

Rising commodity prices and their effect on Latin America and Caribbean economies

The Americas

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Introduction

In recent months commodity prices have risen drastically across the globe. This is a major development for South America and Caribbean countries, as the commodity sector plays a crucial role in their economic development. Because the Latin American economy is heavily reliant on commodity exports, the global prices of commodities have a substantial impact on the region's economic growth. The main exports from Latin America are agricultural products and natural resources such as copper, iron, and petroleum (figure 1).



Figure 1: Exports South America

Global demand for agricultural commodities is rising driven primarily by the growing global population and rising real incomes. According to research conducted by Padilla (2015), the global population is projected to reach 9 billion people by 2050, and demand for food is projected to be 60% higher than it is today. Moreover, unusually high, and dry summer and spring temperatures combined with one of the wettest winters created the ideal conditions to hinder crop output

Oil prices reached a seven-year peak in January 2022 and recorded their sixth straight weekly gain as geopolitical turmoil exacerbated concerns over tight energy supply (figure 2). Some analysts predict, that in conjunction with the geopolitical crisis, the lack of production capacity and limited investment in the fuel sector could cause oil prices to rise to \$90 or even above \$100 a barrel (Sharafedin, 2022)..



Figure 2: OIL (WTI) Commodity prices in US \$

In the first two quarters of 2021, Bloomberg’s commodity index rose more than 20%. This rally was primarily driven by the increase in energy prices, the increase in agricultural goods and industrial metal prices (Figure 3).

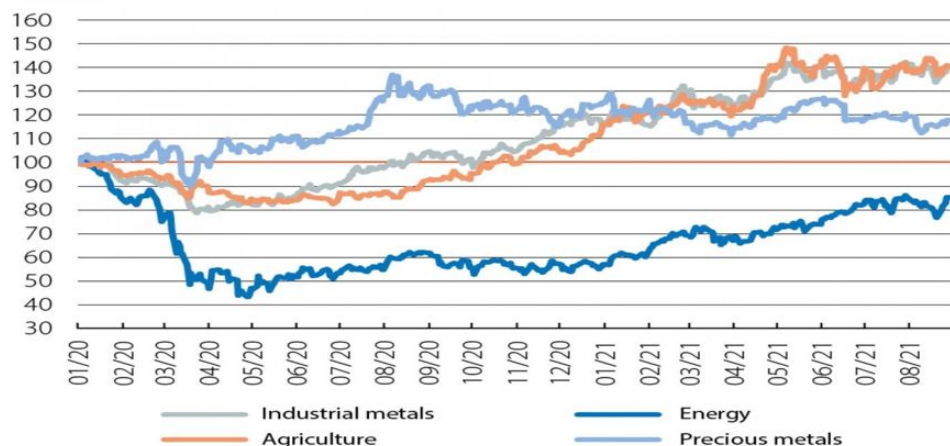


Figure 3. Bloomberg Commodity Index

Impact on exporting economies

According to the United Nations Conference on Trade and Development (UNCTAD), 14 out of the 33 countries in the Latin America and the Caribbean region are commodity-dependent. UNCTAD classifies a country as commodity-dependent when 60% of its total merchandise exports are composed out of commodities (UNCTAD, 2021). The recent rise in commodity prices positively benefited large commodity-exporting countries in Latin America and the Caribbean. The price increase has led to rising commodity export revenues despite stagnating or falling export volumes (UNCTAD, 2021). For example, Brazil's export revenue from oilseeds in the first six months of 2021 was 24.3% higher than in the same period of 2020 although exported volumes were lower (UNCTAD, 2021). For instance, Brazil's agricultural production and export has grown rapidly in recent years. Increasing productivity and expansion in area harvested have enabled Brazil to maintain a leading position as an exporter of soybeans, crude oil, and iron ore. In 2019, Brazil had a total export value of \$225 Billion, however, by 2020 its total export had fallen to \$210 Billion. However, despite the falling volume of export, Brazil's export revenue from oilseeds in the first six months of 2021 was 24.3% higher than in the same period of 2020 (UNCTAD, 2021). Brazil is to utilize anticipated to continue boosting its soybean output in the future. Improved transport infrastructure, together with increased planted area and improvements in yields are believed to allow Brazil to obtain one of the lowest soybean production costs in the world (Padilla, 2015). Second, to Brazil, Argentina is the biggest agricultural producer and exporter in Latin America. In 2020, international trade accounted for 30.5% of its GDP. The country's main exports were oil-cake and other solid residues (13.7%), maize (11%), soy-bean oil and soya beans (10.8%) Argentina has greatly benefited from high international prices, and both exports and production have grown appropriately in the past decade.

Outlook

LAPC countries have greatly benefited from the boom in commodity prices these last few years. And according to BlackRock Inc.'s Evy Hambro, these benefits could be lasting as commodity prices are set to remain high at current levels (Biesheuvel & Lacqua, 2022). However, if commodity prices were to suddenly drop, would this lead to severe consequences for the region? Certain LAPAC countries have successfully diversified away from commodity exports, which will limit the drawbacks of a downturn. More specifically,, Latin America is said to be way more diversified than frothy years ago. Especially, in Mexico and certain Central American countries, non-commodity exports have risen compared to rises in commodity export. At this moment, Mexico's main exports are manufactured products (89 percent of total shipments) and oil and oil products (6 percent). Therefore, if a drop in commodity prices were to occur, the lower dependency on commodity export would result in less severe consequences for the region. However, for countries that remain heavily reliant on commodity exports, a sharp drop in price could be seen on their growth rates.

Impact of high commodity prices on securities:

According to a Blackrock analyst, raw materials, and the share prices of some of these companies could remain on their upwards trend (Biesheuvel & Lacqua, 2022). This rally has driven many of these companies that produce raw materials to reach record high share prices. Commodities giant Glencore Plc stock price was the highest it has been in almost a decade (figure 5 trend (Biesheuvel & Lacqua, 2022)). Commodity Strategies Fund, an index fund that has a majority exposure to Energy (20.3%), Agriculture (16.36%) and Industrial Metals (10.63%). This exposure has driven the massive upwards rally of the fund (Figure 6).



Figure 5: Glencore Plc stock price



Figure 6: Fund Commodity Strategies Fund (BICSX) performance

Conclusion

To conclude, given the steady increase in commodity prices as well as the rise in commodity-related stocks one should consider whether exposure to these securities would enhance their portfolio. All in all, a well-diversified portfolio, exposed to commodities as well as stocks, bonds and will allow investors to ultimately benefit from the rise in commodity prices, and allow them to hedge against possible falls in prices in case of downturns.

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