WHATS HOT LONDON METALS EXCHANGE WEEK 2023 SILVER LININGS BETWEEN A ROCK AND A HARD PLACE

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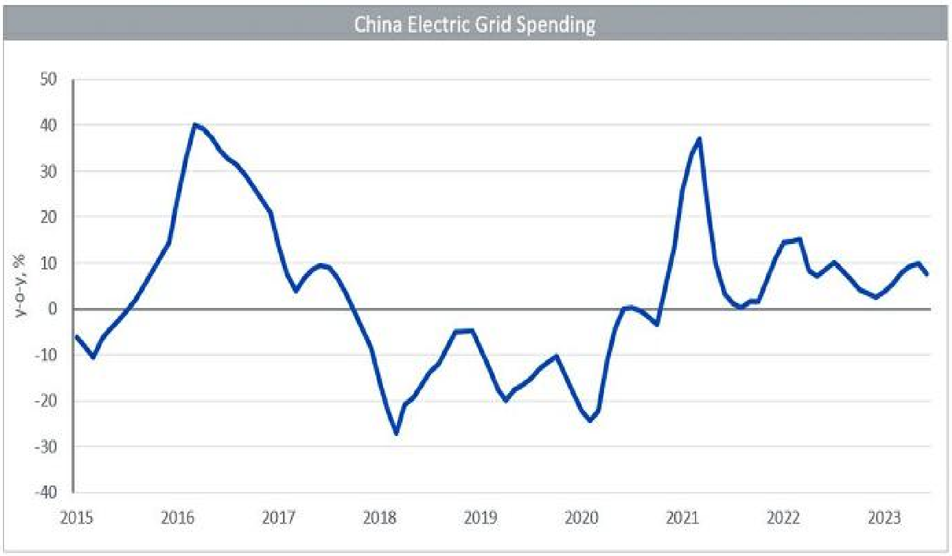
As London Metals Exchange Week 2023 wraps up, we summarise some of the key observations for the state of the base metals in 2023 and what are likely to drivers for the markets going into 2024.

Better than the macro data would indicate
Despite the challenging macroeconomic backdrop especially in China, metal demand is holding up fairly well. Demand indicators are generally holding up better than macroeconomic data would suggest, indicating other forces are at play. The main diver of the discrepancy is likely to be the shift in demand for metals coming from the energy transition.

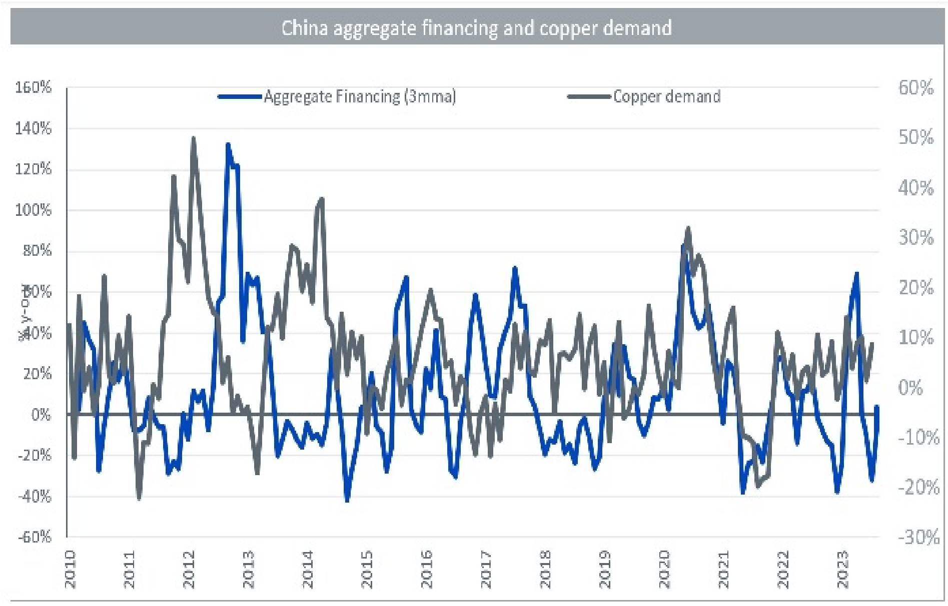
The upside surprise in Chinese demand can be linked to accelerated grid spending in the country which is a metal intensive activity (Figure 1). China has 'net zero' ambitions and has been using this era of relatively low copper prices to accelerate the buildout of its grid infrastructure that will be essential for increasing the capacity of electric vehicles on its roads.



Source: Bloomberg, WisdomTree, March 2015 to August 2023, four-month moving average. Historical performance is not an indication of future performance and any investments may go down in value.

More broadly, China's piece-meal stimulus activity is starting to bear fruits.

Aggregate financing to the real economy has turned a corner after several months of disappointment and is now rising faster than consensus expectations, which could bode well for further metal demand. It's worth noting that copper demand in China had not fallen as much as aggregate financing data would have indicated (Figure 2). We believe the stimulus will continue to support the metals market into 2024, although we note that China has not yet offered a big 'bazooka' of a stimulus package yet.



Source: Bloomberg, WisdomTree, January 2010 to September 2023. Combines old and new total social financing measures to get a longer aggregate financing time series, but readers should be aware of definitional changes in 2018. **Historical performance is not an indication of future performance and any investments may go down in value.**

More metal supply in 2024

Markets are concerned that the supply outages in a range of metals could reverse course next year and therefore start to weigh on price. In its latest projections, the International Copper Study Group (ICSG) now envisages a massive supply surplus of 467,000 tonnes in 2024 (previously 298,000 tonnes). This is thanks to a considerable expansion of refined copper production, especially in China, though new production capacities in Indonesia, India and the US are also set to contribute to nearly 5% year-on-year production growth in 2024. However, the group maintain a deficit forecast in 2023 in the order of 27,000 tonnes, albeit a narrower deficit compared to their April forecast of 114,000 tonnes. Other metal study groups (such as the International Nickel Study Group, International Lead and Zinc Study Group) that met the prior week also expect higher supplies. However, we note that a lot of European metal smelters that went offline during the energy crisis of 2022 are unlikely to come back. Furthermore, these forecasts are based on all planned production coming to the market, which is rarely the case. Usually a 1-2% supply disruption takes place and that has the potential to significantly alter the balance.

Nickel oversupply spilling into Class 1

Market participants are increasingly worried about a Class 1 nickel oversupply in 2024. Indonesia's mining and processing expansion has largely impacted Class 2 nickel. That is the material most suitable for meeting Chinese demand for nickel pig iron (NPI). High quality, Class 1 nickel, however, has been in a supply deficit in recent years. Class 1 has seen increasing demand from battery applications as electric vehicles expand production (and utilisation). However, conversion of Class 2 to Class 1 is looking increasingly economically feasible and Indonesia is at the forefront. There is even potential for a trade deal that could see Indonesian supply become Inflation Reduction Act compliant. That could see US battery demand be met by a new source of metal supply. At the same time, what was thought to be a localised shift to less nickel-intense battery technology in China, could become a more global trend. That is also a source of concern for the market.

Market developments

The London Metal Exchange (LME) Chief Executive Matthew Chamberlain announced at the main LME dinner that the LME has launched a new collaboration on product development with its Chinese rival, the Shanghai Futures Exchange (SHFE). The announcement came after news last month that SHFE was looking into the possible launch of a nickel futures contract for international use. A much larger proportion of industrial nickel use today is Class 2 rather than Class 1. China is seen as the main venue for transactions in Class 2 nickel and should have a greater role in benchmark price formation. The Class 1 LME contract thus has a degree of disconnect with the bulk of current industrial use and therefore has been seen as an imperfect hedging tool. While the LME didn't offer much detail about its collaboration with the SHFE, an obvious area for joint work is in nickel.

Conclusions

Overall, the mood at the LME week was sombre, not just because of the geopolitical events that took place the weekend before the event. However, many were surprised at the strength of current demand. As we have highlighted, commodities tend to be late-cycle performers and we are likely seeing that in play in the current economic cycle. The energy transition is adding further fuel to metal demand that could help the complex during otherwise challenging times if a perfect soft-landing is not achieved.

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