Making Sense of the Recent Drop in Metal Prices

The last few weeks have been tough for commodities, especially for metals. After flirting with 3,500 in early June for the first time since February 2013, the LMEX (London Metal Exchange Index) has declined by 15%.

The recent drop in industrial metal prices is fairly widespread, but the more than 16% drop in copper prices is what’s capturing investor attention. This metal is usually seen as a good barometer of global economic health. There is no question the momentum of the LMEX and copper prices in recent years is largely a reflection of improvements in the international economic environment. In this context, a sudden change in the trend could appear worrisome.

Rising concerns about a trade war have certainly contributed to the recent drop in copper prices, especially now that China’s economy is showing some signs of weakness. It would be a bit of a stretch to interpret this decline as proof that the global economic outlook is deteriorating, however. That assumption is completely at odds with the advances in several stock markets and oil prices staying near US$70 a barrel. The sharp drop in gold prices, a safe haven that usually gets a boost when the economic situation worsens, confirms that commodity prices are being impacted by other factors right now. In particular, one could think that the decline in metals prices was greatly amplified by the rise in the U.S. dollar.

IMPLICATIONS

The recent drop in metal prices partly reflects a spike in concerns about a trade war and China’s economic situation. It does not, in our view, point to a significant deterioration in global demand and the economic outlook, however. The outlook remains quite positive, especially for the U.S. economy.

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