Commodity Trends

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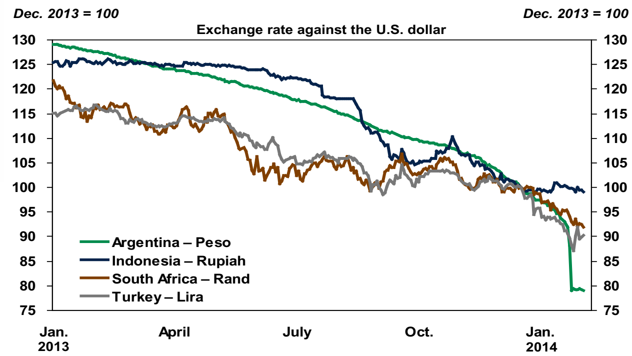
Emerging nations muddy the picture

After several tough years, optimism finally seemed to be coming back to the commodity markets at the dawn of 2014. The promising outlook for the global economy suggested that commodity demand would strengthen and prices would gradually rise.

Despite the Federal Reserve's decision to start tapering its bond purchases, prices for several commodities, particularly base metals, had started to climb in the final weeks of 2013. This breath of optimism quickly gave way to new concerns, though, as investors started to worry about the situation in a number of emerging nations. Initially, the fears primarily revolved around countries with serious political or financial problems (Turkey, Argentina, Ukraine), but signs of contagion have proliferated in recent weeks, prompting a fairly widespread drop in emerging nation currencies (graph 1).

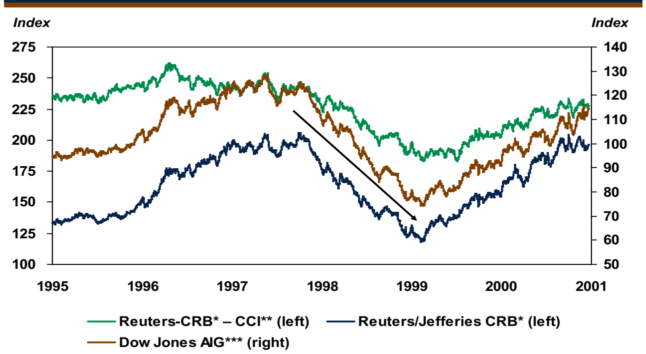
The possibility of a crisis in emerging economies is serious for commodities, as the crises in 1997 and 1998 had made some price indexes plunge about 40% (graph 2). However, it is too early to predict a crisis of that magnitude. In the short run, investors may remain edgy, which could hurt commodity prices. When the situation calms down, however, commodity prices should start to trend up due to the accelerating global economy.

Graph 1 – Renewed worries in some emerging nations



Sources: Datastream and Desjardins, Economic Studies

Graph 2 – Commodity prices plunged during the Asian crisis at the end of the 1990s



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

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

514-281-2336 *or* 1 866 866-7000, ext. 2336
E-mail: desjardins.economics@desjardins.com

Mathieu D'Anjou
Senior Economist

Jimmy Jean
Senior Economist

Hendrix Vachon
Senior Economist

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

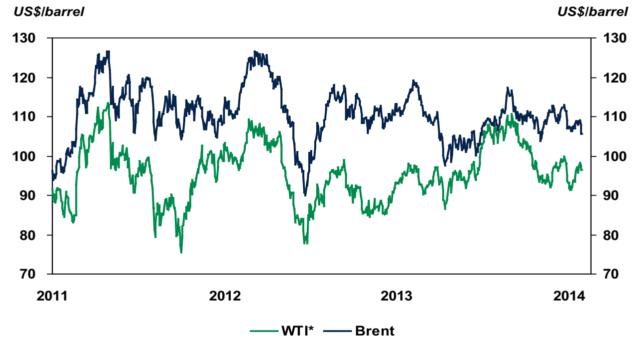
ENERGY

Demand firms up

OIL

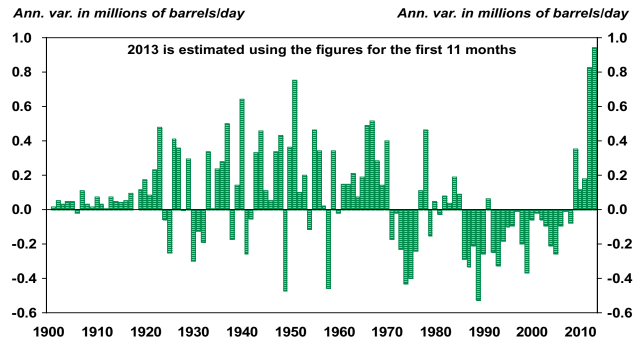
- WTI (West Texas Intermediate) oil prices have been casting about with no clear trend in recent months, hovering slightly below US$100 a barrel since mid-October (graph 3). Brent prices, for their part, have oscillated around US$110 a barrel, with the spread between the two types of oil fluctuating between US$10 and US$15 a barrel.
- In terms of supply, 2014's biggest trend will be the spectacular surge in North America's unconventional production. The latest figures indicate that U.S. crude output rose by nearly one million barrels a day in 2013, beating the record set the previous year (graph 4). Everything suggests that this year will post a similar increase, pointing to further substantial drops in North American oil imports. Moreover, there is increasing talk of the likelihood that the United States will start exporting crude oil again. Elsewhere in the world, also keep an eye on how the Iran situation is evolving. The interim agreement to reduce the sanctions on Iran in exchange for shutting down portions of its nuclear program was a promising development in the second half of 2013, and Iran's exports are already on the rise. A full agreement to lift the sanctions could put substantial downside pressure on crude prices. However, it will be hard to reach such an agreement and a surge in Middle East tensions remains an upside risk for oil prices.
- If the oil supply remains abundant in 2014, accelerating global demand should help keep prices at current levels. Demand for petroleum products outstripped expectations in the last quarter of 2013, as U.S. consumption finally seems to be returning to an uptrend after stagnating for several years (graph 4). North America's harsh winter should also prompt relatively high consumption in early 2014. More generally, the global economy is forecast to accelerate this year, which should stimulate oil demand. However, the situation in emerging nations—especially China and India, major oil consumers—must be kept under watch.

Graph 3 – Oil prices have been fairly stable since last fall



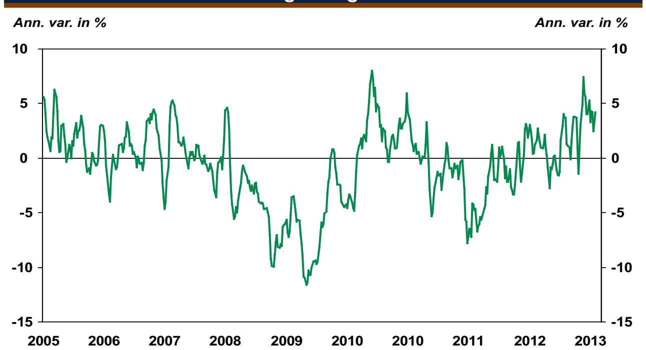
* West Texas Intermediate.
Sources: Datastream and Desjardins, Economic Studies

Graph 4 – U.S. crude oil production has never grown as fast



Sources: Energy Information Administration and Desjardins, Economic Studies

Graph 5 – U.S. demand for petroleum products has started to grow again



Sources: Energy Information Administration and Desjardins, Economic Studies

GASOLINE

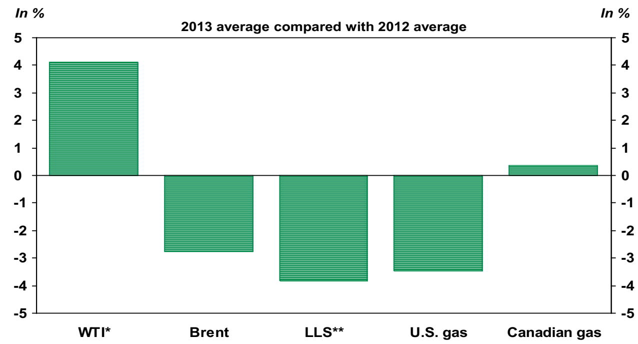
- In recent months, gas prices have been fairly stable in North America. In the United States, a gallon of regular gas is hovering around US$3.30; in Canada, the price is fluctuating just above $1.25 a litre. A look at the annual averages shows that, despite the 2013 rise in WTI oil prices, the average price of gas fell in the United States (graph 6). This primarily reflects the development of transportation infrastructures that are now giving refineries on the Golf of Mexico access to less expensive North American oil. North America's benchmark oil is quickly becoming WTI again, exerting heavy downside pressure on the other types of oil. The trend could persist this year, particularly if the Keystone XL project is approved at last—it has just gotten a new, relatively favourable assessment from the U.S. government. For now, gas prices remain higher in the Northeastern part of the continent, where refineries still have no access to the less expensive oil. Pipeline projects to carry Canadian oil to Eastern Canada could help correct this situation.

NATURAL GAS

- After a calm 2013, North America's natural gas market heated up recently, with prices jumping about 60% to US$5.69 per MMBTU (Million British Thermal Unit) at the end of January, their highest point since February 2010 (graph 7). The unexpected surge of natural gas prices is directly linked to North America's harsh winter, which drove gas demand up and led to a big drop in inventories (graph 8). While natural gas demand could get back to normal shortly, we can expect inventories to remain low for much of 2014, which could keep natural gas prices a little higher than expected in the short run. The market should, however, rebalance within a few quarters, as the higher prices will stimulate production and limit demand, particularly from electricity producers.

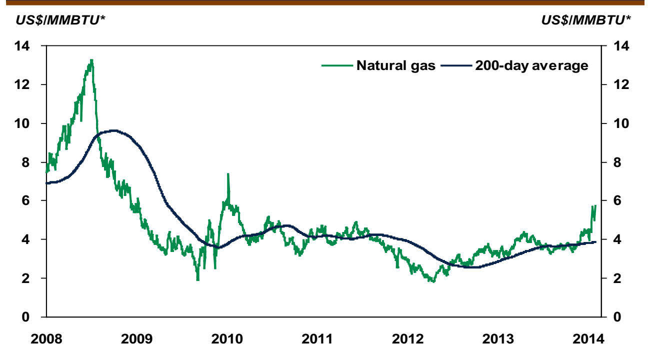
Forecasts: Our main scenario suggests that the global oil market will be relatively balanced this year and we project that the price for WTI oil will average US$95 a barrel in 2014. The main risks to the scenario are to the downside, however, as a crisis in emerging nations or Iranian oil's return to the market could take prices lower. A very strong start to the year and the fact that inventories will remain relatively low for a while prompts us to upgrade our outlook for natural gas prices this year. However, nothing points to an extended surge in prices, as everything suggests that the North American market's supply will be abundant over the medium and long terms.

Graph 6 – The drop in some oil prices helped gas prices retreat in the United States



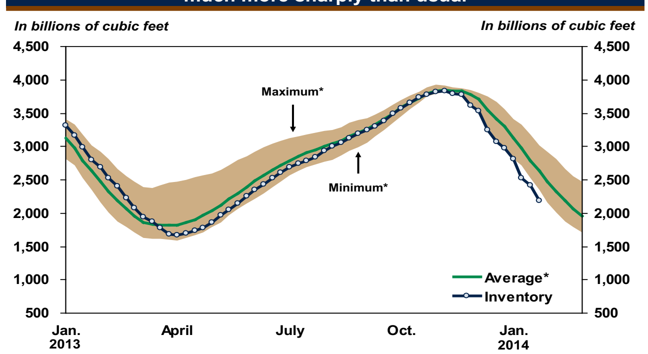
* West Texas Intermediate; ** Louisiana Light Sweet.
Sources: Datastream, Bloomberg and Desjardins, Economic Studies

Graph 7 – Price of natural gas



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

Graph 8 – The very cold winter is making inventories drop much more sharply than usual



* From 2009 to 2013.
Sources: Energy Information Administration and Desjardins, Economic Studies

BASE METALS

Keep a close watch on emerging economies

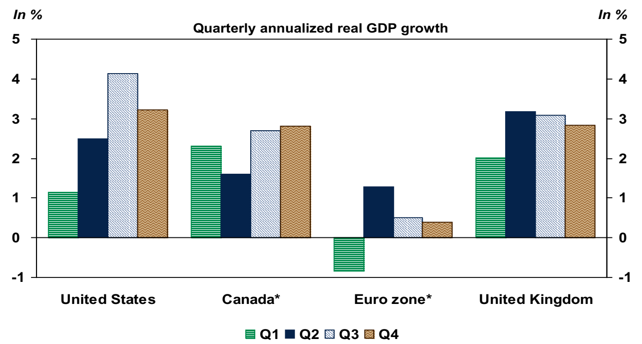
The latest data confirms that economic growth was fairly strong in many advanced economies in the second half of 2013 (graph 9). The more robust activity, which points to substantially stronger growth in 2014, is excellent news for the industrial metals market, which has been facing challenges over the last few years. After falling below 3,000 last summer, the LME (London Metal Exchange) base metal index climbed in the second half of the year, ending 2013 at close to 3,200.

However, renewed concerns about emerging economies have dragged base metal prices down considerably over the last few weeks (graph 10). These countries are essential for industrial metal demand, and a serious financial crisis in emerging nations would lead to a pronounced drop in prices. Countries that depend heavily on foreign financing seem especially at risk, since they could have to raise their key interest rates a lot to prevent a flight by capital, thus putting the brakes on economic growth. For now, only Turkey has had to resort to drastic measures. Furthermore, it is reassuring to see that China, which accounts for more than 40% of the world's base metal demand, seems little affected by this financial instability.

ALUMINUM

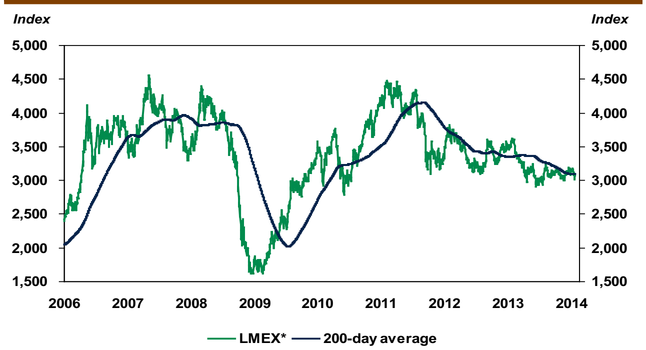
- After retreating 14% between the end of 2012 and the end of 2013, aluminum prices have fallen nearly 7% since the start of 2014. At US$1,634 per tonne in early February, they are at their lowest point since summer 2009 (graph 11). Given the large inventories and rapid growth in global production, aluminum prices seem especially vulnerable to slowing demand from emerging nations. Restrictions on Indonesian bauxite exports could help rebalance the aluminum market by curbing somewhat the thrust of Chinese production. Over the medium term, outlooks for demand growth for this light metal are positive, as, for example, Ford recently introduced a new truck that replaces most of its steel with aluminum.

Graph 9 – Economic growth accelerated in several advanced nations in 2013



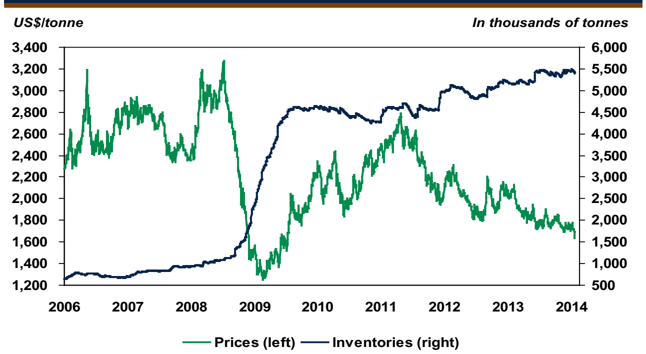
* The fourth quarter is an estimate for Canada and the euro zone.
Sources: Datastream and Desjardins, Economic Studies

Graph 10 – Industrial metal prices remain soft



* London Metal Exchange base metals price index.
Sources: Datastream and Desjardins, Economic Studies

Graph 11 – Aluminum prices and inventories



Sources: Datastream and Desjardins, Economic Studies

COPPER

- Copper prices ended 2013 on a good note, limiting its loss over 12 months to just under 7%. The downtrend in copper inventories recorded by the LME (graph 12), which recently dropped to their lowest point in over a year, helped copper go above US$7,400 per tonne in mid-January. A rebound in China's copper imports, which posted an annual increase of more than 30% in November and December, largely explains the retreat in inventories. However, the recent surge in concern over emerging nations and financial strains have taken copper prices below US$7,100 in the last few days.

NICKEL

- 2013 was an especially tough year for nickel. Prices for this metal, already low at the end of 2012, dropped nearly 20% and ended 2013 at US$13,832 per tonne (graph 13). The considerable surplus in the global nickel market caused inventories recorded by the LME to rise throughout 2013 despite the advance in Chinese imports, explaining the dramatic reduction. 2014 got off to a good start for this metal, as Indonesia's decision to severely restrict ore exports caused nickel prices to jump nearly 6% in mid-January; this gain was quickly erased, however, given the less favourable global context.

ZINC

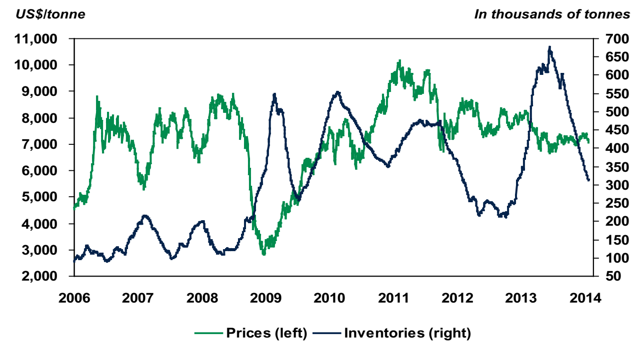
- Thanks to a solid year-end, zinc prices finished 2013 very close to where they were at the end of 2012. They have therefore posted the best performance by a major base metal aside from steel, which recorded a 6% gain (graph 14). The more-than-20% rise in Chinese zinc imports and a nearly 25% reduction in inventories recorded by the LME last year were both important supports for this metal's prices. Like other base metals, zinc prices increased in the first weeks of 2014 before seeing their progress evaporate.

STEEL

- After collapsing in early 2013, with prices below US$100 per tonne, LME steel prices have recovered considerably. They ended 2013 at US$287 per tonne and jumped to US$360 per tonne over the last few days, despite the worries in emerging nations. Some of the upside pressure on international prices could reflect convergence with U.S. prices, as these have been much higher in recent quarters.

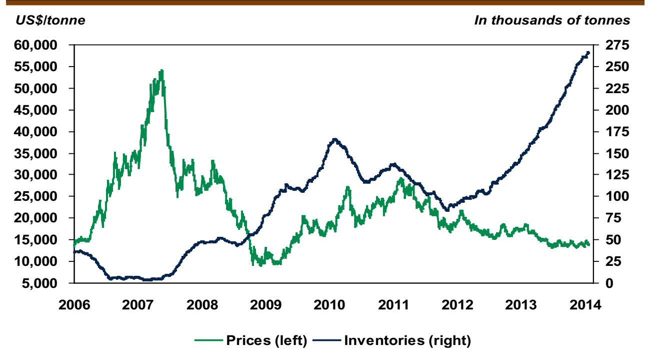
Forecasts: As long as concerns about emerging nations persist, we can expect base metal prices to remain low. If a serious crisis is avoided, we still think that the accelerating global economy should help industrial metal prices start a new uptrend in 2014.

Graph 12 – Copper prices and inventories



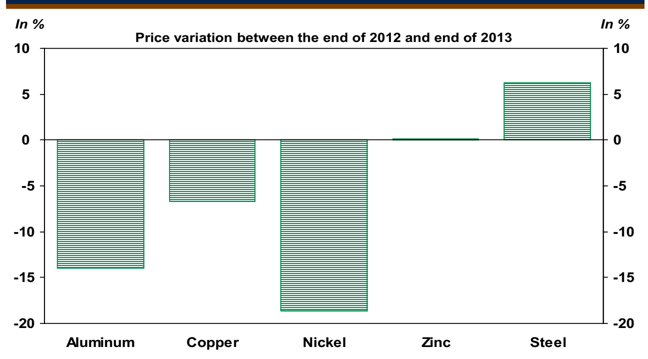
Sources: Datastream and Desjardins, Economic Studies

Graph 13 – Nickel prices and inventories



Sources: Datastream and Desjardins, Economic Studies

Graph 14 – Most base metal prices pulled back in 2013



Sources: Datastream and Desjardins, Economic Studies

PRECIOUS METALS

Renewed worries benefit gold

After an incredibly difficult 2013, gold recently recovered somewhat following the rise in investor fears. This performance is especially encouraging in a context in which the Federal Reserve (Fed) has begun to taper its quantitative policy. The other precious metals have also fared better than industrial metals recently.

GOLD AND SILVER

- In mid-December, the Fed's surprise decision to start gradually tapering its bond purchases put new downside pressure on gold prices. They dropped below US$1,200 per ounce in the last weeks of 2013, while they had started the year above US$1,660 per ounce (graph 15). Some disappointing economic statistics and considerable strains in emerging nations, however, have recently revived investor concerns (graph 16) and taken gold prices back to around US$1,260 per ounce. In addition to the upswing in financial demand, after 2013's spectacular drop, gold is benefiting from signs that physical demand for this metal is currently quite high, including in emerging nations, where gold is currently fulfilling its role as store of value quite well. After falling more than 30% between the end of 2012 and the end of 2013, silver prices have not done as well as gold in early 2014, remaining below US$20 per ounce.

PLATINUM AND PALLADIUM

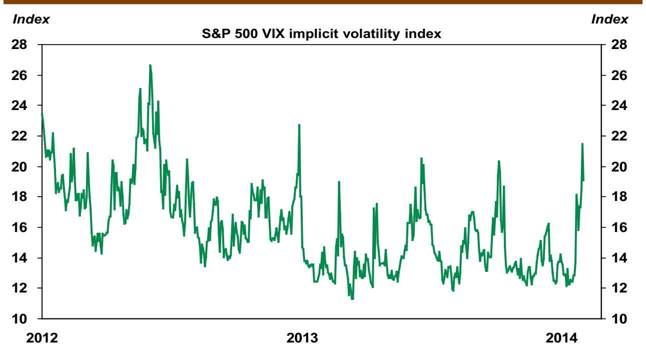
- Platinum prices ended 2013 at around US$1,350 per ounce, down just over 10% from the start of the year (graph 17). Despite the drop, platinum prices are back above gold prices. Palladium prices, for their part, ended the year quite close to where they were in early 2013. Prices for both metals spiked in early 2014, but this trend has lost steam recently, despite the strikes in South Africa.

Forecasts: Economic and financial concerns, as well as strong physical demand, should help gold prices hold above US$1,200 per ounce in the coming months, a support that seems fairly solid. The upswing in investor interest for gold could be short-lived, though, and the renewed uptrend in bond yields should put additional downside pressure on gold prices within the next few quarters.

Graph 15 – Gold and silver prices

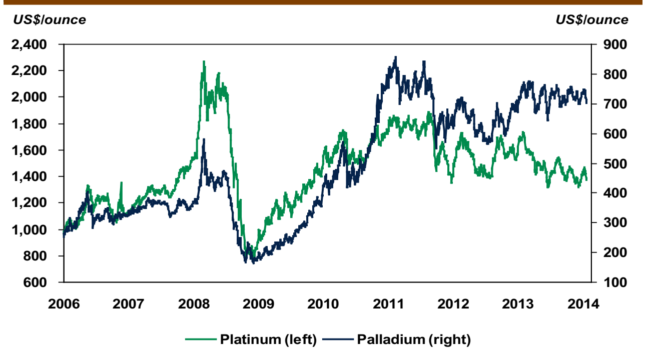
Sources: Datastream and Desjardins, Economic Studies

Graph 16 – Investors are edgier since the start of 2014



Sources: Datastream and Desjardins, Economic Studies

Graph 17 – Platinum and palladium prices



Sources: Datastream and Desjardins, Economic Studies

OTHER COMMODITIES

The context is good for Canadian forest products

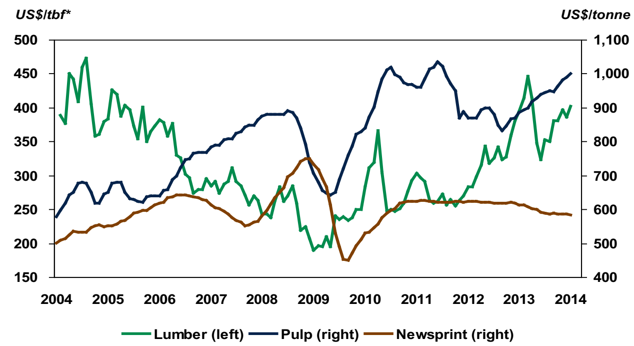
FOREST PRODUCTS

- The favourable economic outlook, especially in the United States, continues to support forest product prices. Although the weather is not propitious for building and some data signals that the U.S. housing market is moderating, lumber prices recently hit US$404 per thousand board feet, the highest level since last April (graph 18). Pulp prices are also still trending up, crossing above US$1,000 a tonne for the first time since the summer of 2011. **These prices are particularly attractive for Canadian forest product producers given the loonie's recent tumble.** Newsprint prices remain stagnant, on the other hand.

AGRICULTURAL COMMODITIES

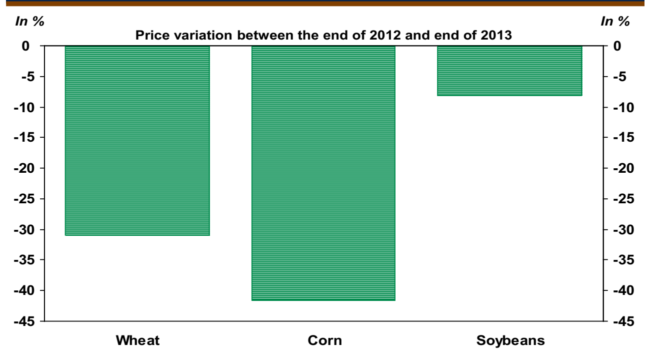
- Subsequent to a string of good years for farmers, 2013 saw the prices of the primary cereals drop sharply as the major droughts of 2012 gave way to record harvests. The contrast between the last two years' harvests was especially striking in the United States and had a major impact on corn prices. The price of corn retreated more than 40% in 2013 (graph 19). Wheat also corrected steeply (-31%), with soybeans pulling back less (-8%).
- The U.S. Department of Agriculture has, overall, continued to upgrade its harvest estimates for the three main cereals. Note, however, that demand for corn and wheat seems to be firming up, a sign that prices may have dropped enough to bring some balance back to the market and rein in inventory growth. The first indications for the next harvest could make cereal prices react. In particular, keep a close watch on U.S. growers' prospective plantings, to be released at the end of March. **However, the weather could once again be the biggest influence on movement in cereal prices in 2014.**
- **Animal producers had faced tough conditions in recent years, but they are at last seeing better circumstances.** The sharp drop in cereal prices lowers their production costs, while the reduction in herds over the last few years is buoying livestock prices. This is particularly true for U.S. beef producers, with prices for some types of animals reaching peaks that date back several decades (graph 20).

Graph 18 – Forest product prices



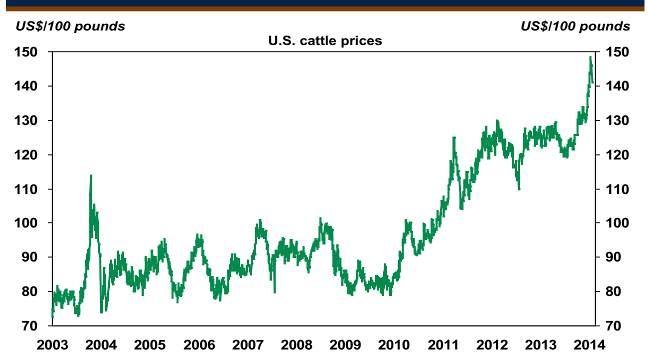
* Thousands of board feet.
Sources: Datastream and Desjardins, Economic Studies

Graph 19 – Cereal prices retreated sharply last year



Sources: Datastream and Desjardins, Economic Studies

Graph 20 – Beef prices have skyrocketed



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

Table 1
Commodities

	Spot price	Percentage return since				Last 52 weeks		
	Feb. 5	1 month	3 months	6 months	1 year	High	Average	Low
Index								
Reuter-CRB[1] (CCI[2])	524.2	2.7	3.9	3.5	-8.1	570.5	524.3	500.4
Reuters/Jefferies CRB[1]	287.1	3.8	5.2	1.4	-5.6	304.1	285.7	272.3
Dow Jones AIG[3]	128.1	2.5	4.3	2.4	-10.4	142.9	129.7	122.0
Bank of Canada	654.2	2.1	6.2	-0.6	3.2	672.4	640.8	589.7
Energy								
Brent oil (US$/barrel)	105.8	-1.2	0.0	-2.9	-9.5	119.2	108.4	97.6
WTI[4] oil (US$/barrel)	97.4	4.0	4.3	-8.6	0.7	110.6	98.0	86.7
Gasoline (US$/gallon)	3.29	-1.2	0.8	-9.4	-7.0	3.78	3.50	3.19
Natural gas (US$/MMBTU[5])	7.91	82.3	135.4	137.5	136.8	7.91	3.88	3.19
Base metals								
LMEX[6]	3,029	-3.1	-2.4	0.2	-15.9	3,606	3,145	2,911
Aluminium (US$/tonne)	1,657	-4.1	-6.4	-5.5	-20.1	2,127	1,815	1,634
Copper (US$/tonne)	7,084	-3.4	-1.0	1.8	-14.0	8,260	7,254	6,638
Nickel (US$/tonne)	13,709	-0.5	-4.0	-0.6	-26.4	18,636	14,684	13,216
Zinc (US$/tonne)	1,971	-3.2	4.5	7.6	-8.3	2,185	1,909	1,785
Steel (US$/tonne)	359.0	23.4	56.1	192.3	29.0	360.0	205.7	99.3
Precious metals								
Gold (US$/ounce)	1,261	2.0	-3.7	-2.9	-24.4	1,680	1,369	1,196
Silver (US$/ounce)	19.6	-2.7	-9.1	-0.7	-38.7	32.0	22.7	18.6
Platinum (US$/ounce)	1,383	-1.5	-4.7	-4.2	-18.7	1,736	1,463	1,317
Palladium (US$/ounce)	717.0	-1.5	-3.8	-2.2	-5.2	774.0	726.5	643.0
Other commodities								
Lumber (US$/tbf[7])	403.0	3.3	3.6	13.2	4.1	451.0	383.5	322.0
Pulp (US$/tonne)	1,006	1.6	4.2	6.3	13.1	1,006	945.0	889.0
Newsprint (US$/tonne)	585.3	-0.1	-0.3	-0.9	-4.8	616.2	594.9	585.0
Wheat (US$/bushel)	5.41	1.6	-10.9	-12.4	-25.8	7.40	6.25	4.98
Corn (US$/bushel)	4.32	5.1	5.1	-24.9	-41.5	7.52	5.68	3.98
Soybean (US$/bushel)	13.10	2.2	5.4	-0.7	-12.8	16.10	14.06	12.43

[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	2012	2013	2014f	2015f
WTI* oil (US$/barrel)	94	98	Target: 94 (range: 86 to 102)	Target: 99 (range: 90 to 108)
Natural gas Henry Hub (US$/MMBTU**)	2.76	3.73	Target: 4.50 (range: 4.00 to 5.50)	Target: 4.00 (range: 3.25 to 5.00)
Gold (US$/ounce)	1,669	1,411	Target: 1,150 (range: 1,100 to 1,300)	Target: 1,050 (range: 900 to 1,200)
LMEX*** index—base metals	3,416	3,183	Target: 3,350 (range: 2,900 to 3,700)	Target: 3,900 (range: 3,400 to 4,300)

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