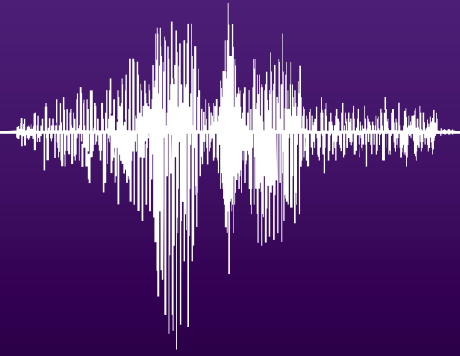


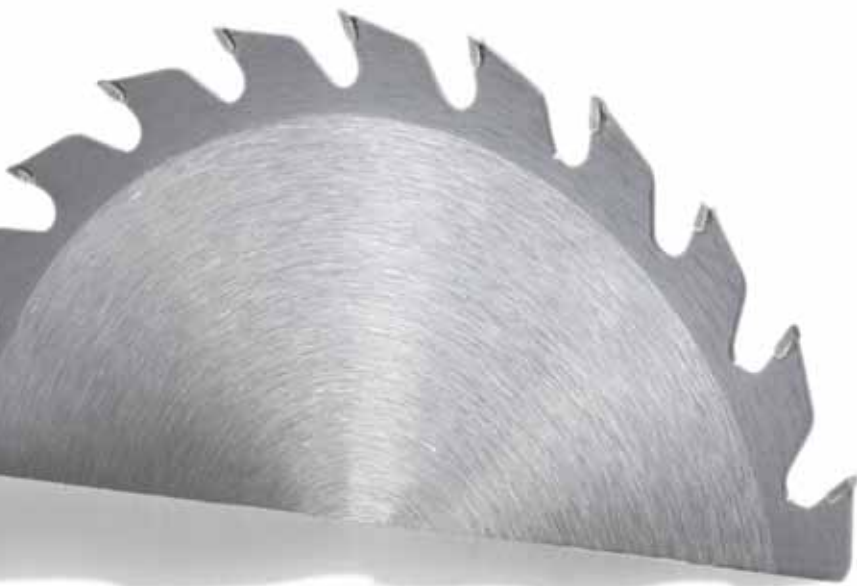
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SPECIAL REPORT: METALS

The aluminum alloy market — strong but beset with uncertainty

Winter 2011/2012



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The world of secondary aluminum has proved remarkably volatile in recent months buffeted not only by fluctuation in demand but also global macroeconomic trends. The automotive industry in particular is a major consumer of secondary aluminum alloys and especially vulnerable to the economic saga of Europe and North America.

This special report examines in detail activity throughout the sector and beyond, in Europe, the US and Asia over the past few months and helps bring focus to the outlook for the first quarter 2012. Despite some falling prices, some diecasters are still buying cautiously on the spot market - but will this continue into 2012? Scrap also remains a concern as merchants are happy to sit on stock until prices rise again – but will they, or will they be drawn back into the market? Platts contributors in Washington DC, London, Singapore and Tokyo tackle these and many other questions in-depth here.

Resurgent global demand for secondary aluminum following the recovery after the Japanese earthquake and tsunami in mid-March was derailed during the third quarter by concerns over European and US debt and budget issues, according to data compiled by Platts.

Prices for major secondary aluminum grades in Asia, Europe and North America surged at the beginning of the third quarter as the global automotive industry recovered from the devastating Japanese natural disasters in March. The automotive industry is a major consumer of secondary aluminum. Russian aluminum alloy that had been diverted to Europe following the March tragedy, depressing prices there, once again was needed in Japan.

The pickup in demand became apparent in August and early September, when Japanese trading houses bought heavily from Chinese producers due to heavy demand from Japanese auto makers.

Toyota Motor, the country's largest automaker, which buys over 10,000 mt/month of alloy, resumed quarterly purchase tenders which were suspended due to the March quake on August 31. The company also revealed its plan to produce 1.79 million passenger vehicles over July to December at its 17 plants in Japan, or an average 290,000-300,000 vehicles/month. Over January-June, its passenger car output averaged 166,666 vehicles/month.

Aisin Seiki, a major central Japan diecaster with 5,000-6,000 mt/month consumption, was also buying on a regular basis, issuing 200-300 mt purchase tenders three times a week.

Around half of Japan's ADC12 supplies are imports from China.

"Demand from Japan has seen a sharp pickup," an east China-based producer noted in early September. "They are making up for the lost production after the March earthquake, tsunami and nuclear crisis."

Japanese traders in late August/early September were heard to be buying from Chinese producers in good-sized 300-1,000 mt lots at \$2,470-2,505/mt CFR Japan for November-December shipments. Most deals were at \$2,470-2,490/mt.

A few Chinese producers told Japanese traders at the time that they had sold out early November shipments thanks to robust demand from Japan. One Japanese diecaster that typically bought several thousand metric tons of ADC12 ingots increased its purchase volumes by 10% from August to early September, possibly contributing to tightness, a Tokyo trader said.

Demand slipped temporarily during summer holiday shutdowns at vehicle assembly and component manufacturing plants in Japan over August 11-19, as well as at Aisin Seiki and other major diecasters.

Q3 PICKS UP ON STRONGER DEMAND

In Europe, market sources said Q3 alloy prices began to push higher after the summer shutdowns.

A number of factors in Europe were at play. The Japanese market was expected to be back up and running by September post tsunami and earthquake.

Furthermore, demand from the car industry, particularly in Germany, had been very strong so far in 2011, and as a result, the summer shutdowns in Germany were shorter than usual. "We will close our operations this summer for less time than we did last year," said a German producer in the summer.

In the US, the alloy market saw increased demand in the summer months as the third quarter began, in part because automotive manufacturers were picking up steam and almost back to full capacity after the March tsunami. The disaster put auto makers on hold, causing tightness in the supply chain, but the return of Japanese auto parts to the US began supporting healthy volumes.

Many players who normally go offline in the summer months for maintenance reported being busier than normal. "July is much stronger than people expected. People are so busy right now they aren't able to do those big furnace rebuilds, or diecast preventative maintenance," one producer said in mid-July. Based on customer demand, producers anticipated prices would rise at the end of the third quarter and stay strong through the fourth quarter.

PRICES BEGIN TO TUMBLE IN LATE Q3

But secondary aluminum prices began falling sharply in September on a global basis.

In Asia, ADC12 prices slipped to Yuan 17,900-18,300/mt (\$1.28-1.31/lb) as of September 27 from Yuan 18,450-18,550 a month earlier. By November 29 ADC prices hit Yuan 17,100-17,500.

In Europe, aluminum alloy 226 fell to Eur 1,790-1,840/mt (\$1.09-1.12/lb) on September 30 from Eur 1,840-1,890 a month before, and by December 2 were Eur 1,680-1,730.

In the US, prices for A380 alloy fell to \$1.13-1.15/lb as of September 29 from \$1.17-1.19 a month earlier. A380 prices then continued to decline hitting \$1.075-1.09 as of December 5.

Sources highlighted weak automotive demand and economic fears among factors depressing prices.

In Asia, sources attributed the drop to a corresponding slippage in exchange-traded high-grade aluminum ingot prices and several Asian holidays. And this was further exacerbated by the October flooding in Thailand, further slowing aluminum alloy demand.

Market players worried that auto production would slow due to a lack of electronic components from Thailand. Prices began slipping further heading into November on weak demand from diecasters in China and Japan. The first slip below Yuan 18,000/mt in the Chinese domestic ADC12 prices occurred in early November following nearly 11 months above that mark.

“Offers dipped slightly below Yuan 18,000/mt due to weaker aluminium ingot prices,” a south China-based trader said in early November. “The spot market is extremely quiet as most medium- and small-sized diecasters have no orders on hand.”

An east China-based diecaster the same week said: “The car industry has not been doing well for the whole year. I have no spot orders and am relying on long-term contracts.”

“Traditionally, diecasters should be busy, trying to meet orders from now till before the Chinese Lunar New Year holiday, which falls in January 2012. However, this is not the case this year,” an east China-based producer said.

But even as offers fell, few buyers emerged. “Despite lower prices, diecasters are not buying any spot material as they do not have any spot orders,” an east China-based trader said in mid-November.

And spot ADC12 import trade into Japan remained thin in mid-November as Japanese diecasters remained uncertain about the outlook for the Japanese automotive output in the first quarter of 2012, market sources said.

In early November, Japanese diecasters were seen buying the minimum requirement, which could have been half their normal consumption, or less, depending on the customer, said one Japanese trader.

There was talk in mid-November that Japanese auto giant Toyota would produce 11,000 passenger vehicles/day in the first quarter of 2012, down from 13,000-14,000 vehicles/day

in November-December 2010 and 14,000-15,000 vehicles/day in October.

In late November, however, officials from major Toyota component suppliers told raw material suppliers that Toyota planned to stick to a 14,000-15,000 vehicles/day output schedule for Q1, confusing many suppliers.

EUROPE FINANCIAL HEALTH SPURS DOWNTURN

The weaker picture in the European market surfaced toward the end of August as concerns swelled over the financial health of the global economy and the likely impact on the European alloy market and the markets it serves, such as the car industry. Despite a high level of demand predicted for Q4, physical aluminum alloy prices continued to fall throughout September as concerns over the debt crises in Europe and the US began to bite.

The negative sentiment over the European economy and future demand at the start of the fourth quarter shrouded the physical market in gloom.

“Our plants are fully booked and sold out for Q4, but everyone is talking about the financial crisis,” said a German producer in early October. A German consumer explained: “People are nervous about what will happen in November and December. I think we will reduce our demand levels slightly [in November].”

In addition, the fall in metals prices on the London Metal Exchange prompted diecasters to push for lower physical alloy prices in October.

“We saw a selloff in copper and aluminium [on the LME], so trend-wise buyers are expecting 226 prices to come down,” said an alloy producer.

Spot prices continued to slide throughout October, hitting a new low of Eur1,700-1,750/mt delivered in early November as the Greek economic crisis unfolded.

Both the LME and financial exchanges across the world were subjected to a roller-coaster ride as markets reacted positively to the EU's solution to the Greek debt crisis, then negatively to the Greek Prime Minister's calls for a referendum on the bailout, sources said.

A two-tier pricing system began to emerge in Germany in November with higher prices for German ingot and well-known importers and lower prices for product from outside of Germany such as from Italy or Spain.

Alloy makers in Italy, and to a lesser extent in Spain, have suffered from depressed demand from domestic automotive manufacturers. As a result, the price of southern European ingot fell as these producers attempted to gain market share in the buoyant German market.

By mid-November aluminum alloy prices stabilized in Europe as the Greek crisis moved closer to a resolution and the resignation of Italian Prime Minister Silvio Berlusconi revived hopes that a new leader would tackle Italy's debt problems. However, prices pulled back another Eur20/mt to Eur1,680-1,730/mt delivered toward the end of November as competition for market share in the key market, Germany, intensified. Lower prices in Germany were predominately driven by competitively priced ingot from Italy, sources said.

Buyers remain haunted by worries over the state of the eurozone economies even though predicted demand levels from the German automotive market still remain strong.

"We're currently holding talks for 2012 contracts and all of our customers are planning an increase in metal demand," said one German producer in late November, who added: "But prices are weakening. It's a strange situation." A European refiner said that volumes for Q1 were the "same" as last year but that only the price was the "problem."

US STOCK MARKET, DEBT WEIGH ON MARKET

In the US, the softening in the market began as the stock market plunge and insecurities about the national debt spurred prices of A380 to drop more than 2 cents in less than a week at the end of September, which led to confusion and shying away from the market.

Even after the debt crisis was resolved and the dollar strengthened, the secondary market continued its downward trend. This led to speculation in the market that the decline was currency related, and a "metal slowdown," but players thought the market would bounce right back. Then news about eurozone weakness flooded the market and rumors of another US recession ran rampant.

On August 19, JD Power and Associates projected auto demand to be lower. "Given the recovery stall that continues to persist and lower expectations for growth in the economy, JD Power is lowering its forecast for light vehicle sales in 2011 and 2012, as slower recovery is expected to extend into next year." Total light vehicle sales dropped to 12.6 million units, down 300,000 units from the previous forecast.

The continued atmosphere of pessimism and ongoing uncertainty led to increased market volatility into the autumn months. The automotive sales that were supposed to ramp up in August never happened, which led to further negative perceptions.

"If you completely shut off the news and didn't look at the stock market and LME, demand in the diecasting and foundry market is still really good," a producer said in September. "The price has just come down because of all the bad news out there."

Prices continued to drag lower in the fourth quarter, despite steady automotive demand. Besides Honda and Toyota, who cut production in North America because of flooding in Thailand, there was more auto demand in October and November than previously speculated. Some smelters reported as much as 20-25% cutbacks from Honda, though.

Producers said diecasters were booking conservatively, which led producers to keep their inventories lean. Many producers sold alloys to other producers who came looking for them so they wouldn't have to make more. They said it was the cheaper option and thought it better to keep their inventories low.

The pessimism continued to drag spot prices further as producers began offering lower numbers to get rid of excess metal. Some producers disagreed with this tactic, wanting to hold metal in the down market in order to keep their margins.

Despite dealers reporting a slowdown in scrap flow into the yards and producers reporting that dealers were sitting on metal for higher prices, scrap prices fell off along with secondary alloy prices. Market players agreed it was counterintuitive for scrap prices to drop, but thought that it was due to the negative sentiment that continued to run rampant in the market. Prices finally began to stabilize around mid-November, and have since been increasing.

OUTLOOK POSITIVE

Looking forward, despite the plethora of negative sentiment on the state of the eurozone economies, both buyers and sellers of aluminum alloy in Europe have said that Q1 demand, certainly in Germany, is expected to remain strong.

"We see Q1 demand stable. Similar to October and November," said one key European consumer, who explained that 2011 demand was at a relatively high level compared with the last two or three years.

"There are still plans for an increase in automotive production in Germany, especially by the premium car producers," said a German producer in late November. "Q1 demand in Europe is good, the sales are there. There is no reason to drop prices," said a European producer, who added that the only problem he could foresee was if producers were unable to secure raw materials at the right price.

But despite strong demand prospects in Germany for Q1, the majority of consumers remain concerned about the eurozone economies and what effect this may have on the market in 2012, and this has kept prices under pressure.

The price of scrap -- the key input cost for secondary aluminum producers -- remains a concern going forward. With 226 prices sub Eur1,700/mt many producers are said to be operating at below the cost of production. Scrap merchants have enjoyed

a profitable year in 2011 and seem happy to sit on stocks and wait for prices to rise during the winter months, a number of sources have said.

European alloy producers have found it increasingly difficult to offer further forward than January because of the unknown price of their key input cost, scrap. "We're only selling for January -- not February or March -- because we don't know how scrap prices will develop," said a European alloy producer in November.

"Scrap availability is not great and margins are being squeezed at the moment," said a German producer, who warned: "Either scrap prices must come down or someone will go bust."

One large European alloy producer said that his company would take steps to cut output in January if scrap availability and prices did not ease. "We'll decide by mid-December whether to cut production," he said, adding that it was almost at a critical point as scrap dealers were unwilling to sell at lower prices and buyers were delaying purchases, pushing for even lower deals. "If we cut output by 20% or 30% then we won't have the pressure to purchase scrap at such high prices and we'll have less pressure to sell at these very low numbers," he said.

In the US, as the end of year holiday lull hit there was less production and weakened sales, producers were looking ahead to the new year. Market players believed that the forecast for 2012 should be better than 2011 because a lot of automotive projects that had been delayed will come online in 2012.

Producers have reported a strong Q1 based on contract deals, but still have a bearish outlook because of the economy and the volatility in the market. In December there were reports of January A380 booking for \$1.11/lb and March at \$1.12/lb. One producer said recently that he was concerned about a collapse in demand for Q1 and Q2, depending on the economy and the Chinese export market. Scrap dealers say that export demand has become more competitive over the last six months and believe this trend will continue into next year.

Diecasters have heard higher spot numbers for alloys in 2012, citing the seasonal trend that secondary aluminum tends to take in which prices firm up in the first quarter. As for 2012 demand, one diecaster said, "We will see a copy of this year. We are not seeing any decline, and a couple of guys are asking for increases. The diecaster is automotive focused, so he thought the increases were because "a couple of car lines must be selling good." He said they weren't big increases, "maybe 5% at most," but they were increases nonetheless.



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