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Zinc demand stalls

Infrequent but long-lasting structural shifts in the forces driving metal markets are often ignored in favour of more convenient narratives promoting speedier and less sustainable changes.

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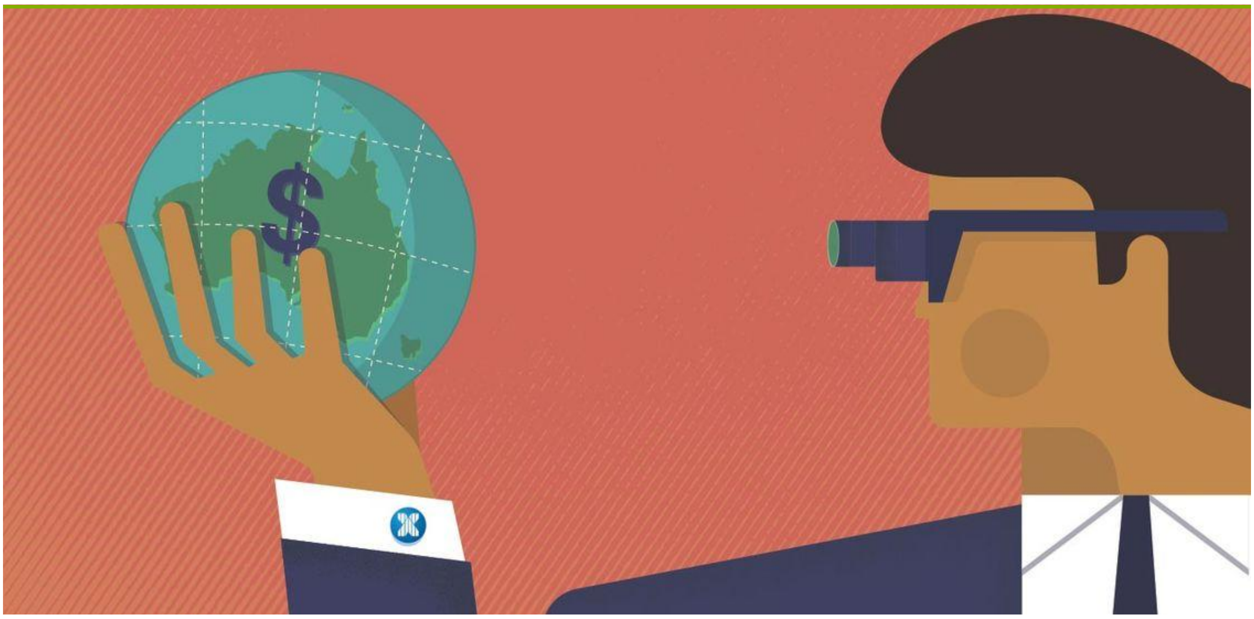

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The International Lead Zinc Study Group (ILZSG) has recently estimated that zinc metal usage in 2018 amounted to 13.7 million tonnes. With that start, historically average growth in usage would imply a need for an additional 350,000-400,000t per annum of new mine production to retain the current market balance.

Replicating such a capacity expansion year after year, or something better as the base builds, would present a considerable challenge offering potentially lucrative investment and market opportunities.

Against this highly favourable scenario, anything approaching a ‘no growth' outcome would almost certainly see rising metal inventories and slumping prices.

Despite so much hinging on the validity of the chosen growth rate assumption, sometimes scant attention is given to the choice even when the incoming data suggest a rethink is warranted.

In some instances, companies with investments to promote simply fail to change a well-worn narrative about market conditions. The directors of Ironbark Zinc, for example, used "the ever-growing global zinc demand" as one of the motivations for the company's Citronen zinc project in Greenland, in reporting to investors as recently as the end of January.

Global zinc usage over the past 60 years can be divided into four clear phases each with unambiguously different growth characteristics.

The first phase extended from 1960 to 1973 during which time metal use doubled to produce an annualised growth rate of 5.4%.

The second phase lasting 20 years was a period of negligible growth in demand The annualised increase over this spread of two decades was 0.3%, nearly one twentieth of the growth rate that had prevailed in the first period.

> “ **This broader perspective suggests prolonged periods of zero gold market returns as the most likely investment outcome**

After 1993, growth accelerated. Over 21 years, metal use again doubled as it posted an annualised growth rate of 3.5%. This is the pace many current-day analysts had become used to extrapolating when they opined about future market conditions.

The third phase ended in 2014. Since then, use has once again stalled. Growth has averaged 0%, according to the ILZSG. The Ironbark depiction of the market easily qualifies for four Pinocchios in any fact checking framework.

Each of the first three of these periods coincided with distinct economic outcomes. During the first, annual global GDP growth exceeded 5%. Post-World War Two reconstruction and, in the advanced economies, a focus on metal intensive capacity expansions and infrastructure developments, spurred activity.

Global economic growth slowed significantly in the second period, averaging a little over 3%. Attempts by the US Federal Reserve to control inflation made this period unusually recession prone. Sharp rises in oil prices, causing an unprecedented and unexpected diversion of financial resources away from oil importing economies, also damaged growth prospects.

The third period marked the arrival of China. The emerging industrial behemoth eventually accounted for more than two thirds of the increase in zinc demand as the Chinese government lifted the lid on years of stifled development and manufacturers relocated production to take account of the new market and low-cost production opportunities.

These sources of abnormally strong growth - post-war reconstruction and the freeing of markets in China - in the first and third of these periods are unreproducible forces peculiar to their eras.

The closest parallel between current economic conditions and historical zinc market outcomes is the second phase between 1973 and 1993. Then and now, outcomes are being dominated by decisions of central banks, fading productivity growth, a reluctance to invest and idiosyncratic national growth patterns.

The recent no-growth period in zinc use may yet prove short-lived by the standards of these earlier outcomes but the case for that happening is largely ignored as promoters of zinc investment speak as though growth has been sustained at pre-2014 rates.

Long periods featuring little change in conditions interrupted occasionally by seismic shifts is not an unusual commodity market pattern.

The gold market offers another example of how a broad historical perspective can change perceptions about what is ‘normal'.

The longer term pattern of gold prices falls into five distinct periods. From the mid-1970s until the beginning of 1980, the US-dollar gold price rose by as much as 500%. It then quickly declined and, between mid-1982 and 1997, showed no net change sitting predominantly within a range of $300-400 per ounce.

In a third relatively short phase lasting up to four years, the price weakened reaching a nadir in 2001. Then, the price rose 600% over the following decade. As in the early 1980s, the price rapidly retreated once it had hit its peak value in 2011 before settling into a similar pattern as in the 1980s, sitting mostly within a range of $1,200-1,400/oz over the past six years.

The only two periods of unusual gold price strength in 50 years came with dramatic alterations in the balance of global economic power and the resulting flow of financial assets. The first was associated with OPEC flexing its economic muscles for the first time to create a massive build-up in Middle East financial reserves. The second came as a huge transfer of wealth to China began to reshape financial markets.

This broader perspective suggests prolonged periods of zero gold market returns as the most likely investment outcome in the absence of a dramatic shift in economic power.

Future trends in zinc or gold related investment returns, and metal markets more generally, cannot be assessed sensibly without recognising the importance of epochal changes in economic structures and, importantly, the infrequency with which they occur.

Lengthy periods - perhaps decades - without sustainable directional momentum should be regarded as the norm in the absence of the pivotal changes needed to make big impacts.

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