Commodities Outlook: A pictorial update into 2H16

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Crude Oil:
Back to the fundamentals once again

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Crude Oil – Executive Summary

- The environment surrounding the first half of 2016 and what is left in the second half is starkly different to begin with. Specifically, we would need to content with the risk of further risk-off sentiments from the Brexit decision that was made in late June.
- To say the least, crude oil as a growth-related commodity, would take negative cues from any events that might even remotely suggest headwinds to global economic growth. Europe as a whole commands about 15% of global oil consumption, or about 1.5 times the production of Saudi Arabia.
- Elsewhere on fundamentals, the recent recovery in crude oil prices before the Brexit decision had encouraged more oil rigs in the US to turn operational. However, we think that the increase in oil-rig counts is unsustainable given (1) more headwinds to oil price given risk-off sentiments, and (2) the supply glut is still present at this juncture.
- On supplies, risk of further upside can be found from recent rhetoric by both Iran and Libya. Specifically, Iran plans to double its crude exports, while Libya state-owned producer mentioned its readiness to reopen oil ports and restore crude oil output. Short-term supply shock from Canada's unforeseen wildfires are also reported to be "under-control".
- We hold on to our call for the rebalancing of supply and demand to continue, though the pace should slow considerably given the events that occurred since the start of this year. Crude oil prices is expected to stay around its $50/bbl for the year, before rallying to above $60/bbl on the acceleration of the rebalancing market then.

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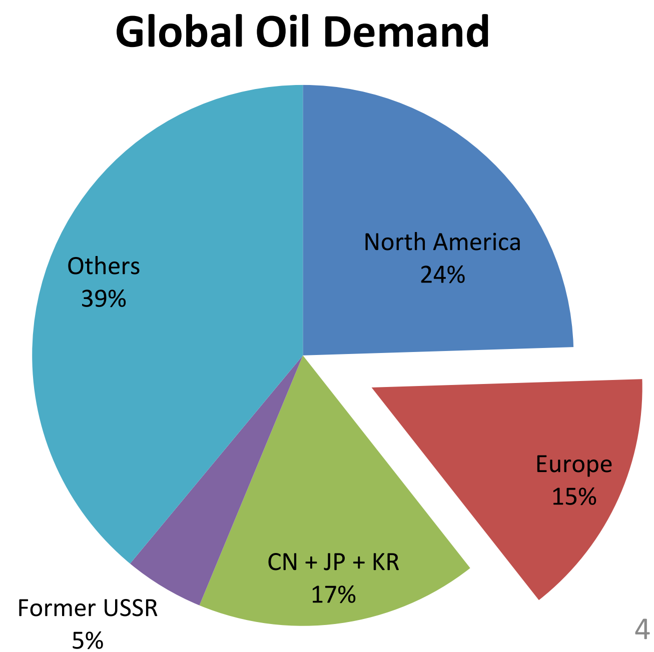
Rebalancing story threatened?

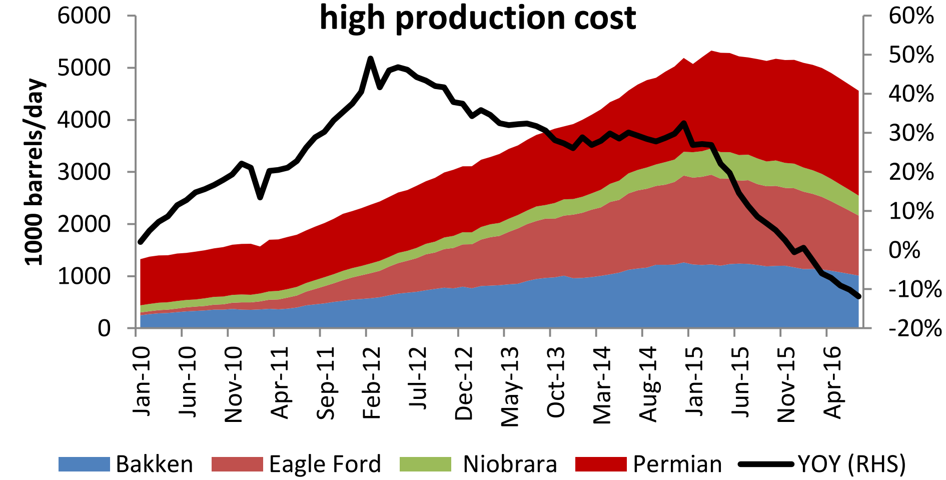
- **The entire notion behind a bullish crude oil outlook is mainly supported by the hope for a rebalancing in the oil markets. Should the rebalancing story be threatened, the hope for crude oil to rally further into 2H16 will turn to naught.**
- At least before the Brexit, the health of global oil demand is not questioned. According to the US Department of Energy, crude oil demand has risen from 91.7mbpd back in March 2013, to a strong 97.2 mbpd at end 2015. The gain in oil demand is largely backed by the thirst especially from China, Europe and the US.
- On the supply side, oil rig counts in the US have risen for three consecutive weeks. Moreover, OPEC remained reluctant to call for a production cap. Elsewhere on the demand side, China has already registered its 2nd month-on-month contraction in crude petroleum oil imports.
- **With the Brexit, do expect concerns over oil demand to resurface given the possible negative economic impact on both Europe and the United Kingdom.** Statistically, Europe commands about 15% of global oil demand, or about 1.5 times the production by Saudi Arabia alone. Still, the Brexit impact on GDP growth appears to be very modest at this juncture, and should allow crude oil to stay around its $50/bbl till the end of this year.



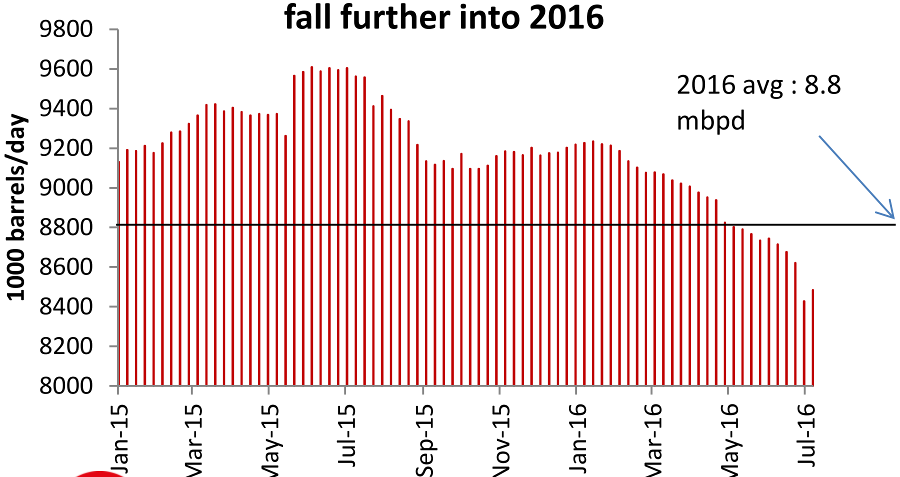
US oil production climate

- Overall US oil production has fallen consistently over the course of the year till the week ended 8 July 2016 (+57 thousand barrels per day).
- Likewise, since May 2016 during the onset of the crude oil price recovery, oil rigs in the US increasingly turn operational.
- We do not think that production increases in the US is sustainable given sustained headwinds to oil prices at this juncture.

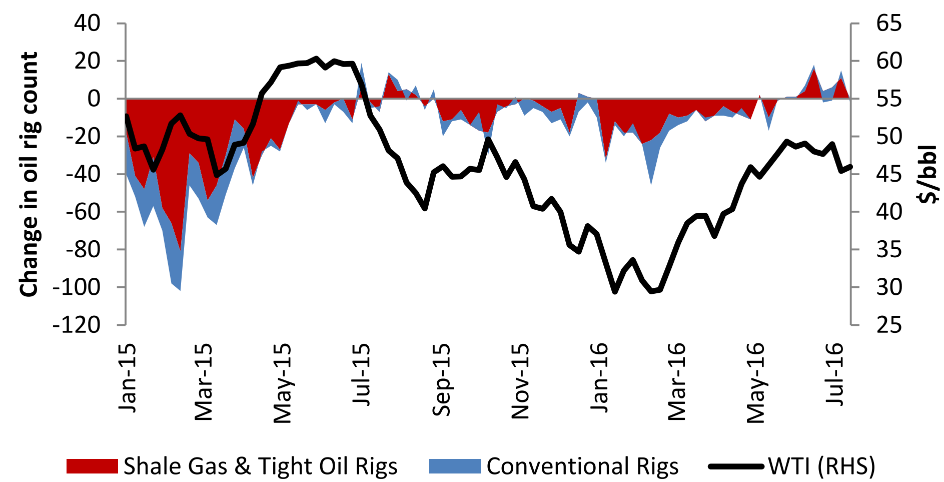
Shale oil production is adversely affected, given high production cost



US production has fallen rapidly in 2015, may fall further into 2016



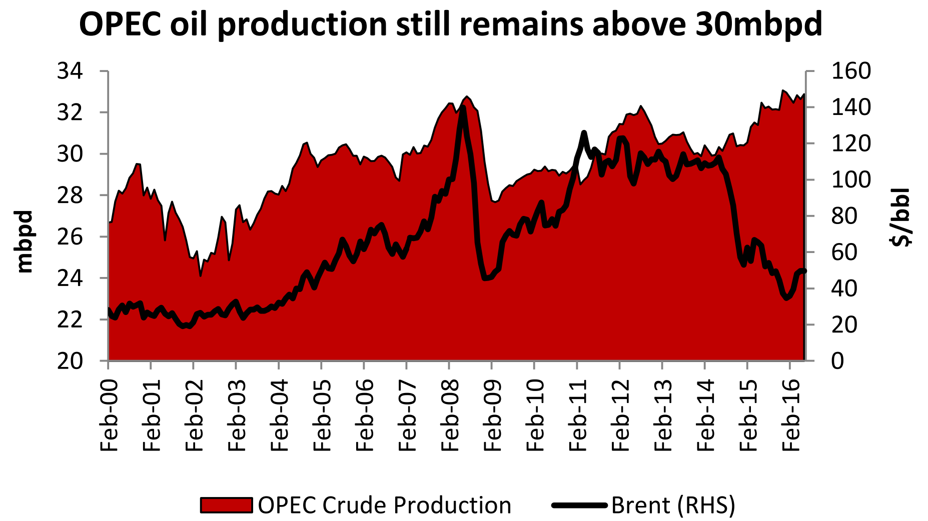
Oil price recovery brought some rigs back

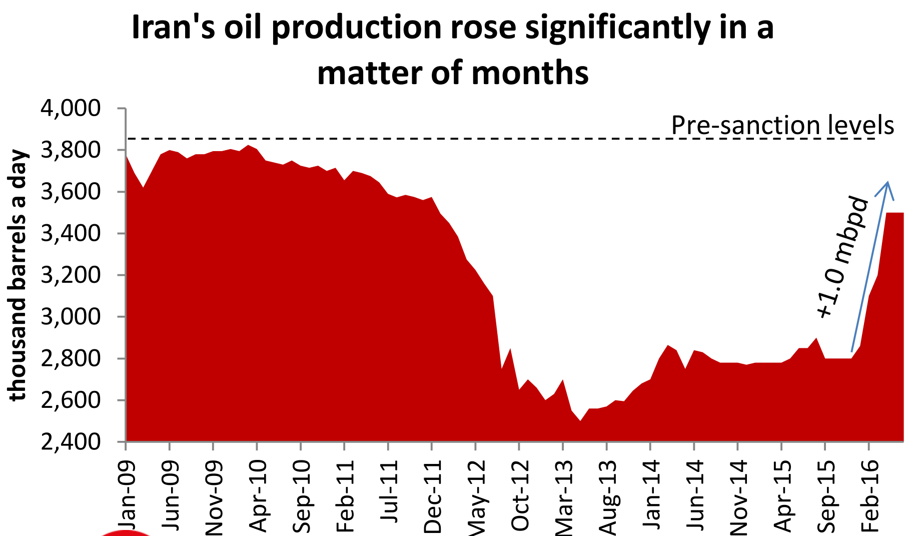


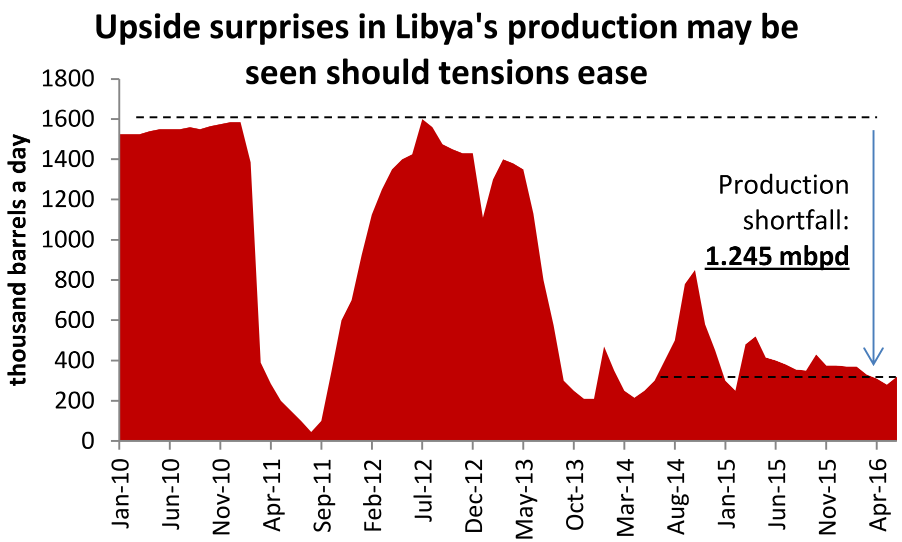
OCBC Bank Source: Bloomberg, OCBC

Sands in the Middle East remains productive

- Elsewhere in the Middle East, oil production remains strong above its 30 million barrels a day handle.
- Note that both Iran and Libya highlighted their intention to boost production and/or exports levels.
- Eyes on OPEC's November 2016 meeting: Will they re-implement individual and collective production quota?

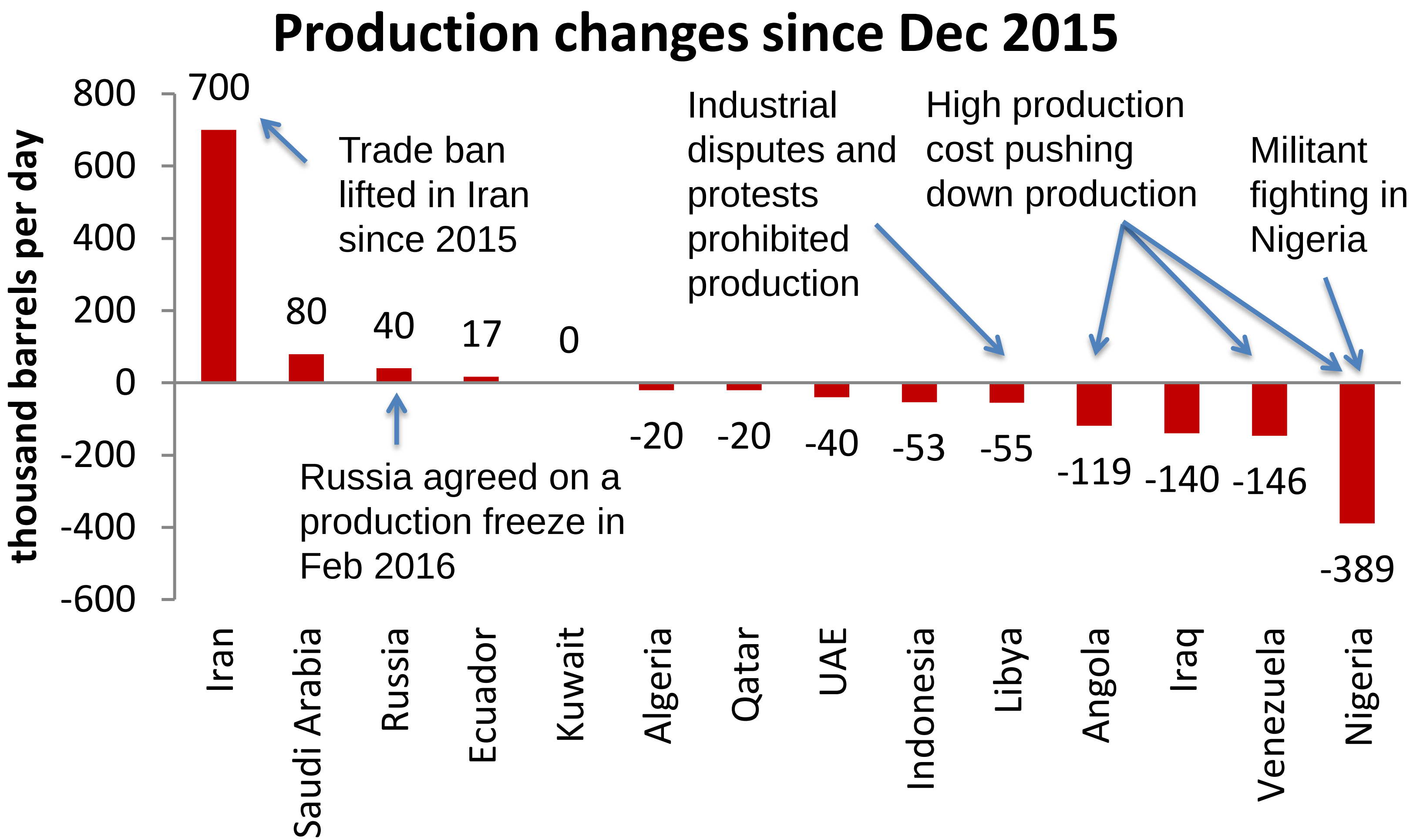






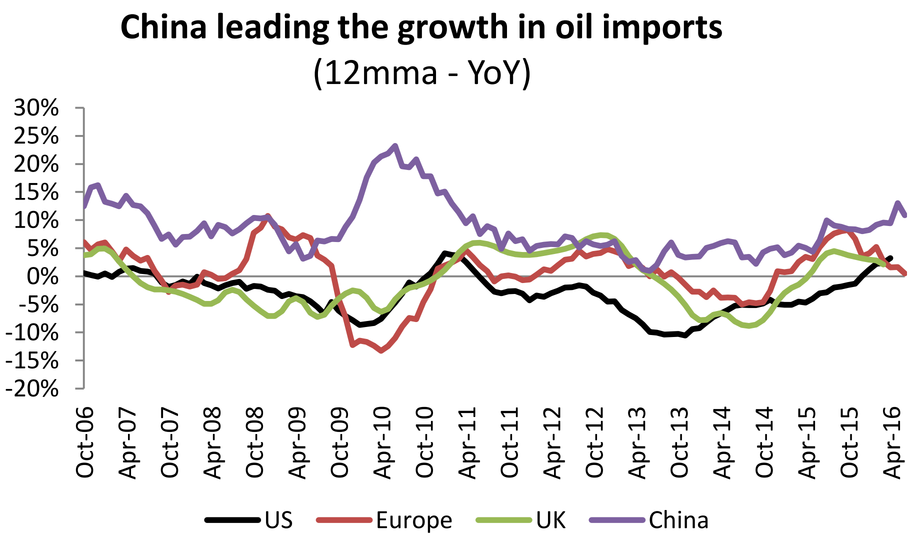
OCBC Bank Source: Bloomberg, OCBC

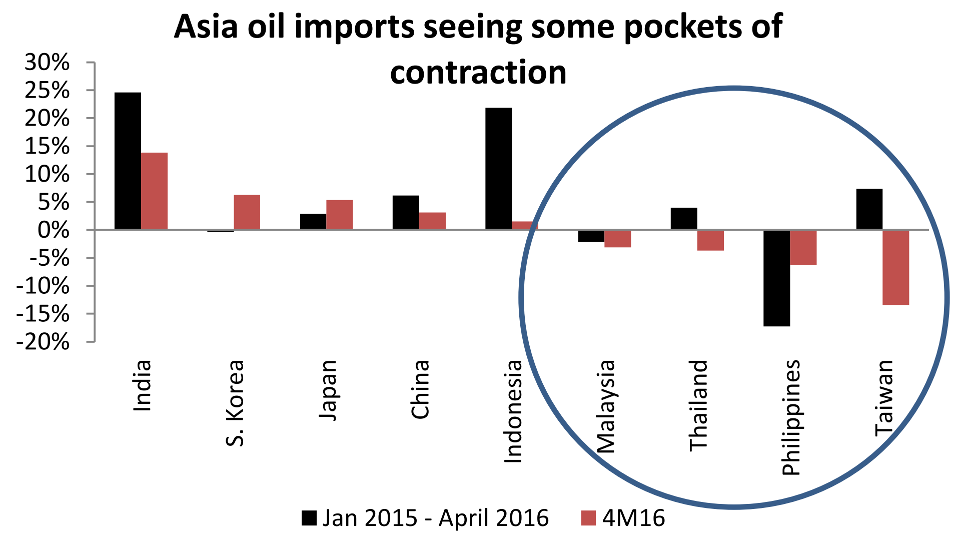
Summary of OPEC + Russia oil production

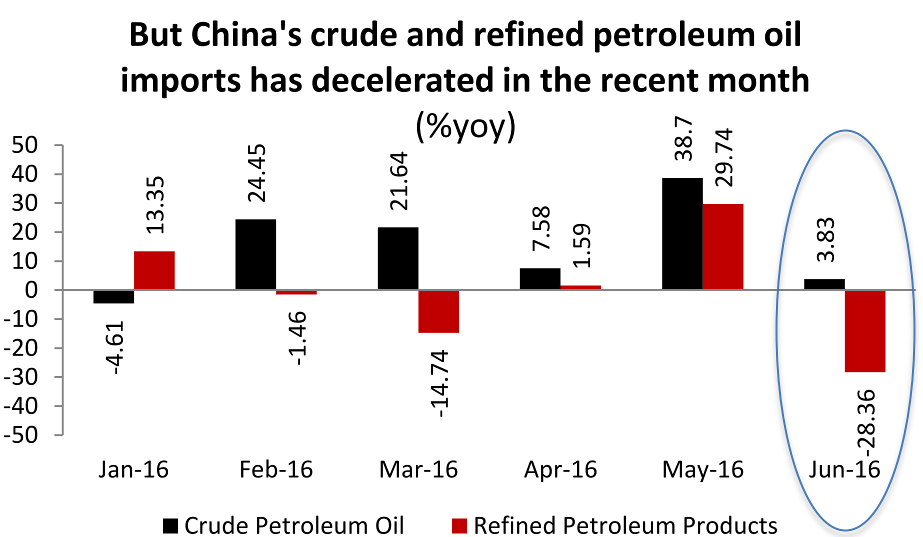


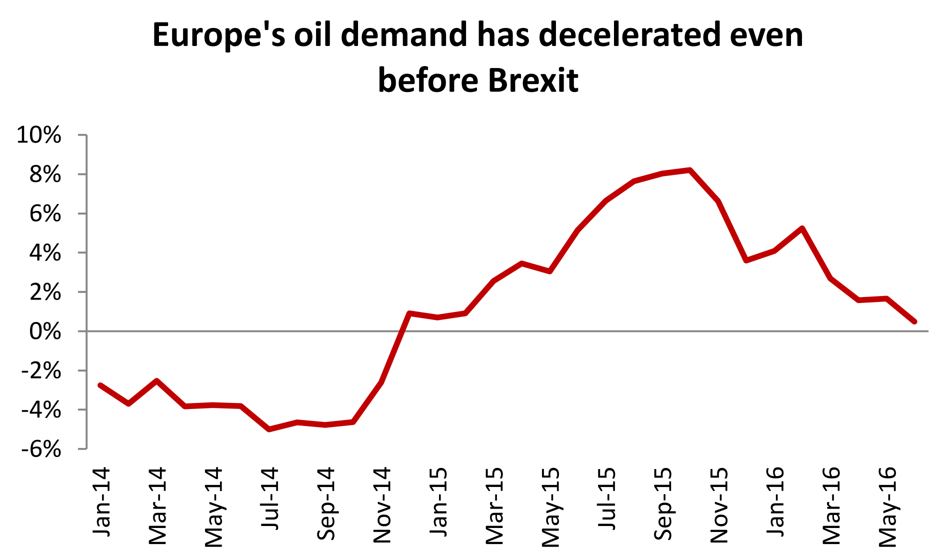
OCBC Bank Source: Bloomberg, OCBC

The changing demand story



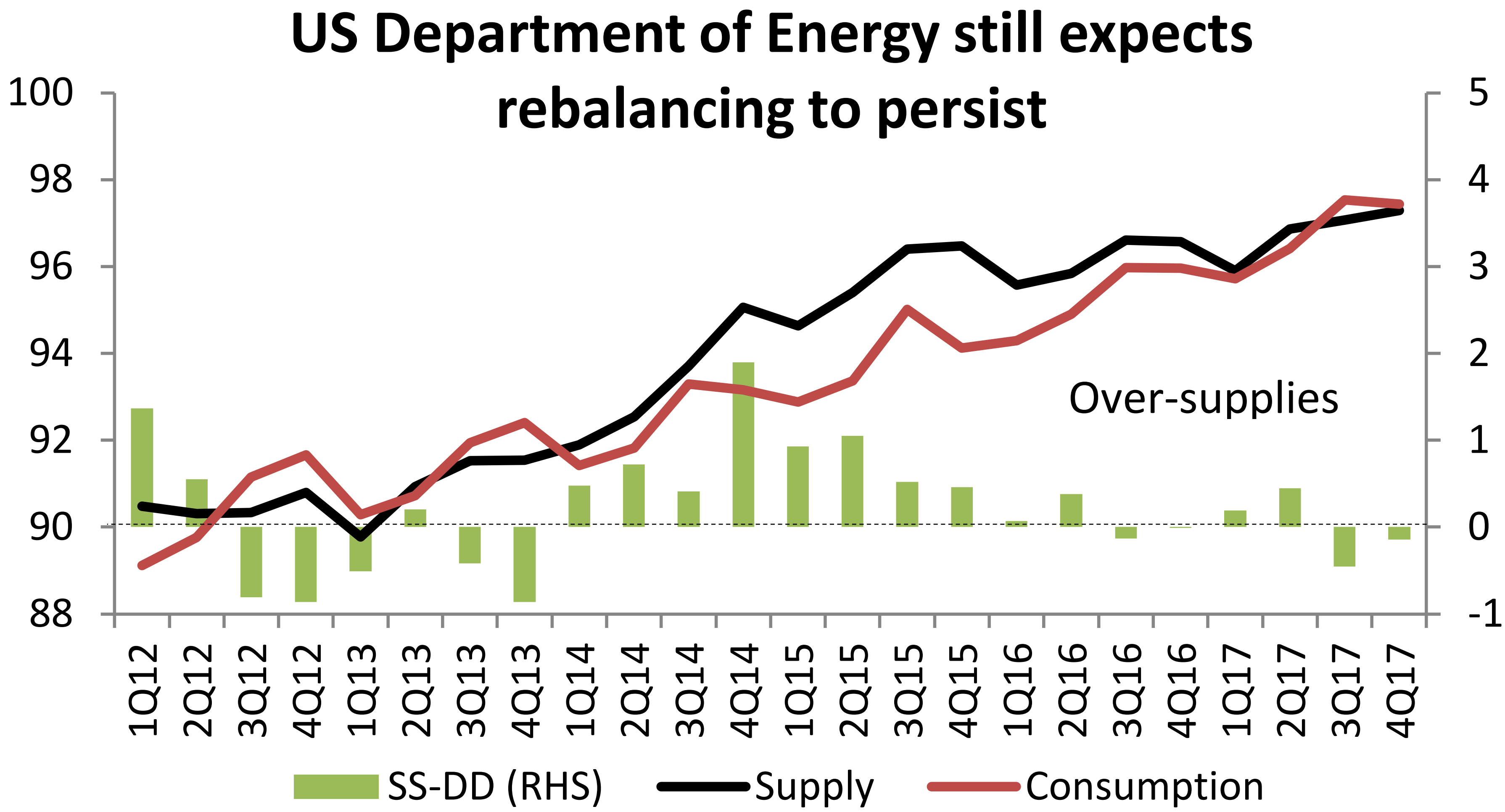






OCBC Bank Source: Bloomberg, OCBC

Rebalancing to be achieved by 2017?



Source: US EIA, OCBC

Gold:
Love those that glimmer

Gold – Executive Summary

- **With UK's exit from the European Union, we expect the risk-off sentiment to persist into the months ahead.** On top of that, many wildcards into the year-end, namely the US Presidential Elections in November, may also add further demand into safe haven assets like gold.
- Still, market risk-on sentiment seemed to have gone back to the table. Note that global monetary bias still looks to see further accommodation, downplaying potential risk for the Brexit to have 'negative and substantial' effects on the global economy. At this juncture, even Wall Street as of 19 July have touched new highs again, underscoring market optimism and its quick turnaround since June.
- **Our bearish call for gold has long been anchored on the rate hikes by the US Federal Reserve.** Noting that the Fed chairwoman Janet Yellen is known dove, and her reference to the global economic health (China's slowdown, Brexit, low oil prices) in her recent speeches leaves us to question if there indeed is going to be a rate hike this year. Even as we speak, the implied probability for a December rate hike is still below 50%, albeit that it has risen substantially from 9.2% back in end June, to July's 41%.
- Though at least one rate hike may still be possible, the drivers for gold is now two-fold: (1) global risk appetite and (2) dollar strength. Even if a Fed rate hike comes to pass at the end of this year, the risk-off sentiment from the suspense should dominate and lift gold to its $1,350 - $1,400/oz easily into the year ahead. Should Yellen fail to hike, gold prices would see further upside risk.

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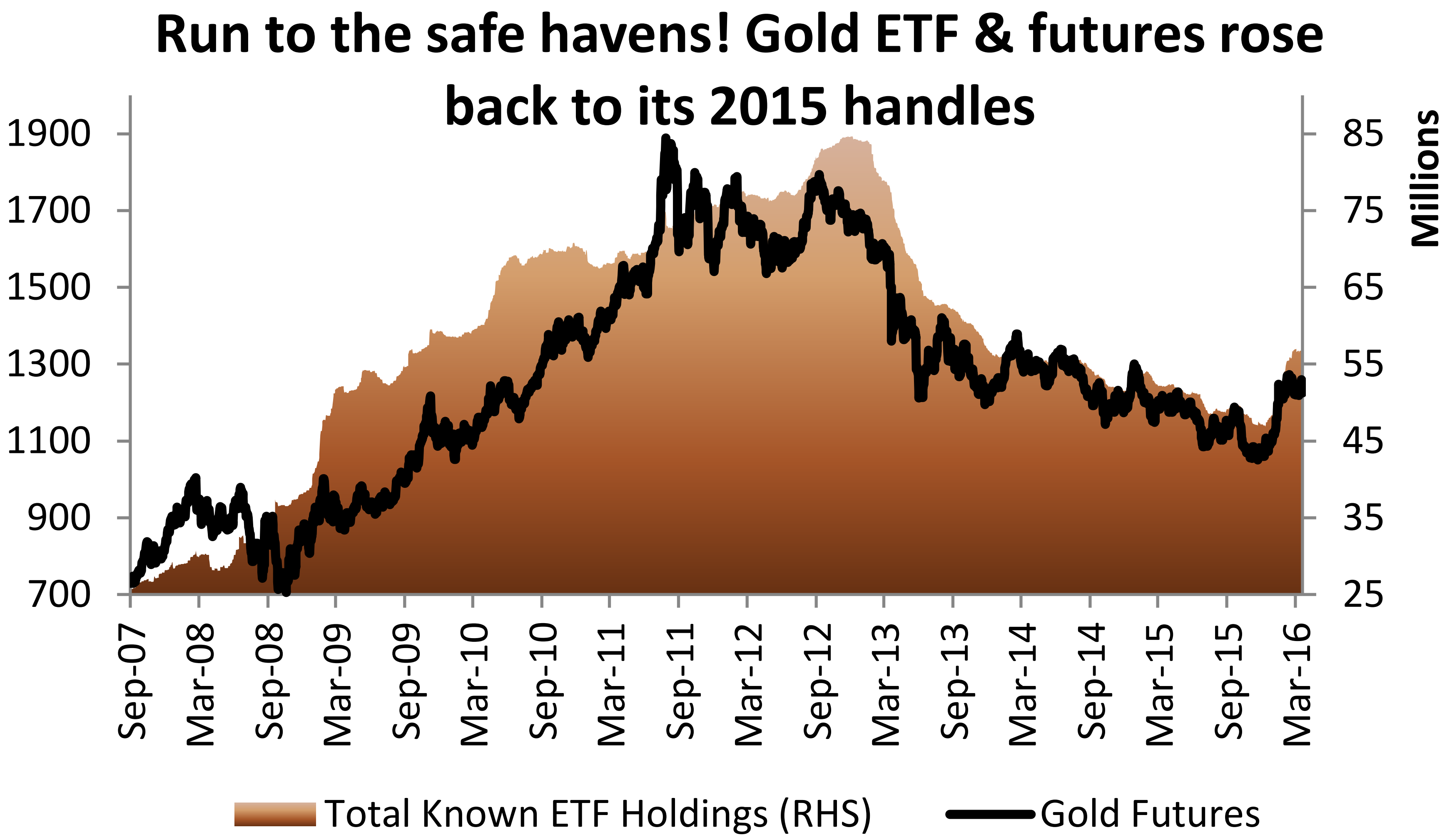
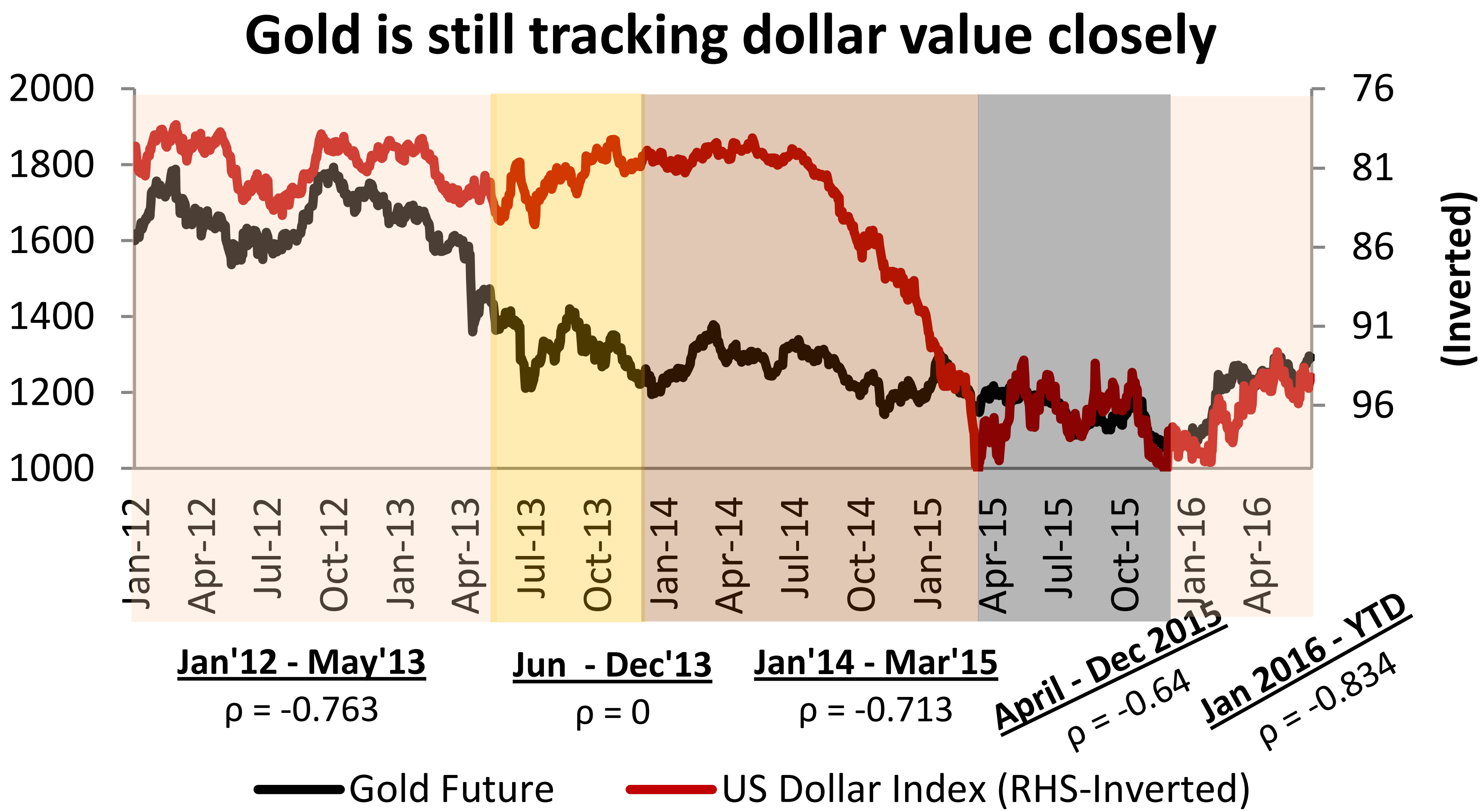
Chart of the month: Run to the safe havens!



Source: Bloomberg, OCBC

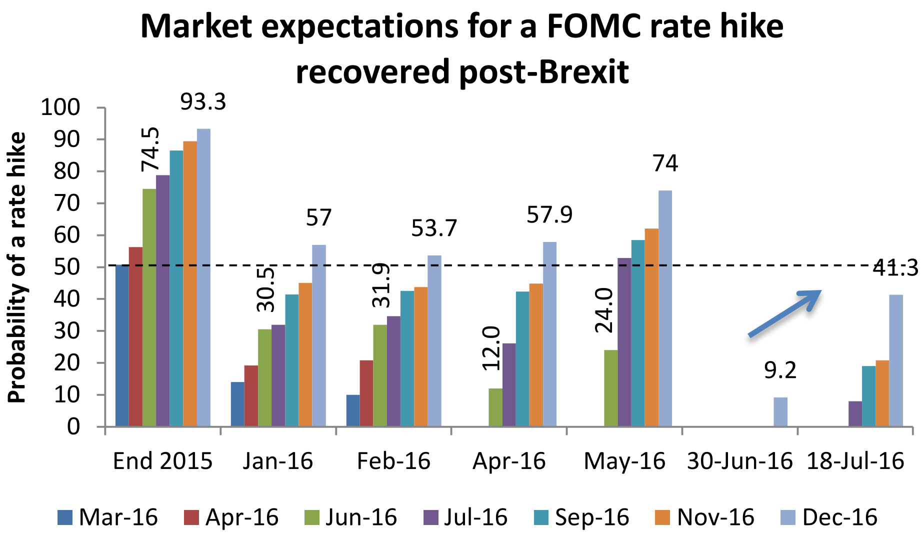
Wither the Fed rate hike? Gold value is (still) very much influenced by the dollar

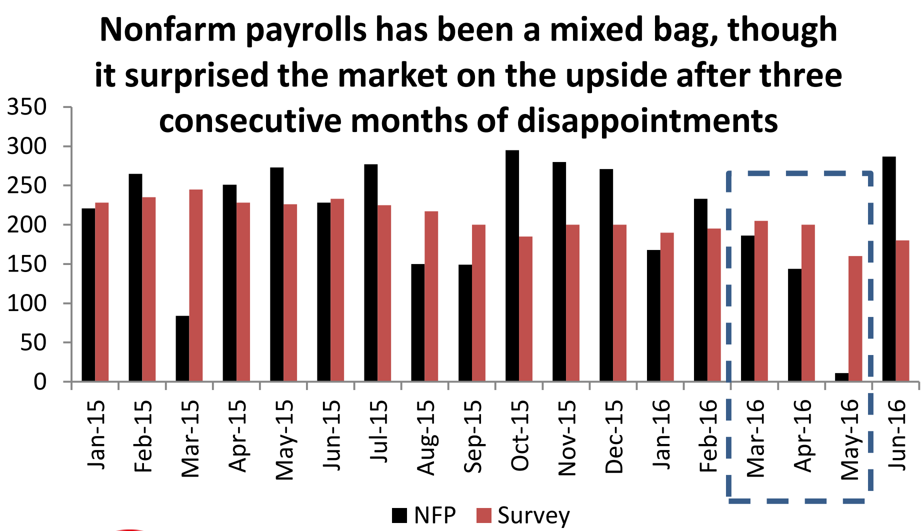


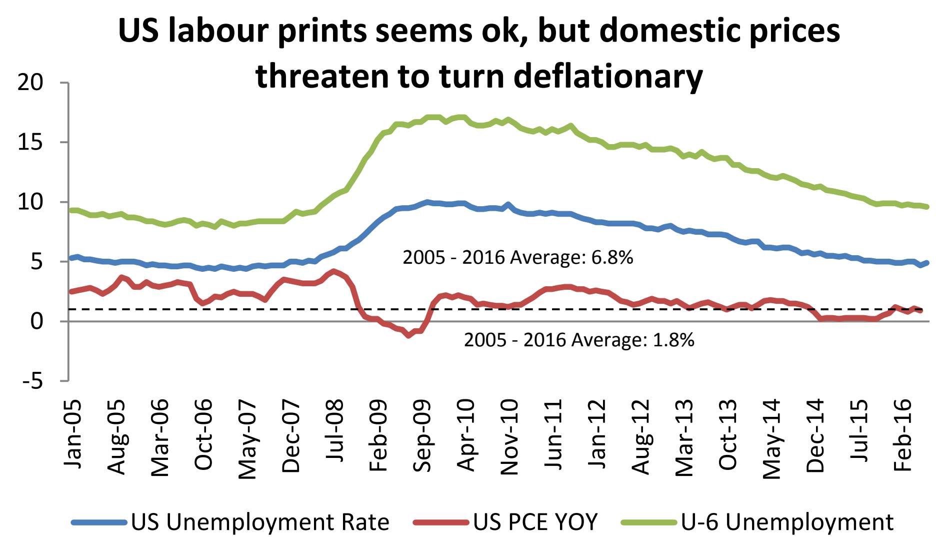
Source: Bloomberg, OCBC

Will the Federal Reserve hike rates?

- Market expectations for a FOMC rate hike in December 2016 has risen significantly post-Brexit. This suggests that some risk-on sentiment and optimism has came back to the table once again.
- US domestic economic indicators are encouraging, though weak oil prices have depressed overall prices.
- We leave our call for a Fed rate hike (+25bp) in their Dec meeting unchanged.





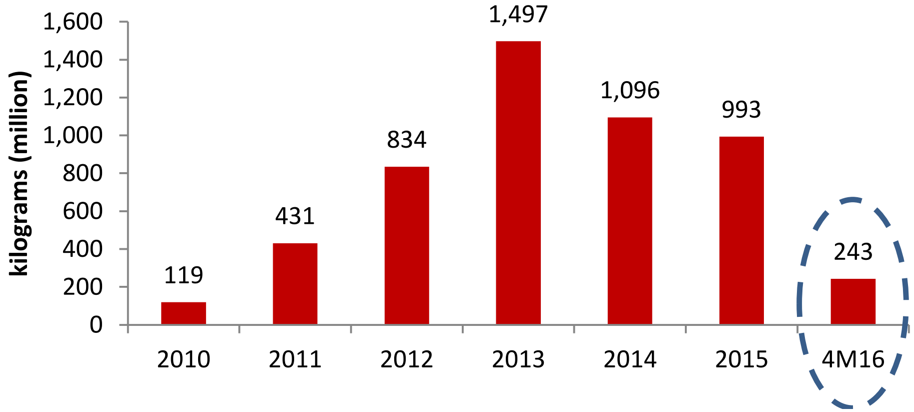


OCBC Bank Source: Bloomberg, OCBC

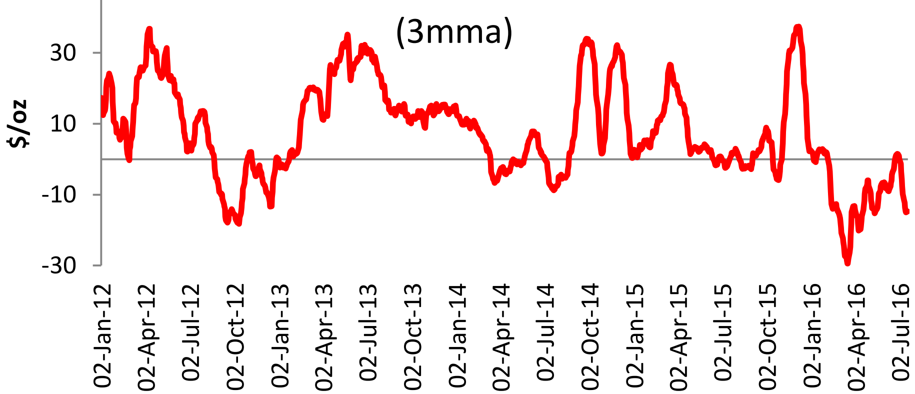
Physical gold demand trends in China and India

- Although paper gold demand has remained strong on safe haven demands, the physical part of the equation is showing stark differences.
- Physical gold demand in both India and China has remained in contraction terms on-year basis. Specifically, India's gold import in 1H16 is merely 24.8% of 2015's total imports.
- Similarly for China, it is 24.5% of total 2015's imports in 4M16

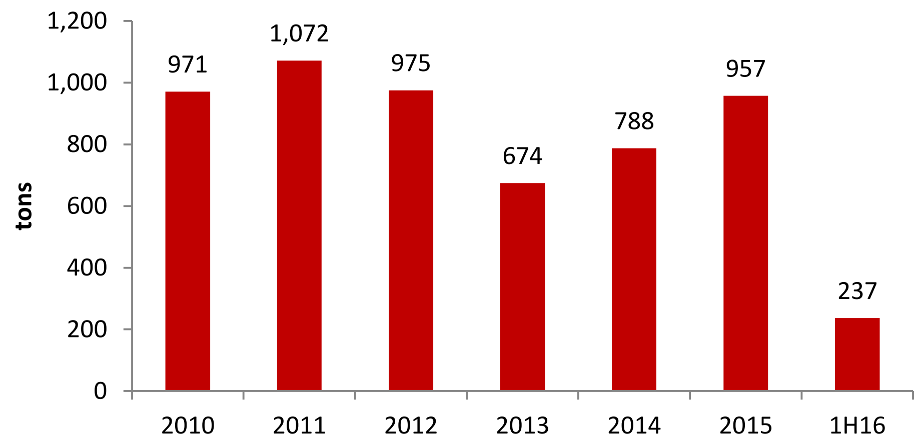
Chinese gold imports from Hong Kong has fallen over the last two years, and is set to fall again this year



Chinese gold discount to international prices widened significantly, suggesting tame gold demand
(3mma)



India gold imports are also far from previous glory



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Source: Bloomberg, OCBC

Base Metals:
Better times ahead?

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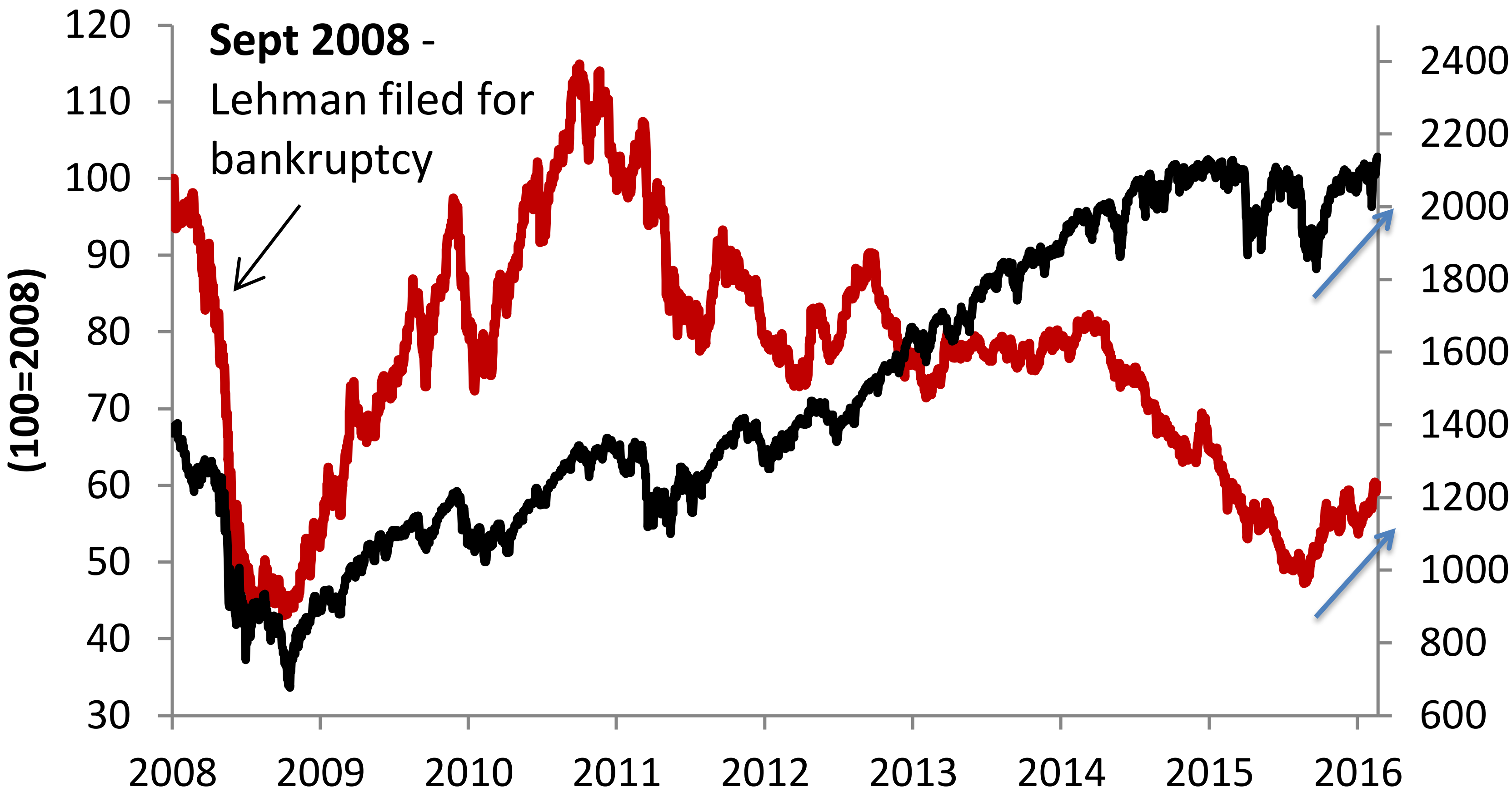
Base Metals – Executive Summary

- At least on a global scale, base metal inventories in London Metal Exchange (LME) and Shanghai Futures Exchange (SHFE) warehouses have declined (except for tin), adding to expectation that the falling stock numbers may give prices the much need fillip.
- Base metals, especially copper, is widely regarded as influenced largely by Chinese economic data, given that China is the top consumer of base metals. On this, note that China-centric economic data of late has been encouraging: (1) 2Q16 GDP grew 6.7% and beating market expectations, (2) industrial production growth accelerated to 6.2% from a previous 6.0%, while (3) fixed asset investment still grew at a healthy 9.0% (albeit slower than the previous 9.6%). Elsewhere, other economic data including money supply, new loans and retail sales are also looking brighter.
- More importantly, copper fundamentals are looking healthy, as global demand has once again outpaced production as of April 2016, snapping the many months of oversupply seen since July 2015. Should demand continue to stay healthy into the year ahead, base metal prices should remain pointing north.
- All-in-all, the recovery in market risk-on sentiment seen of late should benefit growth-related commodities like base metals. According to OCBC base metal index, prices have benefited in tandem with the S&P. On top of that, long speculative positions in copper has gained for the first time in four weeks, suggesting some return in bullish bets.

Good times means healthy base metal prices



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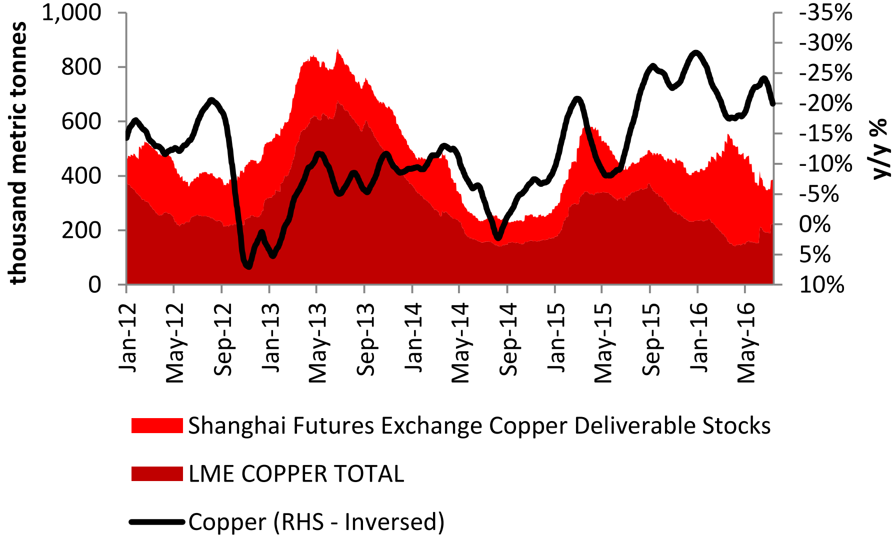
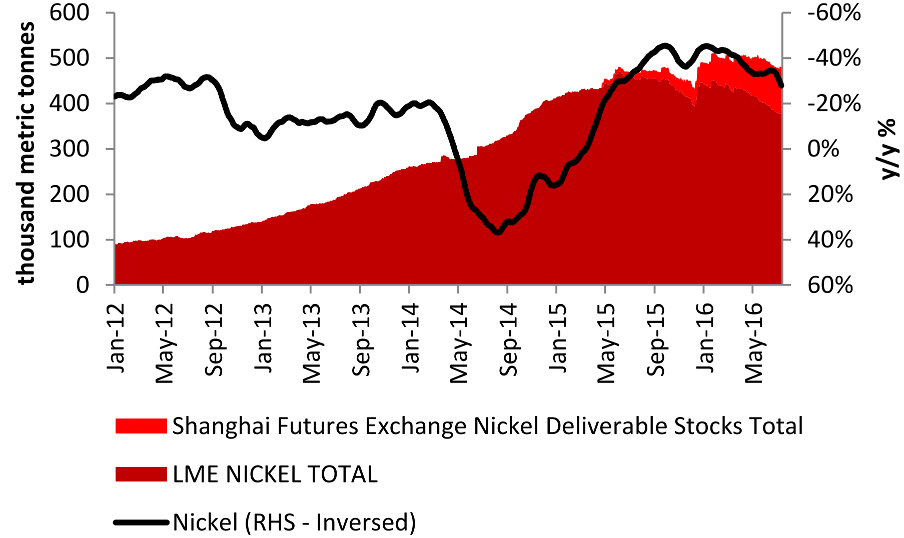
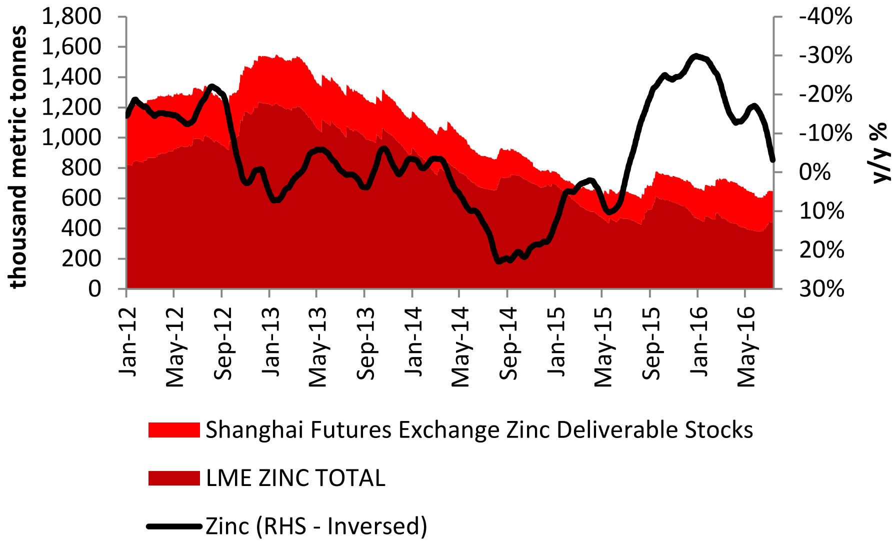
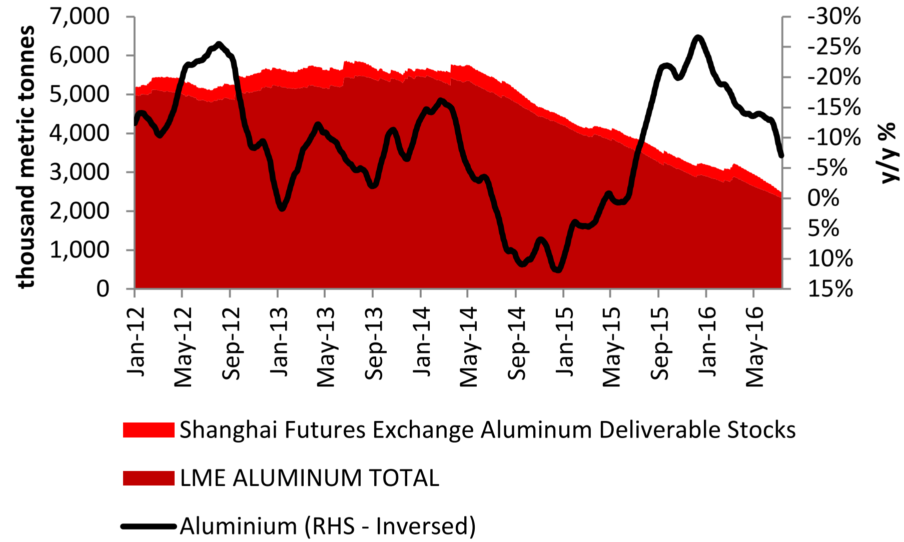
Source: OCBC
OCBC Base Metal Index is indexed at (100=2008), which includes copper, nickel, zinc, aluminium, tin and iron ore

Base metal inventories in LME and SHFE has fallen across time





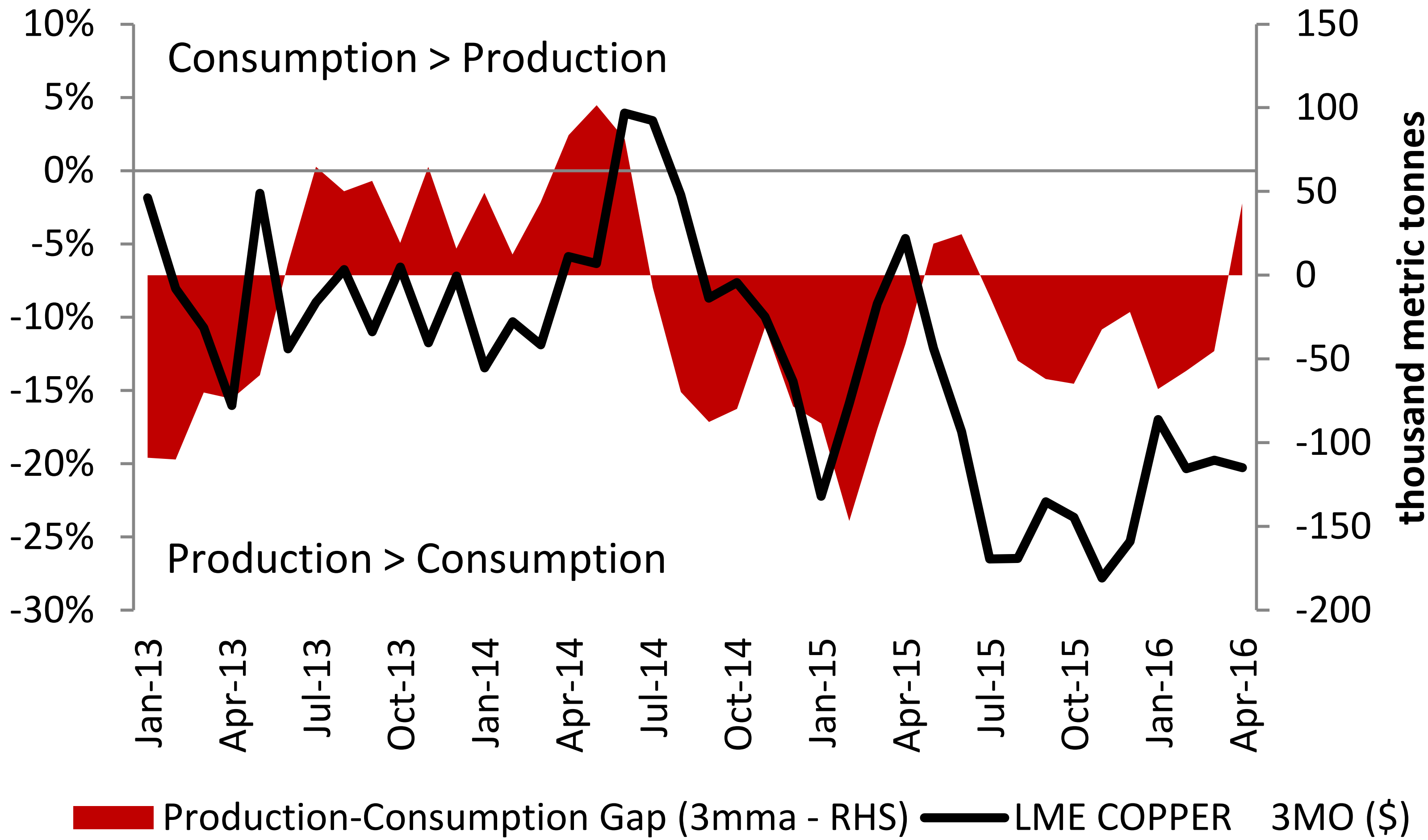




Source: Bloomberg, OCBC

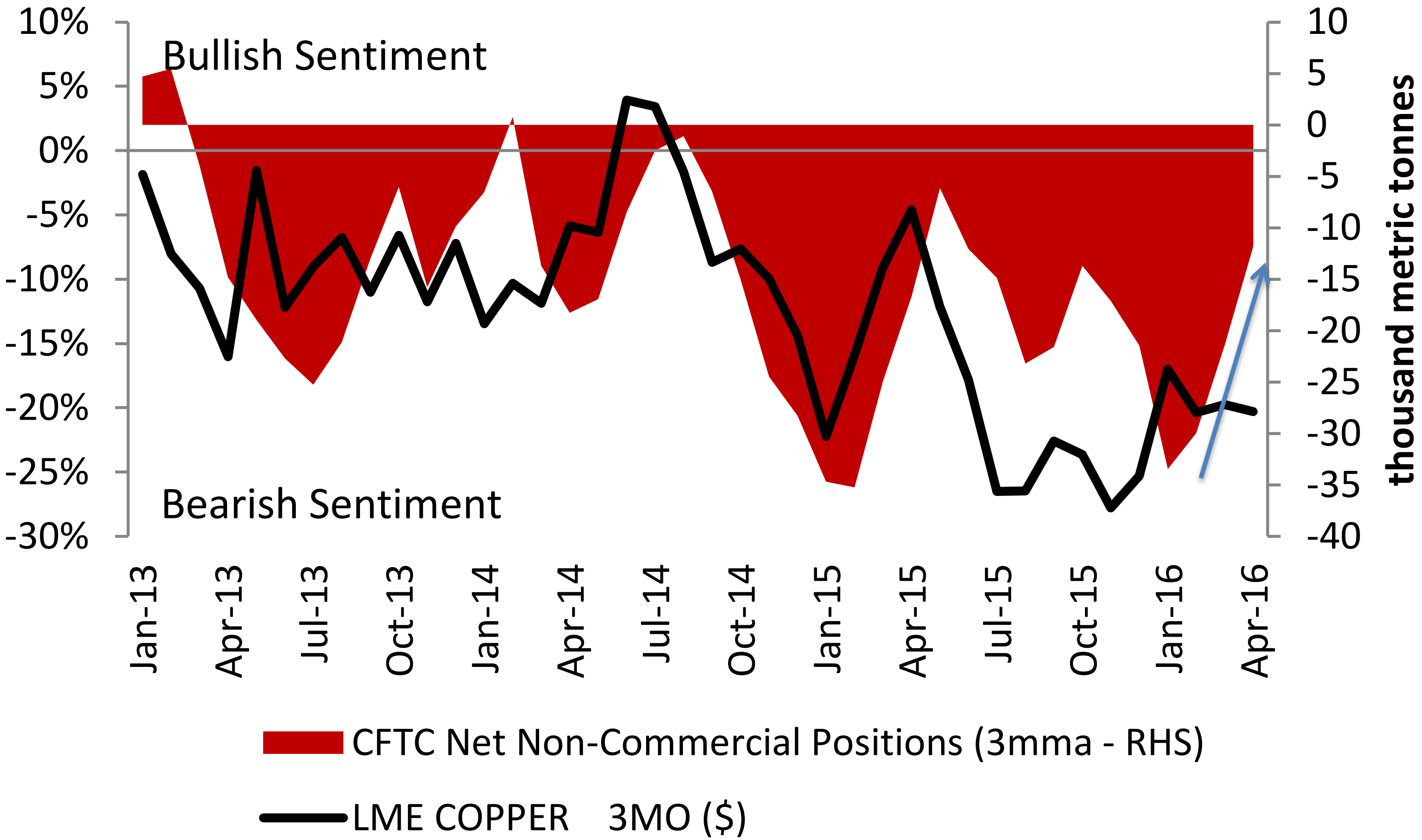
Copper fundamentals

Moving away from oversupply territories



Source: Bloomberg, OCBC

Speculative positions in copper has improved somewhat, though still in net-short territories



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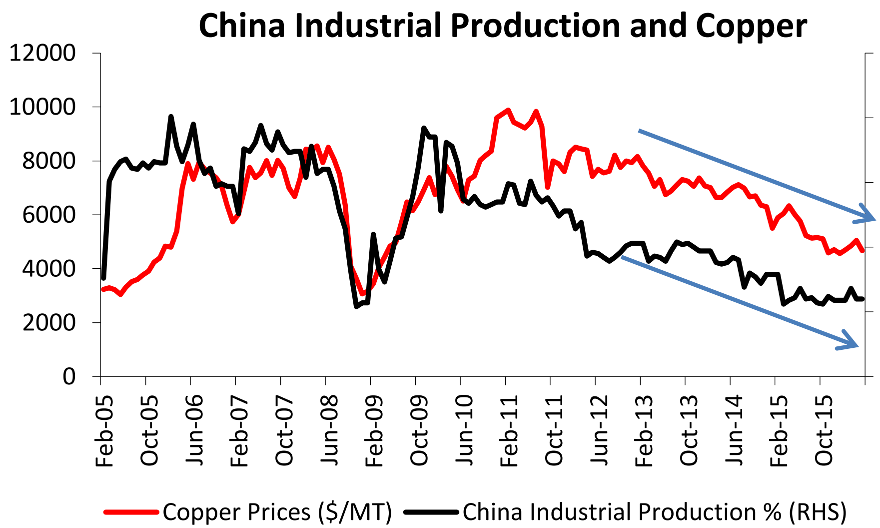
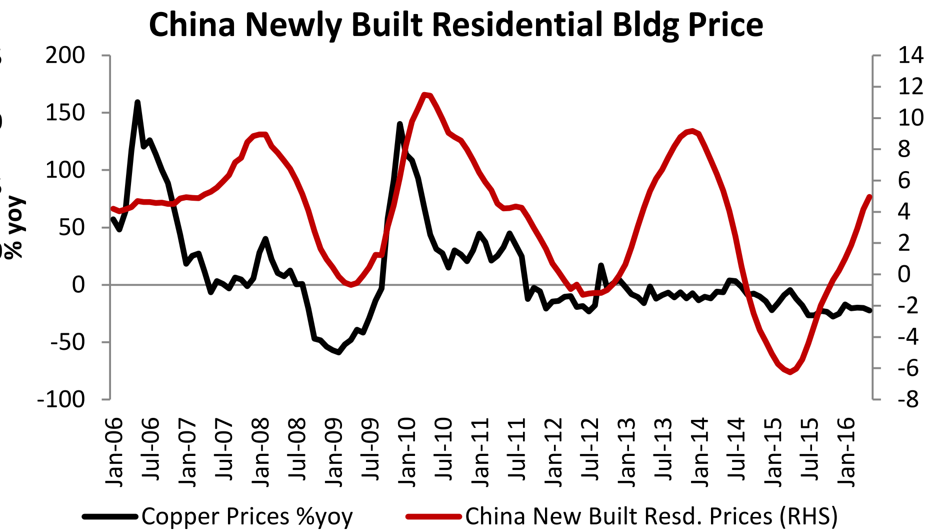
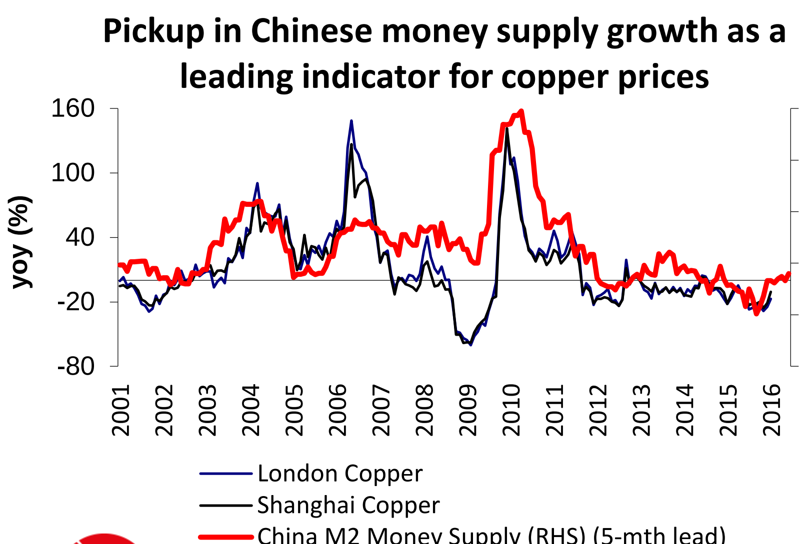
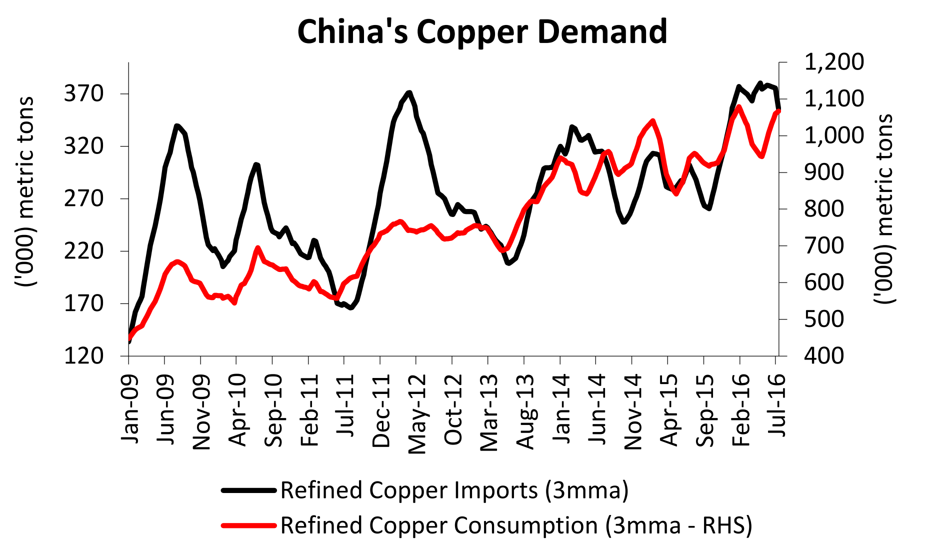
Source: Bloomberg, CFTC, OCBC

Copper is still a Chinese-centric commodity









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Source: Bloomberg, OCBC

Crude Palm Oil:
Don’t forget weather extremities

Crude Palm Oil – Executive Summary

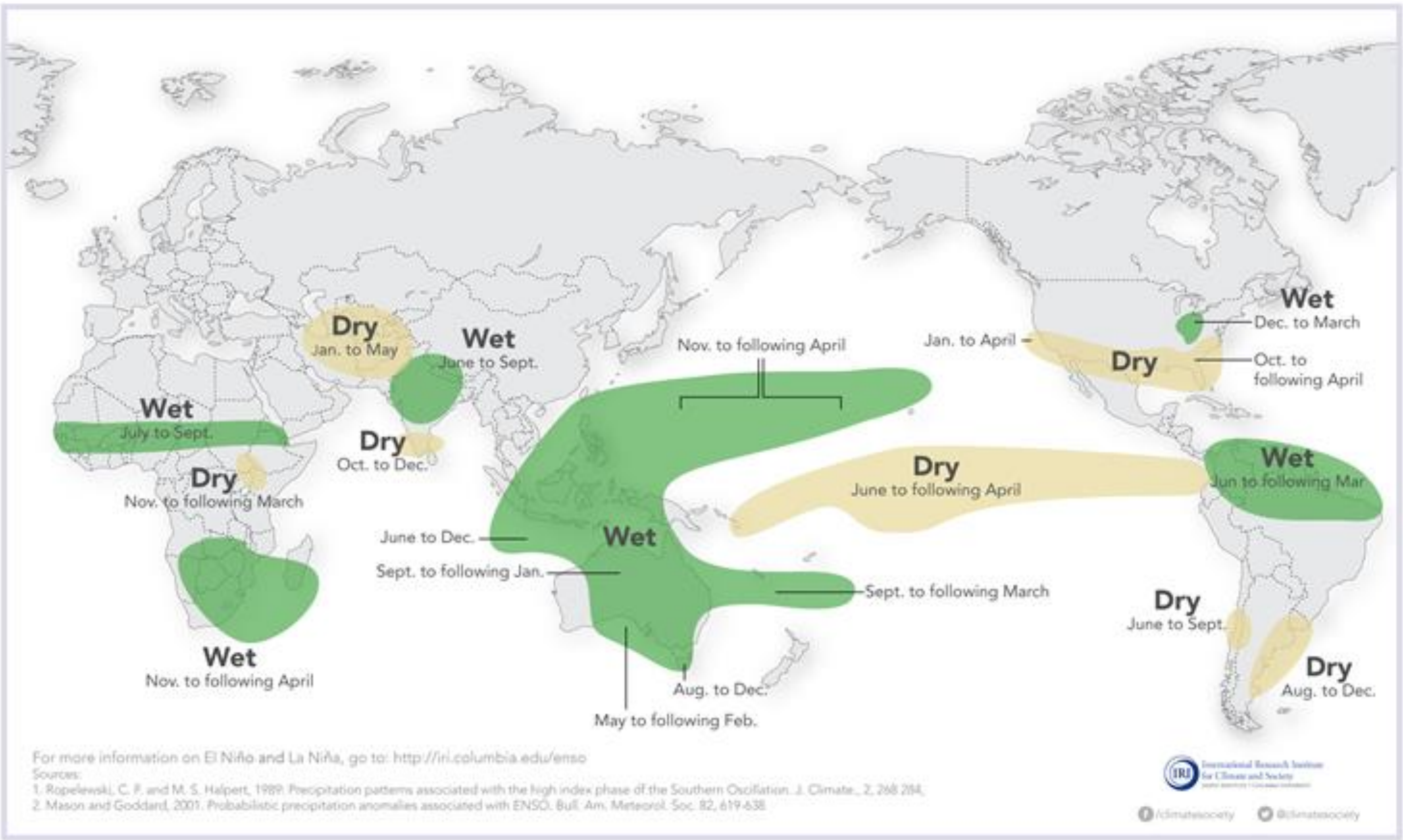
- Crude palm oil prices have turned south after the El Nino scare of late due to (1) slower demand by Asia's key trading partners, (2) cheaper alternatives such as soyoil, and (2) overall stronger supply from Indonesia and Malaysia due to seasonal effects.
- Technically, the absence of previously hot and dry weather does boost palm oil production as well into 2Q16 and 3Q16. On top of that, seasonal production of palm oil does indeed pick up during this said period, adding to the more supply which then dampened prices.
- Still, do note that the rally in palm oil prices due to weather extremities may resurface into the year-end. This is due to the leading indicator seen between palm oil prices and the Oceanic Nino Index (ONI) which points to more rally in the months to come. Elsewhere, wetter-than-usual weathers in Asia may be seen in 4Q16 which would once again prohibit production.
- On the biofuel perspective, the relatively weak crude oil prices versus a year ago would also contribute to weaken palm oil as a biodiesel. Still, mandatory rules in Malaysia and Indonesia to inject palm oil as biodiesel to complement oil consumption should continue to lift domestic palm oil consumption.
- We keep our year-end CPO outlook at MYR2,800/MT as weather extremities and lower production should take form into the later part of this year. Still, downside risk to our forecast exist especially if the poor demand persist.

The death of one, the birth of another

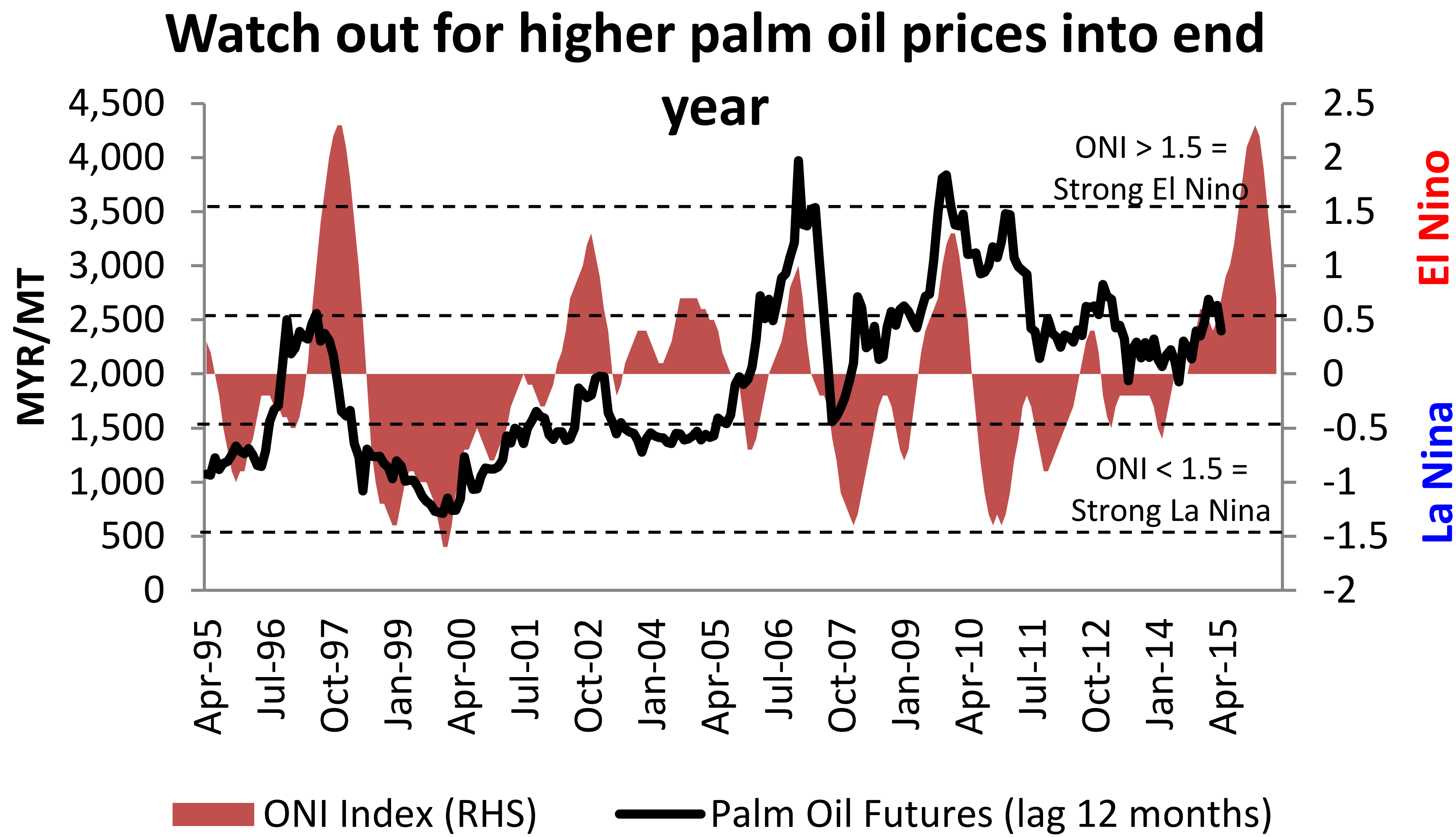
- The El Nino of 2015, measured to be as severe as the one back in 2008, has officially subsided according to the Oceanic Nino Index. Back in recent months, food and grain prices have rallied substantially, including rice, palm oil, sugar etc. Weather extremities are expected to persist, this time in the form of wetter-than-usual weathers.

La Niña and Rainfall

La Niña conditions in the tropical Pacific are known to shift rainfall patterns in many different parts of the world. Although they vary somewhat from one La Niña to the next, the strongest shifts remain fairly consistent in the regions and seasons shown on the map below.



Palm oil futures generally lag the ONI index, and is slated to point north in the coming months



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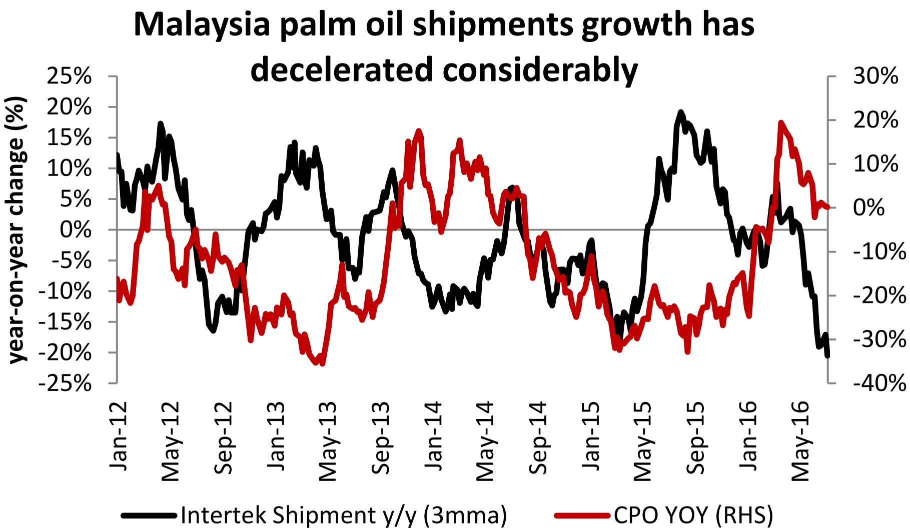
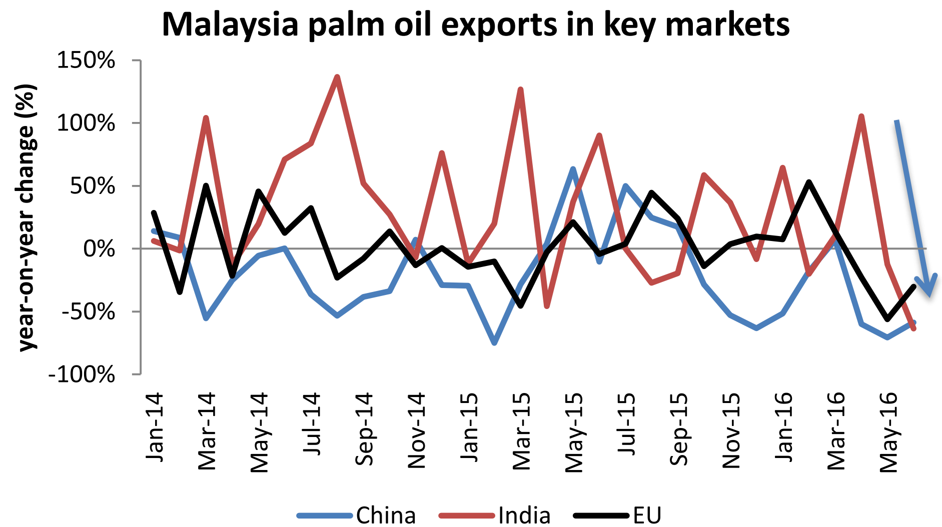
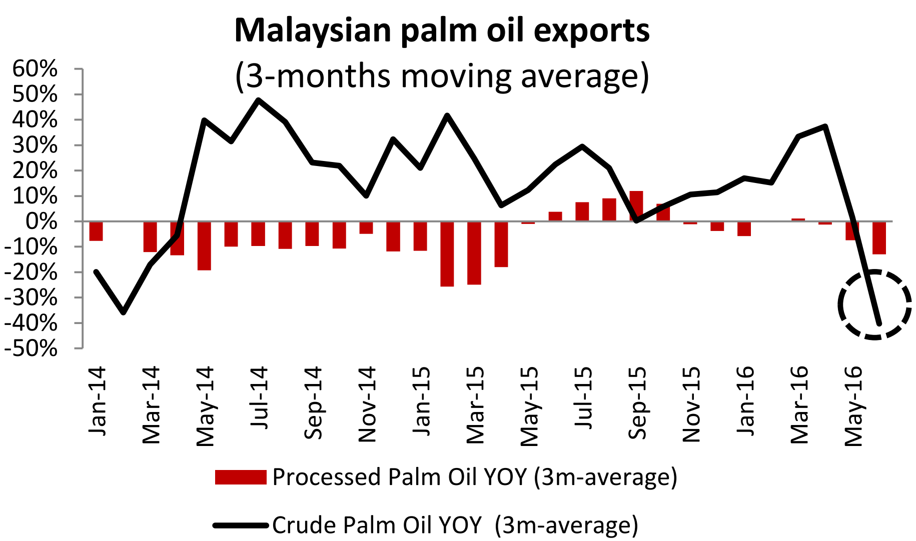
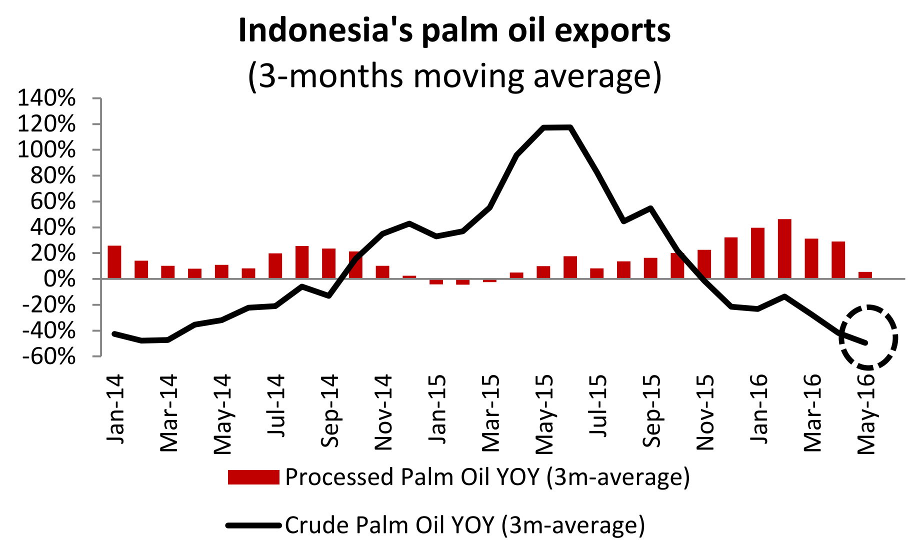
Source: National Oceanic and Atmospheric Administration, Bloomberg, OCBC

Worryingly however, is the (very) poor demand









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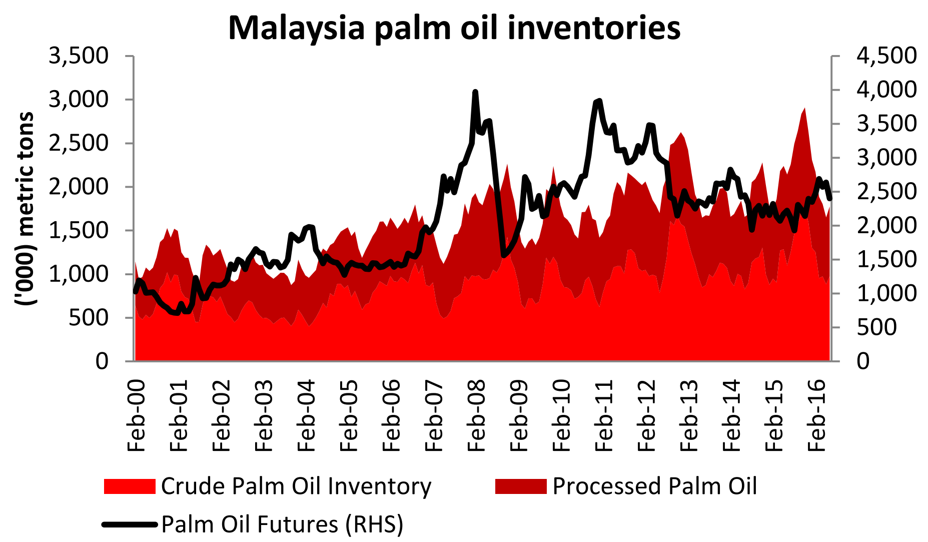
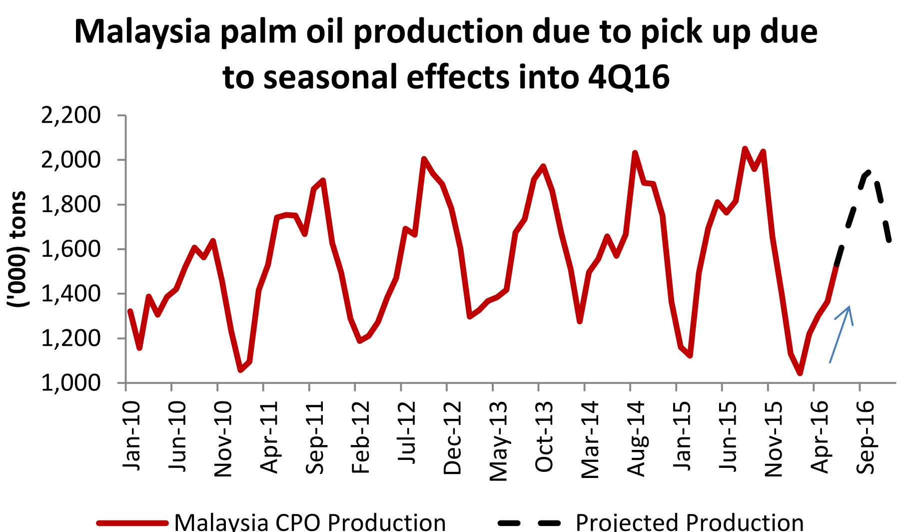
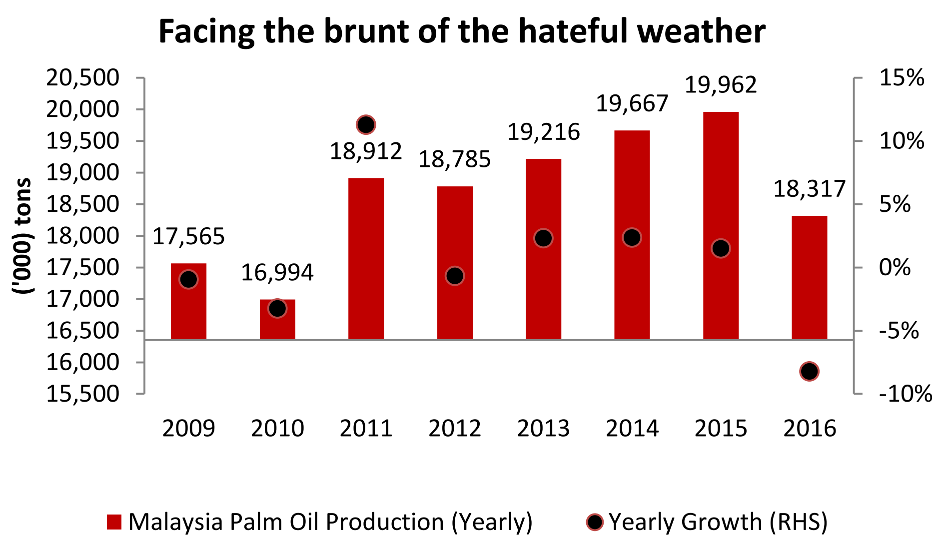
Source: Bloomberg, MPOB, OCBC Bank

Production may continue to grow till 4Q16

- CPO production in Asia will likely increase into October 2016, when it should peak and fall seasonally into April 2017. **Note that the fall in production may be pronounced given the La Nina event should it occur during the same period of time.**
- Full-year CPO production in Malaysia should print in contraction territory this year (-8.2% yoy), given the poor yields seen earlier this year when El Nino extremities were the strongest.







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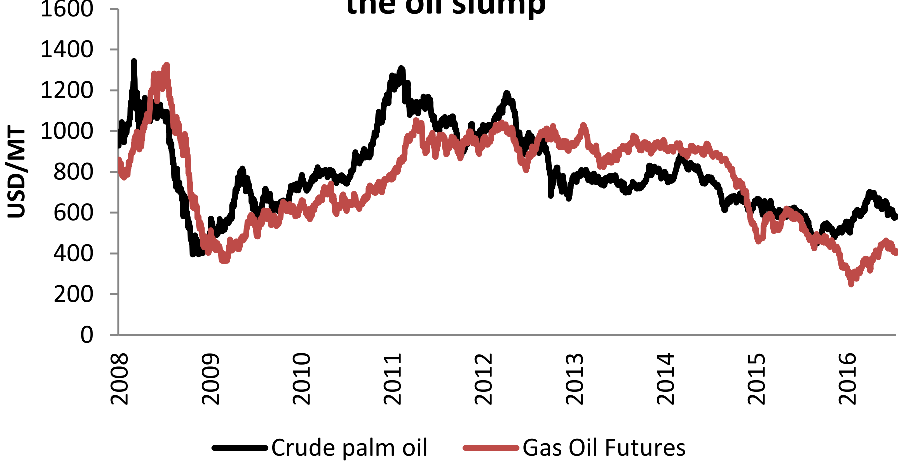
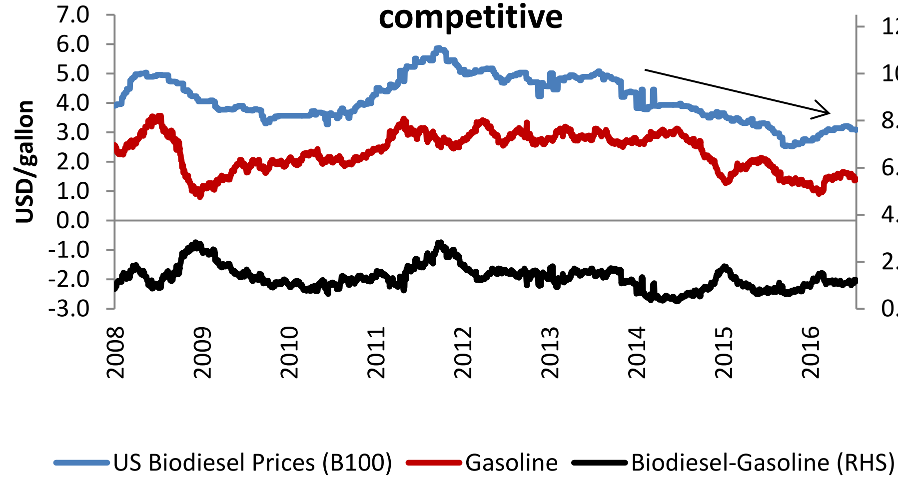
Source: Bloomberg, MPOB, OCBC Bank

Note that alternatives are still cheaper

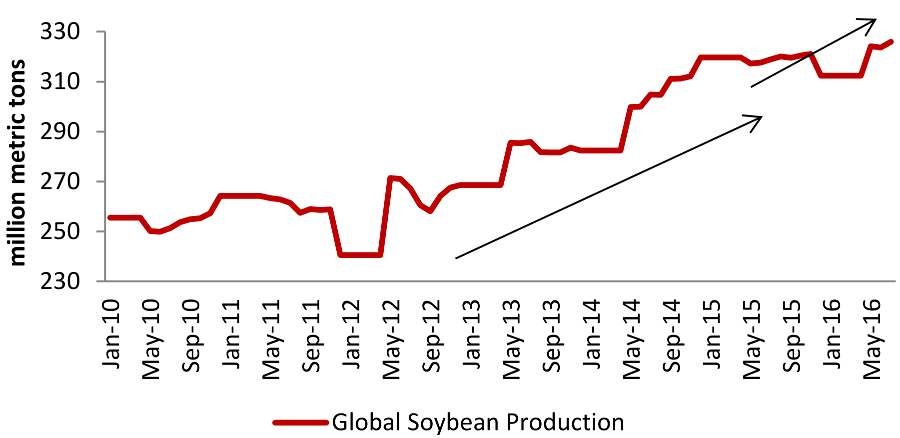
Palm oil turned more costly versus gas oil given the oil slump



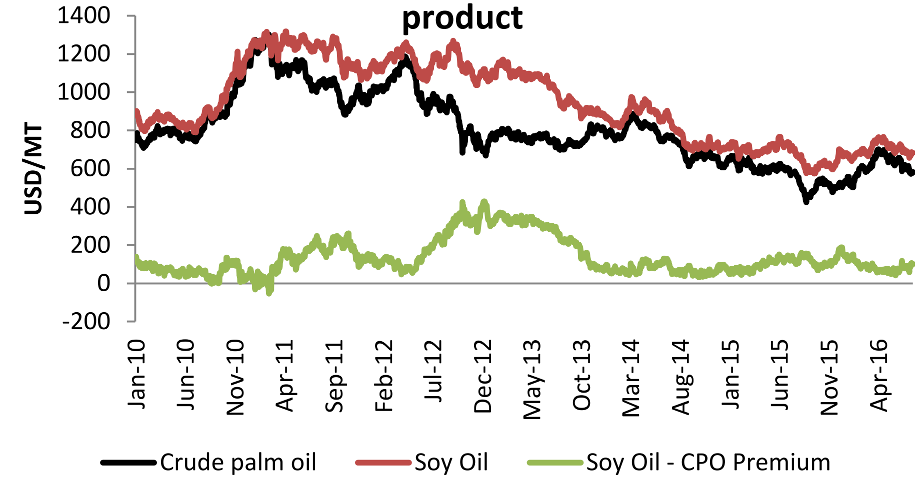
Biodiesel prices has to fall in order to stay competitive



Global soybean production has also picked up after the El Nino event



Cheaper soyoil drags palm oil as an alternative product



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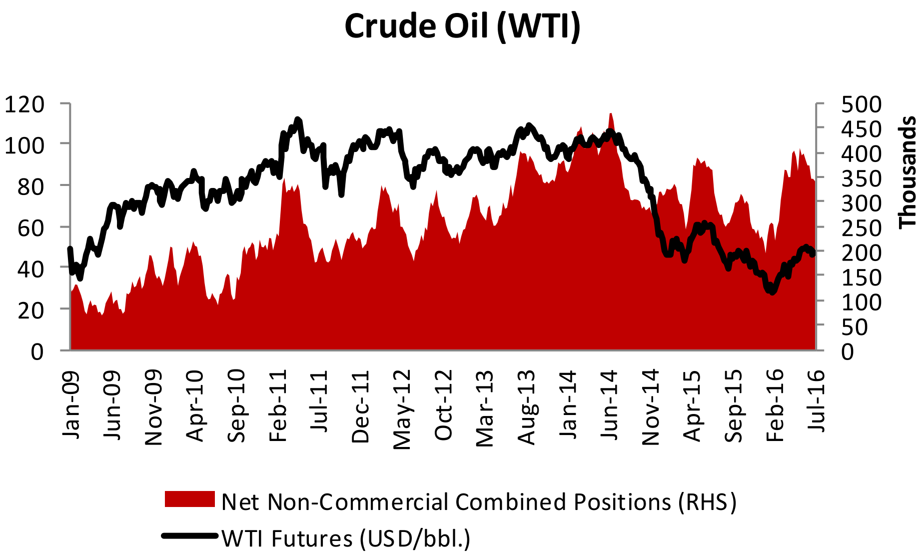
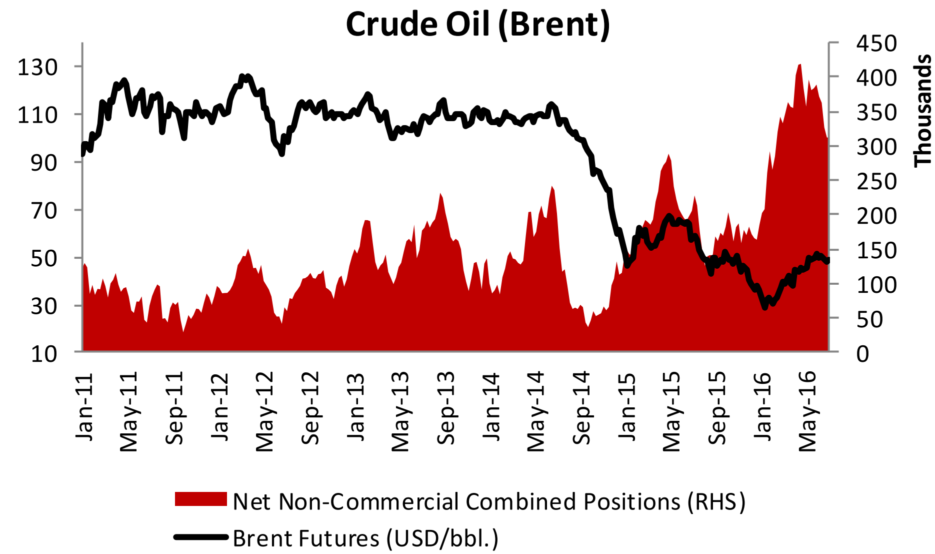
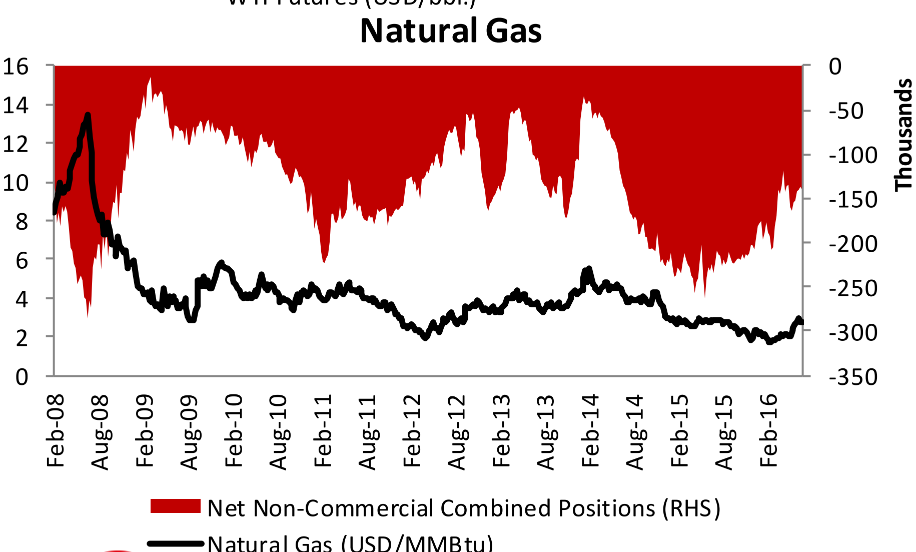
Source: Bloomberg, OCBC Bank

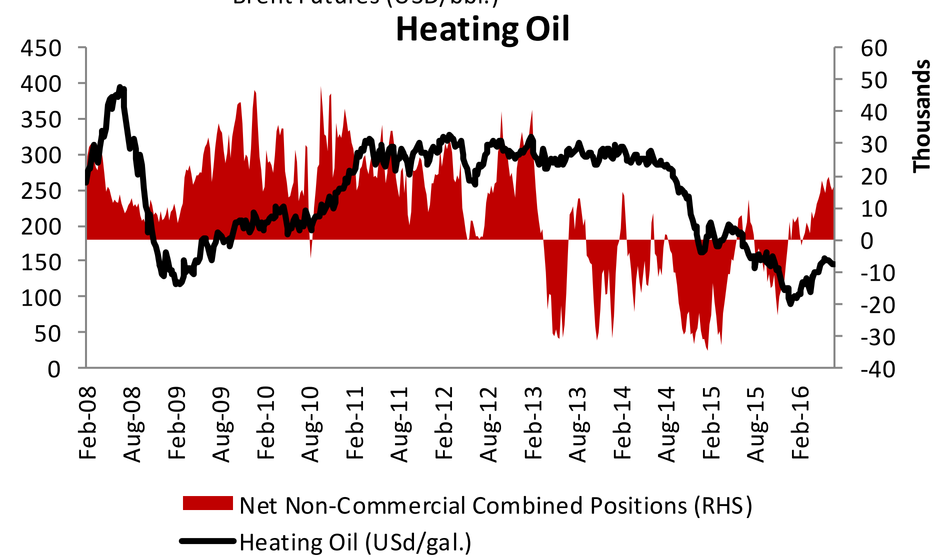
CFTC Positions and Price Forecast

Commodities CFTC Positioning (1)









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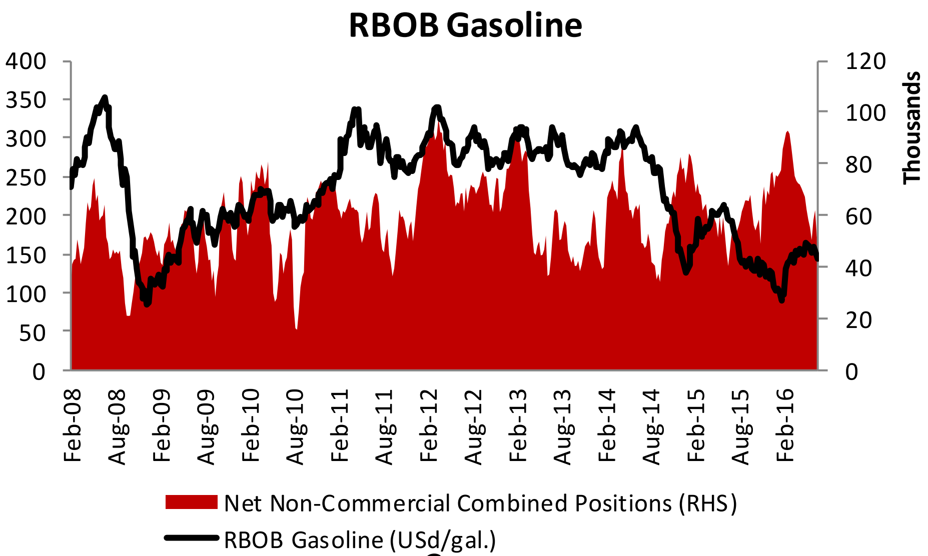
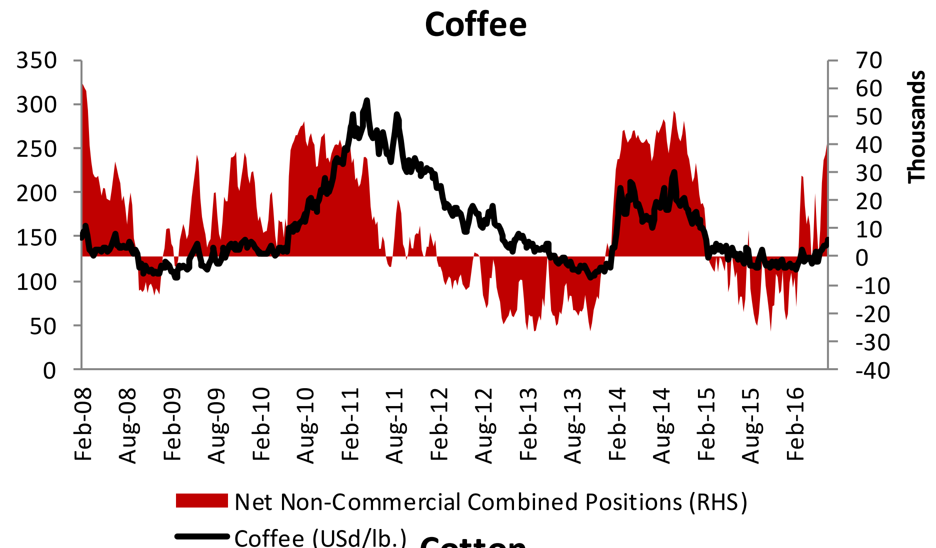
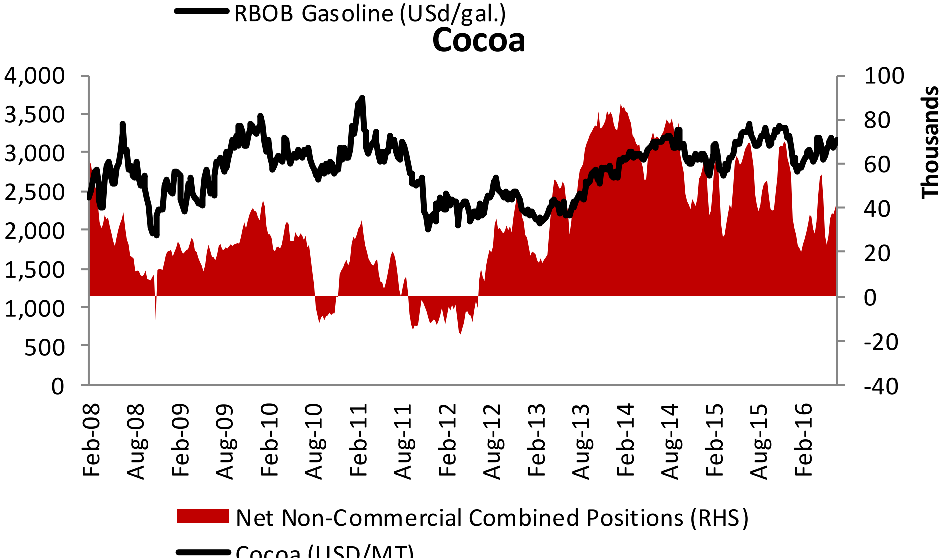
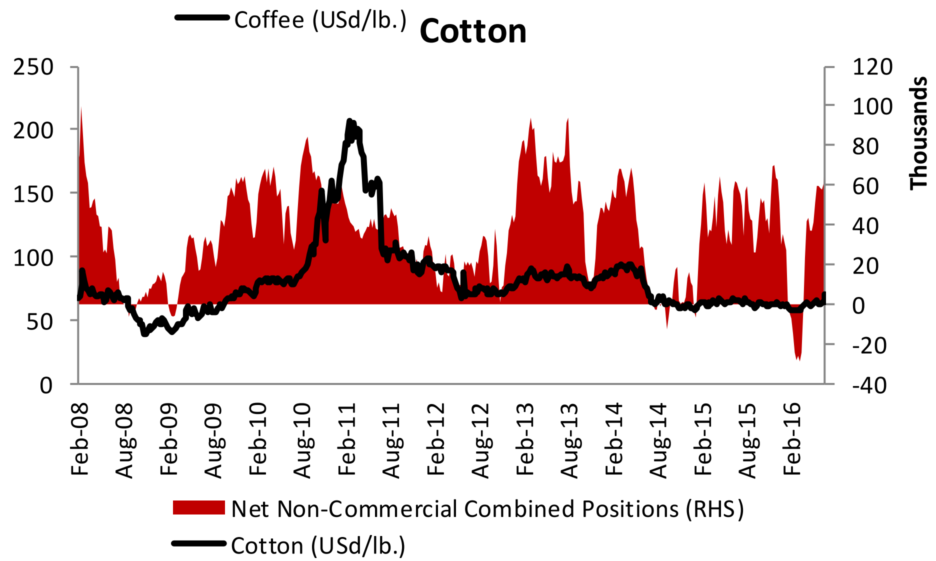
Source: CFTC, Bloomberg

Commodities CFTC Positioning (2)









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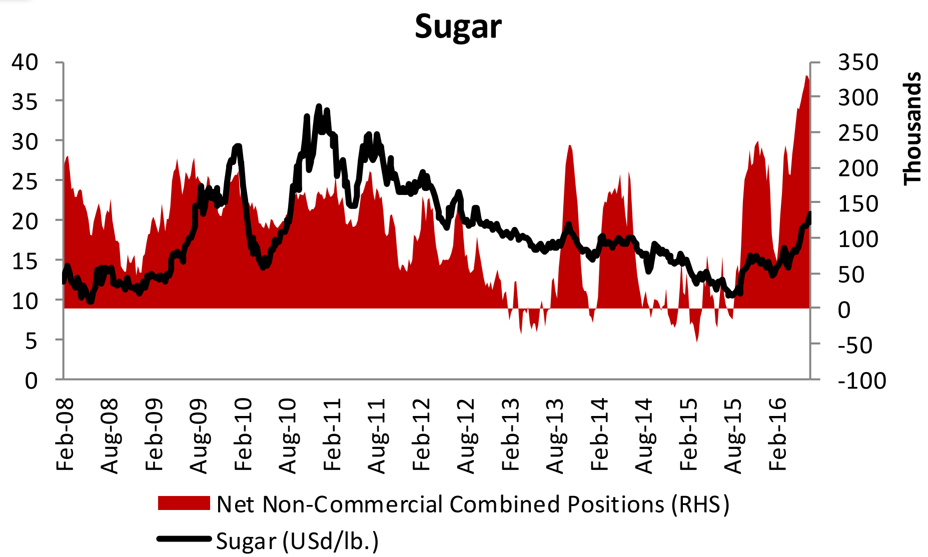
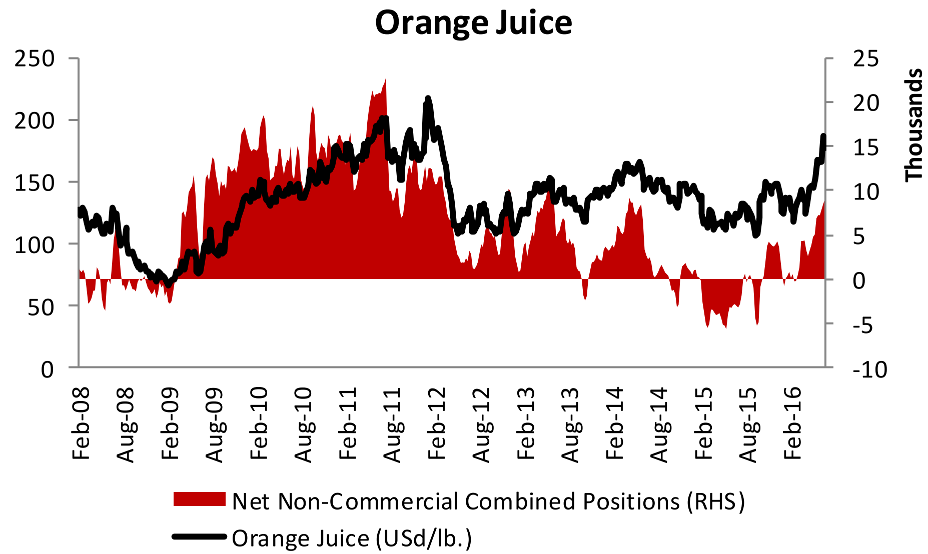
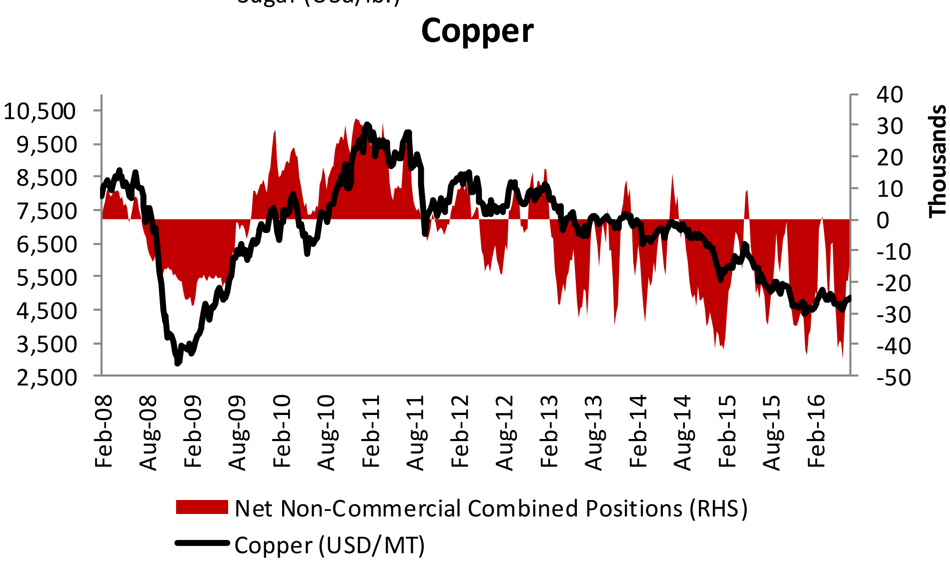
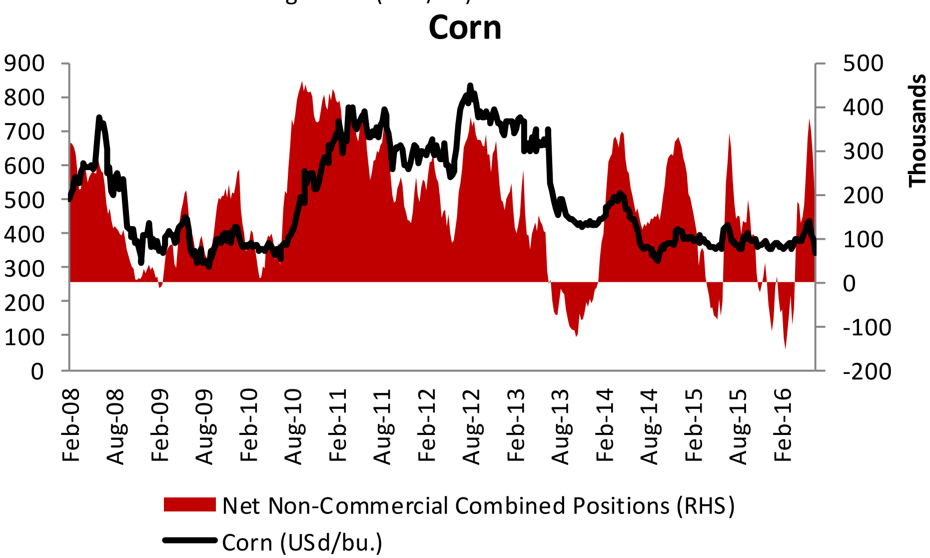
Source: CFTC, Bloomberg

Commodities CFTC Positioning (3)









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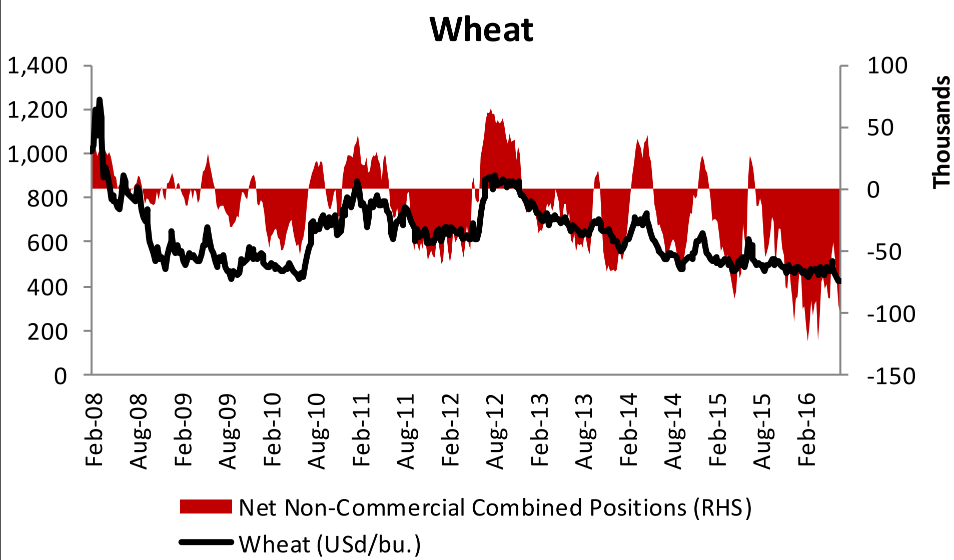
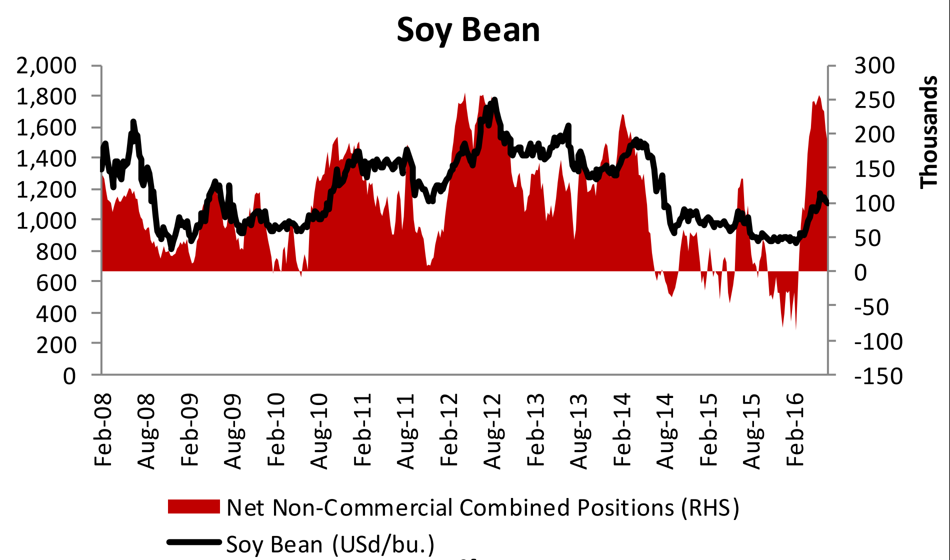
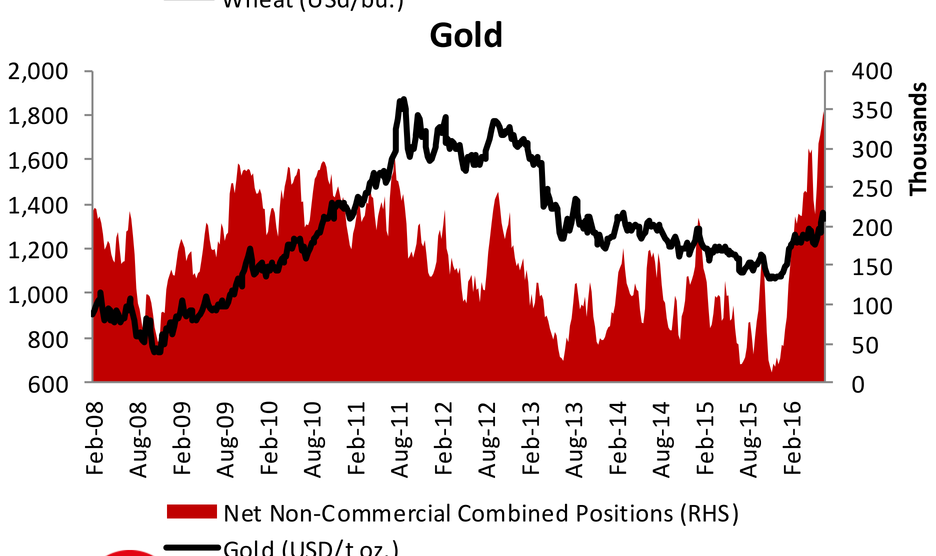
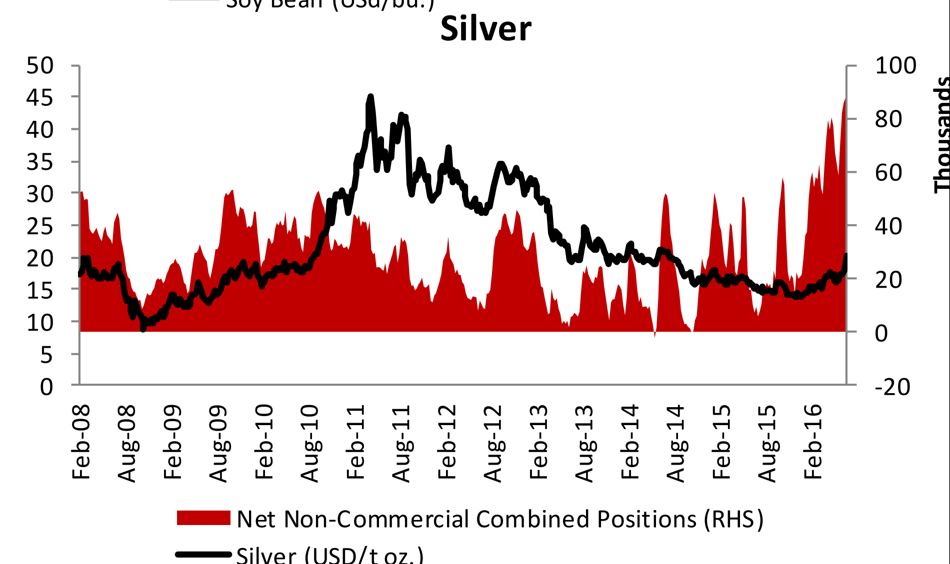
Source: CFTC, Bloomberg

Commodities CFTC Positioning (4)









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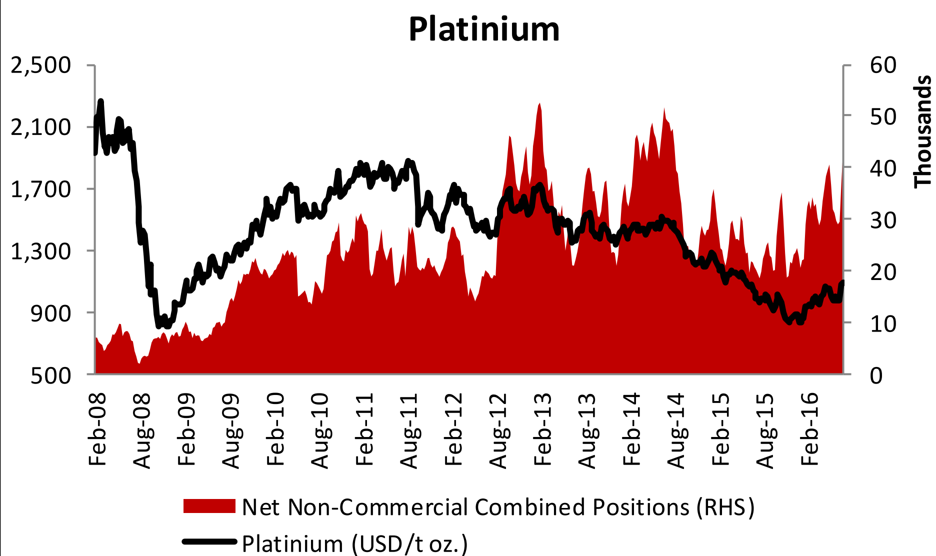
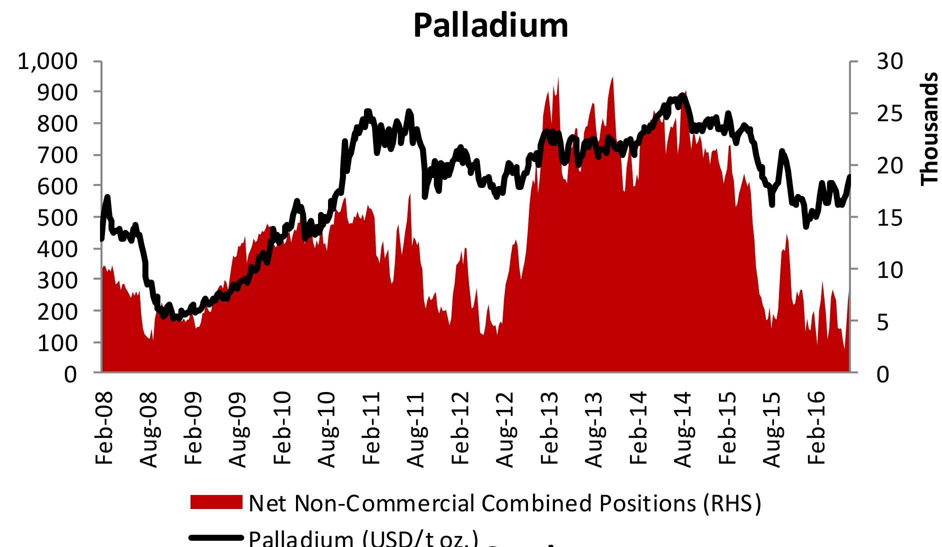
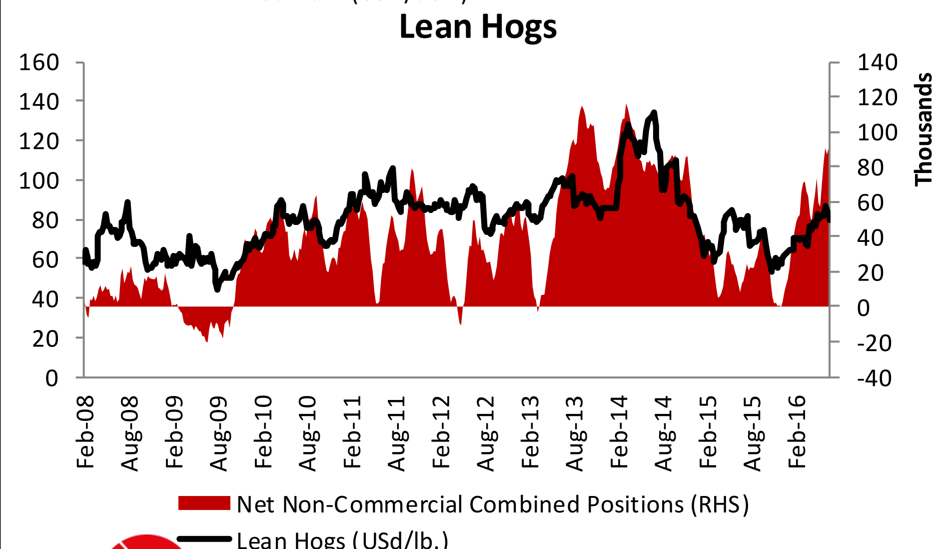
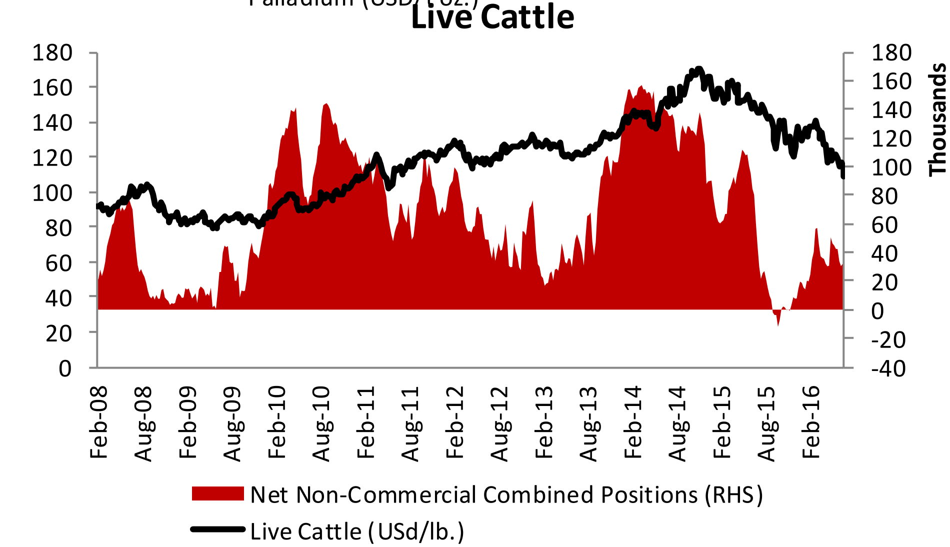
Source: CFTC, Bloomberg

Commodities CFTC Positioning (5)









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Source: CFTC, Bloomberg

OCBC Commodities Price Outlook

As of June 30, 2016	2015				2016			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3F	Q4F
Energy								
WTI ($/bbl)	48.6	58.0	46.5	42.2	33.6	45.7	47.8	50.0
Brent ($/bbl)	55.1	63.5	51.3	44.7	35.2	47.0	48.5	50.0
Gasoline ($/gallon)	1.60	2.00	1.64	1.31	1.18	1.54	1.71	1.56
Natural Gas ($/mmbtu)	2.81	2.74	2.74	2.24	1.98	2.25	2.81	2.50
Precious Metals								
Gold ($/oz)	1,217	1,193	1,124	1,105	1,185	1,260	1,315	1,350
Silver ($/oz)	16.7	16.4	14.9	14.8	14.9	16.8	18.3	18.8
Platinum ($/oz)	1,192	1,128	991	911	919	1,006	1,096	1,227
Palladium ($/oz)	785	758	616	606	526	569	626	711
Base Metals								
Copper ($/MT)	5,805	6,047	5,274	4,882	4,669	4,726	4,838	5,000
Tin ($/MT)	18,369	15,581	15,224	15,093	15,465	16,910	17,279	17,857
Nickel ($/MT)	14,388	13,046	10,605	9,443	8,514	8,825	9,304	9,804
Zinc ($/MT)	2,090	2,191	1,854	1,634	1,684	1,924	1,967	2,000
Aluminum ($/MT)	1,814	1,788	1,623	1,507	1,515	1,582	1,581	1,613
Asian Commodities								
Crude Palm Oil (MYR/MT)	2,270	2,196	2,082	2,220	2,467	2,467	2,450	2,800

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

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Thank You

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Disclaimer

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