SWAMISPEAK Industrial commodity prices are dropping, not rising any more, due to recession

At the Cost of Falling Prices

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Inflation has soared to new heights, with the April consumer price index (CPI) showing prices shooting up 7.8%. Wholesale price inflation in March was a whopping 14.5%. Prices were already rising at the start of 2022, and the Russian invasion of Ukraine in late February added fuel to the fire. Black Sea exports were blockaded, shipping was severely disrupted and Western sanctions on Russia sent the price of oil and gas shooting up. Several other commodity prices rose, too, since Russia is a substantial exporter.

Chances of a ceasefire and quick return to normalcy are remote. Fearing the worst, I looked up commodity prices the other day to judge how far the damage might go. To my surprise, many prices that had soared at the onset of the war in February were now trending down, some quite sharply. In a few cases, prices were actually lower than a year ago (see table).

The Passing Premium

Much has been written of the inflationary supply shock of the war. But it now seems the sharp rise in prices in February-March represented panic as much as, or more than, acute shortages. Markets are notorious for overshooting, and this looks like a good example.

Declining prices since March flow from two causes. One is that Russia has been able to find ways to avoid most sanctions, reducing the supply shock. The second is that world GDP is slowing sharply. The International Monetary Fund (IMF) reckons almost 70 countries are in dire danger of following Sri Lanka into debt default. The Bank of England forecasts outright recession. China's crazy lockdown is creating a hara-kiri recession there.

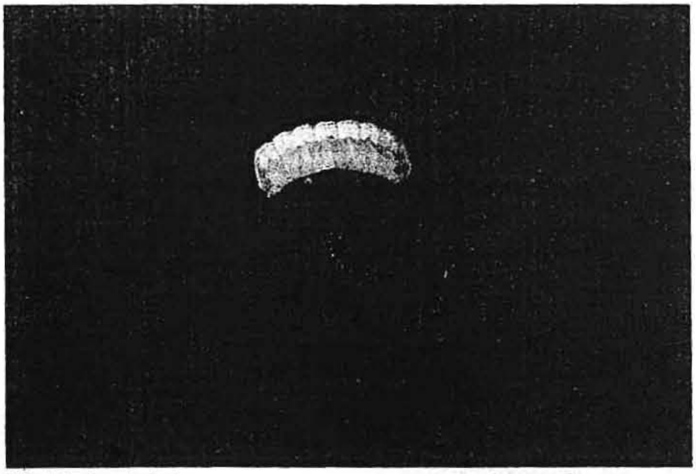
This global slowdown means a fall in commodity demand. The International Energy Agency (IEA) estimated in March that sanctions on Russia would create an oil shortage of 3 million barrels a day. It has now revised that down to 1 million barrels a day because of slowing demand.

The table throws up some real surprises. Russia is the world's biggest producer and exporter of palladium, a metal essential for anti-pollution equipment in automobiles. After the announcement of sanctions, palladium shot up to $3,000 an ounce in March. But this has now crashed to $1,908 an ounce, lower even than the rate of $2,200 a year ago. Clearly, falling global auto production, induced both by a shortage of chips and fading demand, has reduced palladium demand so sharply that prices have fallen despite the supply shock of sanctions.

Copper is a vital indicator of global economic health. Its current price of $4.16 a pound is below the peak of $4.80 reached two months ago, and lower even than the $4.70 a pound a year ago. Aluminium has dropped very sharply from $3,750 a tonne two months ago to just $2,796 a tonne, and zinc from $4,500 a tonne to $3,499 a tonne. These represent declines of 20% or more after the initial overshooting of prices in March.

Silver is currently $21 an ounce, down from a peak of $28 an ounce in May-June last year. Gold at $1,800 an ounce is roughly the same as a year ago, and down from a peak of $2,050 two months ago.

Oil is the most important commodity. The price of Brent crude soared to almost $130 a barrel after the Russian invasion of Ukraine. It is now down to $108 a barrel. This echoes the trend in metals. The decline has been aided by the release of substantial amounts from the strategic oil reserves of countries like the US, and that will not continue long. The optimistic projection in India's budget of oil at $75 a barrel will not look fanciful if a full-blooded recession occurs. None can rule out an escalation of the war that causes another surge in prices. Yet, the inflation optimists have a decent case.



Mind the headwinds

COMMODITY PRICES

	Latest price	Peak price	Price in May 2021
Aluminium	2,796	3,750 (March 22)	2,500
Zinc	3,499	4,500 (April 22)	2,969
Copper	4.16	4.80 (March 22)	4.70
Palladium	1,908	3,000 (March 22)	2,200
Oil (Brent)	108	128 (March 22)	65
Wheat	1,265	1,280 (April 22)	700
Soybean	1,614	1,750 (April 22)	1,400
Sugar	18.52	20.20 (March 22)	17
Cotton	145	160 (April 22)	80
Gold	1,823	2,050 (March 22)	1,800
Silver	20.70	28 (May 21)	28

All prices in ₹

Whither Money Plant?

The pessimists have a much stronger case in agricultural commodities, which have behaved very differently from metals. Farm prices were rising fast even before the war, and have gone even higher today with no sign of the decline evident in metals. While consumers may hope for relief in coming months on the fuel front, food prices look like staying high. Ditto for fertilisers, a key agricultural input of which Russia is an important supplier.

Cotton is an agricultural item but an industrial input. You might have thought its price would decline in the face of a recession. Instead, it has soared to $145 a pound from $80 a pound a year ago. Clearly agro-commodities are in a class of their own, with bad weather exacerbating other adverse trends.

To sum up, a weakening world economy is dampening industrial commodity prices. The panicky rise in all commodity prices in March spurred record inflation the world over in April and May. But the recent decline in metal and oil prices suggests less inflation in the rest of the year even if food prices stay high. We cannot rule out further zigzags in the Ukraine war with unforeseen consequences. But the good news is that the worst inflation may be behind us. The bad news is that this is being caused by a recession.

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