

## A surprise in the works on raw-materials prices?

by David Goldman, Economics Editor

The universally depressed state of advanced industrial economies during the next several quarters is inconsistent with a continuation of the surprisingly strong trend in the prices of some commodities. Most commodity price forecasts which envision a strong rise are simply following the "consensus" scenario for a fourth-quarter economic recovery in the United States. The extraordinarily poor level of inventories of most industrial raw materials would then, according to such forecasts, produce spectacular price increases, perhaps on the scale of 1973.

EIR does not believe that there is any basis in the real world to expect an economic recovery this year, especially not in the industries which are the heaviest users of raw materials, e.g. construction. Those forecasters who assume continued poor economic performance, such as ACLI, cite the reported 8 percent drop in world trade (in volume terms) between first-quarter 1980 and first-quarter 1981 to argue for continued price softness. Nonetheless, even under depressed economic conditions, the commodity markets are capable of a surprise.

Although the Moody's commodities index in the United States stood at 14 percent below its July 1980 level during July 1981, and the Reuters index showed only a 3 percent rise, a handful of commodities registered impressive price gains during the second quarter of this year. Between the end of May 1981 and the end of July, copper had risen 22 percent; zinc 15 percent; coffee 7 percent; and nickel 9 percent. Of course, copper's current price of 91 cents not only stands well below the highs of 1973, but below the level required to put new mining production on line in most of the world. Compared to

the year-earlier price, the end-July price shows only an 8 percent gain, roughly the general rate of inflation in the advanced sector.

Poor economic news expected for the next few months implies that even these modest gains are highly vulnerable in the short term. In the Aug. 5 issue, the Swiss daily *Neue Zürcher Zeitung* attributes the cited price increases to exceptional factors: "The leading developments on international raw materials markets during July were principally determined by abrupt changes on the supply side. Weather factors caused a dramatic upward turn in coffee prices. In the case of lead and zinc, reports of labor conflicts strengthened a trend towards tight supplies that was noticeable for some time."

The industrial slackness prevailing in the United States, including the defense sector, has already forced one major molybdenum producer to drop prices by 9 percent, considerably dampening enthusiasm for the passing fad in "strategic materials." Sharp output drops in the auto and housing sectors, and slower than expected growth in the electronics industry, bode poorly for copper demand.

Nonetheless, the position of the commodity markets with respect to the global monetary picture changes the standard identities the forecasters use. High interest rates have increased demand for money, by raising the world's debt-service bill, while depressing industrial demand for raw materials. Present symptoms are those of a classical bubble, on the Mississippi Company or South Seas Company model. Credit demand in the United States is rising at 32 percent per annum in the corporate sector, coinci-

dent with a federal deficit probably in excess of \$100 billion (see Domestic Credit), while developing nations' indebtedness is growing at a 35 percent annual rate (see International Credit). Much as M. John Law would have insisted throughout 1719 that the Mississippi Company remained a good investment, the managers of the present bubble foresee no problems in continuing this practice indefinitely. What *EIR* thinks of this argument appeared on our cover two weeks ago ("Ten Years Since Aug. 15, 1971: From Dollar Bankruptcy to Breakdown," in *EIR*, Aug. 11).

The standard method by which overextended firms or countries come back into line with their underlying prospects, i.e. the discounting of their paper's collateral, will prevail in the present case. Since the collateral of most of the developing sector's debt is raw materials, for the most part traded on international commodities markets, the implied result is a devaluation of the dollar against the price of raw materials, and, implicitly, against competing currencies. For this reason the West Germans are entirely unconcerned about the sudden weakness of the German mark against the dollar, which rose to 2.58 marks on Aug. 11. Within two days the dollar was back down to 2.49, a movement of 4 percent. As this publication has argued for some months, the U.S. dollar is in a *fundamentally weak position*, regardless of short-term fluctuations.

The significance of commodity collateral for Third World debt is a principal topic of discussion both in the private sector and at the international institutions. Last week in this space we cited the potential importance of the Salomon Brothers-Philipp Brothers merger as a vehicle for such collateral arrangements. Philipp Brothers Chairman David Tendler put it this way to the London *Financial Times* on Aug. 12:

"Asked for examples of the kind of deals [Salomon and Phibro] might do together, Mr. Tendler said he believed that the new firm could play an important role in easing the problem of debt among less developed countries. Increasingly, he believes, Third World countries will find it hard to borrow solely on the strength of the good name of their government. Instead, they will be forced to borrow against their commodity assets, in which case Phibro would go in and assess the collateral and 'commercialize' it. Salomon could then arrange and underwrite the financing." Commercial banks have already indicated enthusiasm for this type of financing.

On the price side, the old commodity price-stabilization scheme forwarded by the United Nations Council on Trade and Development (Unctad) is likely to take shape by March 1982, State Department sources report. Although the United States will not, in all likelihood, become a signator to the proposed Common Fund, the Canadian government will apparently take the lead on behalf of advanced-sector countries to establish the

agreement. The proposed fund would lend money to commodity-producing countries to enable them to withhold raw materials from the market in the event of a price drop, on condition that they apply any windfall gains from rising commodity prices to repayment of debt. If the 90 countries required to form the institution come together next year, the credibility of the commodity-collateral scheme will gain some points.

Strictly speaking, a form of commodity cartel is already in operation, as of the merger between British Petroleum and Selection Trust, in which the Anglo-American mining giant holds 26 percent, and the formation of the new Anglo-American holding company Minorco, which controls 27 percent of the new Phibro-Salomon combination (see *EIR*, Aug. 18, 1981). To the extent that collapsed industrial demand has not reduced copper prices, unexpected contraction of mine output in Zaire, Zambia, Papua New Guinea, Peru, as well as Poland, is responsible. On this basis, copper mining companies expect continued tight stocks, preventing a drop in demand from adversely affecting the copper price, and ensuring that any significant rise in demand will send the copper price through the ceiling. Should the Philipp Brothers plan take effect to mortgage the assets in the ground of developing countries, the trading arm of the world's largest raw materials combination, the Anglo-American group, will have substantial new leverage in the market itself.

The overextension of dollar paper and the scramble for hard-asset collateral imply, at some point in the near future, a major devaluation of the paper against the collateral, i.e., a rise in commodity prices and a fall in the dollar's value against other currencies. In the monetary sphere this will shortly become evident in the case of gold, which is the raw material of signal importance to the individual investor. The cross-winds of fundamental weakness in the credit structure and weak industrial demand for most raw materials make the price movements of the near term entirely unpredictable. Still, the underlying tendency pushes toward a period of substantial commodity-price inflation.

The commercial banks, less than conducting an orderly arrangement to collateralize a debt mass in the developing world that will near \$700 billion by the end of 1981, are scrambling to attach their paper to something of known value. Whether an orderly liquidation-sale of the assets of Third World debtors might proceed in the manner Phibro believes is doubtful. The proper example to cite is the Florentine loans to England during the 13th century: the Bardi and Peruzzi first collateralized their loans to the English crown with all the wool produced in one year in England; to the refinancing of the first loan, all the sheep; to the next refinancing, all the pasture land. The English crown's subsequent default set the Florentines back for two centuries.