

COMMODITIES OUTLOOK

Commodity Prices: Modest Near-Term Upside As Double-Dip Fears Ease

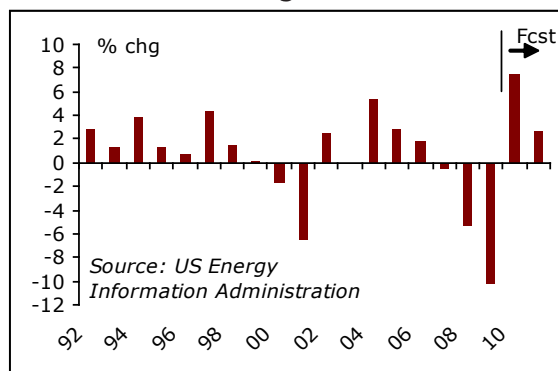
Commodity prices, not surprisingly, have been particularly affected by recovery anxieties, and remain below the spring's peaks even with the recent relief rally. While we've upgraded our forecast for 2010 global GDP growth to 4.5%, that's effectively water under the bridge, reflecting resilient growth in the first half of the year. The road ahead isn't as pretty. While a soft landing in China limits the downside for resource demand there, fiscal austerity will hold OECD growth to a disappointing 2% or less next year.

On a supportive note for gold, unemployment, deflation and double-dip worries signal a longer fuse for central bank rate hikes than we had previously envisioned. That, and the safe-haven bid from smoldering eurozone sovereign debt and banking worries, should see the King of Metals set a new record of \$1300/oz by year-end. Although delayed, the major threat is still Fed retightening. The market's pricing in of that risk will take gold lower by late 2011.

A month ago we trimmed our targets for copper, zinc and the other industrial metals in response to easing although still positive growth prospects and greater risk aversion. Deep cuts in speculative long positions contributed to the correction's vehemence. We are sticking with our above-consensus forecasts for both zinc and copper. China's copper imports have eased modestly, but heavy power grid investments and heightened electric vehicle production should reinforce longer term growth in demand for the red metal there.

Although Henry Hub gas prices have ceded some of the late spring's healthy climb, we believe that the forces are still in place for a further narrowing in the near-record BTU discount to oil over the medium term. Even with non-conventional supply showing traction, total US marketable gas production so far this year is up by only 1.6%, half of last year's rate of increase. After a harsh blow during the recession, natural-gas-weighted industrial production stateside is expected to rise at an unprecedented near-8% pace this year (Chart), bolstering demand. While the BP blowout could have supportive longer term implications for oil, any near-term effects will be trumped by a 6-million barrel/day OPEC supply cushion and demand consequences of a tepid global recovery. Those realities should help to limit WTI spot prices to an average \$80/bbl this year and \$85 in 2011.

Chart
US Natural-Gas-Weighted Ind. Production



Source: US Energy Information Administration

Spot Commodity Prices

| | | Average | | | | | |
|---------------------|------------|---------|-------|------|-------|----------|----------|
| | | 26-Jul | 2007 | 2008 | 2009 | 2010 (f) | 2011 (f) |
| Oil (WTI) | \$/bbl | 79 | 72 | 100 | 62 | 80 | 85 |
| RBOB gasoline | \$/gal | 2.12 | 2.09 | 2.49 | 1.69 | 2.15 | 2.25 |
| Heating Oil (NYH) | \$/gal | 2.02 | 2.03 | 2.86 | 1.65 | 2.08 | 2.20 |
| Natural Gas (Henry) | \$/Mn Btu | 4.70 | 6.97 | 8.89 | 3.82 | 4.90 | 6.00 |
| Gold | \$/troy oz | 1191 | 695 | 872 | 1088* | 1300* | 1150* |
| Copper | \$/lb | 3.18 | 3.24 | 3.16 | 2.35 | 3.25 | 3.15 |
| Aluminum | \$/lb | 0.91 | 1.20 | 1.17 | 0.76 | 0.95 | 0.85 |
| Nickel | \$/lb | 9.20 | 16.86 | 9.57 | 6.69 | 9.00 | 8.00 |
| Zinc | \$/lb | 0.85 | 1.48 | 0.85 | 0.76 | 1.00 | 0.95 |

* end of period