

## Aluminium to stay lower for a little longer

The global aluminium market could return to surplus in 2020 amid growth in supply. Demand, however, isn't keeping up and a raw material surplus is adding to deflationary pressures. Decent contango, warehouse queues and surpluses make financing deals attractive again



### Bearish sentiment set to continue

Aluminium has not had a great year, and we fully expect the bearish sentiment to continue well into 2020. The metal underperformed in 2019, losing 6% year-to-date due to trade war fears and waning downstream demand.

Aluminium supply growth moved further into negative territory in 2019 and production gains, arising largely from fresh capacity in the ex-China market (primarily the Middle East) have largely been offset by a drop in production from China. Global primary aluminium production dropped 1% YoY to 47.6 mln tonnes over the first ten months of 2019, according to IAI data. Total production from the world's top producer is estimated to decrease by 1.4% for the full year for a variety of reasons, not least notable disruption from smelter outages in China due to floods and technical failures.

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## *Bearish sentiment is likely to prevail for the coming year*

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And while aluminium supply growth fell into negative territory, global demand growth sank even deeper. The net effect has left the global market with only a small deficit. A lack of strong fundamental catalysts has left aluminium prices prone to macro and trade talk whims.

Bearish sentiment is likely to prevail for the coming year, as supply is set to recover in 2020 based on our expectations that the global primary supply will return to growth. Some of the Chinese smelting capacity, which was closed earlier due to floods, could be back online while around one to two million tpa of new capacity is likely to start operations next year. We anticipate global primary aluminium output recovering by 2-3% year-on-year to around 65 million tonnes in 2020, though some risks remain, such as capacity closures and delays due to low prices. On the raw materials' side, the alumina market is set to see a growing surplus over the coming year, which again will weigh on prices and this may feed through to cost deflation on primary aluminium.

## **Demand is likely to stay weak, but not forever**

The demand outlook, on the other hand, is expected to stay weak over the coming year. But further downside risks should be limited beyond that. It's too early to call any imminent recovery as uncertainty remains around trade. The automobile sector shows no sign of recovery. In Europe, the car industry is faced with significant uncertainty as President Trump has threatened it with 25% tariffs. The result remains unknown, but this has the potential to hold back short term appetite in investing. The economic slowdown, trade war concerns, tightening emission controls and the rise of the 'sharing economy' will continue to weigh on automobile demand in China. In China's recent prolonged construction cycle, there are signs that the decline in completion growth (in year-to-date cumulative terms) continued to moderate in 2H19.

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This brings some hope that aluminium demand in the late stage of the construction cycle will recover over the coming year should completions continue to increase. However, we are somewhat concerned about a slowdown in Chinese exports of semi-finished products should external demand worsen.

Overall, global aluminium demand is likely to witness flat or even marginally negative growth unless the trade discussions progress towards consensus and industrial activity picks up. One supportive factor for aluminium is the low inventory at LME and SHFE warehouses where surpluses could be absorbed, given the right structure of the forward curve. However, this is purely from a market point of view and doesn't take into account the potential impact of changes in the LME warehouse reporting rules.

The price spread between aluminium 15M/cash increased to a five-year high of around US\$133/t in June 2019 with the current spread of US\$80/t or around 5% of the LME cash prices. Weaker

interest rates, decent contango and small queues at LME once again make financing deals (holding inventory at LME warehouses and selling forwards at a premium) lucrative for traders or financial institutions. Currently, we see the risk to the average price next year tilted to the downside. However, if aluminium demand shows signs of recovery and this is combined with low inventory, this could push prices above 1,800/t over the second half of 2020.

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