NIM
NORFOLK IRON & METAL
MARKET INSIGHT
March 2020

ECONOMIC NEWS

DATA SHOW U.S. ECONOMY ON SOLID FOOTING AS CORONAVIRUS FEARS MOUNT

U.S. services sector activity jumped to a one-year high in February, suggesting strength in the economy before a recent escalation of recession fears ignited by the coronavirus epidemic that prompted an emergency interest rate cut from the Federal Reserve.

The economy's solid fundamentals were also underscored by other data on Wednesday showing private payrolls increased more than expected in February, in part as unseasonably mild weather bolstered hiring at construction sites and in the leisure and hospitality industry. A report from the Fed described the economy as growing at "a modest to moderate rate over the past several weeks," but noted rising concerns over the coronavirus.

The U.S. central bank on Tuesday slashed its benchmark overnight interest rate by a half percentage point to a target range of 1.00% to 1.25%, in the Fed's first emergency rate cut since 2008 at the height of the financial crisis. Fed Chair Jerome Powell said, "The coronavirus poses evolving risks to economic activity."

"Going into any potential coronavirus slowdown, the economy is in good shape," said Joel Naroff, chief economist at Naroff Economics in Holland, Pennsylvania.

The Institute for Supply Management (ISM) said its non-manufacturing activity index increased to a reading of 57.3 last month, the highest level since February 2019, from 55.5 in January. A reading above 50 indicates expansion in the services sector, which accounts for more than two-thirds of U.S. economic activity. Economists polled by Reuters had forecast the index falling to a reading of 54.9 in February.

The ISM said services industries remained "positive about business conditions and the overall economy," but also noted that "most respondents are concerned about the coronavirus and its supply chain impact."

The fast-spreading coronavirus has killed more than 3,000 people and sickened at least 90,000, mostly in China. In the United States, 10 people have died from the respiratory disease called COVID-19 caused by the virus and the number of infections exceeded 100, raising awareness of the disease among Americans starting the last week of February.

Investors fear the coronavirus epidemic could derail the longest U.S. economic expansion in history, now in its 11th year, through disruptions to supply chains and exports. The damage to the services sector is expected to come mostly through the transportation and tourism industries. Economists expect the coronavirus to restrain economic growth in the first half of the year to around 1.0%. The economy grew 2.3% in 2019.

The ISM reported on Monday that the manufacturing sector barely grew in February, with several industries saying the flu-like virus was impacting their businesses. So far, however, the vast services sector and labor market appear to be weathering the coronavirus storm. **Source: Reuters *3/4/2020***

JOB GROWTH SMASHES EXPECTATIONS FOR FEBRUARY AS UNEMPLOYMENT FALLS BACK TO 3.5%

Nonfarm payrolls grew far more than expected in February as companies continued to hire leading into a growing coronavirus scare.

The Labor Department reported Friday that the U.S. economy added 273,000 new jobs during the month, while the unemployment rate was 3.5%, matching its lowest level in more than 50 years. An alternative measure of joblessness that counts those not looking for work and holding part-time jobs for economic reasons edged higher to 7%.

The January and February gains tied for best month since May 2018.

Economists surveyed by Dow Jones had been looking for payroll growth of 175,000 and a 3.5% jobless level. Average hourly earnings grew by 3% over the past year, in line with estimates, while the average work week, considered a key measure of productivity, nudged up to 34.4 hours.

There was more good news for the jobs market: The previous two months' estimates were revised higher by a total of 85,000. December moved up from 147,000 to 184,000, while January went from 225,000 to 273,000. Those revisions brought the three-month average up to a robust 243,000 while the average monthly gain in 2019 was 178,000.

Despite the strong numbers, Wall Street was heading for more losses stemming from worries over the effects of the coronoavirus outbreak, though Friday's futures were off their bottom after the report.

"This could be the last perfect employment report the market gets for some time," said Chris Rupkey, chief financial economist at MUFG Union Bank.

Gains were spread across a multitude of sectors as the total employment level hit 158.8 million, near its December 2019 record.

Health care and social assistance led the way in job creation with 57,000 new positions. Food services and drinking places both added 53,000 while government employment grew by 45,000 due to Census hiring and state government education. Construction added 42,000 thanks to continued mild weather, while professional and technical services contributed 32,000 and finance rose by 26,000, part of a 160,000 gain over the past 12 months.

In the survey of households, employment rose by 126,000 while the ranks of the unemployed decreased by 105,000.

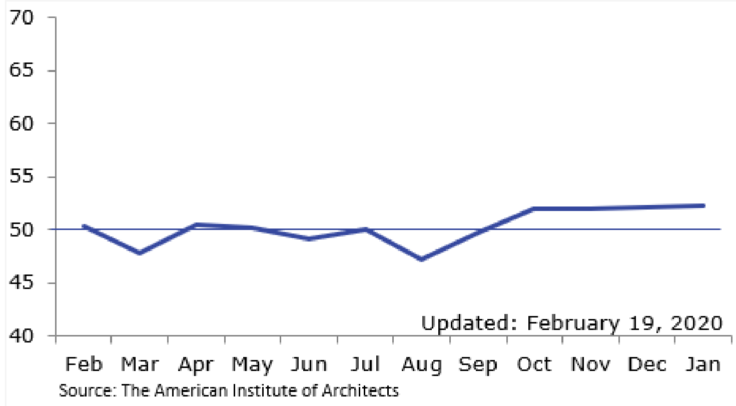
"While it's too early to see the impact of the coronavirus on the labor market, we can say the labor market was in a good place before the virus began to spread," said Nick Bunker, economic research director at job placement firm Indeed. "But the next few months will be a test of just how resilient this labor market is."

The jobs numbers took on particular importance in February as worries intensified over the economic impact from the novel coronavirus, though the report covered the time frame before worries over the disease intensified.

Most of the indicators thus far have shown little damage. Jobless claims remain well within their recent trend, coming in at 216,000 in the latest reading Thursday. ***Source: CNBC, 3/6/2020***

KEY ECONOMIC INDICATORS

Architecture Billings Index (ABI)

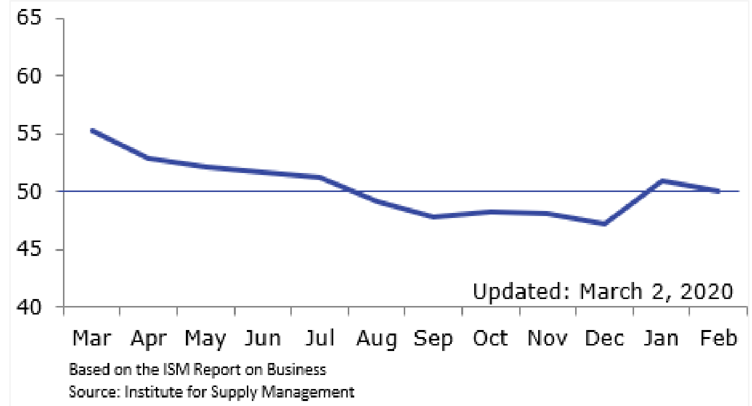


AIA's Architecture Billings Index (ABI) score of 52.2 for January compared to 52.1* in December reflects an increase in design services provided by U.S. architecture firms (any score above 50 indicates an increase in billings). Indicators of work in the pipeline, including new project inquiries and new design contracts remained positive, posting scores of 57.9 and 56.0 respectively.

"Despite the continued presence of volatility in the economy, design activity has begun to accelerate in recent months," said AIA Chief Economist, Kermit Baker, Hon. AIA, PhD. "Even with the ongoing challenges facing the nonresidential construction sector, this upturn points to at least modest growth over the coming year."

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, 2/19/2020***

Purchasing Managers Index®



The February PMI® registered 50.1 percent, down 0.8 percentage point from the January reading of 50.9 percent. The New Orders Index registered 49.8 percent, a decrease of 2.2 percentage points from the January reading of 52 percent. The Production Index registered 50.3 percent, down 4 percentage points compared to the January reading of 54.3 percent. The Backlog of Orders Index registered 50.3 percent, an increase of 4.6 percentage points compared to the January reading of 45.7 percent. The Employment Index registered 46.9 percent, an increase of 0.3 percentage point from the January reading of 46.6 percent. The Supplier Deliveries Index registered 57.3 percent, up 4.4 percentage points from the January reading of 52.9 percent. The Inventories Index registered 46.5 percent, 2.3 percentage points lower than the January reading of 48.8 percent. The Prices Index registered 45.9 percent, down 7.4 percentage points as compared to the January reading of 53.3 percent. The New Export Orders Index registered 51.2 percent, a decrease of 2.1 percentage points as compared to the January reading of 53.3 percent. The Imports Index registered 42.6 percent, an 8.7-percentage point decrease from the January reading of 51.3 percent.

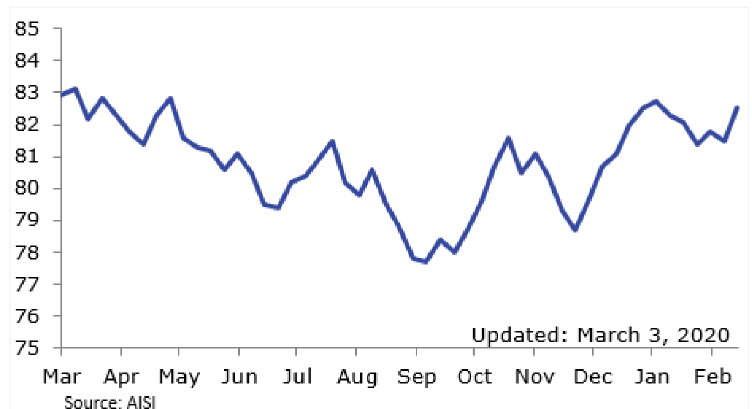
The Purchasing Managers Index® is based on a monthly survey sent to senior executives at more than 400 companies. A PMI above 50 represents an expansion when compared to the previous month. The further from 50, the greater the change. ***Source: Institute for Supply Management, 3/2/2020***

Raw Steel Production

In the week ending on February 29, 2020, domestic raw steel production was 1,923,000 net tons while the capability utilization rate was 82.5 percent. Production was 1,917,000 net tons in the week ending February 29, 2019 while the capability utilization then was 82.4 percent. The current week production represents a 0.3 percent increase from the same period in the previous year. Production for the week ending February 29, 2020 is up 1.2 percent from the previous week ending February 22, 2020 when production was 1,901,000 net tons and the rate of capability utilization was 81.5 percent.

Adjusted year-to-date production through February 29, 2020 was 16,350,000 net tons, at a capability utilization rate of 81.8 percent. That is up 0.8 percent from the 16,228,000 net tons during the same period last year, when the capability utilization rate was 81.3 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, 3/3/2020***



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INDUSTRY NEWS

Steel Stocks Are Bleeding: Will Coronavirus Bring More Pain?

Shares of U.S. steel companies are getting punished amid the coronavirus outbreak, which has been spreading fast outside China of late. The lethal respiratory virus has taken a heavy toll on most commodities due to a slowdown in demand in China – the world's biggest consumer of commodities – and steel is no exception.

Worries over a slump in steel demand in China, the top consumer, has caused a bloodbath in the steel space. The outbreak, which originated in the city of Wuhan in Hubei province, has triggered a broad-based sell-off in U.S. steel stocks. Shares of major American steel makers such as United States Steel Corp. X, Nucor Corporation NUE, Steel Dynamics, Inc. STLD and AK Steel Holding Corp AKS have sank roughly 28%, 24%, 20% and 29%, respectively, year to date.

Coronavirus fears have spooked global stock markets, as investors fret over the impact of the outbreak on global economic growth. Worries over a sharp rise in new coronavirus cases in South Korea, Italy and the West Asia, have triggered sell-offs across stock markets around the world on concerns over greater economic impact from the contagion. Mounting fears over the epidemic have also pushed all three major U.S. indexes into correction territory. Commodities also have been among the worst hit since the virus started spreading across the globe.

Another Shock to An Embattled Industry

Coronavirus has dealt a fresh blow to the U.S. steel industry which faced choppy waters in 2019. The American steel industry reeled under the effects of weaker steel prices, demand slowdown across major markets and damaging impacts of the trade war in 2019.

U.S. steel stocks had been out of favor for most part of 2019. With the exception of AK Steel, all other major American steel makers underperformed the broader market last year with U.S. Steel being the worst performer.

The slump in domestic steel prices has been the major headwind faced by U.S. steel makers in 2019. The Trump administration's imposition of 25% steel tariffs provided a shot in the arm to American steel makers last year and drove their earnings. However, after an initial tariff-induced rally, U.S. steel prices had been on a downswing and were down for much of 2019.

The benchmark hot-rolled coil steel (HRC) prices felt gravity's pull last year after rallying to multi-year highs on the back of steel tariffs during 2018. HRC prices dropped through the first three quarters of 2019.

Higher domestic supply resulting from a ramp up in production contributed to the sharp decline in U.S. steel prices in 2019. Driven by the tariff impetus, U.S. steel mills rushed to bring back capacity and drive production, leading to oversupply in the market.

The global economic downturn and softer steel demand are other key factors for the decline in prices. A slowdown in China's economy amid prolonged trade tensions with the United States triggered a slump in steel demand in China last year. Sluggish automotive and construction sectors also hurt steel demand in Europe, while demand in the United States was mostly hit by weakness in automotive.

Coronavirus Mars Industry's Slow Recovery

The U.S. steel industry witnessed some recovery in late 2019 on the back of an uptick in domestic steel prices, raising hopes for a reversal of fortunes in 2020. HRC prices gained some upward momentum in December, hitting $600 per short ton during the month on the heels of price hike actions by major U.S. steel mills and supply-side actions.

Shares of U.S. steel companies also gained some ground towards the end of 2019 on a recovery in steel prices. The de-escalation in trade tensions due to the announcement of the initial U.S.-China trade deal also provided a boost to shares of American steel makers. Driven by the gains in December, most of the U.S. steel stocks ended 2019 in the green.

However, coronavirus is likely to play spoilsport. China's economy is already feeling the pinch of the outbreak. Steel demand in China is expected to remain weak over the near term as the country struggles to cope with coronavirus.

The epidemic has slowed down activities in the construction space (a major steel end-use market) in China as workers who returned from the Lunar New Year holidays were being quarantined. Coronavirus-induced panic is also hurting China's already weakened automobile sector. The automotive industry, which consumes a big chunk of steel, is among the industries that has been hit the hardest.

Moreover, China's manufacturing sector, which bore the brunt of trade war for most part of 2019 and only rebounded toward the end of the year, is taking another shock. China's factory activity took a nosedive in February, plunging to an all-time low. The official manufacturing purchasing managers' index (PMI) tumbled to 35.7 for the month from 50.0 in January. A reading lower than 50 indicates a contraction in activity.

Manufacturing activities in the country have been disrupted due to the shutdowns imposed by the Chinese authorities. Factories in China are struggling to resume full operations due to shortage of workers resulting from virus-induced travel restrictions and disrupted supply chains and logistics.

The demand environment for steel in China is not expected to get better anytime soon as economic activities in the country are expected remain subdued amid the coronavirus plight. ArcelorMittal MT, a Zacks Rank #3

stock, envisions coronavirus to have a short-term negative impact on demand in China. The world's biggest steelmaker has seen its shares tumble around 17% so far this year.

Rising finished steel inventories have already put downward pressure on China's domestic steel prices of late (Read: China Drives World Steel Growth: Will Coronavirus Curb Output?). Weaker domestic steel demand would further hurt prices in China and globally.

U.S. steel prices also came under pressure over the past couple of months amid the virus crisis. Some of the U.S. steel makers have recently announced fresh rounds of price hikes. However, the current weak economic and demand situations in China do not look supportive for higher steel prices over the near term, thus limiting prospects of a rebound in American steel stocks. ***Source: Yahoo! Finance, March 3, 2020***

Steel leaders urge vigilance on 232 duties

Any weakening in the enforcement of the Section 232 tariffs on steel imports could lead to lower prices for steel commodities with seriously adverse effects on American producers, witnesses testified at a hearing of the Congressional Steel Caucus on Thursday March 5.

This is a particularly vulnerable time for the US steel industry, according to John Brett, president and chief executive officer of ArcelorMittal USA.

Weak US domestic demand for hot-rolled coil has sent prices lower than they were before the tariffs were imposed, making it more important that enforcement of the tariffs remain strong and consistent, Brett told the Congressional panel.

All eight witnesses who testified before the caucus about the state of the American steel industry provided a ringing endorsement of the duties.

"The Section 232 is serving a vital need and must be kept strong," Richard Fruehauf, senior vice president of strategic planning and chief strategy and development officer for U.S. Steel, said in his testimony. "A sudden weakening or dramatic change to the policy could result in a tidal wave of foreign steel swiftly undermining domestic production and jobs," he added.

The United Steelworkers Union's international president Tom Conway expressed concern that the administration might weaken the tariff enforcement for selected countries - such as Brazil and Argentina - and that Congress might take steps to limit 232 authority.

"Steel inventories held by Chinese traders are at their highest levels since May 2006," Conway warned. Given those inventories and more than 400 million tons of excess steel capacity globally, "it is impossible to see a decline of tariffs without significant job loss here in the US."

The Congressional Steel Caucus is chaired by Representative Conor Lamb (Democrat, Pennsylvania), who oversaw the hearing in conjunction with Representative Mike Bost (Republican, Illinois) and Representative Rick Crawford (Republican, Arkansas).

Crawford, in his opening remarks, noted that the import market share for steel in 2019 was at its lowest since the Great Recession.

"More aggressive trade enforcement has been effective in keeping unfairly traded imports out of the US market," Leon Topalian, president and chief investment officer of Nucor Corp, said.

Brett said that 21 million tons of finished steel was imported in 2019 - "the lowest level since 2010 and the lowest market share since 2003."

But despite the lower market share, now is no time to go wobbly, Brett said.

After a banner year in 2018, 2019 "took a challenging turn as consumption of our core products dropped by 4%," he continued, noting that "declines in auto product, service center purchases and construction all contributed to a drop in our business performance."

As a result, "average hot band prices plummeted by $230 per ton to a price lower than pre-Section 232 levels."

Brett argued that when the US economy is stronger than the global economy, steel imports flow into the country. He pointed to the Asian financial crisis of 1997 as an example: During that crisis, imports flooded into the United States, 33 steel companies filed for bankruptcy and thousands of American steelworkers lost their jobs, Brett claimed.

"I can safely say that having the Section 232 tariffs and quotas in place is more important than ever," he told the Congressional panel.

The United States-Mexico-Canada Agreement (USMCA) was roundly lauded for protecting the American steel industry from foreign imports that might be routed through Mexico or Canada into the US.

There were concerns, however, that importers were finding ways around 232 tariffs and the limits contained in USMCA.

"We are concerned about the recent surges of pipe and tube products into the US from Mexico," James Charmley, president and CEO of Bull Moose Tube and chairman of the Committee on Pipe and Tube Imports, said.

"If left unchecked, these imports could take an even greater share of the US market, resulting in job losses for domestic producers," Charmley warned.

Source: AMM, March 6, 2020