Commodity Price Trends and Cycles: When Will the Boom End?

by

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ABSTRACT

A commodity price boom is under way. Can the boom be sustained? We examine trends and cycles in global commodity prices to identify the factors behind the boom. This leads to consideration of the critical developments that will signal the onset of the end of the boom.
Outline

1. Introduction
2. Long-run trends in commodity prices
3. Booms and Busts (short-run volatility)
4. Commodity prices and inflation
5. Global political economy of commodity prices
6. Predictions
1. Introduction - Background Papers

1. Introduction

• Stylised facts of commodity prices
  – slight long-run decline in “real” commodity price (average price of primary commodities divided by average price of manufactures)
  – substantial short-run volatility
  – link to fluctuations in industrial output
  – link to inflation
2. Long-run trends in commodity prices
2. Long-run trends in commodity prices

- Average decrease of about ½% per annum in “real” commodity price
- Long-run trend implication is that advances in technology in primary industries greater than in manufacturing
- Long-run trend is supply driven
2. Long-run trends in commodity prices
3. Booms and busts

Figure 1  Primary Commodity Prices (PCP) and OECD Real GDP: 1960-2006, Quarterly changes (4-quarter m.a)
3. Booms and busts

- Above average industrial growth in 60s and early 70s followed by price spike in early 70s
- Mid-70s recession and below average growth in early 80s followed by sharply falling real prices throughout 80s
- Recession in early 90s and sluggish growth through to early 00s depressed nominal and real prices until boom from ‘04
3. Booms and busts

• Short-run movements in prices are demand driven
• Little evidence of lagged supply response
3. Booms and busts

Figure 1  Primary Commodity Prices (PCP) and OECD Real GDP: 1960-2006, Quarterly changes (4-quarter m.a)
4. Commodity prices and inflation (US)

Primary commodity and producer prices in $US, 1957Q1-2001Q4 (1957Q1=1)
4. Commodity prices and inflation (Japan)

Indexes of primary commodity and consumer prices in Japan, 1957Q1-2001Q4 (1957Q1=1 for all series)
5. Commodity prices and inflation (regressions for US, UK and Japan)

- Commodity price increases flow through to finished good price inflation in each country (elasticity between 0.024 and 0.20 within 5 quarters)
- Finished goods price inflation flows through into wage inflation in each country (elasticity between 0.34 and 0.84 within 5 quarters)
- Growth in output is deflationary for the domestic economy (elasticity of from –0.06 to –0.22)
5. Global political economy of inflation

- Inflationary impact of commodity booms is global
- Industrialised countries suffer together (with long lags - growth in 60s led to inflation in 70s)
- Country that grows fastest suffers least (growth is deflationary)
- Coordinated action required to suppress commodity booms
- Cooperation occurred through G8 in mid 70s
Predictions - June 2004

- Impact of China’s growth on commodity prices?
  - How many years of 10% growth before commodity markets are overwhelmed by Chinese growth?

- Recent trends in commodity prices
  - Overall commodity index up by 40% since middle of 2003
  - Energy up by >60%
  - Many industrial metals up by >35% (especially copper)
  - How long before inflation accelerates?
Situation - September 2007

- Impact of China’s growth on commodity prices?
  - Commodity markets are clearly overwhelmed by Chinese (and Indian) growth

- Recent trends in commodity prices
  - Overall commodity index has risen another 50% since June 2004
  - Energy heading back to all time highs
  - Many industrial metals at or near record levels (especially nickel, copper)
  - Prices of food commodities rising very fast recently
Predictions – September 2007

➢ China’s growth will continue as long as there is demand for its exports (and a bit beyond?)
➢ G8 countries will tighten monetary policy when inflation increases
➢ Commodity prices will fall when Chinese export growth falls
➢ How long before inflation accelerates?