



Is the Slump in Commodities Over?

Description

Commodities, particularly iron ore and steel-making or coking coal, have surged in recent months, giving considerable hope to beaten-down miners. This has triggered a massive rally among miners, including **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK), which is up by an unbelievable 260% for the year to date.

Surprisingly, there are signs that this inconceivable rally may be far from over.

Now what?

You see, the central bank of Australia has daringly called an end to the commodities bust and has lifted the country's terms of trade. It made this bold claim because of the sharp uptick in iron ore and coking coal prices resulting from a tremendous spike in demand from China.

According to the Reserve Bank of Australia, coking coal contracts for the December quarter have settled at US\$200 per tonne, but this is still well below the spot price which reached a jaw-dropping US\$270.50 per tonne at the end of last week.

This is nothing but good news for miners and especially Teck, which derives almost a third of its gross profit from coking coal, particularly with the price being more than double the average realized price over the third quarter.

A significant driver of the extraordinary rise in coking coal prices was China's decision to curtail excess domestic supplies by limiting the operating days for coal mines.

Then there was Beijing's latest round of economic stimulus, which triggered a tremendous demand for steel because of a surge in housing and infrastructure construction.

Nonetheless, there are concerns that these prices won't remain in play indefinitely.

Beijing could easily backtrack on its planned restructuring of China's fragmented coal industry. If this occurred it would spark a significant increase in production, especially because China is responsible

for 60% of the world's coking coal production.

There are the other producers of metallurgical coal that are determined to take full advantage of higher prices. The world's largest miner, **BHP Billiton Ltd.** ([NYSE:BHP](#)), has previously flagged plans to boost coking coal output, and, for the third quarter, its metallurgical coal production grew by 1% year over year.

Meanwhile, diversified mining giant **Rio Tinto plc (ADR)** ([NYSE:RIO](#)) increased its coking coal production by a whopping 17% year over year for the same period.

The very real risk of a substantial expansion in supply poses a major threat to steel-making coal prices.

There is also the danger of China's latest infrastructure and construction boom fizzling out. If this occurred, demand for commodities—most notably coking coal, iron ore, and copper—would fall precipitously, dragging down their prices.

Let's not forget that it was only in August this year when BHP and Rio expressed considerable concerns about the overabundance of commodity supplies and the pressure this was applying to prices. Rio also cautioned that China was in the grip of an unsustainable credit-fueled bounce, which had sparked a massive surge of investment in infrastructure and housing. As we all know, China's construction and manufacturing sectors are the leading drivers of coal and metals demand.

Despite these threats, BHP's tone regarding the outlook for commodities has become increasingly upbeat in recent weeks.

So what?

Clearly, it is difficult to predict what direction commodities prices will go from here because there are just way too many uncertainties to account for. One of the biggest is what is happening in China, particularly with Beijing intent on restructuring a number of industries and moving the economy away from its dependence on manufacturing- and infrastructure-driven investment to drive growth.

This makes it essential that investors approach miners such as Teck and **First Quantum Minerals Ltd.** ([TSX:FM](#)) with caution. The strong gains already made by both stocks could easily be erased if coking coal or base metal prices fall because of sudden increase in supply or weaker demand from China.

CATEGORY

1. Investing
2. Metals and Mining Stocks

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1. Editor's Choice

TICKERS GLOBAL

1. NYSE:BHP (BHP Group)
2. NYSE:RIO (Rio Tinto plc)
3. NYSE:TECK (Teck Resources Limited)

4. TSX:FM (First Quantum Minerals Ltd.)
5. TSX:TECK.B (Teck Resources Limited)

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