

Uncharted Waters

- We now anticipate that the COVID-19 pandemic and escalating efforts to contain it will drive a global economic downturn and pronounced weakness in most commodity prices this year.
- At the moment, Russia looks less likely to blink in the oil price war than Saudi Arabia, adding supply-side downward pressure on oil prices during an unprecedented demand event.
- Industrial metals have seen some pricing support vis-à-vis expectations of a Chinese stimulus package, but their outlook is far from rosy.
- Canada's oil patch provinces face new pressures on their bottom lines and long-term growth prospects. Near-term pain will likely be acute.

DESPERATE TIMES, DESPERATE MEASURES

To say that the global economic outlook has changed since our last commodities note is an understatement. Last month, markets were pricing in a short-lived COVID-19 demand shock largely limited to China. We now anticipate that the virus and escalating efforts to contain it will drive a global economic downturn this year. Cases in China look to have stabilized, but developments across the wider world—from record unemployment insurance applications to complete shutdowns of major industries—already look to be slowing global activity (chart 1). Amid this unprecedented demand-side shock, an oil price war broke out between the world's second- and third-largest producers.

Aggressive stimulus packages announced and expected around the world temporarily stanching the bleeding in equities and commodity prices. Initial news of an economic assistance package in the United States totalling more than USD 2 tn, for instance, was met with improvement in risk sentiment and pricing, as was aggressive monetary stimulus from central banks around the world. Yet uncertainty remains regarding the virus' spread, and price movements for all commodities will continue to be dominated by pandemic-related developments.

All told, we expect pronounced—and in some cases historic—weakness in commodity prices and considerable volatility to persist in the interim. Our base case economic forecast calls for virus-led lockdowns to begin to be lifted by Q3-2020, by which point there is potential for upward pressure on commodity prices to resume.

GOLD: VIRUS' REACH EXCEEDS MARKETS' GRASP

Volatility-induced panic drove gold prices below 1,500 USD/oz. in early and mid-March after they climbed above 1,650 USD/oz. in February. Bullion is normally seen as a safe haven asset in times of market turmoil and weak economic growth, but earlier this month, financial market volatility was so pronounced that many investors fled gold in favour of cash.

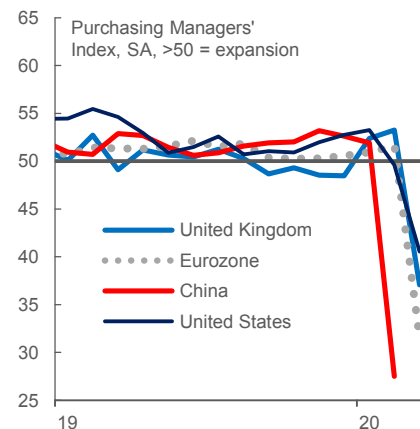
Following worldwide central bank moves to inject liquidity into markets and continued deterioration of the global economic outlook, prices for the yellow

CONTACTS

Marc Desormeaux, Senior Economist
416.866.4733
Scotiabank Economics
marc.desormeaux@scotiabank.com

Chart 1

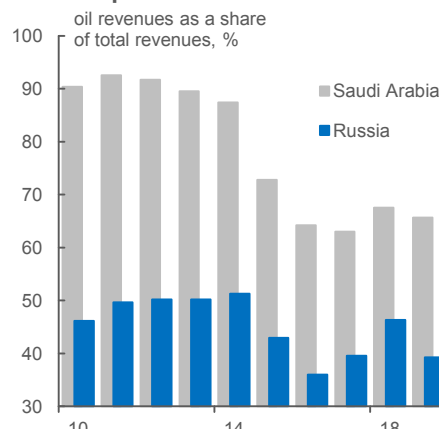
COVID-19: From Epidemic to Pandemic



Sources: Scotiabank Economics, IHS Markit.

Chart 2

Saudi Arabia's Finances More Susceptible to Oil Price Downturn



Sources: Scotiabank Economics, IMF, Ministry of Finance of Russian Federation.

metal resumed their upward trajectory. Gold values finished last week more than 8% higher than the preceding week's close, the steepest gain since 2008.

Going forward, the scope of virus-led shutdowns will continue to impact the physical supply of gold. In Singapore, for instance, supply chain bottlenecks complemented a spike in demand to provide pricing support for the precious metal. On the other hand, physical dealers in India have been offering discounts as the country's three-week lockdown brought trading to a standstill.

OIL PRICE WAR: ADVANTAGE RUSSIA

Russia fired the first shot of the oil price war when it walked away from OPEC talks to extend output quotas on March 6th; the Kingdom of Saudi Arabia's (KSA) retaliatory plans to ramp up its own output threw the crude market into freefall. Prices were already reeling from diminished fuel demand, weak Chinese industrial activity, and depressed investor sentiment, but the prospect of supportive OPEC production cuts had offered a glimmer of hope. At the confluence of an unprecedented demand shock and a surge in new supply, oil prices witnessed the second-sharpest ever percentage decline on March 8th, have remained at rock-bottom levels ever since (chart 2, p.1).

A prolonged price war will unquestionably hurt both economies, but Russia's public finances are better positioned to weather it. Oil accounts for a smaller—albeit significant—share of government revenues in Russia (chart 3). As such, its fiscal breakeven point is estimated at between 40 and 45 USD/bbl, while the Kingdom's is nearer 80 USD/bbl. KSA has acknowledged the need for sizeable—and potentially politically unpopular—public spending cuts if crude values remain depressed. Meanwhile, Russia's National Wealth Fund remains well-stocked according to official statements, providing a cushion against falling prices and fiscal room for promised social and infrastructure outlays.

A flexible exchange rate presents another advantage. Many Russian producers are paid partly in USD but make purchases in rubles; therefore, all else equal, a weaker domestic currency encourages capital spending and output, offering a partial offset to weaker pricing. No such incentive exists in KSA: the Riyal is pegged to the US dollar.

Much will depend on how COVID-19 containment measures affect oil production and storage capacity, but at this point, Russia looks less likely to cave than Saudi Arabia, which should keep crude values depressed relative to prior forecasts.

NORTH AMERICAN OIL PATCH REELING

This has clear negative implications for the US shale patch. Weak balance sheets were already pressuring firms to cut costs and many firms had based their 2020 budgets on price assumptions that now appear very optimistic. Idled rigs and widespread workforce reductions look inevitable.

The situation is also dire for Western Canadian oil. The Western Canada Select benchmark recently fell below 4 USD/bbl—an all-time low. Thus far, US Gulf Coast refiners have been able to maintain decent margins, contributing to demand for heavy oils and some narrowing of the WTI-WCS discount (chart 3). However, margins will be increasingly difficult to preserve as COVID-19 lockdowns reduce demand in Mexico and South America. Inventories are already elevated in the Western Canadian oil patch; that may bring more downward pressure on WCS in the coming months.

Chart 3

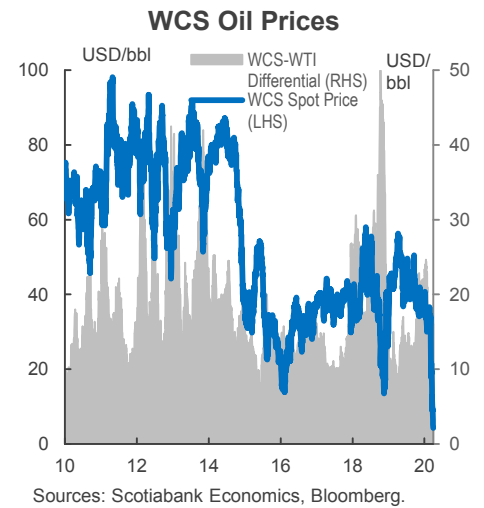


Chart 4

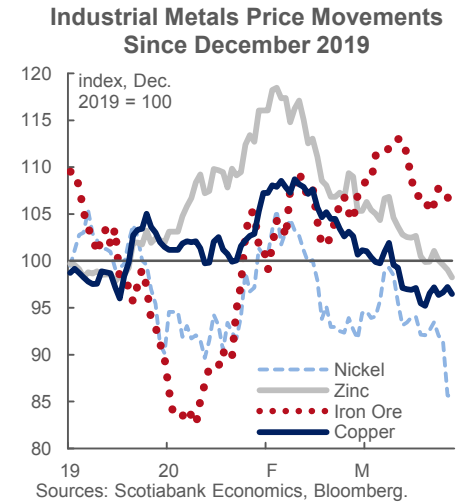
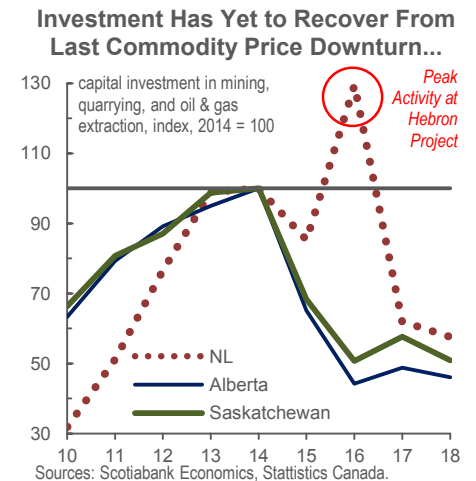


Chart 5



INDUSTRIAL METALS AWAIT CHINESE STIMULUS PACKAGE

Industrial metals prices, while under pressure from coronavirus-related demand weakness and containment efforts, thus far have not fallen as far as crude values. Peak-to-trough declines in Brent and WTI closing values have exceeded 60% versus drops in the 20–30% range for copper, nickel, and zinc (chart 4, p.2). Coal, another staple of the industrial economy, has also been relatively stable in recent weeks.

That resilience reflects expectations of fiscal stimulus from Beijing, which appears almost certain to go ahead. China has long maintained a 3% cap on its budget deficit-to-GDP ratio, which suggested limited potential for further stimulus in light of downward growth revisions. However, the government now looks ready to blow through that target in efforts to revive activity in the world's largest industrial metals consumer. News also broke last week of a surge in special purpose bonds, which are earmarked for local and regional infrastructure projects and don't contribute to China's official deficit. The People's National Congress in April or May would be a natural setting for spending announcements, but the severity of the current situation may prompt earlier action.

Even if a fiscal stimulus package goes ahead in China, the outlook for industrial metals pricing is far from rosy.

Manufactured goods production and industrial activity will be dampened as China's major trading partners in Europe and North America embrace virus-related lockdowns. As such, we expect more pricing weakness in Q2 and Q3 of this year.

LAYING SIEGE TO CANADA'S RESOURCE ECONOMY

For Canada's net oil-producing provinces, the plunge in crude values is set to extend an already lengthy period of economic difficulty. Excluding a one-time, transitory 2016 boost to capital outlays related to the Hebron offshore oil venture in Newfoundland and Labrador, mining and oil & gas investment activity has cratered since the last resource price downturn in 2014–15 (chart 5, p.2). The labour market has also been affected: full-time job creation among prime working-age men has remained soft since the commodity super cycle's zenith (chart 6). This reflects the spread of employment weakness beyond the oil patch into adjacent industries such as construction and manufacturing. The Province has announced a series of supports for households and businesses as lockdowns hit the economy; more stimulus from federal and provincial sources is likely in the coming weeks.

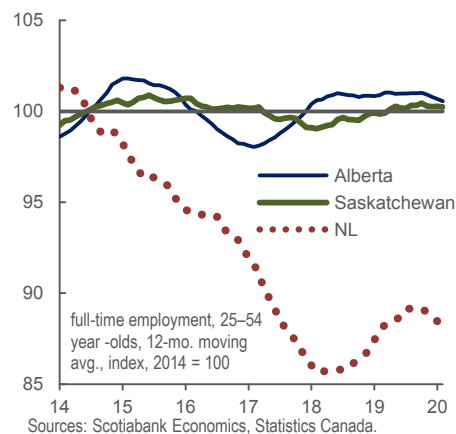
We previously forecast that Alberta would finally recoup its 7.7% 2015–16 real GDP contraction by mid-2020; that is now highly unlikely. Weak crude values and depressed economic activity will also add to the CAD 7.5 bn (1% of GDP) shortfall projected for fiscal year 2020–21, and recently prompted a credit rating downgrade from one agency. Alberta's February 28 budget associated a drop in WTI prices of 1 USD with CAD 355 mn in lost revenue. Our most recent forecast expected WTI to average 31 USD/bbl in calendar year 2020 versus the budget's 58 USD; sensitivities can vary significantly at different price levels, but this estimate gives a sense of how serious the fiscal hit could be. Acknowledging these challenges, the Province formed an Economic Recovery Council to advise how to protect jobs during and after the current downturn.

Saskatchewan unveiled spending estimates for FY21, conceding that the deterioration in the outlook for its commodity-intensive economy rendered prior revenue forecasts out of date. As well, the Cigar Lake uranium mine—the largest in the world—was temporarily shuttered in an effort to contain COVID-19 spread.

Newfoundland and Labrador faces similar challenges. The Province built a Brent price of 63 USD/bbl into its last economic and fiscal forecast—that benchmark has hovered below 25 USD/bbl of late—and will feel additional pain given its status as an iron ore and nickel producer. Full-time employment in the natural resources sector had already been trending lower, as we noted in our last *Provincial Outlook*; suspension of work on the West White Rose offshore energy project and ramp-down of mines and processing facilities in Labrador should add to job losses. These factors will significantly erode Provincial revenues when an updated fiscal plan is released in the coming months.

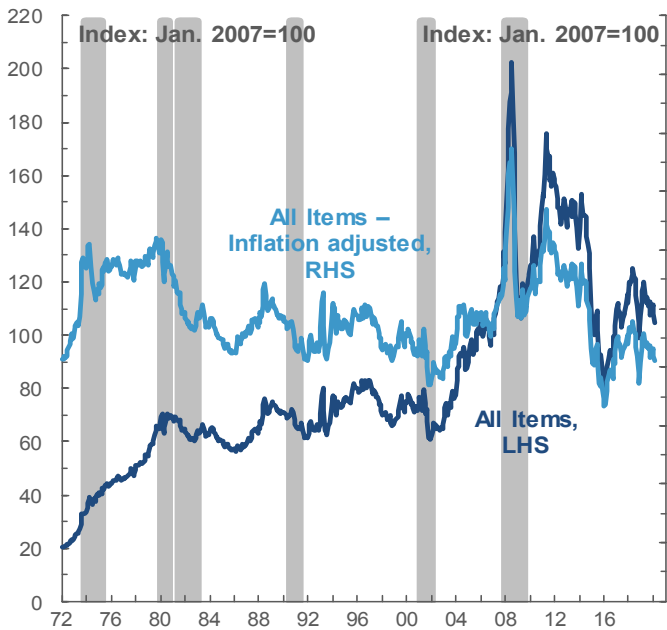
Chart 6

...And Employment Weakness Lingers for Prime Working-Age Men

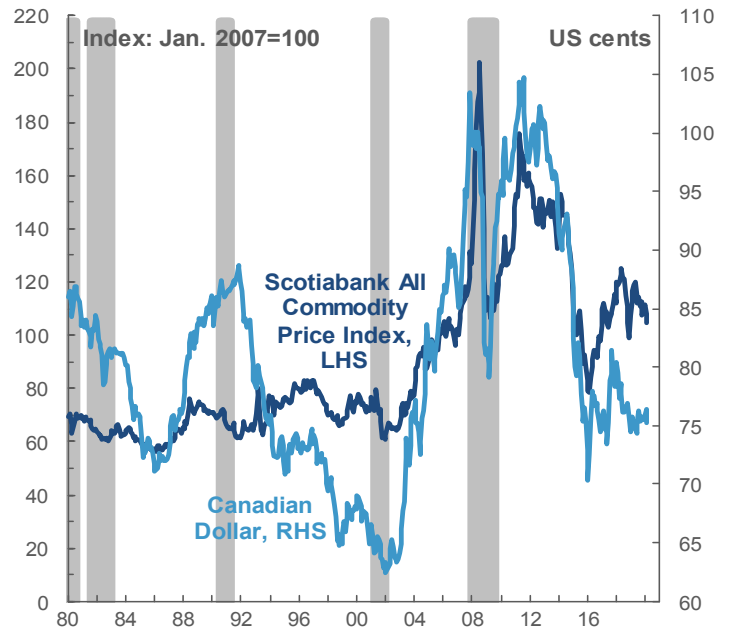


Price Outlook		2010–2018			2019	2020F	2021F
		Low	Period Avg.	High			
Oil & Gas							
Crude Oils							
West Texas Intermediate	USD/bbl	26	74	114	57	31	42
North Sea Brent Blend	USD/bbl	28	82	127	64	35	43
WCS - WTI Discount	USD/bbl	-50	-18	-7	-14	-14	-21
Natural Gas							
Nymex Henry Hub	USD/MMBtu	1.64	3.39	6.15	2.53	2.39	2.63
Metals & Minerals							
Base Metals							
Copper	USD/lb	1.96	3.10	4.60	2.72	2.80	3.00
Nickel	USD/lb	3.50	7.00	13.17	6.32	6.50	7.00
Zinc	USD/lb	0.66	1.02	1.64	1.16	1.10	1.05
Aluminium	USD/lb	0.65	0.89	1.26	0.81	0.90	0.90
Bulk Commodities							
Iron Ore	USD/t	39	101	194	94	78	70
Metallurgical Coal	USD/t	81	179	330	177	145	150
Precious Metals							
Gold	USD/toz	1,049	1,342	1,895	1,393	1,525	1,450

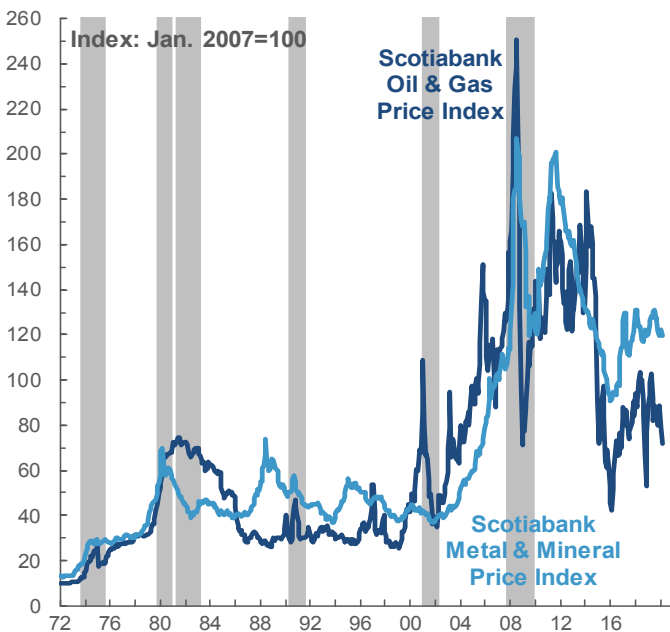
Scotiabank All Commodity Price Index



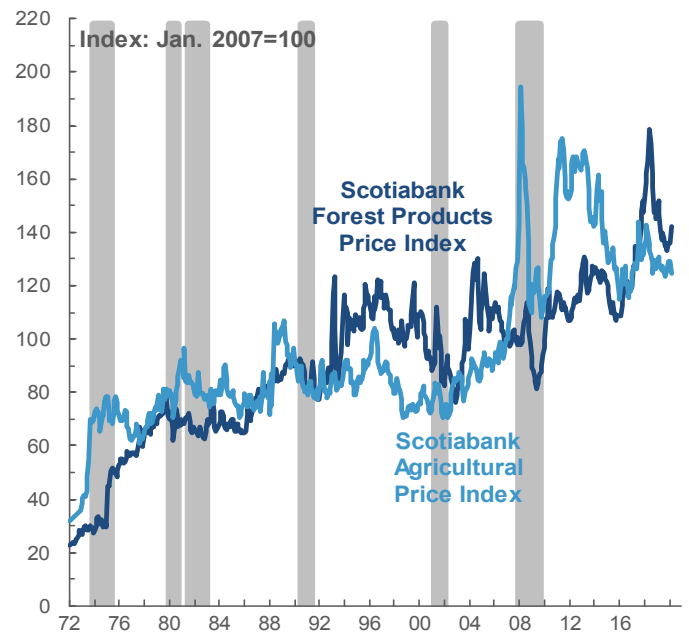
Canadian Dollar vs. Commodity Prices



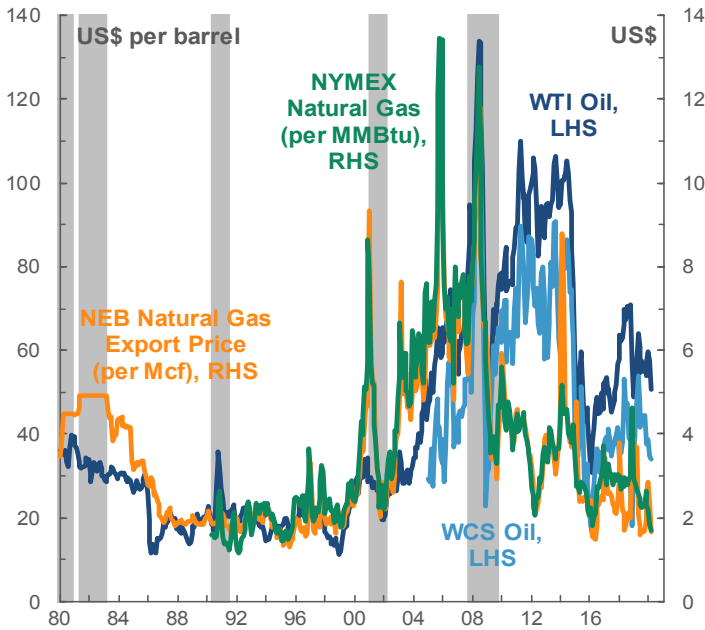
Scotiabank Oil & Gas and Metal & Mineral Indices



Scotiabank Forest Products & Agricultural Indices



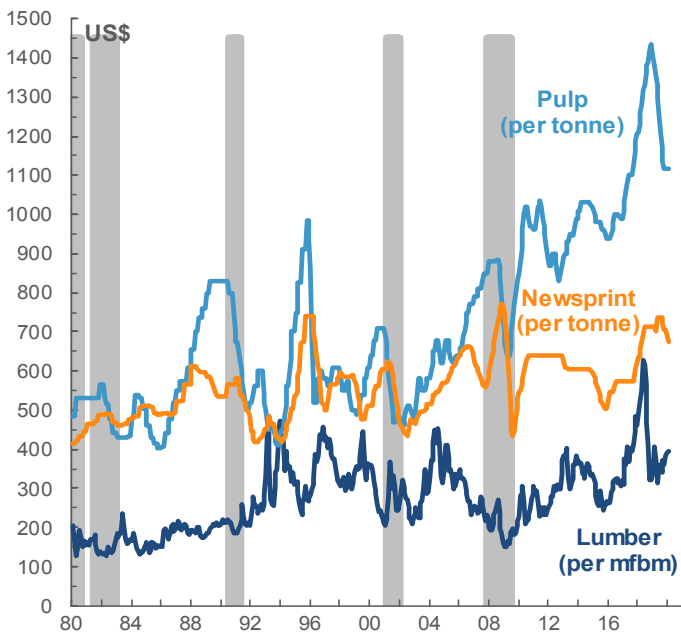
Oil & Gas Prices



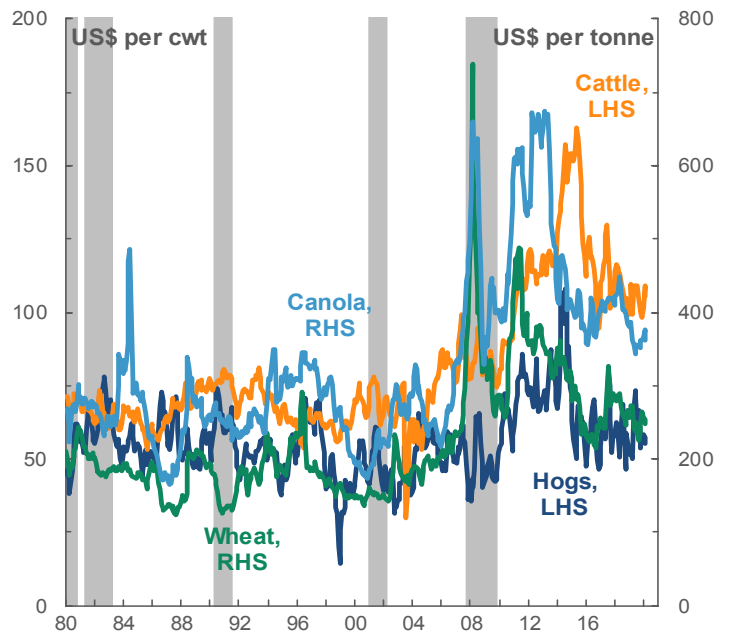
Metals Prices



Forest Products Prices



Agricultural Prices



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) U₃O₈ 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

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