METALS & MINING

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Aluminium outlook healthy but limited price upside in FY24E

- **Aluminium prices to remain in a tight range of US$ 2,300-2,500/t in H1CY23, as per our global channel checks**
- **Prices likely to stay range-bound through H2 as well despite the return of demand, as markets regain balance**
- **Long-term aluminium price outlook soft given potentially lower needs of new primary smelters in China**

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We summarise takeaways from our recent interaction with a global aluminium expert.

Price correction sparked by looming risk of global slowdown: Aluminium price has fallen 9% since Jan'23, with industry experts attributing the correction to the need for a more aggressive US Fed and the possibility of higher interest rates for longer.

H1CY23 pricing to be range-bound…: Our channel checks suggest global aluminium prices will remain in a tight range of US$ 2,300-2,500/t amid a continued surplus in China which is facing a sluggish demand recovery and the risk of below-mandated supply cuts. Outside China as well, demand is likely to be under pressure in H1CY23 even as exports from China are likely to fill any supply gaps. The levy of higher import duty on Russian aluminium by the US will not affect market flows much.

…with similar trends through CY23 as markets regain balance: Key drivers for potentially flattish aluminium pricing through CY23 include (a) the return of modest demand growth across both China and the rest of the world, (b) adequate Chinese supply with the likelihood of lower production cuts, (c) slower return of curtailed European production, and (d) easing of energy inflation.

Long-term price expectations softer but still healthy: With demand in China maturing, the need for new primary aluminium capacity beyond the government's mandated production cap of 45mt decreases. The focus is likely to shift to more scrap generation to increase secondary production of aluminium. Outside China as well, new smelters with coal-based power generation sources are unable to arrange financing. Hence, the probability of pricing breakeven for a new smelter from a high-cost existing producer is reducing, lowering the potential price range in the long run.

Implications for Indian aluminium players: With aluminium price movement likely to be limited in the near-to-medium term, we believe margins for Indian aluminium players will be dependent upon domestic coal availability and international coal prices. Given Coal India's concerted efforts to raise coal production and the allocation of coal blocks to producers, the competitive position of Indian aluminium players is likely to improve over the medium term, in our view.

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Expert call takeaways

Aluminium price to hold in a tight range in H1CY23

Our channel checks suggest global aluminium prices will remain in a tight range of US$ 2,300-2,500/t during the first half of CY23.

- **China likely to remain oversupplied:** The Chinese market is likely to remain in surplus given slower demand recovery amid the impact of power rationing together with higher supply than market expectations as some leading Chinese players in the Yunnan region are defying mandated production cuts.
- **Flagging demand outside China:** Outside China as well, demand is likely to be under pressure in H1CY23 even as gaps from self-sanctions on aluminium production in developed markets are likely to be offset by exports from China, which is currently seeing a positive arbitrage margin on exports.
- **Russian supply unlikely to disrupt market balance:** The levy of higher import duty by the US on Russian aluminium may not materially alter the market balance as Russian supply has already moved to other markets.

Range-bound outlook for CY23 as well

- **Higher interest rates a key risk to demand:** Per industry experts, aluminium price is likely to be supported by a return of global demand growth to 2-3% in CY23 from flat growth a year ago. While Europe remains weak, demand in the US and India remains resilient. However, aluminium demand is more sensitive to interest rates (linkage to construction, auto) than commodity prices, pointing to higher risk.
- **Market balance set to return in CY23:** China is likely to be well-supplied as compliance with proposed smelter cuts is likely to be less than optimal to tide over the potential power shortage amid heatwave conditions. Outside China, close to 1.4mt of capacity has been cut in Europe in response to higher energy prices last year. Potentially half of this supply could return if energy prices move closer to the levels seen before the Russia-Ukraine war. Russian production has not seen much disruption either, due to improved domestic demand and rerouting to alternate markets.

Longer-term prices likely to soften but remain healthy

The previously anticipated upshift in aluminium price to support the full costs of a new marginal greenfield plant is less likely to occur as the need for new primary smelters reduces globally. We see increasing probability of pricing driven by variable costs of existing high-cost smelting capacity. This means that aluminum price is less like to climb higher even over the longer term.

- **China may not need to go beyond primary aluminium capacity cap:** With demand in China maturing, the need for new primary aluminium capacity beyond the government’s mandated production cap of 45mt decreases. The focus is likely to shift to more scrap generation to increase the secondary production of aluminium. Outside China as well, new smelters with coal-based power generation sources are unable to arrange financing.

- **Longer-term shift to green aluminium projects inevitable:** A shift to green aluminium projects over the long term looks inevitable as financing dries up for coal-based smelters and scrap-based secondary production gains momentum.

Green aluminium gaining ground

- **Russia using green supply to access developed markets:** Green aluminium has started gaining ground as Russian producers are using this route as a differential advantage to continue sales. We believe Russian supply of the green metal has increased sharply from 0.05mt in CY20 to 0.3mt in CY21 and to 1.5mt in CY22. Green metal is being offered to sustain sales in developed markets and is not earning a premium at this stage. Western producers too are deriving only a modest premium for their green offerings.

- **Scrap-based production route to increase:** Blending of scrap-based production with primary aluminium is likely to be a preferred route to meet emerging green aluminium demand. The use of renewable energy for aluminium plants is not yet established due to the requirement of stable power supply.

Alumina price upside also limited

- **Global alumina trade in balance:** Alumina is priced at 12-13% of aluminium – in the mid-cycle range by historical standards. Global alumina trade is already in balance as China has stepped in to fill supply gaps in the rest of the world. While the Chinese cost of alumina production is higher due to the import of bauxite and use of coal as an energy source for marginal production, costs are likely to decline near-term as returning Australian supply induces a pullback in thermal coal prices.

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SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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