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Heinz Kolbe*

Trend Changes on Raw Materials Markets

1987 saw a change in trends on many international raw materials markets. Prices, which had been under pressure for several years, began to rise again. This trend cannot be expected to continue everywhere in 1988, however.

There was a clear upward price trend again on international raw materials markets in 1987. The period of excess supply and pressure on prices, which had lasted a number of years, thus came to an end. The more rapid expansion of industrial production in western countries led to an increase in demand on markets for industrial raw materials. Non-ferrous metals were particularly affected by the upward trend, since producers continued to limit the supply in the light of their experiences during the preceding years of downward price trends. In the case of food the upward price trend did not set in until after mid-1987, as lower harvest yields and a slight decrease in the substantial stocks in exporting countries became apparent. On the beverages markets on the other hand, the pressure on prices has so far continued due to the marked increase in the coffee and cocoa supply. The price support measures within the framework of international agreements for these products have merely prevented a further decline in prices.

Measured against the HWWA index of world market prices of raw materials, which is calculated on a dollar basis, the level of prices for both industrial raw materials and food and beverages increased by 25% during the course of 1987 (until December). For consumers in countries outside of the dollar area, however, the increase in the price of raw materials in national currency was much less pronounced due to the drop in the dollar exchange rate.

In real terms, i.e. in relation to the index of export prices of manufactured goods from industrialised

countries – also calculated on a US-dollar basis – the level of prices for raw materials only increased by roughly 5% in 1987. According to this calculation, the price level at the end of 1987 was still roughly 30% below the level at the beginning of the 1980s. This meant a considerable improvement in the terms of trade for the industrialised countries, whereas the importing capacity of those developing countries which export raw materials fell considerably and their debt problems grew worse.

Price Increase for Industrial Raw Materials

On world markets for industrial raw materials demand grew to a much greater extent during 1987 than during 1986. On the one hand, the consumption of raw materials increased as a result of the accelerated increase in industrial production in many western countries. On the other hand, there was an increase in demand, since improved sales expectations induced manufacturers to increase their raw materials stocks as a precaution. The increase in stockpiling activities, however, was also strongly influenced by the continuous deterioration of the fundamental situation on most markets to the detriment of manufacturers after supply-side pressure had already eased somewhat in 1986 in the wake of the gradual reduction of stocks by producers. Voluntary production cutbacks and strike-induced production shortfalls (aluminium, copper, tin, lead and zinc) were contributory factors in this context. Even after the recovery of demand in 1987 many producers were careful not to increase supplies too rapidly in view of the falling prices experienced during preceding years. There was only a slight increase, therefore, in the production of most industrial raw

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materials, and the stocks of producers and at commodity exchanges continued to fall substantially.

Furthermore, buying by manufacturers was stimulated by a general change in the price climate. The increase in the prices of precious metals up until the stockmarket crash in October 1987, for example, also indicates that after the stabilising stimuli emanating from the reduction in energy prices had petered out and as a result of the market monetary expansion worldwide – especially in the years 1985 and 1986 – inflationary expectations tended to increase. What is more, in view of the stabilisation of the dollar exchange rate up until autumn 1987 the manufacturers outside of the dollar area probably no longer expected an exchange rate induced reduction of the import prices of raw materials. In view of these developments the upward trend for raw materials prices was compounded by speculative activities.

After the collapse of stock exchange prices the quotations on commodity exchanges nevertheless initially continued to increase markedly, even after the arithmetical effects of the renewed dollar depreciation are eliminated. In view of the adverse effects on the business climate of the turbulences on financial markets this is a further indication of the substantial shift in the supply-demand relationship in favour of raw materials suppliers.

There was a particular increase in the prices of copper, nickel, aluminium and wool in 1987. Quotations for zinc, tin and timber, on the other hand, hardly increased at all. On the whole, the level of prices of industrial raw materials in December 1987 was 37% higher on a dollar basis than in December 1986 (annual average in 1987: + 21%). For raw materials processors outside of the dollar area, however, the price increases were much less pronounced due to the depreciation of

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Kay-Michael Schanz

AUSLANDSVERSCHULDUNG UND DIE ROLLE VON IWF, BIZ UND PARISER CLUB

Inhalt und Grenzen der Verpflichtungen des Internationalen Währungsfonds sowie der Bank für Internationalen Zahlungsausgleich und der Teilnehmer des Pariser Clubs

FOREIGN DEBTS AND THE ROLE OF IMF, BIS AND PARIS CLUB

Extent and Limits of the Obligations of the International Monetary Fund, the Bank for International Settlements and the Members of the Paris Club

The discussion on foreign debts often neglects or ignores the legal aspects of the participation of the IMF, the Paris Club and the BIS in the solving of debt problems, in particular the question to what extent these institutions are legally obliged to support debtors and creditors. These problems are dealt with in this study by Kay-Michael Schanz, written as his doctoral thesis for the faculty of law of the Johann Wolfgang Goethe University, Frankfurt. The method of procedure of the Paris Club in particular is closely connected with the question of the necessity of an international law on debt rescheduling. The author develops various approaches to an international arbitration procedure which raises the hope that rescheduling can be speeded up.

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the dollar; calculated in European Currency Units (ECU), for example, the increase was 13% and in Yen 8%.

Declining Increase in Demand

In the meantime, fears that the shares shock might trigger a worldwide recession have subsided. However, the stockmarket crash, the continued depreciation of the dollar and greater uncertainty regarding economic policy developments will have an adverse effect on economic growth and thus also on business activity in industry in the western world. Accordingly, there will certainly be a much more restrained increase in the consumption of industrial raw materials during the course of 1988 than in 1987. In view of these subdued economic prospects manufacturers are hardly likely to increase their stocks any further. On the whole, therefore, the increase in demand for raw materials will probably decline considerably during the course of 1988.

As the production of a number of important raw materials lagged behind the sales of producers in 1987 and their stocks – and those at commodity exchanges – decreased considerably, the probable tailing off of the increase in demand does not in itself mean that the markets will again come under supply-side pressure. In the case of a number of non-ferrous metals, however, the price increases so far will probably lead to an expansion of production. In the case of cotton and other agricultural raw materials an extension of the area under cultivation as well as of production can be expected during the 1988/89 season.

All in all, the declining increase in demand and the gradually accelerating increase in production indicate the end of the upward trend on markets for industrial raw materials and the transition to falling prices during the course of the year. In the case of individual raw materials whose prices increased considerably last year there is a relatively high probability of a marked decline in prices. On the whole, however, in view of the underlying assumption of a continued, albeit slower, upward trend for production as a whole in the western industrialised countries there will probably only be a slight decrease in the level of prices for industrial raw materials. However, the forecasting of raw materials prices is burdened with even more risks than the forecasting of overall economic trends as a result of the increased current uncertainty about exchange rates and economic policy parameters in the industrialised countries.

A differentiated development can be expected in 1988 on non-ferrous metal markets. In the case of aluminium, production in the western world lagged behind

consumption for many years, which led to a particularly pronounced increase in prices. However, idle capacities will probably soon be utilised. The gradual easing of the supply situation suggests that the upward price trend on aluminium markets will soon come to an end. A changing trend is also in sight in the case of copper. In 1988 there will probably be a surplus in the western copper balance for the first time in many years and a marked decline in prices can be expected. There will probably only be a slight increase in supply, on the other hand, on zinc and lead markets. Consumption, however, will probably also increase only slightly as a result of the expected reduction in motor vehicle production and the more restrained economic activity in the construction industry and in other zinc and lead processing branches of industry. The on the whole more abundant supply indicates that zinc and lead prices will again come under pressure. On tin markets, on the other hand, a marked increase in prices can be expected during the course of 1988 following the scaling down of the extremely high lead stocks to a "normal level" during the past two years and the agreement between tin-producing countries to sustain export quotas for a further year.

On the cotton markets there are signs of a further substantial increase in production during the 1988/89 season as a result of the extension of the area under cultivation, whereas there is unlikely to be a further increase in consumption due to the flagging textile industry. The more abundant supply situation will lead to a replenishment of the extremely low stocks and pressure on prices can be expected to increase. The increase in production can also be expected to continue in the case of wool. However, as a result of the increased use of less expensive wool-blended fabrics and the very high stocks of virgin wool in importing countries demand will tend to fall. The level of prices, therefore, will fall noticeably despite continued price support measures in exporting countries. In the case of natural rubber production and consumption will be more or less balanced out in 1988. It will probably be possible, therefore, within the framework of the International Natural Rubber Agreement to maintain the current level of prices on these markets.

Unstable Crude Oil Markets

The price trend on the world market for crude oil in 1987 was marked by changing determinants, in particular on the part of suppliers. Via its announcement at the beginning of the year of a limitation of output the OPEC managed to push through a 20% increase in the reference price for crude oil to a level of US \$ 18 per barrel. The fact that the recovery of prices exceeded

the OPEC objective by late summer 1987 indicated that the cartel was again exerting a stronger influence on the market. One main reason why this was successful was that, among other things, the Gulf war induced import dealers to play on the safe side by buying more oil than they could consume. Another main reason was that Saudi Arabia temporarily refrained from making full use of its output quota and was thus able to offset the overshooting of targets by other countries. The higher price, however, stimulated a further increase in output. Accordingly, Saudi Arabia's willingness to reduce its output apparently declined. Although the market leader was not confronted by the serious balance-of-payments problems facing the other OPEC countries it was nevertheless keen to retain its share of the market with an eye to longer-term developments. As a result, spot market quotations decreased, falling clearly below the official prices at the end of 1987. In view of the declining prices on spot markets several OPEC countries, and more recently Saudi Arabia too, decided to grant discount in order to stabilise crude oil sales. Even after the last OPEC conference in December 1987, during which members made the commitment to strictly observe the recommended price, valid since the end of 1986, of US \$ 18 per barrel as well as the output ceilings, this trend continued almost unchanged.

In 1988 there will probably only be a slight increase in the consumption of crude oil due to the more restrained economic activity worldwide, even though growing worldwide restraint with regard to the extension of nuclear energy and the reduction in the price of crude oil, which tends to reduce the incentive to economize, will have a stimulating effect on consumption. Assuming that there is no escalation of the Gulf war, stockpiling in importing countries will also be discontinued. As, on the other hand, producers can be expected to repeatedly exceed agreed output ceilings in view of the frequently strained balance-of-payments situation and abundant unutilised capacities there will probably continue to be a supply surplus on world markets for crude oil. Under these circumstances prices would tend to fall even further. However, considerable uncertainties still exist. The war between Iraq and Iran or the conflicts in the Persian Gulf, for example, could escalate to such an extent that the oil supply would, at least in the short term, be reduced and consumers again increase their stocks. Saudi Arabia may possibly recall its role of leader within the OPEC and try, at least via temporary output restrictions, to bring the price of oil closer to the level regarded as "reasonable", namely US \$ 18 per barrel. The situation on crude oil markets, therefore, will remain unstable.

Renewed Increase of Food Prices

The decline of prices on world markets for food and beverages during recent years continued until late summer 1987. Although substantial stocks had already piled up in major exporting countries during previous years production in some cases still increased even further and/or was only slightly reduced. The substantial stocks and the abundant harvests in the 1986/87 season prompted importers to confine their buying to the level of current demand. During recent months, however, there were growing signs of a decline in harvests in the 1987/88 season. As a result demand picked up noticeably; it was additionally stimulated on North American markets by the depreciation of the dollar since October 1987. Since then there has been a marked increase in the quotations for cereals, sugar, oil-seeds and – following the reintroduction of export quotas – for coffee too, whereas the price decline on the cocoa market continued despite extensive support buying. On the whole, the level of prices on the world markets for food and beverages, calculated on a US dollar basis, was only 5% higher in December 1987 than in December 1986 due to the preceding downward price trend (annual average: -15%); measured against the currencies of other industrialised countries there was a substantial decline.

A marked reduction in the production of wheat and forage cereals seems probable for the 1987/88 season. Consumption will exceed production, therefore, for the first time in several years. Deficits are also to be expected in the case of oil-seeds and sugar despite increasing production. In view of the – in some cases very high – stocks in exporting countries, however, the supply on markets for cereals, oil-seeds and sugar will suffice to keep price rises within limits.

There will probably be very little change in coffee prices in 1988. The International Coffee Organisation will probably be able to neutralise the surpluses via export restrictions. A substantial reduction of the coffee harvest also seems likely during the 1988/89 season, especially in Brazil. In the case of cocoa, on the other hand, continuing pressure on prices can be expected. The latest forecasts expect an increased surplus during 1987/88, and the manager of the international buffer stock has already almost fully exhausted the envisaged framework for support buying. Altogether, the probable development of supply and demand indicates that a slight increase in the level of prices on world markets for food and beverages during the course of 1988 can be expected.