COMMODITY TRENDS

The First Quarter Was Mixed, But the Outlook Is Encouraging

After rising sharply in 2016, the main commodity price indexes declined slightly in the first three months of 2017. A strong pullback on the energy side is the main reason for this decline (graph 1). The very warm winter in North America drove down natural gas prices while the rise in oil output and inventories in the United States hindered crude oil prices. On the other side, a pause in bond yield increases and the greenback's ascent helped gold prices shine.

There are good reasons to believe that movements in gold and energy prices in the first quarter do not represent the start of a new trend. The most important development for commodities is that, far from reversing, the sharp upswing in confidence in the United States at the end of 2016 has held firm in recent months and rippled through to most advanced countries and several emerging nations (graph 2). Even if real GDP in the United States. is still disappointing at the moment, clear signs of a recovery in the manufacturing sector and investment around the globe are very encouraging in terms of demand for industrial commodities. The sharp comeback in base metal prices, which has kept pace since the start of 2017, thus seems completely justified.

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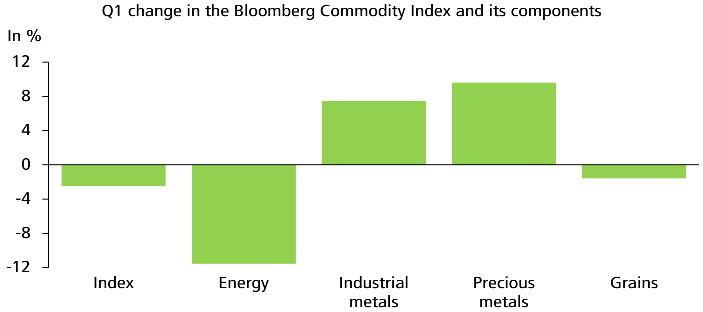
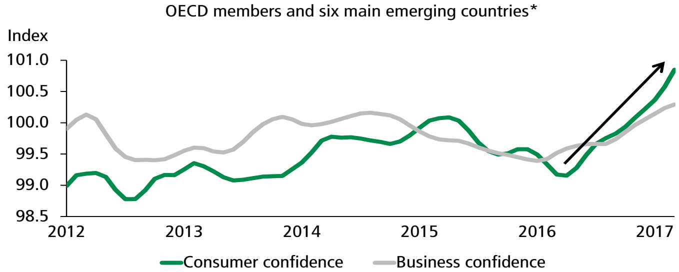
GRAPH 1
No widespread correction for commodity prices



Sources: Datastream and Desjardins, Economic Studies

GRAPH 2
Widespread upswing in confidence



OECD : Organisation for Economic Co-operation and Development; * Brazil, China, India, Indonesia, Russia and South Africa.
Sources: OECD and Desjardins, Economic Studies

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Energy

Nothing points to a lasting collapse in oil prices

FORECASTS

In the short term, changes in oil prices will be heavily influenced by the decision made by OPEC (Organization of the Petroleum Exporting Countries) members to either extend their agreement or not, which should be determined sometime this spring. Whatever the decision, the price of WTI (West Texas Intermediate) oil should quickly recover to about US$55 a barrel however, as the Unite States. will need to increase its output to meet global oil demand in the medium term. After the substantial fluctuations seen in recent months, natural gas prices should stabilize at close to current levels.

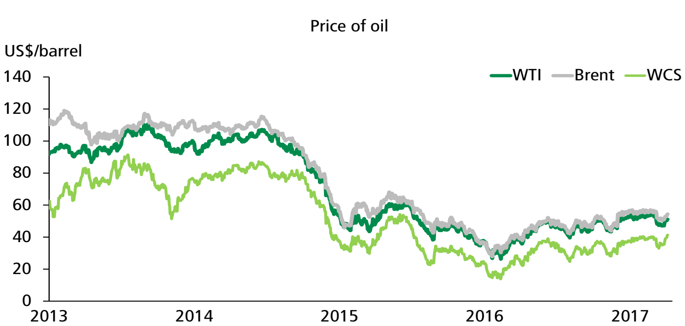
OIL

Oil prices stabilized at slightly more than US$50 a barrel in early 2017. Fresh concerns were raised at the beginning of March, however, driving down WTI prices to about US$47 (graph 3). The main trigger behind this weakness was that U.S. crude oil stocks climbed to their highest level ever recorded. Many viewed this as proof that the rapid rise in U.S. oil output was offsetting the cuts ordered by OPEC, thereby risking that the global oil market would once again be awash in surpluses. Worries about the global economy, fueled in large part by the Trump administration's difficulties, also contributed to dropping oil prices. Seizing on the new administration's approval of the Keystone XL project and a fire at a Syncrude Canada facility, prices for Western Canadian oil have climbed recently compared with WTI prices.

The changes in U.S. crude oil inventories in recent months may seem out of sync with the idea that the global oil market is now in a shortage situation. It is important to remember, however, that seasonal factors exert upside pressure on U.S. oil stocks as each new year unfolds. What's more, the recent rise in crude oil inventories is offset by the sharp drop in the inventory of refined oil products. As a result, total inventory of petroleum products in the United States is declining a bit (graph 4). Lastly, OPEC's recent production cut only started in January 2017; it usually takes several weeks for the downstream impact of a strategy shift at OPEC to affect U.S. oil imports.

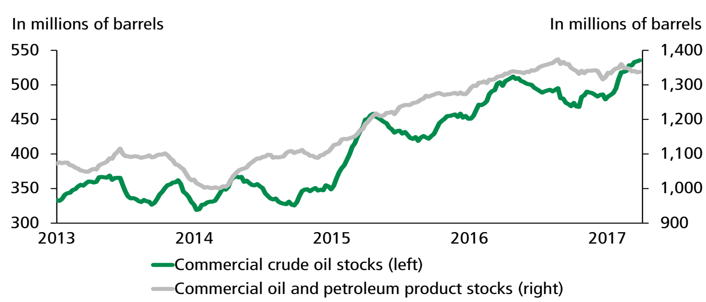
The rapid recovery of U.S. output (graph 5 on page 3) is more meaningful for the global oil market, as it confirms that plummeting oil prices in the last few years have failed to stop shale oil production to any sustainable degree. This, however, is not surprising to most experts, including the International Energy Agency (IEA), which were counting on U.S. oil output to rebound as of 2017. Other than the questions about supply, we have to keep in mind that global demand for oil increases by more than 1 mbd (millions of barrels per day) each year (graph 6 on page 3), a trend that is set to continue, while the demand per capita in India remains very weak, for example. As such, the IEA's medium-term forecasts call for global demand to increase by 7.3 mbd by 2022, which OPEC, whose output is only expected to rise by about 2 mbd over the same period, will be unable to satisfy. The rest of the planet will thus have to increase its output significantly, and this will require prices to stay at sufficiently high enough levels to maintain the solid pace of growth of the shale oil industry. In this context, OPEC's strategies could continue to have some impact on prices, but only for short periods of time, while the United States. has become the marginal producer.

GRAPH 3
Oil prices have declined slightly



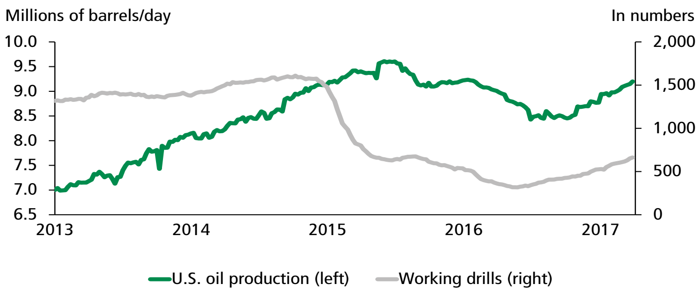
WTI : West Texas Intermediate; WCS : Western Canada Select
Sources: Datastream, Bloomberg and Desjardins, Economic Studies

GRAPH 4
Recent run-up in U.S. crude stocks offset by the drop in refined products



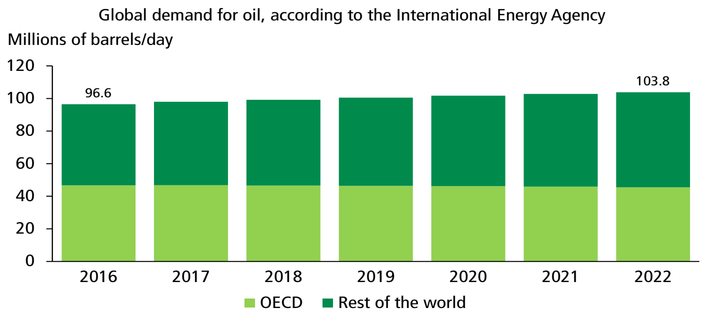
Sources: Energy Information Administration and Desjardins, Economic Studies

GRAPH 5
U.S. oil output continues to climb



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

GRAPH 6
Demand for oil will continue to climb, especially in emerging countries



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

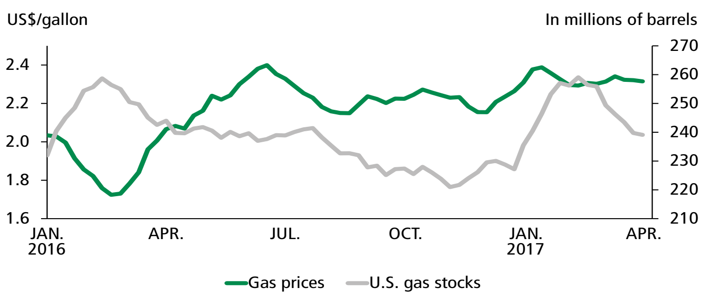
GASOLINE

Unlike oil prices, gasoline prices did not retreat significantly in March. Regular gas in the United States is still trading at about US$2.30 a gallon. Weak demand for gas early in the year raised some concerns, distracting from plummeting inventories. With gas stocks now below last year's levels (graph 7), a spike in demand could fuel gas prices, some analysts fear. This contributed to dispelling the impression that the U.S. oil market was swimming in surplus oil, which helped prices for WTI climb back to about US$50 a barrel.

NATURAL GAS

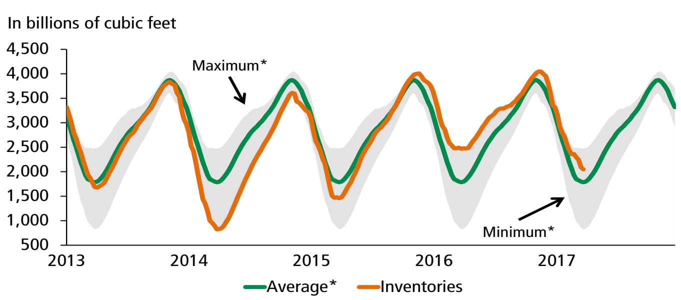
The start of a milder winter in North America hurt natural gas prices, which fell from about US$3.75 US/MMBTU (Million British Thermal Units) at the start of December 2016 to US$2.50 by the end of February. However, a chillier month of March recently bumped prices back up to just over US$3/MMBTU (graph 8). Weak demand this winter pushed gas inventories to relatively high levels, albeit still significantly lower than those recorded a year ago. While the storage capacity increases annually, nothing points to a possible storage shortage in 2017, which should help keep gas prices higher than they were in 2016.

GRAPH 7
The recent drop in gasoline inventories kept prices up despite the decline in oil prices



Sources: Energy Information Administration and Desjardins, Economic Studies

GRAPH 8
Gas inventories are high, but less than at the same time last year



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

Base Metals

Manufacturing continues to send positive signals

FORECASTS

The clear improvement in global economic outlooks over the past year justifies the sharp price increases for industrial metals. This type of price rise could however prompt producers to restart capacities that were sidelined during the weak price environment. As such, the upsurge in prices should lead to a period of consolidation, much like what is occuring with zinc. From a relative standpoint, copper seems to have the biggest upside potential given the serious doubts on the mining supply side in the medium term.

After rising a little more than 20% in 2016, the LME (London Metal Exchange) index of industrial metal prices continued its ascent, gaining more than 7% in the first quarter of 2017 and pushing the index to about 2,900 (graph 9). This increase continues to depend on signs of ramped-up activity in the industrial sector, as a Chinese manufacturing purchasing managers' index recently reached its highest level since 2012. Stronger hiring in the U.S. manufacturing industry (graph 10) is another sign of the renewed vitality sweeping through this sector. The major decline in LME inventories is also helping to sustain prices for metals.

ALUMINIUM

The price of aluminum had a particularly strong showing in the first quarter, with a 15% increase that pushed the price to about US$1,950 per tonne, a first since the end of 2014 (graph 11 on page 5). Signs of strong demand for aluminum and the spectacular declines in LME inventory continued to support the price of this metal in recent months. Hopes that pro-environment efforts by China's government will limit aluminum production in that country also supported the price of this metal. That said, aluminum inventories in China are high, and the substantial price increase could prompt producers to find ways to keep increasing their production despite government incentives. The potential for further price increases for aluminum now seems somewhat limited.

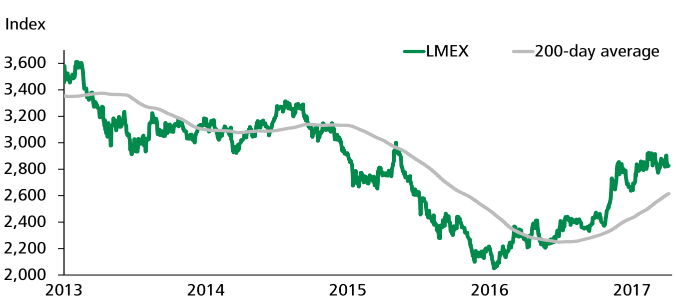
COPPER

The price of copper advanced 5% in the first quarter of 2017, even going above US$6,000 per tonne more than once (graph 12 on page 5). Copper inventories as per the LME have been volatile in the past few months, but they nevertheless declined by 9% in the first quarter. The long, 44-day strike at the Escondida, Chile mine—the world's largest—is now over. But this production stoppage, in addition to other producer problems, could create a deficit on the global copper market this year. Weak investments in mining in recent years and the declining productivity of existing mines is raising serious questions on the supply of copper in the medium term. Copper's limited supply and the difficulty of increasing the supply quickly is a recipe for significant price hikes in the years ahead; this is not the case for metals where the supply can easily adjust.

NICKEL

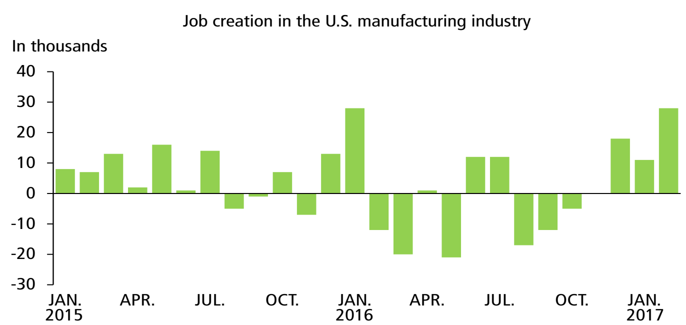
After rebounding in February to more than US$11,000 per tonne, the price of nickel retreated in March, ending the first quarter at

GRAPH 9
Prices for industrial metals post impressive increase



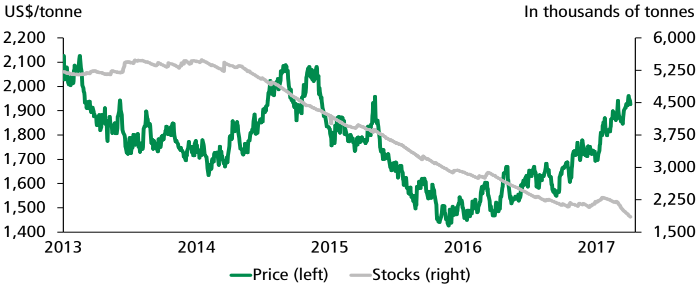
LMEX: London Metal Exchange base metal price index
Sources: Datastream and Desjardins, Economic Studies

GRAPH 10
After two difficult years, U.S. manufacturers ramp up hiring



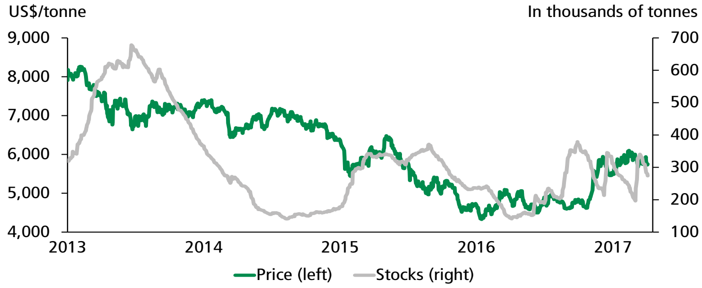
Sources: Bureau of Labor Statistic and Desjardins, Economic Studies

GRAPH 11
Aluminum stocks and prices



Sources: Datastream and Desjardins, Economic Studies

GRAPH 12
Copper prices and stocks



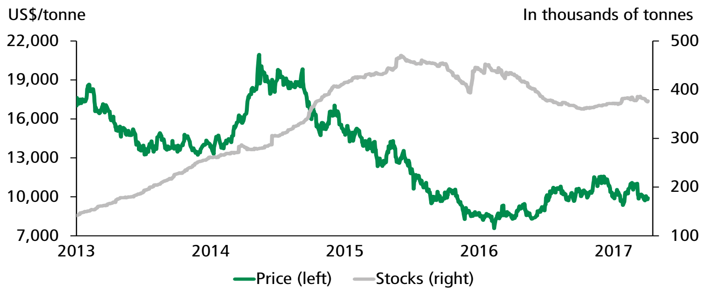
Sources: Datastream and Desjardins, Economic Studies

below US$10,000 per tonne, a level that mirrors that recorded at the end of 2016 (graph 13). Changes in nickel prices in the first quarter were mostly a reflection of the Philippine government's efforts to limit nickel production. Signs of hesitation on this front contributed to the decline in March, as did concerns that Indonesia would increase its nickel exports. Other than these issues that could continue to affect nickel price, this metal should benefit from the upswing in global economic growth.

ZINC

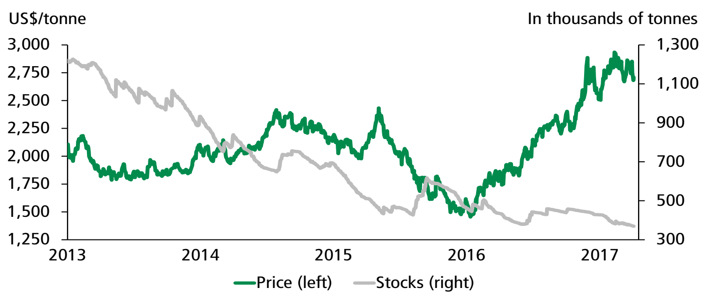
It comes as no surprise that the spectacular run-up in zinc prices in 2016 paved the way for some consolidation, at about US$2,750 an ounce (graph 14), a level that nevertheless represents an increase of more than 50% in the last 12 months. Despite this substantial appreciation, analysts are still quite positive about this metal, as the number of mine closures in the last few years continues to restrict the supply. The decline in zinc inventories as per LME reflects this tight market.

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

Vulnerable underpinnings for gold prices

FORECASTS

The solid performance of silver and gold prices in the first quarter was a reflection of the renewed jitters on the market that drove down the greenback and U.S. bond yields. These movements could suffer a turnaround in the next few quarters; we are maintaining our gold price target of US$1,100 an ounce by the end of 2017. The accelerating global economy should be more favourable to platinum and palladium, especially given the limited supply of these metals.

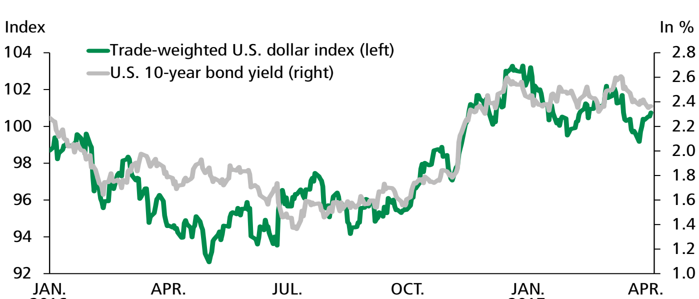
GOLD & SILVER

After a difficult finish to 2016 that drove prices down to about US$1,150 an ounce, gold prices shined once again in the first quarter, climbing back to about US$1,250 an ounce (graph 15). This performance is surprising, especially since the Federal Reserve (Fed) ordered a second straight quarterly key rate hike in mid-March. However, this monetary firming took place amid fresh investor concerns, causing the U.S. dollar and bond yields to retreat in the first quarter (graph 16). If, as we expect, the Fed is right to be optimistic and continues to firm up its monetary policy in the quarters ahead, U.S. bond yields and the greenback should quickly renew with its uptrend again, which is unfavourable for gold. Silver prices had an even better showing, gaining 11% in the first three months of 2016.

PLATINUM & PALLADIUM

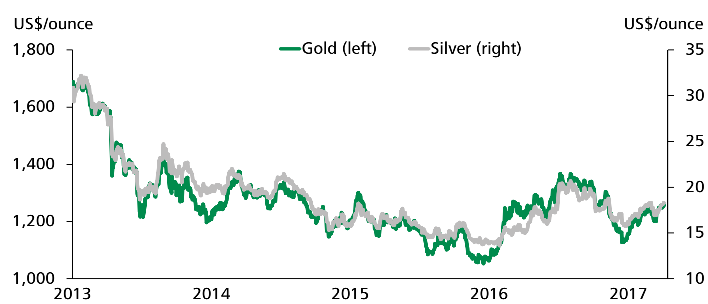
In addition to being favoured by the positive sentiment toward precious metals, the many signs of renewed energy in the industrial sector have also lifted platinum and palladium prices. Palladium prices rose by close to 20% in the first quarter, reaching their highest level since March 2015 (graph 17). Platinum prices were up about 5% in the first quarter, and the outlook is encouraging. The World Platinum Investment Council has recently upgraded the projected deficit for platinum this year as the demand in the automobile industry remains strong and the supply is poised to decline by 4% compared with 2016.

GRAPH 15
After surging at the end of 2016, the greenback and U.S. bond yields fell slightly in Q1



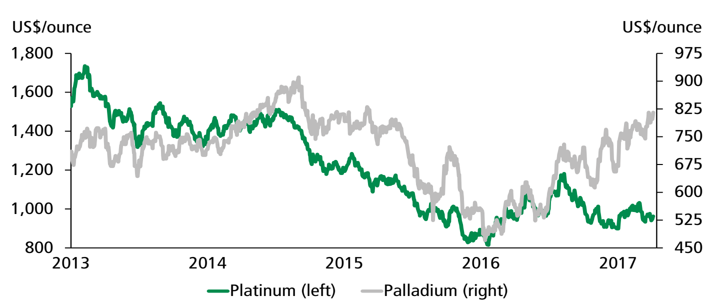
Sources: Datastream and Desjardins, Economic Studies

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

Wood prices are starting to reflect the trade conflict

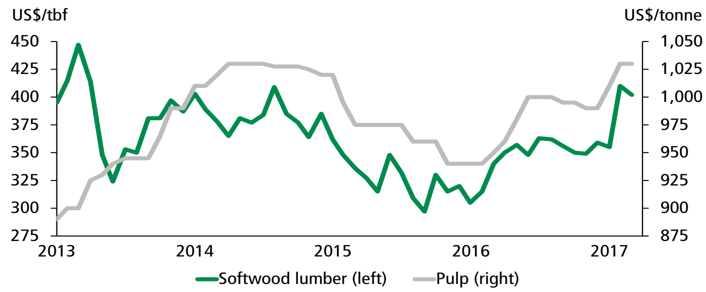
FOREST PRODUCTS

Unlike most industrial resources, forestry product prices did not record sharp price hikes in the last months of 2016. Lumber prices were relatively stable at around US$350/tbf (thousand board feet) while prices for pulp stayed slightly below US$1,000 per tonne (graph 18). Things changed in February, especially for lumber, when the benchmark price jumped to more than US$400/tbf for the first time since September 2014. Improvements in global economic outlooks are good for lumber, **but we could assume that the recent rise in prices is mainly a reflection of the fact that tariffs might soon be imposed on Canadian wood exports. A first decision on this is expected on April 24.** We will have to keep monitoring developments in the talks to reach a new agreement on softwood lumber trade in the coming months.

AGRICULTURAL COMMODITIES

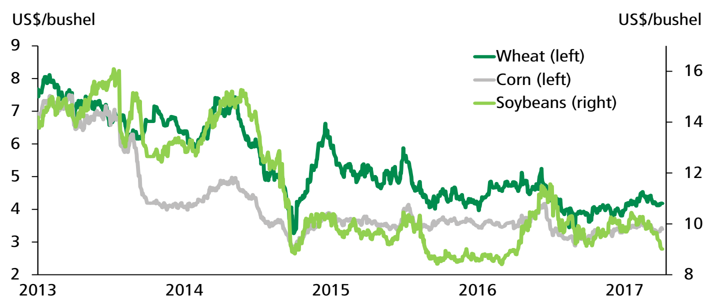
The grains market continues to reflect an abundant supply as the U.S. Department of Agriculture in its March report upgraded its global inventory forecasts for the three main grains. The data on U.S. inventories at the end of the first quarter confirm this surplus while major annual advances were recorded for wheat (+21%), corn (+10%) and soybeans (+13%). After turning in a better performance than other grains last year, soybean prices declined 7% in the first quarter of 2017 (graph 19), while wheat and corn prices posted slight gains. Seeding plans for the next season confirmed that U.S. farmers have decided to turn to soybeans. The area to be used for this crop should increase by 7%, reaching a new record (graph 20). In contrast, the area used for wheat should fall by 8%, to its lowest level since 1919, the year when this data started to be compiled. The capacity of farmers to adjust their output limits price discrepancies between these grains. **Now that seeding intentions are known, the weather conditions will have the most influence over the harvests and prices for grains in the upcoming quarters.**

GRAPH 18
Forest product prices



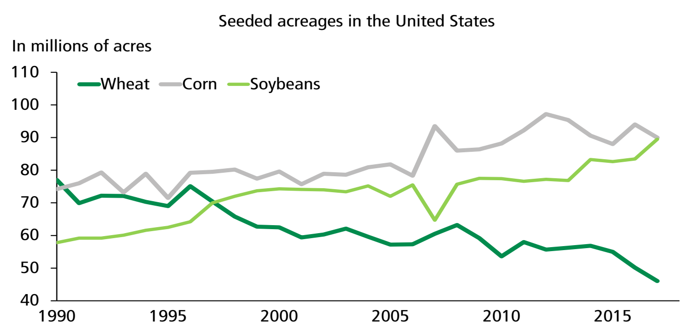
tbf: Thousand board feet
Sources: Datastream and Desjardins, Economic Studies

GRAPH 19
Grain prices



Sources: Datastream and Desjardins, Economic Studies

GRAPH 20
U.S. farmers turn their backs on corn in favour of soybeans



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

TABLE 1
Commodities

	SPOT PRICE	VARIATION (%)				LAST 52 WEEKS		
	April 5	-1 month	-3 months	-6 months	-1 year	Higher	Average	Lower
Index								
Reuter-*CRB* (*CCI*)	416.9	-2.4	-2.8	-0.4	10.4	436.9	419.6	377.6
Reuters/Jefferies *CRB*	186.1	-1.9	-3.9	-1.4	12.7	195.8	186.7	165.2
Bloomberg Commodity Index	85.6	-1.8	-2.2	-0.1	11.2	89.9	85.6	77.0
Bank of Canada	387.7	-3.9	-2.6	2.7	15.6	405.0	377.5	327.3
Energy								
Brent oil (US$/barrel)	54.4	-2.2	-3.1	4.8	43.8	57.1	50.1	37.9
WTI oil (US$/barrel)	51.1	-4.1	-4.9	2.8	42.3	54.5	47.9	35.9
Gasoline (US$/gallon)	2.36	2.0	-0.7	5.1	13.3	2.40	2.26	2.07
Natural gas (US$/MMBTU)	3.21	28.4	-2.7	12.2	68.9	3.76	2.76	1.72
Base metals								
LMEX	2,872	0.5	7.0	17.8	27.8	2,926	2,537	2,204
Aluminium (US$/tonne)	1,948	3.4	13.9	16.8	30.0	1,962	1,693	1,484
Copper (US$/tonne)	5,865	-0.7	5.5	22.7	22.4	6,104	5,166	4,496
Nickel (US$/tonne)	10,230	-6.5	-0.1	2.0	21.2	11,590	10,044	8,286
Zinc (US$/tonne)	2,750	-0.6	5.7	17.9	52.6	2,935	2,373	1,741
Precious metals								
Gold (US$/ounce)	1,248	1.9	5.4	-1.7	1.5	1,369	1,258	1,127
Silver (US$/ounce)	18.3	3.4	10.1	2.6	20.2	20.7	17.8	15.1
Platinum (US$/ounce)	963	-2.4	-0.4	-2.0	0.2	1,182	1,003	898
Palladium (US$/ounce)	816	7.9	10.6	19.5	47.6	816	676	523
Other commodities								
Lumber (US$/tbf)	402	-1.2	12.0	12.9	16.5	410	362	344
Pulp (US$/tonne)	1,030	0.0	4.0	3.5	8.4	1,030	993	950
Wheat (US$/bushel)	4.21	-3.7	0.7	13.8	-12.5	5.25	4.22	3.44
Corn (US$/bushel)	3.41	-4.2	-1.4	6.6	-1.4	4.18	3.41	2.88
Soybean (US$/bushel)	9.07	-8.8	-8.0	-1.8	3.1	11.57	9.98	8.79

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$/barrel)	49	43	Target: 54 (range: 46 to 58)	Target: 57 (range: 45 to 65)
Natural gas Henry Hub (US$/MMBTU)	2.61	2.49	Target: 3.20 (range: 2.70 to 3.60)	Target: 3.75 (range: 2.90 to 4.40)
Gold (US$/ounce)	1,160	1,249	Target: 1,175 (range: 1,125 to 1,300)	Target: 1,050 (range: 950 to 1,200)
LMEX index—base metals	2,550	2,377	Target: 3,000 (range: 2,600 to 3,300)	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