What happened to mine closures?

Historically, large numbers of zinc mine closures and production cuts are not panning out as advocates of zinc-related investments had anticipated.

John Robertson* | 09 Feb 2017 | 7:54 | Opinion

The closure of major zinc mines like Century (Australia) were meant to dent production significantly; they haven't

For years, investment promoters have been asserting zinc would prove an enduringly more attractive investment than other metals. Zinc, they said, did not have to rely on flagging macro forces because mines near exhaustion in Australia and Ireland would soon close.

Voluntary cuts by Glencore, among others, in response to still weak market conditions added to expectations of a dramatic lowering of metal production pushing market balances into a prolonged series of deficits.

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Glencore had foreshadowed a 2016 metal deficit of over 400,000 tonnes in presentations to investors. Smaller companies gladly quoted the zinc behemoth to proselytise their own investment virtues. With all the fervour of lithium explorers, some said stocks were set to disappear by 2020.

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The strongest cyclical price increases have occurred when inventories of metal have experienced their largest declines, as the three bull markets in zinc since 1960 attest.

Between 1972 and 1974, average annual zinc prices rose 227% after a decline of 33% in reported zinc metal stocks. Between 1987 and 1989, prices went up 111% after a 58% fall in stocks. And the biggest price rise came between 2002 and 2006 after stocks dropped by 53% – prices went up 321%.

As late as October 2016, the International Lead Zinc Study Group (ILZSG) was saying "world zinc mine production will fall by 5.6% to 12.47 million tonnes in 2016". It expected a 3.2% drop in zinc metal output.

"Investors have no reason to believe that one metal will offer better investment outcomes than another"

The ILZSG numbers implied a deficit of 310,000 tonnes of metal. If reflected in reported stock movements, this would have been equivalent to a cut in inventories of 37% from their most recent peak at the end of 2012.

Disappointingly, in its January 2017 market report, the ILZSG referred to inventories as having fallen by just 72,000t or 4.3% over the first 11 months of 2016, well short of what had been expected.

According to the latest ILZSG statistics and subject to later revisions, mine output was just 1.2% lower over the first 11 months of 2016 and metal production was sitting within an insignificantly small 2,000t drop.

The apparent misjudgement about the zinc production outcomes highlights some common forecast challenges.

In forecasting metal supply outcomes, taking account of high profile announced mine closures or openings is relatively straightforward.

Analysts, and the industry itself, are less well equipped to assess the impact on overall supply of dozens of individual production shifts, many of which may appear trivial but which, together, can have a meaningful impact on sometimes already tight market balances.

Since 2000, annual zinc mine output has risen by 4.3Mt, according to the ILZSG, equivalent to around another eight of the world's largest mines or over 40 mines of the size that would rank them around 10th in terms of output size.

Mines of this size have not featured in the industry's growth profile. New supplies have come from large numbers of small properties or the infusion of many small and sometimes unsustained production increments.

Oftentimes, no announcement will have been made about company intentions. Unhelpfully, not all miners are obligated to disclose variations in their output publicly, accurately or in a timely manner.

So small are the variations analysts are attempting to track over many dozens of potential sites that accuracy proves elusive.

Occasionally, output surges may temporarily supplement base production. By the time analysts have turned their attention to the new output, it might have already been terminated.

Then, analysts face a disconcerting feedback loop: their forecasts are not independent of the actions of mine operators, with a consensus prices are going to improve encouraging miners to raise production, even if only slightly.

The view that zinc mine closures in 2015 would result in a shortage of metal might have been so pervasive and analysts so convincing that the reaction of the industry prevented it from happening.

Another influence on the market balance has been weaker than expected usage rates.

The same promoters using supply-side adjustments to urge support for zinc-related investments, including Glencore, had taken for granted the likelihood of continuing growth in usage.

Now, the ILZSG is estimating that usage in 2015 was 2% lower than in 2014, equivalent to a loss of 273,000t against the prior year and a whopping 720,000t less than what would have been achieved if use had grown at a historically average rate.

Glencore's estimate of a deficit approaching 500,000t over 2015-2016 is out by more than 400,000t, according to the latest ILZSG statistics.

In any event, the importance to price outcomes of supply disruptions may have been exaggerated, according to data presented at the annual meeting of the American Economic Association in early January 2017.

Using a new dataset starting in 1870, David Jacks and Martin Stuermer ('What Drives Commodity Price Booms and Busts?') concluded that "commodity demand shocks strongly dominate commodity supply shocks in driving prices".

The econometric analysis by the National Bureau of Economic Research and the Federal Reserve Bank of Dallas economists confirms a prolonged cyclical rise in the prices of metals is unlikely to occur without a change in growth momentum.

Since a growth shock will benefit all commodities simultaneously, investors have no reason to believe that one metal will offer better investment outcomes than another.

Those companies which had latched onto the anticipated zinc production shortfall to promote their investment propositions might have to rethink their argument.

Zinc price increases have already outstripped changes in the prices of other metals over the past two years in anticipation of what has turned out to be a rather modest rebalancing of the zinc market.

Generally more buoyant markets are now helping to keep zinc prices aloft but the incoming data raise doubts about zinc market conditions remaining unusually strong or sustainably stronger than in other commodity segments.

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