China’s intervention in metals markets can’t derail the rally

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Commodity prices[1] are up 23% in the first half of this year. The surge in commodity prices is stoking concerns of higher inflation being passed onto the consumer in China, the world’s largest commodity consumer. This was evident after China’s producer price index, which is strongly correlated with commodities prices, surged 9% in May to the highest level since 2018. China’s recent efforts to dampen commodity speculation has cooled the metals rally to some degree, but reflecting on their attempt back in 2010, we expect it to be short-lived in light of the loose monetary policy worldwide and the large stimulus packages in the US.

Tough response from Chinese Regulators

In an effort to rein in commodity price increases, the State Council in China has vowed to pay closer attention to the unfavourable impact of high prices and deploy a two-pronged approach to stabilise markets by increasing supply and enhancing supervision. The National Development and Reform Commission (NDRC) has warned of “zero-tolerance” for excessive speculation, hoarding and monopolies in spot or futures markets. The NDRC’s statement is the toughest comment yet from the government which started raising alarm bells about higher raw material prices back in April. According to the National Food and Strategic Reserves Administration, 20,000 tons of copper (0.2% of China’s refined copper 2021 output), 30,000 tons of zinc and 50,000 tons of aluminium (0.1% of China’s 2021 output) will be sold in the first batch in the first week of July. The banking regulator has also asked lenders to wind down retail investment products linked to commodity futures. China’s State-Owned Enterprises (SOEs) were also ordered by the State-owned Assets Supervision and Administration Commission to reduce their exposure to overseas commodity markets, to reduce speculation in the market.

Figure 1: Chinese remains the world’s largest metals consumer

Source: International Copper Association (ICA), International Aluminium Institute (IAI), International Lead and Zinc Study Group (ILZSG), World Steel Association, Nickel Institute, WisdomTree as of 31 March 2021.

China’s anti-speculation measures can’t curb the metals rally

The last time the State Reserve Board (SRB) reported strategic stock releases was back in November 2010 amid broad-based metals rally similar to the current metals rally. The SRB sold 200kt of aluminium, 50kt of zinc and 35kt of lead to the market in a single month back then, with the average selling price 5%

lower than the prevalent spot price. However, the SRB was unable to reign in the metal's price rally. Further to that point, while China is trying to stabilise commodity prices of copper, aluminium and zinc, it will be challenging as the country will need to find a fine balance between maintaining stable economic growth while also reducing emissions and achieving carbon neutrality across major industries by 2060.

The recent sell-off across industrial metals is in part due to the Fed tapering coupled with Beijing's anti-speculation measures. However, expectations of stronger demand from the rest of the world fuelled by the loose monetary policy and large stimulus packages in the US remain supportive for industrial metals in the post-pandemic phase of the recovery. At the same time, the risk to supply remains high as mine supply from major mining countries remains susceptible due to COVID-19 and labour related strikes. China's climate goals in the form of efforts to reduce upstream carbon emission would also cap the growth of metal supply over the long term, leading to the risk of short-term supply disruptions.

Conclusion

While Beijing's price crackdown measures have so far slowed the rally in industrial metals, we believe the rally is far from over due to supportive fundamentals over the long term. For investors still convinced by the recovery of industrial metal prices, exposure to a basket of industrial metals such as aluminium, copper, nickel and zinc could be an interesting route to consider.

[1] As measured by the Bloomberg Commodity Index from 29 December 2020 to 30 June 2021

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