# Languishing demand to lull copper this year

- Metalworld Research Team

Copper prices are likely to remain under pressure until 2016 due to expected increase in supply to keep the market in surplus and encourage miners to cut production. Post 2016, however, over supply is set to evaporate steadily by 2018 as more mines would become unviable due to sustained level of low price. Gradually, market will turn in supply deficit in 2017. With the demand expected to increase on global economic revival, copper price will bounce back to average beyond the benchmark $7000 only in 2018 to breach its 2013 record of $7354 and to settle down at $7544. Thereafter, the robust trend will continue at least until 2020 until the red metal sets its average at $8231, Deutsche Bank report said.

### Preferred base metal

Copper remains the least preferred long or rather the most preferred short amongst the base metals. This is perhaps unsurprising given the strong likelihood of a surplus market over the next two years, the downside risks from the Chinese property market, and the downdraft from a falling oil price. A falling oil price will impact costs, and will pull down the marginal cost support levels, but the linkage between oil and copper in this instance has been more sentiment driven. Investor positioning on the COMEX has moved to a far more significant net short position, with current positioning not far off the record short positioning seen in November last year and March this year. On the LME, money managers have remained net long, but when expressed as percentage of open interest, copper is one of the lowest among the base metals. Therefore, its net long position fell sharply over the period when the oil price registered its big fall. Copper will remain a favourite short in the base metal market over the course of 2015, with bouts of short covering leading to some volatility over the period

However, for those market participants itching to short copper, the behaviour of the Chinese SRB (State Reserve Bureau) will remain a key risk factor. The exact amount purchased by the SRB in 2014 is keenly debated, but estimates range from 400,000 – 700,000 tonnes. Broad consensus estimates SRB's total purchase at 500,000 tonnes. Channel checks would suggest that the SRB is looking to buy a further 200,000 of metal this year, should the price fall below $6500/t, pushing the total purchases close to 700,000 tonnes. Therefore, the market is likely to remain in surplus of 800,000 tonnes in the next two years, which seems to be within the SRB's capacity to absorb. All things being equal, the SRB's willingness to buy copper when prices fall, would suggest that there is an expectation of future deficits.

### Mined supply disappoints

During 2014, copper supply growth set the new record. At just under 2% growth, we would classify 2014 as average. The reason was of course the number of disruptions and delayed project start-ups. There were a number of high profile disruptions in the year, starting off with the tough stance taken by the Indonesian government hampering concentrate sales. Slower than expected ramp-ups of Ministro Hales, Toromocho, Caserones, Sierra Gorda and Oyu Tolgoi also added to the disruption tally. But all of these disruptions simply makes 2014 a “normal” year, with 5 – 6% or 1 million tonnes of disruptions. Perhaps 2013 was the anomaly where a record mined supply growth was helped by a very low disruption of only 3.5% in the year. The last time, the disruption allowance was below 4%, was in 2004, also a very strong mined supply growth year. Strong mined supply growth forecast continued for the next two years (5% in 2015E and 6.5% in 2016E) with disruptions allowance could be higher (6% of supply in both years).

Given that the copper market always suffers from a high level of disruption, an assessment is needed whether the forecasts of robust mine output in 2015 and 2016 are realistic. Both BHP and Rio have recently guided to lower mined output for 2015 and 2016 at recent investor days. BHP's Escondida mine will see lower grades from the end of 2015, with limitations on water usage restricting the use of the third concentrator until 2017. Therefore, factoring in 160,000 less production in 2016, as a result of this guidance, seems categorical. Rio's Bingham Canyon mine will also see 120,000 tonnes less production in 2015, as a result of remediation work to secure the mine after the 2013 pit wall slippage. The other major mine that will experience a fall in production is Grasberg in 2017, as the operation transitions to an underground block cave. Therefore, the major mines are forecast to deliver significant volume or alternatively see big falls in production. The big contributions amount to 1.1 – 1.2 million tons (Mt) in 2015 and 2016E, which is similar to disruption allowance forecasts. The main contributing region is still Latin American, especially Chile, Peru and Mexico, with an additional 1.7Mt forecast from the region.

World production of refined copper is expected to exceed demand by 390,000 tons in 2015, marking the market's first deficit after five straight years of surplus, the International Copper Study Group said in December. The glut comes as demand from China and Europe falls, while output from expansions and new mining project increases, the ICSG said.

### 7% price rise in 2014

Copper posted 7 per cent rise in 2014, the second yearly loss in a row. Copper remained highly volatile during 2014. On the London

Metal Exchange, the red metal shot up to $7460 on expected bullish sentiment. But, the price slumped to $6230 and closed at $6284 on December 31. The timing of the Fed's first interest rate hike was a significant theme in 2014, which helped drive the U.S. dollar higher and gold prices lower. At a press conference following the December monetary policy meeting, Fed Chair Janet Yellen said that interest rates will remain unchanged for at least two meetings. As a result, some economists are expecting the first rate hike as early as June, but markets are pricing in a move at the September meeting. However, some economists and market analysts have been skeptical that the Fed Funds Rate will move higher in 2015. They have also said that any renewed expectation of looser U.S. monetary policy for a longer period could create some weakness in the U.S. dollar and in turn help push gold prices higher.

The daily decline followed data confirming manufacturing activity in China, the world's largest copper consumer, shrank in December. Copper is widely used in manufactured goods. On December 31st, the final reading of the HSBC Manufacturing Purchasing Managers' Index showed activity in China's manufacturing sector slowed in December, extending a string of disappointing data that have put the spotlight on the country's troubles and the implications for raw-material demand.

China's economy grew at its slowest rate in more than five years in the third quarter, and growth for the full year could fall below the government target of about 7.5 per cent. Beijing has taken steps to support its economy, including easing credit conditions and changing the way it calculates gross domestic product, but many copper investors believe the government hasn't gone far enough to kick-start growth. A stimulus program announced in April fuelled investor optimism and drove prices higher, but that rally fizzled when economic data showed the measures were too narrowly targeted to turn the economy around. Copper prices could slide further next year, analysts said.

U.S. monetary policy might continue to remain loose in 2015 as the Federal Open Market Committee will have a dovish tilt, according to one U.S. economist. In a research note published recently, Joseph LaVorgna, chief U.S. economist at Deutsch Bank, rated the voting members of the FOMC next year, saying that the committee will be significantly more dovish compared to 2014. Looking back at the past year, he gave the FOMC a rating of 2.6 out of five; however, for 2015 he is giving the committee a rating of 1.8 out of five.

## Past and future

The price of the red metal briefly dipped below $3 a pound in March – a near four-year low – on market expectations of a move into surplus after years of deficits. By the third quarter it was clear mining output and shipments were falling far short of predictions thanks to suspended Indonesia concentrate exports and (surprise, surprise) project delays and production disruptions. While oversupply fears proved to be overblown, copper is ending the year down 15% near its lowest for the year as uncertainty over Chinese consumption continues to gnaw at investors.

While not all of it will reach markets, forecast mine output growth through the year of 6% or 1mt and another 800kt in 2016 is still a lot to absorb. Falling oil, the top input costs for all miners bar those lucky enough to sit on copper oxide, could also have the perverse effect of keeping high-cost mines in the game for longer, further depressing prices.

China's refined output is racing ahead hitting a record 7.2mt from January-November, up 11.5% year-on-year and more capacity will come on stream 2015. There's nothing like a crises to focus minds so Mongolian politicians could even resurrect Oyu Tolgoi's much anticipated and mammoth phase II while other long shots like Iran – expected to produce 300kt in 2015 no less – returning to the market could weigh on the price beyond 2015. There is price upside potential: Too much is being asked of Chile and Peru which together must bring 7.5mt to the table in 2015. Codelco's problems with arsenic, grades, labour and funding are well documented. And Peru's new flagship projects like Las Bambas and Constancia still needs work.

## Future drivers

Unicef reports that by 2050 around 70 per cent of the world will live in cities. Australia will also be one of the most urban nations in the world, with 94 per cent of people living in cities or metropolitan areas. China and India alone will have cities with more than a billion people living in them. In the meantime the rural population is predicted to remain flat at around 3.5 billion for the next three decades. As part of this massive shift towards urban centres commodity demand is forecast to grow in line with urban infrastructure growth focus in mind. These people will need to build, power, and run their cities, and copper will be the metal that will allow them to do so. According to BHP, "Chinese copper intensity doubles from rural (less than 500 000 people) to smallest urban centres; and more than triples from rural to large urban centres". It is proven that demand evolves with economic development, although "copper [does] plateau later in the industrialisation cycle" both "China and India are still in the early stages of development". In explicit terms, the total demand for semi-fabricated products is expected to grow at three per cent compound annual growth rate (CAGR) over the coming decade, with the primary drivers China and India sitting at five and ten per cent CAGR respectively. While average industry copper grade percentages remained fairly consist in process feed from 1980 to 1998, they have been on a sharp downward slope that looks to get only worse. Speaking to BNP Paribas managing director energy and natural resources - investment banking Asia Pacific, David McCombe, he explained in the short term "copper will be coming off over 2015 through to 2017, but it will be moving up again to the back end of 2017". Much of this is due to the "current imbalance because of higher supply, as there is around 23 million tonnes of supply but only about 22 million tonnes of demand".

ANZ head of economics corporate and commercial, Justin Fabo, added that "copper looks vulnerable enough to slip back through the US$7000 per tonne mark as we approach the normally quiet northern hemisphere summer. Operating rates at copper tube and pipe fabricators fell below 80 per cent mid-year, an indication that end-user demand is weak; we would be positioned for some further downside in the short-term." In terms of revenue for the industry growth rates are set to slow progressively over the next few years before entering into a brief period of decline in 2017-18, ahead of returning to minimal growth in the next period.

## Conclusion

Copper mining is a dying industry, having passed the point of maturity it is now in decline. While there is extremely moderate growth predicted in the next five years, the world price of copper is forecast to steadily decline. The future is not bright for this crucial metal, even as demand slowly increases. Data collated by the United Nations show, demand for the metal will increase as many third and second world nations develop, creating long term drivers with increased consumption as they build their infrastructure. This in part is due to the massive shift society is seeing, precipitating a decline in rural populations to greater urbanisation and in turn economic development. Thus, Morgan Stanley cut its 2015 forecast for copper by 3 percent to $7,176, while keeping the previous estimate for this year at $6,939.