Aluminium caught up in nickel's wild ride

The epic squeeze in the nickel market has seen other base metals caught in the slipstream amid a margin crunch and broader risk-off sentiment. Meanwhile, alumina prices have risen as the war in Ukraine continues to see market participants self-sanction

China Jiangsu metal processing plant workshop

Aluminium suffers from the shockwave caused by nickel market chaos

Aluminium has been dragged down by the broader risk-off sentiment after an epic surge in the LME nickel market last week driven by supply concerns following Russia's invasion of Ukraine and reported short-covering, as traders who had bet that prices would fall were forced to cover losses. LME aluminium 3M contract prices hit a record US$4,073/tonne on 7 March, and are hovering around US$3,400/tonne today.

While the aluminium on-warrant inventories have continued to decline in LME warehouses, the nearby spreads have collapsed along with other major base metals. The cash/3M spread has remained in backwardation between US$10-50/t since the beginning of February but has slipped into a contango of around US$24/tonne as of today. We have noted the different market dynamics between London and Shanghai here, and we suspect that the recent collapse in LME spreads could be the result of traders lending in the LME market as the wide dislocation between LME and ShFE is dramatically shifting to reverse arbitrage having previously been in favour of normal arbitrage.

On the supply side, production has started to resume in Yunnan and Guangxi province, improving primary aluminium supply. This has seen a sequential recovery in the average daily production, which had risen by 1,900t in February. By April, this is expected to climb further to levels seen in the same period last year, according to SMM data.

On the demand side, the Covid outbreaks in China have led to increasing restrictions on movement and even partial lockdowns among some megacities, weighing heavily on sentiment. While the dip in aluminium prices has attracted fresh purchases from Chinese downstream consumers, the current market dynamics do not support China's imports. Also, onshore market participants have been very cautious about dealing with Russian metals, at least for now. Together, these factors have effectively blocked further metals inflows into the China market. The net effect is that inventories in China have started to turn down as demand has outstripped supply.

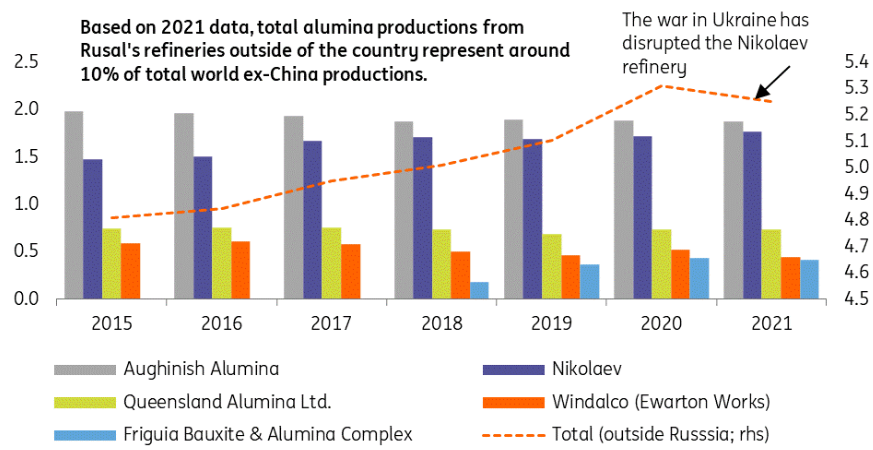
Rising alumina prices add to the pain

Meanwhile, the impact of the Russia-Ukraine crisis continues to unfold. There is increasing evidence that the physical liquidity of Russian origin is dropping out of the market. Supply chains continue to face disruption, primarily due to the self-sanctioning of market participants, which is making Russian metals illiquid. As a result, physical market alumina liquidity has started to shrink.

Alumina prices have jumped to the highest since 2018. Being the second-largest cost component in aluminium smelting, rising alumina prices and already stratospheric power prices suggest that smelters with exposure to these spot markets will be faced with a double whammy.

Rusal has six refineries outside Russia scattered from Europe to Africa and Australia. The aggregate nameplate capacity amounts to roughly 11mn tonnes. Among these six refineries, Nikolaev from Ukraine has already been disrupted by the war. Last year, Rusal contributed to almost 10% of the world's alumina production, ex-China. If alumina supply continues to tighten and drive up prices, we may see China start to export and that would eventually cap any further rise.

Rusal is also a sizable alumina producer (m tonnes)



Source: Rusal, ING

Production calculated based on the pro rata share of the Company's (and its subsidiaries') ownership in corresponding alumina refineries.