

## OCBC Commodities Outlook (March 2018)

### Energy

The numbers are eye-boggling. The U.S. is now pumping more than 10 million barrels per day (bpd), surpassing its previous high in 1970. The expanding production levels are also accompanied by surging exports (both crude and refined) as well as lower stockpiles. Demand has slackened somewhat, though it is primarily driven by the seasonal Lunar New Year effect. Note China's oil import at 7.7 million bpd as of February 2018 is the lowest since October last year.

### Base Metals

Base metal prices appear to have recovered of late, after risk aversion tapered into mid-week. Unsurprisingly, the rally in aluminium prices was short-lived after US President Trump announced a watered-down version of the metal import tariff plan. Moreover, China's aluminium production fell 1.8% in the first two months of 2018, led by pollution crackdown efforts and supply-side reforms.

### Precious Metals

Gold remained range-bound into March, led by the rather tame dollar trajectory and improving Pyongyang-US geopolitical situation. Elsewhere, market volatility seen from the relatively higher VIX continued year-to-date, although the rush into equities resumed after February's sudden sell-off. Do note that the yellow metal is a zero-yielding asset and the opportunity costs of holding it are costlier as interest rate rises.

### Agricultural and Asian Commodities

Palm oil prices rose slightly into the second week of March as market-watchers digested the lower oil production and overall stockpile prints from Malaysia, although exports fell to 1.31 million tons in February, down from 1.51 million tons in January. However, palm oil prices could see further downside risk as market continue to expect stronger palm production out of Asia. Elsewhere, demand (especially India's which increased its palm oil import tax last week) could face downside risk in the medium-term.

### Commodities Performance Table

Updated as of 15 March 2018

Selected Indices	Close	Weekly Change	MTD	QTD	YTD
US Dollar Index (DXY)	89.7	-0.6%	-1.0%	-2.7%	-2.7%
Reuters / Jefferies (CRB)	194.5	0.4%	0.3%	0.3%	0.3%
Dow Jones Industrial Avg	24,758	-0.6%	-1.1%	0.2%	0.2%
Baltic Dry Index	1,169	-2.3%	-1.9%	-14.4%	-14.4%
Energy	Close	Weekly Change	Net Position	Weekly Change	YTD
NYMEX WTI Crude	61.0	1.5%	728,841	-20,644	1.0%
ICE Brent Crude	64.9	2.0%	539,784	-4,588	-2.9%
NYMEX RBOB Gasoline	192.4	3.0%	81,030	-2,047	6.9%
NYMEX Heating Oil	188.9	1.6%	18,713	-3,653	-9.0%
NYMEX Natural Gas	2.7	-0.7%	-119,455	13,484	-7.3%
Base Metals	Close	Weekly Change	Net Position	Weekly Change	YTD
LME Copper	6,989	2.3%	41,534	816	-3.6%
LME Aluminium	2,089	-0.8%	-	-	-7.9%
LME Nickel	13,835	4.3%	-	-	8.4%
Precious Metals	Close	Weekly Change	Net Position	Weekly Change	YTD
COMEX Gold	1,326.7	0.4%	193,337	9,815	1.3%
COMEX Silver	16.6	0.3%	4,876	7,444	-3.5%
NYMEX Platinum	963.6	1.2%	36,169	-6,740	2.7%
NYMEX Palladium	989	2.4%	14,298	-2,649	-6.8%
Agriculture	Close	Weekly Change	Net Position	Weekly Change	YTD
CBOT Corn	390	-1.0%	285,630	110,399	11.0%
CBOT Wheat	492	-1.6%	-4,636	28,207	15.1%
CBOT Soybeans	1,036	-2.7%	196,074	39,165	7.7%
Asian Commodities	Close	Weekly Change	MTD	QTD	YTD
Thai W. Rice 100% (USD/MT)	450	-1.1%	2.3%	5.4%	5.4%
Crude Palm Oil (MYR/MT)	2,443	1.4%	-4.5%	-2.4%	-2.4%
Rubber (JPY/KG)	194	1.2%	0.1%	-6.1%	-6.1%

Source: Bloomberg, CFTC, OCBC Bank

Note: Closing prices are updated as of 15 March 2018

Note: Speculative net positions are updated as of 06 March 2018

Note: Speculative net positions for Aluminium and Nickel are unavailable

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## Commodity Special: The calm after the storm?

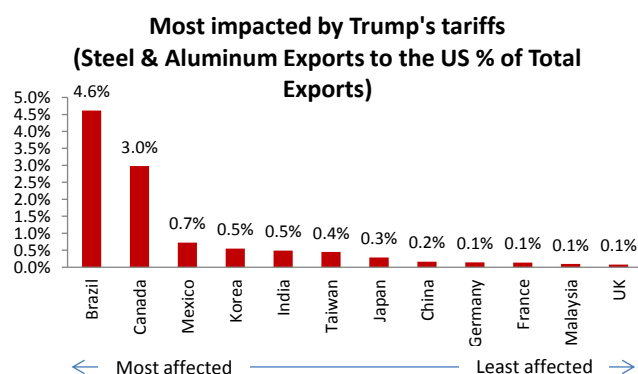
A lot of commodity-centric news have been centered around Trump's tariff plan, and how it could affect commodity prices, especially base metals and crude oil. Elsewhere, gold and silver did rise at the onset of the news, suggesting that safe havens were sought after as the threat of a trade war loomed nearer.

We did a study on Trump's tariff plan to impose a 25% tariff on steel and 10% on aluminium. The takeaway is that the news did spark market concerns on a trade war, and has distinct implications for the US. The US is actually the largest importer of these metals, and Canada remains to be the largest exporter of these metals to the US.

Across the region, we found that Brazil, Canada and Mexico will be most affected by the tariff, while Asia will be relatively unscathed. We note that China accounts for 49.2% of total crude steel production and 50.8% of aluminum production last year, making it the world's largest producer of these commodities. However, much of these metals are domestically consumed, with China exporting only 23% and 11.2% of steel and aluminum exported globally. Should we look in US-centric numbers, total steel and aluminum exports to the US only accounts 0.2% of China's total exports, suggesting that the impact to Chinese trade and economic outlook to be insignificant.

Across industries, we see that the tariffs will be beneficial to steel and aluminium producers, but could have adverse effect on downstream firms, especially automakers, aerospace, manufacturing and construction. Consumers will also see higher inflationary pressures given the higher input costs, and eventually see declining jobs and disposable income. The increased cost of input products, according to the US Aerospace Industries Association, cited "a cascading effect that has fairly significant impacts on our industry's global competitiveness", while the American Automotive Policy Council iterated that the tariffs will "place the US automotive industry, which supports more than seven million American jobs, at a competitive disadvantage". The higher prices for steel and aluminum in the United States, compared to the relatively lower global benchmark seen in other regions, will also affect about 6.9 million American workers in manufacturing and 10.1 million workers in construction, according to the Bureau of Economic Analysis.

We found that the tariff, if implemented, will invariably lift steel and aluminium prices, as it has been already seen at the onset of the announcement. The reason for the higher prices is due to the nature of the tariff; US consumers would need to settle for more expensive domestically produced metals, while imported ones will be more costly given the tariffs. In this area, there are also clear implications for shale oil, given that steel is used in pipeline production, while both steel and aluminium will be used for exploration/rig building efforts. As such, the costs for exploration and production of crude oil in the US may rise if the tariff should be implemented.



Source: Bloomberg, OCBC Bank

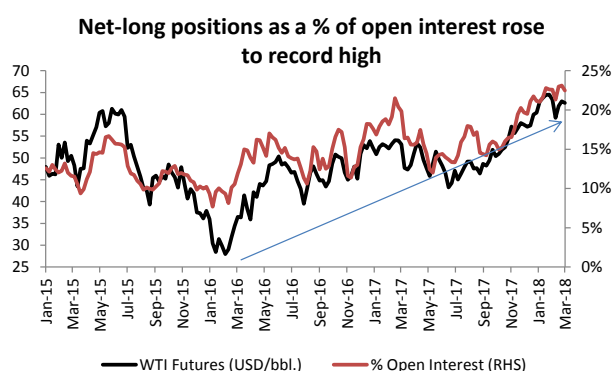
There is not much of a consolation perhaps, other than noting that the impact to Asia's overall trade and economic outlook appears muted, coupled with tariff exemptions for Canada and Mexico. On US especially, the negative impact the tariffs could bring may outweigh the benefits; while steel and aluminium makers benefit, the multitude of consumers of these raw materials could threaten the many jobs American hold.

## Crude Oil: Expanding US oil supplies undermines OPEC's efforts

- The numbers are eye-boggling. The U.S. is now pumping more than 10 million barrels per day (bpd), surpassing its previous high in 1970. The expanding production levels are also accompanied by surging exports (both crude and refined) as well as lower stockpiles.
- Demand has slackened somewhat, though it is primarily driven by the seasonal Lunar New Year effect. Note China's oil import at 7.7 million bpd as of February 2018 is the lowest since October last year.
- Market-players still appear bullish on crude oil, seen from the rising net-long positions. However, some bullish calls have been taken off the table into February and March, though it remains to be seen if this will be sustained into the month ahead. The relatively tame dollar index into March also aided in supporting prices as well. Elsewhere, risk appetite continues to stay supported to-date, thus aiding growth-related commodity prices.

### Listen to the markets

Oil-players were clearly on the bullish side of the table since the start of 2018. Combined net long (including futures and options) positions in Nymex crude continue to grow to its highest on record, bringing net-longs as a percentage of combined open interest to 23.1%, also a record high at end February. Should we break it down into the longs and shorts, total long positions has touched record highs in January before tapering marginally lower into year-to-date, likely on profit-taking from the stellar bull run. Elsewhere, total shorts have fallen to its July 2014 levels, when crude prices were above its \$100/bbl handle.



Source: Bloomberg, OCBC Bank

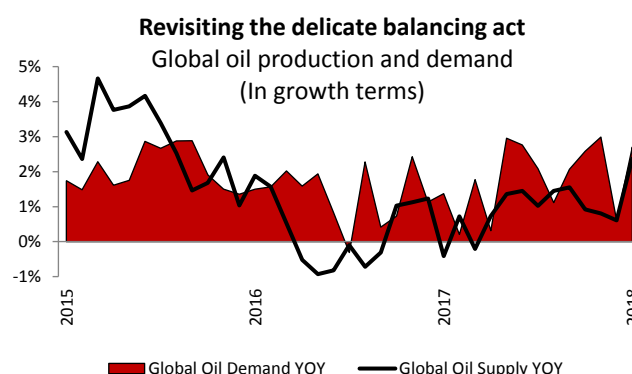
Although the accumulating net-long positions in crude oil provide a persuasive signal for oil bulls to stay bullish, we note that the buy calls are at record high though the buying momentum has recently showed signs of exhaustion into February and March. With expanding crude oil production out

from the OECD region (especially the US), market-watchers would likely draw scenario parallels from the then post-2014 oil plunge and potential sell-off in the oil market should supply growth be left unchecked into the months ahead. More worryingly in fact, net-long positions into March has fallen from its January levels, suggesting that market-watchers are increasingly wary over how supplies may trend into the foreseeable future.

### Looks like a supply glut environment (again)

Our concern over ballooning supplies is not without evidence. The U.S. is now pumping more than 10 million barrels per day (bpd), surpassing its previous high in 1970. The expanding production levels are also accompanied by surging exports (both crude and refined) as well as lower stockpiles. Delving into the numbers, most of US oil production growth came from its shale basins, with total shale oil production accounting for over 78% of total production. In a nutshell, total US oil production has grown at double-digit pace for eight consecutive months into February 2018.

The recent March OPEC report also confirmed such a phenomenon. In consolation, world oil demand is revised higher to 98.63 million barrels per day (bpd), up by 1.6 million bpd from 2017. Importantly, oil demand outlook has been upgraded in both OECD and non-OECD regions, reflecting their higher-than-expected demand numbers in 1Q18. However, global supply growth is likely to outpace demand this year, should OPEC's projections come to pass: non-OPEC supply is expected to grow by 1.66 million bpd (vs global demand growth of 1.6 million bpd), reflecting the stronger supply trend from the US, Europe and China. As history has shown, an oil supply glut is a very persuasive driver to drag oil prices lower, and prices have indeed trended lower into March.



Source: Bloomberg, OCBC Bank

Of course, one could also blame the sell-off on the sharp moves in both equities and risk appetite. Major US stock

market indices did decline sharply while the dollar firmed against a basket of major currencies during February's unexpected increase in volatility and risk aversion. Crude oil, being a growth-related commodity, was also amongst the casualties during the risk-off period. Since then, oil prices have remained below their January levels, as market-watchers weaned off initial concerns amid reduced oil output from Libya and Saudi Arabia's confirmation for OPEC-led oil curbs to continue into 2018.

#### **Politics, an unquantifiable factor**

So far our discussion has brought us around the familiar demand and supply issues that could influence how prices may trend. While we note that the stronger US oil supplies may potentially undermine OPEC's effort in curbing global production growth, recent US-led political manoeuvres could once again overshadow fundamentals.

These recent political manoeuvres are of no stranger to us; US president Trump's decisions to impose metal import tariffs and to dismiss Rex Tillerson as secretary of state took market-watchers by surprise, while the effects of these policies may still be seen into the year ahead. Importantly, these decisions can ultimately boost oil prices in the medium term. We opine that the metal tariffs will have implications for US oil

production, given that steel is used in pipeline production, while both steel and aluminium will be used for exploration/rig building efforts. As such, the costs for exploration and production of crude oil in the US may rise if the tariff should be implemented. Elsewhere, Mike Pompeo, who replaced Rex Tillerson as the Secretary of State, is viewed to be a supporter of Trump's agenda to scrap the Iran nuclear deal, which if come to pass, may raise the risk premium for oil prices.

In a nutshell, we think that the horizon for how oil prices may trend is increasingly hazy given the multitude of risk premiums and political uncertainties in the global economic space. Many questions are there, but answers are few: the prospect over the US trade sanctions against its trading partners, the potential re-visitation of the Iranian nuclear sanctions, and the question over how US shale players may react to further moves in oil prices will leave market-watchers careworn for answers. For now, the uncertainties at play should leave prices range-bound, albeit with some downside risks especially if global oil supplies continue to expand into the near-term. With the rally in oil prices already seeing some tell-tale signs of fatigue in March, the lack of clarity over these said issues may eventually give the market the needed reason to resume profit-taking into April.

## Gold: Loving the uncertainties and turbulences

- Gold remained range-bound into March, led by the rather tame dollar trajectory and improving Pyongyang-US geopolitical situation. Elsewhere, market volatility seen from the relatively higher VIX continued year-to-date, although the rush into equities resumed after February's sudden sell-off.
- With the US Federal Reserve likely to hike rates in the upcoming FOMC, market-watchers should be reminded of the higher interest rate environment into 2018. In such an environment, the demand for gold should invariably tune lower. After all, the yellow metal is a zero-yielding asset and the opportunity costs of holding it are costlier as interest rate rises.
- Seemingly, renewed concerns over US trade and policy manoeuvres plagued market appetite lower into mid-March. Yet again, uncertainties over political-related events can be market-moving but rather unquantifiable as to how gold may react into the months to come.

### As if tariff proposals weren't enough...

It has been a roller-coaster ride over the last weeks, and it hasn't ended... yet. Coupled with US President Trump's trade tariffs on solar panels and washing machines, his recent decision to enact a 25% steel and 10% aluminium import tariffs took market-watchers by surprise. Investors did not take the news kindly, seen from the fall in risk-related assets even as market-talks revolved around how the tariffs could pose more pain than good on the US economy. Still, the effects of the tariffs will likely be less severe than previously expected, owing to exemptions given to Canada, Mexico and Australia (see our special article on page 2). But as the market reels from the shock, Trump's unexpected decision to dismiss Rex Tillerson as US Secretary of State has thrown yet another wench into the rather delicate humming of global growth prospects.

There is however, a winner in all the chaos. The yellow metal's reputation as a safe haven to unexpected market upheavals has benefited prices to-date. Even in the face of an impending rate hike next week, gold has remained supported above its \$1,300/oz handle to-date. In the last weeks, the dollar weakness and the unexpected risk-off environment in February provided the support for gold, which may continue to give the yellow metal the added shine into the months to come if these drivers persist.

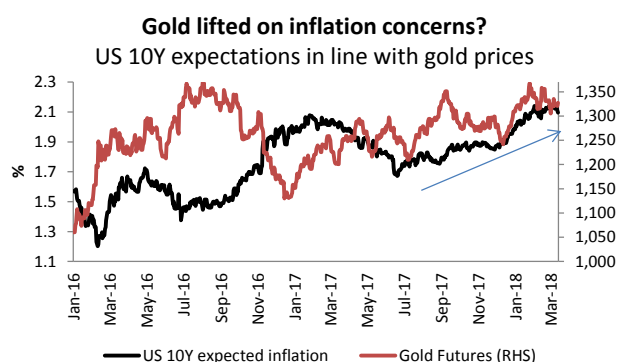
### Watch out for the three risks

Global economic variables including strong growth and low pace of inflation has coined the familiar term "a goldilocks economy". The low risk of inflation meant that central banks'

accommodative monetary efforts need not see any urgent normalisation, while risk-taking behaviour led global equity bourses to print higher into early 2018. Unfortunately, there are tell-tale signs that could threaten the goldilocks phenomenon.

**Inflation risk:** Higher prices across key economies have been observed to-date, while rising wages seen in the US amid strong nonfarm payroll data reinforced inflationary expectations. Note that the US Federal Reserve policy-makers are seeing a labour market that is "near or a little beyond full employment at present", which suggests that the recent wage growth print reflects the tightening labour market. In addition, the combination of US fiscal boost at a time when output gaps are closing can be indicative of higher inflationary pressures in the near term.

Empirically, we are already witnessing accelerating inflation pressures, seen especially in the US (+2.2% in February, up from 2.1% in the previous month). Coupled with higher oil prices since 2017, the improving global economic backdrop could eventually lead global prices higher. The effects on gold prices are quite clear in this regard, stronger inflation pressures could persuade the yellow metal higher given its inflation hedge characteristic.



Source: Bloomberg, OCBC Bank

**Rise of interest rates:** However, higher interest rates as a response to stronger inflationary pressures may overshadow gold's climb. The natural reaction to higher inflation would be a relatively tighter monetary policy by key central banks. With the FOMC committee meeting in a week's time, market-watchers appear to have priced-in another rate hike (note 100% probability as indicated by the futures market). Other key central banks including BOE, BOC, RBNZ and RBA could potentially see more rate hikes this year as well, on condition that growth and inflation pick up into 2018. Even in Asia, we have already seen BNM and BOK hiking rates in the last months to reflect the growing need to institute macro-prudential measures in their own domestic economies. Typically in a

higher interest rate environment, yield-chasing behaviour by market-players could mean lower demand for zero-yielding assets, including gold.

**Political uncertainties:** Beyond the argument of rates and inflation hedging, we note that risk premiums have recently increased given US-led trade tariffs and the change of key appointment holders. Importantly, risk-related asset valuations fell at the onset of these news, reinforcing the view that these manoeuvres could potentially do more harm than good. According to Bloomberg Economics, a full-blown trade war could potentially cost the global economy US\$470 billion. The argument here is simple; gold as a safe haven thrives on

uncertainties, though any quick resolution to these issues would mean further downside risk to gold prices.

#### **It's getting hazy**

The kaleidoscope of uncertainties in the background gives rise to a rather unquantifiable nature of how gold prices may trend. While our base case for gold to trend lower this year remains unchanged, we concede that the rise of political uncertainties and the perceived risks to overall global growth could support gold prices into 2Q18. In the midst of all the haze, we do note one certainty: that gold loves the uncertainties and turbulences given its safe haven attribute.



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