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MARKET INSIGHT
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ECONOMIC NEWS

How a 'Currency War' Could Weaken US Economy

President Donald Trump's trade conflict with China escalated this week when Beijing let its currency fall to its lowest level against the dollar in 11 years and suspended its purchases of U.S. farm goods — and the Trump administration promptly branded China a "currency manipulator."

Trump's response has little immediate practical impact. But together, the new developments raised the dangerous threat of a destabilizing currency war that could infect the global financial system. The stock market responded Monday with its steepest plunge of the year.

Things cooled a bit Tuesday when China appeared to stabilize its currency, and the Dow Jones Industrial Average rebounded 311 points. But that was still less than half its loss Monday.

ARE THE U.S. AND CHINA IN A CURRENCY WAR?

For now, no. The Trump administration has yet to respond to China's allowing its currency to fall by taking its own steps to lower the dollar's value to the yuan. Still, this could happen: The option was raised in the White House late last month, according to media reports, and Trump said July 26 that he could take steps to devalue the dollar "in two seconds if I want to."

And earlier that month, Trump had tweeted that China and Europe were "playing (a) big currency manipulation game" and the U.S. either "should MATCH, or continue being the dummies who sit back and politely watch as other countries continue to play their games."

Megan Greene, an economist and senior fellow at Harvard's Kennedy School of Government, suggested that the Trump administration might decide to lower the dollar's value to retaliate against China simply because it has few other options. Still, she doesn't think the move would prove effective, partly because the yuan isn't widely available on currency markets. It would be hard for the U.S. to buy enough yuan to drive up its value against the dollar.

"It seems like some kind of currency intervention is on the table, just not an effective one," Greene said.

WHAT MIGHT A TRUMP INTERVENTION LOOK LIKE?

The Treasury Department maintains what it calls an Exchange Stabilization Fund. It could use this fund to sell dollars and buy yuan, thereby reducing the dollar's value against the Chinese currency. But the fund contains about $100 billion — not a large sum if your goal is to influence foreign exchange markets, which measure in the trillions of dollars.

And taking such steps would violate the international agreements that the United States has signed not to manipulate the dollar's value to gain trade advantages.

Trump also wants the Federal Reserve to cut short-term interest rates repeatedly and aggressively. Doing so would make the dollar less valuable for investors to hold.

The Fed cut its benchmark rate last week, and investors expect further reductions in the fall. But on Tuesday, James Bullard, president of the Federal Reserve Bank of St. Louis, who voted for last week's rate cut, said the central bank has "done a lot" and argued that it shouldn't respond to every fluctuation in trade tensions.

WHAT DAMAGE COULD A CURRENCY WAR CAUSE?

Over time, it would be significant. For China, driving the yuan lower would make it harder for its companies to pay off their dollar-denominated debts, because each yuan they earn would translate into fewer dollars. In both countries, cheaper currencies generally raise the price of imports, which could spur inflation. That would also make Chinese imports costlier for American consumers.

"For the U.S. to intervene to try to weaken the dollar would be a terrible mistake," said Sung Won Sohn, business economist at Loyola Marymount University in Los Angeles.

Source: The Associated Press, 8/6/2019

US Employers Added 164,000 Jobs in July

The economy is slowing down, but it keeps creating jobs at a healthy pace. Employers added 164,000 jobs last month, as the unemployment rate held steady at 3.7%, the Labor Department said Friday. The jobless rate remains at a nearly 50-year low.

Analysts had expected about 165,000 jobs to be added in July and the unemployment rate to be 3.6%.

Job gains for the two previous months were revised downward by a total of 41,000. Over the past three months, monthly job growth has averaged about 140,000 — down from 233,000 in the final three months of 2018.

Wages have been growing slowly, which has kept a lid on inflation. Average hourly earnings rose 8 cents, to $27.98 last month. That's up 3.2% from a year ago, a slight acceleration from June.

The strong job market continues to draw new people into the workforce. About 370,000 new workers entered the job market last month, and labor force participation inched up to 63%.

Factories added 16,000 jobs in July. Manufacturing growth has suffered in recent months, partly as a result of trade tensions. On Thursday, President Trump announced plans to widen the trade war with 10% tariffs on another $300 billion worth of Chinese imports.

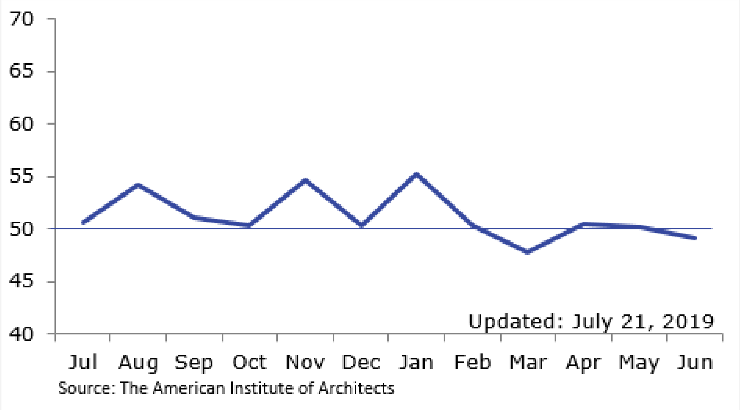
This week, the Federal Reserve announced its first interest-rate cut since 2008. Policymakers at the central bank said the job market remains strong, but that they're worried about the U.S. and global economies slowing down and the uncertainty caused by the U.S.-China trade war.

The U.S. economy grew at a 2.1% rate in the second quarter, slowing from the 3.1% pace of the first three months of 2019 — and the 3% target set by President Trump. The slowdown was attributed to weaker business investment and a drop in exports amid the trade war and global economic weakness.

Source: The Associated Press, 7/5/2019

KEY ECONOMIC INDICATORS

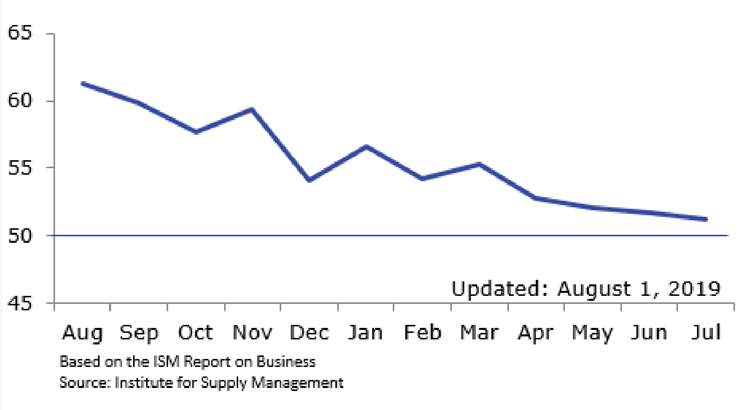
Architecture Billings Index (ABI)



The Architecture Billings Index score for June was 49.1, which is down from 50.2 in May. Any score below 50 indicates a decrease in billings. Both the project inquiries index and the design contracts index continued to soften in June but remained positive.

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, 7/17/2019***

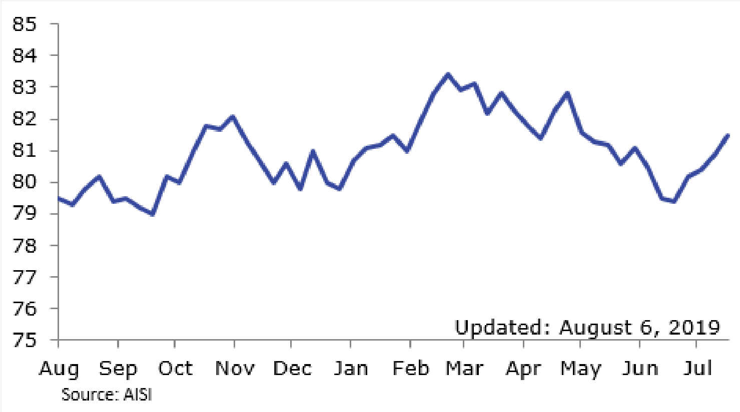
Purchasing Managers Index®



The July PMI® registered 51.2 percent, a decrease of 0.5 percentage point from the June reading of 51.7 percent. The New Orders Index registered 50.8 percent, an increase of 0.8 percentage point from the June reading of 50 percent. The Production Index registered 50.8 percent, a 3.3-percentage point decrease compared to the June reading of 54.1 percent. The Employment Index registered 51.7 percent, a decrease of 2.8 percentage points from the June reading of 54.5 percent. The Supplier Deliveries Index registered 53.3 percent, a 2.6-percentage point increase from the June reading of 50.7 percent. The Inventories Index registered 49.5 percent, an increase of 0.4 percentage point from the June reading of 49.1 percent. The Prices Index registered 45.1 percent, a 2.8-percentage point decrease from the June reading of 47.9 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, 8/1/2019***

Raw Steel Production



In the week ending on August 3, 2019, domestic raw steel production was 1,897,000 net tons while the capability utilization rate was 81.5 percent. Production was 1,848,000 net tons in the week ending August 3, 2018 while the capability utilization then was 78.8 percent. The current week production represents a 2.7 percent increase from the same period in the previous year. Production for the week ending August 3, 2019 is up 0.7 percent from the previous week ending July 27, 2019 when production was 1,884,000 net tons and the rate of capability utilization was 80.9 percent.

Adjusted year-to-date production through August 3, 2019 was 57,945,000 net tons, at a capability utilization rate of 81.1 percent. That is up 4.8 percent from the 55,279,000 net tons during the same period last year, when the capability utilization rate was 77.0 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, 8/6/2019***

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US STEEL INDUSTRY WELCOMES CHINA'S DESIGNATION AS CURRENCY MANIPULATOR

The US Department of Treasury's move Monday to designate China as a currency manipulator is "welcome news" for the steel industry and overall US manufacturing, according to American Iron and Steel Institute CEO Thomas Gibson.

"China was, and remains, a currency manipulator," Gibson said in a statement. "The Chinese government's actions today are just one more instance of its active role in manipulating the value of its currency to promote Chinese exports."

The US Treasury, at the urging of President Donald Trump, officially named China a currency manipulator in response to the country's decision to reduce the value of its currency.

"China has a long history of facilitating an undervalued currency through protracted, large-scale intervention in the foreign exchange market," the Treasury Department said in a statement. "In recent days, China has taken concrete steps to devalue its currency, while maintaining substantial foreign exchange reserves despite active use of such tools in the past. The context of these actions and the implausibility of China's market stability rationale confirm that the purpose of China's currency devaluation is to gain an unfair competitive advantage in international trade."

The AISI and steel industry have long advocated for the US government to take action in regards to currency manipulation.

"We applaud the decisive action today by President Trump and the US government to address the damage, and unfair competitive advantage, that China's undervalued currency has caused to our nation's manufacturing sector - especially the steel industry," Gibson said. ***Source: S&P Global Platts, August 6, 2019***

GLOBAL CRUDE STEEL PRODUCTION RISES 4.6% IN THE FIRST HALF OF 2019

Global crude steel production reached 925.1 million tons for the first six months of the year, marking a 4.6% increase compared with the same period in 2018, the World Steel Association reported.

Year-over-year production growth has fallen each of the last two months, from 6.4% in April to 5.2% in May.

Production in Asia reached 660.2 million tons, up 7.4% compared with 1H 2018. North American production ticked up 1.4% to 60.1 million tons, while E.U. production fell 2.5% to 84.7 million tons. The Commonwealth of Independent States (CIS) bloc produced 50.5 million tons, about flat with production levels in 1H 2018.

Production in China continues to remain elevated over 2018 levels. In June, China churned out 87.5 million tons, up 10.0% on a year-over-year basis. However, June production fell from May's 89.1 million tons.

Worth monitoring is the key steelmaking material, iron ore, which has soared to five-year highs this year.

“Steel prices had been supported by environmentally promoted steel mill closures, restricting supply as government-supported housing construction drove demand,” MetalMiner's Stuart Burns explained Tuesday. “However, although anti-pollution measures are expected to continue, it will require further stimulus to keep the housing market running at the current pace.”

India's production rose 4.0% to 9.3 million tons of crude steel in June 2019. As noted by MetalMiner's Sohrab Darabshaw, Tata Steel announced plans to increase its annual crude steel capacity to 30 million tons by 2025, up from the current 20 million tons.

Japan's production fell 0.4% on a year-over-year basis, down to 8.8 million tons, while South Korea's crude steel production fell 2.6% to 6.0 million tons.

U.S. production reached 7.3 million tons in June, up 3.1% year over year. U.S. steel capacity utilization reached 81.1% as of July 20, according to the American Iron and Steel Institute (AISI).

In Europe, Germany's production fell 5.8% to 3.4 million tons, while Italy saw a 2.5% decline to 2.1 million tons. France's production rose 3.4% to 1.3 million tons, while Spain's production ticked up 2.3% to 1.2 million tons.

Steel production in Turkey, Ukraine and Brazil fell in June on a year-over-year basis. ***Source: Metal Miner, July 31, 2019***

ALUMINUM'S SHORT-TERM FUNDAMENTALS ARE LESS THAN PROMISING

The short-term fundamentals for aluminum do not look promising, if Alcoa's latest report is to be believed.

The major primary producer is struggling to create positive net cash flow, a measure of the firm's ability to pay down its substantial debt, reporting a negative free cash flow of U.S. $7 million on its $2.7 billion second-quarter revenue. The firm posted a net loss of $402 million, or $2.17 per share, although it should be added this included a $319 million one-off cost to divest its interest in the Ma'aden Rolling Company (MRC) in Saudi Arabia (plus $81 million in other special items).

Beyond Alcoa's ongoing woes, its comments regarding the current state of the market and its view of the second half of this year make interesting reading.

New York investment bank Jefferies is quoted as saying a primary aluminum capacity overhang globally and limited supply constraints are concerns going forward, especially in an environment where demand is likely to be relatively weak.

The aluminum price has drifted lower this year, depressed more by investor fears of a slowing global economy and, in particular, by the impact of the ongoing trade war on the world's top producer and consumer, China.

In the case of alumina, a small market surplus has the bank concerned prices will continue to drift lower yet, even at current levels of around $350/ton spot. Primary producers' margins are under pressure, with the LME price in the $1,750-$1,850/ton range. The bank says prices of around $2,100/ton are needed to provide an adequate return; if alumina prices and primary aluminum prices do not find a more equitable equilibrium, more smelter closures may ensue.

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Alcoa is currently trying to close or sell two smelters in Spain, following closures across Europe over the last decade in France, Germany, Italy, the Netherlands and Britain.

Yet in the medium term, prospects for aluminum look promising.

Global demand is growing, albeit not at the level it was earlier in the decade. The market remains undersupplied, as demand is exceeding production to the tune of some 1.5 million-1.7 million tons per year.

The shortfall is being met by shadow stocks held by the stock and finance trade, which built up following the financial crisis of 2008 and are gradually returning to the market. In Jefferies' estimation, global inventories are reaching lows not seen since 2007. So far, this has not impacted either metal prices or investor appetite for the metal.

Looking ahead, S&P is quoted as predicting prices will average $2,000/ton and $2,100/ton for 2020 and 2021, saying the longer-term fundamentals are robust, underpinned by expectations of a continued supply deficit, low inventory and solid aluminum demand growth globally.

Whether S&P's longer-term optimism trumps Alcoa's short-term gloom remains to be seen. Much will depend on global growth and mature markets avoiding a recession in 2020. ***Source: Metal Miner, July 25, 2019***

CHINESE EXPORT SHEET PRICES PRESSURED LOWER

Export prices for Chinese cold-rolled coil and hot-dipped galvanized coil fell during the week to Tuesday August 6 on bearish sentiment arising from the escalating trade tensions between China and the United States, market sources said.

US president Donald Trump has plans to impose 10% tariffs on $300 billion of Chinese imports from September 1.

The Chinese currency breached the 7-yuan-per-$1 level threshold for the first time since 2008 on Monday, with the US Treasury department subsequently deeming China a "currency manipulator."

The Chinese currency was trading at 7.01 yuan to $1 on August 6 compared with 6.88 yuan per $1 a month earlier, according to currency exchange data.

Fastmarkets' weekly price assessment for steel cold-rolled coil export, fob China, was at $535 per tonne on Tuesday August 6, down by $5 per tonne from a week earlier.

One cargo of the assessed product was sold at $535 per tonne fob China to Southeast Asia, Fastmarkets was told.

Liaoning-based Benxi Iron & Steel on Tuesday issued an offer of $545 per tonne fob China for October-shipment CRC, down by $5 per tonne from last week.

Chinese cold-rolled full-hard coil, an intermediate product that is not annealed, was also offered to Southeast Asia at $525 per tonne cfr, however, Fastmarkets' assessment only covers annealed CRC.

"My customers have indicated they will wait for a clearer price direction to emerge because of the weakening Chinese yuan," a trader in Shanghai said.

A weaker yuan makes Chinese steel exports, which are commonly settled in US dollars, cheaper and more competitively priced.

The depreciating currency in China provides domestic producers with the option to lower prices to entice overseas buyers, a trader in Tianjin said.

Fastmarkets' weekly price assessment for steel galvanized coil 1mm export, fob China, was $580-590 per tonne on Tuesday, down by $5 per tonne week on week.

One transaction involving 80g zinc-coated HDG was concluded at $580 per tonne cfr Southeast Asia over the past week, Fastmarkets heard.

On Tuesday August 6, Benxi Steel offered $615 per tonne fob China for October shipments of its zero-spangle, 140g zinc-coated HDG, which is down by $5 per tonne from a week earlier. The offer is equivalent to $600 per tonne fob for the assessed 120g zinc-coated HDG.

Hebei-based Tangshan Iron & Steel was also asking for $600 per tonne fob Tianjin for the assessed product.

Market sources estimated that $580-590 per tonne fob was a workable price for the assessed product.

"There are some traders who have started to offer position cargoes at prices below the market level although it remains to be seen if buyers are willing to accept these prices," a second Shanghai-based trader said.

The recent slump in iron ore prices has also added to expectations that prices could fall further, market sources said.

Fastmarkets' index for iron ore 62% Fe fines, cfr Qingdao, was at $100.56 per tonne on August 5, down by $17.43 per tonne from a week earlier. ***Source: AMM, August 6, 2019***