



Base Metal Markets Monthly – 7 December 2009

Minerals & Energy: Ben Westmore

Key Points

- Over November, prices for aluminium, copper, lead and zinc all recorded solid rises, while nickel prices weakened.
- Metal prices have largely moved in unison this year, following market sentiment towards the global economic recovery.
- Slower Chinese metal imports in November coincided with domestic smelters increasing production.
- Aluminium and nickel inventories remain high, constraining the extent that prices for these metals have risen from their trough.
- The supply overhang in the aluminium market is being exacerbated by new and idled production capacity coming online.
- Over the short-term, weaker Chinese imports will limit the rise in metal prices.
- Further out, high stock levels of aluminium and nickel are expected to cause slower price growth for these metals relative to copper, lead and zinc.
- As market balances improve and global economic growth picks up in the second half of 2010, demand from emerging economies is likely to foster metal price growth (across the complex) that is above long-run average levels.

Most metal prices increased over November

The NAB Base Metals Index (BMI) increased by 1 per cent over November after having risen by 81 per cent since the local trough in December 2008. Sentiment towards metals has been positive in the past two months as aggregate demand continues to show signs of recovery. While a rise in consumption across many of the major economies has to date been largely serviced by businesses running down inventories, industrial production growth continues to show signs of gradual improvement. Readings of PMI surveys in both developed and emerging countries have risen from their lows earlier in the year to now report levels consistent with an expansion in global activity. Furthermore, surveys show that the pace of inventory contraction is slowing in most major economies.

For most of 2009, base metal prices have risen in unison with the gradual recovery in industrial production and the associated restocking cycle supporting demand. While global growth is still in the process of recovery and economic indicators remain important to these markets, we are beginning to enter a period where market specific factors are of greater relevance for explaining fluctuations in metal prices. This has been reflected over the past few months with some divergences in monthly price trends amongst the various metals.

Metal prices over the month*		
	Avg Price (US\$/tonne)	Monthly % change
	November	November
Aluminium	1949	4
Copper	6675	6
Lead	2308	3
Nickel	16987	-8
Zinc	2193	6
Base Metals Index		1

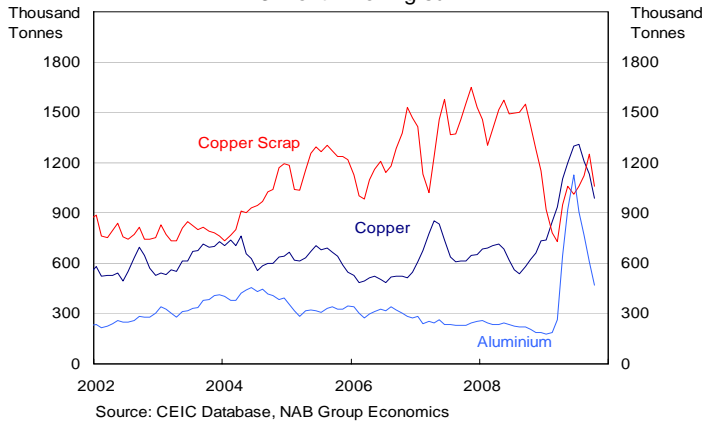
* Prices on an LME cash basis.

Over November, prices for aluminium, copper, lead and zinc all recorded solid rises (see Table). However, nickel prices fell amid reports of an oversupply of stainless steel in China. The stainless steel industry accounts for roughly 60 per cent of nickel off-take, and China produces roughly one third of the world's stainless steel. As such, any changes to the intensity of Chinese stainless steel production can have a significant impact on the nickel market. At this stage, however, reports of a stainless steel glut appear to be overplayed. In October, apparent nickel consumption in China rose by 21 per cent. So, while refined nickel net imports into China fell by 68 per cent, this fall was a product of rising domestic nickel production rather than a lack of demand from steel mills. Whatever the underlying reason, the decline in net imports signals weaker Chinese demand for nickel from overseas markets, which weighed on the price in November.

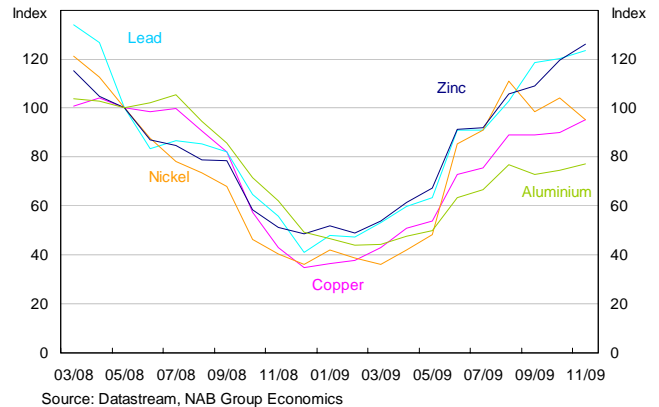
Chinese metal imports weaken as domestic smelters come back online

Slowing Chinese imports despite strong apparent consumption was a common theme across many of the metals in November. It now appears that current price levels are allowing Chinese facilities that were forced to scale back (or shutdown) production with the collapse in metal prices in the second half of 2008 to recommence operations. Relative to the early part of the recovery, both aluminium and copper import volumes have declined sharply in the second half of this year (see Graph 1). This has contributed to more modest rises in the LME copper and aluminium price over the past few months relative to earlier this year (see Graph 2).

Graph 1
Chinese Import Volumes
3 month moving sum



Graph 2
Base Metals Prices
March 2008 = 100

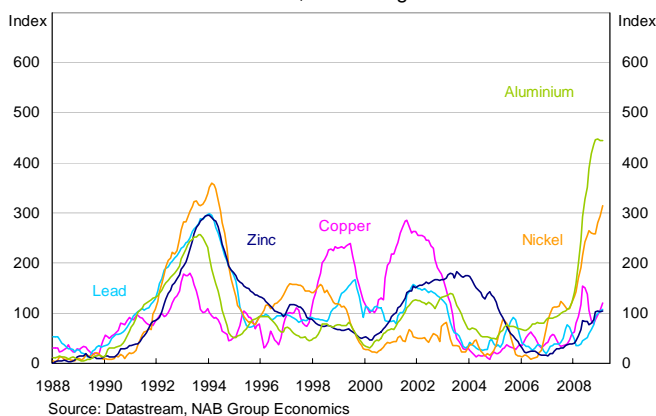


Abundant aluminium and nickel supplies have limited price rises so far

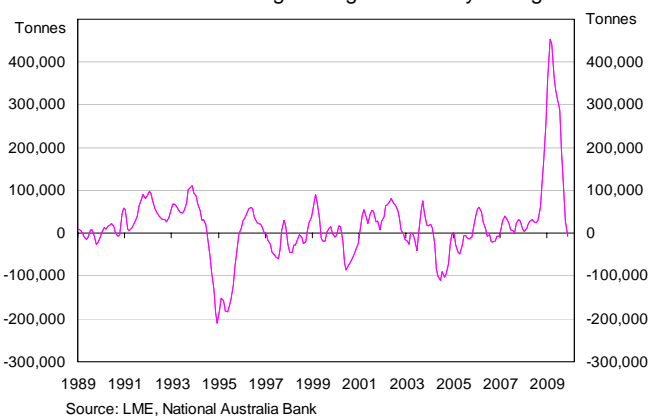
Recent differences in price movements across the metals is explained by conditions on the supply side of the market. While inventories of aluminium and nickel on the London Metals Exchange (LME) remain at historic highs, copper, zinc and lead stocks are at around long-run average levels (see Graph 3). It is not surprising then, that while copper, zinc and lead prices have grown by 120 per cent, 99 per cent and 141 per cent from their respective local troughs, the recovery in aluminium and nickel prices has been more moderate (rising 47 per cent and 76 per cent).

The abundance of aluminium stocks is somewhat surprising given the material is used intensively in the production of fuel-efficient motor vehicles. Over the past year, significant government incentives in the US, Japan and China have led to a significant increase in motor vehicle production. However, while increased aluminium off-take may be reflected by a slowing in the pace of stock builds on the LME, inventories are yet to be drawn down (see Graph 4). This may be explained by reports of aluminium smelters beginning to reinstate idled capacity, despite the supply overhang in the market. This is of concern for future aluminium prices, especially given that new smelters are soon expected to come on line. The Emirates Aluminium project in Abu Dhabi and the Qatalum project in Qatar, with a combined initial capacity of around 2 million tonnes per year, are set to begin production early next year.

Graph 3
LME Base Metals Inventories
Volumes, LR Average = 100



Graph 4
LME Aluminium Inventories
3-month-moving average of monthly change



Increasing attention paid to fundamental conditions in metal markets

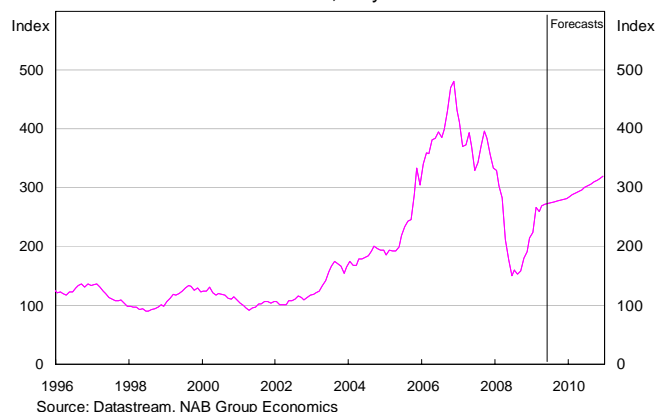
Looking forward, one theme to remain prominent across metal markets is the increased utilisation of Asian production facilities. Metal prices have partially retraced their falls from late last year and are now at levels consistent with economical production from high cost sources. In November, China's imports of all the metals (that we forecast) exhibited declines. Over the short-term, China are likely to continue the switch from imported to domestically produced materials as capacity utilisation at smelters rises further. This will constrain the extent of near-term growth in metal prices, although the complex is expected to trend higher.

Barring a further economic shock, global macroeconomic indicators are becoming less important for metal markets as current price levels already reflect an expectation of a sustainable global recovery. Instead, the market specific conditions around each metal are gaining importance. As price movements begin to accord more with market fundamentals, we are expecting the supply side of the market to receive more attention. The result of this is that the high stock levels of aluminium and nickel are expected to constrain price growth for these metals in relation to copper, lead and zinc. Nevertheless, as market balances improve and global economic growth picks up in the second half of 2010, demand from emerging economies is likely to broadly foster metal price growth that is above long-run average levels (see Graph 5).

Graph 5

Base Metals Index

US dollar terms, July 1993 = 100



Quarterly price profile

Base Metal Forecasts - Quarterly Average Terms

US\$/MT	Forecasts							
	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11
Aluminium	1811	1924	1936	1924	1958	2017	2078	2140
Copper	5864	6569	6891	7114	7348	7591	7842	8102
Lead	1931	2294	2384	2462	2544	2628	2715	2805
Nickel	17694	17500	17010	17032	17390	17928	18483	19055
Zinc	1761	2160	2266	2341	2418	2498	2581	2666
Base Metals Index	250	271	275	280	287	296	306	316

Source: Datastream, NAB Group Economics

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