Commodity Trends

Desjardins Economic Studies
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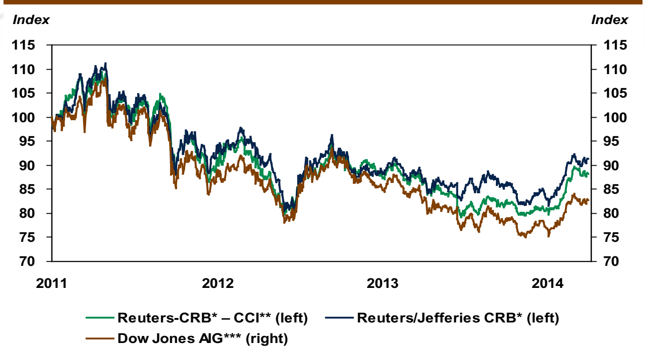
# Some gains pending a true uptrend

The main commodity price indexes advanced 6% to 9% in Q1 2014 (graph 1). Yet, the last few months have seen resurfacing concerns about the outlook for economic growth, particularly in emerging nations.

**Graph 1 – Overall, commodity prices have performed well since the start of 2014**




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

Against this backdrop, industrial metals unsurprisingly posted another retreat in the last few months, unlike other commodities (graph 2). Note that China's economy has recently started to worry investors again. Conversely, cereal prices rebounded sharply, but the rise does not completely offset 2013's steep drop. Like cereals, energy prices capitalized on escalating tensions in the Ukraine—a risk to the world's supply—as well as the very cold winter in North America. International tensions also benefited precious metal prices.

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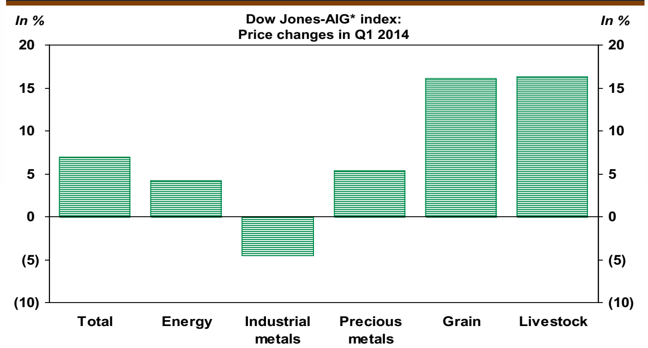
**Graph 2 – Base metal prices were the only ones to retreat in Q1**




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

The recent surge in commodity prices is thus largely based on one-off factors and rebounds on the heels of plunges. A sustainable uptrend would require confirmation of global economic acceleration that would allow base metal prices to recover. Here, the latest statistics are relatively promising, as everything suggests economic activity will rebound this spring in the United States.

**François Dupuis**
Vice-President and Chief Economist

**Mathieu D'Anjou, CFA**
Senior Economist

**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.

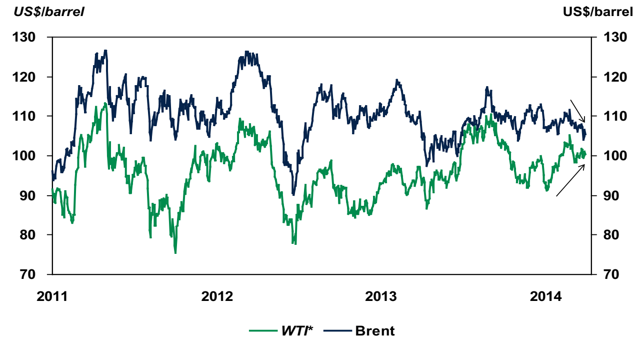
# ENERGY

## Fewer bottlenecks for North American oil

### OIL

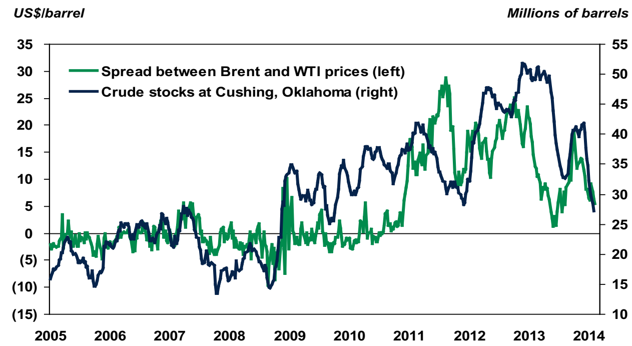
- Prices for WTI (West Texas Intermediate) oil have come up in recent weeks, crossing back over US$100 a barrel. The tension in Ukraine temporarily pushed the price of WTI over US$105 a barrel in early March, but this movement did not last. With Brent prices down 3% in the first quarter of 2014, the WTI's ascent primarily reflects a decline in the discount applied to North American oil (graph 3).
- The spread between Brent and WTI oil prices has thus gone from more than US$13 a barrel at the end of 2013 to around US$5 (graph 4). Beyond the usual volatility in movement of the different types of oil, the lower discount on WTI oil reflects a substantial reduction of the bottlenecks that had, for several years, been limiting U.S. refineries' access to WTI oil. Note that, until 2011, WTI usually traded slightly higher than Brent. Starting in 2011, however, the surge in non-conventional oil production led to a surplus of this type of oil in the U.S. Midwest. With no way to deliver the oil to the rest of the country, inventories in Cushing, Oklahoma skyrocketed and a major discount materialized for WTI oil prices, sometimes more than $25 a barrel.
- The substantial discount gave producers and arbitragers an incentive to develop ways to get oil from the Midwest to the large refineries on the Gulf of Mexico. In addition to highway and rail shipments, increased pipeline capacity means the Gulf area refineries can now use a lot more WTI, with a concomitant drop in the inventories in Cushing. As the refineries in the northeastern part of the continent are still supplied by ship, the discount on WTI could stabilize between US$5 and US$10 a barrel for a while.
- Internationally, the escalating tension with Russia is a focus. True, Russia is one of the largest oil producers and exporters (graph 5). Removing its oil from the market would create substantial shortages, especially in Europe. However, the experts all agree that Russia is even more dependent on its oil exports than Europe could be. Energy accounts for about 70% of Russia's exports, and more than 50% of government revenue. Even during the Cold War, Russia continued to export energy; it is very difficult to imagine a realistic scenario in which it would halt the supply to Europe. However, strains with Russia are lowering the possibility of reaching a lasting agreement with Syria and Iran. We cannot count on tensions in the Middle East waning, or hope that Iranian oil will be back on the market soon. There are some positive developments for Iraq, however, where production has jumped in recent months and hit a 35-year peak (graph 6 on page 3).

**Graph 3 – WTI* oil on the rise, while Brent tends to retreat**



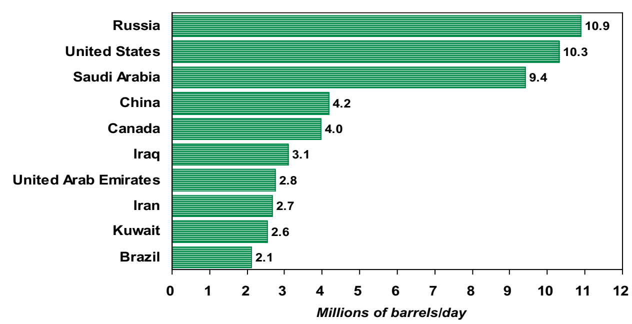

* West Texas Intermediate.
Sources: Datastream and Desjardins, Economic Studies

**Graph 4 – The narrowing spread between Brent and WTI reflects a sharp drop in Midwestern inventories**




Sources: Energy Information Administration and Desjardins, Economic Studies

**Graph 5 – Biggest oil producers in 2013**




Sources: International Energy Agency and Desjardins, Economic Studies

## GASOLINE

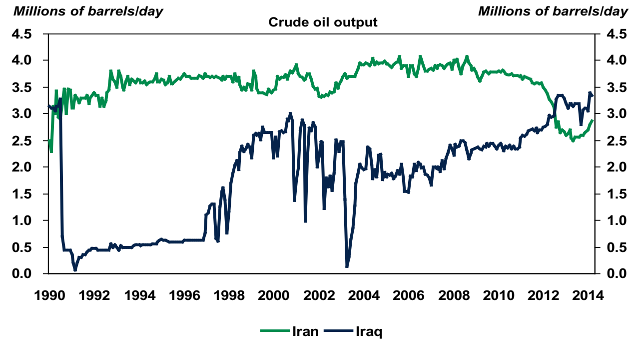
- Gas prices rose somewhat in North America in Q1 2014. In the United States, the price of a gallon of gas went from US$3.33 at the end of 2013 to US$3.60 (graph 7), reflecting the slight increase in WTI oil prices—WTI is now once again the crude benchmark for gas prices in most of the United States. U.S. gas prices also usually rise at the end of winter. Higher ethanol prices are also boosting gas prices. In Canada, the loonie's retreat is also contributing to higher gas prices.

## NATURAL GAS

- After posting a spectacular surge early this winter, which temporarily drove the spot price for natural gas close to US$8 per MMBTU (Million British Thermal Unit), the situation has calmed recently thanks to the more seasonal weather. Natural gas prices have thus fallen to around US$4.50 per MMBTU, which is still more than 10% higher than they were at this time last year. It will take some time for the impacts of this winter to disappear. The very cold weather boosted U.S. natural gas demand by 8% from last year, pulling inventories down to their lowest point in 11 years. However, higher prices will rein in demand in the coming months, with the result that inventories should slowly return to normal.

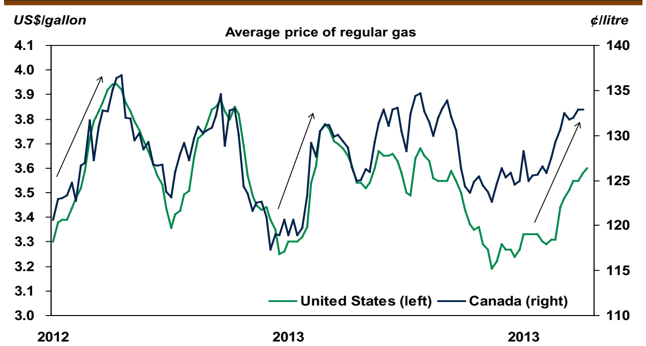
**Forecasts:** A faster-than-anticipated drop in the discount on WTI oil prices prompts us to upgrade our forecast slightly for this type of oil. On average, we expect the price of WTI to be around US$96 a barrel in 2014, rising to US$99 in 2015. Overall, the global oil market should remain well balanced, as North American output will continue to surge. The recent events bolster the decision made in our previous issue to upgrade our expectations for natural gas prices. We continue to expect natural gas prices to be at US$4.50 per MMBTU on average in 2014, as it will take several more months for gas inventories to return to more normal levels.

**Graph 6 – The surge in Iraq's output partially offsets the decline in Iran**



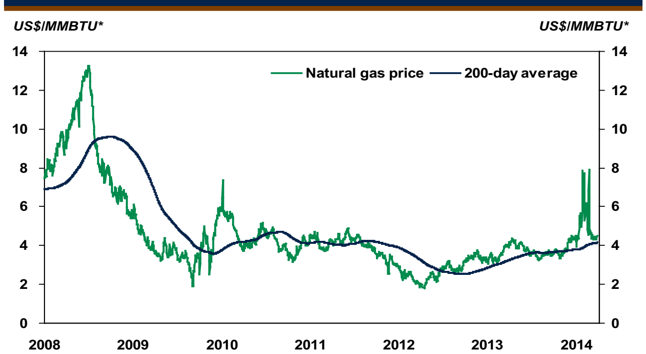

Sources: Bloomberg and Desjardins, Economic Studies

**Graph 7 – Gas prices often go up early in the year**




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

**Graph 8 – Natural gas prices**




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

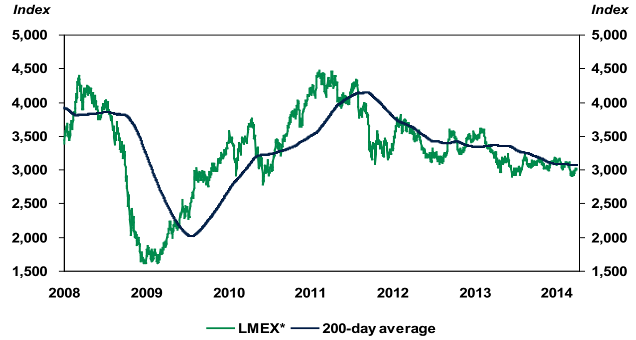
# BASE METALS

## Concerns over China increase

While most commodity prices advanced in Q1 2014, in general, base metal prices fell again. The LME (London Metal Exchange) index of base metal prices ended March below the 3,000 mark, down 8% from where it was at this time last year (graph 9).

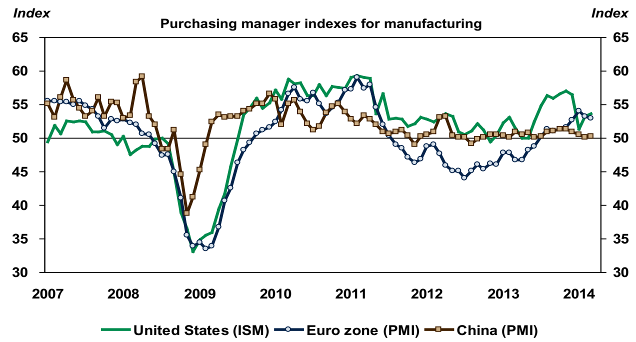
Early in the year, the index was impacted by general concern over emerging nations; the latest pullback in metal prices is due to new fears over China. Not only has the recent Chinese data been disappointing, but the country's first corporate bankruptcy has revived fears of a financial crisis, particularly in the area of unregulated financing, i.e. "shadow banking." It is particularly worrisome for copper, often used in financial transactions. On the other hand, the latest figures for the advanced economies are fairly encouraging for future metal demand (graph 10).

Graph 9 – Industrial metal prices are down again




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

Graph 10 – The manufacturing sector seems to have started growing again, even in the euro zone

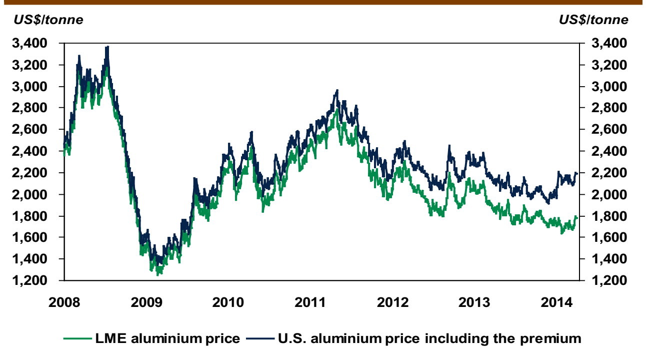



Sources: Bloomberg, Institute for Supply Management and Desjardins, Economic Studies

### ALUMINUM

- After a tough start to the year, aluminium prices edged up, ending the quarter at about US$1,715 a tonne. It continued going up in early April, but it is still very low, historically speaking. In the last few years, aluminium producers have saved the day by charging an ever-increasing premium to major consumers wanting immediate access to aluminium (graph 11). Such a large premium is strange, however, given that aluminium inventories are extremely high according to the LME survey. With some accusing major investment banks that warehouse aluminium of manipulating prices, the LME has changed its rules to force those holding aluminium to make their stocks available more quickly. The new rules have just come into effect and it remains to be seen whether they will actually make the aluminium more available, or whether the stocks will just be moved to unregulated warehouses.

Graph 11 – The surge in the premium paid by some aluminium consumers limits production cuts




Sources: Bloomberg and Desjardins, Economic Studies

## COPPER

- The last few months have been especially tough for copper, whose price fell more than 9% in the first quarter to drop below US$6,700 a tonne (graph 12). The decline occurred even though the inventories surveyed by LME are down sharply. Fears of a Chinese financial crisis made copper prices tumble more than US$600 a tonne in just a few days in early March. Copper mine output is accelerating as well, which may also have had a hand in the pullback of this metal's price.

## NICKEL

- Nickel has done a lot better than the other industrial metals since the start of 2014. Its price jumped more than 15% and went back over US$16,000 a tonne, even though, according to the LME, inventories are up again (graph 13). The price surge is mainly due to Indonesia's decision to stop exporting unprocessed ore—Indonesia is the world's leading producer of nickel ore. It remains to be seen whether Indonesia will stick with this decision for a long time, and whether that will be enough to get the world nickel market back to equilibrium.

## ZINC

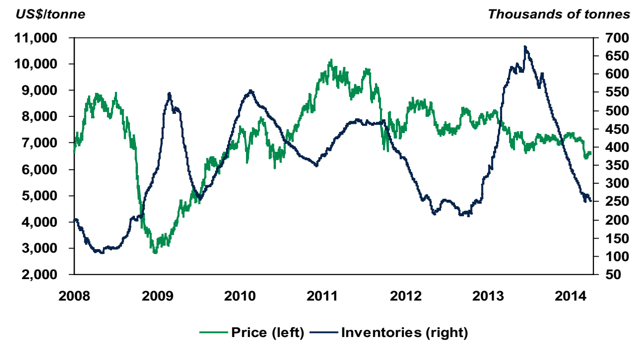
- Zinc prices fell about 4% in the first quarter, sliding just below US$2,000 a tonne (graph 14). Despite the pullback, zinc prices are up more than 8% in the last year, while most of the other industrial metals have lost value. Global demand for zinc should continue to be strong this year and next. However, zinc output should rise at a similar pace.

## STEEL

- The LME steel price continued its impressive climb in Q1 2014, gaining nearly 35%. It recently hit US$396 a tonne, its highest point since the summer of 2012. Steel prices' spectacular surge since last summer largely reflects convergence of international prices towards the higher prices in the U.S. market. This movement seems to be winding down, and steel prices should now start to reflect the shifts in global supply and demand.

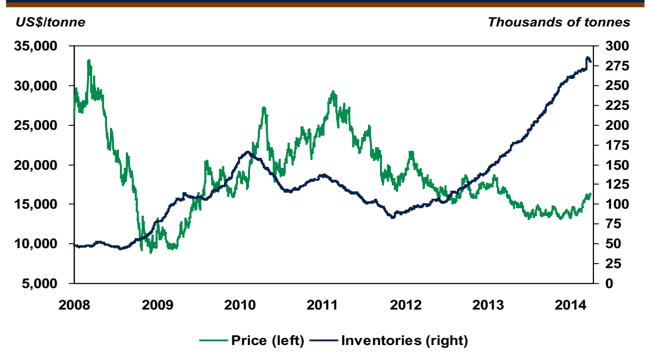
**Forecasts:** In the near term, base metal prices will primarily react to news from China. However, there is hope that the worst will be avoided, as Chinese authorities will do everything possible to avoid an economic or financial crisis. After that, metal prices should capitalize on the global economy's acceleration.

Graph 12 – Copper prices and inventories



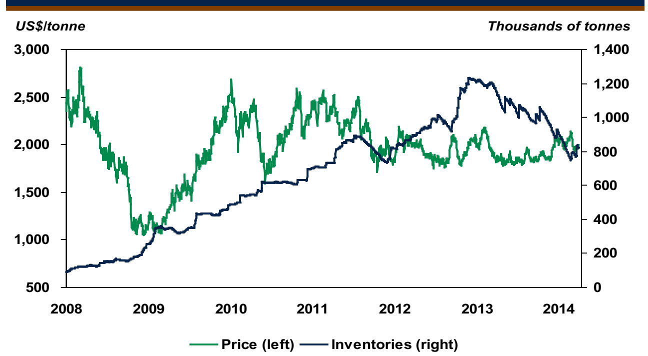

Sources: Datastream and Desjardins, Economic Studies

Graph 13 – Nickel prices and inventories




Sources: Datastream and Desjardins, Economic Studies

Graph 14 – Zinc prices and inventories




Sources: Datastream and Desjardins, Economic Studies

# PRECIOUS METALS

## Gold prices are volatile

The surging tension between Russia and the West in early March benefited precious metals. Most prices started to trend down after the Federal Reserve (Fed) meeting, however.

### GOLD AND SILVER

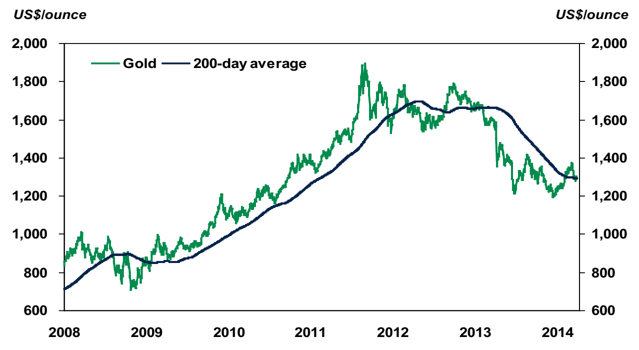
- Investors continued to seek shelter in gold as relations between Russia and the West worsened substantially. The approach of the referendum that confirmed Russia's annexation of Crimea even pushed gold prices above US$1,365 per ounce in mid-March, a peak not seen since last September. After the referendum, however, the situation in the Ukraine seemed to stabilize, leading to easing financial tensions and a drop in gold prices. Gold's slide steepened following the Fed's March 19 meeting at which new Chair Janet Yellen clearly indicated that she planned to keep tapering bond purchases, and even seemed to open the door to key rate increases before mid-2015. Gold prices thus ended the first quarter at around US$1,280 an ounce (graph 15). Silver prices also posted good gains in early 2014, but subsequently fell back very close to where they were at the end of 2013 (graph 16). The major silver surplus in the global market could continue to hurt this metal.

### PLATINUM AND PALLADIUM

- Helped by demand for precious metals prompted by financial strains, platinum and palladium are also benefiting from concerns about supply. South Africa, home to many platinum and palladium mines, is currently undergoing one of the biggest work stoppages of recent years. Despite that, platinum prices followed a trend similar to gold's, jumping above US$1,480 an ounce in mid-March, then sliding to around US$1,400 (graph 17). As potential sanctions could restrict the major palladium supply from Russia, this metal's price did better, staying close to its highest point since the summer of 2011.

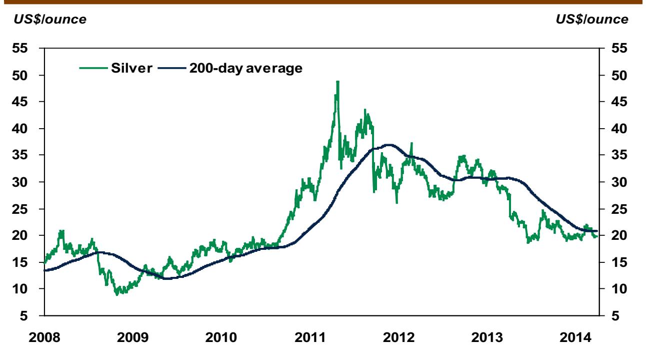
**Forecasts:** The rise of precious metal prices early this year is encouraging after the tumble they took in 2013. Despite that, we continue to expect gold prices to retreat in the coming quarters, as rising bond yields and a better economic and financial situation will give investors an incentive to turn to other investments.

**Graph 15 – Gold prices**



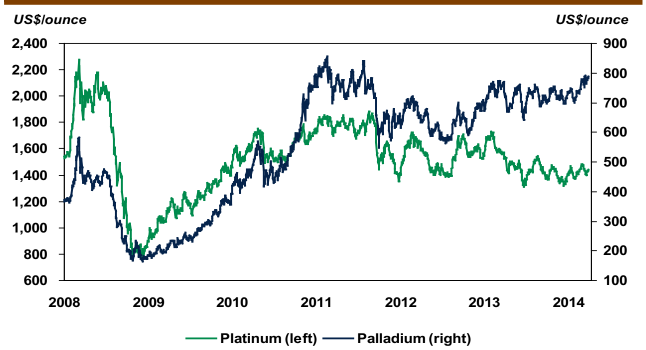

Sources: Datastream and Desjardins, Economic Studies

**Graph 16 – Silver prices**




Sources: Datastream and Desjardins, Economic Studies

**Graph 17 – Platinum and palladium prices**




Sources: Datastream and Desjardins, Economic Studies

# OTHER COMMODITIES

## Cereals benefit from the Ukraine conflict and the weather

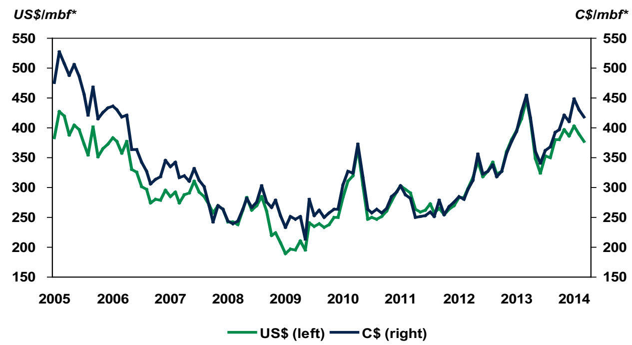
### FOREST PRODUCTS

- Forest product prices have not moved much in the last few weeks. After surging higher than US$400 per thousand board feet at the end of January, lumber prices have slid back to around US$375. This year's particularly cold winter curbed homebuilding in the United States. On the other hand, Moody's recently noted that Canadian forestry companies would be especially benefited by the loonie's pullback (graph 18). While pulp prices have ticked up again, newsprint prices are very stable.

### AGRICULTURAL COMMODITIES

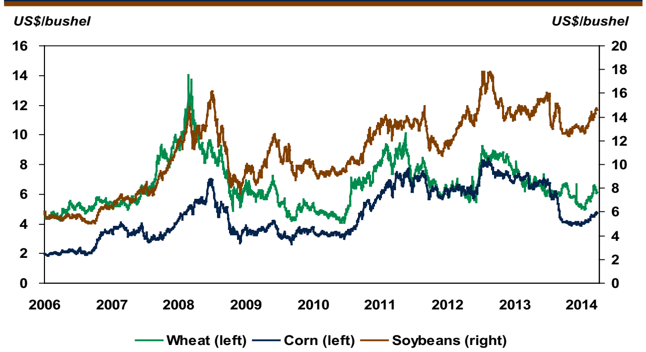
- After a very tough 2013, cereal prices have rebounded substantially in recent months (graph 19). The price for a bushel of wheat jumped 20% in the first quarter, with corn gaining 17% and soybeans up 10%. Some of the gains reflect concerns about the situation in the Ukraine, a major cereal producer. For now, however, Russia's annexation of Crimea should not have a big impact on the global cereal supply, as the large grain shipping ports are located in western Ukraine.
- The weather has also had a hand in rising cereal prices. In the United States, the cold in some regions and drought in others hurt the winter wheat harvest. Big droughts in Brazil and Australia also helped fan speculator interest in cereals. Also, note that last year's drop in prices seems to have inflated demand for some cereals, especially wheat. Despite all this, the U.S. Department of Agriculture's projections have not changed much for 2013–2014, as excellent harvests will make the stocks of the three principal cereals increase. Corn's rise is especially striking: on March 1, 2014, U.S. corn stocks were up 30% from the same date last year.
- Unsurprisingly, U.S. farmers' planting intentions revealed a decline in the acreage devoted to corn, primarily in favour of soybeans (graph 20), a good reflection of the movements by the two cereals' prices. **With a large number of acres still being dedicated to the three primary cereals, it would take poor weather in the coming months to expect the recent price trend to hold.**

Graph 18 – Lumber prices



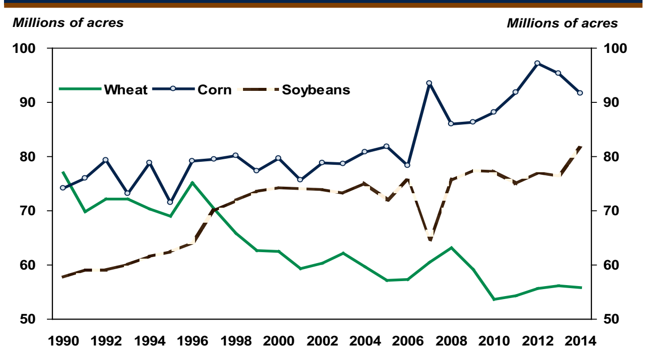

* Thousand board feet.
Sources: Datastream and Desjardins, Economic Studies

Graph 19 – Cereal prices




Sources: Datastream and Desjardins, Economic Studies

Graph 20 – Acres planted in the United States




Sources: Datastream and Desjardins, Economic Studies

## Table 1
## Commodities

| | Spot price | Percentage return since | | | | Last 52 weeks | | |
|---|---|---|---|---|---|---|---|---|
| | April 8 | 1 month | 3 months | 6 months | 1 year | High | Average | Low |
| **Index** | | | | | | | | |
| Reuter-CRB[1] (CCI[2]) | 562.7 | -0.5 | 10.9 | 7.7 | 3.2 | 567.4 | 524.1 | 500.4 |
| Reuters/Jefferies CRB[1] | 308.0 | 0.3 | 12.1 | 6.9 | 6.5 | 308.0 | 286.6 | 272.3 |
| Dow Jones AIG[3] | 136.0 | -0.1 | 10.0 | 5.9 | 1.1 | 136.8 | 128.9 | 122.0 |
| Bank of Canada | 666.6 | -1.8 | 5.7 | 5.2 | -0.2 | 678.9 | 645.1 | 589.7 |
| **Energy** | | | | | | | | |
| Brent oil (US$/barrel) | 106.2 | -2.4 | -1.1 | -3.8 | 2.0 | 117.3 | 107.7 | 97.6 |
| WTI[4] oil (US$/barrel) | 102.6 | -0.2 | 11.6 | -0.9 | 9.9 | 110.6 | 99.1 | 86.7 |
| Gasoline (US$/gallon) | 3.60 | 3.4 | 7.9 | 6.8 | -0.3 | 3.68 | 3.46 | 3.19 |
| Natural gas (US$/MMBTU[5]) | 4.56 | -4.4 | 4.8 | 22.9 | 9.1 | 7.92 | 4.14 | 3.27 |
| **Base metals** | | | | | | | | |
| LMEX[6] | 3,032 | 0.2 | -3.1 | -2.9 | -5.7 | 3,275 | 3,085 | 2,911 |
| Aluminium (US$/tonne) | 1,785 | 3.6 | 3.1 | -1.8 | -3.7 | 1,944 | 1,773 | 1,634 |
| Copper (US$/tonne) | 6,670 | -2.0 | -9.3 | -7.5 | -10.1 | 7,602 | 7,098 | 6,439 |
| Nickel (US$/tonne) | 16,406 | 7.5 | 21.8 | 18.6 | 2.7 | 16,406 | 14,382 | 13,216 |
| Zinc (US$/tonne) | 2,017 | -3.2 | -0.5 | 9.3 | 8.5 | 2,147 | 1,913 | 1,785 |
| Steel (US$/tonne) | 386.5 | 4.5 | 22.7 | 84.0 | 141.6 | 396.0 | 227.7 | 99.3 |
| **Precious metals** | | | | | | | | |
| Gold (US$/ounce) | 1,309 | -2.0 | 7.1 | -1.3 | -16.7 | 1,587 | 1,322 | 1,196 |
| Silver (US$/ounce) | 20.2 | -5.8 | 3.2 | -9.6 | -26.1 | 27.7 | 21.3 | 18.6 |
| Platinum (US$/ounce) | 1,437 | -2.5 | 2.3 | 2.1 | -6.2 | 1,546 | 1,433 | 1,317 |
| Palladium (US$/ounce) | 775.0 | -0.1 | 5.4 | 8.8 | 6.1 | 792.5 | 727.1 | 643.0 |
| **Other commodities** | | | | | | | | |
| Lumber (US$/tbf[7]) | 370.0 | -4.6 | -5.1 | -3.6 | -18.0 | 451.0 | 377.8 | 322.0 |
| Pulp (US$/tonne) | 1,026 | 1.7 | 3.6 | 8.3 | 14.0 | 1,026 | 964.5 | 900.0 |
| Newsprint (US$/tonne) | 583.4 | -0.1 | -0.4 | -1.1 | -3.9 | 607.0 | 590.1 | 583.0 |
| Wheat (US$/bushel) | 6.16 | 3.6 | 15.2 | -7.9 | -8.3 | 7.40 | 6.11 | 4.98 |
| Corn (US$/bushel) | 4.88 | 5.2 | 22.6 | 16.5 | -24.6 | 7.18 | 5.24 | 3.98 |
| Soybean (US$/bushel) | 14.84 | 2.4 | 15.6 | 17.3 | 6.0 | 16.10 | 13.97 | 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$/barrel) | 94 | 98 | Target: 96<br>(range: 90 to 102) | Target: 99<br>(range: 90 to 108) |
| Natural gas Henry Hub (US$/MMBTU**) | 2.76 | 3.73 | Target: 4.50<br>(range: 4.00 to 5.50) | Target: 4.00<br>(range: 3.25 to 5.00) |
| Gold (US$/ounce) | 1,669 | 1,411 | Target: 1,250<br>(range: 1,150 to 1,350) | Target: 1,150<br>(range: 1000 to 1,250) |
| LMEX*** index—base metals | 3,416 | 3,183 | Target: 3,350<br>(range: 2,900 to 3,700) | Target: 3,900<br>(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