Commodity Trends

Desjardins Economic Studies
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In tandem with international events

The main commodity price indexes are currently close to where they were when Commodity Trends was last published, at the end of July. However, this does not mean that the last two months have been calm.

Rising tensions in the Middle East caused oil prices to jump at the end of August, when a U.S. strike on Syria seemed imminent. The conflict was avoided, however, and oil prices quickly trended down. In mid-September, the Federal Reserve's decision not to slow the pace of the third quantitative easing program (QE3) boosted resource prices, but this good news was rapidly eclipsed by the political impasse in Washington, leading to a shutdown of the U.S. government at the start of October.

Besides these events, it is mainly the situation in emerging nations that could have a lasting effect on commodity prices. On a positive note, several Chinese economic statistics have improved recently (graph 1). The marked downturn (graph 2) by several emerging currencies could, however, have negative impacts on demand for base products. We will have to keep a close eye on how the situation unfolds in these countries.

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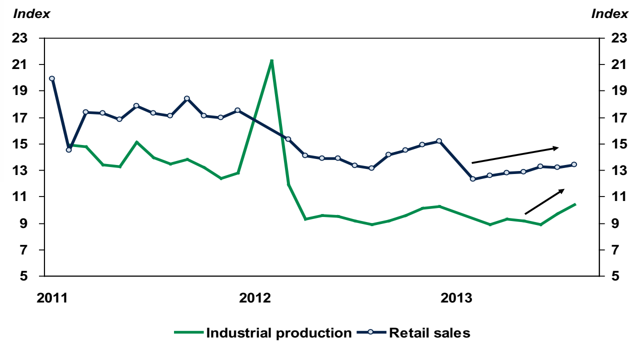
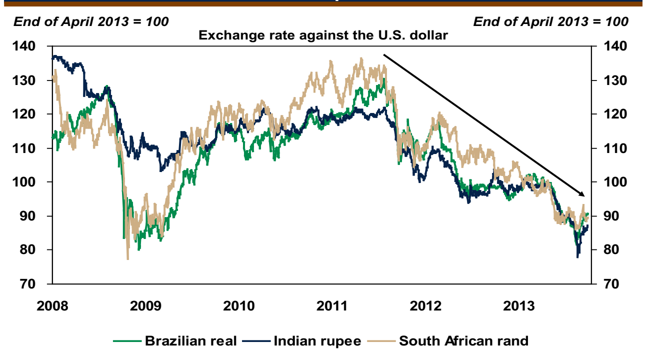
Graph 1 – Some signs of improvement in China



Sources: National Bureau of Statistics of China and Desjardins, Economic Studies

Graph 2 – Numerous emerging currencies have plunged in recent quarters



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.

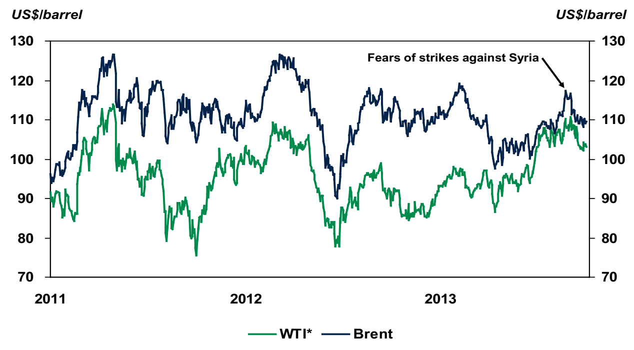
ENERGY

Tensions have eased

OIL

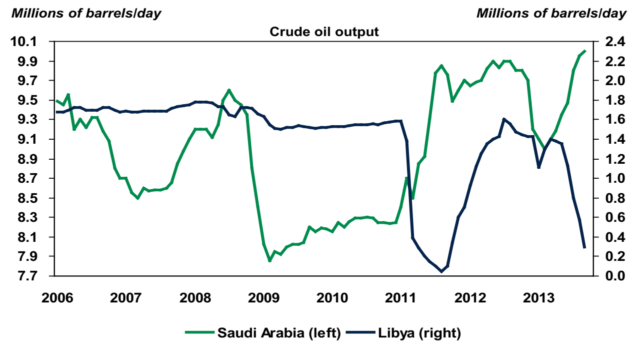
- Oil prices continued to trend up through August. With investors focused on fears that the supply from Africa and the Middle East would be cut off, Brent prices ended up rising the most, in contrast with what had happened in previous months. Brent prices went above US$117 per barrel on August 29 for the first time since February (graph 3).
- Brent hit its recent peak when a military strike against Syria seemed unavoidable. Syria is not a major oil producer, but its close ties to Iran raised fears of a flare-up in the Middle East. The possible closure of the Strait of Hormuz, vital to the world's crude oil supply, therefore became a serious risk again. Although Syria attracted all of the attention, the deteriorating situation in Libya (graph 4), where political conflict and strikes have reduced production by around one million barrels per day (mbd), also helped to push Brent prices up. Some difficulties in Iraqi and Nigerian production magnified these concerns.
- Fears about production have waned substantially over the last few weeks, however. Although not everything has been resolved, diplomatic efforts between Russia and the United States have helped avoid strikes against Syria. Some signs of tension easing between the United States and Iran have even appeared recently. Lastly, fruitful negotiations should lead to increased production in Libya. All this, combined with the worries about the U.S. government shutdown, caused oil prices to drop by around 10 dollars per barrel.
- Beyond the concerns about instability in some areas of the world, outlooks remain favourable for global oil production. Saudi Arabia once again showed its determination to avoid a tighter global crude supply by increasing its production to a 32-year peak. More fundamentally, North American oil production continues to surge, which is giving the global oil market a substantial amount of leeway. The latest forecasts from the International Energy Agency therefore predict a 1.6 mbd production increase by non OPEC nations in 2014, which is more than enough to meet the expected 1.1 mbd growth by global demand (graph 5). In the medium and long terms, growing interest in shale oil from several nations and a possible liberalization of Mexico's oil industry are also encouraging.

Graph 3 – Price of oil



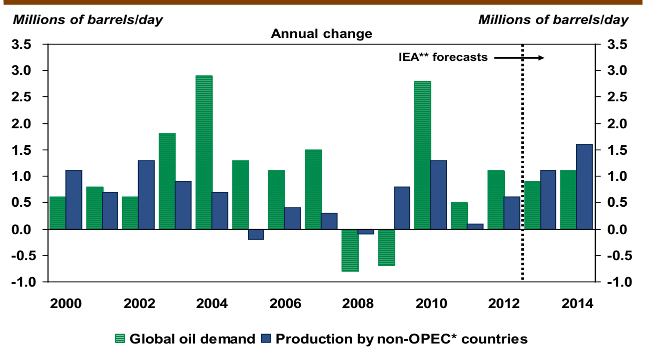
* West Texas Intermediate.
Sources: Datastream and Desjardins, Economic Studies

Graph 4 – Libya's oil output has tumbled, but this was offset by higher output from Saudi Arabia



Sources: Datastream and Desjardins, Economic Studies

Graph 5 – Non-OPEC* output should rise much faster than global oil demand in 2014



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

- With regard to demand for oil, improving economic statistics for advanced nations point to some acceleration next year. However, the plunge of several emerging currencies is a serious risk, as crude prices in local currencies are reaching levels that could limit demand growth (graph 6). In several of these countries, fuel prices are subsidized, which reduces their direct impact on consumers, although the subsidies could quickly become prohibitively expensive for governments. In fact, Malaysian and Indian governments have raised regulated fuel prices substantially over the last few months.

GASOLINE

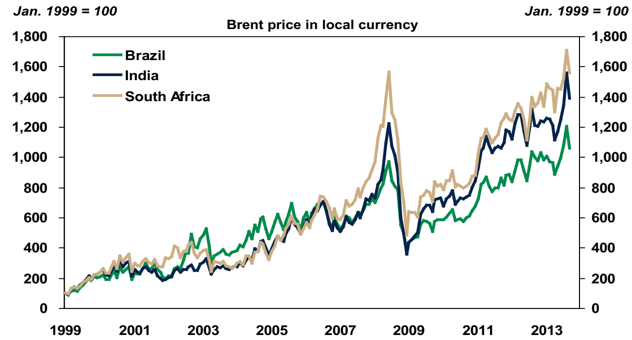
- After flirting with US$3.70 per gallon in late July, regular gas prices in the United States moved downwards, despite soaring crude prices in August, recently falling to around US$3.40 per gallon (graph 7). This reflects lower refinery margins, as the driving season wound down and petroleum product inventories are high. We also wonder whether fairly low gas prices reflect the fact that more and more refineries have access to oil that is sold at a discount against Brent oil. Gas prices were more volatile in Canada, but a downtrend also appeared over the last few weeks.

NATURAL GAS

- Natural gas prices edged up in early September before dropping back to around US$3.60 per MMBTU (Million British Thermal Units). This year, a sharp drop in demand from electricity producers was noted (graph 8), the result of a fairly cool summer and coal's increased popularity compared with last year, when gas prices had dropped to very appealing levels. New U.S. rules on greenhouse gas emissions for new power plants, however, suggest that gas will occupy a growing place in electricity production in the years to come, as these standards seem practically unattainable for coal-based power plants. Watch for the publication of new standards for existing power plants in June 2014, which could potentially impact demand for gas in more quickly.

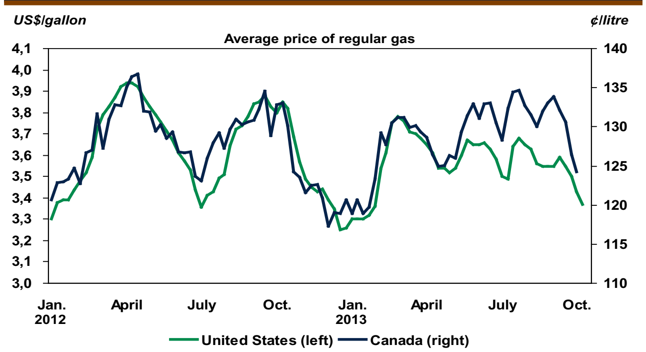
Forecasts: Recent months have shown that geopolitical tensions could still temporarily inflate oil prices. However, the U.S. energy revolution has given the global oil market greater flexibility, and despite higher demand next year, the average price for WTI oil should be slightly below US$100 per barrel. North American natural gas prices should continue to oscillate around US$4 for several quarters.

Graph 6 – Oil is currently very pricey for many emerging nations



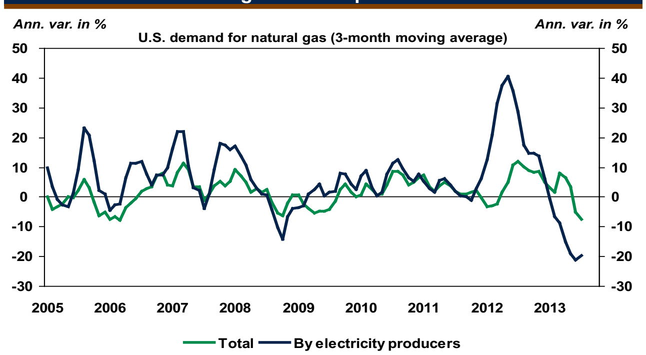
Sources: Datastream and Desjardins, Economic Studies

Graph 7 – Gas prices have come down in the last few weeks



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

Graph 8 – Unlike last summer, power plants sharply decreased their natural gas consumption this summer



Sources: Energy Information Administration and Desjardins, Economic Studies

BASE METALS

Prices could continue to climb gradually

After falling slightly below the 3,000 mark at the end of July, the London Metal Exchange (LME) index of base metal prices rose about 5%, nearing 3,120 (graph 9). The price increase was fairly widespread, since it primarily reflects encouraging signs from China's economy. Annual growth by Chinese industrial output recently rose back up over 10%, and rising purchasing manager indexes in the manufacturing sector bode well for the quarters to come. More robust Chinese metal imports and accelerating electricity production are also positive signals for metal demand. Despite these recent increases, base metal prices remain relatively soft, as fears still linger over outlooks for emerging economies, including China, and new political crisis have arisen in the United States and Europe.

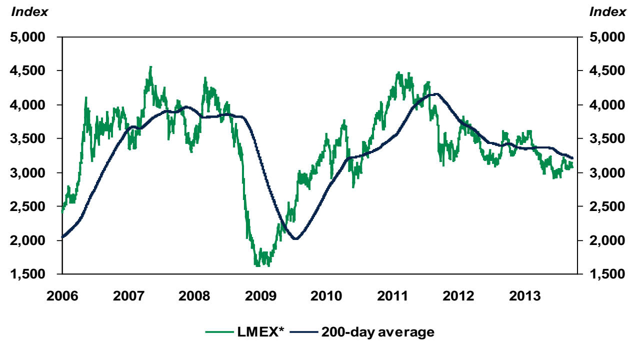
ALUMINUM

- Aluminum prices have ticked up in recent months, returning to around US$1,800 per tonne. Prices for this metal remain weak, however, and are down more than 10% since the start of 2013, and nearly 15% from this time last year. As everything suggests an ongoing surplus in the global market, the matter of the enormous aluminum inventories (graph 10) is getting a lot of attention. With the U.S. government continuing to investigate whether financial giants are manipulating the inventories at the consumer's expense, the LME is planning to introduce new rules to penalize warehouses with overly long delivery times. The possibility that inventory that had been previously set aside for financial reasons could return to the market should help to keep aluminum prices down.

COPPER

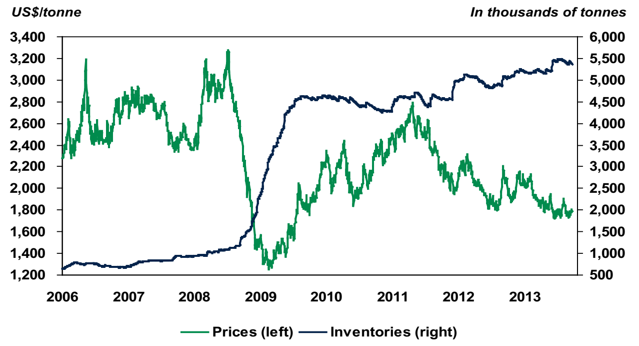
- Copper prices have risen just over 5% since the end of July, returning to around US$7,200 per tonne (graph 11). One piece of good news for copper is that after jumping in the first half of 2013, copper inventories surveyed by the LME have fallen 20% over the last few months. This drop seems directly linked to the strong comeback by Chinese copper imports, whose annual change has been back in positive territory since June. The weak U.S. dollar is also supporting copper prices. However, positive developments in copper production, in Chile as well as other places, are limiting this metal's appreciation potential. The International Copper Study Group predicts that, after three years of stagnation, copper mining will grow 6.5% in 2013 and 4.5% in 2014, and global production of refined copper will grow more quickly than demand.

Graph 9 – Industrial metal prices have edged up



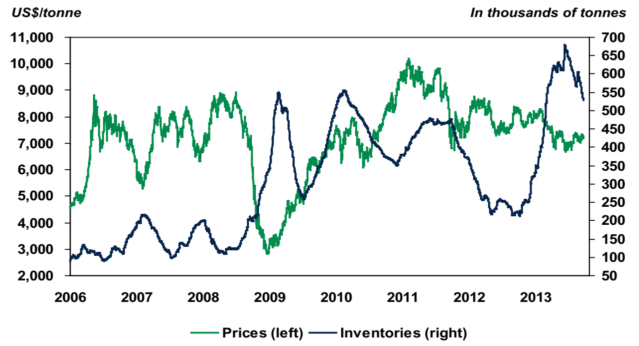
* London Metal Exchange index of base metal prices.
Sources: Energy Information Administration and Desjardins, Economic Studies

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

- After rebounding in early August, nickel prices rapidly dropped back below US$14,000 per tonne. They are down 18% since the start of 2013 and nearly 25% from the same time last year. Despite fairly strong Chinese demand, nickel inventories recorded by the LME have again grown more than 10% since the end of July (graph 12). Nothing suggests that this trend is coming to an end, as global nickel production should once again outstrip demand substantially next year. As many nickel producers are losing money at the current price, cuts to output should be used to rebalance the nickel market. For now, however, announcements to this effect are few and far between.

ZINC

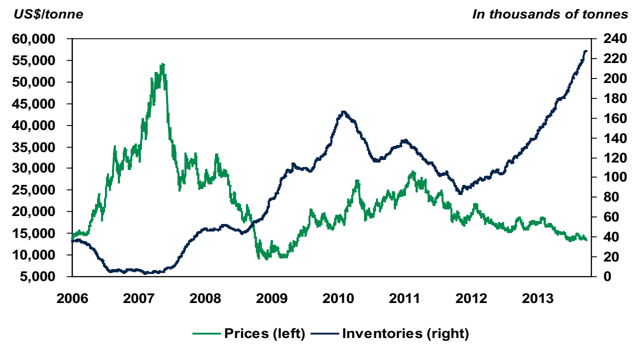
- After jumping to nearly US$2,000 per tonne in mid-August, zinc prices have moderated. They are currently oscillating around US$1,840 per tonne, which still represents gains of 2% since the end of July (graph 13). Zinc stocks, which have fallen since mid-July, recently rebounded. The combination of strong Chinese demand growth and gradual depletion of major zinc mines leaves room to hope that zinc prices will go up in the medium term.

STEEL

- Signs of economic acceleration in China also benefited iron and steel. Strong Chinese demand prompted a substantial rebound in iron prices this summer and the price of steel recorded by the LME has more than doubled since mid-July, climbing above US$200 per pound (graph 14). The uptrend can also be observed on the North American market, as major steel producers have announced prices increases. Despite this recent rebound, steel prices remain low due to ongoing and substantial excess production capacity.

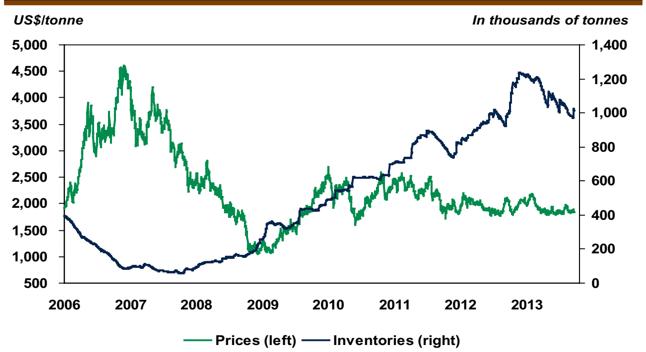
Forecasts: The acceleration forecast for the world economy next year, as global real GDP growth should go from 2.8% in 2013 to 3.7% in 2014, should be good for industrial metal demand and prices. All the same, do not expect prices to close in on their previous peaks, as high inventories and substantial surplus capacity suggest that the additional demand can be met without creating fears of a shortage.

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

Sources: Datastream and Desjardins, Economic Studies

PRECIOUS METALS

Another strike against gold

Surging investor concern and the Fed's decision to continue its quantitative measures pushed gold prices up temporarily in recent months. However, these gains were not lasting, and gold prices remain soft, even though the situation should be in their favour.

GOLD AND SILVER

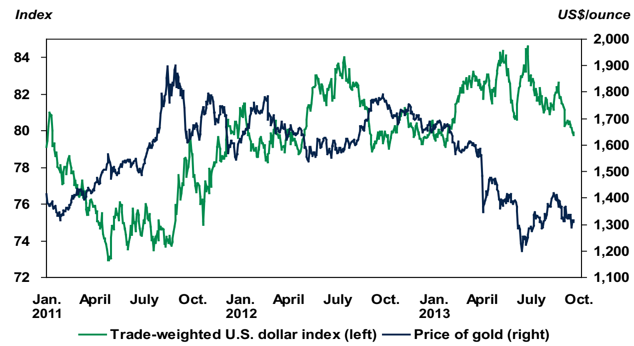
- Gold prices jumped several times in recent months, as its safe-haven status attracted some investors who were worried about conflict with Syria and a political impasse in the United States. The Federal Reserve's decision not to reduce its securities purchases also caused gold to jump nearly US$100 per ounce. These gains were short-lived, however, and despite the weak U.S. dollar, gold dropped back to around US$1,300 per ounce (graph 15). Note that financial demand for gold remains low, and that India's government has instituted new measures to limit gold imports. Silver prices are still weak as well, moving in tandem with gold prices (graph 16).

PLATINUM AND PALLADIUM

- Platinum and palladium prices have shown no clear trend in recent months, remaining close to where they were at the end of July (graph 17). Unlike gold and silver prices, platinum and palladium prices depend heavily on industrial demand, especially from the auto sector. Outlooks remain positive on that end and, combined with ongoing problems in South African mines, suggest that prices for the two metals could go up in the coming quarters.

Forecasts: The fact that gold prices have not risen further despite surging political and economic risks and a very low U.S. dollar seems to confirm that the yellow metal's heyday is behind us. All the same, gold prices could jump in the short term, if investors truly begin to fear a default by the U.S. government. Longer-term outlooks do not seem positive, however, as financial demand for gold will remain low and could even drop next year, as the Federal Reserve should gradually reduce its market interventions. Substantial production costs for gold mines and demand from emerging nations will limit gold's depreciation, however. After reaching an average of US$1,430 per ounce this year, gold prices should stand at US$1,350 per ounce in 2014.

Graph 15 – The last time the greenback was this low, gold was over US$1,650/ounce

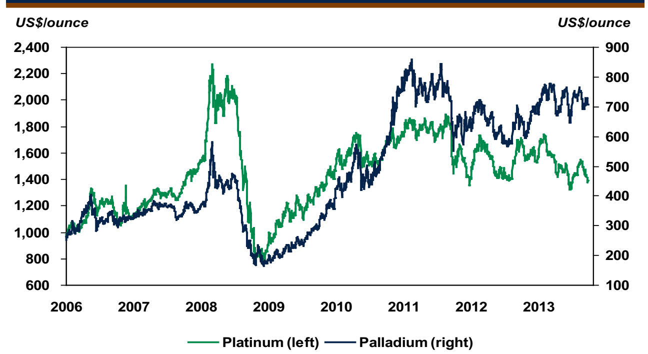


Sources: Bloomberg and Desjardins, Economic Studies

Graph 16 – Gold and silver prices

Sources: Datastream and Desjardins, Economic Studies

Graph 17 – Platinum and palladium prices



Sources: Datastream and Desjardins, Economic Studies

OTHER COMMODITIES

A complete turnaround for corn

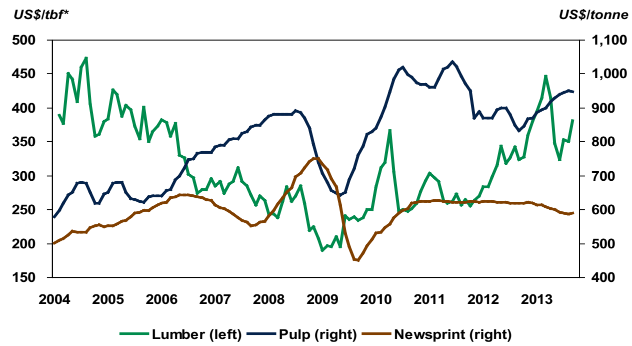
FOREST PRODUCTS

- As we anticipated, lumber prices started to trend back up in recent months, going from around US$325 per thousand board-feet (mbf) in early July to over US$380/mbf recently (graph 18). An important question for lumber is what effect rising mortgage rates will have on the U.S. real estate recovery. Until now, some real estate statistics have held strong, but others, including housing starts, seem to be flagging. The Federal Reserve's recent decision confirms that monetary authorities will do all they can to avoid harmful tightening of financial conditions, however. **Lumber prices should not go much higher until worries about the U.S. economy have waned.** Pulp and newsprint prices have been very stable in recent months.

AGRICULTURAL COMMODITIES

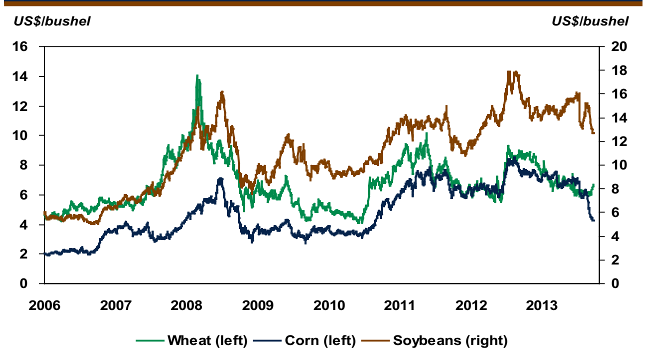
- The sharp rebound of global harvests continues to weigh down cereal prices (graph 19). After falling in the first half of the year, wheat prices have generally moved around US$6 per bushel since the month of July. A less favourable climate for harvests in Argentina allowed wheat prices to climb over US$6.50 per bushel recently, however, which is still 20% below where prices were at this time last year.
- After remaining relatively high for the first half of 2013, corn prices have literally collapsed since the end of June, going from US$7.00 per bushel to around US$4.20 per bushel. This harsh return to reality is not too surprising, as 2012's catastrophic harvest has given way to a record harvest that should lead to a 23.5% increase in global corn stocks and a 180% increase in U.S. inventories. Note that, in addition to stimulating production, last year's high corn prices also caused demand for U.S. corn to fall. The predictable crest of ethanol production may limit corn demand growth in the coming years.
- Favourable harvest weather is also weighing down soybean prices, despite relatively high demand for this cereal. Soybean prices have retreated nearly 20% since the end of June, returning to around US$12.50 per bushel. **Nothing points to a strong rebound of cereal prices, unless Mother Nature stirs the pot once more**.

Graph 18 – Forest product prices



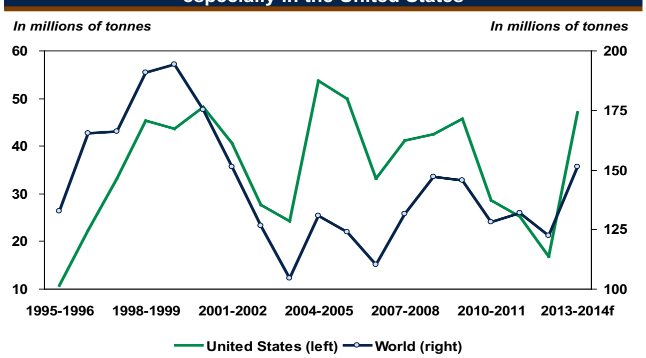
* Thousands of board feet.
Sources: Datastream and Desjardins, Economic Studies

Graph 19 – Cereal prices



Sources: Datastream and Desjardins, Economic Studies

Graph 20 – Corn stocks will bounce back sharply, especially in the United States



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

Table 1
Commodities

	Spot price	Percentage return since				Last 52 weeks		
	October 7	1 month	3 months	6 months	1 year	High	Average	Low
Index								
Reuter-CRB[1] (CCI[2])	521.5	-0.7	3.8	-4.2	-10.2	582.0	542.5	500.4
Reuters/Jefferies CRB[1]	287.3	-2.0	2.4	-0.3	-6.6	309.1	291.9	275.6
Dow Jones AIG[3]	128.1	-2.0	2.0	-4.5	-13.3	148.8	135.1	123.7
Bank of Canada	632.9	-5.5	-2.0	-5.3	-2.3	672.1	638.7	596.0
Energy								
Brent oil (US$/barrel)	109.6	-5.9	2.3	4.6	-1.8	119.2	109.1	97.6
WTI[4] oil (US$/barrel)	103.1	-6.8	-0.0	11.1	14.7	110.6	95.8	84.5
Gasoline (US$/gallon)	3.37	-5.2	-3.7	-7.6	-11.5	3.85	3.55	3.25
Natural gas (US$/MMBTU[5])	3.61	1.7	2.6	-9.3	10.7	4.38	3.62	3.08
Base metals								
LMEX[6]	3,120	0.9	6.4	-2.3	-12.6	3,614	3,252	2,911
Aluminium (US$/tonne)	1,808	1.7	4.9	-2.3	-13.3	2,150	1,900	1,721
Copper (US$/tonne)	7,217	1.2	6.4	-2.2	-13.0	8,295	7,500	6,638
Nickel (US$/tonne)	13,881	-0.2	4.9	-12.6	-23.9	18,662	15,713	13,232
Zinc (US$/tonne)	1,836	-1.0	1.5	-0.8	-10.1	2,185	1,916	1,784
Steel (US$/tonne)	210.0	35.5	52.2	7.3	-39.7	355.8	218.5	99.3
Precious metals								
Gold (US$/ounce)	1,324	-4.5	9.0	-15.4	-25.8	1,785	1,515	1,215
Silver (US$/ounce)	21.8	-5.6	12.7	-19.3	-37.5	34.9	26.6	18.6
Platinum (US$/ounce)	1,386	-7.5	4.4	-9.5	-19.0	1,736	1,531	1,317
Palladium (US$/ounce)	697.0	-0.3	4.2	-3.2	4.5	774.0	707.5	593.0
Other commodities								
Lumber (US$/tbf[7])	384.0	8.5	17.4	-14.9	20.4	451.0	372.9	316.0
Pulp (US$/tonne)	948.4	-0.1	0.9	5.4	14.0	949.7	906.6	832.1
Newsprint (US$/tonne)	590.0	0.2	-0.4	-2.8	-4.7	620.5	605.8	588.0
Wheat (US$/bushel)	6.65	7.8	12.0	-8.4	-21.4	8.84	7.04	5.87
Corn (US$/bushel)	4.19	-23.3	-37.5	-35.0	-43.8	7.69	6.73	4.19
Soybean (US$/bushel)	12.65	-15.5	-19.9	-8.4	-17.8	16.10	14.60	12.65

[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$/barrel)	95	94	Target: 98 (range: 95 to 101)	Target: 97 (range: 90 to 104)
Natural gas Henry Hub (US$/MMBTU**)	3.99	2.76	Target: 3.70 (range: 3.55 to 3.80)	Target: 4.00 (range: 3.25 to 4.75)
Gold (US$/ounce)	1,572	1,669	Target: 1,430 (range: 1,400 to 1,460)	Target: 1,350 (range: 1,100 to 1,600)
LMEX*** index—base metals	3,927	3,416	Target: 3,200 (range: 3,100 to 3,300)	Target: 3,600 (range: 3,200 to 4,000)

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