

# Commodity Outlook 2H 2019



Monday, July 15, 2019

## Crude Oil ▲

**2H forecast: \$68/bbl (Brent); \$58/bbl (WTI)**

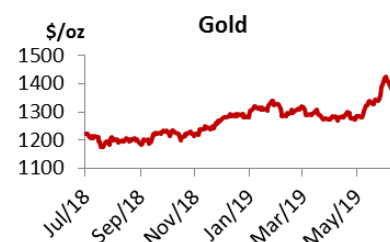
Brent prices are most likely influenced by demand concerns and geopolitical tensions for the rest of 2H 2019. With OPEC+ having settled its position on supply for the next nine months, we expect the market's attention to be firmly on US-Iran relations and the fragile macroeconomic environment. Watch for the drawdown in US crude oil inventories, which are starting to look tight.



## Gold ▲

**2H forecast: \$1,450/oz**

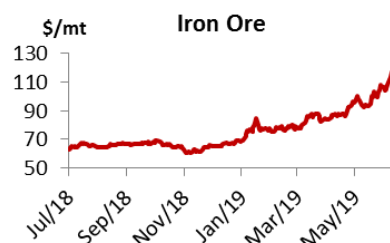
Gold is expected to continue rallying in 2H as the macroeconomic conditions remain supportive of further gains. Multiple trade tensions in the world have taken root while global growth environment remains soft. The US Federal Reserve is expected to cut rates to a certain extent – with it, driving yields and the USD lower, in turn possibly further lifting gold prices. Warmongering rhetoric from Iran towards the US is also starting to sound more aggressive. \$1,500/oz for gold before the end of 2019 does not seem like an unrealistic level, based on current trends and fundamentals.



## Iron Ore ▼

**2H forecast: \$100/mt**

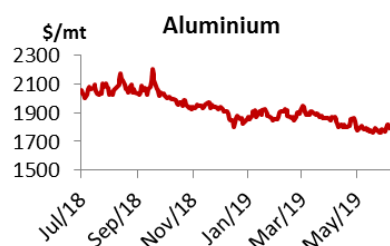
Iron ore rallied more than 60% in 1H on a combination of severe supply issues and a seemingly robust property sector in China despite Sino-US tensions. Australian production has since almost returned to normal following TC Veronica, while steel parities in China suggests that the rally may be running out of steam. The contraction in Chinese auto sales is likely to weigh on the commodity going forward. Losses from Brazil's Vale, however, are unlikely to be offset by demand weaknesses and we do not see prices falling too far below \$100/mt.



## Aluminium ■

**2H forecast: \$1,800-\$2,000/mt**

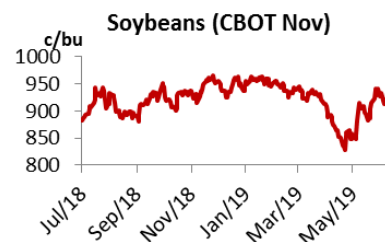
The industry is likely to keep adding capacity in 2H on Rusal's lifted sanctions and Brazil's Norsk Hydro Alunorte resumption of alumina refinery. The US tariffs will continue to disrupt the metal's global trade flow and demand, resulting in China attempting to import more bauxite from Guinea. Auto sales in China have remained weak, contracting every month since July last year, while the US-EU trade tensions on aircrafts are likely to weigh on aluminium prices as well. The fundamentals look overall slightly weak and we expect prices to remain around the \$1,800-2,000/mt range in 2H.



## Soybeans

### 2H forecast: \$8.75/bu (Nov contract)

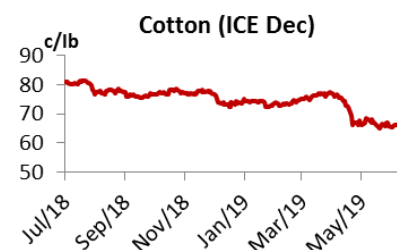
The amount of yield loss from the US floods remains the biggest question on this year's US crop. Planting got off on a very late start and there was a 10% drop in acreage between March's intentions to June's report. The crop condition of US beans is currently the worst since the 2012 mid-year drought, but the drought was an ongoing weather concern whereas the worst of the floods should be behind the crop now. Losses in yields may not be as severe as initially estimated; coupled with the loss in demand from China, it may be shaping up to be another difficult season for soybeans.



## Cotton

### 2H forecast: 63c/lb (Dec contract)

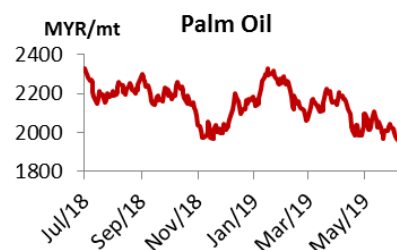
Crop conditions are average in the US and there are no imminent drought concerns that may possibly arise over West Texas for the rest of this year. The only possible damages to crops are the prospects of hurricanes or early frosts, which are difficult to forecast now. We expect yields to remain in-line with trend and the US abandonment rate to stay below 10%. India, however, may face another difficult crop year given the earlier flooding in Gujarat in April, which could set the base for a return of bollworm attack. China is likely to concentrate buying from Australia and Brazil, even importing them on sliding-tariff rule basis; US cotton is likely to find buyers in Vietnam. This divergence is likely to cause non-US basis to widen.



## Palm

### 2H forecast: 2000 MYR/mt

Despite slumping price levels, production and inventory levels are beginning to look tight and that may precipitate an uptick in prices if these trends continue. El Nino appears to have finally taken its toll on Malaysian FFB yields, having stayed at 1.54 ton/ha since March and not displaying its seasonal uptick. MPOB inventories have now sunk to 2.45mil mt in May from the record high of 3.22mil in December. The push for biodiesel mandate, particularly in Indonesia, continues – end-user takeup rate, however, appears to be lacking at present. Stabilisation in soyoil and gasoil prices will likely provide the base for palm prices to rebound off its lows.



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## Commodity Price Forecasts

2019

OCBC COMMODITY FORECAST 2019							
As of 3 July 2019			2019				
	3Y AVG	Spot	Q1	Q2	Q3	Q4	Annual
<b>Energy</b>							
WTI (\$/bbl)	53	60	55	61	58	58	58
Brent (\$/bbl)	57	67	65	69	68	68	68
Gasoline (\$/gallon)	1.65	1.94	1.59	1.96	2.00	2.00	1.89
Natural Gas (\$/mmbtu)	2.89	2.42	2.87	2.59	2.50	2.50	2.62
<b>Precious Metals</b>							
Gold (\$/oz)	1261	1410	1304	1309	1425	1450	1372
<b>Asian Commodities</b>							
Crude Palm Oil (MYR/MT)	2545	1950	2195	2075	2000	2000	2068
Soybeans (c/bu) (1st Active)	965	933	904	866	950	925	911
Cotton (c/lb) (1st Active)	74	62	73	71	62	62	67
<b>Industrials</b>							
Iron Ore (\$/mt)	66	120	83	98	100	100	95.25

2020

OCBC COMMODITY FORECAST 2020							
As of 3 July 2019			2020				
	3Y AVG	Spot	Q1	Q2	Q3	Q4	Annual
<b>Energy</b>							
WTI (\$/bbl)	53	60	63	60	60	60	61
Brent (\$/bbl)	57	67	70	65	65	65	66
Gasoline (\$/gallon)	1.65	1.94	2.08	1.96	1.93	1.93	1.98
Natural Gas (\$/mmbtu)	2.89	2.42	2.55	2.50	2.25	2.25	2.39
<b>Precious Metals</b>							
Gold (\$/oz)	1261	1410	1400	1350	1300	1300	1338
<b>Asian Commodities</b>							
Crude Palm Oil (MYR/MT)	2545	1950	2100	2200	2250	2250	2200
Soybeans (c/bu) (1st Active)	965	933	900	925	950	965	935
Cotton (c/lb) (1st Active)	74	62	65	65	68	68	67
<b>Industrials</b>							
Iron Ore (\$/mt)	66	120	90	80	75	75	80

## Crude Oil ▲

*Prices are likely to stay flat with upside potentials in 2H.*

A downbeat forecast for global energy demand is likely negated by rising geopolitical tensions and constricted supplies from OPEC+. At present, we see factors as bullish for crude oil and think that fears of severely reduced demand have been overblown.

### Big 3 expected to produce 4mbp lesser in 2019

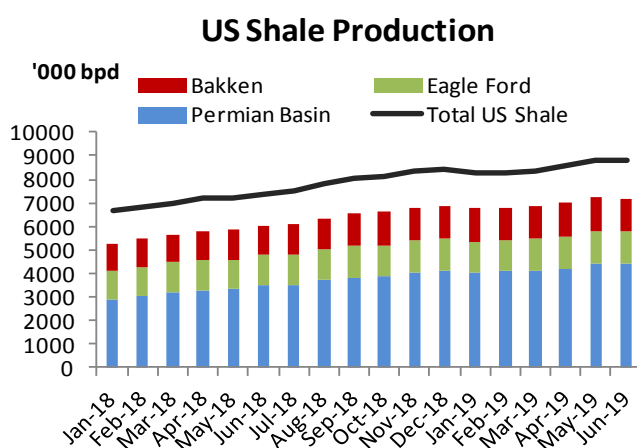
Early July saw OPEC+ members agreeing to keep output at current restricted quotas, as the oil bloc seeks to balance a volatile macroeconomic environment that has dampened global energy consumption. Shale production in the US has slowed and its current pace of output is unlikely to materially affect the supply curbs from OPEC this year. Combined oil production from the big 3 – OPEC, Russia and the US – is likely to finish 2019 with a production of at 51.77 mbdp by our estimates, almost -4 mbdp (-7%) lesser than 2018. The loss of 4 mbdp in production will weigh on the market and likely offset the pessimism surrounding energy consumption, keeping prices supported.

Crude Oil Production by Big 3 Producers						
'000 bpd	3Q 2018	4Q 2018	1Q 2019	2Q 2019F	3Q 2019F	4Q 2019F
<b>OPEC</b>	32,900	32,550	30,275	30,000	30,000	30,000
<b>Russia</b>	11,285	11,451	11,330	11,200	11,200	11,200
<b>US</b>	11,000	11,650	12,080	12,250	12,550	12,850
<b>Combined</b>	55,185	55,651	53,685	53,450	53,750	54,050

Source: OPEC, Bloomberg, EIA, OCBC Bank

### Slowing shale production weighs on US supply

US shale production has also displayed a slowdown in its pace of growth, increasing only 600k bpd in the first half of 2019 – the slowest 6-month growth in 2 years. With non-shale production expected to remain largely the same on the year, we expect that total US crude production may increase only 1.2 mbdp in 2019 – a drop in pace from 2018's 1.9m bpd growth. This is unlikely to offset the decrease of -2.5 mbpd from OPEC alone, without including Russia.

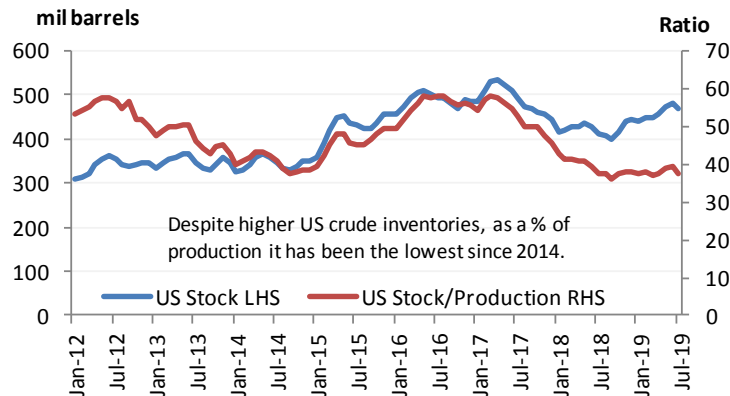


### Declining US inventories a sign of tightness

US crude stockpiles registered a first on-month decrease in June since March. Although inventories remain at elevated levels (468mil barrels) vs a year ago (~420mil barrels), as a percentage of production, stock levels have remained below average and does not adequately reflect the increasing US oil production. Gasoline inventories are also at its 4-year seasonal low. Shale production failing to rise as quickly as expected, coupled with the declining inventories, have supported WTI prices and close the Brent-WTI

spread back to \$6/bbl from as wide as \$11/bbl.

### US Crude Stockpile vs Stockpile/Production Ratio





Source: Bloomberg, EIA, OCBC Bank

### Geopolitical tensions are upside risks

Iran's relation with the US and its allies remain the biggest source of upside risks to oil prices at present. Iran has (allegedly) sabotaged international oil tankers along the Persian Gulf, while the US almost carried out an air strike against Iran after the latter downed its military drone. An Iranian oil tanker was also seized by the UK Royal Marines, to which Iran has vowed retaliatory actions. Armed conflict on Iranian shores is likely to send supply shockwaves in the Middle East and could result in prices escalating quickly. Separately, in addition to Iran, it is also worth noting that Libya still remains in civil war and may face outages in supplies if key pipelines are rendered non-functional.

### Timeline of US-Iran Tensions

	<b>2 May</b> US ends Iranian crude oil waivers	<b>24 May</b> US sends additional 1500 troops to Iran	<b>21 Jun</b> US calls off air strike against Iran, impose sanctions	<b>11 Jul</b> UK forces seize an Iranian tanker en route to Syria
	<b>12 May</b> Four commercial ships allegedly attacked by Iran	<b>13 Jun</b> Two oil tankers allegedly attacked by Iran	<b>20 Jun</b> Iran downs a US military drone	<b>25 Jun</b> Iran calls the White House "retarded"

Source: Various, OCBC Bank

### Demand fears appear overblown at present

Despite the various upside factors, the energy market is concentrating most of its attention on the dull demand story. The US-China trade tensions and suspicion that the global economy is entering its late stage growth are leading to demand forecasts being consistently downgraded. During the GFC, oil consumption fell by -1% in 2009 – assuming the same contraction in oil demand this year, the global supply balance still presents a deficit of almost -300k bpd. Given that the macroeconomic conditions are nowhere near the shocks witnessed in the GFC, it is almost safe to assume that the supply deficit might be even deeper than the -300k bpd estimated.

**Global Crude Oil Demand & Supply**

'000 bpd	Actual			Trend	Worst
Year	2016	2017	2018	2019F	
Demand	96,737	98,406	99,843	101,153	98,844
Supply	96,920	97,490	100,020	98,419	98,550
OPEC	33,140	32,380	32,550	30,000	30,000
Russia	11,218	10,945	11,451	11,200	11,200
US	8,749	9,742	11,650	12,850	12,850
Other	43,814	44,423	44,369	44,500	44,500
Supply Deficit	183	-916	177	-2,734	-294

**Conclusion: prices stable for now but upside potential remains**

We remain bullish on oil in the following six months as current factors appear to resonate more with the oil bulls. This includes the inability of shale to replace OPEC's curbs in the short-run; low US inventory-to-production ratio; and Iran as an epicentre for geopolitical tensions. While the market remains fixated with poor demand for now, the momentum behind the soft consumption story appears to lack conviction and is unlikely to present strong bearish pressures on prices.

## Gold ▲

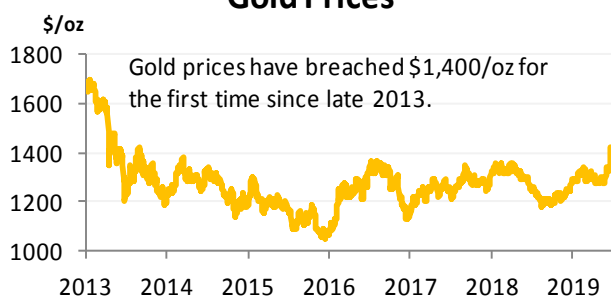
*Supported by weakening economic fundamentals and a global rate cut cycle, gold may rally to \$1,500/oz.*

Gold rallied 10% in 1H, with most of the gains arriving in June. The stars were aligned for the precious metal to rise, including a fragile global economy, softening global interest rates, a weakened dollar and increasing geopolitical/trade tensions. These factors are unlikely to abate in the near-term and are hence expected to continue lifting gold prices higher in 2H.

### Global rate cut cycle

Gold was drifting sleepily in a narrow range of \$1,270-\$1,300/oz in the first two months of Q2. Even with the resumption of the US-China tariffs in mid-May, gold could only muster a rally to \$1,300/oz before retracing. What arguably drove prices to the current levels of \$1,400/oz and above was an increased clarity in late May that the US Federal Reserve was likely to reduce its benchmark rates beginning July. With entrenched expectations that the Fed is now going to embark on a rate cut cycle to a certain degree, gold prices are likely to remain elevated unless the Fed fails to deliver on its rate cut expectations.

### Gold Prices

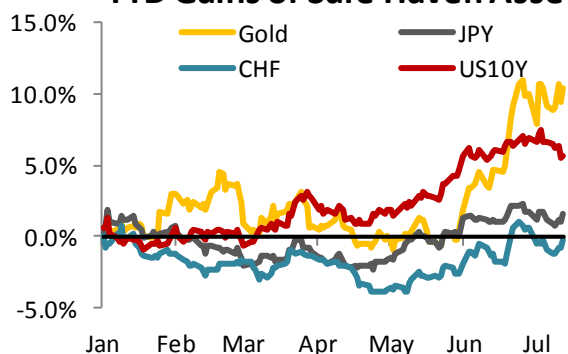


Source: Bloomberg, OCBC Bank

### Gold is the choice of safe haven

By late June, the choice of safe haven asset has clearly shifted to gold, with YTD gains outpacing that of Treasuries. The precious metal has mostly stayed above its 2018 closing price for most of the year, but for much of Q2 the choice of safe haven asset belonged to Treasuries. However, with yields continuously falling, the preferred hedge shifted to gold in late June as 10Y UST yields sunk to 2.0%. It is perhaps telling that among the traditional safe havens, most are eking out YTD gains – suggesting that investors remain sceptical of the intermittent risk-on rallies we have witnessed this year.

### YTD Gains of Safe Haven Assets



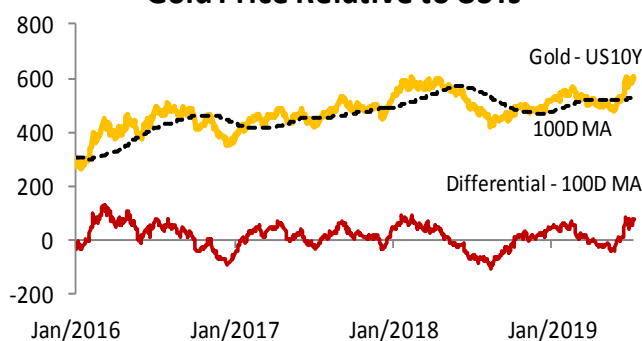
Source: Bloomberg, OCBC Bank

### UST yields key to further gold upside

In the short-run, the bull run on gold prices is likely capped by its relative value to US bonds. Gold prices have reacted to global market pessimism much later than USTs, with the rally only beginning in late June despite the resumption of Sino-US trade wars in mid-May. This has largely boiled down to USTs presenting a better safe haven alternative to gold, given current yield levels of 2.4-2.5% in early Q2. When 10Y yields withered down to near 2.0%, investors appeared to have switched favours to non-income yielding gold, resulting in a gold price rally of more than \$100/oz. The spread between gold and a 10Y UST, however, has reached the technical ceiling of \$600 – a level that has not been breached since 2013/14.

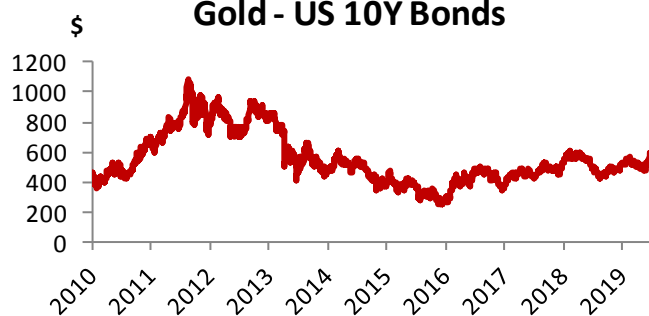
We do not doubt that this level may be breached in 2H 2019 – this spread reached a high of more than a \$1000 in 2011, during the peak of QE programmes in the US. While we do not expect similar monetary policies to be enacted during this economic downturn, more troubling signs of economic vulnerability are needed to push Treasury yields down further for gold to gain value momentum.

### Gold Price Relative to USTs



Source: Bloomberg, OCBC Bank

### Gold - US 10Y Bonds



Source: Bloomberg, OCBC Bank

### Conclusion – Rally still intact

In the short-term, we expect gold prices to take a breather from its remarkable rally as its value relative to USTs has reached its technical ceiling. However, the multiple global trade threat and barriers are likely to continue harming business sentiment and disrupt supply chains. As economic data continues to deteriorate, the declines in yields and further safe-haven seeking are likely to push gold towards the \$1,500/oz level.

## Soybeans —

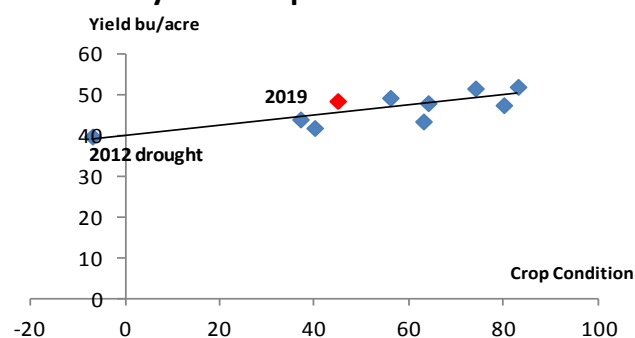
*Despite prospects of a poor US harvest, the pessimistic overhang from the US-China trade war is likely to keep prices below \$10/bu.*

US farmers are facing a turning point, as they stare down the twin barrel of low prices and production for the coming crop year. With prices already greatly pressured, the floods in Q2 are likely to result in poor production this year, further adding to financial stresses.

### US crop facing worst yield since 2012 drought

The US soybean crop is facing the possibility of yields plummeting to its worst since the 2012 droughts. Weekly reports by USDA show that the current crop conditions are the worst since 2012, adding to concerns that even the latest downgrade in yields during the July WASDE are underestimating the severity of the damage caused by the floods. Latest USDA estimates put the US crop size at 3.845 billion bushels, with a downgraded harvested yield from 49.5bu/acre to 48.5bu/acre. This, by our estimates, still presents a yield that is too high – our forecast for 2019/20's US crop is 45.2bu/acre, leaving production at 3.583bn bushels vs USDA's 3.845bn bushels.

### US Soybean Crop Condition vs Yield



Source: USDA, OCBC Bank

### Brazil faces bumper crop but still early days

Brazil is expected to produce 124mil mt of soybeans this year, as higher basis prompt farmers to dedicate as much as half of cultivated land to producing the crop. As planting in Brazil does not take place until November, this estimate still presents a very preliminary forecast and is expected to undergo large adjustments as we approach LatAm crop year. Based on our current estimates, total US and Brazil crop this year are expected to decrease to 8.14bn bushels – the third consecutive year of decline. With the decrease in soy demand from China, however, this presents a sizeable crop that the market seems unable to absorb at the moment.

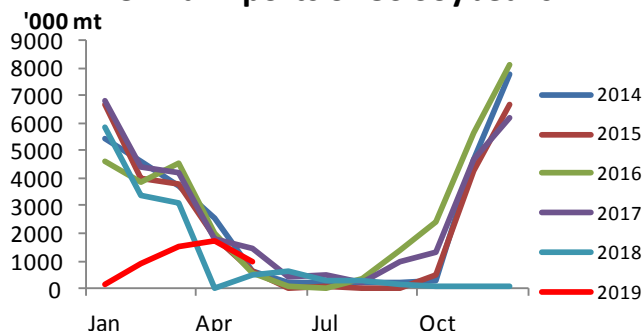
### Soybean Production, USDA/OCBC Estimates

	2015/16	2016/17	2017/18	2018/19	USDA 2019/20	OCBC 2019/20
<i>mil bu</i>						
<b>Brazil</b>	3,546	4,211	4,483	4,299	4,519	4,556
<b>US</b>	3,927	4,296	4,412	4,544	3,845	3,583
<b>US+BR</b>	7,473	8,507	8,894	8,843	8,364	8,139

### China's imports of US beans irregular

Given the strained economic relations between the US and China, Chinese imports of US beans have displayed a non-seasonal pattern that is unprecedented. Imports of US beans failed to display the seasonal pickup in Q4 last year as the trade war grew in intensity. There may have been a structural shift in demand for US beans from China – with or without a trade truce. It is unlikely Chinese crushers will display an appetite for US beans in the near-term, given the trade uncertainty – this will likely continue if Donald Trump is re-elected as US president next year.

### China Imports of US Soybeans

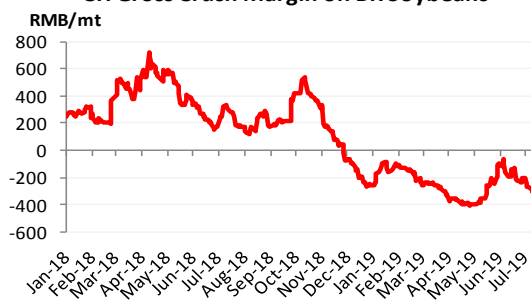


Source: Bloomberg, OCBC Bank

### Chinese crushers still in the red

After enjoying a stellar 2018, Chinese crushers are facing negative crush margins again as soymeal prices have declined. Meal prices have collapsed from a high of 3,650 RMB/mt as recent as October 2018 to current levels of 2,800 RMB/mt, presumably as the price of meal substitutes become more competitive. Chinese pig farmers are reportedly also considering lowering the soymeal content in their pig feed to global levels, reducing the overall demand for soymeal and soybeans.

### CH Gross Crush Margin on BR Soybeans



Source: Bloomberg, OCBC Bank

### Conclusion: challenging year for farmers, crushers

US farmers face the prospect of a poor financial year, with downbeat price and yields forecasts. We believe USDA has overestimated US production and yields at this stage and think further downgrade of US supply is warranted. This may be countered by a large Brazilian crop, but it is still early days for estimating LatAm production. If Brazilian production fails to produce a bumper crop as expected, it will result in higher soybean prices globally, adding to the strains that Chinese crushers are already facing with depressed soymeal prices.

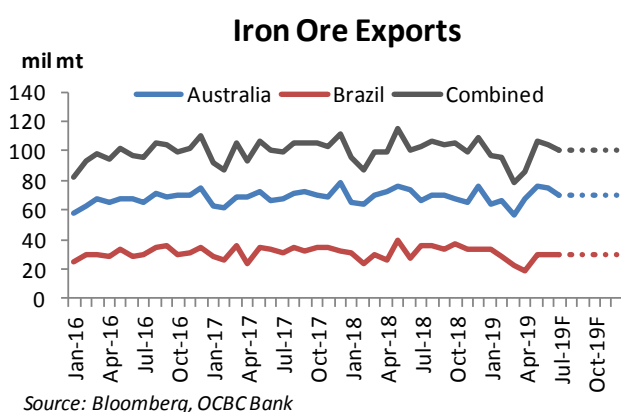
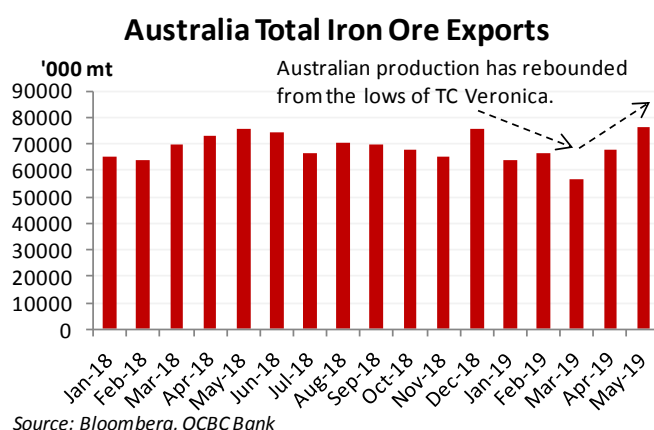
## Iron Ore ▼

*With Australia resuming near-normal operations and the ongoing US-trade war, prices are likely to face bearish pressure, especially at current lofty levels.*

A combination of supply and demand factors combined to send iron ore prices to as high as \$118 in early July – a whopping 80% return YTD. However, Australian exports to China have returned to normal levels and the ensuing trade war is already starting to weigh on steel prices. We see prices at this level as unsustainable and believe a correction below \$100/mt is likely in the short-term.

### Supply: Australia resumes normal output, Brazil increases

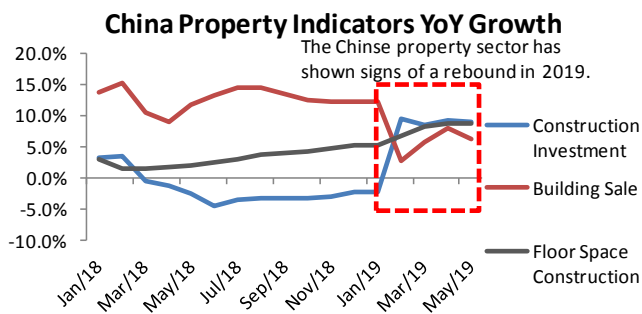
The worst of TC Veronica is now firmly behind Australia, with the country exporting 76.4mil mt in May – near the record high of 78.8mil mt set in December 2017. In Brazil, exports have climbed back to 30mil mt in May and June after sinking to a low of 18.4mil mt in April. Brazilian exports are likely to continue staying at 30mil mt without returning to the 35-40mil mt level prior to the Vale incident; Australian exports are expected to continue trending higher. We estimate that the two countries combined should export an average of 100mil mt of iron ore per month for the rest of the year.



### Demand: Property numbers strong but autos a drag

Chinese property numbers continue to post above-expectations data, with construction investment displaying a sharp rebound after contracting most of 2018. Growth in floor space construction also continues to gather pace, while that of building sales still shows an expansion despite a declining trend. This upbeat numbers in the property sector, however, are negated by sluggish auto sales in China, which have

contracted every month yoy since July 2018. As the trade war drags on, we expect the property sector to be negatively affected as investment in real estate slows.



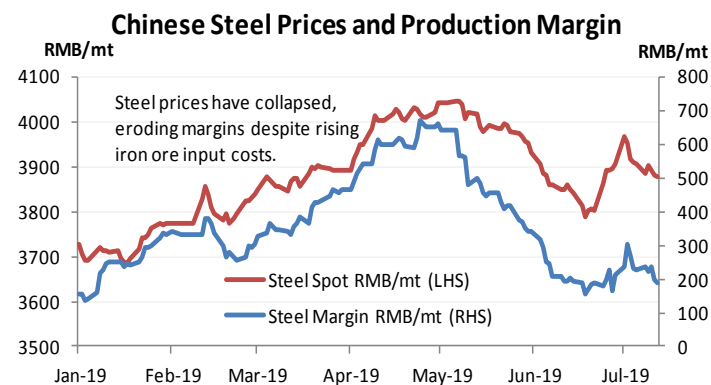
Source: Bloomberg, OCBC Bank



Source: Bloomberg, OCBC Bank

### Steel production margins eroding

A sign that demand for iron ore is waning may be observed via steel prices and the subsequent impact on steel margins. As iron ore prices continue to rally, spot prices of steel in China have failed to keep pace, further compressing production margin.



Source: Bloomberg, OCBC Bank

### Conclusion: prices may correct on soft economic underbelly

With steel prices not having kept pace with the meteoric rise in iron ore's price, the rally appears limited at present. Despite the optimistic data from the property sector, auto sales remain sluggish while Australian and Brazilian exports are expected to increase and stabilise at 100mil mt per month on average from here. Prices appear lofty at current levels and may need to correct to provide some breathing room for steel manufacturers.

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