Commodity Idea
November 26, 2019

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Fundamental report-based call
Key Points
Conclusion
Trade war will keep copper prices down

Fundamental report based call: Sell LME Copper at $5,870, MCX Copper November 435.65, target $5,400/$5,200, stop loss $6,200. Buy 15 lots USD/INR spot at 71.87 to hedge the currency risk. Time frame is six months. Roll over required.

On November 20, 2019, we recommended selling one lot of copper at LME price level of $5,870, the subsequent prices of MCX Copper November contract at 435.60, keeping the stop loss of $6,200 and aiming a target of $5,400/$5,200 in the next six months. We advised to buy 15 lots of USDINR spot at 71.87 to hedge against currency risk.

Our call is based on the following factors mentioned below in brief:

Major macro-economic themes:
- Global economy
- China economic expansion
- China industrial output
- China manufacturing

Metal-specific factors:
- China refined copper output
- Copper to remain under deficit
- China scrap import ban
- TC/RC
- Global copper inventories

Macro-economic factors

Use of copper in power and construction has fallen about 20% from 2018 highs as the U.S.-China trade dispute has weakened global economic growth and the metal’s demand. Copper touched a two-year low of $5,518 in September.

Global economy

The 22 months of trade war has slowed down global expansion. International Monetary Fund expects growth rate to fall to 3%, which is the slowest since the financial crisis of 2007. OECD has also put the global expansion rate to 2.9% from 3% for 2020 and 3% for 2021.

China expansion at decade low

National Institution for Finance and Development says China’s economic growth rate will slow to 5.8% in 2020 from an estimated 6.1% this year.

China, which accounts for 50% of the world’s copper demand, has hit the lowest expansion rate in 27 years. China’s GDP growth slipped to 6% y-o-y in the third quarter, down from 6.2% in the second quarter, and the softest outcome since the first quarter of 1992. The value of Chinese GDP was about $13.2 trillion in 2018.

Manufacturing contraction

Chinese manufacturing activity fell to an eight-month low in October. The dip was seen in overall activities of new export orders and import orders. Global manufacturing PMI recorded the longest contraction stretch since 2012. Eurozone manufacturing activities are at seven-year low, and U.S. ISM manufacturing activities records the lowest reading since June 2009.

Macro-economic factors

Use of copper in power and construction has fallen about 20% from 2018 highs as the U.S.-China trade dispute has weakened global economic growth and the metal’s demand. Copper touched a two-year low of $5,518 in September.
Industrial production, a measure of growth in sectors such as manufacturing, mining and utilities, expanded by 4.7% in October 2019, a little better from 17 years’ low of 4.4% hit in September.

**Hong Kong fight for liberation**

The Hong Kong Human Right Bill could act as a throne to the ongoing trade resolution talks between U.S.-China. China has warned the U.S. not to meddle with Hong Kong issue, which could lead to further truce into the two nations. Meanwhile, U.S. senate unanimously has passed the bill that would require an annual review of the special treatment Hong Kong receives under the U.S. law. The bill, which is tabled across the U.S. President, if signed, would likely bitter trade relations between the U.S. and China.

**Metal specific**

**China’s rising production**

China’s October refined copper output rose by 17.9% y-o-y to a record high of 868,000 tonne, while annual copper production in the first 10 months of 2019 amounted for 7.83 million metric tonne (mmt), up 8.1% from 2018. As, the world’s largest copper producer, China saw its refined copper output at 8.73 mmt in 2018, 40% of the global production. Strong domestic demand kept net imports above 3 mmt last year. China’s imports of ores and concentrates were up 8.3%, as China increased its domestic copper smelting capacity.

**Scarp ban**

The banning of copper scrap imports fell by 35% over the first 10 months in China amid strict environmental restrictions. Market share of refined copper produced from recycled materials narrowed to 16% in 2018 from 37% in 2008, pressured by the expansion of primary copper capacity and government-intensified controls on pollution and waste imports. China imported 86,600 million tonne of copper scrap in October, down 44.1% from September, and down 53.1% from October 2018.

**Global outlook**

The global refined copper market was in a 330,000 tonne deficit for January-August, against 268,000 tonne shortfall in the same period last year. The global world refined copper market showed a surplus of 29,000 tonne in August compared with 71,000 tonne deficit in July.

The International Copper Study Group reports a decline in refined copper output by an unusually high number of smelter disruptions and temporary shutdowns for technical upgrades/modernisation. However, China continues to expand its smelter facilities with advanced technologies.

A rise of around 4% is expected in world refined production in 2020, based on capacity expansion in China, improvements in Africa and return to full capacity of numerous smelters/refineries affected by operational issues this year.

**Global warehouse inventories**

LME-monitored warehouses see copper supply rising by 104% year till date. While at Shanghai, copper stocks are up 13% so far this year.

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**Risk to our call:**

**Treatment and refining charges**

Treatment and refining charges (TC/RC) are one of the primary barometers to gauge the future demand outlook or prevailing economic conditions. Miners pay treatment charges to smelters to process copper concentrate into refined metal. TC/RC tend to rise when copper concentrate supply is abundant and fall when the supply tightens.

It is $80.80/tonne for 2019, but current spot levels are around $60, pointing to a much lower benchmark next year. Freeport-McMoRan Inc. and three Chinese copper smelters agreed a 23% cut in annual TC/RC at $62/tonne for 2020, pushing the industry’s benchmark to a nine-year low.

**Social unrest in South America**

Copper-producing regions in South America are facing labour-related mining disruption since few years, but it has seemed to have aggravated in 2019, which has led to downward revision for 2020 by many miners. These regions account for one-third of global copper mined output.

**Ageing mines**

Copper mines in Chile and neighboring countries are nearing their life time, with low grades and declining ores. These age old mines need huge investments. There are few new mega projects scheduled to come on stream and new deposits simply are becoming harder to find. A number of older mines are getting too deep and are getting to the end of their lives. Chilean miners are facing problems with water access and labour unrest; while in Ecuador, political and social upheavals could derail the development of the biggest copper-gold deposits ever found.
Demand from EV
With the world fast moving to transform towards the electric vehicle segment, demand for copper in general is surely going to rise as a petrol vehicles need 9-22 kg of copper, but an electric car needs as much as 80 kg.

Conclusion
Copper prices are unlikely to make an upward move unless we see any major development in trade talks. We are seeing supply disruption from the major regions of South America, but the world is gradually moving towards a slowdown. Manufacturing contraction in Eurozone is leading to stagflation. Chinese growth has hit its lowest in three decades, while emerging markets are facing double-edge sword of weakening economy and declining currency value. We remain bearish on copper prices.
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