Commodity Trends

Desjardins Economic Studies
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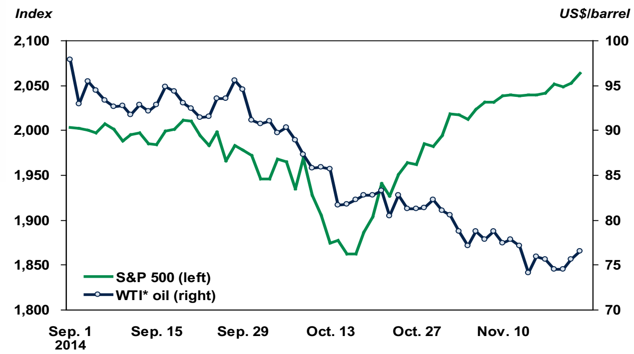
The oil price plunge appears to be exaggerated

The downward trend in commodity prices became a rout in the first part of October, when a wave of panic swept over the financial markets. Investor confidence rebounded quickly, and the U.S. stock market recently reached a new peak, but oil and gold prices have kept on falling in November, reaching lows not seen in many years (graph 1).

Beyond the extreme volatility in the markets, the most striking phenomenon of recent months has been the emergence of very negative sentiment about oil prices due, among other things, to the absence of any strong reaction on the part of Saudi Arabia to rein in the price plunge. Yet, the perception held by some investors that we will be swimming in surpluses of oil in the years to come appears exaggerated. New upward pressure on the greenback has amplified the downturn in commodity prices, especially that of gold (graph 2).

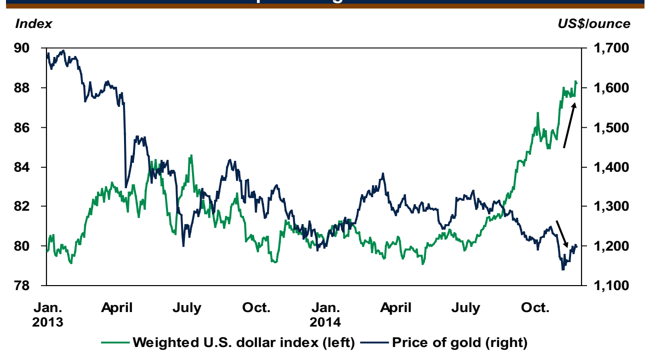
It should be noted that prices for other commodities, including industrial metals, have fared not too badly despite the difficult situation. Commodity price indexes have thus dipped only slightly since the end of September. As the U.S. economy is showing encouraging signs, we are still banking on more robust demand for commodities and an upturn in prices in the next few quarters.

Graph 1 – Contrary to the stock markets, oil prices continued their slump in November



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

Graph 2 – A new surge of the greenback took the price of gold down



Sources: Bloomberg 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.

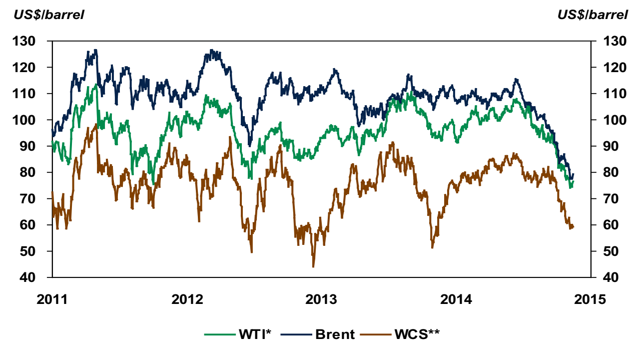
ENERGY

Oil prices should gradually head back up

OIL

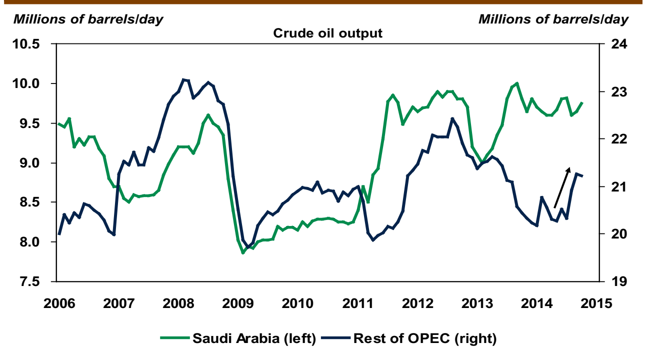
- After starting off the month of October at slightly above US$90 per barrel, the price of West Texas Intermediate (WTI) oil fell sharply to around US$80 per barrel when volatility exploded in the financial markets. Contrary to the stock markets, which quickly rallied, oil prices have kept declining in recent weeks, taking both WTI and even Brent below US$80 per barrel for the first time since September 2010. After showing resilience at the end of the summer, the price of oil from western Canada has also plummeted (graph 3).
- The fundamental reasons behind these low oil prices have been known for several months: the spectacular surge in North American production, and the recent slow growth in global demand. An upturn in the output of certain member countries of the Organization of the Petroleum Exporting Countries (OPEC) has amplified the impression that the global oil market is in a surplus position (graph 4). The greatest surprise lately has been Saudi Arabia's reaction to this price decline: it has opted to lower its prices to protect its market share, rather than unilaterally cut back production to rebalance the global crude market.
- Some analysts believe that Saudi Arabia is now aiming to drive oil prices down in order to do damage to other oil producing countries, including Iran and Russia, and to curb the development of unconventional oil in North America. In our view, there is nothing to indicate a major change in Saudi policy. That country still favours a price close to US$100 per barrel as its ideal scenario. The likely reason why Saudi Arabia did not react strongly to the recent price drop, is that it would prefer to act in concert with the other OPEC members to rebalance the market. We will have to wait for the OPEC meeting in Vienna, on November 27, to see whether the member countries agree to take action.
- Even if OPEC decides to maintain its production close to current levels, the surplus supply in the oil market is likely to be smaller and more short-lived than some investors seem to think. The end of a maintenance period in refineries, and the beginning of winter in the northern hemisphere, should soon trigger stronger demand for oil. In addition, the plunge in crude prices will probably have noteworthy effects on supply in the medium term (by curbing investments) and on demand for oil. We must also keep in mind that the spectacular surge in North American oil production should not last much longer (graph 5) and that OPEC countries will once again begin to wield crucial influence over global supplies within a few years.

Graph 3 – Canadian oil is no longer spared by price slumps



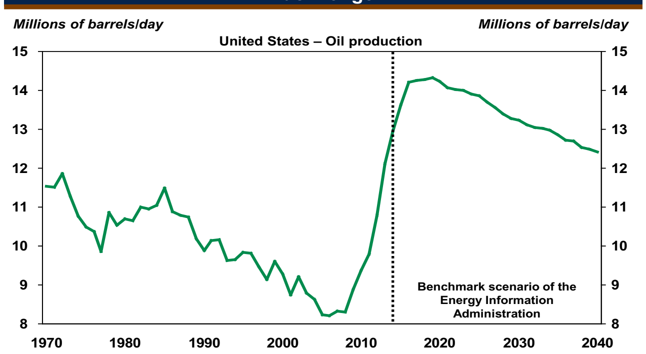
* West Texas Intermediate; ** Western Canada Select.
Sources: Datastream, Bloomberg and Desjardins, Economic Studies

Graph 4 – The acceleration in oil production of other OPEC members complicates the situation



OPEC: Organization of Petroleum Exporting Countries
Sources: Bloomberg and Desjardins, Economic Studies

Graph 5 – The spectacular surge in U.S. production will not last much longer



Sources: Energy Information Administration and Desjardins, Economic Studies

GASOLINE

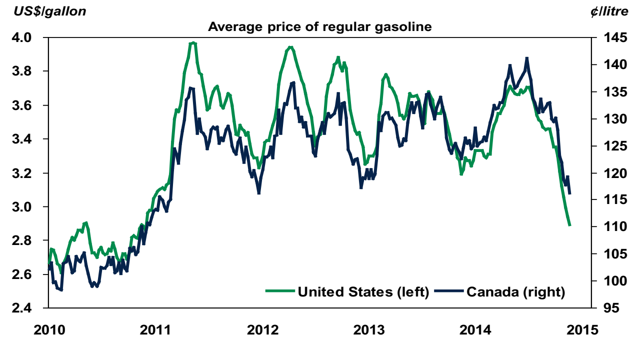
- North American motorists are the big winners in the collapse of oil prices. In the United States, the price of regular gasoline has tumbled from around US$3.70 per gallon in mid-2014 to less than US$2.95 per gallon, its lowest point in nearly four years (graph 6). Given that over 134 billion gallons of gasoline were consumed in the United States in 2013 (graph 7), a price drop of US$0.75 per gallon represents potential annual savings of around US$100B for U.S. gas buyers. If the price of gasoline remains this low and the U.S. economy keeps growing at a decent pace, gasoline consumption could well resume an upward trend in the coming quarters. Canadian motorists also benefit from this situation; the average price of gasoline has fallen by nearly C$0.15 per litre since the end of September.

NATURAL GAS

- The price of North American natural gas lost ground somewhat in October, falling close to US$3.50 per Million British Thermal Units (MMBTU). This was more a reflection of changes in gas supply and demand than of the significant financial tensions that affected other commodity prices. Strong growth in gas production, combined with limp demand in October, has thus boosted natural gas inventories. However, the price of gas managed to climb to over US$4.40 per MMBTU recently (graph 8) since cold November temperatures have triggered a spike in demand. Given that around half of the United States was already covered with snow in mid-November, some investors are betting on a second abnormally cold winter in a row, one that could once again trigger a temporary explosion in gas prices.

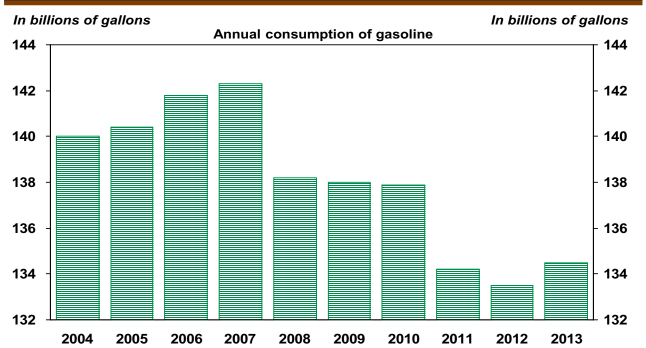
Forecasts: Investor sentiment is likely to remain very negative towards oil in the short term, but the foreseeable trends in global supply and demand for crude oil do not point towards a lasting surplus situation that would justify a further decline in oil prices. We are calling for a gradual upturn in prices in the months to come, when acceleration in the global economy and low prices should translate into stronger demand for oil. Nevertheless, we have significantly downgraded our average price forecasts for 2014 and 2015. The price of natural gas is likely to be very volatile in the months to come, and weather conditions in the United States will have a decisive impact on demand, inventories and the price of gas.

Graph 6 – Gasoline prices have plummeted to lows not seen in many years



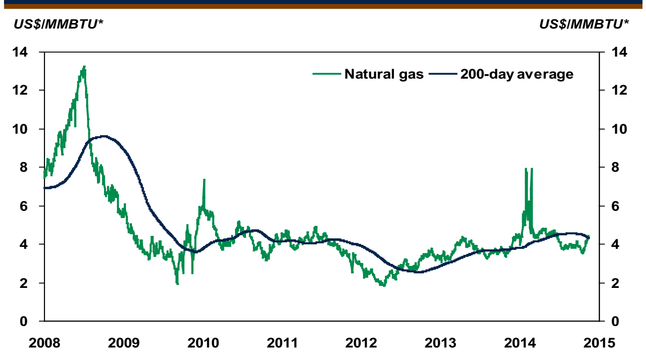
Sources: Datastream, Natural Resources Canada and Desjardins, Economic Studies

Graph 7 – Despite the pullback since the financial crisis, Americans still consume plenty of gasoline



Sources: Energy Information Administration, American Fuels and Desjardins, Economic Studies

Graph 8 – Price of natural gas



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

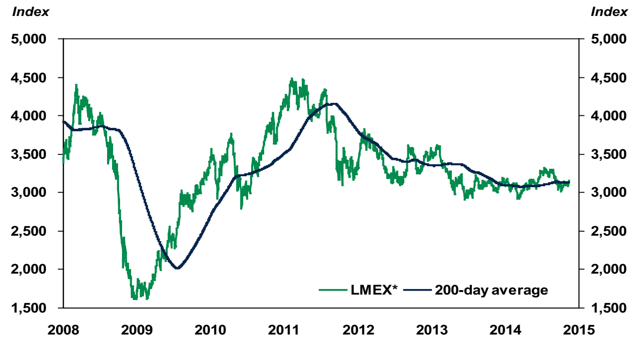
BASE METALS

Metals hold firm

Despite the very negative investor sentiment towards commodities, and the latest appreciation of the greenback, industrial metal prices have not suffered too much in recent weeks (graph 9). Even though it is still below the peak achieved this past summer, the London Metal Exchange (LME) index is up slightly from a year ago, whereas the prices of most other commodities are down.

This performance is quite impressive in a context where credit rationing appears to be leading to destocking in the Chinese industrial metals industry. The robustness of the U.S. economy, where new automobile sales, for instance, have been very strong since the beginning of 2014 (graph 10), compensates for concerns about the overseas economies.

Graph 9 – Industrial metal prices have not experienced a plunge similar to that of oil prices

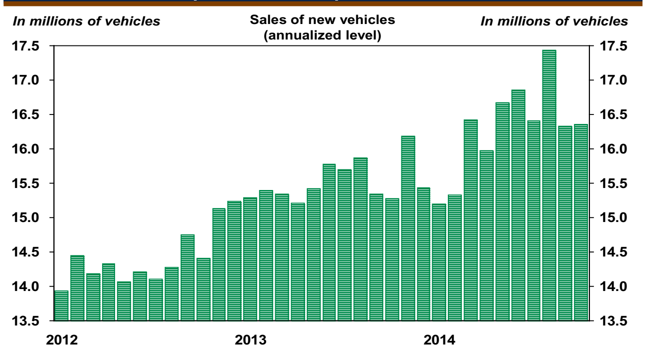


* London Metal Exchange base metal price index.
Sources: Datastream and Desjardins, Economic Studies

ALUMINUM

- After falling to around US$1,850 per tonne in early October, the price of aluminum recently climbed back above US$2,000 per tonne. It now boasts a gain of over 15% from where it stood one year ago. While the premium to be paid by consumers wishing to have quick access to this metal has continued to rise, the effective price on the North American market recently reached its highest level in three years (graph 11). Given that aluminum production outside of China is in decline, rising demand for the product has led to a contraction in aluminum LME inventories of around 20% since the beginning of 2014. This downward trend in inventories is likely to continue, while indications are that the market outside of China will remain in a deficit position next year. The big question is whether Chinese exports will fill the gap, but many analysts are doubtful about that scenario, since the Chinese market does not seem to be in a significant surplus position.

Graph 10 – The increase in automobile sales in the United States is a positive development for metals

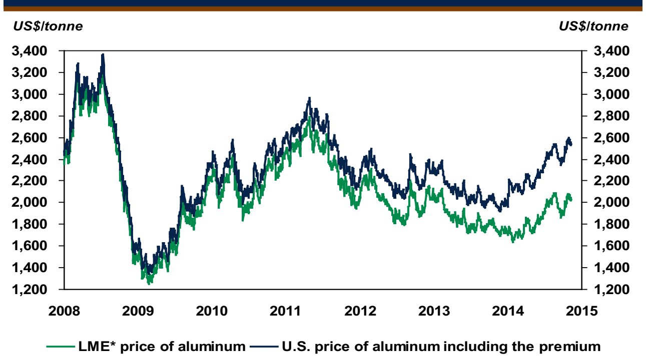


Sources: Bureau of Economic Analysis and Desjardins, Economic Studies

COPPER

- The price of copper fared quite well in October, closing in on US$6,900 per tonne towards the end of the month. But the new surge of the greenback after the Federal Reserve meeting, and some disquieting data from the Chinese real estate sector, subsequently drove the price of copper down to around US$6,700 per tonne (graph 12). The slight expansion in copper LME inventories has continued, but inventories for this metal are still far smaller than they were at the beginning of the year. Despite a slowdown this summer, Chinese imports of copper during the first ten months of 2014 are up by more than 15% compared to the same period last year. Many analysts currently have a rather negative outlook on copper prices, as accelerated mining production raises concerns about a surplus of this metal.

Graph 11 – Price of aluminum



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

NICKEL

- After a spectacular ascent at the beginning of the year that took it to around US$20,000 per tonne, the price of nickel has resumed a downward trend, which recently drove it close to US$15,000 per tonne. It must be pointed out that signs of a shortage of nickel after Indonesia's ban on exports of unprocessed ore have yet to materialize. As a result, the upward trend in nickel LME inventories has continued, and they are now about 50% higher than at the beginning of 2014 (graph 13). China is largely responsible for the recent drop in nickel prices, as it has not only sharply reduced its imports of nickel, but also expanded its own exports. However, this trend does not appear to be sustainable, since indications are that China's need for nickel will exceed its production capacity in the years to come. In this context, the upward trend in nickel inventories is likely to soon reverse itself, especially since global production of this metal is expected to decline next year.

ZINC

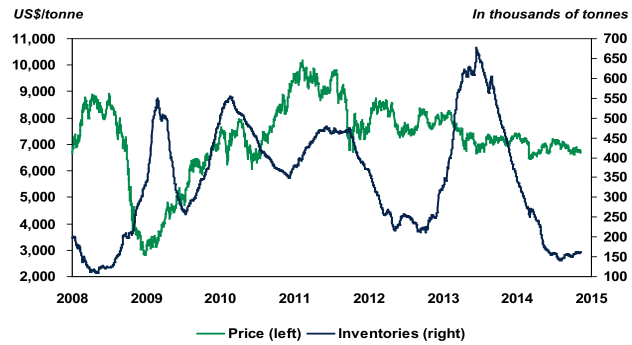
- The price of zinc has dipped slightly since the end of September, but is still relatively high at around US$2,290 per tonne. After rising this past summer, zinc inventories have recently resumed a downward trend, which seems to fit with the perception that the global zinc market is in a deficit position (graph 14), a situation that could continue into next year. China's accelerated production of zinc is still the main barrier to further appreciation in the price of this metal.

STEEL

- The LME benchmark steel price has risen slightly further, reaching US$460 per tonne, around twice what it was a year ago. One can only wonder whether this price truly reflects the global situation given that, in China, the overcapacity for steel production appears to be putting downward pressure on prices. Moreover, the downward trend in iron prices is continuing, and most analysts predict that they will remain low in the years ahead.

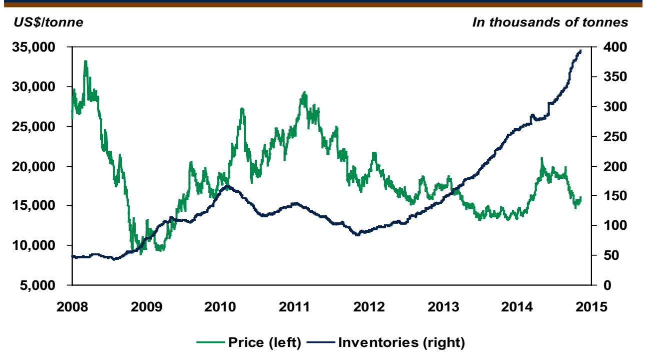
Forecasts: The resilience of base metal prices, despite the difficult circumstances of recent months, is encouraging for the future. While the destocking period in China will come to an end sooner or later, the anticipated acceleration of the global economy in 2015 would suggest an upward trend for industrial metal prices.

Graph 12 – Copper price and inventories



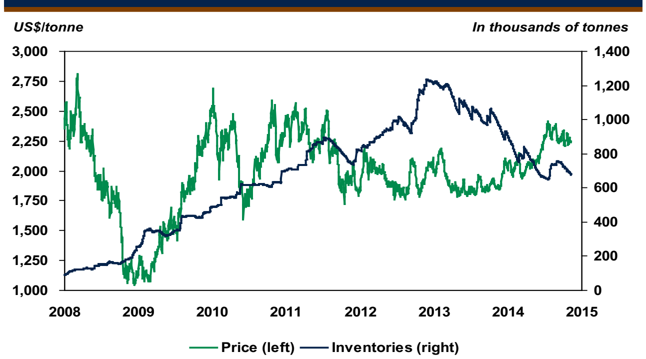
Sources: Datastream and Desjardins, Economic Studies

Graph 13 – Nickel price and inventories



Sources: Datastream and Desjardins, Economic Studies

Graph 14 – Zinc price and inventories



Sources: Datastream and Desjardins, Economic Studies

PRECIOUS METALS

The financial environment will remain unfavourable for gold

Another surge by the greenback has pushed the prices of gold and silver to their lowest levels in more than four years. The price of platinum has also continued to drop.

GOLD AND SILVER

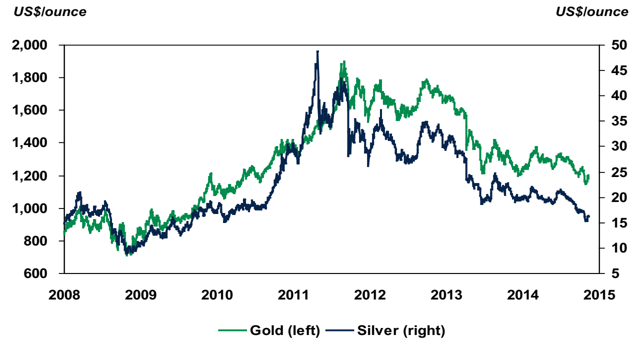
- After declining in September, the price of gold rebounded in mid-October, when a surge of investor concern temporarily pushed it to over US$1,250 per ounce (graph 15). Speculation that the slump in the stock markets, combined with declining inflation expectations, might convince the Federal Reserve (Fed) to continue its third quantitative easing program (QE3) appeared to be especially favourable for gold. But it quickly became evident that these speculations were ill founded and, instead, it was the Bank of Japan that surprised investors by announcing that it would accelerate its purchases of financial assets (graph 16). All this, combined with the confirmation of the end of QE3 and a relatively optimistic press release from the Fed, sent the U.S. dollar soaring again. To no-one's surprise, the price of gold then plunged, reaching US$1,146 per ounce on November 5, its lowest level since the spring of 2010. It subsequently climbed back to around US$1,200 per ounce, thanks to a significant increase in purchases of gold by Russia and the upcoming referendum in Switzerland, on November 30, to force that country's central bank to hold more gold reserves. The price of silver also plummeted, recently closing in on US$15 per ounce.

PLATINUM AND PALLADIUM

- The price of palladium has stayed relatively high, but the price of platinum has kept falling, to around US$1,175 per ounce. Besides being affected by the strength of the greenback, the low platinum prices are due to fears of another recession in the euro zone that would affect the automobile industry. We also note a significant reduction in Chinese imports of platinum, compared with 2013. Still, the accelerated global economy and the limited supply of platinum suggest a more favourable outlook for the price of that metal, compared with that of gold.

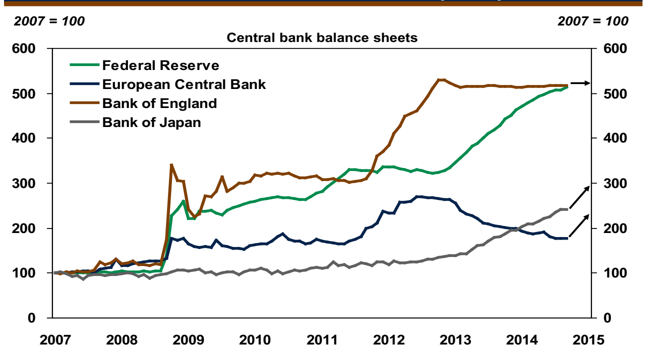
Forecasts: The price of gold could fluctuate with no clear trend in the short term, and end the year at around US$1,200 per ounce. However, the growing divergence in monetary policies should keep favouring the U.S. dollar next year. Nevertheless, supply's reaction to lower prices should keep the price of gold above US$1,000 per ounce.

Graph 15 – Gold and silver prices



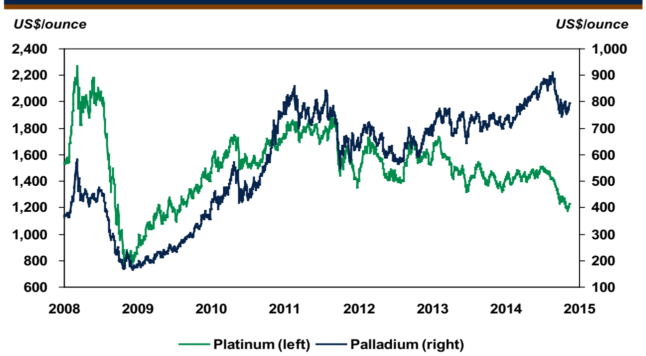
Sources: Datastream and Desjardins, Economic Studies

Graph 16 – Now that the Federal Reserve has finished expanding its balance sheet, other central banks will pick up the torch



Sources: Bloomberg and Desjardins, Economic Studies

Graph 17 – Platinum and palladium prices



Sources: Datastream and Desjardins, Economic Studies

OTHER COMMODITIES

Grain prices turn the corner

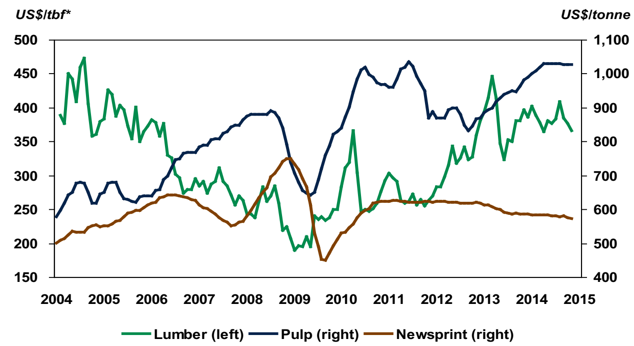
FOREST PRODUCTS

- North American prices for forest products have dipped slightly in recent months (graph 18). Movements were very slight for pulp and newsprint. The decline in the price of lumber is a bit more remarkable: it dropped from US$385 per thousand board feet (mbf) at the end of September to around US$365 per mbf. For Canadian producers, this decline is offset by the appreciation of the U.S. dollar against the loonie.
- **Positive signals from the U.S. economy**, where consumer confidence seems to be benefiting from the drop in gasoline prices (graph 19), **offer hope of an upswing in lumber prices in the next few quarters**. Moreover, U.S. homebuilder confidence climbed back to a good level in November.

AGRICULTURAL COMMODITIES

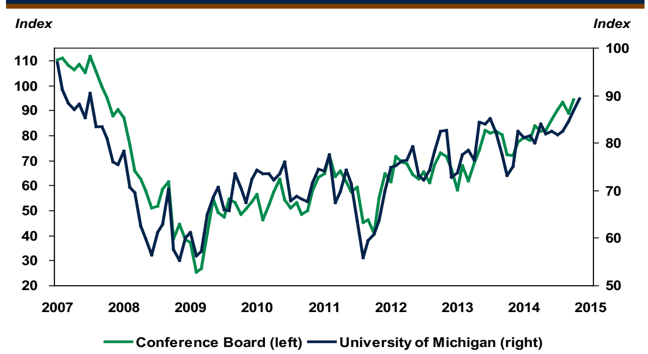
- At the beginning of October, we noted that the spectacular slump in grain prices appeared to be coming to an end. This has been confirmed, and the prices of the three main grains even recorded a significant rally in recent weeks (graph 20) when weather conditions became a bit less favourable for harvest operations in North America and South America.
- Thus, the price of corn has risen by around 25% since the end of September, reaching US$3.50 per bushel. A downward revision to the yield of U.S. cornfields and the cold in early November contributed to the upturn. Despite this rally, the price of corn is still down by more than 10% from where it stood at the beginning of 2014; this appears fully warranted by a year of record harvests.
- Wheat and soybean prices have also recorded significant rebounds of around 15% since the end of September, wiping out a portion of the significant losses that were posted earlier. **Given that global inventories of the three main grains have been significantly boosted by excellent harvests in the past two years, the potential for further price growth is limited, and we cannot rule out a price drop.** Relatively low grain prices still appear to be necessary to restore balance in the global market.

Graph 18 – Forest product prices



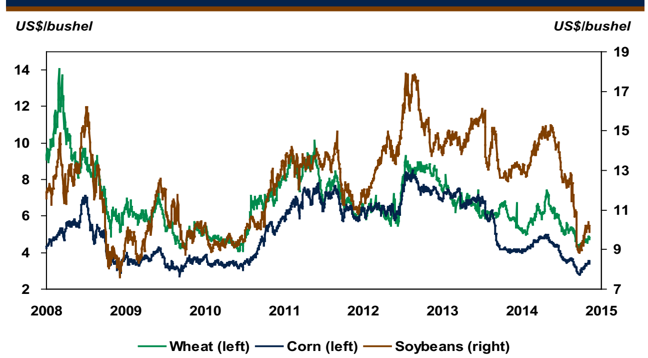
* Thousands of board feet.
Sources: Datastream and Desjardins, Economic Studies

Graph 19 – U.S. household confidence is improving



Sources: Conference Board, University of Michigan and Desjardins, Economic Studies

Graph 20 – Grain prices



Sources: Datastream and Desjardins, Economic Studies

Table 1
Commodities

	Spot price	Percentage return since				Last 52 weeks		
	Nov. 24	1 month	3 months	6 months	1 year	High	Average	Low
Index								
Reuter-CRB[1] (CCI[2])	485.6	0.3	-4.5	-12.5	-4.0	569.6	525.5	476.4
Reuters/Jefferies CRB[1]	269.1	-0.4	-6.8	-12.7	-2.2	312.9	291.5	264.6
Dow Jones AIG[3]	118.1	1.3	-5.8	-13.0	-4.6	138.7	128.3	115.9
Bank of Canada	547.5	-4.8	-13.2	-18.0	-6.7	682.0	636.2	547.5
Energy								
Brent oil (US$/barrel)	79.3	-7.5	-21.5	-29.0	-28.5	115.5	104.2	77.5
WTI[4] oil (US$/barrel)	76.5	-5.8	-18.3	-27.1	-19.1	107.3	96.8	74.1
Gasoline (US$/gallon)	2.89	-7.2	-16.6	-21.0	-10.1	3.71	3.43	2.89
Natural gas (US$/MMBTU[5])	4.31	22.1	11.7	-1.6	14.3	7.92	4.41	3.52
Base metals								
LMEX[6]	3,150	2.6	-4.3	-0.4	2.8	3,316	3,127	2,920
Aluminium (US$/tonne)	2,065	5.4	0.3	16.3	18.8	2,089	1,846	1,634
Copper (US$/tonne)	6,785	0.3	-4.4	-3.4	-4.4	7,406	6,941	6,439
Nickel (US$/tonne)	16,573	10.9	-11.2	-15.4	22.8	20,955	16,653	13,216
Zinc (US$/tonne)	2,292	1.5	-2.4	10.3	21.8	2,417	2,136	1,843
Steel (US$/tonne)	460.0	0.0	10.2	18.6	99.6	460.0	386.0	227.8
Precious metals								
Gold (US$/ounce)	1,205	-2.1	-5.7	-6.8	-3.2	1,376	1,269	1,146
Silver (US$/ounce)	16.3	-5.2	-16.4	-16.1	-18.2	22.1	19.4	15.3
Platinum (US$/ounce)	1,230	-1.9	-13.1	-17.1	-11.9	1,512	1,399	1,178
Palladium (US$/ounce)	794.0	1.3	-10.1	-4.1	10.1	911.0	793.7	700.0
Other commodities								
Lumber (US$/tbf[7])	363.0	-4.7	-10.4	-5.0	-9.0	409.0	384.9	362.0
Pulp (US$/tonne)	1,027	0.1	-0.3	-0.3	5.0	1,030	1,018	978.2
Newsprint (US$/tonne)	574.0	-0.7	-1.2	-1.7	-2.0	585.8	582.6	574.0
Wheat (US$/bushel)	4.89	7.1	-9.2	-23.0	-16.7	7.42	5.55	4.17
Corn (US$/bushel)	3.49	11.1	-5.4	-24.1	-15.0	4.99	4.02	2.79
Soybean (US$/bushel)	10.24	6.8	-19.5	-32.9	-22.0	15.29	12.82	8.83

[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$/barrel)	94	98	Target: 95 (range: 94 to 96)	Target: 93 (range: 85 to 96)
Natural gas Henry Hub (US$/MMBTU**)	2.76	3.73	Target: 4.45 (range: 4.40 to 4.50)	Target: 4.00 (range: 3.25 to 4.75)
Gold (US$/ounce)	1,669	1,411	Target: 1,265 (range: 1,255 to 1,265)	Target: 1,150 (range: 1050 to 1,250)
LMEX*** index—base metals	3,416	3,183	Target: 3,130 (range: 3,110 to 3,150)	Target: 3,500 (range: 3,100 to 3,900)

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