Metals: Mixed signals

The risk-off sentiment has subsided on early signs that things may be improving in the Covid-19 pandemic in Europe. Metals are rallying, as supply disruptions continue to build a cushion to the demand shock. But some have relatively better fundamentals than others

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Investors have been closely monitoring the Covid-19 pandemic and searching for signs of improvement, and there are now reasons for cautious optimism, as the daily increase in new cases from harder hit European countries continues to decline. In Spain, the lockdown has been relaxed and many workers are now allowed to return to work.

Better-than-expected trade data, for now

China released its trade data for March on Monday showing that total exports shrank 6.6% year-on-year, a lot better than the market expected. Looking at the metals sector specifically, the 1Q20 data should not be over-interpreted, as a number of factors are at play. Total iron ore imports grew by 1.3% year-on-year during the first quarter. Meanwhile, total copper and semis imports increased by 9.1% year-on-year, but the concentrate imports declined by 0.5%. Export growth looks worrying, but so far, it has been about as bad as the market had expected. Exports of aluminium and semis contracted by 17.5% year-on-year over the first three months. Anecdotal reports have suggested that exports could worsen in 2Q20.

Car sales look bleak but largely expected

Chinese car market figures released by the Manufacturers Association over the Easter holiday showed that collective sales during 1Q20 plummeted by 45.4% year-on-year, more or less in line with what individual car manufacturers had forecast earlier. Again, the numbers reflect some distortions from Covid-19. March sales, however, rose by more than 361% month-on-month, suggesting that manufacturers have gradually returned. If there are no surprises ahead, the monthly growth in April should be very positive once again.

Searching for stimulus evidence

Investors have also been searching for signals about the impact of China's stimulus measures. Sales of excavators are regarded as a bellwether for infrastructure investment, which is relied upon to boost metals demand. March sales numbers from the China Construction Machinery Association took many by surprise. They showed that sales in the domestic market increased by 11.2% year-on-year while exports jumped by 17.7% year-on-year. The local market is the main one for excavators and strong sales in March suggest the infrastructure sector may be starting to accelerate.

Copper

Copper led the rally on Monday, touching US$5,200/tonne, the highest in a month. Supply side disruptions continue to provide support here. This has partially been reflected in the spot treatment charges to China, which have declined to US$61.2/tonne, according to SMM data, and are slightly below the annual benchmark at US62.5/tonne. If mine disruptions are protracted and have a big impact on concentrate shipments to China, there is a risk that cathode production growth could be tilted to the downside from next month. Meanwhile, the scrap market has also tightened as evidenced by the inversion of the secondary to primary spread.

Aluminium

Aluminium bounced back to more than US$1,500/tonne after hitting a four-year low at US$1,455/tonne last week amid the demand shock and surging LME inventories. As low prices cut into smelters' margins globally, the market has been expecting cutbacks in production, hence the bears are cautious at this point. Some cutbacks have already seen in China but have come at a rather slow pace. So far, there is around 750kt of capacity that has reportedly been temporarily suspended (including planned but not implemented). Still, the loss pales in comparison to annual production of 35mln tonnes. Anecdotal reports have suggested that physical stock has increased as low prices spiked buying interest. Meanwhile, total social inventories declined to 99kt, according to today's data. We think that this may send false signals to producers and potentially delay any price-related cutbacks.

Lead

In terms of inventory, lead is well-positioned against other industrial metals despite the fact that it's the only one trading in the red on the LME. The battery metal has led the rally in today's ShFE market, however. Intuitively, the metal's demand in end-use has been hit by a broad suspension of car manufacturing, and this has mainly been priced in. At the primary use, the average run rate at lead-acid-batteries (LABs) has returned to the same level as last year. However, unlike other metals, which have experienced a surge in inventory over the first quarter, lead's total inventory in the China market has largely been drawn down. Total inventory has plummeted to just 9kt in the first week of April. In truth, the supply of lead was contracting as early as last year, and we estimated a more than 1% decline in global refined lead production from the previous year. Things have not improved this year. The latest data from SMM suggests that primary production was still in decline over 1Q20, by 6.3% year-on-year, the most in the base metals group.

Zinc

However, there has been a substantial divergence when we compare primary lead to its sister metal, zinc. Even though they are mined together, refined zinc production continued to surge by nearly 11% year-on-year in the first quarter, leading to a strong inventory build. From a supply perspective, lead is better positioned than zinc. Current prices may remain a cap on any strong supply recovery and the market could still remain in a small deficit. Secondary production has just started to ramp up, but growth will be restricted by scrap availability. So far, hopes for zinc are pinned on infrastructure investment, but demand growth will still be outpaced by supply this year, leading to a market in surplus.