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NORFOLK IRON & METAL

MARKET INSIGHT

May 2020

ECONOMIC NEWS

Recovery Tracker: A Real-Time Look at the Post-Covid U.S. Economy

In a few short weeks, the coronavirus pandemic slammed the brakes on the U.S. economy, shuttering businesses and putting tens of millions out of work.

A U.S. recession is all but officially under way. The speed at which the economy has ground to a halt has rendered much of the traditional economic data — typically released with a lag of about a month — outdated before it's even published.

To fill the gap, Bloomberg economists Eliza Winger and Tom Orlik created a weekly dashboard of high frequency, alternative and market-based indicators. Right now, the dashboard shows the depths of the downturn. In the weeks ahead — as states move toward re-opening — it should capture the strength of the recovery.

Several of the dashboard's data points signal a deepening contraction, with further declines in consumer confidence and the number of active oil rigs. Others, like jobless claims, suggest the most extreme period of decline is now over, but remain extremely weak and support expectations for the economy to shrink this quarter by the most in records dating back to the 1940s.

"The high-frequency data paint a grim picture," Winger and Orlik said. "Soaring jobless claims, empty restaurants, and a falling count for active oil rigs show the breadth and depth of the blow to the economy."

Americans staying home for fear of transmitting the virus, along with government-ordered shutdowns aimed at protecting lives, have caused the economic downturn. That makes the number of new Covid-19 cases all the more important. That pace eased last week but it remains extremely elevated, and limited testing means the count almost certainly understates the true spread of the disease.

Filings for unemployment benefits (or initial jobless claims) remain extremely high but have fallen for four straight weeks — suggesting the breakneck pace of layoffs may be slowing. Unlike many government reports, jobless claims are reported with just a one-week lag. More than 30 million Americans filed for unemployment benefits since March 15, essentially wiping out all of the jobs created since the last recession.

The Bloomberg Consumer Comfort Index, a weekly confidence measure, has declined in 12 of the last 13 weeks. The measure has plummeted from 67.3 in the last week of January to 39.5, the steepest drop in more than three decades worth of data.

Crushed by the Saudi-Russia price war in March and government shutdowns that have kept Americans off the roads, oil prices have crumbled in recent weeks. The active oil rig count slumped 51% since the first two weeks of January, according to Baker Hughes data.

The housing market hasn't been spared either: Home sales are already down and are expected to crater in the coming months. A more real-time indicator, mortgage applications for home purchases, has fallen 27% since the first two weeks of the year.

Data from OpenTable, a restaurant-booking app, offer insight into the devastating blow faced by the restaurant industry: Restaurant bookings have dropped 99% from last year. Restaurants in some states opened their doors to customers last week, supporting the barest improvement in the figure from a 100% decline.

To view the live tracker, visit: *Bloomberg 5/4/2020*

U.S. employers cut a record 20.5 million payrolls, unemployment rate jumps to 14.7%

The U.S. economy shed a record 20.5 million payrolls in April and the unemployment rate jumped to 14.7%, as the coronavirus pandemic forced businesses across the country to temporarily shut down and lay off or furlough workers.

Estimates for April's change in non-farm payrolls and unemployment rate each spanned a wide range, as economists grappled with gauging the damage as businesses across the country had to cut jobs at a historic rate.

At 20.5 million, the actual decline in payrolls for the month was by far the worst on record, according to government monthly payrolls data spanning back to 1939. The worst fall in payrolls amid the global financial crisis was by 800,000 in March 2009.

April's decline follows March's downwardly revised payrolls drop of 870,000, which captured just the very start of the nationwide lockdowns and business closures, since the Labor Department uses the week of the 12th for its reference period.

The unemployment rate surged to 14.7% in April, representing both the largest one-month jump and highest level on record based on monthly Bureau of Labor Statistics (BLS) data spanning back to 1948. The monthly unemployment rate was estimated to have been about 25% at the peak of the Great Depression in 1933.

The jobless rate would have been nearly 5 percentage points higher, if workers were classified differently during the survey data collection, the BLS added in a note.

There was "a large increase in the number of workers who were classified as employed but absent from work," the BLS said. "As was the case in March, special instructions sent to household survey interviewers called for all employed persons absent from work due to coronavirus-related business closures to be classified as unemployed on temporary layoff. However, it is apparent that not all such workers were classified."

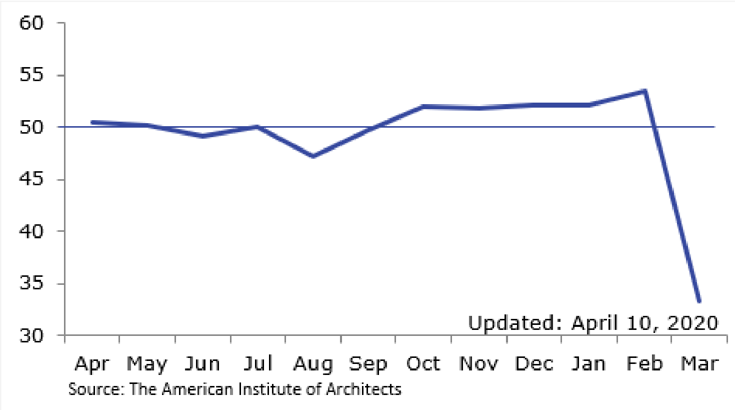
"If the workers who were recorded as employed but absent from work due to 'other reasons' (over and above the number absent for other reasons in a typical April) had been classified as unemployed on temporary layoff, the overall unemployment rate would have been almost 5 percentage points higher than reported (on a not seasonally adjusted basis)," it added.

The BLS's broader U-6 rate, or underemployment rate, jumped to 22.8% in April from 8.7% the prior month, capturing the percentage of those who became discouraged and stopped looking for a job as well as those working full-time but who wanted a full-time position. The labor force participation rate sank to 60.2%, the lowest since 1973.

Meanwhile, average hourly earnings rose well above consensus expectations both over last month and last year. Heading into the report, some economists had expected wage gains to come in at an even quicker clip than the median estimate suggested, "boosted by compositional effects as a result of the rapid destruction of low wage earners," Sam Bullard, Wells Fargo Securities senior economist, said in a note Thursday. ***Source: Yahoo! Finance, 5/8/2020***

KEY ECONOMIC INDICATORS

Architecture Billings Index (ABI)

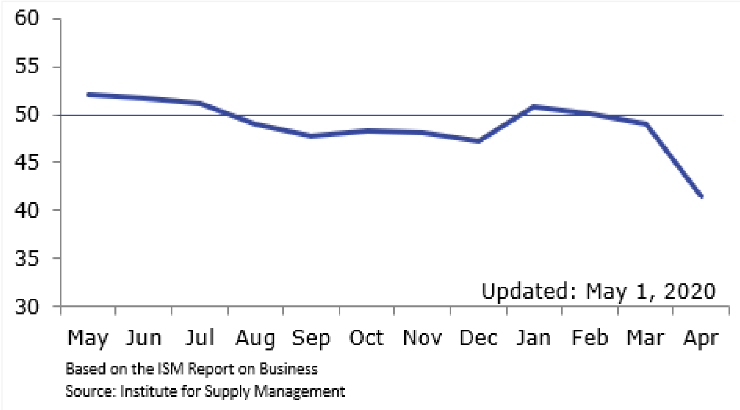


Billings at architecture firms plummeted in March as the Architecture Billings Index (ABI) fell by 20.1 points to a score of 33.3 for the month. This is by far the largest single month decline the index has seen in its nearly 25-year history, far surpassing the declines of 9.4 points seen at the start of the 2001 recession and 8.3 points seen at the start of the Great Recession. It reflects just how quickly business conditions have changed across the country and around the world in the last month as a result of the COVID-19 pandemic.

In addition, indicators of future work also declined at a staggering rate in March as uncertainty abounds. Inquiries into new projects fell particularly low, and while the value of new design contracts signed for the month did not fall quite as far as some projects that were in the works continued to move forward, that score was also extremely low. Firms also reported a sharp decline in their backlogs, from a near record high of 6.3 months at the start of the year to an average of 5.0 months at the end of the first quarter.

The **Architecture Billings Index (ABI)** is an economic indicator for nonresidential construction activity, with a lead time of approximately 9–12 months. 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, 4/10/2020***

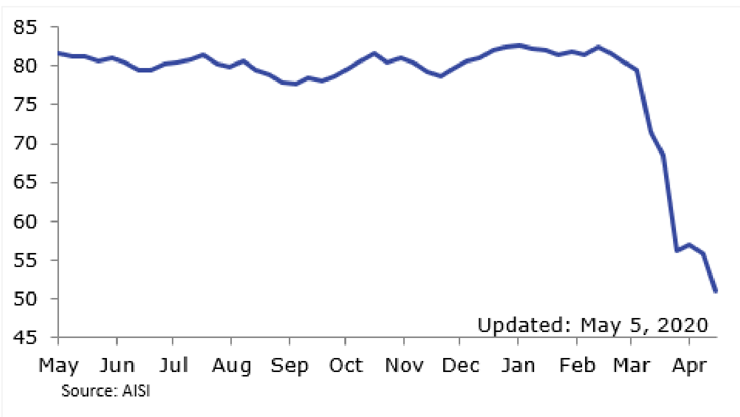
Purchasing Managers Index®



The April PMI® registered 41.5 percent, down 7.6 percentage points from the March reading of 49.1 percent. The New Orders Index registered 27.1 percent, a decrease of 15.1 percentage points from the March reading of 42.2 percent. The Production Index registered 27.5 percent, down 20.2 percentage points compared to the March reading of 47.7 percent. The Backlog of Orders Index registered 37.8 percent, a decrease of 8.1 percentage points compared to the March reading of 45.9 percent. The Employment Index registered 27.5 percent, a decrease of 16.3 percentage points from the March reading of 43.8 percent. The Supplier Deliveries Index registered 76 percent, up 11 percentage points from the March reading of 65 percent, limiting the decrease in the composite PMI®. The Inventories Index registered 49.7 percent; 2.8 percentage points higher than the March reading of 46.9 percent. The Prices Index registered 35.3 percent, down 2.1 percentage points compared to the March reading of 37.4 percent. The New Export Orders Index registered 35.3 percent, a decrease of 11.3 percentage points compared to the March reading of 46.6 percent. The Imports Index registered 42.7 percent, a 0.6-percentage point increase from the March reading of 42.1 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, 5/1/2020***

Raw Steel Production



In the week ending on May 2, 2020, domestic raw steel production was 1,144,000 net tons while the capability utilization rate was 51.1 percent. Production was 1,889,000 net tons in the week ending May 2, 2019 while the capability utilization then was 81.2 percent. The current week production represents a 39.4 percent decrease from the same period in the previous year. Production for the week ending May 2, 2020 is down 8.5 percent from the previous week ending April 25, 2020 when production was 1,250,000 net tons and the rate of capability utilization was 55.8 percent.

Adjusted year-to-date production through May 2, 2020 was 29,655,000 net tons, at a capability utilization rate of 73.2 percent. That is down 11.0 percent from the 33,338,000 net tons during the same period last year, when the capability utilization rate was 81.4 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, 5/5/2020***

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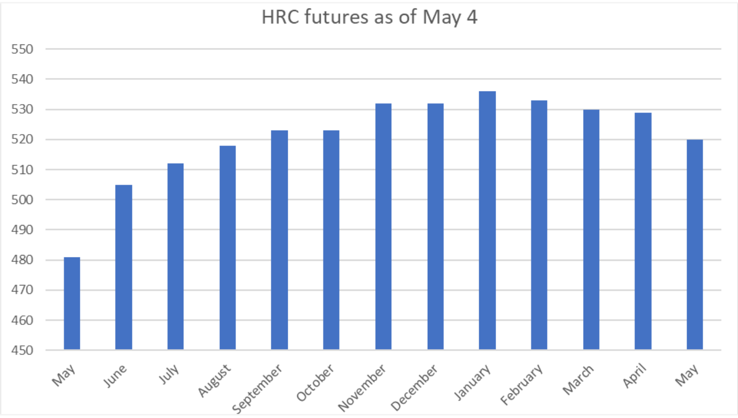
KEY ECONOMIC INDICATORS

Hot Rolled Coil Market

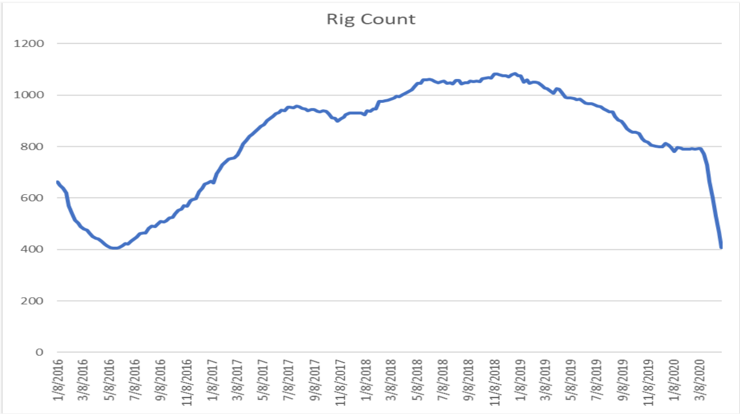


U S Hot Rolled coil prices reached their lowest levels in four years as they fell victim to the economic consequences of the Covid crisis. Large volume transactions during the last week of May dipped below $450/ton and prompted a series of price increase announcements by the mills. Whether these announcements will find legs or not depends on whether the tepid demand caused by auto company shutdowns, the energy sector imploding and “stay at home” orders shutting down construction will exceed the mills idling or blanking blast furnaces, extending tap times on electric arc furnaces and moving up maintenance outages to the tune of eliminating about 680,000 tons of melt per week.

Models indicate the break even point for EAF producers is in the low $400’s and for BF producers something above $450 so the under $450 price does represent a floor based on current scrap prices. If the May scrap market develops with a $20 to $40 increase in the EAF scrap blend, then look for the announced increases to reach the $500 threshold.

Of course, as consumers begin to venture out from their homes again, demand will begin slowly to increase and the mills will have to balance bringing capacity back on line to their desire to maintain pricing discipline.

Energy Sector



The energy market evaporated in late March and April as demand dropped more than 30% just as domestic supply peaked and Saudi Arabia and Russia decided to engage in an oil price war. The resulting carnage of spilling voluminous amounts of oil into a dried-up market collapsed oil prices and sent West Texas Intermediate oil prices negative for the first time in history on April 20th as traders couldn’t find storage for the produced oil and had to pay buyers to take it. WTI oil sank to a low of -$40.32 before rebounding slightly as the market closed. As the month of April closed production cutbacks have mitigated oil pricing negativity but WTI pricing and demand remains near historical lows.

U S producers continued to cut production in early May and WTI futures remain significantly depressed with May WTI trading under $20. And while demand is expected to pick up slowly during May as “stay at home” orders are relaxed, it is still unclear if the production cut-backs will be sufficient to stave off another price plunge before the May futures market settles. The current U S rig count has dropped into the low 400’s after peaking near 1100 in January of 2019. Until the economy improves to pre-Covid demand, look for oil to remain suppressed.

INDUSTRY NEWS

Covid-19 leaves ferrous correlations in disarray

The impact of Covid-19 is undeniably huge. It continues to make its presence felt across all commodity markets, including the ferrous supply chain - from raw materials down to finished steel products.

One significant impact that can be tracked closely through spot pricing is the increasing disarray in price correlations between various segments of the ferrous supply chain after the Covid-19 pandemic began.

A supply chain typically moves together in the same price cycle, allowing for time lags between raw materials input and finished product output amid fluid market conditions. The recycling of steel products back into the supply chain is another factor to consider in a price cycle.

This is especially so in the seaborne commodity market, which is exposed to differing levels of demand and supply in various regions compared with domestic markets that are more stable in terms of trade flows.

Fastmarkets takes a look at the following key benchmark prices in Asia to decipher the Covid-19 impact on the regional steel market.

- Premium hard coking coal, fob DBCT
- Iron ore 62% Fe fines, cfr Qingdao, $/tonne
- Steel reinforcing bar (rebar) index export, fob China main port
- Steel hot-rolled coil index export, fob main port China
- Steel scrap HMS 1&2 (80:20 mix) US material import, cfr main port Taiwan

Looking back at 2019

An analysis of these prices concluded that the strongest correlations in 2019 between prices for raw materials and those for finished steel for mills in Asia that operate blast furnaces were between coking coal and hot-rolled coil (0.85), and rebar (0.84).

Iron ore had a weaker correlation with finished steel, at 0.25 versus HRC and 0.37 for rebar last year.

This is not surprising, given the supply shocks in the seaborne iron ore market after the collapse of one of Vale's tailings dams in January and amid a flurry of other supply disruptions experienced by iron ore producers such as BHP.

In the electric-arc furnace (EAF) segment, scrap prices also showed a strong correlation with those for finished steel product such as HRC (0.89) and rebar (0.81).

Prices for finished steel products were good indicators for each other, with HRC and rebar tracking extremely closely, at 0.95.

Based on these, prices for coking coal and scrap were good indicators of steel prices in 2019. HRC and rebar were almost perfect substitutes for each other in terms of price trends.

The low correlation between iron ore and steel were because prices for the steelmaking raw material moved in the opposite direction of those for finished products during some parts of the year.

Fast-forward to first-quarter 2020

Looking at the same price matrix in the first quarter of 2020, the correlations seen in 2019 have either weakened or reversed.

In the blast furnace segment, prices for coking coal are now moving in the opposite direction of those for steel - at minus 0.44 for HRC and minus 0.56 for rebar. Coking coal's price correlation with iron ore is also at minus 0.10.

Covid-19 has arguably had the biggest effect on fob Australia prices for coking coal, with steelmakers around the world procuring less of the steelmaking raw material in light of worsening downstream demand for steel. This is due to many countries coming under some form of a lockdown to contain the spread of the virus.

Iron ore's correlation with finished steel improved to 0.54 versus HRC and 0.45 for rebar, although the sudden plunge experienced by steel prices in the first quarter have also outstripped iron ore price increases.

Along the EAF route, scrap's price correlation with HRC has held up, at 0.84.

But its price correlation with rebar has deteriorated to 0.62.

This is not surprising, given how rebar futures had supported physical prices in China while the scrap market was battered by tumbling global demand.

Meanwhile, the correlation between HRC and rebar has reduced further to 0.77.

This is largely due to rebar prices increasing strongly amid a bullish futures market and higher demand associated with a restart of China's massive construction industry.

Domestic rebar prices are now higher than those for HRC in China.

While these changes are interesting to see, for scrap the lack of any suggests it remains a good indicator for steel price trends.

One could look at scrap prices in times of high volatility to get a better handle on steel prices.

Incidentally, Fastmarkets launched several new scrap prices earlier this year to complement the existing assessments for Taiwan, Vietnam and China.

The expanded coverage now comprises Japan, Bangladesh and South Korea as well.

While the worst appears to be over for some countries such as Italy, where some semblance of normalcy has returned in terms of production, others such as India remain locked down.

There are doubts in the market about how high steel prices might go, particularly with the International Monetary Fund (IMF) revising its forecast for economic growth downward for countries across the world.

A V-shaped recovery by China will likely support steel prices, and by extension those for steelmaking raw materials. But if other economies contract significantly we will probably see another change in the price correlation between steel and steelmaking raw materials. ***Source: AMM, April 28, 2020***