



2017 Outlook

In 2016, the aluminium industry performed well and exceeded industry predictions. Even during Q4, the industry's low season, the price of aluminium has remained strong.

New transportation policies banning overloaded long-haul transport resulted in a low inventory in China's physical market, as metal has been log-jammed at shipping points. This played a major role in buoying Q4 prices. Finally, the increasing supply of liquid aluminium created an artificial shortage in the aluminium inventory, creating a positive market sentiment that raised prices further.

Based on our analysis, we predict the 2017 output will remain strong with increased restarts and new capacity volume. We expect eight smelters will be introduced with around 2.2 million tonnes of new capacity. Based on estimations of the past five years, 2017 production volume will be around 33.8 million tonnes with 5% growth compared to 2016.

The demand for aluminium will remain strong from infrastructure investment in China. Based on the 13th Five-Year Plan, we have a positive outlook on continued investment in infrastructure. As the second largest economy in the world, China's aluminium industry has enormous development opportunities. Compared to 2016, we may see aluminium consumption decline in the housing construction industry because of policy restrictions on the real estate industry. However, we expect a boost in aluminium consumption in infrastructure and auto industries. Since aluminium packaging is expensive in China, consumption will remain modest in this sector. We predict demand for aluminium will resemble 2016's growth of 5.5% with 33.4 million tonnes.

Even at the beginning of Q4 in 2016, we have seen increased capacity from restarts and new output. From our analysis of demand and supply in 2017, we see China's oversupply issue continuing. If the balance between supply and demand breaks and creates a large surplus, the aluminium price will plummet. We may even see the aluminium future active

price drop as low as RMB 11500 in Q1 2017. The problem is, that price won't be enough to force capacity out of the market, and by the middle of the year, the price could drop to as low as RMB 10,000.

As soon as local demand cannot consume the excess supply, the metal will be shipped overseas. Primary metal exports might remain modest, but the semi-export might rise once a surplus hits China. To complicate matters further, the excess capacity in downstream industries such as rolling mills and extrusion presses is likely to remain, and these factories will look for export opportunities if domestic demand is not strong enough.

As we all know, China's bauxite is low quality. Bauxite imports will continue to increase steadily in China. Australia, Guinea, and Malaysia will remain the major suppliers. Bauxite from Guinea will increase drastically in 2017. India and Brazil will remain the major substitute suppliers for China.

The price of domestic alumina will follow aluminium prices. We expect the domestic price will remain between RMB 1750 to RMB 2600 in 2017. There are only a few smelters in Shandong using imported alumina. Big suppliers, such as Weiqiao, have already built their own alumina refineries in Indonesia. Currently, Weiqiao alumina is reserved for self-use. They plan to sell it to other smelters as soon as they solve the bulk transport issue. JISCO invested two billion USD to purchase Alpart in Jamaica. The output may be exported to China at the end of 2017. Alumina imports will increase slightly.

Environmental inspections are clearly becoming a serious issue in the latter part of 2016. In our estimation, environmental controls will be stricter in the upcoming year. Rigid environmental controls will increase the production cost for the upstream and middle stream by

heightening environmental system costs. This will not impact the big smelters, who already have advanced environmental systems, but it will influence small smelters who are unable to afford upgraded equipment. They will have to face hefty fines or shut down. This is possibly the only major challenge to the over-supply situation facing China's aluminium industry. The current war of words between the USA and China on excess capacity is getting nowhere, and the only likely change to that impasse will come from the new US president and his policies.

The prices of coal and alumina have rallied since Q3 2016. It increased the cash cost for aluminium to around RMB 12500. In early Q1 2017, the price of coal will remain strong due to the cold weather in China. The alumina price, following the aluminium price trend, will decline in Q1. Overall, the production cost will lessen in 2017 because the current cash cost is modest.

Debt management will remain a major problem for the aluminium industry in China. Based on our research, some small smelters were hard-pressed to acquire bank loans in 2016. Many smelters are unable to restart due to financial reasons, even when aluminium prices were high in 2016. Xinjiang Jiarun wanted to restart for three quarters, but were unable to do so due to their debt problem. Because small smelters are good quality assets, bigger smelters may merge with them as soon as the price of aluminium drops.

Overall, the aluminium industry will present parallel development trends for both demand and supply in China in 2017, maintaining the present imbalance. China looks set to produce more metal than it will consume, and the only challenges to that imbalance appear to be the increasing focus on environmental compliance and the ongoing debt problems. ■