OCBC Bank

Friday, May 26, 2017

Weekly Commodities Outlook

Energy: The market was clearly disappointed over the "status-quo" decision revealed at the latest 172nd OPEC meeting in Vienna overnight. For one, the production cuts were only extended for another nine months, rather than twelve months as what the market had hoped. Moreover, the cartel kept its supply cut level unchanged at 1.8 million barrels per day (bpd), disappointing market expectations for a deeper cut beyond that level. With that, the stark increase in selling volume even before the meeting concluded highlighted the immense dissatisfaction market-watchers had.

Surrounding the meeting decision were also many questions unanswered. Firstly, there was no indication of an exit strategy after the nine months are up. On this, Saudi Arabia Khalid al-Falih commented that OPEC will continue to "take action" (i.e. do more?) beyond the first quarter next year especially if (1) a fully balanced oil market is not achieved then and/or (2) global oil inventories continue to remain high. Elsewhere, there is no indication over reinforcing the production cuts, nor there was any update on how it has done so in the past. On this note, while most OPEC members had adhered to the production cuts, a handful of members including Gabon and Venezuela had continued to produce above the stated reference levels. Kindly see the appendix below for the updated OPEC production table.

The key question left unanswered was the lack of a price guidance before the year is up. Market had little to chew on save for the pockets of unofficial price commentaries from OPEC representatives; Venezuela indicated its want for prices to remain above $50/bbl, Nigeria and Iran pointed at a possible $60/bbl ceiling, where Angola said that $60/bbl is a "good price". In a nutshell, oil ministers generally agreed that oil may range $50 to $60 per barrel. These is a stark contrast from past OPEC ambitious rhetoric over oil prices, should we recall Saudi Arabia's comment that "it is not unthinkable we could see $60 (a barrel) by the year end", or Iran's target for oil prices to spike to $100 per barrel in comment just less than two years ago.

Of course, there were news that were interesting, but clearly had little influence on oil prices. One, OPEC confirmed a new member in its ranks, Equatorial Guinea. Two, Libya and Nigeria were reportedly excluded from any production caps. Lastly, and perhaps most interesting, was the Algerian minister losing his post in a Cabinet reshuffle during the meeting. Of course, newswires picked up Saudi Arabia's promise over big cuts of oil shipments to the US, but prices clearly did not react favourably to it in any way.

Updated as of 26 May 2017

Selected Indices	Close	Weekly Change	YTD	MTD	QTD
US Dollar Index (DXY)	97.1	0.0%	-5.0%	-1.9%	-3.2%
Reuters / Jefferies (CRB)	181.2	-2.1%	-5.9%	-0.3%	-2.5%
Dow Jones Industrial Avg	21,083.0	1.3%	6.7%	0.7%	2.0%
Baltic Dry Index	918	-4.0%	-4.5%	-17.2%	-29.2%
Energy	**Close**	**Weekly Change**	**YTD**	**Net Position**	**Weekly Change**
NYMEX WTI Crude	49.2	-2.3%	-8.5%	381,437	-6,169
ICE Brent Crude	51.8	-3.3%	-8.8%	296,399	15,721
NYMEX RBOB Gasoline	162.3	-1.8%	-2.5%	32,340	2,821
NYMEX Heating Oil	156.3	-1.3%	-8.3%	13,135	2,783
NYMEX Natural Gas	3.2	-1.8%	-14.2%	57,455	37,130
Base Metals	**Close**	**Weekly Change**	**YTD**	**Net Position**	**Weekly Change**
LME Copper	5,724	0.7%	3.4%	8,775	518
LME Aluminium	1,960	0.8%	15.8%	-	-
LME Nickel	9,040	-3.4%	-9.8%	-	-
Precious Metals	**Close**	**Weekly Change**	**YTD**	**Net Position**	**Weekly Change**
COMEX Gold	1,261.5	0.6%	9.5%	120,256	-21,130
COMEX Silver	17.2	2.6%	7.5%	43,075	-10,986
NYMEX Platinum	956.6	1.7%	6.1%	11,719	2,507
NYMEX Palladium	772.4	1.5%	13.0%	19,897	-643
Agriculture	**Close**	**Weekly Change**	**YTD**	**Net Position**	**Weekly Change**
CBOT Corn	369	-0.9%	4.9%	-131,826	7,231
CBOT Wheat	431	-1.1%	5.5%	-102,951	-13,139
CBOT Soybeans	937	-1.7%	-6.0%	-21,841	1,062
Asian Commodities	**Close**	**Weekly Change**	**YTD**	**MTD**	**QTD**
Thai W. Rice 100% (USD/MT)	448.0	3.5%	17.6%	11.4%	15.2%
Crude Palm Oil (MYR/MT)	2,848.0	-1.3%	-11.5%	5.7%	0.5%
Rubber (JPY/KG)	275.0	-11.1%	5.0%	4.5%	1.6%

Source: Bloomberg, CFTC, OCBC Bank
Note: Closing prices are updated as of 26 May 2017
Note: Speculative net positions are updated as of 16 May 2017
Note: Speculative net positions for Aluminium and Nickel are unavailable

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So far our discussion has centered on what OPEC had done. Given the status quo result amid a possible gradual rising US oil production into the year, our oil supply outlook was left unchanged even with the last OPEC meeting. With the cut levels unchanged, market interest would once again center on a possible rise in US oil supplies into the months ahead. Empirically, US oil production rose by 4.0% since the start of this year to 9.3 million bpd in April. Moreover, US oil rig counts, widely regarded as a leading indicator for future oil production, has also grown above its 700 mark in the coming weeks. As such, given these indicators, there is a strong possibility for US oil production to grow further into the year. Should that come to pass, the higher non-OPEC production, led by higher US oil production levels, may limit OPEC efforts to lift oil prices sustainably.

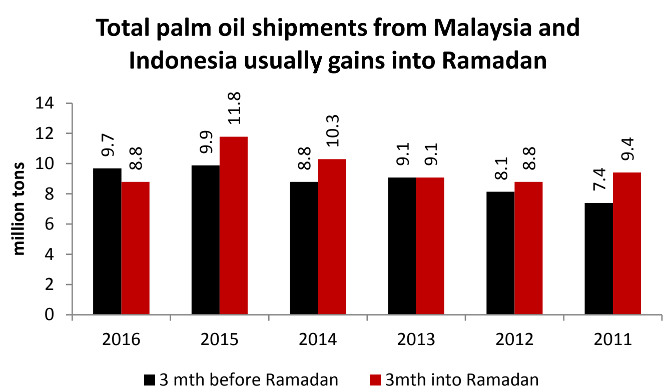
As such, a sustainable rally in oil prices rest on the demand side of the equation. Encouragingly, global oil demand growth remained in expansionary terms, led by Asia especially in China and India. Moreover, energy demand in the US is expected to seasonally pick up into the summer months. With global growth likely still on track, crude oil demand, as a function of global economic resilience and risk appetite, should buoy oil prices into the year. Conclusively, we continue to pencil in WTI and Brent at $55/bbl and $57/bbl at end-year, underpinned by a uptick in demand. However, in the supply point of view, given no change in cut levels, there appears to be little impetus for supply trend to change starkly for the foreseeable future.

Base metals: Copper prices recovered slightly over the past week as it rose by over 1% week on week, and around 0.30% since the beginning of the month, and 15.7% since the start of 2017. On a supply front, copper inventories continued to fall to-date since its rapid uptick in the first week of May. Since its peak on 5th May which saw global copper inventories hitting 724,945 MT, the numbers have slowly begun to taper down to register 675,302 MT to date.

Amid the fall in global stocks, supply concerns remain on table. Note that PT Freeport's union at the world's second largest copper mine in Indonesia, Grasberg, is intending to extend an already month long strike to 30th June which involves 10,000 of the 30,000 workers at the mine. Of which, PT Freeport has laid off over 2000 striking workers in response, on top of the 1,100 dismissed last month which triggered the strike in the first place.

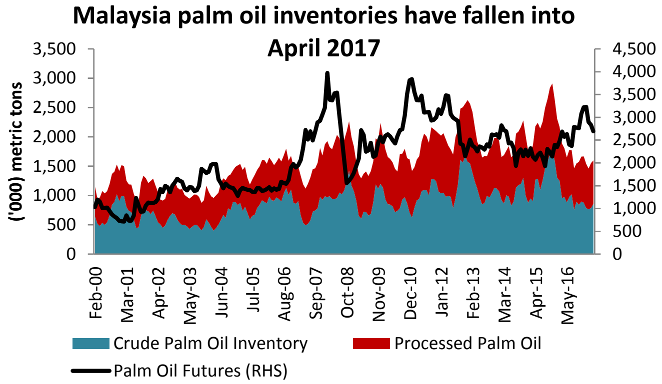
Importantly, there are two issues at play: one, copper production from Grasberg has been cut in half as the result of the strike, though official comments from Freeport cites production levels "on target" while shipments are "on schedule". The second and more pertaining to potential copper supplies, is the risk of export stoppage beyond October 2017 should disagreements between Freeport Indonesia and the government authorities continue. Note that Freeport Indonesia had previously obtained a temporary export permit to ship up to 1.1 million tons of copper concentrate until October this year. Moreover, Freeport must agree to divest and build a smelter, according to government rules, else its contract which expires in 2021 will not be renewed. With inventories tipping lower and production risk from Grasberg, there are indeed further downside risk on global copper production in the weeks ahead.

Palm Oil: Muslims all around the world would be observing the holy celebration of Ramadan, which is slated to start on the 27th May, and will continue for 30 days until 25th June. For the palm oil space, this observation of fasting and feasting has seasonal implication for demand and prices. In a nutshell, Ramadan celebrations seasonally spur higher palm oil demand for cooking. With the relatively weaker palm oil prices seen compared over the last year, palm oil demand is likely to point north into the next month.

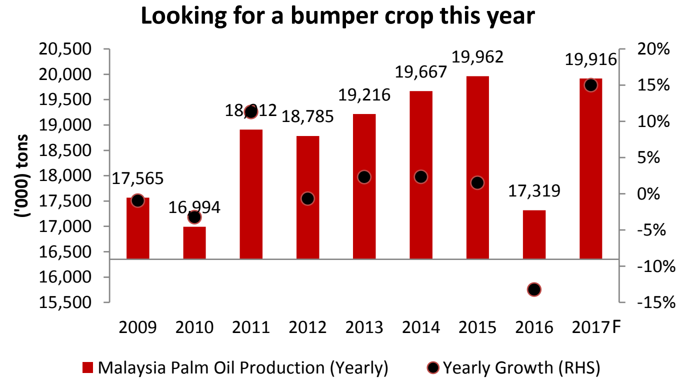


Source: Bloomberg, OCBC Bank

Empirically, palm oil futures had recovered significantly since its trough in April. To-date, palm oil prices are printing around its MYR2,840/MT handle, led by improving export numbers and lower palm oil inventories in Malaysia. Notably, Malaysia's top palm oil export destinations including EU (+48.7%) and China (+30.9%) saw higher year-on-year export growth into April 2017, though India's export demand continued to remain weak (-10.4% yoy). Malaysia palm oil inventories also continued to fall into April at a mere 1.6 million tons (-11.3% yoy).



Source: Bloomberg, OCBC Bank



Source: Bloomberg, OCBC Bank

However, the improved palm oil demand will likely unwind into the end of Ramadan. We note that palm oil prices will remain inherently weak versus that of last year, given the weather extremities and poor production levels seen for the most of 2016. In addition, palm oil production is slated to increase into October this year given seasonal patterns. On the whole, should production levels gain in tandem with historical trend, Malaysia's palm oil production is expected to grow by 15.0% to almost 20 million tons this year, up from a mere 17.3 million tons seen in 2016.

As such, the rally in palm oil prices seen of late will likely be short-lived. The uptick in prices could well be due to the stronger demand in anticipation of the Ramadan celebrations. Once the fasting and feasting are over, the expected slowdown in palm oil demand, amid the expected sustained increase in palm oil supplies should bring crude palm oil prices down to our year-end outlook of MYR2,650/MT.