ING's 2020 Commodities Outlook

From black gold to real gold, sugar to sulphur, we look at how the commodity markets will develop and change throughout 2020

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By Warren Patterson

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2019 has been a year where broader trade and macro concerns have dictated price direction for most of the commodities complex. Given that we are entering...

Overview

Commodities will continue to be at the whim of trade talk negotiations in 2020 unless we get some major breakthrough in the US-China talks. It's been difficult to take a view in 2019 without second-guessing what the next step might be, and prices are likely to continue to whipsaw until we get that clarity. No part of the complex has been left untouched.

Oil has come under pressure despite OPEC+ cuts taking excess crude off the market for much of the year. Instead, market participants have grown increasingly worried about the impact that slowing trade will have on global growth and ultimately what this means for oil demand growth. In 2019 we've already seen significant revisions lower in demand growth estimates. If if we see no improvement in the macro environment over the course of next year, we are likely to see further revisions lower in 2020. Obviously, this scenario would be a headache for OPEC+, which continues to manage supply to keep the market in balance. While the group took action recently at their December meeting to deepen cuts over 1Q20, we expect they will need to take further action when it comes to 2Q20. There are a number of other factors which make the life of an oil analyst more difficult going into the new year. Away from the ongoing trade saga, there is growing uncertainty around US oil production growth given the slowdown that we have seen in US rig activity. In shipping, we're finally going to see the highly anticipated implementation of IMO 2020 sulphur regulations which will change the demand picture for refined products. It will be interesting to see how both the refining and shipping sector tackle this regulation from the 1st January.

> *We must see a resolution in the ongoing trade dispute between China and the US*

The industrial metals complex has also been largely under pressure, with slowing manufacturing activity in most regions weighing on metals' demand. These concerns have been reflected in copper prices, which struggled to trade higher for much of the year despite having fairly supportive fundamentals. Mine supply disruptions in South America has tightened the copper concentrate market while growing smelting capacity in China meant that demand for concentrate has remained strong. The tightening concentrate market is reflected in treatment charges which have weakened over the year.

For 2020, mine supply is set to return to growth, but above-normal disruptions would leave the supply outlook fragile. To be more constructive copper, along with the rest of the industrial metals complex, we believe we must see a resolution in the ongoing trade dispute between China and the US. One stand-out potentially is nickel; the metal saw a significant rally this year following the announcement of the Indonesian ban on nickel ore exports from next year, supplanted by a selloff as demand realities set in. Uncertainty around the effectiveness of the export ban is likely to mean that nickel remains volatile throughout next year.

Turning to precious metals, and we believe they will continue to perform strongly over 2020, gold will likely remain a safe haven asset in the absence of a convincing trade deal. However, stronger prices also mean that physical gold demand will remain under pressure. Palladium has been a star performer this year, edging ever closer towards US$2,000/oz. The market will likely remain focused on the deficit environment and robust demand outlook in the short term. Demand destruction is a key risk for palladium. However, up until now, evidence of this has been lacking.

Agricultural markets have also struggled to shake off the impact of the trade war. Soybean prices have been dictated by US/China trade negotiations, and recent waivers have proved constructive for prices. A trade deal that includes the removal of tariffs on US soybeans would only offer further support to the market. Global soybean stocks are tightening, due to a smaller harvest from the US this season. The demand outlook is more positive, as the worst of African Swine Fever in China seems behind us.

Finally, the sugar market is set to return to deficit in the 2019/20 season, which has been supportive of prices recently. We still hold a constructive view on the sugar market going into 2020. However, any upside will be capped by large Indian sugar stocks which continue to threaten the world market.

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Article | 10 December 2019

OPEC+ to take more action in 2020

Deeper cuts announced by OPEC+ in December should do a good job in supporting oil prices around current levels over the first quarter. But we still think...

OPEC performance

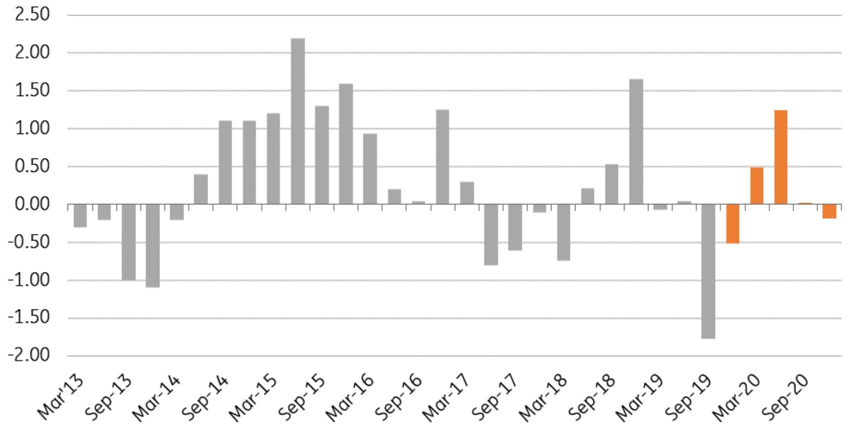
OPEC as a group has done well this year in sticking to its production cuts, with year to date compliance averaging around 137%. That strong overall number does, however, mask the lack of individual compliance by some members. Saudi Arabia has carried the deal, having produced around 500Mbbls/d below their initial quota, and that's helped tighten the market. This has made up for some of the poor compliance from the likes of Nigeria and Iraq. There will be pressure on these two nations to comply in the future, particularly with the group having just recently made deeper cuts.

The largest OPEC declines have come from a member which is exempt from cuts. Iran has seen oil production fall by around 1.17MMbbls since October 2018 - the reference month for cuts for those members in the deal. The driver behind this fall has been the effectiveness of US sanctions in limiting exports of Iranian oil. Looking into 2020, we expect that Iranian output will remain stable at around 2.1MMbbls/d.

One factor that has made the life of OPEC+ even more difficult is the disappointing demand growth seen this year. At the start of 2019, it was forecast that demand over the year would grow by 1.4MMbbls/d, while now the IEA is estimating that it will grow by just 1MMbbls/d. This slowdown shouldn't come as too much of a surprise given the ongoing trade uncertainty and slowdown witnessed in a number of economies.

Despite poorer demand growth, OPEC has managed to draw down inventories by almost 1.8MMbbls/d over 3Q19, and we forecast inventories will decline by around 500Mbbls/d over 4Q19.

Global oil market balance (MMbbls/d)



Source: IEA, EIA, OPEC, ING Research

The 2020 market outlook

The stock draws we have seen for much of this year are expected to reverse in the first half of 2020 despite the fact that the current OPEC+ deal is set to expire at the end of March next year. OPEC+ members at their December meeting agreed to deepen production cuts over 1Q20 by 500Mbbls/d, which takes total production cuts to 1.7MMbbls/d for the quarter. While these cuts alone are not overly constructive given that OPEC+ is already over-complying with the deal, the fact that Saudi Arabia has said it will produce 400Mbbls/d below its quota level makes the cuts look more meaningful. This would see Saudi Arabia producing around 9.7MMbbls/d in 1Q20 compared to an average of around 9.8MMbbls/d so far in 2019. Stronger cuts from Saudi Arabia mean that OPEC+ will in fact be cutting by 2.1MMbbls/d.

> *There is no doubt that the decision from OPEC+ was constructive in the immediate term*

There is no doubt that the decision from OPEC+ was constructive in the immediate term, with deeper than expected cuts. However, whilst the cuts will eat into a significant surplus over 1Q20, it still leaves the market in surplus of around 500Mbbls/d.

The other issue is that whilst OPEC+ has tackled a large part of the surplus in the first quarter of 2020, it has yet to address the surplus over the second quarter. We don't believe this is an issue given that this will be something OPEC+ discusses at its meeting in early March when the group has a better picture on the 2020 environment. Our balance sheet suggests that OPEC+ will need to revert back to cuts of 1.2MMbbls/d over 2Q20 in order to keep the market in balance.

As for the second half of 2020, we see the market as more balanced, with the growing likelihood of a deficit over this period. As such, we don't expect any production limits to be agreed over the latter part of the year.

We believe that the action taken by OPEC+ will be enough to support prices in the short term. Expectations that OPEC+ will take action over 2Q20, followed by tightening market fundamentals for 2H20, mean that we see ICE Brent averaging US$62/bbl over the year.

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Article | 10 December 2019

Shipping to face the sulphur shakeup

The implementation of the International Maritime Organization's new sulphur regulations will lead to significant shifts in the demand outlook for...

Shipping industry facing the realities

The first of January is fast approaching and with that comes the implementation of the long-awaited IMO sulphur shipping regulations, which will see the global shipping fleet having to move from burning fuel oil with a sulphur limit of 3.5% to just 0.5%. The industry has had years to prepare for this, however, and those preparations were slow to start. Many thought or hoped these regulations would be delayed. As we approach the end of the year, the industry has accepted that this really is happening and appears close to be ready to comply with the regulations.

Options for the shipping industry

The shipping industry has several options to comply with this new regulation. Shippers can turn to a compliant fuel - this could either be a very low sulphur fuel oil (VLSFO) or a marine gasoil (MGO). We believe that's the route that most shippers will take. This is already reflected in a very weak high sulphur fuel oil (HSFO) market, where spot cracks in Europe are trading at a discount of US$29/bbl to ICE Brent, a clear sign of the falloff in demand that is expected from the shipping industry. However, switching to a compliant fuel is more expensive and in recent months we have seen the spot gasoil-HSFO spread widen to around US$400/t from US$330/t back at the start of 4Q19. It is similar for the VLSFO-HSFO spread, which widened to as high as US$290/t at one stage in

November, up from US$200/t at the start of 4Q19.

This strong price differential makes another option for the shipping industry more attractive. Shippers can continue to burn the cheaper HSFO as long as they have a scrubber installed on the ship. The wider we see the compliant fuel-HSFO spread trade, the more of an incentive there is for the shipping industry to go the scrubber route; at current spread levels the payback on a scrubber can be as little as one year. However, despite this attractive spread, there are a number of issues with this option. For a start, there is just not enough capacity to install all ships with scrubbers on time for the regulation, and so either way we will see a signifiFcant shift to a compliant fuel.

Owners will seek to avoid being fined while non-compliance also has implications for insurance

Shipowners may want to minimise yard-time for their vessels, particularly if freight rates are buoyant. In fact, strong tanker rates appear to have disrupted scrubber retrofits. A scrubber would also mean that a ship would need to reduce its load. There are still plenty of concerns over scrubbers and the environmental impact they have, particularly for the open-loop system. A number of ports have already banned the use of scrubbers.

Another option for shippers is to go via the LNG route. However, retrofitting vessels will be expensive and so we believe this option would be more viable for new builds. That said, there is also an issue of bunkering infrastructure for LNG, which is fairly limited at the moment.

Of course, ship owners could simply refuse to comply with the regulations, but we believe this will be minimal. We think owners will seek to avoid being fined while non-compliance also has implications for insurance, as the vessel would not be considered seaworthy if it burns non-compliant fuel. The exception to non-compliance would be where a ship has tried to secure compliant fuel but has struggled with availability. In this situation, a waiver for non-compliance would be provided.

In terms of the availability of compliant fuel, refineries are likely to increase refinery run rates to ensure adequate availability. We are also likely to see VGO diverted away from gasoline production in order to produce low sulphur compliant fuel.

Demand shifts & crack response

We believe that we could see around 2.2MMbbls/d of bunker demand shifting from HSFO to MGO/VLSFO. It is more difficult to get an idea of the split between MGO and VLSFO, as availability might prove to be an issue, whilst some shippers may be reluctant to switch to a new VLSFO at least initially, with uncertainty around how it may perform.

The use of scrubbers and also a small element of non-compliance means that we are likely to continue seeing some demand for HSFO. As a result of these shifts in demand, we continue to believe that HSFO cracks will remain weak- currently calendar 2020 3.5% fuel oil cracks in NW Europe are trading at around a discount of US$24/bbl to ICE Brent, and we expect this to weaken to an average of US$26/bbl next year.

For middle distillates, it is more difficult. We continue to hold a constructive view of gasoil cracks. However, worries over economic growth and the potential for a negative impact on oil demand growth frees up some middle distillate availability for the shipping industry, which would reduce some of the bullishness for middle distillate cracks. While the gasoil crack in NW Europe has weakened considerably over November, we do believe that the crack will trade back above US$20/bbl. This is driven by expectations of stronger demand whilst inventory levels in the US are currently around the five-year low, and in the ARA region, gasoil stocks remain below the five-year average.

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Article | 10 December 2019

Aluminium to stay lower for a little longer

The global aluminium market could return to surplus in 2020 amid growth in supply. Demand, however, isn't keeping up and a raw material surplus is...

Bearish sentiment set to continue

Aluminium has not had a great year, and we fully expect the bearish sentiment to continue well into 2020. The metal underperformed in 2019, losing 6% year-to-date due to trade war fears and waning downstream demand.

Aluminium supply growth moved further into negative territory in 2019 and production gains, arising largely from fresh capacity in the ex-China market (primarily the Middle East) have largely been offset by a drop in production from China. Global primary aluminium production dropped 1% YoY to 47.6 mln tonnes over the first ten months of 2019, according to IAI data. Total production from the world's top producer is estimated to decrease by 1.4% for the full year for a variety of reasons, not least notable disruption from smelter outages in China due to floods and technical failures.

> *Bearish sentiment is likely to prevail for the coming year*

And while aluminium supply growth fell into negative territory, global demand growth sank even deeper. The net effect has left the global market with only a small deficit. A lack of strong fundamental catalysts has left aluminium prices prone to macro and trade talk whims.

Bearish sentiment is likely to prevail for the coming year, as supply is set to recover in 2020 based on our expectations that the global primary supply will return to growth. Some of the Chinese smelting capacity, which was closed earlier due to floods, could be back online while around one to two million tpa of new capacity is likely to start operations next year. We anticipate global primary aluminium output recovering by 2-3% year-on-year to around 65 million tonnes in 2020, though some risks remain, such as capacity closures and delays due to low prices. On the raw materials' side, the alumina market is set to see a growing surplus over the coming year, which again will weigh on prices and this may feed through to cost deflation on primary aluminium.

Demand is likely to stay weak, but not forever

The demand outlook, on the other hand, is expected to stay weak over the coming year. But further downside risks should be limited beyond that. It's too early to call any imminent recovery as uncertainty remains around trade. The automobile sector shows no sign of recovery. In Europe, the car industry is faced with significant uncertainty as President Trump has threatened it with 25% tariffs. The result remains unknown, but this has the potential to hold back short term appetite in investing. The economic slowdown, trade war concerns, tightening emission controls and the rise of the 'sharing economy' will continue to weigh on automobile demand in China. In China's recent prolonged construction cycle, there are signs that the decline in completion growth (in year-to-date cumulative terms) continued to moderate in 2H19.

> *It's too early to call any imminent recovery as uncertainty remains around trade*

This brings some hope that aluminium demand in the late stage of the construction cycle will recover over the coming year should completions continue to increase. However, we are somewhat concerned about a slowdown in Chinese exports of semi-finished products should external demand worsen.

Overall, global aluminium demand is likely to witness flat or even marginally negative growth unless the trade discussions progress towards consensus and industrial activity picks up. One supportive factor for aluminium is the low inventory at LME and SHFE warehouses where surpluses could be absorbed, given the right structure of the forward curve. However, this is purely from a market point of view and doesn't take into account the potential impact of changes in the LME warehouse reporting rules.

The price spread between aluminium 15M/cash increased to a five-year high of around US$133/t in June 2019 with the current spread of US$80/t or around 5% of the LME cash prices. Weaker interest rates, decent contango and small queues at LME once again make financing deals (holding inventory at LME warehouses and selling forwards at a premium) lucrative for traders or financial institutions. Currently, we see the risk to the average price next year tilted to the downside. However, if aluminium demand shows signs of recovery and this is combined with low inventory, this could push prices above 1,800/t over the second half of 2020.

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Iron ore supply to normalise

Expect further pressure on iron ore prices in 2020. More supplies from Brazil and higher shipments from Australia mean we're expecting a softening to...

Iron ore processing at a plant in Brazil

A standout 2019

Iron ore supply should normalise next year after a standout 2019. It was one of the commodity outperformers due to supply disruption and relatively healthy demand. The Vale dam incident at the start of the year, along with a train derailment in Australia, sent iron ore prices soaring. At one point, they went higher than US$120/t, which made the mining operations somewhat profitable. Iron ore prices did soften in the second half of the year as Vale restarted mine operations and increased supply faster than initially estimated. That said, prices are still up around 16% YTD.

New projects could face increased scrutiny

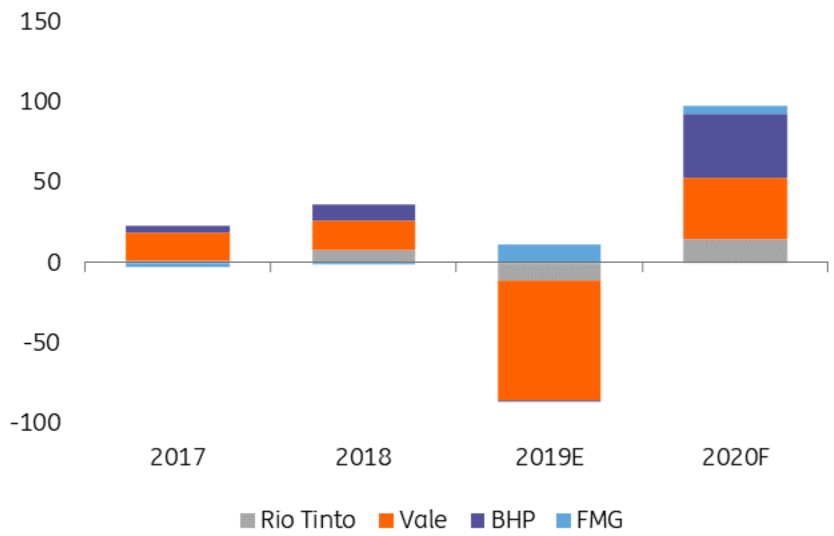
Longer-term, the Vale incident raised regulatory and political risks surrounding iron ore mining, and new projects could face increased scrutiny from both governments and local communities over the coming years. Vale reports that around 48 million tpa of capacity has restarted or has been approved to begin again out of the 90 million tpa of capacity that stopped after the dam incident; the rest of the 42 million tpa capacity will restart by 2021.

Meanwhile, the company continued to ramp up output at the giant S11D mine with production up 28.3% YoY to 54.1 million tonnes over the first three quarters of 2019. It could increase production and reach full capacity of 90 million tpa in 2020. The Samarco mine, closed since 2015 after an incident, has received all approvals to restart operations and production could well resume later next year with around 8-10 million tpa of capacity.

In Australia, ore exports dropped around 1% YoY to 828 million tonnes in 2019, mainly due to disruptions in the first quarter of 2019. They're expected to recover next year on the back of increased production at some new and existing mines. Australia's Department of Industry, Innovation and Science forecasts Australian iron ore exports to increase more than 4% year-on-year to 862 million tonnes in 2020.

With those forecast restarts now in the pipeline, we expect the ore supply to normalise over 2020. Currently, we anticipate production from the big four to grow by around 9% YoY in the next twelve months. As a result, seaborn supply to China is likely to continue improving. And you can already see that reflected in the total China ports' inventory, which has grown by more than 12% since the lows in June. China's domestic iron ore production is also contributing to the supply side; it's grown fairly strongly, by 6.5% YoY, to 712 million tonnes in the first ten months of the year.

Big four iron ore supply changes (million tonnes)



Source: Company Reports, ING

Demand growth mismatch

Should this supply picture hold, there is a mismatch in the outlook for demand growth next year, which may have trouble competing with the speed of supply growth. Data from the World Steel Association shows that global steel production increased 3.9% YoY to 1,391 million tonnes over the first nine months of 2019, which has kept iron ore demand steady during the year.

However, the outlook for 2020 is not as optimistic with the Association estimating global steel demand to slow down to 1.7% YoY. Chinese demand growth is set to slow from 7.8% in 2019 to just 1% in 2020. That said, over the coming year, we expect a relatively firmer 1H and a softer 2H in Chinese iron ore demand, taking steel demand prospects from infrastructure and the construction sectors into consideration.

Steel production exports are expected to continue their downward trend, and this would eventually feed through to iron ore demand by the mills. China's total steel production exports already fell by around 5% YoY in the first nine months of 2019. That said, we expect average prices to be weaker next year with intra-year prices' formation becoming softer towards US75/t by the end of 2020.

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Nickel's high volatility to remain on the cards in 2020

The global nickel market is likely to tighten next year not least because of Indonesia's ban on nickel ore exports. There does seem to be an issue...

A furnace at a Vale nickel plant in Indonesia

Volatility to remain a factor in 2020

Think nickel, think volatility and we're expecting more of that next year. The metal outshone its peers, notably in the third quarter of the year. But those stellar gains virtually reversed in October and November. The rally was triggered by policy in Indonesia which aimed to reshape the supply picture. However, that policy soon unravelled amid demand reality. On top of all that, speculators just added to the volatility. You can see all that reflected in the dramatic flip in the forward curve and acute LME inventory outflows.

In late August 2019, Indonesia announced it was bringing forward an export ban on nickel ore (grade less than 1.7%) from 2020 onwards instead of the initial deadline of 2022. Mining companies were seen to be increasing their ore exports substantially, and investments into the processing sector were somewhat lacklustre. Indonesia is a major nickel ore supplier to China, exporting around 15 million tonnes of ore (+36% YoY) over the first nine months of 2019.

Indonesia's share of Chinese nickel ore imports is around 38%, marginally below the top supplier

Philippines of around 58%. The ban on Indonesian exports would create a short-term supply gap for the nickel market, particularly to China as it had increased large-scale capacity down the supply chain from NPI (nickel pig iron) to stainless steel. Increased appetite prompted the country to boost ore imports ahead of the ban with volumes remaining very strong since September.

Policy change could lead to supply gap

Indonesia's rationale for the ban was to encourage investments towards downstream sectors. Over the last couple of years, the industry has seen a surge in investment into Indonesia from ore mining, NPI to stainless steel as well as HPAL (High-Pressure Acid Leaching). And a large chunk of that investment comes from overseas. That's evidenced by the rising exports of NPI. These could increase from around 260kt in 2018 to around 360kt in 2019 and further to 500+kt in 2020 as Tsingshan and Antam, among others, add capacity. Nevertheless, the supply gap to the Chinese NPI industry remains unresolved despite prebuilt ore stockpiles, and this may start to lead to a curtailment in Chinese NPI sectors as inventories run down.

If circumstances change again and Indonesia really does stick to the ban from the beginning of 2020, the market will begin to feel tightness towards the second half of next year. In the short term, the market needs to deal with low inventory in the LME sheds, particularly when it was reported to be off-loaded by a single buyer; the market had to get a sense of the real market supply and demand dynamics. That said, if low inventory remains in place, this will provide support to prices and prevent them from falling further on fears of a squeeze. Should the current low inventory persist into next year combined with real tightness, it all should provide more solid ground for prices next year.

There are two aspects to nickel's future demand direction

The nickel market is set to see a marginal deficit over next year if Indonesia sticks strictly to the ban. It's hard to stick to a single baseline forecast. We believe that price volatility will remain high. The reason is deeply rooted in an industry which has been reshaping itself both regionally and structurally, and which has partly resulted in an issue in the pricing mechanism. Earlier this year, we highlighted two milestones in the nickel industry and we're set to see a split in the supply chain. With governments and major carmakers gearing towards electric vehicles, we still see a strong demand narrative for power storage batteries and materials, which include nickel. And the latest trend of shifting towards higher nickel content in batteries is encouraging.

In other words, there are two aspects to nickel's future demand direction. The first, as above, is its traditional usage in the making of stainless steel. The second is technological, as it forms a vital element in battery materials. And that's a key thing to consider as it includes a number of HPAL projects which could see a significant breakthrough in the future. In our view, this holds the key to the nickel market's longer-term outlook.

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Article | 10 December 2019

LNG to remain under pressure

The liquified natural gas market has been under pressure this year as a ramping up of export capacity and slower demand growth in Asia led to a surplus...

The state of the market

The market is still struggling to digest the glut of LNG that we are currently experiencing. Asian LNG prices have been weak for much of 2019, as we continue to see a ramp up in supply from the US, Australia and Russia. The autumn rally that we have seen has been short-lived, with the market under pressure once again even as we move into winter. The pressure on Asian prices has also had an impact on hubs in other regions, with record volumes of LNG making their way into Europe this year. We expect much of the same for next year, with supply expected to ramp up further while there will still be questions about the demand outlook, particularly given concerns over slowing growth and contracting factory activity.

Pressure on Asian prices is impacting hubs in other regions

The gap between LNG supply and demand growth has widened in 2019, with demand unable to match the pace of supply we are seeing at the moment. Global LNG supply has increased by around 30-35mt in 2019 with most of this coming from the US, Australia and Russia. We believe that another 30mt of LNG supply could be available to the market in 2020 as capacity start-ups in 2019 (including Cameron T1, Elba island and Freeport T1) continue to ramp up while new projects (including Freeport T2-3 and Cameron T2-3) come online over the course of 2020.

Weaker demand prospects possible in the short term

China's LNG imports have increased by 14% year-on-year to 47.74mt over the first 10 months of 2019, healthy growth by any standard. However, this masks some concerns. This level of demand growth is much lower than the 30%+ seen in recent years. In addition, LNG imports in the month of October fell 11% YoY- which is the first YoY decline in LNG imports since July 2016. There are a number of reasons why growth has slowed. Previous growth rates were unsustainable and largely reflected the coal to gas switch for home heating. We've also seen a slowdown in manufacturing activity in the country, which has likely weighed on demand.

There are two lingering concerns we have over Chinese LNG demand in 2020:.

- If manufacturing activity does not pick up, this could continue to weigh on import demand. Manufacturing activity is going to depend largely on whether we see a convincing trade deal between the US and China.
- Recently, the Power of Siberia pipeline from Russia to China has started up, and we are likely to see increased flows of piped gas into China, which could weigh on LNG flows. While the pipeline is expected to transport as much as 38bcm annually, this will take some time, and over 2020, minimum flows via the pipeline are expected to be 5bcm.

The largest LNG buyer has also disappointed this year. Japanese LNG imports have fallen by 8% YoY over the first ten months of the year, following a 2% YoY decline for full-year 2018. A key driver behind this decline has been the restarting of nuclear capacity in the country. As we see further reactors coming online, this has the potential to weigh on import demand even further over 2020.

Europe & LNG

With another surplus year expected for the LNG market, and assuming similar trends in the Asian market once again in 2020, it appears that we'll continue to see sizeable LNG inflows into Europe. As things stand at the moment, this supply is likely to keep the pressure on European hub prices. However, negotiations around the Ukrainian transit deal for Russian gas, which is set to expire in January, present a key upside risk for the European market.

Failing to come to a new deal will be a bullish development for the European market. The Russians are reluctant to provide another 10-year transit deal, with new pipelines set to connect with European hubs- including the 55bcm/year Nord Stream 2 pipeline, which could start operations in early 2020.

Bullish in the longer term

The scale of supply growth we have seen in LNG has led to the market evolving fairly quickly, with an increasing shift towards short term and spot supply contracts. As supply grows, we would expect this trend to continue. However, a low price environment and more uncertainty with spot contract pricing create longer-term issues for the global LNG market. The current low price environment means that investors may think twice before looking at new supply projects whilst the trend towards spot contracts may also mean that projects struggle to get the financing as easily as they have in the past.

This leaves the longer-term outlook for LNG constructive, particularly with a constructive demand outlook for natural gas, given its role in energy transition. However, before the market reflects this more constructive environment, it will have to deal with the current mismatch in supply and demand for the next couple of years.

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Article | 10 December 2019

Coal weakness to persist

Cheap LNG and a strengthening carbon market in Europe have been weighing on coal prices. Those themes will continue throughout 2020, keeping the coal...

Pressure to persist

2019 has been a year of weakness for thermal coal markets, with API2 prices down more than 37% since the start of the year, and trading down to levels last seen in 2016. The ramping up of LNG export capacity has increased the availability of cheaper alternative fuels for power generation, while in Europe stronger carbon prices mean that gas has been favoured as a feedstock over coal for power generation.

For 2020, it is difficult to see this trend reversing. LNG supply is expected to increase further which should keep gas hub prices relatively week and, as a result, coal prices too. Furthermore, we would expect carbon prices in the EU to remain well supported, with the Market Stability Reserve managing carbon allowances in the market. We expect to see a general shift away from coal power generation to cleaner fuels elsewhere as part of the broader energy transition trend

Demand broadly negative

The demand outlook for coal in Europe remains negative. 2019 has been a year where we have seen record LNG volumes flowing into Europe, given the ramping up of LNG export capacity. Meanwhile, the EU's Emission Trading System has become increasingly more effective due to the strength we have seen in carbon prices. As a result, spark spreads in Europe will likely remain more attractive than dark spreads, which should continue to support the coal-to-gas switch for power generation over 2020.

In Asia, several markets in the region have seen weaker demand so far over 2019. In Japan, cumulative thermal coal imports over the first ten months of the year are down around 3% YoY. The restarting of nuclear capacity in the country is a key factor behind this weakness and with further applications for reactor restarts, we would expect this will continue to weigh on Japanese coal imports in the longer term.

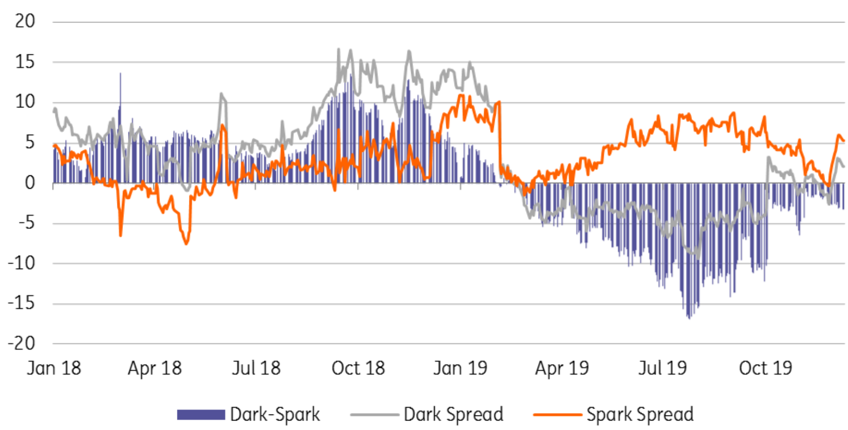
The demand outlook appears to be relatively more bearish in Europe than Asia

South Korea has also seen weaker imports. Over the year the country has temporarily shut down several coal power plants in order to try to lower pollution levels, and similar action will be taken over this winter with the government idling a number of plants. This suggests the outlook for coal demand from the country will remain fairly week as we move through 2020.

China, however, has performed fairly well with imports, with volumes over the first ten months of the year increasing almost 8% year on year. China is key for the seaborne market, and what makes it more challenging is the uncertainty around government policy. In recent years the government has intervened to try to stabilise the domestic market. This could have a dramatic impact on the seaborne market should the government feel the need to take action again in 2020. Domestic coal prices are trading down at levels last seen in 2016 and, if there is further weakness, the government could look at the possibility of restricting imports to try to support the domestic coal industry.

Given that the demand outlook appears to be relatively more bearish in Europe than Asia, we would expect to continue seeing Newcastle coal trading at a healthy premium to API2. However, the key risk to this view is if China does clamp down on imports over the course of 2020.

Dutch spark & dark spreads (EUR/MWh)



Source: Bloomberg, ING Research

Supply to edge lower

Turning to supply, and the low price environment has had an impact. Colombia has seen a downturn in flows, with Europe largely responsible. This, in theory, should mean we see increased flows of Colombian coal into Asia; however, the lack of its competitiveness means that exports have only slowed.

For Indonesia, the country has repeatedly produced above production caps. However, the current low price environment should weigh on output in the future. Additionally, domestic demand growth should also eat into the country's exportable surplus in the long run.

To Australia, where export flows have performed strongly, reaching record levels. They're only set to increase given expansion and the ramping up of new capacity. The longer-term outlook for Australian supply is less uncertain. Despite the high price environment seen in the coal market over 2018, exploration expenditure is still struggling to reach the levels seen back in 2011. This does highlight the general attitude towards coal that with an uncertain demand outlook, miners appear reluctant to invest significantly in new projects while obtaining financing from banks is likely to be another key issue.

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Article | 10 December 2019

Precious metals’ golden year to continue

Demand for gold as a safe-haven is likely to remain strong in 2020, but lacklustre physical demand could cap gains. Palladium continues to outperform, and...

Gold's safe-haven allure

2019 has been a golden year for precious metals as escalated trade disputes created a risk-averse environment among investors and demand for safe-haven assets increased. We expect the trend to continue in 2020 as most issues are still unresolved, even though both the US and China have been making efforts to prevent the situation from getting worse.

Increased prices may continue to weigh on physical gold demand, especially in emerging economies including China and India. A stronger US dollar and higher import duties continue to add pressure on consumers here. For platinum group metals, stronger demand from the automobile sector pushed palladium to a record high; however, the Pt/Pd ratio of around 0.4 increase risks of substitution.

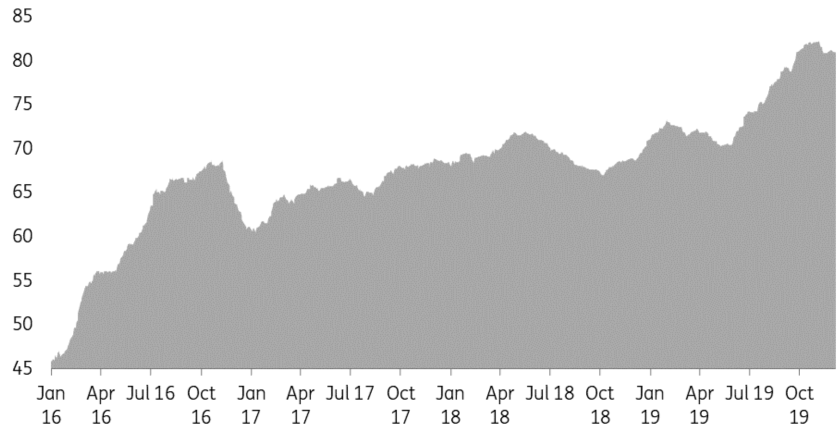
Increased prices may continue to weigh on physical gold demand

Total known ETF holdings of gold increased by c.9.8mOz in 2019 as investors poured more money into the safe-haven asset. The escalated trade war and those associated multiple tariff hikes during the year created a risk-averse environment among investors. Falling Fed rates in the US and negative interest rates in Europe further supported the higher inflow of investment money into precious metals rather than chasing Treasuries only.

Physical demand for gold took a knock in 2H19 as price-sensitive Chinese and Indian gold demand dropped. And the trend is likely to be similar in 2020 where the economic slowdown should keep disposable income under pressure. In India, higher duties on gold imports put further pressure on demand. India's gold imports dropped 5% YoY to 642 tonnes over the first three quarters of 2019 (annualised c.830 tonnes) after falling 11% YoY to 872 tonnes for the full-year 2018 and could stay around 800-825 tonnes in 2020.

In China, the PBoC was a major purchaser of gold in 2019, buying around 3.1mOz of gold; however, the bank appears to have put a brake on its gold buying for now, which may keep Chinese demand under pressure too.

ETF gold holdings (mOz)



Source: Source: Bloomberg, ING

Palladium's 'near sorrow' and 'distant concern'

Palladium has been the best performer in the commodity market with a gain of c.40% in 2019. A key pillar behind palladium's stellar performance over recent years has been the persistent supply deficit and this has widened further. We don't imagine that's going to change much in 2020 and we'll continue to see a sizeable supply deficit.

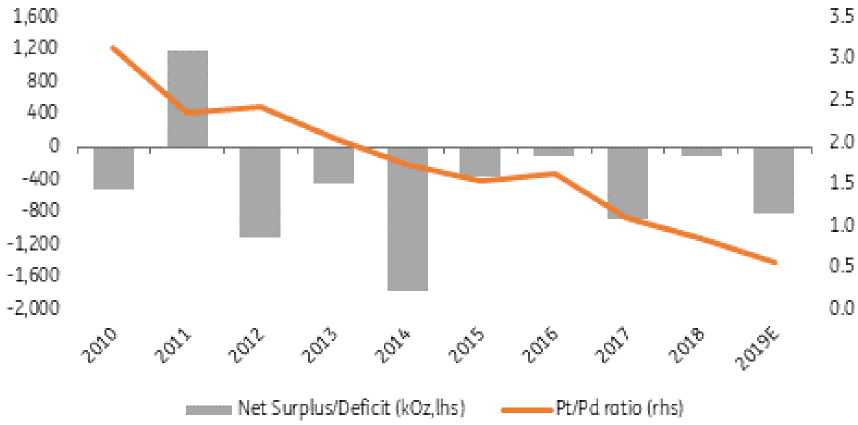
The nature of palladium supply is that it mostly comes as a by-product from platinum and nickel mines, leaving that supply more inelastic compared to the volatile demand picture. In recent years, despite the price strength, both primary production and recycling growth has remained fairly stable. However, the demand picture has been more volatile, and more than 80% of palladium goes towards catalytic converters which have been the key driver behind stronger demand growth. China and Europe have seen the strongest demand here.

The market is likely to remain focused on the deficit environment and the constructive demand picture in the short term

The bullish fundamental picture for palladium has increased speculative interest in the metal. And looking at the CFTC data, we think speculators still have room to add to their positions, with the current net long of 12,776 lots still some distance from the high of 27,471 lots seen in early 2018. You may be surprised at ETF palladium holdings, which stand at just 610koz, down from around 3moz back in 2015. This reduction reflects more tightness in the physical market, with holders lending out the metal due to very healthy lease rates.

However, the momentum may come under risk in 2020 as the Pt/Pd ratio increased to a record low of around 0.4 and some of palladium's demand could be switched to platinum for gasoline vehicles. The key issue is that up until now, there has been little evidence of substitution taking place. We believe the market is likely to remain focused on the deficit environment and the constructive demand picture in the short term. However, longer term we may see growing concerns over demand destruction should higher prices lead to substitution becoming a reality. If this turns out to be the case, that would suggest downward pressure on prices in the longer term.

Palladium market balance vs Pt/Pd ratio



Source: Source: Johnson Matthey, ING

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Article | 10 December 2019

Softs to face tighter fundamentals; key risks remain

Softs had a strong last quarter. We expect these markets will see tighter fundamentals going into 2020, which should support prices. However, the key risk...

A farmer inspects the sugar beet crop

Sugar returns to deficit

The global sugar market is set to return to a deficit of around 6.1mt in the 2019/20 season, having spent the last two seasons in surplus. The change has been driven by lower year-on-year output from the likes of India, Thailand, the EU and Central-South Brazil. Declines in India, Thailand and the EU are due to a combination of poor weather and lower planted area. In CS Brazil, the reduction is driven by the fact that mills in the region continue to favour ethanol production over sugar.

Given the deficit outlook for this season, prices have been fairly well supported over 4Q19, although one might believe that given the scale of the deficit, prices should be even stronger and speculators should be holding far fewer bearish positions than currently. So why the disconnect between tightening fundamentals and prices/sentiment?

There are several factors keeping the lid on sugar prices

There are several factors which are keeping the lid on sugar prices:

Firstly, we have come out of a two-year surplus period, where we saw a significant build-up in stocks, and so we would need to see a drawdown in these levels before we can get overly bullish about the market.

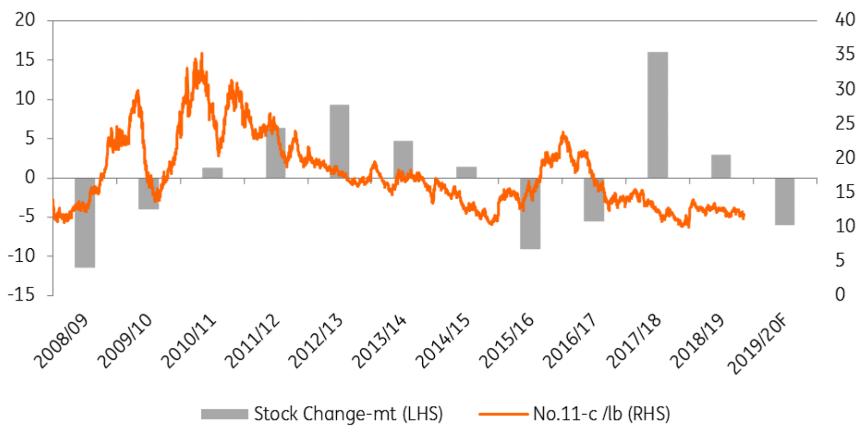
Secondly, India is key for market sentiment. While India is set to see a smaller crop this year- output is estimated at around 26.9mt, which should leave the domestic market fairly balanced this season - they have entered the season with significant stocks levels equivalent to around 55% of annual domestic consumption. These stocks will remain a risk to the world market and so prices are unlikely to move significantly above export parity levels unless the world market needs this sugar. For the moment, it seems, it doesn't.

Thirdly, ethanol/sugar dynamics in Brazil should cap prices. Given that global stocks are still high, we do not believe there is a need for sugar prices to trade above ethanol parity levels. If this were to happen, mills in Brazil would likely allocate more cane to sugar production rather than ethanol. Ensuring sugar prices remain below this parity would help draw down global stocks.

Finally, with Brazil historically the largest sugar producer in the world, prices can be influenced by moves in the Brazilian real, and this year we have seen considerable weakness in the BRL. This appears to have held back global sugar prices which are priced in USD. Further weakness in the BRL could weigh further on sugar prices, although saying that our LatAm economist believes that while there is the potential for further weakness in the near term, we should see some strength in the long run.

We do hold a mildly constructive view on the market and are forecasting that No.11 will average USc13.30/lb over the course of 2020 as we move deeper into deficit. Obviously, key to this assumption is that we do not see any surprises when it comes to production and government policy.

Global sugar stock change vs. No.11 sugar price



Source: FO Licht, ISO, ING Research, Bloomberg

Spec-fueled coffee rally

It has been quite the year for the coffee market, with Arabica initially trading to multi-year lows on the back of a large surplus in the 2018/19 season. The broad weakness we've seen in the BRL has also weighed on the market. These two factors have done little to support sentiment, and speculators have remained largely bearish Arabica for most of the year. However, prices rallied as much as 30% from their 4Q19 lows in the final stages of the year as speculators ran in to cover their shorts. The International Coffee Organization's deficit forecast of 500k bags in 2019/20 is supportive, which is largely driven by the Brazilian crop being in its 'off year' for the biennial crop cycle. Other forecasts for the current season suggest the deficit will be even larger.

Demand has also been robust, with coffee shipments having increased 8.1% YoY to 129.4m bags in 2018/19, largely on the back of stronger exports of Arabica from Brazil. Lower Arabica supply this season, along with stronger demand, has not only been constructive for outright prices but also the Arabica/Robusta spread.

There are worries about the impact of October's dry weather in Brazil on the 2020/21 crop. Brazil's upcoming season will be the higher-yielding season which should naturally see stronger output. But there will be plenty of attention on how much of an impact the dry weather has had on the crop. From a speculators' perspective, they clearly appear uncomfortable with this uncertainty, and hence the reason behind the large amount of short covering we have seen recently.

Grinding away the cocoa surplus

The cocoa market has not missed out on the strength seen across the softs complex. London cocoa prices have rallied as much as 30% from the lows seen at the end of January this year. The International Cocoa Organization estimates that the 2018/19 season saw a deficit of 21kt, which is in contrast to their previous expectations of an 18kt surplus. That balance shift was predominantly driven by stronger demand numbers. Cooperation between the Ivory Coast and Ghana to impose a floor price of US$2,600/t has also been supportive for prices.

The minimum floor price and living income premium of US$400/t is likely to provide support to the market in the short term, but in the long run, these stronger prices do risk bringing additional supply onto the market.

The cocoa market has not missed out on the strength seen across the softs complex

The largest producer Ivory Coast plans to cap output at 2mt in the 2019/20 season, which would be around 200kt lower than what they are estimated to have produced in 2018/19. The key test will be how regulators monitor and cap output; we believe it will be difficult to limit production. Furthermore, a cap could potentially lead to increased smuggling of beans into neighbouring Ghana.

Stronger grinding numbers have been driven by Asia, with quarterly figures this year from the Cocoa Association of Asia showing double-digit percentage growth through until September. Europe and North America have not benefitted from the same level of growth, and have in fact seen declines in some quarters this year. For 2020, the balance for the market will be largely dependent on whether Asian cocoa demand can hold up. Sustaining this growth might be difficult moving ahead, given the higher price environment weighing on processor margins.

Speculative positioning in London cocoa suggests that they are potentially reaching their limits. Speculators hold a net long of almost 78k lots, levels last seen in 2015, and not too far off from their record net long of almost 90k lots back in 2015.

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Soybeans to remain the trade hostage

The outlook for soybeans, as the title suggests, will mostly be dependent on how trade talks progress, as has been the case since early 2018. Any deal...

Trade games

It has been an eventful year for the soybean market. The toing and froing of trade talks has whipsawed soybean prices, with prices coming under pressure earlier in the year when trade talks broke down only to rally following a very wet spring delaying soybean plantings in the US. September saw renewed pressure on CBOT soybeans, with China retaliating to further US tariffs, by increasing them on US soybeans from 20% to 30%. However, Chinese buyers have returned to the market for US beans more recently, with the Chinese government providing tariff waivers. There are media reports however that these quotas are now fully utilised and it is unlikely that further waivers will be issued until a trade deal or at least further progress is made.

Right now, it does seem that trade talks are at a key juncture. Failure to come to a deal by 15th December would likely see the US impose further tariffs. If that's the case, a deal would appear to be somewhat further away, and that could have an impact on US soybean planting in 2020.

China demand

The waivers provided over the latter part of 2019 have seen flows from the US to China pick up once again, with at least 10mt worth of tariff waivers provided. In the 2019/20 marketing year, soybean export sales to China have totalled 5.56mt so far. This is up significantly from just 271kt at the same stage last year. That said, it still falls short of the almost 15mt seen over the same period in 2017/18, prior, of course, to the start of the trade war.

The demand outlook looks more positive for the year ahead

While tariffs have had an impact on flows, another factor which has weighed on total Chinese soybean demand is African Swine Fever, with the mass culling of swines reducing demand for soybean in feed. Soybean imports into China over the first ten months of this year totalled 70.8mt, down 8% YoY. However, the demand outlook does look more positive for the year ahead; while pork prices in China are still significantly above historical levels, they do appear to have peaked. That suggests we are starting to see an improvement in pork's domestic supply picture which should be supportive for soybean imports over 2020.

Supply tightens

Looking at supply, expectations for the US soybean crop in the 2019/20 season is that output will total 3.55b bushels, which is down 20% YoY. There are two factors which have driven output lower: Firstly, with China largely becoming absent as a buyer, US farmers reduced the planted soybean area, choosing to increase corn plantings instead. The USDA estimates that US soybean plantings fell a little more than 14% this year. Secondly, yields have been hit as a result of the very wet planting season, with them estimated to be 7.3% lower YoY.

The longer the trade uncertainty lasts, the more likely it will have an impact on planting decisions for US farmers in 2020. If we enter the planting season, and there is still few signs of a deal, we are likely to see a further shift towards corn at the expense of soybeans, with farmers not wanting to take the risk of being unable to sell their crop. Looking at the soybean/corn ratio at the moment suggests that farmers should plant more corn for the 2020/21 season.

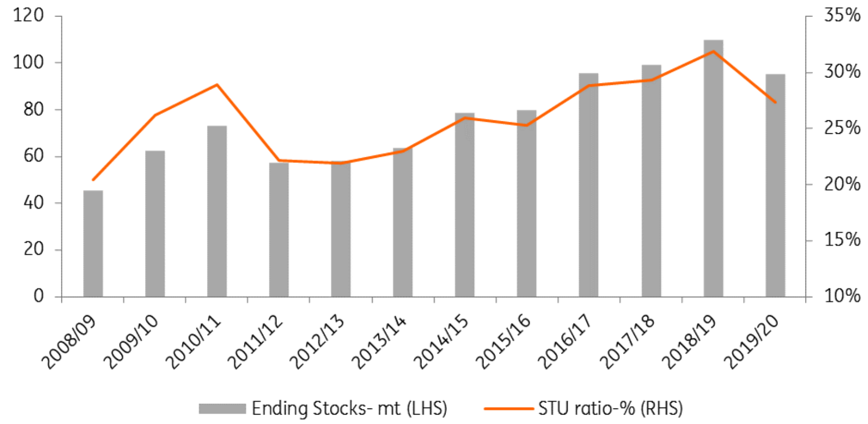
The longer trade uncertainty lasts, the more likely it will have an impact on planting decisions

Turning to South America, and the region continues to produce near-record levels. For the upcoming 2019/20 harvest, Brazil is expected to produce a record 120.86mt of soybeans, up from 115mt in 2018/19. This stronger supply, along with a weaker BRL should mean that Brazilian soybeans remain competitive to export markets. While any lifting of tariffs on US soybeans would likely mean we see weakness in Brazilian cash values.

In Argentina, there is growing uncertainty, following this year's general election. Business-friendly, Mauricio Macri was voted out of power, with Alberto Fernandez from the PJ party taking over, and whose running mate was Cristina Fernandez de Kirchner. The risk is that we see increased intervention from the new government (like when Kirchner was in power), and subsequently the potential exists for increased export taxes on agricultural products. Given the worries surrounding this, there has reportedly been increased selling from farmers in the country trying to beat any tax increase. Taking such action will have an impact on Argentina's competitiveness to export markets.

Finally, the USDA estimates that US soybean ending stocks will total 475m bushels in 2019/20, down from 913m bushels the season before, while this is a significant decrease YoY, it is still well above the 13/14 -17/18 average ending stocks. Meanwhile, global ending stocks in 2019/20 are forecast to total a little over 95mt, down from almost 110mt last year. Tightening stocks should provide support to prices moving forward, however trade developments are likely to trump fundamentals in the short term.

Global soybean ending stocks



Source: USDA, ING Research

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