U.K. commodity markets

An article under this title in the September 1964 *Bulletin* gave an account of the resumption of commodity trading in the various U.K. markets after the 1939-45 War. It described the part played by the Bank of England in drawing up and administering exchange control schemes which gave member firms as much freedom as possible in their overseas transactions; and it went on to explain the value of the markets to the U.K. economy, to outline the broad principles of commodity marketing, including futures trading, and to discuss some of the problems of world trade in commodities and the means of dealing with them.

The present article surveys the events of the succeeding five years, describing the major price movements and other features of world trade, and discussing in some detail the situation of the U.K. markets and developments therein; but first there is a brief review of the nature and functions of the markets.

Background

The U.K. commodity markets collectively provide a centre in which raw materials and basic foodstuffs are bought and sold. The feature which distinguishes them from commodity markets in other countries is that a major part of their members' business consists of international merchanting, that is, both buying and selling in countries other than their own. The basis of trading is the forward contract which lays down the quantity and description of the goods, the place and date of delivery, and the price and method of payment. Delivery and payment may be up to a year, and sometimes more, after the date of the contract.

Because of the price risks inherent in forward commitments of this kind, many of the markets dealing in the major commodities also provide facilities for futures trading. Contracts made in the futures markets are not usually run to maturity, though they provide for delivery and payment at an agreed time just as forward contracts do. A liability under a futures contract can be readily closed out (terminated) at any time by another futures contract made in the reverse direction. Futures markets provide commodity traders with a convenient means of hedging, or insuring, against the price risks which they are often obliged to carry in respect of their forward commitments in the physical commodities. For example, a forward purchase or an unsold stock of a commodity can be hedged by a sale of futures, because if a fall in price causes a loss in the value of the commodity, the price of futures will also fall by roughly the same amount – and this can be recovered by buying the futures back.[1]

The trading community which handles the business of the U.K. commodity markets consists mainly of a large number of dealing and broking firms which have formed themselves into market associations. These associations draw up forms

[1] A fuller description of the use of futures markets was given in the September 1964 *Bulletin*, pages 196-7.

of contract in the types or grades of a commodity which are commonly used in international trade. They also provide arbitration facilities for the settlement of claims and lay down rules of trading and conduct. A list of the principal U.K. commodity market associations concerned with markets referred to in this article is given in the appendix.

Prices

Throughout the period under review world production and trade expanded and the volume of exports from primary producing countries rose fairly steadily. On balance, commodity prices were somewhat below those of 1963-64, which had been relatively high. However, prices fluctuated considerably and there were naturally some wide divergencies. For some basic foodstuffs, prices were at times depressed by excessive supply – particularly cocoa in 1965 and sugar at the end of 1966, though in both cases the position was later reversed. Indeed, in the cocoa season just ending (the fourth in succession of insufficient supply) the market price reached a high point exceeded only once before. Increased competition from synthetics depressed the prices of a number of commodities: sisal, rubber and crossbred wool all touched their lowest points for a decade in 1967, though again there has been some recovery since. On the other hand non-ferrous metal prices generally reached historically very high points during the period; and the market for cotton, almost static for many years, was brought back to life during 1967 after policy changes by the U.S. Government and the running down of their stockpile had restored some freedom of movement to the price.

International agreements

The wide fluctuations in price of some commodities, and the very low prices reached in particular cases, have prompted continued efforts to find solutions to commodity problems. A number of international agreements have been signed in recent years and there are now a better understanding of the problems and a better appreciation of how they may most effectively and practically be solved – thanks in large part to the contribution made by the trade representatives from many countries, including leading members of the U.K. markets, who have taken part as advisers to the official delegations at commodity conferences.

The two major events of the period were the second United Nations Conference on Trade and Development, held in New Delhi last year, and the 'Kennedy round' of tariff negotiations, which took place under G.A.T.T. auspices in Geneva from 1964 to 1967. On both occasions discussions included the problems of individual commodities. At New Delhi a number of commodities were considered and a detailed programme was agreed. In the Kennedy round, though some commodity problems were deferred for separate negotiation, a new International Grains Arrangement formed an essential part of the final settlement. Under this a new wheat agreement, to replace that of 1962, came into being last year. The wheat agreement differs in character from other international commodity agreements in that it does not

attempt to control the world price of wheat by regulating the supply available to the markets; it is merely an undertaking by governments which seeks to provide certain guaranteed outlets for producing members, and supplies for consuming members, at prices within an agreed range. The maximum and minimum prices of the new agreement are higher than before: as wheat is now in surplus and fresh stocks are likely to accumulate, the observance of the higher minimum has already caused difficulty.

A common feature of other forms of international commodity agreement is their aim to restrict price movements within agreed ranges by regulating supplies. This can be accomplished by means of export quotas alone (as for coffee and sugar), or by a buffer stock working in conjunction with an export quota mechanism (as for tin). Because the function of a buffer stock is to remove surplus supplies from the market as the price nears the bottom of the agreed price range, and to release these supplies as the price nears the top, it can act as a restraining influence on price movements in both directions. But it will not be effective unless it has adequate resources. The buffer stocks established under the first and second international agreements for tin did not achieve their object, and in consequence the cash resources for the stock for the third agreement, which came into force in 1966, were considerably increased. The present position is that after some expenditure of cash in order to support the market, the resources of the buffer stock consist of tin and cash in approximately equal proportions and the market price is in the middle sector of the price range.

The usual function of a commodity agreement is to exercise control over prices. Too rigid a control, however, may threaten the existence of a market: this point is well illustrated by the contrasting experiences during the last five years of the tin and coffee agreements. The price range of the tin agreement has been revised upwards several times and with each revision the size of the range has increased, so that the present floor and ceiling prices of £1,280 and £1,630 per ton respectively give a range of £350, or about one quarter of the mid-range price; whereas in 1964 the range was about one sixth of the price. Thus, although the tin scheme has at times caused uncertainty the market has never felt itself confined in a strait-jacket and its efficiency has not suffered. With the coffee agreement, however, the market has been severely handicapped by the narrowness of the price ranges. For Colombian coffee the range has been as narrow (in 1966/67) as one eleventh of the mid-range price; while for Robusta coffee, the variety on which the London futures market is based, it has been about one eighth of the price. These very narrow ranges throw a great strain on the mechanism of the agreement itself and at the same time barely allow the market enough room in which to work. The results of this constriction are reflected in the 60% drop in the volume of business transacted on the London futures market last year as compared with 1965.

The International Sugar Agreement, which had ceased to operate after 1961, was renegotiated under the auspices of the United Nations last autumn. The new agreement is

designed to stabilise the free market price of sugar around 4 U.S. cents per pound, with obligations on the controlling council to adjust export quotas at certain points between 3¼ and 5¼ cents – a range equivalent to nearly half the mid-point price and therefore even wider than that of the tin agreement. The new agreement should be somewhat more effective than the last in its control over the access by exporters outside the scheme to the markets of member importers; but it has one weakness in the absence so far of the E.E.C. countries from amongst the exporting members. The increase in the sugar price to over 3¼ cents, which occurred within three months after the new agreement had come into force, must have been due, in part, to its effectiveness.

Trading currencies

By far the gravest and most far-reaching difficulties confronting U.K. commodity traders in recent times have been those concerned with currency risks. As early as the summer of 1966 representations were being made to the Bank by members of the cocoa and cotton markets, who were concerned because they could not obtain exchange cover for outstanding forward commitments in Nigeria and Uganda when, at the sellers' insistence, they were invoiced in the respective local currencies. The risk was at the time thought to be small because there seemed a high probability that, even if the pound were devalued, most other sterling area currencies would follow suit; but in case they did not, U.K. merchants, who were unable to make forward purchases of the sterling area currencies concerned because forward markets in them did not exist, sought permission to take up forward exchange cover in U.S. dollars.

To have permitted forward commitments in sterling area currencies to be covered in U.S. dollars, however, would have made a severe breach in sterling area arrangements and in the circumstances could have had damaging effects on confidence in the pound. Permission for such cover was accordingly refused and thus, if the U.K. merchants were to continue to do their business at all, it had to be on an uncovered basis.

When the devaluation of sterling was announced on 18th November 1967, many U.K. firms had on their books large commitments in cocoa, cotton and certain other commodities which they had sold for sterling and bought for payment in local sterling area currencies. The values of the two currencies mainly involved – the Nigerian pound and the Ugandan shilling – were not altered; and it soon became apparent that a heavy loss would be incurred when payments in these currencies fell due. Some firms felt that they were facing disaster.

There was clearly a problem not only of assisting traders over their difficulties but also of preventing the possible development of a chain reaction which might have endangered the future of the markets concerned. After discussions between the markets and the authorities the Bank made an offer of unsecured five-year loans at 5% interest to cover 80% of losses up to a total of £5 million. Eighteen firms

accepted the offer and some £3½ million was advanced. Partly as a result of these loans and partly owing to the care and resourcefulness of the firms themselves, all were able to meet their commitments.

Equally serious for commodity traders following devaluation was a problem which they had not foreseen. Exporters in many primary producing countries, both within and outside the sterling area, who had entered into forward contracts to sell their goods for sterling and had not covered their exchange, refused to ship the goods or to deliver documents of title to buyers in the United Kingdom unless the latter agreed to make a supplementary payment equal to the fall in the value of the pound – thus in effect providing free forward cover retrospectively. There were instances of this all round the world where countries had not devalued along with sterling, and they involved U.K. traders dealing in cotton, hard fibres, hides and skins, various grains, oilcakes and other animal feeding stuffs, and many other minor commodities. At the same time there were exporters in many countries who honoured their contracts to the full and some authorities who took steps to assist their exporters. Where additional payments were demanded some U.K. merchants undertook legal proceedings in order to secure possession of the goods from the overseas suppliers. Usually, however, a form of settlement where the U.K. merchant agreed to meet a part, rather than all, of the additional payment sought was arranged. The total amount involved in these cases was never determined but probably ran into millions of pounds. The ability to carry this burden was a notable demonstration of the resilience and strength of the U.K. commodity markets.

The liaison committees

The earlier *Bulletin* article, in describing the origin and purpose of the special exchange control schemes for many of the main U.K. commodity markets, explained that the arrangements provided for regular and frequent consultation between representatives of the Bank and of the executive committees of each market. Two developments since then – a change in the composition of one committee and the formation recently of a new committee – have led certain market associations having no particular interest in the special exchange control schemes to participate in liaison meetings. These regular consultations have been the chief means of maintaining close relations between the markets and the Bank, and the benefits of this were fully exploited during the period under review; indeed, in the critical situation which has just been described the liaison arrangements stood the markets in good stead.

Earnings

The continued ability of a world trading centre such as London to attract earnings from overseas depends largely upon the service given, and this can be judged in terms of knowledge, integrity, convenience, and the other qualities associated with its long trading experience. But it also depends on prices. Business is lost from a trading centre unless the prices quoted in it are the best which both seller

and buyer are likely to get; and because this implies the minimising of profit margins for the merchants themselves, the most successful will be those who combine efficiency with low costs. The problems of financing commodity shipments, however, have become more and more acute for U.K. merchants: interest rates have been high and credit has become difficult to obtain, even with some recourse to the euro-dollar market; moreover, the burden of taxation borne by trading companies has increased, and the greater need to obtain forward exchange cover has also added to costs. Indeed, the difficulties of remaining competitive have sometimes proved too great: some firms have disappeared, while others have amalgamated or been absorbed by bigger ones. One result has been that some of the larger trading houses have been able to widen their interests and gain footholds in new markets. So long as problems of finance remain acute, however, it will be difficult to keep costs as competitive as they must be if trade through London is to continue to flourish.

While financing difficulties may have caused some loss of merchanting trade through London, a marked expansion has occurred in the business of some of the futures markets. Increased overseas earnings in respect of commissions may, therefore, have compensated in some degree for reduced merchanting profits. Statistical information on these matters is still far too sketchy, however, for the separate elements of the markets' contribution to the U.K. economy to be assessed in any detail. Some research on this is being conducted both by the Bank and by the permanent Committee on Invisible Exports, with the help of the British Federation of Commodity Associations.[1]

Futures markets

A prominent part in the expansion of commodity futures trading in London has been played by the London Produce Clearing House. This organisation had for several years provided clearing and guarantee arrangements for four futures markets – for cocoa, coffee, sugar and wool. Some six years ago, through the installation of a computer, its capacity was enormously increased; and through the experience already gained and the organisation which it had built up, the L.P.C.H. has been able to provide continuity and security during a period of rapid growth. In cocoa – the first of the four markets reopened after the War – annual turnover in futures has increased five-fold since 1964, while that of sugar, which rose substantially in 1963, has since increased further. Activity in coffee futures has, as already mentioned, declined; and the wool futures market, having done reasonably well in earlier years, faltered badly in 1967 and 1968. Its management committee accordingly decided to change the contract unit from the Bradford oil-combed merino wool top, on which the market has been based since 1953, to the continental type of dry-combed top now more widely used in the U.K. worsted spinning industry.

In addition to handling the greatly increased trading turnover in cocoa and sugar, the L.P.C.H. has been called upon to provide contract clearing services for other markets. In

1 The Federation obtained figures of the earnings of several U.K. commodity markets for the report "Britain's invisible earnings" published in October 1967 by the Committee on Invisible Exports. Aggregate estimates of earnings of the U.K. commodity markets were given in the article "The overseas earnings of U.K. financial institutions" in the December 1968 *Bulletin*.

June 1967 the London Vegetable Oil Terminal Market Association was formed to conduct futures business – initially in soyabean oil; later in sunflowerseed oil; and soon (1st July) in coconut oil. Last month the Liverpool Cotton Association opened in London a futures market for cotton, in which contracts are expressed in U.S. dollars. However, another venture, by an association formed in March 1967 to conduct a futures market in fishmeal, unhappily failed because trading conditions unexpectedly worsened soon after the market was opened.

The grain futures markets on the Baltic Exchange, which are quite separate from those associated with the L.P.C.H., have had mixed fortunes. Trading in maize futures, after several years of declining activity caused by the dull condition of the U.S. market, finally ceased in 1966. The contracts for homegrown wheat and barley, however, have done well, the barley contract in particular having benefited from greatly expanded production in the United Kingdom. The same support has not been forthcoming for the barley futures market in Liverpool.

The remaining futures markets, also having independent clearing arrangements, are those for rubber and the non-ferrous metals. Activity in the former, which is administered by the London Rubber Exchange Company, has been fairly steady for several years, although substantially less than in the 1950's owing to the stabilising influence which synthetic rubber has had on the price of the natural commodity. The London Metal Exchange, on the other hand, has been transformed by two changes affecting the market for copper: first, the introduction in 1963 of the so-called three-tier contracts which enabled operators to deal in separate types of refined copper instead of in only one standard grade; second, the provision of facilities giving the seller, under an L.M.E. contract, the option to deliver metal at approved warehouses on the Continent as well as in the United Kingdom. These changes have led to a substantial increase in the market's turnover and to increased physical deliveries of metal – in place of contracts being closed out. In its use of delivery by seller to buyer, the copper market differs from the other futures markets already mentioned, where only a small proportion of contracts is left to mature. Likewise the L.M.E. contracts for tin, lead and zinc are used much more for the purpose of actual delivery than is customary in other futures markets, though not to the same extent as are the copper contracts.

In February 1968 the L.M.E. introduced a contract for silver.This step was taken in response to widespread demand – largely from overseas – for a new market in London which would provide the same sort of trading facilities for silver as existed for the other non-ferrous metals dealt in on the Exchange. Because a pre-war venture into silver by the Exchange had not been successful, the approach had to be prepared with particular care. It so happened that silver prices were rising strongly while the preparatory work was taking place, and they reached their peak only four months after dealings started on the L.M.E. So although the establishment of this new market was assisted by the active trading

conditions prevailing when it opened, it was not able to participate in them to the full.

The intensity of the demand for silver at this time was a reflection of its attraction as a currency hedge rather than of a real shortage. Although silver is no longer thought of primarily as a monetary metal, it was still regarded by some as the next best thing to gold and it shared in the demand for gold. In the United Kingdom the impact of this demand was felt mainly by the old-established London Silver Market – a small group whose members are also bullion brokers in the London Gold Market. The London Silver Market is an international market and because the source of the recent heavy demand for silver was mainly foreign, the market's earnings from this trade will have made, and will be making, a useful contribution to the United Kingdom's balance of payments. In the recent period of activity substantial quantities of silver, bought mainly on behalf of foreign clients, were imported into the United Kingdom and remain here held in stock.

The growth which has taken place in recent years in the facilities for commodity futures trading in London has owed much to a widening of popular interest, and this has in turn been encouraged by a proliferation of commodity broking firms known as commission houses. Active British houses have been joined by firms of American parentage in promoting commodity futures as an attractive medium for investment and speculation. Though nowhere near as large as operations in the United States, the amount of such business placed with the commission houses by customers at home and abroad has made a noticeable impact on several London markets; and the technique of the chartists – at its simplest where a decision on when to buy or sell is based not upon a knowledge of market factors but on the shape of a graph plotted from recent prices – has made its way across the Atlantic. The increase in commodity futures business emanating from private sources has broadened the futures markets and thereby made them better able to absorb the hedging transactions of commodity dealers. In general, it is still true that the trading in futures markets is done largely between member firms who deal in the physical commodities.[1] However, in particular cases non-trading interests are prominent at times; often this business originates with persons or firms domiciled outside the United Kingdom.

Conclusion

The devaluation of sterling and the subsequent disturbances in currency markets have considerably altered the trading background of the U.K. commodity markets. In the eighteen months or so since devaluation there has been some return of confidence in the use of sterling as a trading currency, but it has by no means fully regained its former acceptability either inside or outside the sterling area. Settlement in sterling throughout, which for most of the post-war period was customary in international trade through the U.K. markets, has been partially displaced by a variety of currency combinations in matching purchases with sales. Life has become more complicated for the U.K. merchant because he

1 A description of commodity dealing techniques was given in the September 1964 *Bulletin*.

needs to be constantly aware of his currency position as well as his commodity position, and of trading advantages which may accrue from use of forward exchange markets. Merchants still feel concern about the lack of adequate facilities for forward cover in some currencies of the overseas sterling area, although the authorities of a number of sterling area countries – notably in East Africa – have introduced, or extended, forward cover facilities for their own traders.

Problems and challenges of some kind seem likely to continue but, to judge from the way in which the U.K. commodity markets have shown that they can adapt to changing circumstances, it is reasonable to conclude that they will continue to play a vital part in world commodity trade.

Appendix

The following list of commodity market associations includes those concerned with markets mentioned in the article. It is not comprehensive, nor does it name many trade associations in London and the provinces whose members deal solely with commodities imported into or produced in the United Kingdom.

Commodity	Associations	Futures market associations (where applicable)
Animal feeding-stuffs	Cattle Food Trade Association (Inc.)	
Cocoa	Cocoa Association of London	London Cocoa Terminal Market Association
Coffee	Coffee Trade Federation, comprising:	
	Coffee Brokers' Association of London	Coffee Terminal Market Association of London Ltd.
	Coffee Merchants' and Roasters' Association Ltd.	
	United Kingdom Coffee Association Ltd.	
Cotton	Liverpool Cotton Association Ltd.	Liverpool Cotton Futures Market Ltd.
Furs	British Fur Trade Association Inc.	
Grains	National Federation of Corn Trade Associations, comprising:	
	London Corn Trade Association Ltd.,	London Grain Futures Association Ltd.
	Liverpool Corn Trade Association Ltd. and other associations throughout the United Kingdom	Liverpool Corn Trade Association Ltd.
Hides and skins	Hide and Skin Shippers' Agents Association (Inc.)	
Jute	London Jute Association	
Non-ferrous metals	London Metal Exchange	London Metal Exchange
Produce	General Produce Brokers' Association of London	
Rubber	Rubber Trade Association of London	London Rubber Exchange Co., Ltd.
Shellac	London Shellac Trade Association	
Sisal	London Sisal Association	
Sugar	Sugar Association of London	United Terminal Sugar Market Association
	Refined Sugar Association	
	Sugar Traders Association of the United Kingdom	
Tea	Tea Buyers' Association	
	Tea Brokers' Association of London	
	Tea Buying Brokers' Association of London	
Timber	Timber Trade Federation of the United Kingdom	
Vegetable oils and oilseeds, animal fats and marine oils	Federation of Oils, Seeds and Fats Associations, comprising:	London Vegetable Oil Terminal Market Association
	Incorporated Oil Seed Association	
	London Copra Association	
	London Oil and Tallow Trades Association	
	Seed, Oil, Cake and General Produce Association	
Wool	British Wool Federation	London Wool Terminal Market Association