

Commodities / copper

Copper prices fall as demand shows signs of peaking

Price fall linked to weaker demand

Copper prices have dropped sharply in recent weeks. Having risen to an average of \$7,830 per tonne in March, the highest for 20 months, LME copper had fallen to \$6,720 by mid-May – a decline of around 14% and the lowest since mid-November 2009.

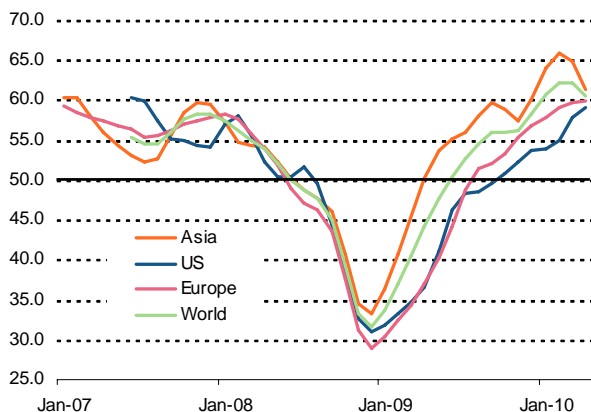
The decline has reflected investor nervousness following signs of slower economic growth in China and the prospect of slower growth in Europe due to the European sovereign debt crisis.

PMI data suggest output growth at global copper-using firms may have peaked

To what extent are these sentiment-driven factors reflected in reality? The rally in copper prices up to March had been underpinned by buoyant demand growth in China, fuelled in particular by the property sector. However, recent action by the Chinese authorities to cool the housing market and prevent overheating has hit the construction sector. PMI data show that manufacturers of building supplies that use copper as a key input to their production process have already been affected, with output growth at Asian copper-using firms easing noticeably in April for the second month running since hitting a peak in February.

Output of copper-using manufacturers

PMI, Output, 50 = no change



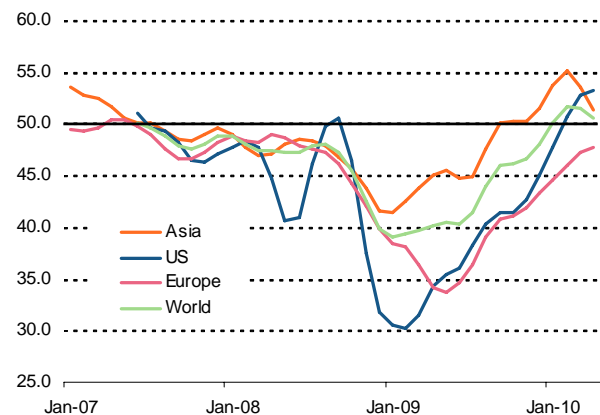
Source: Markit.

Although copper-users' output growth quickened further in April in Europe and the US, the Asian slowdown was enough to push world-wide expansion of output at copper-using firms down to its lowest in 2010 to date (albeit still at a historically marked pace).

PMI data show that these trends in output have affected copper-using firms' decisions regarding their input stock levels. Inventory building at Asian manufacturers peaked in February, and the subsequent easing has more than offset faster growth in the US and a slower rate of decline in Europe.

Stocks at copper-using manufacturers

PMI, Stocks of Purchases, 50 = no change



Source: Markit.

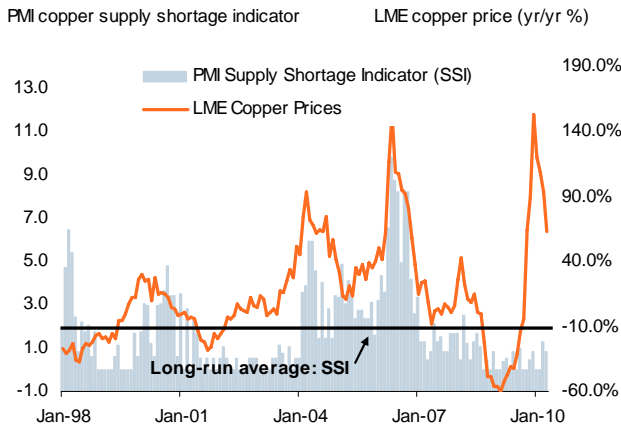
Low incidence of supply shortages

In Europe, fears over government debt and associated necessary fiscal tightening continue to weigh on investor sentiment and, consequently, commodity prices. This reversal of speculative support marks a contrast to the situation over much of the past year, when prices rose rapidly despite few signs of actual physical shortages.

This is highlighted by data from Markit's world-wide surveys of purchasing managers, which have signalled a very low proportion of firms reporting a lack of supply of copper during the latest rally, in contrast to previous

price spikes in 2004 and 2006 when rising prices appeared to have been much more closely associated with real supply issues.

Copper supply shortages



Source: Markit.

However, on the demand side of the equation, global growth fundamentals still appear strong. This is highlighted by the latest Global PMI data, which signalled that world-wide output growth accelerated to a 34-month high during April (see http://www.markit.com/assets/en/docs/commentary/markit-economics/2010/may/global%20economy_10_05_07.pdf)

If this improving trend is sustained and demand for raw materials strengthens accordingly, supply pressures could well emerge to justify prices which remain high from a historical perspective despite the recent fallback.

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