Box II-1

The outlook for aluminium prices

The international financial crisis has caused considerable turmoil in commodity markets in general and in ground metals markets in particular. While prices of the main ground metals rose rapidly during the first half of 2008, aluminium lagged behind, peaking last July at 3,300 US dollars per tonne. The price plunged in autumn 2008 and had fallen by 50% from its July peak by the end of the year.

The impact of the global financial crisis is twofold: on the one hand, less access to credit by hedge funds and commodity dealers has caused them to withdraw from metals markets to some extent. On the other hand, global contraction in the real economy, especially in the construction sector and automotive industries – both of which are major aluminium users – has reduced demand for aluminium.

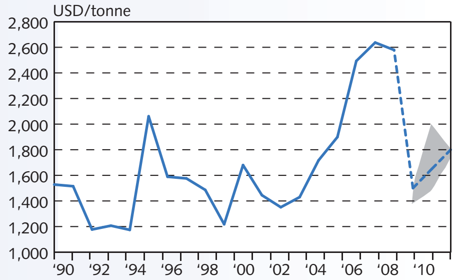
Underlying fundamentals will still be the main drivers behind price developments in coming months. Global growth in demand slowed markedly in 2008, amounting to only about 2% compared to a 10% increase in 2007. According to commodity analysts, a drop in global demand of about 3-4% is anticipated in 2009.[1] However, recent years have seen sizeable increases in aluminium production, which grew by 12% in 2007 and over 5% last year. The increase in production, primarily from China, has exceeded consumption growth in the past few years. While production capacity has been rising rapidly, growth in demand has diminished. This has led to an increasing imbalance between supply and demand and a sudden rise in global inventories.

The LME (London Metal Exchange) aluminium inventories were 1 million tonnes in the first half of 2008. Stocks increased rapidly from mid-2008 and amounted to 3.7 million tonnes in mid-April 2009. Annual consumption in Western industrial countries is estimated at around 40 million tonnes. When this inventory is measured against the rate of consumption, stocks were equivalent to 2.5 weeks' consumption in the first half of 2008, but by mid-April 2009 they amounted to 8 weeks' consumption. The interplay of declining demand and greatly increasing stock levels has therefore depressed prices in the last eight months.

As a result of plummeting prices since last autumn, about three-quarters of global production is currently operating at a loss. A logical reaction would be to curtail production under these circumstances, but production cuts have been slow to emerge for a number of reasons. Production cutbacks in aluminium take time to implement and are expensive due to the technical costs of closing down pot-lines. In addition, power, which is the second-largest expense item, is generally a fixed cost. Moreover, Chinese production has been subsidised to some extent, and the Chinese authorities have been buying domestic aluminium at a premium. All of these factors have slowed the supply response to declining demand.

Aluminium prices are not expected to bounce back in the coming months unless considerable cutbacks in production occur, followed by destocking. On the other hand, the probability is now greater that prices have bottomed out and a slow recovery will set in. The average price during the first fourteen weeks of this year was around 1,400 dollars per tonne, and LME forward prices indicate that the average price for 2009 will be around 1,470 dollars. Price forecasts from analysts and consulting firms average just under 1,500 dollars per tonne for 2009.[2] In addition, the US dollar has depreciated somewhat recently, which generally has a positive effect on commodity prices denominated in dollars. Production curtailments of 14% (about 5.5 million tonnes) have been announced,

Chart 1
Aluminium price
Annual data



1. Central Bank baseline forecast 2009-2011. Shaded area shows highest and lowest projections from forecasters other than the Central Bank.
Sources: Danske Bank, Deutsche Bank, LME, Central Bank of Iceland.

Chart 2
Relation between inventories and aluminium price

Sources: GFMS. London Metal Exchange.

1. Commodity Monthly, Danske Bank, April 2009.
2. Platt's, Deutsche Bank, GFMS Metals Consulting, Danske Bank.

based on CRU estimates, but these cutbacks are not considered sufficient to boost prices in the short term. Some analysts (e.g. Davenport Equity Research and Norsk Hydro) suggest that cuts in production of up to 8-10 million tonnes this year (about one-quarter of annual global production) are necessary to achieve a balance between demand and supply and eventually reduce inventories.

Although economic recovery in the industrialised world would have a positive influence on aluminium prices, surplus production capacity is likely to restrain price increases. Prices are expected to rise only slightly this year, and not until well into 2010 will they increase appreciably. The baseline forecast assumes a 9-10% increase in prices in 2010 and 2011, following a 42% fall in prices this year over 2008. At the end of the forecast period, aluminium prices are expected reach 1,800 dollars per tonne, which is similar to their 2005 level. These assumptions are based on LME futures prices and price forecasts from leading analysts.