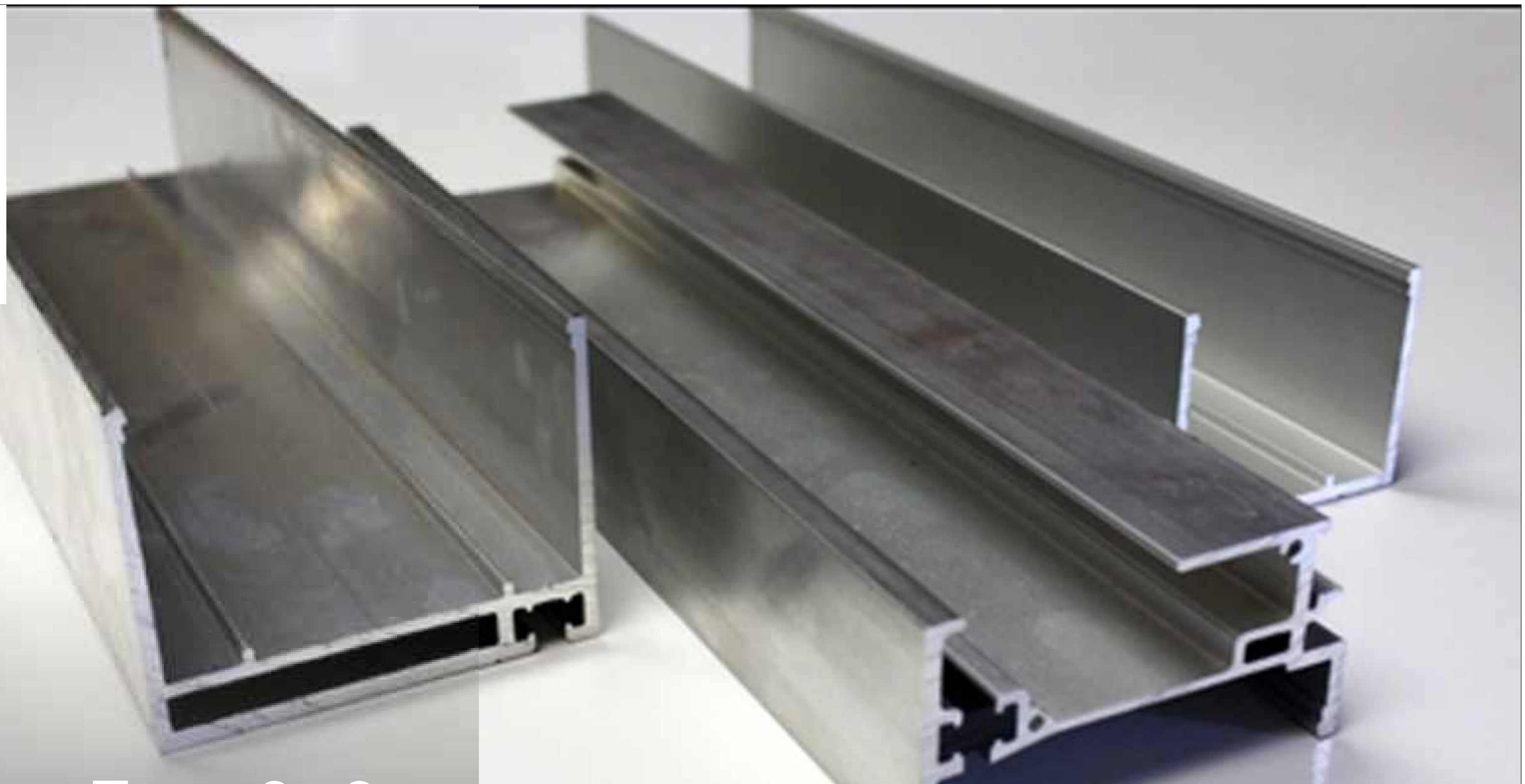

Aluminium Tastes Low Water for A Distant Recovery

Aluminum prices are currently trading near $1830 levels at LME and are down by 12% year to date. Supply overhang and weak demand outlook from top consumer China may continue to weigh on the prices. Prices may further come under pressure tracking reduced risk appetite and firmness in US Dollar amid expectation that US Fed may scale back its aggressive monetary easing in coming months. Loose monetary policy and excessive liquidity was of the major driver for the metal's recovery to $2800 levels from trough of $1280 and withdrawal of this measure will deflate prices. On fundamentals front prices may come under pressure amid record high stocks at LME warehouses and expectation of supply surplus even in 2013.

- Metalworld Research Team

Price Movement

Aluminium prices opened on a higher note in 2013 hitting highs of $2184 on 3rd Jan 2013. Prices however have been trending lower ever since. With euphoria over US debt deal fading, weak fundamentals of Aluminium started weighing on prices. We saw some revival in prices in February amid expectation that demand from top consumer China will pick up post lunar day holiday. However the demand failed to recover and bearishness returned to haunt Aluminum prices.

On macroeconomic front, worries over slowing economic growth in top consumer China coupled with deepening recession in Euro Zone dented market sentiments. In China factory activity or Manufacturing PMI continued to tether near 50 level mark, in first six months of 2013. A PMI of more than 50 represents expansion of the manufacturing sector, while a reading under 50 represents a contraction. Further China's economy expanded at a slower pace of 7.7% in first quarter of 2013 as against market expectation of 8%.

Meanwhile in US factory activity eased to 49 in May from 54.2 in February while in Euro Zone, manufacturing PMI continued to remain below 50 level mark for 23 straight months. Markets further witnessed huge sell off in March and April tracking political instability in Italy and debt crisis in Cyprus.

Cyprus on 25th March clinched a last-ditch deal with international lenders to shut down its second largest bank and inflict heavy losses on uninsured depositors, including wealthy Russians, in return for the bailout. Sentiments turned soured as investors grew wary that unlike previous peripheral euro zone country bailouts, the Cyprus deal tapped individual bank deposits, which up to now had been protected.

Prices however sought some support from news of China buying and supply cuts. China's State Reserve Bureau purchased 300,000 tonnes of aluminum in March. Meanwhile production giant Rusal, US's Alcoa, China's CHALCO and Bosnia's Aluminij Mostar, all announced production cuts in view of weak demand and supply glut.

Aluminium prices ended first half of 2013, almost 14.5% lower at $1773 a ton after hitting lows of $1758 on 27th June 2013. The sharp fall in later June was due to risk erosion after US Fed said it would taper its bond buying programme if economy improves with a target to end it by mid-2014. Meanwhile on fundamentals front, rising stocks at LME warehouses coupled with supply glut weighed on the prices. Aluminium stocks at LME hit record highs of 5.44 million tonnes in June 2013. On domestic exchange prices hit lows of Rs. 96.65 on 2nd May 2013 after hitting lows of 117.95 on 3rd January. Prices were down more than 7% in first half of 2013 compared to December 2012 close.

Demand Supply Scenario

Aluminium market continues to suffer from chronic oversupply. Markets have been in supply surplus since 2004 and in 13 out of last 15 years denting prospect of higher prices. According to World Bureau of Metal Statistics (WBMS), global Aluminum demand rose by 6.65% in 2012 to 45.23 million tonnes as against 42.41 million tonnes in 2011 while global production rose by 3.3% to 46.19 million tonnes from 44.72 million tonnes in 2011. The calculated market surplus for primary aluminium for 2012 was 962,751 tonnes as against a surplus of 2.31 million tonnes recorded for the whole of 2011. Stock to use ratio remained almost unchanged in 2012 at 59.6 days as against 60.2 in 2011 but was lower than peak of 68.5 days in 2009. According to the latest data from WBMS world mined Aluminium production rose by 5.5% in January- April 2013 to 15.68 million tonnes as against 14.86 million tonnes in January-April 2012. Meanwhile world refined Aluminium consumption also rose by 5.5% to 15.11 million tonnes in January-April 2013 from 14.31 million tonnes in January-April 2012.

The calculated market surplus for the first four months of 2013 was 423,000 tonnes up 3.1% from 410100 tonnes in same time frame in 2012. Economist Intelligence unit (EIU) estimates global demand to grow at a slower pace of 3.3% in 2013 to 46.78 while it estimates global production to grow by 4.2% in to 48.095 million tonnes. Overall, Aluminium market may continue to remain in supply surplus in 2013. The surplus may widen to 1.3 million tonnes in 2013 from estimates of 970,000 tonnes in 2012.

Demand is expected to grow at slower pace amid slowdown in demand from top consumer China. China accounts for more than 45% of world's total aluminium consumption. The nation's apparent aluminum consumption in 2012 rose by almost 15%, a three year high, despite slowing

economic growth in the region. The rise in demand was majorly due to rise in imports due to favourable arbitrage opportunity and steps taken by the Chinese government to spur economic growth in the region. China's Aluminium import rose by 130% in 2012 to 517,021 tonnes after declining for prior two years. However most of the metal has gone into bonded warehouses and not actually consumed. Meanwhile the Chinese government in September 2012 announced plans to pump in 1 trillion Yuan ($158 billion) in infrastructure program fuelling to boost economic growth in the region. Also China's State Reserves Bureau (SRB) kicked off its buying spree, taking volumes of 100,000 tonnes of aluminium from domestic smelters.

Demand is expected to slow to sub 4% in 2013 as China's economy continues to slowdown. The economy grew at a slower pace of 7.7% in first quarter of 2013 as against 7.9% in the final quarter of 2012. Further China growing tolerance to this slower growth rate is also signaling weak demand prospect. The nation seeks 7% annual growth this decade, down from more than 10% in the previous 10 years while the government has a full-year target of 7.5% for 2013. Also destocking after last year's huge build up may limit China demand.

Demand from US is expected to grow by around 4% while that from Euro Zone may contract by 0.7% as the region continues to battle deepening recession. On Supply front, Aluminium production in 2012 grew at a slower pace of 3.3% majorly due to production cuts by major aluminium producing firms in response to weak prices and environmental issues. The supply is however expected to grow by slightly better pace of 4.2% in 2013 to 48.09 million tonnes. At current Aluminium price of sub $1800 most of the Aluminium producers are incurring losses. However rising spot premiums have curtailed sharp supply side response. Aluminium premium in Europe have risen to $230 to $250 per ton while those at US have risen to 11 to 12 cents a pound.

Despite this US largest Aluminum producer Alcoa announced it plans to review 460,000 metric tons of aluminum smelting capacity over the next 15 months for possible curtailment in the face of massive global over-production. Further Bosnia's sole aluminium smelter, Aluminij Mostar, said its supervisory board has decided to shut down the plant on June 17 after it had continued to make losses. It has a capacity of 160,000 tonnes a year. Also China's largest producer Chalco has decided to temporarily close some capacity due to weak market conditions. The company said it had decided on a flexible production strategy, which involves a temporary shutdown of production

ALUMINIUM SCENE					
Year	Production (MT)	Consumption (MT)	Surplus (MT)	Stocks (MT)	Avg price ($/t)
2007	38.16	37.40	0.76	2.96	2664
2008	39.18	36.91	2.90	4.71	2623
2009	37.29	34.57	2.72	6.49	1705
2010	41.62	40.18	1.44	6.50	2200
2011	44.72	42.41	2.31	7.00	2421
2012	46.19	45.23	0.96	7.36	2052
2013*	48.10	46.78	1.32	7.45	1956#

*Estimate, # till June 2013, Source: World Bureau of Metal Statistics

capacity of approximately 380,000 tonnes of aluminum. We expect more aluminium producers to announce production cuts in this quarter in response to weak demand and lower prices. However whether or not actual cuts happen will be known later in the year.

However production from Middle East is expected to rise amid lower energy cost. Production from Middle East may rise by 11% in 2013 to 2.1 million tonnes. In Abu Dhabi, Emirates Aluminium (Emal) is expected to boost its production from 800,000 tons now to about 1.3 million tons in the first half of next year when it finishes a $4.5 billion second-phase development project which is already under way.

Stockpiles

Aluminum prices further come under pressure due to rising stockpiles at exchange warehouses. Aluminium stocks at LME and SHFE warehouses put together rose by 3.25% in 2013. Stockpiles at LME warehouses have risen more than 235,000 tonnes or 4.3% in first six months of 2013 hitting record high of 5.45 mn tonnes. However those at SHFE have declined by 9.5% or 41994 tonnes. Despite stocks hitting record highs at LME warehouses prices have continue to seek support from lack of material in the spot market. Most of the stocks lying at LME warehouses is tied up in financing deals making the material unavailable for actual consumption. Of the metal that is not tied up in financing deals is stuck in a long warehouse exit queue. More than 40% of Aluminium stocks or almost 2.25 million tonnes is marked for delivery creating huge exit queue. The LME had raised the minimum rate at which its biggest warehouses must deliver to 3,000 tonnes a day from 1,500 tonnes a day earlier, and has upped the rental costs for users to store aluminium.

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Recently in April it further announced a new plan to deal with rates of warehouse delivery for metals, whereby warehouses that have 30,000 tonnes of commitments for a single metal will have to deliver a further 500 tonnes/day of other metals. However, reportedly there are still long delays creating artificial scarcity in the market. In a surprise move, LME on 1st July announced that from next year (if approved), LME will require warehouse companies to deliver out more metal than they load in at locations where the queue to withdraw metal is 100 days or more. However since the rule may apply from April 2014 it may not have immediate effect on the existing queues nevertheless the premiums that are offered by the warehouses may come down. Going forward we expect Aluminium stocks to trend higher at LME warehouses, amid weak demand and steady production, putting pressure on the prices. However artificial scarcity created due to financing deals and long exit queues may cap the downside.

Outlook

The downside may however be capped amid expectation of robust demand from US. Recent slew of positive data from US is signaling recovery in world's largest economy. On Fundamental front prices may seek support from artificial tightness due to stocks at LME warehouses being tied up in financing deals and higher cancelled warrants ratio that has created long exit queue at LME warehouses. Further supply side response to weak prices may also cap the downside. Aluminium prices have been trading below cost of production for quite some time now. It is believed that at prices below $ 1900 more than 40% of aluminium producers are incurring losses.

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