Commodity Trends

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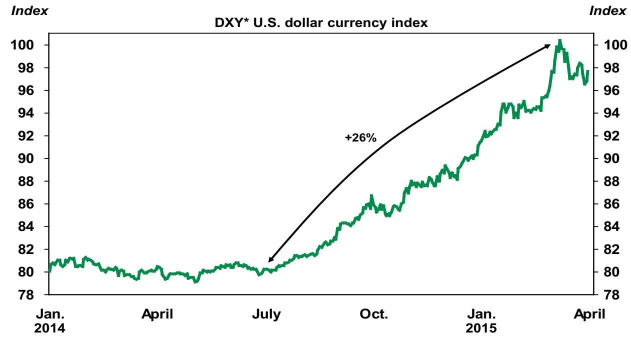
The second half of 2015 should be more favourable for commodities

Gloom continues to pervade the commodities market, and the main price indexes have slumped by around 2% between the end of January and the end of March. That decline is fairly modest, however, considering that the DXY index (which measures the value of the greenback) recently leapt to its highest level since 2003 (graph 1). That index's spectacular escalation of more than 25% since mid-2014 has clearly contributed to the generalized downturn in commodity prices.

The dramatic slide in oil prices has been replaced with stabilizing prices for WTI (West Texas Intermediate) and a slight upturn in the price of Brent since mid-January. However, the expansion of U.S. oil inventories does not point towards any strong price recovery in the months ahead. On the industrial metals front, it is mainly concerns about Chinese demand that are still predominant. Some improvement in the European economic data could have helped matters, were it not for numerous disappointments in U.S. statistics (graph 2).

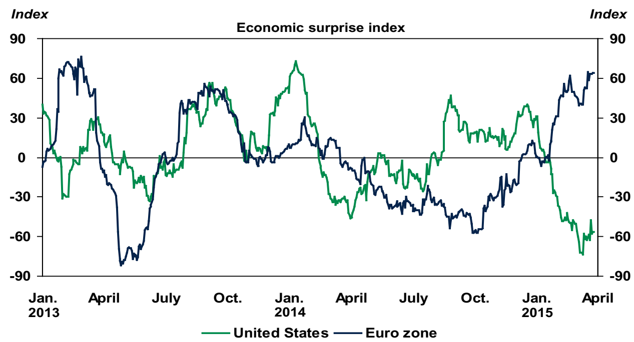
While the next few months do not look very promising, the second half of 2015 should be more favourable for commodity prices. First of all, global growth is likely to be more robust, as the U.S. economy should rebound strongly after the difficult winter, just as we saw in 2014, and the other major economies should benefit from highly stimulative monetary policies. Moreover, the glut in the global oil market should melt away, promoting a rally in crude prices and more favourable investor sentiment towards all commodities.

Graph 1 – The U.S. dollar has made a spectacular surge since last summer



* Weighted U.S. dollar average against six major currencies: the euro, yen, pound, Canadian dollar, Swedish krona and Swiss franc.
Sources: Bloomberg and Desjardins, Economic Studies

Graph 2 – Since the beginning of 2015, the good economic news has mainly come from the euro zone



Sources: Bloomberg, Citigroup 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.

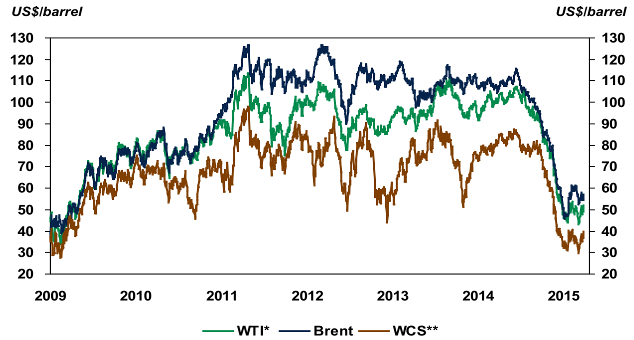
ENERGY

The stability of oil prices masks many opposite forces

OIL

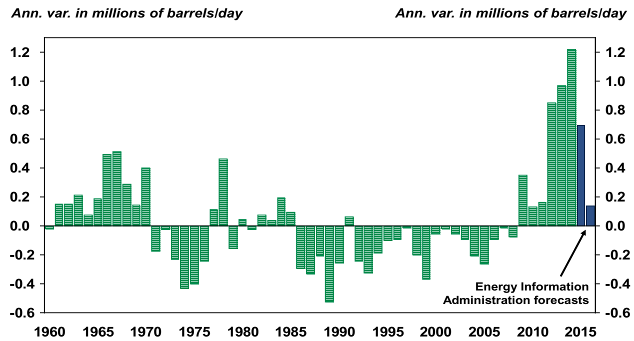
- After plunging from over US$105 at the mid-point of 2014 to less than US$45 at the end of January 2015, the price of a barrel of oil has stabilized; it is now fluctuating within a range spanning US$10 or so, centred at around US$48. The price of Canadian oil is also staying close to its cyclical lows, while the price of Brent has recorded a slightly more significant rally, approaching US$60 per barrel (graph 3). This rally, combined with higher refinery margins due to seasonal and unforeseen refinery outage, has driven gasoline prices back up.
- The end of the oil price slump mainly reflects investors realizing that prices had fallen sufficiently to rebalance the oil market. Keep in mind that the price slump was triggered by the appearance of a global oil surplus around the middle of 2014. This surplus stemmed from the spectacular surge in U.S. output, a surprise increase in Libyan and Iraqi production, and weaker-than-expected global demand. The slump became a collapse at the end of 2014 when the member countries of the Organization of the Petroleum Exporting Countries (OPEC), with Saudi Arabia in the lead, refused to cut their production, allowing prices to rebalance the market.
- It now appears increasingly clear that this rebalancing is in progress. U.S. companies have cut back their drilling by around 50% in recent months, indicating a marked decline in investment towards the development of new oil wells. The downturn in energy sector activity is also evident in Canada. So far, this has not had any effect on the supply, since the United States recorded record growth in its oil production in 2014 (graph 4). However, it looks like this trend is drawing to an end. After a massive increase of 1.2 mbd (millions of barrels per day) in 2014, U.S. output should increase by 0.7 mbd in 2015 and by less than 0.2 mbd in 2016, according to the Energy Information Administration (EIA). Moreover, the increase of 2015 will mainly consist of gains achieved in the past few quarters, whereas U.S. output should practically stagnate from this point onwards. Therefore, the anticipated increase in U.S. oil production from December 2014 to December 2015 is just 0.2 mbd, a clear sign that the low crude prices have put the brakes on production growth. Under these conditions, indications are that the large global oil surplus that we see now will be replaced with a fairly balanced market in the second half of 2015 (graph 5).

Graph 3 – Price of oil



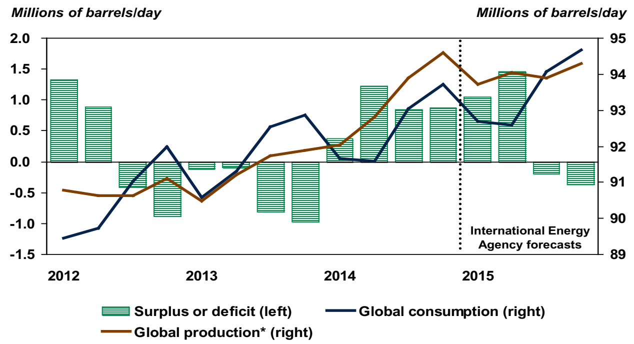
* West Texas Intermediate; ** Western Canada Select.
Sources: Datastream, Bloomberg and Desjardins, Economic Studies

Graph 4 – After record growth in 2014, U.S. oil production will slow down sharply



Sources: Energy Information Administration and Desjardins, Economic Studies

Graph 5 – After expanding at the beginning of 2015, the oversupply of oil should disappear in the second half of the year



* Assuming stable production by the Organization of the Petroleum Exporting Countries (OPEC) at 30 million barrels per day.
Sources: International Energy Agency and Desjardins, Economic Studies

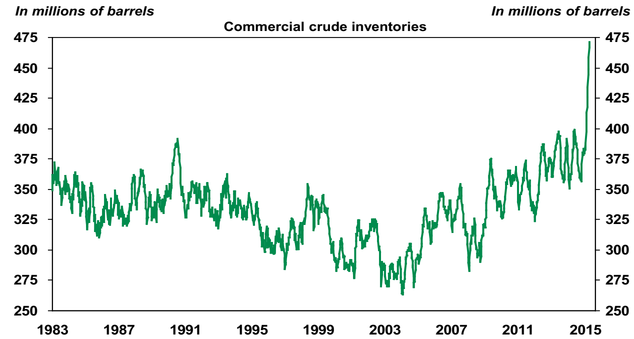
- However, other factors are keeping a lid on oil prices. First, the global surplus is causing U.S. crude inventories to skyrocket (graph 6). Some observers are beginning to apprehend that the maximum storage capacity in the United States might be reached. In theory, this could cause oil prices to collapse if no one wanted to buy oil for lack of a place to store it. But that risk appears to be very slim. A few weeks ago, the EIA estimated that the oil storage capacity was only 60% full. In addition, since the United States is still consuming far more oil than it produces, cutting imports would be a quick way of halting the build-up of inventories, should that become necessary. Nevertheless, further foreseeable expansion of inventories in the months to come is likely to keep weighing North American oil prices down.
- Negotiations surrounding Iran's nuclear program are also limiting the potential for an upturn in oil prices. An agreement could allow Iran to massively expand its oil exports (graph 7), which would amplify and prolong the global crude surplus. A framework agreement had been reached in April, but many details still need to be negotiated. On another front, the military intervention by Saudi Arabia in Yemen presents an upside risk for prices, since it signals escalation of the latent conflict between Saudi Arabia and Iran, which could truly engulf the Middle East.

GASOLINE

- Despite the extremely cold temperatures recorded in February, the prices of North American natural gas are still close to their lowest levels since the summer of 2012. At US$2.62 per MMBTU (Million British Thermal Unit), the price of gas is down by more than 60% from the peaks reached last winter (graph 8) when even colder weather sparked fears of gas shortages. The build-up of natural gas inventories in the autumn and the sharp increase in supply, with U.S. gas output surging 6.1% in 2014, account for the current limp prices. We must now keep an eye on the repercussions of the decline in oil well drilling on gas production, since both products are frequently extracted from the same deposits.

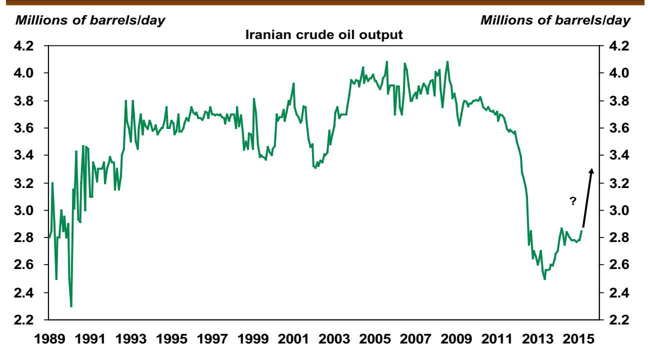
Forecasts: Oil prices should remain very low in the months to come, while crude inventories should keep growing. Nevertheless, we are still counting on a significant upturn in oil prices starting at the mid-point of 2015, when the quasi-stagnation of North American output should be confirmed, thereby rebalancing the crude market. However, a lifting of trade sanctions against Iran could extend the period of limp oil prices, or even drive them to new cyclical lows. Gasoline prices could slip down a bit in the months to come, while indications are that natural gas prices will stay low.

Graph 6 – U.S. oil inventories are skyrocketing



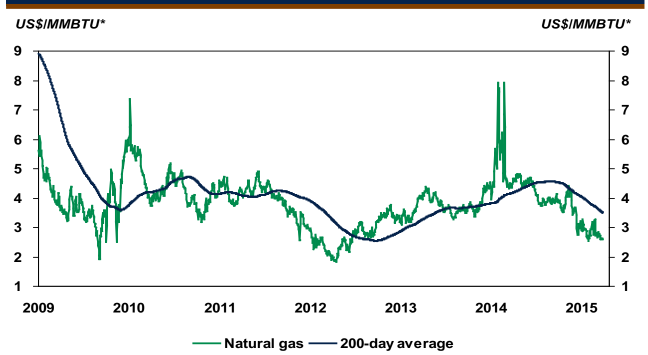
Sources: Energy Information Administration and Desjardins, Economic Studies

Graph 7 – A return to normal in Iran would amplify and prolong the global oil surplus



Sources: Bloomberg and Desjardins, Economic Studies

Graph 8 – Price of natural gas



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

BASE METALS

Chinese demand is still raising concerns

After a challenging month of January, the LME (London Metal Exchange) index of metal prices has edged back up to nearly 2,800 (graph 9). This rise mainly reflects the rally in copper prices, while the prices of most other industrial metals fell recently.

The strength of the U.S. dollar is contributing to the limpness of base metal prices, but the most important factor is still concern about demand from China. The data on Chinese imports are showing a pullback for most metals, compared with last year, in the first months of 2015. We should keep in mind, though, that Chinese data are always highly volatile at the beginning of the year. The willingness of Chinese authorities to take action to avoid a further economic slowdown and an upturn in certain activity indexes provide some grounds for continued hope that Chinese demand will pick up a bit. As for other major economies, the euro zone is sending encouraging signals, but the U.S. economy seems to be struggling at the beginning of 2015 (graph 10).

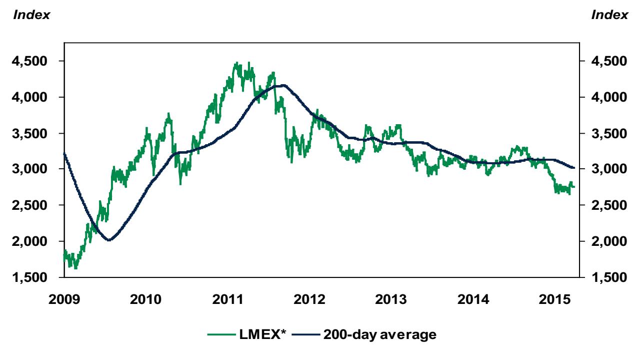
ALUMINUM

- After declining at the end of 2014, the price of aluminum has stabilized at around US$1,800 per tonne. We note, however, that the premium paid by consumers wishing to acquire this metal quickly has dropped significantly in recent months. The price actually paid by large U.S. consumers of aluminum has thus fallen by around US$400 per tonne since last November (graph 11). This cut in the premium appears to reflect less favourable financial conditions for holding inventories and the introduction of new rules by the LME to force metal warehouses to make their inventories available to buyers faster. If this downwards trend of the premium continues, it could encourage aluminum producers to further reduce their production. Given that global consumption of this metal should continue to significantly exceed production this year, the price outlooks remain quite favourable.

COPPER

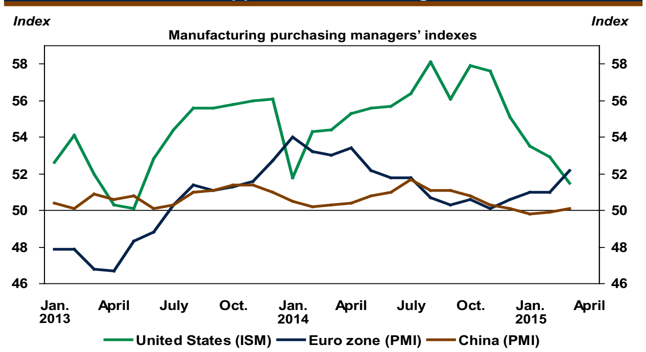
- Contrary to most metals, the price of copper has been doing well lately, climbing from a cyclical low of US$5,433 per tonne at the end of January to a little over US$6,000 (graph 12 on page 5). However, on a year-over-year basis, it is still down by around 10%. Apprehensions about a surplus of copper are continuing to have a dampening effect on its price, especially since Chinese imports of this metal have been flagging lately. Torrential rains in Chile, causing the temporary shutdown of some major mines, have contributed to the recent uptick in prices. Some signs that Chinese demand could soon firm up are also positive for copper.

Graph 9 – Industrial metal prices are still soft



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

Graph 10 – The manufacturing sector is picking up in the euro zone but appears to be faltering in the United States



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

Graph 11 – Price of aluminum

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

NICKEL

- The price of nickel has plummeted by nearly 20% since the beginning of 2015, reaching US$12,339 per tonne, its lowest level since the spring of 2009 (graph 13). This confirms that the surge in nickel prices at the beginning of 2014, after the announcement that Indonesia would stop exporting unprocessed ore, was very premature. Despite quasi-stagnation in global nickel production last year, the market is still in a surplus position, and nickel inventories have kept growing. The limpness of Chinese demand in the second half of 2014 contributed to this state of affairs. An anticipated pullback in nickel output in 2015 should help rebalance the global market and give the price of this metal a little shot in the arm.

ZINC

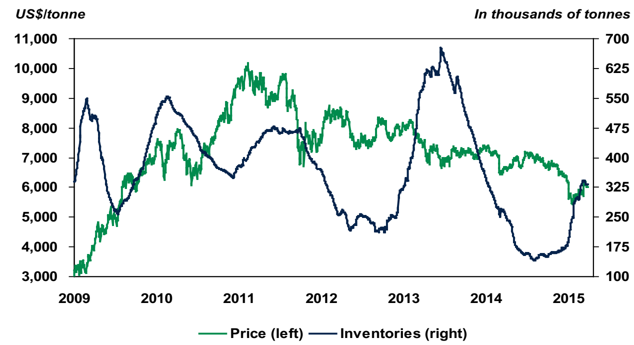
- The price of zinc has continued to hover around US$2,100 per tonne in recent months. With an appreciation of more than 5% over the past year, this is the best showing of the industrial metals that we track. The decline of over 25% in zinc inventories, as recorded by the LME, is contributing to this metal's strong performance. Consumption of zinc should once again exceed production this year.

STEEL

- One of the mysteries of 2014 was the surge in the LME's benchmark price for steel, despite an unfavourable environment for industrial metals and a collapse in iron prices. Reality caught up with this price with a vengeance; it has plunged by 40% since the beginning of 2015, returning to around US$300 per tonne (graph 14). Apart from the extreme fluctuations in the LME steel price, the global steel market is still characterized by relatively soft demand and production overcapacity. The latest data from the World Steel Association show a 1.3% pullback in global output during the first two months of 2015, compared with the same period of 2014.

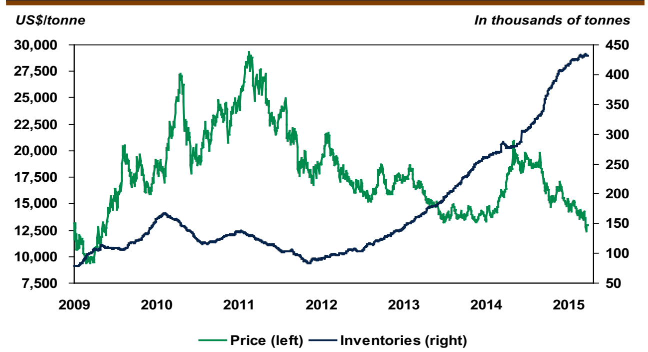
Forecasts: Ongoing uncertainty about the health of the global economy is likely to keep industrial metal prices close to their current low levels in the months to come. Economic conditions should become more favourable in the second quarter, once the U.S. economy gets back to cruising speed. The future trend in Chinese demand will also have a decisive impact.

Graph 12 – Copper price and inventories



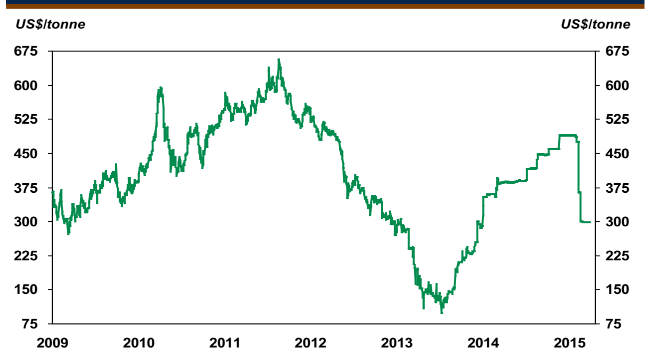
Sources: Datastream and Desjardins, Economic Studies

Graph 13 –Nickel price and inventories



Sources: Datastream and Desjardins, Economic Studies

Graph 14 – Price of steel



Sources: Datastream and Desjardins, Economic Studies

PRECIOUS METALS

Monetary policies and the dollar generate fluctuations in the price of gold

The price of gold has seen some considerable swings in recent months, mainly reflecting developments in monetary policies and in the U.S. dollar. It is not showing any clear trend, however. The price of silver has fared somewhat better, while platinum and palladium prices are on a downwards slope.

GOLD AND SILVER

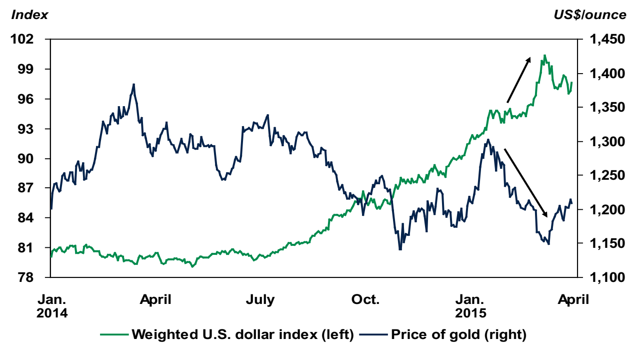
- The series of monetary easing measures announced by central banks at the beginning of 2015 boosted the price of gold from US$1,186 per ounce at the end of 2014 to over US$1,300 per ounce on January 22. That increase was swiftly followed by a drop, however, when the sharp appreciation of the U.S. dollar (graph 15), amplified by the release of good job market statistics at the beginning of February and March, drove the price of gold below US$1,150 per ounce by mid-March. More recently, the message from the Federal Reserve that its monetary tightening would be very gradual sent the price of gold back up over US$1,200 per ounce. Apart from the strength of the greenback, weak inflation is also limiting the attraction of gold in investors' eyes. Declining foreign currency reserves in certain emerging countries could also limit demand for gold on the part of some central banks, especially in the case of Russia, which will struggle to keep increasing its gold holdings under the current circumstances. After a rough ride in 2014, the price of silver is doing somewhat better than that of gold; it is posting a gain of slightly over 5% since the beginning of 2015 (graph 16).

PLATINUM AND PALLADIUM

- Platinum and palladium prices are facing a tough start to the year, since they are affected both by the factors that play against precious metals (in particular the strength of the U.S. dollar) and those that play against industrial metals, including flagging Chinese demand. The price of platinum has fallen by 4% since the beginning of 2015, while that of palladium is down by 7% (graph 17).

Forecasts: Continuing low interest rates and very expansionist monetary policies should enable the price of gold to stay close to its current level in the next few months, especially since the U.S. dollar could weaken temporarily. But the anticipated raising of U.S. key interest rates towards the end of the summer heralds more difficulties for gold prices towards the end of the year. Like industrial metal prices, those of platinum and palladium could start heading up again in the second half of 2015.

Graph 15 – The surge in the greenback has caught up with the price of gold

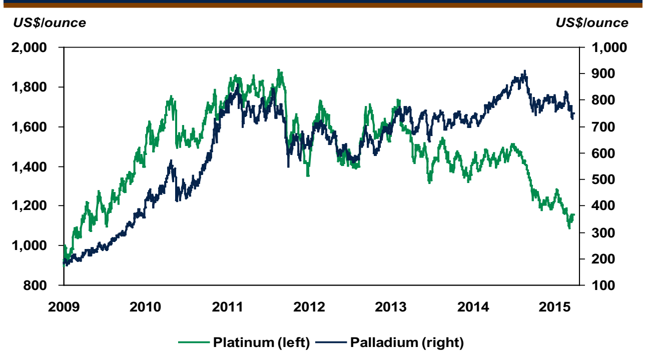


Sources: Bloomberg and Desjardins, Economic Studies

Graph 16 – Price of silver

Sources: Datastream and Desjardins, Economic Studies

Graph 17 – Prices of platinum and palladium



Sources: Datastream and Desjardins, Economic Studies

OTHER COMMODITIES

Farmers adjust to lower prices

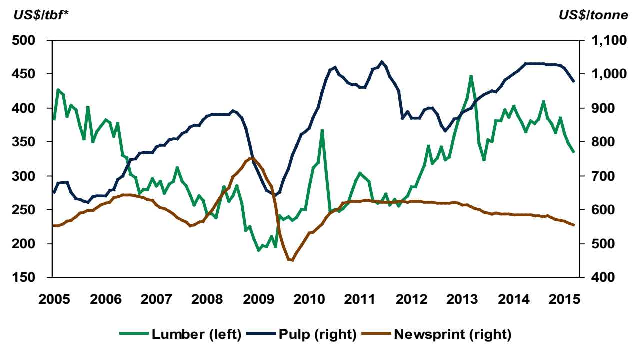
FOREST PRODUCTS

- The downwards trend of commodity prices is not sparing forest products. The price of newsprint has dipped by around 2% since the beginning of 2015, while that of pulp is down by 4.5% (graph 18). The slump in lumber prices is more dramatic: a 12% drop since the start of the year has pushed the price of wood to around US$335/tbf (thousand board feet), its lowest level since the summer of 2013. This is in large measure due to the harsh winter in the United States, which has kept housing starts in check. **However, the latest data from the real estate market are more encouraging, and a rally in U.S. activity should provide some support for lumber prices within a few months.** For Canadian lumber producers, the most important issue of 2015 is clearly the renewal of the lumber exports agreement between Canada and the United States that will expire next October.

AGRICULTURAL COMMODITIES

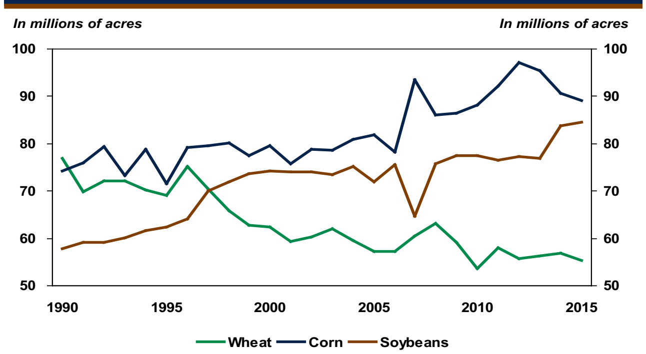
- After the marked slump of 2014, the prices of the main grains have continued along a downwards path in the first months of 2015. Prices of wheat and corn have fallen nearly 25% in the past 12 months, while the bountiful harvests of recent years have generated a significant increase in global grain inventories. The annual drop for the price of soybeans is nearly 35%. Analysts have been waiting eagerly for the end of March, anticipating the release of U.S. farmers' sowing intentions and a new estimate of inventories.
- Sowing intentions confirm the impact of the price slump: the surface areas devoted to the three main grains will probably shrink by around 1% this year. Wheat plantings will be reduced by 3% and corn plantings by 2%, while 1% more fields will be earmarked for soybeans. It should be pointed out that despite a significant drop in soybean prices, this grain is still fairly profitable for farmers. Analysts were predicting an even greater substitution of soybeans for corn, which explains why that piece of news drove corn prices down. Moreover, data on U.S. corn inventories have been showing an expansion of 11% from a year ago, which puts them at their highest level since 1987. **The next few months will be decisive for grain prices, given that weather conditions, especially in the United States, will have a major impact on the 2015–2016 harvest.**

Graph 18 – Prices of forest products



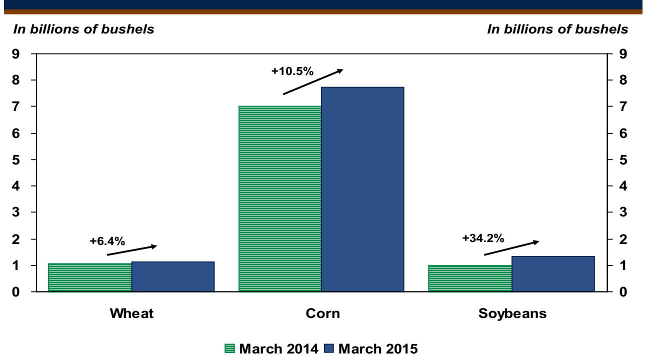
* Thousands of board feet.
Sources: Datastream and Desjardins, Economic Studies

Graph 19 – Seeded acreages in the United States



Sources: Datastream and Desjardins, Economic Studies

Graph 20 – Grain inventories in the United States



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

Table 1
Commodities

	Spot price	Percentage return since				Last 52 weeks		
	April 7	1 month	3 months	6 months	1 year	High	Average	Low
Index								
Reuter-CRB[1] (CCI[2])	426.9	0.8	-4.7	-13.8	-23.5	569.6	493.8	409.7
Reuters/Jefferies CRB[1]	220.0	-0.3	-2.2	-21.4	-27.7	312.9	269.4	209.0
Dow Jones AIG[3]	101.0	0.2	-2.5	-15.8	-25.0	138.7	119.2	97.0
Bank of Canada	418.1	-1.3	-3.0	-32.6	-36.6	684.5	569.6	400.5
Energy								
Brent oil (US$/barrel)	57.2	-4.7	13.7	-37.4	-45.8	115.5	85.3	45.7
WTI[4] oil (US$/barrel)	52.1	5.0	7.0	-41.4	-48.1	107.3	80.1	43.4
Gasoline (US$/gallon)	2.41	-2.4	9.0	-26.9	-32.9	3.71	3.07	2.04
Natural gas (US$/MMBTU[5])	2.62	-9.0	-14.7	-32.3	-42.4	4.83	3.76	2.55
Base metals								
LMEX[6]	2,755	1.7	-3.3	-11.2	-9.0	3,316	3,035	2,652
Aluminium (US$/tonne)	1,781	0.7	1.1	-7.4	-0.0	2,089	1,889	1,718
Copper (US$/tonne)	6,003	4.1	-2.9	-10.5	-10.0	7,186	6,561	5,433
Nickel (US$/tonne)	12,977	-9.3	-16.2	-23.1	-20.7	20,955	16,783	12,339
Zinc (US$/tonne)	2,121	6.0	-0.1	-8.2	6.4	2,417	2,176	1,977
Steel (US$/tonne)	298.0	-0.7	-39.2	-33.3	-22.9	490.0	421.1	298.0
Precious metals								
Gold (US$/ounce)	1,224	4.1	0.7	1.1	-5.9	1,338	1,247	1,146
Silver (US$/ounce)	16.8	5.3	3.1	-3.0	-15.0	21.5	18.1	15.3
Platinum (US$/ounce)	1,154	-1.0	-5.3	-8.3	-19.6	1,512	1,322	1,088
Palladium (US$/ounce)	751.0	-8.7	-5.5	-3.5	-4.3	911.0	812.9	729.0
Other commodities								
Lumber (US$/tbf[7])	337.0	-1.2	-12.5	-11.5	-8.9	409.0	374.1	333.0
Pulp (US$/tonne)	980	-1.9	-4.0	-4.6	-3.9	1,030	1,022	980
Newsprint (US$/tonne)	553.7	-1.0	-2.4	-4.6	-5.0	584.1	575.1	553.7
Wheat (US$/bushel)	5.27	8.8	-9.8	38.3	-24.8	7.45	5.47	3.26
Corn (US$/bushel)	3.68	0.8	-0.8	23.5	-23.3	4.99	3.79	2.79
Soybean (US$/bushel)	9.68	-0.4	-7.0	6.2	-34.1	15.29	11.53	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$/barrel)	98	93	Target: 56 (range: 45 to 60)	Target: 74 (range: 64 to 84)
Natural gas Henry Hub (US$/MMBTU**)	3.73	4.34	Target: 3.25 (range: 2.50 to 3.75)	Target: 4.00 (range: 3.25 to 4.75)
Gold (US$/ounce)	1,411	1,266	Target: 1,200 (range: 1,125 to 1,275)	Target: 1,100 (range: 1,000 to 1,200)
LMEX*** index—base metals	3,183	3,117	Target: 3,000 (range: 2,500 to 3,300)	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