Jefferies Bache Base Metals Report

Monday, June 24, 2013

Macro-Economic Developments and Comments

American consulting macroeconomist Dr. David Horner had the following comments to make about US monetary policy in his latest weekly report to clients: *“The FOMC’s communiqué and the Chairman’s press conference reinforce my forecast that the Fed will announce some reduction in QE at its July 31-August 1 meeting, but will not start tapering until September or the fourth quarter depending on employment, growth projections and inflation data.”*

“The FOMC’s forecast reaches the same conclusion as I do. Economic growth will pick up enough in the second half to warrant some scaling back of fixed income purchases. Because the Fed has been preparing us for tapering, I think they will announce a reduction a month or two before reducing the purchases. And Bernanke will continue to remind us that even reduced purchases are still adding liquidity and providing a stimulus. The Fed will not be tightening; it will be easing less aggressively.”

“Finally, the Fed’s policy will be data-dependent. If their employment and growth forecast are too strong the Fed will either not reduce its purchase or, if growth slows after an initial reduction, they may increase purchases. They will not, in my opinion, increase purchases above the $85 billion per month level unless the economy threatens to fall back into recession.”

Reuters reported on Friday that *“Fasten your seatbelts. And expect lots of turbulence.”* If that was the message Ben Bernanke was trying to deliver when he said the Federal Reserve could soon start scaling back its massive stimulus program for the U.S. economy, it's safe to say investors received it loud and clear.

In fact, the sell-off in stocks, bonds and commodities that rippled around the globe after Bernanke's remarks looks to some like the dawn of a new period of volatile, disorderly trade - a stark change from the calm that prevailed since the Fed began its most recent bond-buying program last autumn. *"When market regimes shift, they rarely do so in an orderly fashion - look at equity prices collapsing at the end of the dot-com bubble or the height of the financial crisis," said Stephen Sachs, head of capital markets at exchange-traded fund issuer ProShares in Bethesda, Maryland. "It usually gets violent. We're going to face that in interest rates now."*

Indeed, the bond market is at the epicentre of the financial market earthquake that Bernanke unleashed. Benchmark yields, which Fed easing had driven to record lows, surged to near two-year highs and are expected to keep climbing as traders come to grips with the prospect of the Fed ending bond purchases by mid-2014.

The aftershocks have rattled markets from Tokyo to Sao Paulo, and assets that had been top performers plunged. U.S. credit markets were hammered, with the gap between junk bond yields and Treasuries hitting their widest so far this year, while global equity markets lost $1 trillion on Thursday alone. The brute force of the decline caught some by surprise, since Bernanke warned in late May that the Fed could slow its bond buying later this year. Even so, watching long-term interest rates rise 0.4 percentage points for the week - the biggest move in more than 10 years - after trading for months near record lows was a wake-up call.

"People live in denial all the time," said Kim Forrest, senior equity research analyst at investment management firm Fort Pitt Capital in Pittsburgh. *"The thinking part of people's brains understood that rates would have to go up sometime. But they weren't ready to be told that reality starts now."* That goes for companies who now face higher funding costs and investors who had borrowed money cheaply to trade.

Investors had been funding trades in riskier markets by borrowing in the stable, low-interest-rate U.S. debt market. But the cost to borrow rises with higher rates and with increased volatility - both of which appear to be here to stay, at least for now. Dan Fuss, vice chairman of investment management firm Loomis Sayles & Co, which manages $191 billion in funds, said: *"Leverage is coming out of the market. These market moves reflect that, but when you get sharp moves like this a lot of people get nervous. That can contribute to more selling."*

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Bond investors hoping to play "follow the Fed" forever face an even more frightening reality. As Zane Brown, a fixed income strategist at asset manager Lord Abbett & Co noted, a return to a more normal level of interest rates would result in a zero total return over the next five years for investors benchmarked to the popular Barclays U.S. Aggregate Bond Index.

Investors pulled $15.1 billion out of taxable bond funds in the first three weeks of June, according to Lipper, a Thomson Reuters service. That is the biggest three-week outflow from the funds since October 2008, at the height of the financial crisis. All of this has left traders and investors scrambling to protect themselves in anticipation of a volatile summer.

Trading in interest-rate futures contracts spiked to a record in late May when Bernanke first broached the subject of winding down stimulus. It soared again this week, when some 12.8 million contracts changed hands on Thursday, according to CME Group, well above May's daily average of 7.9 million. Volume in S&P 500 index options rose to 2.3 million contracts on Thursday, a new one-day record, while overall options volume of 33.3 million contracts made it the busiest day since August 9, 2011, four days after Standard & Poor's stripped the United States of its top credit rating.

Since Bernanke has insisted that winding down bond purchases depends on continued economic improvement, traders now have to assume nearly every economic data release will have the potential to whipsaw financial markets. *"Across the board, we have seen people paying up for insurance in the options market,"* said J.J. Kinahan, chief strategist at online brokerage firm TD Ameritrade. *"The market is going to be hyper-sensitive to anything that the Fed says, and the three major reports on employment, retail sales and housing will continue to dominate the eyes of the market."*

The CBOE Volatility Index, a gauge of anxiety on Wall Street, jumped 23 *percent* on Thursday to 20.49, the first time this year it has exceeded 20, an often-used dividing line between calm and stressed markets. It closed at 18.90 on Friday.

Signs of concern about high-flying assets like emerging markets can be seen in the options market, where more than 1.35 million contracts in the iShares MSCI Emerging Markets exchange-traded fund traded on Thursday - 82 percent of which were put options, generally used to protect against losses.

The Merrill Lynch MOVE Index, a measure of expected volatility in the U.S. Treasury market, rose to 103.7 on Friday; that index sat at 50 in early May, a multi-year low.

The uncertainty the Fed has sowed by telling markets they are on their own means the days of almost uninterrupted gains that have prevailed since late last year are over. And that brings problems of its own for investors and the market.

For one thing, violent price swings make investors more vulnerable to big losses, prompting them to sell assets simply to reduce their value-at-risk (VaR) levels, a statistical method for quantifying portfolio risk over a given period of time. Rack up enough of these forced liquidations and it is not hard to see how a sell-off in one market can spread quickly to other assets and other parts of the world.

Bob Lynch, head of G10 FX strategy at HSBC, said this was a factor driving the bond and equity sell-off in late May *"and could be an important input driving financial asset lower in the current environment."*

"It is too early to tell if the market reaction to the Fed is just noise or the beginning of a greater sell-off in U.S. equities," said Mike Tosaw, portfolio manager at RCM Wealth Advisors, an investment advisory firm in Chicago. *"Over the course of the last month, we have been taking money off the table in the stock market and keeping the cash for the time being. Early next week, we plan to evaluate if this is a buying opportunity in stocks or if we need to run for the hills."*

In Europe the PMIs were better than expected, the services PMI rising from 47.2 to 48.6 (47.5 expected) and the manufacturing PMI rising from 48.3 to 48.7 (48.4 expected). This left the composite PMI up from 47.7 to 48.9, the highest level in 15 months and although still consistent with recession, the figures suggest a shallower contraction than the -1.0%qoq Q1 contraction seen in the first quarter.

In the United States the Philly Fed index was stronger than expected, rising from -5.2 to +12.5 (+2.0 expected).

US existing home sales were better than expected, rising from an annual rate of 4.97M to 5.18M (5.00 expected).

China

On Friday The Financial Times reported that *"Until a few days ago, the notion that China might face an imminent financial crisis was a prediction that only the bravest of bears dared make. But when short-term money market rates soared to as high as 28 per cent on Thursday, forecasts of a crisis no longer seemed so outlandish.*

China, a bastion of stability throughout the global credit crunch, suddenly had some of the feel of a financial system on the brink: its interbank lending market had frozen, local media reported that one of the country's biggest banks had defaulted and rumours spread that the central bank had provided targeted cash injections to another major bank.

Yet the panic subsided on Friday, with borrowing costs falling more than 200 basis points – and without the central bank having to make any public pledge to backstop lenders like the Federal Reserve and the European Central Bank did when facing their own downward spirals.

So what exactly just happened in China?

The first and most important point about these financial strains is that they are of the government's own making. China's banking system is still controlled by the state and the credit crunch has also to a significant extent been controlled by the state. Until late last week the central bank had consistently injected just enough cash in the banking system through its regular bond auctions to keep money market and lending rates within its target range.

When rates started drifting upwards, most analysts and investors predicted the central bank would step forward with fresh cash. It did not. *"Its decision not to intervene shows that it is committed to tightening the policy stance,"* said Zhang Zhiwei, an economist with Nomura. China powered through the global financial crisis in large part thanks to an explosion of credit, first through the formal banking system and then through a series of "shadow banks" and off-balance-sheet vehicles.

The result has been a remarkable increase of leverage in China. The overall credit-to-gross domestic product ratio has shot up from about 120 per cent to nearly 200 per cent over the past five years. *"The Chinese authorities have the ability to address the liquidity pressures, but their hands-off response to date reflects, in part, a new strategy to rein in the growth of shadow finance by constraining the liquidity available to fund new credit extension,"* Fitch Ratings said.

Put another way, regulators have fired a warning shot at the country's banks. Previously, banks believed they could rely on their privileged access to the central bank-controlled interbank market to borrow at low, steady rates and then turn around to make risky, high-yielding investments. The government is now trying to close that door to them.

A second lesson to draw from the cash squeeze is that the country's leaders appear more determined than their predecessors to guide China on to a path of slower, more sustainable growth.

Cracks in the Chinese economic model were already beginning to show. Although credit growth has climbed to about 23 per cent year-on-year, nominal GDP growth has slipped below 10 per cent, pointing to a worrying decline in investment returns. *"One consensus among many government officials and policy advisers is that tough decisions on economic reforms could no longer be delayed and that taking some short-term pain is necessary for healthy long-term growth,"* said Huang Yiping, an economist with Barclays. *"What the People's Bank of China is doing now is simply a reflection of that overall policy strategy."*

However, a third conclusion from the ructions of the past week is that Beijing is far from omnipotent in its management of the Chinese economy. By rapping the country's biggest banks across the knuckles and ordering them to resume lending to other banks, the central bank appears to have been successful in preventing a more serious disturbance. The weighted average bond repurchase rate, a gauge of liquidity, fell to 9 per cent on Friday from 11.6 per cent a day earlier.

But the simple fact that the central bank had to resort to such an extreme measure to get the attention of the market shows that all of the cajoling, threats, rules and regulations of the past few years – when officials first began to express alarm at the surge in credit – had not amounted to much.

So could China face a financial crisis?

The closed nature of the Chinese financial system makes a crisis highly unlikely, said Liu Yuhui, a finance researcher with the Chinese Academy of Social Sciences. *"The credit of the Chinese government forms the backdrop of the entire Chinese financial system. In this kind of system it is almost impossible that banks could go bankrupt,"* he said.

But even if a crisis is improbable, the consequences of the past week might be just as unsettling for the rest of the world, said Arthur Kroeber, managing director of GK Dragonomics. The tightening sends a clear message to banks to lend less, he said. *"This stance raises confidence that Beijing will not let the credit bubble get out of control,"* Mr Kroeber said. *"But it also raises the odds that both credit and economic growth will slow sharply in the coming six to 12 months."* He forecast that Chinese growth

could slow to just over 6 per cent next year – not bad by global standards but a far cry from the 10 per cent average of the past decade.

The June issue of Global Industrial Production Watch, produced by UK-based CHR Economics comes to a rather more bearish view of the Chinese economy. The Global Industrial Production Watch says: *"There is a view, apparently held by many in the investment and financial community, that it is a mistake to underestimate the capacity of the Chinese and their government to solve problems. Thus, while recognising some of China's recent economic excesses, there are many analysts that still believe steady, albeit perhaps slightly slower, growth will be delivered by Beijing over the next few years."*

"In essence, they expect that the headline objective of the current Five-Year plan (2011-2015), annual average GDP growth of 7%, will be fulfilled. Some analysts go further, citing the experience of previous Five-Year plans when actual growth exceeded plan and they expect growth to continue to outperform. And, indeed, reported growth since beginning of this current plan has run ahead of target, with GDP growth of 9.6% in 2011 and 7.8% in 2012 already in the bag."

"We have taken a detailed look at current economic developments in China and have concluded that, so great have been recent excesses in terms of fixed asset investment, especially in real estate and manufacturing capacity, and so poor has been the economic case for much of this investment, it is now inevitable that China will face a sharp slowdown in growth, and most likely an outright contraction in output, within the next year or two. The catalyst for this is likely to be a crisis in the shadow banking sector which will spread quickly to affect financial institutions in the formal sector."

"Given recent revelations about corrupt and fraudulent reporting of various economic data (discussed below), we believe that there should be very real concerns about the fundamental underpinning of many loans and other more exotic products that now populate the financial landscape in China. The government may be tempted to bail out some institutions but we suspect that the scale of the problems that will be revealed as the expected financial crisis unfolds will mean that a comprehensive rescue will be beyond even the capacity of Beijing."

"In developing our new forecast for China we have looked for clues in past crises that have affected industrialising economies, such as the Latin American debt crisis of the 1980s and, more recently, the Asian Financial crisis of the late 1990s. Events in Japan in the late 1980s also provide some useful insights. Amongst other factors, a period of over-investment is a common feature and pre-cursor to all of these earlier crises."

"Our new forecast assumes a period of much slower growth in China over the balance of this year, one final burst of more rapid growth early next year but with the onset of recession in the second half of 2014, extending through into 2015. Industrial production is forecast to barely grow in 2014 and to contract by almost 4% in 2015."

"Evidence has now also come to light of falsification of GDP data. The objective in this case will have been to enhance the political careers of local cadres. The National Bureau of Statistics has found that a county in Guangdong province last year inflated the value of output of 71 local companies from RMB2.2bn (US$350M) to RMB8.5bn (US$1350M). Not only had output been exaggerated but investigators found that perhaps as many as 25% of the companies reporting production had closed down, moved elsewhere or, quite possibly, had never existed. There is always a danger of extrapolating from the specific to the more general but we would be very surprised if this was an isolated case. Our own research convinced us some time ago that China's lead and zinc mine production was being systematically overstated in several provinces."

"Another area of serious concern is the scale of over-capacity in China's residential and commercial real estate markets. China bulls dismiss these worries pointing to official plans for increased urbanisation and the scale of relocation and demand for housing that this implies."

"In our view this misses two key points. Will the government be able to force large numbers of people to move to areas of surplus housing (like Manzhouli on the Russian border or any number of other new or satellite cities in equally remote regions) and why, if there are already so many empty apartments and commercial premises, are developers continuing to build at such a frantic pace? It is impossible to gauge accurately the extent of the current over-capacity in the residential market."

"However, a survey conducted last year by the police in Beijing concluded that the vacancy rate might be as high as 29%. A 'vacant' dwelling was one that was unoccupied for at least six months of the year. Newly-built apartments had a vacancy rate of one-third. Much of the risk associated with Chinese real estate bubble, where prices in May rose at their fastest pace since January 2011, will lie with investors who have bought property rather than leave capital in low interest paying bank accounts. However, undoubtedly, many developers are also exposed to a downturn and may be unable to meet debt repayment schedules."

"In this regard it is apparent that a not insignificant share of 'new' loans in 2013 has been to roll over old debt as it matures. While official lending is rising fast, there are also grave concerns about the scale of the shadow banking sector and the risks it poses for the whole financial sector. Fitch Ratings has recently published new research which calculates that the stock of outstanding credit in China may now be as high as 200% of GDP, up from 125% as recently as 2008. And Fitch Ratings is not alone in seeing total debt at this level."

"Given the scale of deception in reporting key economic data, problems in real estate and issues with bad debt, we do wonder about the complacency shown towards potential serious and looming problems affecting China's economy by many in the

investment and financial community. It is now very likely that China will experience a financial crisis not unlike that which afflicted various emerging western economies in the 1980s and 1990s. However, in the case of China, institutional structures and safeguards are even weaker than those that existed in western markets during these earlier periods of upheaval."

Stochastics

	RSI (14)	%K fast	% D Fast (3)	%D Slow (3)
Copper	25.71	26.86	17.17	17.05
Aluminum	18.81	8.39	13.39	14.70
Zinc	38.72	40.00	42.92	47.70
Nickel	28.59	25.71	26.90	27.38
Lead	26.30	13.00	11.33	19.83
Tin	16.28	19.08	21.28	18.16

Source: Royal Bank of Canada

Moving Averages

	10 day	30 day	100 day	200 day
Copper	7013	7227	7521	7757
Aluminum	1849	1873	1943	1993
Zinc	1856	1874	1957	1981
Nickel	14226	14763	16089	16643
Lead	2090	2093	2166	2197
Tin	20215	20773	22255	22129

Source: Royal Bank of Canada

Support and Resistance

	3rd support	2nd support	1st support	Last price	1st resistance	2nd resistance	3rd resistance
Copper	6762	6501	6692	6822	7001	7096	7367
Aluminum	1716	1809	1790	1796	1863	1885	1948
Zinc	1765	1787	1822	1843	1879	1896	1957
Nickel	12263	12785	13630	13828	14763	14997	15420
Lead	1938	2093	2098	2024	2258	2333	2380
Tin	17586	18279	19400	19477	21775	22129	22300

Source: Royal Bank of Canada

Highs – Lows for 2013 and 2012

	Copper	Aluminum	Lead	Zinc	Nickel	Tin
2013 high/low	8346/6692	2184/1789.5	2499/1938	2230/1811.75	18770/13630	25250/19250
2012 high/low	8765/7219.5	2361.5/1827.25	2347.75/1742	2220/1745	22150/15236	25880/17125

Source: LME – all prices basis three months and in dollars per tonne

The Six LME Metals' Prices							
	LME closing price on 21/6/13	LME closing price on 14/6/13	LME closing price on 7/6/13	LME closing price on 31/5/13	LME closing price on 24/5/13	LME closing price 17/5/13	LME closing price on 10/5/13
Copper	6,818	7,090	7,230	7,309	7,299	7,305	7,375
Aluminum	1,793	1,851	1,940	1,906	1,840	1,849	1,870
Zinc	2,023	2,109	2,164	2,201	2,069	2,014	1,994
Nickel	1,842	1,860	1,904	1,927	1,856	1,840	1,859
Lead	14,075	14,325	15,050	14,825	14,805	14,825	15,360
Tin	20,010	20,395	21,050	20,900	21,050	20,975	20,825

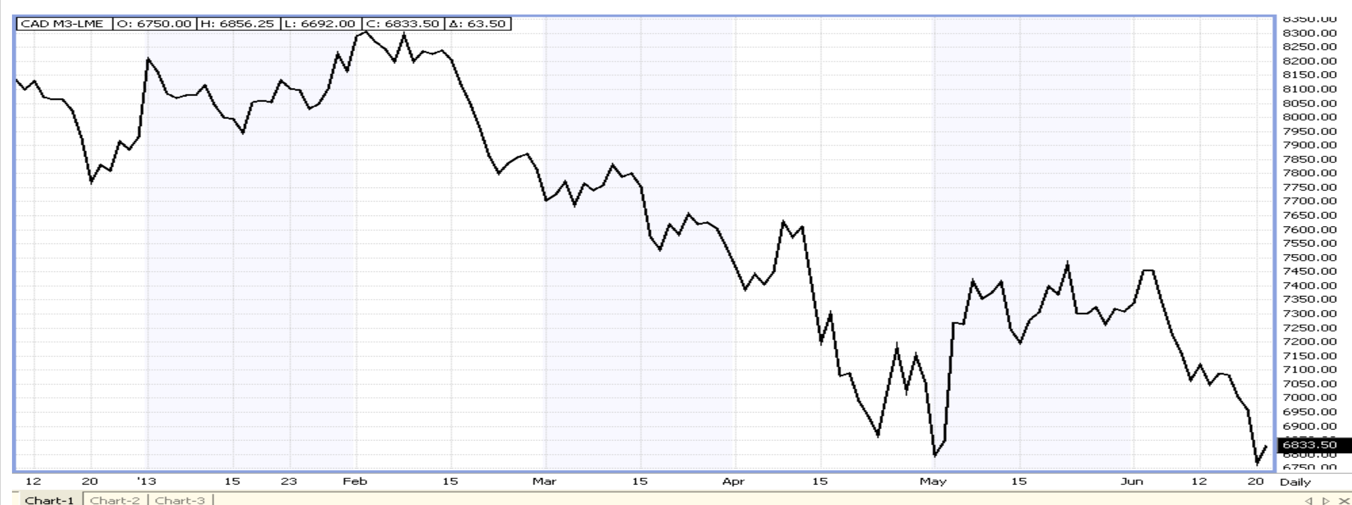
Source of prices: LME. All prices in dollars per metric tonne and basis three months LME.

The Six LME Metals' Stocks						
	21/3/13	14/6/13	7/6/13	End 2012 stock level	Change since end 2012	% ch since end 12
Copper	664,850	618,075	609,875	320,050	344,800	108.0
Aluminum	5,433,950	5,219,825	5,187,275	5,210,050	223,900	4.3
Zinc	199,025	197,350	205,225	320,325	-121,300	-37.9
Nickel	1,071,425	1,087,500	1,110,150	1,220,750	-149,325	-12.2
Lead	185,412	183,708	182,274	139,908	45,504	32.5
Tin	14,250	14,390	14,435	12,825	1,425	11.1

Source: LME N.B. all figures are metric tonnes

Copper

Three months LME copper chart – daily close – December 2012 to the present



Source: FutureSource

Three months LME copper closed on Friday at $6,818 per tonne. This morning three months LME copper is trading at $6,686. Dollar/euro is $1.3100 versus a close on Friday of $1.3120. On Friday copper had a contango of $33 per tonne versus a contango of $34 per tonne on the previous Friday. Copper fell 3.8% last week after falling 1.9 in the previous week. Shanghai copper stocks rose 5,799 tonnes to 189,209 tonnes.

The G-10 currency and interest rate analyst at a large South African bank summed up the present situation very well on Friday. He noted that *"Most probably, next month will see liquidity strains ease in China and money market rates will be able to return to more normal levels. But these periods of uncertainty and volatility breed unease in local money markets. This might well be the PBOC's intention as it seeks to penalise those that misbehave. But it's in contrast to the Fed, which seems to be working overtime not to levy undue pain. Of course the Fed will inflict pain from time to time, as it arguably did on Wednesday, but it's the pain from the PBOC that could exact a bigger toll over time on financial market sentiment."*

"How does this affect commodities, especially those with large exposure to China and industrial in nature? Firstly, tighter credit and control could reduce the demand for metal in China via financing deals. Secondly, tighter credit also implies reduced spending, whether on goods and services or on fixed capital formation. This implies weaker demand for commodities. Thirdly, and possibly the greatest impact on commodity demand, and also perhaps longer-lasting, is the uncertainty that the monetary policy action by the PBOC may introduce into the local market. With policy uncertainty comes risk aversion by companies (and individuals). Risk aversion implies less spending, less expansion and less real economic activity. This may also imply slower commodity demand growth."

Combine these macroeconomic considerations with the technical reality that copper, along with all the other base metals, has moved down into a lower trading range and you are looking at more subdued markets which will be prone to volatile trading from time to time. Copper is heading for its third consecutive quarterly price decline. This will be the longest period of decline in over 10 years. This reflects both slowing growth in China as well as increasing supplies of copper itself. LME copper stocks have risen by 108% since the end of 2012. LME stocks stood at 664,850 tonnes on Friday the 21st.

One technical analyst said in a note to clients that he saw good support coming in at the $6,630 to $6,650 per tonne area basis three months. And this is an area that we know the Chinese are quite keen buyers. On the other hand overhead resistance now comes in at around $6,920 to $6,940 per tonne basis three months.

Chinese imports of refined copper jumped in May from a near two-year low as the difference between Shanghai and London prices prompted traders to place additional orders. Last week's data from the General Administration of Customs indicated that, among many things, inbound shipments were 232,155 metric tons in May, compared with 183,023 tonnes in April and 301,990 tonnes a year ago. On the other hand, copper exports fell for a second straight month to 14,445 tonnes from 29,072 tonnes a month earlier. Imports of scrap-cooper also rose in May, rising to 363,351 tonnes from April's reading of 336,634 tonnes, with arrivals from the U.S. alone rising to 81,943 tonnes from 72,413 tonnes. Meanwhile, copper-concentrate imports experienced declines over the same period, with May imports numbering 729,393 tonnes as opposed to 842,838 in April.

Chinese refined copper production climbed 18.4%yoy to 567,000 tonnes in May, according to the National Bureau of Statistics. Total production in the first five months of the year came in at 2.67 million tonnes, up 14.5%yoy.

Reuters reported last week that: "A shortage of cash in China is boosting its imports of copper as a financing tool, resulting in premiums paid for spot refined metal supplies from overseas climbing to near four-year highs. Rising imports from the world's top copper consumer, also partly driven by a drop in onshore supply, could cushion global metal prices that have fallen more than 11 percent so far this year on worries over the world economy. Copper imports have been used in China for years now as a means to obtain finance. Importers open letters of credit (LCs) with banks paying a small portion of the metal import costs. The metal is then resold in the domestic market to obtain cash, which can be used until the LCs are repaid in three to six months. With a nasty liquidity squeeze roiling China's interbank funding markets in recent weeks, imports of copper for financing purposes have surged, traders said. The benchmark weighted-average seven-day bond repurchase rate, an indicator of short-term funding costs, rose to above 6.8 percent in June, the highest since early 2012."

"The cash market has recently been hit by heavy fund demand, including from the approaching quarter-end and half year-end, when banks need more cash to meet regulatory checks and to boost reported deposit totals in their quarterly reports to shareholders. Firms typically make loan payments by end-June, adding to demand for cash. Some firms imported refined copper because of the liquid nature of the metal's domestic market. Copper importers were seeking to buy bonded stocks in Shanghai or shipments due to arrive in China soon, traders said. But the supply of bonded stocks and soon-to-arrive shipments has fallen after importers stepped up purchases earlier this month when banks relaxed norms for loan-making, traders said. 'Copper that is available for prompt delivery is scarce. Bonded stocks in Shanghai have fallen a lot,' a trader at a large Chinese trading house said. 'If importers take copper from the LME warehouses (in Asia), it would take some time,' he added."

"Bonded stocks in Shanghai or shipments due to arrive in June have mostly changed hands at premiums of above $160 a tonne over the cash LME prices this week, traders said, while increasing numbers of sellers were asking premiums of about $170, the highest since the first half of 2009. Copper stocks in bonded warehouses in Shanghai have fallen to just above 400,000 tonnes, the lowest since the first quarter of 2012, traders estimated. The stocks were below 500,000 tonnes at the beginning of this

month and more than 600,000 tonnes in late April. The bulk of the current bonded stocks were tied up with financing deals with foreign banks and were not immediately available to the spot market, traders said. "400,000 tonnes is a mark that is considered a minimum bonded stock amount by some people given that China uses more than 500,000 tonnes of refined copper a month," a trader at a large refined copper producer said. *"The premium (for imports) is likely to rise to the $200 mark soon."*

Copper premiums in Rotterdam hit seven-year highs last week, according to Metal Bulletin. Premiums for the metal were at $110-150 per tonne over LME, up from $100-140 per tonne in the previous week and up from $70-100 at the start of the year.

Other Copper News

Bloomberg reports that *"Mongolia is insisting that revenue from Rio Tinto Group's $6.6 billion Oyu Tolgoi copper and gold mine be kept in the country before it will allow sales to start, according to a government official with knowledge of the matter. Government officials want revenue from the mine to be held at a Mongolia-based bank, a decision that Rio rejects, said the person, who asked not to be identified as the talks are private. London-based Rio postponed an event scheduled for Friday that was to mark the first shipment of copper concentrate from the mine to China, citing a "request from the government of Mongolia."*

"The standoff threatens Rio's June deadline for shipments and revives a dispute over the mine that will account for 35 percent of Mongolia's GDP when fully operational in 2020. The Manhattan-sized deposit will produce 450,000 metric tons of copper and 330,000 ounces of gold a year, as well as silver and molybdenum. With fees, royalties and the 34 percent stake held by the government, as much as 71 percent of the profits will go to the Mongolians, the International Monetary Fund estimates."

"Rio wouldn't comment on whether the banking issue caused the delay to the first shipment, or specify the reason for the postponement, with Melbourne-based spokesman Bruce Tobin saying the mine is ready to start shipments. In February, the Mongolian government blocked some of Rio's bank accounts in the capital Ulaanbaatar over unpaid tax claims, said three people familiar with the situation. While the accounts were unfrozen, the two sides remained in protracted talks over how to solve a raft of issues, including management control. In April, Rio hired Mongolian national Bold Baatar as president of its copper group. Oyu Tolgoi had invited reporters to a ceremony marking the first shipments of copper to China on Friday the 21st. It was called off late yesterday, the second time this month it had been cancelled. Mongolia holds presidential elections June 26 and there have been media reports that the event was cancelled to avoid politicizing Oyu Tolgoi, a lightning rod for public debate. The official who spoke to Bloomberg denied that the government called off the event because of the election."

The London Metal Exchange is in discussions regarding establishing warehouses in China and in the longer term will also be looking to set up other delivery locations in Southeast Asia. Extending the LME's global warehouse network to China will be a priority for the LME and its owner, Hong Kong Exchanges & Clearing, Liz Milan, md LME Asia, told Metal Bulletin. *"We continue to speak to the relevant people in China and without a doubt Chinese warehousing remains very important to the LME and something that we are looking to try and get on board too,"* Milan, who is now also head of Asia commodities at HKEx, said. Market participants had hoped that the setting up of LME warehouses in China would be expedited with the HKEx takeover of the LME. Milan declined to comment on the status of any discussions about warehousing in China. In the longer term, the LME will also be looking to set up other delivery locations in the region.

On Monday June 17, the LME listed Kaohsiung in Taiwan as a delivery point for base metals and aluminium alloy taking the total number of Asian locations to nine. Due to its proximity to China, Kaohsiung will provide better accessibility to China-based users of the bourse.

It may also consider new locations in Southeast Asia including Vietnam and Thailand, Milan said. *"It's long time frame because you have to have all the fiscal regimes in place from determining and identifying an area to becoming a location you have to get past many things," she pointed. "How it works is first we have to get the location listed once we get everything satisfactorily agreed between us and the port authority and the ministry of finance according to our requirements. Then we would be in a position to list the location and once we list the location we rely on warehouse companies to come to us with applications for listing individual warehouses within that port,"* she said. New locations need to meet conditions including those related to the tax-free movement of material into LME warehouses. *"Some markets are more established than others around there,"* she added.

The International Copper Study Group (ICSG) released preliminary data for March 2013 world copper supply and demand last week. According to preliminary ICSG data, the refined copper market balance for March 2013 showed a production surplus of about 100,000 metric tonnes (t) as apparent refined demand was weak in major consuming regions. When making seasonal adjustments for world refined production and usage, March showed a surplus of 133,000 t. The refined copper balance for the first three months of 2013, including revisions to data previously presented, indicates a production surplus of 222,000 t (a seasonally adjusted surplus of 231,000 t). This compares with a production deficit of 312,000 t (a seasonally adjusted deficit of 307,000 t) in the same period of 2012.

In the first quarter of 2013, world usage is estimated to have declined by around 5.3% compared with that in the same period of 2012. Chinese apparent demand declined by 10% owing to a 46% decline in net imports of refined copper. However, anecdotal evidence suggests that the lower import level was accompanied by a decline in unreported inventories held in bonded warehouses in China, which may have been all or partially directed to domestic industrial use. (In its April 26th forecast press release, ICSG

said that unreported inventories in China were estimated to have risen by about 600,000 t during 2012.) Excluding China, year-on-year world usage declined by around 1.7%. On a regional basis, usage is estimated to have declined by 7.8% in Africa, 1.8% in the Americas, 7.6% in Asia, 0.2% in Europe, and 14.3% in Oceania.

World mine production is estimated to have increased by almost 11% in the first three months of 2013 compared with production in the same period of 2012, mainly owing to a recovery in production levels from constrained output in early 2012. Concentrate production increased by 13.2% and solvent extraction-electro winning (SX-EW) by 2.3%.

Mine production increased by 7.7% in Chile, the world's leading producer accounting for 32% of world mine production, and by 8.2% in the United States, but declined by 1.2% in Peru. On a regional basis, production rose by 31.9% in Africa, 6.6% in the Americas, 18.6% in Asia, 2.8% in Europe, and 11.1% in Oceania.

The average world mine capacity utilization rate for the first quarter of 2013 increased to around 82% from around 77% in the same period of 2012. World refined production is estimated to have increased by 5.2% in the first quarter of 2013 compared with refined production in the same period of 2012: primary production was up by 3.8%, and secondary production (from scrap) increased by 11.6%.

The main contributors to growth were China (12.3%), Democratic Republic of Congo (DRC) (43.4%) and Zambia (17%), with refined production declining by 6.4% in Chile, the world's second largest refined copper producer. On a regional basis, refined production is estimated to have increased in Africa (25%), Asia (9.2%), and Europe (2.5%) but declined in the Americas (2.7%) and Oceania (5.6%). The average world refinery capacity utilization rate for the first three months of 2013 declined to around 79.8% from around 80.1% in the same period of 2012.

Aurubis' copper recycling plant and smelter is expected to reach 2013 production goals, even with scrap availability and pricing at the tightest it has been since 2009, Metal Bulletin reports. *"We see that some extra effort is necessary to get material out of every corner, and fortunately the supply with recyclable materials still works out"* Aurubis' vice president for commercial recycling told a Metals Bulletin conference last week.

Platts reports that: *"Japan's Pan Pacific Copper has concluded the copper concentrate treatment and refining charges (TC/RC) for the second half of the year with global mining major BHP Billiton at levels higher than those agreed earlier this year with several western miners, a PPC official said Wednesday. "We cannot comment on the figures as the negotiation with BHP Billiton is a private one. I can only say we have concluded and the TC/RCs were improved from the earlier talks in January," the official said but declined to disclose the exact charges. In January, Pan Pacific Copper signed the annual 2013 copper concentrate TC/RCs, with several western miners settling at just over 10% above 2012 charges. The 2012 TC/RCs were at $63.50/mt and 6.35 cents/lb respectively. Based on the 2012 charges, the 2013 TC/RCs are at least $69.85/mt and 6.985 cents/lb respectively. Industry sources said they were not surprised with the higher TC/RCs and generally reckoned that the H2 TC/RCs were about $5/mt and 0.5 cents/lb higher than that for H1 respectively. "Generally, the market is still oversupplied with copper concentrate for 2013. Despite the mining halt for the Grasberg mine in Indonesia after a mining accident in May, there are other mines coming online this year," said a north China-based analyst. Among the new projects are the Oyu Tolgoi copper mine in Mongolia and the Salobo project in Brazil."*

Bloomberg reports that *"Japan's copper wire and cable shipments climbed 2.1 percent in May from a year earlier, increasing for the first time in six months on a pick-up in deliveries to construction companies, an industry group said. Shipments totalled 54,200 metric tons last month, compared with 53,067 tons a year earlier, the Japanese Electric Wire & Cable Makers"* Association said today in a statement. Deliveries were 54,945 tons in April, down 1.9 percent from a year earlier. Japan's total exports rose more than forecast in May as Prime Minister Shinzo Abe's stimulus, dubbed as Abenomics, weakened the yen against the dollar. At the same time, the nation's trade balance fell for the 11th straight month as the weaker yen boosted the costs of imports, a Finance Ministry report showed on June 19. *"Shipments to the construction industry gave a boost,"* said Keiichi Ohki, an official at the association's research department. *"Still, demand from automakers and the electric-machinery industry remained subdued as the weaker yen raised the cost of electricity." Copper-cable shipments to the construction industry climbed 9.5 percent in May from a year earlier, while those to automakers fell 9 percent and deliveries to the electric machinery industry declined 5.1 percent, the association said. The Japanese currency has fallen 10 percent against the dollar this year amid Abe's unprecedented monetary stimulus. The yen touched 103.74 on May 17, the weakest since October 2008."*

Platts reports that *"China's largest copper smelting base, Jiangxi province, shut 163,000 mt/year of outdated copper smelting capacity in 2012 to comply with the country's environmental policies, local industry sources said last Thursday, quoting the latest figures from the Jiangxi provincial government. The province also shut a total of 85,000 mt of lead, 25,000 mt/year ferroalloys and 10,000 mt aluminum production capacity during the year. The Jiangxi provincial government in 2012 promoted industry consolidation in the area, requiring closure of excess smelting capacity to help enhance resource utilization, conserve energy and cut pollution. China's Ministry of Industry and Information Technology had earlier announced that a total of 17 outdated copper smelters in China's Jiangxi province with a total smelting capacity of 307,000 mt/year would be shut in 2013."*

"A copper analyst from state-run metals consultancy Beijing Antaike said the outdated capacity closure was to meet the country's environmental standards. "But this won't affect the overall copper output in the province as every year there is new capacity coming on stream," he said. A Chinese trader agreed, adding: "This is part of the provincial government's efforts to help consolidate the nonferrous industry to meet with China's goals for the 12th Five Year Plan running from 2011-2015." China's Jiangxi province produced about 1.16 million mt of refined copper in 2012, up 13.7% year-on-year. Its copper concentrate output was around 317,000 mt during the year, up 9.9% from 2011. The province has the largest copper reserves in China."

Dow Jones reports that: *"China's Chinalco Mining Corp. International has approved a $1.32 billion expansion project for its Toromocho copper project in central Peru. The company said the expansion could increase production capacity at Toromocho by 45%. Construction of the expansion project is expected to be "substantially completed" by the second quarter of 2016, Chinalco said. Chinalco is already investing about $3.5 billion to develop Toromocho, which is one of the biggest copper projects in Peru. The mine, located in Peru's central Andean region of Junin, is expected to start production in late 2013 and will turn out about 250,000 tons of copper per year, according to Peru's Mines and Energy Ministry. "The proposed expansion is not expected to have any material adverse effect on the expected commencement of production or operations of the Toromocho project," Chinalco said in a statement. Chinalco said late Monday that the expansion will be financed from internal working capital, debt financing and proceeds from its initial public offering that were intended for acquisitions of nonferrous and nonaluminum mining projects."*

Reuters reports that *"The London Metal Exchange (LME) is trying to attract Chinese banks as members but has so far succeeded in drawing only one mainland financial institution to the world's biggest metals marketplace, a board member said. LME, which was bought in December by Hong Kong Exchanges and Clearing (HKEx) in a $2.2 billion deal, approved as a member last year the Bank of China International (BOCI) Global Commodities, an arm of the nation's No. 4 lender Bank of China. In order to become a clearing member of the LME, a Chinese firm has to set up a London office, which is regulated by the U.K. regulator with minimum capital required, Romnesh Lamba, who is also executive vice president and co-head of global markets division at HKEx, said. "There are obviously several Chinese banks that have the capability of doing that. So far only one has done it,"* Lamba told Reuters. Asked whether other Chinese banks have applied for membership of the LME, he said: *"Not yet, to my knowledge"*.

"Not all of China's banks are active in commodities today because in the mainland the most active futures players are futures brokers, and the banks are still relatively new to the commodities market, Lamba added. The LME would have the capability to accept the Chinese yuan to clear its dollar-denominated contracts after its own clearing system is launched next year, which could attract more volumes from the Chinese, he said. HKEx did not have any plans for mergers and acquisitions currently, Lamba said. The exchange was looking internally and externally for a new LME CEO to replace Martin Abbott, who will leave by end-2013. Lamba said the new CEO was unlikely to come from the HKEx and he or she would have to meet U.K. and European regulatory requirements. He ruled himself out as a contender. HKEx is considering launching LME 'minis' futures contracts on its arm, Hong Kong Futures Exchange, Lamba said. That would increase commodity trading volumes in the city and would not take away activity from the LME, he said. In the longer term, the Hong Kong Futures Exchange may trade most LME products with smaller sizes and settled by cash, he said."

Aluminum

Three months LME Aluminum chart – daily close – December 2012 to the present

Source: FutureSource

Three months LME aluminium closed on Friday at $1,793 per tonne. This morning three months aluminium is trading at $1,782. On Friday aluminium had a contango of $45 per tonne versus a contango of $41 per tonne on the previous Friday. The contango seen on Friday was the highest aluminium has seen for four years. Aluminium prices fell 3.1% last week after falling 4.6% in the previous week. Shanghai aluminium stocks fell 4,676 tonnes to 418,323 tonnes.

Aluminium was hammered last week with heavy selling from almost all quarters. The fall would have been worse but for some strong bouts of consumer buying interest. Technical analyst now see good support in and around the $1,760 to $1,770 area basis three months while strong overhead resistance comes in at around the $1,840 to $1,850 area basis three months.

Some traders think aluminium is rather over sold and due for a recovery on the back of short covering and perhaps some more consumer buying interest. On the other hand, some dealers report that producers are now beginning to look at selling forward along the curve to lock in some prices on any hint of a reasonable price recovery.

On the news front, The London Metal Exchange has a number of options to address the warehouse problem of stock build-ups keeping material away from the market, but some of those options would be at odds with LME principles, Duncan Hobbs, senior analyst, Macquarie Bank said at the American Metal Market's "Aluminium Summit" in New York last week. There are three policies the LME could implement to help alleviate long load-out queues at some warehouse locations, Hobbs told delegates at the conference. Possibilities include greater data disclosure and transparency, linking load-out rates to the number of warehouse units at a particular location, or setting different load-out rates for different types of transportation from warehouses. These policies would help mitigate the situation, but not resolve it, Hobbs said.

He pointed out two other options that could have more of an impact on the warehouse queues – setting separate load-out rates for separate metals, which have been done on a limited basis already, and capping the amount of metal a warehouse is allowed to hold. But these options would go against the principles of the LME warehouse system, Hobbs pointed out.

"The last two options would have a big impact but they may be at odds with the principles of the system," he said. Besides rule changes on the part of the LME, Hobbs said that there are a number of other ways the situation could be improved for physical consumers. Rising interest rates would likely make warehouse financing deals less viable, but if the forward spreads were to widen at the same time the extra financing costs that come with higher interest rates could be mitigated. "It depends on the spreads, and higher interest rates are a long way off," Hobbs said.

Secondly, banks that own warehouses could be forced to sell them. In USA, the Bank Holding Act prohibits bank holding companies from holding non-banking assets for more than ten years. Thirdly, if the aluminium market was to move into a deficit then warehouse financing would become unviable. Several delegates at the summit said that with the sharp increase in applications for aluminium, the light metal could be in deficit within three years.

Andy Home, the Reuters columnist, wrote an interesting piece on aluminium last Thursday the 20th of June. We reproduce it below: *"For aluminium, as for the other base metals traded on the London Metal Exchange (LME), the early-June relief rally is now history. The price of three-month aluminium hit a high of $1,981 per tonne back on June 5. This morning the lightweight metal crashed through $1,800, the first breach of this long-standing support level since October 2009.*

Macro liquidity drivers are dominant, metal markets caught in the broader swirl of negativity emanating from Chinese credit crunch and U.S. Fed tapering trepidation.

But aluminium's capitulation from what were already historically distress price levels also says much about the real-world aluminium market. The last couple of months have brought what should have been price-positive news flow, particularly from China.

Industry leader Chalco has said it will immediately curtail 380,000 tonnes per year of capacity, joining other major producers such as Alcoa and UC RUSAL. Beijing has returned to its long-running war of attrition against over-capacity in the smelter sector, targeting in particular the north western province of Xinjiang, a fast-growing production hub. Yet the market is clearly unimpressed, the price falling further into production cost territory. And the market is right, judging by the latest global output figures released today by the International Aluminium Institute (IAI).

China's national production, for example, rose again in May, according to figures from the China Nonferrous Metals Industry Association carried on the IAI's website. True, the month-on-month increase was just 25,000 tonnes annualised. And also true, the cumulative increase in annualised output in the first five months of this year was just 47,000 tonnes.

These are highly marginal figures in China's leviathan aluminium sector.

But the fact that production is increasing at all at a time of such weak prices says much about the scale of the new capacity ramping up. AZ China, a research and consultancy company specialising in the Chinese aluminium sector, estimates that 17 Chinese smelters are currently taking cuts totalling 1.7 million tonnes of annual capacity. The figure includes those announced by Chalco.

Yet evidently any impact is being more than offset by new capacity. Particularly new, lower-cost capacity in north western provinces such as Xinjiang.

If Beijing is serious about tackling what it calls "blind investment" in new smelter capacity, and that may be a big "if", it will not affect the current wave of new production, estimated by AZ China at around five million tonnes.

"The North West capacity additions will go ahead as planned," according to AZ China analyst Paul Adkins. "This is due to the fact North West capacities are operating at sufficiently low cash costs to be profitable in the current price depression. In addition, the game in the North West is about turning metal out as fast as possible, taking market share and starting operations."

The company is forecasting production growth of nine percent in China this year. That compares with growth of 11 percent in the first five months. The implication is that there is room for more price-related cuts sufficient to negate ramp-up of new capacity.

But these cuts are temporary. Chinese producers have proven many times in the past that what is curtailed can just as quickly be restarted once the price outlook improves. The core issue of over-capacity in China is only getting worse.

Well, at least production in the rest of the world is falling, right? Right. Just not very fast.

The headlines will tell you that annualised production outside of China fell by 109,500 tonnes between April and May.

It did but the IAI also revised upwards the April figure. What was originally reported as an annualised drop of 219,000 tonnes turns out to have been much smaller at 36,500 tonnes.

Moreover, the cumulative change over the first five months of this year has been a net decline of just 73,000 tonnes annualised. As in China, curtailments are being offset by new, lower-cost capacity.

Annualised production in the Gulf, where Alcoa's Maaden smelter is currently ramping up, hit a new record of 3.94 million tonnes in May. Regional growth has re-accelerated after a slow patch in 2012. In December it was just 1.6 percent. Last month it was 8.1 percent.

Output in both North America and Africa, meanwhile, has returned to levels not seen since 2011, reflecting the return to normal operations of Rio Tinto's Alma smelter in Canada and BHP Billiton's Hillside in South Africa. Both experienced unplanned production losses last year.

Run-rates are falling in Europe, both Western and Eastern, Latin America and in the IAI's Oceania category, covering smelters in Australia and New Zealand. But these are gentle downtrends, largely reflecting curtailments that have already been announced and which can, therefore, to be considered to be "in the price".

Meanwhile, closing smelter capacity, even "out-of-the-money" capacity, is not getting any easier, witness the Bosnian government's eleventh-hour U-turn on saving local producer Aluminij Mostar.

You can start to understand why the market is so down on the aluminium price right now, particularly when LME inventory has just hit a fresh all-time high.

There is an overwhelming analysts consensus that run-rates need to be not just trimmed to balance the current supply-demand dynamic, but to be cut deep enough to start making an impact on the huge legacy stocks overhang.

What the market has actually got so far this year is a big net zero.

Global reported production in May averaged 125,100 tonnes per day. Exactly the same level as in December 2012.

At the time of writing three-month aluminium was trying to haul itself back to that $1,800 technical level. It may win today's battle but this is going to be a long war."

Other aluminium news

Aluminium Bahrain could cut volumes sold in the Middle Eastern market to free up tonnages for the North American market, Tim Murray, the company's ceo, said at Metal Bulletin sister publication AMM's Aluminium Summit in New York. "*To sell more in* North America, we will have to take a little from the Middle East," Murray told delegates. Alba sells about 70% of its production in the Middle East, with about 16% going into Asian markets and just over 10% in Europe. The remainder goes to North America and Alba does not have available units to boost that figure. New production in the Middle East, particularly from the Ma'aden smelter in Saudi Arabia, will allow Alba to free up some local units and increase its sales into USA, where premiums make it the most attractive market for sellers. *"Ma'aden will relieve some pressure so we can go to North America a little more,"* Murray said. *"North America offers the best premium net-back."*

We thought readers would be interested in this point made by a large Australian bank last week in a client report on mining costs. *"Conventional wisdom suggests dollar strength of the like currently seen results in commodity prices falling. This, however, is based on the assumption that the marginal producer is based on a currency other than the USD and thus cost support falls. Almost uniquely in industrial metals and bulk commodity markets, however, Chinese supply marks the marginal tonne. Given the RMB remains semi-pegged to the USD, marginal production costs in China will remain relatively stagnant in this scenario, with limited impact of cost support floors."*

"As such, given most metals are already trading hard into the cost curve, dollar strength is not likely to have a severe impact on industrial metals prices or curve shapes, benefitting those market incumbents who can be successful in taking costs out of the business on a sustainable basis while maintaining output."

"Thus, AUD-denominated producers (and those also seeing currency debasing) will gain competitive benefit versus the marginal producers in markets. The net effect of this will be to steepen cost curves, over and above the cost reductions expected in many cases from the change in management mind set over the past year. Indeed, currency moves such as those seen as QE tapering expectations have come through will likely yield greater savings than any operational cost-cutting exercises – provided the producer has not overhedged FX exposure at a higher currency rate."

China is the marginal producer in almost every metals and bulk commodity market	
Aluminium $2,350 per tonne	Iron ore $135 per tonne
Copper $6,500 per tonne	Metallurgical coal $175 per tonne
Nickel $17,500 per tonne	Thermal coal $95 per tonne
Lead/zinc $1,900 per tonne	Manganese $5.5 per metric tonne unit
Ferrochrome $1.05 per lb	Cobalt $13 per lb
Alumina $325 per tonne	Molybdenum $14 per lb

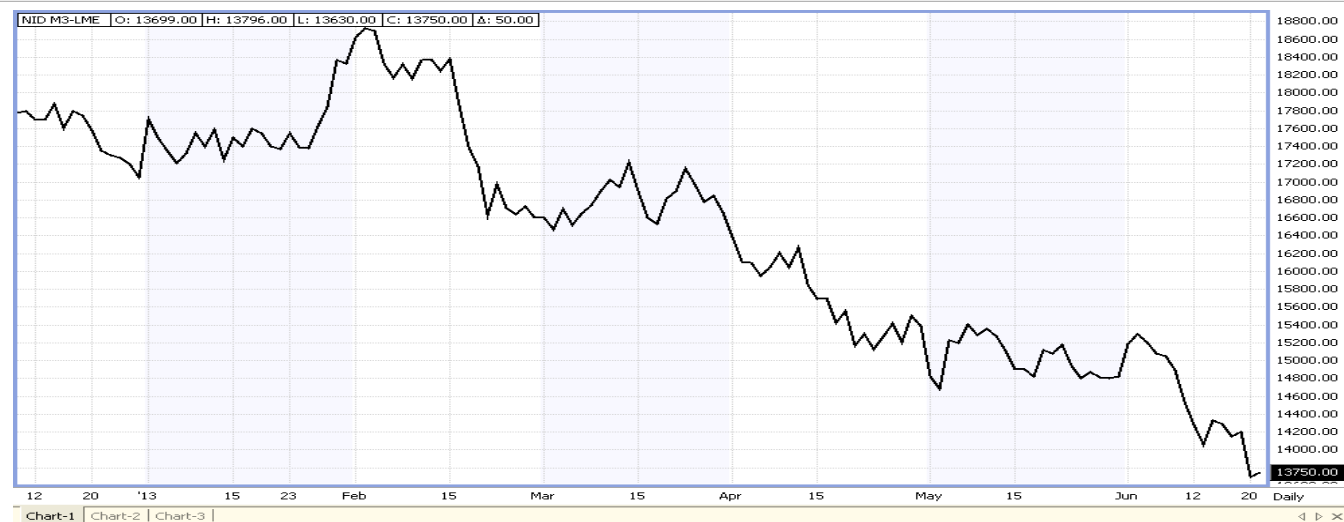
Source: Wood Mackenzie - June 2013

Bloomberg reports that "The fee buyers pay to obtain aluminum in the U.S. climbed to a record amid longer waits for warehouse supplies and reduced availability of scrap metal, Harbor Intelligence said. The so-called Midwest premium is 12 cents to 13 cents a pound, an all-time high, according to Harbor Intelligence, an Austin, Texas-based researcher. The fee was 11.75 cents to 12.5 cents earlier this month. The surcharge is added to the price of aluminum for immediate delivery on the London Metal Exchange. "A steady supply of metal is getting into warehouses and lengthening queues," Jorge Vazquez, a managing director at Harbor, said

in a telephone interview. *"We're also seeing tighter markets for scrap and off-grade metals, as well as a slight pickup in physical demand outside the LME."*

Nickel

Three months LME Nickel chart – daily close – December 2012 to the present



Source: FutureSource

Three months LME nickel closed on Friday at $14,075 per tonne. This morning three months nickel is trading at $13,800. On Friday nickel had a contango of $69 per tonne versus a contango of $71 per tonne on the previous Friday. Nickel fell 1.7% last week after falling 4.8% in the previous week.

Nickel seems to have stabilised itself for the time being. It still looks very fragile on the charts with many technical analysts seeing support coming in at around $13,300 per tonne while overhead resistance is put at around $14,400 per tonne basis three months. Many traders are now side lined waiting to sell into any strong corrective bounces.

On the news front, the global nickel market was in surplus by 32,900 tonnes in the first four months of the year, the latest monthly bulletin from the International Nickel Study Group (INSG) showed. World primary nickel consumption totalled 582,400 tonnes in the year to April, while primary nickel output was 615,300 tonnes. Nickel mine production during the period totalled 639,700 tonnes, down from 685,900 tonnes in the same period last year. Latest figures showed nickel stocks held by producers were at 85,500 tonnes in March, down from 87,200 tonnes in February.

Reuters reports that *"China's nickel pig iron producers are turning in droves to a new technology that allows them to survive at lower prices, a move that suggests nickel prices, already mired at four-year lows, could fall further. As nickel prices near $14,000 a tonne, however, output cuts by loss-making producers with higher costs could steady the market, analysts said. Nickel, mainly used to make stainless steel, is down 17 percent this year. It is the worst performer on an industrial metals complex hit hard by China's slowing growth."*

"Production of nickel pig iron in China, a cheaper substitute for pure nickel used as feedstock by stainless steel mills, has more than quadrupled to an estimated 400,000 tonnes this year from 89,000 tonnes in 2008. At the same time, technical innovations have slashed costs, which have in turn lowered the floor for nickel prices. The break-even cost for nickel pig iron produced by rotary kiln electric furnace (RKEF) technology is now as low as $12,500 a tonne and its market share has soared, said Dennis Zamora, senior vice president for marketing and strategic planning at Nickel Asia Corp."

"RKEF technology uses about a third less power than conventional production methods. "At the moment, around 30 percent of the whole supply in China is made out of RKEF and that figure is growing so that next year you'll have 50 percent," Zamora said in an interview. The Philippine company is one of the world's lowest-cost producers of nickel laterite ore, the low-nickel-content material used in nickel pig iron, 60 percent of which it ships to China. The rise of nickel pig iron, and RKEF plants in particular, has won market share from refined nickel. Combined with a global nickel surplus, this has helped send benchmark nickel on the London Metal Exchange (LME) spiralling lower to near $14,000 a tonne this week, its weakest level since 2009. Current low

prices are hurting producers using older, higher-cost technology, who are expected to cut output. Data this week from the International Nickel Study Group was the latest evidence of a market also burdened by overproduction outside of China."

"The nickel market recorded a surplus of 32,900 tonnes during the first four months of the year. In April, the INSG forecast an annual surplus of 90,000 tonnes this year. Processing of nickel laterite ore, through high pressure acid leach projects, such as Ramu in Papua New Guinea and Ambatovy in Madagascar, have in general been very successful, providing more supply for pig iron producers, said Joel Crane of Morgan Stanley in Melbourne. Of the three nickel pig iron production methods, RKEF has enjoyed the most popularity due to lower costs and to its higher quality. It can be used in popular 300 series stainless steel for a fraction of the cost of refined nickel. The stainless steel industry, also suffering from huge over capacity, is approaching the seasonally-weaker summer months."

Platts reported last week that *"The global nickel market will remain in surplus this year mainly because of the increase in nickel pig iron production, according to John Rowe, secretary-general of the International Stainless Steel Forum. Total nickel production is forecast at 1.85 million mt this year against projected demand of 1.75 million mt, according to Rowe. Two-thirds of nickel is used in stainless steel production. Rowe told a conference in Sheffield last week that NPI production in China could reach 504,000 mt this year, up from 272,000 mt in 2011 and 360,000 mt in 2012. In addition, production costs are decreasing and NPI product quality is rising thanks to improving technologies. Growth is also occurring in integrated NPI and stainless steel production. However, Rowe noted that NPI production trends will change materially if Indonesia and the Philippines tighten their restrictions on the export of nickel ore. Therefore China's competitive advance in stainless steel, which is partially linked to NPI "may not be sustainable" he said."*

Zinc

Three months LME Zinc chart – daily close – December 2012 to the present

Source: FutureSource

Three months LME zinc closed at $1,842 per tonne on Friday. This morning three months zinc is trading at $1,827. On Friday zinc had a contango of $35 per tonne versus a contango of $37 per tonne on the previous Friday. Zinc fell 1.0% last week after falling by 2.4% in the previous week. Shanghai zinc stocks fell 248 tonnes to 286,501 tonnes.

Zinc prices continue to be range bound with many technical analysts putting in strong overhead resistance in $1,890 to $1,900 per tonne area basis three months while good support is expected in and around the $1,810 to $1,820 area basis three months.

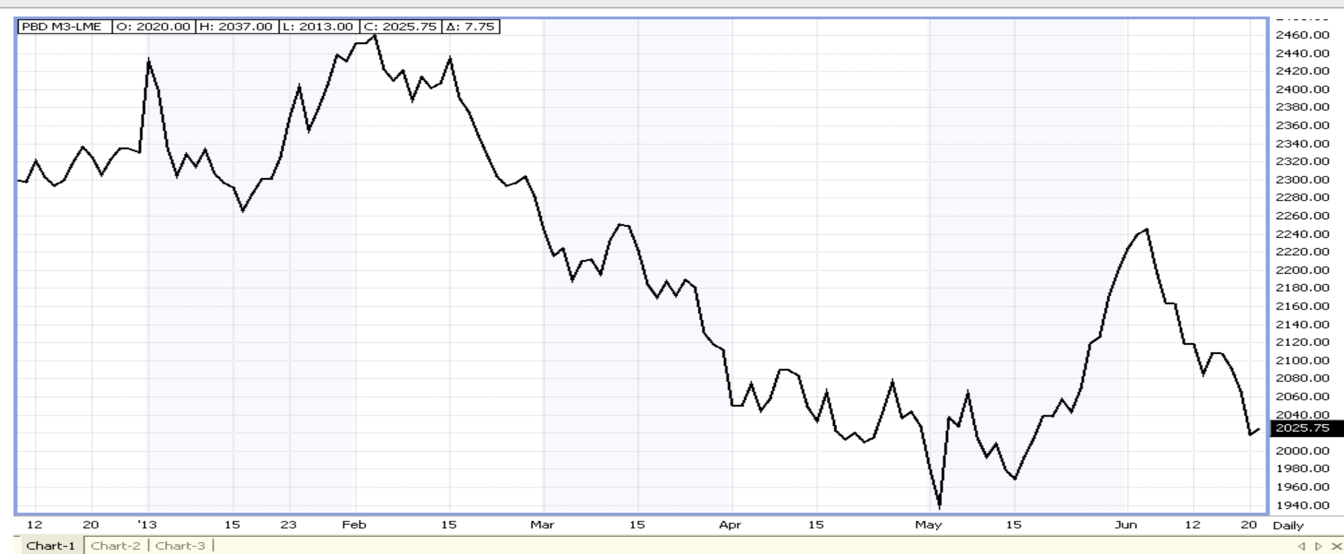
The global zinc market was in surplus by 48,000 tonnes in the first four months of the year, the Lisbon-based International Lead and Zinc Study Group (ILZSG) said last Wednesday. Global refined zinc use in January to April was 4.277 million tonnes, up from 4.048 million tonnes in the same period last year. World refined zinc output was 4.325 million tonnes in January to April, up from 4.182 million tonnes in the same month last year.

Platts reports that *"Spot zinc treatment charges paid to Chinese smelters are about $120-130/mt in June, up 9% from $110-120/mt in May, amid increasing production of zinc concentrates in China, market sources said Wednesday. In comparison, TCs were higher in March at $125-135/mt. Although market sources in China said spot TCs were as high as $135-140/mt in June, a zinc concentrate dealer in northwest China said "deals done at these levels were for zinc concentrates with higher impurities." He added: "For the general material with less impurities, the spot TCs are $120-130/mt this month."*

"In southwest China, a trader with a zinc smelter said: "Due to China's growing national zinc concentrate output, overseas mines need to pay higher fees to get smelters [to convert their concentrates]." In central China, a trader with a zinc smelter said: "This year, we have imported some zinc concentrates in the spot market, but haven't inked any term contracts." He added that in June, the company was buying zinc concentrates mainly from the domestic market as supply was abundant. "If TCs in the coming months are better, we may consider buying some from the overseas spot market," he said. China produced 1.67 million mt of zinc concentrates over January-April this year, up 8% year on year, figures from National Statistics Bureau showed. Meanwhile, China imported 580,009 mt zinc concentrate in the first four months of 2013, down 11% year on year, figures from the country's General Administration of Customs showed."

Lead

Three months LME Lead chart – daily close – December 2012 to the present



Three months LME lead closed on Friday at $2,023 per tonne. This morning three months lead is trading at $2,000. On Friday lead had a contango of $9 per tonne versus a contango of $7 per tonne on the previous Friday. Lead fell 4.1% last week after falling by 2.5% in the previous week. Shanghai lead stocks fell 2,809 tonnes to 115,930 tonnes.

Many technical analysts are looking for a short term corrective price bounce in lead. The current trading range is put at $2,070 to $2,080 per tonne basis three months at the top end of the trading range while good support is expected in and around the $1,990 to $2,000 per tonne area basis three months.

The global lead market was in deficit by 31,000 tonnes in the first four months of the year, the International Lead and Zinc Study Group (ILZSG) said on Wednesday. Global refined lead use was 3.491 million tonnes in January to April this year, up from 3.236 million tonnes in the same period last year. World refined lead output was 3.460 million tonnes, up from 3.274 million tonnes in January to April a year ago.

Tin

Three months LME Tin chart – daily close – December 2012 to the present

Source: FutureSource

Three months LME tin closed on Friday at $20,010 per tonne. This morning tin is trading at $19,400. On Friday tin had a contango $61 per tonne versus a contango of $60 per tonne on the previous Friday. Tin fell 1.9% last week after falling 3.1% in the previous week.

Tin is now trading at the top end of its trading range. Technical analysts put this at $19,900 to $20,000 per tonne basis three months at the top while good support is thought to exist in and around the $18,600 to $18,700 per tonne area basis three months. Many CTAs and technical trading funds are looking to scale up sell on any bounces that may develop in coming days.

Bloomberg reported last week that PT Timah, the world's third-biggest tin producer, expects futures to climb as much as 19 percent in the second half because of reduced shipments from the largest supplier Indonesia, said President Director Sukrisno. Prices will advance as high as $24,000 a metric ton from $20,100 now, said Sukrisno. Exports from Indonesia will drop as much as 24 percent to 75,000 tons in 2013 from a year earlier if the government fully enforces its new purity rules starting from July 1, he said in an interview early last week on Bangka Island, the country's biggest producing area. Indonesia is increasing the minimum grade for tin exports to 99.9 percent from 99.85 percent and reducing lead and cadmium levels.

While Timah says it will meet the new rules, only 13 percent of the independent smelters will be able to do so fully from the start, according to Hidayat Arsani, president of the Indonesian Tin Mining Association. *"The purpose of the new regulation is to increase control over shipments from Indonesia,"* said Sukrisno.

"I heard that some people in China and Malaysia say they're doubtful we can fully implement the rules. My response is that it's a big challenge for our country and the key will be good monitoring." The company has met surveyors in a bid to ensure the purity law is properly applied from the start of July, said Sukrisno.

The independent smelters are in a "*wait and see*" mode and some expect the government to delay or ease the rule, said Arsani. While they can meet the purity level, some find it hard to comply with levels for other minerals, he said in an interview in Bangka on June 17. The government will enforce the new regulations as planned on July 1, said Bachrul Chairi, director general of foreign trade at the Trade Ministry.

The move will increase the value of exports, he said by phone from Jakarta today. CV Serumpun Sebalai, based in central Bangka, is able to increase purity to the required level, said Director Tjahyono Mukmin. The company isn't yet ready to reduce the content of other minerals and will have to invest about $200,000 to buy the equipment from China, he said in an interview in Bangka. *"We haven't ordered it yet and will need time to install it, so we'll have to stop tin ingot exports from July and sell only solder to keep the company running,"* said Mukmin.

Exports from Indonesia climbed the most in eight months in May as smelters shipped material before the rules take effect. Sales surged 18 percent from April to 9,242 tons, boosting the total 17 percent in the first five months to 43,900 tons from a year earlier, according to trade ministry data. Stoppages by miners in protest against allegations of unauthorized mining have also raised concern production may be curbed. About 2,000 miners rallied in front of Timah's office in Pangkalpinang on June 7, Hendra Apollo, protest coordinator, said that day. It followed a demonstration by 1,500 Timah workers on May 22 against what the company calls illegal mining on its concession, said corporate secretary Agung Nugroho.

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