

# ALUMINUM SPECIAL ALERT

FROM THE ALUMINUM AUTHORITY.



EXPERT  
INSIGHT &  
OUTLOOK.



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TALK.

## Life after “fixing” the “Canadian Problem”

August 14, 2020

**US MW Premium Special Analysis.** HARBOR is the only major consultancy and aluminum industry expert that correctly forecasted a sharp increase in the MW duty-paid premium toward 16 cent/lb and highlighted the growing likelihood of a US “fix” to the “Canadian Problem”—which did occur in the form of the re-imposition of a 10% Tariff on Canadian exports of unalloyed aluminum (kicks-in on August 16).

In this context, please find below answers to key questions related to the issue, and our view of how life will be now that the “Canadian Problem” has been “fixed” by the US Administration.

### 1. Why did the US Administration re-impose a 10% Tariff on Canadian exports to the US of unalloyed unwrought aluminum (P1020, purity and off-grade)?

For *breaching* a May 2019 trade agreement.

The May 2019 trade agreement gave Canada an exemption on Section 232 Tariffs on exports of aluminum to the US in exchange for accepting not to increase exports to the US in a meaningful way. Canada accepted to restrict exports (soft quotas) in following aluminum export categories:

a) unalloyed unwrought (P1020, purity and off-grade), b) alloyed unwrought (billet, slab and foundry), and c) wrought aluminum (sheet, plate, foil, extrusions, wire, castings and forgings).

**Very important to remember.** When a country is exempted from a US Tariff in the aluminum industry, the exempted country and its exporters get to charge the Tariff (Midwest duty-paid) but keep it completely for themselves. There is no obligation to pay it back to US Customs. The exemption means free money, a windfall that we estimated to be worth as much as \$600 million usd per year.

Canadian exports to the US of unalloyed unwrought aluminum (P1020, purity and off-grade) started to surge immediately after the May 2019 trade agreement, way before the COVID-19 pandemic. By May 2020, one year after, Canadian exports of unalloyed unwrought aluminum to the US were up 304% y/y and hit an all-time record high. Monthly exports were such that it equated to 1.4 times total US consumption. Because of the exemption, the more that was exported, the bigger the windfall Canadian exporters were getting.

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At the same time of the Canadian export surge to the US, Canadian exports to Europe and other countries fell considerably.

**The unprecedented surge in Canadian exports to the US of unalloyed unwrought aluminum caused the following:**

a) flooded the US aluminum market, b) collapsed the US aluminum price (MW premium), c) put the entire US smelting industry below water, d) caused the closure of one US smelter (*Alcoa's Intalco*) and, e) numbered the days for all of the remaining six operating US smelters probably to no more than a semester, according to HARBOR estimates.

Breach of the May 2019 trade agreement only occurred with unalloyed aluminum (P1020, purity and off-grade). Canadian exports to the US of alloyed unwrought aluminum (billet, slab and foundry) and wrought aluminum declined along with US demand.

Note that, per *Section 232*, the US Administration considers the survival of the last seven smelters in the US (out of 32 that used to exist in 1980) as a matter of National Security given how strategic aluminum is for defense applications (aircrafts, naval vessels, tanks and weapons).

Canadian smelters of primary aluminum produce 3.1 million mton, which is well in excess of the 0.4 million mton that Canada consumes. Excess Canadian production tried to find a home in the US market where it competes with US smelters, more so when exporters get a windfall when exempted.

In this context, after breaching the May 2019 agreement and absent an agreement to restrict exports to the US in the form of a hard quota, the US announced its decision to re-impose on Canada the 10% Section 232 Tariff on unalloyed unwrought aluminum, effective August 16.

When announcing the re-imposition of the Tariff on Canadian exports of unalloyed unwrought aluminum, President Trump stated last week: *"Canadian aluminum producers have broken that commitment and the US Trade Representative, Robert Lighthizer, has advised me that this step to re-impose tariffs is absolutely necessary to defend our aluminum industry."*

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## 2. Who benefits the most from the re-imposition of the 10% Tariff on Canadian exports of unalloyed unwrought aluminum (P1020, purity and off-grade)?

The US aluminum downstream industry benefits the most from the re-imposition of the 10% Tariff. In particular, rolling mills, extruders and re-melters with casthouse operations.

The re-imposition of the 10% Tariff on Canadian exports has doubled the MW premium toward 16 cent/lb (as correctly forecasted by HARBOR) and widened most scrap spreads for the US downstream industry.

Remember, when the MW premium falls, scrap spreads tighten, and US downstream profitability suffers.

When the MW premium increases, scrap spreads widen, and US downstream profitability improves.

For many of the US downstream operations, most of their profitability comes from scrap spreads, not from conversion prices.

The re-imposition of the Tariff has restored lost US downstream profitability which adds as much as \$800 million per year, by far the biggest beneficiary of the re-imposition of this Tariff.

**Indeed, the re-imposition of the Tariff on Canadian metal has restored:**

a) US aluminum prices (MW premium toward 16 cent/lb), b) the profitability and viability of the seven remaining US smelters, and c) the strategic profitability that scrap spreads give to the US downstream industry.

When announcing the re-imposition of the 10% Tariff on Canadian unalloyed unwrought aluminum, the US administration stated that it will closely monitor Canadian exports of aluminum that still enjoy the exemption. These include alloyed unwrought- billet, slab, foundry- and wrought- sheet, plate, foil, extrusions, wire, castings and forgings. The US wants to make sure exports don't surge again and damage the US aluminum industry again.

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### 3. What did we confirm after the announcement of the re-imposition of the 10% Tariff on Canadian exports of unalloyed unwrought aluminum (P1020, purity and off-grade)?

The US administration takes trade agreements seriously, holds parties accountable and does consider the last remaining US smelters as a matter of National Security.

### 4. How do we see market life now that the “Canadian Problem” has been “fixed”?

MW premiums will mainly trade between 16-18 cent/lb.

Canadian exports to the US of alloyed unwrought aluminum (billet, slab and foundry) will be closely **monitored** by the US to make sure they don't increase. If they do increase, as we learned in the case of unalloyed unwrought (P1020, purity, off-grade), Canada will likely lose its exemption in this category. We estimate the current exemption on Canadian alloyed unwrought aluminum (billet, slab and foundry) represents a \$200 million per year windfall for Canadian exporters.

**We believe US upcharges for standard slab, billet and foundry will trend toward levels of 10 cent/lb or higher.** Indeed, because Canadian exports to the US of alloyed unwrought aluminum (billet, slab and foundry) effectively face a soft quota and are thus restricted, we do see Canadian exporters continuing to lose market share in the US aluminum market and firm up upcharges for standard slab, billet and foundry.

**We believe US independent secondary billet and slab suppliers will continue to grow in profitability, volume and US market share.**

**We expect new US rolling mill project investments to be announced**, including possible greenfield project confirmations.

**We expect off-shore suppliers of primary aluminum to the US to consolidate.** Several offshore producers will see their volumes shipped to the US collapse relative to recent years. Only those off-shore producers who are market leaders will see their volumes and market share grow.

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