

 **METALS & MINING**

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Aluminium price floor emerging: Alcoa

- **Aluminium price floor building up with a tighter physical market, but near-term upside capped by high demand uncertainty**
- **Triggers for price breakout include visibility on economic recovery, end to the Russia-Ukraine war, and sanctions on Russian aluminium**
- **Key monitorables are automotive build rates and length of maintenance shutdowns at US plants plus billet premium in Europe**

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We summarise key takeaways from our interaction with Jim Dwyer, VP – Investor Relations and Pension Investments, Alcoa (AA US, Not Rated).

Aluminium price floor emerging: While aluminium prices have been range-bound at US\$ 2,100-2,400/t over the past two months, Alcoa's discussions with western investors suggest that a price floor is building up. This is being supported by aluminium smelters operating nearly halfway into the cost curve and significant margin compression from high energy and raw material costs. Even if raw material inflation starts to ease, it will take one or two quarters for prices to hit the cost base and support margin improvement.

Near-term upside capped by demand uncertainty: Aluminium physical markets are relatively tight with low inventory levels and a reduced demand-supply imbalance post smelter closures, but near-term upsides appear capped by the hazy outlook on demand. Signs of slowdown in Europe, patchy recovery in China and destocking/purchase deferrals by US buyers all make for a volatile demand climate.

Triggers for price breakout: We believe tightness in the aluminium market will start getting priced in once there emerges a strong probability of no major recession in the US, a manageable recession in Europe and sustained recovery in China. An end to the Russia-Ukraine war would also aid economic recovery by way of lowering energy costs and boosting demand. Alternatively, sanctions on Russian aluminium could also be a trigger if they are restrictive enough to block global trades outside the developing world (e.g. curbs on global traders).

Read-across for Indian aluminium players: Although it is difficult to put a timeline to price and margin recovery, we believe that revival may take at least six months considering prevailing demand uncertainty as well as the typical lag in pass-along of raw material costs. For further insights from our discussions with other major global producers, please refer to our report of 20 October, [Aluminium market in need of supply rebalancing](#).



Other takeaways

Sanctions on Russian aluminium a price trigger if restrictive enough

Our discussion with Alcoa suggests that restrictions on aluminium flow into the developed world together with curbs on global trading with the developing world would definitely tighten supply and lead to a near-term price shock. However, the eventual impact will hinge upon actual curtailment of Russian supply and leakage of physical flow escaping sanctions. As sanctions on aluminium have economic consequences for imposing countries, it remains to be seen whether the western world can indeed build a consensus around this proposal.

Difficult to quantify need for incremental closures

While supply adjustments are essential to rebalance global markets, the quantum will depend upon aluminium demand as well as actual closures coming through. For companies with a few smelting sites, closures become an existential crisis. Local governments also encourage players to avoid shutting their doors to limit economic fallout. Chinese companies have initiated closures in Q4CY22, but their duration is uncertain. In light of the spiralling energy costs, Alcoa believes an additional 1mt of European capacity is at relatively higher risk of shutdown.

Key aluminium demand indicators to watch

Variables such as automotive build rates and the length of maintenance shutdowns at automotive and consumer durable plants are lead indicators of North American demand for aluminium. On the property market front, the rise in US interest rates is unlikely to result in a collapse of the real estate sector as 80% of US mortgages are fixed at a rate below 3% for a duration of 15-30 years. The rate hikes could defer closing of these mortgages and new buildouts, but US homeowners can survive this downturn. For Europe, billet premiums offer a sense of underlying demand.

Alumina price floor also building up

Alumina is in relatively greater surplus than aluminium, though supply constraints do exist. As against new refineries built in China, there is pressure to close older plants. Outside China, new refineries with reliance on coal as an energy source are facing cost pressures. Bauxite has also become expensive with the physical market tightening after constraints on supply from Guinea.

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