Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Supplementary Budget Estimates

17 October – 18 October 2012

Question: **SBT 120-123**

Topic: **Iron Ore and Coal Commodity Prices**

Written: **Received from Committee – 26 October 2012**

Senator JOYCE asked:

Commodity prices, and particularly those of iron ore and coal, have been high for much of the last 5-10 years, but have been coming off their peak for some time now.

120. How much of this price reduction is due to softening world demand, and how much may be due to the inevitable mineral supply response from the rest of the world to those sustained high prices?

121. Does this supply impact get over-looked with the attention so focused on the expected demand increases from particularly China and India over the coming years and decades?

122. What are the key competition and productivity implications for Australia from this growing supply response?

123. Have any retrograde policy steps been taken in these regards since the GFC?

Answer:

120-121. Global commodity prices have been highly volatile in recent months.

Iron ore and metallurgical coal are the main inputs to steel production. Their price falls over winter reflect weaker demand for steel, consistent with subdued conditions in the major advanced economies and recent moderation of steel demand growth in emerging Asia, particularly China. Lower steel prices in China also reflect overcapacity in the Chinese steel industry, which has added to the seasonal destocking of iron ore and coal that takes place in the third quarter. Iron ore and metallurgical coal prices have staged a modest recovery from late September.

Thermal coal prices have fallen by around 19 per cent since May. These falls reflect weak global demand conditions, increased availability of alternatives (such as hydro) and additional global supply from coal exporters.

A partial recovery has been built into the near-term forecasts for iron ore and coal prices, largely reflecting an anticipated recovery in iron ore demand as the destocking process in China runs its course. The increase in iron ore prices since mid-September suggests that prices had fallen below levels consistent with market fundamentals.

Considered from a medium term perspective, commodity prices are still expected to be elevated by historical standards, and will still provide an incentive to continue the expansion of low-cost supplies in Australia and around the world.

In the long term, expanding low-cost supply is expected to result in a slow decline in prices of Australia's non-rural commodity exports, even though strong demand from emerging Asia is expected to continue for some years to come.

The Treasury's projections for iron ore and coal prices incorporate an anticipated expansion in global supply.

As a consequence, the terms of trade are projected to decline by 8 per cent in 2012/13, 2¾ per cent in 2013/14 and by a total of around 20 per cent over the subsequent 15-year period, settling around their mid-2000s level.

122. The operation of competitive global markets is a key driver of improvements in productivity in Australia. The continued expansion of low-cost supplies in Australia and around the world is likely to displace less efficient operators in the market.

123. This question is asking officials to canvass the merits of government policy.