

RAPAPORT MONTHLY REPORT

www.diamonds.net

August 2016

Seasonal Quiet and Slow Demand

Executive Summary

The diamond market was quiet in July as trading typically slows in the summer months. But, seasonality aside, dealersexpressed concern that the market contracted this year, with sluggish demand underpinning a rise in polished inventory and narrower profit margins.

Polished prices slipped in July, extending the downtrend that has been entrenched since April and reversing the gains made in the first quarter. The RapNet Diamond Index (RAPI™) for one carat polished diamonds fell 1.7 percent. RAPI for 0.30-carat declined 1.8 percent, while RAPI for 0.50-carat slid 0.5 percent. RAPI for 3-carat diamonds retreated 1.5 percent (see Figure 1).

In the first seven months of 2016, RAPI for 1-carat diamonds fell 1.1 percent, while the index has dropped 4.7 percent from one year ago (see Figure 2).

Miners, manufacturers and jewelers have struggled to keep their stock levels in balance after the unusual shifts in inventory seen last year. Miners continued to cut their stockpile of rough, while manufacturers have replenished their polished inventory.

Throughout this year, the market has been characterized by subdued polished trading, increased rough sales, lower rough-mining production, and cautious consumer demand for diamond jewelry.

This report demonstrates those trends by presenting data, along with intelligence gathered by Rapaport Research, about all three market segments: *polished*, *rough* and *retail*. We expect conditions to remain cautious in the second half, requiring manufacturers to maintain a fine balance between rough purchases and polished sales.

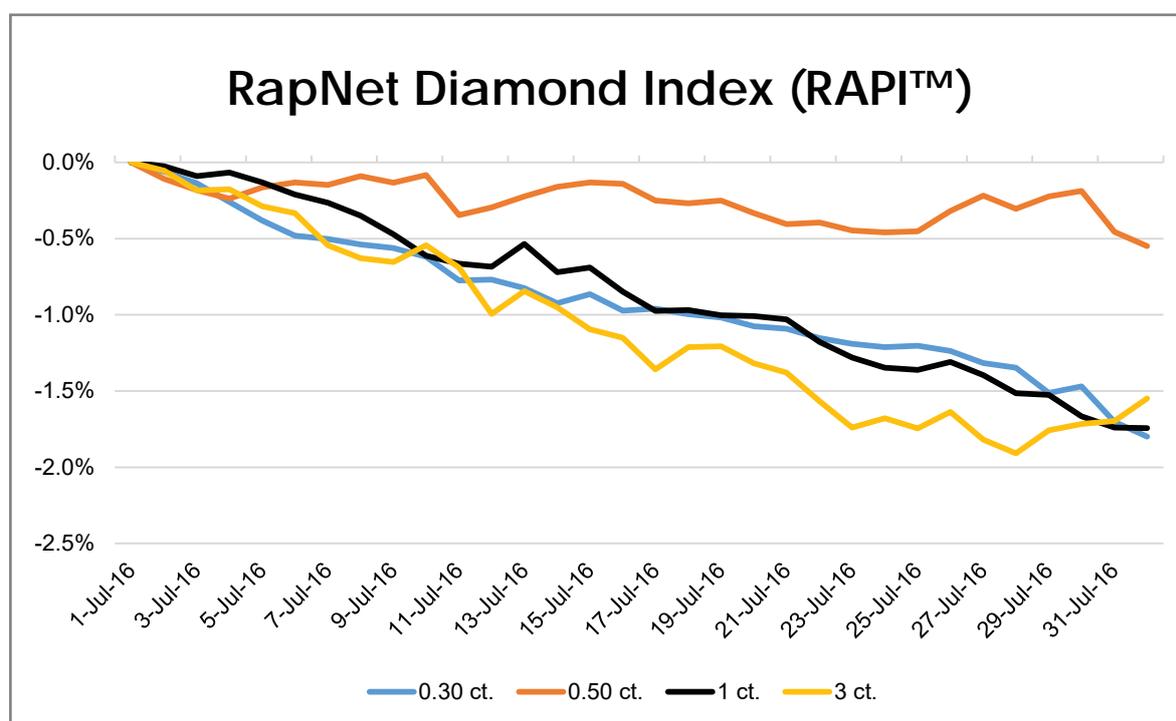


Figure 1

The RapNet Diamond Index (RAPI™) is the average asking price in hundred \$/ct. of the 10 percent best priced diamonds, for each of the top 25 quality round diamonds (D-H, IF-VS2, GIA-graded, RapSpec-A3 and better) offered for sale on RapNet - Rapaport Diamond Trading Network.

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The Polished Market

The polished market was particularly quiet in July as slower demand was compounded by the U.S. wholesale market shutting down for the annual summer vacation period.

Dealers lack the confidence to buy in a market that's trending down as prices continued to soften. Buying was limited to filling orders rather than retailers building up inventory.

Stock levels increased as polished trading slowed. In addition, the large volume of rough bought in the first quarter has been manufactured and now become available as polished. Manufacturing stabilized at an estimated 70 percent of capacity this year.

The number of unique diamonds listed on RapNet, Rapaport's diamond trading network, increased 20 percent since the beginning of the year. There was a particularly strong rise in the stock levels of

Polished Headlines

- ❖ India 1H polished exports -3% to \$10.8B, polished exports -30% to \$1.4B.
- ❖ Israel 1H polished exports -14% to \$2.6B, polished imports -10% to \$1.6B.
- ❖ Belgium 1H polished exports -8% to \$6.7B, polished imports -10% to \$6.5B.
- ❖ U.S. May polished imports +2% to \$3.1B, polished exports -1% to \$1.4B.
- ❖ U.S. government guarantees Barclays Bank \$125M loan facility for Botswana manufacturing.
- ❖ Morgan Stanley predicts lab-grown diamonds to pressure melee prices and capture 15% of melee market.
- ❖ Stéphane Fischler re-elected president of AWDC, elected vice-president of World Diamond Council.

RapNet Diamond Index (RAPI™)			
	July	YTD January 1 - August 1	Y2Y Changes at August 1
RAPI 0.30 ct.	-1.8%	0.0%	2.1%
RAPI 0.50 ct.	-0.5%	3.5%	2.0%
RAPI 1 ct.	-1.7%	-1.1%	-4.7%
RAPI 3 ct.	-1.5%	-9.8%	-16.4%

Figure 2

The RapNet Diamond Index (RAPI™) is the average asking price in hundred \$/ct. of the 10 percent best priced diamonds, for each of the top 25 quality round diamonds (D-H, IF-VS2, GIA-graded, RapSpec-A3 and better) offered for sale on RapNet - Rapaport Diamond Trading Network.

0.30-carat diamonds on RapNet – up 47 percent since January – with excess supply placing additional pressure on prices

Reduced Polished Trading

Recently published data showed activity in the major trading centers – India, Belgium and Israel – contracted in the first half of 2016. Polished exports and imports through these centers declined in each of the past three half-year periods, according to Rapaport records (see Figure 3).

Belgium's exports to each of its largest markets fell in the first half, including to the U.S. (-5 percent), Hong Kong (-17 percent), Israel (-5 percent), India (-22 percent), and Switzerland (-3 percent). Exports to the United Arab Emirates (UAE) were flat.

Similarly, imports from those markets to Belgium slid, with inbound shipments from the U.S. down 3 percent, Hong Kong (-13 percent), Israel (-15 percent), India (-4 percent), and Switzerland (-10 percent). Imports from the

United Arab Emirates (UAE) rose 1 percent.

The U.S. remains the strongest market with steady demand for 1 to 2 ct, G-H, VS-SI diamonds. However, jewelers are insisting on memo rather than buying inventory. Demand in the Far East is cautious, as the retail expansion in China has stagnated and luxury sales in Hong Kong have slumped (see retail section).

Buyers are selective and seeking out the finest cut, commercial-quality diamonds (RapSpec A2). Premiums have increased for triple EX diamonds – excellent cut, polish and symmetry – over lesser-quality goods.

The midstream manufacturers and dealers continue to endure a slow summer and are hoping the September Hong Kong show will signal a return to normalized activity. Subsequently, the fourth-quarter holiday season will take on additional importance as the industry is expected to ramp up its marketing activity to boost demand for diamond jewelry.

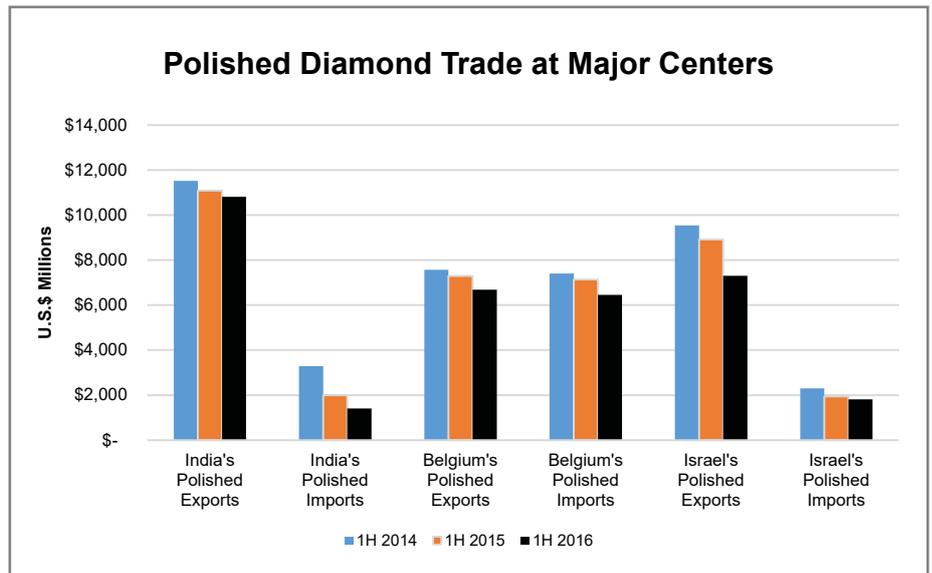


Figure 3

Based on monthly data published by India's Gem & Jewellery Export Promotion Council (GJEPC), Belgium's Antwerp World Diamond Centre (AWDC), and Israel's Economy Ministry. All data is gross exports before returns.

The Rough Market

Increased Rough Sales

Rough demand remains well above last year's levels and the mining companies reported higher sales in the first half. That enabled them to reduce inventory built up in 2015, with a larger quantity of goods sold at lower prices.

De Beers sales volume jumped 29 percent, while the average price at its sales fell 14 percent from a year earlier. The company's rough price index declined 8 percent in the first half. De Beers said it reduced the value of its inventory by \$500 million to about \$1 billion as at June 30.

ALROSA reported similar trends in its half year. The Russian miner saw sales volume increase 21 percent, with the average price of gem-quality diamonds down 7 percent over a year ago. ALROSA reduced its inventory by approximately 4.8 million carats

Rough Headlines

- ❖ De Beers 1H rough sales +11% to \$3.1B, underlying earnings +5% to \$379M production -15% to 13.3M cts., prices -14% to \$177/ct.
- ❖ ALROSA 1H production -16% to 16.9M cts., sales volume +21% to 21.7M cts., prices -3% to \$117/ct.
- ❖ Rio Tinto 1H production +2% to 8.96M cts.
- ❖ Petra Diamonds FY sales +1% to \$431M, production +16% to 3.7M cts.
- ❖ Letseng 1H sales flat at \$106M, prices -16% to \$1,899/ct.
- ❖ Okavango 1H rough sales +23% to \$284M, volume +35% to 1.75M cts.
- ❖ India 1H rough imports +12% to \$8.5B, rough exports +8% to \$737M.
- ❖ Belgium 1H rough imports 2% to \$6.5B, rough exports +5% to \$6.7B.
- ❖ Israel 1H rough imports flat at \$1.6B, rough exports +2% to \$1.4B.
- ❖ Stomway launches ore process at Renard mine, raises \$63M.
- ❖ Russia sells 10.9% stake in ALROSA for \$818M.

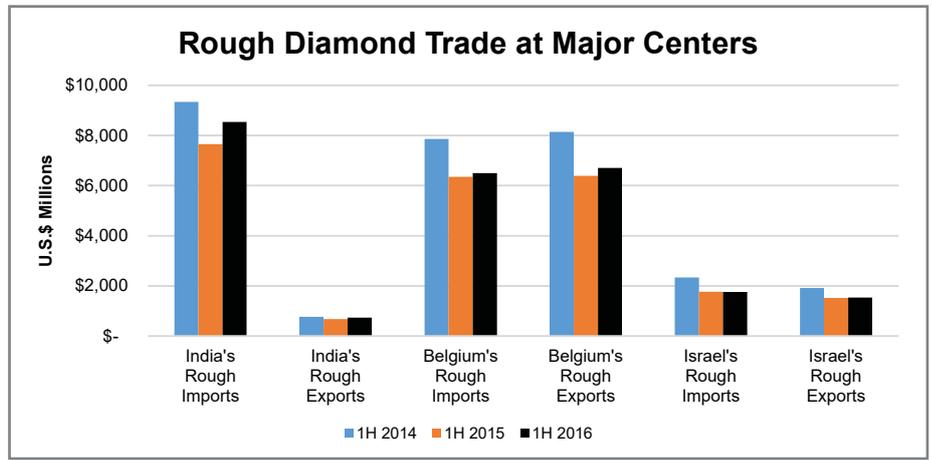


Figure 4
Based on monthly data published by India's Gem & Jewellery Export Promotion Council (GJEPC), Belgium's Antwerp World Diamond Centre (AWDC), and Israel's Economy Ministry. All data is gross exports before returns.

Rough trading improved after manufacturers cut polished inventories by scaling back manufacturing toward the end of last year. Therefore, in the first half of 2016, rough imports by the major manufacturing and trading centers—India, Belgium and Israel—increased (see Figure 4).

The rough market slowed in July, with De Beers and ALROSA citing seasonality as contributing factors. Trading on the secondary market was stable, with boxes trading at slightly lower premiums.

We expect De Beers and ALROSA to continue to record growth in the second half given the lower-base comparisons in the final six months of last year. However, the market is expected to remain cautious as the midstream is determined to avoid an unnecessary buildup of inventory.

Lower Production

De Beers has reduced its production program accordingly. First-half production fell 15 percent (see Figure 5) and the company put the Damtshaa mine in Botswana and the Snap Lake mine in Canada

on care and maintenance, while it sold the Kimberley Underground operation in South Africa.

ALROSA's production fell 16 percent in the first six months indicating a shift in strategy. The Russian miner maintained production growth in 2015 despite a slump in market conditions, arguing it was more cost effective to hold inventory than scale down operations. However, the company subsequently cut its production guidance for this year to 37 million carats. Rio Tinto's production rose 2 percent in the six months as it ramps up underground operations at its Argyle mine, but it also cut its production guidance for the year.

Three new mines coming on stream in the fourth quarter will partially offset the decline in production by the majors.

The revised production plans reflect a cautious outlook among diamond miners for the rest of 2016 and next year. As rough demand tends to slow in the second half, they're likely to end the year still holding excess inventory – albeit at more efficient levels than seven months ago.

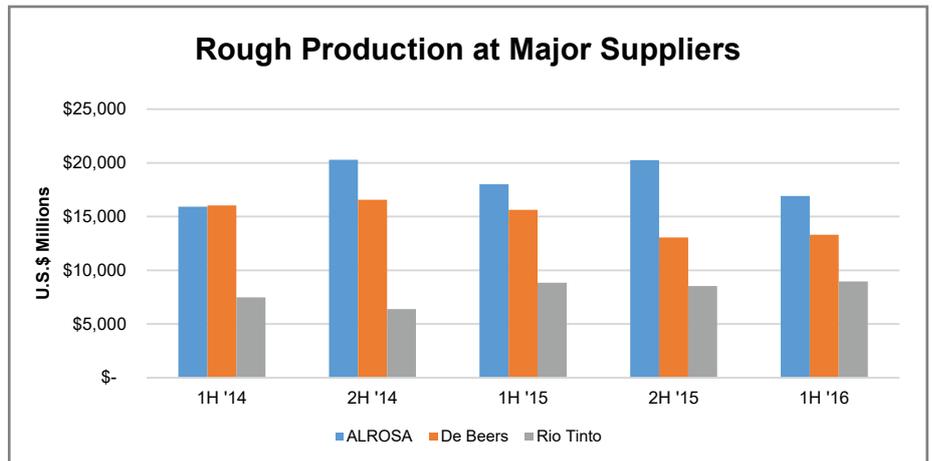


Figure 5
DATA BASED ON PUBLISHED REPORTS BY ALROSA, ANGLO AMERICA AND RIO TINTO.

The Retail Market

Cautious Consumer Demand

Stable U.S. jewelry demand continues to buoy the global market with steady bridal and engagement jewelry sales during the summer wedding season. Consumers are more guarded as the presidential election campaign gathers momentum even as consumer confidence – according to the Conference Board Index – was stable in July.

U.S. jewelry sales rose by an estimated 5 percent year on year in 2016, with growth driven by higher prices as reflected in the consumer price index (CPI) for jewelry, rather than a rise in volume. The high-end luxury segment continues to be resilient, with Harry Winston, Kering and LVMH Moët Hennessy Louis Vuitton all reporting a relatively strong performance in the first half (see Figure 6).

LVMH noted strong momentum in the U.S. and continued growth in Europe, except in France where tourism has taken a hit. Asia improved steadily but Hong Kong and Macau is a difficult

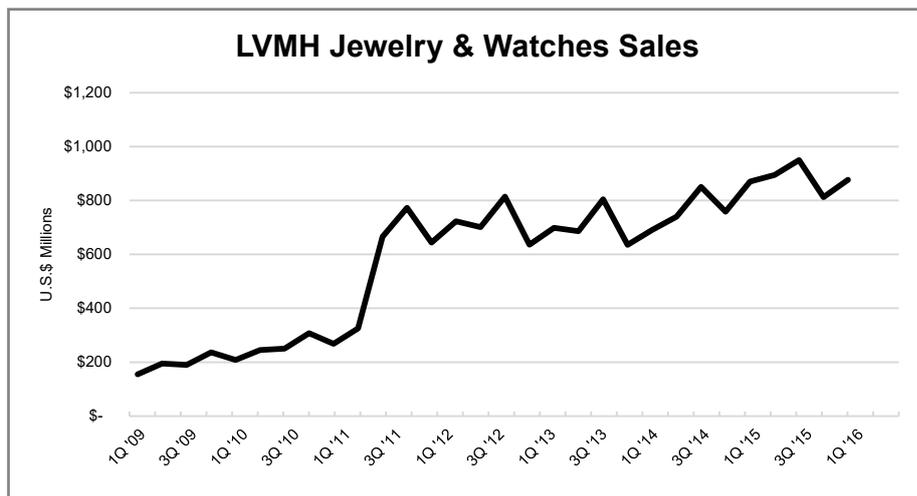


Figure 6

Data published by LVMH in Euro and converted to U.S. dollars by Rapaport News at a constant rate of EUR 1.11=\$1.

environment for tourism, LVMH explained.

The large Hong Kong jewelry retailers – Chow Tai Fook, Chow Sang Sang and Luk Fook – noted similar trends in the Far East as they reported sales continued to slide this year. The declines in Hong Kong and Macau were steeper than in China, largely due to fewer tourist shoppers from the mainland traveling to Hong Kong as they prefer other regional markets such as South Korea and Japan for luxury shopping excursions.

Weaker currencies also hit Chinese spending patterns, with the yuan cut to a five-year low in July (6.70/\$1), which is expected to lower Chinese jewelry imports and restrict tourist spending. A weaker yuan may encourage more domestic spending. Concurrently, jewelry retailers have scaled down their operations, after expanding

aggressively in the past decade.

Gold sales fell at a faster pace than gem-set jewelry at Chow Tai Fook and Luk Fook. In July, gold sales slowed in China and India – the two largest consumer markets for the yellow metal – as prices surged. Gold prices have increased 26 percent this year (see Figure 7), while in rupee terms, gold prices have catapulted 28 percent since the weakening of the Indian rupee against the U.S. dollar.

This month's IJIS show in Mumbai will provide some indication as to the levels of India's domestic gold jewelry demand. More important for the diamond trade, the Hong Kong show in September will provide a gauge of Far East jewelry demand. After all, while the U.S. market is stable, the slowdown in global diamond demand has been largely influenced by the slowdown in China.

Retail Headlines

- ❖ Chow Tai Fook 1Q China sales -13%, HK / Macau sales -22%, plans diamond supply to U.S..
- ❖ Chow Sang Sang warns 1H profit -50%/-60%.
- ❖ Luk Fook 1Q same-store sales -22%.
- ❖ LVMH 1H jewelry & watch sales +4% to \$1.8B, profit flat at \$225M.
- ❖ Swatch 1H sales -11% to \$3.8B, profit -52% to \$267M, Harry Winston performance strong.
- ❖ Swiss watch July exports -16% to \$1.66B.
- ❖ Bluestone raises \$30M for online expansion in India.
- ❖ Birks Group revenue -5% to \$286M, profit of \$5.4M vs. loss of \$8.6M.
- ❖ U.S. May jewelry sales +4% to \$6.3B.

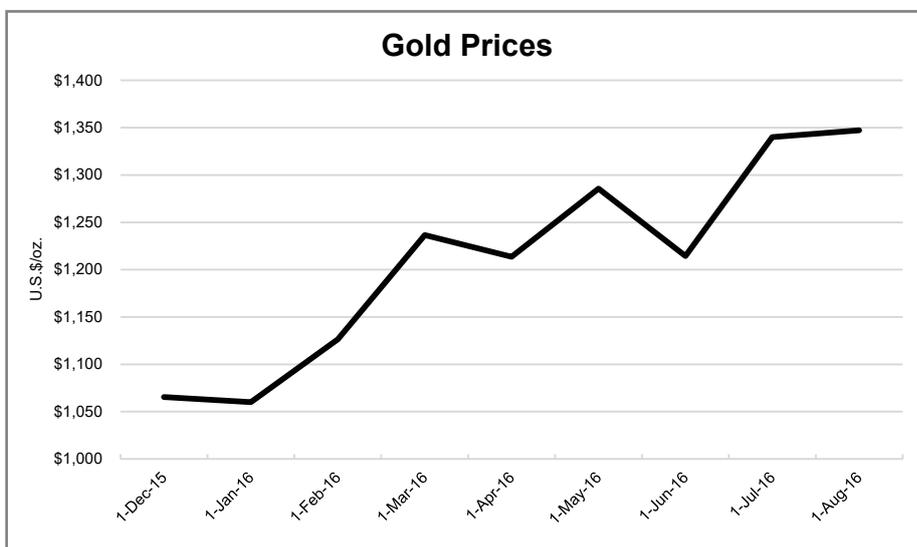


Figure 7

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Rapaport RapNet Diamond Index (RAPI™)

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Additional information is available at www.diamonds.net

The Rapaport Group

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