

Diamond Market Outlook

Group Economics
Macro & Financial Markets
Research

21 November 2016

Outlook is improving

Georgette Boele
Co-ordinator FX & Precious Metals
Strategy
Tel: +31 20 629 7789
georgette.boele@nl.abnamro.com

- Diamond trade data paint a far more optimistic picture than in June...
- ...signalling that trade has turned the corner
- We expect diamond trade to further improve in 2017
- We also expect jewellery demand to improve slightly in 2017...
- ...driven by a lower US savings rate...
- ...and an improvement in Chinese jewellery demand
- Rough and polished prices will likely rise at a modest pace in 2017
- ...reflecting an improvement in end-demand

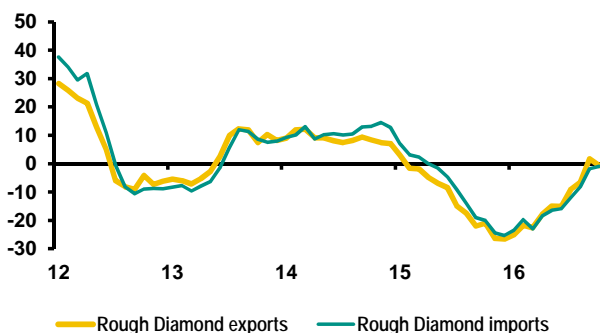
Improvement in diamond trade

Whereas in June, when we last wrote our Diamond Market Outlook, there were still doubts if global diamond trade would improve, recent data paint a far more optimistic picture. Diamond trade data have clearly improved in all centres most noticeably in Antwerp, Israel and India. This in line with:

- the general improvement in global trade we have experienced also filtering through to a niche market like diamonds,
- only a modest slowing of the Chinese economy and
- the effects of the Chinese anti-corruption campaign on jewellery demand are fading out

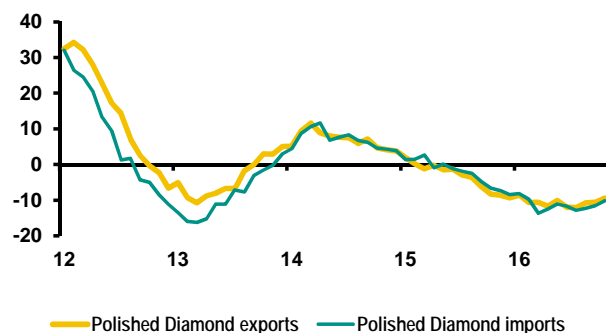
Pick-up in rough diamond trading activity in Antwerp...

12m sum % yoy (value)



...while polished diamond trade is still lacking

12m sum % yoy (value)

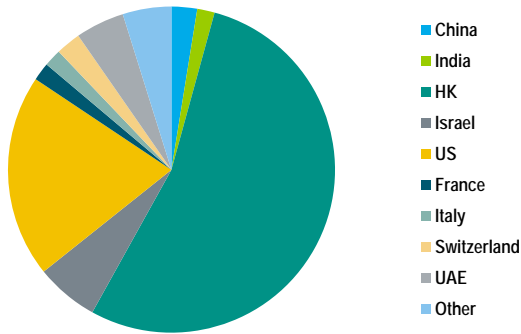


Source: Thomson Reuters Datastream, ABN AMRO Group Economics

Source: Thomson Reuters Datastream, ABN AMRO Group Economics

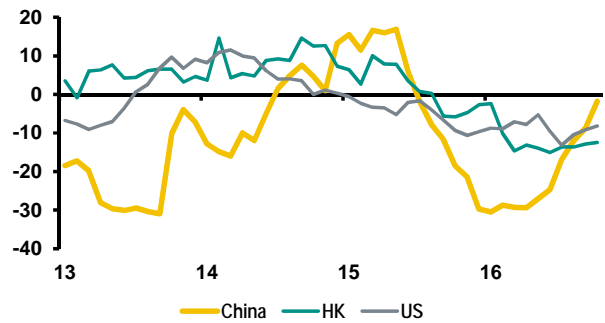
Antwerp exports dominated by Hong Kong & China...

12m sum % yoy



...exports to China are improving

12m sum % yoy (value)



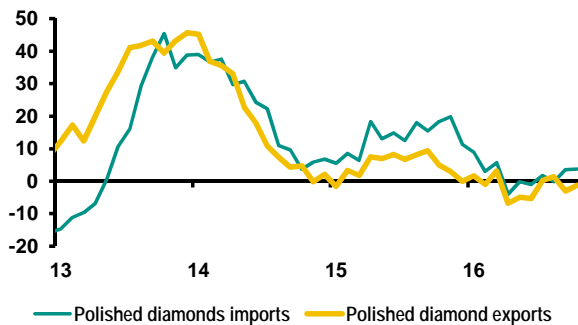
Source: Thomson Reuters Datastream, ABN AMRO Group Economics

Source: Thomson Reuters Datastream, ABN AMRO Group Economics

Not only have Antwerp diamond exports to China improved and Hong Kong stabilised, exports to the US are also bottoming out. Trade data from the two other main trading centres, UAE and Israel also show an improvement in diamond trade in both polished and rough diamonds. This signals that diamond trade has turned the corner and we expect a further improvement in 2017.

UAE polished diamond trade improving...

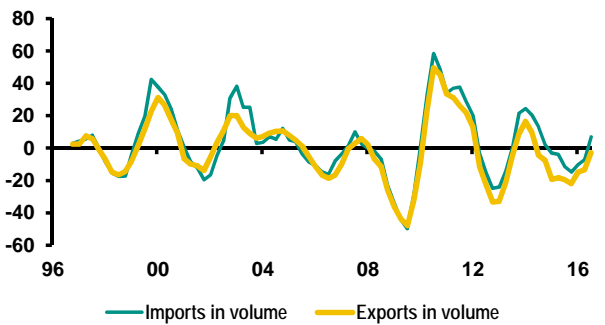
12m sum % yoy



Source: Thomson Reuters Datastream, ABN AMRO Group Economics

...as well as Israel diamond trade

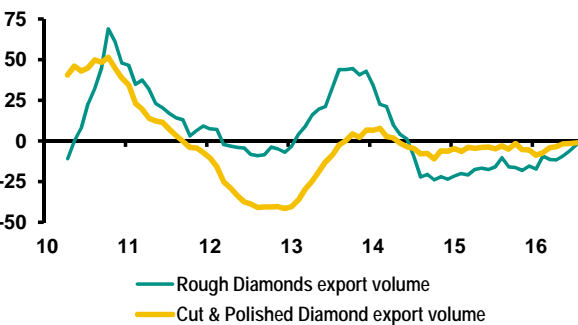
12m sum % yoy (volume)



Source: Thomson Reuters Datastream, ABN AMRO Group Economics

Strong improvement in India rough export volumes...

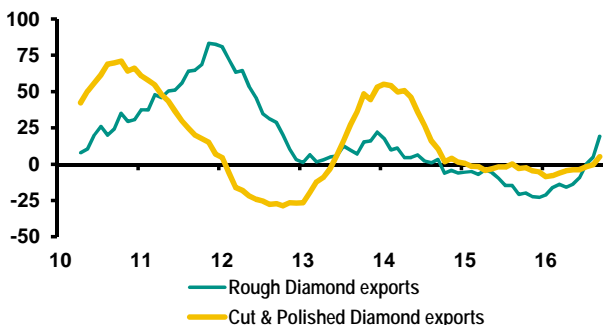
12m sum % yoy



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

... as well in value

12m sum % yoy

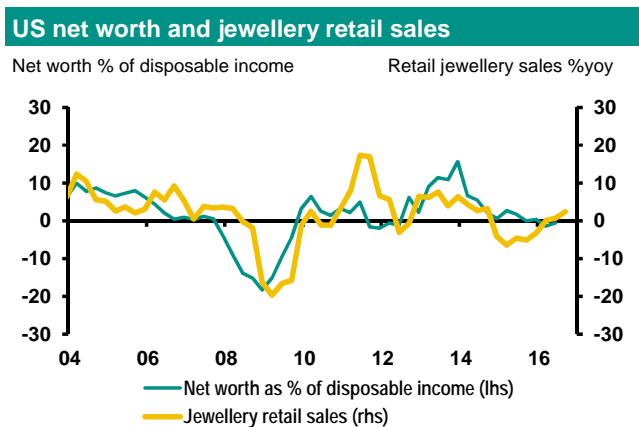


Source: Thomson Reuters Datastream, GJEPC, ABN AMRO Group Economics

India is the main cutting, polishing and manufacturing centre (90%) of diamonds world-wide. The diamond trade data for India have shown an improvement as well. It is likely that the factors behind the improvement are here to stay. Therefore, we think that diamond trade has turned the corner and that 2017 will see further improvements.

A lower savings rate in the US to support demand for jewellery...

The main markets for diamond jewellery are the US, China, India, Japan and Europe. The US is by far the largest market for diamond jewellery accounting for 30-40% of the market. Demand for jewellery highly depends on households' net worth (the value of households' assets minus their liabilities). Home equity, stocks and savings are important components of household net worth and the changes in value of these components affect an individual's financial capability to purchase jewellery. Next to this, the outlook for employment and the economy in general also plays a role. In the US there is a very clear relationship between net worth and jewellery retail sales. An increase in a household net worth fuels demand for jewellery. Demand for jewellery in the US has improved over the recent quarters.



Source: Thomson Reuters Datastream, ABN AMRO Group Economics



Source: Thomson Reuters Datastream, ABN AMRO Group Economics

Going forward we expect jewellery consumption to improve further. Our US economist expects the US savings rate to decline modestly. This reflects that the labour market will remain strong and that house prices will continue to rise at a moderate pace. We expect Mr. Trump's fiscal stimulus to increase US economic growth and to support equity markets. So we expect the main sources of net worth to remain supportive. Taken all together, we expect US jewellery sales to rise further over time.

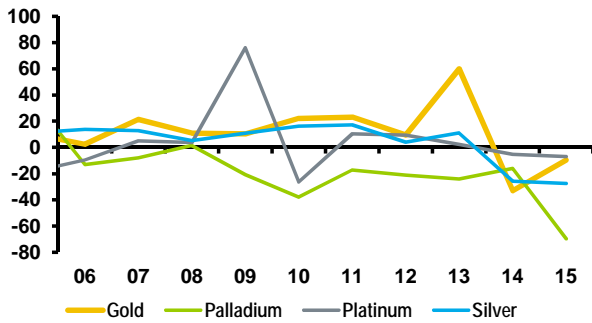
...and tentative signs of improvement Chinese jewellery demand

Overall, the trend in Chinese jewellery consumption has been negative for all precious metals. Diamond jewellery is mainly set in gold and platinum. Despite the improvement in gold jewellery demand in 2015, this demand has weakened again this year in growth terms. However, in absolute numbers Q3 2016 Chinese gold jewellery demand was slightly higher compared to Q2. Although it is still early days to conclude that Chinese gold jewellery demand has bottomed out, there are some tentative signs that the overall outlook is improving. First of all, diamond trade data show that Antwerp diamond exports to China are improving. In addition, the Chinese economy has been more resilient than investors feared earlier this year. Even though the risks of a hard landing of the Chinese economy remain, our China economist thinks that such an event is not likely in 2017. He has recently upgraded his growth forecast for 2017 from 6 to

6.5% (he expects China's slowdown to become even more gradual than before). Our China Outlook for 2017 and 2018 will be released later this week. Against this more constructive outlook, we expect the Chinese middle class to grow and diamond jewellery demand to rise over time. Moreover, it seems that the effects of the anti-corruption campaign on gold jewellery demand are fading out.

Chinese jewellery consumption is still negative...

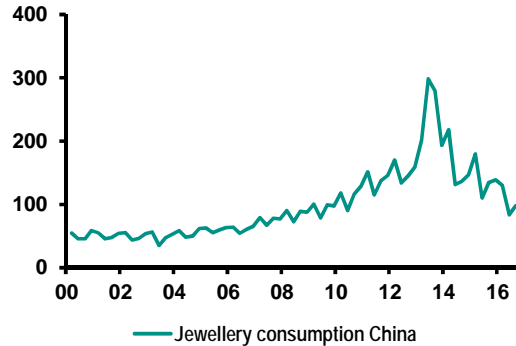
% yoy on yearly data



Source: Thomson Reuters Datastream, ABN AMRO Group Economics

...but some tentative signs of improvement

In metric ton (quarterly)



Source: Thomson Reuters Datastream, ABN AMRO Group Economics

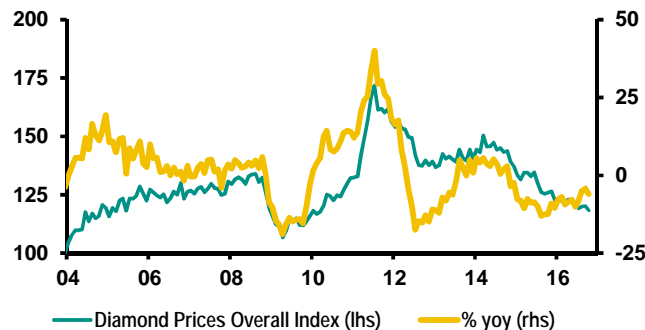
Polished diamond prices are bottoming out...

The overall diamond price index is in the process of bottoming out (see graph below). The price decline compared to 2015 is slowing down, but prices are still moving lower. This reflects that demand for polished diamonds remains weak. We expect demand for polished diamonds to pick up in 2017 driven by an improvement in US and Chinese jewellery demand. The improvement in the US economy with a strong labour market and lower fears of a hard landing in China should give consumers enough confidence to reduce savings and to spend more on luxury products such as jewellery. In addition, the sharp rise in precious metal prices in H1 2016 has been followed by a considerable decline. Precious metals are an important input cost for jewellery. It is likely that the recent decline in precious metal prices will have a dampening effect on jewellery prices. This should also stimulate consumers to buy jewellery.

Diamond indices

Diamond Prices Overall Index

% yoy

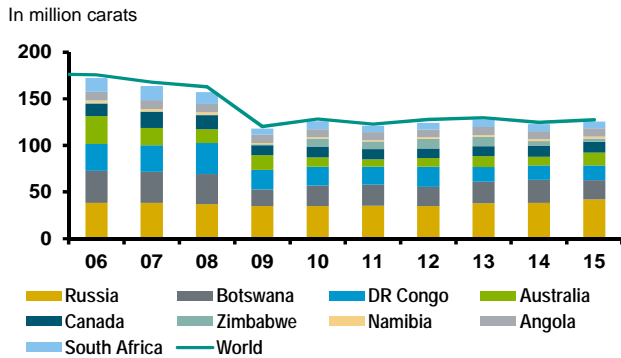


Source: Bloomberg, PolishedPrices.com, ABN AMRO Group Economics

Global diamond mine production to be stable in 2017...

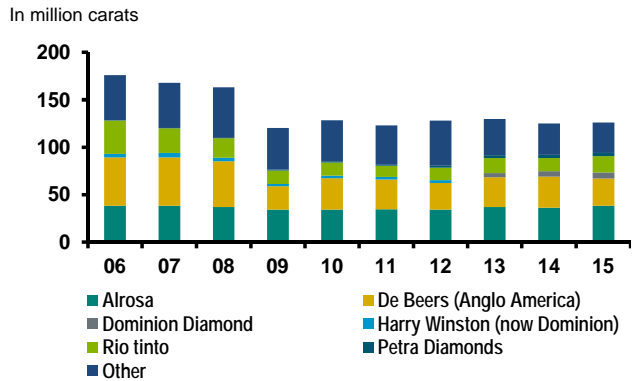
Between 2006 and 2009 global diamond production declined by more than 30%. Since then global production has stabilised close to 126 million carats. For 2017 we expect global production to remain stable at 2016 levels. However, we think that over time rough diamond production will decline on average by 1% per year. Lower ore grade, the depletion of existing deposits and the failure to find new deposits will result in lower global mine production.

Diamond production per country



Source: Kimberley Process statistics, ABN AMRO Group Economics

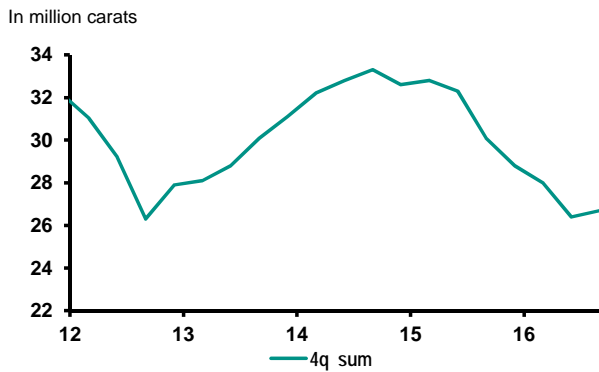
Diamond production per miner



Source: Company reports, ABN AMRO Group Economics

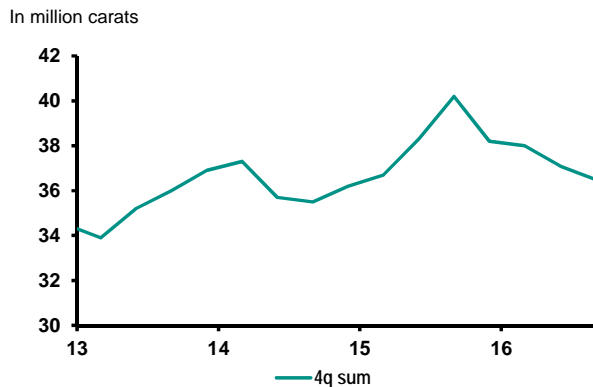
Over time, the production of lab-grown diamonds will compensate for the shortage in natural diamond mining. However, this will depend on consumer acceptance of lab-grown diamonds in jewellery. The disclosure if a diamond is lab-grown, attractive pricing and marketing will play a crucial role in the consumer acceptance of lab-grown diamonds. For 2017, these topics will play a role in the industry but the production of lab-grown diamonds will unlikely be large enough to be a dominant driver for diamond prices on an industry level.

Quarterly diamond production De Beers



Source: Company reports, ABN AMRO Group Economics

Quarterly diamond production Alrosa



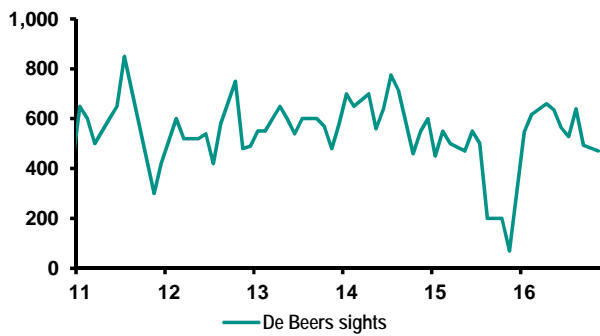
Source: Company reports, ABN AMRO Group Economics

For 2017, the behaviour of the large diamond mining companies will have a more crucial role in the direction of diamond prices. Next to this, the outlook of end-demand will also have a lasting impact on rough and polished diamond prices. In the period Q3 2014 and Q2 2016, De Beers diamond production declined (see graph above on the left). If we take the sum of the four quarters together, production approached the low set in 2012. Q3 2016 production increased by close to 5% compared to Q3 2015. De Beers has given a production guidance for 2016 of 26-28

million carats. It is likely that Q4 2016 will also see a yoy increase resulting in a further bottoming out of production. Meanwhile, Alrosa diamond production has decreased. Alrosa's production guidance for 2016 is 37 million carat. This means that Q4 production will likely be around 9.1 million carat which would be yoy increase of 5.5%. Lower production by De Beers and Alrosa in 2016 has supported rough diamond prices. Meanwhile, so far this year there has been an increase in sales at De Beers sights compared to 2015. This has been possible as the inventory overhang has been reduced and the outlook for diamond demand has improved somewhat. As a result of lower rough diamond supply and higher rough diamond demand, the composite rough diamond index rose in the first half of this year and then stabilised.

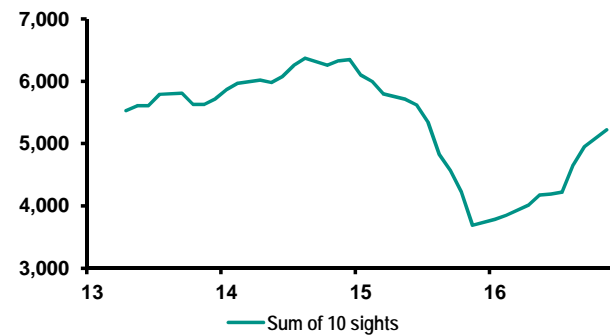
Sales at De Beers sights have strongly recovered

Sales in million US dollar



A further increase is likely if end demand improves

Sales in million US dollar



Source: www.diamonds.net, estimate

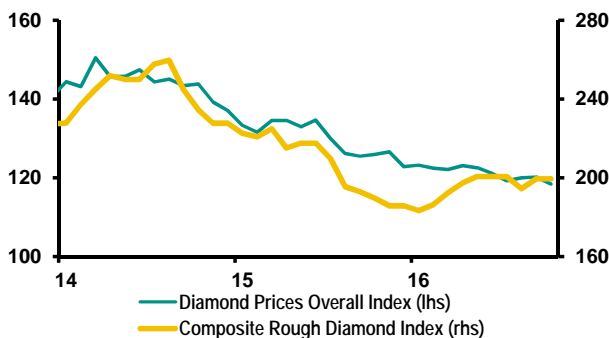
Source: www.diamonds.net, estimate

...but end demand to drive polished and rough prices slightly higher

The recent years have been dominated by the divergence between rough and polished prices. We think that we are currently at an important juncture and that price behaviour will more reflect end-demand. For a start, the lower availability of credit in the industry has resulted in a change in buyer behaviour. Buyers of rough diamonds are more price-sensitive. They will not buy rough diamonds at any price anymore as part of their own liquidity is at stake. Moreover, there also needs to be an improvement in end-demand. This means that they will only buy rough diamonds if there is end-demand or if there is a temporary price discrepancy to arbitrage. We expect a pick-up in global jewellery demand (also set with diamonds) in 2017. As a result, polished and rough diamond prices have room to increase at a modest pace.

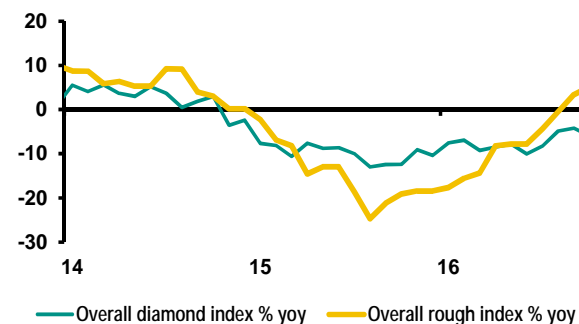
A recovery in rough prices...

Diamond Prices Overall Index Composite Rough Diamond Index



...but more upside depends on direction of polished

% yoy



Source: PolishedPrices.com, ABN AMRO Group Economics

Source: PolishedPrices.com, ABN AMRO Group Economics

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

DISCLAIMER

ABN AMRO Bank N.V., with registered office at Gustav Mahlerlaan 10, 1082 PP Amsterdam, Netherlands (AA), is responsible for the production and the dissemination of this document, which has been prepared by the individual working for AA or any of its affiliates (except ABN AMRO Securities (USA) LLC) and whose identity is mentioned in this document.

This document has been generated and produced by a FX Strategist ("Strategists"). Strategists prepare and produce trade commentary, trade ideas, and other analysis to support the FX Sales and Trading desks. The information in these reports has been obtained or derived from sources that are publicly available, such as Bloomberg and Thomson Reuters Datastream; AA makes no representations as to its accuracy or completeness. Although AA has a strict rule using only the most reliable sources, these sources might not meet that rule at all times. The analysis of our Strategists is subject to change and subsequent analysis may be inconsistent with information previously provided to you. Strategists are not part of any department conducting 'Investment Research' and do not have a direct reporting line to the Head of FX Trading or the Head of FX Sales. The view of the Strategists may differ (materially) from the views of the FX Sales and Trading desks or from the view of the departments conducting 'Investment Research' or other divisions.

This document has been prepared by AA and for the purposes of Regulation (EU) No. 596/2014 and has not been prepared in accordance with the legal and regulatory requirements designed to promote the independence of research. As such regulatory restrictions on AA dealing in any financial instruments mentioned in this marketing communication at any time before it is distributed to you, do not apply.

This document is for your private information only and does not constitute an analysis of all potentially material issues nor does it constitute an offer to buy, hold or sell any investment. Prior to entering into any transaction with AA, you should consider the relevance of the information contained herein to your decision given your own investment objectives, experience, financial and operational resources and any other relevant circumstances. Views expressed herein are not intended to be and should not be viewed as advice or as a recommendation. Any views or opinions expressed herein might conflict with investment research produced by AA. You should take independent advice on issues that are of concern to you.

Neither AA nor other persons shall be liable for any direct, indirect, special, incidental, consequential, punitive or exemplary damages, including lost profits arising in any way from the information contained in this communication.

This document is not intended for distribution to, or use by any person or entity in any jurisdiction where such distribution or use would be contrary to local law or regulation. In particular, this document must not be distributed to any person in the United States or to or for the account of any "US persons" as defined in Regulation S of the United States Securities Act of 1933, as amended.

CONFLICTS OF INTEREST/DISCLOSURES

AA and its affiliated companies may from time to time have long or short positions in, buy or sell (on a principal basis or otherwise), make markets in financial instruments of, and provide or have provided, investment banking, commercial banking or other services to any company or issuer named herein. Any price(s) or value(s) are provided as of the date or time indicated and no representation is made that any trade can be executed at these prices or values.

AA undertakes and seeks to undertake business with companies, financial institutions and public sector organisations covered in its reports. As a result, investors should be aware that AA may have a conflict of interest that could affect the objectivity of this report. AA and/or an affiliate regularly trades, generally deals as principal, and generally provides liquidity (as market maker or otherwise) in financial institutions thereof, that might be the subject of this report.

Furthermore Strategists routinely consult with AA's Sales and Trading desk personnel regarding market information including, but not limited to, pricing, spread levels and trading activity of a specific fixed income security or financial instrument, sector or other asset class.

Any graph or other illustration that is displayed in this document and includes (a comparison of) financial instruments is intended for illustration purposes only and does not contain any investment recommendation, unless otherwise stated in this document.

Trading desks may trade, or have traded, as principal on the basis of the research analyst(s) views and reports. In addition, Strategists receive compensation based, in part, on the quality and accuracy of their analysis, client feedback, Trading desk and firm revenues and competitive factors. As a general matter, AA and/or its affiliates normally make a market and/or trade as principal in securities discussed in marketing communications.

The author of this recommendation has not consulted any external party before disseminating the recommendations made in this publication.

AA has clear policies and restrictions with regard to personal account dealing, including restrictions for Research analysts from trading in any financial instruments they cover.

Publications from Group Economics are being published periodically, depending the market circumstances and are subject to change at the time of changing market conditions.

AA is authorised by De Nederlandsche Bank (DNB), the European Central Bank (ECB) and regulated by the Autoriteit Financiële Markten (AFM) for the conduct aspects of its business in the Netherlands and the Financial Conduct Authority for activities undertaken in the United Kingdom.

Copyright 2016 ABN AMRO. All rights reserved. This communication is for the use of intended recipients only and the contents may not be reproduced, redistributed, or copied in whole or in part for any purpose without express prior consent from AA. This marketing communication is not intended for distribution to retail clients under any circumstances.