



The Recent Commodity Price Surge: A Boon for Latin America and the Caribbean?



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Notes

Use of the term “dollar” (\$) refers to United States dollars.

The term “billion” signifies 1 000 million.

The term “tons” refers to metric tons.

Use of a dash between years (e.g. 2000–2001) signifies the full period involved, including the initial and final years.

Acronyms

AMIS Agricultural Market Information System
IGC..... International Grains Council
Bpd barrels per day
LAC Latin America and the Caribbean
CDDCs Commodity-Dependent Developing Countries
OPEC Organization of Petroleum Exporting Countries
CLP Chilean peso
PEN Peruvian nuevo sol
COP Colombian peso
VIX..... Chicago Board Options Exchange Market Volatility Index

Abstract

This study reviews and analyses the evolution of commodity prices between the start of the Covid-19 pandemic and mid-2021, a period during which commodity prices have increased, in some cases very substantially. It presents the key factors driving these price increases and discusses potential impacts for Commodity-Dependent Developing Countries (CDDCs) in the Latin America and the Caribbean (LAC) region.

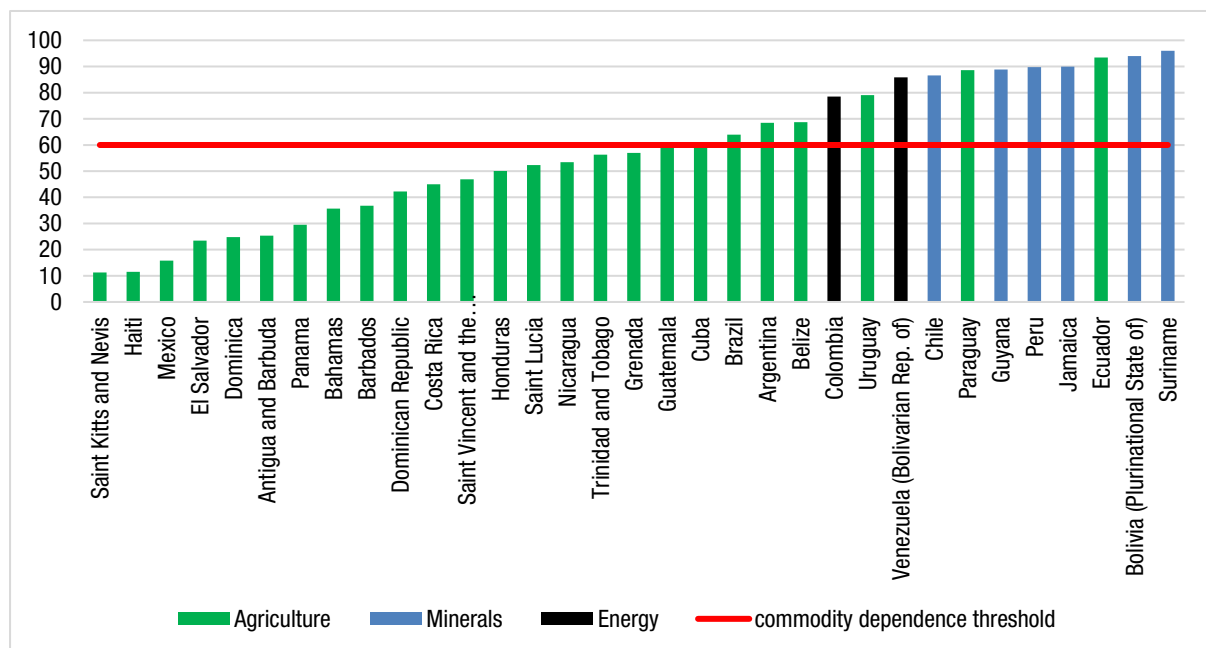
Table of content

I. Introduction	1
II. Export commodity dependence in Latin America and the Caribbean.....	1
III. Recent commodity price evolution	3
IV. Factors affecting recent commodity price increases	6
V. Possible impacts in Latin America and the Caribbean.....	10
VI. Conclusions	15
Bibliography.....	17

I. Introduction

In recent months, commodity prices across the board have increased significantly. This is an important development for the countries in Latin America and the Caribbean (LAC) since commodity sectors play a vital role for many economies in the region. This is illustrated by the fact that 14 countries in LAC are classified as commodity dependent (Figure 1).

Figure 1: Share of primary commodities in total merchandise exports of countries in Latin America and the Caribbean (per cent, average 2015-19)



Source: Authors' calculations using data from UNCTADStat.

Notes: (1) The three categories agriculture, minerals and energy highlight the commodity group with the largest average share in total merchandise exports. (2) Agriculture = SITC 0, 1, 2 (less 27 and 28) and 4; Minerals= SITC 27, 28, 667, 68 and 971; Fuels = SITC 3.

In this note, we analyze the recent rise in commodity prices, highlight its main drivers, and discuss potential implications for the LAC region.

II. Export commodity dependence in Latin America and the Caribbean

An important determinant of a country's sensitivity to commodity price shocks is the share of commodities in its exports,¹ which is the basis of the concept of commodity dependence. A country is export commodity-dependent when commodities account for 60 per cent or

¹ Another consideration is the degree to which countries import commodities, as any net effect of a commodity price change depends on the net overall commodity import position and the magnitude of the changes of each commodity imported and exported. For countries that are large importers of food and energy commodities, for example, but only moderate net exporters of other commodities, the dominant effect of an overall commodity price increase can be the opposite of that experienced by net commodity exporters. In this note we mainly focus on the effects of the price increase on export commodity-dependent countries.

The Recent Commodity Price Surge: A Boon for Latin America and the Caribbean?

more of its total merchandise export revenue. According to this criterion, all countries in South America as well as Jamaica and Belize can be classified as commodity-dependent developing countries (CDDCs). This means that 14 out of 33 countries (42 per cent) in the LAC region are commodity-dependent. Additionally, 7 countries in the region do not meet the 60 per cent threshold but have a commodity share of 50-60 per cent so that the commodity sectors play a major role in their economies.²

Table 1 shows the average commodity export shares as well as the leading export commodity groups for the 14 CDDCs in the LAC region. In these countries, the average (median) share of the leading commodity group in total merchandise exports was 27.0 per cent (24.2 per cent) in the period 2015-2019.

Table 1: Leading commodity exports in LAC CDDCs (2015-2019)

Country	Leading commodity export product group	Average annual share of leading commodity group in total merchandise exports (per cent)	Average annual share of commodities in total merchandise exports (per cent)
Argentina	Feeding stuff for animals (no unmilled cereals)	17.0	68.5
Belize	Sugar, molasses and honey	21.8	68.7
Bolivia (Plurinational State of)	Natural gas, whether or not liquefied	33.5	94.0
Brazil	Oil seeds and oleaginous fruits (excluding flour)	11.8	63.9
Chile	Copper ores and concentrates; copper mattes; cement copper	23.4	86.6
Colombia	Petroleum oils, oils from bitumin. materials, crude	31.3	78.5
Ecuador	Petroleum oils, oils from bitumin. materials, crude	34.0	93.4
Guyana	Gold, non-monetary (excluding gold ores and concentrates)	47.1	88.9
Jamaica	Aluminium ores and concentrates (incl. alumina)	48.4	90.0

² These are Cuba, Guatemala, Grenada, Trinidad and Tobago, Nicaragua, Saint Lucia and Honduras.

Country	Leading commodity export product group	Average annual share of leading commodity group in total merchandise exports (per cent)	Average annual share of commodities in total merchandise exports (per cent)
Paraguay	Oil seeds and oleaginous fruits (excluding flour)	24.9	88.6
Peru	Copper ores and concentrates; copper mattes; cement copper	24.9	89.7
Suriname	Gold, non-monetary (excluding gold ores and concentrates)	74.7	96.0
Uruguay	Meat of bovine animals, fresh, chilled or frozen	21.4	79.1
Venezuela (Bolivarian Republic of)	Petroleum oils, oils from bitumin. materials, crude	67.0	85.9

Source: Authors' calculations using data from UNCTADStat.

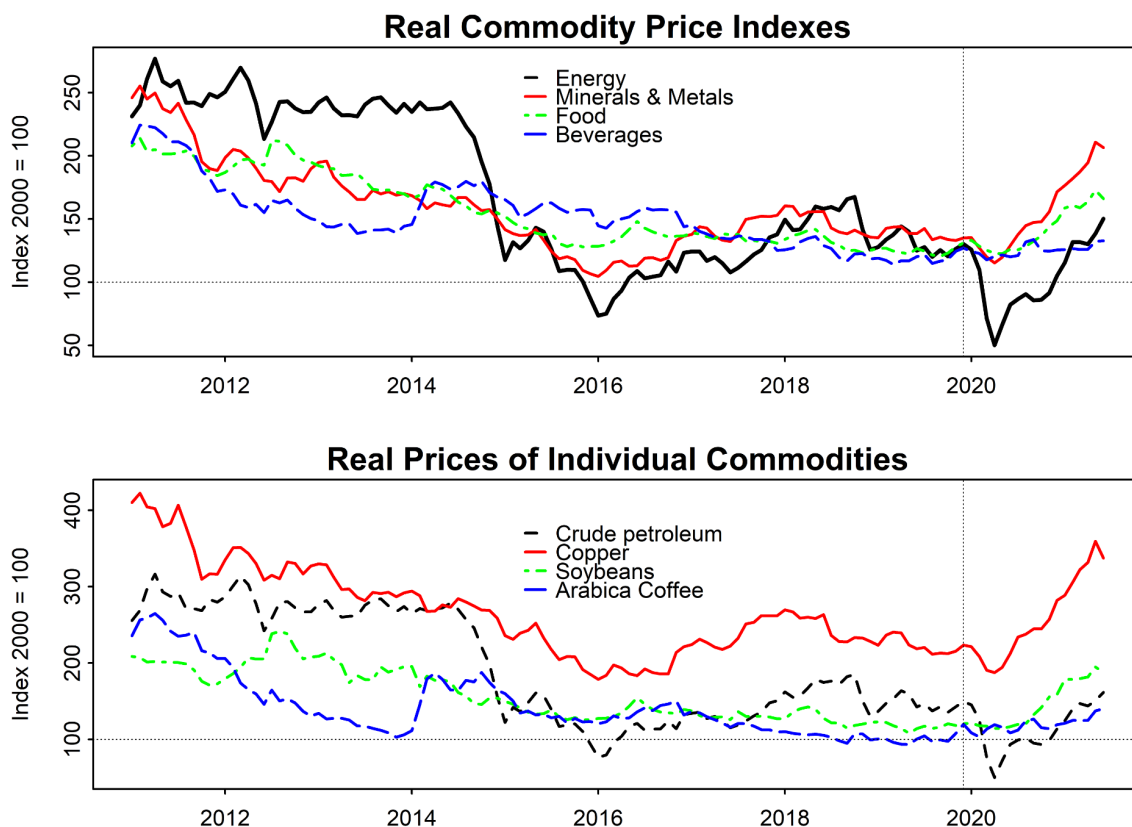
Note: Leading commodity export product groups are based on average export values at SITC 3-digit level within primary commodities defined as SITC 0, 1, 2, 3, 4, 68, 667 and 971 in the period 2015-2019.

III. Recent commodity price evolution

The upper panel of Figure 2 presents the monthly evolution of four major commodity price indexes between 2011 and 2021 while the lower panel shows real prices of key commodities included in each of the indexes. All series are deflated by the monthly United States Consumer Price Index. Figure 2 also includes a horizontal line marking the level of each index in the year 2000, when prices across all commodity categories were low, and a vertical line marking the “start” of the Covid-19 pandemic in December 2019.

Figure 2 is very informative about the impact of the pandemic on the different commodity prices, and three points are worth highlighting. First, we can observe that Energy was the only commodity group that suffered a severe decline in early 2020 following the onset of the Covid-19 pandemic, with a price decline of 61.5 per cent in real terms in the four months January - April 2020. Minerals and Metals experienced a much smaller decline (14.7 per cent) during the same period and prices of the Food and Beverage groups were little affected. Indeed, prices of commodities like soybeans and arabica coffee, as shown in the lower panel of Figure 2, were not affected except for an increase in short-term volatility. These developments reflect the impact of the restrictions to movement that were imposed around the world in 2020 to slow the spread of Covid-19, which affected in particular energy prices; and the increase in uncertainty that brought about a slowdown in investment, which affected the prices of minerals and metals.

Figure 2: Real prices of selected individual commodities and group indexes



Source: Authors' calculations using World Bank and United States Bureau of Labor Statistics data.

Second, what is extraordinary about the drop in energy prices was not only its size but also its speed: the 61.5 per cent real price decline in four months was identical in terms of percentage and speed (but smaller in terms of price declines, due to base differences) to the hitherto largest and fastest fall in energy prices, which occurred between August and December 2008 as a result of the global financial crisis.

Third, recent price increases for the Mining and Metals, Food and Energy groups resulted in real price levels in June 2021 previously not seen since September 2011, June 2014 and October 2018, respectively. For the Minerals and Metals commodity group prices in June 2021 were 22.5 per cent below the peak levels attained in March 2008 before the global financial crisis. Similarly, for the Food commodity group, prices in June 2021 were 25 per cent below the peak prices reached in June 2008. However, Energy prices are at present far below the levels registered pre-financial crisis, in part due expanding supply of gas and petroleum during the last decade, including due to fracking.

Table 2 focuses on the evolution of the real prices of each commodity group during the Covid-19 pandemic, showing for each commodity group: i) the month when the lowest index value was registered after the start of the Covid-19 emergency in December 2019; ii) the index growth in percentage points registered between that minimum and the last price observation available (June 2021), and iii) the index growth in percentage points registered between the start of the Covid-19 emergency in December 2019 and the last observation available (June 2021).

Table 2 shows that while prices of all commodity groups increased with respect to the beginning of the Covid-19 emergency, there was significant heterogeneity in terms of the magnitude of price increases across different commodity groups. On the one hand, prices of Minerals and Metals increased by 53.3 per cent since the start of the Covid-19 pandemic and prices of Food increased 27 per cent. On the other hand, prices of Beverages and Raw Materials only increased 4.7 per cent and 4.5 per cent, respectively. Energy prices have increased by 15.6 per cent since the start of the pandemic and doubled with respect to the minimum levels registered in April 2020. Prices of commodities in the Precious Metals group increased continuously during the pandemic, buoyed by investor demand as a safe asset in the face of expansive monetary policies around the world and the increase in uncertainty due to the Covid-19 pandemic.

Table 2: Real price evolution of aggregate commodity price indexes during the pandemic (December 2019 – June 2021)

Group	Minimum	Max Growth	Covid-19 Growth
Minerals & Metals	01/04/2020	79.2	52.9
Food	01/05/2020	35.4	26.6
Precious Metals	01/12/2019	22.7	22.7
Energy	01/04/2020	199.8	15.3
Beverages	01/03/2020	12.7	4.4
Raw Materials	01/04/2020	10.5	4.2

Source: Authors' calculations using World Bank data and United States Bureau of Labor Statistics.

Table 3 complements the information provided by Table 2, showing the same growth rates and the month with the lowest level of each real price series during the Covid-19 pandemic for individual commodities exported by countries in the LAC region. Within the Minerals and Metals group ³ key commodities like copper, iron ore and aluminium experienced significant price increases, with iron ore showing the largest price increases. Among food commodities there were large price increases for maize, soybeans and products of the latter (soybean oil and soybean meal), which drove the price increase of the Food commodities group.⁴ Finally, in the Beverages group, coffee experienced moderate price increases (from a relatively low base) caused by supply issues during the period and increasing demand, while for cocoa the combination of supply side developments like bumper crops in West Africa with reduced grindings in key markets during the Covid-19 pandemic, resulted in prices in June 2021 that were 7.8 per cent below in real terms than prices at the start of the Covid -19 pandemic in December 2019.

³ Combined, these three commodities account for 84 per cent of the Minerals and Metals group.

⁴ Combined, maize, soybeans, soybean oil and soybean meal account for 37.5 per cent of the Food commodity group.

The Recent Commodity Price Surge: A Boon for Latin America and the Caribbean?

Table 3: Real price evolution of selected commodities (December 2019 – June 2021)

Product	Minimum	Max Growth	Covid-19 Growth
Iron Ore	01/04/2020	139.3	120.5
Coal	01/08/2020	148.2	87.1
Tin	01/04/2020	105.5	80.7
Maize	01/05/2020	91.6	66.6
Soybean Oil	01/04/2020	97.5	62.4
Soybeans	01/05/2020	64.8	55.8
Copper	01/04/2020	80.0	51.0
Silver	01/03/2020	72.7	50.1
Aluminium	01/04/2020	58.4	31.6
Soybean Meal	01/05/2020	30.9	27.0
Nickel	01/03/2020	44.5	23.9
Zinc	01/03/2020	47.6	23.8
Cotton	01/04/2020	40.5	18.6
Gold	01/12/2019	18.2	18.2
Arabica Coffee	01/02/2020	35.5	16.9
Wheat	01/06/2020	30.3	10.3
Petroleum (Average)	01/04/2020	222.6	8.0
Fish Meal	01/02/2020	5.4	5.3
Banana	01/11/2020	4.5	2.8
Plywood	01/06/2021	0.0	-5.6
Cocoa	01/07/2020	7.5	-7.8
Shrimp	01/10/2020	13.4	-8.5

Source: Authors' calculations using World Bank data.

IV. Factors affecting recent commodity price increases

While the evolution of each commodity price is affected by numerous factors, a number of broad-based factors can be highlighted that played a role in the recent increase in commodity prices.

Clearly, the acceleration of world economic activity has boosted the demand for energy and metal commodities. Figure 3 shows the recent evolution of three indicators of world economic activity, the Baltic Dry Index,⁵ the Amplitude-adjusted Composite Leading

⁵ As the main (but not the only) driver of the evolution of the Baltic Dry Index has been attributed to shipping demand shocks (Jacks and Stuermer, 2021), this index and other indicators of dry cargo shipping costs have been used in the

Indicators⁶ for OECD countries and six major emerging market economies, and World steel production (with data for 64 countries from the World Steel Association).⁷

Figure 3 shows the decline of world economic activity across all three indicators at the beginning of the Covid-19 pandemic in December 2019 or shortly thereafter. The spread of the pandemic was accompanied by severe restrictions of contacts and movements around the globe leading to a decline of economic activity. The figure also shows the beginning of a recovery in world economic activity starting in the second quarter of 2020 and accelerating in the first quarter of 2021 as vaccination campaigns took off around the world. The growth in world economic activity has been backstopped by expansive monetary and fiscal policies across the board and the progressive lifting of restrictions of movement and activities. For steel production, the recovery of the Chinese economy played a key role as the country accounted for 56.7 per cent of the global production of crude steel and 56.2 per cent of the global consumption of steel products in 2020.⁸

In parallel to the increase in world economic activity, there has been an improvement of investor expectations as indicated by the reduction in the volatility in international financial markets. This is highlighted by the evolution of the VIX index depicted in Figure 4.⁹ Reduced volatility and improved investor expectations have also led to increased attractiveness of commodities as an asset class, pushing up the number of transactions and prices in some commodity futures markets. The movements of the VIX index presented in Figure 4 shows the progressive but slow improvement of investor expectations from June 2020 onwards, after the widespread market uncertainty experienced during the first quarter of 2020 due to the spread of the Covid-19 pandemic. More recently, policy announcements such as the United States and European Union Covid-19 stimulus packages worth US\$ 1.9 trillion and EUR 750 billion, respectively, may have also supported a favourable outlook by investors and consumers on near-term recovery and growth.

past in the literature (e.g. Killian, 2009) as an indicator of world real economic activity. The index is composed of three sub-indices that measure different sizes of dry bulk carriers: Capesize, which can transport cargoes of about 150,000 tons, Panamax, moving cargoes of around 60-70,000 tons, and Supramax, with capacities between 48,000 and 60,000 tons. The index is constructed using data from commodity transport along 23 different shipping routes.

⁶ The Composite leading indicators of the OECD are used to identify early signals of turning points in business cycles showing fluctuation of the economic activity around its long term potential level.

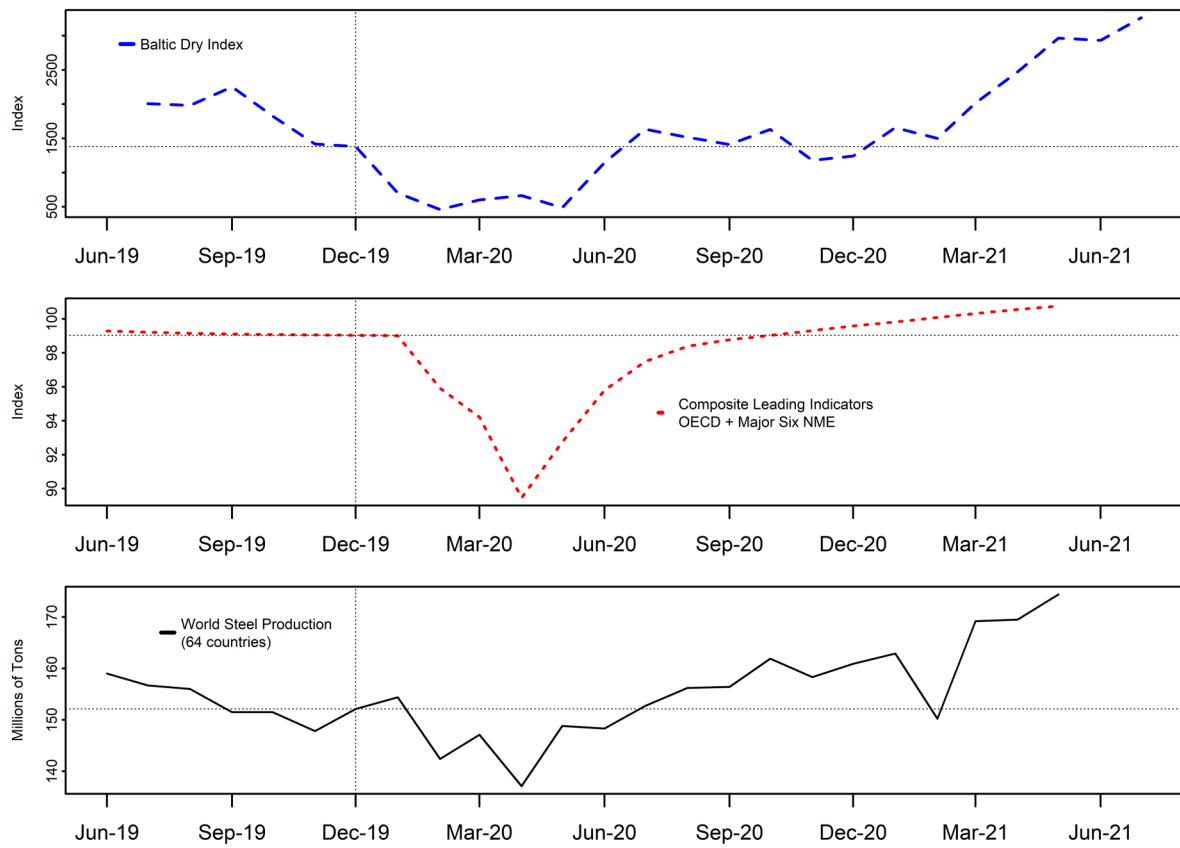
⁷ World production of steel has also been proposed as an indicator for the strength of world real economic activity (Ravazzolo, F. and Vespignani, J.,2020).

⁸ Source: World Steel Association "World Steel in Figures 2021".

⁹ The VIX Index provides a measure of constant, 30-day expected volatility of the **United States** stock market, derived from real-time, mid-quote prices of Standard & Poor's 500 Index (SPX) call and put options. See https://www.cboe.com/tradable_products/vix/

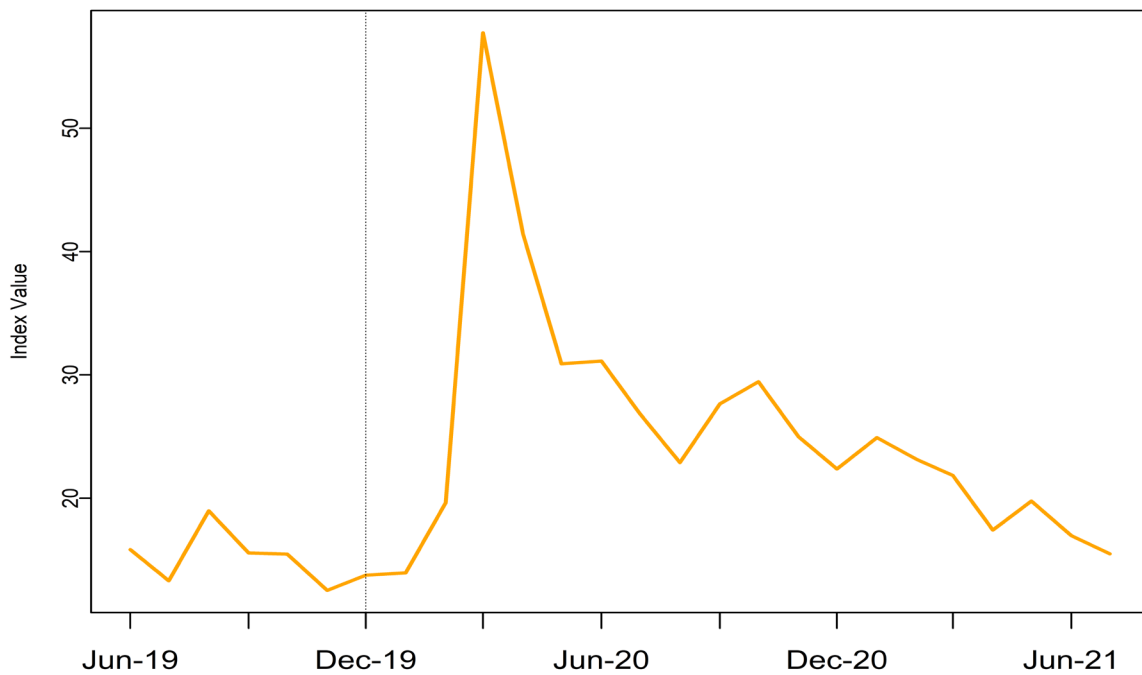
**The Recent Commodity Price Surge:
A Boon for Latin America and the Caribbean?**

Figure 3: Three indicators of world real economic activity



Source: Authors' calculations using data from Thomson Reuters, OECD and World Steel Association.

Figure 4: Chicago board options exchange market volatility index (VIX)



Source: Author's calculations using Thomson Reuters data. Monthly averages of daily closing values.

In light of recovering world economic activity, positive expectations, and expansive macroeconomic policies, including fiscal stimulus, packages relaxed monetary policy and a number of supply-side factors, it is no surprise that commodities linked to construction and infrastructure, like iron ore, coal and copper, have been among the most dynamic commodities in terms of price increases, as shown by Table 3. Indeed, the magnitude of recent commodity price increases of the Minerals and Metals, and Energy groups of commodities have led to a number of countervailing supply responses. For example, during the 19th Organization of Petroleum Exporting Countries (OPEC) and Non-OPEC Ministerial meeting on 18 July 2021, petroleum producing countries agreed to increase production by 0.4 million barrels per day (bpd) each month from August to December 2021. These supply increases are expected to continue until the 5.8 million bpd production adjustment that was implemented by OPEC+ is phased out. Also, it was decided to change the baseline for the calculations of the production adjustments from May 2022.¹⁰

Also, longer term trends such as the rapid growth of the market for low-carbon energy technologies and electric vehicles are starting to impact minerals demand. For instance, battery production is already the largest end use for cobalt and lithium and is absorbing increasing shares of the market for class-I nickel. The global electric car stock has increased by 43 per cent in 2020 and is expected to increase more than tenfold through 2030 (IEA, 2021a). Furthermore, the share of renewables in the global energy mix has increased from 27 per cent in 2019 to 29 per cent in 2020 (IEA, 2021b). As a consequence of these trends, the IEA projects in its baseline scenario that the production of clean technologies will absorb twice as much copper in 2040 than in 2020 and increase its demand for cobalt, nickel, and lithium by factors of 6, 7 and 13, respectively (IEA, 2021c). The recent increases in food prices are due to a number of factors affecting market fundamentals, as well as production costs around the world. First, rising energy prices - as shown in Tables 1 and 2 and Figure 2 - contribute to higher agricultural production costs both directly, through fuel price increases, and indirectly, through the rise in fertilizer prices.¹¹ In the same vein, higher energy prices have driven up transportation costs, which have added to the upwards pressure on food commodity prices. Second, supply uncertainties have contributed to increasing prices of certain agricultural commodities. For example, drought conditions have led to downward revisions of the maize production forecast for the 2020/21 growing season in Brazil, one of the world's largest maize exporters.¹² Third, rising global demand has caused the supply-demand balance to tighten for a number of food commodities. For instance, global utilization of soybeans and maize is expected to outweigh global production in the 2020/21 marketing season, leading to a reduction of global stocks (AMIS, 2021; IGC, 2021).

It is interesting to note that the increase in commodity prices took place despite the appreciation of the United States dollar against other currencies like the Euro or Renminbi,

¹⁰ This involves increasing the baselines for Saudi Arabia, the Russian Federation, Kuwait, Iraq and the United Arab Emirates. See https://www.opec.org/opec_web/en/press_room/6512.htm

¹¹ The index of fertilizer prices of the World Bank, composed of nitrogenous fertilizer (manufactured using natural gas), phosphates, and potassium fertilizers, rose in real terms 57.1 per cent between the start of the Covid-19 pandemic in December 2019 and June 2021, including a rapid rise of 70.2 per cent between June 2020 and June 2021.

¹² According to the Country Brief for Brazil of January 19th, 2021, the Global Information and Early Warning System of the Food and Agriculture Organization of the United Nations, for maize "Yields are expected to be at below-average levels as reduced precipitation amounts from March to May and a cold spell in June adversely affected crops". See <http://www.fao.org/giews/countrybrief/country.jsp?code=BRA>

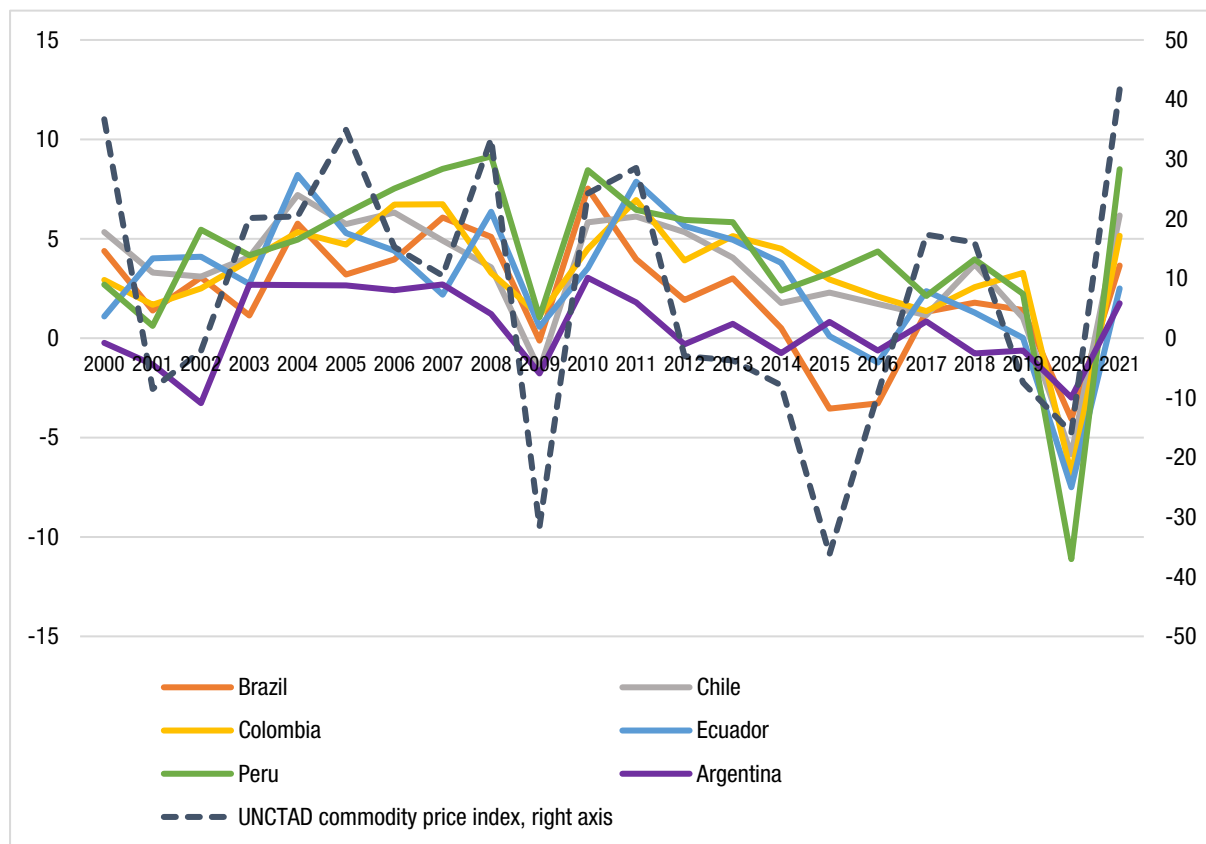
starting in the second quarter of 2020. However, further appreciation of the United States dollar, for example as a result of tightening of interest rates to contain inflationary pressures, may dampen further commodity price increases. Overall, given the persisting uncertainty regarding the evolution of the pandemic at the time of writing (July 2021), in particular regarding the impact of the new virus variants, it can be expected that commodity prices will remain volatile in the near future.

V. Possible impacts in Latin America and the Caribbean

Most if not all countries in the LAC region rely on the production and export of commodities as a source of economic growth through different channels. One channel operates through investment in commodity sectors. In particular mining and energy are very capital intensive sectors where foreign direct investment plays a key role. Another channel operates via capital inflows, which are often positively correlated with the commodity price cycle. Also public and private income and expenditure tend to follow commodity cycles. As a result, the evolution of GDP growth in LAC is correlated with the observed evolution of commodity prices (e.g. Alberola et al., 2016). For example, the (Pearson) correlation coefficient between changes in the UNCTAD commodity prices index and the weighted average¹³ GDP growth of CDDCs in LAC in the period 2000-2020 indicates a linear correlation of 70 per cent between both variables and is statistically significant with a 99 per cent confidence interval. Figure 5 provides an illustration of the link between GDP growth rates and commodity price changes showing the growth rate of six large Latin American CDDCs and the growth rate of UNCTAD's commodity price index. It can be seen that GDP growth rates were high in CDDCs in LAC during the commodity price boom between 2003 and 2011 (only briefly interrupted by the global financial crisis). However, after the end of the boom period in 2011, GDP growth rates in most CDDCs in LAC decelerated in line with falling commodity prices. The recent increase in commodity prices can be expected to strengthen the post-pandemic recovery of CDDCs in the LAC region as shown by growth projections for 2021 included in Figure 5. A key risk factor to this positive outlook is the emergence of new variants of SARS-CoV-2 and their potential to disrupt economic activity in the LAC region and across the globe, either directly or via an increase in uncertainty.

¹³ GDP growth corresponds to the average annual growth rates of GDP of the 14 CDDCs in LAC, weighted by time-varying shares of GDP at PPP. The UNCTAD commodity price index value for 2021 corresponds to the average of the monthly year-on-year percentage changes for the months January-April 2021.

Figure 5: GDP growth rates of selected Latin American CDDCs and changes in commodity prices



Source: Authors' calculations using data from IMF, World Economic Outlook Database and UNCTADStat database.

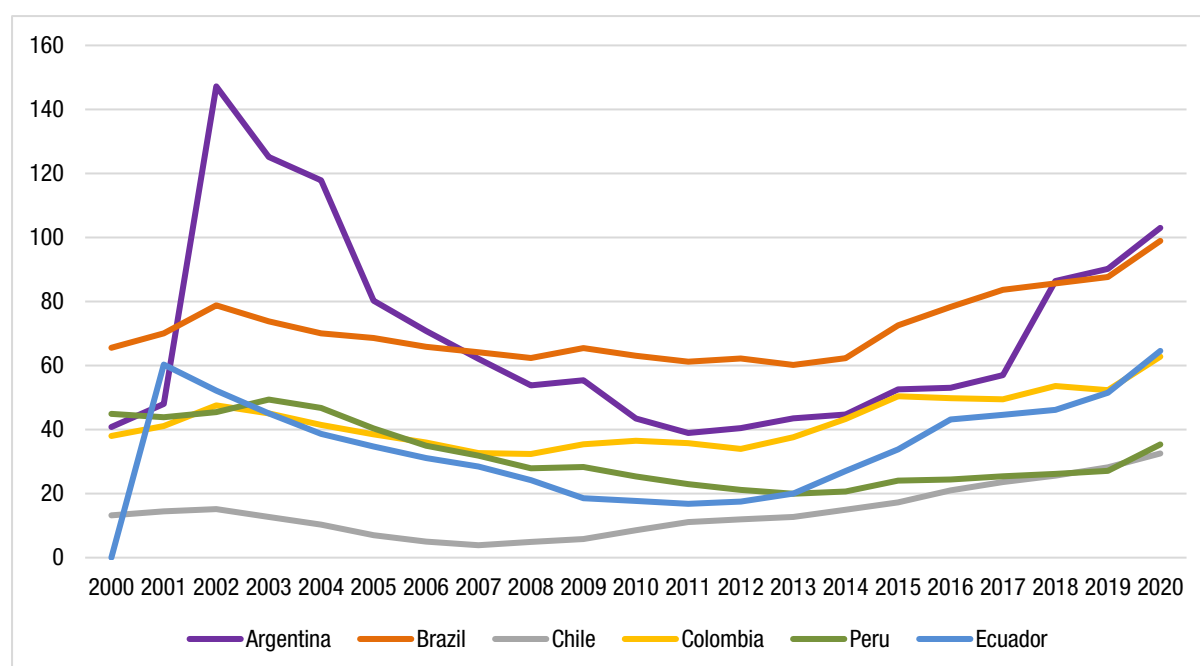
Note: (1) Data for 2020 onwards for Argentina and Ecuador are IMF estimates. (2) The UNCTAD commodity price index value for 2021 corresponds to the average of the monthly year-on-year percentage changes for the months January-April 2021.

Commodity price movements impact the fiscal balance not only through their effects on the economic cycle but also through their link with fiscal revenue both directly (when exports are taxed or public firms engage in commodity export) and indirectly (e.g. via income taxes on exporting firms). Several studies have found evidence of procyclicality of fiscal policy at different periods in different countries in the LAC region.¹⁴ As shown by Figure 6, several CDDCs in the LAC region experienced falling debt-to-GDP ratios during the last commodity price boom and rising debt-to-GDP ratios thereafter. As Figure 6 shows, there exist large differences in debt-to-GDP ratio levels between different countries of the region. The recent commodity price increases can be expected to have a positive impact on GDP growth and public revenue in CDDCs in the LAC region, which could contribute to manage public expenditure needs in the wake of the Covid-19 pandemic.¹⁵

¹⁴ For example, see Klemm (2014) and the references therein. There is also evidence that the evolution of fiscal balances during past commodity booms and busts has been heterogeneous across time and countries. See Cespedes and Velasco (2011) and International Monetary Fund (2015).

¹⁵ However, at the time of writing there is still significant uncertainty surrounding the time of exit from the pandemic and the evolution of fiscal expenditure associated with the latter, both factors that can affect fiscal balances across the region.

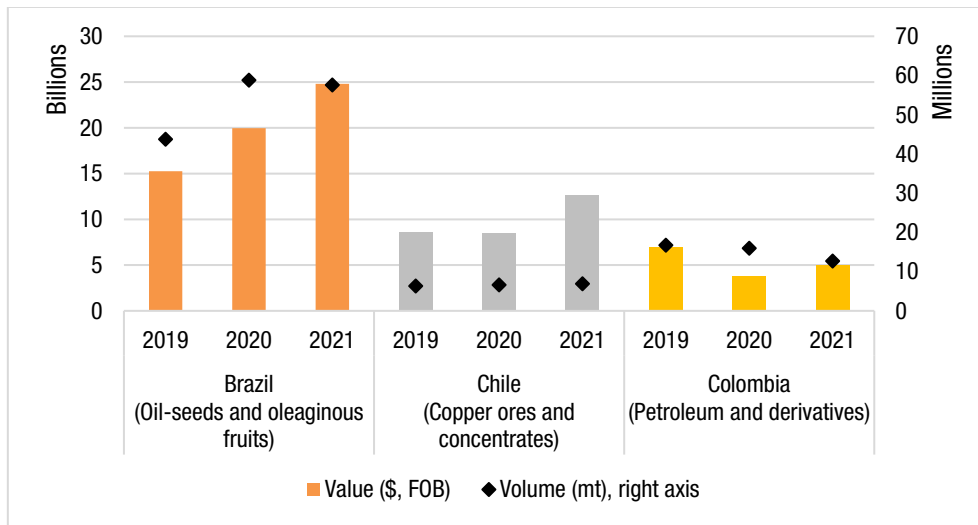
Figure 6: Debt-to-GDP ratios for selected CDDCs



Source: Authors' calculations: IMF, World Economic Outlook Database
Note: Data for 2020 for Argentina, Colombia, Ecuador and Peru are estimations.

Another key impact of the recent commodity price increases on CDDCs in the LAC region will be through the trade balance. For many commodity exporters in LAC, price increases have led to significant increases in commodity export revenues in the first half of 2021, relative to the same period of 2020 and in spite of stagnant or (in some cases) even falling export volumes. For instance, Figure 7 shows that Brazil's Free On Board export revenue from oilseeds in the first 6 months of 2021 was 24.3 per cent higher than in the same period of 2020 although exported volumes were slightly lower in the first half of 2021 with respect to the same period in 2020. Similarly, Chile's export revenue from copper ores and concentrates was 48.8 per cent higher in the first half of 2021 than in the first half of 2020, while exported volumes had only increased by 4.4 per cent. Further, Colombia's export revenue from petroleum and derivatives increased by 29.9 per cent in the period January-May 2021 with respect to the same period of 2020, while exported volumes were 20.6 per cent lower in 2021. On the other hand, commodity price increases have a negative effect on the trade balances of net commodity importers in the LAC region, such as those importing energy and food commodities. For example, Costa Rica's Cost Insurance and Freight cereal import bill during the first five months of 2021 was 34.8 per cent higher than during the same period of 2020, while import volumes only increased by 5 per cent, as shown by Figure 8. Other countries in the LAC region such as El Salvador and Honduras also saw their import bills for basic food commodities increase disproportionately with respect to imported volumes in the first half of 2021.

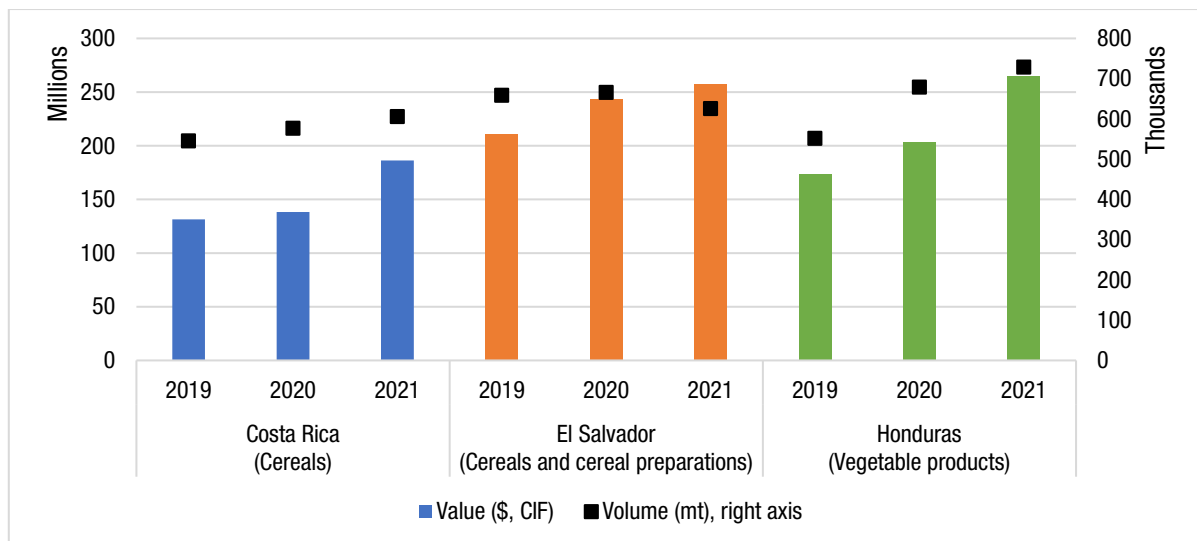
Figure 7: Export revenues and volumes of leading commodity group for selected CDDCs in Latin America (2019-2021)



Source: Authors' calculations using data from the COMEX Stat database of the Ministry of Industry, Foreign Trade and Services (Brazil), Dirección Nacional de Aduanas (Chile) and Departamento Administrativo Nacional de Estadística (Colombia).

Note: Data for Brazil and Chile (Colombia) reflects cumulative export revenue from the months January-June (January-May) of the respective years.

Figure 8: Import costs and volumes of basic food commodities for selected countries in Latin America (2019-2021)



Source: Authors' calculations using data from Portal Estadístico de Comercio Exterior of PROCOMER (Costa Rica), Banco Central de Reserva de El Salvador and Banco Central de Honduras.

Notes: (1) Data for Costa Rica and Honduras (El Salvador) reflects cumulative export revenue from the months January-May (January-June) of the respective years. (2) "Cereals" refers to HS chapter 10; "Cereals and cereal preparation" refers SITC division 04; "Vegetable products" refers to HS section II (cereals accounted for an average of 57.5 per cent of the import value under this section for Honduras in the period 2015-19 based on Comtrade data).

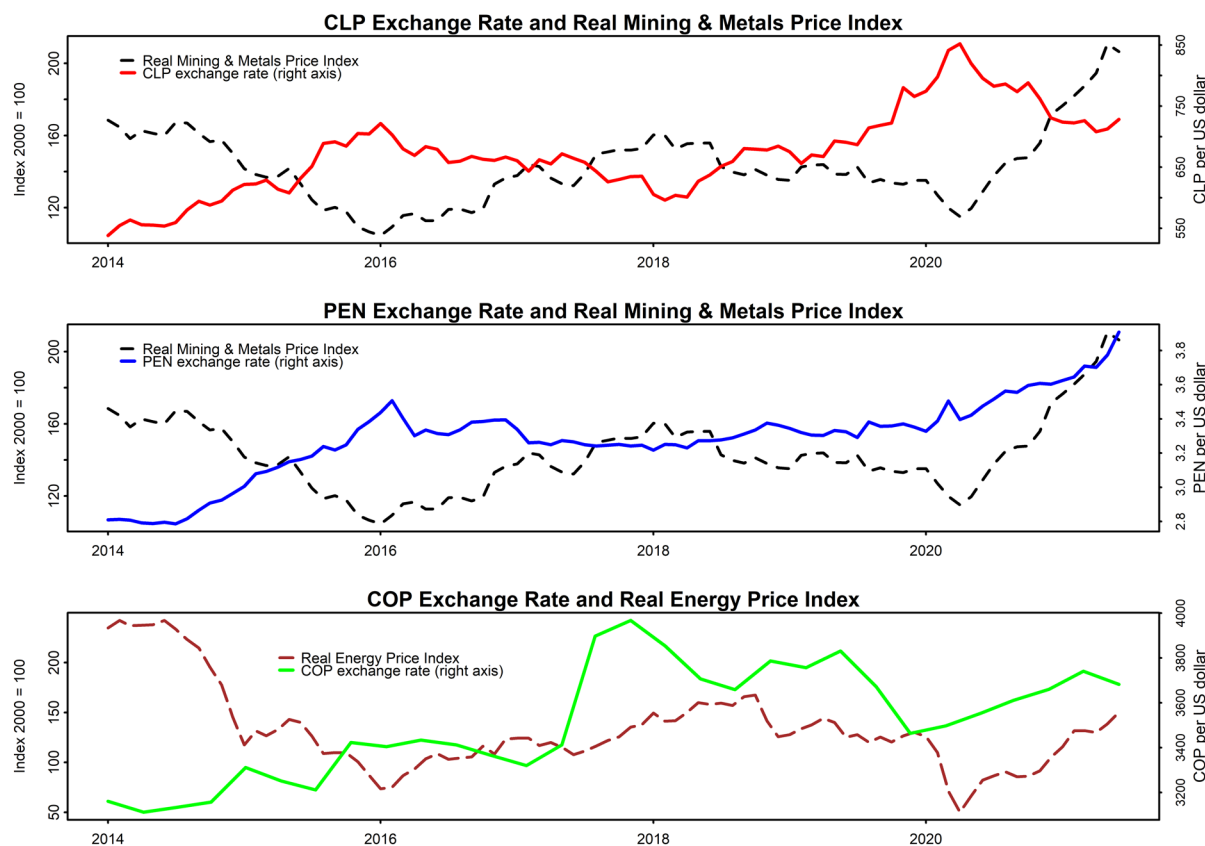
Finally, commodity price movements also result in changes in the nominal and real effective exchange rates of CDDCs in the region, in particular for those countries that are most closely

The Recent Commodity Price Surge: A Boon for Latin America and the Caribbean?

integrated with international capital markets and which follow more flexible exchange rate regimes.

In the past, there has been a close correlation between the evolution of nominal exchange rates of the domestic currencies of those countries vis a vis the United States dollar and the evolution of commodity prices of key export commodities in each country. For example, the (Pearson) correlation between the nominal monthly exchange rates of Chile, Peru and Colombia and the monthly real price index of Minerals and Metals (for Chile and Peru) and of Energy (for Colombia) for the period January 2000 - June 2021 was 63.7 per cent, 64.4 per cent and 68.9 per cent, respectively, and in all three cases significant with a 99 per cent confidence interval.¹⁶ This indicates that a commodity price increase (decrease) of the relevant commodities for each country is closely associated with an appreciation (depreciation) of the nominal exchange rate. The latter relationship is illustrated by Figure 9, which presents in the top and central panel, respectively, the movements of the nominal monthly exchange rates of the Chilean peso and the Peruvian Nuevo Sol against the United States dollar together with the evolution of the real monthly mining and metal price index of the World Bank. The bottom panel shows the evolution of the nominal monthly exchange rate of the Colombian peso against the United States dollar, and the evolution of the real Energy price index of the World Bank.

Figure 9: Select Nominal Exchange Rates and Real Commodity Price Indexes



Source: Authors' calculations using Bloomberg and World Bank data.

¹⁶ Interestingly, the correlation between nominal monthly exchange rates and relevant commodity prices seems to weaken for certain countries in 2020-2021, like Peru.

VI. Conclusions

In this note, we have reviewed the recent increase of commodity prices, presented some key factors driving these price increases and discussed potential impacts for Commodity-Dependent Developing Countries (CDDCs) in the Latin America and the Caribbean (LAC) region.

Commodity prices as a group have increased from the start of the Covid-19 pandemic in December 2019, and especially with respect to the floors attained by several individual commodities in the first half of 2020. However, there has been a wide heterogeneity across groups and especially individual products.

While many different supply and demand factors are behind the recent commodity price increases, it is worth highlighting the roles of two key drivers. First, the recovery in world economic activity as countries advanced in their vaccination efforts and subsequently removed a number of movement restrictions. Second, the improvement in investor and consumer expectations also contributed to commodity price increases, in particular for energy and mineral and metal commodities. For the latter group of commodities in particular, factors associated with the global energy transition might also be contributing to the evolution of prices over the longer term. For certain agricultural commodities like cocoa or maize, supply-side developments have had an effect on the recent evolution of prices. An interesting point is that the recent commodity price increase has taken place despite the appreciation of the United States dollar vis-à-vis other currencies like the Euro or the Renminbi since April 2020, something that tends to dampen commodity demand by making commodities more expensive in other currencies.

The different degrees of commodity dependence across the LAC region indicate that the impacts of commodity price increases on trade and GDP growth in the CDDCs of the LAC region will also be heterogeneous. This is compounded by differences in terms of public indebtedness, domestic policy environments and other socio-political-economic factors impacting on macroeconomic variables. Also, for countries in the LAC region that import substantial amounts of basic commodities such as food and fuels, persistently high commodity price levels could cause additional issues such as cost pressures on prices and a rise in poverty and food insecurity.

Volatility is likely to remain a challenge for CDDCs in the LAC region. As illustrated in section V, commodity price swings are accompanied by movements of key macroeconomic indicators such as GDP growth, trade balances, debt positions and exchange rates. Also, LAC countries that import key commodities such as food and energy are prone to shocks and volatility transmitted via global commodity markets. Unquestionably, the near-term priority for LAC countries is to rebuild their economies after the shock of the Covid-19 pandemic. In this context, high commodity prices, if they are persistent,¹⁷ may provide a welcome boost for commodity exporters in the region. However, the recent commodity price hikes and the high level of uncertainty regarding future commodity market developments are

¹⁷ At the time of writing (July 2021), while some fundamentals like world economic activity increases are expected to continue to support commodity demand, countervailing developments in supply and demand of different commodities, as well as potential further appreciation of the US dollar may dampen commodity prices and increase volatility.

The Recent Commodity Price Surge: A Boon for Latin America and the Caribbean?

a reminder that, over the medium and longer term, it is also important to strengthen domestic institutions and policy frameworks (including fiscal, monetary, macro-prudential and social policies and their associated institutions) with a view to increasing the resilience of LAC economies to the impacts of future exogenous shocks, such as commodity price fluctuations, capital flow volatility and others.¹⁸

¹⁸ For further reading see e.g. Arezki et al. (2012).

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