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Forecast copper supply constraints provide optimism despite 2018 price decline

Following a strong first-half rally in 2018, the copper price dropped amid a slowing Chinese economy and subdued activity in the US and Europe.

Closing the year at around 25% below its June peak, concerns surrounding the strained US-China trade relationship and China's gradual economic slowdown have been sustained into the New Year.

Rhetoric from China's leader Xi Jinping regarding the country's commitment to a "Made in China 2025" policy, as well as little indication of a much-needed economic stimulus, have not assuaged investors and caused further steep declines in the copper price during December.

However, worsening global macro conditions could potentially be offset by forecast declines in global copper production and inventories in 2019, which would positively influence prices.

S&P Global predicts copper will remain at $6,100 a tonne in 2019, rising by $100 in 2020 and again in 2021 to reach $6,500 a tonne.

The copper price today is sitting at just above $5,681 a tonne, or $2.577 a pound.

China's slowdown

A research report from Citigroup in mid-December recognised the persistent concerns over China's macroeconomic conditions in 2019.

The report said: "Mixed China macro data, including a sharp slowdown in household consumption, call for more policy fine-tuning into 2019.

"On the positive side, investment across infrastructure, manufacturing and property improved with levels of infrastructure investment surging in November following weak readings over the past few months."

Credit Suisse analysts expressed optimism in another report released in December, stating they could not rule out the Chinese government reacting to trade tensions and growth pressures by further infrastructure and construction investments.

This tried-and-tested method would provide a boost for commodity demand.

Slow start to 2019

The New Year began with further steep falls after data suggested China's manufacturing sector contracted in December, with global markets all closing lower on Wednesday.

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The ASX was down 1.6% while the Hang Seng, Shanghai Composite, FTSE, CAC and DAX all dropped between 1%-3%.

Forecasts from the International Monetary Fund for world gross domestic product (GDP) growth are 3.7% for both 2018 and 2019, including slower growth for the US and China at 2.5% and 6.2%, respectively.

India's GDP is expected to grow by 7.4%.

Supply-side optimism

According to JPMorgan estimates, China's demand for copper has risen by 5%-6%, with head of metals strategy at the global commodities group Natasha Kaneva saying Chinese copper demand was not as bad as people thought.

The Bank of America Merrill Lynch was more cautious, noting prices were under pressure and the macro environment would remain challenging into 2019.

Coupled with growing demand, forecast supply cuts from some of the world's largest copper producers give some optimism to investors regarding the copper price over the next 12 months.

Production at the Grasberg Copper Mine in Indonesia, operated by Freeport McMoran (NYSE:FCX) and Rio Tinto (LON:RIO), will fall by more than 50% next year as the mine transitions to underground operations.

The transition is expected to reduce copper supply in the market by about 300,000 tonnes, or 1.5% of annual copper mine production.

BHP Billiton Ltd's Escondida Copper Mine in Chile is also expected to produce less copper this year.

Sustained demand yet to show effect

Speaking at the 14th Asia Copper Conference in Shanghai, a Morgan Stanley representative said many industry participants were frustrated that recent strong demand and falling exchange inventory had not resulted in a higher price.

The investment bank's speaker said supply growth to replenish falling stockpiles would be limited while disruption risk remained.

"We maintain our base case forecast of a modest deficit in the copper market in 2019 of around 240,000 tonnes based on China's refined demand growth.

"Limited copper cathode inventory and weak supply growth make the copper market well-positioned to weather any slowdown in China's demand, with little prospect of a significant surplus developing.

"Price upside is likely to remain limited until macroeconomic sentiments turns positive."

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