Commodity Trends

Desjardins Economic Studies
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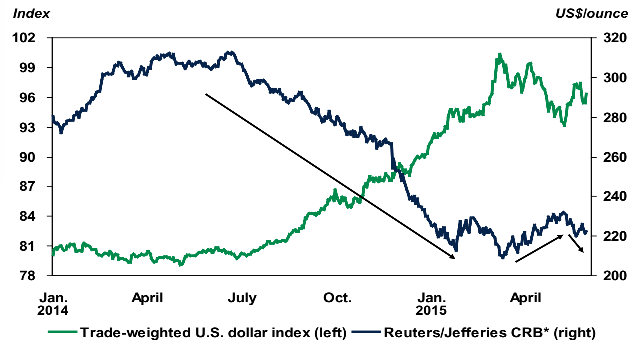
The upswing in prices seems fragile

Following a tough start to the year, the main commodity price indexes have edged up about 5% since mid-March. The rebound primarily reflects a more than 30% surge in oil prices, with WTI (West Texas Intermediate) recently hitting US$60/barrel. This level does not seem sustainable, however, as everything indicates the global crude market will continue to have a surplus. Industrial metal prices also did well in April, but the last few weeks have been hard. As with many other financial assets, the U.S. dollar's fluctuations are currently having a big influence on commodity prices (graph 1).

The surge in commodity prices is not based on signs that the global economy is picking up steam. While the economic news has been generally good in the euro zone and Japan since the start of 2015, the U.S. economy's surprise first-quarter retreat (graph 2) and new signs of slowing in China are a worry. Thankfully, the problems in the U.S. economy should be temporary and more sustained growth is expected as of now.

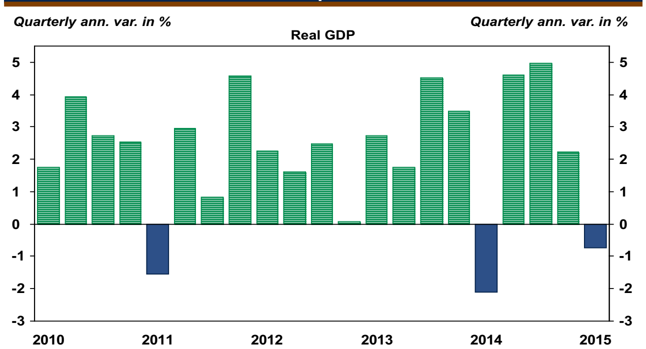
Commodity prices could be volatile in the coming quarters. The macroeconomic context should improve progressively, but another period of greenback appreciation could hurt commodity prices, especially if the Federal Reserve starts to raise its key rates.

Graph 1 – Since mid-2014, commodity price movements have been heavily affected by the dollar



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

Graph 2 – Once again, the U.S. economy saw a very difficult first quarter



Sources: Bureau of Economic Analysis and Desjardins, Economic Studies

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NOTE TO READERS: The letters **k**, **M** and **B** are used in texts and tables to refer to thousands, millions and billions respectively.

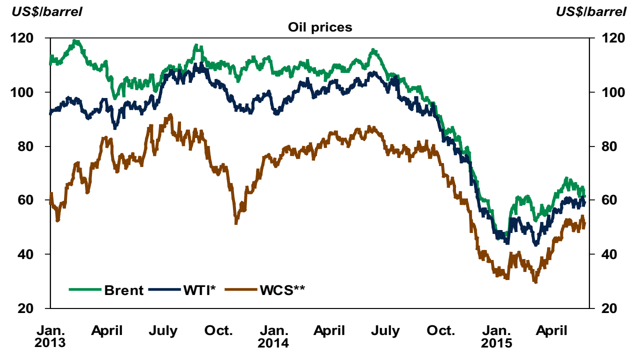
ENERGY

The oil surplus could persist

OIL

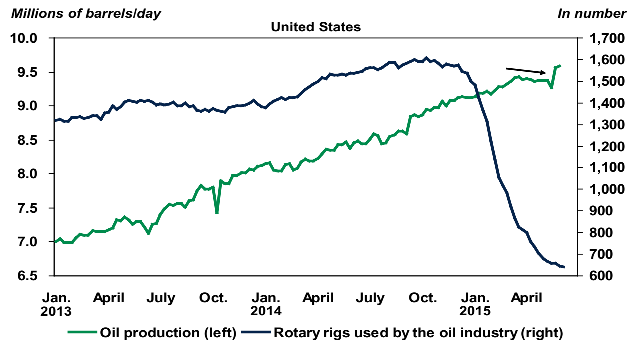
- WTI (West Texas Intermediate) oil went from less than US$45/barrel in mid-March to above US$60 recently (graph 3). The more than 30% gain primarily reflects the confirmation that U.S. oil production is stagnating due to the collapse in drilling as well as the end to the spectacular surge in U.S. crude inventories. Western Canadian oil is also up more than US$20/barrel, a level more attractive to Canadian producers. A sign that the rebound primarily reflects the U.S. context, Brent oil went up much less; it is now trading at just US$3 a barrel more than WTI.
- The movement in U.S. output and inventories seemed to confirm that the spectacular drop in oil prices was in the process of rebalancing the global market by reducing the rise of the oil supply. However, U.S. production jumped higher at the end of May (graph 4). Moreover, crude output is rising strongly in other countries. Far from cutting back, the nations that belong to the Organization of Petroleum Exporting Countries (OPEC) increased their output by close to 1.1 mbd (millions of barrels per day) between January and May of 2015, according to Bloomberg's estimates. This primarily reflects big increases in Saudi Arabia (+0.5 mbd), Iraq (+0.5 mbd) and the United Arab Emirates (+0.2 mbd). The June 5 OPEC meeting confirmed that these countries had no plans to lower their output in the near term. The big surge in OPEC's production suggests that the global oil market will remain in surplus throughout 2015, even though U.S. output is expected to stagnate (graph 5). What remains to be seen is whether a final agreement on Iran's nuclear program will also allow that country to boost output substantially within a few quarters.
- Although the supply news does not seem very promising for crude prices, some signs from demand are more encouraging. After ticking up by just 0.7 mbd in 2014, global demand strengthened in the first quarter, hitting annual growth of 1.4 mbd thanks to a rebound in Europe and a strong advance in Asia. The surge in Chinese oil imports, which hit a new peak in April and are up an annual 9%, could indicate renewed lively demand there. The weekly data on demand for petroleum products in the United States is also showing solid annual growth of around 4% since the start of 2015 (graph 6). The robust oil consumption growth in spite of a fairly difficult economic environment could mean that low prices are having a substantial impact on demand for petroleum products.

Graph 3 – The recent upswing in oil prices has been especially steep in North America



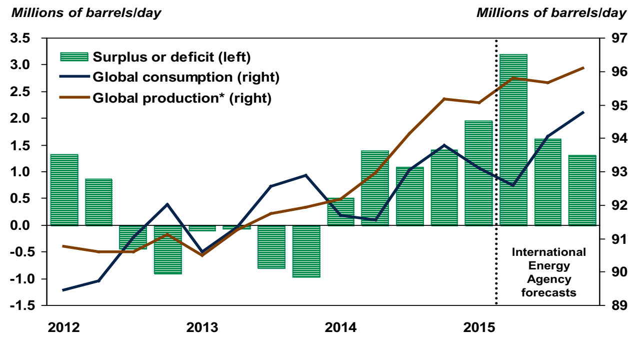
* West Texas Intermediate; ** Western Canada Select.
Sources: Datastream, Bloomberg and Desjardins, Economic Studies

Graph 4 – The drop in drilling put the brakes on U.S. production growth, but it has recently rebounded



Sources: Baker Hughes, Energy Information Administration and Desjardins, Economic Studies

Graph 5 – The global oil market could continue to have a major surplus



* Assuming that production by the Organization of Petroleum Exporting Countries (OPEC) remains stable at 31.5 million barrels per day.
Sources: International Energy Agency and Desjardins, Economic Studies

GASOLINE

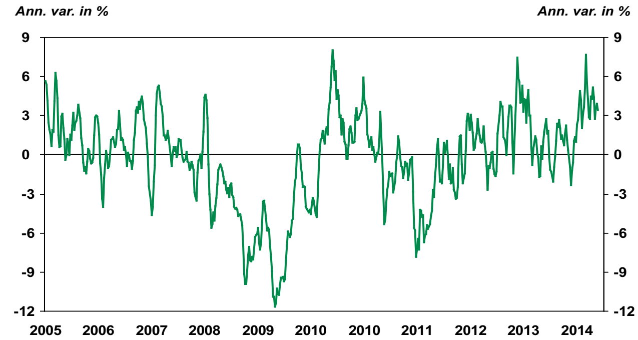
- Like oil prices, gasoline prices have shot up in the last few months. In the United States, a gallon of regular gas recently hit US$2.76, up more than 35% from its low at the end of January (graph 7). In Canada, regular gas has climbed about C$0.25 a litre and now stands at C$1.17/litre. Despite this, in the United States, prices are currently off about 25% from where they were at this time last year; in Canada, they are down about 15%. Beyond the upswing in crude prices, higher gas prices also reflect high refinery margins. The high margins, however, seem to be starting to stimulate gas production in the United States. In the context of already high gasoline inventories, it suggests that margins should normalize, which could benefit drivers.

NATURAL GAS

- Unlike oil prices, natural gas prices remain very low, at around US$2.56/MMBTU (Million British Thermal Units) (graph 8). The low prices reflect a well-supplied U.S. market: even after a relatively harsh winter, natural gas inventories are close to normal levels. Another sign of growing U.S. energy independence is that natural gas imports there retreated 9% last year, dropping to their lowest point since 1987. For 2015, the U.S. government is expecting a robust 6% increase in U.S. natural gas production. Demand should also see solid growth, as low natural gas prices should result in strong demand from energy producers; industrial demand will also be boosted as major plants that use natural gas to produce methanol and fertilizer come on line.

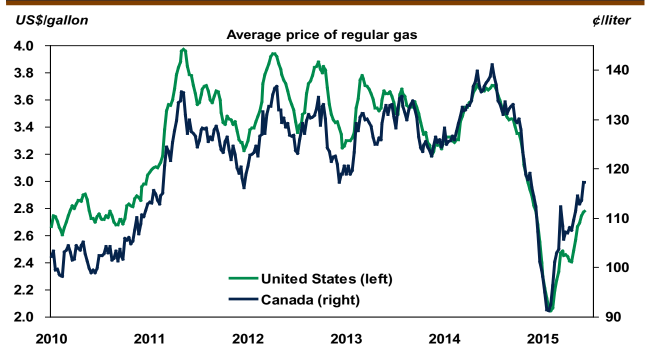
Forecasts: The ongoing global oil surplus paves the way for a temporary dip in oil prices in the months to come, particularly in the event of an agreement with Iran. We therefore expect WTI oil to end 2015 at around US$60/barrel. OPEC will not be able to keep increasing its output at this pace, however, and signs of accelerating demand point to a more lasting rise in prices next year. Despite fairly robust demand, natural gas prices should stay relatively low; we have trimmed our annual forecast for 2015 to US$2.90/MMBTU.

Graph 6 – U.S. demand for petroleum products is strong despite the GDP pullback



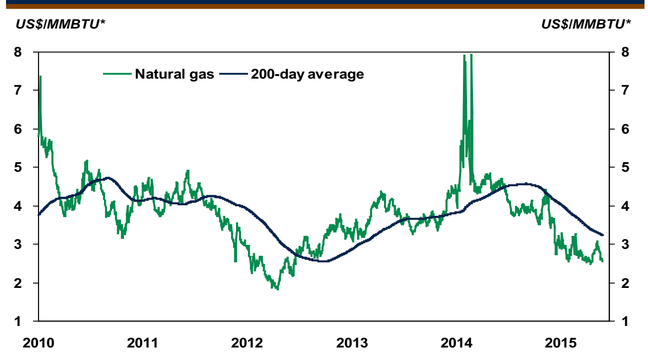
Sources: Energy Information Administration and Desjardins, Economic Studies

Graph 7 – Following a spectacular plunge at the end of 2014, gasoline prices have come up substantially



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

Graph 8 – Natural gas prices



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

BASE METALS

A tougher environment for aluminum

Base metal prices struggled early in the year, then began to rise as of mid-March on a dip of the U.S. dollar. The LME (London Metal Exchange) index of industrial metal prices hit 3,000 at the start of May, its highest point since December of 2014 (graph 9). However, the upswing did not last and another push by the greenback quickly took the LME index down to around 2,750.

Weak metal prices also reflect a fairly disappointing economic environment. The Organisation for Economic Co-operation and Development (OECD) cut its global growth forecast for 2015 by 0.5%, down to just 3.1%. This is not an encouraging development for industrial metal demand, especially as the OECD points to soft investment as a particular disappointment. Although the Chinese economy is slowing (graph 10), the fast-paced rise in the production of some metals there is also putting downside pressure on prices.

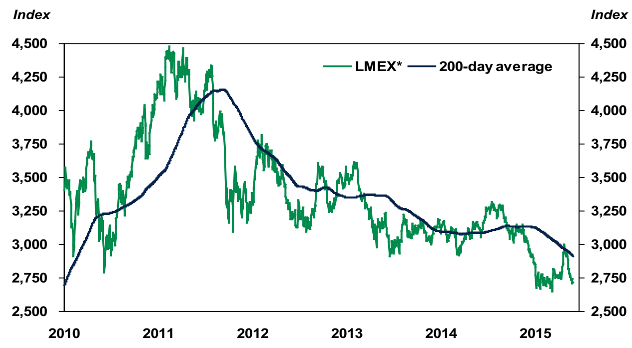
ALUMINUM

- At the end of 2014, aluminum seemed to be in good position to keep appreciating. The global market outside of China was in deficit and nothing augured a push in Chinese exports, especially as some consolidation efforts might curb the sector's growth. Moreover, everything suggested that most of the sizable aluminum inventories would stay in LME warehouses and not affect prices. However, the situation did not unfold as anticipated. Chinese production continues to skyrocket and exports of semi-processed aluminium products have surged. Moreover, the LME's efforts to facilitate access to inventories have paid off: aluminum inventories are down sharply, along with the premium buyers have to pay to get the metal quickly. The LME price for aluminum has recently fallen to around US$1,700 a tonne, off more than 15% since the end of November 2014 (graph 11). Over the same period, the North American price including the premium is down about 25%, which could prompt some smelters to further cut their output.

COPPER

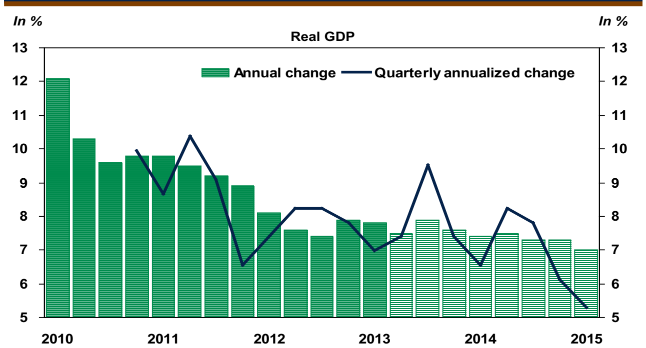
- Following some fluctuation, copper prices returned close to where they were at the end of March. The inventories of copper surveyed by LME jumped at the start of 2015, then retreated somewhat in the last few months (graph 12). This is because Chinese copper imports are a little more robust, although still lower than they were last year. Unlike what is being seen for other metals, the latest figures on Chinese copper output point to annual stagnation; however, the weakness is probably being exaggerated by one-off

Graph 9 – The upswing in industrial metal prices did not last



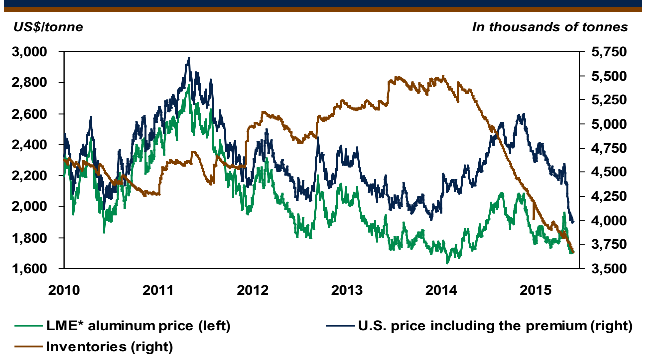
* London Metal Exchange base metal price index.
Sources: Datastream and Desjardins, Economic Studies

Graph 10 – Chinese economic growth is still slowing



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

Graph 11 – Aluminum prices and inventories



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

factors. International Copper Study Group data confirms that the global copper supply outstripped demand in the initial months of 2015.

NICKEL

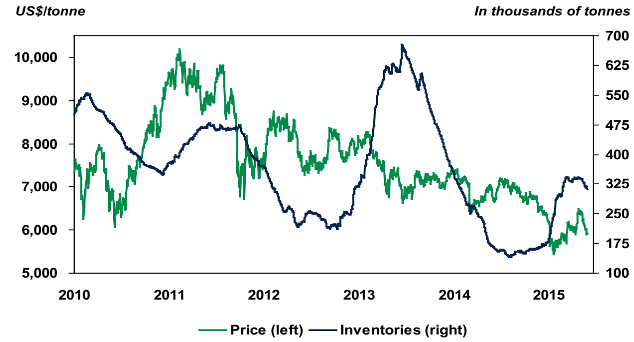
- Nickel prices have been particularly volatile lately. They were at a low of US$12,339 a tonne at the end of March, then jumped above US$14,300 in mid-May, capitalizing on the weak dollar and some renewed investor enthusiasm for commodities. Recently, they dropped back to around US$13,000 a tonne (graph 13). Despite these big swings, the nickel market's fundamentals have not changed much. Chinese nickel imports rebounded in April, but are down more than 20% for the first four months of the year compared with the same time in 2014. The weakness in demand is maintaining a surplus in the global nickel market and the inventories surveyed by the LME continue to surge. However, the decline in global nickel production should get the market back to equilibrium within a few quarters.

ZINC

- Unlike most other metals, zinc prices have not retreated substantially since the start of 2015 (graph 14). At US$2,118 a tonne, they are even up slightly in the last year, while the LME index is down 13%. Note that the global zinc market is in a deficit situation, as the inventories surveyed by the LME have once again fallen 12% since the end of March. However, Chinese zinc production is advancing quickly, resulting in relatively small imports of the metal, and prompting some analysts to say that the deficit is not as large as the drop in LME inventories suggests.

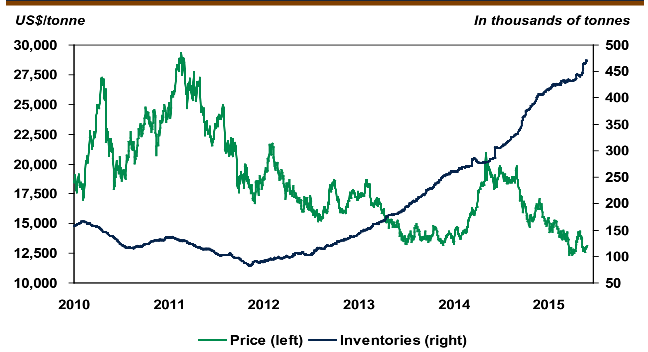
Forecasts: At first glance, the situation for industrial metal prices may seem discouraging. Note, however, that the currently weak prices largely reflect the greenback's surge and economic problems in early 2015. Although the dollar could keep hurting prices in the coming months, the economic statistics should progressively improve, especially in the United States. With growth in the supply of most metals promising to be limited, prices are still forecast to increase slightly by the end of 2015 and in 2016.

Graph 12 – Copper prices and inventories



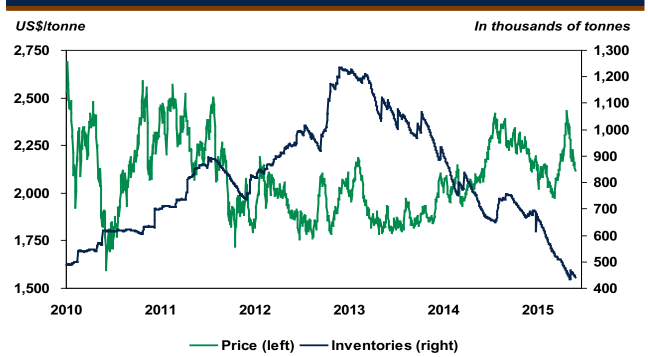
Sources: Datastream and Desjardins, Economic Studies

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 prices are still casting around for a direction

After getting a little boost from the greenback's retreat, precious metal prices pulled back in the last few weeks, generally returning close to where they were at the end of March.

GOLD AND SILVER

- Given the major movements seen in the financial markets, it is a little surprising to note how little gold prices have fluctuated since the end of March. Per ounce, gold has not moved more than US$30 away from US$1,200 in the last two months (graph 15). This level seems to have turned into an important benchmark for gold. The greenback's retreat from mid-March to mid-May did not help gold much, likely because it came with a substantial rise in interest rates. The extensive uncertainty about the timing for the start to the Federal Reserve's (Fed) monetary firming could also explain the hesitation in gold prices. More fundamentally, World Gold Council data shows that gold demand edged down in the first quarter of 2015. In particular, Chinese demand has dropped sharply, with households opting to turn to the stock market (graph 16). For their part, the central banks continue to build their gold reserves. Silver prices closed in on US$18 an ounce in mid-May, but the greenback's rebound took them below US$17.

PLATINUM AND PALLADIUM

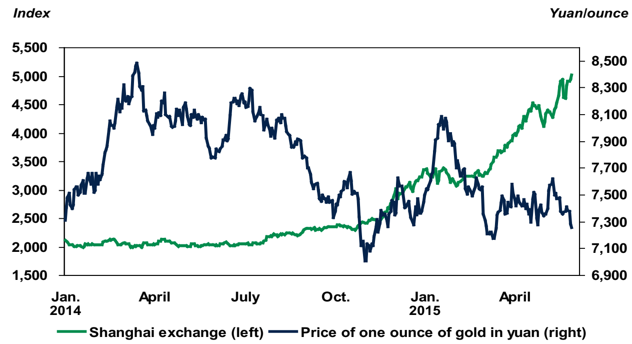
- Like most other metals, platinum and palladium prices rebounded somewhat from mid-March to mid-May, and then dropped substantially in the last few weeks. Platinum prices are down to around US$1,100 an ounce, quite a gap with gold prices (graph 17). Palladium prices followed a similar trend but, at US$750 an ounce, they are still up over US$20 an ounce from their 2015 low. Weak Chinese platinum imports have a hand in this metal' low prices.

Forecasts: Gold could stay close to US$1,200 an ounce for a while longer, capitalizing on ongoing, highly expansionary monetary policies. However, confirmation that the U.S. economy is rebounding, which would pave the way for monetary firming, should take gold prices close to US$1,150 at the end of 2015. Conversely, improvement in the economic environment should foster an upswing in platinum and palladium prices.

Graph 15 – Gold and silver prices

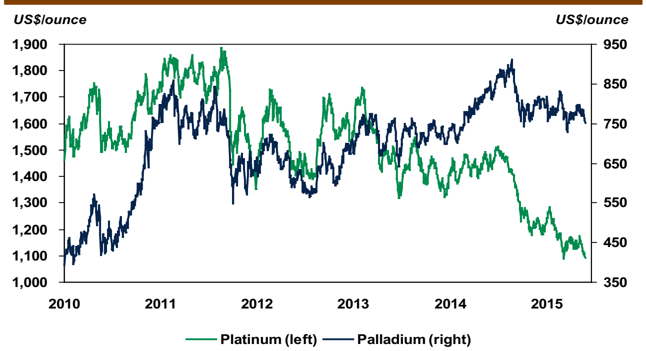
Sources: Datastream and Desjardins, Economic Studies

Graph 16 – Unlike gold, the stock market has been extremely profitable for Chinese investors in the last months



Sources: Datastream and Desjardins, Economic Studies

Graph 17 – Platinum and palladium prices



Sources: Datastream and Desjardins, Economic Studies

OTHER COMMODITIES

Nothing points to a big rebound in grain prices

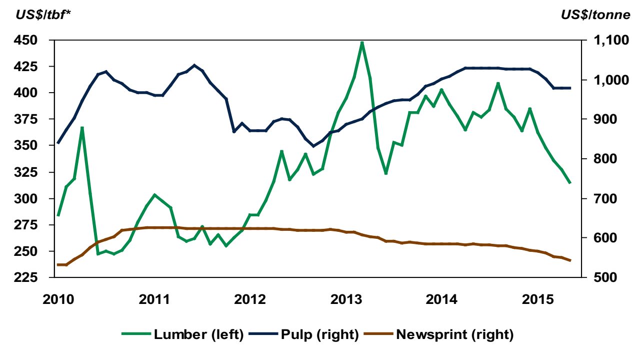
FOREST PRODUCTS

- Newsprint and pulp prices have retreated a bit since the end of March and are now down more than 4% since the start of 2015 (graph 18). Lumber prices are down even more steeply, off by about 12% in the last two months, taking the price to US$315/mbf (thousands of board feet). An abundant supply of wood, especially from British Columbia, and the U.S. economy's struggles had a hand in the sharp pullback in price. **The latest data on the U.S. real estate sector is much more encouraging however for lumber demand; housing starts hit their highest point since November 2007 in April** (graph 19).

AGRICULTURAL COMMODITIES

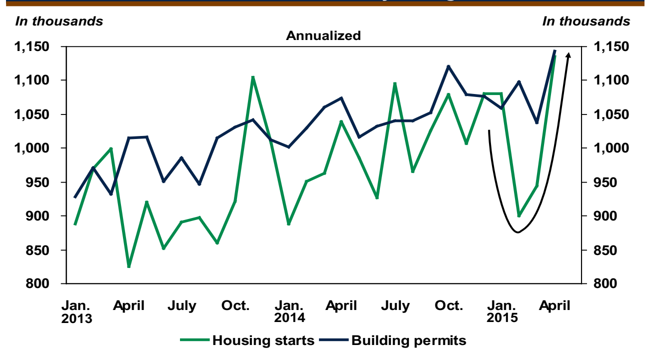
- Unsurprisingly, prices for the primary grains remain low. After plunging early in the year, wheat prices have been fluctuating around US$5.00 a bushel since the end of February, down about 20% from last year. Corn prices have slid around 3% since the end of March, falling below US$3.50 a bushel. Recent months have been tougher for soybeans price, with an annual decline of almost 40% (graph 20).
- The U.S. Department of Agriculture's (USDA) first estimates for the 2015–2016 season may have helped steepen the retreat in soybean prices. While global wheat and corn stocks should be relatively stable, soybean inventories should rise about 12% following the next harvest. An increase in the U.S. soybean seeding area and forecasts of a record harvest in Brazil should keep the global soybean market in surplus.
- **Beyond the USDA's forecasts, the weather in the next few months will be the main factor determining upcoming harvests and movement in grain prices.** For now, the situation seems promising in the United States, as seeding is slightly ahead of the average of recent years and crop conditions are comparable to those seen in 2014, an extraordinary year. Summer drought could quickly change the situation, however. Unlike grain prices, meat prices remain high, especially beef. The recent rain in Texas however ended a drought that lasted several years; this very favourable situation for pasture could foster some rebuilding of herds.

Graph 18 – Forest product prices



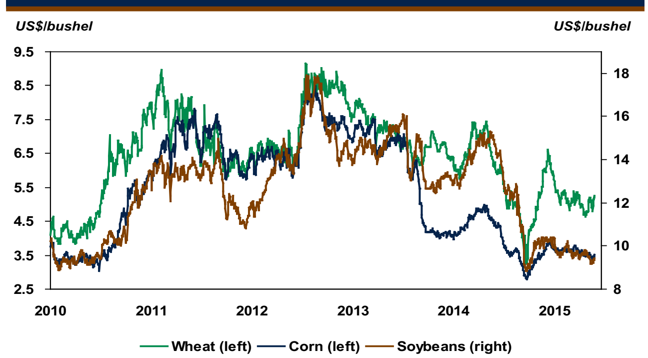
* Thousand board feet.
Sources: Datastream and Desjardins, Economic Studies

Graph 19 – Following a tough winter, U.S. housing starts have rebounded to a multi-year high



Sources: U.S. Census Bureau 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		
	June 8	1 month	3 months	6 months	1 year	High	Average	Low
Index								
Reuter-CRB[1] (CCI[2])	422.1	-2.4	-0.4	-9.7	-23.0	556.8	471.4	409.7
Reuters/Jefferies CRB[1]	222.5	-2.9	0.8	-10.3	-27.1	312.9	255.4	209.0
Dow Jones AIG[3]	100.2	-3.7	-0.5	-9.4	-25.0	136.6	113.4	97.0
Bank of Canada	457.1	0.1	7.8	-13.1	-31.3	684.1	532.4	402.1
Energy								
Brent oil (US$/barrel)	61.5	-5.0	2.4	-7.5	-43.5	115.5	77.6	45.7
WTI[4] oil (US$/barrel)	59.1	-0.5	19.1	-6.4	-42.4	107.3	72.6	43.4
Gasoline (US$/gallon)	2.78	4.4	12.4	3.8	-24.7	3.70	2.90	2.04
Natural gas (US$/MMBTU[5])	2.56	-7.6	-11.1	-26.9	-44.9	4.70	3.45	2.48
Base metals								
LMEX[6]	2,716	-7.4	0.2	-10.2	-13.0	3,316	2,988	2,652
Aluminium (US$/tonne)	1,713	-7.9	-3.2	-12.2	-7.8	2,089	1,892	1,699
Copper (US$/tonne)	5,927	-7.3	2.8	-8.2	-11.5	7,186	6,453	5,433
Nickel (US$/tonne)	13,145	-7.8	-8.1	-20.9	-30.1	19,846	15,871	12,339
Zinc (US$/tonne)	2,118	-10.3	5.9	-4.0	0.7	2,434	2,208	1,977
Steel (US$/tonne)	125.0	-57.5	-58.3	-74.5	-67.9	490.0	403.5	124.5
Precious metals								
Gold (US$/ounce)	1,170	-1.3	-0.5	-2.0	-6.6	1,338	1,231	1,146
Silver (US$/ounce)	16.2	-1.0	1.0	-0.7	-15.1	21.5	17.6	15.3
Platinum (US$/ounce)	1,092	-4.2	-6.3	-11.3	-24.8	1,512	1,271	1,088
Palladium (US$/ounce)	751.0	-5.9	-8.7	-6.5	-10.6	911.0	807.1	729.0
Other commodities								
Lumber (US$/tbf[7])	322.0	2.2	-5.6	-12.0	-14.1	409.0	365.8	310.0
Pulp (US$/tonne)	979.2	-0.0	-2.0	-4.7	-4.9	1,030	1,014	978.0
Newsprint (US$/tonne)	543.2	-1.0	-2.8	-5.0	-7.0	584.0	569.2	543.2
Wheat (US$/bushel)	5.20	8.7	7.3	-14.1	-16.8	6.63	5.15	3.26
Corn (US$/bushel)	3.48	-1.4	-4.8	-4.4	-22.3	4.47	3.59	2.79
Soybean (US$/bushel)	9.36	-3.6	-3.8	-9.7	-36.4	14.72	10.62	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$/barrel)	98	93	Target: 54 (range: 50 to 58)	Target: 68 (range: 58 to 78)
Natural gas Henry Hub (US$/MMBTU**)	3.73	4.34	Target: 2.90 (range: 2.55 to 3.15)	Target: 3.50 (range: 3.00 to 4.00)
Gold (US$/ounce)	1,411	1,266	Target: 1,190 (range: 1,160 to 1,225)	Target: 1,100 (range: 1,000 to 1,200)
LMEX*** index—base metals	3,183	3,117	Target: 2,800 (range: 2,600 to 3,000)	Target: 3,200 (range: 2,900 to 3,500)

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