

## The surge in agricultural prices raises fears of a humanitarian crisis

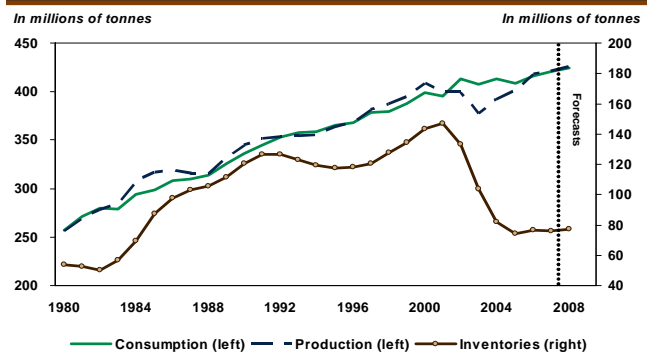
The euphoria surrounding the commodities market has taken a worrisome turn in the last few weeks. The surge in grain prices has spread to rice, raising fears of a worldwide food catastrophe. We will look at this issue in detail in an *Economic Viewpoint* in a few weeks, but here are some preliminary observations.

After having been relatively stable, the price of rice has nearly tripled in the last year. The main problem is that global rice production has been lower than global consumption since the early part of this decade, causing inventories to fall fairly sharply. Poor weather and heightened competition from other, more lucrative crops, whose demand has been inflated by, among other things, the production of biofuel, have limited the production of rice. The increase in energy and fertilizer prices has also driven up production costs, justifying an increase in the price demanded by rice producers.

However, much of the rise is a direct result of panic and debatable responses from some governments. The many countries that have limited grain exports to favour local consumers have made the supply on the global market even smaller and magnified the price rise. What's more, these restrictions, and the imposition of price ceilings, keep production from responding fully to the surge in food prices. It also appears that many citizens and speculators are starting to stock up on rice, creating artificial demand.

The risks of a real rice shortage seem fairly low, however (Graph 1): global output has been back on an upward trend for the last few years, and inventories should rise slightly in 2008. The rapid rise in food prices is a serious problem for some developing nations, however.

**Graph 1 – After a few rough years, global rice production has started to climb**



Sources: U.S. Department of Agriculture and Desjardins, Economic Studies

Overall, commodity prices have gone up again slightly in the last month, but some corrections could show that fundamentals are once again starting to have a bigger influence on prices.

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**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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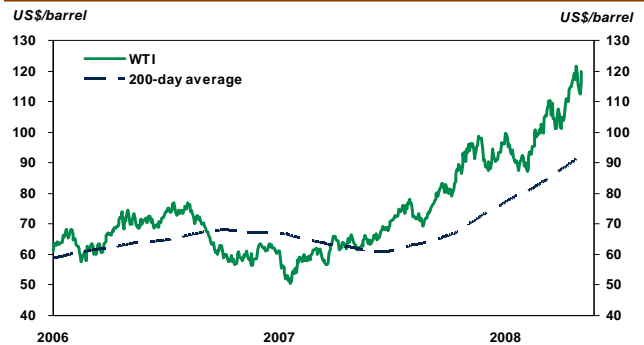
# ENERGY

## Production problems are holding sway over the slowdown in demand for oil

### OIL

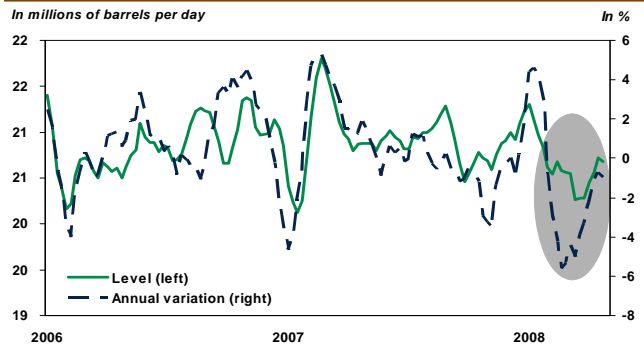
- Movement by oil prices has been the same over the last few weeks: great volatility and new peaks. Another psychological threshold was crossed on April 25, when WTI (West Texas Intermediate) closed trading over US\$120/barrel. In the days that followed, oil quickly retreated toward US\$110 and then bounced back over US\$120 this week (Graph 2).
- The problems some oil exporters are dealing with have a big influence on prices. Another disappointing month for production in Russia and strikes in Scotland and Nigeria reined in the oil supply and helped the price per barrel get to US\$120. The labour conflicts were quickly settled and black gold has started to flow through the pipelines once again. Attacks by Nigerian rebels have intensified lately, however, and could have a more lasting impact on oil output by Africa's biggest producer.
- Record crude prices and the economic slowdown are continuing to rein in consumption in industrialized nations, however, and, sooner or later, this should make oil prices moderate. In its latest monthly report, the IEA (International Energy Agency) once again slashed its projections for global demand in 2008, as U.S. consumption of petroleum products is down sharply since the beginning of the year (Graph 3). For now, strong demand from emerging nations is absorbing much of the drop in industrialized countries, but there is nothing to show that these countries will be immune from the global economic slowdown.
- OPEC (Organization of Petroleum Exporting Countries) seems determined to hold production steady despite the skyrocketing prices. Producer nations think that the price increase is not a reflection of an inadequate oil supply, but rather of excessive speculation that primarily stems from the weak U.S. dollar. According to OPEC's president, a 1% drop in the value of the greenback would lead to a \$4 increase in the price of oil per barrel. This relationship seems to have been true for a while but, historically, the relationship between the dollar and the price of crude has been highly unstable (Graph 4).
- Our own research confirms that, contrary to the trend of the last few years, the surge by crude prices since the start of this year cannot be explained by fundamentals.<sup>1</sup> The current price would thus reflect a speculation and risk premium of more than US\$20/barrel. It is very difficult to predict how this premium will evolve in the months to come.

Graph 2 – Price of oil per barrel



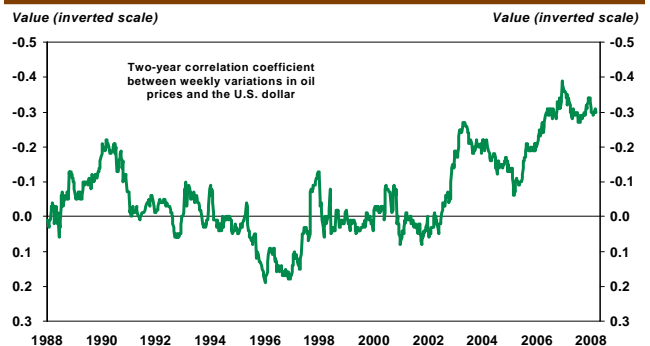
Sources: Datastream and Desjardins, Economic Studies

Graph 3 – U.S. consumption of petroleum products is down since the beginning of the year



Sources: Energy Information Administration and Desjardins, Economic Studies

Graph 4 – The relationship between crude prices and the U.S. dollar varies a lot



Sources: Datastream and Desjardins, Economic Studies

<sup>1</sup> See the *Economic Viewpoint*, «Are current oil prices justified?» April 30, 2008.

## GASOLINE

- The average retail price for gas is still climbing; a new record of US\$3.60/gallon was set last week in the United States (Graph 5). The strength of gas prices in the United States is a direct result of exploding crude prices, as gas inventories are big enough and demand is low. The EIA (Energy Information Administration) is thus forecasting a drop in gas consumption in 2008, for the first time since 1991.

## NATURAL GAS

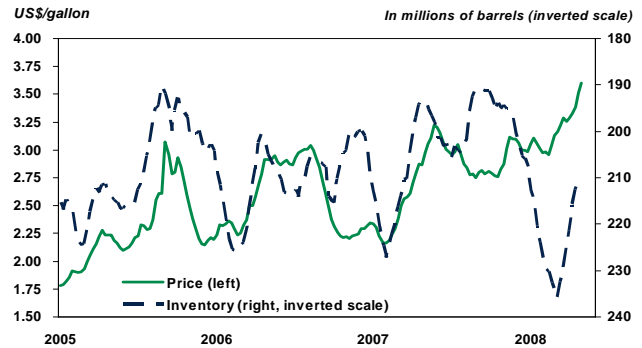
- Natural gas prices continued to go up in the last few weeks, even crossing US\$11/MMBTU (Million British Thermal Unit) (Graph 6). The surge in petroleum product prices and relatively low U.S. natural gas inventories after an especially tough winter are behind the rapid appreciation seen in the last few months. In addition, imports of liquefied natural gas are in sharp decline compared with last year.
- The latest news has been less favourable to natural gas prices, however. Although most had feared a decline, U.S. natural gas output has instead edged up since the beginning of 2008, which will help to meet demand. What's more, the inventory replenishment season has gotten off to a good start, limiting the risks of a shortage next winter.

## URANIUM

- Contrary to what is happening in the rest of the energy sector, the trend for uranium prices is still clearly down. Another 8.5% decrease in the last month took the price of uranium to US\$65/pound, for a decrease of more than 50% from the June 2007 peak (Graph 7). The drop in prices has slowed in the last few weeks, however, which could indicate that we are nearing bottom. Weak immediate demand is the main problem facing uranium sellers.

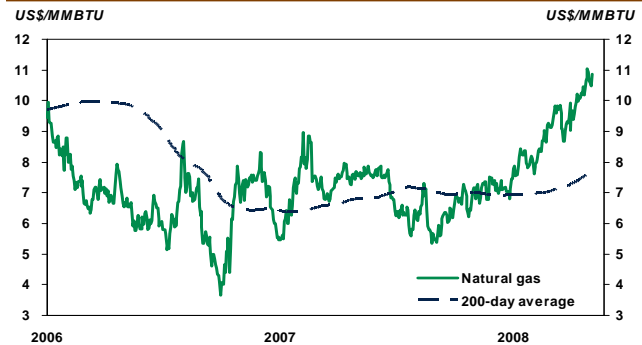
**Forecasts:** Although it is very hard to predict what will happen with geopolitical tensions and the euphoria that is currently inflating crude prices, we still believe that the price of oil should start to go down soon, to better reflect the slowdown in global demand. We think the most likely scenario is a return below US\$100/barrel in the medium term. The risks, however, appear increasingly on the upside. Natural gas prices should also moderate somewhat, but will remain close to US\$10/MMBTU until inventories get back to more comfortable levels.

Graph 5 – Prices and inventories of gasoline



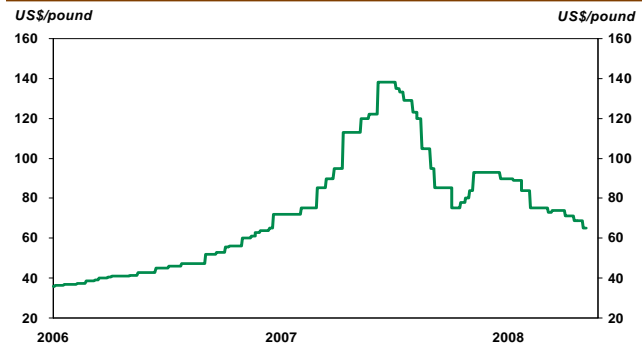
Sources: Energy Information Administration and Desjardins, Economic Studies

Graph 6 – Natural gas prices



Sources: Datastream and Desjardins, Economic Studies

Graph 7 – Uranium prices



Sources: Datastream and Desjardins, Economic Studies

# BASE METALS

## Is this the start of a downward trend?

Overall, base metal prices have pulled back slightly in the last few weeks. The decline is in line with our expectations that the global economic slowdown will end up affecting both demand and prices for industrial metals. For now, the slide is a small one, and the LME index (London Metal Exchange Index) is still well above where it ended in 2007, though down slightly from the same period last year (Graph 8). Over twelve months, evolution by prices for primary base metals is very divergent. Aluminium and copper have recorded slight gains in the last year, while nickel and copper prices have tumbled by almost 50%, and lead and in particular tin prices are up sharply.

### ALUMINIUM

- The price of aluminium continued to fluctuate around US\$3,000/tonne in the last few weeks, although the latest news was rather unfavourable (Graph 9). Global demand grew in the first quarter due mainly to China, but production went up even more quickly, despite the problems with the electrical supply. According to the WBMS (World Bureau of Metal Statistics), the global aluminium production surplus reached 186,800 tonnes in the first three months of 2008, compared with 25,000 tonnes at the same time last year. Note that, after a tough start to the year, Chinese production rebounded sharply in March; this nation remained a net aluminium exporter in the first quarter.
- The substantial surge in aluminium production costs and persistent fears that the power shortages at smelters will once again cut production are supporting the metal's price, however.

### COPPER

- It's still the same story for copper: very low inventories and production problems are keeping the price very high, despite the slowdown in demand. The U.S. dollar's comeback has temporarily pushed copper's price per tonne below US\$8,500, but the trend is still generally upward (Graph 10). The latest problem to hit copper production is a partial strike that started in mid-April at the Chilean firm Codelco, the world's biggest copper producer. This conflict seems to be settled now, which should ease the fears of a shortage.

Graph 8 – LME index of the prices of base metals



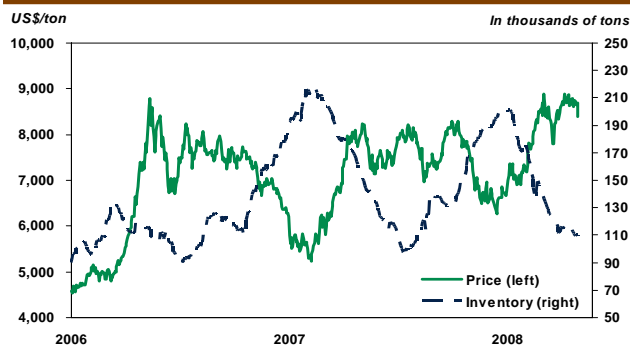
Sources: Datastream and Desjardins, Economic Studies

Graph 9 – Aluminium prices and inventories



Sources: Datastream and Desjardins, Economic Studies

Graph 10 – Copper prices and inventories



Sources: Datastream and Desjardins, Economic Studies

## NICKEL

- Nickel's price has not been very volatile in the last few weeks, staying close to US\$28,000/tonne (Graph 11). The price explosion in early 2007 that had driven it close to US\$55,000/tonne seems remote at this point, and the price has come down by almost 50% since then. Note that nickel inventories are now more than ten times bigger than they were then. What's more, global demand for nickel fell by about 8% in the first two months of 2008 from the same time last year.

## ZINC

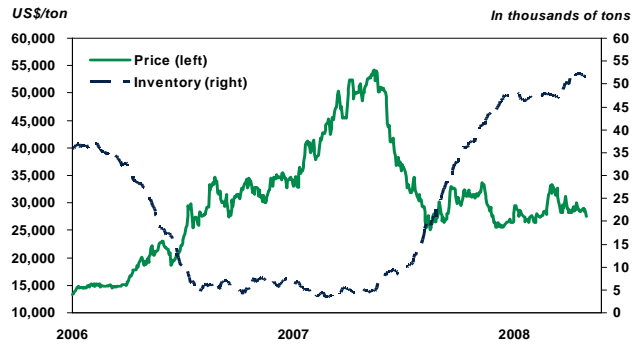
- Zinc prices continued to pull back, declining 3% in the last month (Graph 12). At about US\$2,200/tonne, the price of zinc is now near a low point that dates back more than two years. Global zinc production should continue to go up in the next few months and inventories will continue to climb. The price's current level already reflects much of this unfavourable movement, however, and could soon stabilize.

## TIN AND LEAD

- Lead is the metal that has recorded the biggest depreciation in the last month (-11%). Slower growth by Chinese demand and the solving of most of the problems that hindered mining output in 2007 should push the global lead market from a deficit to a slight surplus this year. This means inventories should continue to rise and put downward pressures on prices.
- The persisting problems of tin producers helped the metal record another jump of over 15% in the last month, while most other base metals were posting declines (Graph 13). The news from China remains very positive for tin, and the substantial drop in output in this country in the first quarter means that it should remain a net tin importer in the short term.

**Forecasts:** If it firms up in the next few months, the slower growth by Chinese demand could augur a fairly substantial downward trend for base metal prices. For now, prudence is in order, as the harsh weather early this year in China could have had a major impact on the statistics. The very different global supply-demand situations could translate into other divergent movements by individual base metal prices.

### Graph 11 – Nickel prices and inventories



Sources: Datastream and Desjardins, Economic Studies

### Graph 12 – Zinc prices and inventories



Sources: Datastream and Desjardins, Economic Studies

### Graph 13 – Tin and lead prices



Sources: Datastream and Desjardins, Economic Studies

# PRECIOUS METALS

## Has gold fever burned itself out?

The pullback by precious metal prices that started halfway through March continued in the last few weeks, as the global economic and financial context soured for this asset category.

### GOLD AND SILVER

- The price of gold continued to move downward, descending close to US\$850/ounce, its lowest level since last January 1 (Graph 14). Some of the trends that had propelled gold prices early this year have faded lately. Investors' fears have lessened and they are now starting to move away from safe-haven securities toward riskier assets. It also appears that the U.S. Federal Reserve will soon put an end to its monetary easing, if it has not already done so, which could mean the end of the greenback's slide. One hope for gold prices is that the markets' renewed optimism seems a little premature and a little bad news could quickly drive gold's appeal back up. Moreover, inflation pressures are still substantial worldwide, which limits the decline by gold's price.
- Silver's price has also fallen over the last few weeks. At US\$16.7/ounce, silver is down by about 20% from its mid-March peak (Graph 15). The drop, bigger than gold's, is not surprising given the rapid growth in silver production.

### PLATINUM AND PALLADIUM

- Platinum and palladium have also depreciated lately (Graph 16). A limited supply and strong industrial demand are limiting platinum's price decrease; platinum is up almost 50% in the last year, compared with 25% for gold and silver, and only 15% for palladium. Palladium has undergone a violent correction of almost 30% from its peak: no surprise, as the fundamentals, especially global supply and demand, did not justify its fiery rise early this year.

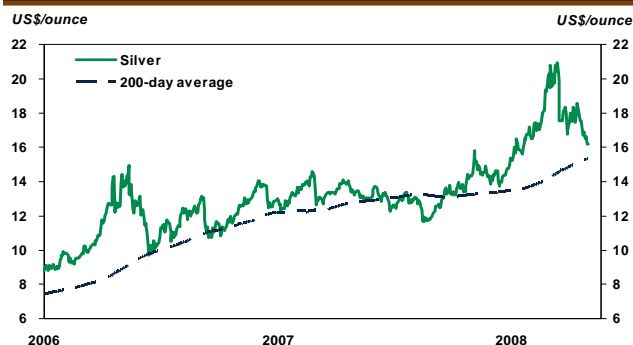
**Forecasts:** If investors' renewed optimism proves lasting and the worst of the credit crisis is really behind us, it would be surprising if precious metal prices were to rebound quickly to where they were at mid-March. However, the economic difficulties could be more protracted than the markets think, and the authorities might have to continue with monetary easing in the second half of the year. This could help push gold up near US\$1,000/ounce.

Graph 14 – Gold prices



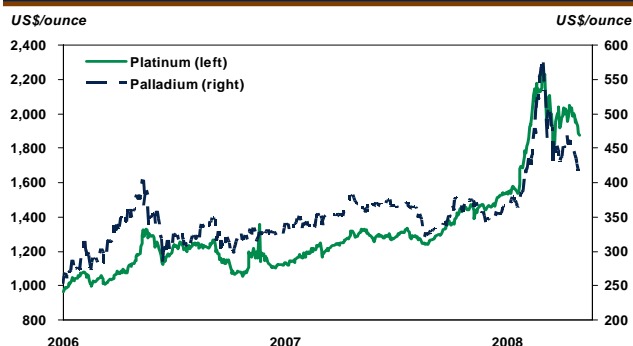
Sources: Datastream and Desjardins, Economic Studies

Graph 15 – Silver prices



Sources: Datastream and Desjardins, Economic Studies

Graph 16 – Platinum and palladium prices



Sources: Datastream and Desjardins, Economic Studies

# AGRICULTURAL COMMODITIES

## A larger supply will limit gains

As we discussed in the abstract, the surge by grain prices has taken a worrisome turn and there are widespread fears of a shortage. However, the response from supply is starting to be felt, which should gradually ease concerns.

### WHEAT

- Wheat prices continued to moderate in the last few weeks, as other major producers (Canada, Australia) expect substantial increases in production of this grain in 2008, along with the United States. At about US\$9.15 a bushel, wheat has lost almost 35% of its value from its February 27 peak (Graph 17). The weakness of global stocks and the high price of other grains will limit the decline in the price of wheat.

### CORN AND SOYBEAN

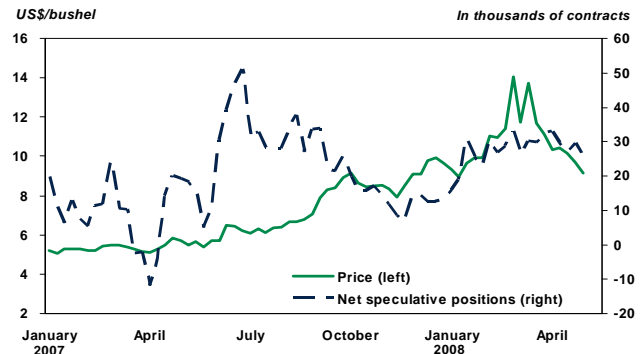
- Strong demand from the ethanol industry and poor weather that is delaying seeding and could limit output this year have allowed corn prices to remain above US\$5.50 a bushel (Graph 18). Despite the major boost in soybean production that is anticipated, its price is still very elevated (Graph 19). Sustained growth by global demand, for biofuel production, among other things, is still helping this grain.

### LIVESTOCK

- Despite the substantial increase in livestock feed costs and growth by demand in some emerging nations, livestock prices have not gone up as much as other agricultural commodities. The U.S. Department of Agriculture is even predicting that prices could come down slightly in the near term. Note that the first outcome of a major surge in livestock production costs is an increase in slaughtering, to decrease herds. This creates a surge in the meat supply and limits price increases. However, expect a fairly large price increase once the transition period is over.

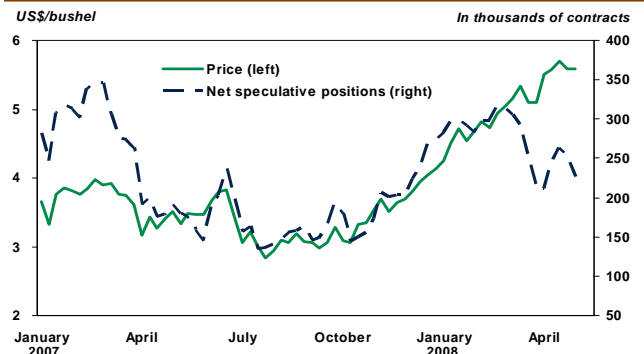
**Forecasts:** Grain prices will remain high over the near term, especially corn and soybean, which will benefit from a major surge in global demand. The potential for further gains appears limited, however. Over the medium term, the increase in food prices should also lead to a substantial rise of meat prices.

Graph 17 – Wheat prices and speculation



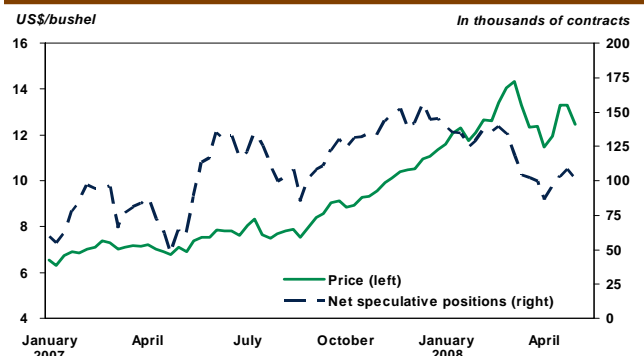
Sources: Datastream, Bloomberg and Desjardins, Economic Studies

Graph 18 – Corn prices and speculation



Sources: Datastream, Bloomberg and Desjardins, Economic Studies

Graph 19 – Soybean prices and speculation



Sources: Datastream, Bloomberg and Desjardins, Economic Studies

### Table 1 Commodities

	Spot price	Percentage return since					Last 52 weeks		
	May-6	1 month	3 months	6 months	1 year	High	Average	Low	
<b>Index</b>									
Reuter-CRB* (CCI**)	543.5	3.1	7.3	18.5	33.9	576.0	463.6	398.1	
Reuters/Jefferies CRB*	418.5	5.9	14.9	17.7	34.5	422.1	349.0	299.8	
Dow Jones AIG***	212.7	3.9	11.6	15.0	22.1	219.1	184.2	161.1	
<b>Energy</b>									
Crude oil (US\$/barrel)	121.8	17.3	39.8	29.6	96.7	121.8	86.9	61.5	
Gasoline (US\$/gallon)	3.61	9.8	21.3	19.9	21.6	3.61	3.04	2.75	
Natural gas (US\$/MMBTU****)	11.12	18.6	40.4	54.4	47.2	11.12	7.59	5.35	
Uranium (US\$/pound)	65.0	-8.5	-13.3	-22.6	-42.5	138.0	95.5	65.0	
<b>Precious metals</b>									
Gold (US\$/ounce)	879.6	-2.9	-2.8	6.8	27.4	1,011.6	786.7	642.5	
Silver (US\$/ounce)	16.7	-4.3	1.3	11.6	24.6	20.9	14.8	6.4	
Platinum (US\$/ounce)	1,940.0	-2.5	7.0	31.8	48.0	2,273.0	1,539.4	1,240.0	
Palladium (US\$/ounce)	425.0	-3.0	1.9	13.0	13.6	582.0	386.0	320.0	
<b>Base metals</b>									
Aluminium (US\$/ton)	2,880.8	1.2	11.2	11.6	2.8	3,174.5	2,633.5	2,316.3	
Copper (US\$/ton)	8,620.0	-0.3	20.0	15.4	4.8	8,884.3	7,662.3	6,272.3	
Nickel (US\$/ton)	28,307.5	-1.5	7.2	-10.3	-46.1	54,150.0	32,074.0	25,052.5	
Zinc (US\$/ton)	2,214.0	-3.0	-7.1	-20.0	-45.9	4,119.8	2,859.8	2,145.5	
Tin (US\$/ton)	23,475.0	17.8	40.8	39.6	64.1	24,152.5	16,536.6	13,572.5	
Lead (US\$/ton)	2,580.5	-11.2	-7.7	-31.8	24.1	3,977.5	2,928.9	1,992.5	
<b>Agricultural commodities</b>									
Wheat (US\$/bushel)	9.16	-15.1	-17.2	8.6	61.9	14.07	8.57	5.34	
Corn (US\$/bushel)	5.51	-2.4	15.9	48.8	54.6	5.73	3.99	2.82	
Soybean (US\$/bushel)	12.41	1.9	-1.6	25.0	77.1	14.88	10.12	6.92	
CRB* Livestock index	507.2	9.9	17.0	19.1	15.4	510.6	447.0	391.7	

\*Commodity Research Bureau; \*\* Continuous Commodity Index; \*\*\* American International Group; \*\*\*\*Million British Thermal Unit.  
Note: Currency table base on previous day closure.

### Table 2 Commodities prices: History and forecasts

	2006	2007	2008 <sup>f</sup>	2009 <sup>f</sup>
Annual average				
WTI* oil (US\$/barrel)	66	72	Target: 97 (range: 90 to 105)	Target: 88 (range: 80 to 100)
Natural gas Henry Hub (US\$/MMBTU**)	6.73	6.97	Target: 9.00 (range: 8.00 to 10.00)	Target: 9.50 (range: 8.50 to 10.50)
Gold (US\$/ounce)	604	697	Target: 950 (range: 900 to 1,000)	Target: 925 (range: 850 to 1,000)
LMEX*** index—base metals	3,396	3,847	Target: 3,800 (range: 3,700 to 4,000)	Target: 3,600 (range: 3,400 to 3,800)

f: forecasts; \* West Texas Intermediate; \*\* Million British Thermal Unit; \*\*\* London Metal Exchange Index.  
Sources: Datastream and Desjardins, Economic Studies