Commodity Trends

Desjardins Economic Studies
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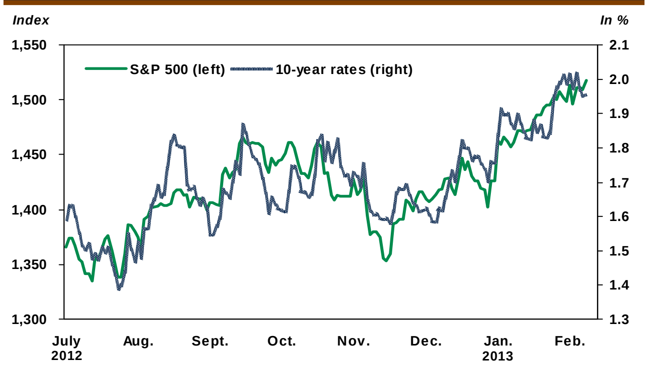
Commodities benefit from the improvement in investor sentiment

A breeze of optimism has been wafting over the financial markets since the beginning of the year. The last-minute agreement to avoid most of the fiscal cliff in the United States, subsiding financial tensions in Europe and encouraging corporate results have given a noticeable boost to the stock markets and to interest rates in recent weeks (graph 1).

Graph 1 – The last few months have been very good for stock markets, but difficult for U.S. bonds

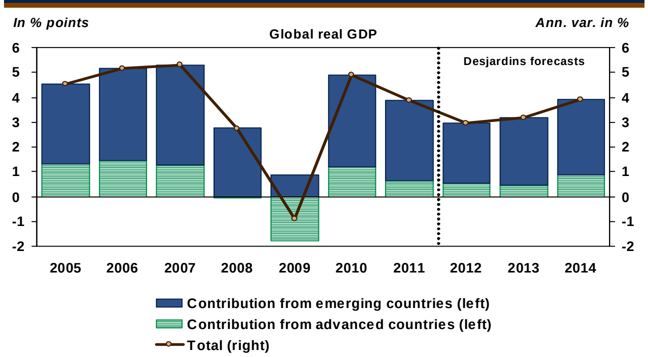


Sources: Bloomberg and Desjardins, Economic Studies

In these conditions, we might have hoped for strong growth in commodity prices. However, the increase observed since the start of the year is fairly modest: the main price indexes have risen by about 2%, compared to more than 6% for the U.S. stock market. The slump in commodity prices that occurred in 2011 and in 2012 may account for investors' hesitation toward this asset class. Oil has however managed to hold its own: its price has risen by approximately US$10 per barrel since mid-December.

The fragility of the global economy warrants some caution with respect to the commodity market. While the most dire scenarios can now be ruled out, indications are that global economic growth will remain modest this year, especially in industrialized countries (graph 2). The contraction in economic activity in many of the major economies at the end of 2012 shows how little conducive conditions are to any surge in commodity prices.

Graph 2 – Global economic growth to remain modest in 2013



Sources: World Bank, Consensus Forecasts 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.

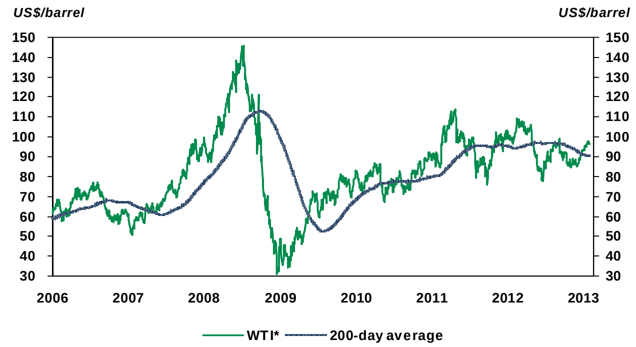
ENERGY

Oil prices rally... but not for Canadian producers

OIL

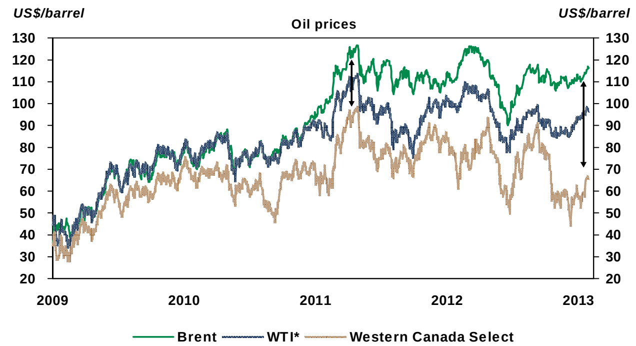
- After a fairly difficult fall, oil prices have recently started to perform well. The price of WTI (West Texas Intermediate) oil has climbed from US$85 per barrel in mid-December 2012 to nearly US$98. Thus, after spending 2012 playing yo-yo, the price of WTI has returned very close to where it stood at this time last year (graph 3).
- Initially, the gain in the price of WTI mainly reflected a reduction in the discount on this type of oil in relation to Brent oil, since the expansion of transportation capacity in the Seaway pipeline pointed towards a contraction of the oil surplus in the U.S. Midwest. However, a postponement of full operations in that pipeline caused the gap between WTI and Brent prices to widen again. The lack of infrastructure to carry the oil is a particularly serious problem for Canadian producers. Oil from Alberta, Western Canada Select, is currently selling nearly US$50 per barrel cheaper than Brent. These two types of oil were trading near the same price a few years ago (graph 4). While international oil prices have been relatively stable in the past 12 months, the price that producers in Western Canada get has dropped sharply; this could curtail investment in this key sector of Canada's economy.
- International oil prices have really been rising in recent weeks, with Brent reaching US$119 per barrel. Some concerns about supply have contributed to that advance. A bloody hostage-taking in an Algerian gas plant, serious political turmoil in Egypt and a strike by Israel against Syria have rekindled a risk premium in the crude oil market. A surprise production cutback by some major OPEC (Organization of the Petroleum Exporting Countries) producers has also supported oil prices (graph 5).
- The increase in crude prices is also due to renewed optimism about the global economy. The International Energy Agency recently revised upwards its global demand forecast for the year 2013 and Chinese demand has recently been stronger than anticipated. Growth in demand will remain modest, however, and should be fully offset by expanding production by non-OPEC member countries. The surge in U.S. oil production is especially impressive, showing year-over-year growth of nearly 15% in November. In these conditions, global oil supply should exceed demand for most of 2013.

Graph 3 – Price of a barrel of oil



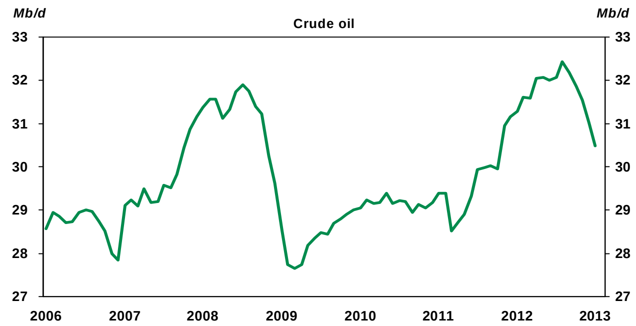
* West Texas Intermediate.
Sources: Datastream and Desjardins, Economic Studies

Graph 4 – Negative spread between Canadian oil price and prices of Brent and WTI* has significantly widened



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

Graph 5 – OPEC* production has declined significantly over the past few months



Mb/d: Millions of barrels per day; OPEC: Organization of Petroleum Exporting Countries
* Excluding Indonesia, but including Iraq.
Sources: Bloomberg and Desjardins, Economic Studies

GASOLINE

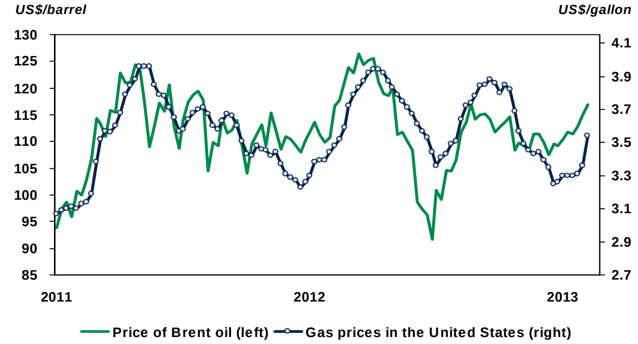
- U.S. gas price has plummeted in recent months, from close to US$3.90 per gallon at the beginning of last fall to less than US$3.30 per gallon at the start of the year. Given that the price of Brent oil remained fairly stable over that period, it is mainly a reduction in the refiners' profit margins, which were abnormally high at the end of the summer, that accounts for this drop. A recent rally in the price of Brent has halted that trend, and the average price of gas has rebounded by more than US$0.20 in the past two weeks (graph 6). This trend bears watching, as any further increase in gas prices could affect U.S. household confidence, which is already quite shaky.

NATURAL GAS

- After a rally during the fall which drove it above US$3.50 per MMBTU (Million British Thermal Unit), the price of natural gas recently fell back to around US$3.25. The mild start to the winter halted the upward trend in the price of gas by limiting its consumption. U.S. gas inventories are therefore still very high.
- The low gas prices have sharply curbed drilling in recent quarters. After a period of rapid growth, U.S. gas production is likely to increase much more moderately in 2013 and 2014 (graph 7). This should restore some degree of balance to the North American gas market, and prevent prices from plunging to new lows. But the proliferation of available gas reserves in the United States suggests that production could quickly accelerate again if demand and price were to justify this. The situation is quite different in other parts of the world, where non-conventional gas extraction methods are still not much used. The prices observed in Asia and in Europe are thus several times higher than in North America (graph 8).

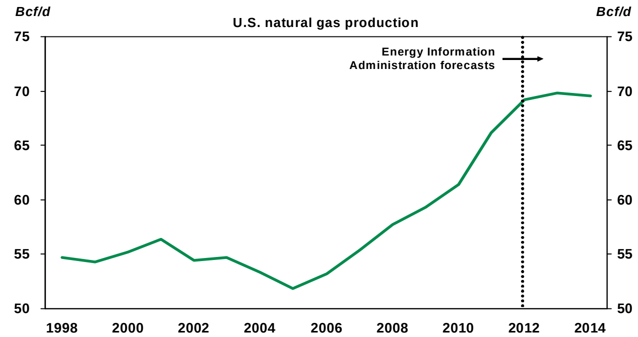
Forecasts: Unless supply suffers a serious shock, oil prices are unlikely to rise much higher. Global demand remains too weak to revive fears of a shortage. Another price increase could also cast a shadow over the economic outlook and further weaken demand, a situation Saudi Arabia will wish to avoid. In the short term, the price of WTI could fall back to around US$90 per barrel before resuming an upward trend in the second half of the year if, as we expect, the outlook for global growth improves. The price of natural gas should stay at around US$3.50 per MMBTU in 2013.

Graph 6 – Oil and gas prices have been trending upwards since the start of 2013



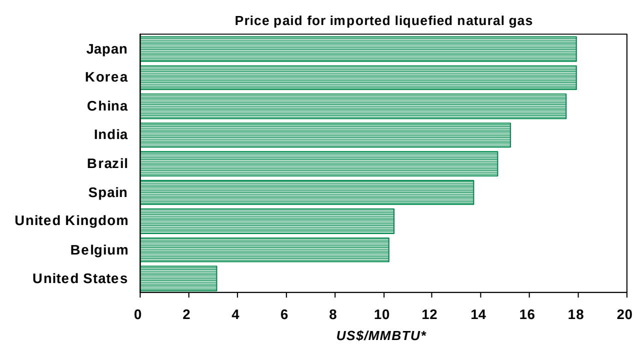
Sources: Bloomberg and Desjardins, Economic Studies

Graph 7 – After a spectacular jump, natural gas production in the United States should stagnate



Bcf/d: Billion cubic feet per day
Sources: Energy Information Administration and Desjardins, Economic Studies

Graph 8 – Natural gas prices are much lower in the United States



* Million British Thermal Unit.
Sources: Federal Energy Regulatory Commission and Desjardins, Economic Studies

BASE METALS

Weak economic growth is still a problem

Times were tough for base metals in 2012. Demand for metals was hard hit by a slowdown in the global economy, which did not spare China. In terms of annual average, the prices of all metals lost ground in 2012 (graph 9). The summer season was the most difficult, when fears of a serious slowdown in the Chinese economy pushed the prices of many metals down to cyclical lows. More encouraging statistics out of China have however enabled the LME (London Metal Exchange) index of industrial metal prices to recover to around 3,500 since fall. Prices have not benefited much from the recent burst of investor enthusiasm, as the sluggishness of the global economy is still keeping demand for metals in check. A reduction of Chinese imports at the end of 2012 has also limited the rally in metal prices.

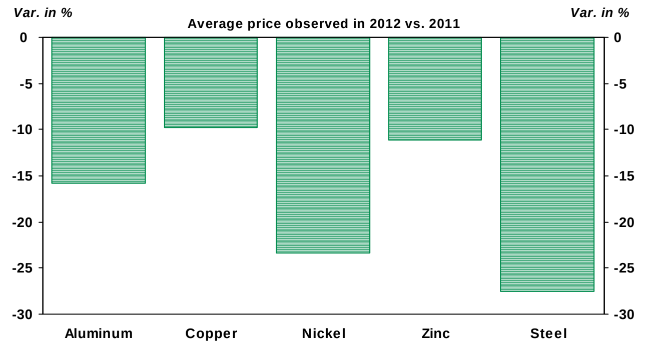
ALUMINUM

- The aluminum market was hard hit in 2012 by the slowdown of the global economy. On average, its price was just US$2,021 per tonne last year, 16% lower than in 2011. After reaching a cyclical low of US$1,796 per tonne in mid-August, the price of aluminum has picked up a bit and is now hovering close to US$2,100 per tonne (graph 10). Prospects for further appreciation in the price of this metal are dim, since global production is likely to exceed demand again this year. This means that the aluminum inventories surveyed by the LME, which reached new peaks at the end of 2012, are likely to keep expanding.

COPPER

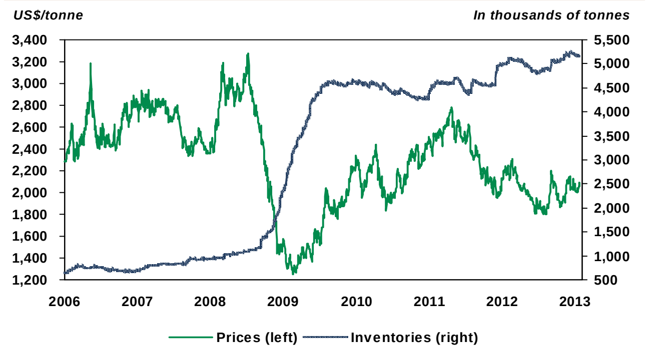
- Thanks to more limited supplies and relatively low inventories, the price of copper performed better than for other base metals last year. Nevertheless, its price declined by nearly 10%, on average, compared with 2011. After generally trading at less than US$8,000 per tonne in recent months, the price of copper has recently climbed back near US$8,250 per tonne (graph 11) even if inventories have rebounded. This rally seems to be mainly supported by an improvement in investor sentiment, as purchases of exchange-traded funds associated with copper have soared since the beginning of 2013. This trend could quickly reverse itself if pessimism gains the upper hand once more.

Graph 9 – Industrial metal prices fell sharply in 2012



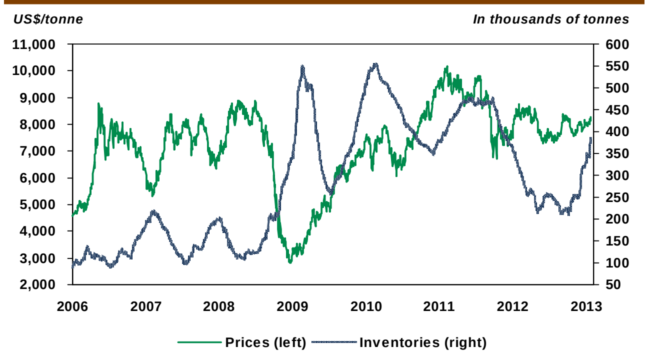
Sources: Datastream and Desjardins, Economic Studies

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 price of nickel had a very rough ride in 2012. On average, it was a mere US$17,522 per tonne, a 23% decline compared with 2011. In a situation of strong nickel production growth, slower demand for this metal exacerbated the surplus and generated a sharp increase in inventories (graph 12). Still, the price of nickel has managed to gain more than US$1,200 per tonne since the start of 2013, climbing back above US$18,000 per tonne. Inventories are still expanding rapidly, however, limiting the potential for further appreciation of this metal.

ZINC

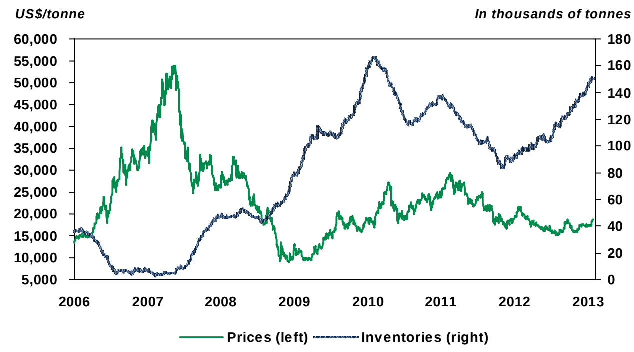
- Despite a large surplus in the global zinc market which has resulted in a ballooning of inventories, the price of this metal fell by just 11% last year, not such a bad performance compared with other industrial metals. The price of zinc has also held up well since the beginning of 2013, gaining over 5% to climb back above US$2,150 per tonne (graph 13). The recent downward trend in inventories is helping to support the price of this metal, but it would be surprising for that trend to continue much longer, as indications are that global zinc production will amply exceed demand again this year.

STEEL

- Given how important iron production is to the Canadian and Quebec mining sector, we have added steel to the list of industrial metals that we cover. Because the iron market is very segmented, it is difficult to find a good global benchmark price. Fortunately, the issuance of a futures contract on steel by the LME in 2008 provides us with a benchmark price for steel; it is mainly that price that we will use in our analyses.
- On average, the price of steel plunged by approximately 28% in 2012 to reach US$406 per tonne. The drop is even more spectacular if we compare the price at the end of 2012 (US$270 per tonne) with that prevailing at the end of 2011 (US$537.50 per tonne) (graph 14). This major slump is mainly due to the significant problem of overcapacity in steel production, which makes the price of this metal very vulnerable to a slowdown in demand. This situation will continue to weigh on prices this year, but some signs of acceleration in demand and an upturn in iron prices could push steel price up slightly.

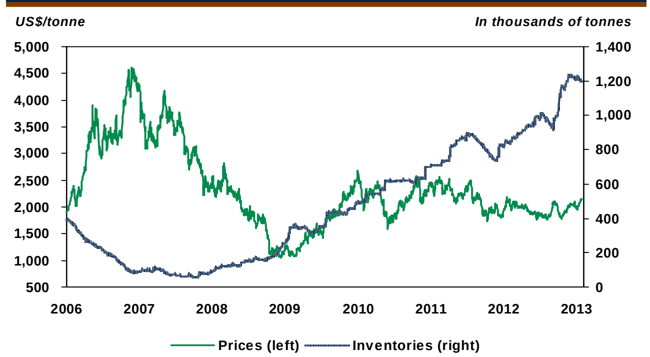
Forecasts: The modest acceleration of the global economy in 2013 should produce slight gains in base metal prices. While the production of most metals should exceed demand once again in 2013, there are no signs of a return to the exuberance of the middle of the 2000 decade. It is worth noting that global real GDP was growing by around 5% per year in those days, a pace that is not likely to be equalled in the short or medium term.

Graph 12 – Nickel prices and inventories



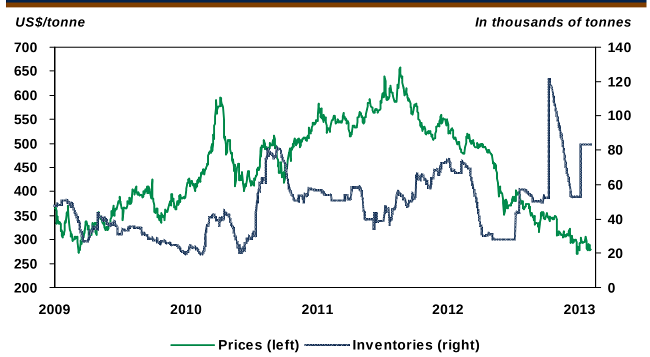
Sources: Datastream and Desjardins, Economic Studies

Graph 13 – Zinc prices and inventories



Sources: Datastream and Desjardins, Economic Studies

Graph 14 – Steel prices and inventories



Sources: Datastream and Desjardins, Economic Studies

PRECIOUS METALS

Have gold prices peaked?

Overall, prices for precious metals got off to a strong start in 2013, continuing the trend that began in the last months of 2012. Gold prices have been more hesitant for the past few quarters, however, which raises the question: Did gold reach its peak in 2011 (graph 15)?

GOLD AND SILVER

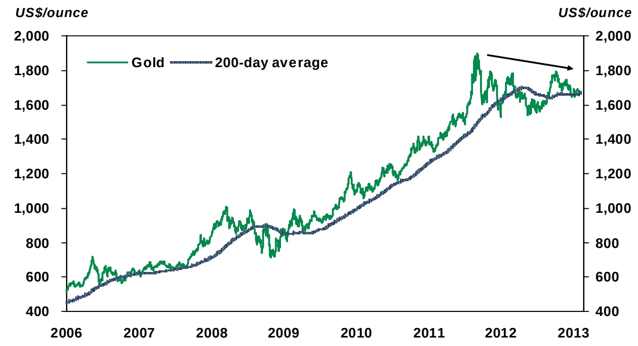
- In terms of annual average, gold is one commodity that had the best showing in 2012, with gains of more than 6%. This metal did not appreciate nearly as much as other precious metals since the middle of 2012 however, with a 5% gain vs. 17% for silver and respective gains of 21% and 32% for platinum and palladium. That gold prices have been at a virtual standstill since the middle of last year is worrisome, especially since the Federal Reserve announced a third round of quantitative easing, stirring up hopes of seeing gold prices reach a new peak. Initially, gold prices responded positively to the actions taken by central banks at the end of last summer, edging close to US$1,800 an ounce. In the end, this gain was not sustainable. Improved investor sentiment in the past few weeks is also not positive for gold. Prices for silver fluctuated strongly throughout 2012, oscillating between US$27 and US$37 an ounce (graph 16). A good start to the year saw silver prices settle back to about US$32, as demand for this metal seems to strengthen.

PLATINUM AND PALLADIUM

- Platinum prices continued to sizzle, with gains of about US$200 an ounce since the beginning of the year. As a result, platinum prices have increased to about US$1,725 an ounce. Producers in South Africa are dealing with difficulties; significant labour conflicts and the recent announcement that some mines would close are some of the reasons for the spike in platinum prices since last summer. This has paved the way for platinum prices to overtake gold prices (graph 17). Palladium prices have also posted sharp advances in the past few months.

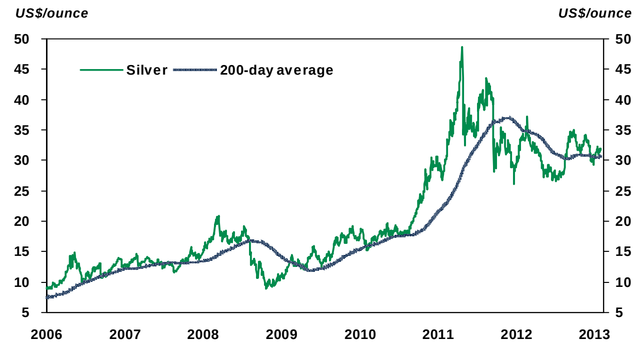
Forecasts: Gold prices may rise somewhat in the short term if investor sentiment becomes less favourable to risk assets. If a new financial crisis can be avoided and global economic outlooks continue to improve, the price of gold should begin to trend downwards, sustainably, in the next few quarters.

Graph 15 – Gold prices



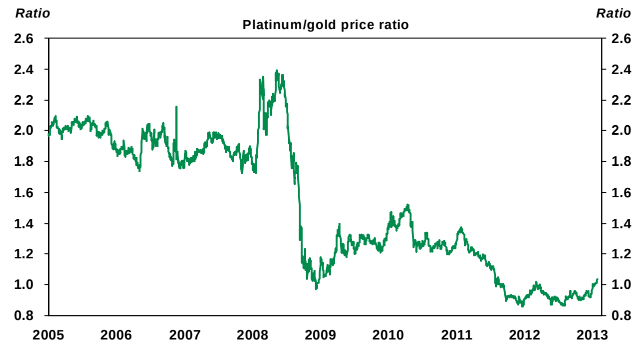
Sources: Datastream and Desjardins, Economic Studies

Graph 16 – Silver prices



Sources: Datastream and Desjardins, Economic Studies

Graph 17 – Platinum prices have overtaken gold prices, slightly



Sources: Datastream and Desjardins, Economic Studies

AGRICULTURAL COMMODITIES

The next U.S. harvest will be critical

2012 was a better year for grain prices than for most other commodities. In terms of annual average, corn and soybean prices reached new peaks last year (graph 18). The drought in the United States dealt a severe blow to the harvests of both of these crops, mostly explaining the rise in prices. Prices have moderated in the past few months, but they remain high (graph 19).

WHEAT

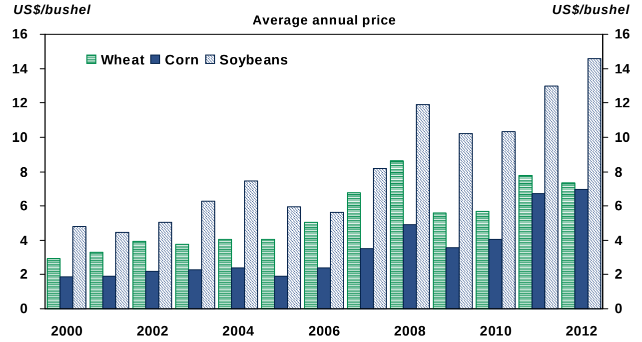
- After surging to around US$9.30 a bushel in July 2012, wheat prices have fallen sharply in the past few months, settling at about US$7.20/bushel. The drought in the United States had little impact on the wheat harvest, which was 10% better than the 2011 harvest. Unfavourable weather conditions saw production in Eastern Europe tumble however, dragging down global production last year. Global inventories declined but they remain relatively high, thus limiting concerns of a shortage.

CORN AND SOYBEANS

- After reaching a historical peak of US$8.49 a bushel in August 2012 amid concerns about a shortage due to the drought, corn prices have moderated in the past few months. Corn prices remained relatively high though while global corn inventories have fallen to worrisome levels (graph 20). High corn prices should convince U.S. farmers to allocate a large portion of their land to growing corn in 2013. This year's harvest could thus yield a bumper crop if the weather is favourable. The drought in the United States also boosted soybean prices sharply. However, good South American harvests triggered an increase in global soybean production and inventories last year.

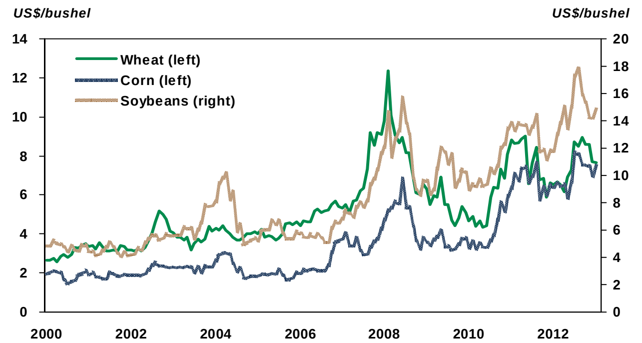
Forecasts: The balance between supply and demand for grains is clearly tighter than at the same period last year, especially for corn. Another drought in the United States or in Eastern Europe could push grain prices to new heights this year. On the flip side, good harvests could lead to a price correction. U.S. prospective planting for 2013, to be published at the end of March, could influence the relative performance of grain prices.

Graph 18 – Corn and soybean prices reached new heights in 2012



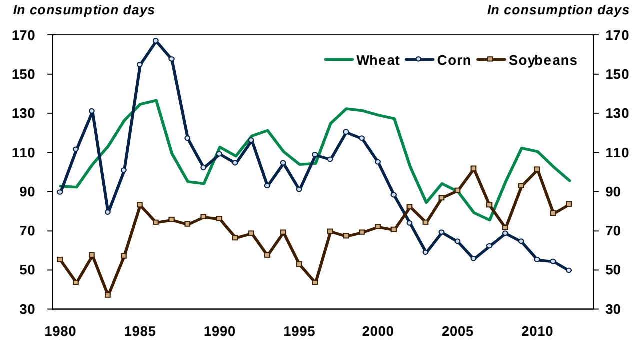
Sources: Datastream and Desjardins, Economic Studies

Graph 19 – Despite the decline, grain prices remain very high



Sources: Datastream and Desjardins, Economic Studies

Graph 20 – Weak global corn inventories are worrisome



Sources: U.S. Department of Agriculture and Desjardins, Economic Studies

Table 1
Commodities

	Spot price	Percentage return since				Last 52 weeks		
	10 février	1 month	3 months	6 months	1 year	High	Average	Low
Index								
Reuter-CRB[1] (CCI[2])	563.6	1.4	0.8	1.0	-3.8	604.8	561.5	503.8
Reuters/Jefferies CRB[1]	301.1	1.5	3.0	-0.2	-3.5	325.9	299.9	267.2
Dow Jones AIG[3]	141.2	2.0	0.3	-1.4	-2.5	152.0	141.3	126.8
Bank of Canada	655.8	5.2	8.6	4.0	3.7	674.2	632.8	567.7
Energy								
Brent oil (US$/barrel)	119.2	6.0	10.2	5.6	1.4	126.5	112.2	90.1
WTI[4] oil (US$/barrel)	95.7	2.0	11.2	3.0	-3.0	109.4	93.6	77.7
Gasoline (US$/gallon)	3.54	7.3	1.4	-2.7	1.7	3.94	3.62	3.25
Natural gas (US$/MMBTU[5])	3.26	5.8	-2.1	14.8	29.0	3.77	2.83	1.82
Precious metals								
Gold (US$/ounce)	1,668	-0.5	-3.7	2.9	-3.2	1,792	1,669	1,541
Silver (US$/ounce)	31.5	3.4	-2.0	13.1	-6.1	37.2	31.1	26.7
Platinum (US$/ounce)	1,714	5.7	9.9	22.5	4.6	1,736	1,564	1,390
Palladium (US$/ounce)	746.0	6.4	21.9	29.1	7.0	764.5	649.7	565.0
Base metals								
LMEX[6]	3,605	2.2	11.1	14.0	-2.7	3,820	3,413	3,095
Aluminium (US$/tonne)	2,080	0.0	9.4	13.0	-5.7	2,312	2,010	1,796
Copper (US$/tonne)	8,260	2.2	9.1	10.4	-2.4	8,738	7,952	7,283
Nickel (US$/tonne)	18,251	5.2	14.7	19.0	-11.4	21,424	17,273	15,190
Zinc (US$/tonne)	2,182	8.3	17.1	19.9	5.6	2,182	1,954	1,758
Steel (US$/tonne)	280.0	-7.9	-11.8	-25.2	-42.0	519.5	382.2	270.0
Agricultural commodities								
Wheat (US$/bushel)	7.22	-0.2	-17.0	-16.1	15.9	9.29	7.49	5.48
Corn (US$/bushel)	7.19	2.9	-2.5	-10.8	13.8	8.49	7.08	5.80
Soybean (US$/bushel)	14.62	4.9	1.4	-13.0	20.6	17.90	14.81	12.11
CRB[1] Livestock index	580.8	-5.4	1.5	-3.9	-2.4	628.8	602.4	569.3

[1] Commodity Research Bureau; [2] Continuous Commodity Index; [3] American International Group; [4] West Texas Intermediate; [5] Million British Thermal Unit; [6] London Metal Exchange Index.
Note: Currency table base on previous day closure.

Table 2
Commodities prices: history and forecasts

Annual average	*2011*	*2012f*	*2013f*	*2014f*
WTI* oil (US$/barrel)	95	94	Target: 93 (range: 80 to 100)	Target: 100 (range: 90 to 110)
Natural gas Henry Hub (US$/MMBTU**)	3.99	2.76	Target: 3.50 (range: 2.75 to 4.25)	Target: 4.00 (range: 3.00 to 5.00)
Gold (US$/ounce)	1,572	1,669	Target: 1,600 (range: 1,400 to 1,800)	Target: 1,500 (range: 1,250 to 1,750)
LMEX*** index—base metals	3,927	3,416	Target: 3,600 (range: 3,100 to 4,100)	Target: 4,000 (range: 3,400 to 4,400)

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