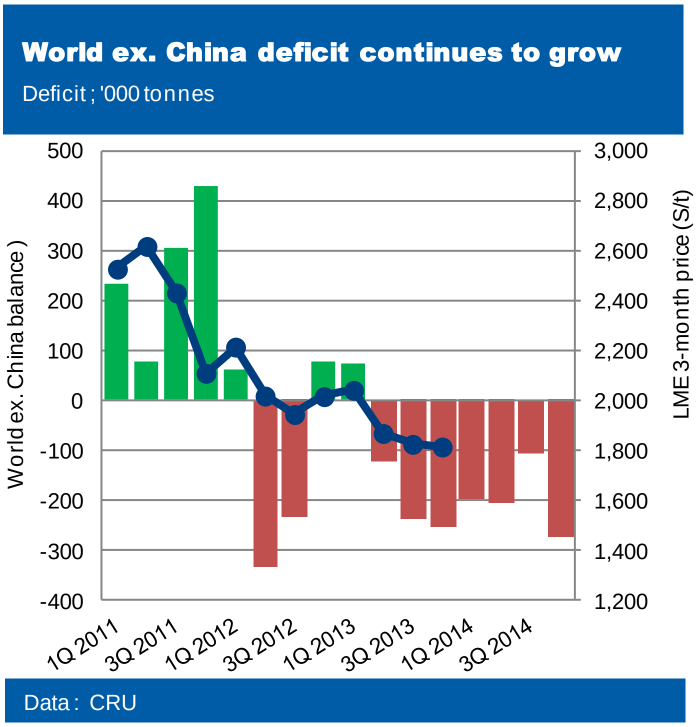
Aluminium: Feast or famine? By Paul Williams, CRU

It was Charles Dickens who wrote in his novel A Tale of Two Cities "it was the best of times, it was the worst of times", and that quote pretty much sums up the state of the aluminium industry at the moment. On the one hand LME prices continue to languish around $1750/t, close to a 4-year low, as the huge stock overhang, coupled with continued over-production in China weighs heavily on the market. On the other hand, ingot premiums reached new heights in mid-January, with the US Midwest premium increasing as much as 6 ¢/lb in just a couple of days, as physical market tightness, together with a shortage of scrap, and further rises in cancelled warrants and queues at Detroit, led to a scramble for metal.

The dichotomy in the LME price and ingot premium is a clear reflection of the massive stock overhang that exists, but which is largely tied up in financing deals and in warehouse queues. 2014 will be a year where, outside of China, the deficit in the market will continue to grow, as supply growth will be kept in check, but in China the surpluses will continue to mount as new capacity in the northwest of the country continues to ramp up.

Thus while prices on the LME will improve, the rise in prices will be kept in check by the weak state of the Chinese market. New LME rules on warehousing and length of queues will bring down regional premiums from their current zenith, but premium levels will be held up by the fact that physical markets will remain tight, especially as the metal deficit will rise in the key North American and European markets.

There is perhaps one curve ball that could be thrown at the aluminium market this year and that is the Indonesian ban on bauxite exports that kicked in on 12th January. We don't think this will significantly impact the growth in the Chinese smelting industry, but if the Indonesian government is true to its word, then the Chinese will be short of bauxite by the second half of this year.



CRU estimates that the world excluding China recorded a market deficit of just over 500,000 tonnes in 2013, which is the largest deficit recorded since 2006 and follows on from a small deficit in 2012. The deficits are a direct result of production curtailments, brought about by the weak metal price. However, world inventory days remained elevated as the Chinese market surplus came in at around 500,000 tonnes in 2013. In 2014, we forecast the deficit in the world excluding China will rise to 725,000 tonnes, and we expect deficits to persist in the world ex. China market for the next few years. In China, however, the market is expected to remain in surplus as new capacity outpaces consumption growth.

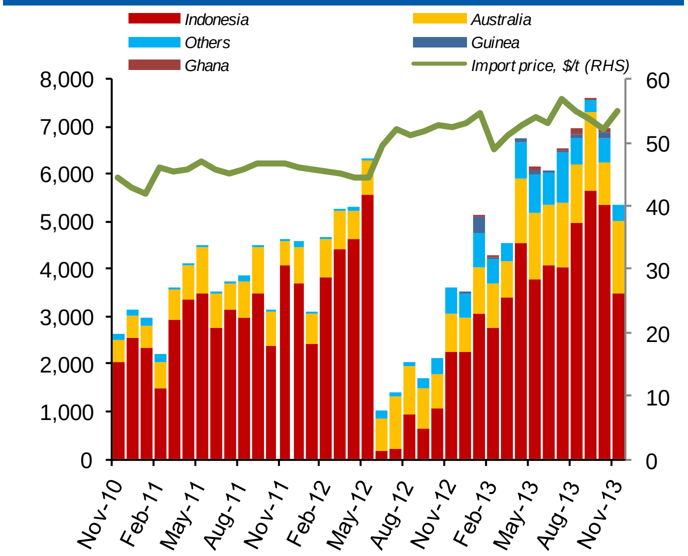
The subdued LME aluminium price has led to mounting pressure on aluminium producers. In the past quarter the Delfzijl smelter, in the Netherlands, ceased production and BHP Billiton has begun consultations to close its Bayside smelter in South Africa. In addition, Alcoa has announced the curtailment of Massena East and shelved the decision until 2015 on whether to modernise the plant. CRU expects that low LME prices will force additional closures in the world ex. China in H1 2014. In Q4 2013, the SHFE aluminium cash price recorded its first q-o-q rise in ten quarters, with a meagre RMB9/t increase. However, the SHFE cash price has declined sharply in the past month and is now RMB1,000/t below its October 2013 high, signalling the need for production cuts in China.

Consumption growth in the world excluding China has continued to gather momentum, buoyed by a recovery in the developed economies in Europe and North America. CRU estimates aluminium consumption in the world ex. China increased by 1% in 2013, with a marked improvement in Q4 of 2.3% y-o-y growth. We forecast that consumption will grow by around 3% in 2014 outside of China. The key driver of demand growth in 2014 and for the foreseeable future will be the transport sector. This is a reflection of both the growth in build rates in emerging markets, the recovery in build rates in developed markets, but also significantly the growth in intensity of use of aluminium in auto body sheet. The new Ford F-150 which will come into production this year will be a major milestone for aluminium and its penetration of auto body sheet into mass volume vehicles. We see significant growth in auto body sheet in both the US and European markets over the next five years, both of heat treated 6xxx series sheets (for outer panels) and 5xxx series sheets (for inner panels). Meanwhile in China, consumption growth was firm in 2013, but insufficient to balance the market. In 2014, we anticipate Chinese demand growth will slow moderately to 9.2% from 10.5% in 2013.

Given where LME prices are starting from, we expect the annual average price will fall in 2014 relative to 2013, when they averaged $1877/t. Prices will remain depressed in H1 2014 but should recover moderately through the remainder of the year. Could prices spike higher? In our opinion it is unlikely unless the market view on China changes dramatically – and this is where Indonesia could be a game changer.

China's reliance on Indonesian bauxite remains high

Chinese monthly bauxite imports; '000 tonnes



Data: GTIS

Since China started importing bauxite in 2005, about three-quarters of these imports have come from Indonesia. Refineries in Shandong are the main importers and in anticipation of the bauxite ban have built up stocks of over six months. Thus China's import based alumina refining capacity appears confident that it can ride out the storm as it did in 2012, when a temporary ban was imposed in that year. CRU's view is that some bauxite exports will be allowed later in 2014, but if the ban remains in force and is effective, China will face shortages by the end of 2014.

While China is looking to diversify supply and import more from Australia and Guinea in the medium-longer term, a bauxite shortage in the very short-term is unlikely to be filled very easily. As noted, we believe that some exports from Indonesia will resume, but stricter controls could be maintained if the country is serious in bringing in investment into its aluminium sector, while at the least, further export tariffs will be imposed. Eyes should be kept firmly focussed on Indonesia as any indication that the ban is being prolonged and is effective could see the Chinese alumina and smelting sectors start to tighten with obvious implications for metal prices.