

Box 4

NON-ENERGY COMMODITY PRICE DEVELOPMENTS AND THEIR IMPACT ON EURO AREA PRODUCER PRICES

The increase in US dollar-denominated non-energy commodity prices over the past two years raises questions about the past and future impact of such developments on euro area prices. This box analyses first the factors behind the recent developments in non-energy commodity prices and second the impact of those developments on euro area producer prices.

Significant rise in non-energy commodity prices since end-2001

By the end of 2001, US dollar-denominated non-energy commodity prices had fallen to their lowest level in years, in part as a result of the slowdown in global economic activity. Downward pressure had also been exerted by the strengthening of the US dollar vis-à-vis the currencies of major commodity-consuming countries, which typically makes commodities more expensive in domestic terms and hence depresses demand. Since then, the non-energy commodity price index (in dollar terms) has increased significantly, reaching its highest level in almost seven years in early 2004. In February 2004 non-energy commodity prices stood 26.0% higher than a year earlier. Over the same period, food prices, non-food agricultural raw materials prices and metals prices increased by 17.0%, 15.8% and 42.9% respectively.

Several factors have contributed to the strengthening of non-energy commodity prices. The main determinant has been a pick-up in demand for raw materials following an improvement in global economic conditions. Demand for some commodities has been particularly strong in China. The global supply of some non-energy commodities, on the other hand, has not yet adjusted to this pick-up in demand. The weakening of the US dollar has also contributed to the rise in non-energy commodity prices. In addition, speculative interest in some commodities has supported price increases, as investment funds have added commodities – which traditionally perform well in the initial stages of an economic upswing – to their portfolios.

Chart A US dollar-denominated non-energy commodity prices

(index: 2000 = 100)

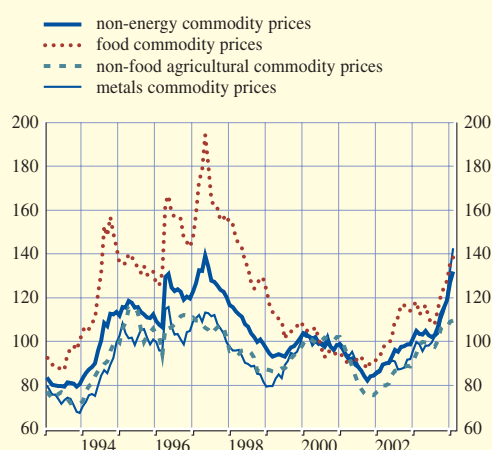
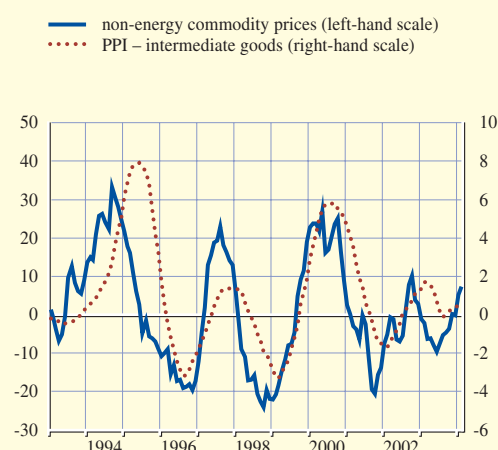


Chart B Euro-denominated non-energy commodity prices and producer prices for intermediate goods

(annual percentage changes)



Sources: HWWA, European Commission and ECB calculations.

The impact of non-energy commodity prices on euro area producer prices

Changes in non-energy commodity prices are passed on to euro area prices via increases in production costs, which may subsequently be passed through to consumer prices as measured by the HICP (see also Box 4 in the September 2001 issue of the Monthly Bulletin). However, the impact of the recent rise in US dollar-denominated non-energy commodity prices has to a large extent been offset by the appreciation of the euro. In euro terms, non-energy commodity prices were 7.2% higher in February 2004 than they had been a year earlier. Over the same period, metals prices increased by 21.7%, while food prices and non-food agricultural raw materials prices decreased by 0.4% and 1.4% respectively.

In the euro area, prices of intermediate goods, which account for approximately 30% of the Producer Price Index, appear to be the most affected by changes in commodity prices. As the amount of commodities produced in the euro area is small, the scope for substituting domestically supplied commodities for imported commodities is limited. This increases the exposure of euro area intermediate goods producers to sharp movements in the prices of imported commodities.

Chart B shows that there is a high degree of correlation between euro area intermediate goods prices and non-energy commodity prices in euro terms. Despite the dampening effect of the appreciation of the euro on non-energy commodity prices, some upward pressure has been apparent over recent months, which could in part be a result of the rise in non-energy commodity prices in euro terms. Overall, however, pressures arising from intermediate goods prices remain subdued.

The chart also shows that in previous periods of rising non-energy commodity prices, euro area intermediate goods prices have tended to react with a lag of several months. As a result, further upward pressure on producer prices can be expected in the coming months. This is also reflected in the most recent Eurozone Input Price Index (EPI), which is compiled as part of the Purchasing Managers' Survey. The EPI for manufactured goods has increased over the last seven months, with survey respondents citing the rise in non-energy commodity prices in euro terms as the main factor pushing up input prices.