Sucden Financial

Quarterly Metals Report

October 2023

Analysis and Forecasts for Base Metals, Precious Metals, Iron Ore & Steel

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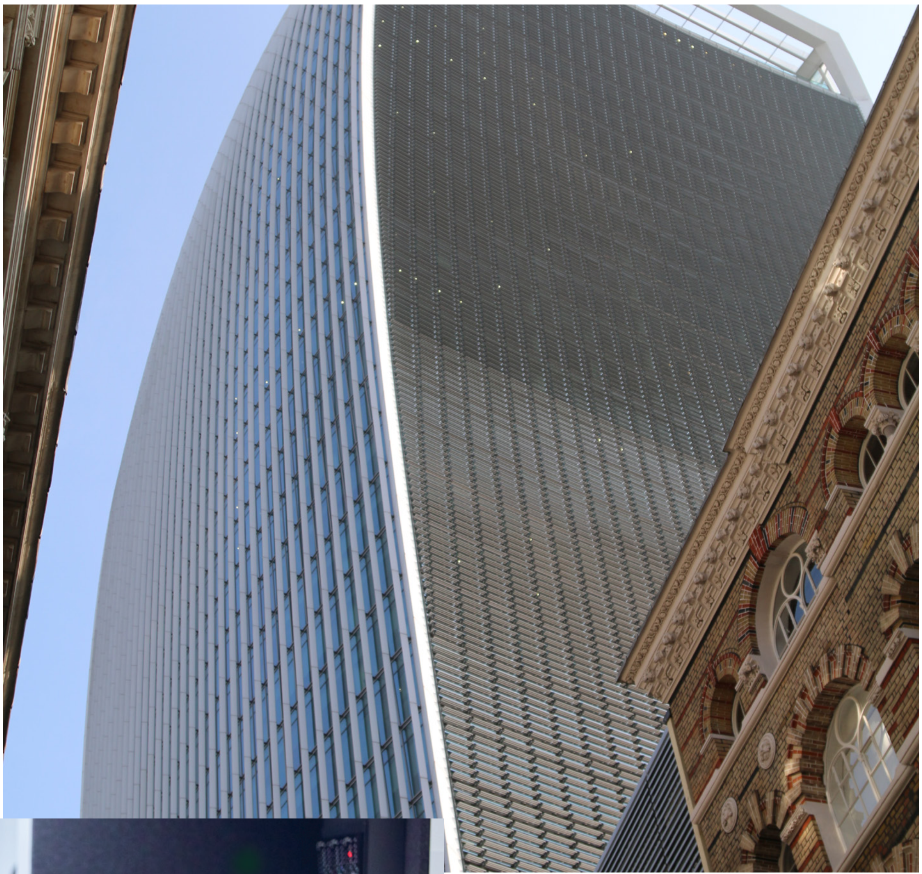

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Summary

The global economy has performed better than expected so far in 2023, but concerns about a cold winter, rising oil prices, high borrowing costs, and China's economic slowdown are looming large. Central banks are keeping the narrative of higher-for-longer interest rates due to persistent higher prices, which have weighed on base and precious metals' performance. Despite pledges from Beijing to support the economy, current measures are not expected to have an immediate impact on the real estate sector, which means there is unlikely to be a large-scale property development that would increase demand for stainless steel prices in the last quarter of the year. Nonetheless, the cumulative impacts of policy support and a dovish monetary policy in China should create a solid foundation for the economy to recover in 2024. Such a transition should push the sentiment from the oversold into neutral. News out of China and the US should bring stronger bounds of volatility in base metals' performance in Q4 2023.

Aluminium (Al)
Aluminium prices fluctuated during the quarter, struggling to break out of the range. The negative correlation with the dollar strengthened in recent months, indicating that macro plays are being acted out in metals' prices. The Chinese government continues to provide support for the economy, but domestic expenditure remains lacklustre. Aluminium prices are expected to remain rangebound in the near term, with a path to Chinese economic recovery next year helping to solidify support levels in Q4 2023.

Copper (Cu)
The copper market remained steady in Q3 2023, with support levels at $8,200/t and $8,000/t now in place. The market is oversold with downbeat sentiment, which diverges from current market fundamentals. Signs of improvement are already seen in the imported copper demand, but potential ore supply risks are bubbling up in the copper market. The global sentiment is expected to further deteriorate into Q4 2023, resulting in increased volatility in risky assets. We expect copper to remain rangebound, and a drift lower is the worst-case scenario.

Lead (Pb)
Lead prices gained momentum in Q3 2023, driven by acute tightness seen in the SHFE contract. The recent spread between lead contracts and spot cargoes widened, resulting in a higher inventory of lead ingots in social warehouses. From the demand side, vehicle production remains stable y/y whilst declining marginally m/m, and we struggle to see demand fundamentals impacting lead prices in the near term. Given the continued replenishment of stocks in LME warehouses, the tightness that we have seen on lead should diminish in Q4 2023.

Nickel (Ni)
Nickel prices have weakened in Q3 2023 due to underwhelming Chinese demand, causing it to underperform in comparison to other base metals. In the meantime, Chinese economic performance is moderating from the highs seen post-reopening, and the government's efforts so far may result in a limited boost to stainless steel consumption rather than its recovery. The market surplus of Class 2 nickel is expected to weigh down prices even further towards the end of the year. As a result, we expect nickel prices to remain under pressure in Q4, averaging below $20,000/t.

Tin (Sn)
Tin prices weakened in August as the Myanmar ban did not translate into immediate fundamental market tightness. Tin ore supply will be ample in the near term due to a surge in Chinese tin ore imports from Myanmar ahead of the ban implementation, and refined tin output is declining. At the same time, poor tin demand has eased some of the supply pressure, and we expect prices will be stuck in a fine balance of fundamental supply tightness and muted demand. This should keep tin prices steady in Q4 2023.

Zinc (Zn)
The summer saw robust downward pressures for construction materials, with China's weakness having the greatest impact on zinc given its construction properties. However, in the second half of the quarter, inventories began to diminish once again, pushing zinc back to the $2,650/t level. From a fundamental perspective, news of production cuts in overseas mines is helping to support zinc prices. Market fundamentals for zinc remain tight, and we expect zinc to trade marginally higher in the coming months.

Iron Ore & Steel
Iron ore prices remained elevated in Q3 2023 despite a struggling Chinese economy. Steel mills are expected to ramp up production during the peak construction season, but low consumer confidence is hampering property investment. Uncertainty around mandatory curbs will weigh on the outlook. Demand in China will continue to be the primary driver for iron prices. We expect prices to average $100/mt in Q4 2023, with downside risks due to potential China steel output cuts and an uncertain property sector outlook.

Gold (Au)
Gold prices fluctuated in Q3, finishing the quarter 2.0% lower due to hawkish statements from policymakers and the strength of the dollar limiting any upward momentum. Persistently high nominal yields continue to put downward pressure on gold, with currency risk dominating markets in recent months. However, long-term fundamentals suggest that tailwinds for precious metals are building up, and expectations of the end of the tightening cycle in November may raise the attractiveness of the precious metal.

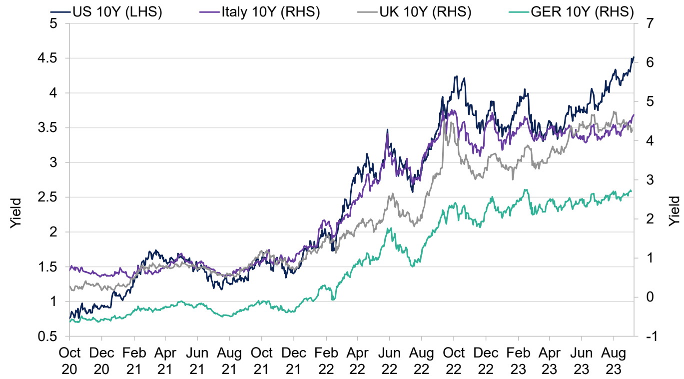
Silver (Ag)
The price of silver has been range-bound in recent months, following gold, on the back of fluctuating US Treasury yields. Precious metal prices are caught between the bearish environment of elevated interest rates and high US Treasury yields on the one hand and growing expectations of global economic slowdown on the other. As silver remains stuck between these two opposing forces, we expect the metal to trade rangebound between $20.85/oz and $24.00/oz until the end of the year.

Market Overview

Global Outlook: While the global economy performed better than expected in the first half of 2023, fears of cold winter, rising oil prices, high borrowing costs and China's economic slowdown loom on global economic prospects, with the global GDP expectations on the downside. The latest IMF predictions see the global economy grow at 3% in 2023 before slowing down to 2.7% in 2024. Progress has been made on combating inflation, but higher prices persist, forcing central banks to keep the narrative of higher-for-longer interest rates. The elevated borrowing costs will continue to have an impact on consumption and manufacturing, softening global economic growth. Still, the worst has been priced in, and subsequent downbeat economic data should be in line with market expectations of softer performance across the world. The souring demand outlook has been the driving force behind the weakness in industrial metals in recent months, as investors flock to the dollar as "the last man standing". We expect the greenback's strength to remain, while softer supply and demand should keep industrial metals in equilibrium until the end of the year when markets start pricing at the end of the Fed's monetary policy tightening.

Developed Economies' 10Yr Yields

Given tight monetary policy, the yields remain elevated.

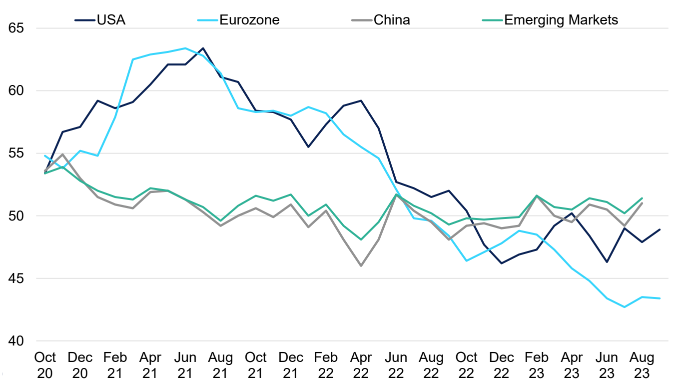


Source: Bloomberg

Oil: Oil futures appreciated strongly in the last couple of months, surging to levels not seen since November 2022. Prices increased by 30% since June and are on track to reach $100/bl amid worries about tight oil supply after Saudi Arabia and Russia extended supply cuts at the start of September. So far this year, OPEC+ output has fallen by 2m bl/d, with overall losses tempered by sharper Iranian flows. According to the International Energy Agency (IEA), the extension by the Saudi-Russian alliance will lead to a substantial market deficit through the fourth quarter. While the economic downturn is on the way in China, oil demand from the world's biggest oil importer has so far been unaffected by the slowdown, putting upward pressure on crude oil prices in the near term.

Major Economies Manufacturing PMIs

Eurozone manufacturing activity has decreased significantly in recent months.



Source: S&P Global

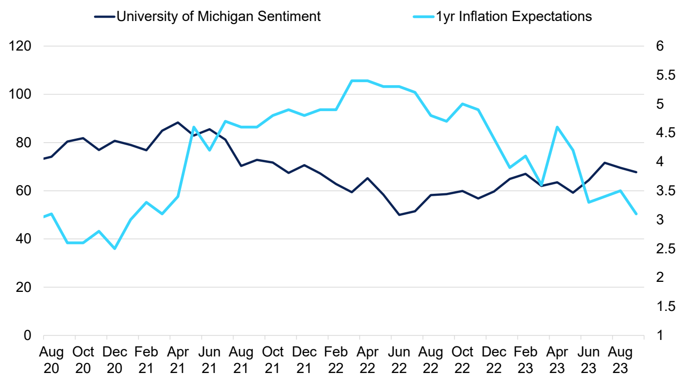
PMI: Global manufacturing remained in contractionary territory, with August's figure at 49.0, compared to 48.6 in July. The slight easing in the rate of contraction owes almost entirely to a large 2.4-point jump in China's output index to 51.0. The euro area remained a weak spot, with output contracting at a marked pace of 43.7, while the US fell back into decline at 47.0. The prevailing trend of falling demand, and, in turn, new orders and exports, weighs on total output, further highlighting the looming weakness as economic performance softens. Business optimism decreased to the lowest level in nine months as the outlook for the manufacturing sector remains subdued.

US: In line with our previous report, among all major economies, the US proves the most resilient to take the hit of higher-for-longer interest rates. While GDP figures continue to come in lower, with the last reading for Q2 2023 at 2.1% compared to 2.4% in the previous quarter, investors are not anticipating a pronounced economic decline in the US in the coming months, and soft landing becomes increasingly more probable. This view is strengthened by the persistently tight labour market, with unemployment in August at 3.7%, well below the historical average of 5.72%. Weekly jobless claims continue to fall short of expectations while nonfarm payrolls remain higher than the pre-pandemic norm, suggesting that overall economic growth is bound to avoid slipping too deeply into contractionary territory in the near term.

We expect labour market tightness to moderate in the coming quarter but remain elevated relative to other major economies. The resilient labour market reflected in consumer confidence, which, albeit retreating to 67.7 in September from the near-two-year high of 71.6 in July, still points to relative optimism among US consumers. Retail sales, a key indicator of the consumer's propensity to spend, marked a sixth straight month of growth in August at 0.6% MoM despite high prices and borrowing costs.

University of Michigan Sentiment vs. 1Yr Inflation Expectations

Despite inflation fears resurfacing, consumers are more positive on price pressures.



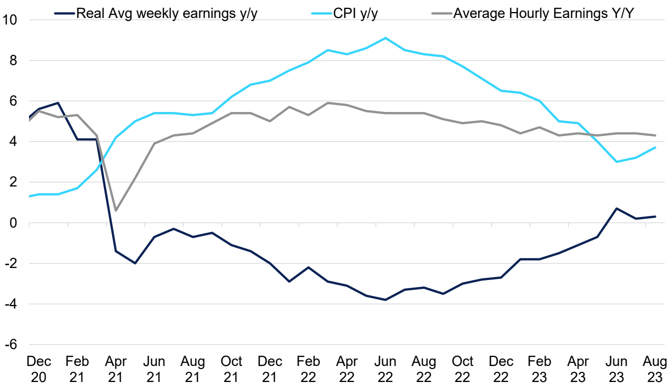
Source: University of Michigan

Annual inflation accelerated for the second consecutive month from 3.2% YoY in July to 3.7% YoY in August, with gasoline accounting for more than half of the increase. Output cuts by OPEC+ drove Brent crude oil to surge above $90/bl at a time of summer driving season in the US, which traditionally represents a period of increased fuel demand and prices. While the core inflation decelerated from 4.7% YoY in July to 4.3% YoY in August, the importance of oil as an intermediate input for goods and services means that the elevated oil prices could also spill over to the core reading in the near term. The risk of inflation resurfacing forced the Federal Reserve to maintain a hawkish stance regarding the path of its monetary policy. At the latest meeting, the central bank kept the federal funds rate unchanged at 5.25%-5.50%, but the quarterly projections released by the policymakers showed that another interest rate hike might materialise by the end of 2023.

We believe the Fed will not raise interest rates further but will maintain a hawkish stance until the end of the year not to let the market's price in interest rates cut too early. At the time of writing, forward swaps are pricing in a 25% chance of a hike in November and do not see a cut materialise until June. While the US economy has so far proved very resilient given the tight monetary policy environment, we believe the high interest rates are yet to fully filter through, bringing softer economic figures. We expect the policymakers to keep the higher-for-longer narrative until the end of the year and come up with a less hawkish statement at the start of 2024.

Real Avg. Weekly Earnings vs. CPI YoY vs. Avg Hourly Earnings

Average Hourly Earnings are rising faster than inflation.



Source: Bureau of Labour Statistics

Eurozone: The last quarter has seen a growing divergence between the Eurozone and the US. While the Fed's monetary tightening campaign appears to have succeeded in bringing inflation closer to the 2% target rate without causing a recession, the outlook for the Eurozone remains much bleaker. The common-currency area has barely avoided a contraction in Q2 2023, with the GDP growth for the quarter downgraded to 0.1% QoQ.

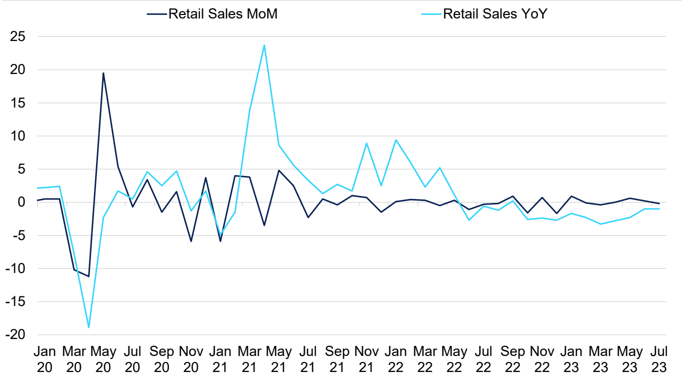
Retail sales flipped into negative territory in July and have remained contractionary year-on-year for ten straight months as customers continue to cut down on spending. Confidence levels continued to decline in August, with the economic sentiment falling to the lowest reading since November 2020, at 93.3. Softening demand for goods is impacting production, with the HCOB Eurozone Manufacturing PMI falling to 43.4, down from 43.5 in August. The readings continue to point to a very fragile and weak manufacturing sector, which is expected to extend into the year-end as tight monetary policy continues to restrain economic activity.

At their latest meeting, the ECB raised its key rate for the 10th consecutive time to the all-time high of 4.0%. We believe that the ECB is more concerned with bringing inflation to the target level in a timely manner than the economy falling into a recession. As a result, hawkish rhetoric is to remain into 2024, especially given the fluctuations that we may see in energy prices over the winter months.

The EU has been stocking up on reserves to replenish the availability of energy for the winter months; natural gas inventories reached 90% of capacity in August, but even completely full gas storage in Europe is only sufficient to satisfy several months' demand and the market could tighten if the weather is harsher than last winter or if lower prices incentivise more gas consumption. If the reserves prove insufficient, Europe will again be reliant on fast access to fossil fuels, which could prolong inflation stickiness. Given the less robust fundamental picture in comparison to the US, we expect the euro to weaken as the common-currency area remains beset with challenges.

Eurozone Retail Sales MoM vs YoY

Both monthly and yearly retail sales readings have been subdued in recent months.



Source: Eurostat

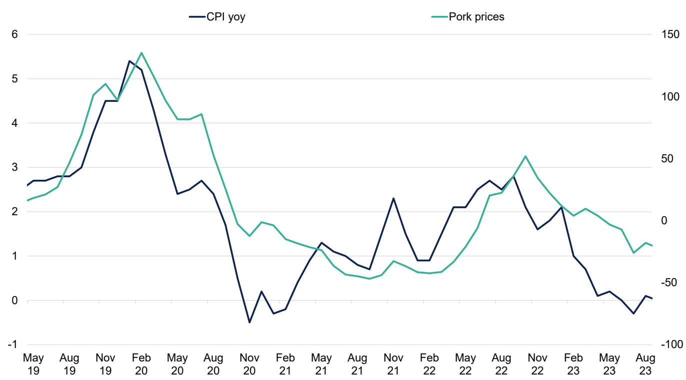
China: The last few months have marked a broad-based slowdown in Chinese economic activity, with most of the individual statistics coming in below consensus expectations. Depressed global goods demand looms on the foreign trade outlook of the biggest exporter in the world at a time when consumer confidence at home remains weak. While economic data released in September pointed to a possible stabilisation in China's downturn, it falls short of the growth most analysts anticipated earlier this year, proving that the highs seen post-reopening are over.

We have seen economists downgrade their GDP expectations, and, as of now, the broad projection remains slightly above the 5% target rate. The trade surplus slumped to $68.36bn in August from $78.65bn in the same period last year. Exports and imports extended declines, decreasing by 8.8% and 7.3% YoY, respectively, marking the fourth consecutive month of annual declines, exacerbated by continued tensions with the US and restrictions on access to technology. A sagging overseas and internal demand was also reflected in the Caixin Composite PMI figure in August at 51.7, which pointed to the softest pace of private sector expansion since January. While factory production increased slightly, tilting towards expansionary territory at 51.0, foreign sales remained weak amid growing fears of a global economic slowdown.

As China can no longer rely on exporting itself to prosperity, policymakers' focus remains on propping up internal demand. Among policy measures announced this summer, authorities have bolstered specific sectors, including plans to increase consumer goods and car sales, as well as extending tax breaks. Nevertheless, boosting internal consumption poses an enormous challenge, given household fears over income security due to adverse wealth effects from the crisis in the property sector, deflationary pressures and record-high youth unemployment. This, coupled with the unwillingness to overinflate debt, will likely cap the scale of any stimulus changes. We expect China's economic growth to remain muted in the coming quarter, weighing on the outlook for the global economy.

China CPi YoY vs. Pork Price Index

Hovering at the brink of deflation.



Source: National Bureau of Statistics

Aluminium

"...the US dollar strength is capping any significant upside gains. Aluminium prices are expected to remain rangebound in the near term."

LME Aluminium, 3MO ($)

Source: Bloomberg, 16.10.2023

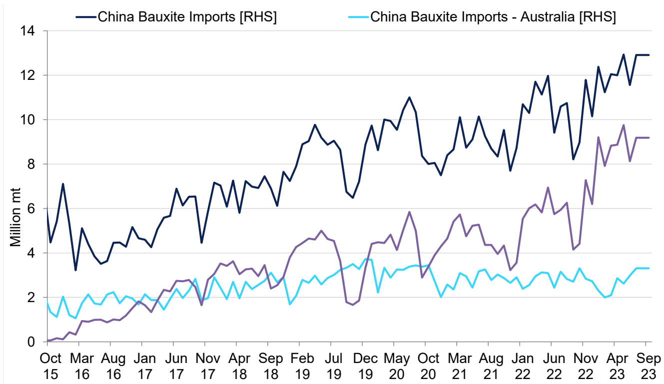
Aluminium prices fluctuated during the quarter, finding support and resistance at $2,130/t and $2,350/t, respectively. Favourable domestic policies are driving aluminium on the day of the announcement; however, the effects are short-lived, and prices tend to follow a mean-reverting strategy. Despite stock withdrawals impacting prices in October, the negative correlation with the dollar strengthened in recent months to 60%, indicating that macro plays are being acted out in metals' prices. Yuan's weakness struggled to bring significant upside momentum, suggesting a large pull away from fundamentals to a more sentiment-driven strategy. Our view of the dollar - marginal strength as the "last man standing" among major currencies. As major central banks come to the end of their tightening cycle, this could boost the dollar valuation in Q4 2023, keeping aluminium prices at the lower end of the longer-term range.

Simultaneously, the Chinese government continues to provide support for the economy, aiming to stimulate local spending. New policies are being introduced, ranging from cutting equity trading taxes to lowering mortgage rates. However, these moves are yet to prove successful. While this is an incremental step forward for the Chinese economy, we do not see it as a game-changer. Domestic expenditure remains lacklustre, and many consumers are awaiting more support from the government to incite spending. In the absence of strong support, prevailing low confidence levels dampen consumer sentiment. Other data pointed to exports out of China falling by 6.2% y/y, vs. -8.8% seen in August. A similar trend was seen in the nation's imports. While it is too early to tell whether trade activity is rebounding, the signs of an easing slump are a welcome relief to China's economic performance. As of now, there is no quick fix for this issue, and China is poised to endure a period of moderate growth while it alleviates some of the debt-service constraints that are weighing on local governments.

From a fundamental standpoint, we see smelter sentiment improving in the near term, with the traditional peak season having started in September. The supply of aluminium increased, up to 3.52m in September, thanks to continued recovery out of Yunnan, where operating capacity recovered to 5.55m mt, according to SMM. We expect supply out of the region to remain a key tailwind to the nation's production. With the upcoming dry season, some smelters are undergoing upgrades, and Sichuan is further reducing capacity.

China Bauxite Imports: Australia and Guinea

China continues rapidly importing bauxite from key miners for domestic demand.



Source: Customs General Administration

We expect production to remain stable year-on-year in Q4 2023, but social inventory is still at a historically low level. To safeguard itself against insufficient inventory in the coming months, the bauxite import volume to China resumed in August at 11.63m mt, and with the restored aluminium ingot profits, aluminium ingot imports increased. The arb rate became positive last month; however, there are no fresh positions. The premium remains within the longer-term average, and Chinese smelters are hesitant to import. Still, in the upcoming quarter, we expect growth in domestic supply to be accompanied by rising imports. We do not expect traditional demand for infrastructure projects in Q4 to stimulate in significant advance in aluminium prices.

While we do not expect to see any major changes in China's fiscal policy support, lower interest rates and easier borrowing conditions seem more likely to emerge to prop up economic growth. The cumulative impacts of policy support and a dovish monetary policy in China will create solid foundation for the economy to recover in 2024. Such transition should push the sentiment from the oversold into neutral in Q4 2023 and we expect the support levels made this quarter to maintain into Q1 2024. However, the US dollar strength is capping any significant upside gains. Aluminium prices are expected to remain rangebound in the near term.

Copper

“...copper prices are likely to remain volatile as the market continues to focus on the broader macroeconomic outlook, with sluggish global growth dampening demand.”

LME Copper 3MO ($)

Source: Bloomberg, 16.10.2023

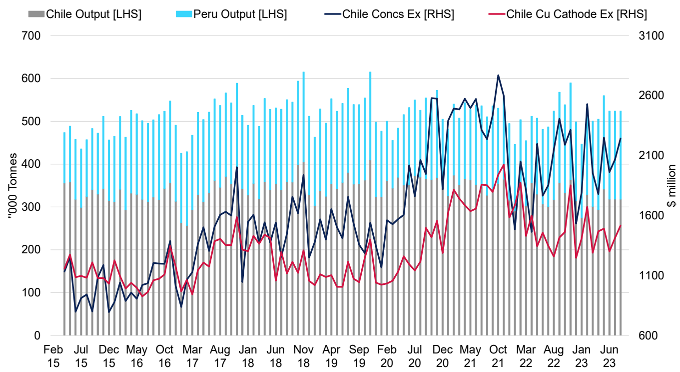
Copper remained steady around $8,400/t for the majority of Q3, similar to the beginning of the quarter. Support at $8,200/t was breached recently, and we now see the next robust support level at $8,000/t. We believe this level will hold firm in Q4 2023. Copper remains one of the more macro-sensitive base metals, alongside aluminium, and news out of China and the US brought stronger bounds of volatility in price performance than in the rest of the complex. Positive momentum was propelled by increasing pledges from Chinese and policymakers to support the economy. However, we do not expect to see protracted upside gains until the economy is recovering in a sustainable manner.

Still, we believe that Chinese risk assets, including copper, are oversold with downbeat sentiment, which diverges from current market fundamentals. The pessimism is now reflected in the price. Why has the market become so negative about China? We believe that strong expectations of post-pandemic recovery have been continually priced down the curve over the course of the pandemic. This is evident in strong copper gains during the periods of little to no lockdown restrictions. In 2023, when restrictions were finally lifted, markets were hopeful but cautious about the sharp rebound in activity, given continued uncertainty in regard to lockdown restrictions. Since then, optimism began to decline: monetary policy across the world tightened, and consumer sentiment declined rapidly. We believe that the market is now fully pricing in the negative impacts of lacklustre economic growth in China. Moreover, a more hawkish narrative from key central banks is weighing heavily on riskier assets; however, this impact will likely lessen towards the year-end. With the slew of measures implemented throughout the year, we expect market sentiment to reverse from strongly oversold to neutral in Q4, which will bring it closer to market fundamentals.

Copper cathode output continued to grow both MoM and YoY, with the latter expanding by 11.3% to 986,100mt, according to SMM. October production should remain marginally unchanged, below 1m mt, despite some smelters coming back to maintenance. In Q4 2023, MoM performance is poised to remains robust on a YoY basis, given the traditional peak season. Signs of improvement are already seen in the imported copper demand: ore and concentrate imports climbed to all-time highs of 2.7m tonnes in August, and the Yangshan copper cathode premium is now at $80.00/mt vs the March low of $19.50/mt. We are, however, cautious of the potential supply risks bubbling up in the copper market. Chilean operations continue to suffer project delays and mine setbacks, resulting in critically low levels of copper in Chinese deliverable inventories. Copper supply will come under strain if Chilean production suffers.

Chile and Peru Production & Export

Chile exports of cathode continue to diminish relative to 2021 highs.



Source: Cochilco Minsterio de Mineria , Banco Central de Chile, Banco Central de Reserva del P

It is becoming increasingly evident that the world is experiencing an economic slowdown. As we approach Q4 of 2023, we anticipate that the global sentiment will further deteriorate. The monetary policy path remains uncertain, and the divergence between economic performance will create additional ambiguity in market expectations. As a result, we foresee increased volatility in risky assets. In the short term, copper prices are likely to remain volatile as the market continues to focus on the broader macroeconomic outlook, with sluggish global growth dampening demand.

Overall, the market remains rangebound, and we expect this momentum to continue into Q4 2023. A drift lower is the worst case scenario. The compounding effect of the fiscal and monetary policy released so far this year is helping to solidify the support level, from which the economy is poised to recover into next year. Additionally, the low levels of visible copper stocks globally are likely to prevent a significant decrease in prices, which will keep copper prices above the level of production costs until consumption improves.

Lead

"This momentum was largely driven by acute tightness seen in the SHFE contract, albeit gains were muted in comparison..."

LME Lead 3MO ($)

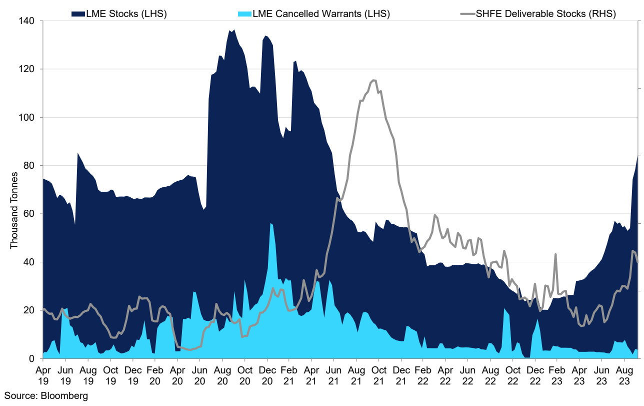
Source: Bloomberg, 16.10.2023

Lead prices gained momentum in Q3 2023, strengthening by 10% to a January high of $2,300/t. This momentum was largely driven by acute tightness seen in the SHFE contract, albeit gains were muted in comparison, given the absence of short position holders. The lead squeeze has been building for a couple of months, and spreads on the LME and SHFE exchanges were already tightening up against a backdrop of low exchange stocks and rising open interest. As businesses purchase based on long-term contracts, the recent spread between lead contracts and spot cargoes widened, prompting sellers to make warehouse deliveries. This resulted in a higher inventory of lead ingots in social warehouses. The LME stocks are now at the high of June 2021 at 91,200mt. Similarly, but less abruptly, deliverable stocks in China are picking up to September 2022 highs of 78,494mt.

With Chinese producers now rushing to deliver metal to the Shanghai market, China's export flows are expected to slow down in the next few months. From the fundamental standpoint, the ILZSG estimates global lead usage contracted by 0.9% in H1 2023, generating a modest 25k mt supply surplus. This would be a welcoming sign for the tightness currently seen in Shanghai. With exchange levels now building and cash to 3-month spreads weakening, the case for a downside is growing.

LME and SHFE Lead Stocks

Both inventories are rising, easing some of the fundamental tightness.



Source: Bloomberg

Chinese refined lead output was 315,900mt, unchanged m/m but up 7.0% y/y in September. Some large enterprises overhauled production, resulting in insignificant output reductions. Meanwhile, other regions resumed their operations after maintenance, and supply tightness in lead concentrate was incentivised by higher stockpiling ahead of the winter season. Lead concentrate TCs fell. Therefore, the output growth largely offsets the output reduction. We expect smelters to restock lead concentrate inventories for winter production in the coming months, limiting smelters' output growth. Given the insufficient raw material supplies we have seen last quarter, we expect the accumulation to be robust. Secondary output also continued to grow. Secondary lead output in China was 458,200mt in September, up 10% m/m and 42% y/y, as many secondary lead smelting companies completed maintenance and resumed production in July, and their output gradually stabilised or returned to normal levels in September. We expect the output of secondary lead to increase in Q4 2023, with occasional maintenance plans. In addition, softer lead prices eased some of the pressure on battery manufacturers, which are planning to ramp up production at their secondary lead smelters to reduce purchases of lead ingot.

Passenger vehicle sales remained broadly unchanged across producing nations, maintaining stable growth so far in 2023. US passenger vehicle sales reached 280,223 units, up by 1.2% m/m and 12.5% y/y. New vehicle sales continued to grow rapidly as the overall consumer demand and supply of vehicles improved, thanks to a continued easing of supply chains. Retailers continue to sell vehicles before they physically arrive at the dealership. However, with increased inventory levels, more shoppers can now purchase vehicles at better prices, further reducing dealer profits. Battery operating rates are expected to increase into the year-end, but the current battery inventory has dropped to less than one month of consumption, and manufacturers in some regions have reported limited improvement in electric battery market consumption.

Given the continued replenishment of stocks on both the SHFE and LME warehouses, the tightness that we have seen in lead should diminish. Lower prices would also alleviate some pressure from the sellers to make warehouse deliveries. Still, the outlook on the LME prices largely depends on the squeeze exit on SHFE. From the demand side, vehicle production remains stable y/y whilst declining marginally m/m, and we struggle to see demand fundamentals impacting lead prices in the near term. Easing supply tightness should push lead prices back to $2,040/t in Q4 2023.

Nickel

"We expect nickel prices to remain under pressure in Q4 as the global surplus builds."

LME Nickel 3MO ($)

Source: Bloomberg, 16.10.2023

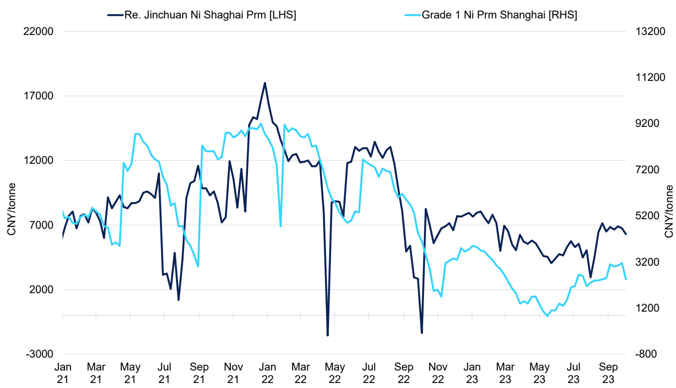
Nickel weakened in Q3 2023, continuing to underperform in comparison to other base metals, down by 40% YTD. The main reason for this is the underwhelming recovery of Chinese demand, causing nickel to drop to a July 2022 low of $18,330 /t in October. This trend shows little sign of abating in the near term. This softness will likely continue amid a weaker macro picture and sustained market surplus. However, downside pressures are likely to be limited in scale in comparison to Q3. Supply from Indonesia continues to surge to meet the growing demand from the battery sector over the long term. The market surplus of Class 2 nickel is expected to weigh down prices even further towards the end of the year.

In the meantime, Class 1 stocks on the LME remain historically low. Despite recent gains to 41,628mt, which we believe to be due to the initiative to reduce approval waiting times for new brands, the level is still at the 2007 low. China's refined output has been solid so far this year, and Chinese producers are poised to increase capacity further. The growth rate of refined nickel this year is faster than that of battery-grade nickel sulphate, which should enable more Class 1 material to be delivered to LME warehouses. September output increased by 43.2% YoY to 22,100 mt. According to SMM, 145,300 mt of new refined class 1 nickel production capacity will be added in China this year. Meanwhile, high-grade NPI prices jumped in September as Indonesia delayed the issuance of nickel ore quotas. As a result, profit margins have expanded, and production increased. Indonesian production in August grew by 19.0% YoY to 120,200 in September. Chinese output totalled 34,500mt, growing by 9.6% YoY. Despite stainless steel softness, the peak season should maintain NPI production at a solid pace into the year-end.

Over the long term, the demand for lithium batteries will continue to drive up the prices of nickel. This, in turn, will benefit NPI and high-grade nickel matte. As NPI is produced mainly in Indonesia, we anticipate that there will be ongoing investments in mining and smelting projects to keep up with the long-term demand projections. However, by 2025, the NPI capacity will gradually reach saturation point, and the growth rate will slow down. On the other hand, the production of high-grade matte is limited in Indonesia. Although there are plans to increase high-grade nickel matte production in the next three years, the incremental growth is not expected to be significant, and the high-grade nickel matte market is still under development

Nickel Premiums

Premiums for Shanghai and Jinchuan remain at the lower end of the range.



Source: Guojin Resources Limited

Chinese economic performance is moderating from the highs seen post-reopening. Some signs suggest the economy's recovery continues to be dragged down by the property sector and muted consumer spending. Manufacturing increased to 50.2 in August, coming out of the contractionary territory for the first time since March. However, less than 50% of construction companies are planning to replenish their inventories before the holiday, with most citing softening demand for housing projects despite peak homebuying season. Property investment declined by 8.8% YTD, with new home sales down 1.5% - these figures are worsening MoM. Demand remains lacklustre, and the question investors pose is whether service spending can continue to grow sustainably. To address the relative weakness of the Chinese economy, the government has taken a variety of measures, such as gradually easing monetary policy, reducing downpayment requirements, and increasing spending on infrastructure investment. However, it will take time to translate these measures into new housing projects, and we expect Q4 performance to be skewed on the downside before finding support at the start of 2024. The government's efforts so far may result in a limited boost to stainless steel consumption rather than its recovery.

We expect nickel prices to remain under pressure in Q4 as the global surplus builds and slowing economy mutes stainless steel demand. We see prices averaging below $20,000/t in the fourth quarter. However, the downside will be limited due to tightness in the LME deliverable market.

Tin

"...a fine balance of fundamental supply tightness and amoebic demand."

LME Tin 3MO ($)

Source: Bloomberg, 16.10.2023

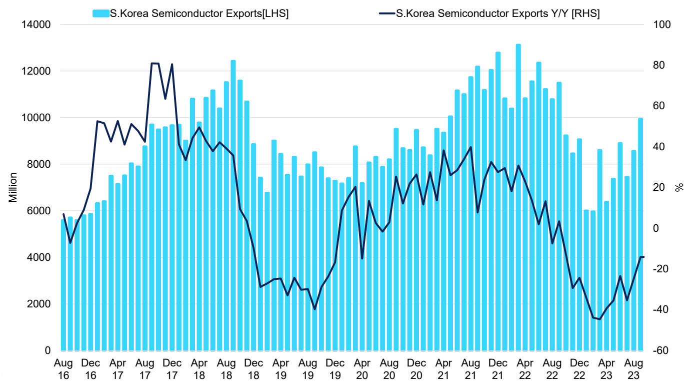
Tin offset earlier gains by the end of Q3 2023 following the Myanmar ban implementation. The rapid price decline following the enactment suggests that it did not translate into immediate fundamental market tightness, especially given a continued lack of demand. This is indicated by a sharp fall in the cash to 3-month spread, now back in contango at -$345/t. This marks the lows below the spread fundamentals ahead of the ban. As mentioned in our previous report, given that authorities have mandated a "smooth demobilisation process for mine workers", it could be a while before a complete phase-out from the export market. The nature of the ban itself remains uncertain. There's still a fair bit of buffer stock in China at the moment, with the SHFE deliverable level at 6,420mt, suggesting that the economy still has enough domestic material to manage its needs. Still, stocks are declining for the first time this year, so the country will probably look for additional ore in the international market. This transition will likely be gradual, putting less pressure on supply fundamentals in Q4 2023.

Thanks to a slew of imported tin ore flowing into China from June to August, tin ore supply will be ample in the near term. Indeed, Chinese tin ore imports from Myanmar surged 86% YoY during May-July to 56,533 mt. Meanwhile, Indonesian ore export is improving, with September level increasing by 17% MoM to 5,834mt. As a result, refined tin output expanded, rising by 45% m/m and 2.2% y/y to 15,430mt. Most smelters kept operations stable, while smelters in Yunnan resumed production from maintenance, partially adding tin ingot production. Output should remain stable in Q4 2023, and we could see Yunnan expansion aid the output recovery; TCs of tin ore out of the region should increase. Over the longer term, before Myanmar resumes production to a normal state, domestic smelting supply will gradually decrease, and returning to the high level will be challenging.

Poor tin demand has eased some of that supply pressure, at least for the remainder of the year. While Korean semiconductor exports are recovering from this year's lows, up by 15% MoM on a year-on-year basis, the figures remain below trend. Policymakers are hoping that continuous monthly recovery will help Korea's economy to grow this year.

South Korean Semiconductor Exports

MoM performance is improving, but longer-term performance remains below trend.



Source: Ministry of Trade, Industry and Energy

Weakening economic conditions in China, the biggest consumer of chips, continue to be a point of concern. Slack demand in China is one factor behind a slump in global semiconductor prices that has cut into earnings at major Korean exporters. Korean exports to China dropped 20% from a year earlier, while exports to the US edged up 2%. At the same time, efforts to roll back restrictions imposed by the US to allow access to chips and chipmaking technology to China are unlikely to improve in the near term. Worldwide, sales of semiconductors grew by 4.7% QoQ but down 17.3% YoY in Q2 2023. Despite global semiconductor sales in 2023 remaining behind YoY, there is cause for optimism as revenue has increased for four consecutive months since June, providing hope that the market will continue to improve in the second half of the year. Electronics, on the other hand, continued to signal weak client demand. The global PMI declined to 46.9 in August, as both output and new orders remained firmly in contractionary territory. Firms often attributed the deterioration to global economic weakness, alongside inflationary pressures and higher interest rates.

Our view is that tin will be stuck in a fine balance of fundamental supply tightness and muted demand. The Myanmar ban implementation resulted in little immediate impact on China's sourcing of ore. Front-loading of imports from Myanmar and ample buffer stock should keep tin prices steady in Q4 2023.

Zinc

"...we believe that the skew for zinc in Q4 is on the upside."

LME Zinc 3MO ($)

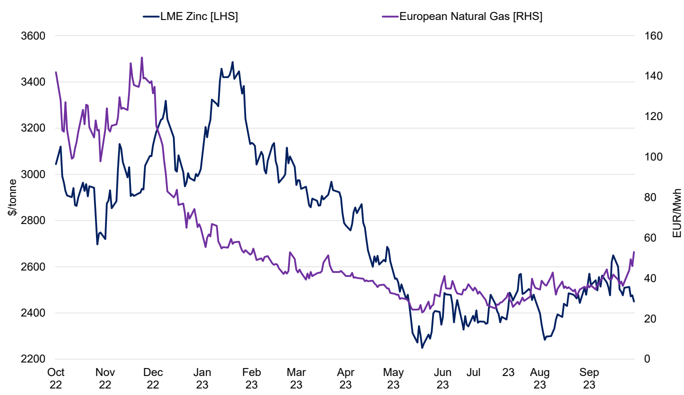
Source: Bloomberg, 16.10.2023

Zinc prices fluctuated during the quarter, finding support and resistance levels at $2,260/t and $2,650/t, respectively. The summer has been a period of robust downward pressures for construction materials. The dollar strength renewed and continued tightening from key central banks weighed on risky assets. However, it was China's weakness that had the greatest impact on the downside of most metals, and the construction industry was hit hardest by this decline. The property sector remains weak, with housing starts and residential floor space sold still in deep contraction, whilst new home prices have started falling once again month-on-month. Moreover, easing tightness in the prompt market, in the form of growing stocks on the LME exchange, led to price declines in zinc. In the second half of the quarter, the picture reversed, as inventories began to diminish once again, pushing zinc back to the $2,550/t level. Still, the cash to 3-month spread remains in contango at -$25.00/t, suggesting that fundamental tightness has abated, at least in the meantime. As a result, we expect zinc prices, in line with lead, to be influenced by supply conditions in the market rather than the macroeconomic environment, as seen in the rest of the complex.

Indeed, zinc, which is typically highly correlated to European natural gas prices, has seen a decrease in this correlation in recent months. The 30-day correlation between the two averaged at -40% in October vs. 70% in Q2 2023. Still, we are of the opinion that volatility in LNG prices could once again bring the topic of energy crisis in Europe into the spotlight for zinc. Last year, the EU successfully managed to wean itself off Russian gas. The modest growth in Q1 2023 dispelled fears of a winter recession as the bloc's economies gathered enough natural gas storage to survive the winter months. However, as winter approaches, so will the energy woes in the region, along with whether the union has learnt from last year's crisis. Although the worst fears from last winter did not materialise, it was the second warmest on record. The upcoming months will reveal whether Europe's energy strategy can handle the impact of colder winter temperatures. Despite the EU reaching its 90% capacity target for natural gas storage, colder winter and energy import disruptions could drain the storage much faster than spring can arrive. If the reserves prove insufficient, Europe will again be reliant on fast access to fossil fuels. However, while most European zinc smelters have reopened their facilities, the respective output remains muted and we struggle to see LNG volatility impacting prices significantly in Q4 2023.

Zinc prices vs European LNG

The correlation between the two weakened significantly in recent months.



Source: Bloomberg

From the fundamental perspective, news of production cuts in overseas mines, which were facing a shortage, has helped to support zinc prices. Zinc SHFE inventories are currently at a low level of 46,104 mt, which we anticipate will lead to a stronger domestic premium in China. This, in turn, should be supportive of zinc prices. In China, domestic mines have continued to maintain normal production and stable output. Refined zinc supply totalled 544,000mt in September, up 3.3% m/m and7.9% y/y. YTD, the output totalled 4.85m mt, up 10% y/y. Currently, refineries mostly use domestic ores, and we expect companies to maintain full production levels through the end of the year. Recovery of smelters in Hunan, Yunnan, Inner Mongolia and Sichuan from maintenance will contribute to most of the output increase.

Market fundamentals for zinc remain tight. Despite domestic output remaining in line with expectations, stock levels on both SHFE and LME are back at low levels, supporting zinc momentum. On the upside, stronger performance in the US and, subsequently, weaker momentum in China continues to weigh on risky assets. Still, we believe that the skew for zinc in Q4 is on the upside, given the prevalent supply shocks from both China and European energy markets. We expect zinc to trade marginally higher in the coming months

Iron Ore & Steel

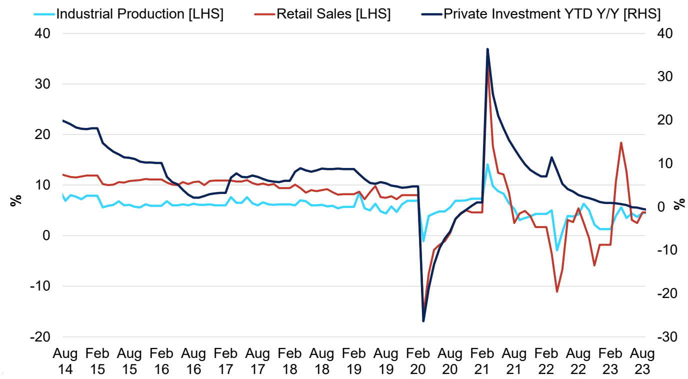
"Risks will remain to the downside heading into the year-end."

Source: Bloomberg, 16.10.2023

Iron ore prices held above the $100/mt mark in Q3 2023 despite worsening property sector in China, which constitutes about 40% of demand. China has continued its efforts to boost the steel-intensive property sector, supporting the upward price momentum in August. However, policymakers have been reluctant to roll out massive stimulus measures, and we have seen economists downgrade their GDP expectations as a result. As of now, the broad projection remains slightly above the 5% target rate. Despite the government's recent efforts to encourage spending, the low level of confidence is hampering consumer willingness to purchase new homes, resulting in a decline in property investment by 8.8% YTD, with new home sales down 1.5%, and these figures are worsening month-on-month. The Chinese economy is struggling under the weight of deflationary pressures, waning exports, and a persistent property crisis. While these measures might not boost growth immediately, they should create a sustainable path for Chinese recovery from lockdown restrictions while balancing stimulus without over-inflating debt. As a result, we expect iron ore, which is a gauge of market sentiment towards China's recovery, to soften on the back muted construction outlook in Q4 2023. The government's focus on reviving home buying by cutting interest rates and loosening mortgage rules will take time to translate into new housing starts, and we do not see this taking place until 2024.

China's Macroeconomic Environment

The Chinese economy is softening post-reopening earlier this year.



Source: National Bureau of Statistics

From a fundamental standpoint, steel mills are expected to ramp up production during the peak construction season. In September, stainless steel output totalled 3.22m mt, up by 0.5% MoM and 16.7% YoY; only the 400-series improved. However, the uncertainty around mandatory curbs will weigh on the outlook. We expect production to remain robust until November when some steel mills are scheduled to undergo maintenance. The extent and timeline of production cuts this year are still unknown, but any steel output cut would add to bearish risks for the iron ore market. China's iron ore stockpiles are currently at their lowest level since August 2020, with 10,520 metric tonnes, as steel mills have been cautious about restocking. We expect inventory to continue to shrink in the first half of the quarter amid tight production schedules for stainless steel; however, the downside will be capped by marginal restocking ahead of the construction season. Low inventories should also support iron ore's price at elevated levels. The iron ore supply side has been largely stable, with imports from Australia and Brazil remaining elevated, at 64.5m and 25.2m in August. As a result, China's iron ore imports were at their strongest in almost three years at 106.4 mt. We believe that demand in China will continue to be the primary driver for iron prices as the supply side remains stable. We are wary of potential government interventions to stabilize price volatility, which could add further downside pressure to performance in Q4 2023. Any steel output cut would contribute to the bearish risks for the iron ore market, and we expect prices to remain volatile as the market continues to respond to any policy changes from Beijing.

We expect prices to average $100/mt in Q4 2023. Risks will remain to the downside heading into the year-end amid potential China steel output cuts, an uncertain outlook for the property sector and healthy supply. Despite pledges from Beijing to support the economy, current measures are not expected to have a significant impact on the real estate sector, which means that there is unlikely to be a large-scale property development that would increase demand for steel and lead to higher iron ore prices in the last quarter of the year.

Gold

“...expectations of the end of the tightening cycle will resurface again, raising the attractiveness of the precious metal.”

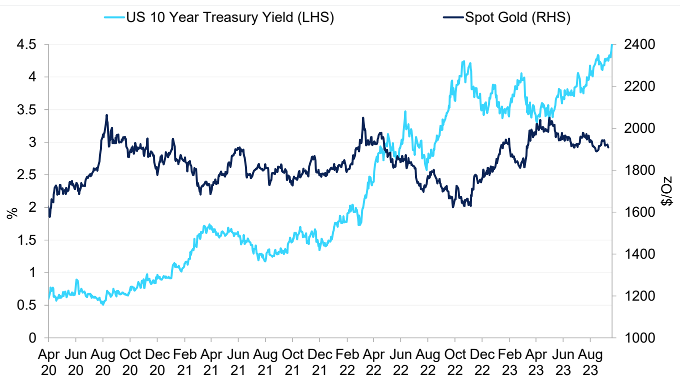
Spot Gold $/Oz

Source: Bloomberg, 02.10.2023

Gold price fluctuated in Q3, finishing the quarter 4% lower. The price rallied and tested $1,980/oz in the first half of July in the wake of the Federal Open Market Committee (FOMC) meeting, which was expected to mark the end of the prolonged monetary tightening cycle. However, the hawkish statement from the policymakers, who announced that more interest hikes would be needed to ensure inflation goes back to the target 2% level, caused the yellow metal to give back its gains, falling below $1,850/oz by September. Since then, persistent dollar strength put a cap on any upside momentum for gold, leading the precious metal to trade range bound, with resistance and support levels forming between $1,940/oz and $1,850/oz, respectively. While September marked a pause in the Fed’s monetary tightening campaign, higher interest rate projections from the board pushed investors’ rate expectations higher, creating further headwinds for gold. The lacklustre demand for the precious metal was further confirmed by ETF holdings, which continued to mark net outflows throughout Q3.

US 10Yr Treasury Yield vs Spot Gold

Persistently high nominal yields continue to put downward pressure on gold.



Source: Bloomberg

Given precious metals’ strong dependency on macroeconomic factors stemming from the US, gold continues to be caught between the bearish environment of elevated interest rates and high nominal yields on the one hand and growing expectations of global economic slowdown on the other. The outbreak of the Hamas-Israel conflict added another force to the picture, reviving safe-haven demand that creates strong tailwinds for gold. In our view, growing fears of the conflict escalating in the region will likely outweigh the downside pressure of high interest rates in the short-term. At the same time, the long-term fundamentals suggest that tailwinds for precious metals are building up. While the US economy has so far proven very resilient given the tight monetary policy environment, we believe the high interest rates are yet to fully filter through, bringing softer economic figures as we get closer to the end of the year. In the meantime, the lack of clear signs of a recession allows the Fed to maintain a hawkish stance, creating upside pressures on the nominal yields and the dollar, which have a strong traditional impact on the speculative side of gold.

Currency risk has dominated markets in the last months, with the greenback rising incessantly as investors hold capital in the US because of more pronounced economic uncertainty in China and Europe. Increasing oil prices fuel fears inflationary pressures might resurface, underscoring the narrative of higher-for-longer interest rates. At the latest Fed meeting, the policymakers kept the federal funds rate unchanged at 5.25%-5.50%, but the quarterly projections released by the central bank showed that another interest rate hike might materialise by the end of 2023. This caused the nominal yields to increase, causing investors to turn away from non-yielding assets like gold. The 10yr US Treasury yield surged by nearly 10bps since June, almost touching 4.7%, the highest level since October 2007 as investors grew increasingly convinced that interest rates would stay elevated for longer.

We believe that monetary tightening by the Fed is already priced in, and while the 10yr US Treasury yield could continue edging slightly higher in the near term, putting downward pressure on gold, the impact will likely soften further down the line.

We expect the 10yr yields to hover around the 4.5% level until expectations of interest rate cuts start being priced at the start of 2024, bringing a more favourable environment for gold. Overall, we expect gold to continue trading range bound between $1,900/oz and $1,950/oz until November, when expectations of the end of the tightening cycle resurface again, raising the attractiveness of the precious metal.

Silver

"As the end of the interest rate hiking cycle did not materialise, nominal yields edged higher, leading silver to give back its gains."

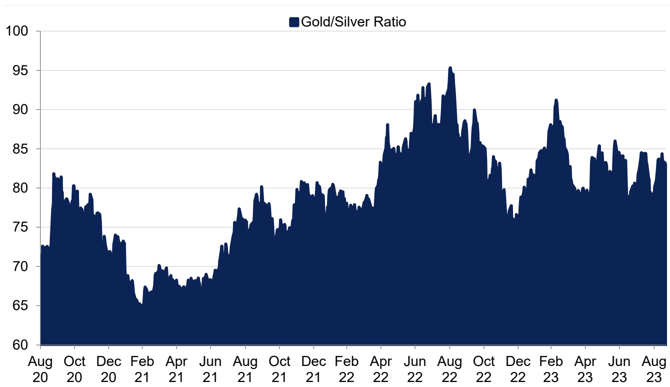
Source: Bloomberg, 02.10.2023

Silver traded range bound in recent months, following gold prices, on the back of fluctuating US Treasury yields, as markets tried to predict the path of the Fed's monetary policy. The white metal peaked in the second half of July, climbing above $25.00/oz amid expectations of the end of the Fed's monetary policy tightening campaign. As the end of the interest rate hiking cycle did not materialise, nominal yields edged higher, leading silver to give back its gains and fall back to $22.00/oz.

The precious metal rebounded in the second half of August amid softer 10yr Treasury yields, which have a strong traditional impact on the speculative side of the metal performance. Compared to gold, silver gains were more pronounced, and the gold-to-silver ratio declined to 80.00, making the white metal relatively more attractive to investors. Nevertheless, any upside momentum proved to be capped by the continued strength of the dollar. Overall, silver finished Q3 marginally lower, closing at $22.00/oz.

Gold to Silver Ratio

Silver marked more pronounced gains when the gold-to-silver ratio declined.



Source: Bloomberg

The main driver for silver in the upcoming quarter is set to be macroeconomic. Silver, like gold, heavily depends on economic factors coming from the US. The world's largest economy has so far remained the most resilient out of all major economies in the tight monetary policy environment, which continues to be reflected in the dollar's enduring strength. Given the inverse correlation between silver and the dollar index, which has increased in the second half of September, approaching -0.80, the strengthening greenback is poised to create downward pressure on the white metal's price.

We expect the dollar to edge higher in the near term as the "last man standing," testing the 106.50 resistance level. This, combined with the prospect of elevated US Treasury yields, which makes investing in non-interest-bearing precious metals less attractive, will further undermine silver prices. We believe the Fed will not raise interest rates further but maintain a hawkish stance not to let the market price in interest rates cut too early; as of now, the forward swaps are pricing in a 25% chance of a rate hike by the end of the year. Whether we see another interest rate hike by the end of the year or not, we expect the markets to price in a Fed pivot after the December meeting at the start of next year. Increasing oil prices fuel fears inflationary pressures might resurface, underscoring the narrative of higher-for-longer interest rates. Brent crude oil prices breached $94.95/blin the third week of September, a level not seen since November 2022.

We expect the core inflation to remain sticky in the near term, and with this in mind, terminal rates from key central banks are likely to stay higher for longer, adding to the slower GDP growth of major economies. Precious metal prices are caught between the bearish environment of elevated interest rates and high US Treasury yields on the one hand and growing expectations of global economic slowdown on the other.

As silver remains stuck between these two opposing forces, we expect the metal to trade rangebound between $20.80/oz and $24.00/oz until the end of the year. In our view, the risks are going be skewed to the downside until interest rate cuts start to be priced in at the start of 2024, which should bring a more positive environment for silver.

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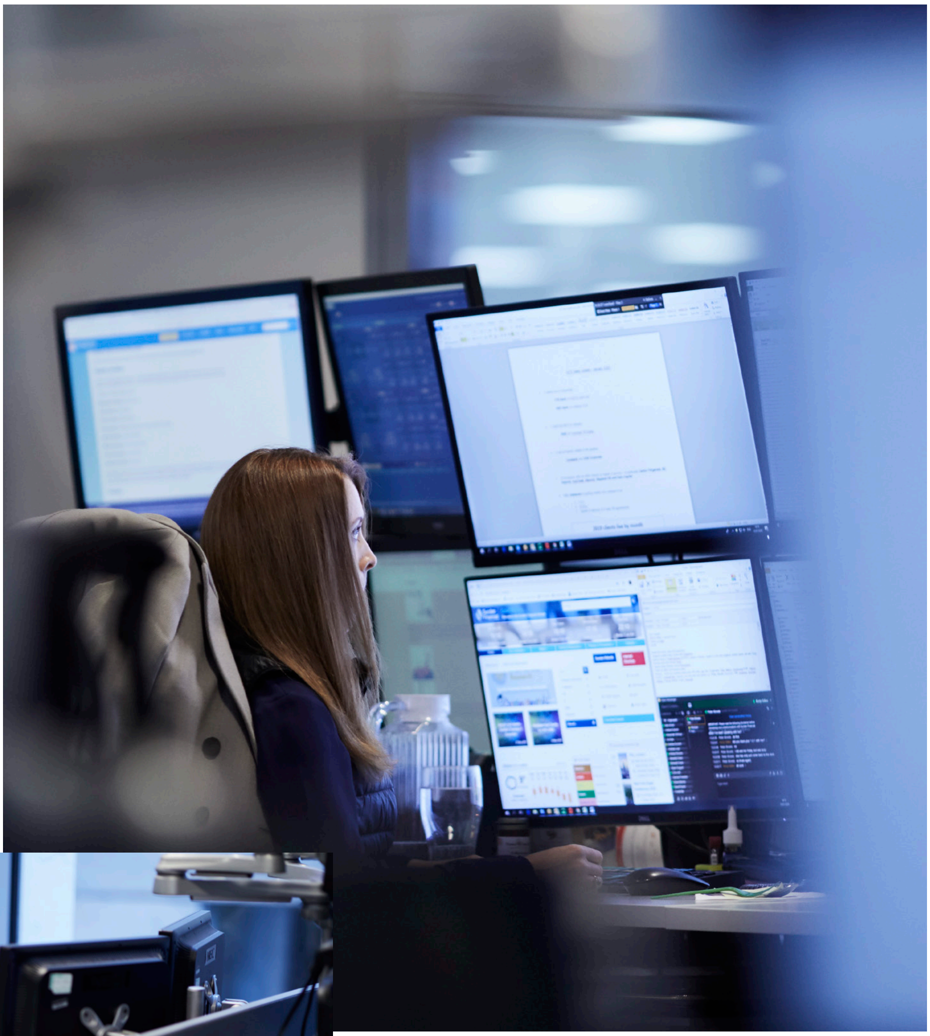

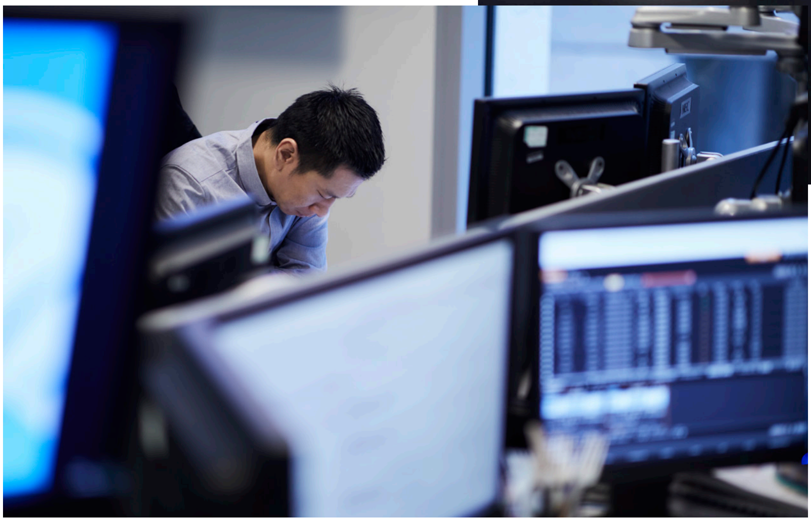

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