Aluminium: Stakes are high for Section 232

The US Commerce Department has recommended sweeping trade tariffs for US imports of primary aluminium and products. They're even tougher then we could have imagined

Source: Shutterstock

July Midwest Premium Swap surges to new highs (Cents/lb)

Making US aluminium Great Again?

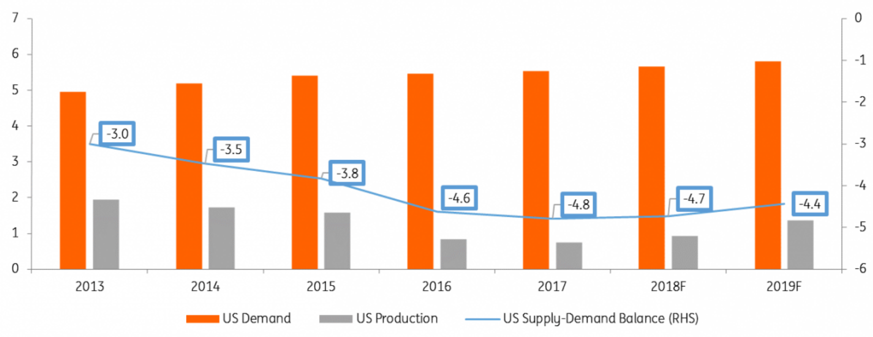
The report, which the Commerce Department delivered to President Trump last month, has now been revealed to recommend blanket import tariffs of 7.7% on primary aluminium and products. Trump has until mid-April to decide whether to adopt the measures. The market was largely expecting just a move on Chinese products and certainly an exemption of the key Canadian supply. China, Russia, Venezuela and Vietnam are highlighted for an even tougher 23.6% treatment. The LME price rose 2% on the news and the CME July 18 Midwest premium contract surged 15% to 15clb. Industry immediately called out for clarification over Canada with downstream fabricators more wholly opposed to primary metal tariffs altogether. Chinese officials have cautioned retaliation.

As per our January report: Making US aluminium Great Again a ruling that includes Canada (over 50% of imports) will mean an effective 1:1 transfer from the duty to the local premium that is paid by US consumers above the LME price. This would mean an almost $8c/lb increase. The situation remains vague however since the report does acknowledge Canada "is important to the US aluminium industry". The milder increase on the CME contracts suggests the market doesn't yet price in a Canada tariff and was in fact already pricing in some duty effect. Most tellingly, even though Midwest freight costs have declined 13% from their December highs, the premiums were still rising this year on 232 speculation.

After Canada the most important suppliers of primary metal are Russia and the Middle East. (16% and 13% of H1 2017 primary imports but much higher for foundry and billet). Russian material is earmarked for further charges but the Middle East might not be able to alleviate as much of a swing supplier since, under the third recommendation, each country's imports would be capped below 2017 levels.

The US is in a near 5Mt deficit of primary material of which Canada supplies 50% and US capacity cannot be built/re-opened quickly enough to fill that void. Total US (demolished) capacity is below 2Mt and at the higher LME prices, we already expected generous restarts for this year. US production is forecast to grow by 180kt this year, 440kt next. But this means we only expect the need for imports to fall to 4.4Mt by 2019. Century Aluminium releases its annual report this Thursday and will be closely watched for an update but recent media reports suggest that electricity negotiations at Mt Holly remain gridlocked.

The US relies on primary imports (metric tonnes)



Source: ING Research

Adding to LME tightness

In our 2018 aluminium outlook we outlined a fundamentally bullish position but expected that near-term dips might arise on the back of higher Chinese exports. That weakness might prove short-lived if the market rushes to price in the 232 effect.

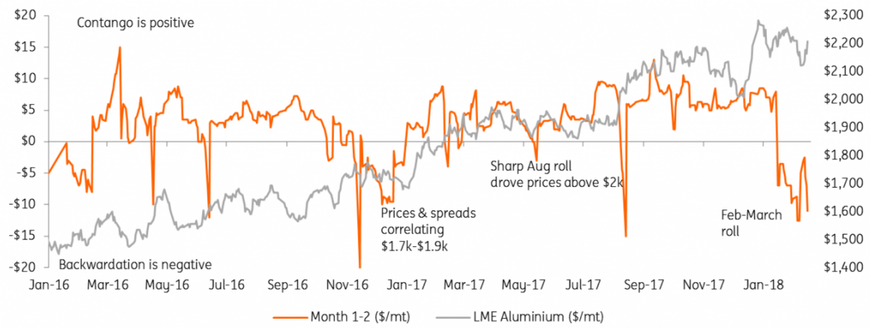
Since LME warehouses, and associated price discovery, takes place in pre-duty paid zones, the 232 tariffs have the most immediate impact on the regional premium. Duties will not be incorporated into the LME price but as we outlined in last week's 2018 Aluminium Outlook, higher premiums do exacerbate the tightness in the LME curve. Backwardations compete with premiums when it comes to incentivising metal to be delivered on to exchange. The tightness on the LME drove prices higher through much of '16/17.

The LME forward curve is repeatedly tight at the front of the curve which demonstrates a thirst for ingot in a growing ex-China deficit. The Feb-March backwardation spiked to as high as $21.50b on Friday (closed at $11b).Such tight rolls have the power to squeeze out shorts, pushing prices higher, but also punishing any holders of stock who need to roll their short hedge. A hefty 265kt was delivered into Asian sheds last week as the backwardation surged. Just like 2016 we expect this material will soon move west to be sold at the higher US premium, likely before any taxes are introduced.

If US duties are indeed imposed upon primary aluminium we can effectively ring fence any customs cleared US stock from being delivered on to the LME. Local premiums will firmly exceed the pull of warehouse incentives and backwardations. Traders might move more stock through customs ahead of the rulings. Any US (or Canadian) origin stock will also likely be cancelled and is unlikely to be delivered.

LME backwardations will therefore need to pull stock foremost into European or more likely the Asian sheds. We have been surprised not to see stronger Asian premiums (MJP), which helped the latest deliveries take place. This is likely the result of high Chinese semi exports including fake coils but if we do get a rush of material west ahead of the duties then Asian premiums will surely rise to close up some of the US gap (pre-duty).

Sharp backwardations at the front of the curve support prices



Source: LME, ING Research

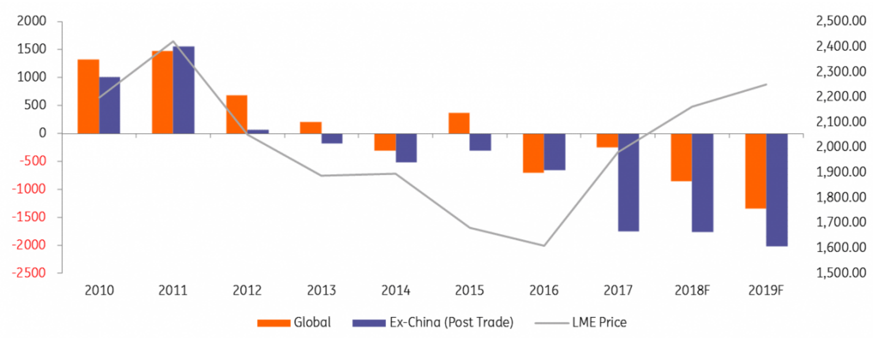
For once, it's not all about China

We stick to our outlook For once it's not all about China. Ex-China markets are set to be short of about 1.7Mt of primary material this year, 2Mt next whilst the Chinese primary metal surplus is stuck behind a 15% export tax. This will drive a tight LME market higher. Our assumptions already included US smelter restarts. Chinese semi's exports are unlikely to alleviate such tightness as tariffs take away customer markets. This is starting with almost 700kt of products that are sent into the US but investigations are also ongoing in India and Europe.

We do not think that in retaliation China would drop the 15% ingot export tax as the effect would be to unwind the success of its supply reform programme. Exporting ingot is tantamount to importing the pollution and exporting the high energy cost of the material.

Location is everything when it comes to the outlook for aluminium prices and the US looks set to top that list.

Growing ex-china deficits to drive LME higher



Source: Company Reports, IAI, WBMS, UN Comtrade, Antaike, ING Research

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