OCBC TREASURY RESEARCH

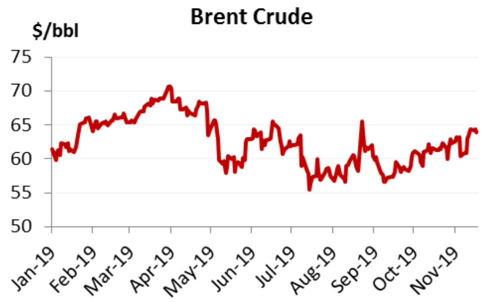
Commodity Outlook 2020

11 December 2019

Crude Oil ▲

2020 forecast: $68/bbl Brent

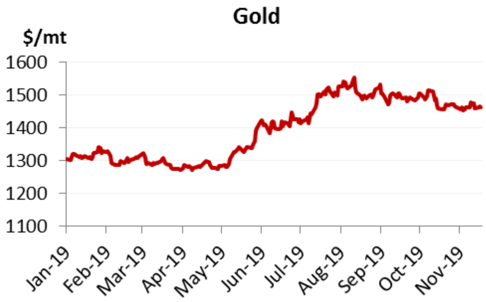
OPEC+ indecision on supply for 2020 means an element of supply risk is added to the market going into the new year. Much of the focus in early 2020 will likely be centred on the US-China trade war again, while the US Presidential Elections may generate even more volatility from Trump's campaigning. Our base case is for OPEC+ to hold onto existing supply quotas through 2020 while we assume US-China relations will not head further south than it already has. This provides a probably base for oil prices to inch higher in 2020, albeit attached with a fair degree of volatility.



Gold ▼

2020 forecast: $1,400/oz

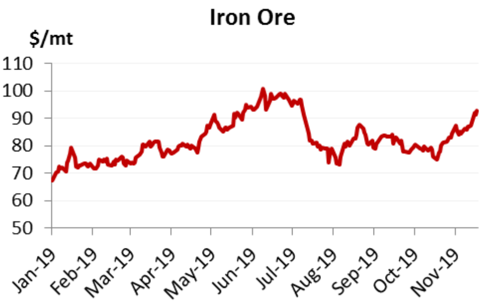
Gold had a good run in early 2H 2019, rising to about $1,550/oz at one stage, but the rally looks to have run out of steam as we head into 2020. A rebound in Treasury yields – largely a result of stabilising US-China relations and a neutral Fed – has dimmed the appeal on the precious metal. Furthermore, the global economy appears to have stabilised after a year of growth uncertainty. If yields on US 10Y yields rise above 1.90%, we think that will signal the end of gold's rally and push prices below $1,400/oz.



Iron Ore ▲

2020 forecast: $100/mt

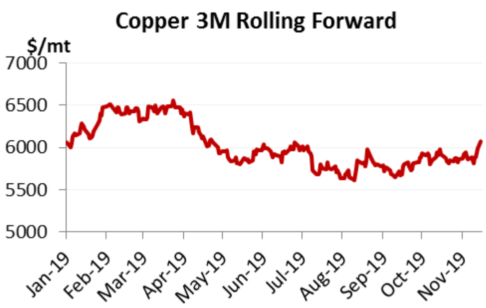
The market has largely been coping with the loss of Brazilian iron ore via demand destruction with higher prices. With Vale's full production likely to only be restored in 2022, the onus is on Australian miners to produce more or for elevated prices to persist. Tightening environmental standards in China and the potential for more fiscal stimulus targeting infrastructure construction are other upside drivers.



Copper ▲

2H forecast: $6,700/mt

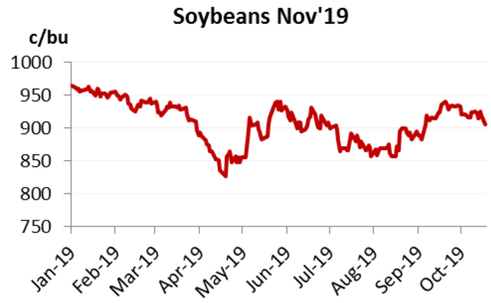
The worst looks to be behind copper and we think the market is set for a rally in 2020. Supply remains tight and we expect production to grow at a meagre 0-2% next year, as unrests in Peru and Chile continue. Infrastructure programs and a robust real estate sector in China are likely to look to copper as a mid-late stage construction material next year. Speculative positions are also heavily on the short end, which could result in massive short-covering, while stocks in China are tight.



Soybeans

2020 forecast: $9.50/bu

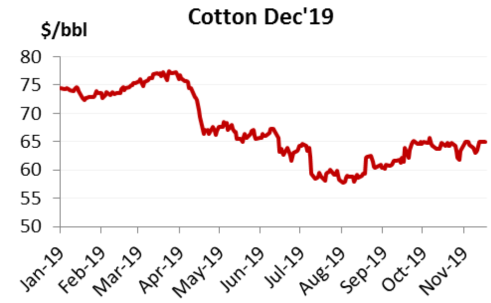
The tightness in supply is beginning to manifest both within and out of China, which ought to result in a rolling waiver of soybean tariff imports into the country. Separately, underwhelming soybean this year means the carryout for the current crop is almost half that of last year's. With Brazil's production also continuously revised downwards, the market is one US-China trade deal away from spiralling into tight carryout territory.



Cotton

2020 forecast: 65c/lb

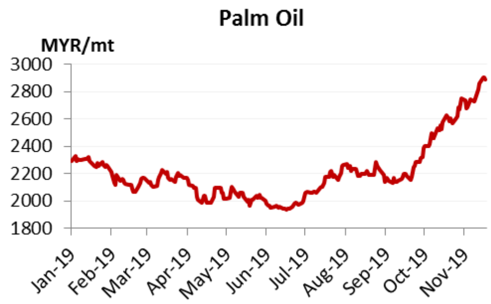
The recent wave of trade optimism has lifted cotton prices but bearish pressures on the commodity remain strong. There are big harvests expected in the US and India, while early estimates on the Brazilian crop looks to unsettle the market late in 2020 with a bumper crop as well. Reports suggest that demand in China remains soft and a downgrade in Chinese consumption of cotton looks highly probable in subsequent WASDEs. Supply in and out of China appears abundant and prices are unlikely to rally too strongly in a buyer's market.



Palm

2020 forecast: 2,600 MYR/mt

A combination of the African swine flu outbreak in China, the B30 biodiesel implementation in Indonesia beginning January 2020 and poor production have combined to send palm prices close to nearly 3000 MYR/mt. The market typically requires six months to correct the supply-demand imbalance and this suggests prices are expected to remain elevated through Q1 2020, before correcting from Q2 2020 onwards. The correction might prove especially deep if China agrees to substantially increase its purchases of US soybeans, which may initially lift palm oil prices but then ultimately deflate when soyoil returns to normal levels in Chinese inventories.



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Commodity Outlook 2020

11 December 2019

Commodity Price Forecasts

2019

OCBC COMMODITY FORECAST							
As of 10 Dec 2019			2019				
	3Y AVG	Spot	Q1	Q2	Q3	Q4	Annual
Energy							
WTI ($/bbl)	53	56	55	61	56	56	57
Brent ($/bbl)	57	61	65	69	61	61	64
Gasoline ($/gallon)	1.65	1.60	1.59	1.96	1.58	1.60	1.68
Natural Gas ($/mmbtu)	2.89	2.47	2.87	2.59	2.32	2.55	2.58
Precious Metals							
Gold ($/oz)	1261	1463	1304	1309	1474	1482	1392
Asian Commodities							
Crude Palm Oil (MYR/MT)	2545	2890	2195	2075	2114	2500	2221
Soybeans (c/bu) (1st Active)	965	915	904	866	887	940	899
Cotton (c/lb) (1st Active)	74	65	73	71	61	65	68
Industrials & Metals							
Iron Ore ($/mt)	66	87	83	98	97	83	90
Copper ($/mt)	5871	6100	6218	6129	5830	5850	6007

2020

OCBC COMMODITY FORECAST							
			2020				
	3Y AVG	Spot	Q1	Q2	Q3	Q4	Annual
Energy							
WTI ($/bbl)	53	56	57	57	58	59	58
Brent ($/bbl)	57	61	61	63	65	68	64
Gasoline ($/gallon)	1.65	1.60	1.65	1.65	1.70	1.75	1.69
Natural Gas ($/mmbtu)	2.89	2.47	2.50	2.50	2.75	2.75	2.63
Precious Metals							
Gold ($/oz)	1261	1463	1475	1450	1425	1400	1438
Asian Commodities							
Crude Palm Oil (MYR/MT)	2545	2890	3000	2800	2700	2600	2775
Soybeans (c/bu) (1st Active)	965	915	900	900	940	950	922.5
Cotton (c/lb) (1st Active)	74	65	66	67	65	65	66
Industrials & Metals							
Iron Ore ($/mt)	66	87	95	95	100	100	97.5
Copper ($/mt)	5871	6100	6250	6500	6600	6700	6512.5

Crude Oil ▲

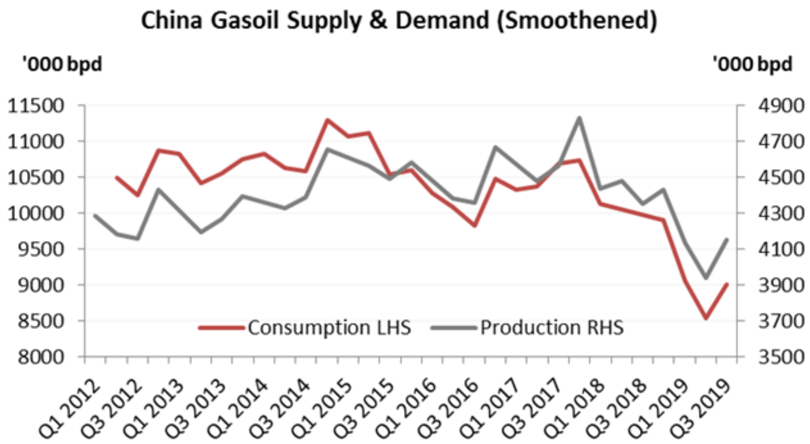
Highlights

- **The market is expected to exhibit a gradual upward bias into 2020 as global growth momentum picks up.**
- **Focus on US-China trade deal likely still the main driver of prices next year, which suggests that prices will remain highly volatile.**
- **Dwindling US crude oil inventories may prompt a return of refinery utilization, but a slow start means the increase in US output is unlikely to top 1mbpd next year.**
- **The wave of political unrests across the globe in 2019 may have contagion effects; non-secular protests could spread in Middle East and Latin America, providing upside risks.**

Price Outlook: We expect Brent to increase to $68/bbl by end 2020, but the upward trajectory will not be smooth.

Chinese gasoil consumption, PMI improving

US-China relations are largely expected to be the main driver in determining oil prices in 2020 once more. A year into the trade war, it is now apparent that global manufacturing has slowed and China has taken a huge hit to its industrial production scene. Gasoil consumption has largely fallen off in Q3 2019 but there are signs of rebounding in Q4. An improvement of the latest Chinese PMI, with numbers returning to expansion territory for the first time since April 2019, has lent credence to the hypothesis.



Source: Bloomberg, OCBC Bank

The emergence of integrated petrochemical complexes in China

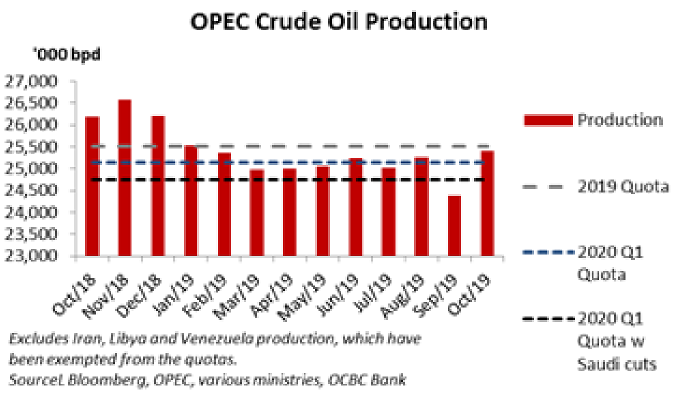
The rebound in gasoil consumption in China is likely negated by the emerging of more oil refineries within the mainland. The Hengli, Rongsheng and Shenghong Groups have introduced new integrated petrochemical complexes that are expected to increase competitive pricing due to their economies of scale and strategic locations along the coast. The three conglomerates are also expected to receive gasoline export quotas in 2020, which is likely to depress refinery margins both within and out of China.

OPEC+ dragging feet over supply cuts is sign of bullishness

OPEC+, especially Saudi Arabia, is keen to add a floor to crude oil prices in view of the bearish macroeconomic environment and weak energy demand from global manufacturers. Saudi's additional voluntary cuts of 400k bpd may serve to deter over-bearishness from taking root, but the larger OPEC+ appears indecisive and has chosen to issue another 500k bpd till Q1 2020.

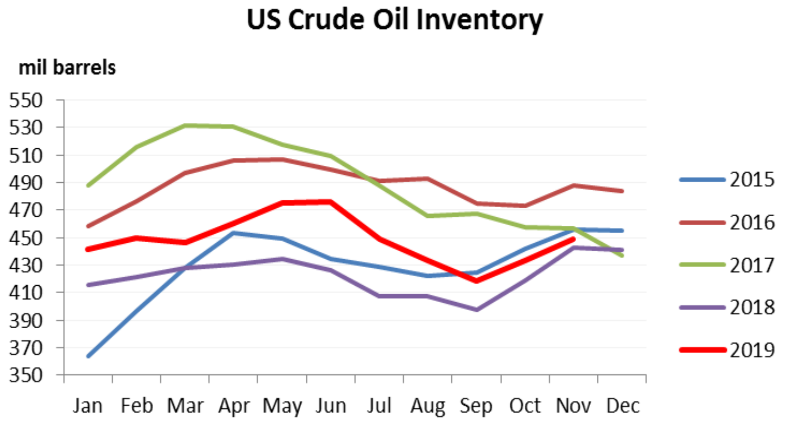
Without the Saudi production cuts, we believed the OPEC+ supply curb of 500k bpd for Q1 2020 would have proven ineffective and might even had the impact of further depressing the market.

- Firstly, for most of this year, OPEC has already been producing at levels around or below the 2020 cuts – in effect, OPEC+ was just formalising current production levels, which had done little to lift crude oil prices for most of 2019.
- Secondly, the production cut was due to last only through Q1 2020, after which another decision will have to be made. This uncertainty and reluctance to look beyond three months might be interpreted as signs of indecision and reluctance to cut production further, which could have brought out more bearish pressures.
- Thirdly, compliance to the quota remains an issue, with the likes of Russia and Iraq having over-produced their 2019 baseline for most of this year. It is not clear how these non-compliant countries would comply with even tighter quotas if there is no clear penalty system in place for over-production.



US crude oil inventory under pressure

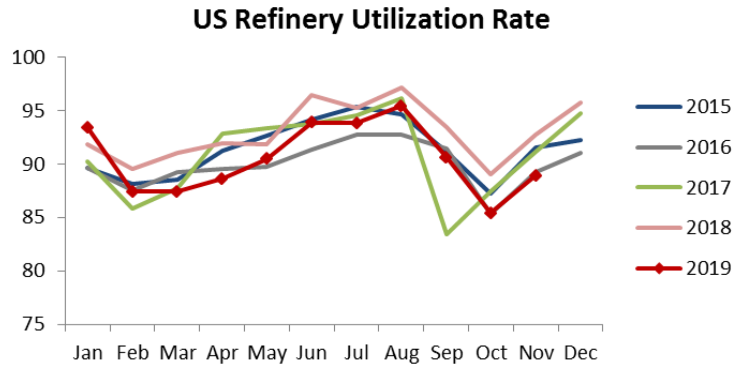
As of November 2019, US crude oil inventories stood at 447.1 million barrels, which is little changed from about a year ago. If inventories continue declining and start 2020 below 440mil barrels, the stockpiles would start the year on the lower end of the past five years' seasonal range. That is a distinct possibility as US exports of shale oil have continued to outpace the growth in production. We expect that orders of US crude oil will pick up pace if the Brent-WTI spread widens to $6/bbl, in effect capping the upper bound of the price differential.



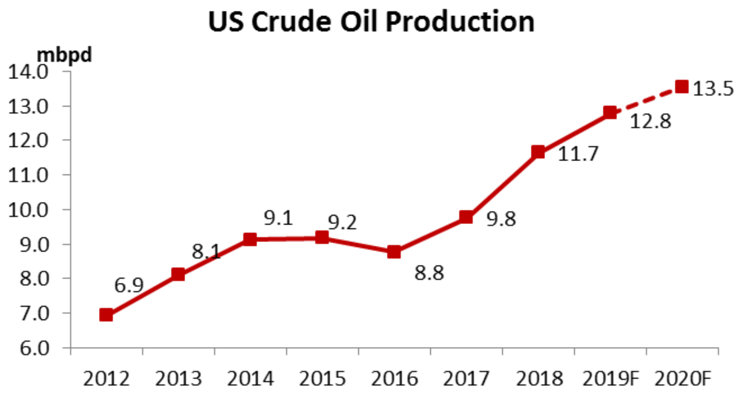
Source: Bloomberg, US DOE, EIA, OCBC Bank

US supply expected to top 13.5mbpd in 2020

The US produced 12.6mbpd of crude oil in October 2019 – putting its position as top producer of crude oil in comfortable distance from Russia (11.3mbpd) and Saudi Arabia (10.1mbpd). This pole position is likely to be cemented in the near term as both Russia and Saudi Arabia continue to embark on production cuts in a bid to put a floor on oil prices. While we expect the US to add another 200kbpd to production before the end of 2019, the pace of production growth is expected to slow in 2020. Falling refinery margin globally, as well as subdued price pressures, mean there is a higher incentive for refineries to adopt lower utilization rates to minimise costs. This has already begun, with the utilization rate in November at 88.9%, the seasonal lowest since 2012. We thus expect the US to increase by 750kbpd to 13.54mbpd in 2020, which is slower than the increases of 2018 and 2019 that are in excess of more than 1mbpd. Assuming that the OPEC+ production quota is extended through 2020, resulting in a decline of 630kbpd from current levels, the increase of US production by 750kbpd would still result in a small increase in global production of about 120kbpd.



Source: US EIA, OCBC Bank



Source: US EIA, OCBC Bank

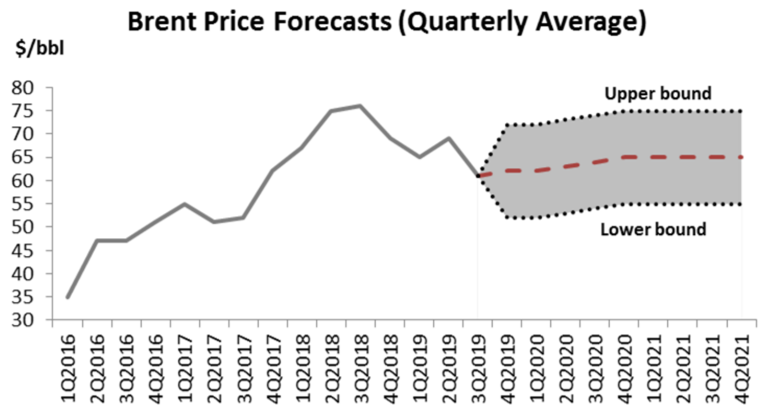
Geopolitical tensions are upside risks

Geopolitical tensions across the world have notably picked up since we wrote the half-year outlook. In addition to Iranian tensions with the West, we have seen uprisings in Peru and Chile; protests in Lebanon; an attempted invasion in Northern Syria by Turkey; and more pertinent for the oil market, civil unrest in Iraq that has cumulated in the resignation of its prime minister. Iraq's production reached a record high of 4.78mbpd in September this year; the street protests might threaten its exports of oil. Aside from Iraq, the other countries mentioned are not key oil producers but there are fears of contagion risks. The multiple riots in the Middle East are sparking talks of a second Arab Spring, while the fear is that unrests in Latin America – which are political and not secular in nature – could spread to key oil producers such as Mexico and Brazil.

Conclusion: higher prices in 2020 but will ultimately be little changed

We think oil prices are likely to drift slightly higher next year largely because we do not expect a further deterioration in US-China relations. Economically, we are seeing signs of growth shoots, which suggests that a year of trade turbulence is starting to stabilise. US inventories are expected to continue declining into the start of the year as refinery utilization rates fall to a six-year seasonal low in November, which in turn would lead to slower production increases for 2020.

We approach this "bullishness" with a large pinch of caution for several reasons. Chiefly, the market continues to be heavily swung by non-quantitative sentiment, and as long as the trade war remains volatile, we expect large swings in prices throughout the year. It is also unclear what strategy OPEC+ is favouring at the moment, with the meeting in December suggesting reluctance in continued production cuts for the rest of the year. We get more clarity on the bloc's stance as we head into 2020. On a more detailed front, the integrated petrochemical complexes in China are expected to add to the glut of runs already present in the market, especially gasoline and diesel, depressing already low refinery margins in the region. These bearish factors suggest that any upward momentum will likely be challenging. We see Brent ultimately ending the year at $68/bbl, but expect the trajectory to be anything but smooth.



Gold ▼

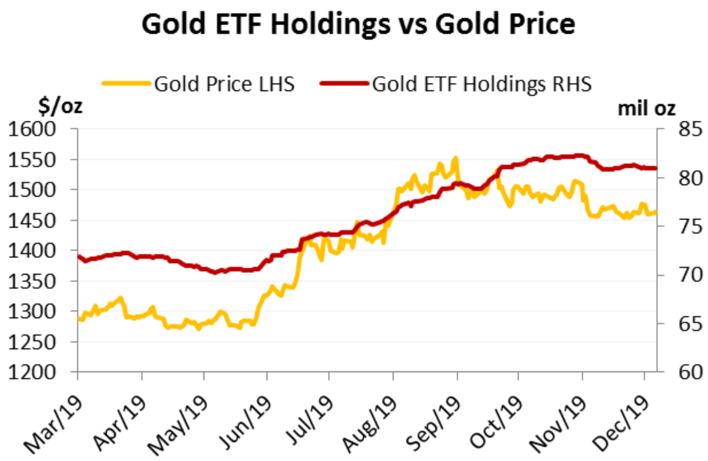
Highlights

- **Gold's appeal has waned on the back of rebounding Treasury yields and a stabilising global economy.**
- **A return of 10Y Treasury yields above 1.9% could potentially sink gold prices below $1,450/oz.**
- **China's and India's physical demand for gold may pick up in 2020 on the back of strengthening currencies, but are expected to provide limited cushioning to any potential selloff.**
- **US-China relations heading south – especially if the US leaves trade negotiations until the election concludes – could push gold back above $1,500/oz.**

Price Outlook: We expect gold to continue trading between $1,450/oz to $1,500/oz in Q1 2020. Selling pressure is expected to intensify from Q2 2020 onwards, potentially falling back to $1,400/oz.

Global rate cuts look set to stall

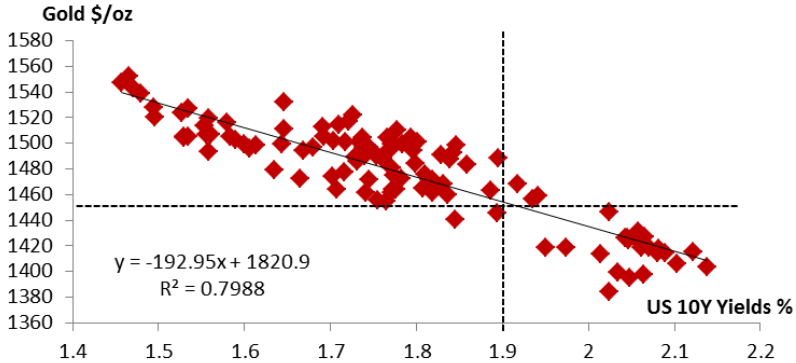
After a year of interest rate cuts, most central banks around the world have appeared to signal that current benchmark rate levels are commensurate with economic fundamentals. Notably, expectations for further aggressive rate cuts by the Fed have fallen, with the market (ourselves included) expecting only one more rate cut in 2020. Other central banks now find themselves with limited monetary easing buffers and have effectively turned over the buck of stimulus to the fiscal department. Without further cuts on interest rates, gold lacks the impetus to rally higher; simultaneously, the rebound in risk appetite from thawing US-China relations and economic green shoots have pushed bond yields higher, in turn depressing gold prices.



Gold's negative correlation with Treasury yields

Since the start of 2H 2019, gold prices and 10Y US Treasury yields have shown a tight negative correlation of almost 80% R-squared. The scatterplot suggests that the catalyst to maintain gold prices above $1,450/oz reside in 10Y yields trading below the 1.9% handle, with rare exceptions. If US 10Y yields return above the 2% level, a cascading run on profit-taking looks likely to take place and algo-trading pressures could quickly lead gold back below the $1,400/oz level. To that end, we think the US 10Y yield levels are worth a close watch.

Scatterplot of 10Y Yields vs Gold Price in 2H2019



Source: Bloomberg, OCBC Bank

Down but not entirely out

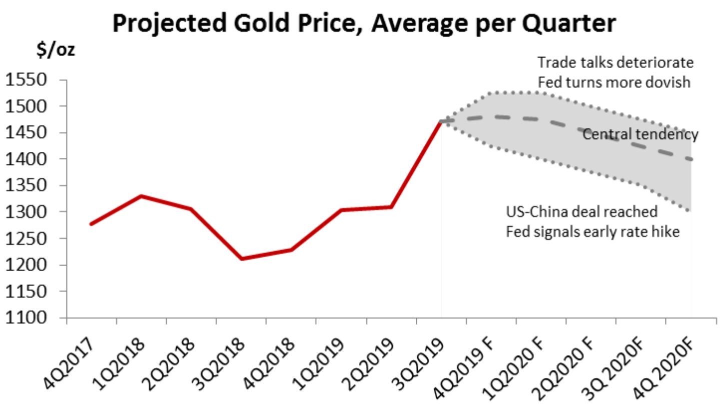
While global risk appetite has noticeably returned compared to half a year ago, we remain cautious that trade negotiations can turn south very quickly. At time of writing, the 15 Dec tariffs are set to go ahead with seemingly no breakthrough in trade discussions. US President Donald Trump has also remarked that he may be contented to leave the tariffs running for a year, only returning to the negotiating table after the 2020 Presidential Elections are completed. If that scenario comes to pass, we think it will likely present an opportunity for gold to return above the $1,500/oz level. The long absence from negotiations plus the pressures from campaigning will likely mean that Trump will turn the screw tighter on China in the one-year interim, resulting in a flight to safety. This scenario exists as a possibility for as long as the phase one trade deal is not signed in ink, and will be especially pronounced if the 15 December tariffs take place.

Softening dollar against RMB, INR may cushion demand fallout

A ray of optimism may reside on physical purchases. Our base case is for a weakening of the dollar as we head deeper into 2020, primarily on the analysis that global growth ought to start gaining traction once the overhang from a slow Q1 wears off. As the RMB and INR strengthen, we expect physical purchases – both from consumers and the central banks – to pick up, cushioning the fallout from prices as global risk appetite rallies. As has been constantly been the case, speculative trading is expected to continue dictating the direction of gold prices – even though improved purchases from China and India may help to cushion any potential selloff, the trend is largely for gold to decline once global growth picks up pace.

Conclusion – rally looks to be largely over

In the absence of any further deterioration in US-China trade relations, we see little reason for gold prices to return above $1,500/oz. We bring forward our long-term bearishness slated for 2021 onward to mid-2020, where we expect an improvement in global growth to push gold prices lower. The resulting improved physical consumption demand as a result of a strengthened RMB and INR are unlikely to majorly stem losses on gold. In the near-term, however, we remain cautious that trade negotiations remain fraught with uncertainty and may head south any moment. This means that the precious metal is not expected to sink below $1,400/oz until the ink dries on the phase one trade deal. Further out, once the Fed begins hiking interest rates – possibly from 2021 onwards – we think gold will eventually find a steady state at $1,350/oz.



Source: Bloomberg, OCBC Bank

Soybeans ▲

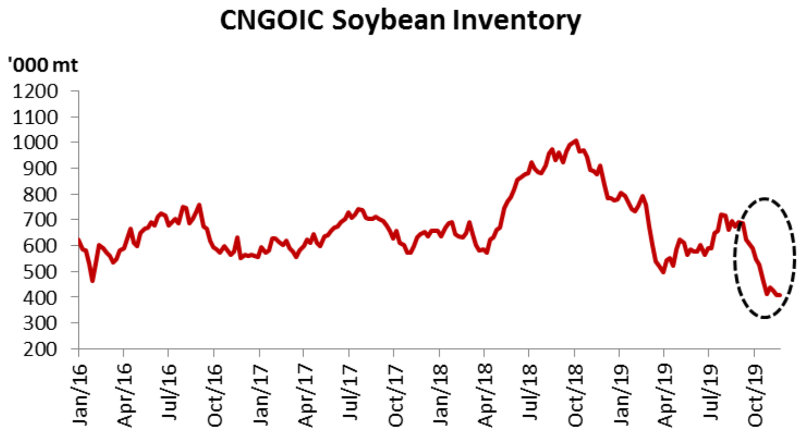
Highlights

- **Inventories of beans in China are running low on a combination of poor demand due to the swine flu and reduced supply.**
- **China has resorted largely to importing from Brazil throughout 2019, but this strategy has its limits and cannot continue indefinitely.**
- **Globally, the supply picture looks tight; we think the market is one trade deal away from a substantial price rally across most bean origins.**

Price Outlook: The supply picture is tighter than what most are expecting and we think a trade deal should signal higher prices. New crop could return to $10/bu if the China buys substantially more beans in the agreement.

Soybean inventory in China running low

China is grappling with the reduced import of US soybeans and the domestic market is dependent on consistent tariff waivers from the government to keep afloat. Chinese buyers used up all of the 10mmt waivers in October and at time of writing, have already placed orders for another 30% of the 1mmt waivers issued in December. Soybean inventory levels in China have dipped to record low levels of 4.09mmt since weekly public data by the CNGOIC was available in 2016. The demand situation in China is partially alleviated by the decrease in pig stock due to the African swine flu, which has seen slaughter numbers and stock fall consistently to record lows since public data was available. The pent-up demand for soybeans, however, remains evident by the fact that crush margins have moved higher since languishing in the red for most of 1H 2019 and are now firmly in positive territory.

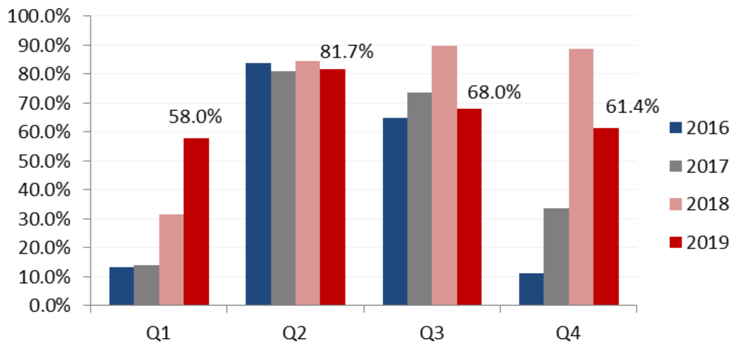


Source: Bloomberg, CNGOIC, OCBC Bank

China has largely bought from Brazil in 2019

Imports of US beans into China have evolved from one that used to be seasonal in nature to a fixed range. US beans traditionally make up for more than 50% of Chinese bean imports in Q1 and Q4, before that switches hands to Brazilian beans in Q2 and Q3. In 2019, US beans were consistently kept between 15-20% of total bean imports by China per quarter. In turn, China has turned to Brazil and Argentina to make up for the import losses in Q1 and Q4. This strategy largely relies on the drawdown of Brazilian and Argentinian stockpiles and cannot be relied upon as a permanent solution, especially if the trade war drags on for years. Stock to use ratios in Brazil are beginning to tighten and the backlash from the recent Amazon rainforest fire would likely put pressure on Brazil in their expansion of farm acreage.

Brazilian Soybeans % of China Soybean Imports

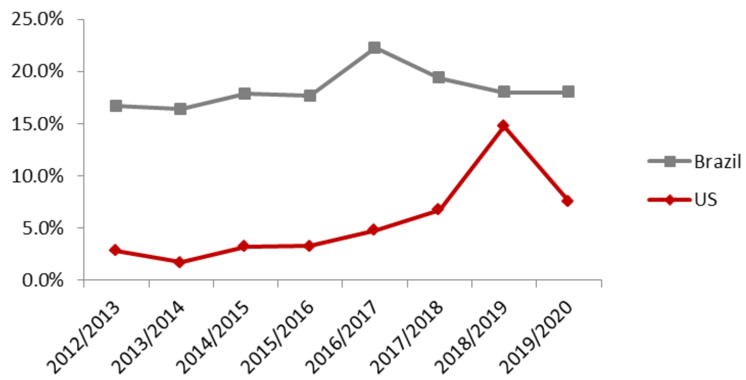


Source: Bloomberg, OCBC Bank

The US is just 225mn bu of exports from stocks returning to average levels

At the same time, it should also be noted that the situation outside China is not one of abundant supply either. US farmers have largely reduced their planting of soybeans for 2019/20. The expected US carryout of 475mn bushels is almost half that of 2018/19 (913mn bushels) and its stock-to-use ratio of 11.8% (as of the November WASDE) is not that far off from 2017/18's level of 10.2%. Reverse engineering suggests that the US is just an additional 225mn bushels of exports (6.1mmt) away from its stock-to-use ratio returning to the 5-year average (excl 2018/19) of 6.0%. At current market prices, that would translate into an additional export worth of $2.14bn – an amount that is well within Trump's calling on China to buy $50bn more of US farm goods.

Soybean Stock-to-Use Ratios



Market is one trade deal announcement away from a rally

Put together, what this means is the soybean market is possibly one purchase announcement from embarking on a rally higher, possibly towards the $10/bu level. We think the downside is limited from here, given that the market has priced in most of the bearishness over the past year. It is increasingly evident that China needs to continue importing beans – whether from Brazil or the US – and the supply tightness is expected to get tighter once the African swine flu recedes and Brazilian carryout is reduced. This is a space where we see Chinese authorities relenting towards in their trade negotiations with the US and on the back of this development, we expect to see acreage for soybeans in 2020 increasing.

Copper ▲

Highlights

- **The worst is likely behind copper and the fundamentals look ripe for copper to embark on a rally.**
- **Infrastructure projects and a robust real estate sector in China are likely to usher in demand for copper as a mid-stage building material in 2020.**
- **We think the ICSG's estimate of refined copper supply growth of 4% is too optimistic, especially on the back of continued unrests in Peru and Chile.**
- **Spec positions reached a record net short in June; it has since rebounded but the space for short covering remains high.**

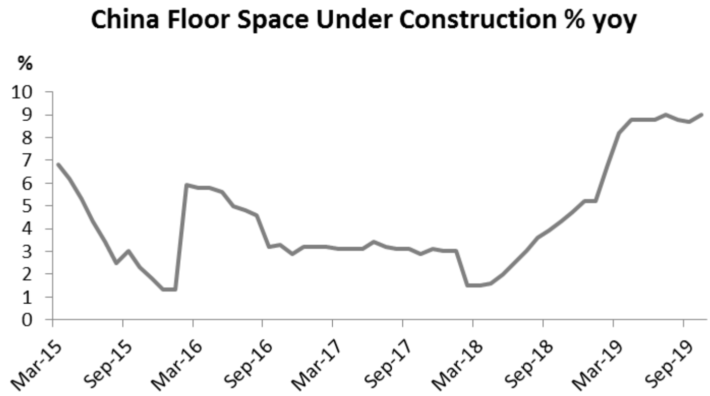
Price Outlook: We see copper prices testing $6,500/mt next year; if the supply outages in Peru and Chile prove more severe than expected, prices may reach $7,000/mt.

The worst is likely behind

Copper has borne the brunt of the trade war for most of 2019 but we think the worst is possibly behind the base metal. Having closed at $5965/mt at the end of 2018, copper rose to as high as $6500/mt during the trade truce in early 2019, before tumbling to an intraday low of $5518/mt in early September. We think that copper prices are set to return to the $6500/mt level in 2020 for several reasons.

Recovering growth momentum and China to improve copper demand

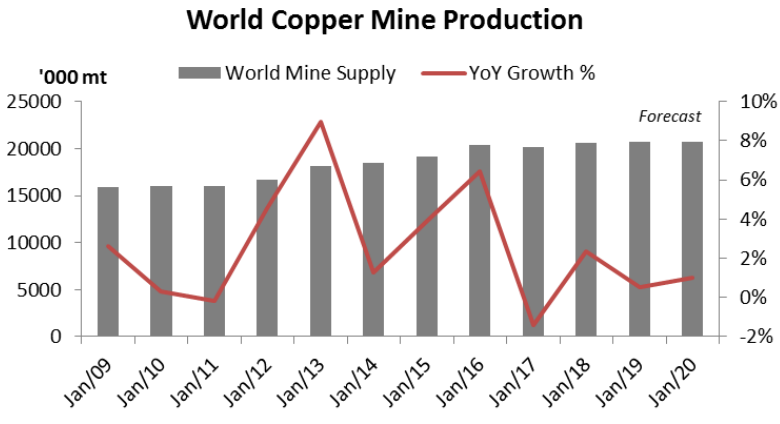
Firstly, the presence of economic green shoots is prompting optimism among manufacturers and that positive sentiment is likely to rub off on copper. While we do not expect demand to pick up substantially in the new year, it is unlikely that consumption of copper will fall below that of 2019's. Our base case is for global growth to pick up momentum in Q2 2020 and that would likely increase demand for copper. The boom in Chinese real estate indicators – ranging from increasing floor space under construction and building sales – largely manifested itself only from the start of this year, which suggests actual demand for copper as a late-stage building metal has yet to materialise fully. This is also in addition to the infrastructure stimulus that was unveiled in mid-2019. Copper demand for both segments is expected to pick up in late 2020 and that is likely to result in higher prices late in the new year.



Source: Bloomberg, National Bureau of Statistics of China, OCBC Bank

Copper supply expected to post minimal growth in 2020

Secondly, we believe that the International Copper Study Group's estimate of a 4% rise in refined output supply is on the higher end of the range. The growth in refined copper output has not exceeded 3% since 2017; with the continued unrests in Peru and Chile and no clear deadline for the return of the Zambian smelters that are being crushed under the weight of the current tax regime, we think a more reasonable increase would be in the region of 0-2% yoy. It is also well documented that the copper industry has been suffering from under-investment for years and that is likely to result in declining ore grades over the short to medium term.

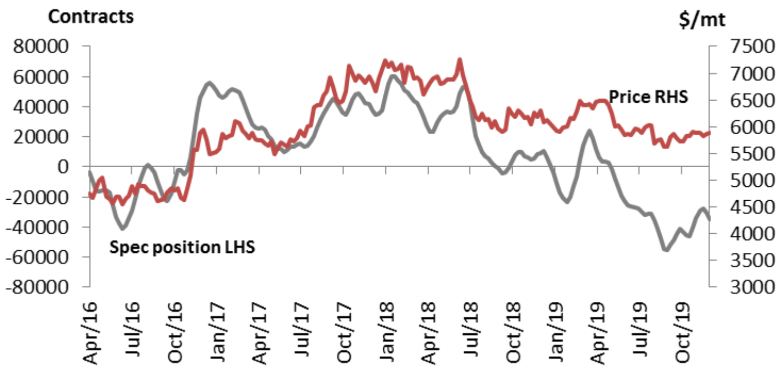


Source: International Copper Study Group (ICSG), OCBC Bank

High net short position leaves space for short-covering rally

Thirdly, we note that the speculative position on copper has sunk to a record short in June, and despite having rebounded since then, is still residing in net short territory. The long-run average of speculative futures position on copper typically resides at zero, which suggests that at current net short levels of 37.7k contracts, there is still considerable room for short covering. The short covering run from 60k to 23k net short on futures of copper resulted in a 8.7% increase in prices; a similar run in covering the current 37.7k net short contracts with the same degree of short cover would likely push prices up to $6500/mt.

Copper CFTC Net Futures Position vs Price



Source: Bloomberg, OCBC Bank

Falling inventories in China

Finally, across the board we are seeing dwindling inventories of the red copper in China. Deliverable stock of copper is at its seasonal lowest since 2014 while stocks in Chinese bonded warehouses are at its lowest since at least 2016. The lack of ready stock would provide another element of bullishness to the copper market.

Bullish factors to push copper towards $6,500/mt

All put together, we expect the copper market to embark on a rally in 2020 and possibly peak at $6500/mt. Improved US-China relations and a higher degree of unrests in Chile and Peru might even push the base metal towards the $7000/mt, although given the still-vulnerable macroeconomic landscape, we think it will be prudent when exercising bullishness.

Palm Oil ▲

Highlights

- **We think the market is likely overbought at this moment but tightening supplies means it may take 2-3 months before the market corrects.**
- **We do not expect Malaysian palm stocks to fall below 1.5mmt but likely to languish below 2mmt in Q1 2020.**
- **A trade deal plus a subsiding of the swine flu in China will likely be bearish for palm.**

Price Outlook: Prices are likely to stay elevated in the near term, but we think a correction is likely due from Q2 onwards and eventually average 2600 MYR/mt in 2020.

Assessing if existing drivers will persist into 2020

It is important to first understand the factors that have driven CPO prices to such lofty heights in the past six months. We then look at these catalysts and then determine if they will continue to persist into 2020.

Factors that have driven CPO higher:

a) **Swine flu in China**. The decline in soymeal demand for stock feed has resulted in a decrease in soybean crushing activity. Soybean oil (soyoil), which is primarily used as in cooking, was inadvertently caught in the crossfire, with supply drying up from the lack of crushing although demand for the vegoil remained intact. In turn, the increase in soyoil prices has dragged palm prices higher.

OCBC Opinion: Reports suggest that the swine flu in China show no signs of abating and we think it is likely to persist into 2020. This ought to keep palm oil prices supported via low soybean crush.

b) **B30 biodiesel mandate in Indonesia**. The mandatory policy beginning 1 Jan 2020, which President Jokowi appears determined to push through, is expected to increase domestic consumption of palm oil by 2.5mmt – an approximate 15% increase from 2019 levels.

OCBC Opinion: There are concerns that the high prices would stop the B30 mandate implementation from going ahead but we think that is unlikely. What may happen is a pushback of the B40 and B50 implementations if economics are unfavourable, although it does appear that President Jokowi is determined to see through at least up till the B50 mandate, if not B100.

c) **Drought in Indonesia.** The drought in Indonesia (which also partially caused the haze that engulfed the region during Q3 2019) has resulted in worse-than-expected yields on Indonesian palm, affecting production.

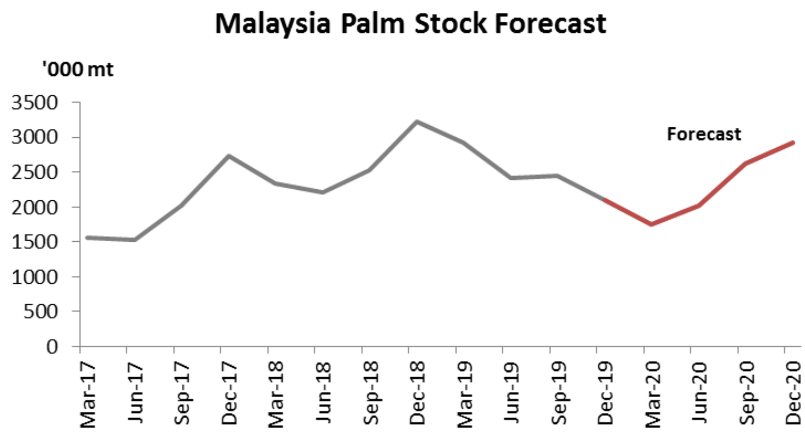
OCBC Opinion: The drop in yields is not expected to last but growers are under pressure from both authorities and environmentalists (and increasingly, ESG-conscious buyers) to produce sustainable palm. Yields might suffer in the near-term.

d) **Poor yields in Malaysia**. Low CPO prices for most of 2018 have led farmers in skimping on fertiliser application last year, resulting in multi-year low FFB yields this year. There are also floods in palm-growing regions in East Malaysia at present.

OCBC Opinion: Fertilisers should now have been reapplied, given the lucrative price of palm. There has been a bout of flooding in East Malaysia around the palm-growing regions and that might affect the yield, although the extent of loss is still unclear.

MPOB inventory of 1.5mmt is the key

Palm inventory levels in Malaysia are the key to determining if CPO prices can continue to languish above 3,000 MYR/mt. The 1.5mmt level has typically been a level that triggers panic buying, which would more often than not send CPO prices firmly above the 3,000 MYR/mt level. Based on our estimates, we think that level will not be reached. We forecast that stocks are likely to fall below 2mmt by end January 2020 and possibly reach a trough at 1.8mmt in February 2020, but a recovery in yields from late Q1 onwards is likely to restore depleted inventories.



Source: MPOB, OCBC Bank

A trade deal is probably bad news for palm prices

We remain wary that once a trade deal is in place – especially one that permits Chinese crushers to buy US soybeans in larger quantities – CPO prices will likely come under heavy selling pressure. The soyoil-palm oil spread is experiencing its first inversion since 2011 and is only sustained by the inability of Chinese crushers to obtain US beans, resulting in oil demand spilling over to palm from soy. Once this constrain to import has been removed, the increase in soyoil supply (especially given positive crushing margins at present) will normalize the inverted spread. The combination of a trade deal and a subsiding of the swine flu in China will likely prove to be even more lethal to palm prices, as soybean crushing goes into overdrive to replenish depleted meal inventories. While it is unclear when the swine flu will eventually be curtailed, we do expect that any phase one trade deal will contain an element of increased US agricultural goods purchase by China.

Overbought market but short-term elevation pressures remain

We expect the poor yields in both Malaysia and Indonesia to persist for another two to three months, which is expected to cause tightness in the market into late Q1 2020. China's continued buying of palm as a substitute for soyoil in the interim means that Malaysia's production is unlikely to meet the combined demand of exports and domestic consumption, resulting in MPOB stocks falling to a possible low of 1.8mmt by February 2020. Indonesia is also expected to begin its B30 biodiesel mandate in less than a month and prices are unlikely to fall before then.

Beyond Q1 2020, we expect the market to undergo a correction as the market rebalances its fundamentals. The normalization of yields from Q2 2020 should ease tightness in the market, while the possibility of China buying more soybeans as part of a phase one agreement (signed or otherwise) should pressure palm prices downwards. A subsiding of the swine flu, resulting in increased crushing activity and hence soyoil supply, would likely be the final nail in the coffin for palm oil's current rally. Risks to the upside include Indonesia pushing ahead of schedule with its B40/50 biodiesel programme; Malaysia finally implementing its B20 biodiesel mandate; weather risks; and deteriorating in US-China relations.

We see palm prices possibly trading at 3000-3050 MYR/mt at its peak in Q1, but to fall to 2500 MYR/mt from Q2 onwards. We see palm averaging 2625 MYR/mt for 2020.

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