Commodity Trends

Desjardins Economic Studies

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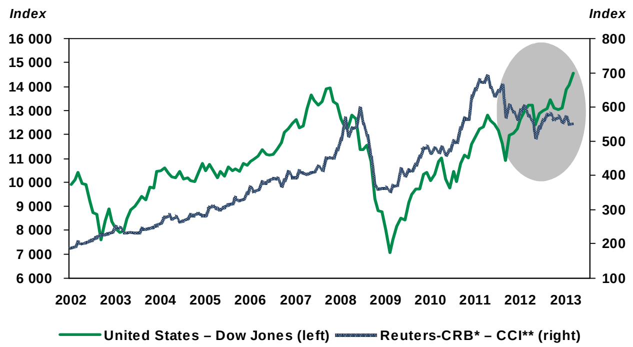
Looking for a direction

While the stock markets maintained their momentum over the last few weeks, commodity performance was not nearly as impressive. Prices for most commodities have come down, dropping close to where they were at the end of 2012. Unlike the U.S. stock indexes, which recently set new historic peaks, commodity price indexes remain quite far from the levels achieved a few years ago (graph 1).

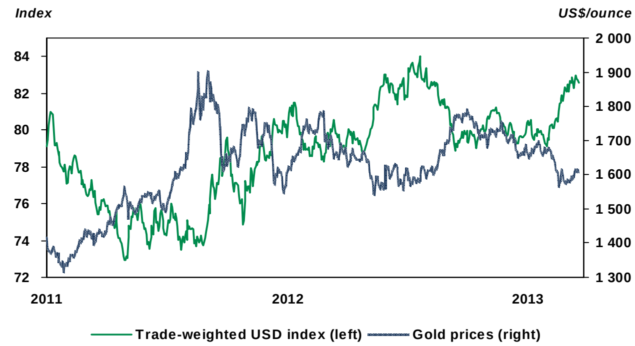
Graph 1 – The trend for commodities has diverged sharply from the U.S. stock market trend since summer 2011



* Commodity Research Bureau; ** Continuous Commodity Index.
Sources: Datastream and Desjardins, Economic Studies

Some of the commodity underperformance compared with other risk assets is due to disappointing Chinese economic statistics, in contrast with the statistics in the United States, which have generally outstripped expectations. Concerns about China's economy, intensified by the announcement of new measures to curb the country's real estate sector, hit base metal prices especially hard. Resource prices have also been hurt by the U.S. dollar's surge since the start of 2013 (graph 2).

Graph 2 – The greenback is up sharply since the start of 2013



Sources: Bloomberg and Desjardins, Economic Studies

Weak economic growth in several major economies and a commodity supply that remains more than enough to meet demand should keep limiting commodity gains in the months to come. However, if global growth accelerates as forecast at mid-year, commodity prices could start to trend up again. Note that we have changed page 7 of this publication, mainly to add a short section on forest products.

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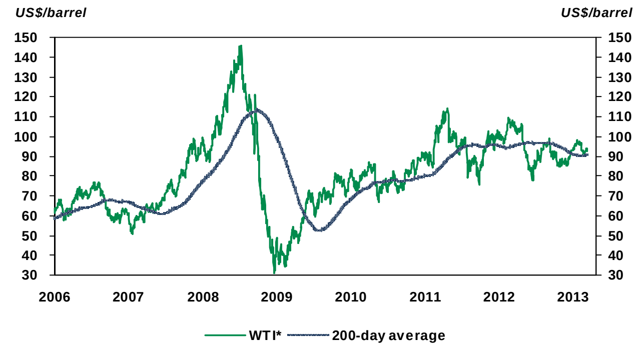
ENERGY

The U.S. energy revolution is starting to have an impact

OIL

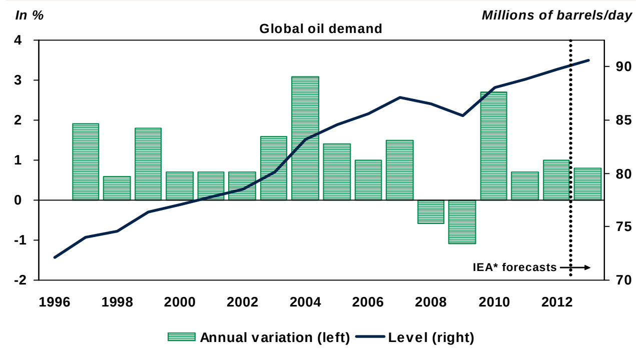
- After jumping close to US$98/barrel at the end of January, the price of WTI (West Texas Intermediate) softened, dropping to around US$90/barrel (graph 3). Brent prices fell nearly US$10/barrel, going below US$110/barrel. The oil pullback was initially based on a temporary upswing in investor concern in mid-February; recently, however, fundamental factors are primarily responsible for the price retreat.
- There are currently two major obstacles to a lasting oil price rise. Firstly, consumption of petroleum products remains very low and the International Energy Agency has downgraded the global demand forecast for 2013 (graph 4). Ongoing economic problems in Europe will be the primary curb on oil demand this year. Although true Chinese demand is hard to measure, the country's economic situation does not seem conducive to spectacular growth.
- The other major trend that is putting the brakes on prices is the surge in U.S. production. It is now clear that the new oil extraction technologies will have major consequences. A few years ago, the United States seemed doomed to a growing dependence on foreign oil; now, everything suggests that the country will, over the medium term, become the largest oil producer and a net exporter of fossil energy. While this phenomenon is well established, the speed at which U.S. output is advancing continues to beat even the most optimistic of expectations. The latest monthly data shows spectacular growth of around 15%; the last time Uncle Sam saw oil production surge this fast was in the 1950s (graph 5).
- Will the infrastructures, especially oil pipelines, be adequate to support the growth in production? Given some bottlenecks, rail transportation is increasingly being used to get oil to the refineries. The fate the Obama government has in store for the Keystone XL pipeline could have a big influence on the price that Canadian output gets, as well as on Alberta's economic and fiscal performance. The spread between the prices from Western Canada Select and WTI, which had exploded at the end of 2012, recently fell substantially, when an environmental report favouring the Keystone XL project was tabled.

Graph 3 – Price of a barrel of oil



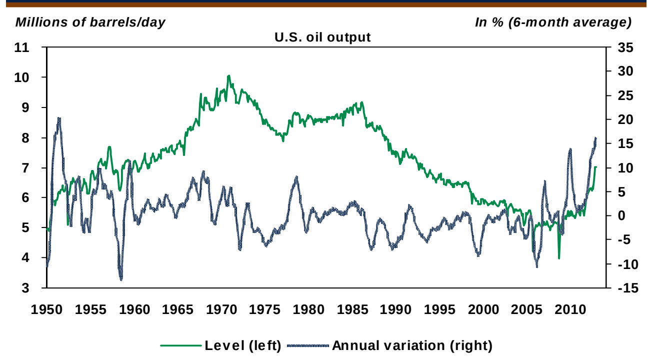
* West Texas Intermediate.
Sources: Datastream and Desjardins, Economic Studies

Graph 4 – Oil demand growth will remain soft in 2013



* International Energy Agency.
Sources: International Energy Agency and Desjardins, Economic Studies

Graph 5 – The U.S. oil production surge is increasingly impressive



Sources: Energy Information Administration and Desjardins, Economic Studies

GASOLINE

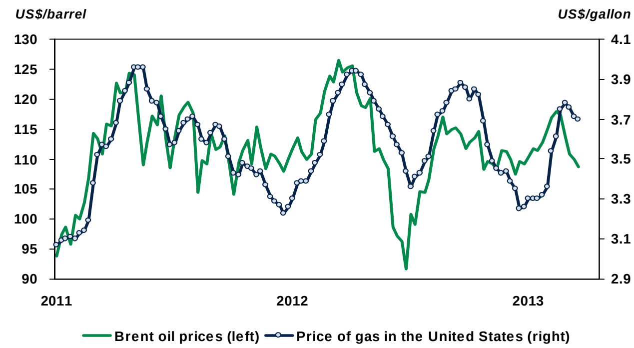
- In the United States, the surge in gas prices early in the year was worrisome, as consumers were already dealing with a tax hike. However, Brent prices have retreated since mid-February, doing away with these concerns. U.S. prices at the pump have dropped below US$3.70 a gallon, a trend which should persist in the near term (graph 6). The explosion of the price of credits that allow refiners to use less ethanol than governments call for could, nevertheless, keep a premium on gas prices. However, the government is likely to loosen its requirements, as ethanol already represents nearly 10% of the total volume of gas in the United States, and most car manufacturers do not recommend using gas with more than 10% ethanol in it.

NATURAL GAS

- Natural gas prices recently rose near US$4.00 MMBTU (Million British Thermal Units), up about 17% from the start of 2013 (graph 7). This good performance is owing to the strong demand that resulted from the cold weather in the last few weeks and greater use of natural gas by electricity producers. Stocks remain historically high, but stagnation in U.S. natural gas production in the near term as a result of the drop in drilling (graph 8) when prices collapsed at the start of 2012 could help maintain some equilibrium in the U.S. natural gas market. For natural gas, the energy revolution seems to have entered a second phase, in which prices and demand will have to adapt to the new reality before production can start to surge again. The United States continues to have enormous natural gas extraction potential and everything suggests that output will gradually gain momentum, with many gas export terminal projects pending approval and several new domestic opportunities being developed, including in transportation.

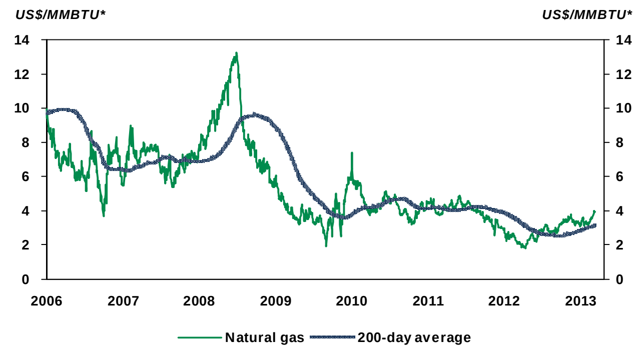
Forecasts: Oil prices could come down further in the near term as everything suggests that demand growth will be weaker than supply growth from countries that do not belong to the Organization of Petroleum Exporting Countries in 2013. Demand for oil should, however, gradually firm up as of mid-2013, prompting a slight upswing by WTI prices. The U.S. energy revolution will have medium- and long-term consequences, however, and we have downgraded our outlooks: WTI prices should not exceed US$110/barrel on a lasting basis. North American prices for natural gas should oscillate close to current levels for several quarters.

Graph 6 – The retreat of Brent prices could bring the average gas price close to US$3.50 in the United States



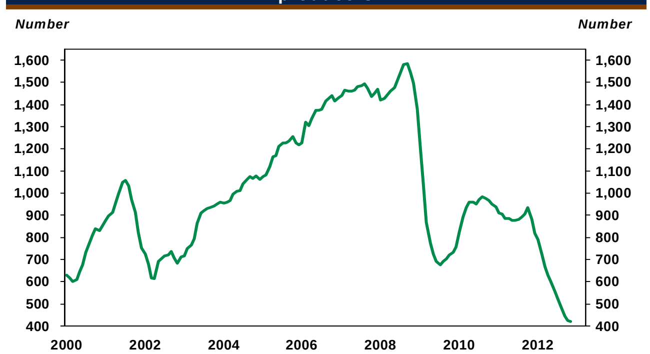
Sources: Datastream and Desjardins, Economic Studies

Graph 7 – Natural gas prices are still on the rise



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

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



Sources: Energy Information Administration and Desjardins, Economic Studies

BASE METALS

China raising worries once again

The release of disappointing Chinese economic figures has magnified downside pressures on industrial metal prices. The purchasing manager indexes fell in February, while the rise of retail sales and industrial output was smaller than anticipated. Moreover, inflation jumped to 3.2%, which could dampen Chinese authorities' appetite for additional stimulus measures (graph 9). The Chinese government even took further action to curb the real estate sector. Combined, these developments hurt industrial metal prices, which already had to deal with an unpropitious environment characterized by weak demand and inventories that are, overall, on the rise. The LME (London Metal Exchange) index of base metal prices, that went above 3,600 in mid-February, has recently dropped below 3,300.

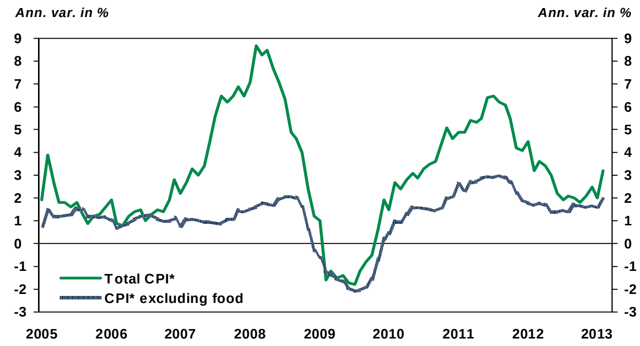
ALUMINUM

- After exceeding US$2,100 a tonne in mid-February, aluminum prices retreated over 10%, falling to around US$1,900 a tonne (graph 10). Despite a major pullback in Europe, global demand for aluminum advanced more than 5% in 2012 and should post similar growth this year. Global supply should grow slightly more slowly than demand in 2013. This will not be enough to rebalance the global market, however, and a seventh straight surplus is expected for 2013.

COPPER

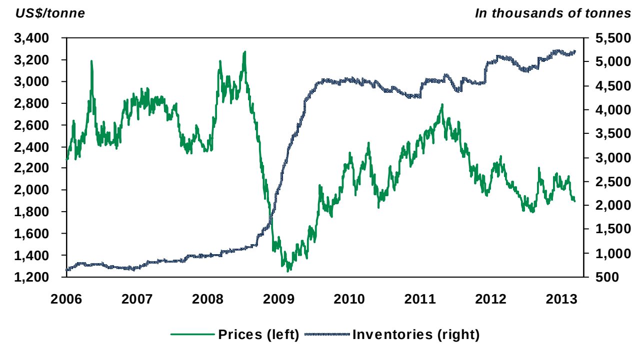
- Following the general trend, copper prices have tumbled over 5% since mid-February, returning to around US$7,500 a tonne (graph 11). The uncertainty about Chinese demand is affecting copper prices, particularly as copper output is finally showing encouraging signs after several disappointing years. The global copper market should see a surplus in 2013. The spectacular increase in copper inventories over the last few months is also helping raise doubts about the ability of copper prices to stay at levels well in excess of production costs, which are estimated at under US$5,000 a tonne.

Graph 9 – Chinese inflation has risen a bit in the last few months



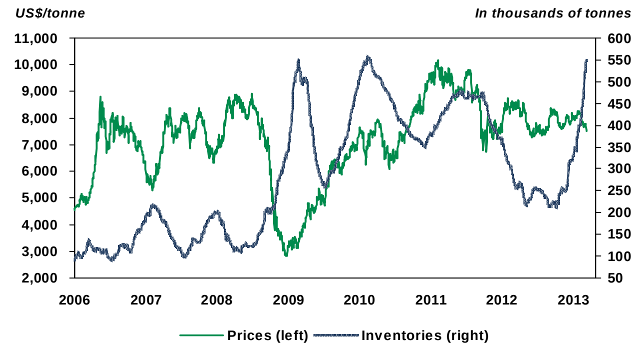
* Consumer price index.
Sources: National Bureau of Statistics of China and Desjardins, Economic Studies

Graph 10 – Aluminum prices and inventories



Sources: Datastream and Desjardins, Economic Studies

Graph 11 – Copper prices and inventories



Sources: Datastream and Desjardins, Economic Studies

NICKEL

- Nickel prices have been volatile since the year began, jumping more than US$1,500 a tonne in the first weeks of 2013 to over US$18,600 in early February. However, a tumble of similar magnitude took it back to around US$17,000 a tonne recently (graph 12). Despite the volatility, the situation in the global nickel market is unchanged. Demand for the metal remains fairly robust, while output is growing just as fast. This means the global nickel market will continue to be in surplus this year, and inventories should keep expanding.

ZINC

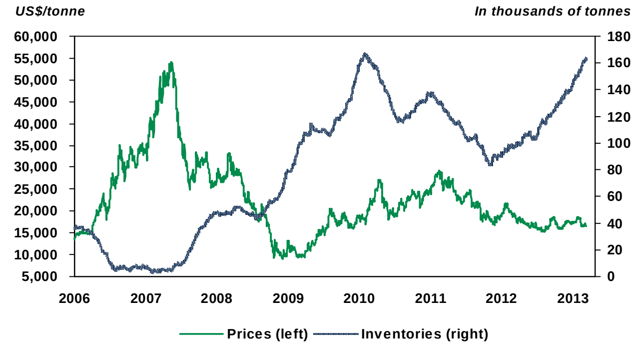
- After a good start to the year, zinc prices have retreated by about 10% since mid-February, dropping below US$2,000 a tonne (graph 13). A plunge by Chinese production in 2012, which resulted in a contraction in global production, gave zinc prices some support, despite the soft demand for this metal. After rebounding at the end of the year, Chinese zinc output seems to have weakened again lately. However, everything suggests that the global zinc supply will once again substantially outstrip demand this year. After falling in the first two months of 2013, zinc inventories have started an uptrend that could persist for several quarters.

STEEL

- Steel prices have kept retreating, dropping near US$200 a tonne, half the price seen at this time last year (graph 14). New measures to rein in China's real estate sector helped keep downside pressures on steel prices. The announcement also put a stop to the surprising surge of iron ore prices seen since last fall. The outlook for steel remains gloomy, as the metal's production capacity solidly outstrips demand. The Chinese government's desire for consolidation in this industry could however gradually reduce the country's excess production capacity.

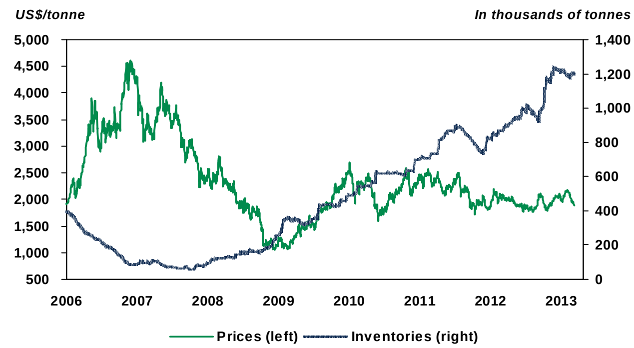
Forecasts: Industrial metal prices should continue to oscillate for some time close to the levels recorded since the start of the year. It would take a steep deterioration in China's economic outlook or another relapse of the U.S. economy to push metal prices much lower. If the signs that the U.S. economy is accelerating firm up, the global economic outlook should gradually improve, opening the door to higher industrial metal prices next year.

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

Gold's popularity with investors is waning

The last few weeks have not been good for precious metals. Investors' general optimism and the strong U.S. dollar are currently reining in these metals' appeal for investors.

GOLD AND SILVER

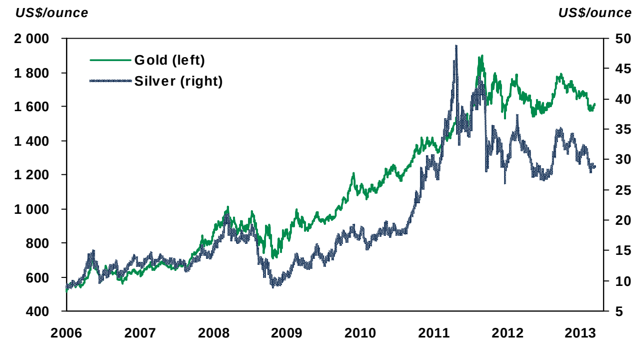
- Gold prices recently fell to around US$1,575 an ounce (graph 15), their lowest point since last summer. The U.S. dollar's surge had a hand in this pullback. Gold prices are down more than 4% since the start of 2013, and more than 10% since last fall. The drop in prices, despite the highly accommodative policies in place at many central banks, especially the Federal Reserve, raises some doubt about gold's potential for maintaining the uptrend of recent years. After exploding at the start of the 2000s, demand for gold-backed exchange traded funds has crested since mid-2010 and has been declining since the start of the year (graph 16). Purchases of gold by central banks were very heavy in 2012, however. Renewed tensions in the eurozone are good for gold. Silver prices recently fell to around US$29/ounce, down more than 4% since the start of the year.

PLATINUM AND PALLADIUM

- After strong growth that took it to US$1,730/ounce in mid-February, the price of platinum has also pulled back in the last few weeks, dropping below US$1,600/ounce (graph 17). The strong dollar and disappointing Chinese data has hurt platinum prices. However, the problems plaguing South African producers remain an important support for this metal's price. The price of palladium has not retreated as much as other metals in the last few weeks; it is still up nearly 9% from the start of the year.

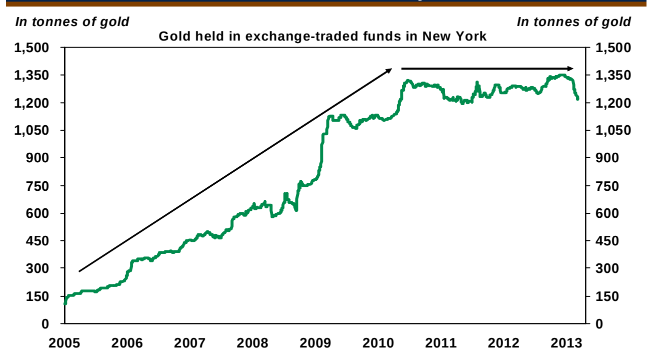
Forecasts: As the surge of the U.S. dollar and the stock markets seems somewhat lengthy, precious metal prices are likely to stabilize or edge up somewhat in the next few months. However, gold prices should continue to slide over the medium term, as the gradual rise of interest rates will continue to reduce this metal's appeal for investors. Platinum and palladium should do better over the medium term, as industrial demand will benefit from an acceleration of the global economy and growth of platinum output will continue to face numerous difficulties.

Graph 15 – Gold and silver prices



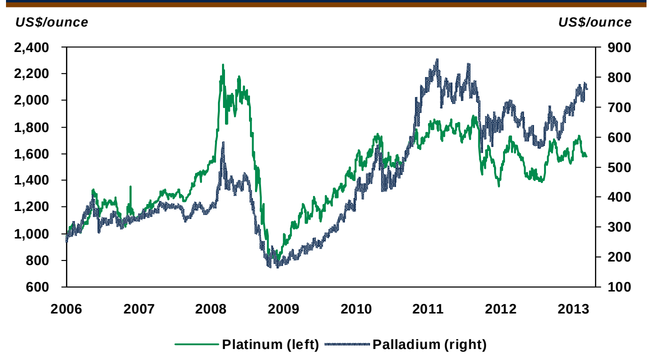
Sources: Datastream and Desjardins, Economic Studies

Graph 16 – Investor demand for gold has crested since mid-2010 and retreated recently



Sources: Exchange Traded Gold and Desjardins, Economic Studies

Graph 17 – Platinum and palladium prices



Sources: Datastream and Desjardins, Economic Studies

OTHER COMMODITIES

The upswing in U.S. real estate makes lumber catch fire

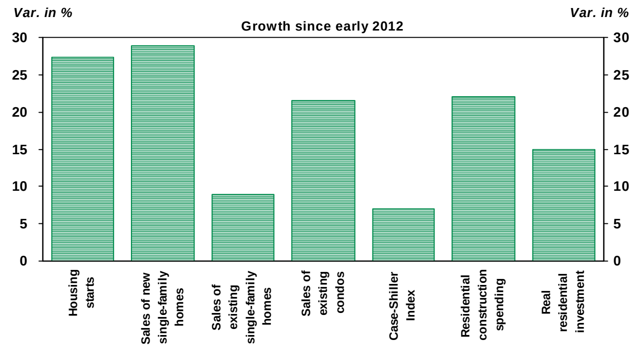
FOREST PRODUCTS

- Following several dire years, the U.S. housing market's renaissance (graph 18) is very good for lumber prices. After generally fluctuating in the US$200 range per thousand board feet (mbf) since mid-2007, the U.S. benchmark price for lumber began to shoot up in 2012, recently hitting $432/mbf, a peak that dates back to 2004 (graph 19). Everything suggests that demand for lumber will keep strengthening in the coming quarters. Although it will not be easy for the many lumber mills that have shut down in recent years to get back into production quickly, **we can expect the high prices to stimulate lumber output. It would therefore be surprising to see lumber prices continue to surge at their recent pace**. Pulp and newsprint prices are not benefiting from the same drive as lumber prices.

CEREALS

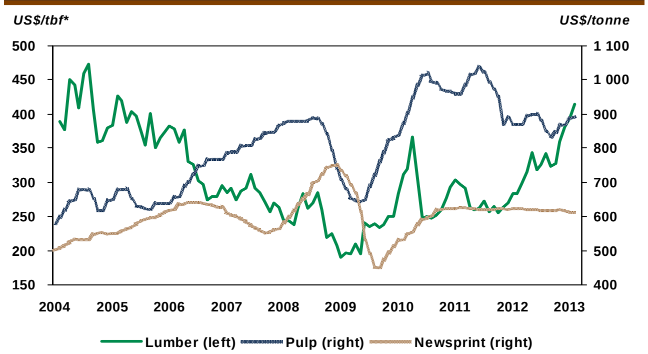
- Cereal prices have been moving in opposite directions since the start of 2013 (graph 20). Wheat prices retreated more than 10%, falling to around US$6.75/bushel. Global wheat production should rebound in 2013 after 2012's major drought in Eastern Europe. A report from the United Nations calls for the global wheat harvest to increase by 4.3% in 2013.
- After moderating at the end of 2012, corn prices have risen by more than 5% from the start of 2013, returning to around US$7.40/bushel. The U.S. government downgraded corn inventories again and there has been little rain in Argentina, buoying the cereal's price recently. Corn prices could be under pressure later this year, however, as yield from U.S. soil should rebound after the 2012 drought. Also keep an eye on U.S. politicians, as a reduction to quotas on the use of ethanol could affect corn prices. Soy prices are still fluctuating around US$14.50 a bushel. **The release of U.S. farmers' seeding plans on March 28 could make cereal prices react. After that, keep a close eye on the weather, particularly in the United States and Eastern Europe.**

Graph 18 – The housing market recovery seems to be well underway



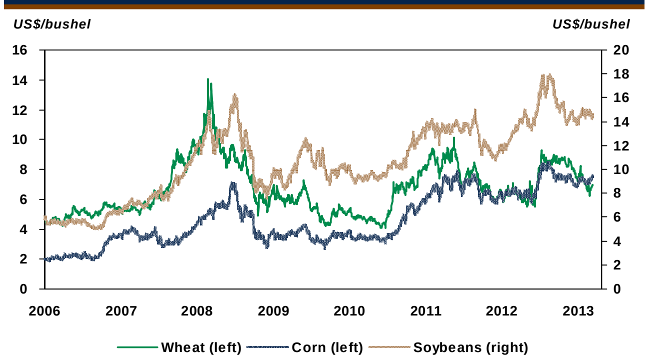
Sources: Datastream and Desjardins, Economic Studies

Graph 19 – Forest product prices



* Thousand of board feet.
Sources: Datastream and Desjardins, Economic Studies

Graph 20 – Cereal prices



Sources: Datastream and Desjardins, Economic Studies

Table 1
Commodities

	Spot price	*Percentage return since*				*Last 52 weeks*		
	March 21	**1 month**	**3 months**	**6 months**	**1 year**	**High**	**Average**	**Low**
Index								
Reuter-CRB[1] (CCI[2])	554.3	0.9	-1.3	-4.6	-4.2	598.1	557.1	503.8
Reuters/Jefferies CRB[1]	294.1	0.3	-0.0	-4.8	-6.9	320.9	297.3	267.2
Dow Jones AIG[3]	138.0	0.9	-0.9	-6.5	-4.4	152.0	140.3	126.8
Bank of Canada	634.1	-3.2	4.4	-4.8	-3.5	674.2	631.7	567.7
Energy								
Brent oil (US$/barrel)	108.3	-5.7	-1.2	-3.1	-12.9	125.8	111.1	90.1
WTI[4] oil (US$/barrel)	92.5	-0.4	4.8	-0.2	-13.5	107.3	92.3	77.7
Gasoline (US$/gallon)	3.70	-1.4	13.6	-4.7	-4.4	3.94	3.62	3.25
Natural gas (US$/MMBTU[5])	4.01	21.9	17.3	45.3	83.5	4.01	2.96	1.82
Base metals								
LMEX[6]	3,281	-4.3	-4.5	-7.8	-9.7	3,642	3,383	3,095
Aluminium (US$/tonne)	1,893	-6.9	-7.6	-10.2	-12.7	2,200	1,983	1,796
Copper (US$/tonne)	7,548	-3.6	-3.3	-8.8	-11.1	8,675	7,880	7,283
Nickel (US$/tonne)	16,828	1.5	-2.6	-7.2	-10.1	18,720	16,974	15,190
Zinc (US$/tonne)	1,905	-8.8	-7.2	-8.7	-5.0	2,185	1,952	1,758
Steel (US$/tonne)	206.5	-27.2	-31.1	-41.9	-57.9	501.5	355.1	206.5
Precious metals								
Gold (US$/ounce)	1,614	2.1	-2.6	-8.9	-2.4	1,792	1,656	1,541
Silver (US$/ounce)	28.9	0.7	-3.3	-16.7	-9.6	35.0	30.6	26.7
Platinum (US$/ounce)	1,583	-1.5	3.3	-3.6	-3.5	1,736	1,558	1,390
Palladium (US$/ounce)	761.0	5.4	12.7	13.2	10.3	774.0	655.3	565.0
Other commodities								
Lumber (US$/tbf[7])	432.0	5.9	15.8	31.3	45.5	432.0	347.6	296.0
Pulp (US$/tonne)	900.7	0.7	3.5	8.3	3.5	900.7	875.0	832.0
Newsprint (US$/tonne)	611.3	-0.8	-1.4	-1.2	-1.9	623.1	619.5	611.3
Wheat (US$/bushel)	6.93	1.7	-12.2	-22.5	9.6	9.29	7.52	5.48
Corn (US$/bushel)	7.50	7.1	6.8	-0.3	17.4	8.49	7.16	5.80
Soybean (US$/bushel)	14.66	-2.1	2.7	-8.9	9.6	17.90	15.01	13.31

[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; [7] Thousand of board feet.
Note: Currency table base on previous day closure.

Table 2
Commodities prices: history and forecasts

Annual average	*2011*	*2012*	*2013f*	*2014f*
WTI* oil (US$/barrel)	95	94	Target: 92 (range: 85 to 100)	Target: 100 (range: 90 to 110)
Natural gas Henry Hub (US$/MMBTU**)	3.99	2.76	Target: 3.60 (range: 3.00 to 4.25)	Target: 4.00 (range: 3.00 to 5.00)
Gold (US$/ounce)	1,572	1,669	Target: 1,550 (range: 1,400 to 1,700)	Target: 1,450 (range: 1,200 to 1,700)
LMEX*** index—base metals	3,927	3,416	Target: 3,600 (range: 3,100 to 3,900)	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