Commodity Trends

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Metals reacted differently after Donald Trump's victory

We could have assumed that a surprise in the U.S. election would trigger a rise in concern that would play against industrial commodities and in favour of safe-haven securities, including gold. In the end, Donald Trump's win had the opposite effect, with investor focus quickly shifting to the fact that the president-elect's program could make the economy and inflation accelerate. What followed was a major surge by yields and the U.S. dollar, and fairly widespread growth in risky asset prices.

In recent weeks, oil prices have essentially fluctuated in tandem with the tough Organization of the Petroleum Exporting Countries negotiations. These countries finally agreed to cut back output substantially, for the first time since 2008, which should help oil prices hold above US$50 a barrel. In this context, industrial metal prices are what primarily benefited from the renewed investor optimism (graph 1). The enthusiastic response to the U.S. election seems a little exaggerated, but relatively encouraging economic figures in advanced nations (graph 2) mean we can hope for more sustained global economic growth in 2017. Industrial commodity prices should thus continue to rise slowly next year.

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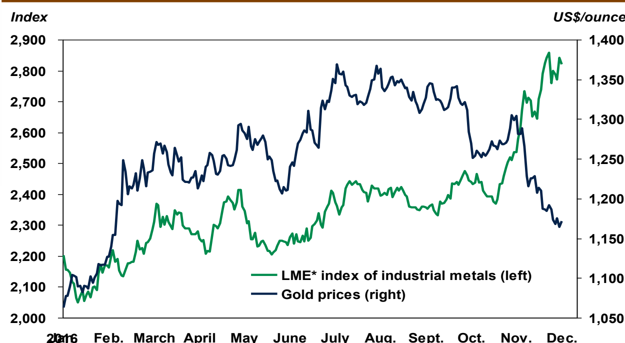
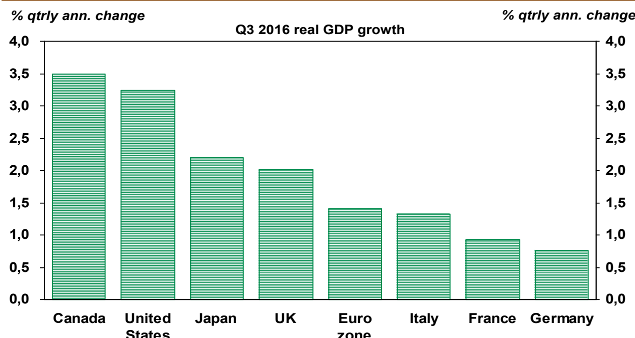
Graph 1 – Base metal prices take off while gold prices tumble



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

Graph 2 – Economic growth was relatively strong in G7 nations this summer



Sources: Datastream and Desjardins, Economic Studies

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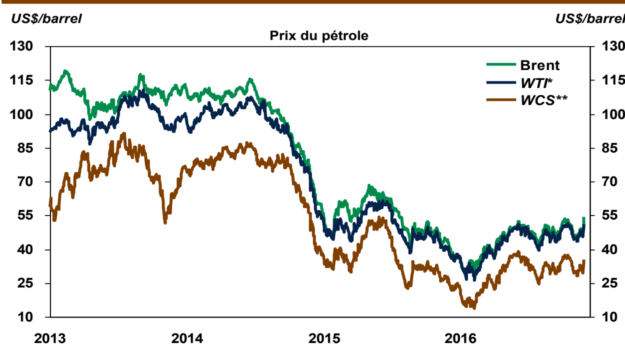
ENERGY

OPEC agrees to slash oil output

OIL

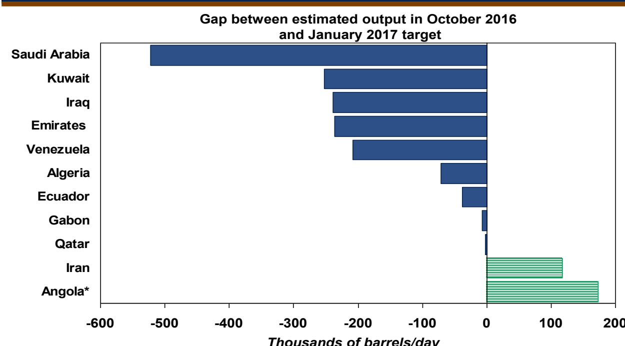
- Oil prices have continued to seesaw in the last few months (graph 3). The preliminary agreement by the Organization of the Petroleum Exporting Countries (OPEC) to reduce their oil supply had allowed West Texas Intermediate (WTI) oil to rise above US$50 a barrel in early October. Doubts over the agreement, with Iran and Iraq quite reticent to cut their output, however, pulled oil prices down to around US$43 in mid-November, despite the fairly positive sentiment in financial markets. Well aware that a failure could make oil prices plunge below US$40/barrel, the OPEC nations finally agreed on November 30, bringing the WTI price over US$50 a barrel (graph 3).
- OPEC thus delivered the goods, agreeing to reduce its oil output to 32.5 million barrels a day (mbd) as of January. This is about 1.2 mbd less than current output (graph 4). Most cartel members will lower their output, while Iran will stabilize it close to its current level. No quotas have been set for Indonesia, Libya and Nigeria, as they are facing particular situations. Saudi Arabia will absorb a big share of the cut, with 0.5 mbd. An additional 0.6 mbd reduction from other producing nations should add to this 1.2 mbd decrease. Russia has already committed to gradually decreasing its output by 0.3 mbd. The OPEC accord will bind the parties for six months, but could be extended if the situation calls for it. A total reduction of 1.8 mbd would be equivalent to nearly 2% of global crude production. How far the signers will respect the agreement remains to be seen; they have not consistently done so in the past.
- The efforts by OPEC and Russia should result in a deficit in the global market as of the first quarter of 2017 (graph 5). This should help reduce the important global crude inventories and support a gradual rise in prices. As global demand should continue to advance steadily, the major issue is how U.S. production will react. The International Energy Agency expects an increase next year, but for now what we are seeing is some stabilization. More positive sentiment about oil and a new U.S. president who wants to maximize fossil fuel exploitation could, however, trigger a sharper rebound by output shortly.

Graph 3 – Is oil back above 50 US$/barrel for good?



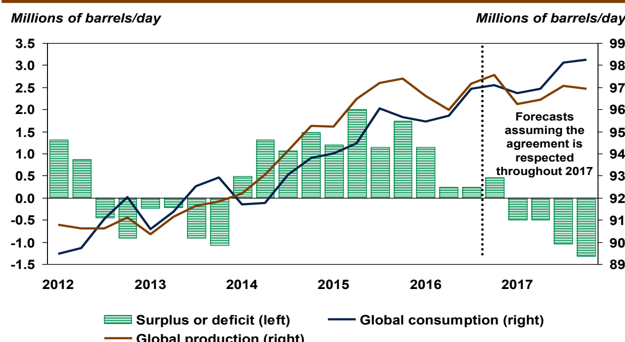
* West Texas Intermediate; ** Western Canada Select.
Sources: Datastream, Bloomberg and Desjardins, Economic Studies

Graph 4 – Several countries have pledged to slash their oil output



*Angola's output already dropped more than 200,000 barrels a day from September to October
Sources: Bloomberg, Organization of Petroleum Exporting Countries and Desjardins, Economic Studies

Graph 5 – The OPEC* agreement suggests global oil demand will outstrip output next year



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

GASOLINE

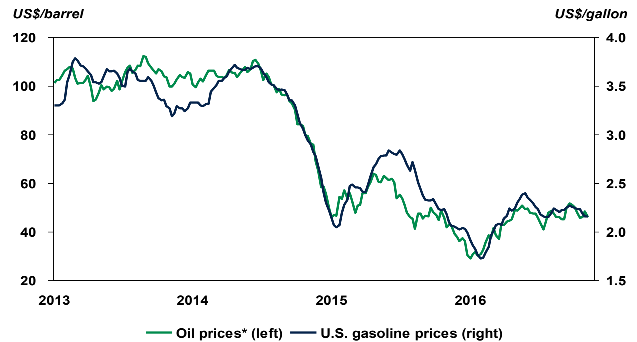
- Like oil prices, gasoline prices have not been showing a clear trend in recent months. Problems with major pipelines temporarily inflated U.S. gas prices, but the national average recently fell to around US$2.15 a gallon (graph 6). U.S. gas stocks remain high, but demand is robust, with an increase in distances travelled on U.S. highways. The impact that electric cars will have on gas demand over the medium and long term is getting more and more attention. Keep a close eye on this situation as the experts are far from unanimous on the matter.

NATURAL GAS

- After a soft patch early in the fall, when continuing warm weather limited heating demand, natural gas prices have shot up in recent weeks, going to US$3.71/MMBTU (Million British Thermal Units) for the first time since December 2014 (graph 7). The recent upswing by natural gas prices stems from the return of colder weather and forecasts that this winter could be relatively harsh. Natural gas inventories remain high, but a cold winter could quickly reverse this situation, especially given that natural gas production is down from last year (graph 8). Production could rebound next year, as drilling has recently started to rise and the new president-elect is making no secret about his plan to bolster fossil fuel exploitation in the United States. The probable elimination of some measures to limit coal use—natural gas's main competitor in electricity production—could also help keep gas prices relatively low in the coming years.

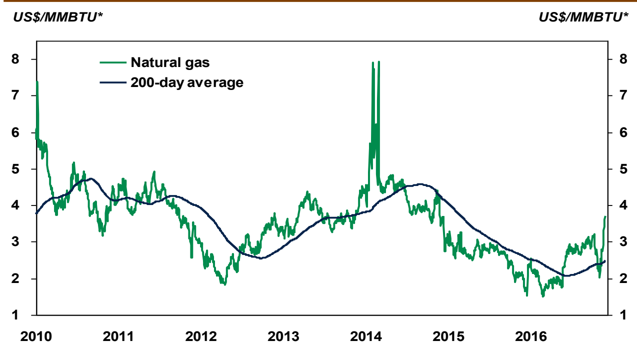
Forecasts: The serious efforts recently instituted to curb oil production and renewed optimism over the global economy do not point to a relapse in oil prices. They should generally continue to rise in the next few quarters, as long as we don't see a major comeback in U.S. production. Our target for WTI oil for the end of 2017 is now US$58 a barrel. The more favourable environment for an increase in U.S. output and eventual return of the output removed by OPEC and Russia should, however, limit growth in oil prices over the medium range. Outside of fluctuations associated with the weather, natural gas prices should generally oscillate close to current levels next year.

Graph 6 – U.S. gas prices now seem to be a good reflection of oil prices



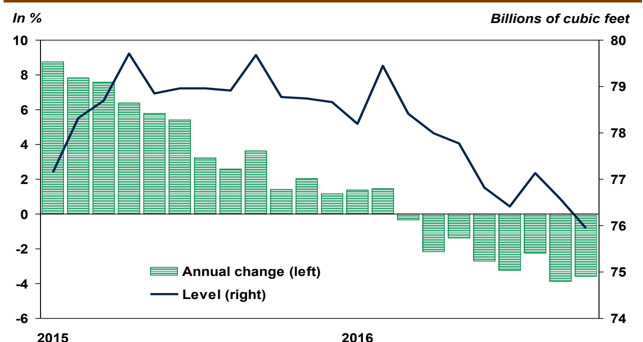
* Average of Brent and West Texas Intermediate oil prices.
Sources: Datastream and Desjardins, Economic Studies

Graph 7 – Natural gas prices



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

Graph 8 – U.S. natural gas production retreated in 2016



Sources: Energy Information Administration and Desjardins, Economic Studies

BASE METALS

The price increase accelerated sharply

At the start of October, we noted that a slow rise had taken the London Metal Exchange (LME) index of industrial metal prices close to 2,500. The uptrend has picked up speed since then, capitalizing on more positive sentiment about copper and a surge in optimism after the U.S. election. Industrial metals' performance is especially impressive given that the U.S. dollar has appreciated sharply. The LMEX index's rise is thus even sharper if expressed in an alternate currency, like the euro (graph 9).

The surge in enthusiasm that followed the U.S. election may seem exaggerated. The promised tax cuts could give the U.S. economy some support in the near term, but the impacts on global demand will probably be quite small. Other priorities of the president-elect, in particular his protectionist plans, could even harm the global economy. Nonetheless, the fact remains that the election of Donald Trump puts another leader in power who is taking a clear stance in favor of increasing infrastructure spending. This trend favourable to public investment, also seen in China and Canada, combined with clear signs of improvement in the manufacturing sector (graph 10) in several countries, justifies some optimism about demand for base metals.

ALUMINUM

- Aluminum prices continued to climb in recent weeks, temporarily reaching US$1,780 a tonne, a peak that dates back to May 2015, then dropping to around US$1,700 (graph 11). Solid demand for aluminum, which could accelerate along with the global economy, should allow consumption of this metal to once again outstrip global output next year. Chinese producers will have to stay disciplined, but for now the fears of a quick rebound there do not seem to be materializing.

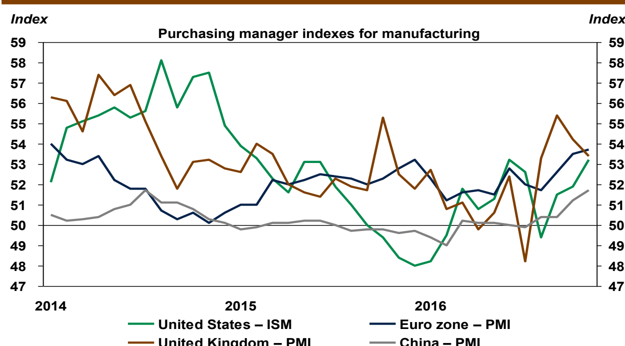
COPPER

- Copper prices underperformed throughout 2016, but then finally posted a surge of about 20% since the end of October, returning to around US$5,700 a tonne (graph 12 on page 5). A substantial drop in the inventories surveyed by the LME strengthened the view that the fears of a potential major global copper surplus were overblown; these fears had hurt the metal's prices in the last few quarters. The recent rise in copper prices also seems to partially reflect a surge in speculator interest, especially in China, which could increase the risk of a relapse in the near term. More robust Chinese demand, production problems in Chile, and

Graph 9 – The upswing in industrial metal prices has accelerated

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

Graph 10 – The manufacturing sector seems to be strengthening in several countries



Sources: Bloomberg, Institute for Supply Management and Desjardins, Economic Studies

Graph 11 – Aluminium prices and stocks

Sources: Datastream and Desjardins, Economic Studies

signs that the global economy is accelerating are however very promising developments for copper prices.

NICKEL

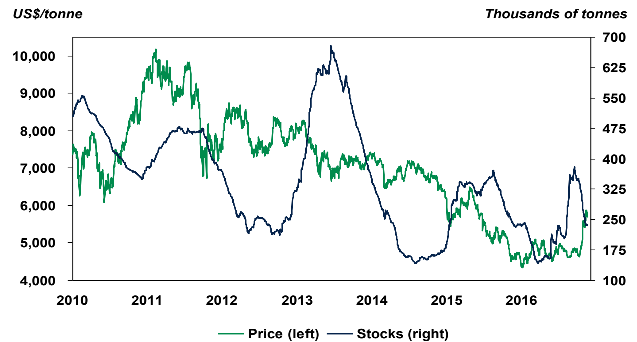
- Nickel prices have continued to climb in the last few months, crossing back above US$11,000 a tonne (graph 13). The signs of renewed strength in demand for stainless steel—the metal's primary use—added to the major restrictions on nickel exports and production previously imposed by the Indonesian and Philippine governments. Indonesia's efforts to transition from being an exporter of unprocessed ore to a major refined nickel producer seem to be starting to pay off, however, which could result in a slight increase in the global supply. Difficulties in finding nickel ore could, though, continue to limit Chinese output and should force the country to increase its nickel imports. Most analysts are therefore predicting that nickel demand will continue to outstrip production next year, a situation that should help nickel prices to keep rising.

ZINC

- Zinc prices have continued to skyrocket, recently hitting US$2,886 a tonne, a peak that dates back to the 2008–2009 financial crisis (graph 14). The metal's price has declined somewhat since, returning to around US$2,700. The surge in zinc prices essentially reflects stagnation in global output, as producers quickly adjusted to last year's drop in prices. Growth in zinc demand is relatively limited, with the result that the global zinc market is almost at equilibrium. In this context, there does not seem to be a lot of potential for zinc prices to rise further, and there is a good risk that they will come down somewhat.

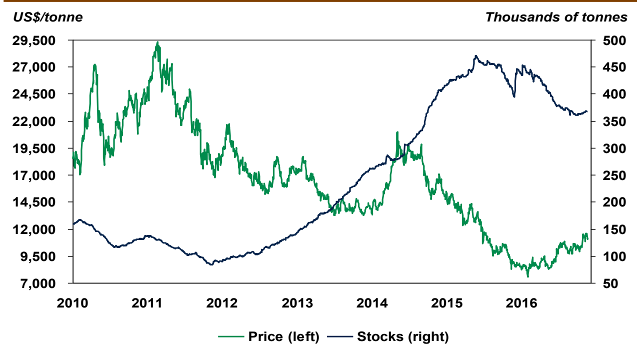
Forecasts: We have long been predicting that it would take a rise in industrial metal prices to balance metal supply and demand over the medium term, following the exaggerated drop in 2014 and 2015. The upswing began with the Chinese government's stimulus efforts and picked up speed following Donald Trump's win. While more positive sentiment about metals seems justified, we must not go too far, as an overly rapid surge in prices could lead to an overly rapid comeback by metal production. We therefore expect metal prices to go up more slowly next year.

Graph 12 – Copper prices and stocks



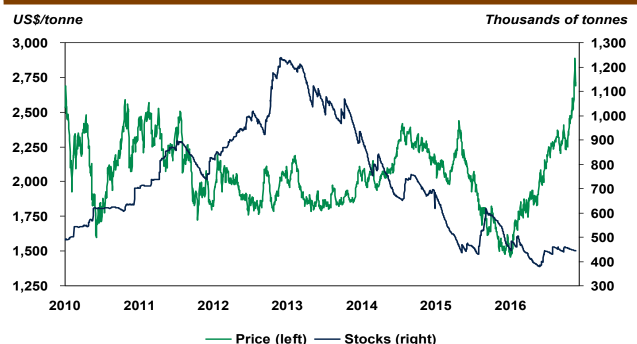
Sources: Datastream and Desjardins, Economic Studies

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

Tough election aftermath

Precious metal prices got 2016 off to an excellent start but they are now facing a much tougher context, marked by a rise in interest rates and the U.S. dollar, especially after the U.S. election.

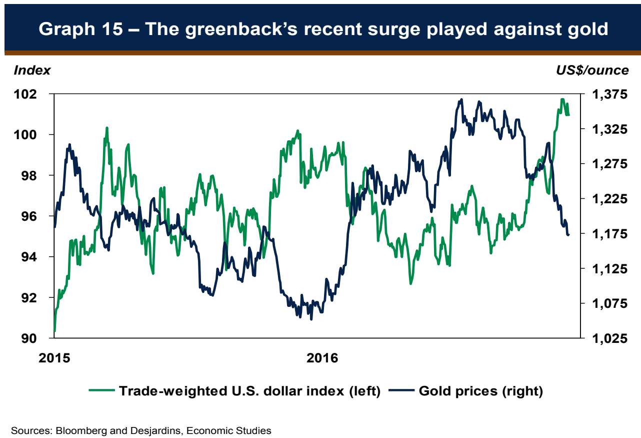
GOLD AND SILVER

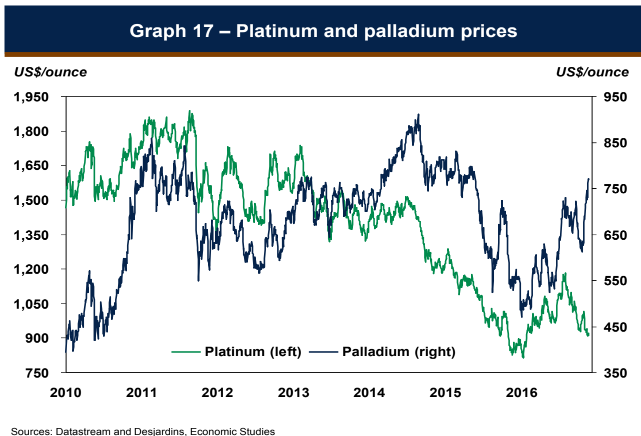
- Gold prices struggled early in the fall, but then rose to around US$1,300 an ounce in early November. Concerned about a surprise outcome to the U.S. election, some investors saw gold as insurance against a tumble in the value of risky assets. The surprise did come, but the panic only lasted a few hours, quickly making way for a surge in optimism, as well as by the greenback and bond yields. These three factors are negative for gold, so it is not surprising that gold prices quickly slid to around US$1,170 an ounce (graph 15). Some may have hoped that the possibility of faster inflation would boost gold. However, recent movements confirm that the greenback and interest rates are now much more important determinants for gold prices. Silver prices have also posted a big pullback in recent weeks (graph 16).

PLATINUM AND PALLADIUM

- Platinum prices were dragged up sharply by gold in the first half of the year, and then took a hit in the recent tumble by precious metal prices. They are down more than 10% since the end of September, going back to around US$900 an ounce (graph 17). Weakness in Chinese jewelry demand is also hurting platinum. Palladium stands out, rebounding strongly recently, with the focus on the ongoing deficit in the global palladium market, which could intensify in a context favourable to the automotive industry, especially in the United States and China. The outlook for non-financial supply and demand also seems fairly favourable for platinum.

Forecasts: Our financial scenarios, which call for interest rates and the U.S. dollar to rise gradually, suggest that gold prices should, in general, move downwards in the next few quarters, to end 2017 at around US$1,100 an ounce. The presence of many uncertainties around the global economy should, however, maintain some financial demand for precious metals. Acceleration of the global economy could help platinum and palladium do better than gold and silver.





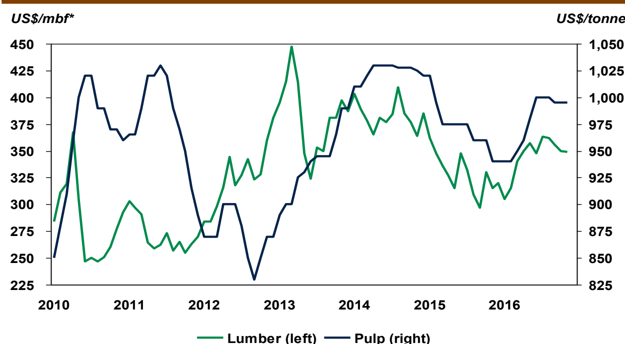
OTHER COMMODITIES

Will Canadian forest producers be able to benefit from U.S. demand?

FOREST PRODUCTS

- Forest product prices have not benefited from the renewed investor optimism about commodities, remaining quite stable in recent months (graph 18). This is especially disappointing for lumber, which has stayed at around US$350/mbf (thousand board feet) despite encouraging signs from the U.S. real estate sector, particularly in terms of demand for single-family homes. However, the recent upswing in mortgage rates raises doubts about the outlook for real estate. **Negotiations over a new lumber agreement between Canada and the United States are taking place in a very tense environment.** The tone is being affected by the White House newcomer's protectionist aims. At the end of November, U.S. producers filed applications to impose countervailing duties on Canadian producers with the U.S. Department of Commerce and U.S. International Trade Commission; this could really hurt producers on this side of the border.

Graph 18 – Forest product prices

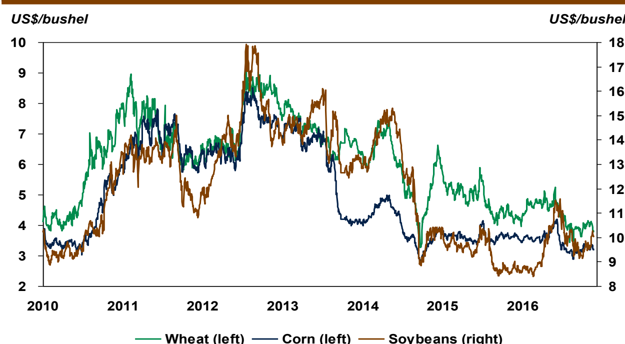


*Thousand board feet.
Sources: Datastream and Desjardins, Economic Studies

AGRICULTURAL COMMODITIES

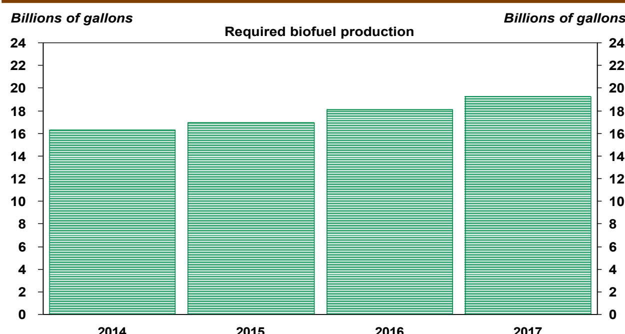
- Wheat and corn prices have remained low, showing no clear trend in the last few months. In its latest report, the U.S. Department of Agriculture once again upgraded its projections for the three main cereals' harvests and stocks. Despite that, soybean prices did better and even edged above US$10 a bushel (graph 19). Among other things, soybeans are benefiting from very strong demand for U.S. soybean exports, especially from China. A 6% increase in the biofuel production requirement in 2017 over 2016 by the U.S. Energy Information Administration is also an encouraging development for corn and soybean demand (graph 20).
- **The potential for cereal prices to go higher remains limited given that the excellent harvests of the last few years have resulted in a major increase in global inventories.** A surge of the greenback could even hurt the competitiveness of U.S. cereal exports and put downside pressure on benchmark prices. Also keep an eye on announcements made by the Trump administration, as a surge in trade tension could hurt cereal prices, as U.S. producers are major exporters. Some would also like to do away with measures that foster biofuel production; this could have a major impact on cereal demand.

Graph 19 – Cereal prices



Sources: Datastream and Desjardins, Economic Studies

Graph 20 – The U.S. government continues to require an increase in biofuel production



Sources: Energy Information Administration and Desjardins, Economic Studies

Table 1
Commodities

	Spot price	*Percentage return since*				*Last 52 weeks*		
	Dec. 7	**1 month**	**3 months**	**6 months**	**1 year**	**High**	**Average**	**Low**
Index								
Reuter-CRB[1] (CCI[2])	425.7	1.1	1.3	-0.6	11.8	436.9	402.9	353.7
Reuters/Jefferies CRB[1]	192.5	4.9	5.5	0.1	7.8	195.8	179.4	155.0
Bloomberg Commodity Index	88.0	5.0	4.9	-0.3	10.7	89.9	82.4	72.9
Bank of Canada	368.5	-0.6	2.2	-3.1	7.3	387.9	349.4	282.8
Energy								
Brent oil (US$/barrel)	54.1	18.4	13.7	5.5	32.6	55.0	43.9	27.8
WTI[3] oil (US$/barrel)	51.0	13.5	12.1	1.2	35.4	51.7	42.2	26.2
Gasoline (US$/gallon)	2.21	-1.1	-0.7	-7.3	7.5	2.40	2.13	1.72
Natural gas (US$/MMBTU[4])	3.71	59.2	31.6	62.0	82.8	3.71	2.37	1.49
Base metals								
LMEX[5]	2,821	9.4	19.4	26.0	31.8	2,857	2,338	2,049
Aluminium (US$/tonne)	1,712	-0.5	8.6	10.2	15.8	1,780	1,588	1,449
Copper (US$/tonne)	5,876	15.7	26.9	28.8	28.9	5,945	4,805	4,328
Nickel (US$/tonne)	11,566	4.3	13.8	35.4	32.6	11,590	9,443	7,562
Zinc (US$/tonne)	2,782	13.4	20.2	39.2	84.1	2,886	2,012	1,455
Steel (US$/tonne)	312.5	0.0	0.0	146.1	60.3	312.5	220.2	75.5
Precious metals								
Gold (US$/ounce)	1,171	-8.6	-12.9	-5.7	8.9	1,369	1,242	1,052
Silver (US$/ounce)	16.7	-8.5	-16.3	2.3	15.1	20.7	16.9	13.6
Platinum (US$/ounce)	941	-5.4	-14.2	-4.6	7.2	1,182	982.8	814.0
Palladium (US$/ounce)	747.0	18.2	7.0	35.8	34.1	770.0	604.2	470.0
Other commodities								
Lumber (US$/tbf[6])	355.0	2.9	0.3	0.0	13.8	369.0	341.7	305.0
Pulp (US$/tonne)	995	0.0	-0.5	1.5	5.9	1,000	970.9	940.0
Wheat (US$/bushel)	3.89	-4.9	0.0	-24.2	-7.4	5.25	4.33	3.44
Corn (US$/bushel)	3.40	3.7	9.7	-16.9	-7.1	4.18	3.46	2.88
Soybean (US$/bushel)	10.21	6.0	2.8	-8.3	16.7	11.57	9.59	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

Annual average	***2014***	***2015***	***2016f***	***2017f***
WTI* oil (US$/barrel)	93	49	Target: 43 (range: 42 to 44)	Target: 55 (range: 46 to 64)
Natural gas Henry Hub (US$/MMBTU**)	4.34	2.65	Target: 2.50 (range: 2.40 to 2.60)	Target: 3.40 (range: 2.80 to 4.00)
Gold (US$/ounce)	1,266	1,160	Target: 1,250 (range: 1,245 to 1,255)	Target: 1,150 (range: 1,050 to 1,275)
LMEX*** index—base metals	3,117	2,550	Target: 2,380 (range: 2,360 to 2,400)	Target: 3,000 (range: 2,500 to 3,400)

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