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HD **Falling commodity prices rattle investors**

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Big picture

Investors in Australian resource stocks face an uncertain period as they wait to see whether prices of key commodities such as **copper** and **iron ore** fall even lower while Beijing continues its crackdown on "hot money" inflows.

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This week, commodity prices tumbled to the lowest level in years as investors fretted that **China**'s poor export performance in February was a sign the country's economic machine is faltering. **Copper** dropped to its lowest level since July 2010, while **iron ore** hit its lowest level since October 2012.

These falls weighed on the share prices of the country's **mining** giants BHP Billiton, Rio Tinto and Fortescue Metals, along with **copper** miners such as OZ Minerals, PanAust and Sandfire Resources.

Investors have been unnerved by the **Chinese** central bank's strong warning to speculators and **Chinese** borrowers not to bet on a continued strengthening of the yuan. So far this year, the People's Bank of **China**, which keeps a tight grip on the currency, has pushed the yuan down by 1.5 per cent, a stark contrast to the 2.9 per cent rise it enjoyed last year.

The PBOC's move has reverberated through global financial markets. Analysts believe that in recent months, a large proportion of the estimated $100 **billion** that has flowed out of troubled emerging markets has made its way to **China**, which was seen as free from currency risk. For **Chinese** firms, it made **commercial** sense to borrow in a currency that was likely to drop, such as the Japanese yen, and to use the proceeds to **buy** high-yielding **Chinese** assets.

Riskier borrowers such as small **property** developers, which find it difficult to obtain loans from the major banks, used **copper** and **iron ore** as collateral for their loans from **China**'s "shadow banks", buying **copper** or **iron ore** abroad using US dollars or yen and storing them in **China** for use as collateral for yuan-denominated loans.

The yuan's fall has choked off some inflows of foreign funds into the shadow banking system. This, combined with concerns over **Chinese** growth, has caused the prices of these two commodities to plunge. These falls have prompted growing margin calls from nervous lenders, worried that the value of their collateral is falling. The fear is that an increasing number of borrowers could be forced to liquidate their stockpiles of **copper** and **iron ore** to repay their loans and that this could drive the prices of both commodities even lower. At the same time, Beijing's determination to reduce overcapacity in its steel industry by closing down loss-making steel mills has fuelled fears that **Chinese** demand for **iron ore** could fall sharply.

Tensions were further exacerbated earlier this month by the first default on a publicly traded corporate bond in **China**, that of **solar**-panel maker Chaori **Solar**.

Analysts warned the default could be the tip of an iceberg as the **Chinese** credit bubble bursts. In particular, they warn loss-making steel mills could be forced to cancel **iron ore** orders as their funding dries up after last week's bond default. A **copper** beat-up

Although some analysts believe the sell-off in **copper** and **iron ore** is likely to continue – and that **iron ore** may fall to $US70 a tonne this year from its present level of just over $US100 a tonne – others believe the latest price declines are overdone. They argue Beijing will make sure **Chinese** growth remains buoyant, which will translate into continued strong demand for Australian commodity exports. What's more, they point out that Beijing's latest policy moves are no cause for alarm because the **Chinese** government has previously signalled its intention to tackle runaway credit growth and to close some older loss-making steel mills.

This view appears to be shared by the miners. This week, Rio Tinto chief Sam Walsh said he expected demand for **iron ore** to remain strong, despite Beijing's move to close down some older mills.

"**China** indicated six months ago they wanted to rationalise their steel industry and we are now seeing that," he said. "If you look at our business, we supply the major steel mills … the blue chip steel mills. Yes, we are seeing volatility. Yes, we are seeing credit tightening. None of that should surprise us because the government had flagged it."

Meanwhile, self-proclaimed "**copper** bull" Owen Hegarty, who has exposure to **copper** through his **stake** in Tigers Realm Minerals **Group**, says he believes speculators are behind the fall in **copper** prices.

"I don't think the data itself is too bad," he told the AFR Weekend. "I can't see anything that is obviously affecting it; there's no big new project that is suddenly throwing lots of **copper** into the market, so I think it's just a bit of speculative activity there."

CO golpla : OZ Minerals Limited | pbchin : The People's Bank of China | sanfir : Sandfire Resources Ltd

IN i211 : Metal Ore Mining | i22 : Primary Metals | i221 : Iron/Steel/Ferroalloys | ibasicm : Basic Materials/Resources | imet : Mining/Quarrying

NS gpersf : Personal Finance | ccat : Corporate/Industrial News | gcat : Political/General News

RE china : China | austr : Australia | beijin : Beijing | apacz : Asia Pacific | asiaz : Asia | ausnz : Australia/Oceania | bric : BRIC Countries | chinaz : Greater China | devgcoz : Emerging Market Countries | dvpcoz : Developing Economies | easiaz : Eastern Asia

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