Weekly Commodity Outlook

Monday, May 27, 2019

Commodity	Market Roundup & Opinion	Likely Price Direction
Crude oil	Prices tanked on Thurs, with WTI now trading $58/bbl and Brent at $68/bbl. Tightness in Mid East and contamination in Russia urals have held Brent up but WTI has been sinking more rapidly as shale production comes on strong. **Overall the supply picture remains tight**, with OPEC expected to continue with the curbs into Q3 with or without Russia. All said, **long liquidation is the order of the day** as US-China tensions take precedence over tight supplies. Net long on CFTC NYMEX still has more to go, by my estimates possibly another 150k contracts more from here since its peak of 547k contracts in late April. **Crack spreads remain healthy** and together with the tight supply and **inverted 1m/12m spreads** on both benchmarks, **we do not expect prices to plunge like last year**. We expect WTI to find support at $55, Brent at $65 and the spread to stabilise at 10c. Brent-Dubai at 4 c/bbl and looks like it may head for 5 c/bbl, possibly led by a Brent rally as IMO 2020 draws close.	→
Soybeans	**Chinese margins are negative on Brazilian beans at -238 RMB/mt**; Chinese crushing US beans are naturally deeper in the red at -680 RMB/mt, with larger tariffs. All things constant, by our estimates **Dalian spot soymeal requires 3200 RMB/mt to breakeven** from 2900 currently, or Brazilian beans CNF China to drop to 420 from 445 USD/mt. The USDA aid package offered to US farmers in light of the trade war was apparently smaller than expected for beans, so many are expecting now a **larger shift in US acreage from beans to corn**, reversing pre-announcement beliefs. **Heavy rain also preventing planting in the US,** holding up prices but in my opinion would eventually have to **grind lower on the structural downgrade in bean demand.**	↓
Palm	Many bearish factors working on palm at the moment, with the **overhang of the large MPOB inventory still pressuring prices lower.** India edible oilseeds inventory is high while Chinese palm stocks are above average. **The swine flu** (which has already spread to Thailand and Vietnam) and the **EU biofuel curbs** on palm oil usage beginning 10 Jun are other bearish factors. El Nino probability is placed at 89% till June and that may offer some balance via production reduction, but **the macro sentiment and inventory overhang will likely outweigh**. Gasoil-palmoil spread has also been dipping; while still elevated, palm is now less cheap compared to ten days ago. All said, **palm at 2000 MYR/mt is likely a reflection of the macro overhang** (trade war + EU ban) and may find it hard to recover past 2200 MYR/mt in the short term. For that reason, we **expect Indo CPO export levy starting next month to be zero** as palm currently trades <$570/ton.	↓
Cotton	**Prices on the Dec contract sank an astonishing 10c/lb** to 67c/lb since the restart of the US-China trade war. The latest WASDE report probably **overstated the amount of exports that the US can ship out** at 17mil bales, as it was published before the tensions restarted and hence assumed the Chinese import sliding tariffs would be in place. Our model suggests that Cotlook prices, given the WASDE estimates, **has a fair value of 88c/lb,** but now perhaps a fairer value would be the 82-85c/lb range. With that as a benchmark, **a reverse engineering of ICE cotton prices would likely be 61-63 c/lb for the new crop**, lower than what is trading now at 67 c/lb.	↓

Iron Ore	**Iron ore on SGX Jun contract finally breached the $100/mt level** on 22 May and has shown no signs of slowing down, trading at $103/mt at time of writing. Inventories in China remain low at two-year levels, **but it is the pace of inventory decline that has sparked the most concerns** – the -13m sudden drop in Chinese inventory in April (~ -10%) was unprecedented. **Profit margin on Chinese steel production remains healthy at +375 RMB/mt,** led by a 5-year high price of hot rolled steel prices in China lingers at the 4000 RMB/mt level. Chinese property indicators such as building sale, floor construction area and property investments all **remain robust with healthy above-average YoY growth rates**, although auto sales and production have been contracting lately. Prices on both SGX and Dalian **remain in backwardation** as the bad Australian weather and depleted Brazilian shipments remain the main focus. Almost all fundamentals appear to suggest that a continued rally in iron ore prices is possible but we remain wary of a) a sudden change in Chinese policy leading to a collapse in steel prices; b) **a rapid profit-taking which may spin a wave of end-user defaults.**	↑
Gold	**Gold still strangely languishing at $1,280** despite all the risk-off sentiment that is going on. In Q1 last year, haven-seeking activity pushed gold to as high as $1,340 so it begets the question of why a repeat is not forthcoming. Our hypothesis is that the difference between now and Q4 last year is **the presence of a "Powell put" on equity markets.** Investors seem confident that even with negative events, the Fed will be there to provide a floor on any potential collapse, thereby continuing to ply into equity markets and **downplaying the need for a portfolio hedge**. Technically the gold chart appears **bearish with lower highs and lower lows**, and we would personally wait for a break above $1,300 to confirm any form of uptrend.	→

OCBC Commodities Research

Howie Lee

howielee@ocbc.com

Co.Reg.no.:193200032W