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US-Canada aluminium trade spat, the facts

In a letter dated 26 May, the American Primary Aluminum Association (APAA), whose members include Century Aluminum and Magnitude 7 Metals, called on US Trade Representative Robert Lighthizer to repeal Canada's exemption to the Section 232 tariffs.

The plea by the APAA comes in response to a "surge of Canadian metal" that "has caused the price to collapse and is endangering the future viability of the U.S. primary industry," the letter states.

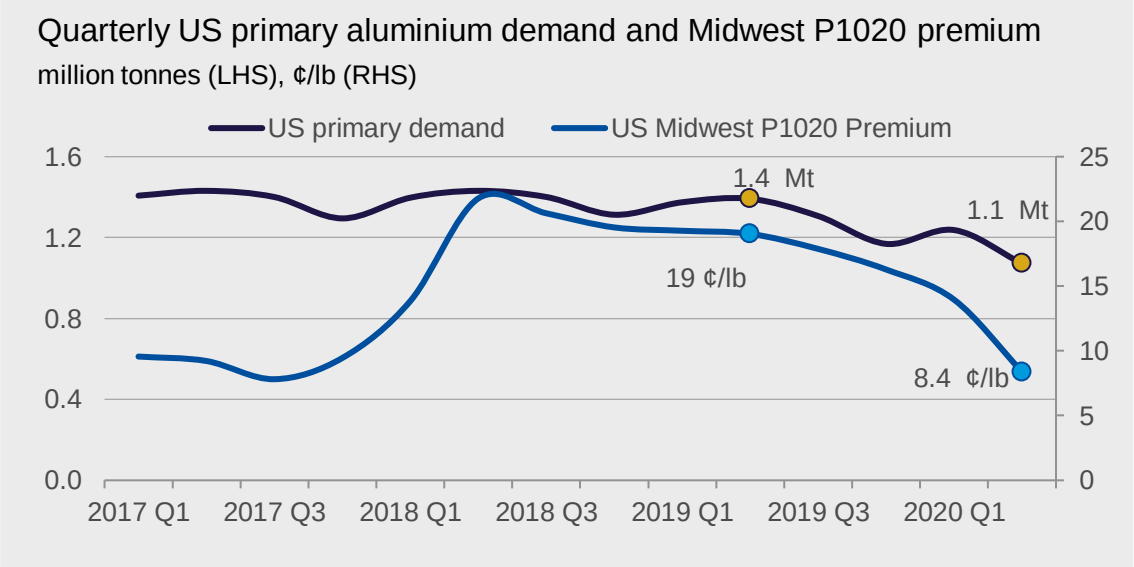
Four days prior to the APAA memo, the US Aluminum Association, whose members include primary producers Alcoa and Rio Tinto, penned a letter to Ambassador Lighthizer pushing back on "false reports" about a surge in imports from Canada. The letter from the AA further states that "imports of primary aluminum from Canada into the U.S. are consistent today with levels prior to the implementation of Section 232 tariffs and below peaks in 2017."

As the two organizations exchange blows over Canada's exempt status, let us examine the facts.

US Midwest premium has been cut in half since the start of the year

The price collapse noted in the letter refers to the US Midwest P1020 premium (MWP), which has been cut in half since the start of the year, falling from 14.6¢/lb to 7.3¢/lb. An increase in US imports has contributed to the decline but is not the only factor.

Figure 1: Collapse in US primary aluminium demand has contributed to lower premiums



DATA: CRU

The MWP surged above 20¢/lb in early 2018 following the implementation of Section 232 duties on aluminium imports. Since then, the MWP has been under steady downward pressure, aided by the Canada exemption which was granted a year ago to support a broader North American trade agreement (i.e. USMCA). Another factor contributing to the decline in

the MWP is the plunge in US primary aluminium demand, which has fallen nearly 23% y/y in Q2 2020 as Covid-19 related lockdowns shuttered manufacturers across the country.

As demand deteriorated, so did the need for US consumers and traders to import P1020 from countries that are not exempt from Section 232 (i.e. countries other than Canada, Australia, and Argentina). This is important because imports from countries that are subject to the duties carry the highest cost, serve as the only alternative to duty free aluminium, and set the floor for the Midwest premium. That logic held true until such imports were no longer needed, which was the case even before the Covid-19 outbreak. In essence, the 10% duty that caused the premium to more than double shortly after the implementation of Section 232 was no longer providing a safety net for US domestic producers.

Higher regional P1020 production is a major driver of lower premium levels

Due primarily to the collapse in the automotive market, primary aluminium smelters in the US and Canada were forced to shift a major portion of production from value-add products (VAP) to commodity-grade P1020 to maintain current operations. All 3 of the major producers in the region confirmed this in their Q1 earnings releases:

- **Century Aluminum** – "In addition, degradation in the order books of certain customers has caused us to move our product mix to a higher proportion of standard products, thus lowering somewhat the average premium we receive."
- **Alcoa** – "Conversion of ~20% of 2Q20 value-add product sales to commodity-grade ingot due to customers requesting shipment postponements and declaring force majeure."
- **Rio Tinto** – "In aluminium, in response to market conditions we have reduced the proportion of primary metal being produced as value added products."

According to the latest estimates published in our April Casthouse Shapes Market Outlook, we estimate this shift in product mix to account for an additional 402,000t of P1020 production from North American smelters in 2020 compared to last year. This figure includes the return of the Alcoa/Rio owned Bécancour smelter, which will produce mostly P1020 this year as the facility ramps up following an extended labour dispute. While still in the process of ramping up, the smelter produced nearly the same amount of aluminium in Q1 2020 as it did during all of 2019.

What constitutes a "meaningful surge"?

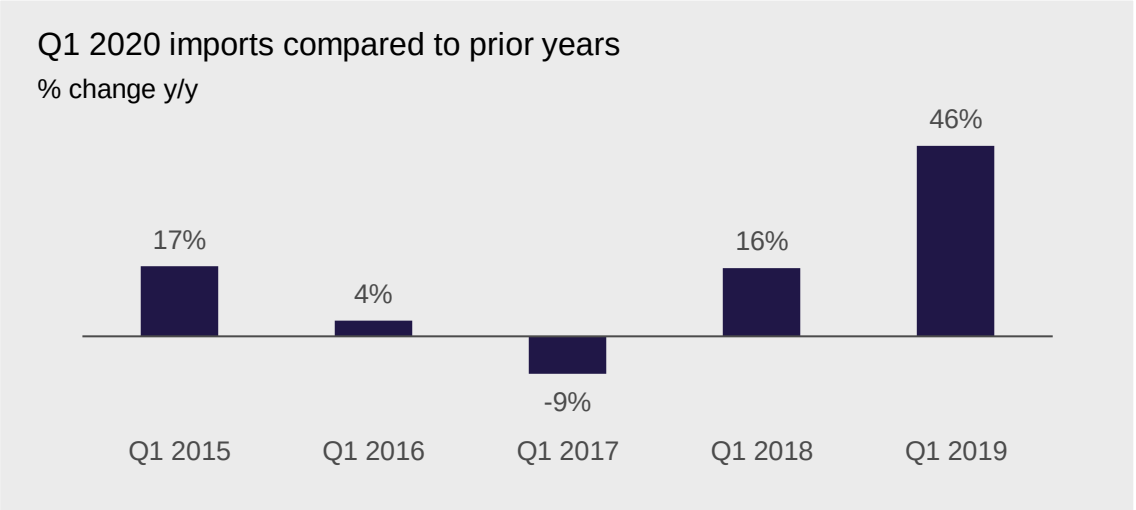
On 18 May 2019, the USTR announced that bilateral agreements were signed with Canada and Mexico to eliminate the Section 232 tariffs, and the subsequent retaliatory tariffs. In addition to the agreement calling for the implementation of monitoring systems to prevent dumping and transhipment, the agreements also stated that the importing party has the option to impose a 10% tariff on imports of aluminium in the event that imports "surge meaningfully beyond historic volumes of trade over a period of time, with consideration of market share." However, the agreements do not define the period of review or what would constitute a "meaningful" surge.

The letter prepared by the APAA references a "surge" in US imports of unwrought aluminium from Canada in Q1 2020 as the basis for its complaint, stating that the increase over Q1 2019 import volumes was nearly 200,000t. CRU analysis of US import data shows that Q1 2020 imports of unwrought aluminium from Canada were up 46% y/y (187,000t). Our analysis

also shows that Q1 2020 imports were 9% lower than Q1 2017 import levels, and 3% above the Q1 average from 2015-2017.

On an annualized basis, US imports of unwrought aluminium from Canada are on pace to total 2.38Mt, or 14% higher than 2019. However, this level of 2020 imports would be 5% lower than 2017 imports, and 2% above the average import levels from 2015-2017.

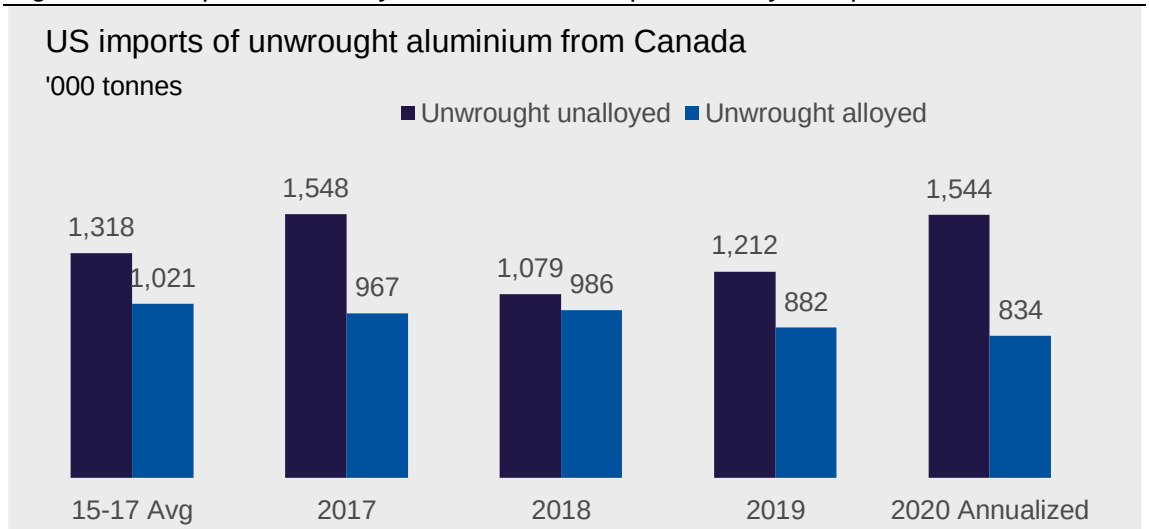
Figure 2: US imports are up significantly from 2019 but well below 2017 levels



DATA: IHS Markit

A lot of focus has been on US imports of unwrought aluminium that is “unalloyed” (i.e. mostly commodity grade P1020) from Canada. On an annualized basis, such imports are on pace to exceed 2019 volumes by 27%, exceed 2015-2017 average volumes by 17%, but be on par with 2017 levels. Looking at imports of unwrought aluminium that is “alloyed” (i.e. mostly value add-products such as billet, slab, and foundry alloy), 2020 import volumes are on pace to be 5% below 2019 volumes. Compared to 2017, such imports are on pace to be off by 14%, and off by 18% from the 2015-2017 average annual volume.

Figure 3: US imports of unalloyed aluminium are up while alloyed imports are down



DATA: IHS Markit

What happens if exemptions go away and/or Section 232 duties rise?

If the proponents of removing Canada's exemption and/or raising the Section 232 duty prevail, it could produce the following outcomes:

- Midwest premium would rise again to the replacement cost of seaborne supply that is not exempt from duties. If Canada simply loses exemption, that would be 10.50-12.00¢/lb over LME duty paid. If Canada loses its exemption and the duty is raised to 20%, then the risks amplify, and we are back to premiums above 20¢/lb. The market may not need seaborne supply, as Canada is still here and still a viable supply. However, the market will price that marginal supply as the clearing price.

- It will have little to no effect on the LME price, which continues to price the effect of rising Chinese production and massive global demand destruction.

Where does the dispute go from here?

After exchanging blows in the public domain, it is unclear what the eventual outcome will be in the dispute between the APAA (and member companies Century Aluminum and Magnitude 7 Metals) and the AA (and member companies Alcoa and Rio Tinto). With the APAA calling for a removal of Canada's exempt status and the AA pushing back on reports of a "surge", more clarity within the bilateral agreement signed in May 2019 would be a step in the right direction. More specifically, an agreement between the two countries on what constitutes a "meaningful surge", and what the baseline should be to determine whether a surge has occurred is necessary to enable the parties to effectively hold one another accountable for complying with the agreement. While some suggest that a quota would be an effective resolution to the dispute, the bilateral agreement does not explicitly provide either country with the ability to implement a quota on imports. While CRU cannot confirm the legality of a quota under the current agreement, it appears to be yet another piece of the agreement that needs clarification.