Commodities Outlook 4Q18
More questions than answers

Barnabas Gan

Economist

Global Treasury Research & Strategy

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OCBC Bank

Oil: Fundamentals does not support higher prices

- **The rally in energy prices continued into end 3Q18,** given potential supply shocks emanating especially from Iranian sanctions amid OPEC's reluctance to lift production in response. Moreover, Saudi Arabia's rhetoric to stay "content" should prices at $80/bbl or higher could have given investors a price target.
- **Fundamentals however are painting a different environment**: OPEC's oil production since May 2018 when Iranian sanctions were announced were decisively higher, with higher supplies seen from Saudi Arabia, Russia and Iraq. The upside in oil production have in fact outweighed the lower production seen in Iran and Venezuela.
- **Demand trend from oil importing economies were also slower in the first seven-eight months of 2018.** This suggest that the rosy economic environment seen in 2017 has somewhat dissipated into 2018. Downside risks to economic growth remains to be US-Sino trade tension, Brexit risks into March 2019, and the ongoing flattening yield curve in the USTs.
- **Incoming oil inventory data is a mixed-bag:** US crude oil inventories tuned below its 5-year average to its lowest since Feb 2015 even as production climbed into Sept 2018. However, floating oil inventories continue to sideline into 2018.
- **Outlook remains bearish for now:** Global oil production remains flushed given OPEC's pledge to pump an extra 1 million barrels a day of crude oil to fill production shortfall created by the economic issues in Venezuela and sanctions against Iran. WTI and Brent f/c at $70/bbl and $80/bbl, respectively.

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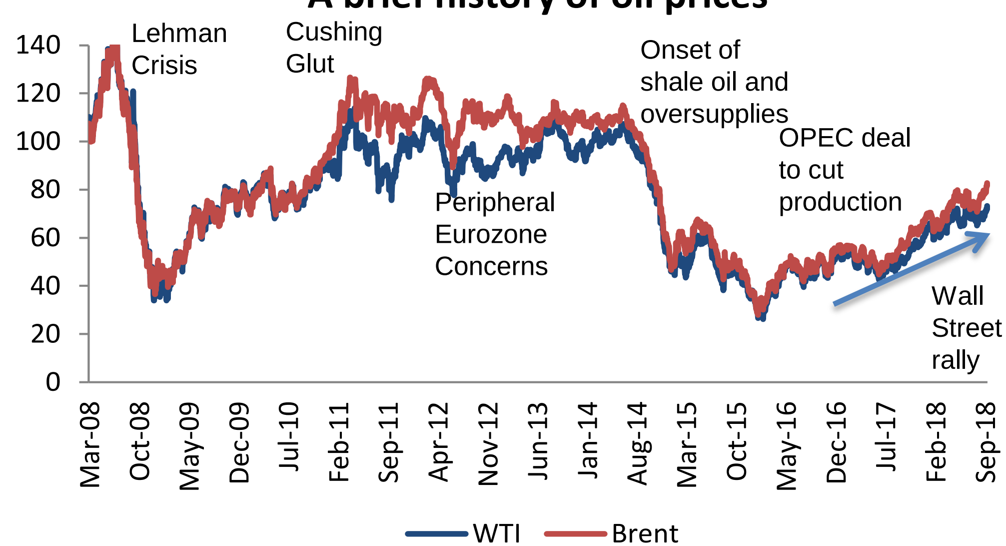
Imperative to pinpoint the right drivers

- **Street talks over further oil supply shortfall from Iranian shores** starting 1st November when US sanctions are effective amid further risk-taking appetite are key drivers that are lifting energy prices. Note that several Asian economies including South Korea, India and Japan have since ceased their Iranian oil imports to-date.
- **The drivers in question have clear implications for crude oil's fundamentals.** Iran's crude oil production accounts for roughly 12% of total OPEC oil production, and is the third largest producer in the OPEC cartel. Since the US decision to place Iran under sanctions in May 2018, Iranian crude oil production has fallen by 300,000 barrels per day (bpd) into August 2018. Compare this with Iran's fall in production by 1.3 million bpd back in 2010 – 2013 during the previous US-led sanctions may lead one to believe that further production shortfalls can be expected into 2019.
- **Higher oil prices may also be attributed to stronger risk-taking.** US stocks across the key indices have rallied into 10M18, with DJIA, S&P and Nasdaq touching its record highs. US-centric economic prints remain rosy to-date amid central bank rhetoric seen in the past week.

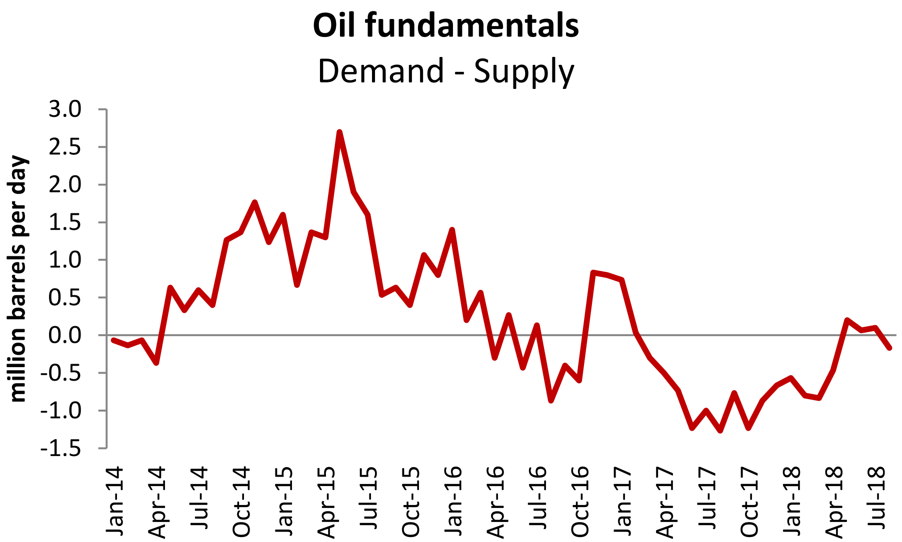
A brief history of oil prices

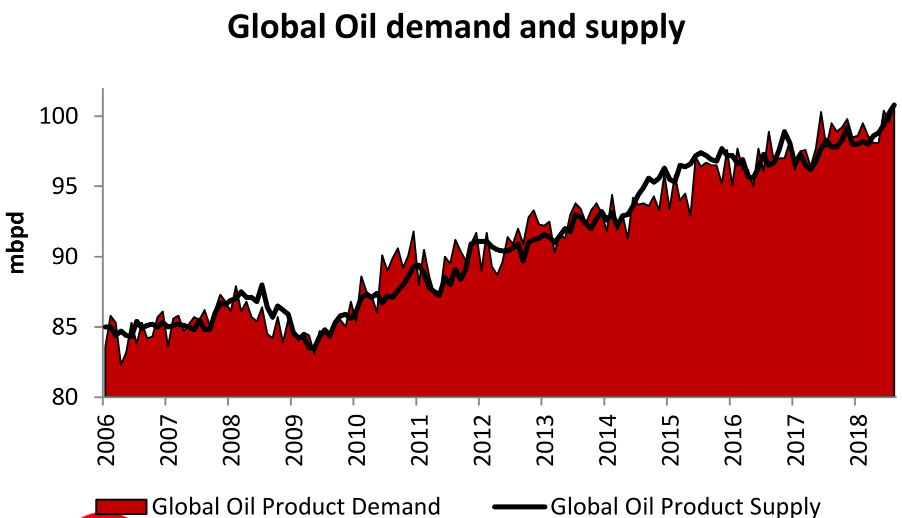


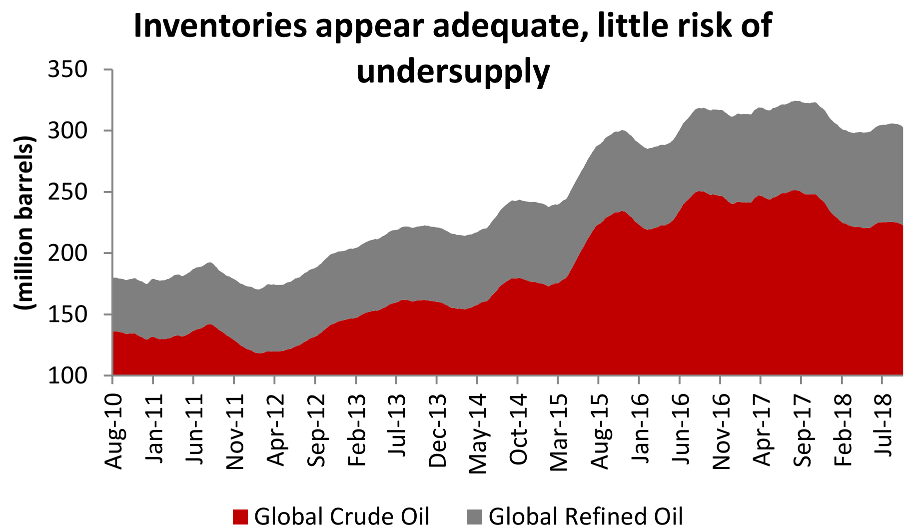
Source: CEIC, Bloomberg, OCBC Bank

The truth about fundamentals

- **Crude oil fundamentals have so far been roughly balanced,** while global supply growth outpacing demand for six consecutive months into August 2018.
- **Supply glut in 2014 has narrowed substantially** into a mild under-supply scenario in the 12 months leading to April 2018 before a balance seen to-date.
- **Global inventories did fall marginally** in 1H18 given supply shortage, though stocks are expected to stabilise into 2019



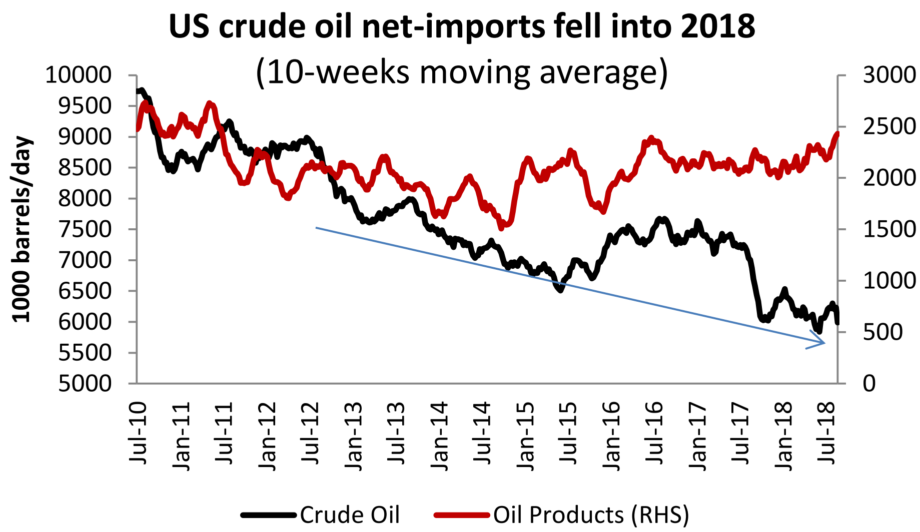


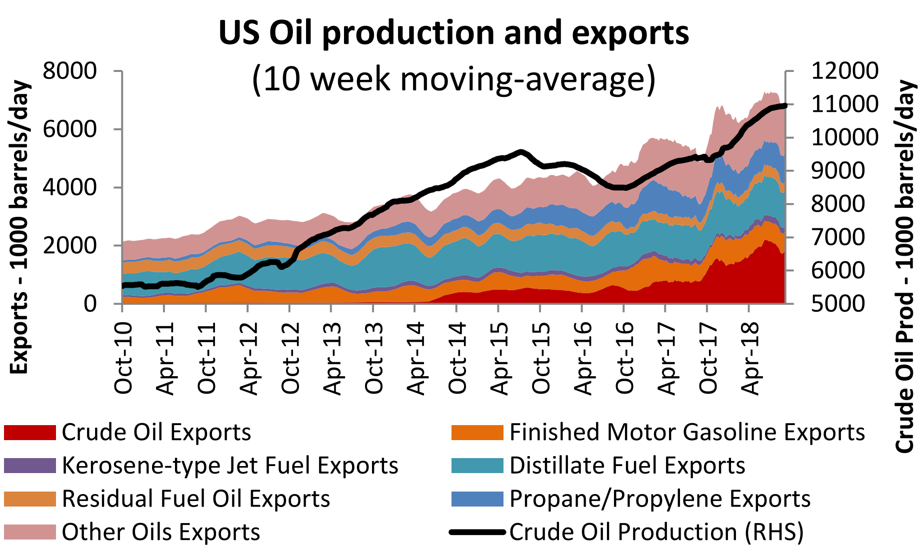


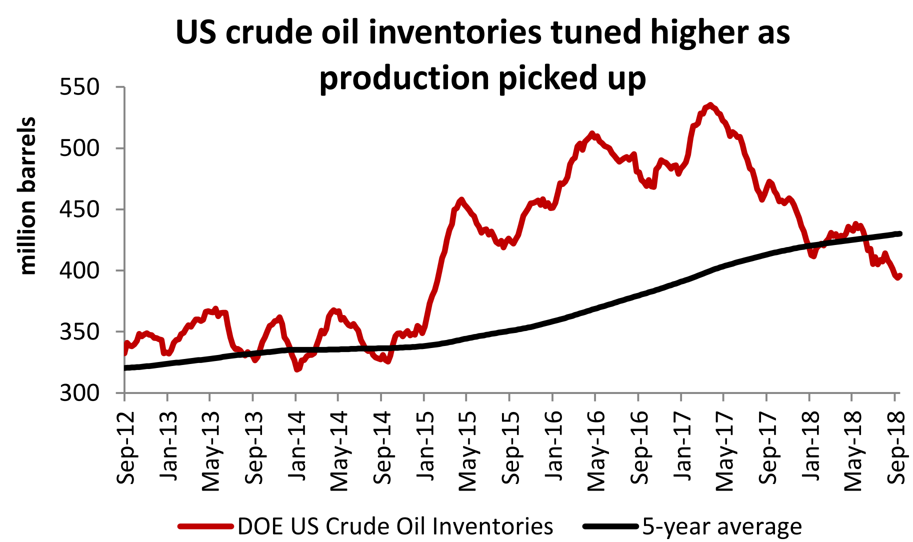
OCBC Bank Source: CEIC, Bloomberg, OCBC Bank

The misnomer on falling US inventories

- **On the surface, US crude oil inventories fell below its 5-year moving average,** and is at its lowest since early 2015.
- **Delving into the details,** note that crude oil exports has increased into 8M18, leading net-imports to its record low over the 10-week moving average since data was made transparent since July 2010.
- **Note that refinery utilization rates** hit its 1997 high of 98.1% in August 2018





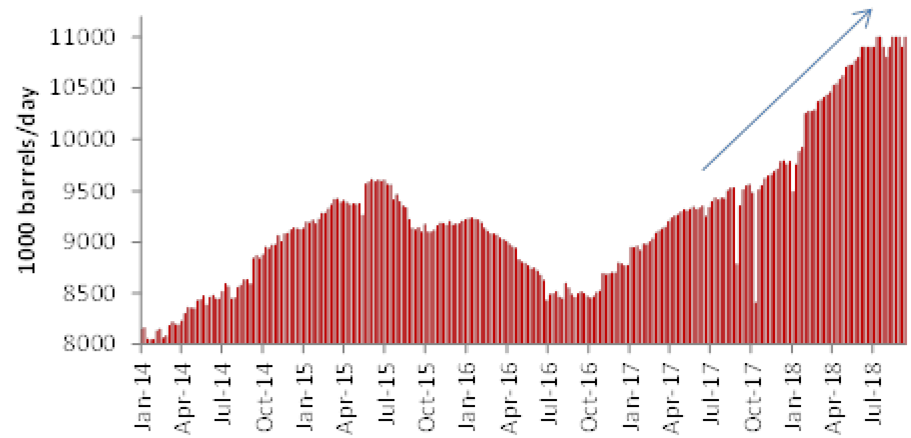


OCBC Bank Source: CEIC, Bloomberg, OCBC Bank

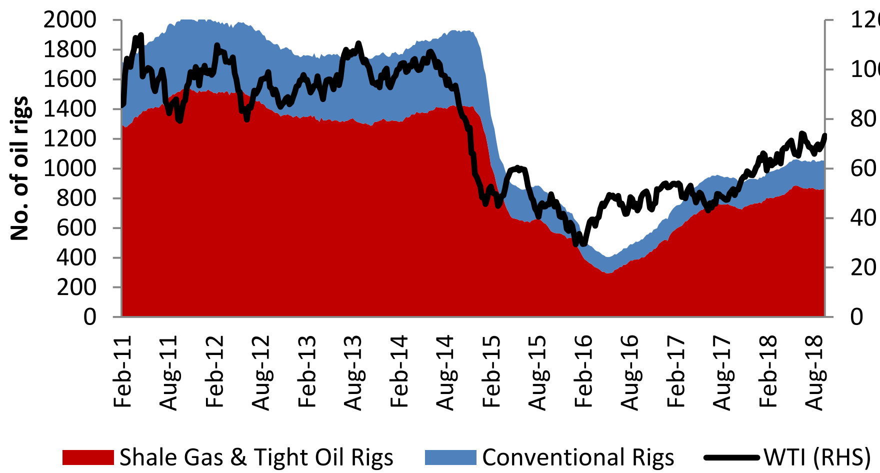
US supplies to climb into 2019

- **There remains upside risk in US shale oil production** and overall strong US oil supplies at 11.0 million bpd (highest on record) as of Sept 2018 and will average 11.5 million bpd into 2019 according to EIA's estimate will surely inject further upside supply risks.
- **Note US oil production surpassed Saudi Arabia**, and is the second largest oil producer globally.

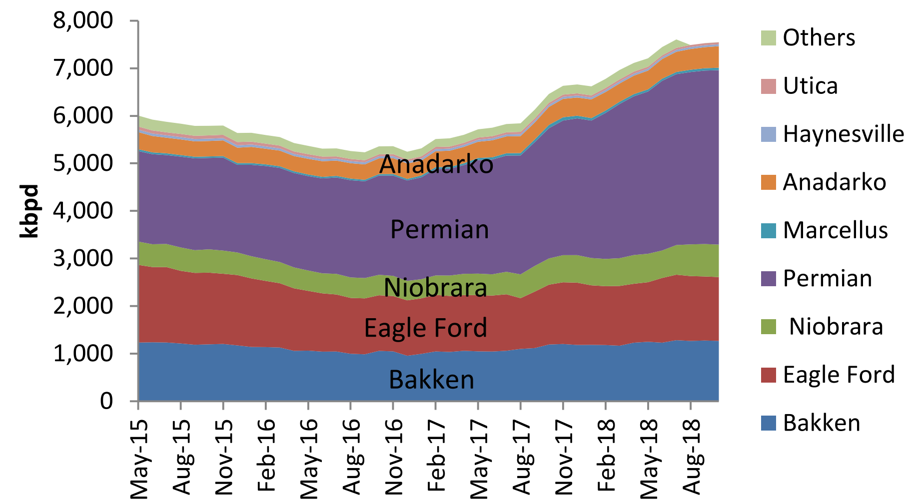
Watch out for higher US-led oil production to near 12 million bpd!



US oil rig count climbs into 2018

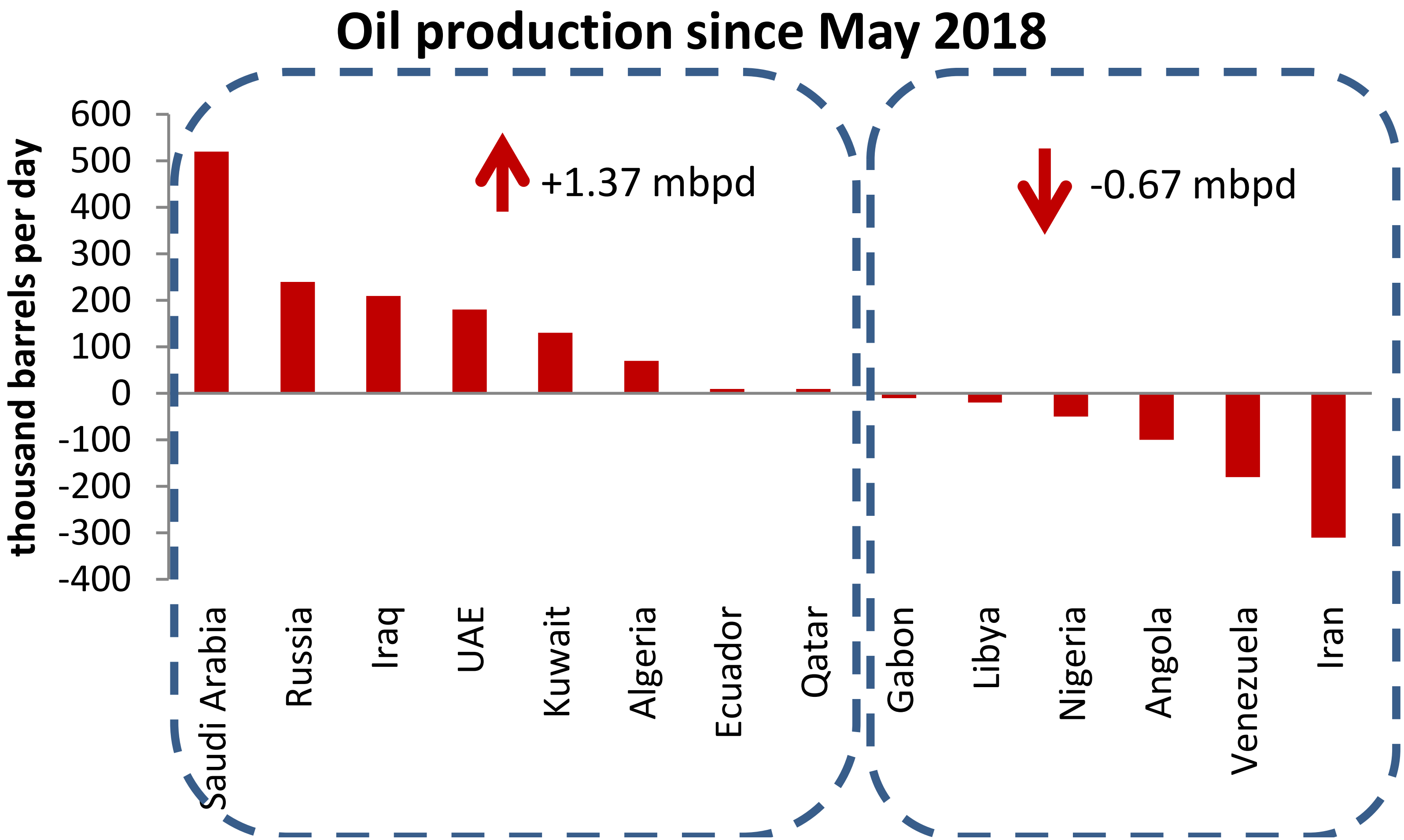


US Shale Oil Production



OCBC Bank Source: CEIC, Bloomberg, OCBC Bank

OPEC's recent production gains since May 2018 has effectively offset Iranian's oil shortage

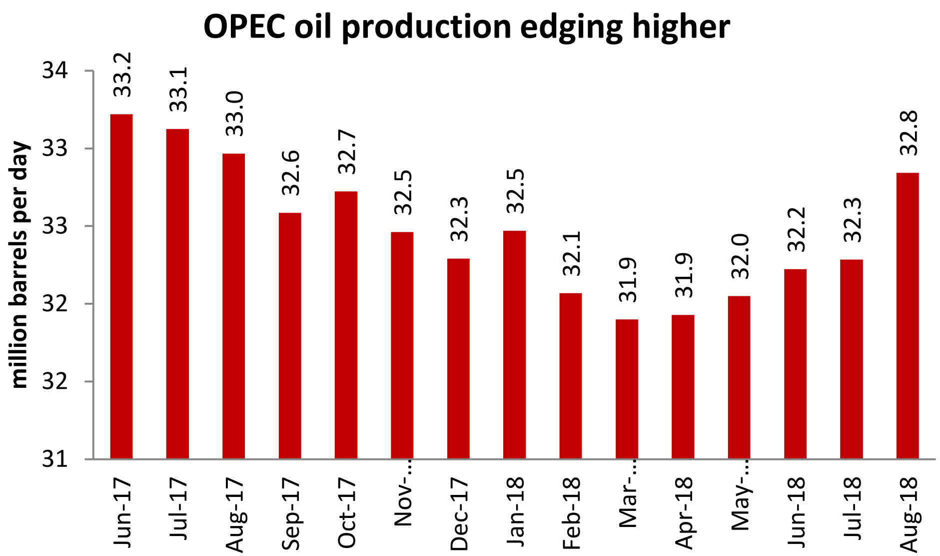


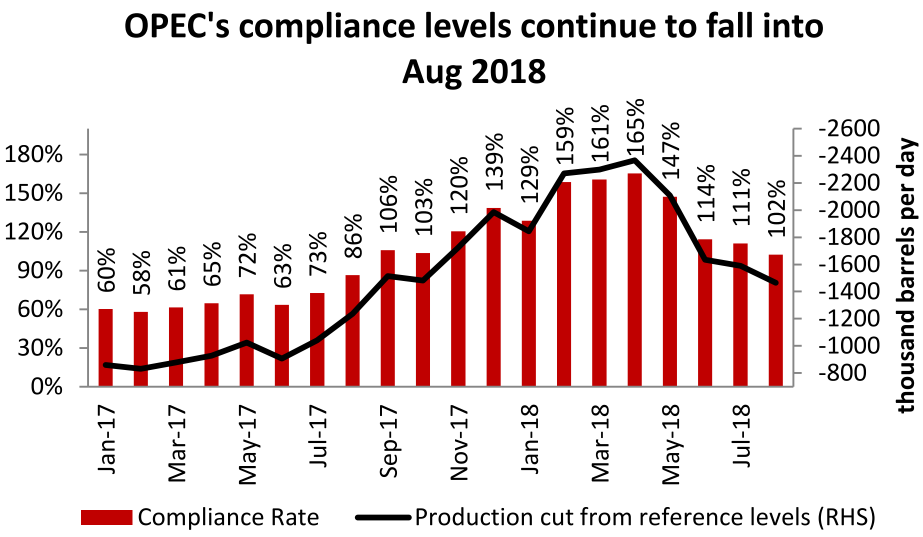
OCBC Bank Source: CEIC, Bloomberg, OCBC Bank

Will OPEC continue to flex its muscles? Maybe!

Brent %chg

- The OPEC cartel and its production adjustments since 2017 have been guiding oil prices. Back in January 2017, the cartel decided to reduce its production by around 1.2 million barrels per day to 32.5 million barrels. **+77.2%**
- In June 2018, OPEC cited its decision to increase oil production to bring compliance back to 100%. **-10.9%**
- In Sept 2018, OPEC commented that the crude oil market is well supplied and there is no more need for further production increase. **+6.8%**

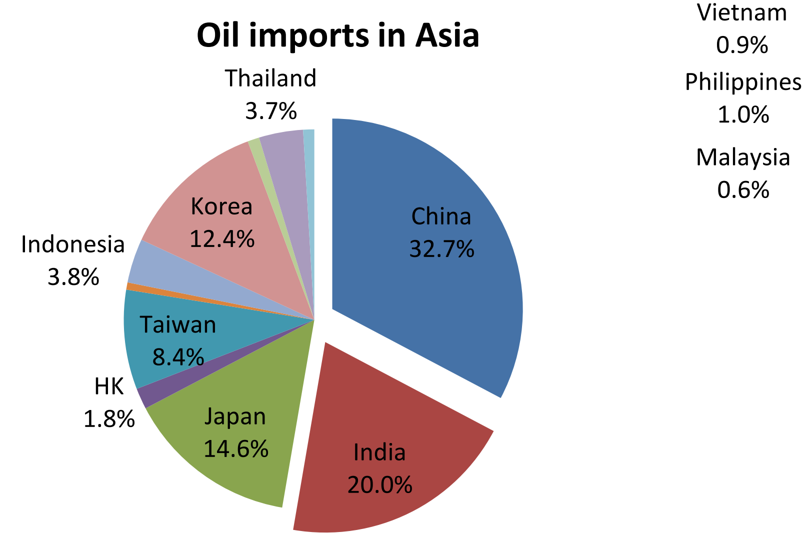


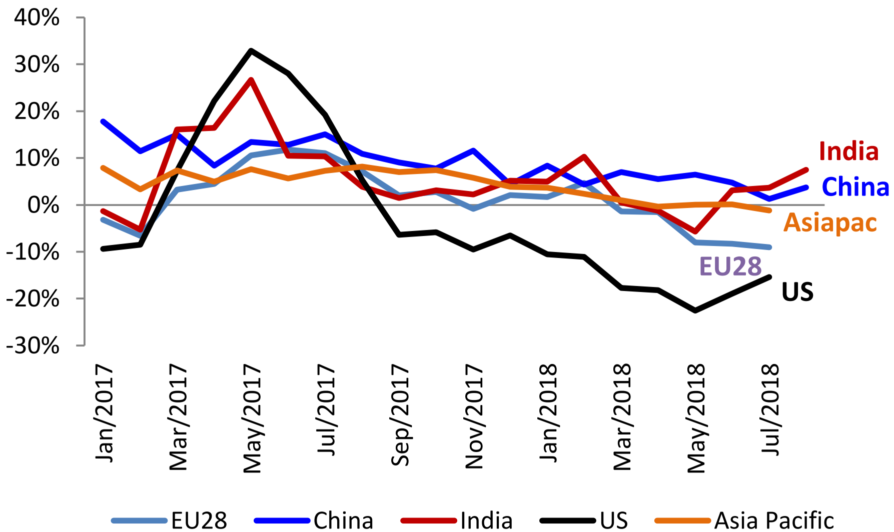


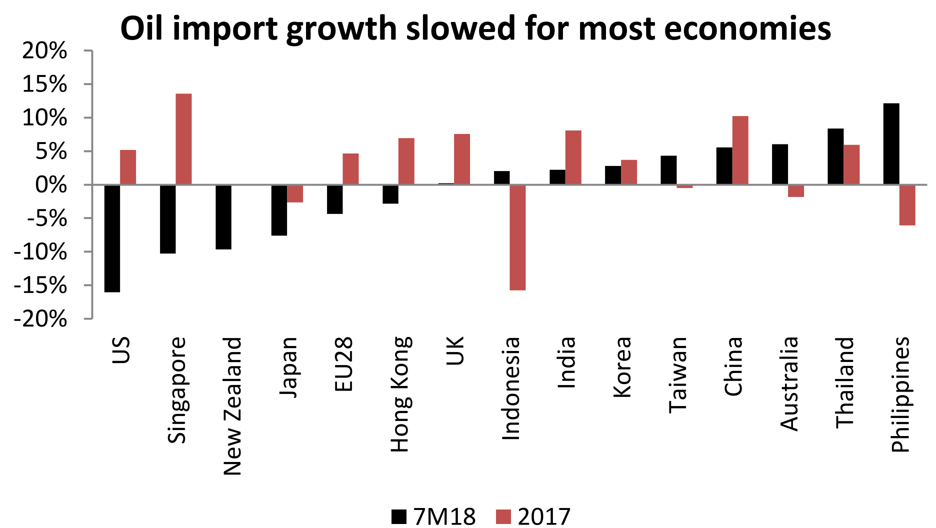
OCBC Bank Source: CEIC, Bloomberg, OCBC Bank

Demand story: Not so supportive so far

- **The flipside of the coin yields a rather lackluster import pace since early 2018.** While global oil imports (led especially by the US and Asia) rose rapidly into most of 2017, it did serve as a high base into 2018.
- **More importantly, import growth seen in US, EU28 and Asia-Pacific effectively contracted into the first seven months of 2018,** while imports led by India and China rose over the same period.







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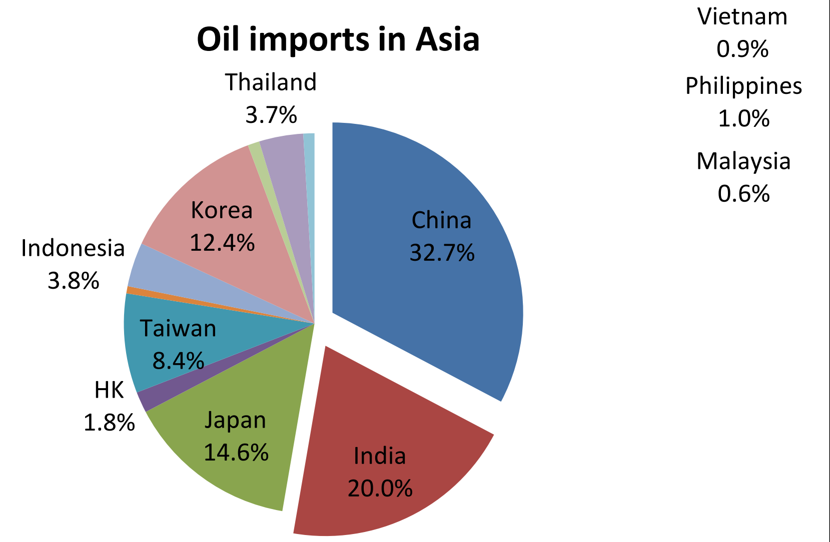
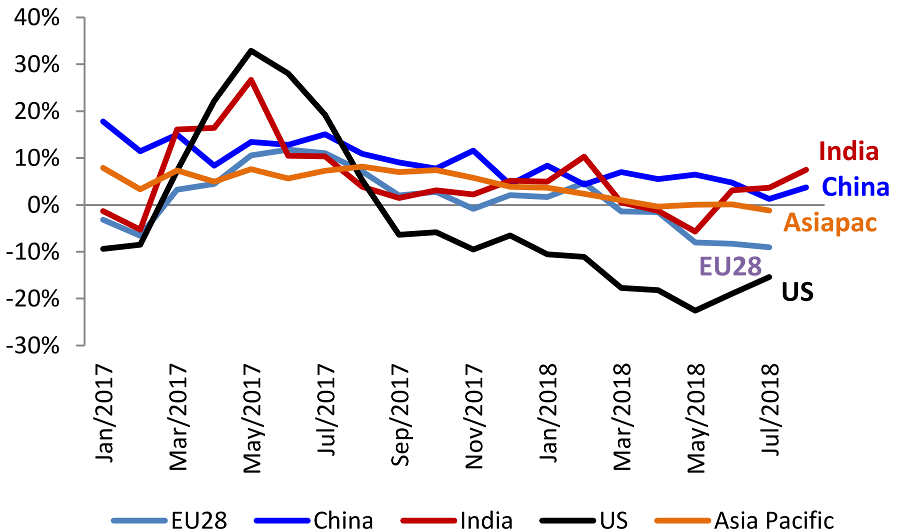
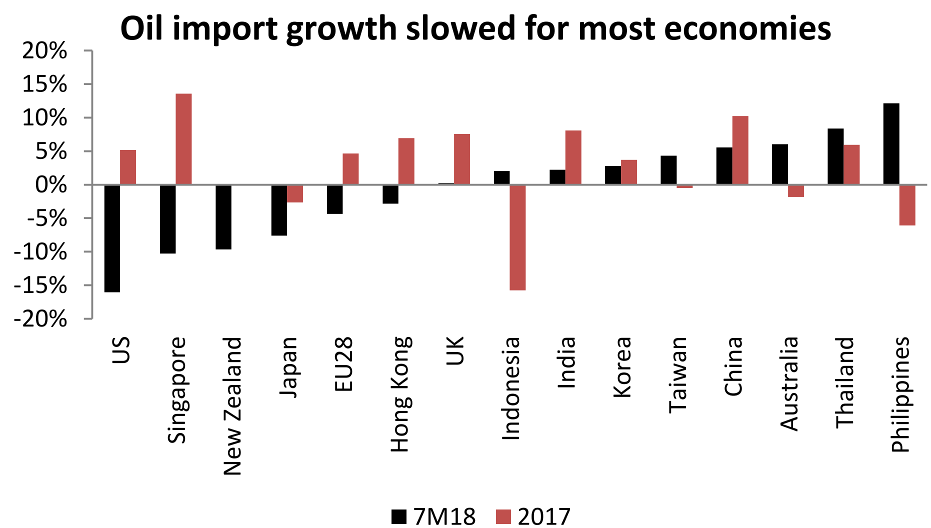
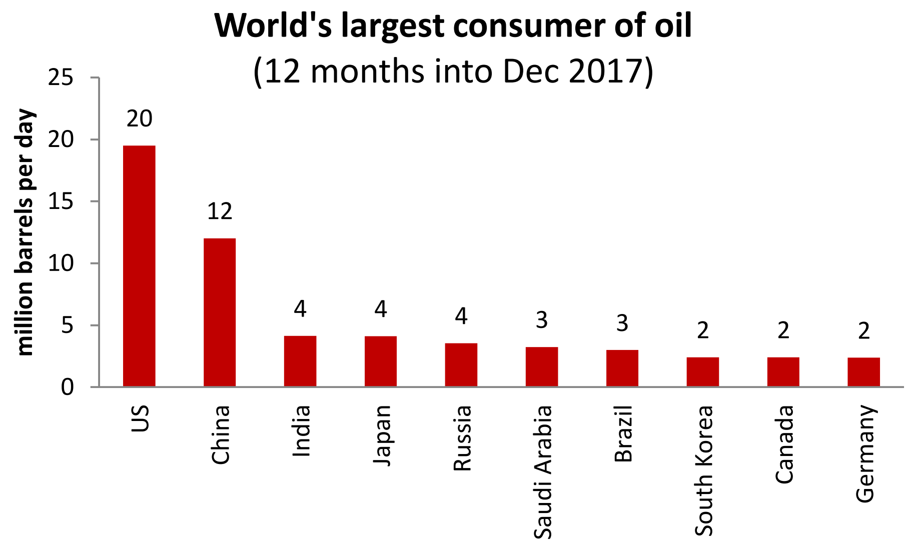


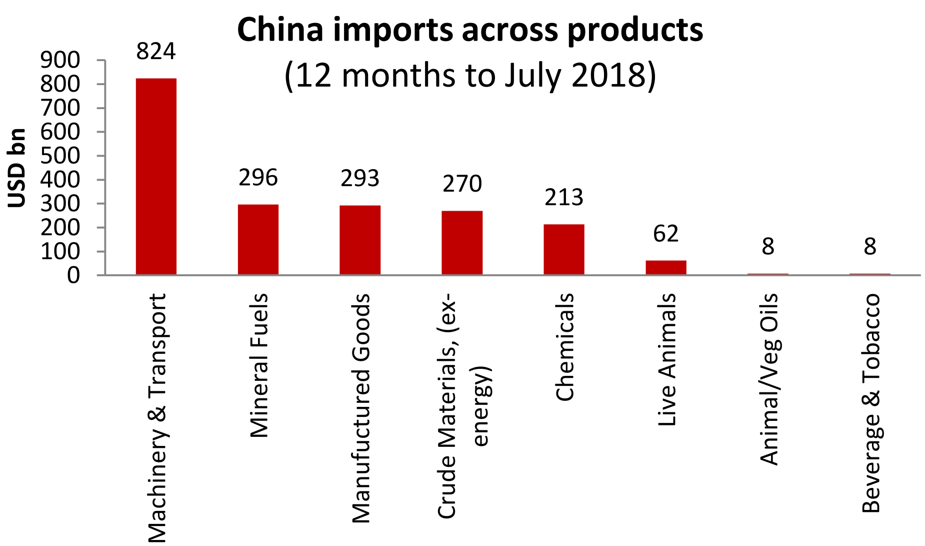




Further escalation of US-Sino trade tension to drag oil demand lower

- **US and China are the world's largest consumer of oil,** and accounted for 1/3 of total consumption in 2017.
- **Crude oil remains to be a growth-related commodity**, which in turn could see declines in import and consumption from the largest two consumers should the trade war drags into 2019.





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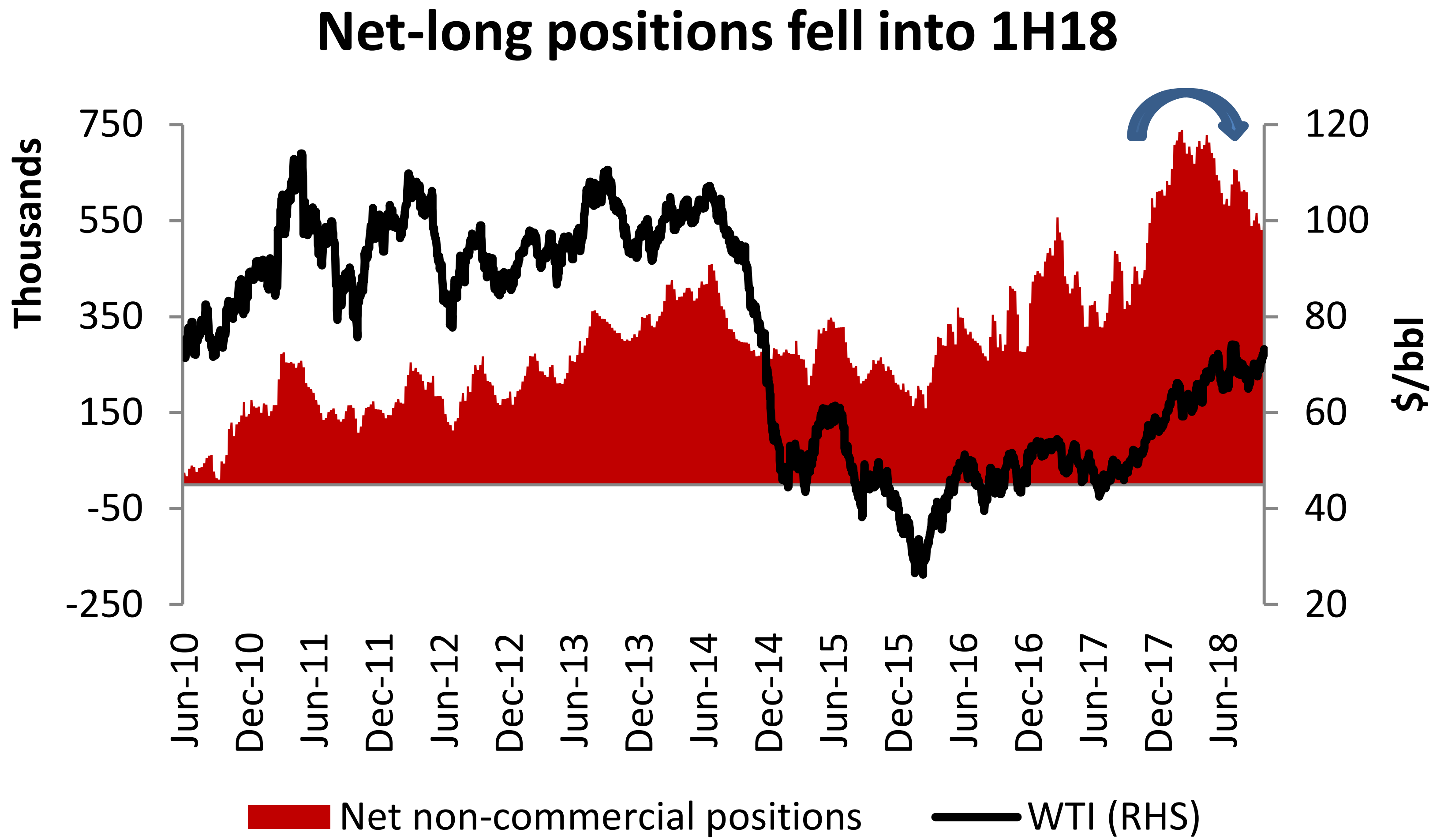
Source: EIA, CEIC, Bloomberg, OCBC Bank
Oil includes crude oil, all other petroleum liquids, and biofuels.

Investors' confidence to lead prices henceforth?

CFTC net-positions continue to point south to-date

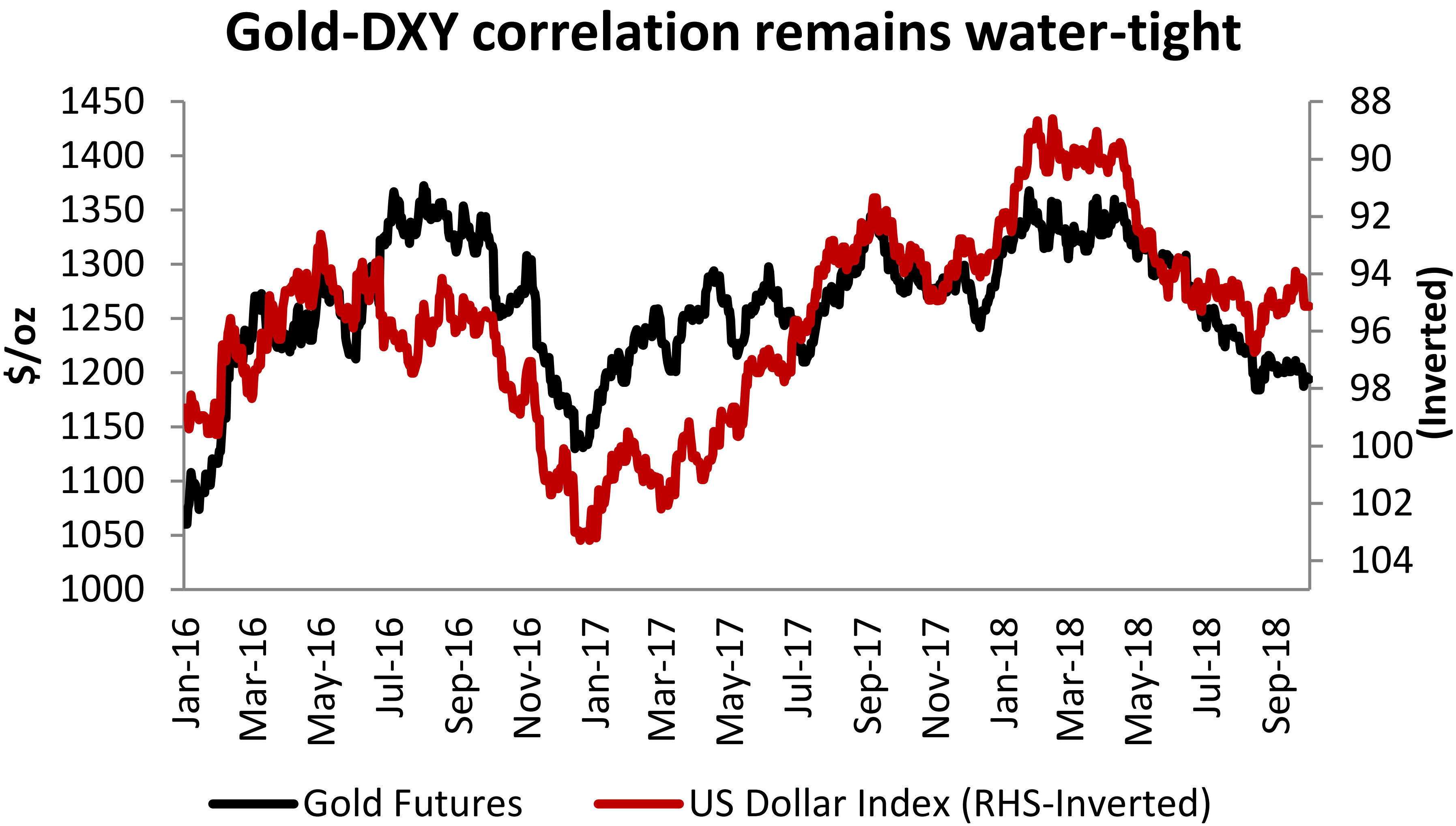


OCBC Bank Source: CEIC, Bloomberg, OCBC Bank

Gold: Slaved to the dollar

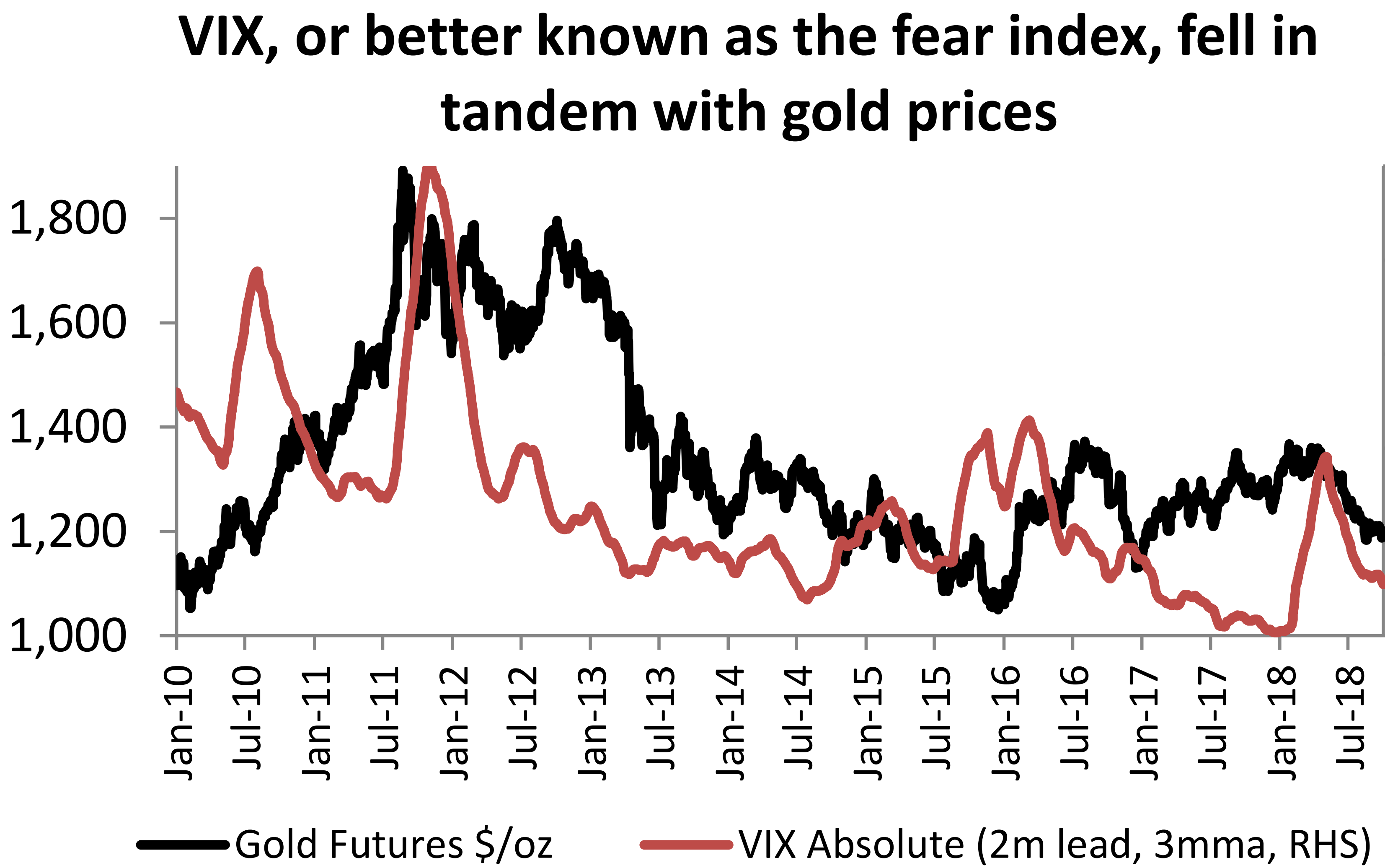
- **To understand gold, one must understand its characteristic.** Traditionally, gold is perceived to be a safe haven against uncertainty. It is also an hedge against currency movements and inflation. As such, gold prices are usually higher during times of economic stress, and/or during surging inflation environments.
- **Gold is also a quasi-FX asset, meaning that it fluctuates in relation to dollar movements.** With the dollar rallying over 9.0% in 2018, gold declined over 14% in response. VIX movements since March 2018 has also correlated with gold movements, suggesting that risk-taking dragged gold prices as well.
- **ETF holdings are also an important parameter to gauge gold demand.** Paper gold demand, in the form of ETF holdings, has been declining in tandem with lower prices. Elsewhere, physical demand in India and China declined into the first seven-eight months of 2018 as well, reinforcing the decline in gold prices.
- **A dichotomy can be seen however between UST yields and gold prices**, suggesting some market imbalance in the horizon. Notably, the flattening yield curve, usually a sign of market stress, is not accompanied by higher gold prices at this juncture.
- **The economic backdrop into 2019 amid dollar movement then will be key determinants for gold.** To-date, while fundamentals stay relatively supportive, further intensification of the US-Sino trade tensions, flattening yield curve and Brexit risks could bring gold higher into the next year.

Where dollar go, gold goes



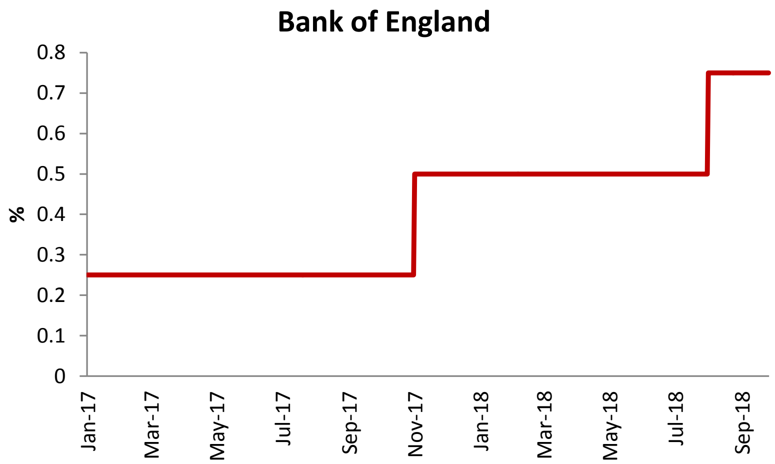
Source: CEIC, Bloomberg, OCBC Bank

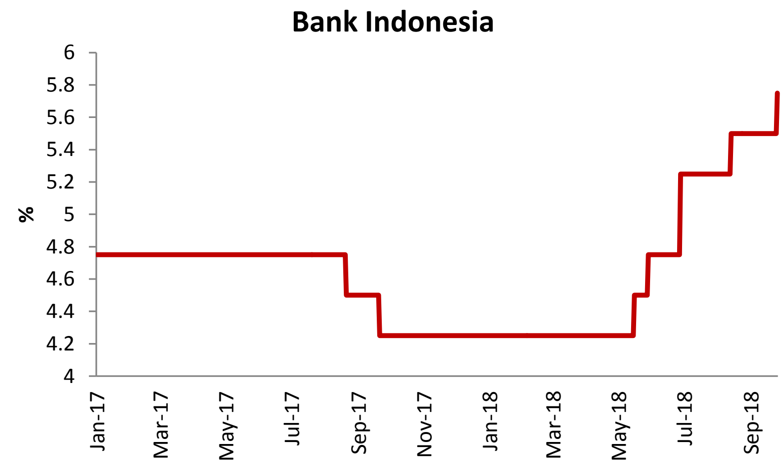
Risk-taking appetite dulls gold as an investment

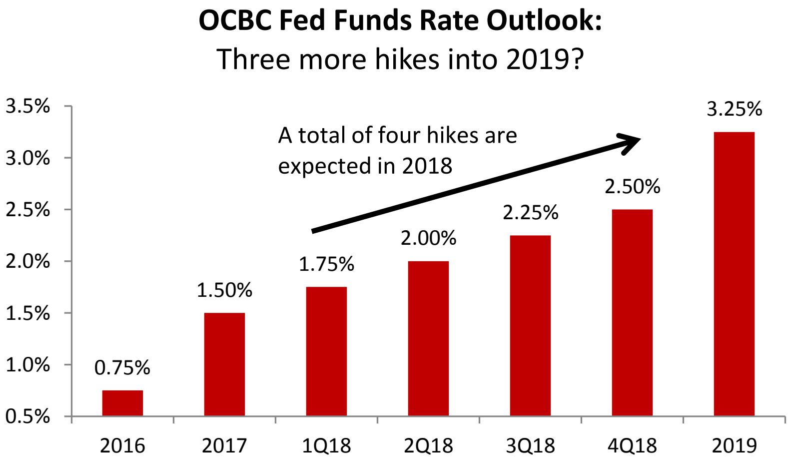


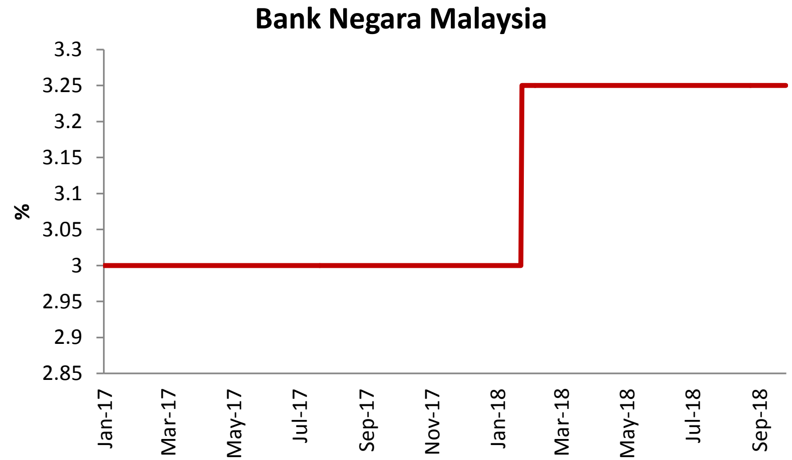
OCBC Bank Source: CEIC, Bloomberg, OCBC Bank

Rate hikes can drag gold lower given the yellow metal's zero-interest yielding characteristic



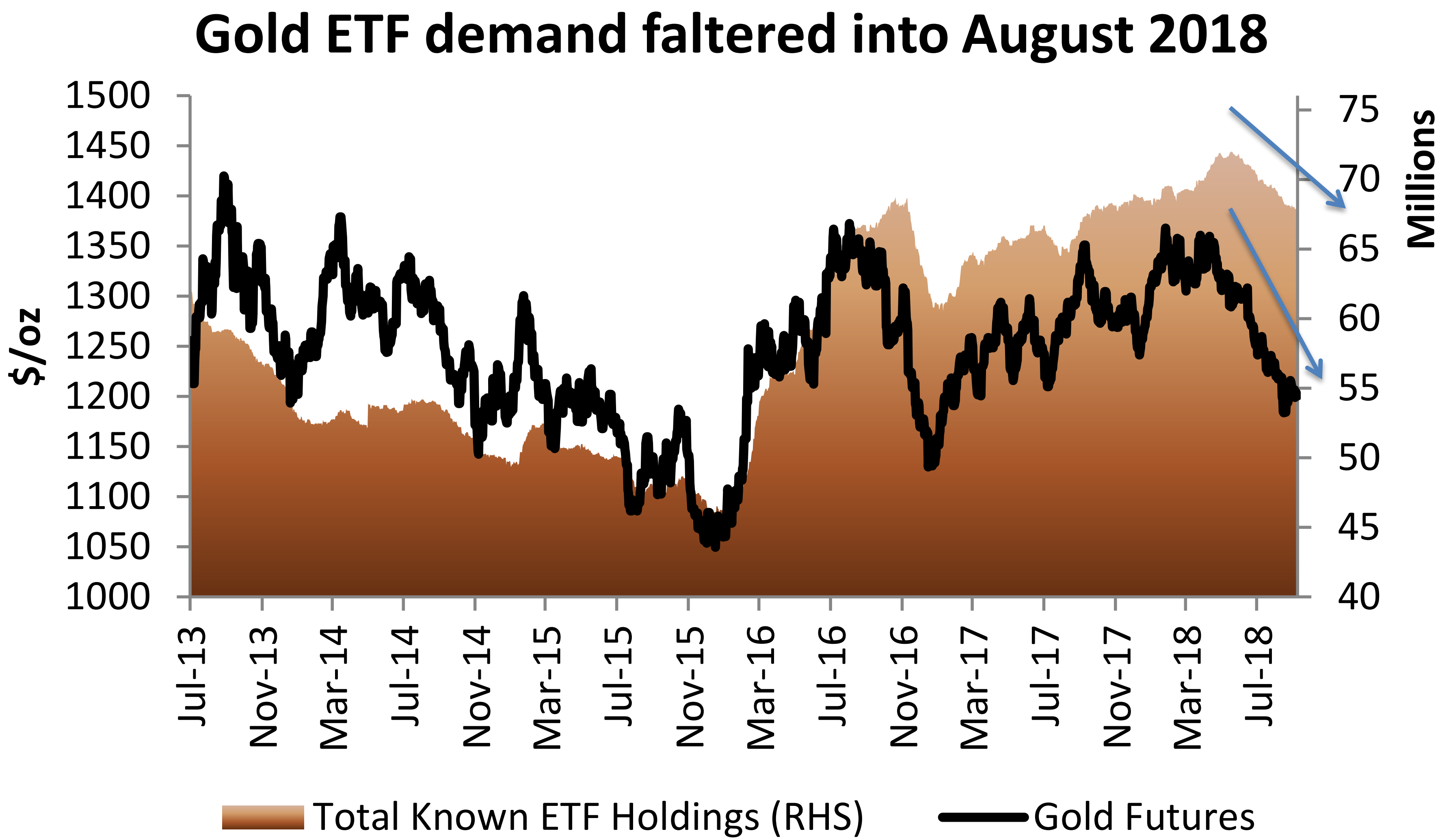






Source: CEIC, Bloomberg, OCBC Bank

No surprise that paper gold demand faded



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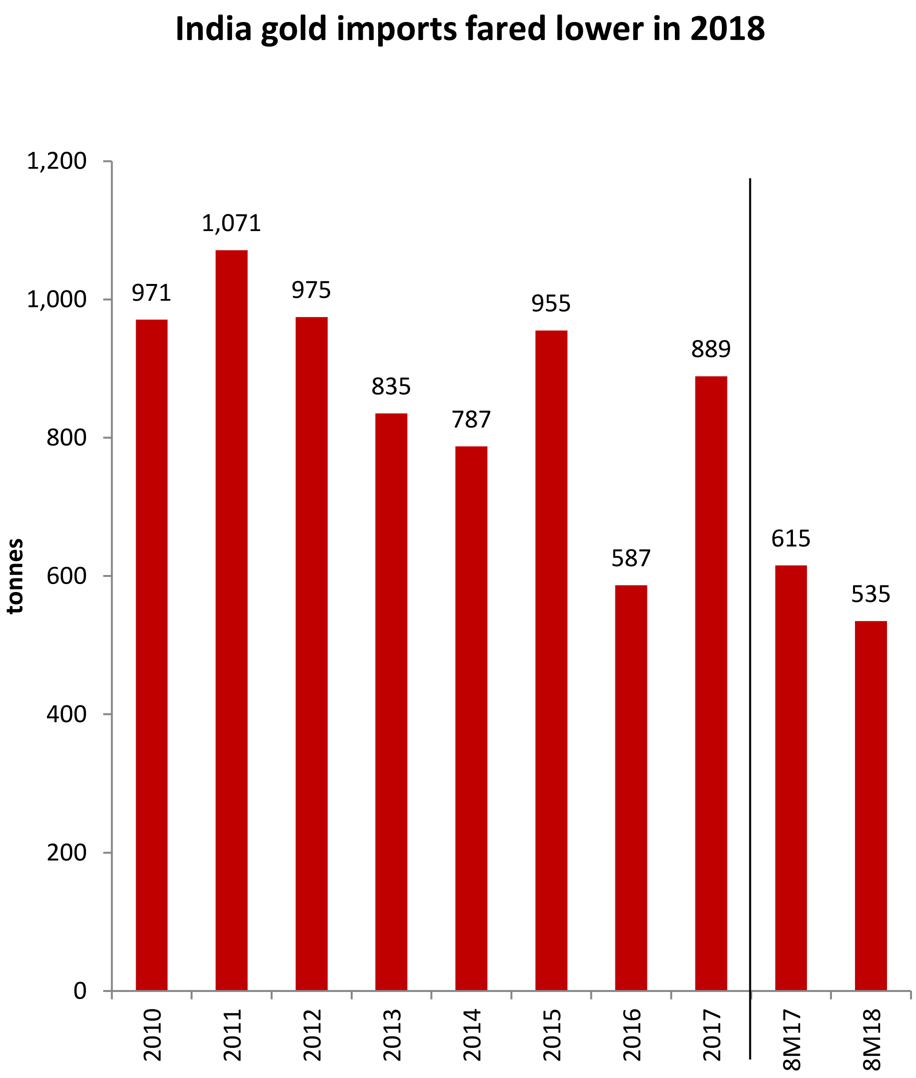
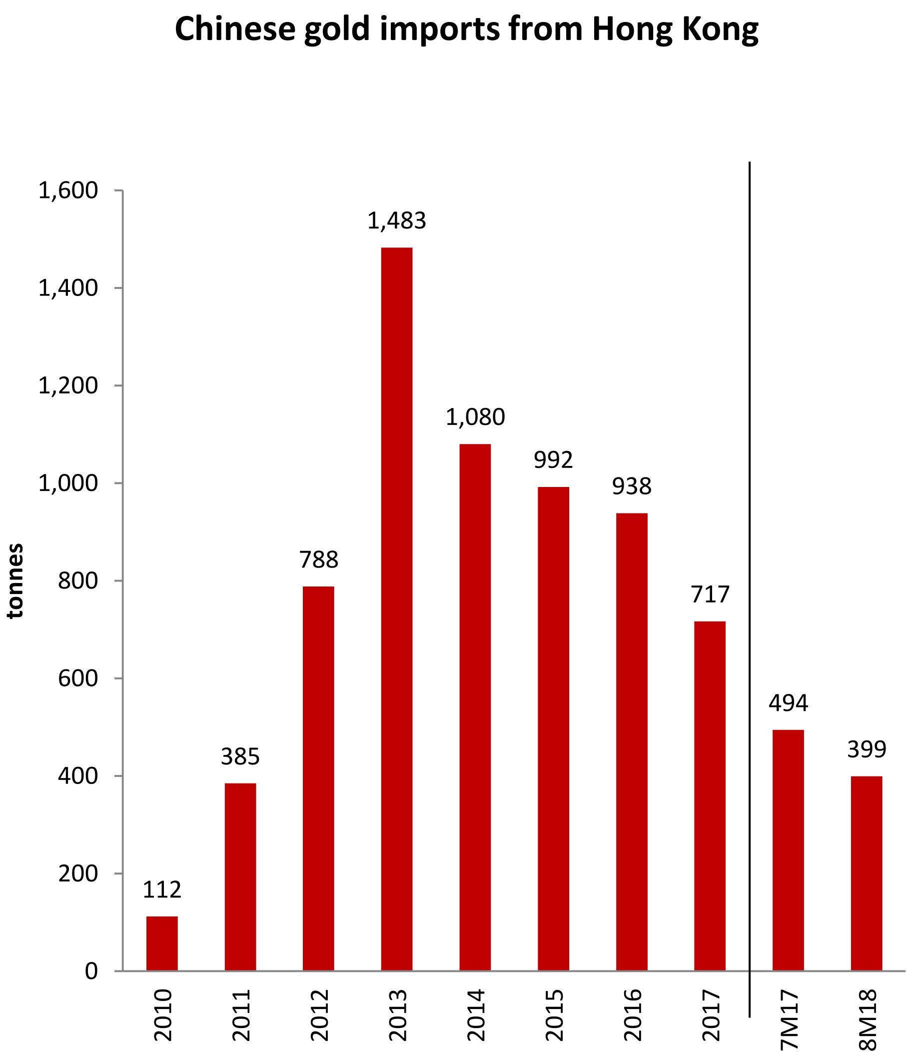
Source: CEIC, Bloomberg, OCBC Bank

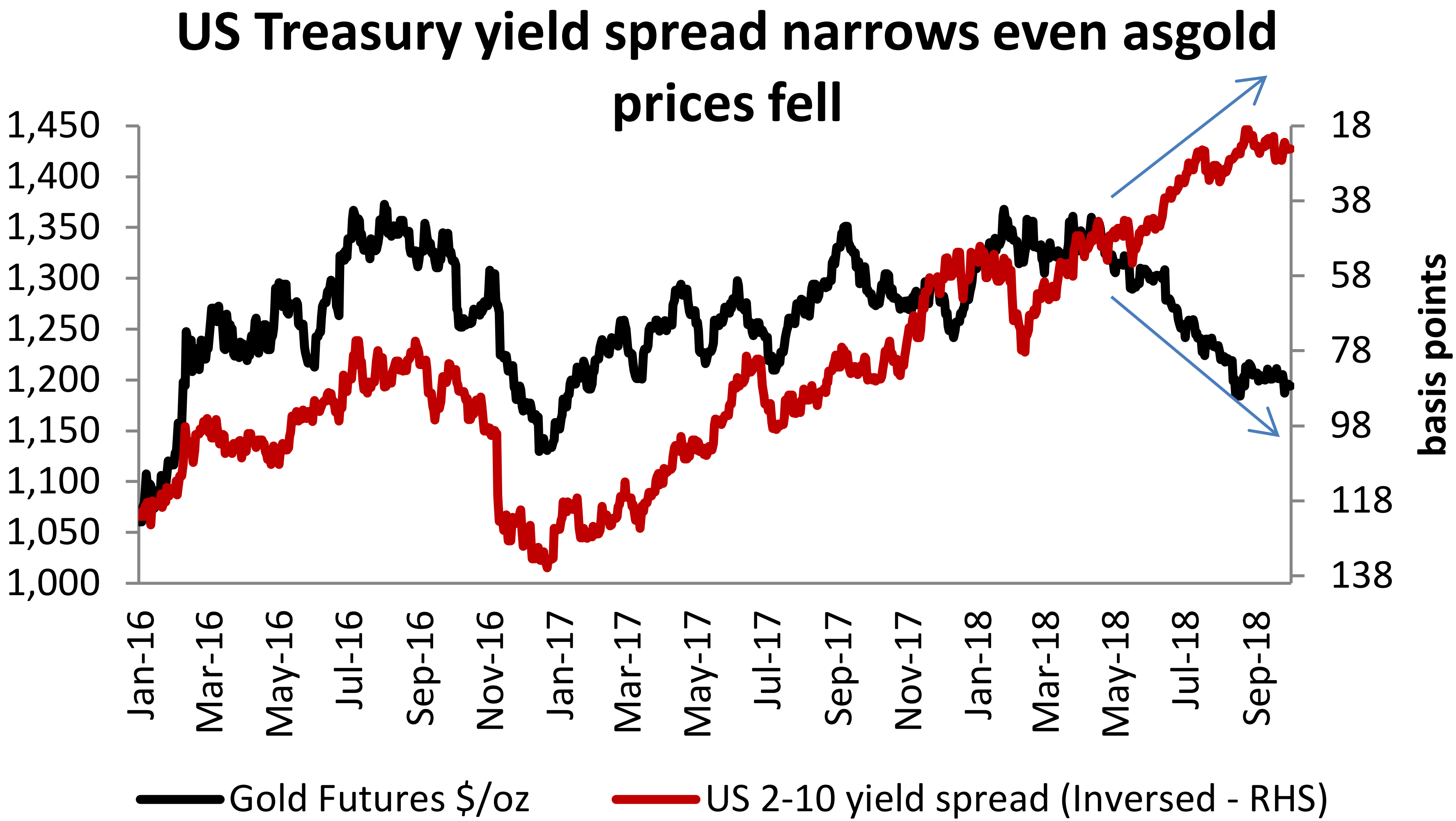
Physical demand was weak as well





Source: CEIC, Bloomberg, OCBC Bank

Caveat? Rise in safe haven demand!

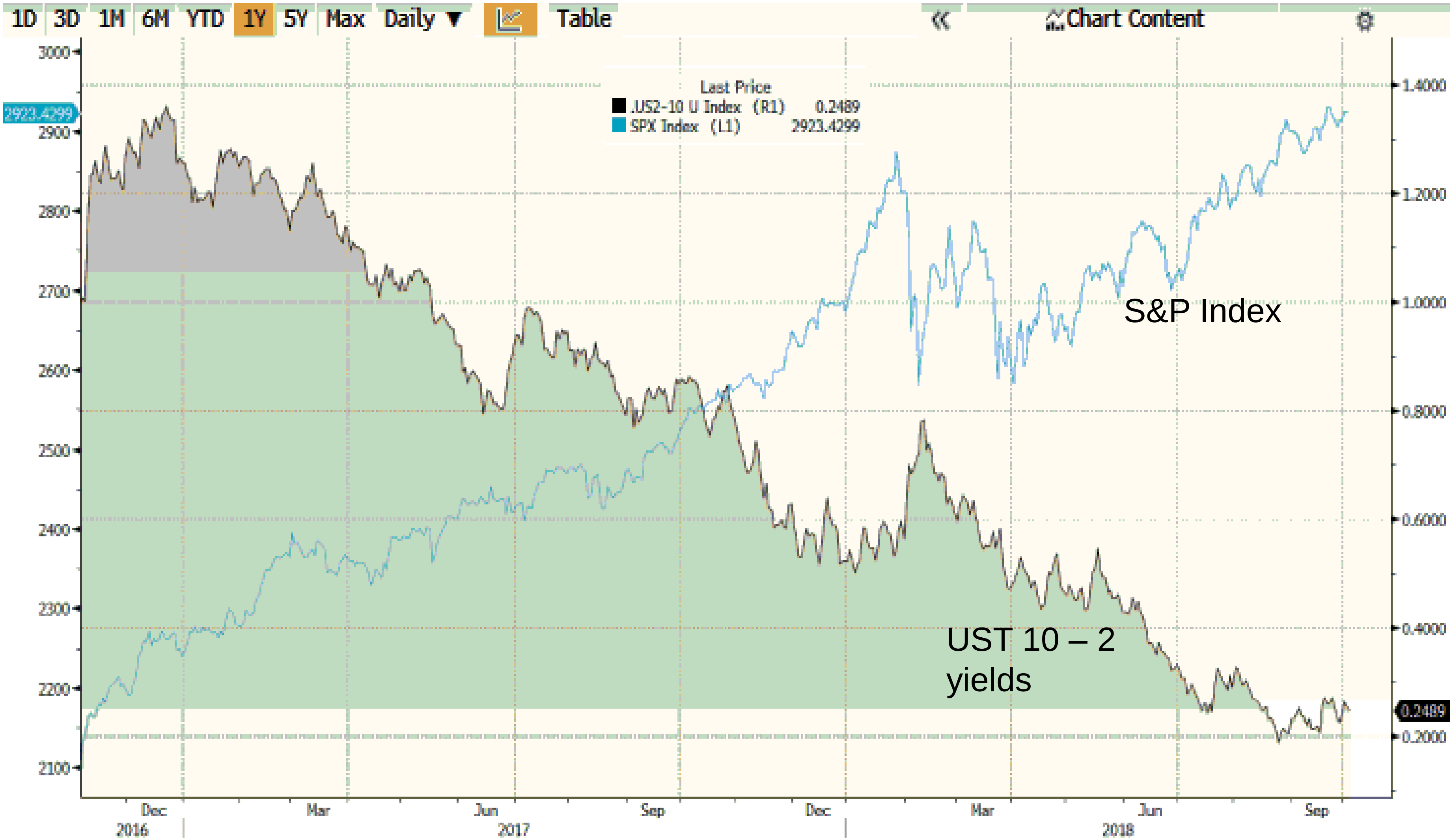


Source: CEIC, Bloomberg, OCBC Bank

Caveat? Rise in safe haven demand!

OCBC Bank Source: Bloomberg

The picture now…



OCBC Bank Source: Bloomberg

OCBC Commodity Forecast into 2019

Updated as of Oct 5, 2018			2018				2019			
	3y AVG	Spot	Q1	Q2	Q3	Q4F	Q1F	Q2F	Q3F	Q4F
Energy										
WTI ($/bbl)	47.1	75.2	62.9	67.9	69.4	70.0	68.8	67.5	66.3	65.0
Brent ($/bbl)	50.7	84.8	67.2	75.0	75.8	80.0	73.8	72.5	71.3	70.0
Gasoline ($/gallon)	1.53	2.13	1.86	2.11	2.06	2.12	2.14	2.19	2.09	1.98
Natural Gas ($/mmbtu)	2.68	3.17	2.85	2.83	2.87	3.20	3.19	2.96	3.02	2.97
Precious Metals										
Gold ($/oz)	1210.4	1,207	1,331	1,309	1,217	1,200	1,225	1,250	1,275	1,300
Silver ($/oz)	16.5	14.7	16.7	16.6	15.0	14.8	14.8	15.1	15.3	15.5
Platinum ($/oz)	994	834	981	907	815	805	825	809	813	812
Palladium ($/oz)	722	1,051	1,026	972	943	923	919	937	1,019	1,104
Base Metals										
Copper ($/MT)	5,523	6,280	6,997	6,998	6,999	6,500	6,375	6,250	6,125	6,000
Tin ($/MT)	17,764	18,960	21,151	20,912	19,326	18,571	18,236	17,762	16,917	16,458
Nickel ($/MT)	10,630	12,436	13,277	14,488	13,275	12,264	11,943	11,705	11,394	11,094
Zinc ($/MT)	2,265	2,665	3,390	3,104	2,520	2,321	2,352	2,275	2,119	2,066
Aluminum ($/MT)	1,737	2,118	2,160	2,262	2,066	2,100	1,946	1,975	1,850	1,801
Asian Commodities										
Crude Palm Oil (MYR/MT)	2,523	2,160	2,491	2,390	2,218	2,400	2,463	2,525	2,588	2,650

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

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Thank You