

Aluminium: Over to China to fill the void

Aluminium prices are up 11% since news that Rusal will be included in the US sanctions list. It's now up to Chinese flows to fill a deepening deficit beyond its borders and curb the LME rally. Keep an eye on the following to navigate the volatility



Source: Shutterstock

1 Rusal sanctions extend beyond the US

On 6 March, the US placed Rusal under sanctions. A temporary license allows existing agreements to be wound down until June 5th. While only explicitly forbidding US entities from dealing with sanctioned parties a non-US entity can be penalised too, and that can vary from denying visas to freezing USD credit lines.

We think this is much more than just a US issue, consumers are worried globally about taking Rusal material especially multinationals with exposure to the US. Rusal produced 13% of aluminium outside of China last year, so the repercussions are serious.

2 Aluminium was already poised to turn

The pace of the rally should be placed in context as LME prices were already looking heavily oversold and ready to jump.

With the LME price now breaching below \$2,000/mt, we **highlighted** before the sanctions were announced, that because prices had fallen less on Shanghai, a closed arbitrage for Chinese semi exports would soon see ex-China markets tighten and prices were likely to recover. With Chinese margins averaging zero, a Shanghai and incremental LME uplift seemed inevitable.

3 Ex-China deficits get tighter, it will be up to China to fill the void

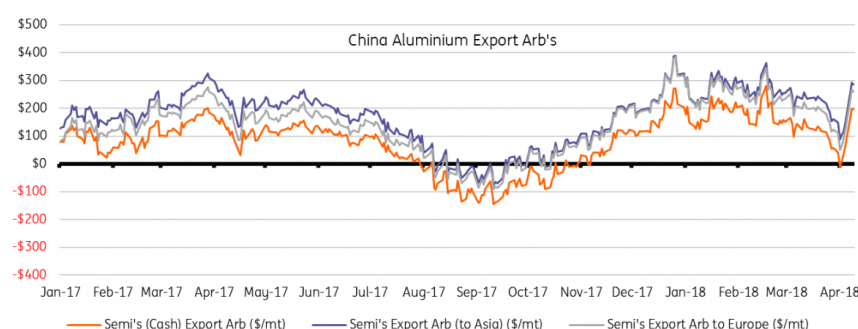
Even before Rusal sanctions, we were **bullish aluminium** expecting \$2,300 by second-half of 2019 because of deepening deficits outside of China which is the main domain of LME prices.

We already had a 1.75Mt 2018 shortage with generous assumptions for US smelters to restart. In a perfect storm, Hydro's recently announced 230kt loss at Albras increases shortage to 2Mt. The more Rusal supply exempt from consumption (3.7MT in total) then deficits both global and Ex-China get astronomical, but we suspect customers will yet appear (at a discount).

The last thing China needs is more aluminium units, but those companies have least to lose from US penalties, and if Rusal can stomach the discount we would expect units to flow here. China could, in turn, boost semi and even primary aluminium exports to ease the rest of world shortage as we explain further below. Chinese capacity utilisation was only 80% last year if higher prices can incentivise an additional 10%, which alone can add 3.6Mt of supply although doing so faces challenges from environmental controls.

Turning profitable for Chinese semi's exports

(\$/mt)



Source: SHFE, LME, Harbor, ING Research

4 The US looks tightest, but rest-of-world premiums should also rise

Russia provided almost 20% of US unwrought aluminium imports last year, so just as US premiums were starting to retreat on section 232 exemptions, the latest scramble by consumers has pushed the front month on CME above 20c/lb. Even the forwards think this has overrun with the curve in backwardation, but 2019 is still a hefty 19.75c/lb.

Since Russia was not 232-exempt, we were expecting Rusal imports to be increasingly displaced by those exempted including Canada, Australia and EU but it will now get even more competitive to source.

High premiums play to our original bullish stance of discouraging LME metal to appear on warrant and escalating the trend of sharp backwardations as explained in our [2018 Aluminium outlook](#). Section 232 and 301, will keep the US looped out from any Chinese export relief supporting the high premiums. Europe and MJP premiums expected to play catch up with the US in near term.

5 LME suspending Rusal brands

After April 17th only material produced before the imposition of sanctions, which was 6 April can be delivered on to the exchange and only if it doesn't involve sanctioned parties. This is a U-turn from the announcement on Friday that the Bourse had no immediate plans to change its requirements.

We had previously cautioned that Rusal deliverability would render premiums more exposed than LME prices, but now its game on for all (ex-China) price benchmarks with Rusal supply excluded. Comex also suspended Rusal, but it remains deliverable on Shanghai.

6 Existing stocks

LME warehouses can still put pre-sanction produced metal on to warrant after April but to avoid challenges, the next few days could see a rush of material. Best estimates circulating suggest Rusal might represent 25% of off-warrant stocks which we believe are around 4MT ex-China. The LME published that already 36% of LME stock are of Eastern European origin, so mostly Rusal.

Meanwhile, just 18kt of LME stock cancelled at Port Klang shows a surprisingly mild run on the non-Rusal stockpiles. Should Rusal stocks continue to dominate, we could see a divergence between premiums and LME back on the cards.

7 Spreads flip

As aluminium surged on Monday, the LME Cash-3M flipped from a contango of \$20.50c to a backwardation of \$16b. Anticipated tightness amid the loss of 13% of ex-China production resulted in a big shuffle of short positions with the resulting squeeze escalating the outright rally.

As Rusal (pre-sanction) stock is delivered, we still expect many consumers to shun those brands. Should this result in, those warrants being churned through clearing rather than financed this could indeed loosen spreads.

We have always emphasised that for Aluminium the curve matters more than it does in any market. If the spreads do indeed ease this will pose near-term resistance for the rally. On the other hand, as the deficits pull on off-warrant metal, the curve will need to tighten to incentivise the unwinding of stocks in financing.

8 Chinese exports: watch the arbs!

As we mentioned above, (point 2) the closed semi's export arb was a sign, markets had oversold, but now the export incentive has rebounded to previous January and February highs.

The growing shortage outside of China will incentivise LME to trade at a growing premium to Shanghai to incentivise exports. Should this differential surpass the 15% export tax, China could even begin to export primary metal.

Should Rusal metal indeed make its way into China then the local SHFE benchmark could depress enough to make this profitable. The flow of Chinese material to fill the rest of world shortage will provide the fundamental ceiling to this rally. We estimate that given average Chinese smelting costs the LME price must trade at above \$2,200 for a Chinese smelter to produce and export at a positive margin.

Author

Amrita Naik Nimbalkar

Junior Economist, Global Macro

amrita.naik.nimbalkar@ing.com

Mateusz Sutowicz

Senior Economist, Poland

mateusz.sutowicz@ing.pl

Alissa Lefebvre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@asia.ing.com

Michiel Tukker

Senior European Rates Strategist

michieltukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Sector Economist, TMT & Healthcare

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@asia.ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials

Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Senior Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Senior Editor and Supervisory Analyst

rebecca.byrne@ing.com

Mirjam Bani

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)

mirjam.bani@ing.com

Timothy Rahill

Credit Strategist

timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland

leszek.kasek@ing.pl

Oleksiy Soroka, CFA

Senior High Yield Credit Strategist

oleksiy.soroka@ing.com

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research

jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare

edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist

jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst

egor.fedorov@ing.com

Sebastian Franke

Consumer Economist

sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy

gerben.hieminga@ing.com

Nadège Tillier

Head of Corporates Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist

+31(0)611172684

laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Piotr Poplawski

Senior Economist, Poland

piotr.poplawski@ing.pl

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research

marieke.blom@ing.com

Raoul Leering

Senior Macro Economist

raoul.leering@ing.com

Maarten Leen

Head of Global IFRS9 ME Scenarios

maarten.leen@ing.com

Maureen Schuller

Head of Financials Sector Strategy

Maureen.Schuller@ing.com

Warren Patterson

Head of Commodities Strategy

Warren.Patterson@asia.ing.com

Rafal Benecki

Chief Economist, Poland

rafal.benecki@ing.pl

Philippe Ledent

Senior Economist, Belgium, Luxembourg

philippe.ledent@ing.com

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Inga Fechner

Senior Economist, Germany, Global Trade

inga.fechner@ing.de

Dimitry Fleming

Senior Data Analyst, Netherlands

Dimitry.Fleming@ing.com

Ciprian Dascalu

Chief Economist, Romania

+40 31 406 8990

ciprian.dascalu@ing.com

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com