Commodity Trends

Desjardins Economic Studies

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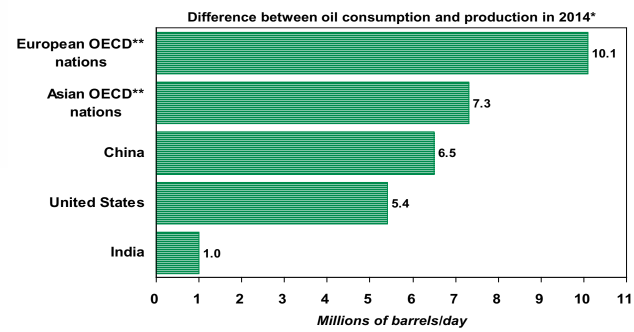
After a difficult 2014, prices haven't stabilize yet

The last few months have been very tough for commodities. The correction in oil prices picked up speed after the Organization of Petroleum Exporting Countries (OPEC) met at the end of November, and Saudi Arabia's change in stance was confirmed. Oil prices have thus recently dropped to more than 5-year lows.

After showing resilience early last fall, industrial metal prices have also pulled back sharply in recent weeks, largely reflecting the negative investor sentiment as inflation and the oil tumble are bolstering fears that the global economy will post disappointing growth again in 2015. In our view, these fears are exaggerated, given that the retreat in oil prices should instead support growth in most of the major economies, as they are net oil importers (graph 1). The surge in U.S. consumer confidence is another reason to think that the current pessimism in the financial markets is overdone (graph 2).

Although most commodities have gotten the year off to a poor start, there are reasons to hope that the situation will get better in the coming months. The slide in oil prices is looking increasingly exaggerated and investors will, sooner or later, realize that prices this low can only revive fears of a shortage over the medium term. Moreover, demand for commodities could be stronger than expected, as the world economy could very well beat investors' low expectations. The 2014 plunge in prices could also have a positive effect on demand. Lastly, the U.S. dollar's spectacular surge should give way to a period of consolidation.

Graph 1 – The global economy's main growth drivers are net oil importers



* Estimates taken from the *International Energy Outlook 2014*; ** Organisation for Economic Cooperation and Development.
Sources: Energy Information Administration and Desjardins, Economic Studies

Graph 2 – Unlike investors, U.S. households are bursting with confidence

Sources: Datastream, University of Michigan 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.

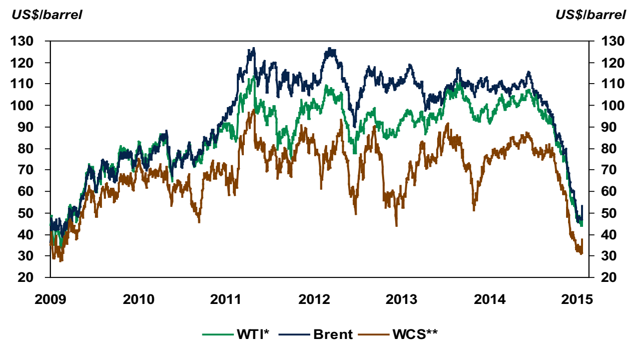
ENERGY

Heading for another oil shortage?

OIL

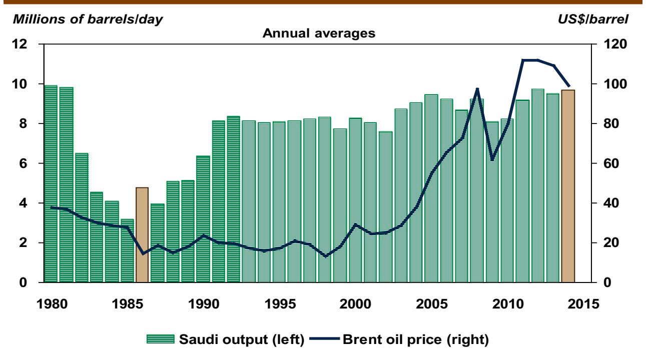
- The oil price correction which took WTI (West Texas Intermediate) price from around US$100/barrel in mid-2014 to US$75 in mid-November, turned into a collapse after the November 27 meeting of the OPEC (Organization of Petroleum Exporting Countries). OPEC leaders not only decided to maintain their quotas, but it became very clear that Saudi Arabia was prepared to tolerate much lower prices than it previously had, and that its main objective was now to protect its market share. WTI and Brent prices thus ended 2014 at around US$55/barrel and recently slid to nearly US$45, as investor concern about the health of the world economy notched up. Canadian oil prices also tumbled to a several-year low (graph 3).
- OPEC's decision and remarks from several Saudi leaders strengthened the view that the plunge in oil prices was a Saudi plot. Although the struggles of other oil producers clearly suit the Saudis, we must remember the fact that, unlike what happened in 1986, the oil price correction is not due to a spike in Saudi output (graph 4). That country's oil output has edged down since mid-2014 and the higher OPEC production primarily stems from a temporary upswing in Libyan oil output and a surge by Iraq's. All we can accuse the Saudis of is no longer wanting to play the role of referee in the global oil market, leaving the work of rebalancing to be done by normal market mechanisms.
- The first signs that the drop in oil prices will, sooner or later, end up rebalancing the market are becoming tangible. After having frequently downgraded its outlooks for oil demand in the last few months, in January, the International Energy Agency slashed its forecast for non-OPEC output for 2015. Further decreases can be expected as more and more major oil companies are announcing layoffs and postponing numerous investment projects (graph 5). Note that prices have tumbled to levels that make many of the world's oil fields unprofitable.
- Low prices should not have a spectacular impact on the global oil supply in the near future, as some countries that are highly dependent on oil could maximize their output to try to curb the fall in revenues. The medium-range impacts could be substantial, however, if oil prices remain too low for too long. Remember that very weak prices in the 1990s paved the way for skyrocketing prices in the 2000s, by discouraging innovation and investment in the energy sector. The impact of overly low prices on supply explains why, over the last 30 years, plunges in oil prices have nearly always been followed by a big rebound (graph 6). The size and timing of the rebound could be determined by how oil demand develops. After a very disappointing 2014, crude demand could post an upside surprise this year, as very low prices will stimulate the use of gasoline, especially in the United States.

Graph 3 – Oil prices



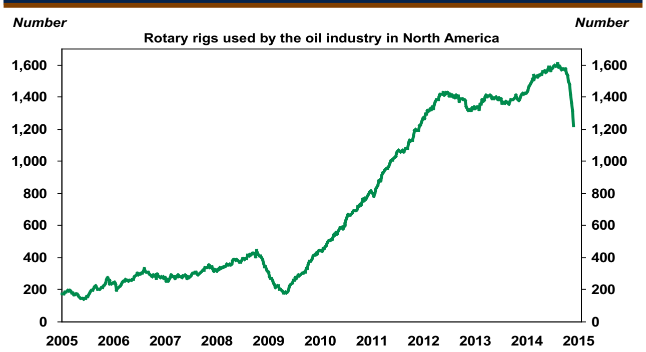
* West Texas Intermediate; ** Western Canada Select.
Sources: Datastream, Bloomberg and Desjardins, Economic Studies

Graph 4 – Unlike the 1986 episode, oil prices did not fall because of a surge in Saudi output



Sources: Bloomberg, Datastream and Desjardins, Economic Studies

Graph 5 – The oil industry begins to slow down its activities



Sources: Baker Hughes and Desjardins, Economic Studies

GASOLINE

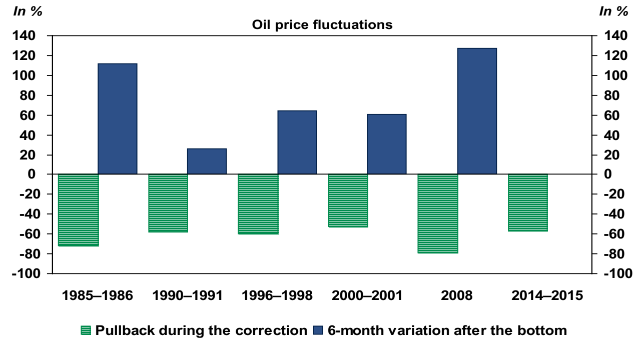
- Unsurprisingly, the collapse in oil prices has resulted in just as spectacular drops in gas prices. Even European drivers have benefited, despite the fact that their currency has pulled back substantially against the U.S. dollar. The gains are especially large in the United States, where a 45% retreat in gas prices since mid-2014 represents annual savings of more than US$800 per household (graph 7). In Canada, too, the drop in prices at the pump is impressive; they are down about 35% since mid-2014, taking the average price for a litre of regular gas close to C$0.90. Less favourable seasonal factors as winter comes to a close and our scenario for oil prices suggest that gas prices will not go much lower and could edge up in the second half of 2015.

NATURAL GAS

- October's retreat in North American natural gas prices continued in recent months. In December, the price even fell to US$2.75/MMBTU (Million British Thermal Units), its lowest since September 2012. A price this low may seem surprising given that natural gas inventories were well below normal during most of 2014. Strong natural gas production growth and a relatively warm fall, however, took inventories back very close to normal levels (graph 8), reducing the worries that a very cold winter could trigger fears of a natural gas shortage similar to those seen in early 2014. Prices could remain volatile in the near term, reflecting the weather in the United States.

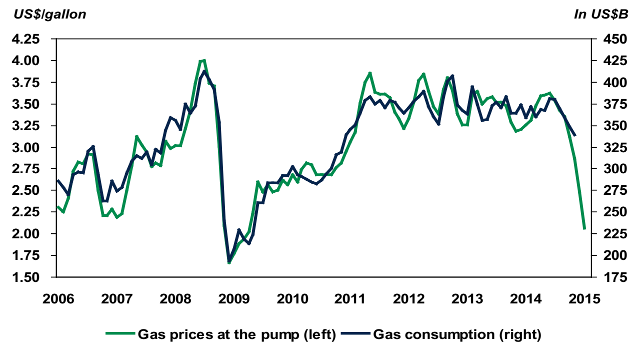
Forecasts: The tumble in oil prices is looking increasingly unsustainable over the medium range. Nonetheless, prices could stay very low for several more months, given the ambient pessimism in the markets. We expect them to start coming up slowly as of this summer, which would take the price of WTI to around US$70 a barrel at the end of 2015. For 2015, the annual average price should be quite low, at around US$57/barrel, then climb to around US$78 next year.

Graph 6 – Oil corrections are often followed by big rebounds



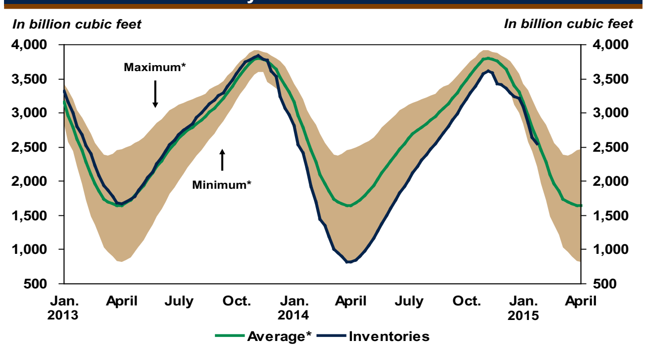
Sources: World Bank, Bloomberg, Datastream and Desjardins, Economic Studies

Graph 7 – The drop in gas prices will be very good for U.S. consumers



Sources: Energy Information Administration , Bureau of Economic Analysis and Desjardins, Economic Studies

Graph 8 – After being very low, natural gas inventories have recently risen to normal levels



* From 2010 to 2014.
Sources: Energy Information Administration and Desjardins, Economic Studies

BASE METALS

Copper prices fall

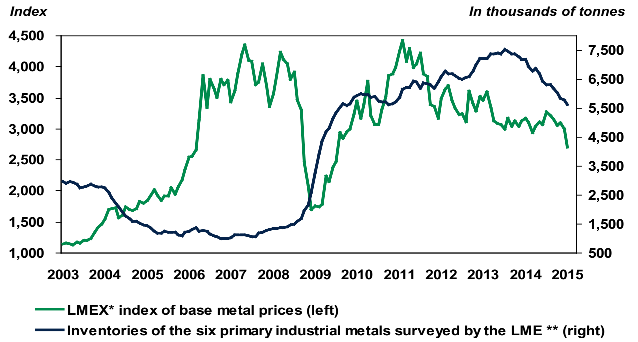
Base metal prices' resilience has given away to some fairly sharp pullbacks since mid-December, especially for copper. The LME (London Metal Exchange) index of base metal prices has gone from around 3,000 last fall to just under 2,700 recently (graph 9). It is off just over 4% for 2014 as a whole, but the close to 20% decline in metal inventories indicates that the price drop does not reflect a widespread surplus.

Much of the recent pullback in metal prices seems to be associated with the spike in investor concern over global economic growth and therefore demand for industrial metals. This sentiment was fuelled by the International Monetary Fund (IMF) downgrade to 2015 global growth. Note that, however, like most forecasters, the IMF is still calling for the global economy to accelerate slightly this year. Moreover, some indexes of manufacturing activity outside the United States have ticked up, which could be the first sign that the slide in energy prices will help inject some life into manufacturing (graph 10). This, along with signs of relatively lively Chinese metal demand at the end of 2014, is inconsistent with the tumble metal prices have taken.

ALUMINUM

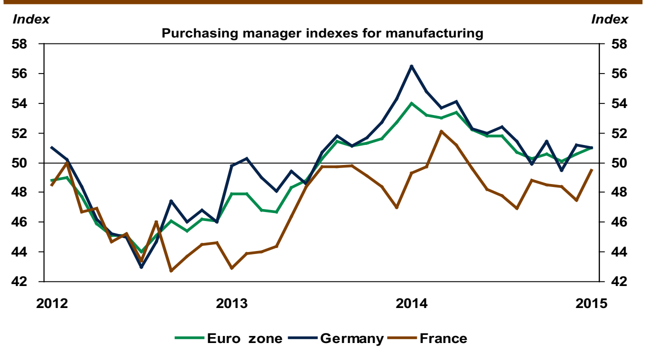
- After going over US$2,075 a tonne at the end of November, aluminum prices have been on a downtrend that temporarily took them close to US$1,750 a tonne in early January. Aluminum prices then quickly rose back to around US$1,850 a tonne (graph 11). Although the last few months have been tougher, aluminum prices are still up nearly 10% in the last year, a reflection of the fact that the global aluminum market (outside of China) is currently in deficit. This has expressed itself in a drop of about 25% in the LME aluminum inventories since the end of 2013. The inventory downtrend could continue in the coming quarters.

Graph 9 – Inventory changes are not responsible for the low metal prices



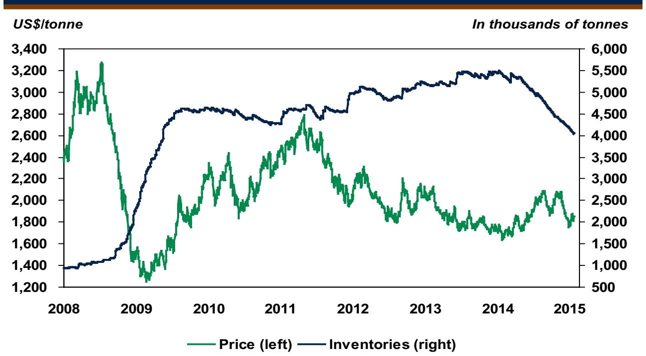
* London Metal Exchange Index; ** London Metal Exchange.
Sources: Datastream, International Monetary Fund and Desjardins, Economic Studies

Graph 10 – After a tough 2014, Euroland's manufacturing sector seems to be starting to recover



Sources: Bloomberg and Desjardins, Economic Studies

Graph 11 – Aluminum prices and inventories

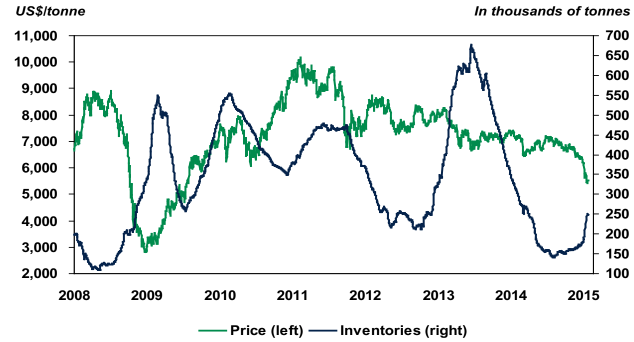


Sources: Datastream and Desjardins, Economic Studies

COPPER

- The last few months have been especially hard for copper: its price fell from over US$6,700 in mid-November to US$5,433 recently, its lowest point since July 2009 (graph 12). Two factors had a hand in the plunge copper prices have taken. Firstly, this metal is particularly sensitive to fluctuations in the financial markets; it is therefore unsurprising that the surge in market concern at the start of the year hit copper especially hard. Moreover, many investors were already fairly negative about the outlook for copper prices, as everything suggests the global copper market will be in surplus for the next few quarters. The big surge in copper inventories in the last few weeks seems to confirm the situation. However, some analysts think the surplus will be short-lived, which could curb the pullback in copper prices.

Graph 12 – Copper prices and inventories

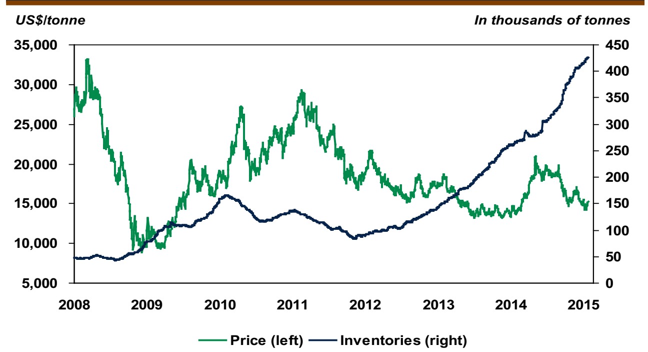


Sources: Datastream and Desjardins, Economic Studies

NICKEL

- After plunging at the start of last fall, nickel prices stabilized at around US$15,000 a tonne. They are still up substantially from the same time last year (graph 13). Weak Chinese nickel imports continue to curb the metal's appreciation, and are helping keep the LME nickel inventories on an uptrend. Following a surprise spike in mid-2014, Chinese nickel exports have slowed sharply in recent months. While Chinese nickel demand is weak for now, we can expect Chinese nickel imports to rise this year. This, combined with a retreat in global output, should end the nickel inventory uptrend and foster a rise in nickel prices.

Graph 13 – Nickel prices and inventories



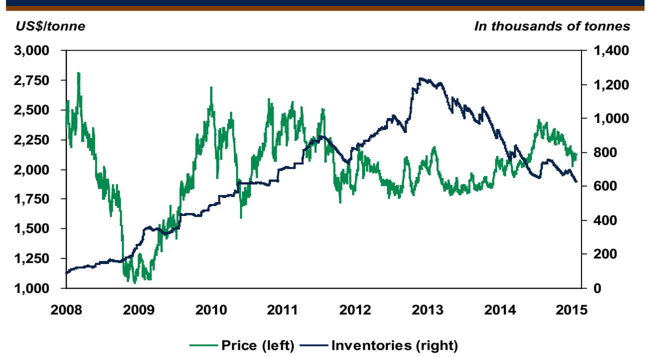
Sources: Datastream and Desjardins, Economic Studies

ZINC

- Zinc prices edged back at the end of the fall, returning to around US$2,100 a tonne (graph 14). They stood up well to the upheaval at the start of 2015, however, staying close to that level. Their resilience got a boost from a big plunge in zinc inventories in recent weeks, which seems to confirm that global demand is outstripping zinc production.

Forecasts: Like the pessimism over the global economy's health, the recent drop in industrial metal prices seems exaggerated, especially as the latest indicators for Chinese demand are fairly encouraging. We thus expect industrial metal prices to start rising gradually within the next few months; the LME index could therefore quickly climb back above 3,000.

Graph 14 – Zinc prices and inventories



Sources: Datastream and Desjardins, Economic Studies

PRECIOUS METALS

Central bank actions are helping gold

After retreating in the second half of 2014, precious metal prices got the year off to a strong start, capitalizing on investor worries and aggressive moves by central banks.

GOLD AND SILVER

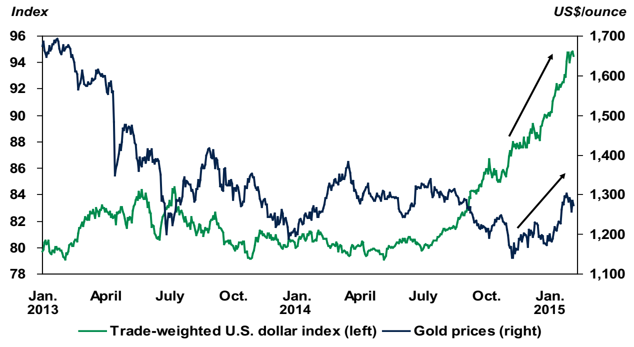
- The U.S. dollar's spectacular rise in the second half of 2014 took gold prices down. They ended 2014 at US$1,186 an ounce after having frequently beaten the US$1,300 mark in the initial months of the year (graph 15). Note that gold and the U.S. dollar often tend to move in opposite directions, as one of the reasons investors hold gold is to shield themselves from a retreat in the greenback. Despite this, gold did not do too badly in 2014, as it ended the year very close to where it ended 2013. Better still, gold prices jumped in the first weeks of 2015, temporarily crossing above US$1,300 an ounce. Negative investor sentiment is partially responsible for gold's solid performance. The shock created by the Swiss National Bank's sudden decision to stop curbing its currency appreciation, and the European Central Bank's announcement of an aggressive sovereign security purchasing program also revived investor interest in gold. Silver prices remain heavily influenced by gold's fluctuations. They are, however, down about 10% in the last year, while gold prices have been relatively steady.

PLATINUM AND PALLADIUM

- Like gold, platinum price has picked up in recent weeks after a very tough second half of 2014 (graph 16). It climbed above US$1,250 an ounce in the last few days, which is still more than 10% below the same time last year. Platinum prices are thus starting to move below gold prices (graph 16). Palladium prices have fallen recently, but are still up over 5% from last year.

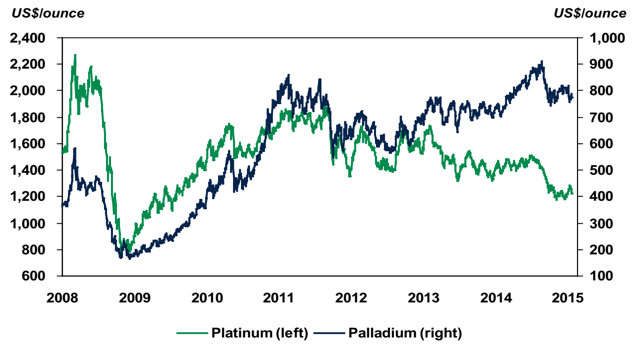
Forecasts: Weak bond yields and highly aggressive central bank monetary policies could allow gold prices to stay relatively high in the coming months. If the Federal Reserve initiates monetary firming in September, as we are expecting, the last few months of 2015 could be more difficult, and gold prices could end the year just below where they were at the end of 2014.

Graph 15 – Gold has risen lately, despite the strong greenback



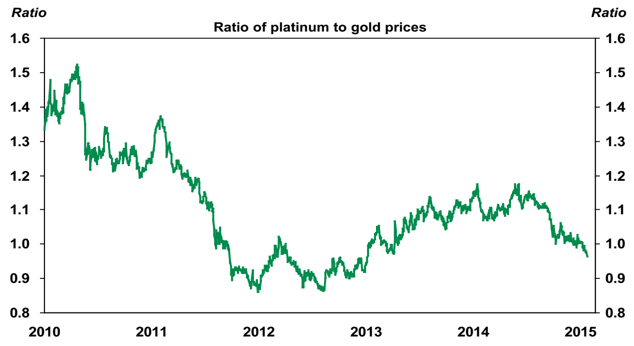
Sources: Bloomberg and Desjardins, Economic Studies

Graph 16 – Platinum and palladium prices



Sources: Datastream and Desjardins, Economic Studies

Graph 17 – Platinum's value has dropped back below gold's



Sources: Datastream and Desjardins, Economic Studies

OTHER COMMODITIES

Will 2015 be as volatile as 2014 for grains?

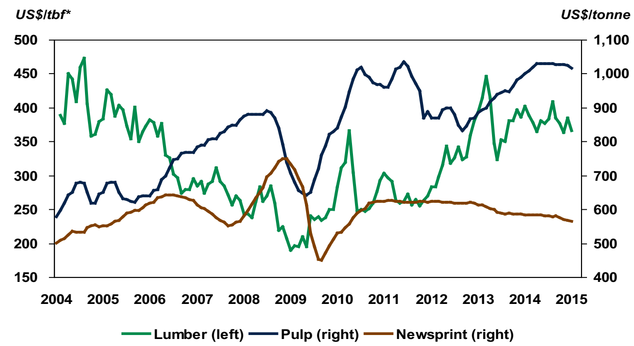
FOREST PRODUCTS

- Compared with the commodities discussed above, for the other resources, the last few months have been quiet. Pulp and newsprint prices continued to edge down, but remain very close to where they have been in recent years (graph 18). For their part, lumber prices rose at the end of 2014 to end the year at US$385/tbf (thousand board feet), then edged down recently, dropping under US$365/tbf.
- **After a somewhat disappointing 2014, there are some hopes of seeing lumber prices advance in the coming quarters.** The surge in U.S. consumer confidence and some encouraging signs from demand for single-family dwellings (graph 19) mean we can look for some acceleration in North American lumber demand. Moreover, a recent report from the International WOOD MARKETS Group predicted that the limited supply of wood could push North American prices to new peaks in 2017.

AGRICULTURAL COMMODITIES

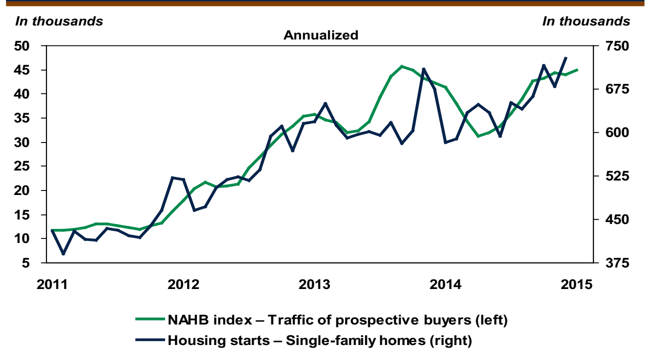
- Major grain prices have not been showing a clear trend in recent months (graph 20). Wheat prices, which had jumped at year-end, quickly fell as excellent harvests in numerous countries compensated for some bad weather in the United States. This calmer period contrasts with the heavy volatility seen in the first three quarters of 2014. The rise in prices at the start of last year was followed by a spectacular plunge when investors realized that, for a second straight year, the global grain harvest would be excellent. After hitting multiyear lows, grain prices recovered somewhat last fall, although they remain fairly low.
- Although the relative calm could last a few more weeks, the onset of spring could introduce more volatility into grain prices. The USDA's announcement of seeding intentions at the end of March sometimes touches off major relative movements in grain prices. It will also be interesting to see whether the substantial drop in grain prices in the last year will prompt U.S. farmers to cut back on seeding. After that, the weather will primarily dictate the trend for grain prices. **Relatively high grain stocks and very low gas prices, which could curb the use of grains for making ethanol and other biofuels, somewhat limit the risks of skyrocketing prices this year.**

Graph 18 – Forest product prices



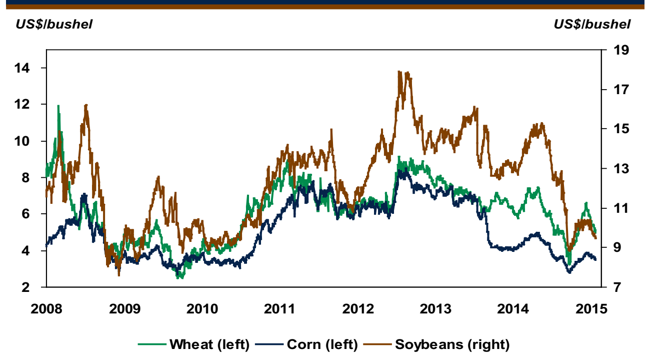
* Thousand board feet.
Sources: Datastream and Desjardins, Economic Studies

Graph 19 – Demand for homes is showing some encouraging signs in the United States



Sources: U.S. Census Bureau, National Association of Realtors 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		
	Feb. 3	1 month	3 months	6 months	1 year	High	Average	Low
Index								
Reuter-CRB[1] (CCI[2])	429.1	-4.1	-11.3	-17.0	-17.1	569.6	514.7	424.5
Reuters/Jefferies CRB[1]	220.4	-3.5	-18.5	-24.6	-22.3	312.9	283.0	212.6
Dow Jones AIG[3]	101.3	-2.4	-13.9	-20.3	-19.8	138.7	124.6	98.8
Bank of Canada	409.8	-8.2	-29.1	-37.1	-36.5	684.5	610.2	409.8
Energy								
Brent oil (US$/barrel)	53.1	-5.1	-37.3	-48.6	-49.7	115.5	94.1	45.7
WTI[4] oil (US$/barrel)	49.3	-6.6	-37.5	-49.7	-48.9	107.3	88.9	44.1
Gasoline (US$/gallon)	2.07	-10.0	-30.9	-41.6	-37.2	3.71	3.26	2.04
Natural gas (US$/MMBTU[5])	2.63	-12.0	-29.1	-29.9	-47.6	7.92	4.20	2.63
Base metals								
LMEX[6]	2,717	-6.2	-13.4	-16.6	-10.1	3,316	3,085	2,667
Aluminium (US$/tonne)	1,856	2.8	-10.6	-5.4	13.6	2,089	1,874	1,634
Copper (US$/tonne)	5,525	-12.6	-18.5	-22.1	-21.9	7,235	6,736	5,433
Nickel (US$/tonne)	15,274	3.5	-2.6	-16.7	10.5	20,955	16,956	13,709
Zinc (US$/tonne)	2,124	-3.2	-8.0	-9.3	8.7	2,417	2,168	1,934
Steel (US$/tonne)	490.0	0.0	6.5	17.5	36.1	490.0	423.4	355.0
Precious metals								
Gold (US$/ounce)	1,272	7.0	8.8	-1.8	0.6	1,376	1,266	1,146
Silver (US$/ounce)	17.2	9.6	6.6	-15.3	-10.6	22.1	18.8	15.3
Platinum (US$/ounce)	1,223	2.5	-1.5	-16.3	-11.8	1,512	1,368	1,178
Palladium (US$/ounce)	773.0	-2.3	-3.4	-11.3	8.9	911.0	807.6	702.0
Other commodities								
Lumber (US$/tbf[7])	362.0	-6.0	-4.0	-6.0	-10.2	409.0	381.3	362.0
Pulp (US$/tonne)	1,018	-0.8	-0.9	-1.2	1.6	1,030	1,025	1,002
Newsprint (US$/tonne)	566.0	-0.3	-1.7	-2.9	-3.3	585.3	579.4	566.0
Wheat (US$/bushel)	4.98	-15.0	9.3	-0.8	-15.3	7.45	5.73	3.26
Corn (US$/bushel)	3.52	-5.1	4.1	1.6	-16.6	4.99	3.94	2.79
Soybean (US$/bushel)	9.46	-4.7	-6.2	-22.0	-26.2	15.29	12.24	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	2013	2014	2015f	2016f
WTI* oil (US$/barrel)	98	93	Target: 57 (range: 45 to 65)	Target: 78 (range: 65 to 85)
Natural gas Henry Hub (US$/MMBTU**)	3.73	4.34	Target: 3.50 (range: 2.75 to 4.00)	Target: 4.00 (range: 3.25 to 4.75)
Gold (US$/ounce)	1,411	1,266	Target: 1,200 (range: 1100 to 1,300)	Target: 1,100 (range: 1000 to 1,200)
LMEX*** index—base metals	3,183	3,117	Target: 3,250 (range: 2,900 to 3,500)	Target: 3,500 (range: 3,100 to 3,800)

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