The Impact of China on Global Commodity Prices

The Global Reshaping of the Resource Sector

by

Mr. Raphael Kaplinsky and Ms. Masuma Farooki,
The Open University,
U.K

"The views expressed are those of the author and do not necessarily reflect the views of UNCTAD"
The Impact of China on Global Commodity Prices

The Global Reshaping of the Resource Sector

Raphael Kaplinsky
Masuma Farooki
Development Policy and Practice Unit
UNCTAD – 25th January 2012

Outline
1. Back to centre stage
2. China as the new driver
3. Commodities and economic growth
4. China as a distinct driver of demand
5. Supply constraints
6. Financialisation of commodity markets
7. Stakeholders response
8. The reshaping of the natural resources sector

China’s Return to Centre Stage

Bar graph showing commodity prices over time.
What are Commodities?

<table>
<thead>
<tr>
<th>Primary Sector Category</th>
<th>Major Use</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Soft Commodities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industrial Crops</td>
<td>Input in manufactures</td>
<td>Timber, Cotton</td>
</tr>
<tr>
<td>Fisheries</td>
<td>Final Consumption (with limited processing)</td>
<td>Prawns, rod</td>
</tr>
<tr>
<td>Cereal</td>
<td></td>
<td>Rice, Wheat</td>
</tr>
<tr>
<td>Beverages</td>
<td></td>
<td>Tea, Coffee, Cocoa</td>
</tr>
<tr>
<td>Livestock</td>
<td></td>
<td>Cattle, Dairy products</td>
</tr>
</tbody>
</table>
### The commodity components of the primary sector

<table>
<thead>
<tr>
<th>Primary Sector Category</th>
<th>Major Use</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Soft Commodities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industrial Crops</td>
<td>Input in manufactures</td>
<td>Timber, Cotton</td>
</tr>
<tr>
<td>Fisheries</td>
<td>Final Consumption (with limited processing)</td>
<td>Prawns, cod</td>
</tr>
<tr>
<td>Cereal</td>
<td></td>
<td>Rice, Wheat</td>
</tr>
<tr>
<td>Beverages</td>
<td></td>
<td>Tea, Coffee, Cocoa</td>
</tr>
<tr>
<td>Livestock</td>
<td></td>
<td>Cattle, Dairy products</td>
</tr>
<tr>
<td><strong>Hard Commodities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Precious Metals</td>
<td>Store of value (i.e. financial investment)</td>
<td>Gold, Silver, Platinum</td>
</tr>
<tr>
<td>Ferrous Metals</td>
<td>Infrastructure and Construction</td>
<td>Iron Ore and Steel</td>
</tr>
<tr>
<td>Non-Ferrous Metals</td>
<td>Input in manufactures</td>
<td>Copper, Zinc, Lead, Aluminium</td>
</tr>
<tr>
<td>Rare metals</td>
<td>Input in manufactures</td>
<td>Molybdenum, Plutonium, Cobalt</td>
</tr>
</tbody>
</table>

**Energy**

- Petroleum products: Fuel for industrial usage
- Coal: Final consumption
- Renewable energy

---

**China as a Distinct Driver of Commodities Demand**

**Percentage share accounted for by China in the increase of global imports (2002-2008)**
Soft commodities

- Slowing down of technological change
- High investment costs of irrigation
- Energy intensity of agriculture
- Growing constraint on water
- Not so much climate change, but climate chaos

Hard commodities

- In most cases global deposits are abundant, at least for some decades
- But easily accessible deposits are nearly-exhausted
- Unexploited or poorly-exploited deposits are in countries with high political risk
- Very long gestation periods

Energy commodities

- Easily accessible deposits are nearly-exhausted
- Unexploited or poorly-exploited deposits are in countries with high political risk
- Very long gestation periods
- Very capital intensive
- Floor price set by shale – circa $80-$100 p/b

Financialisation of Commodity Markets
Determining Commodity Price

- Consumer
- Traditional Investor/Trader
- Producer
- Commodity Price
- Demand
- Supply

Futures and Options Volume on Global Commodity Exchanges, 1990-2008 (excluding OTCs and ETFs)
Determining Commodity Price

- **Demand**
  - Consumer
  - Traditional Investor/Trader
    - Banks
    - OTCs
    - ETFs
    - Commodity Indices
      - Commodity Price
      - Index Trackers
      - Small Investors
    - Floor Traders
  - Institutional Investors (Large)
  - Institutional Investors (Small)

- **Supply**
  - Producer
  - Traditional Investor/Trader
  - Commodity Price
  - Institutional Investors (Large)
  - Institutional Investors (Small)

**Traditional Investor/Trader**

**Consumer**

**Floor Traders**

**Institutional Investors (Large)**

**Institutional Investors (Small)**

**Commodity Price**

**Banks**

**OTCs**

**ETFs**

**Commodity Indices**

**Index Trackers**

**Small Investors**
Price Signals and Fundamentals

1. The size of the commodity market matters
2. The age of the commodity market matters
3. The level of commodity inventory matters
4. The ‘period’ of investment matters
5. The ‘price indifference’ of some investors matters
Stakeholders Response

When resource rents are large, the state is an active player
Financialisation and high internal rates of return disfavour long-term investments
Chinese (and perhaps Indian and Brazilian) firms are less risk-averse, have access to patient capital and benefit from “strategic bundling”

Reshaping of the Natural Resources Sector

Seven Important Lessons

1. China is rapidly remerging as the world’s largest economy
2. China’s impact on other economies is large and growing, as a consequence of its size, its per capita levels and its distinctive actors
3. Since 2002, commodity prices have increased across the board (with a temporary fall in 2008-9), a price cycle which has no historic parallel since the early nineteenth century
Seven Important Lessons

4. China is on a commodities intensive growth trajectory which will endure for some years to come.

5. The supply response in all three families of commodities is limited

6. Financialisation reinforces price upswings and downswings and contributes to high price volatility

7. Northern stakeholders have been slow to respond, Chinese firms have become increasingly important, Governments play a crucial role

Seven Important Questions

1. How long will the boom in commodity prices last?
2. Will the boom in commodity prices lead to a long term structural shift in the terms of trade?
3. How should economies best handle resource rents?
4. (How) Should commodity markets be regulated?
5. How to link industrialisation to the commodities boom?
6. What are the consequences for Global Value Chains which feed into the Chinese market?
7. Beyond commodities – are similar trends emerging in other sectors?