Global commodity prices in sharp decline

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As equity markets in the United States remain at or near record highs, a sharp fall in global commodity prices points to the ongoing stagnation in the world economy and the development of outright recessionary trends.

This week the Bloomberg commodity index, which tracks the prices of major industrial raw materials, reached its lowest point since March 2002. It has declined by more than 40 percent since September 2011.

Two of the most significant price falls are in oil and iron ore. Oil, which began dropping rapidly at the end of last year, is now hovering around $50 per barrel, less than half its level of a year ago. The price of iron ore is down 77 percent from its peak in 2011. The decline reflects the slowdown in the Chinese economy and the attempts of Beijing to shift away from the credit-based investment and infrastructure boom it initiated to counter the impact of the 2008-2009 global financial crisis.

Industrial metals, including copper and zinc, have experienced a significant decline and have now been joined by aluminium, a key input in many products. Its price hit a six-year low this week on the news that China was going to export excess supplies of aluminium, rather than close old or inefficient producers.

China accounts for about 40 percent of global demand in industrial metals. Concerns over its slowdown—annual gross domestic product growth is at its lowest rate in a quarter of a century—are certain to have increased following the recent turbulence in Chinese share markets that saw $3 trillion wiped off market capitalisations.

The fall in metal prices is having an impact on stock market valuations. According to the *Financial Times*, six of the ten worst performers in the FTSE 100 index are mining stocks, while the FTSE industrial metals and mining index is down 26 percent since the start of the year.

In a further indication of global trends, the world's largest mining company, BHP Billiton, has announced plans to cut production of copper, petroleum and metallurgical coal (used for steelmaking) this year. Its output of iron ore will increase, but that is no indication of health, rather the opposite. Despite falling prices, BHP is increasing production in the hope that it can drive higher-cost producers out the market.

BHP has also been hit hard by the fall in copper and oil prices. Yesterday, it announced that it planned to write down profits by an amount between $350 million and $650 million because of weakness in its copper business. Last week, the company wrote down the value of its shale oil operations by $2 billion.

The commodity-price fall is having a major impact on raw-material exporting countries, especially Australia and Canada, which have been heavily dependent on rising demand from China. Falling oil prices, described by the Bank of Canada governor as "atrocious," have hit the Canadian economy hard, sending down the value of its currency against the US dollar.

In Australia, the eyes of financial authorities are firmly fixed on the price of iron ore. In both countries, the central bank has cut official interest rates in a bid to boost flagging economic growth. This has had perverse effects, however, by fueling a housing price bubble. In Toronto and Vancouver, house prices have risen by as much as 9 percent over the past year, even as the economy stagnates.

In Sydney, Australia's largest city, house price escalation has been even steeper. The median price of a home has reached more than $A1 million, after rising by almost 23 percent over the past year.

As house prices go into the stratosphere, the vulnerability of the underlying economy to the shift in commodity prices was highlighted in a recent article in the London-based *Daily Telegraph* warning that Australia could turn into a "new Greece."

The economy enjoyed a boom during what has become known as a commodities "super-cycle." Buying by China drove prices for coal, iron ore and petroleum products ever higher. "However, a collapse in iron ore and coal prices coupled with the impact of mining companies slashing investment has exposed Australia's true vulnerability," the article noted.

Emerging markets and the so-called BRICS group

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(Brazil, Russia, India, China, South Africa), once touted as a new basis for global capitalism, are also being afflicted.

Following the economic stimulus launched by the Chinese government after 2008 and the resultant commodities boom, stock markets in emerging economies outperformed those in more developed countries. That advantage has now been lost. According to *Financial Times* columnist James Mackintosh: “Everything connected to commodities, including a large chunk of emerging markets, looks atrocious.” Brazil, Russia and South Africa, three BRICS members, have been hard hit.

The downturn is now leading to increased unemployment in emerging markets, after it fell during the previous six years. According to figures compiled by JP Morgan, unemployment has risen across these markets to 5.7 percent, after reaching a low of 5.2 percent in January.

JP Morgan chief economist Bruce Kasman told the *Financial Times* that “unemployment is rising rapidly” and the trend is broad-based. “Recessions in Russia and Brazil have been a major driver of the slump in job growth in recent months,” he said. “However, the deceleration also includes such countries as Korea, Mexico, Chile and Hungary.”

Kasman said he expected that the rise in unemployment would be a “lasting development” and it would exacerbate a slump in domestic demand in emerging markets.

In other words, far from contributing to global growth, these economies may compound the recessionary trends, further widening the gap between what is taking place in financial markets and the underlying real economy.

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