Easing trade tensions will send metal prices higher

- 2018 was a turbulent year for industrial metals markets
- Prices will remain heavily influenced by US economic policies in the short term
- Base metals: Prices will rise as soon as trade tensions ease significantly
- Steel: We expect lower steel prices due to weak demand and sufficient supply
- Steel (raw materials): Sufficient supply raw materials puts pressure on prices

The year 2018 has been turbulent so far for industrial metals markets with the trends in industrial metals prices heavily dominated by US trade policy. In the first half of 2018, base metals prices held up reasonably well. Economic conditions were good, investor sentiment was favourable and market deficits led to higher base metals prices. But in March, steel and aluminium market sentiment declined significantly and the US announced trade restrictions on steel and aluminium, which led to market distress. To prevent dumping and protect US heavy industry, the government introduced import tariffs. Then in April, the US announced sanctions on Russian oligarchs. As a result, the output of Russia’s Rusal - the second-largest aluminium producer after China – came under threat and worries increased about the global availability of aluminium.

From May onward, tensions and uncertainty increased further. Industrial metals markets were heavily dictated by US economic policy. The combination of the stricter trade policy and the tighter monetary policy created a lot of uncertainty, which made many investors risk-averse. Base metals prices decreased, initiating a long downward trend. In the ferrous metals markets, price trends showed a more diverse picture this year. The price of Hot Rolled Coil (HRC) steel in the US increased because the available domestic steel capacity proved insufficient to meet steel demand. In the other regions, steel prices fell because of the good availability of steel and weakening demand. In 2019, trade policy will continue to influence metals markets and create volatility. Still, as soon as trade tensions between the...
US and China decrease, fundamental drivers will once again dictate the price trends in industrial metals markets.

**Base metals: Prices will rise once trade tensions decrease**

Demand for base metals remains favourable in the long term, with deficits in base metals markets in 2019 providing a solid basis for higher prices. In particular, demand from the large metal-consuming sectors will grow strongly next year. Metals demand will be fuelled by the further growth of the electrification of transport. The epicentre of this growth is in China. Not only does China produce the majority of electric passenger cars, but sales growth will remain robust for the coming years. On balance, the demand for copper (for wiring), aluminium (for lightweight) and nickel (for battery technology) will increase further.

The ongoing global growth in construction sector activity and the worldwide planned infrastructure investments (particularly in China) also provide a good basis for sustained demand for industrial metals. In a market situation where demand is growing faster than supply, prices tend to rise.

**Figure 2: Base metals price versus balance in base metals markets**

(Price is the weighted average of aluminum, copper, lead, nickel, tin and zinc prices; the total balance sheet is the sum of the balance in aluminum, copper, lead, nickel, tin and zinc markets)

Despite the fact that many base metals markets are currently in deficit, the price is still relatively low. This is because the lack of clarity about US-China trade policy still dominates price trends. As a result, uncertainty amongst investors remains high and they avoid riskier investments such as the very cyclical base metals markets. The persistent uncertainty among investors has a much higher impact on prices than the fundamental supply and demand dynamics. We believe that as soon as the trade tensions between the US and China decline, base metals prices will rise sharply.

We think that base metals prices will increase in the first quarter of 2019 mainly due to strong seasonal demand and deficits. The main risk to this scenario is an escalation of trade tensions, not only between the US and China, but possibly also between the US and the EU. In the aluminium market, there is still a lot of uncertainty surrounding the US sanctions on Russian oligarchs. The decision concerning whether sanctions will remain in force will fall on 21 January. The aluminium price will rise if sanctions are not lifted. Copper prices will also increase on deficits in the copper market, the further decline in copper inventories and favourable macro conditions. We think the copper price will see the sharpest increase of all base metals as soon as the trade tensions have significantly decreased. In the nickel market, inventories currently remain relatively high. The demand...
for nickel remains good, particularly due to demand from the Nickel Pig Iron (NPI) sector in China. Zinc inventories continue to fall and are relatively low. However, the output of zinc is growing slightly faster than demand in 2019. We forecast a more stable price trend for zinc in 2019.

**Steel: Lower prices due to weak demand and sufficient supply**

Global demand for HRC steel has weakened over the past month, while steel production rose further. As a result, the price of steel decreased in all regions. The price in China has fallen by over 15% since the start of the third quarter and prices dropped by 10% in Europe during the same period. Steel prices have also declined in the US since October, but the loss has amounted to just under 8% to date. The further fall in steel prices has led to a decline in the margins of steel factories and steel mills have focused their attention on the minimization of production costs. As a result, demand for cheaper raw materials for making steel increased.

However, weaker steel demand and falling prices have not been an incentive for steel mills to reduce production. Global steel production increased by 5% until October on an annual basis. In China, India and the US, steel production rose at above-average rates in the same period, while output in Japan decreased.

![Steel production in six biggest steel producing countries](Source: Thomson Reuters Datastream, World Steel Association)

The continued strong growth in global steel production does not solve the problem of oversupply. The steel sector has been struggling with oversupply for several years now and this will remain a persistent problem for years to come. In order to balance out supply and demand, considerable capacity reductions are required. These reductions must come mainly from China, but so far Chinese initiatives to reduce steel capacity have not had a big impact. A large part of the Chinese oversupply finds its way to international markets, often at relatively low prices.

The import tariffs announced by the US in March have created a wave of new trade barriers worldwide. As a result, many markets for Chinese steel became less interesting. Chinese steel exports fell by 31% in 2017 and had already fallen by 9% up to November this year on an annual basis.

We think global steel prices will rise slightly in the first quarter of 2019. The demand for steel from large end-users currently remains good, although the pace of growth is lower. In addition, the availability of steel continues to be excellent and this ensures that the price increase will remain muted. Steel prices in the US will continue to fall from their current
relatively high level. The NAFTA deal means the availability of steel is increasing again, which will add pressure to US steel prices.

**Raw materials: Sufficient supply of steel raw materials will pressure prices**

The volatility of the iron ore price has recently increased sharply. In just over a week, prices decreased from a level of USD 75/t to USD 67/t. This is an 11% decline and such a steep drop within a short period of time is relatively uncommon in the iron ore market. The decline was caused by an unexpectedly rapid resumption of supply deliveries after mine disruptions in Australia, the weakening of steel demand and the sharp drop in the oil prices. Oil is an important raw material and cost component in the mine production of iron ore.

Recently, demand for relatively high-quality iron ore has increased due to environmental measures in China. That is because high-quality iron ore requires less energy in the steelmaking process. Making use of higher quality ores reduces CO2 emissions and allows mills to maintain the level steel production. But because the margins of steel mills recently experienced a sharp decline, the demand for lower-quality iron ore increased again for cost reasons.

The import of iron ore comprises over 90% of total Chinese imports of industrial metals and materials. This means that trends in the import of iron ore offer a good indicator of the total activity in China’s heavy industry sector.

![Figure 4: Import iron ore China versus trend in the economy](image)

Source: Bloomberg, Thomson Reuters Datastream, ABN AMRO Group Economics

Because China’s economy still largely relies on the growth of activity in (heavy) industry, there is a parallel between the economic growth of China and the growth of iron ore imports. The transition of the Chinese economy will continue in the coming period. This means that there will be a move from heavy industry to the high-tech industry and the services sector. This will go hand in hand with a decrease in the growth rate of demand for metals. For more information on the Chinese economy, see also the analysis by senior China economist Arjen van Dijkhuizen: [China Outlook 2019](#).

On balance, Chinese iron ore imports fell by 1.3% on an annual basis until November. Chinese iron ore inventories at ports are currently high, demand for steel is relatively weak and the margins of steel mills are low. Moreover, the availability of iron ore is good. We think the price of iron ore will remain low for the time being. However, China is a well-known strategic buyer. This means that low prices for iron ore will be an incentive for
Chinese traders to buy more iron ore. What also helps is that Beijing has ordered local governments to issue more special purpose bonds to finance local infrastructure projects.

The coking coal price will also experience more pressure in the coming period. Not only will activity in the coking coal market decline due to steel factories' relatively low margins, but coking coal inventories are also good and availability remains solid. Still, prices may increase in the short term, mainly due to weather-related issues. The weather can disrupt supply in the coking coal market over the coming period. The first quarter is known to be the 'wet- season' in Australia and is characterized by heavy rainfall. As a result, mines will be flooded and there will be disruptions to the transportation network.