Is the Outlook for Teck Resources Ltd. (TSX:TECK.B) Deteriorating?

Description

After a promising rally at the start of 2017 which saw copper gradually move higher the red metal — generally seen as an indicator of global economic health — copper has weakened significantly in recent days. It has fallen to a one-year low over fears that the emerging trade war between the U.S. and China is about to escalate significantly, as rhetoric between the two nations heats up.

The threat of a trade war couldn't come at a worse time for a global economy facing additional threats, including higher energy costs, rising interest rates, and an already cooling Chinese economy. Then there is the threat of another financial crisis in Europe because of Italy's weak banking system; it's weighed down by a significantly high volume of non-performing loans, which could tip the Eurozone's third-largest economy into crisis.

There are fears that copper and other metals prices will fall further because of growing uncertainty. This certainly isn't good news for metals miners, including Canada's fifth-largest miner **Teck Resources Ltd.** (TSX:TECK.B)(NYSE:TECK).

Now what?

A full-blown trade war is a significant threat to Teck, because not only is it dependent on mining metals such as copper and zinc, which are responsible for 41% of its gross profit, but the remaining 59% is generated by steel-making coal. China, which is the Trump administration's key target, is the world's single largest consumer of steel-making coal, copper, and zinc.

The size and scale of China's manufacturing sector is tremendous. It has been called the workshop of the world, because it is responsible, according *The Economist*, for producing around half of the world's goods. That makes unfettered access to export markets particularly important for Beijing. This is because it lacks sufficient domestic capacity to consume all of the goods produced domestically, and manufacturing is responsible for 40% of the country's gross domestic product (GDP).

Economists are predicting that a full-blown trade war would clip up to 1% off China's GDP growth rate, which would have a marked impact on the consumption of steel, copper, zinc, nickel, and lead. For these reasons, Teck's stock has been roughly handled by the market over the last month, shedding 9%.

Analysts are anticipating that the collapse in base metals prices will be a short-term phenomenon, and that they will recover moving higher over the long term. There are also signs that the trade war will not be as severe as the market is anticipating.

You only need to turn to oil to understand the potential of Trump eventually moderating his position. After taking a particularly hard line on Iran, Trump has started to moderate his position, offering to provide sanction waivers for countries that wish to continue importing Iranian crude.

There is an even greater likelihood of him softening his trade policy, because the damage that a trade war would wreak is not limited to China. The damage to the U.S. economy would be significant. Investment bank Macquarie believes that unemployment could double from current levels and that the U.S. would enter recession in 2019. Clearly, that is contrary to the president's plan to boost U.S. economic growth and reinvigorate domestic industry.

So what?

For these reasons, the dip in Teck's share price could be temporary, and that has created an opportunity for investors seeking exposure to metals.

Furthermore, higher oil prices combined with the ramping up of production at the Fort Hills oil sands, in which Teck owns a 21% stake, will help to offset the financial impact of weaker metals prices. The miner's solid balance sheet and focus on cost reduction has also given it greater financial flexibility to manage the threats emerging in the global economy. This means that investors should not panic and possibly even consider the latest dip to be a buying opportunity.

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