

Aluminium deficit falls deeper following Covid outbreaks in China

Covid outbreaks in Southern China have led to further supply disruptions fuelling the alumina and aluminium prices rally. Meanwhile, Europe saw further curtailments amid elevated power prices



Covid outbreaks in Southern China have led to aluminium supply disruptions

In the first week after the Chinese traders returned from the New Year holidays, LME 3M aluminium prices touched US\$3,236/tonne (intraday high on 8 February), only a step away from the peak of US\$3,380/tonne during July 2008. As for the cash contract, record aluminium prices were last seen back in 1988 at US\$4,290/tonne amid a historical squeeze in LME.

This week's rally is again fueled by further supply disruptions. We had expected that the Chinese market may have seen the peak of supply disruptions during 4Q21 as a result of last year's power crunch and dual-control mandate, while the eased power crunch should allow some to return in 2022 gradually. However, the sudden outbreak of Covid in the Guangxi autonomous region last weekend has thrown a curveball to the supply recovery. As China still ticks to a zero-Covid strategy (now called dynamic clearing), the sporadic outbreaks have led to whack-a-mole style crackdowns and disruption to activities.

Most of the Covid cases are found in the Baise city, the hub of alumina and aluminium productions in Guangxi. The region has some 12.6 million tonnes of alumina refining capacity representing 14% of the Chinese total, with five refineries located in Baise city with a total of 9.6 million tonnes of capacity. Guangxi's total primary aluminium capacity is around 2.7 million tonnes per annum, with 2.2 million tonnes located in the Baise city. We understand that around 500ktpa capacity might not return to the market in 2022, leading to further output losses this year. The Baise local government's stringent lockdown measures have led to disruptions to logistics affecting both alumina and aluminium productions. This would exacerbate the market tightness where inventory is low compared to historical levels. Rising alumina prices are also pushing up aluminium prices. Spot alumina prices have risen by almost 16% so far this year.

In the meantime, elevated power prices and the rising carbon allowance prices in Europe further squeezed smelters in the region. As a result, Sivalco has announced further curtailment of operating capacities to around 60%, from 80% previously. This now brings the total capacity losses to around 850ktpa in Europe (excluding Russia).

We estimate that the primary aluminium market balance is shifting to a deeper deficit of 1.7 million tonnes (versus 1.5 million tonnes in the 4Q21 forecast). As noted previously ([Risk premium pushes aluminium higher](#)), the longer these capacities stay shut, the more supply losses we'll get in 2022. Meanwhile, the restarts of last year's disrupted capacities from elsewhere in China are worth monitoring. Currently, we expect LME 3M aluminium prices to average at US\$3,150 in 2022 (versus US\$2,900 from our 4Q21 forecast)