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Commodity Markets Outlook

Oil Exporters: Policies and Challenges

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Executive Summary

Commodity prices strengthened in the first quarter of 2018. Broad-based price increases were supported by both demand and supply factors. Accelerating global growth lifted demand for commodities, while a number of commodities faced supply constraints. For oil and precious metals, concerns about mounting geopolitical risk also supported prices. Crude oil prices are expected to average $65 per barrel (bbl) in 2018 (up from $53/bbl in 2017) and remain at $65/bbl in 2019—an upward revision from the October 2017 forecast. Metals prices are expected to increase 9 percent in 2018 and, following three years of relative stability, agricultural prices are expected to gain 2 percent in 2018. Looking ahead, policy actions currently under discussion, such as additional tariffs, production cuts, and sanctions, present risks to the short-term outlook. This edition also analyzes the policies of oil exporting economies in response to the 2014 oil price collapse. It concludes that oil exporters with flexible currency regimes, larger fiscal buffers, and more diversified economies fared better than others. The experience of the past four years is a reminder of the urgent need for greater economic diversification and stronger monetary and fiscal policy frameworks in oil exporters.

Recent trends

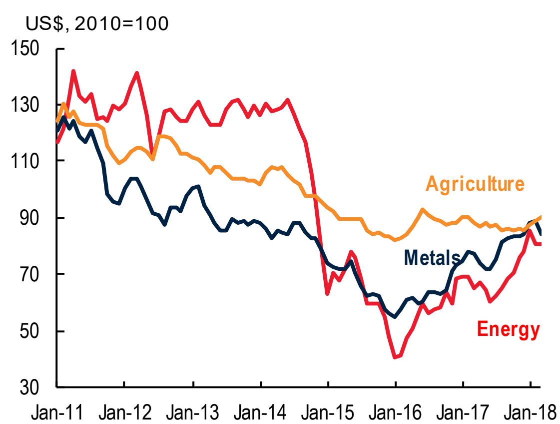
Backdrop. Commodity prices strengthened in three-quarters of commodities in the first quarter of 2018, but prices of more than four-fifths of commodities remained below their 2011 peaks (Figure 1). Prices continue to be supported by a broad-based global recovery, with global GDP growth increasing to 3.1 percent in 2017, from 2.4 percent in 2016. Meanwhile, production has been held back for several commodity-specific reasons, including continued OPEC and non-OPEC oil production restraint, measures by China to reduce polluting metals and energy production, and lower grain planting intentions in the United States. Concerns about mounting geopolitical tensions have lifted oil and some precious metals prices. Several newly enacted or prospective policy actions have contributed to sharp movements in metals prices (e.g. U.S. import tariffs on aluminum and steel; U.S. sanctions on Russian commodity producers). Short-lived volatility on soybean prices was triggered by the discussion of the possibility of higher tariffs on imports to China.

Energy prices surged 10 percent in the first quarter of 2018 (q/q), led by oil and natural gas. Oil prices rose 10 percent, averaging $64.6/bbl over the quarter, and have more than doubled since bottoming in early 2016. Strong oil demand and greater-than-expected compliance by the 22 OPEC and non-OPEC producers to their agreed production cuts helped reduce inventories in the second half of 2017. Rising geopolitical concerns, especially about prospects for renewed sanctions on Iran, and tensions between Iran and Saudi Arabia in Yemen, bolstered prices in late March and rose further to $74/bbl in April. The rise in prices has supported a recovery in U.S. shale production, with total crude production increasing by more than 1.1mb/d in January 2018 relative to the previous year.

Non-energy commodity prices rose 4 percent (q/q) in the first quarter of 2018. *Metals* prices increased over 4 percent due to strengthening global demand and concerns about tightening global supplies. China continued to enforce measures to curtail production of aluminum and steel over the winter to meet pollution goals, although production rose in non-restricted areas. In April, the trade tensions between the United States and China initially weighed on all metals prices. However, aluminum prices subsequently surged and reached a seven-year high following the imposition of sanctions by the United States on the largest Russian aluminum producer (accounting for more than 6 percent of global supply). Nickel prices also rose amid fears that sanctions could be extended to other Russian metals producers—Russia accounts for 9 percent of global nickel production. *Precious metals* prices gained 4 percent on expectations of rising inflation, a weaker dollar and heightened concerns about geopolitical risks. *Agricultural* prices gained 4 percent, the largest quarterly increase in the past two years, largely due to lower wheat and maize plantings in the United States and a La Niña-related impact on banana pro-

1 Commodity price indexes, monthly

Commodity prices strengthened in the first quarter of 2018. Broad-based price increases were supported by both demand and supply factors.



Source: World Bank.
Note: Last observation is March 2018.

duction in Central America and soybean production in Argentina.

Outlook and risks

Prospects. More than half of commodity prices (and all non-coal energy prices) are expected to increase in 2018 but four-fifths of them will remain below their 2011 peaks. *Energy* prices are forecast to rise 20 percent in 2018—a 16 percentage point upward revision from October 2017—and stabilize in 2019 (Table 1). *Non-energy* prices are projected to gain more than 4 percent in 2018 before they stabilize in 2019. These constitute upward revisions of more than 2 percentage points for both years from the October 2017 forecast. If additional tariffs or sanctions are implemented, they could change the outlook for commodity prices in the short-term; however, their effect would likely unwind over the medium-term, as producers and consumers find new distribution channels, export markets or sources of finance.

Oil prices are anticipated to average $65/bbl in 2018 and 2019 on robust demand and continued production restraint by OPEC and non-OPEC producers, notwithstanding increases in U.S. shale oil production. Higher oil prices are expected to eventually feed into higher natural gas prices while coal prices will continue to decline as energy demand shifts towards less polluting sources. Upside risks to the forecasts include potential supply losses arising from geopolitical events, a deterioration in República Bolivariana de Venezuela, deeper cuts by OPEC and non-OPEC countries or an extension of the agreement to a longer-term horizon. Conversely, a weakening of the agreement, or further efficiency gains among U.S. shale producers could depress prices.

Metals prices are projected to increase 9 percent in 2018 due to a further pickup in demand. An 11 percent decline in iron ore prices—reflecting stronger production, especially in China—is expected to be more than offset by projected increases in all other base metals prices. Nickel prices, in particular, are expected to remain 30 percent higher than in 2017, despite a slight moderation from their recent sharp rise, that reflect hopes for buoyant electric vehicle demand and the risk of Russian sanctions. Upside price risks to the forecast include more robust global demand as well as production shortages. Supply could be curtailed by a slower ramp-up of new capacity, further sanctions against metal exporters, and policy changes in China. Downside risks are dominated by slower growth, the easing of pollution-related policies, and the reintroduction of idle capacity in China.

Agricultural prices are forecast to gain 2.2 percent in 2018 and a further 1.3 percent in 2019. Grain prices and oils and meal prices are projected to gain 8 percent and 4 percent, respectively, in 2018, mainly due to lower plantings. A key policy risk is the introduction of countervailing duties on soybeans by China in response to U.S. tariffs.

Special focus on oil exporters

Oil exporters faced substantial policy challenges after the 2014 oil price collapse, as their growth prospects deteriorated and fiscal buffers were depleted to varying degrees across countries. The *Special Focus* section concludes that oil exporters with flexible currency regimes, larger fiscal buffers, and more diversified economies fared better than others. Overall, however, most oil exporting economies still face significant policy challenges as their medium-term prospects for growth and fiscal revenues have deteriorated since 2014. This points to an urgent need for reforms to increase diversification and reinforce monetary and fiscal policy frameworks.

TABLE 1 Nominal price indexes and forecast revisions

	Price Indexes (2010=100)						Change (%)		Index revision[2]	
	2014	2015	2016	2017	2018f[1]	2019f[1]	2017-18	2018-19	2018f	2019f
Energy	118	65	55	68	81	81	19.8	-0.4	10.7	7.4
Non-Energy[3]	97	82	80	84	87	88	4.1	0.3	2.5	2.1
Agriculture	103	88	88	87	89	90	2.2	1.3	-0.4	-0.3
Beverages	102	94	91	83	83	84	-0.2	1.1	-1.4	-1.0
Food	107	89	90	91	93	94	2.6	1.2	-0.3	-0.2
Oils and meals	109	85	90	89	93	94	4.0	1.5	2.1	2.0
Grains	104	87	81	81	87	88	7.5	1.6	3.2	3.0
Other food	107	95	99	102	99	100	-2.5	0.6	-6.5	-6.0
Raw Materials	92	83	80	81	83	85	2.5	1.7	-0.3	-0.2
Fertilizers	101	97	78	74	76	77	2.1	2.4	3.4	3.2
Metals and Minerals	85	67	63	78	85	83	8.6	-2.1	8.4	6.9
Precious Metals	101	91	97	98	101	99	2.8	-1.1	4.0	3.7
Memorandum items										
Crude oil ($/bbl)	96	51	43	53	65	65	23.1	0.0	9.0	6.0
Gold ($/toz)	1,266	1,161	1,249	1,258	1,300	1,282	3.4	-1.4	62.2	56.4

Source: World Bank.
Notes: (1) "f" denotes forecasts. (2) Denotes revision to the index level from the October 2017 report, except for crude oil ($/bbl) and gold ($/toz). (3) The non-energy price index excludes precious metals. See Appendix C for definitions of prices and indexes.