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ETF Securities Commodity Research:

Copper: strong fundamentals and improving sentiment

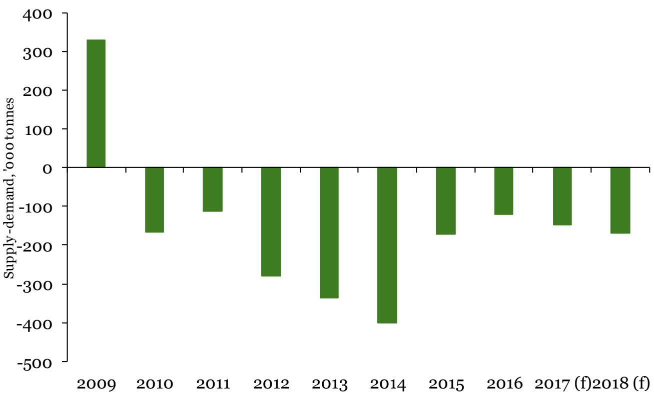
Summary

- Copper is likely to remain in a supply deficit until 2018 at least, marking nine consecutive years of a supply deficit.
- After a shake-out in speculative positioning, long positions in copper futures are being built again.
- While the large mines that closed in February are operational again, the labour disputes and mining rights are still unresolved.

Copper in nine years of deficit

In our research piece [Copper outlook 2017: eighth year of supply deficit](), published in February, we projected copper to go into supply deficit this year, after correcting the International Copper Study Group's (ICSG's) forecasts for a stronger demand profile and the mine closures that commenced in February. Since then the ICSG has revised up demand and revised down supply, pushing their forecast to a deficit and go further to predict a deficit in 2018. That will mark nine years of back-to-back supply deficits.

Refined copper market balance

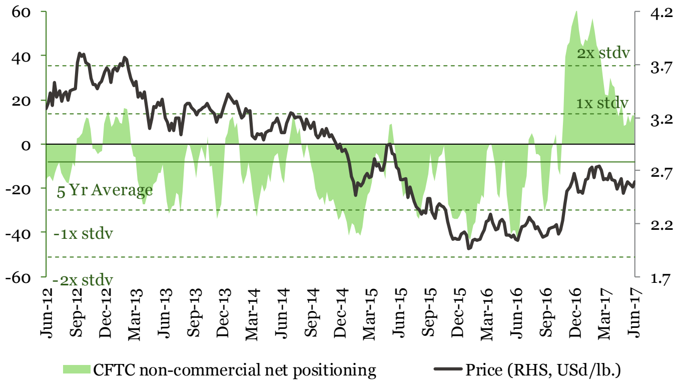


Source: ICSG, ETF Securities, data available as of close 20 June 2017

Speculative shake-out lays ground for stability

Speculative positioning in copper had been largely net short for the 5 years leading up to October 2016, despite the fact that the market was in a supply deficit. Market sentiment toward China, the main consumer of copper was very negative, even though its consumption of copper had been growing throughout the period. Between November 2016 and March 2017, however, speculative positioning in copper rose sharply. Net positioning rose to over 2.5% above the 5-year average. Market sentiment surrounding US President Trump's pro-growth and commodity intensive infrastructure spending plans was a clear catalyst driving up speculative positioning in copper. Added to that, it appears that speculative buying by retail investors in China provided another tailwind. There has been a correction in speculative positioning and copper prices as the Trump-induced optimism has faded and the Chinese regulatory authorities have tightened market access to retail investors.

CFTC Positioning in Copper Futures



Source: ETF Securities, Bloomberg, data as available as close of 20 June 2017

As we highlighted in May in ["Trump fade" represents a commodities buying opportunity](), this shake-out in speculative positioning lays the ground for more sustainable investing based on fundamentals. While speculative positioning has come down from the excessive levels we saw at the beginning of the year, they have not fallen to the levels of deep pessimism we saw in prior years as investors are paying attention to the fundamentals.

Mines reopened but issues unresolved

We reported on the closure of the world's two largest mines, Escondida and Grasberg in February in [Copper outlook 2017: eighth year of supply deficit](). They have reopened. However in the case of Escondida, striking miners only returned to work because the mine operator used an obscure legal provision (Article 369) to revert to previous labour contracts for 18 months. In other words, wage and labour contract negotiations have just been postponed.

In the case of Grasberg, the mine operator, Freeport-McMoRan only managed to secure a licence to export ore after threatening to stop working on a project that would sustain production until 2041. The Indonesian government has changed rules requiring foreign miners to divest 51% stakes in their operations to local investors. That seems too bitter a pill to swallow for the miner. Freeport is looking for greater legal assurances and a stable investment environment before putting in the billions of dollars of investment needed to access underground copper deposits. The two sides have a six month window to make an agreement.

As noted in our recent Commodity Monthly Monitor, Freeport fired 3,000 its 30,000 employees in in recent weeks for not reporting to work (an illegal strike). We doubt that will help when negotiating with a government with a populist agenda and highlights the level of animosity against the company.

So despite these two large mines (accounting for approximately 10% of global supply) resuming operations, the risk of supply disruptions reoccurring are high.

We believe that copper prices are likely to rise as medium-term fundamentals remain positive and speculative positioning is no longer at its extremes.

The intelligent alternative

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