Commodities Slide through June on Trade Concerns

- **Commodity prices fell back through June and July on concerns that ongoing US-led trade disputes would spin out into a broader trade war and dent the world's demand for raw materials.**
- **This latest commodities rout was an attempt to front-run a perceived future danger (i.e. trade war) that, we believe, will ultimately be avoided as cooler heads prevail.**
- **Capricious macro sentiment that pushed copper prices to unsustainably high levels of $3.30/lb in early June had pulled copper contracts to unjustifiably low levels of $2.70/lb by mid-July. The rest of the metals complex has followed a similar pattern.**
- **Speculative sentiment in metals contracts has become overwhelmingly bearish, tipping near-term price risks to the upside as positioning normalizes from exaggerated levels.**
- **WTI rapidly closed the gap against Brent following news of an outage at Canada's Syncrude oil sands facility in late-June, tightening US mid-continent oil balances and temporarily pushing WTI contracts into acute backwardation just as supply conditions appeared to be easing throughout the rest of the world.**

The Scotiabank Commodity Price Index declined by 2.7% m/m in June as industrial commodities fell back on fears that a US-led trade dispute would dent global economic growth and depress the world's demand for raw materials. The LME index of six key industrial metals fell by nearly a fifth between early-June and mid-July in its steepest selloff since late-2011, and Brent crude time spreads have begun to indicate at least temporarily looser supply conditions (chart 1). **While the likelihood that creeping US protectionism spins out into a broader trade war has unfortunately moved from tail risk to plausible scenario, we believe that cooler heads will ultimately prevail, that the world economy will be spared the worst of mercantilism's potential casualties, and that commodity prices will rebound through summer's end.**

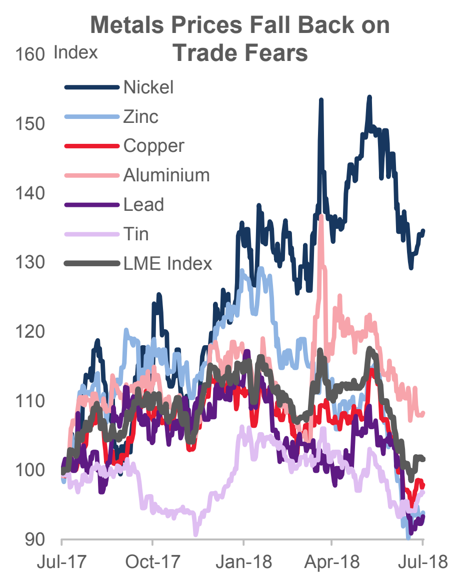
Sudden commodity routs like the one we just experienced are unnerving because their causality is inherently foggy. Bearish investors can interpret the selloff as a canary in the economic coal mine. The 20% drop in the value of Dr. Copper—so named for the red metal's propensity to track the global industrial cycle—in particular has market observers worried that the doctor's failing health is the first sign that our recent spell of strong global economic performance is coming off the rails. But while it is true that macroeconomic indicators have deteriorated slightly (albeit from unquestionably robust levels), **the selloff is better understood as an attempt to front-run a perceived future danger—i.e. tariffs depressing demand—rather than a response to realized present conditions.**

Indeed, much of the selling pressure came from the speculative side of the market as macro sentiment soured. Hedge funds and other asset managers reduced their

CONTACTS

Rory Johnston
416.862.3908
Scotiabank Economics
rory.johnston@scotiabank.com

Chart 1



Sources: Scotiabank Economics, LME, Bloomberg.

Table 1

Scotiabank Commodity Price Index

June 2018	(% change) M/M	Y/Y	YTD
All Commodity*	**-2.7**	**18.5**	**12.6**
Industrials	**-2.8**	**23.3**	**13.8**
Oil & Gas	-7.2	29.3	14.9
Metal & Minerals	-0.3	10.8	5.1
Forest Products	0.4	35.8	28.5
Agriculture	**-2.1**	**-0.8**	**7.2**

January 2007 = 100	2018 Jun	May	YTD avg.
All Commodity	**122.0**	**125.3**	**121.4**
Industrials	**120.0**	**123.5**	**118.6**
Oil & Gas	95.9	103.3	94.9
Metal & Minerals	123.2	123.6	126.8
Forest Products	178.8	178.1	166.0
Agriculture	**132.9**	**135.8**	**137.2**

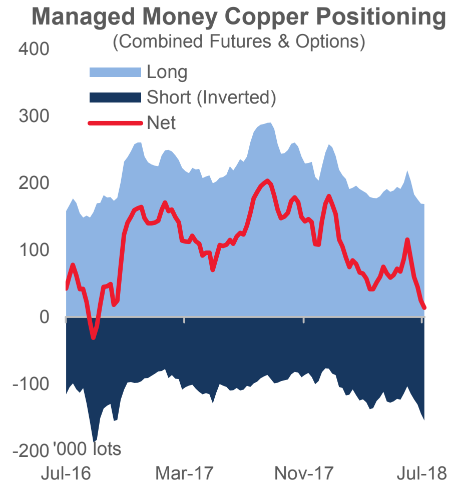
* Weights: Oil & Gas (39.9%), Metal & Minerals (30.1%), Forest Products (14.7%), Agriculture (15.3%); Full technical note on page 6.

net position in copper futures and options to the lowest level since 2016, unwinding the record-setting long position those same funds had built up only months earlier as a bet on a strengthening global economy (chart 2). **Capricious macro sentiment that pushed copper prices to unsustainably high levels of $3.30/lb in early June had pulled contracts to unjustifiably low levels of $2.70/lb by mid-July.** Today's exaggerated bearish sentiment in metals contracts tips the balance of near-term risks to the upside as those positions normalize, though the rapidity of the price movements highlights the sensitivity of current market disposition to news flow related to ongoing trade negotiations. Confirming this interpretation, the LME index bounced back following news that Trump and EC president Juncker had reached an agreement that brought the US-European trade file back from the precipice.

Despite the relief of a marginally warmer trans-Atlantic relationship, commodity prices are expected to more closely follow the evolving standoff across the Pacific where a tit-for-tat tariff exchange between the US and China continues to build. The Chinese economy, which consumes more than half of industrial metals tonnage per year, was already experiencing demand headwinds as Beijing's shift from stimulus toward a tighter monetary and fiscal stance weighed on the domestic construction sector. This deleveraging push brought Chinese credit stimulus in June to its lowest level since mid-2015 (chart 3) and weakened construction activity, but materials consumption received an offset in the form of stronger manufacturing demand for export to booming global markets. **Today's trade dispute with the US threatens to restrict access to those export markets and suppress demand for Chinese manufacturing, and we expect Beijing to at least temporarily pivot from its deleveraging priority to support the economy through looser credit conditions**. The People's Bank of China in mid-July injected a record US$74 billion through its medium-term lending facility in an effort to support domestic banks, complementing other moves to ease capital requirements and boost credit growth. Most of these funds will flow to traditional, materials-intensive sectors like infrastructure and real estate, which should both stabilize the domestic economy and support global metals demand.

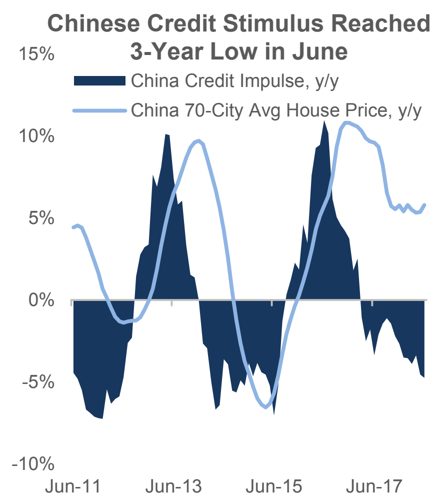
While crude oil fell in sympathy with losses through the rest of the industrial commodities space, the two main global oil prices—WTI in the US and Brent for much of the rest of the world—experienced a reversal of relative fortunes and the WTI-Brent spread pulled an abrupt about-face from more than $11/bbl to back below $5/bbl as of writing. WTI rapidly closed the gap against Brent following news of an outage at Canada's Syncrude oil sands facility, which was producing more than 300 kbpd of light synthetic crude before a power outage brought production to a halt in late-June. The loss of Canadian export barrels materially tightened US mid-continent oil balances and temporarily pushed WTI contracts into acute backwardation just as supply conditions appeared to be easing throughout the rest of the world (chart 4). Power and utilities have been restored at the Syncrude site but unplanned shutdowns as seen in this latest power outage can disrupt operations for months given the need to fix damage and purge product stranded in plant internals. Production is not expected to return to full capacity until mid-September, which should help keep WTI balances tight and the discount to Brent low.

Chart 2



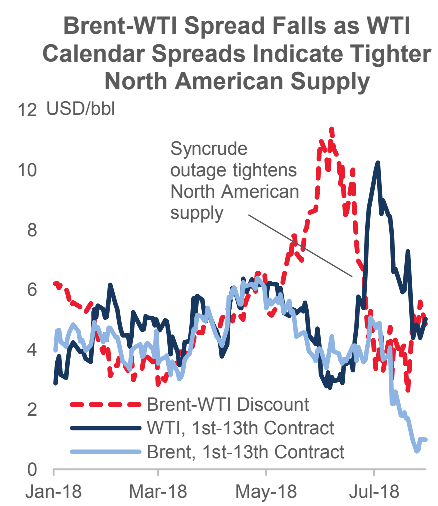
Sources: Scotiabank Economics, LME, CFTC.

Chart 3



Sources: Scotiabank Economics, NBS, Bloomberg.

Chart 4



Sources: Scotiabank Economics, Bloomberg.

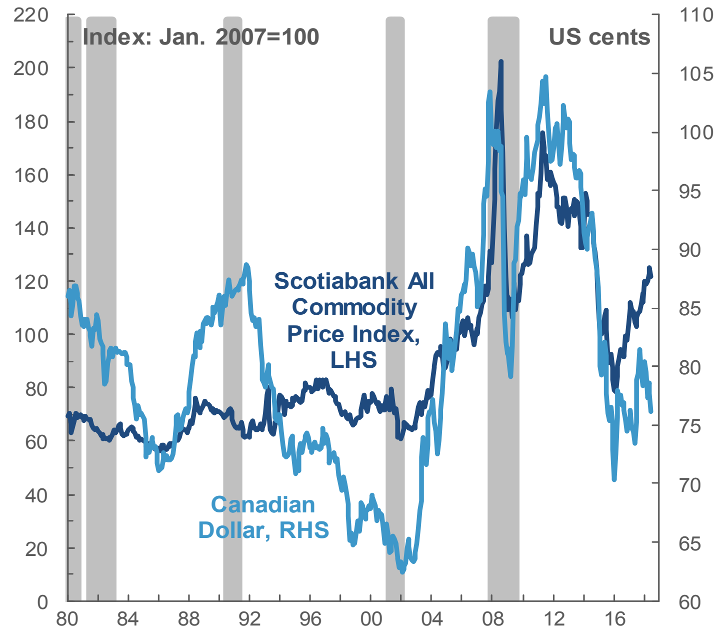
Price Outlook

Oil & Gas		2000–2016 Monthly Avg. Low	2000–2016 Period Avg.	2000–2016 Monthly Avg. High	2017	2018ytd	2018F	2019F
Crude Oils								
West Texas Intermediate	USD/bbl	19.40	62.70	134.02	50.85	66.18	68	71
North Sea Brent Blend	USD/bbl	19.06	65.53	134.56	54.75	71.70	74	77
WCS - WTI Discount*	USD/bbl	-42.50	-16.85	-5.50	-12.74	-21.89	-23	-23
Natural Gas								
Nymex Henry Hub	USD/MMBtu	1.81	4.94	13.46	3.02	2.83	2.93	2.90
Metals & Minerals								
Base Metals								
Copper	USD/lb	0.62	2.35	4.48	2.80	3.09	3.10	3.25
Nickel	USD/lb	2.19	7.26	23.67	4.72	6.29	6.50	7.00
Zinc	USD/lb	0.34	0.81	2.00	1.31	1.44	1.45	1.45
Aluminium	USD/lb	0.58	0.86	1.39	0.89	0.99	0.95	1.00
Bulk Commodities								
Iron Ore	USD/t	27	108	302	72	69	63	60
Metallurgical Coal	USD/t	39	127	330	188	206	190	160
Precious Metals								
Gold	USD/toz	261	869	1,772	1,257	1,307	1,311	1,300

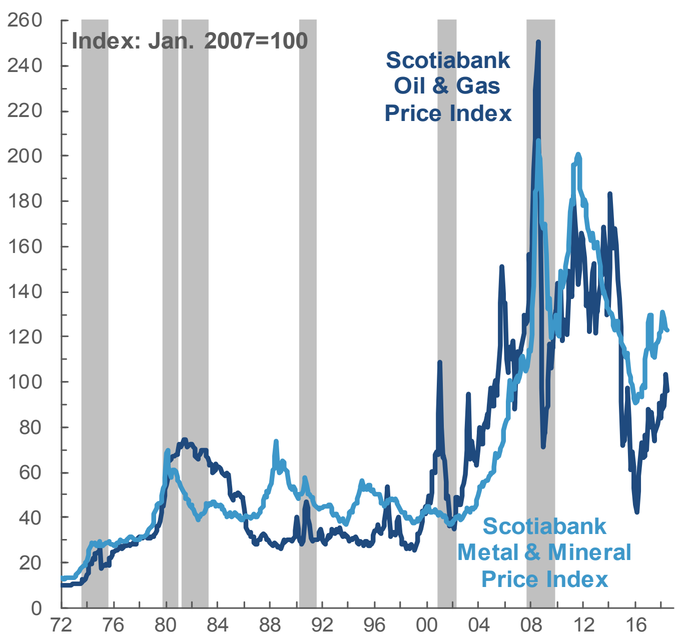
* 2008-16 average.

Scotiabank All Commodity Price Index

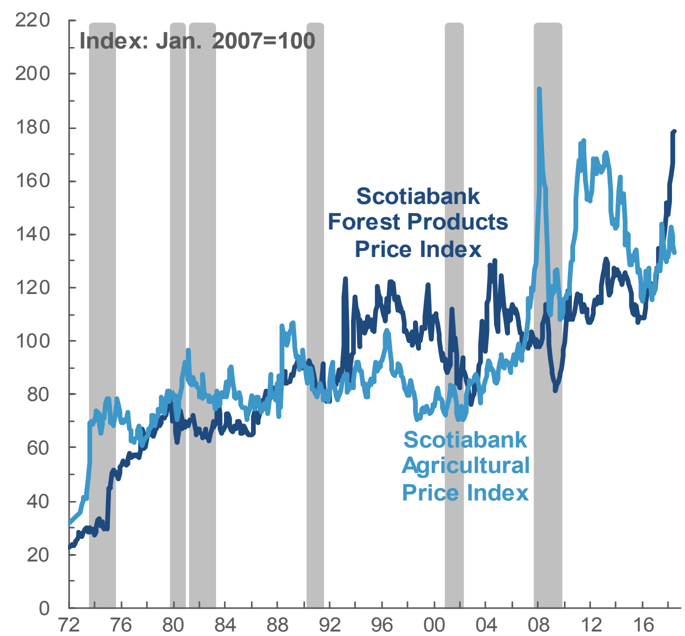
Canadian Dollar vs. Commodity Prices

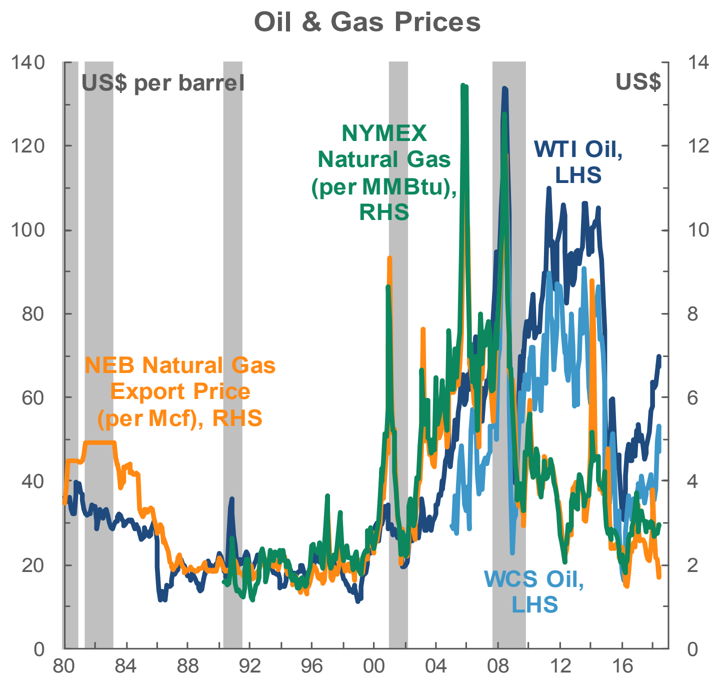


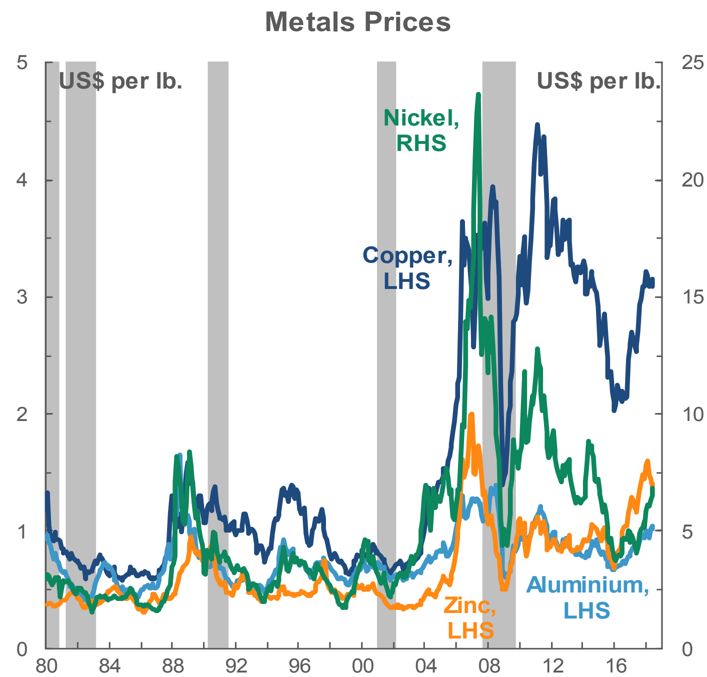
Scotiabank Oil & Gas and Metal & Mineral Indices

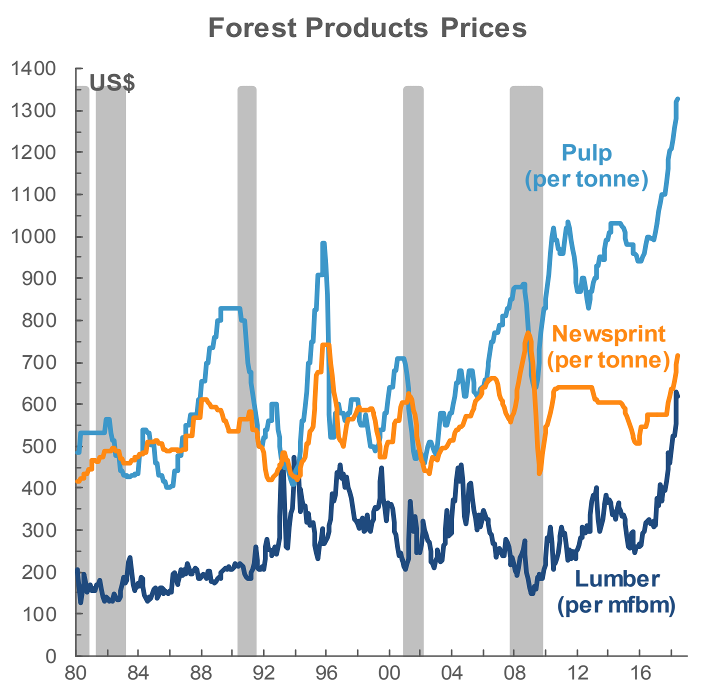


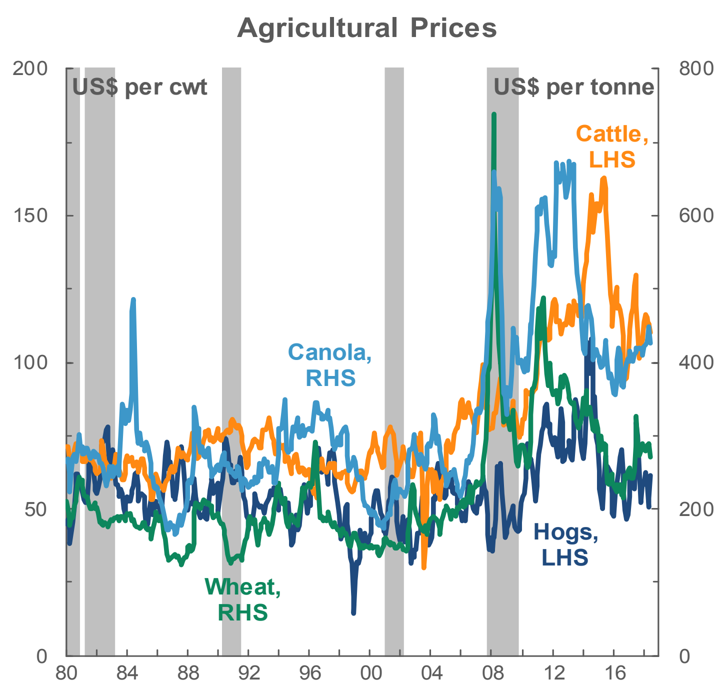
Scotiabank Forest Products & Agricultural Indices




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


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


Forest Products Prices
US$
Pulp (per tonne)
Newsprint (per tonne)
Lumber (per mfbm)
1400
1300
1200
1100
1000
900
800
700
600
500
400
300
200
100
0
80 84 88 92 96 00 04 08 12 16


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

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, 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**