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Super-cycle in the commodity market: case studies of the BRICS countries

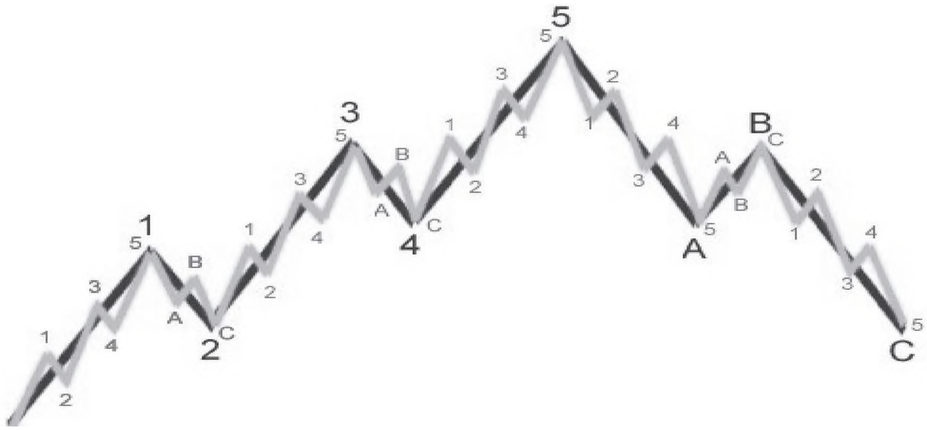
During periods of turmoil in the world economy different theories of cycles, such as Kondratieff cycles, Elliot cycles are particularly in demand. The imposition of the phases of different cycles can be observed always for all in the global economy is connected, and a decline in one area entails a decline in the other.

The paper presents a theory of cycles in the stock market – specifically the waves of the world market prices of commodities. Today, interest in Elliott wave arose because of the high volatility of the world oil prices.

Ralph Elliott created this theory in the 30s of the twentieth century. He reviewed the 80-year period of changes in oil prices and found the existence of eight waves: five of them belonged to bullish trend (upward trend) and three to bearish trend (down trend) (see Fig.1) [2].

Figure 1

Elliott wave: the full market cycle



Source: [2]

Waves 1, 3 and 5 upward waves of the main bullish trend. This is impulse wave. Waves 2 and 4 corrective phases of waves 1 and 3. Waves A, B, C are three down waves of bearish trend. Waves A and C of them are impulse waves and

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wave B – correction wave A. Eight waves together constitute the full market cycle (see Fig.1).

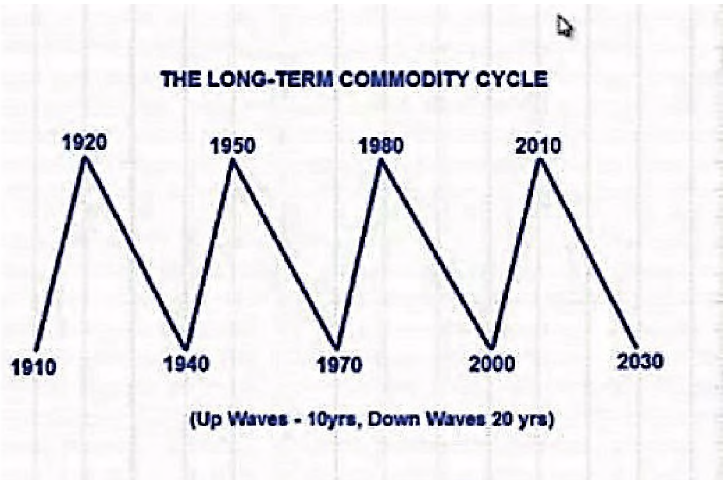
The principle of involvement of small waves to large ones works in cycles Elliot, as well as in other economic cycles. Each impulse consists of five waves of a smaller size, and each corrective wave includes three sub-waves. According to the Elliott's theory, the longest cycle is called the Great super cycle; it consists of eight super cycles and so on [2].

Elliott wave is well studied in retrospective analysis, but they are conditionally show cyclic fluctuations of the stock market in the future. Therefore, the prediction using this theory is rather difficult.

However, in periods of terrible fluctuations in commodity markets, economists are still trying to apply the theory of Elliot to predict. Jeffrey Kennedy, a contemporary analyst of the financial market offers to build on the basis of Elliott wave a thirty-year commodity super-cycle [7]. In his interpretation, the super-cycle has the phase of rising prices, which lasts about ten years, and the phase of decline, which lasts for twenty years (see Fig. 2).

Figure 2

The 30-year commodity cycle



Source: [7]

Principal features of the global commodity cycles have the following characteristics. First, the price growth in excess of trend occurs on a wide range of commodities – often observed for the raw materials necessary for industry and construction.

Second, the basis of the super-cycle is the global market conditions (supply and demand), the demand for raw materials caused by rapid industrialization of a large country or group of countries. B. Baruch said about the world conjuncture: "in fact, imprinted in the fluctuations of the stock market – so it's not themselves events, but the human reaction to these events" [2].

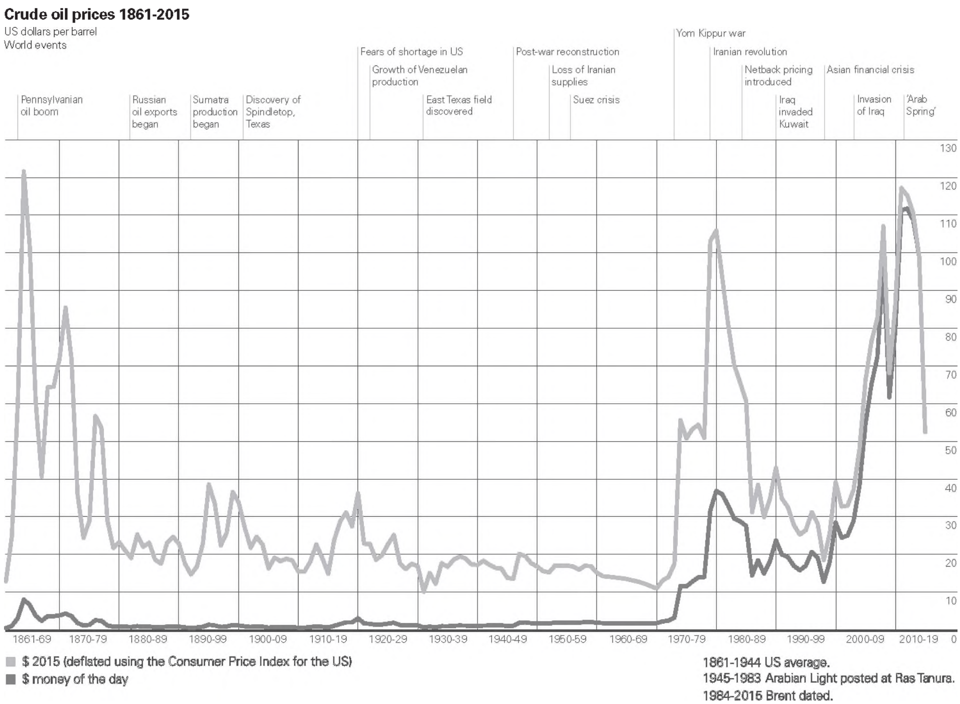
It is assumed that the last commodity super-cycle began in the global economy in the early 2000s in connection with the rapid development of China and some other developing countries such as BRICS. A retrospective analysis of dynamics of prices for oil and metals showed that many analysts in 2013 were talking about the end of the elevation phase of this super-cycle [1].

Consider super-cycle of world oil prices since 1970s. The rise of the early 1970s (with corrective waves of the mid-1970s) was followed by decline in the 1980s (see Fig. 3).

In the oil cycle fifteen years have seen falling prices (1983 to 1998), then ten years of growth (1998-2008). Market oil prices showed a strong volatility in the period of long-term growth and long-term decline. However, the overall trend in all commodities is indicating a change in global trends on commodity prices. In accordance with the theory, it is now possible to expect falling trend to 2025-2028. However, as was mentioned above, it is almost impossible to accurately predict the movement of these cycles.

Figure 3

Crude oil price 1861-2015, US dollars per barrel



Source: [5]

What is the impact on the world commodity market of the BRICS? The share of the BRICS in the global foreign trade balance of goods of the primary sector has grown almost two times (from 10 per cent to 18 per cent) in the period 2000-2013, the Share of exports from extractive industries in the BRICS in world exports of mining industry increased from 10 per cent to 14 per cent and the import share of BRIC countries in global it imports from 7 per cent to 20 per cent. Russia occupied a leading place in the export of products of the mining industry among the BRICS countries in 2013; its share of world exports was 9 per cent. China was the leader in imports of goods mining industry, its share in world imports was 13 per cent. The high growth rate of China's GDP since the beginning of the century and up until the events of 2008 naturally demanded increasing the number of resources used. As a result, China has reached an unprecedented level of world demand for raw materials in this relatively short period of time. Since the beginning of 2000s one can observe in the global market, an increase in commodity flows. The BRICS countries have been the locomotive of this trend, guiding, feeding and pushing its dynamics.

Let us analyze the price changes in this period on natural resources for example oil prices. Due to low prices of raw materials the international mining companies have not invested in production expansion and new technology in the late twentieth century, this company was not ready to a jump in demand from China. The imbalance of supply and demand naturally led to higher prices. A quick jump in the cost of oil has occurred since the end of 2003 to 2005 In early January 2008, for the first time in history, oil prices exceeded US$100 per barrel (however, during the energy crisis of the 1970s oil, adjusted for inflation, was even more expensive), then the trend of rising prices continued. In one day, on June 6th, 2008, oil rose to US$10 per barrel. The maximum price of the resource was reached on July 11th 2008, topping US$147 per barrel and then began a sharp decline, which lasted until December 2008. The oil prices gradually recovered in 2009, and then rose again, in 2011-2013, and continued growing until 2013 [4].

Since mid-2014 due to commodity markets oversupply and weak growth of world consumption and production growth of shale oil in the United States, the price of oil has dropped twofold. In addition, this has helped to increase production of the resource in Saudi Arabia and the refusal of OPEC to cut production quotas in November 2014. Russia had increased production and export of oil to maintain former income level. But prices continued to fall, even though China had increased its imports. And oil prices renewed a thirteen-year low in 2016. At the end of 2016, OPEC and Russia agreed on quotas for oil production, including the reduction of oil production in 2017. As a result, prices rose from November 2016 to January 2017 by about 17 per cent. But, this likely indicates a corrective wave; a full cycle has not yet been overcome by a wave of decline.

Based on the Elliott theory, we can assume that the down trend should last until 2025-2028 [7].

In conclusion, I would like to note that for the theory of super-cycle there are both followers and opponents, their ratio varies depends on the phase of the cycle. So, during the upward trend the number of opponents increases and the down trend is getting more followers.

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