FINANCIAL TIMES

Wednesday February 04 2015

Bearish bets on copper begin to fade

Neil Hume, Commodities Editor

Are copper bears closing their bearish bets? That's the talk in the market place.

Open interest — the number of futures and options contracts outstanding — on the Shanghai Futures Exchange (SHFE) has fallen significantly in recent days, according to Standard Bank, including a 35,800 lot reduction on Tuesday.

It is currently 896,212 lots, down 6 per cent from the record level of 952,018 lots seen on January 30.

"After going aggressively short in the second week of January, and again in the last week of January, it now seems that the Chinese copper speculators are heading for the exit," says Standard Bank analyst Leon Westgate.

Copper slumped to a five-and-a-half-year low last month in the wake of the aggressive selling by a small coterie of Chinese funds. Groups said to be active in metals markets include Zhejiang Dunhe Investment and Shanghai Chaos Investment.

But since the price hit $5,427 on January 30 the price has rallied sharply as some of the short positions have been closed. On Wednesday morning, copper for delivery in three months on the London Metal Exchange stood at $5,647 a tonne.

Based on last month's trading activity, Mr Westgate believes the bulk of the initial Chinese short positions were put on at between Rmb42,000 ($6,722 at current exchange rate) and Rmb45,000. However, the biggest volumes were traded when the price was between Rmb40,000 and Rmb41,500.
"With current prices for the most liquid SHFE contract trading around Rmb40,400 a tonne . . . it looks as if the shorts haven't made as much profit as might have been expected," says Mr Westgate.

That could mean another flurry of short covering if prices continue to move. However, the real significance of the recent assault on copper by the Chinese funds is much wider.

It highlights the increasing power of Asian investors and their growing impact on global metals markets, where the price of everything from aluminium drinks cans to lead batteries is set.

JPMorgan calculates that open interest in copper on three main metal exchanges — LME, CME and SHFE — has risen from about 7m tonnes in 2006 to about 12.5m in 2014. But the share being traded on SHFE has risen from about 6 per cent in 2006 to roughly 26 per cent in 2014.

The bank says almost all of this rise in market share has come at the expense of the LME as the CME's share of copper open interest has stayed roughly flat at 13-14 per cent while the LME's has dropped from 82 per cent in 2006 to about 60 per cent last year.

However, these Chinese funds are not just trading large volumes on the mainland, they are also dealing in less liquid off hours trading on the LME and CME where their aggressive tactics can have an outsized impact on prices.

JPMorgan says a quarter of the average daily trading volume in the benchmark LME copper contract has happened before 8am in London — and before many City-based traders have got to their desks.

It is still not clear why the Chinese funds decided to aggressively short copper last month. Analysts say that many China-based investors are relatively more bearish on base metals prices than their European or American counterparts.

This probably reflects concerns about the health of the country's property market, which accounts for about 50 per cent of China's copper demand, and the crackdown on shadow banking practices. Anecdotal evidence suggests this has had an impact on traders' ability to import copper.

Both of the factors are often unappreciated by western investors who are confident average copper consumption patterns in China will continue.