

Aluminium: Current Drivers and Future Outlook

Carl Firman

Research director

Wood Mackenzie Ltd, Guildford, United Kingdom

carl.firman@woodmac.com

China's environmental initiatives, US trade policy and sanctions, and raw material constraints – are set to dominate the outlook for aluminium.

A decade of oversupply, brought about by rampant capacity build in China, finally looks to be over. Meanwhile market fundamentals are considerably healthier than this time last year. However, the risk of a lower economic activity due to trade conflict could spoil the fundamental support for aluminium prices.

Trade policies – in particular, US tariffs – are already affecting trade flows and creating winners and losers in the aluminium space. While US primary producers have benefitted from higher premia and are responding with capacity restarts, these represent only a small proportion of US primary metal requirements. US semi-fabricators and consumers, on the other hand, have been squeezed with the former suffering higher raw material costs.

Of equal importance have been the US sanctions affecting UC Rusal, which have impacted the global supply chain and triggered uncertainty. Last April, when tariffs and sanctions kicked in, the LME aluminium cash price rocketed from US\$2,000/t to US\$2,600/t. However, it lost most of the gains as a result of a broad-based sell-off in the LME. Wider trade tensions between the US and China threaten to slow down the global economy and negatively affect demand for commodities.

Elsewhere, environmental policies in China are changing the supply and cost landscape for aluminium. For domestic smelters and refineries, the result is lower production and higher costs of raw materials. In fact, all the key inputs for primary aluminium production are now subject to restrictions because the Chinese government has also targeted integrated coal-fired electricity generators.

More than 70% of aluminium production in China operates with dedicated coal-fired power plants so there is a risk that those producers will lose their cost advantage, creating a higher marginal cost support for prices. China's environmental policies are here to stay. However, the Chinese government is not going to allow a breakdown in the aluminium sector. There may be a need to support Chinese producers to navigate the current trade conflict, which could mean a lenient approach during the coming winter cuts.

This year, one of the greatest disruptors to the aluminium market has been to alumina. Earlier in the year, the Brazilian authorities ordered the world's largest alumina plant to close half of its capacity based on alleged environmental damage. This disruption, not surprisingly, caused significant reaction (similar to the Gramercy refinery's unscheduled outage in 1999) that led to alumina prices more than doubling. In a further twist, in early October the refinery stated it would suspended the remaining operational capacity due to technical capacity issues with waste storage. The refinery was later granted exceptional authorisation to use its new press filter technology and ease the waste capacity issue. A full resolution to reinstate all production is subject to judicial and political process.

The fate of the aluminium market today is beholden to US and Chinese policies, and their impact on industry dynamics, global economic activity and consumer confidence. What will matter is the level of tariffs applied to aluminium products by the US and the rigour or leniency with which the Chinese authorities implement environmental policies and capacity controls.

In the longer term, we see a need for development of alumina and primary aluminium capacity in the world (ex-China). The question is where? No longer do we see China supporting global demand through rampant capacity growth of primary metal, but a world in which consumer countries must begin to provide for themselves. So too do we see structural constraints in China's internal bauxite resources necessitating a breakout from domestic alumina capacity development to one more inclusive of resource-rich bauxite producing countries.

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