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INTERNATIONAL BUSINESS

China's Hunger for Commodities Wanes, and Pain Spreads Among Producers

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By **CLIFFORD KRAUSS** JAN. 9, 2016

Chile is expanding its largest open-pit copper mine below the northern desert to dig up 1.7 billion additional tons of minerals, even as metal prices plummet around the globe.

India is building railroad lines that crisscross the country to connect underused coal mines with growing urban populations, threatening to dump more resources into an already glutted market.

Australia is increasing natural gas production by roughly 150 percent over the next four years, as energy companies build half a dozen export terminals to serve dwindling demand.

Across the commodities landscape, this worrisome mismatch mainly traces back to the same source: China.

For years, China voraciously gobbled up all manner of metals, crops and fuels as its economy rapidly expanded. Countries and companies, fueled by cheap debt, aggressively broadened their operations, betting that China's appetite would grow unabated.

Now everything has changed.

China's economy is slumping. American companies, struggling to pay their debts as interest rates rise, must keep producing. All the excess is crushing prices, hurting commodity-dependent economies across emerging markets like Brazil and Venezuela and developed countries like Australia and Canada.

The geopolitical and financial consequences of this shift have shaken investor confidence. Concerns over global growth intensified in recent days, when weakness in China prompted a stock sell-off around the world.

The commodities hangover, the dark side of a decade-long boom, could last for a while.

Multibillion-dollar investment decisions made years ago on big projects, like the oil sands fields in Canada and iron ore mines in West Africa, are just getting up and running. Facing huge costs, companies cannot simply shut off projects. So the excess could take years to work through.

The flood of raw materials is pressuring prices, prompting a painful shakeout. Oil companies have laid off an estimated 250,000 workers worldwide. Alpha Natural Resources and other American coal mining companies have filed for bankruptcy protection.

Saudi Arabia, a giant energy economy, has had to tap the credit markets as its financial reserves dwindle. Venezuela, an oil-rich nation that went on a spending spree, is struggling to meet $10 billion in debt obligations this year, since 95 percent of export earnings depend on crude.

Michael Levi, an energy expert at the Council on Foreign Relations, likened the reversal to a rainfall that first relieved a drought but then created a flood. "Producers ended up being their own worst enemies," he said. "No one ever worried they would produce too much, but that is exactly what has happened and gotten them into this mess."

Lower energy and material prices are often welcomed by consumers. An energy glut has allowed American households to save hundreds of dollars a year on gasoline and heating oil.

But economists worry that the commodity mess reflects a weakening global economy, lowering the value of trade worldwide and perhaps even pushing some countries into the same kind of deflationary spiral that has hampered the Japanese economy for decades. Global turmoil last summer, stemming from China, prompted the United States to delay raising interest rates until the end of last year.

"Lower oil prices have not proven to be as stimulative as economic theory once had it," said Daniel Yergin, the energy historian and vice chairman of the IHS consultancy. "The question is what are weak commodity prices telling us: Is it overinvestment in the past, or signaling a weaker global economy forward? My own feeling is the answer is both."

Commodities have always been subject to booms and busts, rising and falling with the global economy. But China and the cheap debt have changed the equation in some ways.

China's rapid growth led to an increase in crude oil consumption to 7.5 million barrels a day in 2007, from 5.5 million barrels a day in 2003. It is now the world's biggest importer of crude, having surpassed the United States. Other commodities have followed a similar pattern.

The increased demand fueled a surge in prices; copper tripled and zinc doubled over the five-year period ending in 2007. Americans and Europeans found themselves in what amounted to a bidding war for products as diversified as gasoline and coffee.

Then the financial crisis hit in 2008. While the global economy faltered, China continued to grow, buying ever more commodities from developing countries. Those economies, in turn, flourished from the infusion of money.

Peru, with its big bounty of copper and other metals, used its newfound riches to expand its middle class, creating a boom in shopping centers and apartment houses in its capital, Lima. Lagos, Nigeria, experienced the same, benefiting from the high price of oil.

The low interest rates, which had been cut to the bone because of the crisis, fueled the boom. The Brazilian energy company Petrobras accumulated $128 billion in debt, doubling its annual borrowing costs over the last three years.

Then the commodity story started to change when Chinese growth slipped.

In 2015, commodity prices had their worst year since the financial crisis and global slowdown. Nickel, iron ore, palladium, platinum and copper all declined by 25 percent or more. Oil prices have declined by more than 60 percent over the last 18 months. Even corn, oat and wheat prices have sunk.

And the commodity slide has continued into this year. At just over $30 a barrel, oil has reached levels not seen in over a decade.

The bust is made all the more pernicious by rising interest rates, as the Federal Reserve changes gears. Companies that took advantage of the cheap debt to increase production are now stuck with a big bill that will be difficult to cover.

Freeport-McMoRan is putting the finishing touches on a $4.6 billion expansion of the Cerro Verde copper mine in Peru, which will triple production. The project is so big that it could consume nearly 10 percent of Peru's electricity.

With copper prices at their lowest level in seven years, Freeport-McMoRan reported a $3.8 billion loss for the third quarter. The company's shares have dropped by more than 70 percent over the last year. At the behest of the board, the executive chairman James R. Moffett stepped down at the end of 2015, and the company's next moves are uncertain.

Although companies are retrenching, they cannot completely retreat. Many new mines, for example, are designed to function at full capacity to keep them operating efficiently. And the sales are necessary to pay the debts incurred to build them.

At particular risk are coal mines in the United States, Australia, Indonesia and elsewhere. Not only is Chinese demand declining, but rising environmental concerns are also hurting their prospects.

"Raw material producers invest according to current prices without realizing how those prices might affect future demand," said Michael C. Lynch, president of Strategic Energy and Economic Research, a consultancy. "Now that the demand is declining because of high prices, they have too much capacity, and once it's built, you can't unbuild it."

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