Outlook for 2009

Following the sharp decline in industrial output during the second half of 2008, many metals markets have entered 2009 with prices at their lowest level in several years. Whilst the precise shape and length of the current downturn is uncertain, economic activity continues to decline and forward indicators suggest any recovery is unlikely to begin until the second half of the year. The current pace of contraction is such that a large body of commentators expect the world economy in 2009 to record its first year on year fall since the Second World War.

This poor macroeconomic outlook prevails despite government attempts to bolster economic activity through fiscal spending and tax reductions as well as reducing interest rates and injecting cash into lending markets. However, lower equity and housing prices are putting downward pressure on indebted consumers and expectations of a prolonged downturn and tighter access to finance are holding back investment and trade.

Even when a recovery does take place the strength of the upturn may be muted. Recessions associated with reduced credit and declines in house and equity values are typically deeper and are longer than other downturns. Deleveraging of balance sheets, the need to rebuild savings and for governments to eventually rein in ballooning fiscal deficits will restrict future rates of growth.

In the case of the Chinese economy, which now accounts for one third of commodity consumption and to which metals markets are therefore particularly exposed, growth came to a standstill towards the end of 2008. Projections for 2009 have fallen alongside this observed slowdown and greater recognition of trade and investment linkages to other parts of the world. The central government has responded aggressively, announcing a four trillion renminbi (US$585 billion) stimulus package last November.

This has a particular focus on metals intensive public infrastructure spending. Reductions in interest rates and easing in bank reserve ratios will also allow for greater lending whilst cuts in taxes will be additional contributions to the direct spending stimulus. But whilst these measures will be supportive there are significant headwinds from weaker export demand. An inventory overhang is expected to hold back any immediate recovery in housing activity.

Chinese metals demand is expected to rise at a single digit rate in 2009. This is much slower than the over 20 per cent rates of growth realised in recent years and will not be enough to offset a much bigger decline in consumption in other markets. These headline annual changes mask a quarterly pattern of improvement in metals demand over the course of the year but given the development of a large stock and capacity overhang, even with this profile, prices seem unlikely to be able to stage much of a rebound during 2009.

More positively, despite reductions in costs, many metals prices are now below the operating costs of marginal industry producers and the supply side of the industry is responding. This suggests that further downside risk to prices is becoming limited.

Spot prices in bulk commodity markets are currently below benchmark price levels set in the first half of 2008. However, the outcome of price negotiations for the 2009/10 marketing year will depend on the extent and timing of any recovery in spot markets as destocking cycles end and economic growth bottoms out.