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PACIFIC ISLAND COMMODITY MARKETS

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Overall trends in commodity prices

The continued increase in industrial output in the developed countries had a strengthening effect on international prices during 1987. This, in part, reflected a lagged reaction to earlier increases in final demand. The average value of all internationally traded products continued to rise (Chart 1), but primary commodity prices, as a group, rose more rapidly. This resulted partly from declines in stocks that were absorbed in the early stages of the resurgence of growth in the developed countries. Food prices, in general, rose less rapidly than other commodity prices partly because of the continued subsidization of export sales of grain by the United States and the European Community and of sugar sales by the Community. Metal prices, including copper, responded to the growth in industrial demand.

Many commentators have suggested that the recent 'collapse' of stock exchange prices may lead to a severe depression that will bear very heavily

on primary product exporting countries such as those in the South Pacific. In analysing the possibility of such a development, it is necessary to keep facts in perspective. For example, the Australian 'All Ordinaries Index' reached the bottom of a trough at the end of October that was no lower than its level before the 'Bull Market' really took off a year earlier. The New York market only declined to its January level, London to its November 1986 level, and Hong Kong to its October 1986 level.

Attention was drawn in the December 1986 issue of this *Bulletin* to the improved outlook for the Pacific economies. That is, the sources of the recent improvements originated before the 1987 rapid rise in stock exchange values. Specifically, these rapidly rising values had not persisted long enough to have marked wealth effects on consumption and investment expenditures that only appear after a lag. The long length of this lag in recent months may reflect the fact that many final investors and others

Chart 1
International trade price indexes
(1980 SDR values = 100)

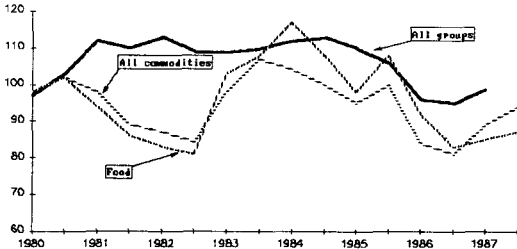


Chart 2
Mineral price indexes
(1980 SDR values = 100)

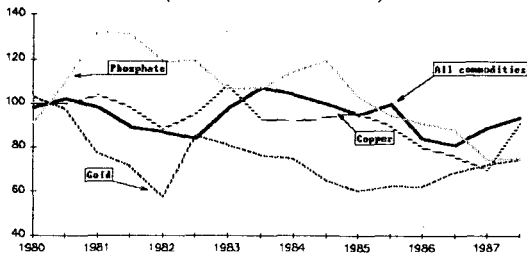


Chart 3
International sugar prices
(1980 SDR values = 100)

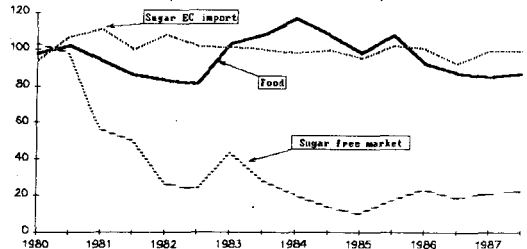
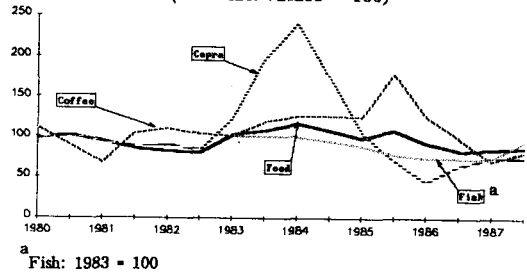


Chart 4
International copra, coffee and fish
prices
(1980 SDR values = 100)



Sources: *The Economist*, *International Financial Statistics*, *The Australian Financial Review*, various issues.

had already discounted the possibility of a reversal of the stock exchange 'bull market'. In the near future, there may be some high wealth effects of earlier increases in security prices, but these should be small. On the other hand, there should be very little wealth effect of recent changes in stock market values on expenditure and output and, therefore, on commodity prices.

Copper

At present, the increase in industrial production has resulted in a faster rise in the demand for copper than in its production, so that inventories are declining. This has produced a rise in prices to their levels prevailing at the height of the early 1970s surge in commodity prices (Chart 2) and is making the copper element in mixed gold and copper exploration activities more attractive. For the near future, this should increase the profitability of PNG mines and encourage exploration expenditures that

are an important part of overall receipts from mineral development (see Warwick Davis, 'Background to Gold Exploration' for comments on the exploration and similar costs of mineral development, and Chart 2 in the editors' 'Papua New Guinea Mineral Resources Stabilization Fund' for an indication of the improved prospects for mineral prices, both in this issue).

Gold

The price of gold continued to follow a rather independent course determined by financial speculative demand rather than basic supply and consumption demand conditions. Thus, the rapid decline in security values in October 1987 had a stronger influence on gold prices, as it was seen as a hedge against paper losses, than any change in the political situation in South Africa, much less any prospects for markedly rising production in the Pacific. Gold prices may well fall from their mid-November levels, but it is almost impossible for them to come

even close to the \$350 per ounce that would make production in the Pacific islands uneconomic.

Sugar

Free market sugar prices remained low in 1987 (Chart 3). The European Community continued to export sugar at prices well below the domestic price and Indian output expanded as the domestic market was liberalized and the system of making payments to producers was made more efficient (the time gap between deliveries to mills and payments to producers was shortened). Chinese and USSR purchases have given some support to free market prices. At the same time, the European Community has continued to purchase sugar at close to domestic market prices from Fiji and (on a small scale) from Papua New Guinea. Papua New Guinea also has a small quota for sales to the United States at approximately three times the free market price. In order to fill its export quotas, Papua New Guinea has imported some sugar at international prices to meet domestic consumption, and Fiji will probably have to do the same as a result of the sharp decline in sugar production in 1987 compared to 1986.

Coconut products and palm oil

A combination of heavy rains in Argentina reducing the sunflower seed crop and droughts in the Philippines and Sri Lanka reducing copra and palm oil output have been among the immediate influences raising the price of copra, coconut oil, and palm oils (Chart 4). It is unlikely that vegetable oil and related prices will return to their 1984 peaks in real terms. On the other hand, any sustained return to the mid-1986 levels would result in a self-correcting decline in production. As noted in the December 1986 issue of this *Bulletin*, vegetable oil prices are among the most volatile of all commodity prices. There apparently is an underlying upward demand trend for these products, but palm oil supply, in particular, is rising; so far, the Euro-

pean Community has not extended protection to support Spanish and Portuguese requests. In brief, the prospects for vegetable oil prices are uncertain, but it is most unlikely we will see any extended return to 1986 levels.

Coffee

Coffee prices are the big exception to the generally rising pattern of commodity prices. The end of the drought in Brazil and an increase in Brazil's production capacity have had a dampening effect. The re-introduction of quotas under the International Coffee Agreement in October should provide a floor under the price, and a prospective decline in output during 1988, partly because of the decline in prices from their 1985 peak, should lead to some strengthening of prices in 1988.

Phosphate

The increasing efficiency in the application of fertilizers was partly responsible for the small decline (12 per cent) in the negotiated price of phosphate in April. This fall had its highest impact on Nauru.

Timber

Despite declining housing starts in the United States, the increasing housebuilding in Japan has evidently provided enough support to the timber market to result in rising prices. This trend in building materials has spread to other markets so that the prices of tropical hardwoods have risen. A decline in construction, or a fall in the demand for quality furniture, could lead to a fall in hardwood prices as well as in those for Fiji pine. However, unless there is a severe recession, this outlook seems to be most unlikely.

Fish

Continued high levels of consumer demand in Japan and elsewhere has given support to fish prices, as exem-

plified by the almost thirty per cent rise in the price of skipjack during 1987.