COMMODITY TRENDS

The Economy Is Weighing on Commodity Prices

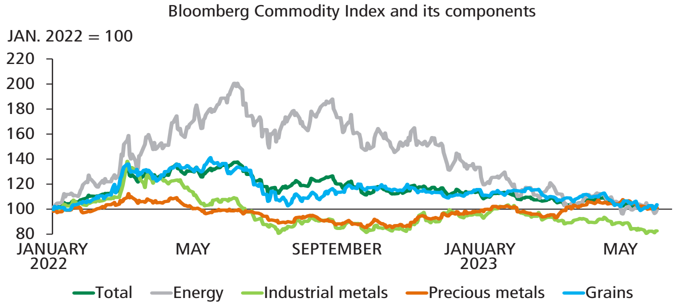
Most commodity prices are down from their Ukraine invasion peak (graph 1). Fears about the war's impact on supply may have been unwarranted. But commodity markets often assume the worst during geopolitical shocks, and prices tend to spike in the ensuing months.

The Ukraine war has significantly affected the energy supply as Western countries have stopped buying from Russia, fragmenting the market. To stabilize prices and replenish commercial inventories, the US flooded the market with 190 million barrels from its Strategic Petroleum Reserve. But the war's impact on Russian production has been minimal so far, and India and China have been buying up Russian oil at a discount, helping to calm prices.

It was initially a different story for grains and vegetable oils, which experienced some shortages in the months after the war erupted. But plentiful harvests and an agreement between Russia and Ukraine on wheat exports have helped stabilize the global food supply and avoid the worst-case scenario. Meanwhile, metals have been relatively untouched by sanctions. However, higher energy prices have pushed metal production costs higher, constraining supply, especially in Europe and China.

In short, supply has been affected, just not by as much as it could have been. But that's not the only reason prices have come down so quickly despite deficits in the oil and other markets. The weakening economy is also behind the decline. Soaring inflation and subsequent interest rate hikes have weighed on prices as demand from sectors like construction, manufacturing and transportation has slowed. And thanks to consumer discipline and warm temperatures, household electricity use was down about 5% in Europe last winter, helping the continent weather the energy crisis. Finally, we saw a shift from goods consumption to services consumption when the final public health restrictions were lifted. All these factors continue to weigh on many commodity prices.

GRAPH 1
Commodity Prices Are Back to Pre-Ukraine War Levels



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

A Market of Contradictions

FORECASTS

The oil market is tightening as the Organization of the Petroleum Exporting Countries and its partners (OPEC+) continues to cut production and the number of active US drilling rigs falls. However, crude values have weakened amid recession fears. Energy prices are therefore likely to remain volatile over the coming months. An economic slowdown should temper demand for oil. But it will probably have a limited effect on prices given the levers available to the market such as replenishing the US Strategic Petroleum Reserve and voluntarily cutting production. As such, we expect crude prices to hover in the US$70 to US$75 per barrel range in the coming months. Meanwhile the issue of the natural gas supply isn't fully resolved, and there's still an upside risk for next winter. Gas prices are expected to recover somewhat after losing ground in recent months. They should average US$3.12 per MMBTU for the year.

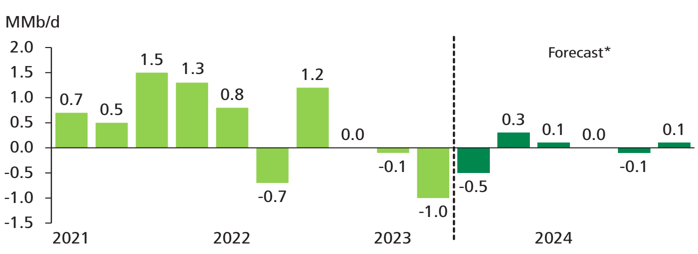
OIL

Saudi Arabia has announced it will cut production by 1 million barrels per day (MMb/d) in July (graph 2). But if prices don't go up enough, it may reduce production for longer. This is surprising given that the cartel previously announced it would start scaling back production by 1.66 MMb/d in May and we hadn't yet seen the full effects of that cut. OPEC+ cited unfavourable demand conditions for the pullback. We expect the recession and the slowdown in China's economic rebound to weigh on oil consumption over the coming quarters. But there's a lot of uncertainty surrounding demand, and if the economy doesn't tip into a recession, acute demand–supply deficits could quickly drive up crude prices.

In the United States, the number of active drilling rigs is down about 10% since the start of the year (graph 3). Up until last month, the decline was almost exclusively concentrated in oil production, but the sharp correction in natural gas prices has resulted in fewer gas rigs as well. US producers remain focused on delivering strong returns to investors, and reduced drilling activity is part of efforts to keep costs low. Against that backdrop, the US Energy Information Administration predicts that crude production will grow by just 0.9% this year compared to 6.9% last year. We should therefore see the number of active drilling rigs continue to fall as the industry waits for more clarity on the economic outlook before opening the spigots again.

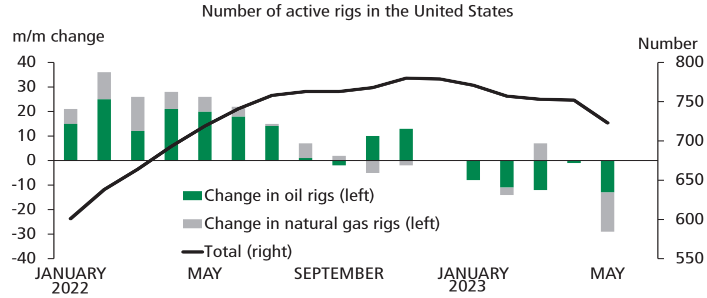
The opening of the Trans Mountain pipeline between Alberta and the West Coast late this year will boost Canada's pipeline transportation capacity by 0.6 MMb/d. In response, some pipeline operators have already announced lower transportation costs. Many see this as the opening salvo in a price war between the major pipeline operators. Limited heavy crude supply is also making Canadian oil more attractive. Despite the uncertainty, Canada looks well positioned. But wildfires in Alberta led to precautionary closures and an estimated 5% to 8% production loss in May, driving the WTI–WCS discount down to around US$13 (graph 4 on page 3). As a result, we now expect the differential to average about US$15.75 this year, with the gap continuing to narrow next year as demand for oil picks up again.

GRAPH 2
OPEC+ Production Is Down Year-to-Date



OPEC+: Organization of the Petroleum Exporting Countries and its partners; MMb/d: million barrels per day; Based on International Energy Agency (IEA) forecasts and OPEC+ production agreement.
Sources: Datastream, IEA and Desjardins Economic Studies

GRAPH 3
The Number of US Natural Gas Rigs Is Down Following the Natural Gas Price Correction



Sources: Datastream and Desjardins Economic Studies

Although supply has tightened, WTI prices fell sharply from US$80 to US$70 per barrel from April to May. This correction is attributable to a major repositioning of the market, which became very pessimistic in view of the waning rebound in China, concerns over the US debt ceiling and economic uncertainty. As a result, many investors sold their barrels, sending crude prices plummeting. Crude prices are now tinged with this negative sentiment, and could quickly rebound if the market regains confidence. That said, risk-on sentiment from the resolution of the US debt ceiling negotiations and the OPEC+ cut have so far had little effect on prices.

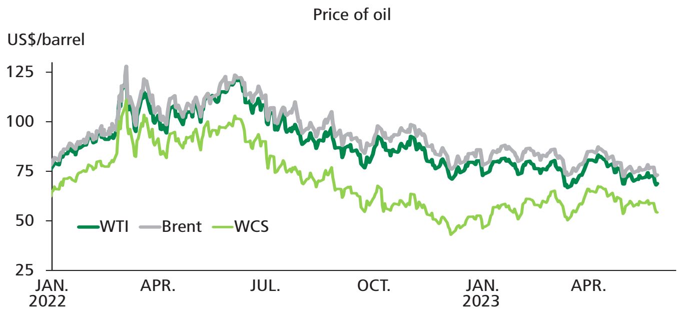
GASOLINE

Low gasoline inventories, disappointing refinery output and high margins have driven up gasoline prices (graph 5). Weaker values of crude oil, the main component in gasoline refining, should also help bring down prices at the pump. Prices could climb a touch higher as peak season approaches, but deteriorating economic conditions should send them lower in the coming quarters.

NATURAL GAS

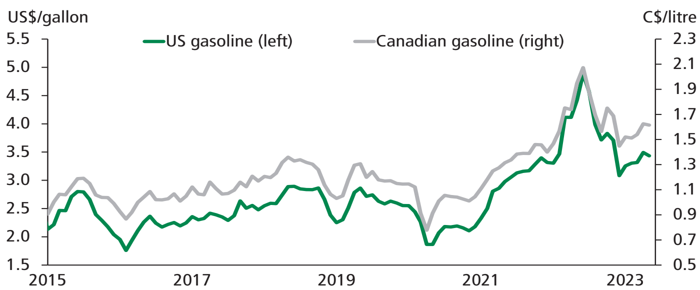
Henry Hub, UK NBP and Dutch TTF prices are off 41%, 56% and 54% respectively since the start of the year (graph 6). Although Europe avoided the worst-case scenario, a hot summer that drives up energy demand for air conditioning could limit inventory buildup for winter. It's still an open question where most of the continent will get its supply, but we don't expect prices to spike again next winter. For one thing, new floating terminals have been built so more liquefied natural gas can be imported. And energy diversification should reduce Europe's dependence on gas.

GRAPH 4
The Gap between Canadian and US Oil Prices Has Narrowed



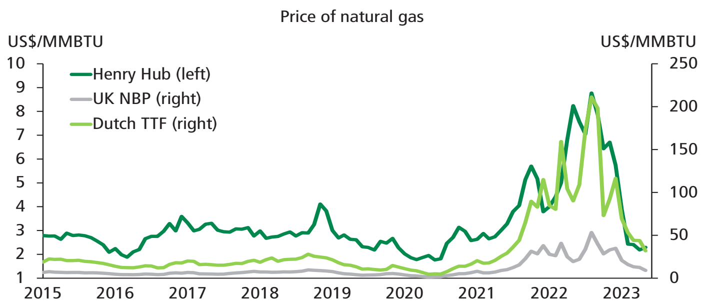
WTI: West Texas Intermediate; WCS: Western Canadian Select
Sources: Datastream, Bloomberg and Desjardins Economic Studies

GRAPH 5
Gasoline Prices Are Up Slightly



Sources: Datastream, Bloomberg and Desjardins Economic Studies

GRAPH 6
Natural Gas Prices Are Back to More Normal Levels



MMBTU: Million British Thermal Units
Sources: Bloomberg and Desjardins Economic Studies

Base Metals

Demand for Base Metals Will Lag for a Few More Quarters

FORECASTS

Industrial metal prices fell faster than expected in the first half of the year despite the resilience of the global economy. Construction and manufacturing—two interest rate-sensitive sectors that affect demand for metals—are already showing signs of slowing or contracting. Support from China's economic rebound has also begun to wane. But while metal prices are down, they remain historically high. We continue to expect prices to fall in the coming months.

Downward pressure on industrial metals values from the automotive industry should intensify, as high vehicle prices in advanced countries will likely drag down sales in the second half of the year. But car prices remain more reasonable in emerging economies, which should limit the drop in demand from the sector. For other types of manufacturers, the most recent manufacturing PMIs suggest a continued slowdown (graph 7). We therefore expect consumption of durable goods, which require more metal to produce, to fall in advanced economies. The faltering economic recovery in China, the world's largest consumer of industrial metals, also suggests that demand could be weaker than anticipated. So does the prospect of more interest rate hikes, as well as the lagged effects of increases already implemented across the world.

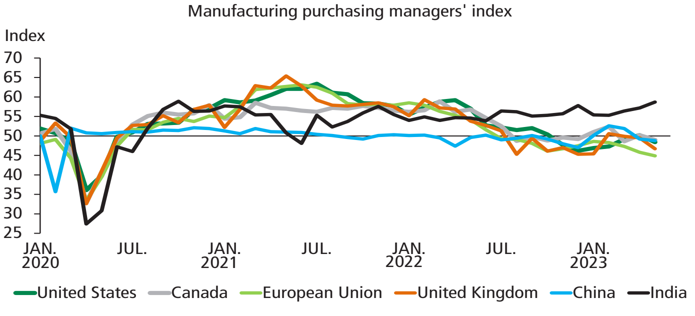
ALUMINUM

The price of aluminum has been relatively stable since declining early this year in response to the risks of a recession and financial market instability. At the time of writing, it's trading around US$2,300 per tonne (graph 8). Conditions have improved for aluminum producers, as lower energy prices—especially in Europe—have reduced operating costs. European production remains well below pre-Ukraine war levels, but should gradually pick up in 2023 before taking off next year. In the short term, we expect the price of aluminum to decline modestly and average US$2,325 per tonne after having started the year around US$2,600. The outlook for 2024 is more favourable, with faster economic growth in the offing. In Canada, aluminum producers are well positioned to weather the looming economic turmoil thanks to continued high prices and decarbonization efforts.

COPPER

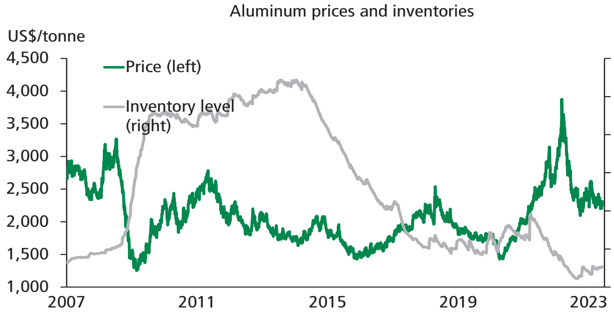
The price of copper has fallen by almost 10% since the beginning of April (graph 9). Copper is mostly used in the production of manufacturing equipment (32%) and in building construction (28%), and these sectors are showing signs of slowing globally. Falling demand is expected to continue to weigh on prices, and China's faltering economic rebound could exacerbate the decline. But supply concerns remain as Chilean mining production is threatened by labour unrest. We could also see new sanctions against Russian copper, which would further limit supply. We therefore expect copper to fall to a US$8,385 per tonne average this year.

GRAPH 7
Manufacturing Activity Has Slowed



Sources: Datastream and Desjardins Economic Studies

GRAPH 8
After Falling Early in the Year, the Price of Aluminum Has Stabilized



Sources: Datastream and Desjardins Economic Studies

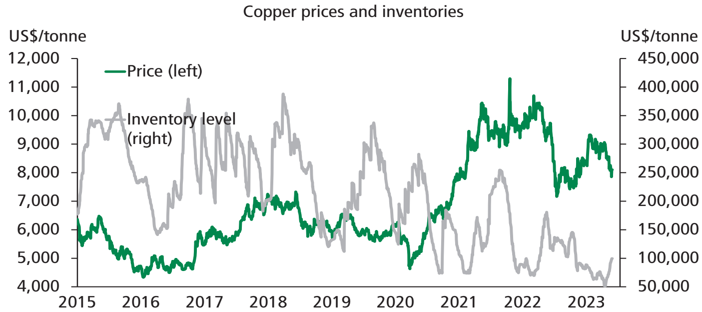
NICKEL

The price of nickel is also down, off 14% from its April high (graph 10). That brings the metal back to a more typical level after a very volatile 2022 that began with a short squeeze. This recent downtrend is expected to continue, with demand for nickel and other base metals slowing and the International Nickel Study Group projecting a market surplus in 2023. We expect nickel to average US$22,885 per tonne this year.

IRON ORE

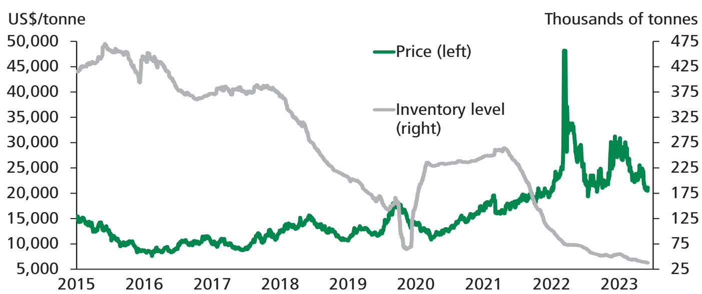
There were high expectations for China's peak construction season, which runs from April to June, but it's been somewhat disappointing so far. That along with strong supply gains—driven by growth in Australian iron exports—has pushed the price of iron ore down 15% from its March peak (graph 11). As with many other metals, lower energy prices also contributed to the price drop as production costs return to normal. But the price correction looks to be largely over, and we expect only minor declines in the coming

GRAPH 9
Copper Demand Is under Pressure and Prices Are Falling



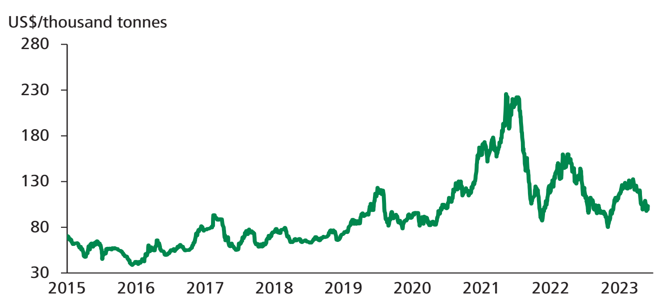
Sources: Datastream and Desjardins Economic Studies

GRAPH 10
Prices Are Back to More Normal Levels



Sources: Datastream and Desjardins Economic Studies

GRAPH 11
Economic Conditions Are Hurting Iron Ore Prices



Sources: Datastream and Desjardins Economic Studies

Precious Metals

Growing Support from Real Interest Rates

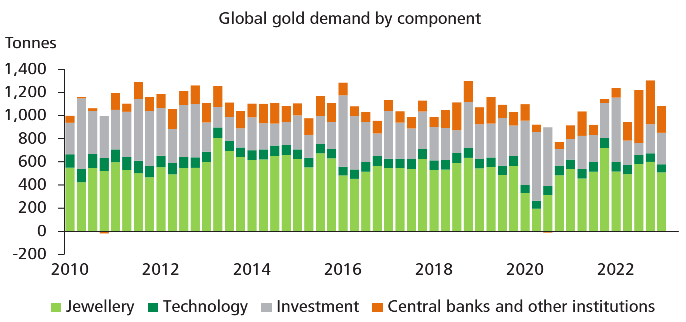
FORECASTS

The price of gold beat expectations in the first half of the year as US banking turmoil, US debt ceiling uncertainty and recession risk drove investors towards safe haven assets. Gold should continue to benefit from its status as a hedge against uncertainty, especially if there's a recession. But it's expected to come off its recent highs in the next few quarters. Gold is expected to end the year at around US$1,870 per ounce.

GOLD & SILVER

Global demand for gold was down 4.7% in the first quarter of 2023 as central bank reserves fell from their summer 2022 record of 458 tonnes (graph 12). High, volatile prices are also hurting jewellery—the largest market segment. This is expected to continue the rest of the year. But investment has offset these headwinds as financial turmoil has driven institutional buyers into safe haven assets. The price of gold topped US$2,000 per ounce in recent weeks, a level not seen since March 2022 (graph 13). It has already started to come down from that peak, but lower yields on Treasury Inflation-Protected Securities (TIPS) should provide some support and mitigate the decline. Meanwhile silver is off more than 10% from its April high. However, limited supply and strong industrial demand should moderate the price drop.

GRAPH 12
Central Bank Gold Reserves Were down in the First Quarter



Sources: Goldhub and Desjardins Economic Studies

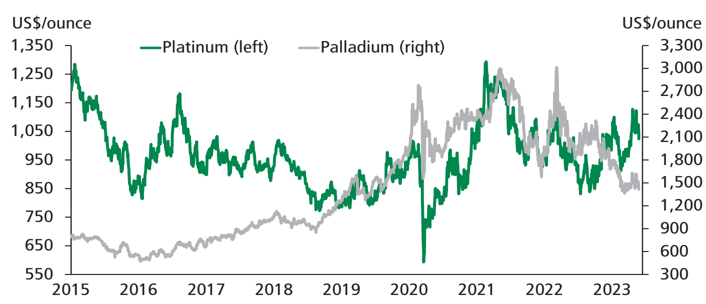
PLATINUM & PALLADIUM

Platinum has outperformed other precious metals, rising 10% from its February low (graph 14). Like gold and silver, it has benefited from the recent financial and economic uncertainty. But its rise is largely due to the imbalance between supply and demand. Part of this is attributable to China's growing appetite for metals, especially for auto production. Palladium stabilized in the first half of the year. But because platinum is so expensive, it could be swapped for palladium, especially to meet industrial demand.

GRAPH 13
Uncertainty Has Pushed Gold and Silver Prices Higher Again

Sources: Datastream and Desjardins Economic Studies

GRAPH 14
Platinum Prices Have Rebounded Due in Large Part to Auto Production



Sources: Datastream and Desjardins Economic Studies

TABLE 1
Commodities

	SPOT PRICE	% CHANGE				LAST 52 WEEKS		
	Jun. 18	1-month	3-month	6-month	1-year	High	Average	Low
Index								
Reuters/Jefferies CRB	270.9	3.5	6.4	-0.2	-12.3	317.2	275.3	253.8
Bloomberg Commodity Index	105.1	4.1	2.5	-6.7	-17.1	130.3	111.5	98.0
Bank of Canada	586.4	0.0	-1.4	-2.2	-33.7	884.9	662.2	584.6
Energy								
Brent oil (US$/barrel)	76.7	1.1	5.6	-3.1	-32.2	120.2	88.3	71.9
WTI oil (US$/barrel)	70.6	-6.9	6.0	-4.8	-35.5	117.6	83.1	66.6
WCS oil (US$/barrel)	59.1	-0.6	17.5	27.6	-34.2	93.7	61.8	43.0
Gasoline (CAN$/litre)	1.67	3.0	11.7	15.6	-20.2	2.06	1.64	1.41
Gasoline (US$/gallon)	3.60	1.7	4.0	11.0	-28.2	5.01	3.72	3.09
Natural gas (US$/MMBTU)	2.63	1.5	12.6	-60.1	-62.1	9.68	4.95	1.99
Base metals								
LME Index	3,837	4.0	-0.4	-2.0	-8.6	4,404	3,865	3,453
Aluminum (US$/tonne)	2,231	-2.7	0.2	-4.6	-10.0	2,624	2,352	2,092
Copper (US$/tonne)	8,555	5.2	-0.2	3.9	-4.6	9,331	8,307	7,160
Nickel (US$/tonne)	22,956	10.3	-0.8	-18.4	-10.3	31,281	24,130	19,333
Zinc (US$/tonne)	2,477	1.1	-15.5	-18.7	-30.7	3,782	3,036	2,230
Iron ore (US$/tonne)	114.9	5.2	-13.0	2.4	-5.4	133	109	79
Precious metals								
Gold (US$/ounce)	1,959	0.3	-0.1	9.5	6.5	2,047	1,828	1,628
Silver (US$/ounce)	24.0	2.0	9.6	5.1	9.8	26.0	21.7	17.8
Platinum (US$/ounce)	987	-7.5	0.8	-1.0	4.7	1,128	969	831
Palladium (US$/ounce)	1,398	-4.5	0.6	-19.2	-24.8	2,315	1,779	1,324
Other commodities								
Wheat (US$/bushel)	6.88	12.4	-3.2	-8.8	-33.5	10.78	7.61	5.91
Corn (US$/bushel)	6.41	11.5	1.4	-0.3	-18.9	8.09	6.55	5.72
Soybeans (US$/bushel)	14.60	8.7	-0.2	-0.2	-14.2	17.17	14.67	13.04

CRB: Commodity Research Bureau; WTI: West Texas Intermediate; MMBTU: Million British Thermal Units; LME: London Metal Exchange; MBF: thousand board feet
NOTE: Commodity table based on previous day's close.

TABLE 2
Commodity prices: History and forecasts

ANNUAL AVERAGES	2021	2022	2023f	2024f
Energy				
WTI oil (US$/barrel)	68	95	74	82
Brent oil (US$/barrel)	71	98	77	85
WCS spread (US$/barrel)	54	75	59	69
Henry Hub natural gas (US$/MMBTU)	3.72	6.51	2.85	4.05
Base Metals				
Aluminum (US$/tonne)	2,473	2,706	2,325	2,430
Copper (US$/tonne)	9,312	8,832	8,385	8,325
Nickel (US$/tonne)	18,460	26,263	22,885	21,550
Iron ore (US$/tonne)	159	120	110	96
Precious metals				
Gold (US$/ounce)	1,800	1,803	1,920	1,740

f: forecasts; WTI: West Texas Intermediate; MMBTU: Million British Thermal Units; WCS: Western Canadian Select
Sources: Datastream and Desjardins, Economic Studies