

SMM Metals Macro Report

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Supply of most base metals to grow as environmental probes end

Copper: spot copper concentrate TCs to rise in Qn3

Unexpected closures of the Vedanta and Pasar smelters and maintenance at domestic smelters drove up spot TCs. The closures are expected to affect some 600,000 mt/year of smelting capacity. As of June 29, SMM reported TCs of spot imported ore at \$83-90/mt, up \$7/mt from a month earlier. The China Smelters Purchase Team (CSPT) did not fix the floor price for the third quarter.

Aluminium: raw material costs to bottom out

For Alumina, Norsk Hydro has not yet resumed production at Alunorte and looks increasingly unlikely to do so before year end which will continue to encourage Chinese alumina exports, meanwhile environmental scrutiny across Shanxi and Henan provinces limited bauxite supply domestically. The 2018/19 winter cuts under the "three-year blue skies" plan would expand from last winter with more regions covered. The operating alumina capacity in these regions accounts for 72% of China's total, making alumina one of the commodities likely to see higher prices into winter.

Lead: primary lead producers to resume production soon

Primary lead smelters are expected to restart production from the second week of July. This will weigh on TCs of domestic and imported lead concentrate to 1,650 yuan/mt (up 100 yuan/mt on the month) and \$20/mt (stay the same of June) respectively in July, SMM believes. SMM understood that secondary lead smelters began to resume production in late June after environmental inspections ended. **SMM estimates the output of primary lead in July at 258,000 mt, up 2.5% from June.**

Zinc: refined zinc output to shrink 2.61% in July

While maintenance works at smelters and environmental reviews have entered into the finale, July's refined zinc output across China is likely to fall from June as the recovery of production is slower than expected due to weak margins. Supply and demand remains poor in the near term. Inventory shrank as inflows of imported materials dwindled amid a closed import arbitrage window and as smelters held back from selling. **We expect the figure to stand at 418,600 mt in July, down 2.61% month on month and 8% year on year.**

Nickel: NPI output to grow 5.41% in July

Production resumption from environmental scrutiny will account for the growth. We will monitor the commissioning of Tsingshan Group's 1 million mt/year of stainless steel project in Indonesia. SMM believes that healthy profits will drive output of stainless steel in July to 1.92 million mt, up 5.48% from June.

Copper: spot copper concentrate TCs to rise in Q3

SMM expects treatment charges (TCs) of spot imported copper concentrate to continue to rise in light of adequate supplies in the third quarter of the year, as smelters have high inventories.

Unexpected closures of the Vedanta and Pasar smelters and maintenance at domestic smelters drove up spot TCs. The closures are expected to affect some 600,000 mt/year of smelting capacity. As of June 29, SMM reported TCs of spot imported ore at \$83-90/mt, up \$7/mt from a month earlier. The China Smelters Purchase Team (CSPT) did not fix the floor price for the third quarter.

Chart 1: Spot TCs of copper concentrate

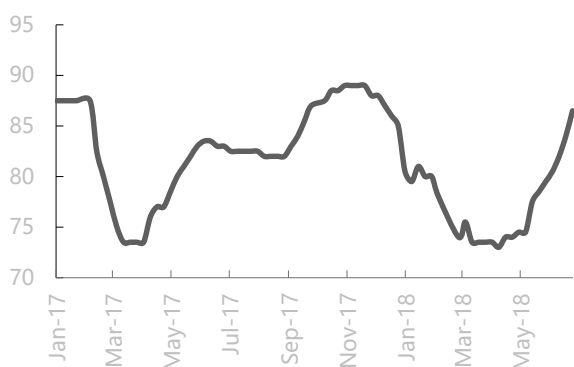
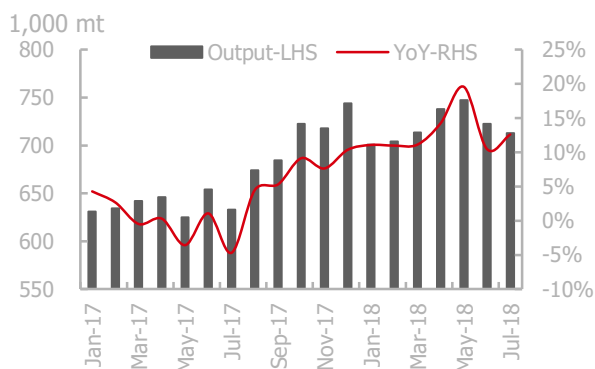


Chart 2: SMM's monthly refined copper output



Weaker demand in the low season and increased supply are expected to weigh on copper prices in the near term.

Operating rates at domestic producers of copper rod and plate in May stood at 80.42 and 79.15%, down 3.29 and 1.54 percentage points on the month respectively. However, operation rates of tube and pipe was 93.91% in May, up 3.59 percentage point from April. For the first half of 2018, SMM expects copper cathode output to gain 12.9% on the year to 4.33 million mt. Imports of copper concentrate and copper anode scored double-digit growth rate in the first half year of 2018. With the crackdown on imports of copper scrap, SMM estimates China's apparent copper consumption for Jan to May at 4.96 million mt, up 15.16% on the year. Despite very weak state grid spending as Beijing lowered infrastructure spending in 1H18. As infrastructure spending increases in 2H, this should support copper demand beyond the weaker summer period.

Chart 3: Operating rates at wire, cable producers

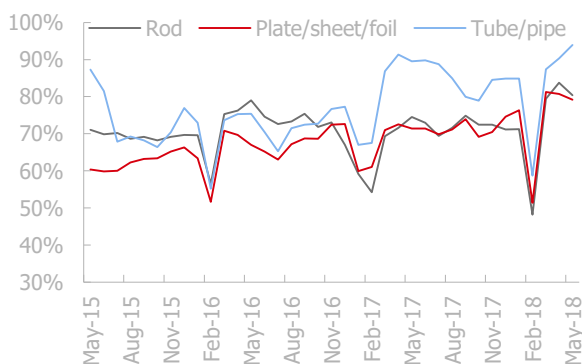
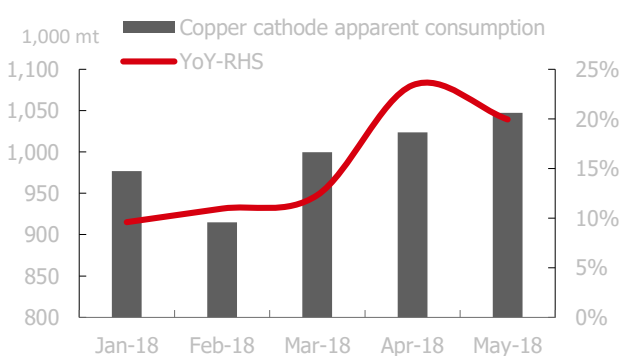


Chart 4: China's monthly apparent copper consumption

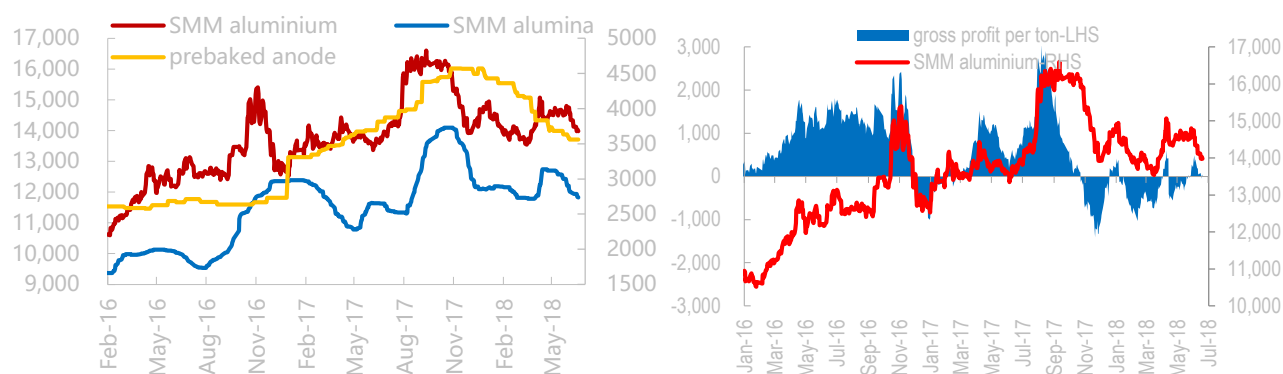


Aluminium: raw material costs to bottom out

Costs of alumina and prebaked anode are likely to bottom out before they rise in July, SMM believes.

For Alumina, Norsk Hydro has not yet resumed production at Alunorte and looks increasingly unlikely to do so before year end which will continue to encourage Chinese alumina exports, meanwhile environmental scrutiny across Shanxi and Henan provinces limited bauxite supply domestically. The 2018/19 winter cuts under the “three-year blue skies” plan would expand from last winter with more regions covered. The operating alumina capacity in these regions accounts for 72% of China’s total, making alumina one of the commodities likely to see higher prices into winter. An SMM survey showed that costs of raw materials have trended downwards since the start of June, with monthly average prices of alumina and prebaked anode in June down 3.3% and 9.4% on the month, respectively. As of late June, average full costs of aluminium stood at 13,942 yuan/mt, down 4.4% from a month earlier. Average profits fell 28.45% on the month to 40 yuan/mt.

Chart 5: SMM’s prices of aluminium/prebaked anode/alumina Chart 6: aluminium’s average profit margins



SMM revised the forecast of new capacity in July down to 600,000 mt/year, from 1 million mt/year, as sluggish aluminium prices will slow the commissioning of new capacity.

Capacity that is expected to come on stream in 2018 was also revised from 4.1 million mt/year to 3.4 million mt/year. We also lowered the forecast of aluminium output in 2018 to 37 million mt/year from 37.8 million mt/year, with growth at 1.9%. This compares with growth of 14.2% last year. Inventories are set to decline through July, though at a slower pace. As of 5 July, SMM reported aluminium inventories across China’s major markets at 1.83 million mt, down 7.23% from a month earlier.

Chart 7: SMM's Aluminium output

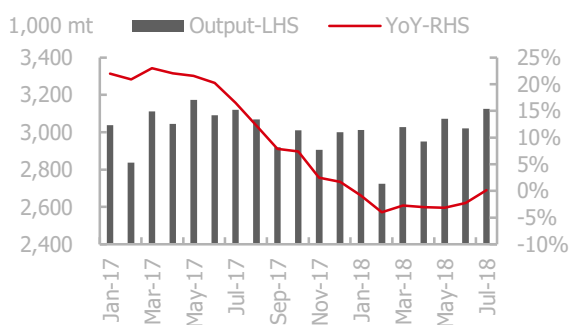


Chart 8: Aluminium inventories



Lead: primary lead producers to resume production soon

SMM estimates the output of primary lead in July at 258,000 mt, up 2.5% from June.

Primary lead smelters are expected to restart production from the second week of July. This will weigh on TCs of domestic and imported lead concentrate to 1,650 yuan/mt (up 100 yuan/mt on the month) and \$20/mt (stay the same of June) respectively in July, SMM believes. SMM understood that secondary lead smelters began to resume production in late June after environmental inspections ended.

Chart 9: SMM's primary lead output

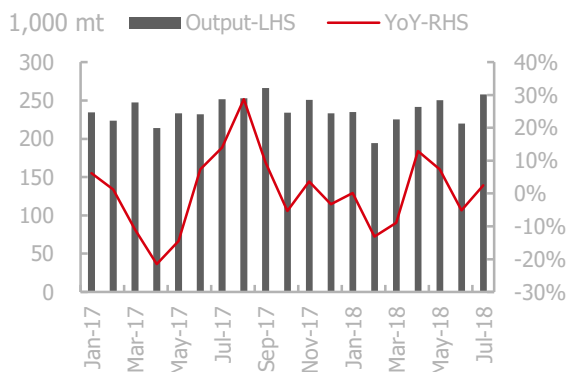
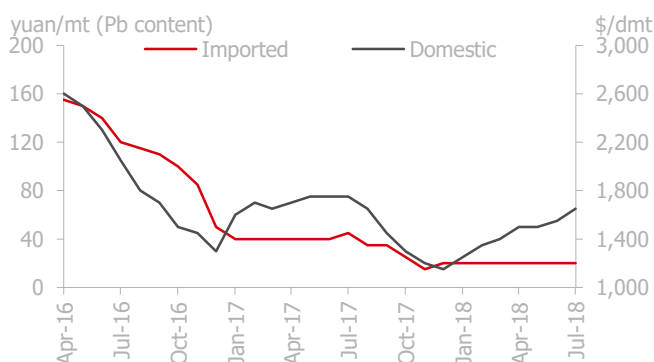


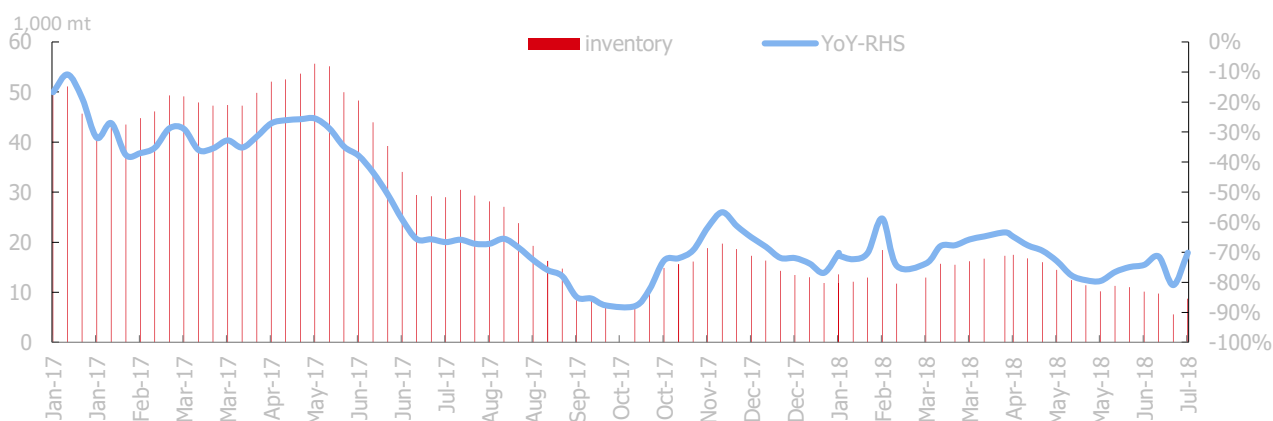
Chart 10: TCs of domestic/imported lead concentrate



SMM will monitor the impact that high season for lead batteries will have on inventories.

The traditional high season for lead batteries is in July and August. As of June 29, lead inventories in Shanghai and Guangdong have declined for four consecutive weeks and stood at 5,600 mt, down 81.1% on the year. And lead ingot inventory stood at 8,700 mt as of July 6, showing the first rebound since June.

Chart 11: SMM's lead ingot inventories



Zinc: refined zinc output to shrink 2.61% in July

We expect the figure to stand at 418,600 mt in July, down 2.61% month on month and 8% year on year.

While maintenance works at smelters and environmental reviews have entered into the finale, July's refined zinc output across China is likely to fall from June as the recovery of production is slower than expected due to weak margins. Supply and demand remains poor in the near term. Inventory shrank as inflows of imported materials dwindled amid a closed import arbitrage window and as smelters held back from selling. Social inventory of refined zinc came in at 109,900 mt this week, down 8.87% from a week ago, while inventory of galvanised steel sheet stood at 962,000 mt, up 2.7% week on week and down 3.0% year on year.

Chart: Social inventory of refined zinc

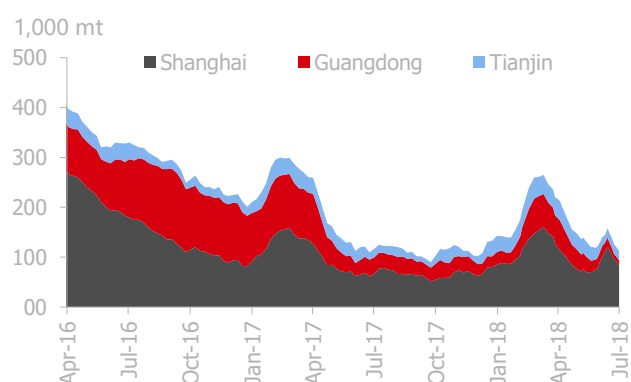
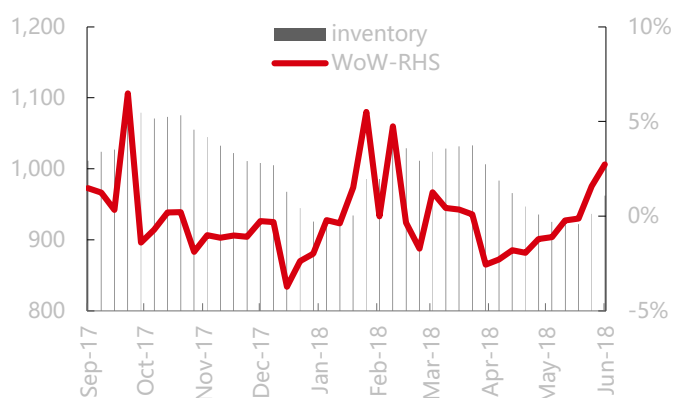


Chart: Social inventory of galvanised steel sheet



A total of 300,000-400,000 mt of supply growth of zinc concentrate is expected in the international market this year with the majority of them in the second half of the year.

MMG's Dugald River mine is estimated to recover 130,000 mt in zinc content and New Century Resources' Century mine would see 100,000 mt in zinc content in the remaining six months of the year. As of last Friday, treatment charges (TCs) for domestic and imported zinc concentrate stood at 3,600 yuan/mt in zinc content and \$25/dmt, up 1.4% and 0% from a week ago, respectively.

SMM believes zinc prices in general would be weak in the second half of the year due to anticipation of more concentrate supply and weaker downstream demand. But actual supply addition remains to be seen.

Chart: TCs for domestic/imported zinc concentrate

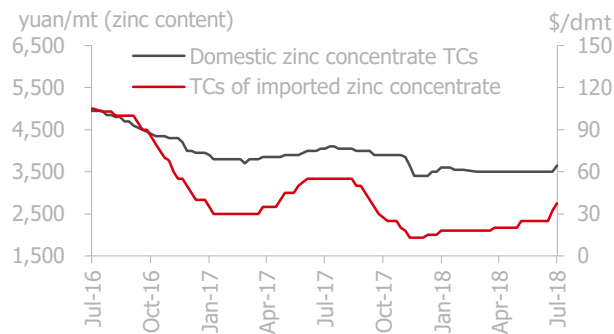
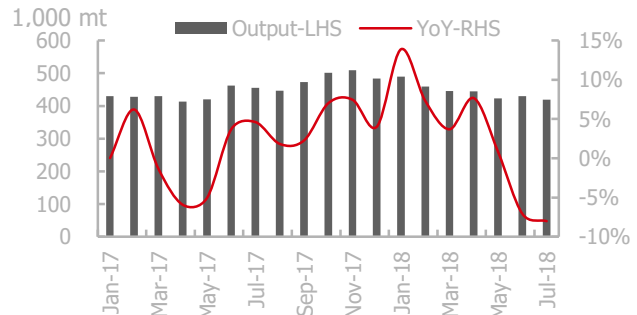


Chart: Output of zinc



Nickel: NPI output to grow 5.41% in July

We expect output of nickel pig iron (NPI) in July to grow 5.41% from June 35,100 mt.

Production resumption from environmental scrutiny will account for the growth. We will monitor the commissioning of Tsingshan Group’s 1 million mt/year of stainless steel project in Indonesia. SMM calculated that the project, if for #300 stainless steel, would consume 6,500 mt of NPI in Ni content, or 3.72% of monthly total nickel consumption globally. This will bolster nickel prices. As of July 6, nickel inventories in the Shanghai bonded zone totalled 60,000 mt, up 14.29% month on month, according to a survey. These inventories may flow to the domestic spot market.

Chart 12: SMM’s NPI output

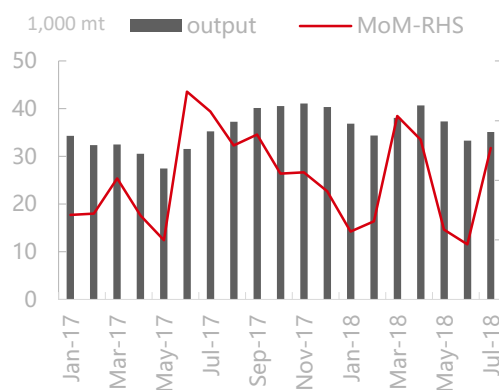
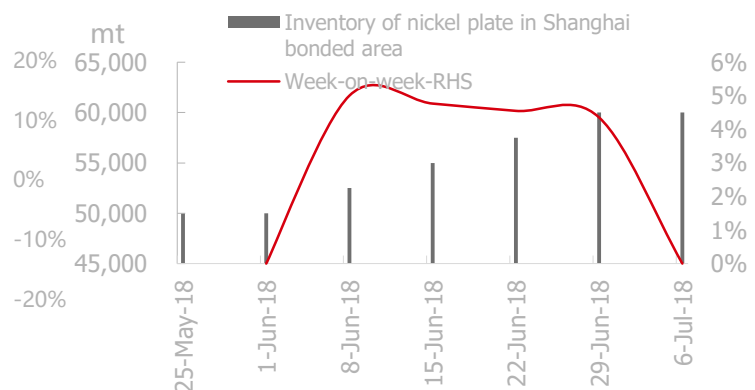


Chart 13: Nickel inventories in Shanghai bonded



Stainless steel output increase 5.48% in July.

Producers with NPI facilities that deploy rotary kilns and electric arc furnaces (RKEF) capitalised on the high profit margins of NPI. Non-integrated plants used more stainless steel scrap to lower costs. According to SMM’s model, NPI average gross profit is 800 yuan/mt as of July 2, up 0.32% month on month. SMM believes that healthy profits will drive output of stainless steel in July to 1.92 million mt, up 5.48% from June.

Chart 14: NPI profit margins per ton

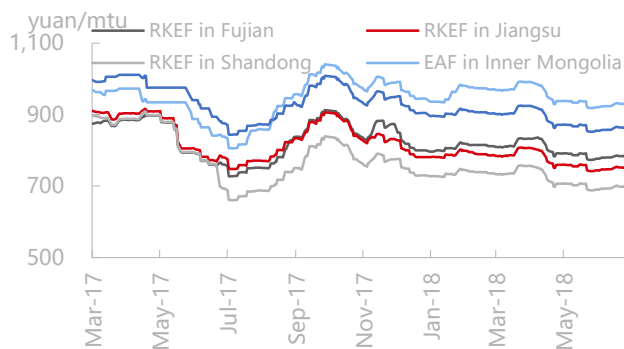
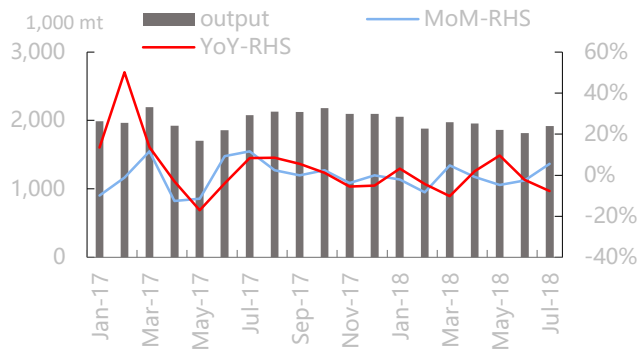


Chart 15: Stainless steel output



Steel: increased supply, soft demand to weigh on steel prices

We believe that steel output will grow in July after environmental inspections end.

Higher supply and weak demand will weigh on steel prices. Mills resumed production in early July after environmental reviews by the central government and environmental inspections across Jiangsu’s Xuzhou city ended. An SMM survey showed that operating rates at blast furnaces and electric arc furnaces (EAFs) in June stood at 86.94% and 69% respectively, down 1.98 percentage points and 5.0 percentage points from May. As of July 6, social inventories and inventories at producers of rebar stood at 4.76 million mt and 2.06 million mt, respectively, down 1.6% and 2.3% from a week earlier. Social inventories and inventories at producers of hot-rolled coil was 2.11 million mt and 1.02 million mt respectively, up 1.0% and 1.2% from a week earlier.

Chart 18: Rebar social inventories

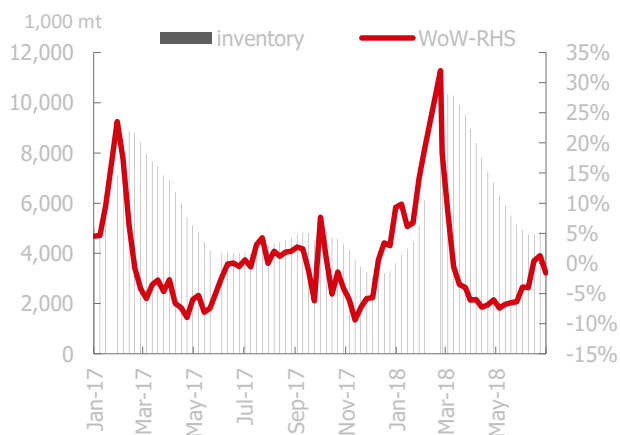
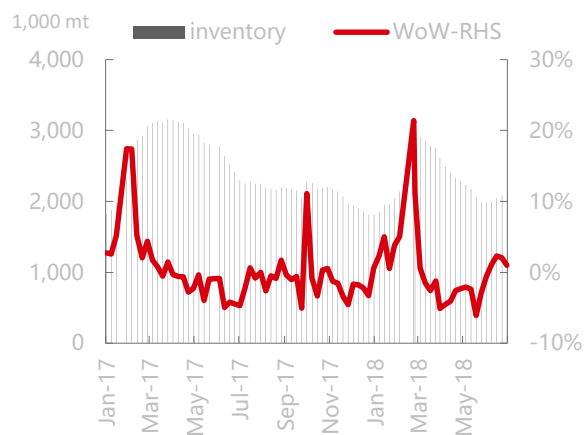


Chart 19: hot-rolled coil social inventories



The low season lowered the purchasing managers’ index (PMI) for steel by 4.39 on the month to 46.57 in June.

The construction PMI fell 4.3 and stood at 47.63. The PMI for machinery lost 5.33 and came in at 43.56. The automobile PMI dipped 2.64 and registered at 46.12. The PMI for home appliances declined 6.4 and stood at 46.4. The PMI for transport dropped 3.99 and came in at 46.04. For shipbuilding, the PMI slid 1.14 and settled at 55.19.

Chart 20: Operating rates at EAFs

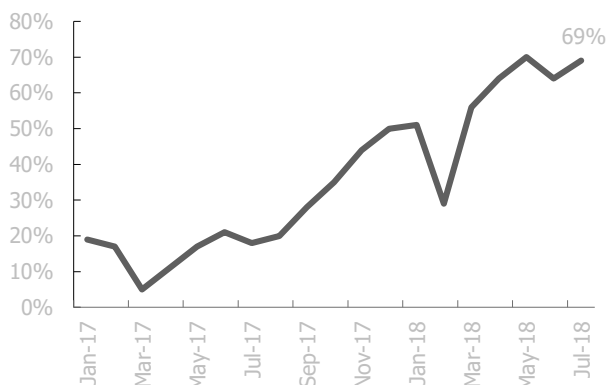
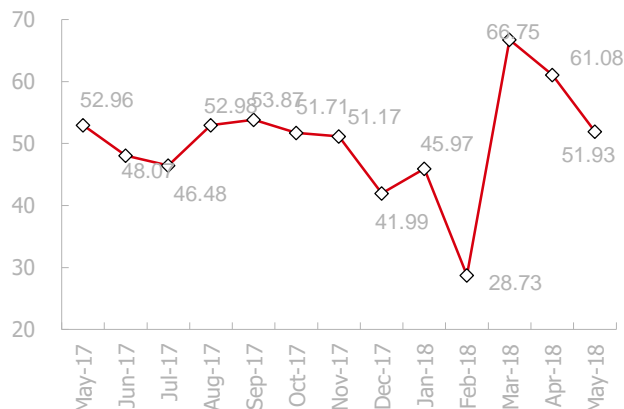


Chart 21: steel construction PMI



Iron ore: iron ore prices to fluctuate at low levels

Prices of iron ore are seen supported at low levels and are expected to outperform steel prices in the near term.

Production resumption across steel mills from environmental issues will increase demand for iron ore. SMM also points to the high gross margins over 600 yuan/mt for mills. Meanwhile, the availability of Brazil low-alumina cargoes, lumps and pellets remained low and is unlikely to improve any time soon. This, combined with yuan’s devaluation, will underpin ore prices.

Chart 21: Rebar gross margin per ton

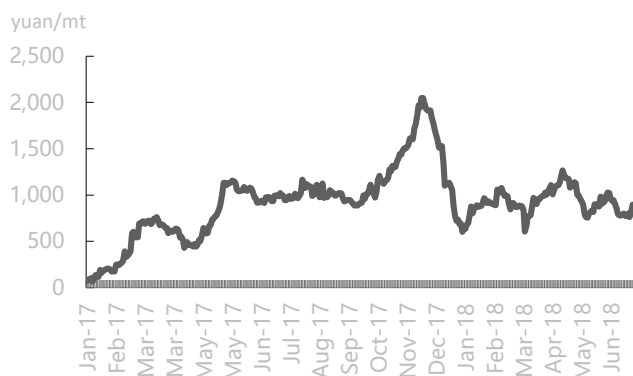
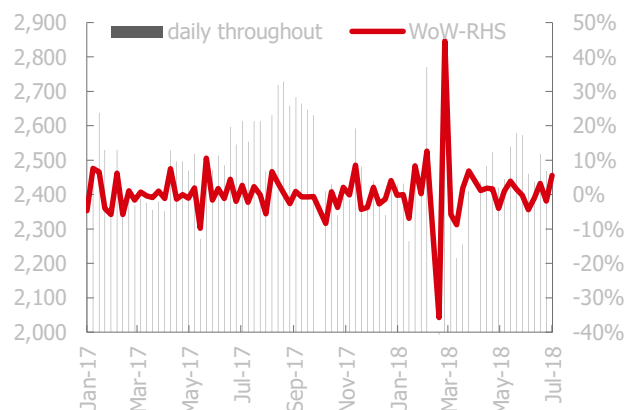


Chart 22: daily throughput of iron ore



However, steel prices and overseas ore supply may weigh on iron ore prices.

SMM expects steel inventories to increase as the low season set in, and this will weigh on steel prices. The correlation between rebar and DCE iron ore prices stands at 0.77. Considerable shipments from Australia and Brazil from late June will also weigh on ore prices.

Chart 23: iron ore inventories at ports

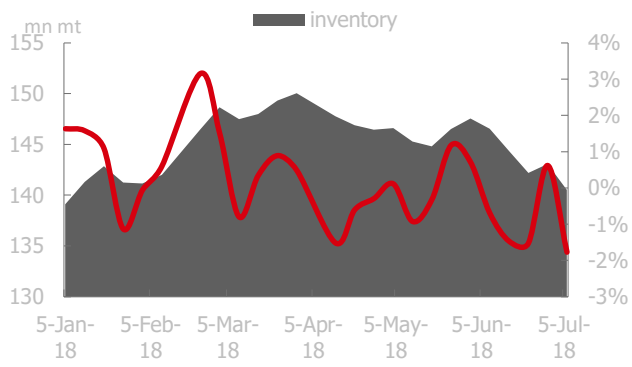
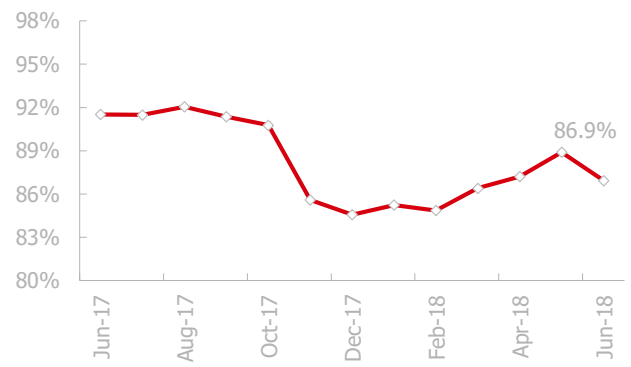


Chart 23: Operating rates at blast furnaces



Related Research

1. SMM Metals Strategy Monthly Report (Issue 1, May 3, 2018)
2. SMM Monthly Base Metal Output Forecast (Issue 1, May 8, 2018)
3. SMM Metal Strategy Monthly Report (Issue 1, June 5, 2018)
4. Demand of Cobalt and Nickel to Benefit from China's EV Subsidy Policy in 2018
5. 2018 Annual Copper TC Set at US\$82.25/ton; SMM Bullish on 2018 Copper Prices
6. China's Supply-Side Reform Continues to Reduce Capacity
7. China's Elimination on Excess Capacity in Steel Continue to Act Positively
8. Spot Copper Concentrate TCs Fall Further in Q2, in Line with SMM Expectation
9. Base Metals Diverge on Rising Supply and Delayed Demand Pickup
10. Aluminium and Nickel Return to Fundamentals with Sanctions on Rusal in Flux



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