NORFOLK IRON & METAL

MARKET INSIGHT

February 2020

ECONOMIC NEWS

U.S. Economic Growth Slowed In 2019 To 2.3%

The U.S. economy grew 2.3% last year, the Commerce Department said Thursday. That's a slowdown from the previous year, when the economy grew 2.9%. And it's well short of the 3% growth target set by the White House.

In the fourth quarter, the economy grew at an annual rate of 2.1%, matching the pace of the previous three months. The Congressional Budget Office is projecting GDP growth of 2.2% this year.

"We anticipate that consumer spending, spurred by rising wages and household wealth, will remain strong," CBO Director Phillip Swagel told a House committee on Wednesday. "We also expect business investment to rebound as several of the factors that weighed on businesses last year abate."

Swagel's forecasts for the rest of the decade are less rosy, with annual GDP growth slumping to an average of just 1.7%.

"That growth rate is lower than the historical average because of long-term demographic trends," Swagel said. "The United States is an aging society. That means the growth of our labor force will be slower in the future than it has been in the past."

The Trump administration has tried to lure more people into the workforce with a combination of carrots and sticks. The carrots include tax cuts that increase take-home pay. The sticks include work requirements and other adjustments to safety-net programs such as food stamps.

A strong job market has drawn more people off the sidelines into the workforce. Labor force participation has climbed from a low of 62.4% in 2015 to 63.2% today, although rates in the U.S. still lag those in other countries.

"I think we've learned quite a lot of good things about the labor market," Federal Reserve Chairman Jerome Powell said Wednesday. "Good things suggesting that there's been more room to run."

Powell said newly signed trade pacts with China, Canada and Mexico could give businesses more confidence to invest in the new year. Lackluster business spending was a drag on growth for much of 2019. However, Powell cautioned that uncertainty surrounding trade policy has not gone away.

"There's a bit of a wait and see attitude," the Fed chairman said.

Consumer spending continues to be a main driver of economic growth, although consumers were a little more cautious in the final months of 2019. The housing market is also rebounding, thanks in part to low interest rates. **Source: NPR *1/30/2020***

January Adds a Much Stronger-Than-Expected 225,000 Jobs, With a Boost From Warm Weather

An unseasonably mild January helped power the U.S. jobs market to more gains, with nonfarm payrolls rising 225,000 for the month, well above Wall Street estimates.

The unemployment rate ticked higher to 3.6%, but for the right reason as the labor force participation rate increased 0.2 percentage points to 63.4%, matching its highest level since June 2013, according to data released Friday by the Labor Department.

Economists surveyed by Dow Jones were looking for payroll growth of 158,000 and the jobless rate to stay at 3.5%, its lowest in more than 50 years.

A more encompassing labor market indicator that includes discouraged workers and those holding part-time positions for economic reasons also moved higher, rising 0.2 percentage points to 6.9%. The so-called real unemployment rate previously had been at its lowest level in the history of the data series.

However, the employment-to-population ratio in the household survey rose to 61.2%, its highest since November 2008 and 0.5 percentage points higher than a year ago.

The weather-sensitive construction industry helped led the way in job creation, adding 44,000 positions, well above its 2019 average of 12,000.

Manufacturing, which has been in a months-long slump, saw a loss of 12,000 positions, owing almost completely to a drop in motor vehicles and parts.

Leisure and hospitality, another sector also impacted by weather, added 36,000, as did health care. Professional and business services grew by 21,000, bringing to 390,000 the number of jobs the sector has added. Transportation and warehousing increased by 28,000.

Despite the strong numbers, markets reacted negatively with the Dow Jones Industrial Average indicating a drop of more than 100 points at the open.

“The report is unambiguously good,” said Ed Campbell, portfolio manager at QMA. “Strong growth and decent but not runaway wage growth should be good for stocks. Of course, we’ve had such a strong week, the markets are taking this in stride given how much we’ve been up so far.”

There was more good news for workers: Average hourly earnings rose 3.1% over a year ago to $28.44, ahead of estimates for 3% growth. That marked 18 consecutive months of wage gains above 3%, as the initially reported 2.9% for December was revised up to 3%.

The average work week was unchanged at 34.3 hours.

Previous months’ revisions also gave a slight boost to the jobs count. November’s estimate rose 5,000 to 261,000 while December was moved up 2,000 to 147,000.

“Weekly hours worked remain worryingly low,” said Julia Pollak, labor economist at online jobs marketplace ZipRecruiter. “That is a problem because many workers are struggling to find jobs that will schedule them to work enough hours so they can make ends meet. It could also be a sign that employers are concerned about the possibility that demand for goods and services might weaken in the coming months.”

There was one piece of bad news as well pertaining to benchmark revisions the department incorporates into its historical count. This year showed a decline in the total nonfarm employment for the year ending March 2019 of 514,000. That was a bit higher than the 500,000 that economists had expected and were indicated back in August. ***Continue reading: CNBC, 2/7/2020***

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MARKET INSIGHT

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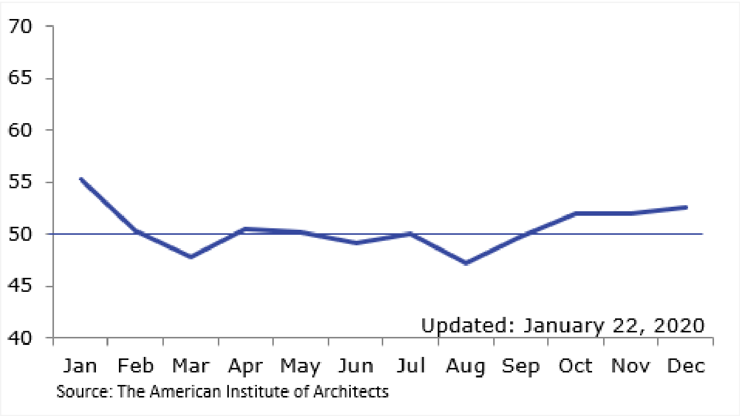
KEY ECONOMIC INDICATORS

ARCHITECTURE BILLINGS INDEX (ABI)

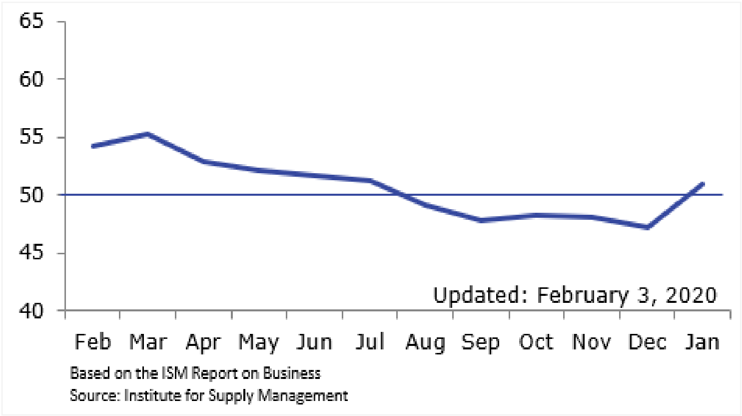


The Architecture Billings Index (ABI) registered a score of 52.5 for the month of December, up from 51.9 in November and 52.0 in October. According to how the index is tabulated, any score above 50.0 indicates an increase in the demand for design services, while a score below 50 indicates a decline in demand. The three-month growth spurt follows contractions that took place over the summer, when the ABI scored 49.7 in September and 47.2 in August.

December's positive score was fueled by growth in both new project inquiries and design contract executions, which surged to show scores of 58.7 and 53.4, respectively. It appears the mid-year slump was likely due to a spate of economic shock that took shape as the Trump administration's trade wars with China and the European Union hit a fever pitch. Trade tensions have lessened comparatively in recent months as uncertainty over issues like Brexit and economic brinksmanship has lessened.

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, 1/22/2020***

PURCHASING MANAGERS INDEX®



The January PMI® registered 50.9 percent, an increase of 3.1 percentage points from the seasonally adjusted December reading of 47.8 percent. The New Orders Index registered 52 percent, an increase of 4.4 percentage points from the seasonally adjusted December reading of 47.6 percent. The Production Index registered 54.3 percent, up 9.5 percentage points compared to the seasonally adjusted December reading of 44.8 percent. The Backlog of Orders Index registered 45.7 percent, up 2.4 percentage points compared to the December reading of 43.3 percent. The Employment Index registered 46.6 percent, a 1.4-percentage point increase from the seasonally adjusted December reading of 45.2 percent. The Inventories Index registered 48.8 percent, a decrease of 0.4 percentage point from the seasonally adjusted December reading of 49.2 percent. The Prices Index registered 53.3 percent, a 1.6-percentage point increase from the December reading of 51.7 percent. The New Export Orders Index registered 53.3 percent, a 6-percentage point increase from the December reading of 47.3 percent. The Imports Index registered 51.3 percent, a 2.5-percentage point increase from the December reading of 48.8 percent.

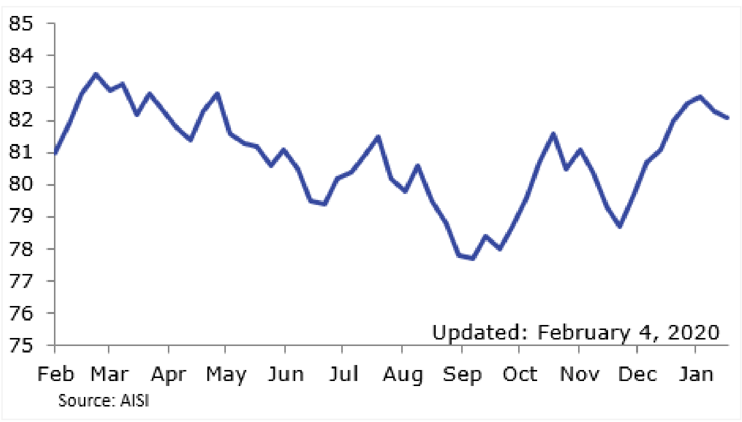
THE PURCHASING MANAGERS INDEX® is based on a monthly survey sent to senior executives at more than 400 companies. A PMI above 50 represents an expansion when compared to the previous month. The further from 50, the greater the change. ***Source: Institute for Supply Management, 2/3/2020***

RAW STEEL PRODUCTION

In the week ending on February 1, 2020, domestic raw steel production was 1,914,000 net tons while the capability utilization rate was 82.1 percent. Production was 1,878,000 net tons in the week ending February 1, 2019 while the capability utilization then was 80.7 percent. The current week production represents a 1.9 percent increase from the same period in the previous year. Production for the week ending February 1, 2020 is down 0.3 percent from the previous week ending January 25, 2020 when production was 1,919,000 net tons and the rate of capability utilization was 82.3 percent.

Adjusted year-to-date production through February 1, 2020 was 8,769,000 net tons, at a capability utilization rate of 82.3 percent. That is up 2.4 percent from the 8,561,000 net tons during the same period last year, when the capability utilization rate was 80.4 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, 2/4/2020***



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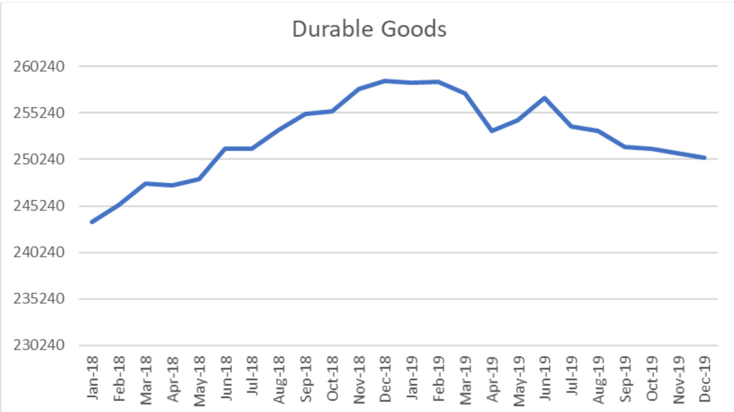
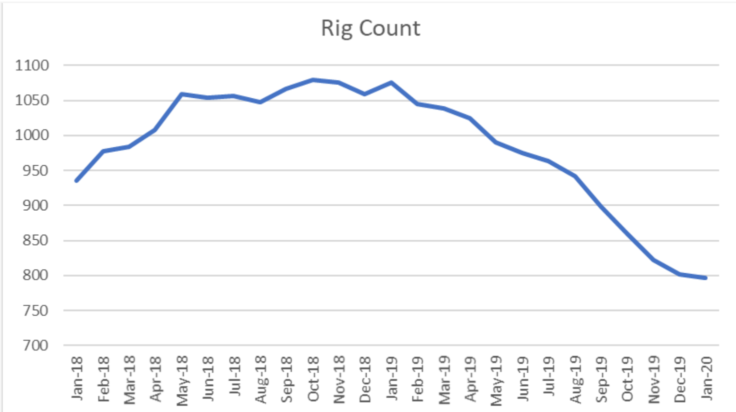
KEY ECONOMIC INDICATORS

DURABLE GOODS



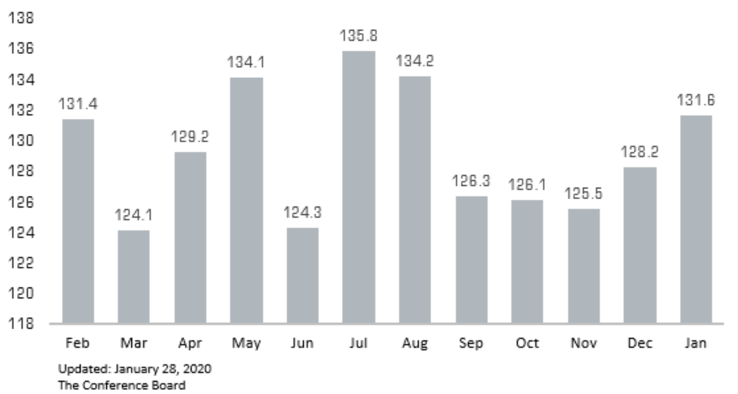
Durable Goods new orders perked up in December, rising 2.4%, and led by an increase in defense spending. While economists were quick to point out that this did not reflect a broad expansion across the manufacturing sector, the passage of a government funding package, the signing of the USMCA, a phase 1 China-US trade agreement all will help improve business investment. Other forward-looking indicators also reflect a turnaround, with projected durable goods orders increasing by Q2 2020. ***Source: U.S. Census Bureau, 1/28/2020***

ENERGY SECTOR



The Baker Hughes rig count is down about 20% compared to a year ago, experiencing a steady decline since January, 2019. However, although exploration has slowed, oil production has continued to increase to the point that the US is effectively energy independent; and in fact, was a net exporter of petroleum in September 2019. U S Crude oil production should average 8% higher in 2020 than 2019. Both oil and gas prices are expected to remain fairly steady in 2020. Renewable energy, (wind, hydro, solar) will become 1/5 of the total electricity produced this year. ***Source: Baker Hughes, 1/31/2020***

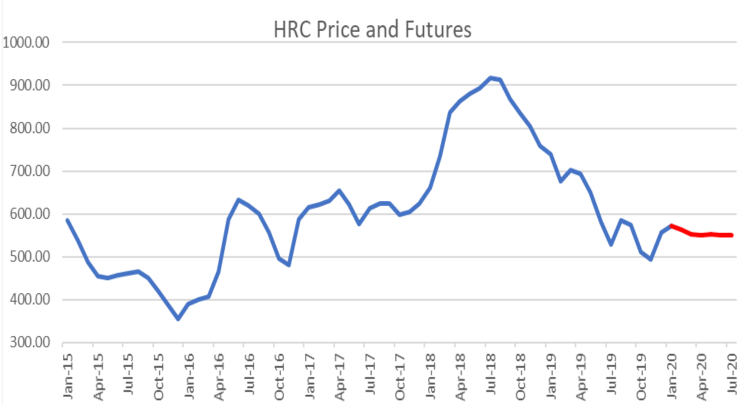
CONSUMER CONFIDENCE



The Conference Board Consumer Confidence Index® increased in January, following a moderate increase in December. The Index now stands at 131.6, up from 128.2 (an upward revision) in December. The Present Situation Index – based on consumers' assessment of current business and labor market conditions – increased from 170.5 to 175.3. The Expectations Index – based on consumers' short-term outlook for income, business and labor market conditions – increased from 100.0 last month to 102.5 this month.

Consumer confidence increased in January, following a moderate advance in December, driven primarily by a more positive assessment of the current job market and increased optimism about future job prospects. ***Source: Conference Board, 1/28/2020***

HOT ROLLED COIL MARKET



After hitting a low in the mid $400's in late October, HRC pricing recovered steadily through the fourth quarter of 2019 into 2020, gaining over 30% through the 4th week of January before stalling. Currently, although imports are no affecting hot roll pricing, weak raw material prices (bushelling is selling around $75/ton less than a year ago) and high capacity utilization (around 83%) and making it hard for the mills to collect higher prices. Mill lead times are no longer extending out and some mills now are back to 4-week lead times for hot roll black. Demand is reported as being good with some demand indices reporting numbers as high as late Q2, 2018. A February price correction is normal in the steel cycle and the balance between demand and supply will determine the direction pricing goes in March.

INDUSTRY NEWS

WILL STEEL DEMAND OUTWEIGH FEB SCRAP FALL?

Market participants and analysts have mixed views about whether end market demand in the United States is sufficient to sustain the upward momentum in steel prices over the past few months.

After slumping for most of 2019, US hot-rolled coil and reinforcing bar spot prices rebounded late last year and into January 2020.

Despite the gains, concerns persist about whether end market demand is strong enough to shore up spot prices due to the possible downturn in ferrous scrap in February trade, with various analysts projecting a $10-25-per-gross-ton decline, depending on the grade.

Is demand strong enough?

“We saw a lot of deterioration in US steel demand throughout the fourth quarter in most of the large steel-consuming segments, including construction,” UBS analyst Andreas Bokkenheuser told Fastmarkets on January 27. “We’re still seeing weakness in autos... [and] some weakness in construction, and that’s obviously the bulk of US steel demand.”

Non-residential spending, the dominant steel-consuming segment of construction, is key to evaluating the true strength of construction demand, he said. And when evaluating non-residential construction spending growth, construction cost inflation must be considered.

“So if those numbers are growing by a couple of percent or slightly more, and one considers 3-5% construction cost inflation, then the real activity is effectively flat to down,” Bokkenheuser said. “So adjusted for construction cost inflation, it does suggest that there is some weakness. Some of it would obviously be seasonal, but seeing that a lot of this is year on year it is probably a little bit more than seasonality.”

Non-residential building starts declined by 20% in December versus November, while non-residential building starts for 2019 fell by 1% year on year, a Dodge Data & Analytics report said.

In automotive, vehicle sales are projected to fall by 0.6% year on year to 1.1 million units in January, J.D. Power and LMC Automotive said in a joint forecast. Full-year sales are projected to fall by 212,000 units to 16.8 million units this year versus 2019.

But Fort Wayne, Indiana-based Steel Dynamics Inc (SDI) laid out a starkly different outlook.

SDI president and chief executive officer Mark Millett told analysts in a fourth-quarter 2019 earnings call that the two principle flat-rolled markets - automotive and construction, representing 60-70% of the steel market - are in great shape, citing “incredibly strong” backlogs.

Executives from Nucor and U.S. Steel Corp were also optimistic about demand.

"We see stable or growing end-use markets, accounting for approximately 70% of our shipments," Nucor chief financial officer, treasurer and executive vice president James Frias told analysts, noting that non-residential construction market strength is expected to continue into 2020.

U.S. Steel CEO David Burritt noted during an earnings call that the Pittsburgh-based steelmaker's flat-rolled order book is healthy and customer interaction suggests demand should be solid, citing continued strength in construction and automotive demand.

Bokkenheuser suggested domestic producers' views on current demand strength might be a function of inorganic growth.

“There is rhetoric from select producers talking about strong order books, but it’s not entirely easy to get a sense of how much of that is actually a market share plan and how much... is end demand growing,” he said. “We’ve seen the [electric-arc furnace producers] capture more market share for several decades now, so they tend to have growing sales even when end demand isn’t growing.”

One flat-rolled mill source agreed.

"It doesn't feel like [demand is] extraordinarily strong in the marketplace," he said, citing weakness it automotive, agriculture and limited opportunities for spot sales.

John Deere expects US and Canadian agricultural equipment sales to decline by 5% due to slackening demand for large equipment, it said in its fourth-quarter earnings report.

And as of January 31, there were 790 active drill rigs in the US, down by 24.4% from 1,045 rigs at the same time last year. This indicates ongoing softness in the oil and gas markets.

Flat-rolled market participants offered a similarly circumspect view on demand.

“We don’t see any unusual strength in any given market sector, more of the same really,” a Midwest service center said. “We think the market will stall as soon as scrap turns sideways or down. This market cannot support [the high prices] based on current demand.”

Bokkenheuser agreed, attributing higher steel prices mostly to ferrous scrap gains from November to January. But with the downward pressure looming for February and mild winter weather yielding smooth scrap flows, he expects that to weigh on both scrap and finished steel prices in February and March.

Moreover, demand for ferrous scrap from overseas has waned.

INDUSTRY NEWS

"My belief remains that the rather significant increases in domestic prices will lose some of their air since fundamental demand remains cautious and uncertain. As long as that cloud hangs over the marketplace, buyers will be careful about inventory control... My read is [the first quarter] will remain positive for the domestic mills, but going into [the second quarter] imports will take some market share back," a Gulf Coast trader said.

Scrap may halt gains in long products

US long product market sources suggested that spot prices could weaken due to the potential scrap decline and ongoing tepid demand.

"The fabricators are hearing from their mill suppliers what they interpret as a little bit of concern that the price increase that they already put out isn't going to stick," Independent Steel Alliance executive director Chris Casey said. "There's a feeling that there's going to be some softness in pricing that's largely driven by scrap."

Further pressure could come from attractively priced foreign material, he added.

A fabricator in an import-sensitive market also said more competitive pricing has emerged on imported rebar.

A rebar buyer noted somewhat flat demand, "but backlogs are still strong and I think we can expect pricing to remain somewhat stable. I expect [pricing] to retract back to pre-increase levels in February with scrap coming back down. Our fabrication backlog remains strong but our resell/distribution business has been weak."

A long products mill source said rebar prices should be resilient enough to withstand moderate downward pressure from declining raw material costs.

"Scrap going down should not have a negative effect, at least for the first month or so," this source said. "If we see scrap continuing to go down there will certainly be pressure, but if demand is strong pricing should be able to hold up. All of this is contingent on the weakest link in the supply chain." ***Source: AMM, February 3, 2020***

Steel industry hopeful about new North American trade deal

U.S. steelmakers are optimistic about the new United States-Mexico-Canada Agreement, which they said should benefit the domestic steel industry.

The trade deal that replaces the North American Free Trade Agreement incentivizes the use of steel made in North America for a variety of products, including cars, auto parts and tube. It imposes new safeguards against steel dumping and stronger rules on what percentage of a vehicle needs to be made in North America.

"USMCA will help create jobs and foster investment in manufacturing, including strengthening our steel industry supply chains with key customers by incentivizing the use of North American steel in manufactured goods," American Iron and Steel Institute President and CEO Thomas Gibson said.

An estimated 90% of exports from U.S. mills go to Canada and Mexico, where the automotive industry often crosses national borders.

"In addition, USMCA promotes increased cooperation and information sharing among the North American government to address circumvention and evasion of trade remedy orders," Gibson said. "This will enhance the ability of our three countries to continue to work together to address the surges of dumped and subsidized steel imports that have plagued the North American steel market. These are all tremendous positive developments for the steel industry."

U.S. Steel President and CEO David Burritt said fair trade is necessary for the health of manufacturing in North America.

"We applaud this example of elected leaders from both parties working together in an effort to support American jobs, industry, and the economy," Burritt said.

But after U.S. Steel lost $642 million last year, Burritt said more action was needed to help the domestic steel industry.

"There is nothing I would like better than to see this same spirit of cooperation focused on advancing an infrastructure investment bill that would restore our nation's preeminent capabilities," he said. "Imagine how every segment of our workforce and economy would flourish with revitalized infrastructure and the renewed manufacturing capabilities needed to support it."

But the new trade deal is a step in the right direction, said Philip Bell, president of the Steel Manufacturers Association.

"The USMCA succeeds in its goal of maintaining free trade between the three countries," Bell said. "This agreement provides strong provisions on new automobile manufacturing, rules of origin content requirements, trade enforcement, labor and the environment. The stronger definition of what constitutes North American steel will help ensure that more steel is made within the region." ***Source: The Times, February 4, 2020***