

Why coal could soon be back

Moneyweek
Mar 20, 2009

Take a walk to the end of the pier in the port of Newcastle in New South Wales, and you'll see something strange... There's no stream of ships being loaded with raw materials as there was last summer. Now they're lying empty and idle offshore. It's a sign of the times...

In Australia, commodities are the life blood of the economy. So it's little wonder that there have been long faces down there. The price of coal has tumbled 60% from its peak a year ago.

Coal exports in January were worth A\$4.5bn, a 20% drop from the previous month and February is unlikely to have been any better. "It's a buyer's" market said one coal producer. "The market is very weak and there is plenty of coal out there."

No wonder the mood is as black as the coal itself. But as we'll see, there are signs of a turning point – and a chance for us to profit from it...

Just a year ago coal miners were cranking up production just as fast as they could. Nobody foresaw an end to the era of high prices. But the global recession has changed that. Even the mighty Chinese economy is not immune from its chill wind.

Why this new deal could spark a revival in the coal market

But let us get a little perspective. Because the gloom could lift much sooner than people realise. Indeed, only last week Xstrata, the world's biggest producer of power station coal settled a supply agreement with Japan's Chubu Electric Power at a price of \$70 per ton. True, this is some way below the \$125 per ton that Chubu settled for last year. But coal industry watchers in Australia are still happy.

And here's why this deal should set the benchmark for other annual supply negotiations taking place around this time...

You see, \$70 per ton is still double the price that coal producers were receiving two years ago before the super-cycle theme got an airing and sent commodity prices into the stratosphere. It is still a level at which any low- or mid-cost mine should comfortably be in profit. And it could also mark the low point of the cycle.

Nobody believes that the long-term picture has changed. Population growth, industrialisation, urbanisation, the desire for motor cars, fridges and washing machines – all of these trends are still very much in place, even if temporarily put on hold. And it's these trends that still point to a great opportunity for investors buying the right coal companies...

The Australian Bureau of Agriculture Resource Economics reckons that China will soon regain its appetite for Australian commodities. It says that the financial crisis is only likely to put a temporary dent in its massive and growing demand for iron ore and coal.

The Bureau acknowledges the likelihood of a slump in export earnings this year. But it predicts that over the five years to 2014, Chinese steel production will grow by an annual average of 7% a year. That means that by 2013-14, it will be consuming up to 44% of the world's steel output. That's more than enough to ensure a healthy demand for coking coal.

China's new multi-billion-dollar kick-start for commodities

But the upturn could come sooner. You see, the lull in demand for coal is as much down to the unwinding of stockpiles that have built up at Chinese ports. But these stockpiles will soon be run down. And China is ready to embark upon a multi-billion dollar construction package to revive its flagging economy. That could be a major fillip to demand for coal and metals.

So it could be a good time for investors to revisit the commodities theme. The share prices of the big mining stocks **Rio Tinto** ([LSE: RIO](#)) and **BHP Billiton** ([LSE: BLT](#)) have been edging up in the last three months.

And I also like the high-yielding shares of **Anglo Pacific** ([LSE: AFP](#)). The share price may have fallen 60% in the past nine months. But last year it received £22m of royalty income from its Australian coal interests and paid out some 8.5% in terms of dividends to shareholders.

Equity investors should take the long-term view – now more than ever. So long as you're able to do that, then commodity stocks at current levels look a good bet.

• This article was written by Tom Bulford for the free daily investment newsletter [The Right Side](#) and was first published on 16 March 2009