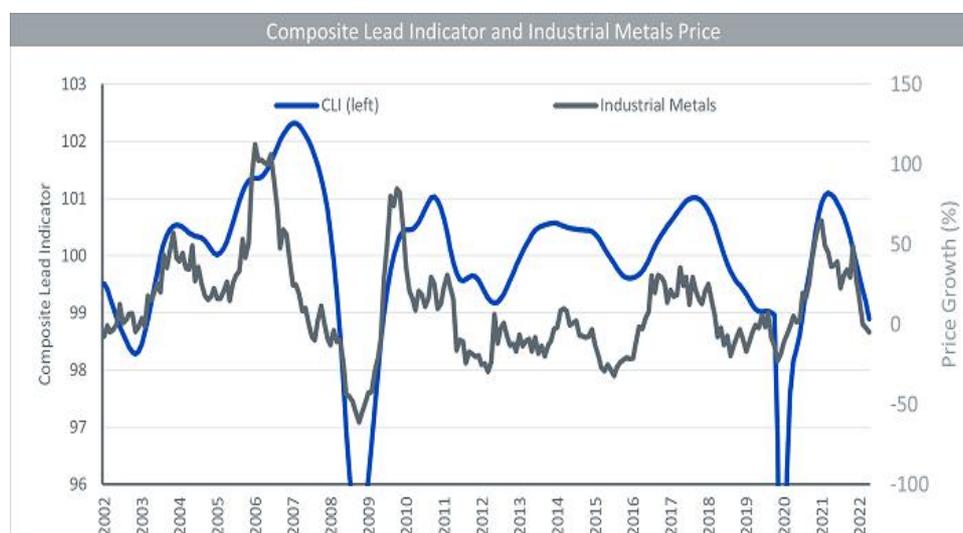


# WHAT'S HOT: INDUSTRIAL METAL CYCLICALITY IS ONLY SKIN-DEEP

Nitesh Shah – Head of Commodities and Macroeconomic Research, WisdomTree Europe  
23 Sep 2022

## Industrial metals prices are traditionally cyclical

Industrial metals have historically been cyclical. In this current downturn, we are finding that metal prices are suffering, as they have done in the past.



Source: WisdomTree, Bloomberg. Industrial Metals = Bloomberg Industrial Metals Subindex Total Return. January 2002 to August 2022. OECD composite leading indicator (CLI) is designed to provide early signals of turning points in business cycles, showing fluctuation of the economic activity around its long-term potential level. CLIs show short-term economic movements in qualitative rather than quantitative terms. CLI is amplitude adjusted, Long-term average = 100.

**Historical performance is not an indication of future performance and any investments may go down in value.**

However, the importance of base metals in delivering the energy transition has never been greater. We are currently living in an energy crisis exacerbated by the war in Ukraine. Europe wants to accelerate the energy transition to reduce reliance on Russian energy sources. That will place a higher onus on renewable energy sources coupled with battery storage to meet our energy needs. In short, that will require a lot more metals. However, the production of many base metals is declining. That's partly due to falling prices, making it more difficult to justify the capital expenditure. Also, high energy prices are making the smelting of metals uneconomical<sup>1</sup>.

We believe there is a risk of supply destruction of base metals due to the energy crisis

being greater than the demand destruction coming from a decelerating economy. So, while sentiment may be weighing on metal prices right now, the fundamentals may be tighter than the market assumes. That could pave the way for a substantial rebound in metal prices when the market refocuses on supply imbalance and sentiment turns.

**Inventories are low**

It is clear from the table below that industrial metal inventory is especially low. We do not believe the year-to-date price performance reflects that degree of tightness. And there is ample room for an upward correction.

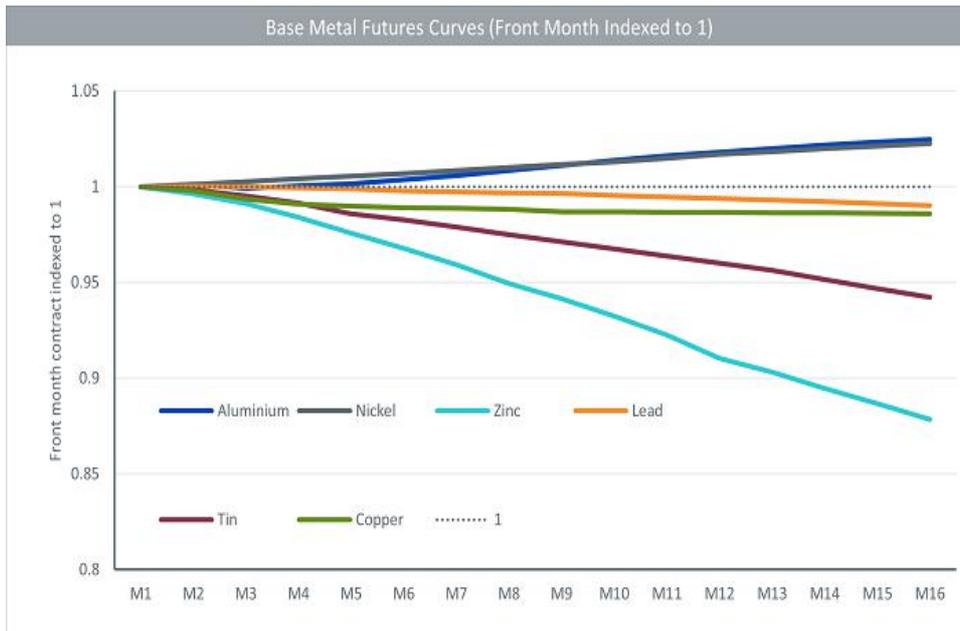
	Current inventory relative to 5-year history	YTD performance
<b>Industrial Metals</b>		
Aluminium	-71%	-20%
Copper	-55%	-20%
Nickel- LME	-74%	20%
Zinc	-34%	-12%
Lead	-25%	-18%
Tin	-25%	-46%

Source: WisdomTree, Bloomberg. Data as of 20th September 2022. Industrial metals inventory refers to exchange inventory summing stocks reported by the London Metals Exchange, Shanghai Futures Exchange and Chicago Mercantile Exchange. Price performance using the first generic futures contracts of commodities in the Bloomberg Commodity Index.

**Historical performance is not an indication of future performance and any investments may go down in value.**

**Most base metals are in backwardation**

With the exception of aluminium and nickel, all base metals are in backwardation. Backwardation is when spot or front-month futures contracts are priced higher than the price of contracts for delivery in later months. The fact that someone is willing to pay for immediate delivery rather than entering a contract for delivery in a few months' time indicates that they need the material urgently. Thus, the backwardation structure of futures markets is another indication of market tightness.

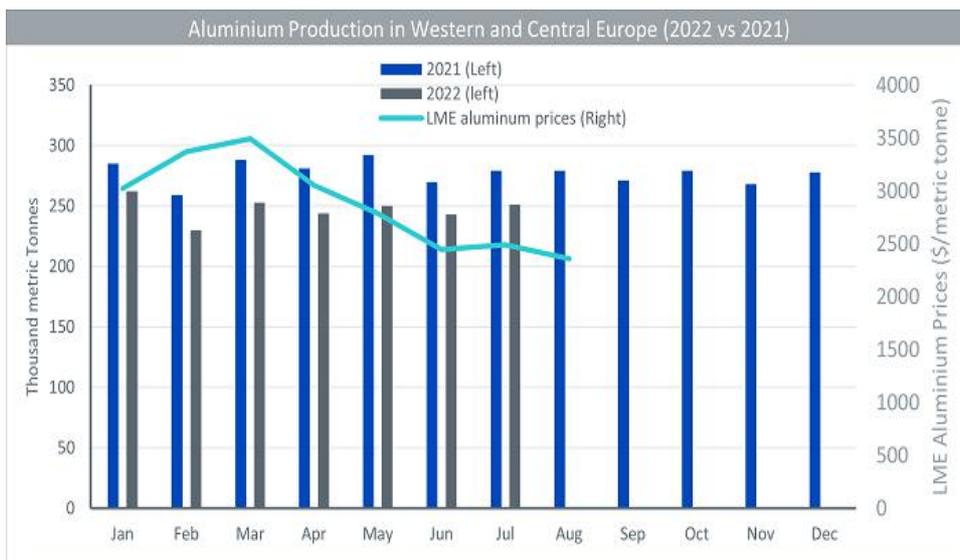


Source: WisdomTree, Bloomberg. Data as of 20th September 2022. Using London Metals Exchange contracts. Lines below '1' indicate a market in backwardation.

**Historical performance is not an indication of future performance and any investments may go down in value.**

**Production is hampered**

Surprisingly, aluminium and nickel are not in backwardation like the other base metals. The inventory table seems to indicate that metal availability is the worst for these two metals. Looking at European aluminium production data this year (to July 2022, the latest data point available) relative to production in 2021 over the same period, production is down 11%. A surge in China's summer temperatures in August 2022 has led to a power crisis, resulting in curtailed power supply to the industrial sector in Sichuan province. Aluminium is very energy-intensive to produce.



Source: WisdomTree, Bloomberg New Energy Finance, International Aluminium Institute. August 2022. Using London Metals Exchange contracts.

**Historical performance is not an indication of future performance, and any**

investments may go down in value.

### Inflation Reduction Act and European policy on energy transition

European policymakers are currently debating the path to secure energy independence from Russia. In her State of the Union speech on 14th September 2022, Ursula von der Leyen, President of the European Commission, emphasised investing further in renewable energy and hydrogen in particular. These investments will be metal demand positive.

In the US, the Inflation Reduction Act, which was signed into law in mid-August, sets out several initiatives to reduce inflation. The US also recognises that energy reform is part of the puzzle. The bill includes circa \$390Bn of spending/credits over the next ten years related to energy and climate change, with the goal of putting the US on the path towards 40% emissions reductions by 2030.

The bill takes steps to enhance energy security and provides credits to help tackle climate change. There are incentives for cleaner fuels (e.g. hydrogen), for consumers to electrify appliances/upgrade home energy efficiency, and tax credits for buying electric vehicles. We expect the bill will be metal demand positive.

### Conclusions

We believe supply destruction is occurring at an equal or faster pace than demand destruction in the base metals space. However, metal prices are currently falling, mirroring historical cyclical patterns for industrial metals. When markets refocus on the fundamentals, we may find prices correct to the upside. Our long-term projections for industrial metal demand – underpinned by an infrastructure rebound and energy transition – remain firm.

### Sources

<sup>1</sup> See [Zinc and aluminium supply tightening amid energy price shock](#)

### Related blogs

- + [What's Hot: Zinc and aluminium supply tightening amid energy price shock](#)
- + [What's hot: Which party will industrial metals attend?](#)
- + [Energy Transition Commodities: Price Resilience to Economic Slowdown](#)

View the online version of this article [here](#).

Important Information

**Marketing communications issued in the European Economic Area (“EEA”):** This document has been issued and approved by WisdomTree Ireland Limited, which is authorised and regulated by the Central Bank of Ireland.

**Marketing communications issued in jurisdictions outside of the EEA:** This document has been issued and approved by WisdomTree UK Limited, which is authorised and regulated by the United Kingdom Financial Conduct Authority.

WisdomTree Ireland Limited and WisdomTree UK Limited are each referred to as “WisdomTree” (as applicable). Our Conflicts of Interest Policy and Inventory are available on request.

**For professional clients only.** The information contained in this document is for your general information only and is neither an offer for sale nor a solicitation of an offer to buy securities or shares. This document should not be used as the basis for any investment decision. Investments may go up or down in value and you may lose some or all of the amount invested. Past performance is not necessarily a guide to future performance. Any decision to invest should be based on the information contained in the appropriate prospectus and after seeking independent investment, tax and legal advice.

The application of regulations and tax laws can often lead to a number of different interpretations. Any views or opinions expressed in this communication represent the views of WisdomTree and should not be construed as regulatory, tax or legal advice. WisdomTree makes no warranty or representation as to the accuracy of any of the views or opinions expressed in this communication. Any decision to invest should be based on the information contained in the appropriate prospectus and after seeking independent investment, tax and legal advice.

This document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public offering of shares or securities in the United States or any province or territory thereof. Neither this document nor any copy hereof should be taken, transmitted or distributed (directly or indirectly) into the United States.

Although WisdomTree endeavours to ensure the accuracy of the content in this document, WisdomTree does not warrant or guarantee its accuracy or correctness. Where WisdomTree has expressed its own opinions related to product or market activity, these views may change. Neither WisdomTree, nor any affiliate, nor any of their respective officers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents.