



Economics Group

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Prospects of Tapering and Commodity Prices

Reports on the potential effects of U.S. Federal Reserve tapering abound and all tend to be bearish on the world economy. However, lower commodity prices may be a blessing in disguise.

Will Tapering Put Downward Pressure on Commodity Prices?

Many reports have been written over the past year regarding the potential effects of tapering by the U.S. Federal Reserve on commodity prices. However, the tone of the reports is as if commodity prices were high due to quantitative easing, when in fact the strong increase in prices pre-date quantitative easing (QE) by approximately six to seven years, depending on what commodity we are discussing. While we are not going to negate that there exists some positive correlation between monetary expansion and commodity prices, the strength in prices seems to be a clear consequence of the strong performance of emerging market economies, especially the Chinese economy.

Some could argue that commodity prices were kept higher than otherwise they would be today by QE, and it would be very difficult to disprove that assertion. At the same time, it would also be difficult to prove the effect of QE on prices given the information available today.

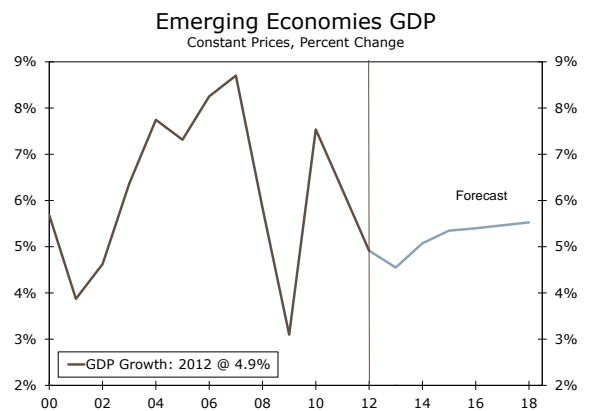
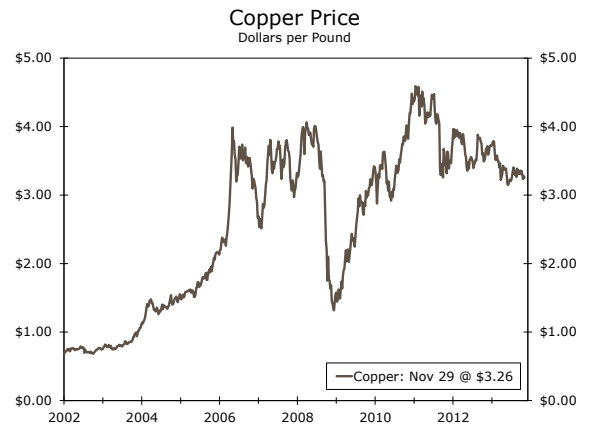
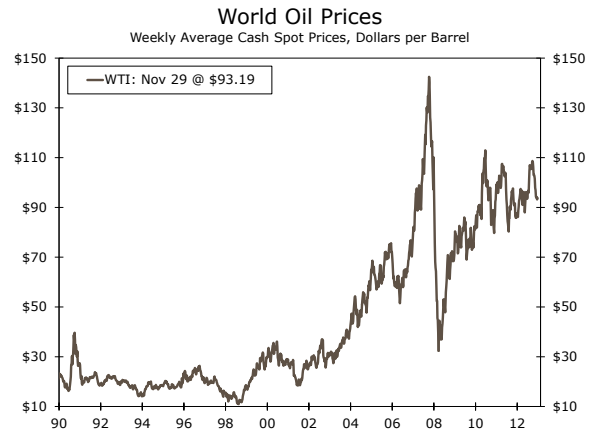
Economic Growth Matters More

As growth in the world economy continues to be positive, and is partially supported by monetary expansion across the world, it is clear that tapering in U.S. monetary policy would have some effect on commodity prices. If tapering finally occurs as we are expecting, at the end of the first quarter of 2014, it will mean that the U.S. economy will be capable of continuing its recovery from the Great Recession without the support of the Federal Reserve. This continuous recovery should be good news, overall, for commodity prices.

Probably the biggest unknown today regarding commodity prices is the outlook for growth in the rest of the world. Weak global economic growth could put downward pressure on commodity prices.

Emerging Market Growth Will Suffer

On this note, commodity prices have positively affected emerging markets as they have enabled emerging market governments to conduct highly expansionary fiscal policies. Thus, if commodity prices continue to weaken, the prospects of further economic weakness will increase in those countries that have relied the most on fiscal expansion to support economic growth over the past decade or so. Thus, we expect commodity-exporting countries to suffer most from weakness in commodity prices. However, consumers of commodities will probably be net beneficiaries of this weakness in commodity prices, as it will enable them to consume larger quantities of commodities at lower prices. Thus, weakness in commodity prices may not be a bad thing for the world economy, even if tapering occurs.



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