Commodity Economics Comment

Free to View

Economics

'Dr Copper' and the 'super-squeeze'

Paul Bloxham
Chief Economist, Australia, New Zealand & Global Commodities
HSBC Bank Australia Limited

Jamie Culling
Economist, Australia, NZ & Global Commodities
HSBC Bank Australia Limited

- No, this is not the title of the next Bond film or Marvel movie. An action-packed story it is though – at least for commodity market observers. Copper prices are up sharply since their October 2023 trough, to a two-year high in the past few weeks. Dr Copper's diagnoses – widely regarded as a bellwether for the global industrial cycle – could be that an upswing in the global industrial cycle has begun. But the 'super-squeeze', the burly hero in our story, has adjusted the plot. Underinvestment in copper mines, combined with a wave of 'green demand' that is coming from the energy transition, is making the copper market tighter than usual. Is 'Dr Copper' in the house, or it is a green imposter? We still have faith in the doctor.

Copper prices have risen sharply in recent weeks, up by over 15% year-to-date and 15% y-o-y (Chart 1). As is also well understood, copper prices are regarded by many observers as a useful timely indicator of the global industrial cycle. 'Dr Copper', as the copper price is often referred to, could be telling us that the global industrial cycle has turned and an upswing is underway.

The idea, of course, is that the copper price is the nexus between demand and supply of the metal, and because copper is such a critical industrial commodity for so many manufactured goods, movements in its price can signal an early read on changes in global demand.

However, as with all products, and commodities in particular, shocks can come from both demand and supply.

As Chart 2 and Chart 3 below show, there has typically been a strong correlation between movements in copper prices and the global manufacturing PMI and China's industrial production, respectively. This correlation was particularly strong prior to 2022.

However, the correlation then dropped to zero in 2022, following Russia's invasion of Ukraine and the sharp supply shock that emerged.

More recently, the correlation between copper prices and global manufacturing has strengthened again.

But the copper market has changed in other ways too.

The copper-intensity of the energy transition means that copper demand is set to be structurally higher for decades to come. Keep in mind that copper is a key input into electrification, used in transmission lines, electrical infrastructure and vehicles. For example, electric vehicles use about four times more copper than internal combustion engine cars.

This is a Free to View version of a report with the same title published on 06-May-24. Please contact your HSBC representative or email AskResearch@hsbc.com for more information.

On IEA estimates, copper demand from clean energy technologies will rise by between 1.7 and 2.7 times between 2020 and 2040, depending on whether the world tracks the 'stated policies scenario' or 'sustainable development scenario'. Global copper production is currently around 22 million tonnes a year and S&P forecasts that 50 million tonnes year will be needed by 2035 – just 11 years from now.

At the same time, investment in new mines has not been particularly strong. Indeed, the projected annual investment spend on copper over the next four years is less than half the nominal spend that occurred at the peak of the last China led 'super cycle', between 2011 and 2014. This has been alongside signs that copper producers would prefer to buy rivals than undertake new projects (Bloomberg, 27 April 2024). Environmental challenges are a key issue in constraining the pace of mine expansion and lifting its cost. Political considerations come into play here too. Copper production, like many other critical commodities, is quite geographically concentrated -- with Chile and Peru accounting for 37% of global supply.

This is part of what we have been calling a 'super-squeeze'. A persistent supply shortfall, in this case largely driven by the energy transition, while for other commodities the super-squeeze has been more about geopolitics recently. For copper, the super-squeeze is helping to explain why copper prices are still high, not just in nominal terms, but also in real terms (that is, relative to the prices of the rest of the consumer basket) (Chart 4).

However, the question remains whether the rise in copper price is just being driven by a more narrowly-based energy transition story, or is it the same powerful guide to the industrial cycle it has been in the past?

Is Dr Copper in the house, or is it a green imposter?

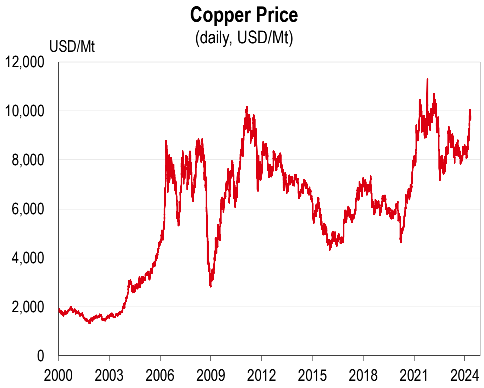
In some ways, it might not matter that much. The energy transition is so ubiquitous, in transportation, construction, energy networks and so many other activities that a green-led upswing in demand is broad-based enough to lift the overall industrial cycle.

Our colleague, Jonathan Brandt, HSBC's key copper market analyst, has recently revised up HSBC's forecasts for copper prices from 2024e-2028e. He describes the market as 'squeezed'. Recent disruptions to supply from a key mine in Panama (1% of global supply) and a cut in production guidance at key producers are playing a role.

As always, tracking both the levels and the changes in prices matters, as well as closely following supply-side developments, like those in Panama recently.

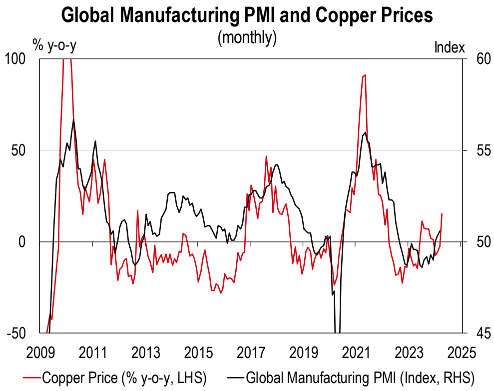
We still have faith in the doctor.

1. Copper prices have risen to a two-month high



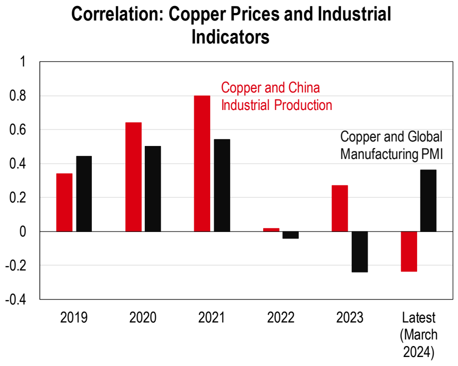
Source: Bloomberg; HSBC

2. Copper prices and the global industrial cycle are closely associated



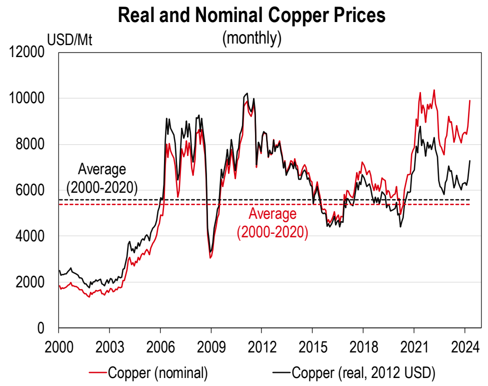
Source: Bloomberg; HSBC

3. Copper prices and the manufacturing PMI have resumed a positive correlation



Source: Bloomberg; HSBC estimates.
Note: The chart shows the annual correlation between 1) Copper price inflation (% y-o-y) and the global manufacturing PMI (index), and 2) Copper price inflation (% y-o-y) and China's industrial production (% y-o-y).

4. Both nominal and real copper prices remain elevated



Source: Bloomberg; HSBC.
Note: Real copper prices calculated using US CPI; the recent spike is evident using core CPI and core PCE too.

Disclosure appendix

The following analyst(s), who is(are) primarily responsible for this document, certifies(y) that the opinion(s), views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Paul Bloxham and Jamie Culling

This document has been issued by the Research Department of HSBC.

HSBC and its affiliates will from time to time sell to and buy from customers the securities/instruments, both equity and debt (including derivatives) of companies covered in HSBC Research on a principal or agency basis or act as a market maker or liquidity provider in the securities/instruments mentioned in this report.

Analysts, economists, and strategists are paid in part by reference to the profitability of HSBC which includes investment banking, sales & trading, and principal trading revenues.

Whether, or in what time frame, an update of this analysis will be published is not determined in advance.

For disclosures in respect of any company mentioned in this report, please see the most recently published report on that company available at www.hsbcnet.com/research.

Additional disclosures

1. This report is dated as at 06 May 2024.
2. All market data included in this report are dated as at close 02 May 2024, unless a different date and/or a specific time of day is indicated in the report.
3. HSBC has procedures in place to identify and manage any potential conflicts of interest that arise in connection with its Research business. HSBC's analysts and its other staff who are involved in the preparation and dissemination of Research operate and have a management reporting line independent of HSBC's Investment Banking business. Information Barrier procedures are in place between the Investment Banking, Principal Trading, and Research businesses to ensure that any confidential and/or price sensitive information is handled in an appropriate manner.
4. You are not permitted to use, for reference, any data in this document for the purpose of (i) determining the interest payable, or other sums due, under loan agreements or under other financial contracts or instruments, (ii) determining the price at which a financial instrument may be bought or sold or traded or redeemed, or the value of a financial instrument, and/or (iii) measuring the performance of a financial instrument or of an investment fund.

Disclaimer

This document has been issued by HSBC Bank Australia Limited, which has based this document on information obtained from sources it believes to be reliable but which it has not independently verified. Neither HSBC Bank Australia Limited nor any member of its group companies ("HSBC") make any guarantee, representation or warranty nor accept any responsibility or liability as to the accuracy or completeness of this document and is not responsible for errors of transmission of factual or analytical data, nor is HSBC liable for damages arising out of any person's reliance on this information. The information and opinions contained within the report are based upon publicly available information at the time of publication, represent the present judgment of HSBC and are subject to change without notice.

This document is not and should not be construed as an offer to sell or solicitation of an offer to purchase or subscribe for any investment or other investment products mentioned in it and/or to participate in any trading strategy. It does not constitute a prospectus or other offering document. Information in this document is general and should not be construed as personal advice, given it has been prepared without taking account of the objectives, financial situation or needs of any particular investor. Accordingly, investors should, before acting on it, consider the appropriateness of the information, having regard to their objectives, financial situation and needs. If necessary, seek professional investment and tax advice.

The decision and responsibility on whether or not to purchase, subscribe or sell (as applicable) must be taken by the investor. In no event will any member of the HSBC group be liable to the recipient for any direct or indirect or any other damages of any kind arising from or in connection with reliance on any information and materials herein.

Past performance is not necessarily a guide to future performance. The value of any investment or income may go down as well as up and you may not get back the full amount invested. Where an investment is denominated in a currency other than the local currency of the recipient of the research report, changes in the exchange rates may have an adverse effect on the value, price or income of that investment. In case of investments for which there is no recognised market it may be difficult for investors to sell their investments or to obtain reliable information about its value or the extent of the risk to which it is exposed. Some of the statements contained in this document may be considered forward looking statements which provide current expectations or forecasts of future events. Such forward looking statements are not guarantees of future performance or events and involve risks and uncertainties. Actual results may differ materially from those described in such forward-looking statements as a result of various factors.

This document is for information purposes only and may not be redistributed or passed on, directly or indirectly, to any other person, in whole or in part, for any purpose. The distribution of this document in other jurisdictions may be restricted by law, and persons into whose possession this document comes should inform themselves about, and observe, any such restrictions. By accepting this report, you agree to be bound by the foregoing instructions. If this report is received by a customer of an affiliate of HSBC, its provision to the recipient is subject to the terms of business in place between the recipient and such affiliate. The document is intended to be distributed in its entirety. Unless governing law permits otherwise, you must contact a HSBC Group member in your home jurisdiction if you wish to use HSBC Group services in effecting a transaction in any investment mentioned in this document.

Certain investment products mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors. Investors should consult with their HSBC representative regarding the suitability of the investment products mentioned in this document.

HSBC and/or its officers, directors and employees may have positions in any securities in companies mentioned in this document. HSBC may act as market maker or may have assumed an underwriting commitment in the securities of companies discussed in this document (or in related investments), may sell or buy securities and may also perform or seek to perform investment banking or underwriting services for or relating to those companies and may also be represented on the supervisory board or any other committee of those companies.

From time to time research analysts conduct site visits of covered issuers. HSBC policies prohibit research analysts from accepting payment or reimbursement for travel expenses from the issuer for such visits.

In Australia, this publication has been distributed by The Hongkong and Shanghai Banking Corporation Limited (ABN 65 117 925 970, AFSL 301737) for the general information of its "wholesale" customers (as defined in the Corporations Act 2001). Where distributed to retail customers, this research is distributed by HSBC Bank Australia Limited (ABN 48 006 434 162 AFSL No. 232595).