Weekly Commodities Outlook

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Refreshed 2017 forecasts and a peep into 2018

Thursday, August 31, 2017

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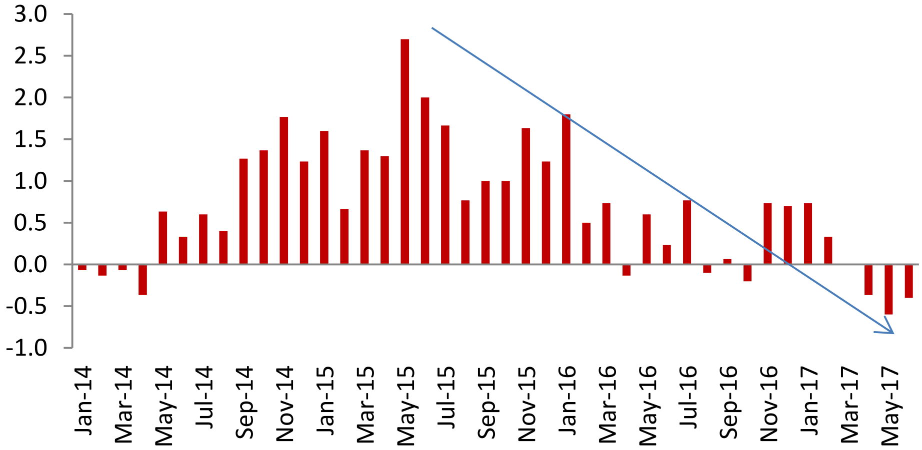
Energy

- We maintain our crude oil outlook for WTI and Brent to touch $55/bbl and $57/bbl, respectively. As written in our past outlooks, our bullish call is chiefly underpinned by the recovering global oil demand, led especially by Asian and European demand. At this juncture, oil prices are pressured on weather reasons, rather than fundamentals. The rosy economic backdrop amid the equivalent support for oil demand should lift oil prices to our 2018 forecast of $65/bbl for both WTI and Brent.
- On the same note, with the recovering demand and tepid supply growth, the initial supply glut that was observed since mid-2014 has narrowed to its equilibrium level as early as March 2017. Since then, global demand has in fact outpaced supply in volume terms. Prices however did not rise significantly even with the rebalanced crude oil market, highlighting market-watchers' concerns over the immense inventory overhang that was accumulated over a span of three years.
- Tropical Storm Harvey had likely injected a short-term shock to both crude oil and gasoline prices. As of this juncture, as much as 4% of US crude oil production (or 379 thousand barrels per day (bpd)) and 19% of US refining capacity (or 3.65 million bpd) have been taken off the table. Given the significant impact to the US refining industry, gasoline prices has surged beyond what fundamentals could have allowed, while speculators pressured crude oil prices lower. We think that the current impact to both crude oil and gasoline prices could be short-lived especially when Harvey moves on.

Excess supplies in crude oil diminished into 2Q17



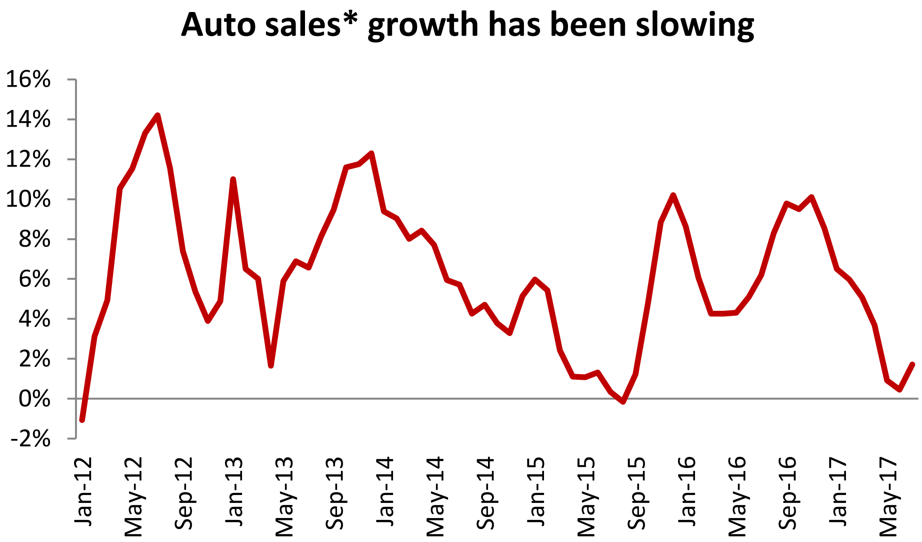
Source: Bloomberg, OCBC Bank

- In a nut-shell, once the weather shocks blows over, market-watchers should refocus back on fundamentals. At least for now, the fundamentals are indicating for a bullish crude oil story given that demand is outpacing supplies. Should this trend continue, the sustained thirst for the sticky liquid should eventually soak up the current inventory overhang.

Precious Metals

- We upgrade our year-end gold outlook to $1,250/oz (previously at $1,200/oz). This is to account for (1) the elevated gold prices on renewed safe haven demand and (2) expected dollar weakness into end-2017. Despite our revision, gold prices are expected to trend lower into 4Q17 given our call for the US Federal Reserve to hike its benchmark rate by another 25 basis points before the year is up. Moreover, we also expect the central bank to initiate their first balance sheet tapering effort in their upcoming Sept meeting.
- At this juncture, gold is clearly regarded as a safe haven asset. Much of gold's strength is underpinned by intensified geopolitical tensions given the recent missile firing across Japan territories, amid Trump's rhetoric that "all options are on the table". Barring a quick resolution to the current stalemate, gold could remain buoyed above $1,300/oz for some time. However, should tensions ease into the year, market-watchers would likely focus back on market fundamentals, where global growth has evidently been rosier amid a recovery in risk appetite since the start of 2017. Elsewhere, Tropical Storm Harvey in the Texas Gulf could also have fuelled further flight to safety.
- Encouragingly, indicators for global growth continue to appear rosy. As of 1H17, economic growth in Asia and Europe has mostly surprised on the upside, led by primarily by stronger global trade prints, which in turn has benefited domestic manufacturing (especially seen in Asia) and consumer/industry confidence levels. Importantly, the International Monetary Fund (IMF) commented that the “global economy is doing well… we see broad-based recovery”, adding that growth prints are expected to reach 3.5% in 2017 and 3.6% in 2018.
- Coupled with the favourable economic fundamentals, a diplomatic resolution to the current North Korea-US bickering, should such a scenario occur, will likely drag gold back below its $1,300/oz handle. Moreover, better growth prospect into 2018 should translate into more risk-taking and yield-chasing behaviour. In turn, safe haven demand especially for gold should invariably trend lower given its zero-yielding aspect. As such, barring a military intervention and an unexpected decoupling of global growth, we look for the yellow metal to trend to $1,100/oz at end-2018.
- For the PGMs, both platinum and palladium prices have risen in tandem with higher gold prices. This is evident given the metals’ association with jewellery especially for platinum (35%) and palladium (11%)[1], thus rubbing off some safe haven influence to these metals. Their rally since the start of this year has also largely been attributed to the strong demand in the automotive industry, given their massive contribution to catalytic converters in gasoline and diesel engines. However, note that auto sales growth in key economies have been declining into July, while Germany’s car exports (largest car exporter in the world and accounting for 21.8% of global car exports in 2016) has fallen to negative growth into June 2017.

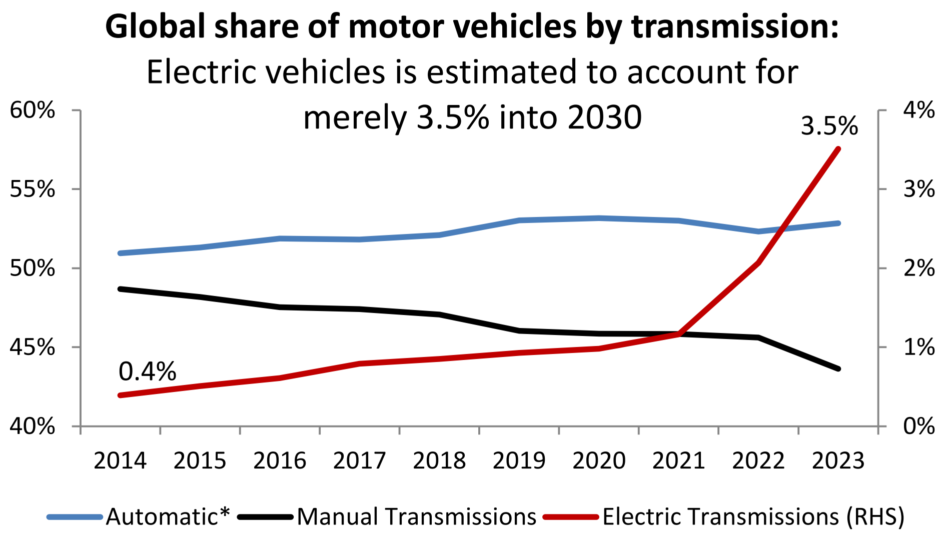
[1] U.S. Geological Survey Minerals



Source: Bloomberg, OCBC Bank

*Countries include US, Canada, Italy, France, UK, Japan, China

- The emergence of electric vehicles must be considered as well in determining the use of PGMs in traditional catalytic engines. As of 2016, only 0.6% of global engine transmissions are accounted by electric vehicles, according to Bloomberg calculations. The share of electric vehicles is then expected to climb to 3.5% into 2030, as consumer demand for manual transmission cars gradually declines. As such, in the medium-term (into 2020 perhaps), the demand for traditional gasoline/diesel cars should continue to outweigh electric cars, though in the long run, the increasing popularity of the latter could eventually dent the industry use of PGMs.



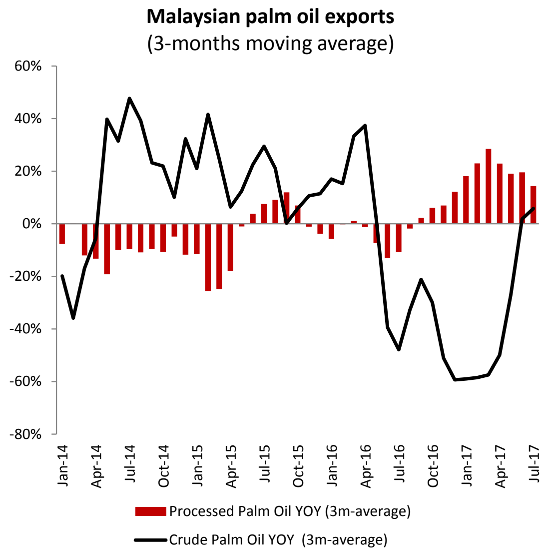
Source: Bloomberg Intelligence, OCBC Bank

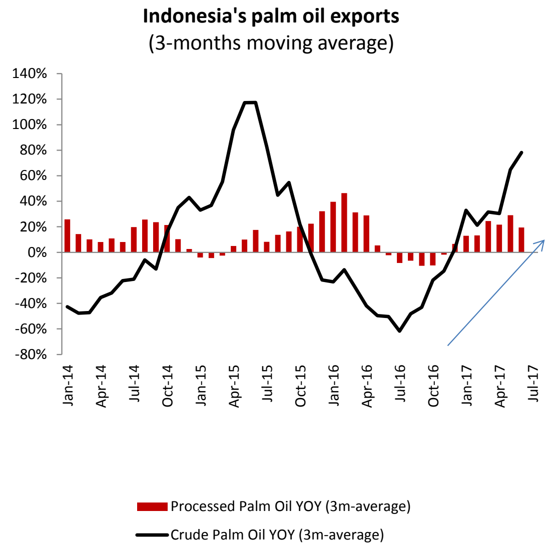
* Automatic Vehicles include AMTs, CVTs and Dual Clutch Transmissions

- In-all, with safe haven demand expected to decline into end 2017/8 on the positive global growth outlook. Coupled with our call for the US Federal Reserve to inject a 25bp rate hike before 2017 is up, and another three rate hikes into 2018, the demand for gold as a zero-yielding asset should decline considerably then. In turn, silver and the PGMs should also trend lower in tandem given lower safe haven demand. Especially for PGMs, we note that automobile demand and export prints have been decelerating to-date, which in turn could further drag both palladium and platinum prices into 2018.

Crude Palm Oil

- We upgrade our Crude Palm Oil (CPO) outlook to MYR2,600/MT (previous MYR2,250/MT). Our revision is chiefly due to the surprise fall in Asia's crude oil production levels (especially seen in Malaysia). Statistically, Malaysia's CPO production surprised market-watchers with a 8.9% month-on-month decline in June, while industry watchers are indicating a likely contraction in August as well. As such, the early decline in palm oil production, traditionally expected only in October – March period, suggests that our initial estimate for Malaysia's CPO production to touch 15.0% year-on-year growth is a tat too much. Overall demand for palm oil has also been healthy in the first seven months of 2017, led by higher import demand from Europe and Asia, thus support CPO prices to-date.





Source: Bloomberg, MPOB, OCBC Bank

- We note that palm oil prices are traditionally driven by three key factors: (1) crude oil prices given its biofuel aspect, (2) alternative cooking oils such as rapeseed oil and soyoil as well as (3) demand for luxury products in household products (cosmetics, cleaning lotions) and pastries (snacks and chocolates). In view for our call for crude oil prices to rise to $65/bbl in 2018, palm oil demand as a biofuel should also turn more viable. Moreover, note Malaysia's and Indonesia's efforts to raise domestic biofuel demand through their B10 and B20 bioduesel blending policies, while EU's demand for biodiesel is expected to climb into 2018, according to the USDA Foreign Agricultural Service.
- Importantly, palm oil's luxury component (given its extensive use in pastries and household products) would also aid in supporting global consumption. In light for global growth to stay supported into 2018, palm oil demand should inherently be supported by higher crude oil prices and higher demand for luxury consumables. In-all, on assumption for favourable weather conditions, we pencil CPO prices at MYR2,800/MT into 2018 on the back of improving global growth and stronger palm oil demand.
- Importantly, palm oil and its price outlook as an agricultural produce is inherently laden with several important but almost unpredictable factors. Adverse weather conditions especially seen during El Nino years have lifted prices beyond market expectations. Elsewhere, the production

levels of alternative fuels (namely soyoil and rape seeds) are also difficult to determine. Weakness in palm oil prices in 1H17 was attributed to the increase in soyoil and rapeseed production in India, while elevated rapeseed stockpiles in China has capped palm oil's advance.

OCBC Commodity Forecast

Updated as of August 31, 2017				2017				2018			
	3y AVG	Spot	1H17 Avg	Q1	Q2	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Energy											
WTI ($/bbl)	60.1	46.3	50.0	51.8	48.2	46.9	55.0	57.5	60.0	62.5	65.0
Brent ($/bbl)	64.5	51.9	52.7	54.6	50.8	49.9	57.0	59.0	61.0	63.0	65.0
Gasoline ($/gallon)	1.84	1.83	1.58	1.58	1.58	1.72	1.67	1.84	1.98	2.10	1.95
Natural Gas ($/mmbtu)	3.06	2.97	3.10	3.06	3.14	2.95	3.33	3.39	3.26	3.70	3.84
Precious Metals											
Gold ($/oz)	1212.3	1,317	1,240.4	1,221	1,259	1,291	1,250	1,213	1,175	1,138	1,100
Silver ($/oz)	17.1	17.5	17.3	17.5	17.2	17.0	16.7	16.4	16.2	16.0	15.7
Platinum ($/oz)	1,127	1,002	963	983	942	976	962	933	933	917	902
Palladium ($/oz)	699	943	791	768	815	912	899	826	761	701	647
Base Metals											
Copper ($/MT)	5733.7	6,792	5,774	5,855	5,692	6,522	6,500	6,200	6,050	5,900	5,750
Tin ($/MT)	18,332	20,485	19,959	20,012	19,906	20,398	19,118	18,235	17,794	17,879	17,969
Nickel ($/MT)	12,628	11,663	9,745	10,277	9,214	10,916	11,207	10,877	10,804	10,727	10,648
Zinc ($/MT)	2,043	3,110	2,697	2,789	2,604	2,997	3,023	2,818	2,792	2,766	2,738
Aluminum ($/MT)	1,711	2,095	1,886	1,858	1,913	2,035	2,063	1,923	1,933	1,867	1,814
Asian Commodities											
Crude Palm Oil (MYR/MT)	2,421	2,713	2,741.3	2,938	2,545	2,680	2,600	2,688	2,725	2,763	2,800

Source:
Historical Data - Bloomberg
Forecasts - OCBC Bank
Data reflects average price

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