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Aluminium: Facing turbulence with resilience

The aluminium market has faced the recent macro turbulence with some resilience and LME 3M prices rallied above US$1,850/tonne this week. Major uncertainties around some key macro events and fundamental headwinds may put any further rally in check but not necessarily stop continued resilience in the short term

Source: Shutterstock

Faced with the whipsawed US stimulus talks and large uncertainties in the macro backdrop ahead of the presidential election, aluminium prices have shown strong resilience, with LME 3M prices hitting US$1,859/tonne this week. The price action is broadly in line with our expectation last month of upside risks to prices (Aluminium: Macro, fundamentals and uncertainty). While uncertainties remain, the road ahead could be bumpy with a risk-on and risk-off vibe. Yet we expect aluminium to demonstrate continued resilience for the remainder of this year, and forecast the average price to gravitate lower from current levels to US$1,830/tonne during 4Q20.

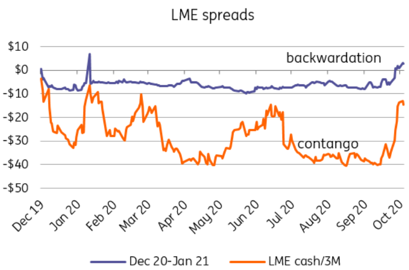
Market pricing - a glass half full approach?

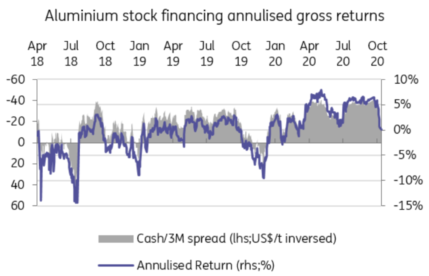
Since 2Q20, the base metals complex has rallied along with broader risk assets, aided by a weaker dollar and a slant towards reflationary market conditions; meanwhile, investors have tended to look at the market through rose-coloured glasses. Despite much turbulence and significant uncertainties with the US presidential election on 3 November, the recent narrative is that the market appears to be pricing in a ‘Blue Wave’ due to a widening of Joe Biden’s lead in the opinion polls, at least giving the market reassurance that the election result will not be contested. If the market believes this scenario could be good for risk and bad for the dollar, it may well serve to partially explain recent metals' price buoyancy despite the resurgent Covid-19 waves damaging the demand outlook.

And if history is anything to go by, some may be looking at the metals market to repeat its post-global financial crisis performance, when Chinese infrastructure investment fuelled a strong price recovery in metals. Recent strong imports to China have been inflating apparent metal demand growth and bolstering these hopes. As the world aluminium market has further polarised post-pandemic, investors seem willing to price in more on the China demand narrative, with a constructive demand outlook. That said, a surplus overhang elsewhere and rising new capacity from China creating supply pressure may be being overlooked, particularly as governments are still committed to generating stimulus.

Part of the LME curve is churning

Breaking this year's stubborn contango structure, part of the LME forward curve has recently started to turn, with the December to January spread continuing to tighten into backwardation. We don’t see any direct fundamental reasons behind this, and it does not suggest a real tightening in market supply but rather how traders might be playing into the curves that could trigger speculative moves. Currently, shorts on the December prompt may be squeezed and found painful if borrowing to the forward date of, say, the January prompt. A potential result could be physical delivery leading to a rise in LME inventory. Meanwhile, the cash/3M and Dec20-Dec21 spreads have seen a flatter contango, and might be demotivating the stock financing trades due to poorer returns. A potentially worrying consequence could be that traders might not be interested in making the trade, which would help lock up the new surplus that the market is creating.





Source: LME, ING

China: plateauing growth but unlikely to be a drag

The V-shaped rally in demand recovery seen during 2Q20 is now plateauing, but the market is unlikely to be a major drag. Inventories in the Chinese market have turned largely flat in recent months after a significant drawdown during the second quarter. Current inventories are 25% lower compared to the same period last year and are well below the five-year average. In the ShFE market, the curve has remained stubbornly in backwardation amid low inventory, keeping the bears nervous as spreads often spike especially ahead of the prompt contract expiry each month.

The market is currently waiting for more fundamental signals to feed in. This week, there is a surfeit of macro data releases. Despite many lagging indicators, they continue to be sourced as evidence of the demand narrative. Released on 13 October, China's September retail car sales rose by 7.4% YoY, marking a third straight monthly gain, according to the China Association of Automobile Manufacturers (CAAM). Overall exports registered strong growth of 8.7% YoY, according to China Customs data. Nevertheless, the detailed number for aluminium exports continued to look gloomy in contrast to China's overall export picture. In the first nine months, exports of primary aluminium and aluminium semis products contracted by 18.4% YoY amid adverse exports market conditions, which is in line with market expectations. However, the export of some aluminium containing end-use products, such as white goods, machinery and medical equipment, have continued to register strong growth, serving as a silver lining. In a polarised market, if we consider the market in two parts, the market's interpretation could be that fewer exports (aluminium semis products) from China are good for the rest of the world market, and more imports (in this case primary aluminium and alloys) are even better at helping to ease the glut.

While the September import figures are not yet available, anecdotal evidence suggests that total imports during September could remain elevated. However, there are reports that aluminium had begun to pile up in Chinese bonded warehouses just before the October holiday as a result of arbitrage close, suggesting imports may slow in pace from October. If this were the case and it continued to unfold at the end of this year, it might hurt the constructive demand narrative.

Demand optimism could still prevail

However, what may prove a wild card in demand prospects is the rising expectation that the nation's grid sector will expedite the tender process in connection with this year's ultra-voltage transmission (UHV) lines projects. As one of the key pillars of this year's 'New Infrastructure' initiative, there is a strong commitment from grid companies to fulfil the target, as evidenced in the latest reports from state media.

Reports from state media on grid construction and budget spending during next 14th Five Year Plan have been sparking the hopes. In the UHV projects, aluminium could benefit given its use in steel core aluminium wires and cables. Should tender demand spike later this year, market optimism may outweigh concerns regarding supply pressure due to rising new capacities, which could see the market demonstrate strong resilience. Meanwhile, during the Chinese government's Fifth Plenum (October 26-29), there is likely to be more detail regarding the major demand sectors. This could be part of the process to draw the map for the 14th Five Year Plan. The market is likely to respond to any promising signals in relevant major end-use sectors that could fuel more optimism in the market.

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