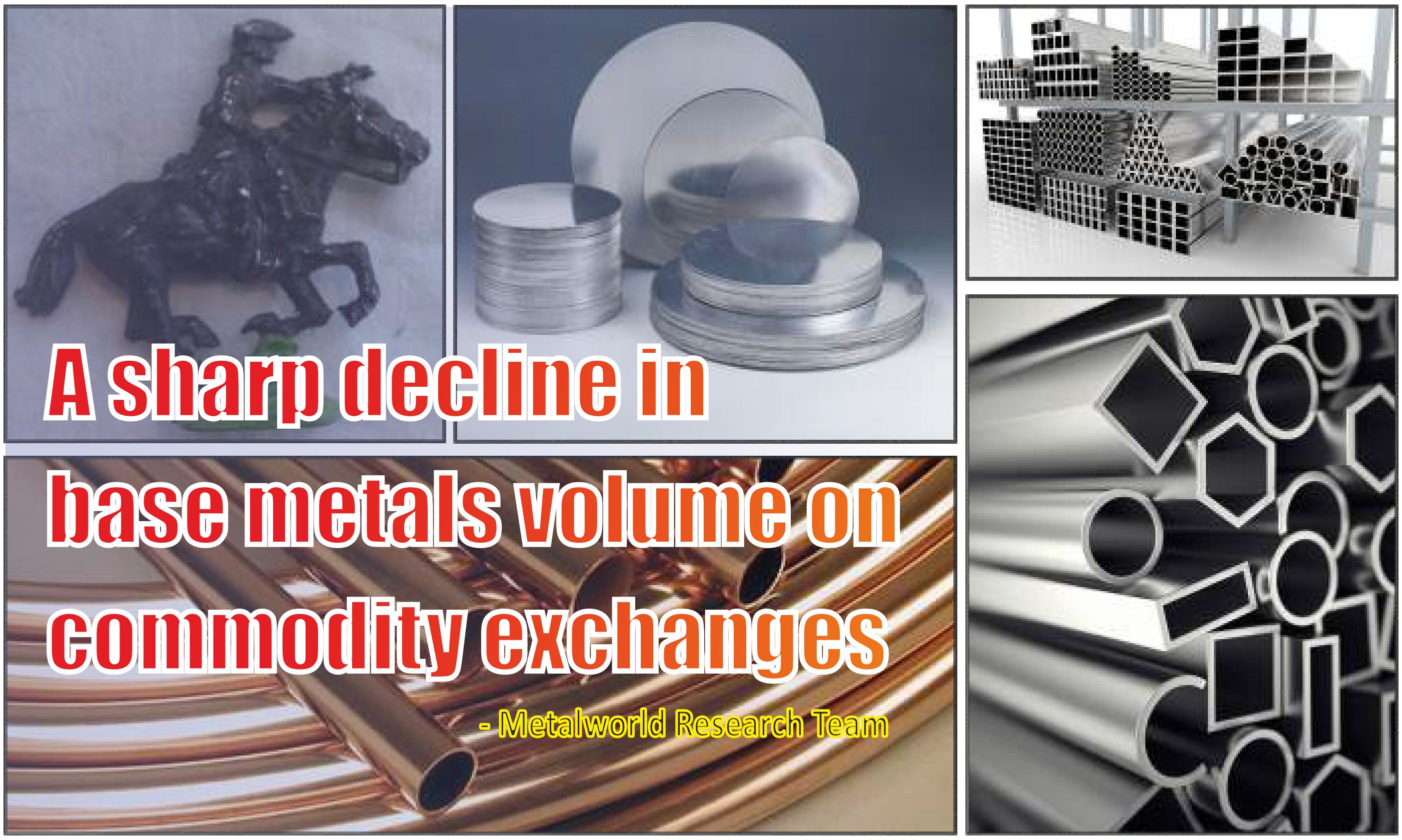

A sharp decline in base metals volume on commodity exchanges

- Metalworld Research Team

Base metals volume drifted lower in 2014 on domestic exchanges due to steep fall in prices overseas coupled with commodities transaction tax (CTT) levied by the government. The trend is unlikely to reverse this year as Indian traders are yet to absorb the additional trading tax burden.

Falling volume

Volume in base metals fell over 37 per cent during April – December 2014 following uncertainty over price movement in the overseas market. Trade data showed, total trading turnover from base metals segment recorded at Rs 947,573.21 crore during the first nine months of the financial year 2014-15 as compared to around Rs 15,00,000 crore of trade reported from this segment in the same period last year. The fall in turnover, however, does not reflect the overall trading sentiment on the exchange in entirety.

From the base metals section, exchanges largely the Multi Commodity Exchange recorded a sharp decline in turnover during the financial year 2013-14. Overall trading from base metals segment was reported at Rs 17,61,359.89 crore during 2013-14, a decline of 46 per cent from Rs 32,60,050.77 crore in the previous year.

Commodity transaction tax (CTT)

CTT is a tax levied on exchange-traded commodity derivatives in India on the lines of the Securities Transaction Tax or STT — a tax imposed on the purchase and sale of securities and their derivatives traded on stock exchanges in the local market. In the 2008-09 Budget, the then Finance Minister P Chidambaram proposed the introduction of CTT on the same lines as STT on options and futures, saying that transactions in commodity futures have come of age. Subsequently, the proposal was dropped after the Prime Minister's Economic Advisory Council or PMEAC cautioned against the levy. Currently, transaction tax is levied only on equity cash and equity derivatives transactions. The argument is that since transaction charge is a well established tax system in the equity market, the same should be replicated in commodity futures trading too. Proponents of the tax further point out that imposing a transaction tax on commodity derivatives will provide a level playing field between equity and commodity trading markets.

The Bombay Stock Exchange pitched for it, saying that a transaction tax on equities was forcing traders to move to the commodities segment. According to commodity exchanges, exchange traded commodity derivatives are risk management platforms for hedging against adverse price movement. CTT on commodity derivatives could increase the cost of hedging transactions, impair hedging efficiency and drive out hedgers, they say. They also fear that imposing CTT will boost illegal dabba trading. Dabba trading is an illegal market in which participants do not have to pay margin requirements, mark-to-market margins, transaction fee and taxes. They point to the fact that no less a body than PMEAC had warned against such a levy and that trades have in fact shifted from equity futures to equity options as tax on the latter is on the option premium, which is much less.

CTT came into effect from July 1 with a levy of 0.01 per cent of the transactional value being applicable on the seller in futures trading of a host of items such as aluminium, copper, zinc and lead. At 0.01 per cent of the transaction value, the levy would work out to Rs.10 on a deal worth Rs.1 lakh. The implementation of CTT, however, got delayed owing to detailed consultations between the Ministry and various stakeholders on the list of non-farm commodities to be brought under the levy.

Hedging risks

When metals' prices witness high volatility, more players including producers, traders and users use futures trading platform as a hedging tool to ensure future prices of metals. But, base metals remained weak during 2014. While lead witnessed the sharpest decline among the base metals quarter, copper and tin followed suit. Lead recorded a sharp decline of 16 per cent to close on December 31 at 1853 a tonne from its opening level of $2206 a tonne on January 1, 2014. Similarly, copper recorded 14 per cent fall to close at $6359 a tonne from $7394.5 a tonne and tin plunged by 13.53 per cent to $19500 a tonne.

Gnanasekar Thiagarajan, Director, Commtrendz, said, "Base metal prices softened on a loss of confidence in global economic growth. The uncertainty was triggered by weak macro-economic data over the last quarter. However, enough indicators still point towards a moderate economic recovery scenario, which should also support demand for base metals going forward."

Conditions in the base metals markets also remain favourable from a fundamental perspective. In 2015 we will still witness some surpluses, but their level will be relatively small. Demand is expected to outpace supply in 2016 and the balance for most metals will be negative. These deficits support stronger metal prices in the long term. For base metals, the 2015 first half average London Metal Exchange forecast for Aluminum prices are at $1,800 a tonne (MCX: Rs 130 a kg) , with copper at $6,700 a tonne (MCX: Rs 450 a kg). Lead is forecast at $2,100 a tonne (MCX: Rs 125 a kg), nickel at $19,000 a tonne (MCX: Rs 1045 a kg), and zinc at $2,200 a tonne (MCX: Rs 145 a kg). Particularly, prices of copper and zinc are likely to remain bullish and lead prices moderately bullish, while neutral on aluminum.

Nickel remained the largest gainer of which the price moved up by 6.91 per cent to $14935 a tonne from $13970 a tonne. Zinc and aluminium also gained, albeit marginally, during 2014.

Ajay Kedia, managing director, Kedia Commodity, said, "In 2014, we have seen decline in the prices from Q2 onwards largely due to the shaky economic story unfolding in China, which is one of the largest consumers of the industrial metal. Barometer for Base metals copper whose prices ended 2014 with a loss of more than 14 percent on concerns that a supply surplus will hit the market next year just as Chinese economic growth shifts down another gear."

Losses in copper, the most widely followed metal, were matched by tin and exceeded only by lead - a market that was in surplus in the year to September - while nickel was the best-performing metal thanks to Indonesia's ore export ban. Weighing on the metal this year, the global copper market is expected to record a surplus of about 390,000 tonnes in 2015, according to an industry group.

That would follow five straight years of deficit. Data showed activity in China's factory sector shrank for the first time in seven months in December, highlighting the urgency behind a series of surprise easing moves by Beijing in the past two months. Zinc in 2014 reached a near three-year high mid-2014, prices benefitted from falling stockpiles and expected supply cuts due to the scheduled closures of among others Australia's Century and the Lisheen mine in Ireland with a combined output of 600,000 tonnes.

Nickel prices showed good gains in 2015 after Indonesia, supplying more than a fifth of global exports, surprised the mining world in January by putting into effect an outright ban on nickel ore exports. Initially record warehouse inventories, massive stockpiling by Chinese pig iron producers and growing mine supply kept a lid on the price which was languishing at near five-year lows on LME below $14,000 a tonne at the start of the year.

The Asian nation, against expectations, stuck to its guns and the ban, in combination with fears that tensions with Russia could affect supply from top miner Norilsk, eventually sent the price of the steelmaking ingredient above $20,000 in May. But as LME stocks continued to rise and Philippines took up some of Indonesia's slack, supply worries subsided and the price tanked again, nearly wiping out all 2014's gains, Kedia said.

Commodity supply, the global growth outlook and the US dollar, will continue to play dominant roles in the first quarter of 2015. Oversupply will remain a challenge for energy markets. This will continue to depress oil prices in 2015, in our view. However, it is likely that in the next three months they will recover somewhat after the brutal sell-off in the last few months. A rise in the US dollar will be a negative for oil and gold prices next year.

Better economic data releases are expected to lift this downbeat sentiment and to support cyclical commodities with a relatively tight supply and demand balance. For example, we expect base metals to do well. In addition, base metals are also relatively resilient to developments in the US dollar.

Conclusion

The commodities exchanges are currently passing through a tough phase now. With the absence of large corporate participation despite tremendous efforts has made going tough for them. But, for smooth future ride, however, primary metals producers like Hindalco Industries, Vedanta and Nalco need to hedge their commodities' trading risk. These companies will not only bring large volume with their bulk orders, but also a number of associate traders including intermediaries and users on the exchange trading platforms.

LME spot price movement ($/tonne)

Metal	Jan 1 (A)	High	Low	Dec 31 (B)	Variations (A-B)
Lead	2206	2269	1814	1853	(-)16
Copper	7394.5	7439.5	6306	6359	(-)14
Tin	22550	23905	18530	19500	(-)13
Aluminium	1764.5	2114	1641.5	1831.5	4
Zinc	2085	2420	1942	2167	4
Nickel	13970	21200	13365	14935	7

Source : Deutsche Bank