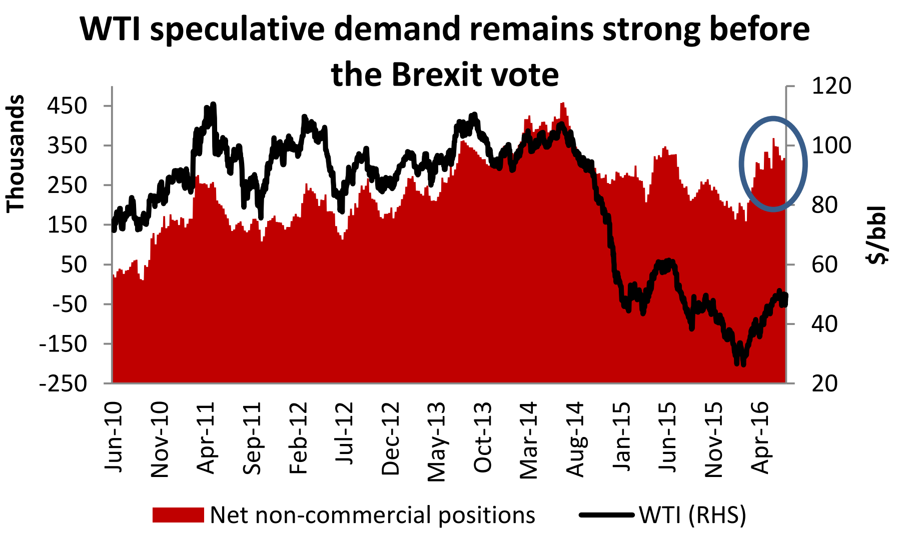
Commodities Research

Life After Brexit?

Thursday, June 30, 2016

Energy

- At least before the Brexit vote, CFTC net-long speculative positions rose for the week ended 21 June 2016. This suggests sustained bullish bets for crude oil prices amid an overall positive view on global growth. Prices also rose steadily before the vote in anticipation for Britain to stay in the European Union, before plummeting to below $50/bbl as the results came in.



Source: Bloomberg, CFTC, OCBC Bank

- The initial risk-off sentiment post-Brexit seemed to have fizzled out for now, with crude oil prices once again rallying past its $50/bbl goal-post less than a week after the unexpected referendum result. At this juncture, much of the relief may stem from the EU officials' rhetoric for an 'orderly' exit of Britain.
- Statistically, Europe commands 15% of global oil demand, or about 1.5 times the production of Saudi Arabia alone. Though not our base case scenario, any significant shortfall in demand following the Brexit would threaten the rebalancing story and subsequently, the bullish trend of crude oil to $50/bbl at year-end. Barring such a scenario, we hope for the rebalancing story to hold up, thus keeping our crude oil forecast unchanged at $50/bbl.
- Stepping away from the Brexit, the crude oil fundamentals still point towards a bull trend:
  - Crude oil prices remained strong even in the face of increasing Iranian production, while US production continued to fall.
  - Elsewhere, US oil rig counts still remained way below 2013 levels, while US consumption is expected to increase into September given the driving season.
  - Most importantly, the latest OPEC meeting back in June showed the cartel's ability to stay united, and is a stepping stone for future OPEC meetings to agree on production quotas.

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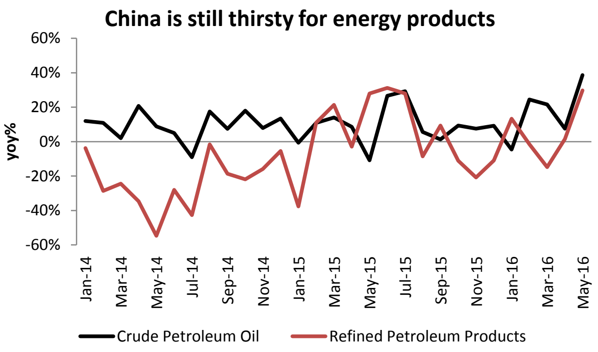
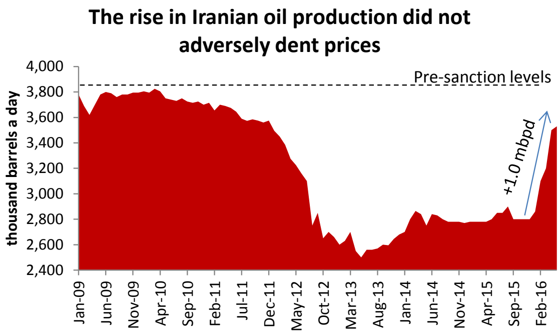
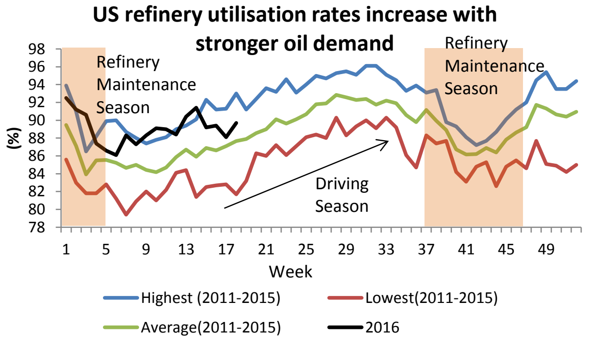
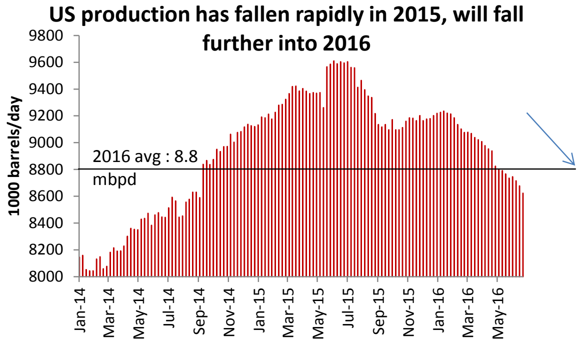




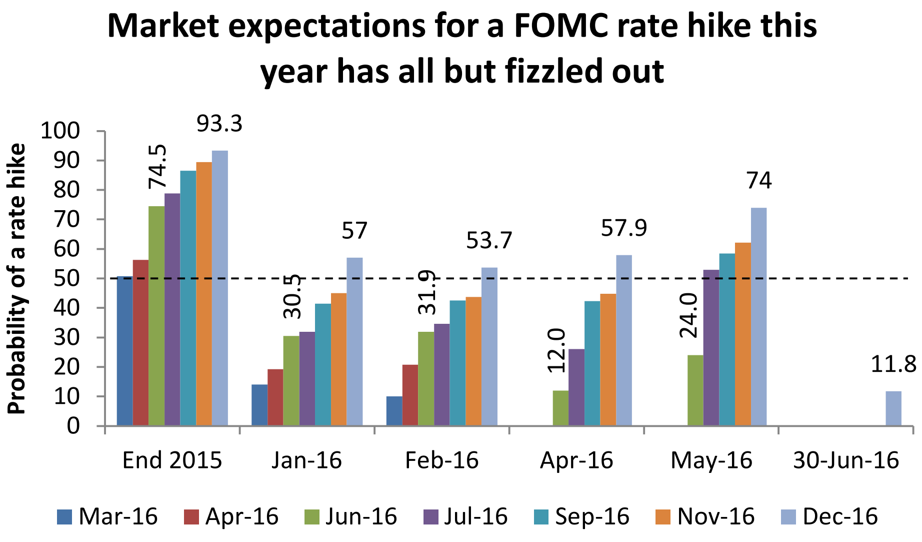




Source: Bloomberg, US Department of Energy, OCBC Bank

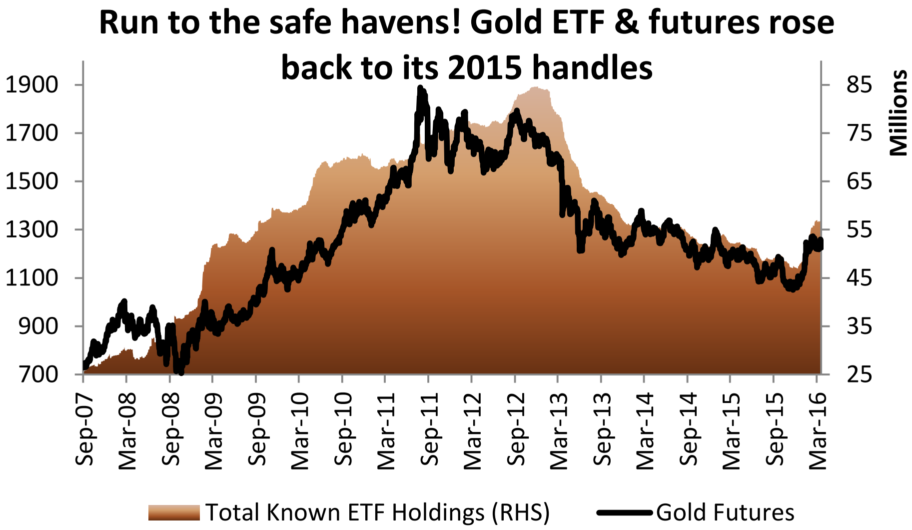
Precious Metals

- With UK's exit from the European Union, we expect the risk-off sentiment to persist into the months ahead. There exist more reasons for suspense now, (1) given the fate of the UK as a trading hub, (2) the health of the EU economy with UK's absence, and (3) the spillover effects into the global economy. Note that the International Monetary Fund stated that a Brexit would trigger 'negative and substantial' effects and erase up to 5.5% of GDP growth. Rating agencies also showed their pessimism with their own respective credit downgrade on the United Kingdom.



Source: Bloomberg, OCBC Bank

- Our bearish call for gold has long been anchored on the rate hikes by the Federal Reserve. Empirically, the probability attached to any rate hikes by the US Federal Reserve has all but faded as Britain voted to leave the EU. According to the implied probability for a Fed rate hike, the probability for a December rate hike is now at a mere 11.8%, versus what was made back at end-May at a strong 74.0%. 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.

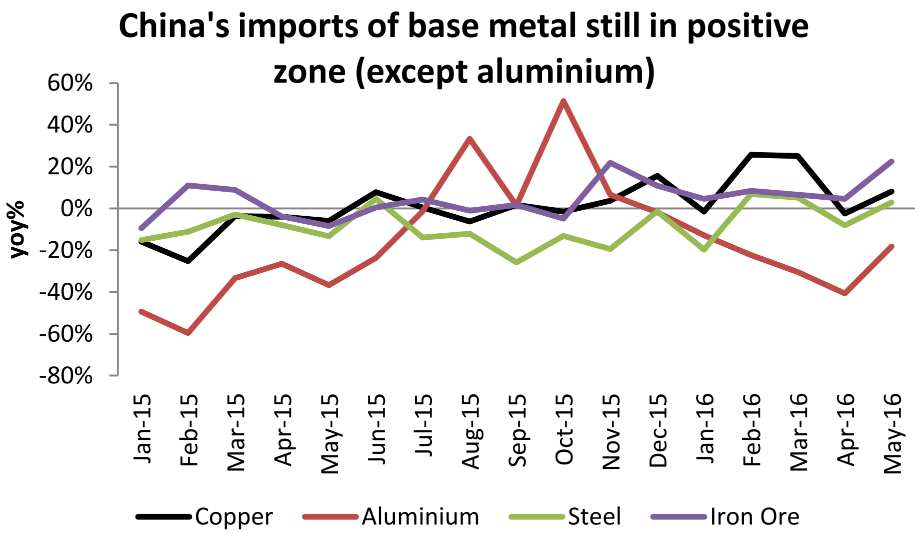


Source: Bloomberg, OCBC Bank

- 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. Despite a rate hike by the Fed, should it come to pass, the risk-off sentiment from the suspense should dominate and lift gold to its $1,350/oz handle easily into the year ahead. Should Yellen fail to hike, gold prices would see further upside risk into the $1,400/oz region.

Base Metals

- Copper prices remained largely rangebound between $4,300 - $5000/MT region in the first six months of this year. At this juncture, copper only gained a tepid 2.2% ytd. Aluminium saw better days at 8.53% ytd while iron ore surged 24% ytd.



Source: Bloomberg, OCBC Bank

- The gains in base metal prices are not surprising, given that China's imports on this commodity class has remained in positive territory. Empirically, iron ore imports has been positive for 7 months already since November 2015, while copper moved into double-digit growth prints in early 2016.
- **Interestingly, base metal prices were largely unaffected by the Brexit referendum, with copper prices wiping off the losses easily 72 hours later.** While some of the recovery can be attributed to the need for an 'orderly' exit by Britain from the EU, the notion that base metal prices are largely influenced by the health and demand of the Chinese economic growth served as an overall support to prices itself.
- Barring a disorderly post-Brexit and any subsequent extreme risk-aversion from such a scenario, global growth should remain on track. On this, we remain comforted by the tremendous progress made by the US economy over the past several years, seen from the significant job gains, rising household incomes and falling unemployment rates. With such a base-case scenario, we do expect base metal prices to see further gains into 2H16.

OCBC Commodities 2H16 Price Forecast

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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