

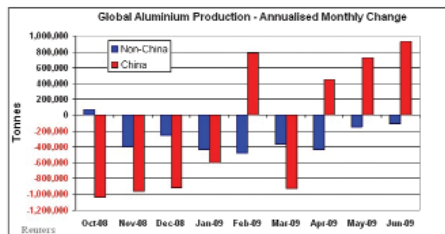
# Aluminium held aloft on the wings of hope and optimism

Goran Djukanovic, an Aluminium Market Analyst, based in Montenegro, charts the recent rise in the price of aluminium. This upward movement may be short lived and the Author suggests that a long period of volatility may lie ahead.

Base metal prices rose above all expectations during July and over the traditional summer slow-down period. The main market drive seemed to be mostly speculation rather than any fundamental reason. Traders, generally, are expecting increased orders and a strong economic demand in the fourth quarter of this year and into 2010. Each base metal could be described as a kite, flying on a wind of optimism.

The price of aluminium has surprised analysts twice during the course of this year. First, when it fell to US\$ 1,251 per tonne at the beginning of the year, and then again in August when it climbed past US\$ 2,000, far sooner than anyone could expect or predict.

The average LME cash price for aluminium for the first seven months of the year was US\$ 1,457.5 per tonne. The growth in LME stocks has slowed in recent weeks, reaching 4.57 million tonnes in the first week of August. Of this, around 2 million tonnes was estimated to be tied up in financing deals and not available to buyers. According to some sources, the quantity thought to be tied up in such a manner was as much as three quarters of the total stocks and these will not be available until the second quarter of 2010 (May?). It is interesting to conjecture what will happen when these stocks are released – will aluminium flood or overwhelm the market?



Global aluminium production from October 2008 to June 2009

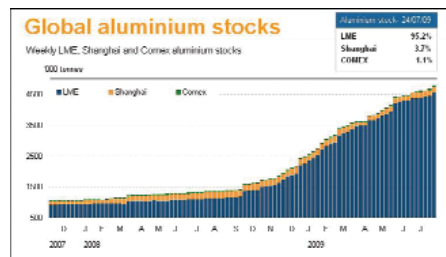
In comparison, most stockholders in the People's Republic of China have not hedged or locked up this metal through trade finance, leaving the stocks in China free to be released at any time. As a result, this may result in a bigger swing factor for prices than the LME stocks.

It seems that the pace in the rally of metal prices has been too fast when compared to the actual fundamentals of the economy. For instance, the prices of base metals and energy are higher now, at a time when the major economies are still in recession, than was the case in 2004-2005, when the economies were in a positive situation, with a growth in GDPs of 2-4%. The major difference between then and now is the role of China in global markets. Watching the current LME prices of aluminium, even the latest Reuters' poll of base metal prices, released in mid-July, now seems quite out of date. About two thirds of analysts have revised to the downward average price forecast for this year, whilst most have lifted this prediction for next year. However, the latest spike in prices

at the end of July forced some institutions that had already lifted their forecasts for this year and next to make a second correction in less than a month. For example, Bank of America's Merrill Lynch in London expect the price of aluminium to average US\$ 1,653 per tonne in 2009 – an 11% increase over the previous prognosis – and US\$ 1,742 in 2010 (+9.5%). Barclays Capital also lifted its average price forecast for aluminium after reversing it down, in early July, to US\$ 1,532 in 2009 (+6.85%). The organisation's forecast for 2010 remained unchanged at US\$ 1,700 per tonne. J P Morgan have suggested that the rally in base metals is likely to be sustained as consumers return to the market. In view of this, they lifted their price forecast for aluminium to US\$ 1,608 in 2009 (+9.5%) and to US\$ 1,775 in 2010 (+8.1%). Goldman Sachs, again amongst the greatest optimists, expects commodity prices to spike sharply higher next year.



Goran Djukanovic



Global aluminium stocks from December 2007 to July 2009

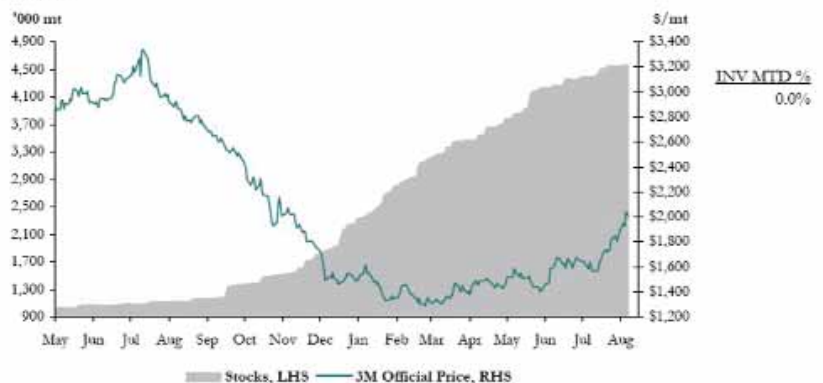
## Trends in the Economy

Some key economics indications are as follows:  
 In the USA, new factory orders rose in June by 0.4% over the previous month. The ISM non-manufacturing index fell in June to 46.4 from 47, the first monthly drop since February, whilst GDP contracted 1% in the second quarter, compared with -6.4% in the previous quarter, both on the annual level. The USA's GDP has fallen for four straight quarters, the

first time since records were started in 1947.  
 In the People's Republic of China, the China Construction Bank, one of the country's largest lenders, is likely to cut new lending by as much as 70%. If this were to happen, it could also slow demand for metals and energy. At the same time, production of aluminium in China has again started to rise, whilst imports are falling. At the current prices, China may soon become a net exporter again. Despite the fact that the Chinese economy has grown by 7.1% in the second quarter, year on year, electricity production has been flat in the first half of the year, and lower than the same period the previous year, indicating that manufacturing and industry at large, including heavy consumers, are yet to recover.  
 German manufacturing orders rose sharply in June, in the face of strong foreign demand, mainly for capital goods. This signalled that Europe's major economy is on track for recovery. Orders rose 4.5% on the month, the biggest gain since 2007 and the fourth con-

## LME Al Stocks Up 0.0% (2,000 mt) At 4,562K mt In Week Of Aug 7

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Aluminium stocks and price per tonne from May 2008 to August 7th 2009



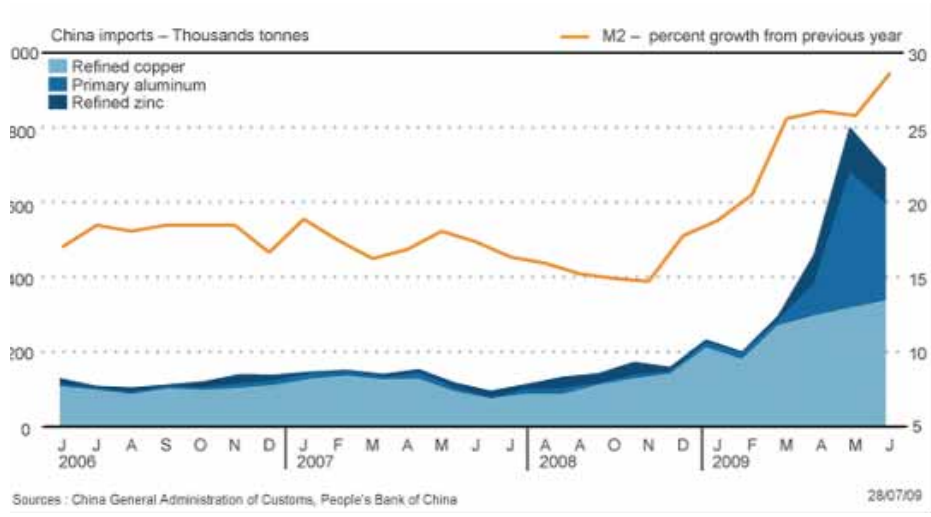
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China imports of aluminium, copper and zinc from July 2006 to July 2009

secutive monthly rise. The German industrial sector contracted at its slowest pace in ten months in July. The same month saw unemployment fall for the first time in nine months.

In Japan, exports increased 14.6% in June, compared with the previous month, narrowing the year-on-year decline to 37%, after a fall of 42.2% in May. The closely-watched core machinery orders rebounded by 9.7% in June, from a record low in the previous month. It was the first increase in four months. Analysts predict that the growth of GDP will have been positive in the second quarter at between 2 to 3%. The economy shrank at an annualised rate of 14.2% in the first quarter of this year.

Although there are firm signs that many major economies have shown signs of recovery, overall indications of consumer demand still point to significant weakness, with purchasers still remaining reserved. The only major exception is the automobile industry where, thanks to the programmes of support put in place by a number of governments, demand started to rise in the third quarter. However, these government initiatives are of a temporary nature and sustainable improvement is yet to emerge.

**Supply and Demand**

According to the International Aluminium Institute (IAI), the global daily-average of primary aluminium production, excluding the People's Republic of China, fell to 63,000 tonnes in June. Total production for June was 1.899 million tonnes, compared to 2.111 million tonnes in June 2008. IAI data shows that average daily production in the first half of 2008 was 70,100 tonnes, compared to an average daily output of 65,000 tonnes in the first half of 2009 (note that the first half of 2008 had one extra day).

Primary aluminium output in China rose to 1.029 million tonnes in June, from 0.984 million tonnes in May, compared with 1.172 million tonnes in June 2008. Production in June was at an estimated figure of 12.5 million tonnes, the highest level since October 2008.

Over the whole of 2008, China produced 13.105 million tonnes of primary aluminium, whilst this year it is forecast that it may reach 14 million tonnes as a result of current and future reinstatement of capacity, encouraged by the rise in the metal's price. China became a net importer of aluminium in the first half of the year, with net imports of nearly 1 million tonnes in the first six months.

It can be concluded from the available figures that world production, excluding China, was almost 2 million tonnes lower for the first half of this year, compared with the same period last year. Taking into account that China has already restarted about 3 million tonnes of primary production, temporarily closed earlier this year, and that other restarts are likely to take place in China and elsewhere, it can be concluded that global aluminium production will only fall by less than 5% in 2009, compared to 2008.

The Author expects that the total world surplus of primary aluminium will amount to 1.5 million tonnes in 2009. The analysts' medium forecast in the traditional Reuters' poll in July was +1.7 million tonnes. Alcoa expects a surplus of 1.2 million tonnes.

Analysts are of the opinion that the USA's US\$ 1 billion programme "cash for clunkers", under which buyers of new cars are able to turn in old cars for a

US\$ 4,500 discount, will boost the demand for new vehicles, and hence increase the demand for aluminium. The US House of Representatives approved a US\$ 2 billion extension of the programme in August. The build rates may go up by 1 million cars in the second half of the year, compared with the first half. The programme is thought to account for an increase of 250,000 vehicles. Altogether, this will result in an increased demand for about 130,000 tonnes of aluminium in the second half of 2009 – mostly in the form of secondary aluminium and plate. Public reaction in the USA in the context of auto-manufacturer bailouts is interesting, inasmuch that 46% of Americans say that they are more likely to buy a car from Ford, because the company did not take Government money to stay in business.

European sales of new cars rose by 2.4% in June, again boosted by scrapping incentive schemes, the first increase in 14 months. In China, car sales rose in June by 47.7% compared to June 2008, to 872,900 units, again supported by Government stimulation. Total vehicle production is expected to reach 11 million units in 2009.

Bloomberg reported that Japan's shipments of rolled aluminium products fell at their slowest pace, in over seven months, in June, as demand from can and automobile manufacturers improved. The Japan Aluminium Association has revealed that supplies to the domestic and export markets in June declined by 21.6% to 158,605 tonnes, compared to 202,221 tonnes for the same month in 2008. The pace of decrease slowed for a fourth month after starting to drop in October. Shipments fell by 39% in February, the worst slump in 34 years.

**Alumina**

Rising aluminium production in China is also increasing demand for alumina, lifting domestic prices

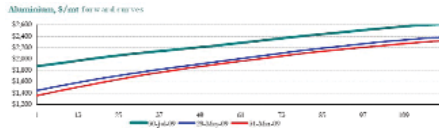
<b>Aluminium cash price forecast 2009 &amp; 2010</b>				
Company	2009		2010	
	US\$/t	USc/pound	US\$/t	USc/pound
ABARE	1510	68.50	1745	79.20
Bank of America	1500	68.00	1600	72.60
Barclays Capital	1427	64.70	1700	77.10
BMO Capital Markets	1521	69.00	1800	80.00
Calyon	1500	68.00	1700	77.10
Citigroup	1430	64.90	1540	69.90
Commerzbank	1550	70.30	1950	88.50
Credit Suisse	1764	80.00	1984	90.00
Deutsche Bank	1422	64.50	1436	65.10
EIU - Economist Intelligence Unit	1487	67.40	1470	66.70
Goldman Sachs	1480	67.10	1800	81.60
HSBC	1499	68.00	1653	75.00
JP Morgan	1455	66.00	1631	74.00
Macquarie Bank	1442	65.40	1543	70.00
Metal Bulletin Research	1463	83.46	1708	77.50
Mitsui Bussan Commod.	1550	73.00	1800	81.65
Morgan Stanley	1499	68.00	1764	80.00
Royal Bank of Scotland	1653	75.00	1984	90.00
Scotia Bank	1477	67.00	1653	75.00
Societe Generale	1441	64.40	1660	75.30
Standard Bank London	1590	72.10	2060	93.40
Standard Chartered	1571	71.30	1825	82.80

Source: Reuters Poll - July 2009; Goran selection;

Reuters aluminium cash price forecast 2009 and 2010

Feature

to around US\$ 350 tonne. Spot alumina was offered for around US\$ 300 tonnes to Chinese ports in mid-July, some US\$ 30 tonnes more than a month earlier. Alumina production in China slipped back in June by 4.3%, year on year, to 1.93 million tonnes. For the first half of the year, production was 10.6 million tonnes, a decline of 4.6% from a year ago. The National Aluminium Company Limited (NALCO) in India has sold 30,000 tonnes of alumina at the beginning of July to a Swiss trader at US\$ 241.3 tonne on a Fob basis.



Aluminium forward curves

*Metal Bulletin* reported that NALCO sold the same amount to the Trafigura trading company at the beginning of August for US\$ 283.69 tonne. This shipment will take place in September.

**Some key price indicators**

At the moment, the US dollar continues to slip downwards against the Euro at 1.42 to 1.43, while most currency analysts expect the value to reach 1.5 per Euro by the end of the year. If this were the case, commodity prices would benefit. However, by the end of 2010, there will be pressures, both political and economic, to begin to tighten interest rates to avoid inflationary trends. These should result in a stronger US dollar.

The Baltic Dry index, which tracks shipping costs and which is considered to be a leading indicator for commodity prices and economic health, had its worst week, since October last year, at the beginning of August. The index fell from 3,350 to 2,772 during the week, a fall of 17.2%, as imports of iron ore and coal into China slowed down. However, some traders believe that imports have only temporarily lost ground as Chinese steel mills are still locked in talks over the pricing of iron ore imports over the next 12 months.

**Conclusion**

There are plenty of these “positive expectations” being aired at the moment. However, there is a great probability that not all of them will be realised, which may result in disappointment. Commodity prices may have risen too early and too fast for the current stage in the world economy at the moment. As a result, it may suffocate it and prolong the recovery over the following months. This seems to be the main risk for the economy in the next term, and it may also speed up inflation. It seems that there are too many economists around voicing too many opinions. However, experience has shown that in daily life the louder majority is not always right. Some economists, who have even helped economies slide into even deeper crises on the backs of their policies, are now amongst the first of those to offer solutions and happy endings. Real sustainable recovery in the global economy will require facts and results, not simply words and optimism.

As for the aluminium industry, there may be even more challenges ahead, compared to some other metals and commodities. Someone may ask how it is possible, for instance, for the price of copper to be three times higher compared to that of aluminium, knowing that in 2003 it was only about 10% higher? How is it possible that as much as 90% of the global alu-

minium industry remained unprofitable in the months leading up to the end of 2008 and into the first quarter of this year?. Has the race to be the number-one aluminium producer in the world brought with it debts, closures and bankruptcies? Once again, it has been proven that a market-led policy is not the best solution for some countries. Some governments have already intervened to save their aluminium industries, including Germany, Montenegro, and above all, the People’s Republic of China.

Before the end of the year, there could be significant restarts of capacity if the price of aluminium remains above US\$ 2,000 per tonne. Some 80% of global production capacity is estimated to be profitable at this price. The 575,000 tonne-per-year Qatalum smelter will commence production by the fourth quarter of 2009. Finally, it would not come as a surprise at all to see China, after importing huge amounts of alumin-

ium in the first half of the year, commence to start exporting the metal again, but this time at higher, current, prices. This will inevitable lead to stocks accumulating even faster in LME warehouses as the remaining part of the year progresses. With waning optimism and still weak demand, this may lead, during the last quarter of this year or the first half of 2010, to a repeat of the sharp fall in the price of aluminium. This is why the latest metal price rally cannot be sustainable at the moment. The global economy would benefit if the latest growth in the price of aluminium was delayed for a year, manifesting itself in September 2010, for example. It would provide the time and the opportunity for the economy to gather pace and warm up for a real and fundamental recovery, readying itself for the next super-cycle. Instead, the Author suspects that a long period of volatility lies ahead.

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