

Copper: Upside risks dominate in the second quarter

Macro tailwinds, lingering risks to supply and a cyclical uplift that is driving demand could see upside risks to copper prices dominate over the second quarter



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A dip in US real yields combined with a softer US dollar fanned a broad-based rally in metals last week. After being stuck in consolidation mode since March, LME copper resumed its bull run last week and further spiked to US\$9,436/t this morning.

In reviewing the factors driving copper prices, we think upside risks to prices could dominate over 2Q21. The current inflationary environment and negative real rates are tailwinds to the commodities sector, and copper stands out thanks to its constructive fundamentals, especially the strong narrative of medium- to longer-term demand linked to energy transition. A further weakening in the greenback could well provide a further boost. From a fundamentals perspective, factors that have been fuelling the bullish optics still have room to run in the short term.

- Firstly, there hasn't been a meaningful improvement to mine supply yet, and the situation is still vulnerable to disruption. China's strong concentrated imports last month have

provided little relief, and the multi-year low spot treatment charges have continued to squeeze smelters' margins. Claims by some Chinese smelters to carry out maintenance work may further tighten the refined market and fuel the bullish sentiment. Some are expecting mine tightness to take a toll on refined copper supply. Yet, smelters' production from China still managed to grow by 15.7% (YoY) over the first quarter, according to Shanghai Metals Markets. April production growth could dip from March, factoring in estimated losses from maintenance work.

- Secondly, demand recovery from major economies outside of China riding the ongoing restocking cycles, and pent-up demand should remain a key theme throughout the year. The new wave of Covid-19 cases from some European countries should not derail the overall demand recovery path. The cyclical uplift in demand continues to support underlying consumption of copper from major end users. The restocking cycle started from roughly the end of 3Q20 by US manufacturers and wholesalers and has not yet come to an end. China's stimulus has been feeding through to the US economy with a lag, which continues to support real demand for the time being.

Macro tailwinds, combined with copper's constructive fundamentals and a 'green' narrative in medium- to longer-term demand, could see upside risks dominate for copper during 2Q21, suggesting the red metal could be on a parabolic run, testing previous highs. However, this strength may dampen as the current restocking cycle approaches an end and slowing credit growth in China weighs on investment demand, which may become more evident in the second half of this year.