Trade war echoes in copper market

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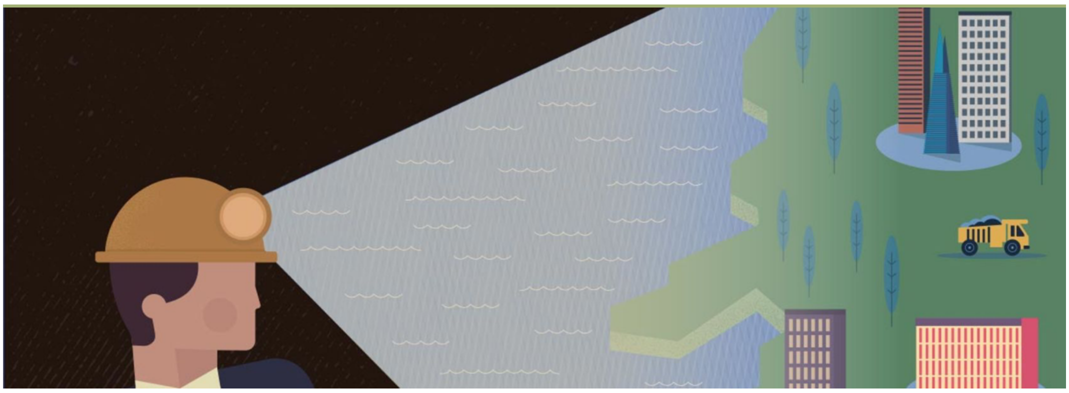
There's something rotten in the copper market, or else the laws of supply and demand have been suspended.



Given the invisible hand of a market economy rarely makes a mistake over time, the only explanation of what's happening in copper, where the price and stockpiles have been falling at the same time, is that some abnormal is occurring.

A clue to the unusual turn of events in copper can be seen on the London Metal Exchange, where the copper price has dropped by around 15% since mid-June, while the stockpile of metal in the exchange's warehouses as fallen by 45%.

If the copper market was behaving normally, and these might not be normal times as China and the US fight a trade war, the copper price would be rising as the surplus of raw material dried up.

But the fall in the copper price from close to US $3.30 a pound four months ago to $2.85/lb has been matched all the way down by a decline in copper stocks from around to 320,000 tonnes to 170,000t.

A similar fall in copper stocks on the US Comex (part of CME Group) can also be seen, as can a stock decline on the Shanghai Futures Exchange.

One explanation, and it might be a worry for investors in copper-mining companies, is that the stockpiles are not drying up, they are simply being shifted out of sight, though why is the greatest unknown.

Speculators, who routinely play games with metal stocks, could be at it again with copper, or it might be Chinese government bolstering its strategic stocks as the trade war with the US heats up.

The key point is that hundreds of thousands of tonnes of copper do not simply disappear in a matter of weeks. It has to be somewhere and that means it is hanging over the market, albeit out of sight.

The puzzle of the disappearing copper stockpile, according to a recent research note by Macquarie Bank, also extends to the nickel and aluminium markets.

In the case of aluminium, visible stock has been falling for the past four years with a factor in that metal being a change in the rules that freed metal locked in US warehouses for prolonged times so the warehouse owner could collect extra rent.

"This business model came to an abrupt end when the LME changed the rules in 2014," Macquarie said. "Metal stuck in a (warehouse) queue for more than 50 days stopped attracting rent."

That change saw metal disappear from warehouses not because it was being consumed, more because cheap warehousing deals were no long offered to favoured owners with the metal shifting to private warehouses.

Copper also appears to be undergoing some sort of change in stockpiling.

Macquarie said copper stocks in exchange warehouses have been on a roller coaster ride this year. Total stocks on all exchanges started the year at 550,000t, peaked at just over 900,000t at the end of March and have been falling since, reaching 472,000t late last week.

"It's the Shanghai Futures Exchange stocks in China that have led the decline with the level now nearing one third of their peak in March," the bank said.

After examining Chinese copper data from several sources Macquarie found that apparent consumption of the metal had risen by 12.3% in the year to July.

"The lacklustre Chinese economy suggests that this is preposterous," the bank said.

"Looking at China's weak (electricity) grid spend, down 14% year-to-date, flat vehicle production, erratic appliance data (washing machines and refrigerators up and air conditioners down), feeble infrastructure spending but firm construction, it does not seem to us a reasonable proposition that copper consumption climbed 12% this year."

A more likely growth in copper consumption was around 4%, which led to Macquarie's conclusion that: "China must be restocking with copper, so it's being drawn out of the Shanghai Futures Exchange and heading into hidden stockpiles."

In other words, the copper is somewhere and has not been consumed, but because it is a strategic metal there is a possibility that it has become caught up in the trade war.

To test that hypothesis Macquarie looked at price premiums for copper in selected markets with premiums higher in both the US and China - the trade war combatants.

"Despite the copper existing somewhere, the fact that it is not immediately accessible is probably the reason for higher premiums in the US and China," the bank said.

"These two nations, of course, are lining up for a trade war, so there may also be some impact on premiums from expected tariffs on metal flows.

"Notable, European premiums are undisturbed."

In other words, copper is doing what it always does in a war, trade or otherwise.