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Systems at Risk | Episode 6
Andy Home, Senior Metals Columnist, Thomson Reuters

We're thrilled to be joined by Thomson Reuters Senior Columnist, Andy Home, for a pulse check on current metals markets. In this episode, he and David Greely explore the readiness of these markets for the supply challenge of decarbonization and how the European power crisis has impacted their preparedness for the energy transition.
Join them to uncover what's needed to prepare and optimize our critical minerals markets for a demanding road ahead.

Andy Home (00s):
We're living in times of scarcity in industrial metals, different markets require different rules, right. You know, this is not like the last 10, 12 years or the metal's complex, which has been characterized by, I mean, basically slowing consumption growth out of China over production. Thanks to the last price boom. We haven't had to worry about genuine scarcity on metal markets in this way for a long time. When you get scarcity, remember the value of one time for me as a trader is probably worth more in the physical supply chain than it is in the financial supply chain. So scarcity will keep LME stocks low because it has to compete with that genuine demand for metal out there.

Announcer (43s):
Welcome to Smarter Markets. A weekly podcast, featuring the icons and entrepreneurs of technology, commodities and finance ranting on the inadequacies of our systems and riffing on ideas for how to solve them. Together we examine the questions. Are we facing a crisis of information or a crisis of trust and will building Smarter Markets be the antidote?

David Greely (01m 08s):
Welcome back to systems at risk on Smarter Markets. I'm David Greely, Chief Economist at Abaxx Technologies. Our guest today is Andy Home, Senior Metals Columnist at Thompson Reuters. We'll be discussing the turmoil in the LME nickel market this year and what it may mean for the broader metals markets and the energy transition. Hello, Andy, welcome to Smarter Markets.

Andy Home (01m 30s):
Hey Dave, thanks very much for having me.

David Greely (01m 32s):
Very glad to, you've been reporting pretty extensively on the turmoil in the LME nickel market this year, which included the suspension of trading and the cancellation of trades as nickel's prices spiked to a $100,000 a ton after the Russian invasion of Ukraine. I'm very glad that you're here to share that reporting and your perspective with us, but for those of our listeners who are less familiar with what happened, would you start us off today by sharing the short version of that story?

Andy Home (02m 01s):
Yeah. I mean, what we do actually is we go back to the start of this year and nickel has already been on a bull run. Yeah, it's on a tear and why is it on a tear, because LME stocks exchange stocks are disappearing. There's kind of, I get it. Why you can sort like chase for available units going on right in this context, probably not the best time to have a major short position in this market, but there is a major short position sitting in the nickel market. It is held by Mr. Xiang, who is Chairman of Tsingshan Industrial Enterprise a huge stainless steel producer based in China, operating in Indonesia, Mr Xiang is convinced that prices are gonna go lower partly because, I mean, he is himself like bringing on more nickel production, his group is, this is the backdrop. We have a tight market stocks disappearing, too short position in the market.

Andy Home (02m 50s):
What could possibly go wrong, yes, exactly what could possibly go wrong. Russia decided to go on what it calls its special military operation in Ukraine. Russia itself produces about 7%, 8% of the world production panic. Suddenly we got a tight market and we look like we could be losing supply from one of the major producers in the world. Yeah and a huge supplier to the European marketplace in the event there were no sanctions, but you can imagine what happened to this price, right, it went stratospheric, March Friday, the 4th

price closes $30,000 per ton on the London Metal Exchange. By sort of Monday, we are at, we've already gone to $50,000 and this settles about $48,000, right. This is a huge problem for anyone holding a short position. You now need to pay your margin calls. The margin calls are of course, immense, the positions are immense and the price movement has been phenomenal, right.

Andy Home (03m 47s):
There's a scramble sort of writers who sort of make sure the money arrives in London at the right time. There's a deferral by the LME of settlement for one day. What could possibly go wrong, we start the next morning that price goes up to $100,000. Of course, if anyone was struggling to meet their margin calls at $48,000 it's now probably so like double the pain, right. Long story short LME decides to suspend the market, fearing a default, let's call it for it is and cancels trades quite correctly. So there we are, it takes us six days of suspension, six days of stop start to get the thing going again and we are limping onwards. That's where we are today, Dave.

David Greely (04m 26s):
And you know, in these situations, you summed up very eloquently. What happened in this particular situation and often when we see something like this, the things that triggered the particular event and then there are all the other things that created the vulnerability in which this type of event could occur and I was curious in your view, is that true in this case and what went wrong, more structurally that allowed this perfect storm of short positions, tough margin calls to escalate the way it did.

Andy Home (04m 59s):
Let's kind of put nickel just for a moment into a little bit of a wider context here, because it's not just nickel, that's turned wild in the last year at the LMEs tin contract went super wild of 2021 with extraordinary premiums being paid across the times, copper had to be restrained in October by the LME, which also intervened in that market. So what we've been seeing in industrial metals is essentially a draw on available metal, right across the Western supply chains. This is part COVID recovery, but this is also the way COVID has itself impacted production yeah. So it's kind of the worst of all possible worlds for metal supply chains. Then you can throw in logistics problems, getting metal from sort of like point, you know, from, from say China to the west coast of the States or back from the other way, container rates have gone also saw like a stratospheric.

Andy Home (05m 51s):
So it all these supply chains, all these metallic supply chains have been really struggling for seven or eight months and it was nickel's turn to some extent what changed the specifics around this was what we think is the size of the short positions that had been accumulated right relative to the size of the market. Now I cannot sit here and tell you today, oh, this is exactly how much he was sitting on in terms of a short position. We could tell just from the way the price reacted, how large that was and there may well have been parallel short positions. You know, he may not have been the only guy who was kind of on betting on the price going down. So you had this kind of like a combination of supply chain pressures, which are real they're out there in the physical world.

Andy Home (06m 38s):
This is where LME stock have been disappearing. These massive short positions where we've got one at other very nickel specific little kink in the story, if you like Dave, right. So the LMEs are delivery driven commodity market, right. You sell forward. The assumption is you will deliver your metal or you will buy back your position or you will roll your position. The LME is also a curious market. This is not standardized. You can trade any day between now and three months forwards that means you have a daily rolling prompt date, which means that if you are short, you can get called daily and of course you could deliver nickel couldn't you, it's a physical delivery option, not for Mr. Xiang and not for his company. The LME only accepts a certain type of nickel for delivery. We call it class one, nickel that's 99.9% pure nickel as close to metal, as you can get, you know, Tsingshan a huge nickel producer, the biggest now nickel producer in the world out of its Indonesian mines.

Andy Home (07m 36s:
But it does not produce one ton of that sort of nickel. Yeah. It produces either sort like stuff that's gonna go straight into a stainless steel mill, always producing sort of what we call like nickel in a format goes into electric batteries eventually. Yet none of it is LME deliverable. Therefore he had no physical delivery escape path from a short position. All he could do forever would be to roll it forward and try and manage that pain. So that's sometimes what can go wrong with physical delivery settlements, right. But nickel has a specific problem. The contractor's traded on LME and in Shanghai, by the way, it's not just the LME it's for a type of nickel that is no longer accounts for the bigger part of what's produced every year. It's probably now less than 50% in shrinking all the time. So that is the other dimension physical delivery in this case was simply not an option for a company that doesn't produce nickel in that form.

David Greely (08m 32s):
So a very tight physical market and a future's market, which hasn't kept pace with the, the commercial market underlying. It sounds like leading to these delivery problems.

Andy Home (08m 42s):
I'm so old and I've been doing this for so long, Dave, that, I mean, I can actually, I'm probably the last guy standing and still remember that the LME has had this problem before in 1988, guess what, it's suspended this nickel contract, which at that stage, I mean, it was all open outcry, you know, went up 50% in prior to the space or one minute open out by trading market was suspended briefly for less than a day and we started again and you know what everyone said at the time, we've got a problem with the specifications of this nickel contract, right. But they could not come to an agreement on a good delivery specification for other forms of nickel. So, you know, this problem is not new. This problem was exactly what caused the market suspension in 1988. So yeah, we still haven't come up with that solution.

David Greely (09m 27s):
Do you have thoughts on what makes the solution, the problem so intractable in 88, that's a long time?

Andy Home (09m 34s):
The problems only intractable if your template, as it was then by the way was physical deliverability, right. So the arguments were about say, we'll take something like fairer nickel, which is a form of nickel that goes and stain the steel furnaces, right and of course it's not deliverable against the LME contract. So they were back then looking at making that deliverable, but nickel, I mean, it can vary from anything for 20% to 50% nickel content iron specs can be all over this all over the place. So as I said, long story short, much debate with the industry participating, with the LME participating, do you think they could come to one specification that would please everyone for fair and nickel, they just couldn't. But we now live in an age where, you know, even the LME is embracing the concept of cash, settle futures, contract benchmarked against third party assessments of the market.

Andy Home (10m 26s):
So the landscape has changed a lot and from that point of view, it genuinely surprises me that, you know, exchanges, haven't sort of like launched more products into this kind of increasingly disparate market and I'm really surprised the Chinese haven't done it actually, because this is largely a Chinese trade, this Indonesia sort of flowing materials into China, but again, no one has, we've all been left trying to price a global industry of this one contract and its very tight specifications, but it's doable. I mean, in principle, I mean, you know, I think people were already sort are starting to look into whether you could price nickel sulfate, which is a battery material. Could you price all a fair nickel, The problem was, from what I know they were devising contracts, which would be based on a core contract in London called the SME nickel contract. So I think that the scope for like a greater creativity

David Greely (11m 17s):
Definitely and you had brought up that even back in, you know, in 1988, they suspended trading in nickel, you know, in the more recent episode that's happened this year, the LME suspended trading, but also canceled trades and that created a lot of controversy to say the least. Why do you think the LME chose to cancel trades and what other options did they have at that point?

Andy Home (11m 42s):
Well, I mean, we are all awaiting with bated breath. The promised forensic reports into what happened, which is being written as we speak by the London Metal Exchange. But pending that, yes, I can understand the genuine sense of shock that the LME would cancel as many trays as it did and sort of behave in the way that it did. So why would it do that, Let's speculate a little bit, what would scare it so much that it would be prepared to really rip up it's free market rule book and behave. Let's call it about what it is as a Chinese exchange. Well, I would suggest to you, there was a genuine concern about a market default and I'm not talking necessarily about the ultimate customer or customers here because this is a daily settled system. If you can't get your money to London in time, guess who picks up the bill, it's your broker, whatever your broker is, not a sort of multi-billion dollar capitalized company, but you know, a much smaller operator.

Andy Home (12m 41s):
And then if that broker were to default, would that trigger a cascade default, is it cascaded to other smaller players in the market. So my guess Dave, and it can only be a guess is they thought they could see the potential for what I call a systemic credit collapse of LME

membership and therefore the entire market. It's hard to think why else they took such drastic action yeah. So that's kind of my gut feel, but it's gonna have to remain a gut until I see the report in you look at the report, we all look at the report that's coming out.

David Greely (13m 13s):
That it'll certainly be fascinating reading and when thinking about this, you know, even if it was the, the best decision in a bad situation and the report will let us give us more information on that. What do you think could be some of the longer term ramifications of this decision in people's confidence in the market?

Andy Home (13m 33s):
Yeah. You know, again, we've kind of, sort to go to look at the culture of the, the LME, which has been here before, not just in nickel but in other markets, the culture is one of, of Laissez-faire capitalism that the market, which is actually populated by large professional players, no widows and orphans on the London metal church that the market will ultimately resolve itself, occasional aberrations, as they love to call it on the occasional aberrations will require the intervention of the London metal exchange, right. As I said, this is a culture. So automatically if you have that culture, by the time you've intervened, something bad has already tended to have happened. The LMEs against what we would expect were called maybe preemptive regulatory reaction. It's not in the culture. It is by the very, every time the LME has been called in something bad has already happened.

Andy Home (14m 24s):
So, you know, that's one problem. The other problem here is visibility, yeah. The LME has sort of like without, you know, has explicitly said that, I mean it only had partial information on what was going on in the nickel market and I think that's probably true, you know, the LME ecosystem is one best thought of as a pyramid of risk trading and a pyramid of netting off of fact risk. What you see on the LME has been distilled multiple times, by the time it's hedged across, a trading ring, right, the bottom of the pyramid of the OTC deals though, the counter deals that could between me and my bank, basically between me as a metals producer and the guy buying my metal down the road, yeah. You don't know all this goes into the mix and it gets to still down, gets still down.

Andy Home (15m 12s):
Right, so the LME has perfect vision on a very small screen. So I think that that has been a, again, a well-known problem on the LME for 15, 20 years, every time they've attempted to extend their supervision into the OTC world, of course the members and the users of the market are pushed back, right. So what's gonna change some stuff has already changed. What's already changed, right. As part of their emergency measures, the LME has put price limits on all of its deliverable contracts previously unthinkable on the free market LME, right, by the way, it discussed several times and we rejected out of hand as a sort of brutal portrayal of what the whole market's about price limits. We also now have what we call backwardation limits. This is how much I can charge you for rolling your short position over one day here again, permanent backwardation limits have previously been deemed unacceptable by the users of that market.

Andy Home (16m 05s):
They're now in place. I do not expect either of those two things to go away anytime soon now, really big change and the one that I think will be fascinating to watch play out the LME is calling for greater powers to see what's happening in OTC trading. If it's connected to the London Metal Exchange, right. This is kind of fairly unprecedented for the LME and for many other sort of markets, by the way, you know, this is not about to say, I want see what you're trading here. I want to see what your entire position is with your bank as a broker, that confidential information you would normally share with anyone, right, but from the other counterpart. So they want to go down this route. I think they have a very powerful lever. If they can say, look, guys, we would've done more. We could have been raising margins, but we simply could not see for the opaque structures that some of you placed around this man's position.

Andy Home (16m 55s):
Right, but I mean, expect considerable pushback as well. I mean, you know, how far do you want to go. I mean, do you want go and see what I'm selling as a producer wire rods to the guy down the road, or I have to show you my contract, you know, it's controversial. Why would I, if I'm a private own company. So I think that's the big battleground that we're gonna see. As I said, price controls, backwardation limits. I don't think they're going anywhere anytime soon, much more controlled marketplace from that point of view, in the same as the Chinese do the same when their commodity markets. But this question, this question, can I see I'm the regulator, can I see everything in a big bank, like JP Morgan or in a big bank, like Goldman Sachs, am I allowed to, should I, is it right when after nickel, there's probably a lot less resistance to that concept than there was before the nickel blow up, right.

David Greely (17m 43s):
Right and when you're thinking about, you know, how to learn from the mistakes, how to prevent this from happening again, you know, there you've been wonderful in detailing quite a number of steps that have been taken some still coming forward, like perhaps more transparency, perhaps better contract specifications. You know, if you were to pick, if you could change things the way you'd like, or the way you think would be most effective what do you think would help prevent a situation like this from happening again?

Andy Home (18m 16s):
I mean, quite evidently, if you had greater transparency at a regulatory level, right. I mean, they would've seen more. They could have seen into, I call the shadows maybe, but you know, I also have this question, Dave, I've been covering this market a long time. I've seen compliance at the LME when I started was sort, I think it was the secretary of the company and there wasn't a compliance function at the LME, right. Compliance was when things went wrong, principles of the market, the principal broker sat down and hammered out this through the board meeting, the board was full, was populated by those guys, right. We've all seen the growth of compliance, right quite rightly, so we want to stop mal instance in all markets. We want them to be level playing fields, right. We don't want people to be ripped off or put out of business, but I question, so I'm gonna take the LME as an example here, right.

Andy Home (19:08):
So it blew up. It also had its copper scandal in the 1990s, the Sumitomo scandal and, you know, they sent somebody in from the treasury of the United Kingdom to write the rule book, which is pretty much the rule book we still have now and he kind of expanded it to sort like having a sliding scale or so like controlling, dominant longs, you know, of making sure people weren't abusing their, their, the positions that they had, right and that all still happens, right and in fact, it's been built up, built out, built, built out, build out. I worry that we have lost what I would. I think what they say in the military, the human angle of this, the human intelligence is compliance. Just making sure that my spreadsheets are all like nicely, like ticked off and all that. Or does someone sometimes need to step back and say, you know what, there's a bigger picture going on here.

Andy Home (19m 55s):
And I can't see it. I know I can't see it. I know I can't see it all. I worry that we have lost that on the London Metal Exchange. You know, I'm gonna go back to the non-compliant days of the 1980s, the 1990s, you would have a chairman or maybe a chief executive who spent most of their time socializing with the brokers, the very market they were regulating, right. This would give a modern day regulator, he BGS even thinking about it, but you know, what they got a lot of human intelligence that way. They heard stuff very early. If people were worried about positions in the market, this is not a mean, it's all like a mean modern day compliance sort of concept, but it sort of worked in this same way. Can we get back human intelligence into market compliance, yeah without compromising obviously sort of, you know, objectivity, et cetera, cetera. One thing, that's the one that I kind of wonder about

David Greely (20m 50s):
Oh, it's a really interesting point. You always say, right. You manage what you measure and when it comes to risk, you're only managing the risk of what you measure and if you're not out there having the human intelligence, understanding the feel of the market and knowing all the things that your metrics and your spreadsheets, aren't picking up, that that leaves a big hole.

Andy Home (21m 08s):
And who does that in organization. How do you structure that flow of information I don't know, but you asked me one thing. I think we've lost human intelligence at our compliance function. I mean, Bloomberg were reporting about this nickel position in publicly and I think February this year, right, so once it's reached that sort of like a mean sort public platform, there's no secret here in the market you know, what I mean if there were a secret, we we're all now in the secret, I wonder whether anyone at the LME or above as a regulator said, you know what I can see what I can see, and I'm not happy about how about what Bloomberg saying or what Reuters then went on to say who fills that gap, yeah, yeah,

David Greely (21:48):
Yeah. The human element.

Andy Home (21m 49s):
The human intelligence, I mean, you know, and you know, bear in mind that I mean, it is a very sort of opaque world out there, particularly in something like industrial metal change, we have very little data, hard data say relative to the energy sector. The

importance of human intelligence is very high under those circumstances when you have a very poor statistical landscape around you, right.

David Greely (22m 12s):
And I imagine this, of course, isn't just the nickel market you know, it happened this time in the nickel market, but a lot of what you've been describing, isn't specific to the nickel market and I think a number of the points you're raising probably apply more broadly across the metals market you brought up, you know, some of the things that have happened in tin and in aluminum is that same notion, the human intelligence elements, something that we should be doing across all these markets to make them more resilient in your opinion, or is that more nickel specific?

Andy Home (22m 44s):
The hardware of resilience comes from you know the price limits, the backwardation limits that the LME has put in, but yes, I think it could apply to all of it must apply to all markets and particularly commodity markets. I think when a regulator looking at the trading that they can see must know that I mean, it's all like, but the tip of a much larger OTC iceberg, right. So given that, how do you try and solve like at the sketch, the picture or the part of the picture that you can't see and yes. I mean, I do think, I mean, you know, this is becoming more acute because you know, when there's a million, tons of metal freely floating around the world's in recession and can't, can't use this stuff, the possibility of these, I mean, something like nickel happening is very remote.

Andy Home (23m 36s):
Right, part of the reason is that there's very little nickel around, but there's very little copper around, there's very little tin around at the moment. So we're living in times of scarcity in industrial metals, you know, different markets require different rules right. You know, this is not like the last 10, 12 years or the year of the metals complex, which has been characterized by, I mean, basically slowing consumption growth out of China over production, thanks to the last price boom. We haven't had to worry about genuine scarcity on metal markets in this way for a long time, when you get scarcity, remember the value of one time for me as a trader is probably worth more in the physical supply chain than it is in the financial supply chain. So scarcity will keep LME stocks live because it has to compete with that genuine demand for metal out there.

David Greely (24m 27s):
Right and this may be an unfair question, but which market do you think is the next one that has the greatest potential to show vulnerability and have some sort of disruption?

Andy Home (24m 37s):
Oh, that's easy. I mean, look, we, we can go for the list here because this is a generic cross metal issue, right. Look at zinc right now, right. The zinc stocks are sort like a mean are fairly bombed out on LME. I think we're down to about sort 85,000 tons, half of it's scheduled to leave, right, spreads are all right now starting to re tighten. Yeah. Metal should be on its way from China to help all like fill the Western supply gaps, which have been corrected by European smelters closing, but guess what, everyone's struggling to get the shipping containers to move across the Atlantic to deliver anywhere, right, aluminum same thing. European smelters are powering down. Can't live with these sort of European power prices, guess what LME stocks are being rated to fill in the gaps in the physical supply chain.

Andy Home (25m 20s):
Yeah. LME spreads still relaxed there, maybe not for long. We'll see, this is happening as I said, across the metallic board, look beyond the LME. Dave, look, what's happening to lithium pricing, look, what's happening at cobalt pricing, right, this is across metallic story. Everything is, is in short supply or if we have got it, it's sitting in the wrong part of the world relative to where we really need it. I mean, so I do see this as a cross theme and therefore that leaves any physically deliverable contract vulnerable to what happened to nickel, or you need someone to have a mask that all like an in short position with an inability to deliver metal and here you go again, which is why I think the LME is gonna keep those restraints on if you like the price and the backwardation restraints.

David Greely (26m 08s):
Right and when we look at, you know, the, the trends in these markets, there's been the recovery from COVID, which is a little bit more of a short term, the supply disruptions, the pickup and demand, but when you, we look at many of these metals, you know, we look at the transition to a low carbon energy system is going to make our energy supply much more reliant on our metal supply. We need massive amounts of metals to support the generation, the distribution, the storage of electricity and this includes copper aluminum

nickel, platinum palladium and as you said, lithium and cobalt, we need all these metals and more to decarbonize and I was gonna ask, are these metals markets up to this challenge and it sounds like not yet.

Andy Home (26m 53s):
Well, you know, in many ways, I mean, sort of the first victim of this, of the transition, if you like, well, it's nickel, right. Why are all those stocks disappearing at the back end of last year you know, this market nickel's been sort of pat itself on the back for four or five years about how it's gonna have a great sort of part of the green metals transition, right. They just forgot to build enough sort of like processing plants there. So what you saw, I mean, particularly in the Western market, which are not part of the Indonesian China flow materials you saw suddenly, hold on guys, you know, we're building all these various giga factories here. They haven't got any nickel, so where can we get the nickel from in the right form, hey, that stuff in the LME is gonna do just fine.

Andy Home (27m 34s):
Right, so this is really what sparked get it while you can sort of attitudes. So like, yeah, man, these guys have got the right sort of nickel that we can like feed through a new battery plant. So yeah, for me, that's the first early warning side, right, we became absolutely. For the first time that EV demand became tangible in nickel, which has been dominated by stainless steel. Everyone's been talking about it for ages, but last year is when it became tangible and you're quite right. What on earth does this mean going forward? I mean, we have, I think collectively, yeah, a big minerals problem here. There's been a lot of talk about sort of what this means for the, the metal sector. As I said, a lot of like, you know, mutual clapping on the back. It's gonna be good times ahead guys, but you look at something like copper, I mean, mining CapEx, hasn't gone up recently.

Andy Home (28m 23s):
It started to go up, you know, but everyone's so burnt after the last cycle that they behaved exactly what you'd expect, any copper producer to do where any other metal producer, right. Well, we got burnt last time. The shareholders hated us so we're not gonna rush into the next one, just in case we get burned again, right. But I'm a believer that this is not just another cycle that we're gonna go into. I'm a big believer that this is a, a very metals intensive cycle that we're going into, right and frankly, investments in new minds is already lagging behind. I mean, that's what every price is telling you. Yeah. Price of lithium is telling you, we have not got enough material for what we need right now. Dave price of nickel, even more extremely though. Well, you know, this bear mind, even after we started trading and nickel is still priced above $30,000 per ton, historically that's extreme right.

Andy Home (29m 13s):
They're all screaming the same thing, bring a more supply. Here's the problem though, right. Most of the supply that can be scaled up easily as Chinese, we all now have a problem with Chinese supply, right and so the, the critical materials world, right. Everyone wants to all like decouple as much as we can, right. So we're gonna have to have more of our own supply. Here's the other thing, no one wants to have a new mine in their back garden or in their backyard, right. A great example we had was Rio Tinto is kind of been working on a giant lithium mine down in Serbia. Yeah. I mean a really big project, right. It's halted after the violent demonstrations, which were playing out every weekend for months on end across Serbia. You want to go green people, but you can't go green without the mind, but you don't want to have the mine, right.

Andy Home (29m 59s):
And you're seeing this play out all over the world. I mean there's many great examples in the United States at the moment for the Biden administration, giving it a great talk about the green transition guys, whilst at the same time, the same administration is canceling permits for new mines, right? Everyone has this problem and I cannot see any short term resolution of this and I cannot see how let's put it this way. Metal supply chains physically are gonna remain stressed for the foreseeable future, right. Really, we've got to the stage in some of these markets like tin, when they just almost ran out last year, we almost need a recessionary vibe just to allow production to sort, can we just refill these, these pipelines a little bit, guys, you know, physical buyers out in the real world are paying huge premiums over and above LME prices just to get physical metal. So you are absolutely spot on. If this is how the new metal cycle starts I would just say, hold your seat belts, put your seat belts on guys. You know, hold your arms, whatever you need to do, it's gonna be rough.

David Greely (31m 04s):
Yeah. So we all go to hold on tight, but it gets worse, right, because many of these metals are not only required to increase the electrification of our energy system, making an energy transition possible, but they also require a lot of electricity for their own production. How has the power crisis in Europe impacted the ability to supply these metals that we need?

Andy Home (31m 27s):
Yeah. Great question. I like to call this so that this, the aluminum paradox, because aluminum is the best example of it. You know, it's gonna play a vital role in the green transition. You know, it it's what forms the battery packs in electric vehicles. It's also sort like used in the packaging of our own solar energy and yet it is a massive power user. This is not a, you don't roast down aluminum. You pass a massive electrical current for alumina to get your metal. It's a derivative of electricity. It's the most extreme case, but all of them, to some extent, your rights are like are big power users in themselves. So let's look at Europe at the moment, right. We have structurally record high power prices at the moment for the obvious reason power prices were going up even before Russia decided to invade Ukraine, right.

Andy Home (32m 15s):
As Europe tries to sort in accelerated double quick time, reduce its dependency on Russian fossil fuels, the obvious has happened. I mean, you look at sort of base load forward prices in Germany record high 23, 24, 25 as far as the eye can see net result of this is you are seeing aluminum smelters in Europe power down as we speak. West European production has always performed for a multiyear low east European production by which I'm really talking about smelters and Slovakia, Slovenia and Montenegro power down even fast actually the Montenegro one has actually completely closed as the smelter. Many others are cushion because they're either sort geo geothermal power based, I've been Iceland or maybe hydro power based in heat. but yes, you'll right. European production is actually falling at the moment due to the power crisis as smelters try and manage those margin pressures. This of course only increases the local price, the local premiums over and above the LME.

Andy Home (33m 17s):
There is very little short term sort of solution to this other than sort like basically an arbitrage window with Asia where, you know, we've even had the Chinese ship aluminum to Rotterdam the last couple of months, despite a 50% Chinese tax on exports, right. That just tells you how desperately tight Europe is. Zinc is following a similar pattern. We've had one sort of bigger smelter. HD has been mothball you to high power prices And everyone else is just trying to modulate their run rates around that peak pricing every day. Yeah, it really is trying to run sort of like with your, your legs tied together,

David Greely (33m 53s):
Soy you've spoken of a real dependence of Europe on metals from China and the not in my backyard challenges to increasing metals production at home, but energy security is now becoming metal security. How is Europe facing this challenge post the Russian invasion of Ukraine, is this on the radar screen of European governments and the European commission?

Andy Home (34m 16s):
Yeah. I mean, sort of it is very much on the radar screen. European Union inevitably moves slowly frustratingly. So given there are 27 voices that must play a part in this, but I would say the issue is absolutely recognized and now the highest level of European commission, you know, they're not idiots they understand exactly that they need to sort like they cannot go green and they cannot go green faster without thinking more about how they're gonna get their green metal as it were, right. There's as always with your there's a lot of sort of meetings. I, I suspect taking place at Brussels. I have written that I think they are searching for an accelerator. What form could that take. Well, in the pandemic, they accelerated the roll out of precursor plants there. What, what I mean by accelerating is Europe, European countries are bound by very complex system of subsidy sort way.

Andy Home (35m 09s):
So I'm not allowed to subsidize my industry because it's against European law, right. When they do an emergency, you measure all the rules are off, whatever you need to do guys, to keep this, to build this plant here or do this PPE plant in that in pandemic case or whatever you need to do to keep that out of medium smell, to operating. It's not inconceivable that they're looking at something like that, because if they don't, it's very simple. These plants aren't gonna reopen anytime soon, you know, power prices have only gone up further since that Italian zinc are closed, right. The only other option, you know, a US company is the way in this old color, which closed its Spanish aluminum smelt for two years, just say it was impossible to operate under current power solar structures. Yeah. It will come back in two years, it's gonna be solar powered, but you know, there's only so much possibility sort of for doing that across the system as a whole, right?

Andy Home (36m 00s):
Yeah, it is really, I think, I think this is one of those things that, you know, was not high on the, you know, the European Commission's agenda a year ago, I think is now very high, straight after sort of like energy security, because it's related your ultimate best defense against Russia is not to buy any of its fossil fuels, right, to do that. You have to like accelerate your green transition to do that, guess what, you have to get those metals in right. In a competitive world when everyone else is trying to do the same. So I general, I know that it has risen to a very near the top of the agenda there. We'll see what they do about it.

David Greely (36m 34s):
Yeah. We will have to wait to see what they do now, before we wrap up, you've been reporting on the metals markets for a long time and so I want to ask your perspective on what are we gonna be seeing in these markets in coming years and what do we need to be doing now to make these markets ready for what they're gonna face.

Andy Home (36m 53s):
It may be that we have to now accept a world where availability cannot be taken for granted. Yeah. This concept that at a certain price, I can get my copper in my yard, wherever I am operating when I want it may simply not hold true, given the various dislocations, the logistics issues. I mean, across the world, that's a new sort of market. That's a new sort of, I mean. I have been doing this a long time as, as you pointed out I mean, I have seen one or two markets individually go nuts, right because of very specific issues at the time, I've never seen them all go nuts together for a generic issue, which is one of scarcity. I mean and scarcity into a cycle which is only gonna need ever more metal, right. I've not really want sort of say this, but the way I've start to think about this and what maybe the lesson from the LME is here's this bastion of free market trading ripping up its rule book.

Andy Home (37m 57s):
You know, it's changed more rules in the space like two days than it did in 20 years because I mean members, when it, you know, wouldn't accept price limits, wouldn't accept all a lending limits in their market, but here we are greater governance, greater regulation and if you like it greater state intervention, right. You know, the Biden administration is now a major direct funder metals projects, particularly in the critical mineral space. I suspect the European Union is gonna go down that way. We are seeing metal markets being politicized again, they may not be fully as free as we've got used to over the last 15, 20 years. Certainly the LME market I suspect is not gonna operate on those old buccaneering sort principles that we could do over the last as I over the last two decades, right. Look what happened.

David Greely (38m 50s):
Thanks again to Andy Home, Senior Metals Columnist at Thompson Reuters, we hope you enjoyed the episode. Join us next week as we continue exploring our systems at risk.

Announcer (39m 02s):
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