

# **OCBC Commodity Outlook**

## Into the fray of geopolitical concerns

Barnabas Gan  
Economist

Global Treasury Research & Strategy

April 2017

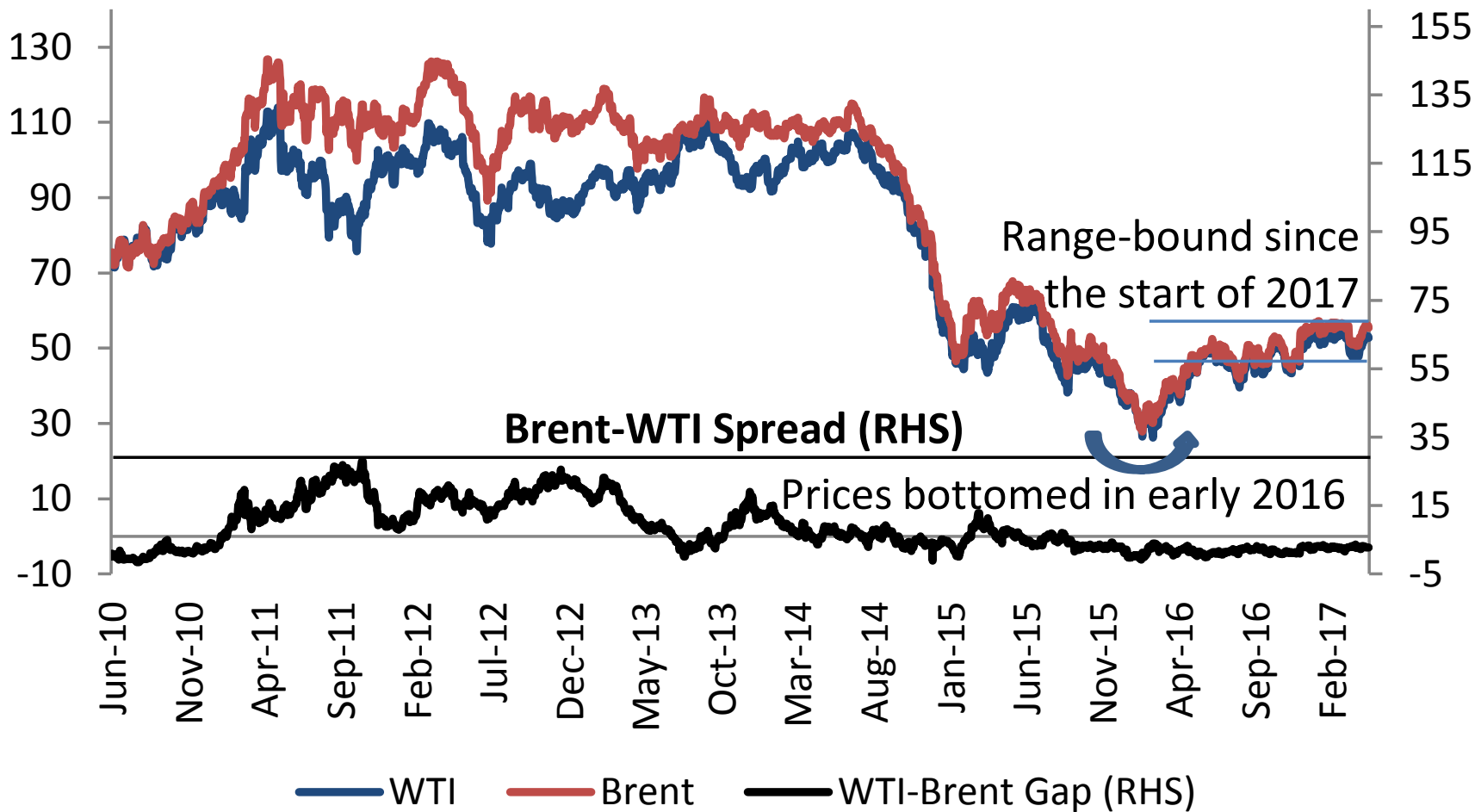
# Crude Oil

**Upside risk given geopolitical concerns**

# Executive Summary

- **Global growth is slated to accelerate faster than previously estimated**, according to the IMF which lifted its global growth target to 3.5% (+0.1%). IMF also upgraded its crude oil growth forecast to grow 28.9% yoy (+9.0%) this year. Meanwhile, global trade volume is penciled to accelerate to 2.4% in 2017, up from a 1.3% print in 2016 according to the WTO.
- **The bad news however, is that the rally in the crude oil market still appears to be fragile.** Even as global growth accelerates, much of the rally into the year must be underpinned by a continued rebalancing in the oil market. To date, OPEC has not been fully compliant on its production cut agreement made in Dec 2016, which then brings to question if an extension of cuts into 2H17 is sufficient to arrest the oversupply issue.
- **Still, early data seen in 2017 looks promising:** demand looks encouraging given recent data from US and China. The OPEC cartel continues to cut production further, down to 32.0 million barrels per day (mbpd) in March 2017 versus a worrying 33.7 mbpd print late last year. From a market perspective, crude oil futures curves point higher while speculative demand positions still suggest some substantial bullish bets into mid-April.
- **We remain bullish on crude oil prices, keeping to our forecast of \$65/bbl at year-end.** Our bullish call is underpinned by better economic fundamentals amid the likelihood for crude oil to rebalance further into 2017. Elsewhere, should history be of reference, geopolitical tensions evidently inject some upside bias to crude oil prices, especially if conflicts are prolonged.

# Crude oil prices remain range-bound around its \$50 - \$55/bbl handle



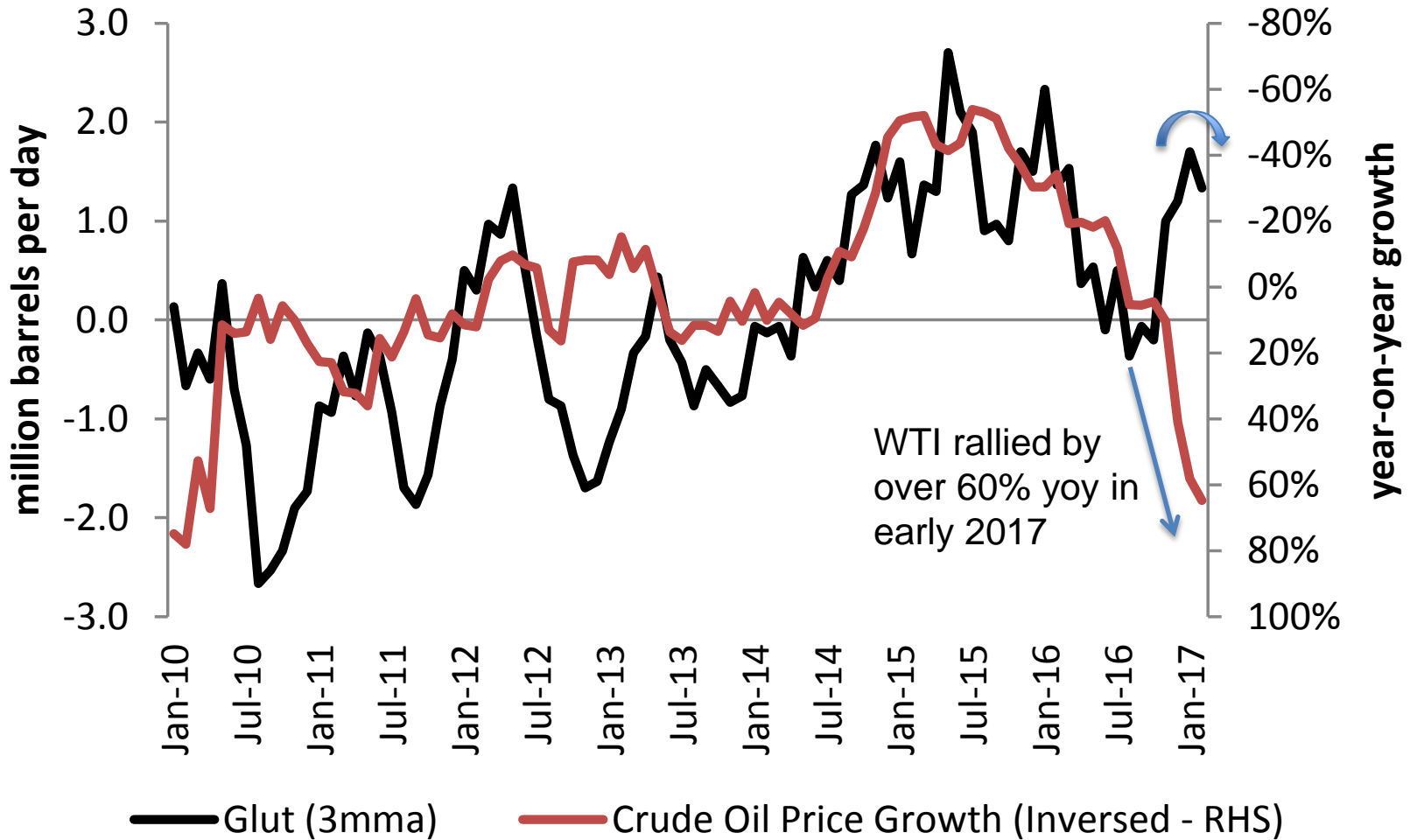
# IMF lifts crude oil and global growth outlook

**Table 1.1. Overview of the *World Economic Outlook* Projections**  
(Percent change, unless noted otherwise)

	2016	Projections		Difference from January 2017 WEO Update <sup>1</sup>	
		2017	2018	2017	2018
<b>World Output</b>	3.1	3.5↑	3.6	0.1	0.0
<b>Advanced Economies</b>	1.7	2.0↑	2.0	0.1	0.0
United States	1.6	2.3	2.5	0.0	0.0
Euro Area	1.7	1.7↑	1.6	0.1	0.0
Germany	1.8	1.6↑	1.5	0.1	0.0
France	1.2	1.4↑	1.6	0.1	0.0
Italy	0.9	0.8↑	0.8	0.1	0.0
Spain	3.2	2.6↑	2.1	0.3	0.0
Japan <sup>2</sup>	1.0	1.2↑	0.6	0.4	0.1
United Kingdom	1.8	2.0↑	1.5	0.5	0.1
Canada	1.4	1.9	2.0	0.0	0.0
Other Advanced Economies <sup>3</sup>	2.2	2.3↑	2.4	0.1	0.0
<b>Emerging Market and Developing Economies</b>	4.1	4.5	4.8	0.0	0.0
Emerging and Developing Asia	6.4	6.4	6.4	0.0	0.1
China	6.7	6.6↑	6.2	0.1	0.2
India <sup>4</sup>	6.8	7.2	7.7	0.0	0.0
ASEAN-5 <sup>5</sup>	4.9	5.0↑	5.2	0.1	0.0
<b>Commodity Prices (U.S. dollars)</b>					
Oil <sup>6</sup>	-15.7	28.9↑	-0.3	9.0	-3.9

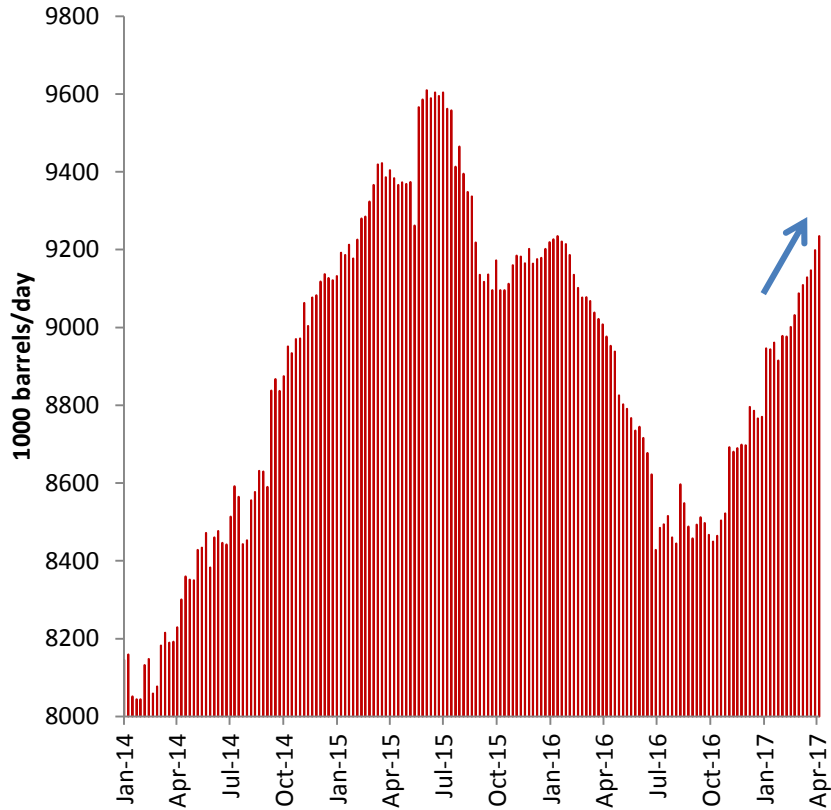
<sup>6</sup>Simple average of prices of U.K. Brent, Dubai Fateh, and West Texas Intermediate crude oil. The average price of oil in U.S. dollars a barrel was \$42.84 in 2016; the assumed price based on futures markets is \$55.23 in 2017 and \$55.06 in 2018.

# Supply glut narrowed into the new year as OPEC production cuts overshadows higher US supplies

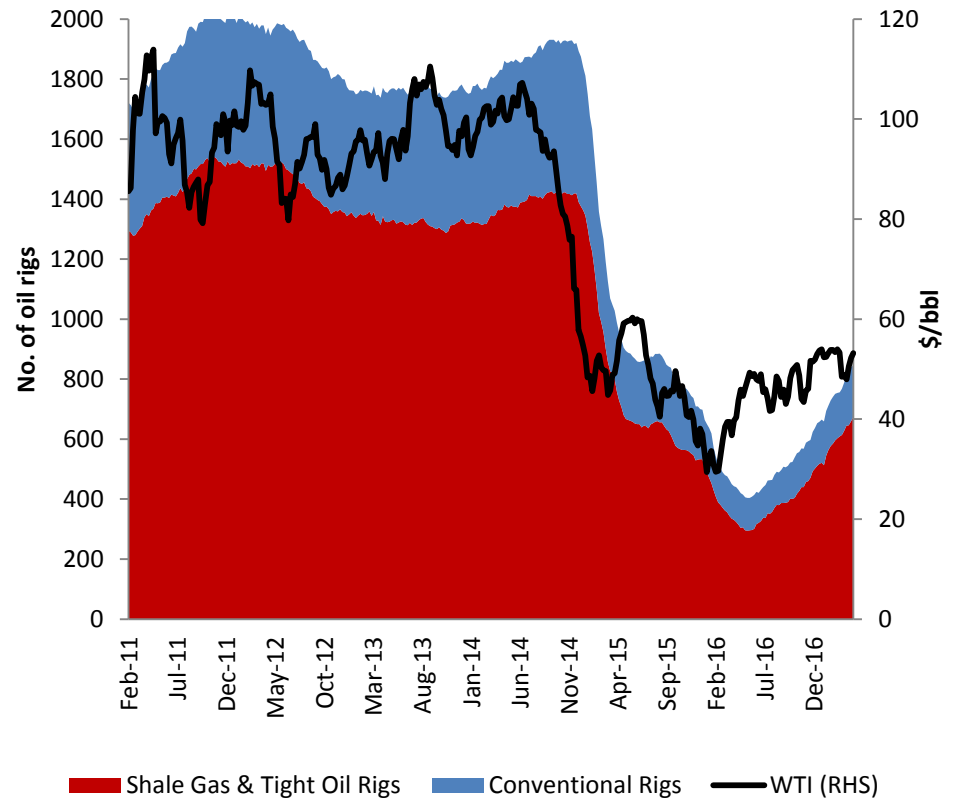


# US crude oil production rose by 465 mbpd since the start of the year

US production grows as oil rig counts rise



US oil rig counts has been increasing since June 2016



# However, OPEC's production cuts at 1.2mbpd as of March overshadows US' supply growth

thousand barrels per day	Reference Production Levels	Targeted production level	Production (Jan 2017)	Production (Feb 2017)	Production (Mar 2017)	Planned cuts vs reference level	Production cuts vs reference level (Jan 2017)	Production cuts vs reference level (Feb 2017)	Production cuts vs reference level (Mar 2017)	Level of Compliance*
	(a)	(b)	(c)	(d)	(e)	(f): (b) - (a)	(g): (c) - (a)	(h): (d) - (a)	(i): (e) - (a)	(j): (i) / (f)
Algeria	1,089	1,039	1,091	1,084	1,085	-50	+2	-5	-4	8.0%
Angola	1,751	1,673	1,615	1,649	1,652	-78	-136	-102	-99	126.9%
Ecuador	548	522	534	535	531	-26	-14	-13	-17	65.4%
Gabon	202	193	203	196	198	-9	+1	-6	-4	44.4%
Iran	3,975	3,797	3,920	3,870	3,790	-178	-55	-105	-185	103.9%
Iraq	4,561	4,351	4,630	4,566	4,402	-210	+69	+5	-159	75.7%
Kuwait	2,838	2,707	2,710	2,705	2,700	-131	-128	-133	-138	105.3%
Libya**	528	-	680	669	622	-	+152	+141	+94	-
Nigeria**	1,390	-	1,533	1,526	1,269	-	+143	+136	-121	-
Qatar	648	618	615	545	621	-30	-33	-103	-27	90.0%
Saudi Arabia	10,544	10,058	9,748	10,011	9,900	-486	-796	-533	-644	132.5%
UAE	3,013	2,874	3,060	2,995	2,973	-139	+47	-18	-40	28.8%
Venezuela	2,067	1,972	2,250	2,248	2,235	-95	+183	+181	+168	-176.8%
<b>Total</b>	<b>33,154</b>	<b>29,804</b>	<b>32,589</b>	<b>32,599</b>	<b>31,978</b>	<b>-1,432</b>	<b>-860</b>	<b>-555</b>	<b>-1176</b>	-

\* Compliance rate above 100% indicates that the country has cut production above what was agreed.

\* A negative compliance print indicates that country has increased production despite the agreement.

\*\* Excluded from production cut agreement

\*\* Reference production levels are assumed at Oct 2016 levels

Figures in blue are obtained from secondary sources

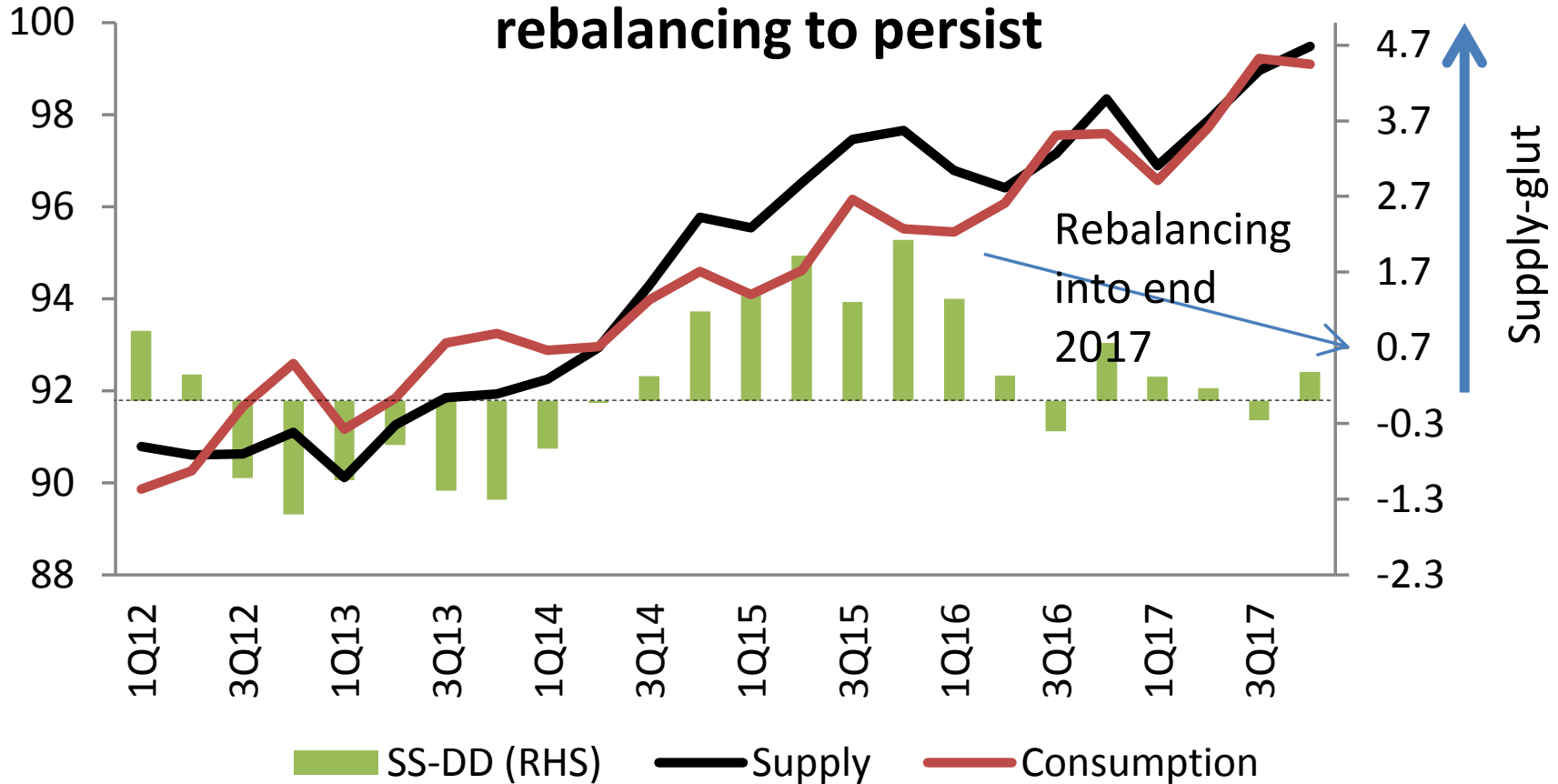
Source: Bloomberg, OPEC MOMR, OCBC Bank





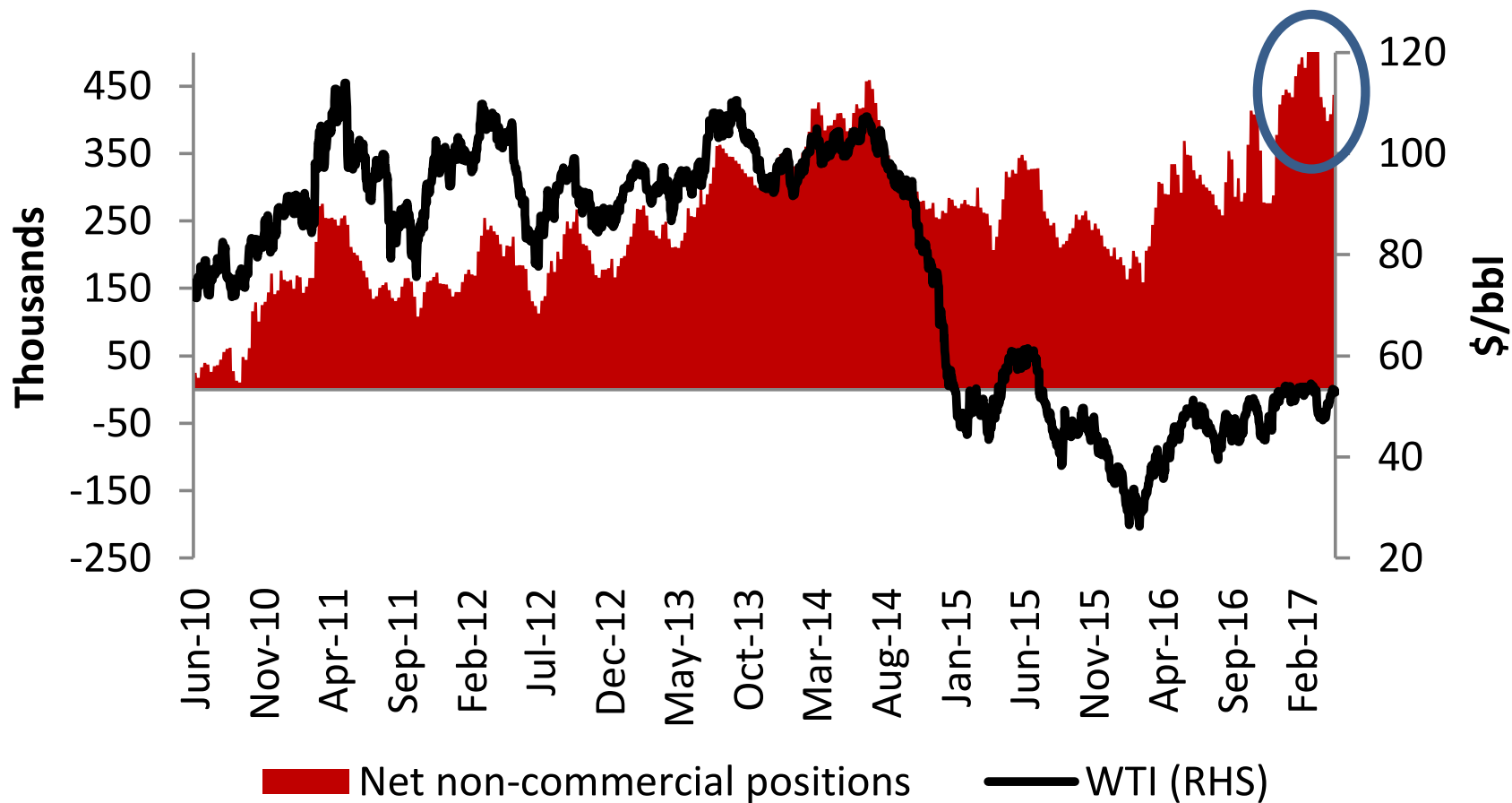
# Rebalancing has already started, and likely to fully rebalance by 3Q17

US Department of Energy still expects rebalancing to persist



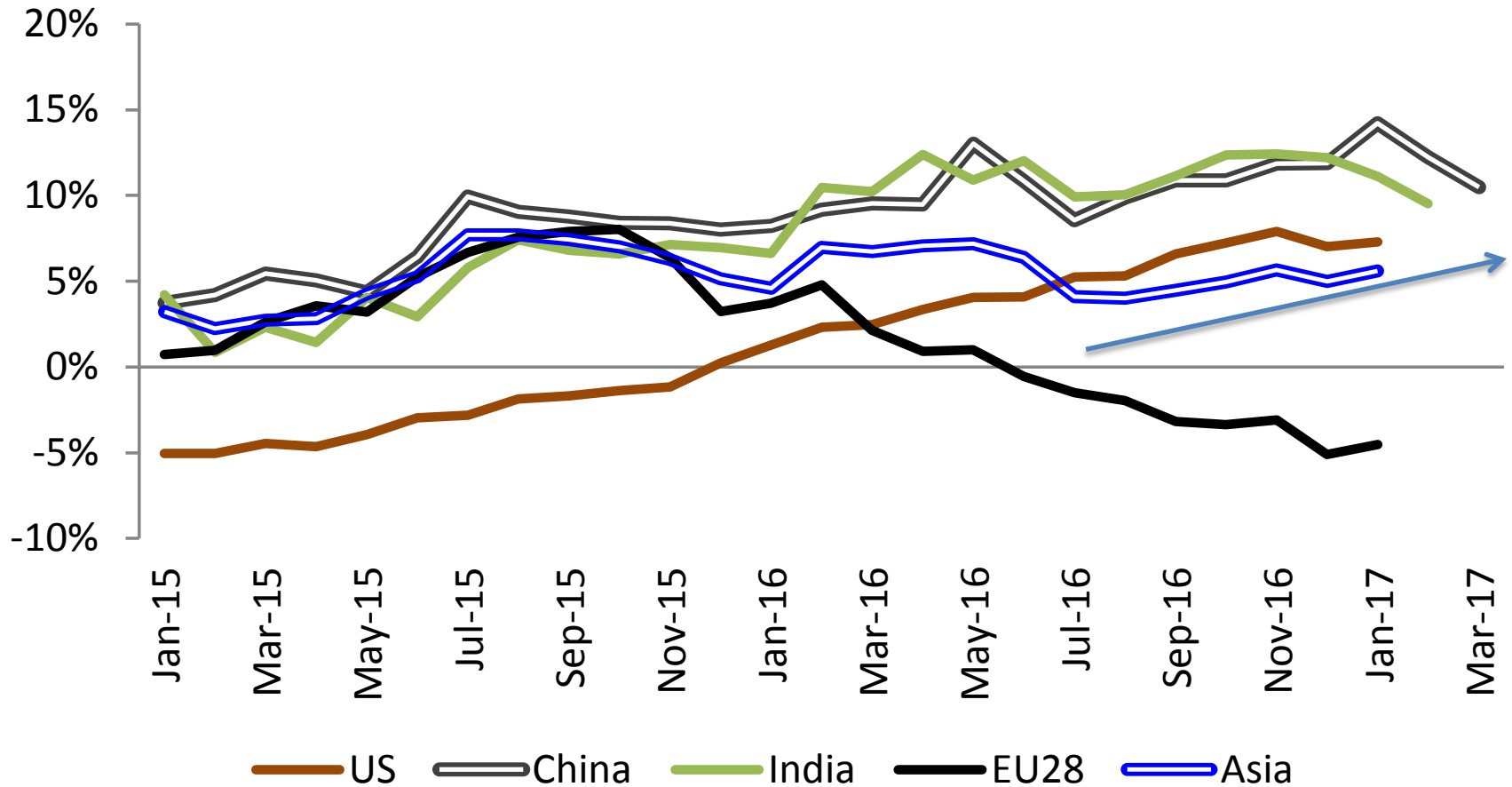
# Market-watchers are still (very) bullish in fact

## Speculative demand remains strong into 2017



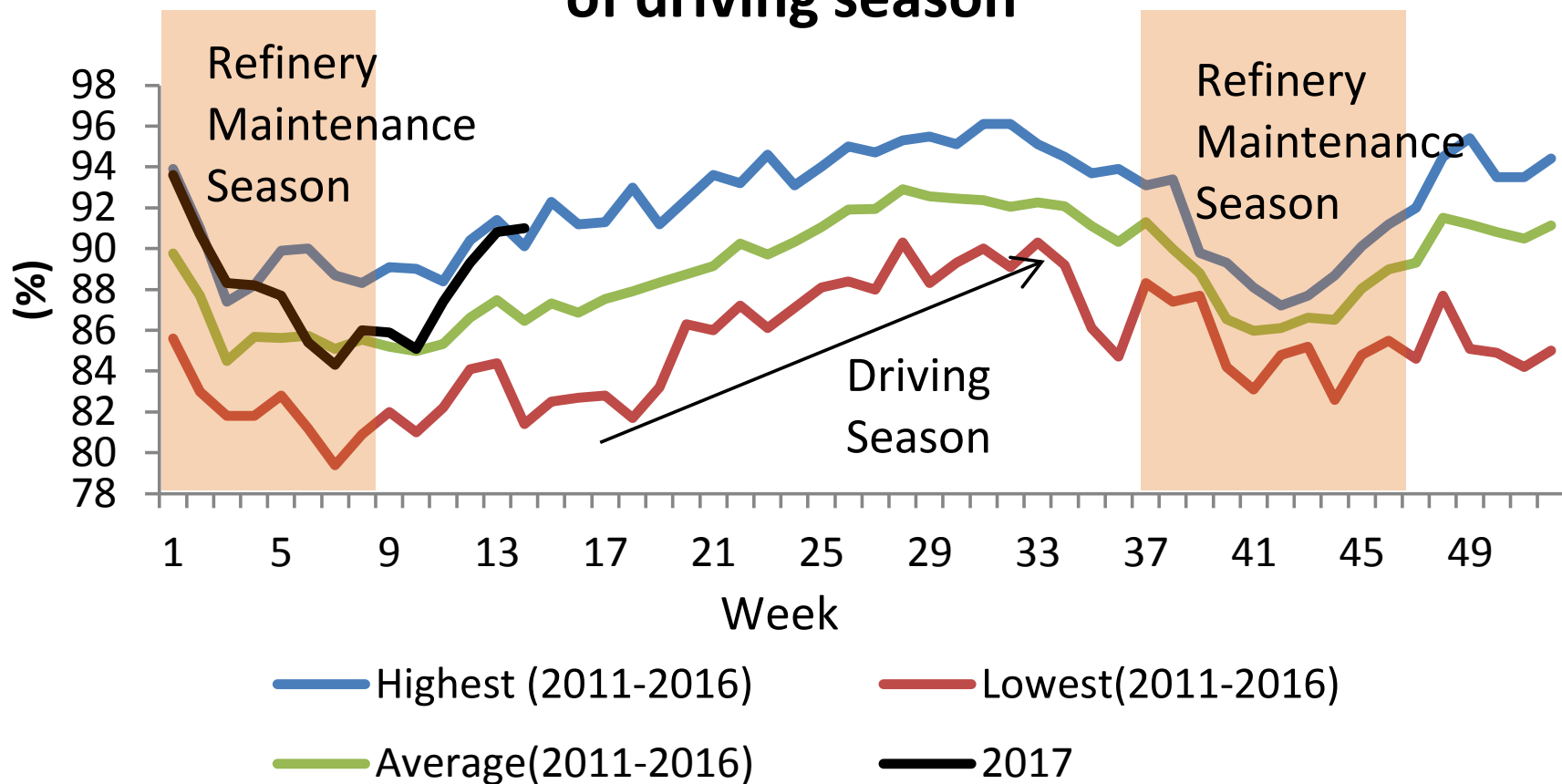
# Crude oil demand growth remains in positive territories

## Crude oil import growth

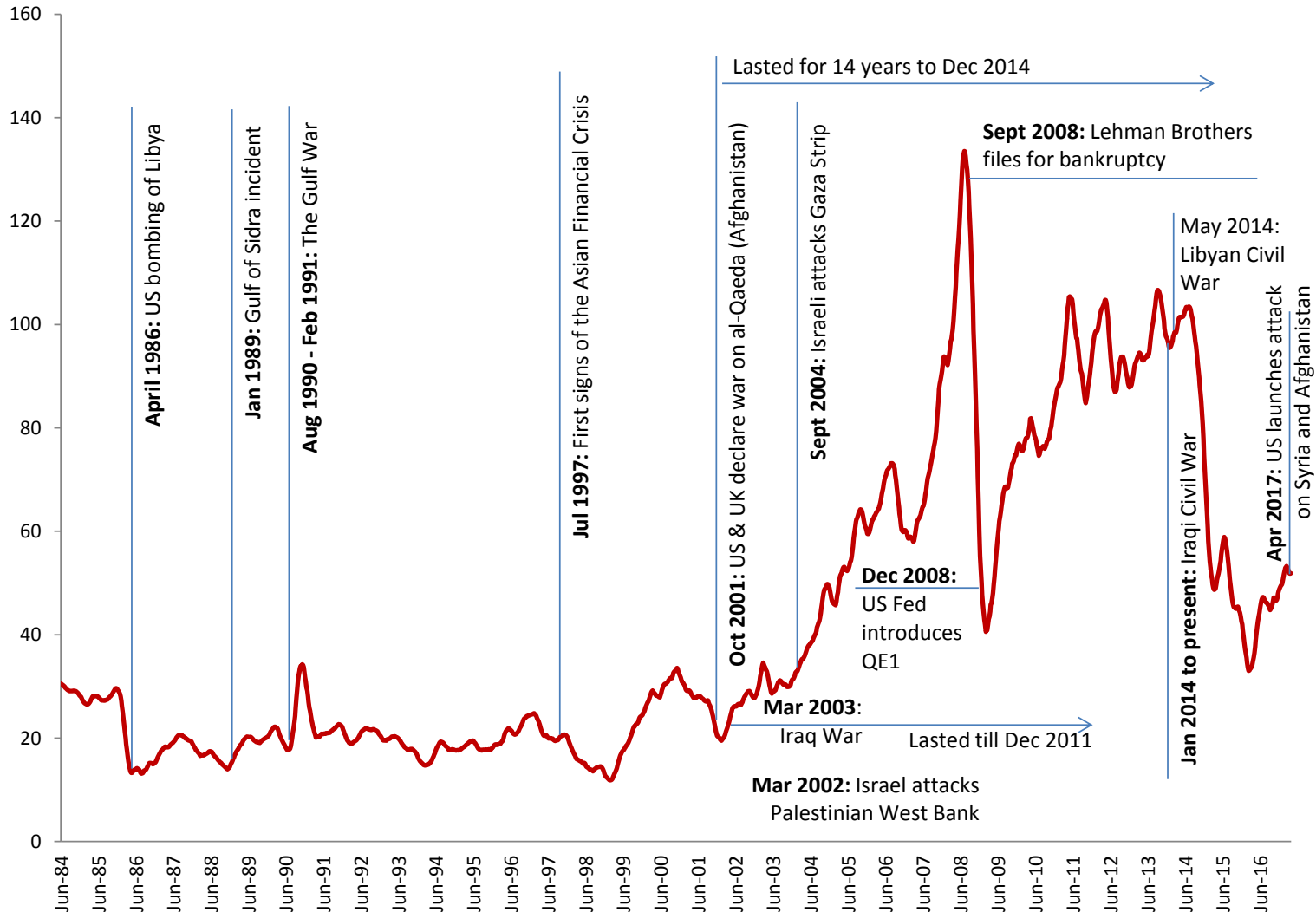


# Look out for summer (and higher consumption)

## US refinery utilisation rates edged higher ahead of driving season



# Watch out! War tends to lift oil prices, especially when prolonged





**Gold:**

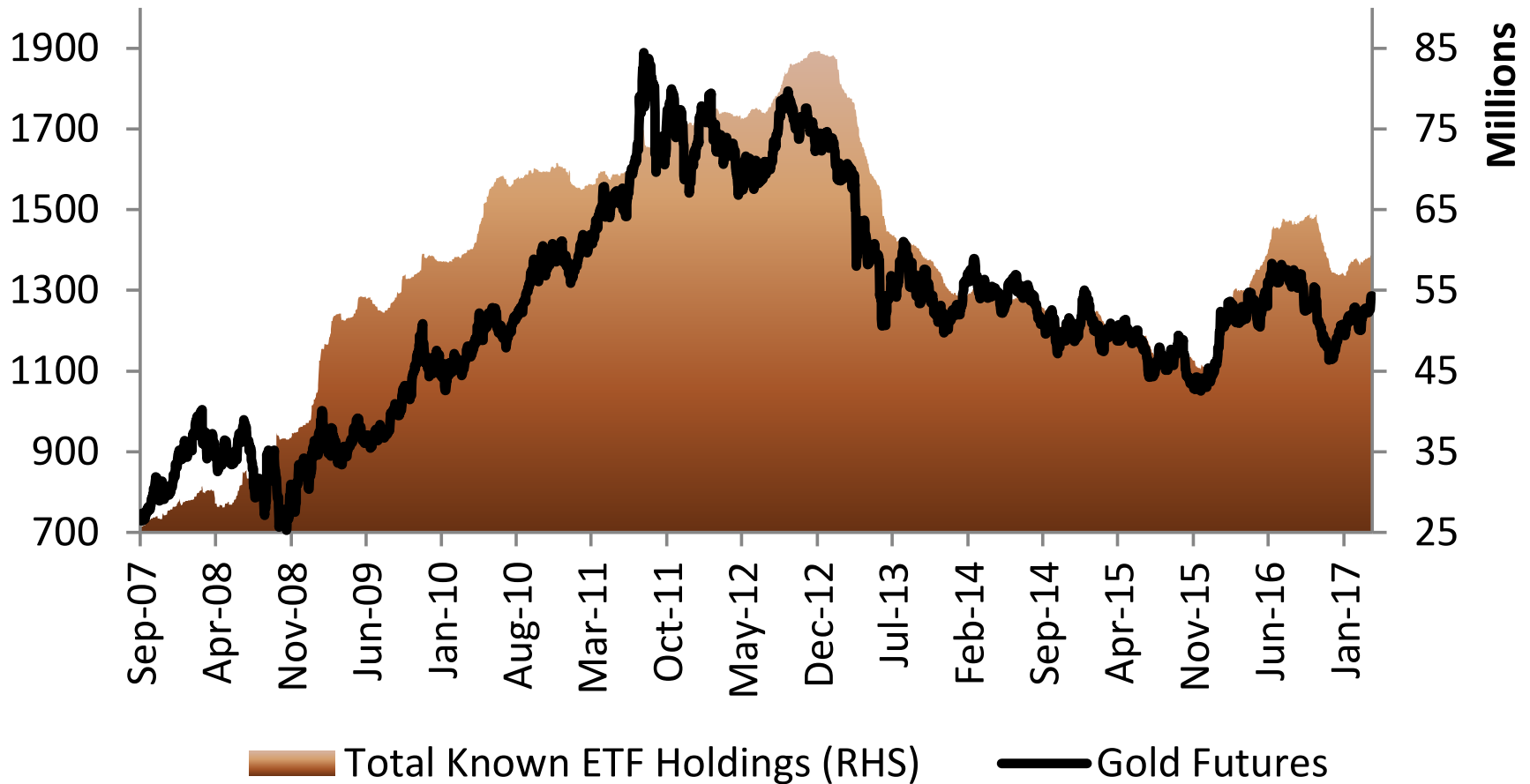
**In doubt, buy the yellow metal**

# Executive Summary

- **The recent rally in gold prices to its \$1,290/oz handle lifted its YTD growth to above 12.0%**, outpacing growth across equity bourses in Asia, Europe and the US. Much of the rally of late is driven by renewed safe haven demand, owing to intensified geopolitical concerns.
- **With geopolitical issues affecting gold prices, price trajectory outlook becomes inherently hazy.** Geopolitical issues remain to be a highly important, but uncomfortably unquantifiable factor when determining market sentiment. Should conflicts intensify into the near future, it will likely cloud the fundamental backdrop, which in this case, a year of rising US interest rates given a rosier economic backdrop, and thus consequently dulling gold as a store of value.
- **Elsewhere, gold prices could have been lifted by physical buying in India as well as the return of reflationary risk in 2017.** Empirically, we have seen a strong 72.3% yoy growth in India gold imports over 1Q17, while the US 10Y TIPS yield has trended in line with higher gold prices.
- **Given the rally seen over the first four months of this year, we raise our gold forecast to touch \$1,200/oz at end 2017.** In the near term however, some upside risk above the \$1,300/oz could be seen especially if geopolitical tensions intensify further. Still, our view for gold to trend lower into the end-year is underpinned by further FOMC rate hikes later this year.

# Gold ETF holdings rose into the new-year likely on safe haven demand

## Gold prices and ETF holdings



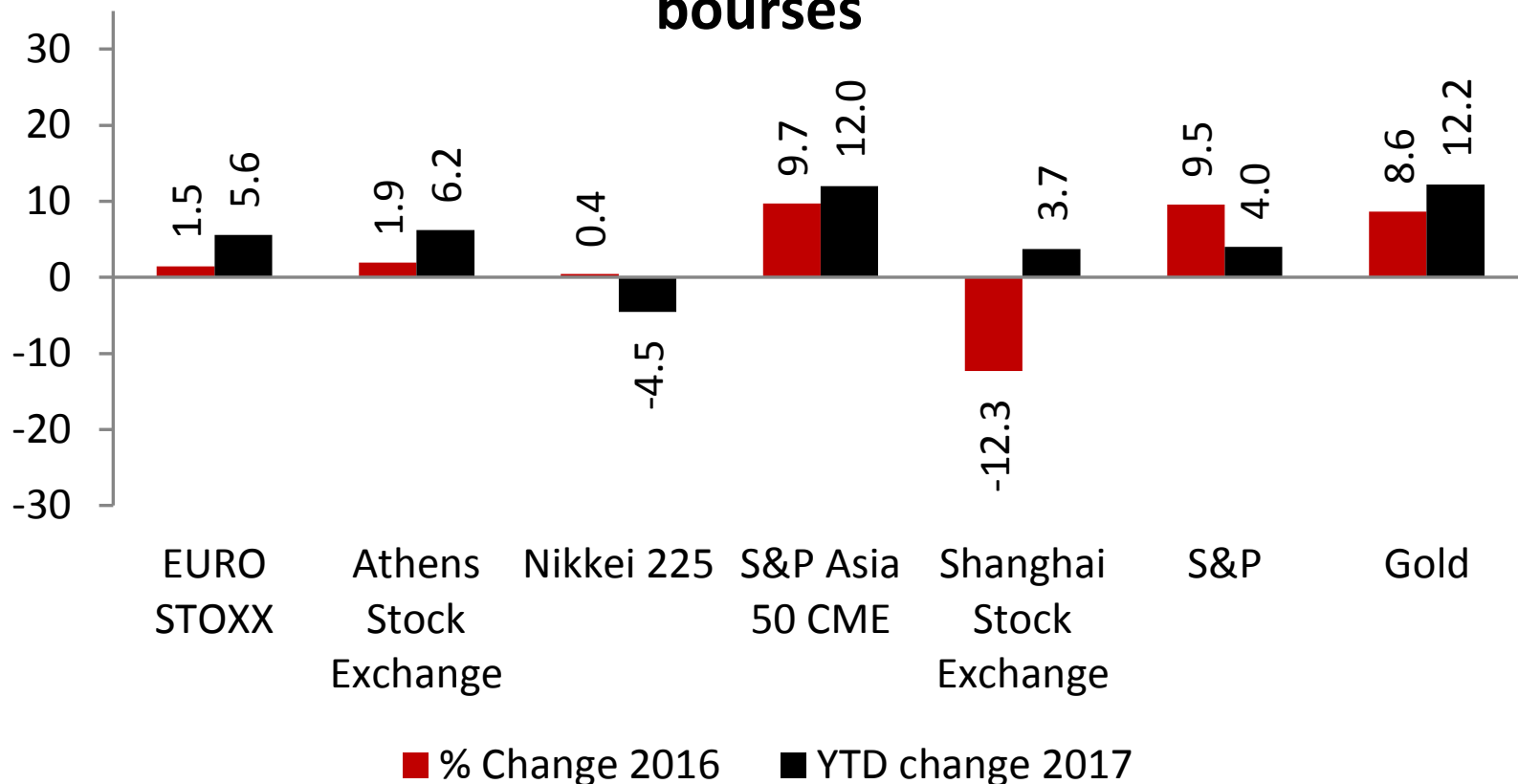
**OCBC Bank**

Source: Bloomberg, OCBC



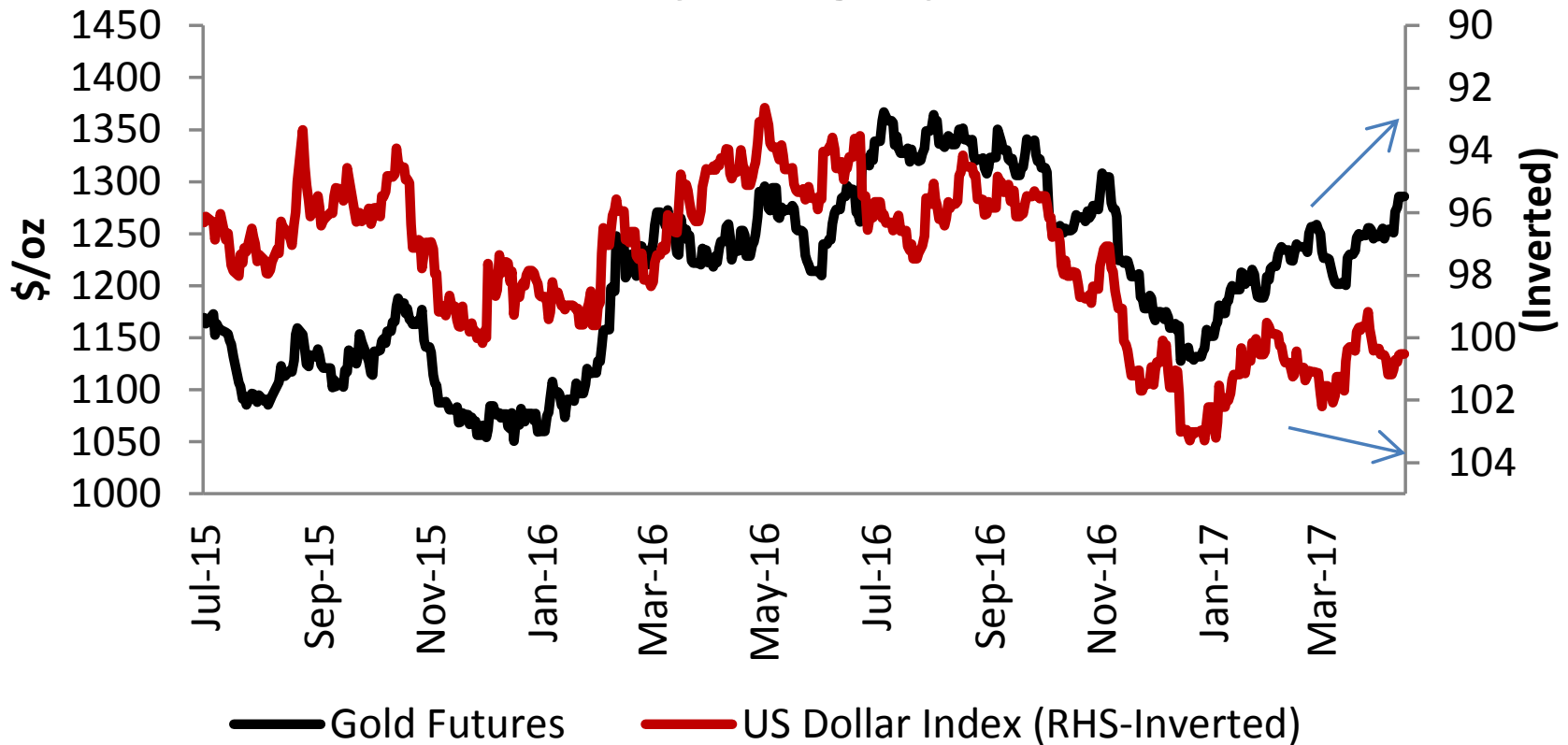
# Gold is sought after especially on geopolitical concerns

## Gold outshines performance of other equity bourses



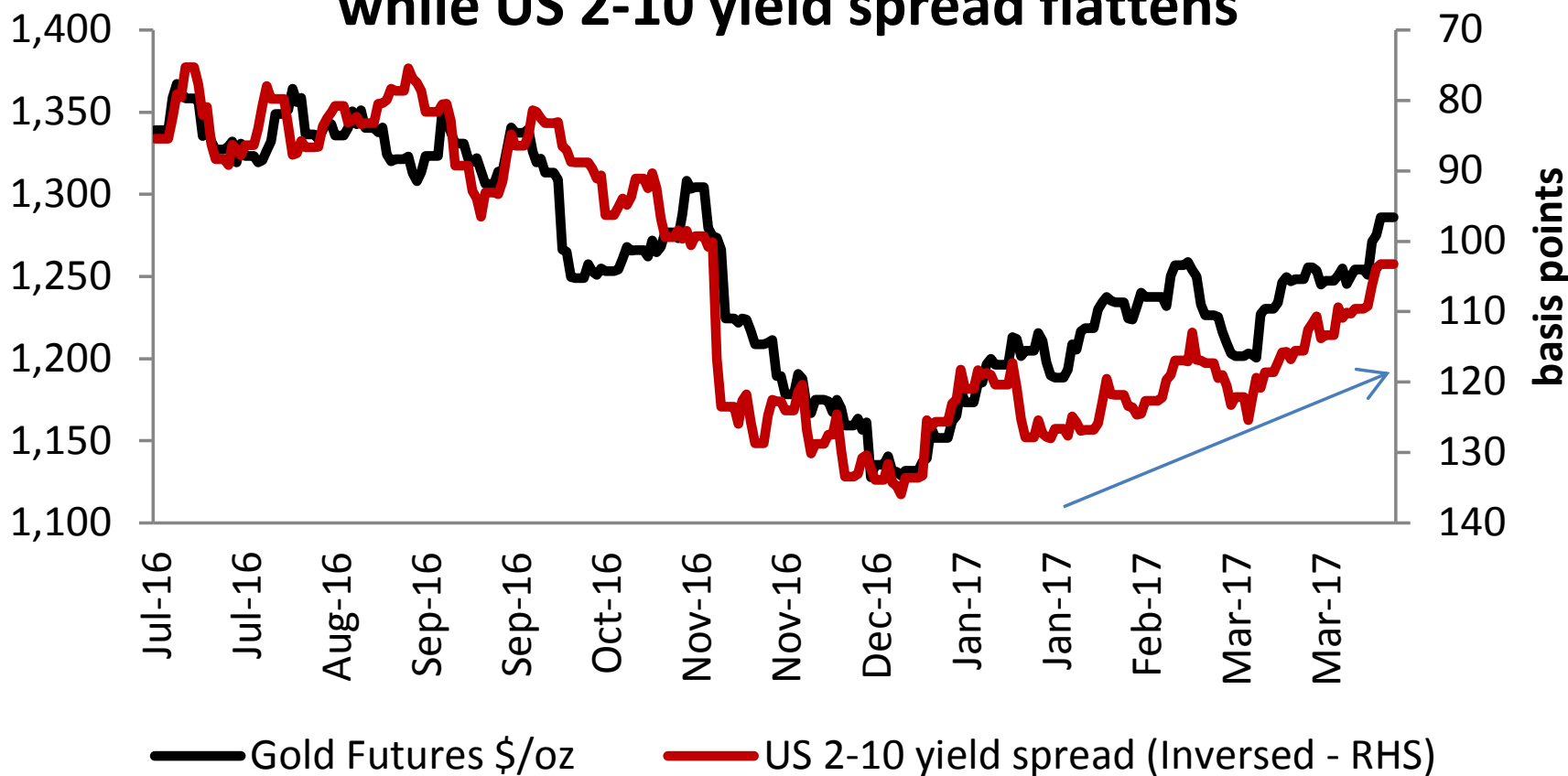
# Breakdown in correlation suggests investors flight to safe haven on geopolitical concerns

## Gold to US dollar correlation weakens as market-watchers eye on geopolitical issues



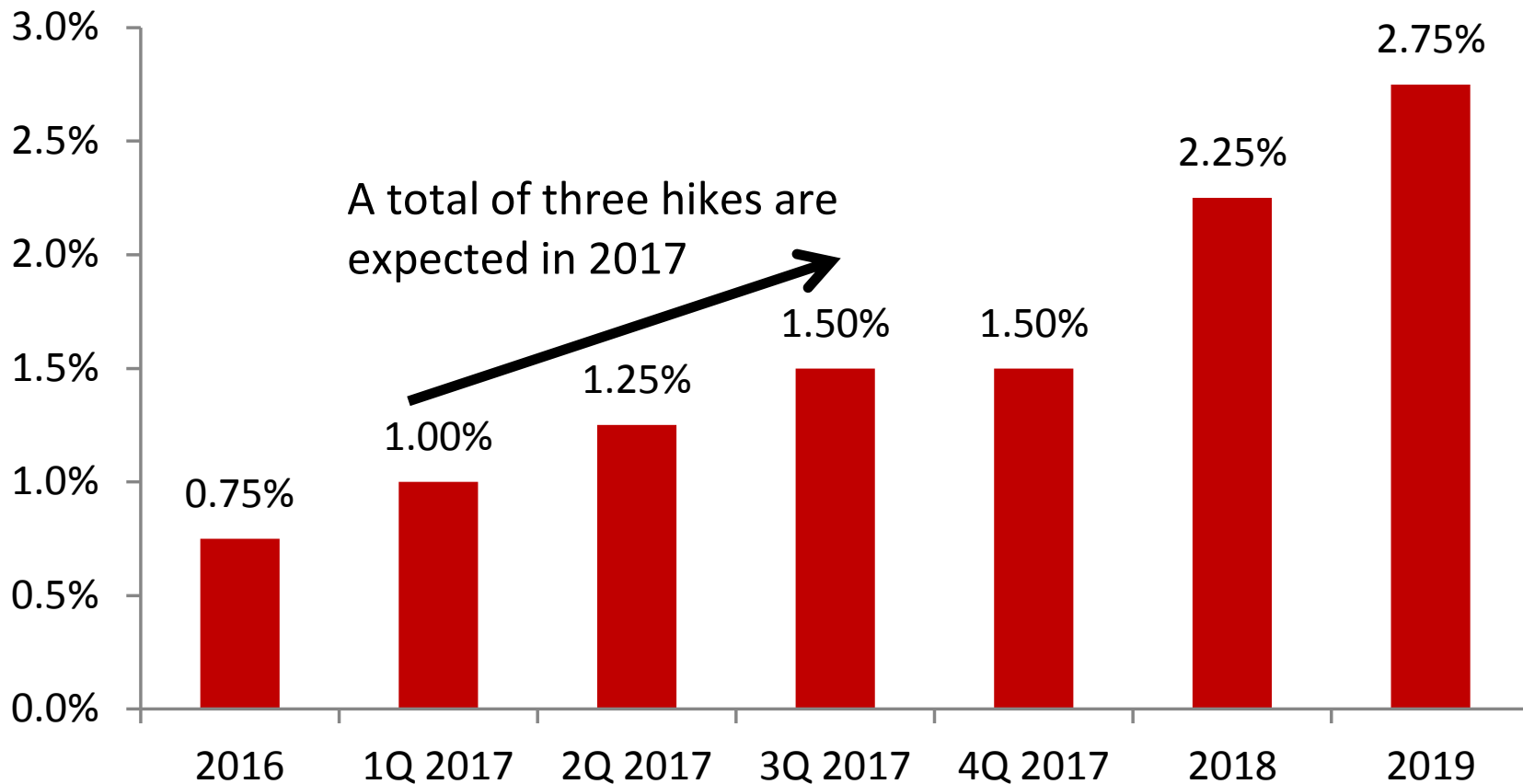
# US 2-10 yield curve flattened into the new year, highlighting some deterioration in risk appetite

Purely a safe haven play? Gold moved higher while US 2-10 yield spread flattens



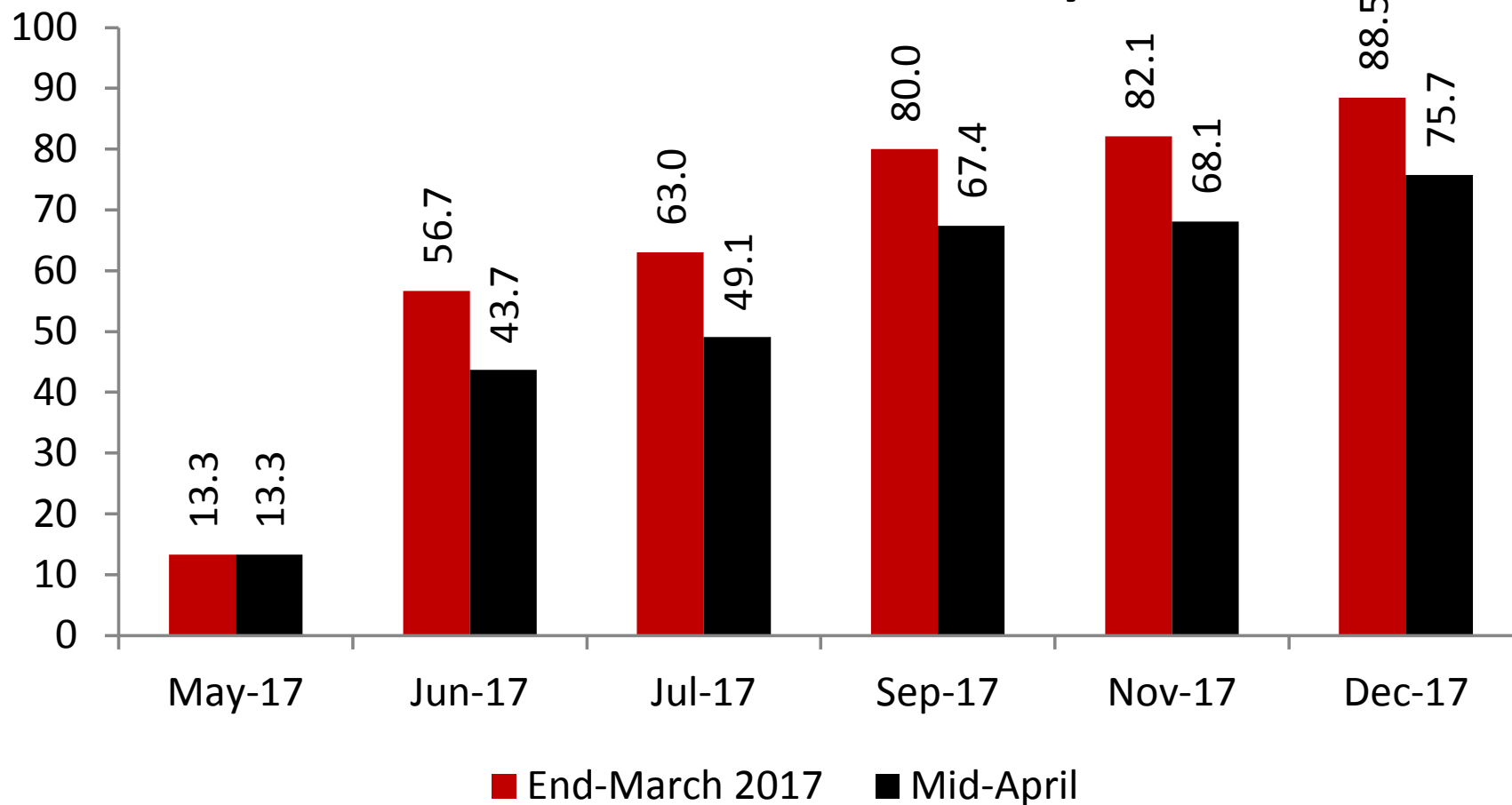
# The US Federal Reserve is slated to hike interest rates by three times in 2017

## Fed Funds Rate Outlook into 2019



# Probability for rate hikes into 2017 has fallen somewhat into April

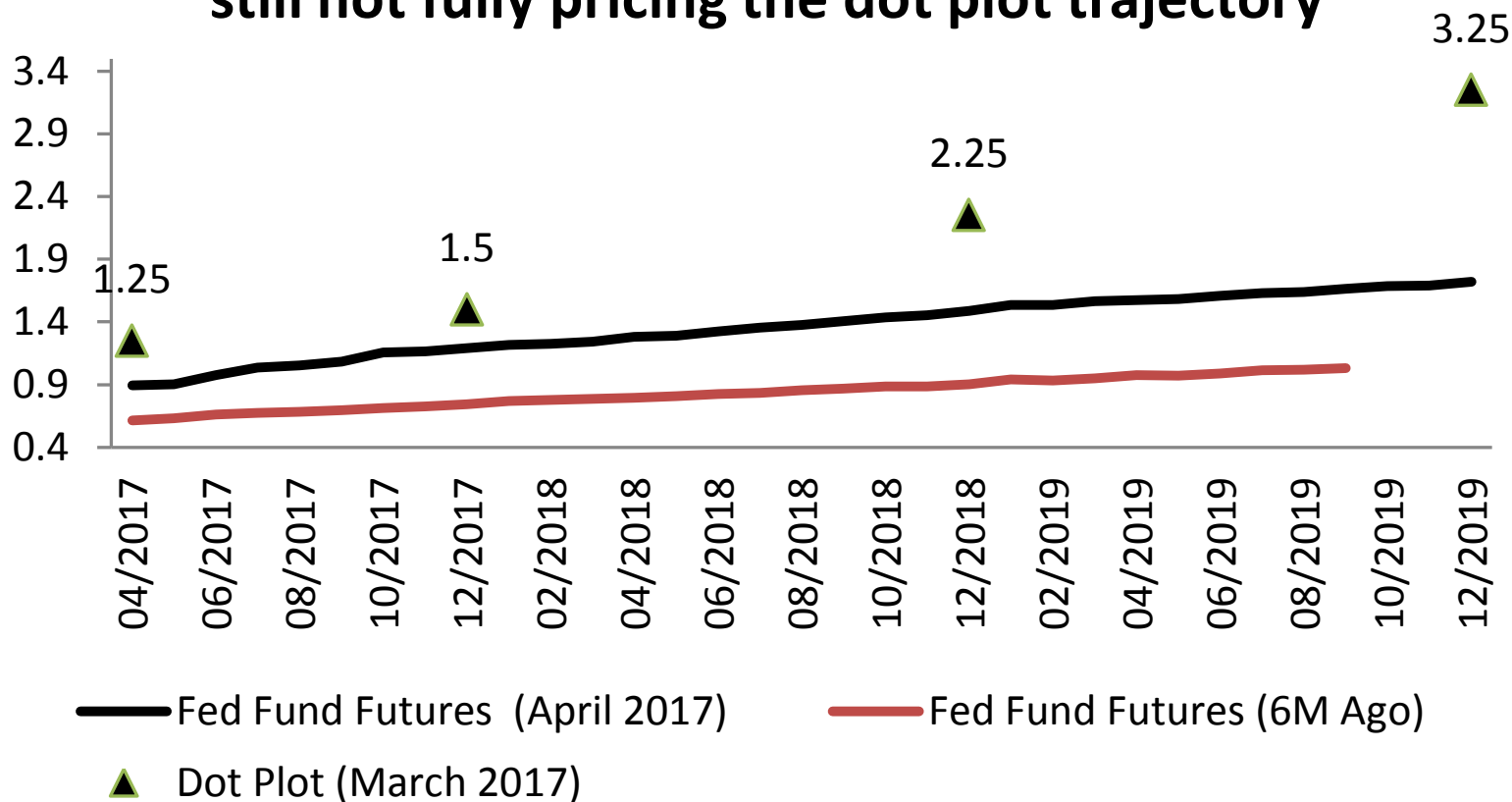
## US Rate Hike Probability



# The market is not fully pricing in three rate hikes

## Fed fund futures remain lower vs the dot plot

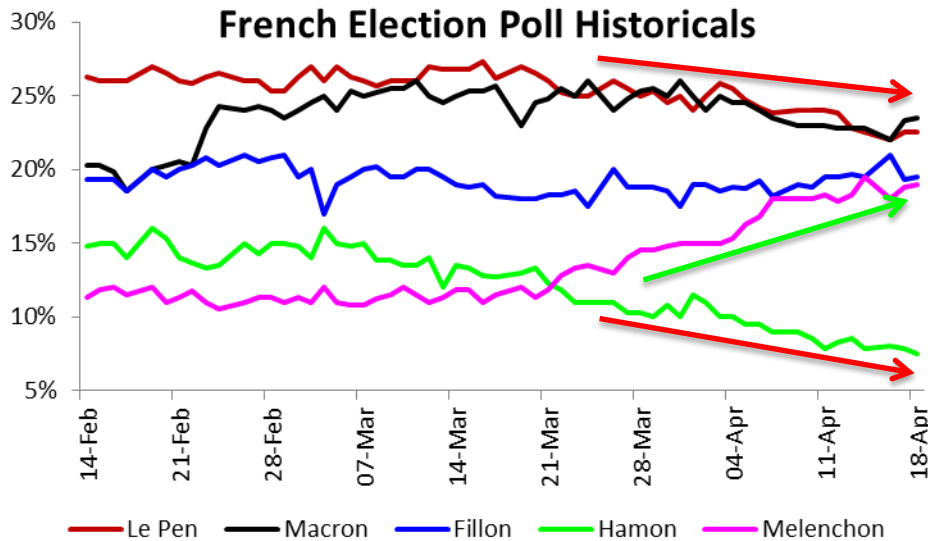
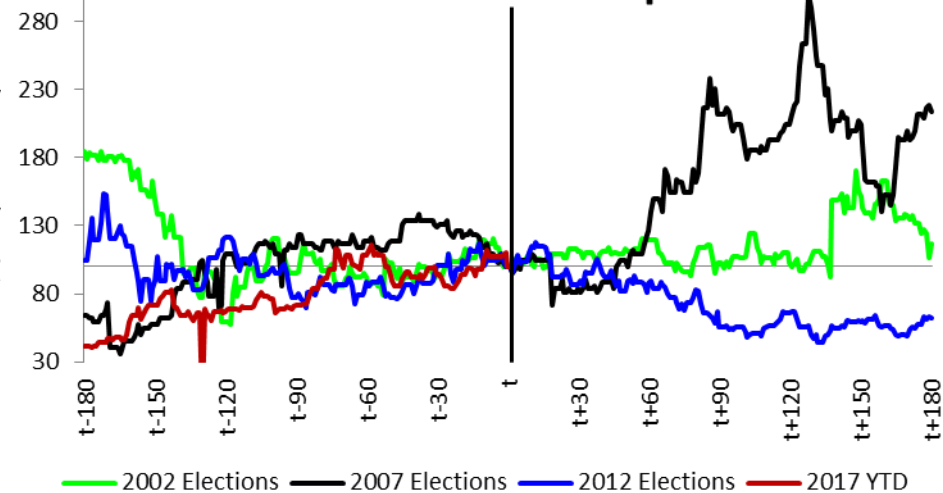
Fed fund futures curve has moved higher, tho still not fully pricing the dot plot trajectory



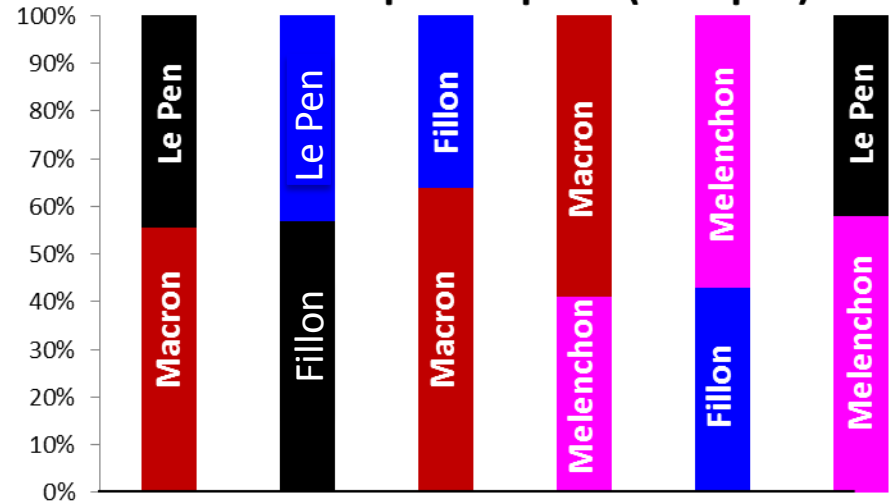
# Remember Brexit, beware Frexit

- Gold rallied impressively by 13% during and after UK's vote to leave the European Union (Brexit), a sign that gold is sought after during times of uncertainty.
- Importantly, French's Melenchon speedy entry into the race posed renewed Frexit fears and uncertainty as reflected in the GE-FR spread reaching -0.785%. Note Marine Le-Pen, or known as "Madame Frexit", remains neck-and-neck with Macron.

10YR FR-GE Yield Spread

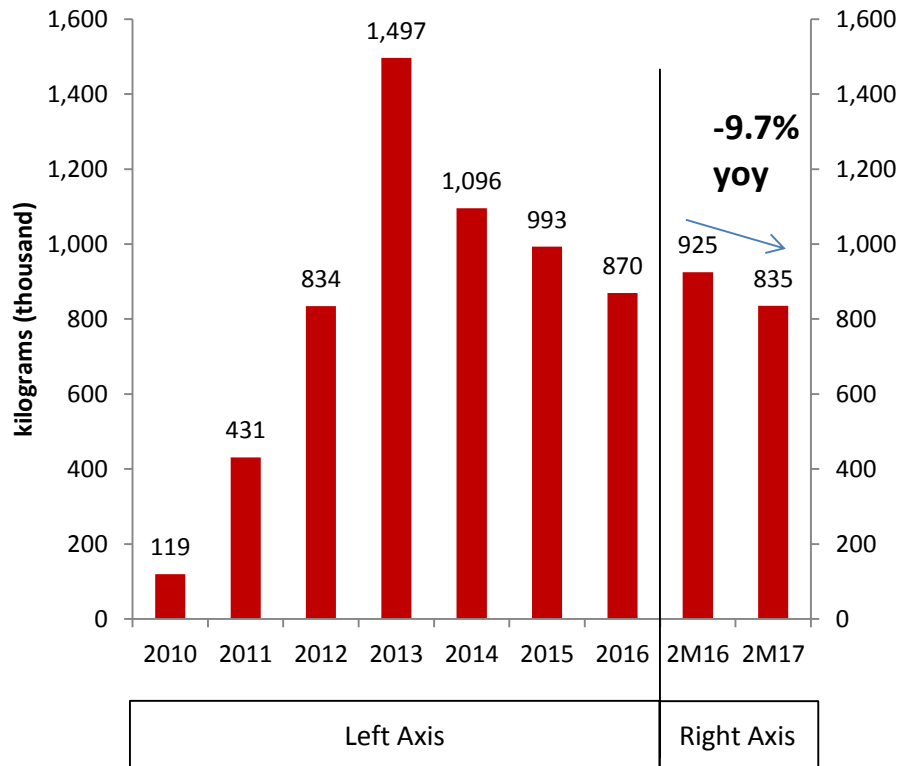


2nd round opinion polls (17 April)

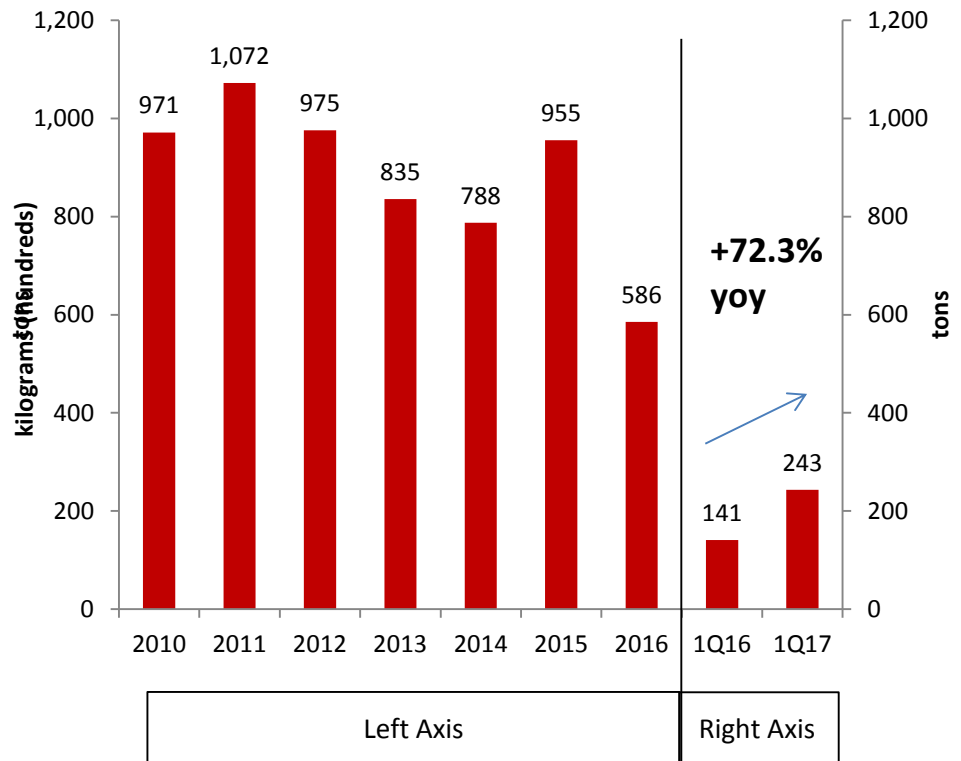


# Going physical – Chinese demand fades further, though Indian gold imports rose into 1Q17

Chinese gold imports from Hong Kong remains in contraction territory



India gold imports fared better in 2017 given low base seen in 2016







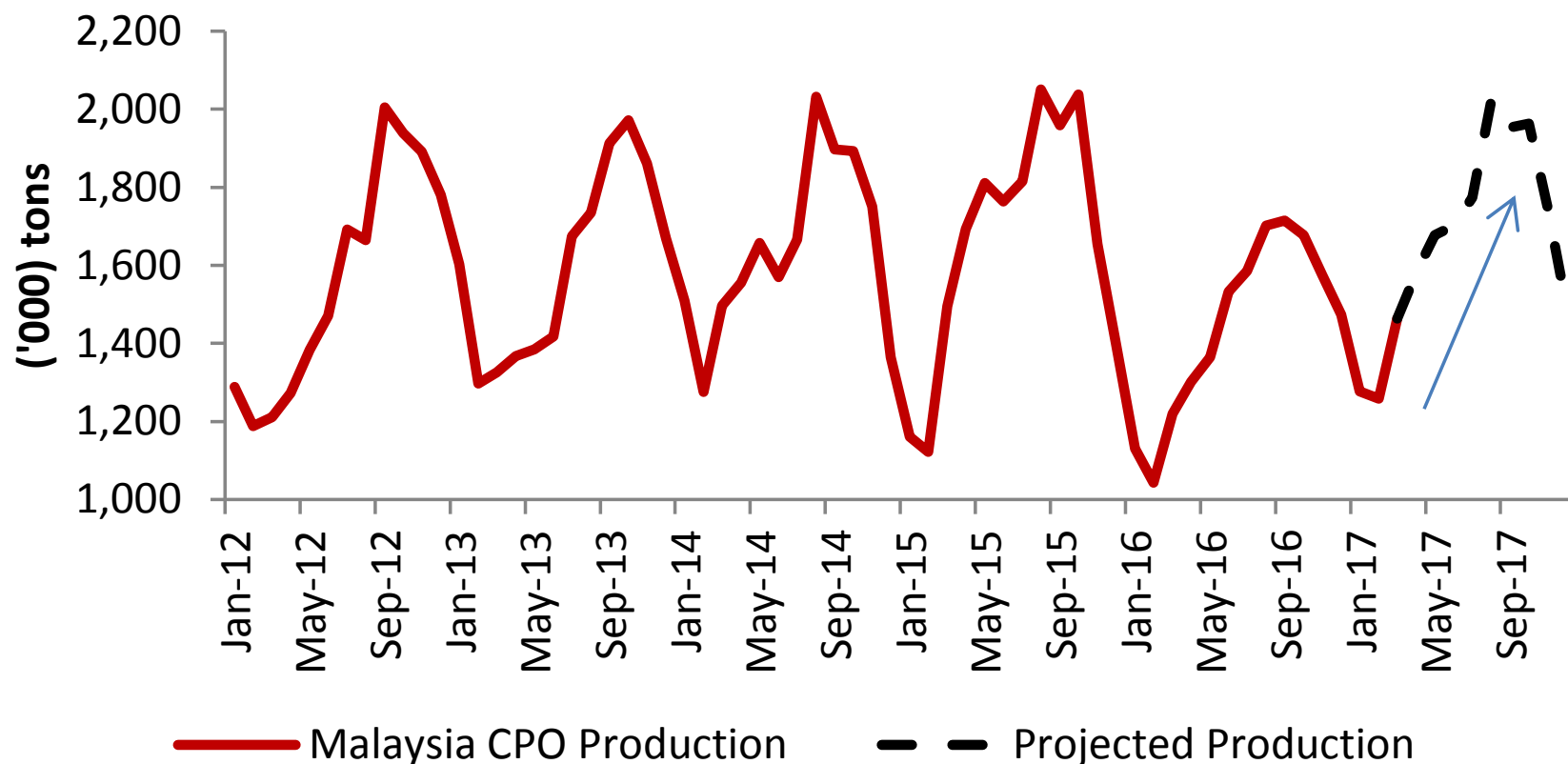
**Crude Palm Oil:**  
**Strong supplies, lackluster demand**

# Executive Summary

- **Palm oil futures have fallen by over 20% since Feb's peak to recent MYR2,600/MT.** Much of the fall is due to the surprisingly strong double-digit growth in Malaysia's palm oil production into 1Q17. Given the strong production seen in the first three months of this year, it is likely that palm oil production may exceed official estimates of 19.4 million tons to our revised estimate of 19.9 million tons (or 15%yoy growth).
- **Importantly, Malaysia's crude palm oil export growth continues to contract,** exacerbating the fall in CPO prices. Empirically, CPO export growth on a year-on-year basis fell for its 7<sup>th</sup> consecutive month into March 2017. Coupled with strong production, total inventories rose above its 1.5 million tons mark. Elsewhere, total palm oil exports (which includes processed palm products) contracted 5.3% over the same period.
- **Delving into details, the fall in palm oil exports was mainly driven by India (-42.2%), US (-31.4%) and EU (-18.7%).** Looking ahead, India's palm oil import demand is likely to fall further as officials looks to encourage domestic palm oil cultivation in hope to reduce import reliance. Elsewhere, EU's palm oil demand may be limited by recent EU's resolution that only environmentally sustainable palm oil may be imported after 2020.
- **On weather conditions, the chance for an El Nino phenomenon is penciled at 50%** this year, though should it come to pass, will present only in late 2017. On the other extreme, concerns over wet conditions caused by the La Nina counterpart has vanished owing to the uptick in Oceanic Nino Index (ONI) of late.
- Owing to the lack of weather extremities amid clear signs of weakness in global palm oil demand, we remain bearish on palm oil and pencil MYR2,650/MT at year-end.

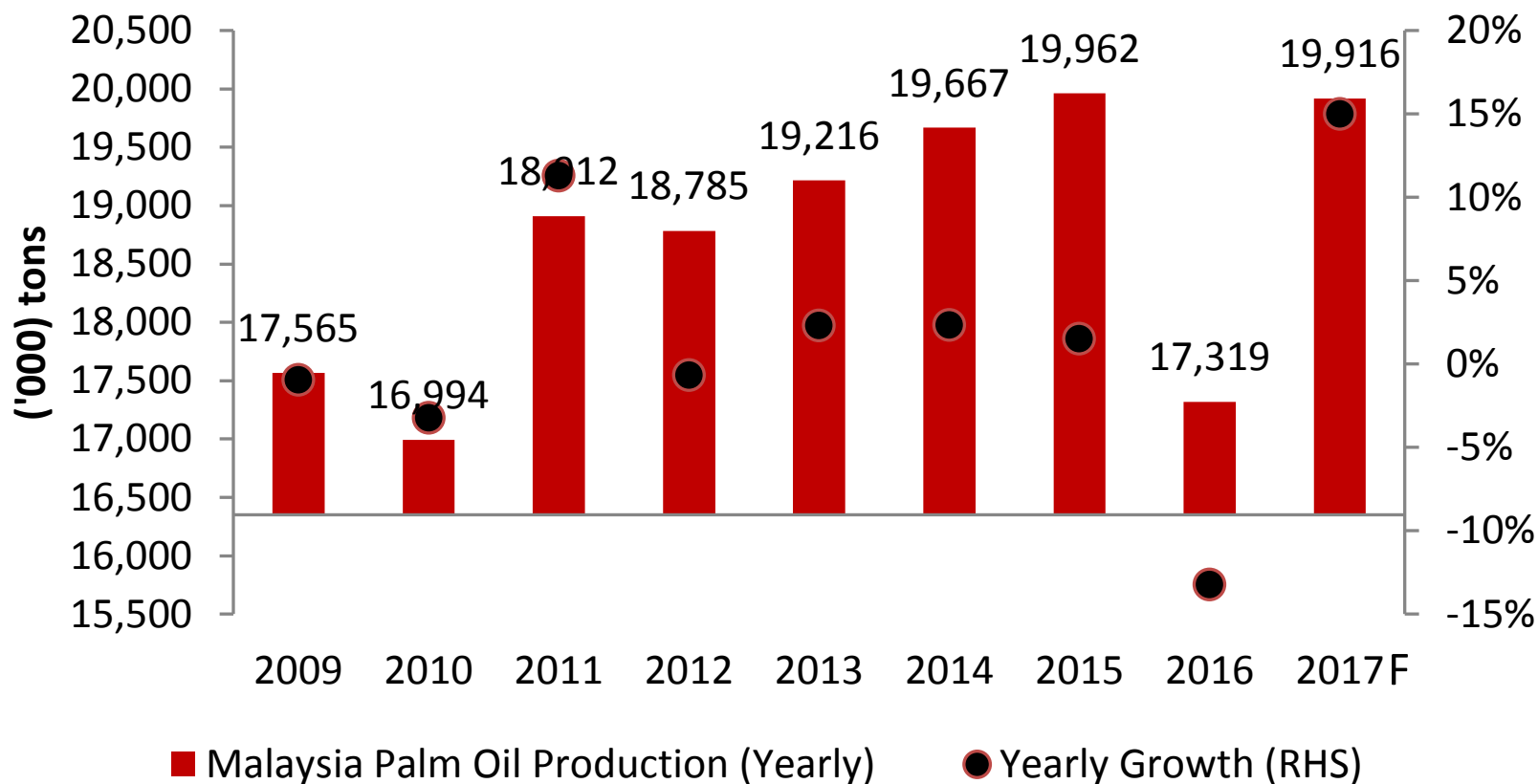
# Malaysia's palm oil production gained rapidly as weather conditions improve

Malaysia palm oil production is slated to grow further into 2017



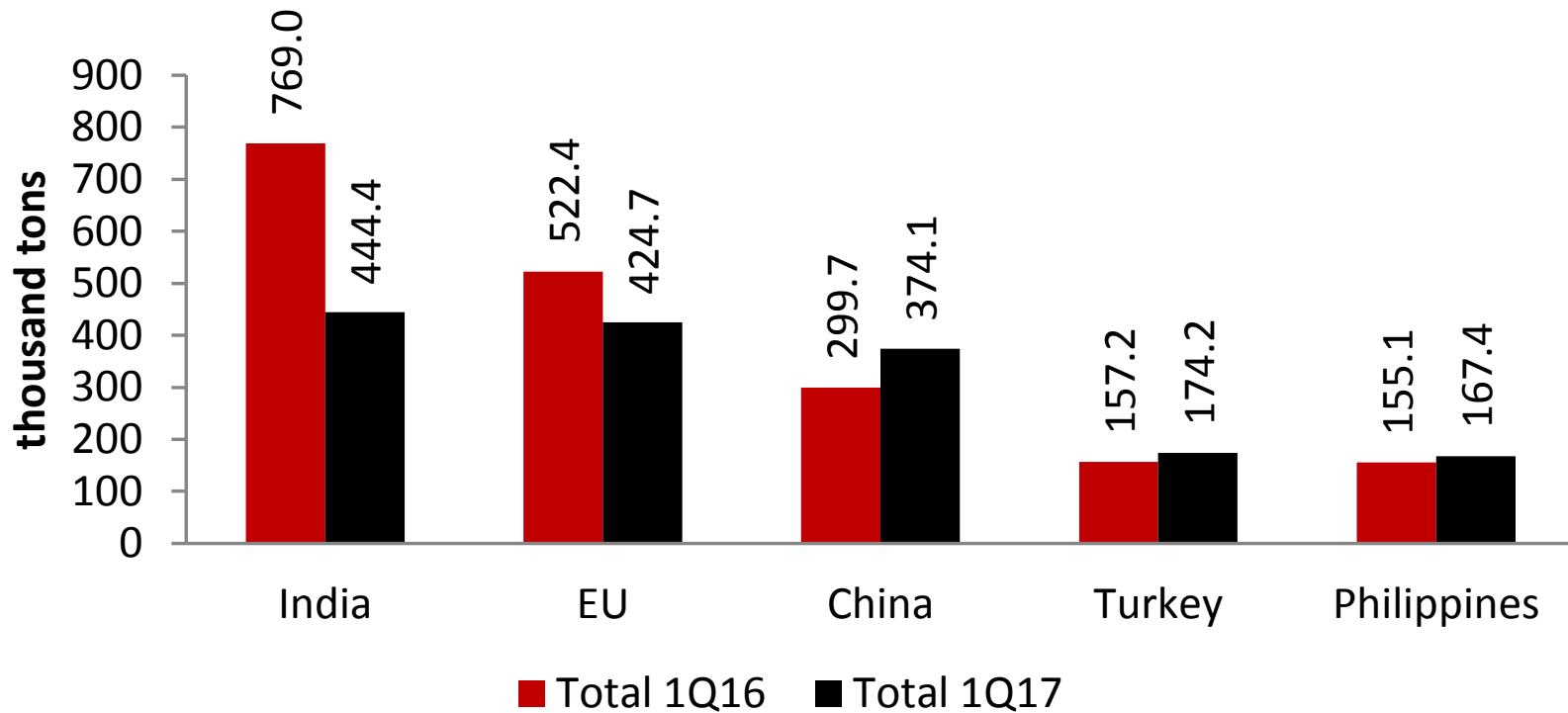
# Malaysia's total CPO production will likely exceed MPOB's target of 19.4 million tons

## Looking for a bumper crop this year



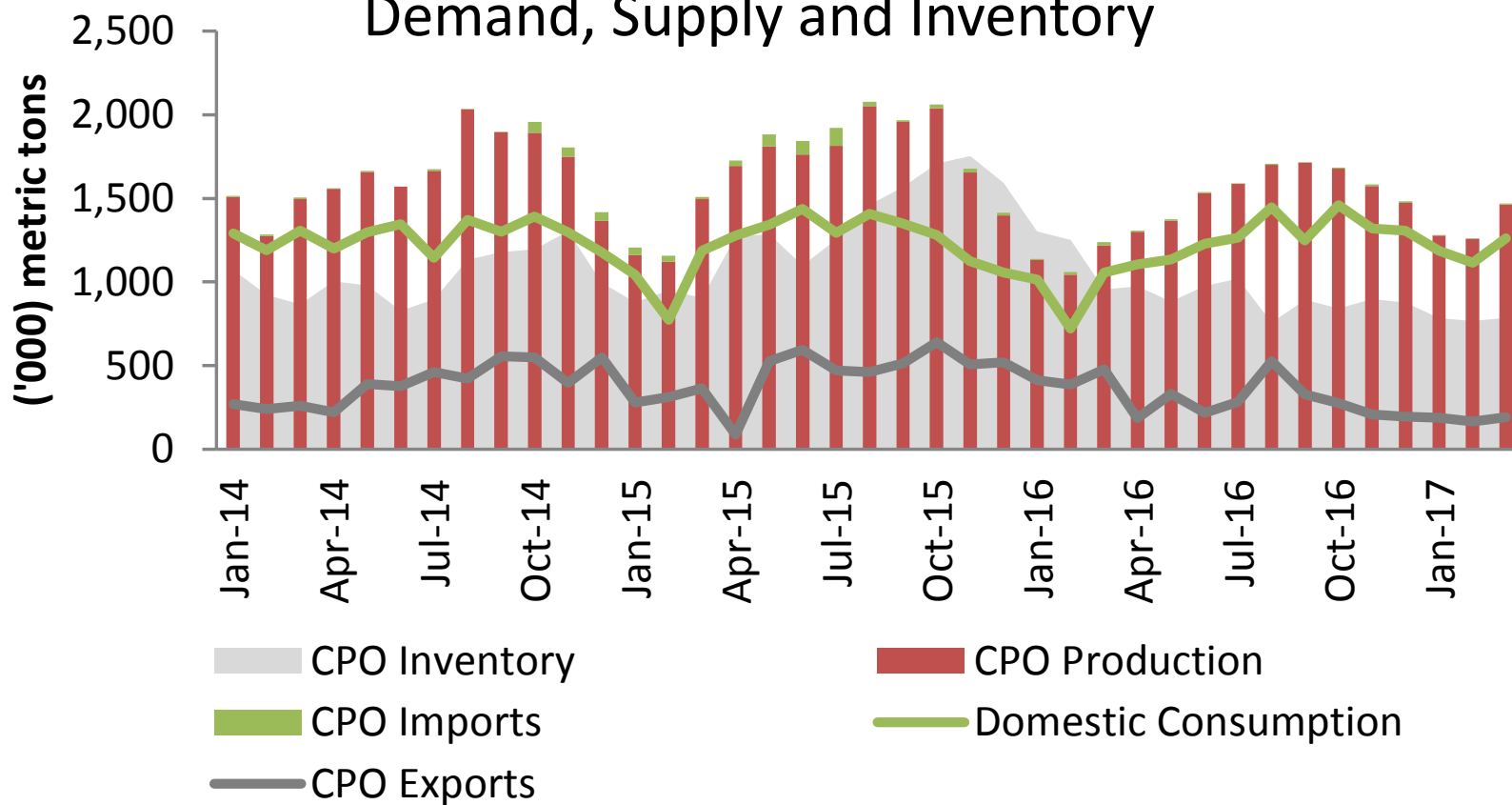
# Exports remain lackluster, especially seen in India and EU

Malaysia's key export destination imported less palm oil into 1Q17



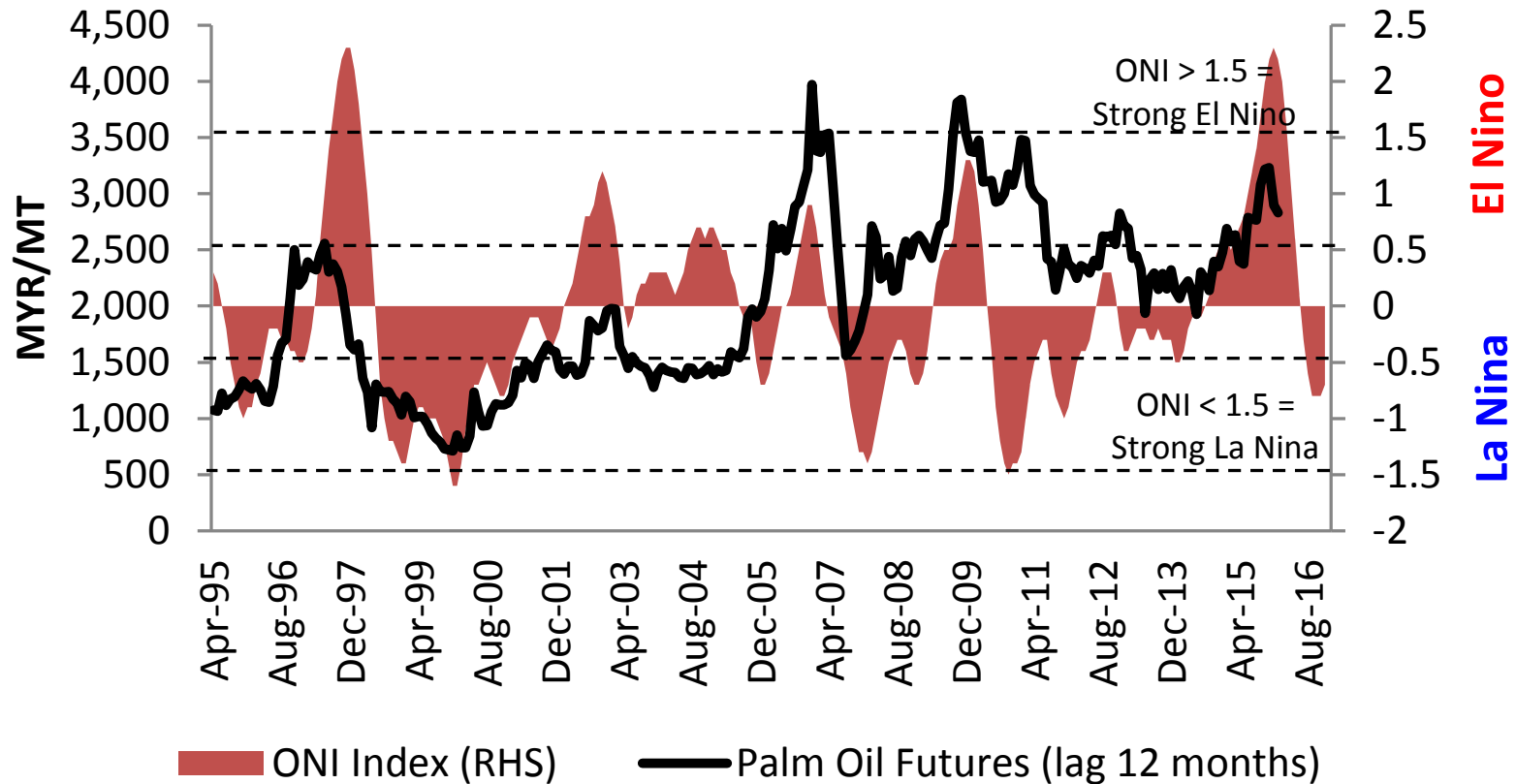
# In a nutshell, production ticked higher, while exports continue to contract

## Malaysia Palm Oil Key Indicators: Demand, Supply and Inventory



# Weather conditions improves, with palm oil futures correcting lower into 1Q17

## Palm oil prices appear to have peaked



# OCBC Commodities Price Outlook

As of April 19, 2017

	Spot	April Avg	2016				2017			
			Q1	Q2	Q3	Q4	Q1	Q2F	Q3F	Q4F
<b>Energy</b>										
WTI (\$/bbl)	52.5	52.2	33.6	45.6	44.9	49.3	51.8	57.5	61.3	65.0
Brent (\$/bbl)	55.0	55.0	35.2	47.0	47.0	51.1	54.6	60.0	62.5	65.0
Gasoline (\$/gallon)	1.70	1.73	1.18	1.54	1.40	1.48	1.58	1.72	1.79	1.86
Natural Gas (\$/mmbtu)	3.14	3.22	1.98	2.25	2.79	3.18	3.06	3.03	3.14	3.25
<b>Precious Metals</b>										
Gold (\$/oz)	1,284	1,267	1,185	1,260	1,334	1,217	1,220	1,280	1,240	1,200
Silver (\$/oz)	18.2	18.3	14.9	16.8	19.6	17.1	17.5	18.3	17.8	17.2
Platinum (\$/oz)	982	964	919	1,007	1,091	944	981	1,000	1,012	1,091
Palladium (\$/oz)	773	797	526	569	680	684	768	776	729	706
<b>Base Metals</b>										
Copper (\$/MT)	5,572	5,748	4,669	4,728	4,793	5,291	5,855	5,750	5,625	5,500
Tin (\$/MT)	19,474	19,928	15,465	16,912	18,592	20,777	20,012	20,536	20,089	19,643
Nickel (\$/MT)	9,266	9,839	8,514	8,834	10,271	10,796	10,277	10,455	10,817	10,377
Zinc (\$/MT)	2,525	2,659	1,684	1,927	2,257	2,527	2,789	2,738	2,679	2,619
Aluminum (\$/MT)	1,892	1,931	1,515	1,583	1,633	1,709	1,858	1,855	1,815	1,774
<b>Asian Commodities</b>										
Crude Palm Oil (MYR/MT)	2,594	2,799	2,467	2,597	2,629	2,933	3,100	2,800	2,750	2,650

**Source:**

Historical Data - Bloomberg

Forecasts - OCBC Bank

Note: Data reflects average price







Thank You

# Disclaimer

## Treasury Market Research & Strategy

Selena Ling ([LingSSSelena@ocbc.com](mailto:LingSSSelena@ocbc.com))

Emmanuel Ng ([NgCYEmmanuel@ocbc.com](mailto:NgCYEmmanuel@ocbc.com))

Wellian Wiranto ([WellianWiranto@ocbc.com](mailto:WellianWiranto@ocbc.com))

Tommy Xie Dongming ([XieD@ocbc.com](mailto:XieD@ocbc.com))

Barnabas Gan ([BarnabasGan@ocbc.com](mailto:BarnabasGan@ocbc.com))

Terence Wu ([TerenceWu@ocbc.com](mailto:TerenceWu@ocbc.com))

## OCBC Credit Research

Andrew Wong ([WongVKAM@ocbc.com](mailto:WongVKAM@ocbc.com))

Wong Liang Mian ([NickWong@ocbc.com](mailto:NickWong@ocbc.com))

Ezien Hoo ([EzienHoo@ocbc.com](mailto:EzienHoo@ocbc.com))

Wong Hong Wei ([WongHongWei@ocbc.com](mailto:WongHongWei@ocbc.com))

Tel : (65) 6530 4887

Tel : (65) 6530 4073

Tel : (65) 6530 5949

Tel : (65) 6530 7256

Tel : (65) 6530 1778

Tel : (65) 6530 4367

Tel : (65) 6530 4736

Tel : (65) 6530 7348

Tel : (65) 6722 2215

Tel: (65) 6722 2533

This publication is solely for information purposes only and may not be published, circulated, reproduced or distributed in whole or in part to any other person without our prior written consent. This publication should not be construed as an offer or solicitation for the subscription, purchase or sale of the securities/instruments mentioned herein. Any forecast on the economy, stock market, bond market and economic trends of the markets provided is not necessarily indicative of the future or likely performance of the securities/instruments. Whilst the information contained herein has been compiled from sources believed to be reliable and we have taken all reasonable care to ensure that the information contained in this publication is not untrue or misleading at the time of publication, we cannot guarantee and we make no representation as to its accuracy or completeness, and you should not act on it without first independently verifying its contents. The securities/instruments mentioned in this publication may not be suitable for investment by all investors. Any opinion or estimate contained in this report is subject to change without notice. We have not given any consideration to and we have not made any investigation of the investment objectives, financial situation or particular needs of the recipient or any class of persons, and accordingly, no warranty whatsoever is given and no liability whatsoever is accepted for any loss arising whether directly or indirectly as a result of the recipient or any class of persons acting on such information or opinion or estimate. This publication may cover a wide range of topics and is not intended to be a comprehensive study or to provide any recommendation or advice on personal investing or financial planning. Accordingly, they should not be relied on or treated as a substitute for specific advice concerning individual situations. Please seek advice from a financial adviser regarding the suitability of any investment product taking into account your specific investment objectives, financial situation or particular needs before you make a commitment to purchase the investment product. OCBC and/or its related and affiliated corporations may at any time make markets in the securities/instruments mentioned in this publication and together with their respective directors and officers, may have or take positions in the securities/instruments mentioned in this publication and may be engaged in purchasing or selling the same for themselves or their clients, and may also perform or seek to perform broking and other investment or securities-related services for the corporations whose securities are mentioned in this publication as well as other parties generally.

Co.Reg.no.:193200032W

