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Investment trends top dictate copper outlook

Future metal consumption gains remain tied to the impact of pandemic control measures on investment decisions just as better than expected global health outcomes have buttressed short term metal demand.

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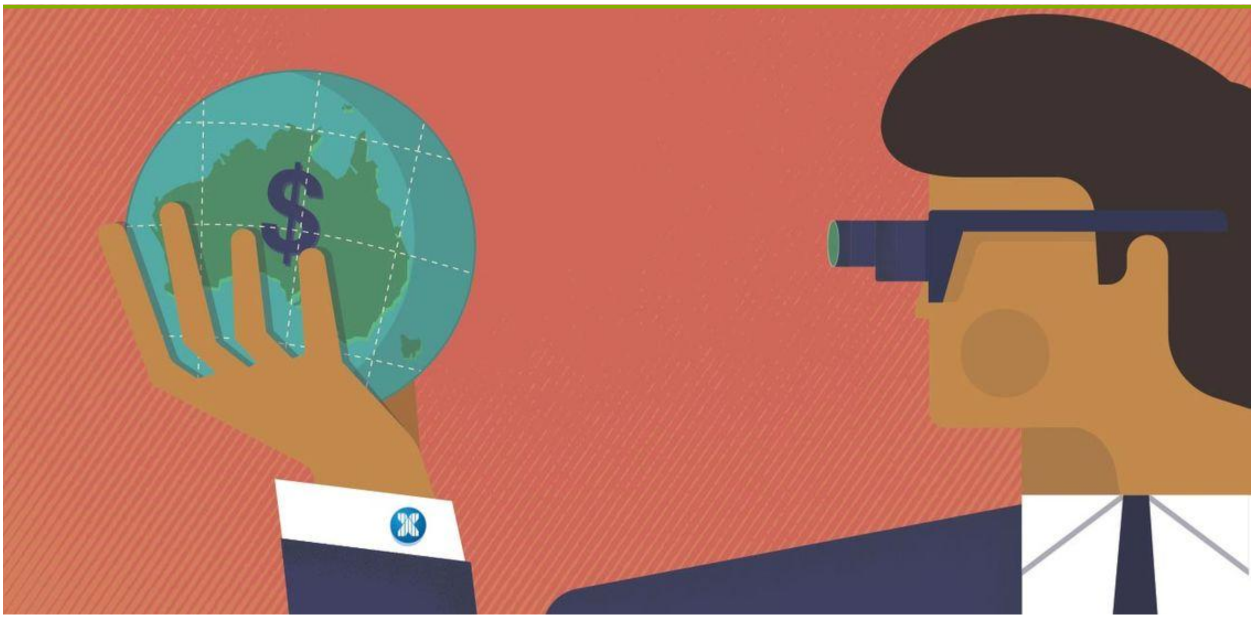

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The International Monetary Fund (IMF) has cut back its estimate of global production losses as a result of the COVID-19 pandemic. Fund forecasters now expect global GDP to contract by 4.4% in 2020 rather than the 5.2% drop in output they had anticipated in June.

The flip side of a better than previously expected 2020 outcome, according to the October World Economic Outlook released this month, is a weaker bounce. The previously expected 5.4% GDP growth rate for 2021 has been pared back to 5.2%.

Even after a 2.3 percentage point upgrade for 2020, advanced economy GDP is expected to fall 5.8%, including a massive 8.3% hit to euro area economies. If realised, the advanced economies will lose production worth US$2,035 billion during 2020.

Amidst the pandemic, economic outcomes have mirrored public health results. Until recently, health authorities have been more adept than first seemed likely at controlling the virus spread, warranting the upward growth revisions.

Despite initial success, and even as the IMF was crediting the improving health response, a large second wave of infections is threatening to derail the more optimistic Fund tone. Downside risks to the forecasts loom.

Despite early signs of deteriorating health outcomes, financial markets had been endorsing the prospect of a successful return to growth. Tumbling US government bond yields stabilised in recent weeks and began edging higher. At the same time, falling low-grade corporate debt yields suggested greater optimism about the business prospects of those companies most highly leveraged to economic conditions.

Copper prices were outstripping gold prices in another sign from financial markets that investors were looking to a strengthening global economy with fewer worries about financial market risks.

Market sentiment has been helped considerably by the quick restoration of growth in China. According to the Chinese government, GDP rebounded by 11.7% in the June quarter after contracting 10% in the three months ended in March. In the just completed September quarter, GDP grew by 2.7%. Chinese production already exceeds pre-pandemic levels.

“ **Extrapolating the close link between copper metal used and Chinese investment spending over the past 20 years suggests a 5% rise could have been expected in the amount of metal used**

The global averages would be much weaker without China. The IMF expects China's GDP to expand by 1.9% in 2020, down from 6.1% in 2019 but 0.9 percentage points better than had been expected in June.

The strength and speed of the Chinese resurgence has been a shot in the arm to the mining sector and, at a macro level, the pandemic-hit Australian economy.

Daily traded base metal prices have generally traded strongly since the weakest point in markets during the second half of March. A 40%-plus copper price rise, in particular, has attracted attention as a bellwether indicator of global growth prospects.

The International Copper Study Group (ICSG) reported last week that copper metal use in the first seven months of 2020 had crept above the amount of metal used over the same period of 2019, an extraordinary outcome in the midst of such dramatic global output losses.

Shortcomings in data availability probably exaggerate how much metal has actually been used. Chinese imports are treated by the ICSG as used metal since its sources cannot access data about changes in the amount of metal held in state-controlled Chinese stockpiles or held by others in domestic supply chains.

The ICSG statistics appear to show Chinese growth of 10% offsetting declines of a similar magnitude elsewhere.

The IMF estimate of Chinese 2020 GDP growth is consistent with an increase in the amount of copper being used in China. Extrapolating the close link between copper metal used and Chinese investment spending over the past 20 years suggests a 5% rise could have been expected in the amount of metal used.

Against the proffered IMF economic backdrop, non-China metal usage would have fallen by 8% based on the historical connection between investment spending and copper metal usage.

These historical links imply a potential fall in non-China copper metal usage of nearly one million tonnes offset by a 600,000 tonne rise in Chinese use.

Beyond 2021, the IMF expects global GDP growth to decelerate slightly each year while averaging 3.8%. Behind the top line economic forecasts from the IMF are views about the trends in investment spending within China and in the rest of the world.

The IMF's longer-term modelling shows a decline in the contribution of investment spending to Chinese GDP from just under 44% in 2020 to slightly over 39% by 2025, consistent with a long-targeted move toward a more domestically biased and consumer oriented economic model.

Historical investment-metal use relationships suggest Chinese copper use would rise from approximately 12.5 million tonnes in 2019 to 14 million tonnes in 2025 if the IMF forecasts were achieved.

Outside China, the investment contribution to GDP is expected to rise slightly from 22.3% this year to 23.2% in 2025. Extrapolating the non-China investment-metal use link suggests a rise in metal use from

11.9 million tonnes in 2019 to 13.9 million tonnes in 2025.

Worldwide growth in metal use over the coming five years will have split 60/40 in favour of countries outside China.

On these numbers, metal consumption growth rates could sit at around 2.5% over the coming five years, requiring an extra four million tonnes of copper production by 2025.

Of course, realisation of such outcomes depends on the IMF numbers being sufficiently accurate and the close historical links between investment spending and metal use being intact. The latter is more likely than the former.

The current surge in coronavirus infections again threatens economic activity and even raises the prospect of rolling disruptions to growth through much of 2021 as immunity takes time to build.

With global investment levels lowered in response to new pandemic restrictions, and corresponding cuts in metal use, copper producers will more easily meet relatively moderate demand growth, tilting the balance of risks toward inventory accumulation and reduced upward price pressures.

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