Commodity Trends

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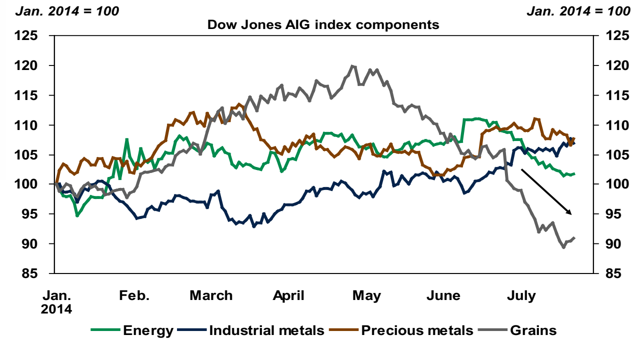
Some encouraging signs for commodity demand

The main commodity price indexes have pulled back around 3% since the end of May. These drops do not reflect a widespread retreat in resource prices, but rather a correction in natural gas and grain prices, as the latest developments confirm that the fears of a shortage that had appeared earlier in the year are no longer justified (graph 1).

While oil prices were volatile, reflecting the evolving situations in Iraq and Ukraine, among other things, it is encouraging to note that the recent uptrend in metal prices has continued and even accelerated over the last few weeks. Further signs that China's economy will avoid an overly steep economic slowdown and U.S. data signalling that activity there is accelerating after a very disappointing start to the year seem to finally have convinced investors to bet on stronger demand for industrial commodities.

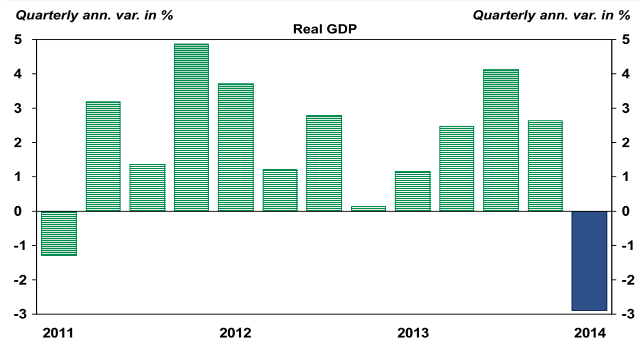
It may seem strange to see metal prices climbing at a time when all the experts are downgrading their global growth forecasts for 2014. However, weaker growth this year stems primarily from the retreat by U.S. activity in the first quarter (graph 2), a phenomenon that will not affect demand for ressources as of now. In this context, we continue to think that commodities will do well in the coming quarters.

Graph 1 – The commodities that had appreciated sharply at the start of the year have done less well recently



Sources: Datastream and Desjardins, Economic Studies

Graph 2 – Winter was even harder on the U.S. economy than previously estimated



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.

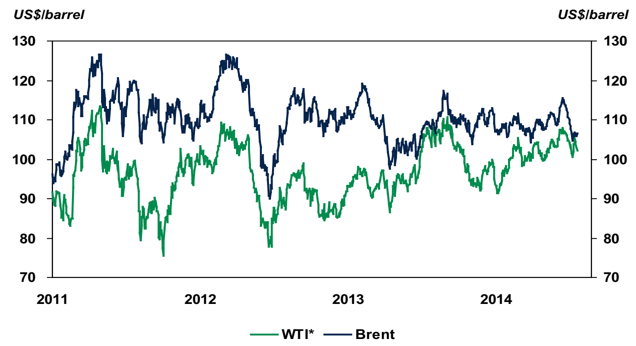
ENERGY

Geopolitical strains have a limited effect

OIL

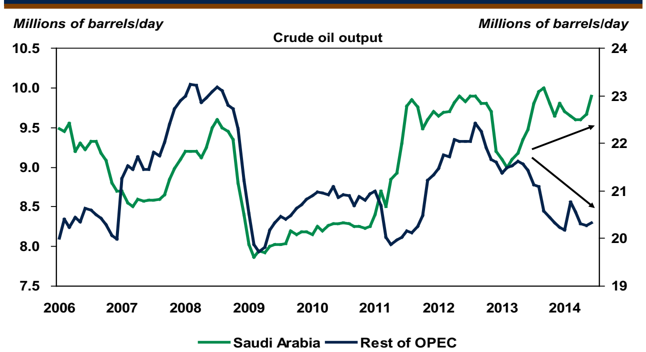
- After showing surprising resilience early in the year, oil prices jumped in mid-June when the situation in Iraq took a worrisome turn. WTI (West Texas Intermediate) prices reached US$108 per barrel, while Brent prices climbed above US$115 per barrel, their highest point since last September (graph 3). Unlike what we could have feared, this spike did not last, and oil prices have descended again in recent weeks, going just under where they were in late May, despite new concerning developments in Ukraine and the Middle East. Beyond these fluctuations, oil prices remain fairly high. In Canada, Western Canada Select prices are holding near US$80 per barrel, high enough to stimulate investment in the oil sector.
- The sudden takeover of a large part of Iraq by the Sunni insurgent group ISIS sent shock waves into the global oil market in mid-June. The insurgents' progress, however, took place in Sunni regions that were hostile to Prime Minister Nouri al-Maliki's Shiite government. It quickly became apparent that most oil plants, concentrated in the northern area under Kurdish control and, more importantly, in the southern, Shiite region of Iraq, were in no immediate danger. All the same, ongoing heightened instability in Iraq will have some impact on oil production, and the U.S. Department of Energy has lowered Iraq's crude production forecast for 2014 and 2015 by 0.3 MMb/d (million barrels per day).
- The problems in Iraq come on top of the ever-present conflicts in Syria, Libya and Nigeria. What's more, negotiations over Iran's nuclear program are stumbling and it is unlikely that Iranian oil will return to the market anytime soon. In this context, total production by OPEC (Organization of Petroleum Exporting Countries) has dropped in recent quarters. This decrease would have been twice as big if not for Saudi Arabia, which took production up to nearly 10 MMb/d in June (graph 4). As for Russia, a decline in oil exports remains highly unlikely, despite rising tensions following the Malaysia Airlines tragedy.
- Fortunately, the troubles in several OPEC countries are occurring when demand for their oil has fallen, given the surge in North American production. In its new medium-term forecast, the International Energy Agency (IEA) has again upgraded its expectations for oil production from non-OPEC nations. Despite stronger forecasted demand, it estimates that practically stable OPEC production, at around 30–31 MMb/d, will be enough to meet global demand from now until 2019 (graph 5). A sentence in the report also merits highlighting: "It is hard to overstate the degree to which the North American supply boom has, since its onset, consistently defied expectations."

Graph 3 – Oil prices



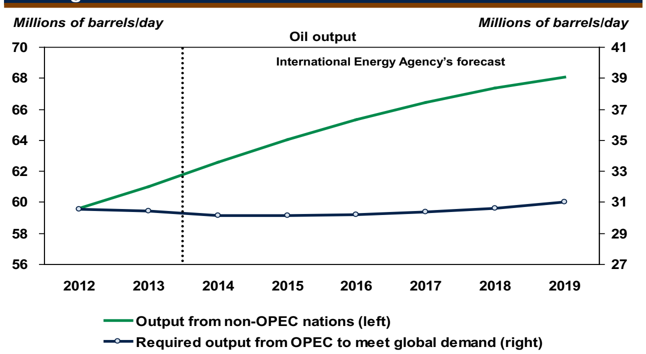
* West Texas Intermediate.
Sources: Datastream and Desjardins, Economic Studies

Graph 4 – Saudi Arabia partially offsets the drop in output of other OPEC* nations



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

Graph 5 – Increased output from non-OPEC* nations will be enough to meet increased demand for oil between now and 2019



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

GASOLINE

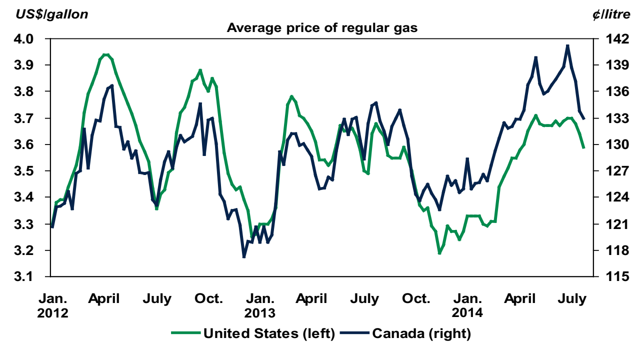
- After a difficult start to the year, North American drivers are finally getting a small break. Spring ended on a worrisome note, when the surge in crude prices following the conflict in Iraq took average regular gas prices to US$3.70 per gallon in the United States and over C$1.40 per litre in Canada. The subsequent drop in crude prices and more favourable seasonal factors, as refinery margins fell after increasing last spring, have since brought gas to around US$3.55 per gallon in the United States and C$1.33 per litre in Canada. Nothing points to any considerable changes in gas prices over the coming weeks.

NATURAL GAS

- After remaining high throughout the first half of 2014, North American natural gas prices slid dramatically over the last few weeks, falling from US$4.70 per MMBTU (Million British Thermal Unit) in mid-June to around US$3.80 per MMBTU, more than 10% lower than in late 2013 (graph 7). Prices are even lower in the eastern United States, where the surge in unconventional production continues. The recent drop mainly reflects soft gas demand, as the unusually cool summer and gas prices that were not as competitive as coal prices limit electricity producers' use of gas. This is causing natural gas inventories to climb even faster than expected (graph 8) after their spectacular retreat during the especially cold 2013–2014 winter.

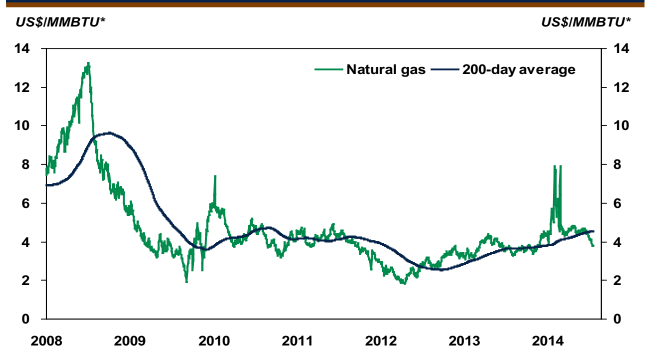
Forecasts: Despite the many conflicts in OPEC nations, the global oil market remains well supplied. In this context, the risks of a surge in crude prices remain relatively low. All the same, the enduring geopolitical strains will offer some support, which should help WTI prices hold near US$100 per barrel. The faster-than-expected replenishment of natural gas inventories confirms that it is difficult for gas price to stay well above US$4 per MMBTU. We are trimming our forecast slightly for average natural gas prices this year, to US$4.35 per MMBTU, and are keeping our 2015 target at US$4.

Graph 6 – Slight break for drivers



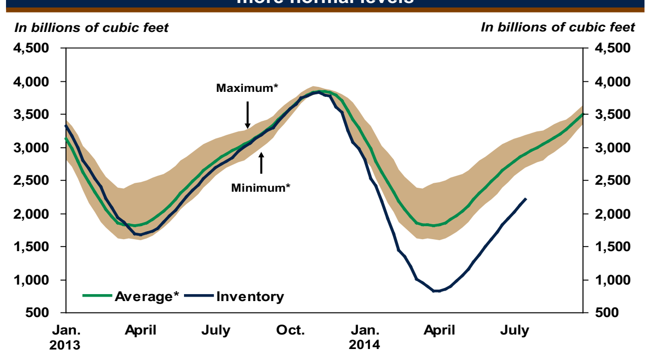
Sources: Datastream, Natural Resources Canada and Desjardins, Economic Studies

Graph 7 – Natural gas prices



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

Graph 8 – Natural gas inventories are climbing rapidly toward more normal levels



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

BASE METALS

Widespread climb in prices

The recent uptrend for industrial metal prices continued over the last few weeks, bringing the London Metal Exchange Index (LME) for base metals to around 3,300, about 4% higher than it was at the end of 2013 (graph 9).

The initial rebound in industrial metal prices chiefly reflected Indonesia's decision to stop exporting unprocessed ore. More recently, prices are being supported by the hope that demand for metals will accelerate, as the economic forecasts seem more positive for the major economies. China's economy, whose importance to the base metal sector cannot be overstated, accelerated in the second quarter of 2014 (graph 10) and rising purchasing manager indexes augurs well for the future. The much stronger U.S. economy in the coming quarters should also lead to higher demand for metals. These more favourable outlooks seem to be attracting investors once more; according to Bloomberg, demand for industrial metal exchange-traded funds has not been this strong since 2009.

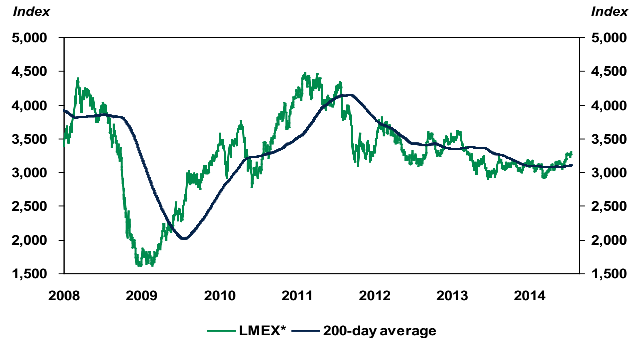
ALUMINUM

- Aluminum is one of the better-performing commodities right now. Prices for this metal have grown about 10% since the end of May, nearing US$2,000 per tonne, a peak since February 2013 (graph 11). Several major alumunium producers have decreased their production capacity over the last few quarters. As the considerable aluminum stocks remain difficult to access, an acceleration of the already relatively lively demand could keep upside pressure on prices for this metal. In the past, aluminum plant closures were more than offset by the spectacular increase in China's production capacities. Indonesia's decision to halt bauxite exports and increased efforts to control pollution could now slow expansion in Chinese production, however.

COPPER

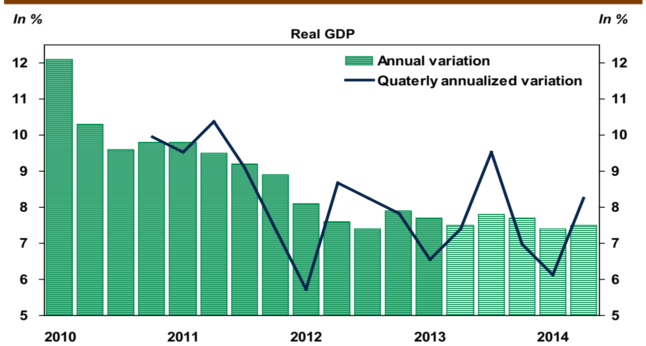
- Copper prices ticked up over the last few weeks, moving just above US$7,000 per tonne. However, they remain nearly 5% lower than where they were at the start of 2014, despite the dramatic decrease in copper inventories recorded by the LME (graph 12 on page 5). Uncertainty over the future of China's sizable inventories held for financial reasons continues to hurt copper prices and could have played a role in the recent slide in Chinese imports of this metal. In terms of supply and demand, the most recent news bodes well for copper price increases, as the International Copper Study Group estimates that global copper consumption substantially outpaced production in the first four months of 2014.

Graph 9 – Industrial metal prices seem to be starting an uptrend



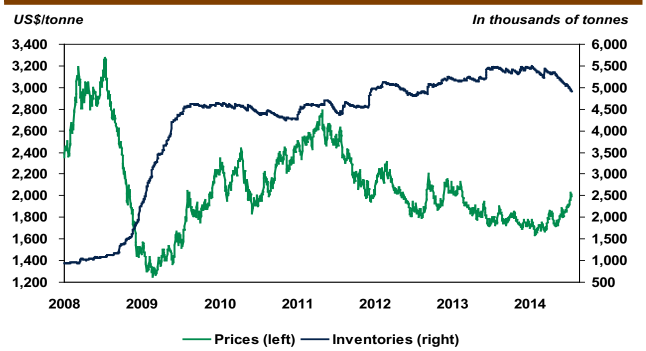
* London Metal Exchange base metal price index.
Sources: Datastream and Desjardins, Economic Studies

Graph 10 – China's economy accelerated in Q2 2014



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

Graph 11 – Aluminum prices and inventories



Sources: Datastream and Desjardins, Economic Studies

NICKEL

- Nickel prices have not risen much in recent weeks, instead staying near US$19,000 per tonne (graph 13). It is not surprising to see some consolidation in nickel prices, given their marked increase at the start of the year. This metal is up by more than 35% since the start of 2014. This performance may seem surprising, since nickel stocks recorded by the LME have jumped nearly 20% since the beginning of the year. However, most analysts predict that Indonesia's suspension of ore exports will take the global market into a deficit situation over the coming quarters.

ZINC

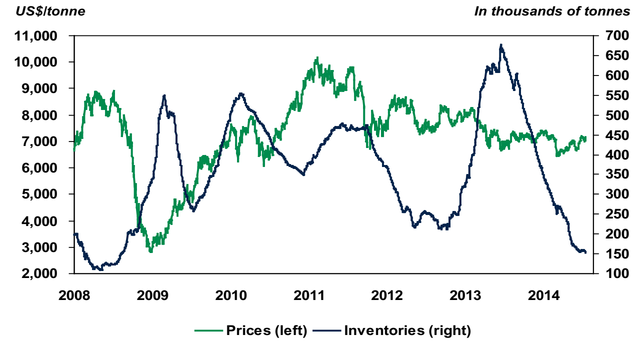
- Zinc prices have fared even better than aluminum recently, gaining nearly 15% since late May and nearing US$2,400 per tonne, their highest point since summer 2011. They also have risen more than 15% since the start of 2014, while inventories of this metal as recorded by the LME have dropped by around 30% (graph 14). Inventories could continue to slide over the coming quarters.

STEEL

- After consolidating for a while, steel prices recorded by the LME resumed their uptrend, hitting US$416 per tonne, a peak since spring 2012. These gains seem to largely reflect improved global economic outlooks, especially for China.

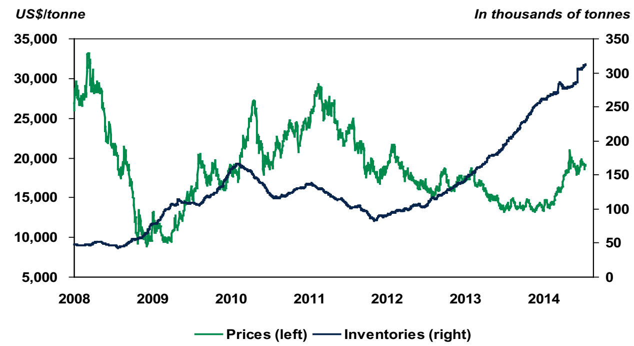
Forecasts: Industrial metal prices should continue to trend up in the coming quarters, reflecting the acceleration of economic activity in several major economies. The fundamental conditions, however, do not justify a price explosion, as risks of a metal shortage remain low for the next few years. All the same, surging speculative demand could lead to a faster price climb than we currently anticipate.

Graph 12 – Copper prices and inventories



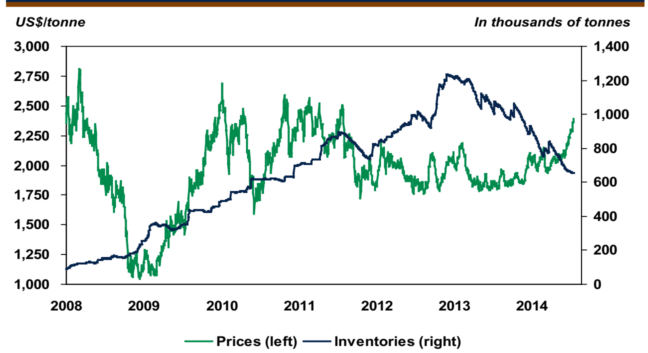
Sources: Datastream and Desjardins, Economic Studies

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

International tensions have not helped gold much

Gold prices have shown no clear trend in recent months, despite heightened international tensions. Their performance in the first half of 2014 remains impressive all the same, though the coming months could be more difficult.

GOLD AND SILVER

- After falling to below US$1,250 per ounce in early June, gold prices resumed their uptrend, boosted by the conflict in Iraq, among other things, to end the first half of the year just above US$1,300 per ounce. Increased tension in Ukraine and Israel even brought prices above US$1,330 per ounce in the first weeks of July, but these gains were not sustainable and gold prices moved back toward US$1,300 per ounce (graph 15). Statistics showing that China's demand for gold retreated 19% in the first half of 2014 may have limit gains of the yellow metal. Contrary to what many predicted, gold prices did have a good first half of 2014 and are still up around 9% from where they were at the end of 2013. In our opinion, this good performance is supported, among other things, by the surprise retreat in bond yields (graph 16), which could reverse in the second half of the year, as the Federal Reserve plans to end its third quantitative easing program after its October meeting. The recent climb in precious metal prices was more pronounced for silver, which is back near US$21 per ounce.

PLATINUM AND PALLADIUM

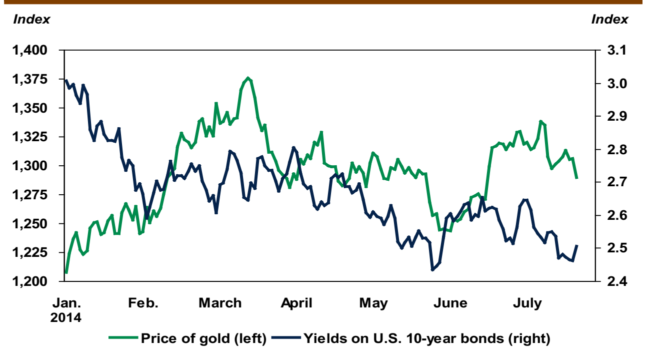
- Platinum prices have advanced about 2% since the end of May and are now posting gains of nearly 10% since the start of 2014. Palladium prices are still rising after their considerable gains during the first months of the year. The major strikes in South Africa, which limited output of these two metals, have recently ended, but strong demand from the automotive industry should continue to support platinum and palladium prices.

Forecasts: In the short term, gold prices could still benefit from the many geopolitical risks. However, the accelerating global economy and expected climb in bond yields lead us to expect that the prices of the yellow metal will pull back in the coming quarters.

Graph 15 – Gold and silver prices

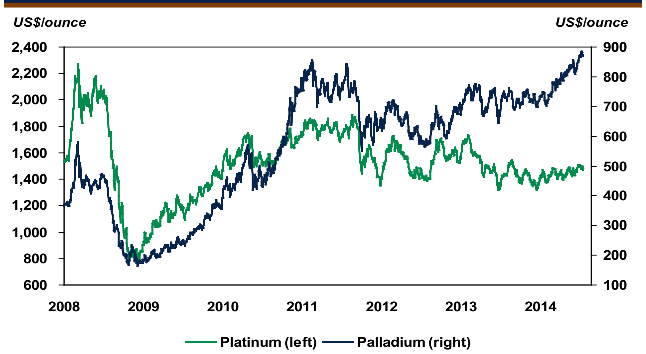
Sources: Datastream and Desjardins, Economic Studies

Graph 16 – The slide in bond yields favoured gold in the first half of 2014



Sources: Datastream and Desjardins, Economic Studies

Graph 17 – Platinum and palladium prices



Sources: Datastream and Desjardins, Economic Studies

OTHER COMMODITIES

A confirmed bounty of grains

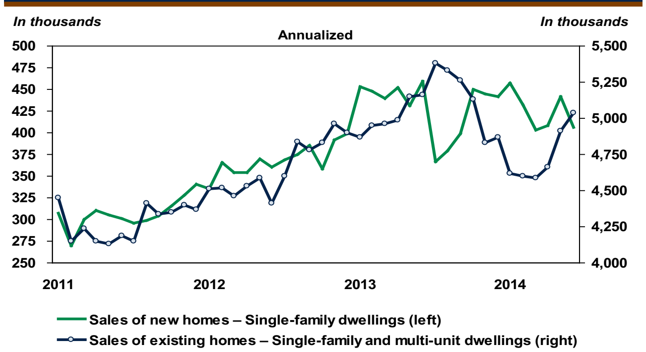
FOREST PRODUCTS

- As a whole, forest product prices have not moved much in the last few weeks. North American reference prices for pulp and paper have been practically the same since the end of April. Lumber prices fell close to US$370 per thousand board feet in mid-June, but have recently climbed to just above US$380. Note that the U.S. housing market seems to be doing better after a worrisome slide at the start of the year. It isn't perfect, as June's housing starts were disappointing, but **accelerating home sales (graph 18) and rising homebuilder confidence allow us to expect activity to pick up somewhat in the residential construction sector**.

AGRICULTURAL COMMODITIES

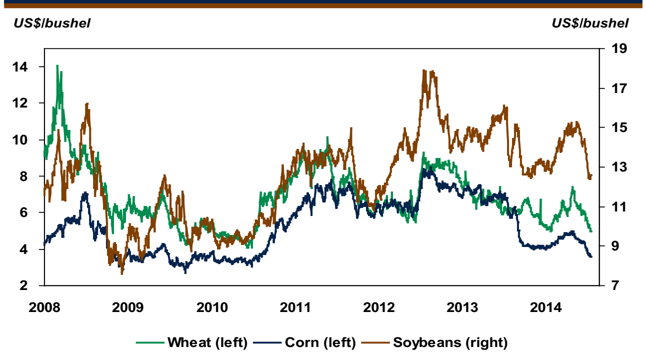
- The price correction for major grains, which began this spring, has continued over recent weeks (graph 19) as the weather seems favourable for harvests, especially in the United States. If the very harsh winter had little effect on harvests, ongoing good weather this summer could lead to a substantial rise in inventories (graph 20).
- U.S. weather is particularly important for corn, as U.S. farmers are responsible for about 35% of the world's production of this grain. The U.S. Department of Agriculture (USDA) recently estimated that 76% of corn plants were in good or excellent condition, the highest percentage for this time of the year since 2004. The high yield by U.S. fields should therefore make up for the fact that the area seeded with corn is smaller than last year. Corn prices have dropped around 20% since mid-May, hitting US$3.58 per bushel, its lowest point since summer 2010.
- The very favourable conditions for harvests are also dragging down wheat and soybean prices, which have fallen about 16% since the end of May. Note that the weather worldwide has also been generally good, including in Europe. Unfortunately, Canada is one exception, as torrential rains out west have negatively impacted harvests. For soybeans, the USDA estimates that the conditions for U.S. crop are the best in the last 20 years, in addition to the more than 10% increase in the area used for this crop. Everything suggests that grain prices will remain weak over the coming months, with other drops a possibility if the weather stays favourable.

Graph 18 – The U.S. housing market is doing better



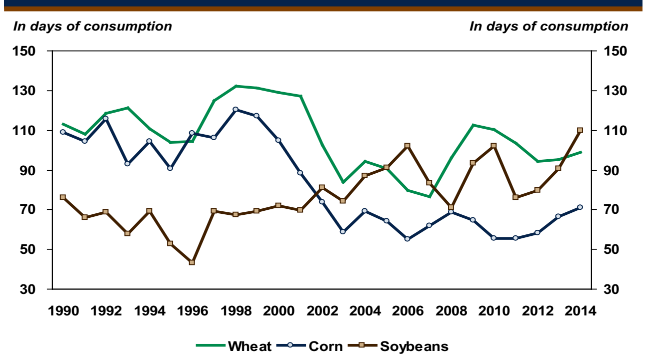
Sources: U.S. Census Bureau, National Association of Realtors and Desjardins, Economic Studies

Graph 19 – Grain prices



Sources: Datastream and Desjardins, Economic Studies

Graph 20 – Global grain inventories will continue to climb in 2014



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

Table 1
Commodities

	Spot price	Percentage return since				Last 52 weeks		
	July 25	1 month	3 months	6 months	1 year	High	Average	Low
Index								
Reuter-CRB[1] (CCI[2])	526.2	-4.8	-7.2	2.1	2.3	569.6	531.3	502.4
Reuters/Jefferies CRB[1]	298.3	-4.6	-4.0	5.6	4.0	312.9	292.9	272.3
Dow Jones AIG[3]	129.3	-5.4	-6.3	1.8	1.2	138.7	130.2	122.0
Bank of Canada	658.8	-3.6	-1.8	4.5	-1.4	683.4	646.4	582.0
Energy								
Brent oil (US$/barrel)	106.4	-6.6	-2.7	-1.7	-1.7	117.3	109.5	103.8
WTI[4] oil (US$/barrel)	102.1	-4.6	1.2	5.6	-3.2	110.6	101.3	91.4
Gasoline (US$/gallon)	3.59	-3.0	-2.4	8.0	-2.4	3.71	3.49	3.19
Natural gas (US$/MMBTU[5])	3.79	-17.1	-19.4	-27.0	3.0	7.92	4.30	3.27
Base metals								
LMEX[6]	3,299	3.9	5.9	6.2	8.8	3,316	3,105	2,920
Aluminium (US$/tonne)	1,980	6.1	9.1	15.2	11.3	2,025	1,778	1,634
Copper (US$/tonne)	7,137	2.9	5.2	-1.0	2.0	7,406	7,035	6,439
Nickel (US$/tonne)	19,143	3.5	4.0	32.6	35.8	20,955	15,630	13,216
Zinc (US$/tonne)	2,393	10.0	16.6	19.3	29.8	2,393	1,999	1,798
Steel (US$/tonne)	416.5	6.8	7.6	15.7	226.7	416.5	302.4	122.8
Precious metals								
Gold (US$/ounce)	1,299	-1.5	-0.2	2.5	-2.1	1,418	1,298	1,196
Silver (US$/ounce)	20.5	-1.5	4.1	1.3	2.7	24.7	20.6	18.8
Platinum (US$/ounce)	1,473	1.0	3.9	2.1	2.1	1,546	1,438	1,321
Palladium (US$/ounce)	876.0	6.1	8.8	17.6	17.9	886.0	763.0	689.0
Other commodities								
Lumber (US$/tbf[7])	384.0	2.9	5.2	-5.0	11.0	404.0	379.0	346.0
Pulp (US$/tonne)	1,030	0.0	0.0	2.7	8.8	1,030	994.1	946.2
Newsprint (US$/tonne)	583.0	0.0	0.0	-0.3	-1.2	590.7	585.7	583.0
Wheat (US$/bushel)	5.21	-12.2	-20.5	0.8	-11.6	7.42	6.00	4.98
Corn (US$/bushel)	3.58	-17.4	-26.7	-14.3	-41.5	6.31	4.54	3.57
Soybean (US$/bushel)	12.62	-11.4	-15.7	-2.2	-7.9	15.29	13.71	12.41

[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: 4.35 (range: 4.15 to 4.60)	Target: 4.00 (range: 3.25 to 5.00)
Gold (US$/ounce)	1,669	1,411	Target: 1,275 (range: 1,235 to 1,325)	Target: 1,150 (range: 1000 to 1,250)
LMEX*** index—base metals	3,416	3,183	Target: 3,225 (range: 3,000 to 3,350)	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