Commodities Outlook (Q4 2019)

****Content reproduced from our recently released quarterly *Scotiabank's Global Outlook* (pp. 37–39).**

MACRO TAKE THE WHEEL

- **Softer macroeconomic conditions, weak industrial activity, and ever-uncertain-yet-steadily-worsening trade tensions have markets on the defensive and industrial commodity prices have waned amidst lowered demand expectations.**
- **While the outlook for most industrial commodities has been revised lower in this outlook, our forecast for crude prices remains relatively unchanged given supply-side risk offsets and should be considered relatively bullish on the commodity given our broader bearish bias.**
- **Gold has enjoyed a resurgence amidst the weakness in industrial commodities and market fears of a further slowdown. Bullion is expected to reach a near-term annual peak in 2020 as the US enters a presidential election amidst impeachment proceedings and a trade war, and Brexit roils Europe across the Atlantic.**

The commodity market finds itself on the other side of the stimulus-aided and optimistically synchronized global growth that supported industrial commodity prices from late-2016 into mid-2018. The prices of most industrial commodities have fallen in the year-and-change since the US-China trade war began in earnest as businesses throttled back on investment amidst volatile US trade policy and disrupted supply chains (chart 1).

As chart 1 makes clear, industrial misfortune has been a boon for gold as investors flocked to safety and central banks around the world reversed their prior tightening biases and began cutting interest rates to help spur demand. While still-healthy consumer demand is floating modest growth across the OECD, commodities will be driven by contracting activity in the materials-intensive and trade-dependent industrial sector, where PMIs are trending negative alongside industrial production and trade indicators (chart 2). Some of this slowdown makes sense simply as the hangover from the stimulus-fuelled strength through to mid-2018, though we believe that the volatility and ever-worsening state of US trade relations has added considerable additional uncertainty—firms are understandably hesitant to put capital in the ground when previously stable supply chains and relationships can unravel at the flippant pace of a presidential tweet thread.

While the outcome of the US presidential showdown will set the tone for the post-2020 global economy we don't expect a resumption of the pre-2016 election status quo. In a scenario where President Trump is re-elected we anticipate that the White House will continue on its current path of policy volatility though to diminishing effect as firms adapt and supply chains are reoriented. A Democratic victory would likely reduce the volatility of the policy-making process—and thus the current level of investment uncertainty—but is expected to nonetheless weigh on markets directly given fiery primary campaign rhetoric that spooked much of Wall Street and has sowed the seeds of at least some degree of

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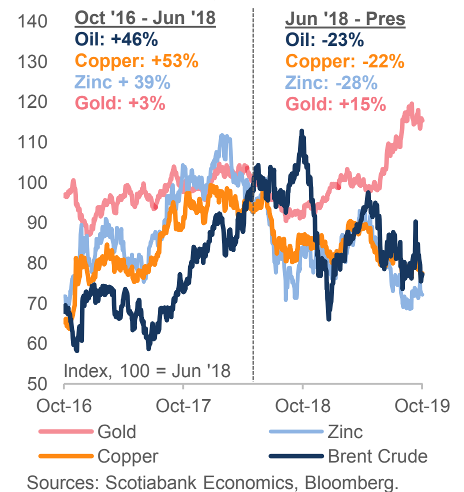
Chart 1

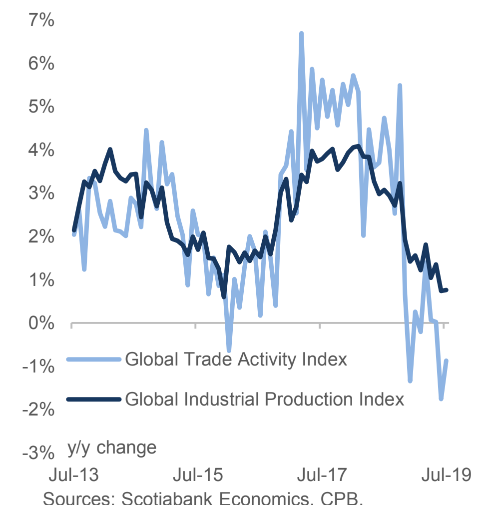
Shift From Synchronized Growth to Trade-Led Slowdown Batters Industrials, Boosts Gold



Sources: Scotiabank Economics, Bloomberg.

Chart 2

Global Industrial Activity Weighed Down by Trade Policy Uncertainty



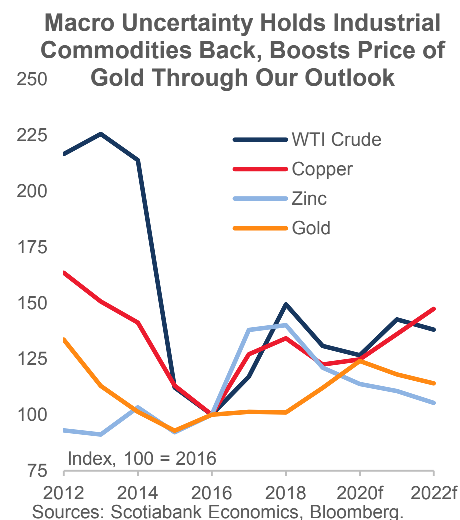
Sources: Scotiabank Economics, CPB.

self-fulfilling prophecy selloff; this weakness is also expected to be temporary and fall off steadily through the early 2020s.

This weaker macroeconomic backdrop continues to dominate commodity price formation, and currently volatile tides of the global economy are expected to drown out most commodity-specific fundamentals until either 1) those fundamentals become particularly acute and financial markets are forced to contend with cash-settlement supply-demand dynamics, or 2) the macro fog is lifted and markets can once again properly discriminate between various materials on a case-by-case basis.

With that backdrop in mind, **we now expect 2020 to be a particularly good year for gold with prices forecast to average $1,550/oz** (up from $1,350/oz in our last outlook) while economic uncertainty will continue to weigh on **copper's prospects and prices are forecast to languish around $2.75/lb** (from $3.00/lb) (chart 3). **Despite an extremely active oil market our WTI crude price forecast has remained more-or-less unchanged at $55/bbl in 2020** as our increasingly bearish macro outlook offsets the political risk boost that oil prices are expected to retain on the back of mid-September attacks against Saudi Arabia's oil industry (see full commentary here).

Chart 3

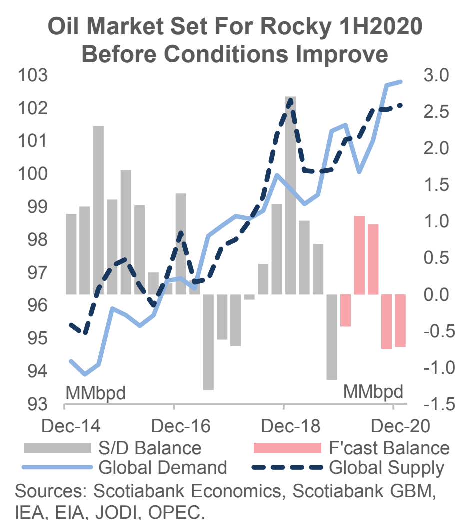


Sources: Scotiabank Economics, Bloomberg.

ENERGY: SUPPLY RISKS HELP CRUDE AVOID MACRO DOWNGRADE

Against a bearish macro backdrop where most industrial commodities are seeing outlooks downgraded, our mostly-unchanged oil price forecast should be seen as fundamentally bullish for the commodity and a reflection of a risk premium embedded in the price following recent attacks in Saudi Arabia—while the market has returned most of the post-attack gains, we would still likely be lower today absent the attacks. We expect WTI crude to average $55/bbl in 2020 and $62/bbl in 2021, with oil balances set to steadily tighten over the coming two years. While our outlook for crude is constructive, the hardest times for oil prices are very nearly upon us as supply-demand balances are expected to tip into acute surplus in the first quarter of 2020. This surplus is more the result of a timing mismatch than a reflection of longer-term weakness, with large non-OPEC fields years in the making coming online together just as demand falls off seasonally (chart 4). Nonetheless, pricing is expected to feel significant pressure as spot markets wane to pay for storage to bridge the demand gap and early weakness will drag on annual average pricing.

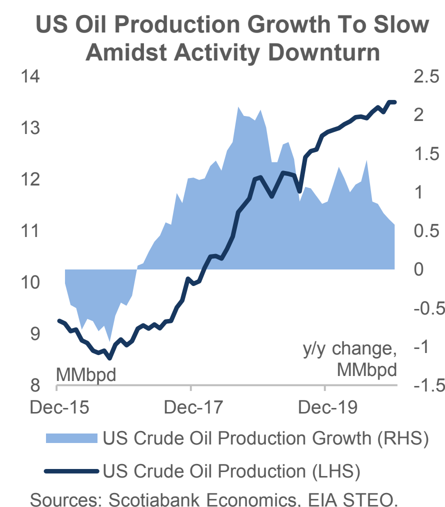
Chart 4



Sources: Scotiabank Economics, Scotiabank GBM, IEA, EIA, JODI, OPEC.

Conditions are set to improve through 2020 as demand growth reaccelerates and US growth—long the sharpest thorn in the side of oil price bulls—finally begins to slow. Oil consumption growth is expected to reaccelerate as business activity picks up following the 2020 US election; while not as investment-driven as metals like copper, oil demand will benefit from faster growth in construction, shipping, and trade. On the supply side, US shale growth continues to slow as expected and now the US Energy Information Administration expects 2020 supply growth to average around 1 MMbpd and exit December at less than 0.6 MMbpd, down from the 1.64 MMbpd high water mark pace averaged in 2018 (chart 5). Oilfield activity across the major US basins has fallen alongside crude prices are there are 151 fewer rigs drilling for oil than this time last year (-18% y/y) and the short-cycle nature of the shale patch means these downturns feed to production far more quickly than in past cycles. While it is clear that the shale patch will be able to accelerate in the event of a prolonged supply shortage, moderate prices around the low $60s (WTI) are expected to now keep shale growing at a modest and decelerating pace while further demand growth provides OPEC+ the space to ease the group's production constraints.

Chart 5



Sources: Scotiabank Economics, EIA STEO.

METALS: COPPER'S PAIN IS GOLD'S GAIN

The prices of major metals diverge strongly in moments of economic weakness and uncertainty such as we're experiencing today. While base metals, most notably copper, have waned amidst weak investment and a sluggish Chinese economy, precious metals like gold have traded at their strongest levels since the eurozone crisis as investors retreat into haven assets and central banks' prior tightening paths give way to renewed interest rate cuts.

Copper is typically best at embodying the narrative facing metals markets and today is no different. Prices are sitting at less than $2.60/lb, down 25% since mid-2018 despite continued global deficits and still-low exchange-listed inventories. We are lowering our base metals price forecasts and copper is now expected to average $2.75/lb in 2020 before finally rising to $3.00/lb in 2021. While the near-term doesn't look particularly strong for copper pricing, the longer-term promise of large supply deficits in the early 2020s remains a constant source of future upward price pressure to front-run those shortages (chart 6).

Gold is experiencing its brightest moment since the eurozone crisis and a bar of the stuff was fetching more than $1,500 per ounce this past month. Looser monetary policy has reduced the opportunity cost of holding non-yielding bullion while mounting political risks—from trade wars to Brexit to impeachment—are providing plenty of safe haven demand (chart 7). Silver is an interesting enigma in this market as prices are yanked skyward despite generally sour fundamentals, which are made worse if one is to factor for the manufacturing malaise weighing down the base metals. We believe that silver's current strength is entirely a result of spillover from gold's impressive rally. Given the gold market's considerably larger overall size, even small leakage from that pool can cause pronounced increases in silver prices and this likely accounts for much of silver's current strength.

Table 1

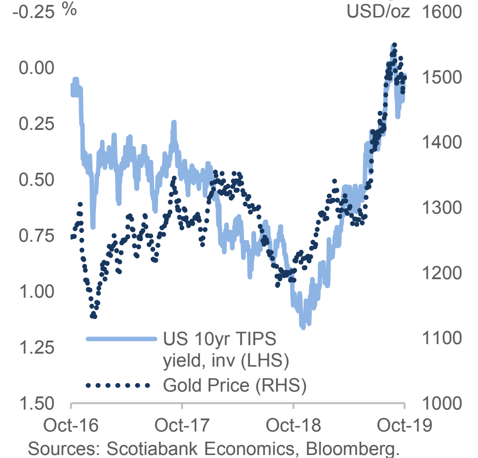
Commodities	2000–2018			Annual Average				
	Low	Avg.	High	2017	2018	2019f	2020f	2021f
WTI Oil (USD/bbl)	17	62	145	51	65	57	55	62
Brent Oil (USD/bbl)	18	65	146	55	72	64	59	65
WCS - WTI Discount* (USD/bbl)	-50	-17	-6	-13	-26	-13	-19	-24
Nymex Natural Gas (USD/mmbtu)	1.64	4.74	15.38	3.02	3.07	2.61	2.64	2.75
Copper (USD/lb)	0.60	2.41	4.60	2.80	2.96	2.70	2.75	3.00
Zinc (USD/lb)	0.33	0.87	2.10	1.31	1.33	1.15	1.08	1.05
Nickel (USD/lb)	2.00	7.06	24.58	4.72	5.95	6.50	7.50	8.00
Aluminium (USD/lb)	0.56	0.87	1.49	0.89	0.96	0.90	0.90	0.90
Iron Ore (USD/tonne)	39	101	194	72	70	90	72	65
Metallurgical Coal (USD/tonne)	39	135	330	187	206	184	150	150
Gold, London PM Fix (USD/oz)	256	910	1,895	1,257	1,268	1,400	1,550	1,475
Silver, London PM Fix (USD/oz)	4.07	14.85	48.70	17.05	15.71	16.50	18.75	17.75

* 2008–18 average.
Sources: Scotiabank Economics, Bloomberg.

Chart 6

Sources: Scotiabank Economics, Wood Mackenzie.

Chart 7



Sources: Scotiabank Economics, Bloomberg.

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