

INTERNATIONAL PRICES OF SELECT COMMODITIES

4.61 In an open economy, movement in domestic prices of commodities depends on the behaviour of their world prices. The pass through, however, is often incomplete and may be influenced by administrative and fiscal interventions. International and domestic trends of inflation in respect of 12 commodity groups indicate that domestic inflation for comparable groups has been significantly lower than the increase in global commodity group indices (Table 4.20 and Figures 4.20 and 4.21).

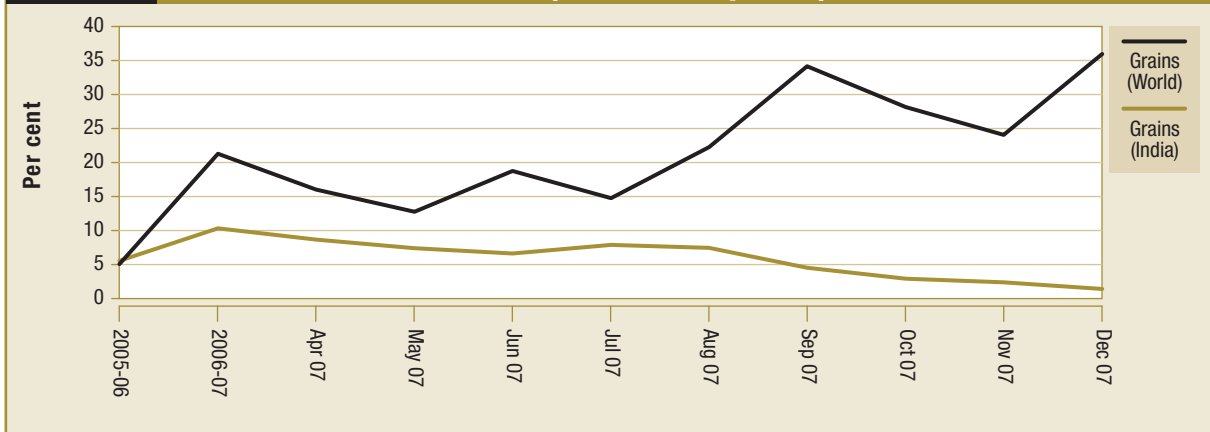
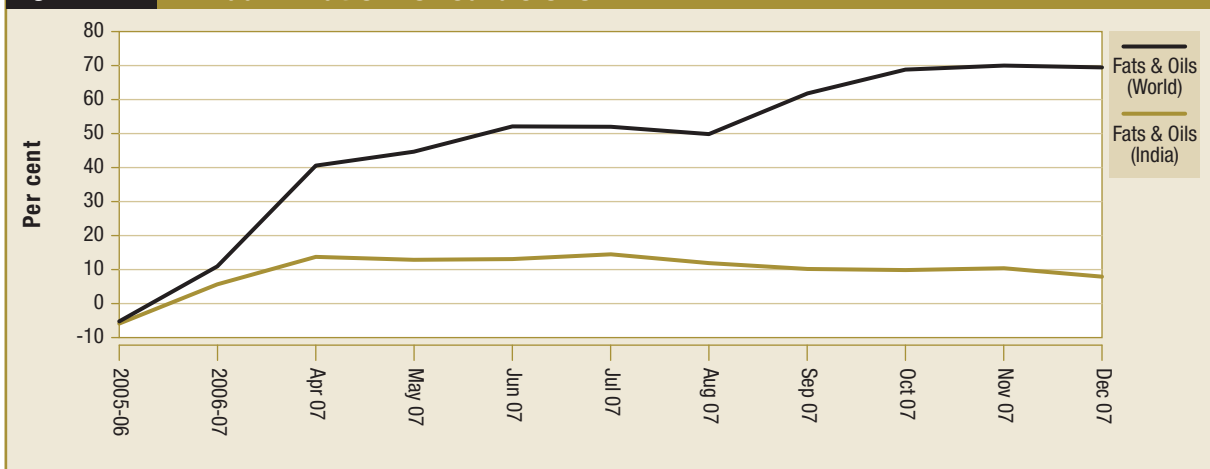
4.62 Four factors contributed to a global increase in the prices of commodities. First, demand for food crops and edible oils increased

because of rapid rise in income in developing countries. Strong demand from the oil exporting countries and increased use of these crops/commodities in biofuels also pushed up their demand. The World Bank in its Global Economic Prospects 2008 has indicated that, in 2006, biofuels accounted for 5-10 per cent of the global production of primary biofuel feed stocks. The United States used 20 per cent of its maize production for biofuels; Brazil used 50 per cent of sugarcane for biofuels; and the European Union used 68 per cent of its vegetable oil production for biofuels. Such large uses, by reducing the availability of these products for food and feed, exerted pressure on prices. Second, food prices also increased because of low output stocks. Global output of grains declined from 2,016 million tonnes in 2005-

Table 4.20 International and domestic trend of inflation (per cent)

Commodities	Average inflation		Year-on-year inflation in 2007-08									
	2005-06	2006-07	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Avr
International inflation based on WPC (in per cent)												
Petroleum	38.3	10.9	-4.3	-5.1	-0.1	1.6	-2.3	23.6	41.5	57.1	46.8	17.6
Non-energy commodities	14.8	24.3	18.5	11.6	16.0	14.5	11.9	16.4	18.2	16.9	15.1	15.5
Agriculture	9.7	11.3	10.2	7.7	11.8	13.3	14.3	21.9	24.7	25.0	24.3	17.0
Beverages	15.9	6.3	9.7	12.7	21.4	19.2	12.6	18.2	22.2	14.1	14.4	16.1
Total food	2.8	10.0	10.5	9.2	20.4	22.0	25.3	32.8	34.0	34.1	37.2	25.1
Fats and oils (world)	-5.0	11.1	40.8	44.9	52.3	52.2	50.0	62.0	69.0	70.2	69.7	56.8
Grains (world)	4.9	21.1	15.8	12.6	18.5	14.5	22.1	33.9	28.0	23.9	35.8	22.8
Other food	10.0	2.8	-15.8	-19.3	-5.8	-0.7	3.3	2.8	1.9	2.3	1.7	-3.3
Total raw materials	14.5	16.4	10.0	3.0	-2.1	0.7	3.7	12.1	15.4	21.5	15.9	8.9
Timber	11.6	14.2	12.8	6.2	7.8	10.4	7.0	7.5	7.2	4.5	-0.7	7.0
Other raw materials	16.8	18.2	8.2	0.8	-8.1	-5.4	1.3	15.7	21.8	35.8	29.8	11.1
Fertilizers	3.2	4.2	37.0	56.4	77.9	76.7	84.6	88.8	92.4	99.7	140.8	83.8
Metals and minerals	27.2	50.4	29.8	14.4	18.5	12.4	4.6	4.8	5.8	1.4	-4.8	9.7
Domestic inflation based on WPI (in per cent)												
Energy	9.5	5.6	1.1	0.6	-0.8	-1.5	-1.9	-2.5	-1.6	-0.2	2.1	-0.5
Non-energy commodities	3.0	5.4	7.8	6.9	6.1	6.5	5.9	5.3	4.5	4.0	4.0	5.7
Agriculture	2.2	7.1	11.8	10.0	7.4	10.9	9.6	7.0	5.2	4.8	4.7	7.9
Beverages	4.9	7.4	10.0	12.2	12.5	12.6	11.0	9.6	9.8	6.9	7.9	10.3
Food	3.3	5.9	8.2	6.5	4.1	7.2	6.3	4.2	3.2	2.6	3.2	5.1
Fats and oils (India)	-5.7	5.9	14.0	13.1	13.3	14.7	12.1	10.3	10.0	10.5	8.4	11.8
Grains (India)	5.3	10.2	8.5	7.2	6.5	7.7	7.3	4.4	2.7	2.2	1.2	5.3
Other food	4.8	19.0	0.3	-1.6	1.8	2.6	1.7	-0.5	-3.9	-6.1	-5.5	-1.2
Raw materials	-1.5	8.0	16.1	13.2	13.2	13.0	10.7	10.9	9.8	9.0	8.4	11.6
Timber	8.4	6.0	3.8	7.1	7.1	7.1	7.1	7.1	6.0	7.1	1.6	6.0
Other raw materials	8.9	7.8	11.0	9.2	9.0	4.9	3.1	4.5	5.0	5.7	6.1	6.5
Fertilizers	2.5	1.3	2.7	2.1	2.4	1.7	1.8	1.4	1.1	0.8	1.4	1.7
Metals and minerals	8.7	8.5	12.3	10.5	10.0	6.4	4.7	4.9	3.7	3.2	2.7	6.5

Note: Composition of WPI Items/groups as compared to World Price Commodities as used in Table 4.20: Energy (Fuel group); Non Energy Commodities (All commodities excluding energy); Agriculture (Food Articles and Non-Food Articles); Beverages (Beverages Tobacco & Tobacco Products); Food (Food Articles and Food Products); Fats and Oils (Edible Oils, Butter and Ghee); Grains (Cereals and Pulses); Other Food (Other Food Articles); Raw Materials (Non-Food Articles and Minerals); Timber (Wood & Wood Products); Other Raw Materials (Naphtha and Basic Metals Alloys & Metals Products); Fertilizers (Fertilizers); Metals and Minerals (Basic Metals Alloys & Metals Products and Minerals)

Figure 4.20 Annual inflation for Grains (cereals and pulses)**Figure 4.21 Annual inflation for edible oils**

06 to an estimated 1,993 million tonnes in 2006-07. Global stocks as of January 2008 were estimated at 309 million tonnes compared to 389 million tonnes at the end of 2005-06 (U.S. Department of Agriculture estimates). Third, higher cost of cultivation due to an increase in the prices of fertilizers and fuels also raised the price expectations. For the foodgrains importing countries, increase in the shipping costs also raised the landed cost of the imported grains and edible oils. The current increase has both a temporary component, low stock and drought and also a structural component, high energy prices and, therefore, is expected to persist longer. Fourth, the increase in the prices of metals was largely because of an increase in demand from the emerging economies, particularly China. Slower growth of the supplies due in part to lower investment and delays in bringing new capacities contributed to the sustained increase. Overall price increase in December 2007 as compared to the

prices during 2005 (January-December) was relatively higher for lead (165.9 per cent), tin (120.4 per cent), copper (79.1 per cent), zinc (70.4 per cent) and aluminium (25.5 per cent). Prices of steel, except steel rebar were either flat or declined.

Reasons for domestic price increase

4.63 The major reasons for an increase in domestic prices during the year, albeit moderate compared to the previous year, were build-up of inflationary pressure in the preceding months and mismatch in demand and supply conditions.

4.64 On demand side, large capital inflows exerted pressure on liquidity conditions. On supply side, shortfalls in the domestic availability of wheat, pulses and edible oils in 2006-07 aggravated mismatches. The production of wheat averaged 69 million tonnes during 2004-06. Lower production led to lower procurement and decline in the carry-

Box 4.2 Impact of crude oil prices increase on global commodity prices

Crude oil prices affect the prices of other commodities in the following ways:

- Affect the prices of inputs which primary commodities use, such as fertilizers and fuel.
- Affect the transport cost of commodities over long distances.
- Prices of commodities, which have energy-intensive production process, particularly metals, get affected because of an increase in energy prices.
- Affect the prices of the products which could become substitutes for crude or could be used as biofuels (like maize and sugar for ethanol production or rapeseed and other oils for biodiesel production).
- Affect the prices of primary commodities which compete with the synthetic products made from crude (like cotton with man-made fibres, natural rubber with synthetic rubber).
- Affect the prices of commodities which can be substituted for crude as sources of energy (like coal, electricity and gas).

Based on annual data from 1960 to 2005 and a simple econometric model, the Working Paper of the World Bank (Policy Research Working Paper No. 4333 – Oil Spills on Other Commodities by John Baffes – August 2007) estimated the degree of pass through of crude oil price changes to the prices of 35 other internationally-traded primary commodities. The elasticity for the non-energy commodity index was estimated at 0.16 indicating that 1 per cent pass through may impact the commodity prices by 16 basis points. No estimates are available for India.

Source: Working Paper No. 4333, World Bank, August 2007.

over stocks, which together resulted in a build-up of inflationary expectations. This got compounded by a global decline in output and stocks, which was reflected in wheat prices of US SRW wheat averaging US\$ 345 per tonne in December 2007 compared to an average of US\$ 136 per tonne during January-December 2005, US\$ 159 in January-December 2006, and US\$ 239 in January-

December 2007. Similarly, in the case of pulses, production during 2004-06 averaged 13.2 million tonnes relative to a demand estimated at around 15 million tonnes. Production of oilseeds also witnessed a decline of about 3.8 million tonnes in 2006-07. A shortfall in domestic availability increased the vulnerability of the domestic prices to international price shocks.