INTL FCStone®

LME Market Outlook 2014/2015

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Overview: Every year at this time and just before LME week, we examine the base metals complex in greater detail and offer our price forecasts for the individual metals going into next year. (See table nearby for those readers who prefer to stop here).

2015 INTL FCStone LME Price Forecasts (3-months)

Metal	2015 High	2015 Low	Average
Copper (page 5)	$7,450	$6,000	$6,700
Aluminum (p. 9)	$2,250	$1,750	$2,100
Zinc (p.13)	$2,550	$1,950	$2,330
Lead (p. 17)	$2,320	$1,800	$2,100
Nickel (p. 20)	$21,500	$13,850	$17,800
Tin (p. 24)	23,000	$17,800	20,700

What's more, the famous adage in our business is that if you want to be good at forecasting, you need to forecast often. We decided to pass on this advice and have instead duplicated our unvarnished forecasts put out at this time last year vs. actual prices. As the second table alongside shows, we have not been that far off track on our 2014 average price calls so far, with nickel and lead being the main outliers.

How our LME forecasts from last year are faring so far...(3-months)

Metal	Projected High	Actual High	Projected Low	Actual Low	Projected Avg.	Actual Avg (ytd).
Copper	8250	7460	6300	6321	7200	6934
Alum.	2200	2119	1650	1671	1800	1836
Zinc	2300	2416	1780	1937	2100	2146
Lead	2500	2307	1830	2013	2250	2126
Nickel	18,000	21,625	12,000	13,334	14,500	17,199
Tin	26,000	23,849	19,000	19,500	22,700	22,486

So what can we say about the year and what is in store for 2015? Price-wise, the trend has been mixed in 2014, with three of the six metals we cover (aluminum, nickel and zinc) all up for the year, while copper, lead and tin are down. Moreover, whereas in last year's report, we thought that five of the six metal complexes were expected to be in large surpluses heading into 2014, three of the six are now either balanced or in deficits, with the remaining three expected to see much lower surpluses.

Looking ahead to 2015, we cannot get too excited about how things look currently, this despite the fact that supply/demand balances will continue to tighten going into next year. Instead, what seems to be a more dominant theme is that there is a sense of malaise overhanging the global macro picture, strongly suggesting that commodities may struggle next year. Global equity markets are currently in a swoon and Reuters reports that fund managers are the gloomiest they have been on the global growth outlook in some two years.

We discuss some of the themes that are certain to be with us next year below and follow their impact on individual metals in the pages that follow:

The Global Macro Environment Suddenly Sours, with the Focus on China: Perhaps most disturbing for the metals space at this stage of the global economic growth cycle, is that apart from the US, all major economies are decelerating, this despite zero interest rates practically the world over and trillions of dollars in stimulus doled out since 2008. We have not seen such an ex-US synchronized slowdown since the 2008/2009 financial crisis and the fact that it could imperil the US is now of rising concern. China is obviously the country that counts the most as far as our business is concerned, consuming or producing roughly 40%-50% of most of the metals we write about in this report.

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We will not rehash China's entire 2014 macro performance here, but recent statistics are worth reviewing to put the slowdown in some perspective. Among some of the prominent numbers, Chinese September factory output is now at its weakest level in nearly 6 years, PMI numbers are hovering near contraction territory, loan demand is off sharply (with the August reading being at a six-year low) and power generation actually dipped last month for the first time in years. The government expects GDP to come in at 7.5% for this year, but this is the lowest reading in about twelve years. Other forecasters are looking at even lower growth rates, ranging from anywhere from 7% (Goldman) to 7.4% (the IMF).

On the credit side, mindful of soaring borrowings, especially at the local level where regional governments have amassed a staggering $3 trillion in debt, the central government has taken tentative steps to turn off the credit spigot, although at the same time, it has been careful not to make thing worse. It has thus proceeded in fits and starts for much of the year, announcing targeted stimulus, but ruling out massive spending programs such as the one it rolled out in 2009. As an example of its tentative approach on the lending side, the central bank disbursed $81.5 billion worth of three-month loans to China's top five banks in September, but announced this without too much fanfare lest it sends the wrong signal.

Nowhere is the government facing a more serious problem than in real estate. Home prices in August fell for a fourth straight month, down in 68 of the 70 major cities compared to a year ago. New home prices are showing their slowest annual growth in 20 months and may actually be falling. Reuters reports that more than 30 local governments have acted to support the property sector by easing buying restrictions; the government followed suit, relaxing mortgage rules for second-home buyers and cutting down-payments to 30% from 60%-70%. These measures will likely not work given the fact that prices are still beyond the reach of most ordinary Chinese. Moreover, more people seem to have shaken off the belief that prices will only rise over time. In fact, a recent central bank survey found that only 19% of respondents see prices going up in the next three months, down from 36% a year ago.

The more serious problem is the billions of dollars of real estate loans that have yet to be "downsized" to reflect the new realities. Already, non-performing loans at Chinese banks have jumped to a five-year high in the first half of the year and worries of more defaults lie ahead, including one belonging to a major property developer who went belly-up just this week.

There are some bright spots, but even here, there are caveats. As examples, the country continues to record trade surpluses, but the gains are coming largely from exports, not imports. Retail sales and fixed asset investment are rising by double digit percentages, but both are well off earlier highs. In the labor markets, jobs are still being created -- some 9.7 million in the first eight months of 2014, but this was a rise of only 100,000 from the same period last year. Should the rate of GDP growth continue to decline, we could see more strains develop in the labor market.

Europe -- Tipping into Recession. Last year at this time, we introduced this section under the header "*Europe, signs of hope, finally",* but unfortunately, the same thing cannot be said this year given recent macro data. For starters, Eurozone growth showed no advance at all in Q2 compared to the 0.2% gain seen in Q1. German growth fell .2%, led by a contraction in industrial production (down.4% year-on year), the first annual drop since July 2013. Elsewhere, France reported no growth in Q2 and with Italy now in recession, we have a situation where Europe's three largest economies are dead in the water. Separately, inflation -- or the lack of it -- remains a problem for the ECB, with September's reading at a scant .4%, well below target. More recent data has not been that much better; PMI manufacturing data came in at a 14-month low and Euro zone industrial production fell by almost 2% in August. German manufacturing PMI decreased for the first time in 15 months just as the Ifo sentiment index dipped to a 17-month low. European retail sales are up a meager .8% year-over-year, while lending to Eurozone households and companies contracted for a 28th month in a row in August.

Alarmed by the deceleration, the ECB said last month that it would cut interest rates and roll out another trillion Euro asset buying program to be phased in over a period of time. The bank also handed out new four-year loans to banks, but take-up was said to be low. Ironically, some institutions are reluctant to participate for fear of being singled out as having problems.

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About the only positive that has come out of Europe of late is the fact that the Euro has dropped precipitously and is now close to a two-year low against the dollar. A weaker Euro could be a rather painless way to jump-start exports and growth, although it will take some time before we see its impact in the data. Meanwhile, the OECD and the IMF both see the Eurozone economy expanding by just 0.8% in 2014, but barring any kind of structural reforms, the ECB measures will likely not trigger much meaningful growth.

The BRICs are looking more like, well, bricks. The outlook is deteriorating in all four countries, with the exception of India, which is growing at its best level in two-years. However, Prime-Minister Modi still seems to be in a prolonged honeymoon period and has yet to make the tough decisions needed to reform the economy. Brazil is now in recession ahead of its second-round October presidential election scheduled for later this month and Russia is slowing sharply as the rouble continues to fall. Markets were rattled on reports last month that the Russian parliament is reportedly discussing a draft law that would allow courts to confiscate assets of foreign investors. This will likely accelerate the exodus of capital; $75 billion has already left the state so far this year, and with overall reserves at about $460 billion, it may not take long (perhaps another 6 months or so) before capital controls are imposed. Meanwhile, the country is on the edge of recession.

The US... bracing for the Fed's rate move. For much of 2014, investors have watched as the Fed terminated its QE program, while setting its sights as to when to raise rates. Certainly, the economic landscape seems to be ready for a lift-off from zero, but recent minutes released suggest that the central bank is not in any hurry and is quite sensitive to the global slowdown going on around it. In fact, the recent plunge in stocks have sent yields crashing and the current forward rate curve does not see the Fed lowering rates until 2016.

In the meantime, the US economy continues to power ahead, with second quarter GDP number coming in at a revised 4.6%, its best reading since 2011. Third quarter data has been strong as well, but we are seeing signs of cooling. As examples, the latest ISM manufacturing index was down three points from August's 59 reading, but still close to a three-year high. Industrial production readings also unexpectedly declined by .1% in August -- the first dip in seven months and retail sales were also off in September. On the housing side, activity has decelerated off from the summer pace and we are seeing the same thing in autos, where sales moderated to 16.4 million units annualized in September, off from the 17.5 million high recorded in August. Inflation remains tame-- CPI rose by 1.7% in the 12 months through August, the smallest increase in five months.

The IMF now sees the US economy growing at 2.2% this year compared with the 1.7% projection it made in July and sees growth expanding to 3.1% next year. However, the current selloff we are seeing in the US stock market is certainly telling us that all these numbers are quite squishy, particularly if the US buckles under the weight of the growing global slowdown.

The dollar; higher still, we think - One variable that was missing from the discussion we had last year and which needs to be talked about this year is the outlook for the dollar. By virtue of the fact that the US economy is the only one that is growing, the greenback has been soaring since July and up to recently, was at a four-year high against a basket of currencies. Although it has rolled back some of its recent gains (in line with retreating US equity markets) we remain bullish on it's prospects going into 2015, which could mean more headwinds for commodities. We also should note that the dollar's three month climb is relatively shallow in terms of duration. When compared to previous dollar up moves, the low-to-high advance lasted anywhere from six months to a year and so based on this record, the greenback's run may not be over.

"Knowns and Unknowns": Both of these abound going into next year, to borrow Donald Rumsfeld's famous phrase. Besides the variables mentioned above, there are brewing geopolitical hotspots that still have the potential to do some unspecified damage. In this regard, the Russian/Ukrainian situations is still far from resolved and Hong Kong could be another flash point down the road. The fighting in the Middle-East seems to be ring-fenced for the moment and not a crucial factor at this stage, but it has the potential to cause collateral damage, possibly through another terrorist attack. Ebola is the latest scare and African cases -- already in the thousands -- are doubling every three weeks. The US is also just starting to grapple with the virus. Finally, next month will see negotiations wrap up with the Iranians on their nuclear program. Barring an agreement, we could see further sanctions or more worrying, the possibility of an Israeli hit on Iranian facilities.

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Metals Outlook for 2015... In sum, we think the 2015 metals landscape will be very similar to what we saw this year, namely relatively reduced volatility and trading ranges, with extended price rallies being capped by poor visibility on the growth side and China-related worries. However, a backdrop of tighter supply/demand fundamentals should keep protracted declines in check, assuming no hard landing in China. The odds of this happening are no longer insignificant and we would now put it at a not too inconsequential 35%.

As the Chinese government attempts to rein in massive borrowing while instituting its reform program, it could, ironically, help metals from the supply side, particularly if some of its policies result in more mergers, acquisitions and outright closures in unprofitable industries. We thought we might see this scenario unfold in 2015 and were encouraged by some signs of reduced output in some sectors like aluminum and steel, but the cuts were not deep enough and may even be irrelevant if demand starts to sag going forward.

Of course, shutting down output just because an industry is losing money has not been a reason for China to act in the past, especially when jobs are involved. However, a Reuters study reveals that subsidies accounted for *four-fifths* of first half 2014 profits reported by an assortment of Chinese manufacturing concerns. It is therefore difficult to see how the government can continue to justify these handouts if at the same time it is serious about reforming the economy. Local governments also find themselves equally strapped and may be unable to help. Of course, the easy way out is to turn the credit tap back on, but with total debt already at a very high level of GDP (250%), China will be in danger of emulating the Japanese model and find itself on an ever-lower growth trajectory going forward. Then again, every country seems to be in hoc these days, which may explain why growth has been so minimal since the financial crisis.
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For their part, central banks seem to be willing to unleash yet another round of easing, although at this stage, we are not sure how much additional punch such a move would carry. One piece of welcome stimulus comes our way through the sharp decline in oil prices, which acts like a global tax cut and could lead to higher consumer spending down the road. Don't tell that to the oil producers, who all must be suffering now, but their plight must be weighed against the billions of consumers who will benefit.

We discuss the outlook for the individual metals in the pages that follow and dig deeper into what is behind our forecasts. None of the complexes particularly stand out as better "plays" on a relative basis, including nickel, which is being highly touted elsewhere. Since so much rides on China when it comes to metals, almost nothing else matters.

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Copper: Copper got to a high of $7389 on the first day of 2014 and it has been pretty much downhill ever since except for an ill-fated rally that took prices to $7200. For much of the year, the market has been hit by a combination of bearish variables, including growing expectations of a copper surplus for both this year and next, rising TC/RC fees (indicative of excess concentrate supply), a stronger dollar and slowing macro growth out of China.

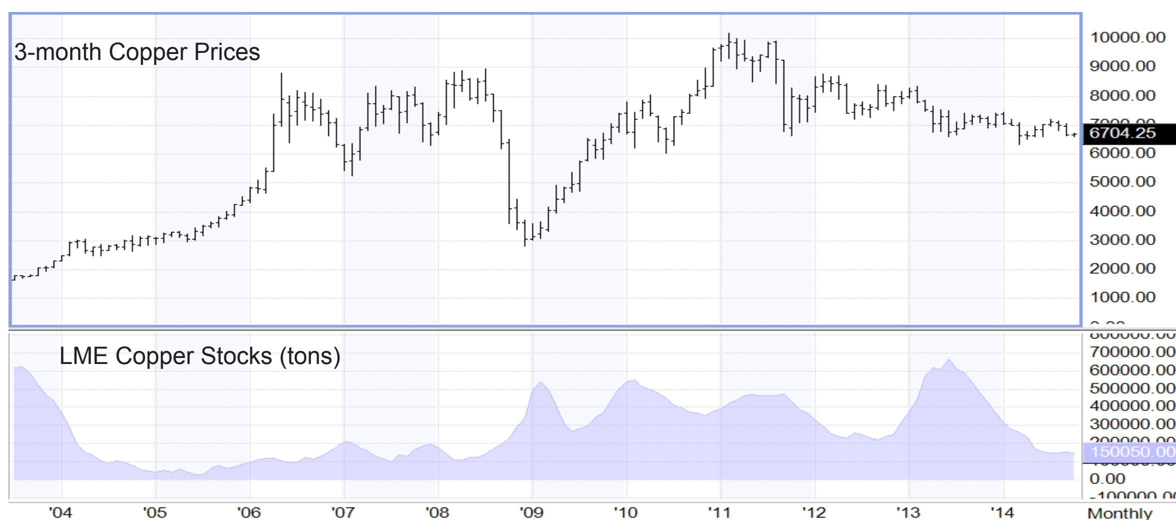
Of this list, at least the surplus part is now under review. In this regard, the International Copper Study Group reversed course on its numbers just this week, saying that it now sees the global copper market in deficit by 270,000 tons for a fifth straight year before moving to a surplus of about 390,000 tons next year. (The estimate reverses the ICSG's previous forecast of a 400,000 ton surplus for 2014).

The ICSG revision was understandable given that the ICSG's monthly data was consistently showing deficits for much of this year and it was therefore unreasonable to expect 2014 to end up in surplus. In addition, stock activity, which is usually a reliable indicator of underlying supply trends, was moving in a direction that did not point to a looser supply picture. In this regard, both LME stocks as well as Shanghai inventories have been trending lower, each off by 80,000 tons and 100,000 tons since May. Both are also down on the year on a cumulative basis. More importantly, bonded copper stockpiles in China have dropped from a high of 1 million tons earlier in the year to an estimated 550,000 tons.

Also hitting the copper market hard in June, was the port lending scandal at Qindao. In essence, importers would open long-dated dollar LC's for refined metal, sell the metal in the local market and invest the proceeds in higher yielding Chinese investments. The LC would be paid back anywhere from 3 to 9 months in what basically was an interest-rate arbitrage play. The scheme fell apart after it was revealed that metal parcels stored at the port were being multipledged, meaning that banks were actually sharing title and were therefore under-collateralized, or worse, not collateralized at all. (We heard stories of warehouses planting "title flags" on top of copper heaps to show visiting bankers, only to remove them when a second lender made the rounds).

A number of Chinese and Western banks have since taken charges against potential losses, but the flood of metal that was supposed to head into exchange warehouses or get dumped onto the physical market did not materialize. What transpired instead, is that lending standards tightened and the borrowing free-for-all that contributed to artificially high import levels for much of last year and the early part of this year came to an end. Chinese refined copper imports dropped sharply in July and although they have recovered in September (hitting a five-month high), it is too early to say whether this is the start of a more sustainable trend higher. The uptick was partly on account of an expected rise in seasonal demand, but there was also speculation that some of the metal brought in was for processing and re-export. We have to wait for next month's data to get a better picture here.

Source for chart: Futuresource.com



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On the mining side, there seems to be an abundant supply of concentrates on the market best reflected in rising treatment costs. One estimate we came across has Chinese conc supply at one million tons above levels recorded in 2013, meaning that there is quite a bit of potential refined metal in the pipeline. Separately, the ICSG sees the mine growth up 3% to 18.6 MT this year, but expects a more substantial rise to 7% in 2015 on account of "new expansions and new mine projects".

Meanwhile, European copper smelters are looking to take advantage of both rising demand by hoping to raise processing some 20% next year. For their part, Chinese smelters will likely ask for as much as $115 a tonne and 11.5 cents a pound, while Japan's Pan Pacific Copper said this month that it wants to raise its TC/RCs 9% to over $100 a ton and 10 cents a pound. On average, copper smelters are now expected to seek as much as around $110 a ton and 11 cents a pound for next year's TC/RCs, compared with $92 and 9.2 cents negotiated at this time last year. Some estimates are projecting charges could rise to $150/$.15 in 2015.

Taking our cue from the ICSG numbers and in line with the stock declines highlighted earlier, we see the overall refined copper market to be in a 150,000 ton deficit this year, rising to a 100,000 ton surplus next year. (See our table on the next page). A Reuters survey in July has the mean estimate calling for a 174,000-ton surplus for 2014, but we suspect that this number will come down in the next poll. (The same July poll calls for a 261,000 ton surplus for next year).

We see 2014 refined copper production and consumption coming in at 21.85 mln tons (up 2% this year) and 22.70 mln tons in 2015 (up 4%). The bulk of new concentrate supply is supposed to hit the market next year, which is why we are more aggressive on our 2015 production outlook.

In terms of individual countries, production seems to be on track in Chile, where year-to-date output through August stands at 3.82 million tons, up 1.8% from a year earlier. Cochilco expects the country to produce 5.95 million tons in 2014, up about 3% from last year, but next year looks more comfortable, with output expected to rise by 5.4% percent to 6.27 million tons. Chile is struggling with degrading ore grades, but new mines and recoveries in older ones keep pushing output higher.

Chinese output is also rising; copper production year-to-date (through August) came in at 4.325 mln tons, running at about 11% higher than last year and on track to hit 7.7 mln tons by year-end, up 12.6% and slightly less than the 16% gain recorded last year. Next year, we see Chinese refined output growing by 10.4% to 8.5 mln tons, likely keeping the lid on an aggressive ramp-up in imports.

Global copper consumption is expected to grow 4.7% this year to 22 mln tons in line with moderating growth we expect for China next year. Chinese copper demand this year has suffered in part on account of the fact that the country's power grid sector -- accounting for nearly half of the country's copper demand -- has not taken its usual allotment of metal. Reuters reports that investment in new power networks was expected to rise more than 10% this year, but in the first half of the year, it is actually down from the year before. (An outgoing audit at the State Grid is not helping matters). We see the rate of growth in Chinese copper demand moderating next year to 5%, bringing overall offtake to 10.9 million tons.

Price Outlook: Over the balance of 2014, we see prices taking a dip to $6400 before turning around and moving higher going into Q1 as Chinese destocking starts to tail off, setting the stage for higher imports going into the first quarter. During 2015, we see a trading range of between $6000–$7450, with an average price of about $6700. We base this lower range on the fact that the Chinese will be hard-pressed to duplicate their recent demand growth patterns in 2015, just as more supply comes to the market. However, if prices were to drop, it would be demand-induced, not supply-induced, as the copper market is not exactly swimming in excess metal. For one thing, visible stocks remain rather low, with LME, COMEX and SHFE metal standing at 265,000 tons as of September, about the same level we were at when prices took off in 2008 and 2011. Even metal in Chinese bonded warehouses (around 550,000 tons) is not that high for a 23 mln ton market. Should the steady flow of concentrates tail off due to an logistical issues, we could see copper tighten quickly, which is why we don't see prices falling much below $6,000 next year.

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Refined Copper Supply/Demand Annual Balance (000 MT)

	2010	2011	2012	2013	Year-to-date to June 2014	2014F	2015F
Consumption	19,340	19,576	20,133	21,012	11,056	22,000	22,600
Yr-Over-Yr Ch		1.22%	2.85%	4.36%		4.70%	2.73%
China Consumption	7,385	7,881	8,896	9,826	5,268	10,420	10,900
Yr-Over-Yr Ch		6.71%	12.88%	10.46%		6.04%	5%
Mine Production	16,136	16,291	17,012	18,320	9,232	18,800	19,600
Yr-Over-Yr Ch		0.96%	4.43%	7.69%		2.62%	4.26%
Refined Production*	19,211	19,817	20,361	21,399	10,759	21,850	22,700
Yr-Over-Yr Ch		3.16%	2.74%	5.10%		2.11%	3.89%
China Refined Production	4,540	5,163	5,879	6,835	3,486	7,700	8,500
Yr-Over-Yr Ch		13.72%	13.87%	16.26%		12.65%	10.39%
Apparent Balance	-129	241	228	387	-296	-150	100
Total Stocks**	994	981	1,061	916	694	600	750
Of Which Held By..							
Producers	296	295	334	284	305	NA	NA
Merchants	21	21	22	14	21	NA	NA
Consumers	109	120	115	111	116	NA	NA
Exchange	568	545	589	507	252	NA	NA
Weeks Use	2.7	2.61	2.7	2.27	3.26	1.4	1.7

*** Includes Secondary**
**** Does not include govt stockpiles**
Source: WBM/ILZSG
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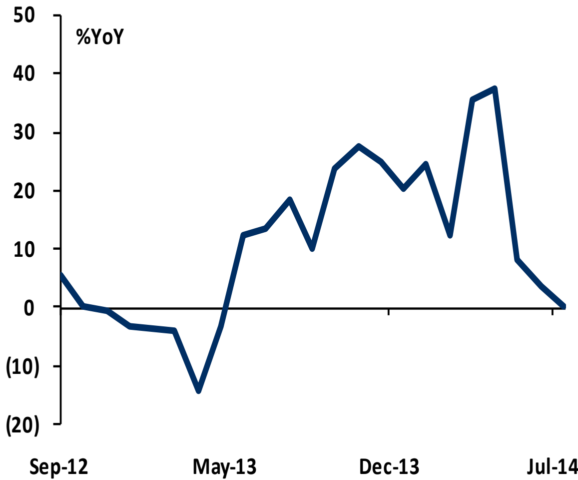

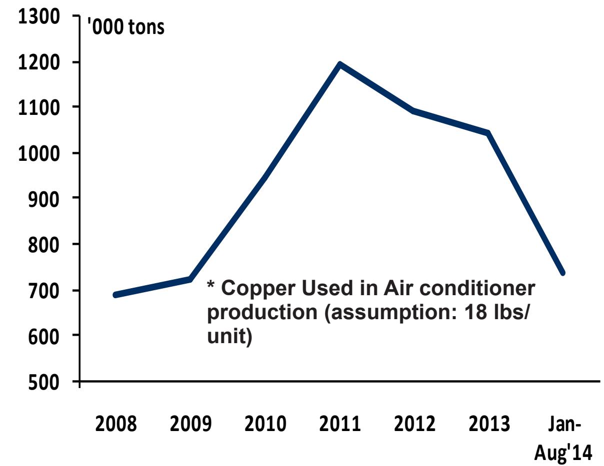

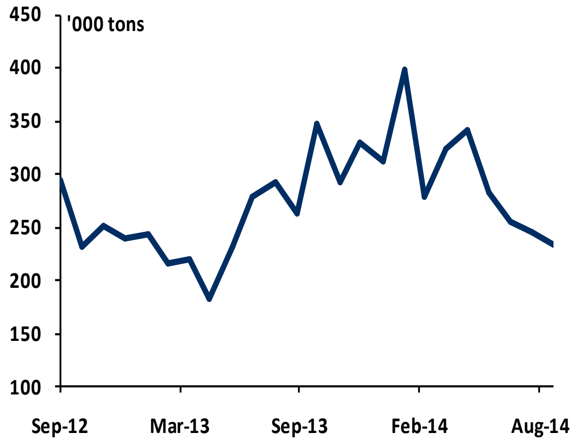

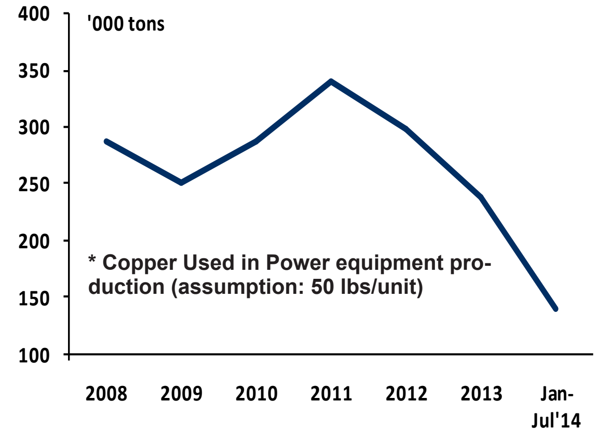

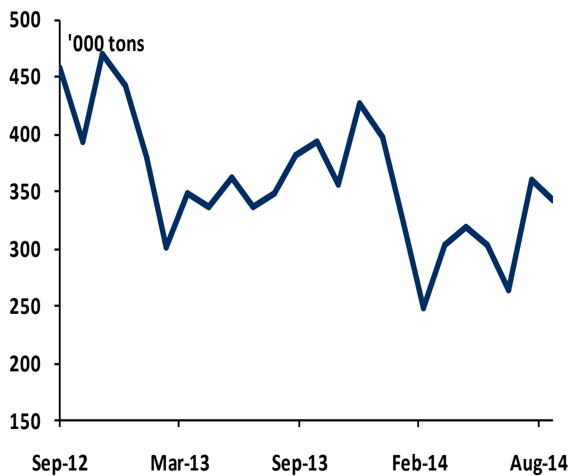

Source for Charts: Bloomberg

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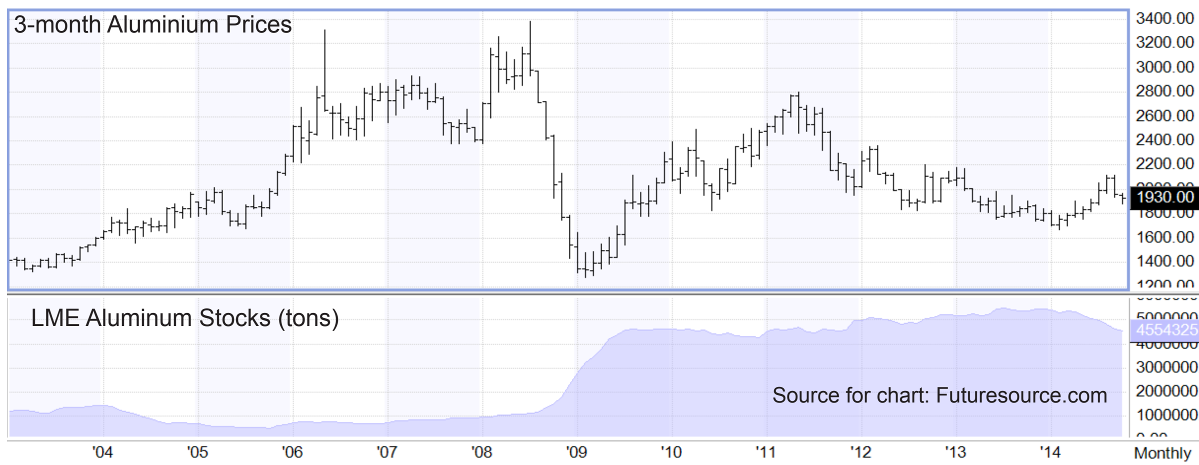
Aluminum: The highlight for the 2014 aluminum market came late in 2013 and into early 2014 when physical premiums staged a spirited advance, the likes of which no one saw before. US Midwest values practically doubled in just a few days time, pulling other geographies up along with it. The firmer tone in premiums was no flash in the pan either and stayed in place for much of the year, becoming so ingrained in valuations in fact, that both the LME and the CME saw fit to launch premium contracts. The Midwest premium now constitutes a whopping 22% of aluminum's current value, extraordinary in terms of size and obviously something that has to be managed just as diligently as flat price risk. (See our charts that follow for premium trends on all the metals).

While premiums were picking up steam early in 2014, flat prices were heading the other way, sinking to a five-year low of $1671 in February, as a relentless surge in production from both China and the Middle-East pressured values lower. After wallowing at the lows for much of the first quarter, the market staged a rather impressive bounce to just under $1900/ton in April, but prices retreated to $1750 by the first half of May. By the second half of the month, the complex staged a much more convincing run, gaining almost $400 an ounce over the next four months to get to hit a 2014 high of $2119 before starting to recede late in Q3.

The bullish tone in the market has been attributable to an increasing sense that cutbacks are mounting and that the global supply/demand balance - certainly in the West -- is now in deficit. By June, projections of ever-increasing deficits were making the rounds. Both Alcoa and Rusal projected global shortfalls in the order of 930,000 tons and 1.4 million, respectively and perceptions of tightness started getting picked up in the cash-to-three's spread, which narrowed to its tightest level since December 2012. Falling LME stockpiles also helped, especially since neither flat prices nor premiums were being impacted as metal left the warehouses. Even the Chinese production trajectory was finally bending; whereas year-over-year production growth was advancing at 13%-15% clip early this year, growth was now back down to the 8%-9% range.

Despite the cutbacks, the global supply numbers we were seeing going into Q3 were simply not confirming any significant *cumulative* supply reduction. Although most Western producers were keeping output in check, the Chinese ramped up output again to record highs in each of the last three months. Indeed, talk circulated last month that anywhere between 1.0-2.0 million tons of capacity has now come back online, in effect offsetting earlier cuts. In the meantime, the latest IAI numbers show that China produced 13.5 million tons of primary through July of this year. Although this is "only" 9% higher than last year and well below the double-digit increases of a year earlier, it is being applied to a much larger base. More importantly, Chinese demand is not growing at 9% (we see it rising 6% for this year), which means that the local market is indeed in surplus.

China's surplus, we think, is not being dumped onto a weaker local market, but is being exported out as product. The latest trade figures show that product exports surged to 2.2 mln tons year-to-date (through August) and could finish the year at about 3.5 mln tons, equivalent to about 9% of overall consumption. The safety valve that semi-finished products offers Chinese primary smelters has been facilitated by the fact that products can leave the country duty-free, which is not the case with primary. In fact, we read that several hundred thousand tons of billets have found their way to Mexico over the summer and might get remelted if they cannot be moved out to extruders at sizable discounts. (We wonder if lawyers handling dumping cases will stir soon).



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In the meantime, the LME-related court cases continued over the course of 2014 for a second year running. Recently, the LME won its appeal to amend warehousing procedures, reversing an earlier decision that deemed LME's consultation on warehousing rules to be 'unfair or unlawful'. Although Rusal was denied the chance to appeal the recent court decision, we understand that it is seeking an alternative route to do so. The ruling now clears the way for LME reforms that will centered on matching load-in & load-out rules more closely. Already, the exchange has given warehouses the needed three-month notice so that the new procedures could kick in by February.

Whatever the legal decisions turn out to be, we never thought the LME reforms went far enough to start with, so we are not sure whether this "victory" will do much to alter the underlying issue, which is to insure that warehouses operating under an LME mandate deliver metal upon demand on presentation of a warrant, as is the case with practically all other global exchanges. In any event, much of this could be a moot point. As long as existing (and profitable) contangos are in place and as long as money is practically free, metal accumulation, redistribution and stockpiling will continue, although given the increased regulatory glare, it will simply move off exchange, as it seems to be doing now. Putting metal outside the LME system has its own drawbacks in that financing becomes more expensive, since the depositor will no longer have access to bankable LME warrants. Ironically, all this may lead in a round-about way to *less supply* coming into the market, precisely what the complex needs in order to mend itself. In addition, the current forward curve is not conducive to additional metal accumulation.

In our last report, we thought that Midwest premiums would drop sharply over the course of 2014 and we were of course wrong in this regard. It seems that premiums are holding up despite the fact that about 1 mln tons of LME stocks have moved "out" since the beginning of the year. We suspect that this metal has either moved off exchange or has trickled back into the physical markets in such small quantities that it is not having much of an impact in denting premiums. During 2015, we believe higher premiums will be with us again as long as metal continues to remain ring-fenced in store-and-carry transactions and not released onto the open markets.

Price Outlook: In light of good producer restraint, particularly out of the West, the markets seems to be on the mend, but we think it is premature to say that we will be in a deficit this year given the recent Chinese additions to supply and still booming Mid-East production. For 2014, we see a 300,000 ton surplus generated by production of 48.8 mln tons (up 2.45% y-o-y) and consumption of 48.5 mln tons (up some 5.2% y-o-y). Next year, the market should be in a rough balance; production should grow by 4.5% to 51 mln tons, while consumption should come in close to that level, growing by 5.1%.

Chinese production is expected to grow by 8.4% this year and 5.8% next; the production trajectory could start to bend going into the second half of next year when we suspect that government reforms will push against the fact that more than half of China's aluminum smelters are losing money. This could mean that many of the subsidies and cheap loans that are currently fueling growth in output could start to subside, but given that this is China, one never knows. Price-wise, we suspect we will be trading between $1850-$2050 for the balance of this year, while next year, our trading range is $1750-$2250, with an average prices of $2,100.

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Primary Aluminium Supply/Demand Annual Balance (000 MT)

	2010	2011	2012	2013	Year-to-date to June 2014	2014F	2015F
Consumption	40,348	42,685	45,528	46,114	24,258	48,500	51,000
Yr-Over-Yr Ch		5.79%	6.66%	1.29%		5.17%	5.15%
China Consumption	15,854	17,702	20,224	21,955	11,441	23,300	24,500
Yr-Over-Yr Ch		11.65%	14.25%	8.56%		6.13%	5.2%
Refined Production	41,496	44,780	46,236	47,633	24,107	48,800	51,000
Yr-Over-Yr Ch		7.91%	3.25%	3.02%		2.45%	4.51%
China Refined Production	16,244	18,135	20,251	22,046	11,486	23,900	25,300
Yr-Over-Yr Ch		11.64%	11.67%	8.86%		8.41%	5.86%
Apparent Balance	1,148	2,095	708	1,519	-151	300	0
Total Stocks	6,502	6,999	7,361	7,171	7,159		
Of Which Held By..							
Producers/Merch./Consumers	1,786	1,812	1,708	1,593	1,689		
Exchange	4,716	5,187	5,653	5,578	5,470		
Weeks Use	8.4	8.5	8.4	8.1	15.3	0.0	0.0

Source: WBM/ILZSG
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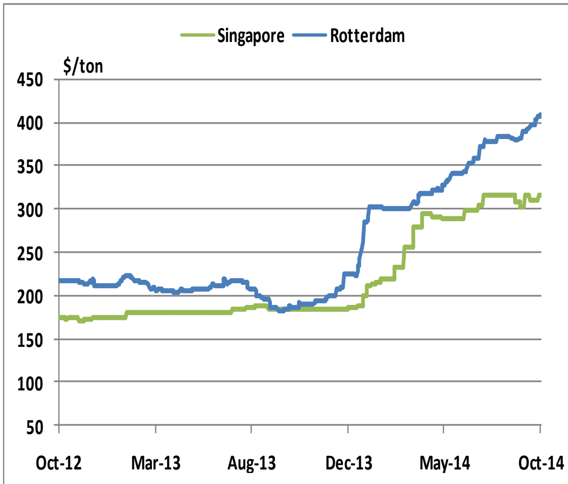
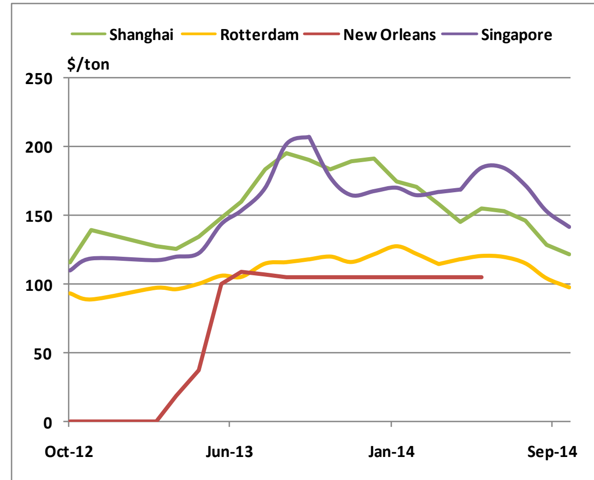
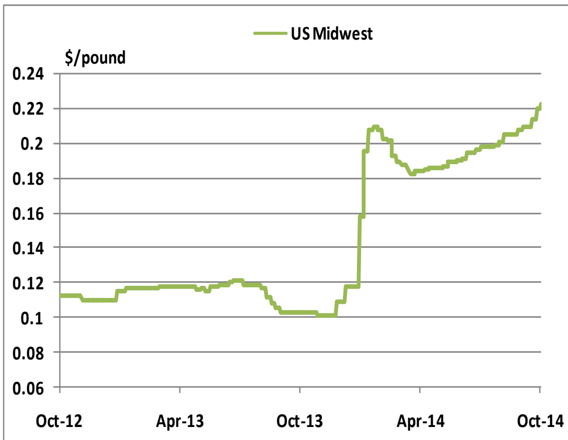
Aluminium Premiums



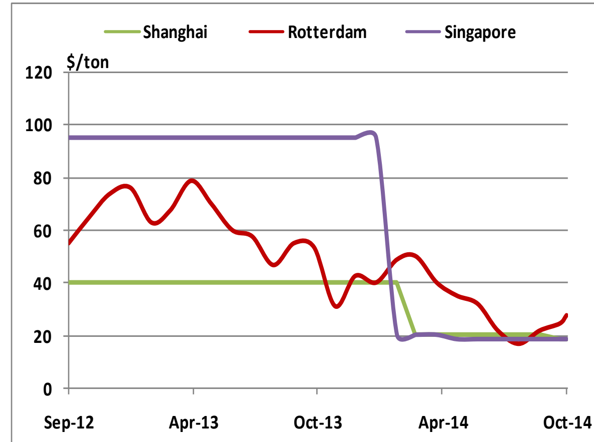
Zinc Premiums



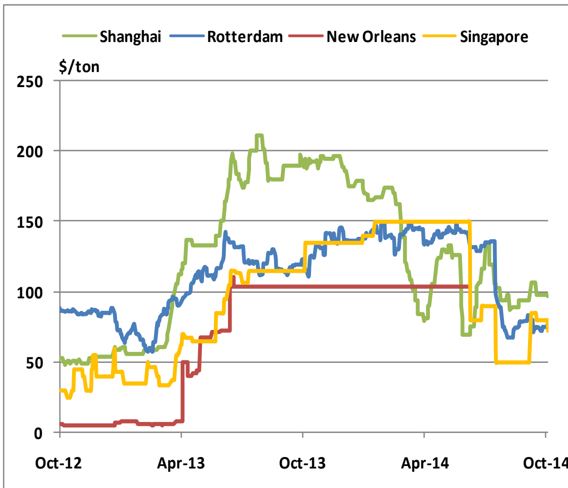
Aluminium Premiums



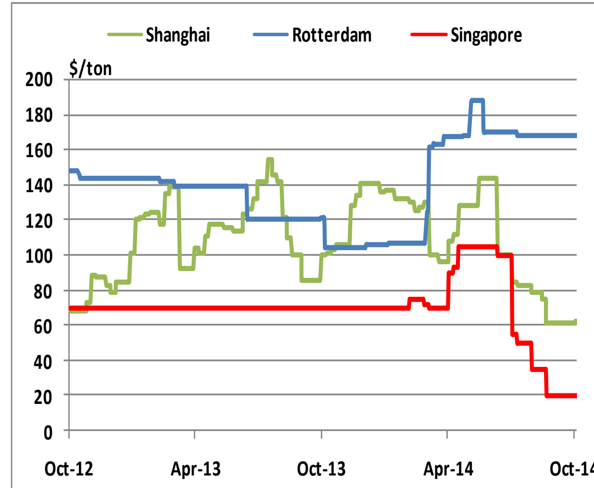
Lead Premiums



Copper Premiums



Nickel Premiums



Source for Charts: Bloomberg

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Zinc: Zinc has been the second best performer in the LME complex this year (after nickel), up almost 13% year-to-date and rallying from a low of $1937 in March to a summer high of $2416 before retracing slightly this past month. Importantly, the complex's fundamental profile looks better than at this time last year. For one thing, the decline in LME and Shanghai stocks since January has been significant; LME stocks are down by some 200,000 tons to currently stand at 730,000 tons, while Shanghai holdings are off by some 90,000 tons over the same period. Both started to creep higher this month, which may explain why prices have retreated.

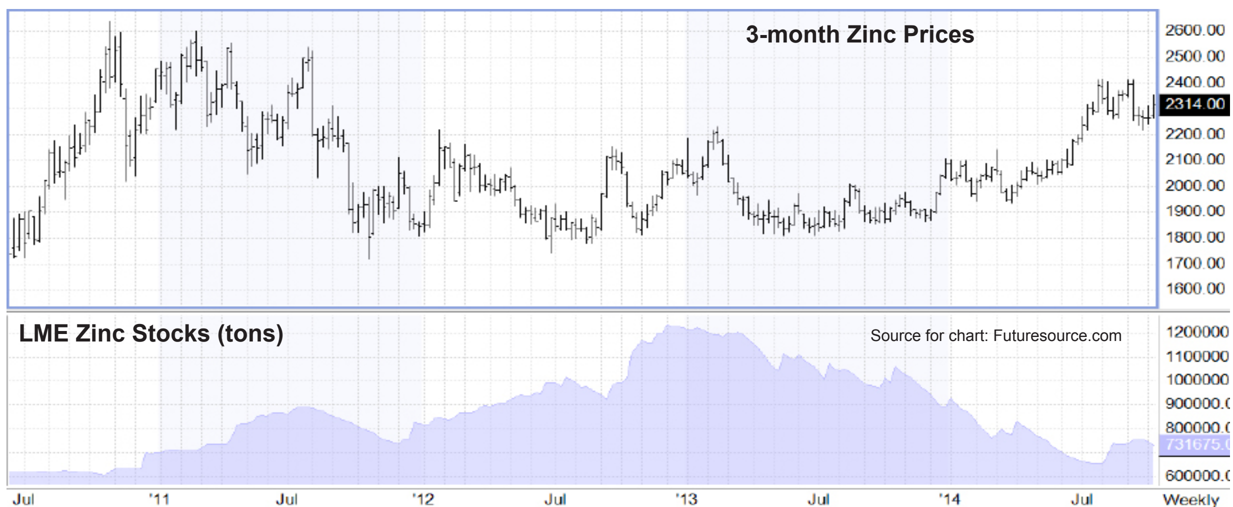
More importantly, zinc has been in a supply retrenchment mode for some time now. WBM numbers show the complex finishing last year with a 60,000 ton deficit, its first short-fall since 2006, as mine supply grew by a scant 1% (ex-China). Mines that are either closed or are closing over the next few years include Brunswick and Persevernace in Canada (shut earlier in the year), Century in Australia, Lisheen in Ireland and Skorpion in Namibia. The "working estimate" is that some 1.5-1.7 million tons would eventually be removed by the end of 2016.

Things look even tighter on the supply side this year, with the ILZSG seeing a deficit of some 248,000 tons through July, while the latest Reuters poll predicts a shortfall of about 170,000. However, a Reuters analysis points out that the ILZSG deficit is concentrated mainly in China, while the rest of the world is in a 138,000-ton surplus (through May). In addition, Reuters says that China's assessed 332,000-ton supply deficit (through May) "comes with a big caveat" in that the ILZSG uses an apparent consumption calculation, meaning that some of the zinc China has imported and which is sitting in stocks is actually being counted as consumption.

For its part, Wood Mackenzie estimates that mine supply in 2014 fell over 7% from peak mid-2013 levels, while next year, supply could fall by another 6.5% from that point. Some of this reduction will come out of China, particularly in the Inner Mongolia and the Fujian regions, as well as from faster rates of decline from the Century mine and a weaker expansion of the McArthur River mine.

While the supply picture looks somewhat quantifiable, the more difficult issue is demand, particularly out of China. Chinese demand is especially vulnerable to the construction sector as well as to autos . The former is weakening dramatically, with new home prices falling in August for a fourth consecutive month after 68 out of 70 cities reported lower prices. Newly-started property construction and sales are also down anywhere from 12% to 16% vs. last year. And as we will see in our lead section that follows, Chinese September car sales have decelerated to their lowest growth rates in 19 months.

Looking ahead, CRU says that after "minimal [Chinese zinc] demand growth in the first quarter and modest growth of around 2% in the second quarter, we believe that third quarter growth will continue to accelerate year-on-year as we move into the traditional peak demand season". The problem with this scenario is that recent macro data out of China does not seem to be pointing to a rebound in Q3 that could conceivably spill over into Q4. If anything, we suspect Chinese macro readings will weaken further going into the last quarter of the year, which is why we are calling for Chinese overall zinc demand to grow by only 2.6% this year.



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Despite the relative weakness seen in various pockets of the Chinese economy, including real estate, autos and steel, Chinese zinc producers do not seem to be rolling back output, as we see in our charts that follow. Instead, refined zinc production hit another record in July, up 5.3% on month (and up 10.3% on the year), while China's July refined zinc imports surged 51%.

Similar to aluminum, a buoyant semis export market seems to be taking up at least some of this refined output. In this regard, CRU reports that Chinese galvanized sheet exports were up by 35% year-on-year for the first half of 2014, with exports to the US up by a whopping 260% over the period. Sales to the EU and Brazil were up by 50% and 40%, respectively. Having said that, we doubt that excess refined zinc production can be entirely taken up by exports alone, as the nominal amount of zinc involved is still fairly small. (See our charts).

Elsewhere, Japanese demand is fairly strong on the back of construction and infrastructure spending that has already started for the 2020 Olympic Games, with much of this work fairly galvanising-intensive.

US demand remains another bright spot, teeing off a strong construction and automobile market, although both sectors are off from their summer peaks. Premiums remain at a healthy 9 cents a pound.

European zinc business remains quiet, particularly after German growth numbers have been weakening noticeably of late. CRU reports that European "construction remains weak across the entire region and there is no indication that demand for rolled zinc or galvanised products which is currently flat at best, will improve in the foreseeable future... Auto sheet demand is expected to continue to grow in the third quarter, but at a more modest rate than earlier in the year".

With regard to the supply/demand fundamentals, we see 2014 refined global production rising by 2.9% to 13.5 mln tons, itself somewhat on the optimistic side given that WBM statistics show that output has barely risen in June on an annualized basis. Refined global consumption should come in at 13.7 million tons, up 5.3% on the year, leaving us with a shortfall of 200,000 tons. As mentioned earlier, we see Chinese refined consumption rising only 2.6% this year, as year-to-date offtake through June is just about flat compared to 2013 levels and we suspect the second half will stay that way.

Next year, we see demand rising by 3.2% over 2014 levels, less than this year, as we think real estate issues in China will manifest themselves more strongly over the course of 2015. Against our 2015 global consumption number of 14.15 mln, we see global refined output rising to 13.9 million tons, up 2.9%, as more reductions in mine supply (down 5.9% in 2014 and 3.5% in 2015) keep the rate of growth in refined production somewhat in check. For 2015 as a whole, we see a 350,000 ton shortfall, bringing ending stocks to roughly 800,000 tons, equivalent to about 3.5 weeks on the ending stock ratio.

Price Outlook: Despite the lackluster demand outlook for both this year and next, the fact that much supply seems to be coming off the market should be supportive for zinc. However, as we are seeing in aluminum, cutbacks need to "stick" if they are to prove effective, particularly out of China. We therefore should be careful about assuming that all this zinc tonnage will indeed be taken off. In fact, CRU remains skeptical about the extent of the proposed cutbacks going into 2015 and even sees a slight zinc *surplus* for the year, going against the consensus view. But the more important variable is Chinese demand and here, we have serious concerns about the country's real estate sector and the ramifications that a prolonged weakening could have on construction demand.

We see zinc trading between $2100–$2350 over the balance of the year, with next year's trading range forecast at $1950–$2550. The average price should come in at around $2330.

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Refined Zinc Supply/Demand Annual Balance (000 MT)

	2010	2011	2012	2013	Year-to-date to June 2014	2014F	2015F
Consumption	12,524	12,553	12,223	13,004	6,671	13,700	14,150
Yr-Over-Yr Ch		0.23%	-2.63%	6.39%		5.35%	3.28%
China Consumption	5,350	5,460	5,396	5,995	3,044	6,150	6,500
Yr-Over-Yr Ch		2.06%	-1.17%	11.09%		2.59%	5.69%
Mine Production	12,364	12,426	13,209	13,763	6,216	12,950	12,500
Yr-Over-Yr Ch		0.50%	6.30%	4.19%		-5.91%	-3.47%
Refined Production	12,919	13,120	12,631	13,120	6,477	13,500	13,800
Yr-Over-Yr Ch		1.55%	-3.73%	3.88%		2.89%	2.22%
China Refined Production	5,209	5,222	5,209	5,222	3180*	5,700	6,050
Yr-Over-Yr Ch		0.25%	-0.25%	0.25%		9.16%	6.14%
Apparent Balance	395	567	408	116	-194	-200	-350
Total Stocks	1,403	1,611	1,929	1,472	1,208	1,010	800
Of Which Held By..							
Producers	215	243	227	212	241		
Merchants	15	16	15	15	15		
Consumers	160	168	155	157	156		
Exchange	1,012	1,184	1,531	1,170	878		
Weeks Use	5.8	6.7	8.2	5.9	9.4	3.8	2.9

Source: WBM/ILZSG
F: INTL FC STONE
*** Through July**

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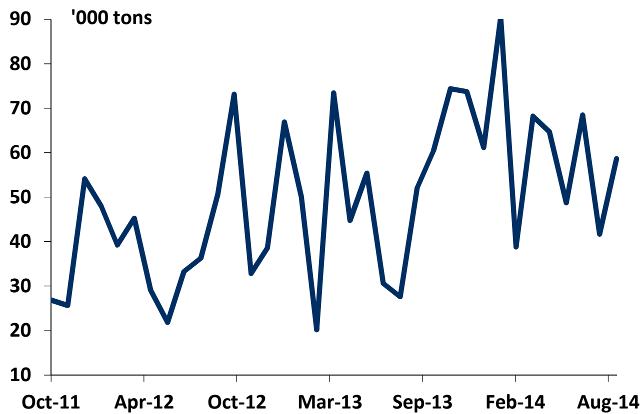
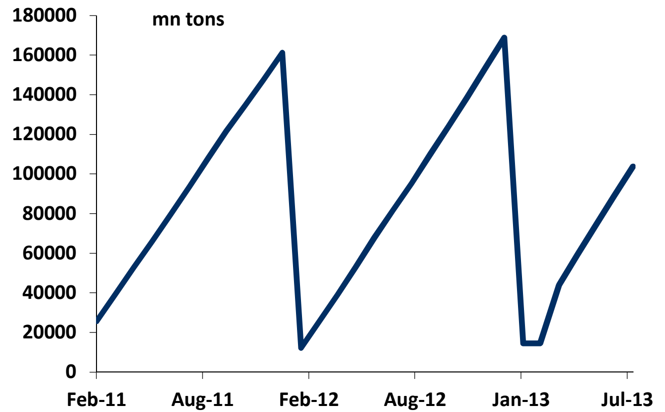
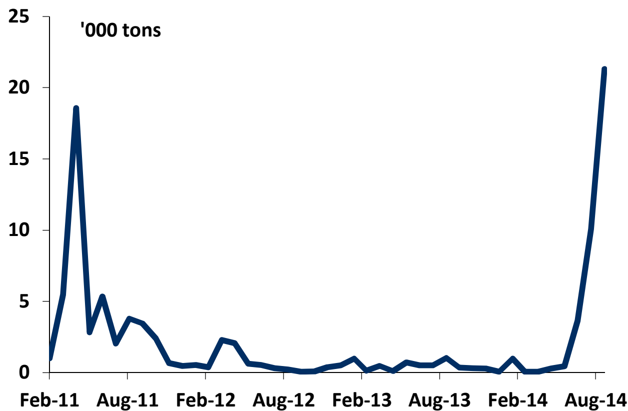
China imports - Refined Zinc



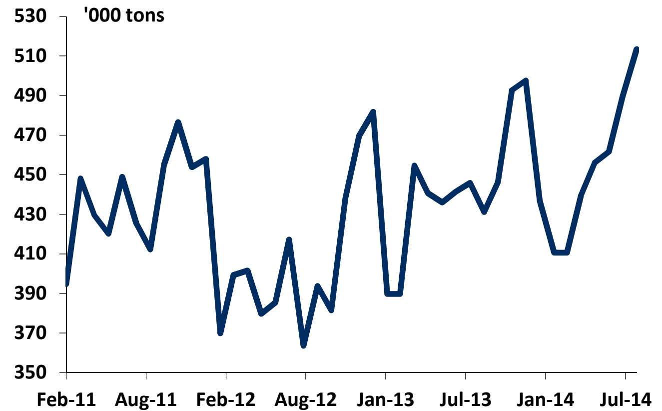
China Sales - Galvanized Steel Plate strip



China exports - Unwrought Zinc & Alloys



China Refined Zinc production



Source for Data: Bloomberg

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Lead: Lead has been somewhat of a disappointment for us, as last year we picked it to be one of the better performing metals in the LME space. Instead, prices are down for the year (some 7%), making the complex the third worst performer so far in 2014. Although the complex's fundamentals look reasonably constructive, several bearish elements have prevented investors from getting upbeat about its prospects. These include rising LME inventories (up some 35,000 tons since the summer and now at a nine-month high) and rather restrained physical demand, particularly out of China. In addition, the Chinese are now net exporters of refined lead (approximately 20,000 tons year-to-date through July, about double 2013 levels. (See our charts that follow). Moreover, even though mine supply has been declining -- off by some 4.1% in the first seven months of the year -- recycling supply has been more than adequate. CRU reports that there is unreported supply hitting the market from 'mixed feed' smelters that are using SKS technology and treating concentrate, battery paste and other lead-bearing residues and slags. Independent analyst Hew Roberts also highlighted this supply surge in one of his earlier reports, saying that the purported supply shortfall is overexaggerated given under-reported growth in Chinese secondary lead production.

On the refined side, we have seen a host of smelter outages, but none have managed to tighten the market all that much. In particular, Eco-Bat's Stolberg smelter in Germany was down for eight weeks in July/August for major maintenance and Glencore Mt. Isa facility restarted in September after being shut for 10 weeks. Teck's Trail smelter will be back online during the second half of November.

In terms of supply/demand balances, the ILZSG sees lead as being in an 11,000-ton surplus in the January-July period, but the stocks-to-consumption ratio remains at a relatively tight 2.9 weeks. For its part, CRU sees the market as being in a rough balance this year and next and expects the market to move into a deficit in two to three years' time at which point it expects prices to revisit their 2011 high of $2850.

Out of China, lead demand has been modest at best this year. Chinese car sales rose at their slowest pace in 19 months in September amid a weakening economy and rising dealer stocks, now approaching 45 days. Passenger car sales were up 6.4% from a year ago, while the more inclusive "total automobile category" that includes commercial vehicles, slowed to +2.5%, down from a whopping 20% rate evident earlier in the year. Things have not been helped by a mild summer, which resulted in disappointing replacement sales, leaving battery makers saddled with excess stock and forcing many to turn to the export market.

The picture is equally mixed in other sectors; CRU says that industrial battery demand is up by high single-digits year-on-year, but weaker telecom usage and slower growth in E-bike sales is offsetting this increase. (E-bikes are the leading source of lead, taking up 45% of all the metal produced in the country). Regulations introduced earlier in the year regarding lower speed and size of E-bikes as well as stricter user licenses deflated sales going into the spring and summer months.

Source for chart: Futuresource.com

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In Europe, the demand trend is lacking real strength, as a relatively uneventful summer weather-wise resulted in disappointing replacement battery demand, not to mention the recent downdraft in general industrial activity. This has prompted many smelters to not be as aggressive in chasing scrap units. In the meantime, European lead players are keeping a close eye on whether a five-year exemption for lead batteries on the wider ban of lead in vehicles within the EU's ELV directive will be extended next year. At this point, the extension is expected to go through.

In the US, lead demand is picking up, but by relatively minor amounts. A mild summer has forced battery makers to trim excess stocks and cut back on output. Indeed, the latest BCI data shows that North American replacement battery shipments are barely higher, up 0.6% year-on-year after declining in both June and July. August shipments are unlikely to be much better, but we do expect to see a slight pick-up going into Q4. July OE North American battery shipments were up 21.3% year-on-year, but this is a far less consequential category in terms of demand. Industrial battery demand also remains fairly strong.

On the supply side, US secondary smelters remain in need of feed and although the recent fall in prices may put some downward pressure on scrap, stronger Q4 demand could keep the extent of the declines in check.

Price Outlook: In terms of our supply/demand outlook, we see 2014 global refined lead demand falling by about 1.4% this year to about 10.48 million tons. We base this on the fact that WBM numbers showed demand growth in the first half of the year trailing last year on an annualized basis (see our table below) and we don't think the second half will be that much better. Production is expected to grow by .9% to about 10.5 million tons, leaving a surplus of 20,000 tons for the year. Next year, we see a balanced market, as production and consumption each grow by about 1.4%, leaving a surplus of 30,000 tons in place. Price-wise, we see values trading between $1850-$2150 over the balance of 2014, while next year's range should be $1800-$2320, with an average price of $2100.

Refined Lead Supply/Demand Annual Balance (000 MT)

	2010	2011	2012	2013	Year-to-date to June 2014	2014F	2015F
Consumption	9,668	10,337	10,411	10,633	5,112	10,480	10,620
Yr-Over-Yr Ch		6.92%	0.72%	2.13%		-1.4%	1.3%
China Consumption	4,171	4,618	4,618	4,467	2,160	4,420	4,500
Yr-Over-Yr Ch		10.73%	-0.01%	-3.27%		-1.0%	1.8%
Mine Production	4,372	4,732	5,061	5,604	2,408	5,100	5,250
Yr-Over-Yr Ch		8.24%	6.94%	10.73%		-9.0%	2.9%
Refined Production	9,693	10,339	10,387	10,408	5,096	10,500	10,650
Yr-Over-Yr Ch		6.66%	0.46%	0.20%		0.9%	1.4%
China Refined Production	4,157	4,604	4,591	4,475	2,167	4,500	4,650
Yr-Over-Yr Ch		10.73%	-0.28%	-2.52%		0.6%	3.3%
Apparent Balance	25	2	-24	-225	197	20	30
Total Stocks	447	602	624	583	542		
Of Which Held By..							
Producers	104	100	107	140	143		
Merchants	1	1	0	0	0		
Consumers	133	119	124	139	138		
Exchange	209	382	393	304	261		
Weeks Use	2.4	3.0	3.1	2.8	5.2	0.0	0.0

Source: WBM/ILZSG
F: INTL FC STONE

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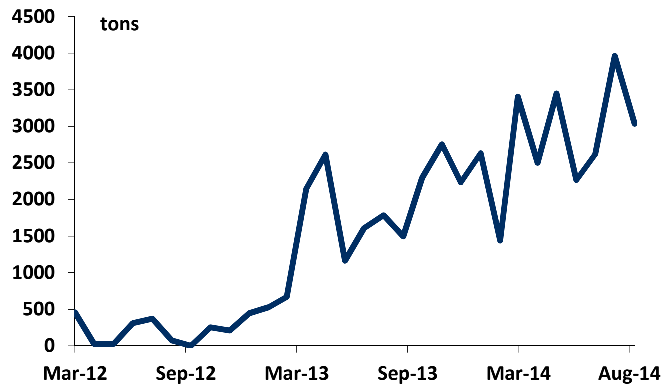

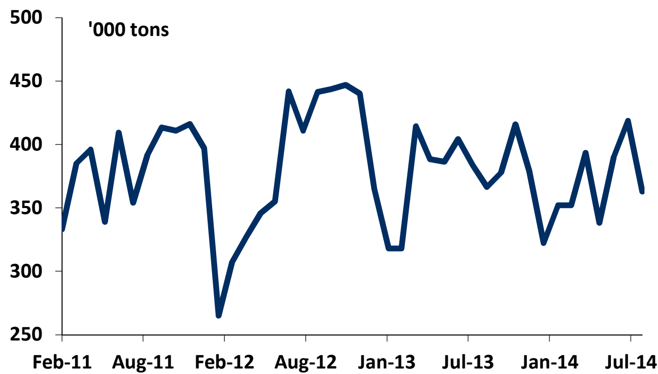

Source for Charts: Bloomberg

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Nickel: Nickel has had an interesting year thus far and must be the preferred metal in the trading community given its heightened volatility. The complex also has the distinction of being the best performer in the LME group in 2014 (+17% year-to-date), vindicating its poor showing in 2013 when it brought up the rear.

The year started off with investors focused on the long-awaited Indonesian ore ban, which went into effect on January 12th. Nickel prices moved up by about $800/MT over the course of the following week, but lost most of their gains just as quickly, spending February in a sideways drift. By March, values started a more impressive run, moving from $14,700 to a high of $21,625 hit in mid-May. Sideways consolidation then set in over the summer months, with values trading between $17,500–$19,500 before a round of heavy selling took prices to below $16,000 this week.

The steep fall surprised the analyst community, as many had boosted their long-term price targets, pitching numbers north of $30,000/ton in some cases. We treated the advance with far more caution and admittedly missed out on a good part of the initial rally, but we were wary about several variables that were not making a persuasive case for the upside.

For starters, much of nickel's move higher this year was largely due to a deliberate manipulation of supply by the Indonesians. Although the government's end-goals make some sense, the fact remains that radical strategies designed to decrease (or increase) supplies of a particular commodity can backfire on the initiating party in that things may not always go according to plan. In this case, outside of imposing a ban, the Indonesian government had little control over the changes that its uncompromising position on the program set in motion. For one thing, months before the ban took effect, the Chinese were already stockpiling millions of tons of concentrates, so much so that they have spent much of this year working off existing supply, thus allowing prices to float lower. The element of surprise was therefore lost.

More importantly, the ban triggered a massive increase of nickel ore coming out of the Philippines. In fact, as we see in our chart on the next page, Chinese ore imports during the last reporting month (August) actually surpassed year-ago levels, in effect underlining the success the Chinese have had in replacing Indonesian ore with Philippine origins. Although Philippine impurities are higher, Chinese stainless producers are making do, by mixing the lower grades with higher ones. Much of the higher grade material is coming from existing stockpiles, but fresh ore is also apparently being used, smuggled out of Indonesia after being shipped out on deceptive paperwork. In addition, Chinese stainless steel producers are stepping up imports of nickel in other forms, such as stainless scrap and ferronickel; imports of the latter have soared by 76% so far this year. In the meantime, China is developing other supply sources; although the imported quantities are small, there is feed coming in from Brazil, Zimbabwe and Vietnam.

CRU also points out that low-grade ore from the Philippines is used by the carbon steel sector, but there is less demand for this grade given the recent weakness in steel and iron ore, thus allowing Philippine miners to start producing medium-grade ores that are more desired by the Chinese smelters.

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Another troubling sign present throughout the 2014 nickel rally was the fact that LME stocks have been steadily increasing and now stand at record level of just under 370,000 tons. Much (although not all) of this increase is on account of exports leaving scandal-plagued Qingdao warehouses, but the fact remains that despite the market allegedly being "tight", nickel supply is accessible on LME exchanges -- with little in the way of queues hampering its release.

While the Indonesian ban continues, we have to suspect that several smelters are already in the process of setting up operations in the country and will likely start exporting refined metal or semi-products sometime in late 2015, meaning that Indonesian supply will eventually come back, al beit in a different form. The problem the Indonesians will then have is whether their Chinese customers have moved on to other suppliers. Also a perennial concern, are metal substitutions or technical changes that could take place if the commodity in question becomes too scarce or expensive. After all, it was nickel's initial surge to $50,000 back in 2006 that led to demand destruction and kick-started pig-iron production as a cheaper and a somewhat legitimate substitute for high-priced nickel. Mindful of losing market share (and current revenue), local miners have urged Indonesian President Widodo to relax the ban and although unlikely for the moment, there is always a chance the market could be surprised by a political about-face, particularly if economic pressures build and if smelter construction does not advance at a fast enough clip.

We should also note that the Philippines was considering its own ban on unprocessed ores roughly a month ago and the announcement briefly sent prices soaring to just under $20,000/MT. However, the proposal was submitted by junior parliamentarians and would involve a five-year grace period, which meant that there was nothing imminent in the works. Not surprisingly, the rally quickly faded.

In terms of supply/demand fundamentals, the latest data from the INSG shows nickel being in a 5,200-ton surplus in July compared with a 12,600-ton surplus a year earlier. We ourselves are looking at a 25,000 ton surplus for this year, followed by a modest 20,000 ton short-fall next year. (The Reuters consensus view is for a 99,000 ton deficit next year, one that we think will be lowered when the next estimates come out).

We also think that nickel's "supply crunch" may not be as bad as the market currently assumes, especially if 2015 Chinese stainless demand comes off the 9%-11% growth rate it is running at so far this year. Some softness is already setting in going into the second half of 2014; CRU is expecting no growth in Chinese Q3 stainless production vs. Q2 and we don't think Q4 numbers will fare any better. Indeed, Chinese stainless producers earlier this month passed on significant product discounts on account of falling nickel prices and ample NPI on the market. Premia in both categories are also falling. Moreover, one independent analysis we came across suggests that the Chinese still have about 27 million tons of Indonesian nickel ore, enough to last them for nine months, perhaps even longer if demand softens. By then, the first trickle of Indonesian supply may be ready to come online.

Price Outlook: We see the prices trading between $14,700-$17,000 for the balance of the year and see some firmness going into Q1 of 2015, which is when the Philippine monsoon season will be in full swing, possibly reducing ore supply. Next year, we see prices falling to $13,850, with a high of $21,500 in place. Prices should average $17,800 over the course 2015. While we appreciate the bullish narrative behind nickel, the intermediate data trends are simply not persuasive enough to make the case for a run-away bull market in 2015; things beyond that point are much more difficult to predict.

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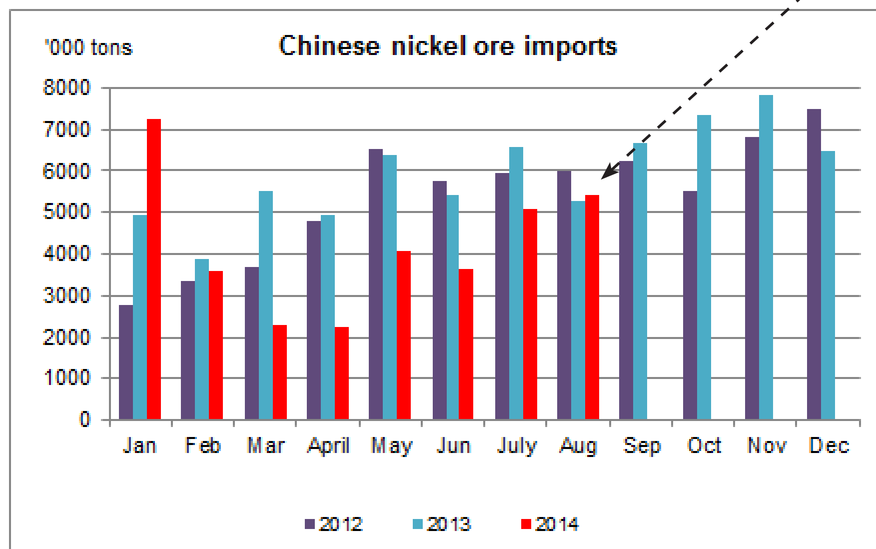
Refined Nickel Supply/Demand Annual Balance (000 MT)

	2010	2011	2012	2013	Year-to-date to June 2014	2014F	2015F
Consumption	1,427	1,661	1,729	1,801	836	1,875	1,970
Yr-Over-Yr Ch		16.44%	4.11%	4.14%		4.11%	5.07%
China Consumption	489	703	805	909	382	920	965
Yr-Over-Yr Ch		43.59%	14.56%	12.96%		1.19%	4.9%
Mine Production	1,526	1,823	2,268	2,512	906	1,950	2,045
Yr-Over-Yr Ch		19.43%	24.40%	10.75%		-22.37%	4.87%
Refined Production	1,436	1,664	1,856	2,002	904	1,900	1,950
Yr-Over-Yr Ch		15.84%	11.57%	7.85%		-5.09%	2.63%
China Refined Production	314	470	591	711	300	700	775
Yr-Over-Yr Ch		49.45%	25.79%	20.27%		-1.50%	10.71%
Apparent Balance	9	2	127	201	69	25	-20
Total Stocks	157	112	162	285	330	355	340
Of Which Held By..							
Merchants/Consumers	20	22	20	24	24		
Exchange	137	91	142	261	305		
Weeks Use	5.7	3.5	4.9	8.2	20.5	9.8	9.0

Source: WBM/ILZSG
F: INTL FCSTONE

Chinese nickel-ore imports in August surpassed year-ago for the first time since the pre-ban import binge took place in January, telling us that the Philippines is taking away market share from Indonesia. The charts on the next page show this more clearly.



Source for data: Thomson-Reuters

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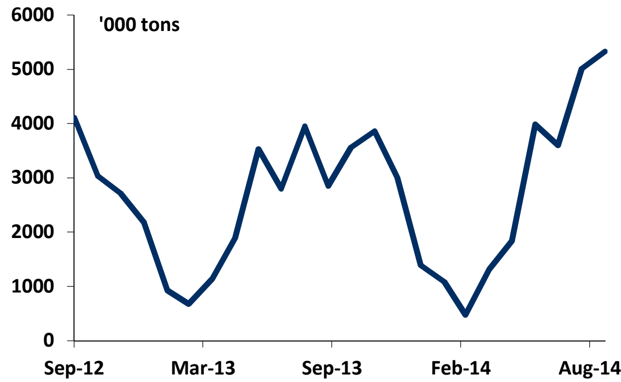
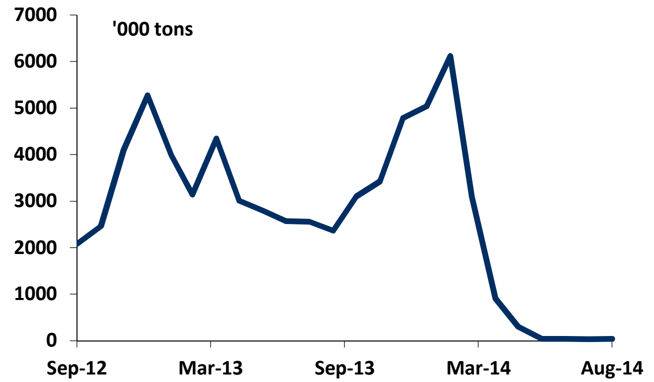
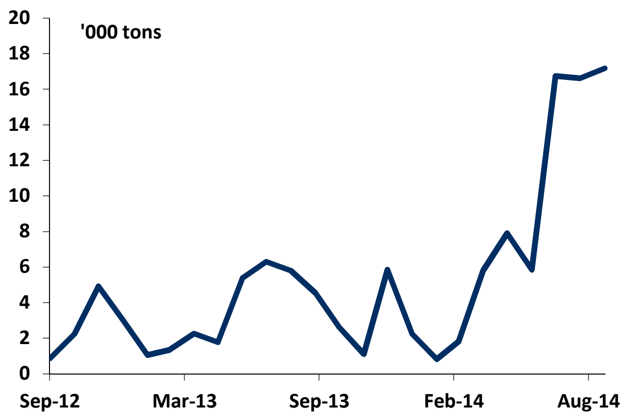
China Nickel Ore imports -Philippines



China Nickel Ore imports - Indonesia



China exports - Refined Nickel



Source for data: Bloomerg

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Tin: Tin was another disappointment for us over the course of 2014, with the complex being the second worst performing metal in the LME space after copper (down 8.7% y-t-d). Prices moved higher over the first four months of the year, getting to a peak of $23,849 at one point in late April before starting a downward trajectory that saw a breach of the $20,000 mark this month -- a 14-month low.

Like nickel, tin has been the subject of market manipulation by the Indonesian government, although it has not suffered the same fate as nickel in that metal units are at least flowing out of the country. Last year, the government rolled out the ICDX exchange and required that all 47 registered tin exporters trade on it if they wanted to ship tin out of the country. In February, the government added that it would establish certain minimum prices for tin below which sales could not be made. The stipulation introduced a considerable degree of uncertainty with regard to shipments in that fluctuations varied from month to month, sometimes by at least 50%. (In fact, the latest September data shows that exports were up 51% from the previous month to 5,441 tons).

New spec changes were introduced at about the same time, but then were quickly rescinded as consumers were not happy about paying higher prices for enhanced purity tin that they did not want. Several producers, including PT Timah, imposed voluntary sales curbs during the late summer months as well, but this did not have much of an impact on prices either. More recently, new standards for packaging, labeling and shipping were introduced. But perhaps the most audacious proposal came out this week from an Indonesian government official who said that in an effort to boost prices, the country is considering imposing limits on export quotas. Although no specific limit was mentioned, the official pointed out that a 35,000–45,000 ton figure could be workable. In the meantime, Indonesia's current output is seen falling 13% this year to about 80,000 tons. Year-to-date, exports through September have dropped to 58,000 tons from just under 69,000 tons a year ago.

Another issue that the Indonesian government is grappling with has to do with the fact that at times nothing trades on the ICDX, but tin continues to leave the country, pointing to either illegal shipments or metal leaving in other forms. Whatever the case, this makes analysis of the market even more difficult, since ICDX transactions are not necessarily an accurate guide of what is going on with respect to exports.

On the demand side, things seems to be getting worse, especially in the electronics sector. ITRI now sees global solder shipments in the first half of 2014 growing at around 2% vs. a year earlier. China's imports are down some 53% from Jan-August levels and some Asian solder makers report that business is off by some 30% lately. Fourth quarter Indonesian sales are reflecting the demand realities and are expected to come in around 16,000 tons (this according to a Bloomberg consensus estimate) down 30% from last year. With regard to tin's supply/demand balances, ITRI is now saying that it expects the market to be in a balanced situation in 2014, scrapping its earlier forecast calling for a 10,700 ton deficit. It cited comfortable supply and weaker demand as the main reasons for its revision. Global output is expected to fall by 4.5% this year to 354,100 tons, while consumption is expected to rise 3.6%, although we suspect that revisions will likely bring this number down to about 2%.

Source for chart: Futuresource.com

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It is very difficult to know what to make of things for next year, since the complex remains in a state of flux depending on what Indonesia does. If nothing else, it seems safe to assume that production will likely continue to trend lower, outpacing demand growth and contributing to the cumulative deficits going forward.

ITRI itself expects prices to be range-bound through year-end, but remains bullish on tin longer-term, saying that mine production is "likely to be flat or declining over most of the next five years" and that prices would have "to increase to a minimum of $25,000 to stimulate new mine investment because of high capital costs and country risk".

Price Outlook: As we have argued in our overview, it is now apparent that just because Indonesia controls a considerable part of the global tin supply, it does not follow that the country is in the driver's seat when it comes to determining price direction. It remains to be seen whether the Indonesians come back for another attempt to "control" the market going into 2015, perhaps by imposing drastic quotas, but we remain wary of such government-operated initiatives foisted onto free markets. More often than not, the consequences of such actions are unpredictable in that they can lead to demand distraction, product substitution or even enhance alternative supply. (In this latter regard, note what is going on with Philippine nickel ore going into China). Having said that, we see tin prices trading between $18,500 –$21,500 for the balance of this year, while next year, a $17,800–$23,000 trading range looks reasonable, with an average price of $20,700.

Refined Tin Supply/Demand Annual Balance (000 MT)

	2013	2014f	Y-O-Y	Q4,'13	Q1,'14	Q2,'14	Q3,'14	Q4,'14	Y-O-Y
World Refined Production	**340.8**	**354**	**3.90%**	**88.8**	**81.9**	**99**	**88.4**	**84.8**	**-4.5%**
World Refined Consumption	**348.3**	**354**	**1.70%**	**86.9**	**86**	**90.7**	**87.4**	**90.0**	**3.6%**
Global Market Balance	**-7.5**	**0**		**1.9**	**-4.1**	**8.3**	**1**	**-5.2**	
Reported Stocks	**26.7**	**25**	**-6.3**	**26.7**	**28.5**	**31.8**	**28.4**	**25**	**-6.3%**
Weeks Consumption Ratio	**4**	**3.6**	**-9.60%**	**4**	**4.3**	**4.6**	**4.2**	**3.6**	**-9.6%**

f- 2014 forecast from ITRI
Historical data from ITRI

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