Commodity Trends

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October 13, 2016

OPEC helps oil get back above US$50 a barrel

A few trend reversals have occurred in the commodity market in the last few weeks. Faced with signs of soft global oil demand and a surge in output by members of the Organization for the Petroleum Exporting Countries (OPEC), West Texas Intermediate fell to around US$43 in mid-September. A surprise agreement from OPEC countries to curb output, however, made oil prices rebound above US$50 a barrel in early October. Conversely, precious metal prices have dropped sharply in the last few weeks, as investors are starting to worry that the central banks will begin cutting back on their intervention (graph 1).

Aside from the recent movements in oil and precious metals, commodity prices have been relatively stable in recent months. Although, overall, resource prices are generally still low, prices for most commodities have made substantial advances from where they were at the start of 2016, in contrast with the general tumbles recorded in 2014 and 2015 (graph 2). The increase is bigger still if we compare current prices with the February 2016 lows. The correction that began in mid-2014 thus seems to be over and we can hope that commodity prices will continue to rise gradually in 2017.

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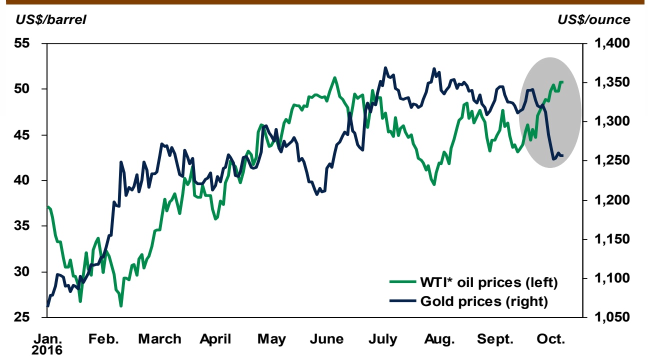
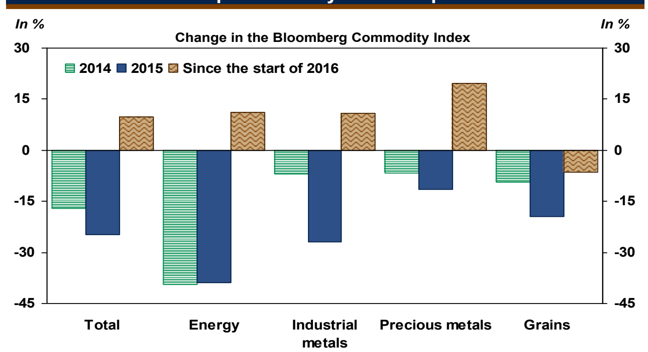
Graph 1 – The last few weeks have been better for oil than gold



* West Texas Intermediate.
Sources: Datastream, Bloomberg and Desjardins, Economic Studies

Graph 2 – After a 2-year correction, we are seeing an almost widespread rise by resource prices



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.

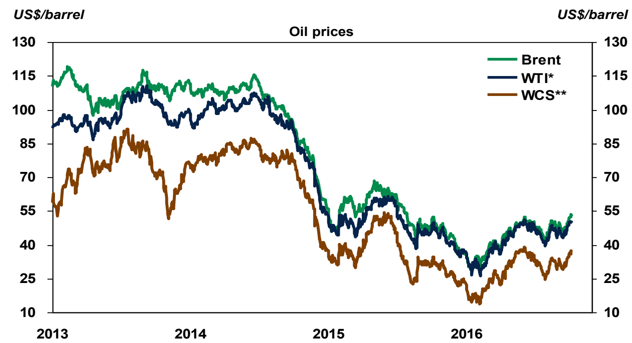
ENERGY

The OPEC agreement could have a positive, yet limited impact

OIL

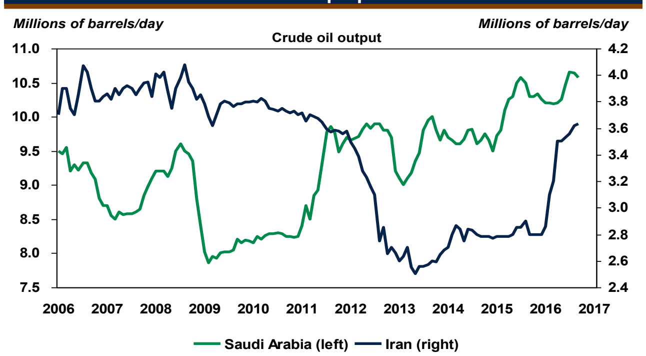
- Oil prices have seesawed in the last few months (graph 3). West Texas Intermediate (WTI) fell to around US$40 a barrel in early August, then quickly climbed to around US$48. Prices then softened again when slightly weaker global demand in combination with a big surge in output from the Organization for the Petroleum Exporting Countries (OPEC) prompted the International Energy Agency to predict that a slight surplus could persist in the global oil market. Oil prices fell, going to US$43 in mid-September, then rebounded again, even crossing above US$50 a barrel following a surprise OPEC agreement to limit oil supply. Like oil prices, gasoline prices fluctuated with no clear trend in the last few months, then strengthened recently.
- After several months of fruitless efforts, the members of the OPEC finally reached an agreement at their September 27 meeting in Algiers. Output by these countries recently hit approximately 33.5 mbd (millions of barrels per day); the agreement aims to take it down between 32.5 mbd and 33.0 mbd. We will have to wait until the agreement is finalized at OPEC's November meeting for it to start having a real impact on oil production. In the meantime, OPEC will try to persuade other countries, particularly Russia, to curb their output as well. Although obstacles remain, an agreement seems possible because it would not be too limiting for the major signatories. Saudi Arabia, Iran and even Russia have boosted output sharply in the last few months (graph 4), and a freeze or even slight decline would leave their production at a very comfortable level.
- Although it does not represent a major change in strategy, with the signing nations apparently determined to keep defending their market shares, ratifying the agreement would be good for oil prices in the near term. It would limit the risk that these nations, especially Saudi Arabia, would keep increasing output. It could even help balance the supply and demand for oil in 2017 (graph 5), as the International Energy Agency's forecast for a slight surplus assumed that OPEC would keep increasing its output. The agreement between OPEC countries should, however, have little impact on oil prices over the medium term, especially as these countries have frequently flouted their commitments in the past.
- The evolution of U.S. oil output will be a lot more critical for oil prices. The recent news there has also been fairly favourable to higher prices, as the weekly figures are still generally showing a drop in oil production, despite the upswing in drilling, and a decline in oil inventories. This supports our view that there will be no sustained upswing in U.S. crude production until prices are clearly entrenched above US$50 a barrel. A recent Dallas Federal Reserve survey shows that most oil and gas companies think that it would take a WTI price of between US$55 and US$69 a barrel to drive drilling up (graph 6).

Graph 3 – Oil prices have risen in recent weeks



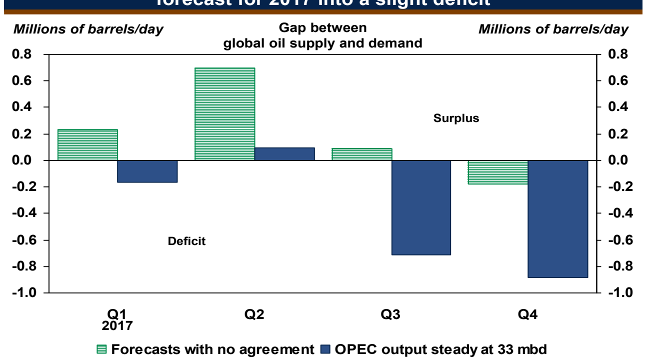
* West Texas Intermediate; ** Western Canada Select.
Sources: Datastream, Bloomberg and Desjardins, Economic Studies

Graph 4 – After boosting output substantially, Iran and Saudi Arabia seem prepared to curb it



Sources: Bloomberg and Desjardins, Economic Studies

Graph 5 – An OPEC freeze could turn the slight oil surplus forecast for 2017 into a slight deficit



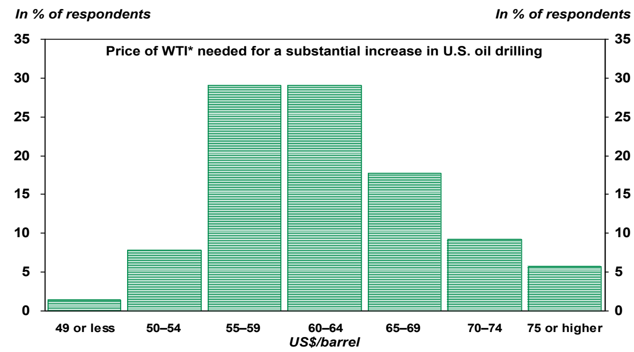
OPEC: Organization of the Petroleum Exporting Countries; mbd: millions of barrels per day
Sources: International Energy Agency and Desjardins, Economic Studies

NATURAL GAS

- Natural gas prices have fluctuated around US$3/MMBTU (Million British Thermal Units) in recent months (graph 7). They are about twice as high as the lows hit at the end of last winter. Strong summer gas demand combined with stagnant production took gas stocks, which had been overly high at the end of last winter, much closer to normal (graph 8). As seen with oil, the spectacular plunge in drilling in the last few years had a major impact on natural gas production. In this context, gas stocks could quickly drop below normal if the coming winter is a cold one. The outcome of the U.S. election could have an impact on natural gas prices, as a Donald Trump victory would pave the way for overturning several regulatory measures that limit coal use to the benefit of natural gas, among other things.

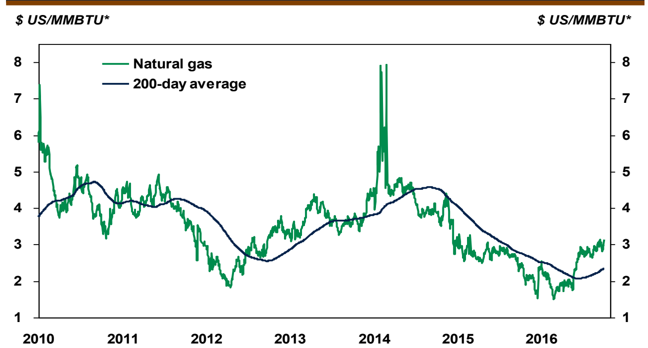
Forecasts: If they really do curb output, OPEC countries should manage to keep oil prices around US$50 a barrel in the coming months. A credible commitment from Russia to do the same could put additional upside pressure on oil prices. The risk of a surge in concern over the U.S. election or a strong rise by the U.S. dollar if the Federal Reserve raises its key rates in December are, however, major downside risks. In this context, we still expect WTI to be around US$50 at the end of 2016. We expect it to head toward US$60 by the end of 2017, making a real upswing in U.S. output possible. Natural gas prices could be volatile in the near term, especially once the first indications of how cold the winter will be are available.

Graph 6 – Most U.S. producers think that a crude price between US$55 and US$69 would kick start drilling



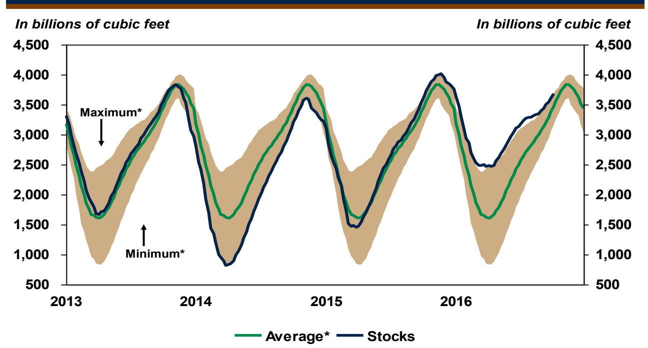
* West Texas Intermediate.
Sources: Federal Reserve of Dallas and Desjardins, Economic Studies

Graph 7 – Natural gas prices



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

Graph 8 – Limited growth this summer put natural gas stocks at more normal levels



* From 2011 to 2015.
Sources: Energy Information Administration and Desjardins, Economic Studies

BASE METALS

Still rising gradually

Unlike precious metals, the greenback's recent upswing and monetary firming expectations in the United States had little impact on industrial metals. The LME (London Metal Exchange) index of industrial metal prices has even edged up in the last few months, going to around 2,465. Although this is still relatively weak, the index is up more than 20% from its cyclical low at the start of 2016 (graph 9). We can therefore say that industrial metal prices are now in a bull market.

Industrial metal prices' recent resilience, despite the greenback's appreciation, primarily seems to be based on relatively favourable developments in the global demand for metals, in the context of an ongoing limited supply. Fears that the European economies would slow sharply after the Brexit win dissipated quickly, and everything suggests the U.S. economy has rebounded after a disappointing first half. August's tumble of the ISM indexes was a dark spot in the U.S. economic picture, but it vanished when the indexes rebounded the following month (graph 10). China's economic numbers have also been relatively encouraging in the last few months, a prerequisite for an ongoing upswing in base metal prices.

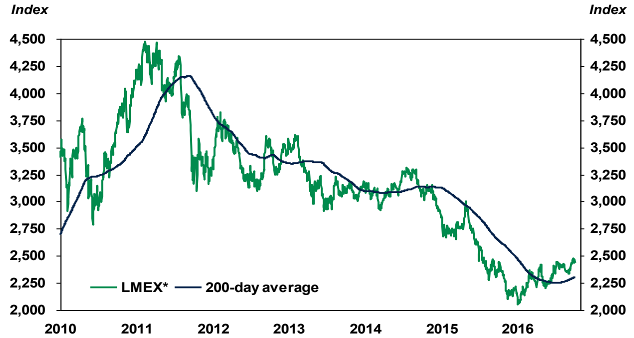
ALUMINUM

- Aluminium prices have been fairly volatile in recent months. They weakened at the end of the summer, and then shot up in the last few weeks, going to US$1,686 a tonne, their highest point in over a year (graph 11). Aluminium has posted a noteworthy gain of better than 12% since the start of the year. The rise in aluminium prices is primarily based on good growth in demand for the metal. The outlook there is positive, with many analysts expecting global aluminium demand to grow 4% to 5% annually in the years to come. Producers' reaction must be watched, however, as an overly rapid bounce back by production could curb the rise in prices.

COPPER

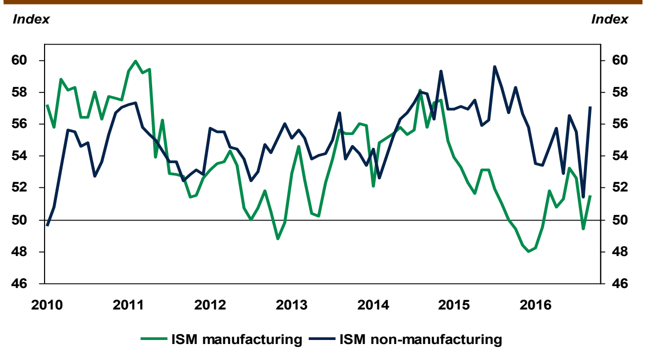
- Copper prices continued to lag behind most other industrial metals, ticking down since the end of July. At around US$4,800 a tonne, copper prices have been casting around with no clear trend since the start of 2016. A surge in copper inventories surveyed by the LME in recent months (graph 12), with Chinese copper imports declining, contributed to the metal's disappointing performance. However, surging inventories seems to be more of a reflection of a shift in inventories between China and the rest of the world,

Graph 9 – Industrial metal prices keep rising slowly



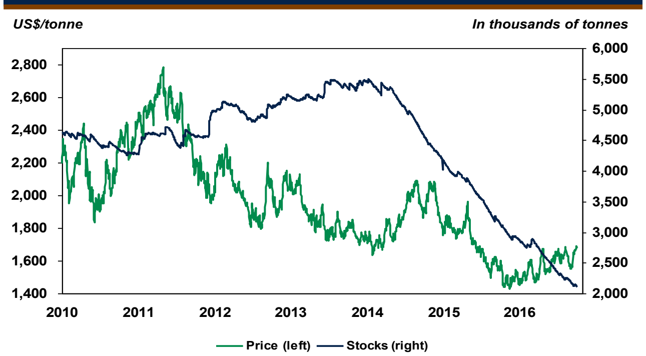
* London Metal Exchange base metal price index.
Sources: Datastream and Desjardins, Economic Studies

Graph 10 – In the end, August's tumble by the ISM indexes seems to have been a false sign of weakness



Sources: Institute for Supply Management and Desjardins, Economic Studies

Graph 11 – Aluminium prices and stocks



Sources: Datastream and Desjardins, Economic Studies

rather than the symptom of a major surplus in the global copper market. Here, data from the International Copper Study Group instead show a deficit in the first half of 2016, with copper demand advancing by a lively 5%. Copper output could outstrip demand in the second half of 2016, but most analysts are predicting a deficit in 2017. Copper prices are also more sensitive to financial variables; the greenback's recent renewed strength could have affected them negatively.

NICKEL

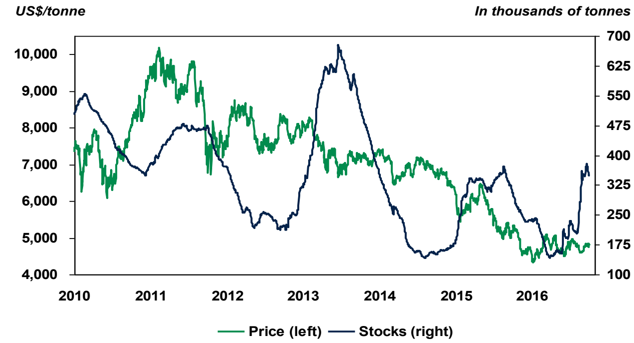
- Nickel prices have been moving with no clear trend since the end of July. They have mostly stayed above US$10,000 a tonne, consolidating the gains made at the end of the spring and start of summer (graph 13). Although still low, nickel prices are up by nearly 20% from the start of 2016, as inventories of the metal surveyed by the LME posted a retreat of a similar magnitude. The shutdown of several nickel mines in the Philippines for environmental reasons is a major support for the metal's price. An upswing in Indonesia's nickel exports could, however, make up for the drop in the Philippines. Global nickel demand should still outstrip production in the coming quarters, pointing to further declines in stocks and paving the way for the metal's price to keep rising.

ZINC

- Zinc prices continued to trend up, crossing back above US$2,300 a tonne and even temporarily brushing US$2,400 (graph 14). Zinc prices have advanced about 45% since the start of 2016, reflecting the emergence of a major deficit in the global zinc market, given that prior price declines reined in zinc production. The zinc market will remain in deficit in the coming quarters, unless an overly rapid surge in prices makes production bounce back.

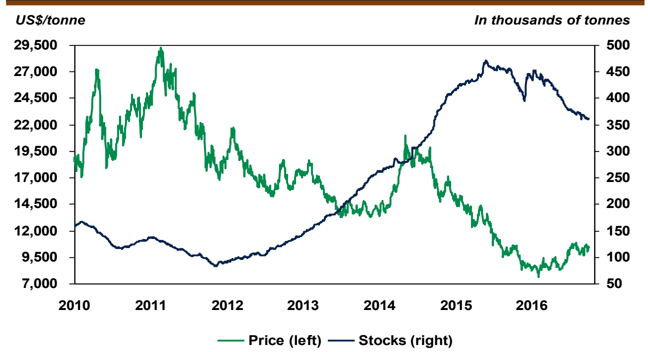
Forecasts: Industrial metal prices will continue to be highly tied to the health of the Chinese economy. Failing nasty surprises there, the balance between global supply and demand should justify an ongoing gradual rise of base metal prices in the quarters to come. However, nothing suggests that prices will skyrocket again.

Graph 12 – Copper prices and stocks



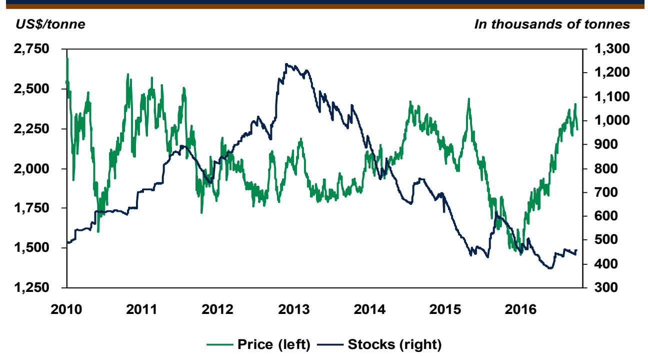
Sources: Datastream and Desjardins, Economic Studies

Graph 13 – Nickel prices and stocks



Sources: Datastream and Desjardins, Economic Studies

Graph 14 – Zinc prices and stocks



Sources: Datastream and Desjardins, Economic Studies

PRECIOUS METALS

Major relapse

Following a very good summer, precious metal prices retreated sharply in the last few weeks and gold prices dropped back close to US$1,250 an ounce. This decline primarily reflects the view that monetary policies may become less favourable to these metals.

GOLD AND SILVER

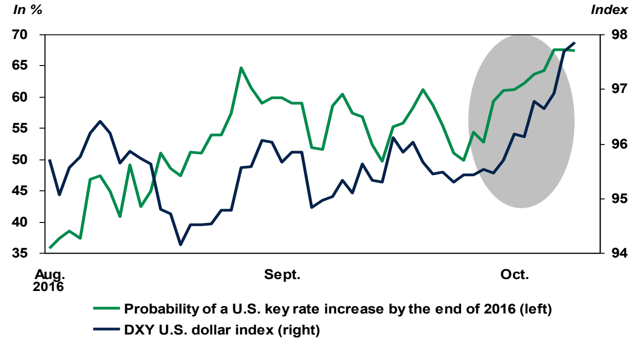
- Gold prices stole the show in the first few months of 2016, and they hit US$1,369 an ounce in early July, a peak that dates back to March 2014, after the Brexit option's surprise win in the United Kingdom. The Brexit win initially seemed to slam the door on any U.S. key rate increase before the end of 2016. However, that perception did not last long, with several Federal Reserve (Fed) leaders rapidly starting to signal a desire to raise key rates soon. Investors now expect a rate increase in December, which favours a rising greenback (graph 15). The desire to raise key rates reflects more encouraging U.S. numbers and a growing concern among central bankers about the consequences of extremely low interest rates. Signs that the Bank of Japan and European Central Bank could curb their intervention also played heavily against gold prices, taking them down to around US$1,250 an ounce recently. Silver prices have also retreated sharply (graph 16).

PLATINUM AND PALLADIUM

- Like gold and silver prices, platinum and palladium prices have retreated sharply in the last few weeks. Platinum hit US$1,182 an ounce in early August, then lost over 15% to drop back below US$1,000 an ounce. During the same period, palladium prices retreated by almost 10%. Despite the last few weeks' substantial drops, prices for the four principal precious metals are still substantially higher than where they started 2016.

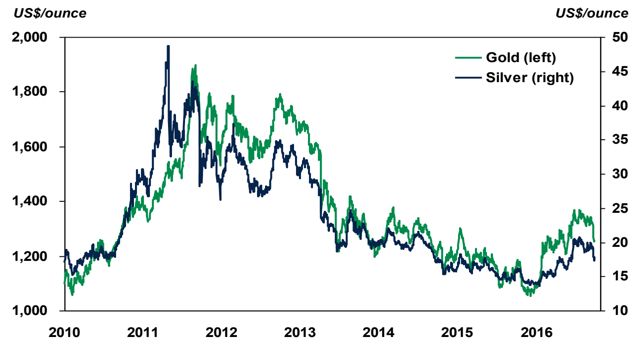
Forecasts: It now seems the Fed will raise its key rates at December's meeting unless the November 8 U.S. election sends too much upheaval into the markets. In this context, precious metal prices could end the year a little lower than we previously anticipated. Gold prices could keep pulling back next year, with ongoing gradual monetary policy normalization.

Graph 15 – U.S. key rate increase expectations are helping the greenback and hurting gold



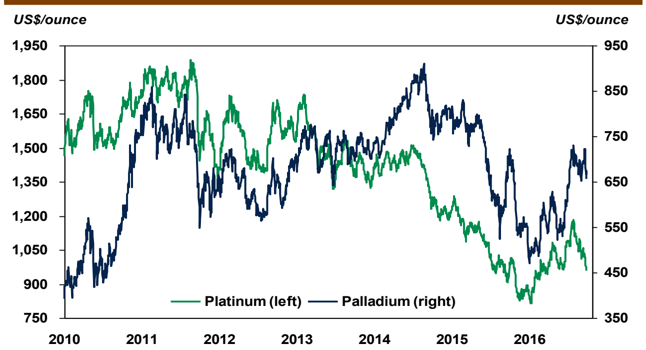
Sources: Bloomberg and Desjardins, Economic Studies

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 abundant supply hurts agricultural prices

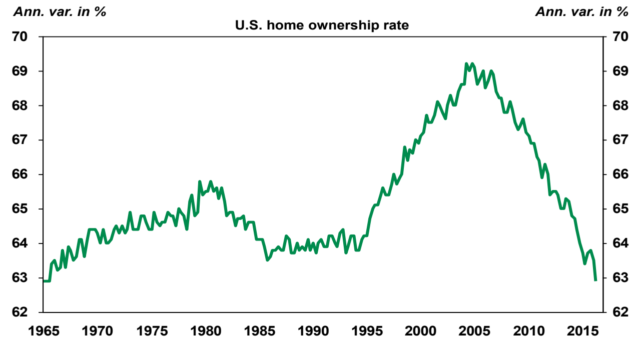
FOREST PRODUCTS

- Forest product prices have not moved much in recent months. Lumber prices are still around US$360/mbf (thousand board feet), up about 12% from the start of 2016. **Signs that the U.S. economy is accelerating after a disappointing first half and positive developments in residential real estate are promising for future wood demand.** In particular, sales of new homes recently jumped to their highest point in over 10 years in the United States; an extended uptrend seems possible in the years to come, as the home ownership rate there has dropped to a several decades low (graph 18). The lack of progress in the negotiations over a new lumber trade agreement between Canada and the United States remains a sizable concern for Canadian wood producers.

AGRICULTURAL COMMODITIES

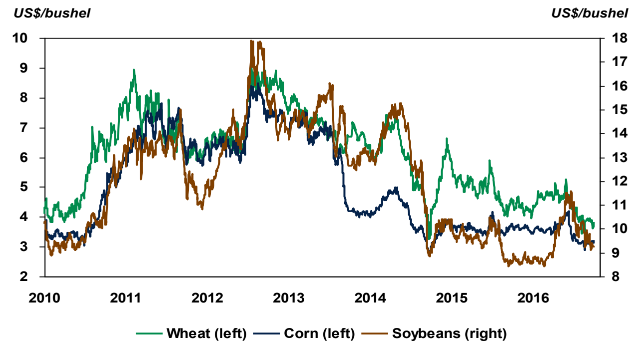
- Prices for the main cereals continued to slide in recent months (graph 19), with the excellent U.S. harvest translating into a very abundant cereal supply. Not only have wheat, corn and soybeans had an excellent year, but the world production of other cereals, including rice, should set records. Low prices seem to favour increased consumption of cereals, as shown by the spectacular surge in U.S. soybean exports in the last few months. Regardless, **global stocks of most cereals will increase again this year, suggesting that prices could stay low in the coming years**.
- A major rebound in supply is also starting to affect livestock prices (graph 20). Herds dwindled dramatically a few years ago, but have been reconstituted, as the drop in cereal costs and surge in meat prices have made animal production a lot more profitable. The abundance of hogs and chickens, and an upswing in the beef supply in the U.S. market are now raising concern about a sharp drop in meat prices, as happened with cereals.

Graph 18 – A low home ownership rate paves the way for construction to pick up



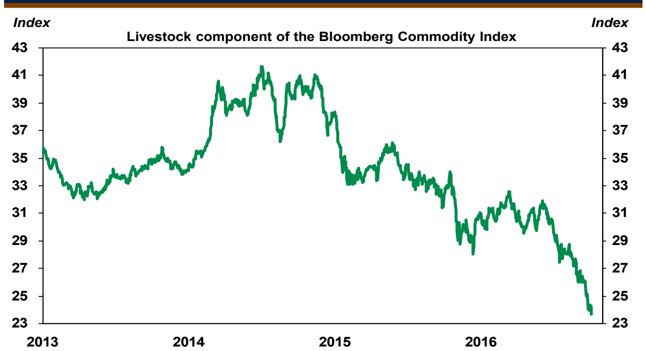
Sources: U.S. Census Bureau and Desjardins, Economic Studies

Graph 19 – Cereal prices



Sources: Datastream and Desjardins, Economic Studies

Graph 20 – It is now livestock's turn to plunge



Sources: Datastream and Desjardins, Economic Studies

Table 1
Commodities

	Spot price	*Percentage return since*				*Last 52 weeks*		
	Oct. 13	**1 month**	**3 months**	**6 months**	**1 year**	**High**	**Average**	**Low**
Index								
Reuter-CRB[1] (CCI[2])	415.9	0.6	-4.3	6.5	2.2	436.9	398.9	353.7
Reuters/Jefferies CRB[1]	188.1	4.2	-0.3	7.1	-5.7	199.8	179.9	155.0
Bloomberg Commodity Index	85.6	3.2	-1.5	5.4	-4.8	90.1	82.4	72.9
Bank of Canada	377.2	4.7	1.8	10.5	1.5	388.7	347.9	281.8
Energy								
Brent oil (US$/barrel)	51.9	9.8	12.0	16.9	4.6	53.4	43.5	27.8
WTI[3] oil (US$/barrel)	50.1	11.6	11.7	20.2	7.4	51.2	41.6	26.2
Gasoline (US$/gallon)	2.27	3.2	0.8	9.8	-2.8	2.40	2.13	1.72
Natural gas (US$/MMBTU[4])	3.17	3.6	12.8	60.1	30.5	3.17	2.28	1.49
Base metals								
LMEX[5]	2,436	4.5	0.3	5.9	0.5	2,474	2,288	2,049
Aluminium (US$/tonne)	1,681	8.6	1.3	8.6	6.7	1,687	1,554	1,426
Copper (US$/tonne)	4,791	3.4	-2.6	-1.2	-9.4	5,329	4,762	4,328
Nickel (US$/tonne)	10,521	7.3	2.1	17.5	0.8	10,815	9,266	7,562
Zinc (US$/tonne)	2,250	1.3	3.6	20.0	25.2	2,404	1,886	1,455
Steel (US$/tonne)	312.5	0.0	0.0	311.2	61.9	312.5	202.7	75.5
Precious metals								
Gold (US$/ounce)	1,252	-5.5	-6.6	0.4	7.3	1,369	1,224	1,052
Silver (US$/ounce)	17.4	-9.0	-14.0	9.1	11.7	20.7	16.6	13.6
Platinum (US$/ounce)	947	-9.5	-13.2	-4.7	-3.7	1,182	979.2	814.0
Palladium (US$/ounce)	651.0	-0.9	1.7	20.3	-5.2	730.0	594.6	470.0
Other commodities								
Lumber (US$/tbf[6])	358.0	2.0	2.6	3.2	17.4	369.0	337.3	305.0
Pulp (US$/tonne)	995	-0.5	-0.5	4.7	3.6	1,000	965.4	940.0
Wheat (US$/bushel)	3.82	-1.5	-13.2	-18.4	-16.2	5.25	4.38	3.44
Corn (US$/bushel)	3.13	1.0	-8.7	-14.0	-14.9	4.18	3.50	2.88
Soybean (US$/bushel)	9.14	-3.4	-17.7	-2.0	2.1	11.57	9.43	8.40

[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

	2014	***2015***	***2016f***	***2017f***
Annual average				
WTI* oil (US$/barrel)	93	49	Target: 44 (range: 42 to 46)	Target: 55 (range: 46 to 64)
Natural gas Henry Hub (US$/MMBTU**)	4.34	2.65	Target: 2.50 (range: 2.35 to 2.60)	Target: 3.25 (range: 2.60 to 3.80)
Gold (US$/ounce)	1,266	1,160	Target: 1,255 (range: 1,240 to 1,270)	Target: 1,200 (range: 1,150 to 1,325)
LMEX*** index—base metals	3,117	2,550	Target: 2,340 (range: 2,300 to 2,370)	Target: 2,700 (range: 2,300 to 3,100)

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