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NEWS

Metals market outlook

The metals market offers very little visibility for the short term, but our view is that its upside potential remains intact.

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There is currently very little certainty surrounding the situation in the metals industry as the economic climate is difficult to read and the outcomes of many of the factors involved are tricky to predict.

The **long-term** trend, meanwhile, remains unchanged. The metals required for the energy transition are in demand and this will upset the demand/supply balance for the foreseeable future, pushing prices upwards.

Shorter term, however, the market is unsure of where it is heading for a number of reasons:

- The **changes being made to monetary policy** and the US Federal Reserve's clear determination to contain inflation by raising interest rates further are **fuelling fears of a global recession.** Europe looks set to be the hardest hit region, although Jamie Dimon (JP Morgan's CEO) recently estimated the likelihood of a recession in the USA at over 50%. A downturn in growth would necessarily take a toll on metals consumption in the short term. This is the main factor currently being priced in by the markets, at least partially, and it explains why metals have trended downwards in recent months.

- **And then we have the situation in China.** China's insistence on a zero-Covid policy has affected the country's economic growth and is another reason for the decline in metals over the past few months. Reassuring news flow on this front in recent weeks had actually enabled metal prices to regain some of the ground lost. But the worries are back now as the virus has picked up again in some of China's key economic hubs and restrictions on electricity consumption have been enforced in certain provinces due to drought. Poor automotive sales figures released in China on 22nd August triggered an immediate and abrupt correction in the prices of platinum and palladium, both of which are widely used in this industry. **But China is bringing in measures to stem the slowdown.** It announced the third biggest recovery plan in China's history earlier this summer (centred around infrastructure, electric vehicles and green energies) and has also recently cut its interest rates twice and adopted a stimulus plan for properties under construction (although the sector is likely to remain in poor shape in the short term as the government is focusing more on deleveraging[1] the property market). This is an important aspect to consider when analysing the metals market. For instance, it is worth bearing in mind that China has been a net importer of zinc for over 10 years but has become a net exporter this year. Any upturn in economic activity would necessarily lead to a rapid increase in tension across all metals as China's economy consumes roughly 50% of all the metals produced worldwide when operating as normal.

- Europe and the USA are at different stages of the economic cycle (mostly because of the energy crisis affecting Europe) and so monetary policy is currently being tightened more in the USA, impacting on the euro/dollar exchange rate and putting the greenback at parity with the euro. This has consequences for commodities as international trade in such products is in dollars.

- **Europe's energy crisis is having various repercussions.** It is currently threatening the region's economic growth, which could potentially take a toll on economic activity and thus on metals consumption. But the surge in energy prices, especially gas prices, is also restricting the production of refined metals. Glencore* (late last year) and Nyrstar* (very recently) have decided to shut down some of their zinc refining capacity as costs have risen too high. Alcoa* and Norsk Hydro* have done the same in the aluminium sector, and we could well see more closures of this kind as producers' margins are in such steeply negative territory! For now, the market is above all taking note of the negative effects on growth rather than the consequences of foundries being mothballed. And yet such decisions are of great structural significance as the plants that have been shut down will remain so at least for several months, whatever happens. Some even say there is a risk that they will remain offstream for good. So, when economic activity takes off again or the development of the energy transition gathers pace, the lack of resources observed during the 2021 recovery (when certain metal prices skyrocketed) could prove even worse this time around! If the coming winter turns out to be a harsh one or if relations with the Russian government worsen, the price of gas could force other capacity closures not only in Europe but also beyond. Let us not forget that there is a limited supply of liquefied gas, and so the share that goes to European states is a share that other countries have to do without! Gas prices are therefore likely to remain high, at least until the war in Ukraine comes to an end.

- **The Ukraine crisis is dragging on.** The conflict is having little impact on metal supplies so far, but if it worsens Europe might also have to limit its imports of such products from Russia. Note that Russia is a major producer of aluminium, nickel, platinum and palladium.

- Despite all the current concerns, **metal stocks remain low** and forward price structures still suggest that supplies are going to come under strain within the next few months. Moreover, open interests on certain metals are currently at historically highly defensive levels. So there now seems to be little downside potential.

In short, there is very little visibility on the metals market for the short term but we cannot rule out another drop in metal prices, especially with the very hawkish(2) tone adopted by the Fed at its Jackson Hole symposium being held from 25th to 27th August. Yet the long-term issues have by no means been resolved and could even worsen due to metal production capacity being closed down. This new "green" demand trend is not some hypothetical scenario for the future; it is already underway. In China, for instance, growth in demand for green energies (electric vehicles, renewable energies and grids) since the start of the year has more than offset the shortfall in consumption created by the country's slowing property sector (+553 kt of copper vs. -431 kt estimated for 2022). For the time being, the market is focusing its attention on the decline in the "old economy" and failing to take note of this new form of demand that is emerging.

So monetary policy decisions could continue to take a toll on prices in the short term. In the medium term, however, we believe the market's upside potential remains intact and is even being reinforced by the closures triggered by the current energy crisis.

(1) Deleveraging: financial debt reduction.
(2) Hawkish: monetary policy aimed at tackling inflation.
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