

Metals: You've got to roll with it

Metals have been hit hard by escalating trade wars and the perceived risks to global growth and demand. Amid the macro gloom, it's hard to see what can provide a firm near-term floor but we do think some over-zealous shorting will be squeezed by sharp backwardations approaching



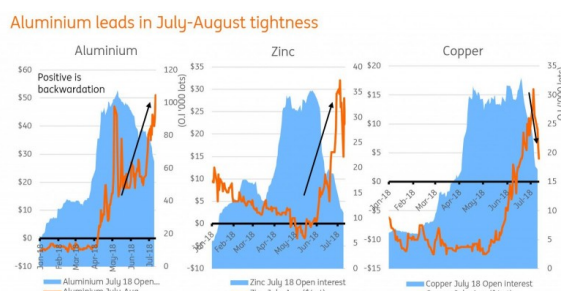
Impending tightness between July-August

Aluminium and zinc are fast approaching sharp rolls between the July-August prompts on the LME that will be costly for any near-term short positions to roll. Traders should be on the look-out for how this impending tightness could drive outright prices higher by causing shorts to exit. From thereon, however, to entice a return of long allocations will depend on the global trade-war sentiment. ING economists think that at least the direct impacts on growth/metal demand are limited and that a deal is probably going to be sought after the US mid-terms, but it's increasingly becoming the indirect effects to business sentiment that are most risky.

In LME metals, spreads between the futures dates have the proven ability to direct prices and especially as key expiries approach. It is important to remember that in a backwardation rolling a short position forward position is costly (buying the nearby is higher than selling the further out). Many commentators focus on the Cash-3 month (Cash-3M) LME spread. This is the price difference between historically the most defined closing prices but it actually tells us little

about the real cost for traders to roll long/short positions in the market. In actual fact, most positions (over 2/3rds of open interest) sit on the LME's regular monthly contracts (3rd Wednesdays) and so most positions are rolled between those dates.

With the July month contract soon to expire (18th July with the last full day of trading on Monday 16th), those still short the contract will be facing costs to roll the short position forward. If they choose to instead just square out their position (buy nearby without also selling further out) that is likely to bring some much needed positive momentum to these markets. The 288 kt equivalent shorts of July Zinc, 428kt of July copper are actually fairly in line at this stage ahead of the expiry, but the 1.6Mt of Aluminium July shorts, that are going down to the wire before rolling, are looking very high making it the most tense of rolls with the most short-squeezing potential.



Source: LME, ING Research

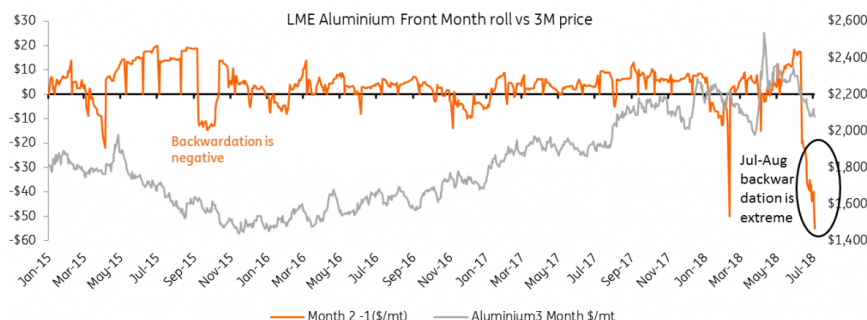
Aluminium: Immense tightness looms

It's been our conviction for a while that in a world of lower LME stocks (vs off-warrant levels) sharp monthly rolls in Aluminium are becoming more commonplace and are actually responsible for a good deal of the rally since 2015. (Read: [It's not all about China](#)).

The situation escalated as premiums get higher and provide the opposite incentive for metal to be bought and sold into the physical market rather than delivered on the LME. US premiums are now at 20c/lb effectively walling off any customs cleared material from being profitably delivered into the exchange. Other regional premiums, such as in Europe, have corrected (\$84/mt down from \$158/mt peak) and even where the forward curve on CME expects a decrease (assuming Rusal sanctions get lifted) premiums are still likely to remain higher than incentives offered by warehouses for metal to be delivered. These incentives have dropped considerably since queues at the LME warehouse were resolved and so we think it's the new normal for the market to trend towards deep pockets of backwardations in an attempt to attract deliveries to the exchange.

For whatever the structural drivers of the sharp rolls, the July-August backwardation is particularly immense: \$50b (b=backwardation) and counting. It's now even surpassed the sharp spasm that occurred through February-March. Short holders who have stocks may well find this situation compelling to unwind any stocks in financing and deliver (even against high premiums) into the exchange, but likely we are also due for a substantial amount of shorts to simply buy out their position and exit the market. Given the high amount of July LME Aluminium positions outstanding (1.6 million tonnes= 62k lots) aluminium may well get the most upward support from the roll as shorts feel the squeeze.

Aluminium's erratic rolls hit new extremes for July-August backwardation



Source: LME, ING Research

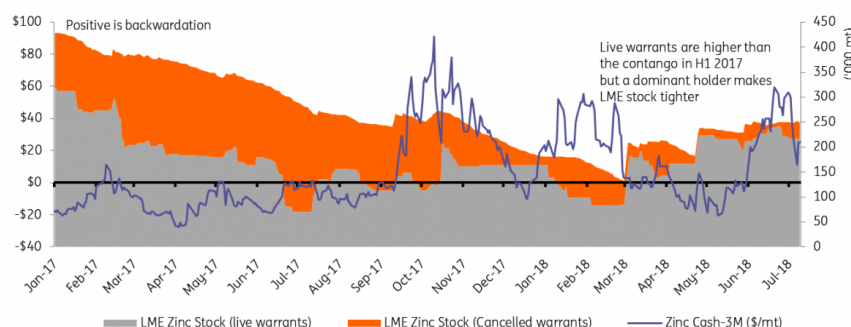
Zinc: Spreads eased but still in backwardation

We warned of a [short-term bear trap](#) from zinc spreads when the Cash-3M surged in June but it hasn't deterred the huge sell-off since: (-20% since the G7 summit). Shorts may well have increased confidence as this spread eased from a high of \$55b to a low of \$11b on Monday 9th. The more significant July-August still remains at a substantial \$22.25b, however, which would pose a big sting to the front month shorts still waiting to roll.

We think much of zinc's downfall this year has been the sheer availability of stocks on the LME. Not just have the stock levels increased but the very high proportion of those stocks on live warrants (only 14% are cancelled) has reflected a situation of high stock churn and associated spread lenders. That eased-zinc tightness certainly prevented what many saw [as a last squeeze higher](#) above \$3k. Through June though, long positions have expired into stock holdings and a single party now holds 50-79% of the LME stocks, LME data shows. The LME Lending Rules prevent a squeeze at the shortest term rolls (tom/next: 1-day rolls) but the influence to the other monthly dates can certainly be felt. Since June the July contract zinc price is down 0.5% less than the 3-month price as near-term supplies/stocks become centralised.

Zinc open interest is up 7% since June, reflecting a wave of new short positions that are being added to ride the sell-off. Whilst these positions are being made out further than the July-August tightness it is still likely that if the dominant stockholder remains in place this tightness will continue and could eventually catch those positions. Whilst we respect that zinc concentrate supply is easing significantly this year, the refined zinc metal market remains in deficit (ILZSG expect a 263kt shortage). Given this, we see no reason why a sizeable cancellation of LME stock to fill the shortfall could not occur and, in turn, maintain the backwardation. Zinc's bull run from a shortage of mine supply is surely ending but shorts need to be cautious to navigate around this squeeze.

LME Zinc stocks have been highly available, but it can quickly change



Source: LME, ING Research

Copper: A short lived backwardation

We don't think Copper's run to \$7,300 was fundamentally justified and put that move down to a technical backwardation in the spreads (read: [Copper goes back to a back](#)). Prices had peaked alongside the Cash-3M which hit a backwardation of \$12/mt before retreating and has now flipped back to a contango.

Once again looking at the monthly rolls tells us more about the strain on the shorts. June-July had peaked at a sizeable \$10.50b and it was as June expired the curve flipped back to contango. It was the roll past June that seemed to set the Cash-3m to flip back to contango. July-August did get as tight as \$16b at the beginning of July but that has retreated considerably since.

Like zinc, in copper we focus on the dominant stockholder to explain. This we believe drove the spreads to tighten through July. The dominant holdings have now retreated from 50-79% of LME (un-cancelled) stock in mid-June to the 40-49% banding currently.

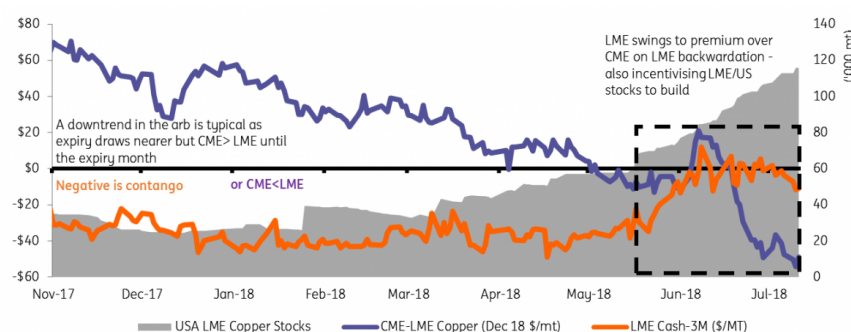
Also amid a considerably lower premium environment than the likes of aluminium (especially as Asian premiums drop) copper spreads need not be so tight to incentivise delivery into the exchange. The spreads haven't yet materialised into any big deliveries in Asia where the premiums are weakest but there has been some previously cancelled stock being put back on warrant. The ratio of cancelled-to-warranted LME Copper stock in Asia has gone from a 9 month high of 0.77:1 at the end of June to 0.43:1 currently.

In fact, the only place the backwardation is visibly drawing stocks into the LME is in the US. Reinforcing our view that the LME's backwardation has been temporary and technical (vs. fundamental), the CME has actually remained in a wide contango (along with SHFE). The divergent curve structure and the squeeze on the LME shorts have seen LME prices recently outperform CME. The CME copper price for December 18 was at a slight premium to the LME until May when the LME backwardation began to surface. Since the 2nd half of June, however, the LME has gone to having around a \$40 premium compared to CME. That LME premium to CME would only normally happen in the expiry month (December).

Some traders have therefore profited from the CME discount by delivering copper into the LME. Comex stocks have only drawn slightly though since most are fairly isolated in Utah and freight costs around the US remain very high. It's those same freight costs that are also supporting US

copper premiums and, in turn, provides competition for the copper to be sold physical material vs. the exchange.

LME Copper backwardation drove premium to CME and incentivised US stock build



Source: CME, LME, ING Research

Author

Amrita Naik Nimbalkar

Junior Economist, Global Macro

amrita.naik.nimbalkar@ing.com

Mateusz Sutowicz

Senior Economist, Poland

mateusz.sutowicz@ing.pl

Alissa Lefebvre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@asia.ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Sector Economist, TMT & Healthcare

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@asia.ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials

Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Senior Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Senior Editor and Supervisory Analyst

rebecca.byrne@ing.com

Mirjam Bani

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)

mirjam.bani@ing.com

Timothy Rahill

Credit Strategist

timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland

leszek.kasek@ing.pl

Oleksiy Soroka, CFA

Senior High Yield Credit Strategist

oleksiy.soroka@ing.com

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research

jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare

edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist
jurjen.witteveen@ing.com

Dmitry Dolgin
Chief Economist, CIS
dmitry.dolgin@ing.de

Nicholas Mapa
Senior Economist, Philippines
nicholas.antonio.mapa@asia.ing.com

Egor Fedorov
Senior Credit Analyst
egor.fedorov@ing.com

Sebastian Franke
Consumer Economist
sebastian.franke@ing.de

Gerben Hieminga
Senior Sector Economist, Energy
gerben.hieminga@ing.com

Nadège Tillier
Head of Corporates Sector Strategy
nadege.tillier@ing.com

Charlotte de Montpellier
Senior Economist, France and Switzerland
charlotte.de.montpellier@ing.com

Laura Straeter
Behavioural Scientist
+31(0)611172684
laura.Straeter@ing.com

Valentin Tataru
Chief Economist, Romania
valentin.tataru@ing.com

James Smith
Developed Markets Economist, UK
james.smith@ing.com

Suvi Platerink Kosonen
Senior Sector Strategist, Financials
suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Piotr Poplawski

Senior Economist, Poland

piotr.poplawski@ing.pl

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research

marieke.blom@ing.com

Raoul Leering

Senior Macro Economist

raoul.leering@ing.com

Maarten Leen

Head of Global IFRS9 ME Scenarios

maarten.leen@ing.com

Maureen Schuller

Head of Financials Sector Strategy

Maureen.Schuller@ing.com

Warren Patterson

Head of Commodities Strategy

Warren.Patterson@asia.ing.com

Rafal Benecki

Chief Economist, Poland

rafal.benecki@ing.pl

Philippe Ledent

Senior Economist, Belgium, Luxembourg

philippe.ledent@ing.com

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Inga Fechner

Senior Economist, Germany, Global Trade

inga.fechner@ing.de

Dimitry Fleming

Senior Data Analyst, Netherlands

Dimitry.Fleming@ing.com

Ciprian Dascalu

Chief Economist, Romania

+40 31 406 8990

ciprian.dascalu@ing.com

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland
Karol.Pogorzelski@ing.pl

Carsten Brzeski
Global Head of Macro
carsten.brzeski@ing.de

Viraj Patel
Foreign Exchange Strategist
+44 20 7767 6405
viraj.patel@ing.com

Owen Thomas
Global Head of Editorial Content
+44 (0) 207 767 5331
owen.thomas@ing.com

Bert Colijn
Chief Economist, Netherlands
bert.colijn@ing.com

Peter Vanden Houte
Chief Economist, Belgium, Luxembourg, Eurozone
peter.vandenhoute@ing.com

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroeder@ing.com

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Gustavo Rangel
Chief Economist, LATAM
+1 646 424 6464
gustavo.rangel@ing.com

Carlo Cocuzzo
Economist, Digital Finance
+44 20 7767 5306
carlo.cocuzzo@ing.com