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Markit Economic Research

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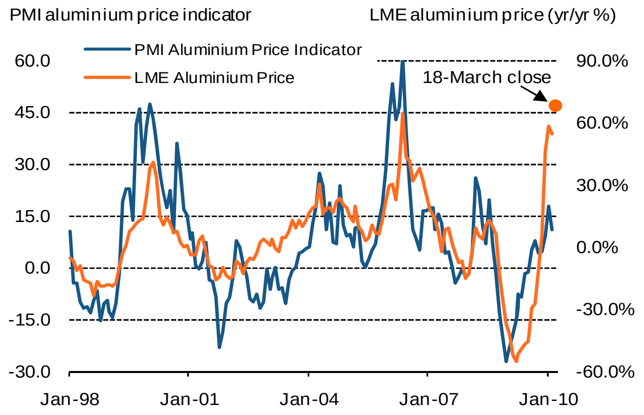
Commodities / aluminium

Aluminium prices rise above level consistent with current demand and supply fundamentals

The average price of aluminium on the London Metals Exchange (LME) in February was US$2,048, representing a marked gain of over 54% from its low of US$1,329 reached one year earlier. At the time of writing, the price of aluminium had also risen by a further 9% since the start of March. However, the price is still around 30% lower than its pre-crisis peak.

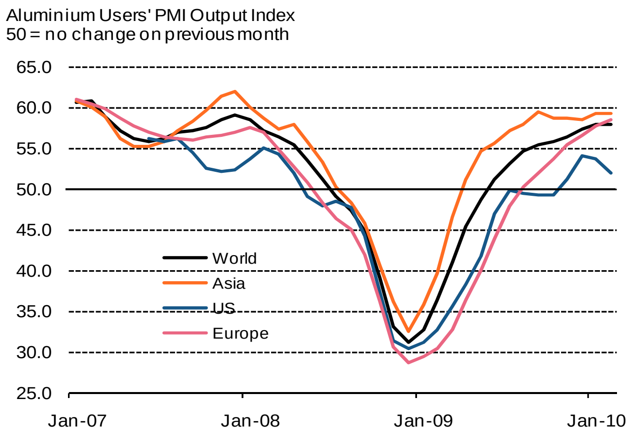
Purchasing managers surveyed by Markit have also been reporting increases in the cost of aluminium. The PMI Aluminium Price Indicator – which reflects the proportion of companies across Markit's worldwide survey panels that report a specific commodity to have changed in price – posted its highest reading for one-and-a-half years in January, before falling slightly in February.

Aluminium Price vs. PMI

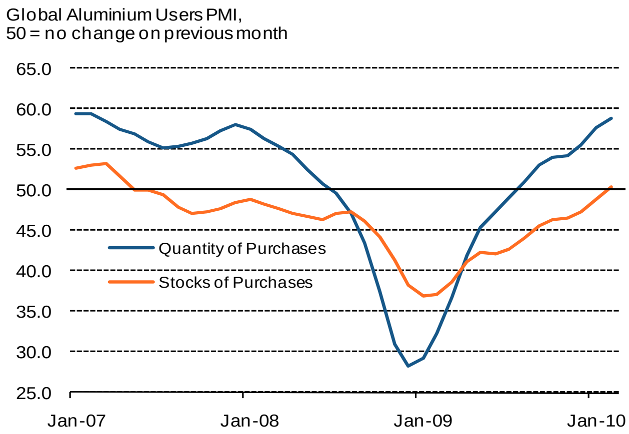


The recent strength of aluminium prices mainly reflects recovering levels of output and increased volumes of raw material purchasing at aluminium-intensive goods manufacturers, especially those based in Asia. According to PMI data, global production of aluminium-based products started to recover in June 2009. Asia began increasing production earlier than this, in April 2009, and well before Europe and the US. Asia has also continued to outperform Europe and the US at the start of 2010.

PMI Output Index



PMI Purchasing and Stock Holding



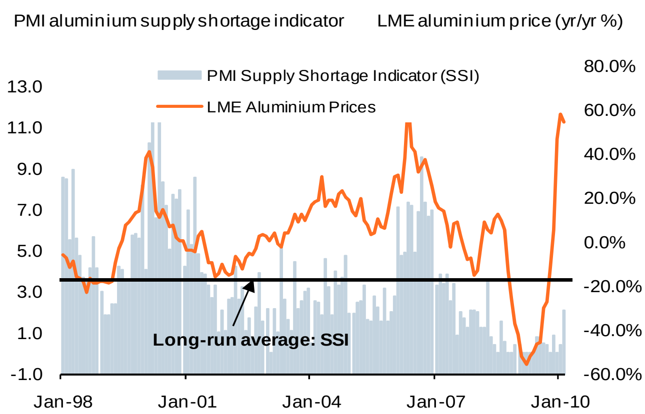
Rising levels of production are leading to increased volumes of raw material purchasing at aluminium-intensive goods producers. Input buying levels globally rose for the seventh month running in February and at the fastest pace since the pre-crisis peak reached three years ago. Rates of increase in purchasing activity hit a series record high in Asia and a 33-month peak in Europe. Input buying also rose slightly for the first time in over one-and-a-half years in the US. Global inventories of raw materials showed a slight gain, centred on Asia, rising for the first time since early-2007 in a sign that increasing numbers of companies are now rebuilding their stock levels.

Higher current demand therefore appears to be playing an important role in steering aluminium price levels. However, the magnitudes of the increases recorded since the start of the year appear to be much stronger than would normally be expected given current demand and supply fundamentals, suggesting that some element of speculation is also supporting price levels, especially on the LME.

To explore the demand and supply situation more fully, Markit has developed a series of PMI Supply Shortage Indicators, which reflect the proportion of companies across Markit's worldwide survey panels that report a specific commodity to be in short supply.

The Indicator for aluminium rose to a 22-month high in February amid the strengthening demand for aluminium at manufacturers, but importantly it remained well below its long-run average. The resulting divergence between supply shortages and price is in marked contrast to the situations seen during the previous aluminium price spikes in late 1999/early 2000 and during 2006, when supply shortages were widespread.

Supply Shortage Indicator (SSI)



Price Outlook

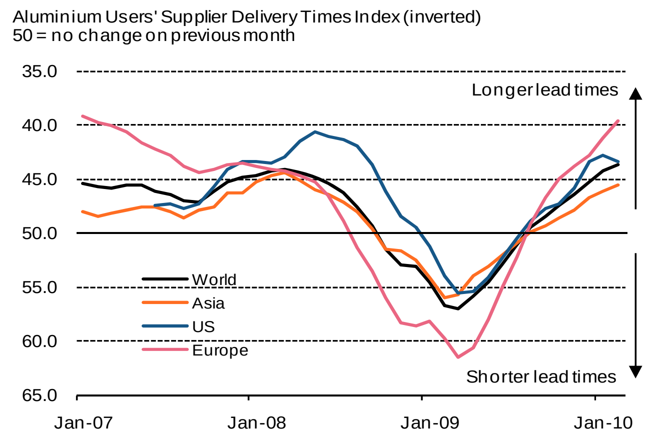
It therefore seems that aluminium prices are being driven above the natural level that would be associated with current demand and supply fundamentals by speculation that demand will outstrip supply in the future. This speculative pressure most likely reflects increased confidence in the global economic outlook, particularly regarding China.

This means that prices may be subject to a substantial downward correction if growth in China – the world's largest consumer of aluminium – fails to meet market expectations.

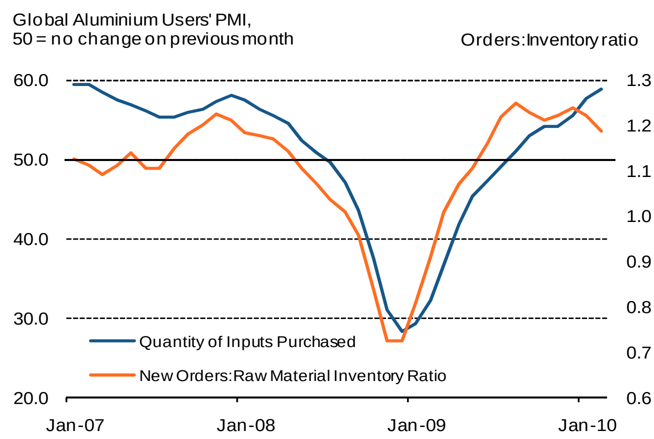
The coming months will therefore be key in determining if current market prices are indeed justified or if a price correction is in the offing.

On one hand, companies using aluminium in Asia, the US and Europe are starting to see marked lengthenings in average vendor lead-times in general, so it is quite feasible that supply delays and shortages for aluminium will become more widespread.

Suppliers' Delivery Times – aluminium users



Inventory Cycle – aluminium users



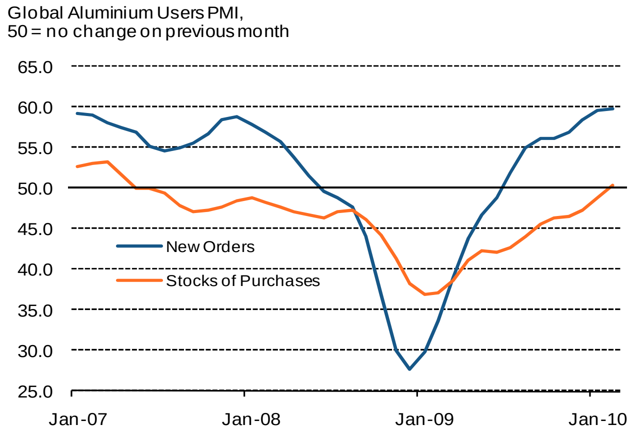
On the other hand, the impact of the inventory cycle on demand for aluminium looks set to wane in coming months. The ratio of aluminium users' order books to stocks of inventories tends to move in advance of changes in their actual purchasing of inputs. This ratio peaked last year and fell sharply in February as inventories rose and growth of new orders slowed. It is always dangerous to read too much into one month's data, but it is likely that the inventory cycle impact on aluminium demand may soften in the near future. In the absence of a further pick up in final demand for aluminium-based goods, this should have a dampening effect on prices.

PMI survey of aluminium using manufacturers

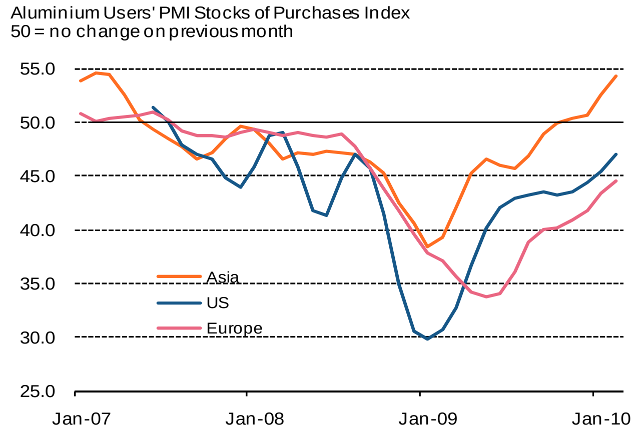
Using data from our established survey panels across Asia, Europe and the US, Markit produce data tracking trends at aluminium-intensive goods producers. Data cover indexes for output, new orders, new export orders, input purchasing, stock holdings, prices, vendor delivery times and employment.

For further information on commodities PMI data, please contact economics@markit.com.

New orders and inventories



Inventories by region



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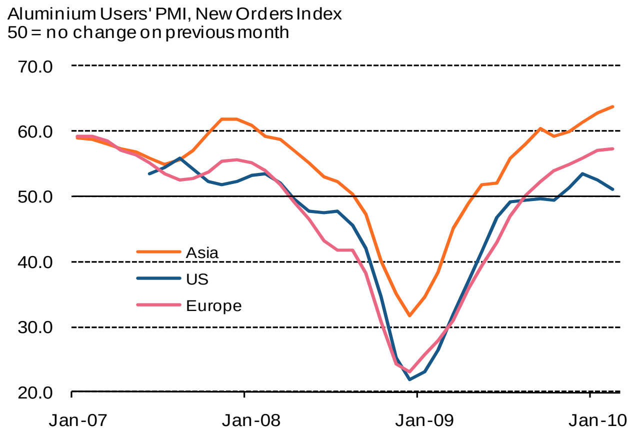
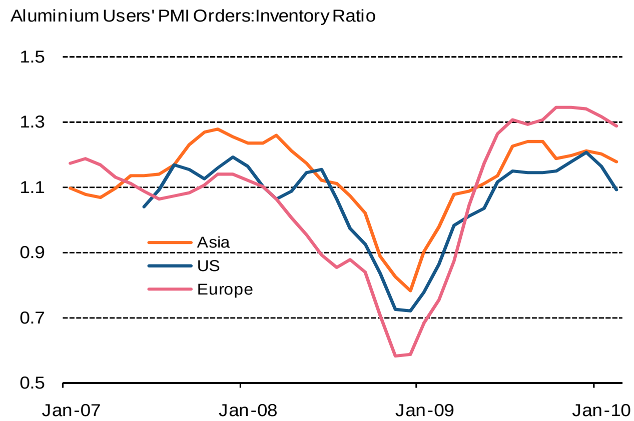


New orders:inventory ratio by region



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