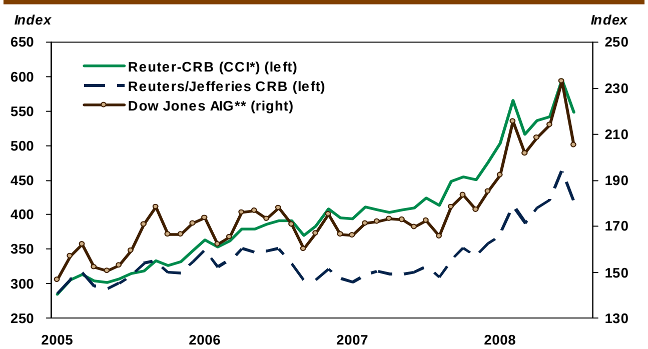
Commodity Trends
Desjardins Economic Studies
www.desjardins.com/economics
August 6, 2008

Most commodity prices decline sharply

The last few weeks have been difficult for the commodity market where several factors—mostly the many signs that the economic slowdown will be prolonged and felt the world over—led to sharp declines in the prices of several commodities. The main price indexes for raw materials declined significantly across the board in July (graph 1) and the 10% drop posted by the Reuters/Jefferies CRB (Commodity Research Bureau) is its worst monthly performance in more than 25 years.

Graph 1 – Sharp declines in commodity price indexes



* Continuous Commodity Index; ** American International Group.
Sources: Datastream and Desjardins, Economic Studies

And yet July had been off to a good start. Declines in the stock markets and new fears of a meltdown in the U.S. financial system incited investors to flee from the greenback and turn to raw materials instead. As such, the price of many commodities, including oil and some grains, hit new highs during the first weeks of July. A rebound in the U.S. dollar and statistics confirming that the economic slowdown and surging prices these past few years have curbed demand for several commodities nevertheless led to sharp price declines. These elements could very well exert downward pressures on resource prices in the short term.

The measures put in motion by several politicians, especially in the United States, to limit and better control speculators' activities on the commodities markets, particularly for crude oil, could very well have contributed to these price declines. While most legislative measures up to now have yet to see the light of day, they have created serious uncertainty for investors and they seem to have already dampened speculative demand. In fact, the open interest on the major commodities declined by about 7% between the start of June and the end of July.

Energy and grain prices, which had both surged over the past few months, suffered the hardest corrections, but most metal prices had declined as well.

François Dupuis
Vice-President and Chief Economist

Mathieu D'Anjou
Senior Economist

Contents

Summary 1
Energy 2
Base metals 4
Precious metals 6
Agricultural commodities 7
Tables 8

François Dupuis
Vice-President and Chief Economist

Yves St-Maurice
Director and Deputy Chief Economist

Mathieu D'Anjou
Senior 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.

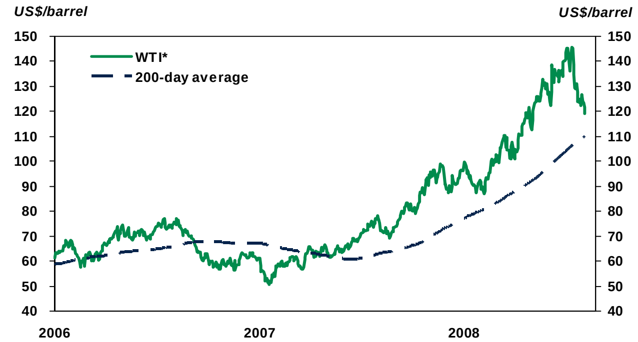
ENERGY

Is the surge in energy prices just a bad memory?

OIL

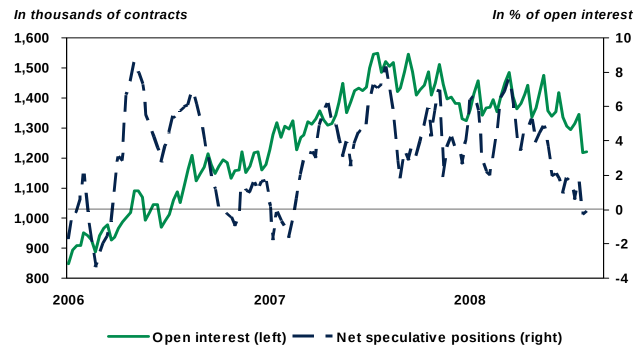
- Oil prices seem to have hit their peak. After flirting with US$150 a barrel in mid-July, the price of a barrel of crude quickly retreated to under US$120 in the following weeks (graph 2). The correction could have been more severe if were it not for new tensions between Iran and Israel.
- The recent drop in the price of black gold reflect the weakness in global demand for oil as a growing number of major countries are feeling the impact of the economic slowdown. The effect of exploding prices on consumption is also increasingly visible, especially in the United States where demand for oil-based products is continuously revised downward and where a substantial drop of 700,000 barrels per day has been posted since the start of 2008, compared with last year.
- For the moment, the drop in demand in developed countries is being offset by increased demand in emerging countries. However, increases in retail prices announced by the governments of several Asian countries at the beginning of summer and the global effects of the economic slowdown should eventually slow demand for oil in these same countries. Overall, the International Energy Agency (IEA) anticipates a modest increase of approximately 1% in worldwide demand for oil in both 2008 and 2009, and it is our opinion that the risks related to this forecast are on the downside.
- The reversal of investor sentiment following the recent drops in oil prices and the threats of new restrictions to stop speculation also contributed to the price correction. Net speculative positions on futures have become negatives and open interest has fallen sharply in the past few weeks while many investors deserted oil (graph 3).
- Some factors continue however to support black gold which should limit price declines. On the one hand, geopolitical risks should remain at the forefront while there's no end in sight to the rebel attacks in Nigeria or to Iran's nuclear program. On the other hand, even though weak demand makes a shortage in the short term highly unlikely, the situation over the long haul remains worrisome. The medium-term report issued by the IEA, published on July 1, anticipates that the oil market will tighten as of 2011 when growth in demand for oil will outstrip supply (graph 4).

Graph 2 – Price of oil per barrel



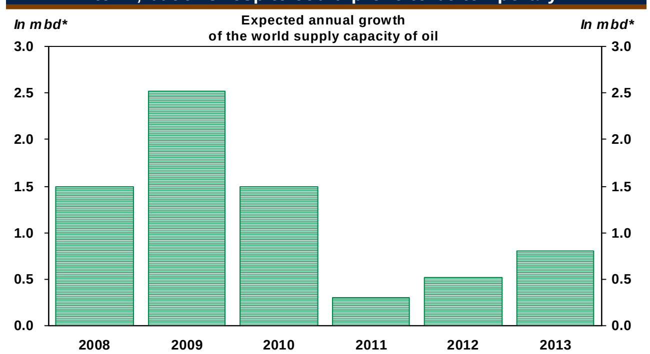
* West Texas Intermediate.
Sources: Datastream and Desjardins, Economic Studies

Graph 3 – Investors reduced their speculative positions on oil



Sources: Bloomberg and Desjardins, Economic Studies

Graph 4 – World crude oil market should calm down in the short term, but this respite could prove to be temporary



* Millions of barrels per day.
Sources: International Energy Agency and Desjardins, Economic Studies

GASOLINE

- The decline in crude oil prices had a ripple effect on other oil-based products. In the United States, after breaking US$4.10 a gallon at the beginning of July, the per-gallon price fell back under $4. While modest at the moment, this price drop could continue given the weak demand for gas. Motorists in the United States have reduced their driving in the past few months compared with the same period last year, a first in more than 20 years (graph 5). Despite the surprise drop at the end of last month, gas inventories remain high, which is also exerting downward pressures on gas prices.

NATURAL GAS

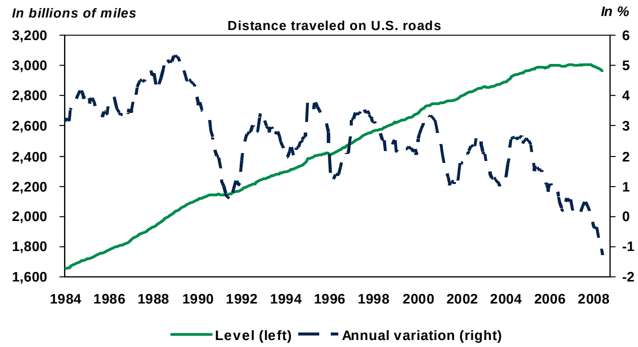
- The correction in natural gas prices was even more marked than for oil prices. Its price fell from US$13 per MMBTU (Million British Thermal Unit) to under US$8 in the past few weeks, a drop of almost 30% (graph 6). This correction is most welcome after the recent price surge—which seemed somewhat overstated—in the first half of 2008. The drop in oil prices and some signs of easing in the U.S. market are the main drivers behind the drop in natural gas prices.
- Even if natural gas inventories stay below last year's levels, the strong growth in U.S. production—up almost 9% after five months compared with 2007—has lessened concerns of a shortage in the United States.

URANIUM

- In contrast to other sources of energy, the price of uranium recently appeared to have hit a cyclical trough at US$57 per pound, and has since gained about US$10 (graph 7). If the immediate demand for uranium remains weak, the future appears to be brighter now that several reactors, mostly located in Asia, are slated to become operational in the next year.

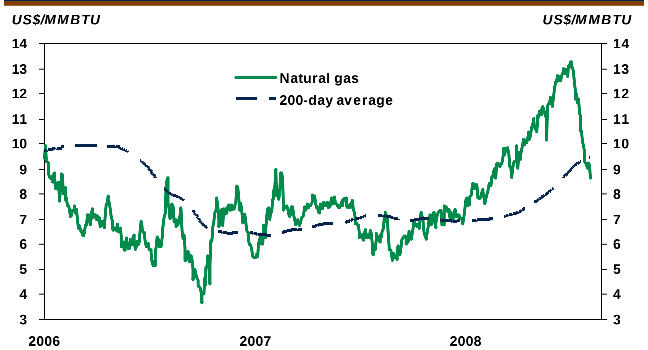
Forecasts: Energy prices could remain very volatile as we approach hurricane season. The cyclical peaks for oil and natural gas should not be tested in the coming months, unless a large-scale catastrophe strikes resource production. The many signs that the global economic slowdown could extend over several more quarters argue in favour of new price declines for oil, which could see the price of a barrel fall to about US$100 by the end of 2008 and perhaps even less than this threshold in the first half of 2009. Production constraints could, however, boost the price of crude oil after that, when the economic environment becomes more favourable once again.

Graph 5 – U.S. motorists change their behaviour



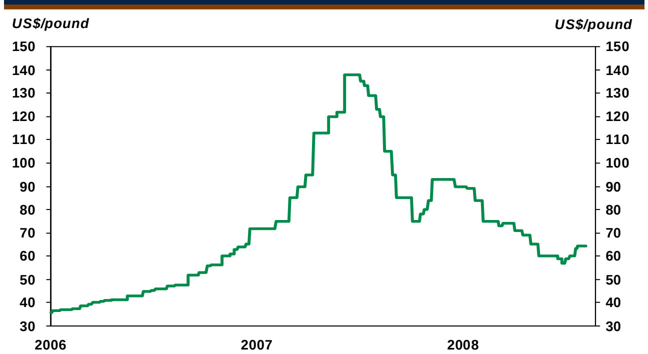
Sources: Federal Highway Administration and Desjardins, Economic Studies

Graph 6 – Natural gas prices



Sources: Datastream and Desjardins, Economic Studies

Graph 7 – Uranium prices



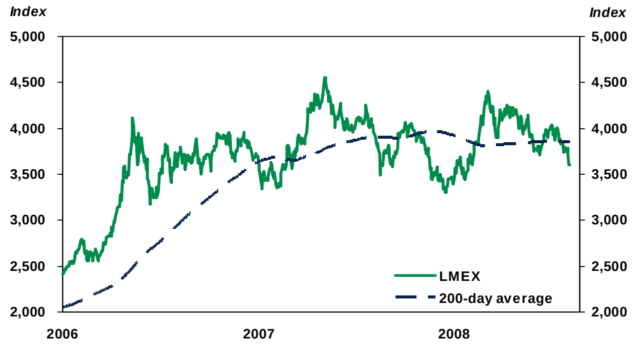
Sources: Datastream and Desjardins, Economic Studies

BASE METALS

An increasingly gloomy economic environment

Prices for the majority of industrial metals declined over the past few weeks. Global demand for metals continues to show signs of weakness, which translates in many cases to rising inventories. As such, the LMEX (London Metal Exchange Index) for base metals fell by more than 8% in the past month and now sits 21% under its peak reached in May 2007 (graph 8).

Graph 8 – LMEX index of the prices of base metals

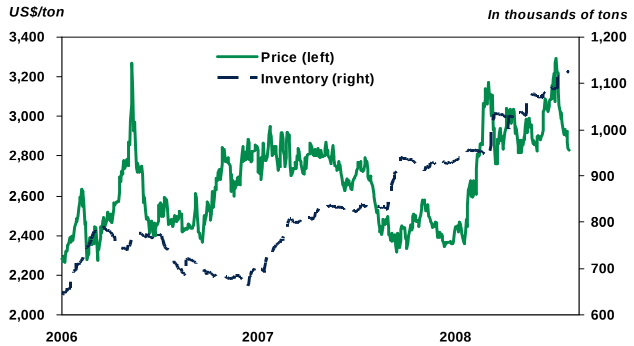


Sources: Datastream and Desjardins, Economic Studies

ALUMINIUM

- Prices for aluminium fell by 8% in the past month but remain over US$2,800 per tonne, a one-year increase of approximately 7% (graph 9). This relatively high price is the result of surging energy prices and production stoppages due to a shortage of electricity in several countries. For example, the aluminium smelters in China recently announced production cuts of 5% to 10% on the heels of increases in electricity rates.
- Despite the many production cuts, the global market for aluminium remains well supplied, and inventories increased in July to a four-year high. Weak global demand for aluminium should continue over the next few quarters while there are no signs that point to the end of the troubles in the automobile and construction sectors in many countries. While a sharp correction seems unlikely, the price of aluminium could therefore continue to decline slightly in the coming months.

Graph 9 – Aluminium prices and inventories

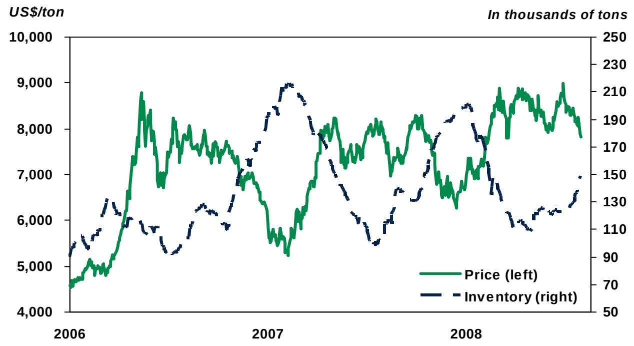


Sources: Datastream and Desjardins, Economic Studies

COPPER

- At first glance, copper's situation appears similar to that of aluminium as production problems are offsetting the weak global demand and keeping prices high (graph 10). One major difference is that copper inventories are very weak, which makes the price of this metal much more volatile. In July only, the price of copper hit a new record at US$8,982.50 per tonne before receding quickly under US$8,000. Major labour conflicts kept the world copper market in a deficit position for the first half of the year, putting upward pressures on prices. However, copper inventories have started to rebound in the past few weeks, a trend that could continue and should lead to a devaluation of this metal.

Graph 10 – Copper prices and inventories



Sources: Datastream and Desjardins, Economic Studies

NICKEL

- The correction in nickel prices continued these past few weeks while global demand remains very weak. As such, the price has fallen by almost 15% in the past few months, hitting a two-year trough at US$17,443 per tonne (graph 11). The rapid drop in nickel prices however is leading to noteworthy production cuts for this metal, especially in China, translating into a slight reduction in inventories, which are still very high. Prices should remain relatively low in the coming months, but the recent decline seems overstated and a return to prices above the US$20,000 per tonne threshold is likely.

ZINC

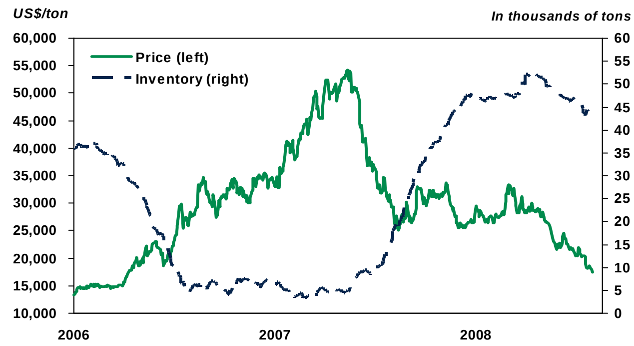
- The price of zinc continued to fall at the beginning of July before rebounding temporarily above US$1,800 per tonne (graph 12). The current price is still more than 60% less than its peak price of US$4,619 per tonne at the end of 2006. The global zinc market is currently running a surplus and inventories should continue to rebound in the coming quarters. The current price, however, already reflects this situation and prices are not expected to fall a lot further.

TIN AND LEAD

- Despite declining 10% last month, the price of tin is still more than 25% higher than it was one year ago (graph 13). This increase is mainly due to insufficient production that is exerting downward pressures on inventories, which are already very weak.
- The spectacular drop in lead prices seems to have come to an end at the beginning of July. The price per tonne of lead reached US$1,546 before rebounding more than 30% to over US$2,000. Signs of a rebound in demand in China and a drop in inventories seem to be at the root of this change in trend. Despite everything, the price of lead remains approximately 40% lower than last year and its rebound could be thwarted by the troubles in the automobile industry.

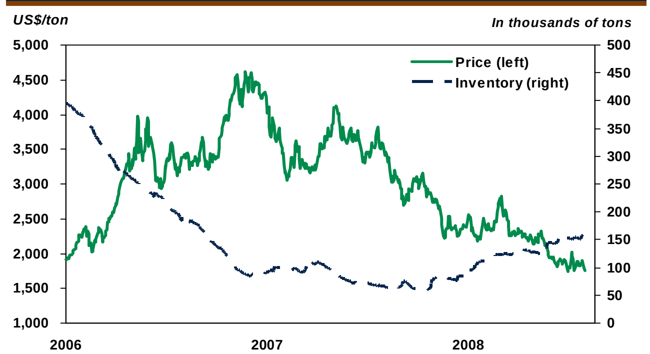
Forecasts: The economic environment for base metals should remain unfavourable over the next few months since everything points to an extension of the global economic slowdown. The prices of aluminium and especially cooper could be the next targets of a genuine downward trend, since the prices of most other industrial metals have already seen a significant correction.

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

The rebound was short-lived

Intensified financial tensions at the beginning of July favoured safe-haven assets and allowed precious metal prices to wipe out a good portion of the losses sustained during the previous months. The rebound did not last, however, and a buoyed U.S. dollar put new downward pressures on prices at the end of the month.

GOLD AND SILVER

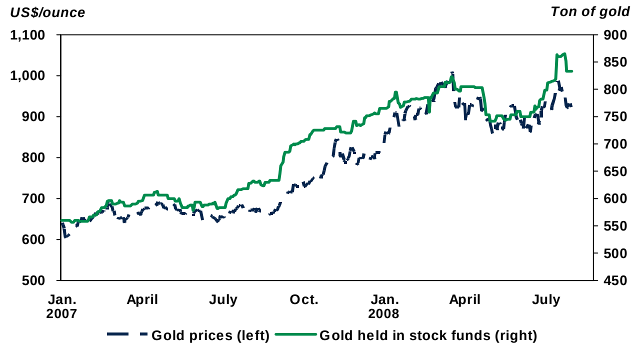
- Faced with new problems in the financial sector, investors sharply increased their positions in gold at the beginning of July, boosting prices to close to the US$1,000 per ounce mark (graph 14). The price of gold then quickly retreated under US$900 as soon as financial tensions began to diminish and U.S. dollar recovered. High gold prices are becoming increasingly dependent on financial demand, since the World Gold Council reported that demand for jewellery plummeted by 21% in the first quarter of 2008 compared with the same period in 2007. Falling oil prices also contributed to gold's recent decline. The price of silver is trending similar to gold prices, reaching US$19.30 per ounce by mid-July before falling under US$17 per ounce (graph 15).

PLATINUM AND PALLADIUM

- Despite the persistent problems plaguing producers in South Africa, platinum prices also fell sharply, from US$2,075 per tonne at the beginning of July to less than US$1,600 today (graph 16). The troubles in the automobile industry seem to be having an impact on this metal that is widely used to manufacture catalytic converters. In spite of this, global production of platinum should continue to trail behind demand over the next few quarters, which may allow this metal to recover its upward trend. At US$354 per ounce, the price of palladium has declined by 39% compared with the cyclical peak reached in March 2008 (and vs. a drop of 31% for platinum). The significant surpluses of palladium around the world lead us to anticipate that this metal will continue to underperform platinum.

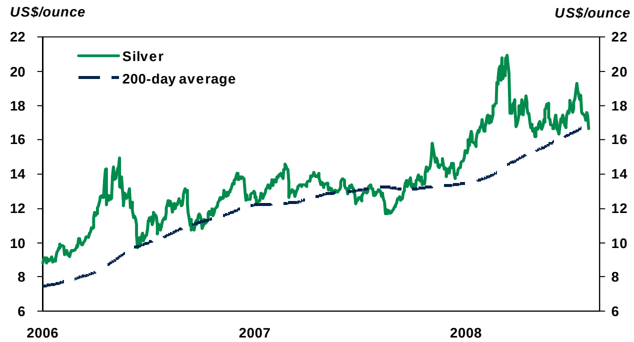
Forecasts: The difficult economic and financial context will favour precious metals compared to other raw materials. However, unless the U.S. dollar falters once again or a new financial crisis arises, we do not anticipate any strong appreciation in the coming months; prices should remain relatively stable instead. We recommend giving preference to platinum vs. other precious metals, given its recent price declines and the shortage of this metal worldwide.

Graph 14 – Gold prices reflect fluctuations in investor demand



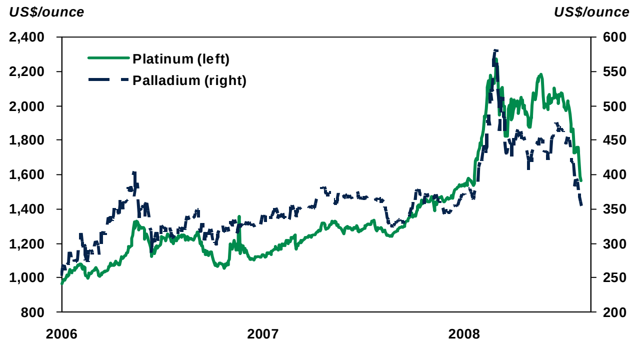
Sources: Datastream, Exchange Traded Gold and Desjardins, Economic Studies

Graph 15 – Silver prices



Sources: Datastream and Desjardins, Economic Studies

Graph 16 – Platinum and palladium prices



Sources: Datastream and Desjardins, Economic Studies

AGRICULTURAL COMMODITIES

Fewer fears of shortages

Grain prices also posted significant declines in the last few weeks. As discussed in a recent study[1], concerns of a worldwide food crisis were overstated since the expected increase in grain production was sufficient to meet demand.

WHEAT

- Wheat prices have continued to decline these past few weeks, the price of a bushel fell to nearly US$8, a decline of almost 40% compared with the historic peak of $14.07 set at the beginning of the year. Thanks to favourable weather and increased seeding around the world, global wheat production should rebound to record levels during the next harvest, which will help replenish inventories. The risk of a wheat shortage has dissipated and speculators are now betting on falling prices (graph 17).

CORN

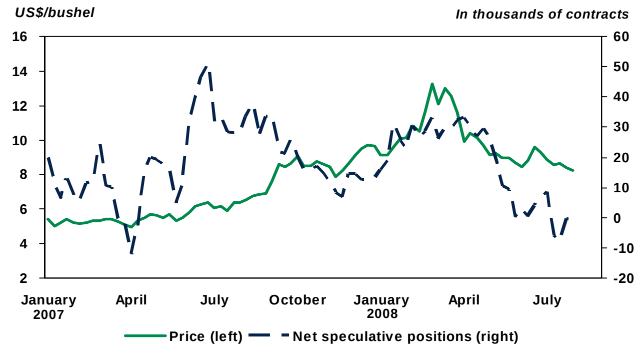
- Torrential rains in the U.S. Midwest boosted corn prices above the US$7 per bushel mark at the end of June. However, the price of corn plummeted below US$5 per bushel in the past few weeks while the weather improved and speculative positions fell considerably (graph 18). Nonetheless, strong global demand, especially from the ethanol industry, and an anticipated drop in inventories this year bode well for this grain.

SOYBEAN

- The price of soybeans tracked a path similar to that of corn, setting a new record of US$16.19 per bushel at the beginning of July before retreating to under US$13 per bushel (graph 19). The more favourable weather in the United States, the world's largest soybean producer, explains this decline. By mid-July, the withdrawal in Argentina, the world's third largest soybeans producer, of a controversial export tax on agricultural products also contributed to price declines for this commodity.

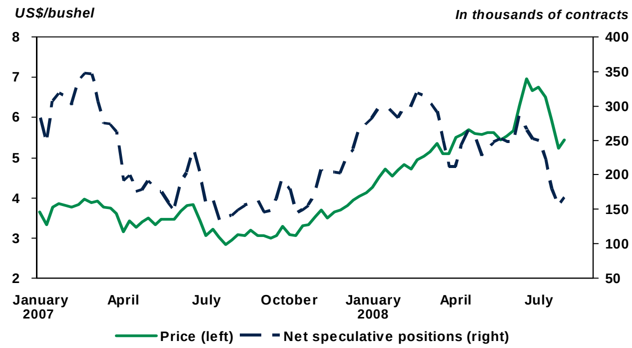
Forecasts: While fears of a shortage have abated, the situation is still favourable to relatively high grain prices due to soaring production costs and a significant increase in global demand for corn and soybeans.

Graph 17 – Wheat prices and speculation



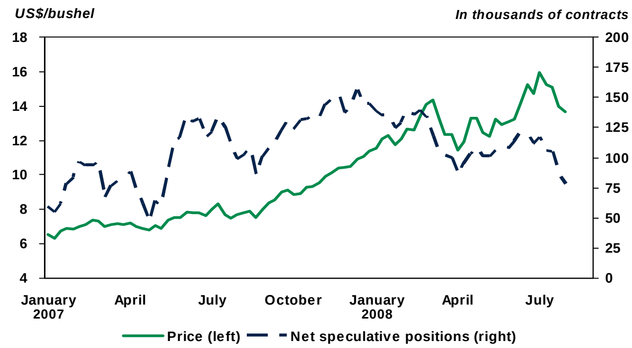
Sources: Datastream, Bloomberg and Desjardins, Economic Studies

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

[1] See the *Economic Viewpoint* "Worldwide food crisis: Fears of a famine are overstated", June 4, 2008.

Table 1
Commodities

	Spot price	Percentage return since				Last 52 weeks		
	August 5	1 month	3 months	6 months	1 year	High	Average	Low
Index								
Reuter-CRB* (CCI**)	524.2	-14.3	-2.5	4.0	23.9	614.6	501.4	398.1
Reuters/Jefferies CRB*	398.4	-15.7	-3.7	9.5	25.2	473.5	378.8	299.8
Dow Jones AIG***	195.6	-17.8	-7.3	2.9	15.3	238.0	196.0	161.1
Energy								
Crude oil (US$/barrel)	119.2	-18.0	-0.7	34.8	57.9	145.7	102.4	69.3
Gasoline (US$/gallon)	3.88	-5.3	7.4	30.3	34.9	4.11	3.27	2.75
Natural gas (US$/MMBTU****)	8.64	-33.8	-20.6	10.1	41.4	13.27	8.72	5.35
Uranium (US$/pound)	64.5	9.3	-0.8	-23.2	-47.6	123.0	78.6	57.0
Precious metals								
Gold (US$/ounce)	880.4	-5.6	2.8	-1.1	31.4	1,011.6	847.8	656.8
Silver (US$/ounce)	16.7	-7.4	3.0	1.0	28.6	20.9	15.9	6.6
Platinum (US$/ounce)	1,564.5	-22.2	-16.7	-11.5	21.7	2,273.0	1,709.5	1,240.0
Palladium (US$/ounce)	354.0	-22.4	-14.1	-14.3	-2.7	582.0	402.7	320.0
Base metals								
Aluminium (US$/ton)	2,830.8	-8.3	0.5	9.0	6.8	3,291.3	2,695.0	2,316.3
Copper (US$/ton)	7,809.0	-9.8	-6.9	8.4	-2.2	8,982.5	7,814.8	6,272.3
Nickel (US$/ton)	17,442.5	-14.4	-36.8	-34.3	-40.7	33,652.5	27,229.7	17,442.5
Zinc (US$/ton)	1,749.5	0.6	-18.5	-27.2	-50.2	3,512.5	2,439.8	1,739.8
Tin (US$/ton)	20,255.0	-10.1	-11.3	22.1	24.6	25,497.5	18,674.7	13,572.5
Lead (US$/ton)	2,015.5	30.3	-20.3	-27.2	-40.5	3,977.5	2,783.1	1,546.3
Agricultural commodities								
Wheat (US$/bushel)	7.96	-13.2	-13.1	-26.5	23.1	14.07	9.27	6.47
Corn (US$/bushel)	4.86	-30.9	-11.8	0.6	62.6	7.11	4.63	2.98
Soybean (US$/bushel)	12.73	-21.4	2.6	0.5	64.1	16.19	11.73	7.39
CRB* Livestock index	533.5	-4.0	5.4	23.8	16.7	565.8	465.2	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

Annual average	2006	2007	2008f	2009f
WTI* oil (US$/barrel)	66	72	Target: 110 (range: 105 to 120)	Target: 95 (range: 85 to 115)
Natural gas Henry Hub (US$/MMBTU**)	6.73	6.97	Target: 9.75 (range: 9.25 to 10.50)	Target: 9.50 (range: 8.50 to 11.00)
Gold (US$/ounce)	604	697	Target: 915 (range: 875 to 950)	Target: 925 (range: 850 to 1,000)
LMEX*** index—base metals	3,396	3,847	Target: 3,800 (range: 3,700 to 3,900)	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