

Not just price of platinum to blow

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Right at the moment when we really didn't need another gasket to blow in the economic-financial engine, one has. This time it isn't a leveraged, insured, hedged, guaranteed, recapitalised, disclosed, rated, structured, financial "asset".

It's a real world process: the mining and refining of platinum. Leverage, or the dependence of a lot of stuff on a little bit of stuff, is a property not only of balance sheets, but of industrial processes. Without sufficient platinum, it is not possible to produce automobiles, trucks, and diesel engines that can be sold in North America, Europe, Japan, and much of the rest of the world. The catalytic converters required by environmental laws do not work without it. And right now, we are on a clear track to running short of the platinum needed to maintain, let alone increase, the production of gasoline and diesel engines.

The problem is the chronic electricity shortages in South Africa. All of the greenhouse gases produced last month by the conferees in Davos did not result in this problem being "addressed", as their organisers would put it. Now the only way to maintain existing clean air standards in the developed world is to build and operate, as rapidly as possible, a series of new coal-fired power stations to supply the country's mines and refineries.

That won't happen until 2012 at the earliest. In the meantime, the already absurdly high platinum price (up more than 40 per cent from a year ago), probably has to rise even higher to squeeze demand out of less critical applications such as jewellery. You can expect some fallback in the current price as you read headlines about South African mines and refineries restarting, reassurances from government ministers and electricity supremos, and so on. That correction won't last, at least in the absence of a collapse of auto and diesel production. For one thing, the very speculators who will help with this price-rationing process will set aside more stocks with which to trade, which will also reduce usable supply.

Substitutions? More efficient use? Already thought of that. Platinum has been very expensive for a long time, which is why they name credit cards after it. Engineers have been making incremental reductions in platinum content for

years, and they will continue to do so. Slowly. The stuff is just too useful as a catalyst, which means it helps promote a chemical reaction, such as breaking down pollutants, without itself being consumed in the process.

South Africa's mines and refineries supply nearly 80 per cent of world production. In the rest of the world, for the most part, platinum is supplied as a by-product of mines principally supplying nickel, palladium, and other metals. That makes it hard to increase alternative supplies, even if the mining engineers and skilled workers were available, which they aren't.

How did South Africa, and the platinum industry, wind up in this mess? Apart from what could be easily mistaken for pure ineptitude on the part of the responsible ministries and the management of Eskom (the electricity utility), the country made a huge bet on the rapid development of hydroelectric resources in neighbouring countries. The state was strongly encouraged to do so by its political supporters among international organisations and foreign governments, since the alternative, coal-fired power, was not environmentally acceptable. The hydroelectric developments, principally around Inga Falls on the Congo River, would have been ambitious even if the political stability and engineering skills existed.

So it's back to the drawing board, and on the drawing boards are going to be a series of coal stations. Power rationing plans have been devised, which now call for a reduction of 10 per cent in electricity use by key industrial customers.

That's worse than it sounds, by the way. You don't make up for cutbacks on that scale in a metals operation by using compact fluorescent bulbs. In the short term, at least, power cutbacks will lead to disproportionate cutbacks in metals production. The very deep mines need to be constantly pumped, cooled, and maintained, lest they flood or collapse. So it is likely that ore will be piled up next to the refineries. The ore can only be used as doorstops or paperweights; to get platinum products you need the refineries.

Michael Jones, the president of Platinum Group Metals, which is building two new platinum projects in South Africa, says: "We can use diesel generation for mining our relatively shallow ounces [of reserves]. As a practical matter you cannot do that with smelting. This [power crisis] will obviously have an enormous impact both in gold and platinum. There is a new engineering factor which has to be taken into account, which is megawatts [of power] per ounce."

There is another interesting possible impact on markets from the power cutbacks. A lot of South African gold production has been hedged through short sales. It may be the case that the banks who lent the gold for the short sales have suggested that the cutback-plagued mines cover their short sales with open market purchases. That could have fuelled part of the gold pop in recent weeks.

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