Copper: Maintaining our view for record high prices in the current super-cycle

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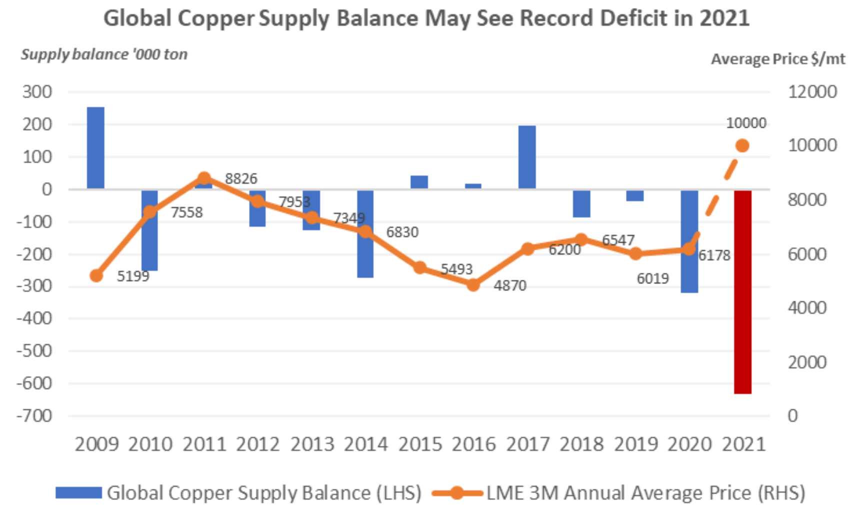
- **We maintain our view that copper could break new record highs in the current super-cycle.**
- **Exceptional end-demand from China, the global green wave and decade-low exchange stocks are prime for copper to break out.**
- **We see copper testing $10,500/mt in the next 12-months, while the 3-12m time spread on LME could test the 2011 high of $200/mt.**

Copper on track to surpass previous high.
In our previous commodity piece last month (This looks like the start of a commodity super cycle), we iterated that copper could top its previous record high of $10,500/mt set in 2010. Specifically, we wrote:

> *"**Copper our top pick**: We are most bullish on copper in this commodity cycle. Not only is copper a proxy for bullish Chinese industrial activity, the demand for EV adoption and electrical grid upgrade infrastructure would be major supportive factors for the base metal. We expect copper to eventually break above its record high and test $10,500/mt in the current super-cycle, which may happen either this year or next."*

The recent price rally of copper to almost $9000/mt on LME (from about $8000/mt when we published the super-cycle idea) reinforces our view that the market is in sharper deficit than previously estimated. **We estimate that the market could be see a supply shortage of some 630k mt in 2021** – more than twice the deficit of 250k in 2010 which eventually drove copper prices past $10,000/mt briefly in Feb'11.

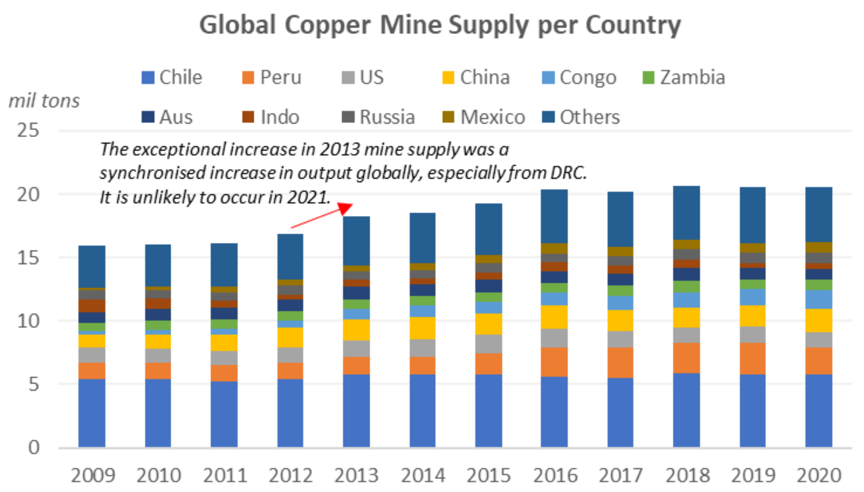


Source: Bloomberg, ICSG, various, OCBC estimates

We see current estimates of supply as overly-optimistic and failing to factor in the multiple headwinds facing South American producers.

Despite the run up in prices, we do not see a material increase in mine supply in 2021 due to the ongoing Covid disruptions. Miners may have generally refrained from issuing downgrades in their 2021 forward guidance thus far, but there has been a conspicuous lack of a commitment towards CAPEX plans. The lack of new growth projects could accelerate the arrival of peak copper supply. Higher prices are needed to incentivize such projects and to attract funds into an investment space that is typically capital-intensive in its initial stages.

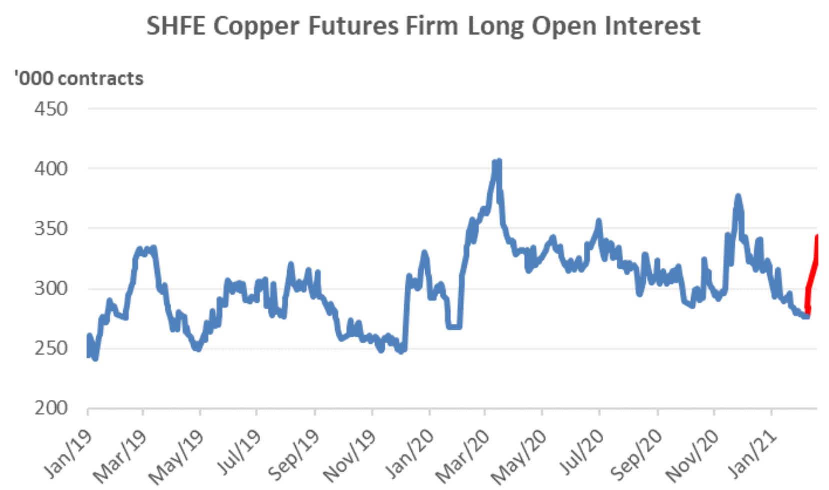
We expect copper mine supply to increase 2% yoy to 21.0 mt this year, which is the average long-run growth rate that we have observed during steady state periods for the commodity. The 8.3% spurt in mined copper supply in 2013 was a result of a synchronise production recovery across major producers simultaneously, especially the DRC which doubled almost its mined output on the year. Going into the end of 2020, we observed the likes of Peru and Chile – accounting for a combined 40% of copper output – still producing below levels monthly on a yoy basis. With the vaccine still in short supply and the WHO warning low GDP-per-capita countries may be left behind in the race to obtain the vaccine, it appears that the two Latin American countries will continue to face difficulties in labour and logistical operations. Copper cathode exports from Chile, for instance, fell sharply in Jan'21, hinting at the ongoing challenges in the upstream copper supply chain.



Source: Bloomberg, various, OCBC estimates

China returns post-LNY to register strong open interest on copper.

There is strong evidence to suggest China's onshore market has continued to tighten and buying interest remains keen. Last Friday we saw open interest for copper spike 20k to 344k contracts on the first day of the LNY reopening, which we believed undoubtedly contributed to the significant gap-up on Chinese copper futures since then from 60,000 RMB/mt to over 69,000 RMB/mt at time of writing. The operating rates for many copper refineries trended at/close to record highs in Jan'21, and there has been reports that many Chinese copper smelters were working through the LNY period. Further upstream, the TC/RC charges of copper have continued to trend lower and is now close to its decade-low, suggesting that the ore and concentrate market remains very tight.



Source: Bloomberg, SHFE, OCBC

Source: Bloomberg, SMM, OCBC

China output of end-user demand remains robust.

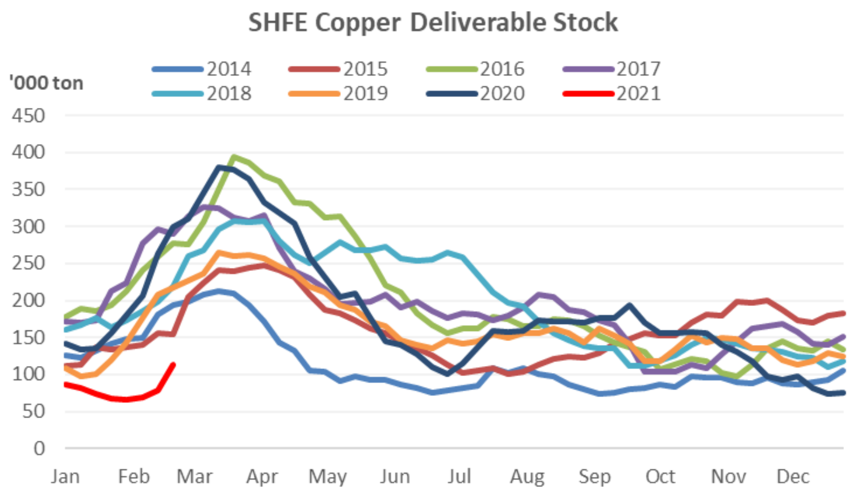
We view the entire shift to clean energy sustainability as highly supportive for the copper market due to the increased demand for electrical grid infrastructure and wiring. China is expected to drive this demand in the coming years, with its investment in electrical grids looking somewhat lacklustre last year, presumably due to the pandemic. The noticeably huge demand in copper ore/concentrates onshore, notably in the form of high copper ore and refined product imports, ought to translate into investments in electrical grid at some stage and the relatively subdued levels last year suggests the pouring of funds into this space could come this year. EV production in China has also surged in 2020, with production rising 66.1% yoy, and we expect this growth to continue as highlighted in China's quest to embark on a domestic green movement in the latest 5-year plan.

Source: Bloomberg, China Automotive Information Net, OCBC

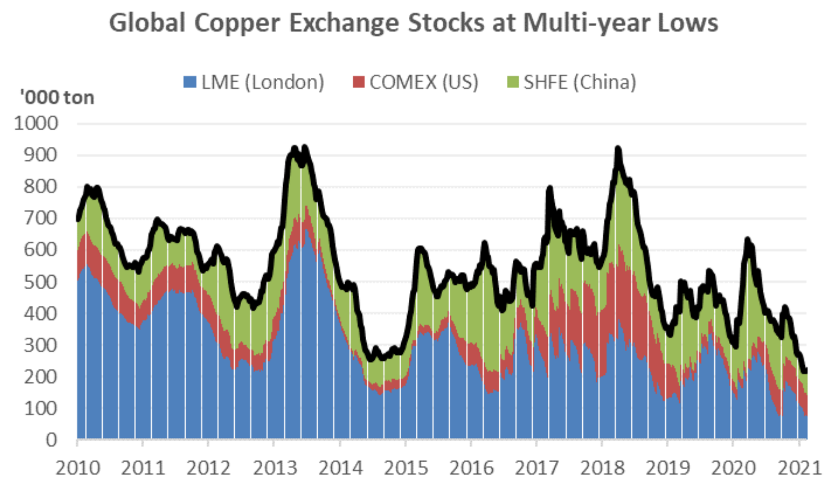
Separately, we also note that the industrial output of freezers and refrigerators have also posted one of their best yoy growth in the past decade, rising 23.1% yoy to a combined 131 million units. Cumulative sales of air-conditioners this year are also trending at its record high, which is noteworthy given China has had to endure a cold snap in early January.

Global copper exchange stocks at dangerously low levels.

Copper stocks across the three major exchanges – LME, COMEX and SHFE – are now at their lowest in at least ten years. In mid-Feb the combined stock declined to as low as 215k tons – falling below the ten-year low of 253k tons in mid-2015. In particular, the seasonal stock-building of stocks in China has been well below what was observed in prior years. At 113k tons, this represents the lowest level in the past ten years and well below the previous low of 155k tons seen in 2015 at a similar stage.



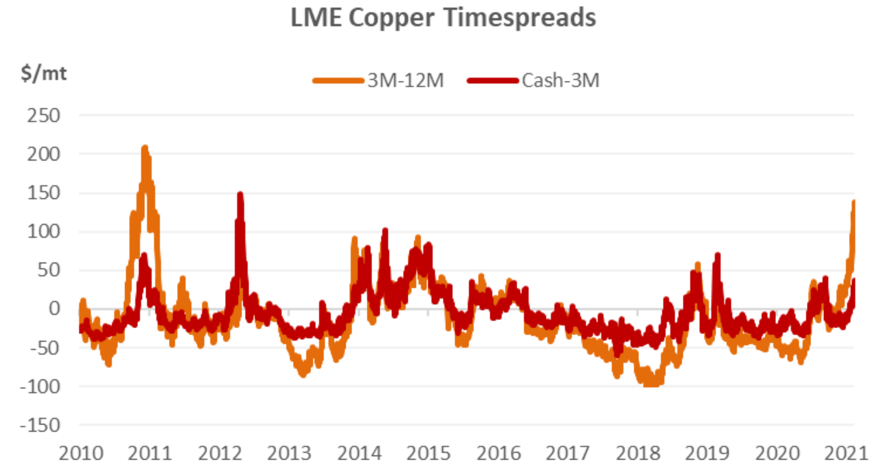
Source: Bloomberg, SHFE, OCBC



Source: Bloomberg, LME, COMEX, SHFE, OCBC

Trade recommendation: Stay long copper, copper time-spread.

We expect copper to set a new high in the current super-cycle of $10,500/mt in the next twelve months on the back of an expected record deficit in the refined market. We see the 3-12m time spread on LME testing the 2011 high of $200/mt from the current $138. The cash-3m time spread could potentially rise above $100/mt by Q4 2021 from the current $37.25/mt.



Source: Bloomberg, LME, OCBC

Conclusion: the rally in copper is only beginning.

we maintain our view that copper prices could embark on a multi-month rally and touch new highs in this super-cycle. Exceptional end-demand trends from China, the global green wave and decade-low stocks among major exchanges create a prime environment for copper to break out higher. We estimate that the refined market could see a record deficit of 600k tons in 2021, more than double that in 2010. While we had originally expect copper to touch a new high of $10,500/mt by Q4 2022 (as telegraphed in our monthly price forecasts), the recent surge in prices have led us to bring forward that forecasts by 6 months to Q1 2022. We recommend staying long the base metals complex, with copper our top pick for now.

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