June 28, 2019

OPEC+ Expected to Roll Over Oil Production Deal, Supply Risks Mount On Rising US-Iran Tension

- **We expect that OPEC+ will roll over its current supply deal through at least the end of 2019** when the producer group meets on July 1st and 2nd, though ministers will be making their decision while looking through a pea soup fog of uncertainty related to a trade-induced economic slowdown and supply losses from US sanctions. **OPEC production is at its lowest since before prices collapsed in 2014.**
- **Further US-Iran escalation represents a serious upside tail risk for oil prices through 2020**, though recent comments from President Trump reveal a reluctance to pursue military action at present, instead preferring to further pressure Tehran via economic sanctions on key Iranian industries and government officials.
- **The Federal Government announced on June 18 that it was approving the Trans Mountain Expansion (TMX) for the second time** following the Federal Court of Appeal's decision to overturn Ottawa's 2016 approval; construction may begin as soon as September, though we expect that TMX will enter service by late-2022 at the earliest.
- **Gold prices reached a six-year high** as the market continues to price in expectations that the US Federal Reserve will cut interest rates, reversing its prior tightening path.

Commodity markets continued to weaken through most of June on fears that demand growth will slow alongside a weakening global economy. We discussed the way we incorporate trade risks into our demand forecasts in last month's report, and we will be updating our major forecasts in our third quarter edition of Scotiabank's Global Outlook in early-July.

OPEC+ EXPECTED TO ROLL OVER CURRENT SUPPLY DEAL

We expect that OPEC+ will roll over its current supply deal through at least the end of 2019 when the producer group meets on July 1–2, though ministers will be making their decision while looking through a pea soup fog of uncertainty related to a trade-induced economic slowdown and the battering of members Iran and Venezuela by US sanctions. The latest forecast from the International Energy Agency indicates that while demand growth is expected to remain firm in 2020, non-OPEC supply will outpace demand and reduce the so-called "call on OPEC" (the volume required to balance the market) by more than 500 kbpd. OPEC production is already at the lowest level since before prices collapsed in 2014, when the cartel boosted output to fight for market share (chart 1).

OPEC ministers from both Iraq and Algeria have indicated to media that their base case expectation is for current production limits to roll over at this meeting. Russia, meanwhile, continues to hold the strongest hand to act as a spoiler in deliberations and has remained noncommittal, claiming that it is waiting to see how conditions evolve in the run-up to the meeting. This makes the

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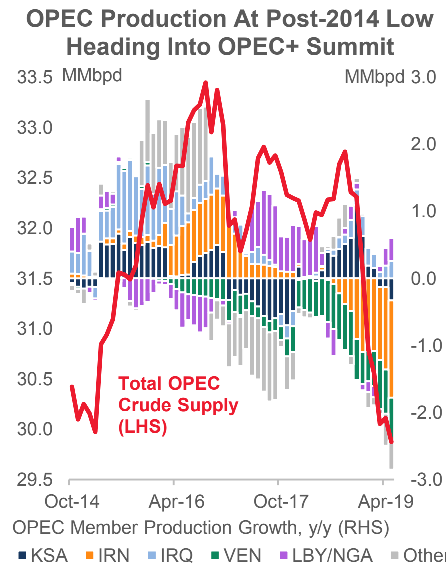
Chart 1



Sources: Scotiabank Economics, OPEC.

Scotiabank Commodity Price Index

May 2019	(% change)		
	M/M	Y/Y	YTD
All Commodity*	**-3.9**	**-8.2**	**-3.9**
Industrials	**-4.5**	**-8.4**	**-3.2**
Oil & Gas	-9.5	-9.8	0.7
Metal & Minerals	-0.4	3.4	-1.7
Forest Products	-2.3	-23.0	-11.7
Agriculture	**-0.8**	**-7.4**	**-7.5**

	January 2007 = 100		
	2019		
	May	Apr	YTD avg.
All Commodity	**115.0**	**119.7**	**116.5**
Industrials	**113.1**	**118.4**	**114.5**
Oil & Gas	93.2	103.0	95.4
Metal & Minerals	127.7	128.2	125.3
Forest Products	137.2	140.4	144.3
Agriculture	**125.8**	**126.7**	**127.7**

* Weights: Oil & Gas (39.9%), Metal & Minerals (30.1%), Forest Products (14.7%), Agriculture (15.3%); Full technical note on page 7.

outcome of the G20 meeting in Osaka, Japan especially important given likely bilateral side discussions between Russia and Saudi Arabia in addition to the Trump-Xi trade negotiations that will dominate macro sentiment following the summit.

TRUMP, IRAN, AND THE STRAIT OF HORMUZ

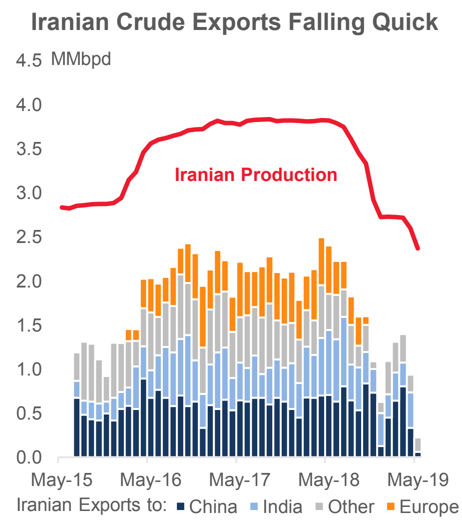
The White House's "maximum pressure" campaign against Iran has succeeded in depressing the country's oil exports—from more than 2 MMbpd in early 2018 to potentially as little as 0.3 MMbpd today (chart 2)—but Tehran isn't sitting idly by, instead ratcheting up hostilities in the region through both direct action as well as through regional proxies. Oil prices have risen by nearly $10/bbl over the past month as Gulf tensions flared and further escalation between Washington and Tehran now represents the key upside tail risk for oil prices through 2020. Iran has repeatedly threatened to disrupt traffic through the Strait of Hormuz, through which roughly one-fifth of the world's crude supplies traverse daily, and even minor sustained losses would provide tremendous upside price pressure—recall that the oversupply that tanked prices in late-2014 was equivalent to only one-tenth of the Strait's throughput.

US-Iran relations reached a recent low on June 20th when Tehran announced that it had shot down a large $130 million US surveillance drone, which Washington claims was operating over international waters while Iran holds that the drone had drifted into Iranian airspace. This follows Iranian- or Iranian-proxy-linked attacks on six tankers around the Gulf, drone attacks on two Saudi pipeline pumping stations, and missile attacks on both a Saudi airport as well as a power station. Media reports indicate that President Trump had planned to retaliate for the downed US done by striking a series of Iranian military targets like radar installations and missile batteries before abruptly calling off the operation. In press engagements following the aborted strike, the President cited the unmanned nature of the drone, the likelihood of Iranian casualties, and the potential that the order did not come from the top of Iran's government as reasons for his decision to abort the retaliatory strike.

While tensions continue to ramp, President Trump's hesitance to strike Iran confirms our prior belief that he does not relish the prospect of military confrontation, despite his hawkish rhetoric and liberal use of sanctions—a sign that should at least for now lessen the probability of a hotter conflict in the Gulf. Nevertheless, new sanctions continue to pile on and Iran called the latest bout of sanctions against Supreme Leader Ayatollah Ali Khamenei and other high ranking government officials a "permanent closure of the path of diplomacy".

Even absent direct confrontation, heightened tensions have increased the cost of insuring tankers making the voyage through the region. So-called war risk premiums charged by maritime insurance companies have risen nearly ten-fold to upwards of $500k, which would amount to a $0.25/bbl increase in the cost of transporting crude in a typical supertanker. And the ultimate grantor of naval security in the region is beginning to chafe at the responsibility, with President Trump tweeting that "we don't even need to be there [in the Strait of Hormuz]" given that "the U.S. has just become (by far) the largest producer of Energy anywhere in the world!". The President hinted that he believes that countries like China and Japan, which are more dependent on supplies travelling through the Strait, should shoulder more of the security burden. Japan's Chief Cabinet Secretary has said that defending sea lanes, particularly around the Strait of Hormuz, is a "matter of life and death for our country in terms of energy security."

Chart 2



Sources: Scotiabank Economics, OPEC, Bloomberg.

TRANS MOUNTAIN EXPANSION APPROVED, AGAIN

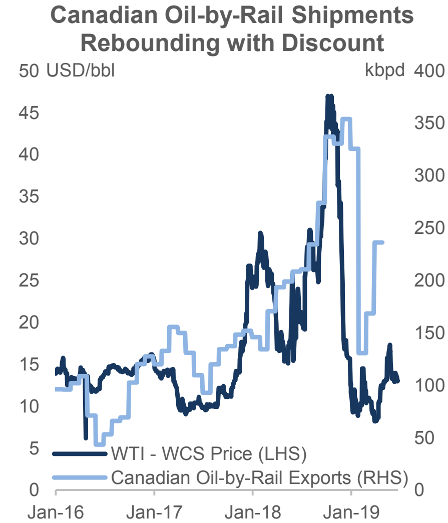
The Federal Government announced on June 18 that it was approving the Trans Mountain Expansion (TMX) for the second time following the Federal Court of Appeal's August 2018 decision to overturn Ottawa's 2016 approval given insufficient indigenous consultation and a lack of consideration for the impact of increased tanker traffic on marine life off the coast of British Columbia. (See our initial reaction to the approval announcement here.) The project, which involves twinning the 66-year old Trans Mountain pipeline, would add 590 kbpd of egress capacity to the bottlenecked oil-producing region and nearly triple the capacity of the existing pipeline. A lack of new pipeline capacity amidst rising production in Western Canada enflamed the discounts borne by Canadian heavy crude and pushed oil-by-rail shipments, which are a pricier but more flexible method of transporting oil, to all-time highs of more than 350 kbpd last December (chart 3).

The Federal Government purchased the legacy Trans Mountain pipeline and the TMX expansion plans from original owner Kinder Morgan in May 2018 for C$4.5 billion after the company suspended non-essential spending on the expansion amidst seemingly never-ending legal challenges. The expansion project was initially expected to cost C$7.4 billion but time is money and delays have pushed up the likely cost to an estimated C$9.3 billion according to the Parliamentary Budget Office. Public statements from Trans Mountain Corp., the crown corporation tasked with building the pipeline, indicate that construction could begin as soon as September absent any additional regulatory or legal challenges and that construction would take 30–34 months. **We expect that TMX will enter service by late-2022 at the earliest**.

GOLD PRICES RALLY AS MARKET PRICES IN FED CUT

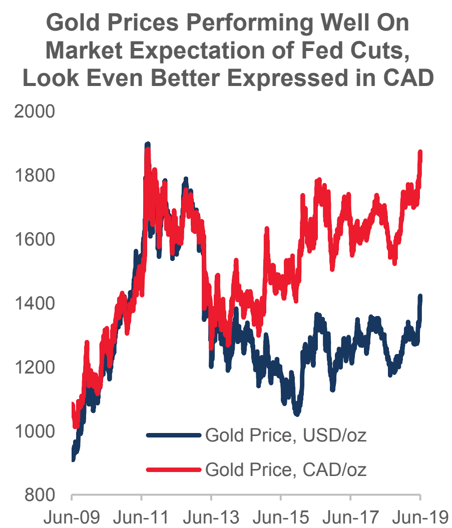
Gold prices reached a six-year high of roughly $1,420/oz in late-June on the back of increasing market confidence that the US Federal Reserve will cut interest rates later this year. For the last six years gold has failed to sustainably breach the $1,350/oz level, held back by tightening monetary conditions, 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 a far way 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 (chart 4).**

Chart 3



Sources: Scotiabank Economics, NEB, Bloomberg.

Chart 4



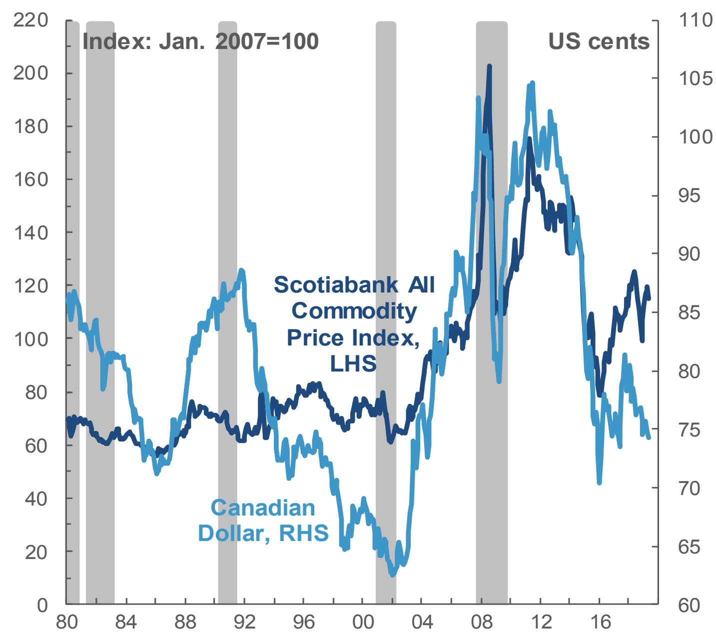
Sources: Scotiabank Economics, Bloomberg.

Price Outlook		2000–2017			2018	2019ytd	2019F	2020F
		Low	Period Avg.	High				
Oil & Gas								
Crude Oils								
West Texas Intermediate	USD/bbl	17.45	62.05	145.29	64.90	57.42	59	61
North Sea Brent Blend	USD/bbl	17.68	64.93	146.08	71.69	66.16	67	68
WCS - WTI Discount*	USD/bbl	-42.50	-16.43	-5.50	-26.29	-11.49	-15	-21
Natural Gas								
Nymex Henry Hub	USD/MMBtu	1.64	4.83	15.38	3.07	2.69	2.90	2.80
Metals & Minerals								
Base Metals								
Copper	USD/lb	0.60	2.38	4.60	2.96	2.80	3.00	3.20
Nickel	USD/lb	2.00	7.12	24.58	5.95	5.58	5.75	6.00
Zinc	USD/lb	0.33	0.84	2.10	1.33	1.24	1.25	1.20
Aluminium	USD/lb	0.56	0.87	1.49	0.96	0.83	0.90	0.90
Bulk Commodities								
Iron Ore	USD/t	27	108	302	70	92	77	70
Metallurgical Coal	USD/t	39	131	330	208	204	185	160
Precious Metals								
Gold	USD/toz	256	890	1,895	1,268	1,304	1,300	1,300

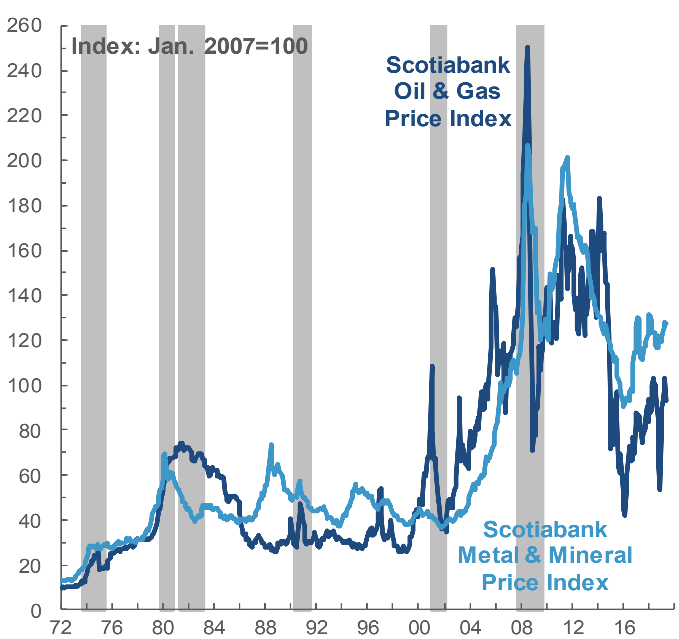
* 2008-17 average.

Scotiabank All Commodity Price Index

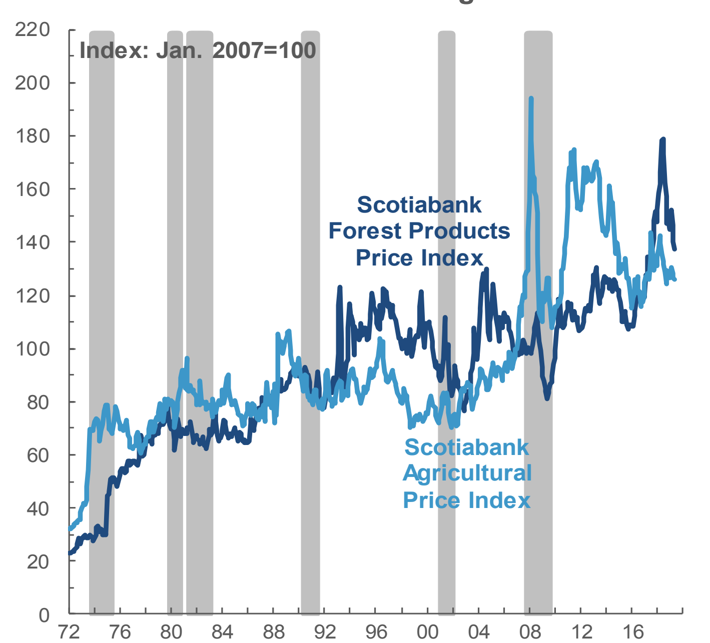
Canadian Dollar vs. Commodity Prices

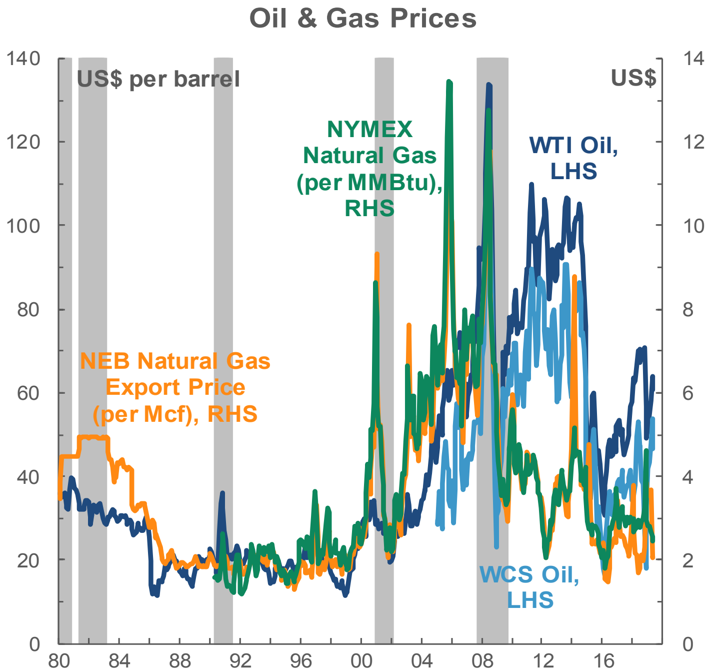


Scotiabank Oil & Gas and Metal & Mineral Indices

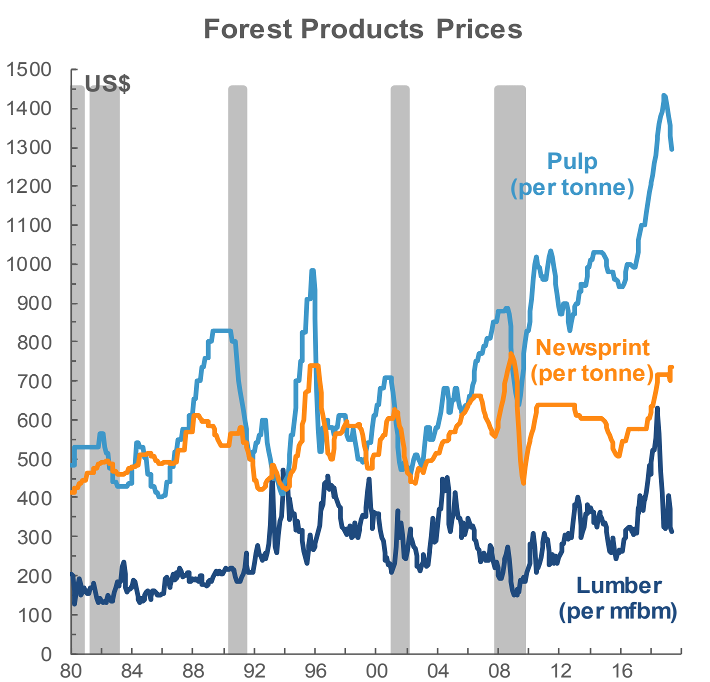


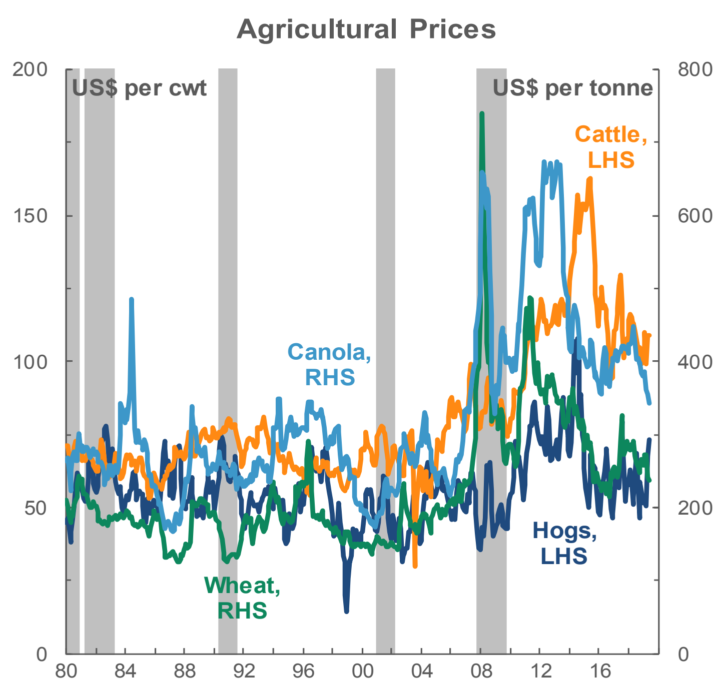
Scotiabank Forest Products & Agricultural Indices




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)
1500
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
Hogs, LHS
Wheat, RHS
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, 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), Saskatchewan 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**