Commodity Markets

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The whole of 2002-03, the outlook of recovery in global economic activity and world trade was generally subdued for a host of reasons including depressed equity markets, weakening US dollar and serious geo-political concerns. Commodity markets across the world were impacted by these developments.

Interestingly, however, the depressed conditions of the previous three years – when consumption demand had trailed supplies – gave way during the year to the beginning of a process of recovery for most commodity markets. This was aided by some weather aberration in parts of the world and cyclical output changes in some key commodities.

Recovery in international commodity prices occurred in the second half of 2002 after bottoming out late 2001 from a prolonged decline in the aftermath of the Asian crisis. Non-fuel commodity prices remained bound by weak demand and inventory drawdown. Metal prices which had declined through the 1990s and again in 1991, recovered weakly.

Gold, however, was an exception. In 2002-03, international gold prices broke through the resistance first at $ 300 an ounce and later to a 6-year high to test resistance at $ 350 an ounce, helped by Iraq war, massive producing de-hedging and weakening US dollar. The safe haven status of gold was reaffirmed.

International prices of food items, agricultural raw materials and beverages firmed up during the year under review after a trough starting in late 1998. Prices of oilseeds, vegetable oils, cotton, foodgrains, coffee etc. improved to the relief of producers.

In case of soft commodities, trade distorting subsidies granted by OECD countries continued to impact global production and prices. Expanding infusion of technology is also seen as a contributory factor. Globally, agricultural subsidies amounted almost $ one billion per day (largely developed economy-centric). This not only seriously impacted the fragile economies of several developing nations, but also weakened the Doha Development Agenda. The effect of global trends was surely felt on Indian commodity markets which are progressively integrating with global markets.

India remained one of the fastest growing significant economies of the world. However, the country suffered a most telling monsoon deficiency in two decades that affected agriculture severely, with agriculture and allied services GDP declining by 3.1 per cent which in turn pulled the overall 2002-03 GDP growth rate down to 4.4 per cent from 5.4 per cent of previous year. In other words, in the first year of the Tenth Five-Year Plan period, the GDP growth rate was 4.4 per cent versus the target of 8 per cent.

It must however be mentioned that this agriculture-pulled deceleration in growth during the year clouds an across-the-board improvement in the growth performance of the industry and services from 3.3 per cent to 6.1 per cent, and from 6.8 per cent to 7.1 per cent respectively between 2001-02 and 2002-03. In other words, despite severe monsoon deficiency the rebound in growth observed since 2001-02 gained momentum in industry and services sectors in the year under review.

The growth recovery was accompanied by continued macroeconomic stability in terms of low inflation, orderly currency market conditions and comfortable foreign exchange reserves. In the past, with their impact on price and availability of foodgrains, droughts had been particularly harsh on the poor. In 2002-03, despite deficit monsoon, there were no shortages in the availability of essential commodities or flare-ups in their prices. Massive foodgrain stocks with Food Corporation of India helped quell inflationary pulls.

After registering the peak of 212 million tons in 2001-02, foodgrains output declined sharply to 184 million tons in 2002-03. Revised estimate of wheat production for 2002-03 is 70.3 million tons (down from 71.8 million tons of previous year) and for rice 76.9 million tons (93.1 million tons previous year). Coarse grains output was down 9 million tons to 25.1 million tons and pulses output 11.8 million tons.

Commercial crops too suffered as the output of nine cultivated oilseeds (15.6 million tons); cotton (8.6 million bales of 170 kgs each); and sugarcane (279 million tons) declined from the previous year. Sugar production was down to 17.2 million tons, but a massive opening stock – in excess of 10 million tons – meant a glut in the market and consumer-friendly prices. In a number of commodities, indigenous shortfall was bridged by continuing imports, especially of edible oil (4.2 million tons); pulses (2.2 million tons); and cotton (1.6 million bales).

During the year under review, FCI procured 37.8 million tons of wheat and rice (down from 41.5 million tons of previous year). Wheat procurement was 19 million tons and ending-stock an estimated 16 million tons, four times the minimum stock norm of four million tons as of March 31. In order to liquidate large buffer stocks, FCI sold wheat and rice for export at subsidized rates. About five million tons of wheat and four million tons of rice were exported during the year. Foodgrain stocks that had touched a record 64.8 million tons by end-May 2002 declined to around 36 million tons by the end of the financial year because of exports, robust domestic offtake and supplies for relief schemes. .

The government created a buffer stock of 20 lakh tons sugar involving an outgo of Rs 412 crores from the Sugar Development Fund. To promote export, the government decided to neutralise the ocean freight disadvantage on export shipments and reimburse the same to sugar factories at Rs 350 a ton with effect from February 14, 2003, in addition to internal transport cost reimbursement on export since June 21, 2002.

Surpassing all expectations, fiscal year 2002-03 recorded robust growth in exports despite a slowdown and adverse developments in the world economy. Exports during the year at $ 51.8 billion, increased by 17.8 per cent against decline of 0.4 per cent during 2001-02. In the commodities section, agricultural and allied products showed a strong growth, having been driven by export of wheat, rice and sugar. Other items included marine products, ores and mines, gems and jewellery and textiles all of which showed positive growth rate in terms of value. In imports, edible oils showed a 24 per cent rise in import value because of firm global prices.

The Union Budget 2003-04 presented to Parliament on February 28, 2003 recognised that agriculture, the life-blood of the economy, after giving the country adequate food security, is now again at the cross-roads, as it prepares to diversify and move up the value chain. It also needs to respond robustly to second-generation issues such as land degradation and water logging. Diversification, resonance with market-forces, and a swift adoption of sunrise technologies are the other needs, according to the Finance Minister.

Gold and silver imports showed a decline because of higher international prices and demand compression due to fall in rural incomes. The domestic market reflected global price gyrations. High prices encouraged domestic sales.

The commodity markets in 2002-03 witnessed an apparently anomalous situation. Despite lower agricultural production, drought in 14 States and a free trade regime, (no restrictions on storage, movement, credit access etc) commodity prices – contrary to their normal behaviour – did not flare up; inflation was and continues to be well under control. The performance of the economy based on several macro-economic indicators has demonstrated its resilience and inherent strength.

Notwithstanding lower indigenous production, commodity prices remained under a tight leash for a combination of reasons. Large domestic stocks of wheat, rice and sugar; intervention in

the form of relief programmes and subsidised sales; continuing imports of essential commodities in short supply; fall in rural incomes compressing consumption growth to some extent; falling interest rates; and a not so attractive risk-reward profile for speculators all combined to rein-in prices. Importantly, the psychosis of shortage that characterised the Indian commodity markets until a few years ago has ceased to exist.

Interestingly, gold turned out to be the strongest major currency last fiscal as it outperformed the other major currencies by between nine and 25 per cent over the year. The yellow metal outperformed the major stock indices too. Over the course of the year, gold outperformed the dollar by 25 per cent, the yen by 14 per cent and the pound sterling by 13 per cent., the euro by 9 per cent and the Swiss franc – the other major recipient of safe haven funds (notably from West Asia) – by 7 per cent.

Futures trading in commodities continued in a lacklustre manner through 2002-03 with the bourses suffering low volumes and poor liquidity. Whether it was cotton, coffee or castorseed, it was the same story of poor participant interest. The Indore-based National Board of Trade (NBoT) managed to muster volumes and performed impressively in soyabean oil futures. Rapeseed/mustard futures have taken off well.

After announcing sugar futures and short-listing three promoters, the government kept the idea in abeyance. With the promised total decontrol now postponed to late 2005, sugar futures are unlikely to be launched any time soon.

In addition to NBoT and the Ahmedabad-based Online Commodity Exchange, two more multi-commodity exchanges with national reach are being set-up. One is the ICICI-led consortium of NSE, NABARD and LIC; and the other promoted by Financial Technologies.

Realising that futures trading as a tool for price risk management and price discovery will succeed only if physical trade was free, the government removed forward trading restrictions on a large number of commodities during the year. Also, several items were removed from the purview of Essential Commodities Act, 1955. Despite this, the physical market is far from organised and transparent. An interesting feature during the year under review was the entry of speculators with large funds in the physical market. They build inventory, hedge the price risk in the futures market and manage to keep market prices high. However, the benefit of high prices does not flow to primary producer – the farmer.

Physical market restrictions still remain in some cases. Open-ended procurement of wheat and rice, subsidised sales of grains in the open market, levy and monthly release mechanism for sugar, channeled imports of gold through designated banks are areas that need attention if futures trading in these commodities has to develop in a healthy manner.

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To rescue the plantation sector suffering from price instability in international markets, a Price Stabilisation Fund with a corpus of Rs 500 crores to help small and marginal farmers in crops such as tea, coffee and natural rubber was announced. The scheme will be operational from 2003-04.

The peak rate of customs duty on imports was reduced from 30 per cent to 25 per cent, excluding agriculture and dairy products. For the gems and jewellery sector, customs duty on roughs and semi-processed diamonds was reduced to zero, while on cut and polished diamonds and gemstones, the duty was reduced to 5 per cent.

Duty on gold was reduced to Rs 100 per 10 grams (from Rs 250), but only when it is brought in the form of serially numbered bars or in the form of gold coins, and not as tola bars. Excise duty on refined oils and vanaspati has been imposed.

Fiscal year 2003-04 has begun on a note of cautious optimism. Foreign exchange reserves are accumulating robustly. The rupee is gaining against the US dollar. Inflation is under control. The industry sector is showing definite signs of growth. A preliminary forecast of southwest monsoon during June-September 2003 indicates below normal performance; however, it remains to be seen whether the new, untested forecast model performs well.

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