Fundamentals to Drive Copper in 2016

- Metalworld Research Team

With China sending ripples over its economic growth prospects in 2016, base metals were pushed into doldrums due to renewed fears over demand from the world's largest consumer of industrial commodities. Following global economic slowdown, copper demand remained under severe pressure over the last few years being its consumption closely linked with the world economic growth. Convention wisdom suggests that copper consumption moves in tandem with global economic growth. Hence, experts keep their fingers crossed for copper demand trend this year. Copper is used in water pipelines, intelligent houses and buildings, electrical motors, power lines, electrical appliances, health care, environment related industries, computers, communication devices, in general, in the industries that are shaping the future.

2015 : A Tough Year

Copper prices declined over 23 per cent during 2015 on strengthening US dollar and slower-than-expected growth in China have weighed on copper prices in 2015, but for many investors, the extent of the shift downward still came as a surprise. China set the copper demand trend in 2015. There was a big twist in copper demand in 2015 due to a slowdown in Chinese economy. Perhaps the biggest twist was that the year saw the collapse of the copper financing business, now described as "moribund" by the market due to China's deleveraging policies and the narrowed global interest rate spread. Instead, "real demand" is once again becoming the key market driver. As a consequence, business trend has shifted from outlook to fundamentals which proved the biggest driver for copper market in 2015. Meanwhile, one outcome of that demand for financing purposes switching from massive to negligible is that the country's refined copper imports probably will show no significant increase for the

COPPER PRODUCTION AND CONSUMPTION IMBALANCE ('000 TONNES)					
Calendar Year	Refined Production	Change (%)	Refined Consumption	Change (%)	Global Balance
2008	18361	1.7	18097	0.7	264
2009	18344	(-) 0.1	17655	(-) 2.4	689
2010	18816	2.6	18598	5.3	218
2011	19583	4.1	19746	6.2	(-)163
2012	20565	5.0	20912	5.9	(-)348
2013	21928	6.6	22067	5.5	(-)138
2014	23218	5.9	23245	5.3	(-)27
2015	24021	3.5	24256	4.3	(-)235
2016 (F)	25219	5.0	25329	4.4	(-)110

(F) : Forecasting

Source : International Copper Study Group

full-year 2015; no change or a slight drop are more likely results. China's refined copper imports during the first ten months of 2015 totaled 2.9 million tonnes, down about 2% year-on-year, according to customs data. In 2014, Goldman Sachs estimated that as much as 1 million tonnes of China's copper imports were tied up with the financing trade. This suggests how financing needs have exaggerated China's demand for copper and warped views about the health of China's overall economy.

Beyond that, a broader rout in commodities prices has led to weaker investor sentiment in the overall metals space. Overall shift in sentiment has had an impact on copper. An average retail investor looking to invest is seeing a lot of negative headlines for commodities in general, and copper is one of the main ones. It has definitely taken the shine off investing in resource stocks, let alone copper-specific stocks. Copper slid along with nickel, zinc and crude oil this year as commodities were pummeled by the slowdown in the biggest user of base metals and excess supplies. While the retreat in copper prompted Glencore to announce supply cuts at operations in Africa, Goldman Sachs said that such reductions served only as a confirmation that demand was weak. The New York-based bank said consumption in China wouldn't grow at all this year, and forecast global surpluses of at least 500,000 tonnes from 2016 to 2019.

The outlook for copper is greatly focused on China. Copper consumption will grow as a consequence of overall economic growth. China has been a shining example of overall economic growth, growing at an annual rate of 9.9% between 1980 and 2010. Most forecasts do not have China slowing down anytime soon; the IMF earlier had predicted China's economy will expand at an annual rate of 9.7% over the next 5 years. Many global economy monitoring agencies have reduced China's economic growth forecast at below 6%, therefore, falling below the economic growth of India at 7%.

Change in Chinese Stance

China for many years wanted a lot of raw materials and metal, like copper, but now, China is not that interested in the copper, and American jobs are being cut because of that. Copper is one of the key indicators of growth on a global level, and this has been hit very hard because of the economic slowdown in China, although there has been a price decline for a while now. Since 2013, prices for copper have fallen around 40 percent, which now means that supply of copper is too high, especially since China has seemed to be not interested as much in the material. Obviously, when there is too much supply and not enough demand, then the prices for said product fall dramatically. Copper is used in a number of products including electronics, cars, wiring, plumbing, and building construction. The biggest boom for China's infrastructure development was within the past 10 years, in which China was always looking to build and develop massive infrastructures, but that boom is finally starting to fade out.

Now the mines are trying to act to this news of a huge loss in interest, some are scaling back activities in the mines, and this means that jobs for workers are also being cut. The world's largest publicly traded copper miner, Freeport-McMoRan (FCX) said it will be cutting mining employees and contractors by 10 percent. This means about 800 jobs in Arizona will be cut and 200 will also be cut in New Mexico. The company will also be looking to suspend the operations at Miami in Arizona, and scale back output by 50 percent at the Tyron site, which is located in New Mexico. The 2016 capital spending plans were also dramatically cut back another 29 percent. This summer the company said it would be scaling back spending targets on both the oil-and-gas projects, and this was due to the severe decrease in energy prices. The shares of Freeport went up 23 percent as a result of this news, and Wall Street is really enjoying Freeport making these moves, and the 23 percent was their biggest gain since 2008. It is also good to mention that there has been a little bit of a rebound in both oil prices and gas prices. In after hours trading, Freeport also gained 20 percent and this came after Carl Icahn, a billionaire, said he had stake in the company. Interestingly, over the past year, Freeport shares have lost about 75 percent of their value, so this could be just what the company needs to get back on track. It is important to remember that China is the biggest force behind all of these conditions, given it has the second-largest economy, and it is one of the main importers of materials like copper. When China was doing well, it needed a lot of raw materials like copper in order to build infrastructure and other construction, but now with the slowdown, most of the construction has stopped, and buildings have also stopped being built. When it comes to copper, China actually has 40 percent of all copper demand globally, according to a mining analyst.

Now, from the largest consumer, China has shut down many smelters in 2015 because of their sustained loss making. According to trade sources, China has shut down over 2 million tonnes of copper production capacity due to weak prices and demand from local sources.

2016 : The Year of Hopes

At the current price, around 20 per cent copper smelters are incurring cash losses. Producers have been able to hang on thus far, but if low prices persist, there could be further production curtailments and mine shutdowns down the road. Hopefully that will be a catalyst which will help prices move higher over the medium term. There have already been cutbacks in the zinc space, with Glencore curtailing production and Nyrstar putting its Middle Tennessee mines on care and maintenance. The stage is set for copper to follow suit. To be sure, Glencore has also announced cuts to its copper production, while Freeport-McMoRan is planning to cut its copper output by 250 million pounds next year. Going into 2016, therefore, copper prices are likely to moderate around the levels they're currently at (below $5000), with things not looking up until the medium to longer term. However, he advised keeping an eye out for 2015 year-end financials from copper companies as they start to come out next year. There's a lot of concern right now that within the producer space there are balance sheet issues. But the change in exploration side arithmetic may revamp entire copper equation. A high-grade discovery in any of the metals could really spark a turnaround in the resource industry.

It's a tough time to be investing in metals. It may even be worth waiting for a definitive positive move in copper prices before investing in the space. Still, for those who want to get into copper now, one can look at individual companies with established production profiles and strong balance sheets that are operating well despite the current market.

Goldman Sachs believes that Copper will slump as the U.S. Federal Reserve starts to raise interest rates, demand growth stalls in China and stockpiles surge, according to Goldman Sachs Group Inc., which stood by a year-end forecast that signals the biggest annual drop since the global financial crisis.

Copper prices will probably drop to $4,800 a metric ton by the end of December and $4,500 at the end of next year, analysts including Max Layton and Jeffery Currie wrote in a report. Separately, the bank cut the target price for Glencore Plc shares, citing a weaker commodities outlook. The miner and trader's stock dropped as much as 8.7%. Of particular importance for copper has been the weakness in China, which points to a hard landing for commodities demand during 2015. A drop to Goldman Sachs's end-2015 target implies a full-year retreat of 24 percent, the most since the 54 percent plunge in 2008.

A fight between miners to cut costs as demand weakens would result in self-reinforcing cost and price deflation, echoing patterns seen in the bulk-commodity markets, the bank said. There will be about 530,000 tons more global supply than demand in 2016, Goldman Sachs said, paring its estimate from about 670,000 tons. The worldwide surplus was seen at 566,000 tons in 2017, 626,000 tons in 2018 and 657,000 tons in 2019. The Fed refrained from the first increase in U.S. borrowing costs since 2006 this month amid concern that financial-market turmoil spurred by China's slowdown may hurt the outlook for U.S. growth and inflation. Policy makers at the U.S. central bank would tighten in December.

Global stockpiles were seen increasing by as much as 1 million tons between November and March, Goldman Sachs said in the report, which was titled 'Copper's bear cycle still has years to run.' Holdings in LME-tracked warehouses stood 322,900 tons, according to bourse data.

Goldman Sachs, widely seen as the most influential bank in commodities, has forecast copper will be trading around $4,500 a tonne at the end of next year, having hit a six-year low of $4,481 last month.

The slowdown in China, which imports 45 per cent of the red metal, is partly behind the bank's view, as Beijing attempts to shift its economy away from overreliance on its decade-long infrastructure splurge.

Supply Deficit

The International Copper Study Group (ICSG) has revised its forecasts for copper. From earlier estimate of surplus supply in 2016, it has now estimated a deficit for the bellwether base metal, despite slowdown in Chinese demand. In April this year, the industry body had projected surplus in 2015 and slightly lower surplus in 2016, too. The forecasts came after discussions with government delegates and industry advisors from leading copper producing and using countries. “Projections for 2015 indicate the market should remain balanced, while in 2016 a small deficit of around 130,000 tonnes is likely as demand growth outpaces production growth. This compares with a surplus of 360,000 tonnes and 230,000 tonnes for 2015 and 2016, respectively, forecast at April 2015 meeting. The revisions reflect substantial changes in market conditions since April 2015. Although a downward revision has been made to global usage in view of lower than anticipated growth in China, larger downward adjustments have been made to production as a result of recent announcements of production cuts,” ICSG said in a release in October. A few major players including Glancore had announced production cuts in copper mines as prices were trading at six-year low levels following depreciation in Chinese currencies. China accounts for 45 per cent of copper demand. In the past six months, copper prices of London Metal Exchange were above $6,400 a tonne, which is now around $4600 a significant fall.

“World mine production after adjusting for historical disruption factors is expected to increase 1.2 per cent in 2015 (a similar growth to 2014) to reach 18.8 million tonnes. Despite announced production cuts, higher growth of four per cent is expected in 2016 as additional supply is expected to arise from expansions at existing operations, ramp-up in production from mines that have recently come on stream and output from a few new mine projects,” said ICSG.