Klaus Matthies*

Commodity Prices Starting to Recover

Prices for industrial raw materials, which had fallen to a record low during the course of last year, have been demonstrating an upward trend this year, and crude oil prices are also beginning to pick up. In view of increasing indications of an improvement in the world economy, is the stage set for a further increase in commodity prices?

World commodity market prices have been increasing since the start of this year. The decline in prices seen last year, which still intensified in the fourth quarter, has come to an end. Prices for industrial raw materials, which in the wake of the global economic slowdown had fallen by 19 % – in US dollar terms – during the course of the year, rose by 5 % in the first two months of this year. In contrast, the increase in prices for food and tropical beverages that had begun in the autumn came to a standstill. Following a marked decline in the fourth quarter, prices for energy raw materials, which are essentially determined by oil price developments, have picked up again in recent months (see HWWA Index of World Market Prices of Commodities, p. 120).

At the end of last year, the price index for industrial raw materials reached its lowest mark, in US dollar terms, for 15 years. The increase that has taken place since then – despite falling prices for some materials (cotton, woodpulp) – has been due to marked price increases for some agricultural commodities (wool, rubber) and non-ferrous metals (nickel, copper), in most cases starting from a low initial price level. With growing indications of a gradual improvement in the global economy[1] we can expect demand for industrial raw materials to increase. While a further rise in prices for industrial raw materials can thus be expected this year, it will probably not be as rapid as has been the case so far. Any stronger increase is unlikely for the time being given that production growth remains restrained and the stockpiling process will probably be relatively slow, as well as in view of the fact that commodity producers have large amounts of unutilised capacity at their disposal. Facilities that had been mothballed because of low price levels will quickly be reactivated as prices increase. Stronger price increases are not likely until economic growth becomes more vigorous again next year. On average this year, there will again be a decline in prices for industrial raw materials compared to the previous year; this decline will be considerably less than that of 2001, however, when these prices fell by 9 %.

Estimates of Global Oil Consumption

Last autumn's accelerated decline in oil prices was due above all to lower demand for oil as a result of the further weakening of the global economy. Estimates of global oil consumption had been repeatedly revised downwards in the months preceding the autumn slump. At the start of the year, for example, the International Energy Agency (IEA) had forecast an increase in oil consumption of 2.2 % (1.7 million barrels a day) in 2001; this forecast was reduced to just 1 % by the start of September. Following an increase of 0.9 % in the previous year, 2001 was in fact characterised by virtual stagnation.

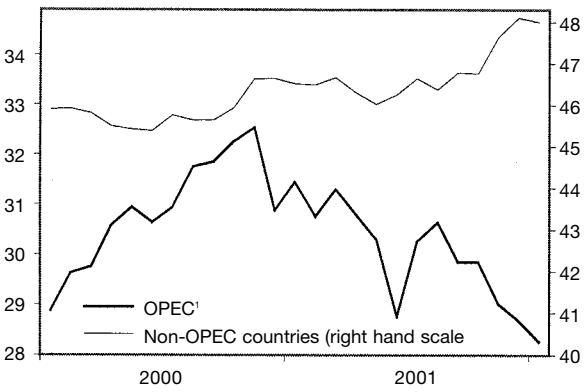
Oil production and oil transportation were unaffected by the events of September 11. Since there was initially a very limited supply side reaction to lower demand levels – OPEC did reduce its output, but at the same time other countries increased their production at a stronger rate (see Figure 1) – world market prices for crude oil fell by around 10 dollars a barrel up to mid-November. Crude oil prices have increased again since then, not least because the OPEC countries, together with other oil producing nations (Russia, Norway, Mexico, Oman and Angola), announced a further cut in output of almost 2 million barrels a day as from January. Uncertainties regarding developments in the Middle East also contributed to higher oil price quotations. The price of Brent crude was recently around 4 dollars a barrel below its September 10 quotation of just over 27 dollars. For the first time since the end of September the oil price has moved back into the OPEC target band of 22 to 28 dollars a barrel (for the "OPEC basket", which is always slightly less expensive than Brent crude). In

* Senior economist, Department of International Macroeconomics, Hamburg Institute of International Economics (HWWA), Germany.

[1] Cf. Günter Weinert: Global Economy in the Doldrums, in: INTERECONOMICS, Vol. 37, No. 1, 2002, pp. 59-64.

Figure 1
OPEC and Non-OPEC Oil Production 2000-2002

(in million barrels per day)



[1] Including Natural Gas Liquids

Source: IEA.

real terms, compared to industrial goods, the price of oil is currently slightly higher than the average level of oil prices from the mid-1980s to the end of the 1990s. However, it is considerably lower than during the first half of the 1980s following the second oil price crisis (see Figure 2).

World oil consumption will presumably not pick up again significantly until the latter part of this year. In its latest monthly report, the IEA expects additional global demand of 0.4 million barrels a day this year, an increase of 0.6 % over 2001.[2] This means that the oil producers must abide by their agreed production cuts for the time being if they wish to prevent a fall in prices.

The agreements to throttle production announced by the oil producing countries at the end of December, which according to OPEC should be valid until the middle of the year, have so far been only partly implemented. In January, the ten OPEC countries, which intended to reduce their joint output by 1.5 million barrels a day, produced considerably more than agreed, though excess production in February was clearly lower (see Table 1). Oil exports from the former Soviet Union did not decrease in January, product exports even increased.[3] It is doubtful whether there will be a general improvement in production discipline. Mexico's state oil company has announced that its output volume will increase by 350,000 barrels a day up to the end of the year compared to the volume of December 2001.[4] There is clearly little inclination within the Russian oil industry to extend output curbs beyond the first quarter of the year.[5]

During their recent conference the OPEC oil ministers decided to leave production targets unchanged for now but to meet again in June, signalling that they will consider increasing oil production if markets are tight. A continuing relatively high oil price level could dampen economic recovery and oil demand. But in the short term, should there be no agreement on output cuts among the oil exporting countries, OPEC will essentially have the choice of once again making the major contribution to supporting oil prices – with the consequent further loss of market shares – or of retracting the production curbs and initiating the price war that was threatened last November. Assuming as we do here that the production cuts are largely implemented as announced, crude oil is likely to become somewhat more expensive during the latter part of this year and next year as well. However, should there be a slackening of production discipline among the oil producing countries we could already see considerably lower oil price quotations in the next few months. A stronger price rise would take place in the latter part of this year if there were to be an unexpectedly rapid and substantial recovery in world oil demand.

Danger of Temporary Oil Price Increases

This evaluation is based on the assumption that global oil supply can continue without interruption. That neither September 11 nor October 7 were followed by an oil price explosion was due to the fact that, unlike the Iraqi invasion of Kuwait in 1990, these events did not lead to any restriction to oil supplies. Meanwhile, there are increasing indications of impending United States military action in the Middle East. The danger of temporary sharp increases in oil prices has thus not yet been averted. Renewed attacks by US aircraft on military targets in the Iraqi no-fly zone in recent weeks have already led to a rise in oil market quotations. Sharp price spikes are to be expected should oil production facilities and transportation installations be affected – either by military operations or as a result of acts of sabotage. This was the experience of the 1990 Gulf Conflict. The destruction of Kuwaiti oil wells by the Iraqi military and the subsequent boycott of Iraqi exports by the oil importing countries led to a rapid increase in oil prices, which at times climbed to more than 40 dollars a barrel.

---

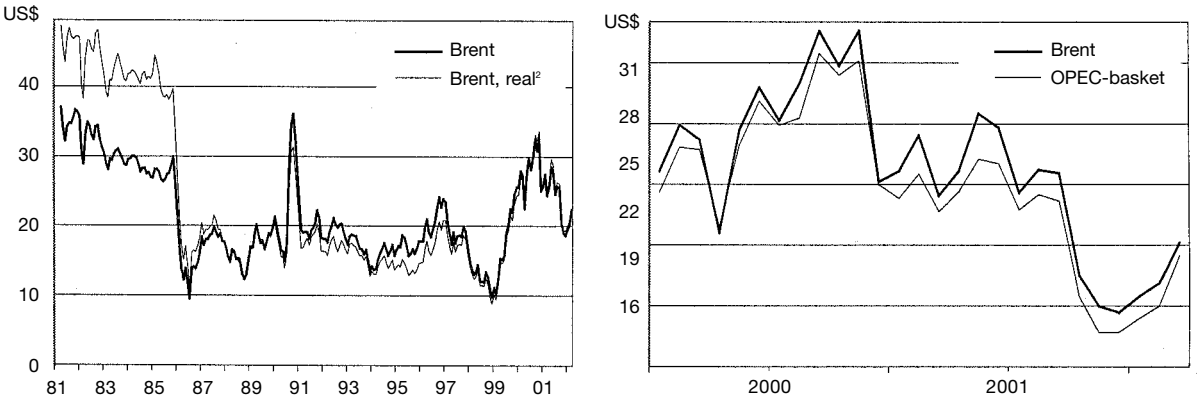
[2] Cf. IEA Oil Market Report, 12.3.2002.

[3] Cf. Anna Ivanova-Galitsina: IEA: Data Show Russia Not Yet Cutting Exports As Pledged, in: Dow Jones Newswires, 6.3.2002.

[4] Anthony Harrup: Mexico's Pemex Plans Biggest Crude Output Jump In 20 Yrs, in: Dow Jones Newswires, 25.2.2002.

[5] Robert Cottrell: Opec pressures Russia to keep oil limits, in: Financial Times, 4.3.2002.

Figure 2
World Market Prices for Oil[1]



[1] Spot prices fob per barrel (monthly figures; March 2002: until 14th).

[2] Deflated with export prices for manufactured goods from industrial countries; base year 2000.

Sources: IEA, OPEC; author's own calculations.

Initially, the events of September 11 have presented oil consumers with lower oil prices and so reduced their energy bills which had risen sharply during the previous year. At the same time, however, the attendant circumstances have again been a reminder that a considerable proportion of oil imports are derived from sources that are politically instable in the extreme. This was not necessarily a cause of undue concern to the oil importing countries in the past, because there were virtually no physical bottlenecks in the oil supply chain. Nonetheless, there were frequent and violent price fluctuations.

Diversification of Energy Supply

Energy supply uncertainty led the western industrialised countries, which coordinate their energy policy within the International Energy Agency that was founded in 1974, to raise the diversification of energy supply, both by regions of origin and by energy sources, to a major objective – alongside aims to conserve energy and improve energy efficiency, and to accumulate oil stocks for times of emergency – at an early stage, namely soon after the oil boycott of Arabian oil countries at the end of 1973.

As the world's largest oil importer, the EU covers half of its energy needs from its own sources, the rest has to be imported from other countries. In 1973 an even higher proportion, 60 %, was accounted for by imports. In comparison, the USA imports one quarter of its energy requirements, Japan imports 80 %. This dependency is greatest in the case of oil, with three quarters of the EU's crude oil imports coming from other countries.[6]

The diversification of energy suppliers has made substantial progress in recent decades. Since 1980, during the second oil crisis when a barrel of oil at times cost more than 40 dollars, the share of imports to the 15 EU countries from the Middle East has declined drastically. Of the EU's crude oil imports from third countries – i.e. excluding imports from Great Britain – there is a strong concentration on the Gulf region, whose oil producers account for around a third of total imports. Because of its geographical position, Germany looks more to the north and east, and last year only 13 % of its crude oil imports from non-EU countries came from the Middle East. In 1980 this share was three times as high (see Table 2). Oil from

Table 1
OPEC: Crude Oil Production Quotas and Actual Production

(in million barrels per day)

	Oil quotas from Sept. 1 2001	Jan. 1 2002	Agreed cuts %	Production in Dec. 2001	Feb. 2002	Production %
Algeria	0.74	0.69	–6.6	0.86	0.77	–10.5
Indonesia	1.20	1.13	–6.5	1.18	1.12	–5.1
Iran	3.41	3.19	–6.5	3.40	3.33	–2.1
Kuwait	1.86	1.74	–6.4	1.98	1.82	–8.1
Libya	1.24	1.16	–6.4	1.30	1.27	–2.3
Nigeria	1.91	1.79	–6.5	2.09	1.91	–8.6
Qatar	0.60	0.56	–6.5	0.60	0.57	–5.0
Saudi Arabia	7.54	7.05	–6.5	7.59	7.19	–5.3
UAE	2.03	1.89	–6.5	2.00	1.91	–4.5
Venezuela	2.67	2.50	–6.6	2.67	2.55	–4.5
OPEC 10	23.20	21.70	–6.5	23.67	22.44	–5.2
Iraq[a]				2.00	2.46	23.0
OPEC total				25.67	24.90	–3.0

[a] Iraq is not a party to the production agreements.

Sources: IEA; OPEC; author's own calculations.

Table 2
Germany's Crude Oil imports from Non-EU Countries

(by country of origin, in %)

	1980	1990	2000	2001
OPEC	71	50	32	26
Middle East	41	23	16	13
(former) Soviet Union	22	29	37	39
Norway	3	9	21	23

Sources: Bundesamt für Wirtschaft, Mineralölwirtschaftsverband.

the Gulf region which in 1973 was largely earmarked for Europe and North America now flows above all to South and East Asia.

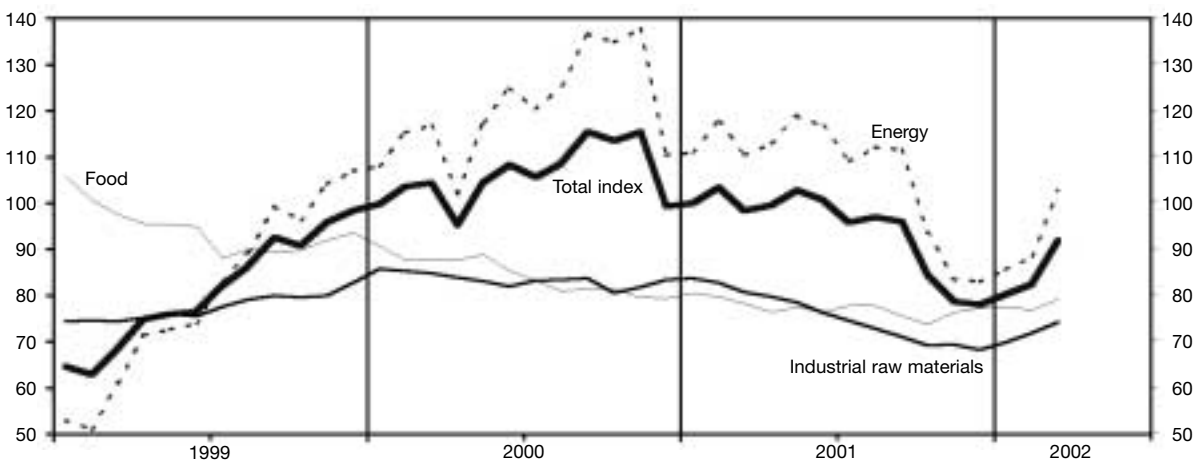
Because of its geographical position, Europe is better placed than other important energy importing countries to concentrate on alternatives to the Gulf region, such as Russia. In the longer term, however, the Middle East will once again play a dominant role because two thirds of confirmed reserves are to be found there. It is unlikely that this high concentration of supply will be significantly affected by expected deposits in Central Asia. Although the extent of these energy resources remains uncertain, available studies indicate that this region will not attain the same major significance as an energy supplier as the Middle East.[7]

[6] Cf. European Commission: Green Paper – Towards a European strategy for the security of energy supplies, Brussels, November 2000, pp. 21-23.

[7] Friedemann Müller: Energiepolitische Interessen in Zentralasien, in: Aus Politik und Zeitgeschichte, 22.2.2002, p. 26.

HWWA Index of World Market Prices of Commodities[1]

(1990 = 100)



Commodity Groups[1]	2001	Sep. 01	Oct. 01	Nov.01	Dec.01	Jan. 02	Feb. 02	Mar. 02[2]
Total Index	94.3 (-10.9)	95.8 (-16.9)	84.2 (-25.7)	78.4 (-31.9)	77.8 (-21.5)	79.9 (-19.9)	82.2 (-20.4)	91.7 (-6.6)
Total, excl. energy	75.8 (-9.2)	72.0 (-13.1)	70.1 (-13.0)	70.9 (-12.4)	70.3 (-14.4)	71.6 (-13.4)	72.9 (-10.8)	75.2 (-5.9)
Food, tropical beverages	77.1 (-8.6)	75.4 (-7.1)	73.6 (-9.5)	76.3 (-3.9)	77.2 (-2.6)	77.3 (-3.7)	76.7 (-3.6)	79.0 (1.2)
Industrial raw materials	75.3 (-9.4)	70.8 (-15.1)	69.0 (-14.1)	69.1 (-15.2)	68.0 (-18.2)	69.6 (-16.6)	71.6 (-13.2)	73.9 (-8.2)
Agricultural raw materials	73.7 (-10.2)	69.2 (-14.4)	67.4 (-14.1)	66.5 (-18.7)	64.1 (-22.8)	65.9 (-20.3)	69.0 (-15.6)	71.6 (-10.7)
Non-ferrous metals	72.7 (-12.4)	66.3 (-23.6)	63.7 (-21.7)	66.1 (-16.3)	67.1 (-18.3)	69.2 (-15.8)	69.6 (-14.0)	72.1 (-7.1)
Energy	106.4 (-11.7)	111.3 (-18.4)	93.3 (-30.6)	83.3 (-39.4)	82.7 (-24.9)	85.3 (-23.0)	88.2 (-24.8)	102.4 (-6.9)

[1] On a US dollar basis, averages for the period; figures in brackets: percentage year-on-year change.

[2] Up to and incl. 22nd March.

Further information: http://www.hwwa.de → Commodity Price Index