

Commodities Outlook (Q3 2019)

**Content reproduced from our recently released quarterly [Scotiabank's Global Outlook](#) (p. 43–45).

OUR SENTIMENT BUT FUNDAMENTALS POINT TO STEADY CONDITIONS

- The global economy remains fundamentally strong but trade war-induced uncertainty continues to weigh on investment activity and on market sentiment towards risk assets like commodities.
- We believe economic sentiment will improve in the second half of 2019 and a rationalization of overly bearish sentiment is expected to support the prices of industrial commodities like copper back toward levels justified by tightening fundamentals (chart 1).
- Oil prices are forecast to remain range-bound and anchored around \$55/bbl (WTI) through the end of 2020 on the back of mildly slower demand growth due to investment stifled by trade uncertainty, still-strong US shale growth, and continued OPEC+ production discipline.
- Most industrial metals are feeling the brunt of downside pressure from sour macro sentiment and prices are expected to rise toward levels more reflective of physical tightness through 2020, while iron ore markets are digesting material supply disruptions in Brazil and Australia and prices are expected to moderate over the next 18 months.
- Gold prices are forecast to remain elevated in 2H19 and trend back toward \$1300/oz by end-2020 as interest rate expectations normalize, leaving annual average prices at roughly \$1350/oz through 2019–20.

The global economy remains fundamentally strong yet uncertainty related to the now year-long trade war between the United States and China continues to weigh on investment activity and market sentiment. The mildly slower global economy has taken the wind out of demand expectations for industrial commodities while cuts from the US Federal Reserve are now forecast to provide a temporary boost to gold prices. The global economy is expected to gradually improve exiting 2020 and the prices of industrial metals like copper are forecast to grind higher on tightening balances and a reversal of bearish sentiment. Oil prices are expected to remain in the mid-\$50s through the end of 2020 as markets balance between shale growth and OPEC+ discipline before rising toward \$60/bbl.

OIL STEADY DESPITE VOLATILITY ON BOTH SIDES OF GLOBAL LEDGER

Oil has spent 2019 range bound between \$50–65/bbl (WTI) as markets bounced between macro concerns and acute supply disruptions. Bearish sentiment can be credited with keeping prices relatively steady despite historically acute sanctions-driven supply losses in Iran and Venezuela, not to mention ever-hotter tensions between the US and Iran most recently punctuated by the downing of a \$130 million US Airforce drone that would have in any other period dramatically spiked risk premiums. **Mildly slower demand growth due to investment stifled by trade uncertainty, still-strong US shale growth, and continued OPEC+ discipline are expected to keep balances in mild deficit (chart 2) and prices steady around current levels averaging roughly \$55/bbl through the end of 2020.**

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Chart 1

Oil and Base Metals Headed Higher Through End-2020 While Iron Ore and Gold Prices Moderate

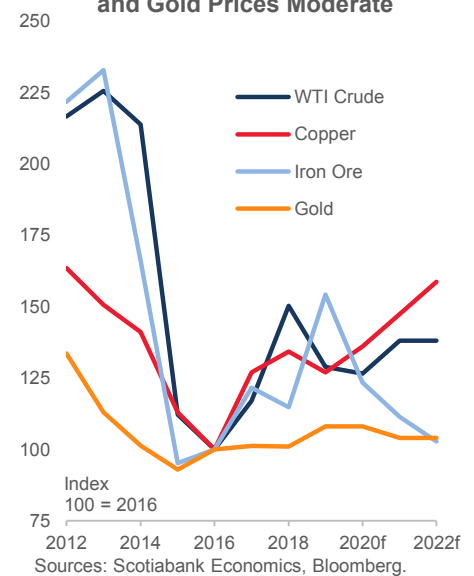
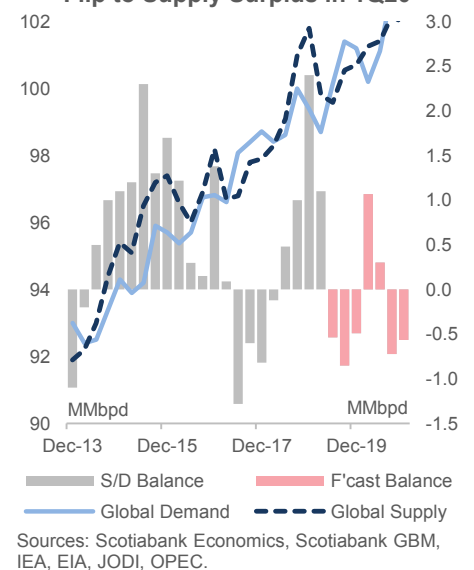


Chart 2

Oil Market Expected to Temporarily Flip to Supply Surplus in 1Q20



Global oil demand continues to advance but remains heavily dependent on India, where growth is returning, and China, where fuel demand—particularly diesel—has been slipping amidst a trade war-induced slowdown in investment and manufacturing and weighed heavily on overall demand growth in the first quarter of 2019. We expect that global demand growth will reaccelerate to 1.7 MMbpd y/y in 2H19 before moderating, keeping annual demand growth flat at 1.3 MMbpd in 2019–2020.

Global supply is expected to remain more-or-less flat on an annual basis through 2019, with strong US gains (+1.5 MMbpd) balanced by significant losses in OPEC supply due to both voluntary cuts (-0.9 MMbpd) and involuntary sanctions impacts (-1 MMbpd). Further OPEC+ discipline and sanctions-related hardship are expected to balance strong but decelerating US production growth through 2020, though shale supplies are likely to tip markets into mild surplus in early-2020. The US shale patch has marked the fastest pace of growth of any major oil basin in history at more than 2 MMbpd in 2018, though we expect that pace to begin easing in 2020 (+1.3 MMbpd) and continue slowing to less than 0.5 MMbpd by the early 2020s as rig counts and productivity plateau (chart 3). Other non-OPEC regions including Brazil are also expected to contribute additional output to 2020 balances, while Canada will add back heavy crude supplies as curtailment is lifted, differentials expand to support oil-by-rail investment, and Line 3 enters service in late-2020.

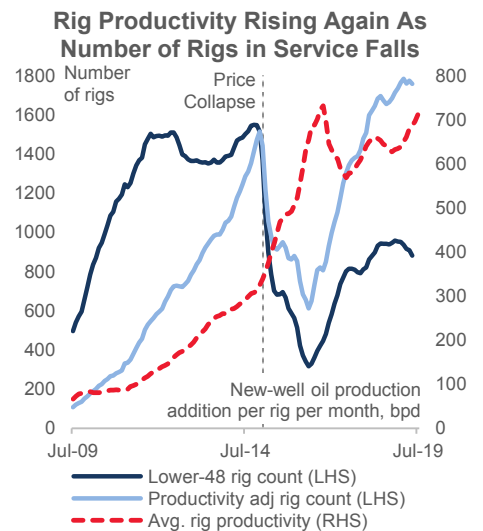
OPEC+ agreed to roll over its current output agreement to keep 1.2 MMbpd of oil off the market, now through the first quarter of 2020. The group mildly beat expectations of a 6-month extension, but a continuation of the group’s status quo was well-telegraphed and baked into market pricing. While the outcome of the meeting was unremarkable, the road taken to get there over the past month has been both interesting and revealing. Planning got off to a rocky start when members couldn’t agree on a date for the joint meetings, finally settling on a compromise of July 1st and 2nd. Yet the first official word of an agreement came before July’s meetings even began as Russian President Putin broke the news following bilateral talks with Saudi Arabia at the G20 meetings in Japan. So while OPEC remains an organization driven by consensus, most members are simply following the lead of OPEC+’s two dominant producers. And while some like Iran may not like it, they are exempt from the deal and have a common interest in maintaining some degree of oil price stability. OPEC production is expected to remain around current post-2014 low levels (chart 4).

METALS PRICES EXPECTED TO RISE AS MACRO SENTIMENT NORMALIZES

Metals like Dr. Copper have felt the brunt of the macro headwinds despite firming fundamentals, given base metals’ strong demand linkage to global economy activity and investment. Meanwhile, supply-side disruptions have roiled the otherwise-staid iron ore market and prices are back above five-year highs. We expect that base metals’ fortunes will reverse through 2020 and prices will rise back to levels more reflective of tight physical balances, while iron ore prices are expected to moderate.

The Chinese economy is reaccelerating as the Beijing’s stimulus efforts feed through and provide a boost to global materials demand. Chinese real estate prices are rising, the recent stimulus boost to housing starts is expected to revive weak building completions (chart 5) and maintain the current strengthening in appliance production, and the first-half collapse in Chinese auto sales looks to be finally turning the corner.

Chart 3



Sources: Scotiabank Economics, EIA, Baker Hughes.

Chart 4

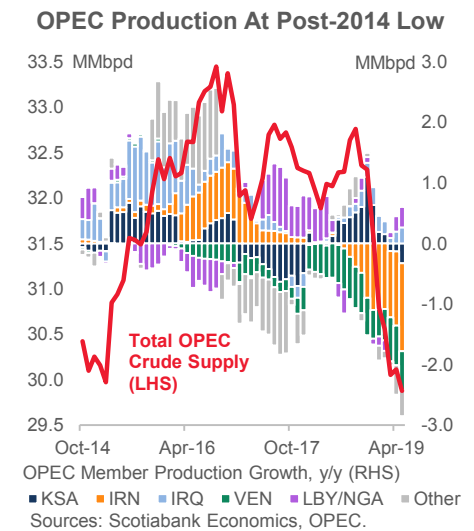
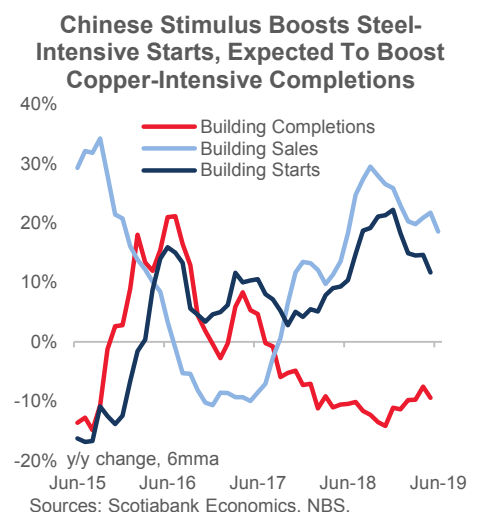


Chart 5



Iron ore prices (62% fines, N. China) reached a five-year high of more than \$125/t in early July on a combination of stronger-than-anticipated Chinese steel demand, supply losses stemming from a crackdown on Brazilian tailings dams, and terrible weather in both Brazil's north and along Australia's northwest coast that crimped exports (chart 6). Current global production losses are running at nearly 90 million tonnes against a total seaborne market of roughly 1.7 billion tonnes and ore inventories held at major Chinese ports are down more than 25% y/y to a three-year low. We believe there may be a few more months of upside for iron ore prices before demand begins to moderate on contracting Chinese steel mill margins—currently at their lowest level since 2016—and currently-idled iron ore mines are incentivized back onto the market to satisfy the gap, pushing prices back toward our long-term iron ore price target of \$60–70/t.

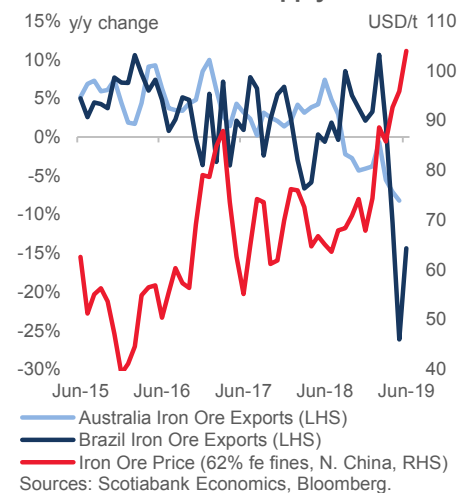
GOLD GAINS TO MODERATE AS MARKET TRIMS FED CUT EXPECTATIONS

Gold prices reached a six-year high of roughly \$1,420/oz in late-June on the back of increasing market confidence that the US Federal Reserve will cut interest rates later this year (chart 7). For the last six years gold has failed to sustainably breach the \$1,350/oz level, held back by tightening monetary conditions, a rising US dollar, and the apparent numbing of investor risk perception amidst a firehose of White House-related news flow. Conditions have recently shifted in gold's favour and bullion has skyrocketed, pushing past the \$1,350/oz six-year resistance level and then continuing as high as \$1,420/oz. While still far off the all-time highs of nearly \$2,000/oz reached in 2011 amidst the Eurozone crisis, the price of bullion expressed in Canadian dollar is flirting with a fresh record and is currently sitting just below C\$1,900/oz.

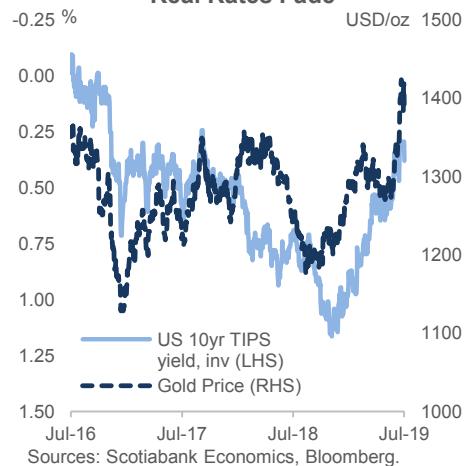
The price of bullion will continue to be driven by interest rates and the trajectory of the US dollar through the end of 2020. We believe that gold prices are artificially high due to exaggerated market pricing of aggressive cuts by the US Federal Reserve relative to our more modest expectations for only 75 basis points of cuts through end-2020. As rate expectations normalize, gold should falter slightly though remain higher than before the Fed paused and reversed its tightening path. Meanwhile, a secular decline in the value of the US dollar should provide steady tailwinds for pricing. We expect that gold prices will average roughly \$1400/oz in the second half of 2019 and begin gradually falling back toward \$1300/oz by end-2020, leaving annual average prices at roughly \$1350/oz in 2019–20.

Chart 6

Iron Ore Prices Rally Hard On Lost Seaborne Supply


Chart 7

Gold Races Higher as Real Rates Fade


Table 1

Commodities	2000–2017			Annual Average			
	Low	Avg.	High	2017	2018	2019f	2020f
WTI Oil (USD/bbl)	17	62	145	51	65	56	55
Brent Oil (USD/bbl)	18	65	146	55	72	65	62
WCS - WTI Discount* (USD/bbl)	-43	-16	-6	-13	-26	-14	-21
Nymex Natural Gas (USD/mmbtu)	1.64	4.83	15.38	3.02	3.07	2.71	2.75
Copper (USD/lb)	0.60	2.38	4.60	2.80	2.96	2.80	3.00
Zinc (USD/lb)	0.33	0.84	2.10	1.31	1.33	1.22	1.20
Nickel (USD/lb)	2.00	7.12	24.58	4.72	5.95	5.70	6.00
Aluminium (USD/lb)	0.56	0.87	1.49	0.89	0.96	0.90	0.90
Iron Ore (USD/tonne)	17	67	187	72	70	90	72
Metallurgical Coal (USD/tonne)	39	131	330	187	206	195	170
Gold, London PM Fix (USD/oz)	256	890	1,895	1,257	1,268	1,350	1,350
Silver, London PM Fix (USD/oz)	4.07	14.80	48.70	17.05	15.71	15.37	15.00

* 2008–16 average.

Sources: Scotiabank Economics, Bloomberg.

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