US, UK Ban Deliveries Of Russian Copper, Nickel And Aluminum To Western Metals Exchanges: Here's What This Means

Description

US /UK : On Friday, the US and UK imposed new restrictions on trading Russian aluminum, copper and nickel in the latest hollow bid to curb President Vladimir Putin's ability to fund his war machine (as discussed previously, Russian oil is now trading above the western embargo "cap" price virtually everywhere).

According to Bloomberg, the rules prohibit delivery of new supplies from Russia to the London Metal Exchange, where the global benchmark prices are set, as well as to the Chicago Mercantile Exchange.

The restrictions apply to copper, nickel and aluminum produced on or after April 13, and the US is also banning Russian imports of all three metals.

Yet like the case of oil sanctions, the decision is purely for popular theater as it will not prevent Russia from being able to sell its metals, since the sanctions do not prevent non-US persons and entities from buying physical Russian copper, nickel or aluminum.

While the LME plays a pivotal role in setting global prices, the vast majority of metals are bought and sold between miners, traders and manufacturers without ever seeing the inside of an LME warehouse.

Already since 2022, the share of Russian metals sales to China has increased substantially, as some western buyers sought alternative suppliers.

Still, as Bloomberg notes, the new restrictions are likely to affect prices on the LME, which are used as a benchmark in a huge number of contracts around the world. For months, an influx of Russian metal has weighed on LME prices – particularly for aluminum – with non-Russian supplies trading at a premium.

The sanctions will also affect the willingness of traders to handle Russian metal, as many view the ability to deliver on the LME as essential, and some contracts include clauses specifying that they will be void if the metal ceases to be LME-deliverable.

That means the metal – like Russian sourced oil – is likely to trade at a widening discount to other origins, thus reducing the revenue Russia receives, while still continuing to flow into the global market and avoiding the impact of full-scale sanctions on crucial raw materials while making billions more for global commodity merchants like Glencore, Vitol and Trafigura who will be willing – and very well paid – middlemen to assist buyers in evading sanctions.

Russian metals exports were worth $25 billion in 2022 and $15 billion in 2023.

“We will reduce Russia’s earnings while protecting our partners and allies from unwanted spillover effects,” US Treasury Secretary Janet Yellen said in a joint statement with her UK counterpart, Jeremy Hunt, who added that the move “will prevent the Kremlin funneling more cash into its war machine.”

No you won’t. All you will achieve is raising the prices of commodities further, but yes, the sanction will raise questions for Glencore which has remained one of the biggest traders of Russian metal thanks to a long-term contract with Rusal.

Russia is a major producer of the three metals, accounting for about 6% of global nickel production, 5% of aluminum and 4% of copper.

However, Russian supplies account for a much larger percentage of metal on the LME. At the end of March, Russian metal accounted for 36% of the nickel in LME warehouses, 62% of the copper and 91% of the aluminum.

Comex copper futures rose after the announcement, while shares of US metal producers including Alcoa Corp. gained in post-market trading.

For a more practical perspective of what the sanctions mean, we go to commodity trading powerhouse Goldman Sachs, whose trading desk has published a note discussing the short and long-term impacts of the delivery ban.

Is this a full sanction on Russian metal ? No, OFAC prohibit:

a. Russian metal being imported into the US

b. OTC derivates settling against Russian metal

c. US persons’ from warranting Russian metal produced after 13th April 2024 on either the COMEX or LME.

There has not been any sanction around the consumption of Russian metal.

How much aluminium, copper and nickel does the US currently import ? Very little, imports for 2021, 2022 and 2023 respectively were

Aluminium (HS code 7601): 215k, 190k, 17k MT

Copper (HS code 7408 + 7403): 10k, 0k, 0k MT

Nickel (HS code 7502): 5k, 10k , 0.6k MT

Therefore Goldman expects the impact on US physical premiums to be modest because US consumers have already diversified their supply chains away from Russian metal

Are many OTC derivatives settled against Russian metal ?

Goldman does not think the Services Determination clause prohibiting settlement of derivatives in Russian metal will impact price because.

i) Most OTC derivatives are cash settled; in our experience brand specific physically settled options and swaps are rare

ii) Off-take agreements and long-term supply contracts, which probably still do reference Russian metal, are likely not to be classified as a derivative under the Services Determination clause (otherwise end-users would be prevented from consuming Russian metal which would be a de-facto full sanction).

What happens to LME inventory? Unclear until we receive further guidance from the LME, which is scheduled for 11am LDN on Sunday. Currently neither UK nor US persons' can deliver fresh Russian metal.

The question market participants are asking is whether the LME will restrict all future deliveries of Russian metal (not just from UK or US persons).

What is the impact on LME spreads? Assuming only US and UK persons' are restricted from delivering fresh Russian production then the c/3M spread (metal for physical delivery at t+2 vs metal for deliver in 3 months' time) should trade to full finance, because a) the cohort of participants who can take delivery of Russian metal on the LME is reduced, and b) non-US / UK names are incentivised to delivery excess units to achieve a rent deal.

Forwards should tighten due to expectation of lower future supply (as Rusal and Norilsk send a higher % of their production to China).

Can China compensate for lower Russian supply? Yes but it takes time. The dynamic in aluminium, where Chinese demand increased by >10%, yet LME struggled to move higher because China were meeting ex-China end-use demand (solar) via primary tolling will, over the medium-term, limit the impact of lower Russian primary supply to ex-China, but it takes time, and won't impact price today.

What is the is the impact on flat price?

Yesterday's announcement did not reduce the supply of spot metal to the ex-China market; end-users are not restricted from consuming Russian metal, US consumption of Russian metal is already essentially zero, and Rusal (aluminium) and Norilsk (nickel) will not immediately divert supply to China due to arbitrage economics and capacity constraints – Rusal rail aluminium to Northern China and Norilsk struggle to price against SHFE due to persistent negative ARB caused from Indonesia supply growth, which is tolled via China , for example.

That being said, history has taught us that the market will price in some "full-sanction" risk premium which when combined with the current macro bid (reflation narrative etc) means we expect a complex wide rally on the Monday's Shanghai open.

At some point the rally (in vol and price) should be faded (especially in nickel), but given where CTA momentum indicators are currently, this is a debate for another day.

BY TYLER DURDEN

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Date Created
04/16/2024