Commodities feel the chills as China sneezes

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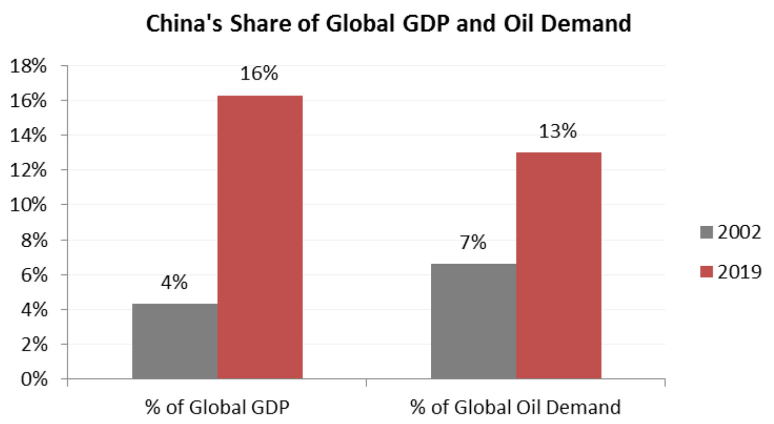
In this week's edition of our Weekly Commodity Update, we highlight three megatrends – oil, food and rubber – and offer our analysis on them.

1. Energy – don't expect a recovery in Chinese demand anytime soon.

Assessing the drawdown on demand is no easy feat. Comparison with the SARS period might prove counterproductive, as the economic model of China has changed vastly since then. There are some whispers in the market that orders for energy products has fallen about 20% in China, which suggests about 2mbpd (2% of global demand) wiped off the market.



Source: IMF, World Bank, US Department of Energy, OCBC Bank

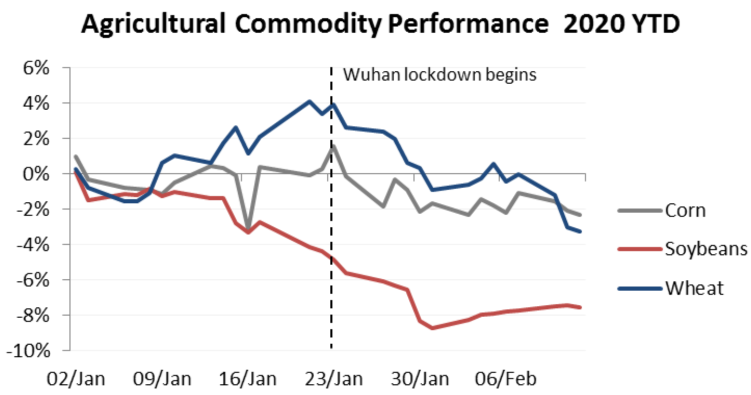
Further downstream, the expected demand losses should come mainly from the gasoline and jet fuel market, given the travel restrictions imposed across the country. While industrial products like diesel and natural gas demand may see less of a downturn, this will depend heavily on how prolonged this coronavirus situation lasts. Caution is advised with regards to the notion that energy consumption can play catch-up once the situation abates:

1) **Although factories can ramp up activity later on, the hit to transportation demand during the Lunar New Year will unlikely be ever recovered.** That means any catch-up in demand is unlikely to be replaced 1-for-1 down the road. The longer this episode drags, the smaller this coefficient will appear to be.

2) **Furthermore, the coronavirus episode has occurred around the Lunar New Year, where stockpiles of crude oil and downstream products are generally high** in anticipation of high commuting volumes. We expect that muted travels in that period would have resulted in higher onshore inventories than expected, which could act as a drag on energy imports into the country.

2. **Food for thought: agricultural prices unlikely to rise on hoarding.**

There is some talk that agricultural commodities could outperform as people rush to stockpile food items. That is highly unlikely to happen. Wheat, which is used to make instant noodles, have fallen 7% so far. Soybean prices have declined 8.5% and crude palm oil prices have dipped about 18%. Even Thai white rice, despite the drought that is going on in North Thailand, has seen prices come off. The reason is simple. Food consumption is heavily linked to income and in addition, China, the epicentre of the coronavirus, has the largest population in the world. A pullback on spending is expected and whether the choice of staple is white rice, pasta or instant noodles, demand for raw food materials is going to be impacted to the downside. Hoarding behaviour in the retail market is unlikely to have a material impact on food prices.



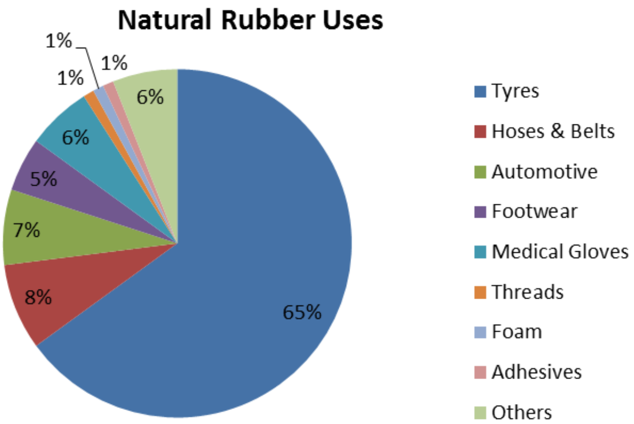
Source: Bloomberg, OCBC Bank

3. Why aren't rubber prices increasing despite high rubber glove demand?

There are some expectations that rubber prices could increase because demand for rubber gloves in healthcare is set to rise exponentially. Yet, rubber prices are down as much as 17%. Why is this happening?

Firstly, only about 10% of natural rubber is used in latex products. The bulk of rubber demand – around 65% to 70% – still belongs to tyre manufacturing. With the travel restrictions in China, poor auto sales extending from last year and the resulting economic slowdown from the virus, tyre demand is expected to slow. Any uptick in demand from gloves is unlikely to compensate the lack of tyre demand.

Secondly, natural rubber latex constitutes about only 30% of total rubber used in the Malaysian rubber glove industry, which accounts for 63% of global supply. The other 70% of the industry utilises synthetic rubber. Among the healthcare industry, there is a preference for nitrile gloves compared to latex gloves. Nitrile, made from synthetic rubber, has higher puncture and chemical resistance and lower allergy rates than its latex counterpart. It used to be more expensive, but recently breakthroughs in technology plus low crude oil prices have started to make them more affordable. Thus, even with the increased demand in rubber gloves, the increased demand is likely to flow through synthetic rubber, not natural latex.



Conclusion: risks to commodity prices remain tilted to the downside.

Overall in the commodity space, we expect depressed prices to continue across the energy, industrial metals or agricultural space. There is a case for deferred consumption for most markets, but any catch up is unlikely to fully compensate the demand drawdown in this period. The longer the coronavirus situation lasts, the more apparent this demand slowdown would appear.

On a final note, stay safe and wash your hands frequently.

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