

Copper's fundamentals displaced by the Coronavirus

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Copper is often regarded as a bellwether of the broader global economy owing to its multiple industrial uses. Since the start of 2020 copper has lost 8.16%¹ as it grapples with slowing demand from the world's largest consumer and producer of commodities namely China. For the first time in 13 years, global financial markets are struggling with a virus-related exogenous shock COVID-19 that originated in China and is spreading to the rest of the world. The Chinese government has taken pro-active measures to loosen financial conditions and boost lending, reduce taxes, lower land prices and initiate industry bailouts. Looking ahead we expect more stimulus announcements from China and other countries to provide a stabilising source for sentiment.

Broad economy concerns weigh on short term copper demand

The uncertainty over the severity and duration of the coronavirus outbreak is dampening the outlook for copper. More than 50% of the Chinese population remains under lockdown which is likely to spark widespread disruptions to global supply chains and subsequent delayed demand. Net speculative positioning on copper futures went from net positive 60352 contracts to net negative -41,3621 contracts within a span of a month (from 21 January 2020 to 18 February 2020) underscoring the extent of the bearishness among investors. Inventories continue to build on the global copper markets as demand remains weak. Over the past month, there has been a 48% inventory build primarily due to the increase in stockpiles on the Shanghai Futures Exchange (SHFE), evident from the chart below.

Source: Bloomberg, WisdomTree as of 21 February 2020. LME: London Metal Exchange.

Historical performance is not an indication of future performance and any investments may go down in value.

Long term supply unlikely to keep pace with rising demand

Investors appear to be overemphasising on transitory weaker demand and have been paying little attention to the supply side situation in global copper markets. After rising for a year and a half since 2017, capital expenditure (capex) among the largest 41 global copper miners²³ has been on a downward trend, -35% year on year (yoy) as of 31 December 2019, illustrated in the chart below.

Source: Bloomberg, WisdomTree calculated as of 27 February 2020.

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The global copper market has been in a supply deficit for the past 5 years. While the International Copper Study Group (INSG) expects the global copper market to be in a supply surplus this year. We caution that INSG tends to overestimate production in the first release of their forecasts. We believe they are underestimating the impact of supply disruptions and overestimating the renewal of smelting capacities in China. The Chilean state copper commission (Cochilco) does not expect the Chilean copper production to recover from its decline in 2019 and expects it to remain largely stagnant at 5.8mn tons. Mining producers are battling with declining ore grades and a shortage of water in Chile, home to nearly 40% of the world's copper supply.

As the world transitions to renewable and cleaner forms of energy and transportation, copper's good conductivity trait makes it a popular metal in larger applications such as Electric Vehicle (EV) batteries, wiring and charging infrastructure. According to the International Copper Association, copper demand from EV charging equipment could rise to 100k by 2027, up from 20k in 2018. Alternative forms of energy such as wind and photovoltaic will also require more copper per Mega Watt (MW) of power generation as these forms of energy tend to be less efficient than centralised coal fired power plants.

In the long run, copper's use in infrastructure will be the cornerstone of the electrification and decarbonisation of the global energy system. While in short term, copper prices will remain under pressure from weak sentiment stemming from transitory delayed demand stemming from the spread of the coronavirus. We believe in the long run copper's fundamentals remain intact, which should support its recovery.

1 Bloomberg, from 31 December 2019 to 3 March 2020.

2 Data according to Commodity Futures Trading Commission (CFTC).

3 Global Copper Miners include : BHP Billiton Ltd, Rio Tinto Ltd, Newmont Mining Corp, Southern Copper Corp, Grupo Mexico SAB, Freeport -McMoran Inc, Anglo American Plc, Zhongjin Gold Corp-A, Vedanta Ltd, Turquoise Hill Resources Ltd, Sumitomo Metal Mining Co Ltd, Sociedad Minera Cerro Verde, Antofagasta Plc, Polymetal International Plc, Jiangxi Copper Co Ltd-H, Boliden AB, First Quantum Minerals Ltd, NMDC Ltd, KGHM Polska Miedz SA, Tongling Nonferrous Metals-A, Mitsubishi Materials Corp, Lundin Mining Corp, Western Mining Co-A, Yunnan Copper Co Ltd-A, South Copper Co Ltd-A, South Copper Corp Peru-INV1, Pengxin international Mini-A, Regis Resources Ltd, OZ Minerals Ltd, Hudbay Minerals Inc, Huludao Zinc Industry Co-A, Minsur SA-Inversiones, Mitsui Mining & Smelting Co, Anhui Truchum Advanced Mat-A, Kaz Minerals Plc, Philex Mining Corp, Hindustan Copper Ltd, Ivanhoe Mines Ltd-CI A, China metal Resources Utiliz, China Gold International RES, Sandfire Resources NL, Merdeka Copper Gold TBK PT.

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