Commodity Trends

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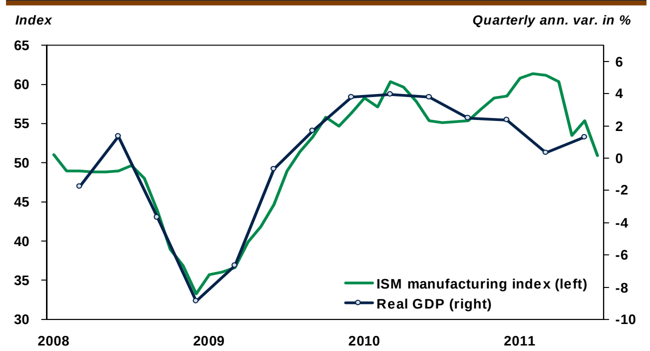
# Economic and financial risks are pummelling commodity prices

The past few weeks have been marked by several worrisome developments for the global economy. The issue of excessive government debt is of increasing concern. In the euro zone, a second agreement has been reached, which should take care of Greece's financial needs for several years. However, these new measures have not convinced investors that the European authorities are capable of truly solving the sovereign debt crisis, and concerns have recently veered towards Spain and Italy. In the United States, even though a last-minute agreement has averted a payment default, the government debt has been downgraded.

In addition to growing financial worries, investor confidence has been affected by the release of very disappointing economic statistics showing that economic growth is slowing in most industrialized countries. The situation is particularly troubling in the United States, where activity stagnated in the first half of the year, and there is no sign of any marked rebound in growth in the third quarter (graph 1).

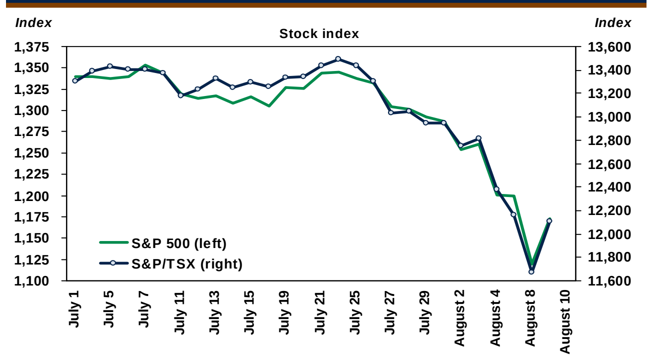
Amid escalating risks, investors have been shunning risk assets in the past few weeks, sparking a correction of about 15% in many stock indexes (graph 2). Gold has benefited from the worries to reach new heights, but prices for industrial commodities have tumbled. The commodities market is set to remain highly volatile in the short term.

**Graph 1 – The ISM manufacturing index again suggests weak U.S. real GDP growth**




Sources: Institute for Supply Management, Bureau of Economic Analysis and Desjardins, Economic Studies

**Graph 2 – Stock markets are correcting**




Sources: Datastream and Desjardins, Economic Studies

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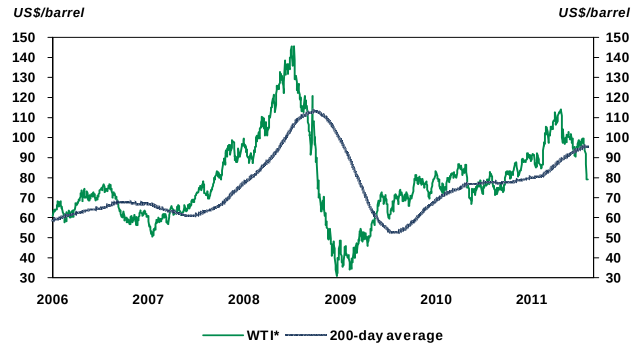
# ENERGY

## The barrel of oil is likely to remain below US$100 for some time

### OIL

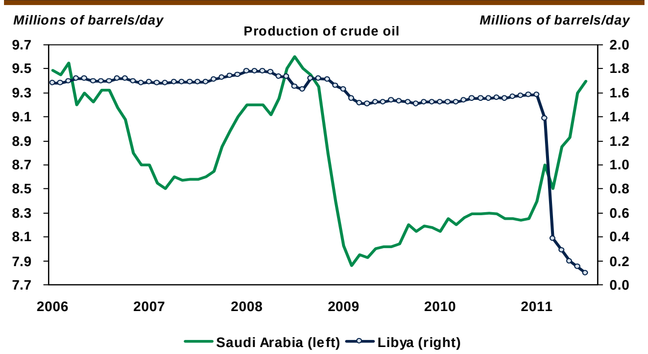
- Since the correction of early May, when WTI (West Texas Intermediate) oil prices went from nearly US$115 per barrel to less than US$100 in the space of just a few days, oil prices have generally fluctuated between US$90 and US$100 per barrel (graph 3). At the beginning of June, dissension at a meeting of the Organization of Petroleum Exporting Countries (OPEC) gave temporary support to the price of oil. This trend was later reversed, however, when the International Energy Agency (IEA) decided to dip into the member countries' strategic reserves, driving the price of crude close to US$90 per barrel. The month of July was relatively calm for crude prices, with the depreciation of the U.S. dollar offsetting the gradual intensification of concerns. Fears of a new recession gained the upper hand at the beginning of August, however, sending oil prices to close to US$80 a barrel.
- The IEA's extraordinary decision to ask member countries to draw upon their strategic reserves to supply the global oil market is a direct consequence of the shortfall in production resulting from the conflict in Libya. Since it was becoming clear that there was no end in sight for the Libyan conflict and that the other OPEC countries were not making up for the lost production as quickly as hoped for, the IEA feared that strong seasonal demand in the third quarter of 2011 might lead to severe shortages in the global oil market and, possibly, a sharp price spike that would be detrimental to the global economy. By releasing 60 million barrels of oil over a 30-day period, the IEA member countries managed to slightly more than compensate for the loss of Libyan production. We note that Saudi Arabia shared the IEA's vision to a large degree and, despite its failure to convince OPEC of the necessity of raising its quotas, it recently expanded its own oil production unilaterally (graph 4).
- While the Libyan conflict does demand some adjustments, it does not present a serious risk for the global oil supply in the medium term. It is even encouraging to note that the spring rebellions in the Arab world have not affected other major producers. Furthermore, according to the IEA's latest forecasts, the production of non-OPEC member countries will moderate in 2011 and then expand sharply once more in 2012 (graph 5). Unless production is disrupted by further shocks, there is reason to think that the main factor influencing oil prices in the months ahead will be trends in global demand. Until just recently, it was forecast that sustained growth in demand from emerging countries would compensate for a slight reduction in that of industrialized countries. However, the feebleness of recent economic statistics, especially out of the United States, is likely to lead to a downwards revision of global demand forecasts for the upcoming quarters.

**Graph 3 – Price of a barrel of oil**



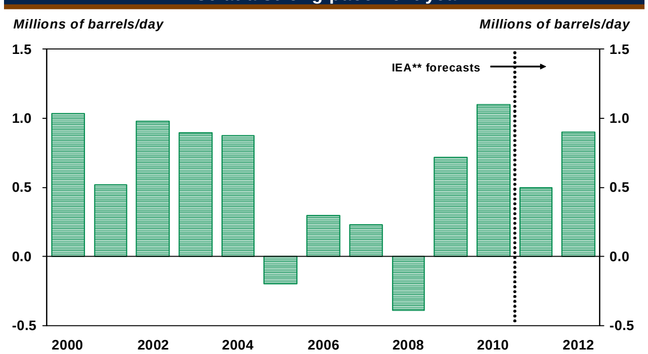

* West Texas Intermediate.
Sources: Datastream and Desjardins, Economic Studies

**Graph 4 – Saudi Arabia boosts its oil production**




Sources: Datastream and Desjardins, Economic Studies

**Graph 5 – The production of non-OPEC member countries should rise at a strong pace next year**




* Organization of Petroleum Exporting Countries; ** International Energy Agency.
Sources: Datastream, International Energy Agency and Desjardins, Economic Studies

## GASOLINE

- Just like crude oil prices, gasoline prices have stabilized, relatively speaking, in recent months after a very volatile first half of the year. After nudging US$4.00 per gallon in May, the average price of gasoline moderated somewhat and recently was hovering around US$3.70 per gallon (graph 6). This price is still high, however, and represents a 35% increase compared with the same period last year. The situation is similar in Canada, where the average price of gasoline has fallen back down below C$1.30 per litre, which is still high. Gas prices should fall in the short term, reflecting the drop in crude oil prices.

## NATURAL GAS

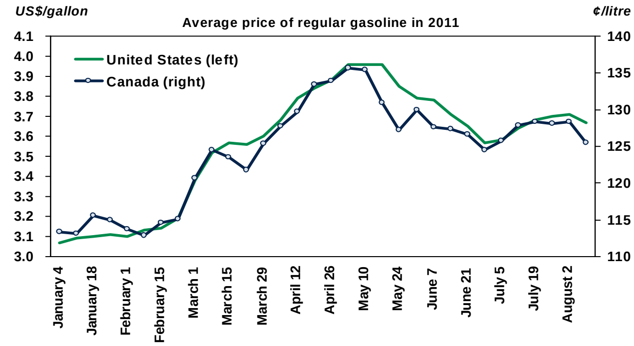
- The price of natural gas has been relatively stable in recent months (graph 7), hovering around US$4.40 per MMBTU (Million British Thermal Unit). Given the very hot summer that North America is having, which inflates demand for gas, this performance is nothing to write home about. Admittedly, restocking has continued at a brisk pace despite the weather, another sign that gas production is amply sufficient. The significant productivity gains achieved on existing facilities are enabling American gas production to keep advancing strongly, despite the fact that low prices have curbed drilling activities. Recent investor panic saw the price of natural gas fall near US$4 per MMBTU.

## URANIUM

- The global uranium market is still being influenced by the nuclear incidents that occurred in Fukushima, Japan. Even though many countries will continue to develop this source of energy, analysts anticipate that demand for uranium will grow at a slower pace than previously thought. After an initial correction, the price of uranium seems inclined to stabilize at around US$50 per pound (graph 8).

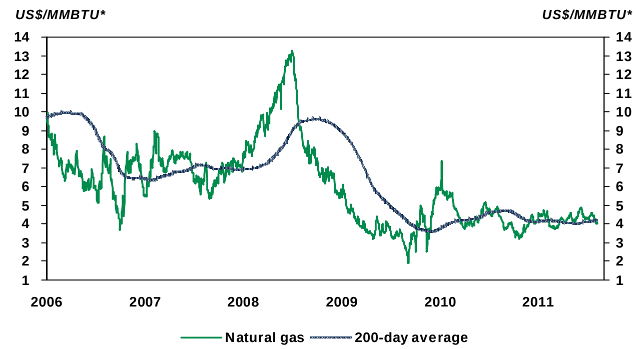
**Forecasts:** Whereas variations in the U.S. exchange rate and oil supply issues have dominated oil price trends in recent months, we should now expect that investors will focus their attention on economic statistics and on signals regarding demand for crude. In the short term, the risk remains on the downside for oil prices. We can only hope that the economic data will gradually improve and enable oil prices to gain a bit of momentum between now and the end of the year. The most favourable scenario for oil prices would be for the Federal Reserve to adopt new quantitative measures or take other actions that would bolster investor confidence and further erode the U.S. dollar.

**Graph 6 – Gasoline prices have moderated but are still high**




Sources: Datastream, Natural Resources Canada and Desjardins, Economic Studies

**Graph 7 – Natural gas prices**




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

**Graph 8 – Uranium prices**


Sources: Bloomberg and Desjardins, Economic Studies

# BASE METALS

## Prices can't escape the gloomy economic outlook

The relationship between base metal prices and economic growth is well known. Since demand for these metals is directly tied to industrial activity, any darkening of economic outlooks is usually accompanied by a downwards adjustment of their prices. Given the considerable intensification of concerns about the state of the global economy (graph 9), to the point where some analysts are beginning to be apprehensive about a new recession in the United States, it is normal that, after putting up a good fight these past few weeks, the prices of most metals have declined sharply since the beginning of August.

The persistence of high metal prices in July despite gloomy economic prospects appeared to be mainly attributable to three factors: the depreciation of the U.S. dollar, new production problems for certain metals, copper in particular, and signs that Chinese demand is firming up.

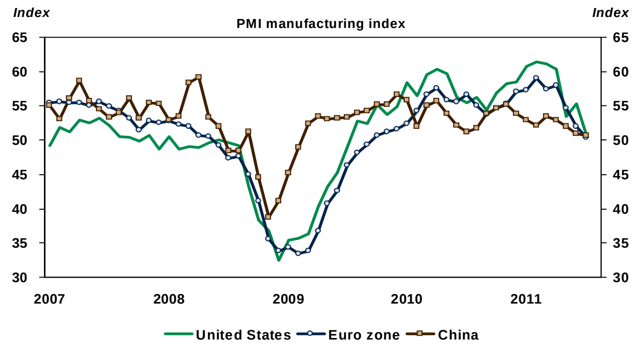
### ALUMINUM

- The price of aluminum has stayed relatively high in recent months, at around US$2,500 per ton (graph 10) before tumbling back near US$2,350 per ton. Despite some effort by the Chinese government to restrict electricity consumption, aluminum production in that country is still posting annual growth of approximately 4%. Production is also on the upswing in other parts of the world, which is helping to keep global inventories very high. Strong growth in global demand for aluminum is therefore the main support for the price of this metal but, in light of recent economic statistics, a pullback is possible in the months ahead.

### COPPER

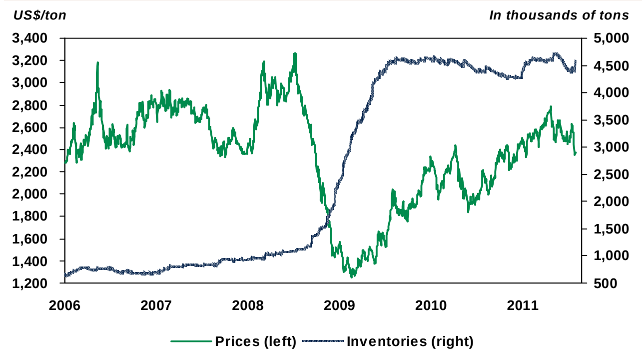
- After falling below US$9,000 per ton a few times in June, the price of copper rose through the month of July to over US$9,500 per ton temporarily (graph 11). The fragility of the U.S. dollar and a slight upturn in Chinese imports of this metal have been to copper's advantage at the beginning of the summer. However, it is mainly the problems faced by copper producers that are keeping the price high: production stoppages, due mainly to weather conditions and labour disputes, have proliferated.

**Graph 9 – The manufacturing sector seems to be slowing in the major economies**



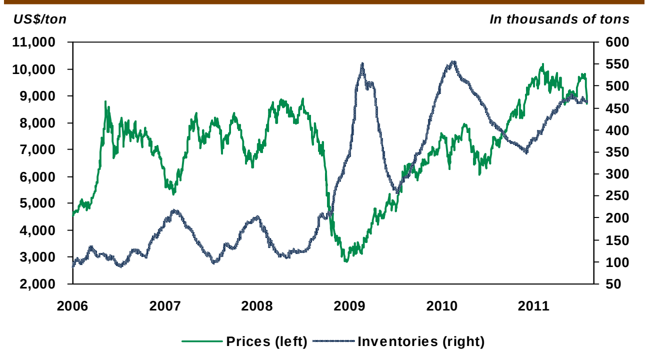

Sources: Bloomberg, Institute for Supply Management and Desjardins, Economic Studies

**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 dropping to around US$21,500 per ton in the middle of June, the price of nickel has rallied to nearly US$25,000 per ton temporarily (graph 12). A surge in Chinese demand and gradual depletion of inventories played to this metal's advantage in the first half of the year. An expected acceleration of production in the second half of the year, given that many major facilities have recently resumed their activity and new projects will soon be completed, could be detrimental to nickel prices.

## ZINC

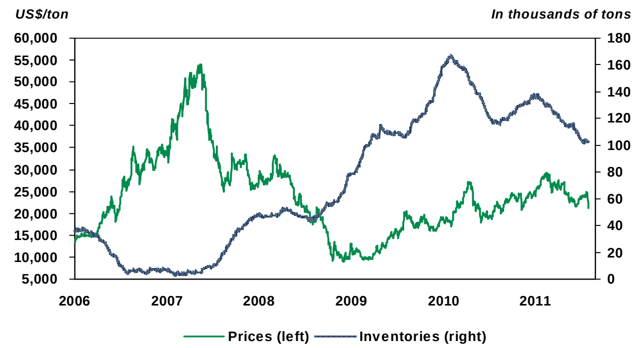
- Thanks to relatively robust demand, the price of zinc recently climbed close to US$2,500 per ton (graph 13). The potential for further rises seems limited, however, since the global market for this metal is likely to remain in a surplus position. Global zinc inventories will therefore probably continue their rapid expansion. Escalating concerns these past few days have brought zinc prices back to around US$2,000 per ton.

## TIN AND LEAD

- The price of tin has been volatile in recent months, moving from a historic peak of US$33,265 per ton in April to less than US$25,000 in mid-June, then rebounding temporarily to around US$28,000. The springtime correction in the price of tin was largely attributable to a decline in global demand. However, Chinese demand is starting to firm up again, and the limited expansion of tin production should continue to support its price.
- The price of lead has not shown any clear trend in the past few months, fluctuating instead around US$2,500 per ton before falling back to below US$2,200 per ton. The extended closure of the Magellan mine in Australia is giving some support to the price of lead. Flagging Chinese demand, where stricter environmental rules have curbed battery production, constitutes a negative factor. Ongoing high inventories of lead are also limiting the potential for this metal to appreciate.

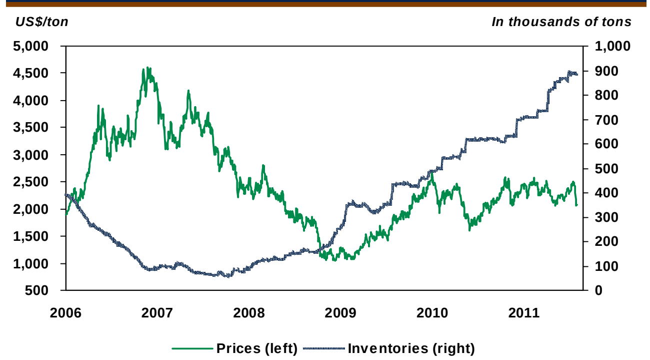
**Forecasts:** In light of the clouds hanging over economic outlooks, the prices of most industrial metals should remain significantly below their 2011 peaks in the months ahead. Only further depreciation of the U.S. dollar or rapid improvement in economic outlooks could cause a rebond in metal prices. Persistent supply-side problems for certain metals, such as copper and tin, will limit the downwards potential for their 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

## Gold propelled skywards by sovereign debt concerns

Profiting from the growing financial uncertainty, the price of gold stole the show in recent weeks, setting one record after another. Although they garnered less attention, the other precious metals were also boosted by this increased demand for safe-haven investments.

### GOLD AND SILVER

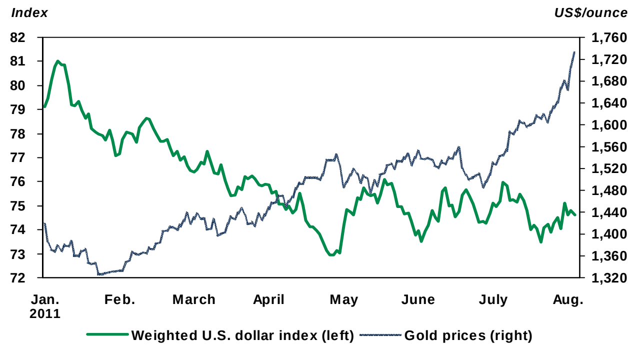
- Now that the contagion of the European debt crisis has spread to Spain and Italy and the political crisis in the United States caused U.S. Treasury instruments to be downgraded, nervous investors have few options for protecting themselves in the event of a financial crisis that would weaken the euro or the greenback. The other currencies have gained the advantage, especially the yen and the Swiss franc. It comes as no surprise that the other big beneficiary of the weakness of the major paper currencies has been gold, whose price has reached a new peak of over US$1,700 per ounce (graph 15). One might have thought that the last-minute agreement to avert default by the United States would have halted the surge in gold prices, but growing fears of a new recession have instead accelerated its rise, especially since they open the door to new quantitative measures. The price of silver has also benefited from these uncertainties, climbing back up to around US$40 per ounce (graph 16).

### PLATINUM AND PALLADIUM

- The prices of platinum and palladium have also fared very well recently (graph 17). Besides benefiting from investors' worries, there is also reason to think that the prices of these two metals have prospered from signs that the automobile industry is on the verge of getting back to cruising speeds after the problems stemming from the disasters in Japan.

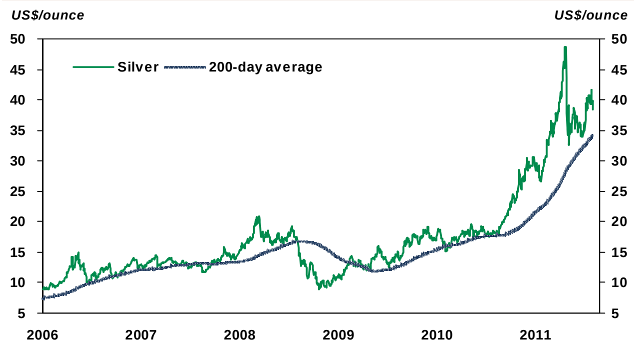
**Forecasts:** It appears that the economic and financial climate will remain in gold's favour for longer than we had previously thought. Sluggish economic growth will induce the central banks to maintain highly expansionary monetary policies, and we can no longer rule out the possibility of new quantitative measures in the United States. Persistently low interest rates and doubts about sovereign debts will support demand for gold. These circumstances will generally be favourable for the other precious metals, but any pronounced economic slowdown could do damage to the prices of platinum and palladium, demand for which is largely tied to the health of the automobile industry.

**Graph 15 – The difficulties of the U.S. dollar have propelled the price of gold to a new high**



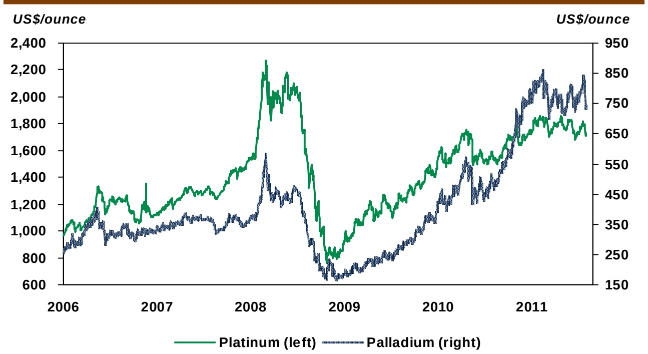

Sources: Bloomberg, Datastream and Desjardins, Economic Studies

**Graph 16 – Silver prices**




Sources: Datastream and Desjardins, Economic Studies

**Graph 17 – Platinum and palladium prices**




Sources: Datastream and Desjardins, Economic Studies

# AGRICULTURAL COMMODITIES

## The outlook for grain prices seems slightly less favourable

At the beginning of 2011, adverse harvesting weather gave a strong boost to grain prices. In recent months the trend has been less pronounced, particularly for the price of wheat, which has seen a significant pullback. The very hot summer has affected American harvests of corn and soybeans, but the weather finally seems to be starting to improve. Demand for certain grains, especially those used to produce bio-fuels, could also be affected by economic turmoil.

### WHEAT

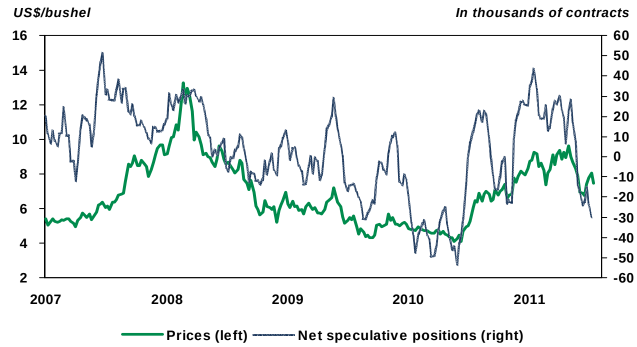
- After slightly surpassing US$10 per bushel towards the end of May, the price of wheat saw a sharp correction that drove it down to US$6.54 per bushel on July 11, a low that dates back to October 2010. The main reason for that correction lies in Europe, where the weather became more conducive to harvesting, to the point where Russia was able to resume wheat exports. Since then, excessively hot temperatures in North America in July have sent the price of wheat to back to around US$8 per bushel temporarily.

### CORN AND SOYBEANS

- Given the dominant role that American producers play on the global corn and soybean market, the prices of these two grains did not react as much to the more favourable harvesting weather in Europe. Since the American harvest was affected by very hot temperatures in July, the price of corn rallied to around US$7 per bushel; in fact, compared with a year ago, it is up by nearly 100%. Robust demand from ethanol producers is contributing to that high price. It remains to be seen whether efforts to repair American public finances will affect the subsidies that this industry enjoys. The budget cuts that were decided on at the beginning of August spared that sector, but it may just be a matter of time. The price of soybeans is also relatively high, near US$13 per bushel.

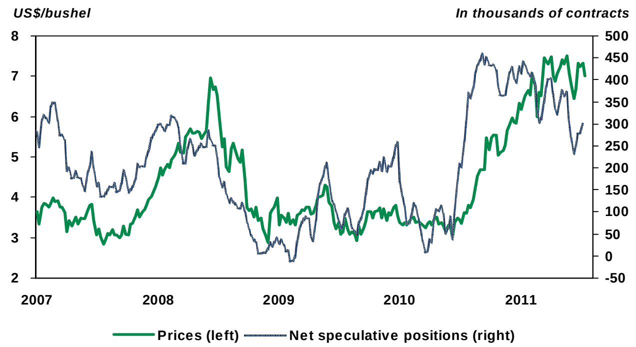
**Forecasts:** The latest weather forecasts are finally giving American farmers a glimmer of hope; nevertheless, it is too late to look forward to good harvests, so the global corn and soybean markets will remain quite tight. Generally, grain prices are not influenced all that much by changes in economic outlooks, but an overly sharp decline in activity could affect demand for ethanol. Weather conditions will also continue to strongly influence prices.

Graph 18 – Wheat prices and speculation



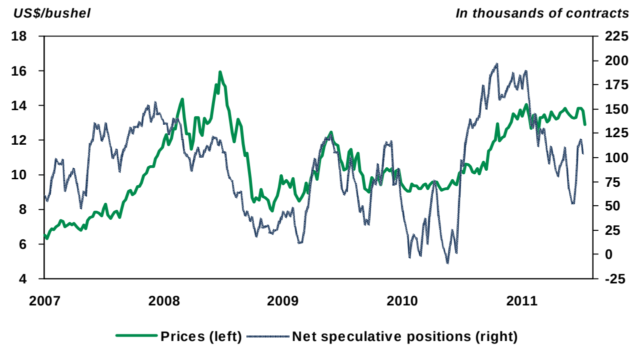

Sources: Datastream, Bloomberg and Desjardins, Economic Studies

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 | | |
|---|---|---|---|---|---|---|---|---|
| | Aug. 10 | 1 month | 3 months | 6 months | 1 year | High | Average | Low |
| **Index** | | | | | | | | |
| Reuter-CRB* (CCI**) | 618.6 | -3.7 | -4.6 | -6.3 | 25.2 | 690.1 | 612.7 | 487.4 |
| Reuters/Jefferies CRB* | 320.4 | -6.7 | -8.1 | -5.7 | 17.7 | 370.6 | 325.4 | 261.8 |
| Dow Jones AIG*** | 154.8 | -3.8 | -6.0 | -5.2 | 15.8 | 175.4 | 156.2 | 128.8 |
| **Energy** | | | | | | | | |
| Crude oil (US$/barrel) | 82.9 | -13.8 | -20.2 | -4.4 | 3.3 | 113.9 | 91.3 | 71.2 |
| Gasoline (US$/gallon) | 3.67 | 2.5 | -7.3 | 17.3 | 32.0 | 3.96 | 3.27 | 2.68 |
| Natural gas (US$/MMBTU****) | 4.09 | -2.9 | -2.2 | -0.7 | -7.8 | 4.92 | 4.12 | 3.17 |
| **Precious metals** | | | | | | | | |
| Gold (US$/ounce) | 1,777.8 | 15.3 | 17.2 | 30.6 | 48.9 | 1,777.8 | 1,417.1 | 1,194.3 |
| Silver (US$/ounce) | 38.3 | 5.6 | -0.2 | 28.6 | 111.8 | 48.7 | 31.1 | 17.9 |
| Platinum (US$/ounce) | 1,754.0 | 0.8 | -2.2 | -4.2 | 14.0 | 1,858.0 | 1,729.8 | 1,494.0 |
| Palladium (US$/ounce) | 741.0 | -4.5 | 1.1 | -9.9 | 54.7 | 858.0 | 714.5 | 465.0 |
| **Base metals** | | | | | | | | |
| Aluminium (US$/tonne) | 2,363.5 | -5.6 | -10.9 | -6.1 | 9.4 | 2,785.5 | 2,435.5 | 1,992.3 |
| Copper (US$/tonne) | 8,573.0 | -11.1 | -3.5 | -13.8 | 17.9 | 10,179.5 | 8,953.6 | 7,080.8 |
| Nickel (US$/tonne) | 20,923.0 | -12.3 | -15.8 | -24.8 | -5.5 | 29,281.0 | 24,347.2 | 20,031.0 |
| Zinc (US$/tonne) | 2,071.8 | -11.1 | -3.9 | -14.7 | 0.9 | 2,587.5 | 2,292.1 | 1,932.0 |
| Tin (US$/tonne) | 22,670.0 | -15.2 | -23.3 | -27.9 | 10.1 | 33,265.0 | 27,113.2 | 19,845.0 |
| Lead (US$/tonne) | 2,266.0 | -16.4 | -3.9 | -10.4 | 8.0 | 2,924.5 | 2,466.5 | 1,934.0 |
| **Agricultural commodities** | | | | | | | | |
| Wheat (US$/bushel) | 7.70 | 15.0 | -17.0 | -16.6 | 18.6 | 10.13 | 7.84 | 6.26 |
| Corn (US$/bushel) | 7.02 | 5.3 | 2.3 | 4.1 | 94.7 | 7.81 | 6.10 | 3.61 |
| Soybean (US$/bushel) | 12.90 | -4.6 | -2.3 | -7.9 | 22.2 | 14.19 | 12.70 | 10.02 |
| CRB* Livestock index | 660.4 | 3.7 | 6.6 | 13.0 | 42.7 | 662.5 | 564.3 | 462.9 |

*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 | 2009 | 2010 | 2011f | 2012f |
|---|---|---|---|---|
| WTI* oil (US$/barrel) | 62 | 80 | Target: 93 (range: 90 to 95) | Target: 96 (range: 85 to 105) |
| Natural gas Henry Hub (US$/MMBTU**) | 3.95 | 4.38 | Target: 4.25 (range: 4.00 to 4.50) | Target: 4.75 (range: 4.00 to 5.75) |
| Gold (US$/ounce) | 973 | 1,226 | Target: 1,575 (range: 1,500 to 1,650) | Target: 1,400 (range: 1,200 to 1,700) |
| LMEX*** index—base metals | 2,471 | 3,466 | Target: 4,000 (range: 3,800 to 4,200) | Target: 4,200 (range: 3,800 to 4,500) |

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