Commodity Trends
Desjardins Economic Studies
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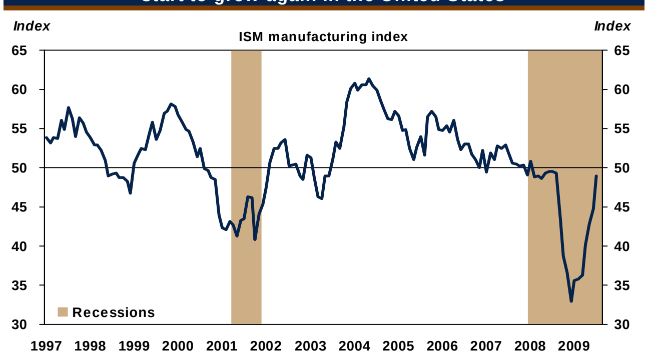
The anticipated economic recovery will continue to buoy commodity prices

Appreciation should be limited in the near term, however

The improvement in the economic and financial environment in recent months has been very good for commodities. It seems that, in most countries, the recession will end in the second half of 2009 or early 2010 (graph 1). The looming comeback of economic growth, even if it is modest, will have a substantial impact on demand for commodities. The marked easing of financial strains also prompts appreciation of risky assets such as stock and commodities, along with depreciation of the U.S. dollar, another development that favours resource prices.

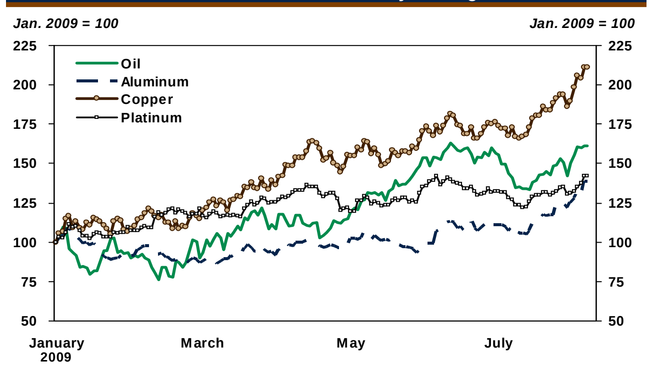
Prices for many commodities, especially those most affected by the recession, are thus showing substantial gains since the year began (graph 2). The price of oil is now over US$70/barrel, up more than 100% from last December's low. Industrial metal prices have performed just as remarkably, primarily as a result of the extraordinary demand from China.

Graph 1 – The ISM index shows that manufacturing could soon start to grow again in the United States



Sources: Institute for Supply Management and Desjardins, Economic Studies

Graph 2 – After correcting in 2008, prices for many commodities have rebounded since the year began



Sources: Datastream and Desjardins, Economic Studies

Overall, the recent price increases do not seem exaggerated, commodities having been hit especially hard by the recession. The trend should remain positive for a medium range horizon. In the near term, however, global demand for a number of industrial commodities is still very soft, which could limit their appreciation. The second half of 2009 could therefore be a consolidation period. However the markets are still rife with speculation, which could still prompt substantial upward and downward movements in commodity prices.

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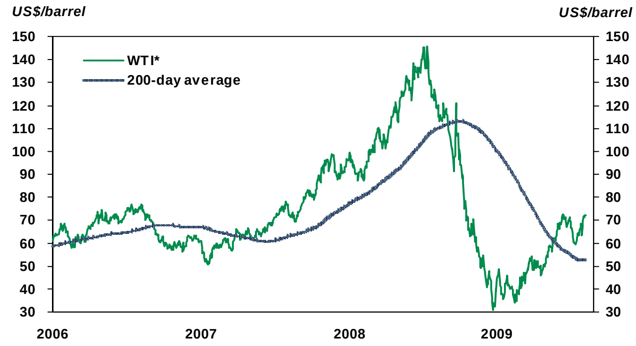
ENERGY

Oil prices reflect future demand

OIL

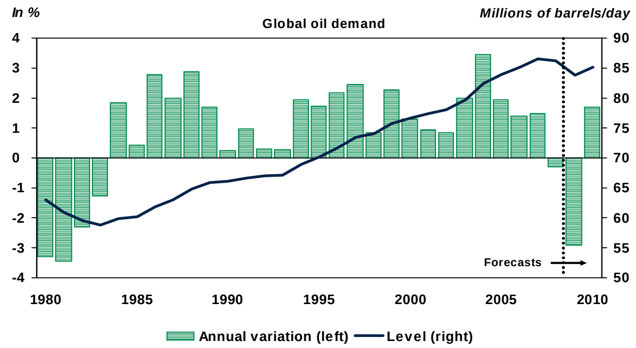
- Oil prices have been highly volatile in the last few weeks, reacting sharply to each indication that the economic recovery would be lively or sluggish. After jumping over US$70 in mid-June, the barrel of WTI (West Texas Intermediate) dropped below US$60 at the beginning of July on the release of poor economic statistics in the United States. Another breath of optimism, however, has put crude prices back over US$70/barrel in the last few days (graph 3).
- The increasingly numerous signs of a global economic recovery are very good for oil. However, they should not make us overlook the current situation: extremely soft demand is leaving the global market with a surplus. The situation is quite tangible in the United States where, for a second straight year, the driving season has shown only a very slight increase in gas consumption. Since 2009 began, U.S. demand for petroleum products is down by more than 6% from last year. The other industrialized nations are showing similar decreases. Despite growth of oil consumption in India and, more recently, China, 2009 will surely end with a very large contraction in global demand.
- 2010 promises to be better; according to the International Energy Agency (IEA), renewed economic activity will prompt a 1.7% jump in demand (graph 4). This forecast could be upgraded if the economic outlook keeps improving. Despite this rebound, global oil demand would remain below levels seen prior to the recent economic crisis. According to the IEA's new medium-term scenario, it could even be 2012 before we see global demand exceed 2008 levels. There is still a risk of an eventual oil shortage, but not in the near term.
- The latest news on the oil supply is not very promising for further appreciation by black gold. After having slashed production at the end of 2008 and in early 2009, members of the Organization of the Petroleum Exporting Countries (OPEC) have recently been having some difficulty abiding by their quotas. According to Bloomberg's estimates, OPEC's output advanced slightly for a fourth straight month in July (graph 5) and is exceeding quotas by about 1.2 million barrels per day. In this context, and given the recent upswing in prices, it would be surprising if OPEC were to announce further limits on oil output at its September 9 meeting. An unexpected rebound in Russian production is another factor that is contributing to maintaining a surplus in the global crude market.

Graph 3 – Oil price per barrel



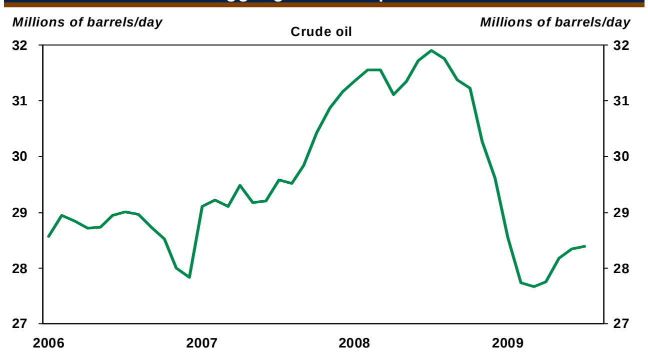
* West Texas Intermediate.
Sources: Datastream and Desjardins, Economic Studies

Graph 4 – Oil demand is expected to rise again in 2010



Sources: Datastream, International Energy Agency and Desjardins, Economic Studies

Graph 5 – Organization of the Petroleum Exporting Countries* is struggling to rein in production



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

GASOLINE

- The comeback of oil prices in recent months has had a big impact on gas prices. In the United States, the price per gallon has gone from a low of US$1.61 at the beginning of the year to about US$2.50 today, a gain of more than 55%. The rapid price surge could have helped to limit gas demand and the number of miles driven this summer. After declining last spring, gas inventories have shot up since the beginning of June (graph 6), another sign of soft demand. Now that the summer is coming to an end, pressure on prices at the pump could be to the downside unless crude prices surge again.

NATURAL GAS

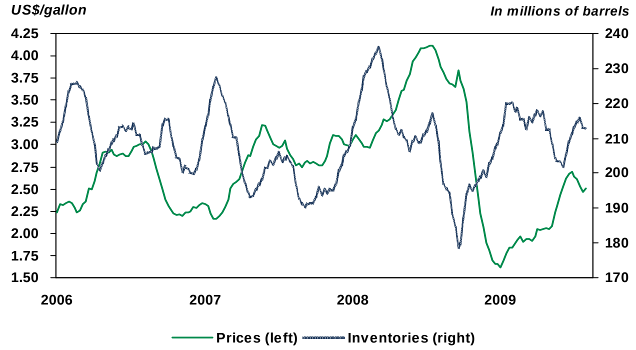
- Natural gas prices remain depressed and spent all of July under US$4.00 per MMBTU (Million British Thermal Unit) (graph 7). Natural gas is thus down by over 55% in the last year and by over 35% since the beginning of 2009, whereas all of the other commodities we track, except for wheat and corn, appreciated in 2009. The problems with natural gas are primarily a reflection of soft U.S. demand for energy and rapid growth of natural gas inventories (graph 8). At the pace seen in the last few months, the stockpiling season should end this fall with a record volume. It could even reach capacity, which could prompt another tumble by natural gas prices. However, in the last few weeks, the pace of inventory growth has been moderating slightly. Hot weather at the end of summer or a hurricane that affects some natural gas production would be all it takes to ensure adequate inventory capacity.

URANIUM

- After going back over US$50 per pound, uranium's price has edged back in the last few weeks. Soft demand and its strong sensitivity to price evolution are still major obstacles to a substantial jump in uranium prices.

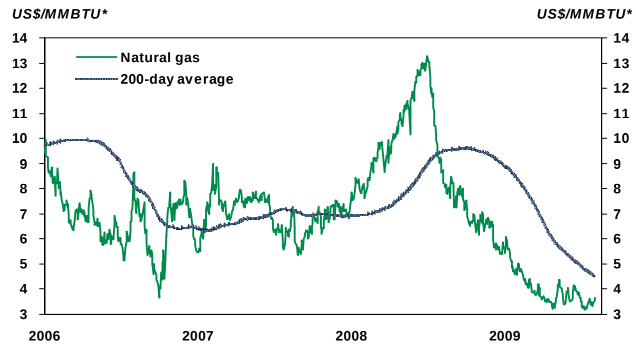
Forecasts: The substantial improvement in the economic outlook justifies an upswing of crude prices to about US$70/barrel. However, the global supply could beat demand for some time yet. In a context in which inventories are already large, this should limit a further increase by prices in the near term. Our target for the end of the year is therefore US$78/barrel, but prices could temporarily spike higher. It should continue to rise in 2010 to about US$90 at year's end. As the other energy commodities are more directly affected by current market conditions and less by financial factors, their prices may not start truly coming up until 2010. The course of the hurricane season could also have a major impact on oil and natural gas prices.

Graph 6 – Gas prices and inventories



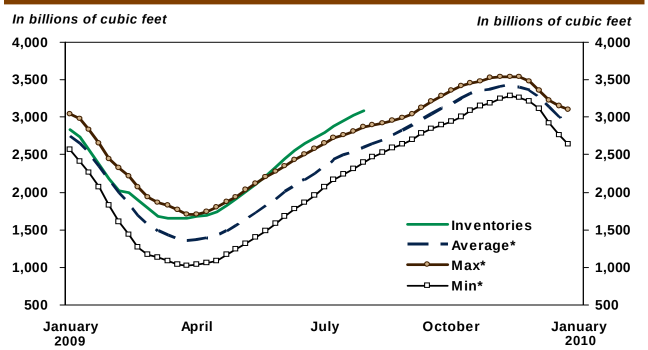
Sources: Energy Information Administration and Desjardins, Economic Studies

Graph 7 – Natural gas prices



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

Graph 8 – U.S. natural gas inventories have shot up this year



* For the previous five years.
Sources: Energy Information Administration and Desjardins, Economic Studies

BASE METALS

Signs that industrial activity is recovering, at last!

Industrial metal prices maintained their momentum in the last few weeks. The London Metal Exchange Index (LMEX) has jumped 20% since the end of June, taking its advance to over 75% since 2009 began (graph 9). The main factor supporting the surge of metal prices in the first half of the year was no doubt the explosion of Chinese imports. Although China's economic statistics are still improving, this factor could be less predominant in the second half of the year, as credit growth, which may have fuelled the stockpiling of metal inventories, should slow. However, demand from the rest of the world should gradually improve as the recession's end appears to be imminent and even the housing and auto sectors are starting to show signs of life in a number of countries.

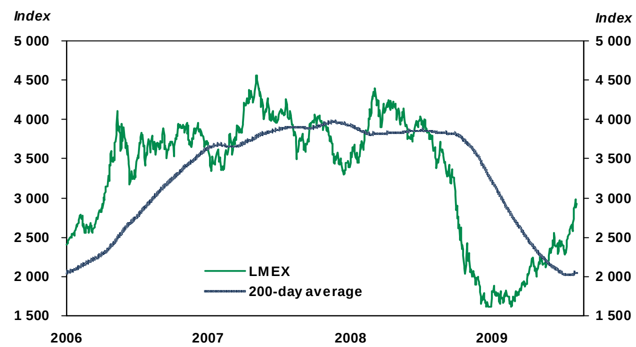
ALUMINIUM

- After posting modest growth in the first half of the year, the price of aluminum has jumped by more than 20% since the beginning of July to over US$2,000/tonne for the first time since last November (graph 10). However, there are still two major curbs on further appreciation by aluminum. Firstly, the global market still has a surplus as the already enormous aluminum inventories continue to grow. Secondly, many smelters are poised to go back into production as soon as the price goes up. This phenomenon can already be seen in China, where aluminum production shot up in May. However, signs that the auto industry and even construction are recovering augur that demand for the metal will eventually improve.

COPPER

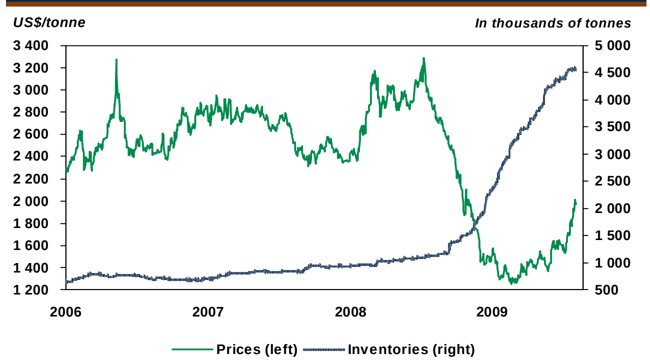
- The price of copper continued to advance. An increase of more than 15% since the end of June has taken it over US$6,000 a tonne (graph 11). In contrast with what happened with aluminum, the surge in copper prices has, until quite recently, been supported by a rapid decline in inventories recorded by the LME (London Metal Exchange). The drop in inventory despite soft global economic activity is essentially due to Chinese demand. This factor should not be as strong in the coming months. However, the progressive recovery of industrial activity and construction, with the copper supply still limited, could allow the metal to hang onto its recent price gains.

Graph 9 – LMEX index of base metal prices



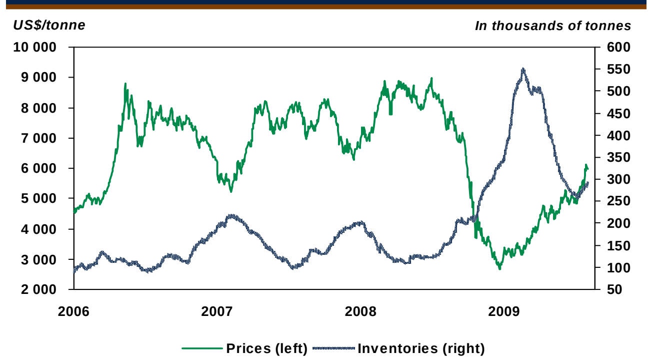
* London Metal Exchange Index.
Sources: Datastream and Desjardins, Economic Studies

Graph 10 – Aluminum prices and inventories



Sources: Datastream and Desjardins, Economic Studies

Graph 11 – Copper prices and inventories



Sources: Datastream and Desjardins, Economic Studies

NICKEL

- After pulling back in early July, the price of nickel returned to an up trend that accelerated in early August, taking it over US$20,000/tonne (graph 12), a gain of more than 100% from the end of March. As with most metals, a surge in Chinese imports played a large role in the upswing in nickel prices. The sharp price correction from mid-2007 to early 2009 is also making the current upswing look more spectacular than it actually is. As with aluminum, large inventories, despite a slight dip recently, and renewed activity by a number of Chinese producers could put downside pressure on nickel prices.

ZINC

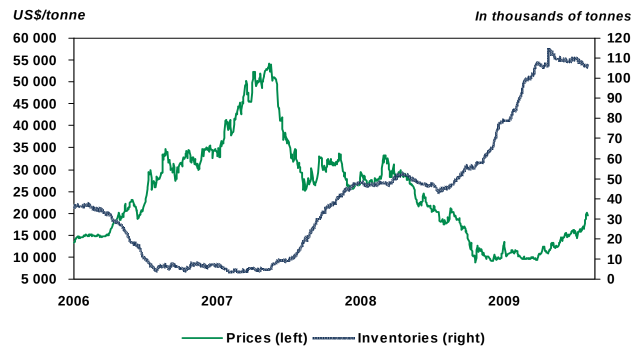
- Following the general trend, the price of zinc has advanced by more than 15% since July began, going above US$1,800/tonne (graph 13). It reached this level even though inventories have come back strongly in the last few days. Although they remain large, Chinese zinc imports have declined in the last few months, a trend that should continue. If China is no longer absorbing the world's zinc surplus, inventories should continue to rise, limiting the metal's price increase.

TIN AND LEAD

- The price of tin has dropped slightly since the end of June, the worst performance of all of the base metals (graph 14). Steadily rising inventories and a rebound in Chinese production, which led to a substantial drop in tin imports in June, are behind tin's under-performance.
- After remaining fairly stable in July, the price of lead has jumped in the last few days, nearing US$2,000 a tonne. The onset of auto sector improvement is excellent news for lead. However, an increase in Chinese lead output could cause the country's imports of the metal to slide. The relatively fast increase in inventories could also rein in lead's appreciation.

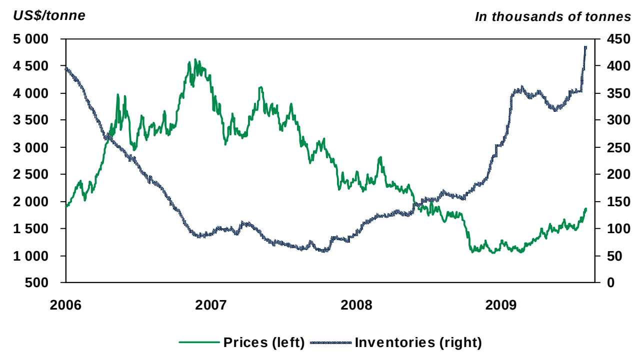
Forecasts: Base metal prices will not be able to keep rising at this pace for long; some small, temporary corrections are even likely as soon as disappointing economic statistics come out. However, the turnaround by the leading indicators and credible signs that the global recession is coming to an end are a fundamental development for industrial metals. We could reasonably claim that the prices are ahead of change in the economic situation. In our opinion, for most metals, this would now justify a period of consolidation rather than a substantial price correction.

Graph 12 – Nickel prices and inventories



Sources: Datastream and Desjardins, Economic Studies

Graph 13 – Zinc prices and inventories



Sources: Datastream and Desjardins, Economic Studies

Graph 14 – Tin and lead prices

Sources: Datastream and Desjardins, Economic Studies

PRECIOUS METALS

The soft greenback saves the day

Precious metal prices have edged up in the last few weeks, adding to the gains made since the year began. The metals' performance—especially gold's—is not as impressive as the performance posted by industrial metals, however. Investors' renewed optimism is not as good for safe-haven securities.

GOLD AND SILVER

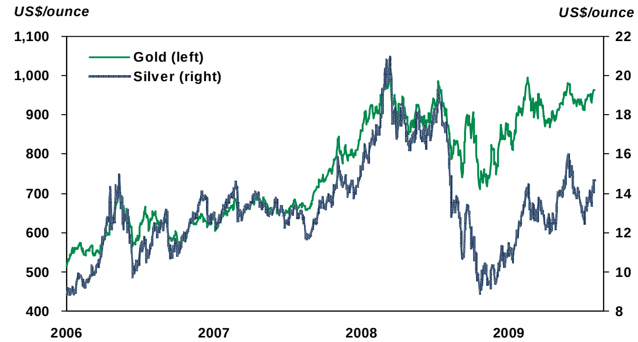
- Gold's price has continued to fluctuate in US$900/oz with no clear trend in the last few months (graph 15). Investors' renewed optimism reduces the yellow metal's appeal as a safe-haven security vs. stock and industrial commodities. Positions in gold funds have thus ticked down recently (graph 16) and investors' sentiment about gold is fairly negative. The U.S. dollar's weakness, however, is providing substantial support for the price of gold, allowing it to remain steady and even recently once again close in on the US$1,000/oz mark. Silver's price has been more volatile, reaching US$15.97/oz at the beginning of June, a peak that dates back to August 2008, and then retreating temporarily below US$14.

PLATINUM AND PALLADIUM

- Platinum and palladium prices have appreciated in recent months (graph 17) as the signs of an economic recovery promise an eventual upswing in demand for both metals. The first indications that new vehicle sales may have bottomed out and could be starting to come back in the United States and Europe, thanks to government incentive programs such as "cash for clunkers", were especially good for these two metals, for which the auto industry accounts for over 50% of demand.

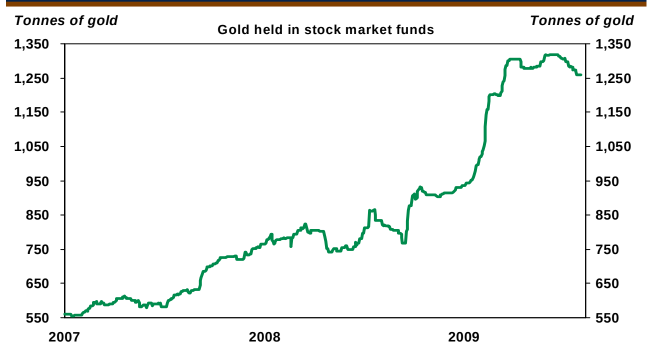
Forecasts: As the economic recovery builds, the appeal of safe-haven securities will continue to falter. Rebounding real demand from the jewellery and industrial sectors could, however, help keep prices fairly high. Platinum and palladium prices could even continue to rise. Gold's potential for appreciation appears to be limited unless there is further rapid depreciation of the U.S. dollar. Also, keep an eye on the International Monetary Funds' (IMF) sales of gold on the gold market; sales could start soon. This increased in gold supply should, however, be compensated by small sales from central banks.

Graph 15 – Gold and silver prices



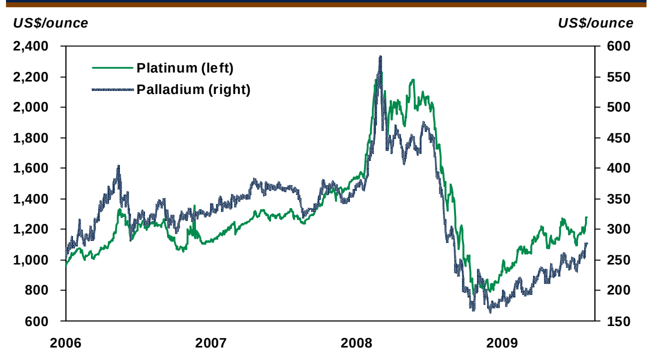
Sources: Datastream and Desjardins, Economic Studies

Graph 16 – Investors have trimmed their gold investments slightly



Sources: Exchange Traded Gold and Desjardins, Economic Studies

Graph 17 – Platinum and palladium prices



Sources: Datastream and Desjardins, Economic Studies

AGRICULTURAL COMMODITIES

Cereal prices are not benefiting from the enthusiasm for other commodities

We have frequently noted that the economic situation has less of an impact on the demand for and prices of agricultural commodities than most other commodities. It is therefore not surprising that they are now not benefiting as much from the signs of an imminent recovery of the global economy, especially as it has been good weather for the harvests and investors' speculative positions have declined until recently.

WHEAT

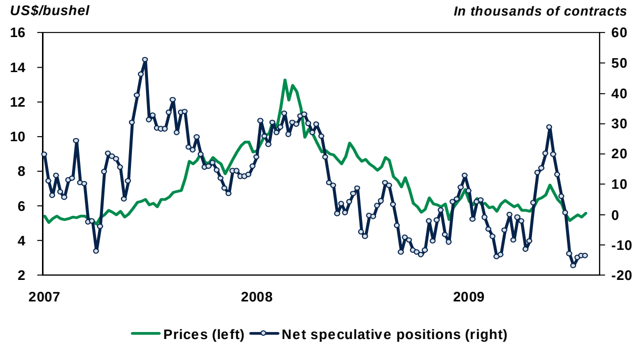
- The price of wheat has been volatile in the last few weeks. At about US$5.00/bushel, it is more than 20% lower than it was at the beginning of the year (graph 18). Although it is down from the record 2008-2009 season, the 2009-2010 harvest promises to be large enough for further restocking. Overall, the weather has been good for most of the major producer nations, including the United States, although dry weather in western Canada could reduce the harvest there.

CORN & SOYBEANS

- After hitting US$4.30 a bushel in early June, the price of corn fell to almost US$3.00 (graph 19). In July's report, the U.S. Department of Agriculture (USDA) sharply upgraded the 2009-2010 forecast for the corn harvest, as a greater area seems to have been seeded for corn. The forecast decline in corn inventories is now very small, which will give the price little support. Despite a slight pullback in July, the price of soybeans remains high at over US$11 a bushel, up over 15% since the year began (graph 20). Strong demand for soybeans, especially in China, is still an important pillar for the price, offsetting the slight increase in the harvest and inventories forecast for 2009-2010.

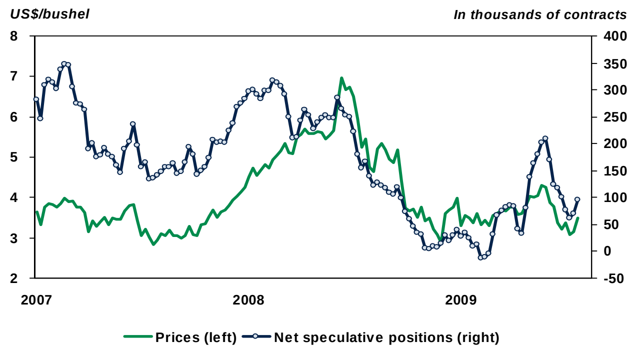
Forecasts: Fluctuations of cereal prices should remain fairly small in the near future. Market conditions are still favourable for historically high prices. However, unless weather events have a big impact on the harvests, fears of shortages should not resurface. Wheat and corn prices should thus stay well off their 2008 peaks. Thanks to strong demand from China, soybeans are in the best relative position.

Graph 18 – Wheat prices and speculation



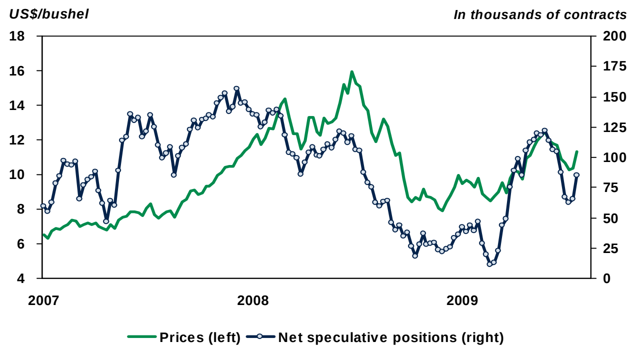
Sources: Datastream, Bloomberg and Desjardins, Economic Studies

Graph 19 – Corn prices and speculation



Sources: Datastream, Bloomberg and Desjardins, Economic Studies

Graph 20 – Soy prices and speculation



Sources: Datastream, Bloomberg and Desjardins, Economic Studies

Table 1
Commodities

	Spot price	Percentage return since				Last 52 weeks		
	Aug. 9	1 month	3 months	6 months	1 year	High	Average	Low
Index								
Reuter-CRB* (CCI**)	421.3	8.3	4.7	14.2	-17.5	528.2	395.2	323.2
Reuters/Jefferies CRB*	264.8	12.9	8.9	18.2	-31.7	405.9	259.4	200.3
Dow Jones AIG***	130.4	13.6	7.9	15.6	-31.1	198.4	128.8	102.0
Energy								
Crude oil (US$/barrel)	71.9	19.1	22.7	81.9	-37.6	120.9	63.4	30.8
Gasoline (US$/gallon)	2.56	-2.1	23.1	32.8	-34.1	3.88	2.45	1.61
Natural gas (US$/MMBTU****)	3.74	12.2	-10.4	-21.5	-54.6	8.74	5.20	3.19
Precious metals								
Gold (US$/ounce)	965.0	5.5	5.9	7.5	13.2	995.2	874.7	710.8
Silver (US$/ounce)	14.7	13.8	5.5	12.8	-6.9	16.7	12.5	8.9
Platinum (US$/ounce)	1,281.0	15.6	11.5	30.6	-17.5	1,612.0	1,082.3	763.0
Palladium (US$/ounce)	273.0	14.7	12.8	31.9	-20.9	364.0	222.3	164.0
Base metals								
Aluminium (US$/ton)	2,001.3	30.0	32.1	41.0	-29.0	2,865.5	1,736.7	1,253.3
Copper (US$/ton)	6,034.5	25.2	27.0	71.1	-20.0	7,870.5	4,634.8	2,667.5
Nickel (US$/ton)	20,072.5	34.1	51.5	74.5	12.5	21,100.0	12,993.3	8,807.5
Zinc (US$/ton)	1,872.3	26.1	21.5	59.7	10.8	1,872.3	1,380.1	1,041.0
Tin (US$/ton)	15,675.0	17.5	9.3	38.9	-21.3	21,750.0	13,681.6	9,950.0
Lead (US$/ton)	1,896.5	19.0	28.7	60.8	-5.4	2,118.8	1,429.2	877.5
Agricultural commodities								
Wheat (US$/bushel)	5.16	-1.7	-18.9	-17.0	-35.8	9.28	6.32	4.87
Corn (US$/bushel)	3.41	4.8	-14.3	-5.5	-24.3	5.55	3.82	2.72
Soybean (US$/bushel)	11.46	5.1	3.6	15.9	-0.7	13.28	10.15	7.60
CRB* Livestock index	388.9	11.9	16.1	26.6	-29.0	548.0	365.6	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$/barrel)	72	99	Target: 62 (range: 55 to 65)	Target: 78 (range: 65 to 95)
Natural gas Henry Hub (US$/MMBTU**)	6.97	8.84	Target: 4.00 (range: 3.70 to 4.30)	Target: 6.00 (range: 4.50 to 7.50)
Gold (US$/ounce)	697	872	Target: 940 (range: 920 to 960)	Target: 1,000 (range: 900 to 1,100)
LMEX*** index—base metals	3,847	3,377	Target: 2,300 (range: 2,100 to 2,500)	Target: 3,000 (range: 2,500 to 3,500)

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