Why Are Commodity Prices Important?

Commodities traded on the world market ranges from raw materials to intermediate or semi-processed goods; or simply goods that are used to manufacture other goods. The prices of these commodities are set in the world market by market forces; buyers and sellers or demand and supply. The most commonly traded commodities include crude oil, gold, copper, wheat, cotton, silver, natural gas, sugar, coffee, and corn.

In the case of Fiji, prices of commodities such as crude oil, sugar, gold, wheat and aluminium are very important, as these have a direct and significant impact on our exports and imports which then influence Fiji's overall external position with the rest of the world.

For instance, higher world market prices for export commodities sugar and gold (two traditional Fijian exports) are favourable as they raise the value of our exports thus boosting foreign exchange earnings and improving Fiji's external position. On a micro level, this means more income for local farmers, mine workers and relevant businesses, more employment opportunities for people and an overall improvement in the welfare of all Fijians.

On the same note, higher prices of crude oil that we import, would push up the prices of petroleum products such as diesel, kerosene and petrol used by our local industries, businesses and individuals for machines, cars and homes. This in turn would raise our import bill, lower Fiji's foreign exchange reserves level and worsen Fiji's external balance. Moreover, higher prices of other imported commodities or tradeable goods especially raw materials used to manufacture other goods and services in Fiji would lead to an increase in the local prices of finished goods and services. This would have implications for the prices of other products and non-tradeable goods and services in Fiji and impact movements in the general price level, more commonly known as the **inflation rate**.

Given the important role commodities play in our daily activities, analysts, policy makers and businesses keep a close watch on their price movements which can be very volatile, moving up or down, often quite sharply, over short periods. Often the sharp changes in commodity prices are due to two major factors: (i) changes in the supply and demand and (ii) expectations of future supply and demand. Expectations are especially important in the short term as on some days the prices of commodities like gold and oil can vary sharply even though the underlying supply and demand for the commodity has not really changed. The price change is because people expect some price changes to occur in the future, so they are buying or selling today in anticipation of making a profit or limiting losses when the expected change occurs. Over longer periods, more fundamental demand and supply effects tend to dominate. In addition, other factors such as changes in interest rates, exchange rates and the return on various types of bonds, equities and other financial assets also influence commodity prices as these represent alternative investment options.

Volatility in commodity prices also has implications for monetary and fiscal policy. Commodity price shocks pose challenges to the maintenance of price stability (low inflation) and external stability (adequate foreign reserves) by the Reserve Bank. In an environment of volatile commodity prices, sudden and temporary changes or shifts in prices which are mostly beyond the control of the local authorities have to be absorbed by the economy and ultimately consumers, at the end of the economic chain. Moreover, such ad-hoc movements in commodity prices can cause sharp upswings or downturns in the overall inflation rate. This could influence prices of other goods and services and in turn push up wage demand. Normally, such temporary and supply side price shocks do not necessarily warrant policy responses from authorities. However, if volatilities appear to be of a longer time horizon then the respective authorities may intervene with appropriate policies to manage the impact of changes in prices and provide relief to consumers.

In conclusion, given the large share of commodities in Fiji's total trade with the rest of the world, the importance of commodity price movements to our economy cannot be understated. Commodity price changes are one of the key considerations in businesses' and consumers' decision making - as they imply gains or losses depending on whether they are consumers or producers of these commodities. More broadly, commodity price movements also impact the livelihoods of people, business profitability, and influence macroeconomic policies. An ensuing article will cover recent movements in selected international commodity prices and their implications for Fiji's major commodities.