

Commodities: An East-West Tug of War

SUMMARY

- COVID-19's resurgence in North America and Europe arrives as cases are stable and industrial activity is ramping up in China; this implies more divergent paths for commodity prices going forward.
- Industrial metals prices remain well-supported, though we anticipate more muted gains in the coming months.
- A more modest demand outlook and ongoing adjustments to the supply glut built up earlier this year suggest a modest trajectory for crude prices in the near-term.
- US dollar appreciation is weighing down precious metals prices.

VIRUS STABLE IN CHINA, RESURGENT IN NORTH AMERICA, EUROPE

The world economy looks increasingly to be progressing along two tracks, with China's buoyant post-COVID-19 lockdown rebound offering the best news for commodity pricing. The strength of demand in the world's largest metals consumer continues to surprise on the upside, anchored by relatively early reopening, sustained by control of the virus' spread, and bolstered by fiscal and monetary stimulus. In line with most forecasters, we anticipate that China will lead most nations' growth this year, providing an offset to the drop in global activity as during the 2008–09 Global Financial Crisis (GFC) (chart 1).

By contrast, a second pandemic wave is incipient in North America and Europe. Many US states are reporting rising infection and positive test rates, and surges are prompting new restrictions in Canada's largest provinces. Cases are also at or near all-time daily highs in France, the UK, and the Netherlands, which have reinstated some containment measures. Clearly, continuation of this trend could undermine the gains made in the last several months, though we suspect that future lockdown measures will be less all-encompassing than those implemented during the first wave.

Against that backdrop, Sino-US trade and diplomatic tensions remain pertinent. Recall that uncertainty related to the spat between the world's two largest economies weighed down industrial sector activity last year. With the US presidential election now in full swing, further brash and self-defeating political posturing can reasonably be expected for at least the next few weeks.

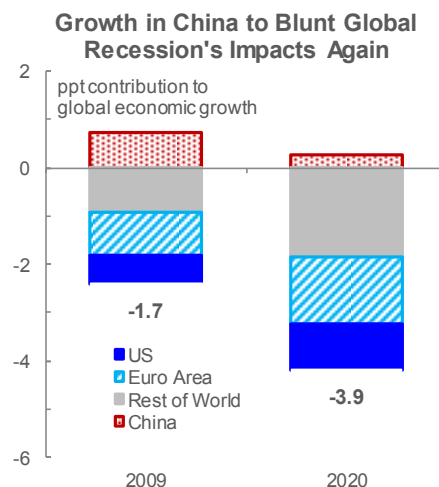
INDUSTRIAL METALS STILL CLIMBING, BUT DON'T EXPECT 2009 REPEAT

Copper's remarkable rally—which persisted in early September but eased somewhat towards the end of the month—is invoking comparisons to the post-GFC boom. There are parallels, but we reiterate some key differences. One is the pandemic-led supply shock that coincided with the initial demand hit to keep the peak-to-trough price drop less than 30%—versus a decline of more than 60% in H2-2008. With a sustained South American output disruption now looking less

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Chart 1



Sources: Scotiabank Economics, Bloomberg.

Scotiabank Commodity Price Index

	August 2020		
	(% change)		
	M/M	Y/Y	YTD
All Commodity*	7.8	0.7	-14.1
Industrials	8.9	0.9	-16.1
Oil & Gas	2.3	-23.7	-38.6
Metal & Minerals	5.4	1.6	-4.8
Forest Products	21.7	41.7	2.6
Agriculture	2.8	-0.7	-4.2
	January 2007 = 100		
	2020		
	Aug	Jul	YTD avg.
All Commodity	111.5	103.4	98.7
Industrials	109.5	100.6	94.6
Oil & Gas	64.8	63.3	56.1
Metal & Minerals	129.1	122.4	120.8
Forest Products	190.9	156.9	145.5
Agriculture	122.6	119.3	121.5

* Weights: Oil & Gas (39.9%), Metal & Minerals (30.1%), Forest Products (14.7%), Agriculture (15.3%); Full technical note on page 7.

likely given stable caseloads in key mining regions, there may be less room to run than in 2009 when supply responses were more lagged. Physical market tightness and China's public spending plans should assist price momentum near-term, but we expect more modest gains for copper entering 2021 than in 2009–10.

Pricing for other base metals such as zinc and nickel continues to broadly mirror the expansion of the global economy. Liquidity infused by central banks and the slide in the US dollar earlier this year also lent pricing support.

Iron ore prices are hovering in the 115–120 USD/t range—more than 20 USD/t higher than in the months prior to the onset of the pandemic—but appear to be retreating. A core ingredient in steel production, the metal has also benefited from China's industrial sector boom. Underlying the recent pullback is an increasing sense that supply may be catching up to demand. Brazilian iron ore production looks to be recovering nicely and inventories at Chinese ports have been trending gradually higher since mid-August. Top producer Vale also announced plans to step up output across its operations, reinforcing stronger-than-anticipated Q4 output guidance from other firms. We foresee further easing of prices entering 2021.

A BUSY MONTH FOR OIL MARKETS

WTI retreated this month. The principal development came in the form of weaker-than-expected crude demand forecasts released by OPEC and the EIA, though markets looked to have already begun to price in virus-related fears. US production has also recovered from Hurricane Laura-related shutdowns that extended into early September. Combined, these effects pushed the US benchmark below 40 USD/bbl for much of the month, after it averaged about 42 USD/bbl in August. Further deterioration of the economic milieu—whether in North America or in Asia as the report anticipates—could clearly result in more price weakness, though we note that US fuel demand generally continued to improve this month (chart 2).

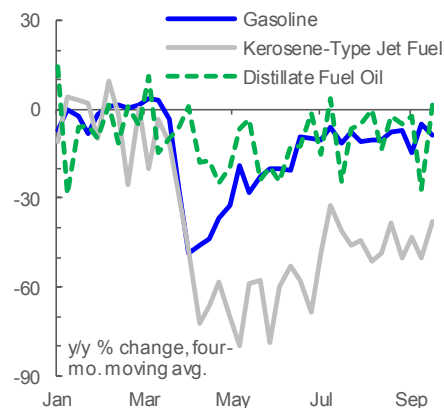
Following the September dip, OPEC+ maintained current production cut plans of 7.7 mn bpd through December, but stressed that members remain flexible to take additional measures should conditions dictate. That modestly lifted both Brent and WTI, but the durability of that boost remains to be seen. Earlier concerns that Saudi Arabia was attempting to flood the US crude market for now seem to have been allayed by the significant fallback in oil imports from the Kingdom.

The US refining industry is facing increasingly challenging conditions. NY Harbour and Gulf Coast crack spreads are well below seasonal averages, reflecting still-bloated product inventories. This continues to translate into low rates of refinery utilization, which may well trend lower near-term in light of the present supply glut and the potential for softer overall economic activity and fuel consumption.

Mirroring these challenges, WCS has fallen about 2 USD/bbl in recent weeks; that followed an earlier boost to the Western Canadian benchmark via Inter Pipeline's shutdown of its Polaris conduit. Service has been partially restored, but the resulting reduction in the flow of diluent has resulted in at least one oil sands operation halting production until transportation capacity normalizes. This occurs as the Western Canada oil market continues its long rebalancing process. Lagged data for July showed an eight-year low for crude-by-rail shipments, a sign of the shift towards now-free space in pipelines that was prompted by weak pricing and

Chart 2

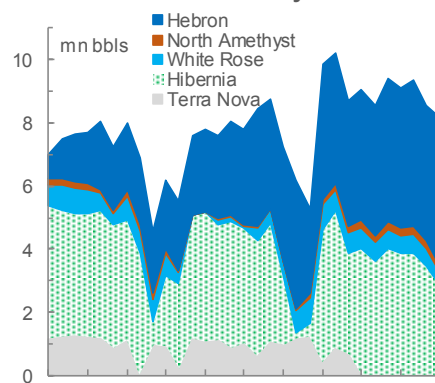
US Fuel Demand Improves



Sources: Scotiabank Economics, EIA.

Chart 3

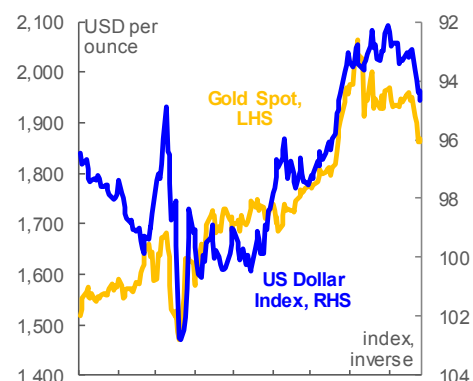
Newfoundland and Labrador Oil Production by Field



Sources: Scotiabank Economics, Canada-Newfoundland and Labrador Offshore Petroleum Board.

Chart 4

Gold Continues to Move With US Dollar



Sources: Scotiabank Economics, Bloomberg.

plunging production, the latter of which is now recovering. Alberta crude inventories, bloated before the pandemic, have also fallen to levels not seen since early 2019.

In Newfoundland and Labrador, a promising start to the year is increasingly giving way to new fears about the oil and gas sector. The West White Rose extension project, positioned as critical to the long-run viability of the existing White Rose offshore oil field, is under review by Husky, its proponent, and the provincial government rejected calls for direct public support. Meanwhile, operations at the Terra Nova field are still suspended with no restart date announced, eroding some of the gains associated with continued ramp-up of Hebron field output (chart 3, p.2).

SAFE HAVEN USD DRIVES PRECIOUS METALS LOWER

Bullion prices dropped below 1,900 USD/oz towards the end of September after spending much of August north of the 2,000 USD/oz mark. More recent selling pressure looks to reflect perceptions of *relative* rather than absolute risk in foreign exchange markets, which are bidding up the US dollar (chart 4, p.2). At first blush, American currency appreciation in the face of heightened domestic political risk and rising COVID-19 cases would seem counterintuitive, but the greenback is seen as a port in a storm of European infections. Medium-term yellow metal fundamentals remain constructive. In particular, the Federal Reserve's stated tolerance for stronger inflation, though subject to implementation challenges, has the potential to weigh on US real rates.

Silver also fell back in the month, with a pronounced drop materializing in more recent weeks. Like gold, greenback appreciation has been the driving force behind the decline. Expectations of faltering construction and manufacturing activity in the Western world—the “white metal” is less dependent on Chinese consumption than its industrial counterparts—also look to be increasingly weighing on prices.

POLICY GROUND UNDER CANADIAN LUMBER AND ALUMINUM SHIFTS (AGAIN)

The government of British Columbia implemented new regulations to support the domestic lumber industry this month. New rules—initially intended to come into effect in July but delayed due to the pandemic—encourage within-province lumber production and processing by tightening conditions under which export permits can be granted. All else equal, they have the potential to push industry costs higher at a time when prices are sky-high, even after recently retreating from unsustainable levels. More modest domestic price gains might be expected to the extent that the policy does incent more production, which is still recovering from pandemic-induced cuts, though lumber shortages remain a Canada-wide issue. Against that backdrop, conflagrations in BC's interior and the US West Coast are figuratively and literally adding fuel to the lumber supply crunch fire.

Canadian metals producers received good news when the Trump administration once again backed off threats to apply tariffs to imports of aluminum from the Great White North. The reversal apparently came in response to plans for retaliatory moves in political US battleground states, though to some extent, the threat was never credible given the US's well-documented reliance on Canadian shipments to meet domestic consumption requirements.

Price Outlook		2010–2018			2019	2020F	2021F
		Low	Period Avg.	High			
Oil & Gas							
Crude Oils							
West Texas Intermediate	USD/bbl	26	74	114	57	41	50
North Sea Brent Blend	USD/bbl	28	82	127	64	45	53
WCS - WTI Discount	USD/bbl	-50	-18	-7	-14	-14	-15
Natural Gas							
Nymex Henry Hub	USD/MMBtu	1.64	3.39	6.15	2.53	1.93	2.50
Metals & Minerals							
Base Metals							
Copper	USD/lb	1.96	3.10	4.60	2.72	2.75	3.00
Nickel	USD/lb	3.50	7.00	13.17	6.32	5.70	6.00
Zinc	USD/lb	0.66	1.02	1.64	1.16	0.92	1.00
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	87	70
Metallurgical Coal	USD/t	81	179	330	177	130	140
Precious Metals							
Gold	USD/toz	1,049	1,342	1,895	1,393	1,650	1,700

Scotiabank All Commodity Price Index



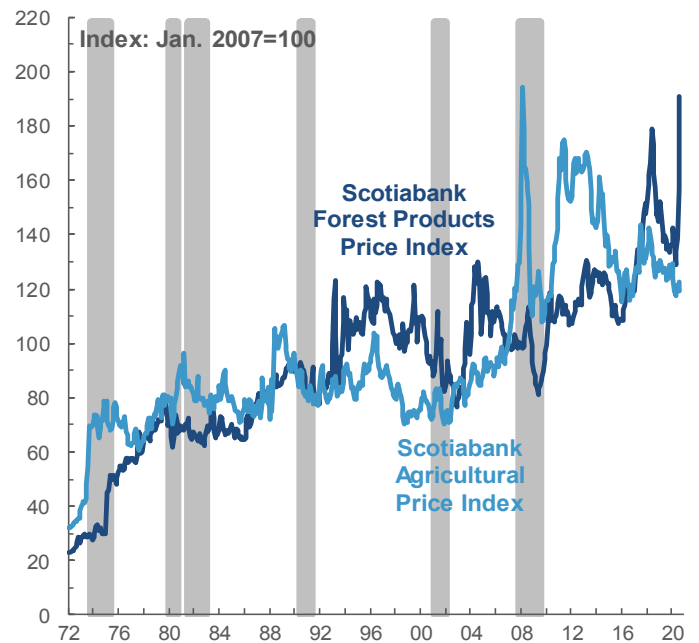
Canadian Dollar vs. Commodity Prices



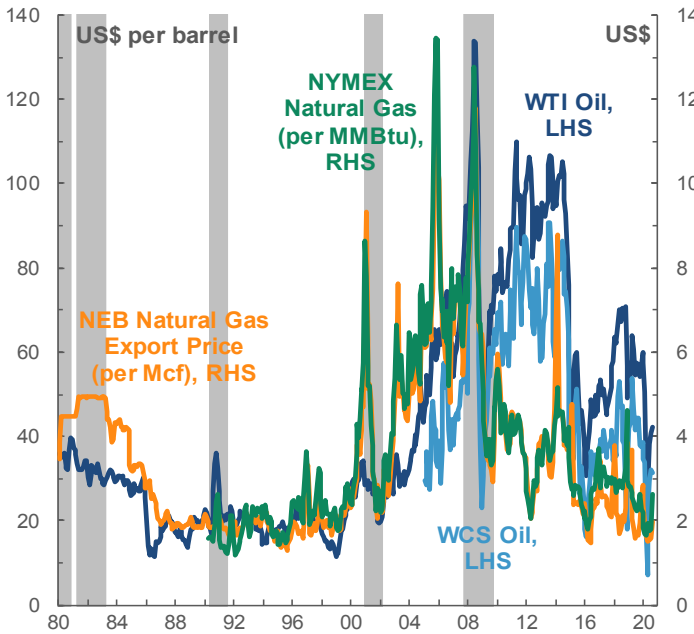
Scotiabank Oil & Gas and Metal & Mineral Indices



Scotiabank Forest Products & Agricultural Indices



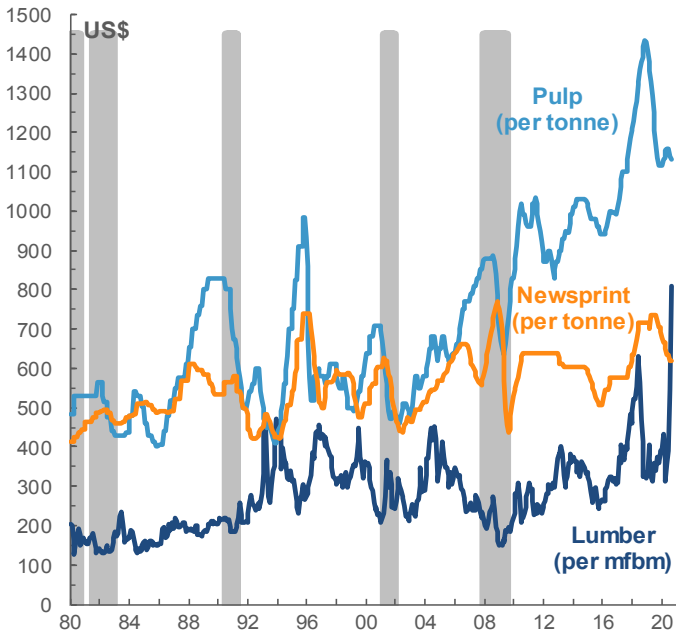
Oil & Gas Prices



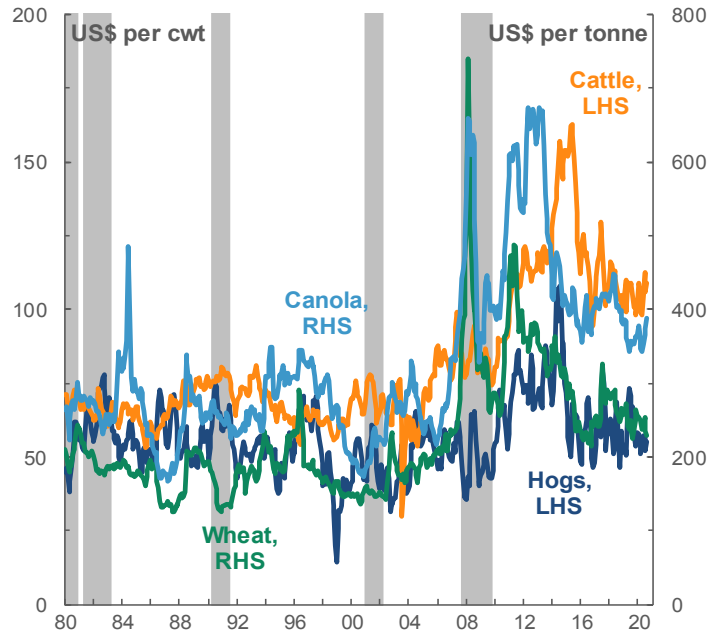
Metals Prices



Forest Products Prices



Agricultural Prices



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) U₃O₈ 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), Manitoba Agriculture and Food No. 1 Canadian western barley 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

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