Metal Sales Desk
Lawrence Bauman
Adam Weis
Ian Littlewood, CFA
+1-646-921-1300
bw@paragonglobalmarkets.com

Loose lips can sink ships and copper as headline risks abound

Copper has started the year on the front foot, with three month LME prices bouncing off support levels around $8,750/t to rally close to $9,300/t. The strength of the dollar had weighed on the red metal through December but the perceived toning down of US tariff threats and hopes for interest rate cuts led to the greenback softening in January and this allowed prices to climb.

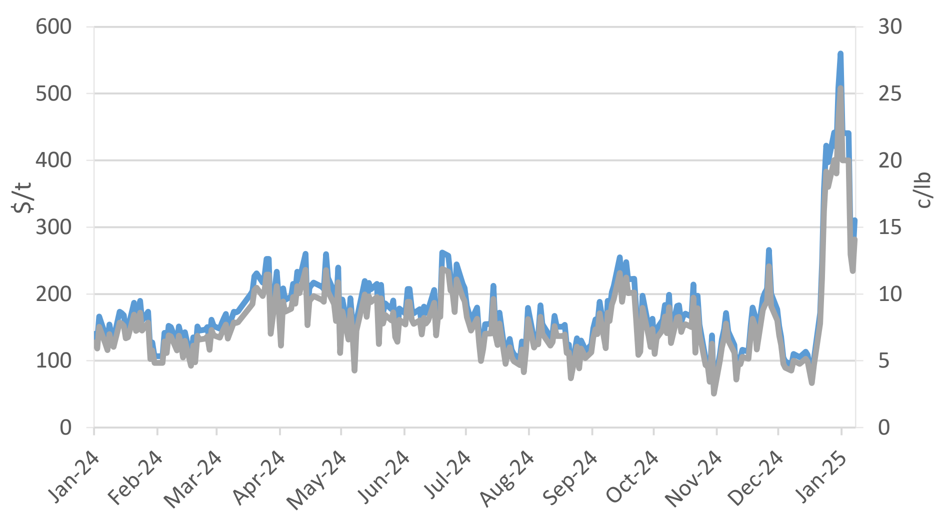
The higher prices were at least partly justified from a fundamental perspective. In the wake of the Trump presidential victory, fears that tariffs would be levied on Chinese goods led to a short term upturn in the production of intermediate and finished goods. This lifted demand for copper and was evident in a decline in visible inventories and a rise in the premium. However, this didn't result in a permanent upturn in demand, rather it was a temporary boost as future consumption was merely brought forward. Given that we are now heading into the Chinese New Year and a seasonally weak period for demand, which is likely to be extended owing to consumption being brought forward, we expect a short term period of fundamental weakness.

Dollar weakening has allowed copper prices to climb

After the Chinese New Year, there is typically a tightening in fundamentals as demand ramps up into the seasonally strong second quarter. Meanwhile, the copper market is exposed to tariff headline risk. News is likely to directly affect copper but also via the transmission mechanism of the dollar as policy announcements feed through into LME prices. On balance, we expect copper to drift lower over the coming weeks.

The copper market has already felt the impact of tariff speculation, with the COMEX copper spread to the LME ballooning out on fears of tariffs being levied on imports of copper. COMEX copper has traded at 5-10c/lb higher than LME prices over most of the past year, with a notable interruption, but this spread surged to over 25c/lb in the middle of January. Traders began pricing the expected cost of the tariff into COMEX prices, although the spread has now narrowed back to more normal levels as tariff fears have dissipated. Local copper consumers do have the option to consume more scrap, in lieu of refined copper imports, although there are limits to this. Nonetheless, this further raises the prospect of trade disruptions and sharp movements in time, COMEX to LME and scrap spreads.

COMEX to LME spreads surged on tariff fears



Source: Bloomberg

Demand

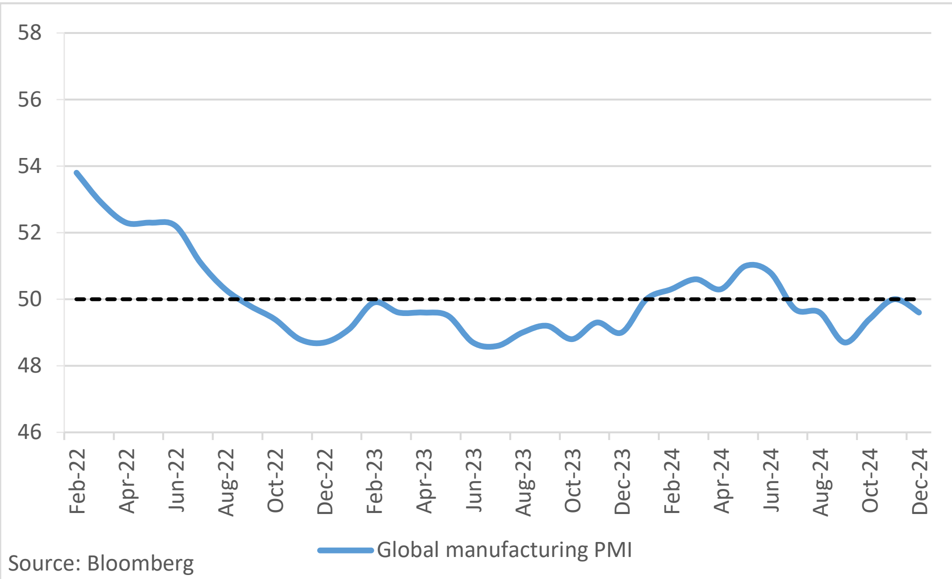
Demand for copper is somewhat sluggish, with the near term outlook for the global economy and consumption of the red metal best described as delicately poised. Much of the recent focus of short term forecasts has related to the impact of the Presidential election on the US economy and, indirectly, the rest of the world, with a particular focus on trade relations. The prospect of tariffs being applied to various countries and end use goods looms large over international commerce and this has already had an effect on demand.

It appears that Chinese production of various intermediate and finished goods was boosted in the final part of the year in what is assumed to be a concerted effort to ship products ahead of the implementation of tarrifs. There was a jump in refined copper production in China in December and also an upturn in copper semis output. As a result, exchange and other visible inventories in China declined and the local copper premium climbed.

However, this simply appears to be China bringing forward demand for copper as other local indicators point to the Chinese economy remaining in the doldrums. Given that we are about to head into the Chinese New Year, when industrial activity slows to a halt, demand is likely to be in for a hangover for the next month or so. For now, President Trump has not levied new tariffs on anyone, but the threat remains and even the very overhanging fear of tariffs is likely, in our view, to have a slight tempering effect on trade.

As it stands, global industrial activity remains muted, and this is evident in manufacturing PMIs. Having climbed to 50 in November, the global manufacturing PMI slipped back to contraction in December, edging down to 49.6, with slight improvements in the USA being offset by deterioration in China and the European Union. Industrial production data shows a similarly downbeat performance, with data showing contraction in major consuming regions of the US, Japan and the European Union.

Global manufacturing PMI continues to flag



The downbeat tone to the industrial economy is mirrored in the main consuming sectors of copper, with construction and transportation both continuing to struggle. Construction indicators, including housing starts, are contracting in the US, Japan and China, although they are edging higher in the European Union. Car production is declining in the US and Japan, although is expanding in China and car sales are creeping higher in the European Union. Although there are pockets of strength, these pockets are not actually all that strong and they are being offset by the negative performance of other areas.

One of the best performing sectors across almost all countries over the past few years has been renewable energy. That is expected to continue in most countries, although under a new administration in the US, these investments are likely to slow dramatically, if not outright contract, and with it, the copper consumption that goes with it. The same is true of copper intensive electric vehicles, sales of which are likely to slow dramatically as purchase incentives are withdrawn.

The short term outlook for demand is rather weak, with consumption in China having been brought forward and owing to the Chinese New year. Meanwhile, economic conditions in the rest of the world remain delicately balanced and susceptible to the negative implications of tariffs and trade wars. The risks to growth seem skewed to the downside for now.

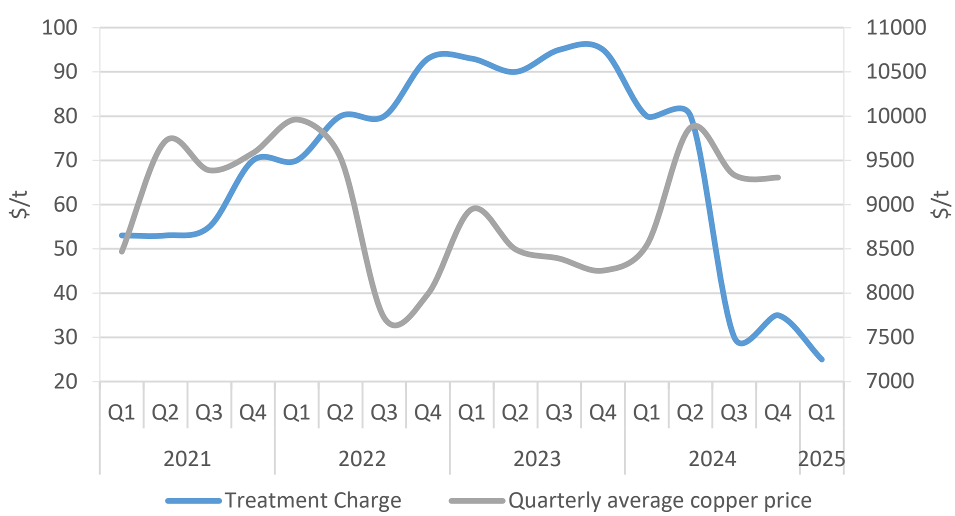
Supply

Global copper production slowed sharply through the second half of last year, with growth ebbing lower almost each and every month. Latest data from the International Copper Study Group (ICSG) reveals that global refined copper production eased to a 3.7% expansion in the first eleven months of 2024, compared to output that was up by 6.2% through the first half of the year. The sharp decline in copper treatment charges, amid sluggish mine output, led to smelter growth moderating through the year.

According to the ICSG, global mine production rose by only 1.5% in the January to November period of last year, although this marks a significant deceleration from the 3.1% pace of growth in the first half of 2024. This slowdown came despite a solid 4% expansion in mining behemoth Chile and a 10% jump in the DRC, along with a further sharp 15% recovery in Indonesia. Growth was tempered by weakness in Peru, which edged lower by 1%, while output in the US fell by 6%.

Looking to the year ahead, the ICSG expects a recovery in mined production to 3.5% growth in 2025, which, if it comes to fruition, would be strongest pace of growth in a decade. Refined production is expected to slow to only 1.6%, after two years that have seen copper concentrate stocks drawn down as cathode production outpaced mined output. Even with an expected increase in mine production, the market for copper concentrates is expected to remain tight, and with this in mind, treatment charges are reported at a multi-year low of $21.25/t for 2025, perhaps suggesting that the market views the ICSG forecasts as a little optimistic. Meanwhile, quarterly treatment charges are at a similarly low level of $25/t and thus pointing to a tight market for refined copper also as these levels will disincentivize smelter output.

Quarterly treatment charges hit multi-period low



Source: Bloomberg, Industry Sources

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14 Wall St | Suite 1625 | New York, NY | 10005 | www.paragonglobalmarkets.com