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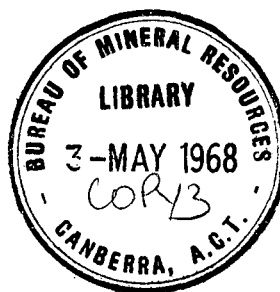
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A NOTE ON THE EFFECTS OF STERLING DEVALUATION ON THE VALUE
OF AUSTRALIAN MINERAL EXPORTS

by

J. WARD

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On 18th November, 1967 the Pound Sterling was devalued by 14.3 percent to a parity of \$US2.4 (from \$2.80) and to a parity of \$A2.14 (from \$2.50). Sterling devaluation was followed by devaluation on a similar scale by Denmark, Yugoslavia, Guyana, Ireland, Hong Kong, Uganda, Kenya, New Zealand and Spain. The purpose of this note is to outline briefly the impact of these currency changes on Australian mineral export earnings which in 1966 amounted to some \$A331 million.

In brief, possible effects fall into two categories - the direct, short-term effects resulting from the immediate price reaction to devaluation, and the indirect, long-term effects which may be anticipated as repercussions of devaluation on the overall world economy.

Direct, Short-Term Effects

As in the case of most commodities, quotations for metals and ores, both fixed price and open market, were increased by roughly compensatory amounts in the United Kingdom on the first trading day following devaluation. Table 1 summarises adjustments made to the London prices of the major metal commodities. In the case of metals traded on the London Metal Exchange viz. lead, zinc, copper and tin, there was an upward adjustment of 10 to 11 percent which did not fully compensate for devaluation. There is little doubt that the hedging operations in previous weeks had already discounted devaluation to some degree. On the other hand, mineral commodity prices which are not determined on a terminal market e.g. aluminium, nickel, silver (and in effect zinc as traded on the producer price basis) were adjusted to compensate fully for devaluation. As might be expected, silver followed neither of these patterns. Comments on the movement of silver prices are made further on in this article. Tungsten ore prices are as quoted by the London Metal Bulletin, and there is some doubt as to how much reliance can be placed on these quotations as a true representation of prices covering actual transactions even under normal conditions, without adding the uncertainty engendered by devaluation.

It is a fact then that the impact of devaluation on spot prices has been in the main on a minor scale. Subsequent price movements on the L.M.E. indicate a trend towards full compensation of pre-devaluation price levels. However, the bulk of Australian mineral exports to world markets are covered by forward contracts, many written in sterling, and in cases where contracts are written at a fixed price, and without a currency clause, domestic exporters could stand to lose substantially. The following notes outline the position of exporters of the major metals and minerals in this regard. Reference should be made to Table 2 which sets out details of value and destination of Australian mineral exports in 1966.

Lead and Zinc. In 1966, lead and zinc together accounted for three-quarters of the value of mineral exports to the United Kingdom - lead for 53 percent and zinc for 23 percent. Total exports of refined lead, lead bullion and lead concentrates amounted to \$A80.8 million of which 43 percent was directed to the United Kingdom. Total exports of zinc were valued at \$A46.9 million, 32 percent of which went to the

United Kingdom. Contracts covering Australian lead exports are based directly on L.M.E. prices and will be affected only in so far as L.M.E. price adjustments do not fully compensate for sterling devaluation. Zinc exports are based on the producers' zinc price which, as already noted, has been adjusted to compensate fully for devaluation.

Silver. Australian exports of refined silver are expected to increase to about 5 million oz. a year following cessation of Treasury purchases. Australian domestic prices and export prices of silver are a direct conversion of the London silver price. On the first day of trading following devaluation, the London spot silver price rose to 202 pence per oz., an increase of 18.1 percent over the pre-devaluation level. Under pressure of a tight supply position caused by strikes in the non-ferrous metal industries which have shut down about 85 percent of U.S. processing capacity, and possibly further hedge buying, prices were forced up to 220 pence by 27th November, an increase of 28 percent on the pre-devaluation level.

Copper. In 1966 exports of copper (mainly in the form of unwrought shapes) to the United Kingdom accounted for less than 10 percent of the total value of copper exports of \$A34.9million. Apart from refined copper, which is traded on the basis of L.M.E. spot prices, the bulk of exports viz. blister copper from Mt. Morgan and copper concentrates from Peko, are covered by forward contracts. Exports of blister copper from Mt. Morgan to the Sumitomo Company, Japan, (\$A10.8 million in 1966) are based on the 3 months forward L.M.E. quotation and the contract is therefore safeguarded by adjustments to L.M.E. prices. Exports of copper concentrates (\$A9.6m in 1966), mainly from Peko to Sumitomo are based on the New York (E and MJ) export refinery quotation.

Aluminium. The bulk of exports of bauxite are made under long-term contracts to non-sterling countries (Japan, Germany, France etc.). Details of bauxite exports are not available, but it is known that only one very small shipment has been made to the United Kingdom over the past two years.

Exports of alumina are made to Japan and the United States from Western Australia under long-term contracts written in \$US.

Significant tonnages of refined aluminium are exported to countries which have recently devalued their currency. Exports to Hong Kong, New Zealand, and the United Kingdom of about \$A2 million in 1966 represented about 30 percent of total exports of this item. No direct loss will be sustained because of sterling devaluation, as the United Kingdom price for primary aluminium has already been fully compensated (see Table 1).

Iron Ore. Recorded exports of iron ore to the United Kingdom in 1966/67 were valued at \$A0.6 million compared with a total iron ore export income of \$46 million. Exports of iron ore are expected to increase to \$86 million in 1967/68 of which about \$A2 million will be directed to the United Kingdom. Value of contracts held by domestic producers total approximately \$A2,620 million. Except for one contract valued at approximately \$A4 million f.o.b., all contracts with overseas steel mills are written in U.S. dollars. The exception is that signed by Hamersley Iron Pty.Ltd. and the Steel Company of Wales, based on sterling. It is understood that prices are to be renegotiated following the devaluation of sterling.

Black Coal. In 1966, Australia exported black coal valued at \$A65.6 million, of which approximately 95.4 percent was directed to Japan. Exports to Japan, particularly from Queensland, will increase steadily up to 1975. In general, contract prices are quoted on the basis of f.o.b.t., Australian ports. According to the Joint Coal Board all contracts involving Queensland coal have been written in \$US. Of the others, those written in sterling have a covering clause providing for an equivalent Australian return in the event of a change in the parity rate of sterling.

Nickel. Nickel concentrates to the value of \$A4 million should be exported to Japan in 1967/68 under a ten-year contract. Additional exports of concentrates are being made to Canada for refining and subsequent sale to consumers both in Australia and elsewhere, and contracts are written in United States dollars.

Manganese. Exports of manganese ore in 1966/67 were valued at \$A6.4 million, of which \$A5.7 million went to Japan. Contracts are written in United States dollars.

Mineral Sands. The bulk of long-term contracts for rutile are signed with United States pigment producers and are written in Australian dollars. Short-term contracts for rutile (with manufacturers of electric welding rods) and for zircon (for foundry operations) are for the most part written in Australian dollars. Exports of ilmenite concentrates provide the exception. Exports of ilmenite to the United Kingdom (about 60 percent of total ilmenite exports) consist principally of ilmenite shipped to British Titan Products by Western Mineral Sands and Westralian Oil. The five-year contract covering these shipments is written in sterling and at a fixed price. It is reported that the relevant contract will now be renegotiated.

Tin. Australia exported tin concentrates to the value of \$A3.6 million in 1966. Forward contracts are based directly or indirectly on L.M.E. prices which have been compensated to some extent following sterling devaluation. Contracts covering exports to Malaysia and Japan are written in \$U.S. Exports of tin concentrates to the United Kingdom have virtually ceased (Ardlethan concentrates are now shipped to Penang). The price of Australian exports of tin are further safeguarded by adjustment to the Buffer Stock range which has been adjusted upwards, the floor price becoming £1280 (£110 previously) and the ceiling price £1630 (£1400 previously).

Tungsten. Exports of wolfram and scheelite concentrates are covered by contracts the prices of which are based directly on price quotation provided by the London Metal Bulletin. This quotation has now been adjusted to compensate fully for sterling devaluation. The Aberfoyle group stand to lose a small amount (about \$A25,000) representing shipment of wolfram made prior to devaluation and for which payment has not as yet been received.

It might be concluded from the foregoing that Australian mineral exports have been relatively unaffected as a direct result of sterling devaluation. And yet perhaps this is an over-simplification, bearing in mind the possibility of increases in freight rates currently under discussion. At the time of writing, an increase of $12\frac{1}{2}$ percent in freight rates to the United Kingdom is mooted. Complete details of freight charges, insurance and handling charges are not available, but such details for rutile and zircon, extracted from the Metal Bulletin, will serve to illustrate the importance of shipping charges on the landed value of these two mineral commodities. Working on the value of the post-devaluation quotation of \$A44-48 f.o.b. for zircon and \$A86-88 f.o.b. for rutile, adding freight of 150 shillings for zircon and 151 shillings for rutile, a surcharge of $3\frac{1}{4}$ percent and insurance, the c.i.f. European prices for zircon and rutile, are increased to £27 $\frac{3}{4}$ - 29 $\frac{5}{8}$ per ton and £47 $\frac{7}{8}$ - 49 $\frac{1}{4}$ respectively. Calculated on even current shipping rates, freight and charges to Europe amount to roughly 30 percent (for zircon) and 20 percent (for rutile) of the f.o.b. value of these minerals.

Indirect, Long-Term Effects

Devaluation of sterling is only one manifestation of the British Government's overall economic policy of restoring order to the United Kingdom's balance of payments situation. Other measures accompanying devaluation are an increase in Bank Rate from $6\frac{1}{2}$ to 8 percent; restrictions on bank advances; change in hire purchase regulations; a reduction in defence spending and a cut of £100 million in public spending, including capital investment by the nationalized industries. In effect, the measures are designed to produce a marked shift in resources to exports and private manufacturing investment at the expense of government expenditure and private consumption. These measures could adversely affect the value of Australian mineral exports in the following ways :-

(a) By easing the flow of British capital into Australian mining projects. Although reports indicate that there has been no rush to repatriate British capital presently invested in Australian mineral development, it is only logical to expect that, in view of the higher bank rate, the flow of capital investment from this source will be curtailed in the future.

(b) By reducing United Kingdom demand for metals for internal consumption. United Kingdom ranks as a major world consumer of metals and ores, and reduced consumption of metals for the home market must in effect be reflected in a significant reduction in over-all world demand.

(c) By triggering off a "beggar-my-neighbour" policy. In theory, the United Kingdom exports of manufactured metal products will increase as British manufacturers take advantage of their improved competitive position. However, expanded markets will be gained only at the expense of other industrialised countries. The over-all result could be a reduction in world metal prices without an accompanying increase in world demand.

(d) By encouraging devaluation of other major currencies. Concomitant with the loss of international confidence and the run on gold reserves, the United States dollar, Japanese yen and the Swiss franc have come under increasing pressure. Any devaluation of the United States dollar would no doubt have a snow-balling effect on other world currencies and in the resultant economic chaos, international trade would be disrupted with the introduction of trade barriers - import duties, quota etc.

In summary and broadly speaking, sterling devaluation has had only a limited effect on mineral exports and those commodities adversely affected contribute only minor amounts to overall export income. However, the long-term effects of devaluation on the value of mineral exports could be much more serious. World metal prices, particularly of base metals, are currently being maintained at an artificially high level as prolonged strikes are continued at mines in North and South America. Long-term studies undertaken by international study groups and other metal research organisations indicate future surpluses of lead, zinc, tin and even of copper. Development of such surpluses would be further aggravated by a general world economic recession and Australian mineral exports would be subjected to severe pressures. In such an eventuality it is reassuring to note that possible losses to base metal exports would be buffered by increasing exports of iron ore and coal.

TABLE 1

VARIATIONS IN LONDON METAL PRICES

Metal	Price on 17th Nov.	Price on 20th Nov.	Adjustment
Lead	£84.813	£93.875	+ 10.68%
Silver	171 ^d	21st Nov. 202 ^d	+ 18.13%
Zinc	£99.875	£110.875	+ 11%
	<u>Producer</u> £98	<u>Producer</u> £114-1/3	+ 16.67%
Copper	£502.50	£556.00	+ 10.65%
Aluminium	£196	£228-2/3	+ 16.67%
Tin	£1225.000	£1344.000	+ 9.71%
Nickel	£773 ¹ / ₂	£902	+ 16.61%
Wolfram	352/6 - 372/6	385/- - 405/-	+ 9.22%

TABLE 2 - DESTINATION OF EXPORTS, VALUE, 1966

(\$'000)

	Aluminium	Copper	Lead	Zinc	Iron & Steel	Manganese	Tungsten	Rutile	Zircon	Ilmenite	Tin	Coal	Opal	Other	Total	Percentage
<u>Europe -</u>																
United Kingdom	870	3235	34567	15329	1779	-	536	1702	1284	2210	1900	-	254	1643	65307	19.72
E.E.C.	2004	7582	12676	4517	1911	-	1658	3063	2059	561	87	-	702	866	38687	11.68
Other Non-Communist Europe (a)	1	40	1248	1801	3694	-	262	1105	362	60	1274	-	145	247	10239	3.09
USSR and Communist Europe	-	-	-	-	430	-	-	499	91	-	-	-	-	-	1021	0.31
Total Europe	2876	10856	48491	21647	7814	-	2456	6368	4797	2831	3260	-	1101	2756	115254	34.80
<u>Asia -</u>																
Japan	3913	22742	4501	3193	16368	3365	206	1734	1356	409	168	62548	3170	530	124203	37.50
India	233	-	4732	3335	5	-	-	167	-	-	-	-	4	189	8665	2.61
Hong Kong	752	-	9	693	1018	-	-	15	-	-	-	231	1801	154	4673	1.40
Philippines	188	-	963	1890	2725	-	-	12	-	-	-	-	-	239	6017	1.81
Malaysia and Singapore	19	-	72	691	124	-	-	1	-	-	65	177	26	480	1655	0.50
Middle East	57	-	9	315	-	-	-	69	1	-	-	-	19	-	470	0.14
Mainland China	-	-	-	15	-	-	-	-	-	-	-	-	-	-	15	0.04
Other Asian	887	-	753	4337	4871	-	-	64	9	2	-	521	54	417	11914	3.95
Total Asia	6049	22742	11040	14470	25111	3366	206	2061	1366	411	233	63477	5073	2009	157612	47.59
<u>America -</u>																
United States	1206	1279	19514	7782	1675	-	837	8440	2366	393	-	-	1417	1116	46025	13.93
Canada	178	-	-	-	-	-	-	417	292	-	-	-	34	46	968	0.29
Other American	192	-	-	898	-	-	-	201	113	-	81	-	1	26	1513	0.46
Total American	1576	1279	19514	8680	1675	-	837	9059	2771	393	81	-	1453	1189	48506	14.65
<u>Oceania -</u>																
New Zealand	640	2	1766	1334	519	4	-	16	10	-	2	465	3	1273	6034	1.83
Other Pacific	20	-	11	11	24	-	-	-	-	-	1	1684	21	100	1837	0.56
Total Oceania	660	2	1777	1345	543	4	-	16	10	-	4	2149	24	1373	7908	2.39
<u>Africa -</u>																
South Africa	-	-	-	561	3	-	603	189	34	87	-	-	1	22	1501	0.46
Other African	-	-	4	160	-	-	-	151	-	-	-	-	-	58	374	0.11
Total African	-	-	4	722	3	-	603	340	34	87	-	-	1	80	1875	0.57
<u>TOTAL</u>	11161	34878	80827	46863	35146	3370	4103	17844	8978	3721	3578	65626	7652	7406	331154	100.00

(a) Includes Yugoslavia

NOTE : Any discrepancies between totals and sums of components are due to rounding.