Aluminium Industry: FY18 update and Outlook for FY19

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The Aluminium industry in India is primarily dominated by 3 companies: Hindalco and Vedanta which are privately owned and NALCO which is a public sector undertaking having a Navratna status.

Domestic performance of the Aluminium industry during FY18

Primary aluminium

- Production of primary aluminium has increased by 21.1% y-o-y compared with 15.5% last year. Increase in production can be attributed to better operational efficiencies on account of better capacity utilization and additions in existing capacity. (Vedanta's aluminium plant underwent a ramp up of additional pots at the Jharsuguda-II smelter and a complete ramp up of BALCO-II smelter).

- Aluminium consumption India is driven by its use in the power (48%), automobiles (15%), construction (13%), packaging (8%), industrial (7%) and consumer durables (7%) sectors. Development of smart cities, rural electrification, focus on building renewable energy projects and growth in the transportation segment has augmented the consumption of aluminium during FY18. Consumption of aluminium has risen by 4.3% during FY18 as against a decline of 0.9% during FY17.

- Exports have risen by 36.3% during FY18. Globally markets faced a deficit as demand for aluminium exceeded supply. This has benefited India as aluminium is oversupplied in the domestic markets. During FY18, India mainly exported primary aluminium to South Korea (31%), Malaysia (30%), USA (11%), Turkey (9%), Japan (5%), Bangladesh (4%) and Spain (4%).

Table 1: Domestic Production, Exports, Imports and Consumption of Primary Aluminium (KT*)

	Production	% change	Consumption	% change	Exports	% change	Imports	% change
FY16	2,425	-	2,017	-	829	-	421	-
FY17	2,800	15.5%	1,998	-0.9%	1,224	47.6%	422	0.2%
FY18	3,392	21.1%	2,088	4.3%	1,669	36.3%	360	-14.7%

Source: Company filings, Department of Commerce and Industry

Note: KT kilotonnes*

Challenges and Headwinds

Increase in alumina imports: The alumina produced is used for domestic consumption i.e. by the respective companies which manufacture it, for the manufacturing of the aluminium metal. During FY18, smelters had to import alumina due to the fall in bauxite mining (bauxite is converted into alumina) which is why growth in domestic production of alumina has been subdued during FY18.

Table 2: Domestic Production, Exports, Imports and Consumption of Alumina (KT)

	Production	% change	Consumption	% change	Exports	% change	Imports	% change
FY16	5,634	-	5,188	-	1,367	-	922	-
FY17	6,108	8.4%	5,898	13.7%	1,508	10.3%	1,298	40.8%
FY18	6,196	1.4%	6,951	17.9%	1,360	-9.8%	**2,114**	**62.9%**

Source: Company filings, Department of Commerce and Industry

Increase in the imports of scarp: Low import duty on aluminium scarp (2.5%), has led to an increase in the import of aluminium scarp. Producers find this an issue as it impedes with the production of primary aluminium. Imports of aluminium scarp are eating into the market share of domestic producers.

Table 3: Imports of Aluminium Scarp (KT)

	Imports	% change
FY16	867	-
FY17	931	7.4%
FY18	**1,121**	**20.4%**

Source: Department of Commerce and Industry

Availability of coal/ Problems with the coal linkage policy: Domestic players rely on coal-fired captive plants for power and fuel requirements. Aluminium is a highly power-intensive industry in which power accounts to 45% of production cost. With the recent change in the regulations where the government has prioritized coal supplies to power stations to boost their inventories, aluminium producers are facing coal shortages thus increasing the reliance on expensive imported coal.

Global Developments

Imposition of tariffs by the US government: The US government imposed a tariff of 10% on imported aluminium, a measure aimed in reviving and boosting the US metals industry. The imposition of tariffs on imported aluminium was aimed at protecting the internal economy of the United States which has been affected by cheap imports.

Argentina, Australia and Brazil have been exempted from these tariffs as these countries have agreed to put limits on the volume of metal they can ship to the US. Initially EU, Canada and Mexico were granted temporary exemptions but from 1st June 2018 onwards, the following countries are also subject to the imposed US tariffs as well. *This move has given way to retaliatory measures undertaken by the affected nations particularly from Mexico, Canada, China and EU starting an era of trade wars.*

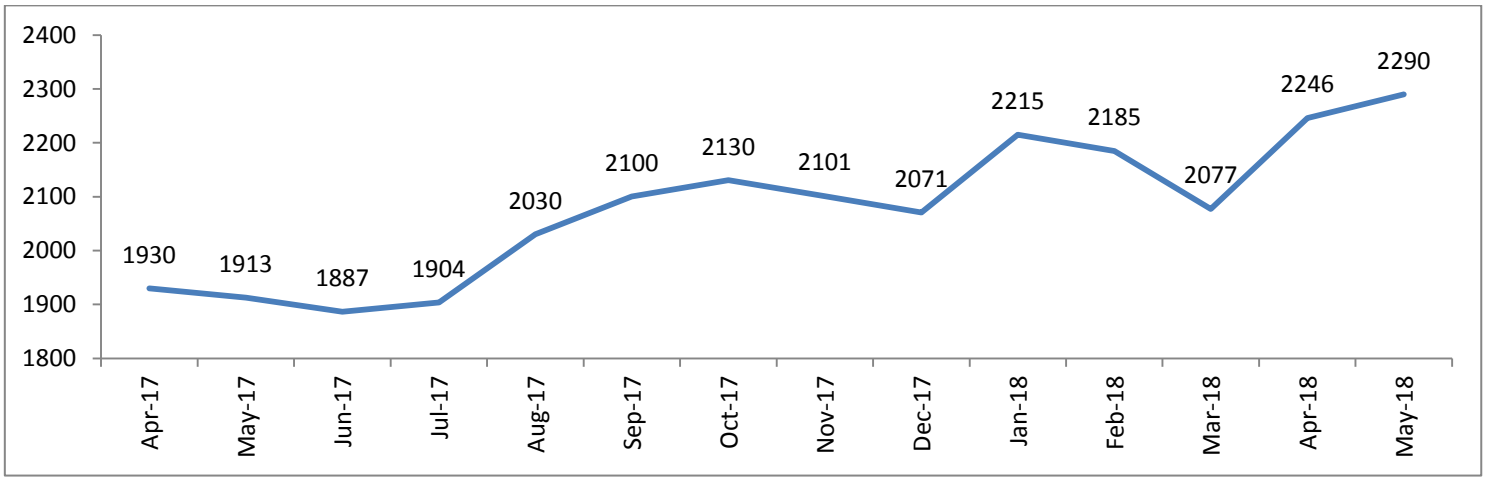
Imposition of sanctions on United Company Rusal by the US government: The US government imposed sanctions on Russian company, United Company Rusal which is the world's second-largest aluminium producer and the largest outside China (Rusal produces 3,700 KT of aluminium approximately in a year, which is 6%-7% of the world's aluminium and it operates mines, smelters and refineries across the world from Guinea to Ireland, Russia to Jamaica). *US sanctions on Rusal have put $3 billion of aluminium in jeopardy.*

Partial shutdown of Norsk Hydro's alumina refinery in Brazil: Norwegian aluminium maker Norsk Hydro has been told by the Brazilian environment regulator to cut output from its Alunorte alumina refinery by 50%. The regulator's ruling followed claims by Brazilian federal and state prosecutors of a waste spill at one of Alunorte's bauxite refuse deposits after heavy rain. Alunorte is the world's largest alumina refinery, situated in Brazil's Amazon region. The plant made 6,400 KT of alumina in the previous year. On average, 14% of Alunorte's production stays in Brazil and 86% of it is exported to the Middle East, North American and Europe.

The alumina refinery is supposed to operate on 50% capacity until it complies with an order to safeguard the environment. *The partial shutdown of the refinery has resulted in increasing the prices of alumina in the global market.*

Global Aluminium Price Movements

Chart 1: Trend price movements of Aluminium during FY18 (USD/tonne)



Source: LME

Table 4: Global aluminium prices (USD/tonne)

	FY16	FY17	FY18
LME Aluminium	1,607	1,688	2,045
Growth (%) y-o-y		5.0%	21.1%

Source: LME

Prices of aluminium have risen sharply by 21.1% during FY18 compared with FY17. In addition to the revival of demand for aluminium, one of the key reasons for the rise in the prices of aluminium was due to the supply cuts undertaken by the Chinese government in order to control the pollution levels.

Rise in the prices of aluminium was also supported by the rise in the input costs as prices of alumina, caustic soda, petroleum coke and coal tar pitch also rose during the year. Prices of aluminium started rising from December 2017 onwards as the Chinese government shut down the operations of smelters which had 2 million MT production capacity, but this was not for long as prices started receding in March 2018, when the US government announced a 10% tariff on imported aluminium.

Prices however have rebound from the start of FY19 as the US government announced sanctions on United Co. Rusal which caused a rally in the prices on the fear the global market could face a shortage.

CARE Ratings Views and Opinion: Outlook for FY19

India's **aluminium production is to be stable at 3,426 KT during FY19** as all the domestic smelters are now operating at full capacity. Aluminium production during FY18 was 3,392 KT.

- We can expect further capacity ramp-ups of aluminium smelters only when the coal availability and coal pricing becomes more stable.

Aluminium has been continuously finding new applications due to rising price competence since it is cheaper than copper, due to its superior weight to strength ratio, corrosion resistance, formability, dampness etc. Reforms proposed by the Government of India like the Make in India Campaign, Smart Cities, Rural Electrification and a focus on building renewable energy projects under the National Electricity Policy have augmented the usage of the metal during FY18. Buoyant demand and market recovery across businesses in India is to further increase the demand for aluminium.

- **Aluminium demand is to grow around 5% to 2,200 KT during FY19.** Consumption during FY18 was 2,088 KT.
- The growth in consumption is likely to be driven by the growth in power transmission and the automobile sector. Demand from the building & construction activities to pick up due to the affordable housing for all program whereas demand from the packaging sector is likely to support the domestic demand.
- Aluminium to continue replacing copper demand from the electrical and the consumer durable segment.

Global aluminium markets faced a deficit during CY17 as demand exceeded supply. Given the latest developments in the global markets with the sanctions imposed on Rusal and the embargo on Alunorte, **India has the opportunity to expand its aluminium and alumina exports in the global markets.**

- EU is expected to generate robust demand majorly driven by transport and construction sectors**.**
- China is focusing on increasing the intensity of aluminium usage in electric vehicles which will generate additional demand for aluminium in China.

Global aluminium prices to hover around USD 2,110-2,200 per tonne during the short to medium term period on a monthly basis.

- The aluminium prices will continue getting affected due to changing macros on account of recent trade wars which will impact the global demand supply dynamics.

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