![OCBC Bank]

Wednesday, January 13, 2016

OCBC Commodities Outlook 2016

Energy

Our view for crude oil remains to be one of a rebalancing scenario, where the supply glut will gradually narrow as producers adjust to lower oil prices while demand picks up on a rosier 2016 global economic standing. Still, the biggest wildcard will be the resilience of oversupplies into 2016. The production in the Middle East will likely remain strong, while the lifting of the oil export ban in the US injects further suspense for oil supplies into 2016. Indeed, time is the key story-teller on how prices will react based on this kaleidoscope of factors.

Base Metals

Base metal had performed poorly in 2015, alongside other growth-related commodities like crude oil. Much of the poor performance is attributed to Chinese growth concerns and the resultant lower demand of base metals. Elsewhere, the fall in iron ore prices on shadow banking curbs and Chinese-centric scandals have invariably pressured base metals lower. Still, our expectation for Chinese economic growth to remain respectable at 6.7%, on top of rosier 2016 economic outlook should benefit base metals this year.

Precious Metals

Precious metals ended 2015 with a whimper – Gold fell 10.5% to close at $1,060.2/oz on 31 Dec last year, just marginally above our call for a $1,050/oz mark. The factors behind the fall however, deserve much attention – higher US rates and a stronger dollar are key drags to the bullion. Still, recent episodes of risk aversion have spooked equities lower and safe haven assets higher. Risk-off market sentiment in fact, is a credible driver for higher bullion prices, a tail-end risk that we cannot ignore.

Agricultural Commodities

Crude palm oil prices closed flattishly in 2015, although much of the rally is seen in 4Q15 on El Nino-related reasons. The expected poor harvest to be seen in 2016, as well as emerging La Nina weather extremities would be detrimental to future harvest. This presents a bullish case for agricultural products across Asia including sugar, palm oil, rice etc.

Commodities Performance Table

Updated as of 04 January 2016

Selected Indices	Close	Weekly Change	MTD	QTD	YTD
US Dollar Index (DXY)	98.2	0.3%	-0.4%	-0.4%	-0.4%
Reuters / Jefferies (CRB)	176.3	1.0%	0.0%	0.0%	0.0%
Dow Jones Industrial Avg	17,425.0	-0.6%	0.0%	0.0%	0.0%
Baltic Dry Index	478	0.0%	0.0%	0.0%	0.0%
Energy	**Close**	**Weekly Change**	**YTD**	**Net Position**	**Weekly Change**
NYMEX WTI Crude	37.4	1.5%	0.9%	229,522	4,570
ICE Brent Crude	37.6	2.6%	0.8%	163,672	-2,362
NYMEX RBOB Gasoline	127.3	3.3%	0.5%	75,996	8,190
NYMEX Heating Oil	113.0	3.7%	2.7%	-6,891	5,835
NYMEX Natural Gas	2.3	3.2%	-1.6%	-207,741	-4,646
Base Metals	**Close**	**Weekly Change**	**YTD**	**Net Position**	**Weekly Change**
LME Copper	4,705	0.3%	0.0%	-30,017	159
LME Aluminium	1,507	-1.7%	0.0%	-	-
LME Nickel	8,820	2.1%	0.0%	-	-
Precious Metals	**Close**	**Weekly Change**	**YTD**	**Net Position**	**Weekly Change**
COMEX Gold	1,070.1	0.0%	0.9%	23,311	-8,873
COMEX Silver	13.9	0.3%	0.8%	19,872	-2,460
NYMEX Platinum	881.4	0.1%	-1.2%	23,534	434
NYMEX Palladium	547.8	-0.8%	-2.5%	7,989	18
Agriculture	**Close**	**Weekly Change**	**YTD**	**Net Position**	**Weekly Change**
CBOT Corn	358	-0.9%	-0.3%	-50,912	-54,631
CBOT Wheat	470	0.7%	-0.1%	-89,630	-12,471
CBOT Soybeans	864	-0.1%	-0.8%	-60,670	-29,067
Asian Commodities	**Close**	**Weekly Change**	**MTD**	**QTD**	**YTD**
Thai W. Rice 100% (USD/MT)	365	0.0%	-3.7%	0.0%	0.0%
Crude Palm Oil (MYR/MT)	2,265	0.8%	-5.5%	-5.5%	-5.5%
Rubber (JPY/KG)	140	-5.7%	-5.0%	-5.0%	-5.0%

Source: Bloomberg, CFTC, OCBC Bank
Note: Closing prices are updated as of 04 January 2016
Note: Speculative net positions are updated as of 29 December 2015
Note: Speculative net positions for Aluminium and Nickel are unavailable

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Energy: The rebalancing story stays

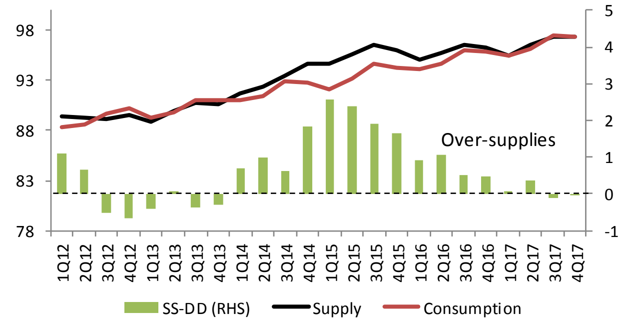
Highlights

- Our view for crude oil remains to be one of a rebalancing scenario, where the supply glut will gradually narrow as producers adjust to lower oil prices while demand picks up on a rosier 2016 global economic standing.
- Let's not forget however, the possibility of geopolitical tensions in the Middle East, a factor unquantifiable but yet significant to how oil prices path its way into the new year. Elsewhere, China's thirst for oil, seen in its growing imports of the sticky liquid in the last year, will be pivotal as well.
- The biggest wildcard will still be the resilience of oversupplies into 2016. The production in the Middle East will likely remain strong, while the lifting of the oil export ban in the US injects further suspense for oil supplies into 2016. Indeed, time is the key story-teller on how prices will react based on this kaleidoscope of factors.

The demand-supply equation

Should market-watchers review how oil prices behaved back in 2015, one may come to a conclusion that global growth fundamentals did not have the final say in determining energy prices. It was however, the simple demand-supply equation that sent oil prices below what many had not predicted. Indeed, 2015 met us with a widening oversupply environment for crude oil, exacerbated by the growing US oil production and the reluctance of OPEC to taper theirs in response.

The infallable DD-SS equation



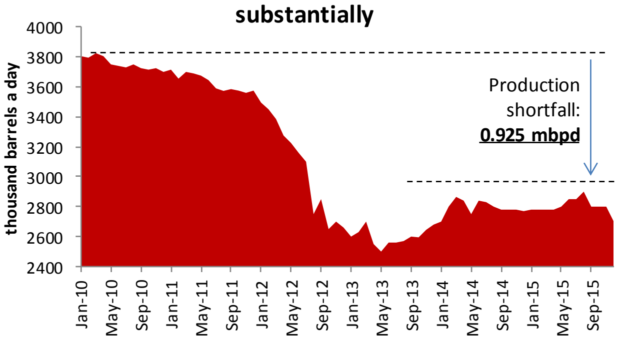
Source: Energy Information Administration, OCBC Bank

And as we start the new year, macroeconomic and supply outlook are indeed bearish for crude oil.

It is unsurprising that oversupply woes are still present, especially as we are met with news of the US export ban lift on the last day of 2015. The lifting of the crude oil export ban ultimately, spells the certainty for the US to play a larger role in determining (and contribution to) global crude oil supply. Indeed, the rapid increase in US crude oil imports, statistically by a whopping growth of 67% since 2010, is a trend to reckon with.

Elsewhere, there is more headroom for supplies to increase this year, on Iran's plans to increase oil production by as much as 1 million barrels per day (mbpd) in attempt to seize back lost market share. We also note that Libya's oil production has been largely pressured below capacity on domestic issues, and thus may see some recovery in oil production should geopolitical issues improve.

Iranian crude oil production has been pressured substantially



Source: Bloomberg, OCBC Bank

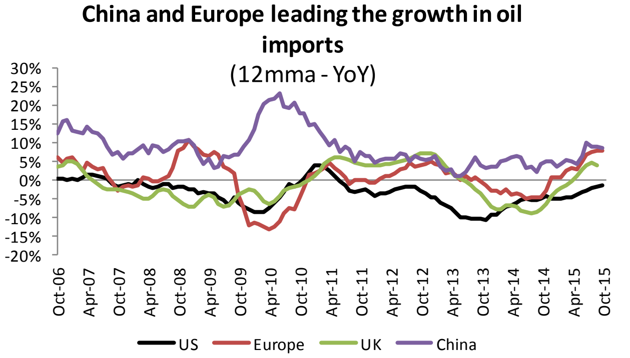
To exacerbate issues further, renewed Chinese growth concerns and market volatility led market-watchers to expect weaker demand and consumption from the world's largest consumer of base metals and energy. The overall risk aversion seen in the market, evident from the relatively weaker equity markets already seen in the first two weeks of 2016, has invariably spooked crude oil prices given its association with economic growth. Needless to say, the collective result of the above factors left crude oil sprawling at $30 per barrels as we speak.

Look out for volatility and uncertainty

Going forward into 2016, we need to consider three key themes (amongst the multitudinous of others) that would have paramount significance to how prices may trend.

Firstly, the prospect of how supply may course in the new year would likely be the kingpin, considering the oversupply environment seen for the past couple of years. The risk of oversupplies into 2016 is very real, on the back of fresh US crude oil exports and OPEC's reluctance to taper production. Still, with the risk of lower oil prices to as low as $20/bbl (should it fall further), we suspect the need for some credible action from oil producers to finally collectively agree to shore up prices. In this, oil bulls would welcome the emergency OPEC meeting proposed in early March, especially on grounds that even the mighty Saudi Arabia is hurting substantially from low oil prices.

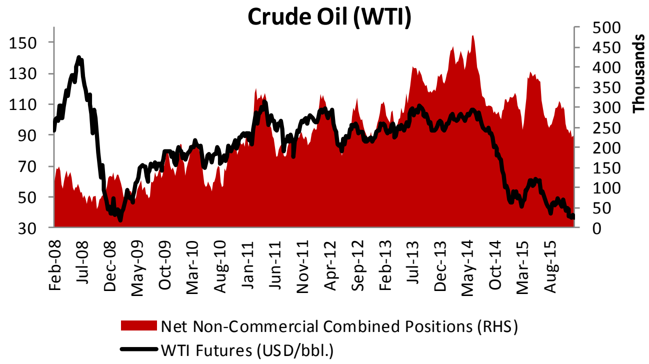
Demand however, being in the other side of the equation, will perhaps be the saving grace for the oil bulls. This second theme, which relates to crude oil as a growth-related commodity, does offer a scenario for higher oil prices underpinned by a rosier global economy in 2016 compared to the previous year. Indeed, on this note, we observe that crude oil demand, in quantity terms, has been healthy despite the risk-off sentiment seen (evident from the equity sell-off in Asia) largely in the second half of 2015.



Source: Bloomberg, OCBC Bank

For the year ahead, though we recognise some risk aversion in the market at this juncture, we remain confident of Chinese economic growth (estimate 6.7% yoy in 2016) and consequently the sustained hunger for commodities. Elsewhere, Europe started on a fairly sonorous note on the back of the expansionary Purchasing Manager Index (PMI) prints seen in early Janaury 2016. Crucially as well, the robust job growth in the US was a persuasive sign for the Federal Reserve to hike interest rates for the first time since 2006. All-in-all, we continue to expect healthy crude oil demand, led by a sustained thirst from China, Europe and the US.

The rebalancing story into 2016 is thus reinforced should we consider both supply and consumption. Supplies in our view, should taper lower as producers (especially non-OPEC) adjust to lower oil prices, while the rosier 2016 is likely to encourage consumption. Encouraging as well, the Energy Information Administration (EIA), in its latest January Short Term Energy Outlook, estimates that oversupplies will narrow from 1.94 mbpd in 2015, to 0.74 mbpd in 2016, led by a jump in global oil consumption by 1.42 mbpd to 95.19 mbpd this year. Elsewhere, we are still encouraged by the upward sloping in the oil futures curve, as well as supported non-commercial positions seen in CFTC positioning data, suggesting that investors are still eying on a possible rallying of oil prices this year.



Source: CFTC, OCBC Bank

Lastly, despite the rebalancing story that we are painting, do expect another year of volatility (and perhaps uncertainty) for the energy market. The key wildcard will likely be geopolitical risk, an important but highly unquantifiable factor for the crude oil space. Indeed, we are observing pockets of such risk, ranging from the recent clash between Saudi Arabia and Iran, while bombings in Libyan oil terminal were also reported. Needless to say, the intensification of geopolitical risk is price-positive for crude oil.

It's very cloudy

It is not much of a consolation, we admit, given the many conflicting factors for oil prices for 2016. Still, our view for a rebalancing scenario into 2016 stays firm. This view is underpinned by the expectation for a healthier pick-up in oil demand on a rosier global economic standing, led by recovering import demand especially from China, Europe and the US. Elsewhere, the low oil prices should dissuade oil producers from contributing to the over-supply environment. We also find solace in the supported non-commercial positions and upward-sloping futures curve which serve as precursors for a tepid oil price recovery.

Still, the current market environment has undoubtedly given market-watchers a strong reason to remain bearish on crude oil prices, where it may remain pressured at below $40/bbl at least in the first half of 2016 should OPEC (or the US for that matter) does nothing to assure the market. Still, our view for a rebalancing environment should gain traction into the second half of the year to lift both WTI and Brent to $50/bbl at end-year.

Gold: What can go wrong?

Highlights

- Precious metals ended 2015 with a whimper – Gold fell 10.5% to close at $1,060.2/oz on 31 Dec last year, just marginally above our call for a $1,050/oz mark. The factors behind the fall however, deserve much attention – higher US rates and a stronger dollar are key drags to the bullion.
- The factors that dragged gold prices in 2015 should persist into 2016. On this, we look for US Federal Reserve to inject three more rate hikes in 2016 to a year-end forecast of 1.25%. The higher rates should further strengthen the greenback
- Still, recent episodes of risk aversion have spooked equities lower and safe haven assets higher. Risk-off market sentiment in fact, is a credible driver for higher bullion prices, a tail-end risk that we cannot ignore.

No surprises there

In times of geopolitical peace and higher interest rates, gold as a safe haven asset is perhaps largely forgotten. Truth be told, gold had fallen 10.5% in the year 2015, while the US fed fund rate and the corresponding increases in bond yields across the globe dulled gold as a zero interest-yielding asset. Elsewhere, market-watchers also shrugged off Chinese-centric growth concerns, and focused largely on the strengthening greenback, thus kicking gold another leg-down. Coupled with lackluster physical gold demand from India and China, the bullion had only one direction to trend – downwards.

It is thus imperative to recognize the drivers which attributed to the fall in gold prices. But more importantly perhaps, is our expectation for these drivers to persist into 2016. The market may have started the year with a depressing note so far, but an eventual rosier 2016 will bring gold to new lows.

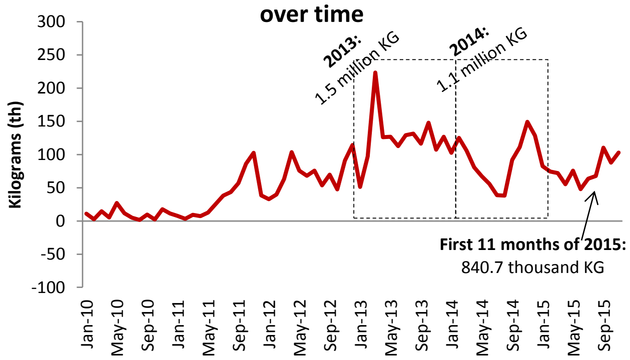
Don't stay myopic

There are no good news so far as we start the second week of the year. We are faced with renewed uncertainty in Chinese economic growth and its resultant decline in equities. Elsewhere, fresh geopolitical risk in the Middle East was observed. Ostensibly, the reluctance for oil prices to inch higher despite the Middle East turmoil gives market-watchers all the more reason to caution on low oil prices as a leading indicator for more bad news to come. Unsurprising, gold prices rallied substantially as we add one year to the calendar, given that the bullion is widely considered as a safe haven.

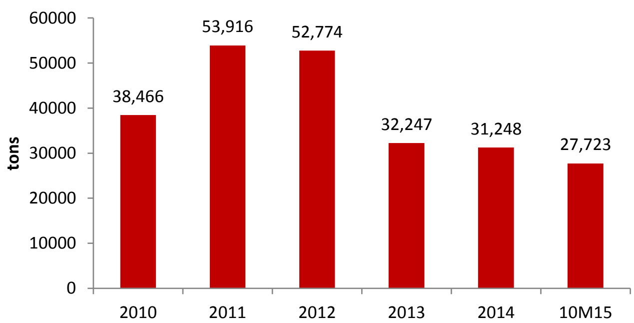
However, short-term bouts of economic uncertainty are by far, part and parcel of how volatile markets can be, and should not take precedence over the longer-term climate that may present itself. The classic gold outlook may well be divided into two main themes: the speculative demand, and the physical demand. To be fair, both themes have had their specific factors to drive gold lower last year.

Let's talk physical first. Physical demand for gold in China and India, the two largest consumer of the yellow metal, has fallen for the most of 2015. Statistically, Chinese gold imports from Hong Kong have edged lower for two consecutive years now, with imports in the first 11 months of 2015 measuring 840.7 thousand kilograms (-13.1% yoy). Much of the decline in demand is likely due to the shadow banking curbs and corruption clampdown, thus depressing gold demand as an instrument for gift-giving and means of collateral. In the case for India, rural demand for gold, which accounts for 60% of total Indian demand, will likely decline into this year as farmer income suffer on poor agricultural produce given poor weather conditions.

Hong Kong Gold Exports to China edged lower over time



India gold imports are also far from previous glory



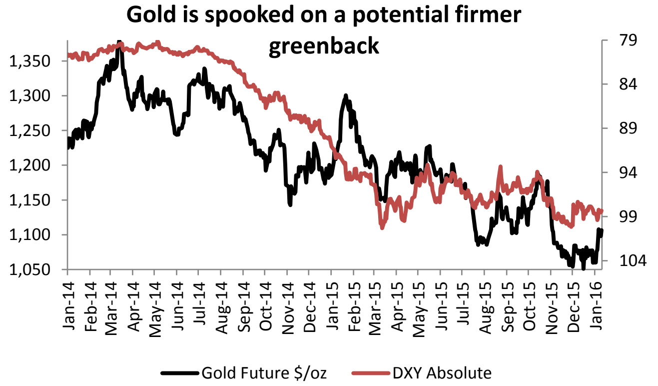
Source: Bloomberg, OCBC Bank

The only bright spot perhaps for physical gold demand is from central bank buying, where purchases remained tame at 175 tons of gold as of 3Q15 . It is also encouraging to note that the People's Bank of China (PBoC) has announced gold holding increase of over 50% since 2009. Still, total central bank buying only accounts a meager 15% of total gold demand, and would likely be insignificant should physical demand in India and China falls further into 2016.

The key driver for bearish gold

With physical demand likely to trend lower into the year, the argument for lower oil prices is thus made complete with an accurate projection of the speculative demand aspect. Suffice to say, the prospect for higher interest rates and a rosier economic outlook this year has rendered it looking bleak.

First off, we remain firm on our expectation for the US Federal Reserve to hike interest rates, at least, by three more times this year to an eventual 1.25% print at end-year. Should history be of any reference, gold had fallen in value mainly on the Fed's lift off in December, which had immediate first-order effect to trigger a stronger greenback and overall higher interest rates in Europe and Asia over the same period. As such, the prospect of higher interest rates into 2016 is to us, the kingpin for lower gold prices.



Source: Bloomberg, OCBC Bank

Elsewhere, despite gold behaving once again like a safe haven asset given current market volatility, economic conditions seen in the US and Europe, and even arguably China, remain luster. In the US alone, economic indicators belonging to the labor market (now that nonfarm payrolls printed a strong 292k in December), housing and manufacturing have improved markedly since the 2008/9 Lehman Brothers triggered financial crisis. Elsewhere, greenshoots in Europe are seen with Purchasing Manager Indices (PMIs) in peripheral Eurozone countries like Spain, Italy and Greece have moved to expansionary territories. China by itself, with our forecast for growth to print a slower but respectable 6.7% yoy print in 2016 is still showing some resilience with central bank intervention of an expected interest rate cut and two Reserve Requirement Ratio (RRR) cut. At least for what we can see, 2016 seems to be a rosier year compared to 2015, and by that, safe haven demand may turn unattractive into the weeks ahead.

What can go wrong?

Our expectation for a bearish gold outlook is predicated on a rosy 2016 economic outlook, higher Fed fund rates and an expensive greenback.

Should our expectations come to pass, gold prices are expected to stage another leg-down to our forecast of $950/oz this year. The caveat to this would naturally be a severe turn-around in economic conditions, led by a possible (1) the negative impact to Asian central banks from an unexpected rapid increases in US rates and (2) Chinese hard-landing and the contagion to the global economy. Elsewhere, we recognise the Federal Reserve's data-watching stance, and there remains the risk for the central bank to engage in further rate hikes.

As such, should economic conditions turn unfavorable, gold prices may in response turn higher to touch $1,200/oz instead on safe haven demand once again.

OCBC Commodity Forecast for 2016

As of January 13, 2016	2015				2016			
	Q1	Q2	Q3	Q4	Q1F	Q2F	Q3F	Q4F
Energy								
WTI ($/bbl)	48.6	58.0	46.5	42.2	35.0	40.0	45.0	50.0
Brent ($/bbl)	55.1	63.5	51.3	44.7	35.0	40.0	45.0	50.0
Gasoline ($/gallon)	1.60	2.00	1.64	1.31	1.17	1.33	1.50	1.67
Natural Gas ($/mmbtu)	2.81	2.74	2.74	2.24	2.02	1.89	2.65	2.50
Precious Metals								
Gold ($/oz)	1,217	1,193	1,124	1,105	1,025	1,000	975	950
Silver ($/oz)	16.7	16.4	14.9	14.8	14.4	14.5	14.6	14.6
Platinum ($/oz)	1,192	1,128	991	911	882	889	897	905
Palladium ($/oz)	785	758	616	606	653	658	663	669
Base Metals								
Copper ($/MT)	5,805	6,047	5,274	4,882	4,514	4,676	4,838	5,000
Tin ($/MT)	18,369	15,581	15,224	15,093	13,277	13,753	14,229	14,706
Nickel ($/MT)	14,388	13,046	10,605	9,443	9,604	9,949	10,294	10,638
Zinc ($/MT)	2,090	2,191	1,854	1,634	1,557	1,612	1,668	1,724
Aluminum ($/MT)	1,814	1,788	1,623	1,507	1,347	1,396	1,444	1,493
Asian Commodities								
Crude Palm Oil (MYR/MT)	2,270	2,196	2,082	2,220	2,388	2,475	2,563	2,650

Source:

Historical Data - Bloomberg

Forecasts - OCBC Bank

Note: Data reflects average price