Coronavirus Roils Commodity Markets

- **Commodity markets have been dominated by news of the novel coronavirus (nCoV, COVID-19), with production shutdowns, travel bans, and reduced risk appetite driving plunges in most commodity prices.**
- **The virus is clearly a negative risk event with considerable downside potential, but the situation is fluid and some signs of stability are surfacing. More information on the extent to which demand is destroyed or simply delayed should emerge in the coming months.**
- **Other recent energy sector developments included the dismissal of a major pipeline appeal and details of Alberta's crude-by-rail program divestment plan in Canada, as well as supply concerns in Venezuela and Libya.**

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INITIAL RESPONSE PRONOUNCED, LONG-RUN IMPACTS STILL UNCLEAR

Like global headlines, commodity market developments were dominated by news of COVID-19, the first case of which was reported in Wuhan, China. Amid fears that the outbreak and containment measures—which include travel restrictions and production shutdowns—would erode fuel demand and bring Chinese industrial activity to a standstill, prices for most commodities plunged.

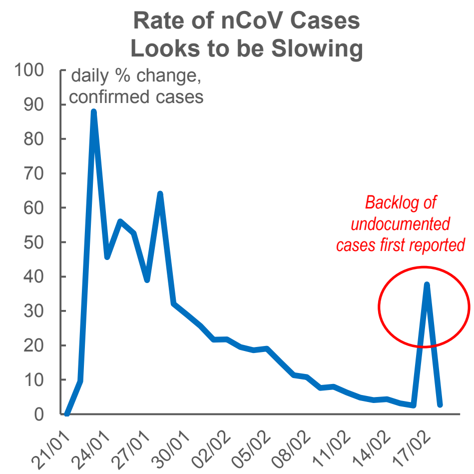
While COVID-19 is clearly a negative risk event, the situation is evolving. Our recent report models a scenario wherein the virus' peak occurs in April; in it, Chinese growth and commodity prices rebound from a weak Q1-2020, with the annual hit diminished as the year progresses. Indeed, after a mid-February spike in nCoV instances largely attributed to a backlog of previously unreported cases, the daily pace of infection appears to be slowing (chart 1). There is pressure on idled factories to resume operations, and prices responded positively to news of additional liquidity measures from the Chinese Government and OPEC+ cuts. Tail risks remain, but there is a conceivable situation in which risk appetite resumes the gradual upward trajectory we anticipated prior to the virus' outbreak.

VIRUS FEARS THROTTLE OIL PRICES, OVERSHADOWING OTHER NEWS

Light oil prices, from a closing trading value perspective, look to have reached their nadir on Feb. 10, shortly after the World Health Organization (WHO) declared nCoV a global health emergency. On that date, WTI crude fell to USD 49.57/bbl (more than USD 13/bbl below its Jan. 6, 2020 peak) and the Brent benchmark price reached USD 53.27/bbl (almost USD $16/bbl below its Jan. 6, 2020 peak). Feb. 10 closes were the lowest since December 2018 for Brent, and the softest since January 2019 for WTI.

Negative demand-side news overshadowed supply concerns that have emerged in Libya and Venezuela. In Libya, military conflict has resulted in a blockade of export terminals and a shutdown of operations that generate more than half of domestic oil production. That conflict is ongoing, having already lasted for more than one month. US sanctions related to a major oil producer's ties to the latter nation have raised the prospect of weaker crude exports from Venezuela. Amid some easing of Chinese demand fears, markets appear to be increasingly pricing in a weaker supply outlook.

Chart 1



Sources: Scotiabank Economics. WHO.

Scotiabank Commodity Price Index

January 2020	(% change)		
	M/M	Y/Y	YTD
All Commodity*	**-3.4**	**-4.6**	**-4.6**
Industrials	**-4.4**	**-6.0**	**-6.0**
Oil & Gas	-11.4	-12.0	-12.0
Metal & Minerals	-0.1	0.3	0.3
Forest Products	0.0	-6.5	-6.5
Agriculture	**1.2**	**1.6**	**1.6**

January 2007 = 100	2020		
	Jan	Dec	YTD avg.
All Commodity	**107.3**	**111.2**	**107.3**
Industrials	**103.4**	**108.2**	**103.4**
Oil & Gas	78.3	88.4	78.3
Metal & Minerals	120.7	120.8	120.7
Forest Products	136.0	136.0	136.0
Agriculture	**129.2**	**127.7**	**129.2**

* Weights: Oil & Gas (39.9%), Metal & Minerals (30.1%), Forest Products (14.7%), Agriculture (15.3%); Full technical note on page 6.

Canadian heavy oil prices were hurt by negative nCoV news, but saw smaller peak-to-trough declines and a nice rebound in recent weeks (chart 2)**.** Some of the recent price gains likely stem from stronger crude-by-rail volumes—multiple companies recently reported January shipment increases—which link demand from US refineries with Western Canadian production and take pressure off of pipelines. However, nationwide rail disruptions via Coastal Gas Link LNG pipeline protests may undermine further gains. Against that backdrop, Alberta announced that it will divest of the previous administration's crude-by-rail program this year; the cost is expected to be $200 mn lower than the *Budget 2019* forecast. Over the longer-run, reduced rail reliance is appropriate, but calibrating the policy with expected production rises and early-year price volatility will be a fine balance.

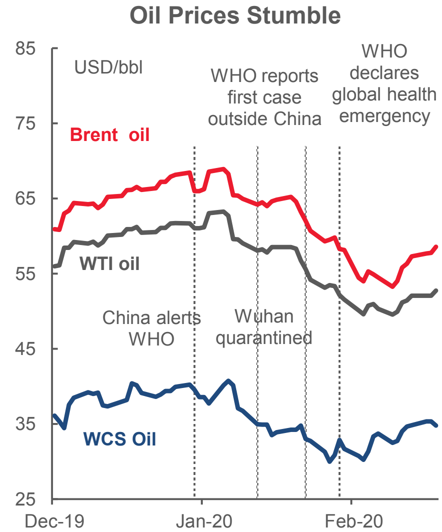
Irrespective of coronavirus-related headlines, the early months of 2020 have been eventful ones for Canada's oil industry. The Supreme Court of Canada dismissed the Province of British Columbia's appeal to regulate the flow of heavy oil across its borders. Had the appeal been granted, it could have further delayed construction and the 2022 in-service date of the Trans Mountain pipeline expansion project, which is needed to bring the Canadian heavy crude market into balance. The Federal Government continues to weigh the economic benefits of the proposed CAD 20 bn Frontier oil sands mine against carbon emissions targets. A decision had been expected by the end of this month, but may be postponed until after the Alberta Budget on Feb. 27.

For Canadian gas markets, LNG Canada project protests and related uncertainty have important implications. Eventual start-up of the export facility would also lift export capacity for Canadian gas facing pipeline bottlenecks and increasingly displaced from the US market by rapidly rising domestic production. Ramp-up of the venture is also a key factor behind our Canadian growth forecast—especially in BC—and delays would likely mean mark-downs to the outlook, though the Provincial Government has pledged to move the project forward.

INDUSTRIAL METALS LESS RESPONSIVE THAN OIL

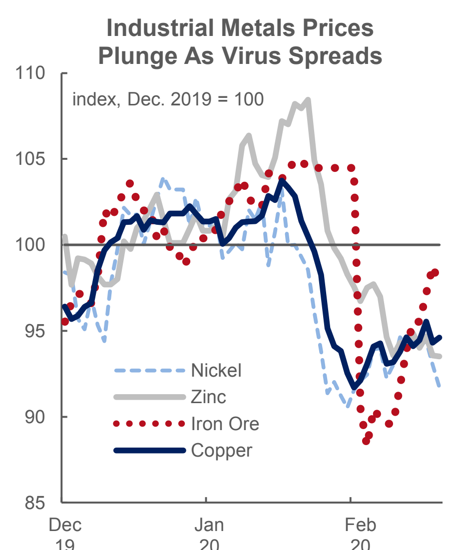
Copper has also traded significantly lower in the months following the COVID-19 outbreak. This is not surprising given the commodity's reputation as a bellwether of the industrial economy and the fact that China accounts for about half of the metal's global consumption. Declines were steep, but prices have since moved onto a gentle upward trend. We've noted the physical market's tightness and a weak supply outlook in past reports, which give prices a buffer against demand shocks. Yet sensitivity to Chinese macroeconomic conditions leaves copper prices particularly vulnerable to a prolonged virus-related slowdown.

Chart 2



Sources: Scotiabank Economics, Bloomberg.

Chart 3



Sources: Scotiabank Economics, Bloomberg.

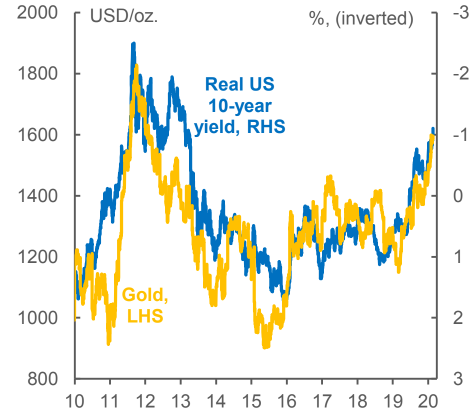
It was a similar story across the base metals complex, as well as for iron ore (chart 3)**.** Closing nickel prices fell to their lowest level since July of last year on January 30. On February 4, iron ore prices closed at their lowest level since November 2019, and zinc continues to fall, albeit at a moderating pace. Prices look to be broadly stabilizing, but on a fundamentals basis, near-term movements for all of these commodities should continue to be influenced by industrial activity in China.

Still, declines in industrial metals prices have not been quite as steep as those for crude values. Peak-to-trough drops have thus far been contained to the 10–15% range for key metals, versus plunges of more than 20% for both WTI and Brent. Baseline supply-demand balances may explain some of the discrepancy. Prior to the virus' outbreak, crude markets had been expected to experience surplus supply conditions in early 2020 as three long-lead-time offshore jurisdictions ramped up production, whereas copper, zinc, and nickel balances were tighter. Crude demand should also be more impacted by diminished air travel.

GOLD PRICES CLIMB IN HEIGHTENED RISK ENVIRONMENT

With macroeconomic uncertainty on the rise, prices for safe haven gold were bid up. Prices have risen steadily from about USD 1,517/oz on Jan. 1st to levels well above USD 1,600/oz this week, drifting higher alongside real rates (chart 4). The metal's near-term trajectory will undoubtedly continue to be driven by nCoV-related news, and its price floor may have shifted higher. Irrespective of the virus' path, 2020 should be a good year for gold, with political uncertainty concentrated in a contentious US presidential election and lingering US-Iran tensions, as well as broadly accommodative monetary policy that should put upward pressure on prices.

Chart 4 Gold vs. US 10-Year Treasury Real Yields



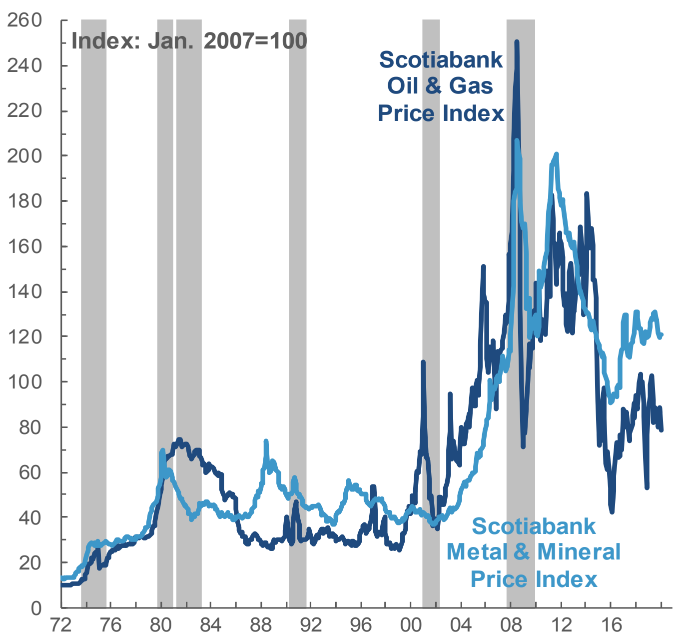
Sources: Scotiabank Economics, Bloomberg.

Price Outlook		2010–2018 Low	Period Avg.	High	2019	2020F	2021F
Oil & Gas							
Crude Oils							
West Texas Intermediate	USD/bbl	26	74	114	57	59	64
North Sea Brent Blend	USD/bbl	28	82	127	64	63	67
WCS - WTI Discount	USD/bbl	-50	-18	-7	-14	-20	-24
Natural Gas							
Nymex Henry Hub	USD/MMBtu	1.64	3.39	6.15	2.53	2.39	2.63
Metals & Minerals							
Base Metals							
Copper	USD/lb	1.96	3.10	4.60	2.72	2.80	3.00
Nickel	USD/lb	3.50	7.00	13.17	6.32	6.50	7.00
Zinc	USD/lb	0.66	1.02	1.64	1.16	1.10	1.05
Aluminium	USD/lb	0.65	0.89	1.26	0.81	0.90	0.90
Bulk Commodities							
Iron Ore	USD/t	39	101	194	94	78	70
Metallurgical Coal	USD/t	81	179	330	177	145	150
Precious Metals							
Gold	USD/toz	1,049	1,342	1,895	1,393	1,525	1,450

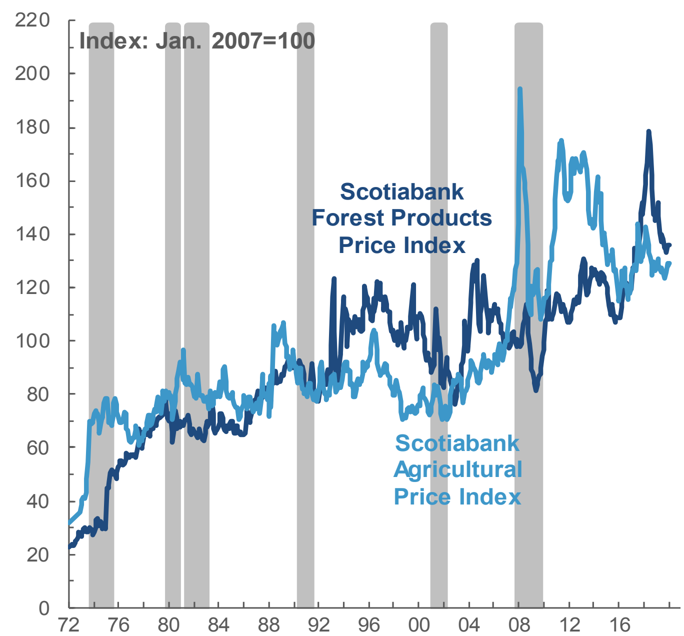
Scotiabank All Commodity Price Index

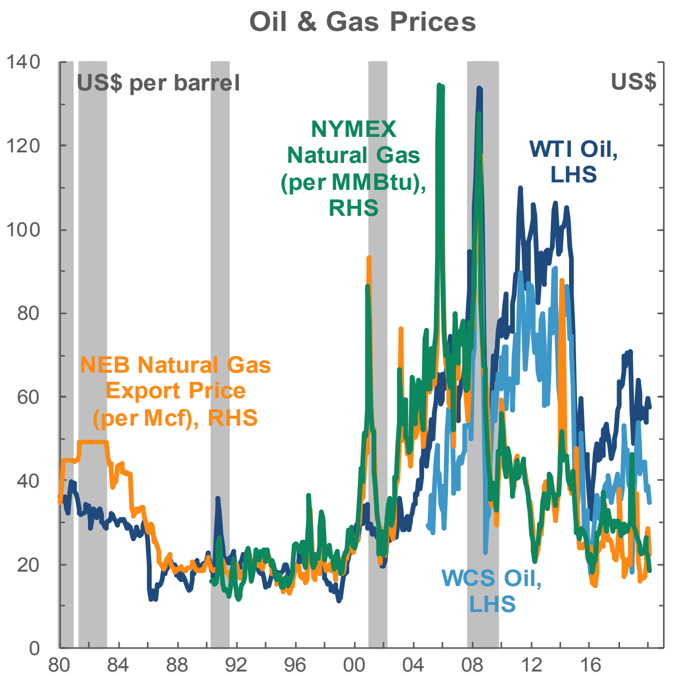
Canadian Dollar vs. Commodity Prices

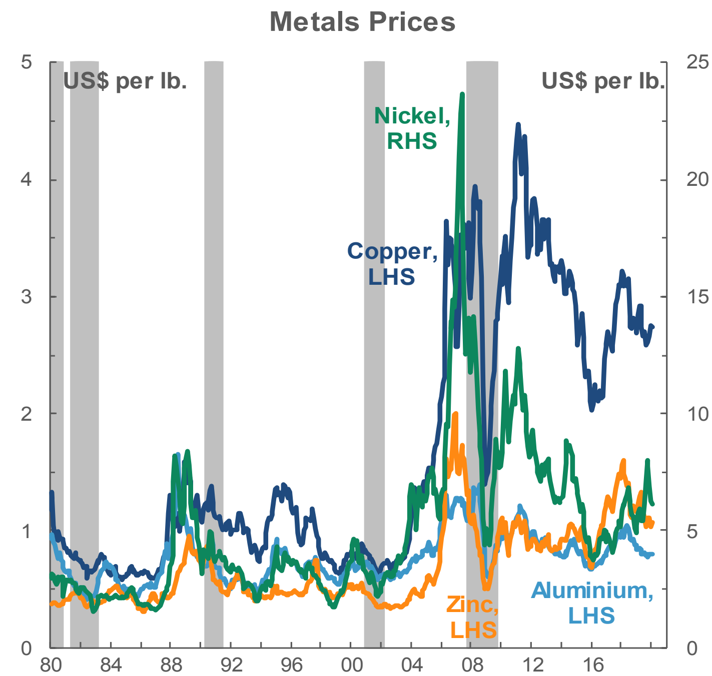
Scotiabank Oil & Gas and Metal & Mineral Indices

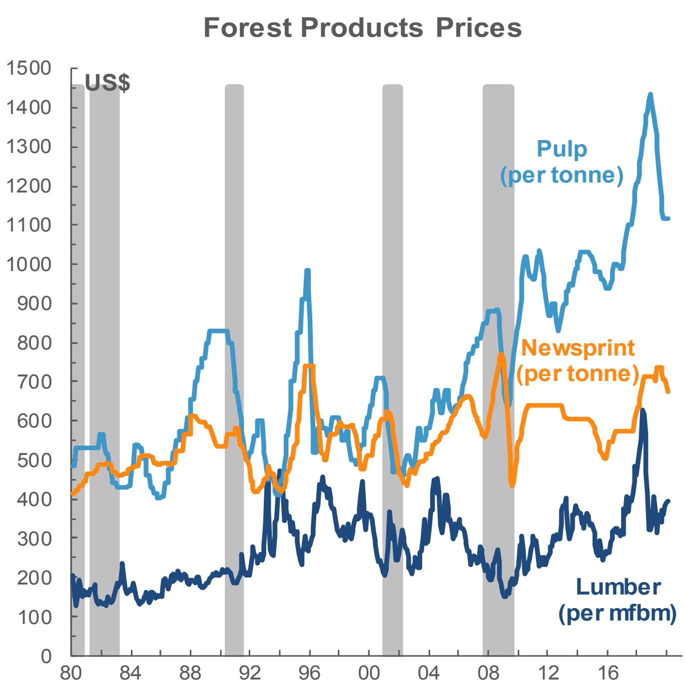


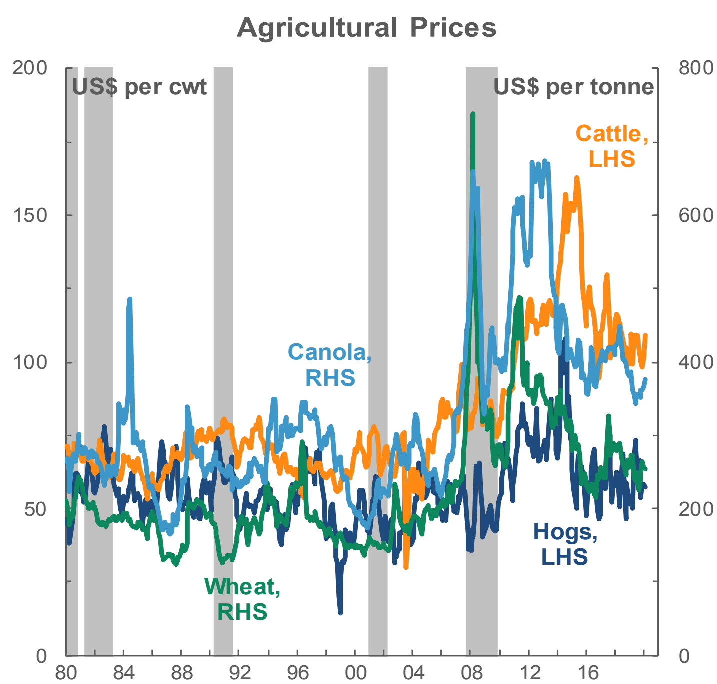
Scotiabank Forest Products & Agricultural Indices




Oil & Gas Prices
US$ per barrel
US$
NYMEX Natural Gas (per MMBtu), RHS
WTI Oil, LHS
NEB Natural Gas Export Price (per Mcf), RHS
WCS Oil, LHS
140
120
100
80
60
40
20
0
14
12
10
8
6
4
2
0
80
84
88
92
96
00
04
08
12
16


Metals Prices
US$ per lb.
US$ per lb.
Nickel, RHS
Copper, LHS
Zinc, LHS
Aluminium, LHS
5
4
3
2
1
0
25
20
15
10
5
0
80
84
88
92
96
00
04
08
12
16


Forest Products Prices
US$
Pulp (per tonne)
Newsprint (per tonne)
Lumber (per mfbm)
1500
1400
1300
1200
1100
1000
900
800
700
600
500
400
300
200
100
0
80
84
88
92
96
00
04
08
12
16


Agricultural Prices
US$ per cwt
US$ per tonne
Cattle, LHS
Canola, RHS
Hogs, LHS
Wheat, RHS
200
150
100
50
0
800
600
400
200
0
80
84
88
92
96
00
04
08
12
16

Technical Note
Scotiabank Commodity Price Index — Principal Canadian Exports
January 2007 = 100

This Index has been designed to track the spot or transactions prices paid in U.S. dollars for key Canadian commodities and resource-based manufactured goods in export markets. The weight of each component is based upon its net export value in 2010. Prior to January 2007, the weight of each component was based on its export value in 1995-97, except for crude oil & refined petroleum products, uncoated freesheet paper and linerboard, where net exports were used. Canada imports a significant quantity of these products, and use of their export value alone would have overstated the importance in Canada's trade performance.

The following prices are included:

OIL & GAS

Crude Oil & Refined Petroleum Products (US$ per bbl) MSW light sweet crude oil at Edmonton (previously Edmonton Par crude) and Western Canadian Select heavy oil at Hardisty, Alberta; price differentials off WTI near-by futures from Bloomberg.

Natural Gas (US$ per mcf) Average export price quoted by the National Energy Board.

Natural Gas Liquids (NGLs – Propane, Butane, Ethane & Pentanes-Plus) (US$ per bbl), Propane at Edmonton & Sarnia.

METALS & MINERALS

Copper & Products (US$ per lb) LME official cash settlement price for grade A copper.

Zinc (US$ per lb) LME SHG cash settlement: prior to Sept 1990, U.S. producers' price for high-grade zinc delivered.

Lead (US$ per lb) LME official cash settlement price; prior to Jan. 1991, U.S. producers' price for common grade delivered.

Aluminium & Products (US$ per lb) since 1979, LME official cash settlement price.

Nickel (US$ per lb) since 1980, LME official cash settlement price.

Gold (US$ per oz) 'LBMA Gold Price PM' as of March 20, 2015.

Potash (US$ per tonne) Standard potassium chloride, spot price, FOB Vancouver.

Sulphur (US$ per tonne) Solid, spot price, FOB Vancouver.

Metallurgical Coal (US$ per tonne) Contract price for premium-grade hard coking coal, FOB Vancouver.

Iron Ore (US cents per dmtu) Spot price fines 62% Fe, CFR Qingdao, China; prior to Jan 2011, term-contract price for concentrates 66% Fe from Labrador/Quebec to Northern Europe (FOB Sept-Iles).

Uranium (US$ per lb) U_3O_8 near-by-futures from Bloomberg.

Molybdenum (US$ per lb) since March 1992, MW dealer oxide.

Cobalt (US$ per lb) MW dealer price.

FOREST PRODUCTS

Lumber & Wood Products, Western Spruce-Pine-Fir 2x4 No.2 & Btr (US$ per mfbm) FOB mill.

Oriented Strandboard (US$ per thousand sq. ft.), U.S. North Central region, 7/16 inch.

Pulp, Bleached Northern Softwood Kraft (US$ per tonne) Transactions price, delivery USA.

Newsprint (US$ per tonne) Average transactions price, 45 grams, delivery Eastern USA.

Groundwood Specialty Papers (US$ per ton) Supercalendered-A paper, 35 lb., delivery USA.

Linerboard (US$ per ton), delivery Eastern USA with zone discounts.

AGRICULTURE

Wheat & Flour (US$ per tonne), DNS No 1 14% protein Duluth, Minn; prior to April 2011 No.1 CWRS, 13.5% protein at St. Lawrence.

Barley (US$ per tonne), Saskatchewan aggregate spot price; historical data No. 1 at Lethbridge, Alberta.

Canola & Oilseeds (US$ per tonne) No.1 Canada, in store Vancouver.

Cattle & Beef (US$ per cwt) Steers over 1,051 pounds at Toronto; from Jan 1993, Ontario average.

Hogs & Pork (US$ per cwt) 100 Index Hogs at Toronto; from Jan 1993, Ontario average.

Fish & Seafood (US$ per lb) West Coast silver coho salmon; Atlantic lobster prices; prior to 1986 cod fillets & blocks.

Scotiabank Commodity Price Index — Components And Weights

Index Components	Net Export Value In 2010 (millions of dollars)	Index Weight (per cent)
OIL & GAS INDEX	**46,537**	**39.90**
Crude Oil & Refined Products	33,231	28.49
Natural Gas & LNG	11,741	10.07
NGLs	1,565	1.34
METAL & MINERAL INDEX	**35,109**	**30.10**
Copper	3,160	2.71
Zinc	1,255	1.08
Lead	579	0.50
Aluminium	6,045	5.18
Nickel	4,246	3.64
Gold	4,678	4.01
Coal	4,757	4.08
Iron Ore	3,346	2.87
Potash	5,161	4.42
Sulphur	457	0.39
Uranium	891	0.76
Cobalt	288	0.25
Molybdenum	246	0.21
FOREST PRODUCTS INDEX	**17,081**	**14.66**
Lumber & Wood Products	4,673	4.01
OSB	812	0.70
Pulp	6,818	5.85
Newsprint	2,734	2.34
Groundwood Spec. Papers	1,971	1.69
Linerboard	87	0.07
AGRICULTURAL INDEX	**17,901**	**15.35**
Wheat & Flour	4,693	4.02
Barley & Feedgrains	1,088	0.93
Canola & Oilseeds	5,398	4.63
Cattle & Beef	1,640	1.41
Hogs & Pork	2,378	2.04
Fish & Seafood	2,704	2.32
TOTAL INDEX	**116,643**	**100.00**