Commodity Trends

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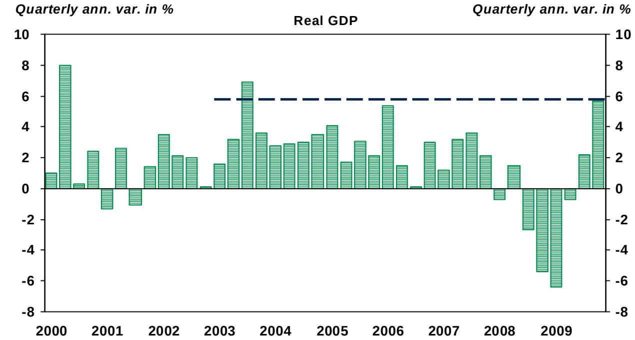
Investor concern drags commodity prices down

The rapid advance that commodity prices made at the end of 2009 and at the start of the new year ground to a brutal halt in mid-January, when a wind of concern blew through the financial markets. Despite encouraging economic statistics, with the U.S. economy posting rapid growth at the end of 2009 (graph 1), fears that Greece would default on a debt payment and the onset of monetary firming in China prompted investors to turn their backs on risky assets, including commodities. The flight to quality also helped the U.S. dollar (graph 2), another development that played against base product prices.

Abundant credit in China was one of the key factors behind the strong upswing in base metal prices in 2009, which is why the sector was especially hard hit by Chinese authorities' efforts to rein in credit expansion. Note that price increases for some base metals in the last few months seemed exaggerated. Cereal prices also pulled back sharply, as harvest forecasts were once again upgraded substantially.

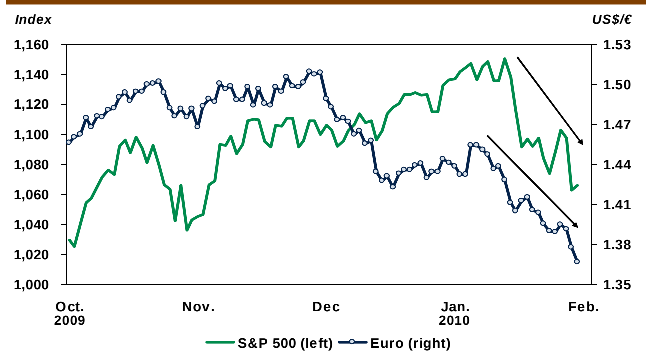
Beyond fluctuations arising from the change in investor mood, we still think that, combined, the gradual acceleration in global economic activity and a supply that is more than able to meet demand argue for relatively modest commodity price increases in 2010. Investors' growing interest in this sector should continue to provide some price support, but we should keep an eye on any impact the new regulations could have, especially in the United States.

Graph 1 – The stronger U.S. growth since the third quarter of 2003



Sources: Bureau of Economic Analysis and Desjardins, Economic Studies

Graph 2 – Investor concern favors the U.S. dollar



Sources: Datastream and Desjardins, Economic Studies

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Note to readers: The letters **k**, **M** and **B** are used in texts and tables to refer to thousands, millions and billions respectively.

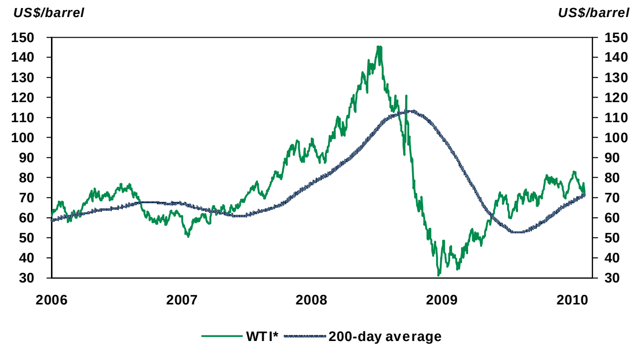
ENERGY

Investor pessimism brings prices down

OIL

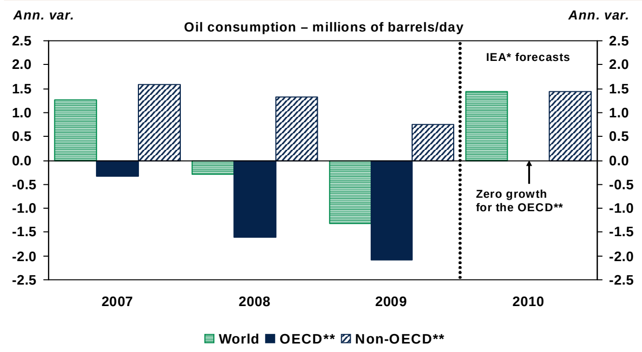
- After a brief foray over US$80/barrel for WTI (West Texas Intermediate), renewed pessimism in the markets took oil prices back below US$75 a barrel (graph 3). The trend for the last few months thus seems inclined to continue, with oil oscillating in a range of US$70 to US$80 a barrel. In our view, prices at this level are a fairly good reflection of the situation in the international market. Oil producers–OPEC (Organization of Petroleum Exporting Countries) and the rest of the world–also seem to be happy with prices at this level.
- There is still a big dichotomy between demand in emerging nations and in industrialized countries. While Chinese oil imports are ascending rapidly, demand from OECD (Organisation for Economic Co-operation and Development) countries remains quite soft. Although economic growth has accelerated steeply, U.S. consumption of petroleum products was down by about 2% in the last few weeks from January 2009's already very low levels. Increasingly, we may wonder whether renewed economic growth will quickly put rich countries' oil consumption back at pre-recession levels, or whether there have been some real changes in consumption habits. In all, the International Energy Agency still expects global oil consumption to grow 1.7% in 2010, thanks to emerging nations (graph 4).
- Although global demand is showing growing signs of improvement in the last few months, this has not put the market back in balance. In fact, the global oil supply rose steeply at the end of 2009, primarily due to an increase in shipments from OPEC nations and Russia. 2009 thus ended with a significant increase in output from non-OPEC nations (graph 5). This did a lot to take oil stocks to very comfortable levels. The 2010 outlook for Russian output is uncertain but, for now, everything suggests that the oil market will be well supplied.
- As the months go by, the petroleum market should slowly close in on equilibrium and supply security issues could start to loom again. The political uncertainty in Nigeria and Iran's continuing uranium enrichment program could thus prompt a renewed risk premium on oil prices.

Graph 3 – Price of oil per barrel



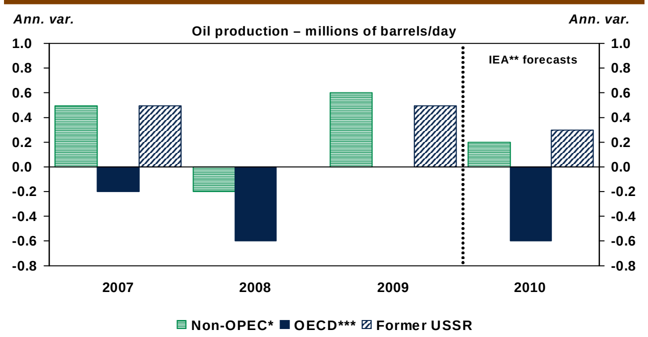
* West Texas Intermediate.
Sources: Datastream and Desjardins, Economic Studies

Graph 4 – All of the rise in oil demand will come from emerging nations



* International Energy Agency; ** Organisation for Economic Co-operation and Development.
Sources: International Energy Agency and Desjardins, Economic Studies

Graph 5 – Outside OPEC, oil production will mainly increase in the former USSR



* Organization of the Petroleum Exporting Countries; ** International Energy Agency;
*** Organisation for Economic Co-operation and Development.
Sources: International Energy Agency and Desjardins, Economic Studies

GASOLINE

- Like crude prices, gas prices have not shown a clear trend in recent months. Prices at the pump still reached an over one-year peak in mid-January, at US$2.75 a gallon (graph 6). Oil's recent drop did, however, bring gas prices down somewhat; this trend could continue if oil remains under US$75/barrel. A downward movement could also be fostered by the large gas inventories.

NATURAL GAS

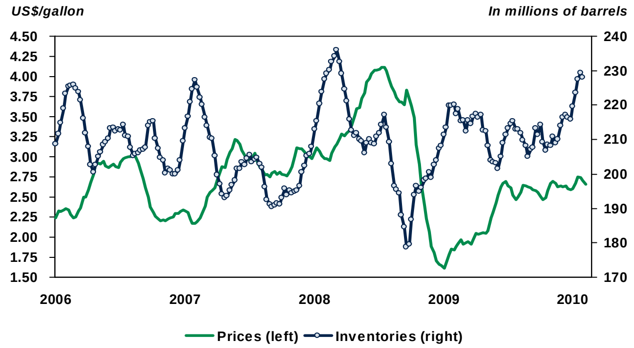
- As forecast, natural gas was unable to hang onto its gains. After jumping to US$7.38 per MMBTU (Million British Thermal Unit), it quickly fell to almost US$5.00 (graph 7). The cold snap in December and early January was follow by warm weeks which cause inventories to drop less than normally at this time of the year.
- Despite a spectacular nosedive by drilling in 2009, U.S. gas production advanced last year, with major productivity gains being made in existing fields. The impact of the decline in drilling could be more felt this year, but the increase in exploration in the last few months suggests that 2010 production will not drop much (graph 8). Moreover, a large increase in imports of liquefied natural gas will go a long way toward offsetting the drop in domestic output. Despite the end of the recession, consumption of natural gas could edge down this year when, unlike 2009, this energy source should give up some ground to coal in the electric power sector.

URANIUM

- Uranium prices continued to trend down in January, pulling back by 5% and dropping to US$42.25 a pound, a low that dates back to last April. Given soft demand, the fairly abundant uranium supply explains the downside pressure on prices. The main hope for 2010 is that electricity generators will capitalize on low prices to increase their purchases.

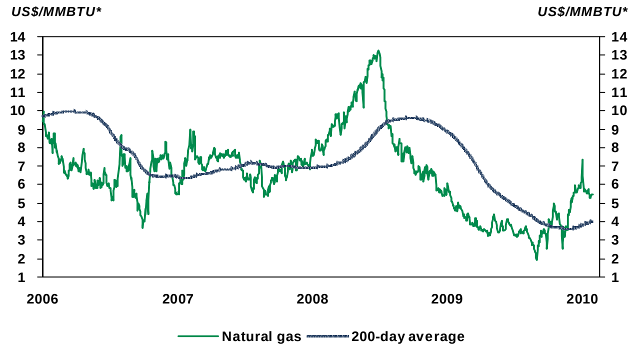
Forecasts: In our opinion, large oil inventories and the uncertainty surrounding the strength of the recovery in industrialized nations should keep crude prices close to current levels in the months to come. However, we expect some gains in the second half of the year, when concerns about supply's ability to handle the growing demand from Asia will slowly re-emerge, potentially taking crude prices to around US$90 a barrel at the end of 2010. Despite the winter's cold start, North America's natural gas market will be dominated by elevated inventories throughout 2010. We are thus maintaining our forecast for an average price of US$5.00 per MMBTU.

Graph 6 – Gasoline prices and inventories



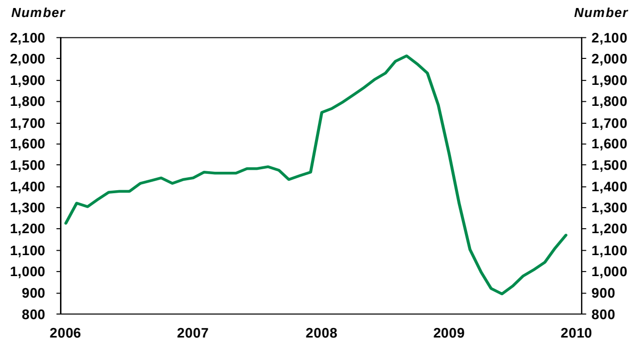
Sources: Energy Information Administration and Desjardins, Economic Studies

Graph 7 – Natural gas prices



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

Graph 8 – Drills used in the United States by natural gas producers



Sources: Energy Information Administration and Desjardins, Economic Studies

BASE METALS

The Chinese government's actions raise anxiety

Last month, we deemed that the rise in base metal prices had gotten well ahead of the improvement in the balance between global supply and demand. The LMEX (London Metal Exchange Index) index's almost 15% pullback since mid-January is thus not surprising, especially as global stocks have continued to grow. The trigger for the recent decline was the efforts the Chinese government is making to attempt to rein in credit growth. To date, the actions have had fairly limited reach, but the message is clear: the efforts instituted last year to support growth will slowly make way for measures to keep the economy from overheating. As the spectacular surge in base metal prices was mainly based on the growth in Chinese demand, with the country even becoming the world's biggest buyer of motor vehicles (graph 9), news from China will continue to have a big impact on prices. Note, however, that, to date, Chinese demand is still very robust, as base metal imports ended the year strong.

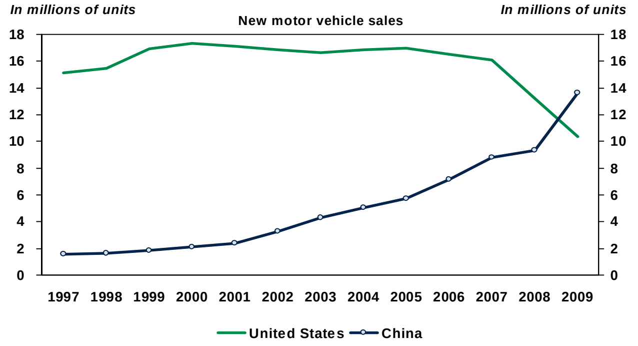
ALUMINUM

- After making an impressive almost 25% gain from the start of November to mid-January, aluminum prices retreated by over 10%, descending close to US$2,000 a tonne (graph 10). An upswing in global demand seems to be shaping up, with inventories unchanged in the last few weeks. However, the rapid growth in global output, particularly in China, but in other parts of the world as well, seems to ensure that there will be a surplus of this metal this year. It will be hard for this pause to continue; inventories should go back to their up trend in the coming quarters. In this context, aluminum prices will have a tough time staying over US$2,000 a tonne.

COPPER

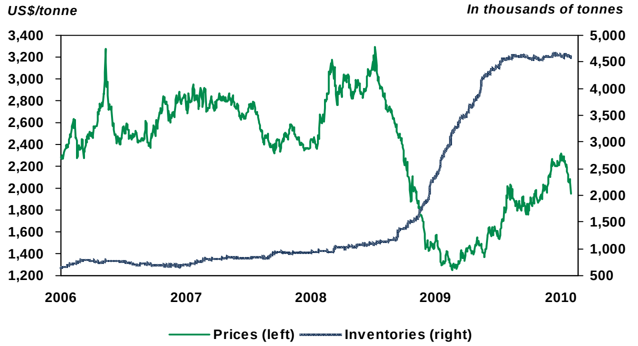
- After brushing US$7,700 a tonne, copper prices lost over 15%, dropping back below US$6,500 (graph 11). In addition to the Chinese issue, copper, which is more sensitive to investor sentiment, was affected by the rising strain in the markets in the last few weeks. The news on global supply and demand was mixed. Chinese copper imports jumped again in December, but inventories continued to rise. The quick conclusion to labour disputes at two major copper mines also helped to bring prices down. Contrary to recent years, growth of mining output is looking relatively strong in 2010, which should help meet the forecast rise in demand.

Graph 9 – Motor vehicle sales continue to explode in China



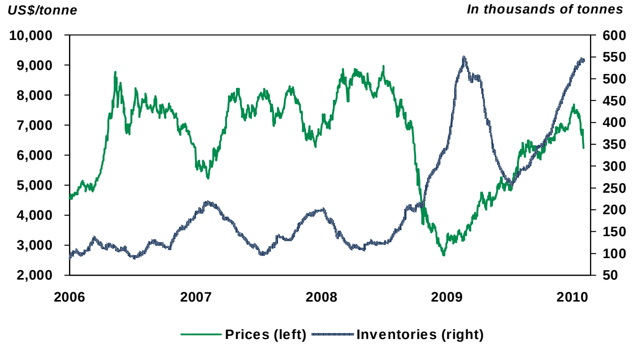
Sources: Datastream and Desjardins, Economic Studies

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

- Nickel prices have continued to fluctuate within a band around US$18,000 a tonne in the last few weeks. The already sizeable world nickel stocks continued to rise, reaching a record peak (graph 12); this will limit any price increase. Although stainless steel producers are sending out mixed signals, global nickel demand should rebound this year. However, this will also come with a substantial increase in world output, which could keep the nickel market in surplus.

ZINC

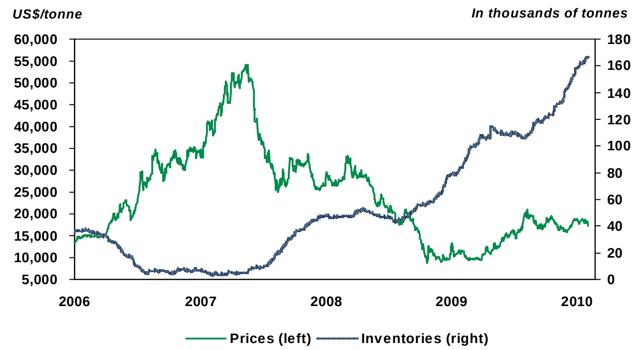
- Recent weeks have been especially hard for zinc prices, which have tumbled by more than 15% since 2010 began, returning to close to US$2,000 a tonne (graph 13). This correction did not come as a surprise: we wrote last month that it would be hard to hang onto 2009's surprising gains. December's drop in Chinese zinc imports took away the metal's last price support. All signs suggest that global zinc production will substantially outstrip demand in 2010.

TIN AND LEAD

- The price of tin has been volatile since the year began. It jumped by close to 10% in the first weeks of January, then edged back below where it ended 2009 (graph 14). The fundamental determinants of tin prices are still more favourable than those of most other metals. Following 2009's major surplus, further stagnation by global output and an upswing in tin demand should take the market very close to equilibrium this year.
- Lead prices were also hurt in recent weeks, dropping over US$500 to near US$1,900 a tonne, a low that dates back to last August. As we had said, the surge by lead inventories, which have jumped again since this year began, is a sizeable risk to the metal's price. One positive point for lead is strong demand from China. However, the fact that, despite strong domestic demand, the country once again became a net lead exporter in the last few months is somewhat worrisome.

Forecasts: Although much of it stems from financial factors, the recent decline in base metal prices has taken them to levels that are more in line with their fundamentals. As, for most metals, the supply seems to be enough to keep pace with demand in the coming months, price increases should be small. Any sign of demand softness, particularly in China, could bring on further big drops by industrial metal prices.

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

Will gold fever make way for platinum fever?

Precious metals are the commodities that have performed the best in January. However, a new jump of the U.S. dollar at the beginning of February caused their prices to drop back.

GOLD AND SILVER

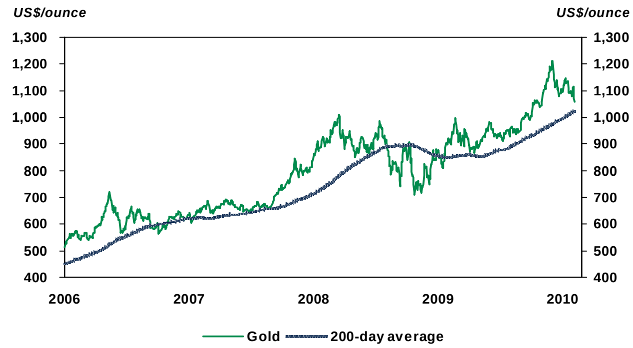
- After grabbing the spotlight at the end of 2009, gold has had a fairly calm January, fluctuating around US$1,100 an ounce (graph 15) before dropping near US$1050 at the beginning of February. The impact of the upswing in financial strains, which could have boosted a safe-haven security like gold, was offset by further greenback appreciation. The idea that the U.S. dollar could lose its role as a global reference seems even less plausible now, as the euro, its only real competitor, is facing its own problems. Investor demand remains essential for mopping up the surplus of physical gold, as the gold produced by mines or put back on the market should exceed 2010 demand from jewellery manufacturers and industry by over 50%. Silver's price was more volatile: it jumped to almost US$19 an ounce to then drop back below US$16 (graph 16). The sizeable surplus of physical silver also makes the metal's price highly dependent on investor demand.

PLATINUM AND PALLADIUM

- Very encouraging signs from global demand allowed platinum and palladium prices to post small gains since the start of this year (graph 17). In particular, imports of both metals are up sharply in China, where they are increasingly used in making jewellery and motor vehicles. The recent launch of exchange-traded platinum and palladium funds will also help inflate demand for the two metals this year.

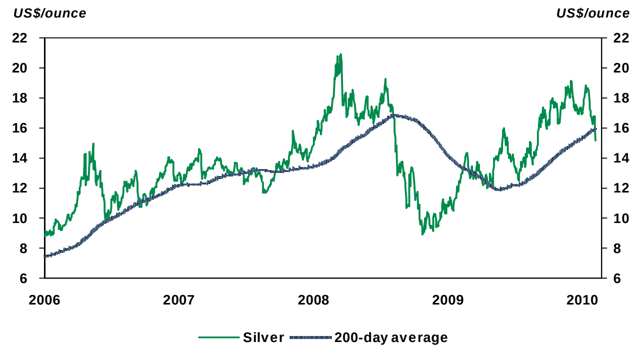
Forecasts: It is hard to predict how gold prices will move, as movement is entirely dependent on how investors feel about this metal and the U.S. dollar. The euro's problems bolster our view that we must not count on major greenback devaluations this year. Gold and silver prices thus seem to have limited upward potential. We still prefer platinum and palladium, which will benefit from a big increase in demand this year.

Graph 15 – Gold prices



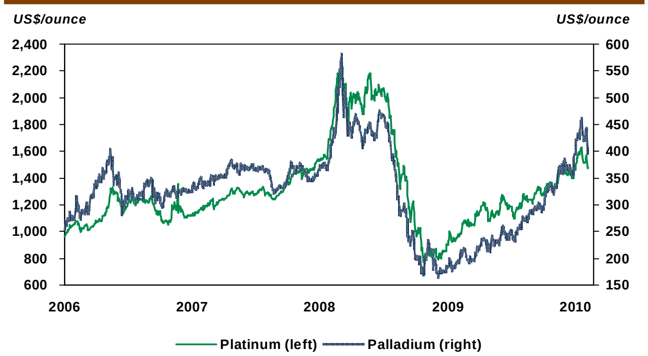
Sources: Datastream and Desjardins, Economic Studies

Graph 16 – Silver prices



Sources: Datastream and Desjardins, Economic Studies

Graph 17 – Platinum and palladium prices



Sources: Datastream and Desjardins, Economic Studies

AGRICULTURAL COMMODITIES

Harvest forecasts upgraded again

The hope that the cold snap would give lasting support to wheat, corn and soybean prices, through a smaller harvest, met with bitter disappointment in mid-January, when the U.S. Department of Agriculture sharply raised the production forecast for the three primary cereals. This prompted a substantial drop in speculative positions and a big pullback by cereal prices. The only good news for prices came from demand, with Chinese cereal imports going strong.

WHEAT

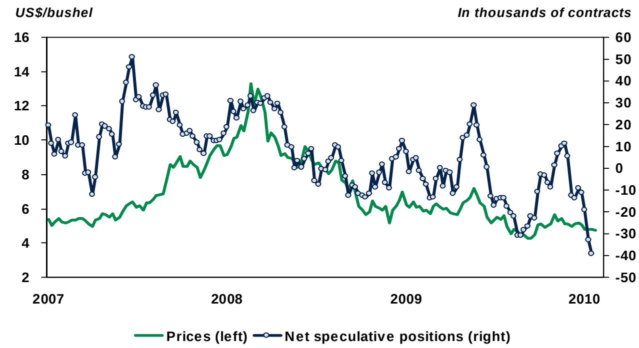
- Wheat prices are off more than 5% since the year began, dropping back below US$5/bushel (graph 18). The positive gap between global supply and demand widened further, as Russia's harvest forecast has been revised upward substantially and the cereal's utilisation has been revised downward slightly. After jumping 35% with the last harvest, global wheat stocks should thus climb by almost 20% in the 2009-2010 season. Given that the market is clearly in surplus, U.S. farmers appear to want to cut their wheat plantings in favour of other cereals. If the rest of the planet falls into step, supply and demand could start to get back into balance next year.

CORN AND SOYBEANS

- Excellent yields in the United States prompted an especially big upward revision to the forecast corn harvest, taking the cereal's price down by over 10% (graph 19). Regardless, corn demand promises to be strong from both China and the ethanol industry. Despite a record harvest, corn stocks are therefore still forecast to edge down at the end of this season. Soybean prices also responded negatively to an upward change to the harvest forecasts for the United States and Brazil (graph 20). Global demand remains strong, however, with Chinese soybean imports hitting another record last December.

Forecasts: As long as the weather remains so favourable, pressure on cereal prices should be to the downside. Given the abundant supply, the only hope of a price increase would be strong demand growth. Here, soybeans and particularly corn are in much better positions than wheat. Certainly, fears of food shortages should not resurface quickly.

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 – Soybean prices and speculation

Sources: Datastream, Bloomberg and Desjardins, Economic Studies

Table 1
Commodities

	Spot price	Percentage return since				Last 52 weeks		
	Feb. 8	1 month	3 months	6 months	1 year	High	Average	Low
Index								
Reuter-CRB* (CCI**)	459.6	-8.8	0.8	9.0	24.7	504.7	420.9	341.8
Reuters/Jefferies CRB*	261.5	-10.1	-2.8	-1.1	16.6	293.8	251.8	200.3
Dow Jones AIG***	128.0	-10.1	-2.6	-1.7	13.1	145.0	124.3	102.0
Energy								
Crude oil (US$/barrel)	71.9	-13.1	-7.2	1.4	79.0	83.2	65.5	34.0
Gasoline (US$/gallon)	2.66	-0.2	-1.2	4.1	40.6	2.75	2.44	1.89
Natural gas (US$/MMBTU****)	5.73	-11.7	48.1	61.0	21.3	7.38	4.02	1.92
Precious metals								
Gold (US$/ounce)	1,071.4	-5.3	-1.7	11.8	17.4	1,212.0	997.7	868.1
Silver (US$/ounce)	15.1	-16.4	-13.6	3.3	17.5	19.2	15.2	12.0
Platinum (US$/ounce)	1,477.0	-5.9	9.7	17.2	49.3	1,627.0	1,265.7	981.0
Palladium (US$/ounce)	405.0	-6.0	22.7	49.4	94.7	462.0	288.5	191.0
Base metals								
Aluminium (US$/ton)	1,973.8	-12.7	4.6	0.1	38.8	2,320.3	1,747.5	1,253.3
Copper (US$/ton)	6,328.8	-15.0	-3.1	6.1	84.0	7,682.5	5,568.0	3,147.5
Nickel (US$/ton)	17,032.5	-6.0	-4.3	-12.7	48.3	21,067.5	15,386.6	9,402.5
Zinc (US$/ton)	1,998.5	-21.0	-7.8	9.7	76.0	2,634.3	1,779.7	1,059.3
Tin (US$/ton)	14,937.5	-14.1	-0.2	0.6	33.7	18,187.5	14,182.3	10,052.5
Lead (US$/ton)	1,932.5	-23.4	-16.7	6.5	66.0	2,590.5	1,840.5	991.3
Agricultural commodities								
Wheat (US$/bushel)	4.78	-10.9	-1.5	-5.5	-22.2	7.29	5.44	4.22
Corn (US$/bushel)	3.30	-14.7	-3.4	4.6	-8.6	4.30	3.54	2.70
Soybean (US$/bushel)	9.10	-8.4	-2.4	-20.2	-7.9	12.60	10.19	8.35
CRB* Livestock index	405.1	-2.5	8.3	1.7	32.5	421.2	362.8	268.0

*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	2008	2009	2010f	2011f
WTI* oil (US$/barrel)	99	62	Target: 80 (range: 70 to 90)	Target: 95 (range: 85 to 105)
Natural gas Henry Hub (US$/MMBTU**)	8.84	3.95	Target: 5.00 (range: 4.00 to 6.50)	Target: 6,00 (range: 5.00 to 7.50)
Gold (US$/ounce)	872	973	Target: 1,100 (range: 1,000 to 1,200)	Target: 1,000 (range: 900 to 1,100)
LMEX*** index—base metals	3,377	2,471	Target: 3,500 (range: 2,800 to 4,200)	Target: 4,200 (range: 3,500 to 5,000)

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