Metalwest
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MARKET INSIGHT
October 2019

ECONOMIC NEWS

AMERICA'S FACTORIES JUST SUFFERED THEIR WORST MONTH IN A DECADE

U.S. manufacturing activity contracted for the second month in a row in September, falling to a level not seen in 10 years.

The Institute of Supply Management's closely-watched manufacturing index dropped to 47.8 in September, its lowest level since June 2009 and worse than what economists had expected.

The index measures month-to-month changes in the industry. A reading above 50 denotes growth in the sector.

"Global trade remains the most significant issue, as demonstrated by the contraction in new export orders that began in July 2019," said Timothy Fiore, chair of the ISM's manufacturing business survey committee.

Making matters worse, the contraction in September was steeper than it was in August, when the sector contracted for the first time in three years because of higher prices that factories pay for materials and weaker global demand.

And the slowdown isn't over.

Companies that make machinery cited softening demand and reduced backlogs, but food, beverage and tobacco producers said Chinese tariffs are hurting their businesses, the ISM survey showed.

The overall index number was bad, but more worrisome is the report's drop in factory orders of exports, said Torsten Slok, chief economist at Deutsche Bank. "There is no end in sight to this slowdown, the recession risk is real," he wrote in a note to clients.

As recession worries resurface, investors wonder whether the Federal Reserve could turn more dovish as the year comes to an end.

The central banks cut interest rates twice this year, in July and again last month, to boost the economy. But at its September meeting the average forecast from policy committee members didn't account for further cuts this year. The softening manufacturing data could change this.

Market expectations for a quarter percentage points interest rate cut in October jumped to 65%, compared to under 40% Monday in the wake of the ISM data, according to the CME FedWatch Tool.

The index's sharp decline also might be related to the General Motors strike, now in its third week, suggested Paul Ashworth, chief economist at Capital Economics.

Source: CNN Business, 10/1/2019

U.S. UNEMPLOYMENT RATE FALLS TO 3.5%; JOB GROWTH STEADY

U.S. job growth increased moderately in September, with the unemployment rate dropping to near a 50-year low of 3.5%, assuaging financial market concerns that the slowing economy was on the brink of a recession amid lingering trade tensions.

The Labor Department’s closely watched monthly employment report on Friday, however, showed wage growth stagnating and manufacturing payrolls declining for the first time in six months. The retail sector also continued to shed jobs.

The report came on the heels of a string of weak economic reports, including a plunge in manufacturing activity to more than a 10-year low in September and a sharp slowdown in services industry growth to levels last seen in 2016, that heightened fears the economy was flirting with a recession.

With signs that the Trump administration’s 15-month trade war with China is spilling over to the broader economy, continued labor market strength is a critical buffer against an economic downturn. The trade war has eroded business confidence, sinking investment and manufacturing.

Nonfarm payrolls increased by 136,000 jobs last month, the government said. August data was revised to show 168,000 jobs created instead of the previously reported 130,000 positions.

The initial August job count was probably held back by a seasonal quirk related to students leaving their summer jobs and returning to school. Economists polled by Reuters had forecast payrolls would increase by 145,000 jobs in September.

U.S. stock index futures pared losses after the release of the data and later moved into positive territory. U.S. Treasury yields jumped and the dollar trimmed losses against the yen and euro.

Regardless of the continued moderate employment growth and sharp drop in the jobless rate, economists expect the Federal Reserve to cut interest rates at least one more time this year, given the trade policy uncertainty.

Washington announced this week tariffs on aircraft, other industrial products and agricultural products from the European Union as part of a World Trade Organization penalty award in a long-running aircraft subsidy case. Trade experts expect the EU will impose tariffs on U.S. goods next year over state subsidies for Boeing BA.N.

The U.S. central bank cut rates last month after reducing borrowing costs in July for the first time since 2008, to keep the longest economic expansion in history, now in its 11th year, on track. Growth estimates for the third quarter range from as low as a 1.3% annualized rate to as high as a 1.9% pace. The economy grew at a 2.0% pace in the second quarter, slowing from a 3.1% rate in the January-March period.

STRONG GOVERNMENT HIRING

Steady job growth last month came despite the Institute for Supply Management’s (ISM) measure of manufacturing employment tumbling to more than a 3-1/2-year low. In September, the ISM’s gauge of services industry employment fell to its lowest reading since February 2014.

While September’s job gains were below the monthly average of 161,000 this year, they were still above the roughly 100,000 needed each month to keep up with growth in the working-age population. The two-tenths of a percentage point drop in the unemployment rate from 3.7% in August pushed it to its lowest level since December 1969. ***View the rest of the article here: Reuters, October 3, 2019***

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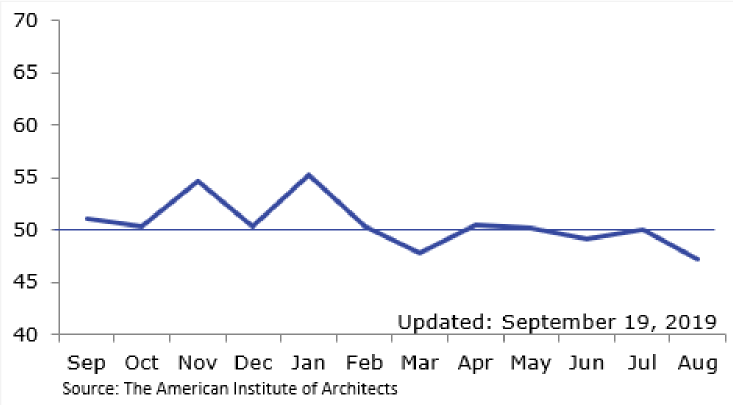
KEY ECONOMIC INDICATORS

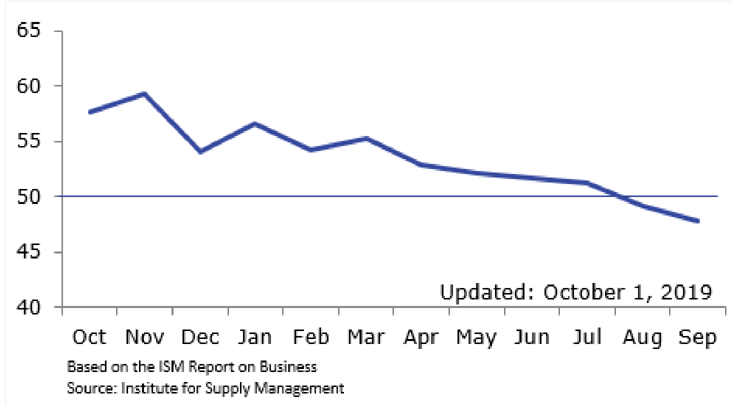
ARCHITECTURE BILLINGS INDEX (ABI)



The American Institute of Architects (AIA) this week, in its latest Architecture Billings Index (ABI) report, found that there was a "substantial" decrease in architecture firm billings from July to August and a corresponding drop in the index's score from 50.1 to 47.2. The AIA said this shift signifies the biggest weakness in design activity in the last several years. The Project Inquiries Index was in positive territory with an August score of 54.5, but the Design Contracts Index landed at 47.9. As part of a sector analysis, the AIA gave scores to institutional (50.6); multifamily residential (50.5); commercial-industrial (46.9); and mixed practice (46.3) billings as well.

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, 9/19/2019***

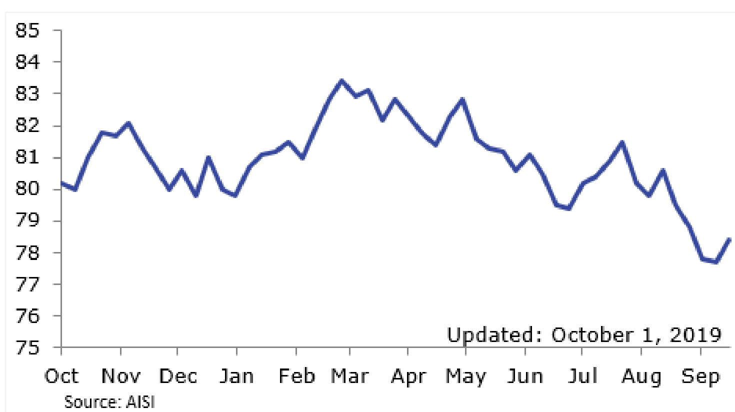
PURCHASING MANAGERS INDEX®



The September PMI® registered 47.8 percent, a decrease of 1.3 percentage points from the August reading of 49.1 percent. The New Orders Index registered 47.3 percent, an increase of 0.1 percentage point from the August reading of 47.2 percent. The Production Index registered 47.3 percent, a 2.2-percentage point decrease compared to the August reading of 49.5 percent. The Employment Index registered 46.3 percent, a decrease of 1.1 percentage points from the August reading of 47.4 percent. The Supplier Deliveries Index registered 51.1 percent, a 0.3-percentage point decrease from the August reading of 51.4 percent. The Inventories Index registered 46.9 percent, a decrease of 3 percentage points from the August reading of 49.9 percent. The Prices Index registered 49.7 percent, a 3.7-percentage point increase from the August reading of 46 percent. The New Export Orders Index registered 41 percent, a 2.3-percentage point decrease from the August reading of 43.3 percent. The Imports Index registered 48.1 percent, a 2.1-percentage point increase from the August reading of 46 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, 10/1/2019***

RAW STEEL PRODUCTION



In the week ending on September 28, 2019, domestic raw steel production was 1,825,000 net tons while the capability utilization rate was 78.4 percent. Production was 1,866,000 net tons in the week ending September 28, 2018 while the capability utilization then was 79.6 percent. The current week production represents a 2.2 percent decrease from the same period in the previous year. Production for the week ending September 28, 2019 is up 0.9 percent from the previous week ending September 21, 2019 when production was 1,809,000 net tons and the rate of capability utilization was 77.7 percent.

Adjusted year-to-date production through September 28, 2019 was 72,593,000 net tons, at a capability utilization rate of 80.6 percent. That is up 3.4 percent from the 70,187,000 net tons during the same period last year, when the capability utilization rate was 77.5 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, 10/1/2019***

INDUSTRY NEWS

'Thriving' US Steel Sector Could Face More Troubles in Q4

Although the steel sector has been weak this year, Trump said in August that it was "thriving" under his administration. Protecting the US steel industry was a key part of Trump's presidential campaign. Despite imposing a 25% tariff on US steel imports, Trump doesn't seem to have revived the sector.

U.S. Steel Corporation (X) stock has whipsawed over the last few trading sessions. On Tuesday, it rose after the company announced an investment in Big River Steel. However, the stock tumbled yesterday, along with Nucor (NUE), AK Steel (AKS), and ArcelorMittal (MT). U.S. Steel Corporation was the weakest of the lot, falling 8.3% yesterday. The stock is now approaching its 52-week low.

Trump's tariffs

Trump also imposed a 10% tariff on US aluminum imports, which failed to have much impact. While US aluminum production has risen, prices have fallen, dented Alcoa's and Century Aluminum's profitability. Furthermore, as there have been no new smelter announcements, the US continues to import most of its aluminum from overseas. Canada, the largest aluminum and steel exporter to the US, was exempted from Section 232 tariffs earlier this year. The exemption further fueled US steel's sell-off.

However, Alcoa (AA) benefited from the exemption, as it ships aluminum from Canadian smelters to the US. Before the exemption, Alcoa was paying tariffs on these shipments. When Trump announced Section 232 tariffs last year, Alcoa wasn't thrilled, unlike its steel counterparts. Instead, Alcoa asked the Trump administration to address the core issue of Chinese smelting overcapacity.

Third-quarter earnings guidance

Last year, Section 232 tariffs boosted US steel prices and companies' earnings. Nucor posted record earnings, and U.S. Steel Corporation's and AK Steel's earnings rose year-over-year. However, US steel companies' earnings have fallen this year, and they expect them to fall further in the third quarter. U.S. Steel Corporation's Q3 2019 earnings guidance was way below analysts' expectation. Nucor's was also low, due to lower metal prices and tepid demand.

US steel sector could face another rough quarter

We're now into the fourth quarter, where end-user demand is usually weak. General Motors' (GM) ongoing strike is also hurting investor sentiment. Notably, the automotive sector is the second-largest end steel user. AKS ships most of its steel to auto companies.

Furthermore, scrap prices have tumbled. S&P Global Platts reported that scrap prices might fall more this month. It attributed scrap prices' weakness to "mill outages in October, a weakening export market throughout the month of September, weak overall steel demand, and an ongoing strike at GM."

What the weakness in scrap indicates for the US steel sector

Scrap and steel prices tend to move in tandem. Therefore, scrap prices falling in October could impact finished steel prices. Generally, when scrap prices fall, end buyers hold back their steel purchases. We have no reason to believe this won't happen again.

If scrap prices and steel prices fall, mini-mills such as Nucor could still somewhat protect their margins. Mini-mills primarily use scrap in production, giving them a natural hedge. Simply put, as scrap and steel prices fall in tandem, mini-mills don't experience the margin pressure felt by integrated mills, which rely on iron ore. However, mini-mills also have upstream scrap processing facilities, meaning they could still be affected by scrap prices falling sharply.

Integrated steel mills

Integrated mills such as U.S. Steel Corporation also produce iron ore. The company's US operations are especially self-sufficient when it comes to iron ore. In fact, it sells some iron ore to third parties. Therefore, while falling steel prices lower U.S. Steel Corporation's average selling prices, its input prices don't fall much, as it doesn't use much scrap in its blast furnaces. This disconnect between raw material and finished product prices makes integrated steel mills' earnings volatile.

Furthermore, there are concerns about U.S. Steel Corporation's leverage. The company's capex plan is set to burn cash, and it announced it was acquiring a stake in Big River Steel earlier this week. The acquisition could either increase its leverage or dilute its equity. In either scenario, U.S. Steel Corporation's short-term outlook is muddled. ***Source: Market Realist, October 3, 2019***

US Mills Fall into Autumn with Wave of Outages

Domestic mills have scheduled a host of outages next month, but sources aren't convinced they will help falling steel prices.

Case in point: AK Steel plans to press ahead with an October outage at its Dearborn Works in Michigan, a company spokesperson confirmed.

The outage is expected to last less than 20 days. "We plan in advance to have appropriate product to meet our customers' needs," she said in an email to Fastmarkets on Monday September 23. The spokesperson declined further comment.

Fastmarkets reported in July that AK Steel was planning a $60-million maintenance outage, beginning in October, at its Dearborn Works blast furnace and steel shop.

Dearborn Works produces hot-rolled, cold-rolled and hot-dipped galvanized flat-rolled steel as well as advanced high-strength steel. The facility supplies original equipment manufacturers, including customers in the automotive industry, according to AK's website.

AK not alone

Several domestic mills - both integrated and mini-mill producers - also have outages slated for the fall

On the integrated mill side, ArcelorMittal told Fastmarkets in June that it planned to take autumn maintenance outages at two of its US blast furnaces. The planned outages will take place at ArcelorMittal's Burns Harbor steelmaking

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complex outside of Chicago and its Cleveland steelmaking operations.

At Burns Harbor, the C furnace will be taken down for two weeks in October for stack shotcrete work, large bell hopper replacement and other routine maintenance, a company spokesperson said in an email to Fastmarkets on Monday.

At Cleveland, the C-6 furnace will be taken down for one week in November for stack shotcrete work and routine repairs, she said.

Both mills produce flat-rolled steel. Both outages were scheduled months in advance, the spokesperson noted.

On the mini mill side, Gerdau Long Steel North America's mill in Midlothian, Texas, will take a nearly two-week planned outage in October, a company spokesperson confirmed to Fastmarkets in August.

Fastmarkets has confirmed the outages even if precise dated are not available. Market participants said other mills have outages scheduled for October and November too.

U.S. Steel was said to have a significant outage coming up at its Gary Works outside of Chicago.

"Regarding the outage, we do not have anything to report outside of the earnings calls," a U.S. Steel spokesperson said in an email to Fastmarkets.

U.S. Steel's third-quarter earnings call is scheduled for Friday November 1, she added.

U.S. Steel has already idled furnaces at Gary Works and Great Lakes Works near Detroit. Those idlings will last into 2020.

The U.S. Steel idlings haven't materially reduced supplies, Cowen analyst Tyler Kenyon wrote in a research note last week. "We continue to believe that inventory accumulation ahead of these outages will delay any supply-side relief until early [fourth quarter 2019]," he wrote.

Mills typically build up inventory ahead of outages or idlings so that customers won't be left short of supplies.

Nucor also has significant outages coming up between now and the end of the year, according to market sources. The company did not respond to a request for comment.

Price impact

While some market participants have said such outages should support steel prices by reducing supplies, others have said that the downtime will pressure scrap prices, because mills will require less scrap. Lower scrap prices will, in turn, lead to negative sentiment around steel prices, the sources said.

Fastmarkets' daily steel hot-rolled coil index, fob mill US stood at $27.61 per hundredweight ($552.20 per short ton) at the time of publication, up 0.7% from a two-month low of $27.42 per cwt hit last week but down 6.8% ($2 per cwt) from an August average of $29.61 per cwt.

The declines in steel roughly match those in scrap, where prime scrap fell by $40 per gross ton in September. Scrap prices are expected to continue to fall in October. ***Source: AMM, September 23, 2019***

Estimated aluminium arbitrage relatively steady

Estimated arbitrage opportunities between Southeast Asian warehouses and the US Midwest were little changed in September on a steady US aluminium market.

Fastmarkets' assessment of the monthly average midpoint for the aluminium P1020A premium, ddp Midwest US was $391.32 per tonne for September, unchanged from $391.93 per tonne the month before.

A lack of liquidity on the back of weak demand and unchanged market fundamentals have led to a pressured but stable premium in the US for most of September.

Despite the stagnant market, premiums in the US Midwest continue to stay strong compared to markets in Europe and Asia, both of which declined in recent weeks

The benchmark premium paid for the supply of aluminium to Main Japanese Ports in the fourth quarter of 2019 settled at $97 per tonne Tuesday October 1, down nearly 6% compared with the same time last year.

Market participants in Japan are expecting an increased influx of metal from Australia - metal that had previously gone to the US - as well as more shipments from Brazil with the restart of the Albras smelter.

In Europe, Fastmarkets' Aluminium P1020A premium, in-whs dup Rotterdam was assessed at $100-105 per tonne Tuesday, down from $100-110 per tonne on Monday September 30.

"If there is one good market, it's the US. It has the strongest premium in the world," one market participant said.

Offsetting freight factors

Freight rates have been volatile due to potential new global shipping policies coming online in the months ahead, but a drop in barging rates has helped offset those costs and helped keep overall shipping costs relatively stable.

"Ocean freight rates strengthened and operators are beginning to factor-in the impact of [the International Maritime Organization's 2020 requirement that operators] use low-sulfur fuels from January and the possible shortage of supplies of [that fuel]," a market source said.

"[New Orleans] to Owensboro spot barge rates [in the US] dropped back to July levels with a reduction of around $8 per tonne, which mitigated a similar rise in ocean freight [rates]," the source added.

For duty-free metal originating from warehouses in Singapore, the estimated arbitrage was at $223.58 per tonne for shipments of 10,000 tonnes via break-bulk vessels, up from $222.85 per tonne the month before.

In Busan, South Korea, the estimated arbitrage for duty-free metal in September widened slightly to $234.32 per tonne for shipments of 10,000 tonnes via break-bulk vessels, compared with $231.30 per tonne in August.

In Malaysia, the estimated arbitrage rate for duty-free metal from both Port Klang and Johor in September was $238.18 per tonne for shipments of 10,000 tonnes via break-bulk vessels, up from $237.38 per tonne in August. ***Source: AMM, October 2, 2019***