Copper prices, seen as economic barometer for centuries, give recession warning

by Zachary Halaschak, Economics Reporter | July 10, 2022 07:00 AM

Economists look at the price of copper as an indicator that the economy is at risk of recession, and it is flashing red.

While not as commonly talked about as other economic metrics, such as the unemployment rate or yield curves, copper has proven over centuries to be a procyclical commodity, which means that when its price goes up, so typically goes the economy. But when its price starts to fall, it could mean the economy is heading in the same direction.

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Copper is now trading at about $3.57 per pound. That is a steep and aggressive decline from its peak of $4.94 in March — a nearly 28% decline in just a matter of months.

Meanwhile, U.S. GDP also declined by 1.6% in the first quarter of this year and appears to be in danger of contracting again during the second quarter. Last week, the Atlanta Federal Reserve’s “GDPNow” tracker predicted GDP growth will decrease for a second straight quarter.

"I think that it is correctly moving with the economy, so we’ve seen a softening in terms of real GDP, and copper is reflecting that," Campbell
Copper has been a strong indicator of recessions in the past and is so well regarded that some refer to it as "Doctor Copper," a tongue-in-cheek suggestion that the metal has a doctorate in economics.

In early 2008, copper prices were trading between $3 and $4 per pound, peaking at about $3.95 in late June of that year. Then they suddenly collapsed, plunging to just about $1.30 in December 2008 — an abrupt decline of 67%. Similarly, economic output cratered and stocks plummeted in what is now known as the Great Recession.

Copper fell just prior to, and then in tandem with, the recession of the early 2000s as well as during the recessions of the early 1980s, a period that featured Paul Volcker’s Fed aggressively jacking up interest rates by double digits to rein in the country’s historic inflation — a scenario that is somewhat analogous to the situation the economy is in right now.

Price of copper per pound
Copper Prices - 45 Year Historical Chart

The reason copper is such a good indicator is that it is used in just about everything that consumers buy, from household appliances to automobiles. It is also used in the construction of new homes and commercial buildings.

When copper prices are soaring, it means people are going out and buying things and that workers are building new structures — signs that the economy is hot and consumers are spending. Thus, prices of the commodity go up to match demand.

Conversely, when prices start to slow, it can show that manufacturers are slowing output because demand is falling, an indication that GDP is starting to contract and, in the extreme, that the economy is tumbling into a recessionary period.

Harvey said that of all the commodities, copper is the one that most closely tracks what is happening in the overall economy. He said other commodities, such as oil, aren’t as good of indicators because of the complexity of supply problems, embargoes, and other exogenous factors.

While a reliable indicator, copper isn’t a perfect one, and it is subject to price fluctuations that don’t always portend a recession.

The price of copper is also tied to the mining and refining of copper itself. For copper miners, it is important to get a sense of where the economy is going because it determines whether they will open a mine, close a mine, or cut back production in anticipation of dampened demand.

Copper prices have historically been tied to major events and economic shifts. For instance, in the late 18th and early 19th centuries, ships, which were the only way to carry goods from Europe to the Americas, began to be built with copper bottoms. After the Royal Navy decided to re-hull its fleet, copper prices exploded, more than doubling from 1785 to 1807.

Copper prices also skyrocketed during World War I when the metal was in hot demand for cartridges, machinery, and other weapon parts. The Great War sent prices up and created an economic windfall for miners.

Other commodities, while less reliable as economic bellwethers, have also been in decline.

West Texas Intermediate crude, the United States’s oil benchmark, fell earlier this week and was trading at less than $100 per barrel for the first
Lumber, a key building material, has also been falling for the past several months, while cotton has shed more than a third of its price since early May. Additionally, a broad index of commodities maintained by Bloomberg was down by about 15% on Friday from a month ago.

Many economists say a recession is very likely this year. The National Bureau of Economic Research, a private academic group, defines a recession as “a significant decline in economic activity that is spread across the economy and that lasts more than a few months.”

Two straight quarters of downward growth are typically seen as recessionary, and given that the first quarter of this year saw negative growth and the second quarter might also show negative growth, some economists believe the U.S. is already in a recession or on the brink of recession.

Recessions are difficult because they aren’t typically known to be in that state until well after they have begun. For instance, it took until July 2021 for the National Bureau of Economic Research to put out a release noting that the brief recession at the start of the coronavirus pandemic lasted two months — the missive came a year after the recession had ended.

Some prominent figures and institutions have been warning about the state of the economy, particularly given that the Fed has begun to jack up rates much more aggressively than previously thought to tamp down inflation, something that naturally depresses the economy.

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Copper prices, taken together with other key economic indicators, will be essential in planning for an economic downturn.

“Given all of the uncertainty that we face today, both managers and consumers need to exercise caution, and this is just one more piece of evidence that’s consistent with a slowing economy,” Harvey said.

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