In a World Filled With Gluts, One Metal Is Suddenly Hard to Find

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Tucked away in the remote limestone plateaus of northern Australia, the owners of a massive zinc mine have begun preparing its transition back to cattle-grazing land.

For the miner, China's MMG Ltd., it's a problem because replacing the tapped-out mine -- which is responsible for 4 percent of the world's zinc output -- with a fresh source of the metal has proven elusive. For commodity investors who have grown accustomed to the emergence of supply gluts sparking selloffs in everything from copper to wheat, it's a boon.

Zinc, unlike those other raw materials, is rebounding, having posted an 8 percent gain over the past three weeks that stemmed an eight-month slide.

That's largely because the fate of MMG's mine highlights a growing new trend in the zinc market. From Africa to Ireland, mines that have produced the metal for decades are now tapped out. Morgan Stanley estimates that by 2017 more than 1.2 million metric tons of annual mined supply will be taken out of production. That's more than the U.S. uses in an entire year.

"It's all about supply," Clive Burstow, a London-based investment manager at Baring Asset Management, which oversees $44 billion, said in a telephone interview. "It's simply that the big mines are coming off stream this year, and there's no big supply to replace it. So, we're naturally moving into an increasing deficit market."

Tighter supplies are prompting banks including BNP Paribas SA and Goldman Sachs Group Inc. to forecast higher prices for the metal that's used in steel auto parts, brass plumbing fixtures and sunscreen. Demand exceeded output by the most in nine years in 2014 and the deficit will almost double next year, according to data from the International Lead & Zinc Study Group and Bloomberg Intelligence.

Price Gains

The recent rally in zinc left prices up 7.5 percent over the past 12 months on the London Metal Exchange, to $2,174 a ton. That's the only gain among the six main metals traded on the LME. The Bloomberg Industrial Metals Subindex slumped 15 percent the nine months through March, and fell 9.3 percent in the past year as the Bloomberg Commodity Index of 22 raw materials tumbled 27 percent.

Prices will rise as high as $2,397 by year end, according to the average estimate in a Bloomberg survey of nine traders and analysts. Goldman forecast $2,500 in 12 months, and BNP Paribas predicted an average of $2,850 in 2016.

The world's refined-zinc supply fell short of demand by 310,000 tons last year, the most since 2005, International Lead & Zinc Study Group data show. The gap could expand to 1.98 million tons by 2017, Bloomberg Intelligence analysts Kenneth Hoffman and Sean Gilmartin said in a report last month.

Fewer Deposits

The supply lag comes after a decade-long boom for metals demand in China, the world's top consumer, spurred miners to dig ore out of the ground as quickly as possible. At the same time, rising costs and a lack of untapped big deposits meant that producers had a hard time bringing on replacement supplies as consumption increased.

MMG, the Hong Kong-listed unit of China's biggest state-owned metals trader, plans to close the Century mine in Australia by midyear and has failed to identify a replacement.

"We can't find any more zinc of significance, which tells us even more that it's going to be tight," Andrew Michelmore, MMG's chief executive officer, said in a March 10 interview on Bloomberg Television. "We're very bullish on zinc."

It's so hard to find new mines that producers are being driven to increasingly remote locations. Ironbark Zinc Ltd., an Australian explorer backed by Glencore Plc and Nyrstar NV, is exploring a deposit near an inlet on northern Greenland, a coastal area of icebergs and polar bears, that may contain 13 billion pounds (5.9 million tons) of lead and zinc.

China Demand

Even as mines shut, slowing growth in China threatens demand and a stronger dollar curbs the appeal of commodities as alternative investments, said Bart Melek, the head of commodity strategy at TD Securities Inc.

More than half of global supplies are used to galvanize steel, Morgan Stanley estimates. China accounted for 51 percent of the world's crude-steel production in February, according to the latest data from the World Steel Association. China steel producers estimate their output will contract this year after consumption peaked and more mills are shut.

"We have some concerns about demand, and we've seen a lot less restocking than we'd normally get this time of year," Melek said by telephone from Toronto. "There's concern that China's steel output will be lower because of a glut of steel, and that means you're going to use less galvanized product, which means less zinc."

Exploration Budgets

China's economy is still growing. The country will use about 6.9 million tons in 2015, Morgan

Stanley analysts Tom Price and Joel Crane said in March 24 report. That's the most since at least 2007.

Even with the rally in prices over the past year, zinc is more than 50 percent below its record in 2006, which has discouraged spending on new mines.

"Current prices don't allow us to develop the projects that we have," said David Gleit, head of investor relations for Lima-based Volcan Cia. Minera SAA, the biggest Latin American producer.

Stockpiles monitored by the LME tumbled 26 percent in the first quarter, the biggest loss since 2007. In addition to the Century closing, Vedanta Resources Plc plans to shut its Lisheen mine in Ireland, cutting supply by 175,000 tons, Bloomberg Intelligence estimates.

"The amount of new mines coming on stream to replace these mines ending their life -- the number and amount produced -- is relatively limited," Stephen Briggs, a senior strategist at BNP Paribas, said in a telephone interview.