Monday, March 14, 2016

OCBC Commodities Outlook

Energy

The rebalancing is ongoing as we speak – US crude oil production has fallen, and is expected to fall further to 8.7mbpd in 2016 according to EIA estimates, in line with our call for a slightly higher 8.8mbpd. Elsewhere, prices seem to have bottomed after touching their sub-$30/bbl handle many weeks back. All-in-all, a healthy expected pickup in global demand by 1.15mbpd this year in EIA's STEO report should add further upside to oil prices.

Base Metals

A no-surprise growth call of 6.5-7.0% in the recent China's National People's Congress meeting, amid the surprise reserve requirement ratio cut to 17.0% (-50bps) gave market a reason to salivate after growth-related commodities like base metals. Indeed, copper surged up to $5,000/MT this week, and only edging lower on poor Chinese trade prints. Though we continue to stick to our bullish call for base metals at year-end, we recognise that further data disappointment especially from China will serve as effective price-drags.

Precious Metals

Gold once again shone brightly in times of adversity, especially as calls for a very hawkish US Fed faded and interest rate cut by the BOJ dulled both the greenback and the yen as traditional safe haven assets. Still, we observe that some calls for the Fed to resume its interest rate hike this year, given recent strong nonfarm payrolls and stronger-than-expected manufacturing PMI. The favourable economic prints and higher interest rate towards 2H16 should serve as effective drags on gold prices.

Agricultural and Asian Commodities

Malaysia's crude palm oil production has fallen considerably since the start of the year, to the lowest January print since 2011, as palm produce likely suffered from the drought seen since 2H15. Production is likely to contract (-3.0%) in 2016, given the lagging effect from the El Nino phenomenon, as well as a likely La Nina episode in 4Q16. Like almost any agricultural commodity, the poor production (aside from the strong export seen at the start of this year), may lift CPO futures considerably this year.

Commodities Performance Table

Updated as of 07 March 2016

Selected Indices	Close	Weekly Change	MTD	QTD	YTD
US Dollar Index (DXY)	97.4	-0.9%	-0.9%	-1.3%	-1.3%
Reuters / Jefferies (CRB)	168.5	3.3%	3.3%	-4.3%	-4.3%
Dow Jones Industrial Avg	17,006.8	3.0%	3.0%	-2.4%	-2.4%
Baltic Dry Index	349	6.1%	6.1%	-27.0%	-27.0%
Energy	**Close**	**Weekly Change**	**YTD**	**Net Position**	**Weekly Change**
NYMEX WTI Crude	36.3	7.5%	-2.1%	260,687	13,561
ICE Brent Crude	39.0	8.5%	4.6%	342,460	22,171
NYMEX RBOB Gasoline	134.3	27.9%	6.0%	92,074	3,291
NYMEX Heating Oil	116.5	8.3%	5.8%	-1,843	-3,644
NYMEX Natural Gas	1.6	-5.3%	-30.7%	-192,268	-3,771
Base Metals	**Close**	**Weekly Change**	**YTD**	**Net Position**	**Weekly Change**
LME Copper	5,028	7.1%	6.9%	-24,619	-1,574
LME Aluminium	1,587	0.9%	5.3%	-	-
LME Nickel	9,340	9.6%	5.9%	-	-
Precious Metals	**Close**	**Weekly Change**	**YTD**	**Net Position**	**Weekly Change**
COMEX Gold	1,264.5	2.4%	19.3%	183,616	4,637
COMEX Silver	15.6	4.9%	13.2%	54,121	-5,649
NYMEX Platinum	984.9	5.4%	10.5%	31,861	-1,708
NYMEX Palladium	563.1	13.6%	0.2%	2,656	-1,511
Agriculture	**Close**	**Weekly Change**	**YTD**	**Net Position**	**Weekly Change**
CBOT Corn	355	0.3%	-1.2%	-128,032	-66,049
CBOT Wheat	455	2.2%	-3.2%	-123,086	-12,678
CBOT Soybeans	871	2.1%	-0.1%	-85,959	-55,267
Asian Commodities	**Close**	**Weekly Change**	**MTD**	**QTD**	**YTD**
Thai W. Rice 100% (USD/MT)	388	0.0%	-0.3%	6.3%	6.3%
Crude Palm Oil (MYR/MT)	2,464	-0.6%	-0.6%	2.8%	2.8%
Rubber (JPY/KG)	169	15.4%	15.4%	14.6%	14.6%

Source: Bloomberg, CFTC, OCBC Bank
Note: Closing prices are updated as of 07 March 2016
Note: Speculative net positions are updated as of 01 March 2016
Note: Speculative net positions for Aluminium and Nickel are unavailable

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Energy: The rebalancing act continues

Highlights

- A substantial rally in both WTI and Brent was seen since the start of the week, suggesting that our call for a bottoming is turning to fruition. Statistically, Brent touched its $40/bbl handle in early March.
- Indeed, tell-tale signs for crude oil to rally further can be seen from (1) higher and steeper forward curves, (2) pick-up in speculative positions, and (3) reinforced rebalancing expectations into 2016.
- Although upside risk in global oil production remains, the rebalancing is expected to continue given the higher pace of demand growth vs supply. Should an OPEC production cut surfaces in the near future, the rebalancing would surely accelerate considerably.

What the EIA did not say

The recent Short-Term Energy Outlook (STEO) report by the US Energy Information Administration (EIA) had lowered their forecast for WTI and Brent prices to average $34/bbl and $40/bbl in 2016 and 2017, respectively, citing that "production is more resilient to lower prices than previously expected". Elsewhere, the fall in global demand for petroleum and other liquid fuels also stood out, with consumption now expected to grow by only 1.1 mbpd (-0.1mbpd vs Feb's STEO) and 1.2 mbpd (-0.2mbpd) in 2016 and 2017 respectively.

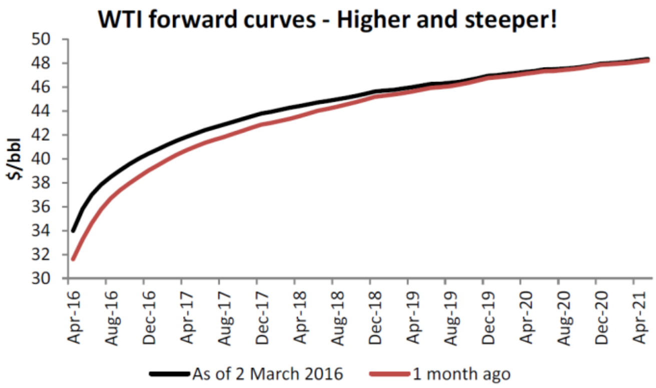
These numbers though, only speak half the tale. While global oil consumption growth forecast has fallen once again, the pace of the increase still manages to outstrip the expected pace of global supply growth, penciled in at a mere +0.7 mbpd over the same period. More importantly, global demand is expected to accelerate (+1.21mbpd) into 2017 while supply (+0.3mbpd) counterpart slows further. All these put together, continues to reinforce the scenario for the oil market to rebalance further, the key factor underpinning our bullish call for oil prices.

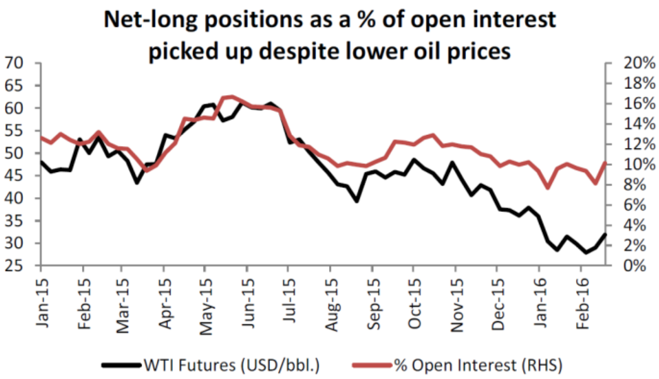
It's not hard to stay bullish

Given how Brent rallied into its $40/bbl territory (while WTI trailed slightly behind), it is vital to understand the tell-tale signs that signaled this rally. Such, while may explain why the rally occurred, may spell factors to suggest the sustenance of this episode.

The whole bullish cycle may have likely spun off Russia's cooperation with the other OPEC members on the agreed supply freeze. Technically, the countries in the Doha talks then earlier in February, had agreed to freeze production output at their January levels. Although the skeptic (including us) eyed warily on what this may entail to oil prices, it is for the fact that this was the first OPEC and non-OPEC deal in 15 years, and thus signaled a start to further cooperation, if necessary, to stem further slump in prices.

Data and numbers however, do not lie. The production freeze, amid expectations that the fall in oil prices could be overdone by January 2016, prices started to inch higher. Thus, observing that prices have already fallen by a good twenty months now, the higher and steeper forward curves seen in both WTI and Brent is a welcome sight to oil bulls. Elsewhere, the pick-up in speculative positions and open interest in Nymex Crude reinforces the buying interest by market-watchers.





Source: Bloomberg, OCBC Bank

Light at the end of a long dark tunnel – IEA

Oil prices in our opinion, have likely bottomed after touching its sub-$30/bbl. Following the signals that buying interest has indeed returned, prices may continue to inch higher into the year. In addition, we remain expectant over a likely production cut by the OPEC cartel in its upcoming June meeting (and on further rhetoric should a 20 March meeting rumored by the market occur then). Should a cut in production come to pass, the rebalancing of the oil market would surely accelerate, and place upside risk to our year-end forecast for WTI and Brent to touch $50/bbl then.

Gold: Rate divergences play out

Highlights

- Favorable US-centric economic data resulting in a general improvement in optimism has led the probability for the Fed rate hike higher. Statistically, the probability for a rate hike now is penciled at 77.1% at the Dec 2016 meeting, up from a 36.9% seen at end Feb.
- We have been firm in keeping our expectation for further Fed rate hikes this year, previously calling for at least one hike this year (and one to two more beyond that should data prints favorably). Following good labor and growth prints so far, we do see a clearer path for two rate hikes in the course of this year.
- Indeed, the rate divergence between the US and the rest of the world is a phenomenon to watch closely, now that ECB sent rates deeper into negative territories, while RBNZ cut rates further. The potentially higher US rates will be a strong signal for a strong greenback, and subsequently duller gold.

Paper and Physical Demand

The higher gold price seen in 1Q16, on top of safe haven demand amid the stock market volatility, may have likely been fuelled by physical demand as well. Statistically, India had imported 83 tonnes of gold in January, a level over twice as much as volume in January 2015. This is likely because of (1) lower gold prices seen at the start of 2016, (2) front-loading of physical purchases given possibly higher import taxes, and (3) seasonal factors given the earlier wedding season which occurs between mid-January to the first week of March. This data is critical to explaining higher gold prices, given that now, both paper demand – owing to safe haven demands, and physical demand have seen some uptick in the last couple of months.

In the same vein, it is important to gauge the current environment in determining gold price trends. Firstly on paper demand, we continue to expect higher interest rates in the US, thus benefiting the greenback and dragging gold prices. This outlook is predicated on the better-than-expected US-centric economic data seen of late, and thus suggests the economic recovery in the US is still on track. Even in the eyes of the market, the steeper Fed Fund Rate Futures curve is now indicating a strong 77.1% probability for a rate hike in Dec 2016, up from a tepid 36.9% seen back at end Feb.

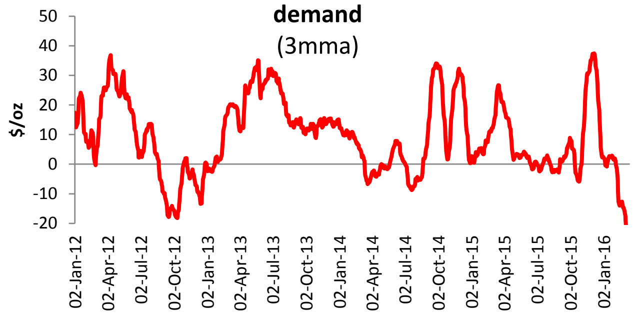
Diverging rates may lift gold

In the same vein, the wider rate divergence between the US rates and the rest of the world will likely benefit the US dollar further. Do note that rate cuts in many major central banks including ECB, RBNZ, BOJ, and in Asia, Bank Indonesia. China itself had also eased monetary policy by cutting its reserve requirement ratio by 50bps in a surprise move in February. Needless to say, the need for further interest cuts in these economies, coupled with the real possibility for higher US rates, is a phenomenon to watch closely. This rate divergence, at least for the dollar-denominated commodities space, is an extremely persuasive factor to drag gold prices lower.

Physical demand may see some tapering

Given that some uptick in gold may be attributed to stronger Indian gold imports, it is important to account for the recent changes in gold import rules. Statistically, there is at least three takeaways from India's FY17 budget – (1) gold dore import tax was raised by 75bps to 8.75%, (2) an excise tax of 1.0% was introduced for gold jewellery, and (3) although gold bullion import tax was kept at 10%. Putting both points one and two together, it is more costly to import and own physical gold in India, and thus explains why there may be a front-loading of gold imports in the first two months of 2016. As such, future gold imports in India may see some tapering going forward, as the market digest the higher taxes amid the end of the wedding season. Elsewhere, gold exports to China from Hong Kong had slowed to 37 thousand kilograms in January, down 54.7% on-month from December, while domestic discount to international gold price had widened significantly of late, suggesting further lacklustre demand in Chinese physical buying.

Chinese gold discount to international prices widened significantly, suggesting tame gold demand (3mma)



Source: Bloomberg, OCBC Bank

Still keeping bearish

Our bearish outlook on gold remains unchanged, given for the fact that we continue to expect higher interest rates in the US, amid poorer physical demand going forward. As such, we keep our gold outlook unchanged at $1,100/oz at end-year.

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