June 29, 2021

Commodities: Fundamentals Versus Fedspeak

SUMMARY

- **Incoming data continue to indicate that a strong economic rebound is progressing around the globe; we still expect inflation to ease towards its target rate as the year progresses.**
- **Hawkish Federal Reserve communications negatively impacted prices for many commodities this month.**
- **The steep climb across major crude benchmarks persisted in June as fundamentals strengthened; OPEC+ and Iran nuclear deal talks continue to hang over the market.**
- **Key industrial metals witnessed more moderate price gains in June than in May—copper values fell—but fundamental demand-supply drivers remain in place.**

ECONOMIC BACKDROP: FED TONE SHIFTS

Incoming data continue to indicate that a strong economic rebound is progressing around the globe. Statistics released in some nations for the period of the third wave suggest that momentum stalled in April and May; rising vaccination rates—particularly in Canada—bode well for a rebound, and reopening is underway in many jurisdictions. We still anticipate global growth north of 6% in 2021—that would represent the strongest expansion since at least 1980.

Canadian and US data for May showed the strongest inflation rate since the early 2000s; we still expect the supply side of the economy to rise enough in the coming months to ease the pace of price appreciation towards its target. Accordingly, we still believe that the Bank of Canada will lift its policy rate in Q3-2022 and that the Federal Reserve will likely begin tapering in January 2022 before raising interest rates in Q2-2023. In the interim, however, price surges via product shortages are possible. Relative US labour market weakness (chart 1) argues for extended monetary stimulus, though improvement on this front is likely.

Nonetheless, market participants clearly responded to inflationary signals and to the change in the tone of US Federal Reserve communications this month. That impacted prices of many commodities in our coverage universe.

GOLD PRICE TUMBLES AT MONTH'S END

Bullion was one casualty of hawkish Federal Reserve communications this month (chart 2, p.2)**.** One trading day after the latest FOMC minutes were released, gold prices fell by more than 80 USD/oz—the steepest one-day plunge since August of last year. The yellow metal's high level over the last year has been anchored by the US central bank's guidance that it would tolerate above-target inflation and keep rates low for the next several years. Neither policy plank was abandoned in the June FOMC minutes, but stronger inflation and growth projections and a tilt towards earlier rate hikes by some committee participants evidently had some gold buyers rethinking their expectations for US real rates.

CONTACTS

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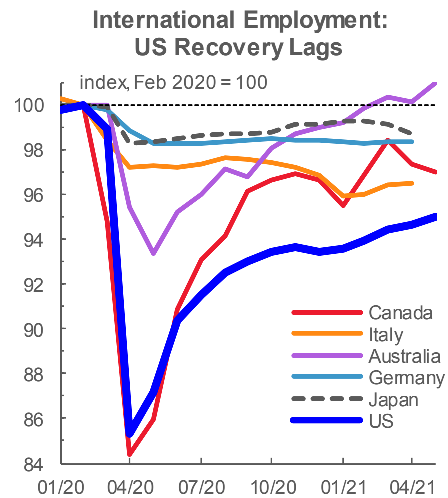
Chart 1



Sources: Scotiabank Economics, Statistics Canada, BLS, ISTAT, ABS, Bbk, MHLW.

Scotiabank Commodity Price Index

May 2021	(% change)		
	M/M	Y/Y	YTD
All Commodity*	**8.1**	**79.4**	**55.3**
Industrials	**8.9**	**85.7**	**59.8**
Oil & Gas	3.8	118.8	90.4
Metal & Minerals	6.7	36.6	25.8
Forest Products	16.2	142.1	88.7
Agriculture	**4.6**	**54.0**	**36.9**

January 2007 = 100	2021		
	May	Apr	YTD avg.
All Commodity	**165.6**	**153.2**	**147.9**
Industrials	**162.2**	**148.9**	**144.5**
Oil & Gas	103.9	100.1	99.7
Metal & Minerals	160.5	150.3	149.6
Forest Products	324.2	279.1	255.7
Agriculture	**184.5**	**176.4**	**166.8**

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

CRUDE'S BEST MONTH SINCE BEFORE THE PANDEMIC

The steep climb across major crude benchmarks persisted in June as fundamentals continued to strengthen. At the time of writing, WTI and Brent were both at their highest levels since late 2018 (chart 3), having breached the 70 USD/bbl mark and averaging roughly 50% higher to date this year than for all of 2020. In the US, refinery activity continued to rise last month, as did fuel consumption—including beleaguered jet fuel as reopening progressed and with travel activity's recovery underway. The supply side of the market is also contributing to tightness, with crude stocks in the week of June 18th at their lowest level since March 2020 and output still well below pre-pandemic levels.

In the near-term, crude values will no doubt respond to developments on two fronts. The first is the tenor of Iranian nuclear accord talks, agreement on which could bring significant new crude supply online. An apparent pause in discussions this month was followed by a spike in crude values; nuclear talk news drove similar volatility earlier this year. The second is the outcome of this week's OPEC+ talks. The bloc's production discipline to date has lent significant support to crude values; early indications are that its members will vote to ease quotas in respect of the stronger oil price environment.

WCS has followed the light benchmarks' leads, approaching the 60 USD/bbl mark this month. Against that backdrop, and with an assist from the late-2020 end of the provincial government's curtailment program that restricted production, output and drilling are up substantially in Alberta to date this year. A positive Minnesota Court of Appeals ruling on the Line 3 pipeline—critical to Western Canadian egress capacity in the medium-term—likely clears the way for the project to be completed late this year.

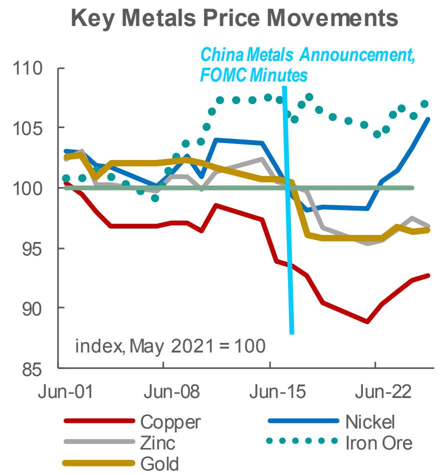
INDUSTRIAL METALS PRICES PAUSE, REMAIN WELL-SUPPORTED

Two forces drove the price of copper's fall from the record levels achieved in May. The first was the hawkish FOMC minutes, which bid up the US dollar and put downward pressure on values of all greenback-priced products. The second was Beijing's announcement that it would auction off some of its strategic reserves of key base metals in an effort to cool the torrid pace of recent price gains. That hit copper—perhaps the biggest beneficiary of improving risk appetite since the peak lockdown period—hard, but drops were witnessed across industrial and agricultural commodities. The red metal's forward curve shifted lower mid-month (chart 4). Still, copper prices remain very high relative to historical averages, and should stay supported by the global recovery this year and by battery demand plus limited output growth in the longer run.

Recent momentum in nickel and zinc prices also stalled in the second half of June. Values for both metals declined following the June 16th Federal Reserve communication, but have since rallied. Nickel in particular has seen strong gains over the past week on strong demand signals and some speculative activity.

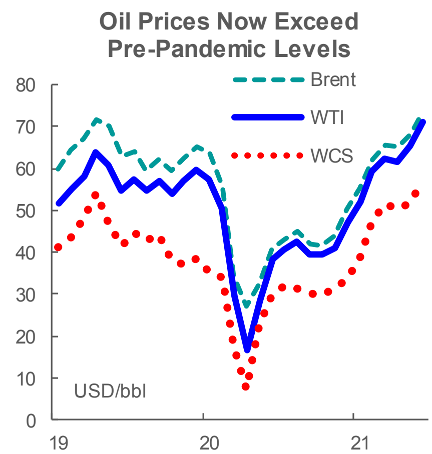
Though affected by many of the same factors as the other industrial metals, iron ore values continued to climb in June. Reports of record Chinese steel output lifted prices for iron ore—an important ingredient in steel production. Suspension of major mines—two in Brazil following a local evacuation order and one in China in response to flooding—may further tighten the market. As we near 2022, we expect a ramp-up in Latin American iron ore output and diminishing speculative activity to help narrow the gap between supply and demand and push prices down towards the 100 USD/t mark.

Chart 2



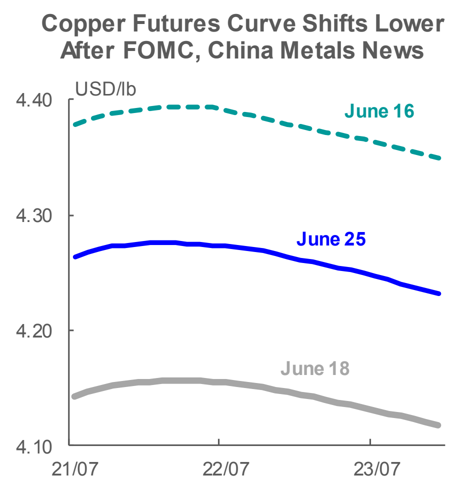
Sources: Scotiabank Economics, Bloomberg.

Chart 3



June 2021 value equal to June 1–25 average.
Sources: Scotiabank Economics, Bloomberg.

Chart 4



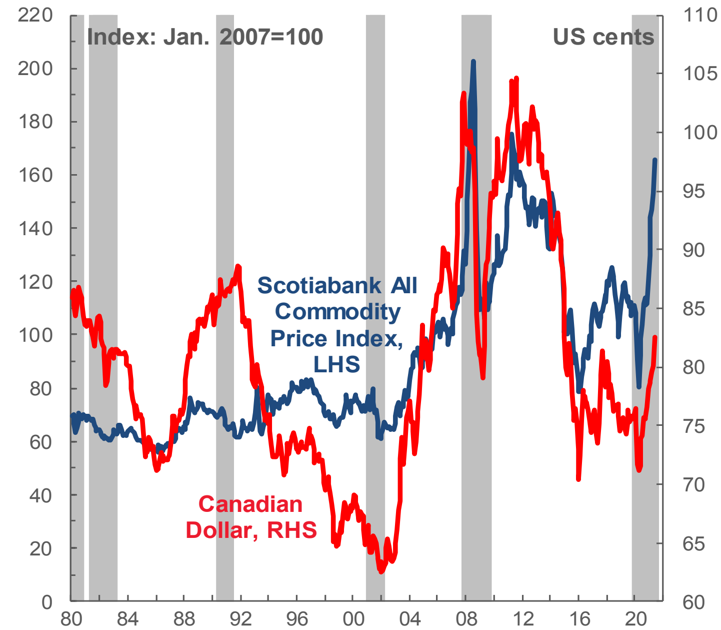
Sources: Scotiabank Economics, Bloomberg.

Price Outlook

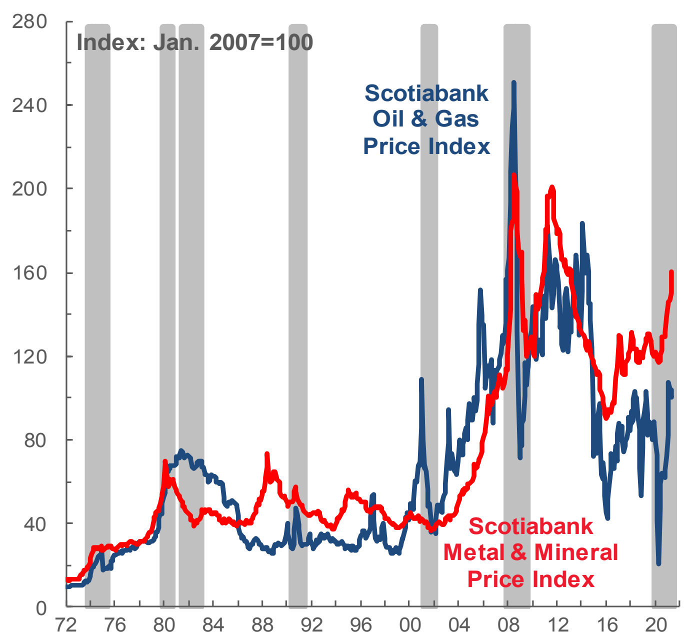
		2010–2020			2020	2021F	2022F
Oil & Gas		Low	Period Avg.	High			
Crude Oils							
West Texas Intermediate	USD/bbl	-38	69	114	39	59	62
North Sea Brent Blend	USD/bbl	19	77	127	43	62	65
WCS - WTI Discount	USD/bbl	-50	-17	-3	-12	-13	-15
Natural Gas							
Nymex Henry Hub	USD/MMBtu	1.48	3.20	6.15	2.13	2.85	2.70
Metals & Minerals							
Base Metals							
Copper	USD/lb	1.96	3.04	4.60	2.80	3.80	4.00
Nickel	USD/lb	3.50	6.87	13.17	6.25	7.50	7.25
Zinc	USD/lb	0.66	1.03	1.64	1.03	1.25	1.20
Bulk Commodities							
Iron Ore	USD/t	39	101	194	110	142	100
Metallurgical Coal	USD/t	81	174	330	125	125	140
Precious Metals							
Gold	USD/toz	1,049	1,386	2,067	1,770	1,837	1,850

Scotiabank All Commodity Price Index

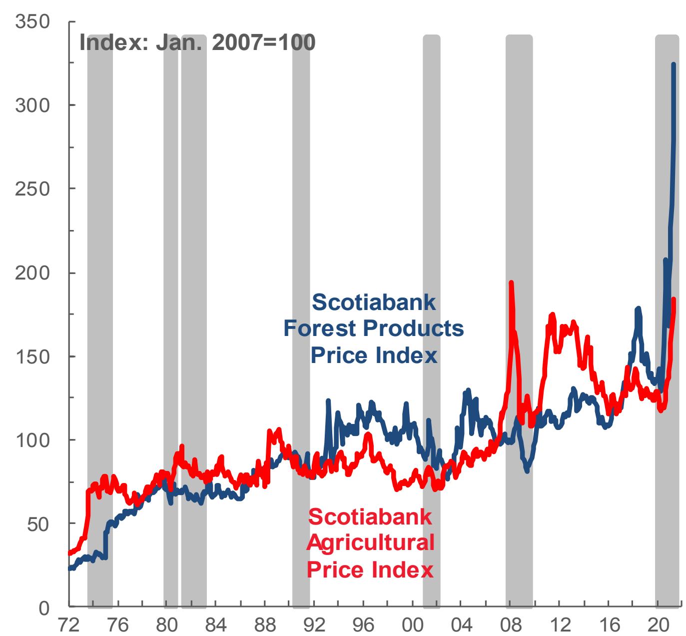
Canadian Dollar vs. Commodity Prices

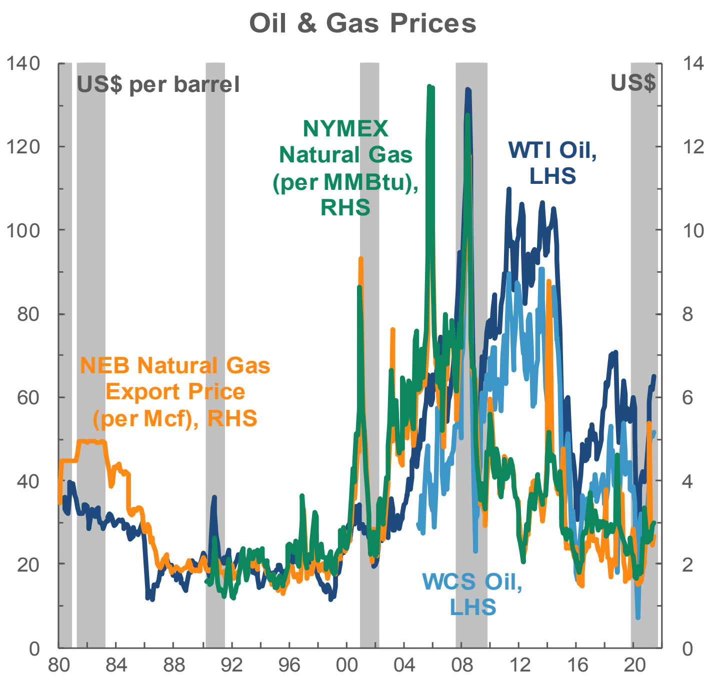


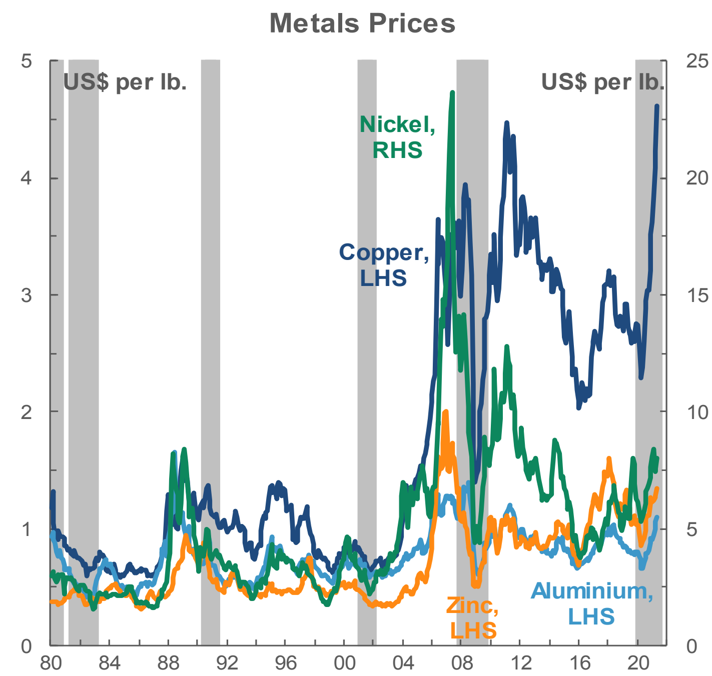
Scotiabank Oil & Gas and Metal & Mineral Indices

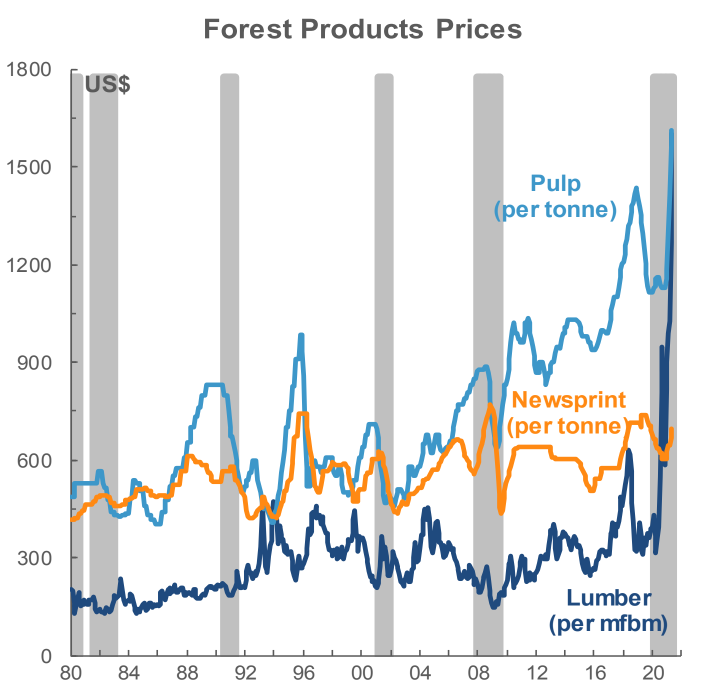


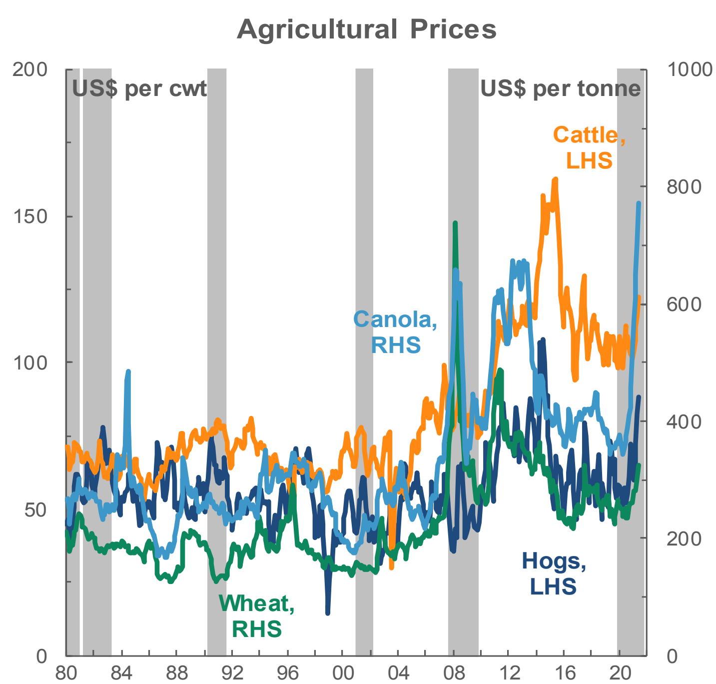
Scotiabank Forest Products & Agricultural Indices




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 20


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 20


Forest Products Prices
US$
Pulp (per tonne)
Newsprint (per tonne)
Lumber (per mfbm)
1800
1500
1200
900
600
300
0
80 84 88 92 96 00 04 08 12 16 20


Agricultural Prices
US$ per cwt
US$ per tonne
Cattle, LHS
Canola, RHS
Hogs, LHS
Wheat, RHS
200
150
100
50
0
1000
800
600
400
200
0
80 84 88 92 96 00 04 08 12 16 20

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), 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**