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Commodity Commonalities

Over the past month or so, UxC President Jeff Combs has spoken at two commodity conferences, one in Toronto and the other in Cape Town. Below are some perspectives gleaned from these conferences which may have some relevance to the uranium market going forward.

Scotia Capital (Toronto)

The Scotia Capital commodities conference in Toronto covered a number of commodities besides uranium. One paper that had a number of interesting parallels with uranium was one on molybdenum presented by Catherine Virga of the CPM Group.* We have selected this paper to examine, not just because of the parallels, but because it looks at the market in much the same way we do, and it has interesting implications for what might happen in the future.

One of the most striking similarities with uranium was historical price behavior. The chart on this page shows the historical price of molybdenum in nominal dollars and a projection for this year in real dollars. Look familiar? Price spiked up in the late 1970s, only to fall back sharply before making an abortive recovery in the mid-1990s and sharply escalating in 2004 and 2005, before retreating in 2006, only to bounce back in 2007. Now, this isn't exactly what happened in uranium, but it's pretty close. The question is whether both prices were subject to the same forces or whether this is just some sort of strange coincidence.

The answer to this question is important in that people in this industry point to what has happened in other commodities to explain the likely evolution of uranium prices. In some cases, this is to show how speculative activity has driven up prices only to see them fall back to earth, posited as a harbinger of what is to come in uranium. Of course, this is not the only reason for price volatility; as we will see, market fundamentals have been extremely important in molybdenum as they have for uranium.

Ms. Virga explained that the slump in molybdenum prices during the 1980s was due to substitution, overproduction in the steel market, the recession, and relatively limited end-markets. Certainly uranium was affected by overproduction (both of uranium and enrichment) and the recession, while the end market for uranium has always been limited. (When uranium prices fall, demand doesn't increase for the other uses of uranium because there aren't any.)

One of the reasons for the up-tick of molybdenum prices in the mid-1990s was due to reduced Chinese imports. A similar thing happened in uranium with reduced CIS imports due to the closing of the bypass loophole.

Other similarities with uranium can be found in the reasons for the strong growth of molybdenum prices this decade. Years of underinvestment in molybdenum resulted in low production and production lagging consumption, a key factor in the uranium market. Also, there is the evolving geopolitical climate, where countries like China have been locking up resources to meet their future demand. For readers of this space, you are aware of our focus on the changing geopolitical dimensions of the market.

One of the most interesting observations was that the recent rally in molybdenum's prices was different than the rally in the late 1970s. Three major reasons for this were given: 1) shifting originations of molybdenum supplies, widening scope of end-users, and diminishing inventories.

Right off the bat we can see that the latter two reasons apply to uranium as well. Under the widening scope of end-users, two additional points were made: expanding energy sectors and limited substitutability. Of course, these individual observations apply even more to uranium than to molybdenum, as energy is the only commercial use of uranium (molybdenum has a number of other uses), and there is essentially no substitutes for uranium except for enrichment.

Again, we have stated on a number of occasions that the recent price boom in uranium is much different than what occurred in the 1970s. Then, the U.S. government artificially inflated uranium demand through its monopoly control of enrichment, which eventually led to overproduction and a massive build-up of inventories, which were later liquidated in the market. The price cycle in which we currently find ourselves was not precipitated by artificially high demand, but rather by what can more appropriately be called artificially low supply, as price was pushed to extremely low levels and production and exploration suffered as a result.

We would venture to say that the recent price recovery in uranium was less demand driven than molybdenum, and was more due to the really bizarre way this market has evolved, where production was beaten down as all kinds of inventories—including those from dismantled nuclear warheads – were liquidated in the 1990s, creating the false impression that there was an endless

source of supply at low prices.

Most importantly, because of the factors currently shaping price, Ms. Virga concluded that molybdenum prices would not reverse to much lower levels like they did in the 1970s and that price in 2009 would be higher than price levels in 2007. (The projection for 2008 is shown in the chart.) More than this, she believes that molybdenum prices will be permanently higher in the future.

Will this be true for uranium as well? We have noted on a number of occasions that it is highly unlikely that the confluence of events that pushed prices to extremely low levels in the 1990s and early this decade – massive liquidation of inventories by commercial participants and governments coupled with a moribund nuclear power industry – will be repeated in the future. Instead, there is a growing appetite for uranium, as well as all commodities, as economies around the world continue to grow. Uranium price cycles tend to be painfully long; it depends whether you are a buyer or seller when it comes to feeling the pain.

*For more information on the molybdenum market, contact Catherine Virga of the CPM Group <http://www.cpmgroup.com/> This chart was used with the permission of the CPM Group.

Mining Indaba (Cape Town)

Earlier this month, the Mining Indaba conference was held in Cape Town. A number of excellent papers were presented in a Commodities Review & Forecasts panel, the first phase of the conference.

One interesting observation on general commodity behavior by Dr. Martin Murenbeeld, Chief Economist of DundeeWealth Economics, was that if supply cannot expand at the rate of demand, the price of the commodity must rise and “squeeze” demand back to available supplies. He noted that this is not inflation in the true sense, but a rising price is the market’s way of rationing supplies.

Of course, the notion of squeezing demand and rationing supplies is not really applicable to uranium, and this lack of demand elasticity is why uranium prices can go to quite high levels, as was seen last year. That is, uranium prices would have to go quite high in order to negatively impact the demand for uranium, except to the extent that tails assays can be changed and enrichment can be substituted.

A relatively new phenomenon that also applies to commodities in general is commodities as an asset class, where commodities should be 3-5% of one’s portfolio. Dr. Murenbeeld made the observation that commodities have a much smaller share of the pie than this, so this could add to demand down the road.

On the subject of market cycles, Dr. Murenbeeld noted that we are only in the seventh year of an up cycle in copper, and the shortest cycle is 9 years while the average is 16 years.

While noting that recession was not good for commodities, Dr. Murenbeeld pointed out that it was not axiomatic that a recession in the U.S. would pull the rest of the world down with it, and hence there could be a certain amount of “decoupling” of the U.S. economy with the rest of the world’s economy, especially that of China, which has been a driver in the recent commodity boom.

Dr. Paul Walker, CEO of GFMS, spoke about gold. He noted that new mine production in gold, which is often an overlooked factor, has been greater than new net demand, and this could potentially end the rally in gold. Of course, a similar development would also kill the rally in uranium, although so far new production has not been outstripping new demand.

Another development that is key for gold but also important for uranium (and really every commodity for that matter) is the future value of the U.S. dollar. He opined that the euro could reach \$1.60 before the dollar bear market ends. (In this regard, it has recently flirted with \$1.50.) Can you say \$160 SWU prices?

Finally, Robin Baskin of Fortis Bank projected that the pending recession in the United States will negatively impact copper demand and price. However, she noted that the global economy has surged, led by a huge boom in copper imports by China. Baskin believes that the impact of China means the copper price will bottom at twice the level of previous down cycles, another indication that the future may be nothing like the past.

Although this outlook may be exactly the same as for molybdenum, the general message for commodities is that there is a new paradigm in place, where the market fundamentals should on balance remain strong in the foreseeable future.

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