Case for copper builds as Chinese walls rise

Mining Journal – May 27, 2019
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If supply news is a guide copper could be edging towards an outage-driven price boost similar to the way iron ore has reacted to Brazil's production cuts.

Events in Zambia and Peru are potential flash points for a copper awakening with reports of reduced output in Chile adding to a possible supply squeeze.

Trade war concerns are believed to be masking what's happening on the supply side of copper which is heavily dependent on Chinese demand.

Over the past two months as the US and China have ratcheted up their exchange of mutually damaging tariffs the copper price has sagged from tantalisingly close to US$3 a pound to the latest price of around $2.67/lb.

The copper end-use tracking tool developed by Citi, an investment bank, is highlighting weaker demand in China with copper consumption in April up, but only just, at an increase of 1%.

March consumption growth was much higher at 5.2% year-on-year, but that was at a time when trade war language was much milder than today.

The latest measure of copper usage is in line with a decline in a more widely used measure of economic activity, the purchasing manager's index (PMI) which slipped in April to 50.1 with a measure above 50 pointing to economic expansion and below pointing to contraction.

Since the latest copper tracking measure of demand there has been a series of supply events, none as serious as Brazil's dam collapses which has have had a serious effect on iron ore supply, though collectively they do indicate a future possible supply decline.

In Zambia, one of the world's more important copper sources, government intervention in the mining industry is threatening a repeat of history, back to a time more than 50 years ago when Zambia nationalised its copper mines - triggering a collapse in production.

This time around the attack on the mining industry is largely through tax increases and a threat to repeat the nationalisation process, starting with the copper assets of India's Vedanta Resources.

Depending on how far the government of Zambia wants to press its allegations of a tax shortfall it is possible to see a sharp fall in copper production, perhaps as much as the 65% drop suffered in the last outbreak of extreme resource nationalism.

What's happening in Zambia is no different to the attack on mining companies waged in neighboring countries, including the Democratic Republic of Congo and Tanzania.

Disruptions in Peru are also starting to cut copper production at the Las Bambas mine while in Chile there is concern that converting the big opencut Chuquicamata mine to underground operations might see output reduced by up to 40%.

Chile's state-owned copper miner, Codelco, disputes reports of a decline in supply from one of the world's biggest copper mines which was first reported late last week by the Reuters news service. It claims to have sighted an internal management report.

Over the next three years copper production at Chuquicamata could drop by as much as 182,000 tonnes a year, reducing Codelco's overall group output by 4%, according to Reuters.

Like iron ore, which has enjoyed a "double whammy" boost with the Brazilian supply squeeze meeting higher-than-expected Chinese demand, there could be an increase in China's copper usage as a government orchestrated construction boom sucks in commodities.

According to one view of Chinese demand the focus has been on steel usage in high-rise building and infrastructure projects designed to minimise the negative effects of the US trade war.

But in time demand for other metals will pick up as builders apply the finishing touches such as plumbing and painting with the plumbers calling for copper and the painters consuming titanium dioxide pigment.

In what might be called a night-follow-day economic argument it's not possible to lift new building starts by a whopping 13% in the first four months of the year without having an effect on demand for steel (iron ore) and without then having an effect on copper and paint, as well as ceramics for bathroom fit-outs, which should lift the price of zircon.

Copper, however, is the metal in line for the next double-whammy of the sort enjoyed by iron ore as China rushes to build its way out of a financial corner and miners of the red metal struggle to maintain output.

Citi, as well as tracking copper demand in China, is keeping a close eye on supply and while disruptions to supply this year have been much the same as in previous years that could quickly change.

"So far, copper disruptions are running roughly in line with our annual disruption allowance," Citi said in a note to clients late last week.

"However, the probability of disruptions occurring is rising rapidly," the bank said.

As well as political issues in Zambia there is a power shortage caused by an ongoing drought which has dried up river flows into Zambia's hydroelectric dams.

"This matters because Zambia is an important global copper producer, accounting for around 4% of supply and around 15% of expected supply growth over the next two years," Citi said.

Copper supply is not being squeezed yet - but neither was iron ore until a few months ago, leading to a 55% increase in the price as steel mills scrambled to secure tightening supplies.