COMMODITY TRENDS

Accelerating global growth should favour commodities

Although 2016 got off to a tough start, when a wave of concern pulled oil prices below US$30/barrel about a year ago, the main commodity price indexes posted a gain of about 10% for the year. Aside from agricultural products, the gains were fairly general both for energy and metals (graph 1). Precious metals stole the show in the first half of 2016, then had a tougher second half. Industrial commodities have done especially well in recent months, capitalizing on factors such as renewed optimism after the U.S. presidential election.

Like other financial assets, commodities have not been showing a clear trend since 2017 began. Investors seem to be waiting for confirmation that late 2016's surge in optimism was justified before driving commodity prices higher. Although numerous uncertainties persist about the measures the new U.S. administration will put in place, the many signs of accelerating global growth are very encouraging (graph 2). Commodity prices should therefore keep trending up for the quarters to come.

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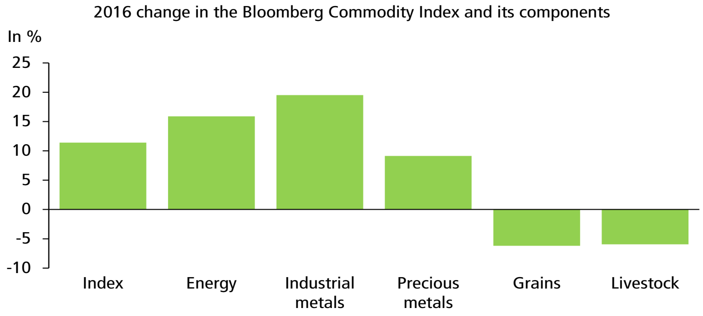
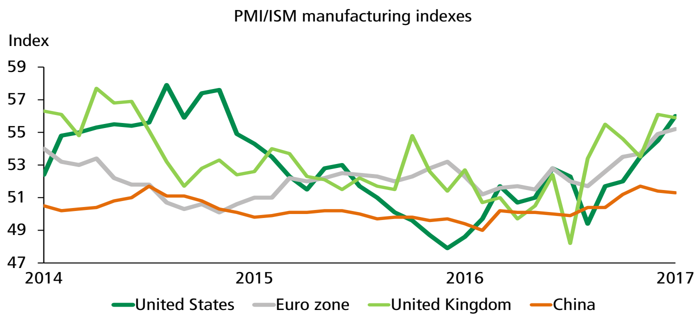
GRAPH 1
Metals and energy shot up in 2016



Sources: Datastream and Desjardins, Economic Studies

GRAPH 2
Business is sending encouraging signals



Sources: Bloomberg and Desjardins, Economic Studies

CONTENTS

Editorial 1
Energy 2
Base metals 4
Precious metals 6
Other commodities 7
Tables 8

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Energy

The comeback of North American production will limit the rise in oil prices

FORECASTS

Global demand that exceeds oil production in the coming months should result in a gradual reduction of global stocks and slight increase in oil prices. The upswing in U.S. crude output and a potential increase from Organization of the Petroleum Exporting Countries (OPEC) in the second half of 2017 should, however, keep WTI (West Texas Intermediate) oil prices below US$60 a barrel. Natural gas prices should fluctuate close to current levels and, for 2017 as a whole, post a substantial gain from the weak level seen in 2016.

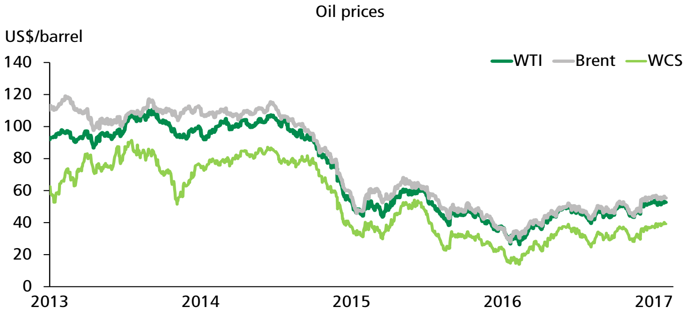
OIL

Oil prices settled above US$50 a barrel following the agreement among OPEC members to curb global production and reduce the sizable crude inventories. WTI prices even brushed US$55 at the end of 2016 before edging back at the start of 2017 (graph 3). WTI's price is still about twice what it was at its US$26 low, hit in February 2016. At around US$2.30 a gallon, the price of regular gasoline in the United States is also up substantially from the US$1.72 low hit last year. Brent oil is maintaining a premium of about US$3/barrel over WTI. Canadian oil has done a little better recently, reaching around US$40/barrel. It seems to have benefited from President Trump's decision to re-open the door to the Keystone XL project.

In addition to capitalizing on the greater optimism among investors and signs that the global economy is accelerating, the upswing in oil prices at the end of 2016 was largely based on the commitment from OPEC nations and other major producers to curb their oil output. Although doubts remain about several countries' ability and will to abide by their pledge, Saudi Arabia and its allies seem determined to do their part. Saudi output, which was in excess of 10.6 mbd (millions of barrels a day) last summer, has dropped to around 10 mbd in January. The producers' efforts and an upgrade to global demand according to the International Energy Agency's (IEA) latest estimates suggest the global oil market will be in substantial deficit as of the first quarter of 2017 (graph 4). This should help gradually get global stocks back to more normal levels (graph 5 on page 3).

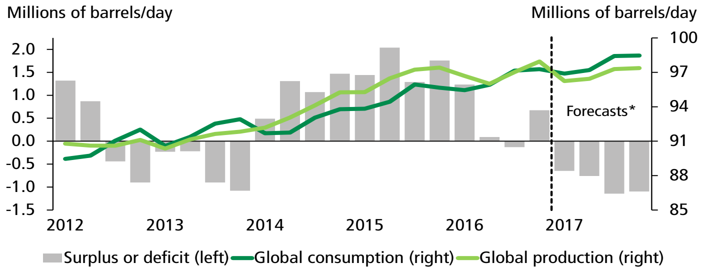
At this time, the balance between oil supply and demand seems very favourable to rising crude prices. We must keep a close watch on two factors, however. Firstly, for how long will OPEC nations want to curb output? The agreement signed last November is only valid for the first half of 2017, unless they agree on an extension in May. The possibility of another surge in OPEC production in the second half clearly limits the potential increase this year. North American production could also rise more steeply than anticipated. The latest signs there are promising, as drilling continues to rise and production has already come up near 9 mbd (graph 6 on page 3). In addition to reflecting the rise in prices, the comeback by North American output can only benefit from the advent of a new U.S. administration that is much more favourable to exploiting hydrocarbons and building pipelines.

GRAPH 3
Oil prices keep climbing



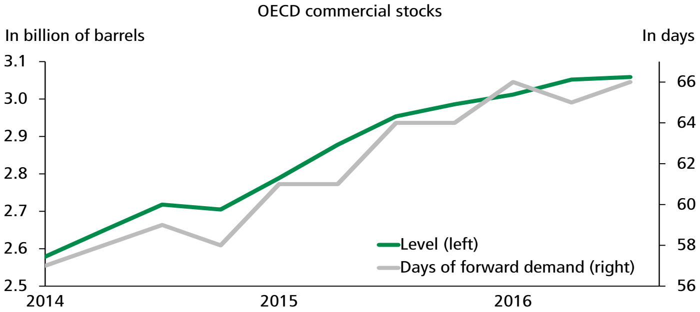
WTI: West Texas Intermediate; WCS: Western Canada Select
Sources: Datastream, Bloomberg and Desjardins, Economic Studies

GRAPH 4
The global oil market may be in deficit now



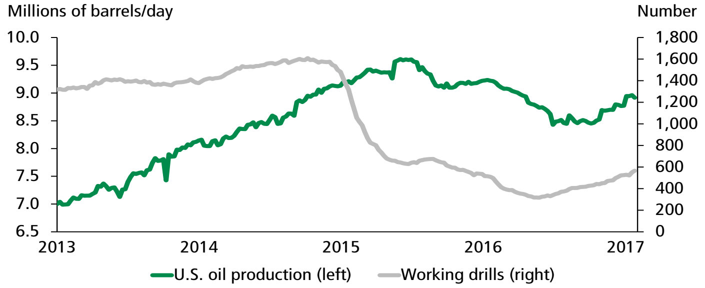
* Assuming the Organization of the Petroleum Exporting Countries (OPEC) agreement is respected throughout 2017.
Sources: Datastream and Desjardins, Economic Studies

GRAPH 5
Global crude inventories are sky high



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

GRAPH 6
U.S. oil production is trending up again

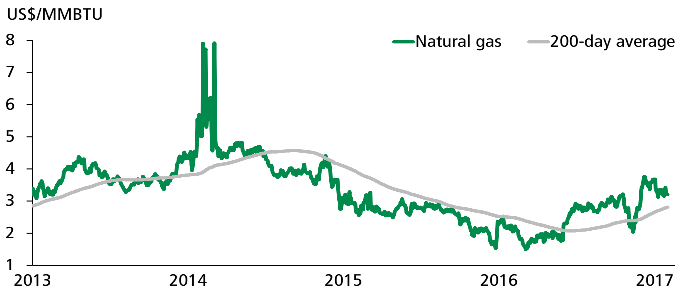


Sources: Baker Hughes, Energy Information Administration and Desjardins, Economic Studies

NATURAL GAS

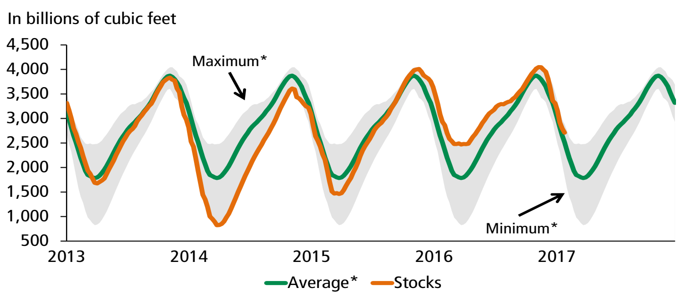
At this time of year, natural gas prices are always heavily influenced by the kind of winter North America is getting. For instance, a particularly cold winter drove prices above US$7/MMBTU (Million British Thermal Units) in early 2014; last year, a mild winter pulled them below US$2. Gas prices averaged just US$2.49/MMBTU over 2016, a low that dates back to 1999. The temperature had an impact this year again, with a cold December stimulating gas demand and pushing the price up to around US$3.75/MMBTU. After that, milder weather took the price down to around US$3.25 (graph 7). Beyond the weather, which could keep generating price volatility in the near term, the situation now seems much better for gas prices than it was a year ago. A drop in U.S. gas output combined with last summer's strong demand from electric power producers and an increase in exports have taken U.S. natural gas stocks back to relatively normal levels (graph 8). After surging in the final months of 2016, gas prices should consolidate their gains in 2017.

GRAPH 7
Natural gas prices



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

GRAPH 8
Although early winter was relatively warm, gas inventories are back at more normal levels



* From 2012 to 2016.
Sources: Datastream and Desjardins, Economic Studies

Base metals

The prospects are favourable

FORECASTS
Surging industrial metal prices in the last few months partly reflects the exaggerated drop that preceded it. The signs that the global economy is accelerating are promising and should result in stronger metal demand in 2017. Base metal prices should therefore keep trending up in the coming quarters, although price increases should be smaller than in 2016.

Along with oil, industrial metals stole the show in 2016, when the London Metal Exchange (LME) index jumped more than 20% to end the year at around 2,650. The uptrend continued in January and the LME index is now oscillating around 2,800, up more than 35% from its cyclical low, hit in mid-January 2016 (graph 9). We may well wonder whether the global economic situation has changed enough to justify such a spectacular rebound. In our opinion, what is going on is that metal prices' previous plunge was exaggerated, with investors apparently getting into position for a period of economic stagnation and continuous metal surpluses. While global growth was subdued last year, demand for several metals was relatively solid and it is very encouraging to see that the Chinese government's efforts seem to have succeeded in stabilizing the country's economy (graph 10). Rising manufacturing sector activity indexes in several countries suggests that metal prices could keep rising.

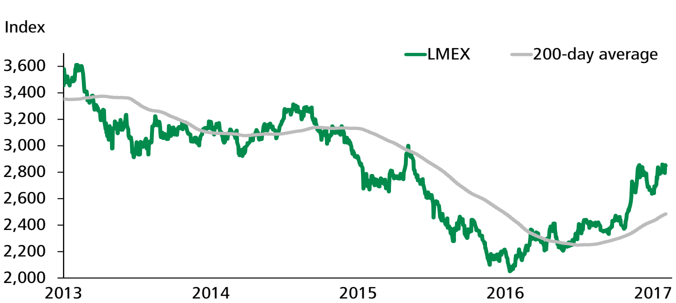
ALUMINIUM

Aluminum prices recently hit US$1,871 a tonne then returned to around US$1,800, which still represents an increase of about 20% in the last year (graph 11 on page 5). Last year's rebound of aluminum prices was based on a temporary drop in Chinese output at the start of 2016. China's production subsequently climbed to a new peak, a worrisome development. However, the Chinese government seems to be preparing to impose major cuts on aluminum output for environmental reasons. The possibility of substantial tariffs being imposed on Chinese aluminum exports could also favour a price increase for this metal.

COPPER

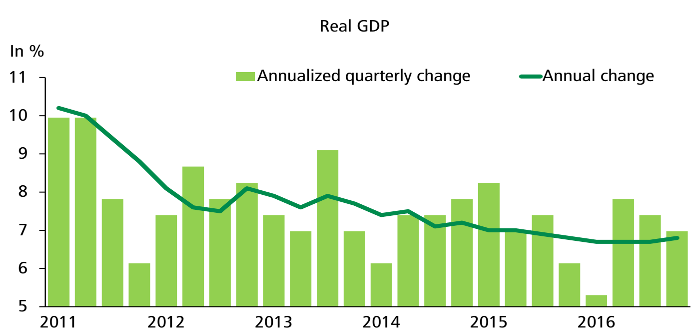
A rebound of copper inventories surveyed by the LME hurt copper prices at the close of 2016, but copper inventories have started to slide again since then. The strike vote at Chile's Escondida mine, which is the world's biggest and accounting for about 6% of global production, allowed copper prices to go back near US$6,000 a tonne for the first time since the spring of 2015 (graph 12 on page 5). Copper demand should also benefit from more robust global growth in 2017.

GRAPH 9
The wind seems to have changed for industrial metal prices



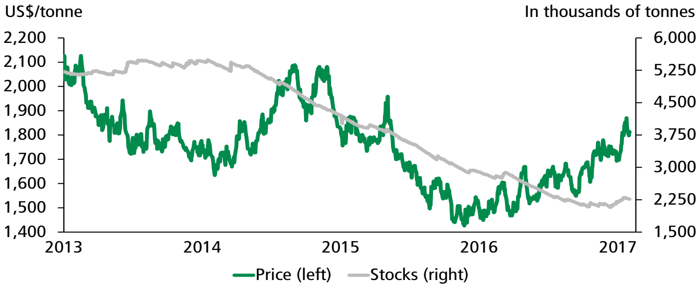
LMEX: London Metal Exchange base metal price index
Sources: Datastream and Desjardins, Economic Studies

GRAPH 10
Growth stabilized during the year in China



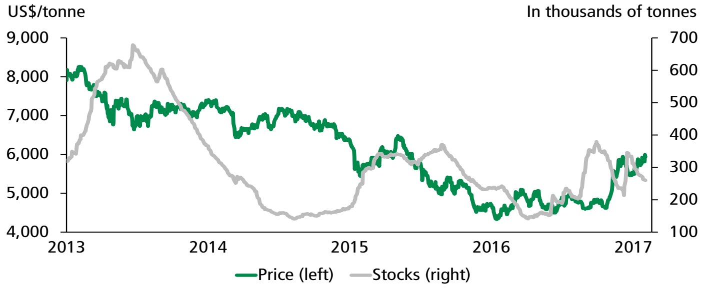
Sources: National Bureau of Statistics of China and Desjardins, Economic Studies

GRAPH 11
Aluminum prices and stocks



Sources: Datastream and Desjardins, Economic Studies

GRAPH 12
Copper prices and stocks

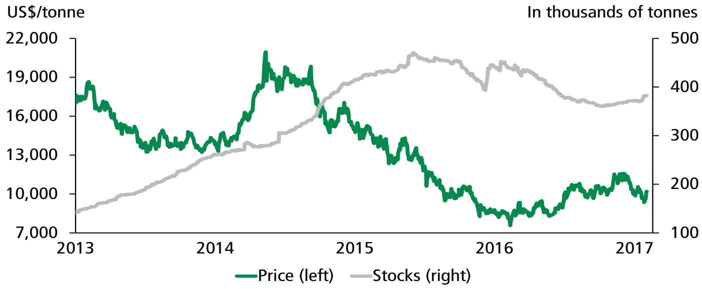


Sources: Datastream and Desjardins, Economic Studies

NICKEL

Last year, a major rebound took nickel prices above US$11,000 a tonne in November; since then, they have been struggling somewhat. Indonesia's surprise decision to ease the measures to restrict unprocessed ore exports was especially painful early this year, temporarily taking nickel prices down to around US$9,400 a tonne (graph 13). The 2016 upswing in nickel demand from stainless steel producers, among others, is encouraging for this metal's price, however.

GRAPH 13
Nickel prices and stocks

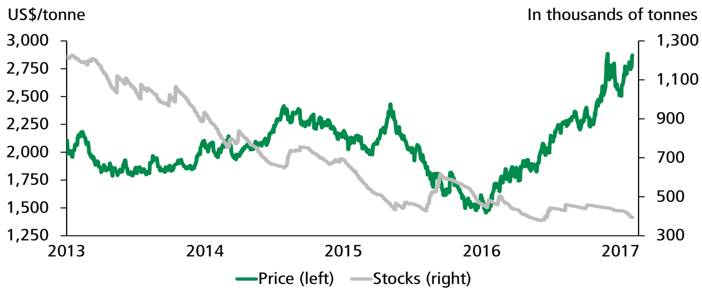


Sources: Datastream and Desjardins, Economic Studies

ZINC

Zinc prices have been volatile in the last few months. They jumped above US$2,850 a tonne at the end of November, then fell to nearly US$2,500 in December before recently going back above US$2,800. Zinc prices are therefore still posting a spectacular increase of about 70% over the last 12 months (graph 14). The appearance of a deficit in the global zinc market last year, given stagnant production, is behind the surge. We must now watch to see how the price rebound will affect production of the metal.

GRAPH 14
Zinc prices and stocks



Sources: Datastream and Desjardins, Economic Studies

Precious metals

A break for gold that may not last

FORECASTS
The uptrend for interest rates and the U.S. dollar played against precious metals, especially gold, in the second half of 2016, and should continue to do so in 2017. We therefore still expect gold prices to end the year at around US$1,100 an ounce.

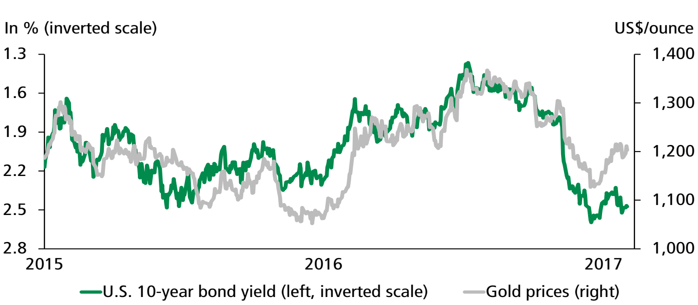
GOLD & SILVER

Gold really stole the show for much of 2016, recording a nearly 30% jump, which took it above US$1,350 an ounce. This excellent performance was, however, largely based on another tumble by interest rates worldwide. Bond yields rose in the final months of 2016 which, along with another surge of the U.S. dollar, pulled gold prices down to nearly US$1,125 an ounce in mid-December (graph 15). The hesitation in the financial markets in recent weeks has allowed gold to climb to around US$1,200 an ounce. Signs of accelerating growth and inflation in advanced nations, however, point to further increases in bond yields in the coming months. Keep a close eye on the Federal Reserve, whose leaders seem fairly determined to move forward with monetary firming. The many uncertainties, including fears of major trade disputes, could maintain some demand for gold, however. Silver prices have continued to move in tandem with gold, recently going to around US$17.50 an ounce.

PLATINUM & PALLADIUM

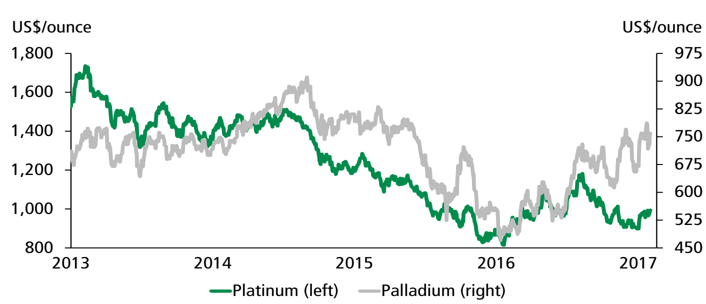
As we noted last fall, signs of accelerating global demand are better for platinum and palladium than for other precious metals, given that the metals are heavily used in industry. These two metals have done well recently, posting gains of almost 10% in January 2017 (graph 16). The news remains positive for the auto industry, with LMC Automotive estimating that global sales of light vehicles jumped 4.6% last year, compared with a 2.1% gain in 2015, hitting a new peak of 93.2 million units. This fast growth is primarily based on a 12.3% increase in vehicle sales in China. Strong vehicle sales in China and the United States is especially good for palladium, contributing to the over 50% price increase for the metal over the last 12 months.

GRAPH 15
Gold prices are heavily influenced by bond yield movement



Sources: Datastream and Desjardins, Economic Studies

GRAPH 16
Platinum and palladium prices



Sources: Datastream and Desjardins, Economic Studies

Other commodities

Protectionism could have a major impact

FOREST PRODUCTS

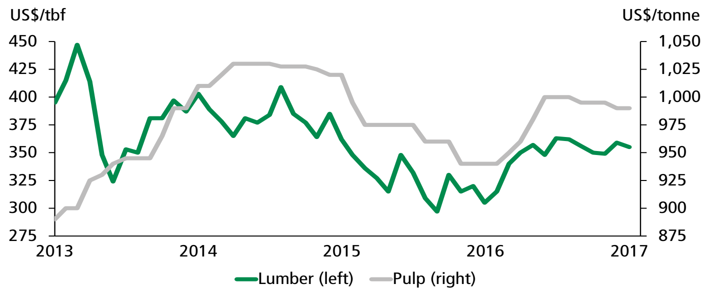
The stability in forest product prices continued in the last few months, with lumber prices still fluctuating around US$350/tbf (thousand board feet) and pulp prices remaining just under US$1,000 a tonne (graph 17). The hope, already faint, that a new lumber agreement between the United States and Canada would be reached quickly disappeared altogether with Donald Trump's surprise win. The new president is not hiding his protectionist plans, rapidly confirming his intention to renegotiate the North American Free Trade Agreement (NAFTA). Rather than focusing its efforts on the lumber issue, the Canadian government will have to do everything it can to keep from being dragged into a general trade war with the United States. So far, the news is encouraging on this front, as U.S. protectionist intentions seem to be much more focused on Mexico and China. One can hope that the lumber issue will eventually be settled in the framework of renegotiating NAFTA, but that could take a while. **In the meantime, everything suggests that tariffs will shortly be imposed on Canadian wood exports to the United States, a situation that should drive U.S. prices up.**

AGRICULTURAL COMMODITIES

Prices for the main cereals plunged in 2014 and 2015, then remained weak last year, even dropping somewhat in the case of wheat and corn. However, soybeans did a little better. Capitalizing on a spectacular surge in U.S. soybean exports, which even had a major impact on the U.S. economic accounts for Q3 and Q4 of 2016, soybean prices climbed to around US$10 a bushel (graph 18). In general, cereal prices have been showing a more positive trend in recent months.

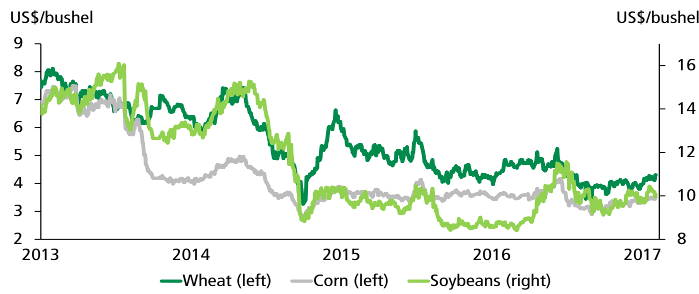
At first glance, there is little reason to anticipate major shifts in cereal prices in 2017, as inventories should remain high. However, a trade war could have substantial impacts. U.S. farmers export enormous amounts of cereal (graph 19); if markets were to be closed, the result could be a collapse in U.S. prices and skyrocketing prices internationally.

GRAPH 17
Forest product prices



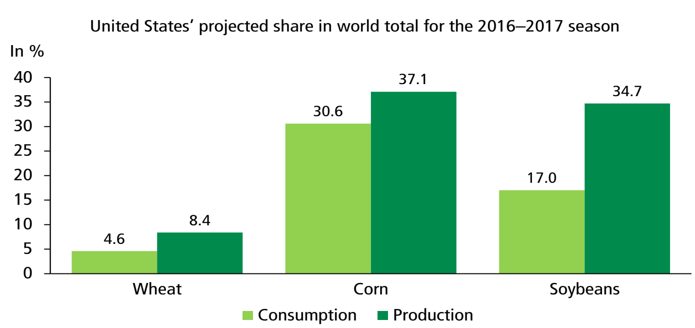
tbf: thousand board feet
Sources: Datastream and Desjardins, Economic Studies

GRAPH 18
Cereal prices



Sources: Datastream and Desjardins, Economic Studies

GRAPH 19
The U.S. produces much more cereals than it consumes



Sources: United States Department of Agriculture and Desjardins, Economic Studies

TABLE 1
Commodities

	SPOT PRICE	VARIATION (%)				LAST 52 WEEKS		
	Feb. 3	-1 month	-3 months	-6 months	-1 year	Higher	Average	Lower
Index								
Reuter-*CRB* (*CCI*)	430.1	2.0	2.4	2.6	15.8	436.9	411.8	363.1
Reuters/Jefferies *CRB*	193.2	1.6	5.4	7.5	17.7	195.8	183.1	155.0
Bloomberg Commodity Index	87.9	2.2	5.2	5.3	15.3	89.9	84.1	73.9
Bank of Canada	398.9	-0.1	7.6	13.9	34.0	399.1	363.4	286.1
Energy								
Brent oil (US$/barrel)	57.0	1.3	22.9	34.1	65.8	57.0	47.3	30.2
WTI oil (US$/barrel)	53.8	2.8	20.5	31.9	66.6	54.0	45.2	26.2
Gasoline (US$/gallon)	2.30	-3.4	3.0	6.3	26.0	2.40	2.18	1.72
Natural gas (US$/MMBTU)	3.00	-11.5	27.1	4.2	45.6	3.76	2.59	1.49
Base metals								
LMEX	2,800	6.1	10.5	15.8	27.3	2,861	2,438	2,133
Aluminium (US$/tonne)	1,822	7.3	5.5	11.8	19.3	1,871	1,633	1,467
Copper (US$/tonne)	5,764	5.1	16.5	18.6	24.3	5,994	4,989	4,450
Nickel (US$/tonne)	10,171	3.2	-2.6	-4.9	19.9	11,590	9,730	7,562
Zinc (US$/tonne)	2,794	11.6	12.9	23.1	64.4	2,886	2,201	1,647
Precious metals								
Gold (US$/ounce)	1,218	5.4	-6.2	-10.3	6.9	1,369	1,257	1,127
Silver (US$/ounce)	17.3	8.3	-4.4	-16.1	19.9	20.7	17.4	14.4
Platinum (US$/ounce)	992	6.8	0.6	-14.6	15.2	1,182	997	861
Palladium (US$/ounce)	747	5.8	19.1	5.8	51.5	787	636	487
Other commodities								
Lumber (US$/tbf)	366	1.9	4.6	0.8	20.0	369	349	305
Pulp (US$/tonne)	990	0.0	-0.5	-1.0	5.3	1,000	979	940
Wheat (US$/bushel)	4.30	7.8	5.9	8.6	-11.5	5.25	4.29	3.44
Corn (US$/bushel)	3.48	2.1	5.1	11.2	-4.4	4.18	3.43	2.88
Soybean (US$/bushel)	9.96	2.9	5.1	2.9	14.7	11.57	9.80	8.40

CRB: Commodity Research Bureau; CCI: Continuous Commodity Index; WTI: West Texas Intermediate; MMBTU: Million British Thermal Unit;
LMEX: London Metal Exchange Index; tbf: thousand of board feet
NOTE: Currency table base on previous day closure.

TABLE 2
Commodities prices: History and forecasts

ANNUAL AVERAGE	2015	2016	2017f	2018f
WTI oil (US$/barrel)	49	43	Target: 55 (range: 46 to 64)	Target: 57 (range: 48 to 68)
Natural gas Henry Hub (US$/MMBTU)	2.61	2.49	Target: 3.30 (range: 2.80 to 3.80)	Target: 3.75 (range: 2.90 to 4.40)
Gold (US$/ounce)	1,160	1,249	Target: 1,150 (range: 1,050 to 1,275)	Target: 1,050 (range: 950 to 1,200)
LMEX index—base metals	2,550	2,377	Target: 3,000 (range: 2,500 to 3,400)	Target: 3,300 (range: 2,700 to 3,900)

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