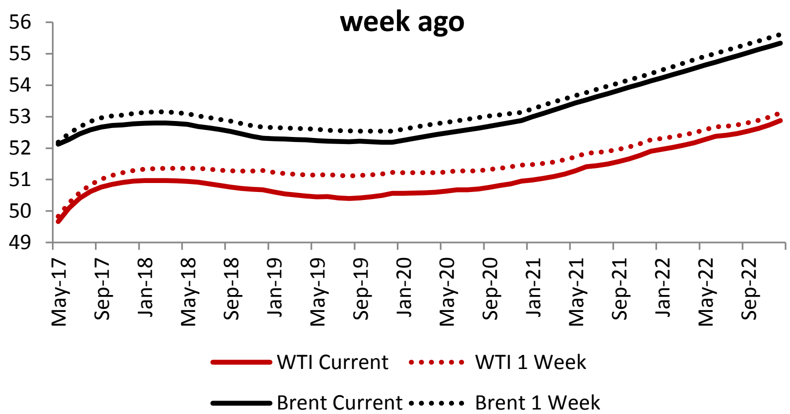
Friday, March 17, 2017

Weekly Commodities Outlook

Energy: News after news of potentially higher crude oil supplies have been dragging oil prices lower. As early as two weeks ago, market-watchers had to content with higher production and inventory data from the United States. At that time, oil bulls were likely expecting lower OPEC oil production to offset the marginal increase in non-OPEC production. This bastion of hope was however compromised by the most recent OPEC Monthly Report (dated 14 March), which indicated an unexpected increase in Saudi Arabia's oil production to 10.0 million barrels per day (bpd) in February, up from 9.75 million bpd seen in the previous month. This increase in Riyadh's oil production contrast with production estimates from non-OPEC (secondary) sources, which suggested Saudi's oil production continued to fall to 9.8 million bpd (-68 thousand bpd) over the same period. As such, with upside production surprise from both OPEC and US oil sources, WTI remained below its $50/bbl handle as of this morning.

The fall in oil prices does remind us of one fundamental aspect: market-watchers do not take kindly when OPEC oil production rises. Notably, we did see some initial upside risk in oil prices in early March, especially as investors place the much-needed faith in OPEC's compliance on its agreed production cut. To us, even as Saudi Arabia's oil production rose in February, we note that (1) Riyadh's oil production is still below its agreed production level of 10.06 million bpd made back in Dec 2016, and (2) total OPEC oil production still fell into Feb, led falling oil production from Iran (-106 million bpd), Qatar (-70 million bpd), UAE (-65 million bpd) and Iraq (-64 million bpd). For details of the latest OPEC production, kindly refer to the appendix below.

Crude oil futures curves edged lower from a week ago



Source: Bloomberg, OCBC Bank

More importantly, OPEC continued to suggest its want to lift oil prices into the year. Despite the fall in oil prices below its $50/bbl handle, Saudi Arabia had commented its assurance that

Commodities Futures

Energy	**Futures**	**% chg**
WTI (per barrel)	48.75	-0.23%
Brent (per barrel)	51.74	-0.14%
Heating Oil (per gallon)	1.504	-0.54%
Gasoline (per gallon)	1.594	0.68%
Natural Gas (per MMBtu)	2.902	-2.65%
Base Metals	**Futures**	**% chg**
Copper (per mt)	5,876.4	0.76%
Nickel (per mt)	10,183	0.16%
Aluminium (per mt)	1,894.0	0.68%
Precious Metals	**Futures**	**% chg**
Gold (per oz)	1,227.1	2.20%
Silver (per oz)	17.296	2.42%
Platinum (per oz)	958.4	2.31%
Palladium (per oz)	768.7	2.84%
Soft Commodities	**Futures**	**% chg**
Coffee (per lb)	1.398	0.40%
Cotton (per lb)	0.7817	0.12%
Sugar (per lb)	0.1825	0.11%
Orange Juice (per lb)	1.7750	-0.34%
Cocoa (per mt)	2,027	-1.03%
Grains	**Futures**	**% chg**
Wheat (per bushel)	4.3600	--
Soybean (per bushel)	10.015	0.35%
Corn (per bushel)	3.6600	0.69%
Asian Commodities	**Futures**	**% chg**
Crude Palm Oil (MYR/MT)	2,963.0	-1.89%
Rubber (JPY/KG)	284.1	-1.11%

Source: Bloomberg, OCBC Bank

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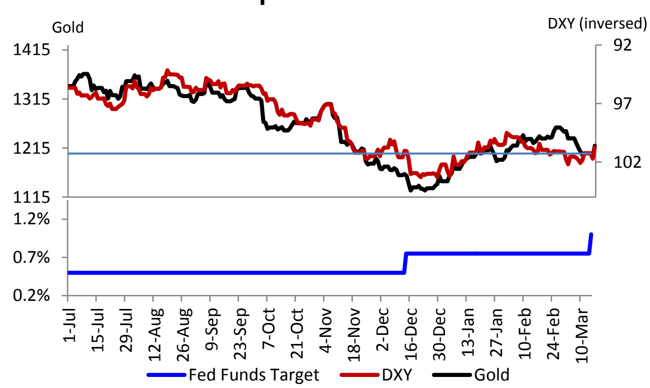
OPEC may prolong production cuts after the current agreement expires in June, especially if global oil stocks remain excessive. Do note that Saudi Arabia and other OPEC countries have pencilled in a goal for oil to hit $60/bbl from its ongoing production curb drive.

Still, we do sense some bearish indicators in the crude oil space. For one, futures curves belonging to both West Texas Intermediate (WTI) and Brent have moved lower from a week ago. Also, crude oil net-long speculative positions had also fallen for two consecutive weeks into the first week of March. Lastly, should we revisit oil fundamentals, OPEC's total crude oil production is still marginally above its agreed 32.5 million bpd made in Dec 2016, while overproduction over the agreed levels by Iraq and Venezuela (2.4% and 190.5% higher versus the targeted production level, respectively) may eventually spook oil prices lower if their production growth is not kept in check into the near future.

Precious Metals: In a nut-shell, the Fed's recent message behind its latest monetary policy meeting is a message of cautiousness. Yes, the Federal Reserve did hike interest rates by 25bps to a range of 0.75% - 1.0% overnight, as widely expected by the markets. After-all, the Fed had reiterated a series of rather hawkish commentaries over the previous weeks, which led to pricing-in of yesterday's rate hike result.

Gold remained above its $1,200/oz handle despite a Fed rate hike



Source: Bloomberg, OCBC Bank

However, with future rate hike expectation unchanged at 1.375% (or about 3 rate hikes in 2017), according to the latest dot-plot chart, yesterday's decision can be thus referred to as a 'dovish hike', explaining the immediate dollar weakness at the onset of the announcement. Thus, given that gold prices have been traditionally swayed by dollar movements, the relatively similar dot-plot result sent gold rising to its $1,220/oz handle while leaving the dollar index weaker. As such, rates did move higher, but the lack of new hawkish guidance was also seen as well.

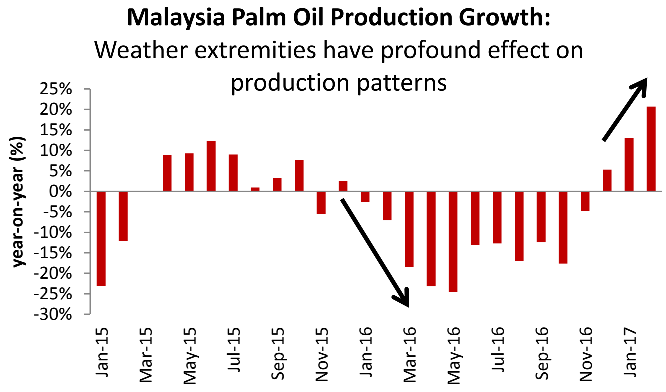
As mentioned in our previous Commodities Weekly report, the more pertinent question is of two words: "**What now?"** Importantly, we need to re-assess the climate we may face after this week's rate hike. To date, little has changed other than new developments regarding the recent Dutch elections, where market confidence has taken a lift from exit polls indicating a clear victory for incumbent PM Mark Rutte's VVD party (32 seats) versus Geert Wilders' PVV party (19 seats). Suffice to say, the lack of popularity for the PVV party also suggests that the Netherlands will not path its way to a European Union exit (or better known as "Nexit") as preached by Wilders' party.

We continue to see some support for gold prices in the near term. The clear victory for Netherlands to steer clear from a Nexit scenario should not be seen as a leading indicator for France's Marine Le Pen's call for a "Frexit" in the upcoming April's election. Indeed, the somewhat surprise result for Mark Rutte to soundly beat Wilders' party eased exit concerns, lifted the EUR (which consequently dragged the greenback lower) and gave gold a boost back above its $1,220/oz handle. Still, market-watchers will likely eye closely on other event risks, amid the sustained lack of clarity over Trump's trade and fiscal policies. As such, gold should remain supported given its safe haven appeal.

Agriculturals: Palm oil prices have been range-trading around its MYR3,000/MT into mid-March, as market expectations for higher Asian palm oil production into April is matched with news of a possible El Nino into the year. According to the US National Oceanic and Atmospheric Administration (NOAA), an El Nino phenomenon has a 50% to occur later this year, suggesting that weather extremities may once again lift agricultural prices. Should we recall, El Nino weathers had gravely affected production levels in Indonesia and Malaysia, home to more than 85% of global crude palm oil production in 2016 and lifted prices to above MYR3,200/MT.

Elsewhere, Malaysia palm oil exports seem to have seen some recovery into March, thus explaining palm oil's reluctance to fall deeper below its MYR3,000/MT handle. Empirically, Malaysia's palm oil export at +1.1% m/m over the first two weeks of March, according to Intertek data. Note that Malaysia has also reduced its

CPO export tax to 7.5% into April (from 8.0% in March), which may suggest more incentive for palm oil importers to demand more crude palm oil into the second quarter.



Source: Bloomberg, MPOB, OCBC Bank

In determining future palm oil prices, we would prefer to wait for more clarity over weather conditions, especially as palm oil production in Asia is largely dependent on weather conditions. Given the low production volume in 2016, any recovery in production into 2017 is a persuasive driver to drag prices lower to our year-end outlook of MYR2,650/MT. Moreover, crude palm oil production in Indonesia and Malaysia has seen positive growth prints in the first two months of 2017, vis-à-vis a contraction print seen in the same period last year.

Appendix

OPEC Production – Have they delivered what was promised?

thousand barrels per day	Reference Production Levels (a)	Targeted production level (b)	Actual Production (Dec 2016) (c)	Actual Production (Jan 2017) (d)	Actual Production (Feb 2017) (e)	Plan cuts from reference level (f): (b) - (a)	Actual cuts in Jan 2017 (g): (d) - (a)	Actual cuts in Feb 2017 (h): (e) - (a)	Compliance (%) vs planned cuts in Jan* (g) / (f)	Compliance (%) vs planned cuts in Feb* (h) / (f)
Algeria	1,089	1,039	1,149	1,091	1,084	-50	+2	-5	-4.0%	10.0%
Angola	1,751	1,673	1,639	1,615	1,649	-78	-136	-102	174.4%	130.8%
Ecuador	548	522	544	534	535	-26	-14	-13	53.8%	50.0%
Gabon*	202	193	209	201	194	-9	-1	-8	11.1%	88.9%
Iran	3,975	3,797	4,010	3,920	3,814	-178	-55	-161	30.9%	90.4%
Iraq	4,561	4,351	4,830	4,630	4,566	-210	+69	+5	-32.9%	-2.4%
Kuwait	2,838	2,707	2,844	2,710	2,705	-131	-128	-133	97.7%	101.5%
Libya**	528	-	610	680	669	-	+152	+141	-	-
Nigeria**	1,390	-	1,370	1,533	1,526	-	+143	+136	-	-
Qatar	648	618	611	615	545	-30	-33	-103	110.0%	343.3%
Saudi Arabia	10,544	10,058	10,465	9,748	10,011	-486	-796	-533	163.8%	109.7%
UAE	3,013	2,874	3,220	3,060	2,995	-139	+47	-18	-33.8%	12.9%
Venezuela	2,067	1,972	2,270	2,250	2,248	-95	+183	+181	-192.6%	-190.5%
Total	**33,154**	**29,804**	**33,771**	**32,587**	**32,541**	**-1,432**	**-862**	**-613**	**34.4%**	**67.7%**

* 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