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Tariffs on the double, toil and trouble

Tariffs have been a major focus of debate ever since the presidential election and even before President Trump took office. There had already been a notable impact on metals markets during the transition period as the aluminum Mid-West Premium edged higher amid concerns that tariffs would be implemented, while there have since been notable effects on the steel and copper markets also.

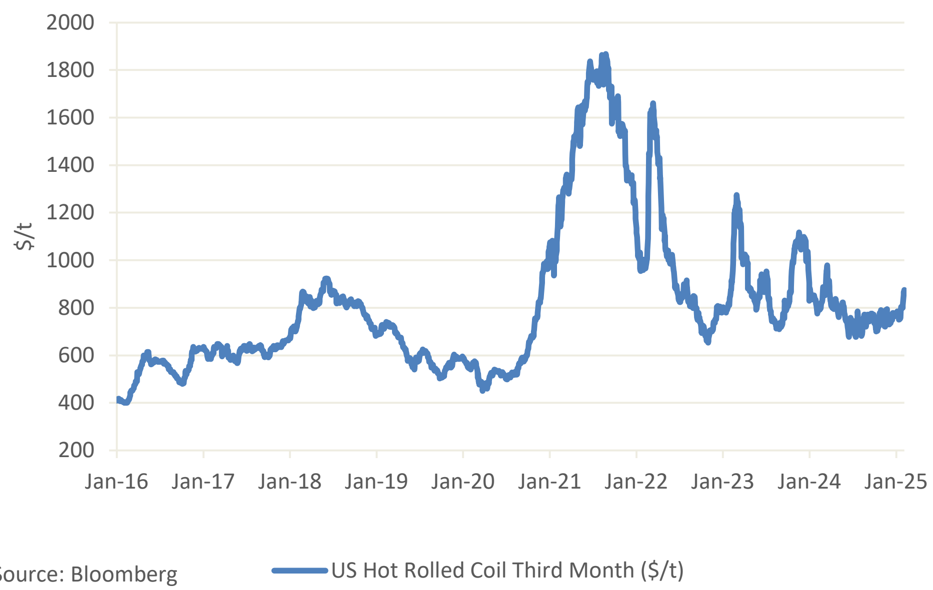
First President Trump announced that there would be 25% tariffs on Canadian and Mexican imports from February 1, although this was then pushed back to Feb 4 before being put on hold until March 1 after last minute discussions between President Trump and Mexican and Canadian leaders. Meanwhile, tariffs have been introduced on the imports of all aluminum and steel products at a rate of 25%. Should the tariffs be fully enforced and remain in place, we anticipate no direct impact on LME aluminum prices but an increase in the MWP to 37-47c/lb to fully account for the additional costs of the tariff that importers will have to pay.

MWP surges to 40c/lb with further creep possible

Source: Bloomberg

The US steel industry is more self-sufficient than aluminum, with a larger share of domestic consumption produced in country. However, the tariffs had a similar sharp upward impact on steel prices. Hot rolled Coil prices rose from just over $600/t in late 2017 to climb to the low $900/t level in the second quarter of 2018, although prices then went into steady decline to less than $500/t by the end of 2019. Since tariffs were announced, HRC prices have jumped around $100/t to $875/t at the time of writing. We anticipate steel prices remaining elevated for now, with perhaps slightly more room to run towards $900/t to fully account for higher costs of imports, albeit with the limited role that they play in the US market.

Steel prices likely to edge higher above $100/t



Source: Bloomberg

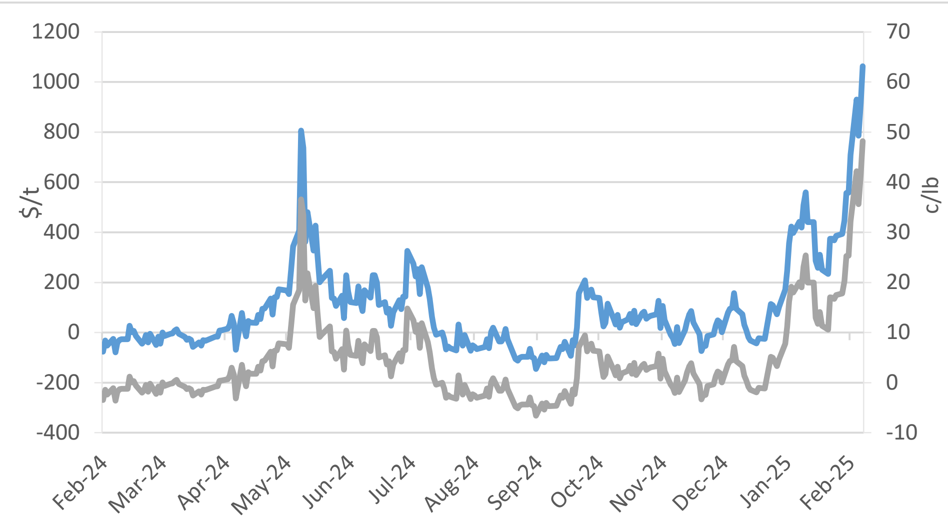
It is worth remembering that there are already Section 232 tariffs on imports of Steel and Aluminum, after they were introduced in 2018, although there were many exceptions, including Mexico and Canada but a number of other countries also. These were levied at 10% for aluminum and 25% for steel but as noted, many of the major importing countries were exempt from these tariffs. There are no notable imports of primary steel or aluminum from China, although there are imports of semi-finished products but these have been diminished by various specific anti-dumping and countervailing duties against the goods in question. The latest tariff announcement is actually a re-affirmation of the Section 232 tariffs, albeit with the rate on aluminum raised to 25% and eliminating the exemptions for both metals.

Prior to the imposition of Section 232 tariffs, the aluminum MWP had ranged around 6-10c/lb in the year or two before but then shot up to the 20c/lb level. The extra 10-12c/lb roughly approximated the 10% duty that importers would have to pay. However, because of the large number of exemptions, most imports, including those from Canada, didn’t have duties applied to them. But overseas material was still selling at the inflated MWP and as such, the tariffs meant that the US consumer was providing a massive subsidy to aluminum producers in Canada and elsewhere. Given that the US imports more than three quarters of its consumption of primary aluminum, the US consumer was subsidizing foreign companies to a much greater degree than it was benefiting US producers. The elimination of tariff exemptions will at least mean that the higher MWP will not accrue directly to overseas producers but will garner some import revenue. Buyers of aluminum will be worse off though. Meanwhile, aluminum production stood at 741kt in 2017, having declined from over 2 million tonnes per year in 2012, and output did increase to just over a million tonnes in 2019, although declined to 750kt in 2023.

Tariffs on copper have been mooted, although President Trump has suggested that any tariffs on the red metal may come later in the year. That hasn't stopped the copper market from having its own gyrations though, with the spread between COMEX copper prices and the LME surging to over 50c/lb from 5c/lb at the end of last year. The market is currently pricing in tariffs of around 10% based on current levels, although this is subject to headline risk. The LME cash to 3s contango also narrowed significantly as traders rushed to withdraw metal from LME warehouses and ship it to the US.

An added complication for copper comes from the latest announcement that the US would apply reciprocal tariffs levied at the same or similar level that trading partners place on US goods. Chile has a free trade agreement with the US and ostensibly that would mean zero tariff on their imports but Canada and Mexico are also major copper trading partners (and also have a free trade agreement) and there do appear to be tariffs on the horizon. If copper trades in a similar way to aluminum, there would be a direct pass through of tariff rates to the COMEX premium over LME prices at a level equivalent to the tariff rate, although this would open up an arbitrage opportunity for importers from countries with no tariffs. Unless of course there are blanket tariffs applied to all products, with no exemptions, in which case we would expect to see the premium of remain around its current levels in the case of a 10% tariff but in excess of 100c/lb in the event a blanket 25% tariff was introduced.

CME copper premium over LME could surge to over 100c/lb with 25% tariffs



Source: Bloomberg