

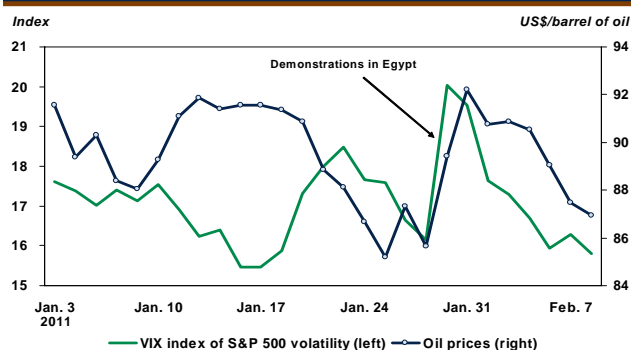
Geopolitical risks take centre stage again

Commodity prices still hold a dominant place in the news. Protest movement in Tunisia, partly related to rising food prices, finally led to a regime change. The protestors' victory encouraged the opposition in neighbouring countries, especially Egypt. The unstable situation in that country has raised fears about oil deliveries to Europe, quickly taking oil prices back above US\$90 a barrel (graph 1). The final results of the current protest movement will not be known for several months, but an ongoing risk premium on crude prices is to be expected. In addition to representing some real risks, geopolitical strains could fan speculators' interest in base products, especially oil. Even though there is still a fairly good balance between the global oil supply and demand, the po-

tential for a speculative surge by oil prices similar to the one that occurred in the first half of 2008 has certainly gone up.

The release of promising economic statistics is also supporting prices for industrial commodities. In particular, the news remains good in the United States, where real GDP accelerated at the end of 2010 on strong household consumption growth (graph 2). Prices for most industrial metals have kept rising since 2011 began. However, the renewed investor optimism was not as good for gold and silver prices, whose safe-haven characteristics now seem less prized. Overall, the latest developments argue for most commodity prices to remain high and volatile in 2011.

Graph 1 – Events in Egypt have made oil prices and investors' concerns rebound



Sources: Datastream and Desjardins, Economic Studies

Graph 2 – The U.S. economy accelerated at the end of 2010



Sources: Bureau of Economic Analysis and Desjardins, Economic Studies

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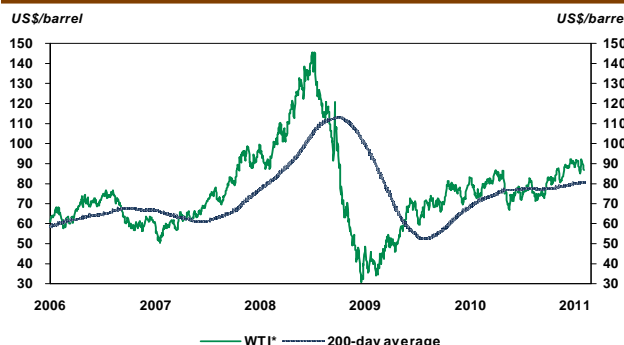
ENERGY

What will be the consequences of the protest movement in the Arab world?

OIL

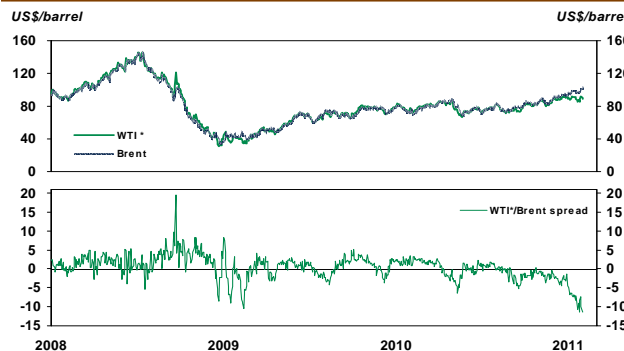
- Oil prices have been highly volatile in recent weeks. Another upside change to the International Energy Agency's (IEA) forecast for global demand supported oil prices at the start of January. After that, reassuring comments from Saudi authorities, saying that OPEC (the Organization of Petroleum Exporting Countries) could take action to prevent prices from rising too quickly brought the price for WTI (West Texas Intermediate) down to around US\$85/barrel. The increasingly large demonstrations in Egypt, however, temporarily pushed crude prices back over US\$90/barrel (graph 3).
- Although WTI is currently pricy, it looks cheap compared to Brent, which recently crossed over US\$100/barrel. It is rare to see a spread this big—it even exceeded US\$10/barrel in the last few weeks—between the two global benchmarks for crude prices. On average, the price for WTI has stayed just over US\$1/barrel above Brent's price since the start of 2000 (graph 4). Large inventories in the United States, especially in Cushing, Oklahoma (graph 5), where WTI futures are settled, are limiting WTI gains. Conversely, the supply of Brent is being limited by the decline in oil output in the North Sea and some production stoppages in Norway. The more precarious supply in Europe seems to be the main reason for the big price spread.
- It is hard to predict how the situation will develop in the Arab world. For oil prices, the main issue is whether current events jeopardize the global oil supply. As Egypt is not a major energy exporter, the market's concern is mainly about the potential that crude transportation will be affected. About 3% of crude oil—over 2 million barrels per day—is estimated to pass through the Suez Canal and a major pipeline that crosses Egypt. For now, the popular uprising is not affecting oil transportation and, regardless of Egypt's future government, it will have a major economic stake in keeping the Suez Canal open. Even in the extreme case that oil tankers could no longer use the canal, this oil would not be lost and could be delivered to consumers using other routes.
- However, this does not mean investors are wrong to keep a close eye on the situation in North Africa. An Egyptian government more hostile to the West and Israel could jeopardize the Middle-East's precarious stability. A conflict erupting in this region is never good news for oil consumers. Moreover, there is a real risk that the protest movement will continue to spread, eventually affecting a major oil exporter. In particular, a violent revolution in Saudi Arabia could make oil prices skyrocket.

Graph 3 – Price of oil per barrel



* West Texas Intermediate.
Sources: Datastream and Desjardins, Economic Studies

Graph 4 – The price of WTI* oil has rarely been this low compared with Brent prices



* West Texas Intermediate.
Sources: Datastream and Desjardins, Economic Studies

Graph 5 – U.S. crude inventories at Cushing, Oklahoma posted a new record



Sources: Energy Information Administration and Desjardins, Economic Studies

GASOLINE

- Despite the major fluctuations of crude prices, gas prices have not changed much in the last few weeks. A gallon of regular gas has cost around US\$3.10/gallon since the year began. A rapid rise in gas inventories in the last few weeks (graph 6) and some signs that fuel demand is slowing may have helped to curb the surge in prices at the pump.

NATURAL GAS

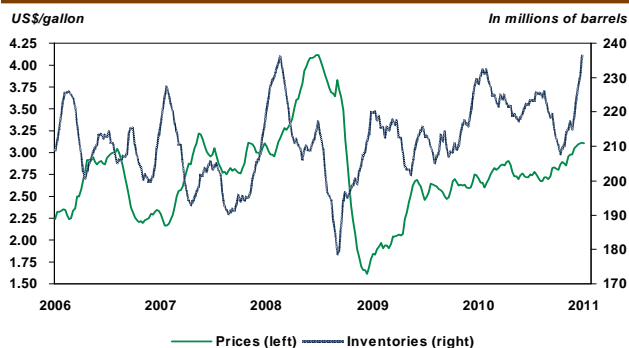
- The particularly tough winter in North America has continued to push natural gas demand up, allowing its price to close in on US\$4.70/MMBTU (Million British Thermal Unit) (graph 7). Given the especially favourable weather, the rise in gas prices is not impressive. It tends to confirm our assessment that the resource's potential for appreciation will be quite limited in 2011. Note that, despite stronger demand this winter, gas inventories remain slightly above last year's levels and everything suggests that the North American gas supply will largely exceed demand this year.

URANIUM

- Uranium price has maintained its impressive rise in the last few weeks. The metal's price has jumped by more than US\$10/pound since the start of the year, going above US\$70/pound (graph 8). In an already favourable context characterized by ambitious plans to build nuclear power plants in China and renewed speculator interest, the news that a major Australian producer was suspending operations for three months due to the overly heavy rains immediately impacted uranium prices.

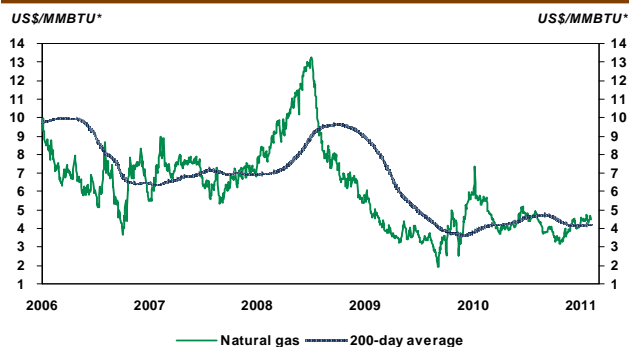
Forecasts: A close watch must be kept on the Arab world for the next few months. For now, the risk of a substantial impact on the global crude supply remains small, but big enough to justify an ongoing geopolitical risk premium on crude prices. What's more, good economic news could continue to prompt upside changes to the forecast for global demand in 2011. These two factors therefore justify a slight increase to our outlook for oil prices in 2011. On average, we now expect the price for WTI to be around US\$90/barrel this year. The limited natural gas price gains despite the harsh winter led us to reduce again our forecast for 2011.

Graph 6 – Gas prices and inventories



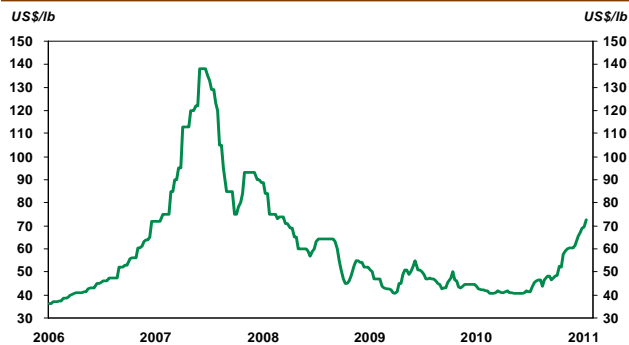
Sources: Energy Information Administration and Desjardins, Economic Studies

Graph 7 – Natural gas prices



* Million British Thermal Unit.
Sources: Datastream and Desjardins, Economic Studies

Graph 8 – Uranium prices



Sources: Datastream and Desjardins, Economic Studies

BASE METALS

The rapid rise in prices opens the door for a temporary correction

The release of good economic statistics, including another rise of the major economies' manufacturing indicators, continued to buoy base metal prices over the last few weeks. The LME (London Metal Exchange Index) is up more than 5% since 2011 began, closing in on its historic high of 4,556, reached in May 2007 (graph 9).

It is surprising to see metal prices setting or touching records in the very early days of the global expansion cycle. 2010's major gains were mainly based on spectacular, widespread growth in metal demand, primarily in emerging nations, but also in industrialized countries. The bad weather in Australia, a major metal producer, is also currently inflating prices. Metal demand should keep advancing this year but, now that the post-recession adjustment is well underway, we can expect less spectacular growth.

ALUMINUM

- Aluminum prices have been oscillating around US\$2,500 a tonne since 2011 opened, consolidating the substantial gains recorded at the end of 2010 (graph 10). After a spectacular rise last year, global aluminum demand now seems to be advancing more slowly. The major unknown for 2011 is Chinese aluminum output. According to official figures, it tumbled at the end of the year, when the government instituted measures to limit electricity consumption. However, the latest commercial figures do not point to a rebound of the country's aluminum imports, a sign that the Chinese measures are having a limited impact on the global market. It would also be surprising for Chinese authorities to curb the supply of this important metal for much longer. Everything suggests that there will be enough global output to meet demand and maintain very high inventories over the coming quarters, a situation that is not very supportive for aluminum prices. The rise in the metal's production costs will give prices some support, however.

COPPER

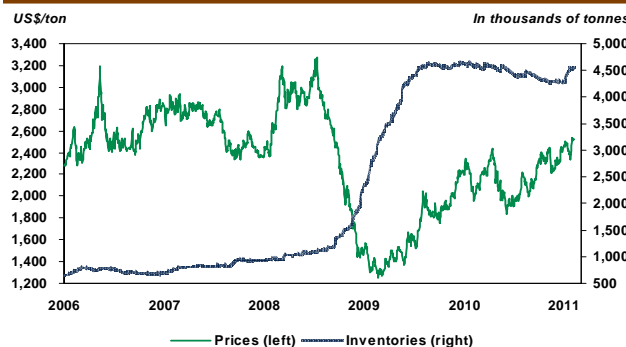
- Copper prices continued to rise in the last few weeks. They even set a new historic record in January, while the US\$10,000 a tonne level was broken in early February (graph 11). These peaks were hit despite the over 10% rise in inventories recorded by the LME (London Metal Exchange) in the last two months. However, the uptrend for inventories promises to be short-lived, as copper mine output's very soft growth could keep the metal's global market in a deficit situation for the coming years. Copper prices are thus likely to remain very elevated, failing a major shadow over global economic outlooks.

Graph 9 – LME* index of base metal prices



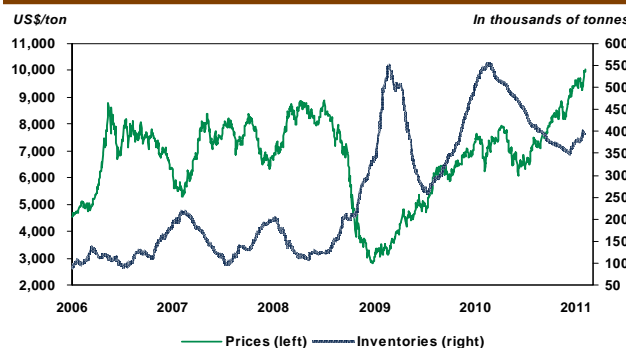
* London Metal Exchange Index.
 Sources: Datastream and Desjardins, Economic Studies

Graph 10 – Aluminum prices and inventories



Sources: Datastream and Desjardins, Economic Studies

Graph 11 – Copper prices and inventories



Sources: Datastream and Desjardins, Economic Studies

NICKEL

- Nickel is one of the raw materials that have surged the most lately. It is up 15% since the year began, taking nickel prices over US\$28,000 a tonne for the first time since May 2008 (graph 12). The flooding in Australia, which pushed coal prices up, could limit the production of nickel pig iron, the main nickel substitute. The outlook is also fairly good for stainless steel output. In 2011, however, global output and demand should rise at similar paces, keeping the nickel market fairly balanced.

ZINC

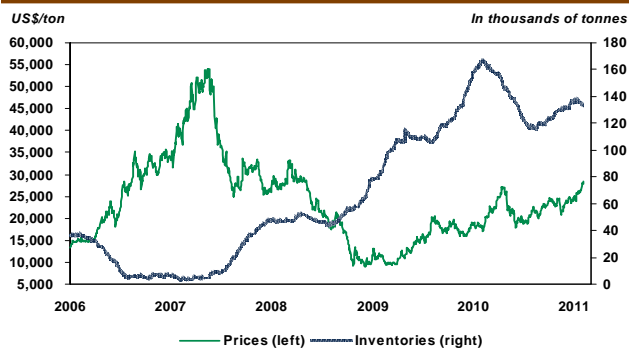
- Zinc prices have not changed much since 2011 began, staying around US\$2,450 a tonne (graph 13). China has delivered some good news for the metal—its zinc imports rebounded in December. However, global inventories continue to rise and everything suggests zinc output will continue to handily outstrip demand in 2011.

TIN AND LEAD

- Tin prices have continued to skyrocket, rising more than 15% at the start of 2011 to over US\$31,000 a tonne (graph 14), a new record. Concerns about tin output were magnified by heavy rains in Indonesia, the world's second largest producer of the metal. Despite the recent rise in inventories, the global tin market should maintain a deficit this year.
- Lead prices have edged up since the year began, going back over US\$2,600 a tonne. The rise seems shaky, however, as lead inventories have jumped nearly 40% since the start of 2011, hitting a 15-year peak. Failing a rapid acceleration of Chinese demand, the next few months promise to be tough ones for lead.

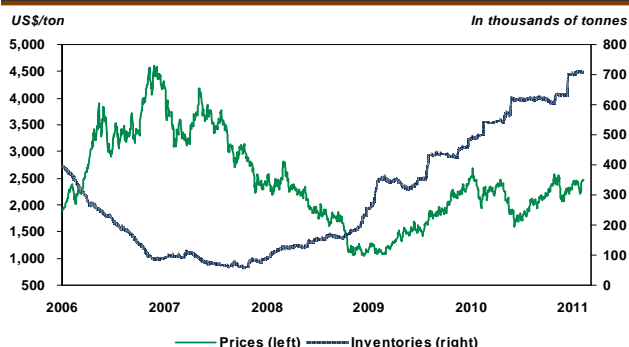
Forecasts: Overall, the economic situation should favour high base metal prices in 2011. However, the recent rise in prices for several metals seems to be too fast in a context where inventory movements do not point to a shortage. Any sag by investor optimism could therefore prompt temporary price corrections for most base metals.

Graph 12 – Nickel prices and inventories



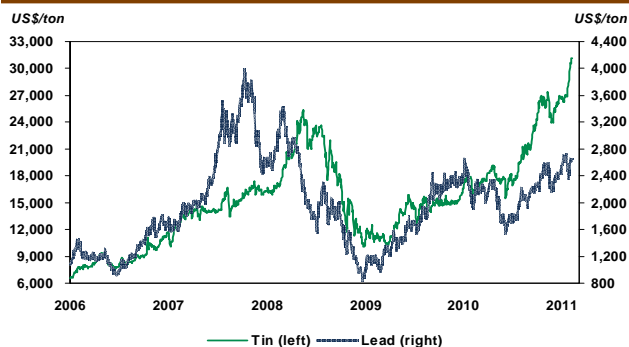
Sources: Datastream and Desjardins, Economic Studies

Graph 13 – Zinc prices and inventories



Sources: Datastream and Desjardins, Economic Studies

Graph 14 – Tin and lead prices



Sources: Datastream and Desjardins, Economic Studies

PRECIOUS METALS

Have gold and silver prices already begun to correct?

After skyrocketing in 2010, gold and silver prices are seeing a fairly tough start to the year, as easing strains in Europe and good economic news have appeared to lessen investor interest in these two safe-haven securities. Capitalizing on promising outlooks for the industrial sector, platinum and palladium prices have continued to advance, however.

GOLD AND SILVER

- The price of gold pulled back more than 6% in January, dropping to its lowest point since last October. Capitalizing on the surge in geopolitical tension, it climbed to around US\$1,350/ounce at the start of February (graph 15); however, it remains well below its peak of US\$1,418/ounce. The recent dip in gold price mainly stems from a decline in speculator interest (graph 16) on the release of encouraging economic statistics. The rise in global inflation pressures and a U.S. dollar pullback did not maintain gold price. Silver prices posted a similar dip at the start of the year. Given the constantly rising output by silver mining in the last few years, the metal's prices could be hard hit by a change in investor sentiment.

PLATINUM AND PALLADIUM

- Platinum and palladium prices have continued to advance since the year started, respectively crossing the US\$1,800/ounce and US\$800/ounce (graph 17). Growing global auto production should continue to support prices for both metals this year. The uncertainty about production, with platinum mines concentrated in South Africa and the status of Russian palladium inventories unknown, could also favour these metals.

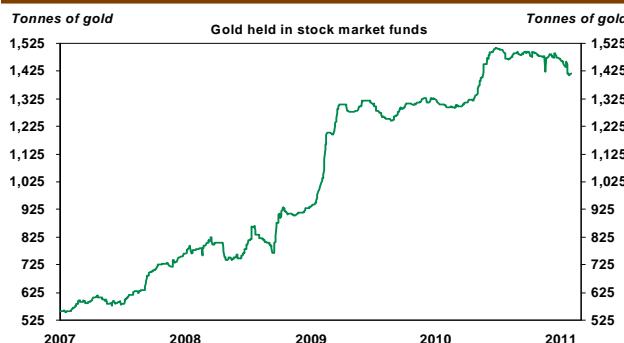
Forecasts: We think it is still too early to see a real correction of gold and silver prices. As long as the Federal Reserve (Fed) keeps injecting major liquidity into the financial markets, any rebound of investors' fears could give prices for both metals a push. The second half of the year, when the Fed's actions will be over, promises to be tougher; gold could end 2011 below US\$1,200/ounce.

Graph 15 – Gold and silver prices



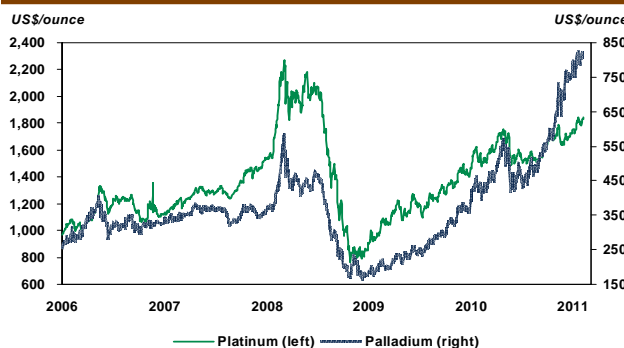
Sources: Datastream and Desjardins, Economic Studies

Graph 16 – Investor interest in gold has edged down since 2011 started



Sources: Datastream, Exchange Traded Gold and Desjardins, Economic Studies

Graph 17 – Platinum and palladium prices



Sources: Datastream and Desjardins, Economic Studies

AGRICULTURAL COMMODITIES

Prices continue to surge

Cereal prices have continued to deliver an excellent performance in the last few months. The uncertainty surrounding the harvests rose again after unusual weather events in Australia and the United States. Strong demand for U.S. cereals is also currently supporting prices.

WHEAT

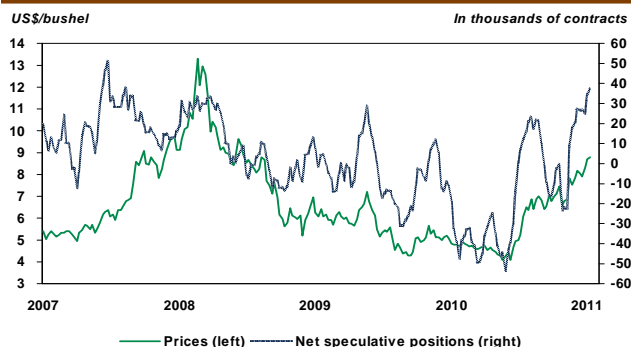
- Wheat prices are up more than 10% since 2011 started, crossing US\$9/bushel (graph 18). Flooding in Australia and extreme cold in the United States could lead to another downside change to the wheat harvest forecast. Troubles in the Arab world could also support demand for this cereal, as some countries will want to increase their stocks to avoid a shortage or skyrocketing local prices. Some countries have already decided to maintain food price subsidies, to contain popular discontent. The fact that Egypt—the leading wheat importer—started to buy this cereal again at the start of February, despite major domestic troubles, also reassured the markets.

CORN AND SOYBEANS

- Corn prices also got 2011 off to a strong start. A rise of more than 10% took the cereal's price to around US\$6.50 a bushel in the last few days, a peak that dates back to the summer of 2008 (graph 19). Despite December's pullback, everything suggests that Chinese corn imports will keep rising quickly in the coming quarters. Soybean prices have also risen to around US\$14/bushel (graph 20). The rise continue to be less spectacular than the rises being posted by wheat and corn prices, reflecting the fact that the movement by soybean harvests and inventories has not been as worrisome.

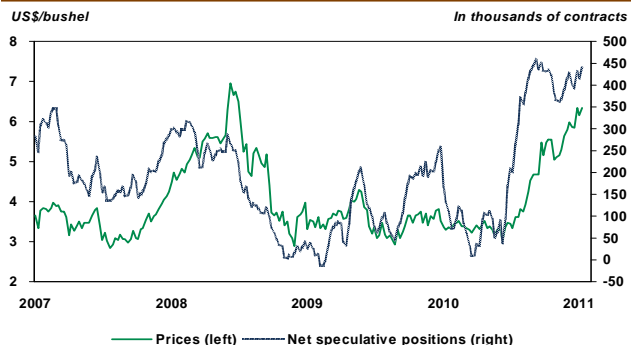
Forecasts: The context could remain favourable for cereal prices in the near future, as fears of shortages or runaway prices could prompt many countries to increase their grain inventories. Cereals' relative performances will certainly be influenced by how U.S. growers allot their cropland next season. Over the medium term, high cereal prices could prompt a major response from growers which, combined with more normal weather conditions, should dissipate shortage fears.

Graph 18 – Wheat prices and speculation



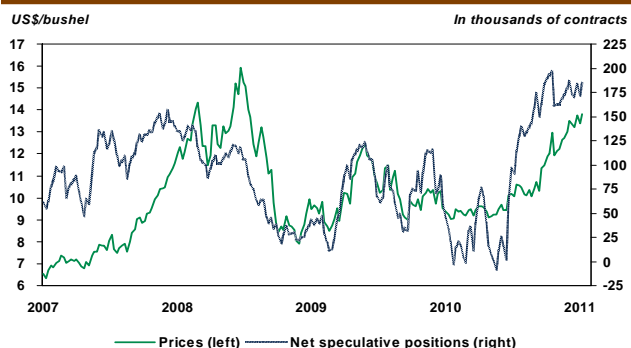
Sources: Datastream, Bloomberg and Desjardins, Economic Studies

Graph 19 – Corn prices and speculation



Sources: Datastream, Bloomberg and Desjardins, Economic Studies

Graph 20 – Soybean prices and speculation



Sources: Datastream, Bloomberg and Desjardins, Economic Studies

Table 1
Commodities

	Spot price	Percentage return since					Last 52 weeks		
	Feb. 8	1 month	3 months	6 months	1 year		High	Average	Low
Index									
Reuter-CRB* (CCI**)	654.9	6.4	10.6	31.0	42.5		659.4	521.3	450.2
Reuters/Jefferies CRB*	337.3	4.1	7.0	22.8	29.0		343.8	285.2	248.8
Dow Jones AIG***	162.9	3.2	5.9	20.4	27.3		165.3	139.1	122.0
Energy									
Crude oil (US\$/barrel)	86.9	-1.2	-0.1	7.7	20.9		92.2	80.7	66.9
Gasoline (US\$/gallon)	3.13	2.0	9.3	14.5	18.1		3.13	2.82	2.61
Natural gas (US\$/MMBTU****)	4.25	-4.1	18.9	-7.7	-25.9		5.73	4.25	3.17
Precious metals									
Gold (US\$/ounce)	1,366.0	-0.8	-2.0	13.0	27.5		1,417.9	1,251.2	1,066.2
Silver (US\$/ounce)	29.4	3.6	10.1	60.8	94.3		30.7	21.3	15.1
Platinum (US\$/ounce)	1,848.0	6.5	5.5	17.6	25.1		1,848.0	1,635.4	1,477.0
Palladium (US\$/ounce)	823.0	9.2	18.6	67.6	103.2		824.0	565.4	405.0
Base metals									
Aluminium (US\$/ton)	2,545.3	1.6	5.9	16.7	28.5		2,545.3	2,202.8	1,834.8
Copper (US\$/ton)	10,070.0	6.8	16.2	37.1	56.7		10,070.0	7,805.1	6,067.8
Nickel (US\$/ton)	28,365.0	17.3	17.9	28.7	64.9		28,365.0	22,647.9	17,201.0
Zinc (US\$/ton)	2,491.0	2.3	1.5	18.6	24.1		2,587.5	2,167.4	1,596.5
Tin (US\$/ton)	31,400.0	18.6	18.0	51.7	107.4		31,400.0	21,518.4	15,139.0
Lead (US\$/ton)	2,609.0	-2.5	5.1	22.2	34.2		2,711.0	2,181.6	1,529.0
Agricultural commodities									
Wheat (US\$/bushel)	9.27	15.7	23.2	42.2	94.1		9.27	6.06	4.09
Corn (US\$/bushel)	6.52	14.1	15.4	75.7	97.9		6.55	4.31	3.03
Soybean (US\$/bushel)	14.04	5.6	12.8	31.5	54.2		14.04	10.75	8.97
CRB* Livestock index	578.2	6.1	21.9	24.7	42.7		578.2	485.4	405.1

*Commodity Research Bureau; ** Continuous Commodity Index; *** American International Group; ****Million British Thermal Unit.

Note: Currency table base on previous day closure.

Table 2
Commodities prices: history and forecasts

	2009	2010	2011f	2012f
Annual average				
WTI* oil (US\$/barrel)	62	80	Target: 90 (range: 80 to 100)	Target: 100 (range: 90 to 110)
Natural gas Henry Hub (US\$/MMBTU**)	3.95	4.38	Target: 4.50 (range: 3.50 to 5.50)	Target: 5.50 (range: 4.50 to 6.50)
Gold (US\$/ounce)	973	1,226	Target: 1,250 (range: 1,150 to 1,350)	Target: 1,150 (range: 1,050 to 1,250)
LMEX*** index—base metals	2,471	3,466	Target: 4,500 (range: 4,000 to 5,000)	Target: 4,750 (range: 4,250 to 5,250)

f: forecasts; * West Texas Intermediate; ** Million British Thermal Unit; *** London Metal Exchange Index.

Sources: Datastream and Desjardins, Economic Studies