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Raw Materials Prices under Pressure

by Heinz Kolbe, Hamburg*

Since April 1984 there has been a general fall in world market prices for industrial raw materials following upon increases which, in some cases, had been quite considerable. What are the reasons for this development? What are the prospects for 1985?

The weak underlying trend which can be observed on most raw materials markets since last April reflects in particular the slowing-down of the general economic recovery in the West and, consequently, decelerated growth in the consumption of raw materials. In addition, the more cautious estimates of further expansion are inducing manufacturers to keep their stocks of raw materials at a low level. This trend is further encouraged by high interest rates and the unexpected continued strength of the dollar which causes uncertainty in international raw materials trade based on the dollar. These factors are producing a cautious attitude not only on the part of manufacturers but also of dealers and – in view of the anticipated low inflation rates – of speculative buyers as well. The slack demand is particularly evident in relation to those raw materials of which considerable inventories are being held by producers, on the commodity exchanges and in buffer stocks or for which a marked increase in production can be observed, such as cotton. In terms of the dollar the price level for industrial raw materials on world markets fell by approximately 8 % between April and October 1984, representing a 6.5 % drop over the year (since October 1983).

If the world economy remains quiescent, as expected, no fundamental change in the trend of market prices for industrial raw materials is foreseen during the remainder of this year and during 1985. The growth of the gross national product in 1985 is expected to be well below the 1984 level in the USA and Japan while it will remain restrained in Western Europe. Consequently, the demand for industrial raw materials will experience

only a slow increase. In particular, the demand for non-ferrous metals will grow only slightly as a result of the slackening-off of activity in the motor vehicle and building industries. Under these circumstances, manufacturers will be more inclined to reduce their stocks of raw materials, especially since storage is very expensive because of high interest rates.

Some recovery in the prices of various raw materials may, however, occur after the initial, very pronounced reaction to the slackening of economic activity and the renewed upward movement of the dollar. Prices on the non-ferrous metals markets, in particular, should show some advance.

Nevertheless, the rise in demand during 1985 will once again be slight. To counter a drop in raw materials prices, many producers will try to reduce output and take other steps to restrict the available supplies, but the conditions needed for such actions vary greatly from product to product. In any case, many developing countries are actually trying to increase their exports of raw materials in order to ease their debt problems. Overall, the price level for industrial raw materials should not rise between the end of 1984 and the end of 1985 when measured against the HWWA Index on a dollar basis and at present rates of exchange. The annual mean level for 1985 will thus be only slightly higher than for 1984.

Owing to differences in supply situations, considerable deviations from the general trend of prices may occur in 1985 on the various markets for industrial raw materials.

Only a small rise in the demand for **cotton** is expected during the new 1984/85 season while output will

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increase strongly owing to particularly favourable weather conditions. It will probably rise by 8.5 million to 76 million bales so that, at over 100 million bales, total supplies for 1984/85 will be well above the 1983/84 level. Only a slight increase will occur in cotton consumption as a result of the comparatively minor rise in purchases of textiles. Demand could be stimulated to some extent when manufacturers – and especially those in Asia – have reduced their cotton stocks to a minimum. The recent slump in prices also favours a renewed expansion in the use of cotton instead of synthetic fibres, especially since their prices have risen considerably during the current year. Overall, however, continued pressure upon cotton prices must be expected during the 1984/85 season in view of the anticipated increase in supplies.

Demand was very restrained at the first 1984/85 wool auctions in Australia. The Wool Commission had to intervene with support buying in order to maintain minimum prices. In contrast, there was a marked recovery in New Zealand wool prices but this trend was essentially assisted by the 20 % fall in the value of the New Zealand dollar. Australia did not raise the minimum wool price at the beginning of the season while New Zealand applied only a minor increase. Only a slight further improvement in demand will probably be seen as the economic situation of the western industrialized nations' textile industry slowly recovers. In contrast, world production will increase more strongly than in recent years, probably by 2 % to 1.67 million tonnes, because a considerable rise must be expected in Australia after the expansion of the national sheep flock. When the partially increased wool stocks of the main exporting nations (222,000 tonnes at the beginning of the season) are also taken into account, more ample supplies are available for the 1984/85 season. The resultant pressure on prices should, however, be

cushioned by the Wool Commission's intervention policy.

The decline in prices on the **natural rubber** markets has not continued during the last few months. Some of the rubber processors in the western industrialized nations are no longer holding back demand. Renewed buying in London by the Soviet Union has also supported rubber prices. On the other hand, the considerably increased rubber production in South-East Asia during the early months of 1984 as a result of extremely favourable weather conditions is still depressing the market. World output is expected to rise by 4 % to 4.17 million tonnes for the entire year. In view of the continued favourable growth of motor vehicle production and consequently of tyre manufacturing, consumption should rise by more or less the same percentage. This will not reduce the surplus. Ample supplies of natural rubber will therefore still be available, especially since the exporting nations have relatively large stocks and the international buffer stock holds a further 270,000 tonnes. In addition, competition from synthetic rubber is bound to be intensified because the manufacturers will be more willing to grant discounts in view of the available surplus capacities and cheaper inputs. Against this background, the pressure on natural rubber prices will be maintained.

Copper prices have stabilized over the last few months. Spot prices in London have hovered around £1,000 per tonne for quite a while. Buyers obviously no longer expected the USA to introduce import quotas which would have increased the supplies available from South America in Europe. The revived demand together with large-scale buying by the People's Republic of China have helped to produce a further drop in the copper available on the London Metal Exchange. Demand has also been stimulated by the now prevalent view that copper production in 1984 will increase only

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slightly, by an estimated 1 % to 7.39 million tonnes. Consumption shows a 5 % rise to 7.10 million tonnes and so – assuming that net exports to China and other socialist nations remain unchanged – the fundamental situation in the western world's copper sector will be more or less in equilibrium. After the rejection of the application to introduce import restrictions in the USA, London copper prices should maintain their present level while prices in the USA will fall.

The slackening of demand on the **zinc** market has caused a pronounced drop in prices in recent months. The London price for zinc at the end of October was only £638 per tonne after having reached a 1984 maximum of £798 per tonne during the preceding boom. The European zinc producers reduced the official selling price from US \$ 1,090 to US \$ 900 per tonne to encourage buying by consumers. In the USA, too, the smelting works reacted to stagnating demand by reducing their list prices.

According to the available statistics of the International Lead and Zinc Study Group, a 6 % increase, bringing the West's zinc production to 4.92 million tonnes, is indicated for the whole of 1984. Consumption should rise by about 4 % to 4.75 million tonnes, assuming a decelerated increase in the industrialized nations during the second half of the year. A deficit will again occur in 1984 if allowance is made for net deliveries of an estimated 220,000 tonnes to the socialist countries. The shortage which the last boom led to be expected for this year has not, however, arisen. Producers' zinc stocks have increased since the beginning of the year and the reductions in the London zinc market's stocks – which were initially severe – have been discontinued. Under these circumstances the pressure on zinc prices will probably continue.

Sharp price movements have occurred on the **lead** markets during recent months. In July the spot price in London broke a new record for the year at £387 but by the end of October had fallen back to £345. The hectic movements on the lead market are mainly attributable to the strikes which have repeatedly been called for various lengths of time in America and Australia over the past few months. The West's lead consumption should increase by 3 % to 3.91 million tonnes in 1984. Output will probably rise by only 2 % to 3.98 million tonnes so that – if the Eastern bloc's purchases from Western Europe remain at the same high level – there will be a slight deficit of about 50,000 tonnes. The price level will not fall any lower after the continuing reduction of stocks on the London Metal Exchange and the concomitant easing of pressure from the supply side. In the USA,

however, the lead smelters will probably continue with the present reduction of their list prices after production has regained its normal level.

There has been no change on the **tin** market. By constant intervention the Director of the buffer stock in Penang is preventing the price from falling below the minimum of 29.15 ringitt per kg as fixed in the International Tin Agreement. The spot price on the London Metal Exchange is hovering around that level with an upward trend in recent months owing to the revaluation of the Malaysian dollar against the pound sterling. The marked 12 % reduction in the officially recorded output to 159,000 tonnes in 1983 has caused a comparatively modest fall in the considerable surpluses held in the West. Firstly, consumption did not initially react to the general economic recovery in the industrialised nations and remained more or less unchanged at 158,000 tonnes. Secondly, the export quotas continue to be evaded by unofficial deliveries of tin amounting to 12,000 tonnes a year from South-East Asia. Furthermore, Brazil, which is not a signatory to the Tin Agreement, has now doubled its output. Although the tin stocks on the London Metal Exchange have been reduced since the beginning of the year – owing to large-scale exports to the Eastern bloc – by now the Director of the buffer stock must almost have exhausted the limit of approximately 40,000 tonnes as fixed in the 6th International Tin Agreement. Little change should occur in 1985 in the underlying situation for tin although the improvement in the general economy indicates that a further slight rise in consumption may occur. It is impossible to foresee whether the South-East Asian countries will again be prepared to make a drastic cut in output and whether they will succeed in stopping tin smuggling. Despite these uncertainties, it can be assumed that the Pool Director will manage to hold tin prices more or less at the present level. A number of producer nations have recently provided the Pool Director with new funds for his intervention operations.

Despite the efforts to save energy and find substitutes for oil, there has been a further marked increase in the consumption of **crude oil** during 1984 as part of the worldwide economic revival. But the increase in supplies was even greater, partially because the output of the OPEC nations by the middle of the year exceeded the agreed quantities. Thus, despite the continuing Gulf War, world market prices for crude oil were subject to increasing pressure due to the seasonal fall in demand in the early summer; a considerable drop occurred in the prices on the spot markets, which are estimated to handle up to one-third of crude oil deliveries. Between the end of May and the end of July "Arabian Light"

became about 5 % cheaper – falling to US\$2 below the official price of US\$29 per barrel – while the drop in North Sea oil prices was twice as large. This increased the pressure to lower the official prices. To counter this, the OPEC nations, and especially Saudi Arabia and Iran, imposed considerable restrictions on output from August onwards. The spot market prices then recovered at least part of the fall.

The imminent seasonal growth in the demand for crude oil during the winter should – if only temporarily – have led a stabilizing of prices at an even higher level to be expected, but the recent price reductions by Norway, Great Britain and Nigeria have aroused new uncertainties on the crude oil markets. This placed pressure on the OPEC nations and especially Saudi Arabia. At their last meeting they decided to reduce output in order to support prices by producing a shortage.

As a result of the slowdown in economic growth in the industrialized nations – combined with continued energy savings and oil substitution – only a slight increase in crude oil consumption can, however, be expected in 1985. The OPEC nations will probably make further reductions in output in order to maintain their official sales prices but those prices are bound to be considerably undercut on the spot markets owing to the anticipated downswing of demand.

Prices on the world markets for **food and beverages** experienced an extremely strong rise in 1983 and the early months of 1984 as a result of the deterioration in supplies. At the end of 1982 the opinion still prevailed that, in view of the high stocks, the exporting nations' attempts effectively to limit supplies would have little success. In no case was this assumption confirmed. National programmes to restrict production, especially in the USA (wheat, maize, soya beans), interventions under international agreements (coffee) and also smaller harvests as a result of bad weather (cocoa, sugar) have led to shortages and in some cases to spectacular price rises.

Demand weakened in the summer of 1984, however, and most prices experienced a marked fall. Buyers obviously reacted to estimates indicating that the harvests of the main foods and beverages would be substantially better in 1984/85 than in the previous season. In addition, the upward movement of the dollar encouraged many importing countries to delay their purchases on the North American markets which dominate the world's food trade. In particular, cereals, oil-seeds, sugar and cocoa were all cheaper. Overall, world market prices for food and beverages fell by 12 % between May and October 1984 when measured

against the HWWA sub-index on a dollar basis. The 8 % fall from the level in October 1983 is somewhat smaller owing to the earlier price rises.

When forecasting developments in 1985 we can justifiably assume that, essentially, the expected surpluses in the major exporting countries have already been reflected in the severe drop in prices over the last few months. Additional demand, especially from the USSR, should have a stabilizing effect upon the **wheat and fodder cereals** markets. Nevertheless, the large harvests will increase the world's stocks. Thus, a more restrictive cultivation policy will presumably be applied in the USA and the EC during the 1985/86 season. For some time now **sugar** prices have been hovering between 4 and 6 cents per lb, i.e. well below the minimum price of the International Sugar Agreement. Now that all the negotiations on more effective stabilizing measures have collapsed, only drastic restrictions on production in the main exporting countries could cause any shift in the market's trend. Since such restrictions can no longer be expected during the present season, the sharp fluctuations in prices around a low base level will probably continue. In the case of **vegetable oil-seeds and oils** the fall in prices will probably not be succeeded by a slight recovery until the second half of 1985 in view of the pronounced increase in output, especially that of soja bean production in the USA. Coffee prices will probably remain under pressure because, despite the frosts in the Brazilian plantations, a larger world output is indicated. The amount available on the market is, however, determined by the export regulations in the International Coffee Agreement. In 1985 the Coffee Organization's very flexible policy on quantities should again succeed in maintaining more or less the present level of prices. On the other hand, **cocoa** prices will show a slight advance; while consumption is increasing moderately, the supplies of good qualities from Nigeria during the current season are being affected by delivery problems.

Taking a general view, the present trends of production and consumption indicate that pressure from the supply side upon the world's markets for food and beverages will largely continue into 1985. No serious adjustments to the production estimates for the 1984/85 season will be required unless extreme weather conditions occur. Generally speaking, therefore, prices will only just maintain their present level. Nevertheless, the trend could be reversed during the first half of 1985 if it appeared that the exporting countries were reacting to the low prices by limiting their cultivation operations during the 1985/86 season.