Commodity Trends

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Commodity prices are doing fairly well under the circumstances

2015 was a very tough year for commodities—the main price indexes retreated by 15% to 25%. Although attention was primarily focused on collapsing oil prices, there was a broad correction by resource prices, and even precious metal prices retreated sharply (graph 1). Beyond the supply and demand imbalance in some commodities, the price correction reflected the highly negative sentiment about this asset class, magnified by the U.S. dollar's surge.

Under these circumstances, we could have expected the panic that blew through the financial markets in early 2016 to be especially damaging to commodities, as the surge in concern was once again associated with fears about the situation in China and tumbling oil prices. WTI (West Texas Intermediate) fell to US$26 a barrel on February 11 for the first time since 2003, while global stock markets were crashing. Aside from energy, commodity prices have, however, done fairly well since the start of 2016 (graph 2). The greenback's early February pullback was especially good for metals, but it is still too early to predict the start of a true U.S. dollar downtrend. Commodity prices' recent resilience does, however, support our view that prices have now retreated enough to have substantial medium-term impacts on the supply of resources.

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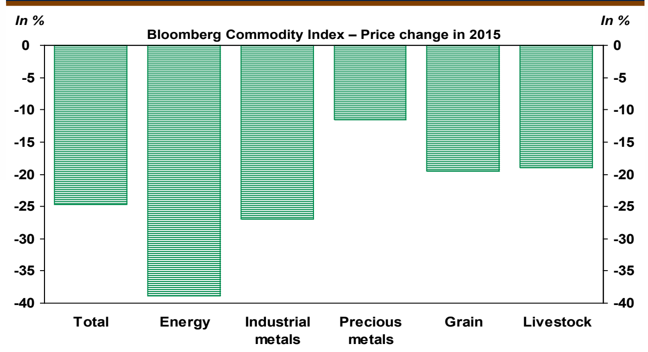
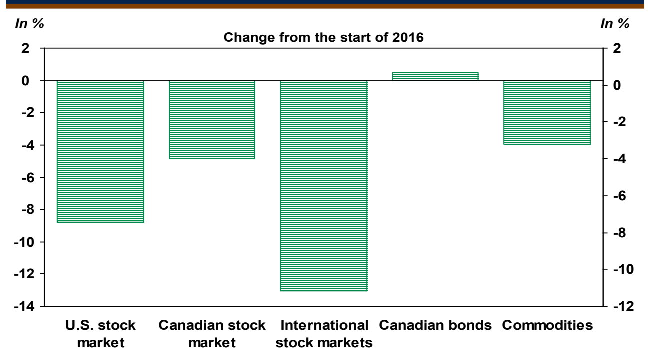
Graph 1 – Widespread, brutal tumble by commodity prices in 2015



Sources: Datastream and Desjardins, Economic Studies

Graph 2 – Relatively speaking, commodities have been doing well since the start of 2016



Sources: Datastream 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.

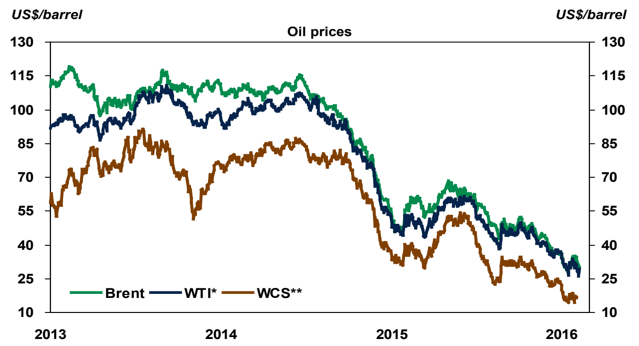
ENERGY

Energy prices may have bottomed out, but don't expect a quick rebound

OIL

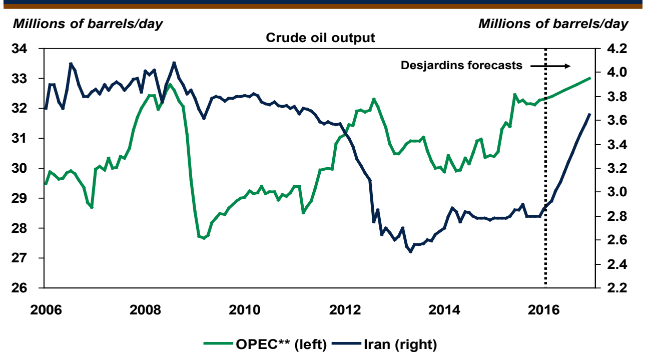
- WTI (West Texas Intermediate) cast around with no clear trend for most of last fall, then started to trend down again at the end of November, closing 2015 at around US$37 a barrel, down 30% from where it ended 2014. Prices started to retreat faster in early 2016, with WTI hitting a 12-year low on February 11 at US$26 a barrel (graph 3). In addition to the very poor financial environment, confirmation that trade sanctions against Iran were being lifted helped drive oil prices that low. Brent was not spared and its price even went below WTI's a few times. In Canada, WCS (Western Canada Select) tumbled to around US$15 a barrel, too low to cover the variable cost of several projects. Oil prices have risen a few times, benefiting from rumours of an agreement between the Organization of the Petroleum Exporting Countries (OPEC) and Russia to curb output and of a greenback retreat.
- It is a little surprising to see how much impact remarks from OPEC leaders still have on oil prices. The December 4 meeting ended with no agreement, helping bring back negative sentiment about oil and the rumoured discussions between Russia and OPEC had a substantial positive impact on prices recently. Yet, it is clear that Saudi Arabia would not agree to cut output to help Iran get back into the market. Moreover, even in the unlikely event that these countries were to announce a deal to trim their output, there would be no way to enforce such an agreement. We therefore still expect OPEC output to go up substantially in 2016, primarily reflecting an increase in Iranian production (graph 4).
- Are OPEC production cuts really needed to rebalance the market? In the very near term, they are, as the global supply still exceeds demand. Over the medium term, the answer is very different. A recent Wood Mackenzie study concluded that plunging prices had directly led to the closure of projects that represented just 0.1% of global oil output since the start of 2015. However, this number does not factor in the production lost due to the tumble by investments and drilling, a phenomenon that is especially important for shale oil, where fields are quickly depleted. After peaking at 9.6 mbd (millions of barrels per day) in mid-2015, U.S. oil output returned to around 9.2 mbd recently. The weakness in drilling suggests that the downtrend will persist (graph 5). Growing demand for petroleum products (graph 6 on page 3), especially in China and the United States, will also help the oil market return to equilibrium over the next few quarters. Rebalancing could occur more rapidly if the low prices prompted more producers to stop operations.

Graph 3 – Oil prices reach new cyclical lows



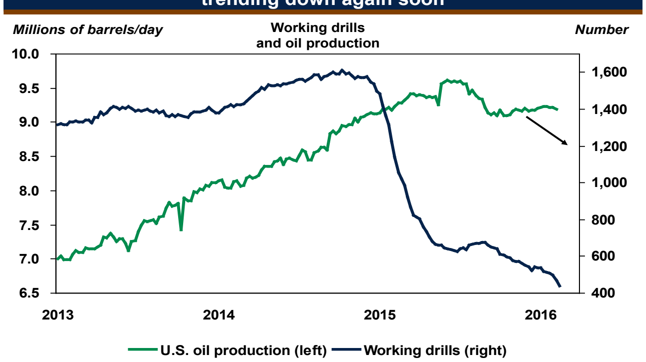
* West Texas Intermediate; ** Western Canada Select.
Sources: Datastream, Bloomberg and Desjardins, Economic Studies

Graph 4 – OPEC* output will keep increasing after the lifting of trade sanctions on Iran



* Organization of the Petroleum Exporting Countries; **Excluding Indonesia, but including Iraq.
Sources: Bloomberg and Desjardins, Economic Studies

Graph 5 – Everything suggests that U.S. oil production will start trending down again soon



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

GASOLINE

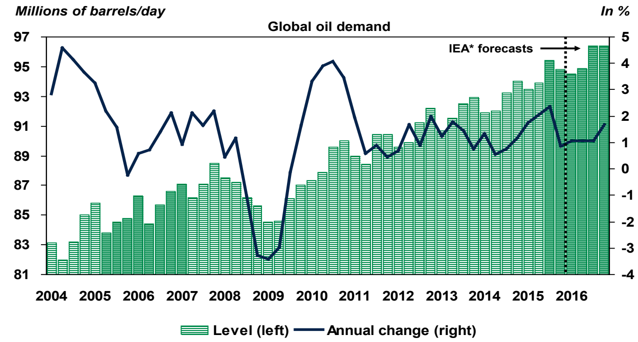
- Gasoline prices continued to pull back quickly (graph 7) thanks to the drop in oil prices and shrinking refinery margins. Regular gas recently fell to an average of less than US$1.70 a gallon for the first time since January 2009. Canadian drivers were not left out: the average price of a litre of gas fell to $0.89, down more than $0.15 since the start of December. The big surge in U.S. gasoline stocks is partially responsible for the drop in refinery margins. Like crude prices, gasoline prices should stabilize after plunging in recent months.

NATURAL GAS

- The start of the winter was very mild in the United States, taking natural gas prices down to US$1.53/MMBTU (Million British Thermal Units) just before Christmas, their lowest point since 1998. Since then, natural gas prices have come back to just over US$2, which is still very low. Beyond the mild weather, which limits demand, the low prices are due to elevated natural gas inventories that are about 18% above the average level for the last five years for this period. Hopes that the U.S. natural gas surplus could be liquefied and exported to Asia or Europe dwindled as prices in those markets have come down substantially in the last few quarters (graph 8). As with oil, the drop in investment and drilling will, however, impact output. Following 2015's 5.7% increase, the Energy Information Administration expects U.S. natural gas output to increase just 0.7% in 2016.

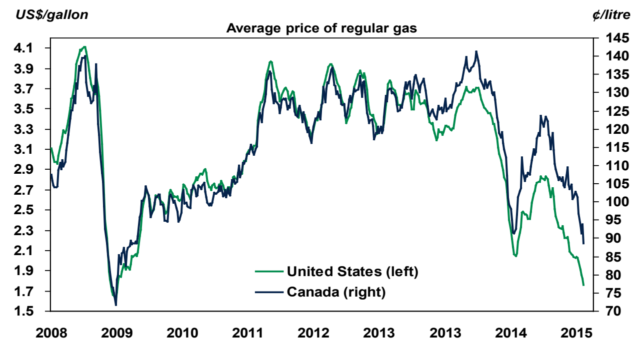
Forecasts: Failing OPEC production cuts or a real U.S. dollar downtrend, we do not expect oil prices to go much above US$30 a barrel in the first half of 2016. Low prices will help the market gradually rebalance, however, and prices should start to rise gradually as of next summer. Our year-end target for WTI this year is US$46 a barrel, and the uptrend should continue in 2017. The large inventories will also keep natural gas prices very low in the months to come, but prices there should also be higher in a few quarters.

Graph 6 – Global oil demand will also help rebalance the market



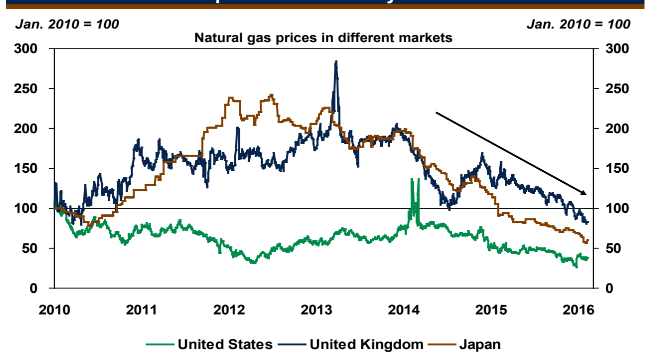
* International Energy Agency.
Sources: International Energy Agency and Desjardins, Economic Studies

Graph 7 – In the United States, gas prices have fallen very close to levels seen in the last recession



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

Graph 8 – Unlike the situation in 2012, international natural gas prices are also very low



Sources: Datastream and Desjardins, Economic Studies

BASE METALS

Surprisingly resilient

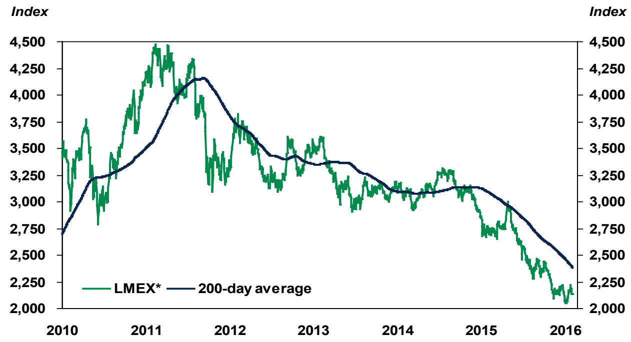
New concerns about China, tumbling stock markets and oil, fears of a global recession... a perfect scenario for base metal prices to keep plunging. The LME (London Metal Exchange) index of industrial metal prices thus started 2016 on a slide, even hitting 2,049 on January 12, a new cyclical low (graph 9). Despite the ongoing very negative sentiment in the markets, the LME index has rebounded since then, however, returning to around 2,200. The upswing is partly based on the U.S. dollar's pullback, a trend we do not think will last, but it also seems to reflect a perception that, with the LME off 24% in 2015 and down 48% since the end of 2010, it has fallen enough to rebalance the global metal market.

Beyond financial movements, the latest data is fairly encouraging for metal demand. In particular, Chinese imports of some metals have been quite strong in the last few months; this could indicate that the Chinese government's efforts to kick-start economic activity are starting to bear fruit (graph 10). Other Chinese figures, such as strong retail sales and auto sales, also contrast with the alarmist statements often heard about China. The last quarter of 2015 was tougher in several advanced economies, but growth outlooks remain relatively positive for 2016.

ALUMINUM

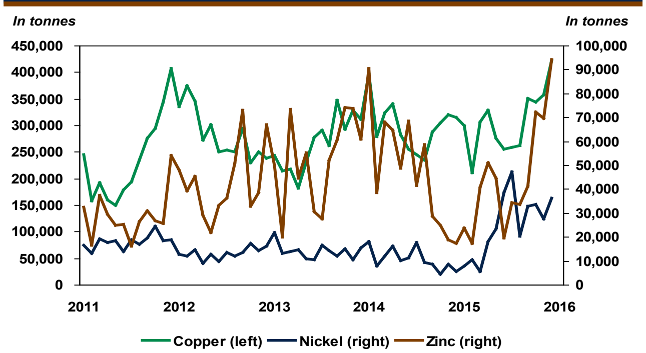
- Like other base metals, aluminum prices have edged up in the last few weeks, settling close to US$1,500 a tonne (graph 11). This is still 20% below where the price was a year ago. The surge in Chinese production and exports of aluminum was disastrous last year. Several analysts project that the global aluminum market will remain in surplus this year, which could send the metal's price even lower. Chinese aluminum production tumbled at the end of 2015, however, in response to some government's incentives, providing a ray of hope for the market to rebalance more quickly. A close watch must be kept on this situation.

Graph 9 – Metal prices have edged up lately



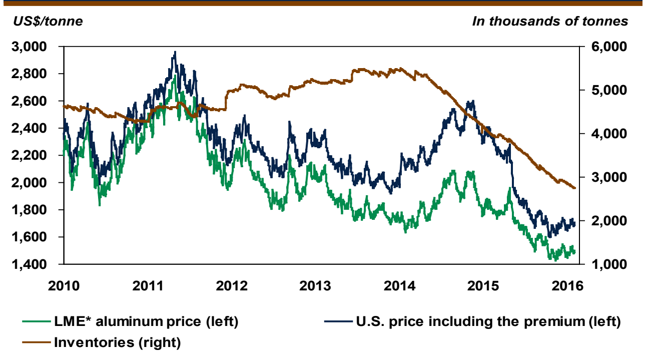
* London Metal Exchange base metal price index.
Sources: Datastream and Desjardins, Economic Studies

Graph 10 – Chinese imports of some metals were very strong at the end of 2015



Sources: Bloomberg and Desjardins, Economic Studies

Graph 11 – Aluminum prices and inventories

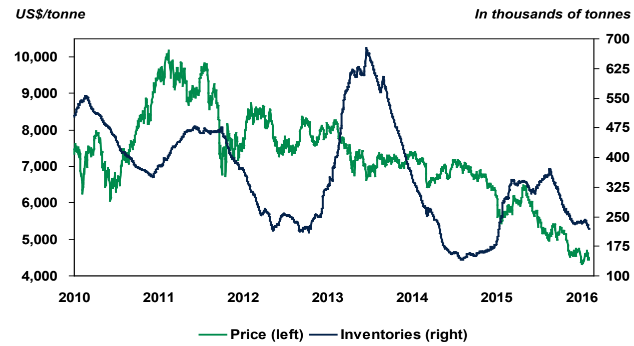


* London Metal Exchange.
Sources: Datastream, Bloomberg and Desjardins, Economic Studies

COPPER

- Copper prices have been volatile lately. After ending the year on a high note, prices fell to a new cyclical low of US$4,327.50 a tonne in mid-January, then rebounded temporarily above US$4,600 a tonne (graph 12). Global copper output growth should remain fairly robust in the coming quarters as a result of the major investments made when the metal's price was very high. There are also some encouraging signs for demand, however, especially in China where imports have recently surged. This allowed the inventories surveyed by the LME to retreat substantially.

Graph 12 – Copper prices and inventories

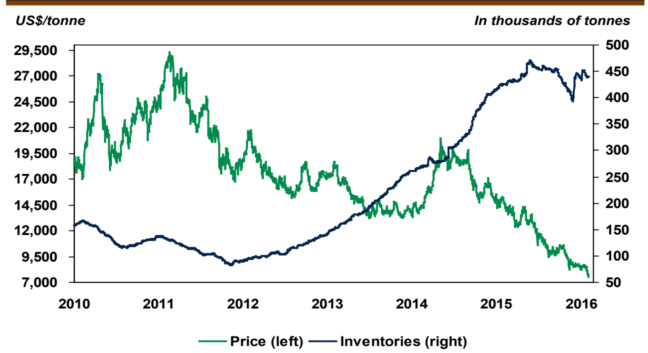


Sources: Datastream and Desjardins, Economic Studies

NICKEL

- We could have hoped that nickel prices had finished correcting after last year's spectacular plunge. Yet, the metal's price has kept retreating in the last few months, hitting US$7,561.50 a tonne recently, down nearly 50% over 12 months (graph 13). At first glance, this disappointing performance is hard to reconcile with the fact that Chinese nickel imports more than doubled last year. Unfortunately, it seems the purchases were mainly used to expand Chinese inventories. It is also disturbing to note that the nickel inventories surveyed by the LME are extremely high and have even started to trend up in the last few months, despite China's huge purchases. Although we still think the current price is not sustainable over the medium range, nickel prices could remain very low for some time, as additional production cuts could be needed to rebalance the market.

Graph 13 – Nickel prices and inventories

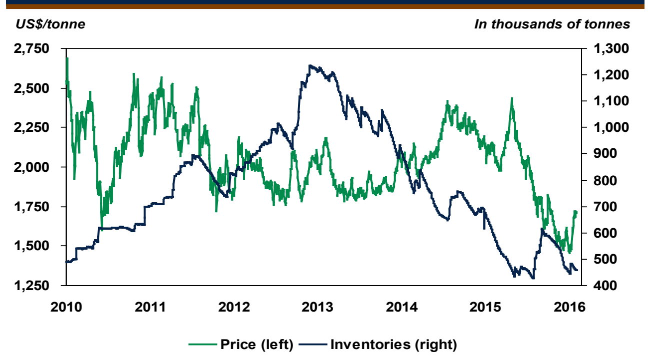


Sources: Datastream and Desjardins, Economic Studies

ZINC

- Like the other metals, 2015 was a tough year for zinc and its price retreated 26%. It has, however, rebounded 7% since the start of 2016, returning to around US$1,700 a tonne (graph 14). Several analysts think the outlook is better for zinc than for other base metals, given that metal producers have announced major production cuts. As for demand, Chinese imports ended 2015 very well, in contrast with a tough first half.

Graph 14 – Zinc prices and inventories



Sources: Datastream and Desjardins, Economic Studies

Forecasts: We still expect industrial metal prices to come up somewhat over the medium range to make them high enough to justify some investment. However, nothing suggests that the very high prices seen in 2007 and 2011 will be back. In the near term, the recent upswing price seems fragile, as we are not expecting the greenback to drop further. Heightened fears of a global recession would also be dangerous to metal prices.

PRECIOUS METALS

Will the environment stay as good for gold?

Early January's surge in market concern allowed precious metal prices to rise somewhat. The upswing accelerated when the U.S. dollar ran into difficulties.

GOLD AND SILVER

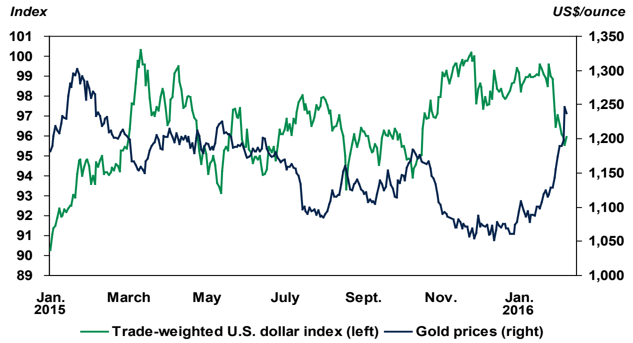
- The first increase in U.S. key rates in nearly 10 years pulled gold prices down to US$1,052 in mid-December. The subsequent upswing in market concern quickly boosted gold to around US$1,100 an ounce. The uptrend accelerated sharply at the end of January when investors started to expect U.S. key rates to be flat throughout 2016, taking the greenback down. The combination of a surge in concern in the markets and a dip of the greenback is ideal for gold. Gold recently jumped above US$1,200 an ounce (graph 15), with numerous investors apparently regaining an interest in the metal. Robust central bank demand for gold at the end of 2015 may also have played a role in the return of more positive sentiment about gold. Silver prices have followed a similar trend, recently taking them back above US$15 an ounce (graph 16).

PLATINUM AND PALLADIUM

- Platinum prices retreated 28% in 2015, but have climbed about 10% since the start of 2016, beating US$950 a tonne (graph 17). However, the negative spread between platinum and gold prices recently hit a record US$300 an ounce. Note that the surge in investor concern and fears of a global recession are casting doubt on industrial demand for platinum and palladium. The last few months have been especially tough for palladium; its price is down another 5% since the start of the new year.

Forecasts: Recent gains by gold and silver prices could persist in the near term. However, they seem quite fragile, as they primarily reflect the upswing in investor concern and the perception that U.S. key rates could stay where they are all year. In our opinion, it is more likely that the situation will eventually calm down and that the Federal Reserve will raise its key rates twice. This scenario would foster a rise of the greenback and should take gold prices back to around US$1,050 an ounce at the end of 2016.

Graph 15 – The greenback's recent retreat helped take gold prices above US$1,200 per ounce

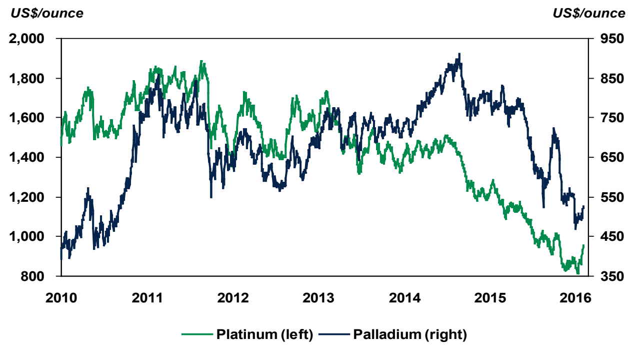


Sources: Bloomberg and Desjardins, Economic Studies

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 strong U.S. dollar is helping keep prices low

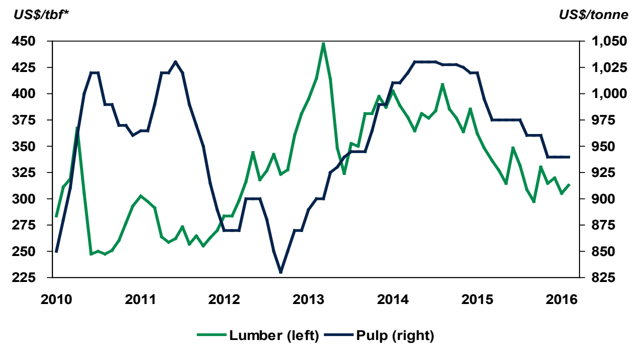
FOREST PRODUCTS

- The benchmark price for U.S. lumber fell 17% in 2015, and is now down just over 2% since the start of 2016. At US$313/tbf (thousand board feet), wood prices are still slightly higher than they were last September (graph 18). With the news still relatively promising for the U.S. housing market, low wood prices primarily reflect concerns about Chinese demand. A recent news item suggesting that the value of Chinese wood imports was down an annual 24% in November may seem disastrous at first glance. However, the drop in imports primarily stems from the 30% decline in the price of Chinese wood imports, not a collapse by true Chinese demand. **Nonetheless, this is a good illustration of the problems U.S. producers face in exporting to international markets on the heels of the greenback's surge.** Producers from other regions, like Russia, Europe and even Canada, can accept lower U.S. dollar prices because, when denominated in U.S. dollars, their local production costs have fallen. Pulp prices have been stable recently following last year's 8% drop.

AGRICULTURAL COMMODITIES

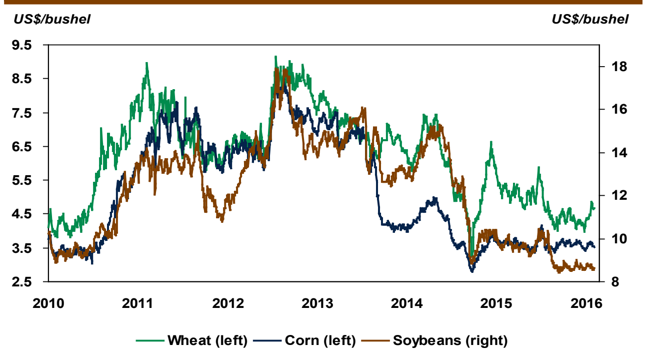
- Overall, cereal prices have been low and relatively stable in recent months (graph 19). However, wheat prices remained volatile, tumbling below US$4 a bushel very early in 2016, then rebounding to around US$4.80 recently. The rebound reflects the drop in U.S. winter wheat planting and the greenback's retreat. The latest forecast from the U.S. Department of Agriculture, however, confirms that the global cereal supply continues to be abundant, and wheat stocks expected for the end of the 2015–2016 season have been upgraded.
- For 2015 as a whole, wheat, corn and soybean prices dropped 29%, 6% and 15% respectively. Such price decreases usually help rebalance the market by encouraging farmers to reduce production. For foreign farmers, however, prices denominated in local currency remain high (graph 20), especially in countries like Brazil, Argentina and Russia whose currencies have plunged. The U.S. Department of Agriculture thus estimates that, last year, U.S. wheat exports tumbled to their lowest point since 1971–1972! **We expect the U.S. dollar to stay strong overall in 2016—one more reason not to look for cereal prices to rebound sharply.**

Graph 18 – Forest product prices



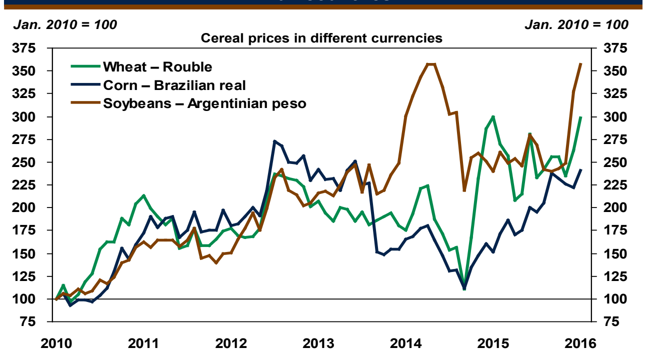
* Thousand board feet.
Sources: Datastream and Desjardins, Economic Studies

Graph 19 – Cereal prices



Sources: Datastream and Desjardins, Economic Studies

Graph 20 – Current prices will not curb cereal production in all countries



Sources: Datastream and Desjardins, Economic Studies

Table 1
Commodities

	Spot price	Percentage return since				Last 52 weeks		
	Feb. 15	1 month	3 months	6 months	1 year	High	Average	Low
Index								
Reuter-CRB[1] (CCI[2])	367.6	2.4	-4.4	-8.5	-16.6	440.9	403.6	353.7
Reuters/Jefferies CRB[1]	160.4	0.3	-13.2	-19.0	-30.0	231.8	201.3	155.0
Bloomberg Commodity Index	75.4	2.7	-8.5	-16.5	-27.8	105.5	91.4	72.9
Bank of Canada	292.7	-3.6	-18.9	-20.7	-30.0	456.4	385.9	288.1
Energy								
Brent oil (US$/barrel)	32.9	10.4	-24.3	-32.5	-45.8	68.2	50.8	27.8
WTI[3] oil (US$/barrel)	29.3	-0.4	-27.9	-30.9	-44.3	61.4	46.6	26.2
Gasoline (US$/gallon)	1.76	-11.9	-21.3	-33.1	-19.7	2.84	2.40	1.76
Natural gas (US$/MMBTU[4])	2.07	-5.0	3.0	-26.9	-24.2	3.27	2.53	1.53
Base metals								
LMEX[5]	2,155	4.9	-3.3	-10.0	-21.6	3,003	2,475	2,049
Aluminium (US$/tonne)	1,503	1.8	1.6	-3.1	-17.6	1,959	1,625	1,426
Copper (US$/tonne)	4,507	4.1	-6.7	-12.6	-21.7	6,482	5,357	4,328
Nickel (US$/tonne)	7,790	-6.8	-17.0	-26.3	-46.6	14,648	11,075	7,562
Zinc (US$/tonne)	1,711	16.5	6.7	-6.4	-20.1	2,434	1,866	1,455
Steel (US$/tonne)	196.0	-0.4	0.8	57.1	-58.7	475.0	207.4	123.8
Precious metals								
Gold (US$/ounce)	1,234	13.2	14.0	10.7	0.1	1,248	1,145	1,052
Silver (US$/ounce)	15.6	13.3	8.7	0.6	-7.2	17.7	15.4	13.6
Platinum (US$/ounce)	957.0	14.1	10.5	-4.0	-20.3	1,206	1,009	814.0
Palladium (US$/ounce)	526.0	6.9	-3.0	-15.6	-33.1	831.0	657.8	470.0
Other commodities								
Lumber (US$/tbf[6])	313.0	-0.6	-4.0	-4.0	-13.5	363.0	324.1	294.0
Pulp (US$/tonne)	940.0	0.0	-2.1	-3.6	-7.8	1,020	967.5	940.0
Wheat (US$/bushel)	4.66	6.8	6.5	1.2	-13.5	5.88	4.70	3.97
Corn (US$/bushel)	3.53	-0.7	-0.4	1.1	-3.2	4.15	3.60	3.36
Soybean (US$/bushel)	8.65	-1.5	1.8	-9.5	-11.3	10.47	9.23	8.42

[1] Commodity Research Bureau; [2] Continuous Commodity Index; [3] West Texas Intermediate; [4] Million British Thermal Unit; [5] London Metal Exchange Index; [6] Thousand of board feet.
Note: Currency table base on previous day closure.

Table 2
Commodities prices: history and forecasts

Annual average	2014	2015	2016f	2017f
WTI* oil (US$/barrel)	93	49	Target: 36 (range: 28 to 44)	Target: 52 (range: 40 to 60)
Natural gas Henry Hub (US$/MMBTU**)	4.34	2.65	Target: 2.40 (range: 2.00 to 3.00)	Target: 2.80 (range: 2.25 to 3.50)
Gold (US$/ounce)	1,266	1,160	Target: 1,120 (range: 1,050 to 1,300)	Target: 1,000 (range: 925 to 1,150)
LMEX*** index—base metals	3,117	2,550	Target: 2,400 (range: 2,100 to 2,700)	Target: 2,700 (range: 2,200 to 3,200)

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