COMMODITIES

For Commodity Prices, China's Output Is Becoming a Growing Factor

Expecations of declining production of goods from aluminum to coal are triggering price swings and increasing investors' concerns

China triggered a surge in international coal prices last year when it restricted the working days of the country's producers. Above, employees unload coal from a truck at a Chinese coal mine. *PHOTO: QILAI SHEN/BLOOMBERG NEWS*

By **RHIANNON HOYLE**

Updated March 29, 2017 6:43 p.m. ET

Chinese demand has long been the driving force in many global commodity markets. Now, expectations of falling production of goods from aluminum to coal are moving prices and getting more attention from investors.

For example, last year, the world's No. 2 economy upended the global coal market by restricting the working days of the country's producers to 276 from 330. The decision triggered a 25% jump in Chinese imports and a surge in international coal prices.

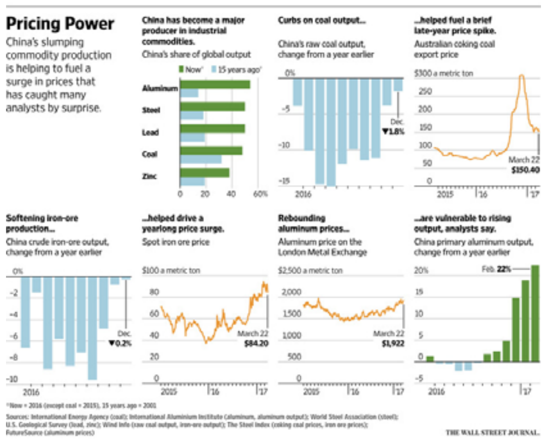
Given China's outsize role as a producer, such volatility could spread to other commodities. The country ranks among the top three producers of commodities ranging from aluminum to zinc. It supplies 50% of the world's lead, compared with 19% 15 years ago, and about 48% of the world's coal, up from 32%.

Another hurdle for investors is that data from China involve guesswork because of the difficulty in getting reliable production figures from the country's commodities industry. Analysts say official data can overstate production in markets such as copper and can vary significantly from numbers collected by private data providers.

"The supply data is detective work," said Campbell Harvey, a finance professor at Duke University's Fuqua School of Business. "We have focused so long on the demand aspect, on China's growing economy, and that is only half the story."

Many investors seek alternative information sources, including satellite imagery, and some consultants even track the number of excavator trucks moving around mine sites and count worker tents to predict commodity supply.

"It is a murky world," said Tom Diamond, president and co-founder of Chicago-based Remote Sensing Metrics. The firm, which publishes data on global metal stocks, including in China, analyzes thousands of black-and-white images bought from satellite companies.



"If you are a mining company trying to decide how much to invest in a new project, you want to be able to see what is going on elsewhere," said Mr. Diamond.

Supply news from China has become a swing factor in how investors view commodity prices.

Aluminum prices could rise to $2,000 a ton this year from less than $1,700 at the start of 2017, according to analysts at Goldman Sachs Group Inc., after Beijing ordered production cuts during the winter months largely in regions that account for around a fifth of the global supply of the metal.

Big mining companies are trying to figure out if China will increase production of other commodities.

China's output of iron ore, the world's second most heavily traded commodity after oil, fell to about 250 million to 275 million metric tons last year from roughly 400 million tons about three years ago, according to estimates from Rio Tinto PLC, the world's No. 2 mining company. The reduction came as falling prices dented returns from its mines, some of the most expensive to run globally.

Rio Chief Executive Jean-Sébastien Jacques said that while he isn't concerned about the Chinese economy, "the real uncertainty is around the domestic iron-ore production" and whether Chinese mining companies will go back to "300-plus" million metric tons of annual output now that prices have recovered. Any big increase in Chinese output could hit Rio, which relies on iron ore for the bulk of its profit.

Meanwhile, China's waning oil output could support a global oil-price recovery, as its aging fields mean the country—which is among the world's top five oil producers—may have passed a peak in output and could increasingly depend on imported fuel. Beijing forecasts domestic oil production will fall 7% by 2020 from 2015 levels.

Chinese government rhetoric suggests it doesn't want to create big swings in commodity prices, which could create inflationary pressures in its own economy.

"If China thinks prices are going to get too high, they can relax some constraints on their own producers" and restart mines, said Peter Markey, Ernst & Young LLP's China and Mongolia mining and metals leader. "That gives policy makers an extra string in their bow."

Write to Rhiannon Hoyle at rhiannon.hoyle@wsj.com

Appeared in the Mar. 30, 2017, print edition as 'China's Falling Output Tests Investors.'