

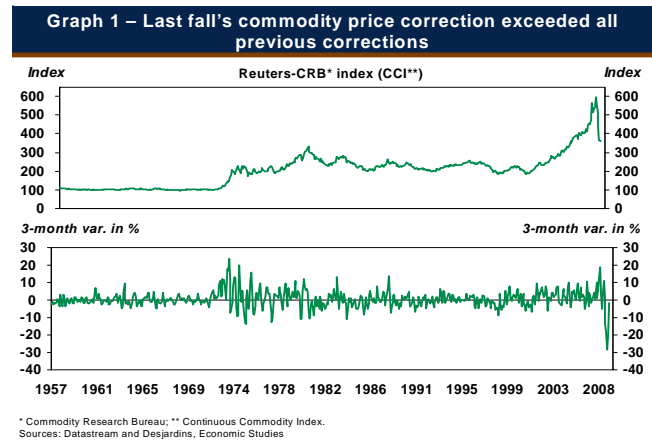
## Will 2009 bring calm back to the commodities market?

The year that has just ended was a memorable one for commodities. In the first half of 2008, prices for most base products continued to soar, setting some new records when, for example, gold went over US\$1,000 an ounce and oil over US\$145 a barrel.

As we reiterated several times, however, the explosion in raw materials prices was increasingly based on speculative demand, as the evolution of the fundamentals slowly turned against commodities. The price surge that started in the early part of this decade thus came to a sudden end last summer. The subsequent correction was unprecedentedly sharp (graph 1) and prices for most commodities collapsed by over 50% in the second half of 2008.

The fall's financial crisis and, in particular, the confirmation that the global economic downturn would not spare emerging economies made prices for several commodities plummet to levels that would have been unthinkable just a few months earlier, for even the most pessimistic analysts. Oil prices thus temporarily dropped below US\$31 a barrel on December 22, a low that dates back to 2003.

The re-emergence of geopolitical strain and renewed investor confidence, however, have temporarily pushed commodity prices back up in the last few days. In our view, the trough may be behind us because of the limited supply of many raw



materials. The economic context will, however, remain very negative for demand for commodities in the next few months, limiting the potential for a sharper surge in prices in the near future. The first signs that the global economy is stabilizing could, however, bring on a bigger increase in commodity prices in the second half of the year. At first glance, 2009 promises to be calmer as the fundamental determinants appear to be once more winning out over speculation, but movements in commodity prices could once again be surprisingly violent.

**François Dupuis**  
Vice-President and Chief Economist

**Mathieu D'Anjou**  
Senior Economist

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**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](mailto:desjardins.economics@desjardins.com)

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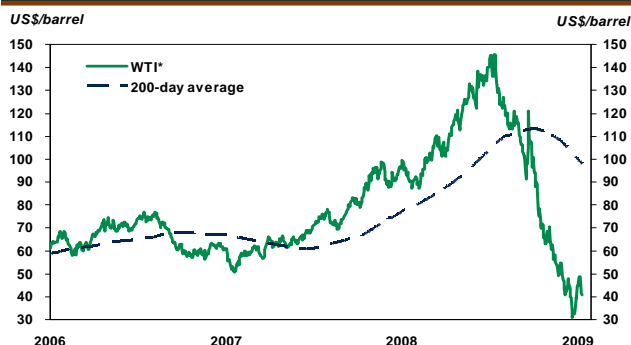
# ENERGY

## Geopolitical tension re-emerges

### OIL

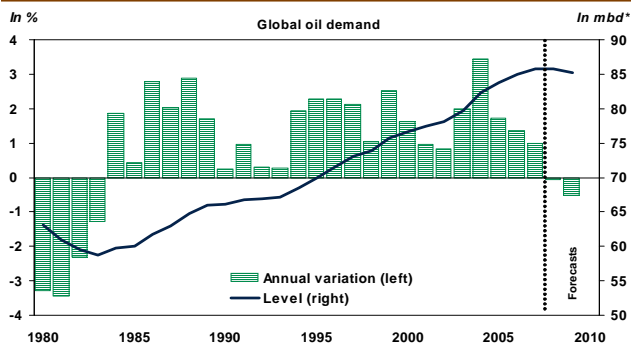
- The collapse of crude prices reached its climax on December 22, when a barrel of WTI (West Texas Intermediate) traded for US\$30.81, a low that dates back more than five years. However, the conflict in the Gaza Strip broke out, temporarily pushing the price per barrel to almost US\$50. Oil prices are still very low and down more than 70% from last summer's peak (graph 2).
- Soft oil demand remains a major obstacle to a further increase in oil prices. Most analysts now expect the global recession to lead to a second straight year of declining oil demand in 2009 (graph 3). The drop is mainly focused in the United States, where oil consumption is thought to have declined by almost 1.5 million barrels per day in 2008, but the demand downturn is now affecting the entire planet. Despite the major drop in prices, the economic downturn should bring on further demand declines until at least mid-2009.
- The nations that make up the Organization of Petroleum Exporting Countries (OPEC) have responded strongly to tumbling demand by once again lowering quotas in December, this time by over two million barrels a day. More important than the news of a drop in quotas: several signs confirm that member nations, particularly Saudi Arabia, have started to slash their petroleum output. The production cut's immediate impact on prices could be limited, as there is still more than enough supply to meet the soft demand. At best, the cut will stave off too sharp a surge in global inventories, although it may be too late to prevent it completely (graph 4). The conflict in Palestine could be a short-term risk to the oil supply but, to date, Middle Eastern exporters (aside from Iran) are not showing any desire to use oil as a weapon to punish western countries. Nonetheless, this conflict, combined with Russia's threat to cut off Europe's natural gas supply, has revived geopolitical risks.
- A phenomenon that is much more worrisome for the future is the fact that the collapse of crude prices in conjunction with tightened credit conditions has caused many investments in new oil fields to be postponed or dropped. Alberta's tar sands development is being hard hit and, worldwide, oil field development, which often needs a price of more than US\$75 a barrel to be profitable, is in jeopardy. Unless there is a drastic change in consumption habits, the fears of an oil shortage could resurface over the medium range, as soon as the global economy begins to recover.

Graph 2 – Price of oil per barrel



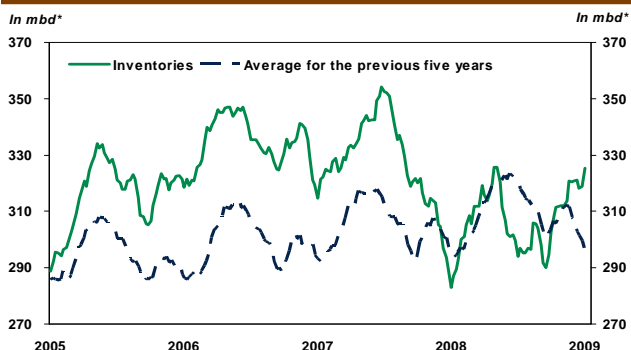
\* West Texas Intermediate.  
Sources: Datastream and Desjardins, Economic Studies

Graph 3 – The decline in oil consumption to steepen in 2009



\* Millions of barrels a day.  
Sources: Datastream, Energy Information Administration and Desjardins, Economic Studies

Graph 4 – The rise in US crude oil inventories speeds up



\* Millions of barrels a day.  
Sources: Energy Information Administration and Desjardins, Economic Studies

- Like us, the futures markets do not seem to think the price per barrel will stay under US\$40 for long (graph 5). At the low point in December, it was possible to get a premium of more than US\$20 a barrel by selling oil for delivery in 12 months rather than delivering it immediately. This strong contango situation (i.e. future prices that are higher than the spot price) has even prompted major investors to store oil on ships to take advantage of elevated future prices. This arbitrage could have played a role in the rise of crude prices in the last few weeks. The spread between the spot price and the 12-month future price is still almost US\$20, a sign that the markets expect crude prices to keep going up.

## GASOLINE

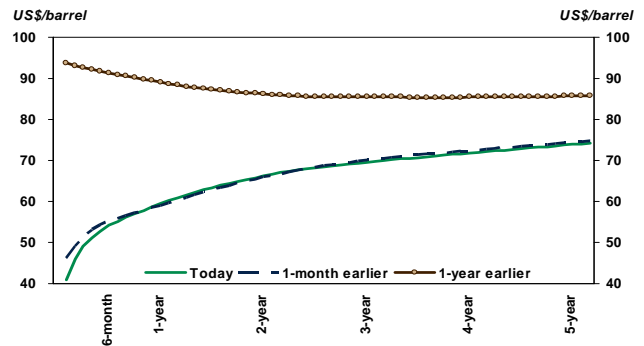
- Following the trend for crude prices, gas depreciated sharply at the end of 2008, even dropping below US\$0.70 a litre in Canada and nearing US\$1.60 a gallon in the United States (graph 6). However, the long decline of gas prices seems to be coming to an end and, if oil prices hold near US\$40/barrel, we can expect gas prices to come up in the next few weeks. Soft prices and soft demand for gas are putting a lot of pressure on the refineries, which have reduced their operations and postponed substantial investments intended to increase their output capacity.

## NATURAL GAS

- Prices for natural gas continued to soften in the last few weeks, even dropping under US\$5.50 per MMBTU (Million British Thermal Unit) several times (graph 7). The soft demand and sharp increase in non-conventional output in 2008 are keeping the U.S. market very well supplied. Gas inventories are thus at comfortable levels, although they are not at peaks. Even though the American market is not directly influenced by the situation in Europe, the conflict between Ukraine and Russia, which is jeopardizing the gas supplies of several countries in Europe, could give gas prices some support in North America. As with the other raw materials, investment in new natural gas deposits is being jeopardized by the recent drop in prices and tough financial conditions. However, the risks of a shortage over the medium range are much smaller than they are for oil.

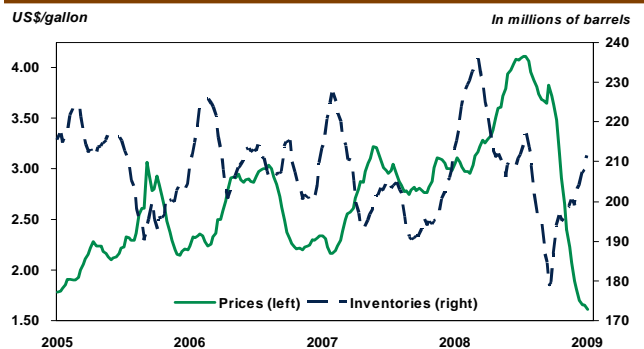
**Forecasts:** Although no improvement in demand for energy products is foreseeable in the short term, prices could hang onto their recent gains and oscillate around current levels for several months. Oil prices are still too low to justify developing new fields. Fears about the future supply should therefore start to resurface as of mid-year and could take crude prices close to US\$80 by the end of 2009.

Graph 5 – Oil futures



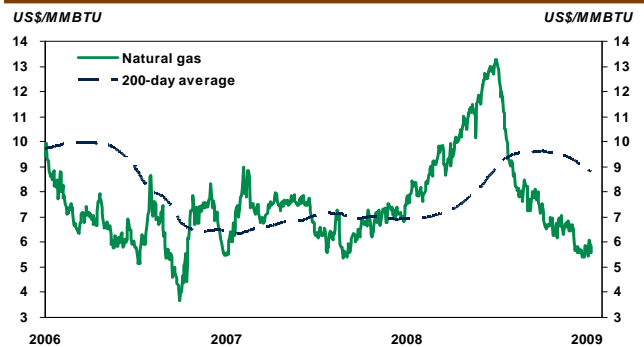
Sources: Bloomberg and Desjardins, Economic Studies

Graph 6 – Gasoline prices and inventories



Sources: Energy Information Administration and Desjardins, Economic Studies

Graph 7 – Natural gas prices



Sources: Datastream and Desjardins, Economic Studies

# BASE METALS

## Heading for price stabilization?

Prices for base metals are still being pummelled by the economic situation and downturn in global industrial output. The Chinese economy's growing difficulties snuffed out the last hopes of resilience in demand for metals (graph 8). The only positive developments are the many government plans to support the economy, especially in China and the United States, which should result in huge investments in infrastructures. However, it will take several months before these public investments start supporting demand for metals.

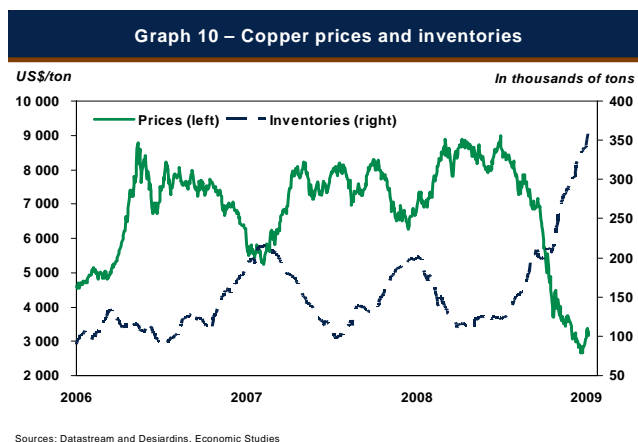
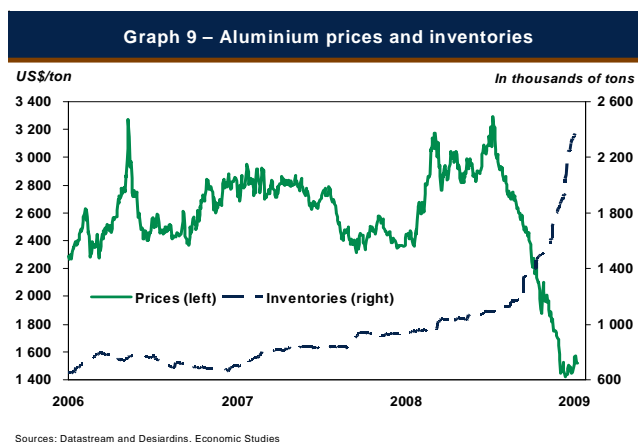
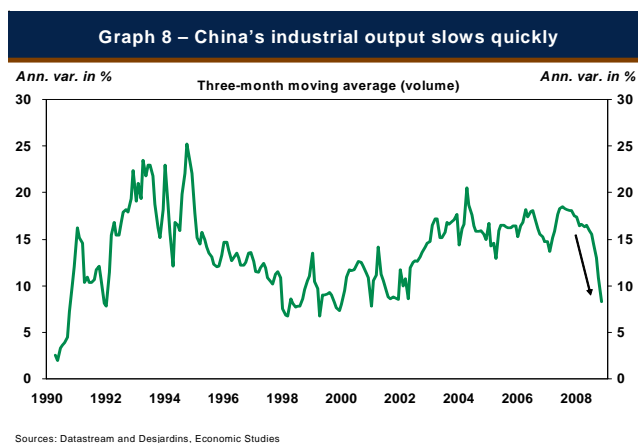
Although it has edged up, the LME index (London Metal Exchange Index) is still down by over 50% on an annual basis. Inventories are still growing, a sign that cuts to output have not yet managed to bring the market back to equilibrium. The drop in investment in new production capacity is, however, opening the door to a substantial surge in base metal prices over the medium range.

### ALUMINIUM

- Despite the many production cut announcements, the global aluminum market is clearly in surplus. Inventories have once more jumped by over 30% since the end of November, reaching an almost 15-year peak, and there is nothing to show that the trend is ending. The metal's price is therefore still low, around US\$1,500 a tonne (graph 9). Aluminium's demand outlook remains very grim, as the problems in the construction and automotive sector worsen steadily. Giants Alcoa and Rio Tinto are now taking their turn announcing substantial cuts to output and investments in 2009, to adjust to the difficult economic situation.

### COPPER

- Copper prices continued to collapse at the end of 2008. The value of one tonne of this metal even fell to US\$2,668 in December, a July 2004 low, before rising to just over US\$3,000 (graph 10). As demand has weakened substantially even in China, where copper imports fell in the first 10 months of 2008, and production cuts are much smaller than in other metals, the surplus situation has brought on another substantial increase in inventories. Further increases are to be expected, which will limit any rebound of copper prices.



## NICKEL

- The price of nickel has rebounded by about 20% in the last few days, rising back over US\$11,000 a tonne (graph 11). This metal's price is still down by almost 60% from where it was last year. We could conclude that the substantial cuts to nickel output are behind the price rebound. Yet inventories continue to surge, which seems to show that the global market still has a surplus. Rather, it appears that what is behind the rebound in the price of this metal is the overall rise of commodities and the fact that nickel's weight in the Dow Jones-AIG index has been increased.

## ZINC

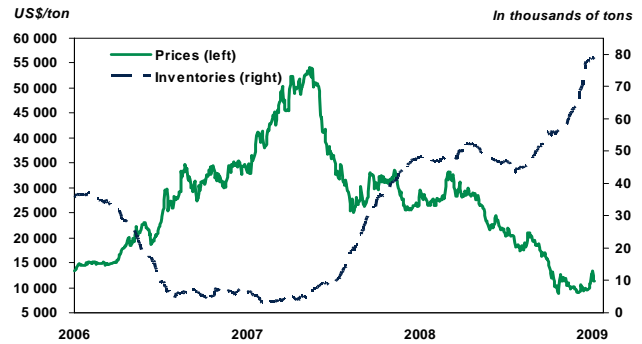
- As with nickel, zinc's price capitalized on the increase of its weight in the Dow Jones-AIG index to record gains in early 2009 (graph 12). Despite many production interruptions, the balance between global zinc supplies and demand is still playing against its price as inventories continue to rise. A lasting surge in zinc prices thus seems unlikely in the near future.

## TIN AND LEAD

- The price of tin fell below US\$10,000 a tonne at the end of 2008, then climbed to around US\$11,000 (graph 13). Despite the many problems tin producers are facing, the metal's inventories have shot up, but it is still too early to say whether this trend will last.
- Lead prices have been oscillating close to US\$1,000 since the end of November. Inventories have edged up lately but are still well below the levels reached earlier in 2008. The problems in the automotive industry are not good for lead prices, but demand for replacement batteries, which accounts for about 40% of global lead consumption, seems to be holding up fairly well. The demand outlook for lead is thus not as grim as for most of the other base metals.

**Forecasts:** The impacts of the global recession will continue to batter demand for industrial metals over the next few months. Price rebounds could thus be fragile and short lived, as they are essentially based on technical or financial factors. In this context, prices could oscillate close to current levels for several months, and perhaps even set new lows. A true rise would be surprising before the second half of 2009, when the impacts of production cuts and public infrastructure investments will start to be felt.

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

## Gold's price could close in on its peak

Like the other commodities, prices for precious metals have shot up in the last few weeks. Unlike gold, whose movement will primarily depend on the US dollar, the rise in prices for other precious metals will be greatly limited by soft industrial demand.

### GOLD AND SILVER

- As we had hoped, the price of gold recorded a substantial rebound after a fairly tough early fall. Gold thus went from about US\$720/oz in mid-October to almost US\$900 at the end of 2008 (graph 14). Renewed American dollar strength brought gold's price back down to almost US\$850 in the last few days but, in our opinion, the financial environment still favours gold. Unlike the other commodities, demand for gold is not much affected by the global economic downturn, which is why its price is almost stable on a year-over-year basis. Of course, jewellery demand could be affected by the economic slowdown. However, investors' demand for gold has risen in the last few months (graph 15), and aggressive action from monetary authorities—especially the Federal Reserve—to support the economy and stave off deflation should eventually favour gold over the other safe haven assets. Despite a substantial rebound in the last month, the price of silver is still down by almost 30% year over year.

### PLATINUM AND PALLADIUM

- After collapsing last fall, platinum and palladium prices have come back by about 20% since early December (graph 16). Prices for the two metals are still down by over 35% from the same time last year. The news from the automotive industry remains very negative, as the major automakers are steadily announcing cuts to production, especially in North America, where motor vehicle sales have collapsed. Although we are still expecting platinum's price to rise over the medium range, its price should remain relatively soft over the coming months.

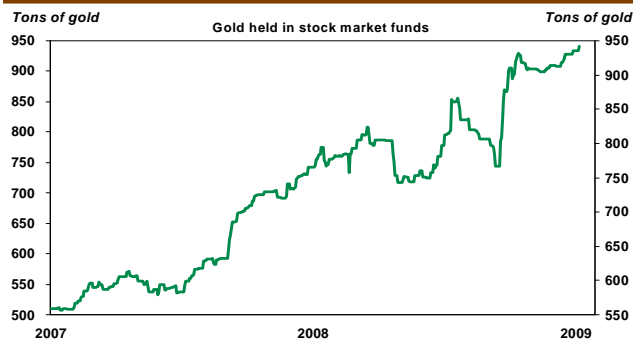
**Forecasts:** Except for gold, the recent rise in precious metal prices seems fragile as industrial demand could continue to flag. Given its role as a safe haven, gold is in a better position to hang onto its recent gains and even go up further. In the short term, the greenback could remain strong, however, which would limit gold's gains.

Graph 14 – Gold and silver prices



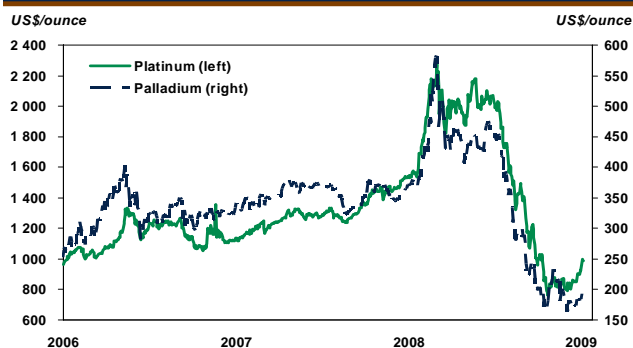
Sources: Datastream and Desjardins, Economic Studies

Graph 15 – Investor interest in gold is strong



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

Graph 16 – Platinum and palladium prices



Sources: Datastream and Desjardins, Economic Studies

# AGRICULTURAL COMMODITIES

## Prices could continue to climb

Prices for agricultural commodities have recorded an especially steep rise in the last few weeks. Prices for the three main cereals have jumped by over 20% since December 5, and even livestock has appreciated substantially. In most cases, demand for agricultural products is not very influenced by economic conditions and it should thus be less affected by the global recession. Moreover, poorer weather conditions and less intensive use of fertilizer could limit upcoming harvests. Renewed speculator interest in the agriculture sector also contributed to the rise in prices.

### WHEAT

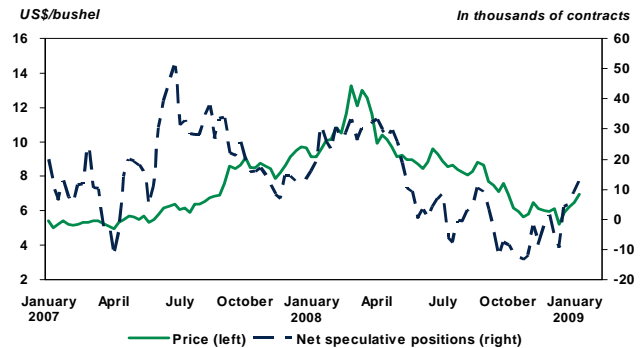
- After several soft weeks at the end of the November, the price of wheat returned to an up trend, climbing to almost US\$6.50 a bushel (graph 17). The worldwide economic situation does not seem to be affecting global demand for wheat, which is essentially used for human consumption. Several countries are taking advantage of the relatively low prices to increase their imports of North American wheat. Global demand should thus increase a little this year, limiting the rise in inventories despite the record 2008-2009 harvest.

### CORN AND SOYBEAN

- After hitting an over two-year low in December, the price of corn quickly rose to almost US\$4/bushel (graph 18). Demand for this cereal is more sensitive to the economic situation, which is starting to affect the ethanol industry. The election of Barack Obama, who is set on pursuing the development of alternative energies, limits the risks that support measures for this industry will be dropped. Corn production could be especially hard hit by tightened credit conditions and relatively high fertilizer prices, which will prompt farmers to turn to crops that take less fertilizer, like soybean. Soybean's price climbed to almost US\$10/bushel recently (graph 19), as global demand from China, among others, seems to be holding up and South America's harvest is threatened by the lack of rain.

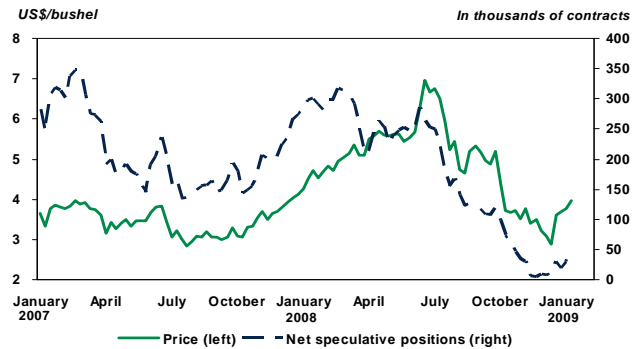
**Forecasts:** Overall, the fundamentals are still much more favourable for agricultural commodities than for most other raw materials. Cereal prices could hang onto their recent gains and even see further moderate appreciation in 2009, without, however, swinging back to the peaks recorded in the first half of 2008.

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		
	Jan. 11	1 month	3 months	6 months	1 year	High	Average	Low
<b>Index</b>								
Reuter-CRB* (CCI**)	372.9	7.0	-5.1	-37.2	-24.0	614.6	487.5	323.2
Reuters/Jefferies CRB*	230.1	-0.3	-20.6	-50.1	-37.0	473.5	361.6	208.6
Dow Jones AIG***	118.3	3.5	-16.8	-48.8	-37.8	238.0	182.8	106.1
<b>Energy</b>								
Crude oil (US\$/barrel)	40.8	-14.9	-47.5	-72.0	-56.0	145.7	98.1	30.8
Gasoline (US\$/gallon)	1.68	-0.9	-51.7	-59.1	-45.8	4.11	3.22	1.61
Natural gas (US\$/MMBTU****)	5.59	-4.3	-14.3	-53.4	-31.5	13.27	8.79	5.40
<b>Precious metals</b>								
Gold (US\$/ounce)	855.4	3.6	-4.0	-11.3	-4.6	1,011.6	871.7	710.8
Silver (US\$/ounce)	11.2	8.0	-4.4	-39.0	-30.1	20.9	14.9	8.9
Platinum (US\$/ounce)	988.0	17.3	-1.3	-51.3	-36.8	2,273.0	1,555.6	763.0
Palladium (US\$/ounce)	196.0	8.3	3.2	-56.8	-47.7	582.0	345.8	164.0
<b>Base metals</b>								
Aluminium (US\$/ton)	1,520.3	-0.3	-29.7	-53.8	-37.1	3,291.3	2,542.1	1,422.8
Copper (US\$/ton)	3,279.8	1.5	-34.4	-61.4	-54.4	8,982.5	6,839.6	2,667.5
Nickel (US\$/ton)	11,372.5	7.2	-4.8	-47.5	-58.8	33,275.0	20,648.1	8,807.5
Zinc (US\$/ton)	1,219.8	12.6	-8.7	-39.7	-47.4	2,825.3	1,839.5	1,041.0
Tin (US\$/ton)	11,325.0	-7.5	-17.8	-51.4	-30.0	25,497.5	18,332.6	9,950.0
Lead (US\$/ton)	1,182.5	14.8	-20.3	-41.0	-53.6	3,459.8	2,043.7	877.5
<b>Agricultural commodities</b>								
Wheat (US\$/bushel)	6.36	15.9	8.3	-27.4	-32.1	14.07	8.53	4.87
Corn (US\$/bushel)	3.76	18.4	7.6	-41.2	-18.4	7.11	4.88	2.72
Soybean (US\$/bushel)	9.65	15.4	18.6	-39.3	-21.7	16.19	11.85	7.60
CRB* Livestock index	340.0	27.2	-21.3	-39.0	-18.1	565.8	454.2	267.1

\*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

	2007	2008	2009f	2010f
Annual average				
WTI* oil (US\$/barrel)	72	99	Target: 62 (range: 50 to 75)	Target: 83 (range: 70 to 100)
Natural gas Henry Hub (US\$/MMBTU**)	6.97	8.84	Target: 7.50 (range: 6.00 to 8.50)	Target: 8.00 (range: 6.50 to 9.50)
Gold (US\$/ounce)	697	872	Target: 900 (range: 750 to 1,000)	Target: 1,000 (range: 850 to 1,000)
LMEX*** index—base metals	3,847	3,377	Target: 2,000 (range: 1,500 to 3,000)	Target: 2,300 (range: 1,750 to 3,500)

f: forecasts; \* West Texas Intermediate; \*\* Million British Thermal Unit; \*\*\* London Metal Exchange Index.

Sources: Datastream and Desjardins, Economic Studies