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Commodities and terms of trade from a really long-term perspective

By

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The views expressed are those of the author and do not necessarily reflect the views of UNCTAD.

GLOBAL COMMODITIES FORUM

COMMODITIES AND TERMS OF TRADE FROM A REALLY LONG-TERM PERSPECTIVE

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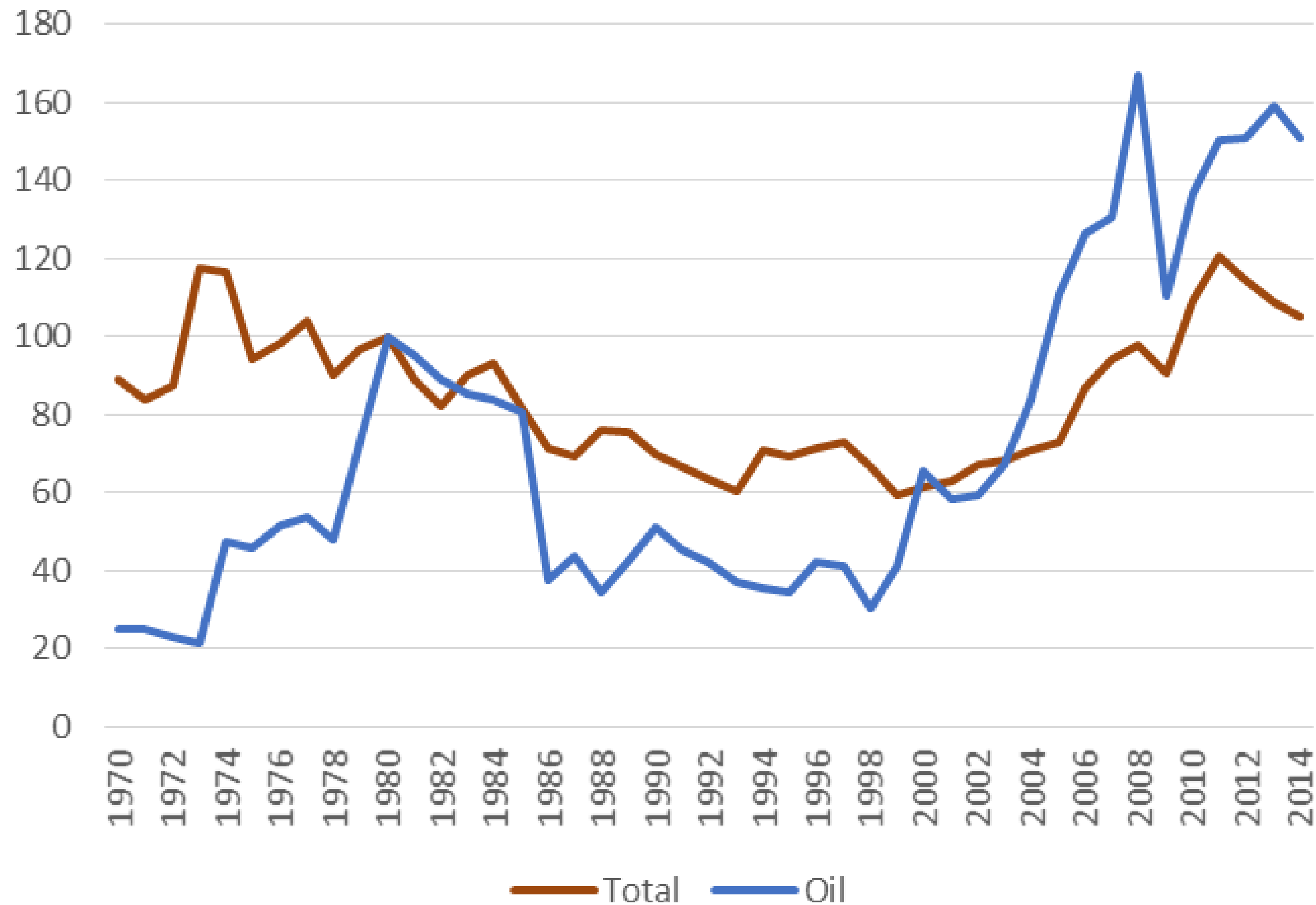
UNITED NATIONS

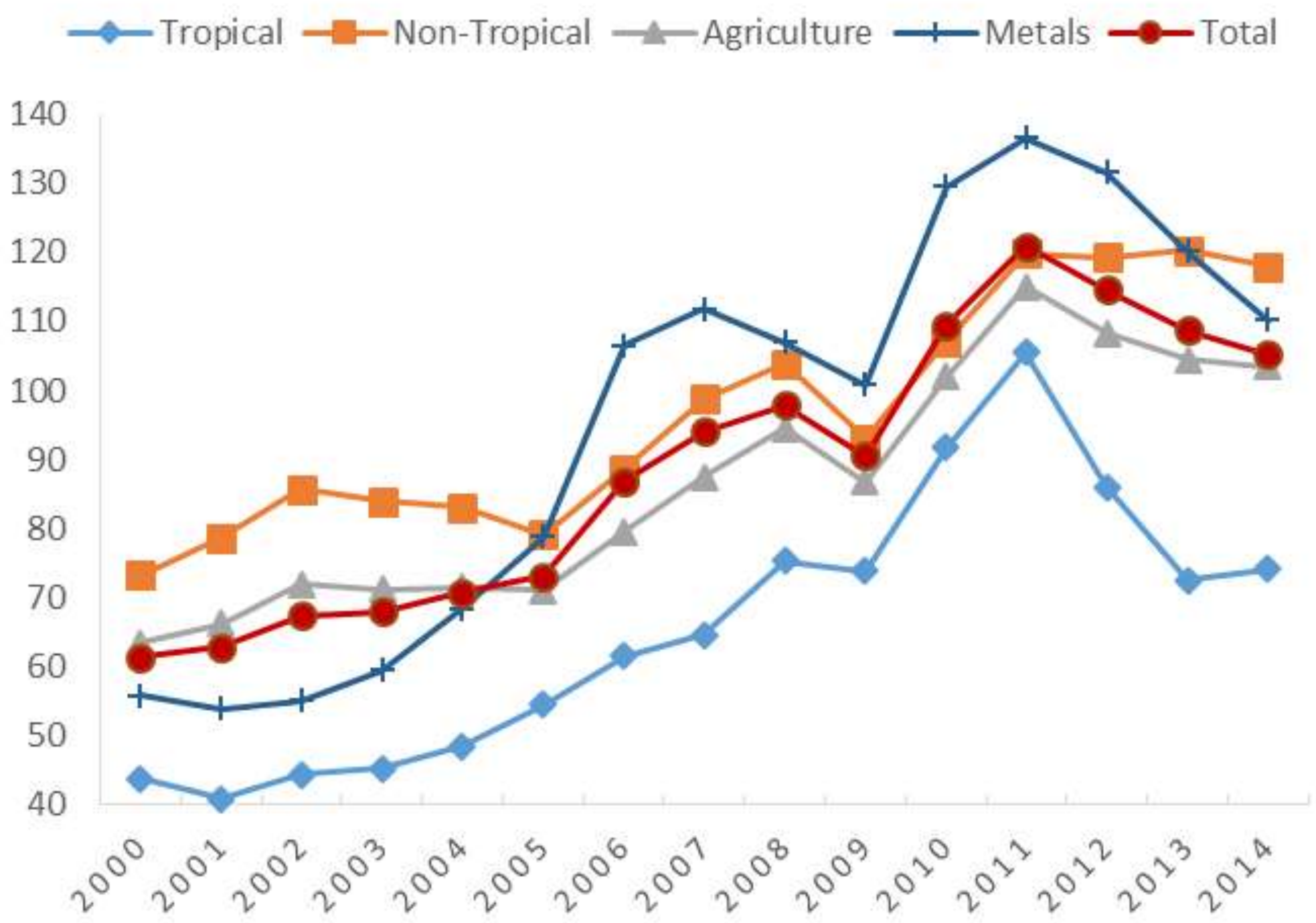
Geneva, April 14, 2015

REAL OIL PRICES INCREASED THREEFOLD SINCE 1999

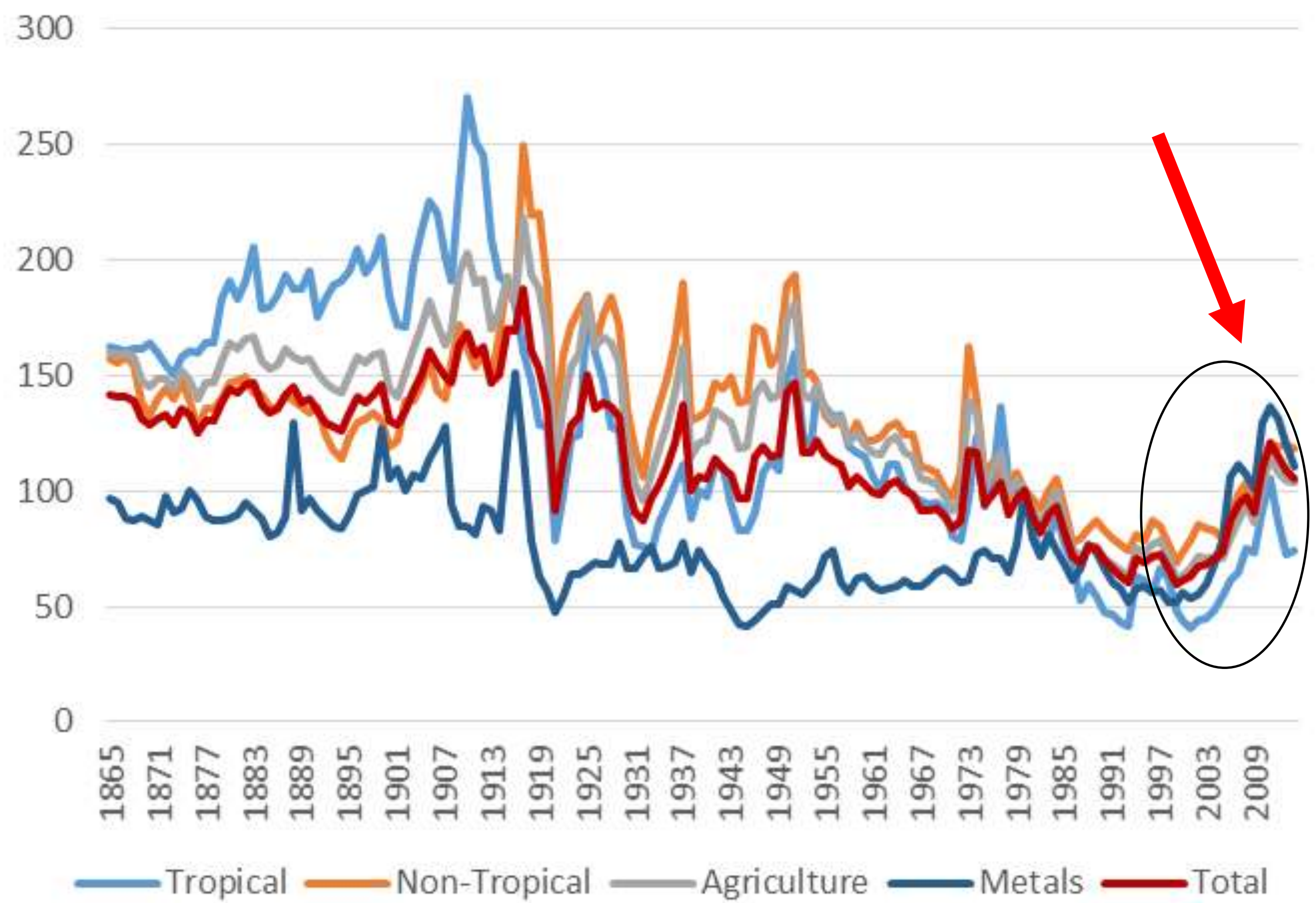
NON-OIL COMMODITY PRICES JUST RECOVERED, DOUBLING



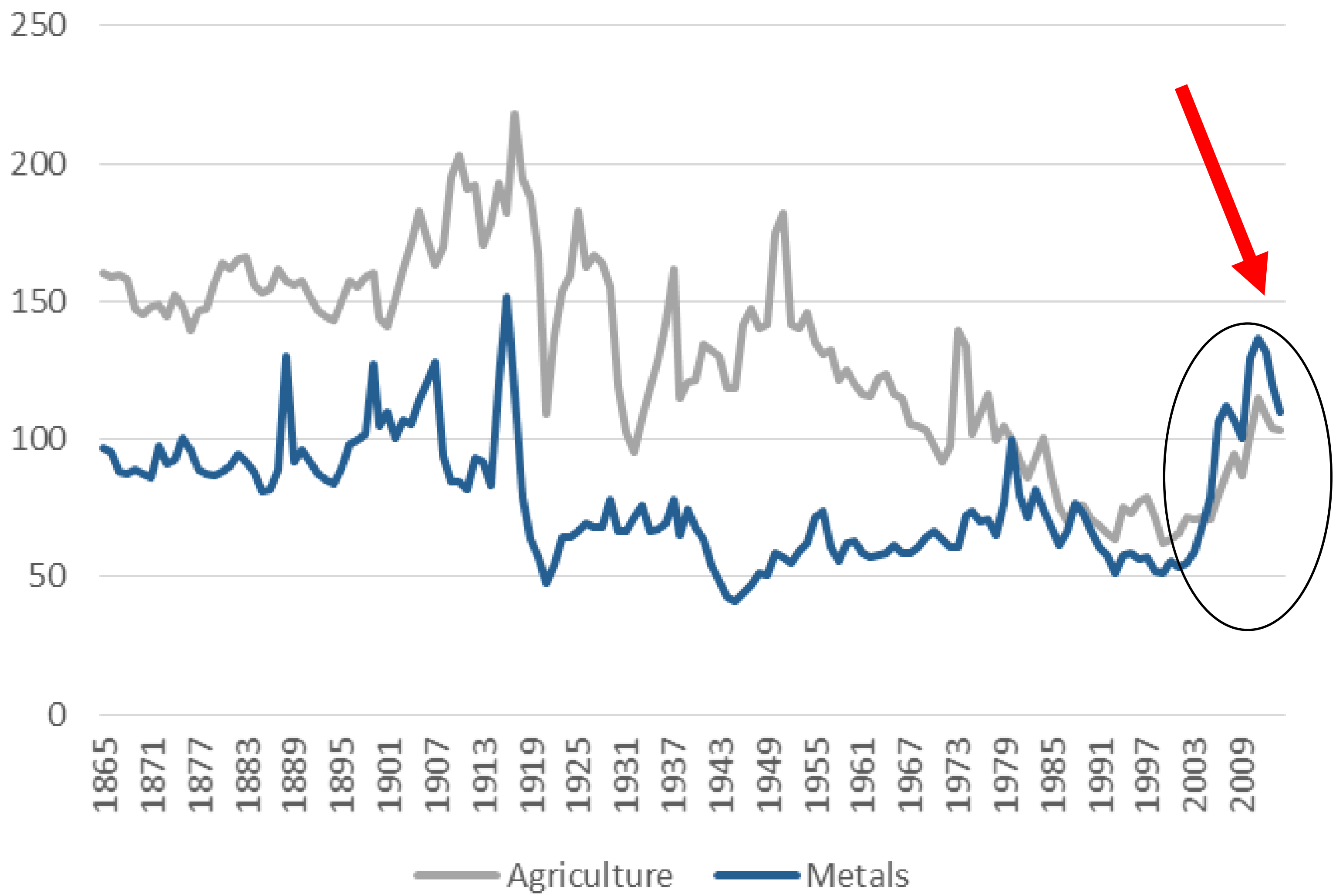
METALS LED THE GROUP



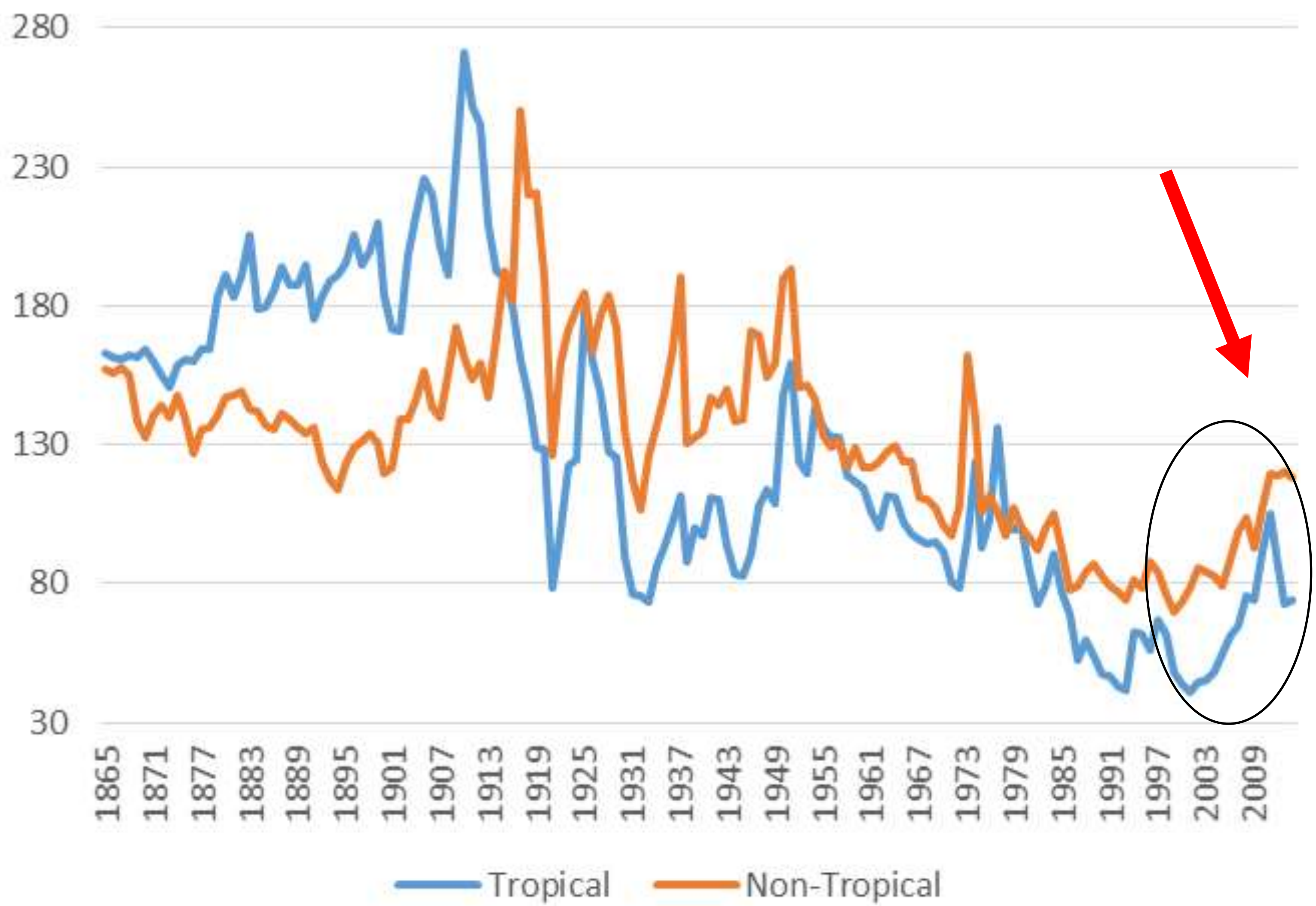
PUTTING IT IN PERSPECTIVE



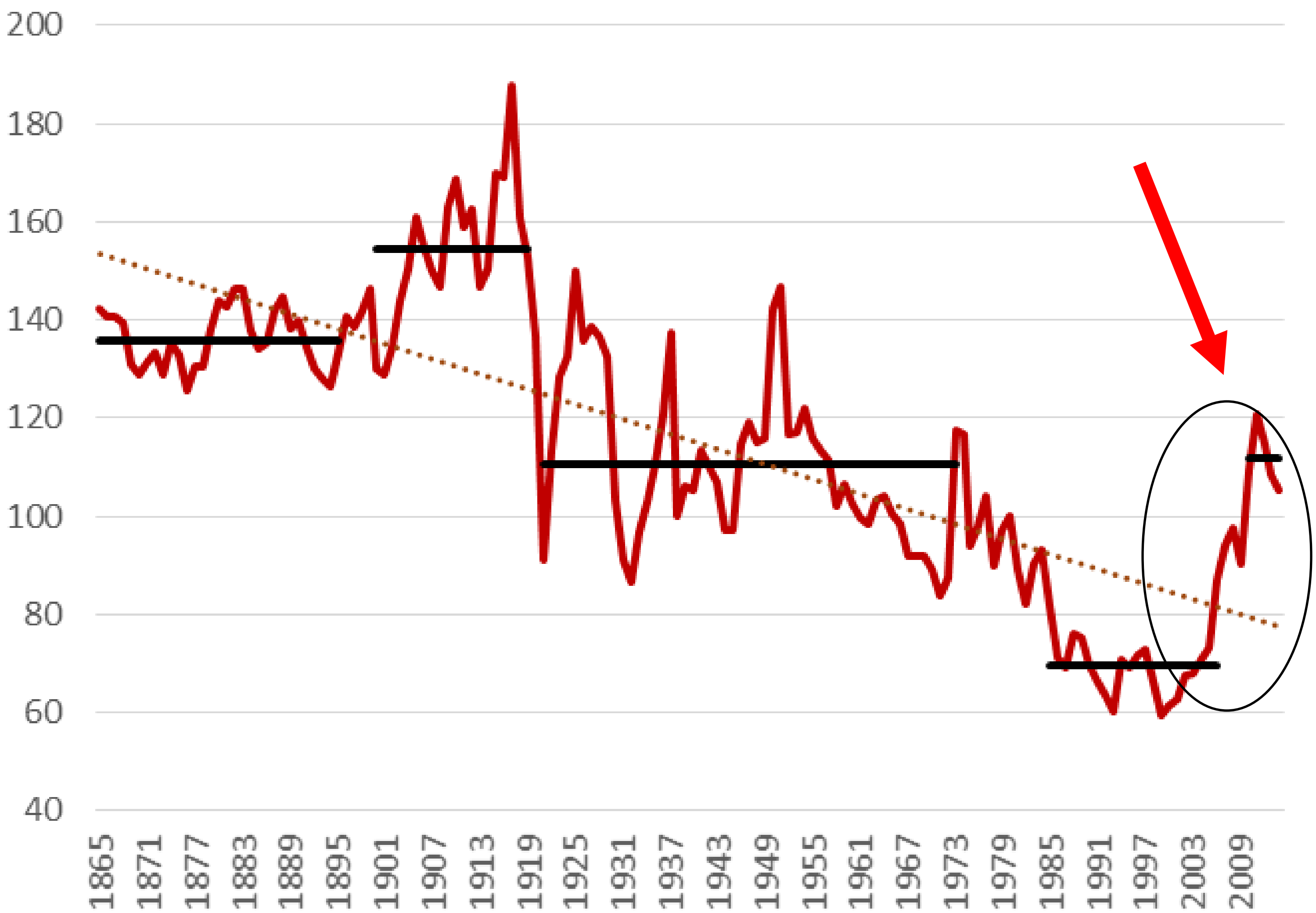
METALS REMAINED DEPRESSED AFTER 1921



TROPICAL COMMODITIES ARE THE MOST AFFECTED IN BUSTS



STEPWISE DECLINE IN NON-OIL COMMODITY PRICES
Ocampo-Parra 2010



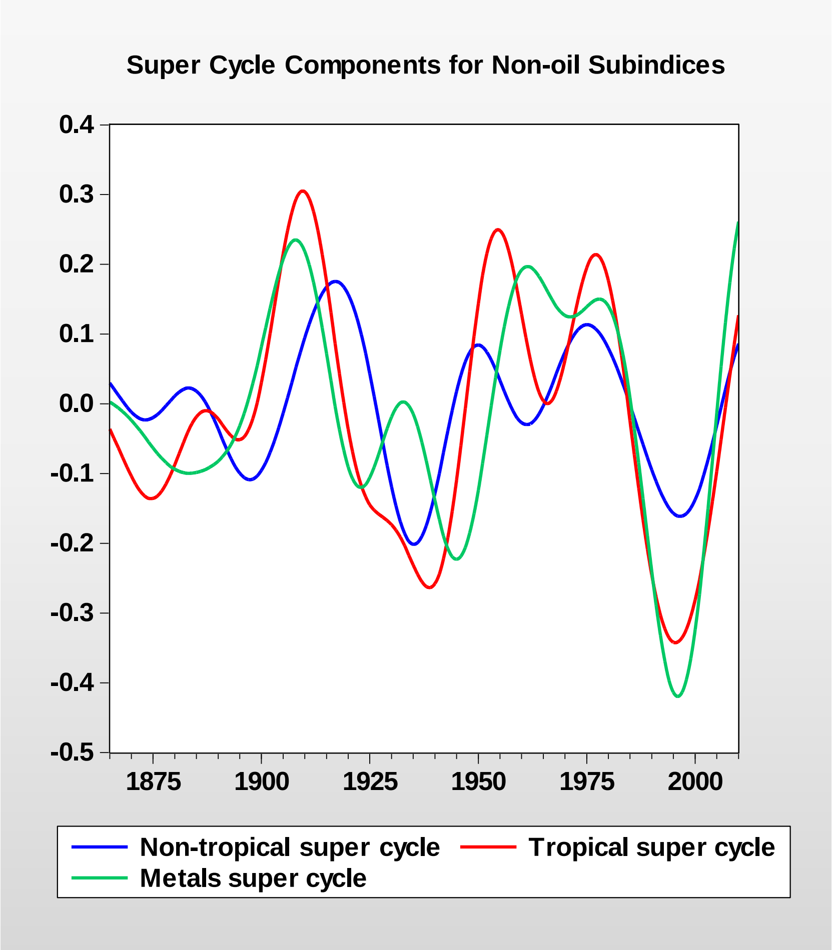
VOLATILITY AND CUMULATIVE DECLINE

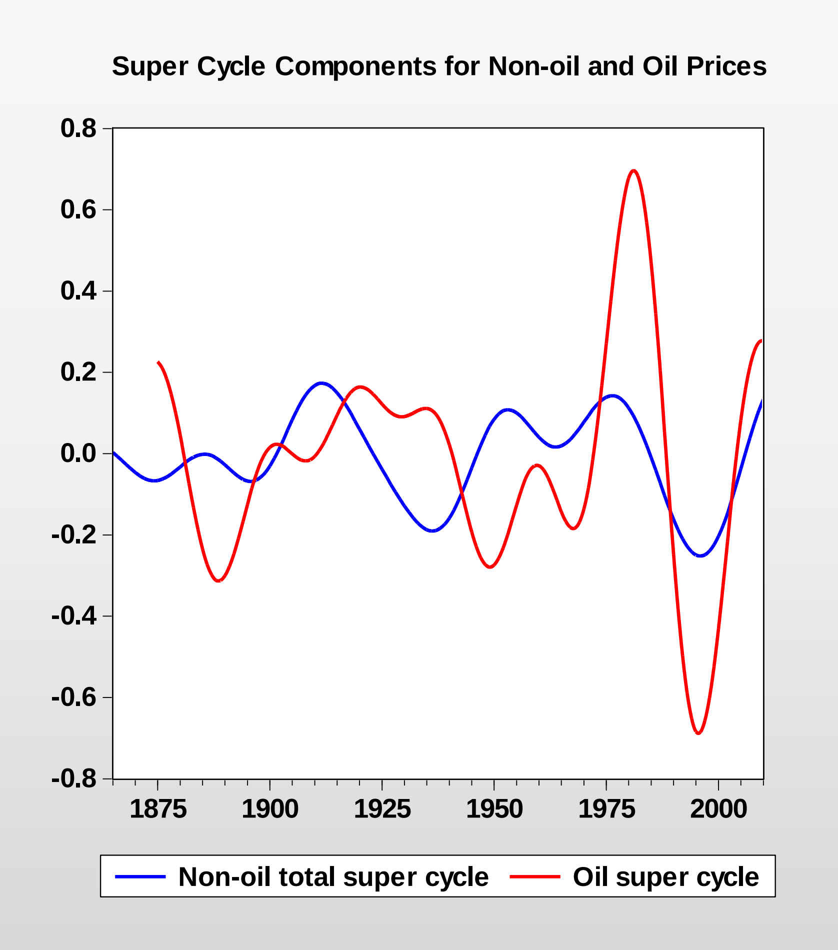
- Cashin and McDermott (2002) found a downward trend of 1.3% per year. Oddly enough, they interpreted it as small compared to the variability of prices, even though it translates into a cumulative decline of 75%!!! over 1862-1999
- The far-reaching changes that the world economy underwent around 1920 and again around 1979 led to a stepwise deterioration reflected in roughly a halving of real commodity prices

OCAMPO-PARRA 2010: EVIDENCE

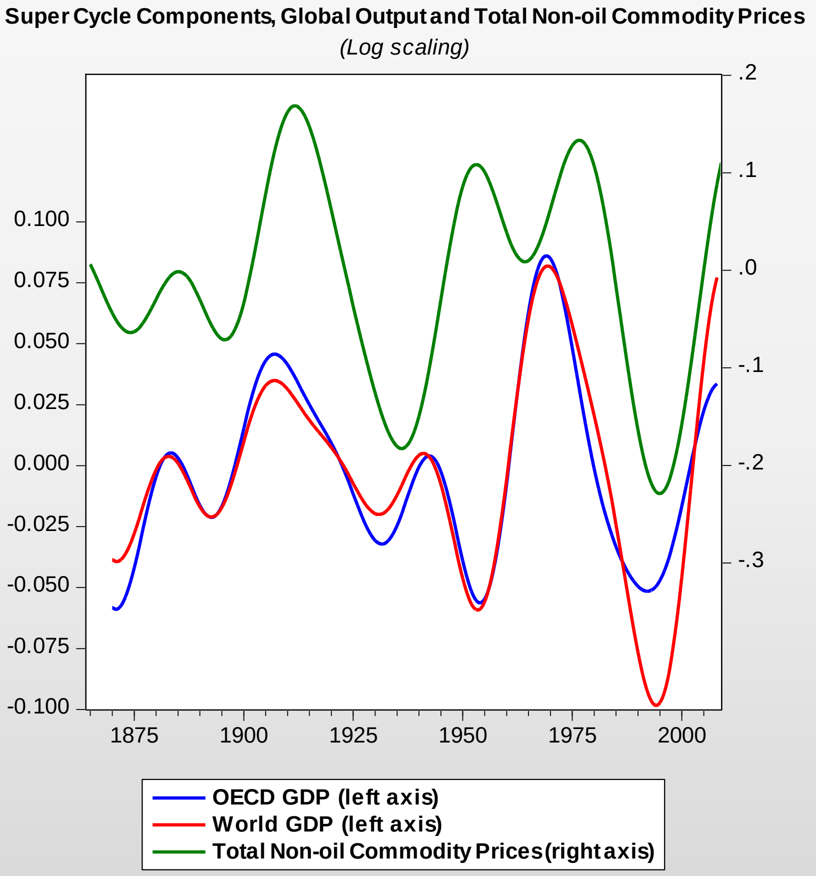
- The largest price drops followed, with a lag, the two major slowdowns in the industrialized economies' long-term growth rates during the First World War and in 1973, respectively
- This reflects the crucial role that world economic growth has as a determinant of the commodity terms of trade.
- Will the Great Recession and recent deceleration of emerging markets be followed by large drops? Too early to know, but if history is any indication it may well be the case

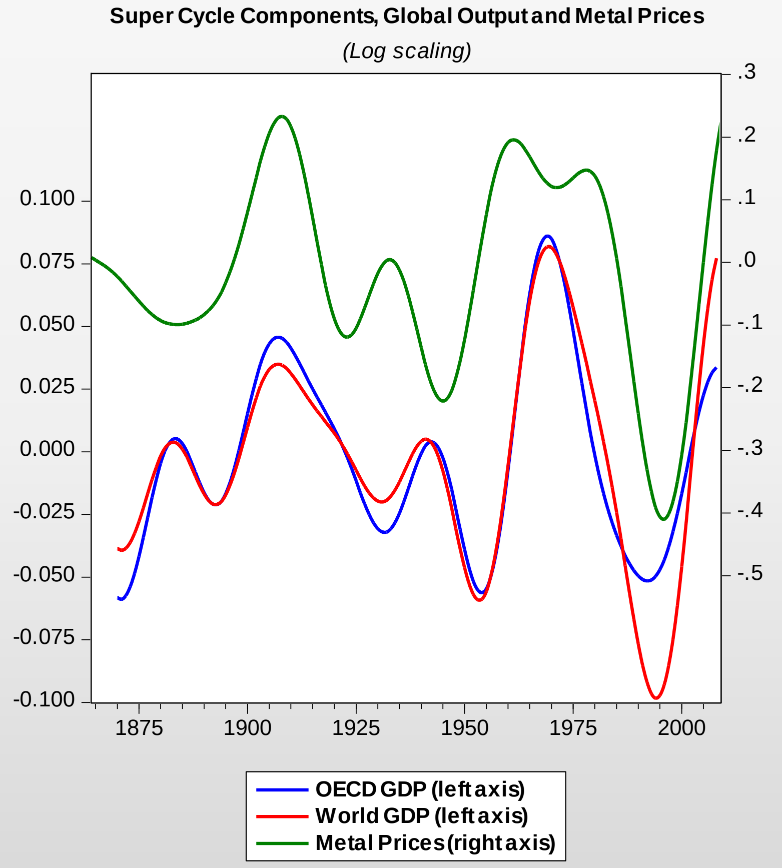
ERTEN-OCAMPO (2012): OVERLAPPING SUPER CYCLES





WORLD ECONOMIC ACTIVITY IS A STRONG PREDICTOR OF COMMODITY PRICES





CONCLUSIONS: ERTEN-OCAMPO (2012)

- A major characteristic of commodity prices is 30-40 year-long super cycles, overlapping significantly across sub-indices (including oil since the 1950s).
- The amplitudes vary between 20-40 percent from long-run trend: tropical agriculture exhibits super-cycles with greater amplitude.
- **The mean of each super-cycle for non-fuel commodities <u>has a tendency to be lower than previous one</u>, a step-wise deterioration over time.**

CONCLUSIONS: ERTEN-OCAMPO (2012)

- Commodity price boom could have lasted only if China and other major developing countries were capable of delinking from slow growth in developed countries.
- Commodity-dependent countries should be aware of price cycles
- Develop policies to take advantage of the expansionary phases
- While taking precautionary action against the contraction phases
- Step-wise deterioration underlines the importance of diversification.

Diversify towards what?

OCAMPO-PARRA (2006)
TWO TRADITIONAL EXPORT STRATEGIES AND FALLACY OF COMPOSITION

1. Increasing market shares in sectors where a specific country has an established position
2. Diversifying into higher technology products

The actual strategy of an individual country may involve a mix between them

- Individual countries can succeed in any of these strategies
- As a group, developing countries can only succeed in the first if developed countries lose market shares

Without protectionism and if the demand is elastic enough

THE TWO VARIANTS OF THE PREBISCH-SINGER HYPOTHESIS

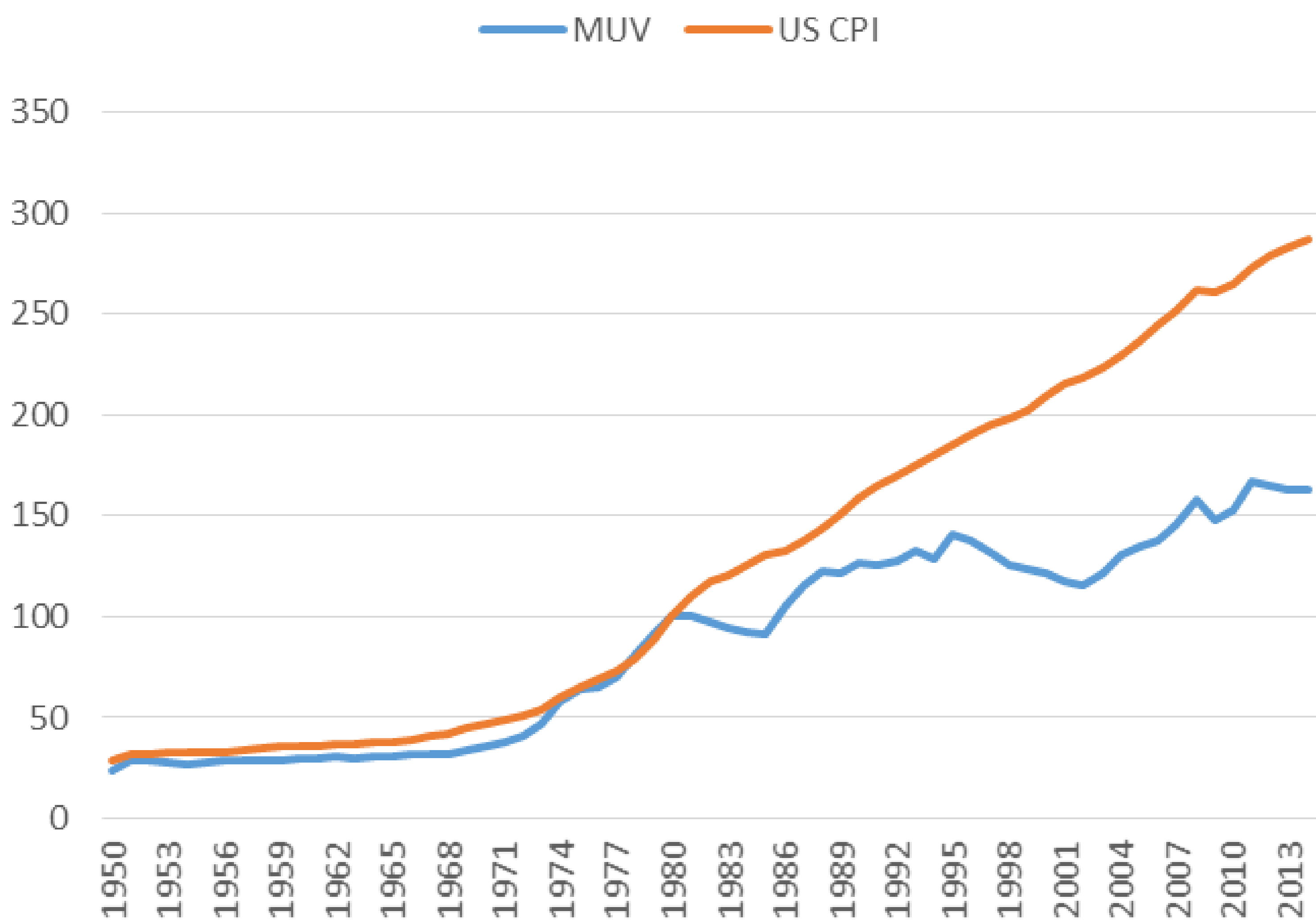
1. Different income-elasticities of demand for commodities vs. manufactures, due to changes in the structure of production/demand:

- applies only to goods and services that exhibit a low income-elasticity of demand / what matters is the goods and services being traded

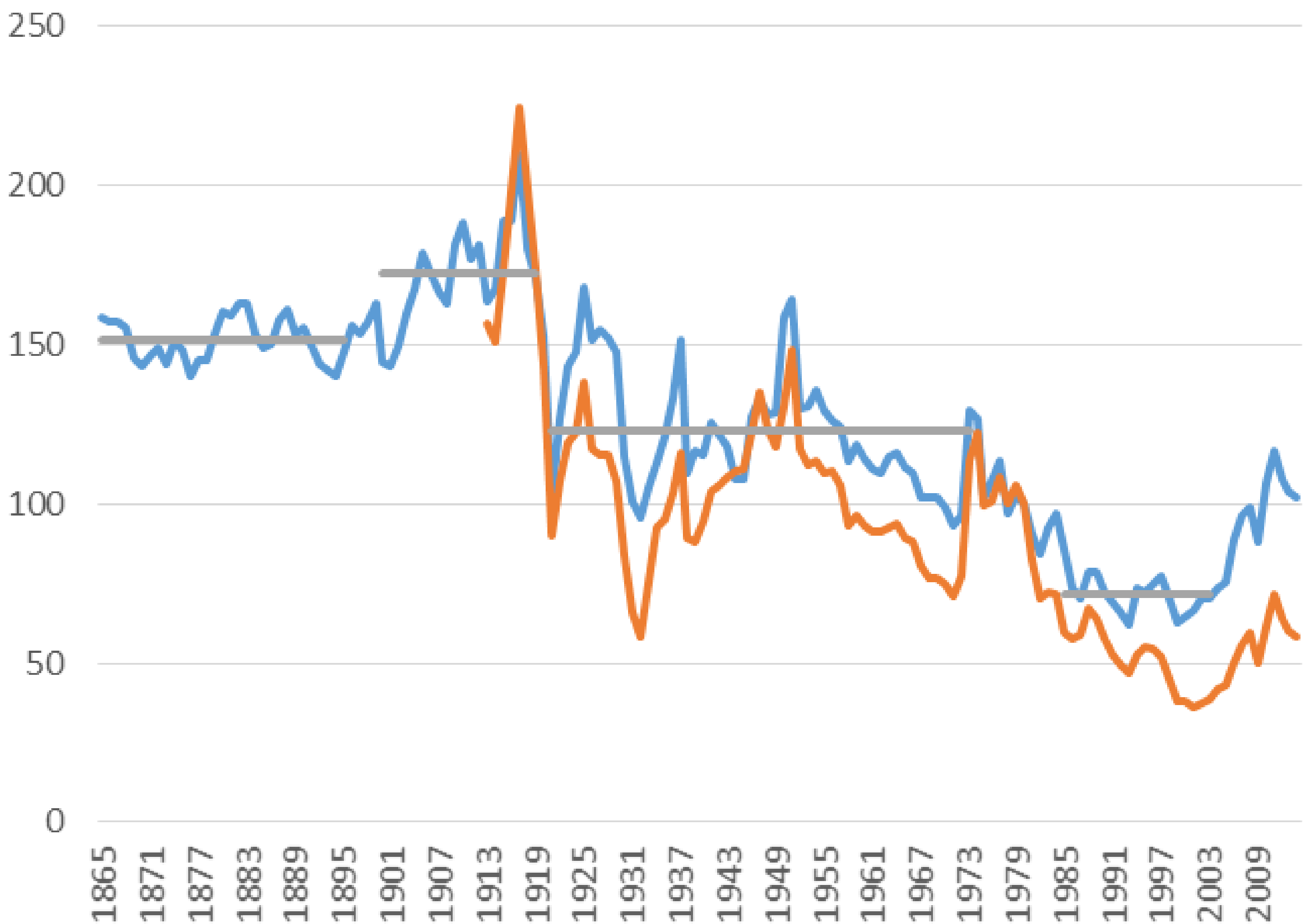
2. Asymmetries in the structure of labor markets generate unequal distribution of the benefits of technical progress:

- applies to all goods and services produced by developing countries / what matters is where they are produced

GLOBAL VALUE CHAINS HAVE BEEN INSTRUMENTAL IN COMMODITIZATION OF MANUFACTURES



WITH US CPI THE CUMULATIVE FALL HAS BEEN EVEN MORE PRONOUNCED



A THIRD STRATEGY?

- Trade in tasks offer opportunities to developing countries
- Trade facilitation is needed but active policies are crucial
- Building production capabilities that can be used in similar products
- Accompanied by incentives and regulations to avoid footloose and exploitative interactions
- Avoid race to the bottom in taxes and regulation
- Control trade misinvoicing: Commercial illicit financial flows (including tax evasion, trade and services mis-pricing and transfer pricing by multinational corporations) account for the largest proportion of illicit financial flows in Africa

SUMMARY

1. The recent boom was much more pronounced for oil and metals.
2. Analysis of the Prebisch-Singer hypothesis follow the evolution of time-series econometrics
3. Commodity prices decreased in a stepwise fashion in the twentieth century
4. Tropical commodities (banana, cocoa, coffee, jute, palmoil, rice, rubber, sugar, tea)
5. Volatility is high, but should not let us forget the decrease in commodity price levels

SUMMARY

6. Super cycles analysis confirms stepwise deterioration
7. World economic activity is a strong predictor of commodity prices
8. Diversification is advised but diversify towards what?
   - Increasing market shares in established positions
   - Diversifying into higher technology products
   - Global value chains?

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