ALUMINIUM FEDERATION

MARKET REPORT

DECEMBER 2017 – JANUARY 2018

ECONOMY

The manufacturing sector accounts for 10% of the UK economy compared to 80% for services. For Q4 2017 the manufacturing sector finished the year with the best quarter's growth in three years. The Purchasing Managers Index, PMI, in November was at 58.2 and in December it was 56.3 (any number over 50 indicates growth). The EEF, the manufacturer's organisation, reports that with the global economy expanding, there are very positive indicators for UK manufacturing, with productivity, sales, profit margins and hiring levels all positive. Manufacturing output at the end of November 2017 was at its highest level since February 2008.

Looking at the service sector, the PMI for December was at 54.2, up from 53.8 in November. Taking all the sectors into account the data suggests that UK growth in Q4 2017 will be above expectations at 0.5%. The first half year for the UK economy was poor but the second half year has been an improvement and the UK should be on track to grow at 1.8- 1.9% for the whole year, which will equal France and beat Italy. The official growth figures are not released until later.

Inflation during December fell to 3.0%, against the November figure of 3.1%. Wages including bonuses increased to 2.5% during Q3 but are still trailing inflation.

The UK has one of the highest employment rates in Europe, although there was a fall in the numbers employed in UK towards the end on 2017. Unexpectedly, the decline in employment level reversed in December and the employment rate is now 75.3%, the highest level since records began in 1971. Economists have expressed concern about UK productivity compared to other countries, but the Office for National Statistics has presented data showing the fastest rise in UK productivity since 2011. The economy is growing, with fewer workers working fewer hours.

Consumer spending is at its lowest for five years as real wages and economic uncertainty put a strain on household budgets.

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Economic indicators across the world are positive, in Europe, USA and China. The Nikkei 225, Hang Seng, FTSE 100, Nasdaq and Dow Jones have all made very significant gains between January and December 2017. The Eurozone is expected to show growth in 2017 of 2.4% and USA at 2.2%. The PMI for Eurozone in December was 58.1. With the ECB quantitative easing program of buying government bonds for 30 billion euros each month, lending rates in the Eurozone are very low, encouraging growth.

The IMF has confirmed that the global economy has been growing strongly during 2017 and they expect growth to be 3.7% when all factors are taken into account. This is just short of the 4% growth that was normal before the financial crash of 2007/8 and better than the 3% growth globally for 2016.

At the beginning of December 2017 £1 would buy you 1.13 euros or US$1.35. At the end of January 2018 £1 buys you 1.14 euros or US$1.40, the pound against the dollar having peaked during January at US$1.42.

ALUMINIUM

International Aluminium Institute (IAI) has now released data for the global primary aluminium production in December, and the total for 2017 is 63.4 million tonnes – another record year. Of the ten regions of the world that report to IAI only China and Asia made a significant increase in production, but in the other eight regions there were no significant reductions in primary production. China now accounts for 57% of the global total.

The US Department of Commerce has been investigating whether cheap imports of aluminium into US have been damaging local producers, and their report is now with the President for a decision. The US producers are asking for 20% duties. During the last few months of the year there has been a surge of imports of unwrought aluminium from China into US to beat the deadline, should such levels of duty be imposed. In December the tonnage reached 440,000 tonnes of unwrought aluminium. US primary aluminium production and end use despatches of aluminium products are so widely different that imports of aluminium are always going to be required, the key question is the origin of the imports and the price.

On the LME primary aluminium started December at around $2050 and by the middle of the month it had fallen below $2000. It picked up sharply and finished December at $2240. At the end of January aluminium stood at $2224 per tonne.

Reflecting the better UK manufacturing sector and an expanding Eurozone economy the UK extruders finished 2017 on a positive note. Home despatches in 2017 were up by 5% and exports up by 17% over the previous year.

In mid-December Metal Bulletin were reporting billet premiums from Germany at $380-400 per tonne, delivered, with Q2 2018 $10-15 up on this. Rotterdam were reporting $340-360, in warehouse, undelivered, and Italy at $375-390, delivered. In mid-January these prices were unchanged. Ingot premium, duty paid, Rotterdam, in warehouse, at the end of December was $160. In late January Metal Bulletin reports that this price is moving higher. Inventories of metal have been reducing during last year and this trend is expected to continue in 2018, putting pressure on premiums. LME warehouse stocks halved from January 2017 down to 1.1 million tonnes as the year ended. The LME reports that queues for metal from warehouses have now disappeared; in the recent past the queue was about two years.

Liberty House, part of the GFG Alliance, owners of the Lochaber smelter in Scotland, has made a binding, conditional offer for the Dunkerque primary aluminium smelter currently owned by Rio Tinto. The offer, subject to final adjustments, is $500 million. The Dunkerque smelter, originally owned by Pechiney, is rated at 280,000 tonnes and is Europe's largest. Consultation with the workforce of 570 and with stakeholders will now take place and should be concluded for a hand-over in Q2 2018. Liberty House is now fulfilling its strategy to become a major player in the world aluminium market. The price rise in the LME aluminium contract during 2017 made the deal attractive, and the company is bullish about the price outlook for aluminium and the expanding end-user demand, particularly from Europe's transport sector.

Rio Tinto has been streamlining its portfolio of iron ore, copper and aluminium and has recently sold $8 billion worth of assets to reduce debt and increase returns to shareholders. Still for sale on their books are the primary smelter in Iceland, and Pacific Aluminium, with plants in Australia and New Zealand.

Another primary smelter development in Europe, perhaps driven by the better aluminium price, is the possible sale of the Portovesme primary smelter in Italy, which Alcoa moth-balled in 2014. Sider Alloys, based in Switzerland, are the possible buyers. The plant had capacity at 150,000 tonnes, half of which was aluminium billet. It is hoped that the deal can be completed by mid-February. Alcoa also announce the permanent closure of their Rockdale smelter in Texas, which has been mothballed since 2008.

Arconic are also streamlining their business and focusing on higher margin products with the sales to Hydro Extruded Solutions AS of two extrusion plants in Brazil. The economic problems in Brazil have hit the end-user market for extruded products.

In the secondary aluminium sector in Europe, Oetinger Aluminium, once one of Europe's largest secondary aluminium refiners, has been sold to Comax Group from the Czech Republic. Oetinger has two plants in Germany producing aluminium casting alloys, with deliveries as both molten metal and ingot. They have a capacity of about 190,000 tonnes.

The parent company of Real Alloy, secondary refiners, intends to put their European operations up for sale, reports Metal Bulletin. This has put some pressure on ingot prices across Europe and Metal Bulletin are reporting DIN226 at 1730 – 1790 euros per tonne. Parent company Real Industry in USA are now in Chapter 11 protection.

AUTOMOTIVE

Even before SMMT published the data for new car registrations in December 2017 everybody knew that the figures would be disappointing, after eight months of declining sales. August and December are the poor months for new car sales and 2017 has been a poor year. In the event 152,473 new cars were registered in UK in December, 14% down on December 2016. Diesel took the brunt of the reduction, down 31% on December 2016 while registrations for petrol cars were down by only 2% on December last year. The alternative fuel car registrations for December were in fact well up on comparable vehicles in December 2016, up by 37%. In December 2016 petrol and diesel new car registrations were about on an even share, 49.5% against 47.0%. For December 2017 the values were 56.6% against 37.8%.

For the whole year 2017, new car registrations were 2,540,617, which is a fall on the previous year of 5.7%. Of the recent past years only 2015 and 2016 were better than 2017 but thereafter you would need to go back to 2003, 2004 and 2005 before you find comparable sales figures.

The UK car production data for December 2017 was never going to be encouraging and indeed it wasn't. The December total of 100,604 cars was 11.7% down on December 2016. For the whole year 2017 the total of 1,671,166 was 3% down on year 2016 total. Commercial vehicle production was also down, year on year, by 17%. UK engine production did surprisingly well in 2017, up on the previous year by 7% and more than half of those engines are made for export.

Since UK car sales had been falling in the second half of the year, it follows that car production will also fall. But the even more worrying statistic from SMMT is that investment in the UK car industry and in supporting companies has fallen in 2017 to £1.1 billion from £1.6 billion in 2016. There are concerns over the effect of Brexit and the government's attack, environmentally and financially on diesel engines. The sector has asked the government for a better relationship and for clarity over the future of diesel vehicles.

Clearly the growth in new car registrations that lasted year-on-year from 2011 to 2017 was never going to continue indefinitely, but the precipitous actions by the government over diesel engines has made a difficult situation even worse. Jaguar Land Rover particularly came out strongly against the government as they announced the year end result of their worldwide sales. In 2017 they produced 621,000 vehicles, 7% up on the previous year and a record year for them.

But government actions from Department of Environment and the Treasury have had a massive effect on their sales of diesel cars, which is JLR's most popular fuel source. Their diesel engines are made in their state-of-the-art Wolverhampton factory, producing clean diesel engines that emit less CO_2 emissions than from petrol engines. The extra tax on new diesel sales of up to £500 can only effectively increase emissions and reduce fuel efficiency as drivers switch to petrol or stay with older diesel engines rather than buy a new car. JLR has announced that they will scale back production at Halewood in Q2 2018 of Discovery Sport and Range Rover Evoque models, moving from three shifts per day to two.

Looking at the list of top ten best sellers in 2017 it emphasises the point that most of the cars we buy in UK are imported and most of the cars we manufacture are exported. Ford with places 1 and 3 with their Fiesta and Focus were most successful. Volkswagen took places 2 and 7 with Golf and Polo, Nissan were in 4th place, Vauxhall were in 5th and 6th with Corsa and Astra, MINI was in 8th and Mercedes Benz took 9th and 10th with C Class and A Class.

The Vauxhall plant at Ellesmere Port has had a question mark over its future ever since the company was sold by General Motors to PSA, owners of Peugeot and Citroen. Their position in the best sellers list with 5th and 6th places, which amount to 7.6% of all UK new car sales, will not be disappointing in a poor year, particularly with Astra in 6th place, made at Ellesmere Port. But PSA has some difficult decisions to make and Ellesmere Port may be closed. They have laid off 650 workers in the last few months. On the other hand it would be odd to buy a car plant with the intention of selling it shortly afterwards. Plans are being discussed locally to make Ellesmere Port the major site for manufacture of electric and hybrid vehicles for Vauxhall, Peugeot and Citroen cars. Government money may be available for such a project. PSA have just made a commitment that by 2025 there will be an electric option on all of their cars. It can only help.

PSA's Luton plant also produces commercial vehicles. It is the UK's largest commercial vehicle plant, and that sector is also in recession, down about 15% year-to-year. PSA has now filed a claim against General Motors for £705 million, half of the purchase price of Opel and Vauxhall, for giving them misleading data on carbon dioxide emissions from Opel cars when they made the sale.

Morgan Motor Company are also going electric with EV3, a design based on the bullet-shaped three wheelers re-introduced in 2011. Will we miss the roar of their petrol engine when we buy the EV3? We are promised the squeal of the wheels and even faster acceleration. The range initially will be 120 miles per charge.

The London Electric Vehicle Company, owned by Geely of China, has won contracts to supply an Oslo importer with their black cabs which have been designed to comply with new London emission regulations. Norway has the world's largest number of battery-powered vehicles per capita. They claim that 30% of their cars in Norway are zero-emission. Well not quite. The electricity that is generated to charge the battery has emissions, although with Norway's hydroelectric generation it's closer to zero as any other source, a fact that keeps Norway's aluminium industry in good health.

Geely are now also the largest shareholder of Volvo Lorry and Buses. They already own Volvo Cars. At their plant in Coventry Geely are developing designs for hybrid-electric home-shopping delivery vans. Dare we remember that 70 years ago the milkman had an electric milk-float. What goes around comes around.

Of the world's big three in car manufacturing, General Motors, Volkswagen and Toyota, Toyota is the first to announce some actual numbers of their intended production by 2030 of cars running on hybrid-electrics, battery-electrics or hydrogen fuel-cells. Their number for 2030 is 5.5 million per year. They have been world leaders in hybrid vehicles with Prius from 20 years ago. Their annual total of all cars at the moment is 10 million cars. Their planned growth in battery-electric vehicles will begin in China, where pollution is now so bad in cities that the Politburo has mandated electric car quotas.

At the end of 2017, with production data available for the year, the alliance of Renault-Nissan-Mitsubishi also laid a claim to be the world's largest. They claim that some of the other contenders are including heavy truck production. The alliance sold 10.6 million vehicles last year.

Having just a quick look at the way that electric car manufacture is developing rapidly, and the fact that rail companies like Great Western are switching from diesel to electric trains, one expects that the UK government is looking closely at the expansion of electricity generation in UK in ten and twenty years' time. With a quick look at the energy generation scenario at the moment in the UK, it's difficult to be optimistic. The government in turn is accusing local authorities of not accepting funding for the installation of road-side charging points for electric cars. Only five LAs have accepted the funding. More than a third of UK car owners have no off-street parking and they would have to use public charging points, which may be expensive and inconvenient. This aspect alone is a disincentive to potential buyers of electric cars.

AEROSPACE

When the order was not placed at the Dubai Air Show in 2017 for A380s it was thought that Emirates Airline would not now be buying any more A380s from Airbus. They operate 100 A380s and 42 more are on order, yet to be delivered. Instead Emirates opted for 40 smaller and more flexible 787 Dreamliners from Boeing. That then raised questions about the future production of the A380. Only one per month is now being produced in Toulouse. With the ability to move 800+ passengers, the A380 should be attractive to the Chinese market. Airbus is now in discussions with China to produce A380s in China in exchange for orders. Airbus currently produces 50 planes per month of the Airbus A320 in China. However at the eleventh hour in mid-January, Emirates Airline placed an order for 20 A380s, with an option for 16 more later. Otherwise Airbus would have had no choice but to scale down construction in Toulouse. The new order confirms that the A380 production will continue as normal for the next ten years.

Airbus employs 15,000 people in UK, producing particularly Airbus wings at Broughton, North Wales in both aluminium and composites. So the news of new orders was good for them. But Airbus has also now opened up a competition for the engines, currently Trent 900 produced by Rolls Royce, but Airbus could switch to US rivals GE/Pratt and Whitney, so not such good news for Rolls Royce UK employees.

“Imitation is the sincerest form of flattery” we are told, and Boeing are following the adage. Airbus has recently done a deal with Bombardier to produce their C Series plane in their plant in Alabama, thus circumventing the US authorities’ decision to impose 300% duties on the planes ordered from Bombardier by Delta Air Lines. That has given Bombardier a life-line, good news for their 4,000 employees in Northern Ireland. Boeing is now in discussions with Embraer in Brazil for a similar arrangement. Embraer is the world’s third largest aircraft manufacturer after Boeing and Airbus. They build the smaller, more flexible aircraft, such as their E195, which seats up to 124 passengers. This is the biggest rival to Bombardier C Series. The partnership with Boeing, whose smallest plane seats 126, would be very similar to Airbus and Bombardier. Boeing would prefer a take-over but Embraer want a partnership. The Brazilian government holds a golden share in the company and national pride in their aircraft manufacturer will surely lead to a partnership rather than a take-over.

In the event, at the end of January the US Courts reversed their earlier decision on the duties imposed on Bombardier on the grounds that sales of the C Series actually caused no harm to US companies.

Canada has now sent a formal complaint to WTO about USA decisions on recent trade deals, only one of which concerned Bombardier. The US is threatening to withdraw from the North American Free Trade Agreement, which, without the US as a member, would no longer really exist.

BUILDING AND CONSTRUCTION

The Purchasing Managers Index for Construction is derived from surveys monthly of 170 UK companies in building and construction. Any number above 50 is expansion, below 50 is contraction. For December 2017 the index fell to 52.2 from a five-month high of 53.1 in the previous month. Residential building was up and civil engineering showed no change. During the whole of 2017 the average was 52.3 against the 2016 average of 51.6. The Euro-area countries showed an average of 53.3, of which France reported 54.0, Germany 53.7 and Italy 51.5.

The Federation of Master Builders highlights the grave shortages of skilled craftsmen in the sector. Expansion in house building and infrastructure projects such as HS2, Heathrow expansion and Hinkley Point will be impossible. New entrants into the industry are not appearing and many skilled workers are returning to the EU with uncertainties over Brexit.

Barratt Developments, the UK's largest house-builder, reported a flat second half 2017 for sales. Investors believe that the house-builders are now at the peak of what they can deliver in profit growth. Barratt, Persimmon and Taylor Wimpey reported solid trading updates at the beginning of 2018 but their shares all fell and were the biggest fallers in the FTSE 100. The current view is that previous annual volume growth rates, which have been at 7-8%, are no longer sustainable and are likely to be around 1-2% this year and perhaps 3-5% thereafter.

ENERGY GENERATION

The TV programme "Have I got news for you" used to begin with a short cartoon clip of a gentleman who looked Russian, standing over a gas or oil pipeline and shutting down the pipeline. In the background the lights in Europe are seen to be going off. It was of course intended to be humorous but suddenly events during December have put an edge of reality on the question of the UK energy supply.

In Aberdeen in December a hairline crack was discovered in a North Sea oil pipeline which had to be closed down, in turn closing down 80 North Sea oil fields. The Forties pipeline belongs to Ineos who had bought the pipeline system from BP only six weeks earlier. The pipeline normally brings in 40% of the North Sea oil to shore. That was followed the next day by an explosion at the main gas hub at Baumgarten near Vienna, which is a major hub for Europe for reception and distribution of gas imports, including from Russia. It was eventually repaired but not before the lack of supply in Italy and four central European countries gave rise to big problems for industry and rocketing prices in those countries. In UK the price of gas for immediate delivery went up by 35% to 92p per therm. The gas price did fall back quickly but was still well up on the earlier levels. In normal times the UK gas supply comes from home production 38%, Norway 42%, Continent 10%, UK storage 6%, and Qatar and others 4%.

As a result of these two incidents, at a peak of cold weather across Europe, the UK received its first direct supplies of gas at the end of December from Russia, from a plant in the Russian Arctic, operated ironically by a company subjected to US sanctions over Ukraine. The gas was shipped to the UK by a company from Malaysia. This fact alone of restricted gas supply will give a boost to fracking activities in UK. There are also calls for larger UK storage capacity. Our largest seasonal storage facility for gas, "Rough", is being shut down by Centrica because it is not financially viable to keep it maintained. Cuadrilla report that their fracking site in Lancashire is showing very encouraging signs of a large quantity of natural gas.

We learnt subsequently that the shipment of Russian gas did arrive in UK but was immediately sent on to Boston USA where temperatures have plummeted to minus 10C, with large shortages of fuels and huge hikes in price. The Boston price was more attractive than the UK price to the owners of the gas. Organisations for small businesses in UK are reporting that escalating energy prices now are one of the factors causing great concern.

They now know that energy suppliers are not sympathetic to complaints of high prices and shortages.

An earlier government pledge that coal-fired electricity generation will end by 2025 unless the station is fitted with technology to cut emissions, has now been made a legal requirement. In Q2 2017 coal- fired electricity generation accounted for only 2% of the total, a record low.

The share of the total generation by renewables, 30%, is also a record high. The full list shows the following sources for UK electricity generation:

Gas 41%, Renewables 30%, Nuclear 24%, Oil 3%, Coal 2%

Oil prices are now recovering some of their lost ground. Go back to the beginning of 2014 and Brent Crude was selling at $110 per barrel. It went as low as $30 at the end of 2015, was stuck at around $50 for much of 2016/17 but in the second half of 2017 it moved up and touched $70 per barrel at the end of 2017. That has boosted oil exploration across the world particularly deep-water drilling on either side of the US Atlantic coast. It has also boosted US shale oil production which is now running at 10 million barrels per day.

On the nuclear generation front the news is less than encouraging. Spiraling costs and delays at Hinkley Point C could well jeopardize plans for other UK nuclear stations. The original intention of EDF, when the Hinkley Point C Station was planned in 2007, was for it to be up and running in 2017. It is likely now not to start until 2027. The original contract price from Hinkley Point was £92.50 per megawatt-hour which in 2013 was double the wholesale contract price and today, taking inflation into account, would be equivalent to £100 per megawatt-hour. The construction costs at £30 billion are way above the original estimates. The reactor design chosen has yet to be built successfully anywhere, with projects across the world facing delays.

At Moorside in Cumbria, Toshiba were hoping to build a nuclear station, NuGen, using a Westinghouse Electric Company reactor but Westinghouse themselves had to seek protection from bankruptcy last year and are now owned by an investment company. Toshiba has now sold NuGen to Kepco of South Korea, who will use their own reactor design which has yet to get UK approval. So that project will be delayed by at least four or five years beyond the original estimate. And meanwhile the success of shale gas in USA in bringing in cheaper energy has dented the hopes for nuclear.

When the Wylfa Power Station on Anglesey, running a Magnox reactor, was scheduled for closure it put a question mark over the future of the Anglesey Aluminium primary smelter, which eventually closed in 2009. Horizon Nuclear Power is now planning the replacement nuclear station on that same site, too late to save the smelter, and they hope to be up and running by mid-2020s. Experience suggests that the target date is optimistic. On the smelter site itself is a biomass park, processing waste wood as a power source.

OTHER MATERIALS

With the exception of tin, all of the non-ferrous metals on the LME did well during the year 2017. Copper particularly started 2017 at $5485 per tonne and ended the year at $7215. At the end of January copper was trading at $7061. But that is still some way short of the $8600 level of January 2012.

The tin residues that are now left in Cornwall after the last tin mine there closed, are found to be high in lithium. Lithium has long been of interest to the aluminium industry since the development of the Al-Li alloys that were developed in the 1970s and are an essential part of the aluminium alloys available to the aerospace industry. Lithium is now of great interest to the automotive sector as lithium batteries are being developed for the electric car. The county of Cornwall has one of the lowest salary levels per head of the UK population since farming is the major employer. Re-starting a UK lithium mining industry could be a big advantage.

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