

ALUMINUM SPECIAL ALERT

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The “Canadian Problem”, Section 232 and US aluminum premiums

May 7, 2020

US MW PREMIUM SPECIAL ANALYSIS. Since the US granted a Section 232 Tariff exemption to Canada, Canadian exports of primary aluminum to the US have increased considerably, both in volume and as a percentage of total US imports. In the process: a) the MW premium and US product upcharges have collapsed amid deep discounting, b) embedded Section 232 Tariffs on primary aluminum prices have evaporated, and c) all US smelters became unprofitable and unviable again. This chain of events is what some US market participants have called the “*Canadian problem*”.

Q. What is the stated purpose of Section 232 Tariffs?

A. Help US aluminum smelters and US rolling mills restart/expand capacity, by boosting their profitability.

[In more detail.](#)

Section 232 proclamation states that the 10% Tariff aims to “*help (US) domestic aluminum industry to revive idled facilities, open closed smelters and (rolling) mills*”.

Q. How does Section 232 aim to accomplish its two-fold goal of US smelting and US rolling mill revival?

A. Impose a 10% Tariff on US imports of aluminum products such as primary aluminum, secondary aluminum, extrusions, flat rolled products, and castings but exclude aluminum scrap.

[In more detail.](#)

Section 232 aims to boost net income of US smelters by imposing a 10% Tariff on primary aluminum imports (US smelters sell at the duty-paid price and keep the duty for themselves). The idea behind this is to do this by increasing the US regional price of primary aluminum via the MW premium and product upcharges.

Section 232 aims also to boost net income of US rolling mills by increasing US conversion prices of rolled products with the 10% Tariff on flat rolled products imports and by widening scrap discounts (via the exemption of scrap) which is the most important feedstock cost for US rolling mills.

Q. Were Section 232 Tariffs successful in boosting profitability and production of US smelters and rolling mills?

A. Yes, in both cases.

[In more detail.](#)

US Smelters. The US regional price of primary aluminum did increase by \$238 per mton or 10.6% via higher MW premiums and product upcharges. For example, the MW premium doubled from 8.3 cent/lb in December 2017 to 16.9 cent/lb on May 16, 2019 and the embedded duty in the MW premium increased from zero to 8.2 cent/lb (\$181 per mton). Moreover, the spot upcharge for US billet (6063) increased by 20% or 2.2 cent/lb (\$57 per mton) from 8.3 cent/lb in December 2017 to 10.5 cent/lb on May 16, 2019.

Given the boost that the 10% Tariff had on the MW premium and product upcharges (and thus US smelting profitability), US smelting production jumped by 53%, from 750 kmtpy in December 2017 to 1,150 kmtpy in May 2019. In fact, by May 2019, almost all US smelters were back in operations at full capacity or ramping up toward full capacity.

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US Rolling Mills. Scrap discounts such as those for UBCs widened also by 10 cent/lb or \$220 per mton, from 25 cent/lb in December 2017 to 35 cent/lb in May 2019. Common alloy sheet (3003 alloy) conversion prices doubled (also boosted by AD/CV duties) from \$785 per mton in December 2017 toward \$1,465 per mton in May 2019. Indeed, US rolling mill production reached full operating capacity in early 2019 and restarts/new mill expansions were announced and/or confirmed by *Braidley, JW Aluminum, Texarkana, and Granges.*

Q. When was Canada exempted from Section 232 Tariffs and under what conditions?

A. On May 20, 2019, Canada received from the US a full exemption from Section 232 Tariffs under the condition of a “soft quota”, which is a commitment to not increase its primary aluminum exports to the US in a meaningful way or alter its market share in the US market.

[In more detail.](#)

President Trump’s proclamation on May 19, 2019 stated: a) “I have decided to exclude Canada ... from the tariff proclaimed...”; b) “The United States has agreed on a range of measures ... to allow imports of aluminum from Canada and Mexico to remain stable at historical levels without meaningful increases”; and c) “The United States will monitor the implementation and effectiveness of these measures in addressing our national security needs, and I may revisit this determination as appropriate.”

A joint statement between the US and Canada about the exemption mentioned that: “In the event that imports of aluminum or steel products surge meaningfully beyond historic volumes of trade over a period of time, with consideration of market share, the importing country may request consultations with the exporting country. After such consultations, the importing party may impose duties of ... 10 percent for aluminum...”.

Q. What is the benefit of an exemption?

A. When exempted, a Canadian producer sells aluminum in the US at a full market duty-paid price and keeps the entire duty for itself (since it is exempted of paying it back to the US government). An exemption represents a notorious economic windfall for the Canadian producer. Alternatively, the exempted producer can share with a customer part of that duty it keeps (via market price discounting) and gain more business and market share (even more so during oversupply conditions).

Q. What happened to Canadian exports of primary aluminum after the Section 232 exemption?

A. Since the exemption was granted, Canadian exports of primary aluminum to the US have surged despite an oversupplied US market, according to government data. Since then, the MW premium and product upcharges have collapsed, eroding almost the entire “benefit” of the 10% Tariff embedded in them. As a result, all US smelters are today underwater and unviable again. Indeed, last week, *Alcoa* announced the first US smelter curtailment since the Section 232 exemption was granted to Canada.

HARBOR’s analysis indicates that absent the evaporation of the 10% Tariff “benefit”, all US smelters would have been cash positive even after the collapse of the LME price that has occurred as a result of the COVID-19 pandemic.

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Canadian Exports. Since exemptions were granted to Canada last May, Canadian exports of primary aluminum have surged in volume and as a percentage of US total imports despite US oversupplied market conditions. During the ten months prior to the Section 232 exemption, Canada exported to the US around 1.55 million mton of primary aluminum, representing 48% of total US imports. During the ten months after the exemption, Canada exported 2 million mton, or 30% more than in the prior ten months (while all other countries exported 15% less to the US in the same period).

The 30% increase in Canadian exports to the US market is partially explained by the restart of 340,000 mton of idled capacity at ABI, a Canadian smelter with 450,000 mton per year of capacity that had an 18-month long lockout that ended in July of last year, less than two months after the exemption. The ABI smelter had always exported most of its metal to the US. As ABI's production increased, so did exports to the US market.

As a result, Canada's average market share of total US primary aluminum imports increased by twelve percentage points to 60% during the ten months following the exemption. By the end of Q1 2020, Canadian exports represented 70% of total US primary aluminum imports and 81% of total US unalloyed aluminum imports.

During the same period of the Canadian export surge and as a result of discounting from the duty component given oversupplied market conditions, the MW duty-paid premium collapsed from 16.9 cent/lb on May 16, 2019 to 9.5 cent/lb today. The embedded duty in the MW premium fell from 8.2 cent/lb to just 1.7 cent/lb (\$37 per mton). At the same time, and as a result of excess availability of metal, product upcharges such as billet (6063) collapsed from 10.5 cent/lb to 2.5 cent/lb.

In this context of a collapse in US market pricing, *Alcoa* announced (April 22) its decision to shut down the remaining 230 kmtpy of operating capacity at its Intalco primary aluminum smelter in Ferndale, Washington.

Today, there are only six operating primary aluminum smelters left in the US (Mt. Holly, New Madrid, Seabee, Massena West, Hawesville, and Warrick), which according to our estimates are all underwater and unviable at current collapsed MW premium and product upcharge levels.

[Q. In this context, what has been referred to as the “Canadian problem”?](#)

A. Some US market participants have referred to it as the surge in Canadian exports of primary aluminum to the US market that took place after the exemption, and as the subsequent collapse of the US regional price of primary aluminum (MW premium and product upcharges).

[In more detail.](#)

Last week, a US smelter executive was quoted saying that there has been discussions with relevant US authorities regarding the “Canadian problem”.

(see executive chart next)

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This week, the *American Primary Aluminum Association (APAA)* issued a statement which mentioned that an increase in imports of Canadian primary aluminum “has persisted at rates far above demand levels in the United States leading to a collapse in U.S. aluminum prices and putting severe financial pressure on U.S. producers.”

Q. What does HARBOR see ahead?

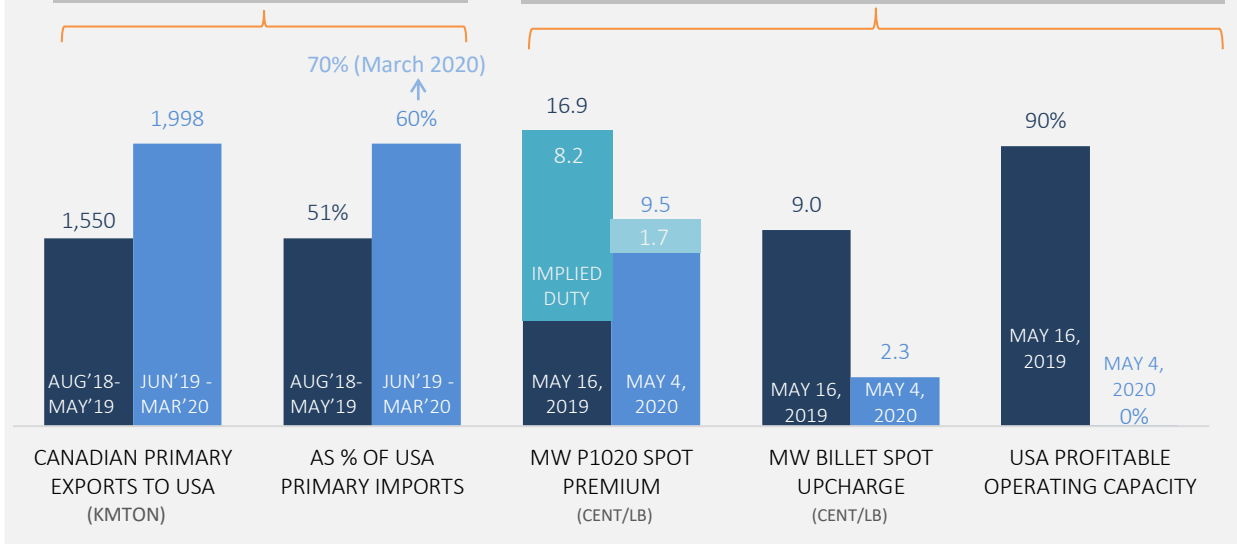
A. Basically the entire “benefit” of Section 232 Tariffs embedded in the MW premium and product upcharges has evaporated in a context of oversupply conditions, a surge in Canadian exports of primary aluminum to the US that followed the exemption, and related deep price discounting. As a result, there is renewed pressure on US authorities to raise Section 232 Tariffs and/or restrict Canadian exports to the US in such a way that in the end, the MW premium and product upcharges increase enough to boost US smelter profitability and guarantee the viability of existing US smelters even during depressed LME prices.

USA IMPORTS FROM CANADA, ALUMINUM PREMIUMS, & US SMELTING PROFITABILITY

BEFORE CANADA'S S.232 EXEMPTION AFTER EXEMPTION

1. Canadian aluminum exports to the US climbed by 30% y/y in the ten months following the exemption, expanding their share of US total primary aluminum imports to 70% by March 2020.

2. Since the exemption was granted, Canadian exports of primary aluminum have increased meaningfully, according to official data. At the same time, the MW premium and product upcharges have collapsed amid price discounting, evaporating the entire “benefit” of the 10% Tariff embedded in them. As a result, US smelters are today underwater and unviable again. Absent the evaporation of the 10% Tariff embedded in the MW premium and product upcharges, all US smelters would have remained cash positive even under current depressed LME prices, according to our estimates.



Source: HARBOR Aluminum and US Census data.

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