Base Metals Outlook

Who is afraid of lower oil?

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Overview

Base metals performance was dragged down by stronger US dollar and drop in oil prices. After its peak in 2014 on June 19, oil prices started to spiral downward which accelerated base metal downfall significantly. Base metals are dependent on oil primarily for two reasons. First, oil holds a major share in investing indices; therefore a pullback in oil positions compels the investor to reduce concurrently their base metal positions. Secondly, the base metal productions are energy intensive processes. Lower oil significantly reduced the treatment charge.

In addition to this, base metals are inversely related to the value of US dollar. A strong dollar suppresses the price for base metals as all international trade is done in US dollars. Yet, another variable in pricing equation is China's growth rate which grew at the slowest pace in years.

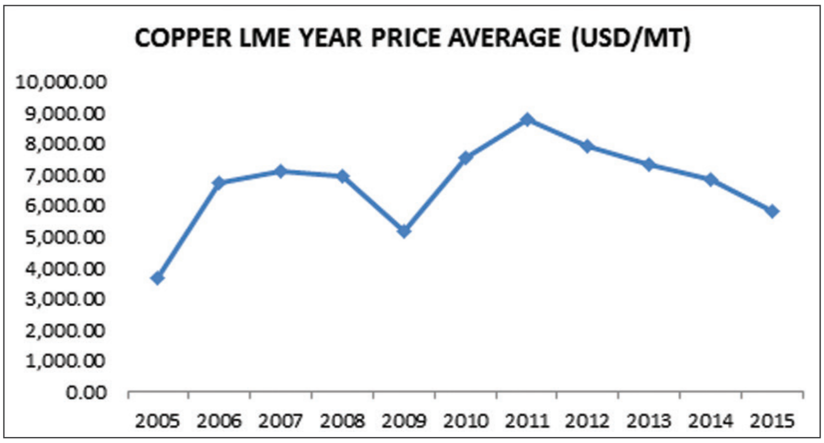
Global economies are projected to slow down for 2015. China which is a major importer of industrial metal is projected to slow by 0.5% this year. China's macro-economic scenario seems gloomy when H2 2014 data showed a significant growth decline.

This is good news as China is targeting at 7% growth for 2015 and will come up with various stimulus packages. The outlook for BRIC economies is forecasted to be positive thus providing solid base for industrial metals.

Though the numbers state copper and aluminium will be in oversupply in 2015, the market's speculation response is overdone. Accordingly we expect a correction in midterm and prices will improve from current levels.

Copper

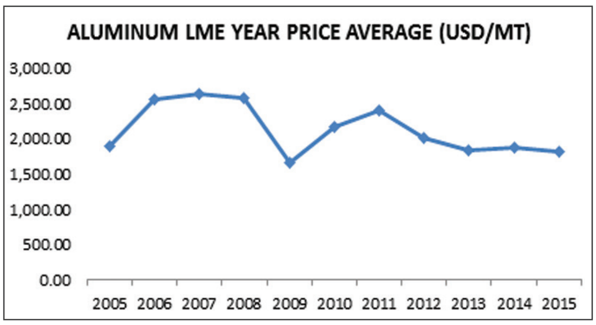
The year started with yet another 13% downfall in January. Copper lost a massive $700/MT at one point in 40 hours primarily due to negative data coming out from China. Intraday low reached the $530 level which is five and a half year historic low.



Chinese copper smelters are cutting demand for scrap according to industry news. The margin in refined production is significantly unlike in scrap where material cost is considerably high. All major copper ore suppliers including Codelco, Vedanta and Antofagasta have announced production cuts to reverse the 2015 estimated surplus of around 100,000MT. Ironically Chile will be producing more copper than last year and LME (by 50,000MT) and Shanghai inventories are huskily up in January. Imports in China will decline due to 14% YOY domestic production increase.

Aluminium

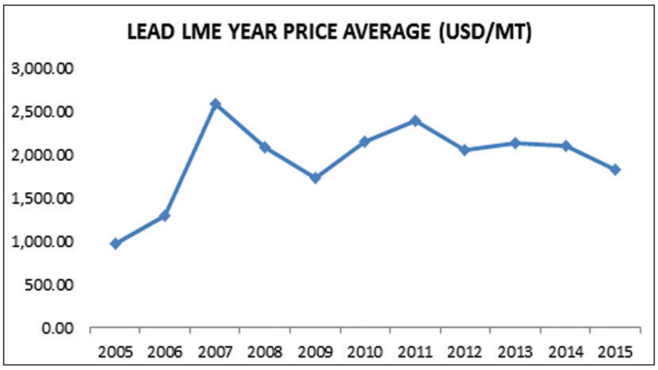
There was modest rise in Aluminium prices after its multiple-month lowest. Except South America, all major producing regions are not expected to reduce production thanks to firmer premiums due to solid demand from aviation and automotive industry.



The local demand in China is at record high due to exports v(40% increase in 2014 YOY) of finished products. As per polls the market is in deficit in 2015 and would widen even more by 2016.

Lead

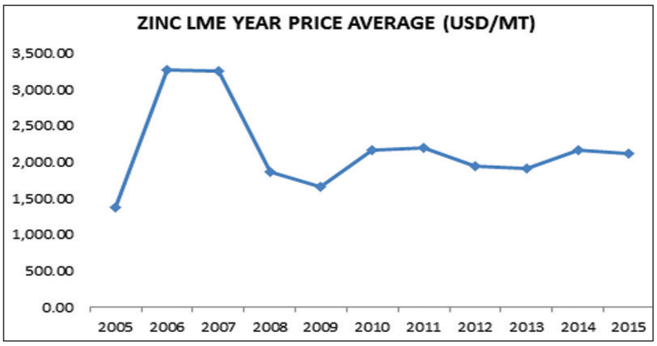
Lead was the worst performer across the LME group by dropping 16% in 2014 despite strong fundamentals. Once again the culprit is China and its weaker than expected E-bike, new car sales and replacement automotive battery. Several large smelters have cut down on their production, for instance, Henan Yuguag Lead and Gold (China's largest) by 30%.



Despite lead's stock-to-consumption ratio being the lowest (2.4) in LME group, the metal has been struggling for quite some time. Despite cut down from miners, the supply is ever increasing from secondary sector mainly due to efficiency factor and lower pollution cost of investment.

Zinc

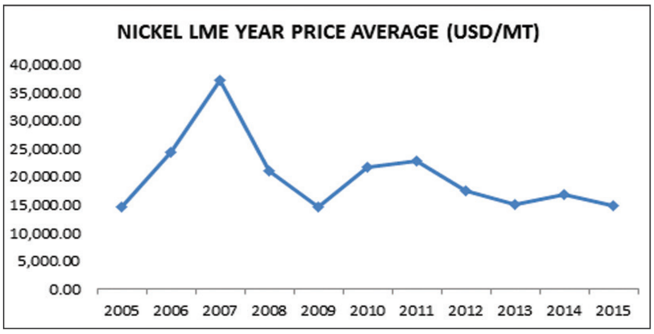
One of the best performers last year Zinc ended 6% higher in 2014 end. Several mines (including Century mine) have abruptly closed down raising speculation of deficit expectation. Fundamental however does not look rosy either due to property slump and slow automotive growth in China which explains 2.4% price decline in January.
Premiums in Asia are weaker which are now at two years low which are backed by flat LME inventories and rising prices among LME group.



Nickel

Despite a shining performance early last year, Nickel trembled in December by $2000/MT ending annual rise to 9% (from 80% in May) to acquire top position across the base metal group in 2014.

Nickel price is still sensitive to Indonesian export ban; however, it is offset by exports from Philippines (which now accounts for 76% of total imports) to China, although not as clean as Indonesian ore. Indonesian ore is still being exported using fake documentation, which is expected to be curbed by the government.



An increasing LME stock (at a record high of 425,000MT) exhibits there is not any supply constrain in the market. INSG also reports that market is in surplus of 8,900MT in October which should refrain market from speculative rise in price in midterm.

Base Metals Price Forecast

LME Cash (USD/MT)	2014 (Actual)	2014 Q4 (Actual)	2015 Q1 (Forecast)	2015 Q2 (Forecast)
Aluminium	**1,867**	**1,966**	**1,750**	**1,850**
Copper	**6,862**	**6,624**	**5,900**	**6,150**
Lead	**2,096**	**2,000**	**1,800**	**1,925**
Zinc	**2,164**	**2,235**	**2,100**	**2,200**
Nickel	**16,867**	**15,799**	**14,900**	**16,000**
Tin	**21,893**	**19,900**	**19,400**	**20,550**

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

- *Non-fundamentals weigh on prices*
- *Base metals prices softened on plummeting oil prices, stronger dollar and demand worries*
- *Prices to strengthen and demand to remain resilient during 2015*

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