OCBC Commodities 2H18 Outlook:
Price rallies dissipated… What now?

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Gold: In disfavor with investors

- **Gold prices faded lower despite the uptick in risk aversion into June**, highlighting gold's disfavor with investors as a safe haven asset to-date. Since the start of 2018, gold prices declined from its \$1,300/oz handle to as low as \$1,278.5/oz in mid-June.
- **The yellow metal's 60-day correlation with the greenback tuned stronger into May** to as strong as -0.77, suggesting that much of gold's movement has been predicated by dollar trend.
- **Fundamentally, the relatively rosier US-centric economic indicators have supported dollar strength**, led by strong job gains, lower unemployment levels, higher household spending and business fixed investment. Elsewhere, the surprisingly dovish central bank rhetoric by the ECB and BOJ also gave the greenback further strength into June.
- **Paper demand however, remains strong into end-June.** Gold ETF holdings continue to climb even as gold prices tumble, suggesting that investors' need to diversify given ongoing uncertainties can still be seen. Physical demand however, remains lacklustre.
- **Inflation risks remain muted into end of 1H18,** despite the higher oil prices seen to-date. US-centric inflation expectations seen from the 5Y and 10Y TIPS suggest that CPI pressures remains tame. This is seen to be trending in line with gold prices to-date.
- **We downgrade our gold outlook at \$1,300/oz at end-year**. While a firmer dollar story into 3Q18 could potentially keep gold bulls at bay, some unwinding of dollar strength in 4Q18 will likely give gold the necessary boost to our year-end target.

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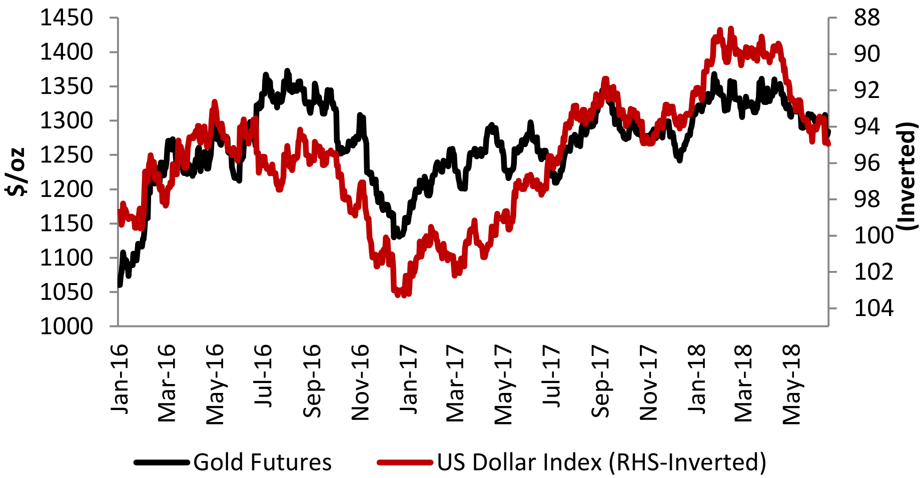
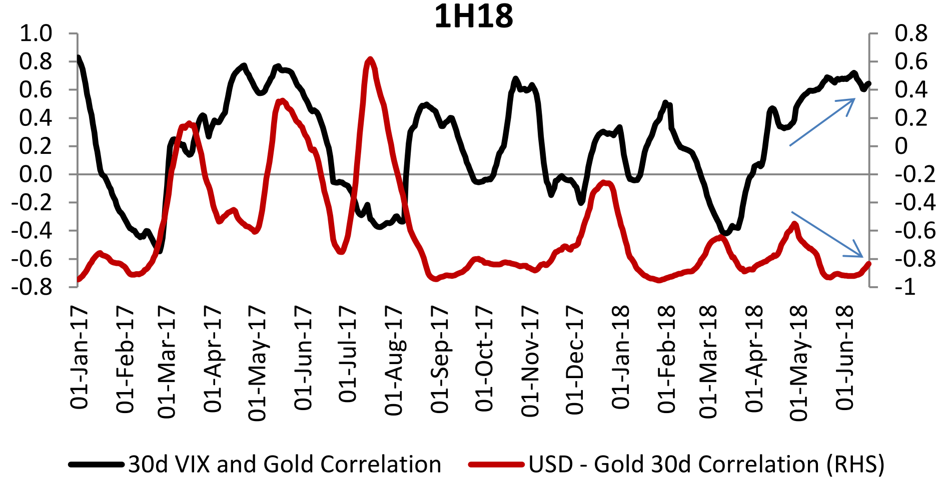
Gold prices will depend on key correlation patterns

- Gold prices have remained "well-behaved" based on correlation patterns. Gold-DXY 30-day correlation sustained near close to -1.0 into end-June, while VIX-Gold correlation remained in positive zone.
- Conventional wisdom indicates that a dearer greenback will depress gold prices, given gold being a dollar-denominated asset. Sustained negative correlation with the greenback suggest that dollar movement will likely persuade gold's behavior into 2H18.
- The VIX index, on the other hand, has picked up modestly to-date. More commonly known as the 'fear index', the uptick in the VIX suggest market concerns over the brewing US-Sino trade tensions.

Gold-DXY correlation remains water-tight



Correlation behaves in an orderly fashion into 1H18



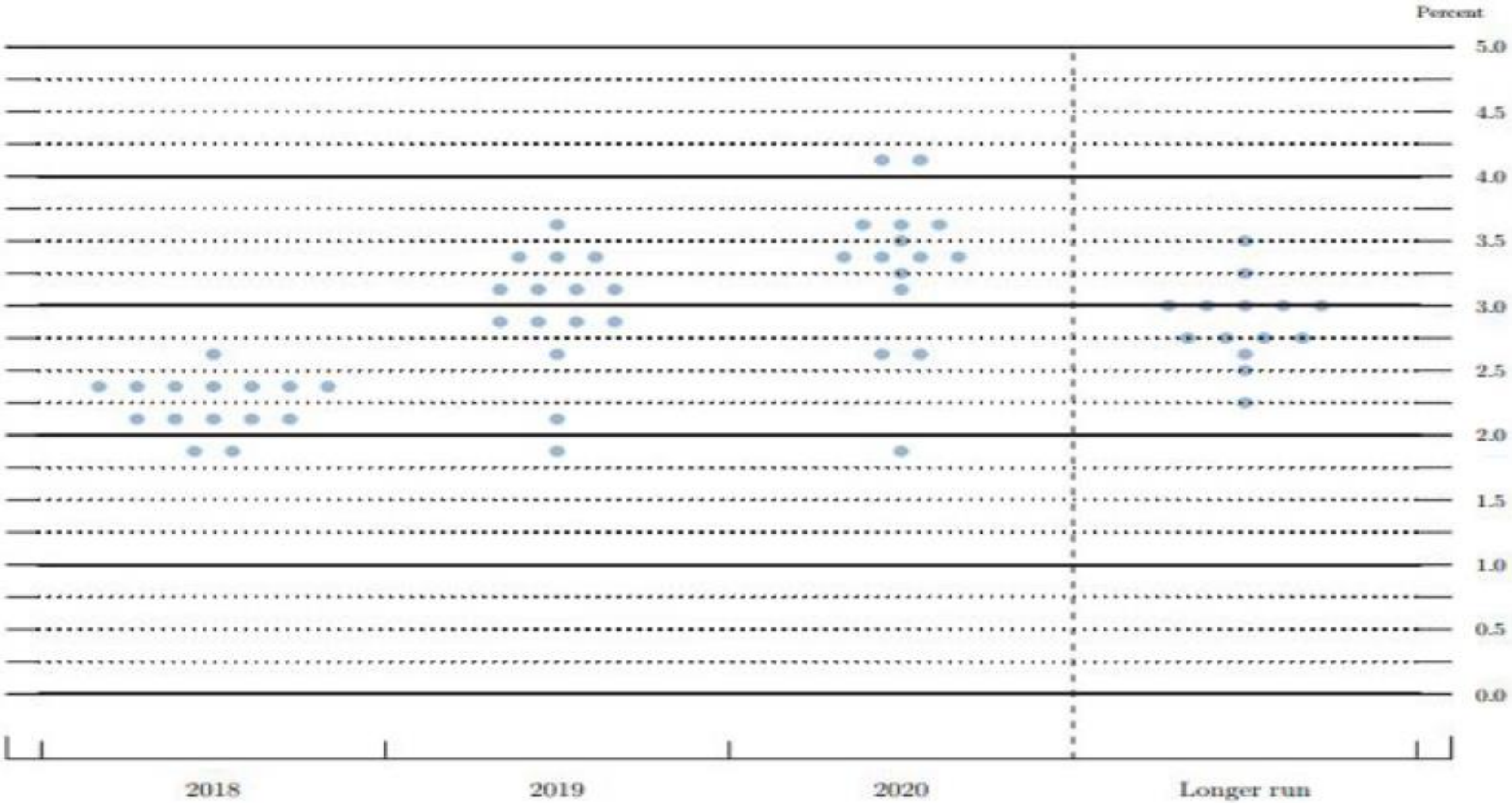
OCBC Bank Source: Bloomberg, CEIC, OCBC Bank

Dollar movement to persuade gold into 3Q18

1. **US-centric economic indicators continue to print in a rosy fashion.** Job gains have been strong and unemployment rate has declined. Household spending has picked up while business fixed investment has continued to grow strongly.
2. **More rate hikes incoming:** The recent FOMC dot-plot in June now points to four rate hikes into 2018, up from three hikes in its March's report. Since 2015, the US Federal Reserve has hiked rates seven times in all (from 0.25% to 2.0%).
3. **Surprisingly dovish central bank rhetoric** by the European Central Bank and the Bank of Japan.
4. **Trade tariffs serves to narrow US trade deficit**, which in theory should rally the greenback.
5. **Safe haven demand?** The dollar has been traditionally a safe haven asset, and could be re-positioned as such especially if risk events and uncertainties continue to brew into the backdrop.

June’s FOMC dot-plot chart signals four rate hikes

- **The FOMC committee’s recent dot-plot chart** signals a total of four rate hikes into 2018, and three more into 2019.
- **Expectations for higher US-centric rates,** amid recent dovish rhetoric by ECB and BOJ will likely dull gold’s luster as a store of value, given a relatively dearer greenback.

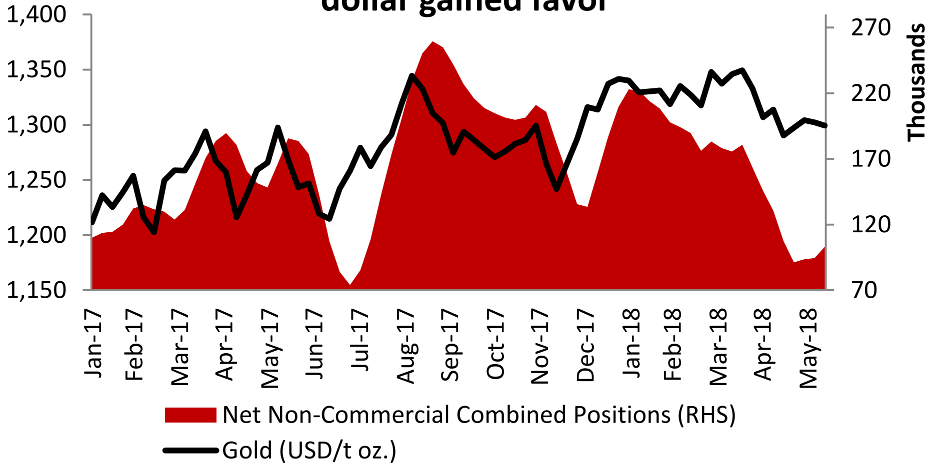


Source: FOMC

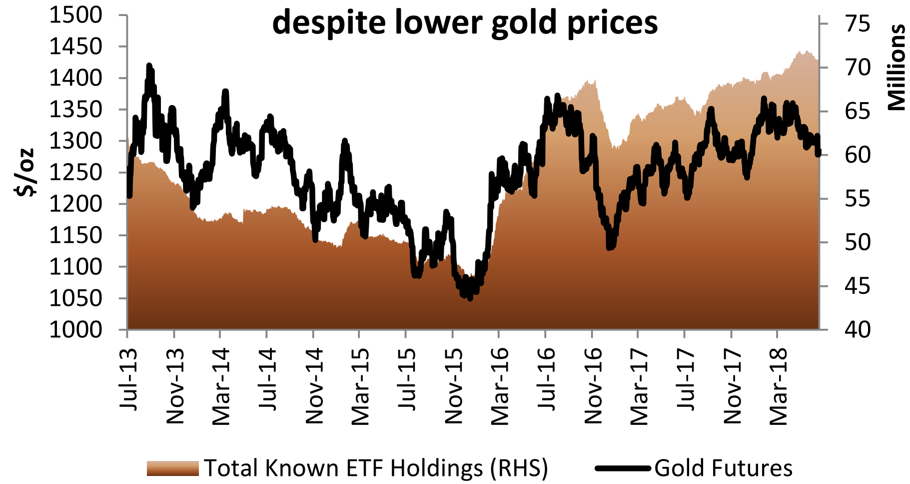
Recent pick-up in ETF demand… but?

- **ETF demand continues to climb into June** despite lower gold prices. Global ETF holdings into mid-June clocked 70.7 million troy ounces, up from 66.3 million troy ounces during the same period in 2017. The sustained demand for ETF exposure suggest investors' need for diversification especially during uncertainties seen to-date.
- **Money-managers on the other hand,** focused largely on a stronger dollar seen since mid-April, and reduced speculative holdings in gold options and futures. Over a four-week moving average, speculative net-long positions in gold has fallen to its lowest since July 2017, a time when global economic fundamentals were showing clear signs of broad-based recovery and optimism.

Net-long speculative interest in gold declined as dollar gained favor



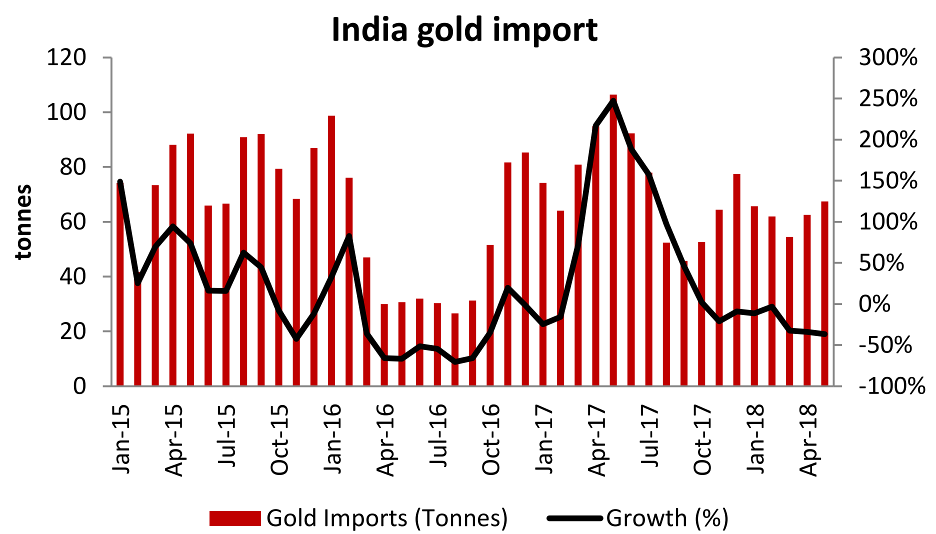
Gold ETF demand continue to point north despite lower gold prices



OCBC Bank Source: Bloomberg, OCBC Bank

Physical gold demand remains lackluster

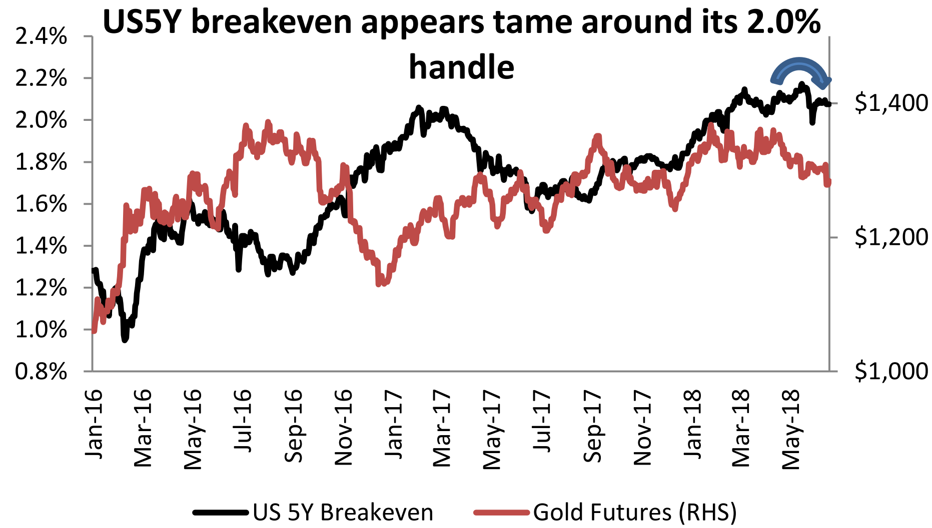
- **The World Gold Council reports that overall gold demand of 973.5 tonnes in 1Q18 was the lowest Q1 print since 2008,** led by a sharp downturn in Indian jewelry demand (-12% y/y), while China's bar and coin demand fell by an alarming 26% y/y over the same period.
- **Central bank demand buoyed demand at +42% y/y,** the highest 1Q growth since 2014. The higher demand was led by buying seen in Russia, Turkey and Kazakhstan.
- **Industrial demand rose by a tepid 4.0% in 1Q,** though the positive print does also suggest the healthy demand in industrial products especially in the wireless and memory sectors.

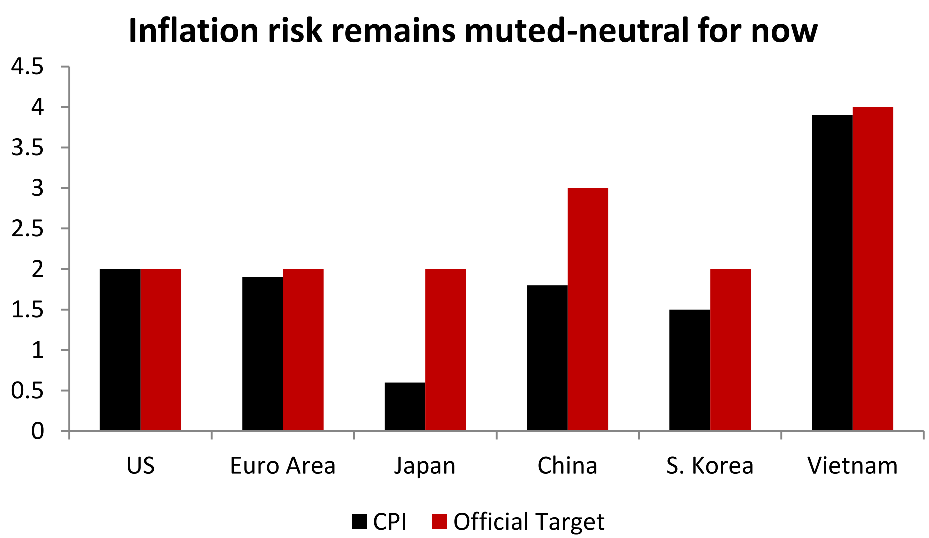


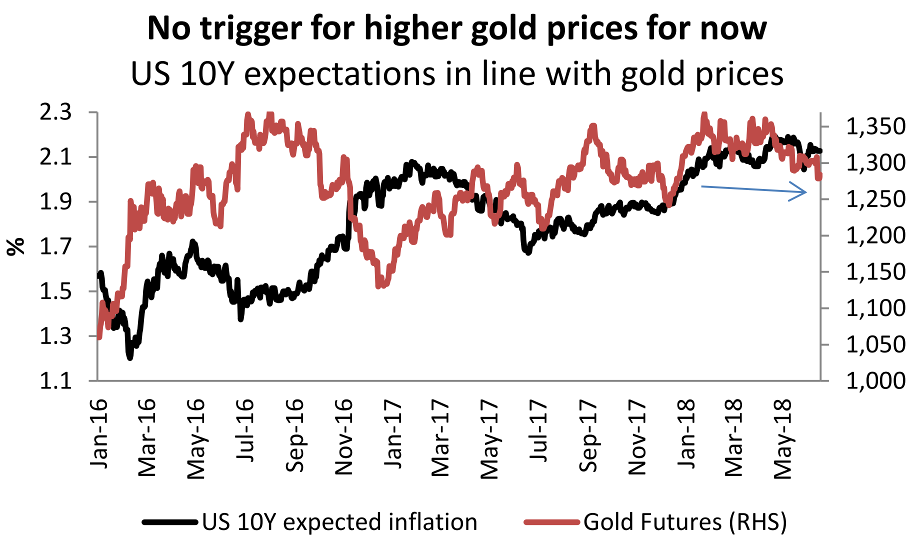
OCBC Bank Source: World Gold Council, Bloomberg, OCBC Bank

Tame inflationary pressures to keep gold at bay

- There remains little inflation risk to-date despite stronger oil prices. Across key economies, recent inflation prints remains in-line with official targets.
- Tame inflationary pressures in past years suggest that the yellow metal hasn't been regarded as an inflation-hedge.
- Gold prices appear to be in a sweet spot given real interest rates levels across G7 and APXJ.







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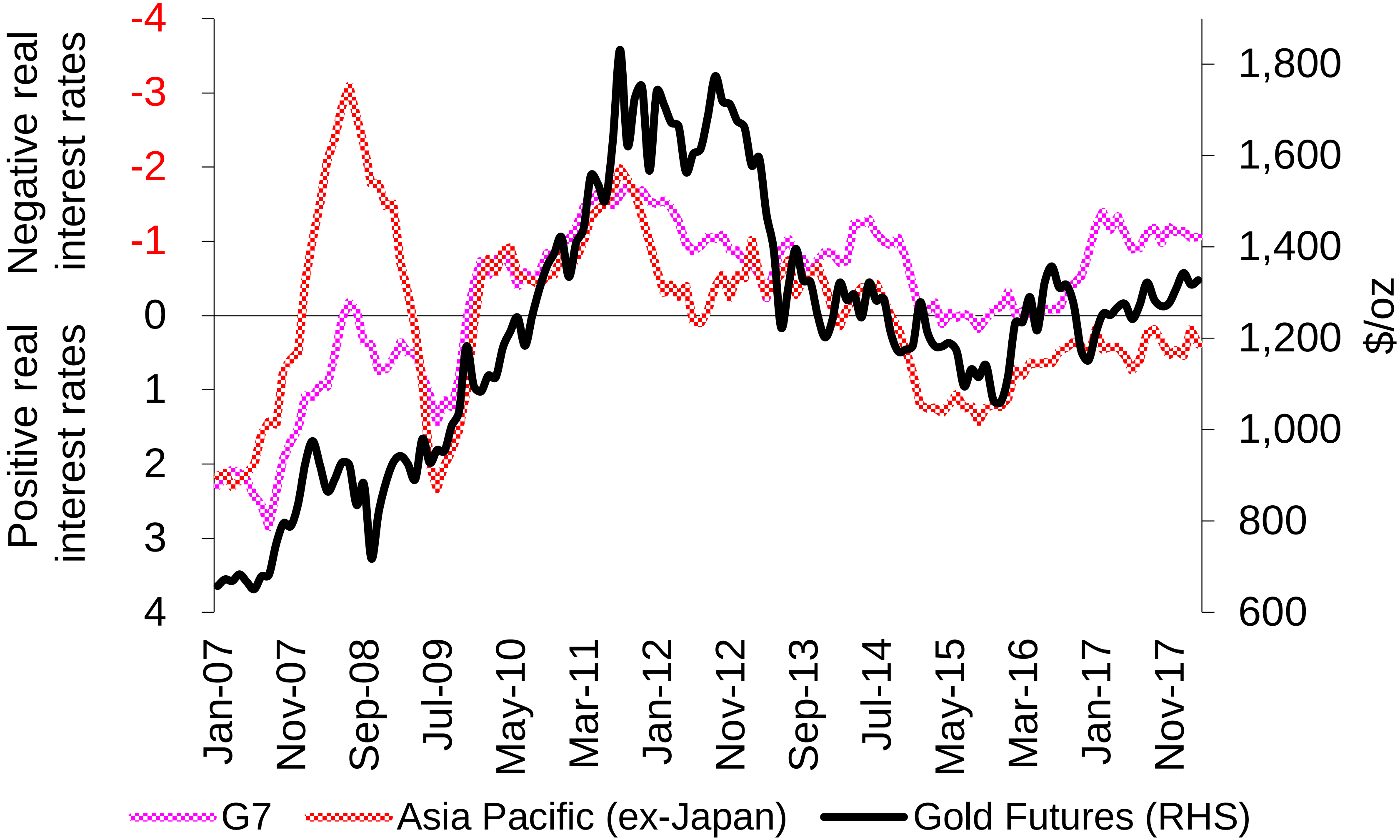
Source: Bloomberg, OCBC Bank

Gold in a sweet spot for now



Source: Bloomberg, OCBC Bank

Crude Oil: Look out for higher supplies

- **Oil prices saw a knee-jerk reaction in late June, as investors reacted to a seemingly lower-than-expected rise in OPEC's production hike.** According to the OPEC meeting notes on Friday, it stated that countries "will strive to adhere to the overall conformity level, voluntarily adjusted to 100%, as of 1 July 2018". Anonymous sources who are reported to be familiar with the deal's technical aspects hint that production gains translates into about 600,000 bpd for now.
- **Oil prices may continue to dip further into the months ahead,** following OPEC's decision to raise production into 2H18. Still, note that the proposed rise in production is considered to be small, given a total of 2.4 million bpd of production cut seen since 2016. Information regarding who and by how much the production hikes may affect remains to be an unknown at this juncture.
- **Further upside risk in US-led oil production cannot be ruled out.** US crude oil production rose to new record highs of 10.9 million barrels (+16.6% y/y) as of 15th June 2018. Oil-rig counts continue to gain as well into end 1H18, a leading indicator that US-led production will likely grow further into 2018.
- **Note that global fundamentals indicate that supplies have surpassed demand seen since March 2018,** and any exacerbation of the supply glut may persuade oil prices lower. Accounting for further upside risk in oil production into 2H18 given potentially higher US and OPEC supply, we continue to see lower WTI and Brent prices into the second half to touch \$65/bbl and \$70/bbl, respectively.

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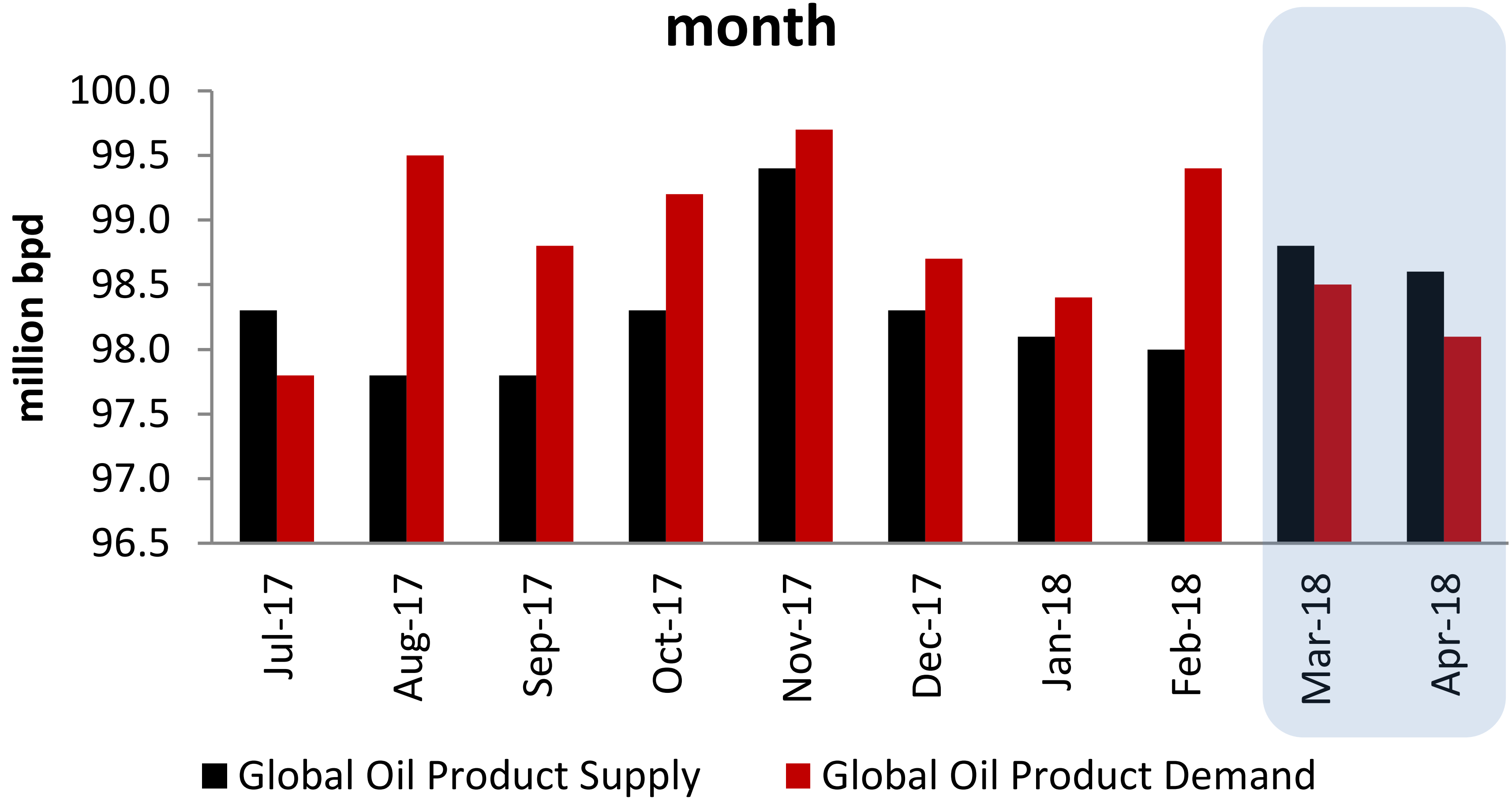
Chart of the month: Back in oversupply territories

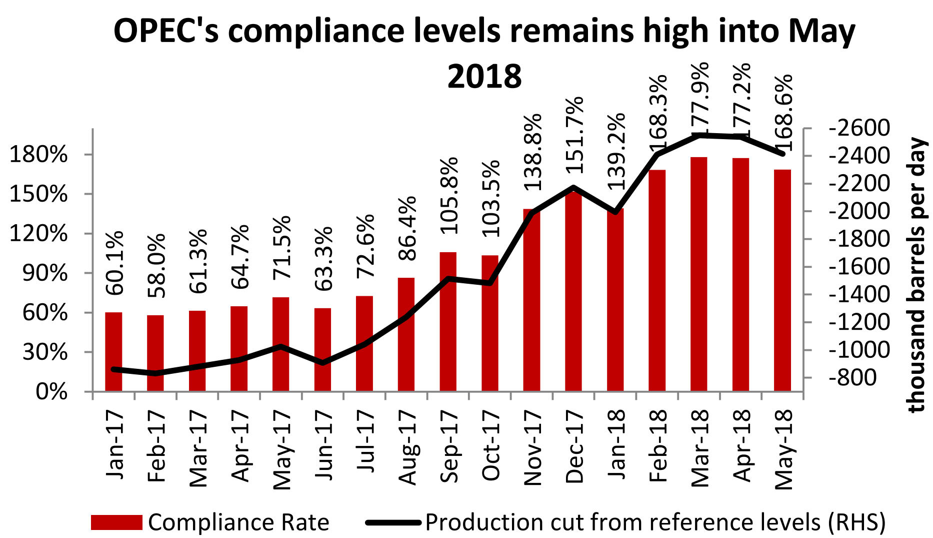
Global supply surpassed demand for the second month

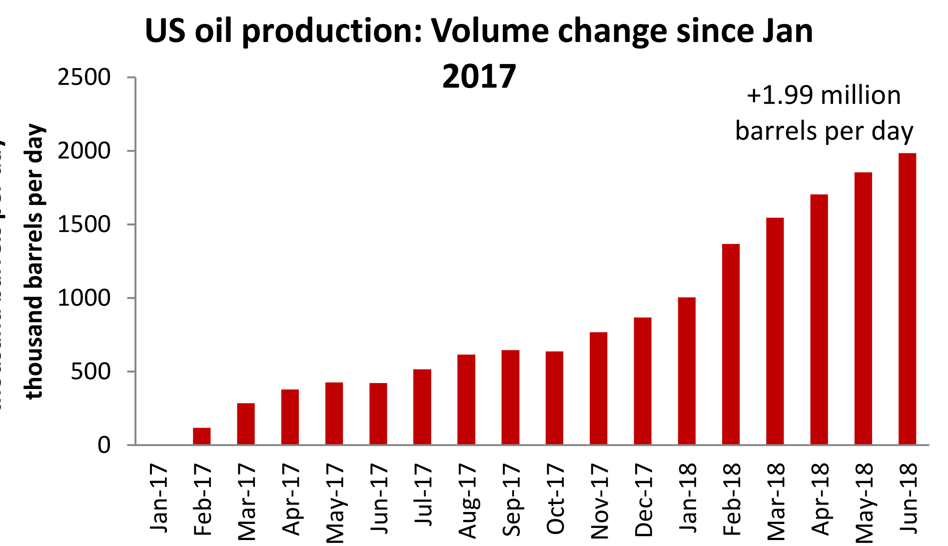


OCBC Bank Source: Bloomberg, OCBC Bank

Production update: OPEC to raise production

- **OPEC has been complying with production cuts** as per the implication of the Algiers Accord to reduce production by around 1.2 million barrels per day (bpd). Since May 2018, total production cut in OPEC alone measured 2.4 million bpd.
- **Over the same period, US oil production rose by almost 2.0 million bpd** since January 2017 to June's print of 10.9 million bpd, less than the production cuts seen in OPEC. Into end-2018, the US Energy Information Administration views total US oil production to average 10.8 million bpd (currently 6M18 average: 10.4 million bpd).
- **The uptick in OPEC supplies into 2H18 would invariably raise global oil production**, assuming sustained US production climb over the same period, and likely exacerbate the over supply climate seen to-date.





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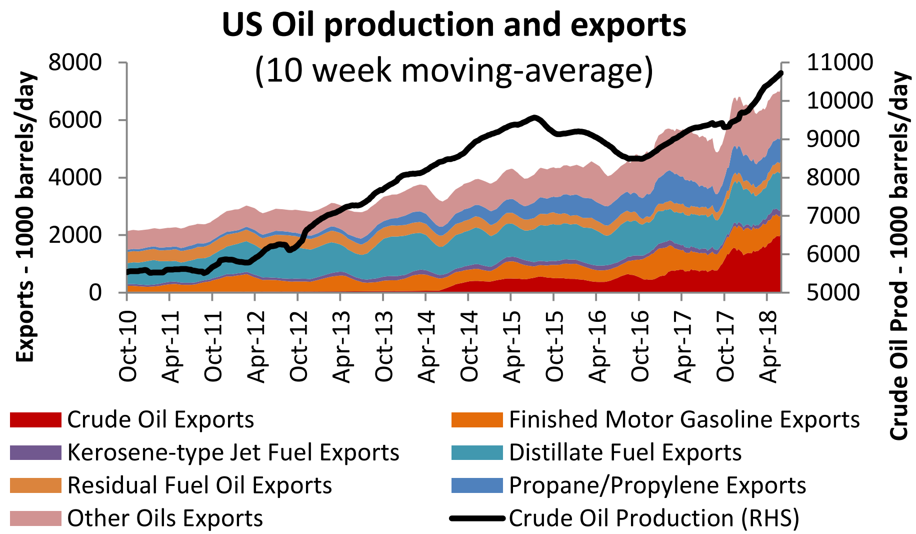
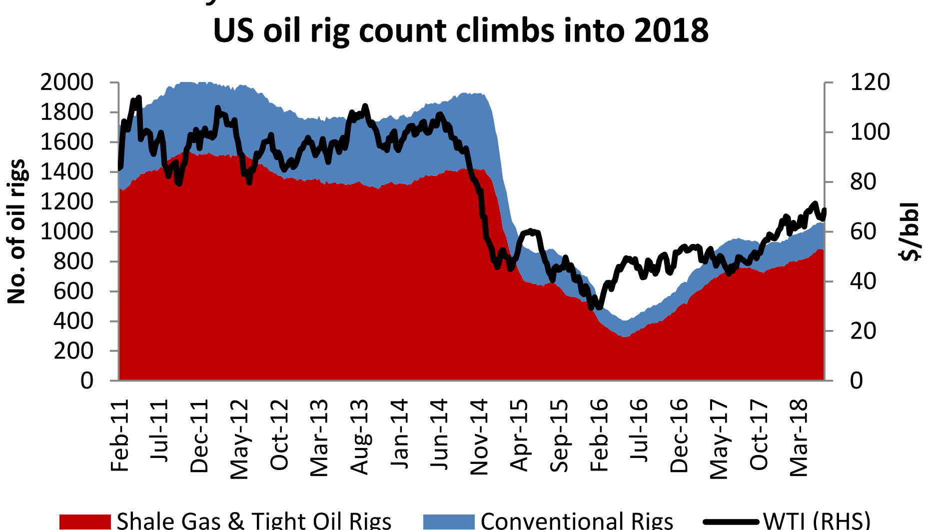
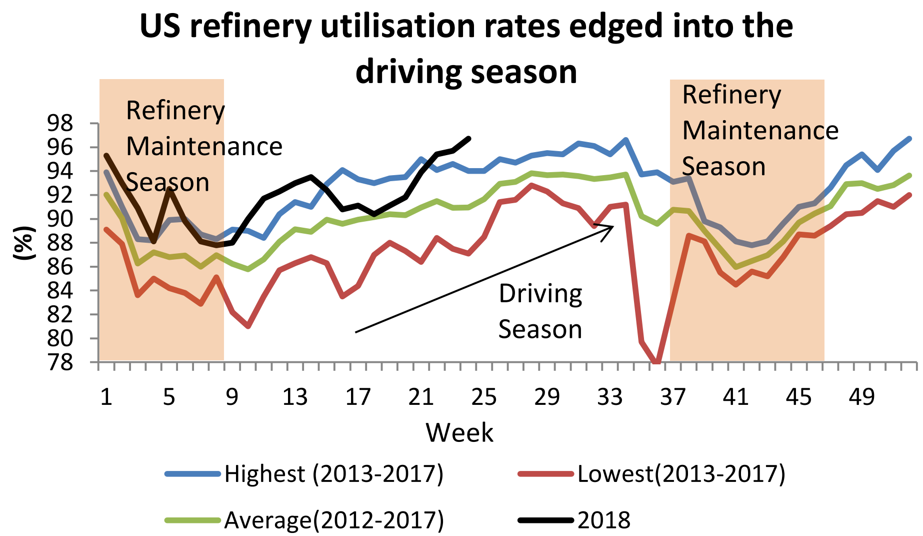
Source: Bloomberg, OCBC Bank

US oil exports also a key wildcard into 2H18

- **US crude oil exports grew** into mid-June to new record highs of 2.1 million bpd over a 10-week moving average.
- **US rig counts continue to climb over the same period**, a leading indicator that oil production may rise into 2H18.
- **Note that while US crude oil inventories remain near its 5-year average**, much of the decline is also due to stronger refinery utilisation rates into mid-year.

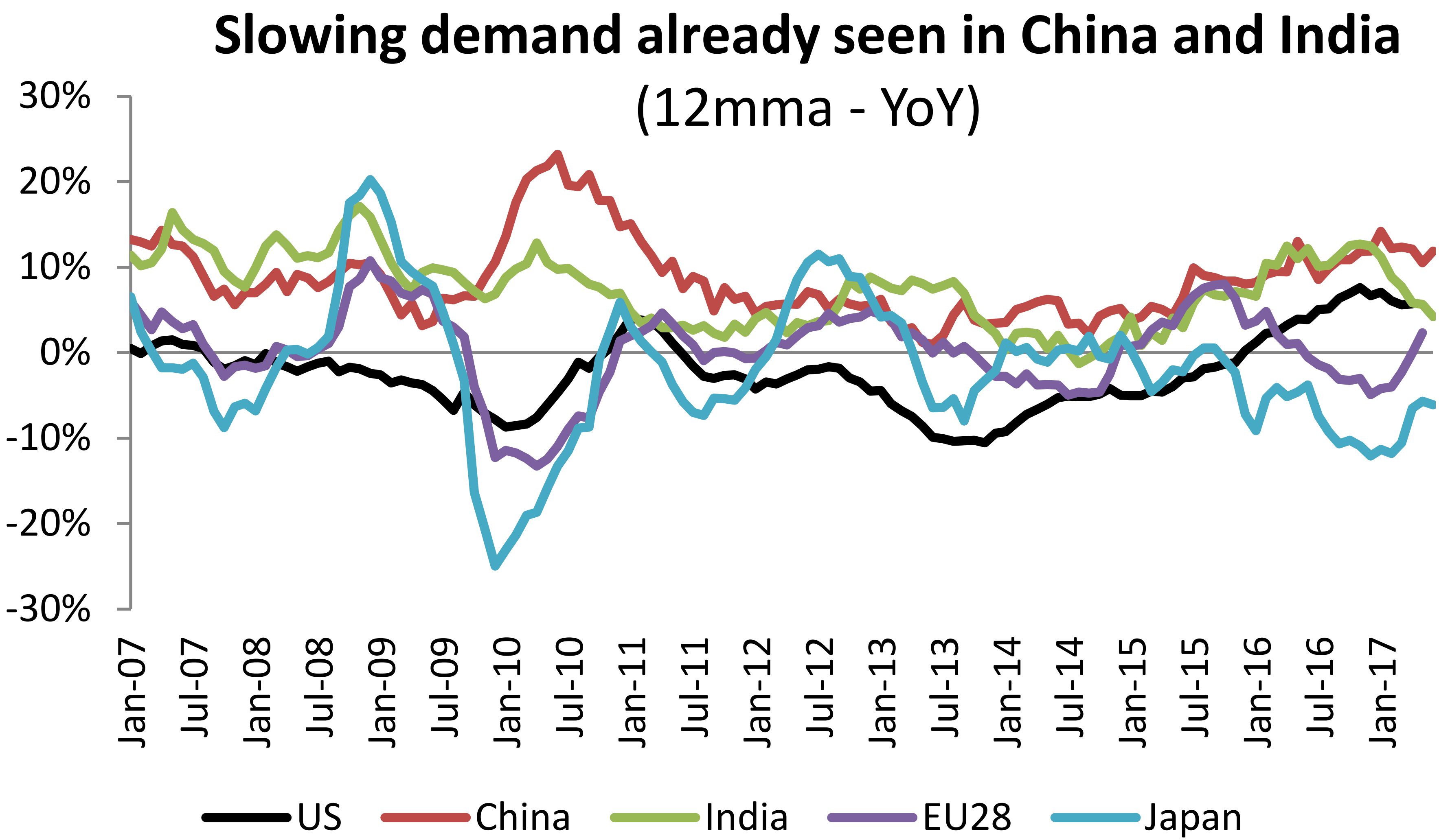






Source: Bloomberg, OCBC Bank

Demand has been slowing in key importers



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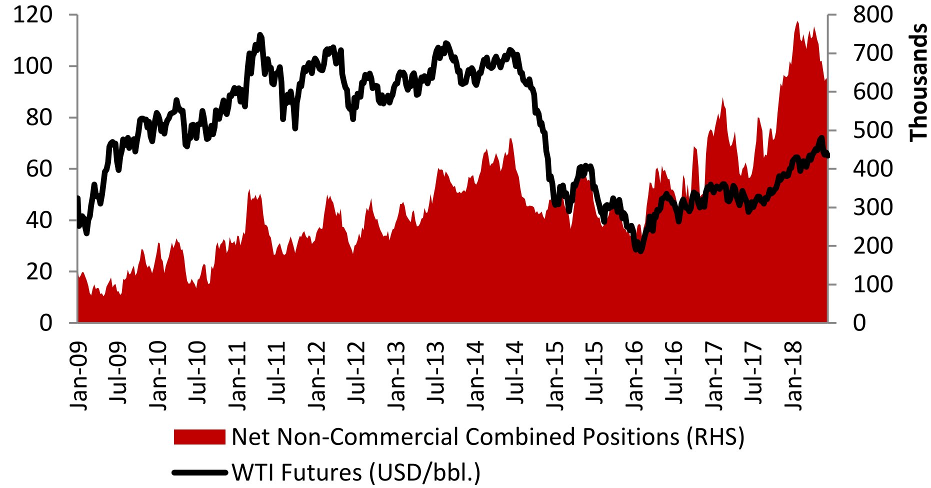
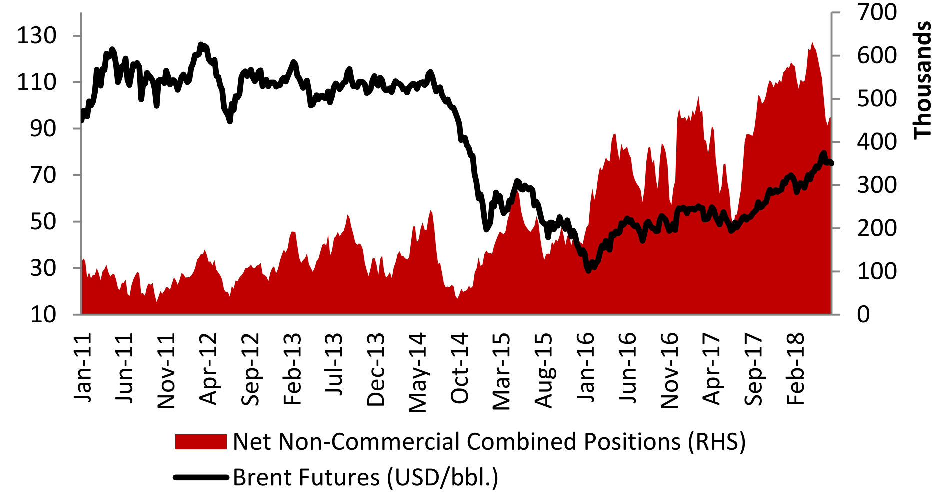
Source: Bloomberg, OCBC Bank

Bullish bets on crude oil dissipated

Crude Oil (WTI)

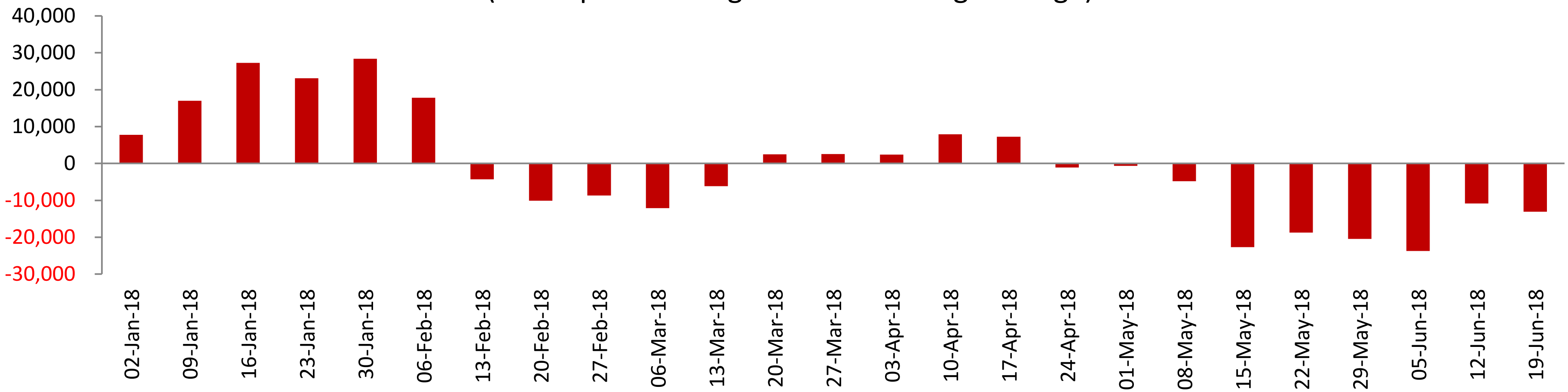


Crude Oil (Brent)



Bullish bets on oil are fading

(CFTC spec net-longs - 4-week average change)



Source: Bloomberg, CFTC, OCBC Bank

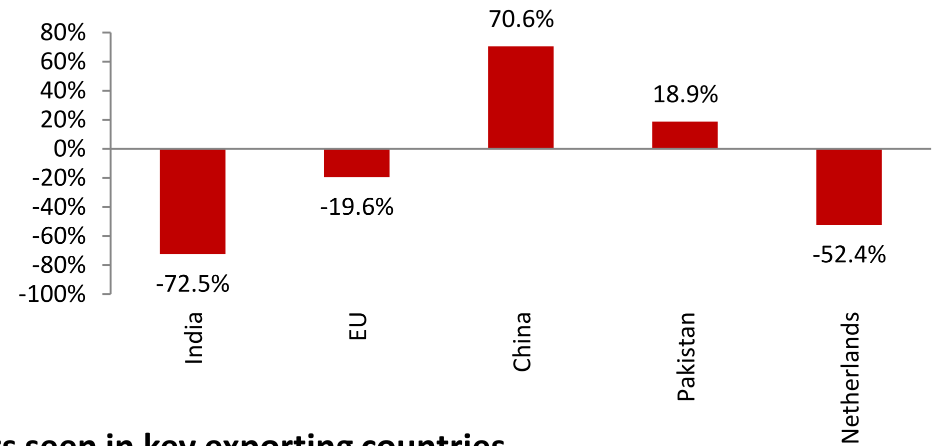
Palm Oil: Poor, poor fundamentals

- **The disconcerting aspect of palm oil prices is the surprisingly weak demand despite the recent Ramadan season.** Demand has been surprisingly weak into June 2018, a key driver for falling palm oil prices of late. Statistically, Malaysia's crude palm oil exports in May fell 70.5% y/y to 107 thousand metric tonnes, the lowest level since Feb 2007. Indonesia's crude palm oil exports has also contracted by four consecutive months into April 2018.
- **Production declined as well**, seen from a 7.8% y/y contraction in Malaysia's CPO production in May. Inventories however remain flushed at 2.2 million metric tonnes in the same period, highlighting that supplies remain adequate to-date. Still, supplies are also expected to expand further into October 2018 given seasonal factors, a rather persuasive driver that could keep palm oil bulls at bay for now.
- **Trade tariffs and China's threat to restrict soybean imports** from the US should drive palm oil prices higher, though it remains to be seen at this juncture. Should history be of reference, palm oil prices surged on fresh trade tariff-related news in April 2018, highlighting market bets over potentially higher Chinese palm-related imports.
- **We continue to stay bearish over palm oil prices into 2H18 given the fundamental picture.** With supplies likely to print higher into the third quarter amid lackluster demand, we keep our 3Q price outlook at MYR2,250/MT with downside risks, before seeing some recovery to our MYR2,400/MT estimate into year-end as supplies dwindle then.

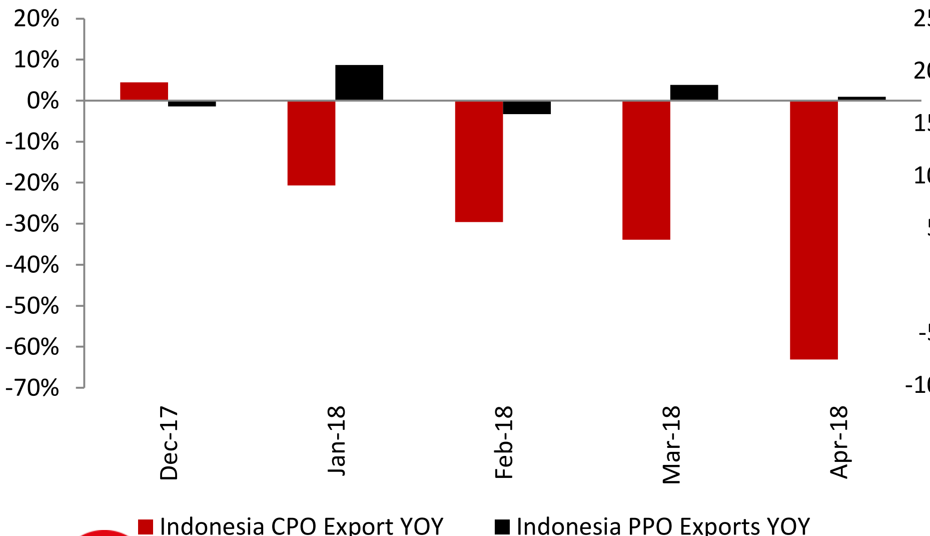
Ramadan-led events failed to spur demand

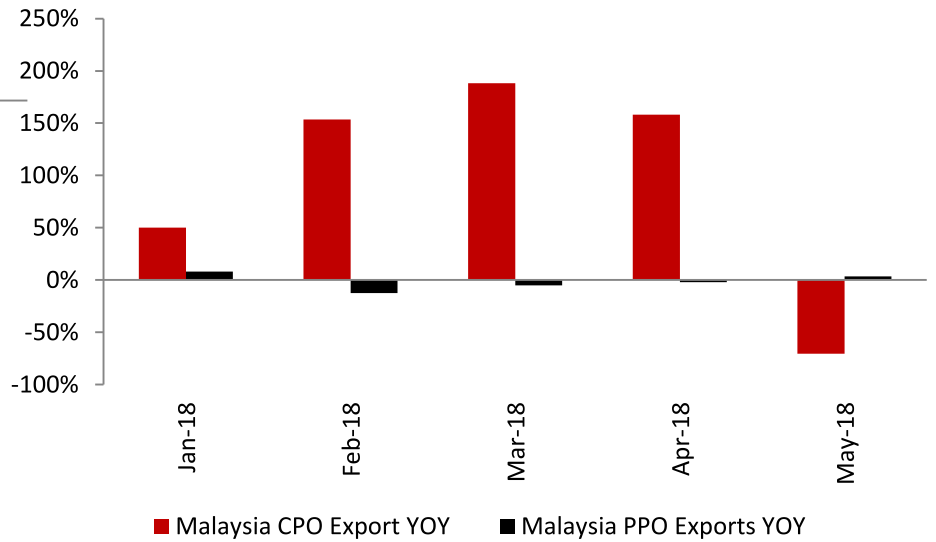
- **The demand boost from Ramadan-led celebrations seen in past years did not materialise in 2018.** Palm oil demand was surprisingly weak pre-Ramadan, led by lower demand from India, EU, and Netherlands.
- **Note Indonesia's crude palm oil** (CPO) exports declined for four consecutive months, while Malaysia surprisingly clocked a contraction in May.

Palm oil import growth in May 2018, across top five importing countries



Weak palm oil export prints seen in key exporting countries





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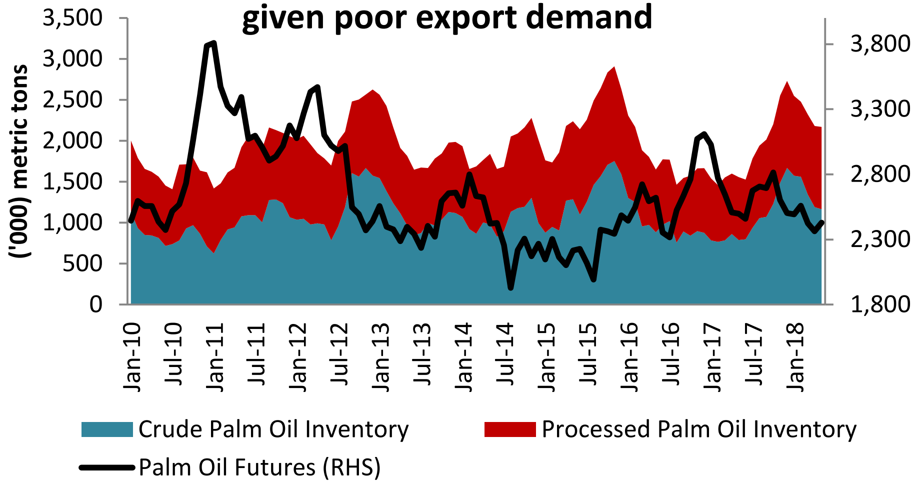
Source: Bloomberg, OCBC Bank

Supplies were weak, albeit to grow into 2H18

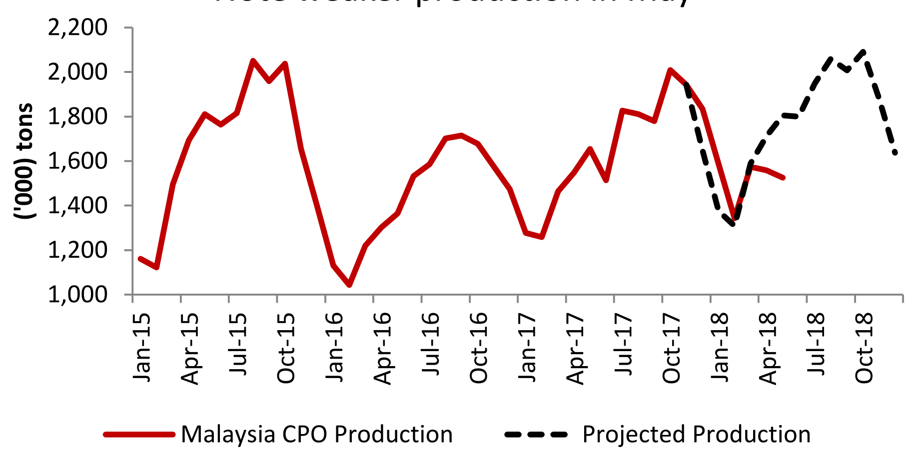
- **Despite the relatively weaker export demand seen in 1H18,** Malaysia palm oil inventories remain flushed into end-May at 2.17 million tonnes (vs 5-year average of 1.98 million tonnes).
- **Supplies were soft as well in May** following replanting exercises in key producing estates in Peninsula Malaysia (-3.9%) and Sabah (-6.6%). Accounting for the fall, total palm oil production in Malaysia clocked its first y/y contraction (-7.8%) since June 2017.
- **Malaysia's palm oil production will likely grow further into 3Q18** given seasonal factors, as palm fruit production and oil yield traditionally picks up during this period. Coupled with the poor demand seen of late, overall palm oil prices could see further downside risk at least into 3Q18.

Malaysia palm oil inventories remain flushed given poor export demand



Malaysia's CPO production to grow into 2018

Note weaker production in May



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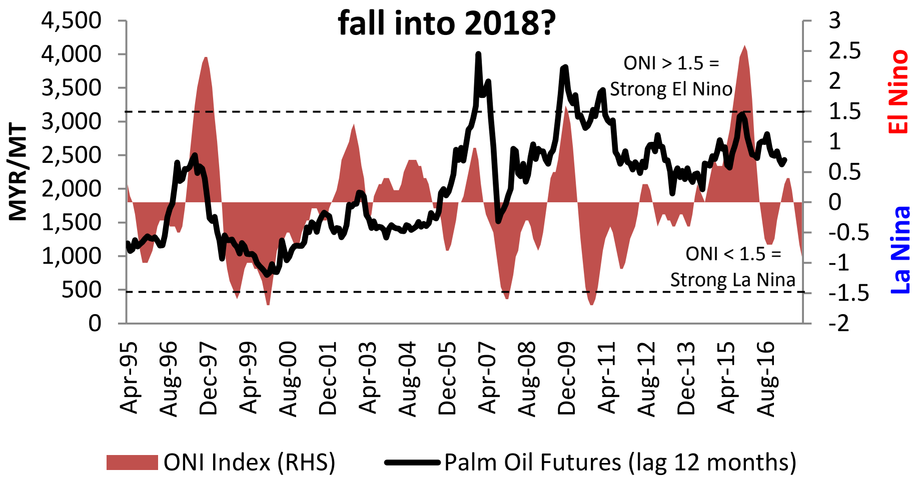
Source: Bloomberg, OCBC Bank

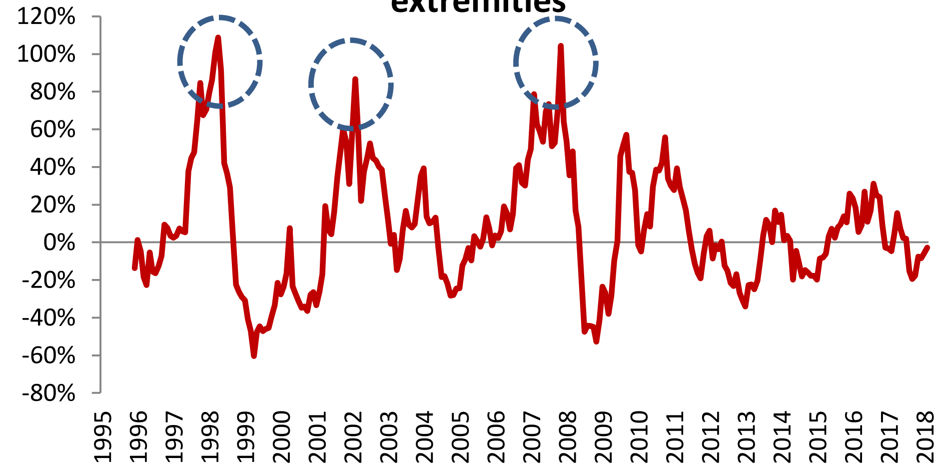
‘Normal’ weather conditions for now

- **While weak La Nina conditions were reported in early 2018,** indicators are now “consistent with an imminent decay” of the said La Nina event, according to the World Meteorological Organization. The agency added that there will be a transition to neutral conditions and a continuation of La Nina condition will be unlikely into 2018.
- **We note that past weather extremities are drivers that rallied palm oil prices** (1998, 2001, 2008). Recent El Nino as of 2015 did rally prices by as much as 31% y/y, though recent declines in palm prices indicate the lack of weather extremities to-date.
- **With neutral weather conditions to play out,** it suggest that any swings in palm oil prices due to weather conditions is highly unlikely at this juncture.

Palm oil prices appear to have peaked, prices to fall into 2018?

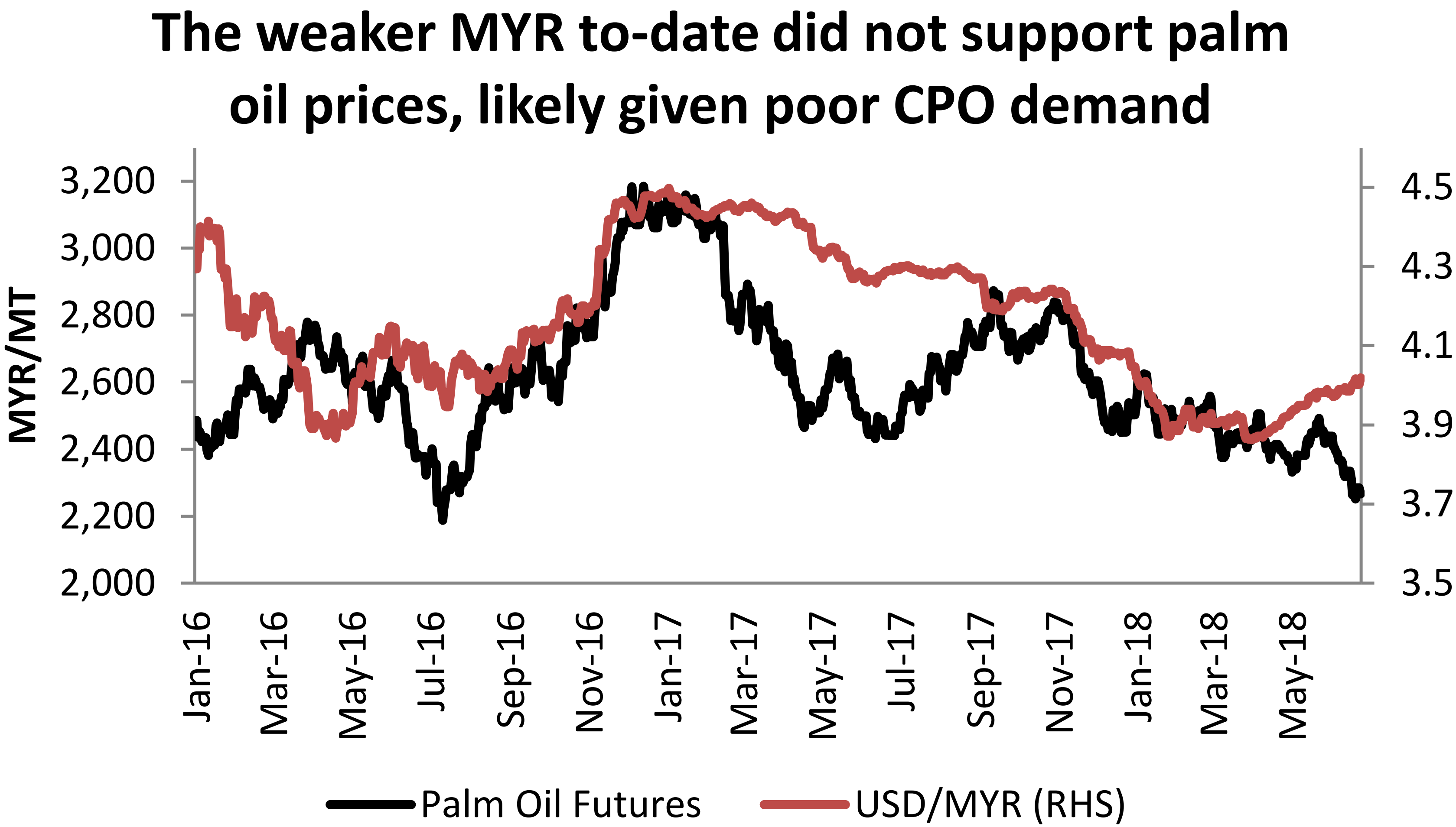


Palm prices rally significantly on weather extremities



Source: Bloomberg, OCBC Bank

Wither the ringgit? Weaker MYR should support prices

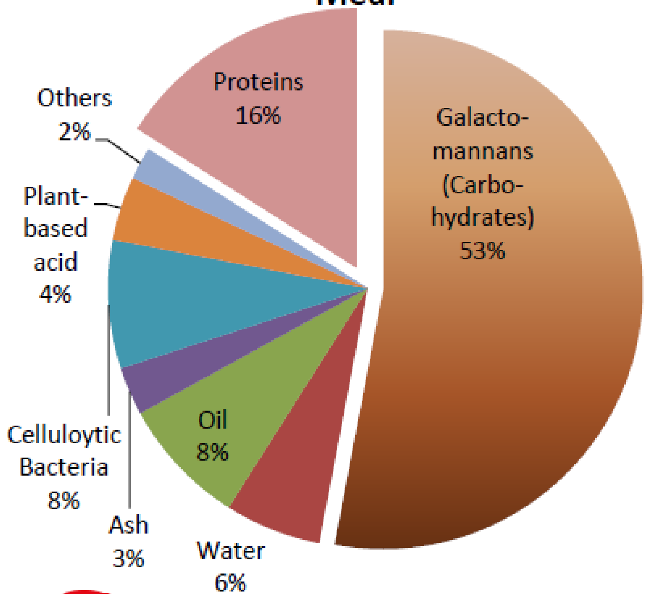


OCBC Bank Source: Bloomberg, OCBC Bank

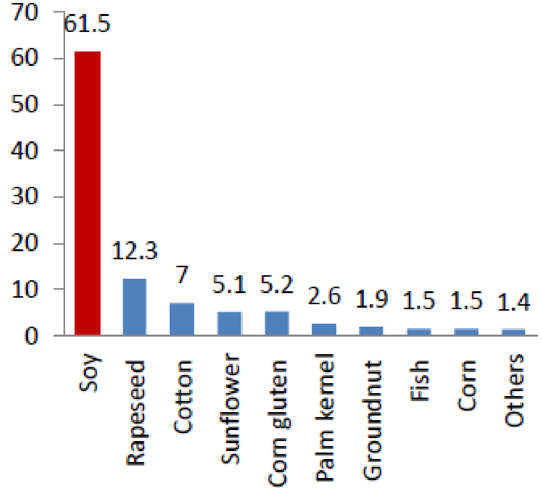
US-Sino trade tariffs should benefit palm oil… but?

- **Palm oil is said to be second only to soybean oil in world production of vegetable oils.** Palm fruits have long been considered to be a viable substitute for soybeans. From the edible oils perspective, both commodities are used to produce cooking oils, used for frying, baking and other types of cooking.
- **Palm oil is also used in the production of livestock feed.** Palm fatty acid distillate (PFAD) is also an active ingredient as a fat supplement for livestock. Palm kernel meal, a by-product after oil has been extracted, has also been used as a viable substitute to soy meals.

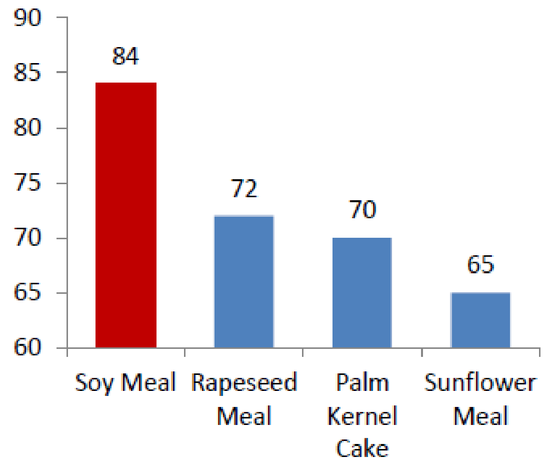
Nutritive Profile of Palm Kernel Meal



Global Consumption of Meals (2013)



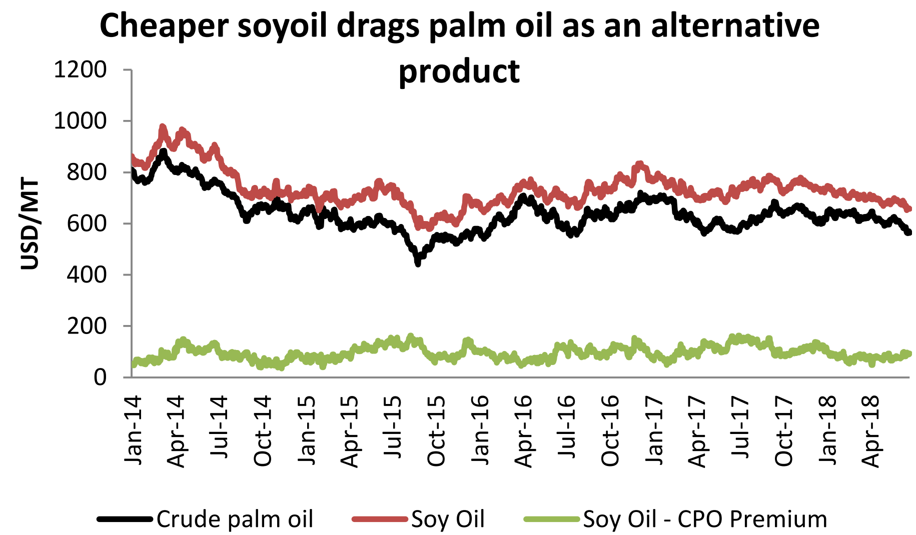
Palm Kernal Cake is the third most nutritious meal
(Digestable Nutrients %)

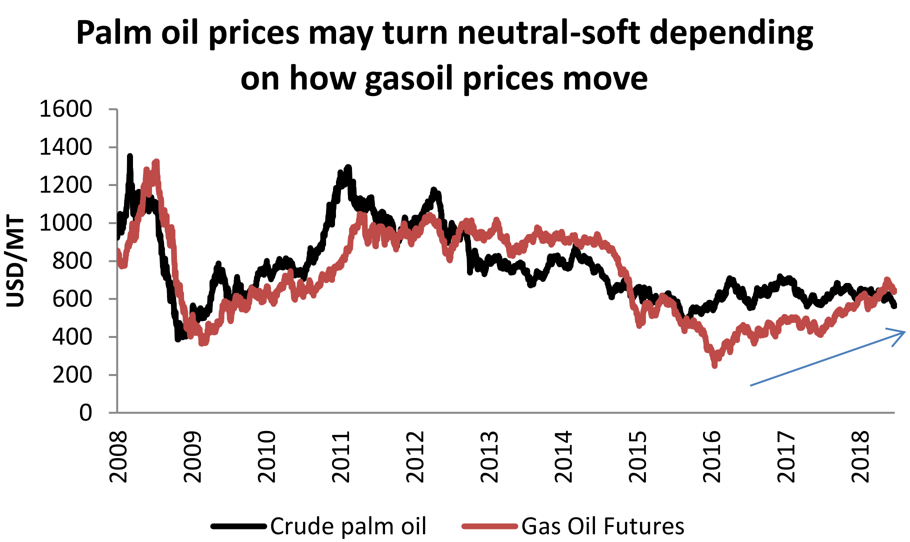


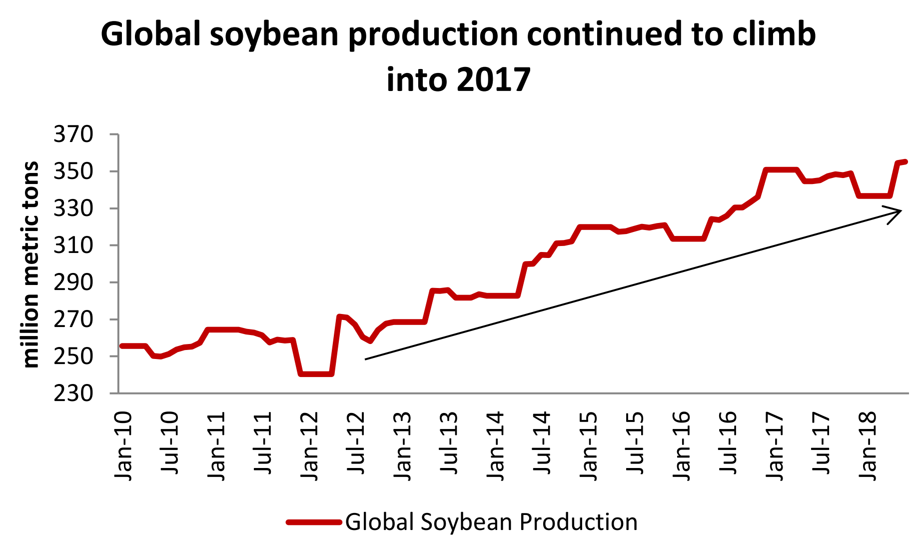
OCBC Bank Source: MPOB, OCBC Bank

Other factors: Soybeans and other risk assets

- **Movement in palm oil prices** will also depend on other growth-related commodities including copper and crude oil remain near 2010 levels, with recent movements hinting at some price consolidations at this juncture.
- **Global soybean production** continue to print new highs at 355 million tonnes (+3.1% y/y in May 2018).







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Source: Bloomberg, OCBC Bank

OCBC Commodity Forecast 2H18

Updated as of June 26, 2018

			2017				2018			
	3y AVG	Spot	Q1	Q2	Q3	Q4	Q1	Q2F	Q3F	Q4F
Energy										
WTI ($/bbl)	47.1	68.1	51.8	48.2	48.2	55.3	62.9	67.6	66.3	65.0
Brent ($/bbl)	50.7	74.7	54.6	50.8	52.2	61.5	67.2	74.7	71.3	70.0
Gasoline ($/gallon)	1.53	2.05	1.58	1.58	1.63	1.71	1.86	2.11	2.16	1.97
Natural Gas ($/mmbtu)	2.68	2.92	3.06	3.14	2.95	2.92	2.85	2.83	3.24	3.18
Precious Metals										
Gold ($/oz)	1210.4	1,269	1,221	1,259	1,283	1,279	1,331	1,312	1,273	1,300
Silver ($/oz)	16.5	16.4	17.5	17.2	16.9	16.7	16.7	16.6	16.2	16.6
Platinum ($/oz)	994	871	983	942	957	925	981	909	909	963
Palladium ($/oz)	722	935	768	815	899	988	1,026	973	943	1,000
Base Metals										
Copper ($/MT)	5,523	6,755	5,855	5,692	6,383	6,856	6,997	6,909	6,705	6,500
Tin ($/MT)	17,764	20,190	20,012	19,906	20,482	19,817	21,151	20,975	20,317	20,313
Nickel ($/MT)	10,630	14,668	10,277	9,214	10,547	11,614	13,277	14,454	13,683	13,000
Zinc ($/MT)	2,265	2,858	2,789	2,604	2,961	3,198	3,390	3,116	3,048	3,023
Aluminum ($/MT)	1,737	2,155	1,858	1,913	2,027	2,122	2,160	2,261	2,225	2,100
Asian Commodities										
Crude Palm Oil (MYR/MT)	2,523	2,290	2,938	2,545	2,670	2,659	2,491	2,394	2,250	2,400

Source:

Historical Data - Bloomberg

Forecasts - OCBC Bank

Data reflects average price

Thank You

Disclaimer

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