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MARKET INSIGHT
June 2019

ECONOMIC NEWS

Fed Policymakers Promise Response If U.S. Economy Slows

Signs that the economy is losing momentum hung over a Federal Reserve summit for a second straight day as policymakers hinted they would be ready to cut interest rates if the U.S. trade war threatens a decade-long expansion.

Investors added to bets that the Fed would have to lower borrowing costs multiple times by year-end on Wednesday after a report by a payrolls processor showed private employers added 27,000 jobs in May, well below economists' expectations and the smallest monthly gain in more than nine years.

The U.S. economy will mark 10 years of expansion in July, the longest on record. Strong job gains have been a key feature. But rising trade tensions between the United States and China have led to tit-for-tat tariffs, put a chill on U.S. businesses' spending and exacerbated a manufacturing slowdown.

Current and threatened U.S.-China tariffs could slash global economic output by 0.5% in 2020, the International Monetary Fund warned on Wednesday as world finance leaders prepare to meet in Japan this weekend.

"We'll be prepared to adjust policy to sustain the expansion," Fed Governor Lael Brainard said in an interview with Yahoo Finance on the sidelines of the Fed's Chicago summit. "The U.S. economy, generally, is in the midst of a very lengthy expansion, the U.S. consumer remains confident, but trade policy is definitely a downside risk."

Brainard's remarks follow a pledge on Tuesday by Fed Chairman Jerome Powell to react "as appropriate" to trade-war fallout. Other Fed officials struck a similarly cautious tone.

Since the Fed's last rate-setting meeting, Trump slapped new 25% tariffs on $200 billion of Chinese imports and threatened new import taxes on Mexican goods unless immigration slows. Until recently officials had been largely signaling that they would keep rates at their 2.25-2.50% target range.

The trade war added urgency to what was intended to be a strategy session at the Chicago Fed focused on how the central bank can shore up its policies. Officials worry that economies risk getting stuck in a self-fulfilling cycle of low rates and low inflation that will make it harder to rebound from recessions and require increasingly forceful intervention.

To combat those risks, Fed officials are considering whether they want to temporarily welcome inflation a bit above their 2%-a-year target - and keep rates lower for longer - in the hopes that such a strategy will make attaining the central bank's goals for maximum employment and price stability more likely.

Policymakers are also revisiting exactly what maximum employment means and whether they are doing a good enough job in how they speak to the public. No changes are expected until next year.

Source: Reuters, 6/5/2019

Hiring Slows Amid Trade Tensions, With Only 75,000 Jobs Added In May

Hiring slowed last month, as U.S. employers added just 75,000 jobs even as the unemployment rate held steady at 3.6%. The report suggests businesses are increasingly cautious in the face of the Trump administration's ongoing trade wars. And it could increase the odds of interest rate cuts.

The job gains in May were well below economists' forecasts of 185,000 jobs and the three-month average of 151,000 jobs. Revised job gains of 153,000 for March and 224,000 for April represented a total drop of 75,000 from initial figures.

Manufacturing continued to be a soft spot, with just 3,000 factory jobs added in May. An index of manufacturing activity released Monday fell to its lowest level in 2 1/2 years.

Manufacturing is especially sensitive to trade disputes, which can raise costs, disrupt supply chains and depress foreign demand. Last month, the administration increased tariffs on $200 billion worth of imports from China. The president has also threatened to impose tariffs on imports from Mexico, beginning next week.

"There's increasing evidence that the ongoing trade war here is beginning to have some tangible effects on the U.S. economy," said Tim Quinlan, a senior economist at Wells Fargo Securities. "We're not on the edge of the cliff here. But the pace of expansion in [manufacturing] is the slowest of the Trump era."

The picture is only somewhat brighter in the much larger services sector, where tariffs seem to be taking less of a toll. An index of service activity released on Wednesday showed accelerating growth. But private employers added just 82,000 service jobs in May, less than half the number of the month before.

"The question moving forward is whether or not slowing growth in the goods sector could pull down the services sector," said Martha Gimbel, director of economic research at Indeed Hiring Lab. "Goods industries in general are more sensitive to trade wars, commodity prices and other unpredictable factors."

An escalation of the trade battle with Mexico could be especially damaging to the auto industry.

"I don't think it's possible to overstate how integrated the North American manufacturing process is," Quinlan said. "Quintessentially 'American-made' vehicles rely on parts made in Mexico. So Ford's F-150, for example, is 15% Mexican made. Forty-four percent of the Chevy Silverado comes from Mexico. So supply chain disruptions here could really pose significant harms to U.S. business interests."

The weaker-than-expected jobs report will be another factor for central bankers to consider as they work to preserve economic growth in the face of rising trade tensions.

"We don't know how or when these issues will be resolved," Federal Reserve Chairman Jerome Powell said this week. "We are closely monitoring the implications of these developments for the U.S. economic outlook and, as always, we will act as appropriate to sustain the expansion."

The Fed's interest rate-setting committee is set to meet in less than two weeks. Full article.

Source: NPR, 6/7/2019

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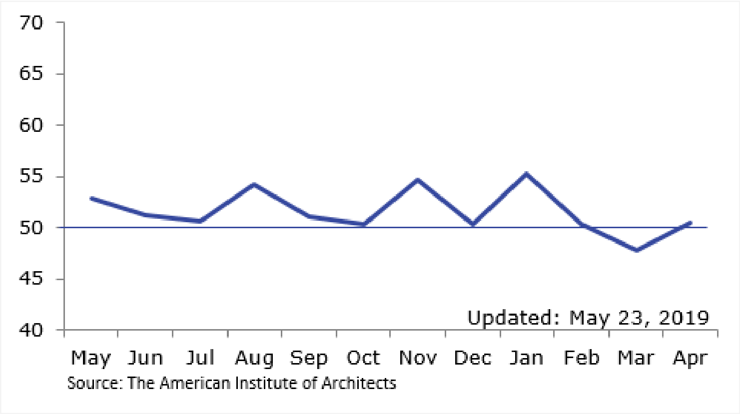
KEY ECONOMIC INDICATORS

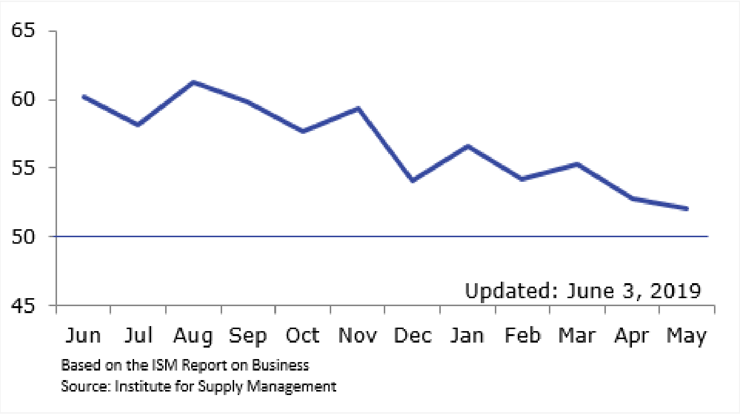
Architecture Billings Index (ABI)



AIA's monthly Architecture Billings Index (ABI) for April came in at a score of 50.5. This is a 2.7-point increase from last month's score of 47.8, which had marked the end of a 25-month run of positive billings.

The **Architecture Billings Index (ABI)** is an economic indicator for nonresidential construction activity, with a lead time of approximately 9–12 months. The index is derived from AIA’s Work-on-the-Boards survey, which has gathered data on shifts in billings from architectural firm leaders for over 20 years. An index score of 50 represents no change in firm billings from the previous month, a score above 50 indicates an increase in firm billings from the previous month, and a score below 50 indicates a decline in firm billings from the previous month. *Source:* ***American Institute for AIA, 5/22/19***

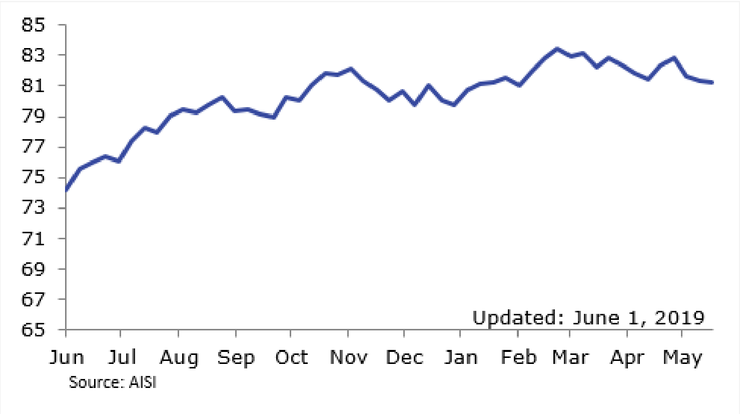
Purchasing Managers Index®



The May PMI® registered 52.1 percent, a decrease of 0.7 percentage point from the April reading of 52.8 percent. The New Orders Index registered 52.7 percent, an increase of 1 percentage point from the April reading of 51.7 percent. The Production Index registered 51.3 percent, a 1-percentage point decrease compared to the April reading of 52.3 percent. The Employment Index registered 53.7 percent, an increase of 1.3 percentage points from the April reading of 52.4 percent. The Supplier Deliveries Index registered 52 percent, a 2.6-percentage point decrease from the April reading of 54.6 percent. The Inventories Index registered 50.9 percent, a decrease of 2 percentage points from the April reading of 52.9 percent. The Prices Index registered 53.2 percent, a 3.2-percentage point increase from the April reading of 50 percent.

The Purchasing Managers Index® is based on a monthly survey sent to senior executives at more than 400 companies. A PMI above4 50 represents an expansion when compared to the previous month. The further from 50, the greater the change. ***Source: Institute for Supply Management, 6/3/2019***

Raw Steel Production



In the week ending on June 1, 2019, domestic raw steel production was 1,890,000 net tons while the capability utilization rate was 81.2 percent. Production was 1,809,000 net tons in the week ending June 1, 2018 while the capability utilization then was 77.2 percent. The current week production represents a 4.5 percent increase from the same period in the previous year. Production for the week ending June 1, 2019 is down 0.1 percent from the previous week ending May 25, 2019 when production was 1,892,000 net tons and the rate of capability utilization was 81.3 percent.

Adjusted year-to-date production through June 1, 2019 was 41,235,000 net tons, at a capability utilization rate of 81.6 percent. That is up 6.2 percent from the 38,842,000 net tons during the same period last year, when the capability utilization rate was 76.6 percent.

Raw Steel Production is a domestic report based on estimates from companies representing approximately 90% of the Industry’s Raw Steel Capability as compiled by the American Iron and Steel Institute. ***Source: AISI, 6/1/2019***

INDUSTRY NEWS

Global HRC prices warn of recession

It's beginning to look a lot like a steel market downturn. Fastmarkets examines whether that trend is confined to steel - or whether the broader global economy is in trouble.

Hot-rolled coil prices have begun reflecting trends not seen since the 2008 global financial crisis and its aftermath - the Great Recession. Fastmarkets has taken the pulse of markets in the United States, Europe, China and Turkey to get a better sense of where HRC stands in these volatile times.

US HRC limbo: How low can it go?

One point to keep an eye on: Fastmarkets' price assessment for hot-rolled coil in southern Europe has been below the Chinese export price for the last two months. The southern European price averaged $461.97 per short ton ($23.10 per hundredweight) at the midpoint in May, modestly below the Chinese HRC export price average of $467.01 per ton, according to Fastmarkets' data.

The European HRC price is down 27.5% from a recent peak of of $636.68 per ton in late March 2018. And that price has averaged more than $500 per ton only once this year - in February, when the assessment averaged $501.29 per ton.

The steep decline compared with 2018 and the persistently low prices this year led ArcelorMittal to announce one wave of production cuts at its European operations in early May, followed by another announcement late in the month.

The southern European HRC price has not fallen below the Chinese HRC price since January 2009, when the European and Chinese prices averaged $479.25 per ton and $498.95 per ton respectively. The US price that month averaged $520 per ton.

But things were different a decade ago in one very important way: The US led prices down during the 2008 financial crisis, which was sparked in large part by a domestic housing bubble. The US HRC price bottomed out at $385 per ton in June 2009 - less than half their June 2008 average of $1,080 per ton, according to Fastmarkets' archives.

The US HRC price in June 2009 was well below the prices seen in southern Europe and China - $478.05 per ton and $444.52 per ton respectively. And the $600-per-ton mark recorded in the US in January 2010 marked the beginning of recovery that continued largely uninterrupted until an oil price crash in late 2014 and 2015.

In recent months, in contrast, Europe has led prices lower. And US prices might have some catching up to do unless world prices rebound. The US hot-rolled coil price crashed moved $600 per ton in late May and shows no immediate signs of rebounding given scant spot market activity during the northern hemisphere's typically slower summer months.

Prices below $600 per ton might be uncomfortably close to breakeven for some integrated mills. And ArcelorMittal's production cuts in Europe could foreshadow curtailments at other companies and in other regions of the world, Keybanc analyst Philip Gibbs warned in a late May research note.

"We expect other steel producers, in Europe and globally, could more aggressively curb supply as global finished carbon sheet steel pricing falls below marginal production cost," he wrote.

"That's not our business, to sell and make no margin," one mill source said, adding that it might be time for US producers to counter a buyers' strike with a "mill strike."

No production cuts have been announced in the US - yet.

That might be because there is an important structural difference between the US and European steel markets. Integrated flat-rolled mills in Europe - unlike those in the US - don't face intense competition from mini-mills that are able to follow prices lower thanks to a lower cost structure and lower scrap prices.

Integrated mills might have little choice but to chase prices lower or lose market share to mini-mills, some sources said.

"We're not to the bottom, and the mini-mills are not going to stop - and they're the ones who control the price on the way down," a second mill source said.

Europe hits the brakes, hikes the price

While US market participants think HRC prices are more likely to find an abyss than a floor, sources in Europe contend that prices have begun rebounding after hitting bottom.

European HRC prices are expected to remain stable in the first half of June, thanks to reduced mill output and a lack of competitive import offers. And prices might rise slowly toward the end of the month once buyers re-stock, sources said.

That's a big change from the second quarter, when the European HRC price fell on poor demand. ArcelorMittal announced two waves of production cuts in an attempt to address the resulting supply glut and to keep prices from falling further.

Higher prices should result if other European mills cut production, too. And some might already have done so.

ArcelorMittal "is seeing other European steelmakers curb output as well" without "being as vocal about it," Keybanc's Gibbs wrote in a separate late May research note, recapping comments made by ArcelorMittal management at an industry conference.

After those cuts, steelmakers announced price hikes. European flat steel producers, including ArcelorMittal and Marcegaglia, have increased offer prices for HRC. Others have stopped discounting.

The midpoint of Fastmarkets' weekly price assessment for HRC in northern Europe was $491.89 per ton ex-works on May 29, up modestly from $490.94 per ton a week earlier. And the midpoint for the assessment for southern European HRC was at $461.46 per ton ex-works on May 29, up 0.7% from a $458.05 per ton one week earlier.

Turkey: Lower US tariffs increase steel's hopes

Demand for flat-rolled steel remains weak in Turkey. But exports have strengthened since the US reduced its Section 232 tariff on Turkish steel to 25% from 50%.

Negative sentiment had dominated Turkey's domestic steel market since August 2018, when the Turkish lira lost significant ground against the US dollar in the wake of US President Donald Trump doubling of Turkey's Section 232 duty.

But steel prices have been increasing in the country since those duties were reduced last month. Domestic offers for hot-rolled coil in Turkey averaged $483.08 per ton ex-works at the end of May, up 3.9% from $464.93 per ton on May 17 - the day Turkey's Section 232 tariff was halved.

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Turkish producers should not to raise prices too quickly because Europe is a bigger market for Turkish material than the US, and prices in Europe are lower than those in the US.

And prices in the US have been falling fast, too.

Turkish steel shipments to the US are still subject to a 25% tariff, in addition to freight costs of approximately $45 per ton, Turkish sources noted. That means Turkish hot band may be priced higher than material from some US mills.

US prices have fallen hard since Turkey was hit with doubled Section 232 duties last summer.

Fastmarkets AMM's daily US Midwest hot-rolled coil index stood at $586.60 per ton on May 31, down 36% from a nearly 10-year peak of $916.80 per ton reached in early July 2018.

Turkey will be celebrate the Eid al-Fitr holiday in the first week of June, to mark the end of Ramadan. Prices won't change much during the week because of soft demand at home and abroad, market participants predicted.

China brings the tons, breaks the floor

Trends in China - the largest steelmaking nation in the world - cast doubt on the sustainability of a potential HRC price rebound in Europe or Turkey.

China's hot-rolled coil prices have fallen on weak demand in both the domestic and export markets.

Despite increasing raw material costs - iron ore prices hit $106-108 per tonne in late May - mills have had to lower prices to secure orders, sources told Fastmarkets.

The price for ex-warehouse HRC in northern China averaged $507.69 per at the end of May, down 3.6% from $526.43 per ton a month earlier. Spot activity has remained slow despite lower offers because market participants expect prices to fall further.

That bearish outlook comes in part because at least 13 HRC production lines - capable of making 31 million tonnes per year - are under construction and expected to start operations this year.

To put that in perspective, annual US steel consumption - flat products, long products and tubular products - totals about 115 million tons.

Making matters worse: Downstream demand is unlikely to improve.

Output in the automobile sector - one of the main consumers of flat-rolled steel - fell by 15.8% to 2.02 million units in April, according to China's National Bureau of Statistics.

Chinese export prices, meanwhile, have slumped to around $500 per tonne fob. And some mills are in urgent need of exports because they do not have enough domestic orders.

"Although our official offer prices are $515-520 per tonne fob, the actual tradeable prices will be as low as $500-505 per tonne fob if a mill really means to sell," a source at an eastern China-based mill said.

"Overseas buyers are barely bidding, seeing the big drops in China's domestic HRC prices. They are waiting and will only place orders when prices bottom out," he said.

Some deals have been reported even lower in recent days, at around $490-495 per tonne fob, a Beijing-based trader said. "Most market participants are bearish on [the] price trend," he added. ***Source: AMM, 6/3/2019***

American Steel CEOs Surprised By Mexico Tariffs Amid USMCA Fear

Executives of three of the largest U.S. steelmakers are pushing back against President Donald Trump's abrupt announcement he intends to slap tariffs on Mexican imports, fearing it will stymie the new North American free-trade deal.

Speaking at an industry conference in Washington, the chief executive officers of Nucor Corp., Steel Dynamics Inc. and AK Steel Holding Corp. said the U.S.-Mexico-Canada trade deal will benefit the American steel industry through new rules-of-origin requirements for raw materials sourced from North America.

"Our reaction was surprise," John Ferriola, CEO of Nucor, the largest U.S. steelmaker, said Tuesday of the tariff announcement. "We hope it does not impact the USMCA — we think that's a good thing for the steel industry and manufacturing in general in the U.S. and the economy as a whole."

His comments — which were echoed by Steel Dynamics' Mark Millett and AK Steel's Roger Newport — joined criticism of the threatened tariffs from politicians including Senate Republicans. Senator Kevin Cramer, a North Dakota Republican, predicted that the Senate would have enough votes to override a presidential veto of any measure that would keep Trump's tariffs on Mexico from going into effect June 10.

American steelmakers are heavily integrated with a number of industries like the automotive sector, which has a large part of its supply chain in Mexico. Tariffs will perpetuate more uncertainty for steelmakers that have seen their stock prices tumble from recent multiyear highs, according to Phil Gibbs, an analyst at Keybanc Capital Markets.

"Investors are frustrated because they don't know how to invest in this market when you have the rules changed every day," Gibbs said. "Plus, it's one thing when you were using trade tactics to get trade issues done, and it's different when you're using this for social issues, that's what the market is saying." ***Source: Bloomberg, 6/4/2019***