



## Can the Commodities Rally Last Throughout 2017?

### Description

Towards the end of 2016, investors witnessed an impressive recovery in the price of commodities which saw metals and coal surge to multiyear highs. This sparked a massive rally among coal and metals miners with the likes of **Teck Resources Ltd.** ([TSX:TECK.B](#))([NYSE:TECK](#)) and **First Quantum Minerals Ltd.** ([TSX:FM](#)) experiencing solid rallies over the last six months.

There is now growing speculation among analysts as to whether this rally is sustainable, particularly as fears grow regarding the economic health of China, the world's single largest consumer of commodities.

### Now what?

The greatest fear is that China's debt-fueled economic stimulus over the long term is unsustainable. When combined with Beijing's plan to reposition China's economy to one dependent on domestic consumption rather than export-led manufacturing, there are fears that growth will weaken significantly. This can only mean one thing: demand for commodities will fall sharply as manufacturing and construction activity falls.

Not only was it Beijing's renewed economic stimulus that helped to drive metals and coal prices higher in the second half of 2016, but it was also sharp production cuts at many of China's mines which caused supplies to fall. This made the manufacturing and construction industries more dependent on commodities imports.

There are signs, however, that China's domestic production will grow in coming months as local producers seek to ramp up activities to cash in on higher prices. A number of miners, including **BHP Billiton Ltd.** and **Rio Tinto Plc.**, are focused on ramping up metals and coal production; this means that global supplies will grow over the course of 2017.

A marked growth in global commodities supplies coupled with falling demand from China does not bode well for higher commodity prices.

The growing threat of a trade war between the U.S. and China magnifies the threat of a pullback in commodity prices, as do the fears that Trump's planned trillion-dollar infrastructure investment will fail

to materialize. This doesn't augur well for miners, especially with some analysts fearing that the solid rally in mining stocks has significantly outstripped the value of the underlying commodities.

Steel-making coal prices have fallen sharply, crashing through US\$200 per tonne to settle around \$168 per tonne, or US\$140 lower than the multiyear peak reached in November 2016. This trend is expected to continue over the course of 2017 as construction activity in China slows and Beijing's moves to reposition the economy to one focused on domestic consumption as a key driver of growth gains.

### **So what?**

There is a very real danger that metals and steel-making coal prices could fall further over the course of 2017 as China's economic stimulus slows and global supplies increase. Copper is expected to firm over the first half of 2017, but the decline in steel-making coal is expected to continue.

While this won't prevent Teck from hiking its dividend later this year, it will certainly apply pressure to its earnings and share price, making unlikely that it will experience the gains already witnessed. Any bad news out of China would also impact First Quantum; although, with it not having enjoyed the same run as Teck coupled with copper and nickel prices expected to rebound, it still offers some potential upside for investors over the short term.

### **CATEGORY**

1. Investing
2. Metals and Mining Stocks

### **TICKERS GLOBAL**

1. NYSE:TECK (Teck Resources Limited)
2. TSX:FM (First Quantum Minerals Ltd.)
3. TSX:TECK.B (Teck Resources Limited)

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