Commodities Down Slightly in February Following Strong January Gains

- **Oil prices regained momentum after an early-February pullback and WTI remains higher than we had initially anticipated in Q1; price risk is now firmly to the upside of our 2018 forecast of $57/bbl WTI.**
- **Industrial metal prices were firm through the month as strong manufacturing activity offset waning investor interest and fresh inflows of copper into LME inventories.**
- **Scotiabank Economics also took a deeper dive into the Canadian oil patch and published notes on the impact of ongoing pipeline shortages in Western Canada as well as the vulnerability of the Canadian energy sector to a US-led NAFTA disruption.**

The Scotiabank Commodity Price Index slid 0.3% m/m in February following a 5.8% gain in January. The two largest drivers of this recent performance have been global oil market rally and the acutely depressed price of Canadian heavy crude, which is discussed more thoroughly below.

OIL & GAS: Q1 OIL PRICES REMAIN MORE ROBUST THAN EXPECTED

Oil prices have regained their upward momentum after falling back from a more than three-year high in late-January and forward curves remain firmly in backwardation for the year ahead (chart 1). Much of crude's recent sell-off was driven by soured sentiment following the sharp equity market sell-off in late-January/early-February as well as profit-taking by speculative investors who are beginning to withdraw from a record net-long position of more than 1.1 billion paper barrels. While some of this length was anticipated to remain sticky given the recent flip to backwardation, it was always likely that we would see some downward pressure from profit-taking that would need to be normalized before crude could make its next move higher. From a late-January high of $66/bbl, WTI prices bottomed around $59/bbl following the sharp stock market sell-off and associated risk-off sentiment shift before rising against to above $60/bbl today.

We believe that the risk is now clearly to the upside of our 2018 WTI forecast of $57/bbl given the crude complex's resilience in the face of what we view as the fundamentally weakest period of the year. Mild season supply surpluses in the first quarter were expected to weigh prices down to the mid-$50s, lower than the market has appeared willing to take prompt contracts. Fundamentals are only expected to get better from here and we anticipate net supply deficits for 2018 as a whole, supporting prices higher.

Beyond the view on shifting global supply and demand fundamentals, Scotiabank Economics took a deep dive into some Canadian-centric energy sector topics this past month.

First, we took a look at the pipeline capacity challenge in Western Canada in Pipeline Approval Delays: the Costs of Inaction. The report found that once again, Canada's oil patch finds itself with too much crude and too few pipelines, which continues to depress the value of Canadian crude relative to US and global

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Chart 1

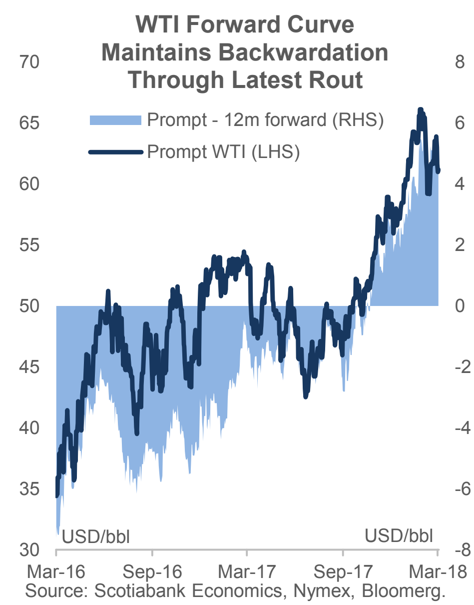


Table 1

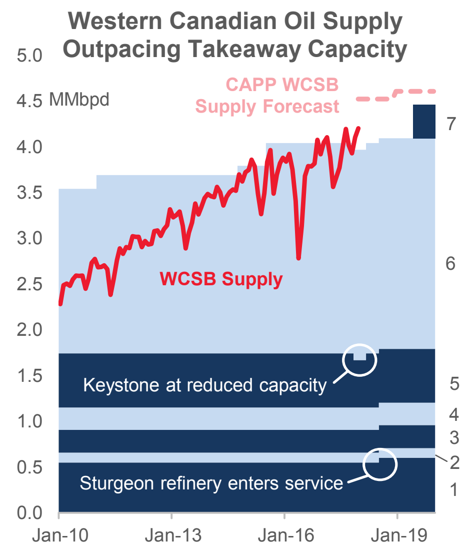
Scotiabank Commodity Price Index			
February 2018	(% change)		
	M/M	Y/Y	YTD
All Commodity*	**-0.3**	**6.0**	**7.2**
Industrials	**-0.8**	**5.5**	**7.0**
Oil & Gas	-3.9	0.4	1.8
Metal & Minerals	-0.2	1.4	3.0
Forest Products	3.4	23.4	25.5
Agriculture	**1.9**	**8.3**	**8.2**
	January 2007 = 100		
	2018		
	Feb	Jan	YTD avg.
All Commodity	**118.5**	**118.9**	**118.7**
Industrials	**115.1**	**116.0**	**115.5**
Oil & Gas	87.1	90.6	88.8
Metal & Minerals	131.7	131.9	131.8
Forest Products	157.4	152.3	154.9
Agriculture	**137.4**	**134.8**	**136.1**

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

benchmarks. While this capacity constraint was anticipated and Canadian crude discounts were forecast to rise in 2018, the mid-November service suspension on the Keystone pipeline hastened the arrival of this tightness and backed up millions of barrels of heavy crude into Albertan storage tanks, which are now holding the highest volume of oil on record. The Keystone outage sparked the latest blowout of Canadian crude oil differentials and the discount suffered by benchmark Western Canadian Select (WCS) rose from $13/bbl to more than $30/bbl by early February. While we anticipate that differentials will fall back to below $20/bbl as oil-by-rail services step in to fill the pipeline gap and that Line 3 will help alleviate some of the worst of this tightness (chart 2), we believe that it will require the construction of either the Trans Mountain Expansion (TMX) or Keystone XL (KXL) pipelines before discounts fall back to a level reflective of adequate takeaway capacity. The report concluded that Western Canada's pipeline deficit is costing the Canadian economy billions of dollars per year in foregone energy sector revenue; more than C$3.2 billion dollars since the Keystone outage in mid-November and upwards of C$10.8 billion for full-year 2018.

Second, we assessed the Canadian oil patch's vulnerability to NAFTA-related challenges amidst ongoing renegotiation headlines in NAFTA Disruptions: Possible Impact on the Canadian Energy Sector. In short, we believe that any US-led disruption in NAFTA would have a negligible impact on the Canadian energy sector. Even in a worst-case scenario where bilateral US-Canada energy trade moved to most favoured nation (MFN) rates, the impact on Canadian crude benchmarks would be limited to $0.21/bbl under a punitive decision relative to the roughly $28/bbl WCS is currently trading under WTI. Indeed, given the likely negative impacts on the value of the Canadian dollar, a US-led NAFTA withdrawal could have a mildly positive direct impact on the profitability of the Canadian oil patch in the short term.

Chart 2



1. W. Cdn Refineries
2. Rangeland/Milk River
3. Trans Mountain
4. Express
5. Keystone
6. Mainline
7. Line 3 (2H19 expected)

Source: Scotiabank Economics, NEB, CAPP, RBN.

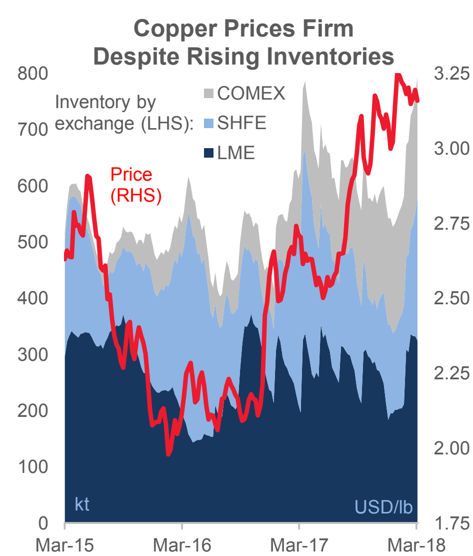
METALS & MINERALS: SYNCHRONIZED GROWTH AS TAILWIND, CHINA LOOMS

Industrial metals remained relatively firm through February, supported by robust manufacturing activity and a weaker dollar despite some recent inventory inflows and mildly waning investor interest. Most indicators continue to confirm the prevailing synchronized global economic acceleration macro narrative and both realized and anticipated metals demand is strengthening.

That said, China continues to be a downside risk for metals consumption, with the latest official PMI figures signaling a marked slowdown in manufacturing activity. Stronger manufacturing tied to a booming export market had been offsetting worries about fewer building completions and weaker grid investment, but there now appears to be fewer sources of upside hope for 2018 demand after last year's surprisingly robust showing. While end-demand may be suffering, global finished metal prices will continue to find support from Chinese environmental policies that limited the import of certain scrap metals, artificially inflating demand for metal refined outside the country.

Nickel posted the strongest February gains, with persistent spot market deficits, rising Chinese import demand, and EV-related sentiment overriding concerns about elevated inventories. Copper was less lucky and significant LME inventory inflows (when?) prompted profit-taking among speculators, putting the brakes on the a bull run that has taken the red metal from barely above $2/lb in late-2016 to healthily above $3/lb today. Chinese iron ore prices continued to benefit from Beijing's ongoing environmental crackdown, which has impacted both the production of domestic iron ore as well as the operation of lower-quality steel mills and increased to value of higher-grade ores.

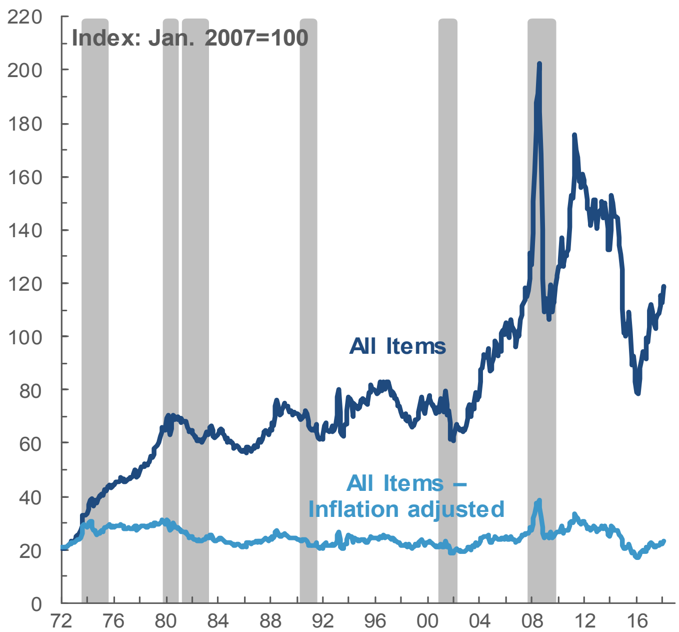
Chart 3



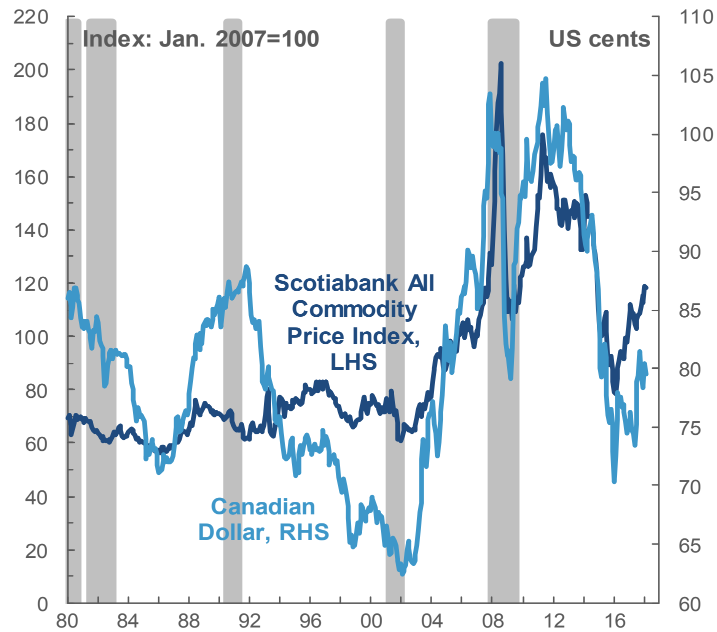
Sources: Scotiabank Economics, LME, SHFE, COMEX.

Price Outlook		2000–2016 Monthly Avg. Low	2000–2016 Period Avg.	2000–2016 Monthly Avg. High	2018YTD	2017	2018F	2019F
Oil & Gas								
Crude Oils								
West Texas Intermediate	USD/bbl	19.40	62.70	134.02	62.87	50.85	57	60
North Sea Brent Blend	USD/bbl	19.06	65.53	134.56	67.33	54.75	62	65
Natural Gas								
Nymex Henry Hub	USD/MMBtu	1.81	4.94	13.46	2.91	3.02	2.95	2.95
Metals & Minerals								
Base Metals								
Copper	USD/lb	0.62	2.35	4.48	3.19	2.80	3.05	3.25
Nickel	USD/lb	2.19	7.26	23.67	6.00	4.72	6.00	6.50
Zinc	USD/lb	0.34	0.81	2.00	1.58	1.31	1.60	1.60
Aluminium	USD/lb	0.58	0.86	1.39	1.00	0.89	0.95	1.00
Bulk Commodities								
Iron Ore	USD/t	27	108	302	77	72	60	60
Metallurgical Coal	USD/t	39	127	330	235	187	170	150
Precious Metals								
Gold	USD/toz	261	869	1,772	1,331	1,257	1,300	1,300

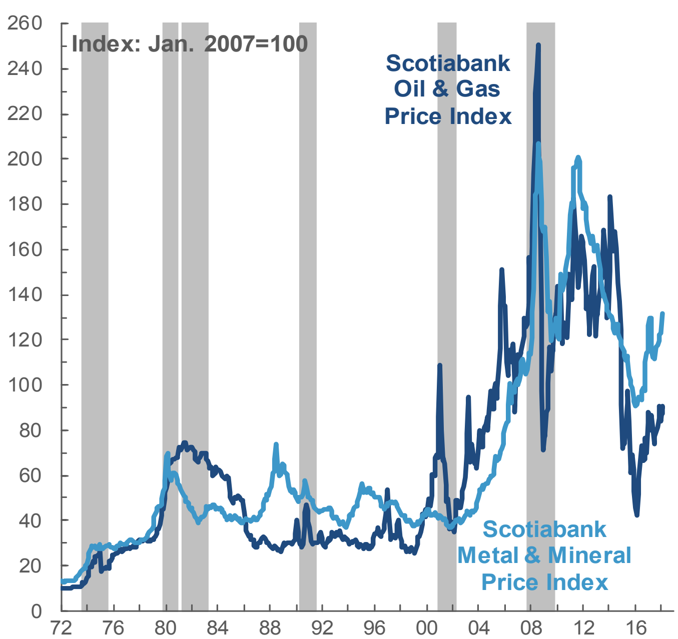
Scotiabank All Commodity Price Index



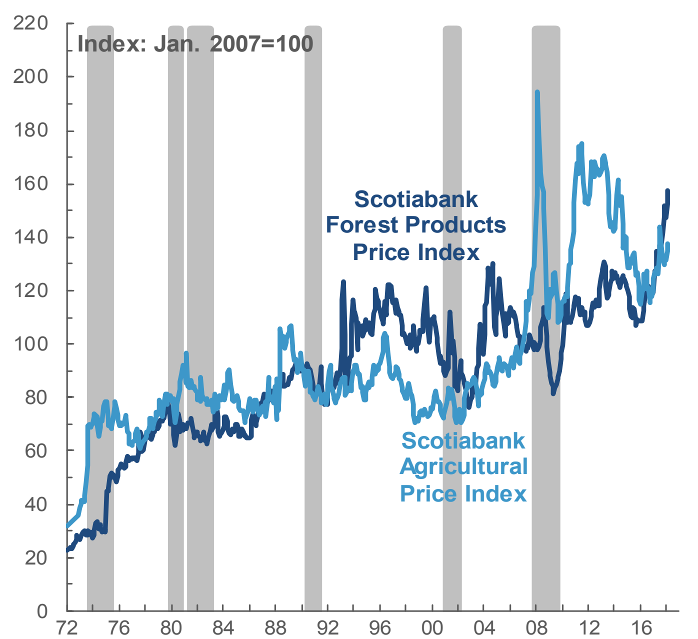
Canadian Dollar vs. Commodity Prices



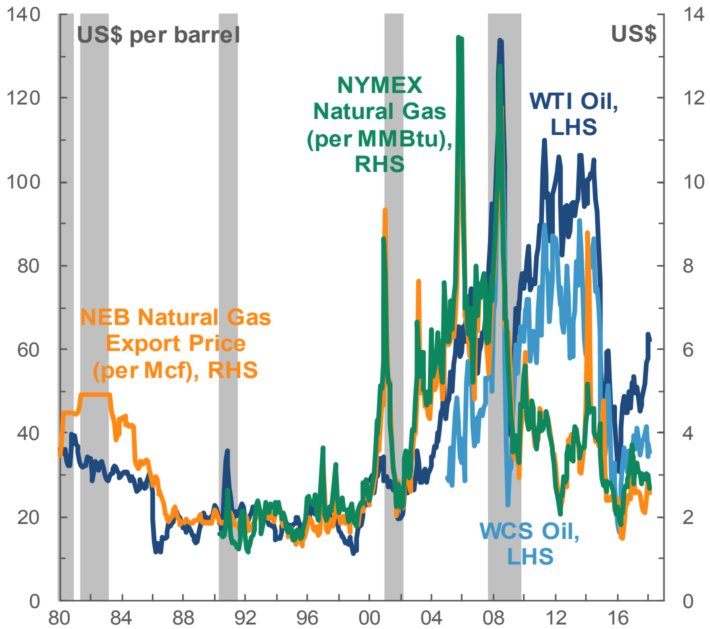
Scotiabank Oil & Gas and Metal & Mineral Indices



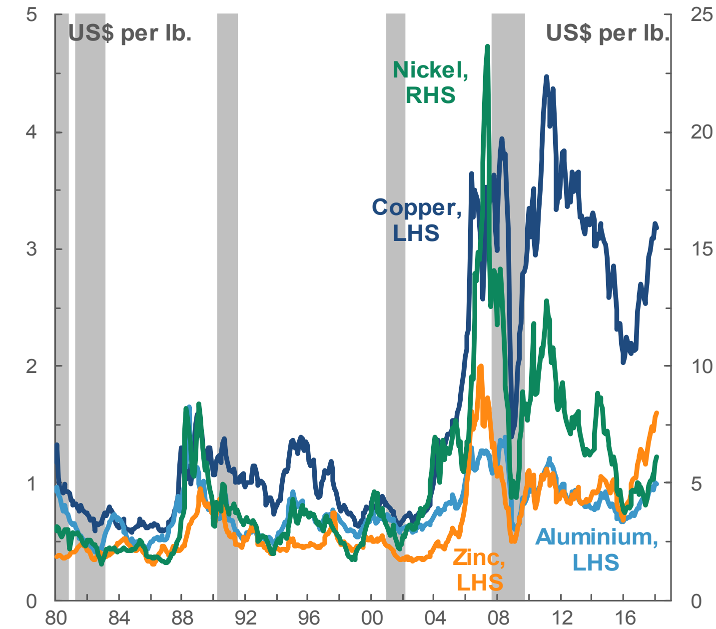
Scotiabank Forest Products & Agricultural Indices



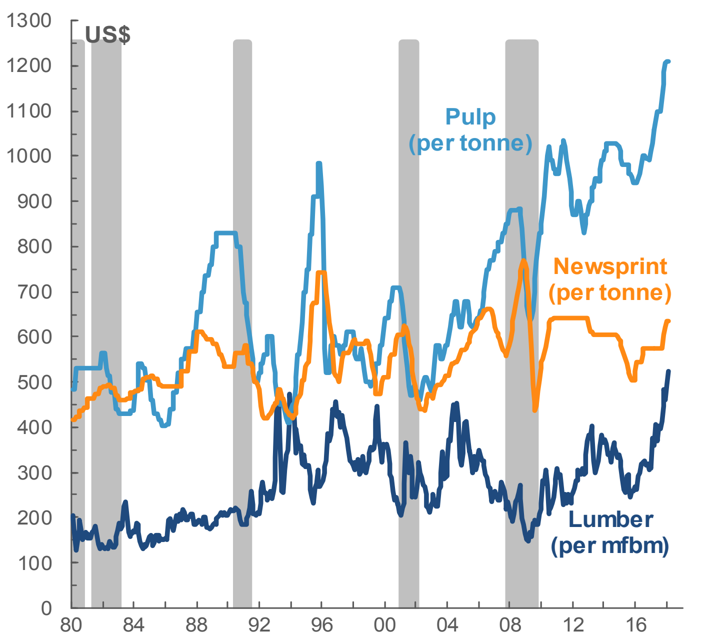
Oil & Gas Prices



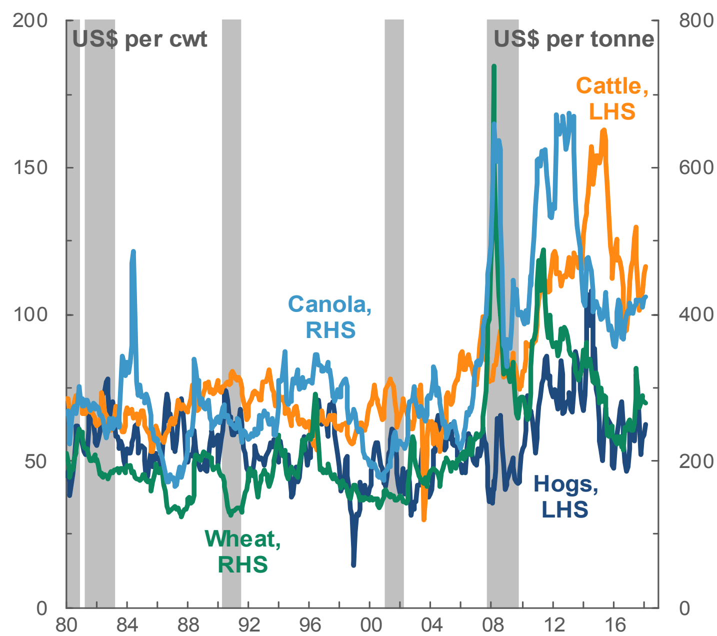
Metals Prices



Forest Products Prices



Agricultural Prices



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 TMX/Shorcan Energy Brokers.

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) Spot price for U3O8.

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, 48.8 gsm, 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), since Dec.1994, 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**