ABN·AMRO

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Industrial Metals Monitor

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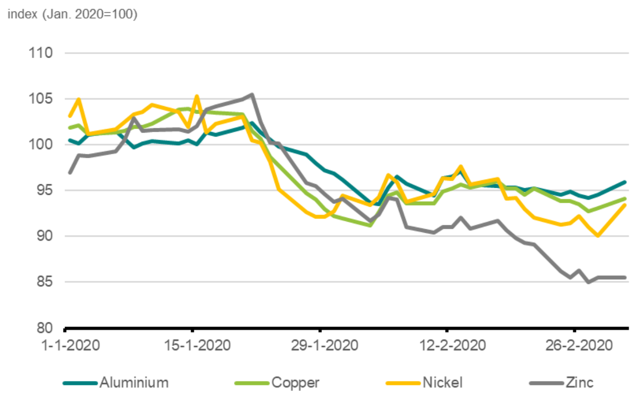
Metal prices remain strongly linked to the economy

- **Economic trends and industrial metal prices go hand-in-hand**
- **Base metals: heightened uncertainty and weak sentiment brings lower prices**
- **Steel: Chinese steel sector at a standstill; nervousness in the US and EU is increasing**
- **Steel (raw materials): iron ore prices under pressure due to weaker steel demand**

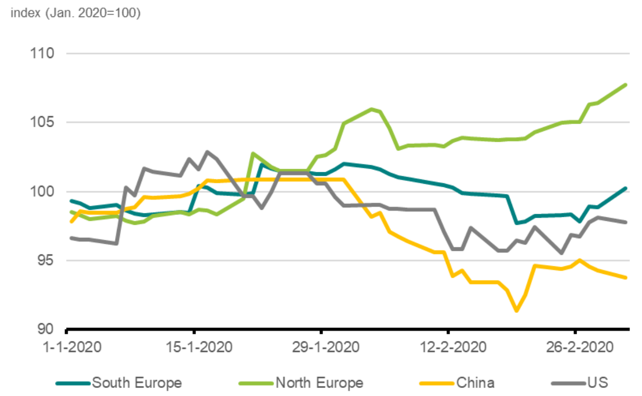
The coronavirus is having a significant impact on society and paralyzing many economies. Uncertainty is heightened and sentiment is weak, which is hitting demand for industrial metals. The prices of base metals in particular are under pressure. This once again confirms how highly sensitive these markets are to cyclical developments.

Trends in base metals prices during 2020



Source: Refinitiv

Trends in steel prices (HRC) during 2020



Source: Refinitiv, CRU, Argus Metals

The average fall in prices in the base metals markets is around 8% so far this year. Of all the base metals, the price of zinc fell the most. This is because zinc is a much sought-after metal in the construction sector and activity in this sector is particularly weak in China. The price is currently down 11% this year. The situation is more diverse in the ferrous metals markets. On average, the steel price has risen by only 1%, but this does not mean that this market is immune to the coronavirus and declining economic activity. Indeed, the steel price in China is under pressure due to the coronavirus. Prices in other countries will also soften as the virus spreads further and economic activity sharply decreases.

In order to curb the economic downturn, both the Fed (US), the ECB (EU) and the PBoC (China) are embarking on stimulating economic policies. This monetary easing cycle is bringing some stabilization to the major economies, which is. This is resulting in some relief to metals markets. However, the downside risks remain high for the time being and the continuing uncertainty is keeping prices for industrial metals low.

Base metals: heightened uncertainty and weak sentiment brings lower prices

It will continue to be important to monitor the trends in the Chinese economy with regard to base metals markets. The Chinese economy slowed down faster than expected because of the coronavirus. As a result of the internationalization of value chains over the past decades, the US and EU feel that the pressure on their economies is also increasing. This has left deep marks on base metals markets. Both the supply and the demand side will suffer considerable shocks due to less international transport capacity, fewer workers and therefore lower business activity.

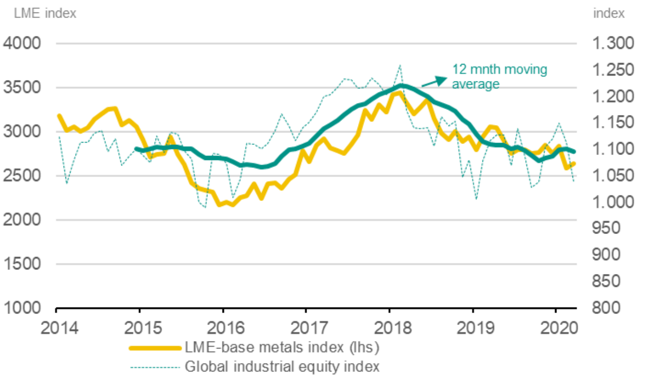
Gov. bond China (10yr) vs. price index base metals

Source: Refinitiv

US dollar vs. price index base metals

Source: Refinitiv

PMI manufacturing China vs. price index base metals



Source: Markit, Refinitiv

World trade vs. price index base metals

Source: CPB, Refinitiv

The correlation between the average base metals price (the so-called LME index) and cyclical indicators in China is large. This is due to China's large stake in the base metals markets. For example, the yield of 10-year government bonds versus the LME index is still very high. After all, when there is a high degree of economic uncertainty, investors are more likely to settle for less return on government bonds to keep their money safe. The Chinese industrial sector purchasing managers' index is also closely linked with pricing. Less base metals purchasing activity among end users results in a lower price.

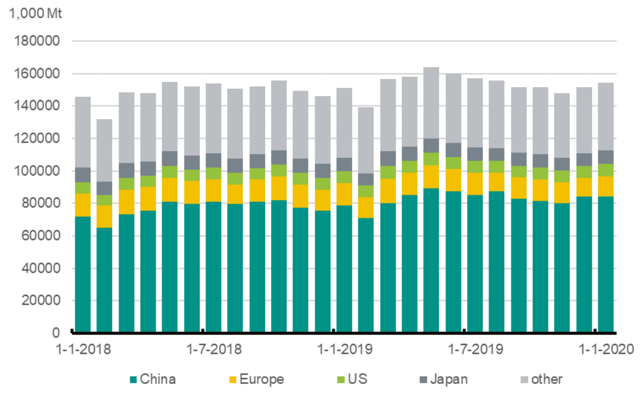
The US dollar also continues to influence the price trend. A stronger dollar has had a downward effect on base metal prices over the past two years. This is because the purchasing power of metal buyers then decreases in counter currencies and this has a negative effect on metals demand. In the coming period metals prices will continue to be influenced by the volatility of the dollar.

Investors have reduced their positions in the cyclical base metals markets in advance of a series of poor macroeconomic figures coming out due to the coronavirus, particularly from China. Those figures will be released in the coming weeks. Despite the fact that this bad news has already largely been priced in, the release of these data will have a significant impact on base metals prices in the coming months. Because a longer series of poor macroeconomic figures increases the chance of economic stimulation by central banks, this will have an upward effect on prices.

Steel: Chinese steel sector at a standstill; nervousness in the US and EU is increasing

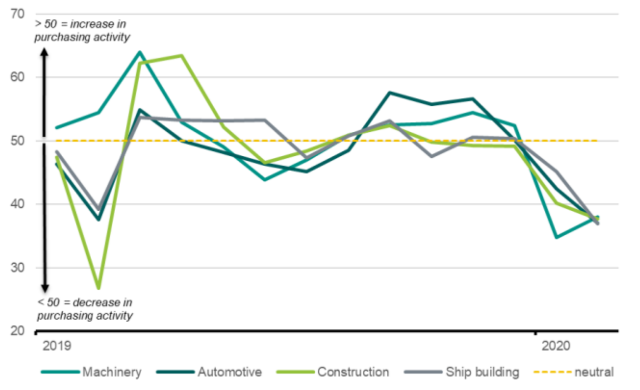
The coronavirus has led to substantial anxiety among steel mills and end users in China. The Chinese steel mills were faced with weaker demand from end users, particularly in the manufacturing and construction sectors. But despite this weaker demand, the output of steel mills remains at a relatively high level. In January 2020, Chinese steel production increased by 7% on an annual basis. If demand is disappointing, this will result in higher stocks and lower steel prices. Chinese steel production will shrink in February compared to last year.

Monthly steel production by region



Source: World Steel Association, Refinitiv

Steel purchasing activity in China (PMI)

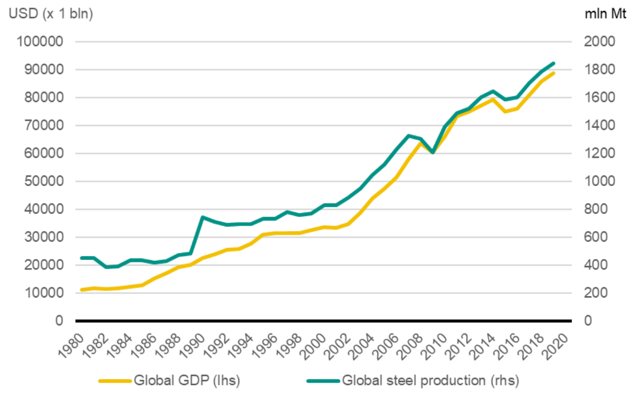


Source: Refinitiv

Demand from large end users in China will not recover quickly. In January, confidence among Chinese steel purchasing managers declined sharply. Steel purchasing activity fell sharply in machine building, construction, automotive and shipbuilding. This situation will deteriorate further in March. After all, a recovery of construction activity will not be rapid given that many employees will not return to work quickly. Moreover, transport restrictions still apply throughout the country, making steel transport more difficult.

Meanwhile, steel prices in the US and the EU continue to rise. However, the pace of increase is slow and here, too, dark clouds are gathering. If the spread of the virus in the US and the EU intensifies, the steel sector in these regions will be negatively affected. This is because in this sector, the relationship with economic activity remains high.

Global steel production vs. Global GDP



Source: World Steel Association, World bank, Refinitiv

Global steel price vs. construction equity index

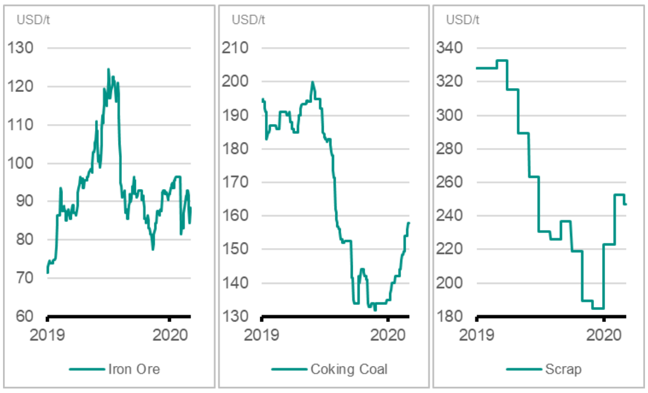
Source: Refinitiv, ABN AMRO Group Economics

According to the World Steel Association, the gross value added of the global steel sector is approximately USD 500 billion. This is around 0.7% of global GDP. But the indirect influence is many times greater, as steel is an important input factor for many other sectors. The relationship with the business cycle and activity is high. As soon as business activity among end users falls, there is a direct negative effect on the demand for steel and thus prices.

Steel (raw materials): iron ore prices under pressure due to weaker steel demand

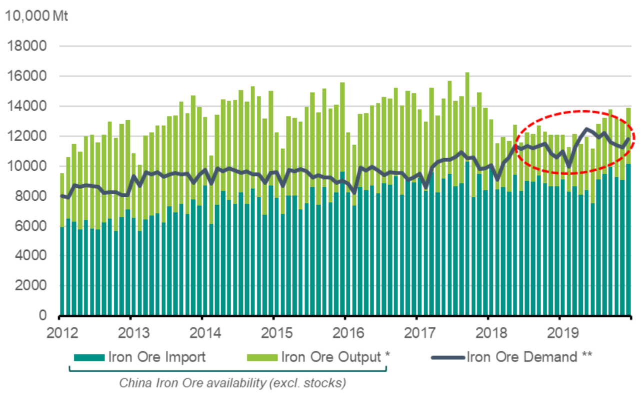
In the first quarter of 2020, the iron ore market was mainly influenced by weather conditions. Brazilian production was lower due to heavy rainfall, especially in the Minas Gerias region. And the Australian iron ore mines in the Northwest were already challenged by three cyclones this year. As a result, deliveries of iron ore destined for the export market suffered considerable delays and iron ore prices remained high. But here, too, the coronavirus has depressed sentiment and prices. This was much less the case in the coking coal and steel scrap market. Supply disruptions prevailed there, leading to higher prices.

Price trends steelmaking raw materials



Source: Refinitiv

China and the need for iron ore

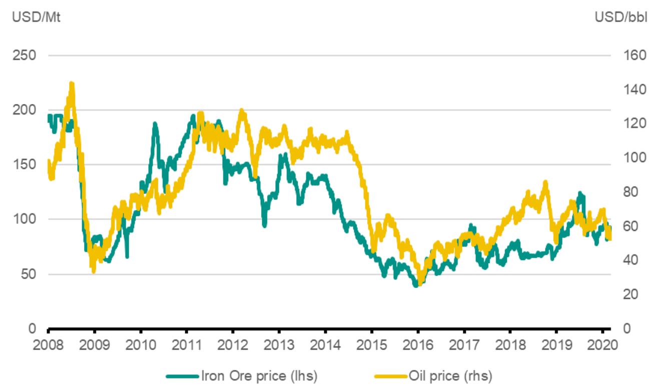


Source: World Steel Association, Refinitiv, ABN AMRO Gr. Economics
* Iron ore output converted to global average quality content
** Iron ore demand based on monthly steel production (factor 1.4)

The Chinese steel mills still have sufficient iron ore reserves to maintain current production levels. Stocks in the Chinese ports are also relatively high. Since 2018, the import of iron ore plus domestic production has been sufficient to meet Chinese iron ore needs. This means that over the last two years, more has been sourced from the Chinese iron ore stocks at ports. If low iron ore prices persist, these stocks will be replenished again.

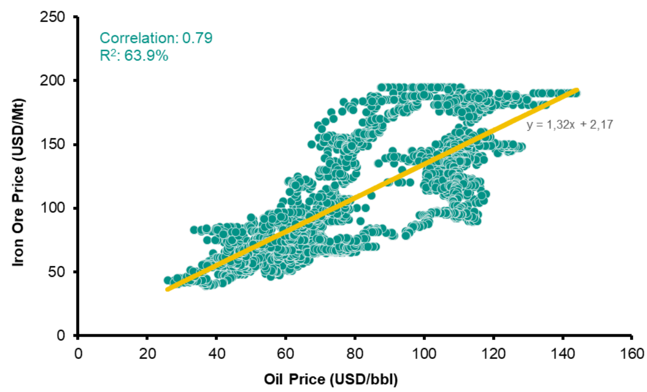
We expect the iron ore price to remain weak as long as steel mills are under pressure and the coronavirus is affecting the economy. This is because many steel mills have high steel inventories, while demand is weakening as the virus impacts the economy. In addition, the iron ore price is closely related to trends in the Chinese economy, as two-thirds of the seaborne iron ore trade is destined for China.

Iron ore price vs. oil price



Source: Refinitiv

Correlation iron ore price and oil price



Source: Refinitiv, ABN AMRO Group Economics

The volatility of crude oil prices has major consequences for the four major iron ore companies (Vale, Rio Tinto, BHP Billiton and Fortescue Metals Group) and their seaborne iron ore trade. They have a share of around 70% of the global export of iron ore. It is therefore not surprising that oil price volatility strongly influences the transport costs of these companies and thus has a direct impact on the price of iron ore. The price trends of both iron ore and oil remain highly dependent on demand from China. The Chinese economy is under strong pressure from the coronavirus and this will have a downward effect on the demand for both iron ore and oil.

Sources:

For this publication several sources were used, of which Argus Metals, CRU, Mining Journal, OECD, ISGS and Refinitiv (formerly Thomson Reuters Datastream) are the most important.

Text closed on 4 March 2020