Article: Why have commodity prices fallen and what will the consequences be?

Prices of crude oil and base metals have fallen over a long time. The Riksbank assesses that the price fall is partly the result of an increase in supply, due in part to earlier investments in increased production capacity, and in part to demand for commodities having declined, where the ongoing rebalancing of the Chinese economy plays an important role. The price fall is judged to be largely the effect of an increase in supply, which is positive for GDP growth in Sweden and globally. However, growth will be lower in countries that are net exporters of commodities. Inflation will be lower in most countries, as lower commodity prices entail lower fuel prices and input costs for companies.

Both supply and demand effects behind the price fall

Prices of crude oil and base metals – which include iron ore, copper, aluminium and nickel – have followed one another fairly closely since the early 2000s. Rising demand pushed up prices at that time, which stimulated investment in order to increase production capacity. However, the picture changed in 2011. Base metal prices, with a few exceptions, have followed a steady downward trend. China consumes around half of the global production of base metals and the ongoing rebalancing away from commodity-heavy sectors has contributed to the lower prices. Extraction costs have also fallen thanks to low energy prices and this, together with lower demand from China, contributes to the expectation that metal prices will remain low for some time to come. This is reflected in the forward pricing of these metals (see Figure 4:19).

The oil price was relatively stable at around USD 110 per barrel until summer 2014, as the price was being held up supply shocks, caused by, among other things, geopolitical unease, and production quotas for the OPEC countries, which were intended to maintain the price level. Since then the oil price has fallen by 75 per cent and the spot price is now around USD 30 per barrel, the lowest listed price in more than ten years. The heavy price fall is partly due to weaker demand from China, and partly to supply-related factors, including a large increase in production of shale oil in the United States, which reduced the country's need to import. A new strategy from the OPEC countries, defending market shares and pushing out producers with higher production costs rather than maintaining prices, has also contributed to the decline. In addition, the recent lifting of sanctions against Iran opens the door to increased production which contributes further to supply. Russia, too, has increased its production to slow down the decline in income (see Figure 4:20). The low oil price and expectations of an increase in supply also mean that expectations of future oil prices have fallen gradually (see Figure 4.1).

Effects on GDP growth and inflation

The effects on GDP growth are due to a number of different factors, for instance, whether a country is a net exporter or net importer of commodities, whether the price fall is supply-driven or demand-driven and how economic policy reacts. For a commodity-exporting country, lower commodity prices mean lower growth as export income declines. Growth can also be held back by the country feeling obliged to either cut public expenditure or raise taxes to compensate for the lower export income. For a commodity-importing country, lower commodity prices are positive for growth if the price fall is largely supply-driven and if economic policy reacts in a normal way.

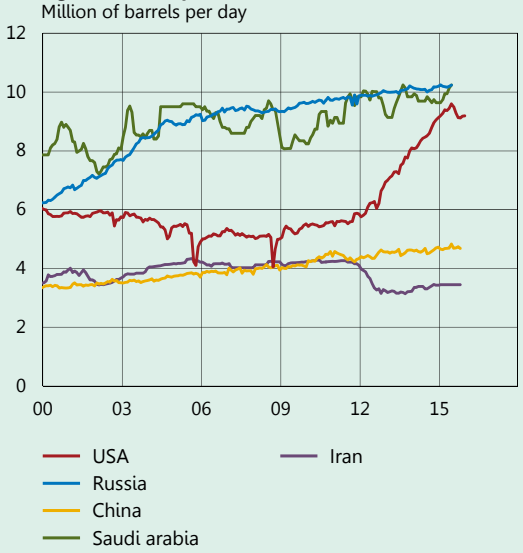
Crude oil is an important input product in several industries, such as petrochemicals, paper production and the manufacturing industry. The transport sector is also a large oil consumer. A lower oil price thus entails lower input costs for companies. This is positive for corporate profits and ultimately for corporate investment. Households also benefit through lower petrol prices and heating costs, which give greater scope for other consumption. A lower oil price also ultimately affects the price of other, competing types of energy, which puts pressure on energy prices in general. Base metals, like oil, are important input goods in various sections of industry, and changes in prices thus affect companies' costs.

Inventories of oil-related products have risen sharply in the past twelve months (see Figure 4:21). The Riksbank assumes, in line with the IMF, OECD and World Bank, that the lower oil price and rising inventories are largely an effect of an increased supply. KIX-weighted GDP is thereby affected positively since most of Sweden's most important trading partners are commodity importers. Overall, GDP growth in these countries is deemed to be somewhat weaker compared with the Monetary Policy Report in December. This is due to weaker growth prospects otherwise; the recovery in investment in the euro area is, for example, deemed to be weaker than in the previous forecast.

The decline in the oil price in recent months is also deemed to be positive for growth in Sweden. The GDP level has therefore been revised up a couple of tenths of a per cent, compared with the assessment in December, because of the oil price fall. It is mainly the current year in which growth is expected to be somewhat higher. This is counteracted by other factors, however, including unease on the financial markets and weaker international demand, which mean that GDP growth overall remains in principal unchanged.

The low oil price has an immediate impact on the consumer price index in Sweden and also in most other countries. For some commodity-exporting countries, however, a weaker exchange rate means that inflation will instead be higher or that the decline will at least be significantly subdued. Of the downward revision in this year´s forecast for CPIF inflation in Sweden, 0.2 percentage points is due to lower energy prices. The low energy prices are also assumed to dampen prices of other goods and services with some time lag. These indirect effects of the fall in the oil price have meant that the CPIF inflation has been revised down by another 0.1 percentage points or so per year for 2017–2018.

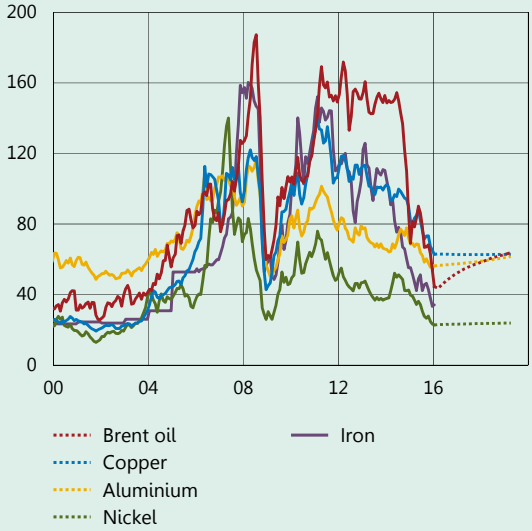
Figure 4:20. Oil production
Million of barrels per day



Note. Refers to crude oil production in Russia, Saudi Arabia and USA and total oil production in China and Iran.

Source: Energy Information Agency (EIA)

Figure 4:19. Commodity prices, outcomes and futures
Index, 2007 = 100



Note. Futures are calculated as a 15-day average. Outcomes represent monthly averages of spot prices.

Sources: London Metal Exchange, Macrobond, The World Bank and the Riksbank

Figure 4:21. Global stocks of oil products
Billion of barrels

Note. Refers to Crude oil, condensate and products obtained from the processing of crude oil and natural gas.

Source: Energy information Agency (EIA)