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Metals
Copper Markets Show Fundamental Strength

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HIGHLIGHTS

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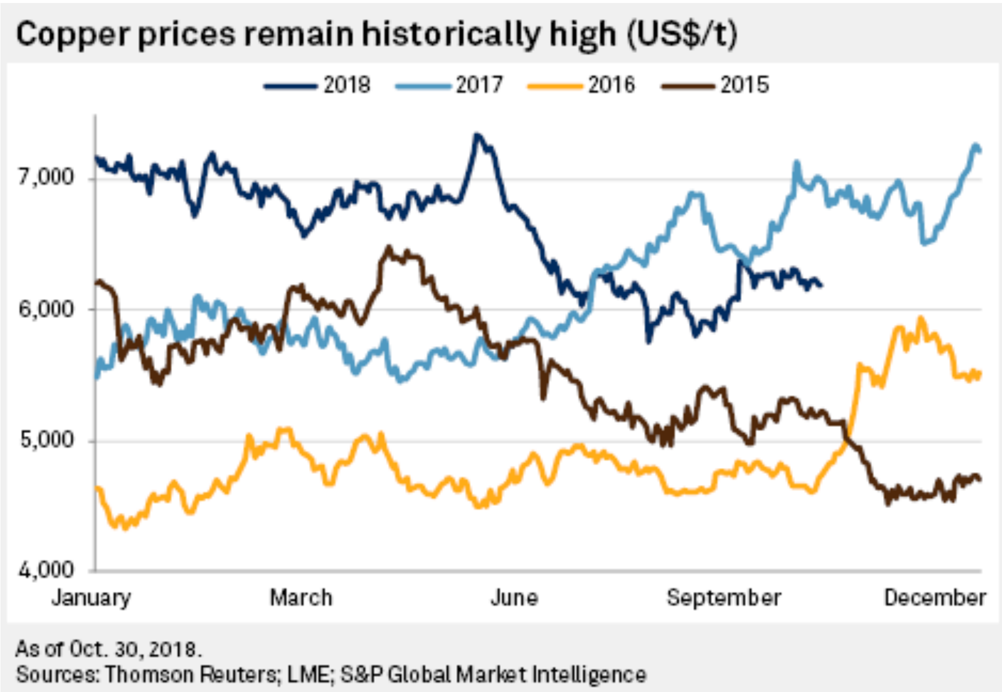
Nov. 06 2018 — Global consumption of refined copper has expanded this year as a cyclical upturn in the United States has coincided with a Chinese financial stimulus worth approximately 3% of national GDP. Both purchasing managers' indexes, or PMIs, and consumer confidence measures in the U.S. indicate positive market sentiment at 59.8 and 138.4, respectively. Chinese industrial production growth remains buoyant and has increased by approximately 6.4% on a year-over-year comparison with the first nine months of this year. The data shows no imminent threat of a hard landing in China. We expect robust economic growth to continue into 2019 but do note the escalation of headwinds associated with a deepening trade war between key markets for end-use copper. In addition, divergent monetary policy between the U.S. and China will maintain downward pressure on the Chinese yuan, which could crowd out further increases in copper consumption. This is likely to reduce the China import arbitrage across the London Metal Exchange and Shanghai Futures Exchange markets.

As sentiment among market participants continues to rebound following July's selloff, we expect some of the price strength harbored in physical premiums to be transferred to LME-traded copper prices. Despite the earlier backwardation, we expect an annual average LME cash price of US$6,510/t in 2018, or 5.5% higher than they were in 2017; prices are then likely to rise by 2.8% year over year to average US$6,664/t in 2019. This increase will be driven by fundamental tightness in China and, more broadly, Asia.

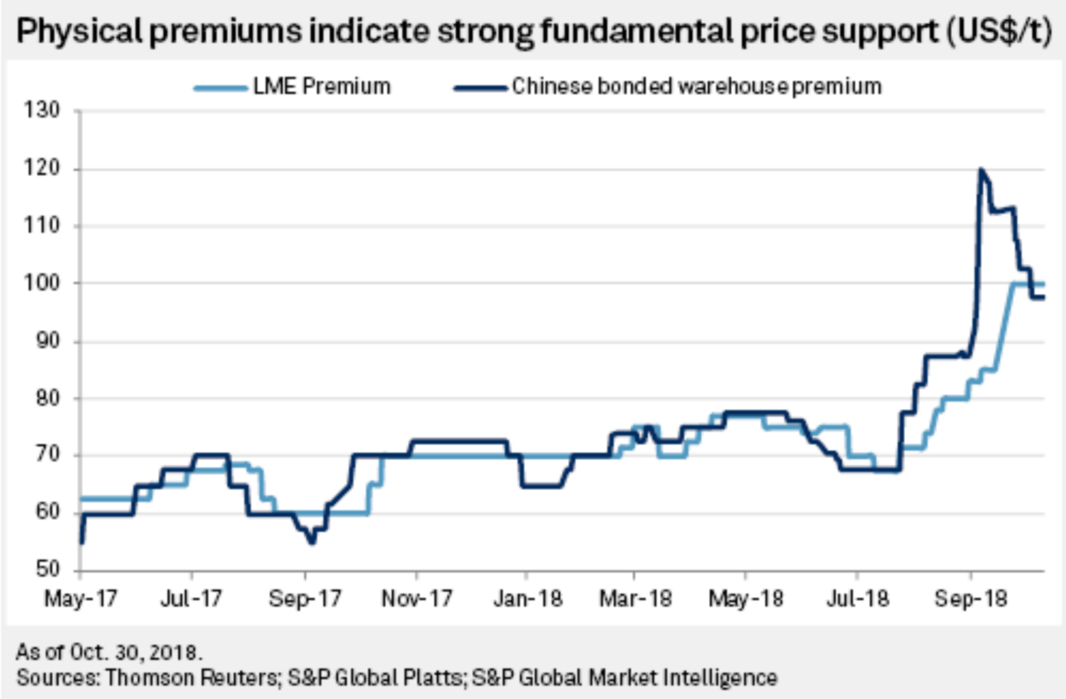


An increasing deficit in the global supply of refined copper is set to coincide with stronger global demand conditions due to a lack of investment in a metal that is geologically scarce in terms of economic quantities. This year will see a closer market balance than previous years. This balance will be followed by increasing deficits of 65,000 tonnes in 2019 to 150,000 tonnes in 2020.

Smelter expansions in China have offset smelter disruptions in the rest of the world and are indicative of increasing demand. High prices for concentrate are limiting Chinese smelters' liquidity, with Jiangxi Copper Co. Ltd. claiming 4% margins at the LME week conference in London this year. Unfortunately, this lack of liquidity is likely to persist when restrictions on Category 7 scrap further impede Chinese scrap imports and as over 1 million tonnes of new Chinese smelting capacity is set to ramp up in 2019.

However, Chinese smelters have been gaining market share not least because of outages at international smelters. Glencore PLC's Pasar and Vedanta Ltd.'s Tuticorin smelters have both recently been taken offline due to maintenance and political disruption. Pasar and Tuticorin produce 330,000 tonnes per year and 400,000 tonnes per year, respectively. Codelco also announced that it will shut down its Chuquicamata and Porterillos smelters in December, which produce 350,000 tonnes per year and 125,000 tonnes per year, respectively, to perform upgrades. These planned outages will last approximately 75 days and 45 days, respectively, and could affect a total of 87,000 tonnes of refined production.

We believe that tightness in the concentrate market through the near term will bring renewed pressure on smelters to reduce spot treatment and refining charges to secure material. Indeed, we expect a 6.1% year-over-year decrease in the annual average spot treatment and refining charges to US$73.2/t and 7.3 U.S. cents per pound, on a cost insurance and freight basis delivered to Shanghai in 2019 and a further 2.3% fall in 2020.



Our global refined consumption forecast for 2018 remains 23.6 Mt, a year-over-year growth of 2.6%, which is an acceleration from the 1.9% growth rate measured in 2017.

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