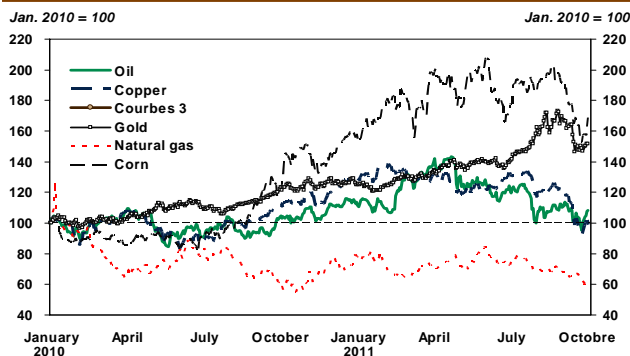


## Commodities being swept up in the wave of panic

The last few weeks have confirmed how macroeconomic developments can have a major impact on commodity prices. Reaping the benefits of sustained demand from emerging countries and the weak U.S. dollar, commodity prices remained relatively high in July and August despite the release of many disappointing economic statistics and the intensifying sovereign debt crisis in Europe. However, the modest price decline turned into a tailspin these past few weeks, when concerns edge up another notch, prompting investors to flee from risky assets (graph 1).

**Graph 1 – The last few weeks have been hard on commodity prices**

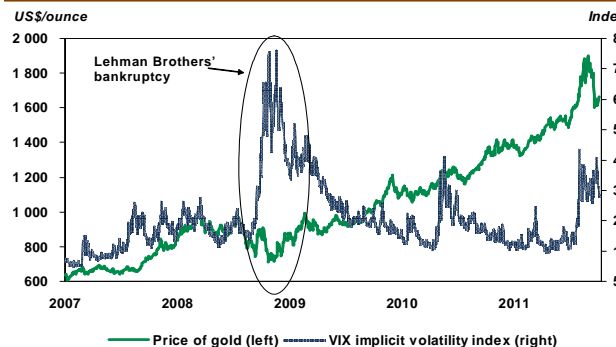


Sources: Datastream and Desjardins, Economic Studies

The dark clouds hanging over the economic outlook are a major development for commodities where demand depends on industrial activity. Demand forecasts for energy and industrial metals have already been revised downwards, and there's no potential of a shortage.

The recent drop in prices for precious metals and agricultural products is harder to explain by fundamental factors. The sudden drop in gold prices could be particularly surprising as recent events should have boosted demand for safe-haven securities. The financial crisis in the fall of 2008 showed us, however, that a spike in financial tensions was unfavourable to gold (graph 2).

**Graph 2 – Gold increases when financial tensions rise, but not when they explode**



Sources: Datastream and Desjardins, Economic Studies

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**François Dupuis**  
Vice-President and Chief Economist

**Mathieu D'Anjou, CFA**  
Senior Economist

**François Dupuis**  
Vice-President and Chief Economist

**Yves St-Maurice**  
Senior Director and Deputy Chief Economist

**Mathieu D'Anjou**  
Senior Economist

**Jimmy Jean**  
Senior Economist

**Hendrix Vachon**  
Senior Economist

514-281-2336 or 1 866 866-7000, ext. 2336  
E-mail: [desjardins.economics@desjardins.com](mailto:desjardins.economics@desjardins.com)

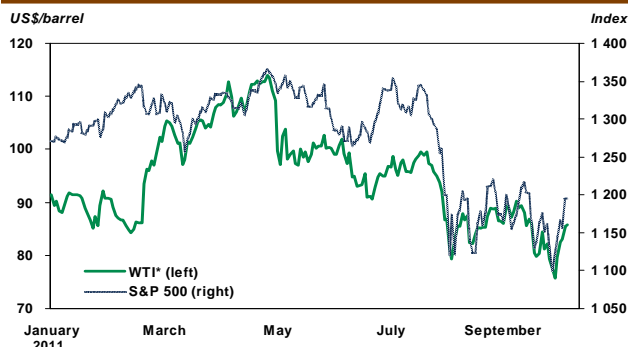
# ENERGY

## Demand for oil is weakening

### OIL

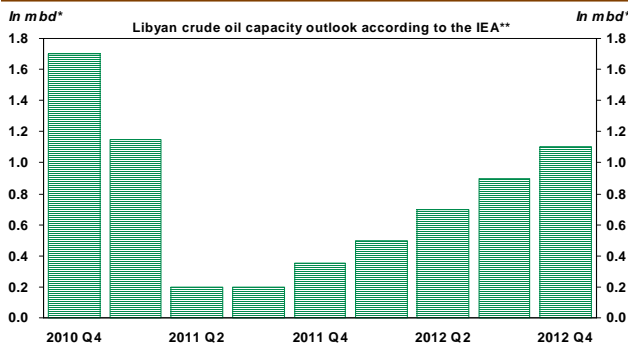
- Oil prices have been very volatile in the last few weeks. After falling to about US\$80 a barrel in early August, prices for WTI (West Texas Intermediate) gradually climbed back to about US\$90 a barrel in mid-September. Renewed concerns about the sovereign debt in the euro zone countries saw prices for black gold tumble to US\$75 a barrel in early October, the lowest level in the past 12 months. Recent fluctuations in oil prices seem to mimic stock index movements (graph 3), a sign that these changes strongly reflect investor sentiment.
- Beyond financial influences, that things have changed fairly dramatically on global oil markets these past few months. In early 2011, all signs pointed to global consumption, after a major rebound in 2010, advancing at a good pace for the next few years. In this context, the revolt in the Arab world led to fears of a shortage, especially when oil production in Libya was affected. Fearing a sharp price increase, the International Energy Agency (IEA) even asked its member countries to dip into their strategic reserves at the beginning of the summer to make sure an adequate supply was available.
- The situation has evolved quickly since then. Saudi Arabia unilaterally decided to increase its oil production to offset the production drop in Libya. Then, the conflict in that country finally tilted in favour of the regime's opponents, suggesting that oil production in Libya could increase gradually in the coming quarters (graph 4). The outlook is also encouraging for production in non-member countries of the Organization of the Petroleum Exporting Countries (OPEC), which should accelerate next year after making limited advances in 2011.
- Not only are concerns about the oil supply dwindling, declining prices are also a reflection of more modest forecasts in terms of demand. The pace of global economic growth is a deciding factor that underpins oil consumption. Signs of economic stagnation—even contraction—in several industrialized countries are enough to foresee a drop in their demand for oil in 2011 and 2012. As a result, the IEA has already downgraded its forecasts for global oil product consumption (graph 5), and other adjustments are expected.

**Graph 3 – The recent volatility of oil prices is in line with frenetic stock market shifts**



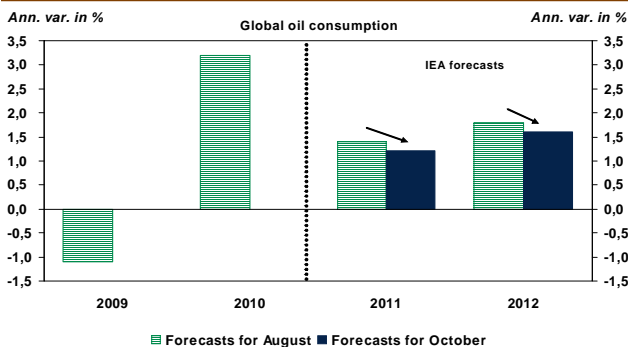
\* West Texas Intermediate.  
Sources: Datastream and Desjardins, Economic Studies

**Graph 4 – The situation should gradually get back to normal in Libya**



\* Millions of barrels/day; \*\* International Energy Agency.  
Sources: Datastream, International Energy Agency and Desjardins, Economic Studies

**Graph 5 – The growth outlook on demand for oil seems to be getting weaker by the minute**



Sources: International Energy Agency and Desjardins, Economic Studies

## GASOLINE

- Declining prices for WTI these past few months have had a limited impact on gas prices. While oil prices are now lower than they were in early 2011, gas prices are still higher by about 10% in Canada and in the United States (graph 6). The increase in refinery margins at the beginning of fall, when hurricane season was getting underway, partly explains this phenomenon. The fact that prices for other types of oil have drop a lot less than WTI prices contributes to keeping gas prices elevated and could continue to limit the positive impact of falling oil prices for motorists.

## NATURAL GAS

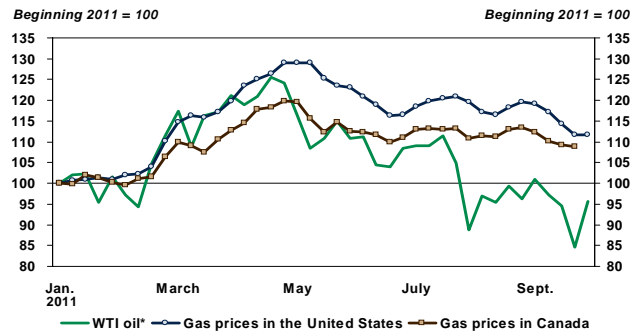
- At already weak levels, the price of natural gas fell to about US\$3.50 per MMBTU (Million British Thermal Unit) at the beginning of October (graph 7), as investors were turning away from commodities. Weak economic growth expected in the United States will limit growth in the demand for natural gas in North America for the next few years. Natural gas prices should therefore remain weak, especially since producers don't seem to be getting ready to rein in production. That said, prices should not fall much lower as this would boost demand from electricity producers, prompting them perhaps to dump charcoal in favour of natural gas.

## URANIUM

- Uranium prices have not been as hard hit by recent events, with the price of uranium hovering at slightly above US\$50 a pound since the middle of the year (graph 8). The drop in demand due to the events in Japan last March is a major obstacle to price increases for uranium.

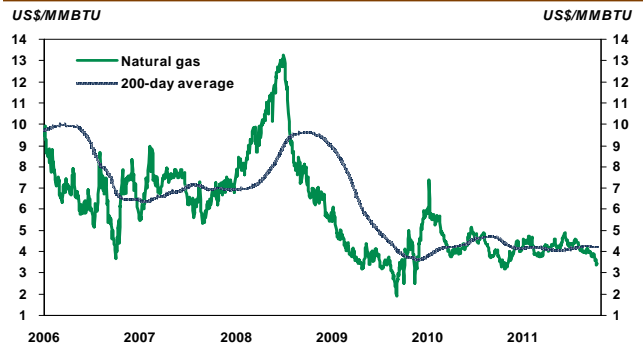
**Forecasts:** In the short term, fluctuations in investor sentiment will have a strong influence on changes in oil prices. Beyond financial matters, the weak outlook for economic growth suggests that oil supplies worldwide will remain largely sufficient to meet the demand. Under the circumstances, we have downgraded our forecasts for oil prices. The annual average for WTI prices should hover around US\$ 92 a barrel in 2011, before declining slightly to US\$88 next year. All signs point to natural gas price remaining weak for several more quarters.

Graph 6 – Gas prices remain high despite falling oil prices



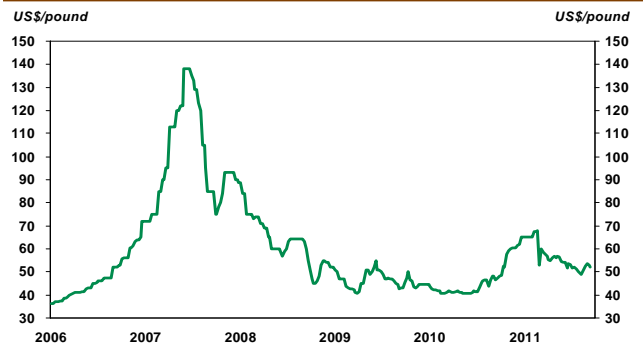
\* West Texas Intermediate.  
Sources: Datastream, Natural Resources Canada and Desjardins, Economic Studies

Graph 7 – Natural gas prices



Sources: Datastream and Desjardins, Economic Studies

Graph 8 – Uranium prices



Sources: Bloomberg and Desjardins, Economic Studies

# BASE METALS

## A far less favourable economic environment

The fact that the gloomier economic outlook has greatly hit prices for most base metals these past few months is no surprise. Very high prices early in the year were a reflection of the rapid growth in demand around the world and the difficulty some metal producers were having—especially copper and tin producers—to ramp up supply. Signs of stagnation, even economic contraction, in the United States and Europe completely reversed the picture in terms of demand. Positive financial factors, including a weak greenback, that softened the blow of falling prices for industrial metals in July and August, have suddenly tilted to the downside sharply these past few weeks, bringing the LME (London Metal Exchange Index) below 3200, a 30% decline compared to the peaks reached in early 2011 (graph 9).

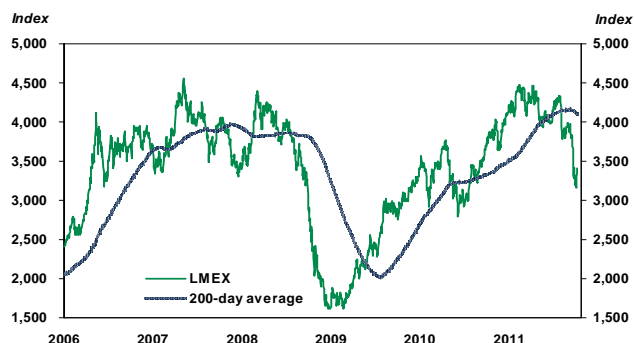
### ALUMINUM

- After climbing above US\$2,600 a tonne at the end of July, aluminum prices started to trend downward. It drop close to US\$2,100 a tonne in early October (graph 10), a low point for over a year. The latest economic statistics confirm that the sharp advance in demand seen these past few quarters is unsustainable. The potential for any further depreciation seems limited however, as falling aluminum prices have rendered a significant number of smelters unprofitable. Some signs of a production slowdown are already being seen in China and industrialized countries.

### COPPER

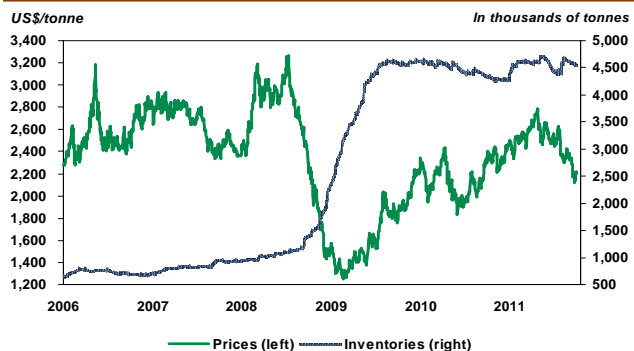
- After dipping temporarily in early August, the price of copper quickly climbed back above US\$9,000 a tonne. The correction at the end of September was far more painful, and copper prices tumbled more than 25% to around US\$6,800 a tonne (graph 11). The biggest factor that kept copper prices at lofty highs—disappointing growth in mining output—is still present. However, this limited supply should have much less of an impact in an environment where the global economy and demand for copper are set to slow down. Moreover, it's worth noting that despite the limited copper production, inventories of this metal tracked by the LME are up 25% since the start of the year. China could, however, respond to falling prices by boosting its copper inventories.

Graphique 9 – Indice LME du prix des métaux de base



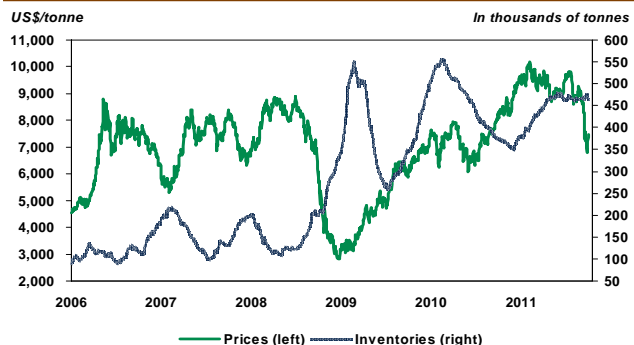
Sources: Datastream and Desjardins, Economic Studies

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

- The last few months have also been very hard on the price of nickel, which has been plummeting by more than 25% since July to around US\$18,000 a tonne (graph 12). This correction occurred even though nickel inventories continue to dwindle. However, all signs indicate that the global nickel market will soon be in a surplus situation, with demand softening and supply expected to soar. The very low price seen today is insufficient to kick-start the production of nickel pig iron in China, however, a situation that should somewhat support the price for this metal.

## ZINC

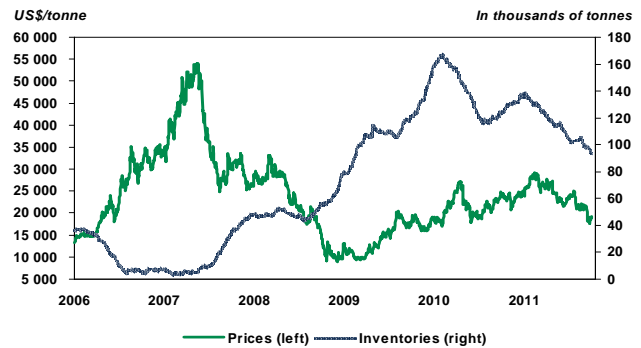
- The darkening global economic and financial outlooks also triggered a major pullback in zinc prices, which fell from about US\$2,500 a tonne at the end of July to US\$1,825 a tonne recently (graph 13). In terms of the global supply and demand, the news has been relatively supportive these past few months. However, the global zinc market is likely to evolve in a surplus situation over the next few years, especially if economic growth remains weak.

## TIN AND LEAD

- Like the other industrial metals, the price of tin suffered a massive correction in the past few weeks, even temporarily falling below US\$20,000 a tonne (graph 14). Tin inventories have not tracked a clear trend these past few months, but they remain much higher now than at the beginning of the year. The gloomier economic outlook means that the troubles producers are experiencing to bump up tin supplies are less likely to lead to a shortage.
- After climbing to about US\$2,500 a tonne at the beginning of September, the price of lead fell sharply to around US\$1,900. After falling at the beginning of summer for environmental reasons, battery production in China is on the upswing, a positive development that could boost demand for lead. However, the rapid rise of lead inventories has a negative impact on its price.

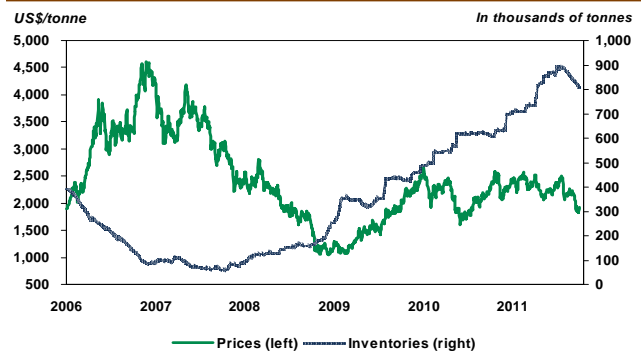
**Forecasts:** Even before the global economic outlook deteriorated, base metal prices appeared to be unsustainable given their high inventories levels. In a context where growth in demand is expected to be limited for the next several quarters, we can forecast that metal prices will remain far from their peaks. Growing demand in the emerging countries, especially China, should support prices and prevent any further price collapses. That said, any sign of a substantial slowdown in China's economy could lead to a new and severe correction in prices for base metals.

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

## Even gold is losing some of its shimmer

Unlike other commodities, precious metals first reaped the benefits of the negative economic and financial news as concerned investors were seeking safe havens. Their prices dropped brutally at the end of September, however, as concerns reached a fever pitch.

### GOLD AND SILVER

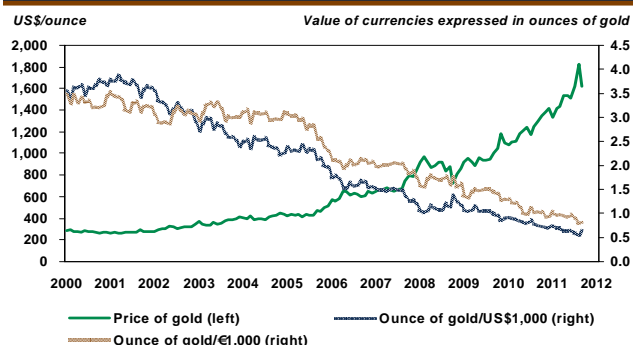
- Gold prices stole the show at the end of summer, soaring by about US\$400 an ounce to set a new record of nearly US\$1,900 an ounce in early September. Faced with the possibility of the euro's dissolution and a new recession in the United States, gold was seen as the ideal safe haven. Gold can thus be viewed as a solid currency that holds its own when paper currencies are suffering from widespread weakness. Skyrocketing gold prices in the past few years could be the reflection of the falling value of paper currencies, expressed in an ounce of gold (graph 15). This logic did not, however, prevent gold prices from dropping sharply to close to US\$1,600 an ounce as September drew to a close. This correction can be explained by concerns about the collapse of the banking system, which would trigger a liquidity crisis similar to what occurred in 2008 when investors had to cash in their investments in precious metals. The price decline was pushed further due to profit taking by several investors. Silver prices tracked a similar trend, jumping over US\$42 an ounce in early September before falling below US\$30 an ounce (graph 16).

### PLATINUM AND PALLADIUM

- Prices for platinum and palladium remained relatively stable at the end of summer while the risk of more bad economic news weighing down the automobile sector offset investors' keen interest in safe-haven assets. The recent and widespread correction in commodity prices drove down platinum and palladium prices to their lowest levels in more than a year (graph 17).

**Forecasts:** Aside from the current volatility, the context should remain generally favourable for gold in the coming quarters. Interest rates are still at floor levels, and concerns about sovereign debt and the global financial system will continue to support investor demand for gold. Gold prices should thus stay very high in the quarters ahead.

**Graph 15 – Does gold's price reflect a speculative bubble or simply the major currencies' weakness?**



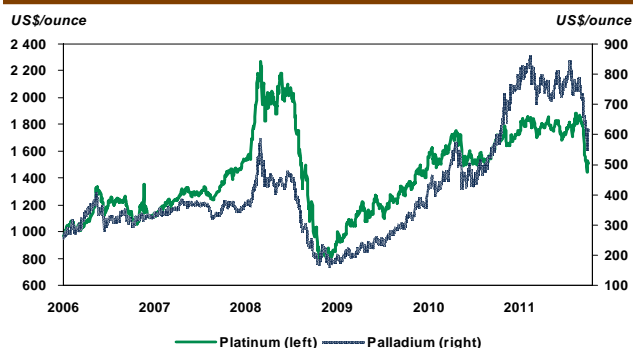
Sources: Datastream and Desjardins, Economic Studies

**Graph 16 – Gold and silver prices**



Sources: Datastream and Desjardins, Economic Studies

**Graph 17 – Platinum and palladium prices**



Sources: Datastream and Desjardins, Economic Studies

# AGRICULTURAL COMMODITIES

## Cereal prices also drawn into the vortex

Price fluctuations for agricultural goods usually reflect the outlook on supply and demand. Softening wheat prices since last spring thus seemed justified now that exports from Russia and the Ukraine are back on world markets. However, when panic peaks on financial markets, speculative factors can sometimes win out. A stunning example of this was the almost 20% drop in prices for the three principal grains since the start of September.

### WHEAT

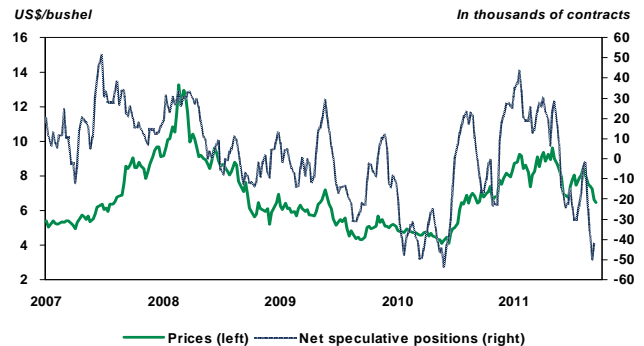
- After nose-diving to a low of US\$6.54 a bushel on July 11, 2011, after it was announced that Russia and the Ukraine would be exporting grains again, wheat prices were once again trending higher. With temperatures unfavourable to crops continuing in the United States, wheat prices edged closer to US\$8.50 a bushel at the end of August. The upward revisions to wheat production forecasts released by the United States Department of Agriculture (USDA) brought this uptrend to a halt in early September. Prices then started to decline more sharply (graph 18) as the intensifying debt crisis in Europe prompted investors to turn their backs on commodities.

### CORN AND SOYBEANS

- Following the widespread trend, corn prices have fallen a little more than 20% since the end of August, slipping back below US\$6.00 a bushel (graph 19). The darkening global economic outlook and falling oil prices could slow ethanol production. Despite this, all signs seem to indicate that corn inventories, which are already quite low, will continue to decline. After flirting with US\$15 a bushel at the beginning of September, when concerns about the crops in the United States started to rise, soybean prices dropped dramatically to almost US\$11 in early October (graph 20). It appears as though soybean inventories will remain relatively high.

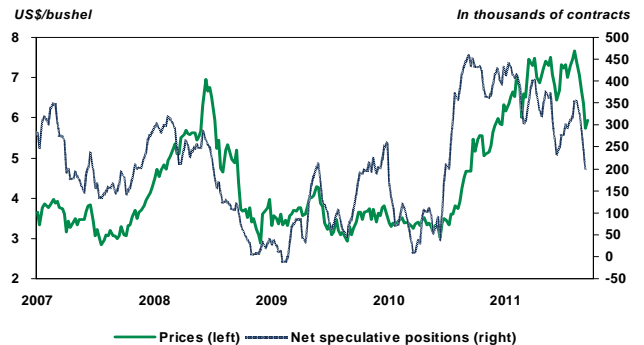
**Forecasts:** As soon as the financial tensions start to ease, the fundamental factors should once again set the pace of changes in grain prices. Grain prices could shift upward slightly, but the revision to the downside of global economic growth will limit concerns of a shortage.

Graph 18 – Wheat prices and speculation



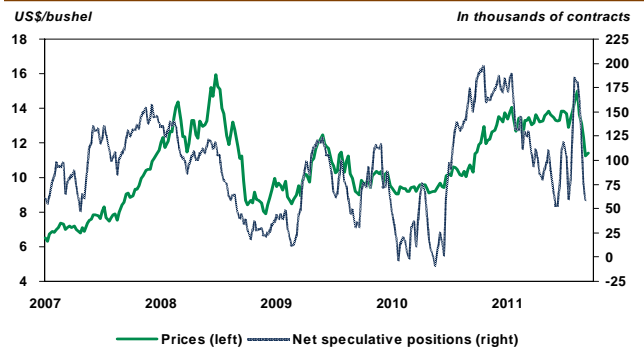
Sources: Datastream, Bloomberg and Desjardins, Economic Studies

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		
	Oct. 11	1 month	3 months	6 months	1 year	High	Average	Low	
<b>Index</b>									
Reuter-CRB* (CCI**)	588.5	-9.3	-7.7	-14.1	6.8	690.1	631.1	546.7	
Reuters/Jefferies CRB*	310.5	-7.1	-8.8	-15.2	4.8	370.6	333.5	293.0	
Dow Jones AIG***	145.9	-9.2	-8.8	-15.6	0.6	175.4	159.3	138.4	
<b>Energy</b>									
Crude oil (US\$/barrel)	85.8	-1.6	-9.8	-21.9	4.4	113.9	92.8	75.7	
Gasoline (US\$/gallon)	3.42	-6.8	-6.0	-9.8	21.3	3.96	3.41	2.81	
Natural gas (US\$/MMBTU****)	3.53	-10.9	-19.4	-13.1	2.1	4.92	4.11	3.17	
<b>Precious metals</b>									
Gold (US\$/ounce)	1,663.0	-10.4	7.6	13.1	23.4	1,898.3	1,500.5	1,322.3	
Silver (US\$/ounce)	31.4	-24.2	-13.7	-24.2	34.6	48.7	34.1	23.0	
Platinum (US\$/ounce)	1,514.0	-17.8	-12.5	-16.0	-10.2	1,887.0	1,755.8	1,444.0	
Palladium (US\$/ounce)	602.0	-19.5	-21.8	-24.3	3.1	858.0	745.1	549.0	
<b>Base metals</b>									
Aluminium (US\$/tonne)	2,195.5	-5.9	-10.3	-17.4	-7.1	2,785.5	2,458.1	2,124.0	
Copper (US\$/tonne)	7,271.3	-17.4	-23.9	-26.1	-12.2	10,179.5	9,071.9	6,779.3	
Nickel (US\$/tonne)	18,836.0	-10.9	-18.8	-32.0	-22.4	29,281.0	24,026.8	17,570.0	
Zinc (US\$/tonne)	1,891.3	-12.7	-17.2	-25.1	-17.8	2,587.5	2,285.0	1,822.8	
Tin (US\$/tonne)	22,358.0	-4.6	-15.7	-32.8	-14.7	33,265.0	27,168.4	19,776.0	
Lead (US\$/tonne)	1,978.5	-20.0	-25.8	-32.3	-13.5	2,924.5	2,487.8	1,897.0	
<b>Agricultural commodities</b>									
Wheat (US\$/bushel)	6.92	-12.1	5.8	-21.2	-1.7	10.13	7.98	6.47	
Corn (US\$/bushel)	6.35	-11.9	-4.9	-16.1	21.0	7.81	6.54	4.98	
Soybean (US\$/bushel)	12.02	-14.1	-11.7	-10.4	7.7	14.99	13.16	11.16	
CRB* Livestock index	613.2	-1.3	-3.7	-3.1	18.0	662.5	587.1	465.1	

\*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

	2009	2010	2011f	2012f
Annual average				
WTI* oil (US\$/barrel)	62	80	Target: 92 (range: 90 to 95)	Target: 88 (range: 78 to 98)
Natural gas Henry Hub (US\$/MMBTU**)	3.95	4.38	Target: 4.20 (range: 4.00 to 4.40)	Target: 4.25 (range: 3.75 to 5.00)
Gold (US\$/ounce)	973	1,226	Target: 1,625 (range: 1,560 to 1,660)	Target: 1,675 (range: 1,500 to 1,900)
LMEX*** index—base metals	2,471	3,466	Target: 4,050 (range: 3,950 to 4,150)	Target: 3,800 (range: 3,500 to 4,300)

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