Where the Markets are Headed:
The 2018 Global Base Metals Outlook

Thomson Reuters GFMS analysts capture the essentials of the global trade outlook for copper, nickel and zinc. Using our proprietary data, insights and access to a network of on-the-ground resources, the GFMS team provides the most authoritative analysis on market trends, price forecasts and supply/demand in the global metals markets.

Read our outlook for base metals trade in 2018.


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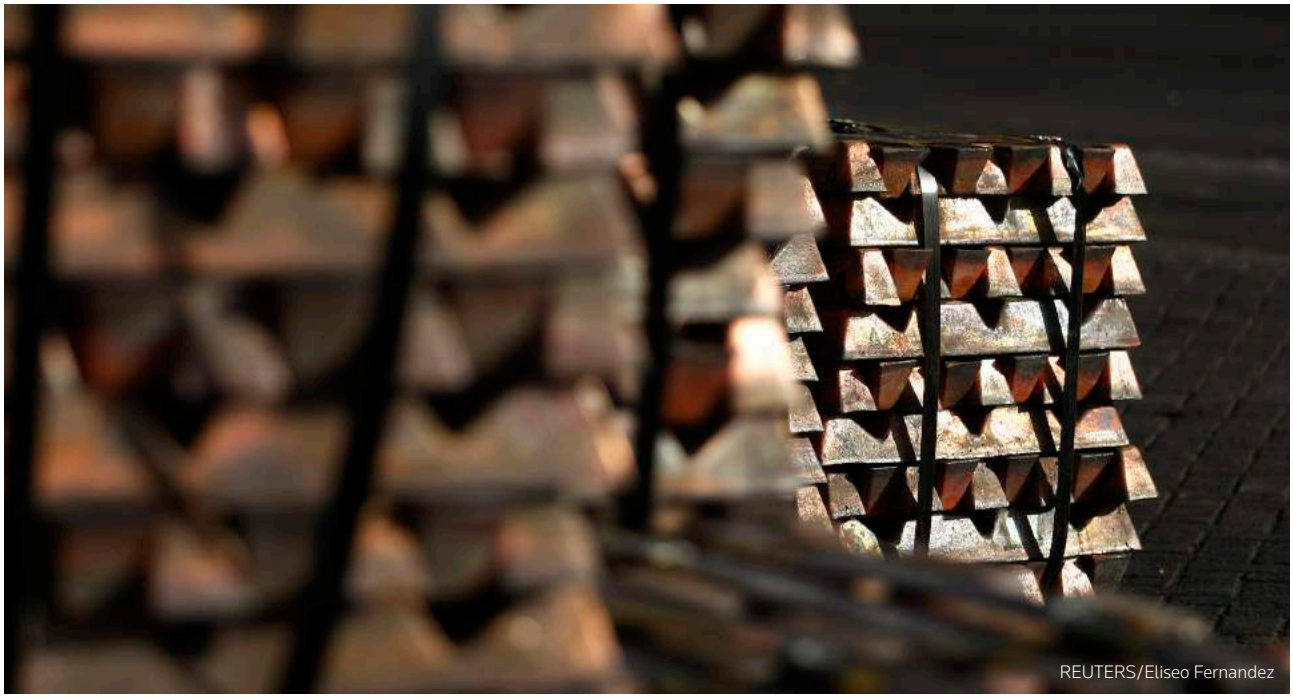
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COPPER

Tide turns despite 2018 surplus

Despite the major supply disruptions that plagued copper in the early months of 2017 and underpinned widespread talk of deficits, we estimate that the market was more or less in balance last year. The surplus is expected to widen again in 2018, albeit still to a relatively modest one, before showing signs of contracting on a sustainable basis as the end of the decade approaches. Despite the surplus, in terms of sentiment the tide appears to have turned, although we are mindful that conditions may well be volatile at times.

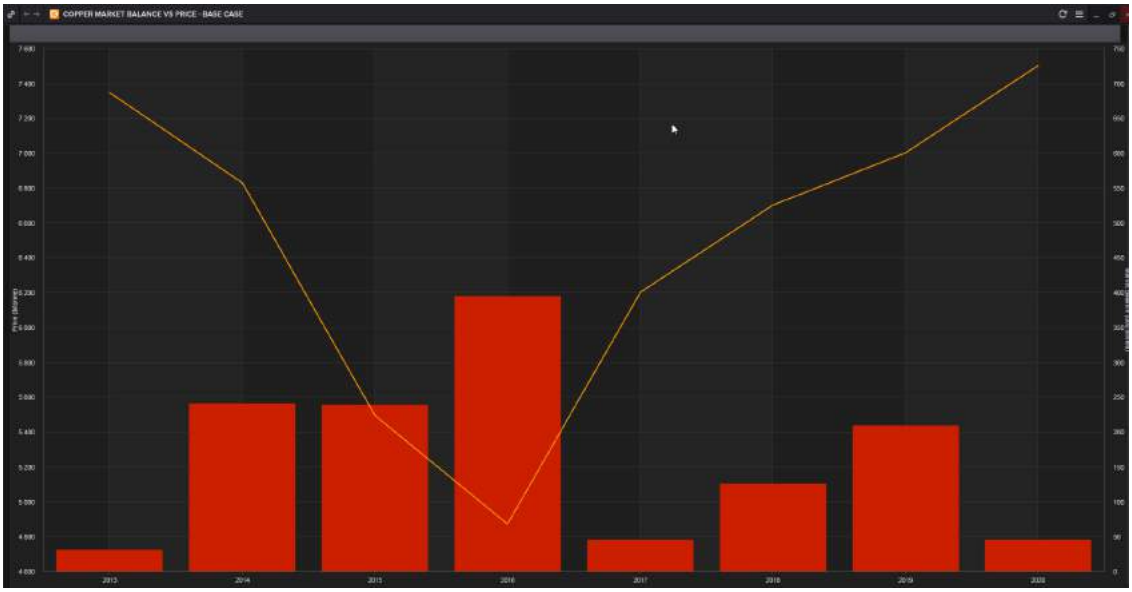
Supply concerns in the form of Chinese scrap import restrictions, potential labor disputes at some of the world's biggest mines and a looming shortage further ahead of new mine capacity are seen supporting a continued general uptrend in prices ahead of a sustained period of market deficit. Meanwhile, consumption growth is expected to chart a steady course, with the greater risk to this view likely to the upside on faster-than-expected widespread adoption of electric vehicles.

That resurgent bullishness resulted in copper making further gains in the final quarter of last year, with LME three-months reaching a near four-year high of $7,313/tonne in late December and rising by 7% and 30% on a sequential and year-on-year basis, respectively, during the period. **On an annual basis, copper averaged $6,200/tonne in 2017 for a 27% gain on the previous year,** with U.S. dollar weakness a significant influence, ably assisted also by robust Chinese economic data and the timing of an expected property market slowdown pushed out to later in 2018.

Despite their general ebb and flow, the timing of the general downtrend in LME stocks during the same period was also helpful. However, inventories in Comex warehouses more than doubled in 2017 such that total exchange stocks actually increased slightly over the period.

Market uncertainties

Looking to this year, the uncertainty over scrap imports amid stricter impurity thresholds will remain a supportive factor at least into early 2018 as it takes a while for the dust to settle. While the complete ban on category 7 material starts in 2019, other measures such as more rigorous inspections and new regulations for importers are seen as having an impact sooner, with higher demand instead for concentrates and cathode imports.



Annual Copper Market Balance vs. Price from 2013 to 2020

We are in the middle of the Q4 reporting season, but provisional estimates indicate that global copper mine production may have dipped slightly in 2017. But this year looks set to be a stronger one. Admittedly, the plethora of labor contract expiries, including most notably at the Escondida mine in Chile, which was hit by a 44-day strike early last year, will keep the market nervous. Indications of a repeat, though not our assumption, may cause prices to spike higher than we would otherwise anticipate.

Demand growth reasonable

In terms of Chinese copper demand, power, which accounts for around half of the country's total usage, will provide the main impetus under the current 13th Five-Year Plan (2016-2020). Greater intensity of use in electricity infrastructure investment will be the key driver, even as overall investment growth in the sector slows.

As 2018 progresses, China's property sector is expected to slow further and peg back overall copper demand growth this year. The growth in total property sales by floor space, which serves as an indicator of future demand prospects, slowed to 7.7% last year from 22.5% in 2016. Late last year, at least two Chinese tier 2 cities announced they would remove restrictions on property purchasing in the face of falling sales, but as it stands, mortgage policies are not seen supporting another upturn in the sector.

In other sectors, we note that investment in railway construction looks set to fall by 8.6% year-on-year in 2018. Overall, we are looking for a slight drop in the pace of Chinese demand growth this year.

Solid but unspectacular

However, any slack from China will be taken up elsewhere. While U.S. demand disappointed last year, expectations are stronger for this year amid a largely solid growth story.

Elsewhere, we envisage a generally positive, albeit still unspectacular, contribution from other mature economies, while an expected bottoming out in emerging nations such as Brazil and Russia will also have a more positive influence on demand from this year. Even so, the potential for gains in Russia will be limited by the earlier removal of the export tax on cathodes.

Meanwhile, growth rates in India are expected to pick up again, fuelled by the "Make in India" campaign and plans for new smart cities. To help satisfy the increased demand, companies such as Hindalco, Sterlite and Adani Enterprises have plans to install substantial new downstream capacity in coming years.

Surplus to widen in 2018

While we predict a wider surplus this year and next, they will still be relatively modest and not enough to dampen spirits, particularly as deficit markets loom from around the turn of the decade. Against this backdrop, we now expect prices to rise by a further 8.1% this year to average $6,700/tonne, and reach $7,500/tonne by 2020.


REUTERS/Yusuf Ahmad

NICKEL

Deficit points to fairly modest price rise in 2018, but risks are to the upside

The nickel market looks set to record another sizable deficit this year, but not sufficient from a fundamental viewpoint to herald a substantial increase in prices during the period. Nevertheless, we remain mindful of the long-term battery narrative and the growing chorus of market watchers of more bullish bent.

In the final months of last year, nickel prices began to strike out more on their own from the rest of the LME complex, benefiting from expectations of surging demand from the battery sector as part of the electric vehicle (EV) evolution. **As a result, they averaged $10,414/tonne for the year as a whole, up 8.4% from the previous year.** On a quarterly basis, prices reached an average of $11,665/tonne, while on a spot price in early January 2018, they rose to $13,200/tonne, their highest since mid-2015.

Nevertheless, bullishness has been tempered for now by a realization that this is a longer-term story, more likely for beyond the turn of the decade, and also probably with several twists and turns yet to play out. Prospects are dependent on a number of factors, including the speed and extent of the uptake of EVs in the major economies, the support given to EV producers by various governments and the winning battery technology.

At the moment, while nickel looks to be very well positioned, this is certainly a moving feast. The surge in cobalt prices and concerns over a stable supply source have led to a preference for higher nickel content in lithium-ion batteries (a ratio of 8:1:1 of nickel, cobalt and manganese versus 6:2:2), at the expense of the former. It is also worth noting, though, that some battery makers are looking at batteries containing neither nickel nor cobalt.

With briquettes one of the preferred sources from which to produce the nickel sulphate used in batteries, the high levels of this material currently stored in LME warehouses (close to 80% of the total) will be closely watched for significant drawdown.

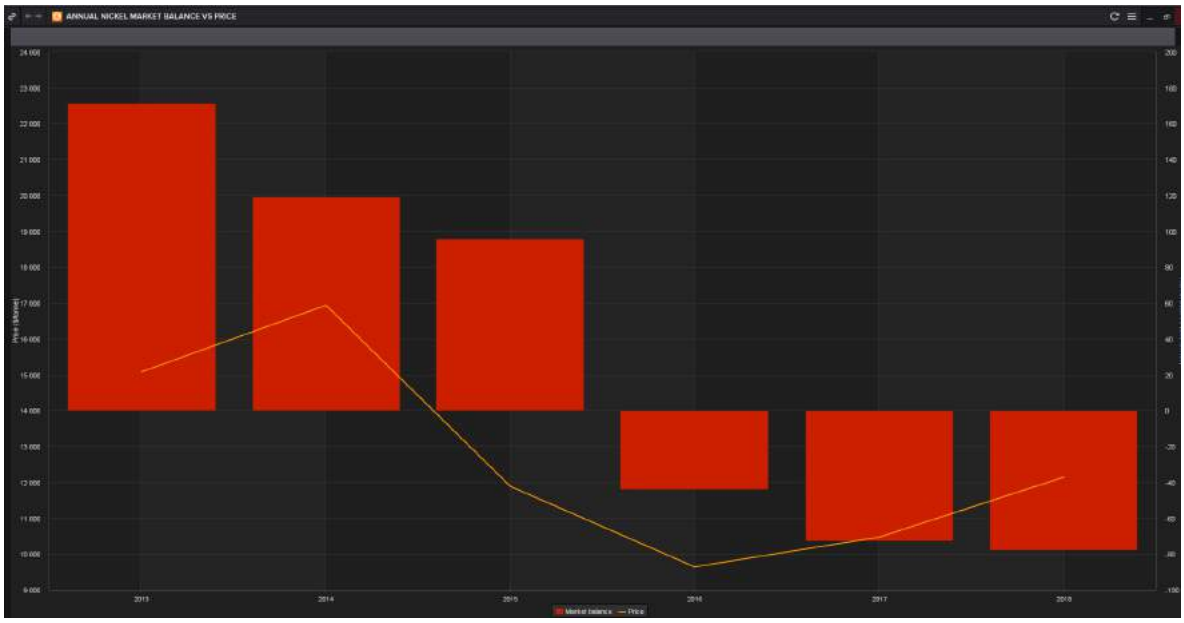
Supply to come back to the fore

As the battery story takes a back seat for now, more immediate supply issues are likely to start to feature more significantly again this year. Vale announced last December that its 2018 production would be 15% below previous guidance of 308,000 tonnes, citing as part of this care and maintenance at its Stobie and Birchtree mines. While we believe these figures overstate somewhat the impact on the bottom line for output, it will add to persistent uncertainties over how much the Philippines and Indonesia will produce and export, and, in the latter's case, over what form those exports are likely to take.

Interestingly, following the resumption in ore exports from Indonesia, the country's mine output actually slightly exceeded Philippines production in the first 11 months of last year, according to International Nickel Study Group (INSG) data.

Meanwhile, based on our latest assessment, we estimate global refined nickel output rose by almost 4% last year and that growth will only fall slightly short of that pace this year, even allowing for recent problems at sizable operations such as Ambatovy in Madagascar.

Chinese nickel pig iron (NPI) output actually grew in 2017 by close to 10% with, as we believed, the impact of environmental-related cuts substantially exaggerated. For now, the rapid growth of Indonesia's NPI industry (driven largely by Chinese firms) has not as yet come at the expense of China's NPI sector. Nor do we see this happening in 2018. Having almost doubled in 2017, total Indonesian production (including PT Antam) is seen growing by almost one-third again this year to around 270,000 tonnes as the country's stainless steel sector continues to establish itself.



Annual Nickel Market Balance vs. Price from 2013 to 2018

Indonesia's growing influence

We estimate that global nickel demand enjoyed another year of strong growth last year, despite the somewhat erratic performance of key consumer China's stainless steel industry, which was affected by periods of destocking and caution among traders. Some quarters estimate that Chinese stainless output rose by around 5% last year, with growth in higher nickel content 300 series outpacing that rate.

Meanwhile, INSG data for January to November 2017 showed that Indonesia added 40,000 tonnes to global demand for the period as the aforementioned new stainless capacity came on line. Furthermore, Tsingshan Group's 2 million tonnes per annum (tpa) 304 series stainless capacity is expected to reach full capacity this year, while the addition of another 1 million tpa of 200 series capacity will also play a role, albeit a significantly smaller one given the lower amounts of nickel required.

Amid expectations of a period of synchronized economic growth, we currently forecast that global nickel demand will remain reasonably robust again this year (+ circa 4%). This in turn will result in another year of relatively sizable deficit.

Nevertheless, this will not be sufficient to reduce inventories of nickel to disconcertingly low levels next year, or even into 2019. **Based on this fundamental picture, we forecast that nickel prices will rise by around 16% this year – a respectable, but not stellar, performance.**

However, this is a market prone to volatility and extreme reactions to industry developments. As a result, we are mindful of those who predict sharp rises in the offing for this market, ahead of a marked and sustained improvement in the fundamental picture. The risks certainly appear to be greater to the upside for nickel, and news of supply problems, for example, may have a disproportionate impact, boosting prices beyond justified levels.


REUTERS/David Mercado

ZINC

Another turn as "star performer" among the base metals complex?

Given zinc's healthy fundamentals and a backdrop of stronger global economic growth and a weak dollar, the market has once again pinned zinc with expectations of the "star performer" within the base metals complex.

Higher zinc prices have helped miners' profit margins, and this should work as an incentive to miners to speed up their pipeline of projects or restart idled operations. However, it is "too little, too late" to fill the concentrate supply gap that we forecast in 2018. Further, in China's Central Economic Work Conference held last December, the government put forward pollution control as one of the "three tough battles" for 2018. This, together with further news headlines about production disruptions, most recently from Henan province, indicates that Chinese output will be restricted.

On the demand side, improved margins for steelmakers against the backdrop of healthy offtake from end-use sectors galvanized production last year. A tightening zinc market is also evident through a declining stocks-to-consumption ratio. This has dropped from above 5.5-6.5 weeks before 2016 to 3-4 weeks since Q3 2017. **Zinc stocks at LME and SHFE both reached decade lows last year.** The LME cash to three-month spread hit its widest for many years last September. And with stocks still being drained out of LME warehouses into January, the nearby spread widened again. We expect the refined zinc market to stay in a deficit in 2018, though a slightly smaller one than last year. Meanwhile, as the U.S. dollar continues to weaken, prices are likely to remain well supported in the absence of significant gains in stocks.

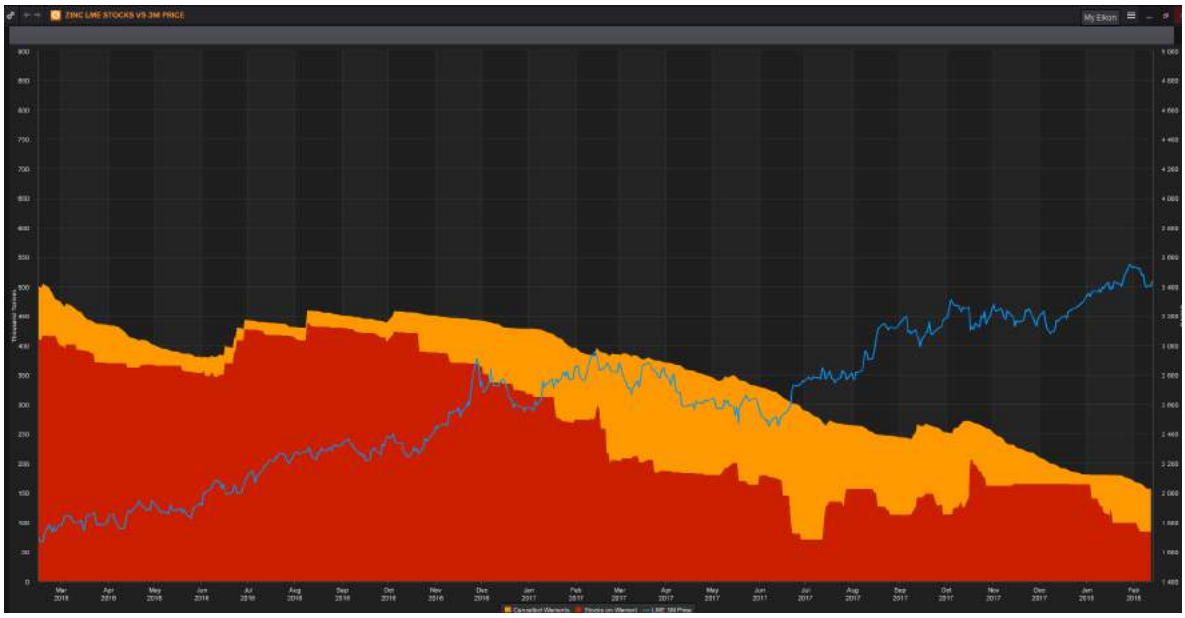
Concentrate supplies to improve, but no quick return to balance

Despite the fact that some pipeline mine projects are starting to come through and reduce the concentrate shortfall, overall there is no quick solution. Based on our latest review of the timetable of western mining projects and harder-to-assess Chinese zinc mines, it will be some time yet before a recovery in concentrate supply comes to the aid of the refined market balance.

Towards the end of last year, Glencore announced its plan to partially restart its Australian projects, while Dugald River started commercial production and the first batch of concentrates has already been shipped to China. In addition, the Gamsberg project is set to start in mid-2018 and, together with other smaller increases, these will begin to relieve concentrate supply tightness from the second half of 2018. We currently estimate some 600kt of contained zinc supply coming from ramp-ups, expansions and restarts.

The tightened refined zinc market is evidenced by the declining stocks-to-consumption ratio. We estimate global refined production in 2017 has seen a second year of decline. Major losses were seen in China (-2.6%), South Korea (-4.3%), Canada (-9.7%) and Peru (-10%). Extremely low treatment charges to smelters as a result of tight concentrate supply have taken their toll on smelters' margins.

This should be largely responsible for the losses from the world's top producer, China, and the second largest producer, South Korea. Last year we saw prolonged maintenance closure at smelters and forced suspensions due to environmental inspections. Korea Zinc, the dominant zinc producer in South Korea, announced at the beginning of last year that it would slash production. We also saw losses from Canada and Peru due to labor issues at the Valleyfield refinery and flood disruptions at Votorantim's Cajamarquilla smelter, respectively. Overall zinc supply in 2018 is expected to grow only moderately, in line with a slow improvement in mine supply. However, this is likely to be less evident in the first half of the year.



Zinc LME stocks vs. Price from March 2016 to February 2018

Prices remain supported by low stocks, weaker dollar

World zinc consumption accelerated last year amid stronger economic momentum in major economies. Improved margins encouraged steelmakers to run at higher utilization rates and there have been ramp-ups of additional galvanizing capacities in Europe. This was particularly evident in China during Q3 last year as well as in Turkey, though from a smaller consumption base. In Turkey, galvanizers' production was boosted by stronger regional demand and export market tailwinds as well as a weaker lira.

For 2018, we estimate global zinc demand growth will be flat on last year at 1.7%.

Demand from European countries will continue upward momentum, though steelmakers' expansion projects will see some divergence in some countries. Demand from the United States is estimated to accelerate amid a continuous improvement in the country's economy. The outlook for both the auto and construction sectors looks positive. Meanwhile, the number of houses and cars damaged by last year's hurricanes should given an additional boost to demand for cars and to reconstruction.

We currently expect demand from China to slow to a moderate 2.1% in 2018, compared to 3.6% in 2017. It is difficult to see the high margins for steelmakers continue to rise in 2018, which may disincentivize production growth in galvanized products. In the auto sector, the rising percentage of cars with higher zinc content in China should provide a boon for demand. However, the slowing construction of new starts will offset this somewhat. The construction sector could be further hobbled by rising debt burdens at China's central and provincial levels, which should knock hopes for any rapid expansions in infrastructure projects.

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