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ECONOMIC TRENDS

Prices of Raw Materials Continue to Rise

by Heinz Kolbe, Hamburg*

Following the abatement of the boom market during the early months of 1983, the coming months will see an "adjustment" of world market prices for industrial raw materials to "fundamental" market conditions. Price fluctuations are likely during this period. A gradual increase in demand for raw materials and a moderate rise in raw materials prices can be expected during the further course of 1983 and in 1984.

The price levels of industrial raw materials on international markets were prompt to react to the first signs of economic improvement in the industrialised countries at the start of 1983. Measured in terms of the HWWA Index of World Market Prices of Industrial Raw Materials, the level of prices – calculated on a dollar basis – rose within half a year (up until June 1983) by 10 %. This followed a period in which this level had fallen by almost a third since the start of 1980 as a result of the worldwide recession.

More recently, however, the price quotations for raw materials have been rising at a slower pace. The substantial increase in demand would appear to have died down. Speculations that there would be a sharp increase in manufacturers' demand and thus a more lasting upward price movement have proved to be incorrect. Raw materials traders, therefore, have for the time being readopted a wait-and-see attitude. Among the reasons for the settling-down of the market are the renewed increase in interest rates and of the US dollar and pound Sterling exchange rates. For buyers of raw materials in other currency areas industrial raw materials, which are mostly traded in dollars or pounds, have increased markedly in price over the past three months.

Leaving aside the transitional speculative excesses, the trend reversal on the markets for industrial raw materials, following the almost three-year slump, is definitely economically grounded. The economic recovery in the USA and the improving economic situation in a number of western European countries have led to a renewed increase in raw materials consumption in the western world. There is a greater willingness on the part of the manufacturers to increase their stocks of raw materials, which have hitherto been kept at a minimum level. In expectation of rising prices, many socialist countries have also stepped up their buying activities in a number of western raw materials exporting countries.

As a result of mixed reactions of manufacturers to the first general wave of price increases, the recent price quotations for industrial raw materials have not developed in a uniform way on individual markets. Following the cessation of buying for international buffer stocks, for example, there has been a drop in the prices of tin and natural rubber. Lead also fell in price due to the fact that production was expanded again at an early stage. Cotton prices, on the other hand, have continued to move up appreciably on account of the restrictive cultivation policies pursued in the USA. Aluminium is also still enjoying a boom market. Copper and zinc have been able to maintain their high price levels for some time now.

The phase of consolidation on the raw materials markets is likely to persist for some time to come, particularly in view of the approaching summer slack season. The development during the second half of the year will continue to be characterised, on the one hand, by a lasting increase in raw materials consumption in the western world and, on the other hand, by in many cases high levels of stocks held by manufacturers and at commodity exchanges, which in some cases still increased during the early months of 1983. In view of the continuing uncertainty with regard to the extent to which the economic upswing will last in industrialised countries, the stock-cyclical impulses will only increase slightly, even though the current raw materials stocks of manufacturers are generally below their long-term average.

Assuming the maintenance of the restrictive production and supply policies, the producers may well be able to generally reduce existing surpluses. This is particularly the case for those raw materials which are mainly produced in the industrialised countries themselves (aluminium, zinc, nickel, timber, cellulose). A few major North American aluminium producers, however, have already announced increases in production, their intention being to cut costs by improving capacity utilisation. The supply situation for copper, natural rubber and tin, on the other hand, presents a different picture. The dominant developing

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countries were concerned about greater foreign exchange earnings virtually "at all costs" and only hesitantly curbed production during the demand recession period. Should prices continue to rise, a rapid reduction of existing and costly buffer stocks would be possible. As against that, the reductions in the state-financed cotton stocks in the USA and wool stocks in Australia will be very limited. The governments of both countries are obliged by law to guarantee their farmers an adequate income and are therefore unlikely to put pressure on the prices.

On the whole, moderate price increases can be expected on markets for industrial raw materials during the second half of 1983, even assuming only the predicted gradual increase in demand for raw materials. The development for individual raw materials depends of course to a large degree on the specific determinant factors in each case.

In the case of *copper*, the agreement reached between one of the largest American copper companies and the union on a new wage settlement means that the strike planned for July is unlikely to materialise. The statistics now available for 1982 show that the drastic cutback in production recorded for the USA was almost evened out by increases in other countries. Total copper production in the western world in 1982 only fell by 3.4 % to 7.11 million t. Consumption dropped by 7.2 % to 6.72 million t. Taking into account the net imports from socialist countries, this leaves a surplus figure of 450,000 t. Assuming the strike does not take place in the American copper industry, another surplus to the tune of about 300,000 t can be expected for 1983. This figure is based on the assumptions that production increases by 2 % to 7.25 million t and that the level of net imports from the Eastern bloc remains at about 50,000 t. Due to the cyclically-induced increase in car sales and in construction activities, consumption is likely to increase by about 4 % to 7.00 million t. The surplus situation is marked by a lasting increase in copper stocks at the London and New York metal exchanges, the joint figure reaching 643,000 t by the end of May this year (December 1982: 502,000 t). Producers' stocks, at about 580,000 t, are also relatively high. Such an abundant supply situation means that the second half of 1983 is unlikely to see a price increase worth mentioning.

A renewed increase in the *tin* consumption of the western world by about 4 % to 167,000 t is expected during 1983. Production is likely to fall by about 5 % to 176,000 t, which means that including exports to socialist countries the account will be more or less balanced on this score. Even assuming a more brisk demand on the part of the manufacturers on account of

the economic recovery, the allocation of export quotas in existence since mid-1982 is likely to be maintained throughout 1983. This would significantly reduce the amount of tin available to the market from current production. However, a tin shortage is not to be expected. The buffer stock level is at 60,000 t, 21,700 t of which are to be sold by the administrator by mid-1984. The development of prices on international tin markets is likely to continue to be determined by the administrator of the international buffer stock. Even allowing for a lasting increase in demand, the London price of tin is unlikely to exceed 9,000 £/t.

The supply policies for agricultural raw materials vary from those for industrial raw materials. As in many cases state intervention plays a large part in the most important exporting countries, the organisation of such intervention will be a decisive factor in the future development of the market situation. The USA provides the best example in this respect. Here the state-financed stockpiling of *cotton*, for example, increased to about two-thirds of the current annual production. The government is therefore going for a drastic reduction. In addition to reducing the amount of cultivable land via the government-backed fallow land programme, the cotton farmers, like producers of other agricultural products, are being offered additional subsidies if they cut down cotton cultivation during 1983/84. However, it was not taken into account that cotton cultivation in other countries will now increase considerably. The world production figure, therefore, is only likely to drop by about 1 % to 67 million bales. Total world consumption will increase by about 2 % to 68 million bales. The prices are only likely to increase slightly during the 1983/84 season, particularly as the reduction in the prices of crude-oil products has a favourable effect on the manufacture and use of synthetic fibres in the textiles industry.

The drop in the prices for *crude oil* has led to a lower overall price level on the markets for energy raw materials during the first half of 1983. Under the pressure of a worldwide supply surplus, the OPEC countries brought down their reference price for "Arabian light" by US \$ 5 to US \$ 29 per barrel. The prices for other crude oils were cut accordingly. Demand for oil decreased rapidly after autumn 1982, with distributors, manufacturers and users reacting to the downward price trend by reducing stocks. The efforts for energy conservation and oil substitution continued. OPEC production has consequently fallen to 13 to 15 million barrels per day, even though a global production quota of 17.5 million barrels per day was agreed upon last March.

More recently, the spot-market prices for crude oil have become more stable, an indication of the fact that the preceding increased recourse to stocks by oil-importing countries is now declining. Total OPEC production, therefore, is likely to gradually approach the production figure agreed upon. This means that Saudi Arabia may well be able to play its role of "swing producer" better than it was hitherto. This applies at least as long as other oil-producing countries do not exceed their production quotas to too great a degree. The temptation to do so is still great in view of the strained balance-of-payments situation facing many oil-exporting countries. On the other hand, the fear of triggering renewed restraint in demand and price pressure, thus damaging their own interests, would seem to have a disciplining effect on the members of the cartel.

In view of the forthcoming seasonal pick-up in demand for oil, which intensifies the general cyclical impulses, the current state of equilibrium on the international oil market, although unstable, is likely to continue for the time being. A few oil-exporting countries will probably raise their prices somewhat or take back hidden rebates towards the end of the year. Ignoring this aspect, the level of oil prices can be expected to remain virtually the same until well into the coming year.

The level of prices on the world markets for food and tropical beverages, measured on a dollar basis according to the HWWA Index, has increased by 17 % since the low of September 1982. This pronounced increase is primarily due to changed expectations with regard to the harvests during the 1983/84 season.

The price of sugar on the free international market increased by 65 %. The main reasons for the substantial increase in demand were the prospects of a definite reduction in world production and the participation for the first time of the European

Community in negotiations on a new International Sugar Agreement. Up to now, the EC had put pressure on world market prices by exporting its surplus sugar. The price can be expected to go even higher, although at a slower pace than hitherto. Cocoa prices have risen by 40 %. According to recent estimates, a production deficit of 60,000 t is to be expected. The unsold stocks in the exporting countries (620,000 t) correspond to about 40 % of annual world consumption. However, they are reputed to have deteriorated in quality due to long storage. During the coming months, cocoa prices are likely to stay at their present level, particularly considering that a production surplus can be expected for the coming season. The world's coffee harvest will increase considerably in 1983/84 now that the results of frost damage in the Brazilian coffee areas have been overcome. The quotations, which have increased slightly in association with the export restrictions of the International Coffee Agreement, are therefore likely to come under pressure once again. The price increases for wheat and forage cereal continued during recent months. Although a further production increase is expected during the current season, the farmers in the USA are expected to stockpile even more grain as part of the national support programmes. Partly as a result of the fallow land programme, the American Department of Agriculture expects a sharp decline in wheat and maize harvests in the USA. The increase in prices will, however, soon level off markedly. The upward price movement for soya beans and other oil seeds has recently come to a standstill. The supply surplus for oil seeds will also become smaller as a marked reduction in the soya seed cropping areas in the USA is to be expected. The prices for oil seeds, therefore, are likely to increase slightly.

Altogether, the increase in the price level of food and tropical beverages will slow down appreciably during the second half of 1983.

HWWA Index of World Market Prices of Raw Materials¹
(1975=100)

Raw Materials and Groups of Materials	1982		1983					
	AA ²	June	March	April	May	June	July 7	July 22
Total index	228.6	226.0	214.1	203.1	204.0	204.0	204.7	204.8
Total, excl. energy raw materials	117.9	117.5	116.4	119.4	122.2	122.7	124.1	124.4
Food, tropical beverages	106.1	104.7	105.7	109.4	113.6	115.2	115.7	117.0
Industrial raw materials	126.4	127.2	124.6	127.0	128.8	128.4	130.6	130.0
Agricultural raw materials	127.1	134.5	118.5	122.7	124.6	125.8	130.4	130.1
Non-ferrous metals	134.9	123.6	142.8	148.3	152.5	150.4	151.1	149.9
Energy raw materials	293.4	289.4	271.1	252.0	251.7	251.5	251.8	251.8

¹ On dollar basis. - ² Annual Average. For the method of computation of the HWWA Index cf. INTERECONOMICS No. 5, 1980, p. 261 ff.