Box 6.1

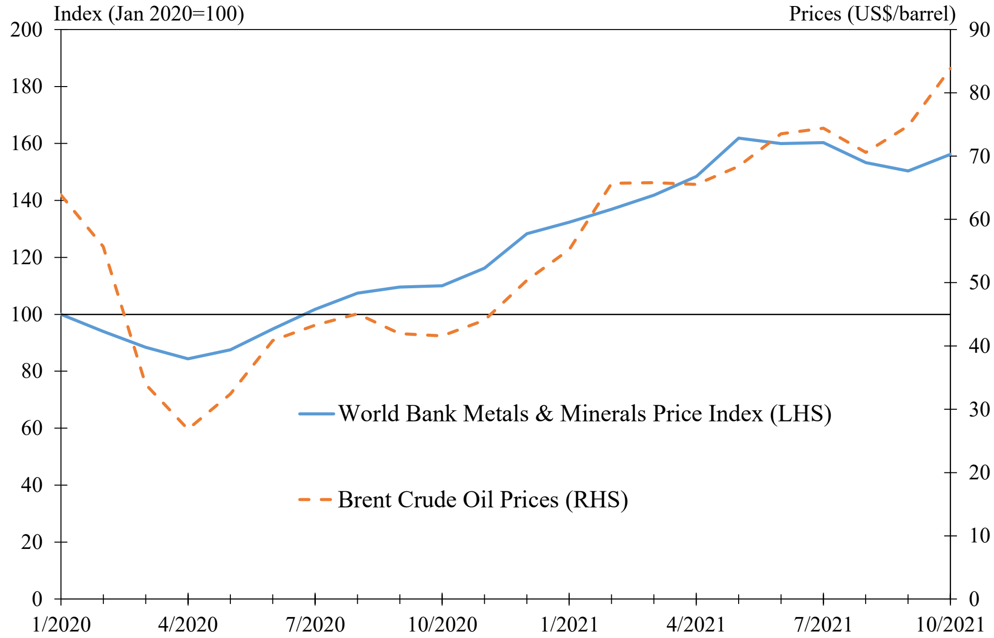
Recent movements of international commodity and food prices

International commodity and food prices, after their significant downward adjustments following the outbreak of the COVID-19 pandemic in early 2020, have rebounded sharply amid some fluctuations over the past one and half years, alongside the global economic recovery. This box article reviews the recent movements of commodity and food prices in the international markets and discusses the possible implications for Hong Kong's consumer price inflation.

Recent trend of international commodity prices

According to the price index compiled by the World Bank, prices of metals and minerals fell to a low in April 2020, a 16% drop from January 2020, reflecting the serious disruptions to economic activities worldwide as the disease evolved into a pandemic. Yet, with the global economy beginning to recover in the second half of the year, prices of metals and minerals firmed up in tandem. Entering 2021, supply disruptions in some key producers[(1)] stemming from transportation interruptions and pandemic-induced labour shortages, together with strengthening global demand, contributed to a further surge in commodity prices. The price index stayed elevated in October 2021 despite some retreat in the preceding months, and was 56% higher than its pre-pandemic level ***(Chart 1)***.

Chart 1: Commodity prices notably surpassed their pre-pandemic levels



International oil prices showed similar movements but even greater volatility, with the monthly average of Brent crude oil prices plummeting in the early stage of the pandemic to a multi-year low of US$27/barrel in April 2020. Besides the shrinkage in manufacturing activities, the plunge in international travel that dampened demand for aircraft fuel, the failure of members of the Organization of the Petroleum Exporting Countries and other oil-producing countries (OPEC+) to reach an agreement on cutting oil supply in March 2020 and the limited availability of unused oil storage space in the US all contributed to the price decline. Oil prices rebounded subsequently thanks to the production cut by the OPEC+ and the improving global economy.

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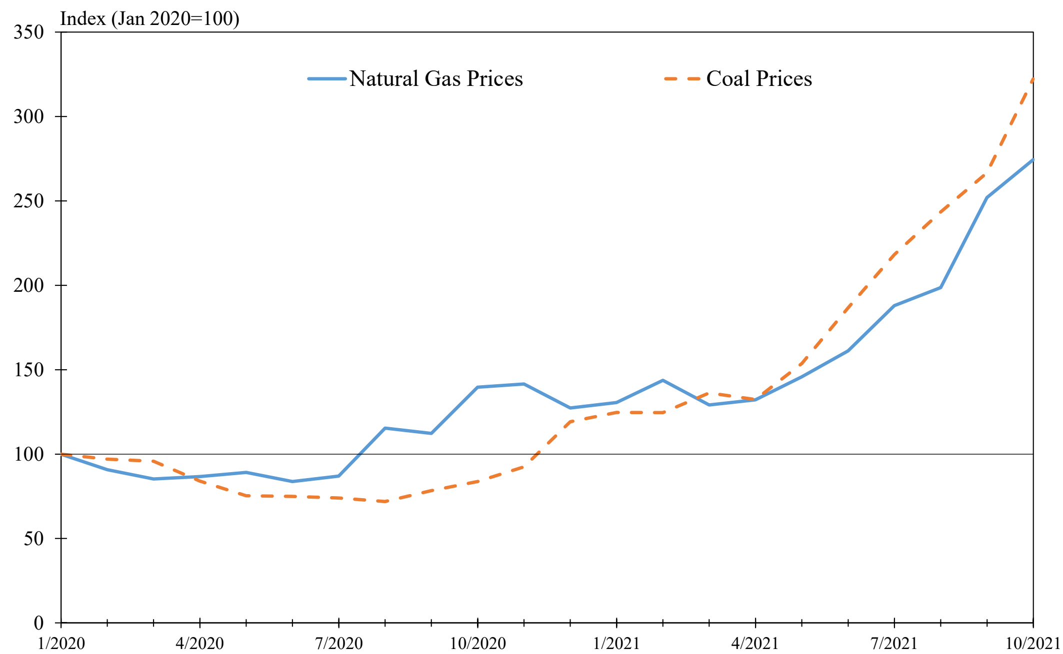
(1) For instance, the World Bank noted in its Commodity Markets Outlook (April 2021) that copper supply in Peru and Chile, and iron ore supply in Australia were disrupted.

Box 6.1 (Cont'd)

While the OPEC+ agreed in July 2021 to phase out the output cut in view of the growing demand, oil supply may still fall short of demand in the near term. Moreover, the relatively low output of alternative energy such as wind energy and the concern of a cold winter in the Northern hemisphere have also reportedly pushed up oil prices. Brent crude oil prices rose to an average of US$84 in October 2021, the highest level since October 2014.

Prices of coal[(2)] and natural gas also rose sharply, having declined in the first half of 2020. In October 2021, they were 222% and 174% respectively higher than their levels at the beginning of 2020 ***(Chart 2)***. The increase in coal prices partly reflected the surging demand for power generation alongside the pick-up in production activities. Meanwhile, the supply of coals has also been constrained by tighter regulations and adverse weather conditions in certain coal producing areas. As for natural gas, in its latest World Economic Outlook, the International Monetary Fund attributed the sharp price increase mainly to depleted natural gas stocks after a harsh winter in 2020, hot summer weather in the Northern Hemisphere, rebounding industrial activity, and idiosyncratic factors such as low hydropower output in Brazil.

Chart 2: Coal and natural gas prices surged in the past year or so



Recent trend of global food prices

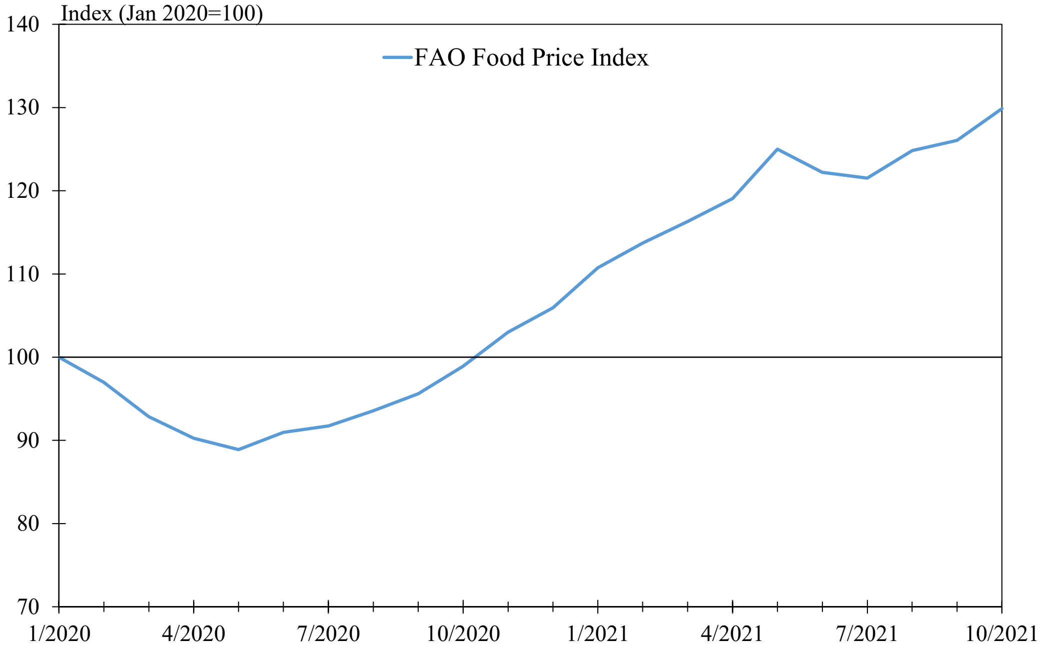
According to the price index compiled by the Food and Agriculture Organization of the United Nations (FAO), global food prices fell by over 10% from January 2020 to May 2020 ***(Chart 3)***. According to the FAO, this could reflect lower food consumption amid anti-epidemic measures such as closure of restaurants and reduced household incomes. Subsequently, the FAO food price index more than recouped the earlier loss alongside the global economic recovery. In October 2021, the index rose visibly by 31% over a year

(2) Refer to prices of thermal coal at Newcastle port in Australia, which is the world's largest market for the fuel and is the benchmark in Asian market.

Box 6.1 (Cont'd)

earlier and was 30% higher than its pre-pandemic level. The supply-side issues such as insufficient labour, bad weather conditions[(3)], soaring shipping and transport costs[(4)], as well as higher prices of inputs (e.g. fertilizer) also contributed to the surge in global food prices.

Chart 3: Global food prices rebounded markedly



Conclusion

The outlook for international commodity and food prices remains highly uncertain. The spread of more contagious COVID-19 variants around the world continues to cloud the global economic recovery. At the same time, the pandemic-related restrictions imposed by many governments also posed strain on the global supply chains. Any unpredictable supply shocks, such as adverse weather conditions and geopolitical tensions, can also entail considerable price fluctuations in the international markets.

As a small and open economy, Hong Kong is highly dependent on imports for essential goods. Yet, consumer price inflation remained contained as the local economy was still running below capacity. In particular, the basic food inflation stayed modest at 1.0% in the third quarter, reflecting the wider coverage of the local CPI food basket than the FAO food price index[(5)] and the modest food inflation in the Mainland[(6)]. Also, as a highly service-oriented economy, fuel costs on average only account for a small proportion of business costs in Hong Kong. Nevertheless, the external price developments over the past year, if persist, will increase the upside risks to Hong Kong's inflation. The Government will continue to closely monitor the inflation situation in our major import sources, the supply conditions of essential food and fuels, as well as their possible impacts on Hong Kong's consumer price inflation.

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(3) In its blog about soaring consumer food prices published in June 2021, the International Monetary Fund noted that the 2020-2021 La Niña episode, a global weather event occurring every few years, has led to dry weather in key food exporting countries, including Argentina, Brazil, Russia, Ukraine, and the United States. This has caused, in some cases, harvests and harvest outlooks to fall short of expectations.

(4) Ocean freight rates as measured by the Baltic Dry Index (a measure of shipping costs) surged by 196% in October 2021 over a year earlier.

(5) The FAO food price index covers meat, cereals, oils, dairy products and sugar only. Their respective weights are 33%, 29%, 17%, 14% and 7%.

(6) The Mainland was the largest source of Hong Kong's retained imports of foodstuffs, contributing around 30% of the total in 2020.