Is copper heading to $4.5 /lb?

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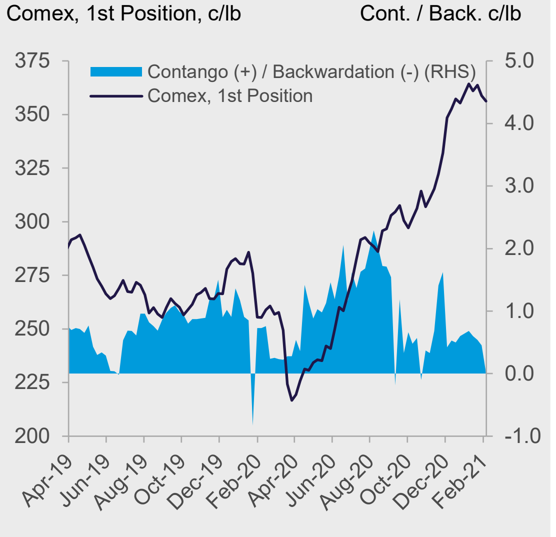
The copper price has risen to an eight-year high. Recent rises can be attributed to a range of factors, including: investor appetite for risk assets, vaccine developments, weakness in the US$, and continuing pledges of government fiscal support and central bank monetary accommodation. Copper specific factors have also supported this uplift, namely: low visible stocks, capital inflows into net long copper positions, and continued positive Chinese economic data.

Will copper go even higher?



Data: CME Weekly averages

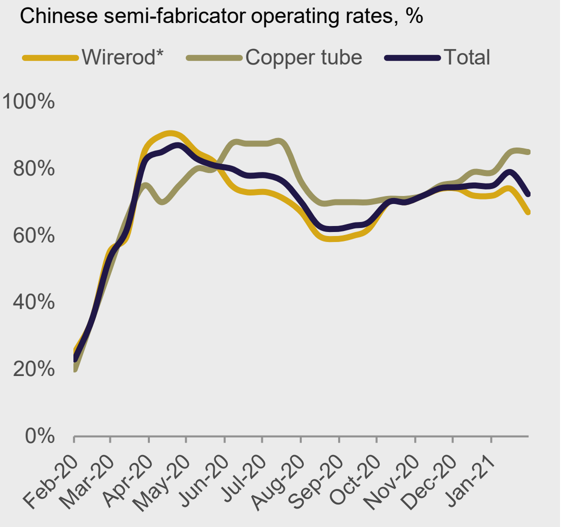
However, prices are still a long way short of the $4.5 /lb level some are calling for. If we are to see prices consistently at this level, then there will need to be a considerable and concerted push from a range of both macro and micro drivers. In short, multiple price drivers would be required in unison. The most likely candidates to enable $4.5 /lb copper are, US$ weakness, a continuation in China's credit cycle, large scale copper supply disruptions, and further large capital inflows into commodity markets.

These things happening together is a possibility, and as one fund commented to us copper is currently a very easy story to sell.

Copper demand recovery gathering momentum

Last year, Chinese demand accounted for a staggering 54% of global refined copper consumption. Copper's recovery is underpinned by Chinese demand, driven by government stimulus. Although we see fiscal and monetary policy support being tapered during 2021, there is still positive momentum feeding into copper using sectors.

Chinese demand remains possitive



Data: CRU

The large copper tube producers we have spoken with recently plan to run without stopping during the Chinese New Year holiday or will take only a few days off. Strong orderbooks are supporting operating rates and shipments. Operating rates at wirerod and wire and cable producers will follow a more normal seasonal pattern but will be up sharply on Q1 2020 levels. China will see another year of positive demand growth, with 2021 forecast to see refined copper demand grow by 3.5%.

Our recent calls with consumers and traders in Europe and the US were characterised by a sense of guarded optimism. A common theme was that 2020 production and sales were not as bad as many feared at the hight of the pandemic, in part due to a stronger than anticipated Q4 2020. When factoring the firm Q1 2020, full year sales at fabricators generally saw mid-single digit declines.

Globally there have also been some concerns about demand from the automotive sector, in the wake of the global semi-conductor shortages. This has not hit copper order volumes yet but could dampen the recovery.

Despite some risks, CRU is forecasting demand outside of China will increase by 7.1% this year. However, this is still a way behind 2019 levels. This improving demand and tight freight markets have not yet translated into significantly higher premiums. This could be construed as bearish, given the higher costs needed to move metal.

Mine supply recovers and could scrap spoil the party?

Miners recovered strongly during H2 2020, spurred on by the higher copper price. We now estimate mine production fell by only 0.7% to 20.53 Mt last year. The immediate threat of Covid-19-related supply disruptions has lessened. Yet, there are some short term concerns related to weather conditions in Chile, container freight availability, and some of the strategic steps last year, at the height of the pandemic, which may have caused some miners to stray from their mine plans. Chile and Peru have busy political calendars in 2021 and there are several labour contract negotiations to be settled this year. Our 2021 mine disruption rate remains above the long term average at 5.5%. However, even with this risk factored in, we forecast mine supply to grow by 2.9% to 21.12 Mt this year.

Scrap supply is being supported by higher copper prices. Chinese import volumes, while significantly improved in November and December, remain well below historic peaks. This said, we still encountered scrap traders who were currently unwilling to ship to China, due to the risks surrounding the new rules. Cathode markets in both Europe and North America would be significantly tighter were it not for the good availability of scrap. Scrap discounts in Europe and the US are at or close to multi-year highs and mills remain well covered, although direct melt scrap in Europe is not quite as widely available as it was in late Q4 2020. Scrap remains a variable to watch; significantly more supply and the refined market could disappoint.

Outlook: sustained $4.5 /lb copper is possible but unlikely

The last few weeks have seen some market jitters and then a recovery in prices. We forecast that the copper price will average around $3.70 /lb in Q1 2021, still a way short of the $4.5 /lb level some are calling for. Prices will be bolstered by the promise of continued macro-laden support. However, to trend much higher copper specific factors, such as serious supply side issues, lower scrap outflows, and further inflows of speculative capital, will be required.

Copper hitting $4.5 /lb is not impossible, at least temporarily, but we are going to need prolonged macro and micro support for it to stick there for any length of time.

If you would like more information about copper please email metals@cmegroup.com

Find out more about CRU's Copper analysis service here.

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