Base Metals Outlook

Demand still slow with less promising upside

Overview

Though metals drew little comfort from Chinese policy action, apart from aluminium and nickel other base metals resumed divergence. Aluminium and nickel are most exposed to harsh sanctions on Russia is more chance than cause. Fundamentally, LME stock inventories have decreased across the board with exception of nickel. Ironically the major metal prices have seeped too. Aluminium is gradually tightening up with producers going through stressful industry restructuring. Copper prices remain at 10 month low and are heading for bearish Q2, with less signs of improvement. Zinc and Lead are second and third worst performers among the base metals this year. Nickel on other hand has steady demand backed by rising cost has pushed prices up around 25% FYTD making the best buy metal this year.

Dr. Sayed J. Hussain
CEO, Sayed Metal

Aluminium

Aluminium continues to rise primarily due to inventory overhand and how the material is stored. With substantial demand and lowering inventory, the widely used metal has promising market support. With Rusal taking the LME to court and winning, the warehouse queues and logistics barriers ultimately has supported the aluminium price to appreciate about 6% this year.

LME queue model is debateable and will be under attack throughout the year. Aluminium is held in a traditional rent-deal model where metal is stocked as collateral for financing purpose. In a low interest scenario like now, it hardly matters whether it is queue model or a rent-deal model. However in long term from a premium point of view, queue model derails the future contracts, should the interest rates changes over the period of time.

With stocks depleting, the producers are apparently going through a difficult restructuring of the industry. Rusal has halted its 750kt/y troubled Taishet smelter project. This year analysts expect further deficit until the demand supply balances by 2016.

Copper

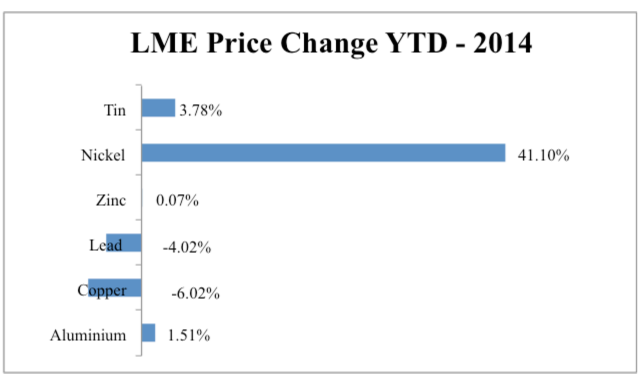
With fears over gloomy world economy, combined with concerns of China's first mainland corporate default saw its domino effect in march copper prices. There was heavy sell off which reduced the LME stock by 35% from year start. The metal price dropped significantly by 52% during the same time clearly exhibiting the bearish view of the world economy. Though the prices have stabilised after Chinese government's reassurance growth target and low interest rate announcement from EU and USA.

Investors are bearish about copper market keeping in view that on supply side there is surge in mine supply which will feed in the market through refined market and slowing China demand which accounts for 40% of world consumption. This surplus speculation has left large unreported stock in bonded warehouse in China which is expected to increase for several months ahead.

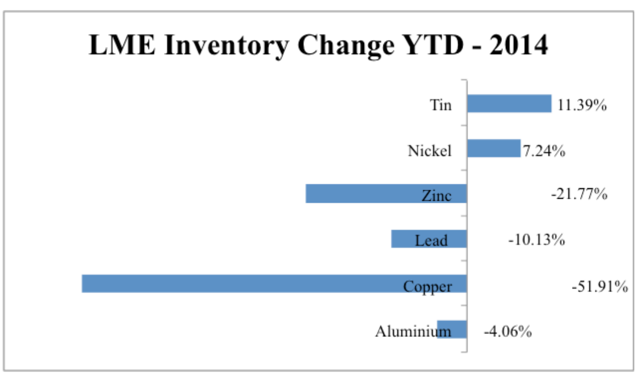
The only optimistic aspect of copper market is narrowing of arbitrage in SHFE-LME which began when prices dropped around 600USD in March. Premium in domestic Chinese market is now CNY350 compared to CNY300 two months ago. With high TC/RCs and copper trading below USD6000 level could trigger cracks in supply-side anecdote. Any mining disruptions could give easily give copper quick price rise in short term.

Though there is going to be a strong seasonal demand for the fact that the market is perceived generally as over supplied, the Q2 is going to be lacklustre with prices averaging USD6850. However inventories are now dropping to 2008 levels with Chinese demand once again the main culprit could bounce the fundamentals in Q3.

Lead & Zinc



* Source: LME



* Source: LME

Across the board, lead by far has the far tighter demand/supply fundamental which means prices in Q2 will be almost same as Q1. As projected the zinc's fundamental will start tightening from 2015, therefore the premium between lead and zinc will consistently narrow down. Lead prices are down around 4% from year start while zinc is almost same which is primarily due to its apathy to copper market price, though situation will improve by Q3 onwards. The lead smelters around the globe have reported a low demand from manufacturers citing sluggish demand and no shortage of the material. Though the prices of both the metals are expected to rebound in Q3 as physical interest would pick up and possible rally by next year.

Nickel

Thanks to the belated Indonesia's export ban this year, nickel prices are rallied about 41% since the beginning of the year. However much is contributed by speculative bulls in the market and not by inventory which increased by 7% this year so far. The interesting point however is if short position of at least 90,000 contracts is in any way related to physical market or not can be known by June.

The market has already priced in the potential future ban of nickel production in China and its domino effect adds to the interesting Q2 sharp price rise of the metal. Amazingly the trading volumes (LME Select daily) have risen by 50% which drives the rally story of tempting short covering and technical traders. The trading has been now at its historical peak which currently is at 4600 lots/day.

(USD/MT)	2013 (Actual)	2014 Q1 (Actual)	2014 Q2 (Forecast)	2014 Q3 (Forecast)
Aluminium	1,845	1,708	1,750	1,850
Copper	7,322	7,041	6,850	6,750
Lead	2,141	2,106	2,100	2,200
Zinc	1,909	2,029	2,050	2,100
Nickel	15,003	14,643	16,000	16,850
Tin	22,304	22,648	24,000	25,000

* Source: LME, Bloomberg, Reuters, Sayed Metal Commodity Risk Analysis