

## World Bank: Commodity Price Prospects

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The World Bank has provided its take on commodity prices for the rest of the year and more importantly for 2022. 2021 has been typified by a commodity boom which has led to high inflation in almost all countries which in turn has been a consideration for most central banks. Interestingly they have considered this commodity led inflation to be transient. The World Bank does expect prices to stabilize in general in 2022 and hence except for certain pockets there should be less concern. The boom in 2021 can be attributed to the sharp recovery in most countries leading to an increase in demand which in turn has spooked prices as supply responses has been erratic. The cooling of prices also means that on an incremental basis the benefits that companies in the commodity business witnessed in 2021 will not be replicated for sure in 2022. However, some of the projections on oil are quite bold as the present scene of price being in the \$ 80-85 band looks hard to reverse. But the World Bank is holding hopes of the price averaging \$ 74/bbl.

### Price movements in 2021

Energy prices rose sharply in Q3- 2021 while non-energy prices plateaued. Among the four major non-energy indices, agriculture, fertilizers, and precious metals are about one-third above their pre-pandemic levels, while metals and minerals are around one-half higher. Adverse weather has buffeted most commodity markets. For instance, unusually high summer temperatures increased demand for electricity. Droughts reduced hydroelectricity supply and affected some agricultural commodities, while floods impacted the supply of some metals and coal.

- Commodity markets have also been affected by the uneven recovery from the COVID-19 pandemic and supply chain disruptions. Energy prices rose by 16% in Q3-2021 (q/q), continuing their upward trajectory since the start of the year, with natural gas and coal prices rising much faster than crude oil prices.
- Crude oil prices averaged \$72/bbl in Q3-2021, an increase of 7% on the previous quarter, but with prices fluctuating significantly during the period. Prices initially softened in August amid worries about renewed outbreaks of the pandemic, but these were offset later in the quarter by supply disruptions in the U.S. arising from Hurricane Ida, as well as the broader rally in energy prices. Crude oil prices have risen rapidly over the past few months, with the price of Brent reaching a seven-year high of almost \$85/bbl by mid-October. Prices have been lifted by production disruptions as well as an announcement by OPEC+ at its meeting in October that the group intends to maintain its previously announced production increases. Among OPEC countries, the shortfall was mainly due to Nigeria and Angola.
- Natural gas prices rose by 69% in Q3-2021, and coal prices by 44%. The economic recovery particularly in China is largely behind the surge as it has boosted demand for fossil fuels for electricity generation. Unusually hot weather in some countries also boosted electricity demand for cooling. Furthermore, electricity production from renewable sources declined in several countries due to drought and low wind speeds.
- Production of coal fell 5% in 2020 and has been slower to pick up than consumption. In China, the world's largest coal producer as well as consumer, safety regulations introduced earlier this year have limited the ability of coal mines to raise production. Coal production in China—up 4% between January to August 2021 compared to the previous year—has been broadly flat since the first quarter, while electricity demand soared. China's import ban on Australian coal in late 2020 has also disrupted the international trade of coal. Australia is the world's largest exporter of coking coal (typically used in steel manufacturing) and second-largest exporter of thermal coal (used in electricity generation), accounting for 46% and 27% of total coking and thermal coal exports, respectively, in 2019.

Although non-energy prices were unchanged in Q3-2021 (q/q) as a group, there has been significant variation among commodities.

- The Metals and Minerals Price Index declined 1% in the quarter, with drops in iron ore (-17%) and copper (-3%) and gains in other base metals (9%) on average. The sharp fall in iron ore prices was largely due to China's reduction in steel production to meet zero-growth targets for the year. Demand for base metals has continued to increase, driven by the global economic recovery, while production has been disrupted by energy shortages and lockdowns.

- Precious metal prices fell 3% in Q3-2021 (q/q) amid a rise in U.S. 10-year Treasury yields, with larger falls for platinum (-13%) and silver (-9%) compared to gold (-1%). Platinum prices have been depressed by disruptions to car production globally, which have reduced demand for catalytic converters.

Agricultural commodity prices stabilized during Q3-2021, with declines in some food prices (e.g., rice) being offset by higher beverage prices (especially coffee).

- Despite tight supply conditions for some food commodities due to unfavourable weather (e.g., maize and soybeans), most food commodity markets remain adequately supplied by historical norms.
- However, the rally in energy prices, especially coal and natural gas, have sharply increased agricultural input costs. This includes fertilizers, which have risen more than 55% since January, with several fertilizer manufacturers halting or reducing production capacity.
- Elevated food prices combined with the recent spike in energy costs is pushing food price inflation up in several low-income countries (such as Ethiopia, Zambia, and Zimbabwe) as well as higher-income EMDEs, including Argentina and Turkey.

### How have Indian prices being affected based on our inflation indices?

The table below gives the price inflation that has been witnessed in India so far where it is reckoned on a year-on-year basis. For some products the CPI does not exist as they are not in the consumer basket. In some other cases the close equivalent has been put in. Clearly where India is a price taker, inflation indices have followed the global path.

#### Inflation in India: September 2021 over September 2020 (%)

	WPI	CPI
Crude oil	71.9	-
Petrol	54.9	22.3
Diesel	51.8	22.4
Coal	1.0	0.53
Natural Gas	-14.4	41.4 (LPG)
Urea	0.6	-
Phosphatic fertilizers	5.3 to 9.3	-
Edible oils	36.9	34.2
Steel	20.0 to 47.7	-
Iron ore	94.3	-
Aluminium	20.9	-
Copper	17.9	-
Coffee	14.4	1.30
Tea	-41.1	16.0
Cotton	39.9	-
Rubber	31.9	-
Sugar	6.2	3.6

Source: MOSPI and Office of Economic Advisor

### World Bank Price Outlook for 2022

Oil prices are forecast to average \$74/bbl in 2022, up from a projected \$70/bbl in 2021, before dropping to \$65/bbl in 2023. Oil demand is expected to continue its recovery and reach its pre-pandemic level by the second half of 2022. Oil production is expected to increase as supply outages are resolved.

Oil demand is expected to reach its pre-pandemic level in 2022, although estimates for the speed of recovery vary among forecasters. Large EMDEs, notably China, India, and Russia, account for most of the rise in demand, while demand in several advanced economies remains subdued and may not recover to pre-pandemic levels. Oil production is forecast to see a robust recovery of around 6mb/d in 2022.

Investment shortfalls in new production, including U.S. shale, pose an upside risk. Investment in new oil production fell sharply in 2020 and has been slower to pick up than after previous price collapses. Furthermore, the substitution of crude oil for coal and natural gas in heating and electricity production poses another upside risk. Additional outbreaks of COVID-19 remain a downside risk to oil demand.

Continued use of crude oil as a substitute for natural gas presents an upside risk to the demand outlook, while downside risks include the potential for higher energy prices to weigh on growth, as well as renewed outbreaks of COVID19. For supply, the impact of persistently weak investment on new crude oil production presents the biggest upside risk, while a new nuclear deal for Islamic Republic of Iran, which would lift the country's exports, offers a downside risk.

Natural gas and coal prices are expected to decline in 2022 and fall further in 2023, as demand growth eases (especially outside of Asia) and production and exports increase, driven by the United States. Further price spikes are likely, however, as inventories remain very low, and production is not expected to materially increase until 2022.

Natural gas and coal prices are expected to remain at high levels through the start of 2022 but then decline as supply constraints ease and production increases. However, additional bouts of price volatility remain a distinct possibility. European natural gas prices and Australian coal prices are forecast to each decline 14% in 2022 and then fall a further 27% and 25%, respectively, in 2023.

Coal production is also expected to increase as some of the supply disruptions seen this year ease. China's coal production is expected to rise in response to government efforts to raise output. Natural gas production is expected to rise in the United States, alongside the recovery in shale oil production. EIA forecast a 6% increase in U.S. LNG exports. Exports from Russia and Azerbaijan are also expected to rise, facilitated by new pipelines in the region.

#### Energy price movements with forecasts for 2022

	Unit	2019	2020	2021	2022
Coal, Australia	\$/mt	77.9	60.8	140.0	120.0
Crude oil, avg	\$/bbl	61.4	41.3	70.0	74.0
Natural gas, Europe	\$/mmbtu	4.8	3.2	14.6	12.6
Natural gas, US	\$/mmbtu	2.5	2.0	4.1	4.0
LNG Japan	\$/mmbtu	10.6	8.3	11.9	11.4

Metal prices are forecast to fall 5% in 2022 following a projected increase of 48% in 2021 as the global recovery eases and supply disruptions are addressed. Bottlenecks in the supply chain are not expected to be fully resolved until the end of 2022, as energy and shipping shortages take time to normalize. Key risks to the metal price forecast are the outlook for China's property sector and energy-related supply disruptions.

#### Metal price movements with forecasts for 2022

	Unit	2019	2020	2021	2022
Aluminium	\$/mt	1,794	1,704	2,550	2,700
Copper	\$/mt	6,010	6,174	9,300	8,800
Iron ore	\$/dmt	93.8	108.9	165.0	130.0
Lead	\$/mt	1,997	1,825	2,200	2,100
Nickel	\$/mt	13,914	13,787	18,500	17,750
Tin	\$/mt	18,661	17,125	31,250	31,000
Zinc	\$/mt	2,550	2,266	2,950	2,822
Gold	\$/toz	1,392	1,770	1,795	1,750
Silver	\$/toz	16.2	20.5	25.5	24.8
Platinum	\$/toz	864	883	1,100	1,000

Aluminium prices are forecast to increase 6% in 2022 after a projected jump of 50% in 2021, but ease going forward as energy constraints dissipate. Copper prices are forecast to fall 5% in 2022, after an estimated increase of 51% in 2021 as supply increases. Mine supplies are expected to increase strongly over the next two years, notably from the new Kamoakakula mine in the Democratic Republic of Congo, as well as in Chile, Indonesia, Peru, Russia and Serbia. Copper is set to be a main beneficiary of the energy transition, with usage expected to increase for electric vehicles, charging, renewables generation, and grid storage.

Iron ore prices are forecast to fall 21% in 2022 after a projected surge of 51% in 2021. Lead will be negatively impacted by the energy transition as demand for electric vehicles (which use nickel/lithium batteries) expands and gas-powered cars (which use lead-acid batteries) recedes. Meanwhile, lead supply is expected to increase given its by-product output from zinc mines, further weighing on prices. Lead prices are forecast to fall by 5% in 2022 after a projected increase of 21% in 2021.

Despite strong growth prospects for both batteries and stainless steel, nickel supply growth is expected to be adequate. Nickel prices are forecast to decline 4% in 2022 after a projected gain of 34% in 2021. In the near term, pandemic-related issues may further disrupt mining, but in the longer term several new tin mining projects are underway, although environmental policies could limit their scope. Demand continues to grow rapidly, and global supply may struggle to keep pace.

Tin prices are expected to record an 82% jump in 2021 and decline only slightly in 2022. The slowdown in the property sector in China and a government cap on steel production could curtail demand for zinc—a key input for galvanizing steel.

Zinc prices are expected to decline by 4% in 2022 after increasing an estimated 30% in 2021.

**Precious metals:** Central banks have also reduced gold purchases in recent months. On the other hand, firm jewellery demand in China and India provided some reprieve to gold prices. Gold prices are anticipated to average nearly 1.5% higher in 2021, before falling by 2.5% in 2022, weighed down by higher yields on bonds. China and Japan are major producers of products containing silver, such as electronics, solar panels, and photographic equipment. Silver prices are projected to decline nearly 3% in 2022, following an expected increase of 24% in 2021.

**Agricultural prices** are expected to decline modestly in 2022 and 2023, following a projected 22% increase in 2021, as supply conditions improve. Upside risks to agricultural prices include high input prices, especially fertilizers, and more diversion of food commodities to the production of biofuels linked to efforts to decarbonize the global economy.

The Grain Price Index is expected to stabilize in 2022, following a projected increase of 22% in 2021. However, considerable heterogeneity in price paths is expected among its key commodities. Maize is expected to average more than 50% higher this year and decline 10% in 2022. Wheat is expected to be broadly stable in 2022, following a 21% increase this year, while rice is projected to decline both this year and next. The Oils and Meals Index is projected to average 40% higher in 2021 and remain flat in 2022.

High food prices have raised concerns about food insecurity in several EMDEs. In addition to lower incomes due to pandemic-driven production disruptions, several food-importing EMDEs are facing high international food prices and energy costs.

#### Agri products price movements with forecast for 2022

	Unit	2019	2020	2021	2022
Coffee, Arabica	\$/kg	2.88	3.32	4.30	4.20
Coffee, Robusta	\$/kg	1.62	1.52	1.95	2.00
Tea, average	\$/kg	2.56	2.70	2.65	2.60
Coconut oil	\$/mt	736	1,010	1,525	1,560
Groundnut oil	\$/mt	1,407	1,698	2,050	1,950
Palm oil	\$/mt	601	752	1,100	1,075
Soybean meal	\$/mt	347	394	485	490
Soybean oil	\$/mt	765	838	1,375	1,425
Soybeans	\$/mt	369	407	580	585
Maize	\$/mt	170	165	250	225
Rice, Thailand, 5%	\$/mt	418	497	455	400
Wheat, US, HRW	\$/mt	202	211	255	250
Sugar, World	\$/kg	0.28	0.28	0.39	0.37

Global production of coffee is expected to drop to 161 million bags during the 2021-22 season, almost 10% lower than last season's record crop of 178 million bags. With consumption projected to exceed 172 million bags, a sharp drawdown of inventories is expected in 2021-22. Thus, Arabica and Robusta prices are expected to average about 30% higher in 2021 compared to 2020 before stabilizing in 2022 as production in Brazil recovers and mobility restrictions in Vietnam ease. In view of the generally adequate supplies of tea, prices (three-auction average) are expected to decline by 2% in 2021 and 2022.

Cotton prices are expected to gain 5% in 2022, following a projected increase of 32% in 2021. Natural rubber prices are expected to decline 10% in 2022, following a projected gain of 19% in 2021. This forecast, however, is subject to upside and downside risks. On the demand side are risks related to how quickly the semiconductor sector for automobiles returns to pre-COVID levels, while on the supply side, risks relate to how long the mobility restrictions recently introduced in key Southeast Asia countries persist.

#### Prices of fertilizers with forecasts for 2022

	Unit	2019	2020	2021	2022
DAP	\$/mt	306	312	590	600
Phosphate rock	\$/mt	88	76	120	130
Potassium chloride	\$/mt	256	218	210	325
TSP	\$/mt	295	265	525	520
Urea, E. Europe	\$/mt	245	229	380	375

Urea prices are expected to stabilize in 2022 as feedstock prices moderate, following a projected 66% increase in 2021. China's recent suspension of phosphate exports until at least June 2022 put even more pressure on DAP prices; the country accounts for 30% of global trade in DAP. Following a nearly doubling in 2021, DAP prices are expected to experience a modest increase in 2022 on expectations of continued tight supply. Potash prices (based on Vancouver f.o.b. contract) are expected to increase by more than 50% in 2022 as the historically large divergence across markets subsides.

*(All data quoted here are from the World Bank Report except where it has been specified to be otherwise)*

### What does this imply for India?

1. On the fuel side we can expect prices to ease on the refining side. It will then be interesting to see how the government reacts as there will be the case of VAT collections being affected as the taxable base comes down. The centre may continue to hold on to the excise duty and it does look unlikely that the prices of petrol and diesel will come down below the Rs 100 level as the excess revenue will be used as a part of the tax revenues to support the Budget.
2. Metal prices coming down would be a signal to the manufacturing sector as both producers and users. A decline in prices of most metals augurs well for core inflation on both the CPI and WPI as a high base and decline in prices will lower inflation of manufactured goods.
3. Agricultural prices would still be driven mainly by the domestic factors and the kharif and rabi prospects and the MSPs will hold the key. India's food inflation will continue to be vulnerable to the prospects of the onion and tomato crop and hence the monsoon course will be important. In fact, of late more than the quantum of rainfall the withdrawal has been more crucial for the crop prospects as delays have tended to damage crops which in turn has affected prices.
4. Lower coal prices are a good sign for the power sector though it is expected that the present shortage witnessed will be sorted out before end of calendar 2021. But if we are to import more coal, then definitely lower prices are a good sign.

#### Contact:

Economics Department  
Mradul Mishra

-  
Media Relations

-  
mradul.mishra@careratings.com

-  
+91-22-6837 4424

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Corporate Office: 4th Floor, Godrej Coliseum, Somaiya Hospital Road, Off Eastern Express Highway, Sion (East), Mumbai - 400 022  
Tel. : +91-22-6754 3456 | CIN: L67190MH1993PLC071691

Connect :

