Industrial Metals Monitor

Worries setting the scene for industrial metals prices

Sector Advisory

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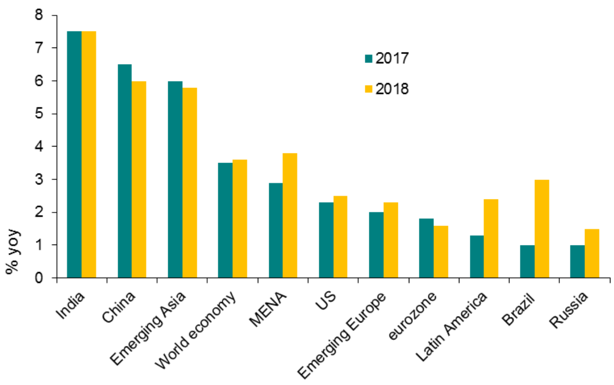
19 May 2017

- **Investor concerns about the state of the Chinese economy are depressing industrial metal prices**
- **Global economic growth, rising demand for metals and cyclical recovery in industrial output point to accelerating prices in the longer term**
- **China is causing great unrest in ferrous markets, but outlook remains stable**

Figure 1: GDP expectations 2017 and 2018

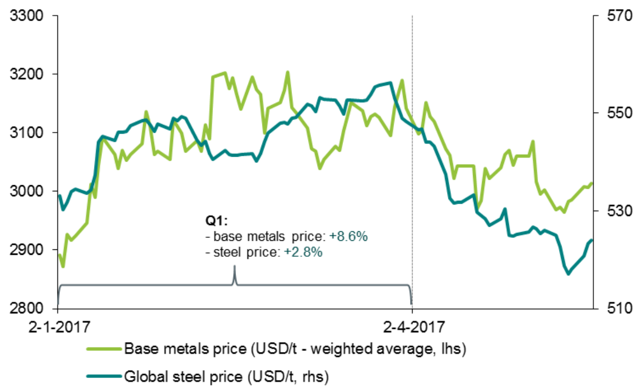


Source: ABN AMRO Group Economics

Growth returns to Latin America

The global economy will maintain its current growth momentum in 2017 and 2018. This places demand for metals on a firm footing. But Chinese economic trends remain the overriding factor for metal markets. Confidence there dipped at the start of the second quarter. The manufacturing PMI, for instance, took a big step backwards in April and concerns about the state of the Chinese economy grew. This made many investors in the metal markets nervous, pushing metal prices lower. The positive macro news comes from Latin America. Economic growth there is poised for a sharp uplift next year, most notably in Brazil. The Brazilian economy is already benefiting from solid export growth (including iron ore) and reviving investments this year. And it will receive an even stronger impulse in 2018 as interest rates start to fall on lower inflation.

Figure 2: Trend in industrial metals prices



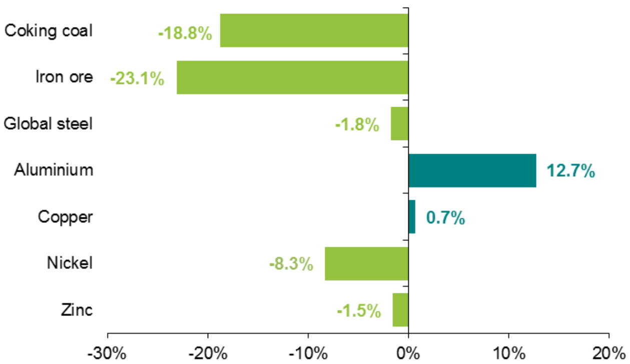
Source: TR Datastream, ABN AMRO Sector Advisory

Metal prices lower at start of Q2

In the first quarter, industrial metal prices were on an upward trend. The base metal price jumped 8.6% on average and the global steel price advanced 2.8%. But these gains soon evaporated at the start of the second quarter, with the steel price retreating particularly sharply. Market-specific trends played a role in this price movement, but heightened geopolitical tensions and disappointing macro data from major economies also made many investors more risk-averse. China is once again at the centre of things. The flagging PMI and disappointing trade figures dealt a strong blow to base metal prices. Ferrous metal prices slid sharply, particularly in China and the CIS. Chinese steel exports slumped and steel production hit a record high, while steel inventories in China remain elevated. The result was falling prices. Steel prices in the US and Europe held up, but only thanks to the protective shield of import duties.

Figure 3: Industrial metals prices in 2017

(% change in prices since 1 January 2017)

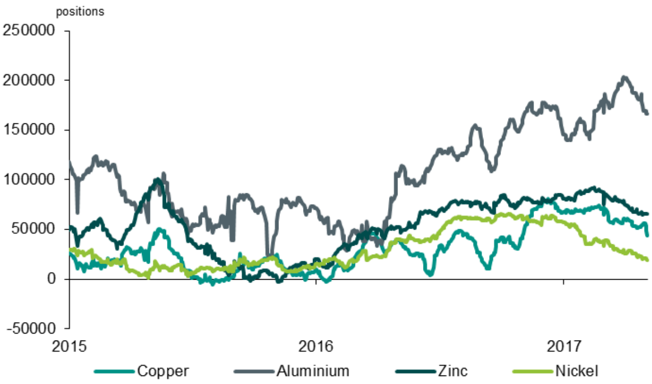


Source: Thomson Reuters Datastream

Aluminium price standing firm

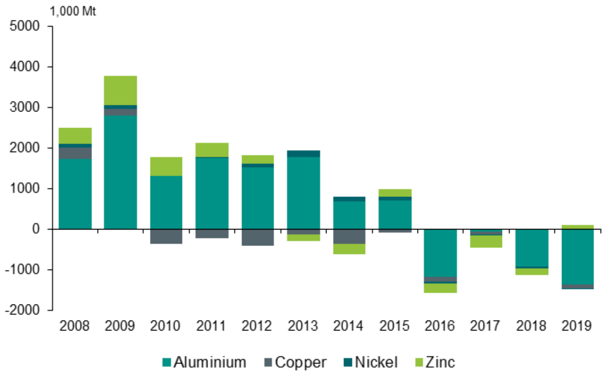
The best-performing industrial metal is aluminium. Since the start of the year, the price has climbed more than 10%, which is an exceptional achievement. Other industrial metals only edged marginally higher or came under further pressure. Copper gained slightly opposite to 1 January, but nickel ran into a strong headwind. Zinc lost almost 2% since the start of the year. The copper price mainly responds to macroeconomic trends (notably in China), but volatility in LME inventories is also worrying investors. The nickel price was hit hard by the anticipation of a strong increase in supply from Indonesia and the Philippines. Ferrous metal prices have also languished in negative territory since early 2017. The global steel price remained reasonably stable. But the price of iron ore plummeted on tighter monetary and housing market policies in China, while coking coal became cheaper on recovering supply from Australia.

Figure 4: Net investor positions base metals



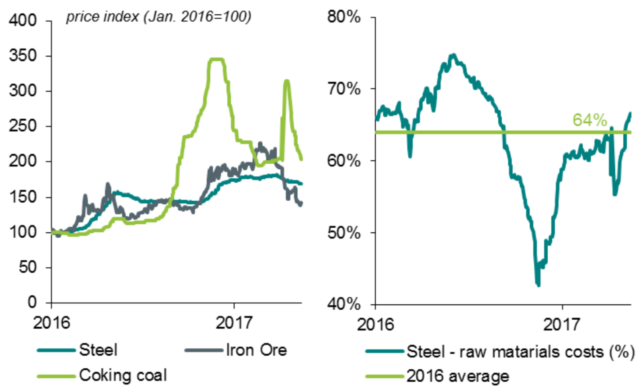
Source: Bloomberg

Figure 5: Balance base metals



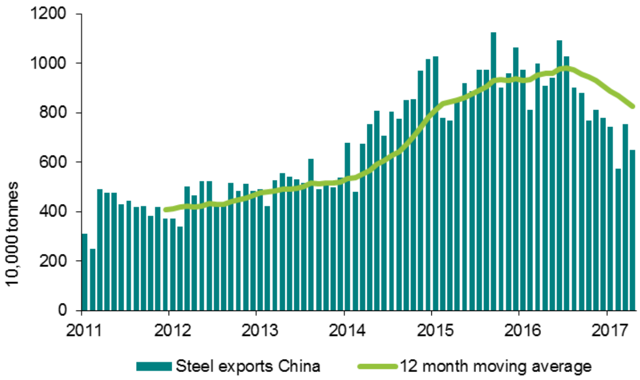
Source: Metal Bulletin

Figure 6: Steel price vs raw materials



Source: Thomson Reuters Datastream

Figure 7: Steel exports China



Source: Thomson Reuters Datastream

Investors are reducing net positions

Commodity investors have lost confidence in commodities markets and this sentiment has put pressure on base metal prices. The greatest source of unrest is the state of the Chinese economy. The combination of weaker macroeconomic data and monetary tightening in China is a cause for concern for many investors. Industrial output grew in April by 6.5% y-o-y, versus the anticipated growth rate of 7.1%. Retail sales still did relatively well in China, but capital expenditures increased by less than expected. The long-term outlook, however, remains bright in our view. The global economy is growing, while a further cyclical recovery of industrial output, sustained growth in construction activity and accelerating car sales provide a solid basis for growth.

Market balances negative in coming years

The weakness in base metal prices since 1 April is at odds with the fundamental expectations given that the market balance points to an upward trend. The base metals market balance will be negative for many base metals until 2019, and this typically coincides with rising prices. Aluminium output will outstrip demand this year (6.1% versus 4.0%), but the scales will tip in 2018 and 2019. Production growth is expected to decelerate sharply in both years, partly because China plans to shut down significant output capacity in the coming winter. Aluminium demand, by contrast, will retain upward momentum. In the copper market, we foresee a deficit in the coming years, but volumes remain relatively low. This means that the copper market is effectively in balance. The nickel market will see a stronger acceleration in supply in the coming years, partly due to the expected increase in supply from the Philippines. On balance, however, a deficit will persist here until 2019.

Spike in steel commodity volatility

The prices of commodities used to manufacture steel (iron ore and coking coal) largely determine the direction of the steel price. The price of iron ore is mainly driven by developments in China, which accounts for two-thirds of the total overseas trade in iron ore. China is above all a strategic buyer of iron ore and will not hesitate to step up its purchases if the price remains relatively low. The supply of coking coal is reviving, so that the availability is once again sufficient. In response, the price of coking coal dropped strongly and a further weakening is likely in the short term. China may still cause some worries in ferrous markets, but we believe that the outlook for global ferrous markets remains stable.

Steel exports from China falling

Sentiment about the future demand for steel is weak. The reason is that many aspects of the Chinese investment programme remain unclear. The absence of details makes it difficult to gauge the impact on the future demand for steel. But end demand is holding up well. Construction activity is picking up around the world and demand for cars continues to grow in China and Europe, while the industrial sector is also recovering worldwide. At the same time, steel production in China is still rising (+5% y-o-y in Q1 2017), despite promises from the Chinese government to tackle overcapacity. The volumes of Chinese exported steel also fell sharply (-26% y-o-y in Q1 2017), principally due to higher import duties in the US and EU in order to keep out cheap Chinese (and Russian) steel. In April, Chinese steel exports plunged by a further 29% y-o-y. Steel prices have dropped sharply in China on higher availability and lower exports, while remaining stable in Europe and the US. And if Chinese steel prices retreat further, importation of Chinese steel will once again be an attractive option for end users in the US and Europe, despite all the import restrictions.

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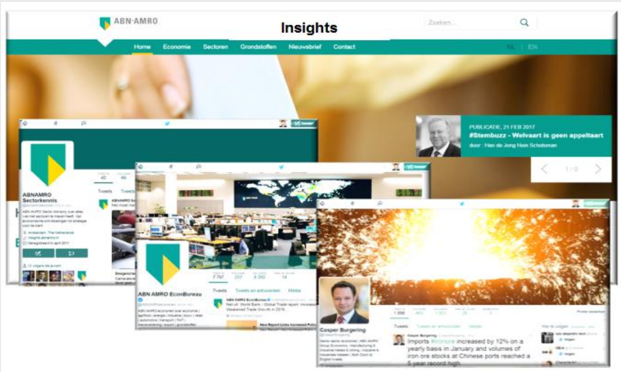

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The text in this publication was last updated on 18 May 2017.