Commodity Trends

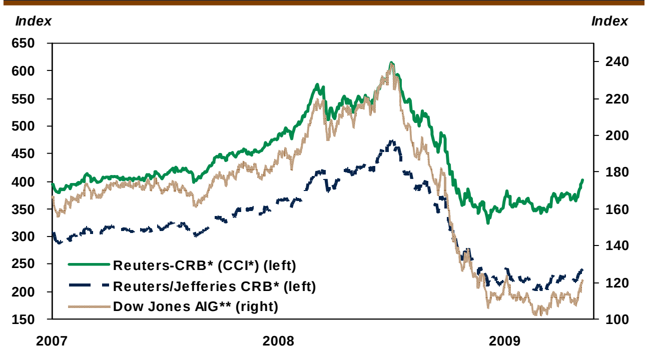
Desjardins Economic Studies
www.desjardins.com/economics

May 11, 2009

Influenza A(H1N1) is eclipsed by hopes of an economic recovery

The commodity price indexes were fairly stable in April, consolidating March's substantial gains. Other encouraging economic statistics at the beginning of May even bolstered investors' optimism and led to further appreciation of base products (graph 1). A U.S. dollar pullback also played a role in the recent price increase.

Graph 1 – The commodity price indexes' rise is small compared to the tumble they took at the end of 2008



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

Improved investor sentiment once again gave industrial raw materials a boost. After having come down to around US$45 in mid-April, the price of oil per barrel has bounced over US$58 in the last few days. Thanks to further signs of recovery and record imports in China, base metal prices have also continued to climb. However, the decline in risk aversion hurt precious metals.

The sudden emergence in Mexico of a new strain of the flu, which quickly spread to the United States and threatens to become a global pandemic, constitutes a risk to commodity prices. In theory, a serious pandemic could magnify the global economy's contraction and prolong the recession. Demand for oil could be especially hard hit if people stop travelling to keep from catching the flu. Luckily, although Influenza A(H1N1) is quickly spreading around the world, so far, it does not appear to be very deadly. This is why, in general, the pandemic threat has not had much impact on raw material prices.

Influenza A(H1N1) is having a bigger impact on the agricultural sector, however. The disease, which has some association with swine, has initially made pork prices tumble by over 10%. Yet experts agree on the fact that eating pork meat does not pose any risk of contamination. The predictable decline in hog herds, with Egypt already announcing that it will slaughter all of the pigs in its territory, could also reduce demand and prices for some cereals.

François Dupuis
Vice-President and Chief Economist

Mathieu D'Anjou
Senior Economist

Contents

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

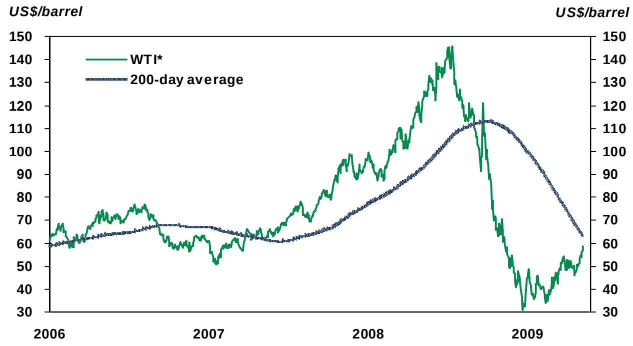
ENERGY

Hopes that the economy is stabilizing buoy crude prices

OIL

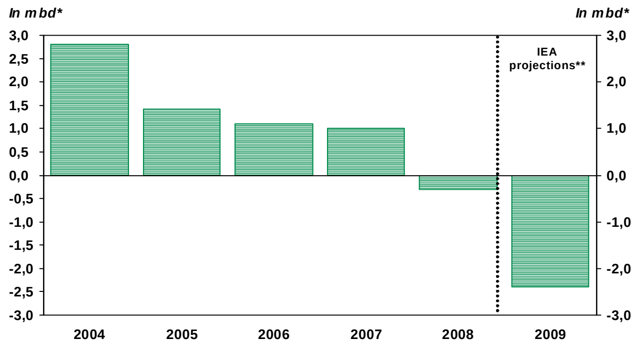
- After having stood still in April, oil prices went back on a rising trend in early May. West Texas Intermediate (WTI) crossed above US$58 a barrel, a peak that dates back to November 2008 (graph 2). Oil's solid performance is primarily due to the fact that some economic statistics are looking up, fanning hopes of renewed activity in the second half of the year. The statistics on the crude supply, demand and inventories are not as good for black gold's price.
- Oil producers' main headache is still the collapse of global demand. Downgrades to economic outlooks and much weaker oil consumption than expected early in the year prompted the International Energy Agency (IEA) to cut its demand forecasts again (graph 3). The IEA is now projecting a huge 2.8% tumble in oil demand this year. In our opinion, this scenario must be considered pessimistic, as most of the other experts are calling for smaller decline. One thing is certain, there are still very few signs of stabilization in global consumption of petroleum products; the Influenza A(H1N1) epidemic, which could slow passenger transportation and even the shipping of freight, will not do anything to make the situation better.
- For its part, global crude production appears to be stabilizing. After a spectacular tumble at the end of 2008 and early in 2009, the drop in output of OPEC (Organization of Petroleum Exporting Countries) members has slowed sharply in the last few months (graph 4). It now seems to be hard for OPEC to do much more to cut supply and get prices back to levels that are deemed more acceptable, especially as some members' production is still exceeding their quotas. Moreover, OPEC's output is already at its lowest level in five years.
- Even if OPEC managed to get global supply and demand back into balance, their will still be a substantial obstacle to a rapid comeback of oil prices. Substantial upward revisions show that petroleum product stocks have jumped in the last few months. In terms of days of consumption, countries belonging to the Organisation for Economic Co-operation and Development (OECD) now have inventories of 61.6 days of consumption, a peak that dates back to 1993. This figure is, however, a little inflated by soft current demand.

Graph 2 – Price of oil per barrel



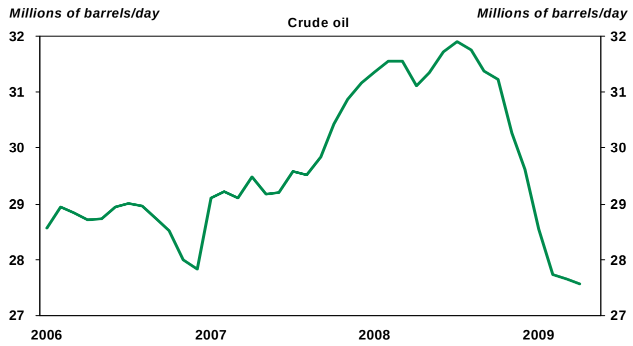
* West Texas Intermediate.
Sources: Datastream and Desjardins, Economic Studies

Graph 3 – Growth in global oil demand



* Million barrels per day; ** International Energy Agency.
Sources: Datastream, International Energy Agency and Desjardins, Economic Studies

Graph 4 – The drop in output of OPEC* member nations slows



* Excluding Indonesia, but including Iraq.
Sources: Datastream and Desjardins, Economic Studies

GASOLINE

- As we had expected, the rise in gas prices has given way to some consolidation close to US$2 a gallon in the United States (graph 5). While the stabilization in gas consumption may justify the increase in prices since the year began, we are still nowhere near the kind of sharp demand growth that could drive prices close to the peaks reached last year. Gas prices should stay close to current levels for the next few months. The Energy Information Administration (EIA) is predicting an average price of US$2.23 a gallon this summer, compared with US$3.81 in 2008.

NATURAL GAS

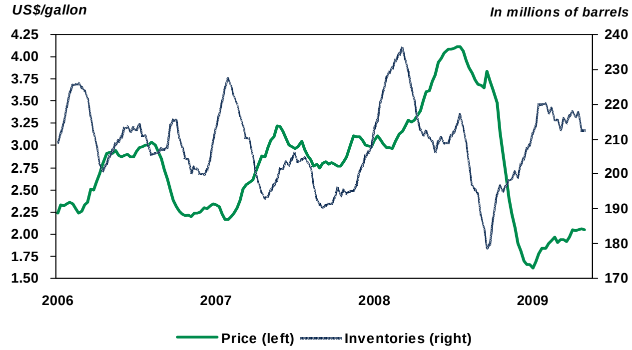
- Natural gas prices continued to slide in the last few weeks, even temporarily reaching US$3.21/MMBTU (Million British Thermal Unit), a low that is more than six years old (graph 6). Everything suggests that the North American natural gas market will maintain a surplus, as industrial demand is off substantially and the supply could be inflated by an increase in liquid gas imports. Utilities' demand for natural gas is up from last year, however, and could increase in the next few months, as the drop in prices plays in favour of producing electricity using natural gas rather than coal. The demand shift from coal to natural gas should help the latter set a price floor soon.

URANIUM

- After a long tough period, the uranium market saw activity spike up in April, with numerous deals taking place. Renewed demand, especially from utilities, helped to lower inventories. As a result, uranium prices have finally gone back on an up trend, going from a cyclical low of US$40.5/pound to US$45 (graph 7).

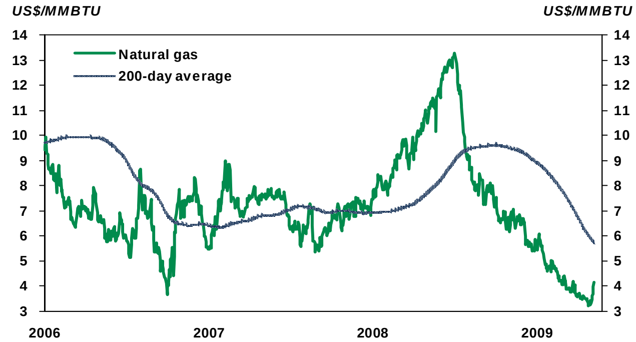
Forecasts: Oil prices' fundamental determinants are still very weak, limiting the likelihood of a further increase in crude prices in the next few months. Renewed pessimism in the markets could thus quickly take crude prices back down near US$50/barrel. Over the medium range however, we still predict that the rise in demand and current under-investment in new production capacities will drive crude prices up substantially. For the same reasons, the natural gas surplus should gradually vanish, leading to a sharp price increase in 2010.

Graph 5 – Gasoline prices and inventories



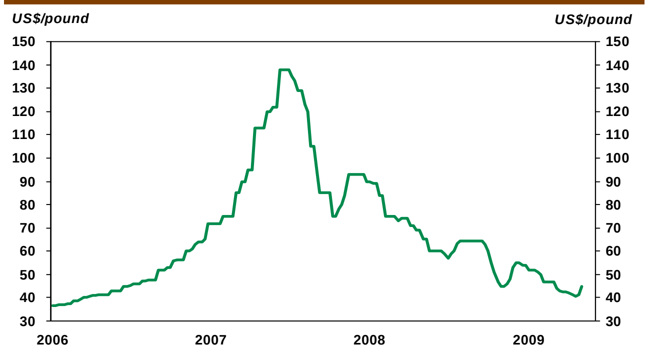
Sources: Energy Information Administration and Desjardins, Economic Studies

Graph 6 – Natural gas prices



Sources: Datastream and Desjardins, Economic Studies

Graph 7 – Uranium prices



Sources: Datastream and Desjardins, Economic Studies

BASE METALS

Once again, it's all about China!

Industrial metal prices continued to climb with the London Metal Exchange Index (LMEX) reaching 2255, a peak that has held since November 2008. Prices for most metals corrected temporarily around mid-April before going back on an up trend in early May. In the end, the LMEX index has advanced by about 17% since the end of March, taking its gain from the beginning of the year to over 35%.

The first signs of stabilization of industrialized economies and renewed investor confidence certainly favoured base metal prices in the last few months. However, the dominant factor behind the rise is, without a doubt, renewed activity in China and another surge in its metal imports. More and more statistics appear to be confirming that the economy is already back on an up trend there (graph 8), thanks to, among other things, huge infrastructure investments. It remains to be seen whether China will be able to support metal prices all on its own until the recovery spreads to the rest of the world.

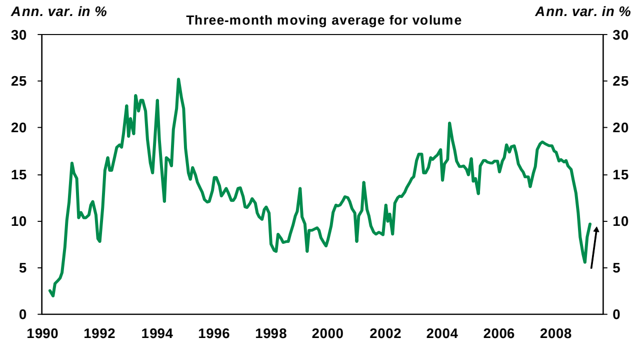
ALUMINIUM

- Aluminium is still one of the metals with the least positive fundamentals, as weak global demand has led to skyrocketing inventories, a surge which continued in April. This did not keep the metal's price from following the sector's trend and rising by over 10% since the end of March (graph 9). At about US$1,500 a tonne, the price of aluminum has gone slightly above where it was at the start of the year. March's surge in Chinese aluminum imports is behind its recent price increase. High prices in China, however, are prompting a number of local producers to fire up the smelters again, threatening to increase the global surplus.

COPPER

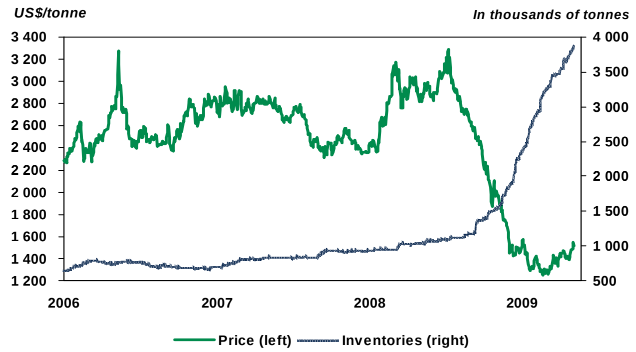
- The price of copper has been volatile in recent weeks. It jumped over US$4,750 a tonne in mid-April before correcting to below $4,200, then coming back to around US$4,750 a tonne (graph 10). Beyond this volatility, the trend for the last few months is very positive for this metal, whose gain since the year began now stands over 60%. Given the ongoing difficulties affecting global copper production, China's surge in demand in the last few months seems to have been enough to turn the global surplus into a deficit. Copper stocks have thus melted by about 20% since March ended.

Graph 8 – China's industrial output has started to pick up speed



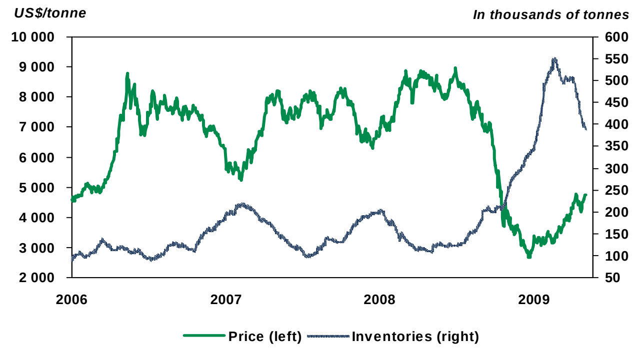
Sources: Datastream and Desjardins, Economic Studies

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

- The price of nickel has been extremely volatile in recent weeks. From under US$9,500 a tonne at the end of March, the price jumped to almost US$12,500 by mid-April, a gain of more than 30% in just a few days. It then corrected, but good economic news allowed nickel's price to surge again to over US$13,000 (graph 11). The recent surge in the price of nickel appears to be primarily due to some anecdotal signs of renewed activity in global stainless steel production, the main use of nickel. However, very substantial nickel stocks will keep downside pressures on the prices.

ZINC

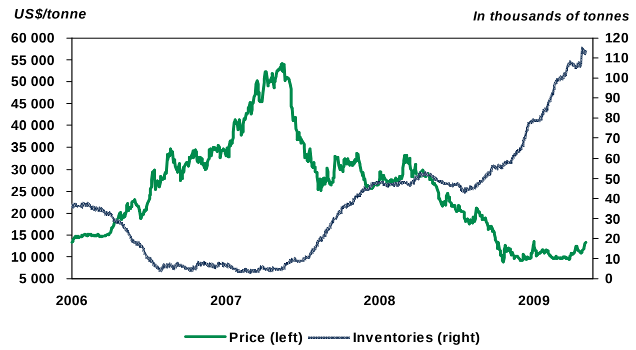
- Like copper, zinc is one of the metals that has gotten the most help from recent developments in China. Although most experts agree that the global market is still in surplus, record Chinese zinc imports have decreased the stocks reported by the London Metal Exchange (LME) by 6% since the end of March. This allowed the metal's price to come up to around US$1,540 a tonne, a gain of over 35% from the beginning of 2009 (graph 12).

TIN AND LEAD

- After posting fairly disappointing performance in March, the price of tin rose by over 35% in the last few weeks, reaching US$14,300 a tonne, a peak that dates back to last November (graph 13). In March, Chinese government restocking and local producers' difficulties pushed net tin imports to their highest point since September 2007. Note, however, that inventories are still going up, though they remain relatively low.
- The price of lead followed the other metals' trend, recording an up trend and substantial volatility. At nearly US$1,500 a tonne, lead is up by about 15% from the end of March and by 55% since the year began. The combination of another surge in Chinese imports and stocks that are fairly low, though rising, is behind the increase in lead prices.

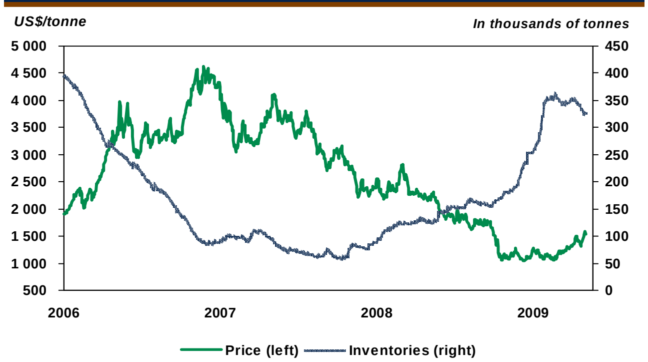
Forecasts: We still think that base metal prices' dependence on what's happening in China, an emerging economy, constitutes a substantial risk. We must acknowledge, however, that the statistics that have come out lately tend to confirm that this economy is bouncing back. The Chinese government's plans really seem to be translating into infrastructure investments and thus real consumption of metals. Despite this, the pace of China's imports does not seem to be sustainable, and this factor could be less positive for metals' prices within the next few months. If the global economy continues to show signs of stabilizing, industrial metals could hang onto their recent gains. However, there is a major risk that further bad news will sour investors' recent optimism.

Graph 11 – Nickel prices and inventories



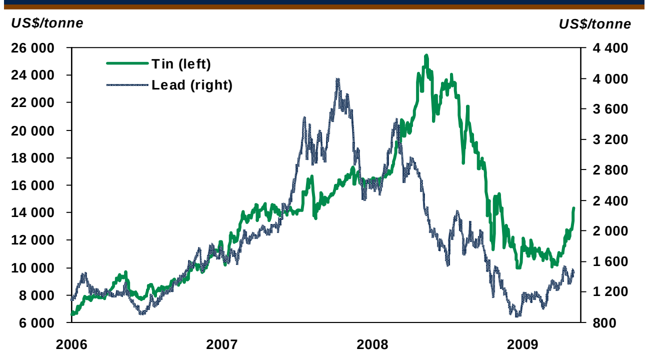
Sources: Datastream and Desjardins, Economic Studies

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

For protection against another tumble in confidence

Improved market sentiment and hopes that the global economy is stabilizing or even recovering are much less favourable to safe-haven securities. Precious metal thus depreciated in April. The drop in prices is small, however, as many investors realize that the improvement of recent months is shaky and that they need to be equipped for another drop in investor sentiment.

GOLD AND SILVER

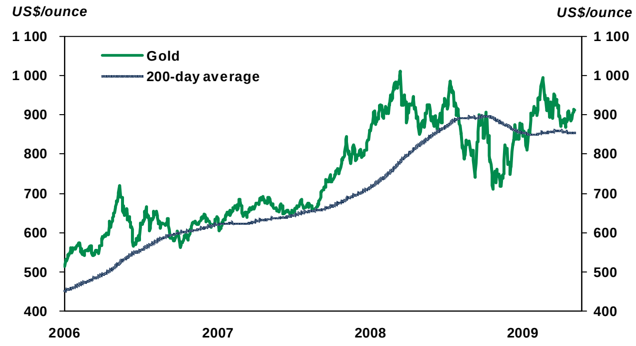
- Gold's price stayed mostly below US$900 an ounce in April. The American dollar's recent weakness, however, let it come back over this level (graph 14). Investors continue to have hefty gold investments, but they are no longer expanding their positions, opting instead to turn toward riskier assets. Demand for gold for industrial uses and jewellery is still low, given the pullback in global economic activity. On the other hand, the trend for mining output is also negative. The news that China has substantially increased its gold reserves in the last few years only had a temporary impact on the metal's price. However, if this action marks the start of a more general trend toward diversifying international reserves in favour of gold, it could have a striking impact over the medium range. Silver's price continued to move in tandem with gold's, but its price has rebounded more stongly in the last few days (graph 15).

PLATINUM AND PALLADIUM

- The increase in platinum price culminated in mid-April, with the metal's price exceeding US$1,220 an ounce (graph 16). The announcement of a first platinum exchange-traded fund (ETF) in the United States helped to intensify the price surge. Its price has come back down since then, as the demand outlook for this metals is still being affected by the auto industry's shakeout.

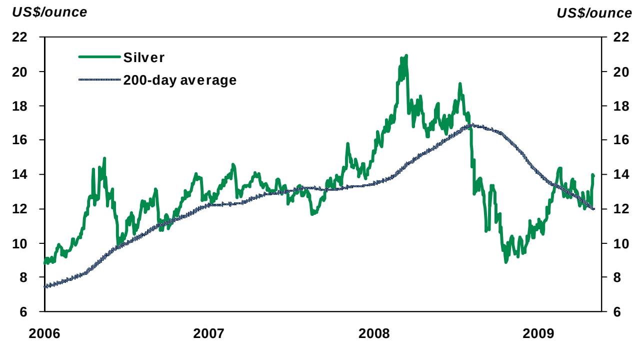
Forecasts: The current context does not favour sharp appreciation of gold, as investors are demonstrating greater risk tolerance. However, a number of developments could play in favour of gold prices over the short and medium range. For example, we could very well see another wave of pessimism, and investors could then turn to gold, given the doubts about the solidity of the U.S. dollar and government bonds. An eventual inflation surge could also favour the yellow metal.

Graph 14 – Gold prices



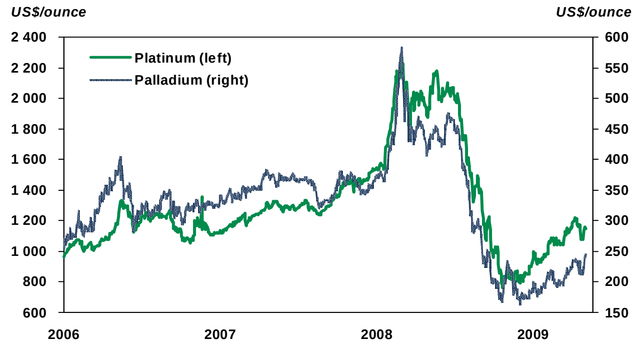
Sources: Datastream and Desjardins, Economic Studies

Graph 15 – Silver prices



Sources: Datastream and Desjardins, Economic Studies

Graph 16 – Platinum and palladium prices



Sources: Datastream and Desjardins, Economic Studies

AGRICULTURAL COMMODITIES

Soybeans steal the show

Cereals' prices have not moved uniformly in the last few weeks: a good reflection of the global supply and demand conditions specific to each crop. The news of the outbreak of Influenza A(H1N1) made cereal prices drop initially, but this did not last. However, demand for animal feed could be affected. The news was much more damaging to pork meat (graph 17); prices could continue to take a beating, especially in the countries that are the most affected, such as Canada.

WHEAT

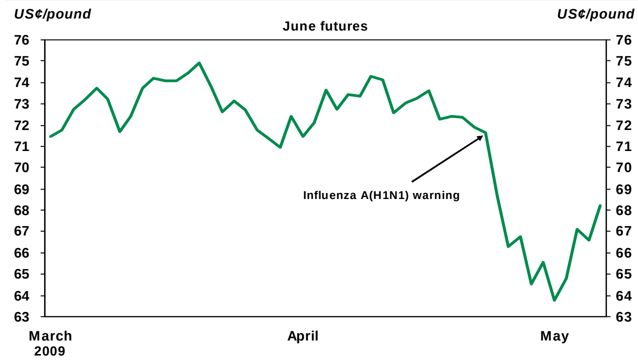
- After hitting US$6.30 a bushel in the first week of April, the price of wheat went on a down trend, dropping back near US$6.00 (graph 18). The 2008-2009 season's record wheat harvest is still a drag on prices, even though the weather has not been as good lately in the United States. The substantial jump in wheat production in Russia and the Ukraine is enabling these countries to substantially boost their exports, limiting demand for U.S. wheat and putting downside pressures on prices.

CORN AND SOYBEANS

- Corn's price has been relatively stable in the last few weeks, hovering just under US$4.00 a bushel (graph 19). The lower than forecast decline in corn seeding in the United States is reining in this cereal's appreciation potential in the short term. A new gas standard in California, which will require lower carbon content as of 2011, is a threat to the ethanol industry. As we had forecast last month, the price of soybeans has risen in the last few weeks, even nearing US$11 a bushel. The combination of a slight increase in U.S. seeding, another decline in Argentina's harvest forecast and strong demand from China indicates that global inventories could continue to dwindle.

Forecasts: Cereal prices are a fairly good reflection of the current conditions for global supply and demand. On May 12, watch for the U.S. Department of Agriculture's release of the next *World Agricultural Supply and Demand Estimates (WASDE)*. It will contain the first projections for the 2009-2010 harvest. Influenza A(H1N1) developments could also have further substantial impacts on agricultural prices.

Graph 17 – Pork prices have been slammed by pandemic fears

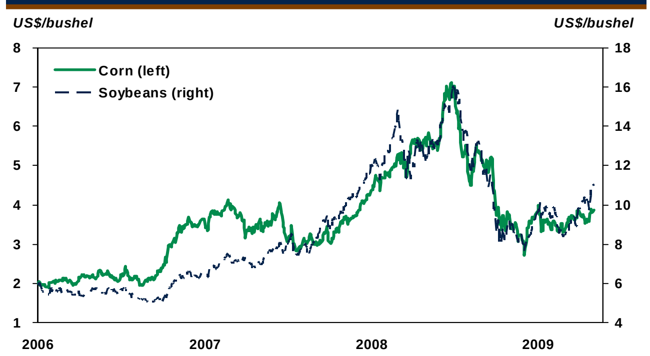


Sources: Datastream and Desjardins, Economic Studies

Graph 18 – Wheat prices and speculation

Sources: Datastream, Bloomberg and Desjardins, Economic Studies

Graph 19 – Corn and soybean prices



Sources: Datastream and Desjardins, Economic Studies

Table 1
Commodities

	Spot price	Percentage return since				Last 52 weeks		
	May. 10	1 month	3 months	6 months	1 year	High	Average	Low
Index								
Reuter-CRB* (CCI**)	402.4	6.9	10.4	8.7	-27.5	614.6	433.9	323.2
Reuters/Jefferies CRB*	243.2	6.7	11.4	-6.9	-43.1	473.5	305.0	200.3
Dow Jones AIG***	120.8	6.8	9.3	-7.5	-44.2	238.0	152.4	102.0
Energy								
Crude oil (US$/barrel)	58.6	12.2	56.1	-6.1	-53.5	145.7	79.5	30.8
Gasoline (US$/gallon)	2.08	2.0	7.9	-6.6	-42.5	4.11	2.81	1.61
Natural gas (US$/MMBTU****)	4.17	17.0	-13.6	-40.9	-63.1	13.27	7.14	3.21
Precious metals								
Gold (US$/ounce)	911.1	3.6	-0.2	21.4	4.0	995.2	867.0	710.8
Silver (US$/ounce)	13.9	13.0	7.3	34.8	-18.1	19.3	13.3	8.9
Platinum (US$/ounce)	1,149.0	-3.8	17.0	30.6	-44.7	2,182.0	1,279.2	763.0
Palladium (US$/ounce)	242.0	3.0	13.1	6.6	-44.6	475.0	268.7	164.0
Base metals								
Aluminium (US$/ton)	1,515.3	4.4	9.1	-23.1	-47.2	3,291.3	2,074.0	1,253.3
Copper (US$/ton)	4,751.5	6.4	37.3	18.7	-43.4	8,982.5	5,436.8	2,667.5
Nickel (US$/ton)	13,252.5	23.3	21.4	11.3	-50.7	27,575.0	14,715.9	8,807.5
Zinc (US$/ton)	1,540.5	14.0	34.5	39.1	-28.9	2,322.5	1,474.6	1,041.0
Tin (US$/ton)	14,335.0	29.7	28.7	-7.1	-41.6	25,497.5	15,784.5	9,950.0
Lead (US$/ton)	1,473.3	9.0	28.0	4.4	-35.5	2,410.3	1,512.4	877.5
Agricultural commodities								
Wheat (US$/bushel)	6.12	5.4	-0.7	1.6	-35.3	9.67	7.00	4.87
Corn (US$/bushel)	3.89	4.7	7.8	11.5	-33.5	7.11	4.38	2.72
Soybean (US$/bushel)	10.97	10.3	11.9	20.9	-15.9	16.19	10.83	7.60
CRB* Livestock index	334.9	6.6	9.0	-9.0	-34.8	565.8	406.5	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

Annual average	2007	2008	2009f	2010f
WTI* oil (US$/barrel)	72	99	Target: 52 (range: 40 to 60)	Target: 68 (range: 55 to 85)
Natural gas Henry Hub (US$/MMBTU**)	6.97	8.84	Target: 4.50 (range: 3.50 to 5.25)	Target: 6.50 (range: 5.00 to 8.00)
Gold (US$/ounce)	697	872	Target: 925 (range: 850 to 950)	Target: 1,000 (range: 850 to 1,100)
LMEX*** index—base metals	3,847	3,377	Target: 2,000 (range: 1,600 to 2,300)	Target: 2,500 (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