

The metals market has yet to hit bottom

The short-term outlook for the metals market is only getting gloomier. The supply growth of some metals hasn't slowed as many expected, and the large inventory overhang is just a mirror of how bad demand looks. As Covid-19 continues to unfold globally, despite some positive signs from China, the market is set to become more volatile



China Jiangsu metal processing plant workshop

We are far from calling a bottom in the industrial metals market. And that's despite early indications that things in China may be starting to improve. It was only three weeks ago that the Covid-19 shockwave started to hit outside the country and we had little idea how quickly things would change.

[Sell-off pressure](#) across the metals board has continued, even shrugging off the [Federal Reserve's 'double bazooka'](#) last night.

Cutback expectations are misplaced

Lagging indicators from the latest data on Chinese production from January to February have pretty much proved the fact that there were no meaningful cutbacks during the two months when the country was mostly in lockdown mode, and there were significant logistical issues. Supply growth has been far outpacing demand which has led to inventory surging over the last couple of

weeks. Take aluminium, for example. The latest official data showed that production rose by 2.4% year-on-year in the first two months of 2020. Meanwhile, inventory has soared by over 168% year-to-date.

However, as the market senses more economic damage, there's increasing hope that yet more meaningful stimulus will kick in soon. Indeed, it was a busy week for central banks to kick off monetary easing, including the latest Fed move. We're also expecting that China, along with other countries, will announce more extensive fiscal stimulus. However, it's questionable how effective these measures can be to boost demand in an environment characterised by a short-term supply and demand mismatch. This may lead to more chronic problems in the market.

Expect yet more volatility

Some China-centred (demand) commodities tend to frontrun on stimulus hopes. For base metals, China's demand share is around 55% of the world total on average. The 'new infrastructure' investment plan has provided some hope to investors. Some people are comparing this plan to the 2008 Global Financial Crisis stimulus, which added some 4 trillion yuan to the country's construction infrastructure. Based on available detail from Chinese authorities, we don't think we'll see the same sort of post-GFC results. Our base case view is that additional demand from Beijing's 'new infrastructure' package would just offset the decline in other sectors such as the automotive industry and the decline in export demand.

A key question has been where the nation's metal-intensive real estate sector is heading? Before the Covid-19 outbreak, we expected some metals including copper and aluminium to benefit from the latter stages of the construction cycle. The outlook for this sector in the second half of the year has become increasingly uncertain, and it's not clear that the loss of demand in the first quarter will be made up later on.

It is still early to call a bottom but we expect the market to remain volatile. In the next couple of weeks or so, we would not be surprised if inventory building started to slow, which the market would take as a sign of demand recovery. In addition, China may come up with more detailed measures to stimulate the economy if the current COVID-19 containment continues to improve. However, the virus outside China may still be peaking. Base metals could be stuck in a tug-of-war between marginal improvement in China and the Covid-19 shockwaves from other countries.

Also adding to the volatility is the rising risk of supply disruption from major metals suppliers. Peru has just announced it will close the border, and the Philippines has closed its northern border. Other countries may do the same and we will be watching to see whether this could impact copper concentrate or nickel ore shipments.

We are getting a bit more concerned that the demand shock from outside China may unfold via both short term supply-chain disruption and medium-term demand destruction depending on how Covid-19 develops. The external demand shock will negatively feed back to China demand via China's exports.

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