

Scotiabank Commodity Price Index

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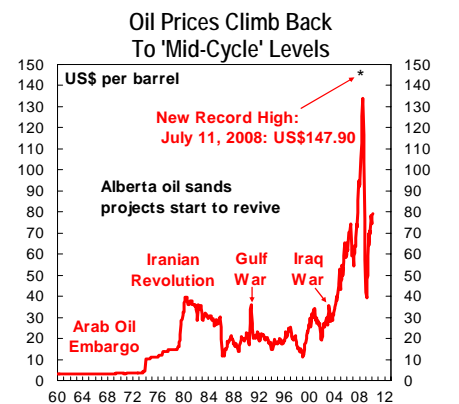
Scotiabank Commodity Price Index Strengthens in January

- *Commodity markets anticipate a restocking-led recovery in U.S. demand.*
- *'Tight oil' resource plays likely to rejuvenate Western Canadian Sedimentary Basin.*
- *President Obama embraces nuclear energy, a positive for uranium.*
- *'Random Lengths Framing Lumber Composite Price' surges over US\$315; if maintained, the Canada-U.S. Softwood Lumber Agreement will permit a cut in the export tax on U.S. shipments.*

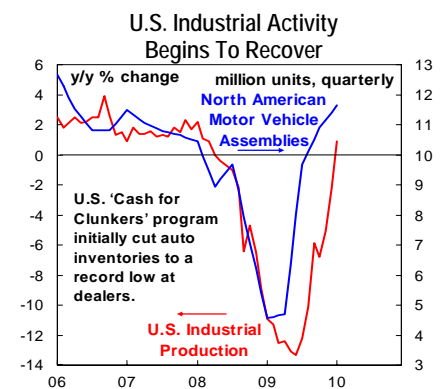
Scotiabank's Commodity Price Index jumped by 4.8% m/m in January, beginning 2010 on a strong note. The All Items Index has advanced by 26.5% from the cyclical bottom in April 2009.

Commodity prices have been exceptionally volatile in the opening months of 2010, surging in early January on speculative demand for base metals in China and as a severe cold snap across much of the Northern Hemisphere sent oil & gas prices higher. However, prices retreated significantly from mid-January through early February as China and then India began to tighten monetary policy to prevent inflation from heating up and asset bubbles from forming, raising concerns — albeit likely overdone — over a potential slowdown in 'emerging-market' demand. China now accounts for almost 40% of world demand for the four key base metals and the United States only 10% (excluding inventory accumulation). Possible sovereign debt defaults in Greece, Portugal and Spain also lessened investor appetite for 'riskier' assets, causing a temporary shift back into 'safe-haven' U.S. dollar Treasury securities. The resultant strengthening of the U.S. dollar against the euro pushed down oil, gold and other dollar-denominated commodity prices through early February, though gold held up relatively well.

Investor 'risk appetite' has recently returned, with market attention shifting from the fallout on Euro Zone growth and bond markets from Greece's excessively high debt-to-GDP ratio (12.5%) to an improving manufacturing environment in the United States (though the risk of a Greek credit downgrade may continue to rile markets from time to time). The Fed's move to increase the discount rate by 25 basis points to 75 bp (closer to the normal 100 bp spread over the Fed funds rate) — the rate at which commercial banks can tap 'emergency' funds from the Federal Reserve Board — has been taken as a sign that monetary policy is being 'normalized' and that the U.S. economy and credit conditions are on the mend. **Commodity prices are expected to strengthen in the first half of 2010, with restocking of manufactured goods and raw materials in the United States adding to 'emerging-market' demand.** U.S. Purchasing Manager Indices have shown a marked pick-up in shipments and output in recent months. **A big increase in annual contract prices for coking coal and iron ore, as tight international supplies strain to meet strong Asian demand, will add to gains.**



WTI oil February 24, 2010: US\$80.
 Prices bottomed at US\$32.40 on December 19, 2008.



U.S. motor vehicle assemblies (including General Motors, Mitsubishi, Nissan...) totalled 8.7 million units in 2008, dropped to 5.7 million in 2009 and are expected to edge up to 7.2 million in 2010. Assemblies averaged about 12 million from 1993-2007. Assemblies started to pick up in 2009:Q3 and continue to strengthen in 2010:Q1.

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In January, the **Oil & Gas Index** led the way, climbing 12.5% m/m. A snap-back in Canadian export prices for natural gas to an estimated US\$5.73 per mcf — alongside cold winter weather in the United States — led the gain. The Edmonton par price for light crude oil also rallied over US\$75 per barrel and medium/heavy crude oil prices at Hardisty, Alberta jumped even more, as did propane prices in Edmonton and Sarnia.

The **Forest Products Index** posted the second-best advance in January, rising 3.3% m/m. **U.S. linerboard prices** rose by US\$50 to a lucrative US\$580 per ton, with cardboard box converters attempting to restock low inventories alongside rebounding U.S. industrial activity (up 5.5% since the June-2009 bottom and posting a slight 0.9% yr/yr gain in January — the first increase since March 2008). After a -7.5% drop in U.S. box shipments in 2009, shipments are expected to rise by 4.3% in 2010 — given restocking — and level out with a 1% gain in 2011. Linerboard mill closures in the United States and on the B.C. Coast (Eurocan) have also given producers more pricing power.

Western Spruce-Pine-Fir 2x4 No. 2 & Btr lumber prices also surged to US\$290 in mid-February — a genuinely profitable level over full breakeven costs including depreciation for B.C. Interior producers. While the recovery in U.S. housing starts remains fragile and slow (inhibited by snow in many parts of the United States in January and February), lumber inventories across the distribution system fell to exceptionally low levels by late 2009 (almost none) and U.S. dealers are now restocking in the face of supply constraints. B.C. Interior lumber mills are only operating at 50-60% of capacity, with Canfor and West Fraser recently stating that they will not step up output in the near-term. Roughly 43% of U.S. & Canadian lumber mill capacity is currently shut and record rainfall continues to inhibit logging in the U.S. South.

Metals & Minerals also advanced by 1.0% m/m in January. Widespread strength in base metals and steel-alloying agents (molybdenum and cobalt) was moderated by a sharp drop in potash prices — now at a bottom. Finally, the **Agricultural Index** also posted a 1.9% m/m gain in January. Cattle and hog prices rallied from quite low levels and Atlantic Coast lobster prices strengthened seasonally, offsetting slight declines in wheat and canola.

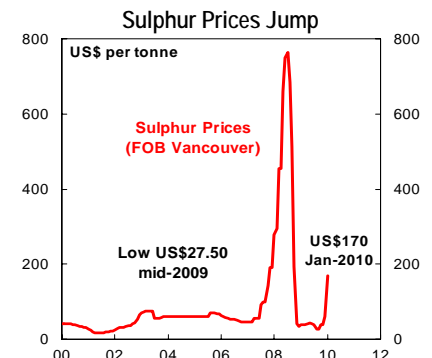
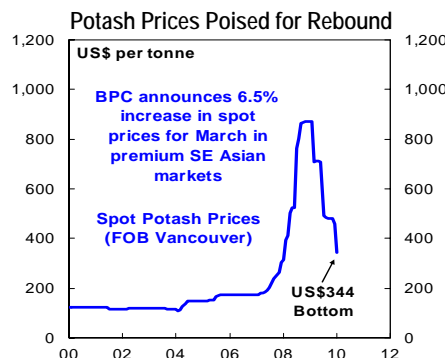
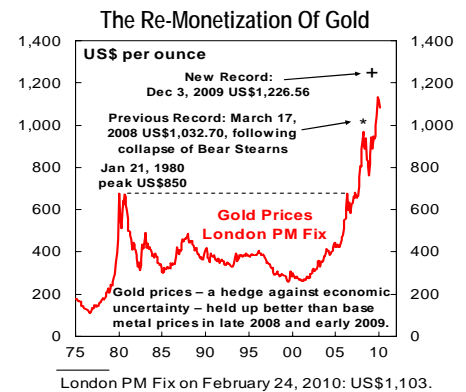
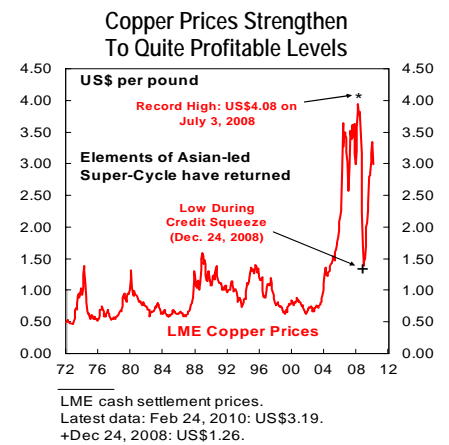
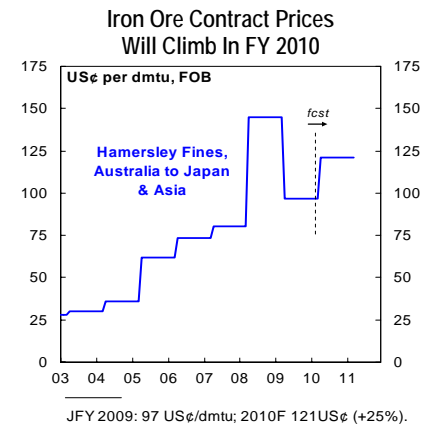
Metals & Minerals

LME copper prices (the bellwether) climbed from US\$3.17 per pound in December to US\$3.35 in January. After touching a near-term high of US\$3.49 per pound on January 11, prices fell to a low of US\$2.83 on February 5, before rebounding to US\$3.19 on February 24. Current prices remain exceptionally lucrative yielding a 61% profit margin over average world breakeven costs of only US\$1.23 (including depreciation).

While G7 demand was still weak in late 2009, China's copper consumption rose by an extraordinary 30.6% last year (excluding inventory building) and by an even bigger 42% (including 'strategic' stockpiling by China's State Reserve Bureau and speculative buying). Though global inventories rose to 65 days of consumption in 2009 — with overall world demand declining by -3.1% — 65 days is only slightly higher than the 60-day average of 2000-09. Inventories were a much higher 86 days from 2001-03, following the 2001 recession. Copper is considered a 'strategic' metal in China, with most of today's high inventories likely 'willingly' held.

Global supply/demand conditions should actually improve in 2010, with world demand up 5.9% as U.S. consumption begins to recover and adds to another 9% gain in China (assuming GDP growth of 9.5% in 2010). Market conditions should shift into 'deficit' in 2011, with global consumption surpassing refined output. While prices could pull back temporarily when the Fed tightens monetary policy later this year, copper should still average at least US\$3.15 in 2010 and climb to US\$3.50 in 2011.

Spot uranium prices have fallen to a low ebb of US\$41.75 per pound — down from US\$54 in mid-June 2009. Long-term base contract prices (prior to escalation at time of delivery) have also eased to US\$60, down from US\$70 a year ago. Last summer's announcement by the U.S. Department of Energy that it would barter significant quantities of 'surplus' UF₆ inventory over a four-year period to pay for an



environmental cleanup at a closed uranium enrichment plant in Ohio has hurt prices. However, in a positive development, U.S. Energy Secretary Chu recently indicated that the DOE has re-considered and will not barter volumes in FY2011-13. The DOE has applied for funding through the normal budgetary process. This follows President Obama's State of the Union address that stressed the merits of nuclear energy (emitting virtually no GHGs) as well as considerable criticism from the uranium mining states, which have faced job loss due to low uranium prices.

In keeping with a shift towards a pro-nuclear policy, the DOE has requested a tripling of funding for nuclear reactor loan guarantees for FY2011. The first conditional loan guarantee was recently awarded to Southern Company and its partners for development of two new AP1000 reactors in Georgia. The expanded loan guarantee program is intended to back seven to ten new nuclear reactors. While positive, this is likely to be swamped by China's reactor program. China now has 11 operating reactors and another 28 under construction, funded through normal commercial banking arrangements.

Spot potash prices (FOB Vancouver) dropped from US\$460 per tonne in December to US\$344 in January — at or close to a bottom — and are poised to rebound as 2010 unfolds. BPC — a joint venture between Russia's Uralkali, Belaruskali and the Belarusian railway company — has announced that it intends to increase spot prices from US\$385 (cfr or delivered) to US\$410 per tonne for shipments to Brazil and Southeast Asia (Malaysia, Indonesia and Vietnam) in March. It is interesting to note that spot prices have remained above BPC's recent one-year contract price with China (US\$350 cfr or delivered). Canpotex has also negotiated the sale of 350,000 tonnes to China's Sinofert (at an undisclosed price) and 600,000 tonnes to India on short-term contract at US\$370 cfr through June 2010. **Demand in Southeast Asia, Europe and the United States has picked up substantially in early 2010, following the recent drop in prices.** Urea (nitrogen) and DAP prices also continue to rally.

Sulphur prices (FOB Vancouver), a by-product of oil & gas production in Western Canada, have jumped from US\$60 per tonne in December to US\$170 in January alongside pent-up demand for phosphate fertilizers (DAP) and tighter supplies due to reduced refinery runs in the U.S. Gulf Coast. Sulphur prices at the Port of Vancouver fell as low as US\$27.50 in August 2009.

International market conditions for **iron ore** are also tightening. As of late January, Indian spot iron ore prices (63.5% Fe dry) bound for China were around US\$130-135 per tonne, up from US\$105 in early December. While the increase has been more modest for domestic iron ore in China, rising spot prices should increase the leverage of major iron ore producers (BHP Billiton, Rio Tinto and Vale) in annual contract negotiations in Asia. China's leading steel mills began talks with these producers in early February in Singapore. While 40% price hikes are being sought by miners, an increase of 25-30% appears more likely. Rio Tinto's iron ore production in the Pilbara region of Australia was above nameplate capacity in the second half of 2009 and BHP Billiton is expediting a series of rapid development projects to keep up with growing Chinese demand (imports up 42% in 2009). **Eastern Canadian producers should enjoy at least a 25% price hike for pellets bound for West European markets in FY2010.**

Oil & Gas

WTI oil prices climbed to US\$78.38 per barrel in January from US\$74.52 in December. Prices have been exceptionally volatile in early 2010, trading in a range of US\$69-83, buffeted by the ebb and tide of expectations for U.S. and global economic growth. Current prices sit at US\$80. U.S. petroleum demand has been slow to recover, but managed to edge up 1.3% yr/yr in mid-February. Rather than an 'oil-less recovery', as expected by the International Energy Agency, we think recent weak demand reflects the severe snowstorms in early 2010, which have crippled rail & truck transport in the Eastern United States. Demand should pick up with a more complete industrial recovery.

New drilling technology — 'multi-stage fracture stimulation' — is triggering new '**tight oil**' plays in Western Canada in the same way that this technology is allowing development of 'unconventional' natural gas shales and 'tight sands' in the Montney & Horn River areas of Northeastern B.C. and Alberta. While the Bakken 'light oil' play in Southeast Saskatchewan (Crescent Point Energy, 42° light oil similar to

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Growth Trends

(per cent change at annual rates)

	Weights	One Month	Three Months	One Year	Five Years	Ten Years
All Commodity Price Index	100	76.2	64.3	10.7	6.1	6.3
Industrials	83	85.0	68.7	14.0	6.3	6.6
Forest Products	40	47.3	58.2	7.2	-1.7	-0.4
Metal and Minerals	27	13.2	28.6	3.1	13.5	10.3
Oil and Gas	16	312.6	154.3	37.9	6.1	10.6
Agriculture	17	25.3	36.6	-8.2	4.7	4.3

Index 1997 = 100

	2010	2009			
	Jan	Dec	Nov	Oct	Jan
All Commodity Price Index*	184.3 *	175.8 *	170.1	162.8	166.5
Industrials*	194.2 *	184.5 *	178.6	170.4	170.4
Forest Products	96.1	93.1	90.5	85.7	89.7
Metal and Minerals	253.7	251.1	244.1	238.2	246.0
Oil and Gas*	333.5 *	296.4 *	284.1	264.1	241.9
Agriculture	134.9	132.4	128.0	124.8	146.9

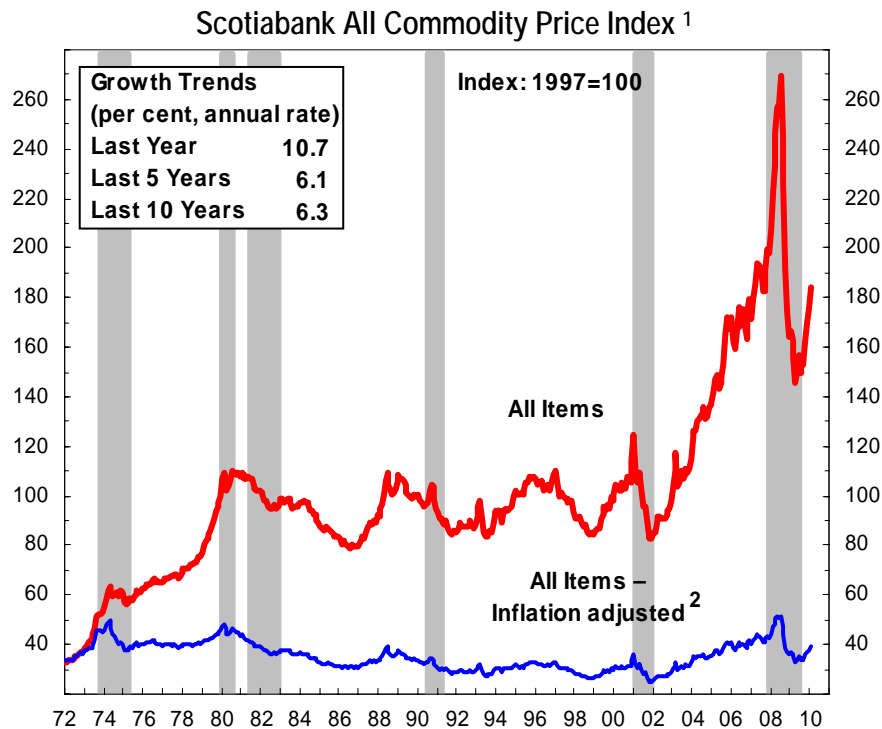
*Natural gas and propane prices are subject to revision.



WTI is a 'greenfield' development, multi-stage fraising is opening up opportunities to increase recovery from mature 'brownfield' oil fields in Western Canada. Key among these is the **Cardium** formation containing the legacy Pembina oil pool in Alberta, Canada's largest oil field. An incremental recovery factor of 5-15% could be achieved. NAL Oil & Gas, PennWest and ARC Energy are involved. **Other 'tight oil' plays gaining momentum include Viking and the Lower Shaunavon.**

Forest Products

Western Spruce-Pine-Fir 2x4 lumber prices have jumped from US\$218 per mfbm in December to US\$290 in mid-February (+90% yr/yr) — more than covering break-even costs of US\$242 and the 15% export tax into the United States. Equally interesting, the 'Random Lengths Framing Lumber Composite Price', an average of lumber prices across the U.S. and Canada, rose to US\$317 per mfbm on February 19. If maintained above the US\$315 trigger point for four consecutive weeks, the Canada-U.S. Softwood Lumber Agreement will allow an export tax reduction on Western Canadian lumber shipments to the U.S. from 15% to 10%. At no time since implementation of the Softwood Lumber Agreement has the tax dropped below 15%. (Should the Composite rise above US\$335, the tax would be cut to 5%, and above US\$355 to zero.) While lumber prices could ease back in coming weeks, the improvement is starting to boost earnings for major Western Canadian producers. **We have revised up the lumber price forecast to an average of US\$237 for 2010.** While many smaller mills will likely be restarted as 2010 unfolds, the 'capital destruction' during this downturn has been severe throughout the supply chain and many operations may not return. **NBSK pulp** prices are also strengthening.



1. A trade-weighted U.S. dollar-based index of principal Canadian exports.

2. Index deflated by U.S. Producer Price Index for Intermediate Goods.

– Shaded areas represent U.S. recession periods.