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Sluggish Raw Material Markets

by Heinz Kolbe, Hamburg*

During the course of 1986 the prices of most raw materials were under considerable pressure. For 1987 there are no indications of a fundamental change in price trends on world markets.

World markets for industrial raw materials in 1986 were primarily characterised by a moderate increase in demand and an abundant supply situation. Even the again slightly more pronounced cyclical upswing in industrialised countries during the second half of the year did not produce a significant stimulation of demand. Raw materials consumption increased only slightly. Under these circumstances, manufacturers and dealers tried to keep stocks as low as possible. Particularly in the case of industrial raw materials traded in dollars the development of exchange rates probably also had a retardant effect on demand, since buyers in Japan and most Western European industrialised countries were able to count on the possibility of a further drop in prices due to the increasingly low value of the US dollar. In this situation even lower interest rates were hardly able to stimulate demand for raw materials.

The prices of most industrial raw materials during 1986, therefore, were under noticeable pressure. The exceptions were agricultural raw materials, whose prices increased somewhat as a result of the demand revival towards the middle of the year. The marked increase in the case of zinc and lead was mainly caused by various strikes, which at times led to fears of a supply shortage. Although there was also a renewed increase in the price of tin the price level was much lower than that reached before the collapse of the price support system.

In view of the substantial shift in exchange rates the price trends for individual raw materials were also dependent to a substantial degree on the distribution of suppliers and buyers throughout the currency areas and

on the currency in which exchange quotations were listed. If reference is made to the Special Drawing Rights of the International Monetary Fund as a common denominator to calculate a "world price level for raw materials" the result is a price decrease of 3 % during 1986 (up until December) on the basis of the HWWA sub-index for industrial raw materials. This was equivalent to a price decrease of 10 % – in terms of ECUs – for European and 15 % – in terms of DM – for German manufacturers alone, whereas buyers from the dollar area faced a price increase of a good 7 %.

There is no sign of a fundamental change in world market price trends for industrial raw materials in 1987. In view of the restrained economic growth expected in industrialised countries the consumption of raw materials will, as in 1986, increase only slightly. Manufacturers will probably continue to pursue a restrained stockpiling policy, since the supply of industrial raw materials will generally remain abundant. Producers still hold very high stocks in the case of a number of raw materials, e.g. cotton, wool, rubber and tin. In other cases, e.g. non-ferrous metals, there are considerable unutilised capacities, which means that the supply levels can be rapidly increased. Furthermore, the highly-indebted developing countries are still obliged to continue exporting almost "at any price". Under these circumstances, the prices of industrial raw materials will tend to decline in 1987, too. Changes in exchange rates will also undoubtedly continue to influence the situation, although these are difficult to forecast.

The price trend for *cotton* in the 1985/86 season (August-July) was very differentiated. Pressure on

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prices increased on markets outside of the USA due to a supply surplus. The Liverpool cif quotation relevant for European cotton mills fell to 36c/lb by July 1986. In New York, on the other hand, the price increased to 69c/lb, by the end of the 1985/86 season, since stocks had been enlarged in the USA within the framework of the support programme for cotton. The result was a two-thirds drop in American cotton exports to a level of 2 million bales in the 1985/86 season and a considerable increase in government stocks. In order to put a stop to this development and restore the competitiveness of American cotton, the prices guaranteed by the government were lowered. This led to a downward adjustment of the New York cotton prices for supplies from the new harvest to the price level on other world markets. During recent months, however, prices have on the whole risen appreciably; the last listing was 60c/lb. As a result of restrictions on production world cotton output in the 1986/87 season can be expected to fall to

73 million bales. Assuming an increase in consumption to a level of 76 million bales, however, this would only result in a relatively low deficit. The stock level of 47 million bales is also very high. In view of this favourable supply situation cotton prices will probably again tend to find themselves under pressure.

On wool markets the cyclical recovery of the sales of clothing and other textile products in 1986 led to an increase in demand and to higher prices. In Australia the purchases of manufacturers from major importing countries were additionally encouraged by the continued devaluation of the Australian dollar. During the first few months there was a particular increase in demand from Western Europe, North America and the socialist countries. The Japanese manufacturers first began buying larger quantities of raw wool again after a reduction of their yarn and fabric stocks in the second half of 1986. At a level of 1.67 million tonnes (washed)

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world wool output during the 1986/87 season (July-June) will probably match the previous year's figure. The increase in Australia will probably be offset by lower shearing figures in New Zealand and other countries. Taking into account the stocks in the main exporting countries, which had increased to roughly 192,000 tonnes by the beginning of the season, a slightly increased supply seems likely. Demand will probably only expand slightly in 1987. Under these circumstances, and assuming that there are no noticeable changes in the exchange rate of the Australian dollar, wool prices can hardly be expected to maintain their current level during the course of the year.

The prices for *natural rubber* increased during the second half of 1986 due to greater demand from the western industrialised countries and the People's Republic of China. The Director of the international buffer stock no longer needed to intervene in the market to maintain the minimum price level agreed in the International Natural Rubber Agreement. Together with the increased production of other rubber products the growth in motor vehicle production and tyre manufacturing in 1986, however, probably only led to a 1% increase in world consumption of natural rubber to a level of 4.40 million tonnes. The technology-induced additional use of natural rubber for tyre manufacturing is on the decline and in other fields of application the competitiveness of synthetic rubber has improved substantially due to the considerable drop in the prices of raw materials containing oil. The trend towards surplus production of natural rubber will probably continue in 1987, especially since Indonesia and Thailand step up their output even further and consumption in industrialised countries will continue to increase at an unchanged moderate pace due to the restrained economic activity. In addition, the market is overshadowed by uncertainty whether agreement will be reached between producer and consumer countries on the renewal of the International Natural Rubber Agreement which expires in October 1987. All negotiations so far have been unsuccessful. If agreement is not reached there is a danger that the buffer stock, which currently holds 375,000 tonnes of natural rubber, will be terminated. Under these circumstances, demand will probably soon slacken again and prices can once more be expected to come under pressure.

On *copper* markets the pressure on prices increased further after mid-1986. Demand slackened after new pay agreements in the USA in July had averted strikes and thus prevented losses of production. The copper stocks of the London Metal Exchange have again

increased during recent months. Copper consumption will probably grow again by 2% to a level of roughly 7.6 million tonnes during 1987. As regards output a somewhat higher increase can be expected, to the same level of 7.6 million tonnes. In the USA substantial wage cuts led to a marked improvement in the competitive strength of the copper smelters. The South American copper producing countries Chile and Peru, on the other hand, continue to make efforts to extend output and exports. The pressure on copper prices, therefore, will continue.

With a brisk demand and a supply reduction in the wake of lengthy strikes in major Canadian and Australian zinc works *zinc* prices increased appreciably up until autumn 1986. Demand slackened again after the industrial disputes, and prices fell. The list price of European zinc producers, which at times reached US \$ 920, has now fallen to US \$ 780 per tonne. Following the normalisation of production in Canada and assuming a higher output in South Korea total output in 1987 can be expected to increase by 5% to 5.1 million tonnes. Consumption will probably increase by 2% to 5.0 million tonnes. Assuming that there is no change in net exports to socialist countries the fundamental situation in the zinc sector in 1987 can be expected to be more or less in equilibrium. Under these circumstances, a further decrease in prices can be expected, even though the producers' and Metal Exchanges' zinc stocks are low.

Strike-induced production shortfalls in Australia and in other countries and announcements of voluntary production cutbacks led to growing uncertainty about the further development of the supply situation on *lead* markets in the second half of 1986. The demand of manufacturers picked up because of precautionary stockpiling, and prices increased. Following the settlement of the pay disputes, however, there was a renewed downward trend. In view of the continuingly moderate cyclical upswing in the industrialised countries and the reduced use of lead in the production of petrol as well as in the production of car batteries lead consumption will probably increase once more by merely 1% in 1987 to 4.1 million tonnes. Output will probably increase by 3% to the same level of 4.1 million tonnes. Even if the high level of net exports to the socialist countries remains unchanged a more balanced supply situation for lead in western countries seems probable. Following the winter months, lead prices will probably tend to fall even more during the course of the year.

Since October 1986 *tin* prices on Western European markets have increased by 25% to approximately 4,500

£/t. This level, however, is still roughly 50 % lower than the last official quotation before the London Tin Exchange closed down in autumn 1985. The improvement results from a noticeable revival of demand as well as announced or already effected production cuts. Furthermore, the banks, which have taken over the tin stocks of the international buffer stock in compensation for their irrecoverable claims on the International Tin Council, are pursuing a very restrained supply policy. Although the high stocks have decreased considerably since the price support system collapsed there is still a plentiful supply of tin. Once again there will only be a slight increase in consumption this year, even though the lower price level will favour the use of tin in, for example, the sheet metal and packaging industries. Output, on the other hand, will probably continue to fall. The members of the Association of Tin Producing Countries (ATPC) recently agreed on a restriction of tin exports, linked with a reduction in output, for 1987. At the same time, efforts will be made to induce the major outsiders, Brazil and China, to join the envisaged output and supply restrictions. If these plans are successful an arithmetical deficit of roughly 40,000 tonnes would result for the western world. This would enable a more rapid reduction of surpluses. Even though some tin producing countries will probably fail to heed the resolutions to their full extent despite corresponding declarations of intent, a decrease in output and supply levels is to be expected which will probably bring about a further increase in tin prices.

There were sharp price movements during the course of 1986 on the world *crude oil* market. Under the pressure of the supply surplus following the substantial expansion of output in Saudi Arabia the average price fell from almost US \$ 28 per barrel at the end of 1985 to roughly US \$ 10 per barrel in July 1986. After OPEC's subsequent reduction of output the price again climbed to US \$ 15 per barrel. The success of this measure, which enabled the loss of revenue caused by quantitative reductions to be overcompensated by higher prices, was apparently the decisive reason for OPEC's announcement in December 1986 of a further reduction of the output level for the second half of 1987. In the meantime the envisaged price level of US \$ 18 per barrel has already been reached, the increase in demand caused by the severe winter in Western Europe playing a substantial role. This seasonally induced stimulus to demand will soon recede very rapidly. After their stocks were already substantially replenished during the course of 1986 there will be a weaker increase in the overall demand of oil consumers in 1987 – in view of the restrained economic growth and the

continuing effects of austerity measures. This time, on the other hand, OPEC nations expressed their determination more resolutely than on previous occasions to keep to the reduced output quotas. Iraq is the only member which has laid claim to more than its allotted quota right from the start. The behaviour of oil producing countries outside of OPEC is also difficult to forecast. Apart from the short-term reactions to the resolutions adopted by OPEC in December a great deal would suggest that there will soon be a renewed slight decrease in the world market price of crude oil. This presupposes, however, that the intensification of the Gulf War does not lead to increased supply shortfalls.

In the course of the year 1986 world market prices for *food and beverages* largely dropped substantially due to the supply surplus, even though they were for the most part listed in dollars. Above all, maize, wheat, coffee and cocoa became cheaper. The prices for soya beans and several other oil-seeds, on the other hand, fell only slightly. On a dollar basis the level of world market prices for food and beverages fell, measured against the HWWA sub-index, by 18 % during 1986 (up until December). Despite the in many cases even much more pronounced drop in prices demand by importers outside of the dollar area remained low, since domestic output increased substantially. The Soviet Union in particular was less dependent on additional purchases on the world market.

Despite extremely high *cereals* surpluses an only slight reduction of the total area under cultivation in the exporting countries seems likely. The world harvests of wheat, maize and other forage cereals in the 1986/87 season, therefore, will probably again exceed demand. Contrary to the intentions of the new agricultural policy, farmers in the USA, however, will probably stockpile more cereals in government silos, thus withholding these quantities from the world market. This will tend to stabilise cereals prices. Substantial changes in the world market prices of *sugar* and *oil seeds* are also improbable. The increase in output will probably more or less correspond to the increase in demand, which means that the stocks of these products will probably more or less remain at their currently high levels. There is great uncertainty as regards *coffee* and *cocoa*. Decisions have not yet been made within the framework of the international stabilisation agreements on the reintroduction of export quotas for coffee or additional stockpiling measures for cocoa. Such measures could cushion the pressure on prices emanating from the expected output surpluses. On the whole, only a slight drop in the level of world market prices for food and beverages can be expected in 1987.