

## Sell-off pressure increases on metals as coronavirus spreads

With increasing cases of the Covid-19 outbreak reported from South Korea, Italy, Iran and Japan, base metals are now facing further sell-off pressure



Workers in Daegu, South Korea, where there's been a spike in new coronavirus infections

### Supply and demand exposure

Let's start at the metal supply and demand exposure. We've seen rising cases over the past few days from South Korea, Japan, Italy and Japan. Their collective base metals' supply and demand picture is relatively low globally and certainly when compared to China. More importantly, there are no reports of actual disruption to metals' physical operations in these areas, at least up to now.

The sell-off in the base metals complex over the last few days largely reflects the heightened risk-off sentiment or 'fear-factor' across broader riskier assets. Those fears could weigh more on the global economic outlook if Covid-19 spreads still further. We talked about those risks in Europe [here](#). However, supply chain risks may have more a far-reaching impact than their respective supply and demand figures suggest. These percentage figures are based on production and consumption in terms of primary metals; usage further downstream may not be fully captured.

## Italy

Italy consumes around 2% of global primary aluminium and is the second-largest consumer within Europe. It makes up a similar proportion of global consumption when it comes to refined copper. Both primary copper and aluminium output from the country is negligible. Looking at other base metals, Italy is a small player on the global stage. However, looking regionally, the country is a fairly sizeable market within Europe. For instance, it's the continent's largest user of lead, consuming around 260kt annually. It's the fourth biggest consumer of refined zinc with an average of 230kt per year and the second-biggest copper consumer at 550kt per year.

Europe as a whole makes up around 10-15% of both global supply and demand when it comes to base metals, of which Germany holds the largest share. On the mine side, Southern Europe's percentage is rather negligible; only Spain produces a relatively high proportion of global zinc, lead and copper concentrate. Elsewhere in the region, Northern Europe, including Sweden and Ireland, has a slightly higher proportion of mine supply for these two metals.

## Iran, South Korea and Japan

Iran's metals' industry may be facing higher risks as a result of the spread of Covid-19. This is an additional risk on top of US sanctions against their major metals products from earlier this year. However, Iran's base metals portfolio is too small to upset the global metals supply chain.

For South Korea, both refined lead and zinc production account for around 7% of the global total, and about 2.5% of refined copper. So far, the centre of the Covid-19 outbreak appears to be in Daegu. South Korea's primary Onsan smelter is located in Ulsan, around 75km away. Japan only has a slightly larger share of refined copper and aluminium supply and demand, on average, 3.5% of the global total.

## Base metals' reaction

The spread of Covid-19 outside China continues to add more uncertainty to the metals market. If the number of cases continues to rise throughout Europe or the US, there is further downside risk to prices. Still, a large focus in the market remains on China's supply and demand as it represents half the global market. A key observation is a surge in metals inventory as a result of short-term supply growth outpacing the demand recovery, which has weighed on prices.

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A major development in the past couple of weeks has been that local logistics and transportation appear to be recovering. Beijing has come up with a number of measures to encourage businesses to return to normal, including putting temporary waivers on tolls on all highways across the country. This could offer some relief to smelters when it comes to resolving issues with sulphuric acid storage, as well as raw material and product shipments. This could help to avoid some shutdowns or the bringing forward of maintenance work.

We tend to believe that metals with higher smelting margins and low-cost smelters have an even higher incentive to keep utilisation rates high and they're less likely to make cutbacks unless there are unexpected difficulties. Zinc smelting margins remain high mainly as a result of high Treatment Charges amid the recent mining cycle. We would therefore expect refined supply growth to remain strong. We've written about zinc turning the tide amid the coronavirus outbreak [here](#). We remain bearish in the short term as far as the zinc market is concerned unless we see meaningful cutbacks or strong inventory drawdowns by end users.

In comparison, on the overall demand side, downstream consumers are more widely dispersed and many may not be able to ramp up efficiently. These include private firms, such as semi-fabricators of copper cables, zinc galvanisers and alloy makers, and they may find it difficult to restart or are only able to work at limited capacity.

Therefore, in the short term, the imbalance between supply and demand recovery points towards stock builds and that would be difficult for the market to digest.