Commodity Trends

Desjardins Economic Studies

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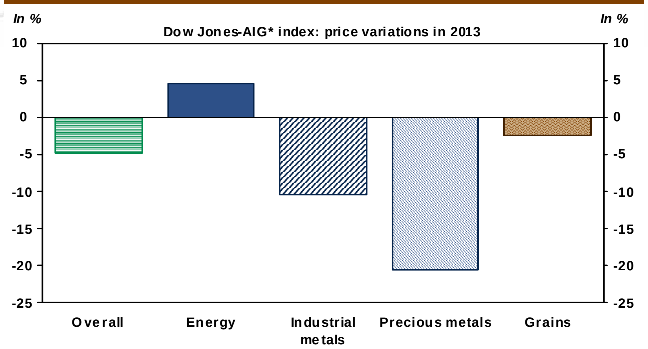
More and more worries

The last few weeks have been fairly difficult for commodity prices. Major resource price indexes have pulled back slightly, now posting losses of around 5% since the start of 2013 (graph 1).

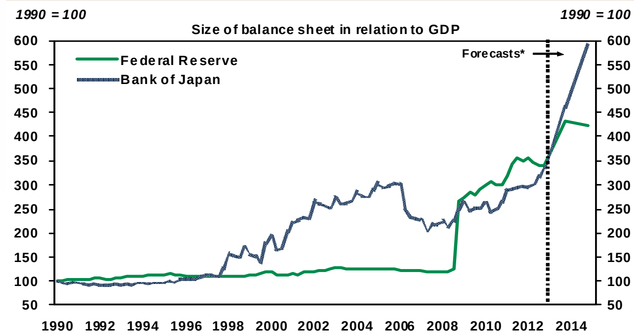
Graph 1 – Only energy prices have risen in the last few months



* American International Group.
Sources: Datastream and Desjardins, Economic Studies

Nevertheless, prices for most commodities remain relatively high, and the decreases seen in recent months have been modest overall. This sector's performance is increasingly worrisome, however, in a context in which prices for other risky assets continue to rise. The highly aggressive stimulus from central banks, especially the Federal Reserve and the Bank of Japan (graph 2), continue to inflate demand for stocks and low-quality bonds, but not for resources.

Graph 2 – The Bank of Japan's interventions will outstrip the Federal Reserve's



* Assumes the Bank of Japan will go through with what it has announced to date and the Federal Reserve will pursue its current purchases until the fall of 2013, then gradually wind them up.
Sources: Federal Reserve, Bank of Japan and Desjardins, Economic Studies

Note that almost all major categories of commodities are facing significant questions. For energy, not all of the consequences of the U.S. energy revolution are known yet. For industrial metals, signs of a slowdown in emerging nations are worrying. Lastly, the spectacular tumble by gold prices seems to confirm that investors have turned their backs on precious metals. Even so, the negativity currently surrounding the natural resources sector opens the door to a better performance in the coming quarters, when global growth should pick up.

François Dupuis
Vice-President and Chief Economist

Mathieu D'Anjou, CFA
Senior Economist

Contents

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

Note to readers: The letters **k**, **M** and **B** are used in texts and tables to refer to thousands, millions and billions respectively.

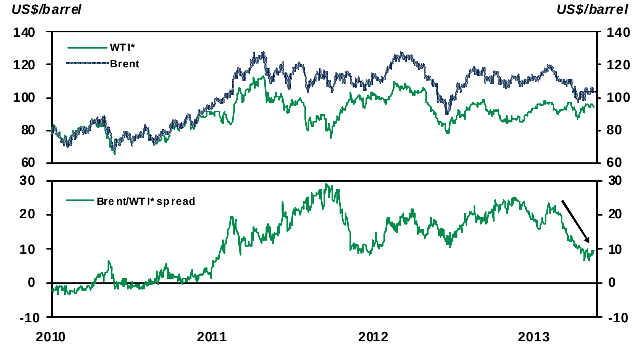
ENERGY

A revolution that will affect all aspects of the oil industry

OIL

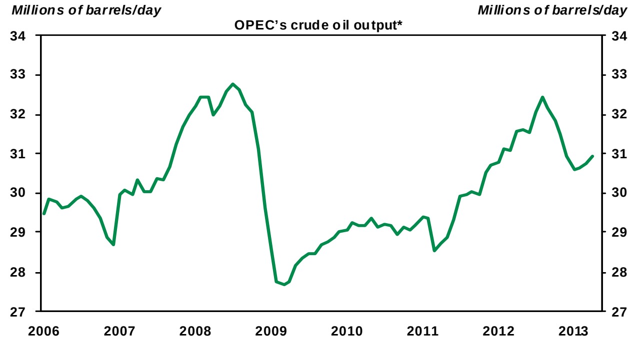
- Energy prices have fared better than other commodity prices over the last few months. After falling to around US$87 per barrel in mid-April, WTI (West Texas Intermediate) oil prices have recently climbed back to around US$95 per barrel, nearly $5 more than at the start of 2013. The situation is different for Brent oil prices, which have dropped around US$15 per barrel since the beginning of February and are now down by around US$5 per barrel from where they were at the start of the year. The contrasting movement by oil prices, which has taken the Brent-WTI spread to a more than two-year low (graph 3), is primarily caused by the substantial investments made to facilitate North American oil transport, especially by using railways. This reduces the discount on WTI oil.
- The global oil market's current situation justifies the recent retreat by Brent prices. Short-term outlooks from the International Energy Agency (IEA) have hardly changed over the last few months, continuing to point to soft global demand, especially in Europe, where the 2013 consumption of petroleum products will be at its lowest since the 1980s. Conversely, oil production and refining capacities are showing robust growth, keeping oil inventories high. After plummeting in late 2012, production by the Organization of the Petroleum Exporting Countries (OPEC) has edged up in the last few months (graph 4).
- Longer-term outlooks also seem less and less favourable to a surge of crude prices (graph 5). In its new medium-term scenario, the IEA is no longer hesitant to speak of a North American oil production revolution which will have a major impact on all aspects of the global oil industry. The IEA now predicts that North American oil production will grow by a massive 3.9 million barrels per day by 2018, more than Canada's total output in 2012. This will slash net oil imports by the United States and OPEC will have to turn to emerging nations, which will be responsible for most of the world's growing demand for oil.

Graph 3 – The gap between Brent and WTI* crude has narrowed substantially



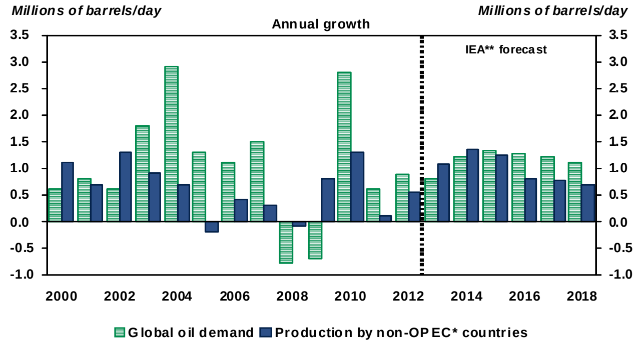
* West Texas Intermediate.
Sources: Datastream and Desjardins, Economic Studies

Graph 4 – OPEC's oil output has climbed somewhat



OPEC: Organization of the Petroleum Exporting Countries; * Excluding Indonesia but including Iraq.
Sources: Bloomberg and Desjardins, Economic Studies

Graph 5 – Non-OPEC* output will rise nearly as fast as global demand by 2018



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

GASOLINE

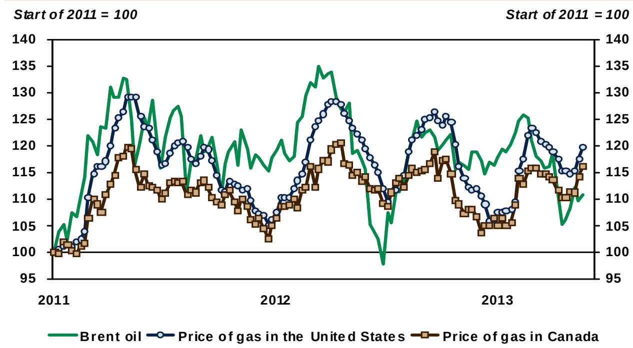
- The pullback by Brent prices, which remain the primary determinant for gasoline prices in North America, has continued to put downside pressure on fuel prices in recent months. The price of gasoline in the United States went from around US$3.80 per gallon at the end of February to US$3.52 per gallon at the end of April. Fuel prices have recovered somewhat in recent weeks, though, especially in Canada (graph 6), in tandem with the trend for oil prices and the many temporary closures of U.S. refineries. However, as the important summer season approaches, nothing points to a sharp increase of gasoline prices.

NATURAL GAS

- Natural gas prices have continued to climb over the last few months, reaching US$4.38 per MMBTU (Million British Thermal Unit), its highest point since July 2011, before returning to around US$4.15 (graph 7). Natural gas prices have risen more than 20% since the start of 2013, and are up around 60% from the same time last year. This is clearly the best performance among all of the resources that we regularly track. A very cold winter's end, which inflated demand for natural gas and brought North American inventories to more normal levels (graph 8), contributed greatly to the recent upswing by natural gas prices. However, inventories could keep rising over the next few months, and the rise of natural gas prices could limit electricity producers' use of this energy source. Watch to see if climbing prices prompt natural gas producers to intensify their prospecting efforts.

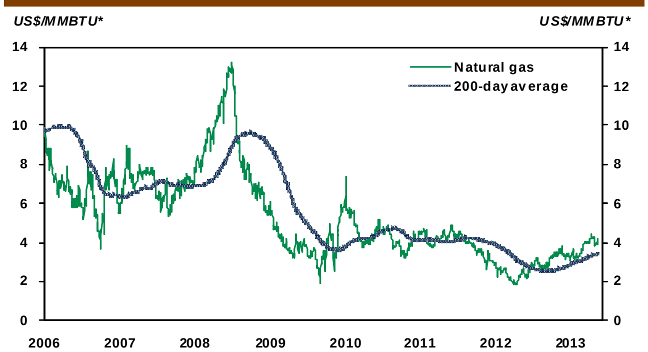
Forecasts: The recent rise by oil prices seems fragile, as everything suggests that growth by crude production will remain higher than growth by demand. We predict that WTI prices will soon fall back to around US$90 per barrel, which could bring gasoline prices down somewhat this summer. A more lasting rise by oil prices should start this fall, when the global economic outlooks could improve. However, due to the U.S. energy revolution, the risk of another spectacular surge by crude prices in the short or medium term has decreased substantially. This phenomenon will also sharply limit the potential for additional gains by natural gas prices.

Graph 6 – After dipping in March and April, gas prices have risen recently



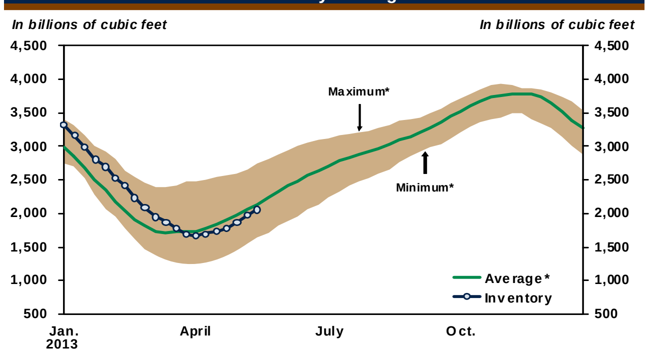
Sources: Datastream, Natural Resources Canada and Desjardins, Economic Studies

Graph 7 – Natural gas prices have continued to rise



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

Graph 8 – U.S. natural gas inventories are close to the average for recent years again



* Of the five previous years.
Sources: Energy Information Administration and Desjardins, Economic Studies

BASE METALS

Patience is in order

Persisting concerns about emerging nations, the strength of the U.S. dollar and the widespread pullback by commodity prices in mid-April all continued to exert downside pressure on industrial metal prices. The LME (London Metal Exchange) index of base metal prices has recently dropped to around 3,100, close to the cyclical troughs observed in the last few years (graph 9). China's situation remains decisive for industrial metal prices. The latest news from this country has not been encouraging, with metal imports down substantially from last year and the first quarter's economic growth, as well as the most recent data on industrial output, coming in below expectations. Recent developments have been more positive in the United States, though, where the important housing and automotive sectors have clearly improved over the last few months.

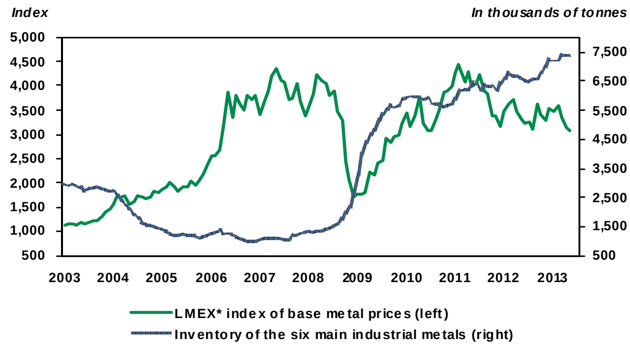
ALUMINUM

- Aluminum prices continued to retreat in recent weeks, even falling to US$1,774 a tonne in early May, their lowest level since October 2009. They have since climbed back to around US$1,800 a tonne (graph 10), but they are still down around 10% since the start of the year. As demand for aluminum continues to grow around 5% each year, these soft prices can largely be attributed to increased production of this metal, especially in China, where aluminum output increased nearly 13% in the first quarter of 2013.

COPPER

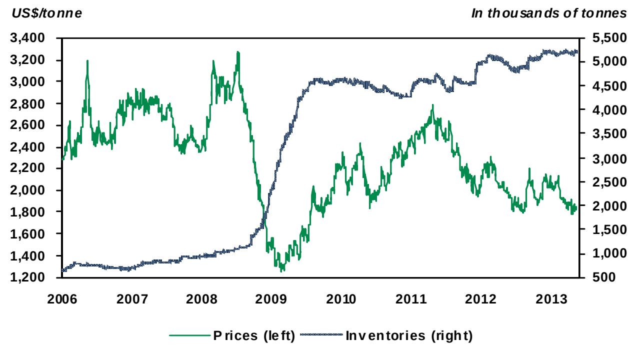
- Copper was hard hit by the U.S. dollar's rise and negative investor sentiment toward commodities. Copper prices fell to US$6,762 a tonne in early May before climbing near US$7,300 a tonne (graph 11) following an accident that halted production at a major Indonesian copper mine. The spectacular surge by copper stocks inventoried by the LME, which is partially due to the 35% drop in Chinese copper imports in the first four months of 2013 from the same time last year, should continue to weigh prices for this metal down.

Graph 9 – Base metal prices have pulled back as inventories continue to rise



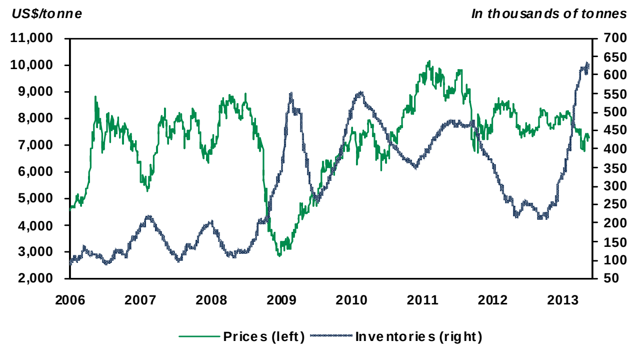
* London Metal Exchange Index.
Sources: Datastream, International Monetary Fund and Desjardins, Economic Studies

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

- Following the overall trend, nickel prices pulled back over the last few weeks, dropping to around US$15,000 a tonne. The weakness is no surprise, as inventories of this metal have jumped nearly 30% since the start of 2013, reaching a historic peak (graph 12). The latest indicators are not very encouraging, as nickel demand seems to be growing a bit slower than hoped and production of this metal will once again rise sharply in 2013.

ZINC

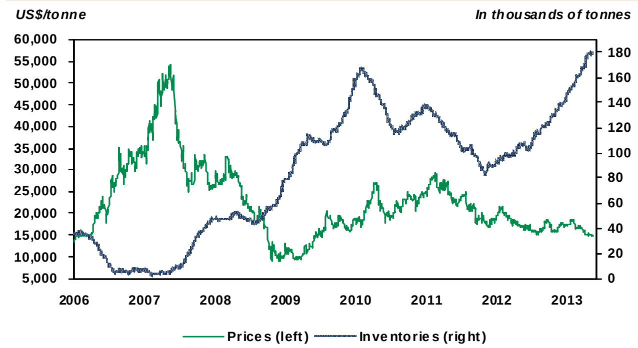
- Zinc prices have also gone down recently, hitting around US$1,820 a tonne (graph 13), a drop of just over 10% from the end of 2012. The pullback occurred despite further declines in zinc inventories, which still remain very high. After global production and consumption of zinc fell in 2012, the reverse should occur this year, as supply is rebounding, particularly in China, and demand is recovering in the United States and elsewhere. Nevertheless, the global zinc market should remain in surplus for several more quarters.

STEEL

- The global steel market remains depressed, and the LME steel price recently fell close to US$100 a tonne before returning to around US$150 a tonne. Despite the slight bounce back, prices are down nearly 40% from where they were in early 2013, and are over 60% lower than a year ago (graph 14). The drops by iron prices and other indicators for steel prices have been less dramatic, but prices for the industry as a whole are down. As inventories are high and China continues to increase its steel output capacity, only substantial growth by demand from emerging nations could rebalance the global steel market. However, recent news has not been very encouraging on that front, which signals future difficulties for steel producers.

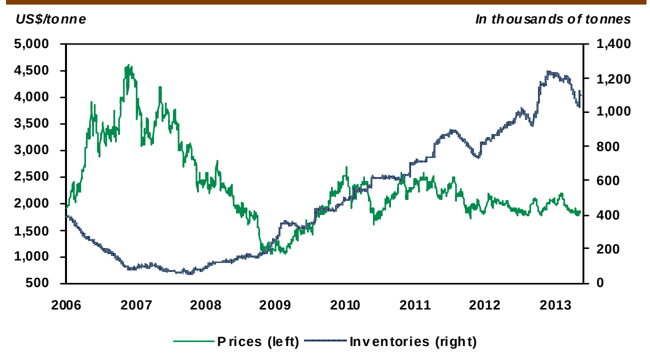
Forecasts: The outlook for base metal prices has not changed. The current difficulties may persist for several more months, as the soft global economy will continue to harm this sector. An improvement to the economic outlook, however, should give base metal prices a bit of a boost in the second half of the year.

Graph 12 – Nickel prices and inventories



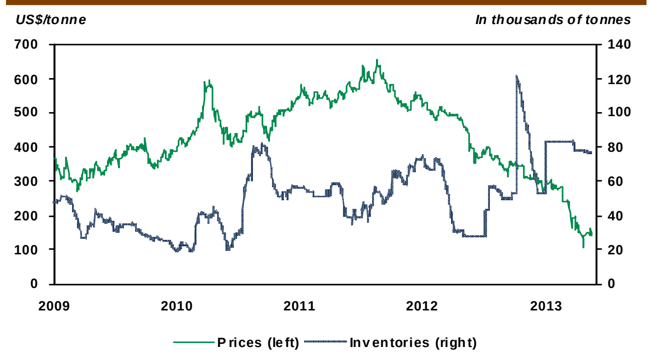
Sources: Datastream and Desjardins, Economic Studies

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

Sharp correction

Despite low interest rates and more than abundant liquidity in financial markets, gold and silver prices have dropped spectacularly over the last few weeks, as investors seem to have turned their backs on these metals.

GOLD AND SILVER

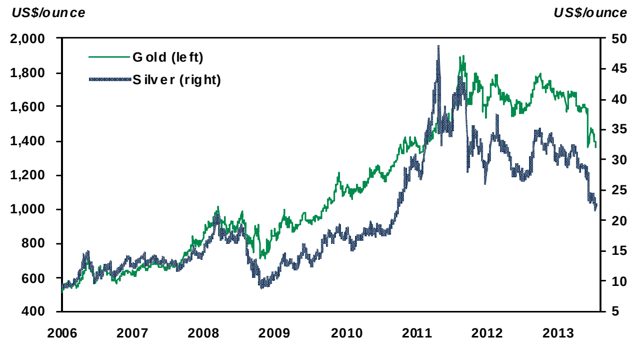
- Our fear that investors would turn their backs on gold was confirmed in mid-April, when gold prices dropped by more than US$200 per ounce in just two sessions, falling to their lowest level since the start of 2011. After a short-lived rebound of around US$100 per ounce, the price of the yellow metal dropped back under US$1,400 per ounce (graph 15). This tumble is especially striking because it came just a few days after the Bank of Japan announced its intention to inject massive amounts of liquidity into the financial markets. Investors reacted by rushing to the U.S. dollar while liquidating their gold positions, among other things (graph 16). However, lower investor interest should be partially offset by an increase in gold demand from consumers in emerging nations, especially India, where demand jumped 27% in the first quarter of 2013. Silver prices also corrected sharply, and are now off 25% from the start of 2013 and more than 50% from their peak in spring 2011.

PLATINUM AND PALLADIUM

- As their price depends less on investor sentiment and more on changes to real supply and demand, platinum and palladium prices have done better recently. All the same, platinum prices dropped to around US$1,450 per ounce in the wake of the correction by gold prices (graph 17). Worries about the depletion of Russian inventories are helping palladium prices, which have advanced 5% since the beginning of the year. The tense situation in South African mines is also a major support for prices for the two metals.

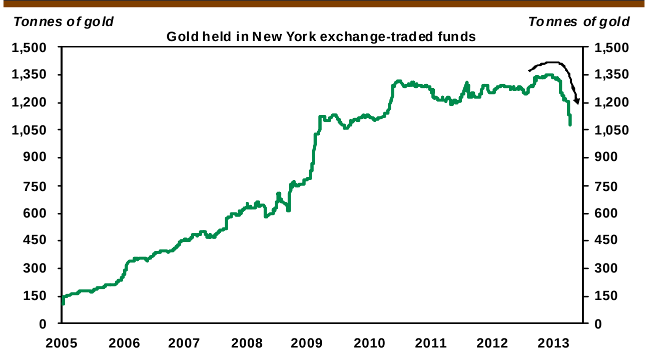
Forecasts: We can now confirm that gold's long uptrend is over, as gold prices are oscillating about 30% below their summer 2011 peak. Future price movements are hard to predict, but demand from emerging nations and ongoing very low interest rates could help gold prices end the year slightly above current levels.

Graph 15 – Gold and silver prices



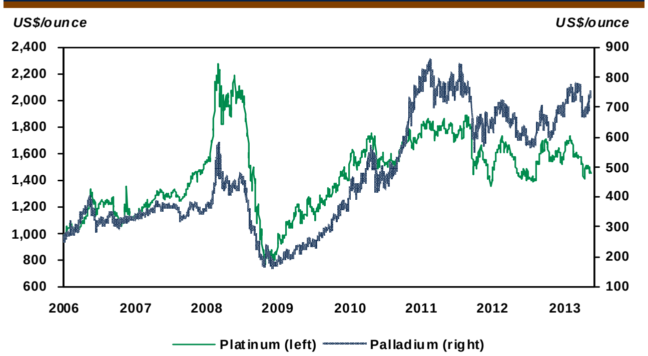
Sources: Datastream and Desjardins, Economic Studies

Graph 16 – Investor demand for gold is dropping sharply



Sources: Exchange Traded Gold and Desjardins, Economic Studies

Graph 17 – Platinum and palladium prices



Sources: Datastream and Desjardins, Economic Studies

OTHER COMMODITIES

Corn prices seem vulnerable

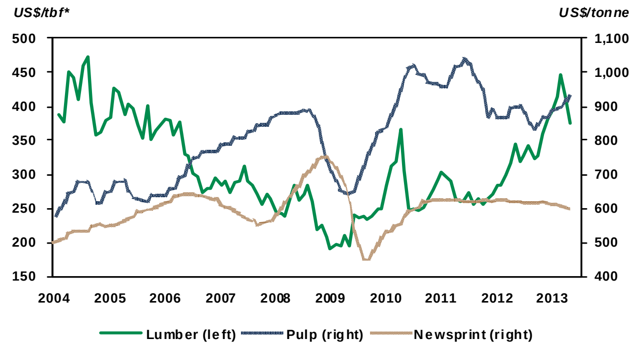
FOREST PRODUCTS

- After a spectacular surge in 2012 and early 2013, lumber prices have corrected somewhat. The benchmark price for U.S. lumber, which had reached US$451 per thousand board-feet (mbf) in mid-April, its highest point in over eight years, has recently fallen back to around US$360/mbf (graph 18). **This fairly unsurprising moderation by lumber prices can be attributed to signs that high prices have triggered a reaction from lumber producers, as well as the realization that, despite some recovery, U.S. residential construction will remain relatively weak this year.** Pulp price has risen and paper price has been stable in recent months.

AGRICULTURAL COMMODITIES

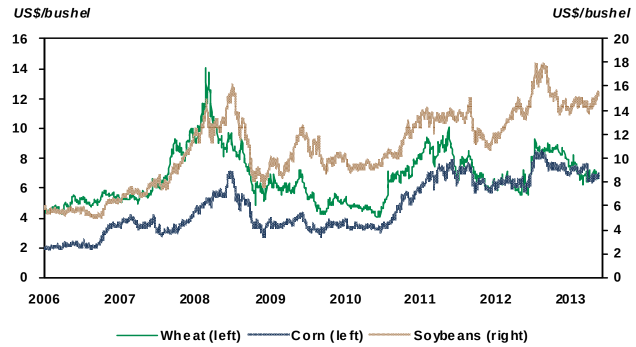
- The divergent movements by cereal prices have persisted in recent months (graph 19). After falling at the start of the year, wheat prices ticked down to around US$6.60 per bushel. The rebound by corn prices at the beginning of the year has been wiped out in recent months, although soybean prices continue to rise, posting a 10% gain since early 2013.
- These movements are fairly accurate reflections of the latest news about cereal supply and demand. After a 2012-2013 season that was marked by numerous droughts, global wheat and corn harvests should jump this year (graph 20), reaching new peaks and leading to increased inventories of these two cereals. **As more and more voices call for a review of U.S. policy on ethanol, whose future appears increasingly uncertain given the North American energy revolution, in which natural gas could become a more competitive alternative fuel, the confirmation of a record harvest could lead to a substantial correction in corn prices.** The 2013-2014 soybean harvest is also looking quite good, but strong demand for this cereal, especially from China, continues to justify high prices. For livestock, the reduction of cattle herd sizes in recent years and increased cereal costs could maintain upside pressure on prices.

Graph 18 – Forest product prices



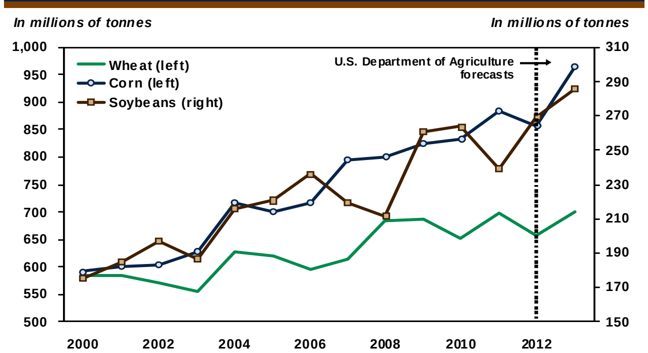
* Thousands of board-feet.
Sources: Datastream and Desjardins, Economic Studies

Graph 19 – Cereal prices



Sources: Datastream and Desjardins, Economic Studies

Graph 20 – Global cereal harvests should jump to a record level in 2013



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

Table 1
Commodities

	Spot price	Percentage return since				Last 52 weeks		
	May 27	1 month	3 months	6 months	1 year	High	Average	Low
Index								
Reuter-CRB[1] (CCI[2])	530.0	-0.9	-3.6	-7.6	2.3	598.1	555.0	503.8
Reuters/Jefferies CRB[1]	284.9	-0.2	-2.7	-4.3	1.0	320.9	295.0	267.2
Dow Jones AIG[3]	132.0	0.0	-3.4	-8.4	-0.5	152.0	139.4	126.8
Bank of Canada	649.7	1.2	1.7	5.9	2.8	673.3	631.6	567.7
Energy								
Brent oil (US$/barrel)	102.0	-0.6	-9.7	-8.4	-5.7	119.2	108.5	90.1
WTI[4] oil (US$/barrel)	93.8	1.3	1.1	8.1	3.5	98.9	91.0	77.7
Gasoline (US$/gallon)	3.67	3.9	-2.9	6.9	-1.1	3.88	3.57	3.25
Natural gas (US$/MMBTU[5])	4.15	-0.2	18.9	10.1	62.1	4.38	3.31	2.17
Base metals								
LMEX[6]	3,119	1.3	-8.6	-7.5	-5.5	3,614	3,325	2,977
Aluminium (US$/tonne)	1,806	-2.1	-8.6	-9.7	-8.6	2,200	1,948	1,774
Copper (US$/tonne)	7,270	3.9	-7.3	-6.7	-5.2	8,363	7,714	6,762
Nickel (US$/tonne)	14,736	-2.6	-11.6	-12.8	-13.2	18,673	16,601	14,609
Zinc (US$/tonne)	1,822	-2.2	-12.1	-7.6	-4.3	2,185	1,928	1,758
Steel (US$/tonne)	147.5	3.1	-44.2	-51.7	-62.0	410.0	298.1	108.0
Precious metals								
Gold (US$/ounce)	1,394	-5.7	-13.0	-20.2	-11.0	1,792	1,628	1,359
Silver (US$/ounce)	22.4	-6.8	-23.0	-34.3	-20.8	35.0	29.5	21.7
Platinum (US$/ounce)	1,455	-1.9	-9.6	-10.1	2.2	1,736	1,548	1,390
Palladium (US$/ounce)	729.0	7.0	-1.6	8.8	23.6	774.0	668.3	565.0
Other commodities								
Lumber (US$/tbf[7])	361.0	-12.8	-13.0	1.7	4.9	451.0	366.6	316.0
Pulp (US$/tonne)	929.1	1.1	3.9	7.3	3.2	929.1	879.9	832.0
Newsprint (US$/tonne)	600.0	-0.5	-2.4	-3.3	-3.4	621.1	616.2	600.0
Wheat (US$/bushel)	6.63	-2.2	-0.5	-22.7	3.1	9.29	7.64	5.49
Corn (US$/bushel)	6.89	6.4	-3.4	-9.5	14.1	8.49	7.24	5.80
Soybean (US$/bushel)	15.11	3.7	3.5	5.2	10.3	17.90	15.11	13.32

[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$/barrel)	95	94	Target: 93 (range: 85 to 100)	Target: 100 (range: 90 to 110)
Natural gas Henry Hub (US$/MMBTU**)	3.99	2.76	Target: 3.80 (range: 3.40 to 4.20)	Target: 4.00 (range: 3.25 to 4.75)
Gold (US$/ounce)	1,572	1,669	Target: 1,475 (range: 1,400 to 1,550)	Target: 1,350 (range: 1,100 to 1,600)
LMEX*** index—base metals	3,927	3,416	Target: 3,350 (range: 3,000 to 3,650)	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