OCBC TREASURY RESEARCH

Copper & ferrous metals

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The metals rally is only just beginning

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- **Strong demand from China, both from construction and ex-construction usage, is expected to continue driving copper and iron ore prices higher.**
- **We see copper and iron ore testing $12,000/mt and $250/mt in the next 12-18 months.**

Copper remains our top pick in the current super-cycle.

Copper and iron ore have both set new record highs in the past week, but we think there is still further upside to their prices. Supply tightness aside, the run-up in metal prices has and is still being driven by robust demand both from China and the global green revolution.

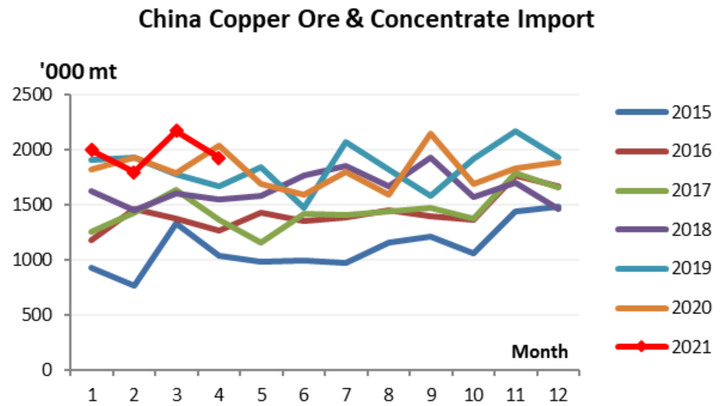
While we expect both copper and iron ore prices to continue rallying in the short to medium term, we expect the gains in copper to outpace that of iron ore. In addition to China's relentless demand for infrastructure raw materials, copper has the added tailwind of the ongoing Green Revolution, particularly in the global push for electrification.

We see copper eventually testing a high of $12,000/mt and iron ore at $250/mt within the next 12-18 months.

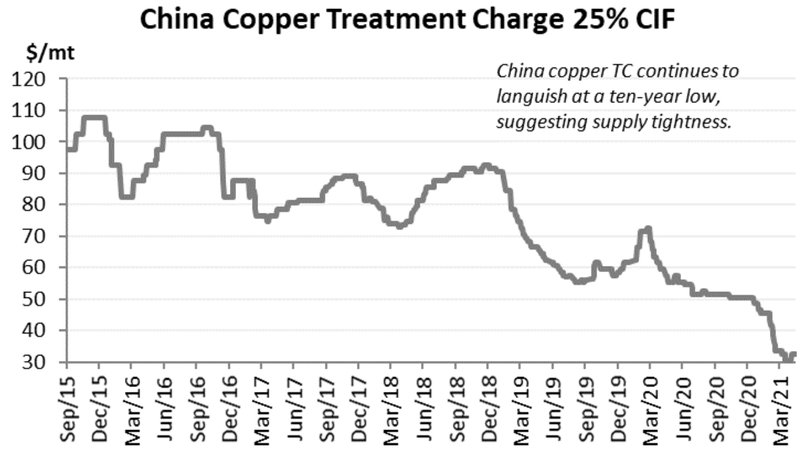
Despite high imports, copper TC remains at a ten-year low.

Among the key commodity imports into China last month – crude oil, iron ore and copper – copper continues to stand out. Copper ore and concentrate import totalled 1.92mil tons in April – a drop from March's record import of 2.17mil tons, but still languishing near seasonal highs. Despite the continued high volume of copper concentrate imports, the treatment charge (TC) in China remains heavily suppressed at $32.50/mt for 25% copper concentrate CIF, suggesting that supply even at current levels is insufficient.

Despite copper concentrates languishing at all time highs…



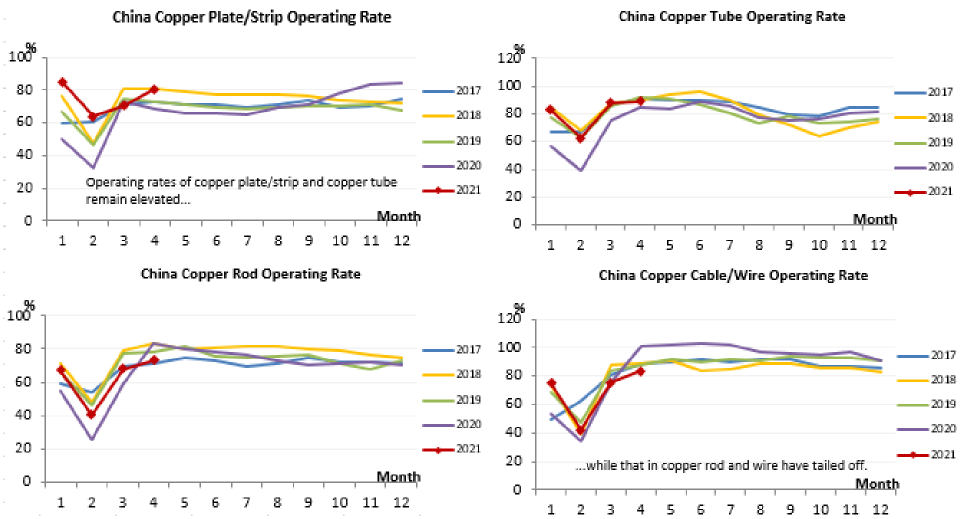
…copper TC in China remains at a ten year low, suggesting supply tightness.



Source: Bloomberg, China Customs General Administration, OCBC

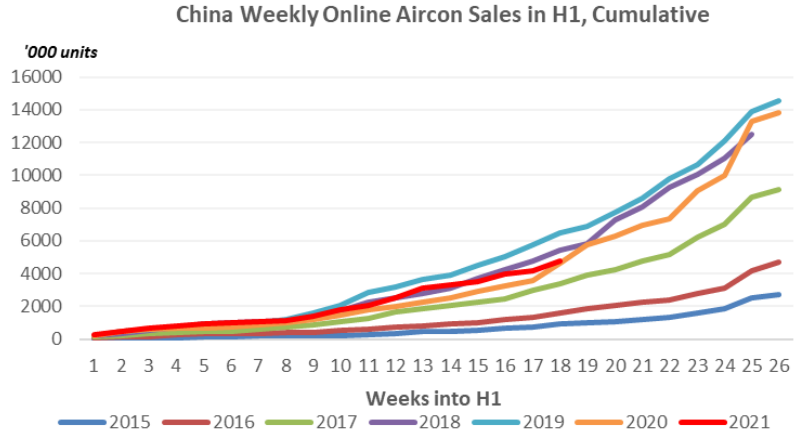
Chinese copper consumption finds strength in ex-construction usage.

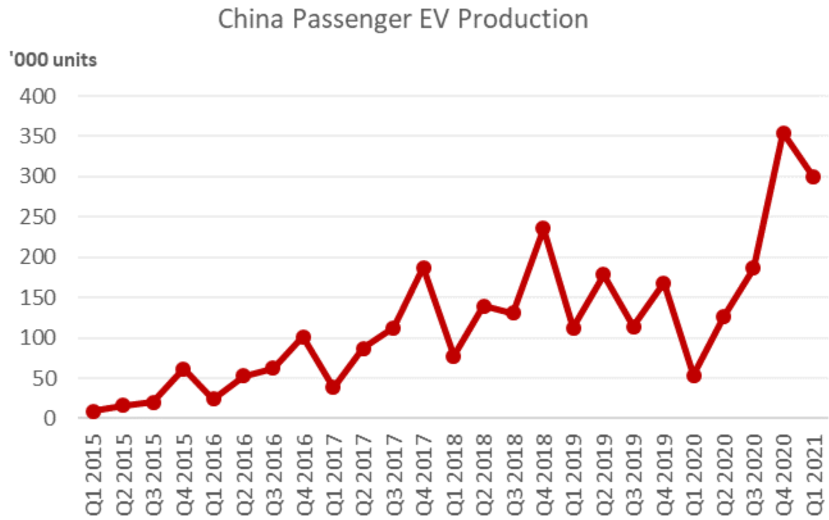
Interestingly, copper consumption in China has been increasingly diverse, with consumption strength increasingly found outside of ex-construction usage. The operating rate of China's copper tube and copper plate producers are trending close to their seasonal highs. These products are typically associated with the production of appliances such as such as air-condition units and refrigerators (copper tube) and electrical/ industrial machinery applications (copper plate/strip).

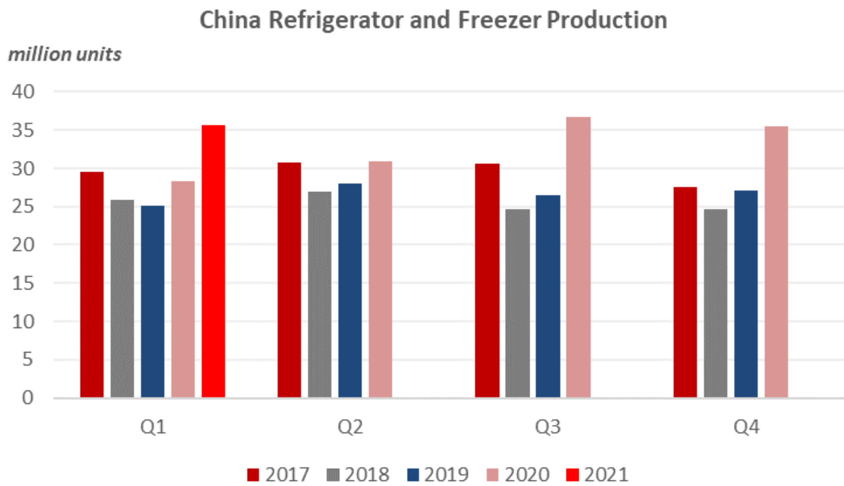


Source: Bloomberg, SMM Information & Technology, OCBC

A look at China's end-user demand affirms this theory. Production of EVs, air-conditions, refrigerators and freezers have continued to soar in Q1 2021. Investment into electrical grid infrastructure, although the highest in three years, is still nowhere near the peak seen in 2016-17, suggesting space for further upside.







Source: Bloomberg, China National Bureau of Statistics, China Market Monitor, OCBC

Copper supply to remain tight on Latin America disruption.

Copper supply tightness from Latin America is also expected to persist amid the resurgence of Covid-19 in Chile and Peru. Combined production from these two countries – which account for 40% of total global supply – continue to languish below pre-pandemic levels with little sight of recovery.

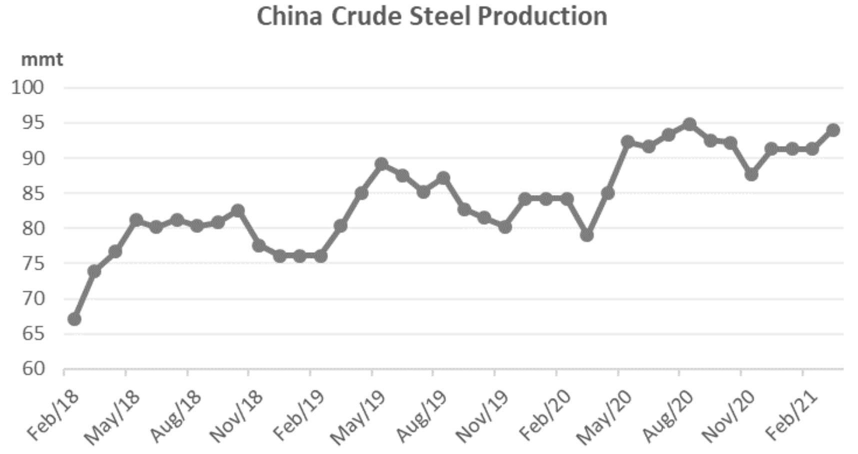
Source: Bloomberg, OCBC

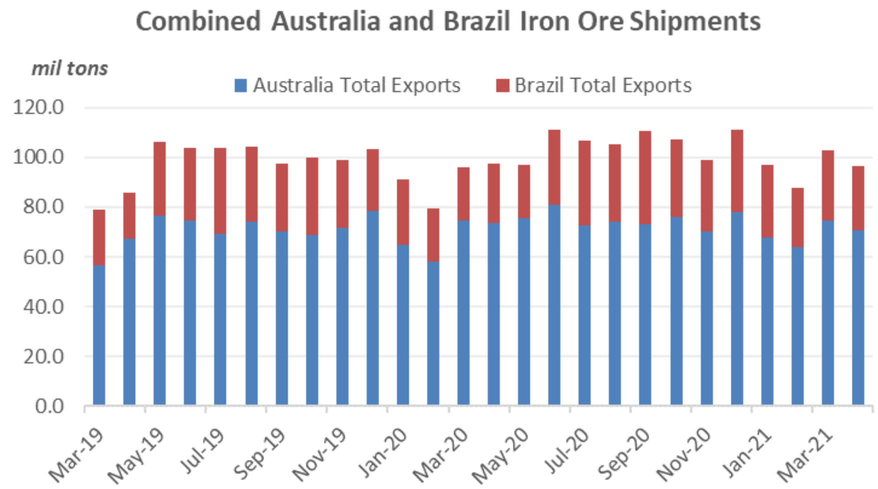
We see copper testing $12,000/mt in the next 12-18 months.

We note that unlike other commodities – notably in the agriculture space – the main driver of copper's upturn is a result of strong demand from China and the global green revolution. As a result, it is our opinion that even if supply begins to regulate towards normalcy beginning 2022, the marginal production is likely to be easily absorbed by an imbalanced market. We therefore see much scope for copper to continue rising, possibly to as high as $12,000/mt in the next 12-18 months.

Iron ore: riding higher on China's new infrastructure plans
Similar trends are observed in the iron ore market, albeit to a lesser extent. Total imports of iron ore into China have trended below 100mmt in five of the past six months, largely as a result of the coronavirus outbreak in Brazil. 98.6mil tons of imports in April, however, is still a respectable number albeit on a lesser scale than that seen in copper.

Despite the softer import numbers, crude steel production has remained strong. March saw a near-record 94.0mmt of crude steel production, suggesting the soft imports – like copper – are a result of supply disruptions from Latin America more than a dip in demand.

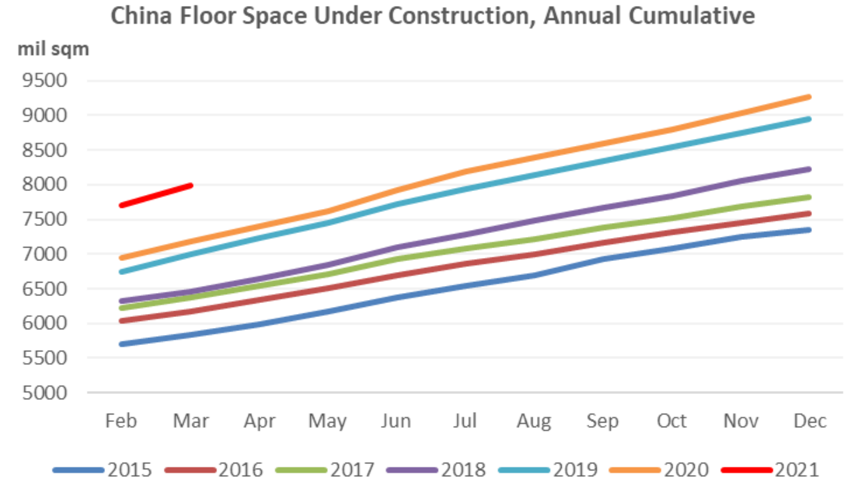




Source: Bloomberg, China National Bureau of Statistics, China Customs General Administration, various, OCBC

Iron ore demand in construction remains robust.

We note that the demand for steel – and consequentially, iron ore – have continued to centre around infrastructure projects, despite the persistent decline in long-flat steel price spread. Property investment, building sales and floor space under construction all continue to post strong growth rates in Q1 2021. Automobile sales, meanwhile, are close to pre-pandemic levels in China.



Source: National Bureau of Statistics, OCBC

China's partnering with the private sector for new infrastructure programs lessens risks of credit pullback.

China's "new infrastructure" projects have been estimated to total 10 to 20 trillion RMB from 2021 to 2025, which means the demand for raw materials now is only just beginning. Construction projects fall into all of the three broad aspects of China's "new infrastructure" plan, including Innovative Infrastructure (industrial parks), Information Infrastructure (data centers) and Integrated Infrastructure (rail systems, EV charging, UHV power transmission).

Unlike the usual playbook last seen in 2008 where infrastructure projects are predominantly led by SOEs, the 2020 infrastructure plan relies on a fair degree of state-private partnerships. SOEs will continue to play a key role in the construction of bridges and railways, but digital infrastructure such as 5G base stations and EV charging points look to be largely led by private tech firms. We see the risk of an abrupt deleveraging from the Chinese government – spurred by local Chinese municipals and SOEs landing in excessive debt – as more reduced in the 2020 plan compared to the 2008 episode.

Copper benefits more from China's infrastructure plans than iron ore.

Since China's new infrastructure plan heavily focuses on the further digitalisation and electrification of the economy, the demand for copper is expected to be more relevant than steel, especially in the later stages. In that regard, while we expect both copper and iron ore to continue rallying in the next 12-18 months, we expect copper to outperform other base and ferrous metals.

Hence, while we expect another 20% upside for copper, the upside for iron ore is more limited at a further 10%.

Conclusion: the metal rally is only just beginning

The recent record highs in metal prices are probably just the beginning. While supply constraints have played their role, there has been genuine demand for both copper and iron ore, propelled by China and the ongoing Green Revolution. We see copper topping $12,000/mt and iron ore at $250/mt within the next 12-18 months.

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