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The Carlyle Compass

By Jeff Currie

April 8, 2025

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*Welcome back to **The Carlyle Compass**, your weekly newsletter that brings together the latest research and market insights from our global team. This week's edition features guest author Jeff Currie, Chief Strategy Officer of Energy Pathways at Carlyle. Received this email as a forward? Subscribe here.*

The international system built by the U.S. in the aftermath of the Second World War is coming to an end. The security, financial, and trade institutions that were underwritten by the U.S. are being dismantled, not least because some in the U.S. no longer see the benefits of free-flowing trade and capital while the financial and military burdens have become ever more apparent. In our recent piece, The New Joule Order, we explored how achieving energy independence has allowed the U.S. to step back from many of these commitments, particularly with respect to traded energy – that is, crude oil.

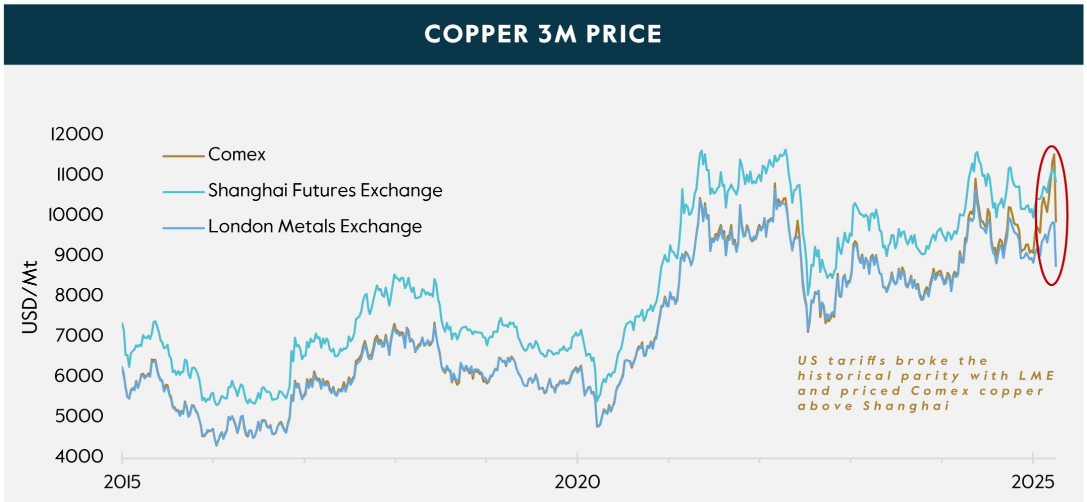
The U.S. announced a broad range of tariffs last week which have all but upended the trade regime sponsored by the U.S. with the GATT from 1948. Launched in the ashes of the Second World War, the idea was that the various quotas and barriers of the pre-war era would all be replaced by tariffs, that these tariffs would be harmonized, that they would be reduced over successive rounds of negotiations, and that disputes would be discussed and adjudicated. And it worked. There was wide prosperity in the West, especially in the U.S., and eventually the East joined the system as well. All this time there had been lingering imbalances and strains, but when the system went from Western to Global, it began to buckle.

All these components – from the trade deficit and the financing of the U.S. debt to the flow of energy and the network of military alliances around the world – are connected, in complex ways. Simple and abrupt solutions to a problem in one are guaranteed to result only in unintended consequences in other areas. This is particularly true for trade.

Copper provides a perfect microeconomic window onto how tariffs and tariff uncertainty can roil both the markets and the real economy. It is a fungible commodity, freely traded, and with futures markets segmented by regions. This means that we can see in real-time how a tariff would be expected to be priced into the market, particularly with the on-again/off-again uncertainty.

Just the expectation of a tariff was enough to push the cost of copper in the U.S. above that in China. All else equal, tariffs swiftly made it more expensive to consume copper in the U.S. relative to China – and that has been a political, not an economic, decision (Figure 1).

Figure 1: Tariff Threats Made US Copper More Expensive than Chinese



Source: Carlyle Analysis; Bloomberg, March 2025. There is no guarantee any trends will continue.

Thus, when the U.S. announced a broad range of tariffs last week, it was all the more interesting that copper was excluded. There still may be a copper tariff to come as the U.S. pursues Section 232 investigations, but for the time being at least copper is exempt.

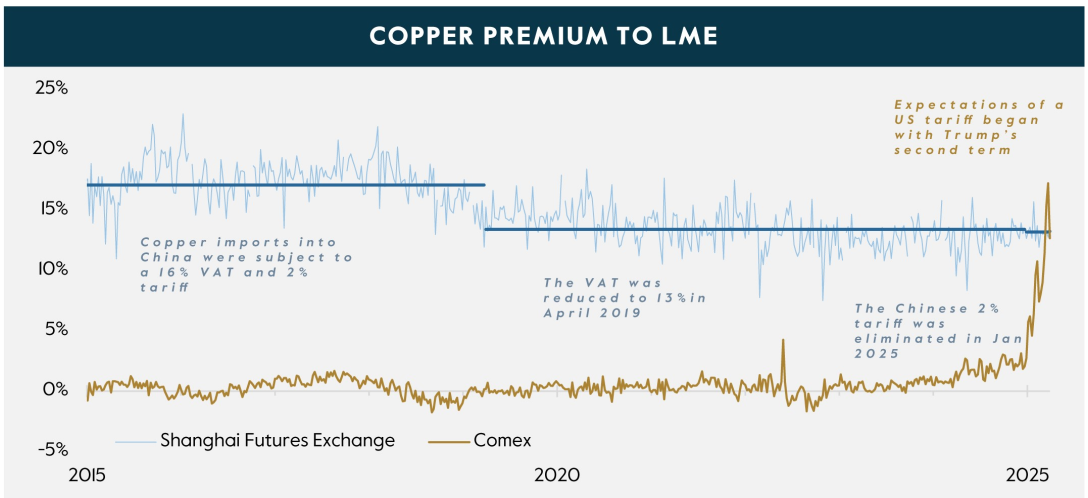
This no doubt came as a surprise to the copper market, which saw a large shift in relative prices over the past several months as traders moved metal to the U.S. in order to pre-empt an anticipated tariff. The unwind of this trade has already been swift, and no doubt painful.

Tariffs on U.S. copper imports would likely result in a straight pass through to the price of all copper consumed in the U.S. – not just imports. This would be consistent with the Chinese experience with tax differentials on copper imports and with what the copper market is telling us. The potential benefit from an increase in U.S. production is likely to be years down the road, as profitability isn't necessarily the most pressing constraint. The hit to consumers is already here.

For decades, Comex and LME copper have traded at parity, plus or minus two percent. U.S. copper imports were duty-free, so delivery into the Comex warehouses (all of which are in the U.S.) represented a clean U.S. price to balance supply and demand. By contrast, LME warehouses are generally located in free trade zones around the world and thus reflect a global price. Thus, the arbitrage between the two has been constrained only by the cost of moving metal out of one warehouse and into another, and as a result the futures markets have been able to converge and provide a reliable and tradable copper benchmark both globally and regionally.

Over the past few months, the spread between Comex (i.e. the U.S.) and the LME (i.e. much of the rest of the world) widened sharply to unprecedented levels and rose at one point to 17% (Figure 2). This reflects the expectation of a 25% tariff, with some discount for the risk that the tariff wouldn't happen. When the final question of the tariff level does get settled, we should expect the Comex/LME differential to closely approximate whatever level it is set at. If it didn't, then traders would be able to make a riskless profit by simply selling the LME, buying the Comex, and moving and swapping the metal as necessary.

Figure 2: Copper Premium to LME is a Function of Taxes



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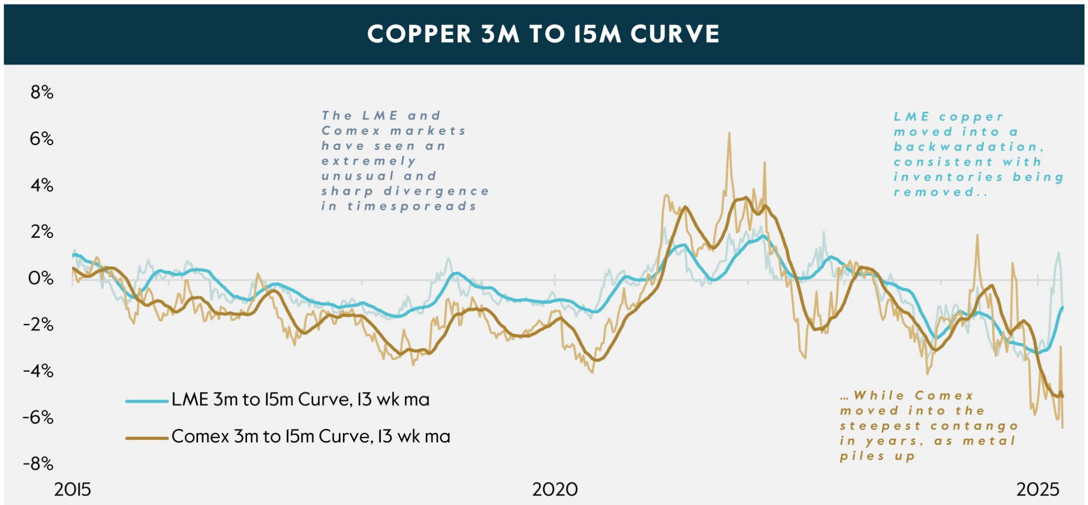
The LME does not currently have warehouses in mainland China, though the approval of Hong Kong warehouses was announced on January 20, 2025. Copper deliverable into China has historically been subject to VAT and a tariff. Up until April 2019, this was 16% for VAT plus a 2% tariff, after which the VAT fell to 13%. The tariff was eliminated at the beginning of 2025. Unsurprisingly, the Shanghai Futures Exchange, which is a domestic deliverable, like Comex is for the U.S., has had an average premium of 17% against the LME until April 2019, and since averaged 13.5%, falling a bit further since the start of this year. In other words, the premium for metal in China (SHFE) versus the rest of the world (LME) has tracked the tax wedge (VAT, tariffs).

The anticipated tariff showed up as an extreme divergence in the timespreads on LME and Comex (Figure 3). The LME saw the curve tighten sharply, consistent with shipments out of the LME system and into the U.S. Conversely, the U.S. curve moved into a deep contango, reflective of speculative stockpiling ahead of a tariff. Once the tariff is in place, these flows should cease. In the U.S., the excess inventory would likely then be drawn down, while in the LME system inventory would be rebuilt. The two timespreads would likely re-converge, even though the flat price wouldn't, and the tariff wedge would likely make the spreads less correlated in the future.

Figure 3: Copper Timespreads Show Tight LME, Loose Comex



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So, what are the likely economic implications of a copper tariff that drives a spread between Comex and LME? For consumers, it will be higher *relative* copper prices – and *not* just for the copper that is imported, but for *all* copper consumed in the U.S. Because copper is a fungible commodity that can be easily arbitraged, copper melted in the U.S. is typically priced as a spread to Comex – the cheapest-to-deliver liquid benchmark. As the market clearing price is set by the last pound on the Comex that balances supply and demand on the exchange, this will be in an arbitrage relationship that equals LME plus tariff.

While a higher market price for all copper sold in the U.S. means higher costs for *all* copper consumers located in the U.S., it also means higher returns for *all* copper producers located in the U.S. (and thus behind the tariff wall). If a producer was already profitable before the tariff, then after the tariff they will simply be *more* profitable (at the expense, of course, of the consumer). The behavior among owners of existing mines is unlikely to change, apart from booking larger profits.

Some marginal producers in the U.S. will become profitable, which is why a tariff is likely to result in higher U.S. production – someday. It seems that this is a main goal for the tariffs. But that day may be far away, and the marginal producer that then becomes economic will, by definition, be a higher cost producer. This may very well be an optimal strategy from a resource nationalism perspective, but the economic costs are clear. Whether they are worth paying is a political decision.

There are a number of copper projects in the U.S. that are financially viable but have been delayed or blocked for various reasons. For many of these it isn't about the price, it is about the legal, environmental or regulatory constraints. Changing the profit margin for these projects won't make those obstacles go away, and making the obstacles go away won't be a function of tariffs. Of course, whether the non-economic obstacles to copper projects in the U.S. should be removed is a political decision.

In any event, copper mines and smelters take time to build, even if we were to assume a relatively unfettered legal and regulatory environment. In the meantime, consumers of copper in the U.S. will be bearing the burden of this higher price - probably for many years. This might make some manufacturing or infrastructure projects less profitable, and perhaps even unviable. Once again, this may be a worthwhile trade-off, but that is a political decision.

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