

Short Insight – Base Metals

Group Economics

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Sweet and sour taste base metals price recovery

The sudden drop in demand in the copper, nickel and zinc markets due to the Covid-19 pandemic quickly put an end to supply problems. Overnight, the focus shifted to overproduction and higher stocks. For the time being, surpluses are the new normal, while the global demand outlook for base metals remains bleak. However, the improving economy in China and the support from central banks has fuelled positive sentiment in the market and among investors, which is currently giving prices some support.

- **Support from central banks fosters recovery in base metals prices**
- **Cautiously positive economic trends in China restore investors' courage**
- **More optimism among copper buyers in China**
- **Abrupt demand cuts and few production cutbacks result in higher stocks**
- **Premiums for direct delivery of copper and nickel have increased in China**

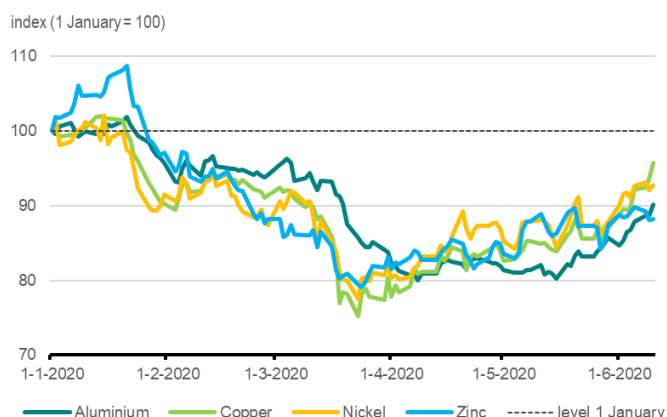
Support central banks fosters recovery in base metals prices

Strong support from the Fed, ECB and PBoC at the end of March has helped to reverse negative sentiment among investors. This proved to be a good support for base metals prices and prices of copper, nickel and zinc recovered swiftly. Although uncertainty is higher than normal, it appears that the Chinese economy is in more stable waters. This is particularly important for base metals markets, given the significant importance of China in these markets, and means that new price lows are not an imminent scenario. The reboot of many other economies is also positive but it may be a bit too soon to take an optimistic stance. After all, the Covid-19 pandemic has resulted in surpluses and higher stocks. In addition, numerous weak macro figures are set to come out in the near future and renewed tensions between the US and China could seriously dent optimism.

Positive economic trends in China restore investors' courage

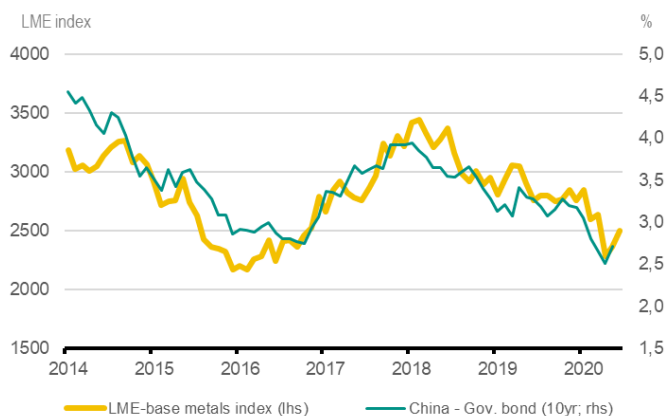
China has a share of about 50% of global demand for base metals. This means there is a very strong relationship between the average base metals price (or LME index) and the trend in the Chinese economy. For example, the performance of 10-year Chinese government bonds is closely related to the price trend in base metals. If uncertainty about the Chinese economy is increasing, investors are more likely to settle for a lower return on these bonds to keep their money safe. Higher economic uncertainty also means lower base metal prices and vice versa. The recent price recovery and higher government bond yields were partly prompted by the rapid recovery of Chinese industry. They are the first green shoots and give many investors a bit more courage.

Trend in base metals prices in 2020



Source: Refinitiv

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

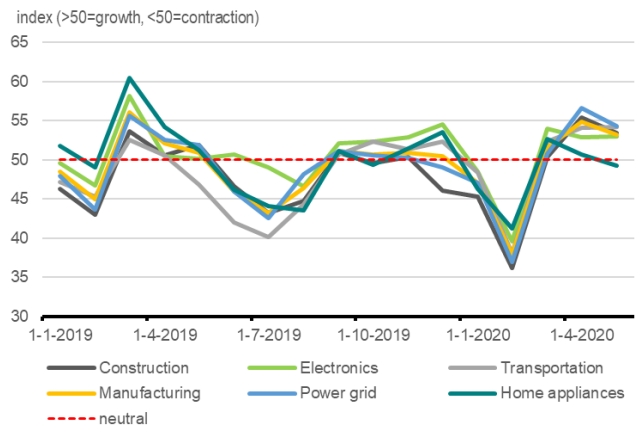


Source: Refinitiv

More optimism among copper buyers in China

The Chinese services sector is still lagging behind and consumers are still conservative in their spending. This means that domestic spending has not yet normalized. This recovery will be a gradual process. Indeed, consumers are still cautious despite the relaxation of restrictions. However, sentiment among the larger metal processors has recovered much faster. After a deep dip in March, confidence among buyers of copper, for example, increased sharply again in April. All major sectors are witnessing a pick-up in purchasing activity again, which means that metal producers' orders are also rising. The smooth recovery of this optimism is contributing to the price rebound. The dip in buyers' confidence of producers of household consumer products reflects the still relatively low willingness of Chinese consumers to buy.

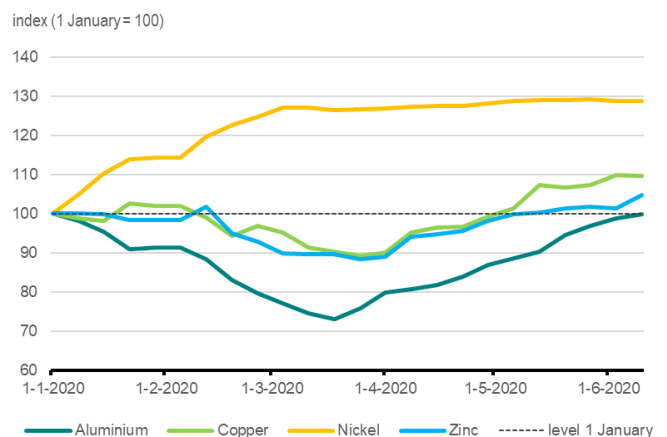
Sentiment purchasers of copper in China



Abrupt demand cuts, few output cutbacks result in higher stocks

As a result of the coronavirus crisis, inventories of base metals in warehouses of the London Metal Exchange (LME) and the Shanghai Futures Exchange (SHFE) have risen sharply. With the sudden drop in demand, only a few producers had the discipline to shut down production, which continued at lower utilization rates. This is because the complete shutdown of production facilities would have had even greater adverse financial consequences for many producers. The continued flow of materials created a reservoir of supplies. This currently remains an obstacle to a rapid recovery in base metals markets. Before the crisis, the copper, nickel and zinc markets were still facing shortages, while the supply in the aluminium market was ample. Now, there are surpluses in all base metal markets. This indicates that there may be reasons for a price recovery from a macroeconomic point of view, but that caution is still needed from a fundamental perspective.

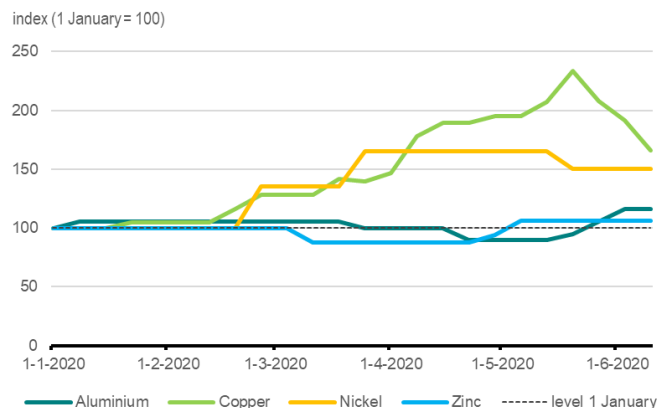
Trend in LME & SHFE stocks base metals in 2020



Premiums copper and nickel have increased in China

If demand for a certain type of metal is weak, the premiums for direct delivery of that metal from official warehouses will also decrease. At this stage, end users are well covered with long-term purchase contracts. These contracts must first be complied with and this will suppress purchasing activity on the spot market. Moreover, if availability of the material remains high, it will have a further depressing effect on direct delivery premiums. This is now the case in Europe and the US. Demand is still weak there, as the recovery in many metal-processing sectors, such as construction, automotive and other industries, remains weak. China has ended its lockdown and industrial orders are picking up. This means that direct delivery premiums are again showing signs of recovery, especially for copper and nickel. This is positive, but downside risks remain high for China. The recovery with trading partners is challenging, and the pace remains uncertain.

Premiums direct delivery base metals China



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