GFMS METALS CONSULTING

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GFMS Metals Consulting increases copper price forecasts

In our earlier analysis, we believed that the market would begin to focus on the sharp increases to copper production in the pipeline, and that prices would quickly come under pressure in 2005, even though inventories were set to remain at historically low levels. Spot treatment charges have traditionally be a good leading indicator of a turnaround in the copper market, which typically lags the turnaround in the spot TC market by 6-9 months. Spot treatment charges bottomed in the summer of 2004 with isolated reports of negative TCs.

Higher mine supply continues to boost treatment charges. TC/RCs are up at $140/tonne-14c/lb in Europe. Chinese TC/RCs remain at the $140/tonne-14c/lb level, however many market participants expect that deals of $150/tonne-15c/lb may soon be achieved.

Consumption growth to slow?

The other reason for our caution on the market was the belief that copper consumption would slow after the strong rebound seen in 2004. Although there is some evidence of this, the focus of the market remains exceptionally tight terminal market stocks and China's huge import requirements.

Although the historical shipments data from organisations such as the Copper and Brass Servicenter remain positive, some of the leading US fabricators have experienced a slow down in the rate of demand growth. For example, although Olin experienced a 27% year-on-year increase in Q4 sales, the improvement primarily reflected significantly higher copper prices and shipments rose by 1%. Shipments to the ammunition and coinage segments increased 26% and 4%, respectively, while shipments to more general industrial sectors performed less well. Shipments to the automotive, electronics, and building products segments declined by 9%, 16%, and 3%, respectively. GFMS Metals Consulting is forecasting refined copper consumption growth of 3.0% in the US this year following growth of 10% in 2004.

As industrial production growth falls in Japan, recent data suggests the slowdown is having an effect on the copper market. The Japanese Electric Wire and Cable Makers' Association has reported December's production rose by a modest 0.2% year-on-year to 69,400 tonnes.

Despite some evidence of slowing demand growth, speculative interest is high. The CFTC data shows an increase in the non-commercial long futures position to 27,671 contracts, 4,017 contracts higher than the previous week. The net position rose from 17,581 contracts to 19,880 contracts reversing a trend of falling long exposure seen previously this year. Sentiment is becoming increasingly bullish that copper can make and sustain new highs in the coming weeks.

China underpins the market short-term

Chinese growth is expected to remain strong; we forecast an 8% increase in demand to 3.7m tonnes. Domestic production is only likely to reach 2.3m tonnes – very little of which will be exported given tight domestic supply and a new 5% export tax. The deficit will be made up from imports, which could be in the region of 1.5m tonnes of refined material, which is significantly higher than the 1.076m tonnes imported (net) in 2004 when there was considerable de-stocking, primarily by the SRB, in the country. This de-stocking is largely over and we are forecasting strong import figures +100,000 tonnes per month for most of the year.

Higher mine supply will eventually kick in

The Chilean National Statistics Institute has reported that the country produced 5.338m tonnes of copper in 2004, a 9.8% year-on-year increase. In a sign that output is set to continue growing December's production was up by 13.5% year-on-year to 517,177 tonnes, an annualised rate of 6.2m tonnes.

The Chilean copper commission, Cochilco, has said that mine output from the country will rise by 3.5% in 2005 to 5.5m tonnes as state-owned Codelco and the giant Escondida and Collahuasi mines ramp up production. GFMS Metals Consulting forecasts slightly higher mine production from Chile in 2005. This along with substantial increases in output from the US, Brazil and the Grasberg mine in Indonesia should allow Western World supply of refined copper to rise by a forecast 7.4%, which in our view will reduce the full year market deficit to 256,000 tonnes, with the market finally moving to a surplus in Q4.

The commission also said that it expects a continued deficit in 2005 of 170,000 tonnes that will support prices at high levels. The commission forecasts that average prices in 2005 will be in a range of $2,557-2,645/tonne. Our own view is of a larger deficit in 2005 with prices averaging $2,800/tonne.

Our revised forecasts still suggest plenty of downside potential from current levels. Although we expect the market to make new highs in Q1 after the Chinese New Year, the downside potential from over $3,000/tonne is considerable. In this cycle, we have already seen sharp, albeit temporary corrections, in other base metal prices. As increased refined production starts to show in higher inventories, GFMS Metals Consulting expects a move towards $2,400/tonne as the year progresses.

Note to Editors about GFMS Metals Consulting Ltd:
GFMS Metals Consulting was established to build upon GFMS Limited's unparalleled reputation for providing authoritative analysis on the precious metals markets. GFMS Metals Consulting will utilise the same in-depth research techniques to meet the industries' demands for market information and analysis on the base metals, steel and related sectors.

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