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Why has aluminium been so resilient so far this year?

Despite the increasing macro headwinds and the stock release from China in a bid to tame the market, Aluminium prices have remained resilient, and supply disruptions and curbs continue to keep a lid on growth

China Jiangsu metal processing plant workshop

Aluminium prices gained 34% year-to-date on the LME market, ranking the second-best performer after tin, as micro positivity continues to prop up prices, and the light metal largely shrugged off a total 210kt stock release from the Chinese state reserve bureau in a bid to tame prices.

We see two major issues on the supply side that are going on in the market.

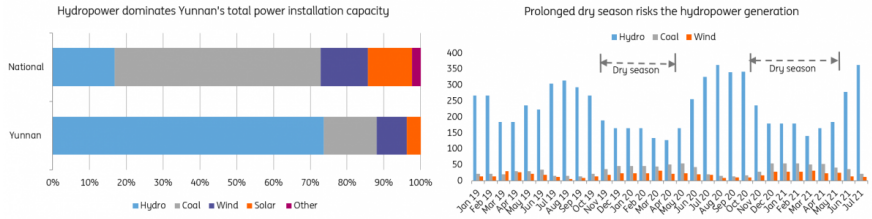
China state reserve stock release

	Copper	Aluminium	Zinc
1st batch release (July 5-6): tonnes	**20,000**	**50,000**	**30,000**
% of mthly consumption	2%	5%	3%
2nd batch release (July 21): tonnes	**30,000**	**90,000**	**50,000**
% of mthly consumption	3%	9%	5%
3rd batch release (Sep 1): tonnes	**30,000**	**70,000**	**50,000**
% of mthly consumption	3%	7%	5%
4th batch release-to be announced... (Sep 21?)	?	?	?

First of all, rising supply-side disruptions at the world's largest primary aluminium producer are one of the major drivers of the market.

But there are three types of supply disruptions.

1. **Power rationing:** Smelters at China's multiple provinces are told to keep power load lower or stagger power usage. As a result, smelters have had to lower their operating rate, resulting in lower production. Monthly productions have been declining three-month in a row—in provinces including Inner Mongolia, Guangxi, Guizhou and Yunnan. However, there is a risk that another province, Qinghai, may also face the same problem as the local grid has issued a warning to smelters on potential power shortage. The province has a collective capacity of around 2.8 million tonnes and relies 100% on the grid power supply instead of captive power. While many blame the nation's tight power market, many market participants hope the situation will improve after summer power consumption peaked. However, another concern arises from Yunnan as the region will be entering into dry season again from September. The previous prolonged dry season had led to lower water reservoirs at local rivers and resulted in lower hydropower generation.



Source: CEC

2. **Floods:** Severe floods at the end of July caused disruptions to a major smelter with an annual capacity at around 440ktpa in Henan and an explosion at a local alloy maker.

3. **Dual control:** We noted this earlier in the year with smelters in Inner Mongolia being asked to slash productions and newly built smelters unable to ramp up. Unlike power rationing or floods disruptions which may be short term problems, the dual-control is tied to China's long term pursuit for peak carbon emissions and carbon net-zero. The latest move by Changji prefecture in Xinjiang in asking local smelters to curb productions are most likely to result from the red alert the region received last week from China's central NDRC, as it failed to bring down energy intensity during 1H21, whilst receiving a yellow alert on total energy consumption. We discussed this in our note on Monday.

Besides the disruptions to existing operations, some new projects have failed to ramp up on schedule for the reasons above. At the end of last year, we expected over three million tonnes of additional capacity to come online; however, this has come down to less than one million tonnes; although things remained fluid, we will need to monitor the situation. As the Chinese market remains in deficit, and those disruptions only add to wider deficits; as a result, it continues to import the metal from the ex-China market absorbing the surplus.

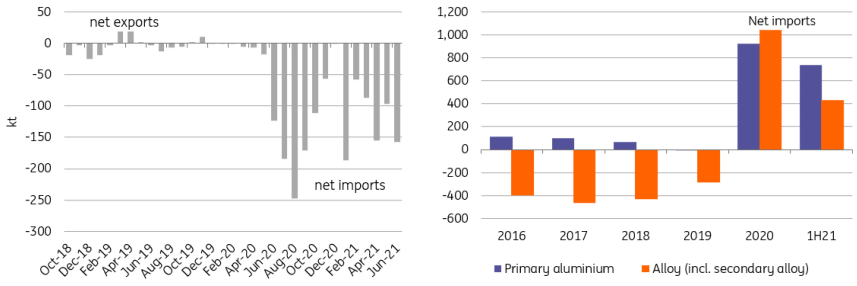
Elsewhere, there's an outage at Noble's alumina refinery in Jamaica last week. Yet, it remained to be seen whether this would further lead to raw material disruptions to its aluminium smelters customers. Earlier this month, Australia's largest aluminium smelter Tomago wared of the rising Covid-19 cases threatening their operations.

Second, supply chain bottlenecks are preventing stocks go to the right location at the right time, which further pushed the regional premia.

The aluminium market recovery has been uneven post-pandemic, where the North American market continues to see tight supply and premium continue to climb. One of the major drivers behind is the high shipping costs, and also, the US inland trucking costs are one of the key drivers behind the scene. As a result, the available stocks elsewhere are just not incentivised enough to go to the market.

Other supply chain bottlenecks are seen in the China market, where floods and the nation's draconian Covid-19 related control had led to logistic restrictions that has impacted the physical market flows.

China's imports of primary aluminium and alloy



Source: China Customs

In the end, all those supply disruptions have further lowered the supply elasticity of primary aluminium, and the pursuit of decarbonisation by China and elsewhere will have a longer-term impact on the aluminium supply landscape in the future.

Therefore, we continue to hold a constructive view towards aluminium in the long term. However, there could be a bumpy road ahead for prices in light of the macro headwinds amid the Fed's policy normalisation journey.

We maintain our price forecasts for 3Q21 at US$2,600/t (quarterly average) and expect annual average prices could rise from this year's US$2,420 to above US$2,630 in 2022 and US$2,700 in 2023.