Commodity Trends

Desjardins Economic Studies
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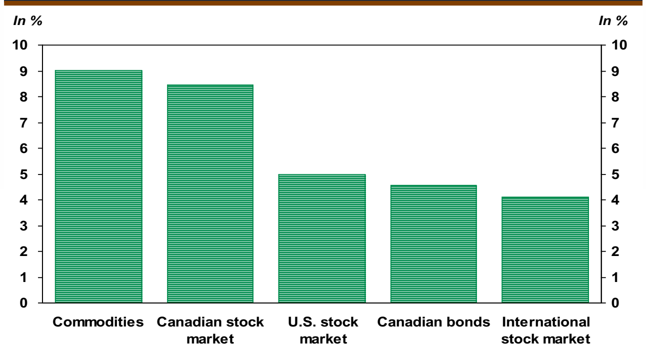
Things are looking good for the next few months

After gaining approximately 10% in the first four months of 2014, the main commodity price indexes lost a bit of ground in May. Contrary to what had been observed in previous years, however, commodities are still one of the asset classes that have been the most profitable for investors since the beginning of the year (graph 1).

The recent price slumps mainly affected those resources that had appreciated strongly at the beginning of the year, in particular natural gas, gold, wheat and corn. Conversely, industrial metal prices finally resumed an upwards trend in recent weeks.

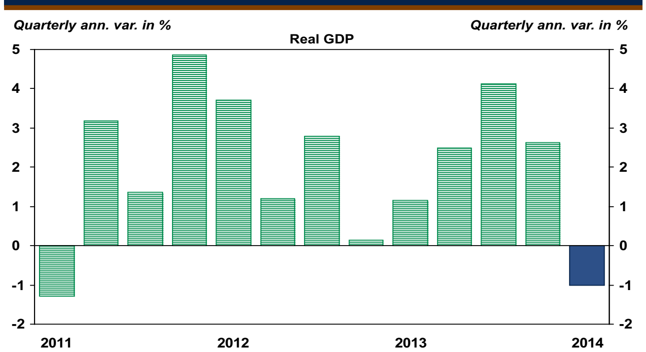
It is reasonable to assume that the difficulties that affected several major economies at the beginning of the year limited commodity price gains. The U.S. real GDP fell by 1.0% in the first quarter of 2014 (graph 2), as particularly severe weather reined in business output and the housing sector, among other things. Not only was growth still sluggish in the euro zone; China also showed signs of weakness. Fortunately, the latest statistics confirm a definite rebound in activity in the United States in the spring. The upturn in the manufacturing purchasing managers' index in China also points towards stronger demand for commodities and price increases in the coming quarters.

Graph 1 – Return from the beginning of 2014 to the end of May



Sources: Datastream and Desjardins, Economic Studies

Graph 2 – It was a tough winter for the U.S. economy



Sources: Bureau of Economic Analysis 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

Energy prices remain high

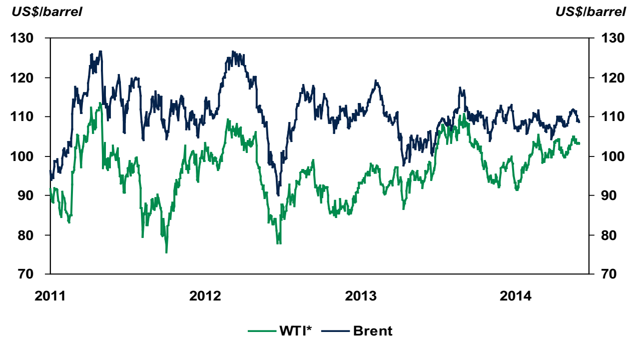
OIL

- The price of WTI (West Texas Intermediate) oil has been fluctuating between US$100 and US$105 per barrel since mid-March (graph 3). As for the price of Brent oil, it has climbed back to around US$110 per barrel, and the discount on WTI oil has expanded from a little less than US$5 per barrel at the beginning of April to a little over US$7. We still think that the spread between these two types of oil will generally vary between US$5 and US$10 per barrel in the months ahead; this reflects the extra cost of transporting U.S. oil to the refineries in the U.S. Northeast.
- The resilience shown by oil prices despite the difficulties experienced by the global economy at the beginning of 2014 is impressive. The latest statistics on oil consumption have been relatively strong, leading the International Energy Agency to revise its forecast of growth in global demand for this year, upwards slightly. A surge in Chinese imports of oil is also limiting growth in oil inventories in developed countries.
- Apart from the resilient demand for oil, crude prices are also supported by a continuing uncertain geopolitical climate. Despite the election of a new president on the first ballot, the situation in the eastern part of Ukraine is still anarchic. Russia recently withdrew its troops from the Ukrainian border, but it is far too soon to look forward to a return to normal in the region. Internal conflicts are also continuing to limit oil production in many member countries of the Organization of the Petroleum Exporting Countries, including Iraq, Libya and Nigeria.
- The situation in North America is still the main impediment to any further appreciation of oil prices. U.S. crude oil production is still growing very quickly, and this trend will continue for a while, according to U.S. government forecasts (graph 4). Indeed, not only is U.S. crude production expanding at a frenetic pace, but the proven reserves of oil are also increasing by leaps and bounds (graph 5). Some of the consequences of the abundance of oil in the United States are a reduction in imports of crude, a surge in exports of refined products and even growing exports of crude oil to Canadian refineries.

GASOLINE

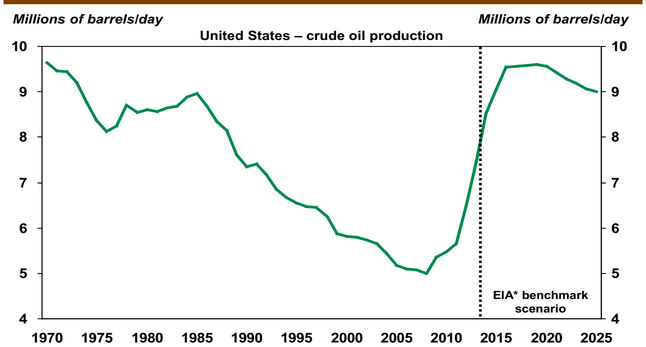
- Gasoline prices kept rising in North America throughout the month of April. They reached US$3.71 per gallon in the United States and C$1.40 per litre in Canada before dipping slightly in May. The surge in gasoline prices since mid-February mainly reflects seasonal factors that temporarily inflate refiners' margins towards the end of the winter. The acceleration in demand as the driving season approaches, temporary shutdowns of many refineries and the transition to production of summer gasoline tend, year after year, to give a temporary boost to gasoline prices

Graph 3 – Oil prices are still relatively high



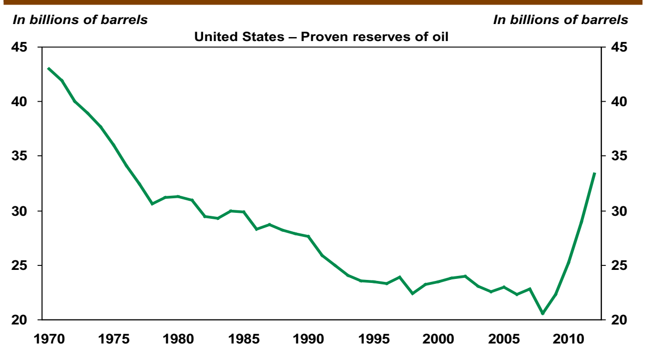
* West Texas Intermediate.
Sources: Datastream and Desjardins, Economic Studies

Graph 4 – U.S. oil production will keep increasing at a brisk pace in the years ahead



* Energy Information Administration.
Sources: Energy Information Administration and Desjardins, Economic Studies

Graph 5 – Proven reserves of oil are also increasing at a spectacular rate



Sources: Energy Information Administration and Desjardins, Economic Studies between February and May (graph 6). The good news is that these temporary factors are dissipating, allowing gasoline prices to dip slightly.

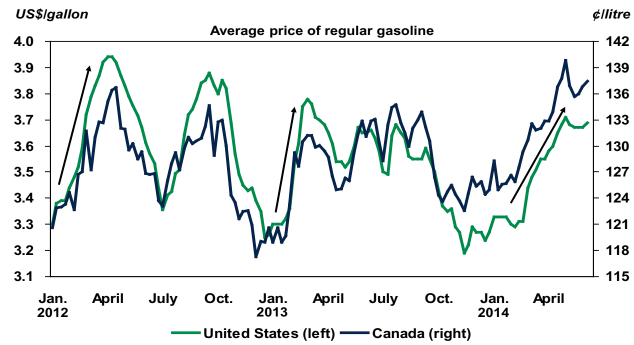
- Seasonal factors aside, gasoline prices remain close to historic peaks in Quebec, despite the fact that oil prices are still significantly below the high of over US$145 per barrel that was reached in 2008. In a recent *Economic Viewpoint*,[1] we showed that this is mainly due to the depreciation of the Canadian dollar and to the significant increase in gasoline taxes in recent years (graph 7).

NATURAL GAS

- The spectacular jump in natural gas prices at the beginning of the year has given way to a much calmer state of affairs in recent weeks. Since mid-March, the price of U.S. natural gas has been fluctuating within a limited range centred on US$4.50 per MMBTU (Million British Thermal Unit). As of the end of March, U.S. natural gas inventories had fallen to their lowest level since the spring of 2003, but the restocking season has started off at a strong pace (graph 8). The boom in gas production—up by around 5% compared to the same period last year—and the limited demand from electricity producers (for whom coal is becoming more attractive, given the relatively high price of gas) should trigger a sharp increase in gas inventories in the months ahead. While competition from coal will put downwards pressure on gas prices in the short term, we must take into account the ambitious plan put forward by President Obama to reduce power plant emissions 30% by 2030. If it is implemented, this plan will put coal-fired power stations at a clear disadvantage and stimulate demand for natural gas in the medium term.

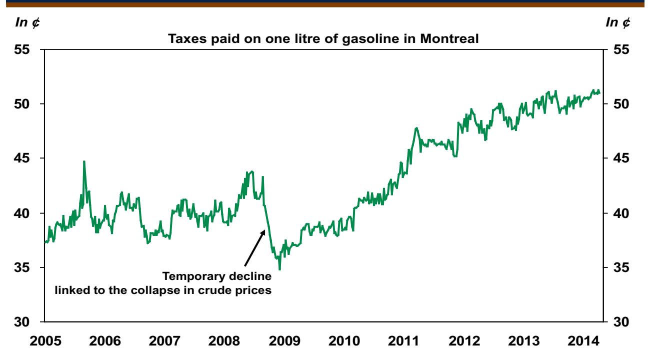
Forecasts: The resilience of oil prices and signs of acceleration in the global economy do not suggest any sustainable return to crude prices below US$100 per barrel. Even though the market will remain well supplied, we are now calling for a WTI price slightly above US$100 per barrel in the coming quarters. As for natural gas, we are maintaining our forecast of US$4.50 per MMBTU, on average, for 2014.

Graph 6 – The seasonal increase in gasoline prices is coming to an end



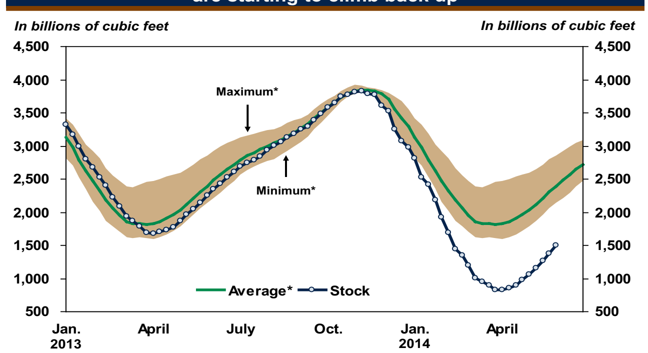
Sources: Datastream, Natural Resources Canada and Desjardins, Economic Studies

Graph 7 – Taxes on gasoline have increased nearly 10¢ per litre since the end of the 2000s



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

Graph 8 – After a spectacular plunge, natural gas inventories are starting to climb back up



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

[1] Desjardins, Economic Studies, *Economic Viewpoint*, "Several factors behind Quebec's high gas prices", May 7, 2014, www.desjardins.com/ressources/pdf/pv140507-e.pdf?resVer=1399474056000.

BASE METALS

A few encouraging developments

After a difficult start to the year, industrial metal prices have risen in recent weeks. The LME (London Metal Exchange) index of base metal prices has edged up from less than 2,950 in the middle of March to around 3,120. This is a limited increase, however, as the LME index is still slightly below the already weak level where it stood at the beginning of 2014 (graph 9). On the supply side of things, the halt in mineral exports by Indonesia is still providing major support for industrial metal prices, especially for nickel. Hopes of accelerating activity in the major economies after a difficult start to the year (especially in the United States and China) also point towards stronger demand for base metals. The increase in the purchasing managers' indexes for the month of May, for instance, heralds more robust activity (graph 10). However, concerns about the fragility of the shadow banking lending sector in China are limiting the appreciation of metal prices.

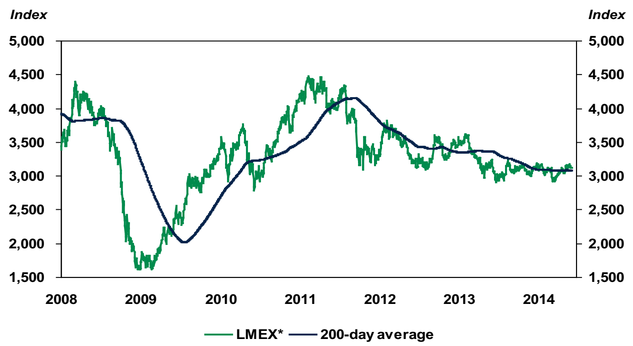
ALUMINUM

- The price of aluminum has kept on climbing in recent weeks, returning to around US$1,885 per tonne, a gain of 15% from the lows reached last February (graph 11). The halt in bauxite exports by Indonesia, which accounts for a little over 10% of global production of that mineral, could affect aluminum production in China and thus help bring the global market back to a balanced state. The decline in aluminum stocks evaluated by the LME is also to this metal's advantage. The premium that large consumers pay to have immediate access to aluminum is still very high. We should point out that the giant Rusal has succeeded in obtaining an injunction to temporarily prevent the LME from adopting its new rules that would force those holding stockpiles of aluminum to make their stocks available more quickly.

COPPER

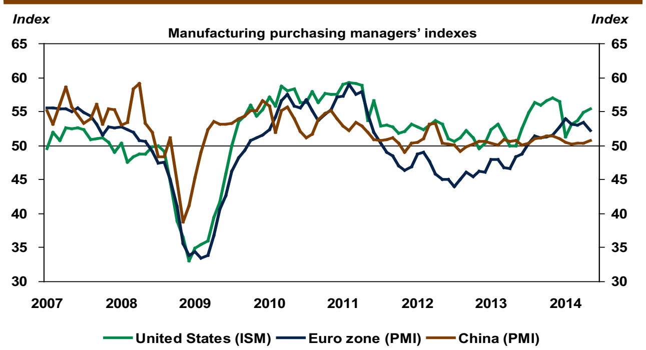
- Despite a slight uptick, copper prices are still relatively low: near US$6,700 per tonne, having fallen by more than 9% since the beginning of 2014 (graph 12 on page 5). The decline in copper stocks assessed by the LME has continued; they have now dropped by more than 50% since the start of the year. Two factors are currently limiting the appreciation of copper prices. First: the perception that the global market is back to a surplus position, after several years of deficit. Second: the risk of the substantial stockpiles of copper that are held in China for financial purposes landing back on the market if the government attacks the shadow banking phenomenon. Accordingly, the announcement that the Chinese government was carrying out an investigation into the use of copper as collateral in financial transactions drove down the price of this metal at the beginning of June.

Graph 9 – Industrial metal prices are still low



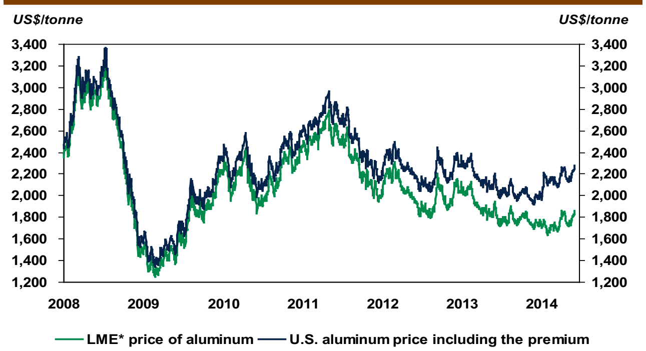
* London Metal Exchange base metals price index.
Sources: Datastream and Desjardins, Economic Studies

Graph 10 – The manufacturing sector appears to be picking up a bit of steam



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

Graph 11 – Price of aluminum



* London Metal Exchange.
Sources: Bloomberg and Desjardins, Economic Studies

NICKEL

- The rally in the price of nickel accelerated at the beginning of the spring; it even soared briefly above US$20,000 per tonne in the middle of May (graph 13). Since then, the price has dropped back to around US$19,000 per tonne, but the increase since the beginning of 2014 still exceeds 35%. This spectacular rebound in prices is mainly due to the decision by Indonesia, the world's leading producer of nickel ore, to halt its exports of unrefined minerals. Indonesia's goal is to encourage the refining of metal in its own territory, and, in fact, nickel refinery projects are currently under development. For the time being, the mineral is not being used, however, which is causing a tightening of the global nickel market. Nevertheless, the stocks of nickel evaluated by the LME have kept expanding since the beginning of 2014.

ZINC

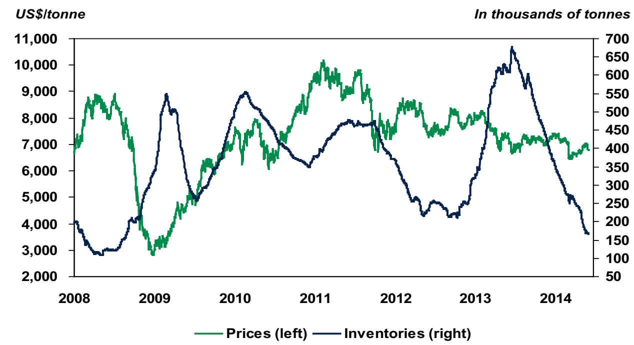
- The price of zinc has edged up slightly, approaching US$2,100 per tonne; this represents a gain of about 2% since the beginning of 2014. According to the LME, zinc stocks have shrunk by around 25% since the beginning of the year, but are still high from a historical perspective (graph 14). As in the case of aluminum, those holding stockpiles of zinc are accused of artificially restricting access to the metal, forcing consumers who want access to it quickly to pay a significant premium.

STEEL

- To no one's surprise, the period of spectacular gains in the price of steel has given way to a period of consolidation, at around US$390 per tonne. The latest forecasts by the World Steel Association are calling for 3.1% growth in global demand for steel in 2014, after a 3.6% increase in 2013. After dipping by 0.3% in 2013, demand from the developed countries should grow by 2.5% in 2014. Demand growth in the emerging countries will slow, however, from 5.1% in 2013 to 3.2% this year, as demand from China is likely to grow at half its 2013 pace.

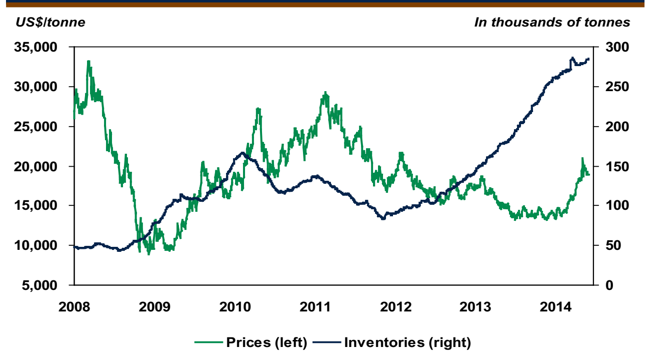
Forecasts: The recent upwards trend in industrial metal prices could well continue in the coming quarters, since we are counting on an acceleration in the global economy. The main risk facing metal prices is still a further slowdown in the Chinese economy, but any correction would probably be limited, since the prices of most of the industrial metals are already low.

Graph 12 – Copper prices and inventories



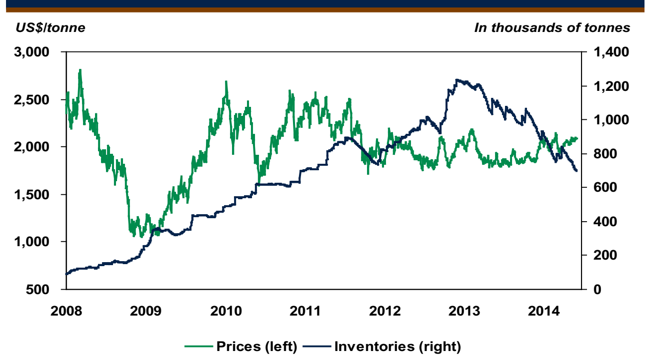
Sources: Datastream and Desjardins, Economic Studies

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

New downwards pressure on the price of gold

After a good start to the year, the prices of gold and silver recently resumed a downwards trend (graph 15). This mainly seems to reflect subsiding worries on the part of investors. On the other hand, the prices of platinum and palladium are doing better.

GOLD AND SILVER

- After surpassing US$1,375 per ounce in the middle of March, the price of gold quickly fell back to around US$1,300. It should be noted that investor worries about a possible financial crisis arising from the emerging countries, or a conflict between Russia and the West, have subsided considerably in recent months, putting safe havens at a disadvantage. Indeed, many analysts perceive the weakness of the VIX index (which measures the implicit volatility of the U.S. stock market) as a sign of complacency by investors (graph 16). The recent appreciation of the U.S. dollar has also adversely affected the prices of gold and silver. Renewed optimism in Ukraine after the presidential election, and signs of flagging Chinese demand for gold, have even driven the price of gold below US$1,250 per ounce in the past few days. The price of silver has followed a similar trend and has now pulled back by around 2.5% from where it stood at the beginning of 2014.

PLATINUM AND PALLADIUM

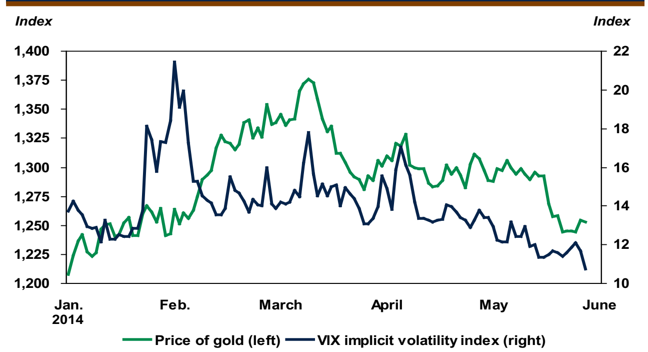
- Despite less favourable conditions for safe havens, the prices of platinum and palladium have kept rising and now show gains of 7% and 17%, respectively, since the beginning of 2014. As a result, the ratio between the price of platinum and that of gold has grown substantially (graph 17). Signs of acceleration in the global economy point towards stronger demand for platinum and palladium. Given that doubts persist regarding supplies from Russia and South Africa, risks of shortages of these two metals are not negligible.

Forecasts: The recent pullback in the price of gold is not surprising, considering that the economic and financial environment is less favourable for safe havens. In a way, it is reassuring to see gold beginning to play its safe haven role more effectively again. Our base scenario, which calls for an acceleration in the advanced economies and rising bond yields, does not play to gold's advantage. This asset could serve as an insurance policy for investors who apprehend new instances of turbulence in the markets, however.

Graph 15 – Gold and silver prices

Sources: Datastream and Desjardins, Economic Studies

Graph 16 – Subsiding investor worries are adversely affecting gold



Sources: Datastream and Desjardins, Economic Studies

Graph 17 – Platinum is gaining versus gold

Sources: Datastream and Desjardins, Economic Studies

OTHER COMMODITIES

Moderation in grain prices, but concern regarding other farm commodities

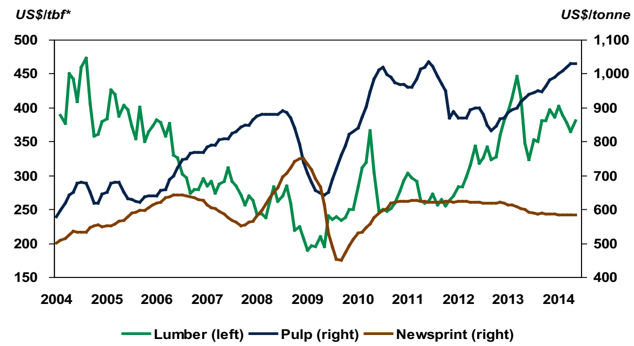
FOREST PRODUCTS

- After falling to US$362 per thousand board feet in mid-April, the price of lumber has started to rally, recently surpassing US$380 (graph 18). Signs of acceleration in the U.S. economy after a very severe winter are contributing to this upturn. Some concerns persist about the strength of the housing sector in the United States, but the rebound in housing starts in April provides reassurance about demand for lumber. After a period of growth, the price of pulp has stabilized since the end of April, but it is up by around 10% over the past year, similar to the increase in the price of lumber. As for paper, its price has remained very stable since the beginning of 2014 and is down by slightly more than 2% compared with the same period last year.

AGRICULTURAL COMMODITIES

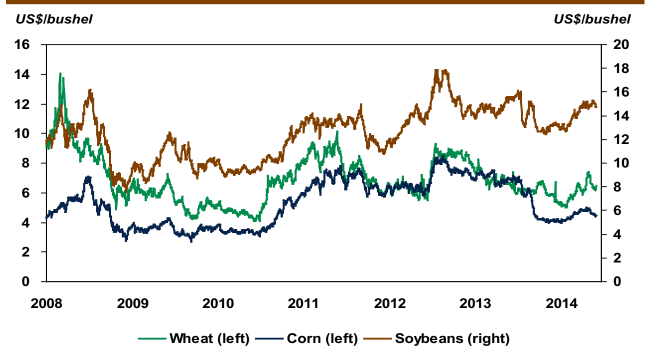
- As expected, the strong rally in grain prices at the beginning of the year has been followed by a correction (graph 19). The confirmation that the troubles in Ukraine have little impact on the global grain market contributed to this decline, especially where wheat is concerned. The return of milder weather and a good start to the sowing season also did damage to grain prices. Moreover, the initial estimates by the U.S. Department of Agriculture for 2014–2015 harvests suggest another increase in global inventories of wheat, corn and soybeans.
- Even though the particularly severe winter conditions affected the U.S. harvest of winter wheat, the price of that grain has tumbled by around 15% since the beginning of May, returning to the neighbourhood of US$6.25 per bushel. Competition from Eastern European wheat contributed to this decline. The price of corn has fallen by nearly 10%, reflecting the favourable outlooks for the U.S. harvest. The price of soybeans has remained very high, however, near US$15 per bushel.
- **While there are no signs of a grain shortage or spike in prices, there is far more concern about other farm commodities that are affected by the serious drought in the Southwest United States.** Prices of many vegetables produced in California are up significantly, and this trend could continue. This drought, also affecting Texas and other states, is also amplifying the upwards pressure on beef prices, while the price of pork is being inflated by the porcine epidemic diarrhea. All of these factors generate a significant increase in food prices (graph 20).

Graph 18 – Prices of forest products



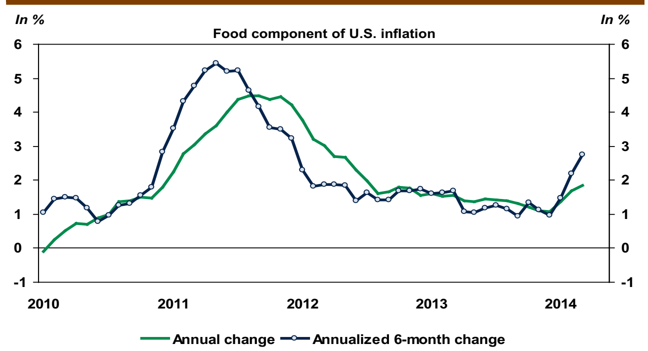
* Thousands of board feet.
Sources: Datastream and Desjardins, Economic Studies

Graph 19 – Grain prices



Sources: Datastream and Desjardins, Economic Studies

Graph 20 – Food costs are starting to accelerate again



Sources: Bureau of Labor Statistics and Desjardins, Economic Studies

Table 1
Commodities

	Spot price	Percentage return since				Last 52 weeks		
	June 9	1 month	3 months	6 months	1 year	High	Average	Low
Index								
Reuter-CRB[1] (CCI[2])	546.9	-1.8	-3.3	7.3	2.8	569.6	528.0	500.4
Reuters/Jefferies CRB[1]	306.2	0.5	-0.3	9.8	6.4	312.2	290.2	272.3
Dow Jones AIG[3]	133.8	-1.4	-1.7	6.2	1.9	138.7	129.6	122.0
Bank of Canada	667.8	0.5	-0.8	11.0	5.9	675.9	644.8	584.7
Energy								
Brent oil (US$/barrel)	110.3	2.0	1.2	0.2	5.7	117.3	108.9	100.1
WTI[4] oil (US$/barrel)	105.1	4.8	2.2	8.2	9.3	110.6	100.7	91.4
Gasoline (US$/gallon)	3.67	-0.3	5.6	12.4	0.8	3.71	3.48	3.19
Natural gas (US$/MMBTU[5])	4.66	2.0	-2.3	10.7	23.0	7.92	4.23	3.27
Base metals								
LMEX[6]	3,120	0.9	3.1	1.2	-1.1	3,226	3,079	2,911
Aluminium (US$/tonne)	1,886	9.8	9.4	7.9	-0.9	1,903	1,763	1,634
Copper (US$/tonne)	6,689	-1.6	-1.7	-6.3	-7.1	7,406	7,026	6,439
Nickel (US$/tonne)	18,831	-5.3	23.4	35.5	25.7	20,955	14,983	13,216
Zinc (US$/tonne)	2,127	4.8	2.1	11.0	13.8	2,147	1,948	1,788
Steel (US$/tonne)	390.0	1.0	5.4	52.9	174.6	396.0	267.6	99.3
Precious metals								
Gold (US$/ounce)	1,254	-2.7	-6.1	1.4	-9.2	1,418	1,298	1,196
Silver (US$/ounce)	19.1	-0.7	-10.6	-2.0	-15.4	24.7	20.6	18.6
Platinum (US$/ounce)	1,449	1.4	-1.7	5.5	-3.7	1,546	1,428	1,317
Palladium (US$/ounce)	844.0	5.0	8.8	14.2	11.9	844.0	744.3	643.0
Other commodities								
Lumber (US$/tbf[7])	375.0	-0.3	-3.4	-3.4	10.3	404.0	373.2	322.0
Pulp (US$/tonne)	1,030	0.0	2.0	4.8	10.8	1,030	982.6	930.0
Newsprint (US$/tonne)	584.0	-0.0	-0.0	-0.2	-2.6	599.6	586.9	583.0
Wheat (US$/bushel)	6.43	-9.2	8.2	10.3	-1.3	7.42	6.08	4.98
Corn (US$/bushel)	4.42	-9.5	-4.8	5.2	-36.6	7.18	4.90	3.98
Soybean (US$/bushel)	14.64	-1.8	1.1	9.5	-5.8	16.10	13.98	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$/barrel)	94	98	Target: 100 (range: 95 to 105)	Target: 102 (range: 92 to 112)
Natural gas Henry Hub (US$/MMBTU**)	2.76	3.73	Target: 4.50 (range: 4.00 to 5.00	Target: 4.00 (range: 3.25 to 5.00)
Gold (US$/ounce)	1,669	1,411	Target: 1,250 (range: 1,200 to 1,350)	Target: 1,150 (range: 1000 to 1,250)
LMEX*** index—base metals	3,416	3,183	Target: 3,225 (range: 2,900 to 3,450)	Target: 3,800 (range: 3,400 to 4,200)

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