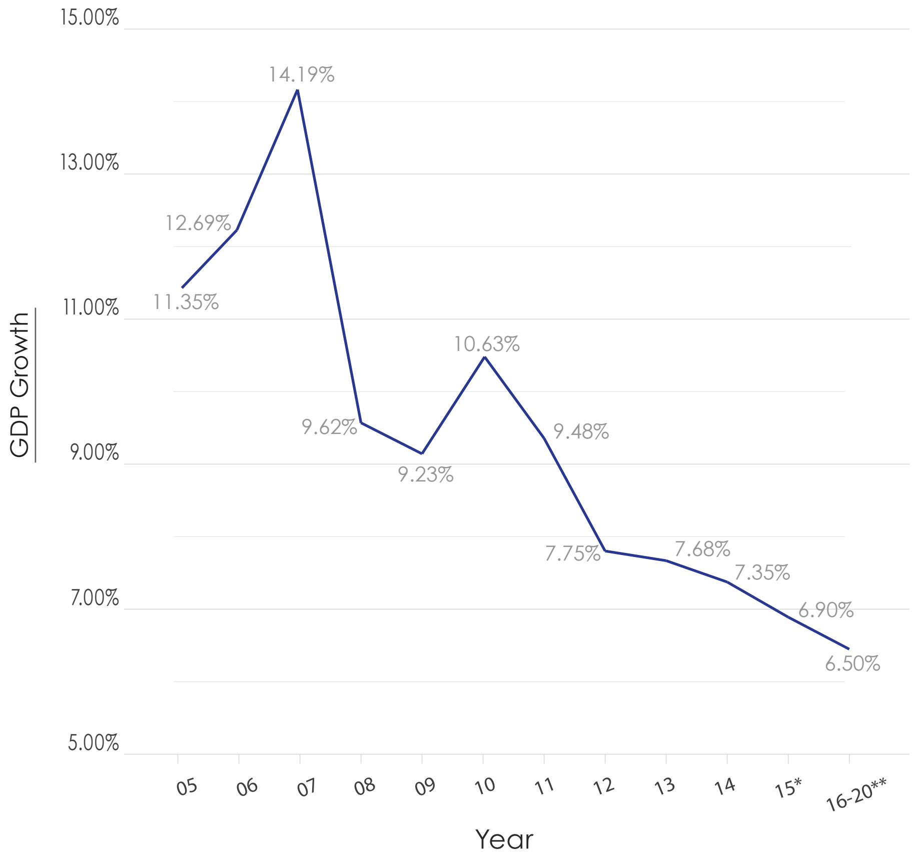
Source: http://www.industry.gov.au/Office-of-the-Chief-Economist/Publications/Pages/Resources-and-energy-quarterly.aspx#



China will remain Australia's most important export destination

Figure 7: Annual China GDP growth (y-o-y %)

Source: World Development inidcators, China Daily, The State Council of The People's Republic of China



* Estimated ** Annual average growth rate

Throughout 2015, much has been speculated about the future for the world's second largest economy, China; an economy that has achieved consecutive annual year-on-year growth since 1977 and is Australia's most important trading partner.

Despite China transitioning from an export-led growth model to one increasingly driven by consumption and services, its key economic and socio-economic parameters remain strong and its need for commodities will continue:

- It is forecast that China's 2015 economic growth will be around 7%, which is more than double the International Monetary Fund's 2015 global growth projection of 3.3%.
- China's President Xi Jinping told the Fifth Plenary Session of the 18th Central Committee of the Communist Party, that 6.5% economic growth would be the minimum level of economic growth required as part of China's 13th Five-Year Plan (for the period 2016-2020).
- The main economic target of China's new Five-Year Plan is to join the ranks of developed economies and become a high income society by 2020, with the aim of increasing average per capita incomes to USD$12,000 a year by 2020. This will require a doubling of China's 2010 per capita GDP by 2020.
- It is forecast that China will increase its urbanisation ratio to 45% by 2020.
- China is to end the one-child-policy, which is likely to cause a spike in birth rates.

While there is consensus that China has fallen and will continue to contract from double digit economic growth, some forecasts are highly embellished, for instance that China's GDP growth in 2016 will fall into the 3% to 4% range. Unquestionably, Australia's resource success will continue to be driven by China. It is, and will continue to be, the primary export destination for Australian resource commodities in 2016 and beyond; and opportunities for Australian resource exporters to tap into this growth market will only be increased when the Chinese Free Trade Agreement comes into effect from late 2015.

Defining factors for 2016

A defining feature of resource commodities is that each has its own independent trajectory based on particular factors (e.g. consumption rates) and interdependencies (e.g. export reliant countries relying on maintaining secured supply from an importer). External events that may impact Australian resource exports during 2016 are likely to include:

- Multiple increases in US interest rates;
- Changes in bond rates;
- Ongoing moves towards investment in renewable energy;
- Increases in automation;
- Heightened geopolitical risks;
- Increased capital mobility (including changes in foreign direct investment policies);
- Increased global supply from recently completed new mines and mine expansions;
- Transitioning economies (including industrialisation and transitions to service based economies); and
- Globally, more resource projects stalling prior to construction as project proponents wait for conditions to improve.

Such developments will impact each commodity in a different way and to a varying degree, creating increased volatility in:

- Commodity prices;
- Sales volumes;
- Transportation shipping routes and demand;
- Procurement spending and inventory levels;
- Productively managing staffing in line with operational demands; and
- Commodity specific exploration and construction levels.

Commodity prices

Nearly every commodity in the Australian resource industry has been hit by falling prices in 2015. The RBA Index of Commodity Prices shows commodity prices have retreated to 2005/06 levels.

All of Australia's key export reliant commodities have been impacted. This has damaged resource company profitability, state and federal budgets, direct and indirect employment, exploration spend as well as contributing to a reduction in Australia's investment pipeline of future major resources and energy projects.

World Bank commodity markets data shows resource prices falling significantly between 2014 and 2015:

Crude oil, avg, spot ($/bbl)	↓45.43%
Iron ore ($/dmt)	↓40.21%
Natural gas, Japan ($/mmbtu)	↓35.79%
Coal, Australia ($/mt)	↓17.26%
Copper ($/mt)	↓18.04%
Aluminium ($/mt)	↓8.94%
Zinc ($/mt)	↓8.38%
Gold ($/toz)	↓7.19%

There is a broad consensus that prices will remain suppressed in 2016. For example, it is forecast that the price of iron ore (62% Iron Ore Fines CFR) in Q1 and Q2 will trade in the high $30's to mid $40's, and both the World Bank and Australia's Office of the Chief Economist, forecast that iron ore, natural gas, crude oil, gold and copper will not return to their 2014 price levels.

Figure 8: RBA Index of Commodity Prices (SDR, 2013/14 avg = 100)

Source: RBA

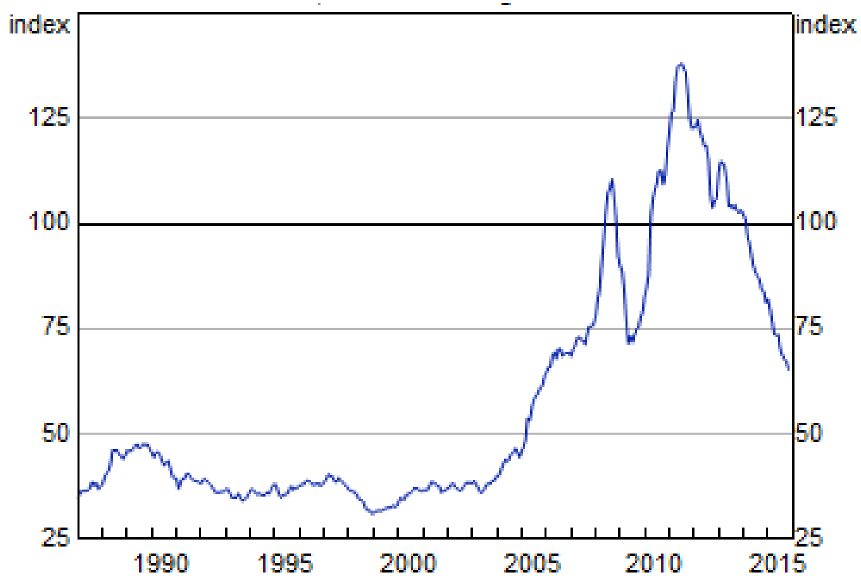


Figure 9a: Projected **copper** price comparison

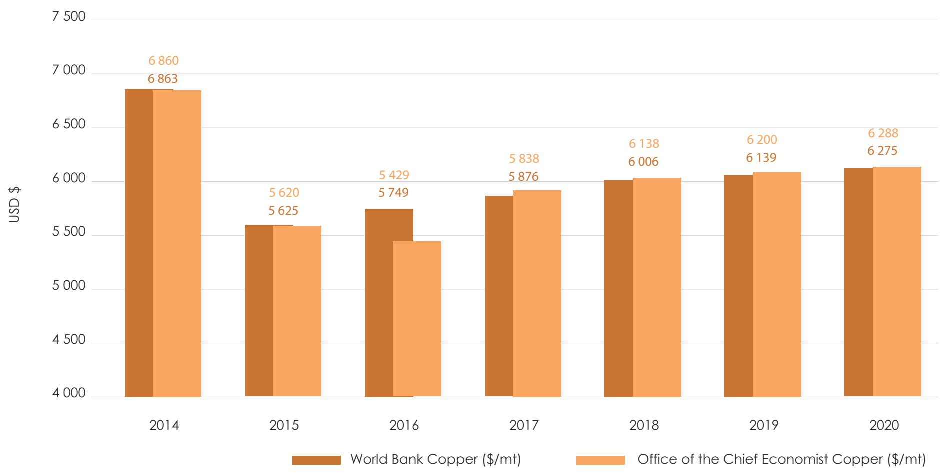


Figure 9b: Projected **iron ore** price comparison

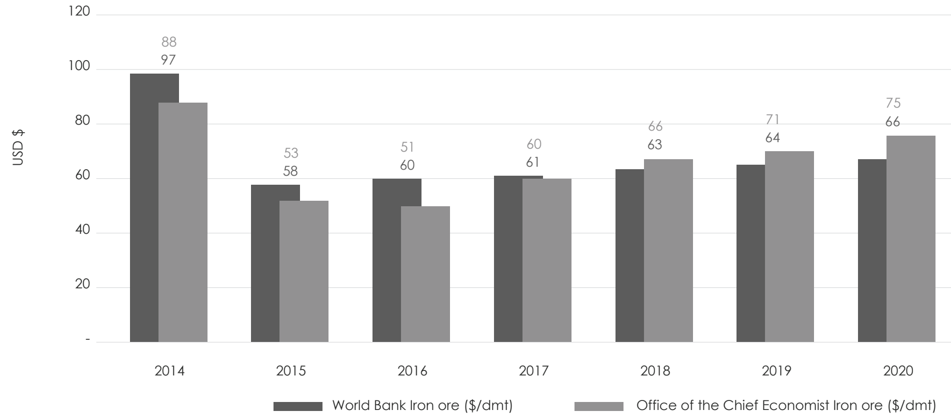


Figure 9c: Projected **zinc** price comparison

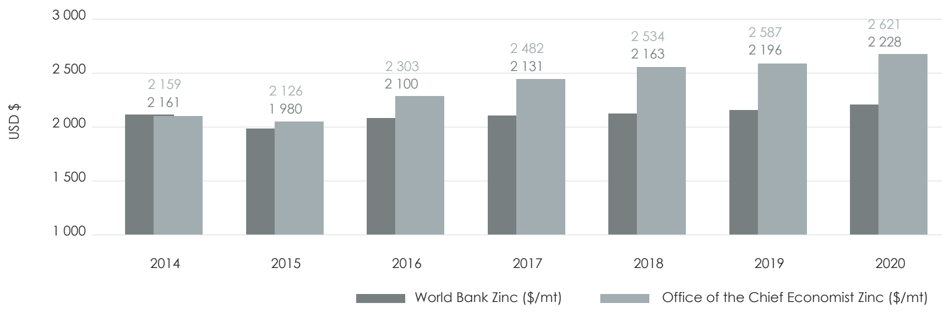


Figure 9d: Projected **crude oil** price comparison

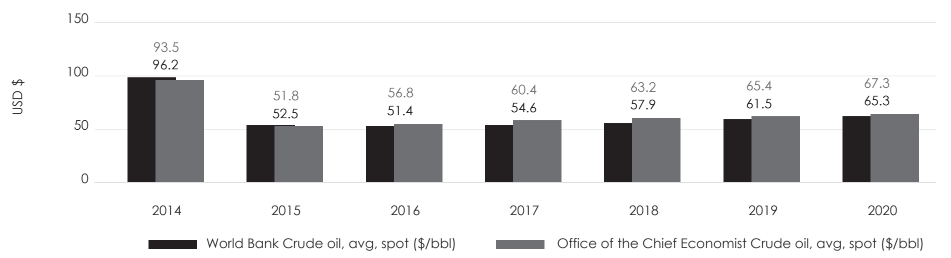


Figure 9e: Projected **aluminium** price comparison

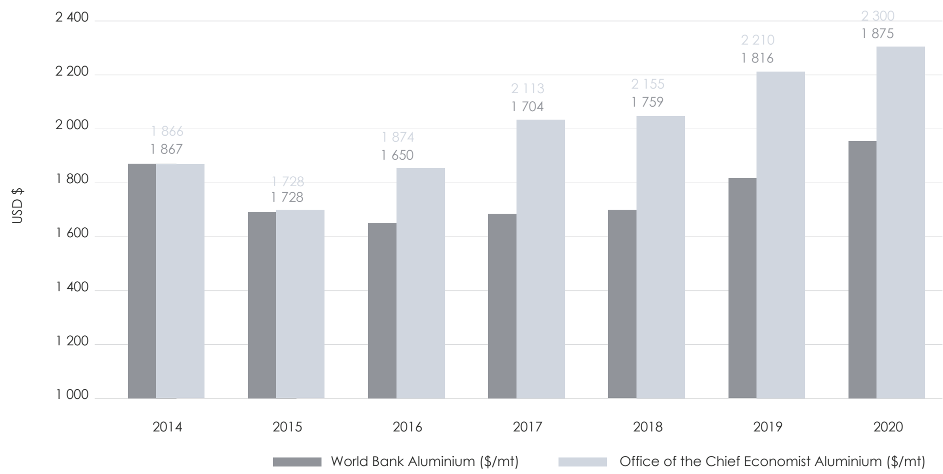


Figure 9f: Projected **gold** price comparison

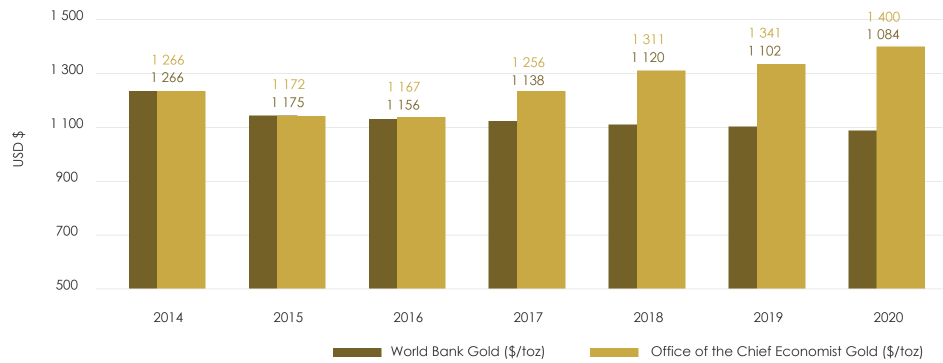
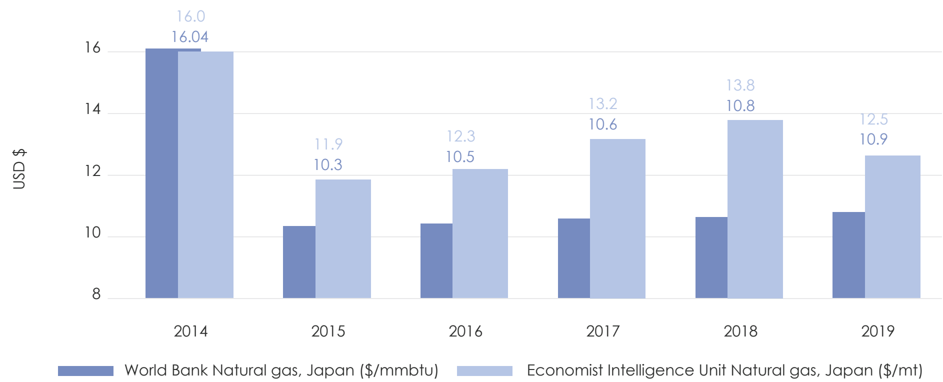


Figure 9g: Projected **natural gas** price comparison



Profitability relies on volume and margins

As we enter 2016, many commodities remain suppressed and are trading below their yearly (2015) averaged price. While recovery to 'boom time' prices is highly unlikely, in 2016 we anticipate an overall upward, but sporadic and turbulent, market correction and a recalibration of longer-term commodity prices that should be seen as the new norm going forward.

Figure 10: Commodity Prices

Source 1: Averaged prices from World Bank pink sheets, Office of the Chief Economist, Economist Intelligence Unit, AMMA Analysis; Source 2: UBS, LME, Reuters, Barchart

2016 - Forecast commodity prices by commodity in USD

2 December 2015 commodity prices in USD

Commodity	2016 - Forecast commodity prices in USD	2 December 2015 commodity prices in USD
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The primary take-out for resource organisations is that the profitability game has shifted from one based on commodity prices to being reliant on volume, with a greater emphasis on margins. If organisations can lower their operating cash-costs and all-in costs-per-unit-produced (and operate in the lowest cost quartile compared to their competitors) while simultaneously increasing labour and capital productivity, this will help organisations achieve short-term profits and lay the foundation for longer-term profitability, and even expansion, as prices gradually recover.

Ongoing challenges to drive M&As

Every cloud has a silver lining: Expect greater M&A activity in 2016

The resource industry is experiencing a perfect storm of challenges, led by suppressed commodity prices, and followed by legislative and regulative policies that are impacting on the attractiveness and commerciality of investing and doing business in Australia. This is creating anxiety and uncertainty for explorers, constructors, operators, mining, equipment, technology and services (METS) companies, and those offering support and services to the resource industry.

With some light at the end of the tunnel starting to appear, particularly for those that have long-life, high grade, tier 1 quality ore deposits and projects, we expect to see targeted and heightened merger and acquisition (M&A) activity in 2016. This M&A activity (both in the lead-up-to-sale and following) may impact a company's direct and indirect value chain. Thus, 2016 may create greater uncertainties for organisations, and their employees, that are either targeters or targetees of M&A activity.

Exploration

Quarterly analysis

Exploration spend continues to trend at critically low levels.

In original data terms, mineral exploration expenditure rose 14.5% (or +$50.0m) to $394.0m in the September quarter 2015.

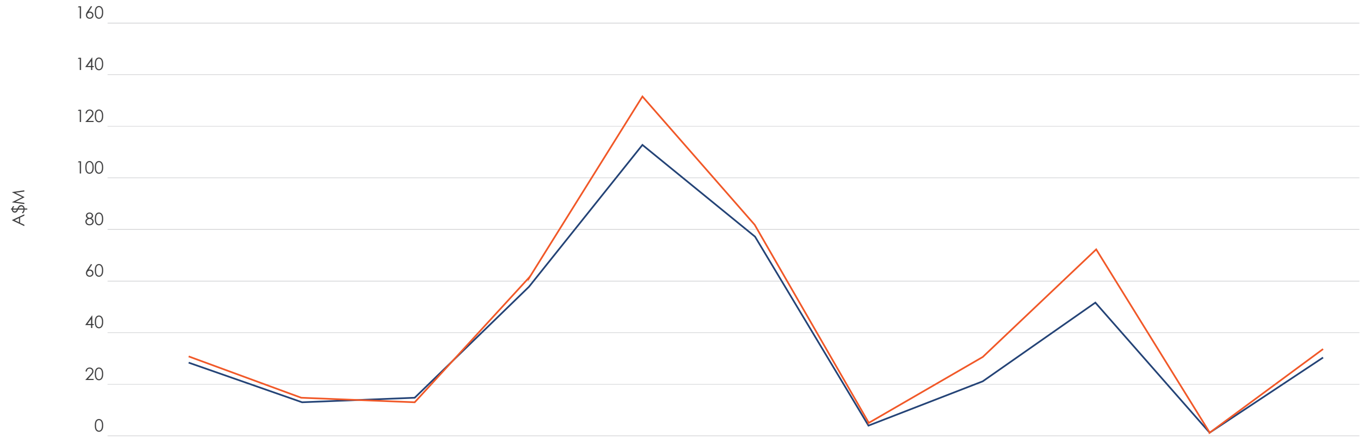
Exploration expenditure on existing deposits rose 21.3% (or +$49.0m) and for new deposits rose 0.9% (or +$1.0m).

The largest increase by commodity came from expenditure on gold (up 19.2% or +$21.6m). The next largest increase came from expenditure on coal (up 12.2% or +$6.1m).

However, the trend estimate (which smooths irregularities from the seasonally adjusted series) for total mineral exploration expenditure actually fell 3.5% (or -$12.3m) to $344.1m in the September quarter 2015. The largest contributor to this fall in the trend estimate this quarter was Western Australia (down 3.1% or -$6.5m).

Figure 11: Australia: Quarterly increase in mineral exploration spend

Source: ABS Cat. 8412. Table 5.



	Copper	Silver, lead, zinc	Nickel, cobalt	Selected base metals total	Gold	Iron ore	Mineral sands	Uranium	Coal	Diamonds	Other
Jun-2015	28.1	13.2	16.7	58.0	112.4	77.2	5.8	10.4	50.1	1.2	29.5
Sep-2015	30.2	16.4	14.7	61.4	133.7	82.2	6.6	15.4	56.3	1.6	36.6

This comes as no surprise given that Australia's leading and most economically important export, iron ore, the flagship commodity export for WA, has fallen by more than 75% over the past 6 years. With iron ore prices expected to remain at decade rate lows, it is unsurprising that exploration for this orebody has declined.

Absent from the 'quarterly' graph, is that in original terms onshore petroleum exploration also fell in the last quarter by 18.1% (or $43.7m to $198.9m), while offshore petroleum exploration fell by 15.6% (or $71.2m to $384m).

According to the ABS the trend estimate for total petroleum exploration expenditure fell 21.0% (or -$162.3m to $608.8m) in the September quarter 2015. Exploration expenditure on production leases fell 12.6% (or -$20.0m), while exploration expenditure on all other areas fell 19.8% (or -$120.9m)… "The largest contributor to the decrease in the trend estimate was Queensland (down 24.5% or -$38.4m) and the largest contributor to the fall in the seasonally adjusted estimate was Queensland (down 39.1% or -$62.3m)".

Exploration - tactical to medium term analysis

In original terms, mineral exploration expenditure in the past year has fallen by 13.41% (or $61m), by 38.28% (or $244.4m) compared to two years ago, by 55.96% (or $500.7m) compared to three years ago, escalating to 59.93% (or $589.4m) compared to four years ago.

Absent from the graph is that in original terms, onshore petroleum exploration in the past year fell by 33.3% (or $99.4m to $384m) and offshore petroleum exploration fell by 43.6% (or $297.6m to $384m).

While increases in gold and uranium exploration is encouraging, it is isolated and doesn't diminish strong concerns for the long-term viability of the Australian resource industry arising from significant reductions in exploration.

Australia will have to find new ways of encouraging and incentivising investment in exploration, for example through taxation concessions, to maintain the economic and social benefits that we became accustomed to during the 'commodity price boom'. Failure to identify future exploration opportunities will put significant pressure on other industries to grow the economy, maintain living standards and address growing public debt.

Figure 12a: Australia: Annual mineral exploration expenditure

Source: ABS Cat. 8412. Table 5

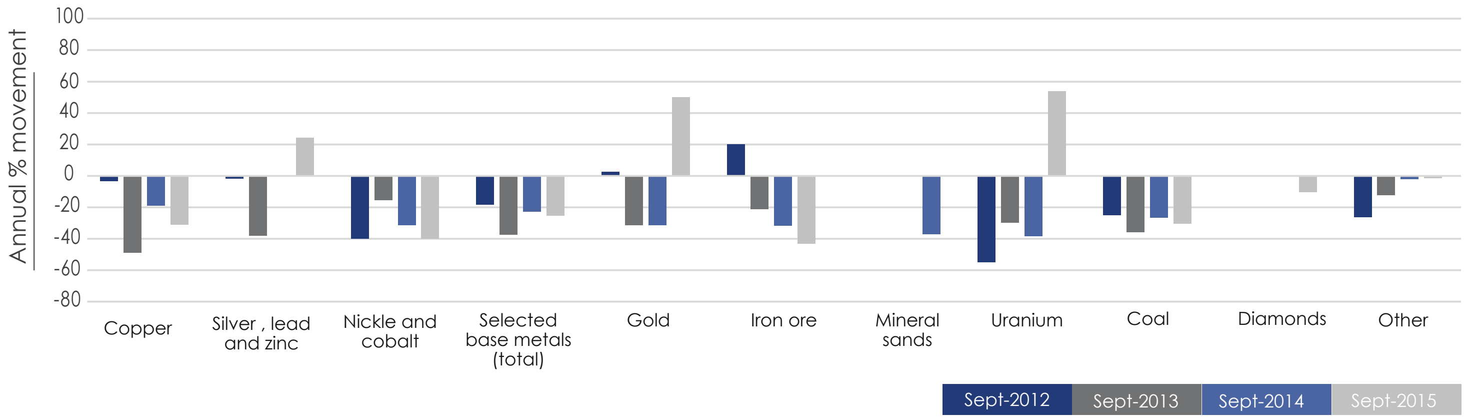
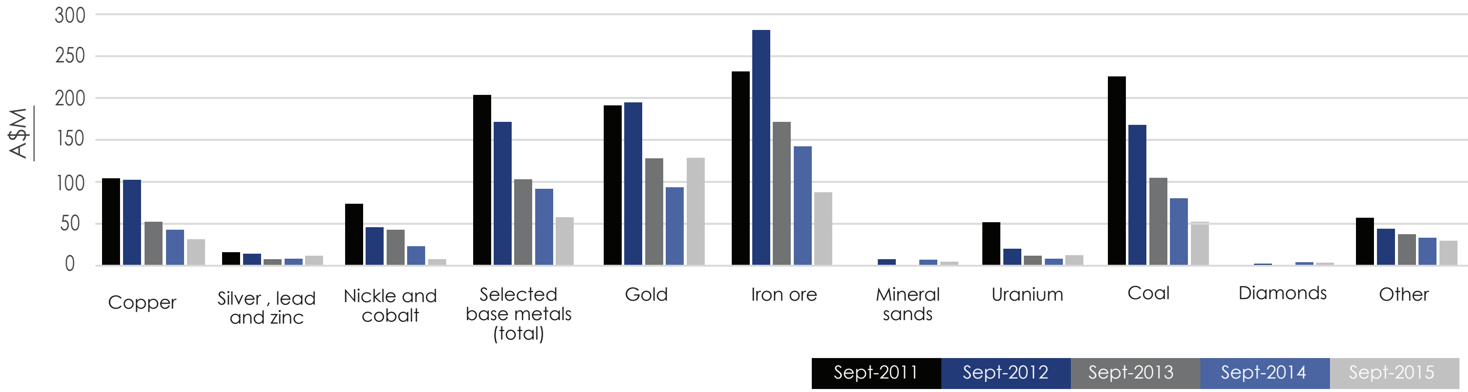


Figure 12b: Australia: Annual mineral exploration expenditure

Source: ABS Cat. 8412. Table 5



Pipeline of growth

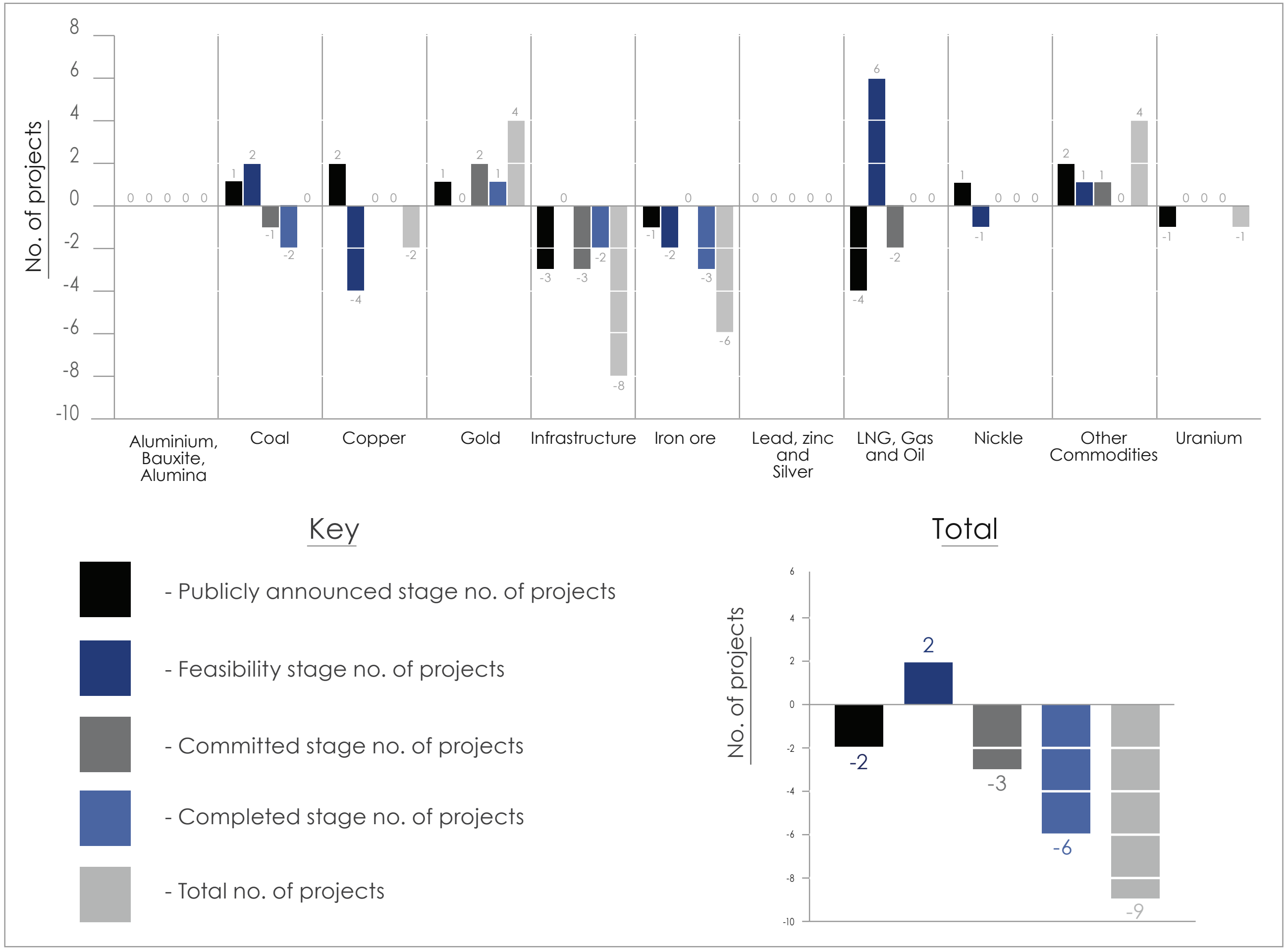
At the end of October 2015, Australia had 223 major resources and energy projects in the pipeline with a combined value of $428.8+bn. Six months earlier at the end of April 2015, there were 232 major projects in the 'pipeline' with a combined value of $439.4bn. This means a net loss to Australia of nine projects in six months with a combined value of $10.5bn.

While not ideal, it appears that the rapid reduction in the investment pipeline seen within preceding periods has subsided. Extending the comparison over 12 months (back to October 2014) shows there are 23 fewer major projects today with a declined pipeline value of $21.9bn. Over the course of two years, (Oct 13 to Oct 15) there are 112 fewer projects and a declined pipeline value of $159.6bn, indicating the first 12 months from October 2013 saw the greatest fall in the investment pipeline.

Nonetheless, $159.6bn in lost resource projects value over two years is a significant number - higher than the combined 2015-16 Federal Budget spend for health, education, public order and safety, defence and the operation of general public services.

Figure 13: 6 month analysis: Net increase/decrease of projects by commodity April 2015 to October 2015

Source: Office of the Chief Economist - Resources and Energy Major Projects

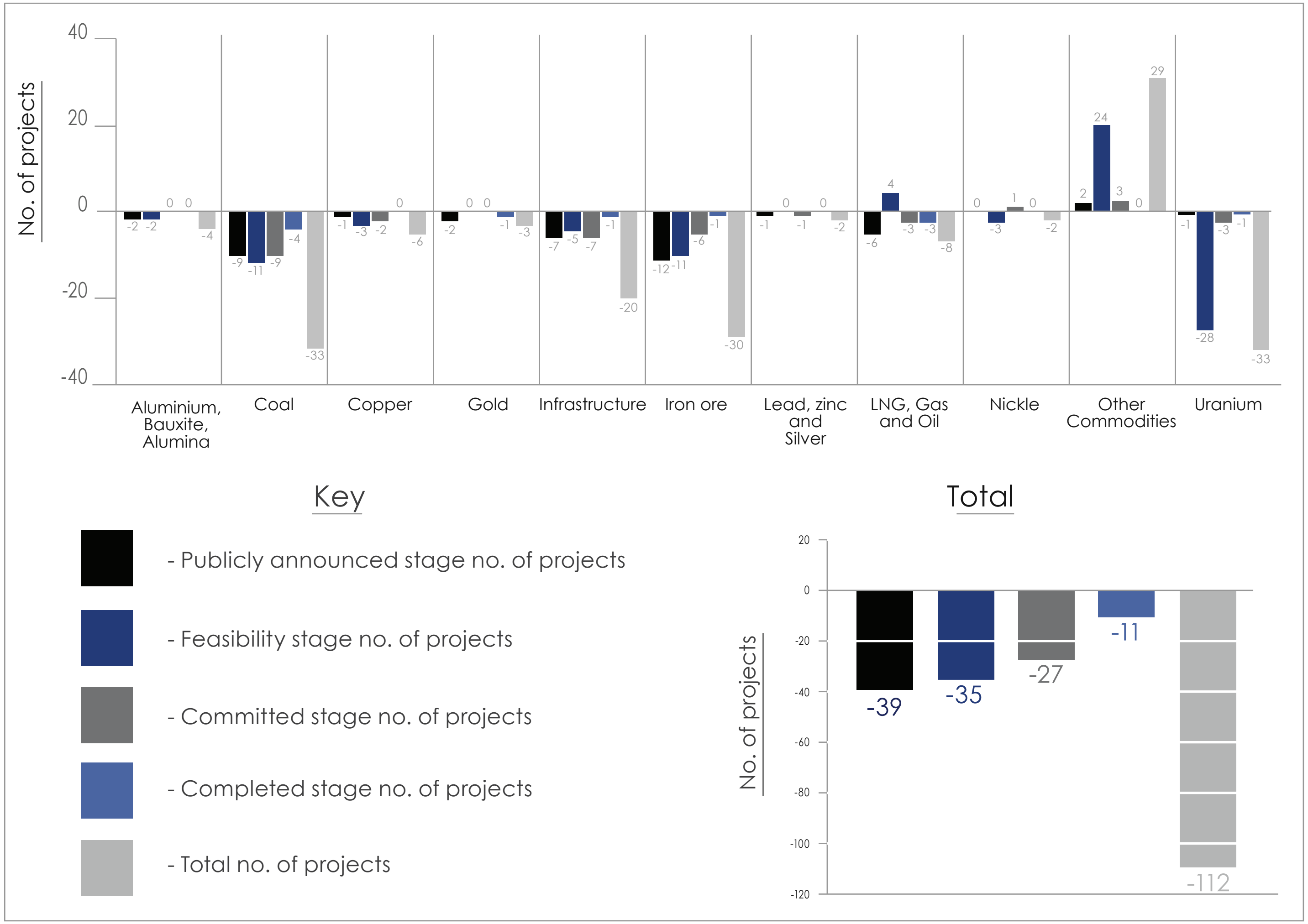


While the transition of more than 80 projects from construction into production over the past 24 months is a partial driver of this reduction in the major projects investment pipeline, the elephant in the room is that more than 150 projects (many announced prior to Oct 2013) have been scrapped in the past two years, with a conservative combined value of more than $160bn.

Previously announced projects have not proceeded after being determined unviable given changed economic circumstances or removed from the major project listing as they have deferred/ stalled for an extended period and are considered unlikely to proceed into the construction phase.

Figure 14: 24 month analysis: Net increase/decrease of projects by commodity October 2013 to October 2015

Source: Office of the Chief Economist - Resources and Energy Major Projects



Major projects are stalling and not reaching construction

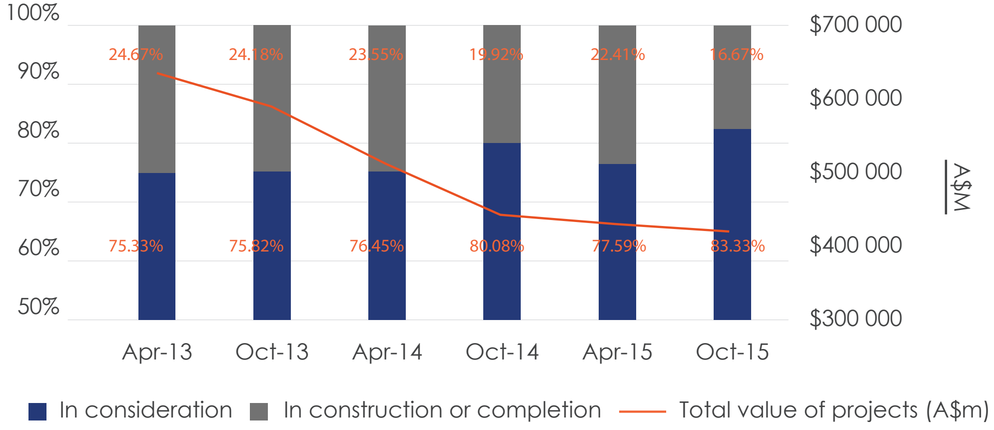
The majority of scrapped projects were discontinued at the "feasibility stage", where exhaustive analysis is typically undertaken to finalise project scope, complete engineering designs, assess environmental impacts and develop commercial plans. This comes after a project has been announced, but before the project has commenced construction.

This is part of wider structural changes in Australia's major resources and energy projects pipeline:

- We are seeing a structural change and increased weighting toward hydrocarbon commodities in Australia's resource and energy major project pipeline. At the end of October 2015, 12 LNG projects represented 49.3% of the total carrying value ($428.8bn) of all resources and energy major projects in Australia. This represents a 7% jump in just two years.
- With 12 LNG projects representing nearly 50% of the value of the Australia's resource and energy major project pipeline, Australia has a rising diversification risk.
- In addition, once these LNG projects go live, the value of Australia's resource and energy major projects pipeline will materially fall, as will employment.

Figure 15: Projects in consideration vs projects in construction

Source: Office of the Chief Economist/Publications/Pages/Resources and energy major projects.aspx



- With on average 10 construction jobs for every operational job in the gas industry (and on average three construction jobs for every one operational job in the metal ore industry), we can expect significantly increased unemployment for many people currently working in our 'construction orientated' resource industry. On the other hand we can expect rising royalties and taxes paid to our governments as companies commence production.
- 83.3% of all resources and energy major projects in Australia are currently in consideration, with just 16.7% in the construction or completion phase. This is higher than two years ago when 75.82% of all resources and energy major projects in Australia were in consideration. Australia is seeing an increase in potential projects stalled during this stage, showing that for more projects to proceed, investors and resource proponents will require more attractive commodity prices and greater long-term certainty. Investors will also increasingly demand a more supportive policy environment that stimulates and supports growth and doing business, rather than the existing regulatory environment which is often criticised for being convoluted, complex, riddled in red-tape, costly and inconsistent with world's leading practice.

In the short-term (six to 12 months) with investment curtailed and access to capital markets restricted for borrowing, we expect to see the current pipeline of resource and energy major projects remain relatively stable. However, we are concerned that the damage caused by critically low levels of exploration today will materially impact the pipeline of project growth in 12 to 24 months' time as fewer new resources and energy projects are identified and pursued.

Turning to the more positive stage of the cycle, while it is extremely unlikely that the next up-swing will be of the same magnitude as the previous 'commodity price boom', history looks likely to repeat itself to some extent. When this upswing comes, we may see a re-emergence of competition for labour, equipment and inventory as investors and operators with renewed confidence seek to simultaneously construct currently stalled projects.

Investor confidence

Tracking various events and developments that impact on sentiment and market realities, AMMA's volatility index is a forward looking short-term tracker that gauges the level of volatility and investor confidence in resource stocks.

This is telling as high volatility typically correlates to poor resource-related share market performance (with the exception of safe haven commodities) and can also have a close relationship with growth or contraction in the pipeline of future major resources and energy projects.

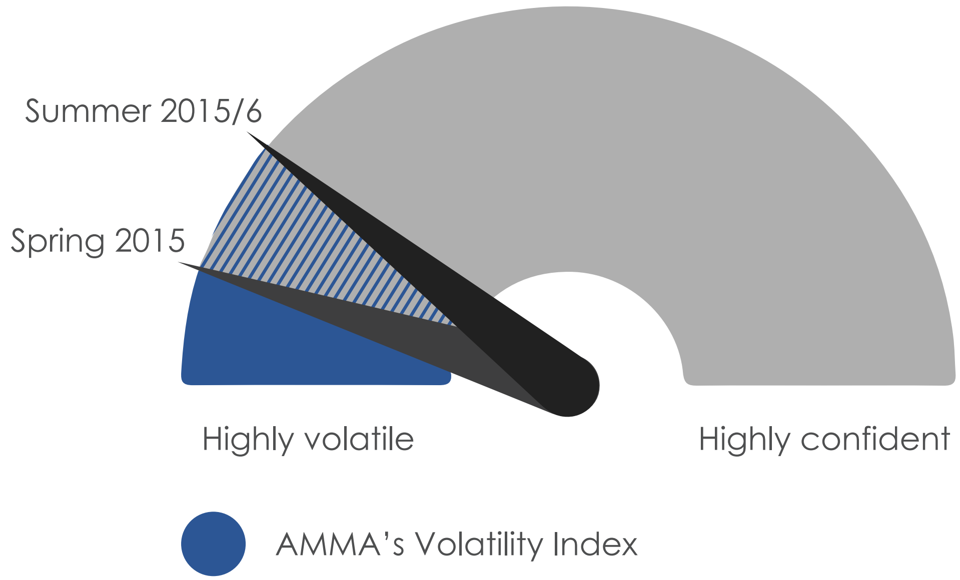
The period since the previous edition of the Market Outlook (September 2015) has seen strong movement on AMMA's volatility index. The index firstly swung into a more volatile position due to concerning trends in major economic parameters (terms of trade, unemployment etc.) and the tragic events at the Samarco iron ore operation in Brazil and the wider implications for the industry's safe use of tailings dams.

Trends and resource industry developments such as depressed commodity prices, rising global competition, falling margins and share market volatility also pushed AMMA's Index further into the volatile range. However, more recently the volatility index swung slightly back from the 'highly volatile' zone due to factors including softening commodity fundamentals, a stronger US dollar, growth in India rising by 7.4% (July – September), falling steel inventories in Japan and signs of stabilisation albeit at low levels in safe-haven commodity stocks.

Volatility does however remain at near five year highs and, as 2015 draws to a close, we expect volatility will fluctuate depending on the speculation and outcomes from the climate change summit in Paris, and particularly in relation to the Fossil-Fuel Subsidy Reform Communiqué.

The Australian resource industry will closely monitor the posturing, positioning and what communiqués are signed and signals sent by our competitors and those of our key trading partners, on fossil fuels and other climate related matters impacting the industry.

Figure 16: AMMA's Volatility Index



A leading short-term metric to assess volatility and confidence, provided by resource organisations themselves, is expected capital resource expenditure.

In the past three months (since the last Market Outlook) there has been further buoyancy with resource companies now expected to increase 2016 capital expenditure by 2.3% (or by $1.278bn to $56.27bn), or by 4.6% (or by $2.449bn) compared to the original 2016 estimates.

However, estimates of capital expenditure entering into 2016 are markedly lower than in previous years.

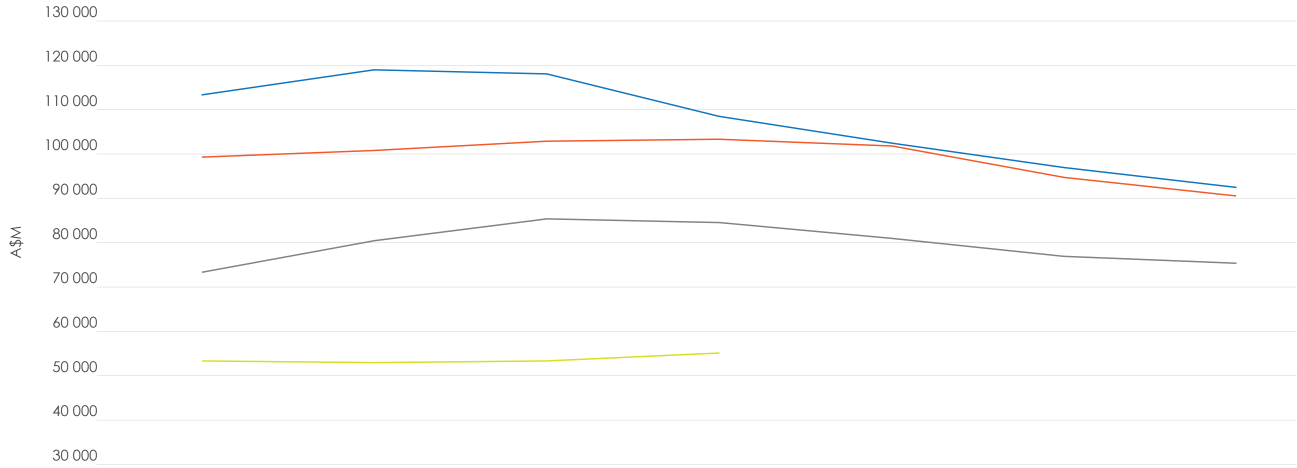
Forecasts of capital expenditure entering into 2016 are a staggering 36% (or $30.9bn) lower than at the same time last year, 55% lower than 2013 levels ($118.9bn expenditure) and 47% (or $48.4bn) lower than 2012 levels.

As capital year-on-year investment falls, resource companies have had little choice but to hold their current assets for longer. According to the ABS, in 2011-12, 3.3% of total annual capital expenditure of mining assets were disposed of. This escalated to 3.61% in 2012-13 but fell to 2.24% in 2013-14 [1].

This shows that mining companies are concerned about the current economic climate but also see new marginal growth opportunities opening up. In the short term however, falls in capital expenditure will see asset depreciation rates rise on ageing capital assets (impacting income statements and balance sheets). The longer-term could see ageing production assets reduce multifactor productivity levels thereby reducing company profitability levels.

Figure 17: Expected capital resource expenditure - 2016

Source: ABS Cat. 5625. Table 12A



	Estimate 1: 12 months expectation as reported in Jan-Feb of previous financial year	Estimate 2: 12 months expectation as reported in Apr-May of previous financial year	Estimate 3: 12 months expectation as reported in Jul-Aug	Estimate 4: 3 months actual and 9 months expectation as reported in Oct-Nov	Estimate 5: 6 months actual and 6 months expectation as reported in Jan-Feb	Estimate 5: 9 months actual and 9 months expectation as reported in Apr-May	Estimate 7: 12 months actual; Resource; Total
Jun-2013	113 396	119 290	118 984	108 065	103 622	97 587	94 710
Jun-2014	99 224	101 482	103 379	103 608	102 528	95 365	90 393
Jun-2015	74 199	80 201	85 927	85 327	80 752	77 832	76 133
Jun-2016	53 820	53 058	54 991	56 269			

[1]ABS Cat 84150 - Mining operations, Australia, 2013-14. Table 5

Major economic parameters

Whether it's the 2015-16 Federal Budget or the latest set of data from the International Monetary Fund (IMF), key economic indicators and forecasts point to another challenging year ahead in 2016.

One of the most concerning statistics hidden away in the IMF's memorandum items regards real net national disposable income per capita. This indicator provides one of the best metrics to assess current and future national living standards.

The IMF forecasts another year of falling real net disposable incomes per capita in Australia. This will make it even more important that government increases efforts to encourage investment in Australia and provide greater scope for Australian operations to become more productive and globally competitive.

Figure 18: Australia - key economic indicators annual percentage change

Source: IMF Country Report No. 15/274

	2015	2016	2017	2018	2019	2020
National accounts						
Real GDP	2.5	3	3.1	3	2.9	2.8
Labour market						
Employment	1.6	1.7	1.7	1.6	1.6	1.6
Unemployment (per cent of labour force)	6.2	6.1	6	5.8	5.7	5.5
Wages (nominal per cent change) - WPI	2.7	3.3	3.5	3.7	3.8	3.8
Prices						
Consumer price (avg) -CPI	1.8	2.6	2.4	2.5	2.5	2.5
Financial						
RBA cash rate (per cent, avg)	1.7	1.8	2.2	2.6	3	3.4
10-year treasury bond yield (percent, avg)	2.1	2.3	2.7	3.1	3.5	3.9
Mortgage lending rate (per cent, avg)	5.3	5.4	5.8	6.2	6.6	7
Memorandum items						
Real net national disposable income per capita (% change)	-1.9	-0.3	0.2	0.4	0.9	1

Another significant concern is wages (WPI) continuing to rise in excess of consumer price inflation (CPI). Notably, with average 'mining salaries' significantly higher than the all-industries average, a lower percentage rise in the mining WPI, may still equate in real dollar terms to significantly higher mining salaries that will challenge cost parameters and the bottom line for employers seeking to navigate constrained markets.

With resource companies scrutinising all discretionary spend and looking at ways to correctly size and steer their businesses, escalating wage costs in excess of growth in prices and divorced from productivity improvements, make labour costs a significant expense outlier. It will be of no surprise if organisations undertake greater scrutiny of this P&L line item.

The other notable forecast is for a progressive rise in 10-year treasury bond yield rates.

With yields rising, investors may consider transitioning capital from the stock market into treasury bonds, as they provide less risk and are guaranteed. As a result, traded resource stocks will need to offer premiums above the bond yield (recognising the risk) to sustain capital investments, and must work to outperform other indices and companies to attract increased levels of equity. This may become more challenging in 2016.

Australia is a trade exposed nation with the resource industry generating more than 50% of all export earnings. With a number of Australia's key commodities being traded in US dollars it is important to recognise that the USD-AUD is forecast to rise and this will provide some cushioning in the form of a natural hedge against falling commodity prices, which will benefit parts of the industry (those that have their commodities traded in US dollar) in 2016.

Governance and corruption

During the past three months the resource industry has seen notable alleged corruption scandals in Brazil and China, with allegations made against industry representatives and government officials relating to collusion, price fixing, bribes, kickbacks and other unlawful activities.

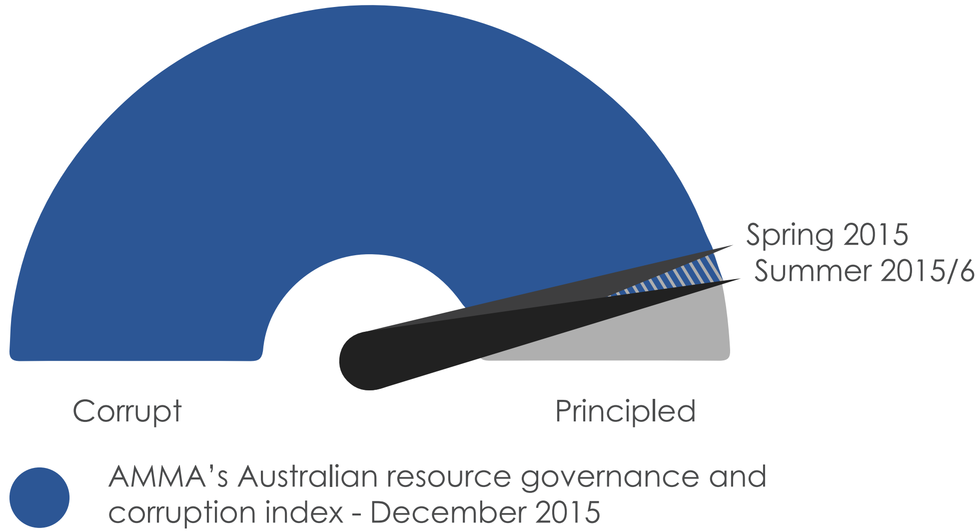
Companies involved in these allegations saw their stock prices decrease and questions raised about their governance and internal audit procedures.

With further M&A activity predicted for the resource industry domestically and internationally, it is important that investors, project principals and contract operators undertake comprehensive due diligence prior to investing and committing capital and resources. It is also essential to assess the sovereign risk for any nation a company may be considering trading in or with, particularly governance standards and corruption levels, adherence to law, reviewing prospective trading partners, 'know your customer' (KYC) policies and procedures (for instance third parties may have links to terror groups) as well as security factors such as physical security of personnel and the security and stability of a mining lease.

Figure 19 rates the Australian resource industry from a governance and corruption perspective, showing over the past three months Australia's rating has remained relatively unchanged.

Australia remains very well regarded internationally, with our 'no tolerance' approach to corruption welcomed by the global investment community. Over the past three months there has been a minor shift towards 'principled' from the last Market Outlook edition, which is a positive sign for the industry and should be well received and regarded by foreign companies seeking to do business with Australian resource companies.

Figure 19: Governance and corruption index



Divestment campaigns in the spotlight

2015 saw the intensification of global campaigns targeting investors, seeking to have them withdraw financial capital from companies in the non-renewable or fossil fuel sector.

These strategies appear largely ideologically driven. 2015 has seen an extension of the global movement on divestment into Australia.

For instance, in September the ACT Minister for Territory and Municipal Services announced that Canberra buses would no longer display advertising promoting 'junk food, alcohol, gambling, fossil fuels and weapons', grouping the products of the resource industry upon which Australians rely daily with 'sin stocks' and products whose misuse and abuse causes serious social and health problems.

Further, the Melbourne City Council has also withdrawn investment from resource companies that are 'aligned' to fossil fuels and introduced a policy to screen banks based on their investment or financing of fossil fuels. Ironically, this announcement came at the same time as the Victorian Government hosted the International Mining and Resources Conference and promoted Victoria as an attractive place for global mining and hydrocarbon investment.

As 2015 draws to a close, the Paris Climate Summit has provided a focal point for anti-fossil fuel campaigning, with little regard to the transformations the industry has driven on emissions and clean production. It is difficult to forecast where the divestment campaign, and pressures on fossil fuels through global climate action may move to in 2016, however this may well include:

- More campaigns, both general and targeted to specific companies, seeking to put pressure on governments, banks and investors to divest from companies linked to fossil fuels;
- Counter-campaigns by resource industry organisations to inject facts and provide balance in public debate in this area. This may include pointing out that there are more than 1 billion people in the world without access to electricity; and
- More highly polarised debates within Australia over the climate and renewable energy policies in the wake of the Paris Climate Change Summit and in the lead up to the 2016 election.

Conclusion

2015 has been another very challenging year for the resource industry. While the entire resource industry needs to brace itself for further turbulence in the year ahead, there are signs of recovery and evidence that falling commodity prices and the number of major projects being scrapped before reaching construction and production, is slowly subsiding.

2016 will be another big year. It is forecast that we will continue to see above average swings in commodity prices causing uncertainty and anxiety across the industry. However, by 2016 calendar year end, the market is forecasting that commodity prices will trend marginally upwards.

Australians will also go to the polls in an election set to have significant implications not only for the Australian community and the national economy, but also for investing and doing business in the resource industry.

AMMA's lobbying and influence activities on behalf of members will again be critical in 2016, directed to federal and state governments, and the variety of regulators on issues critical to the industry. AMMA will continue to prosecute policy reform centred on ensuring Australia's resource industry is internationally competitive, able to attract investment and to grow.

Australia must continuously strive to be a global resource exporter of choice and the premier resource nation in which to invest. With Australia being ranked number one in the world for iron ore, uranium, gold, zinc and nickel reserves, second for copper and bauxite reserves, fifth for thermal coal reserves, sixth for shale oil reserves and seventh for shale gas reserves, it is precisely now, during a period of contraction, that Australia should prepare and position itself to capture future growth opportunities as the market, commodity and investment cycle changes.

Future updates

The autumn 2016 AMMA Market Update will provide an update on movements and developments in commodity prices, exploration activity, pipeline of growth, confidence levels, volatility levels, as well as other notable developments impacting the resource industry and the economy.

If there are any other resource economic or resource related public affairs issues that you would like AMMA to cover or any questions arising from this analysis, we would like to hear from you.

Feedback

This summer 2015/16 edition provides an update on movements and developments in commodity prices, exploration activity, pipeline of growth, confidence levels, volatility levels, as well as other notable developments impacting the resource industry and the economy.

AMMA values your feedback about any other economic or resource-related issues you would like covered in this update. Refer to contact details on the insert page.

If you would like to be added to our mailing list to receive this publication, please contact: tristan.menalda@amma.org.au

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