Market Talks
EDUCATION CENTER

COMMODITIES · BEGINNER · LESSON 14 OF 15

Supply, Demand and the Dollar

The common forces behind every commodity: how supply and demand meet, why inventories matter, why prices overshoot, and how the US dollar and interest rates push all commodities at once

13 min read · 8 quiz questions with answer key

COMMODITIES · BEGINNER · LESSON 14 OF 15

Supply, Demand and the Dollar

IN ONE SENTENCE

Every commodity in this track, from oil to cocoa, is priced by the same forces. Supply and demand decide whether the market is short or long of material, and inventories show how big the cushion is. Because new supply takes years and demand adapts slowly, prices often overshoot in both directions, and high prices eventually cure themselves. On top of this, almost all commodities are priced in US dollars, so a stronger dollar tends to make them cheaper in dollar terms, and higher US interest rates raise the cost of holding them. In November 2026 the dollar index was near a 19-month high after the Federal Reserve's first rate hike since 2023.

Every price is a balance

You have now seen energy, metals, grains and softs. They look very different, but each price comes from the same question: **is there more or less of this material than people want to use?**

On the **supply** side are new production, stocks left from before, recycling, and sometimes sales from government reserves. On the **demand** side are what factories, power plants, farmers and consumers use, what other countries import, and what investors and stockpilers buy to hold.

When demand is bigger than supply, the market is in **deficit**: stocks are drawn down and prices tend to rise. When supply is bigger, the market is in **surplus**: stocks build up and prices tend to fall. You saw this with silver's five deficit years in Lesson 10, copper's forecast surplus in Lesson 11 and the WASDE balance sheet in Lesson 12.

Remember that markets trade **expectations**. A price moves when the expected balance changes, often long before the material itself runs short or piles up.

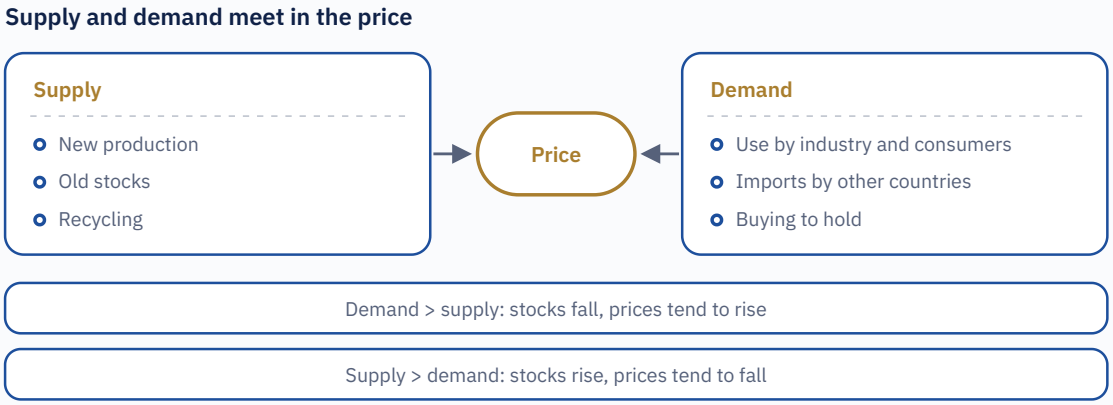


Figure 1. The price moves to balance what is produced and stored against what is used and held.

Inventories: the cushion

Inventories, or stocks, are the material already produced and waiting to be used: oil in tanks, metal in warehouses, grain in silos, cocoa in exchange-approved stores. They are the cushion that absorbs surprises.

When stocks are high, a mine accident or a poor harvest is easier to handle, and prices stay calm. When stocks are low, the same problem can cause a sharp jump, because buyers must compete for what is left.

The futures curve, which you will study in depth at the Intermediate level, shows this. When material is scarce, buyers pay more for delivery now than later, so near months trade above later months. This is called **backwardation**. When material is plentiful, later months trade above near months, because someone has to pay to store it. This is called **contango**.

Many inventory numbers are public and updated often: the US Energy Information Administration's weekly oil and gas storage reports, daily warehouse stocks from the LME, COMEX and ICE, and USDA ending stocks. In November 2026, rising ICE cocoa stocks and rising LME copper stocks were both pressing on prices.



Figure 2. The shape of the futures curve shows whether stocks are scarce or plentiful. Months run from left to right.

Why prices overshoot

In the short run, both supply and demand are slow to change. A new copper mine can take more than ten years from discovery to production. A new cocoa or coffee tree needs several years to bear a full crop. And people still need fuel to drive and food to eat, even when prices rise.

Because neither side can adjust quickly, a small shortage can cause a big price jump. But over time, high prices change behaviour. Producers invest and new supply arrives. Buyers use less, switch to cheaper materials or go without. You saw this with silver in solar panels (thrifting), platinum and palladium in catalysts (substitution) and chocolate makers using less cocoa.

Traders say **the cure for high prices is high prices**, and the reverse is true too. When prices fall far enough, producers cut investment and close expensive mines or farms, and cheap prices encourage more use. That sets up the next shortage. This is the **commodity cycle**, and it is why commodity prices rarely stay at extreme levels for long.

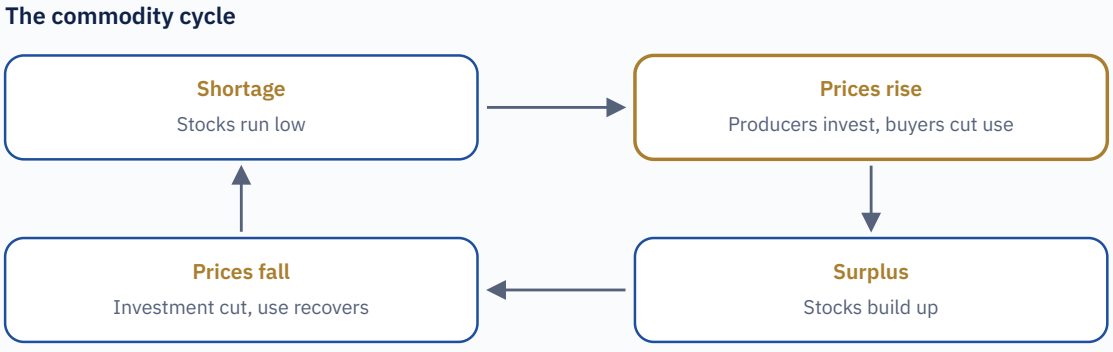


Figure 3. High prices cure themselves, and so do low prices.

Why the dollar matters

Almost all major commodities are priced in **US dollars**, wherever they are produced or used. That creates a link between the dollar and commodity prices.

When the dollar gets stronger, a commodity with an unchanged dollar price becomes more expensive for buyers who pay in euros, yen, rupees or yuan, so their demand tends to fall. At the same time, producers outside the US earn more in their own currency for every dollar of sales, so they are happy to sell more. Both effects tend to push dollar prices **down**. A weaker dollar tends to do the opposite.

Traders follow the **US Dollar Index (DXY)**, which measures the dollar against six major currencies. The euro and the yen together make up about 71% of the index. In mid-November 2026 the DXY rose above 103, its highest level since spring 2025, driven largely by a weaker euro and by expectations of higher US interest rates.

The link is a tendency, not a rule. A war or a supply shock can lift both the dollar and oil at the same time, and a crisis can push both the dollar and gold up as investors look for safety. Use the dollar as one input among several.

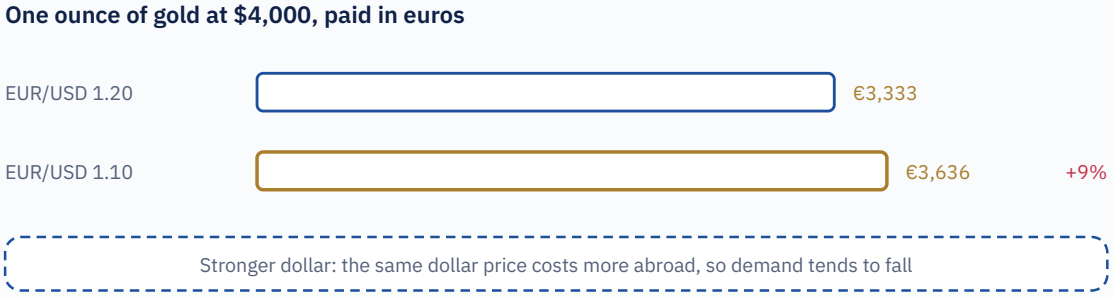


Figure 4. A stronger dollar raises the cost of commodities for buyers paying in other currencies.

EXAMPLE: THE SAME PRICE, A DIFFERENT COST

Anna runs a jewellery workshop in Germany and pays for gold in euros. Gold is $4,000 an ounce. When the euro is worth $1.20, one ounce costs her about €3,333. If the euro falls to $1.10 while gold stays at $4,000, the same ounce costs her about €3,636, roughly 9% more. Anna buys less gold, and so do many buyers like her. That reduced demand is one way a stronger dollar weighs on the dollar price of gold.

Interest rates and money flows

Interest rates affect commodities in three main ways. First, higher US rates usually make the dollar stronger, with the effects you just saw. Second, holding a commodity earns no interest and costs

money to store and insure, so when interest rates rise, holding stocks becomes more expensive and the opportunity cost of owning gold or other metals goes up. Third, higher rates can slow economic growth, which lowers demand for energy and industrial metals.

In 2026 this was a live story. On **September 16, 2026**, the US Federal Reserve raised its target range for the federal funds rate by a quarter point to 3.75% to 4%, its first rate increase since 2023, because inflation stayed high. It held rates in October, while markets expected further hikes. The 10-year US Treasury yield hovered around 5%. This background of a firmer dollar and higher yields was one reason many commodities struggled after their early-2026 highs.

Finally, **investment flows** matter. Hedge funds, index funds and ETF investors can move large amounts of money into or out of commodities quickly. Their positions are published every week in the CFTC's Commitments of Traders report, which you will learn to read at the Intermediate level.

Putting it together: a checklist

Before forming a view on any commodity, run through four questions:

1. **Supply:** Is production rising or falling? Are there outages, strikes, bad weather, export bans or OPEC+ decisions?
2. **Demand:** Is the main buyer, often China, using more or less? Is the season or the economic cycle helping or hurting?
3. **Stocks:** Are inventories rising or falling, and is the curve in backwardation or contango?
4. **Dollar and rates:** Is the dollar strengthening or weakening? Are interest rates and bond yields rising or falling?

No single answer decides the price. The skill is to see which force is strongest right now, and to notice when that changes.

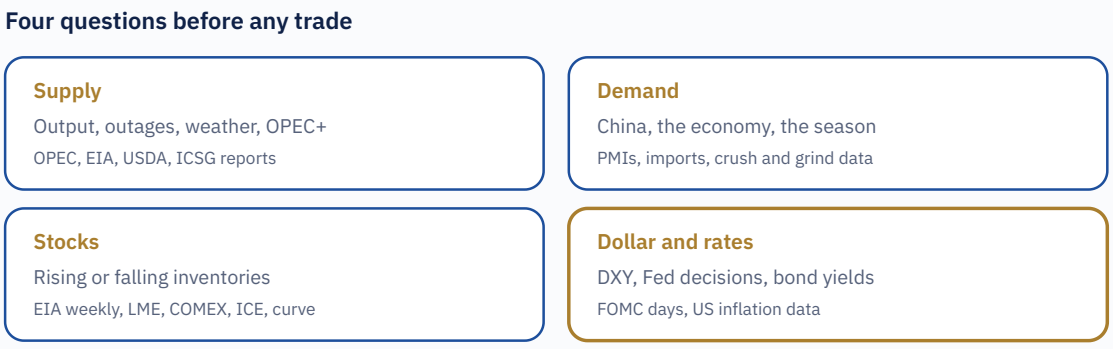


Figure 5. A simple checklist that works for any commodity.

Why this matters for traders

- **Think in balances.** Ask whether the market is moving towards a deficit or a surplus, and how that compares with what is already expected.
- **Watch inventories and the curve.** They tell you how much cushion the market has.
- **Respect the cycle.** Extreme prices tend to correct themselves, but the timing can take months or years.
- **Keep an eye on the DXY and US yields.** A strong move in the dollar can lift or press many commodities at once.
- **Mark central bank days.** Federal Reserve decisions move the dollar, yields and gold within minutes.

Key terms

Deficit	A period when demand is larger than supply, so stocks fall.
Surplus	A period when supply is larger than demand, so stocks rise.
Inventories	Material already produced and held in storage, such as oil in tanks or metal in warehouses.
Backwardation	A futures curve where near months trade above later months, usually when material is scarce.
Contango	A futures curve where later months trade above near months, usually when material is plentiful.
Commodity cycle	The repeating pattern of shortage, high prices, new supply and lower demand, surplus, low prices and less investment.
US Dollar Index (DXY)	An index of the US dollar against six major currencies, led by the euro and the yen.
Opportunity cost	The return you give up by holding one asset instead of another, such as interest on cash instead of gold.

Key takeaways

1. Every commodity price reflects a balance between supply and demand, and markets trade changes in the expected balance.
2. Inventories are the cushion. Low stocks make prices jumpy and often put the curve in backwardation; high stocks calm prices and often bring contango.
3. Supply and demand adjust slowly, so prices overshoot. The cure for high prices is high prices, and low prices plant the next shortage.
4. Most commodities are priced in US dollars. A stronger dollar tends to push dollar prices down, and a weaker dollar tends to push them up, but this is a tendency, not a rule.
5. Higher interest rates strengthen the dollar, raise the cost of holding commodities and can slow growth. In September 2026 the Fed raised rates for the first time since 2023.

Test yourself

Circle one answer for each question. The answer key with explanations is on the next page. You can also take this quiz online at markettalks.info and see your score instantly.

1. A market is in deficit. What usually happens to inventories?

- A They rise
- B They fall
- C They stay exactly the same
- D They are sold by the exchange

2. Why do low inventories make prices more volatile?

- A Because exchanges close
- B Because there is little cushion, so any supply problem forces buyers to compete for what is left
- C Because low stocks mean nobody wants the commodity
- D Because prices are fixed by law

3. Near-month futures trade above later months. What is this called?

A Contango
B Backwardation
C Arbitrage
D Thrifting

4. What does the phrase 'the cure for high prices is high prices' mean?

A Prices can only go up
B High prices encourage more supply and less use, which eventually brings prices down
C Governments always cap prices
D High prices stop all trading

5. The US dollar strengthens sharply while nothing else changes. What tends to happen to commodity prices in dollars?

A They tend to rise
B They tend to fall
C They always stay the same
D They double

6. Gold is $4,000. The euro falls from $1.20 to $1.10. What happens to the euro cost of one ounce?

A It falls from about €3,636 to €3,333
B It rises from about €3,333 to €3,636
C It stays at €4,000
D It halves

7. Which two currencies make up about 71% of the US Dollar Index?

A The pound and the Swiss franc
B The euro and the yen
C The yuan and the rupee
D The Canadian dollar and the krona

8. How can higher interest rates weigh on commodity prices?

A. They make storage free

B. They usually strengthen the dollar, raise the cost of holding stocks and can slow economic growth

C. They force mines to close immediately

D. They have no effect on commodities

Answer key

1 B

They fall

In a deficit, demand is larger than supply, so the gap is filled from stocks and inventories fall.

2 B

Because there is little cushion, so any supply problem forces buyers to compete for what is left

With little in storage, a disruption cannot be absorbed easily, so prices react strongly.

3 B

Backwardation

Backwardation usually appears when material is scarce and buyers pay more for delivery now.

4 B

High prices encourage more supply and less use, which eventually brings prices down

High prices lead to investment, substitution and thrifting, which rebalance the market.

5 B

They tend to fall

A stronger dollar makes commodities more expensive for non-US buyers and more profitable for non-US sellers, which tends to push dollar prices down.

6 B

It rises from about €3,333 to €3,636

4,000 ÷ 1.20 is about €3,333 and 4,000 ÷ 1.10 is about €3,636, so euro buyers pay about 9% more.

7 B

The euro and the yen

The DXY is dominated by the euro, with the yen second.

8 B

They usually strengthen the dollar, raise the cost of holding stocks and can slow economic growth

Higher rates work through the dollar, the cost of carrying inventory and the demand outlook.

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