Commodity Trends

Desjardins Economic Studies
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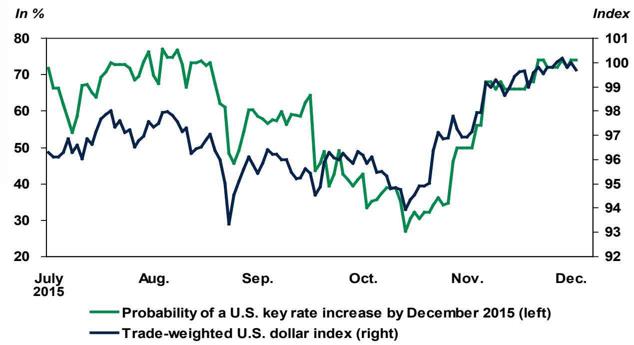
Several prices have dropped to unsustainable levels

After a very tough summer, commodity prices stabilized and even rose somewhat in October. The lull did not last: commodity prices plunged again in November, taking many prices to lows that date back several years. The new decline is partially a reflection of the growing expectation that the Federal Reserve will kick off monetary firming as of December, prompting another rise by the U.S. dollar (graph 1).

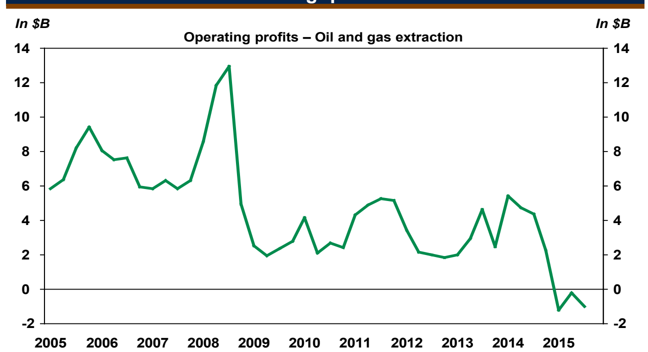
The current weakness in commodity prices also reflects investors' extremely negative sentiment about this asset class. Developments that are unfavourable to commodities get the attention, while potentially positive developments, such as the surge in geopolitical strain, seem to be completely overlooked. Given this context, it is hard to imagine a major rebound by prices in the near future. A look at the prices shown in table 1 on page 8 indicates that they are off by more than 30% on average in the last year; this collapse will, however, have major consequences on supply and demand for base products. The losses in Canada's energy sector (graph 2) are a clear illustration of the devastating impacts that tumbling prices have on commodity producers. Following the spectacular plunge taken by investment, we can expect major production cuts for numerous resources if prices stay this low. In most cases, the current commodity prices do not seem sustainable: sooner or later, they will have to come up substantially to ensure that there is enough supply to meet demand.

Graph 1 – Rising monetary firming expectations favoured the U.S. dollar



Sources: Bloomberg and Desjardins, Economic Studies

Graph 2 – Canada's energy sector posted a third straight losing quarter



Sources: Statistics Canada and Desjardins, Economic Studies

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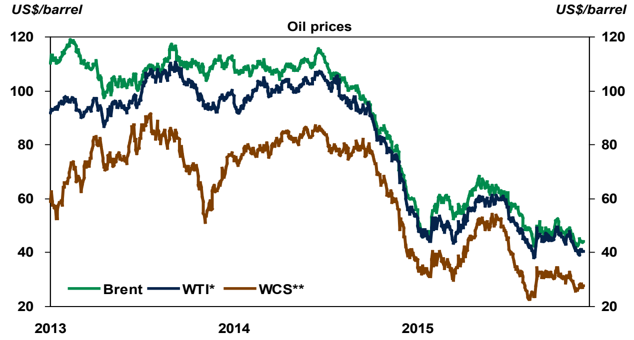
ENERGY

Surplus in the near term, shortage over the medium range?

OIL

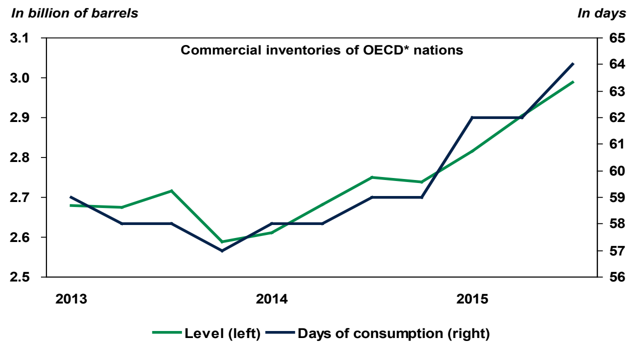
- The price of WTI (West Texas Intermediate) oil generally stayed above US$45/barrel in October and even closed in on US$50 a few times. But the strong greenback and another upswing in pessimism about commodities then took the price of WTI down to around US$40 (graph 3).
- The lack of a clear trend for oil prices points to two contrary influences. On one hand, the negative impact that very low prices have on investment and future oil production is becoming increasingly clear. On the other, global oil inventories are extremely high (graph 4), and could keep expanding in the near term. This could potentially take prices a lot lower if space for storage were to run too low. Given that everything indicates that the global oil market will remain in surplus for several more quarters; that winter is promising to be relatively warm in major markets and could temporarily curb demand; and that the upcoming lifting of trade sanctions against Iran should bring new oil supply to the market, the risk of another price drop in the near term cannot be overlooked.
- The increase in global crude stocks, however, reflects factors that are already known and it is already largely reflected in the prices. Oil supply and demand trends are a lot more encouraging for prices over the medium term. The International Energy Agency (IEA) has once again upgraded its outlook for global oil demand, with a spectacular 1.8 mbd (millions of barrels per day) surge now forecast for 2015. Around the world, low prices seem to be swelling consumption. The IEA notes a 6% increase in emerging Asian nations in the third quarter, based on resilient Chinese demand and skyrocketing demand in India. After an extraordinary year, a number of experts anticipate more normal oil demand growth in 2016. Experts had, however, seriously underestimated the positive impact of low prices on demand in 2015; we would therefore not be surprised to see the same phenomenon occur next year (graph 5).
- Low prices will also have a major impact on production. Oil prices have relapsed since last summer, prompting another drop in North American drilling. Everything suggests that energy sector investment will remain extremely limited. After showing some resilience this year, oil production outside of the Organization of the Petroleum Exporting Countries (OPEC) should therefore contract 0.6 mbd in 2016, according to the IEA. The contradictory movement of global demand and non-OPEC output is a clear sign that tumbling oil prices are prompting some rebalancing in the global oil market (graph 6 on page 3). Surging OPEC output, especially from Iraq and Saudi Arabia in 2015 and from Iran in 2016, obscures the rebalancing, and could keep the market in surplus for a few more quarters. However, these countries do not have infinite surplus capacity and we can seriously wonder who will be able to meet the demand growth in 2017 if prices stay close to current levels.

Graph 3 – Oil prices dropped back close to August's lows



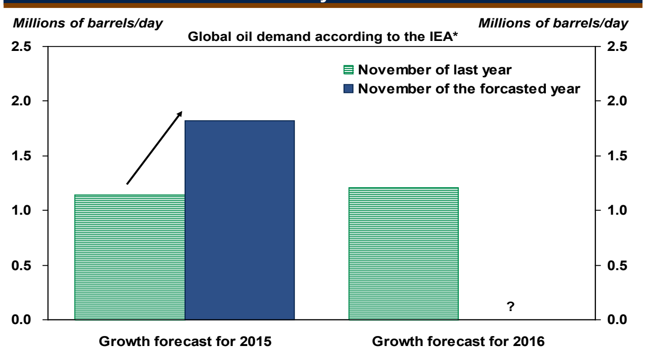
* West Texas Intermediate; ** Western Canada Select.
Sources: Datastream, Bloomberg and Desjardins, Economic Studies

Graph 4 – The oil market surplus has taken global inventories to a record high



* Organisation for Economic Co-operation and Development.
Sources: International Energy Agency and Desjardins, Economic Studies

Graph 5 – Will global oil demand surprise again on the upside next year?



* International Energy Agency.
Sources: International Energy Agency and Desjardins, Economic Studies

GASOLINE

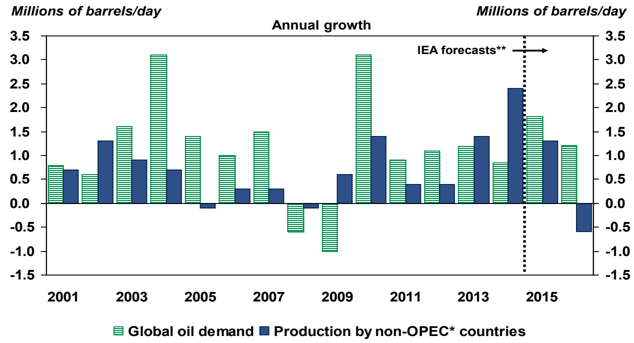
- Gasoline prices retreated further in the United States, recently dropping back below US$2.10 a gallon. The trend was not as clear in Canada, but the price of regular gas still recently hit its lowest point since last February. Very large gas inventories in the United States for this time of year seem to be starting to put downside pressure on refiners' margins. U.S. drivers therefore benefited from the lowest gas prices in seven years for the Thanksgiving holiday (graph 7).

NATURAL GAS

- The slide by North American natural gas prices picked up speed in the last few months, as the signs of a fairly mild winter are increasing concerns about a major natural gas surplus. Natural gas prices therefore fell to US$1.90/MMBTU (Million British Thermal Units) at the start of November, close to their historic low. For the previous two winters, very cold weather pushed prices up and took inventories below normal levels. Heavy stockpiling last summer combined with a relatively warm fall have now driven natural gas inventories to a historic peak (graph 8). If El Niño delivers a milder winter, as forecast, the surplus could increase in the next few months and keep prices very low.

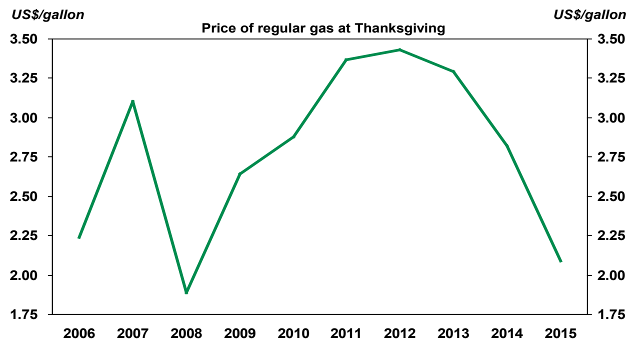
Forecasts: Oil prices should remain very low in the near term, with the focus remaining on the inventory question. Only a further aggravation of the situation in the Middle East which would affect major producers, or a surprise upholding of sanctions against Iran could justify a big price upswing. An agreement between Russia and Saudi Arabia to limit output is very unlikely. Increasingly clear signs of market rebalancing should, however, trigger a gradual oil price rise as of next summer, taking the price of WTI back to around US$60/barrel by the end of 2016. Natural gas is in a similar situation: the surplus should keep prices very low in the near term, unless winter proves much harsher than forecast.

Graph 6 – The oil price correction is stimulating demand and has halted the surge of non-OPEC* output



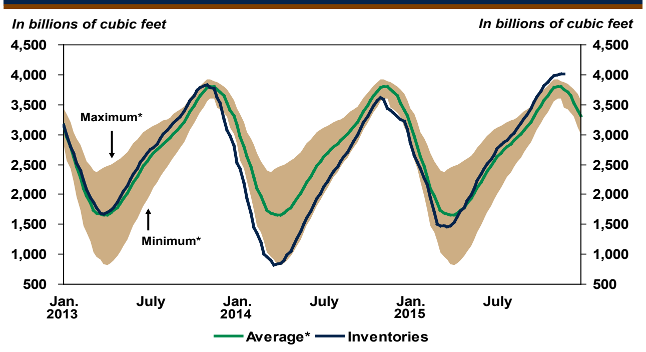
* Organization of the Petroleum Exporting Countries; ** International Energy Agency.
Sources: International Energy Agency and Desjardins, Economic Studies

Graph 7 – U.S. gas prices have not been this low at this time of year since 2008



Sources: Energy Information administration and Desjardins, Economic Studies

Graph 8 – Natural gas inventories hit a record peak and are slow to start their seasonal decline



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

BASE METALS

Chinese government to the rescue?

Already very low, industrial metal prices slid further in early November, in several cases dropping to lows not reached in several years. The LME (London Metal Exchange) index of industrial metal prices recently dropped below 2,100 for the first time since April 2009, just after the financial crisis ended (graph 9). The recent price drop seems to reflect the U.S. dollar's strength, along with new fears about China's economy.

Metal prices have now come down so much that they are worrying Chinese authorities. The Chinese government thus recently signalled that it could take price support action by expanding its metal purchases and dealing with speculators who are banking on prices coming down further. Chinese metal producers also seem to be starting to contemplate production cuts to help rebalance the market. Outside China, the price weakness should also have a growing impact on the supply of metals.

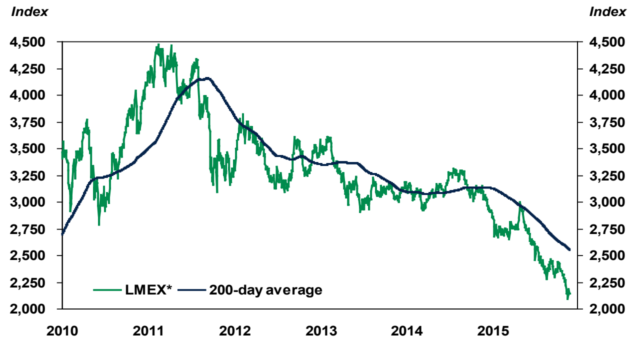
ALUMINUM

- Aluminum prices plunged at the end of October, settling at around US$1,450 per tonne. They have fluctuated around that level since then, temporarily dropping to US$1,425.50 recently, their lowest point since May 2009 (graph 10). Note, however, that after tumbling in the last year, the premium that aluminum buyers pay for accelerated shipments has recently notched up. With the low prices limiting the aluminum supply elsewhere in the world, the surge in Chinese production and exports explains the ongoing downside pressure on the metal's price. Cuts to Chinese aluminum production would pave the way for a rebound by prices, but the news there is not encouraging, as producers instead seem to be banking on a cut to taxes on their aluminum exports. We will have to watch the situation to see if environmental issues prompt the Chinese government to take stricter measures against this sector.

COPPER

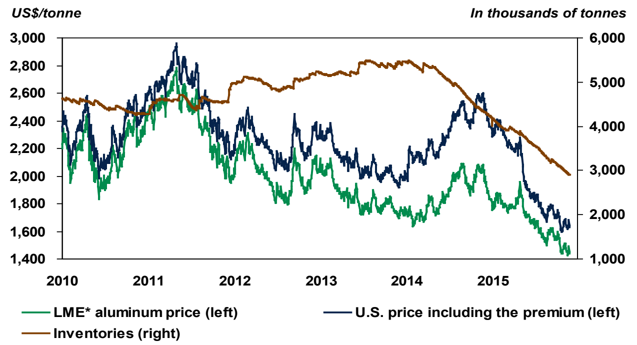
- As usual, copper has been especially sensitive to the financial factors that hurt base metal prices at the start of November. Copper prices recently fell to US$4,512.50 a tonne, their lowest point since May 2009 (graph 11). Although copper dropped 30% in the last year, Chile's Codelco, the leading copper producer, is opting to try to cut costs rather than curbing output. A major drought in Chile is making life harder for copper producers, however, as they struggle to gain access to all the water they need to run the mines. Chinese producers, for their part, have agreed to cut production next year. In all cases, the more than 30% drop

Graph 9 – Metal prices are still correcting



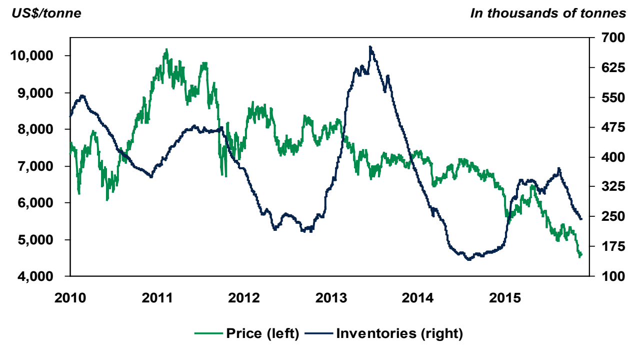
* London Metal Exchange base metal price index.
Sources: Datastream and Desjardins, Economic Studies

Graph 10 – Aluminum prices and inventories



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

Graph 11 – Copper prices and inventories



Sources: Datastream and Desjardins, Economic Studies

in copper inventories surveyed by the LME since the end of August do not point to a major surplus in the world's copper market.

NICKEL

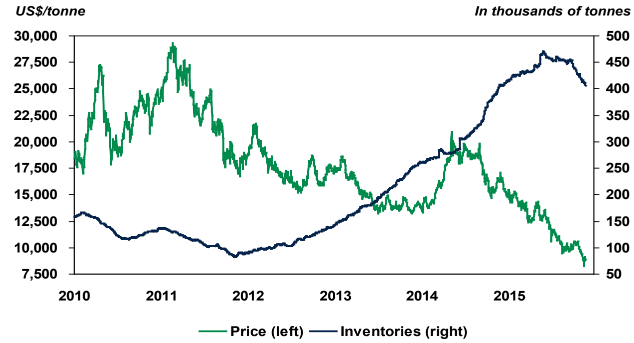
- Nickel prices have plunged again, recently falling to US$8,267 a tonne, a low that dates back more than 12 years (graph 12). The situation for nickel has changed a lot since 2007, when a global shortage had propelled prices to around US$55,000 a tonne. The recent low price seems to be a reflection of the greenback's strength, as well as signs of weakness in Chinese demand for stainless steel, what nickel is primarily used for. The current price level seems unsustainable, however, as over 50% of global output is in the red at this level. The global nickel market already seems to be in the process of rebalancing, with even Chinese output down. This is resulting in very strong Chinese nickel imports (graph 13), as well as a drop in the inventories surveyed by the LME. Note that, unlike steel and copper, nickel and zinc should not be hurt by a Chinese economic transition that favours consumption over investment.

ZINC

- Zinc prices continued to drop in recent weeks, temporarily slipping below US$1,500 a tonne for the first time in more than six years (graph 14). Following September's spectacular surge, zinc inventories started to trend down again. This seems to confirm that September's inventory upswing did not reflect the situation in the global market, but rather the problems facing giant Glencore. The recent movement by zinc prices is disappointing in a context in which major production cuts have been announced in both China and elsewhere. Note that weak demand for zinc, especially in China, continues to worry investors. However, Chinese zinc imports have been a little stronger lately.

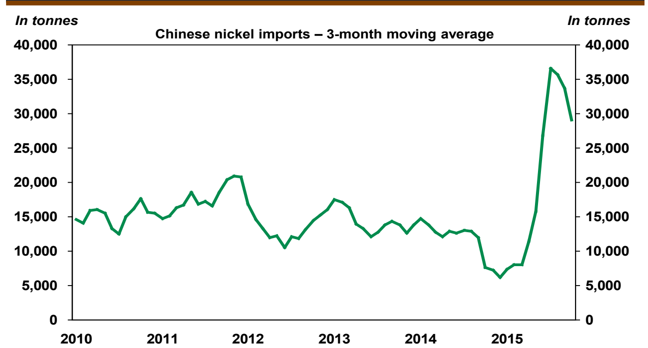
Forecasts: We continue to think that metal prices are down more than enough, in most cases, to do away with the surplus situation that had a hand in the correction of the last few quarters. Iron and aluminum could however continue to face a difficult situation. Conversely, nickel prices seem to be particularly well positioned to rebound next year.

Graph 12 – Nickel prices and inventories



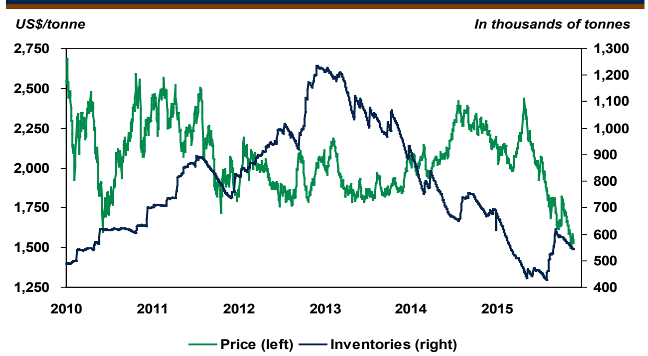
Sources: Datastream and Desjardins, Economic Studies

Graph 13 – Chinese nickel imports boomed this year



Sources: Bloomberg and Desjardins, Economic Studies

Graph 14 – Zinc prices and inventories



Sources: Datastream and Desjardins, Economic Studies

PRECIOUS METALS

The looming U.S. key rate increase hurts

Early this fall, precious metals benefited from the postponement of U.S. monetary firming. Unsurprisingly, they have taken a big hit with the growing signs that a key rate increase is now imminent.

GOLD AND SILVER

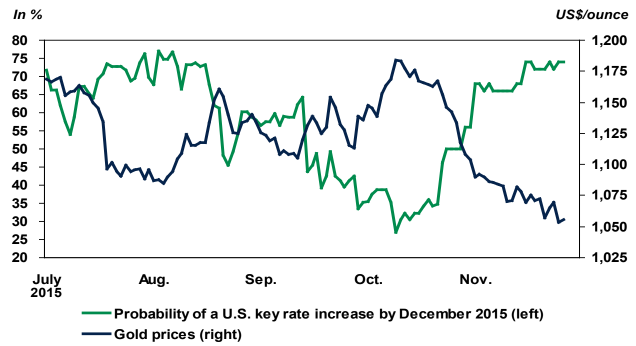
- Gold prices started to rise in mid-September, when the Federal Reserve (Fed) took on a worried stance and opted for the status quo. The rise ended suddenly at the end of October when the Fed's surprise statement opened the door to a key rate increase in December. The excellent U.S. labour market numbers at the start of November pushed the probability of monetary firming up further, and magnified the pullback in gold prices (graph 15). Gold was at US$1,185 an ounce in mid-October. It recently fell to around US$1,050, a low that dates back to November 2009. In addition to putting upside pressure on the greenback, higher interest rates would increase the cost of holding gold, as well as improve the appeal of other investments. Silver prices have also fallen a lot in recent weeks, nearing about US$14 per ounce (graph 16).

PLATINUM AND PALLADIUM

- Expectations of U.S. monetary policy firming have also led to a big tumble by platinum and palladium prices (graph 17). Investors' very negative sentiment about industrial metals also seems to be affecting these two metals, which are heavily used by the automotive industry. In this context, numerous investors have cashed out their investments in exchange-traded funds that are tied to platinum and palladium prices; increasing the price pullback for the two metals. Despite the Volkswagen scandal, the automotive industry is doing fairly well. Nataxis estimates that global auto sales were up by an annual 5.5% in October.

Forecasts: Financial factors could keep playing against precious metal prices in the months to come. However, fundamental factors could keep prices from dropping much further. The outlook for physical demand is not bad and some unprofitable mines could cease or slow operations. Gold prices could therefore end 2016 at around US$1,000 an ounce.

Graph 15 – Gold prices reacted sharply to the change in expectations about U.S. monetary policy

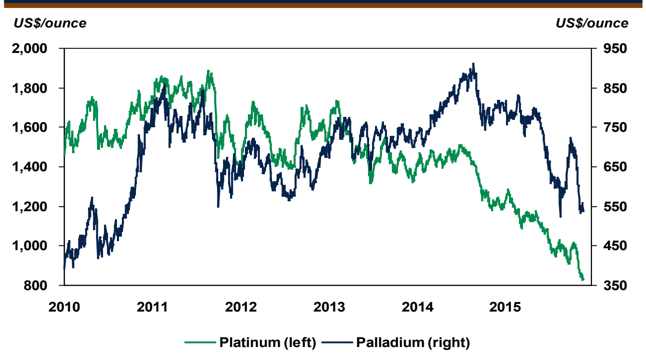


Sources: Bloomberg and Desjardins, Economic Studies

Graph 16 – Gold and silver prices

Sources: Datastream and Desjardins, Economic Studies

Graph 17 – Platinum and palladium prices



Sources: Datastream and Desjardins, Economic Studies

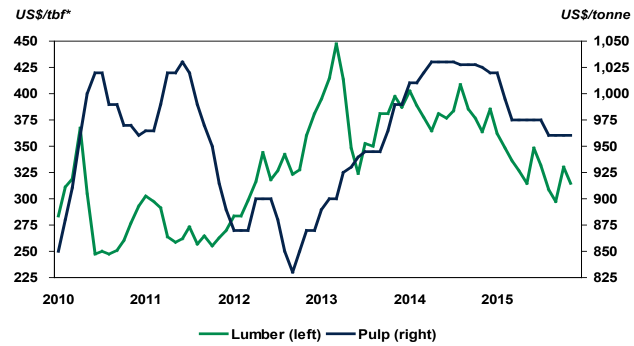
OTHER COMMODITIES

Limited price movements

FOREST PRODUCTS

- Lumber prices have been seesawing in recent months. They fell below US$300/mbf (thousands of board feet) in September, then rebounded more than 10% in October, and recently dropped to around US$315/mbf (graph 18). **Fairly encouraging U.S. economic situation and gradual acceleration of housing sector activity are the most encouraging factors for wood prices.** For pulp, price stability persisted in the last few weeks. The Forest Products Association of Canada was enthusiastic about the conclusion of the Trans-Pacific Partnership Agreement, deeming that it could pave the way for market diversification and increased exports for the forest industry. Note that we recently released a study on the situation and outlook for Quebec's wood product and pulp and paper industries[1].

Graph 18 – Forest product prices

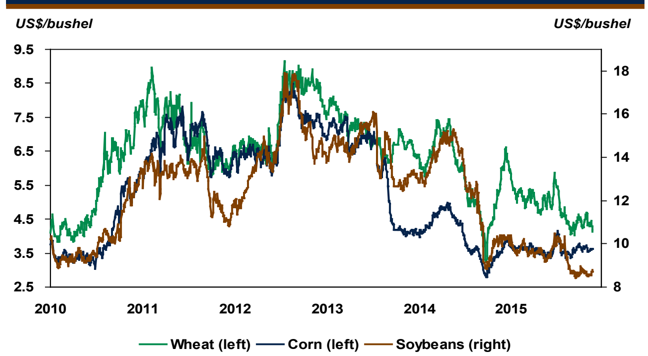


* Thousands of board feet.
Sources: Datastream and Desjardins, Economic Studies

AGRICULTURAL COMMODITIES

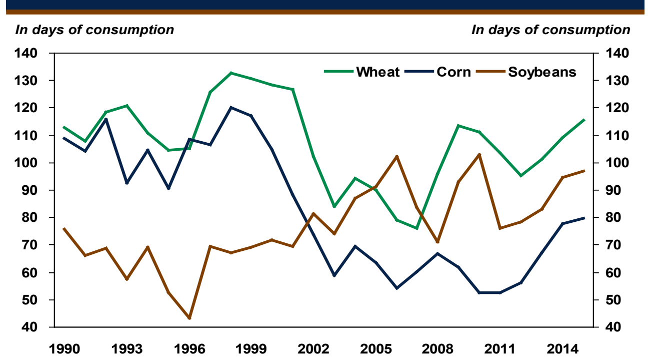
- Prices for the main cereals continue to reflect abundant supplies (graph 19). In a context in which another good year of harvests prompts a widespread increase in global inventories (graph 20), it is not surprising to note that cereal prices remain low. The last few weeks have been especially tough for wheat, as Argentina's new government announced it would soon be eliminating the export tax on corn and wheat.
- Corn prices have been more stable, at around US$3.60 a bushel. But the news is not very encouraging: a substantial upgrade to the U.S. harvest and a change in estimates for China now suggest that global corn stocks will rise. China did not have good harvest weather recently, however, which may be why this cereal's price is being resilient. The U.S. Department of Agriculture also upgraded its forecast for the U.S. soybean harvest, but this was offset by problems in India and slightly stronger global demand. Soybean prices have been fairly stable since fall began. **The coming months promise to be fairly calm for cereal prices, as we will have to wait toward the end of winter before getting the first hints about the next harvest.**

Graph 19 – Cereal prices



Sources: Datastream and Desjardins, Economic Studies

Graph 20 – Global cereal inventories continued to climb in 2015



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

[1] Desjardins, Economic Studies, *Perspective*, "The wood product and pulp and paper industries: between tradition and innovation," volume 25, October–November 2015, www.desjardins.com/ressources/pdf/per1115e.pdf.

Table 1
Commodities

	Spot price	Percentage return since				Last 52 weeks		
	Dec. 3	1 month	3 months	6 months	1 year	High	Average	Low
Index								
Reuter-CRB[1] (CCI[2])	379.6	-5.5	-4.2	-10.4	-19.5	473.2	419.1	379.6
Reuters/Jefferies CRB[1]	180.8	-8.5	-8.9	-19.1	-28.5	253.3	213.7	180.8
Dow Jones AIG[3]	80.4	-8.3	-10.1	-20.4	-28.3	112.5	97.0	80.4
Bank of Canada	342.5	-5.8	-8.7	-24.5	-34.1	551.8	411.3	342.5
Energy								
Brent oil (US$/barrel)	42.9	-12.9	-16.5	-32.7	-38.7	71.0	54.9	42.1
WTI[4] oil (US$/barrel)	39.9	-16.6	-14.6	-33.1	-40.7	67.3	50.5	38.2
Gasoline (US$/gallon)	2.06	-7.4	-18.0	-25.9	-25.9	2.84	2.47	2.04
Natural gas (US$/MMBTU[5])	2.17	14.2	-18.7	-17.5	-40.2	3.74	2.73	1.90
Base metals								
LMEX[6]	2,167	-6.7	-10.4	-21.0	-28.3	3,064	2,616	2,097
Aluminium (US$/tonne)	1,478	0.4	-8.2	-13.8	-24.9	1,995	1,696	1,426
Copper (US$/tonne)	4,568	-11.2	-13.2	-23.9	-29.0	6,542	5,655	4,513
Nickel (US$/tonne)	8,943	-9.5	-10.4	-31.0	-45.9	17,055	12,428	8,267
Zinc (US$/tonne)	1,530	-8.3	-15.2	-29.2	-30.8	2,434	1,982	1,495
Steel (US$/tonne)	195.0	0.8	54.8	-30.1	-60.2	490.0	265.6	123.8
Precious metals								
Gold (US$/ounce)	1,056	-6.1	-6.1	-11.3	-12.9	1,302	1,170	1,056
Silver (US$/ounce)	14.1	-8.1	-3.9	-14.8	-13.3	18.2	15.9	14.0
Platinum (US$/ounce)	834.0	-13.1	-16.8	-24.8	-31.8	1,285	1,081	827.0
Palladium (US$/ounce)	529.0	-17.9	-9.6	-30.8	-34.2	831.0	711.3	524.0
Other commodities								
Lumber (US$/tbf[7])	315.0	-4.5	1.9	0.0	-13.5	385.0	335.9	294.0
Pulp (US$/tonne)	960.0	0.0	0.0	-1.5	-6.3	1,025	984.0	960.0
Wheat (US$/bushel)	4.06	-11.6	0.1	-21.0	-32.0	6.63	4.98	4.01
Corn (US$/bushel)	3.61	-2.7	7.1	4.0	1.7	4.15	3.63	3.36
Soybean (US$/bushel)	8.90	2.8	2.8	-4.6	-10.1	10.47	9.49	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

Annual average	2013	2014	2015f	2016f
WTI* oil (US$/barrel)	98	93	Target: 49 (range: 48 to 50)	Target: 51 (range: 42 to 58)
Natural gas Henry Hub (US$/MMBTU**)	3.73	4.34	Target: 2.65 (range: 2.60 to 2.70)	Target: 2.50 (range: 2.00 to 3.25)
Gold (US$/ounce)	1,411	1,266	Target: 1,160 (range: 1,155 to 1,165)	Target: 1,030 (range: 950 to 1,110)
LMEX*** index—base metals	3,183	3,117	Target: 2,550 (range: 2,535 to 2,565)	Target: 2,600 (range: 2,200 to 3,000)

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