

Easing pressure on commodity prices

After sharp increase in global commodity prices, post the outbreak of Russia-Ukraine war, prices have witnessed a dip in the last month. Key reasons for moderation in prices is a mix of fear of global growth slowdown and improvement in supply chains as bottlenecks eased.

In early Q2CY22 major cities in China remained in lockdown to combat surge in Covid-19 cases. This impacted demand of several metals and coal. However in June, lockdown restrictions eased, also helping in easing pressure on supply chain bottlenecks. Elsewhere in the US, as CPI continues to inch up, Fed has asserted an aggressive monetary policy stance to tame prices. This has added to fears of an economic recession. Even high-frequency data prints are showing that high interest rates are beginning to take a toll on economic activity. Initial jobless claims for the week ending 16 Jul 2022 rose to 251,000 (highest since Jan'22), up by 7,000 from the previous week. In addition, US manufacturing activity slowed (Markit PMI) in Jun'22 while services activity contracted.

Further, with sanctions announced on Russia's energy imports, there looms and energy crisis in Europe which is set to impact economic growth of the region. Germany's Ifo business climate index fell to 88.6 in Jul'22, sharply lower than estimated 90.2. It was 92.2 in Jun'22. Energy crisis is also expected to keep retail prices uncomfortably high. Recently ECB delivered a larger (50bps) than expected (25bps) rate hike to keep inflation in check, despite impending risks to growth.

However, cooling global commodity prices have come in as a breather for India's WPI. In the table below, we have compared the trends in global commodity prices in Jun'22 versus Feb'22, and drawn a parallel to commodity-wise movement in India's wholesale prices.

While most of the commodity prices in India's WPI are moving in tandem with international prices, there some items where dip in prices have not been passed on as yet. For instance, in case of natural gas, while international prices are up by 32%, in India's WPI it is up by 74%. India import dependence for natural gas is at ~50%. In case of other major commodities like Iron ore, copper, and palm oil, while internationally prices are declining by 8.5%, 9.2%, 1.4% respectively, in India's WPI they continue to inch up by 6.4%, 0.1% and 10.3%, respectively. Palm oil accounts for 50% of India's import of vegetable oils.

Even aluminium prices have fallen (2.6%) only marginally so far compared with decline in global prices (21%). Other commodities like coffee and groundnut oil, are also witnessing increase in domestic prices, while global prices have come down significantly. However, in this case domestic factors are more at play since India is an exporter of groundnut oil and coffee.

On the other hand, prices of crude oil, gold, silver, rice, wheat, sugar, soybean oil and sunflower oil are moving much in tandem with international prices.

We believe that global commodity prices will remain moderated over the next few months, as investors analyze the economic impact of aggressive rate hikes by major central banks. This will be positive for prices (both wholesale and retail) in India. However, we continue to expect RBI to hike rates by another 25 bps in the upcoming policy, to maintain interest rate parity, stem FII outflows, and ease pressure on depreciating rupee.

Table 1—Commodity price trends

	World Bank (change from Feb'22)	India WPI (change from Feb'22)
	Jun'22	Jun'22
Crude oil, avg	24.9	22.3
Coal	45.0	0.0
Natural Gas	31.8	74.3
Coffee	(3.0)	9.8
Tea	5.9	11.6
Coconut oil	(20.8)	(8.0)
Groundnut oil	(13.2)	11.8
Palm oil	(1.4)	10.3
Soybean oil	9.8	12.8
Sunflower oil	25.7	16.2
Maize	14.7	9.8
Rice	5.2	2.5
wheat	15.0	3.4
Sugar	6.1	0.6
Aluminium	(21.0)	(2.6)
Iron ore, cfr spot	(8.5)	6.4
Copper	(9.2)	0.1
Lead	(10.0)	(2.8)
Zinc	0.3	4.0
Gold	(1.1)	(0.9)
Silver	(8.4)	(4.0)

Source: World Bank pink sheet, CEIC, Bank of Baroda Research

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