Global Crisis and Commodity Prices

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As an extraordinary year draws to a close, all that is clear for the future is that very little is clear. In the global economy, many processes that were unleashed during this period are yet to unfold fully, and their future direction is dependent upon several imponderables, not least of which is the strength of the policy response to the ongoing financial crisis and economic recession. As this response by governments across the world is still not co-ordinated, not even between the major players of the capitalist system such as the US, the European Union (particularly Germany) and Japan and China, the immediate future remains bleak, since it means that the market-driven forces of downswing are likely to rule for some more time.

One feature of the recent past has been the extreme volatility of global commodity markets, which have experienced unprecedented price swings in the course of the past year. Because economic analysts have become more and more short-term and short-sighted in their outlook, each of these rapid movements has been over-interpreted as reflecting structural changes in global demand and supply rather than conjunctural forces that are themselves liable to change.

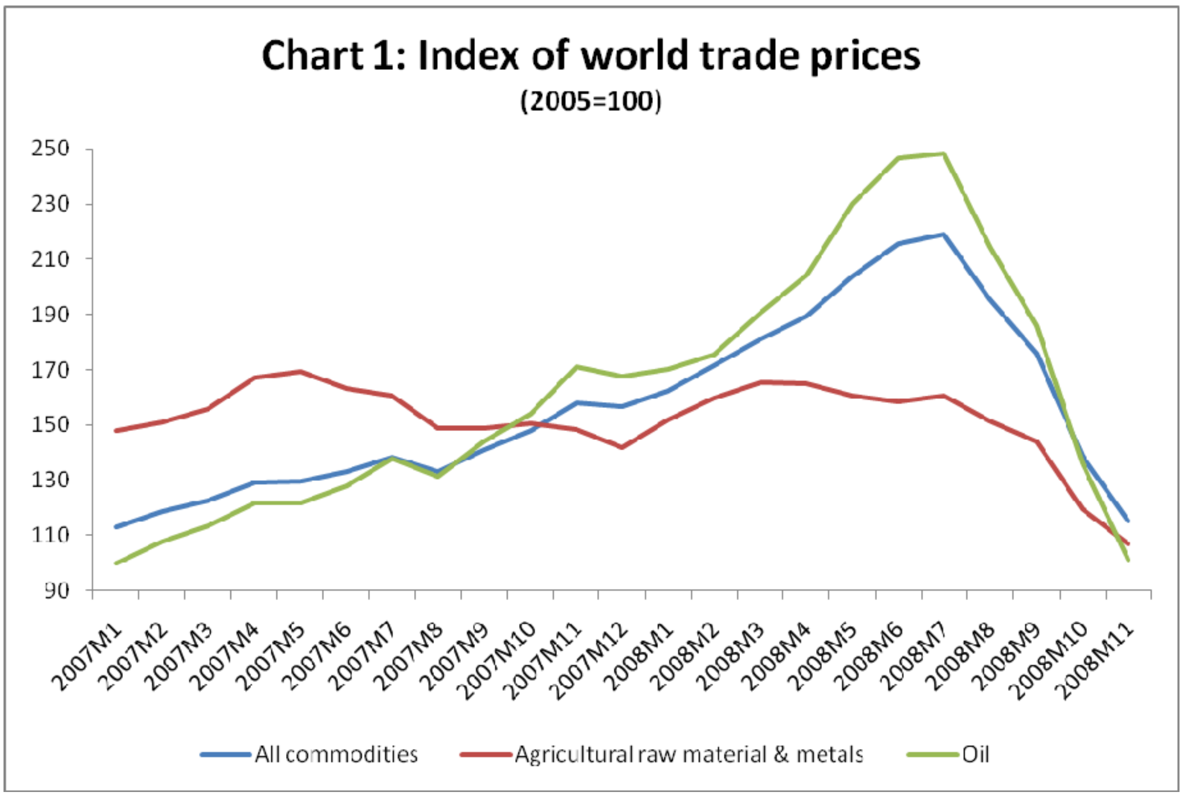
For example, when global prices in oil and other commodity markets zoomed to stratospheric levels by the middle of 2008, we were told that it had nothing to do with speculation. Eminent economists joined bankers, financial market consultants and even policy makers, in emphasising that these price rises were all about “fundamentals” that reflected real changes in demand and supply, rather than the market-influencing actions of a bunch of large players with enough financial clout and a desire to profit from changing prices.

In oil markets, we were warned that the dire predictions of the “peak oil” doomsayers were finally coming to pass. In global food markets the rise in prices of staples was correctly identified to be at least partly related to the medium term policy neglect of agriculture by governments especially in the developing world, but the role of speculation in commodity futures, enabled by financial deregulation, was denied.

Further, it was also argued that the real gainers of this process were the direct producers: not only oil exporting countries but small farmers producing food grains that were becoming highly valued internationally. The commodity price boom was supposed to translate directly to income gains for such producers, to the point where some governments even argued that there was no need to provide any protection to agriculture since cultivators were already gaining from the high crop prices.

But the subsequent collapse of commodity prices - both oil and non-oil - has shown how wrong the earlier explanations were, and how little primary commodity producers are likely to have gained, especially small producers in the developing world. Chart 1 tracks the behaviour of the aggregate indices of primary commodity prices in world trade over the past two years.

It is evident that all the price gains of the period January2007 to mid-2008 have been wiped out by the later fall in prices. Oil prices in November 2008 were back to the nominal level of January 2007, which implies a decline in real terms. And non-oil commodities, specifically agricultural raw materials and metals were actually lower even in nominal terms. It is worth noting that the latter group did not experience much of a price rise even when the commodity price boom of 2007-08 was supposedly operating in full force.

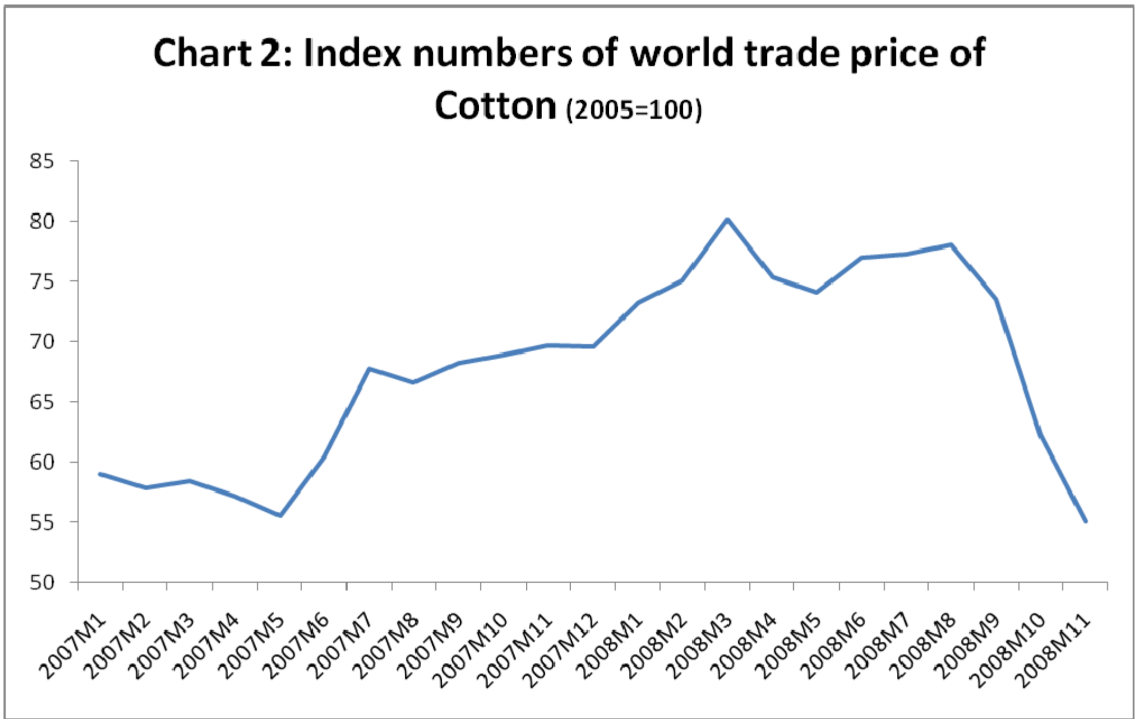


The likelihood of agriculturalists benefitng from such a short-lived price boom is therefore unlikely, especially given the lags of supply response. Indeed, it is even likely that they could face opposite effect: farmers shifting acreage in response to price increases could find that prices have crashed by the end of the growing season.

Consider, for example, the case of cotton, the most widely planted non-food cash crop that directly affects the livelihood of millions of farmers. Chart 2 shows the behaviour of cotton prices, providing an index of the Liverpool c.i.f price of middling staple cotton. This price had fallen significantly in the past few years, so that in January 2007 it was less than 60 per cent of the level reached in 2005. The price started to increase around the middle of 2007, and by March 2008 had increased by 44 per cent compared to May 2007. But after that peak there has been quite a sharp crash in prices in just a few months, such that in November 2008 the price was actually lower than it had been in January 2007!

Such volatility can be only very partially expalined by real changes in demand and supply, It is true that there was an increase in demand from China, the world's foremost garment exporter, around the middle of 2007. But the rapid price thereafter was beacuase speculators took over. Similarly, while the ongoing global recession has affected demand for clothing and therefore for cotton, the collapse in prices cannot be explained only by this decline, but is also the result of speculators offloading their stocks.

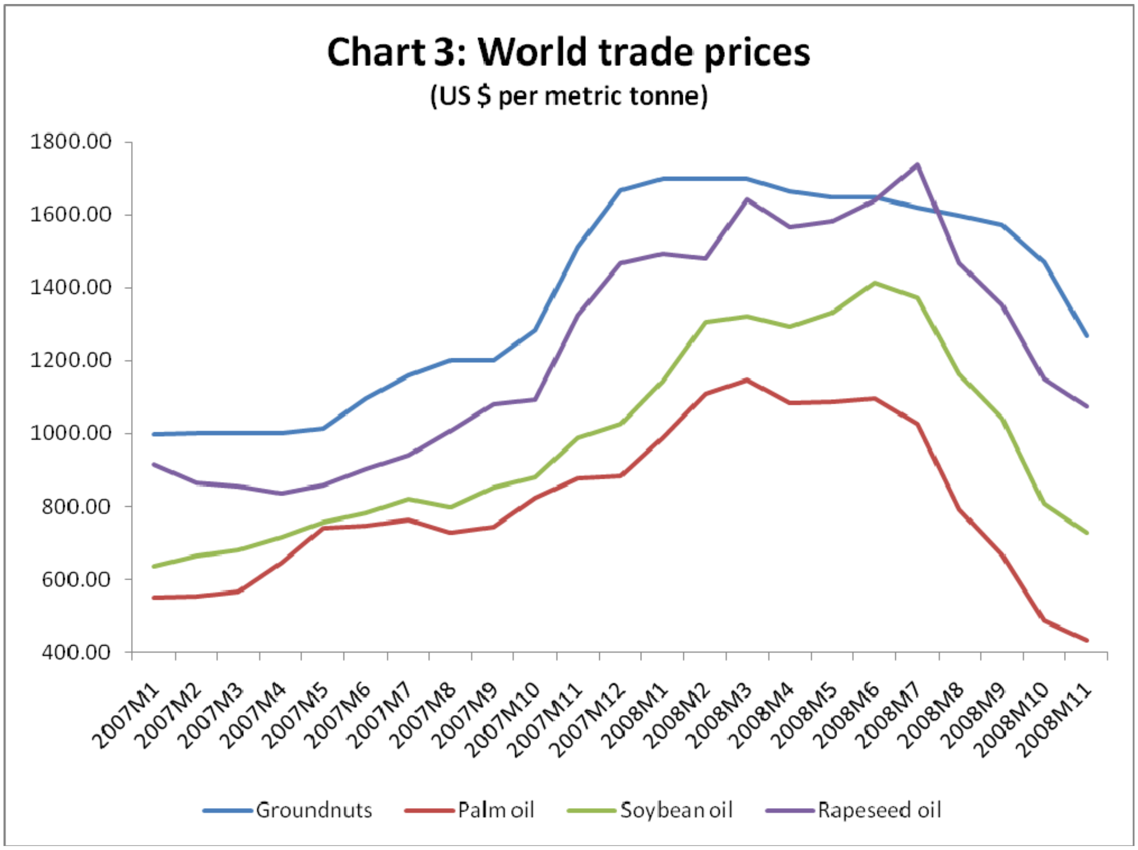
The point is that cultivators who had responded to the price signals of the short-lived boom to sow more cotton will now find themselves stuck with a crop whose price has nearly halved in just eight months.



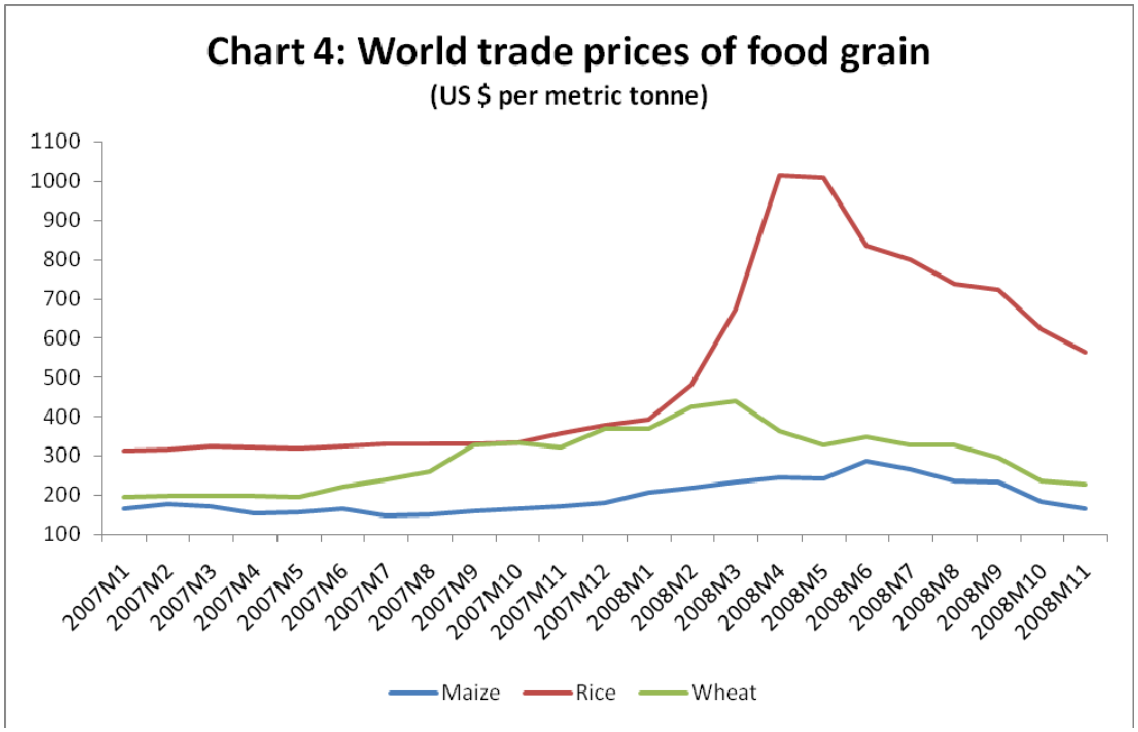
The other major cash crops that dominate cutlivation are all oilseeds, and here too, very volatile and sharp swings in prices are evident over the recent period. Chart 3 describes the behaviour of world trade prices of groundnuts which are used to make peanut oil, as well as the other major cooking oils: palm oil, soybean oil and rapeseed oil. All of them show similar trends in prices, with continuous and substantial increases from January 2007 onwards, followed by sharp declines int he second half of the current year.

Only groundnuts prices are still significantly higher than they were at the start of the period, having increased by 70 per cent over 2007 and then fallen by 34 per cent in the current year. Soybean oil prices more than doubled between January 2007 and March 2008, and then fell by 45 per cent, so that in Novemeber 2008 the price was only 15 per cent higher than it was at the start of the period. A similar tendency was apparent for rapseed oil. The sharpest rise and fall occurred in the palm oil price – increasing by 208 per cent to March 2008 and then declining by 62 per cent, such that the price in November 2008 was more than 20 per cent lower than it had been in January 2007.

Once again, cultivators who opted to sow these crops when their prices were at their peak would now have to face a completely different environment with very different configurations of costs and prices that coudl easily make the cultivation process completely unviable financially.



Among the agricultural prices that matter the most, of course, are food grain prices. The world food crisis that briefly grabbed international headlines in the middle of the year was essentially reflected in very darmatic increases in prices of the most important food grains. As Chart 4 shows, these too have been subject to significant volatility, especially in the current year.



The most extreme trends have been evident in rice prices, which were broadly stable, increasing only gradually though most of 2007, but then exploded to increase by more than two and a half times between January and May 2008. Rice prices have fallen thereafter but are still 80 per cent higher than they were at the start of the period.

Some of this is atributable to the fact that the world trade market for rice is relatively thin compared to total production, as most rice producing countries are also major consumers of their own output. The sharp rise in prices in early 2008 can be partly attributed to the export bans imposed by two major exporters: India, which the previous year exported around 5 million tonnes and Egypt which exported around 2 million tonees out of total world exports of around 18 million tonnes. Once again, however, speculative pressures are likely to have pushed up trade prices well beyond anything that could be explained by demand-supply imbalances.

Wheat prices also more than doubled between January 2007 and March 2008, and declined subsequently although they are still 16 per cent higher than they were at the start of the period. Maize prices went up less sharply but continued to increase until June this year, but thereafter fell so sharply that the maize price is now below what it was in January 2007.

While world trade prices of these food grains did fluctuate dramatically, and have now fallen in ways that will adversely affect exporters of these crops, retail prices of these grains have not come down in most developing country markets. Therefore we have a strange situation in which both the direct producers and the final consumers appear to be worse off because of the volatility.

In another context it could be concluded that speculators have gained from this boom-and-bust price cycle, but given the chaos in global financial markets even such a conclusion may not be warranted. A weird example, then, of a negative sum game in global capitalism.