Industrial Metals Monitor

China's industrial metal imports hold up well

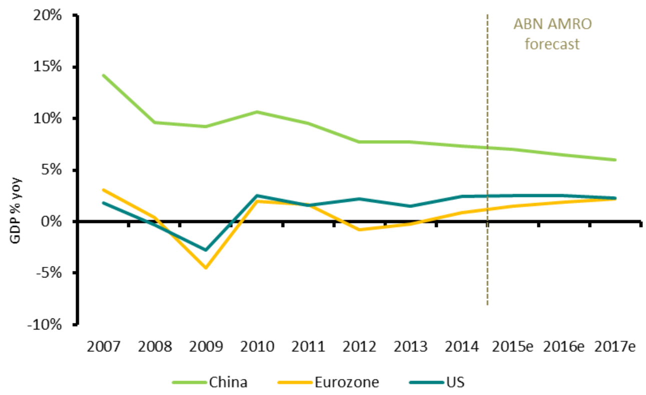
Group Economics

Casper Burgering
casper.burgering@nl.abnamro.com

January 2016

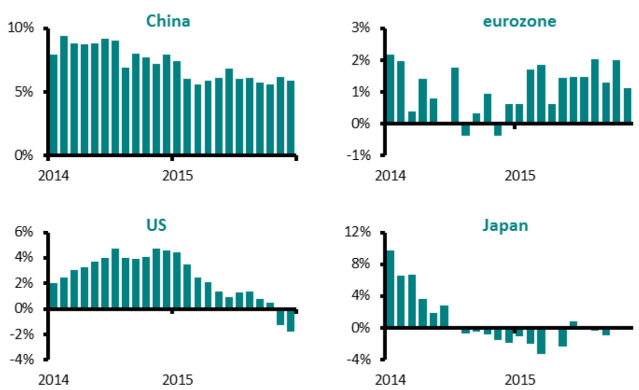
- **Despite the tumultuous start to the year, our outlook remains intact: price recovery during 2016**
- **Chinese iron and copper oar imports hit record highs at year-end 2015**
- **The state of the Chinese economy dictates sentiment and prices**

Figure 1 GDP growth by region (% y-o-y)



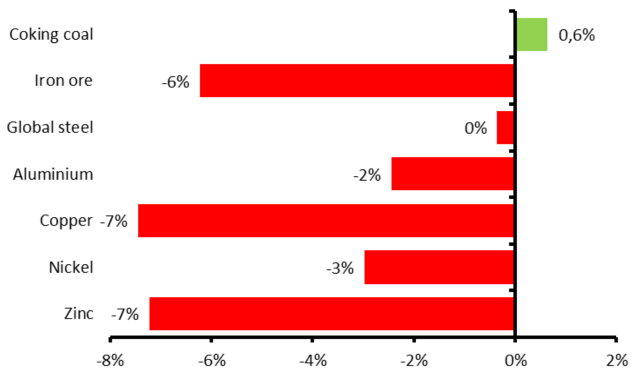
Source: ABN AMRO Group Economics

Figure 2 Industrial output growth (% y-o-y)



Source: Thomson Reuters

Figure 3 Industrial metal prices in 2016



Source: Thomson Reuters

Tumultuous start to 2016, but outlook remains unchanged

Despite the tumultuous start to 2016 – notably due to the turmoil in China – we remain convinced that the global economy is on track for further growth this year. This sustained global growth provides a solid foundation for the demand for industrial metals. We see the Chinese economy continuing to cool at a gradual pace and expect the Chinese authorities to stimulate the economy if really necessary. One downside of Chinese economic cooling is that demand for industrial materials will also decelerate. Meanwhile, the eurozone economy will maintain its growth path in the coming year, partly aided by ECB stimulus measures. Finally, the US economy is powering ahead thanks to strong domestic – mainly consumer-driven – demand, while both the labour market and housing market will continue to recover in 2016.

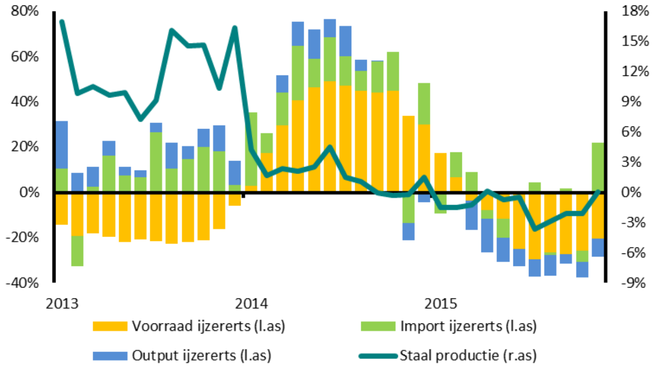
Industrial output in US and Japan under pressure

The industrial sector is under pressure in several countries due to flagging business activity. In the US, year-on-year industrial activity decreased in November for the first time after almost six years of uninterrupted output growth. The sector is mainly contending with the strong dollar, which is giving rise to two problems: US industrial products are more expensive in foreign currency terms (leading to less export demand) and imports are cheaper than before. In Japan, too, industrial output is under pressure and 2015 will end with slight contraction (of about 1%). Japan's output declined in November, notably in the machine building, chemicals and metal sectors. The industrial sector in China is still expanding, with growth averaging 6.1% y-o-y in 2015 (until November). However, the pace of deceleration is rapid and considerable ground has been lost over the years. The only bright spot is the output in the eurozone. Despite disappointing production data for November, output advanced by an average of 1.4% y-o-y until end-of November. That's a positive noise, but hardly spectacular from a historical perspective.

Industrial metal prices off to a weak start

The first week of 2016 provided anything but a quiet start to the year and China once again stole the limelight. The Chinese currency was devalued, triggering a negative reaction in the equity markets. The nervousness about the Chinese economy soared to new heights, causing base metal prices to retreat sharply. Fortunately, there was also some positive news in the form of relatively favourable trading figures. Total exports unexpectedly grew 2.3% y-o-y in December, signalling a recovery of sorts after a period of contraction. Also, Chinese import data point to a stabilisation in late 2015, with industrial metal imports already presenting a stable picture for some time now. However, prices barely responded to these data. Ample availability in numerous markets kept prices low. So any cut-backs in production will be more than welcome to firm up the market. In the current quarter, however, all eyes will remain on the state of the Chinese economy, which will continue to dictate both sentiment and the direction of prices.

Figure 4 China's iron ore stocks, output, imports

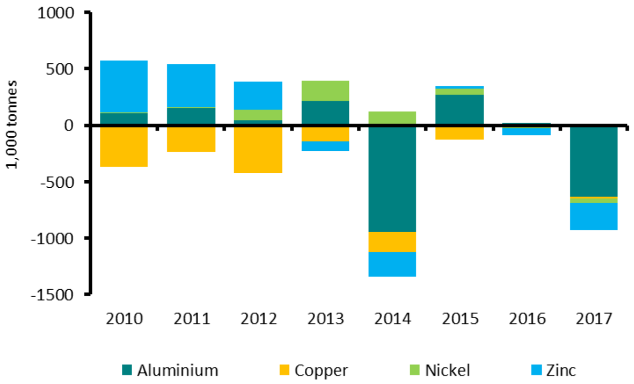


Source: Thomson Reuters

Figure 5 Steel exports from China

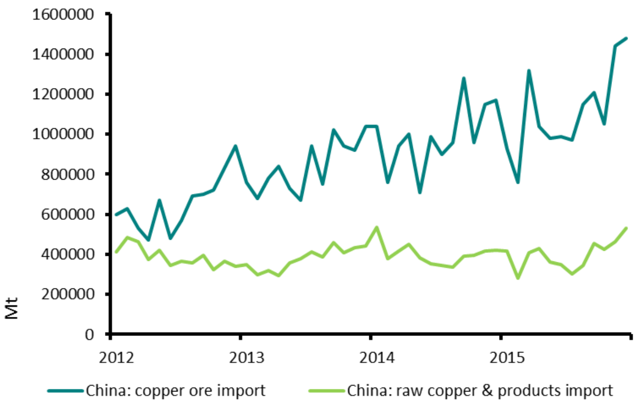
Source: Thomson Reuters

Figure 6 Base Metals Market Balance



Source: Metal Bulletin

Figure 7 Chinese copper imports



Source: Thomson Reuters

Chinese iron ore imports stage a robust recovery at end of 2015

In our Metals Monitor of early November last year, we wondered when China's iron ore stocks would finally become exhausted. At the time, we noted that a strong decline in China's stocks, combined with the traditional strength of the market in the final and first quarters of the year, would probably trigger fresh buying activity in Q4 and Q1 2016. The revival in demand was not long in coming: imports surged in November and December, with volumes even rising to record levels in December. However, due to the continuing large global availability of iron ore, prices failed to react to this sharp spike in demand. This ample availability is also holding steel plants back from purchasing more material than they need. As soon as more production cut-backs and mine closures lead to a significant decrease in supply, prices can recover more strongly.

Chinese steel exports continue unabated

Chinese steel exports continue to grow, advancing 22% in 2015. Chinese steel surpluses are finding their way to international sales markets and this cheaper steel is putting pressure on markets. Chinese steel production, by contrast, shrank by about 2% in 2015. This, in a sense, should be good news for a sector that is labouring under overcapacity, but the pace of contraction is not sufficient to create market equilibrium. For this reason, our outlook for the steel sector remains negative and 2016 is unlikely to be a spectacular year in terms of price recovery. The steel demand forecasts in many regions are still too weak and the supply-and-demand gap still too wide. However, we do think that the scope for further falls is limited, now that many steel plants are already selling materials below cost in both export and domestic markets.

Base metals in equilibrium in 2016, shortages in 2017

Chinese metal producers are also feeling the pain of low prices and realise that something must be done about the current overcapacity. Plans have already been announced to reduce the aluminium, copper, nickel and zinc production capacity in China. On balance, however, these capacity reductions have had little impact on market sentiment. Various other mining companies and producers (e.g. Glencore and Alcoa) have now also cut back output. All announced production restrictions will eventually feed through in the market balance outlooks for base metals in 2016 and 2017. This year, the current glut of aluminium will melt away to a modest oversupply, while shortages will arise in copper, nickel and zinc.

Chinese copper material imports are rising

Iron ore was not the only Chinese import to stage a year-end spurt. Copper ore imports also soared to record highs in November and December. It was partly due to this strong increase that copper ore imports surged by 12.3% in 2015. Imports of semi-finished and finished copper products also increased in 2015, albeit at the slower pace of 6.2%. This demonstrates that China is still hungry for copper, notably to expand its electricity network. It also suggests that China engages in strategic purchases when prices are relatively low – because copper prices recently sank to a record low, comparable to the level of May 2009. Even weaker prices could prompt more strategic buying. Though the market balance looks favourable for 2016 and 2017, sentiment on the Chinese economy will dictate prices and there is still too much resistance to permit an improvement in prices. It will take a healthy series of Chinese macroeconomic data to make sentiment turn for the better. Until then, prices for virtually all base metals will remain weak.

ABN AMRO Group Economics

Casper Burgering
Senior sector economist – Industry & Industrial Metals

Casper Burgering
@CasperBurgering

Telephone: 020 (+31) 383 26 93
casper.burgering@nl.abnamro.com

All publications of ABN AMRO can be found on: **https://insights.abnamro.nl.** Follow ABN AMRO on Twitter: **https://twitter.com/abnamroeconomen** and **https://twitter.com/CasperBurgering**