

October 2018

Economic Indicators and Comment:

According to the U.S. Commerce Department's first estimate of third-quarter GDP growth, the U.S. economy slowed less than expected as a tariff-related drop in soybean exports was partially offset by the strongest consumer spending in nearly four years and a surge in inventory investment. GDP increased at a 3.5% annual rate also supported by solid government spending. This was down from a 4.2% increase in Q2. Compared to Q3 2017, the economy grew 3%. The economic expansion, now in its ninth year, is the second longest on record. Economists polled by Reuters had forecast GDP to expand 3.3% in the third quarter.

China's economic growth slowed more than expected in the third quarter, as weak industrial output data and what the Chinese government called the "severe international situation" challenged efforts to stabilize the economy. In Q3 2018 GDP increased 6.5% from a year earlier and compared with a 6.7% increase in the previous quarter. It is the lowest increase since 2009. The problems caused by worsening trade tensions and a slumping stock market have prompted officials to step up stimulus and pledges of further support but the impact of those measures has yet to be felt. China's National Bureau of Statistics said that while the international situation was bringing "downward pressure" on China's economy, growth is still stable and the nation is on track to achieve the full-year growth target of about 6.5%.

Growth in the eurozone has slowed to its lowest level in over four years, as the region's recovery appears to falter. Eurozone GDP only rose by 0.2% in July-September, down from 0.4% in April-June. Economists say the figures are disappointing and weaker than expected and could even precede a wider recession. Italy's growth rate fell to zero. France did better - its economy grew by 0.4%, thanks to a pick-up in consumer spending and business investment.

The UK's ONS said the rate of GDP growth in August dropped to 0% from 0.4% in July and 0.2% in June, missing City economists' forecasts of 0.1%. The stagnation in August was across much of the economy, with only a modest improvement in the rate of output in the industrial sector thanks to mining and quarrying activity. Analysts said momentum in the UK economy was fading after robust growth earlier in the summer and warned that the weak August reading could serve as a signal for weaker economic growth in the months ahead, amid mounting concerns over the risks from a no-deal Brexit. Despite the weaker performance in August, the rolling three-monthly GDP figure revealed the strongest growth in almost two years, with 0.7% across the three months. The services sector, which accounts for more than four-fifths of the economy, recorded zero growth. Manufacturing output slid by 0.2%, while construction output dropped 0.7%. The National Institute for Economic and Social Research said it expected the UK economy would expand by 0.7% in the third quarter of 2018 and by 0.5% in the final three months of the year, pointing to economic growth for the year as a whole of about 1.5%.

Market Commentary and News:

Aurubis, Europe's biggest copper smelter, has offered 2019 copper cathode premiums to its customers of US\$96/t basis CIF delivery, the company said at the start of October, confirming earlier reports from traders. This compares to US\$86/t in both 2018 and 2017.

Codelco reported that it had locked in copper cathode supply contracts with European buyers at a premium of US\$98/t, the highest since 2015. Premiums for contracts signed with customers in China and the U.S. are also up by 15% to 17%. The company's VP, Roberto Ecclefield said that this year's sales are "amazingly good", adding that; "It's the first time you see China, the U.S., and the Europeans very strong. And that is unique in many years." The miner is "almost done" with its annual sales campaign, and is expecting to finish before the end of October, he said.

Codelco is in talks to sell up to 60,000tpa of copper a year to China Minmetals from 2019 to 2021, marking a change in sales strategy at the state-owned miner which typically has made deals on an annual basis, industry sources said. Sources

say the aim was to agree "evergreen" three-year deals in which the Chinese company would commit to buy 50,000tpa to 60,000tpa of copper for the period.

Meanwhile, Codelco is facing an extended stoppage at one of its smelters as it struggles to complete an overhaul in time for the start of stricter emission standards. The company is having difficulties installing equipment while the smelter is operating. As a result, some "processes" could experience delays of about 80 days from mid-December, the company said.

The copper market should see a deficit of 92,000t this year and a deficit of 65,000t in 2019, the International Copper Study Group (ICSG) said. This is more than double the forecast it made in April. The global world refined copper market showed a 47,000t deficit in July, compared with a 38,000t deficit in June. For the first 7 months of the year, the market was in a 157,000t deficit compared with a 188,000t deficit in the same period a year earlier. World refined copper output in July was 1.98 million tonnes, while consumption was 2.03 million tonnes. Bonded stocks of copper in China showed a 60,000t deficit in July compared with a 40,000t deficit in June.

Rising industrial demand in China and declining mining output will help support copper prices next year, according CRU Group analysts. During a presentation at the LME Seminar, analysts said they expected global copper demand to grow 2.9% next year. Historically, copper demand grows about 2% each year. Demand is being driven by China, which is trying to move away from investment-led growth to more consumer-led growth. Demand from most end-use sectors in China is expected to remain firm, resulting in copper demand growth of about 3.5% next year. Tightness in copper scrap supply is also expected to boost Chinese demand for refined copper next year. China severely restricted the flow of copper scrap imports this year after implementing import bans early in the year. Copper prices are also likely to be supported by declining mine output. Global mine output is expected to grow only 1.2% next year compared with about 1.8% this year, CRU said.

China's Belt and Road Initiative to boost trade and infrastructure in 64 countries is expected to help boost copper demand in those nations to 6.5 million tpa by 2027. That is a 22% increase from 2017 and about 10% higher than if China had not launched its initiative, according to data presented by China Minmetals UK. The increase is due to higher copper demand for power and transport infrastructure, such as power grids and railways, the company said in a presentation sponsored by the International Copper Association. The forecast also includes indirect impacts, such as more electrical appliances and home construction made possible by the additional infrastructure. Electricity consumption in the 64 countries is due to more than double from 1,600 kilowatt hours per capita per year in 2015 to 4,166 KWh by 2030, it said. The 64 countries accounted for 43.5% of global population and 16.1% of world GDP in 2016. State-owned China Minmetals Corp is China's biggest and most international mining company and its UK unit is a trader in metals, minerals and metal fabricated products.

China's unwrought copper imports surged to their highest in 2-1/2 years in September, while copper concentrate imports climbed an all-time high as the crackdown on scrap leaves it needing other forms of the metal. China's imports of copper, which include anode, refined, alloy and semi-finished copper products, rose 24% from August to 521,000t last month, data from the General Administration of Customs showed.

Global aluminium production grew by just 0.3% in the first nine months of 2018, the slowest rate of expansion since the financial crisis in 2008-2009. Smelter outages in Canada and Brazil continue to constrain run rates in the Western World, while structural reform in China is capping output there. Aluminium production in China fell by 0.7% over the first nine months of the year, according to the International Aluminium Institute (IAI) which estimates that China produced 27.18 million tonnes in the January to September period. Production outside of China grew by 1.9%. Asia (excluding China) showed the fastest production growth at 14% - largely due to the ramp-up of new capacity in India. Restarts in the U.S. are also building momentum but their impact on regional output is being mitigated by the continuing strike action at Alcoa's Becancour smelter in Canada and restricted output at Hydro's Albras smelter in Brazil.

Global primary aluminium output fell to 5.301 million tonnes in September from revised 5.485 million tonnes in August, data from IAI showed. Estimated Chinese production fell to 3.01 million tonnes in September from 3.12 million tonnes in August, it added. In contrast, data from the National Bureau of Statistics showed that primary aluminium production was 2.79 million tonnes of the metal in September - its lowest level since May.

These figures were released as China's environment ministry issued a stern warning to companies across heavy industry not to flout the nation's tough emission rules - a move seen as quashing speculation that the 2018 winter anti-smog campaign will be more lenient.

Norsk Hydro has been granted a permit in Brazil to use new technology to extend the life of a disposal area for its Alunorte alumina refinery, the world's largest, which should lead to the restart of operations at 50% of capacity, the firm reported mid-month.

Indian aluminium makers including Hindalco Industries and Vedanta Ltd are boosting sales to Japan as U.S. sanctions against Russia's Rusal and import tariffs shake up traditional supply routes. India's product has generally not been regarded as high enough quality by Japan's demanding buyers, who have preferred top-tier producers like Rio Tinto, Alcoa and Rusal.

Premiums for Japanese aluminium shipments for the October to December quarter were set at US\$103/t, down 22% from the previous quarter, as Asian spot premiums fell amid ample supply, sources said. The new premium compares with the US\$132/t premium in the July to September quarter and follows three quarters of rising premiums.

The U.S. said mid-month that it was granting investors another month to divest their holdings of sanctioned Russian companies EN+ and Rusal and was giving the firms more time to address their business operations. The U.S. Treasury Department in April imposed sanctions against billionaire Oleg Deripaska and eight companies in which he is a large shareholder, including aluminium exporter Rusal, citing "malign activities" by Russia. This comes as the company steps up its efforts to convince the legislators in Washington to lift sanctions.

According to the European Commission, LME members will be permitted to clear via London even if no Brexit deal is reached, although it remains unclear whether this reprieve would also apply in the event of Brexit being agreed with a deal on March 29, 2019. The move was designed to ensure a catastrophic impact on clearing in the derivatives industry was averted in the event of a no-Brexit scenario. The Commission did not say whether the UK's clearing houses would be able to clear European Economic Area-incorporated members before they become recognized central counterparty clearing houses (CCPs), which is a restriction currently in place under Brexit.

The LME has published a position paper detailing new proposed requirements for listed brands regarding the responsible sourcing of metals, with a particular emphasis on cobalt and tin. The requirements align with principles set out by the OECD's 'Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas', the LME said.

New steel and alumina contracts have the best chance of succeeding as the LME unleashes 10 new products early next year in an attempt to compete more effectively with rival exchanges, industry sources said. The new products range from hot rolled coil (HRC) steel to alumina, the raw material for aluminium, as well as cobalt, which is key for electric vehicle (EV) batteries. The LME also plans to launch a contract for lithium, another important metal for EVs, but that will come later, perhaps in 2020.

LME Commentary:

Supply security concerns are combining with the metals industry's growing focus on sustainability to change physical producer-buyer relationships. The market is expecting the removal of sanctions against Rusal by mid-November but this will not change the hostile political landscape between the U.S. and Russia. Russian aluminium carries a new political risk going forwards which is why Japanese buyers have been turning away from Russia towards India this year - imports from that country doubling in the first eight months. Rusal itself is looking to expand its sales and marketing presence in China. It is not just the aluminium supply chain that is having to adapt to the new reality of politicised markets. Chile's Codelco, the world's largest copper producer, and China's state-owned Minmetals, are looking to transform their current annual supply contract to a rolling three-year "evergreen" arrangement – something Codelco have historically been at pains to avoid.

Analysts told the LME's Seminar during LME Week that the trade war impact has come in the form of waves of fund selling in the metals futures market. The LME base metals have been trapped in a 'bear tariff narrative' of dollar strength and weakened growth in China, a double-whammy of bad news for the likes of copper. The LME base metals index slumped by 19% between June and September. It has stabilised in October but most analysts think the sell-off has gone too far and it is time for fundamentals to fight-back with prices, particularly copper, driven by investor positioning not fundamentals. This tension between robust internal supply-demand dynamics and investors' negative view of base metals in the current tariff climate is currently playing out in LME forward spread tightness. There are backwardations in the LME copper, lead and zinc markets right now with aluminium trading at a much reduced contango.

LME aluminium prices rose to their highest levels in more than three months in the first week of the month to record the biggest weekly gain in nearly six months, amid worries the closure of the world's largest alumina refinery in Brazil would lead to alumina shortages. The LME cash price hit £1726.96/t as the underlying USD price hit a high of \$2251/t. Thereafter, prices fell sharply following a broad sell-off in equity markets which hit metals prices and after a Brazilian court approved emergency waste measures to allow the world's biggest alumina refinery to resume production. Analysts have suggested that the market expects the sanctions against Rusal to be lifted sometime mid-November – certainly before the extended deadline of 12th November. The LME aluminium cash price hovering around \$2000/t it is almost exactly where it was before sanctions sent it rocketing to 7-year highs above \$2,600/t in April.

The LME GBP aluminium cash price closed the month on a low of £1526.87/t while the underlying USD price hit a 14-month low of \$1946/t after data release at the end of the month showed that China's manufacturing sector grew at its slowest pace since July 2016.

LME primary aluminium stocks hit their lowest levels since January 2006 at 926,100t on 12 October – down only 175,275t this year but some way from the peaks of over 5,000,000t last seen in July 2014. It appears that prices are not being supported by falling stocks - there is a strong suspicion that erosion of LME inventory is as much to do with the exchange's warehousing function as with market reality. Stocks increased by month end to close at 1,047,325t.

Copper prices traded erratically through the month when earlier bullish reports of supply issues and near record Chinese imports of copper in September were offset by the on-going trade tariff issues, a strong US Dollar and worse than forecast Chinese economic data. Prices recovered towards month end, closing at £4881.47/t on 29 October, its highest since early July this year, aided by a weak Sterling against the US Dollar (which closed at 1.2745, its lowest level since mid-August) and a sharp fall in LME exchange stocks. LME stocks closed the month at 136,675t, the lowest since 2008 and for the first time below 150,000t since early July this year.

Of greater concern to hedging fabricators was the development of the forward backwardation during October. Averaging £29.76/t over the month, the cash to 3-month copper spread moved out to £67.16/t at month end. Brokers suggest the tension between robust internal supply-demand dynamics and investors' negative view of base metals in the current tariff climate is currently playing out in LME forward spread tightness. The backwardation in the LME copper price is mirrored in the lead and zinc markets while the aluminium contango narrowed.

LME Statistics and Charts: October 2018:

| | Copper | | | Aluminium | | | USD:GBP |
|-------------------|----------|---------|---------|-----------|----------|-----------|---------|
| | Cash £/t | 3M £/t | Stocks | Cash \$/t | Cash £/t | Stocks | |
| Opening | 4738.58 | 4709.59 | 199,125 | 2047.50 | 1,571.98 | 987,800 | 1.3025 |
| Average | 4777.56 | 4747.80 | | 2034.17 | 1563.36 | | 1.3012 |
| High | 4881.47 | 4836.41 | | 2243.50 | 1726.96 | | 1.3232 |
| Low | 4651.60 | 4619.35 | | 1946.00 | 1526.87 | | 1.2745 |
| Range | 229.87 | 217.06 | | 297.50 | 200.09 | | 0.0487 |
| Closing | 4765.01 | 4697.85 | 136,675 | 1946.00 | 1526.87 | 1,047,325 | 1.2745 |
| Opening:Closing Δ | -26.4 | +11.74 | -62,450 | -101.50 | -45.11 | +59,525 | |
| YTD Average | 4897.43 | 4895.74 | | 2143.88 | 1593.12 | | |
| YTD High | 5421.80 | 5402.51 | | 2602.50 | 1828.11 | | |
| YTD Low | 4465.44 | 4463.76 | | 1946.00 | 1403.52 | | |





