WHAT'S HOT: COPPER IS RED HOT ON CHINA'S REOPENING, BUT THERE IS MORE TO IT

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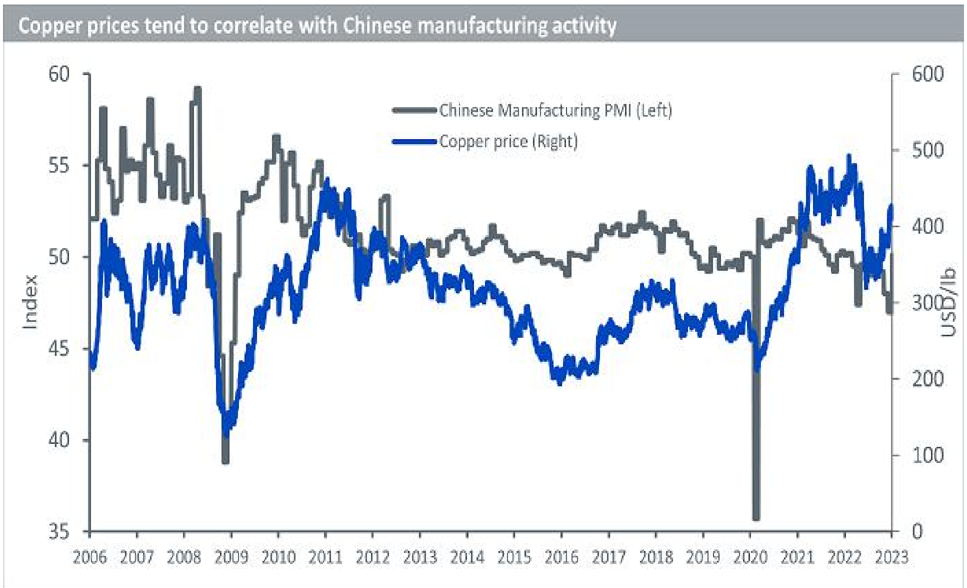
Copper is to commodities, what tech stocks are to equities. They are both historically cyclical but also promise potential long-term growth. Tech stocks were down last year, not because the underlying technologies were dead, but because central banks were aggressively tightening monetary policy. Copper too endured the same fate on account of macro headwinds despite the accelerating energy transition. Lockdowns in China added another layer of disappointment.

So, with the macro backdrop changing this year, is the red metal becoming red hot? Markets appear to be endorsing that narrative. What does the demand and supply situation look like?

China reopening

China consumes more than half of global refined copper with its demand experiencing an eight-fold increase in the past four decades[1]. Chinese manufacturing activity, therefore, is inevitably a key driver of copper prices (see figure below).



Source: WisdomTree, Bloomberg, data as of 02 February 2023. PMI is Purchasing Managers' Index.

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Chinese manufacturing activity remained contractionary through August till December last year, as evident from the Manufacturing Purchasing Managers' Index. In January, while the number remained contractionary at 49.2[2], the expectation is for it to pick up in the coming months if lockdowns remain sustainably lifted.

China is a crucial source of copper's green demand too. Chinese subsidies for electric vehicle (EV) makers have given rise to a booming industry to the point where BYD is now competing fiercely with Tesla for market share worldwide. Although subsidies for producers will come to an end this year, tax exemptions for buyers will remain in place through 2023. This will further be supported by the rollout of charging infrastructure, a key component of China's 14th 5-year plan issued in December 2022.

A battery EV can require three to four times as much copper as an equivalent internal combustion engine vehicle. Similarly, a 200 kilowatt (kW) fast charging station uses around 8 kilograms of copper[3]. There is a similar multiplicative effect on copper demand from other energy transition applications like renewable wind and solar power, which China is heavily investing in.

The supply side

In What's Hot: Dr Copper's misdiagnosis, we highlighted how copper's inventories on exchanges are perilously low, a sign of supply tightness which could exacerbate if demand picked up quickly.

According to Wood Mackenzie, copper may see a slight global refined market surplus of 170 kilotons (kt) in 2023[4]. But there is considerable uncertainty surrounding this forecast. On the supply side, disruptions such as the ones we've seen recently in Peru could play an important role. Peru is the second largest copper producing nation and is responsible for around 10% of global mined production.

Anti-government demonstrations in Peru have led to shipments being halted at the 300 kt Las Bambas mine, and disruptions at Glencore's 180 kt Antapaccay mine, and other mines including Constancia (117 kt) and Cuajone (148 kt)[5].

The figures above highlight how disruption in supply from Peru can easily tip the copper market into a deficit. While disruption may not be as severe this time as it was when Covid caused mine closures in Chile and Peru in 2020-2021, it could still be meaningful especially if coupled with more demand from China. Market pricing has been moving in response to these developments.

The energy transition

At the World Economic Forum in Davos in January, European Commission President Ursula von der Leyen pledged unprecedented support in clean technology across all sectors of the energy transition. For Europe to remain competitive in the new era of clean energy, it must offer something that can rival the US Inflation Reduction Act. In 2023, we expect more action from US, Europe, and China now that energy security has become synonymous with the energy transition.

According to Wood Mackenzie, for the world to be on track for net zero by 2050, 9.7 Mt of mine supply will need to come from projects that are yet to be approved. This amounts to $23bn of investment a year in new projects, 64% higher than the average annual spend over the last 30 years.

Conclusion

Copper’s long-term demand trends suggest it could continue trending upwards but remain cyclical depending on the macroeconomics. Cyclical pullbacks could create interesting entry points for investors who recognise copper’s structural case.

Sources

[1] International Copper Study Group’s Factbook 2022.

[2] Bloomberg, January 2023.

[3] International Copper Study Group 2023.

[4] Wood Mackenzie’ report, “Copper: Things to look for in 2023” dated January 2023.

[5] Morgan Stanley as of January 2023.

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