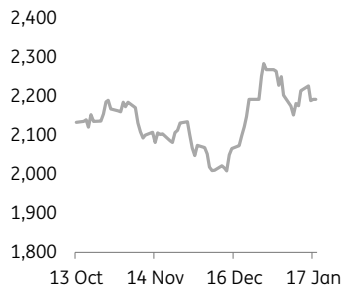


18 January 2018

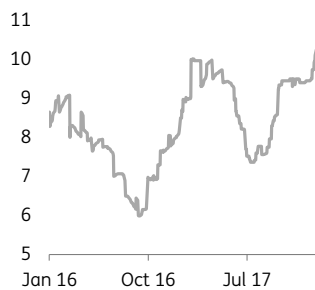
Metals

LME Aluminium (17/01/18)
US\$2,192/t

LME Aluminium (US\$/t)



US Aluminium Premia (US\$/lb)



Source for all data: Bloomberg

Industrial metals

Making US aluminium great again?

Section 232: US fabricators at risk of premium squeeze

On Monday, 22 January, Trump is scheduled to receive the section 232 aluminium report from the Department of Commerce. The report will give guidance on potential tariffs, quotas and restrictions of aluminium imports into the US. The stakes are high for US aluminium consumers after premiums already jump to three-year highs.

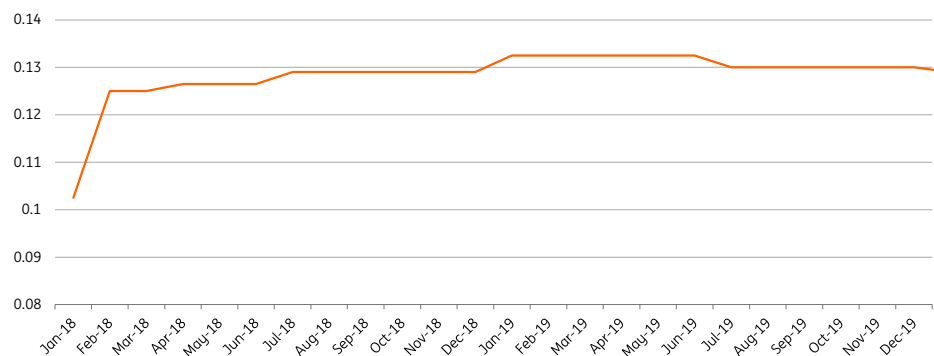
The stakes: Trump has 90 days to decide the actions and except for a leak or knee jerk tweet, it is likely we will be left guessing Commerce's recommendations for some time. Original scope had targeted just higher purity military grade material with insignificant tonnages. Lobby groups and local industry have however pushed hard to include semi-fabricated material and even primary ingot. The countries targeted are also unknown. China is in the spotlight, Canada likely safe (even with NAFTA on a knife edge), but the Russian and Middle Eastern treatment could make all the difference.

A blanket action on primary ingots could see US premiums explode for some time. Commentators seem to think it is unlikely but we heard differently on the rumour mill.

A perfect storm: Harbor, typically the more conservative, has assessed Midwest Premiums at US\$10.10-11.25/lb. This is the highest since early 2015 when LME stock sat behind queues lasting 360+ days. The queues have gone but a c.4 Million tonne annual US deficit must incentivise imports. With trucking costs on the rise the US premium was already on the up. Disruptions at Alcoa's 420ktpa ABI Canadian smelter lit the fuse.

The only way is up?: The forward curve for CME premium swaps expects more gains. The February and March 18 contracts have jumped to US\$12.5 c/lb. If these 20% gains are realised, and given our already high expectations for the base LME Aluminium price it could involve substantial pain for any US Consumers who are under-hedged.

CME Midwest Aluminium Forward Curve (US\$/lb)



Source: Bloomberg

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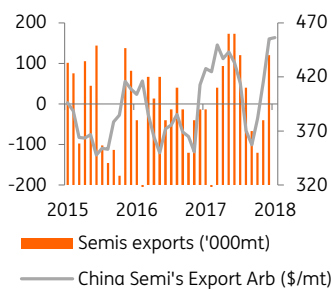
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Price forecasts (US\$/t)

| | 2018 | | | | 2019 | | | | 2020 | | | |
|-----------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| | 1QF | 2QF | 3QF | 4QF | 1QF | 2QF | 3QF | 4QF | 1QF | 2QF | 3QF | 4QF |
| Aluminium | 2,200 | 2,050 | 2,000 | 2,000 | 2,200 | 2,050 | 2,050 | 2,100 | 2,150 | 2,250 | 2,200 | 2,200 |

Source: Bloomberg, ING estimates

China Semi's export and arb:



Source: LME, SHFE, China Customs

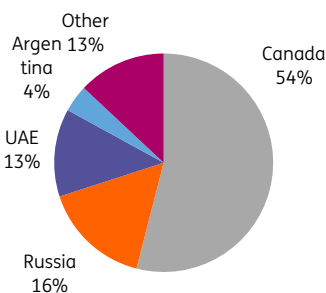
Weighing the imports

China is a very minor exporter of primary aluminium ingot because of a 15% export tax. A 13% VAT rebate for fabricated products however often makes product exports profitable when SHFE prices are significantly below the LME. This was the case in H1 2017 and again in Nov/Dec which drove higher exports. The USGS reckon over 30% of fabricated aluminium US imports is Chinese origin and mostly flat rolled products or foils. China's dominance in foils were already expected to be taxed from June 2017 and is likely a first target for 232. The trade commission has also pre-empted its own anti-dumping case on alloy sheet. Together this raises the likelihood that 232 will at the least impose upon Chinese semi products. The market impact in this scenario would be incremental US demand for products (c.500kt, +10%). Probably mild upside for the primary aluminium premium but stronger gains for downstream products. There would be more relative downside for SHFE as more of the Chinese surplus looks for a home.

A tariff on primary aluminium or upstream billets/foundry products would be much more dramatic. Canada provides over 50% of the primary imports that are needed to balance the 4Mt annual US shortage. By far outpacing the USA's own production we could expect an almost 1:1 impact from any duty on to the US premium, especially now that the US has to compete with a duty free status for Canadian ingots in Europe. The IAI puts US smelter capacity below 2MT so even at full restarts it cannot fill this import gap.

We would be very surprised therefore were Commerce to push such additional costs on to US fabricators and even risk starving them of material. After Canada the next two biggest suppliers are UAE and Russia (c.16% and 13% in H1 2017). Tariffs would not flow through as significantly on ingot premiums but they could have a more marked effect for billet and foundry surcharges where the import proportions get much larger.

US Primary Aluminium Imports (2016)



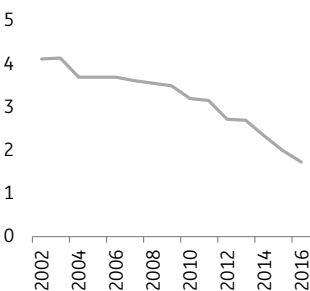
Source: CRU

Making US Aluminium great again?

The motivation to impose duties on primary imports is to drive a recovery in US smelting. On the surface this seems in line with Trump's pledge to create jobs and protect local industry, but we suspect the incremental costs to be borne by the far larger consumer base (can makers, converters, extruders etc) could be more damaging.

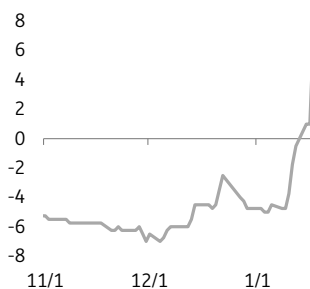
Currently there are just 5 smelters operating in the US and this is down from 23 pre-2000. Given higher prices (which is more LME than premium), Alcoa is already restarting its 290ktpa Wartree smelter in 2018. On the side lines are also Wenatchee (Alcoa), Magnitude 7 (New Madrid), halted capacity at Hawesville/Mt Holly (Century) and Ferndale's earmarked closure (Alcoa). But, given ING's expectations for Aluminium prices above \$2,000, a 20% swing in the premium only brings 2% to the top line so is unlikely to drive the investment decision. These smelters future depends far more so on securing electricity deals.

US Aluminium Capacity (Mtpa)



Source: IAI

LME Aluminium Feb-March '18 (+ve is backwardation)



Source: LME

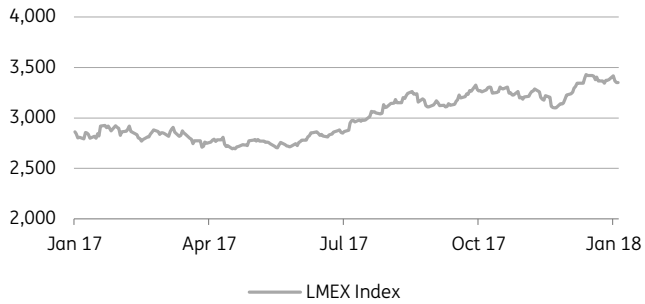
Knock on effects to LME

Premiums fight with backwardations when it comes to attracting metal into the LME. Stock financiers who want to liquidate rather than pay the cost of rolling the short hedge will hunt for the extra non-LME revenue. But following the LME's warehouse reform (e.g. queue based rent capping) the incentives paid for putting metal on warrant has dropped. The nearby time premium of the backwardation must therefore make up this shortfall to attract deliveries.

Key to our high LME price forecast is the support of an ex-China deficit in primary aluminium and a tightness in the LME system so that backwardations support prices. Sharp backwardations as monthly rolls expire have been increasingly common since 2015. At the time of writing, the Feb- March 18 spread has surged to a \$7.5b. A higher US premium necessitates such tightness by discouraging warranted stock. 232 risks increasing US smelting in the long term but nearer term it reinforces our bullish view.

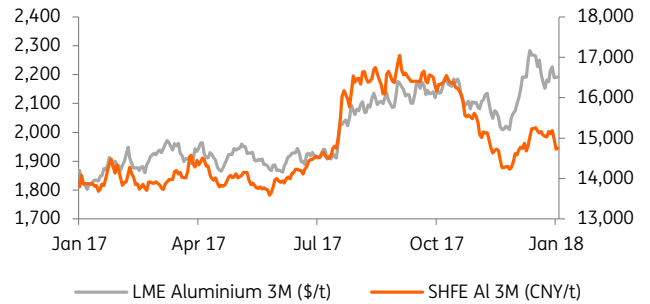
Charts

Fig 1 LME index



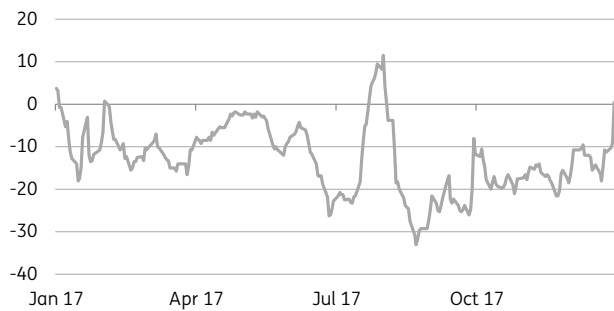
Source: Bloomberg

Fig 2 Aluminium prices



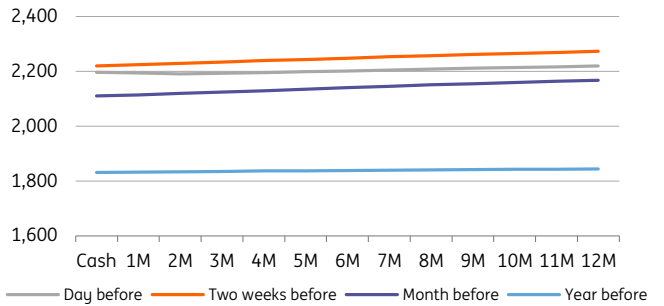
Source: Bloomberg

Fig 3 LME aluminium cash-3M price spread (US\$/t)



Source: Bloomberg

Fig 4 1Yr forward curve: LME aluminium (US\$/t)



Source: Bloomberg

Fig 5 SHFE-LME spread: Aluminium (US\$/t)



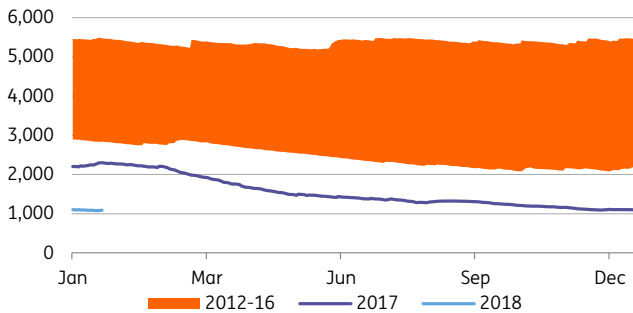
Source: Bloomberg

Fig 6 LME Al net managed money (000 lots)



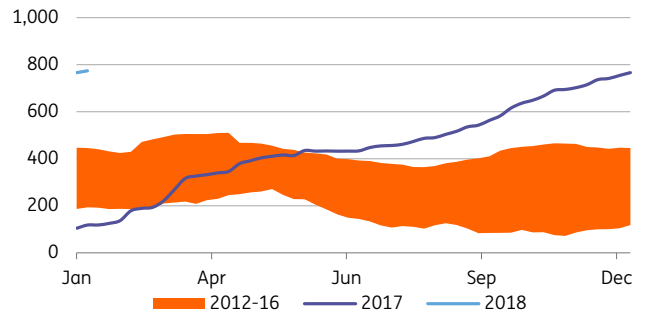
Source: Bloomberg

Fig 7 LME aluminium stocks (000t)



Source: Bloomberg

Fig 8 SHFE aluminium stocks (000t)



Source: Bloomberg

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