Bullish Sentiment Creeps in, New Risks Crystallize

- **Easing of COVID-19 containment measures anchored a risk-on May that supported pricing for most commodities.**
- **It was a particularly good month for oil prices, which are benefiting from rallying demand that is beginning to drain bloated inventories, though crude market rebalancing is a still a ways away.**
- **China's proposed national security law for Hong Kong reignited Sino-US tensions, while its long-awaited stimulus package looks modest in size and appears to acknowledge the risk of further economic deterioration.**
- **As economies reopen, the course of the virus—especially the prospect of a second wave—remains the key risk to the recovery in global growth and commodity prices.**

ECONOMIES REOPENING, BUT...

This month marked the initial easing of COVID-19 restrictions across many jurisdictions as evidence mounted of stabilizing infection rates. Broadly speaking, that is translating into improving overall economic activity and upward movement in commodity prices, even as lagged data reports highlight the depths of the trough that occurred in April.

Still, we highlight two COVID-19-related economic themes, which contribute to an uncertain global outlook. These add to country-specific disparities with respect to containment efforts, caseloads, and reopening timelines.

The principal risk surrounds the prospect of additional waves of the virus. This was a feature of past pandemics—the 1918 flu's secondary phase was more deadly than its first (table)—and public health authorities around the world are increasingly framing round 2 as a question of "when, not if." Clearly, a mutation or resurgence of COVID-19 later this year could spur fresh containment measures that once again sap economic growth.

The nature of the post-lockdown bounce-back is another important consideration. Data from the US suggest that while heightened social distancing measures coincided with a pronounced drop in economic activity, growth has not improved reciprocally since restrictions were lightened (chart 1). That is consistent with our forecast assumption that the rebound will be gradual—brought on by continued adherence to social distancing rules and cautious consumer and business outlays in the coming months—even if no second wave occurs.

In the shadow of the virus, Sino-US tensions have come to the fore once again. Protectionist posturing between the world's two largest economies dominated macroeconomic headlines and weighed heavily on risk sentiment in 2019. The catalyst this time was proposed legislation for Hong Kong, which would criminalize a range of activities deemed to be in violation of Mainland China's national security interests. Perceived by some as a threat to Hong Kong's status as a global financial services hub as well as a human rights issue, the move has already been met with warnings of retaliatory sanctions from the US.

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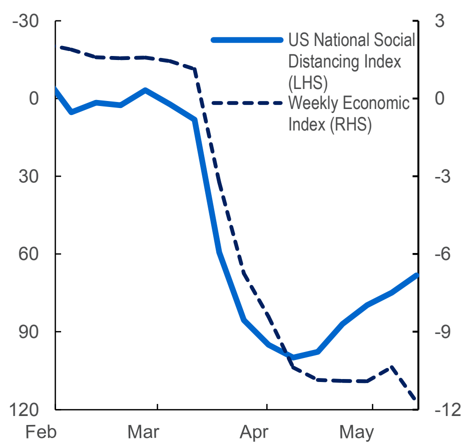
First Two Waves of 1918 Flu Pandemic For Select Cities

	First Wave		Second Wave	
	Week Ending	Deaths	Week Ending	Deaths
Amsterdam	Aug. 17	24	Nov. 2	290
Birmingham	Jul. 18	125	Nov. 30	388
Dublin	Jul. 27	78	Nov. 2	216
Glasgow	Jul. 13	26	Oct. 19	336
Kolkata	Jul. 27	179	Nov. 16	483
Liverpool	Jul. 13	33	Oct. 26	230
London	Jul. 13	287	Nov. 2	2,458
Madras	Jul. 27	60	Oct. 26	390
Manchester	Jul. 13	119	Nov. 30	374
Mumbai	Jul. 6	90	Oct. 12	984
Paris	Jul. 13	16	Oct. 26	1,263

Sources: Scotiabank Economics, University of Michigan.

Chart 1

Economic Activity Plunged During Lockdowns, Recovery May Lag



Sources: Scotiabank Economics, Federal Reserve Bank of Dallas.

CRUDE PRICES OUT OF THE BASEMENT

May has been a particularly good month for oil, which witnessed some erosion of the previous months' severe supply-demand imbalances. After ending April 20th in negative territory and trading below 20 USD/bbl throughout the month, WTI has closed above 30 USD/bbl in each of the last seven days. The key North American benchmark's forward curve has shifted higher again (chart 2), with commensurate pricing support for Brent. The curve remains contangoed but has flattened considerably versus prior months, signifying much-improved expectations for near-term crude prices.

The gradual reopening of economies around the world continues to lift the demand side of the market from its March–April nadir. In the US, gasoline demand was down 28% y/y—a marked improvement from the declines approaching 50% in early April—and jet fuel use looks to have bottomed out, though it remains weak in the face of ongoing travel restrictions. In another bullish sign, some reports indicated that Chinese gasoline and diesel consumption have returned to pre-virus levels in April, with crude imports surging as well. Refinery activity has picked up in both the US and China.

By the same token, the massive global crude glut finally looks to be beginning to draw down. The brimming 180 mn bbl repository in floating storage that built up amid a global supply-demand imbalance has moderated to about 173 mn bbl, and stocks held at the key Cushing, OK hub have declined in two consecutive weeks. That reflects the beginnings of OPEC+ supply cuts that took effect this month, as well as a reduction in US shale patch production in reaction to weaker pricing.

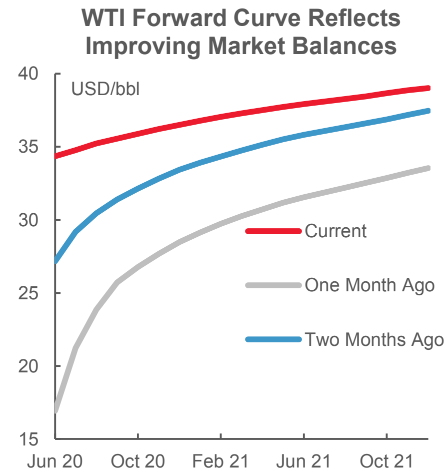
Improving physical oil market dynamics may put WTI contract rollover challenges witnessed last month—and the prospect of further negative pricing—behind us. We emphasize, however, that crude values remain about 50% lower than the heights reached in January in spite of better-than-anticipated results in May. As well, still historically elevated inventories will take time to absorb, even as demand returns and drilling activity is aggressively cut back.

MORE PAIN LIKELY COMING IN CANADIAN OIL PATCH

Earlier this month, the Western Canada Select (WCS) discount to WTI hovered near 4 USD/bbl—its narrowest-ever recorded level. That fundamentally reflected two factors. One was the extent of the Western Canadian oil production pullback in the face of cratered prices. Several Canadian firms have throttled back drilling and capital expenditure plans, and the number of active drilling wells in Alberta fell to the lowest level since at least 1991 in April (chart 3). Enbridge provided a further pricing boost when it offered a portion of the Line 3 pipeline as a temporary, 900k bbl repository for storage-strapped producers. The WCS-WTI discount has since widened to a reading nearer 10 USD/bbl, consistent with strengthening light oil prices.

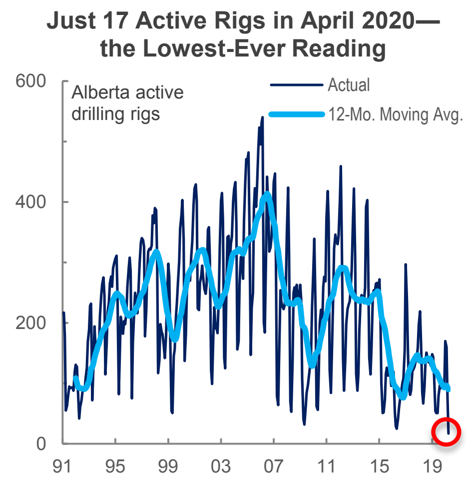
Despite some upward price movement in May, the next few months are likely to remain challenging in the Canadian oil and gas industry. Production cuts begin the delicate process of market rebalancing, but also mean layoffs and reduced local incomes. Given the timing of corporate guidance and the relatively muted declines in jobs and working hours reported thus far (chart 4), we suspect that the full effect of the oil price plunge has yet to rear its ugly head in Alberta's labour market.

Chart 2



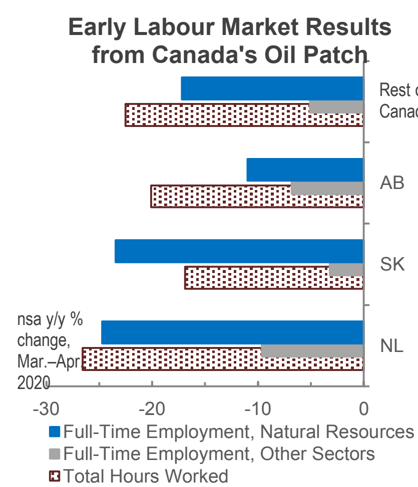
Sources: Scotiabank Economics, Bloomberg.

Chart 3



Sources: Scotiabank Economics, Alberta Energy Regulator.

Chart 4



Sources: Scotiabank Economics, Statistics Canada.

DRAGON'S FIRE HEATS UP BASE METALS

The ebbs and flows of the base metals complex continued to mirror demand signals from China. Copper's sharpest daily price decline in the month—at more than 3%—came early in May after an initial Chinese factory activity reading failed to impress markets. The metal has since drifted higher to more than 2.40 USD/lb—some of its highest level since early March. Zinc and nickel have also moved generally higher with industrial activity.

At the confluence of improving demand and new supply disruptions, iron ore prices stood out for a late-month jump to some of their highest levels since August 2019. Acute concerns about global supply have surfaced in the wake of a surge in COVID-19 cases in key producer Brazil, where output has been held back since the collapse of a tailings dam early last year. Meanwhile, iron ore inventories are clearly trending downward—alongside those of other metals (chart 5)—with one report indicating that seaborne iron ore stocks at Chinese ports had fallen to their lowest reading in roughly three years.

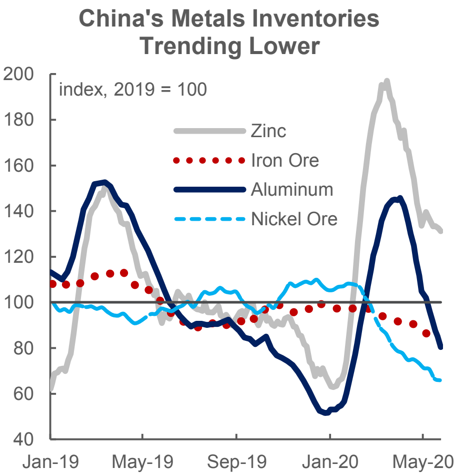
Initial details of China's long-awaited COVID-19 stimulus plan contain two interesting strands. First, the total fiscal support announced—just over USD 500 bn, between 3 and 3.5% of GDP—is well short of that unveiled during the 2008–09 crisis (chart 6). That modest package and its tilt towards off-balance sheet local bonds acknowledge the reality of the elevated debt levels accrued since the last recession, but may open the door for further action if external conditions remain weak or a second virus wave occurs. Second, the 2020 package targets "new infrastructure" like 5G networks and electric vehicle charging stations rather than traditional infrastructure projects such as roads and bridges. As such, the suite of new measures may not provide the same industrial sector boost that 2008–09 stimulus efforts did.

PRECIOUS METALS: GOLD'S CLIMB SLOWS, SILVER SURGES

Gold price gains were limited this month as stability in equity markets and a more upbeat growth outlook reduced investor appetite for the safe haven metal. Bullion has averaged about 2% higher than month-earlier levels thus far in May, far softer than the climb approaching 6% witnessed in April, though some pressure began to build towards the end of the month as China-US tensions simmered.

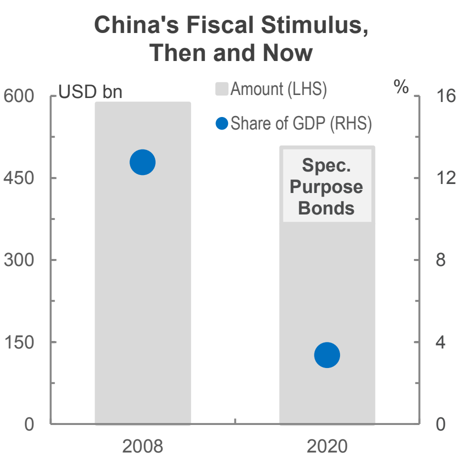
For silver, improvements in physical demand are driving a jump in prices. The metal has hovered above 17 USD/oz—more than 10% higher than one month ago—throughout most of the last two weeks. Used in a range of industrial applications, it is being supported by rising industrial consumption and investment demand.

Chart 5



Sources: Scotiabank Economics, Bloomberg.

Chart 6



Sources: Scotiabank Economics, IMF, Dezan Shira & Associates.

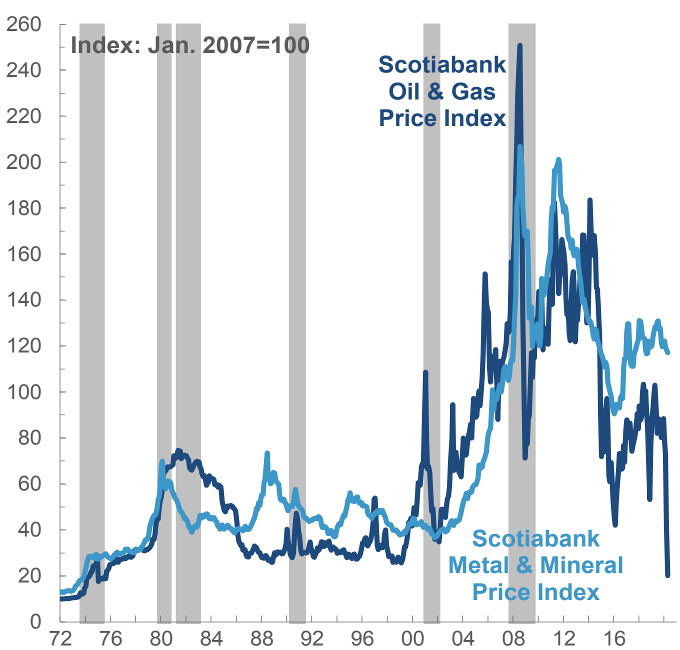
Price Outlook

Oil & Gas		Low	2010–2018 Period Avg.	High	2019	2020F	2021F
Crude Oils							
West Texas Intermediate	USD/bbl	26	74	114	57	30	40
North Sea Brent Blend	USD/bbl	28	82	127	64	33	42
WCS - WTI Discount	USD/bbl	-50	-18	-7	-14	-16	-21
Natural Gas							
Nymex Henry Hub	USD/MMBtu	1.64	3.39	6.15	2.53	1.95	2.40
Metals & Minerals							
Base Metals							
Copper	USD/lb	1.96	3.10	4.60	2.72	2.25	2.75
Nickel	USD/lb	3.50	7.00	13.17	6.32	5.40	6.00
Zinc	USD/lb	0.66	1.02	1.64	1.16	0.90	1.00
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	77	70
Metallurgical Coal	USD/t	81	179	330	177	134	140
Precious Metals							
Gold	USD/toz	1,049	1,342	1,895	1,393	1,650	1,700

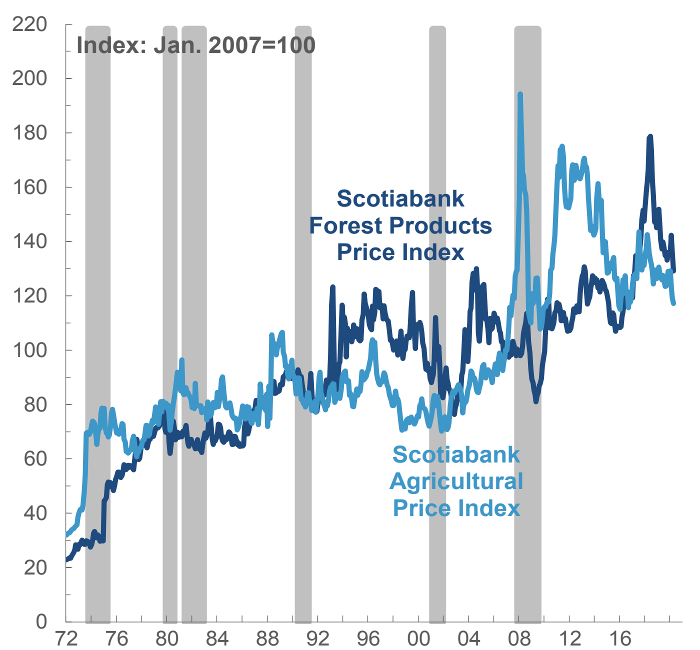
Scotiabank All Commodity Price Index

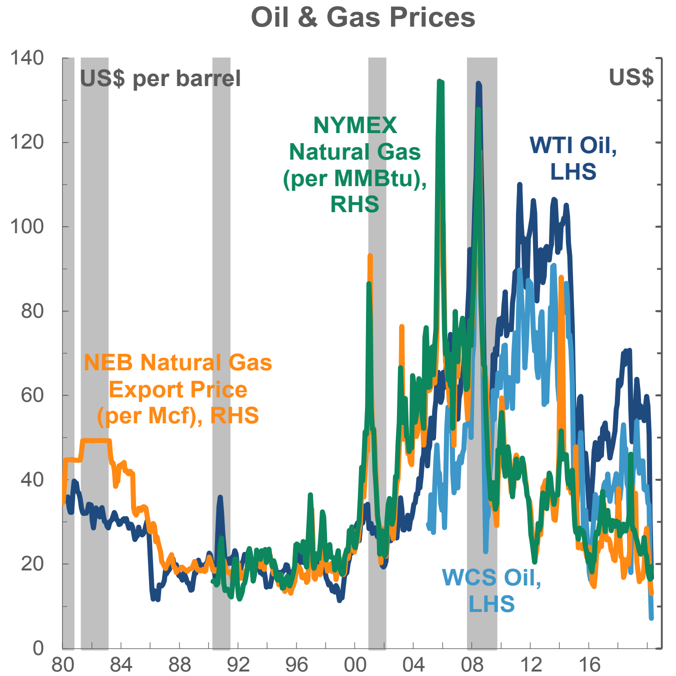
Canadian Dollar vs. Commodity Prices

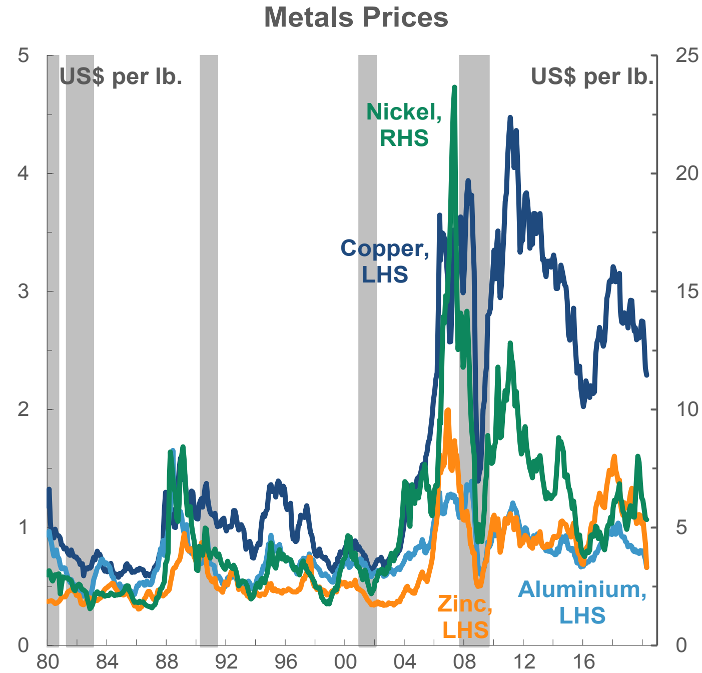
Scotiabank Oil & Gas and Metal & Mineral Indices

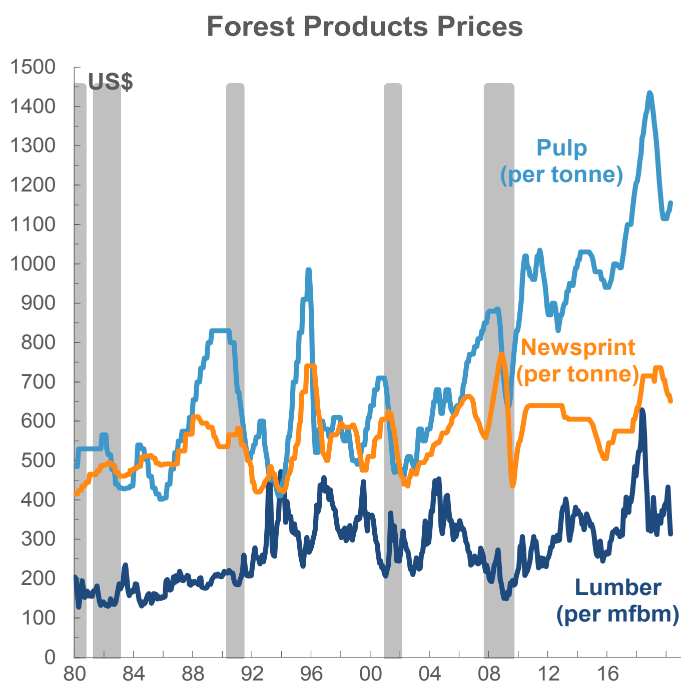


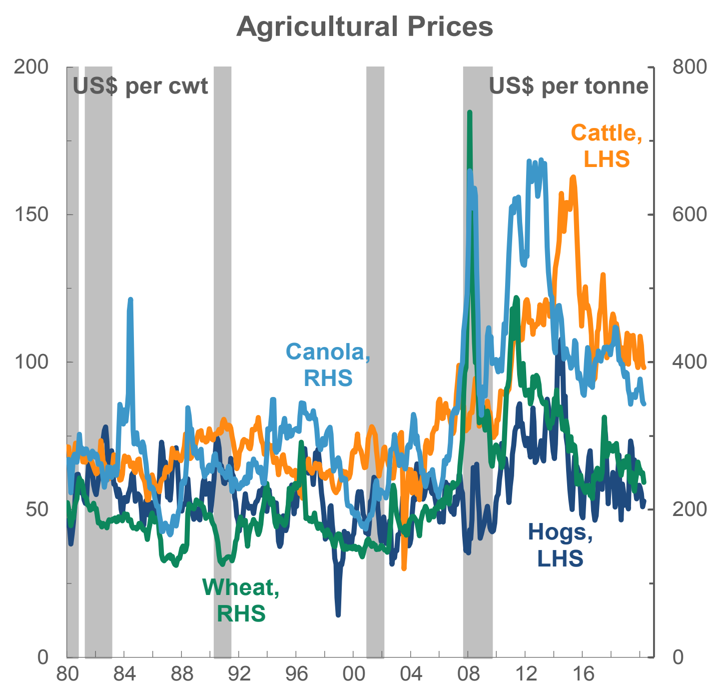
Scotiabank Forest Products & Agricultural Indices




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), Manitoba Agriculture and Food No. 1 Canadian western barley 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**