METALS AND MINING 2017 YEAR AHEAD: UNCERTAINTY IN 2017 FOLLOWS A MARKET RALLY IN 2016

"Mined commodities rallied in 2016 as markets rebalanced, and the global macroeconomic environment should remain supportive in 2017. While market consensus remains cautious, and we agree that ultra-long cycles are unlikely to be repeated soon, the metals and mining sector has resumed its traditional cyclical role with periodic upcycles followed by sell-offs. Not being long, the sector during rallies could impose significant opportunity costs."

– Michael Widmer, Metals Strategist

Our view

A rebalancing of the global mined commodity markets, driven by a slowdown in supply additions and steady demand growth, was the key driver of our constructive sector view in 2016, which saw mined raw materials rally across the board. Heading into 2017, we remain optimistic that the global economy should support mined commodities. However, our view is more cautious for the second half of 2017. A possible crackdown on trade and globalization could generate considerable headwinds. Also, even if China's appetite for a meaningful growth slowdown is limited ahead of November's National Congress, its fiscal and monetary stimulus is set to become less supportive around and after that event. We take a differentiated view on the commodity sectors and are bullish base metals/steel but bearish precious metals and bulk materials.

Base metals: Further upside

Base metals look fundamentally strong, especially in the first half of the year. Through 2016, zinc has been the outperformer in the base metal complex. This is unlikely to change next year. Regardless of supply disruptions in the Philippines, nickel market deficits are likely; further mine closures would extenuate supply shortfalls. Copper mine supply additions have gradually ground to a halt. Having been the laggard among base metals through 2016, copper could catch up in the first half of 2017, as supply rises and demand expands on fiscal stimulus. A possible price correction toward year-end 2016 would be an entry point with a view toward rising prices next year – an average of $6,000 per ton ($2.72 per lb.) looks likely by the second quarter of 2017.

Precious metals: In the doldrums

Gold is in the doldrums: the economic policy outline of U.S. President-elect Trump has pushed nominal rates higher. Even if many of the discussed measures may turn out to be inflationary, inflation and inflation expectations have remained subdued, reflected in rising real rates, a key gold price driver. As such, we see a risk that gold will trade at $1,200/oz. by mid-2017, implying limited upside near-term. Having said that, we keep a more constructive view further out on a confluence of factors.

Bulk materials: Rolling over, but supported above the lows

Bulk materials have been the outperformer this year, initially through stimulus in China, the impact of which was then exacerbated by supply-side reform, especially in coal. We expect the impact of this dynamic to persist into 2017, but prices should fall coming out of winter. Having said that, a full retracement to 2015 lows is not our base case.

Steel: Upside for regional producers on protectionism

The met coal market imbalance should persist through H1 2017 after recent tightening measures in China, driving costs and, therefore, steel prices globally. Regions with more captive coal, such as the U.S. and Russia, stand to benefit as costs rise less than in those countries buying met coal on the inflated spot market, including China. We also note that the recent U.S. presidential election could add to protectionist measures that have helped sheet prices in the past 18 months, extending to long products that have less tariff protection. With imports unattractive, we expect U.S. mills may be able to name their price for some products through much of 2017.

Exotic commodities: Uranium not radiating

The uranium market looks oversupplied through 2023, including a large average annual surplus of 33 million pounds 2017–2021, at an average 16 percent of consumption. The Japanese overhang continues given the disappointing pace of power plant restarts, high inventory levels, continuing high production and secondary supply such as underfeeding. There is little incentive for utilities to contract significant new quantities of uranium in 2017, given the steep structural surplus. As a result, we have lowered our 2017–2019 spot uranium forecasts. However, the long-term outlook remains the same due to factors such as expected nuclear reactor launches in China.

Key calls

- **Base metals** – We have raised our 2017 average price forecasts to $5,350/t for copper, $2,113/t for lead and $2,713 for zinc. Our price estimates for aluminum and nickel are unchanged.
- **Precious metals** – Gold may fall to $1,200/oz. by mid-2017. Our 2017 price forecast of $18.21 for silver reflects our view that the worst for silver may be behind it.
- **Bulk materials** – These have been the outperformer this year; coal was driven by government-mandated production cuts. China's authorities are unlikely to cause sustained bull markets and hence, a correction is likely.
- **Steel** – We anticipate potential volatility in steel prices – a potential anti-globalization trade – on factors driven not by supply and demand, but by raw material input costs. We have raised our forecast for steel-making coal to $215/t for 2017 from a prior $140/t.