



Gold and oil prices are at peaks

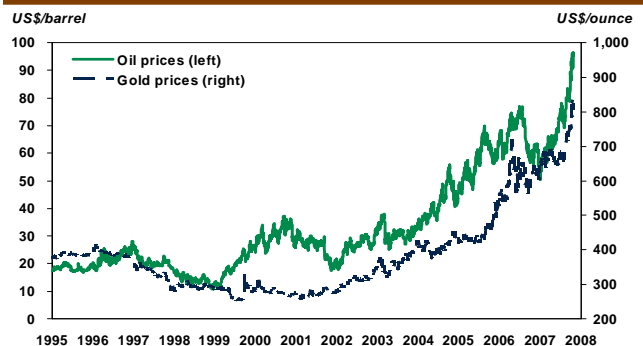
Highlights

- The price of oil has jumped in the last few months and is now flirting with US\$100/barrel. Prices will remain volatile before coming down toward about US\$80/barrel next year. Natural gas prices have gone up much less.
- Gold has also soared, taking the other precious metals up.
- Performance by base metals has been less spectacular, as rising inventories and doubts about how demand will evolve limited price increases and even triggered some pullbacks.
- After peaking in early October, the price of wheat has come down recently. Overall, grains will remain expensive next year.

Editorial

The spectacular surge by gold and oil prices has captured the attention of the commodities markets in the last few months. WTI's (West Texas Intermediate) price per barrel has gone up by over US\$20 from the beginning of September, shattering its previous record and even closing in on US\$100. Gold jumped by about US\$175 during the same time, occasionally crossing the US\$840 mark for the first time since 1980 (Graph 1).

Graph 1 – Oil is close to \$100 and gold is near \$850...



Sources: Datastream and Desjardins, Economic Studies

No one expected to see prices leap so high so fast. In particular, it is hard to imagine that oil is now trading at a price that, a few months ago, had only been anticipated in the event of catastrophes (major hurricane, war in Iran and closing of the Strait of Hormuz, etc.).

THE U.S. DOLLAR'S SLIDE IS PART OF THE EXPLANATION

The American dollar's pronounced drop in the last few months has certainly contributed to the rise in gold and oil prices. In general, commodities prices are denominated in U.S. dollars. It is therefore normal to see them go up when the greenback depreciates. If prices did not adjust, an American dollar decline

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François Dupuis
Vice-President and Chief Economist

Yves St-Maurice
Director and Deputy Chief Economist

Mathieu D'Anjou
Economist

Martin Lefebvre
Senior Economist

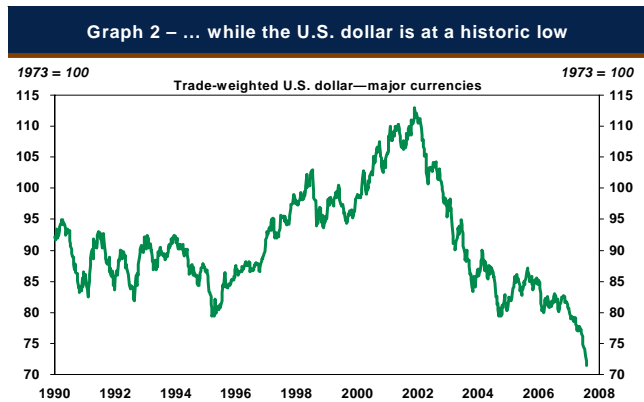
Hendrix Vachon
Economist

514-281-2336 or 1 866 866-7000, ext. 2336
E-mail: desjardins.economics@desjardins.com

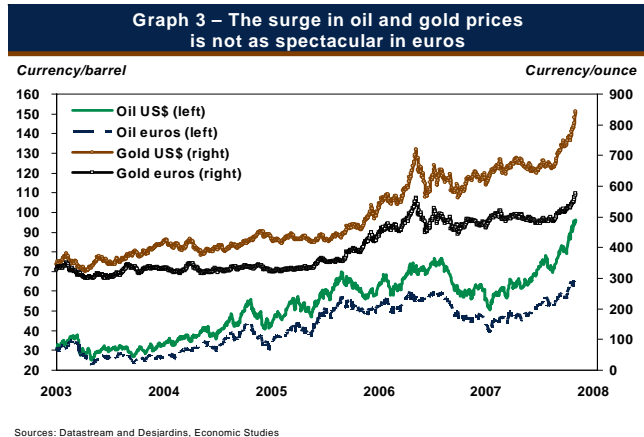
NOTE TO READERS: The letters **k**, **M** and **B** are used in texts and tables to refer to thousands, millions and billions respectively.

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would cause an unjustified decrease in the revenues of countries that produce natural resources. It should not come as a surprise, therefore, that the recent peaks reached by gold and oil occurred when the U.S. dollar was reaching a historic low (Graph 2).



Under these circumstances, it is not surprising to note that the recent appreciation by oil and gold is less spectacular when we look at how the prices evolve in euros or Canadian dollars (Graph 3).

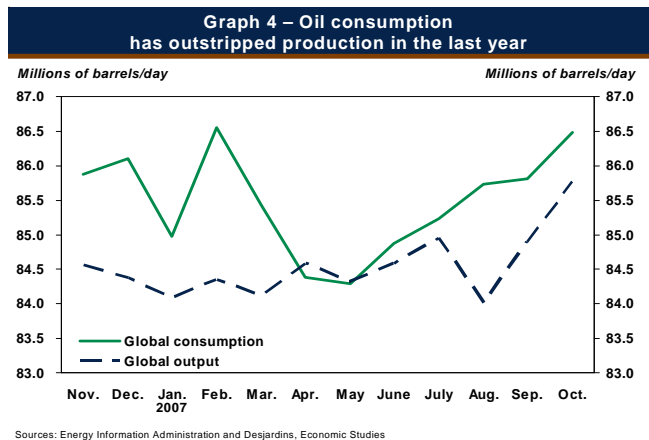


Demand for raw materials, especially gold, has also been inflated by investors who expect the American dollar to depreciate further. Several features of gold (liquidity, high price/volume ratio, historic role during uncertain times) make it the vehicle for investors who expect the greenback to slide. What's more, over the last two years, the evolution of gold and the U.S. dollar show a very negative correlation coefficient (-0.91). Oil's correlation coefficient is also negative, but not as negative as gold's. Our calculations thus tend to confirm the studies that conclude that gold is the commodity that provides the best protection against a U.S. dollar decline.

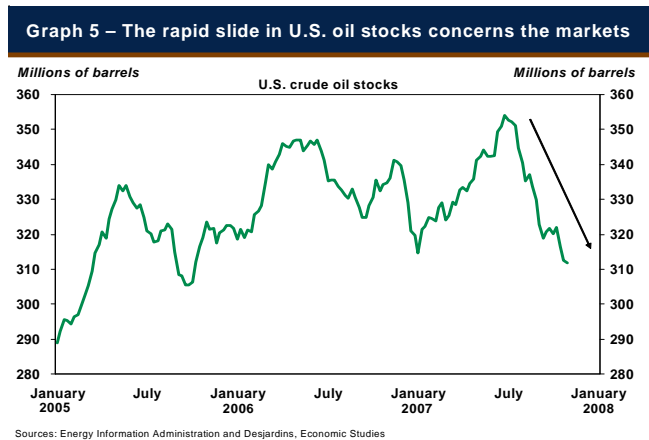
SHORTAGE FEARS ARE BENEFITING OIL

The greenback's slide does not, however, explain everything. Other factors helped skyrocket gold and oil prices. For oil, the very precarious balance between global consumption and output has had a big influence on prices.

For several years, the skyrocketing economic growth undergone by emerging nations, especially China and India, has driven demand up very rapidly while global output has not advanced much. Surplus oil production capacity has thus fallen sharply and global oil consumption is thought to have outstripped production for the last four quarters (Graph 4). The ongoing slide in surplus capacity largely explains the sustained growth of oil prices per barrel; note that oil was trading at around US\$30 in 2003.



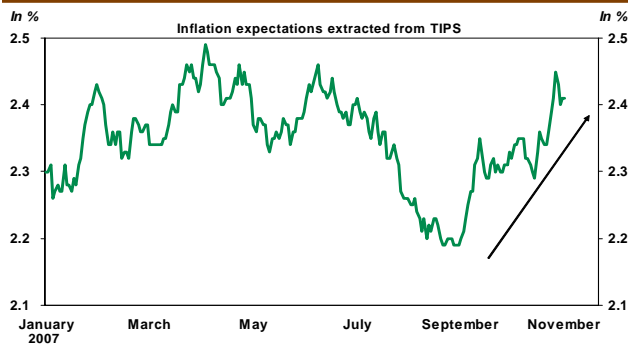
In this situation, it is normal for investors to be very nervous and react strongly to any hint at a coming oil shortage. The rapid slide in U.S. oil inventories (Graph 5) and heightened tensions in the Middle East in the last few months (new sanctions against Iran and conflict between Turkey and the Kurds of Northern Iraq) have had a substantial impact on oil prices. The current price of black gold thus reflects a very large risk premium.



GOLD IS BENEFITING FROM THE FINANCIAL CRISIS AND THE ACCELERATION OF INFLATION PRESSURES

Gold, for its part, is seen as one of investors' main safe haven securities. It is therefore normal that gold benefited from the resurgence by risk that followed the summer's financial crisis. Historically, gold is also used as a shield against acceleration by inflation. Very high commodities prices, especially gold and grain prices, are causing fears of a strong comeback by inflation. Food prices are already showing signs of accelerating in several countries and, unless oil comes down sharply, gas prices can be expected to shoot up. Movement by real return bonds thus points to an increase in inflation risks in the last several months (Graph 6), and inflation continues to be a concern for central banks. In this context, it is normal to see gold perform especially well.

Graph 6 – Inflation fears have risen in recent months

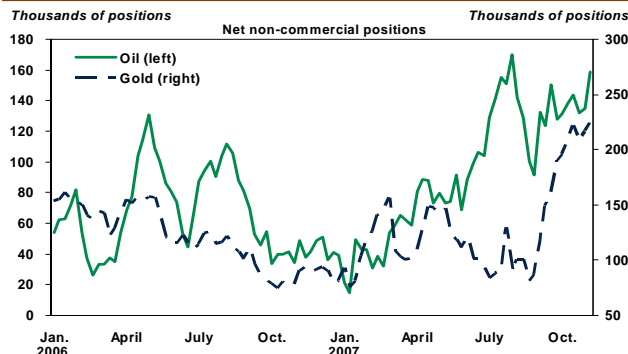


* Treasury Inflation-Protected Securities.
 Sources: Datastream and Desjardins, Economic Studies

CURRENT LEVELS WILL BE HARD TO SUSTAIN OVER THE MEDIUM TERM

In the short term, given how much speculation there is (Graph 7), we can expect gold and oil prices to be volatile. A correction could occur at any time. However, nothing points to an imminent reversal of the trend. The factors that support the increase by these commodities should remain positive

Graph 7 – Speculators have taken substantial positions on gold and oil



Sources: Bloomberg and Desjardins, Economic Studies

over the next few months, allowing prices for these assets to reach new peaks.

However, things should start to change during 2008, when upward pressures on gold and oil prices will ease. Firstly, the greenback's tumble cannot last much longer at this rate, and we are expecting it to stabilize somewhat next year. The American dollar has already seen a slight rebound in the last few days, and it was immediately reflected in gold and oil prices. However, it is too early to see whether the increase is the start of a new trend for the greenback or just a break before it slides further.

Then, unless there are real problems with oil production, fears of a shortage should progressively ease, especially if the U.S. economic situation remains difficult. There will still be major questions regarding the long-term capacity to deal with growth in global oil demand. This uncertainty justifies high prices (around US\$80), but not current levels.

Finally, as for gold, we are confident that monetary authorities will maintain a hawkish rhetoric, which will stave off a real surge by inflation and will limit the metal's appeal. It will also be interesting to see how real demand will respond to prices that are over US\$800. Note that the last surge by gold prices in 2006 caused demand for jewellery to tumble in India. As with oil, gold prices will certainly remain high historically speaking, but should come back well below current levels.

François Dupuis
 Vice-President and Chief Economist

Mathieu D'Anjou
 Economist

ENERGY

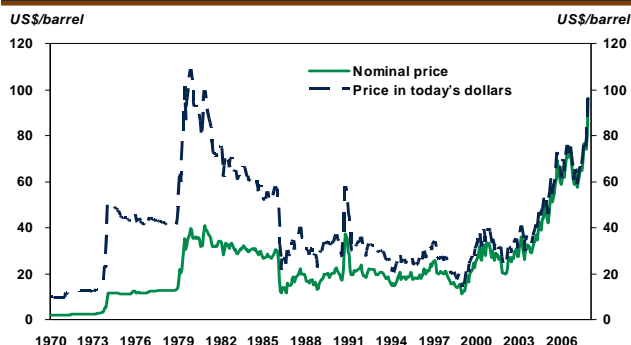
Oil prices jumped close to \$100

- Oil prices recently soared to set a new record, at close to US\$100/barrel. They are now up 55% since the year began. Even after taking inflation into account, the real price per barrel is near its historic peak, set in 1979 during the last oil crisis (Graph 8).
- Oil prices will remain high in the near term. The weak U.S. dollar, the drop in crude inventories, and fears of a shortage will continue to support the price of black gold in the next several months.
- After that, oil prices should come back down somewhat as the dollar stops tumbling and the risks of a shortage ease. Moderate U.S. economic growth and high prices should limit oil demand growth next year as the Organization of the Petroleum Exporting Countries (OPEC) will raise its production.
- Natural gas prices will also remain relatively weak, as U.S. inventories remain high. The increase in futures prices, however, shows that an increase is likely over the next few months, unless North America has a very mild winter (Graph 9).
- Following a sharp correction since the summer, uranium prices have gone back on a rising trend recently. For now, the increase is much less spectacular than at the beginning of the year, but it tends to confirm that this energy source could remain expensive (Graph 10). Demand for uranium should benefit from heightened use of nuclear energy over the mid- and long-term.

Forecasts

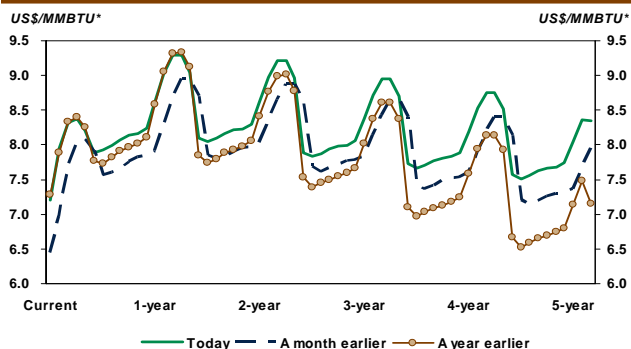
We expect the rise by oil prices to conclude in the next few months, with the barrel coming back to about US\$80. Natural gas, for its part, should near US\$8 per million BTU (British Thermal Unit) next year.

Graph 8 – Even in real terms, oil is no longer far from its peak



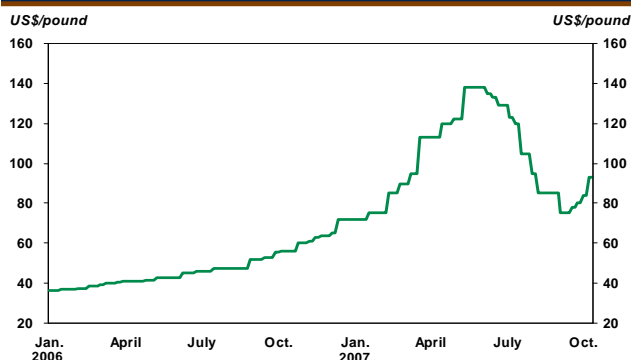
Sources: Datastream and Desjardins, Economic Studies

Graph 9 – Futures point to an increase in natural gas prices



* Million British Thermal Unit.
Sources: Bloomberg and Desjardins, Economic Studies

Graph 10 – Uranium has started to climb



Sources: Bloomberg and Desjardins, Economic Studies

PRECIOUS METALS

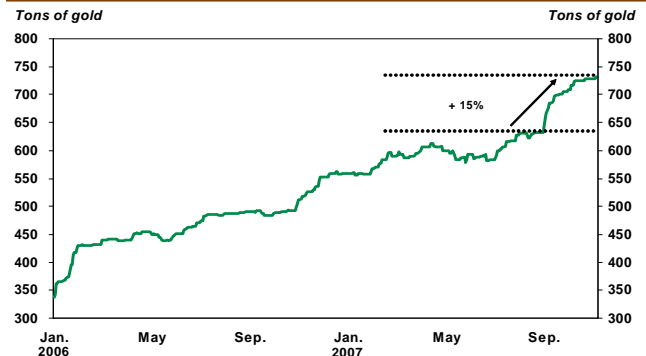
Gold is taking the other metals up

- Gold prices went over US\$840 in November, for a better than 30% gain since the year began. Contrary to oil, the yellow metal is still quite far from its historic record. In today's dollars, in 1980, an ounce of gold was trading in the neighbourhood of US\$2,000. It would be very surprising to see these levels again in the next few years.
- The recent surge by gold prices is in large part due to stronger investor demand. In addition to taking speculative positions using derivatives, investors have used exchange traded funds (ETF) to benefit from gold's rise. The amount of gold held in ETFs thus jumped to a peak in the last few weeks (Graph 11).
- The surge by gold prices helped prices for other precious metals. Investors took major speculative positions on silver, platinum and palladium (Graph 12), which was reflected in these metals' prices.
- Although it has not been in the spotlight as much, silver's price has shot up just as fast as gold's price in the last few months (Graph 13). The ratio of gold and silver prices is currently below its average for the last few years. Silver thus does not seem as attractive as gold at this time.
- Due to the recent price increases, platinum has managed to set a new peak, at \$1,472/oz. At about \$370 an ounce, palladium is well below its record \$1,090 an ounce set in 2001.

Forecasts

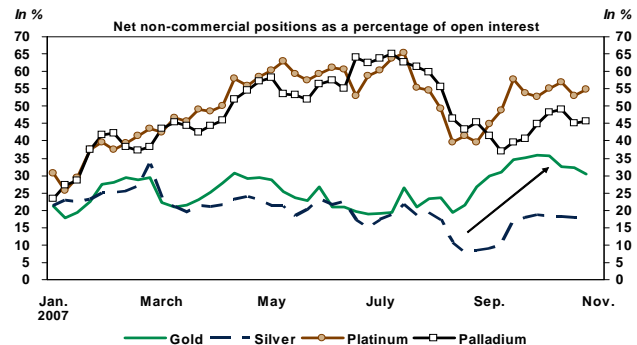
Like gold, all precious metals could continue to appreciate somewhat in the near future. However, current prices will be hard to sustain, and a correction is possible at some point in 2008 when speculators will shift toward other assets that have become more appealing.

Graph 11 – Increasingly, gold is being held in exchange traded funds



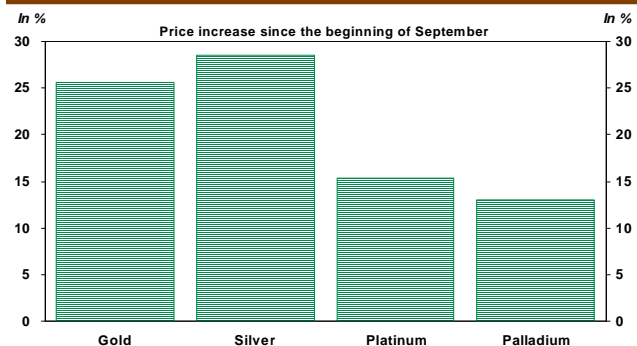
Sources: Exchange Traded Gold and Desjardins, Economic Studies

Graph 12 – Speculative positions have increased since the beginning of September



Sources: Bloomberg and Desjardins, Economic Studies

Graph 13 – Precious metals have shot up in recent months



Sources: Datastream and Desjardins, Economic Studies

BASE METALS

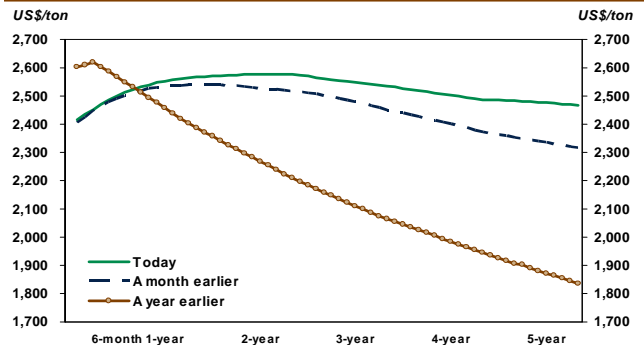
Prices could fall next year

- Overall, base metals have not delivered impressive performance in the last few months. Fears of a slowdown by global demand as the economic outlook dims, especially in the United States, and an increase in inventories have kept metals prices from taking full advantage of the U.S. dollar's tumble.
- The price of copper has thus recently come back down to close to US\$7,000 a tonne, as demand for the metal has shown some signs of softness. Some labour conflicts have been resolved, suggesting that mining output will increase.
- Despite some gains in the last few weeks, aluminium prices are fairly soft, below where they were 12 months ago. This is not surprising given the substantial increase in inventories in the last year. However, prices for long-term futures have gone up lately, a sign that there is some potential for this metal to appreciate over the longer term (Graph 14).
- The surge in inventories is especially striking in the case of nickel. The tumble by demand for stainless steel, the primary use for the metal, has pushed nickel inventories to their highest level in 7 years. Under these circumstances, the price did fairly well in staying over US\$30,000 a tonne (Graph 15).
- While some concerns have emerged regarding demand for base metals, the problem does not come from China. Chinese metal imports are showing strong growth since the beginning of 2007 (Graph 16).

Forecasts

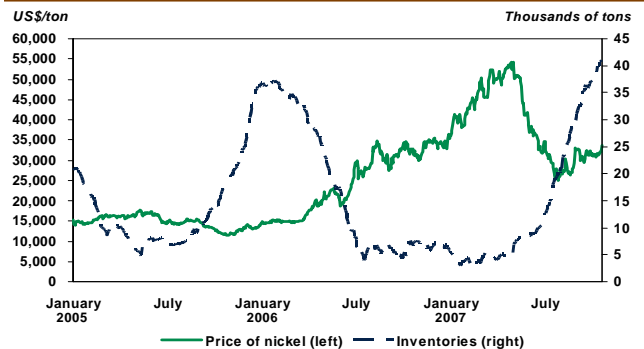
The uncertainty as to how global demand will evolve should cause slower appreciation or even a pullback by prices for most metals in the next few months. However, a sharp correction would be surprising as long as China's runaway economic growth continues to support demand.

Graph 14 – Futures have upgraded future aluminium prices



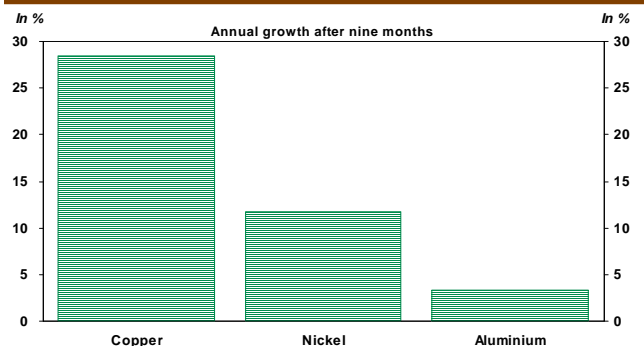
Sources: Bloomberg and Desjardins, Economic Studies

Graph 15 – The rise in inventories limits nickel's appreciation



Sources: Datastream and Desjardins, Economic Studies

Graph 16 – China continues to increase its imports of most base metals



Sources: Bloomberg and Desjardins, Economic Studies

AGRICULTURAL COMMODITIES

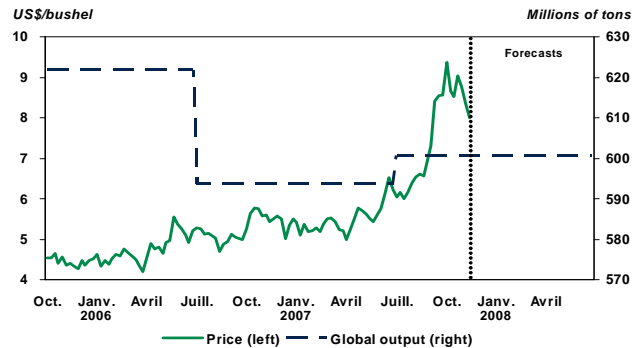
The surge by wheat prices could be over

- The increase in grain prices, especially wheat, and the resulting inflation fears grabbed observers' attention in recent months.
- The price of wheat per bushel jumped by almost 50% between the beginning of August and October 1, reaching a historic high of US\$9.37. Unlike what has happened with several other commodities, the reason for the increase in wheat prices is not a surge by demand but rather two consecutive years of poor harvests. Thus, the United States Department of Agriculture forecasts that global wheat stocks will be at their lowest level in 30 years at the end of the 2007-2008 season (Graph 17).
- However, farmers are able to adjust quickly. It thus appears that the rise by wheat prices will cause a sharp increase in wheat seeding next year, as recently occurred with corn. This should help refill the silos. As a result, the price of wheat started to edge down at the beginning of the month, and we believe the downward trend will continue for some time.
- As the total amount of farmland is relatively fixed over the short term, we can expect other crops to benefit from wheat's new popularity. For now, movement by noncommercial positions indicates that speculators have primarily turned to soybean (Graph 18). Note that demand for this foodstuff, which China must import in growing quantities, has good growth potential.
- The Baltic Dry Index, an index of dry commodities maritime shipping costs, reached a record level recently (Graph 19). This surge in transportation costs is also boosting food prices.

Forecasts

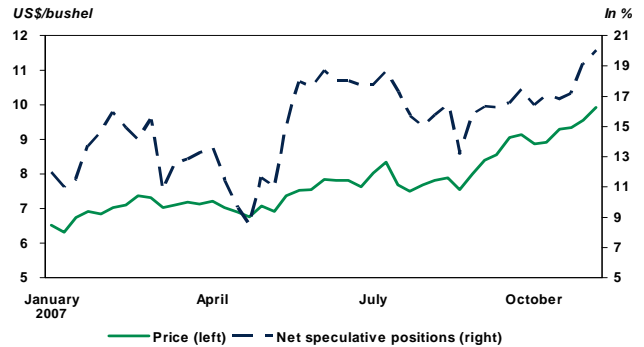
The price of wheat should continue to slide somewhat, but will remain very high, historically speaking. Prices for other grains will also stay high.

Graph 17 – The decline of wheat harvests has driven prices



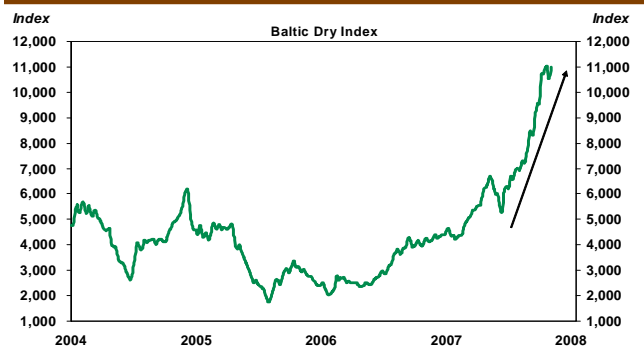
Sources: Datastream and Desjardins, Economic Studies

Graph 18 – Soybean prices and speculation have increased in the last few weeks



Sources: Datastream, Bloomberg and Desjardins, Economic Studies

Graph 19 – The cost of shipping is climbing rapidly



Sources: Datastream and Desjardins, Economic Studies

Table 2 Commodities

	Spot price	Previous data				Last 52 weeks		
	Nov-14	-1 month	-3 months	-6 months	-1 year	Higher	Average	Lower
Energy								
Crude oil (US\$/barrel)	94.1	83.7	72.4	62.5	58.3	96.4	68.2	50.5
Gasoline (US\$/gallon)	3.1	2.8	2.8	3.1	2.2	3.2	2.7	2.2
Natural gas (US\$/MMBTU*)	7.3	6.6	6.9	7.9	7.5	9.0	6.9	5.4
Uranium (US\$/pound)	93.0	75.0	120.0	120.0	60.3	138.0	95.5	60.3
Precious metals								
Gold (US\$/ounce)	808.4	747.9	668.8	668.9	620.9	845.0	674.6	604.0
Silver (US\$/ounce)	15.0	13.8	12.8	13.2	12.9	15.8	13.2	6.0
Platinum (US\$/ounce)	1,440.0	1,416.0	1,272.0	1,329.0	1,186.0	1,472.0	1,262.5	1,104.0
Palladium (US\$/ounce)	371.0	377.0	350.0	363.0	322.0	382.0	350.9	314.0
Base metals								
Aluminium (US\$/ton)	2,553.5	2,428.5	2,527.5	2,804.8	2,708.5	2,952.5	2,681.8	2,316.3
Copper (US\$/ton)	7,020.5	8,099.8	7,695.0	7,905.5	6,966.0	8,300.5	7,134.8	5,225.3
Nickel (US\$/ton)	33,402.5	31,802.5	27,797.5	53,150.0	31,275.0	54,150.0	38,025.0	25,052.5
Zinc (US\$/ton)	2,681.3	3,105.3	3,340.5	4,023.3	4,302.5	4,619.3	3,506.3	2,639.8
Tin (US\$/ton)	16,922.5	16,252.5	15,047.5	14,412.5	10,022.5	16,922.5	13,798.8	9,637.5
Lead (US\$/ton)	3,579.5	3,894.3	3,120.5	2,057.5	1,536.0	3,977.5	2,441.7	1,469.5
Agricultural commodities								
Wheat (US\$/bushel)	7.85	8.77	6.77	5.50	5.45	9.37	6.27	4.97
Corn (US\$/bushel)	3.51	3.21	3.06	3.41	3.45	4.13	3.46	2.82
Soybean (US\$/bushel)	10.11	9.24	7.90	7.28	6.40	10.11	7.62	6.27
CRB** Livestock index	423.1	429.4	445.7	445.7	356.6	468.3	421.7	356.6

*Million British Thermal Unit; ** Commodity Research Bureau.
Note: Currency table base on previous day closure.

Table 2 Commodity prices: History and forecasts

	2005	2006	2007 ^f	2008 ^f
Annual average				
WTI* oil (US\$/barrel)	56.58	66.11	Target: 72 (range: 70 to 75)	Target: 80 (range: 70 to 95)
Natural gas Henry Hub (US\$/MMBTU**)	8.92	6.73	Target: 7.00 (range: 6.90 to 7.15)	Target: 8.00 (range: 7.00 to 9.50)
Gold (US\$/ounce)	445.31	604.42	700	815
CRB*** index—base metals	371.43	605.85	Target: 865 (range: 855 to 875)	Target: 840 (range: 800 to 900)

f: forecasts

* West Texas Intermediate; ** Million British Thermal Unit; *** Commodity Research Bureau.

Sources: Datastream and Desjardins, Economic Studies