Copper: Is the worst over?

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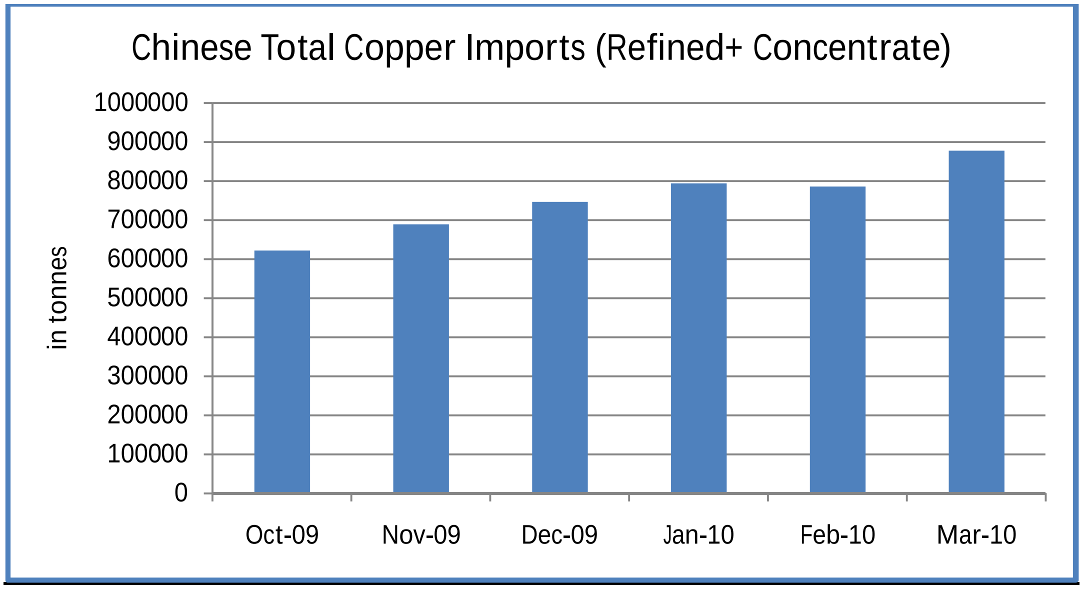
In the last weak we have seen a major correction in the prices of industrial metals and copper was not immune from this fall. Debt concerns in some of European countries hurt the sentiments of the investors which prompted a many to move out of the riskier assets. Also, Securities Exchange Commission filed fraud charges against Goldman Sachs over marketing of sub-prime mortgage products while also betting against the same debt. Due to these developments we have seen a dollar regaining strength, as uncertainty lingered over the outcome of the debt crisis of euro zone and Goldman news. The downgrading of Greece, Portugal and Spain by Standard & Poor added fuel to the negative sentiments. Copper was see-sawing at $8000 mark on LME before these developments took place in the Euro zone. And these developments have dragged the prices of copper as low as $7345 on LME. Now the question to be asked out here is “Is the Worst Over?” In this article we would try to look at the macro-economic events lined up in coming weeks and try to ascertain the effect of the same of the prices of Copper.

Scenario at the beginning of the year

A similar correction in the prices of metals was seen at the start of the year 2010. The world was about to discover the crisis in some of the debt laden countries in euro zone led by Greece. Also, we has People’s bank of China raising its RRR by 50 basis points effective from 18th January 2010. This move from china was a response of the government to the rising inflation in China. This move helped the government to withdraw 200 billion yuan from the market and try to control the inflation. Again in the month of February we could see second RRR hike from china in this year. This move was again expected to suck up 300 billion yuan from the Chinese economy.

As China is the highest copper consuming country, we coukd see a 12-13 percent correction in the prices of copper. Copper was trading at $7500 on LME at the start of the year 2010. Because of the above economic developments in euro zone and China, copper was back again to $6500 level.

Chinese Actions



Source: Reuters, NB Research

Despite of an increase in the RRR requirements by the Chinese officials, the Chinese demand was still robust. Chinese copper imports were edging higher during that period. We could see a 40 percent increase in the amount of total copper imports by china in March 2010 from October 2009 levels. The number of shipments due to be delivered in the month of February were delayed and the goods were delivered at Chinese ports in the month of March. For this reason, we could see a sharp rise in the number of copper imports by china during the month of March.

The level of arbitrage window between LME and Shanghai gave support to the prices of copper to a great extent. Copper being traded at a premium in Chinese local markets over LME prompted many to make the most of this available opportunity. A premium of above 250-300 US$ was used as a good arbitrage opportunity. This phenomenon highly supported the prices of copper traded on LME as we could see Chinese interest being strong in the metal during that period. Also a surge in Chinese GDP, Industrial production activities, Housing activities in the US was gaining strength. This again built-in some demand optimism in the metal and hence, we could see copper reaching year highs and touching $8000 per tonne mark on LME.

Recent Developments

Closure of Arbitrage Window

Last week we have seen copper prices tumbling from $8000 mark to a low of $7300 per tonne. Euro zone debt crisis majorly led to this correction in prices. We could also see a closure of the arbitrage window of copper prices traded on LME and Shanghai. Local copper prices in china were pressurized due to high amount of imports and output of the metal leading to high supply. Thus, the practice of free money by making the most out of the arbitrage window has come to a standstill. For this reason we feel that China's imports in the month of April and May will face a slowdown.

China's Residential Property Rates

Chinese economy has been over-heating for quite a while now due to increasing house property rates. Prices in major cities rose 11.7 per cent year-on-year last month, the fastest pace since July 2005, official data showed. Also, average price of a new apartment in the Beijing was 21,164 yuan per square metre, double that of last year, state media said. Residential property in China is expensive if house prices are compared with household incomes. To purchase a house or an apartment a Chinese household will currently have to pay on average around 8 times its annual income. In major cities like Beijing and Shanghai a household will even have to pay a whopping 14 times its annual household income for an apartment.

High level of speculative buying with respect to high house property has resulted into this. We have seen a series of steps taken by the Chinese government with respect to cooling off its increasing house property rates. China raised mortgage rates and down payment requirements and also it raised taxes on people owning a second and third home to rein in speculative property buying, a move seen slowing construction investment. Also, China is likely to introduce a property tax on residential housing in the first half of the year on a trial basis in Beijing, Shanghai, the southwestern area of Chongqing and the southern city of Shenzhen.

China has raised its RRR requirements by further 50 basis points last week. This is the third time in the current year China has raised by RRR rate. By this move Chinese officials are aiming to further limit the excess liquidity from local markets. Again, this move is expected to cool off house property prices in china.

Monetary tightening moves could have a direct impact on economic growth of China as it has to deal with the trade-off between growth and stabilization. This is expected to have a direct impact on the prices of metals as china is the highest consumer of metals.

Conclusion: Is the worst over??

In the beginning of the year 2010 we had seen a similar fall in the prices of copper. But the metal was bailed out from the fall due to robust demand from China. Now when we have again have a correction of about 8 percent in the prices of copper, the question to be answered is "Is the worst over?". We feel still copper prices may witness some downside as China will not be able to support the fall at this point of time. Economic worries is china will further weigh on the prices of metals and especially copper. Also, the debt concerns in euro zone are not out of picture. Any further major development with respect to debt concerns in European countries will affect the prices of copper.

On the other hand if we weigh the bulls, fundamentally the world economy is in favor of the metal. With level of Industrial production across the globe, ever-increasing automobile sales, surge in housing activities in the US are some of the factors supporting the prices. But, for a short-term perspective we see a further correction in the prices of copper.

China's move with respect to cooling off its economy from over-heating will put short-term breaks on the construction sector which will directly have an impact of the prices of metals. We again see copper trading at $6800 on LME and Rs.308-312 on MCX.