

Tuesday, October 31, 2017

OCBC Monthly Commodities Outlook (Nov 2017)

Energy

Crude oil prices remain supported amid uncertainty over Iraq's oil-rich Kirkuk oil production while falling US oil rig counts for three consecutive weeks gave oil bulls concrete reasons to lift prices higher. At this juncture, market expectations for US crude oil stocks to fall further for the week ended 20th October should continue provide a convincing support above \$50/bbl.

Base Metals

Year-to-date performance of base metals has been stellar; copper futures recently rose above its \$7,000/MT handle, highest since mid-2014, with other base metals trending in tandem. Of late, investors likely took PBOC Chief Zhou Xiaochuan's comment for a 7.0% growth in 2H17 favorably, coupled with the acceleration in its industrial production (Sept: +6.6% y/y). Elsewhere, aluminium production has fallen substantially into 9M17, leading prices higher to-date.

Precious Metals

Gold prices continued to fall in October, as risk appetite improves considerably on strong US corporate earnings. Of late, record high Wall Street prints and the stronger dollar has also depressed the yellow metal. We note that gold essentially remains to be zero-yielding asset in a rising yield environment, and an eventual Fed rate hike in Dec should force gold prices to take another step down.

Agricultural

Palm oil prices continue to climb in October, although still printing a notch below September high of MYR2,896/MT. A mix of stronger Malaysia palm oil exports (+11.6% m/m) in the first 20 days of October, as well as the lower-than-expected CPO production (+3.8% y/y in Sep) led palm oil prices higher to-date. Crucially, palm oil production is slated to fall further into end-year due to seasonal effects, which could give prices a near-term support above MYR2,700/MT.

Commodities Performance Table

Updated as of 24 October 2017

| Selected Indices | Close | Weekly Change | MTD | QTD | YTD |
|----------------------------|---------|---------------|--------------|---------------|--------|
| US Dollar Index (DXY) | 93.8 | 0.3% | 0.8% | 0.8% | -8.2% |
| Reuters / Jefferies (CRB) | 184.7 | 0.3% | 0.9% | 0.9% | -4.1% |
| Dow Jones Industrial Avg | 23,274 | 1.2% | 3.9% | 3.9% | 17.8% |
| Baltic Dry Index | 1,586 | 2.2% | 17.0% | 17.0% | 65.0% |
| Energy | Close | Weekly Change | Net Position | Weekly Change | YTD |
| NYMEX WTI Crude | 51.9 | 0.1% | 478,294 | 3,493 | -3.4% |
| ICE Brent Crude | 57.4 | -0.9% | 494,139 | 5,985 | 1.0% |
| NYMEX RBOB Gasoline | 167.4 | 2.7% | 68,160 | -1,027 | 0.5% |
| NYMEX Heating Oil | 178.5 | -1.4% | 50,813 | -796 | 4.7% |
| NYMEX Natural Gas | 3.0 | 0.9% | -57,953 | 23,348 | -19.7% |
| Base Metals | Close | Weekly Change | Net Position | Weekly Change | YTD |
| LME Copper | 7,004 | -0.3% | 50,488 | 10,283 | 26.5% |
| LME Aluminium | 2,137 | -0.1% | - | - | 26.2% |
| LME Nickel | 11,860 | 0.8% | - | - | 18.4% |
| Precious Metals | Close | Weekly Change | Net Position | Weekly Change | YTD |
| COMEX Gold | 1,282.9 | -0.3% | 209,646 | -4,893 | 11.4% |
| COMEX Silver | 17.1 | 0.6% | 62,928 | 4,577 | 7.2% |
| NYMEX Platinum | 929.3 | -0.6% | 24,189 | 2,204 | 2.6% |
| NYMEX Palladium | 961 | -1.5% | 22,708 | 2,030 | 40.6% |
| Agriculture | Close | Weekly Change | Net Position | Weekly Change | YTD |
| CBOT Corn | 352 | 0.4% | -96,318 | -13,574 | -0.1% |
| CBOT Wheat | 437 | 0.4% | -51,198 | -9,096 | 7.0% |
| CBOT Soybeans | 992 | 0.7% | 81,215 | 40,601 | -1.2% |
| Asian Commodities | Close | Weekly Change | MTD | QTD | YTD |
| Thai W. Rice 100% (USD/MT) | 409 | 0.5% | -2.4% | -2.4% | 7.3% |
| Crude Palm Oil (MYR/MT) | 2,800 | 2.2% | 3.9% | 3.9% | -9.9% |
| Rubber (JPY/KG) | 198 | 1.4% | -1.7% | -1.7% | -24.9% |

Source: Bloomberg, CFTC, OCBC Bank

Note: Closing prices are updated as of 24 October 2017

Note: Speculative net positions are updated as of 17 October 2017

Note: Speculative net positions for Aluminium and Nickel are unavailable

OCBC Treasury Advisory

Analyst:

Barnabas Gan

+65 6530-1778

BarnabasGan@ocbc.com

Corporate FX & Structured Products

Tel: 6349-1888 / 1881

Investments & Structured Products

Tel: 6349-1886

Interest Rate Derivatives

Tel: 6349-1899

Institutional Sales

Tel: 6349-1810

Energy: Still more upside to be expected

Highlights

- Crude oil prices have gained substantially on improved growth outlook; IMF upgraded global growth outlook earlier in October on the back of the improved external environment. Uncertainties surrounding Iraq's Kirkuk oil fields and its production outlook have also lifted supply concerns.
- Into the next quarter, crude oil prices revolve around three key factors: (1) OPEC decision on its production curb plans in its upcoming November meeting, (2) demand outlook till end-year and (3) geopolitical wildcards that could impact market outlook.
- Despite the measurable climb in crude oil prices, we remain bullish on prices, on the back on our expectation for OPEC to extend its production cut period by at least three more months (till June 2018), amid a relatively rosier economic outlook into the next year. Also, note that crude oil prices should seasonally edge higher into December given the end of refinery maintenance amid the coming of winters.

It has been a roller-coaster year

We recall the sentiments felt when 2017 first started; the camps were evenly split between those who predicted higher oil prices, and those preached the message of lower oil prices, slow economic growth and ballooning oil inventories.

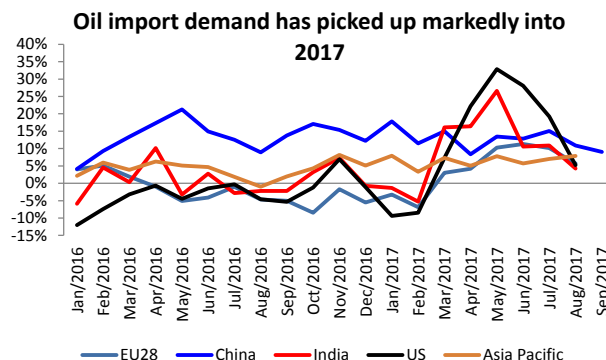
To that end, prices indeed had recovered substantially since its trough in 2Q17; the West Texas Intermediate has rallied to its multi-month high at ~\$52/bbl at end Oct. Still, WTI remain marginally below the level when the year first started, as WTI started the year at a strong \$53.8/bbl, although Brent ride the upward trend to ~\$58/bbl, up from end-2016's level of \$56.8/bbl. Brent was the key beneficiary of OPEC's adamant diligence over its production cut agreement, surprising many given the remarkable coordination of cuts made across the 14-member cartel.

Still, many will agree that the outlook for crude oil has been roller-coaster in nature; at this juncture stands the question as to whether the rally will sustain into 4Q17. We think it is likely to be possible, given the improving market fundamentals and diminishing oil inventories to-date. Should these phenomena sustain in the next months, crude oil prices should continue to point north.

Improving fundamentals

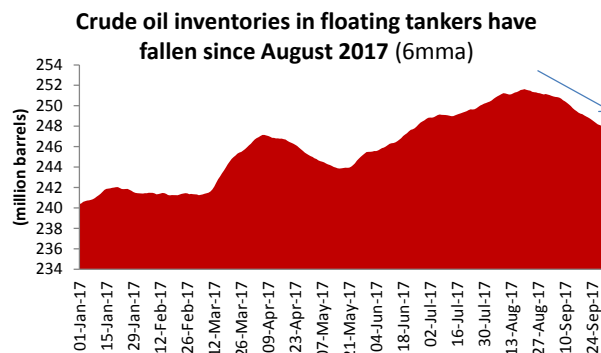
Though outlook may still differ, many will agree that oil fundamentals have improved markedly since we started the

year. Oil demand across key importing countries have tuned higher over the course of 2017. Across the regions, US and EU28 have seen a strong uptick in oil demand, up from negative growth seen at the beginning of the year. In Asia, oil import numbers from China and India continued to support overall Asia-centric oil demand.



Source: Bloomberg, CEIC, OCBC Bank

Moreover, supplies have tapered even lower into end 3Q17; OPEC compliance level as calculated in our model has increased to 88.3%, up from 60.1% in Jan 2017. Should we account for both demand and supply trends in volume terms, the oil market has been rebalanced, with demand periodically outpacing supply to-date. As such, global oil stocks, seen in both in the US as well as those in floating tankers have diminished.



Source: Bloomberg, OCBC Bank

Year-end outlook

Given the improving market conditions and oil fundamentals, it is unsurprising to see the higher oil prices. Market talks are indicating an expectation for OPEC to extend its production cuts by another three months, which OPEC (we believe) will concede to in order to preserve the rally trend else risk a potentially quick correction of oil prices. To that end, we look for oil prices to rally further (OCBC year-end WTI outlook: \$55/bbl).

Gold: Further liquidity crunch is to be expected

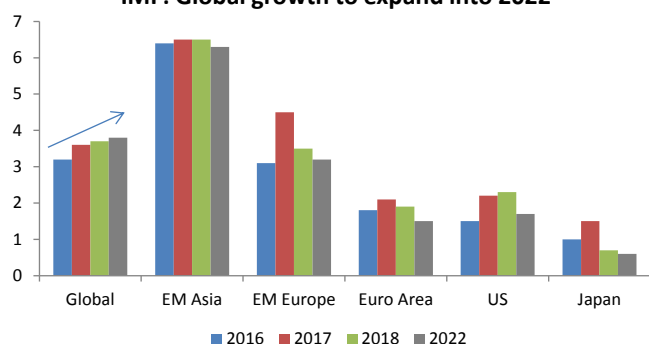
Highlights

- The mix of heightened geopolitical tensions and its potential impact on derailing global growth has clouded the rosy reality. Even with the yellow metal falling to \$1,270/oz (down from Sept's peak of \$1,362/oz) at end October, we think gold is still too rich for our comfort.
- Quite simply, another Fed rate hike into end-year, as well as ECB's recent decision to taper its QE programme starting January 2018, signals further tighter liquidity conditions. The decision to further tighten policy stance can also be regarded as a response to the rather stellar global growth to-date.
- Potentially higher interest rates and improved risk appetite are strong drivers for a softer gold, especially with the yellow metal being a zero-yielding asset in a rising yield environment. We expect gold's safe haven appeal to dull gradually as market appetite improves.

The outlook is strengthening

Global growth has undoubtedly improved over the last year, underpinned by a recovery in trade, investor appetite, and commodity prices. Importantly, the recovery is broad-based across most industries, as well as synchronized across both developed and developing economies. To that end, the International Monetary Fund upgraded their global growth outlook to 3.6% and 3.7% in 2017 and 2018, respectively.

IMF: Global growth to expand into 2022



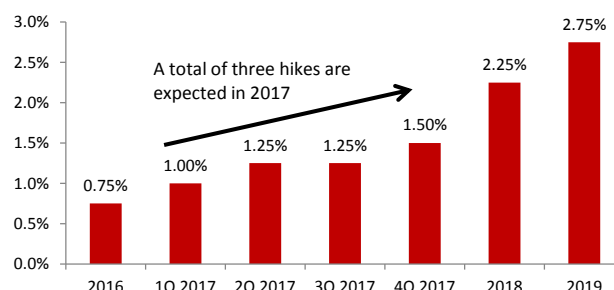
Source: The International Monetary Fund, OCBC Bank

The relationship global economic growth and gold prices is a closely knitted one; with global interest rates still at relatively low levels versus historical standards, policy-makers especially in developed economies have gradually shifted their dovish tone to one of signaling higher interest rates in response to improving macroeconomic fundamentals. There then lies a strong urge for investors to tune risk taking appetite higher: an observable uptick in growth prospect, coupled with potentially higher interest rates are the ingredients to fuel yield-chasing behavior, which in turn should depress gold demand given the

yellow metal being a zero-yielding asset.

OCBC Fed Funds Rate Outlook:

One more hike before the year is up



Source: Bloomberg, OCBC Bank

Demand update and outlook

Physical gold demand is relatively mixed in the first 9 months of the year. Although India's gold imports grew 98.5% in 9M17, this is largely due lower imports given a jewelry tax in 2016. Chinese gold imports from Hong Kong as well, tapered lower into 8M17 (-12.3% y/y), down from its peak seen in 2013. Given that jewelry accounts for a strong 50% of global gold demand, the rather tepid growth seen in the top two gold importing economies could have done little to fuel higher gold prices.

China gold imports shrinks as M2 supply slows



Source: Bloomberg, OCBC Bank

Expect gold to dull further

The rosier economic environment in 2017 amid higher oil prices was the spark that central banks need to shed their initial dovish stances. With the FOMC and the ECB tapering their balance sheet amid higher rates by developed economies, gold as a zero-yielding asset is likely to see further dulling into 2018. Moreover, physical demand remains tepid by key importing countries. Still, geopolitical tensions that could potentially derail global growth remain to be a wildcard that could lift prices higher. Barring that risk, we keep our gold outlook at \$1,250 and \$1,100/oz for 2017 and 2018 respectively.

Palm Oil: Labour shortages are here to stay

Highlights

- Malaysian palm oil production for 2017 will likely disappoint initial estimates; a mix of labour shortages and poor weather conditions saw production peaking earlier in August.
- Note that overall production will likely fall further into end-year given seasonal patterns. Should our expectation come to pass, full-year Malaysia's palm oil production growth will likely print a slightly lower 9.3% y/y growth.
- We upgrade our palm oil outlook to MYR3,000/MT at year-end (up from MYR2,600/MT), underpinned by expected lower production into year-end. Recent healthy palm oil shipments, should it sustain into end-year, will be supportive of higher palm prices.

It's a labour-intensive industry

The Malaysian palm oil industry is particularly labour-intensive and in-turn, heavily-reliant on foreign labour. The Malaysian Palm Oil Board statistics indicate that there are around 428,000 workers in its palm oil sector, where foreign labour accounts 77% (or 328,400) of the total workforce.

To illustrate palm oil production's extent of its labour-intensive needs, total labour employed in Malaysia's palm oil industry (accounting for merely 3.6% of GDP) is a strong 40.8% if compared to total employed in its manufacturing space (accounting for 23% of GDP). Given the nature of the work, palm oil plantation workers reportedly face physically-demanding work conditions and meager compensations at around MYR1,000/month. Coupled with better working conditions in Indonesia (plantation workers are seeing slightly higher wages at IDR3.35 million) and tighter labour regulations in Malaysia, increasing labour shortages during peak production seasons in the last few months has led overall production levels lower.

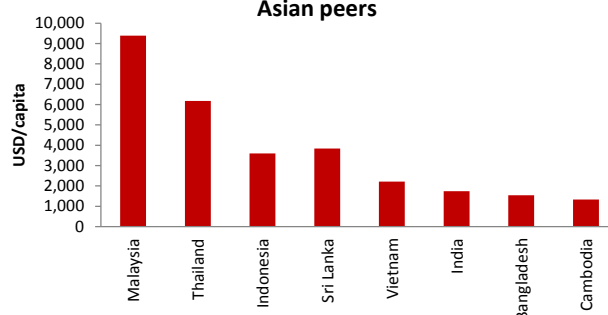
Labour shortages could be here to stay

The Malaysian government has long since imposed various labour regulations in tackling the influx of foreign labour. Citing Malaysia's Plantation Industries and Commodities Minister Datuk Nasrun, he said that "high dependency on foreign workers creates risk to the country's palm oil industry... while the influx of foreign workers may also contribute to social problems".

As recent as July this year, Malaysia embarked on a crackdown on undocumented foreign workers thus affecting a slew of affected industries including construction and agricultural plantations. The crackdown isn't the first; Malaysia

embarked on similar operations between 2014 and 2016, suggesting that labour shortages in palm oil plantations is not a new phenomenon. We view that the labour shortages are likely here to stay unless wages rise to attract domestic labour: Malaysia's dependency on foreign labour in its plantations is inherently driven by higher standard of living and improving GDP/capita, which surpasses many of its Asian peers.

Malaysia's GDP per capita surpasses many of its Asian peers



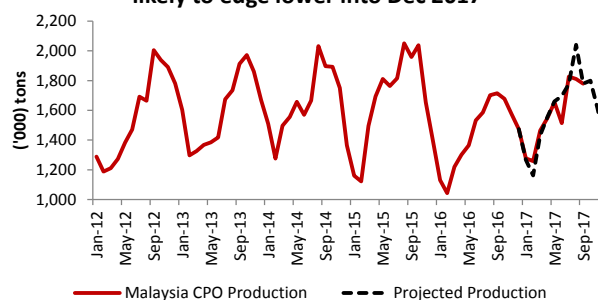
Source: CEIC, OCBC Bank

Fundamentals may lift prices higher into year-end

Beyond the labour shortages, lower production and stronger demand are factors that lifted prices of late.

Our initial outlook for Malaysia's crude palm oil production into 2017 was in line with historical production trend (2012 – 2015). Given the disappointing production growth in the first nine months of 2017 and accounting seasonal falls in production into end-year, we downgrade our production growth estimate to 9.3% y/y (from 15.0% y/y).

Malaysia palm oil production surprised lower, likely to edge lower into Dec 2017



Source: Bloomberg, OCBC Bank

In the last two months of 2017, note that Asia's palm production should decline on seasonal factors and potentially lift prices higher. As such, we upgrade our palm oil outlook to MYR3,000/MT at end-2017, while prices could potentially edge higher into 2018 then.

Aluminum: Low production levels may not persist

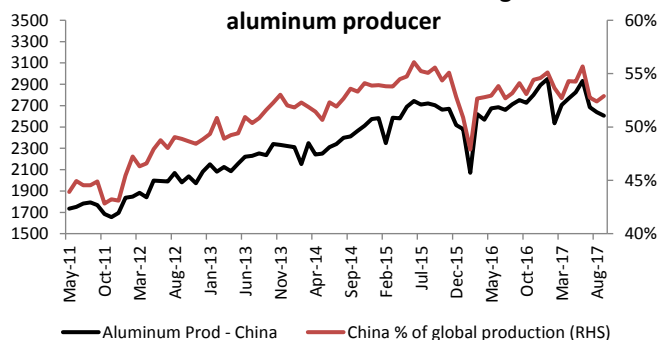
Highlights

- It is the mix of rosier economic fundamentals, falling aluminum inventories and the recent Chinese pollution control measures that lifted aluminum prices to-date. As of end-Oct, aluminum prices printed the highest in 5-years.
- At this juncture, the production shortfall from China's pollution control would already have been priced-in; the plan is to run for six months from October – March 2018. It is slated affect smelters in 28 cities and cut aluminum production by at least 30%.
- It remains to be seen if prices will sustain at current highs. The production cuts by China will last until March 2018. Moreover, global aluminum production is projected to resume growth into 2018 on the back of increased production capacity in China and other Asian countries.

China, the game-changer

Market-players practically rushed to lift aluminum prices higher on news that China will curb production into the six months from October 2017, with aluminium futures rising many folds to its highest since 2012. The decision to turn bullish on prices is understandable: China is the world's largest aluminium producer, accounting for over 50% of global production. Chinese curbs on aluminium production stems from its need to tackle the smog-prone provinces in its 28 cities, as well as to limit excess capacities in aluminium production. This act alone is slated to cut primary aluminium production by at least 30% into its winter season from October to March 2018.

China remains to be the world's largest aluminum producer



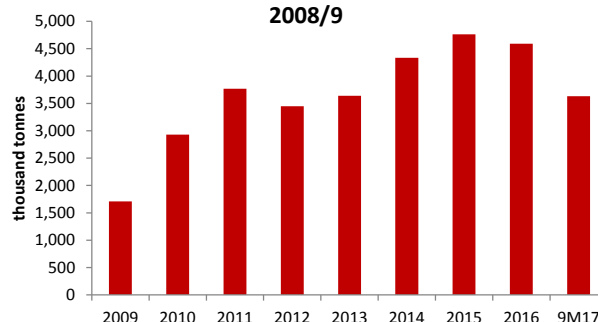
Source: Bloomberg, International Aluminium Institute, OCBC

Statistically, the total production cut from the winter curtailment is estimated to be around 7 million tonnes, of which Shandong Province is expected to account for 70% (or 4.8 million tonnes) of total curbs. At this juncture, China Hongqiao Group, the world's largest aluminium producer, has reportedly removed around 3.2 million tonnes of production capacity, and is slated to cut further into end-2017.

Lower production volumes may not be here to stay

Looking beyond 2017, Chinese smelters will likely ramp up production again when the curbs are lifted in March 2018. We note that past aluminium curbs in China had not curbed excessive capacities; Chinese environmental regulation was first introduced in 2015, which did little to curb total production at end 2015 (which subsequently led into a supply-glut and depressed prices).

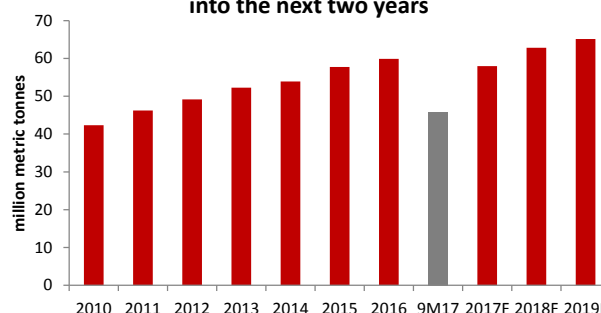
China's aluminium production grew rapidly post 2008/9



Source: Bloomberg, CEIC, OCBC Bank

Elsewhere, aluminium production in Asia and the Middle East are expected to increase into 2018 in response to higher prices. According to Australia official estimates, Asia (ex-China) production is slated to grow 21% while Middle East production is penciled to climb 2.3% into 2017, thus cushioning the overall Chinese-led production shortfall. Attracted by higher prices amid the end of smelting curbs in China into 2018, we expect global aluminium production to climb into the next two years.

Global aluminium production is slated to grow into the next two years



Source: Bloomberg, Australia Department of Industry, Innovation and Science, OCBC Bank

As such, while prices may likely stay supported into early 2018, higher production into the rest of 2018 could normalize prices. While we upgrade our outlook to average \$2,150/MT in 4Q17, we pencil prices at \$1,900/MT into 2018 as production upticks then.

This publication is solely for information purposes only and may not be published, circulated, reproduced or distributed in whole or in part to any other person without our prior written consent. This publication should not be construed as an offer or solicitation for the subscription, purchase or sale of the securities/instruments mentioned herein. Any forecast on the economy, stock market, bond market and economic trends of the markets provided is not necessarily indicative of the future or likely performance of the securities/instruments. Whilst the information contained herein has been compiled from sources believed to be reliable and we have taken all reasonable care to ensure that the information contained in this publication is not untrue or misleading at the time of publication, we cannot guarantee and we make no representation as to its accuracy or completeness, and you should not act on it without first independently verifying its contents. The securities/instruments mentioned in this publication may not be suitable for investment by all investors. Any opinion or estimate contained in this report is subject to change without notice. We have not given any consideration to and we have not made any investigation of the investment objectives, financial situation or particular needs of the recipient or any class of persons, and accordingly, no warranty whatsoever is given and no liability whatsoever is accepted for any loss arising whether directly or indirectly as a result of the recipient or any class of persons acting on such information or opinion or estimate. This publication may cover a wide range of topics and is not intended to be a comprehensive study or to provide any recommendation or advice on personal investing or financial planning. Accordingly, they should not be relied on or treated as a substitute for specific advice concerning individual situations. Please seek advice from a financial adviser regarding the suitability of any investment product taking into account your specific investment objectives, financial situation or particular needs before you make a commitment to purchase the investment product. OCBC and/or its related and affiliated corporations may at any time make markets in the securities/instruments mentioned in this publication and together with their respective directors and officers, may have or take positions in the securities/instruments mentioned in this publication and may be engaged in purchasing or selling the same for themselves or their clients, and may also perform or seek to perform broking and other investment or securities-related services for the corporations whose securities are mentioned in this publication as well as other parties generally.

Co.Reg.no.:19320003