

Diamond Market Outlook

Group Economics
Macro & Financial Markets
Research

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Recovery grinds to a halt

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- The recovery in the diamond trade has grinded to a halt at the start of 2017...
- ...as US consumer spending has been disappointing ...
- ...and Chinese jewellery demand has remained weak
- We expect an improvement in US diamond jewellery demand...
- ...but Chinese jewellery demand to disappoint...
- ...as the Chinese economy has peaked
- The bottoming out process of polished diamond prices to continue...
- ...while rough prices will be supported by the strategy of miners

Improvements in diamond trade peter out...

In our Diamond Market Outlook report from 21 November 2016 we highlighted the fact that there had been an improvement in the global diamond trade. At the end of last year there was a clear improvement in the diamond trade but this improvement has petered out since the start of 2017. There are several reasons for this. For a start, US economic growth and consumer spending in particular (the largest market) has been disappointing in Q1. This has weighed on end-demand. Moreover, lower consumption in Hong Kong and Macau has also negatively affected demand for diamond jewellery (according to company reports from main jewellers in the region). Finally, Chinese retail sales were weaker in January and February (but there was a recovery in March).

Antwerp rough diamond trade is slowing...

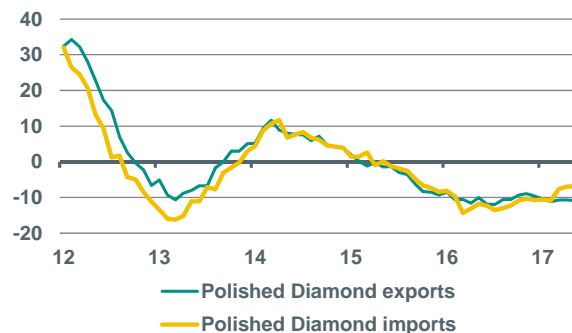
12m sum % yoy (value)



Source: Thomson Reuters Datastream, ABN AMRO Group Economics

...while polished trade has failed to improve

12m sum % yoy (value)

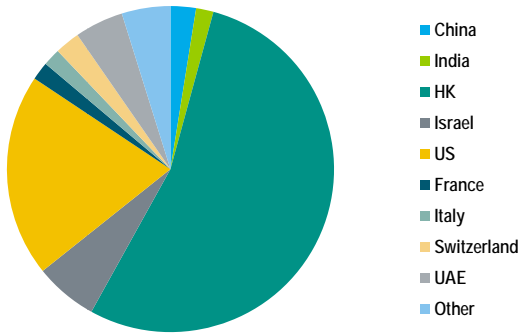


Source: Thomson Reuters Datastream, ABN AMRO Group Economics

Antwerp diamond trade data show that the improvement in rough trade has already peaked while polished trade never recovered in the first place. These data also show that Antwerp diamond exports to China (also because of a gap in the data), Hong Kong and the US have been very weak.

Antwerp exports dominated by Hong Kong & China

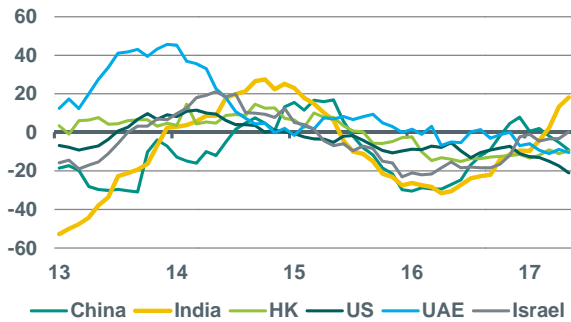
In %



Source: Thomson Reuters Datastream, ABN AMRO Group Economics

Exports to India are the only bright spot

12m sum % yoy (value)

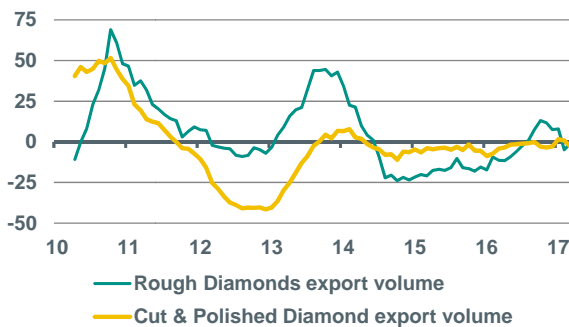


Source: Thomson Reuters Datastream, ABN AMRO Group Economics

The only bright spot has been exports to India which highlight a pick-up in activity in Indian diamond manufacturing. India is the global diamond manufacturing hub. In terms of end-demand India only accounts for around 7% of global demand. However, Indian diamond export data (see below) paint a less convincing picture. Moreover, the announcement of the higher Goods & Service Tax (or GST) in India has resulted in concerns that it will ruin small traders and manufacturers. Per 1 July the GST on polished diamonds will be 3%, on diamond trading 18% and on rough diamonds 0.25%.

Halt to improvement in India rough export volumes...

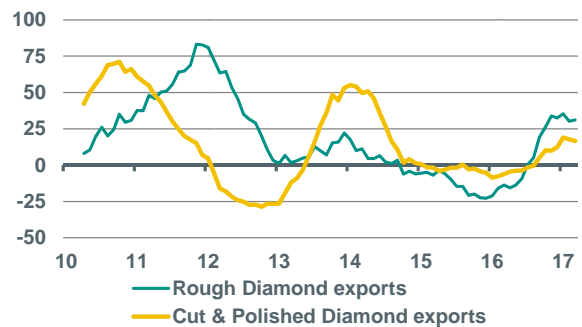
12m sum % yoy



Source: Thomson Reuters Datastream, GJEPC, ABN AMRO Group Economics

... but value improved

12m sum % yoy

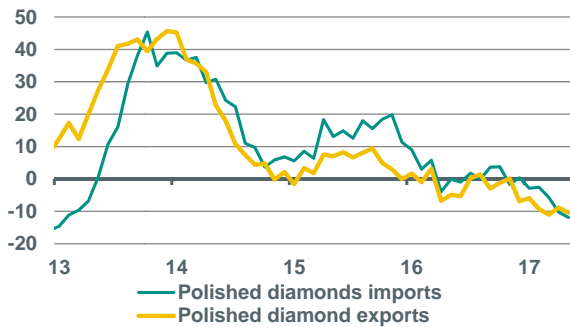


Source: Thomson Reuters Datastream, GJEPC, ABN AMRO Group Economics

As is the case for the Antwerp diamond trade, the UAE polished diamond trade has also deteriorated. The Israel diamond trade has improved considerably but the question remains for how long, as the improvement has already been substantial.

UAE polished diamond trade has deteriorated...

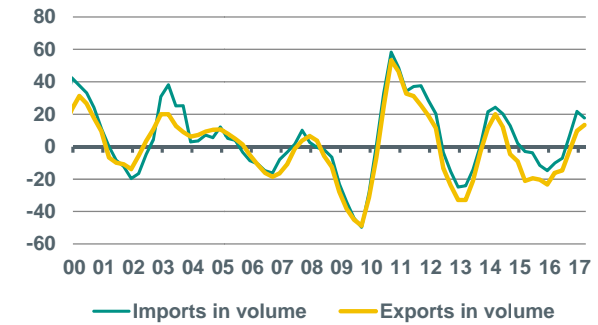
12m sum % yoy



Source: Thomson Reuters Datastream, ABN AMRO Group Economics

...while as Israel diamond trade has done well

12m sum % yoy (volume)



Source: Thomson Reuters Datastream, ABN AMRO Group Economics

Latest trade shows show cautious buyers...

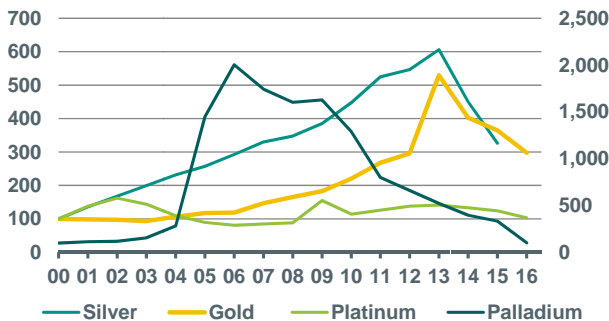
According to www.diamonds.net the Hong Kong International Jewellery show (in March) showed good demand for specific diamonds and there were selective buyers. At the Basle Watch and Jewellery show (March) there was lower visitor traffic and fewer exhibitions. At the Carat+ fair in Antwerp (first time, May) there was a positive mood (I was also a visitor) but in future the exhibition needs to attract more buyers. Recently, the JCK show in Las Vegas saw fewer but more serious buyers with a lower budget reflecting lower inventory needs. Overall, there have been reports that jewellery retailers are cautious in building up too much inventory as consumer demand has been soft.

...as end-demand remains cautious

As mentioned above US consumer spending (largest diamond market) has been disappointing. Moreover, in recent years, Chinese jewellery consumption of the various precious metals has declined substantially (graph on the left below). The anti-corruption measures are probably an important reason for the decrease in demand. However, Chinese gold jewellery demand improved somewhat in Q1 2017, but this was when Chinese economic growth was strong.

Chinese jewellery consumption is falling...

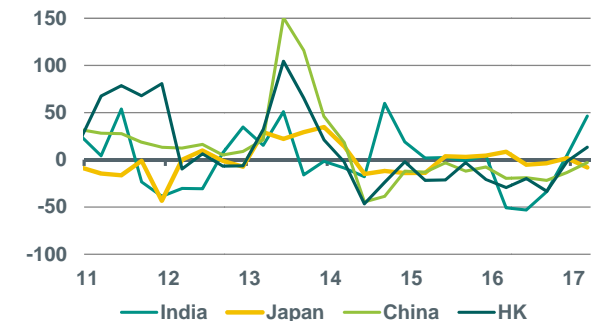
Annual demand index gold, platinum, silver demand index palladium



Source: GFMS Thomson Reuters Datastream, ABN AMRO Group Economics

...but signs of improvement in gold jewellery demand

% yoy

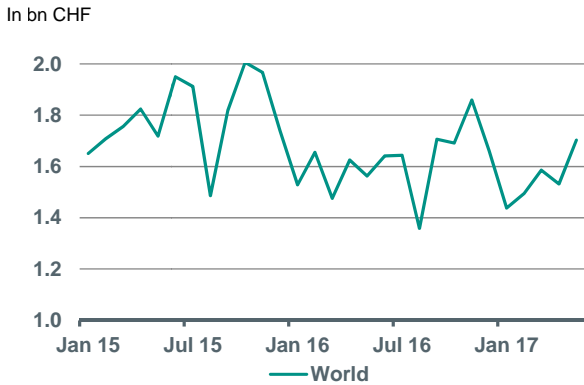


Source: GFMS Thomson Reuters Datastream, ABN AMRO Group Economics

The latest Swiss trade data (for May) show that there is some pick-up in momentum in watch exports especially to the largest destinations Hong Kong and the US. There have also been signs of improvement in demand in the UK, Japan, Italy and France. As far as the situation in

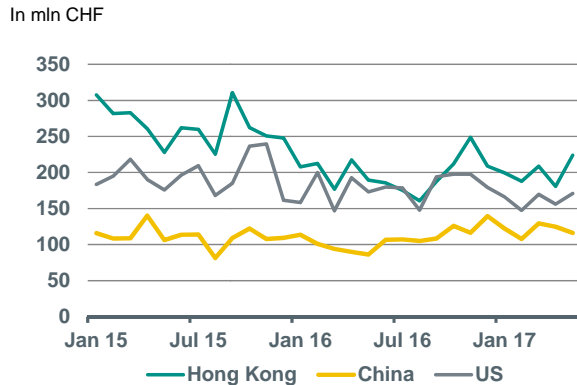
the UK is concerned, this is likely to be temporary, as there is currently a squeeze in real wages, which has already led to lower car sales. Overall, end-demand does not seem to be picking up for now. Swiss watch exports to China are still soft.

Swiss watch exports gain some momentum...



Source: Federation of the Swiss Watch Industry FH, ABN AMRO Group Economics

...especially to Hong Kong and the US

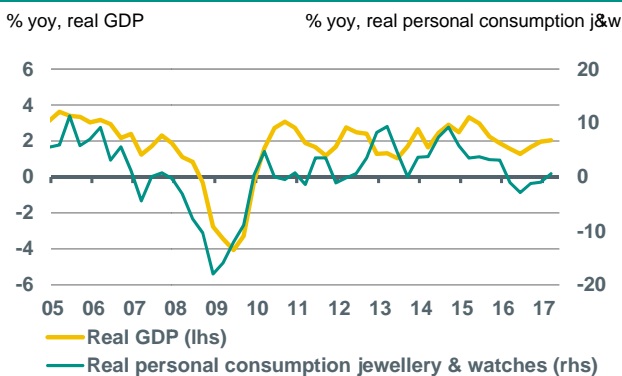


Source: Federation of the Swiss Watch Industry FH, ABN AMRO Group Economics

But higher US net-worth and strong economy should support jewellery spending...

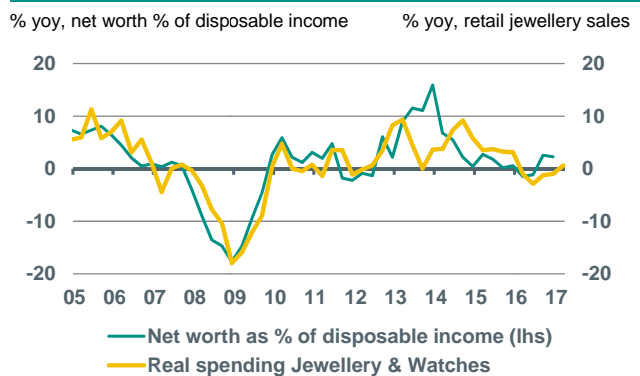
The US is by far the largest market for diamond jewellery accounting for more than 40% of the market. Weaker-than-expected US consumer spending in Q1 has weighed on demand for jewellery (including set with diamonds). In general, an increase in US real GDP goes hand in hand with an increase in real personal consumption in jewellery and watches. Households' net worth continues to rise in the US based on higher house prices and stocks. Moreover, the US labour market is tight, which will provide some job security. Therefore, we think that US consumer spending will rise and the savings rate will decline. An increase in households' net worth generally fuels demand for jewellery, so we expect higher US demand for jewellery (including set with diamonds).

Improvement in US real GDP & jewellery spending...



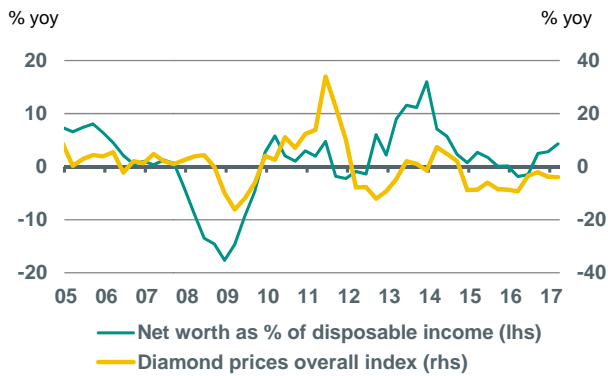
Source: Thomson Reuters Datastream, ABN AMRO Group Economics

...as well as in net worth



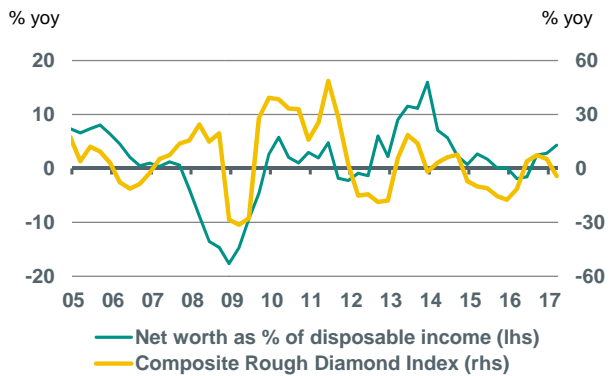
Source: Thomson Reuters Datastream, ABN AMRO Group Economics

Pick-up in net worth supportive for diamond prices...



Source: Thomson Reuters Datastream, PolishedPrices.com, ABN AMRO Group Economics

...including rough diamond index...



Source: Thomson Reuters Datastream, PolishedPrices.com, ABN AMRO Group Economics

...but Chinese demand remains a risk

Our China economist expects that Chinese economic growth has peaked in Q1 and that it will gradually slow down going forward (see [China Watch – Views from Shanghai](#)). It is likely that this will weigh on private consumption and jewellery demand. The anti-corruption measures will probably continue to weigh on Chinese jewellery spending as well. In the years ahead, it is likely that the growing of the middle class will result in higher overall jewellery demand (including diamonds) but this will take time.

Only modest upside in polished prices

We think that end-demand in the US will probably pick up because of the strong US economy in 2017 and an increase in households' net worth. This should provide support to polished diamond prices going forward and prices should continue to bottom out. However, the upside will probably be dampened by weak demand from China.

Diamond prices bottoming out...



Source: PolishedPrices.com, ABN AMRO Group Economics

...but the momentum is low



Source: PolishedPrices.com, ABN AMRO Group Economics

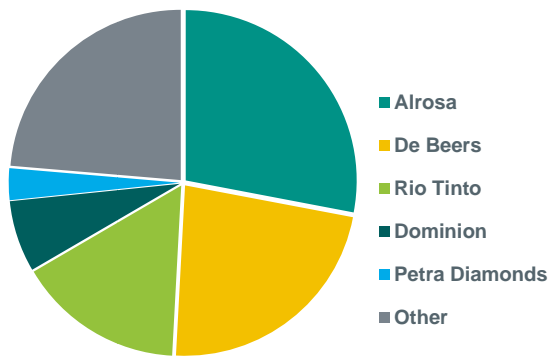
A substantial increase in global mine production in 2017...

The production guidance from De Beers for 2017 is 31-33 million carats compared to the 2016 production of 27.3 million carats. Alrosa has indicated that it will increase production by 5% in 2017 to 39.2 million carats by the end of 2017. Moreover, Rio Tinto has indicated that it will ramp up production to 19 to 24 million carats this year from close to 18 million carats in 2016. A substantial proportion of these diamonds come from the Argyle mine which is the largest source

for brown, champagne-coloured diamonds. This would mean that for both De Beers and Alrosa, production in carats would be back at 2015 levels and Rio Tinto’s diamond production would be the highest since 2008. Global diamond production for 2016 was around 128 million carats. For 2017 we expect production to increase to 140 million carats, or an increase of 9%. This sharp increase is based on the production guidance of the large mining companies and on the assumption that the share of the other mining companies will remain at around 33% of global annual mine production.

Market share per miner (based on carats) , 2016

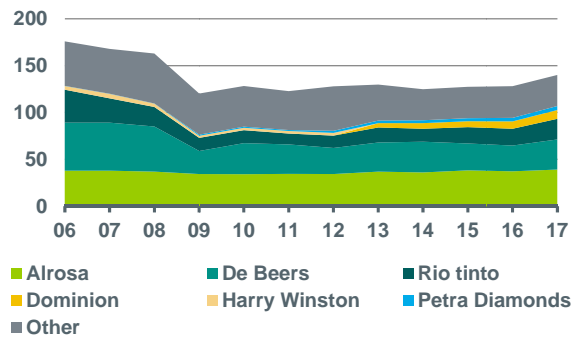
Share of total production



Source: Company reports, ABN AMRO Group Economics

Projected increase in diamond production this year

Production in mln carat, 2017 = company guidance



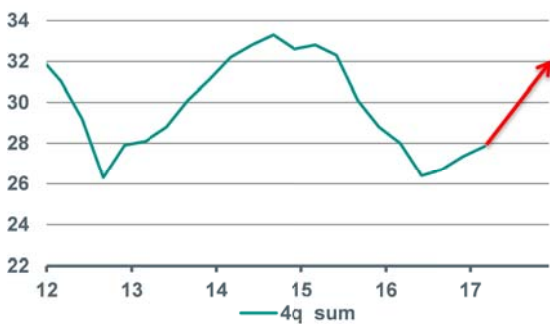
Source: Company reports, ABN AMRO Group Economics

...but no sell-off in rough diamond prices

In a fully competitive market environment, this increase in global diamond production should result in downward pressure on rough diamond prices. However, the oligopolistic structure of the industry is likely to prevent rough diamond prices from dropping substantially. Instead, the mining companies will find different ways to avoid lowering their prices substantially like for instance keeping the surplus diamonds in inventory until end-demand strengthens. In fact, so far this year prices at the De Beers’ sights have increased.

De Beers

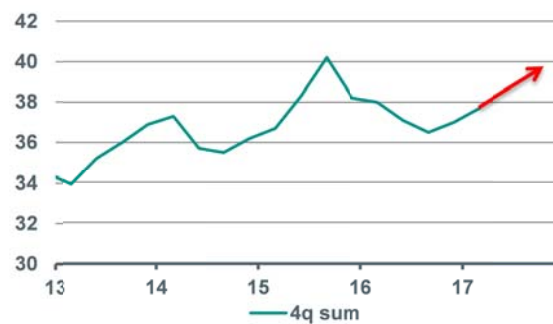
In mln carats, red arrow is the production guidance



Source: Company reports, ABN AMRO Group Economics

Alrosa

In mln carats, red arrow is the production guidance



Source: Company reports, ABN AMRO Group Economics

There have been reports that at four out five sights so far this year prices for certain diamonds have risen and/or there was an adjustment of the assortment in goods. Furthermore, end of March, De Beers announced that it will lower sight holders’ allocations of rough diamonds as it fulfils its commitment to support diamond manufacturing in Namibia. It is likely that these

diamonds will make their way to the global market via another channel. However, sight holders will probably be confronted with lower supply creating a sense of shortage for certain diamonds. Demand at De Beers' sights was very strong at the start of the year but has fallen since then. This could be the result of inventory already in place to meet modest demand or that industry players are cautious about the outlook for end-demand and therefore being hesitant to buy rough.

De Beers' sales are coming off...

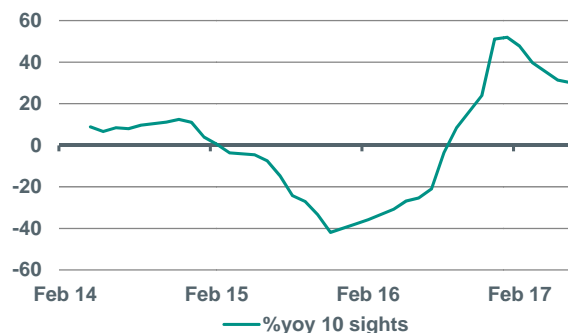
Sales in mln US dollar



Source: www.diamonds.net, ABN AMRO Group Economics

...and the overall trend is weakening

In % yoy of sum of 10 sights (De Beers)



Source: www.diamonds.net, ABN AMRO Group Economics

Find out more about Group Economics at: <https://insights.abnamro.nl/en/>

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