Copper – still lots of bear arguments to make

On balance there are more bear factors developing for copper than there are bull factors.

On the charts the trading range continues to be lowered with overhead resistance now seen in and around the $7,500 per tonne level basis three months LME while some technical analysts are talking about the $7,380 level being broken which could lead to a lurch down to $7,200 per tonne. Mind you, at $7,200 one would expect to see an awful lot of forward buying from the Chinese as many, if not most, Chinese firms and dealers see the ideal buying range as being $7,300 to $7,200 per tonne.

Chinese consumption remains quite subdued. One Chinese merchant said in an email to clients that only 40% of some 2,000 copper fabricators in Jiangxi province were working.

The chief economist of a large hedge fund summed the situation up well in a note to clients on Tuesday. He said: "Against a backdrop of generally soft macro data the continued resilience in commodity prices is somewhat surprising."

"True the continued firmness in crude prices has helped support industrial metals, as the positive impact of broad index buying has more than offset the negative impact on global economic growth. But with possible inflationary consequences of higher energy and food prices set to diminish policy makers options then prices are still more likely to head lower than higher."

"The 'super bears' will point out that immediately after the Olympics in 2004 copper was trading around $7,400/t and crude around $114/bbl before slumping aggressively through September."

"Banker and broker sentiment remains favourable towards a likely Q4 rally. Options volatility has continued to decline as traders look to generate revenue by selling vol in a sideways drifting market."

"Copper prices have been little changed in recent trading with more interest coming through in spreads. August-Sept tightened as Chinese customers looked to borrow and roll positions, pushing the market to a

$3/t backwardation. However, hopes of a squeeze proved unfounded and immediate tightness seems to be dissipating."

"Physical market remains quiet and with talk of Chinese exports rising in response to the removal of the export tax on tolling business there seems little reason to expect any renewed tightness any time soon. Options market remains very quiet, with front month vol at 22%-23%, a historically low level and one where it could prove dangerous to be short. China has been supportive, looking to close spec shorts on lower prices."

On the news front a major bank, which is a leading financier of bonded copper stocks in China, said in a note to clients that it estimates copper stock levels in the bonded zones of Waigaoqia and Yangshan at 600,000 tonnes in early August, up from 500,000 tonnes in July. The bank says that "including commercial stocks held in the domestic market, total stockpiles sit at around one million tonnes, equivalent to roughly seven weeks of demand and a manifestation of the slowing growth in the Chinese economy."

"The ground has finally cracked under the weight of China's copper inventories," the bank said. "China's rising copper inventory will act as a head wind to three month LME copper prices in the coming weeks."

The bank warned that "Investors should be wary of linking import data to China's real demand, as the vast majority of imports are based on one year term contracts rather than spot buying."

Easing policies by Beijing anticipated for later this year should kick start a recovery in demand for copper late in the fourth quarter, although "…it will be modest at best," the bank said.

"We recommend that consumers buy on dips towards the $7,220 a tonne (level), looking for a rally back up towards $8,000 a tonne."

Another bearish development was the decision by Cochilco, Chile's state copper commission, to lower its price forecast for cash LME copper this year to $3.52 a lb ($7,760 per tonne) from $3.85 a lb ($8,488 per tonne). It also lowered its average price forecast for 2013 to $3.48 ($7,672 per tonne) from $3.75 per lb ($8,267 per tonne).

Cochilco said it expected global demand for copper to rise 0.9% this year to 20.07 million tonnes. This is down from its previous forecast of 2.4% rise. Cochilco is a bit more optimistic for next year seeing global copper usage rising by 1.8% to 20.4 million tonnes.

Global mined copper output is expected to rise 1.6% this year to 16.6 million tonnes on better supplies from Chile, China, and Mexico. Output will increase again in 2013 by 1.9% to 16.9 million tonnes.

Cochilco sees Chilean output rising 2.7% this year to 5.4 million tonnes and then rising again next year by 1.9% to 5.5 million tonnes. There will be a global supply deficit of 214,000 tonnes this year which will fall, Cochilco says, to 26,000 tonnes in 2013.

US industrial production figures better than expected

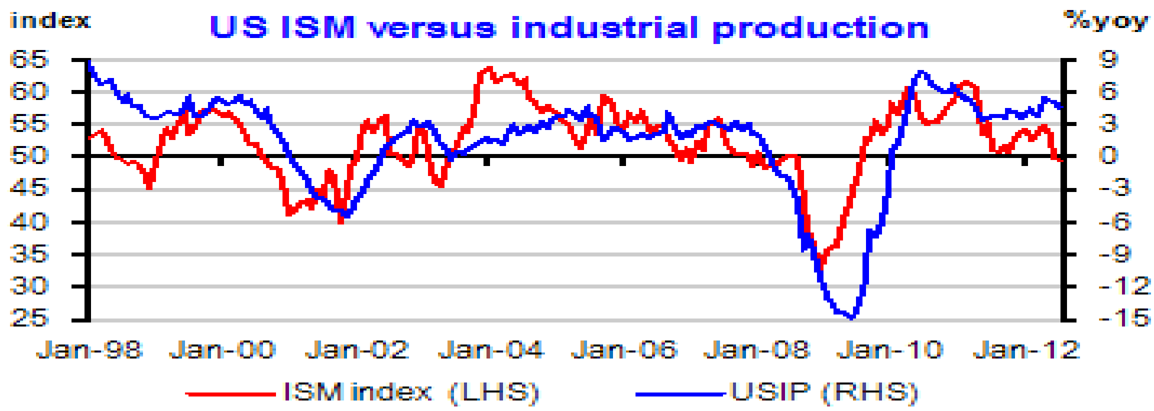
US industrial production growth was stronger than had been expected in July, but a larger downwards revision to June makes the data a net negative. Output in July rose 0.6% month on month (0.5% was consensus) although June was revised down from a rise of 0.4% month on month to a rise of 0.1% month on month.

On an annualised basis, US industrial production growth in July increased by 4.4% year on year, a much healthier level than that suggested by the recent weakness in the ISM.

US inflation was softer than had been expected, with the month-on-month change in headline CPI flat for the second month in a row, against an expected 0.2% month on month rise. The annualised rate of inflation eased from 1.7% year on year to 1.4% year on year (consensus was for 1.6%) Core CPI rose by 0.1% month on month (0.2% was consensus) leaving the annualised rate of increase at 2.1% year on year (2.2% year on year was expected).

The Empire manufacturing index was weaker than had been expected, falling from +7.4 to -5.9 (+6.4 expected).

The NAHB index of house builder confidence rose from 35 to 37 (expected 35), the highest level since February 2007. This is still some way off the long term average of 47, but at least the housing sector is now making a small positive contribution to US growth.



Source: Ecowin

The chief economist of a large hedge fund said in a note to clients today that: “Tuesday’s better than expected US retail sales data has seen market expectations for Fed QE in September scaled back. Although there is still a consensus that the Fed will eventually need to ease policy, the time frame for any action seems to be being pushed back towards the end of the year or into 2013. As a result the dollar was a touch firmer today (Wednesday) and this proved sufficient to pressure base metals lower, notwithstanding the continued ascent of crude oil prices, with Brent over $115/bbl today.”

Eurozone continues to decline while US retail sales impress

Eurozone GDP contracted by 0.2% quarter on quarter in Q2, in line with market expectations. Growth in France and Germany surprised on the upside while exports also allowed the Netherlands and Austria to grow.

Elsewhere the contractions were deep, particularly in Italy, Finland and Portugal. With virtually all indicators pointing to a sharper decline in Q3 GDP, it is clear that the Eurozone has moved back into a recession.

This will make it even more difficult for most member states, not just those in the periphery, to meet their fiscal targets.

Eurozone industrial production in June fell 0.6% month on month. This was much worse than the 0.2% month on month fall expected, although on a positive note May’s increase was revised higher from 0.6% month on month to 0.9% month on month. This left Eurozone industrial production down 2.1% year on year.

In Germany the ZEW survey of economic sentiment was worse than expected, falling from -19.6 to -25.5 (-18.0 was consensus).

In contrast the US retail sales figures were stronger than had been expected. US retail sales jumped unexpectedly in July and by the biggest amount in five months, the Commerce Department said.Lower fuel prices and modest growth in employment helped spur a 0.8% monthly rise in retail and food services sales. Consensus was for a rise of only 0.3% month on month. On an annualised basis retail sales were up 4.1% year on year.

They amounted to a seasonally-adjusted $404bn in July and were 4.1% higher from a year earlier. The data pointed to a modest recovery in the economy, as spending makes up nearly three-quarters of America's economic output.

Employers last month added 163,000 jobs, while consumer confidence also rose in July for the first time in six months. The housing market is also rebounding, albeit slowly. In July, the biggest sales were recorded in building materials, furniture and health products, data showed. Sales of cars were also up.

“The retail sales data suggest that the US economy fared surprisingly well in July in the face of on-going uncertainty and renewed contraction in the Eurozone” said Chris Williamson, the chief economist of Markit. Mr Williamson cautioned that the sales data can be volatile. "The 0.8% rise in July came on the back of a 0.7% fall in June," he said.

Ten killed in clashes at South African platinum mine

Production at Lonmin's South African platinum mines has been severely disrupted after a serious outbreak of violence over the weekend. On Friday about 3,000 Lonmin rock drill operators began an illegal work stoppage and protest march.

The following violence between rival unions has resulted in the deaths of eight Lonmin workers and two policemen. This incident comes after Impala, the world's second largest platinum producer halted operations at its Rustenberg mine five month ago due to conflict between unions at its operations (the National Union of Mineworkers and the Association of Mineworkers and Construction Union).

If the situation continues for the same period as with Impala, Lonmin could lose 80,000 to 100,000 ozs of production depending on the subsequent ramp-up period.

Most analysts are forecasting a slight surplus in the platinum market this year, but depending on how long hostilities at Lonmin last and if the unrest spreads to other miners on the Western limb of the platinum mining area, the surplus of around 150,000 to 200,000 ozs could easily be wiped out.

Some South African stock brokers think all the miners are vulnerable to this sort of violence (which the police seem increasingly incapable of controlling or preventing). The brokers are recommending their clients go long of metal and short of equity as a trading strategy.

Lonmin said the situation remained “volatile” at its Western Platinum mine, 100km north-west of Johannesburg. The plant was operating at reduced capacity and was under heavy police guard.

The mine is part of Lonmin’s Marikana operations, which produced 1.3m ounces of platinum group metals in 2011. Company officials could not say how much production had been lost but they are expected to update the market later on this week.

The clashes involve a struggle for membership between the dominant National Union of Mineworkers (NUM) and the upstart Association of Mineworkers and Construction Union (AMCU).

At least three people were killed in a similar round of violence in January that led to a six-week closure of the world’s largest platinum mine, run by Impala Platinum.

The whole platinum sector is grappling with declining world prices for the precious metal and a surge in union militancy in South Africa, home to 80% of known platinum reserves.

The platinum group metals basket (pgm) has averaged around $9,740 per oz for the year to date. All the pgm metals (platinum, palladium, and rhodium) are mined together as they occur homogenously in the ore of the South African platinum mines. The basket price calculation is made on the value of the different metals and their percentage weighting in total refined production.

At the current South African rand price for the basket of rand 8,990 per pgm oz, mining analysts estimate that 14.6% of platinum production (690,000 ozs) is at risk as well as 13.15% of palladium production

(353,000 ozs) and 12.9% of rhodium production. The price is thought to be some 30% below a sustainable industry price to produce pgm metals.

Aquarius Platinum briefly shut one of its shafts this month after an attack by unidentified assailants that left three dead and at least 20 injured.

January's stoppage at Implats also started with an illegal strike by rock drillers.

NUM and Lonmin officials said workers who wanted to report for duty were being intimidated. AMCU has faced the same allegations elsewhere but has always denied them.

The AMCU/NUM rivalry, which has already caused friction at Lonmin's Karee mine, has now spread to other shafts at a time when the company is cutting back on investment plans in the face of weak demand and shrinking margins.

The challenge to the dominance of the 300,000-strong NUM also has political ramifications given its role as a key support base for the ruling African National Congress.

Congressman Ryan should add specifics to the fiscal debate

Consulting American economist Dr David Horner told clients in his latest report that "Romney's choice of Ryan is very interesting. Whatever ones politics, Ryan will add specifics to the fiscal debate and to the debate on income distribution that Romney has, thus far, avoided. This, in turn, will allow for a more distinctive choice, at least from an economic perspective. The market was mostly unresponsive to the choice, but it is premature, in my opinion, to conclude how it will help or hurt the two parties."

Japanese second quarter GDP figures disappoint

Japan's economy, the world's third largest, grew at an annualised 1.4% in the second quarter versus consensus expectations of a 2.3% rise, as weak exports and softer consumer spending offset strong public investment in the tsunami-stricken region of Tohoku. This left the annualised rate of GDP growth at 2.5% year on year. Japanese GDP is still 3.3% below its Q1 2008 peak as the chart below shows.

The disappointing data represented a sharp drop from the first quarter, which saw annualised growth of 5.5% as Japanese consumers finally shook off their post-tsunami restraint.

Japan has struggled to adjust to the effects of a strengthening yen and faltering growth in key export partners such as China and the EU. During the second quarter the yen rose 4% against the US dollar, as a surplus of imports over exports trimmed 0.1% from overall output.

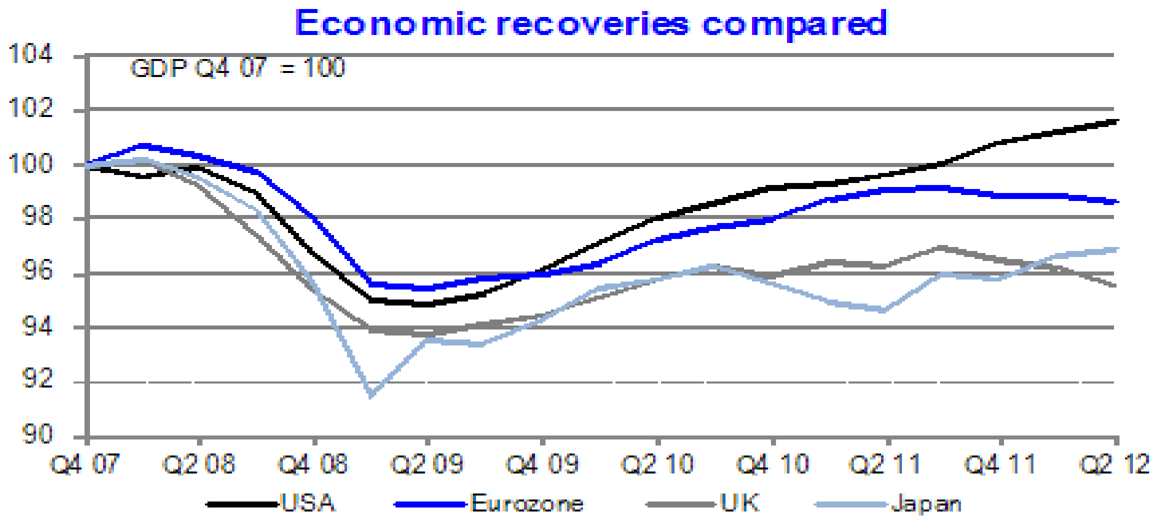
The strongest figure in the preliminary GDP figures came from public investment, which rose 1.7% from the first quarter. Spending was led by rubble clearance and decontamination projects in Fukushima, Miyagi and Iwate, the three north-eastern prefectures hit hardest by the earthquake and tsunami in March 2011.

While heavy spending on rebuilding is necessary, economists said, it suggests that growth may fall more in the second half of this year as less cash is disbursed to the region from central government.

Japan’s dependence on state spending to fuel growth is also worrying, in the context of the government’s growing debt burden. The International Monetary Fund warned this month that Japan’s growing state borrowings – now exceeding Y1,000tn ($12.8tn), including guarantees – leave it exposed to an increase in interest rates caused by a loss of confidence in fiscal sustainability.

Yields surged last week to a two-month high over fears that plans to raise the level of sales tax – the centrepiece of the fiscal reform efforts of Yoshihiko Noda, the prime minister – would be derailed. In the event, the law was passed, sending yields a little lower but the focus on state finances may mean that the government struggles to pass a supplementary budget in the autumn, as it had planned.

That would put the onus on policy makers at the Bank of Japan to consider fresh monetary stimulus to shore up domestic demand.



Economic recoveries compared
GDP Q4 07 = 100
104
102
100
98
96
94
92
90
Q4 07
Q2 08
Q4 08
Q2 09
Q4 09
Q2 10
Q4 10
Q2 11
Q4 11
Q2 12
USA
Eurozone
UK
Japan