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Klaus Matthies\*

## Raw Materials Prices Remain Low

*While there has been little change in prices for industrial commodities since last autumn, the price of oil continued its downward trend to the end of the year. Many commodity exporting countries are suffering under the burden of low prices. Will the long-awaited recovery begin this year?*

The decline in world commodity prices continued in recent months. In February, measured in terms of the HWWA index on a US dollar basis, they were 20% lower than a year previously, and since autumn 1997 they had even decreased by a good 30% (see HWWA Index of World Market Prices of Raw Materials, p. 104). Oil prices fell particularly sharply. At the end of last year Brent crude cost US\$10 a barrel, the lowest level since the mid-1980s. Price quotations began to pick up in early March, however, in anticipation of further production cuts after the next OPEC conference. The price index for non-energy commodities, on the other hand, has slipped only slightly since last October.

Although the decline in industrial commodity prices largely came to a standstill in the final months of last year, there has as yet been no recovery. This is primarily due to the ongoing crisis in Asia since the eastern Asian economies are important purchasers of industrial commodities. Their low level of demand for inputs, particularly those required in the production of goods for domestic demand and for export, is a major cause of the continuing weakness of world industrial commodity prices. In addition, commodity suppliers increased their production in order to offset domestic losses. In so doing they also utilised the scope for lowering prices presented by devaluation.

### Commodity Exporters in Difficulties

Low commodity prices have greatly impaired economic development in many countries dependent on commodity exports. In Latin America, where primary commodities account for half of the region's merchandise exports – excluding Mexico, commodities even

account for as much as 70% of total exports – weak commodity prices have led to a considerable fall in foreign exchange income and also, in some cases, to substantially lower tax revenues.

Venezuela – the region's second largest oil exporting country after Mexico – is particularly badly affected. In recent years, crude oil and oil products accounted for three quarters of the country's export income, and the oil sector provided half of state revenue. Between the third quarter of 1997 and the fourth quarter of 1998 oil exports declined by 40% in value terms, reducing oil's share of total exports from 78% to two thirds.

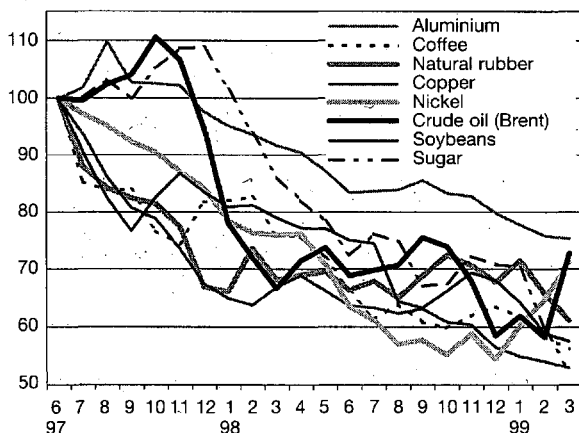
In Chile and Peru, a single commodity – copper – accounts for 30% and 20% of exports respectively. The price of this metal has almost halved since mid-1997 (see Figure 1) and is currently at its lowest level for twelve years. For Argentina and Brazil, foodstuffs represent major export goods. As a whole, Latin America is a net exporter of energy – as it is of raw materials altogether – yet several countries benefit as energy importers from substantially lower oil bills.<sup>1</sup>

As an export market, Asia is of major significance only for a small number of Latin American countries. The emerging economies of East Asia together with Japan receive approximately one tenth of Latin America's commodity exports. This proportion is considerably larger – about 15% – in the case of Peru and Brazil. Chile – with a quarter of its commodity exports going to the region – is particularly badly affected by the recession in Japan which alone accounts for one fifth of Chilean copper exports. Devaluations and weak domestic demand in Asia, moreover, have led to

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<sup>1</sup> Five of the eleven members of the Latin American integration association (ALADI) are net fuel importers: Brazil, Chile, Paraguay, Peru, Uruguay.

**Figure 1**  
**Price Developments of Selected Commodities**  
 (US\$ prices, monthly averages,<sup>1</sup> June 1997 = 100)



<sup>1</sup> March 1999: up to and incl. 26th.

Source: HWWA Raw Materials Price Index.

an intensification of international competition. More than half of total Latin American exports to the OECD countries have to compete with Asian suppliers.<sup>2</sup> For Brazil, this shift was corrected by this year's devaluation of its own currency.

The decline in raw materials prices is badly affecting a great number of Africa's commodity exporting countries. In recent years, 14 of Africa's 51 developing countries achieved more than half of their export earnings with a single commodity; for more than 20 countries the same is true of their most important two or three commodities. For most African countries however – 43 are oil importers – the positive effects of low oil prices probably outweigh the disadvantages of declining prices for other commodities.<sup>3</sup>

### Commodity Demand Recovery Remains Sluggish

As a result of the crises in Asia, Russia and Latin America, economic expansion in Europe has slowed down, for the time being at least; in the USA the boom can be expected to level off, and in Asia recovery will be slow to assert itself. Thus any increase in demand from processors of industrial commodities will, initially, be restrained. In the case of several industrial commodities, weak prices are fostered by abundant supplies – caused by extensive production capacity and copious stockpiles – as well as by noticeable reductions in production costs as a result of techno-

logical advances. Some countries will probably continue to try to stabilise their foreign exchange revenues by increasing exports – of non-ferrous metals for instance. Thus announcements of production cuts have so far largely failed to be implemented.

Uncertainty remains regarding the development of Russian commodity exports. Russia plays an important role as a supplier, especially – in addition to energy commodities – of metals.<sup>4</sup> The strong devaluation of the rouble has raised the incentive for domestic producers to increase their incomes with additional exports, yet their capability to do so appears to be sharply limited by technical and financial constraints. While there was a strong increase in nickel exports – of which Russia is the largest producer and exporter – in the second half of 1998, this was due primarily to sales of remaining strategic stockpiles.

All in all, commodities continue to be available in abundant global supply and as a consequence, in spite of the expected stabilisation of the situation in Asia's emerging economies and the start of recovery in Japan, any consolidation of industrial commodity prices will remain gradual. On average – with a slight recovery during the course of the year – a further decline can be expected in 1999, albeit considerably less substantial than the 14% fall registered in 1998.

### Oil Remains in Abundant Supply

The world oil market, too, continues to be characterised primarily by weak demand in Asia and by a supply side which has been slow to react. Oil demand, which still saw 2.4% growth in 1997, increased by only 0.5% in 1998. Oil supply – as in 1997 – grew slightly faster than demand. Cuts in output implemented by the producing countries last year proved insufficient to stop the oil price decline. Russian suppliers made use of their improved competitiveness resulting from the devaluation of the rouble such that exports from the countries of the former Soviet Union – where production remained virtually unchanged and domestic consumption declined – increased still further. Stronger growth is hindered i.a. by insufficient transport capacity. Oil deliveries from Iraq, which are not covered by the OPEC agreements to cut output, have continued to increase this year; production volumes in February were only 17% below the mid-1990 level prior to the invasion of Kuwait. Faster expansion, which would be

<sup>2</sup> Cf. UNCTAD: Trade and Development Report, 1998, p. IV.

<sup>3</sup> Cf. IMF: World Economic Outlook, October 1998, p. 76.

<sup>4</sup> Cf. K. Matthies: Commodity Prices Continue to Fall, in: INTERECONOMICS, Vol. 33 (1998), No. 5, p. 247.

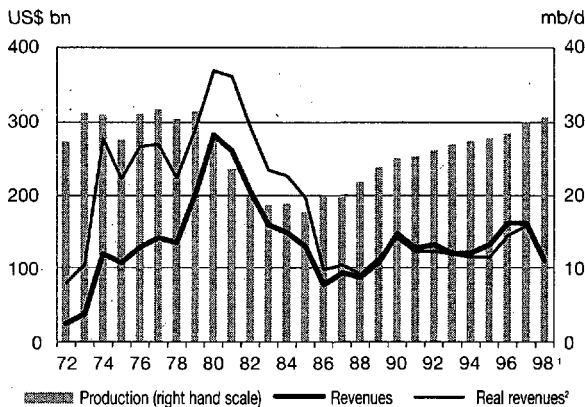
politically feasible since the United Nations raised Iraq's sales quota, has so far failed primarily as a result of technical problems.

The harsh onset of winter in the USA led to falling stockpiles and a consequent temporary increase in oil price quotations in January. A second upward surge in spot market prices was seen at the start of March in anticipation of the OPEC spring conference resolution to further limit oil production. This can hardly be regarded as a trend reversal, however. Oil is still available in abundance and despite the current low price levels there is little willingness – and in many countries little capability, given their extremely tense budgetary situation – to implement stricter production restrictions.

For many producing countries, oil remains the most significant source of income, and so the price decline since October 1997 has had serious consequences for their export revenues and state budgets. In the year prior to the Asian crisis, the OPEC members of northern Africa and the Middle East – with the exception of the United Arab Emirates where, in contrast to oil production, there was a strong expansion of natural gas extraction – acquired more than 70% of their total export revenues from oil, as did Venezuela. While most countries have become less dependent on oil since the 1970s, in some cases the opposite has been true (see Table 1). As a result of the decline

Figure 2

OPEC: Oil Production and Oil Revenues



<sup>1</sup> 1998 revenues estimated.  
<sup>2</sup> Deflated with manufactured goods export price (1998 US-\$).

Source: IEA; OPEC; own calculations.

in oil prices, total earnings in the OPEC countries last year fell by a third over the previous year (see Figure 2). These earnings have shrunk to a third – and to as little as a fifth in real terms –<sup>5</sup> compared to 1980, the year when oil prices were at their highest. At the beginning of this year real oil prices had reached their lowest mark since before the first oil price crisis in mid-1973. The scale of the price slump experienced since October 1997 is comparable with that of 1986 when Saudi Arabia abandoned its output ceiling.

Table 1  
**Opec: Oil's Share of Export Earnings**  
**1972, 1995-97**  
 (in per cent)

	1972	1995	1996	1997
<b>South America</b>				
Venezuela	90.2	74.4	80.3	78.7
<b>Gulf region</b>				
Iran	90.0	81.5	80.2	74.0
Iraq	90.2	92.9	93.0	97.0
Kuwait	94.8	93.2	94.9	93.3
Libya	99.7	91.9	94.2	90.0
Qatar	96.2	81.8	85.5	85.2
Saudi Arabia	99.7	84.9	87.3	85.0
UAE	94.6	53.4	54.2	49.8
<b>North Africa</b>				
Algeria	79.0	67.8	72.6	63.3
Nigeria	82.6	97.6	95.4	93.7
<b>South East Asia</b>				
Indonesia	51.4	14.2	15.8	13.9

Source: Calculation based on OPEC figures.

Agreement on Production Cuts

In view of the depressed state of the world economy any increases in oil demand will remain restrained, and without a significant reduction in supply the scope for price increases will be limited. Although price hikes cannot be ruled out should there be renewed intensification of the Iraq conflict, even then a sustained increase would seem improbable since other producers would soon fill the gap in order to augment their own revenues.

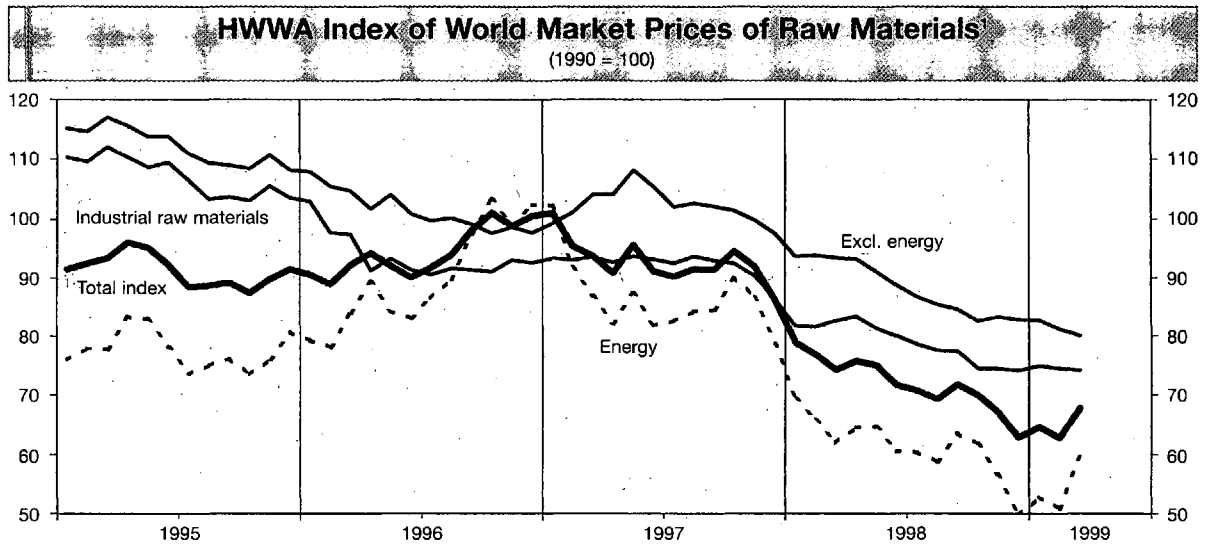
Given the precarious budgetary situation in the oil producing countries, the OPEC conference in November did not conclude any further reductions, particularly in view of the fact that crude output remained about 40 per cent above the volume previously agreed. Decisions on further cuts which were considered necessary by several members failed, among

<sup>5</sup> Deflated with manufactured goods export prices.

other things, because of marked differences between the two largest producers, Saudi Arabia and Iran, regarding procedures for apportioning the 'sacrifices' among the member countries. While Saudi Arabia wished any cuts to be founded on current production levels, Iran based its calculations on mid-1990, pre-Gulf crisis volumes. The Iranian proposal would mean greater cuts for Saudi Arabia but an expansion of Iranian output. Other OPEC members also requested that Saudi Arabia substantially reduce its production. Venezuela, which in addition to Iran accounted for a large share of excess production, promised to meet its obligations in time for the OPEC conference in March.

At that conference a further production cut of 2.1 million barrels per day (mb/d) – 1.7 million barrels for

OPEC and 0.4 mb/d for other oil producing countries – or 2.6 per cent of world oil production was announced. Saudi Arabia agreed to make the largest reduction; if the country complies, a quarter of the total will be taken off the market. Judging from previous experience it appears unlikely that all the participating countries will comply with the agreed reductions to the full extent. Fulfilment of their commitments to a degree comparable to that observed in 1998 (about 70 per cent) would be necessary to sustain the current price level of 14 dollars per barrel (Brent) for the remainder of this year. A moderate further price increase can be expected next year when world oil demand will recover more strongly. Should the oil producing countries fail to limit production, however, a further price decline appears inevitable.



Raw Materials and Groups of Materials <sup>1</sup>	1998	Sep. 98	Oct. 98	Nov. 98	Dec. 98	Jan. 99	Feb. 99	Mar. 99 <sup>2</sup>
Total Index	72.0 (-22.4)	71.8 (-21.5)	69.9 (-26.0)	67.0 (-27.0)	62.8 (-27.1)	64.6 (-18.2)	62.8 (-18.3)	67.7 (-8.9)
Total, excl. energy	88.2 (-13.7)	84.6 (-17.2)	82.5 (-18.5)	83.2 (-16.6)	82.8 (-15.1)	82.7 (-11.7)	81.1 (-13.5)	80.0 (-14.3)
Food, tropical beverages	115.8 (-12.2)	105.6 (-18.3)	106.3 (-16.8)	109.0 (-14.7)	108.2 (-17.3)	105.5 (-18.3)	100.5 (-22.7)	97.2 (-22.5)
Industrial raw materials	78.9 (-14.5)	77.5 (-16.6)	74.5 (-19.4)	74.5 (-17.5)	74.2 (-13.9)	75.0 (-8.2)	74.6 (-8.6)	74.2 (-10.2)
Agricultural raw materials	79.3 (-14.4)	77.9 (-17.3)	74.4 (-21.3)	74.6 (-19.2)	75.8 (-13.6)	77.7 (-4.0)	78.3 (-3.9)	77.8 (-6.2)
Non-ferrous metals	71.1 (-20.8)	69.8 (-21.5)	67.5 (-21.8)	67.6 (-19.1)	64.6 (-18.1)	63.5 (-17.0)	63.3 (-15.5)	63.4 (-15.9)
Energy	61.4 (-29.0)	63.4 (-24.9)	61.7 (-31.4)	56.5 (-34.8)	49.7 (-36.8)	52.7 (-23.9)	50.8 (-22.8)	59.6 (-3.7)

<sup>1</sup> On a US dollar basis, averages for the period; figures in brackets: percentage year-on-year change.

<sup>2</sup> Up to and incl. 26th March.