

The price surge makes way for a consolidation period

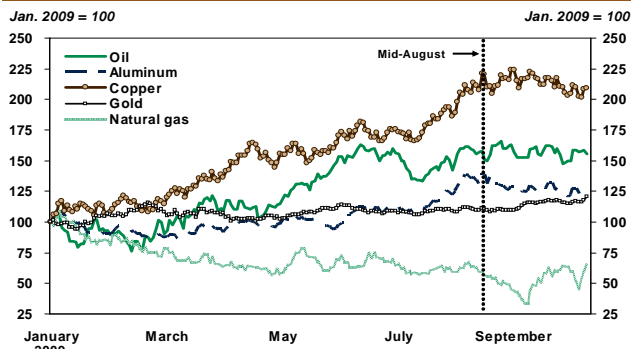
The rapid surge in commodity prices that started at the beginning of 2009 stopped in the middle of August. Prices for most commodities have thus fluctuated in fairly tight ranges in the last few weeks. Some sector rebalancing has also occurred, with precious metals doing well for the last few months in comparison with industrial commodities, which had headed up the price surge in the first half of the year (graph 1). The price of gold has hit a new record in the last few days, capitalizing on concerns about the strength of the economic recovery and the U.S. dollar.

Commodity prices had been expected to undergo a period of consolidation. The pace at which they had been appreciating

last spring could not be sustained for long in the context of ongoing soft global economic activity. Now that the global economy's recovery seems to be confirmed, the question is whether it will be strong enough to take prices close to their pre-crisis peaks. The latest economic statistics, especially in the United States, appear to be pointing to a fairly sluggish recovery and, although this is not our basic scenario, there is more than a slight risk of another decline and a "W" recession. Moderating Chinese imports of a number of commodities after the surge in early 2009 is also putting downside pressure on resource prices.

Ironically, the stagnation in commodity prices coincides with a number of signs of an improving balance between the supply and demand for commodities. Consumption of oil and a number of metals finally seems to have started growing again, although it is still weak for now. The fact that fundamentals are catching up with the surge in prices limits the risk of a sharp correction. The consolidation period could last for a while, but industrial commodity prices should continue to rise in 2010. Gold prices could continue to appreciate in the near term, as doubts about the American dollar's solidity will remain with us. However, we believe that the greenback will keep its benchmark role, which should limit gold's gains.

Graph 1 – The surge in industrial commodity prices has paused



Sources: Datastream and Desjardins, Economic Studies

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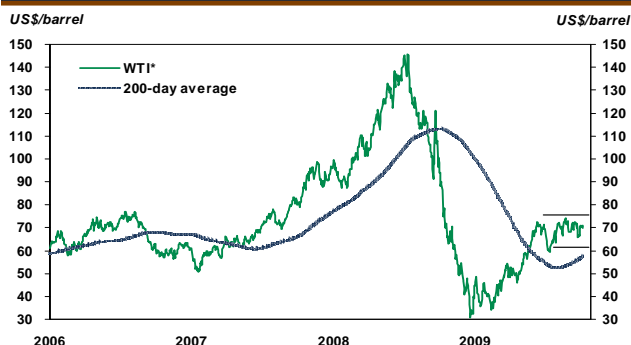
ENERGY

Demand for oil starts to rise

OIL

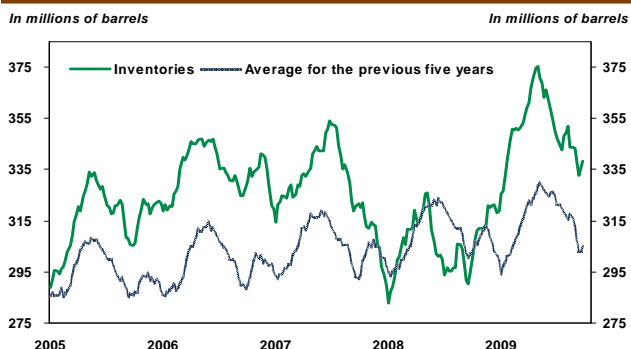
- In the last few weeks, the price of WTI (West Texas Intermediate) oil has kept fluctuating close to US\$70/barrel. Technically, the US\$75/barrel level has provided solid resistance in the last few months (graph 2). The price of crude is still being heavily swayed by economic news and stock movements. The recent disappointing statistics have taken it below US\$70 despite the soft greenback.
- The good news for oil is that global demand finally seems to be starting to grow again. The latest data on oil consumption have been stronger than forecast not only in China but in the United States as well. Cumulatively, U.S. demand is still down since the beginning of 2009. However, the latest weekly figures point to an increase of about 5% compared with the same time in 2008. As a result, the International Energy Agency (IEA) has substantially upgraded its projections for global oil demand for 2009 and 2010. However, the 1.5% growth in oil consumption forecast for 2010 is still quite modest.
- The more promising signs from demand had only a slight impact on crude prices, as investors chose to focus on inventories, which remain high, especially in the United States (graph 3). The growing likelihood of a sluggish economic recovery is also a drag on the crude market.
- Under current conditions, members of the Organization of Petroleum Exporting Countries (OPEC) seem to be comfortable with prices close to US\$70/barrel. Unsurprisingly, they did not announce a change to output quotas at their September meeting. A key difference with the situation prior to the crisis is that, as a result of its production cuts over the last year, OPEC now has substantial surplus capacity. In the event of a spectacular crude price surge that would jeopardize the economic recovery, we could think that OPEC would quickly boost its output. Although the time of major surpluses in the global oil market seems to be over (graph 4), the risks of a shortage will be quite small for several quarters.
- The regulatory changes that are underway in commodity derivatives markets also limit the risks of skyrocketing oil prices. Changes to how futures transactions are reported have already been instituted and U.S. regulatory agencies now want to set stricter limits on derivative positions. For now, the impact of the regulatory changes is not very certain; however, the uncertainty could limit speculators' actions in the near term.

Graph 2 – Oil is struggling to cross the US\$75/barrel mark



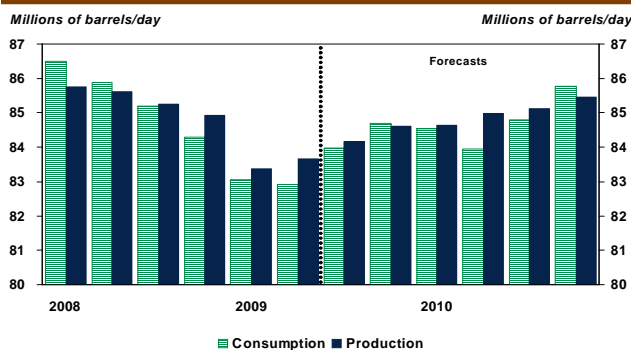
* West Texas Intermediate.
Sources: Datastream and Desjardins, Economic Studies

Graph 3 – U.S. crude inventories remain high



Sources: Energy Information Administration and Desjardins, Economic Studies

Graph 4 – The global oil market should soon be back at equilibrium



Sources: Energy Information Administration and Desjardins, Economic Studies

GASOLINE

- After jumping to almost US\$2.70 a gallon at the beginning of summer, the price of gas has edged down in the United States in the last few months, going to US\$2.47 a gallon (graph 5). Note that the rise by gas prices had been a little ahead of the rise in crude prices at the beginning of the year, explaining gas's recent underperformance against crude. Although demand for gas has recently started to climb, it is still soft. Large gas inventories should also help keep prices close to current levels until the end of the year.

NATURAL GAS

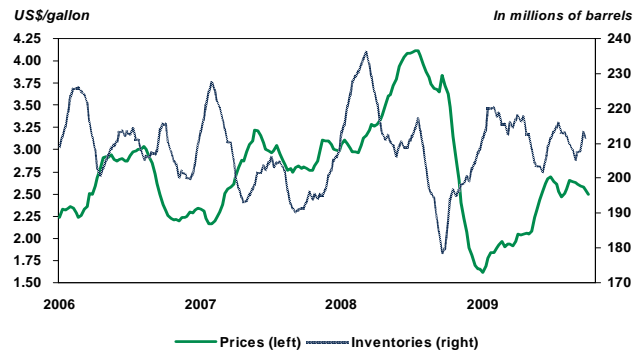
- Unlike the other energy commodities, natural gas prices have been very volatile in recent weeks. Rapidly mounting inventories took the price below US\$2.00 per MMBTU (Million British Thermal Unit) at the beginning of September for the first time in seven years. However, this level, which clearly cannot be sustained over the medium term, has seemed to pique investors' interest. A slight flagging in inventory growth also helped make the price quickly rebound over US\$3.60 at the end of the month, a gain of more than 85% in just a few days. However, inventories are still threatening to reach storage capacity (graph 6). Replacing coal with natural gas at a number of power plants has helped to limit the decline in gas demand and should help to keep its price above the lows reached at summer's end.

URANIUM

- The U.S. government's plan to put a sizeable amount of uranium on the market has put downside pressure on prices in recent weeks. A number of sellers tried to sell off their inventories ahead of this possible American government action, taking uranium prices down to US\$43 a pound (graph 7).

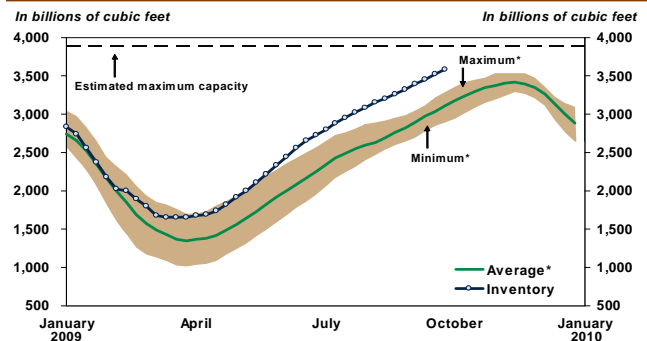
Forecasts: The start of a rise in global oil demand is a fundamental change that signals that some equilibrium will soon return to the crude market. The risk that oil prices will tumble back below US\$60/barrel seems low, unless the global economy plunges back into a recession. Very high inventories and the lack of shortage risk should limit the upswing in oil prices until the end of 2009, but they should continue to rise in 2010 to around US\$95/barrel by year's end. Natural gas prices could remain highly volatile for a few more weeks, but a stronger up trend should start at the beginning of the winter.

Graph 5 – Gas prices and inventories



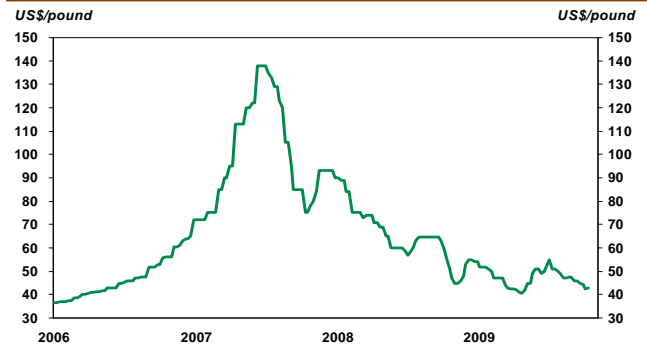
Sources: Energy Information Administration and Desjardins, Economic Studies

Graph 6 – U.S. natural gas inventories continue to mount



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

Graph 7 – Uranium prices



Sources: Datastream and Desjardins, Economic Studies

BASE METALS

The drop in Chinese imports reins in the price surge

The spectacular surge in industrial metal prices has made way for some consolidation in the last few weeks. After going over the 3,000-point mark in mid-August, the LME (London Metal Exchange Index) quickly dropped back below this level. The sharp pullback by Chinese industrial metals imports (graph 8), which is logical after the boom seen at the beginning of the year, is the main factor behind the pause in the price surge. The disappointing economic statistics released in the United States also contributed downside pressure, taking the LME index temporarily below 2,800 at the beginning of October.

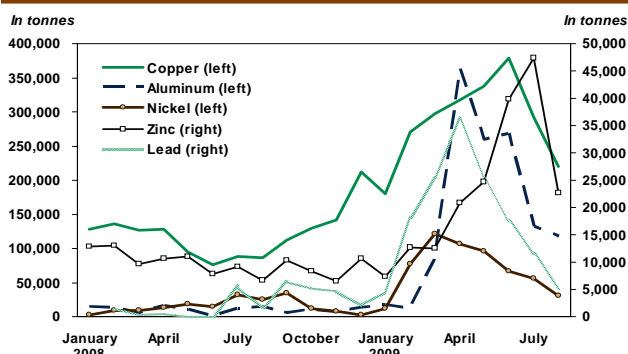
ALUMINIUM

- Aluminum prices were unable to stay above US\$2,000 a tonne for long, a level they reached at the beginning of August. They quickly dropped back to around US\$1,900 a tonne. The bigger-than-forecast drop in new motor vehicle sales when the Cash for Clunkers program ended, has even taken aluminium below US\$1,800 a tonne in the last few days (graph 9). The slight correction is not a surprise given how weak the metal's fundamentals are. Despite the recession's end, global demand is soft for now, even though the first signs of improvement can be seen. Inventories fell slightly in September but remain very high. In China, the main problem for aluminum is not the drop in imports but rather the surge in production. The International Aluminum Institute estimates that China's aluminum output advanced by 31% from March to July of this year. Some figures show that production has started to edge up elsewhere in the world, as well.

COPPER

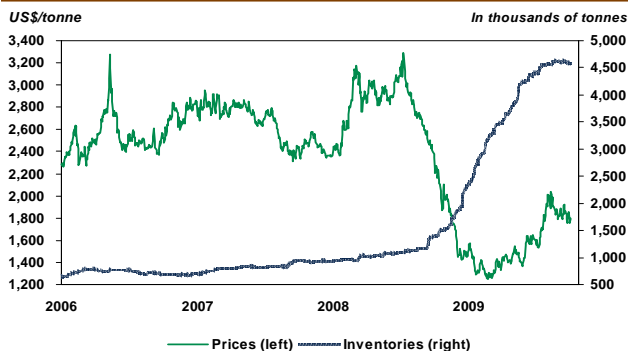
- Copper prices are still volatile, brushing US\$6,500 a tonne at the end of August then descending to around US\$6,000 (graph 10). Despite the drop of about 8%, copper prices are still twice as high as they were at the end of 2008. Given that global output is still limited, demand will have a heavy influence on price fluctuations. The drop in Chinese imports could pick up speed in the next few months and continue to be a drag on prices over the near term, now that the country seems to have stopped stockpiling the metal. The drop in Chinese imports has already had an impact on the inventories surveyed by the London Metal Exchange (LME): inventories have grown by about 35% since mid-July.

Graph 8 – The surge in Chinese imports seems to be over



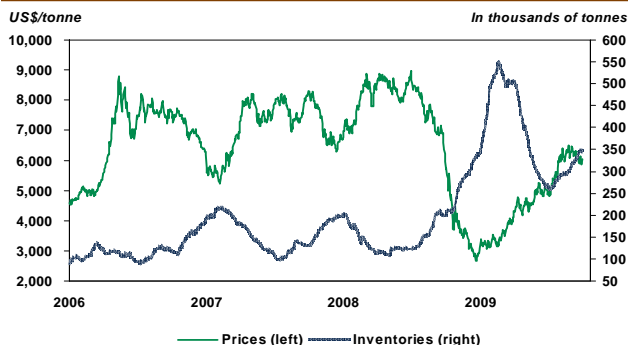
Sources: Bloomberg and Desjardins, Economic Studies

Graph 9 – Aluminum prices and inventories



Sources: Datastream and Desjardins, Economic Studies

Graph 10 – Copper prices and inventories



Sources: Datastream and Desjardins, Economic Studies

NICKEL

- Nickel prices have followed the same trend as other base metals jumping above US\$20,000 in mid-August and then returning to around US\$18,000 recently (graph 11). The situation for nickel has several points in common with the situation for aluminum. Nickel inventories are very large and production has started to rise in China. The news is better for nickel demand, however. The long-awaited comeback by stainless steel production, the main use for nickel, has finally been confirmed, auguring a sizeable increase for Chinese nickel demand. This should help nickel prices consolidate their sizeable gains since the year began.

ZINC

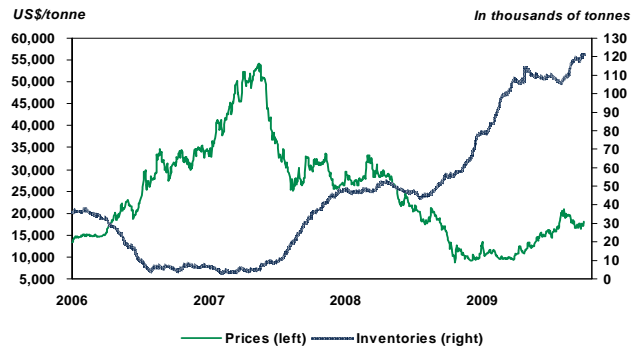
- Zinc prices have fluctuated without setting a clear direction in the last few weeks. At around US\$1,900 a tonne, they are less than 5% below their 2009 peak (graph 12). The news from China is not very promising: imports of the metal fell 46% in August from the previous month and national zinc output is growing. The trend for inventories is still upward, but some signs of stabilization have emerged recently. The drop of about 8% in zinc global output in the seven first months of 2009 over the same period last year is providing the metal's price with some support, however.

TIN AND LEAD

- Tin prices have been relatively stable in the last few months, generally fluctuating between US\$14,000 and US\$15,550 a tonne (graph 13). The sharp drop in Indonesian output is supporting the metal's price. However, the global market still seems to be in surplus as inventories continue to rise.
- Lead prices remain high, managing to stay above US\$2,000 a tonne since the end of August. Temporary major shutdowns of Chinese producers, as investigations into many lead poisoning cases continue, pushed prices up at the beginning of September. Demand for lead outside of China is soft, however, which is still driving inventories up.

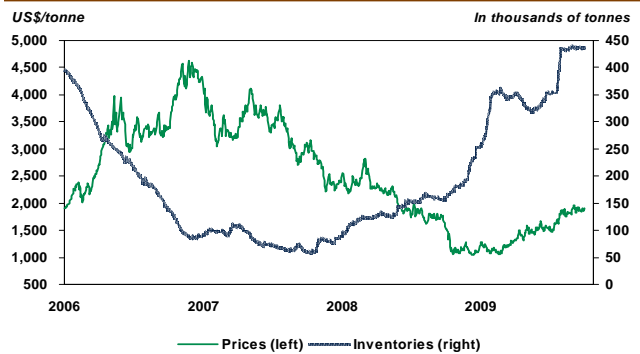
Forecasts: Prices for base metals were expected to consolidate after the surge seen in the first half of 2009. More moderate price declines could occur in the near term as Chinese imports will keep declining and demand will remain limited and uncertain elsewhere in the world. Over the medium range, industrial metals should keep rising, however, and be the first to capitalize on renewed economic activity.

Graph 11 – Nickel prices and inventories



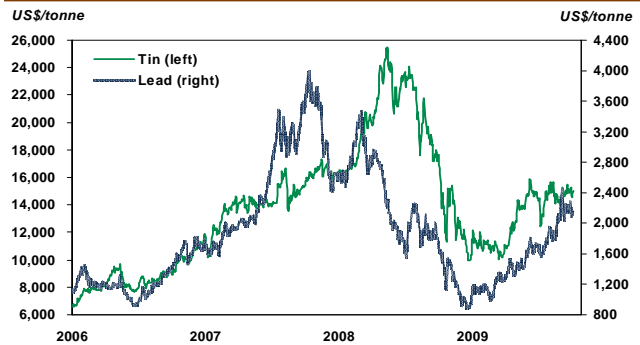
Sources: Datastream and Desjardins, Economic Studies

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 propelled to another peak by the greenback's struggles

After dragging their heels in the first half of the year, precious metals have recently outperformed other commodities. This is particularly true for gold, which started to surge in early September, taking it to another historic peak in the last few days.

GOLD AND SILVER

- Unlike the other commodities, gold has not really been helped by resurgent investor confidence since March, as it is a safe-haven security. Gold prices were thus fairly stable at around US\$950/oz from March to August of 2009. Renewed investor concern and further downside pressure on the U.S. dollar, however, helped gold to temporarily jump over the US\$1,000/oz mark in September (graph 14). After several calmer weeks, a rumour that the Arab countries and China, Russia, Japan and France are in negotiations to stop trading oil in U.S. dollars even allowed the price of gold to hit another historic peak at US\$1,061 an ounce. Silver, which had been benefiting from signs that the global economy was recovering since the beginning of the year, was also helped by gold's recent appreciation. At about US\$17 an ounce, silver is now up 60% since the year began (graph 15).

PLATINUM AND PALLADIUM

- Platinum and palladium prices have continued to move like industrial metals rather than like gold. This is due to the fact that about 75% of demand for the two metals stems from industry, especially the auto sector. They have still appreciated slightly in the last few weeks, taking platinum prices over US\$1,300 an ounce and palladium prices above US\$300 an ounce (graph 16).

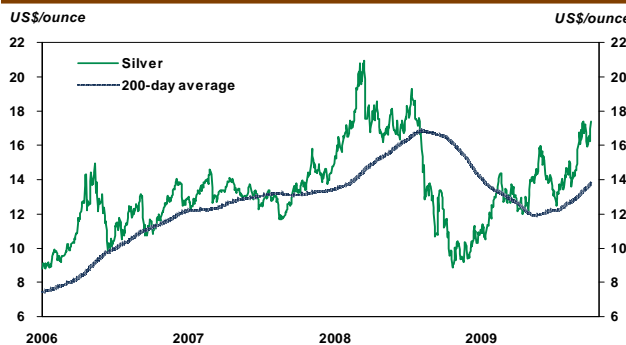
Forecasts: Gold prices could continue to appreciate in the near term, as doubts about the U.S. dollar's solidity will remain with us. Fears that the financial system will collapse again or that inflation will surge should even allow gold to stay over US\$1,000 for several quarters. However, we believe that the greenback will keep its benchmark role, which should limit gold's gains. Demand for jewellery could also be impacted by gold's recent appreciation. Platinum and palladium prices will continue to be heavily influenced by auto sector activity.

Graph 14 – The soft U.S. dollar helped gold hit a new peak



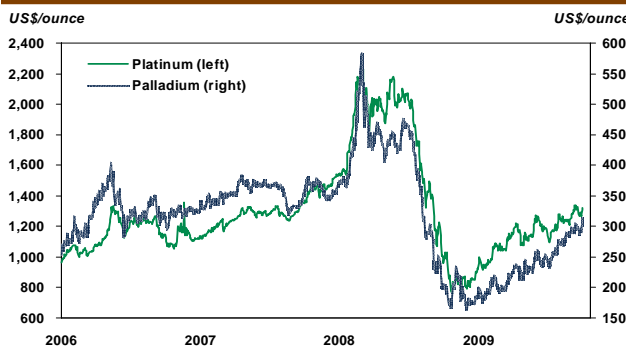
Sources: Datastream and Desjardins, Economic Studies

Graph 15 – Silver prices



Sources: Datastream and Desjardins, Economic Studies

Graph 16 – Platinum and palladium prices



Sources: Datastream and Desjardins, Economic Studies

AGRICULTURAL COMMODITIES

A good harvest is not synonymous with wealth

The last few months have been especially tough for agricultural commodity prices. Of the commodities we track, cereals are the only commodity that has depreciated in the last six months. This is mainly due to the good harvests seen almost worldwide which, combined with modest demand, are making people forget the fears of shortage that reigned just over a year ago. Soft demand is also affecting meat prices, especially for pork.

WHEAT

- Wheat prices have drop in September, reaching an over three-year low at US\$4.22 a bushel (graph 17). The upgraded projections for the 2009-2010 harvest, especially in the former USSR and the European Union, should allow global stocks to climb by about 10% next year. The explosion in short speculative positions in wheat has magnified its price tumble, so a slight technical rebound now seems likely.

CORN AND SOYBEAN

- After hitting an almost three-year low at US\$2.70 a bushel in early September, corn prices have rebounded by about 25% to edge back over US\$3.40 (graph 18). A comeback in demand from ethanol producers and downgraded harvest forecasts for China and South America, where some farmers have opted to boost soybean production, are behind the rise in corn prices. The cereal's price is still down 10% since the year began. Soybeans, which had done well in early 2009, have depreciated by over 20% since mid-August (graph 19). A higher forecast harvest and, in particular, a sharp drop in China's soybean imports are behind the recent drop in prices. The sell-off of major speculative positions also seems to have steepened soybean's depreciation.

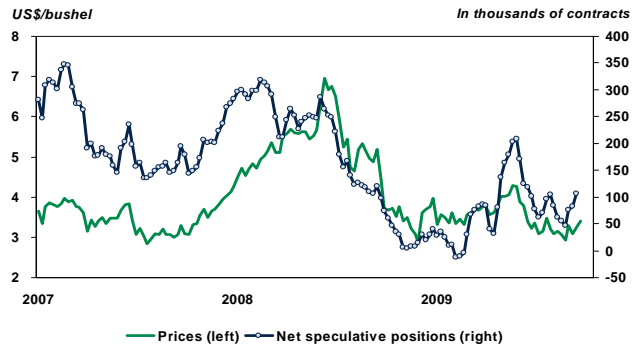
Forecasts: The limited demand does not promise a substantial comeback in cereal prices in the near term. Global stocks remain historically low, however. This limits the potential for decline, especially for wheat and corn. The Chinese demand will have a major impact on soybean prices. In our opinion, imports should rise after a lull of a few months, justifying relatively high soybean prices.

Graph 17 – Wheat prices and speculation



Sources: Datastream, Bloomberg and Desjardins, Economic Studies

Graph 18 – Corn prices and speculation



Sources: Datastream, Bloomberg and Desjardins, Economic Studies

Graph 19 – Soybean prices and speculation



Sources: Datastream, Bloomberg and Desjardins, Economic Studies

Table 1 Commodities

	Spot price	Percentage return since					Last 52 weeks		
	Oct. 7	1 month	3 months	6 months	1 year	High	Average	Low	
Index									
Reuter-CRB* (CCI**)	435.6	6.0	12.0	17.3	4.5	435.6	383.7	323.2	
Reuters/Jefferies CRB*	258.4	4.4	9.2	15.9	-17.4	312.8	240.0	200.3	
Dow Jones AIG***	127.2	3.4	9.4	14.9	-16.4	152.1	119.5	102.0	
Energy									
Crude oil (US\$/barrel)	69.6	2.3	10.6	41.5	-22.8	90.1	57.0	30.8	
Gasoline (US\$/gallon)	2.47	-4.6	-5.5	21.2	-29.2	3.48	2.26	1.61	
Natural gas (US\$/MMBTU****)	3.66	90.4	10.4	1.8	-45.9	7.06	4.39	1.92	
Precious metals									
Gold (US\$/ounce)	1,041.9	4.8	12.6	18.3	18.7	1,041.9	899.9	710.8	
Silver (US\$/ounce)	17.4	7.3	30.6	43.0	49.5	17.4	12.9	8.9	
Platinum (US\$/ounce)	1,323.0	5.4	15.7	14.0	31.3	1,339.0	1,077.5	763.0	
Palladium (US\$/ounce)	312.0	6.8	28.9	38.7	53.7	312.0	225.7	164.0	
Base metals									
Aluminium (US\$/ton)	1,795.3	-1.4	11.5	25.9	-19.4	2,271.8	1,613.8	1,253.3	
Copper (US\$/ton)	6,060.3	-3.8	20.9	40.7	5.6	6,490.3	4,471.4	2,667.5	
Nickel (US\$/ton)	18,132.5	2.2	12.9	71.3	29.5	21,067.5	13,028.3	8,807.5	
Zinc (US\$/ton)	1,902.3	-0.3	21.3	44.1	25.5	1,966.5	1,404.4	1,041.0	
Tin (US\$/ton)	15,025.0	2.2	4.0	38.4	-7.8	16,297.5	12,993.7	9,950.0	
Lead (US\$/ton)	2,140.0	-9.0	24.8	62.8	29.7	2,447.3	1,465.8	877.5	
Agricultural commodities									
Wheat (US\$/bushel)	4.52	0.9	-12.6	-25.1	-26.6	7.29	5.77	4.22	
Corn (US\$/bushel)	3.42	17.3	6.4	-9.2	-8.3	4.30	3.51	2.70	
Soybean (US\$/bushel)	9.00	-11.5	-17.3	-8.0	3.4	12.60	9.89	7.60	
CRB* Livestock index	347.0	-13.7	-3.0	10.4	-25.7	466.9	346.0	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: 60 (range: 55 to 65)	Target: 82 (range: 70 to 95)
Natural gas Henry Hub (US\$/MMBTU**)	6.97	8.84	Target: 3.70 (range: 3.40 to 3.90)	Target: 5.00 (range: 4.00 to 6.50)
Gold (US\$/ounce)	697	872	Target: 960 (range: 940 to 975)	Target: 1,050 (range: 900 to 1,200)
LMEX*** index—base metals	3,847	3,377	Target: 2,400 (range: 2,200 to 2,525)	Target: 3,500 (range: 2,700 to 4,000)

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