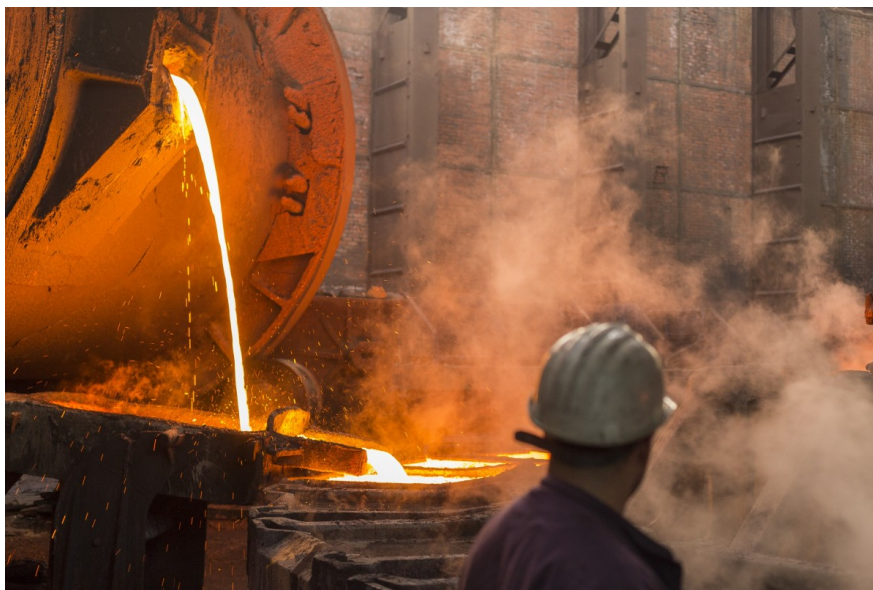


## Metals continue their 2021 rally

Both macro and fundamental forces have propped up the metals market so far this year. But not all metals are performing as strongly as others



Copper remains most sensitive to macro trends

In the three weeks of trading so far this year, the metals complex has maintained most of the buoyancy it experienced at the end of 2021. While some metals have extended their rallies, copper has lagged. We think there are three key themes behind the metals market at the moment.

### **Macro tailwinds prevail ahead of a key Fed meeting next week**

While macro markets have been debating the scale and timing of the Federal Reserve's tapering, interest rate hikes, and rundown of its balance sheet in the months ahead, there is still ample liquidity in the market to keep asset prices afloat. Meanwhile, the rally in the greenback in the fourth quarter has since taken a breather, with the trade-weighted dollar index slipping this year and easing pressure on metals.

The spreading Omicron variant and related supply chain bottlenecks have done little to help the supply and demand dislocations, and some regional premiums in the physical market have surged. Commodities, regarded by some as a hedge against inflationary pressures, have continued to benefit from the current macro environment. And there may be some asset reallocation, with

funds being diverted into commodities amid a stretched equity market.

There is some caution ahead, however. Some investors are wary ahead of the Fed meeting next week – as our economists discuss in more detail [here](#).

## **China unveils more pro-growth measures with a tilt towards more green projects**

While the US is on a path to tighten monetary policy this year, China has been going in the other direction. After a change in rhetoric at the Central Economic Conference last December, which emphasised stability, Chinese authorities have responded with both monetary and fiscal measures.

On 17 January, the People's Bank of China cut a key rate for the first time since April 2020. The nation's top economic planning agency, the National Development and Reform Commission (NDRC), has repeatedly called to 'front load' special bond quotas to sustain growth and speed up investment in infrastructure projects which are planned for the 14th Five Year Plan (2021-25).

A point worth noting is that the move towards renewable projects - as the country seeks to speed up its energy transition - is a priority, and President Xi Jinping has pinpointed two key targets to decarbonise the economy (i.e. peak carbon emissions by 2030 and carbon neutrality by 2060). A power crunch during the last quarter of 2021 may have encouraged the state to accelerate those projects for energy security purposes. To support these targets, the State Grid has just unveiled a record-high budget for 2022 at more than 501bn yuan (US\$79bn). Last week, the China Passenger Car Association (CPCA) released its latest data for December on new energy vehicles (NEV), with retail sales growing 129% year-on-year. Total NEV sales grew by 169% in 2021. There was strong growth in the EV sector because higher copper demand intensity together with a continued recovery in the large internal combustion engine (ICE) vehicles markets, supported copper demand in China, helping to offset some weakness in the property sector last year.

We think that China should remain a major driver of growth for metals exposed to the energy transition. Following strong growth in 'green' areas last year (as we noted in our [copper outlook](#)), copper and aluminium, among other materials, should continue to benefit from China's government-led investment in renewable power projects, including wind and solar installations going forward.

It remains to be seen how quickly these measures feed through to China's market. However, we think demand could beat the market's expectations, particularly if the property sector, which is the traditional engine of demand, shows signs of picking up this year. A potential upside risk to prices could come if demand reemerges in China before the US Fed has taken any meaningful action to combat inflation.

## **Fundamentals remain supportive**

Against the backdrop detailed above, fundamentals still appear to be supportive, with low observable inventories being a key feature across some London Metal Exchange (LME) base metals, including copper, nickel, zinc, while aluminium has been playing catch-up in its inventory drawdown.

As a result, traders are wary of building any significant shorts in metals which may be at risk of a

short squeeze. After a historic squeeze in copper in October 2021, which took the Tom-Next spread to extreme levels, nickel seems to be following suit, with spreads spiking to the highest level seen in more than a decade, backed by strong fundamentals (as we [discussed](#) last week).

Copper has remained most sensitive to macro trends. Prices tentatively broke higher, above \$10,000/tonne in London, last week. However, it has so far failed to maintain its year-to-date gains. There are some early signs of copper inventories starting to build in the LME, with the recent uptrend in Comex. As of 18 January, LME copper stocks have risen for three days in a row, gaining more than 10kt chiefly in European warehouses, easing fears of spot supply tightness. Year-to-date, it has gained 5.6kt to 94.5kt.

Stocks in Comex, meanwhile, have also risen by 8.4kt to 78kt. Copper stocks are starting to build in China's market, tracking both social inventory and bonded warehouse inventories. Total bonded warehouses increased by 13kt last week to more than 217kt as of 14 January, rising for three weeks in a row. Though it remains to be seen how much further the LME copper inventory drawdown can go, the current synchronised inventory building across major regions has weighed on market sentiment this week. Investors may remain cautious about copper ahead of next week's key Fed meeting and data from the US.