The Goods

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A monthly commodity watch

July 2018

Commodities Enter Summer Doldrums

Escalating trade tensions undermining fundamental improvements, with further weakness ahead

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The **BMO Capital Markets Commodity Price Index** fell 2.3% in June, marking the largest monthly drop in a year. Each of the sub-indices posted losses, with the largest declines seen in oil, lumber and crops. Notwithstanding a brief oil recovery in late June-early July, any gains will be offset by the sharp sell-off across the metals space in recent weeks. Overall the commodity index is expected to trend sideways over the next few months.

The **Oil & Gas Index** dropped 3.5% in June, led down by a near-4% drop in crude oil. This weakness reflected fears that rising U.S. interest rates and increasing U.S.-China trade frictions would slow global economic growth, particularly in emerging market nations which are the primary source of growth in oil demand. Oil rallied sharply in the latter part of June and early July, followed by a subsequent retreat, roiled by a confluence of fundamental and geopolitical drivers (see feature on oil.)

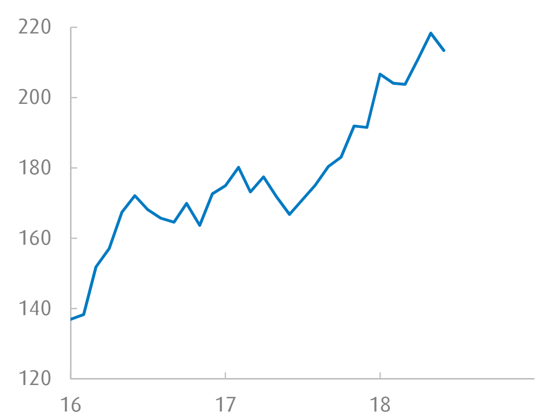
The **Metals & Minerals Index** dipped 0.3%, preceding what is likely to prove a larger decline this month. Both precious and base metals started to skid around the middle of June following the double whammy of a hawkish interest rate hike by the Fed and, more importantly, the confirmation of U.S. tariffs on US$50 billion of Chinese imports. In addition to gold, copper and zinc have been hit particularly hard, reflecting the former's close link to global industrial cycles and the latter's waning fundamental support.

The **Forest Products Index** declined for the first time in six months, skidding 3.2% as lumber prices backslid from record levels. As we've frequently mentioned in our commentary, it wasn't a matter of if, but when lumber prices would correct. The logistical log-jam responsible for the recent surge started to clear in June, which, combined with weaker housing starts, led to a US$35 drop for Spruce-Pine-Fir. Prices are expected to decline further as supply frees up and seasonal demand wanes. Oriented-Strand-Board prices remained stable, but similar dynamics saw mill quotes start to decline in early July.

The **Agriculture Index** ended its five-month winning streak with a 2.5% decrease in June. The drop resulted from weaker crop prices, with canola down 4.0% as China's threatened soybean tariffs undermined the broader oilseed space, and wheat prices losing 3.1% after the U.S. Department of Agriculture once again raised its projection of domestic carry-out stocks. In the livestock space, hog and cattle prices both advanced in June but remain below year-ago levels amid widespread supply abundance.

BMO CAPITAL MARKETS COMMODITY PRICE INDEX
(2003 = 100)

All Commodities Index



	Jun. Level (2003=100)	% Change from Mth. Ago	Yr. Ago
All Commodities	213.4	-2.3	28.0
Oil & Gas	195.5	-3.5	46.4
Metals & Minerals	265.6	-0.3	9.6
Forest Products	214.9	-3.2	61.1
Agriculture	149.2	-2.5	4.3

Commodity Focus: Crude Oil

Fundamentals and geopolitics are a volatile mix

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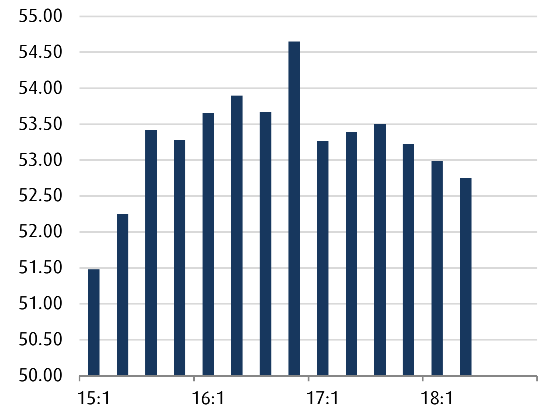
The global oil market is being impacted by fundamental drivers of supply and demand that are influencing medium- and longer-term price expectations, as well as by geopolitics, which are playing an important role in near-term pricing and in fanning volatility. The agreement in late 2016 among OPEC, Russia, and several other exporters (OPEC+) to curtail production in order to eliminate a glut at that time (Chart 1), combined with surging global demand for petroleum products fueled by low prices and strengthening global growth, succeeded in rebalancing the market. International Energy Agency (IEA) data show that OECD inventories (a proxy for global stocks) declined from 14% above their five-year average at the beginning of 2016 to a little under that benchmark in the first quarter of 2018 (*Chart 2*). Taking into consideration rising consumption during that period, inventories as measured by the number of days of forward demand, have fallen 3.5% below their five-year average. Concurrent with the correction in inventories, oil prices have risen sharply from their lows of a couple of years ago (*Chart 3*). U.S. benchmark West Texas Intermediate (WTI) reached US$74/barrel in early July (and European benchmark, Brent, close to US$79), before retreating to $68 (Brent, $72) at mid-month as escalating trade tensions between the United States and China raised fears of a global economic slowdown. While fundamentals have played a role in this recovery, geopolitics clearly is exerting a heavy hand.

OPEC+ production has actually been running well below what the original agreement had specified, reflecting collapsing output in Venezuela (due to political turmoil and a failing economy), insurgency-related on-again/off-again disruptions in Nigeria and Libya, and downward trending output in Mexico, Azerbaijan, and Angola. And now, following the departure of the United States from the Iran nuclear deal, renewed U.S. sanctions on Iran, scheduled to commence on November 4th, could reduce oil exports from there by up to 1.0 million barrels per day (mmb/d), raising supply risk in investors' minds. Prices also received a lift from a power outage in late June at Syncrude's oilsands complex in western Canada (capacity of 360,000 barrels/day) that is not expected to get back to full production until the first half of September.

Wishing to avoid an unruly price spike in oil that could lead to another boom/bust, OPEC+ recently concluded a meeting where it decided (despite opposition from Iran and a few other participants)

CHART 1: PROXY* FOR OPEC+ PRODUCTION
(millions of barrels per day)



* Includes oil produced in OPEC, the Former Soviet Union (capturing output in Russia, Kazakhstan, and Azerbaijan), Brazil, Mexico, Oman, and Malaysia.

CHART 2: OECD COMMERCIAL OIL STOCKS
(% deviation from 5-year average)

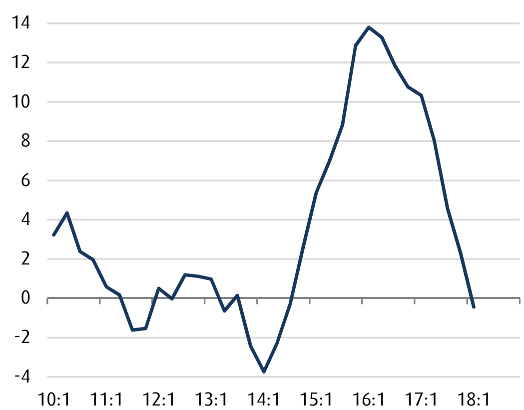
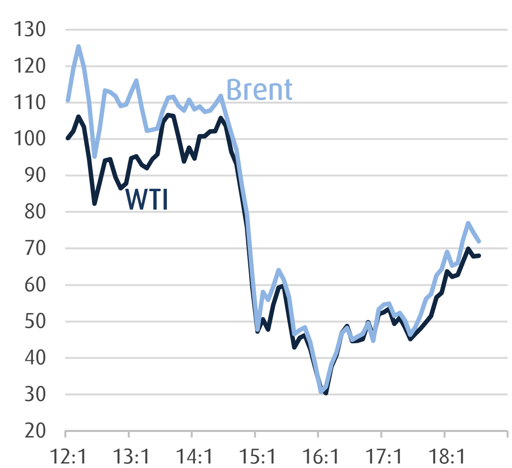


CHART 3: OIL PRICES
(US$ per barrel)



to raise the group's output by up to 1.0 mmb/d, starting this month, basically to eliminate unintended over-compliance with the original agreement and to prevent further market tightening. However, country-specific quotas were not announced and the actual increase is likely to be less than agreed due to capacity constraints. Only Saudi Arabia, Russia, Kuwait, and the UAE have spare capacity. Most is in Saudi Arabia, which is likely to be cautious in raising output too quickly, lest prices decline sharply in advance of the privatization of part of its national oil company, now scheduled for some time in 2019. Additionally, Saudi Arabia, embroiled in regional conflicts and requiring substantial revenues to restructure the economy, has a fairly high fiscal breakeven oil price, in the vicinity of US$90/barrel (for Brent). While the planned output increase by OPEC+ is intended to offset anticipated declines in Venezuela and, later this year and in 2019, in Iran, it doesn't seem to have assuaged President Trump's anxiety (and increasingly vigorous warnings to OPEC) about rising gasoline prices in advance of the U.S. mid-term elections.

Meanwhile, Non-OPEC+ supply[1] is continuing to grow at a brisk pace, with IEA-projected average annual growth during 2018 and 2019 concentrated in the United States (1.5mmb/d) and Canada (0.2mmb/d). That should be sufficient to meet rising global consumption of oil, projected by the IEA to climb at an average annual pace of 1.4mmb/d this year and next. In view of the global market remaining roughly balanced, we anticipate that WTI will average US$67/barrel in 2018 (it averaged $65.40 during the first half of the year) and US$65 in 2019.

Nevertheless, pronounced volatility in prices will remain a feature of the market. Given the current global context, risks to this forecast are elevated, both to the downside and upside, though skewed to the latter over the next year and a half. Upside risks include the following:

- slowing increase in U.S. oil output due to rising costs and production and transportation bottlenecks in the increasingly crowded Permian Basin, from where much of the growth has been emanating ;
- larger-than-expected declines in supply from Iran and Venezuela;
- Iran following through on threats to disrupt the flow of oil through the Strait of Hormuz;
- market participants becoming increasingly uneasy about the diminishing buffer of global excess productive capacity available to deal with supply shocks, as Saudi Arabia, the holder of most of that excess capacity, raises production; and,
- expectations of impending supply gaps reflecting the sharp reduction in global investment in oil industry exploration and development following the collapse of prices in 2014-2015.

Downside risks are also prominent, including:

- slower growth in the demand for oil should trade frictions between the United States, China, and most everywhere else escalate, dampening global economic activity;
- weaker-than-expected compliance with U.S. sanctions on Iran;
- OPEC+ raising production more than intended as participants attempt to reap the benefits of higher prices.

[1] Comprises crude oil, condensates, natural gas liquids (NGLs), and oil from non-conventional sources.

Energy and Materials

		Crude Oil (WTI)	Natural Gas (Henry Hub)	Natural Gas (Alta. Empress)	Lumber
		US$/bbl	US$/mmbtu	US$/mmbtu	US$/mbf
	2005	56.46	8.81	7.51	347
	2006	66.10	6.74	5.92	290
	2007	72.36	6.98	6.32	245
	2008	99.57	8.86	8.09	215
	2009	61.69	3.95	3.46	177
	2010	79.43	4.39	3.59	255
	2011	95.08	4.00	3.28	255
	2012	94.20	2.75	2.19	299
	2013	97.93	3.73	2.98	356
	2014	93.26	4.39	4.56	349
	2015	48.69	2.63	2.33	277
	2016	43.21	2.52	1.68	305
	2017	50.91	2.99	2.01	401
	y-t-d 2018	65.96	2.96	1.97	559
2017	July	46.61	2.98	2.05	403
	August	48.05	2.90	1.53	395
	September	49.83	2.98	1.68	419
	October	51.60	2.88	1.99	446
	November	56.66	3.01	2.34	484
	December	57.93	2.82	2.45	457
2018	January	63.66	3.88	2.84	493
	February	62.21	2.67	1.77	523
	March	62.76	2.69	1.81	524
	April	66.26	2.80	1.83	552
	May	69.99	2.80	1.79	634
	June	67.33	2.97	1.86	609
	m-t-d July	72.26	2.90	1.98	590
Forecast	2018 Avg.	**67.00** ↑	**2.95** ↓	**2.05** ↓	**550** ↓
	2019 Avg.	**65.00**	**3.10**	**2.45**	**430** ↓

Commodity price forecasts are by BMO Capital Markets Economics and are independent of those used by BMO Capital Markets Equity Research.
↑ and ↓ indicate annual forecast changes from last month.

Base and Precious Metals

		Copper	Aluminum	Zinc	Nickel	Gold	Silver
			US$/lb			US$/oz	
	2005	1.67	0.86	0.63	6.69	445	7.31
	2006	3.05	1.17	1.48	11.00	605	11.58
	2007	3.23	1.20	1.47	16.89	697	13.40
	2008	3.15	1.17	0.85	9.57	872	15.01
	2009	2.34	0.75	0.75	6.64	973	14.67
	2010	3.42	0.99	0.98	9.89	1225	20.16
	2011	4.00	1.09	0.99	10.38	1570	35.11
	2012	3.61	0.92	0.88	7.96	1668	31.15
	2013	3.32	0.84	0.87	6.81	1411	23.83
	2014	3.11	0.85	0.98	7.65	1266	19.08
	2015	2.50	0.75	0.88	5.37	1160	15.70
	2016	2.21	0.73	0.95	4.35	1248	17.10
	2017	2.80	0.89	1.31	4.72	1258	17.06
	y-t-d 2018	3.12	1.00	1.46	6.30	1313	16.59
2017	July	2.71	0.86	1.26	4.30	1235	16.16
	August	2.94	0.92	1.35	4.92	1282	16.90
	September	2.99	0.95	1.41	5.09	1317	17.46
	October	3.08	0.97	1.48	5.13	1281	16.94
	November	3.10	0.95	1.47	5.44	1283	17.02
	December	3.08	0.94	1.45	5.17	1266	16.16
2018	January	3.21	1.00	1.56	5.84	1333	17.19
	February	3.18	0.99	1.61	6.16	1334	16.65
	March	3.08	0.94	1.49	6.08	1326	16.47
	April	3.10	1.02	1.45	6.32	1334	16.60
	May	3.09	1.04	1.39	6.51	1304	16.45
	June	3.15	1.02	1.40	6.85	1282	16.51
	m-t-d July	2.87	0.96	1.23	6.36	1250	15.95
Forecast	2018 Avg.	**3.10**	**0.98**	**1.40**	**6.00**	**1305** ↓	**16.65** ↓
	2019 Avg.	**3.20**	**0.99**	**1.36**	**5.75**	**1300**	**17.75**

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Agriculture

		Wheat	Canola		Cattle	Hogs
		US$/bushel	US$/tonne		US$/cwt	
	2005	3.19	224		87.34	68.58
	2006	4.02	257		86.23	64.08
	2007	6.38	378		93.92	65.56
	2008	7.98	527		93.60	66.05
	2009	5.30	371		83.85	58.11
	2010	5.81	429		94.95	75.60
	2011	7.10	566		114.54	90.34
	2012	7.50	601		122.65	84.93
	2013	6.84	545		126.40	89.33
	2014	5.88	400		151.50	105.83
	2015	5.08	371		146.49	69.40
	2016	4.36	366		118.61	65.60
	2017	4.36	393		117.90	69.87
	y-t-d 2018	4.78	403		115.45	70.89
2017	July	5.04	419		115.15	86.65
	August	4.29	398		108.94	72.50
	September	4.37	399		107.80	59.14
	October	4.35	398		112.56	62.39
	November	4.22	403		121.21	63.23
	December	4.11	390		118.46	66.83
2018	January	4.32	395		121.53	72.26
	February	4.56	403		127.54	71.99
	March	4.75	402		120.05	64.16
	April	4.75	416		117.21	61.01
	May	5.17	414		104.96	71.13
	June	5.01	398		107.63	80.01
	m-t-d July	4.91	385		105.81	81.08
Forecast	2018 Avg.	**4.90**	**395**	↓	**113.00**	**66.00**
	2019 Avg.	**5.20**	**415**		**118.00**	**68.00**

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↑ and ↓ indicate annual forecast changes from last month.

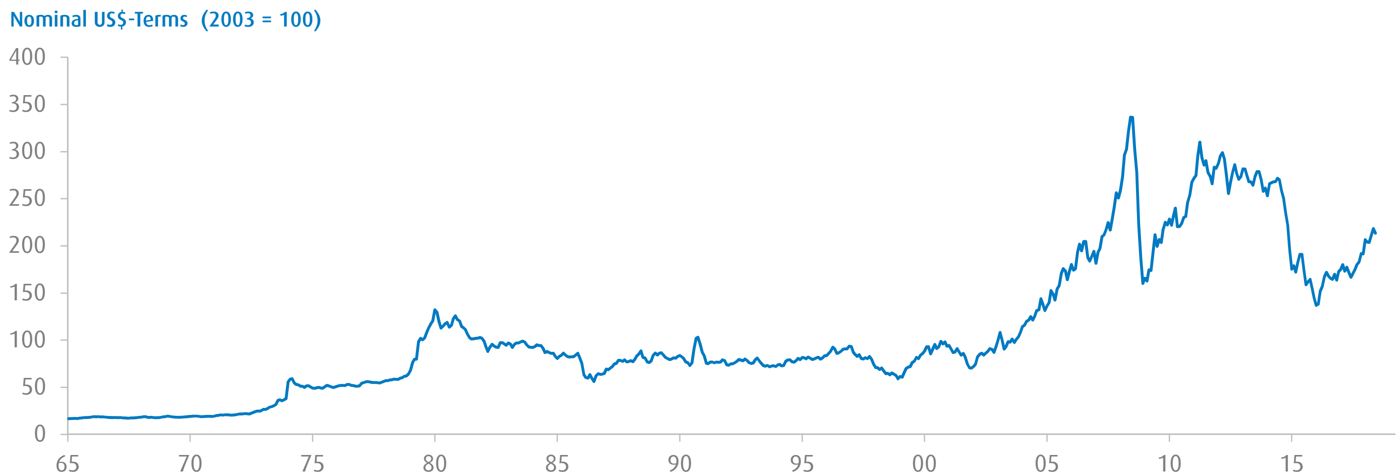
Commodity Indices and Forecasts[2]

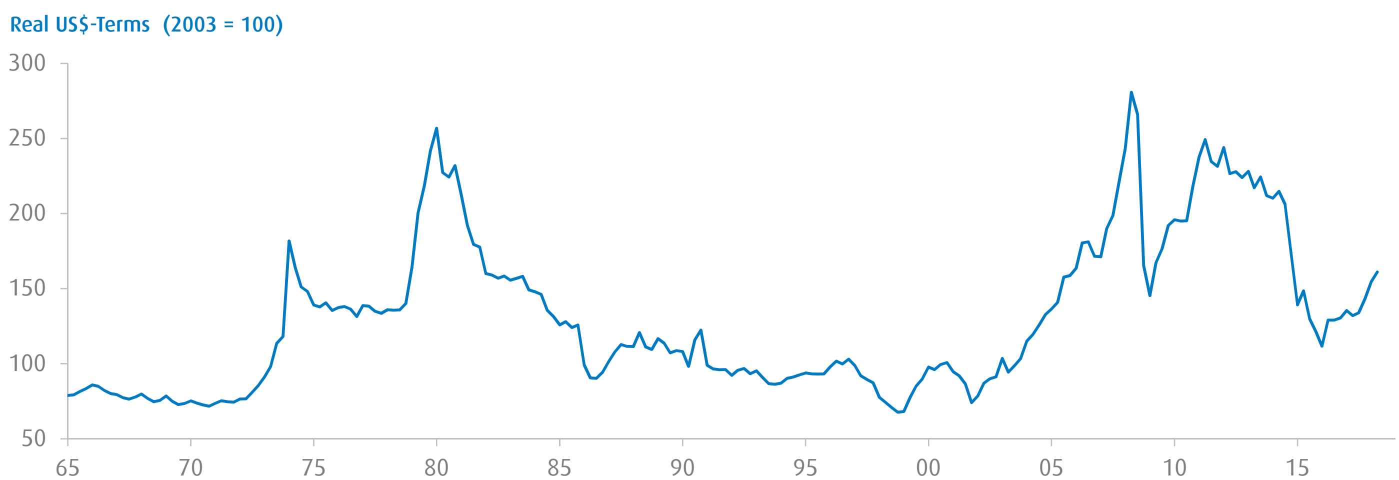
US$-terms : 2003 = 100		All Commodities	Oil & Gas	Metals & Minerals	Forest Products	Agricultural Products	All Commodities C$-terms
Annual							
	2009	196.3	182.0	267.1	64.3	145.2	159.1
	2010	234.6	232.7	291.1	92.0	163.4	172.5
	2011	283.7	275.6	364.8	90.1	205.3	200.3
	2012	279.7	270.2	353.8	108.4	216.9	199.5
	2013	271.7	283.0	304.1	128.6	200.1	199.6
	2014	252.1	271.4	270.5	121.3	170.0	198.4
	2015	170.9	142.5	244.8	98.3	151.3	155.5
	2016	160.7	126.9	241.1	110.3	135.9	151.8
	2017	178.1	149.6	249.4	144.8	139.8	165.0
Forecast	2018	**210.9**	**194.5**	**264.4**	**192.4**	**147.1**	**193.2**
	2019	**207.3**	**189.3**	**268.6**	**150.4**	**155.2**	**186.6**
Quarterly							
2016	Q4	168.7	144.9	236.0	114.2	130.5	160.7
2017	Q1	176.1	152.2	242.7	124.9	138.0	166.2
	Q2	172.0	142.3	243.6	139.4	139.2	165.3
	Q3	175.5	141.8	252.6	149.3	143.8	157.1
	Q4	188.8	161.9	258.8	165.5	138.0	171.2
2018	Q1	204.9	183.3	268.2	180.9	144.2	184.6
	Q2	214.3	196.7	266.9	210.7	150.1	197.2
Forecast	Q3	**210.5**	**196.8**	**258.4**	**197.4**	**145.0**	**195.3**
	Q4	**213.9**	**201.3**	**264.1**	**180.7**	**149.1**	**195.6**
2019	Q1	**213.5**	**200.6**	**265.4**	**167.8**	**153.2**	**193.7**
Monthly							
2017	Jun	166.8	133.5	242.4	133.4	143.0	158.6
	Jul	170.9	137.5	242.4	146.9	154.1	155.0
	Aug	175.1	141.3	254.5	146.1	138.4	157.7
	Sep	180.4	146.5	260.9	154.9	138.8	158.7
	Oct	183.0	151.2	258.8	164.5	139.1	164.3
	Nov	191.9	165.7	260.5	172.2	139.2	174.9
	Dec	191.5	168.8	257.2	159.7	135.6	174.5
2018	Jan	206.7	187.3	270.2	171.7	140.2	183.6
	Feb	204.1	180.5	269.5	184.6	145.5	182.5
	Mar	203.8	182.0	264.9	186.3	146.8	187.8
	Apr	211.0	192.1	268.5	195.0	148.2	191.7
	May	218.3	202.6	266.4	222.2	153.0	200.3
	Jun	213.4	195.5	265.6	214.9	149.2	199.6

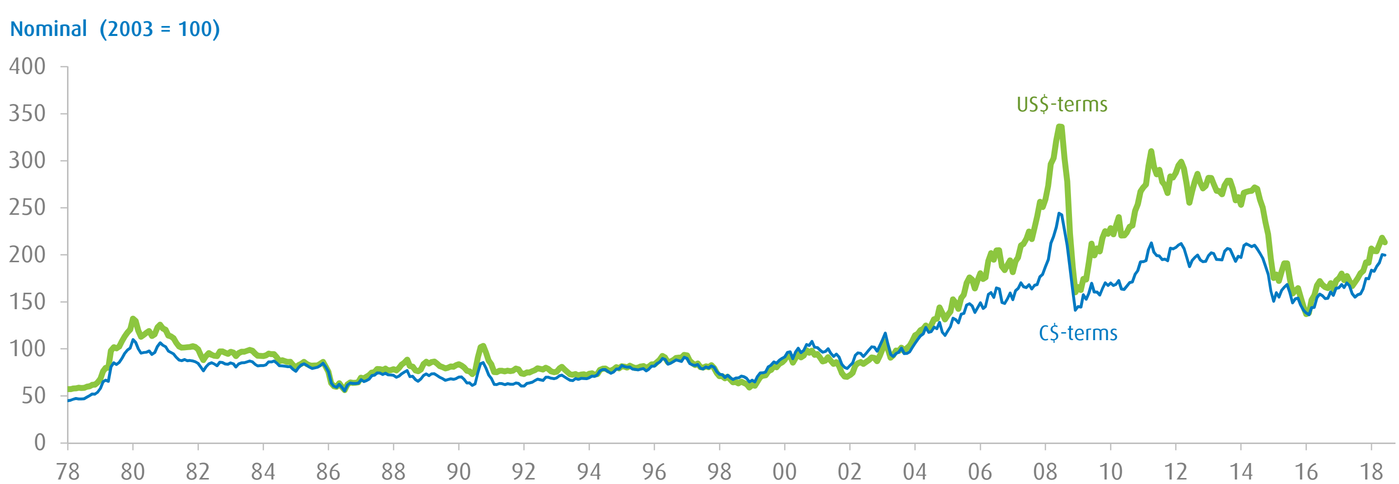
Commodity price indices and forecasts are by BMO Capital Markets Economics.
Forecasts are independent of those used by BMO Capital Markets Equity Research.

[2] Due to data availability issues, the following series have been removed from the Forest Products and All Commodities Indices: newsprint, market pulp, supercalendered paper.

Historical Charts: All-Commodity Index







Technical Note

The BMO Capital Markets Commodity Price Index is a fixed-weight, export-based index that encompasses the price movement of 16 commodities key to Canadian exports. Weights are each commodity's average share of the total value of exports of the 16 commodities during the period 2012-16. Similarly, weights of sub-index components reflect the relative importance of commodities within their respective product group.

The all-commodities index and sub-indices consist of the following:

Percent	Weight in All-Commodities Index	Weight in Sub-Index		Weight in All-Commodities Index	Weight in Sub-Index
Metals & Minerals	**29.8**	**100.0**	**Forest Products**	**6.5**	**100.0**
Gold	10.6	35.4	Lumber	5.5	84.1
Silver	1.4	4.6	OSB	1.0	15.9
Aluminum	6.4	21.4			
Copper	2.3	7.8	**Agricultural Products**	**9.1**	**100.0**
Nickel	3.2	10.8	Wheat	4.5	49.5
Zinc	0.9	3.0	Canola	3.3	36.6
Uranium	1.3	4.4	Hogs	0.3	3.0
Potash	3.8	12.6	Beef Cattle	1.0	10.9
Oil and Gas	**54.6**	**100.0**	**All Commodities**	**100.0**	
Crude Oil	47.6	87.2			
Canadian Natural Gas	7.0	12.8			

Unless otherwise specified, all indices reported in this publication correspond to prices in U.S. dollars.