SEARCHING FOR A BOTTOM

• The last few months have not been kind to commodity prices, with declines seen nearly across the board. Crude oil prices in particular have been in the spotlight, sinking by roughly 40% since peaking in June. Weaker-than-expected economic performances in Europe, Japan and several emerging markets – including China – an appreciation in the U.S. dollar, and increased supply have weighed on prices in several commodity markets. Some commodities have bounced back somewhat since the October lows, however prices have not recouped all that was lost.

• While further declines are likely in store for several markets over the next couple of months, the overall outlook for commodity prices is generally more positive. The U.S. will remain the bright spot in the near term, while economic growth in other key world economies is expected to be softer than originally anticipated. This continued divergence will help maintain the upward trend in the U.S. dollar over the next 6-9 months, with the greenback peaking in the third quarter of 2015. Towards the end of next year and into 2016, the global economy should gain some traction, which will bode well for commodity demand and prices. Supply side factors will arguably play a larger role in commodity price movements going forward – particularly in the near term – with some commodities poised for significant gains over the next two years.

• After trading above the US$100 per barrel mark for six out of the first seven months of the year, a sharp selloff has since sent crude oil prices down 40% to a 5-year low of US$57 per barrel. The initial drop to about US$75 per barrel was driven by weak data out of China and Europe, combined with record output in the U.S., and higher than expected OPEC production. At the much-anticipated OPEC meeting at the end of November, the cartel decided to leave production quotas unchanged, which then sent prices below the US$70 per barrel mark. While further weakness in the near term is quite possible, we don’t expect prices to remain below current levels for a sustained period of time. Already, oil producers are slashing investment plans, and more cuts are likely in store if prices remain in the low US$60s (or lower). As a result, production growth will slow. Meanwhile, overall supply from currently producing tight oil wells will eventually taper as they are depleted. This supply response – or perhaps even expectations of it – should drive prices higher. Moreover, with economic growth across the globe expected to pick up modestly by the end of next year, oil prices should follow suit. We forecast WTI prices to hover in the US$60-65 per barrel range through the first half of 2015, before rising gradually thereafter, topping US$80 per barrel in 2016.

• Natural gas prices started this year off quite strong thanks to the Polar Vortex that led to extremely cold temperatures in key consuming regions of the U.S. and in Canada during the first quarter, which dramatically drew down storage levels. Since then, prices have been trending lower, as weather conditions normalized and higher production began to replenish inventories. While another cold spell hit the Midwest and Northeast U.S. in November triggering a short-lived rally, the outlook for the rest of the heating season is for milder temperatures relative to a year ago. Meanwhile, production is on the rise, suggesting that storage levels are likely to increase over the winter months, painting a much different picture than was the case last winter. Accordingly, we expect natural gas prices to remain relatively subdued, averaging US$3.60 per MMBtu over the next two years.
Precious metals prices have been trending down since mid-year, with both gold and silver prices reaching levels not seen since early 2010. Gold prices fell to US$1150/oz and silver prices slid below US$16/oz in November, driven largely by a sharp appreciation of the U.S. dollar and strong performances of competing asset groups such as equities. While precious metals prices could see more downside in the near term, given that the firming trend in the U.S. dollar is expected to continue into 2015, we do expect to see some strengthening in prices towards the latter half of next year and into 2016. However, with inflation likely to remain subdued, and the greenback projected to stay elevated, the upside for precious metals prices appears to be limited. Overall, after bottoming in the first quarter of 2015, we expect gold to trade in the US$1200-1300/oz range through the remainder of the forecast period, while silver prices are projected to hover in the US$17-20/oz range.

Given that China is by far the largest consumer of base metals, and that Europe is a distant second, the weak economic data coming out of these regions has weighed heavily on prices in recent months. Massive aluminum inventories at the global level suggest that there will be excess supply in the market, even once demand begins to recover heading into 2016. Hence, the recent rebound in aluminum prices is likely to be short lived. The copper market is also expected to be in a healthy surplus position next year, and given the elevated stockpiles in China, copper prices are likely to lose some ground over the next year. On the flipside, zinc and nickel are expected to be top performers. With large scale mines set to close, and new mines slow to open, production will continue to lag demand in the zinc market, suggesting that there is plenty of upside for zinc prices. Similarly, due to the raw ore export ban in Indonesia, coupled with a slow build of mines globally, the nickel market is expected to swing into a deficit position next year, driving prices back up towards the highs seen in 2011.

The agricultural sector has seen a divergence in prices between crops and livestock. Like the rest of the commodity complex, crop prices took a hit this year, falling 30-60% below their 2012 peaks to 4-year lows. Favourable growing conditions in most parts of the world led to a second consecutive year of a bumper harvest, dramatically increasing inventories. On the flipside, tight supplies of livestock have driven cattle and hog prices to record highs, although hog prices have since come off their peaks after a virus that killed millions of young pigs appeared to be contained. Looking ahead, ample carryover stocks across most crop markets will take time to work down, keeping a lid on prices over the next couple of years. For livestock, given the time it takes to rebuild a herd, prices are likely to remain quite elevated. That said, we do expected them to lose some ground, as the hog supply is likely to rise next year and the cattle market will be faced with competition from other meat markets.

After rising through the second half of 2013, lumber prices have been relatively flat this year, as strong North American demand has been offset by weaker offshore demand. The momentum in the U.S. homebuilding market is expected to continue, propping up consumption Stateside, while offshore demand is expected to see only modest growth. Meanwhile, North American supply will be constrained due to declining timber supplies in Canada as a result of the mountain pine beetle infestation in British Columbia. An expected tightening in the domestic market will lead to higher lumber prices throughout the forecast horizon.

Overall, we expect commodity prices, on average, to bottom by mid-next year before beginning to grind higher thereafter alongside an uptick in global economic growth. Nickel and zinc are expected to be at the top of the leaderboard, gaining an average of over 20% over the next two years. Energy prices will trail the pack, as a weak handoff for 2015 will lead to annual average declines of around 20% for natural gas prices and 30% for oil prices next year.

Dina Ignjatovic, Economist
416-982-2555

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December 15, 2014
### COMMODITY PRICE FORECAST SUMMARY

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  - Lumber: Random Lengths' Framing Lumber Composite ($/1000 Bd Ft)
  - Pulp: NBSK, delivered in east U.S. ($/mt)
  - Newsprint: New York ($/mt)
- **ENERGY**
  - Oil: Domestic Spot Market Price: West Texas Intermediate, Cushing ($/Barrel)
  - Natural Gas: Henry Hub, LA ($/mmbtu)
  - Coal: Austr. Therm ($/mt)
- **PRECIOUS METALS**
  - Gold: Cash Price: London Gold Bullion, PM Fix ($/Troy oz)
  - Silver: Cash price: Silver, Troy Oz, Handy & Harman Base Price ($/Troy oz)
- **NON-PRECIOUS METALS & MINERALS**
  - Aluminum: LME Aluminum, 99.7% Purity: Closing Cash Price (Cents/lb)
  - Copper: LME Copper, Grade A: Closing Cash Price (Cents/lb)
  - Nickel: LME Nickel: Closing Cash Price ($/lb)
  - Zinc: LME Zinc: Closing Cash Price (Cents/lb)
  - Uranium: Ux U308 ($/lb)
- **AGRICULTURE**
  - Wheat: Spring, 14% Protein: Minneapolis ($/bu)
  - Barley: Canada: Cash Prices: Feed Barley: Lethbridge: Grade 1 CW (C$/mt)
  - Canola: Canada: Cash: Canola: Instore Vancouver: Grade 1 Canada NCC (C$/mt)
  - Cattle: Live Cattle Futures Price: 1st Expiring Contract Open (Cents/lb)
  - Hogs: Lean Hogs Futures Price: 1st Expiring Contract Open (Cents/lb)

### Sources

*Forecasts by TD Economics; **Forecasts by TD Securities