Signs of a commodities supercycle

What is the issue?

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- Globally, the prices of commodities are rising or expected to rise.
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- This is seen as a sign of a likely commodities supercycle.
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- The development is to be understood in view of the relationship between commodities prices and the US dollar.
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What is a supercycle?

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- In economic terms, a Supercycle is the longest period or wave in the growth of a financial market.
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- e.x: In 1700s, due to the Industrial Revolution in Britain, prices of coal, cotton, sugar, tea etc went up and greater quantities were produced.
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- But over time, the innovation worn out, demand lowered when supply was growing, and the prices of commodities dropped, causing the end of the super-cycle.
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- The last commodities super cycle was roughly from 2000 to 2014.
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- This **boom in commodity prices** was largely due to the rising demand from emerging markets as well as the result of concerns over long-term supply availability.
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How does US dollar influence the commodity prices?

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- Historically there is an **inverse relationship** between the value of the dollar and commodity prices.
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- When the value of the dollar drops, other countries will have more buying power, as it takes less of their currencies to purchase a dollar.
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- This increased buying power naturally increases the demand and subsequently commodity prices increases and vice versa.
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What happened after 2014?

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- **Deviation in relationship** - The two years following the 2014 commodities supercycle witnessed a steep fall in prices.
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- This coincided with the slowdown in the Chinese economy and resultant poor investment in the commodities space and poor demand globally.
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- As a result, the association between the dollar and commodities prices reversed to a **new direct relationship**.
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- Despite a strengthening dollar scenario, commodity prices increased due to -
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1. Election of Trump as the U.S. President leading to hopes of increased public investment in infrastructure projects.
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2. Signs of economic recovery and stimulus investment made in Chinese infrastructure making favourable impact on commodity prices.
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3. Global growth was getting stronger and as a consequence there was a boom in resources.
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Why is the Supercycle expected now?

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- The above mentioned market euphoria around a recovery in commodities demand due to a stronger global economy has died out.
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- The U.S. dollar index has now dropped by almost 10% since the beginning of the year.
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- But there is a rise in global commodities prices, reflecting the return of inverse relationship between dollar and commodity price.
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Source: The Hindu, Business Standard

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