ICRA Indonesia Comment

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ICRA Indonesia: Limited Impact of the Ban on Raw Mineral Export

Contact:

Pradnya Desai
Manager Analyst
desai.pradnya@icraindonesia.com

+62 21 576 1516

www.icraindonesia.com

Foreword

Effective January 12, 2014, the Government of Indonesia has implemented a ban on export of unprocessed minerals. This commentary attempts to assess the impact of the ban, keeping in perspective the objective of indigenous growth, which was the reason behind the introduction of the ban. The ban regulation itself has the following key provisions:

1. The ban would be fully applicable for bauxite, nickel, tin, chromium, gold and silver. These minerals would be required to be fully processed or refined before export. ICRA Indonesia has referred to these minerals as 'the fully banned mineral ores' during the course of this commentary.
2. Few minerals, viz, copper, iron, lead, manganese and zinc in semi-pure form have been granted a leeway as for some time these can be exported in semi-processed/ore form. ICRA Indonesia has referred to these minerals as 'the temporarily exempted mineral ores'.
3. The temporarily exempted mineral ores can be exported in unprocessed form only until 2017, after which there will be a complete ban to any export of unprocessed mineral ores.
4. The exports of the temporarily exempted mineral ores will be subject to progressive export tax until 2017. Higher export taxes will be imposed on minerals having lower levels of purification or processing. The tax would begin minimum at 20% in 2014 depending on the individual mineral and will be gradually increased so that by end 2016 it would reach 60%.
5. It is expected that the smelters would be in place latest by 2017 when the full ban would come into effect for the exempted minerals.

ICRA Indonesia has attempted to assess the impact of each of these provisions in the short-term horizon as well as perspective in the long term, and the conclusions thereof will be discussed in the following sections. Apart from the above metal minerals, the ban is also applicable for 8 non-metals including zircon, feldspar, diamond, etc and non-minerals such as marbles, granite, onyx, etc. However the scope of this commentary is limited only to the metallic minerals.

Prices of nickel and tin are appreciated

Chart – 1 Nickel spot prices

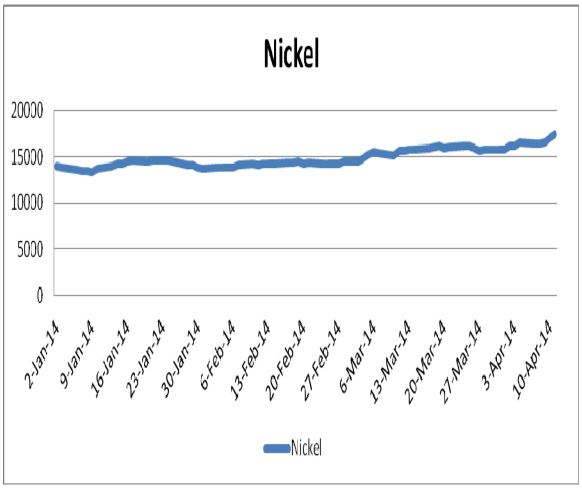
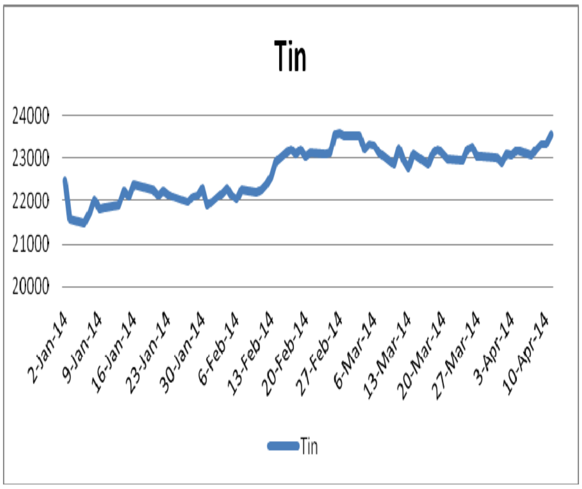


Chart – 2 Tin spot prices



Source: London Metal Exchange (LME) spot values

Subsequent to the announcement of latest provision of the ban, nickel and tin have witnessed a sharp price appreciation. Indonesia contributes 18-20% of the world nickel supplies and almost about similar amount for tin.

The world tin supplies are already in deficit with respect to demand. Indonesia's domestic smelting capacity was shut for the better part of 2012 and 2013 due to bearish tin market. During the same period, the government implemented a regime to regulate tin prices stating that all the tin trading for export must be done within a bourse called the Indonesia Tin Exchange (INATIN), a part of Indonesia Commodity and Derivatives Exchange (ICDX). Trading at INATIN also requires a compliance with the quality standards set by ICDX and INATIN. The result has been a cascading slowdown in the tin production activity itself. Thus presently, while the international tin prices have recovered following the ban on tin ore export, the miners have not scaled up production proportionately and the deficit is expected to deepen. The nickel supply too is expected to swing to deficit in 2015. Domestically, the capacity to process nickel is currently insufficient.

Given the deficit, the prices of both minerals are expected to continue to witness an appreciation in 2014 -- all the other variables remaining constant. Nickel is expected to moderate over the medium term until larger smelting capacities are built, as compared to tin, which may moderate earlier if the tin smelters scale up the production from the existing. However, since most of the upcoming nickel smelting plants are at drawing board stage, the availability of additional capacity by 2017 shall be subject to how soon the execution takes place.

Prices of other minerals to appreciate over the long term

The other minerals such as aluminum, copper, zinc and lead did not show any immediate trend or price impact so far after the declaration of ban.

Chart – 3 Aluminium Spot prices

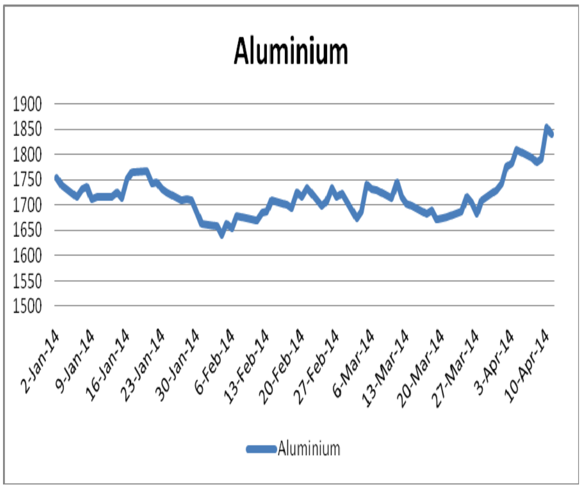


Chart – 4 Copper Spot prices

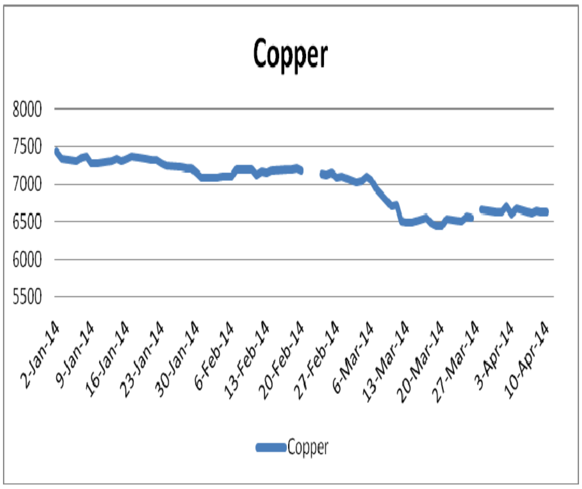


Chart – 5 Zinc spot prices

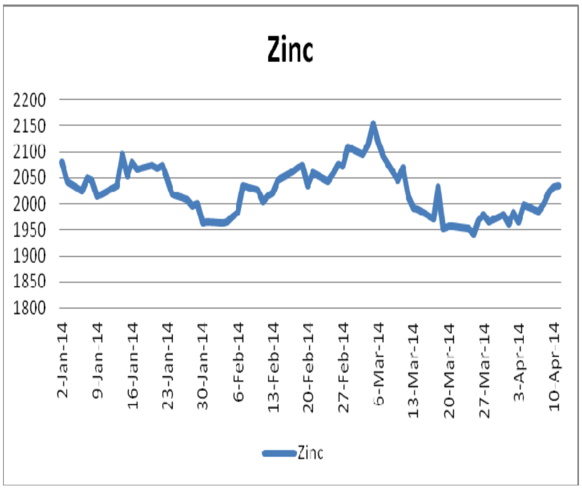
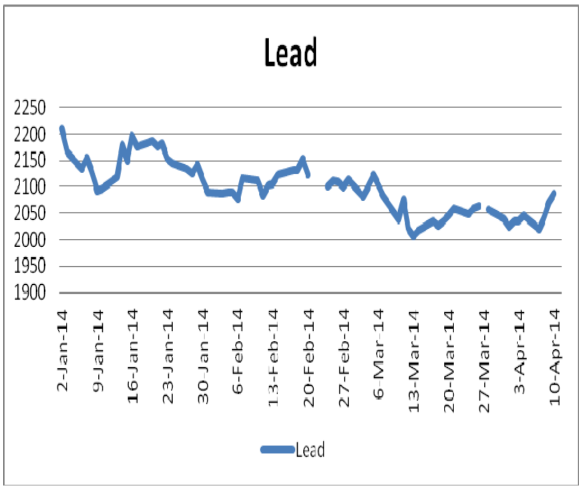


Chart – 6 Lead spot prices



Source: LME spot prices (values for lead and copper were unavailable for February 21, March 27 and April 11, 2014)

The prices of the four above minerals initially rose in reaction to the declaration of the ban, however have subsequently corrected. Aluminum prices which had seen corrections due to oversupply have subsequently improved somewhat on the possibilities that the players may reduce the output. Prices of zinc, lead and copper have in fact reduced on account of supply-demand mismatch. This also factors in the lower demand from countries such as China following the economic slowdown. However, as the world economy recovers and the demand increases, there is a fair chance that the output gap resulted out of Indonesia's export ban would lead to appreciation in these minerals as well.

According to the Indonesian mining association, the present domestic cost environment is not in favour of lead, zinc and copper smelting plants, and hence large smelting capacities for these minerals may not be built. Copper, zinc and lead have been temporarily exempted from export ban. However, the exporters have to pay additional export duty. Thus, these exports could also be costlier as compared to competitors in the international market. As a result, the deficit created by Indonesia would impact the demand-supply equation gradually. Overall, the mining activity of these minerals would reduce until such time the smelters are commissioned.

In the above discussion, we have not covered price impact on gold and silver because their prices also are largely subject to other variables such as USD currency movements and world macroeconomic developments.

Limited impact on exports

While overall share of mining sector to Indonesia's exports in year 2013 was around 32%, the non-energy based mining contributed only up to 4% of total exports (FOB value as per Bank Indonesia's data). This puts the relative importance of non-energy mineral exports in perspective. Overall, on a relative basis, the export ban on these minerals therefore will have a limited impact. Presently, the breakup of all mineral exports is not available. However, the following were the main export categories under non-energy minerals for year 2013.

Table 1 – Export contribution of non oil and gas minerals

Mineral	Copper ore	Nickel Ore	Bauxite	Other mining	Total	Per Month	Per Month (fully banned)
USD Million	3,122.6	1,685.8	1,318.7	592.6	6,719.7	559.9	250.4 (A)
Volume ('000 Ton)	1,420.0	64,839.0	55,557.0	32,881.0	154,697.0	12,891.4	10,033
USD/Ton	2,199.0	26.0	23.7	18.2	NA	NA	NA

(Source: BI data)

Out of the above, nickel and bauxite are fully banned minerals ores, whereas copper is temporarily exempted. Therefore, the likely impact on nickel and bauxite ore exports would be 100% or USD 3.0 billion in the above case (USD 250.4 million per month).

In case of copper, two foreign players, PT Newmont Nusa Tenggara and PT Freeport Indonesia constitute about 97% of ore production. Freeport's total share in domestic copper production is 73%, while Newmont's is 24%. Out of their total production, Freeport processes about 40% domestically while the figure for Newmont is about 23-25% both are through the smelter facility in Gresik, and the rest is exported. Recently, Freeport has indicated a reduction in its production by 60%. This 60% refers to the copper ores that are being exported. Newmont is yet to release a statement though. To assess an impact range of the ban, following scenarios can be considered as an example, assuming the duty is levied on the price of concerned minerals. In short, for every percent reduction in the copper export, the corresponding reduction in exports would be USD 30.3 million, based on the value of 97% of total ore exports (as contributed by Freeport and Newmont jointly), which amount to USD 3,028.9 million.

Table 2 – Various export scenarios in case of levy of 25% export duty

Scenario	Shortfall of exports at 2013 average prices (USD million)	Per month shortfall (USD million)	Export duty 2014 (USD million)
If 100% of copper ore export by PT Freeport and PT Newmont is discontinued	3,028.9	252.4(B)	-
If 15% of copper ore export is made by PT Freeport and PT Newmont	2,574.6	214.5	72.4
If 40% of copper ore export is made by PT Freeport and PT Newmont	2,257.0	188.1	193.0
If entire copper ore is still exported by PT Freeport and PT Newmont	-	-	482.4

(Source: ICRA Indonesia's estimates)

While the relative share of non-energy mineral exports is not a significant portion of the total exports, in absolute term it will definitely impact the trade balance. However the impact will be limited. Further, there have been talks to lower the duty up to 5-10%. That will lead to a further reduction of the shortfall gap as well as export duty collection.

Short-term impact on trade balance and forex reserves

The impact on trade balance will in turn have a consequence in foreign exchange (forex) reserves. The month of January 2014 saw a trade deficit of USD 440 million as compared to a surplus of USD 400 million in the month of December 2013. This is mainly attributed to the raw mineral export ban which was implemented mid month and the floods in various parts of the country which dampenedexport activities. Going forward, over 2014, the likelihood of an impact within range of up to USD 500 million per month is reasonable based on the above numbers (A+B from the tables). However this range considers extremes of 100% or nil export of copper compared to previous levels. Hence, on average basis, an impact of USD 375-400 million per month is more likely. This gap is likely to reduce over 2017 on account of various smelting capacities that would get added and also of the sales of temporarily exempted mineral ores that may take place under export duty obligations, especially for the minerals that are likely to witness supply deficit. Factors such as recovery in the IDR-USD rate and the price trend in the international markets will also impact this equation.

Overall, the trade deficit on account of the raw mineral ban translates into a similar type of impact on the forex reserves. However, the forex numbers will also get impacted by various other factors such as value of imports (which in turn would depend on IDR value), USD debt issues, the level of foreign direct investment (FDI), comparative position as international investment destination, etc. The forex reserves stood at USD 102 billion at the end of February, which was in fact an increase of 1.6% over the previous month. The gap resulting out of the ban imposed in January 2014 was countered by reduction in imports as well as increase in Indonesia's attractiveness as an investment destination. If going forward such situation continues, then the impact of gap on the forex reserves will be muted.

Medium-term recovery expected on the basis of upcoming smelting plants

As per Indonesia Investment Coordinating Board (BKPM), around 25 smelting plants are under construction whereas 3 are ready to be commissioned in year 2014. Of these 25 plants, 3 are bauxite, 5 are iron ore, 14 are nickel smelters and 3 are copper smelters. An amount approximating to IDR 150 trillion (USD 12.4 billion) will be invested in the development. Additionally, by now, about 253 mining license (IUP) holder companies have signed a smelter development pact. Of these, 178 have submitted proposals to build smelters. However, only 112 have conducted a feasibility study, while only 28 (of the 112) have requested for permission to the BKPM to start construction of the smelters. These plants would not only support the medium term capacity build up, but also contribute to the FDI and domestic capital formation.

Long-term impact on FDI however is less significant

FDI is one area where there could be adverse impact too. The stipulation of the law that foreign players cannot be majority shareholders in a mining company will likely act as a deterrent to the inflow of FDI in mining, which would also be required to build smelting capacities. In addition, the existing majority shareholding will have to be reduced. Presently however, the adverse macroeconomic conditions elsewhere in the world have prompted investors to route their investments to Indonesia. The BKPM data above also confirms it. As a result, while mining is likely to suffer as a sector, net FDI inflows are less likely to reduce significantly. FDI investment in year 2013 was IDR 270.4 trillion, an increase of 22.4% over the previous year. For year 2014, the targeted increase is 15% keeping election year in mind. While the foreign players are expected to reduce their stakes gradually, the investment in smelters is expected sooner and hence, overall, the specific impact on the ban of unprocessed minerals in FDI will not be immediately felt in the near term.

Since the contribution of non-energy minerals remains limited to the national GDP, the export ban impact will be limited and felt in particular by its own stakeholders. While initial hiccups are expected in the implementation of the ban that shall have impact even on the macro variables, a medium term improvement is expected, which will also pave the way for the long term fundamental development of the economy. Especially considering the huge price gap between current international prices of minerals at a given purity level as compared to the ore forms, smelting capacities will definitely be a huge contributors to the national income over the long term.

Other important variables that need further clarity

While the likely impact of the ban regulation on the above factors can be assessed, below are variables that in ICRA Indonesia view need further clarity from the government:

1. Detailed mechanism of export of exempted minerals under new duty structure
2. Regulations with respect to treatment of employees as the mining activity is expected to reduce until the smelters are commissioned.
3. Support/steps to be taken by smaller and marginal miners who may not have the resources to set up smelting facilities
4. Environmental norms to be laid for the new smelters.

While ICRA Indonesia generally sees the impact of the ban is limited, the above variables could change the quantum of the total impact in the overall economy.

Conclusion

1. The raw mineral ban will lead to gradual appreciation of all the banned minerals as the global demand recovers. In the short run, the minerals currently in deficit supply such as tin and nickel would continue to appreciate.

2. Over the short run, trade balance is likely to be affected till the economy is able to counter the impact of lower raw mineral exports by increasing other exports / reducing imports. On average, such an impact is likely to range between USD 375-400 million per month.

3. The ban is likely to adversely impact FDI in mining over the long term considering several disincentives. However, on a net basis, the FDI is not likely to be significantly affected, given the fact that the investors are routing investments into Indonesia on account of present adverse economic conditions elsewhere.

4. The raw mineral ban will have a limited impact on the overall economy given the limited contribution of non – fuel minerals to the overall GDP.

5. There are some variables need further clarity from the government, including the operational implementation of various provisions of the new law, directives with respect to possible layoffs (if any), directives for smaller and marginal miners who may not have the resources to set up smelting facilities as well as environmental norms for the new smelters. These variables could change the quantum of the total impact of the ban in the overall economy.