Box 7.1

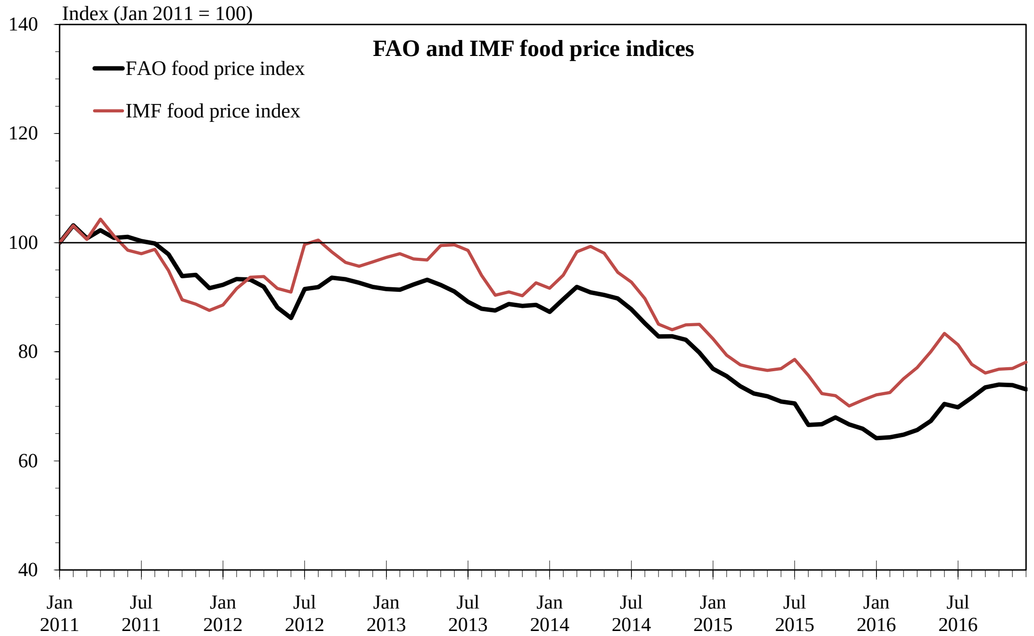
Recent movements of food and commodity prices in the international markets

International commodity prices have experienced visible ups and downs in the past few years. Besides the increasingly complicated global monetary and financial conditions under an uncertain global economic landscape, other supply-side factors, such as the policy changes in the suppliers, weather conditions, and geopolitical tensions, would also be relevant factors behind the wide price fluctuations. Among the various commodities, the prices of foodstuff and, to a lesser extent, fuels, could have a direct bearing on Hong Kong's consumer price inflation. This note describes the recent movements of global food and commodity prices, and discusses their possible implications for our consumer price inflation.

Recent trend of global food prices

According to the Food and Agriculture Organization of the United Nations (FAO) and the International Monetary Fund (IMF), global food prices have been on a general downtrend in 2014 and 2015, but exhibited some signs of stabilisation over the course of 2016 amid a generally tighter demand/supply balance on the back of some improvement in global economic conditions, as well as the unfavourable weather conditions in a number of key producers like Brazil and Malaysia (***Chart 1***). For instance, the FAO Food Price Index has reverted to a year-on-year increase since August 2016, as a result of a broad-based increase in many of the food items against a very low base of comparison in 2015. For 2016 as a whole, the FAO Food Price Index edged down merely by 2%, narrowed visibly from the 19% plunge in 2015.

Chart 1 : Global food prices stabilised somewhat on entering 2016



According to the FAO's latest report on food outlook[(1)], the recent supply/demand conditions in different food markets were mixed. For the cereal market, the upward pressures on prices should remain limited as the supply is at record high level. Specifically, the production of rice, which is the staple food in Hong Kong, should conceivably benefit from the more benign weather conditions after the waning of the El Nino effect in mid-2016. The supply of wheat is also likely to be abundant, thanks to the good yield in major producers. Yet, the situations in non-cereal markets are more diverse. The global supply of meat is relatively tighter, while global consumer demand for fish is poised to remain strong.

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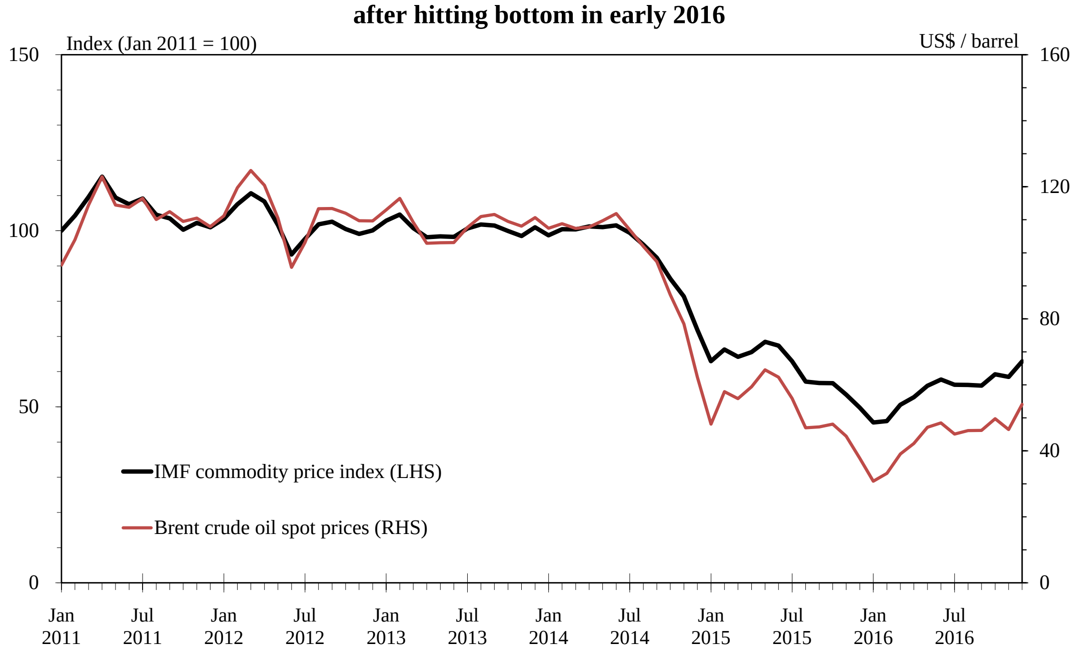
(1) Food Outlook, Biannual Report on Global Food Markets (October 2016 issue), FAO.

Box 7.1 (Cont'd)

Recent trend of international commodity prices

International commodity prices, likewise, underwent huge swings in the past two years. The IMF commodity price index was on a general downtrend since mid-2014. However, as the global economy gradually picked up in 2016, commodity prices also stabilised in the second half. Take the monthly average of North Sea Brent Oil spot price for illustration. After plummeting notably in the second half of 2014 and bouncing back somewhat in early 2015, it went on to another visible downward trend and nosedived to around US$31 per barrel on entering 2016, which was its 12-year low. The oil prices recovered some lost ground afterwards, conceivably due to the lower-than-expected oil inventory and supply tightness in some of the key refineries. The rebound of oil prices turned even more appreciable towards the end of the year, when OPEC formally announced that they had reached an agreement on their daily production targets, while some non-OPEC countries, including Russia, would also follow suit to reduce their oil production (***Chart 2***). In January 2017, the average spot price of Brent oil stood at US$55 per barrel, 78% higher than the year-ago level, but was still 15% lower than the recent monthly peak of US$65 reached in May 2015.

Chart 2 : Global commodity prices also recovered partially after hitting bottom in early 2016



Looking ahead, the outlook for food and commodity prices remains uncertain. The global economy is only expected to grow moderately in the near term, being clouded by such factors as the elevated policy uncertainties in various advanced economies, particularly in the US, and the ongoing Brexit and other political developments across Europe. How the notable monetary policy divergence among major central banks will affect the currency movements, such as the strength of the US dollar, is another factor worth monitoring. Needless to say, any further intensification of geopolitical tensions or sudden changes in weather conditions could disrupt the supply chains of food and commodities, adding further volatility to their prices.

As a small and open economy, most of our demands have to be fulfilled by imports, and hence understandably, the fluctuations in global commodity and oil prices would inevitably impact on our local inflation. While the upside risks from external prices should still be rather safely contained at this juncture under a modest growth scenario, and domestic cost pressures are also expected to stay mild in the coming period, we still need to stay alert to the price fluctuations and their possible ramifications on the livelihood of the lower-income households.