Dr. Copper gives troubling prognosis for China's economy

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Price of metal has flattened out despite some stronger Chinese data

TOKYO/BEIJING -- While recent economic data has brought a ray of hope into the otherwise gloomy Chinese economy, one closely followed indicator is tempering expectations of a vigorous rebound in the world's second-largest economy.

China's manufacturing sector unexpectedly rebounded in March, according to the government's purchasing managers index (PMI), but copper prices, often viewed as an early indicator of China's economic health, are struggling to perk up.

Since copper is used in a wide range of industries, the commodity is called Dr. Copper for being a reliable prognosticator of where the world economy is heading. Many market players closely watch copper prices as a good gauge of the economic outlook in China. The country accounted for about half the 23.46 million tons of copper consumed worldwide in 2017, up from just 25% a decade earlier.

The fact that copper prices remain soft despite some strong economic data from Beijing points to structural problems that are threatening to choke China's future growth, not least among them a mountain of debt.

On March 28, Chinese Premier Li Keqiang spoke in an upbeat tone about the "steadiness" of the nation's economy. While meeting with foreign and Chinese executives at the Boao forum in the southern island province of Hainan, Li stressed that the "steadiness" in the economy in the first three months of this year had "exceeded our expectations."

China's economy started slowing down sharply in the second half of 2018. But Chinese policymakers are beginning to regain confidence in their economic management.

The PMI for March, announced on March 31 by the National Bureau of Statistics, rose 1.3 points from the previous month to 50.5, climbing above the neutral 50-mark dividing expansion from contraction for the first time in five months.

Dr. Copper actually anticipated the manufacturing sector's return to growth three months ago. Copper futures on the London Metal Exchange, the global benchmark for the market, took a turn upward in early January and had climbed more than 10% by the end of February.

The rise followed the annual Central Economic Work Conference, which was held in December in Beijing and proposed a fresh package of economic stimulus featuring hefty tax cuts and massive infrastructure investment.

In response to the announcement of the measures to stoke economic growth, Chinese government contractors started purchasing such items as power transmission wires and construction materials, pushing up copper prices.

True to its reputation as a reliable leading indicator of economic health, the base metal's value rose ahead of the bounce in China's manufacturing sector. Rubber, which plays a similar role due to its use in tires, also picked up.

But copper prices have flattened out in recent weeks. Copper has been under selling pressure since the beginning of March and has yet to rise above the latest high logged at the end of February despite a spike following the PMI announcement.

The weakness of the copper market probably reflects the deterioration of China's economy.

China has piled on debt to finance a series of fiscal stimulus packages that have been implemented to shore up the economy since the global recession triggered by the 2008 collapse of U.S. investment bank Lehman Brothers.

China's debt-to-gross-domestic-product ratio surged 110 percentage points in 10 years to over 250% in 2018, according to the Bank for International Settlements.The corporate sector accounted for 55 points of the rise, with companies responsible for executing the government's infrastructure plans -- such as state-owned enterprises and local-government financing vehicles -- becoming paralyzed by their debt burdens.

"The Chinese government does not want to and cannot afford to give fiscal and monetary largesse," says Guang Qingyou, president of the Rushi Advanced Institute of Finance.

When it cobbled together the epic 4 trillion yuan ($600 billion at current rates) economic stimulus plan in 2008, helping pull the world economy out of recession, Beijing was far more willing to go on a spending spree to keep the nation's economy rolling.

Public and private investment in fixed assets soared 30% in 2009, giving a sizable boost to global economic growth.

And while measures such as industrial output showed a recovery in March 2009, copper and rubber bottomed out months beforehand, in December 2008. Copper prices responded vigorously to Beijing's debt-financed spending binge by skyrocketing 220% in the two or so years after hitting bottom.

As part of its latest policy efforts to rev up the economy, Beijing has unveiled a 2 trillion yuan tax cut package. But the tax stimulus will be partly financed by spending cuts, which means the real economic impact will not be as powerful as it seems. The comparatively smaller bounce in copper prices reflects that.

"The stimulus this time around is only big enough to limit the slump," said Naohiro Niimura, a commodities expert at Market Risk Advisory in Tokyo.

China's economy is being battered by its trade war with the U.S., which is driving away plants at a time when the nation's demographic decline is beginning to take a toll on its economic strength.

Dr. Copper's melancholic behavior may be a warning that China can no longer serve as the powerful driver of global economic growth it once was.