

Commodities: Bloodbath on Trump's new tariff threat**Monday, May 06, 2019****Highlights**

- **Commodities enduring heavy losses this morning as President Trump issues new tariff threat to China.**
- **Threat comes on the heels of North Korea's weapons test over the weekend.**
- **Soybeans, crude oil among heavier-hit commodities enduring losses.**
- **Prices of commodities likely to be swung by trade talk headlines, market sentiment more than fundamentals in the short-term.**

Executive Summary

Commodities are in a bloodbath this morning after US President Donald Trump threatened to unleash a new set of tariffs on China. The abrupt switch from Trump caught markets by surprise and China is reportedly mulling over its attendance of this week's high level trade talks in Washington. It remains debatable whether this tweet may have been used as a diversion tactic against North Korea's weapons test over the weekend – US-China talks have, after all, been advancing well and are now approaching the home stretch. The unpredictability of Trump, however, may have longer lasting impacts on the likes of agri-commodities as Chinese buyers are, once again, reminded of the importance of import stability.

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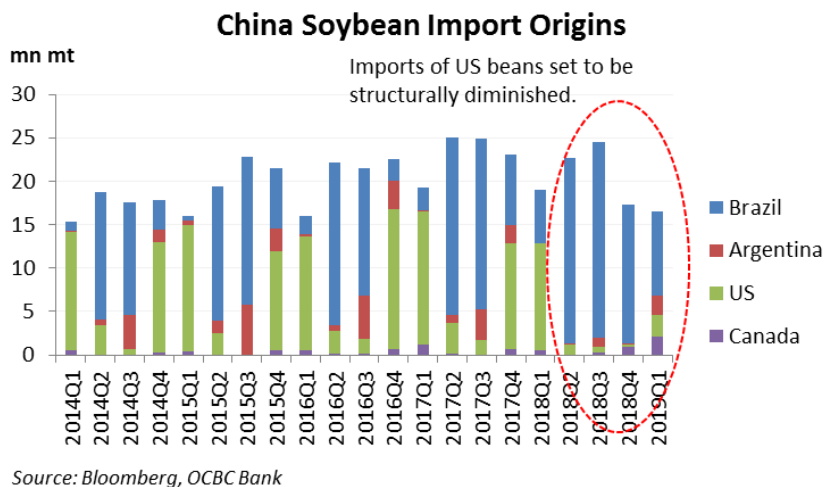
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Agricultural

This morning so far: Major commodities such as corn, soybeans and cotton are all in the red this morning, as Trump's continued unpredictability weighs heavily on Chinese purchasers. Prices on the July contract for corn, soybeans and cotton are down 2-3% while those on the new crop have sunk 1.5-2.5%. Soybean prices, in particular, have sunk below the low of last year (during the peak of trade tensions) and are now at its lowest since Dec 2008.

Analysis: The impact of the year-long trade tension may already have resulted in major structural shifts in Chinese agricultural buying patterns, and this latest episode may only reinforce any import-aversion towards the US that China may currently be carrying. Chinese imports of US soybeans have evidently not picked up in 1Q despite the opportunity for front-loading. Businesses in China crave stability among most other factors – they typically seek for certainty in raw input prices and RMB rates. Going forward, it is likely that Chinese crushers may source for most of its soybean requirements from Latin America. The risk premia attached to US soybeans may erode eventually but for now it appears exceedingly high for Chinese businesses.

Likely price action: Aversion to imports of US agricultural commodities appears reinforced, with the slump in soybeans dragging most other complexes down. Downside bias on US prices may likely persist, especially on soybeans and cotton. Spreads between US agricultural prices and other origins are expected to widen further. Trump's tweet could not have arrived at a more volatile period, with USDA releasing its first estimate of new crop productions this Friday in a typical high-volatile event – expect huge swing in prices for the rest of the week.



Energy

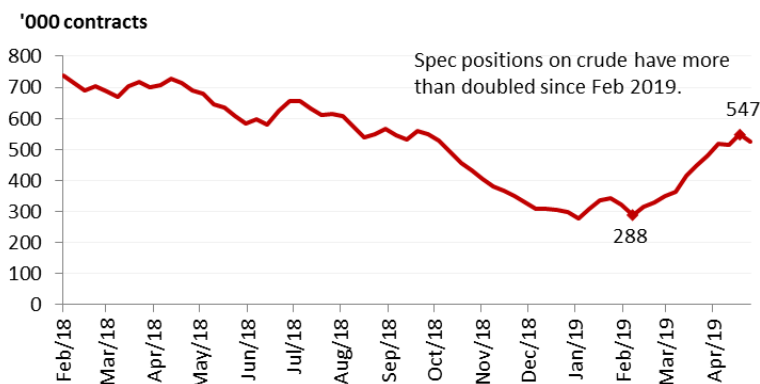
This morning so far: WTI is down -2.3% and is about 50 points from breaking below \$60/bbl at time of writing. Brent has fallen below the crucial \$70/bbl level after taking a hit of -2%. Prices rose slightly on Friday after the better-than-expected US jobs data but took a heavy tumble on Trump's threatening tweet.

Analysis: Although US crude oil is not included on Beijing's import tariff list, energy prices have been hit in a secondary channel via slower growth repercussions globally. Part of the heavy losses sustained by crude this morning has been partly due to profit-taking from speculators. Net non-commercial futures position on NYMEX have increased steadily from 288k in mid-Feb to 547k by mid-Apr, with Brent prices closing in on \$75/bbl in that period. Profit-taking and long liquidation were likely on the cards and Trump's tweets provided the catalyst for that.

Fundamentally, the market still remains tight. It is still an unknown if Saudi will produce enough to fill the voids left by Iran and Venezuela, while Libya is likely to face supply outages on the current militia insurgency. Talks of US shale replacing the production gaps by OPEC is premature at this stage – in the first 4 months of 2019, shale production increased only by 252k bpd, less half of last year's 515k bpd in the same period. The market is likely to focus on the trade-talk story for now, but once the dust has settled, the tight fundamentals may once again prove to be the prevailing force in price movements.

Likely price action: Long liquidation is likely the order of the week as speculators take some money off the table until they get some clarity on trade talks. OPEC report next week may also add to some cautiousness among market participants. If talks prevail – as they should, before Trump's surprise tweet – prices are likely to rebound, with Brent potentially testing the \$72/bbl and \$75/bbl in the near-term. If the new threats are followed through – notwithstanding that the 150-day truce is due to expire before the end of May – then prices may likely sink in a major fashion not unlike what was observed in 4Q last year.

CFTC NYMEX Net Crude Oil Non-Comm Position (Futures Only)



Source: Bloomberg, CFTC, OCBC Bank

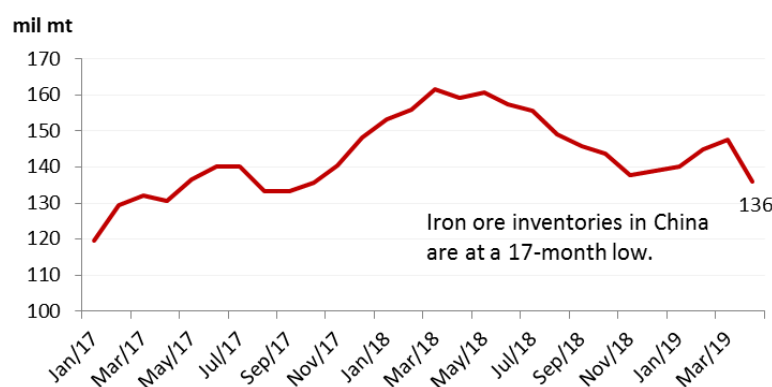
Iron Ore

This morning so far: Prices on SGX are down across the curve, but losses have been capped. Further-dated futures on the Aug/Sep contracts have taken a larger hit than the May/Jun contracts. Dalian futures are up, with the Sep contract up a marginal +0.3%.

Analysis: Like crude oil, prices of iron ore are affected in a secondary channel via reduced demand for construction materials and vehicles, given that most of China's iron ore imports are of Australian and Brazilian origins. There has been a recent buoyancy over China's property segment, with investments recording a sharp increase in Feb and growth of floor space under construction rising steadily for 13 months. Iron ore inventories in China have also fallen to its lowest since Oct 2017. The Vale SA incident and unfavourable weather in Australia continue to dominate headlines and have cushioned any price fallout from Trump's tweet.

Likely price action: The market continues to be in tight supply, with inventories dipping to a 17-month low and Vale's production still an overhanging question. Further declines in inventories and a positive turnaround in US-China trade talks may send prices on the May SGX contract above the elusive \$100/mt level.

Steelhome China Iron Ore Total Ports Inventory



Source: Bloomberg, Shanghai Steelhome, OCBC Bank

China Iron Ore Demand Indicators YoY Growth



Source: Bloomberg, OCBC Bank

Precious metals

This morning so far: Gold prices have risen this morning as demand for portfolio hedging grows. The other more industrial-use precious metals – silver, platinum and palladium – have fallen.

Analysis: Gold has benefited from the growing trade talk uncertainty, although gains have been subdued at 0.3%. Silver – widely used in electronics – have seen a dip. Platinum and palladium, which are valued for its usages as catalytic converters in vehicles, have also endured heavy losses as concerns over vehicle sales growth climb over a potential global slowdown.

Likely price action: Despite the increase in gold prices, technical analysis suggests that downward pressure on the yellow metal continue to manifest, with a series of lower highs since February. It is likely this morning's price increase is a result of short covering and hedging demand – the medium term still suggests a large range-bound consolidation of \$1,270/oz to \$1,300/oz.

Gold Spot Price



Source: Bloomberg, OCBC Bank

Conclusion

Trump's unexpected renewed tariff threat towards China has resulted in a bloodbath for most commodities, with agri-commodities like soybeans and cotton feeling the most direct impact via higher import costs. Crude prices have tumbled also, partially on long liquidation as the rally runs out of short-term steam. Beyond the apparent drag on prices in the near term, the prolonged trade tensions may have resulted in behavioural changes from Chinese buyers, who may now look at other non-US origins for import stability. Expect a widening gulf between price spreads of US and non-US sources – the Brazilian-US bean spread and Brent-WTI spread are two major pairs that may see a growing divergence.

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