A positive outlook for commodities

George Werniuk

Last year at this time the world was suffering through a financial crises that had commodity analysts feeling as depressed as metal prices. What a difference a year can make.

Andrew Keen of HSBC Securities in London addressed several hundred people this afternoon and had some good news. Following last year's unexpected recession there has been time to analyze what happened and what we can expect this year.

Keen is bullish on metal fundamentals particularly in the medium term. A year ago we were in the trough for metal prices. In the intervening twelve months, prices in general have doubled, aside from gold. He thinks that the West is about half way through the metal recovery cycle.

The doubling of metal prices has been largely driven by the demand from China. The Chinese approached the financial crisis differently from the United States. Whereas the United States tried to spend itself out of the recession by handing money over to the states, China spent money on transportation, infrastructure and housing projects, which required copper, steel and aluminum. Not totally immune from the crisis, China has experienced a growth rate that is lower than in previous years but it is still healthy.

Chinese inventories of copper, zinc, nickel and aluminum have increased by7 to 8% since last year, an interesting fact considering that metal demand contracted by the same amount during the crisis.

Looking to the future is fraught with difficulties. Last year nobody expected prices to double; today nobody expects prices to drop by half. The best way to make forecasts is to use fundamentals. We need to think about commodities that could double but not drop by half (such as contract iron ore, coking coal and platinum). We should also think of prices that could drop by half but not double (such as copper).

Overall, what will happen to all the money being generated? In 2010 and 2011, the money is probably going to go to investments. Money will go into capital expenditures but there are not enough projects being generated to absorb all of it. So some of the money will go into acquisitions and mergers, particularly with juniors.

Keen concludes that: the risks of decelerating growth in China are overestimated; in the medium- to long-term the outlook is good; the positive outlook is mostly a function of demand not shortage of supply (the world is not running out of minerals); the recovery is happening in some commodity and equity prices; and finally there is lots of cash available after balance sheets have been repaired and costs have been cut.