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GLOBAL ECONOMICS

COMMODITY NOTE

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Contributors

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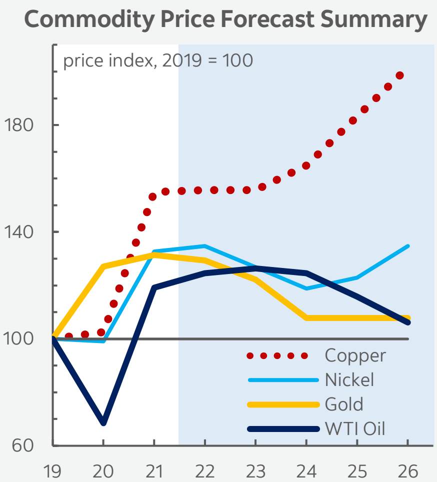
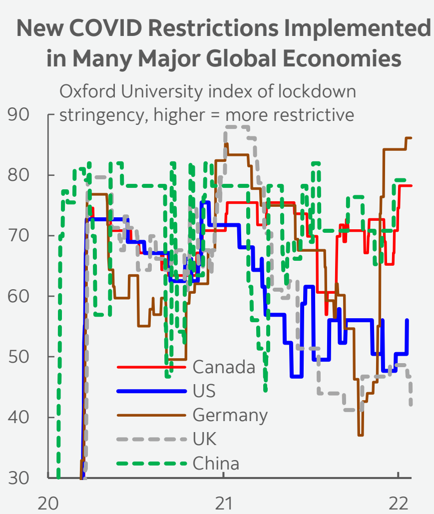
Chart 1



Sources: Scotiabank Economics, Scotiabank Global Banking & Markets, Bloomberg.

Chart 2



Sources: Scotiabank Economics, Oxford University.

Commodity Price Fundamentals Strong Despite Omicron

SUMMARY

- **Our January 19, 2022 economic projections assume: a significant but short-lived drag from the omicron variant, stronger inflation, and a monetary policy response; still, we expect commodity prices to remain elevated this year and next** (chart 1)**.**
- **We anticipate that crude values will remain well-supported above the 70 USD/bbl mark in the next several years, but ease from their current levels near 85 USD/bbl.**
- **We expect WCS's discount to WTI to hover between 14.50 and 15 USD/bbl in 2022, with new egress capacity offsetting rising production, still-recovering refinery activity, and more abundant heavy sour crude in the US Gulf Coast (USGC).**
- **Our copper price forecasts are unchanged—we still expect the red metal to fetch a record high 5 USD/lb by mid-decade—while we've raised our projections for nickel values higher in respect of late-2021 momentum.**
- **With US interest rate hikes now expected to come earlier and more frequently this year, we have lowered our gold and silver price forecasts incrementally.**

MORE RESTRICTIONS, MORE INFLATION, MORE RATE HIKES

We have updated our economic projections in two key ways: a) a more significant, though short-lived drag from omicron variant restrictions, b) stronger inflation globally. Stricter containment measures in many countries (chart 2) will bite in the first quarter of 2022, but we foresee a bounce-back in global growth in Q2—caseloads have peaked in many jurisdictions and restrictions have begun to ease. With capacity limitations across much of the world and our updated assessment of supply chain constraints' outsized impacts on inflation, we have also upped our forecasts for price growth, and penciled in a greater degree of persistence through 2023.

In light of those changes, Scotiabank Economics predicts more robust monetary policy responses across the world. Even with a Q1 slowdown, we now expect both the US Federal Reserve and the Bank of Canada to increase policy rates by 175 bp by the end of this year. This was our view before last week, when markets caught up with the latest central bank communications.

CRUDE FORECASTS RAISED, BUT PRICES TO EASE FROM CURRENT HEIGHTS

Our latest commodity price forecasts assume that crude values will remain well-supported in the next several years, but ease from their current levels near 85 USD/bbl. We expect WTI to average 71 USD/bbl this year and 72 USD/bbl in 2023; for Brent, we anticipate an annual average of 75 USD/bbl in both years. Upward revisions since our last set of projections reflect the degree of global market tightness that has lifted prices since October. They also incorporate our expectation that—eventually—the global economy will continue to recover as COVID-19 is brought under control, reopening proceeds, and supply chain issues ease. Our view that crude values will fall from current heights is based on the assumption that OPEC+ production increases will go ahead as planned, leading to an inventory build and pushing global supply above demand in H1-2022.

Yet, with such a strong first month of 2022 and two of the drivers of the recent spike in crude values likely to persist in the coming months, there is upside risk to our latest set of projections. For one, several reports have broken that some OPEC+ members have not been able to ramp production up to target rates. We expect Libyan crude output in particular to continue to be impacted by domestic political challenges; broadly, recent years' underinvestment amid a volatile price environment could contribute to declining spare capacity. Second, Russia-Ukraine tensions appear likely to persist for some time. This could continue to boost crude values directly if sanctions on Russia's oil industry disrupt supply, or indirectly if a spike in natural gas prices fuels more gas-to-oil substitution.

For WCS, we expect the discount to WTI to hover between 14.50 and 15 USD/bbl in 2022. This year, rising Canadian output and a high number of barrels in storage (chart 3) should contribute to looser market balances, and we begin 2022 with seasonally weak USGC refinery activity. As more OPEC+ barrels are pumped, that should also increase the availability of heavy sour crude in the USGC, thereby reducing Canadian barrels' recent competitive advantage. The good news is that we expect these forces to be roughly offset by new Canadian pipeline egress capacity in the form of the now operational Line 3 conduit. The completion of TMX—which we anticipate in H1-2023—should add further support over the longer-run.

INDUSTRIAL METALS OUTLOOK SOLID

We continue to anticipate that copper values will climb from an average of about 4.25 USD/lb towards a record level near 5 USD/lb by mid-decade. In the next couple of years, we expect the global recovery to keep values of the bellwether red metal strong, with supply disruptions via Latin American geopolitical developments likely to provide additional pricing support. Over the longer-run, we assume that strong demand growth will come via global decarbonization efforts—copper is expected to be a key input for battery production and climate infrastructure construction. With few new copper mines or major capacity expansions expected in the next few years—we assume production growth of just 1% per year from 2024 to 2026—weak supply growth (chart 4) should further contribute to price gains.

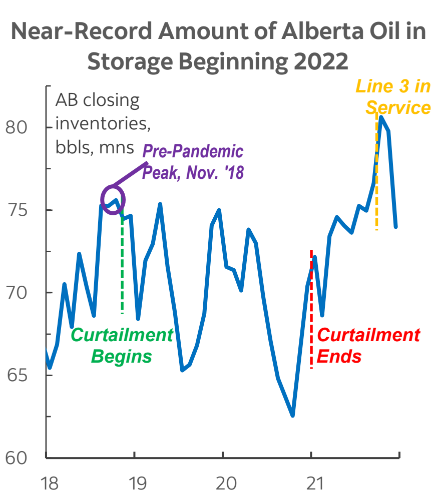
Since the last quarterly update in October 2021, we have increased our nickel price projections for 2022 and raised our long-run price assumption from 8 USD/lb to 8.50 USD/lb. Demand for stainless steel products—for which nickel is a key input product—drove a supply-demand deficit in 2021, but we still expect the metal's global market to be oversupplied for the next four years as Indonesian production ramps up.

For iron ore, we anticipate stability following a turbulent 2021. In the summer of last year, a combination of hefty gains in Chinese steel production—into which iron ore is a key ingredient—and tight supply out of Brazil drove prices to record highs near 230 USD/t. Second-half output curbs in the Middle Kingdom to meet emissions targets then anchored a plunge towards 90 USD/t. We anticipate virtually flat steel production out of China this year, with support from the infrastructure and manufacturing sectors ramping up after the Winter Olympic Games, though a more significant-than-expected real estate market correction presents downside risk for steel demand. Guidance from company statements also suggests that major iron ore producers will remain challenged in increasing shipments.

PRECIOUS METALS PROSPECTS STRONG DESPITE MORE AGGRESSIVE MONETARY POLICY

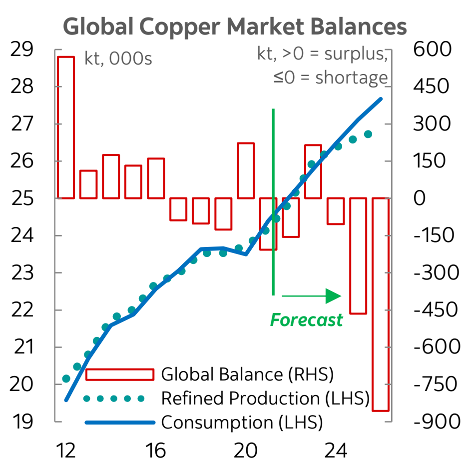
With interest rate hikes now expected to come earlier and more often this year, we have lowered our gold and silver price forecasts incrementally. For bullion, we now project an annual average of 1,800 USD/oz—$50/oz lower than previously—with silver's 2022 mean revised 0.50 USD/oz lower to 24.50 USD/oz. Despite the downgrade, our projection for gold in 2022 would still be the highest annual average price since at least 1988. Given the acceleration in inflation, the rate environment remains very accommodative despite our more hawkish shift—our forecast is consistent with negative real US 10-year rates through 2023 (chart 5). Market uncertainty should also remain elevated albeit easing as we continue to grapple with COVID-19, which supports the attractiveness of precious metals as safe haven assets.

Chart 3



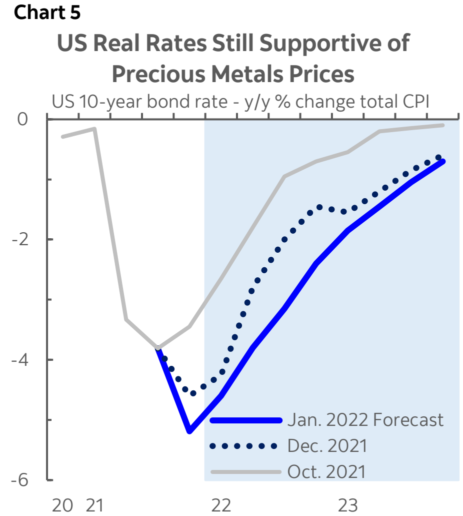
Sources: Scotiabank Economics, AER.

Chart 4



Sources: Scotiabank Economics, Scotiabank Global Banking and Markets.

Chart 5



Sources: Scotiabank Economics, Bloomberg.

Price Outlook

Oil & Gas		2010–2020 Low	2010–2020 Period Avg.	2010–2020 High	2020	2021F	2022F	2023F
Crude Oils								
West Texas Intermediate	USD/bbl	-38	69	114	39	68	71	72
North Sea Brent Blend	USD/bbl	19	77	127	43	70	75	75
WCS - WTI Discount	USD/bbl	-50	-17	-3	-12	-13	-15	-16
Natural Gas								
Nymex Henry Hub	USD/MMBtu	1.48	3.20	6.15	2.13	3.84	3.75	3.28
Metals & Minerals								
Base Metals								
Copper	USD/lb	1.96	3.04	4.60	2.80	4.23	4.25	4.25
Nickel	USD/lb	3.50	6.87	13.17	6.25	8.37	8.50	8.00
Zinc	USD/lb	0.66	1.03	1.64	1.03	1.36	1.50	1.40
Bulk Commodities								
Iron Ore	USD/t	39	101	194	110	160	115	100
Metallurgical Coal	USD/t	81	174	330	125	204	250	175
Precious Metals								
Gold	USD/toz	1,049	1,386	2,067	1,770	1,799	1,800	1,700