OCBC Bank

Monday, June 19, 2017

Weekly Commodities Outlook – A peep into 2H17

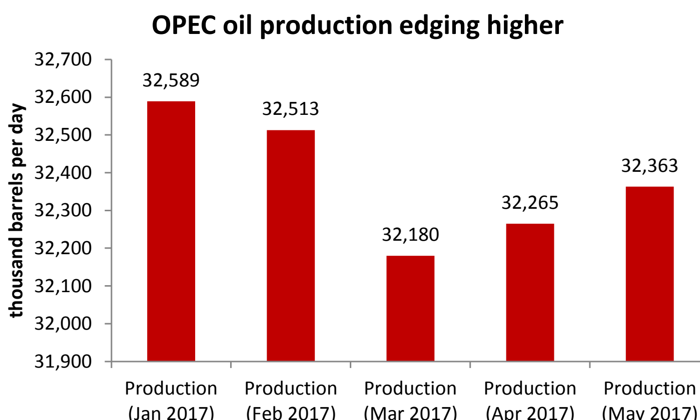
Crude Oil: Is the rebalancing act still intact?

Market calls for higher oil supply for the rest of 2017 is getting louder. Previous calls for a rebalanced fundamental backdrop for crude oil are gradually being muted as a result.

Production may continue to climb into 2H17

OPEC's latest June MOMR report pencilled in a non-OPEC oil supply growth of 0.84 million barrels per day (bpd), a stark contrast to its initial outlook for a 150 thousand bpd decline in its Dec 2016 report. Moreover, the cartel expects another 500 thousand bpd climb in non-OPEC oil production into 2H17 compared to the production level seen in 1H17, led by higher US oil production of 0.76 million bpd, followed by Brazil (+0.12 mbpd) and Canada (+0.06 mbpd). However, should we delve into the individual oil production by the OPEC members, the significantly higher oil production from Libya and Nigeria had worryingly exceeded the production cuts that were painfully endured by the other members in the two months of April and May 2017. Specifically, Libya's oil production is set to grow further after its National Oil Corporation (NOC) said last week that it had reached an interim deal with Germany's Winterhall to immediately resume production of 160 thousand barrels per day (bpd) of oil that were previously under dispute.

Similarly, based on other US-centric indicators, we continue to see further upside risk to US oil production. US oil rig counts have been increasing consistently for many months now. Empirically, rig counts according to Baker Hughes data, have gained starkly to its recent 747 print, a whopping 119% increase from a 341 rig count in July 2016. Interestingly, US total oil production, led by its shale oil space, rose to its recent 9.3 mbpd print over the same period. Of note, oil rig counts are generally regarded as a leading indicator to future US oil production, thus illustrate that US oil production will likely climb further into 2H17.



Source: OPEC MOMR, OCBC Bank
(Obtained from both direct communication and secondary sources)

Updated as of 19 June 2017

Selected Indices	Close	Weekly Change	YTD	MTD	QTD
US Dollar Index (DXY)	97.2	0.0%	-4.9%	0.3%	-3.2%
Reuters / Jefferies (CRB)	173.1	-1.6%	-10.1%	-3.7%	-6.9%
Dow Jones Industrial Avg	21,384.3	0.7%	8.2%	1.8%	3.5%
Baltic Dry Index	851	-2.2%	-11.4%	-3.1%	-34.4%
Energy	**Close**	**Weekly Change**	**YTD**	**Net Position**	**Weekly Change**
NYMEX WTI Crude	44.6	-3.2%	-17.0%	403,363	-13,110
ICE Brent Crude	47.2	-2.2%	-16.9%	307,523	0
NYMEX RBOB Gasoline	145.8	-2.0%	-12.5%	41,781	-8,608
NYMEX Heating Oil	142.3	-0.2%	-16.5%	-695	-7,500
NYMEX Natural Gas	3.0	-2.4%	-20.8%	-4,305	-1,374
Base Metals	**Close**	**Weekly Change**	**YTD**	**Net Position**	**Weekly Change**
LME Copper	5,663	-1.9%	2.3%	18,809	5,961
LME Aluminium	1,867	-1.2%	10.3%	-	-
LME Nickel	8,940	1.6%	-10.8%	-	-
Precious Metals	**Close**	**Weekly Change**	**YTD**	**Net Position**	**Weekly Change**
COMEX Gold	1,252.2	-1.1%	8.7%	197,121	-16,980
COMEX Silver	16.6	-1.8%	4.0%	60,262	-5,048
NYMEX Platinum	927.4	-1.8%	2.9%	14,367	-5,414
NYMEX Palladium	888.7	1.8%	30.1%	21,257	121
Agriculture	**Close**	**Weekly Change**	**YTD**	**Net Position**	**Weekly Change**
CBOT Corn	379	0.4%	7.6%	29,681	112,752
CBOT Wheat	462	6.5%	13.2%	-74,046	17,770
CBOT Soybeans	943	1.2%	-5.4%	-72,342	17,447
Asian Commodities	**Close**	**Weekly Change**	**YTD**	**MTD**	**QTD**
Thai W. Rice 100% (USD/MT)	477.0	1.5%	25.2%	5.3%	22.6%
Crude Palm Oil (MYR/MT)	2,690.0	0.4%	-16.4%	-2.1%	-5.0%
Rubber (JPY/KG)	213.0	12.0%	-18.7%	-12.0%	-21.3%

Source: Bloomberg, CFTC, OCBC Bank
Note: Closing prices are updated as of 19 June 2017
Note: Speculative net positions are updated as of 13 June 2017
Note: Speculative net positions for Aluminium and Nickel are unavailable

OCBC Treasury Research

Barnabas Gan
Commodity Economist
+65 6530-1778
BarnabasGan@ocbc.com

OCBC Treasury Advisory

FX & Structured Products
Tel: 6349-1888 / 1881

Interest Rate Derivatives
Tel: 6349-1899

Investments & Structured Products
Tel: 6349-1886

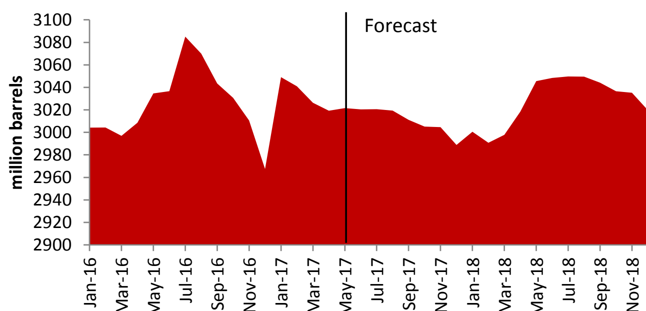
Institutional Sales
Tel: 6349-1810

With further risks of oversupply extending into 2H17 amid the recent collapse of oil prices, the International Energy Agency commented for "non-OPEC production to grow… slightly more than the expected increase in global demand" into 2018, suggesting that the oil glut may persist till then.

Inventories and Demand

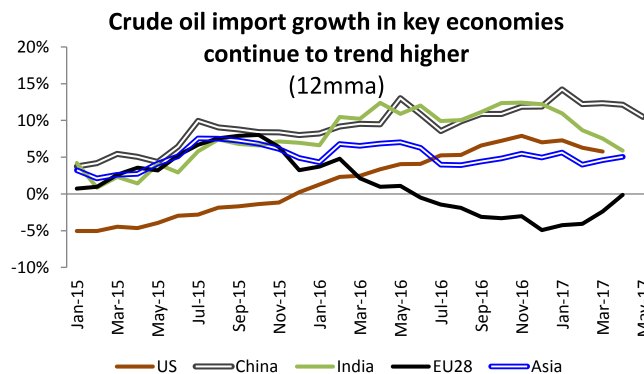
The natural spill-over effect to the rising supplies is the onset of ballooning oil inventories. OECD commercial oil inventories have remained above its 5-year average at 3.0 billion barrels (5-year avg: 2.8 billion barrels) in May this year. Stocks have been climbing in the first five months of 2017, with 5M17 growth at 0.72% (equivalent to adding 108.5 million barrels).

Moreover, US oil inventories have risen to 511.5 million barrels in June, up from 496 million barrels seen in same period last year. Indeed, the climbing global oil inventories have been also cited as credible reasons for weaker oil prices of late. However, note that draw-downs in stocks have already started in May, with OECD commercial oil stocks already falling 0.43% in May, and is projected to fall further into the year, according to the US Department of Energy.



Source: Bloomberg, DOE, OCBC Bank

The draw-downs, despite the likely gains in supplies into 2H17, should be driven by the climb in oil demand. Empirically, crude oil import in net-importing countries has remained healthy of late. Notably, China's crude petroleum oil import has risen by 15.4% in May 2017, clocking a strong 13.1% in the first five months of 2017. Should we account for the rest of Asia[1], total crude oil import growth saw a strong double-digit growth of 10.7% in April 2017. Elsewhere, EU28 oil import growth has accelerated to 18.8% yoy over the same period, clocking its fourth consecutive positive growth in oil imports. Should we look into the upcoming driving season in the US, energy demand is likely to pick up further into the immediate months ahead.



Source: Bloomberg, CEIC, OCBC Bank

Price Outlook

It all boils down to what market-watchers are invariably concerned about, which thus determines how oil prices may move in the immediate term. At least for now, the looming risk over further supply growth has been keeping a cap on any oil rally. With concerns over higher supply dominating market sentiment, we opine that any news reinforcing higher supplies in the near term is a strong and persuasive driver to keep the bulls at bay.

Still, lower oil prices are likely to be short-lived; demand has grown tremendously at the start of this year, and is slated to grow further into 2018. The higher demand, should it keep up its pace, will potentially inject further draw-downs in global oil inventories into 2H17. <u>In short, though the rebalancing scenario has been delayed, the strong uptick in demand should eventually soak up the excess supplies seen to-date</u>. As such, we keep to our crude oil outlook for WTI and Brent to touch $55/bbl and $57/bbl, respectively at year-end.

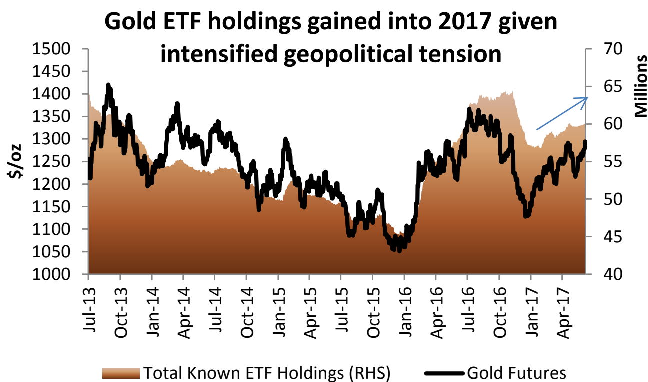
[1] Asia includes China, India, Japan, Hong Kong, Taiwan, Indonesia, Korea, Philippines, Thailand and Vietnam

Gold: A changing environment into 2H17

Gold prices are still starkly higher than when it started off beginning this year. The episodes of growth woes and numerous event uncertainties led risk aversion and safe haven demand higher. Empirically, gold prices rose 8.7% since the start of this year, while global gold ETF holdings rose to its highest since late Nov 2016.

Better days ahead?

However, the shifting economic environment may be in motion already as we speak. Market-watchers have arguably realized that global economic resilience saw little fragmentation despite the Brexit vote, nor did the US see any clear signs of recessionary indicators post Donald Trump's election as president, nor neither did any of the missile tests by North Korea spark any immediate risk of military intervention.

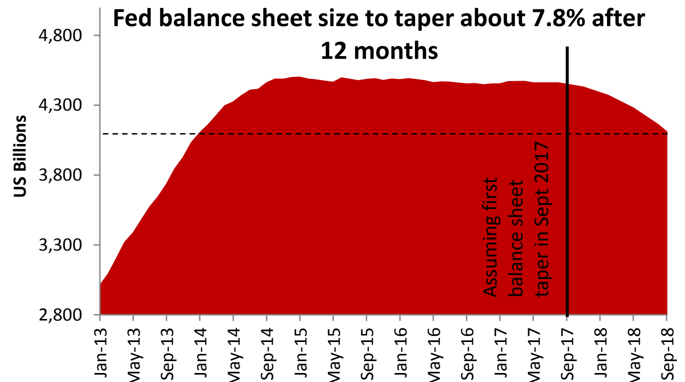


Source: Bloomberg, OCBC Bank

On the contrary, optimism can be seen from the improving global trade numbers, especially with recent Chinese trade numbers amid WTO's comment that trade is expected to "expand moderately" into the second quarter. Also, Eurozone governments approved another credit lifeline of EUR8.5billion, and offering more clarity on a roadmap to possible debt relief in the future. In the latest news, exit polls projecting France President Emmanuel Macron's party to win a large majority in parliamentary elections (as many as 403 seats out of 577), suggesting that Mr Macron will garner enough support to implement a business-friendly, pro-EU programme.

Fed tightening could drag gold prices

Besides the optimism already seen to-date, gold prices have trended lower post the recent hawkish FOMC rhetoric in its last FOMC meeting. Essentially, the Federal Reserve hiked rates by another 25bps, bringing it to 1.0 to 1.25%, in a signal to reflect "the progress the economy has made, and is expected to make, toward maximum employment and price stability objectives." More importantly, the central bank expects that "ongoing strength… will warrant gradual increases in the federal funds rate", while planning to implementing a balance sheet normalization program later this year. To that end, the dollar index has rallied substantially beyond its 97.40 level (up from pre-FOMC at below 97.0), and dragging gold prices as a result.



Source: Bloomberg, OCBC Bank

With the latest dot-plot chart, the FOMC is also indicating another rate hike later this year, in line with our expectations for a third rate hike before the year is up. Coupled with the Fed's reduction in their securities holdings ($6 billion per month for Treasuries and $4 billion per month for agencies securities), these monetary tightening measures should signal to the markets that the US economy is recovering in line with market expectations. Given how gold prices reacted from the recent FOMC statement, the yellow metal is slated to fall further into 2H17 especially if US-centric data remains positive, thus fueling further expectations for further rate hike and balance sheet reduction later this year. For statistical reference, should we assume (1) the start of the tapering to be in Sept 2017 and (2) the reduction cap to be fully utilized to a maximum of $30 billion per month of Treasuries and $20 billion per month for agency securities, the Federal Reserve Balance Sheet size is slated to fall by 7.8% after 12 months.

Caveats: Geopolitics and risk aversion

So far our discussions have centered on the possibility of lower gold prices into 2H17. However, these factors (rate hike and balance sheet reduction) have been present since the start of this year, which arguably had little effect in dousing the gold rally in 1H17. The reason is clearly due to the onset of risk aversion, led by geopolitical tensions and other growth uncertainties.

In that light, although we remain bearish on gold prices, we admit that geopolitical tensions are still present to-date, especially the ongoing North Korea missile provocations and Brexit negotiations. As reiterated in our previous

reports, these factors are highly significant to gold prices, but are also highly unquantifiable as well, given the many ways these scenarios may pan out, as well as the many differing severity it may take in the months ahead.

Till then, should the optimism remain amid the hope for quick resolutions for the above-mentioned exogenous events, we look for gold to trend to our $1,200/oz at year-end.

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