Trade War and its effects on commodities

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Executive Summary

- **Trade war concerns intensified** now with US President Trump's comment to "consider whether US$100 billion of additional tariffs would be appropriate" in response to China's proposal to impose US$50 billion tariffs against US aircrafts, automotive and soybeans. At the time of writing as of 6th April 2018, US stock index futures and growth-related commodities fell immediately while safe haven demand into gold rallied the yellow metal.
- **IMF commented that trade wars "not only hurt global growth, they are also unwinnable"** while World Bank chimed in that protectionism can "disrupt worldwide supply chains and affect long-term productivity". According to Bloomberg Economics, a full-blown trade war may cost the global economy $470 billion (or about 89.3% of total US imports from China in 2017). Note that both US and China have substantial trade exposures, with US' total trade with China at 16.9% of its total trade with the rest of the world, vice versa China's total trade with the US at 14.3%.
- **Should trade tariff proposals turn concrete,** we opine that growth-related commodities could potentially trend similarly to a growth-recessionary year (crude oil, base metals: -10% to 30%), while safe haven demand into gold will lift the yellow metal beyond $1,600/oz. Impact on agricultural will likely be mixed, as crude palm oil could find favor with Chinese importers, while soybean prices could potentially fall as demand slackens.
- **At least for now, the trade tariff threats are merely… just threats.** Risk appetite could eventually recover should it stay as a war of threats (and executive orders). Watch out for potential huge swings in the commodity market (as well as the overall financial markets) should things escalate further.

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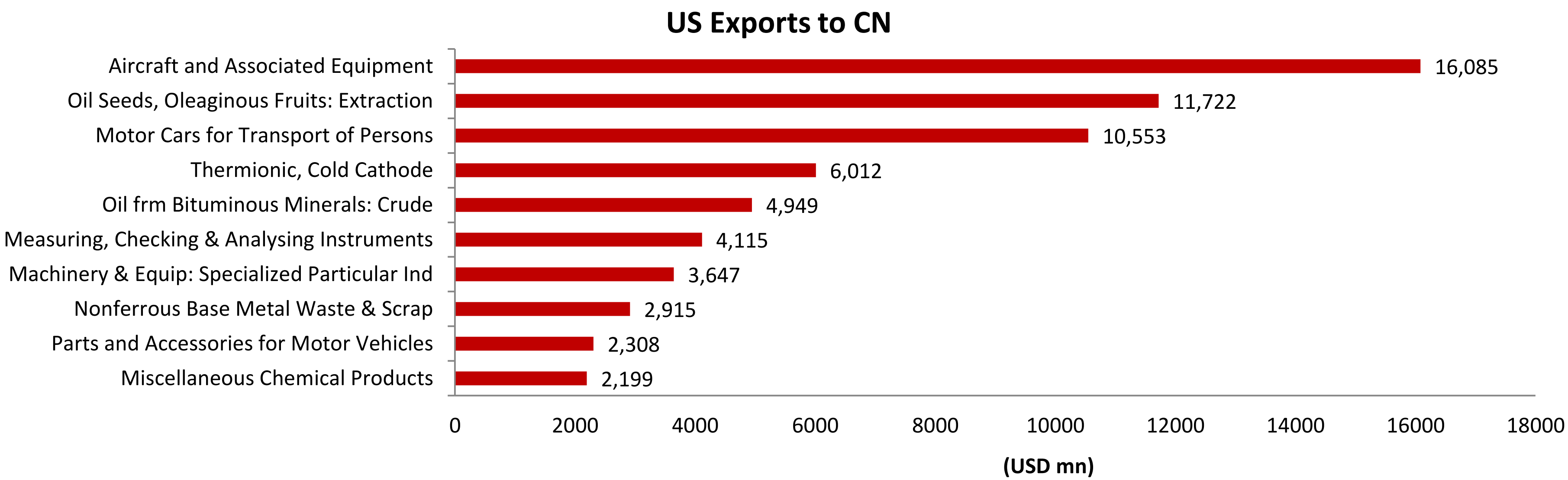
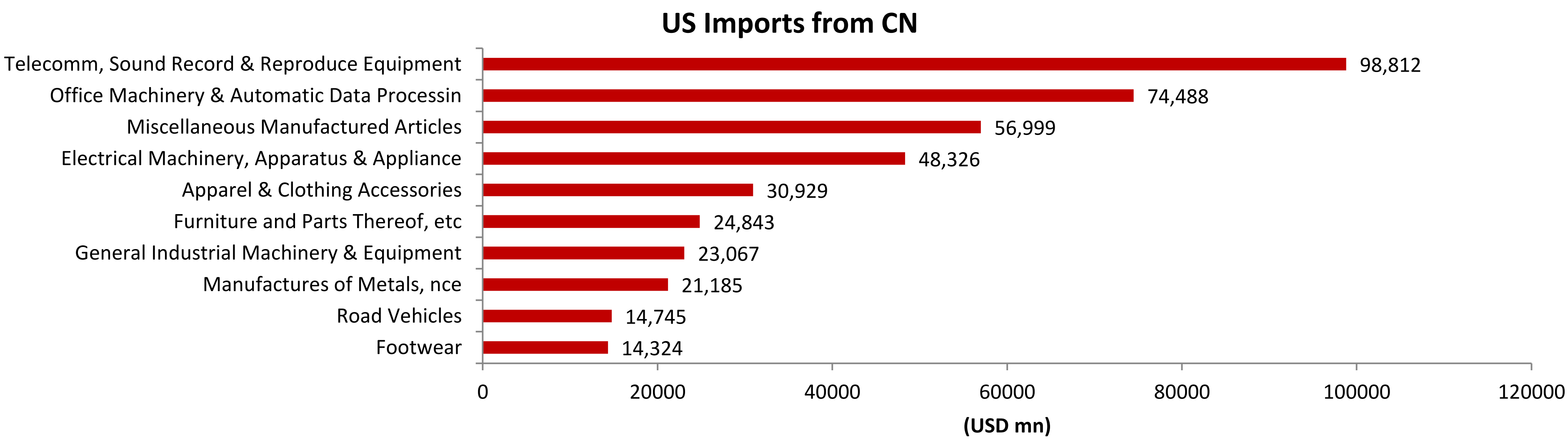
Economics in brief: Who buys where and what?





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Source: CEIC, OCBC. Trade data is calculated as a sum of 12 months into Jan 2018.

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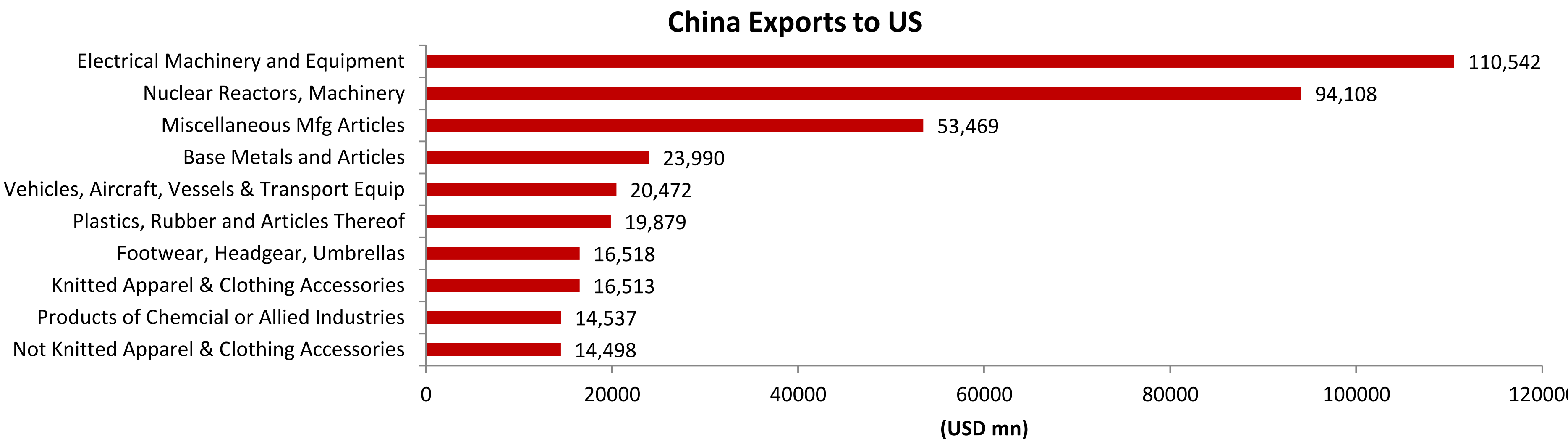

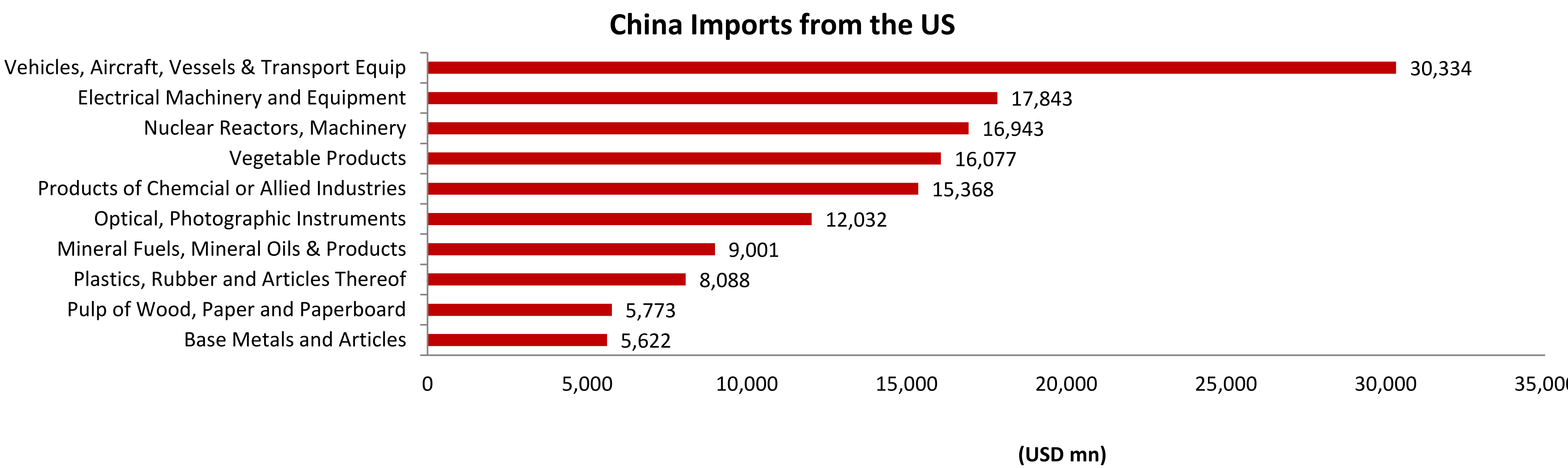

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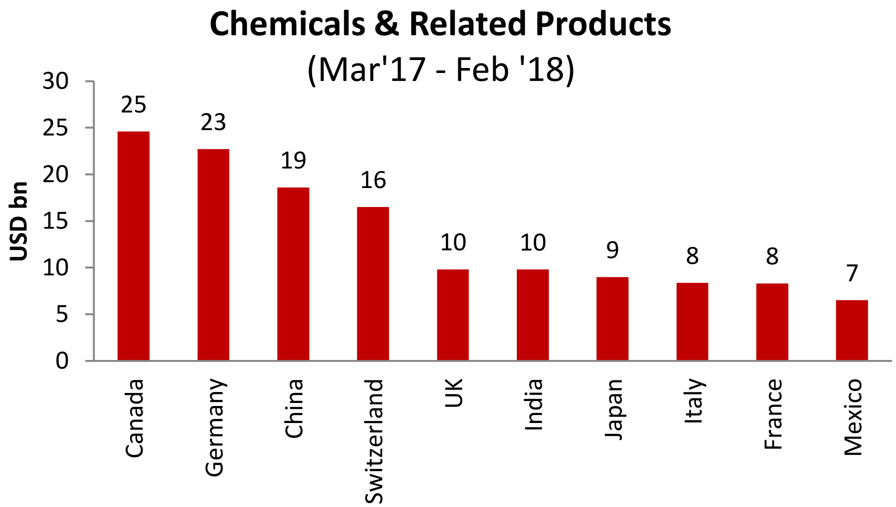
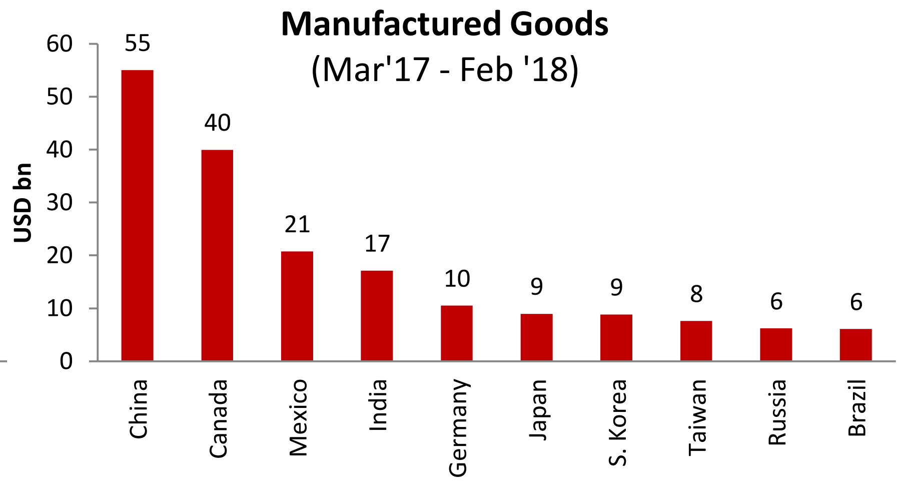
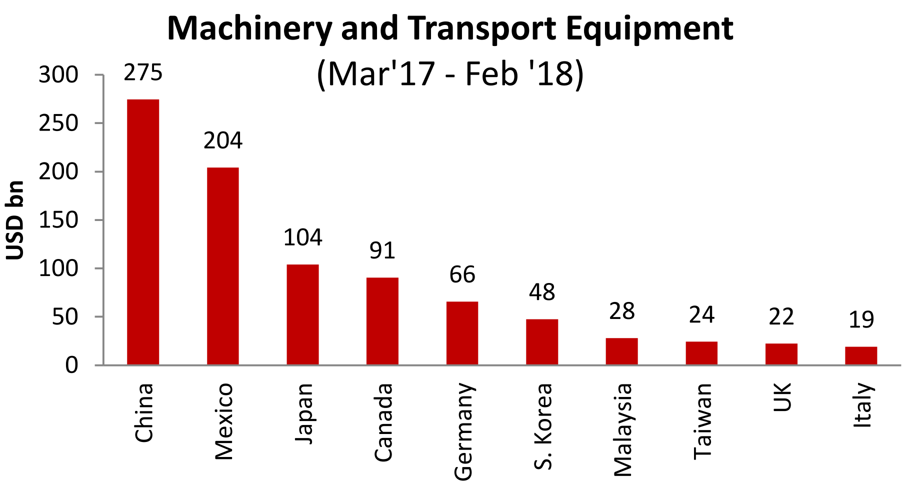
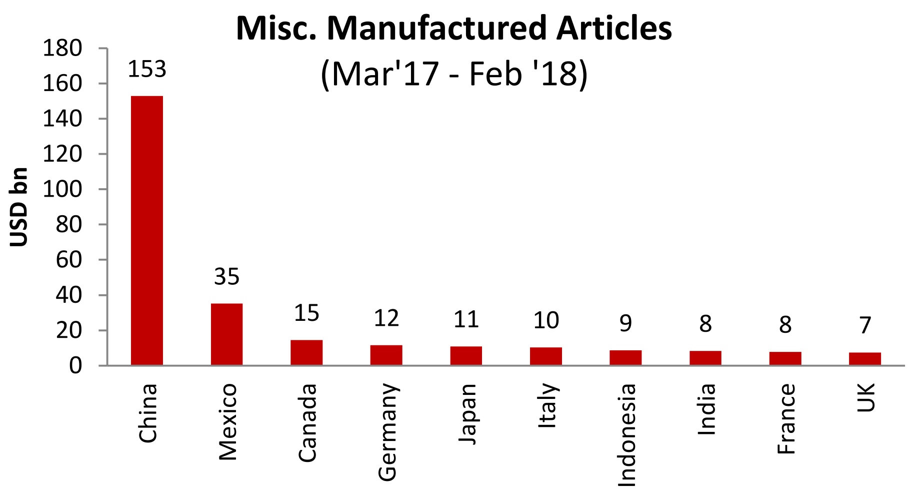
Source: CEIC, OCBC. Trade data is calculated as a sum of 12 months into Feb 2018.

Top US import sources of products



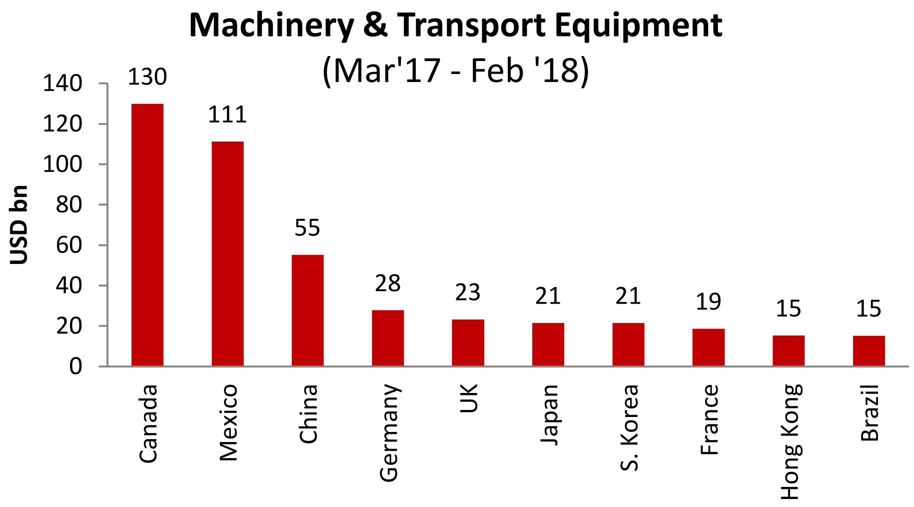


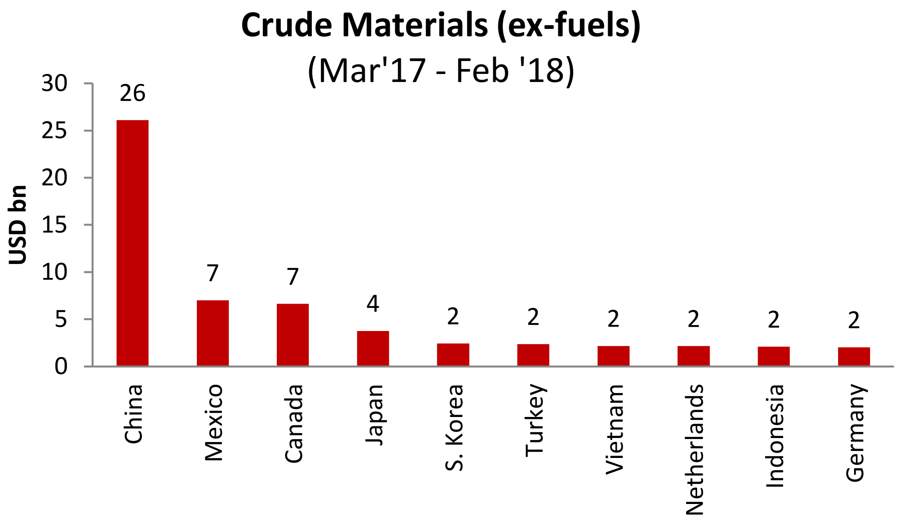


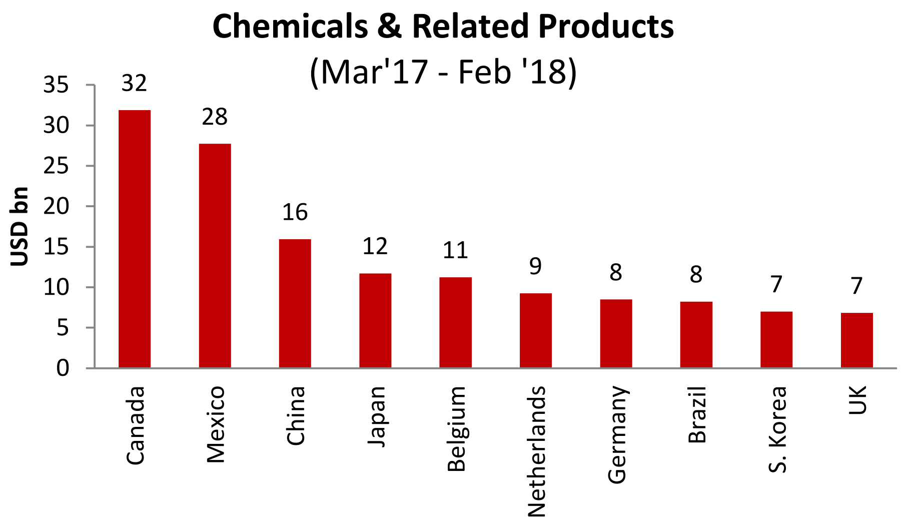


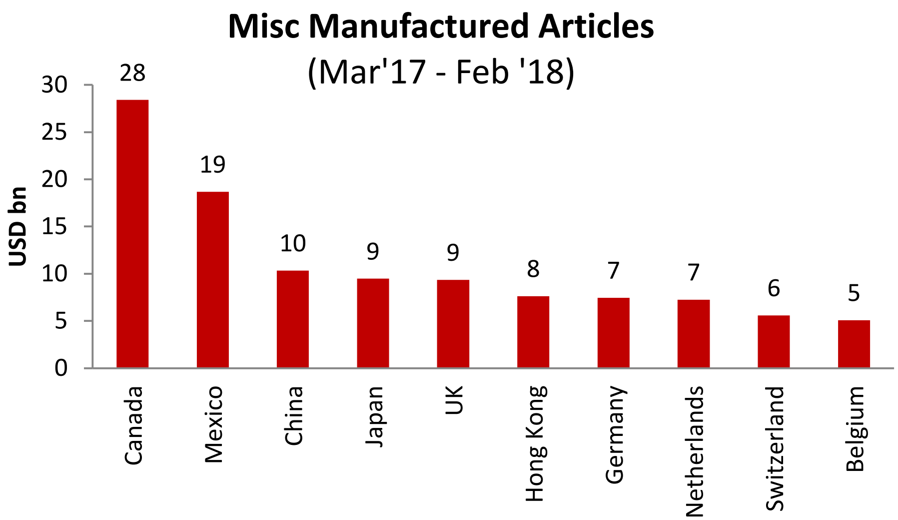
OCBC Bank Source: CEIC, OCBC

Top US export sources of products





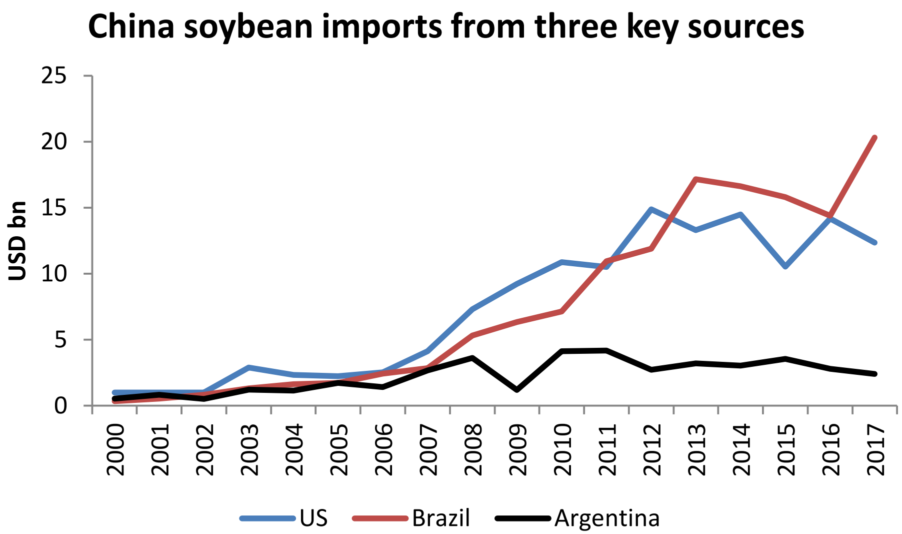


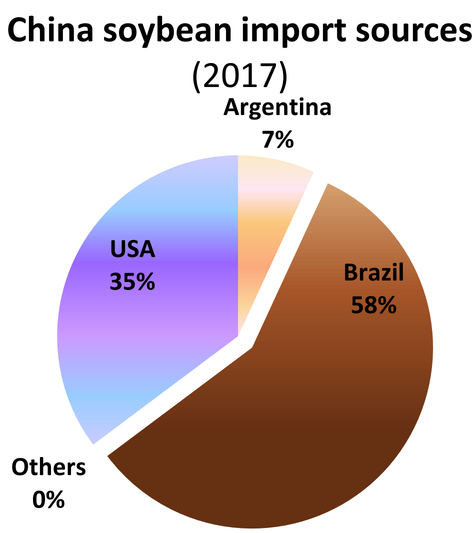


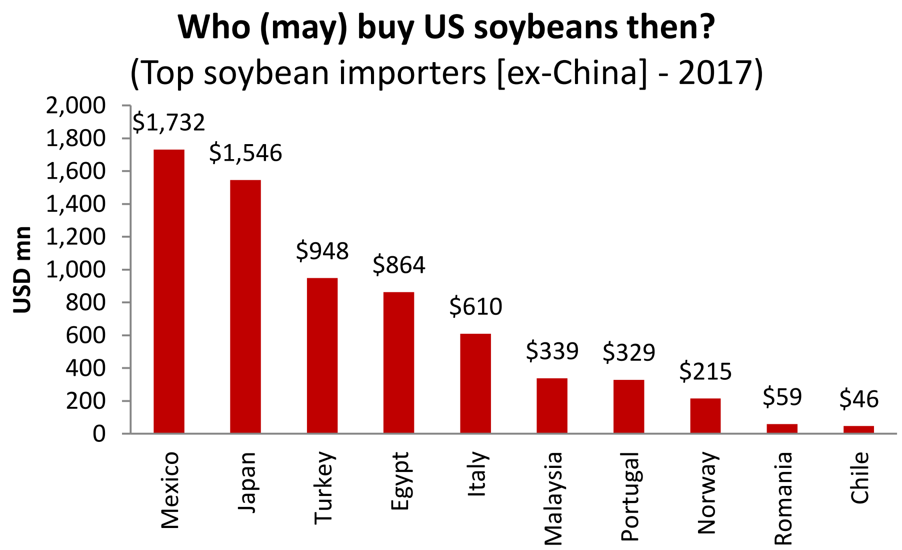
OCBC Bank Source: CEIC, OCBC

Soybeans: The sensitivities surrounding it

- Globally, China is the world's top soybean importer, and Brazil, US and Argentina are the top three exporters.
- China imports 60% of the soybeans traded worldwide in 2017, up from 41% back in 2005.
- Note that China is also the top soybean importer from the US, accounting for 57.1% of US total soybean exports.



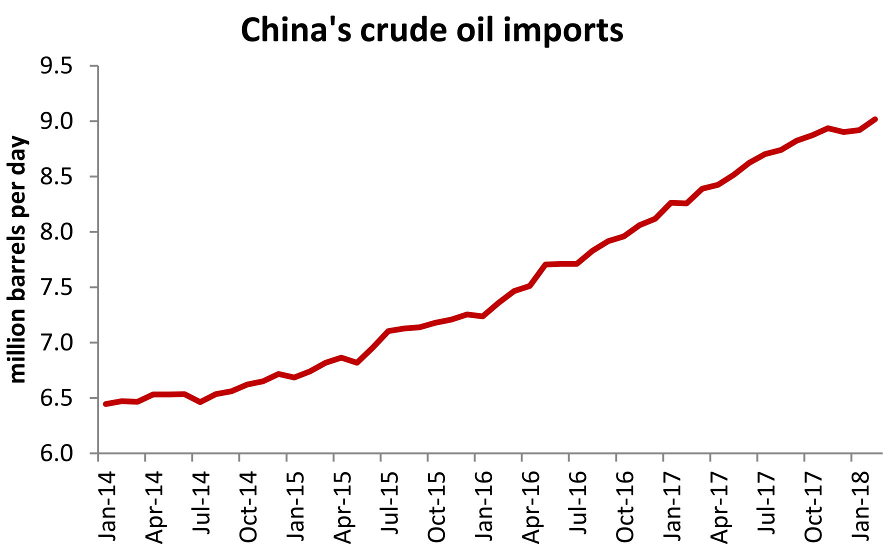


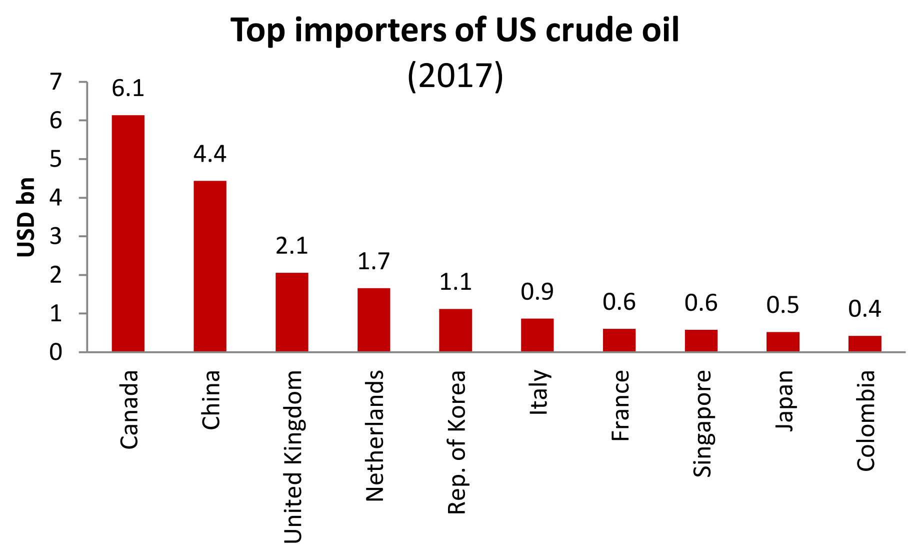


Source: UN Comtrade, OCBC

Crude Oil: Excluded from tariffs… for now

- **Note that energy trade has been excluded** from the tit-for-tat tariff threats… for now, likely as China remains thirsty for crude oil and its distillates.
- **Trade-wise, China imported US$4.4bn of US crude oil in 2017**, or 20.3% of total US crude oil exports. Assuming 2017's average price of $54.9/bbl, China imported 222 thousand barrels per day from the US, or merely 0.22% of global demand.
- **We view that China's potential move to impose tariffs on US-imported crude remains unlikely**, given the very small impact it has on trade balances, as well as China's increasing demand for crude oil over the many years.



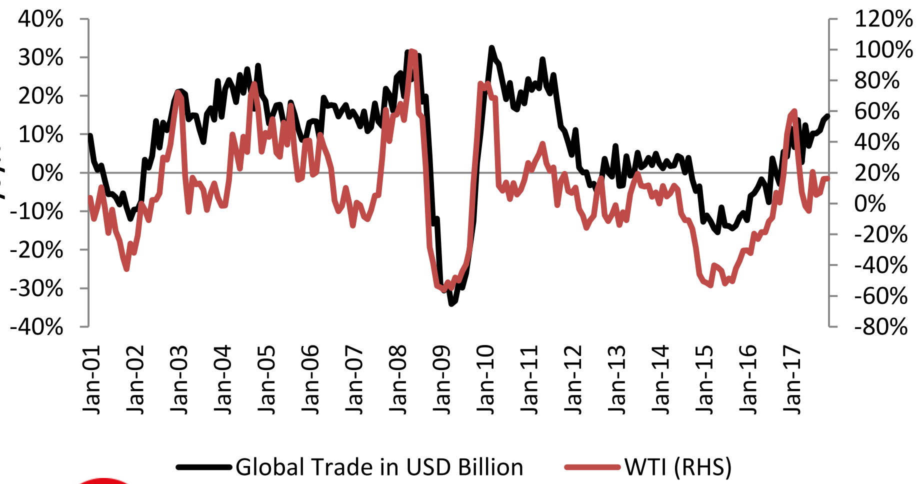


OCBC Bank Source: Bloomberg, CEIC, OCBC

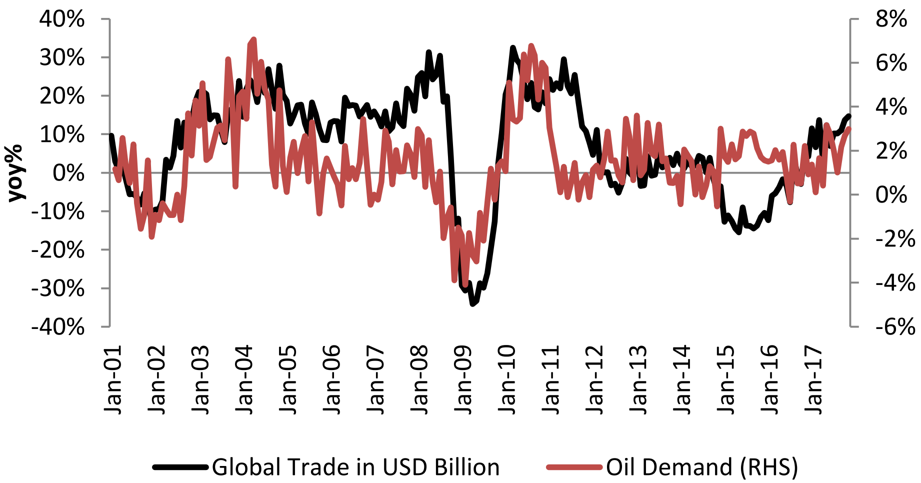
Crude Oil: Growth-related in nature

- **Still, crude oil prices remain to be intricately correlated** with investors' risk appetite and global growth prospects. While trade tariff proposals from both US and China had left energy trade untouched, energy prices turned south into early April 2018.
- **The reason behind lower crude oil prices is simple:** the inhibition of world trade through trade tariffs between the two largest economies in the world (which represents 48.5% of global nominal GDP) will negatively impact global trade activities, growth prospects, and eventually oil prices.
- **The shortfall in demand, should world trade dampens, will likely be a second-order effect;** the negative impact trade war has on global growth has broad implication on income, employment and inflation, which then consequently affects demand for global commodities including crude oil.

World trade and oil prices



World trade and oil demand

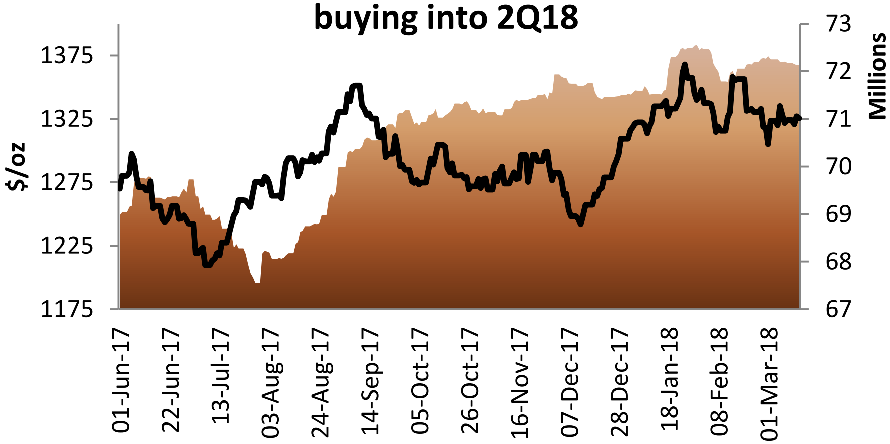


OCBC Bank Source: Bloomberg, IMF, OCBC

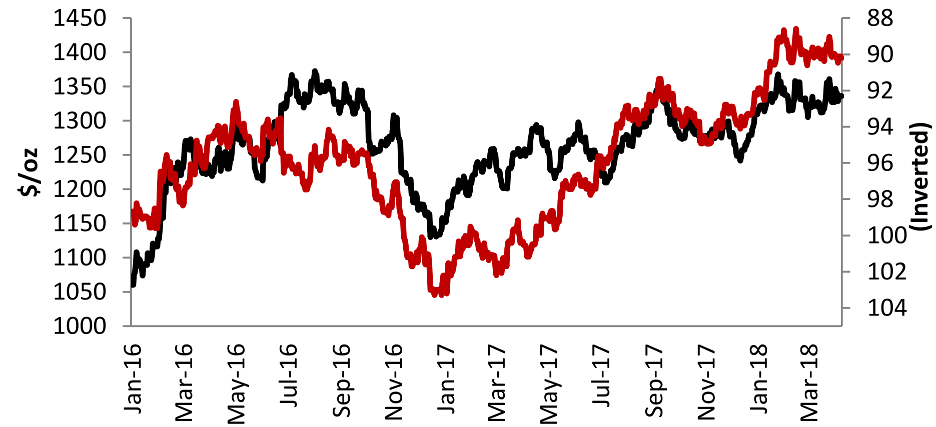
Gold: Fear gives gold wings

- **Trade war concerns have rallied the yellow metal since the first signs of tariff threats emerged.** As recent as early March when US President Trump signed executive orders pertaining to the steel and aluminium tariffs, gold prices rose to as high as $1,360/oz, up from $1,305/oz in end-February.
- **In tandem with higher gold prices, ETF buying has pick-up** over the same period, suggesting that higher paper demand was the pillar behind the stronger gold price, although the relatively weaker greenback did support it as well.
- **Note that past 30-day USD-Gold correlation remained strong at -0.812**, suggesting that the dollar weakness, should it persist, is a persuasive driver in supporting the yellow metal.

Safe haven demand rose, seen from higher ETF buying into 2Q18



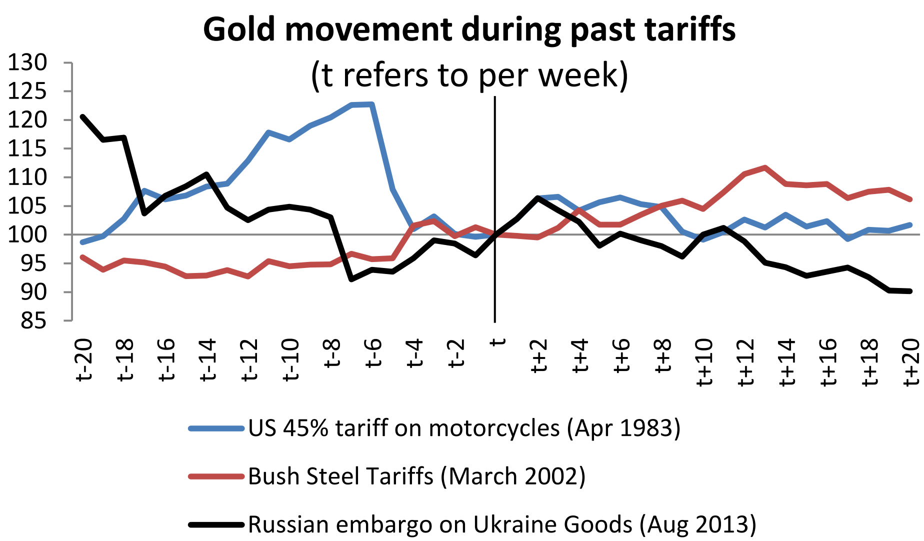
Gold-DXY correlation remain water-tight



OCBC Bank Source: CFTC, Bloomberg, OCBC

Gold: Any negative news are likely gold-friendly

- **IMF: Trade wars "not only hurt global growth, they are also unwinnable"**. World Bank chimed in that protectionism can "disrupt worldwide supply chains and affect long-term productivity".
- **A full-blown trade war may cost the global economy $470 billion** (or about 89.3% of total US imports from China in 2017), according to Bloomberg. Note that both US and China have substantial trade exposures, with US' total trade with China at 16.9% of its total trade with the rest of the world, vice versa China's total trade with the US at 14.3%.
- **We view that trade wars has the potential to inject negative consequences on both growth and trade activities.** However, the impact on the yellow metal should we view historical reference, was positive in the near term but mixed into the longer period.
- **Also, note that the recent (and similar) steel tariffs imposed** during the Bush administration back in 2002 saw an estimate welfare loss of $41.6 million (according to the US International Trade Commission) and affected almost 50,000 jobs in metal, machinery and equipment producing industries and 197,000 lost in steel-consuming industries.

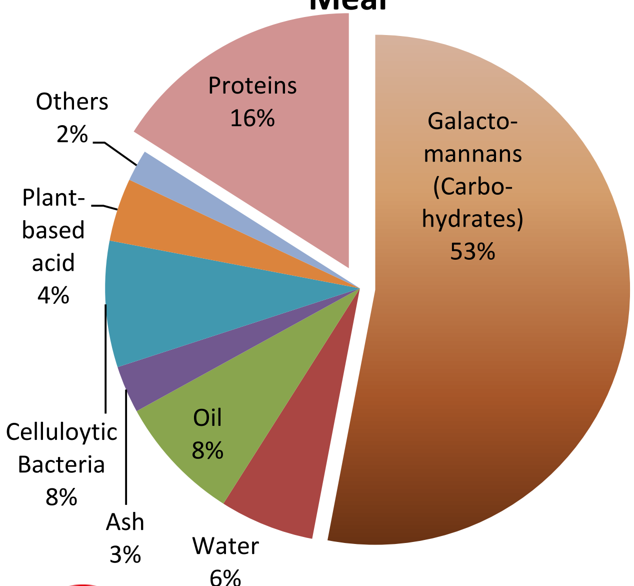


OCBC Bank Source: CFTC, Bloomberg, OCBC

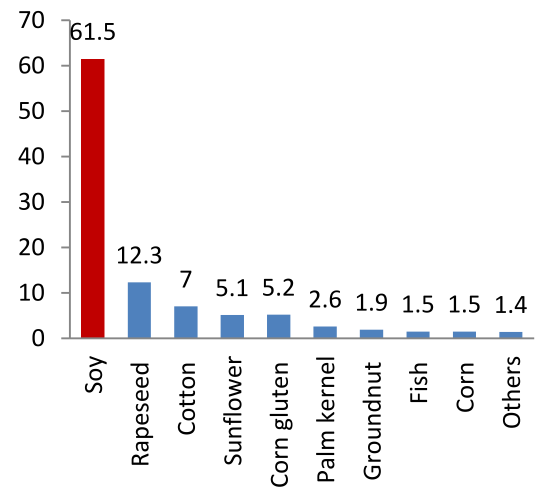
Palm oil to benefit from soybean-related tariffs

- **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.

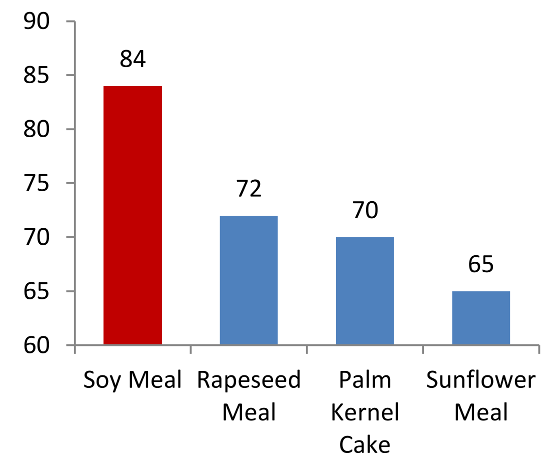
Nutritive Profile of Palm Kernel Meal



Global Consumption of Meals (2013)



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

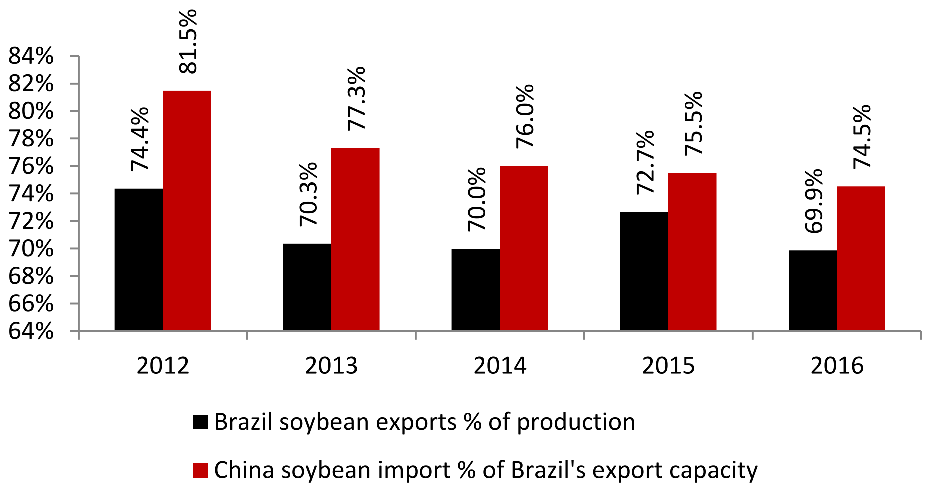


OCBC Bank Source: MPOB, OCBC

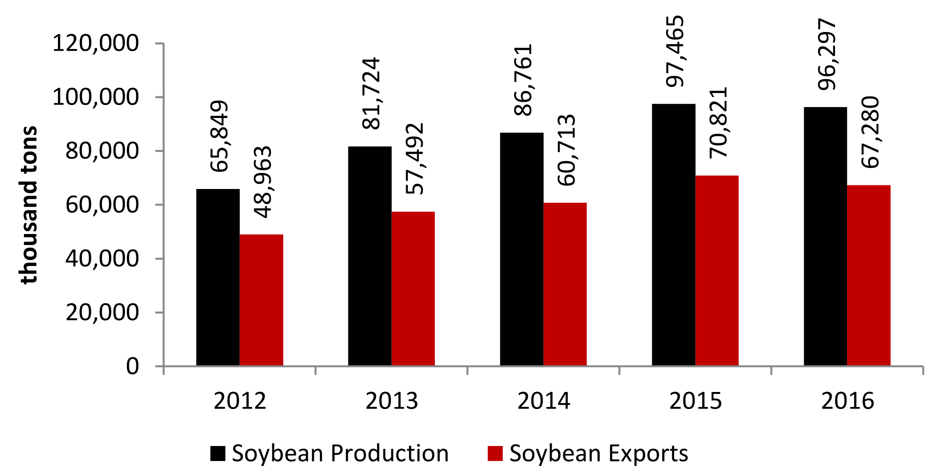
Brazil could benefit too, but?

- **Brazil being the world's largest exporter of soybean,** could benefit from China's increased demand away from US-grown soybeans. As of 2016, China imports 40% of total Brazil's soybean production.
- **However, Brazil's soybean production capacity has been nearing its peak.** Over 70% of Brazil's soybean export capacity[1] is from China's demand.
- **Should China totally cease import demand from US-grown soybean,** around $12.0 billion worth of soybean (or 33.2 thousand tons) of import demand would need to be sourced from elsewhere. Assuming Brazil's soybean export capacity of 74.5% as of 2016, only 13.2 thousand tons of soybean are export-ready, and also assuming that Brazil exports only to China alone.

Brazil soybean export capacity to China is >70%



Most of Brazil's soybean production is exported



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Source: UN Comtrade, USDA, OCBC

[1] Calculated by total Chinese soybean exports as a % of Brazil's production, after accounting for domestic consumption

Summary of impact on commodities

	Perceived Impact	Percentage Change
Crude Oil	Crude Oil remains to be a growth-related commodity. Although current trade tariff proposals have said little on energy trade, the negative impact it may have on global growth and trade activities should eventually drag crude oil prices. A full-blown trade war, depending its severity, could be recessionary in nature, thus placing downward pressure on crude oil especially.	-10% to -30%
Gold	Gold is perceived to be a favored safe haven asset in times of trade war. This is especially given the possibility of a weaker greenback, as well as first-order negative impact on both the US and China's economies. Should a full-blown trade war occur, the concerns surrounding it will likely discount the relatively rosier economic fundamental we are facing today.	+10% to +20%
PGMs and Silver	The Platinum Group Metals and Silver prices could see mixed behaviour, depending on the intensity of the risk aversion. The PGMs and Silver assets are considered to be quasi precious-industrial metals, in which risk aversion could leave prices in a range. Still, we think the industrial component of these metals may dominate should risk aversion takes hold.	-5% to -10%
Base Metals	Base metals, similar to crude oil, will likely trend in line with risk aversion and growth concerns. Base metal prices are also intricately related to China's demand, given China being the largest consumer of base metals. With the trade war centering on China as well, the negative impact it may have on overall Chinese economic growth could well limit global base metal demand. Negative spill-over effects into global growth would also play a part in limiting base metal prices.	-10% to -15%
Palm Oil	Palm fruits are considered to be a viable substitute to soybeans, both from cooking oils and animal feeds. Key beneficiaries to higher palm prices will center on Asia, especially Indonesia and Malaysia as the world's largest palm producers. Should China completely cease imports of US-grown soybeans, about 33.2 thousand tons of soybean demand have to sourced elsewhere, in which a part of it may be fulfilled by palm.	+5% to 15%

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Thank You

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