MARKET REPORT – SDEPTEMBER 2017

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ALUMINIUM FEDERATION

MARKET REPORT

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ECONOMY

The The official figures for August show a faster-than-expected fall in UK government borrowing, with a £10 billion windfall, as the deficit dropped to its lowest August level for ten years. VAT receipts hit record highs and state spending fell. This follows the surprise data in July which had shown a first surplus for that month in 15 years. Inflation in August was the highest for five years at 2.9%. Thus far the Bank of England is not increasing interest rates although under pressure to do so.

In the last Market Report for July-August there were concerns about the value of sterling, at $1.29 and 1.08 euros. The position has improved to $1.34 and 1.14 euros. The pound is now at its highest point against the US dollar since the referendum. The FTSE 100 has been climbing over the last two weeks to 7,372 and similarly the FTSE 250 has also been climbing for the last two weeks, now at 19,874.

At the beginning of the month various reports indicated that the pace of business quickened in August, with the West Midlands showing the highest index of 58.6, (numbers above 50 indicate growth) and Yorkshire and Humber a close second at 58.1. The South East was at 53.3 and the North East 48.8. Across the retail sector a CBI survey showed 56% reporting that sales were up in September compared to September last year and 15% reported that sale were down year-on-year. For the manufacturing sector the CBI showed that in September total order books and export order books are strong but down on previous recent months. They believe that the slow-down in September is due to moderation in domestic demand. Two separate reports at the end of September, one for small businesses and one for mid-sized companies, both concluded that there is less confidence from those who reported about their growth prospects compared to their view three months or so ago.

The OECD has kept their forecasts on UK growth at 1.6% and 1.0% for 2017 and 2018 but they estimate that the UK will then be behind Japan, USA, Canada, France and Italy.

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ALUMINIUM

Good news came from South Wales with the announcement from Sapa, owned by Norsk Hydro, that their plant in Bedwas will be re-opened. This aluminium extrusion plant was Norsk Hydro's first investment outside of Norway when it opened in the early 1970s. For many years it was a leading UK aluminium extruder supplying to the building and construction sector. Sadly it closed in 2014 as the company cited over-capacity in the market. Sapa is investing £9.6 million and has secured £555,000 from the Welsh government for the re-opening. The plant will initially employ 58 people from Q4 2017 and expects to grow that to more than 200 over the next five years. The re-opening is the company's response to the increased demand for aluminium components used in light-weight electric and green cars. The plant will supply The London Electric Vehicle Company, owned by Geely, at their plant in Coventry which opened in March this year where they are producing the zero emissions hybrid London black cabs.

According to the World Bureau of Metal Statistics the global aluminium industry for the first seven months of 2017 was in deficit to a total of 1.38 million tonnes, up from 750,000 tonnes for the whole of 2016. Demand for primary aluminium in the first seven months was recorded as 35.93 million tonnes compared to 33.71 for the same period in 2016. The data on LME warehouse aluminium stocks bears out this information, stocks this year have fallen month by month and at the moment, at 1,300,000 tonnes, are about half of the January figure.

On the LME primary aluminium started the month on $2116 per tonne and fluctuated up and down marginally during the month but ended up at $2110. Aluminium alloy is quoted at $1770. Metal Bulletin are pointing to billet premiums across Europe at a multi-year high of as much as $400 per tonne for the last remaining shipments for 2017. Spain is at $360-375 and in the Ruhr extruders are facing billet premium of $400, the highest since August 2015. At the start of the year they were quoted at $335-355 per tonne. An indication of what is to come, in Italy for 2018 delivery, the value quoted is as high as $400-410.

AUTOMOTIVE

Anybody wanting a quick look at the future of global car-making needed to be at the Frankfurt Motor Show this month. On every stand, cars with conventional engines, petrol or diesel, were at the back of the stand and cars without conventional engines were right at the front and a few cars on show even had no steering wheel. According to Ian Robertson of BMW, the highest-ranking Briton in the global car industry, "The industry is going to change more in the next five years than it has in the last one hundred" he told The Times. He expected that combustion engines will get leaner and cleaner, battery and electric motor technology will get more sophisticated and within less than ten years electric technology and combustion engines will have similar offerings. But the industry is expressing fears that in the early days of the move towards electric cars the profit margins will be hit. UBS in Zurich predict that by 2025 diesel sales will have dropped to less than one third of their current level as customers fear a clamp down on where they can be driven and extra taxation, a trend already showing in the UK sales statistics from SMMT.

Renault-Nissan is set to produce 12 new all-electric cars by 2022, Mercedes will offer electric versions of all its cars by 2022, VW claim that it will produce 50 all-electric models by 2025 and electrify 300 models by 2030 and BMW promise to build 25 new electric models by 2025. At the same time, the European car industry is asking the European Commission to slow down the pace of tightening emissions legislation because, as yet, the public are not heavily engaged in buying electric cars and governments are not installing sufficient charging infrastructure. At present carmakers must produce vehicles that on average produce 95 g/km of carbon dioxide or less by 2020. It is expected that this target will be moved to 70 g/km by 2025. Having discovered the recent emissions scandal on diesels by Volkswagen and others, the car companies are not in a good position to dictate on anything to the legislators.

Two of Britain's best hopes with electric cars were not at Frankfurt. The next generation Nissan Leaf to be built in Sunderland was not on display because Nissan prefers to unveil the model at their home show in Tokyo in October. The Jaguar I-Pace is not yet ready for the motor shows. They expect to have it ready for the Geneva Motor Show in March 2018. However, Jaguar promise that from 2020 all of its models will in some way be available as electric. BMW's Mini Electric, to be built at the Cowley plant from 2019, was on display, showing the design changes that will come with electric cars, not least having no need for fuel tanks and front grills. Low slung chassis, over-sized wheels and lots of glass will be the order of the day.

the 3,000 Vauxhall workers at Ellesmere Port and Luton, are no nearer to hearing about their future; their parent company PSA is waiting for clarity over Brexit before deciding which of their several business models they have developed, will be used.

Showing confidence in UK manufacturing sector, Ineos, the chemicals, oil and gas company led by Jim Ratcliffe, is hoping to obtain government, support for a production line to build a similar version of the Land Rover Defender 4x4 that Jaguar stopped making a while ago in Solihull. It will need some new designs since Jaguar stopped production after hitting safety and emissions problems. Without UK government support Ineos could set up this production line in Germany. The company has earmarked an investment of £600 million. Jaguar Land Rover is now active in protecting their unique design of the Defender with its own trade mark.

Another UK entrepreneur, Sir James Dyson, has announced his intention to enter the electric car market with a £2 billion investment that was started two years ago in Wiltshire with 400 engineers working on a unique battery powered vehicle. He sees the largest market for this in the Far East and the production could well be in that area although the technology will be developed in UK and could result in 4,000 jobs here.

According to SMMT, in August the UK registered 76,433 new cars, which was down on August 2016 by 6.4%. For the year-to-date 2017, new car registrations are down by 2.4%, but not unexpectedly new diesel car registrations are down by 12% over last year and petrol driven cars so far this year are up on last year by 4%. The alternative fuel cars so far, this year are up on last year by 58%, 3,968 compared to 2,507 in 2016. The trend continues. For the first time in some months Ford did not top the sales list, that place was taken by Volkswagen Golf.

Car production in August in the UK was 5.3% down on the figure for August 2016, with 103,232 vehicles produced. The year-to -date figure is 1,106,285 vehicles, 1.9% down on last year. The SMMT do not regard the reduction as significant since August is usually the month for works shut downs and plant maintenance. Commercial vehicles production did better in August, up 18% on last year's figure. Export of commercial vehicles was 62% up on last year. Engine production also had a good August, the number of engines produced in the UK, 151,141, was 12% up on last year, of which the exports were 20% up on last year. Jaguar Land Rover has announced that they will be producing more of their engines at their own Wolverhampton plant and their contract with Ford at Bridgend for petrol engines will end earlier than expected in 2020.

AEROSPACE

Two years ago the province of Quebec invested $1 billion in Bombardier who were running into financial problems over their development of the C Series single aisle plane which is now a challenger in the small commercial jet market. This plane takes 100-150 passengers and is smaller than the planes that are attractive to the Boeing and Airbus. The province took a 49% stake in the company. The UK government also put up £113 million to the Bombardier plant in Belfast, known as Shorts, under a repayment launch investment. Cost - cutting helped Shorts to turn a loss in 2015 of $339 million into a profit of $76 million last year. Delta Airlines signed a contract with Bombardier to buy 125 of the C Series planes. Boeing has now taken a case of state aid against Bombardier to the US International Trade Commission because they claim that Bombardier are selling the planes to Delta at below cost price. It is worth noting that Boeing actually doesn't produce a plane as small as the C Series so there was no competition between the two companies for the contract. If

Bombardier loses, penalties could be imposed on the purchase price of the C Series that would cripple the contract and the company.

Canada and USA are now at loggerheads over this and it can radically affect the viability of the Shorts plant in Belfast, where some 4,200 workers are employed making wings, fuselages and engine casings and some 16,000 more are employed in the supply chain. Canada has put on hold an order for Boeing Super Hornet fighter jets in retaliation. Seeing the way of the wind blowing, Embraer, Brazil, is also taking action in the WTO against Bombardier since their own Embraer aircraft is a competitor for the small commercial aircraft. Bombardier claim that the investments are all in accordance with Canada's international trade obligations, pointing out meanwhile the position of Brazilian state loans to Embraer.

The cost and long-term gestation period for producing advanced civil aircraft means that often some form of state aid is involved and the long-standing dispute over state aid between Boeing and Airbus has never yet been properly resolved. Employment in Belfast, in an area of high unemployment in the UK, is at risk here. Bombardier has already announced some redundancies in Belfast and they have also lost some jobs at their train plant in Derby.

It is worth noting that in the recent past the UK government has invested considerable sums in buying military helicopters from Boeing and an adverse decision will not be viewed favourably by the UK government, particularly because, in the House of Commons, the Northern Ireland MPs hold the difference between a Conservative government majority and a minority. Boeing themselves point to their 2,200 UK workforce that they intend to double and they are building facilities in Sheffield, Gatwick and Lossiemouth. The preliminary announcement from the USA at the end of September is a recommendation that Bombardier will have to pay extra duties of 220% on each of their C Series planes, but the decision will not be confirmed until later in the year. There is some way to go yet on this one.

BUILDING AND CONSTRUCTION

The UK construction sector has experienced its sharpest slowdown in a year as commercial building work dries up. The purchasing managers index for construction fell from 51.9 in July to 51.1 in August, the third consecutive drop in the monthly reading. Key to the position is the lack of new orders as projects are completed. Reduced government spending and concerns over the economic future means that decisions on spending are being held up.

The Office of National Statistics runs to a slower timescale that the PMI index and they report that in Q2 2017 new orders fell by 7.8% dropping to the lowest level since Q1 2014. The fall in new orders was due to the fall in new housing, 4.9% down, and all other work falling by 9.0%. The falls continued in their July data.

The larger house builders are doing well. Barratt Developments unveiled a 12% rise in profits for the year at the end of June, having built 17,395 houses in the year, their highest figure since 2008. Taylor Wimpey, Persimmon and Barratt Developments have all seen profits rising since 2012. These companies are helped by the "Help to Buy" scheme where buyers can purchase with a 5% deposit so long as it is new build, under £600,000. The cost of building materials has also stopped rising, having shot up as the fall in the value of the pound drove up the price of imports.

But the Federation of Master Builders claims that banks are not lending to the smaller housebuilders who they regard as high risk. It is the small housebuilders who buy up smaller plots for redevelopment that are not of interest to the larger companies.

Growth in civil engineering work is now close to stagnation in spite of data showing that factories are having their best period for three years.

ENERGY SUPPLY

During the period June 21 to September 22, sometimes known to people as “summer”, more than half of the UK’s electricity was produced by low carbon sources, nuclear or renewables. The present 52% of the total generated by low carbon sources has increased year on year from the 2013 value of 35%. The guaranteed price for off-shore wind power is now around £57.50 per MWh for new contracts, half of what it was two years ago. The Hornsea One wind farm off Grimsby three years ago won a contract for £140 per MWh. Hornsea Two wind farm, due to come on line in 2023, is now at a guaranteed price for 15 years of £57.50 per MWh. The target set by government for the total of electricity demand generated by off-shore turbines by 2020 has been achieved four years early. Similarly, on the Continent, wind generated electricity prices have fallen and some installations in Germany have no subsidies.

The government clearly can’t put all the eggs in one basket and rely only on wind power but gas can provide the base load far cheaper than nuclear and, dare one say, more reliably too. Hinkley Point C Station’s design and construction are still on-going issues and we are signed up to £92.50 per MWh. But that was at 2012 index-linked prices, already at about £100 today, and the station is still years away from coming on-line, with possibly more nuclear stations to come. The consumers pay the bill.

There is ample evidence that electric cars across the world will expand in numbers but precious little evidence that in the UK the national grid would be able to cope. The Business, Energy and Industrial Strategy committee will examine the challenges posed by electric cars to the infrastructure and consider what actions will need to be taken.

Britain’s first solar farm without subsidies opened at the end of September. It has 31,000 solar panels on 45 acres of farmland. The cost of the panels has fallen rapidly and this site uses large batteries to store power and release it at peak demand. The owners claim that solar farms without subsidies are not economically viable yet and they are seeking the ability to bid for fixed price contracts alongside the offshore wind farms.

Oil prices are holding up well and at the month end Brent crude was fetching up to $59 per barrel, largely because of a threat from Turkey to cut off the oil pipeline from the north of Iraq.

OTHER MATERIALS

An expansion in the production of electric cars will lead to new developments in battery technology. Most of the present generation of electric cars use lithium-ion batteries. Estimates are now being made of the demand for lithium to accommodate this end use. Currently the world supply is of the order of 180,000 tonnes, largely confined to four major companies in Chile. Within 20 years world production is estimated to rise to over 3 million tonnes, with many mining companies anxious to come on board. Since 2015 the price of lithium has more than doubled to $14,000 per tonne.

The cost of replacement batteries is a considerable percentage of the car’s cost as new, 40% is being mentioned. Additionally, at the present time, only 5% of the lithium-ion batteries at the end of their life are being recycled. The International Energy Agency estimates that by 2030 there will be 11 million tonnes of spent battery packs, which can emit toxic gases, cause water pollution and cause extreme fire hazards.

Leading UK precious metals company Johnson Matthey will be spending £200 million on expanding its battery business, both in UK and China. Over the past year a total of $1 billion has been raised by lithium developers and it is estimated that $6 billion will be needed by 2025 to meet demand. New developments in producing lithium in Australia and Mexico are typical.

The copper industry has also put down a marker, claiming that the switch to electric cars will boost demand for copper at a greater rate than can be accommodated by new copper discoveries. Electric cars require four times more copper than today’s conventional models. At the beginning of September the price of copper was at a three year high at $6776 per tonne but has fallen back since to $6470. BHP, a multi-metal miner, has copper as one of its priorities with its mines in Chile and Australia.

Tata Steel and Thyssenkrupp have taken the first steps towards merging their European steel operations. They have signed a memorandum of understanding on creating a 50-50 joint venture which will be reviewed in 2020. They have pledged not to close any operation that would not have been closed had the businesses remained separate. The UK workforce is asking the company to show their commitment to the Port Talbot works by agreeing to re-line the Blast Furnace Number 5 at Port Talbot, which would then give it a life of at least ten years.

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