

Commodity Supercycle Slows Down in 2012

Mark Konold | September 27, 2013

Global commodity prices dropped by 6 percent in 2012, a marked change from the dizzying growth during the “commodities supercycle” of 2002–12, when prices surged an average of 9.5 percent a year, or 150 percent over the 10-year period.¹ This change of pace is largely attributed to China’s shift to less commodity-intensive growth.² Yet while prices declined overall in 2012, some commodity categories—energy, food, and precious metals—continued their decade-long trend of price increases.³ (See Table 1.)

The commodities market consists of various raw materials and agricultural products with fluctuating value that are bought and sold in global exchanges. This includes agricultural products, such as corn, wheat, soybeans, and cotton; energy sources, such as crude oil and natural gas; metals used in construction, such as copper and aluminum; and precious metals that are often used for financial security, such as gold, silver, and platinum. Commodities categories are not always mutually exclusive: some products (corn, for example) are used as an input for other commodities (such as cattle.)

Commodity prices were generally in decline for decades before 2002. But as the number of rapidly growing emerging economies grew after 2000, urbanization led to a surge in demand. Commodities supplies, however, were weak due to underinvestment in new capital expenditures as well as the difficulty of procuring new supplies because of factors such as stricter environmental regulations and

Table. 1 Annual Commodity Indices Prices

	Energy	Food	Beverages	Fertilizers	Raw Materials	Precious Metals	Metals
(dollars, 2005 = 100)							
2002	55.43	99.17	99.17	74.43	90.85	80.77	61.39
2003	61.10	100.52	94.53	79.77	96.90	87.29	64.33
2004	74.43	105.13	89.68	87.95	95.68	94.62	82.10
2005	100.00	100.00	100.00	100.00	100.00	100.00	100.00
2006	115.07	108.40	104.57	101.51	115.32	136.82	150.97
2007	120.02	128.19	114.00	137.05	118.49	148.55	171.22
2008	155.78	159.22	129.42	340.63	122.19	168.28	153.95
2009	104.63	142.40	144.03	186.42	117.94	194.31	110.03
2010	128.11	150.18	161.26	165.70	147.21	241.04	159.03
2011	153.60	171.47	169.96	217.88	168.67	303.57	167.70
2012	156.26	176.44	138.61	216.14	137.83	315.40	145.12
(percent)							
Change 2002 - 2011	177.1%	72.9%	71.4%	192.7%	85.7%	275.8%	173.2%
Change 2011 - 2012	1.7%	2.9%	-18.4%	-0.8%	-18.3%	3.9%	-13.5%

Source: World Bank Annual Commodity Indices Price Data, Real 2005 US dollars

deposits that were more remote.⁴ This opened the door to a dizzying climb in commodities prices over the next 10 years.

During the supercycle, the financial sector took advantage of the changing landscape, and the commodities market went from being little more than a banking service as an input to trading to being a full-fledged asset class—what some people refer to as “the financialization of commodities.” These days, large investment banks that participate in both the financial and commercial aspects of commodities trading dominate the landscape.⁵ At the turn of the century, total commodity assets under management came to just over \$10 billion.⁶ By 2008 that number had increased to \$160 billion, although \$57 billion of that left the market that year during the global financial crisis.⁷ The decline was short-lived, however, and by the end of the third quarter in 2012, the total commodity assets under management had reached a staggering \$439 billion.⁸

Oil market prices, though still high, were stable in 2012, with the average selling price for crude oil around \$105 per barrel, in current dollars.⁹ (See Figure 1.) Global supplies of oil grew by 2.5 million barrels per day (mbd), with more than 1 mbd in inventories.¹⁰ Growth was largely attributed to recovered production in Libya and increased output in Saudi Arabia and Iraq.¹¹ Toward the end of 2012, however, global supplies began to contract due to outages in Nigeria, reduced Saudi production, and the effects in Iran of a European Union oil embargo and U.S. economic sanctions.¹² Demand, meanwhile, grew at 1.5 mbd in non-OECD countries and declined by 0.6 mbd in OECD countries, a total global growth of only 900,000 barrels per day.¹³ Oil use in OECD countries has abated, thanks to higher prices, increased efficiency, and the global recession. And although emerging market demand has also decreased, it is expected to ramp up to around 0.8 mbd in 2013 as countries such as China and Brazil continue to emerge from the global recession.¹⁴

Figure 1 | Nominal Average Price of Crude Oil, 1980 - 2012

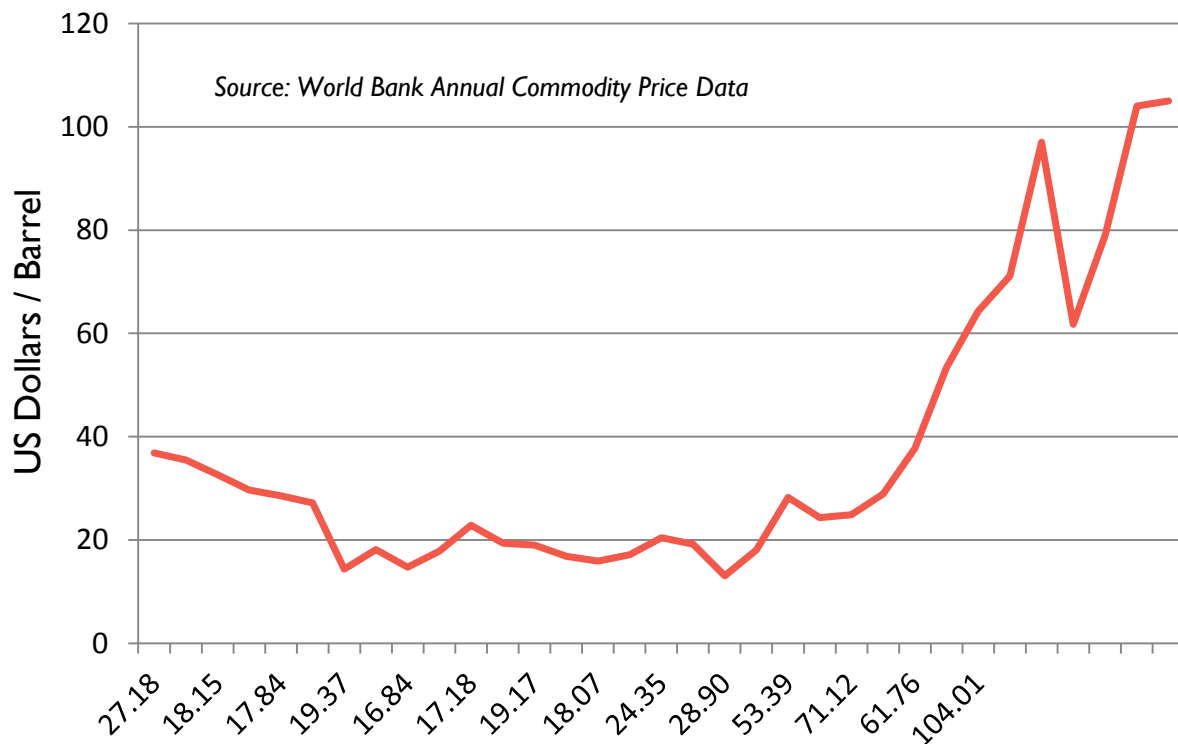
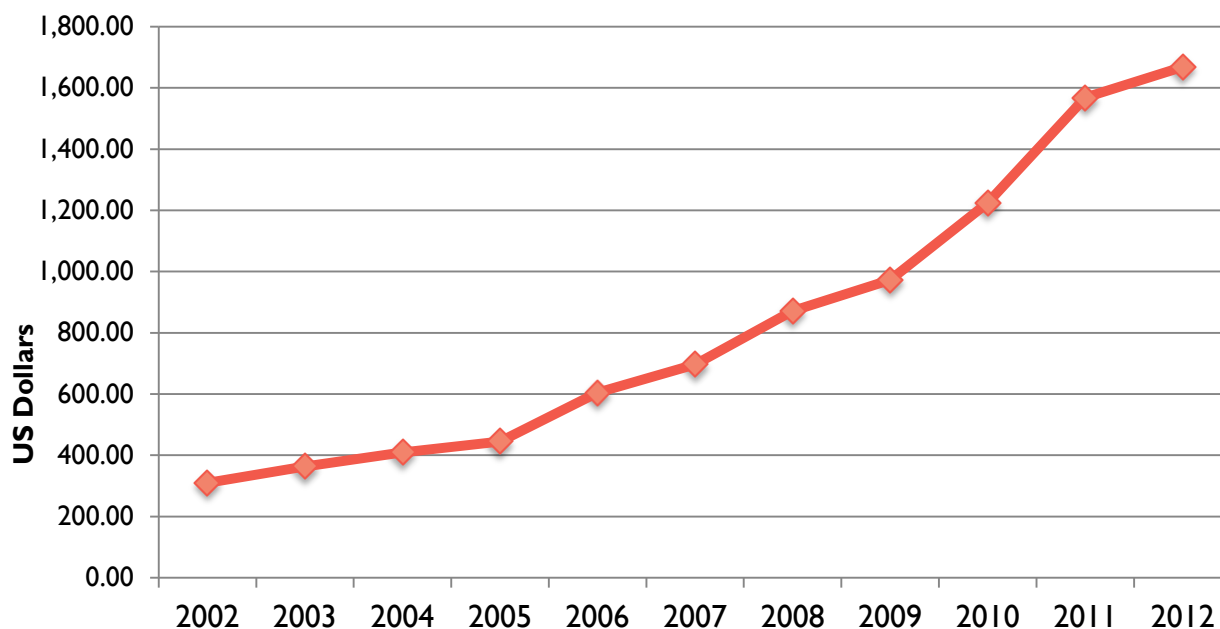


Figure 2 | Yearly Average Gold Price, 2002 - 2012



The widespread drought in 2012 had an adverse affect on many parts of the agricultural commodities landscape, with corn being hit the hardest. According to the International Monetary Fund, corn is the

most vulnerable of crops to price shocks because stocks of the grain remain low.¹⁵ In 2011, corn yields stood at 147 bushels per acre, but in 2012 yields went as low as 122.6 bushels, a 17 percent drop.¹⁶ By year's end that number had risen only slightly.

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According to the U.S. Department of Agriculture, the adverse effects of the drop in corn yields will be felt more strongly in 2013, as supplies will remain tight. Last year's drought also had an indirect impact on other important grains, such as wheat. While the wheat harvest was not substantially reduced, the shortage of corn caused consumers to turn to wheat as a substitute. The further tightening of overall supply led to a projected wheat price for 2012–13 of \$7.75–8.45 per bushel, breaking the 2011–12 record of \$7.24.¹⁷

In 2000, countries began reducing grain stocks as years of stable, low food prices and more-liberalized trade eased concerns about food supplies.¹⁸ The resulting low supply levels were swiftly outstripped by growing demand for grains and oilseeds in rapidly growing emerging economies whose populations were suddenly racing up

“the food chain,” driving prices upward.¹⁹ Thanks to improved supply, agricultural prices have begun to retreat from those levels in recent years.²⁰ But the cost of inputs remains high and so, therefore, do prices.²¹

Further complicating price dynamics in the agricultural sector is a crop’s end use, especially whether it is used for food or biofuels. According to a 2011 report by the Farm Foundation, global corn use in the category “food, seed, and industrial” has expanded by 88 percent since the 2005–06 marketing year.²² Ethanol falls in this category. During this time in the United States use of corn increased by 2.23 billion bushels, and corn usage for ethanol increased by 2.46 billion bushels.²³ The strong demand put upward pressure on corn prices and on the price of other commodities displaced by the expanded area devoted to corn production.

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3.9%
increase from
2011

Throughout the commodities supercycle the price of precious metals grew robustly. Although the rate of price increases for some precious metals slowed recently, gold maintained its momentum in 2012. In constant 2012 dollars, the average annual price for gold was \$1,669 per troy ounce (oz t). , a 3.9 percent increase from 2011.²⁴ (See Figure 2.) A large factor in gold’s increase in value was purchases by central banks. For the eighth year in a row, central banks were net buyers of gold, with purchases in 2012 up 17 percent from 2011.²⁵ Other precious metals saw substantial declines in price. Silver fell 13 percent to \$31.15 per oz t., platinum dropped 11.7 percent to \$1,551 per oz t., and palladium fell 14 percent to \$643 per oz t.²⁶

Prices of other metals and minerals sustained high levels in 2012, largely because of continued high levels of consumption. Despite price reductions for aluminum in large economies like the European Union and Brazil of 7.7 and 5.2 percent, respectively, the metal’s price surged in economies like India and China, 7.5 and 15 percent, respectively, for an overall global increase of 6.8 percent in one year.²⁷ High prices were also sustained because of supply constraints. Aluminum supplies grew by only 3.2 percent and copper grew by just 4.4 percent.²⁸ One of the few metals to see significant growth in availability was nickel, which saw a 13 percent boost in supplies.²⁹

Stockpiling by owners was another reason for sustained metal prices in 2012. As the demand for metals declined at the start of the financial crisis in 2008, owners set aside inventory to prop up prices. In one year, metal inventories registered on the London Metal Exchange jumped by 313 percent.³⁰ As a result, banks and trading companies began buying up warehouse space and storing surplus supplies, thereby inflating the prices of metals.³¹

The slowdown in commodity price growth in 2012 was indeed notable, but it is still not clear if the supercycle is completely over. Prices are still much higher than they were in 2002, but the dramatic slowdown in Chinese demand has investors abandoning these markets. By the end of April 2013 the commodities markets saw a loss of \$63 billion, and Barclays Bank claimed that total commodity assets

under management had dropped to their lowest level in three years.³² It is going to take a little more time to find out whether the commodities market has permanently cooled, reverses dramatically, or picks up and resumes its blistering pace.

Mark Konold is the Caribbean Program Manager for the Climate and Energy Program..

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Worldwatch Institute
1400 16th St., NW, Suite 430
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Notes

¹ Calculations based on World Bank, Commodity Price Data, September 2013. Prices for annual indices used in these calculations are real value adjusted using the World Bank's Manufacturing Unit Value Index, with 2005 = 100.

² Javier Blas, "Supercycle Runs Out of Steam – For Now," *Financial Times*, 17 July 2012.

³ World Bank, op. cit. note 1.

⁴ Blas, op. cit. note 2.

⁵ U.N. Conference on Trade and Development, *Global Commodities Forum: Harnessing Development Gains from Commodities Production and Trade* (Geneva: 2012), p. 9.

⁶ Pauline Skypala, "Enthusiasm Wanes As Regulators Sharpen Focus," *Financial Times*, 1 December 2012.

⁷ Ibid.

⁸ Ibid.

⁹ International Monetary Fund (IMF), *World Economic Outlook* (Washington, DC: April 2013), p. 27. Figure 1 is an average of West Texas Intermediate and Brent prices.

¹⁰ Ibid., p. 28.

¹¹ Ibid.

¹² Ibid.

¹³ Ibid., p. 27.

¹⁴ Ibid., p. 28.

¹⁵ Ibid., p. 29.

¹⁶ U.S. Department of Agriculture (USDA), *Crop Production 2012 Summary* (Washington, DC: January 2013).

¹⁷ Gary Vocke and Olga Liefert, "Wheat Outlook: Lower Exports Raise Ending Stocks," USDA, Washington, DC, December 2012.

¹⁸ Ronald Trostle, "Global Agricultural Supply and Demand: Factors Contributing to the Recent Increase in Food Commodity Prices," USDA, Washington, DC, May 2008, p. 13.

¹⁹ L. Plantier, *Commodity Markets and Commodity Mutual Funds*, ICI Research Perspective 18, no. 3 (Washington, DC: Investment Company Institute, May 2012), p. 9.

²⁰ IMF, op. cit. note 9, p. 28.

²¹ Ibid.

²² Philip C. Abbott, Christopher Hurt, and Wallace E Tyner, *What's Driving Food Prices in 2011?* (Oak Brook, IL: Farm Foundation, NFP, July 2011), p. 2.

²³ Ibid., p. 3.

²⁴ Minefund, "Snapshot of Precious Metals Price Performance in 2012," at minefund.com/wordpress/snapshot-of-precious-metals-price-performance-in-2012.

²⁵ World Gold Council, *Gold Demand Trends: Full Year 2012* (London: December 2012), p.7.

²⁶ Minefund, op. cit note 24 .

²⁷ John Bagges and Damir Ćosić, *Global Economic Prospects: Commodity Markets Outlook* (Washington, DC: World Bank, July 2013), p. 8.

²⁸ Ibid.

²⁹ Ibid.

³⁰ Jack Farchy, "Storage Stacks Up for Traders," *Financial Times*, 17 July 2012.

³¹ Ibid.

³² Jack Farchy, "Investors Flee from Commodities at Record Pace," *Financial Times*, 19 July 2013.