August 25, 2010

Getting on the band wagon

The following example shows how difficult it is to judge developments on the nickel market at the moment. On the 18th August 2010 the news agency Bloomberg released two reports taken from research of leading commodity banks. One had the title of "In the 4th quarter nickel can increase by 14% since demand is rising" (Société Générale), the other had the headline "Due to weak demand for stainless steel [up to year end] nickel can fall by 23%" (UBS). Which report can be used? The one which looks better, or the one where the analysts seem to have the most experience? If just expertise is required, then the report of the Société Générale would be more reliable, since its leading base metal analyst is the former head economist of Norilsk Nickel, which is the biggest nickel producer in the world. The man behind the UBS report is a certain Mr. Tom Price, who worked as a geologist in the mining industry in Australia for many years, although it is presumed that his experience has been gained more from iron ore and coal. Before his move to UBS, Price was working as an analyst at Merrill Lynch, Citigroup and AME Mineral Economics.

It is indeed much more complex to see which direction the market will take rather than to compare the expertise of different market analysts. Yet two things do become very clear: one of them is that, at this moment in time, analysts are not at all in agreement about future development. By the way, and as seldom before, this also applies to assessments in other financial and commodity markets. The other is that analysis made on paper is weakened by a lack of direct contact to the industry, and so does not contain primary information about the commodity in question. This reflects the necessity of listening intently on what the stainless steel producers have to actually say. Looking at the second quarter of 2010, all producers have reported better economic figures than in the loss-making quarters previously, but a fear of falling back into a recessionary period is still expressed. Especially in view of the substantial but necessary recent inventory devaluations, companies have an almost crippling respect for worsening commodity prices. Further depreciations should be avoided by holding as low a stock as possible, which actually strengthens commodity market movements rather than stifling it.

Unfortunately it has to be confirmed that the outrageous discussions over the summer months about the soundness of the European economy and currency have had a noticeable effect on the real economy. Even at the moment, there are speculations going around in the media about a double dip scenario, based on weaker figures coming out of the USA. Yet as the levels of influence of the US economy over the global economy are receding – thankfully there are other economic machines in the world today - , the US American media is still vehemently trying to defend its claim of being a leader in opinion making. There is, however, a large discrepancy between perception and reality here.

For reasons expressed above, production levels in the stainless steel industry were considerably reduced in the 3rd quarter, effecting nickel prices as seen by all. Yet if we had been in a normal economic environment and not in the fourth year of a financial and economic crisis, then nobody would have thought much about this reduction in capacity. Now though, the question of the further development of the situation and the flow of new orders for the fourth quarter can be seen as the acid test for a sustained economic recovery, not just in the steel industry, but for the whole economy. This does, understandably in the context of living through the actual crisis, make not just the financial markets, but also the players in the field somewhat nervous.

At the moment a picture cannot be clearly formed, but on first information coming from Asia for the fourth quarter, the situation looks promising. But, especially in view of Europe, there are still uncertainties. Even the nickel market, with prices around the USD 20,000.00/mt level, shows that participants and decision makers are not absolutely convinced of a probable recovery. This position can change, however, very quickly if just a couple more positive pieces of news come out of Asia. And then of course, it will be a mad dash to get on the band wagon.

A report made by the South Korean steel producer, Posco, shows that the steel industry, including this representative in Asia, are expecting, at least medium to long term, further rises in commodity prices and a shortage in supply. The head of Posco, Chung Joon-yang has demanded of competitors in China and Japan that they confront the mining companies in future by forming a unified regional industrial committee. The committee should preside over raw material price explosions, shortening of contract durations and also excess capacity. The backdrop to this is that Chung expects commodities to become the survival factor in steel production.

As could be anticipated, over the year price expectations made by analysts, or in other words by the general consensus, have moved up quite a few notches for nickel in 2010 and 2011. In the traditional poll of around 50 research houses, taken by Reuters twice a year the average price for Nickel at the end of January 2010 for the year 2010 was USD 18,286.60/mt. In more or less the same poll taken at the end of July, the average was USD 20,310.50/mt. The corresponding value for 2011 was, in January, USD 19,069.00/mt and then in July USD 21,502.50/mt. Incidentally, in July 2009, the experts world-wide had expected a nickel price for 2010 of USD 14,712.00/mt! The experience with nearly all these consensus opinions shows that they are never really correct. The change in expectations can indeed show a tendency, but without enough primary information from the industry itself these expectations can only follow developments instead of actually anticipating them.

In this context it is fitting that analysts at the English bank, Standard Chartered, expect the copper price to increase to about USD 12,000.00/mt over the next two years due to its basic supply situation. Should this estimation be correct, then it will be very interesting to see how far copper will distance itself from the base metals aluminium and nickel, with its own supply and demand figures. Up to now these three metals have only run uncorrelated for relatively short times. If this then would still be true, independent of the actual consumer situation but certainly enhanced by a revived investment interest, with copper at levels of USD 12,000.00/mt, nickel would be at least USD 30,000.00/mt or more.

LME (London Metal Exchange)

LME Official Close (3 month)

August 25, 2010			
	Nickel (Ni)	Copper (Cu)	Aluminium (Al)
Official Close 3 Mon. Ask	20,145.00 USD/mt	7,095.00 USD/mt	2,013.00 USD/mt

LME stocks in mt

	July 23, 2010	August 25, 2010	Delta in mt	Delta in %
Nickel (Ni)	116,814	**118,302**	+ 1,488	+ 1.27%
Copper (Cu)	419,650	**402,425**	- 17,225	- 4.11%
Aluminium (Al)	4,409,975	**4,452,700**	+ 42,725	+ 0.97%