Commodity Trends
Desjardins Economic Studies
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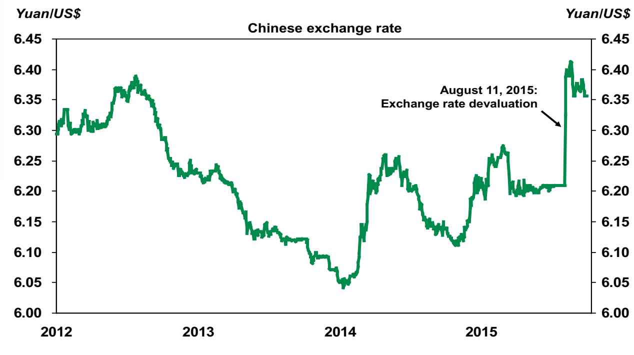
The tough environment persists

Investor sentiment remains highly negative about commodities. Following July's spectacular plunge, base product prices slid even further in mid-August, as China's surprise decision to devalue its currency was read as a desperate move (graph 1).

Some calm returned to the markets, making prices for several commodities rise substantially until mid-September. However, this break did not last, with the Federal Reserve's decision to keep its key rates at their floor and disappointing data on the manufacturing sector and job market raising doubts about the strength of the U.S. recovery (graph 2). These concerns and the problems facing mining giant Glencore once again took commodity prices down in the last few weeks.

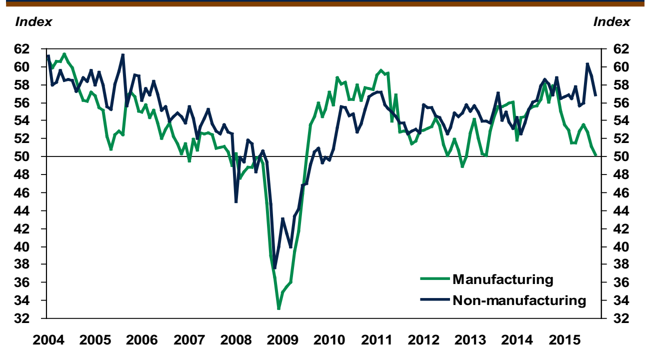
Overall, however, the reduction in commodity prices has been limited since the end of July, with the major price indexes down by about 2%. While the financial and macroeconomic trends have been very unfavourable, the fundamental determinants are more promising: for several commodities, supply and demand seem to be adjusting to the very low prices. The current investor pessimism about the global economy seems exaggerated in a context in which U.S. household consumption should remain robust. This opens the door for an upswing in commodity prices next year.

Graph 1 – The yuan's devaluation caused a surge in concern over China and the emerging nations in mid-August



Sources: Datastream and Desjardins, Economic Studies

Graph 2 – The U.S. ISM manufacturing index is down



Sources: Institute for Supply Management and Desjardins, Economic Studies

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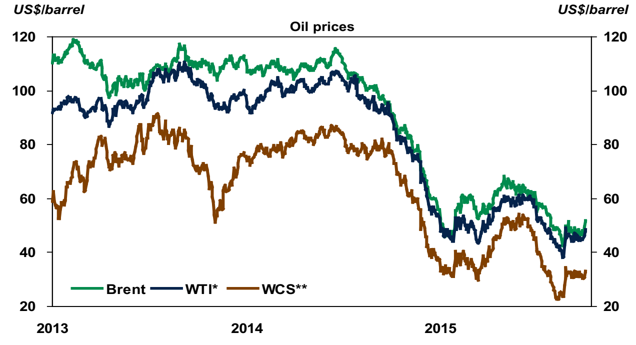
ENERGY

A second supply shock rather than a demand shock

OIL

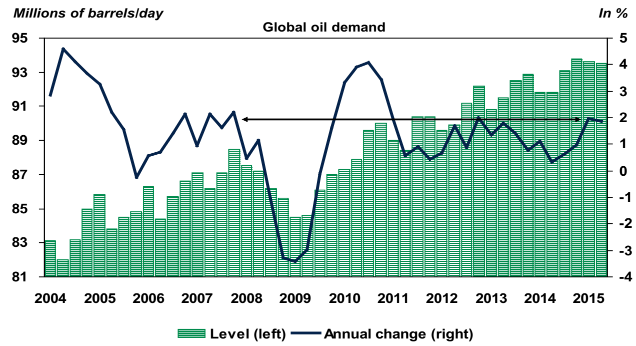
- The sharp surge in concern over China and emerging markets, and the panic that blew through the financial markets took the price of WTI (West Texas Intermediate) oil down to around US$38/barrel on August 24, its lowest point since the 2008 financial crisis (graph 3). Western Canadian oil plunged even more violently, as it also had to cope with some technical constraints, including the temporary closure of some pipelines and a major U.S. refinery. WCS (Western Canada Select) prices temporarily fell to around US$23, which is not high enough to justify operating some fields. However, WTI and WCS prices quickly came back to around US$45 and US$30 per barrel, similar to where they were at the end of July.
- Although they are up from the lows reached in mid-August, oil prices remain very soft. Many read this as proof of the global economy's weakness. In our opinion, this is incorrect, as the price weakness primarily stems from factors associated with the oil supply. Conversely, the latest news on demand is rather favourable; this could be why oil prices, unlike industrial metal prices, did not dip too much at the end of September. The International Energy Agency has substantially upgraded its outlook for global oil demand in the last few months. It is now calling for lively growth of 1.7 mbd (million barrels a day) in 2015, the strongest growth in five years, followed by a very respectable 1.4 mbd gain in 2016. In fact, global oil demand is growing nearly as fast as it did when crude prices boomed at the start of the new millennium (graph 4). The lively demand growth stems from renewed activity by U.S. drivers, as well as a better than 5% advance of Chinese demand in the first half of 2015.
- Despite strong demand for oil, the global petroleum market could remain in surplus for several more quarters. Following the spectacular jump in U.S. production since 2009, Saudi Arabia's attitude changed about a year ago, constituting a second major supply shock. Rather than cutting output to rebalance the market, Saudi Arabia decided to increase its production as well, to maximize its market share. In a context in which Iraqi output is posting spectacular growth and Iran is making continued steps toward having the trade sanctions curbing its exports lifted, everything suggests the global supply will continue to substantially outstrip demand next year, especially if U.S. output remains resilient (graph 5).

Graph 3 – Oil prices plunged to a cyclical low in August, then rebounded slightly



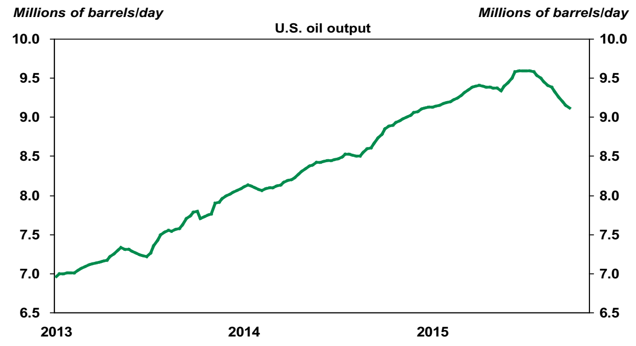
* West Texas Intermediate; ** Western Canada Select.
Sources: Datastream, Bloomberg and Desjardins, Economic Studies

Graph 4 –Global oil demand growth is relatively robust



Sources: International Energy Agency and Desjardins, Economic Studies

Graph 5 – After showing resilience, U.S. oil production is starting to flag



Sources: Energy Information Administration and Desjardins, Economic Studies

GASOLINE

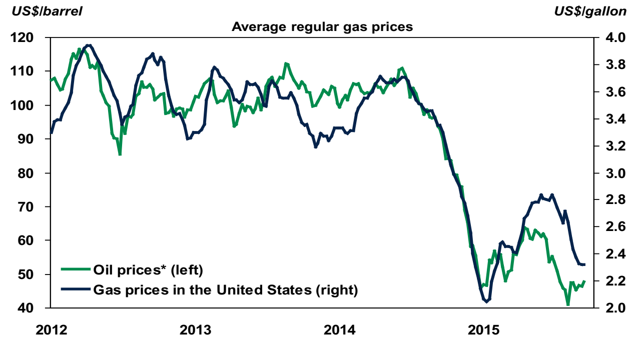
- As we projected at the start of August, North American driver frustration gave way to some relief in the last few months, as prices at the pump are down about 15% in the United States and 10% in Canada since the end of July. Gasoline prices now seem to be more in line with crude oil prices (graph 6). Compared with this period last year, prices at the pump were down 31% in the United States and 18% in Canada at the end of the third quarter of 2015; this certainly contributes to the strengthened demand for gas. Prices did not drop as much in Canada partly because the loonie has pulled back sharply over the last year.

NATURAL GAS

- North American natural gas prices were much more stable than other commodity prices in August and September, generally staying around US$2.70/MMBTU (Million British Thermal Units). However, they have pulled back substantially in the last few days, dropping to US$2.26/MMBTU, their lowest point since June 2012 (graph 7). Capitalizing on a relatively mild early autumn, natural gas inventories have continued to expand quickly, rising above their average for this time of year (graph 8). The substantial increase in inventories seen in the last few months also reflects the rapid growth by U.S. output, which was up an annual 6% last July. However, growth could slow next year, given the low prices and the marked drop in oil and natural gas well drilling. In the near term, natural gas prices could primarily be affected by how cold next winter is. The presence of El Niño somewhat lessens the likelihood of a North American winter as cold as the last two.

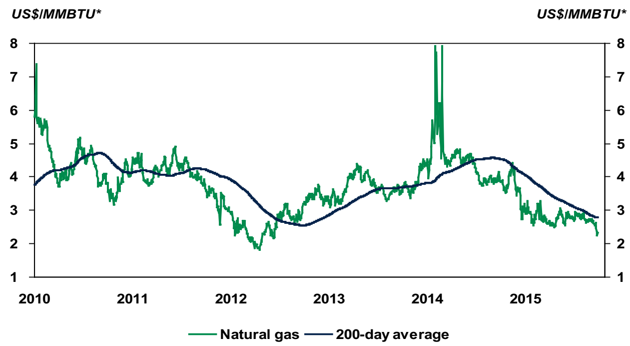
Forecasts: Oil prices seem to be at an appropriate level; this should allow the global market to gradually rebalance over the next few quarters. Here, global demand's positive response to the low prices is encouraging. The return of Iranian oil toward the start of 2016 could temporarily put downside pressure on oil prices, but we expect prices to generally stay close to current levels until mid-2016, then start to rise slowly. Gas prices should also be fairly stable, while natural gas prices are likely to edge up.

Graph 6 – Gas prices have adjusted to better reflect the tumble in oil prices



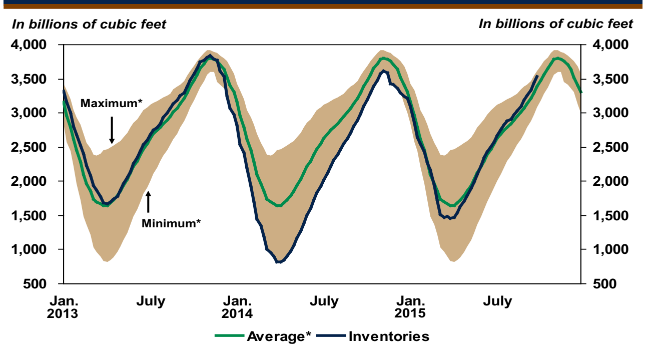
* Average of Brent and WTI (West Texas Intermediate) oil prices.
Sources: Datastream and Desjardins, Economic Studies

Graph 7 – Natural gas prices



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

Graph 8 – Natural gas inventories have recently gone back above normal levels



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

BASE METALS

The current pessimism paves the way for a rebound

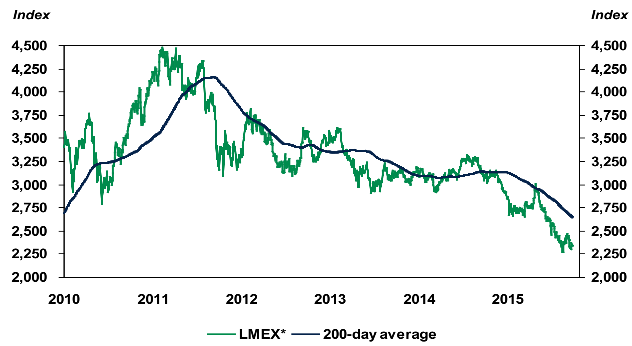
The LME (London Metal Exchange) index of industrial metal prices fell to a cyclical low at the end of August when another surge in concern over emerging nations brought on a short period of panic in the financial markets. Metal prices then rebounded fairly sharply until mid-September, but an upswing in concern over the U.S. economy following the Federal Reserve's decision to maintain the status quo took prices down again after that. In early October, the LME index was down slightly from the end of July and off nearly 25% from the same time last year (graph 9).

Investor worries over emerging nations have continued to rise in the last few months, while signs of slowing by manufacturing activity also emerged in the United States. However, the actual news about metal's supply and demand are inconsistent with investors' extreme pessimism. As with oil, Chinese metal imports are still relatively strong in terms of volume, with nickel imports even booming recently (graph 10). The substantial drop in the value of Chinese imports therefore seems to primarily be a reflection of the plunge taken by resource prices over the last year, rather than a true decline in demand. The downtrend seen in the inventories recorded by the LME for most metals is another sign that the global market for metals is not having the same oversupply problems as the petroleum market. The major difficulties facing the giant concern Glencore at the end of September are a good illustration of the problems facing metal producers, which could keep announcing production cuts as long as metal prices stay this low.

ALUMINUM

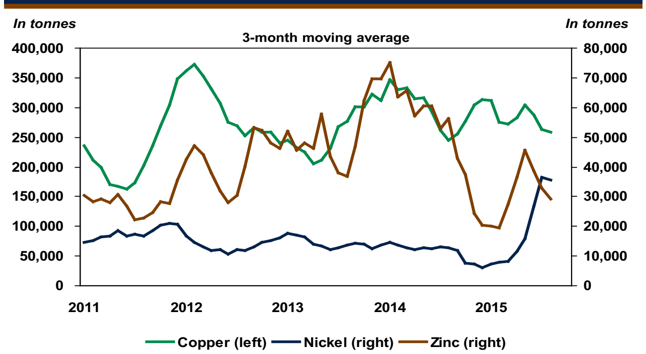
- Aluminum prices are under pressure, as this year's surge in Chinese output offsets the efforts made by other producers to rebalance the global market. Affected by the panic in the markets, the LME price for aluminum thus fell below US$1,500 a tonne on August 24 for the first time since June 2009 (graph 11). Renewed investor confidence and signs that Chinese producers could lower their production in turn pushed aluminum prices above US$1,620 a tonne in mid-September, but new concerns over the global economy then took prices down to around US$1,550 a tonne.

Graph 9 – Metal prices still falling



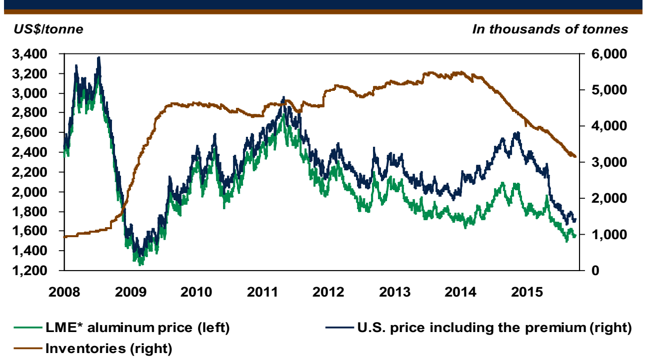
* London Metal Exchange base metal price index.
Sources: Datastream and Desjardins, Economic Studies

Graph 10 – Chinese base metal imports remain relatively high



Sources: Bloomberg and Desjardins, Economic Studies

Graph 11 – Aluminum prices and inventories



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

COPPER

- Following the general trend, copper prices have been fairly volatile, even dropping below US$5,000 a tonne at the end of August and the end of September (graph 12). According to the International Copper Study Group (ICSG), the global copper market had a slight surplus in the first half of 2015, when copper output rose 3% and consumption fell 2%. This surplus could quickly give way to shortages,however, as low copper prices have prompted a number of producers, including BHP and Glencore, to announce production cuts. The copper inventories surveyed by LME are down more than 8% since the end of July, likely meaning that the copper surplus period is already over.

NICKEL

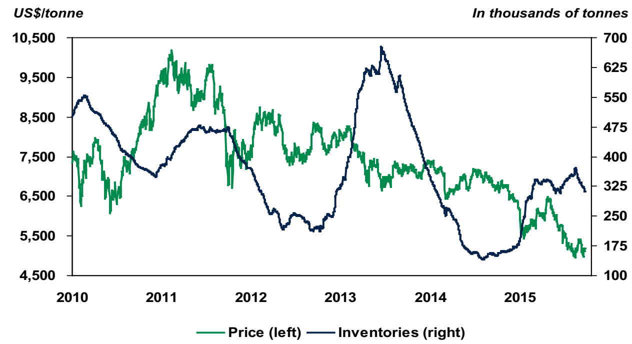
- Despite very encouraging numbers on Chinese nickel imports, nickel prices continued to retreat, dropping below US$10,000 a tonne (graph 13). The nickel inventories surveyed by LME have stabilized in the last few months, but remain very high. Note that nickel producers seem fairly hesitant to cut production, despite the very low prices. While there is little sign of an imminent rebound, prices are still very likely to rise over the medium range, as producers will not maintain money-loosing operations forever.

ZINC

- Following a long period of resilience, zinc prices have been correcting sharply in the last few months. Zinc prices are down 13% since late July, falling to around US$1,665 per tonne. Note that the downtrend in inventories recorded by the LME has given way to a more than 30% jump since the end of July. The spectacular surge could be partly due to Glencore's difficulties; it sold off some inventory in order to acquire some liquidity. Weak Chinese zinc imports—down 40% over the first eight months of 2015—are also largely responsible for the recent problems with the metal's price. The low prices are having consequences for supply, however, with two major zinc mines wrapping up operations this year.

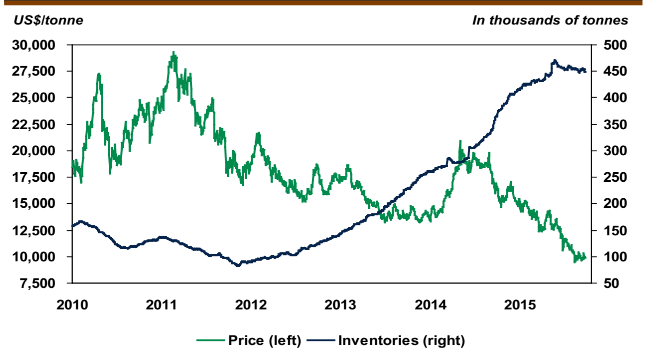
Forecasts: In a context in which metal demand does not appear to be as weak as some investors think, the major production cuts announced by metal producers pave the way for prices to rebound in the coming quarters. It would take additional major disappointments from the U.S. economy and global growth to justify prices staying this low.

Graph 12 – Copper prices and inventories



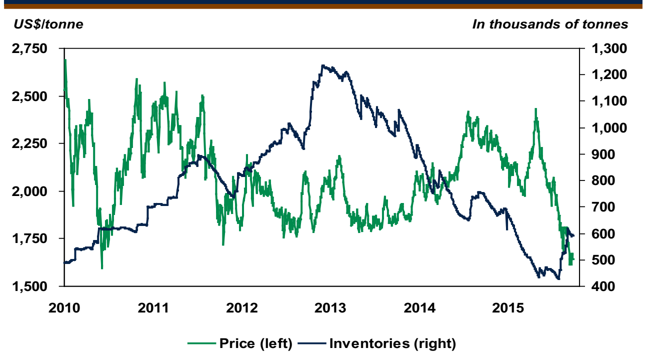
Sources: Datastream and Desjardins, Economic Studies

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

The Federal Reserve's caution is met with relief

The recent evolution of the financial environment has been much more favourable for precious metal prices. They have, in general, risen since the end of July, except for platinum, which is being hurt by the scandal surrounding Volkswagen and diesel cars.

GOLD AND SILVER

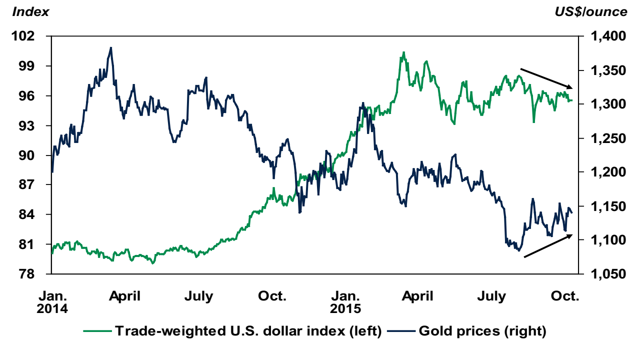
- The commodity price correction early this summer did not leave gold prices unscathed. Gold prices even fell to US$1,084/ounce on July 24, its lowest point since February 2010. However, it has been doing a better job at its safe-haven role recently, capitalizing on the upswing in investor concern and climbing above US$1,100/ounce. The decision by the Federal Reserve (Fed) to postpone the onset of monetary firming is also good for gold, among other things, due to a weaker U.S. dollar (graph 15). Silver prices have also edged up since the end of July (graph 16). The small uptick by both metal prices despite very positive financial developments seems to confirm that investor interest in such metals remains limited, however.

PLATINUM AND PALLADIUM

- The most important recent development for platinum and palladium is certainly the scandal over Volkswagen, which admitted having falsified emission tests for several of its diesel cars. Note that, even though they are considered precious, the primary source of demand for these two metals is the auto industry, which uses them in its anti-pollution systems. Palladium is primarily used in gas powered cars, while platinum is used mainly in diesel powered vehicles. According to some analysts, the Volkswagen scandal could spell the end for diesel cars, a situation that could result in a surge in palladium demand at the expense of platinum demand. In this context, it is not surprising to note that platinum prices are down since the scandal broke, while palladium prices have jumped (graph 17).

Forecasts: In the near term, gold and silver prices could advance a little more if concern about the U.S. economy continues to mount. However, the movement could be short-lived. In our opinion, the current pessimism is exaggerated and the Fed should kick off monetary firming soon. We therefore continue to expect gold prices to slide over the coming quarters.

Graph 15 – The greenback has edged down in the last few months, fostering an upswing in gold prices

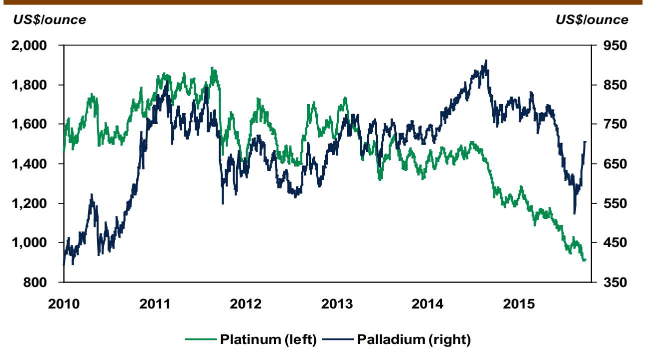


Sources: Bloomberg and Desjardins, Economic Studies

Graph 16 – Gold and silver prices

Sources: Datastream and Desjardins, Economic Studies

Graph 17 – Platinum and palladium prices



Sources: Datastream and Desjardins, Economic Studies

OTHER COMMODITIES

The correction also affects lumber

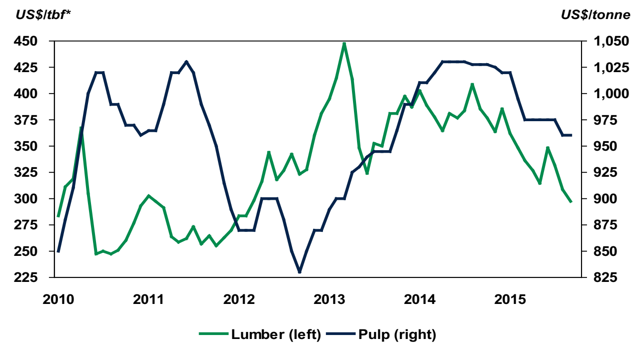
FOREST PRODUCTS

- Lumber prices had been relatively resilient early this summer, holding at around US$330/tbf (thousand board feet). The last few months have been tougher, with lumber prices down over 10% since the end of July, dropping below US$300/tbf for the first time since the spring of 2012 (graph 18). Lumber prices have thus dropped more than 20% over the last 12 months. Such price weakness is disappointing in a context in which the U.S. housing sector is still sending encouraging signals. The concerns over Chinese demand are contributing to the drop in lumber prices, as China is the primary export market for U.S. wood. **The weak prices could also be explained by the expiry of the Canada–U.S. lumber trade agreement on October 12.** The end of the agreement opens the door to more imports of Canadian wood in the near term, but could lead to heavier trade sanctions over the medium range. This explains why most Canadian producers seem to favour extending the current agreement. **Developments around this question could prompt heavy short-term volatility in wood prices.**

AGRICULTURAL COMMODITIES

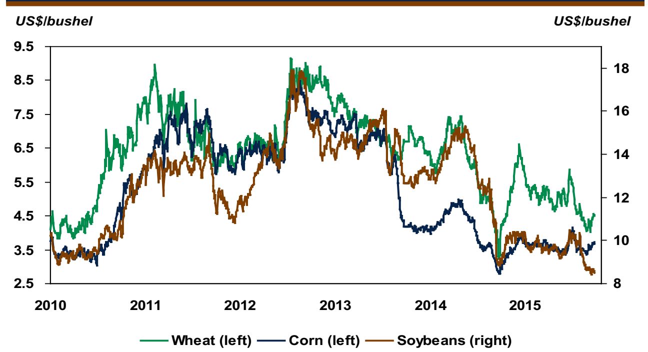
- The prices for the three primary cereals have been fairly volatile in recent months (graph 19). Wheat prices plunged in July and August, then rebounded in September. At around US$4.55 a bushel, wheat prices are down about 20% from where they were three months ago, however. This reflects a significant upgrade to the outlook for global wheat stocks and harvests, with better-than-anticipated results in Europe more than offsetting the problems in other countries, including Canada. Corn has done a little better, recently climbing to around US$3.75 a bushel. While wheat and corn prices are lower than they were three months ago, they are still up from last fall's very low levels. The situation is otherwise for soybeans: the price for this cereal has plunged in the last few months, tumbling to around US$8.65 a bushel, below where it was at this time in 2014. Given that the global soybean supply already outstrips demand, the concerns over China may have had a hand in the cereal's low prices, as China is a very major soybean importer (graph 20). **Now that the harvest is almost over in the major producing countries, cereal prices could be less volatile for a few months.**

Graph 18 – Forest product prices



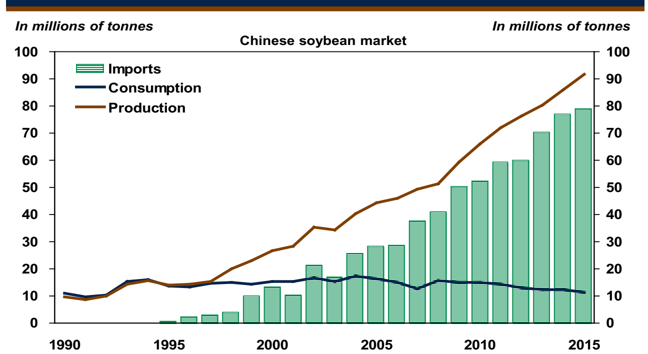
* Thousand board feet.
Sources: Datastream and Desjardins, Economic Studies

Graph 19 – Cereal prices



Sources: Datastream and Desjardins, Economic Studies

Graph 20 – China imports huge quantities of soybeans



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

Table 1
Commodities

	Spot price	*Percentage return since*				*Last 52 weeks*		
	October 8	**1 month**	**3 months**	**6 months**	**1 year**	**High**	**Average**	**Low**
Index								
Reuter-CRB[1] (CCI[2])	401.7	1.0	-4.7	-4.8	-18.6	495.5	432.9	382.9
Reuters/Jefferies CRB[1]	199.6	0.6	-7.3	-7.8	-28.0	280.0	225.7	185.3
Dow Jones AIG[3]	90.1	0.8	-7.9	-9.2	-24.2	119.9	101.9	85.1
Bank of Canada	371.0	-1.3	-14.1	-11.2	-39.0	618.6	444.6	350.5
Energy								
Brent oil (US$/barrel)	51.7	5.3	-7.8	-8.6	-43.0	91.3	60.4	42.6
WTI[4] oil (US$/barrel)	47.9	4.2	-7.3	-5.1	-45.2	88.9	55.8	38.2
Gasoline (US$/gallon)	2.32	-4.9	-17.0	-3.9	-29.7	3.30	2.60	2.04
Natural gas (US$/MMBTU[5])	2.46	-9.9	-9.2	-7.9	-36.6	4.41	3.00	2.26
Base metals								
LMEX[6]	2,375	-2.6	-5.8	-13.8	-22.9	3,150	2,740	2,276
Aluminium (US$/tonne)	1,561	-3.0	-4.2	-11.8	-18.2	2,082	1,776	1,496
Copper (US$/tonne)	5,196	-3.2	-5.7	-13.8	-22.3	6,891	5,922	4,963
Nickel (US$/tonne)	10,131	1.6	-7.2	-19.1	-38.5	17,055	13,352	9,478
Zinc (US$/tonne)	1,670	-7.6	-15.7	-22.4	-27.7	2,434	2,075	1,612
Steel (US$/tonne)	188.0	50.4	50.4	-36.6	-57.9	490.0	306.7	123.8
Precious metals								
Gold (US$/ounce)	1,147	2.2	-1.2	-4.8	-5.2	1,302	1,183	1,084
Silver (US$/ounce)	15.8	8.1	5.5	-6.1	-8.8	18.2	16.1	14.3
Platinum (US$/ounce)	945.0	-5.3	-7.0	-19.2	-25.9	1,285	1,127	908.0
Palladium (US$/ounce)	696.0	17.0	8.4	-8.9	-12.8	831.0	735.6	524.0
Other commodities								
Lumber (US$/tbf[7])	299.0	0.3	-14.3	-11.3	-21.5	385.0	344.3	294.0
Pulp (US$/tonne)	960.0	0.0	-1.5	-1.5	-6.6	1,028	994.3	960.0
Wheat (US$/bushel)	4.54	9.3	-16.7	-13.9	6.8	6.63	5.04	3.81
Corn (US$/bushel)	3.77	9.6	-5.6	4.1	25.5	4.15	3.58	2.94
Soybean (US$/bushel)	8.66	-1.0	-12.8	-9.9	-4.5	10.47	9.67	8.42

[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

	2013	*2014*	*2015f*	*2016f*
Annual average				
WTI* oil (US$/barrel)	98	93	Target: 50 (range: 48 to 52)	Target: 52 (range: 45 to 59)
Natural gas Henry Hub (US$/MMBTU**)	3.73	4.34	Target: 2.75 (range: 2.65 to 2.85)	Target: 3.00 (range: 2.50 to 3.50)
Gold (US$/ounce)	1,411	1,266	Target: 1,160 (range: 1,140 to 1,180)	Target: 1,060 (range: 980 to 1,150)
LMEX*** index—base metals	3,183	3,117	Target: 2,590 (range: 2,520 to 2,650)	Target: 2,800 (range: 2,400 to 3,300)

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