Copper confusion at Shanghai CESCO

Mining Journal – November 21st, 2018
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Tim Treadgold

Copper, in theory, should be trading at a higher price than its current US$2.79 a pound but the fact that it isn't, even as the global stockpile of the metal plummets to a near 10-year low, is the best indication of a deeply-confused market.

Last week's Asia CESCO conference in Shanghai was expected to throw some light on the contradictions in the market for copper, arguably the most important metal in the global economy because of its widespread uses in everything from electronics to construction.

But anyone expecting a clear picture at the event organised by a Chilean-based think tank (Centro de Estudios del Cobre Y La Minera, or CESCO for short) would have been disappointed.

"Copper's Shanghai jitters", is how Morgan Stanley, an investment bank, summed up the mood of the conference.

"Many industry participants were frustrated that recent strong demand and falling exchange inventory didn't result in a higher price," the bank said.

"But, the market's balanced supply-demand (fundamentals) and stable trade belie a wealth of demand uncertainty."

China's trade war with the US is the greatest of the worries in the copper market, a point picked up by Macquarie Bank which also attended the Shanghai event.

"Chinese investors are caught between concerns over the trade war and a slowing property market versus tight metal conditions," Macquarie said.

"In particular the apparent copper consumption numbers are provoking much head scratching."

What no-one could explain at the conference was why China appears to be importing a record amount of copper without there being a corresponding boost to the price of the metal which has lost 40c/lb this year even as the global copper surplus has been contracting.

The best measure of the falling stockpile remains the London Metal Exchange where warehoused material has declined by 60% from 385,000 tonnes as recently as April to the latest reading of 151,625t.

Under normal conditions that fall, which is mirrored by a decline on other exchanges, would have been offset by a rising metal price, and not the 12% fall from around $3.20/lb.

Inflows of copper into China, if they continue at the rate seen in the first 10-months, will total 11.1 million tonnes by the end of the year, up 15.7% on the 9.6Mt imported in 2017.

"The puzzle is, where is all this copper going?" Macquarie asked.

"Intuitively, the idea that Chinese copper demand has grown by 15.7% this year is not credible.

"Prices did reach a four-and-a-half-year peak briefly in June, but this was buoyed by extremely strong global macro sentiment drawing in money."

The trade war, Macquarie said, demolished the price rise and today prices are languishing in the low $6,000/t ($2.70/lb) range, something that double-digit growth in China, which represents 48% of the global copper market, should not permit.

Rather than looking for a sharp increase in copper consumption the conclusion of the banks is that stockpiling behind China's "bamboo wall" is taking place, though the motivation for a big stockpile is unknown.

Ideas discussed by copper traders and mining companies at CESCO included:

• Exceedingly quiet buying by the State Reserves Bureau or some other state-led entity.

• Stocking ahead of a potential shock from new regulations governing the scrap metal market.

• Working stock for new metal fabrication plants, or

• Domestic collateral financing in China's opaque shadow banking community.

Morgan Stanley was just as confused as Macquarie in its attempt to explain the copper market after the Shanghai conference.

Supply growth to replenish falling stockpiles appears to be limited while disruption risk remains, which meant the market would be tight from a supply perspective, Morgan Stanley said.

"We maintain our base case forecast of a modest deficit in the copper market in 2019 of around 240,000t based on China's refined demand growth although we left Shanghai with a heightened sense of the economic fears there.

"Limited copper cathode inventory and weak supply growth make the copper market well-positioned to weather any slowdown in China's demand, with little prospect of a significant surplus developing."

Unfortunately for investors the conclusion of the banks is that even with the supply and demand fundamentals moving in favour of a rising copper price that eventuality is seen as unlikely anytime soon.

"Price upside is likely to remain limited, until macro-economic sentiment turns positive," Morgan Stanley said.

De-coded, copper is in limbo until the trade war ends or is toned down, but when/if that happens there could be a significant upward price move given the declining stockpile and limited new supply. stone said.