**Nickel: Big rebounds still likely**

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**Market Outlook**

**Sentiment in the nickel market remains surprisingly weak given that prices are so far into the marginal cost curve and that there are some bullish signs developing. For example, Chinese refined nickel imports rose 22.5% in July to 47,472 tonnes and were up 168% on the year, so a shift in the dynamics of nickel supply is underway. We would have thought that even though nickel is a popular metal to be used in financial deals in China, the drop in NPI production is also likely to be contributing to the pick-up in imports and demand for refined metal. As such, we do feel changes are in progress, but consumers do not seem in any hurry to restock as LME inventories are plentiful and there are no large warrant holders. As is always the case with nickel, when prices are falling there tends to be destocking by stainless steel mills and stockists. But when prices rise, then the whole market is thrown into reverse with buying and restocking at the same time. So at some stage we expect that to happen again, but there is no sign of it yet. Indeed it may end up being triggered by short-covering in other metals, which looks most likely at the moment. If buying does start to emerge in nickel, then we would expect it to lead to some sharp moves that could be quite drawn out.**

**More producers under water, but still holding out**
Nickel prices continue to trend lower. The spike down to $9,100/tonne two weeks ago was quickly reversed, but after a brief period of consolidation around the $10,500/tonne level prices have headed south again, dropping back deep into the $9,000s again. This relentless weakness is surprising, given that round half of all nickel producers are now believed to be loss-making. But markets have a habit of overshooting and, although this must be causing considerable pain to so many, it seems as though they are prepared to ride it out. We feel – and those producers clinging on must agree – that prices down at these levels are unsustainable.

From a nickel-specific perspective, prices are under pressure now largely because stocks built up more than thought in recent years, especially in China, and after the Qingdao port scandal a lot of that metal turned up in LME warehouses, where banks would finance it again. The increased transparency this created has provided a large cushion against further tightness, while supply has been resilient and demand has disappointed. That said, the lower prices are likely to bring about a faster move towards supply deficit, as cutbacks should materialise in time.

**INSG data shows a small surplus in H1 2015**
The latest INSG data for June showed the market was in a supply surplus of 8,000 tonnes with production of 173,500 tonnes and consumption of 164,000 tonnes. In the first half of the year, the supply surplus was 31,000 tonnes, which was similar to the 33,000-tonne surplus in H1 2014. So far this year, refined supply and demand have not changed much, with production up 0.4% year-on-year at 983,100 tonnes and consumption up 0.6% at 951,600 tonnes. So the impact of Indonesia's ore export ban has still to be felt at the global level, but that is because of the extent stocks were built up before the ban, which had been well telegraphed.

Global mine production in H1 2015 dropped 3.3% to 1.040m tonnes, with Indonesia's output down 47.6% at 67,200 tonnes and down 84% on 2013's level on a pro-rata basis. Given this, we do still feel that nickel's bullish fundamental argument remains intact, albeit somewhat diluted. Also it has taken significantly longer for ore stockpiles to be drawn down and slower demand growth has also enabled the stockpiles to last longer. Ironically the stockpiles might last even longer now as more NPI production is shut down due to cost considerations rather than due to shortages of Indonesian ore.

**Vulnerable to short covering**
The cash to three-month spread is generally narrower at $24-33/tonne contango, although it has not narrowed much having averaged around $40/tonne so far in August. But with prices still falling, it does not look as though there has been much short-covering around yet. The market remains vulnerable to significant short-covering rallies, we think.

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