February 14, 2019

COMMODITIES UPDATE

REP-019
MARKET VISTA

Dazed and confused' from global developments

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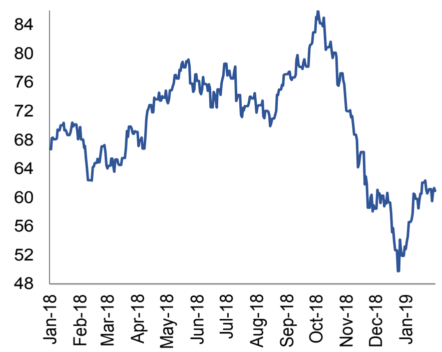
- **Recovering from a weak 4QCY18, global commodity prices bounced back as fears of global economic growth remained prominent (IMF pulling 2019 global growth forecast to 3.5%), despite which a spate of geopolitical developments (Venezuela sanctions, China's coal import slowdown) pushed the TRJ Commodities index higher (up 5.8%MoM)**
- **Energy commodities witnessed mixed performance with Crude benchmarks rising (Brent/Arab Light prices up 14.6/14.4%MoM) from US sanctions levied on crude from Venezuela pushing prices for heavy grades, while slowing demand from China kept Coal prices soft (Richard's Bay coal fell 7.1%MoM)**
- **Steel prices remain subdued where the outlook is showing signs of improvement, while Cotton (-3.7%MoM), Urea (-2.4%MoM) and Food (FAO index +1.8%MoM) price indices undergo modest moves as damaging weather events and altered supply chains reflected in prices**
- **While effectively rolling forward and doubling previous oil financing arrangements with Saudi Arabia, the role of the Kingdom in supplying crude (evenly split between UAE and Saudi) is set to solidify with the Crown Prince's visit and inking of agreements to establish a refining complex.**
- **While core food and energy commodities remain in relatively soft territory, any space provided on the external front is significant, while providing a window to enact tough reforms (energy prices, fiscal measures) mandated under any IMF program without exerting undue pressures on consumer purchasing power.**

Brent (US$/bbl)



COAL Price (US$/MT)

Source: Bloomberg & AKD Research

Crude undergoes a 'dead cat bounce', Venezuela sanctions help: Brent/Arab light prices averaged US$59.4/59.7/bbl for Jan'19, recovering from a bear market that saw major crude benchmarks shed more than 40% of their value between Oct-Dec'19. Imposition of sanctions on import of Venezuela's crude to the US has created a shortfall of heavy crude (Venezuela supplied 1mnbpd of 7mnbpd global heavy crude supply) pushing prices for medium and heavy grades, while Saudi adherence to the Dec'18 OPEC summit production cuts (0.8mnbpd of 1.2mnbpd to be cut) pushed wider benchmarks Brent/Arab Light prices up 14.6/14.4%MoM. The market for heavy crudes is particularly undersupplied as the brunt of global supply additions in the US have been of light crude, which refiners must blend with heavier grades to maximize middle distillate product yields (HSD). Going forwards, tightening in global crude benchmarks could gain traction from: 1) expiration of sanctions given to China, India and the EU to import from Iran (expires in June'18) where markets re-adjust to accommodate ~75% of Iran's 1.2mnbpd of supply and 2) trade tensions between US and China reach a period of relative calm, where the threat of further tariff escalations (held-off till March'19) are subdued, as both sides conclude key negotia-

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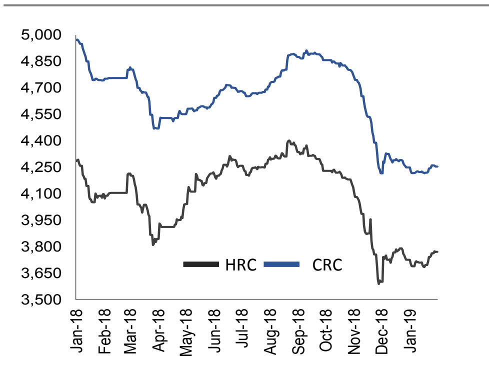
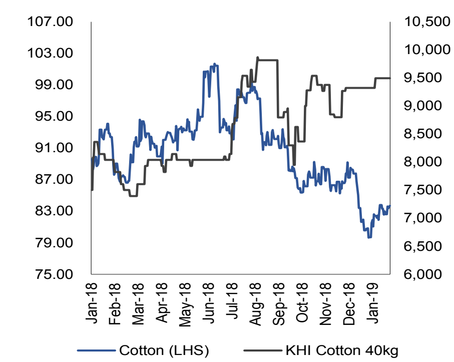
tions.

Fears of a slowdown in China looming large over coal prices: The benchmark Richard's Bay Spot price is currently trading at ~USD83/ton after coming down by 11% since the start of Dec'18 while declining by 20% since Jun'18. The steep decline comes on the back of low demand ahead of Chinese Lunar New Year while fears of moderate growth in the Chinese economy, and ongoing trade tensions between US and China (a major demand center for coal) subdue the outlook for demand. Moving forward, we do not expect coal prices to sustain the downward momentum as Chinese demand resumes post holidays while the resumption of steel and cement plants in China after the winter break will also provide an impetus to demand. To highlight, PIOC is the most sensitive player from our universe, on standalone basis, to a change in coal prices while LUCK resides on the other end of the spectrum.

Steel price (CNY/MT)



Cotton Price (Usc/lb)



Source: KCA, Bloomberg & AKD Research

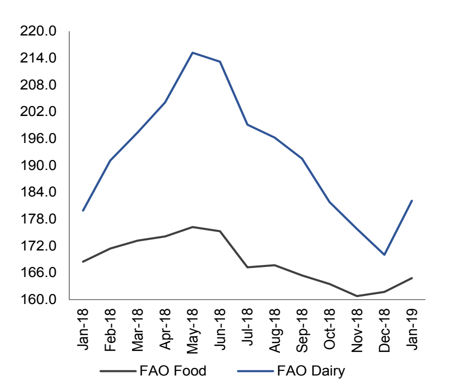
Steel continues to bear the brunt of demand weakness: Demand weakness in China along with cyclical slowdown in construction activity continued to weigh on steel prices, with average re-bar/billet prices declining by 2.0/2.2%MoM in Jan'19. In flat steel, prices remained largely flat, with marginal declines in average CRC/HRC prices by 1.16%/0.54%MoM. While long term out-look remains weak due to continuing slowdown in China, cost pressures as a result of Vale's dam tragedy in Brazil could reverse downward trend in steel prices in the near term. Also, recovering demand in certain markets (i.e. Turkey) should further extend support to declining prices. That said, weak global economic outlook as reflected in recent IMF's forecasts would have subsequent long term spillover effects on commodity prices particularly steel.

Cotton exhibits diverging trend in Jan'19: Lingering trade talks between China & US continued to weigh on international cotton prices, with cotlook A index falling 3.7%MoM in Jan'19. Domestic prices however moved up 1%MoM as a result of fresh buying interest from the local spinners. This trend is likely to reverse following the ECC's decision to withdraw levies on import of cotton. Globally, several factors are at play in setting the direction of cotton prices, with risks presently titled towards downside. Weak demand outlook and favorable sowing conditions with wide ex-pectations of large production increases could continue to weigh on prices. However, the China's decision to replenish its inventory level which now stands at multi year low of 6.6mn tons could extend crucial support to cotton prices going forward.

Edible oils deliver momentum to food prices: FAO Food Price Index (FFPI) averaged 164.8pts in Jan'19, +1.8%MoM but down 2.2%YoY. Importantly, Vegetable Oil Price Index rose 4.3%MoM to average at 131.2pts in Jan'19, rising 5.4 points, marking the second consecutive increase after a protracted fall. It was at the back of increase in palm oil prices by 9.2%MoM to US$584.58/mt as inventories eased from a near two decade high as demand increased amid falling production. Malaysian production fell 6.7%MoM, first time in eight months, to 3.0mn tonnes. We expect bullish momentum in palm oil prices likely to continue in the short term as production declines in key Malaysian states amid higher demand from EU, China and India. However, in the medium term prices are expected to fall palm oil industry faces pressure from environmentally sensitive countries, particularly EU. To this end, the French and Norwegian Governments have passed an amendment to exclude palm oil as biodiesel feedstock starting from 2020. To highlight, the trend in palm oil prices impacts GMs of EFOODS and UNITY.

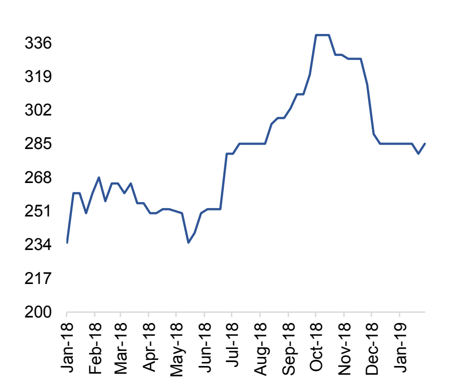
Urea supply glut continues as demand recedes: Urea prices moderated in Jan'19 trading at US$280/mt (down 2.4%MoM) due to smaller-than-expected tender purchase from India and continued slow demand in the U.S. and Brazil. Additional pressure emanates from Chinese ex-ports albeit at reduced levels and softening gas prices in key markets. However, seasonally in-creasing demand in the U.S. and Europe should help keep prices steady through February. Do-mestic prices are currently standing at PkR1740/bag, still trading at discount of 25.1%.

FAO Index



Source: FOA & AKD Research

Urea Middle East Granular (US$/MT)



Source: Bloomberg & AKD Research

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Buy	＞ 19% expected total return （Rf: 13% ＋ Rp: 6%)
Neutral	＞ 13% to ＜ 19% expected total return
Sell	＜ 13% expected total return （Rf: 13%）

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Buy	＞ 20% upside potential
Accumulate	＞ 5% to < 20% upside potential
Neutral	＜ 5% to > -5% potential
Reduce	＜ -5% to > -20% downside potential
Sell	＜ -20% downside potential
Not Rated	No investment opinion or recommendation

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