IRON ORE ROYALTY REVENUE

- Iron ore royalty revenue is expected to decline from a peak of almost $5.5 billion in 2013-14 (19.5% of total general government revenue) to $3.0 billion in 2015-16 (11.5% of total revenue).
- The sharp contraction in iron ore royalties is due to a dramatic fall in the iron ore price, which is expected to average $US68.80 per tonne in 2014-15 and $US47.50 per tonne in 2015-16, compared to an average of $US122.80 per tonne in 2013-14.
- The impact of the sharp fall in the iron ore price on royalty income is only partially offset by higher production volumes and a lower $US/$A exchange rate.

Table 1

IRON ORE ROYALTY INCOME

	2013-14 Actual	2014-15 Estimated Actual	2015-16 Budget Estimate	2016-17 Forward Estimate	2017-18 Forward Estimate	2018-19 Forward Estimate
Forecast assumptions						
– Iron ore price ($US per tonne)[a]	122.8	68.8	47.5	50.7	56.3	61.8
– Production volumes (million tonnes)[b]	632	716	748	772	797	799
– $US/$A exchange rate (US cents)	91.8	83.3	75.9	75.0	74.3	73.9
IRON ORE ROYALTY INCOME ($ MILLION)	**5,450**	**3,853**	**3,036**	**3,392**	**3,936**	**4,351**

(a) The iron ore price benchmark used by Treasury is 'The Steel Index' 62%Fe, delivered to China (including 'cost and freight' or CFR). Projections are derived from iron ore derivatives over the first 12 months, then transition towards a consensus long-term price over the remainder of the forecast period.

(b) Iron ore volumes are informed by a survey of producers undertaken by the Department of Mines and Petroleum and independent (external) analysis.

Source: Reuters Datastream, Consensus Economics, Department of Treasury.

Factors Contributing to Price Fall

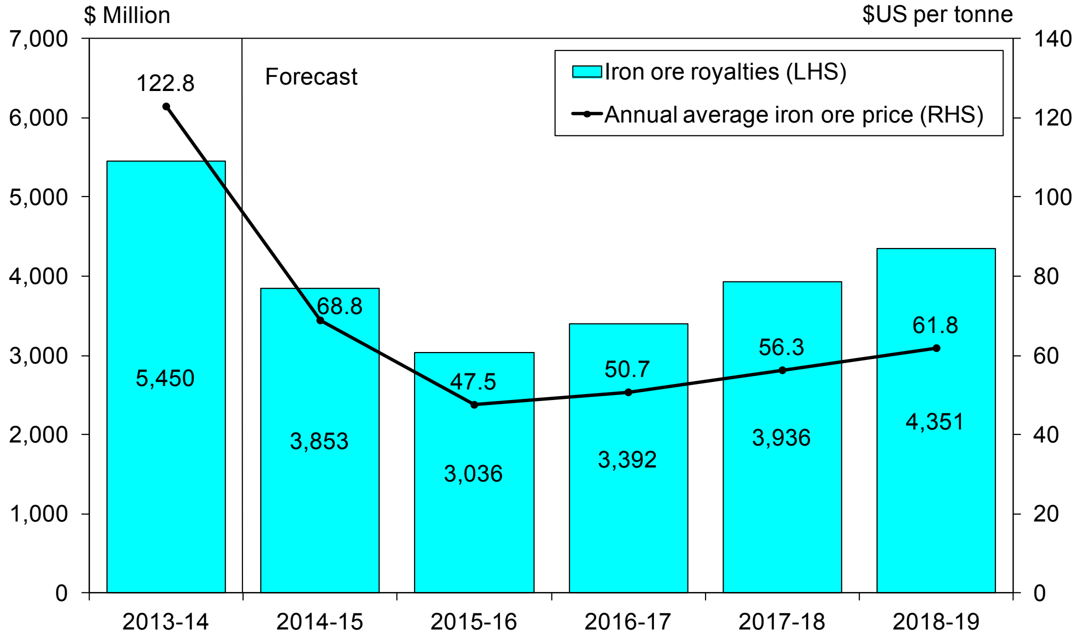
The benchmark iron ore price has fallen by more than 60% from around $US135 per tonne at the beginning of 2014 to a low of $US46.70 per tonne in early April 2015, its lowest level since 2004. By 21 April 2015 (the 2015-16 Budget cut-off date), the spot price of iron ore had recovered marginally to $US50.80 per tonne. The substantial fall in price has been due to:

- a significant increase in production by the world's largest iron ore producers (Vale, Rio Tinto, BHP Billiton, Anglo American and FMG), which collectively increased sales by more than 140 million tonnes in 2014. This equates to around 10% of the global seaborne market in 2014;
- expectations of further increases in production as new mines are constructed and production expansions are completed. These include construction of the world's largest iron ore project (Vale's 90 million tonne per annum S11D project); and
- a softening in Chinese demand for iron ore arising from a decline in domestic steel consumption, which in turn is a result of a slowdown in Chinese residential property construction. New residential building construction starts declined by 14.4% in 2014. In 2015, new house prices and residential construction have continued to decline.

The strong growth in new low-cost supply in excess of demand has resulted in significant oversupply in the iron ore market. A significant proportion of global supply has become uneconomic at the lower price and some higher cost production has been displaced, including output from Chinese domestic producers.

Figure 1

IRON ORE PRICE ASSUMPTIONS AND ROYALTY INCOME



Source: Reuters Datastream, Consensus Economic, Department of Treasury.

Changes to the Iron Ore Forecasting Methodology

The Department of Treasury (Treasury) has revised the starting point of its iron ore price forecasting methodology to provide a market-based assessment of the outlook for prices in the near-term. The new starting point comprises 12 months of iron ore derivative contract prices rather than the previous method of an annual average of historical spot and derivative prices.

The resulting profile of price assumptions better represents the large fall in iron ore prices over the past year and reflects the widely held belief that the iron ore market has moved firmly into oversupply and will stay there for some time.

The price assumption of $US47.50 per tonne in 2015-16 is also consistent with Standard and Poor's latest iron ore price forecast of $US45 per tonne for the rest of 2015 and $US50 per tonne in 2016.

Iron Ore Production Volumes

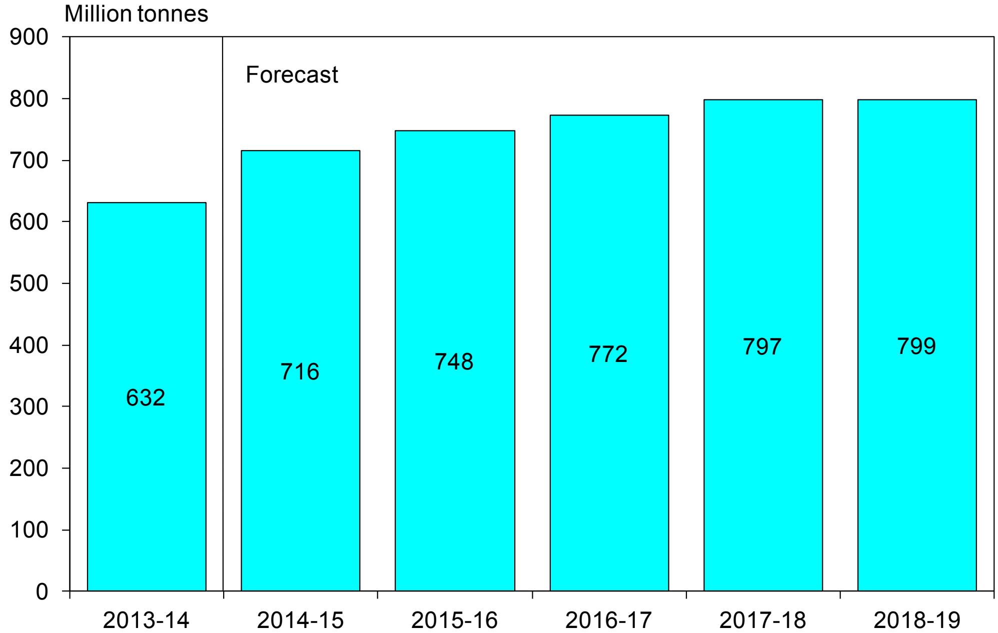
The expansion of the three largest iron ore miners, Rio Tinto, BHP Billiton and FMG, has resulted in a substantial increase in Western Australian iron ore production volumes. This is expected to far outweigh declines in output due to announced and potential closures of smaller higher cost operations. The three largest miners are expected to account for 92.8% of production volumes in 2014-15, and 94.2% of royalty income.

Iron ore volumes are forecast to increase from 632 million tonnes in 2013-14 to 716 million tonnes in 2014-15 and 799 million tonnes by 2018-19.

The increased volumes, together with a projected gradual improvement in the iron ore price and a lower $US/$A exchange rate, are expected to increase iron ore royalty revenue to around $4.4 billion by 2018-19.

Figure 2

IRON ORE VOLUME PROJECTIONS



Source: Department of Mines and Petroleum, Department of Treasury.

Royalty Rebate Scheme

On 19 December 2014, the State Government announced that it will provide financial assistance for eligible small iron ore (hematite) miners. Under the program:

- assistance will be provided as a rebate of 50% of royalty payments on eligible hematite iron ore projects. This assistance is to occur through ex-gratia payments after the Department of Mines and Petroleum (DMP) receives actual quarterly royalty payments. The royalty will continue to be paid under applicable legislation;
- the rebate will be available for a period commencing with the royalty payment for the December 2014 quarter and concluding with the September 2015 quarter; and
- the rebate must be repaid by 31 December 2017.

As at the 2015-16 Budget cut-off date, one company, BC Iron, had reported that it has secured the rebate to the Australian Stock Exchange.