The Telegraph

Is the wild ride in commodities over?

JON YEOMANS

14 AUGUST 2016 • 7:23PM

A steel furnace in China, which has powered demand for resources over the last decade

Congratulations if you called the path of commodity prices this year. You're probably also among the 0.0001pc of people who guessed Leicester City would win the Premier League. And of course, you predicted Brexit.

In a topsy-turvy world, metals have shown surprising strength. After cratering in 2015, a basket of major commodities has soared in price this year, from the remarkable 36pc climb of iron ore, to the stellar performance of precious metals, with gold and silver up 25pc and 43pc respectively. Zinc, a mineral used to galvanise other metals to stop them rusting, has chalked up a 41pc rise.

One of the few analysts to call iron ore's recovery was Jason Schenker, of Prestige Economics, who now thinks the metal – used to make steel – will probably extend its rally into the second half, averaging $55 a tonne. Some of the FTSE 100 miners would probably bite your arm off if you offered them iron ore at that price. BHP Billiton, Rio Tinto and Anglo

American all produce the metal at far below that level, meaning they can comfortably bank cash at $55 a tonne and get on with paying down debt.

The copper price recovery has been lacklustre

It's been an awful year for BHP, which reports annual results on Tuesday. Last November, a dam at its Samarco joint venture in Brazil collapsed, killing 19 in a devastating flood. Claims and counterclaims over the disaster could take years to settle. Earlier this year, the Anglo-Australian giant took a $5bn write-down on its US shale assets, and now it and its rival Rio are facing calls for a punitive new tax on iron ore in Western Australia.

Perhaps counter-intuitively, BHP has decided its long-term growth will come from oil and copper, two commodities that have largely sat out this year's rally. Crude languishes at around $45 a barrel, while copper has inched up just 3pc. Trading giant Noble Group noted last week that large stockpiles of copper in China mean a global shortage this year is unlikely. And supply continues to build: London-listed Antofagasta, which reports interims on Tuesday, is looking to ramp up production from its copper mines in Chile.

Global uncertainty has pushed gold prices up

The mining sector now finds itself in an unusual situation: having been the whipping boy of the FTSE in 2015, equities have pushed higher, buoyed not just by rising commodity prices, but by companies' relative immunity to the storms of Brexit and the Eurozone. The wild see-saw of the last year, from bust to apparent recovery, makes a mockery of plans. Witness Anglo's determination to back out of iron ore, only to find it is suddenly doing rather nicely out of it.

The commodities recovery this year has been driven by a splurge in Chinese spending. By some estimates, China injected up to £600bn into its economy earlier this year, shoring up construction in a stuttering housing market. That spending spree is winding down, as data released last week illustrated. State investment in fixed assets was up 13pc year on year in July, but was down significantly on its level in February, when it was 24pc higher.

Glencore boss Ivan Glasenberg has been one of the few to cut production

The effects of that gigantic stimulus may be felt for some time yet, keeping demand for metals high. But for the rally to be sustained, supply needs to fall – something most experts are not expecting to see until 2017 at the earliest. The mining industry's problem all along has been that it missed the slowdown in China: by the time it noticed demand was cooling off, too much new supply was coming on to the market, accelerating the fall in prices.

The miners themselves are cautious, and rightly so. Zinc's recovery has been powered in part by Glencore's decision to cut production by a third, preferring to leave it in the ground. Tellingly, there was no change in that strategy when Glencore updated the market last week. That's because, while prices of most metals are perkier than they looked in December, they are still a way off their levels a year ago. The average price of copper in the first half was down 21pc year on year; iron ore was down 13pc, and zinc 16pc. Take their five-year averages, and the picture is even worse. Meanwhile the outlook in China is no better: the IMF forecast last week that GDP growth there could fall below 6pc by 2020. Small wonder the big miners are still cutting costs.

A slowdown in Chinese construction could be bad news for the miners

Commodity prices, and mining equities for that matter, have spent much of this year regaining ground they lost in 2015. But the likelihood is – in the face of slowing growth in China – they are finding their level, post the ‘supercycle’, and they’re likely to stay lower than miners would like.

This unpredictable year may have more surprises yet. A lurch upwards in US interest rates, for example, could make dollar-priced commodities more expensive, although the market is not expecting such a move until early next year. Never mind the Premier League: if you can predict when the Fed will next hike rates, then you’re really on to something.