



Commodities Update

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Commodity Prices: Holding Pattern to Continue

After an sizzling climb from the recession's lows, the commodity rally appears to have run out of steam. A number of factors, including sub-consensus global GDP growth and a slowing US industrial sector, suggest a continued horizontal ride for commodities over the next 12-18 months. Potential upside exists beyond that as some of the forces restraining the US and other industrial economies begin to ease. The Asian emerging markets pacing the recovery are metals- rather than energy-intensive, a potential plus for the former market segments. Adding to general volatility, rising index investment means commodity prices follow the broad ebb and flow of investor sentiment more closely than they once did.

Above-average levels of risk aversion along with low yields have helped gold set new highs. We are staying for now with our earlier year-end target of \$1300/oz., but we've raised our call for 2011 to reflect upside associated with Fed quantitative easing. A solution to Europe's debt problems remains elusive. While that's a further near-term plus for safe-haven demand for the yellow metal, higher rates still pose a longer-term threat for gold, and central bank re-tightening will quench the rally in 2012.

We've pared our projections for both oil and natural gas amidst evidence of weakening growth and signs of ample supply. WTI is now expected to average \$77/bbl this year and \$75 next. Limiting the potential headroom for prices, OECD inventories are running at a near-record 61.4 days of forward cover. OPEC's excess capacity overhang also remains available to meet any unexpected surge in demand. Our forecast for tepid 3.6% global GDP growth suggests, as well, some potential downside risk to the IEA's forecast for a healthy 1.5% rise in global oil demand next year. A warm summer has helped cut natural gas inventories. But the drag on demand from a slowing US factory sector will help hold Henry Hub prices to an average \$5.00/MM Btu in 2011, firming somewhat to \$5.50 in 2012.

continued

Table 1

Commodity Price Forecast

		Average					
		17-Sep	2008	2009	2010 (f)	2011 (f)	2012 (f)
Oil (WTI)	\$/bbl	74	100	62	77	75	80
Natural Gas (Henry)	\$/Mn Btu	4.11	8.89	3.82	4.50	5.00	5.50
Gold	\$/troy oz	1274	872	1088*	1300*	1400*	1150*
Copper	\$/lb	3.51	3.16	2.35	3.25	3.50	3.60
Aluminum	\$/lb	0.98	1.17	0.76	0.95	0.85	0.90
Nickel	\$/lb	10.55	9.57	6.69	9.00	8.50	8.00
Zinc	\$/lb	0.97	0.85	0.76	1.00	0.90	0.95
Lumber**	\$/'000 bd ft	239	252	221	235	255	280

* end of period ** 1st Futures

Prices for copper—our top base metal choice—have shown resilience recently. China accounts for about 40% of global demand for the metal. Grid investment and plans to produce highly copper-intensive electric vehicles should keep demand there on a healthy rising track. Demand growth will approximate capacity additions in 2011, keeping global markets tightly supplied. We are less bullish on some of the other major base metals. Nickel inventories remain at particularly high levels.

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