

Copper: Red hot enthusiasm

Copper seems to be marching towards the peak from its previous cycle thanks to risk-taking and inflation fears. The red metal's constructive fundamentals, and green narrative on the demand side, seem to be reinforcing the bull run. Given that policymakers seem to be allowing the economy and markets to run hotter, we see further upside for prices near-term



Long term, the outlook for copper remains bullish because of its key role in the energy transition. But for 2024, it will be the supply and demand balance that drives the price.

Inflation fears boost bullish bets in commodities

The commodities sector has been under the spotlight as macro investors pile into the asset class, with a particular focus on 'green-tinted' metals where future demand hinges on decarbonisation and energy transition. The story is nuanced though, with varying levels of relative fundamental strength playing underneath, differentiating the magnitude of the price rally.

With falling Covid-19 cases and accelerating vaccination programmes, investors are more confident about economies reopening and returning to growth. As real assets, commodities look attractive to those riding the recovery and growth trade. However, the more imminent concern appears to be inflation, not growth, and that has pushed investors into commodities. These fears seem to have heightened, especially since oil has risen above US\$60/bbl, and we see [further upside risk to oil prices](#). There now appears to be a self-feeding virtuous cycle between

rising commodity prices and inflation fears.

With US Treasury yields rising fast, policymakers seem to be allowing the economy to run hotter than they would have in previous cycles, which may create more upside for commodities in the near term. Cross-asset valuations suggests that commodity indexes are relatively cheap compared to other asset classes, such as super-stretched equity market valuations.

Dr. Copper, the prime candidate?

Copper seems to be the prime candidate in current market conditions, with LME 3M prices fast approaching the previous peak during the post-global financial crisis cycle. A rising tide lifts all boats. The eye-popping spike in copper prices has seen the copper-to-aluminium ratio rise to levels never seen before (above 4.2), exceeding the level back in 2012-2013. Speculation could easily arise and prices could spike on supply concerns, even if there is a large surplus market and no imminent shortage. Just this week, we have seen concern in the aluminium market that local policy changes on power tariffs in China Inner Mongolia could impact capacity, and nickel further spiked on news of disruptions at Norilsk Nickel's mines.

Fundamentals reinforce the bull vibe

We came into 2021 with a view that [energy transition would fuel robust demand growth for copper](#). We expect strong growth in green-related copper projects to accelerate from 2021, and there seems to be stronger-than-expected enthusiasm for this in the markets. Investors seem to be focusing on the speed of the growth, not the absolute demand figures currently coming from green projects. Battery electric vehicles continued to excel in January. Copper consumption in global electric vehicles is less than 4% of the total consumption a year. This year, the broader copper demand will be on a synchronous recovery driven by a cyclical uplift and a nascent global 'green' recovery.

During the first two months of the year, visible copper stocks remained low and those in LME sheds have continued to edge lower. The LME market has seen a structural tightness begin to unfold as nearby spreads tightened in backwardation. Meanwhile, the seasonal stock building, usually starting ahead of the Chinese New Year, looked disappointing; again, speed matters more.

Developments on the supply side are also fuelling expectations of tightening. The spot market's multi-year low treatment charges have continued to shift lower and squeeze into smelters' margins. As a result, China's top two smelters, China Copper and Tongling, have revealed plans to slash production. There have been no meaningful actions taken yet but such news headlines help to fuel the bullish sentiment.

Is this time (cycle) different?

I am not joining the debate as to whether we should call this a supercycle. There are two aspects we need to be wary of. If we draw a parallel to copper's post-GFC bull run, China was the locomotive during the last cycle with ultra-expansionary fiscal stimulus being poured into sectors where demand for metals was high. Those were years of double-digit growth for the nation's property and infrastructure sectors.

Coming into 2021, China now seems to be looking at restarting its [deleveraging](#) reforms. The cumulative year-on-year growth of property completions now remains deep in negative territory.

There was a bright spot in Chinese exports of some copper-heavy products (air-con, refrigeration etc.) last year as Covid disrupted world trade. But it's unclear yet whether that momentum will be sustained. A strong Chinese yuan, combined with fast-rising metal/raw material prices, may have ramifications for the downstream. And don't forget, the China State Reserve Bureau (SRB) bought at low tide last year, with anecdotal reports of 600kt for strategic or opportunistic purposes. There are few reasons to expect them to come back any time soon.

High level cruising, but what next?

A pullback seems to be long overdue after a V-shaped rally since 2Q20. However, the key theme to watch for the copper market is likely to be macro developments and higher inflation. For now, copper remains driven by macro news, and there seems to be little to stop it. We think there are still more upside risks to copper prices in the near term as policymakers seem to be allowing the economy to run hotter, but there are also risks to the downside in the medium- to longer-term.

It's unclear how policymakers are going to successfully navigate through the next three months without causing jitters in cross-assets markets and spreading volatility throughout the whole metals complex.