9 June 2020
Article

Aluminium: Markets moving towards convergence

LME aluminium prices are gaining momentum and catching up with the ShFE amid a broader pick up in risk appetite

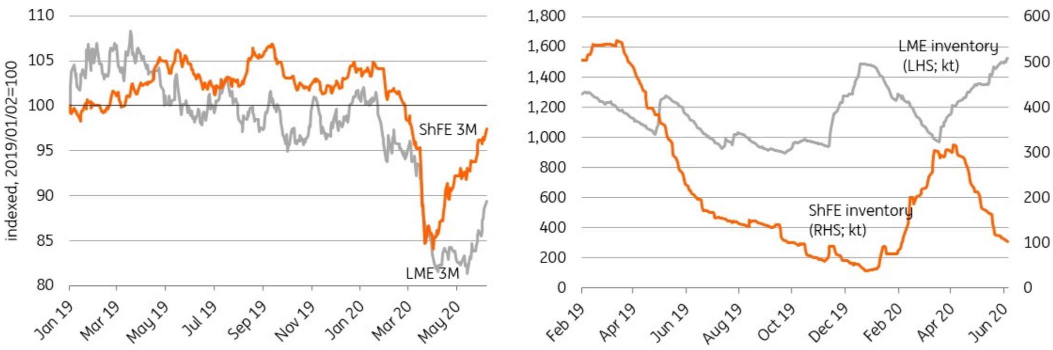
Source: Shutterstock

Content

1 London aluminium price rally defies surging reportable inventory

LME 3M aluminium touched US$1,614/t on Monday (8 June), the highest since March this year. Yet from a fundamental perspective there's been no change in terms of the surplus in the market. We discussed in May that there has been a decoupling between the LME and ShFE, with prices in the latter stronger than the former. Since mid-May, LME aluminium has been playing catch-up and the two markets have been moving towards convergence, although there is still some way to go for LME aluminium. What hasn't changed is the inventory trajectory. LME warehouses have continued to see inflows while the ShFE has been destocking since the Covid-19 related lockdowns came to an end.

Fig 1. Stocks remained on divergent trajectories, but the price in LME is catching up with its ShFE peer

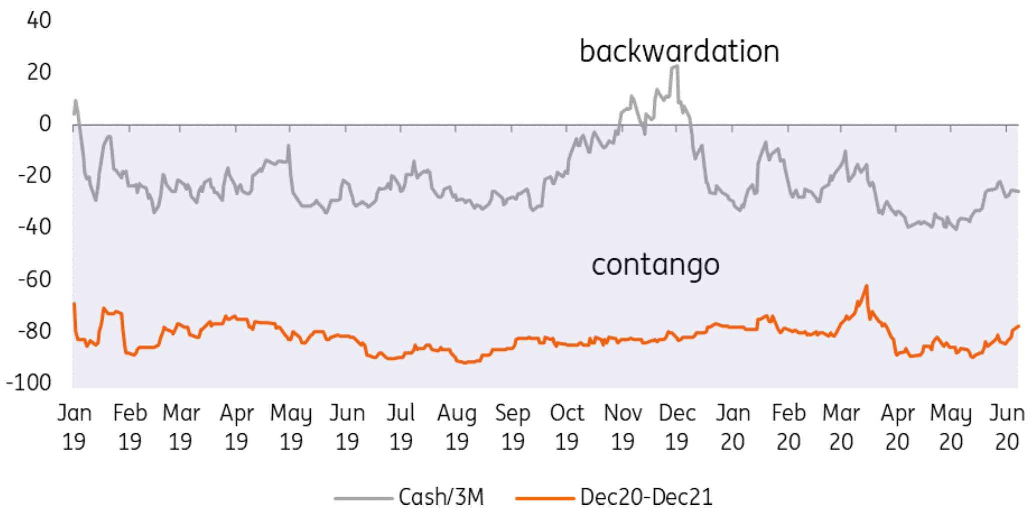


Source: Bloomberg, ING

2 Opaque aluminium inventory may only get larger

A theoretical inverse relationship between prices and inventory from LME warehouses has long been weak. Indeed, surging inventories since March do not seem to have had an impact on the recent price recovery. Last week, the level of inventory surpassed the peak seen at the end of last year and now stands at the highest since May 2017. Nevertheless, a vast quantity of unreportable aluminium stocks has remained a 'known unknown' to the market. We believe there has been an increasing amount of inventory building so far this year, which has not come under the radar of LME reportable inventory. In fact, the LME forward structure, with steep contango across different tenors, has offered some lucrative carry opportunities. Presumably, a large number of stocks has been locked for financing purposes.

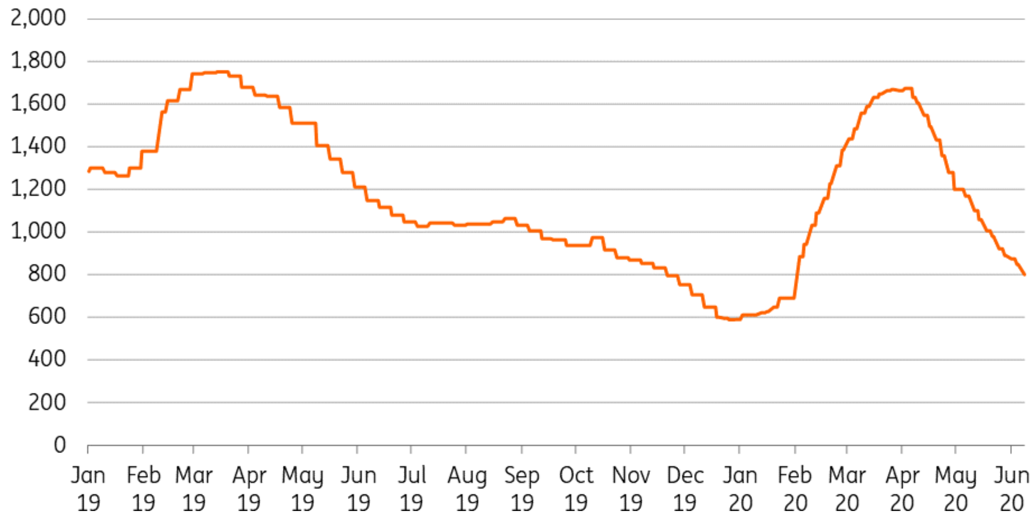
Fig 2. LME aluminium spreads (US$/t)



Source: Bloomberg, ING

ShFE inventory is usually more about the local market supply and demand dynamics. But market participants are monitoring the so-called social inventory, which includes inventory from non- ShFE warehouses, and are tracking the net amount of stock inflows and outflows. What matters more is the speed of change in the stocks. The speed of destocking has slowed since May and this is putting on pressure on the short-term demand picture, which is not as vigorous as in April.

Fig 3. China aluminium social inventory (kt)

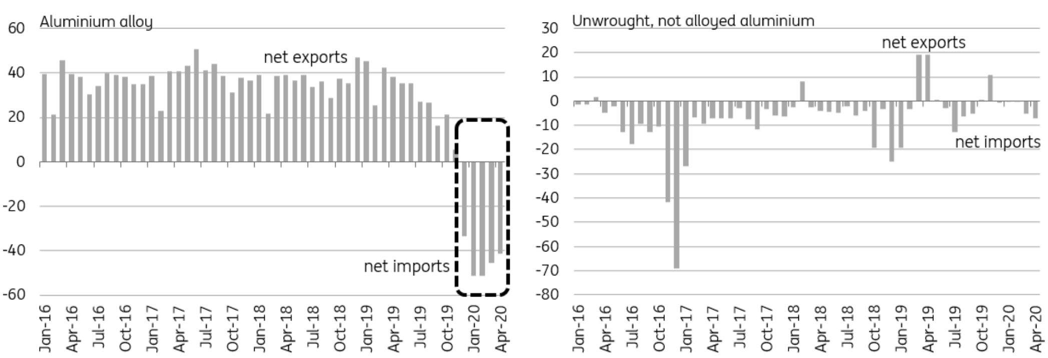


Source: Bloomberg, ING

3 Why is LME aluminium catching up?

The latest developments in China seem to suggest that the market is seeing less support from fundamentals and it doesn't look good for local prices but this might not be pertinent to the LME in our view. We want to focus on the LME and examine why prices have been picking up some momentum. Below are our thoughts: There has been a broader return in risk appetite to the commodities complex driven by unprecedented quantitative easing from central banks as well as fiscal stimulus to support the post-Covid-19 recovery. Aluminium has benefited from the recovery seen in the broader industrial metals sphere along with other riskier assets in the financial world. As more economies emerge from lockdown and major consumer sectors return to business, there is hope that we can expect a marginal pick-up in demand. China has been helping to absorb some supply pressure from the rest of the world via imports, which should provide some support to the LME although the move could bring the opposite effect to the ShFE. One consequence of the earlier decoupling between the two markets is that this has created a rare opportunity for China to import certain products. As a result, it has turned into a net importer (see Fig 4).

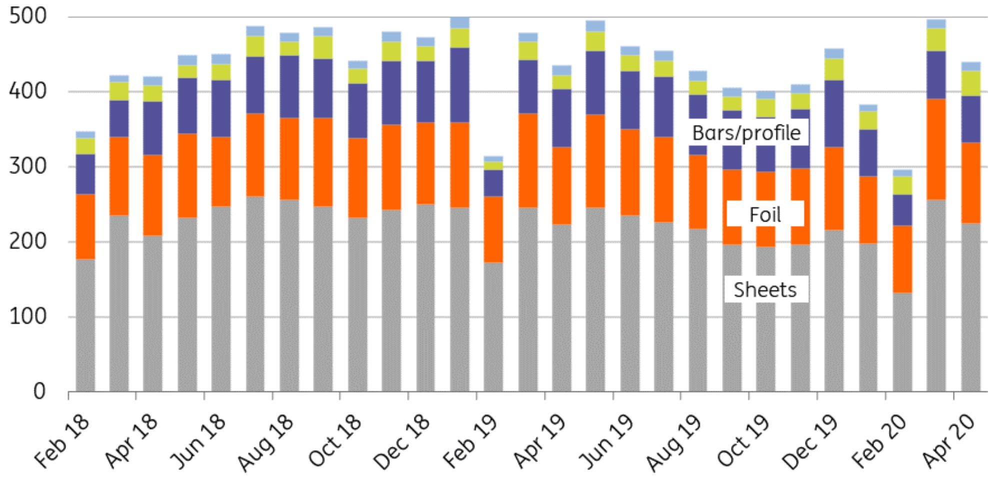
Fig 4. China has turned into a net importer of unwrought aluminium and alloy (kt)



Source: China Customs, ING

In the meantime, exports in the form of semis products have been in a steady decline. Over the past weekend, China Customs revealed its preliminary trade data for May. It suggested that total exports of unwrought aluminium and semis products declined to 383kt, a decline for three months in a row. The breakdown (into different semis products and unwrought aluminium) will only be available at the end of this month. But we already foresee that the numbers in May (see Fig 5) will fall further.

Fig 5. However, exports of semis products are slowing (kt)



Source: China Customs, ING

The first two points discussed above may still have room to unfold and should continue to provide support to the short-term LME aluminium market. However, evidence of a demand pick-up has yet to be seen in the ex-China market. In Japan, the latest premium for 3Q20 offered to buyers was reported at US$85, a marginal increase from US$82/t in 2Q20 and we are expecting some discussion from Europe on this front soon. What could weigh on LME aluminium is China returning to its normal position as a net exporter of alloys (likely) although we could still see weaker semis exports ahead.

Wenyu Yao
Senior Commodities Strategist
+44 (0)20 77676909
wenyu.yao@ing.com

Disclaimer