Box 7.1

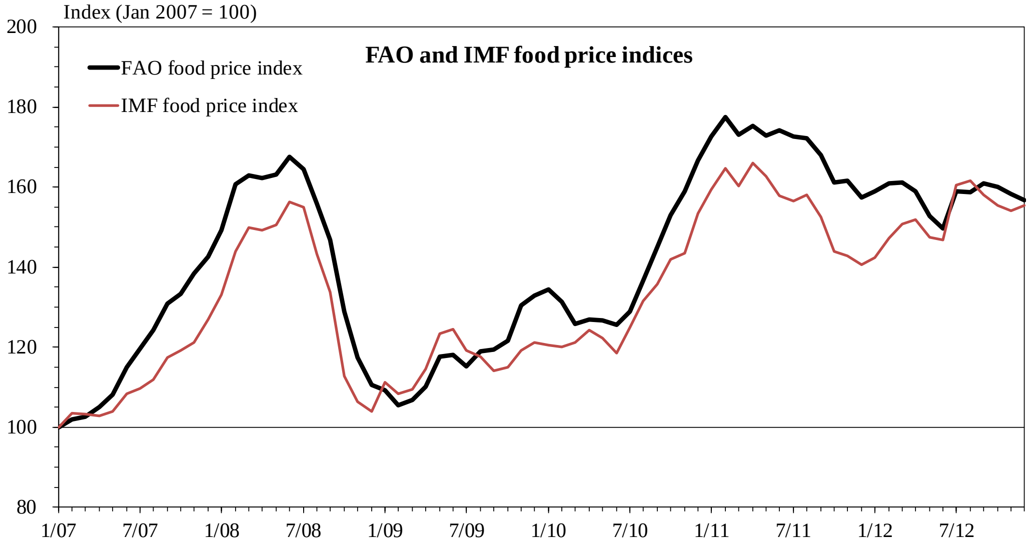
Recent movements of food and commodity prices in the international markets

International commodity prices, particularly those of foodstuffs and fuels, can have a direct bearing on Hong Kong's inflation. They are well-known to be volatile, influenced by a multitude of factors, including economic prospects, global monetary conditions, policy changes in the suppliers, and other specific factors affecting demand and supply conditions. This note reviews the recent trends of global food and commodity prices, and discusses their possible implications for Hong Kong's imported 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 eased in the second half of 2011 and the first half of 2012, due partly to improving demand-supply balance and partly to dimmer global economic prospects amid the re-intensification of the eurozone sovereign debt crisis **(Chart 1)**. Yet, a number of adverse supply shocks, including notably the drought in the US, arrested the downtrend and resulted in a jump in food prices during the summer of 2012. Nevertheless, global food prices tended to soften again towards the end of the year. For 2012 as a whole, the FAO Food Price Index was still 7% lower than in 2011.

Chart 1 : Global food prices followed an easing trend in 2011 and 2012 amid some fluctuations



According to the FAO[(1)], the latest demand/supply conditions in different food markets are diverse. Global cereal supply/demand balance is forecast to tighten considerably in the near term due mainly to declines in wheat and maize production. Nevertheless, for rice, which is the main staple food in Hong Kong, world production is still supported by favourable growing conditions, but its future price movements can be affected by the high price policy implemented by some supplier countries and the conditions in the wheat and maize markets. The global supply of meat has been growing only slowly, being affected by rising feed prices. As to fish and sugar, the global supply conditions are still favourable relative to demand.

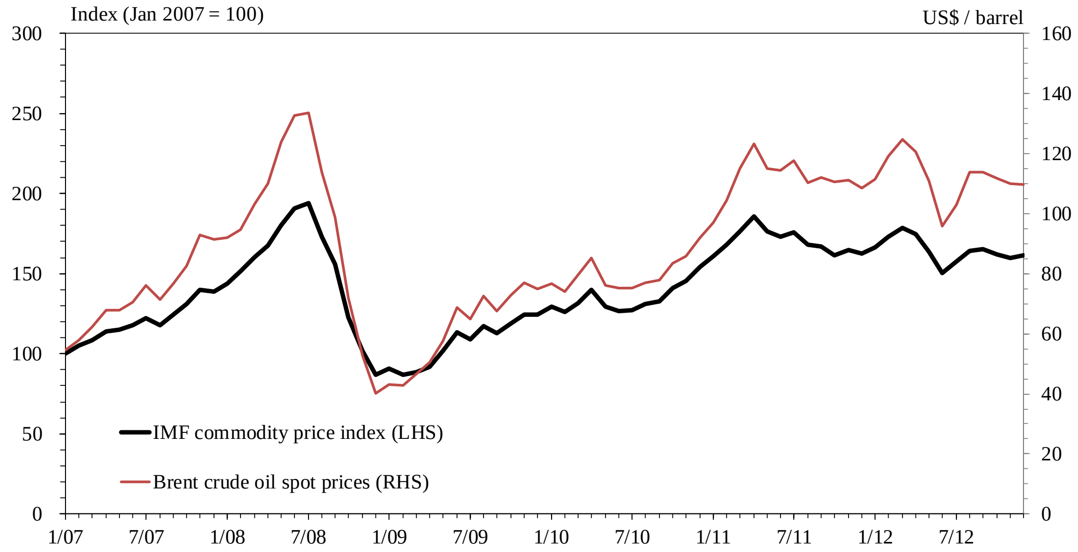
(1) Food Outlook, Global Market Analysis (November 2012 issue), FAO

Box 7.1 (Cont'd)

Recent trend of international commodity prices

Major commodity prices in the international markets exhibited significant gyrations in recent years **(Chart 2)**. According to IMF's Primary Commodity Price Index, global commodity prices embarked on an uptrend in early 2009, peaking out during the second quarter of 2011. Since then, commodity prices displayed a general downtrend, though with significant volatility. Take the monthly average of the spot price of North Sea Brent Oil as an example. It rose steadily from the recent trough at US$40.3 per barrel in December 2008 to a peak of US$123.3 in April 2011, followed by some easing to US$108.3 in December 2011. Oil prices continued to exhibit much gyration in 2012, rising rapidly to US$124.7 per barrel by March but then fell sharply to US$95.9 per barrel in June, before recovering to US$109.6 in December.

Chart 2 : Gloabl commodity prices displayed much volatility in recent years



The evolving eurozone sovereign debt crisis and quantitative easing measures by the major central banks in 2012 have conceivably contributed to the notable gyrations in international commodity prices, in addition to other factors such as demand-supply dynamics. With the US Federal Reserve anticipating the prevailing ultra-low interest rates to be maintained so long as the unemployment rate stays above 6.5% in the context of inflation expectations staying anchored, the exceptionally loose global monetary environment will likely continue for an extended period. The resulting global liquidity glut can be expected to fuel further volatility in international commodity prices.

As a small and open economy, Hong Kong is highly dependent on the imports from overseas, particularly foodstuffs and fuels, and hence Hong Kong's imported inflation is susceptible to the movements of global food and commodity prices. The expected increase in volatility in the global food and commodity markets will pose upside risks to Hong Kong's imported inflation going forward. The Government will continue to closely monitor the developments.