Thursday, July 06, 2017

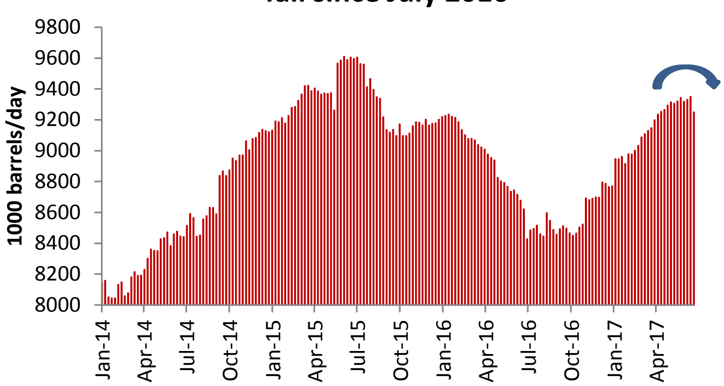
Weekly Commodities Outlook

Energy: More good news for the bulls? Crude oil prices had rallied for over a week, in which their price gains are by no means insubstantial. WTI in particular rallied comfortably beyond its $47/bbl handle, and thus having the coveted $50/bbl in sight again. Brent had likewise rallied in tandem, an inch just below its $50/bbl at current levels.

The rally is supported by a multitude of factors. On a technical aspect, crude oil prices have fallen from its May's peak to oversold territories at end-June. To-date, money managers have increasingly decelerated their short accumulations in the sticky liquid for the week ended 27th June 2017, suggesting that selling pressures are slowly losing its momentum. Also, given the higher oil prices of late, the forward curves have shifted north while still maintaining their contango form.

But equally important as well are the shifting fundamentals. With global demand likely to point higher into the US summer holidays, it is unsurprising that prices have rallied by over 12.0% since its June's trough. Empirically (and encouragingly), US gasoline demand rose 547,000 barrels per day (bpd) on 9 – 16 June 2017, the highest print since March 2017, suggesting that the US driving season is coming full steam into 2H17. Moreover, US crude oil production had the biggest weekly fall since July 2016, coupled with a surprise fall in weekly US crude oil rig count for the first time in 24 weeks. Given that ballooning US oil production are commonly regarded as a key reason for falling crude oil prices, the recent prints mentioned must have been very persuasive to had driven crude oil futures higher to-date.

US crude oil production saw its biggest weekly fall since July 2016



Source: Bloomberg, OCBC Bank

Of course, the risk of higher oil production into 2H17 remains on the cards, exacerbated by the fact that even a downward oil price

Updated as of 28 June 2017

Selected Indices	Close	Weekly Change	YTD	MTD
US Dollar Index (DXY)	96.4	-1.2%	-5.7%	-0.5%
Reuters / Jefferies (CRB)	170.0	1.5%	-11.7%	-5.4%
Dow Jones Industrial Avg	21,310.7	-0.5%	7.8%	1.4%
Baltic Dry Index	884	4.7%	-8.0%	0.7%
Energy	**Close**	**Weekly Change**	**YTD**	**Net Position**
NYMEX WTI Crude	43.9	3.2%	-18.3%	377,620
ICE Brent Crude	46.4	3.5%	-18.4%	200,204
NYMEX RBOB Gasoline	144.8	2.6%	-13.1%	38,857
NYMEX Heating Oil	140.2	2.8%	-17.7%	-5,919
NYMEX Natural Gas	3.0	4.6%	-18.7%	-30,311
Base Metals	**Close**	**Weekly Change**	**YTD**	**Net Position**
LME Copper	5,858	2.0%	5.8%	13,549
LME Aluminium	1,883	0.9%	11.2%	-
LME Nickel	9,260	2.8%	-7.6%	-
Precious Metals	**Close**	**Weekly Change**	**YTD**	**Net Position**
COMEX Gold	1,246.4	0.2%	8.2%	132,157
COMEX Silver	16.7	1.8%	4.3%	35,101
NYMEX Platinum	919.7	-0.8%	2.0%	10,482
NYMEX Palladium	875.3	-2.1%	28.1%	20,569
Agriculture	**Close**	**Weekly Change**	**YTD**	**Net Position**
CBOT Corn	360	-2.4%	2.2%	-61,311
CBOT Wheat	454	-2.2%	11.3%	-11,730
CBOT Soybeans	914	-0.6%	-8.3%	-113,144
Asian Commodities	**Close**	**Weekly Change**	**YTD**	**MTD**
Thai W. Rice 100% (USD/MT)	476.0	0.0%	24.9%	5.1%
Crude Palm Oil (MYR/MT)	2,589.0	0.1%	-19.5%	-5.8%
Rubber (JPY/KG)	199.7	1.4%	-23.8%	-17.5%

Source: Bloomberg, CFTC, OCBC Bank
Note: Closing prices are updated as of 28 June 2017
Note: Speculative net positions are updated as of 27 June 2017
Note: Speculative net positions for Aluminium and Nickel are unavailable

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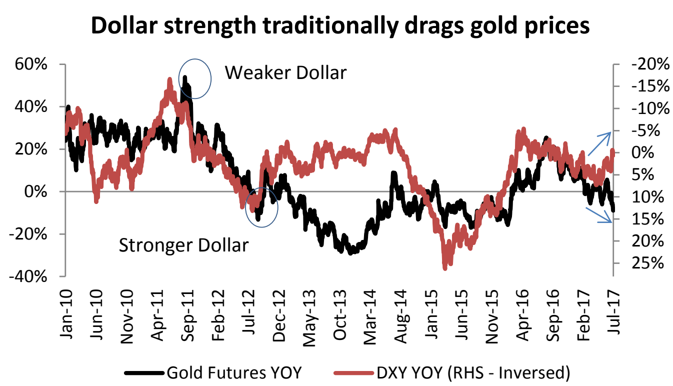
correction may only have a limited influence in persuading oil producers to keep production prudent. Note that Iranian oil production has exceeded 3.9 million bpd in June, according to government rhetoric, up from its 2.5 million bpd handle during past sanctions. Moreover, OPEC's total oil production had gained into April and May, led by stronger production from Libya and Nigeria.

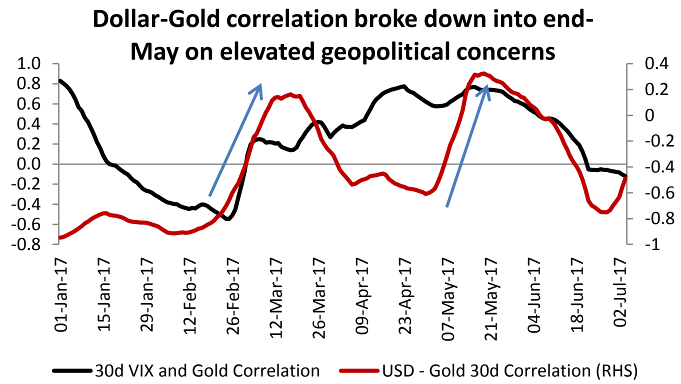
For now, we think that market expectation for demand to point higher has likely taken the front-seat, for now. With prices rallying steadily amid greenshoot signs for prices to rally even further, we continue to pencil WTI and Brent to touch $55/bbl and $57/bbl, respectively, by year-end.

Precious Metals: Gold prices have been falling steadily ever since the last FOMC meeting. To recap, the median dot-plot chart had indicated a possible rate hike in 2H17, coupled with specific plans to reduce its balance sheet size sometime this year. At the onset of this relatively hawkish rhetoric, the dollar index rallied 0.85% before weakening around its 96.0 handle on a stronger EUR into early July on ECB Draghi's "(ECB) can accompany the recovery by adjusting the parameters of its policy instruments" comment.



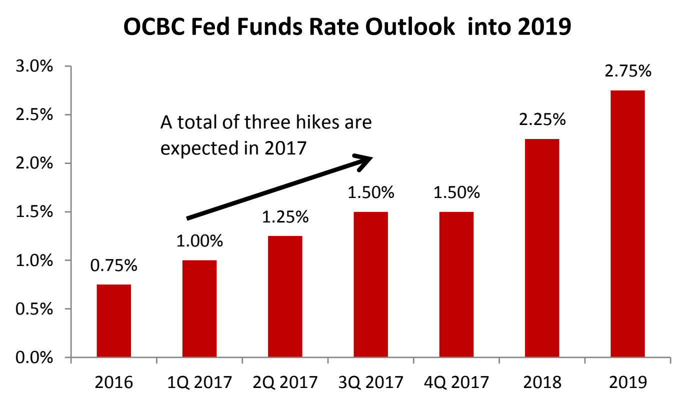
Source: Bloomberg, OCBC Bank

The interesting fact was that gold prices continued their downtrend despite the recent dollar weakness. Technically, prices declined since early-June after the bullion failed to break above its $1,300/oz resistance level. Moreover, geopolitical concerns were relatively muted as market-watchers look past North Korea's missile aggression (that is, until the recent ICBM launch). For that matter, the VIX, or commonly referred to as the fear index, has declined considerably since its April peak of 124.8 to early-June's 76.3 print. Thus, with a sizable uncertainty taken off the table, gold as a safe haven has unsurprisingly trended lower into June.



Source: Bloomberg, OCBC Bank

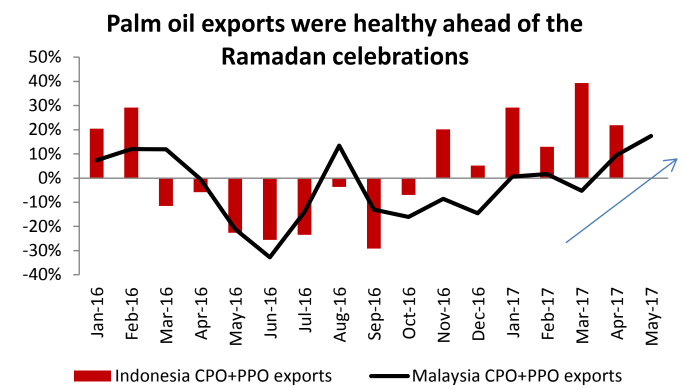
Although we maintain our bearish outlook for the yellow metal to touch $1,200/oz at end-year, uncertainty woes were once again observed into early July. On the geopolitical scale, the recent North Korea's intercontinental ballistic missile (ICBM) test launch demonstrated Pyongyang's capability to reach the US state of Alaska. Elsewhere, global economic growth prospects are also subjected to other uncertainties, including how the US economic and foreign trade policies may pan out, monetary policy directions of major advanced economics and China's economic structural reforms. In a nutshell, gold thrives on uncertainties, and any exacerbation of these risks will be regarded as credible reasons for higher gold prices.



Source: OCBC Bank

Palm Oil (Originally published on 29th June): As the seasonal period of fasting and feasting ended with the end of a month-long Ramadan, palm oil watchers would also recognise that seasonal higher demand for palm oil would likely fade into July. Should history be of reference, palm oil prices should rise as feasting practices observed by Muslims worldwide during the said festive lifts the demand for cooking oil. In fact, Malaysia's palm oil exports were up 17.4% in May, led by a substantial spike in import demand from destination markets like Bangladesh, India, Pakistan and Egypt.

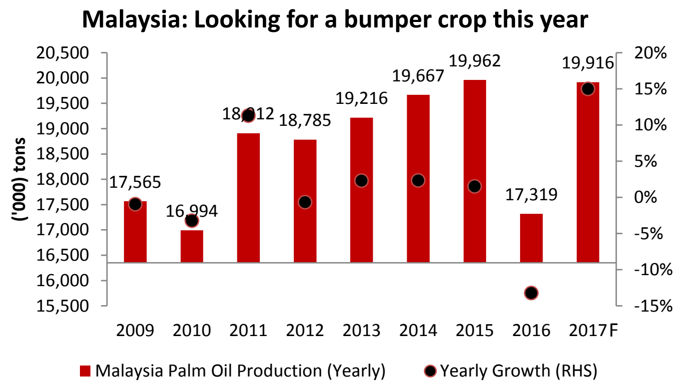
However, unlike previous years where Ramadan celebrations seasonally lifts palm oil prices, this year's palm oil fundamentals are starkly different. In a nutshell, the higher demand in cooking oil seen over April and May are also met with ballooning crude palm oil (CPO) production. Owing to the El Nino phenemonon seen in 2016, palm oil production growth in key producing countries including Indonesia and Malaysia has fallen 13.2% yoy. Given the recovery in palm oil production in the first five months of 2017, coupled with the low base year, market concerns over ballooning production effectively overshadowed the relatively pallid demand gains over two mere months.



Source: Bloomberg, OCBC Bank

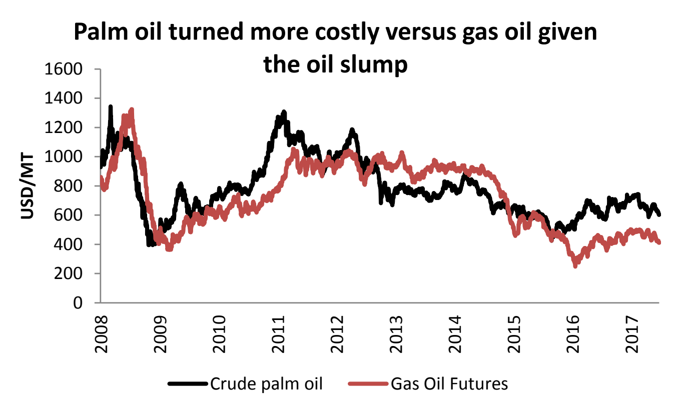
The absence of any significant rally in CPO prices illustrates an important point: market-players remain in close scrutiny over the ballooning palm oil production. However, the higher production into the year is only one of the many reasons to why palm oil prices should decline into the year. On top of (1) strong CPO production into 2017, we recognise two other key reasons to explain our bearish take: (2) sustained low oil prices to-date and (3) healthy alternative oilseed supplies globally.

Strong CPO Production Outlook: Accounting for the low production base in 2016, we expect Asia's CPO production to gain starkly into 2017. Indonesia, the biggest palm oil producer in the world, has cited upside risk in its production to 32 – 33 million tons this year, up from 28.5 million tons in 2016. Elsewhere, the second largest producer, Malaysia, should see CPO production to rise by 15.0% into 2017 according to our estimates. Empirically, Malaysia's CPO production had gained for six consecutive months into May, averaged 18.8% in 5M17 (strongest growth print since 2008 over the same period). Moreover, production is slated to rise further into August 2017 before tapering lower on seasonal patterns, suggesting that more upside risk to production levels can be expected into 2H17. Statistically, we opine that palm oil prices have already peaked in 2016 since the onset of the El Nino weather conditions, and should continue to point south as weather conditions improve.



Source: MPOB, Bloomberg, OCBC Bank

Sustained low oil prices: The low oil prices seen of late have also contributed to weak palm oil prices. Aside from palm oil being the world's most consumed cooking oil, the red oil is also a key input product to produce biodiesel. However, with the falling oil prices over the last years, gasoline prices have fallen starkly in tandem and left the rather expensive alternative biodiesel on the shelf. According to the Malaysian Biodiesel Association, biodiesel plants in Malaysia had been unable to make profits given the low oil price, and utilisation capacity is merely under 25%. Statistically, gasoil futures are already 31% cheaper compared to unrefined palm oil, thus making CPO as a biodiesel not only expensive, but also enormously unviable. Globally, we opine that biodiesel demand will likely taper into 2018, driven not only by the low oil prices, but also due to the recent withdrawal of the United States from the Paris Climate Accord, which in essence has the potential to limit the adoption of clean energy in the US while promoting coal and crude oil as key energy sources instead.

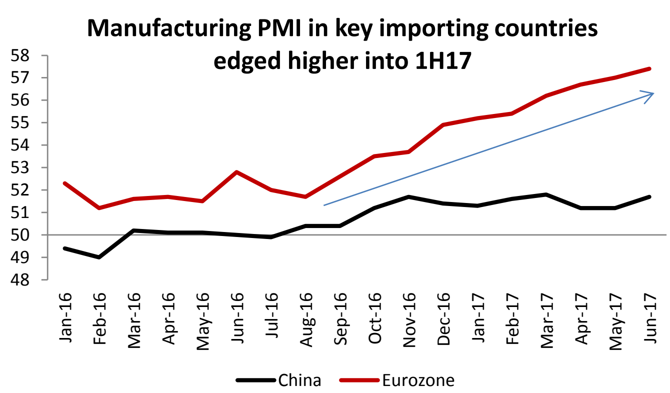


Source: Bloomberg, OCBC Bank

Healthy alternative oilseed supplies globally: Unfortunately for palm oil producers, the relatively healthier outlook for alternative oilseed production globally may continue to weigh on overall oilseed prices. According to the United States Department of Agriculture (USDA), global oilseed production grew into 2016/7, underpinned by higher soybean production in Brazil and Argentina, which rose global stocks by 3.1 million tons to 93.2 million over the same period. Into 2017/8, the USDA continues to expect higher global production and stock build-up for global oilseeds – cottonseed and sunflowerseed production is expected to gain further, though rapeseed production may decline on lower projected yields in Germany given the dry & sub-freezing seasons into the year. Soybean crop, a key substitute to palm oil, is projected to grow higher given strong yields in recently harvested areas particularly in Rio Grande, Brazil.[1]

Given the above-mentioned factors that will likely drag palm oil futures lower into the year, we downgrade our Crude Palm Oil price outlook to MYR2,250/MT at year-end. More importantly, prices are set to decline further from now on, as indicated by the leading indicators especially seen from the Oceanic Nino Index.

Base Metals: The base metal complex gained broadly from the last week, especially seen in Nickel (+2.8%) and Copper (+2.0%)[2]. In a nutshell, the gains are likely driven by three key reasons: (1) continued strength in China's manufacturing purchasing managers' index (PMI), (2) sustained mine strikes in Indonesia and Chile and (3) severe weather striking the South American mines.

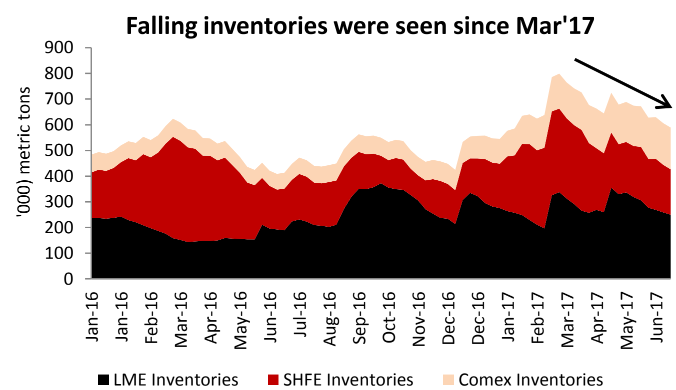


Source: Bloomberg, OCBC Bank

The uptick in China's manufacturing PMI for June likely supported the recent copper rally. The manufacturing print for the 2nd largest economy, and the largest copper consumer in the world continued to show signs of manufacturing strength seen from its PMI print of 51.7 in June (vs market estimate of 51.0). In addition, manufacturing PMI for the Eurozone, which accounts for around 16% of global copper consumption, rose to its highest print (57.4) since last available data in 2011.

On a supply front, production concerns arising from mine strikes and severe weather conditions likely supported the bullish copper trend in June. For one, the 2nd largest mine in the world, Grasberg from Indonesia, laid off 3,000 workers (10% of the mine's total workforce) in early June following the strike that began in May. Even though Freeport officials declared that the mine is still running as normal, Freeport Industrial Union has indicated that 6,000 workers still remains on strike. Furthermore, it is important to note that Freeport officials have yet to successfully negotiate a deal with the Indonesian government, exacerbated by an expiry of its export permit into February 2018.

Elsewhere, snow, heavy rain and strong winds hit northern Chile's Atacama Desert in early to mid-June, slowing or even halting mining operations temporarily. Some of the major mines that were affected includes, the world's largest copper mine (Escondida), Chuquicamata, and Zaldivar. To add on, the Chilean mining company, Antofagasta, reported that two of its mines, Zaldivar and Centinela, could potentially enter 2H17 with strikes. Workers have already voted to strike, but expects government mediation to extend negotiations for a few more days. Collectively, both mines have an annual production of 160,000 tonnes of copper. In a nutshell, the higher copper demand seen of late, coupled with falling copper production given the above-mentioned reasons left global inventories lower into 2Q17.



Source: Bloomberg, OCBC Bank

All-in-all, copper prices have rallied substantially since Dec 2016, underpinned by rosier global economic environment and robust Chinese demand. However, the

[1] United States Department of Agriculture, *"World Agricultural Supply and Demand Estimates"*, 9th June 2017.
[2] Kindly refer to the summary table on the first page

higher copper prices are also driven by the ongoing supply constraints, in which some immediate downside risk may prevail should a quick resolution to the mine strikes be achieved. In short, we opine that copper prices are elevated at current prices and may stage a correction to our revised outlook of $5,500/MT (previously $5,250/MT) at year-end.