Commodity Spotlight Base Metals

23 October 2013

Varied picture on the metal markets

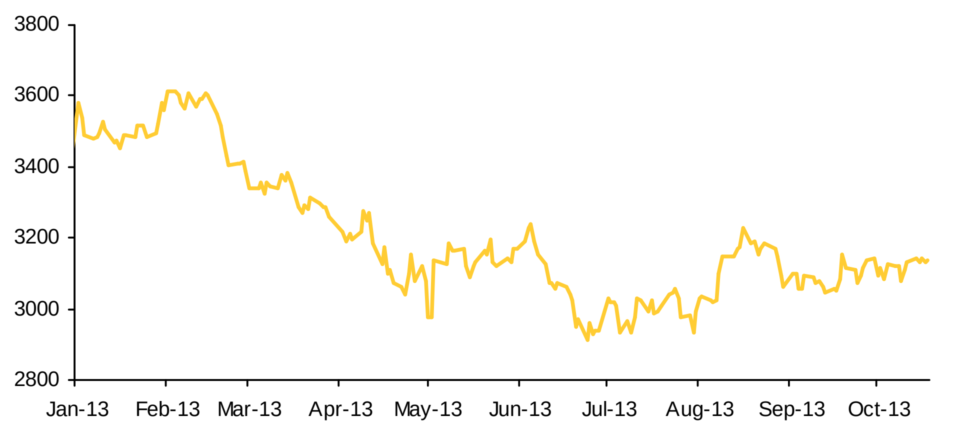
At present, the specific situation on the metal markets is being overshadowed by general macro data and political imponderables. The fundamental data, however, should not be ignored. The autumn meetings of the various International Study Groups have provided an insight into the situation on the respective metal markets, revealing extremely different trends: while the supply of copper and nickel is being expanded, the situation for zinc and above all for lead is becoming ever tighter.

Despite better economic data, especially in China and the US, not to mention signs of an economic recovery in Europe and a weak US dollar, metal prices have so far hardly managed at all to recover from the considerable losses they suffered in the first half of 2013. Measured against the LME's base metal index, they have gained by a mere 6.6% since the beginning of the second half year. By way of comparison, losses in the first six months of the year totalled 14.9% (Chart 1). What is more, metal prices, with just a few exceptions, have been trending sideways in a narrow corridor for around two months now. The ongoing failure to finally resolve the budget dispute in the US and the just temporary suspension of the debt ceiling until February 2014 are likely to continue to hang over prices like the sword of Damocles and block any significant price rises. Prices will doubtless be given a real boost only once a long-term solution or agreement is achieved, for financial investors would then also be likely to show greater optimism again – for a time they had built up enormous short positions (in copper, for example). In the past, such pessimistic market positioning would often be followed by a phase of marked price gains in the subsequent weeks and months.

From a fundamental viewpoint, market participants have again begun to focus more on supply and demand of late. While solid economic data and the inventory build observed for many metals point to robust demand, there is currently a great deal of discussion about the development of supply in particular. At the beginning of the month, the International Study Groups had presented their view of the situation during their autumn meetings. In this Commodity Spotlight we will be summarizing the statements made by the International Study Groups for the copper, nickel, lead and zinc markets.

Copper: The International Copper Study Group (ICSG) believes the global copper market will show a supply surplus again this year for the first time in four years. It puts the surplus at 387 thousand tons, thus remaining only marginally below its April estimate. Next year, the surplus looks set to increase to 632 thousand tons (Chart 2, Page 2). Although this sounds like a lot at first, setting the surpluses in relation to the anticipated demand soon puts the figures into context. After all, the surplus accounts for only 1.9% of global demand in 2013, but will account for 2.9% in 2014. Generally speaking, the surpluses come about as the

CHART 1**: Metal prices recoup losses only slowly**



Source: LME, Bloomberg, Commerzbank Corporates & Markets

Commerzbank Forecasts 2013/14

	Q4	Q1	Q2
Base metals			
Copper	7400	7650	8000
Aluminium	1900	1925	2000
Nickel	14350	14650	15200
Lead	2150	2200	2275
Zinc	1925	1975	2025
Tin	23200	23600	24250

US$ per mt

Head of Commodity Research

Eugen Weinberg
+49 69 136 43417
eugen.weinberg@commerzbank.com

Analyst

Carsten Fritsch
+49 69 136 21006
carsten.fritsch@commerzbank.com

Analyst

Barbara Lambrecht
+49 69 136 22295
barbara.lambrecht@commerzbank.com

Analyst

Michaela Kuhl
+49 69 136 29363
michaela.kuhl@commerzbank.com

Analyst

Daniel Briesemann
+49 69 136 29158
daniel.briesemann@commerzbank.com

Declining copper stocks despite increased supply

result of a significant increase in supply. For example, a series of new mining projects has gone into operation again for the first time in many years. What is more, production in existing mines has been expanded. The increased supply has no longer been reflected in rising inventory levels of late. On the contrary, the LME copper stocks have been continuously reduced since the middle of the year, and currently find themselves at a 7½ -month low. Stocks in the warehouses of the SHFE have also been cut significantly in recent months. Other new mines will be opened over the next two years, most of them projects that were postponed due to sharp price falls during the 2008 financial crisis. That said, we do not expect to see structural supply surpluses on the global copper market over the space of many years, for the biggest worry for mining companies remains the declining copper ore grades. Furthermore, when the copper prices fell well below the $7,000 per ton mark in the summer, planned mining projects were again postponed or put on ice. This could mean that the copper market will once again lack urgently needed supply post-2015.

Moderate price rise anticipated

In other words, while the situation on the global copper market is easing from a short-term point of view, it is likely to tighten noticeably again in the medium to long term. Looking ahead, this should contribute to higher copper prices. By year's end 2013 we envisage copper prices of $7,500 per ton. Next year we expect an average copper price of $8,100 per ton.

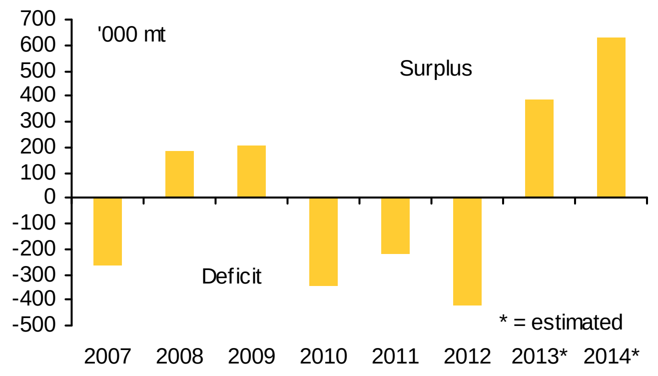
Record surplus on nickel market

Nickel: The International Nickel Study Group (INSG) has revised its spring estimate of this year's supply surplus noticeably upwards and now expects supply to outstrip demand on the global nickel market by a record 140 thousand tons. What is more, the surplus is set to fall only slightly next year to 120 thousand tons (Chart 3). The scale of the surpluses is only too clear when viewed in the context of the relatively small size of the nickel market, which has an annual production of just shy of 2 million tons. It is above all the huge increase in nickel pig iron (NPI) production in China that is contributing to the surplus – according to industrial sources, it could reach 450 thousand tons this year. Unlike copper, the supply surplus has literally catapulted the LME nickel stocks upwards in the past two years. They have soared by 170% since the end of 2011 and at over 230 thousand tons are currently at an all-time high.

Cost pressure on producers likely to preclude marked fall in prices

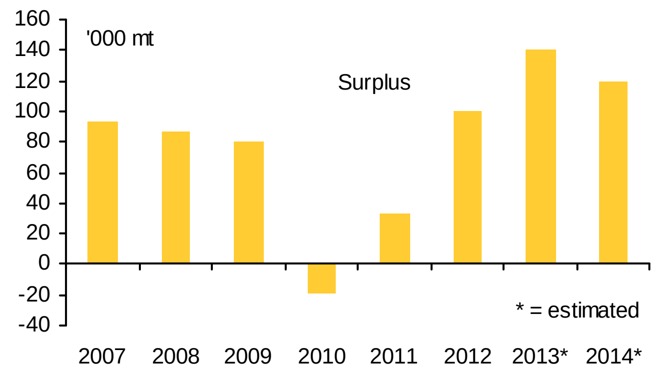
Despite the ongoing surpluses, we see virtually no downside potential for the nickel price. After all, producing nickel pig iron remains an expensive undertaking, even following considerable investment in new production facilities and the efficiency gains that have been achieved as a result. What is more, conventional nickel manufacturers are also feeling the pressure of costs. Glencore Xstrata, for example, is once again closing the Falcondo nickel mine in the Dominican Republic on account of the low prices. The mine had already been closed for similar reasons in August 2008 and only reopened in March 2011. Furthermore, other nickel producers are experiencing production problems: the mining company Anglo American has to rebuild two smelting furnaces at its Barro Alto facility in Brazil, with the result that production capacities there will be significantly reduced until mid-2016.

CHART 2: **Situation easing on global copper market**



Source: ICSG, Commerzbank Corporates & Markets

CHART 3: **Nickel still showing high surpluses**



Source: INSG, Commerzbank Corporates & Markets

Noticeable price increases only in event of production cuts

We also do not expect prices to make any great leaps upwards, however. We are only likely to see noticeable price increases if considerable unprofitable mining capacities are withdrawn from the market. Russian firm Norilsk Nickel, the world's largest nickel producer, had urged its competitors at the end of September to shut down their unprofitable facilities. Norilsk estimates that 35-40% of nickel producers worldwide are not operating at a profit. The planned ban on nickel ore exports in Indonesia from next year could also help curb the surpluses and thus lend support to prices. By the end of 2013 we envisage a nickel price of $14,600 per ton, and expect to see nickel trading at $15,400 per ton on average next year.

Lead market in deficit again fort he first time in five years

Lead: Whereas the situation on the copper and nickel markets is easing, in other words, the situation on the global lead market is becoming ever tighter. According to estimates of the International Lead and Zinc Study Group (ILZSG), the surplus seen in recent years on the lead market will continue to decline. In 2013 it is expected to total "only" 22 thousand tons. Next year, the ILZSG even envisages a supply deficit to the tune of 23 thousand tons, the first deficit to be seen since 2009 (Chart 4). This will come about as a result of increased demand, particularly from China, which will exceed the growth in supply. Demand for lead is growing as China steps up its production of cars and e-bikes and expands its mobile phone system, part of which involves developing the world's largest 4G network.

Tight supply should spark higher prices

So far this year, the higher demand has been reflected in falling LME inventory levels. LME lead stocks, for example, have plunged by 27% since the beginning of the year and reached a 3-year low mid-September. Stocks in the SHFE's warehouses likewise find themselves at a 10-month low. In our opinion, the global lead market is currently the tightest of all the base metal markets. We therefore believe that the price should be well-supported. By the end of this year lead is likely to be trading at $2,175 per ton – in 2014 we see lead trading at $2,300 per ton on average.

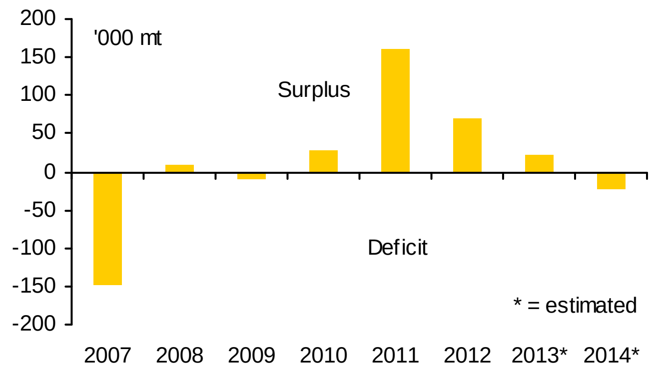
Zinc price supported by robust demand

Zinc: As with lead, ILZSG figures reveal that the supply surplus on the global zinc market will also be reduced, i.e. to 120 thousand tons this year. Once again, this is primarily due to Chinese demand. The ILZSG expects supply and demand to see similarly strong growth next year, with the result that the surplus should remain virtually unchanged at 115 thousand tons (Chart 5). As with lead, exchange-registered stocks of zinc also fell sharply this year – by 14% on the LME and by 18% on the SHFE. Because China also imported more zinc at the same time – in the first nine months of the year, the country's imports surged 6% year-on-year to 507 thousand tons – this points to robust demand there. If this trend were to continue, the zinc price should also be well-supported. At the end of 2013 zinc should be trading at $1,950 per ton and in 2014 it should have climbed to $2,050 per ton on average.

Declining aluminium premiums on the back of uncertainty among market players

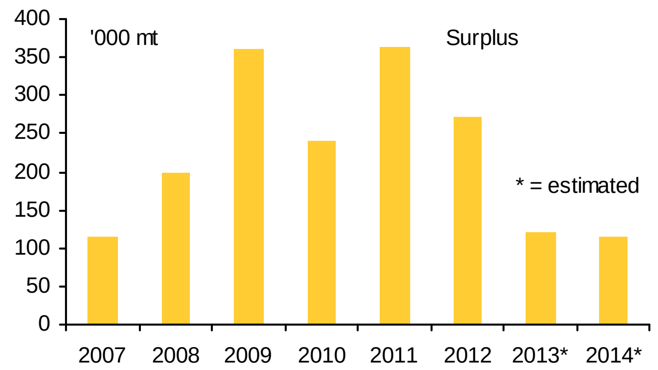
Aluminium: In the case of aluminium, it is neither the record-high supply nor the robust demand that is currently the main focus. Instead, market participants are focusing their attention on the new market regulations. At the end of September, the deadline expired for submitting feedback about the LME's proposed plans to change the warehousing regulations, due to enter into force on 1 April 2014. While the proposals do not go far enough in the eyes of consumers, producers are pushing for the planned measures to be postponed. This is because critics believe that the planned rule changes, which are designed to allow aluminium to be shipped more quickly from

CHART 4: **Deficit envisaged on global lead market**



Source: ILZSG, Commerzbank Corporates & Markets

CHART 5: **Zinc surpluses decline**



Source: ILZSG, Commerzbank Corporates & Markets the warehouses, will further distort the aluminium market and reduce transparency. As a result of the associated uncertainty among market participants and following official investigations in the US, financial transactions were scaled back somewhat of late, which is being reflected in declining physical premiums. In Europe, for example, a premium of $230-250 per ton currently has to be paid on the LME aluminium price – the premium in the US is just under 10 US cents per pound. At their peak, premiums of up to $290 per ton in Europe and 13 US cents per pound in the US were being paid (Chart 6).

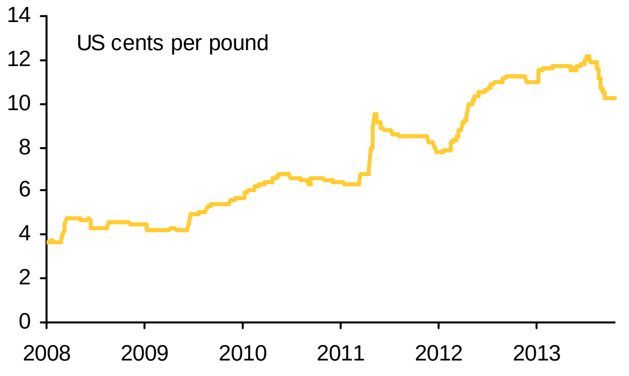
High production to preclude marked price rises

We do not expect the aluminium price to make any strong gains in the next few months, for record-high production levels will preclude marked price rises. Although some manufacturers have somewhat scaled back their production, this has been more than offset by new smelting plants that have been commissioned in low-cost regions. Though this may go some way to reducing the marginal costs of production, they are still well in excess of $2,000 per ton. We therefore expect further unprofitable facilities to be shut down, which should provide the aluminium price with downside support. We see aluminium at $1,925 per ton at year's end and at $2,025 per ton on average in 2014.

Supply bottlenecks on the tin market support prices

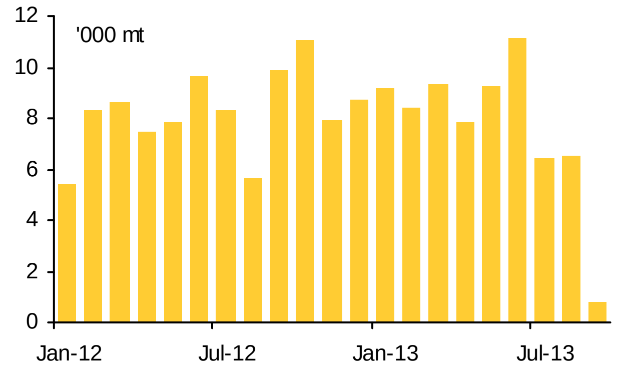
Tin: By contrast, the smallest of the metal markets – the tin market – is extremely tight at present. This is because the global tin market could well see serious supply bottlenecks now that Indonesian tin exports have collapsed almost entirely. After China, Indonesia is the world's second-largest tin producer and the world's largest exporter of tin. Since the beginning of September, tin in Indonesia must be traded on the Indonesia Commodity and Derivatives Exchange (ICDX) in Jakarta before it is allowed to be exported. According to the exchange operator, only 24 members were registered for tin trading there as of mid-month. Thus only 786 tons of tin were exported in September – compare this to average monthly export volumes of 8,500 tons between January and August (Chart 7). Because the number of members on the ICDX is likely to grow in the coming weeks and months, however, this should also lead to higher trade volumes and, ultimately, to higher exports. That said, it is likely to take several months before exports regain their previous levels, so the tin price should be well-supported for the time being. Despite the low exports, production will continue, meaning that inventories will build up. This could be placed on the market at a later date, thus preventing any further leaps in price – at its peak, the tin price has gained by more than 20% since the end of July. By the end of this year, tin should be trading at $23,250 per ton and at $24,500 per ton on average in 2014.

CHART 6: **Uncertainty leads to declining premiums**



Source: Metal Bulletin, Bloomberg, Commerzbank Corporates & Markets

CHART 7: **Indonesian tin exports collapse**



Source: Indon. Ministry of Trade, Bloomberg, Commerzb. Corporates & Markets

At a glance

TABLE 1: **Our forecasts**

		Current									Yearly average		
	Unit	22.10.	Q1 13	Q2 13	Q3 13	Q4 13	Q1 14	Q2 14	Q3 14	Q4 14	2012	2013	2014
Copper	US$/ton	7325	7954	7187	7104	7400	7650	8000	8250	8400	7953	7400	8100
	USc/pound	332	361	326	322	336	347	363	374	381	361	336	367
Aluminium	US$/ton	1884	2039	1871	1828	1900	1925	2000	2075	2100	2053	1900	2025
	USc/pound	85	93	85	83	86	87	91	94	95	93	86	92
Lead	US$/ton	2202	2306	2066	2117	2150	2200	2275	2325	2375	2076	2150	2300
	USc/pound	100	105	94	96	98	100	103	105	108	94	98	104
Tin	US$/ton	23225	24065	20936	21327	23200	23600	24250	25000	25000	21123	22400	24500
	USc/pound	1053	1092	950	967	1052	1070	1100	1134	1134	958	1016	1111
Zinc	US$/ton	1964	2054	1876	1897	1925	1975	2025	2075	2125	1967	1950	2050
	USc/pound	89	93	85	86	87	90	92	94	96	89	88	93
Nickel	US$/ton	14751	17370	15024	14025	14350	14650	15200	15750	16100	17603	15200	15400
	USc/pound	669	788	681	636	651	665	689	714	730	798	689	699

*Quarterly averages, 3months contracts (LME) (*previous day) Source: Commerzbank Corporates & Markets, Bloomberg*

TABLE 2: **Inventories**

	current	1 day	1 week	1 month	1 year	52 week high	52 week low
Aluminium LME	5407525	-0.1%	1.1%	-0.3%	7%	5486100	5052625
Aluminium Shanghai	214627	-	3.2%	-16.6%	-51%	509988	208033
Copper LME	494850	-0.5%	-2.2%	-12.4%	121%	678225	218700
Copper COMEX	28386	0.2%	-4.0%	-10.2%	-48%	86175	28386
Copper Shanghai	172109	-	6.5%	9.5%	-13%	247591	150994
Lead LME	232825	0.0%	-0.4%	-4.7%	-22%	362350	180425
Lead Shanghai	85900	-	1.2%	-8.9%	167%	140750	34785
Nickel LME	230760	0.3%	1.3%	5.6%	82%	231480	127134
Tin LME	13010	0.4%	2.2%	-4.9%	11%	15440	11195
Zinc LME	1055775	-0.5%	6.5%	7.3%	-6%	1235975	966425
Zinc Shanghai	253731	-	1.2%	0.0%	-16%	329404	250717

Source: Bloomberg, Commerzbank Corporates & Markets

TABLE 3: **History**

	current	Percentage change				Historical development							
	US$/mt	1 week	1 month	ytd	1 year	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12
Aluminium	1884	1.6	4.7	-9.1	-3.9	2528	2622	2432	2114	2219	2018	1954	2022
Copper	7325	1.2	0.6	-7.6	-7.9	9634	9178	9003	7529	8327	7829	7732	7925
Nickel	14751	5.4	5.1	-13.5	-11.1	26938	24321	22065	18402	19724	17220	16424	17043
Zinc	1964	1.8	4.9	-5.6	5.8	2417	2275	2250	1917	2042	1932	1909	1983
Lead	2202	2.8	5.7	-5.5	6.5	2573	2536	2453	2010	2118	1985	1995	2205
Tin	23225	0.7	0.8	-0.7	13.5	29882	28862	24724	20882	22995	20580	19324	21592

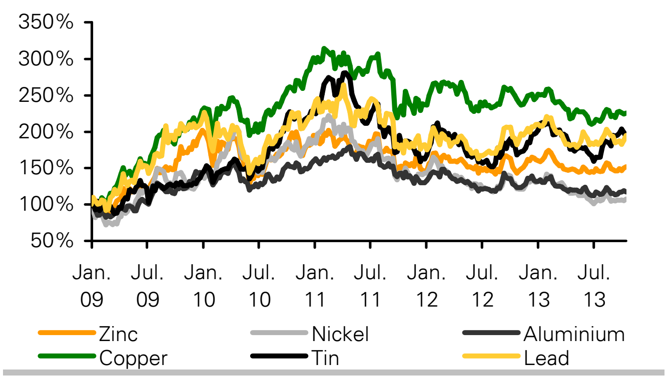
Source: Bloomberg, Commerzbank Corporates & Markets

TABLE 4: **Upcoming events**

24.10. / 21.11.	CHN	HSBC Flash Manufacturing PMI, October / November
25.10. / 27.11.	USA	Durable Goods Orders, September / October
30.10.	USA	GDP 3Q 2013
01.11. / 01.12.	CHN	Manufacturing PMI, October / November
01.11. / 02.12.	USA	ISM Manufacturing, October / November
09.11.	CHN	Imports & Exports, October
09.11.	CHN	Industrial Production & Fixed Assets Investments, October
15.11.	USA	Industrial Production, October
19.11.	USA	Housing Starts & Building Permits, October

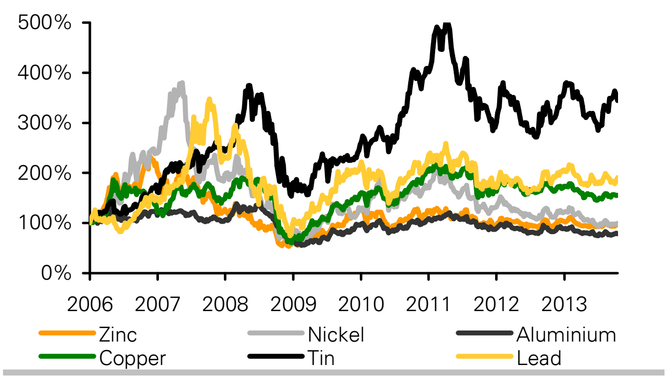
Source: Bloomberg, Commerzbank Corporates & Markets

CHART 8: **Performance industrial metals: Since 2009**



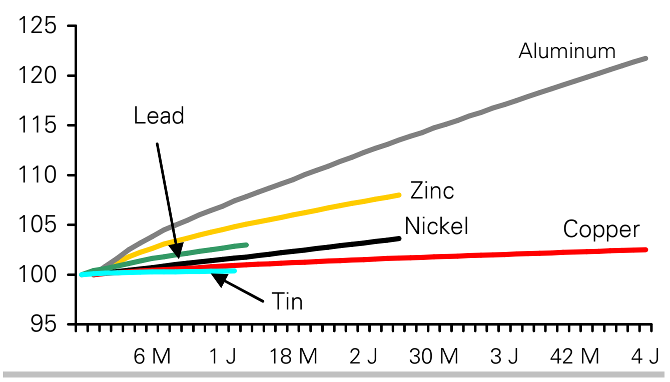
Source: LME, Bloomberg, Commerzbank Corporates & Markets

CHART 9: **Performance industrial metals: Since 2006**



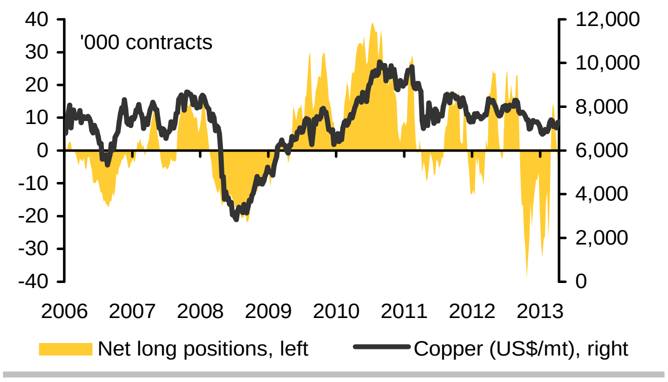
Source: LME, Bloomberg, Commerzbank Corporates & Markets

CHART 10: **Forward curves industrial metals**



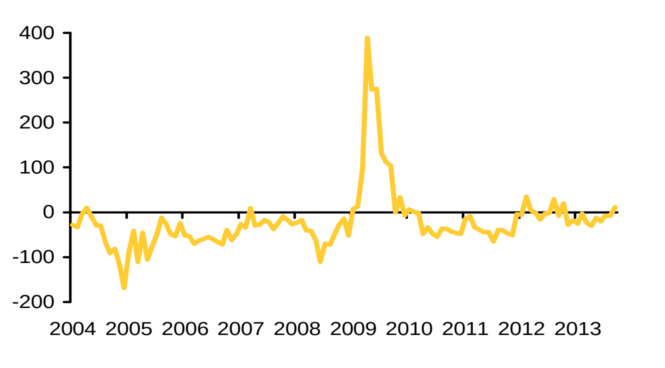
Source: LME, Bloomberg, Commerzbank Corporates & Markets

CHART 11: **Copper: managed money (COMEX)**



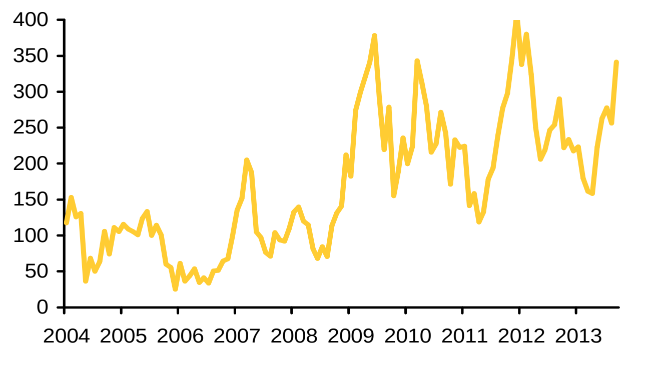
Source: CFTC, COMEX, Bloomberg, Commerzbank Corporates & Markets

CHART 12: **Aluminium: net imports China ('000 mt)**



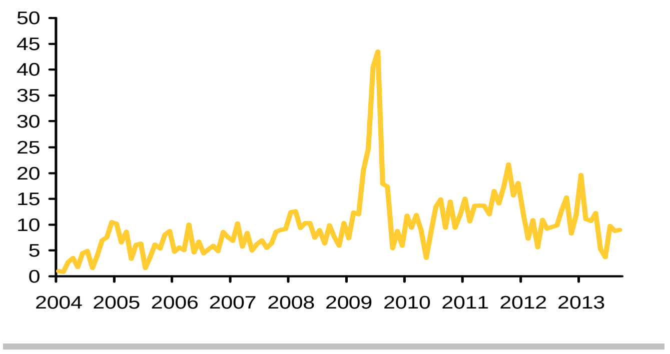
Source: China Customs, Bloomberg, Commerzbank Corporates & Markets

CHART 13: **Copper: net imports China ('000 mt)**



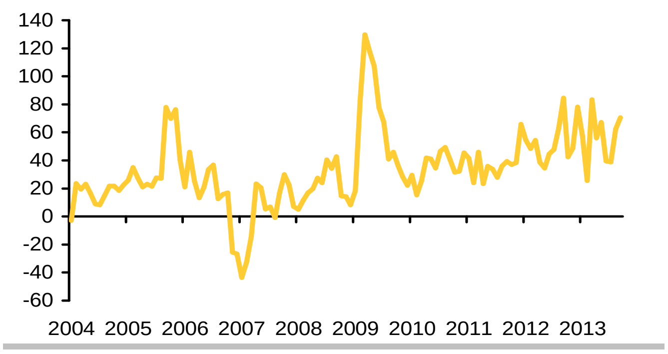
Source: China Customs, Bloomberg, Commerzbank Corporates & Markets

CHART 14: **Nickel: net imports China ('000 mt)**



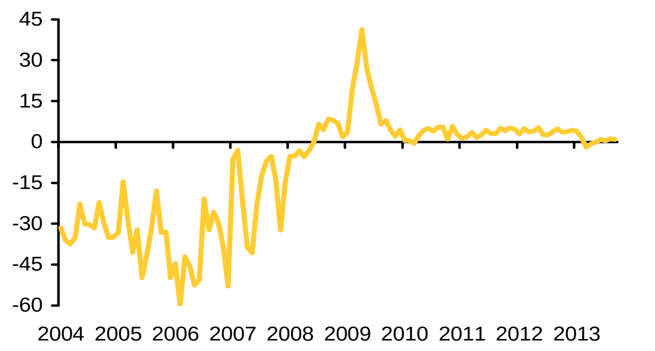
Source: China Customs, Bloomberg, Commerzbank Corporates & Markets

CHART 15: **Zinc: net imports China ('000 mt)**



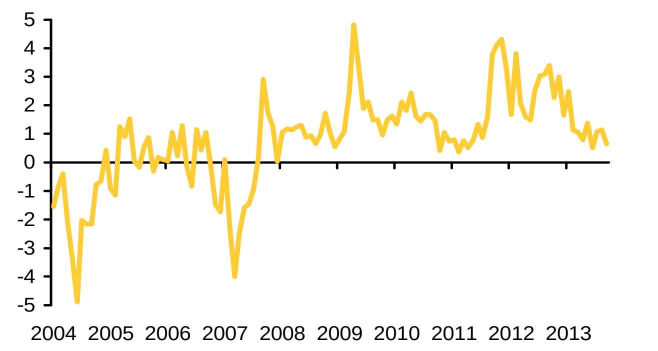
Source: China Customs, Bloomberg, Commerzbank Corporates & Markets

CHART 16: **Lead: net imports China ('000 mt)**



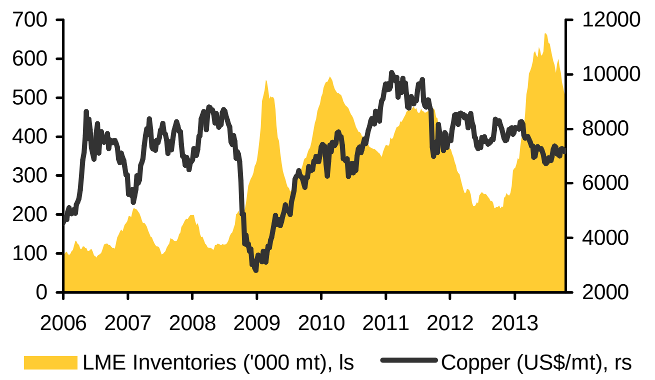
Source: China Customs, Bloomberg, Commerzbank Corporates & Markets

CHART 17: **Tin: net imports China ('000 mt)**



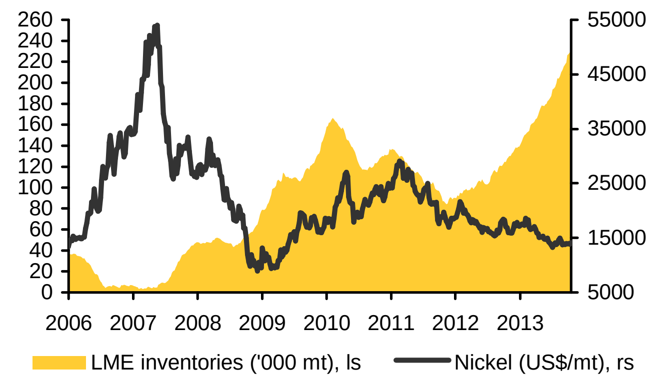
Source: China Customs, Bloomberg, Commerzbank Corporates & Markets

CHART 18: **Copper: LME inventories**



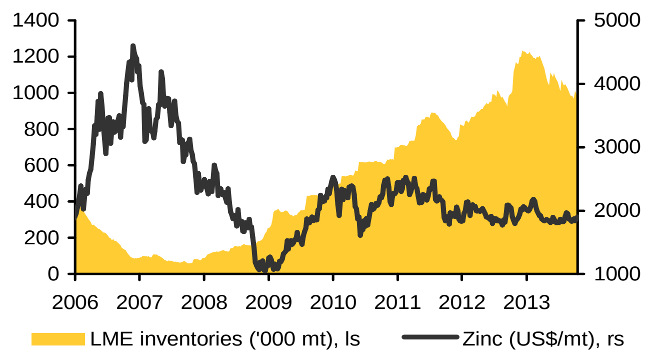
Source: LME, Bloomberg, Commerzbank Corporates & Markets

CHART 19: **Nickel: LME inventories**



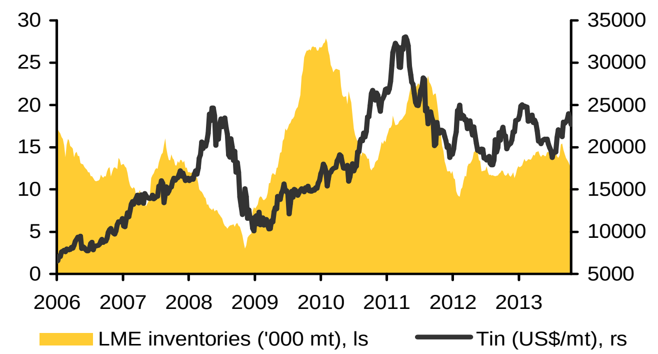
Source: LME, Bloomberg, Commerzbank Corporates & Markets

CHART 20: **Zinc: LME inventories**



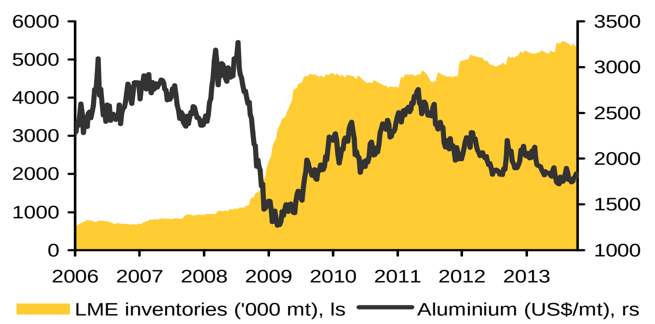
Source: LME, Bloomberg, Commerzbank Corporates & Markets

CHART 21: **Tin: LME inventories**



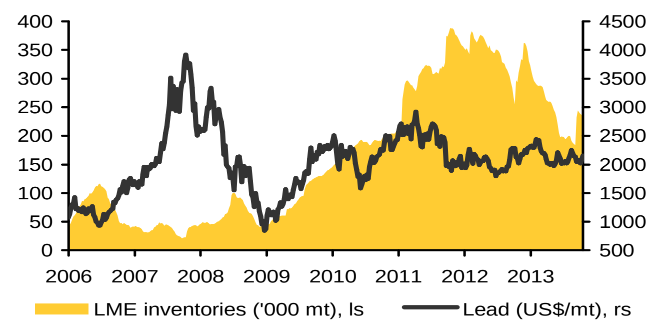
Source: LME, Bloomberg, Commerzbank Corporates & Markets

CHART 22: **Aluminium: LME inventories**



Source: LME, Bloomberg, Commerzbank Corporates & Markets

CHART 23: **Lead: LME inventories**



Source: LME, Bloomberg, Commerzbank Corporates & Markets

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Frankfurt	**London**	**New York**	**Singapore Branch**	**Hong Kong Branch**
Commerzbank AG	Commerzbank AG London Branch	Commerzbank AG	Commerzbank AG	Commerzbank AG
DLZ - Gebäude 2, Händlerhaus Mainzer Landstraße 153 60327 Frankfurt	PO BOX 52715 30 Gresham Street London, EC2P 2XY	2 World Financial Center, 31st floor New York, NY 10281	71 Robinson Road, #12-01 Singapore 068895	29/F, Two IFC 8 Finance Street Central Hong Kong
Tel: + 49 69 13621200	Tel: + 44 207 623 8000	Tel: + 1 212 703 4000	Tel: +65 63110000	Tel: +852 3988 0988