Commodity Trends

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The greenback's surge and concerns about China hurt

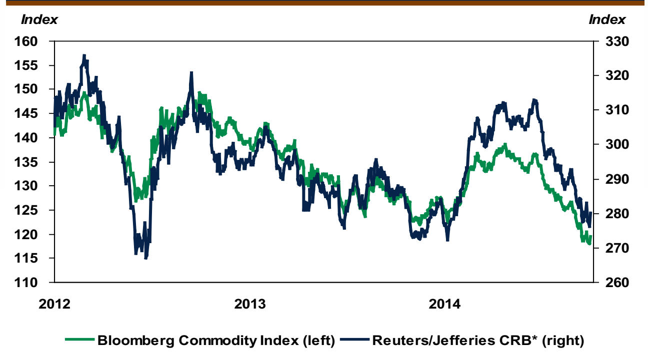
The pullback in commodity prices seen early this summer continued over the last few months and has even broadened. The main commodity indexes are down about 10% since the end of June (graph 1).

Initially, the price retreat chiefly reflected the correction of natural gas and cereal prices. While natural gas prices have stabilized since July, cereal prices have continued to plummet, hitting their lowest points in several years. The surge of the U.S. dollar (graph 2) also put downside pressure on commodity prices[1] , especially precious metals. A steep slide by oil prices, in spite of the geopolitical context, also played a role in the drop of the indexes.

Until the start of September, industrial metal prices had stood up fairly well to the downtrend for other commodity prices, while the release of encouraging economic data in North America offset the greenback's gains. New concerns about China's economy and an additional push by the U.S. dollar, however, have also taken base metal prices down over the last few weeks. Despite this, we continue to expect commodity prices to come back up in the coming quarters, as global economic growth should pick up considerably.

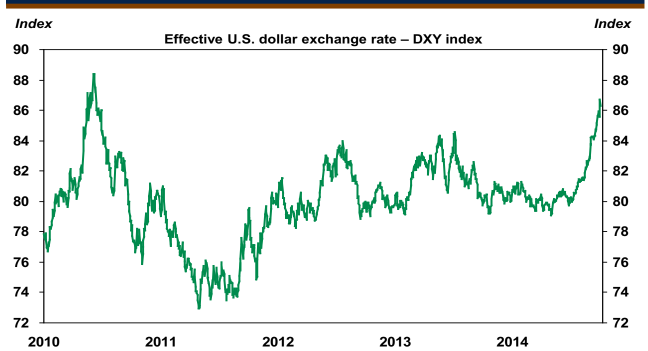
[1] As commodity prices are calculated in U.S. dollars, they tend to move inversely to the U.S. dollar, in order to maintain a similar value in other currencies, among other reasons.

Graph 1 – Commodity prices are back near where they started 2014



* Commodity Research Bureau
Sources: Datastream and Desjardins, Economic Studies

Graph 2 – The U.S. dollar is at its highest since summer 2010



Sources: Bloomberg and Desjardins, Economic Studies

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François Dupuis
Vice-President and Chief Economist

Mathieu D'Anjou, CFA
Senior Economist

François Dupuis
Vice-President and 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.
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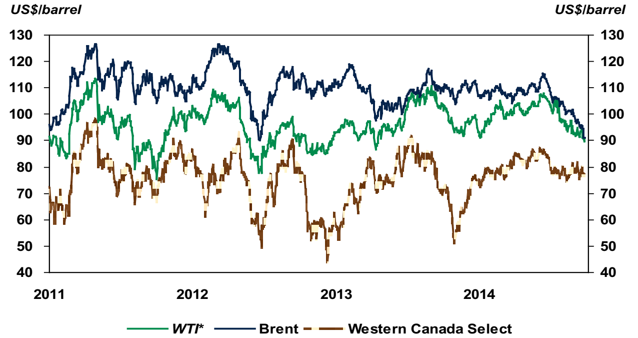
ENERGY

Oil prices should climb back up

OIL

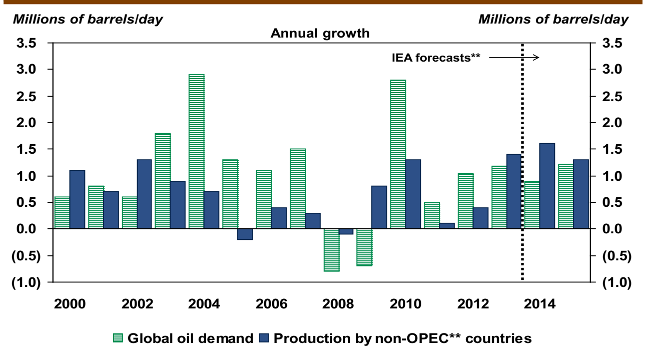
- Oil prices remained oblivious to the geopolitical risks in the Middle East and Eastern Europe, even dropping considerably over the last few months. At around US$100 per barrel in late July, West Texas Intermediate (WTI) prices fell below US$90 per barrel recently. The last few months have been even tougher for Brent prices, which are down about US$13 since the end of July. The spread between Brent and WTI prices has thus narrowed, and is close to the lower levels seen since the end of 2010. As in July, Canadian oil prices were barely affected by this recent downtrend, with Western Canadian Select remaining around US$80 per barrel (graph 3).
- Though supply issues were on everyone's minds earlier this summer, investors are now most worried about weak global oil demand. In September, the International Energy Agency (IEA) substantially downgraded its demand forecasts for 2014 and 2015 (graph 4) following a very soft second quarter and a worse outlook for Europe and China. For the first time in over two years, global demand for oil has posted annual growth of less than 500,000 barrels per day during the spring, a slowdown that the IEA did not hesitate to call remarkable. U.S. demand for oil seems a little stronger, but that is not enough to offset the weakness seen elsewhere around the world.
- Given such subdued demand, the faster-than-anticipated climb by Libya's production (graph 5) destabilized the European oil market, causing Brent prices to fall. As the situation remains very unstable in Libya, it is hard to see which way the country's crude exports will trend. In a context in which global demand is weaker than expected and North American production continues to climb, Saudi Arabia was quick to act. This country had amped up its production considerably in recent quarters to compensate for the problems in other nations also members of the Organization of the Petroleum Exporting Countries (OPEC). The country had hoped to keep oil prices from skyrocketing; something that could have hurt the global economy. Although Saudi Arabia does not want to see runaway oil prices, it does prefer them to be above US$100 per barrel. It has therefore reduced its crude exports considerably to curb the price drop. However, Saudi Arabia also cut its export prices to protect its market share. OPEC is also seriously considering lowering its production quotas, given how soft demand is.

Graph 3 – Oil prices



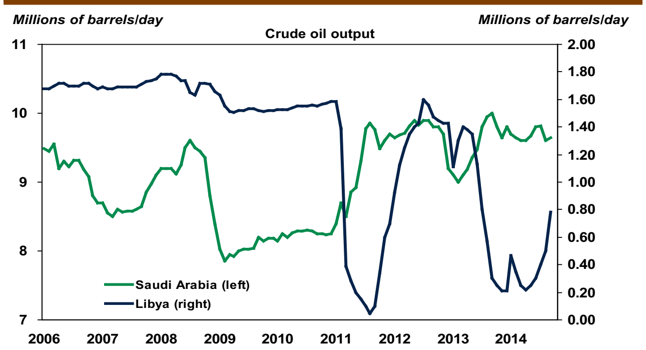
* West Texas Intermediate.
Sources: Datastream, Bloomberg and Desjardins, Economic Studies

Graph 4 – Global oil demand growth will be limited and lower than growth of non-OPEC production



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

Graph 5 – The return of Libyan oil should prompt some moderation of Saudi production



Sources: Bloomberg and Desjardins, Economic Studies

GASOLINE

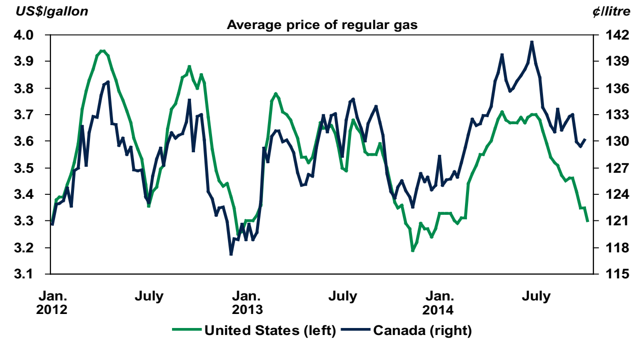
- The drop in oil prices is helping motorists somewhat. In the United States, gas prices continued to trend down, hitting US$3.30 per gallon (graph 6). In Canada, prices were fairly stable in August and early September, but plummeted from mid-September onwards, taking gas below CAN$1.30 per litre. On both sides of the border, gas prices are now at their lowest point since last February. While U.S. gasoline inventories are at normal levels, production has been suspended at several refineries for maintenance purposes; this could now curb the drop by gas prices.

NATURAL GAS

- After diving in late spring and early summer, North American natural gas prices have stabilized, generally fluctuating just below US$4.00 per Million British Thermal Units (MMBTU) since mid-July (graph 7). Although natural gas prices are down 50% from the dizzying heights reached for a few days last February, they are still up nearly 10% from the same period last year. This reflects the fact that natural gas inventories are lower than usual as winter approaches (graph 8), even though they have grown considerably in recent months. This is not a big worry in and of itself, but we cannot rule out another temporary price surge if North America experiences a second unusually cold winter in a row.

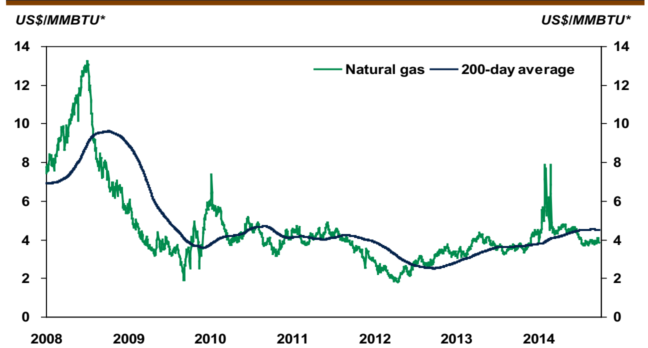
Forecasts: Everything suggests that the global oil market will remain well provisioned over the coming quarters. In the short term, the instability in the Middle East would have to spread to Saudi Arabia before we contemplate a surge in prices. This scenario is unlikely, but could justify the emergence of a geopolitical premium on oil prices. After an especially soft second quarter, global oil demand should pick up in the coming quarters, as the world economy promises to be a little more robust. Already, the most recent statistics on China's oil imports are painting a less negative picture of the country's demand. Saudi Arabia's efforts to rein in the drop of crude prices also points to a slight price increase in the next few months. In the short term, natural gas prices will be highly influenced by North America's winter weather.

Graph 6 – Gas prices continue to pull back



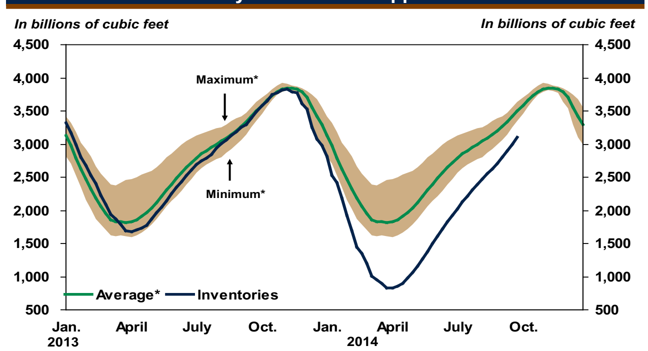
Sources: Datastream, Natural Resources Canada and Desjardins, Economic Studies

Graph 7 – Natural gas prices



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

Graph 8 – Despite an impressive climb, natural gas inventories are relatively low as winter approaches



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

BASE METALS

Chinese demand is worrying

Industrial metals have generally fared better than other commodity prices over the last few months. After hitting 3,300 in late July, the London Metal Exchange (LME) index of base metal prices held close to this number until early September (graph 9), despite the greenback's surge. The release of worrisome figures from China, especially the pronounced slowdown by industrial production in August (graph 10), however, has worn down the resilience of industrial metal prices, and the LME index recently dropped back below 3,100.

A further slowdown of China's economy would certainly hurt base metal prices. Even though some figures have been disappointing recently, we continue to expect China's economy to grow 7.4% this year, and 7.2% in 2015. China's authorities recently announced they were injecting liquidity into the banking system to prevent a deeper economic slowdown. However, massive infrastructure investments, which would be especially beneficial for industrial metals, do not seem to be the avenue preferred by China's leaders for stimulating the economy.

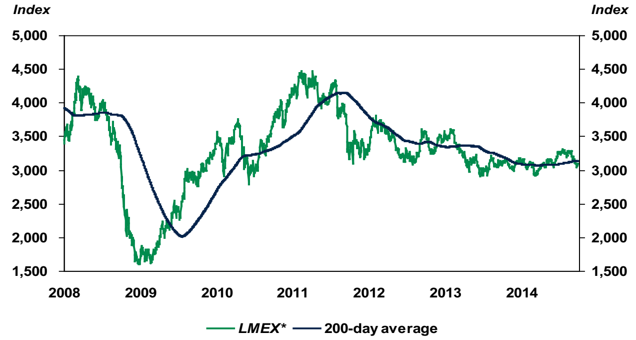
ALUMINUM

- After nearing US$2,100 per tonne at the start of September, aluminum prices fell back under US$1,900 per tonne (graph 11). Despite this slide, aluminum prices are still up over 7% from the beginning of the year. Note that China's aluminum market is relatively self-sufficient. China's aluminum imports are one tenth the volume and less than one thirtieth the value of its copper imports. Elsewhere around the globe, the outlook is fairly positive for aluminum prices, as the faster economic growth in the United States should lead to strong demand for the metal, especially from the automotive sector, and production capacities outside of China have fallen in recent years.

COPPER

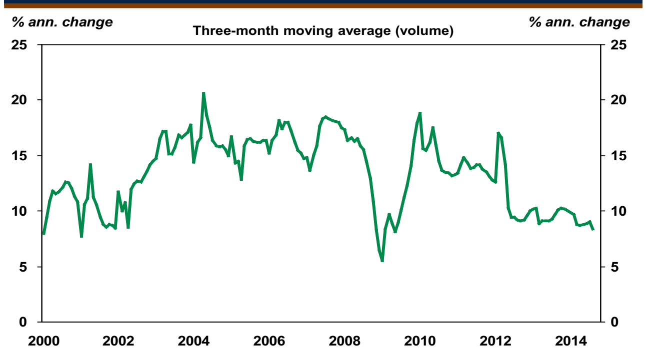
- Copper prices have slid around 5% since late July, falling to around US$6,700 per tonne (graph 12 on page 5). While prices for most other base metals are up substantially from the start of 2014, copper prices are now down about 10%. The strong U.S. dollar is especially hard on copper prices, which tend to be more strongly influenced by financial factors. Doubts about the solidity of Chinese demand are also directly impacting copper. Strong at the start of the year, China's copper imports have posted negative annual changes since June, contributing to the inventory growth

Graph 9 – Industrial metal prices recently edged down



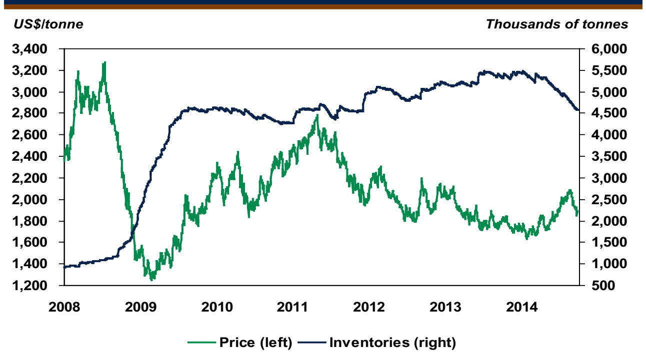
* London Metal Exchange base metal price index.
Sources: Datastream and Desjardins, Economic Studies

Graph 10 – China's industrial production slowdown is worrisome



Sources: Datastream and Desjardins, Economic Studies

Graph 11 – Aluminum prices and inventories



Sources: Datastream and Desjardins, Economic Studies

recorded by LME. Some analysts, though, are seeing signs that Chinese copper demand has firmed up a bit recently.

NICKEL

- Recent months have been fairly difficult for nickel, whose prices have dropped more than 10% since late July, returning below US$17,000 per tonne. Like copper, nickel is imported in great quantities by China, leaving prices for this metal vulnerable to the changing situation there. Although Indonesia has halted its exports of unprocessed ore, Chinese nickel producers seem to be managing to find a supply in the Philippines and other countries. While domestic demand for nickel is still low, Chinese manufacturers have even bumped up their exports of refined nickel considerably in recent months. Nickel inventories recorded by the LME have therefore continued to increase. Despite everything, nickel prices are still up nearly 20% from the start of 2014, as analysts continue to expect global nickel demand to substantially outstrip supply next year.

ZINC

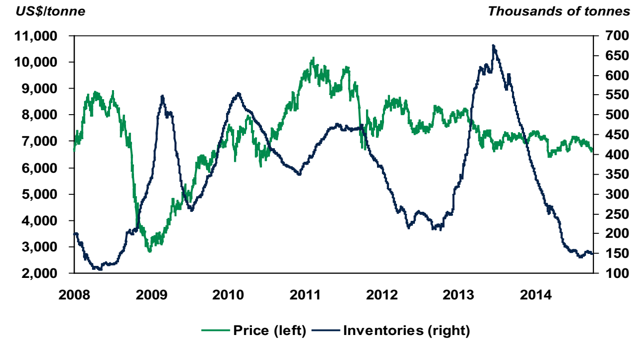
- Despite a recent slide of around 5%, zinc prices remain relatively high, at around US$2,300 per tonne. After plunging in the first half of 2014, zinc inventories have recently resumed their uptrend. This seems to be coming from a significant acceleration in Chinese output for this metal following the price increase. However, the outlook remains fairly promising, as the global zinc market should still be in deficit next year.

STEEL

- The recent problems for commodities have had no impact on the LME's reference price for steel, which has continued to trend up, nearing US$450 per tonne, its highest point since May 2012. This upward trend may be nearing its end, though, especially since iron ore prices have been plummeting for several months now. Given the excess production capacity for steel and uncertain Chinese demand, the drop of input prices should soon impact steel prices.

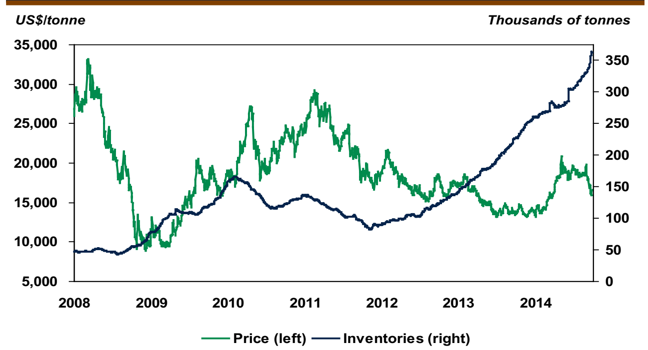
Forecasts: The strong greenback and uncertain Chinese economy could continue to hurt industrial metal prices in the short term. All the same, we expect the global economy to accelerate substantially in 2015, putting base metal prices back on an uptrend.

Graph 12 – Copper prices and inventories



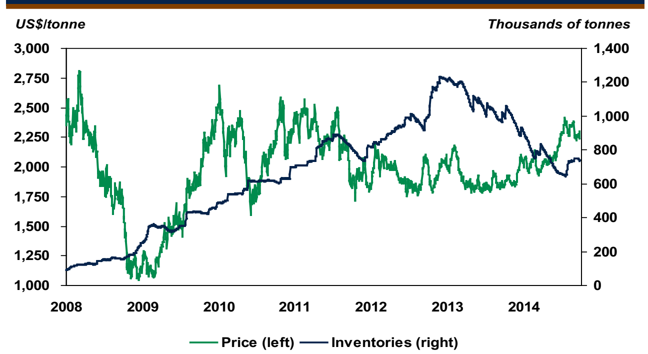
Sources: Datastream and Desjardins, Economic Studies

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 hit hard by the greenback's upswing

Strong appreciation by the U.S. dollar has been especially bad for precious metals in recent months.

GOLD AND SILVER

- In July, we warned that the coming months promised to be tough for gold prices, which fell even more steeply than we expected; gold prices are down from nearly US$1,300 an ounce in late July to around US$1,200 an ounce, their lowest point since December 2013 (graph 15). The coming end to the Federal Reserve's third quantitative easing program and intensifying debate about the timing for initiating key rate increases have propelled the greenback up at a time when other central banks, especially the European Central Bank and the Bank of Japan, continue to relax their monetary policy. Economic data from the United States is much better than the data from most of the other major economies, helping the currency as well (graph 16). The greenback's appreciation is especially bad for gold, as one of the reasons investors own gold is to protect themselves from depreciating paper currencies. Though interest rates remain quite low for now, signs that they will increase in 2015 also point to rising opportunity costs if investors hold onto their gold. Silver prices have also fallen dramatically, nearing US$17 per ounce.

PLATINUM AND PALLADIUM

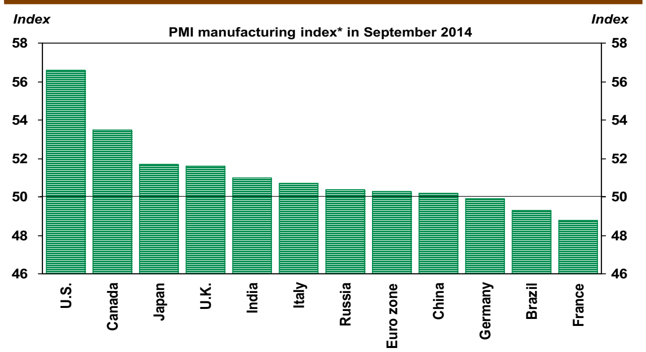
- Platinum and palladium prices have not escaped the downtrend and both are down around 15% from late July (graph 17). Though palladium prices remain relatively high, platinum prices are currently at their lowest point in five years. Besides the negative trend for all commodities, the price pullback for these two metals also reflects the end of the long strike at South African mines and some doubts about demand for motor vehicles, given the soft economies abroad.

Forecasts: In the short term, movement by gold and silver prices will largely reflect the greenback's. If, as we predict, the U.S. dollar consolidates its gains until the end of the year, gold prices could remain close to current levels, then start to trend down again next year. However, there is a considerable downside risk for gold prices, as the greenback could continue to surge. The global economy's acceleration in the coming quarters should, however, cause platinum prices to climb.

Graph 15 – Gold and silver prices

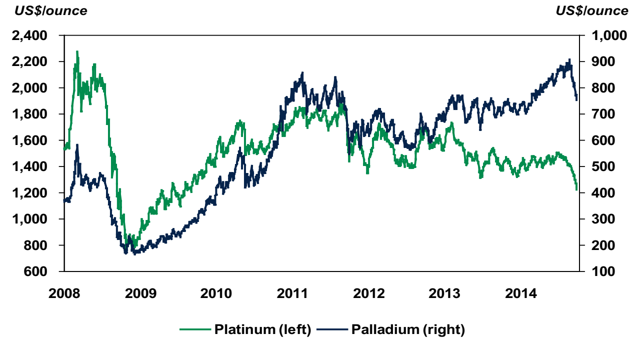
Sources: Datastream and Desjardins, Economic Studies

Graph 16 – The economic outlook is stronger for the United States



* ISM manufacturing index for the United States.
Sources: Institute for Supply Management, Markit, Bloomberg, Datastream and Desjardins, Economic Studies

Graph 17 – Platinum and palladium prices



Sources: Datastream and Desjardins, Economic Studies

OTHER COMMODITIES

Corn prices are at a 5-year low

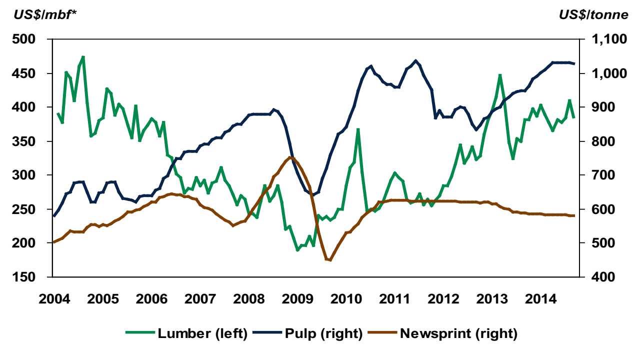
FOREST PRODUCTS

- North American forest product prices were barely affected by the recent downtrend in commodity prices (graph 18). Reference prices for pulp and newsprint have remained very stable, posting just a slight dip since the start of the second half of 2014. Lumber prices moved up in July and August, hitting US$409 per thousand board feet (mbf), their highest point since May 2013. The last few weeks have been more difficult, as a sharp drop by U.S. housing starts took lumber prices down to around US$380/mbf. The slide by housing starts is not too worrisome, though, especially since U.S. housing market figures are extremely volatile right now (graph 19). **The solid economic growth expected for the coming quarters should lead to fairly strong demand for lumber.** However, the lumber supply could also grow fairly quickly, thus likely limiting price growth.

AGRICULTURAL COMMODITIES

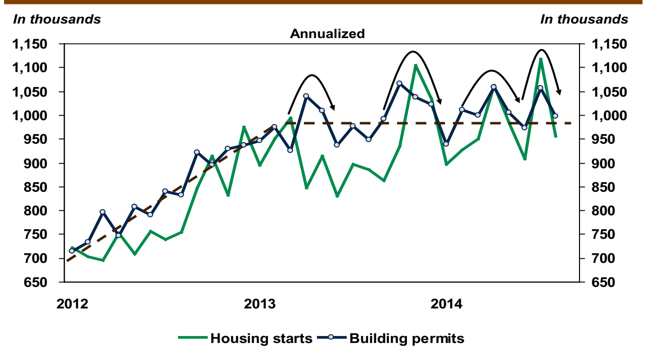
- The spectacular drop of cereal prices continued as the weather remained generally quite favourable for harvests, especially in the United States. The U.S. Department of Agriculture (USDA) therefore continued to upgrade its forecasts for supply over the last few months, increasing downside pressure on prices (graph 20).
- The record corn yields will cause U.S. production to grow more than 3% from its previous record, posted last year, even though the area dedicated to this crop was reduced substantially. For farmers, the news is not all good, as corn prices recently fell to US$2.80 per bushel, their lowest point in over five years.
- After holding up well initially, soybean prices recently posted a spectacular plunge, as the USDA continues to upgrade its supply forecast for this cereal as well. Fears about China's economic health may also have increased negative sentiment toward soybeans, given that China is their largest importer. Soybean prices have therefore gone from above US$12.35 per bushel at the end of August to less than $9 recently. They are down about 30% from last year, results that are similar to those for wheat and corn. Wheat prices have fallen less dramatically in recent times, but prices are still at their lowest point since summer 2010. **After such an extraordinary drop, cereals prices should soon stabilize and even tick up. However, the abundant supply should keep prices low for several months.**

Graph 18 – Forest product prices



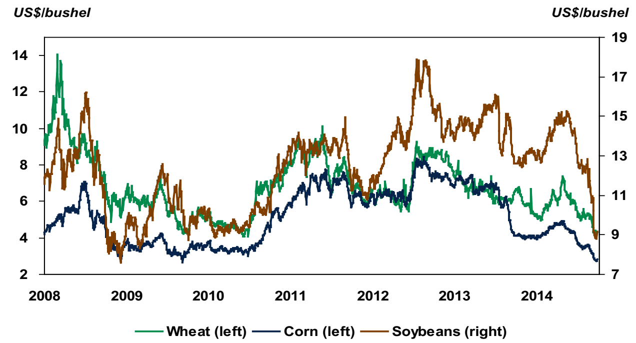
* Thousands of board feet.
Sources: Datastream and Desjardins, Economic Studies

Graph 19 – Residential construction struggles to renew with sustained growth



Sources: U.S. Census Bureau and Desjardins, Economic Studies

Graph 20 – Cereal prices



Sources: Datastream and Desjardins, Economic Studies

Table 1
Commodities

	Spot price	Percentage return since				Last 52 weeks		
	Oct. 7	1 month	3 months	6 months	1 year	High	Average	Low
Index								
Reuter-CRB[1] (CCI[2])	494.1	-3.0	-8.6	-11.4	-5.3	569.6	529.1	485.8
Reuters/Jefferies CRB[1]	280.2	-2.7	-7.7	-7.9	-2.5	312.9	292.7	272.3
Bloomberg Commodity Index	119.6	-4.2	-9.9	-11.2	-6.7	138.7	129.3	118.0
Bank of Canada	617.1	-3.0	-8.9	-6.3	-1.5	683.3	641.5	582.0
Energy								
Brent oil (US$/barrel)	91.3	-9.2	-17.1	-13.5	-16.7	115.5	107.3	91.2
WTI[3] oil (US$/barrel)	90.3	-3.2	-12.7	-10.1	-12.4	107.3	99.1	89.8
Gasoline (US$/gallon)	3.30	-4.6	-10.3	-8.3	-2.0	3.71	3.47	3.19
Natural gas (US$/MMBTU[4])	3.88	1.0	-8.7	-14.7	7.5	7.92	4.38	3.36
Base metals								
LMEX[5]	3,101	-5.6	-4.7	2.4	-0.6	3,316	3,128	2,920
Aluminium (US$/tonne)	1,900	-8.0	0.4	6.6	5.1	2,089	1,819	1,634
Copper (US$/tonne)	6,750	-3.5	-5.3	1.2	-6.5	7,406	6,993	6,439
Nickel (US$/tonne)	16,628	-14.7	-13.6	1.6	19.8	20,955	16,442	13,216
Zinc (US$/tonne)	2,302	-3.4	2.1	15.5	25.4	2,417	2,086	1,835
Steel (US$/tonne)	446.3	-0.2	14.4	15.5	112.5	448.0	355.9	210.0
Precious metals								
Gold (US$/ounce)	1,202	-5.1	-8.6	-7.6	-9.2	1,376	1,283	1,194
Silver (US$/ounce)	17.0	-11.0	-18.8	-14.1	-21.8	22.7	20.1	17.0
Platinum (US$/ounce)	1,229	-12.6	-18.1	-14.4	-11.3	1,512	1,424	1,229
Palladium (US$/ounce)	756.0	-14.8	-12.9	-3.7	8.5	911.0	787.8	697.0
Other commodities								
Lumber (US$/tbf[6])	381.0	-6.6	1.1	3.0	-0.8	409.0	386.2	362.0
Pulp (US$/tonne)	1,027	-0.1	-0.3	0.8	8.3	1,030	1,009.7	948.0
Newsprint (US$/tonne)	580.4	-0.1	-0.4	-0.4	-1.6	590.0	584.1	580.0
Wheat (US$/bushel)	4.35	-17.0	-22.7	-29.7	-34.6	7.42	5.77	4.17
Corn (US$/bushel)	2.88	-16.0	-26.6	-40.0	-31.3	4.99	4.14	2.79
Soybean (US$/bushel)	9.19	-18.7	-31.5	-37.4	-27.4	15.29	13.21	8.83

[1] Commodity Research Bureau; [2] Continuous Commodity Index; [3] West Texas Intermediate; [4] Million British Thermal Unit;
[5] London Metal Exchange Index; [6] 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$/barrel)	94	98	Target: 99 (range: 97 to 100)	Target: 101 (range: 91 to 111)
Natural gas Henry Hub (US$/MMBTU**)	2.76	3.73	Target: 4.40 (range: 4.25 to 4.50)	Target: 4.00 (range: 3.25 to 4.75)
Gold (US$/ounce)	1,669	1,411	Target: 1,260 (range: 1,240 to 1,290)	Target: 1,125 (range: 1000 to 1,250)
LMEX*** index—base metals	3,416	3,183	Target: 3,150 (range: 3,050 to 3,200)	Target: 3,600 (range: 3,200 to 4,000)

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