COMMODITY TRENDS

China's Appetite for Commodities Is Waning

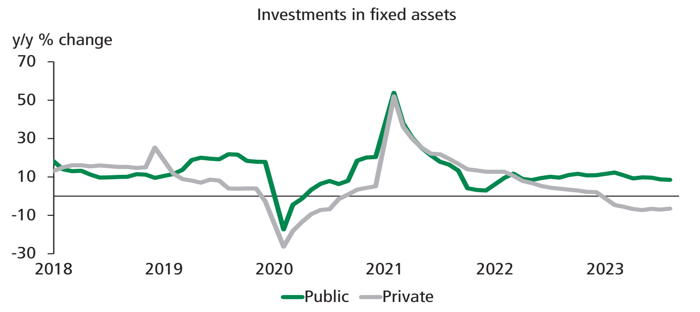
China's breakneck pace of industrialization and enormous population have turned it into the world's biggest consumer of commodities. The massive increase in its infrastructure spending in the early 2000s coincided with a commodity supercycle that sent prices soaring, especially for metals. But the situation in China has changed over the past few years and the limits to its investment- and debt-driven economic growth are becoming increasingly clear.

The first break with the status quo of recent decades was the trade war with the United States that started in 2018, leading the rest of the world to reconsider its investments in China. Since then, foreign investment in strategic industries like chip manufacturing has plummeted by around 65% according to the International Monetary Fund. The second break occurred when the property bubble burst after Evergrande, one of China's biggest property developers, defaulted on its debt in 2021. This crisis, along with the country's zero-COVID policy, shook both consumer and business confidence, significantly denting domestic demand. Meanwhile other problems such as a shrinking population and excessive local government debt have helped curtail Chinese growth.

Given the gloomy global environment and profound economic challenges, we expect China's real GDP growth to come in at 5.0% in 2023 and 4.3% in 2024, down from almost 10% a decade ago. The government introduced more stimulus measures and even trotted out its old standby, infrastructure spending, earlier this year. But that wasn't enough to coax private investors off the sidelines (graph 1).

Although this paradigm shift can be partly explained by the modernization of China's economy, which is recalibrating the country's growth to levels more typical of advanced markets, it's also a sign that the construction sector's seemingly endless expansion, driven by the infrastructure and housing sectors, is coming to a close. The central and local governments no longer have the same fiscal flexibility that they used to, and the big projects completed over the past few decades mean that most of China's needs have already been met. After all, there are only so many highways, railroads and ports a country can build. This means that growth in China's demand for commodities, especially metals, will slow over the medium term. It won't collapse, since the energy transition and the manufacturing sector will continue to fuel demand. Even the construction sector will eventually stabilize, but demand will moderate, especially as the population drops. These conditions should put less upward pressure on certain commodities like iron ore.

GRAPH 1
Private Investment Is Struggling to Recover



Sources: National Bureau of Statistics of China and Desjardins Economic Studies

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Jimmy Jean, Vice-President, Chief Economist and Strategist • Marc-Antoine Dumont, Economist • Florence Jean-Jacobs, Principal Economist
Desjardins Economic Studies: 514-281-2336 or 1-866-866-7000, ext. 5552336 • desjardins.economics@desjardins.com • desjardins.com/economics

Energy

A Tight Oil Market

FORECASTS

The decision by OPEC+ to extend its voluntary production cut will push the market into deficit until the end of 2023. Combined with relatively high demand in recent quarters due to the recovery of domestic travel and the boom in China's petrochemical industry, these extended supply cuts caused us to revise our year-end price target for West Texas Intermediate (WTI) up to US$80 per barrel. But the recent price rally won't last. Global oil consumption is expected to fall in Q4 2023 and Q1 2024, sending oil prices tumbling. Economic uncertainty and the determination of OPEC+ to keep prices above US$80 may nevertheless keep them from falling too far. Crude prices will likely start moving back up in the second half of 2024. As for natural gas, abundant US supply has kept prices low in North America compared to recent years, even though El Niño has sent temperatures climing. But prices are expected to inch back up to around US$4.00 per Million British Thermal Units (MMBTU) as winter sets in.

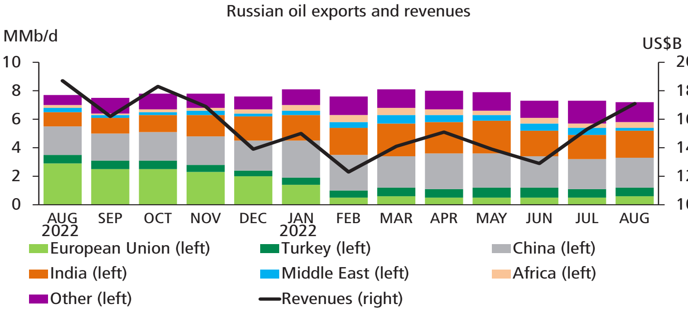
OIL

Saudi Arabia is extending its voluntary million-barrel-per-day (MMb/d) production cut until the end of the year. Russia followed suit with its 0.3 mbpd reduction in exports. Russian oil has found new markets, especially China and India (graph 2), since the European Union put it under embargo. But exports to both countries have dipped slightly since March as demand has faltered alongside global economic activity. On top of that, China's post-COVID economic recovery is quickly running out of steam, which should cool demand driven by transportation and petrochemicals. According to the International Energy Agency (IEA), OPEC+ production will go down by 1.8 MMb/d this year, mainly due to voluntary cuts, while the rest of the world's output will probably increase by 1.3 MMb/d. All this will most likely result in the oil market staying in deficit until the end of 2023 (graph 3). Although OPEC+ has the resources to prevent deficits expected to reach 1.5 MMb/d in the third quarter and 0.6 MMb/d in the fourth, it aims to keep prices between US$80 and US$90 per barrel. OPEC+ has achieved this goal for now, with the price of WTI hovering around US$90 per barrel (graph 4 on page 3). But this won't last, since the demand outlook suggests a downward price trajectory.

Approximately 90% of the contraction in demand, from peak to trough, will be from advanced economies, where high interest rates are biting the most. Furthermore, growth in Western demand for petroleum products is expected to weaken over the medium term as electric vehicles rise in popularity and people continue to work from home. As for emerging economies, recent developments in China may stunt growth. Although our forecasts for Chinese real GDP have been revised downward, there remains a risk of further deterioration, which would be an additional drag on demand.

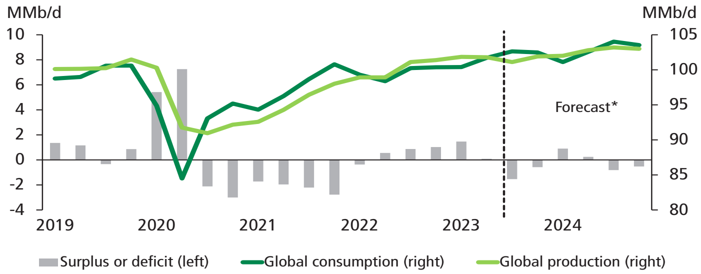
Despite this uncertainty, the Canadian oil industry is holding up pretty well, all things considered. Domestic production should reach an average of 5.8 MMb/d this year, up 1.5% from 2022. The opening of the new Trans Mountain pipeline from Alberta to the West Coast will expand transportation capacity, which will in turn create room for greater production next year. Canadian

GRAPH 2
Russian Oil Exports Are Holding Steady



MMb/d: Million barrels per day
Sources: International Energy Agency and Desjardins Economic Studies

GRAPH 3
The Oil Market Fell into Deficit Last Summer



* International Energy Agency (IEA) outlook assuming members adhere to the production agreement.
Sources: IEA and Desjardins Economic Studies

producers' profitability should also continue to get a boost in 2024 from the narrow spread between WTI and WCS, even though oil prices are expected to drop.

Meanwhile US producers are on track to ramp up output by 7.3% this year, up from 5.8% in 2022, according to the U.S. Energy Information Administration. But current economic conditions are inspiring caution among US producers, despite high prices. This is reflected in the active rig count, which is down 17.5% from its September 2022 peak. The increase in production is expected to fall to just 2.9% next year.

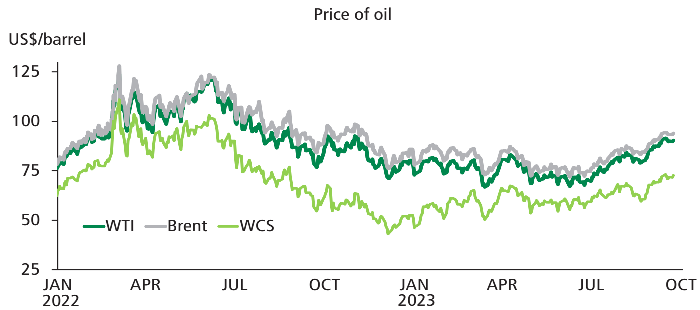
GASOLINE

The recent spike in crude prices looked a lot like the trajectory for gasoline prices in August (graph 5). The prices of both commodities should stay high for another few weeks, but will likely fall as demand dies down. Furthermore, supply chain disruptions have raised refinery margins, especially in Europe and Asia. That said, the expected contraction in demand will probably put downward pressure on gasoline prices.

NATURAL GAS

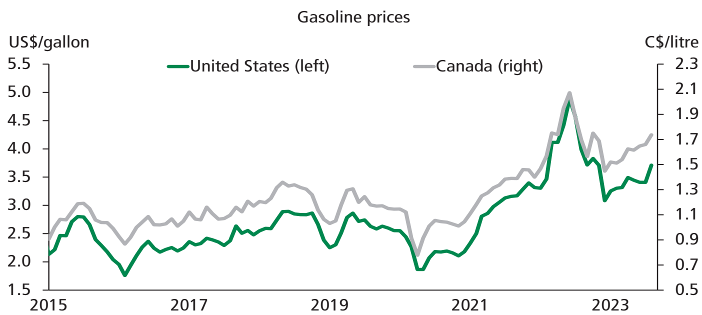
The North American price for Henry Hub natural gas has plunged about 25% since the start of the year (graph 6). This is because supply within North America is plentiful, while export capacity and demand are relatively constraint. But prices should start rising again in the next few months as winter drives demand for heating. In combination with new liquefied natural gas export terminals that are starting to come online, this should lift prices to approximately US$4/MMBTU. Meanwhile in Europe, fierce competition for exportable natural gas is also expected to fuel prices over the coming months. The increase in US exports should nevertheless keep prices from skyrocketing once more.

GRAPH 4
The WTI/WCS Spread Stayed Flat



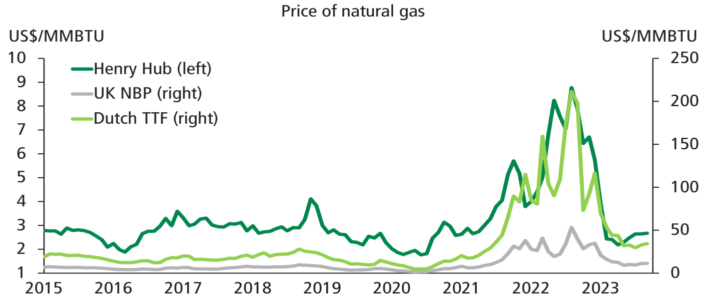
WTI: West Texas Intermediate; WCS: Western Canadian Select
Sources: Datastream, Bloomberg and Desjardins Economic Studies

GRAPH 5
Gasoline Prices Recently Spiked, but the Expected Drop in Demand Will Probably Drag Them Down



Sources: Datastream, Bloomberg and Desjardins Economic Studies

GRAPH 6
After Several Months of Declines, Natural Gas Prices Are Expected to Heat Up as Cooler Winter Temperatures Set In



MMBTU: Million British Thermal Units
Sources: Bloomberg and Desjardins Economic Studies

Base Metals

Some Industrial Metals Still Have Room to Fall

FORECASTS

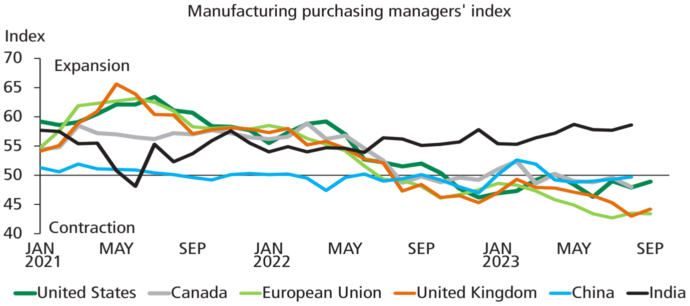
Industrial metal prices are expected to decline slightly by year-end as the global economic environment deteriorates and China's recovery stalls. The latest manufacturing PMIs show that manufacturing activity is flagging in most major economies, including the United States, the eurozone and China. But the expected pullback in prices won't erase all of the gains of recent years, and they should start going back up once growth returns in the second half of 2024. Overall, the demand outlook for metals still looks good over the medium term as decarbonization efforts intensify.

Manufacturing activity is on the decline in the eurozone as high energy prices and interest rate hikes have kept the PMI below 50 points since July 2022 (graph 7). Activity in this sector is also contracting in China as growth in domestic demand remains modest and global goods consumption wanes. Other emerging economies, such as India, are nevertheless proving more resilient in the face of worsening economic conditions. But they won't remain immune to the challenges plaguing advanced economies, which will likely start taking a toll on emerging market growth over the next few months. Additional factors are the recent jump in energy prices and appreciation of the US dollar, which limit the appeal of metals and drive up production costs. This means demand for base metals will likely stay sluggish for another few months, especially without any major Chinese stimulus measures. But conditions should improve once growth comes back into the picture in the second half of 2024.

ALUMINUM

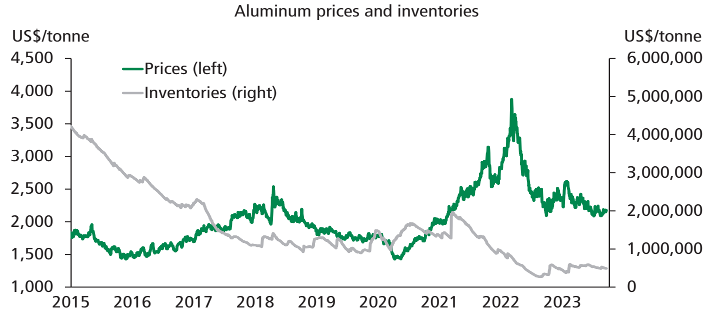
The price of aluminum has slid 14% since the year began and is currently hovering around US$2,175 per tonne (graph 8). Although the current economic environment suggests the price will slip even further, it shouldn't lose much more ground. However, the recent rise in energy prices has renewed fears over production costs. We'll also need to keep a close eye on whether China introduces new stimulus measures. Over the medium term, the outlook for aluminum is still bright, as decarbonization efforts and renewed economic growth will boost demand. With prices expected to average US$2,360 per tonne in 2024 and energy prices returning to normal, especially in Europe, aluminum production should rise next year.

GRAPH 7
Manufacturing Activity Is Contracting in Most Major Economies



Sources: Datastream, S&P Global and Desjardins Economic Studies

GRAPH 8
After Falling Early in the Year, the Price of Aluminum Has Stabilized

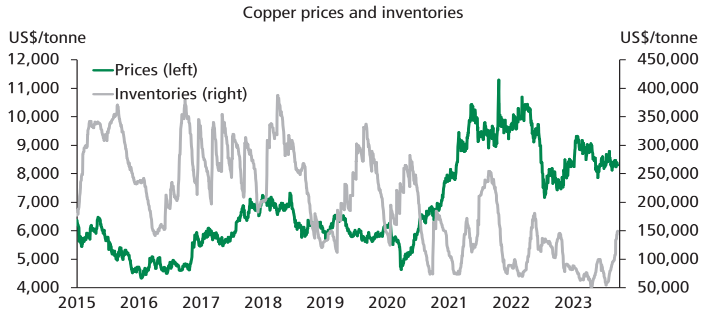


Sources: Datastream and Desjardins Economic Studies

COPPER

After starting the year above US$9,000 per tonne, the price of copper has retreated to around US$8,100 at the time of writing (graph 9). It's expected to fall even further, but not to the same extent. As for supply, global copper mining output rose around 2% in the first half of the year, as gains were limited by certain operational challenges in Indonesia, China and Chile. Speaking of operational problems, the labour disputes that disrupted production in Peruvian mines this summer have dissipated, allowing production to ramp up in August. As a result, copper supply got a boost while the economic climate cooled demand. That said, manufacturing activity is expected to rebound in 2024, which will likely drive demand back up and fuel price growth.

GRAPH 9
Abundant Supply Has Undermined Copper Prices

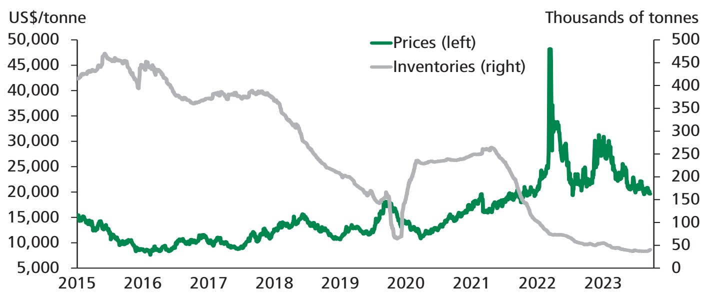


Sources: Datastream and Desjardins Economic Studies

NICKEL

Nickel has fared the worst of any industrial metal, plummeting 28% since the year began (graph 11). But last year's nickel prices were unusually high due to rampant speculation and high volatility. Prices are gradually normalizing, which is good news for a manufacturing sector faced with increasingly price-conscious consumers. Medium-term prospects are bright since, like aluminum and copper, nickel is critical to the energy transition. Conventional gasoline-powered vehicles don't need any nickel, but electric vehicles require 40 kilograms, mostly for batteries. Current conditions could nevertheless send nickel prices down even further, but we expect modest growth driven by higher demand in the second half of 2024.

GRAPH 10
Nickel Prices Have Continued to Drop alongside Industrial Demand



Sources: Datastream and Desjardins Economic Studies

IRON ORE

Iron prices have ticked higher in recent weeks as steel producers have pre-emptively stepped up production on fears that China may limit output. This has temporarily boosted iron imports to China. The price of iron should therefore start going back down once the economy begins weighing on demand (graph 12). Even with a return to growth in 2024, iron prices are only expected to stabilize around US$90 per tonne. Weaker Chinese demand for metals plus a return to more normal supply levels and energy prices should offset the positive impact of stronger global growth.

GRAPH 11
Iron Prices Climbed Due to Fears about Future Production Restrictions in China

Sources: Datastream and Desjardins Economic Studies

Precious Metals

The US Dollar Is Undermining Gold Prices

FORECASTS

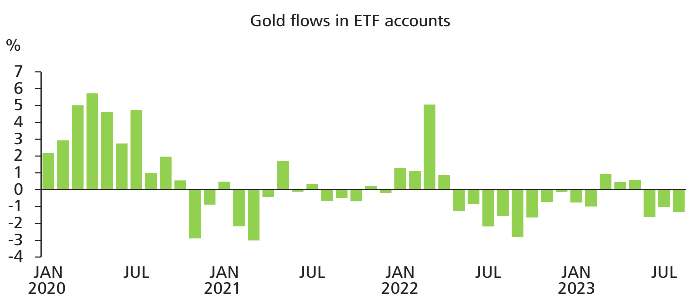
High bond yields and a strong greenback are exerting downward pressure on gold prices. But uncertainty is almost entirely negating their impact as investors seek out safe havens like gold. We therefore expect the price of gold to slip slightly over the coming months to end the year at around US$1,880 per ounce. But a sunnier economic climate in the second half of 2024 should put a major damper on gold prices.

GOLD & SILVER

Gold volumes in exchange-traded funds have edged downward for the third straight month, shedding 1.4% in August (graph 12). This selloff is in line with fading interest in gold as 10-year US bond yields moved above 4.3%. The strong US dollar also held back gold prices. But demand received some support from central banks, which are continuing to buy substantial volumes. All things considered, the price of gold has fallen slightly by 1.2% since the start of the year (graph 14). Over the very short term, gold prices should dip only a little as uncertainty pushes investors to seek safety.

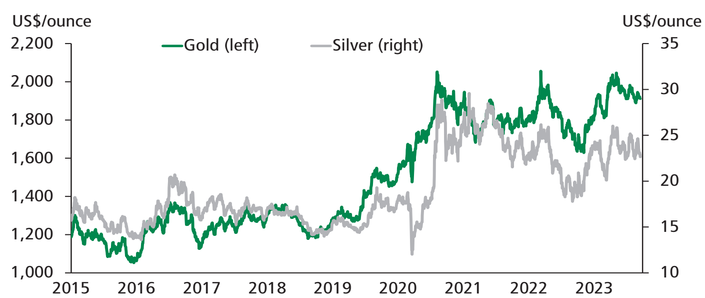
Meanwhile, as of this writing, the price of silver is down 6.5% year-to-date (graph 13). Since silver is used in electric vehicles, demand from this rapidly growing sector should keep its price relatively stable for the rest of the year.

GRAPH 12
Investors Moved to Bonds and the US Dollar and Away from Gold



Sources: Goldhub and Desjardins Economic Studies

GRAPH 13
Silver Prices Are Expected to Stabilize for the Rest of the Year

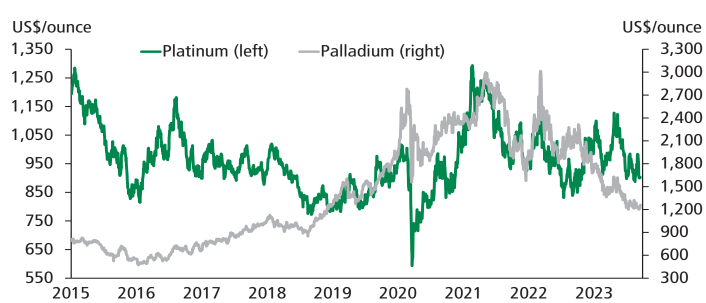


Sources: Datastream and Desjardins Economic Studies

PLATINUM & PALLADIUM

Plentiful supply has sent the price of platinum down around 20% from its May high (graph 14). South African mining production is expected to keep growing at a rapid clip for the rest of the year, taking an even bigger bite out of prices. Financial conditions, including high bond yields and a strong US dollar, are also likely to keep precious metal prices in check. Palladium supply is also abundant, but high prices may encourage manufacturers to replace it with platinum. Moreover, palladium isn't needed to produce electric vehicles, which should limit increases in demand.

GRAPH 14
Platinum Prices Have Rebounded Due in Large Part to Auto Production



Sources: Datastream and Desjardins Economic Studies

TABLE 1
Commodities

	SPOT PRICE	% CHANGE				LAST 52 WEEKS		
	September 27	1-month	3-month	6-month	1-year	High	Average	Low
Index								
Reuters/Jefferies CRB	284.7	2.3	9.6	8.5	7.1	290.3	272.0	253.8
Bloomberg Commodity Index	105.4	-0.1	4.1	1.6	-4.6	118.1	107.6	98.0
Bank of Canada	660.0	6.4	9.8	12.9	-4.3	690.6	623.1	584.0
Energy								
Brent oil (US$/barrel)	94.1	11.2	30.2	20.3	9.0	98.8	83.6	71.9
WTI oil (US$/barrel)	90.4	6.9	33.5	24.1	14.5	92.6	78.5	66.6
WCS oil (US$/barrel)	72.7	20.1	29.3	24.6	29.2	73.2	59.2	43.0
Gasoline (CAN$/litre)	1.66	-3.26	2.46	9.04	1.16	1.82	1.62	1.41
Gasoline (US$/gallon)	3.84	-0.8	7.4	12.2	3.4	3.91	3.57	3.09
Natural gas (US$/MMBTU)	2.66	4.6	-3.9	27.2	-60.1	7.31	3.53	1.99
Base metals								
LME Index	3,640	-1.2	-1.9	-9.3	5.4	4,404	3,851	3,453
Aluminum (US$/tonne)	2,204	4.3	2.2	-5.0	5.4	2,624	2,287	2,084
Copper (US$/tonne)	8,034	-3.4	-4.1	-10.2	8.2	9,331	8,436	7,422
Nickel (US$/tonne)	18,622	-9.7	-9.5	-21.3	-14.3	31,281	23,608	18,622
Zinc (US$/tonne)	2,487	4.9	4.6	-15.5	-13.5	3,508	2,782	2,230
Iron ore (US$/tonne)	118.7	2.1	3.4	-2.5	21.6	133.4	111.7	79.4
Precious metals								
Gold (US$/ounce)	1,904	0.0	-0.6	-2.8	16.5	2,047	1,877	1,628
Silver (US$/ounce)	23.0	-4.8	0.8	0.5	23.2	26.0	22.8	18.3
Platinum (US$/ounce)	906	-4.5	-2.1	-7.2	5.5	1,128	979	849
Palladium (US$/ounce)	1,213	-1.6	-7.8	-13.7	-42.0	2,315	1,563	1,200
Other commodities								
Wheat (US$/bushel)	5.89	-0.7	-14.0	-15.6	-32.5	9.38	7.07	5.56
Corn (US$/bushel)	4.48	-9.1	-23.9	-30.8	-30.5	6.79	6.08	4.09
Soybeans (US$/bushel)	12.65	-11.1	-13.3	-11.4	-7.8	15.81	14.29	12.56

CRB: Commodity Research Bureau; WTI: West Texas Intermediate; WCS: Western Canadian Select; MMBTU: Million British Thermal Units; LME: London Metal Exchange
NOTE: Commodity table based on previous day's close.

TABLE 2
Commodity prices: History and forecasts

ANNUAL AVERAGES	2021	2022	2023f	2024f
Energy				
WTI oil (US$/barrel)	68	95	79	82
Brent oil (US$/barrel)	99	99	83	85
WCS spread (US$/barrel)	54	75	63	70
Henry Hub natural gas (US$/MMBTU)	3.72	6.51	2.80	4.05
Base metals				
Aluminum (US$/tonne)	2,473	2,706	2,255	2,365
Copper (US$/tonne)	9,312	8,832	8,400	8,325
Nickel (US$/tonne)	18,460	26,263	22,590	21,550
Iron ore (US$/tonne)	159	120	112	96
Precious metals				
Gold (US$/ounce)	1,800	1,803	1,920	1,790

f: forecasts; WTI: West Texas Intermediate; WCS: Western Canadian Select; MMBTU: Million British Thermal Units
Sources: Datastream and Desjardins Economic Studies