MARKET REPORT – JULY-AUGUST 2017

ALUMINIUM FEDERATION

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ECONOMY

As has often been the case recently, it is difficult to determine whether the UK economy is a glass half full or half empty. The indicators can be confusing. Certainly, the Bank of England this month indicated that growth in the economy will be weaker than expected, real wages will fall by more than anticipated and inflation will be higher. The Bank is expecting a growth rate this year of 1.7% against their earlier projections of 1.9% in May and 2.0% in February. They point to gloomy expectations on consumer spending. But they suggest that growth in 2018 will be stronger. The Bank also expects that their target inflation figure of 2% will be exceeded over the next three years. On the other hand, the unemployment rate has fallen below their expectations and at 4.5% is the lowest figure for forty years and will fall further.

Surprisingly there has been an increase in the number of employees in UK companies coming from long established EU countries such as Germany, Italy, Spain and France. But during the last month UK net immigration has fallen, apparently with an exodus of people back to the Eastern European countries, particularly Poland. There is therefore a behavioral difference between those from western and those from eastern Europe. With the falling pound relative to the euro, it becomes less attractive to send money home to countries like Poland.

The International Monetary Fund also takes the Bank's less optimistic view, expecting growth this year to be 1.7%, down from their earlier 2% figure. IMF put 2018 at 1.5% growth. Those with long memories will recall that both the Bank of England and the IMF have previously taken a more pessimistic view of the UK economy that they had to revise. It is thought that it is unlikely that the Bank of England will signal a rise in interest rates any time soon.

A surprising statistic was published at the end of August showing that for the first time in 15 years July resulted in the UK economy showing a surplus, albeit a modest one. A sum of £200 million more was collected in tax than was spent. This may give the Chancellor room in the next budget, expected in November, to ease the public sector pay restraint.

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The Institute of Chartered Accountants survey of business confidence shows a negative outlook for up to Q1 2018 against positives in Q2 2017.

The Purchasing Manager's Index, (PMI) for manufacturing at 55.1 in July, revealed that the sector has accelerated after a disappointing second quarter. Foreign demand for goods has risen to the second strongest level seen in the PMI index, exceeded only in April 2010. The domestic demand was also high, but not as strong as had been the case earlier in the year. Of the manufacturers surveyed, 50% thought that next year's production will be higher than this year, only 5% thought the opposite. A CBI report confirmed the trend, suggesting that factories are now producing at the highest rate for 22 years, particularly among food and drink manufacturers - an encouraging sign for aluminium packaging.

Data suggests that the level of UK business investment will remain flat in 2017 and 2018.

At the month end the FTSE 100 is trading at 7,400 and the FTSE 250 at 19,700. One pound sterling will buy you $1.29 or 1.08 euros.

The Eurozone economy is currently growing at a higher rate than the UK, its Q2 2017 figure was 0.6%. Germany has been the powerhouse, with Spain posting good Q2 figures. France and Netherlands were well up on previous years and even Italy has now posted three consecutive quarters of growth at 0.2% in each quarter, the first time since 2010. As a result, the euro is very strong, even to the point that a strong euro may hold back export opportunities in the euro-zone. With the strong euro, the pound is now at an eight-year low against the euro (£1 gets 1.08 euros) and at tourist exchange booths at airports the two currencies are at parity.

ALUMINIUM

At the end of the first half year 2017 major aluminium companies were posting financial reports. Arconic Inc ended the first half with significantly less debt, a strong cash position and good liquidity. Revenue was $3.3 billion - an increase of 1% year on year, driven by increased volumes across all business sectors and higher aluminium prices.

Aleris Corporation reported a net loss in Q2 of $2 million compared to a loss in Q2 2016 of $13 million. Adjusted earnings before interest, tax, depreciation and amortization were up slightly to $66 million. Wage inflation, higher raw material costs and a weaker dollar had negative impacts, with pressure in Europe on both aerospace and automotive products. A planned merger with Zhongwang USA has still to be confirmed, subject to regulatory approvals. Meanwhile Zhongwang Aluminium GmbH has bought the German aluminium extruders, Aluminiumwerk Unna, near Dortmund.

Norsk Hydro will take back full ownership of aluminium products maker Sapa by buying a 50% stake in conglomerate Orkla. The transaction values Sapa at $3.24 billion. Sapa has been jointly owned by Orkla and Norsk Hydro since 2013 and worldwide the company has 22,400 employees. Norsk Hydro produces primary aluminium while Sapa is the producer of semi-fabricated products for aerospace, automotive and the construction sectors. Norsk Hydro itself reported positive second quarter results, driven by higher aluminium prices and favorable currency movements, but offset by higher raw materials and lower alumina prices. Earnings in Q2 were 30% up on Q1.

The Liberty House Group has acquired from administrators a top UK manufacturer of cast aluminium engine and vehicle components, with the purchase of Amtec Aluminium Castings and they have also bought King Automotive Systems, part of the Amtec Group. The companies have some 550 employees and are Tier 1 suppliers to vehicle manufacturers in both UK and Europe. The operations are in Witham, Essex, Coventry and Kidderminster. This strengthens Liberty's wider ambition of increasing the percentage of UK produced components into the UK automotive industry.

Rio Tinto will return $3 billion to shareholders after rising commodity prices helped it to double its earnings in the first half year 2017. Iron ore sales did well, but the impact of strikes in copper mining meant that the company missed the expectations of financial analysts.

Rusal earnings in Q2 2017 fell by nearly 40% due to weak aluminium prices, but this was slightly better than the market feared and a better result than they had in Q1 2017.

Commodity trader Glencore is looking to buy Rio Tinto's Pacific Aluminium that runs three primary smelters in Australia and New Zealand. Rio has been trying to sell these in 2013 and again in 2015, and with aluminium on the LME now at well over $2,000 per tonne, a deal could be struck. The move to electric cars holds no fear for aluminium for battery systems and car bodies, and Glencore is also investing further in copper, cobalt and zinc.

Two marketing reports have just appeared. Marketstudyreport.com informs us that the world-wide compound annual growth rate for aluminium castings from 2017 to 2021 will be 5.87% - not a surprise. Another marketing report on aluminum powder and paste production tells us that up to 2021 the compound annual growth rate world-wide will be 3.51%/ Its figure for total production in 2016 is 590,000 tonnes. Of all the companies listed as major suppliers worldwide, more than half of them are in China. That's not a surprise either.

On the subject of aluminium powder, a report turned up this month in the New Scientist about a nano-structure aluminium powder, that is powder of a particle size measured in microns, that when compacted with a second alloying element, also in nano-particle size, virtually instantaneously produced copious volumes of hydrogen when mixed with water. This is unusual; aluminium exposed to water quickly oxidises and the reaction stops. This could have significant importance for the production of hydrogen for fuel cells. The discovery was made in a US Army Research Laboratory in Maryland. The details of the second alloying element are now the subject of a patent application, merely noting that the alloy is a conventional high strength aluminium alloy. One could be forgiven for thinking that lithium is involved here. If this develops commercially it has great potential for aluminium powder end use, since hydrogen could be produced using equipment that should be light and readily transported. Similarly, the development of the thermite process using aluminium powder once made big inroads into welding in remote areas, for example joining steel rails in new railway projects, with readily transported equipment.

In the marketplace primary aluminium started July on the LME at around $1,900 per tonne and failed to move from that level for the month. It climbed rapidly during August to over $2,000, and in the middle of the month topped $2,095. It finished August around $2,070. It was last at this level in the middle of 2014. Aluminium alloy is now trading at around $1,780 per tonne.

Metal Bulletin published their assessment of 6063 alloy billet premiums in mid-August for various countries in Europe; Rotterdam 335-355, Spain 350-360, Italy 360-375 and Germany 370-390.

There are reports that China is now considering restrictions on metal scrap imports, including aluminium, for environmental reasons by the end of 2017. Such reports about the intentions of the Chinese do not always result in real action, but should this be correct, having regard to the huge export of aluminium scrap to China from the EU, it could change the whole nature of the global aluminium scrap flow.

AUTOMOTIVE

The SMMT data for car manufacture in June 2017 confirms the earlier trend that was developing; that this year will not be yet another record for manufacturers. The total for June 2017 was 136,901 cars against the June 2016 figure of 158,641, down 14%. The export percentage of the total held up well, 78.4% of all cars manufactured in UK went to export. For the first six months of this year the export of UK built cars is down by only 0.9%, a much better figure than had been feared.

For the manufacture of commercial vehicles, the June 2017 total of 7,324 was 5% down on June 2016.

The data for car manufacture in July 2017 was published by SMMT towards the end of August and the data came as a surprise, albeit a pleasant surprise. What appeared in the June data as a trend towards lower production levels was turned around in July. The total number of vehicles produced in July was 136,397, up 8% on July 2016. Home dispatches were up by 18% and exports were up by 5% compared to July 2016. For the year to date figure for UK car production, so far, this year is only 2% down on the year to date figure for 2016, which of course was a record year. The number of engine units manufactured in the UK in July 2017 was up on July 2016 by 12%. The year to date figure for engine production is now 5% up on year to date July 2016. Home sales were up by 26% compared to last year. So, all round good news, particularly because July is often a month where holidays and plant shutdown for maintenance begin to interrupt production schedules.

The data for UK car registrations in July 2017 also confirms the trend seen earlier, that diesel cars are losing out to petrol, and the alternative fuels are gaining rapidly. The total for car registration was 161,997, down 9% on June 2016. Registration of diesel cars was down 20% on June 2016, while the total registrations for petrol cars was down by only 3%. For the alternative fuels, the total registrations for 2017 were up by 64% on June 2016 but of course the total number itself at 8871, is only 5% of the total registrations for the month. However, at the current rate of increase, the hybrid and electric cars are likely to top 130,000 for the whole year 2017. Car sales to businesses this month were down 23% on last year, the manufacturers pointing to economic uncertainties.

The UK car industry has abandoned the hope of producing 2 million cars per year by 2020 and can claim to feel somewhat neglected in Brexit discussions, and even more so for not being in the loop when the Government announced that after 2040 new cars will not be petrol or diesel driven. Volvo has brought that target somewhat nearer with an announcement that within two years all of their cars will be electric or hybrid. Last year Volvo sold 47,000 cars in UK.

The "luxury" car manufacturers are less than enthusiastic about the planned change, pointing out that marques such as Bentley, Rolls Royce, Aston Martin and McLaren will still need to produce petrol and diesel models for their export markets. The SMMT themselves were critical, pointing to only 12,000 publicly available charging points for electric vehicles and that the present electricity generation in the UK would need to be increased by 50%, or nine new Hinckley Point nuclear power stations. The fate of car owners who do not have the luxury of a garage, or even a parking space on the front drive seems to have been totally ignored. One would have expected some rather more in-depth consultations before such a sweeping change could be announced – or is this a "kick it into the long grass" exercise?

In USA Tesla has just unveiled its Tesla Model 3, and world-wide the company expects to sell 500,000 of these. These announcements have caused some in-depth thinking in the mining companies about the increased demand that will ensue for metals such as lithium, copper and cobalt. Provocatively Tesla has just opened a flagship store in Stuttgart, home of the German car industry for over a century. The town council in Stuttgart is planning to ban diesel cars in the town in the next two years. Electric cars in Germany are not popular because German drivers apparently want to hear the roar of the horsepower under the bonnet. Surely sound effects can be provided as an add-on?

There were celebrations in Oxford in July when BMW announced that its new fully electric version of the Mini will be built there from 2019. BMW reported that it had neither sought nor received any reassurances from the UK government on post-Brexit trading arrangements. About 360,000 BMW Minis are built each year, 60% in Oxford. The new model is very similar to the Mini now produced at Oxford, but the drivetrain, motor, gear box and battery pack will be made in Germany and sent to Oxford.

News also on electric cars came from the Morgan Motor Company which is now planning a Morgan 3 electric driven car. It does not produce cars in thousands - currently it is making 800 per year - but there is a waiting list of nine months. The Company was established 108 years ago, and is still in the ownership of the Morgan family; its credentials as a sustainable company are without equal.

Ford is now seeking a joint venture with a Chinese car company to produce electric vehicles in China. PSA is now considering the future production of the Vauxhall Astra - and it may not be in the UK.

Aston Martin reported a £21 million pre-tax profit for the first half on 2017, reversing years of losses, and a deficit in H1 2016 of £82 million. Production levels at Gaydon were 67% up, at 2,439 cars. Its new factory near Cardiff will open in 2019.

BUILDING AND CONSTRUCTION

The Markit/CIPS Construction PMI dropped in July from 54.8 to 51.9, against the expected figure of 54.5. While any number above 50 indicates growth, the data is very disappointing, showing the weakest pace of expansion since August 2016. Commercial building contracted while housing activity expanded at the slower pace. New business volumes declined for the first time since September 2016. Business optimism regarding growth prospects was at the lowest level since July 2016. Cost inflation remained elevated due to the higher prices paid for imported materials.

The Construction Products Association keeps a count of cranes on the country's skylines as a crude indication of the health of the construction sector economy. The CPA predicts that growth in the sector will drop to a six-year low. A slower economy, falling real wages and rising costs will hamper the sector in 2018. The sector will be more reliant on major infrastructure projects and on social housing repair and maintenance contracts after the Grenfell Tower fire.

ENERGY SUPPLY

Oil production by members of the OPEC cartel increased this month for the third month in a row, casting doubts on whether OPEC will ever be able to reduce the global stockpile that has kept oil prices at their low level. Libya, Nigeria and Saudi Arabia increased their production in July; significant particularly that Saudi Arabia broke ranks since it had taken the lion's share of the production cuts at the start of the year. Brent crude is now selling at around $52 per barrel.

Further delays on the completion of Hinkley Point nuclear station have surfaced. The original target was 2025 and EDF now indicates that it could well not be operational before 2027. EDF and CGN of China will take the up-front production costs in exchange for a guaranteed price for electricity of £92.50 per megawatt-hour. The National Audit Office suggests that the original costs to the UK consumers have gone from £6 billion to £30 billion.

Cuadrilla has started drilling in Lancashire for an exploration well, two miles deep. If the signs are positive they expect to begin fracking by the end of the year. This could be a pivotal point for UK oil, the first fracking since 2011, when earth tremors caused the attempt to be abandoned. The whole issue of fracking in Lancashire is still before the courts with a latest appeal from protesters.

OTHER MATERIALS

Tata Steel has come to an agreement with the Pensions Regulator that it will inject £550 million into its pension fund and give the trustees a 33% share of the equity stake of the business, in exchange for the Regulator taking responsibility for the pension scheme. Members can join a new company Tata pension scheme, or remain in the old one and be under the Pension Protection Fund. Having cleared this hurdle, Tata Steel may now be able to enter into a merger with Thyssenkrupp, which should keep the Port Talbot plant operational. Why should the UK aluminium industry be concerned about the wellbeing of a competing industry sector? When the future of steel making at Port Talbot was being called into question, the UK car companies, customers of Port Talbot, indicated that should the steel works close it would jeopardize their own UK operations. That would not have been in the best interest of anybody.

Meanwhile, Liberty House, owners of the Lochaber primary aluminium smelter, has bought two Tata Steel mills in UK. The plants in Hartlepool employ 140 people in the manufacture of heavy duty pipes. Liberty House also acquired the struggling outfit Caparo Merchant Bar in Scunthorpe. The company has now expanded rapidly from its roots as a commodities trader into a major UK metals manufacturer, ferrous and non-ferrous.

Aluminium is not the only metal to show higher prices: copper at $6,750 per tonne on the LME is at a three year high. The LME is considering a lithium contract, in view of the expected coming importance of this metal in electric cars and batteries.

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