Metalwest
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MARKET INSIGHT
August 2020

ECONOMIC NEWS

The U.S. Economy Has Seen The Bottom. Now How Will It Rise?

Weeks of record job losses have left the U.S. with unemployment rates not seen since the Great Depression. In the second quarter, the gross domestic product declined a shocking 33 percent. Every day clients ask us, "Have we seen a durable bottom in U.S. economic and stock markets?"

I am happy to tell them that, despite all the bad news, the leading economic indicators we track signal that yes, a durable economic and market bottom is in. The shortest recession in memory is over. While political wrangling and a wobbly economy driven by ongoing coronavirus fears could lead to periodic bouts of volatility, the backdrop for longer-term investors remains robust.

Now comes the longer economic recovery, shape to be determined – if COVID-19 cooperates.

Three components are necessary for a durable recovery. First, we need broad-based confidence – consumer, business and investor – to drive the economy forward. Next, we look for green shoots, signs beneath the surface that economic expansion is starting to take hold. Third, the alleviation of significant financial stresses. That entire progression happened over the second quarter.

The U.S. Federal Reserve's (Fed) quick and decisive actions more than restored market function and order. Financial conditions improved as liquidity was restored, primary capital markets re-opened and volatility declined. Thus, recovery is taking hold on Wall Street before Main Street.

Central banks have played a key role in shoring up and encouraging global equity markets, not only the Fed but the European Central Bank and others. We hope – and expect – that they will continue with these important actions.

Government stimulus has played an equally important role, worldwide, and continued Congressional action is clearly necessary. The amount of government support may be shrinking, but it is not going away entirely. Overall fiscal policy should remain accommodative through 2021 and become a modest headwind in 2022. Policymakers likely will continue to find ways to provide support to their constituents so long as COVID-19 remains a major economic threat.

Consumer behavior is not getting worse, which is also encouraging. Buoyed by rock bottom interest rates and the easing of lockdowns, the housing market is showing signs of life with solid improvement in housing starts in May and June.

The next few months could be choppy. The sudden increase of COVID-19 infections in the Sunbelt is a major public health concern.

The recession may be over, but the U.S. economy remains fragile. Recovery could be hard, and long. This will create both risks and opportunities for U.S. equity investors – if they are careful. With so much stimulus in the system, now could be a good time to consider adding exposure to value stocks, which have trailed growth significantly through the selloff and the rebound. Value could see a bid in the short term, especially if manufacturing PMI numbers continue to improve and yields start to climb. But we haven't seen enough progress to boost the U.S. economy out of its low growth trajectory, which means growth equities should continue to lead over the longer term. In sum, some moderate rebalancing from growth to value at this juncture makes sense. **Source: Forbes, August 5, 2020.**

July jobs report: Economy added back 1.763 million payrolls in July

The US economy regained fewer jobs in July after a record gain in June, as a resurgence of coronavirus cases in some states earlier this summer weighed on the labor market recovery. However, the number of jobs added topped estimates, and the unemployment rate fell more than expected.

The change in total non-farm payrolls for June was revised down slightly by 9,000 to 4.791 million, while May's payrolls were revised up by 26,000 to 2.725 million.

Contracts on the three major US stock indices pared overnight losses after the better-than-expected July print was released.

July marked the third straight month that the economy added jobs on net. However, even with the past several months of gains, the economy has not made up the entirety of the lost jobs since the start of the pandemic – especially after April's record drop of more than 20 million payrolls.

In July, the number of unemployed individuals on temporary layoffs fell by 1.3 million to 9.2 million. That was half of April's level, as Americans began returning to work following temporary virus-related business closures. However, the number of permanent job losers held steady in July over the prior month at 2.9 million, underscoring the longer-lasting impact to the labor market due to the pandemic.

The services sector again led non-farm payroll gains in July, after the services economy was cut deeply by shelter in place orders and business closures earlier on this year. The leisure and hospitality industry added back 592,000 jobs after gaining nearly 2 million in June, and retail trade jobs increased by 258,000 in July after a rise of more than 800,000 during the prior month.

Within services, information-related industries were the only group to shed jobs on net in July, losing 15,000. Within the goods-producing sector, mining and logging jobs fell by 7,000.

Government jobs rose by 301,000 in July, after an increase of 54,000 in June.

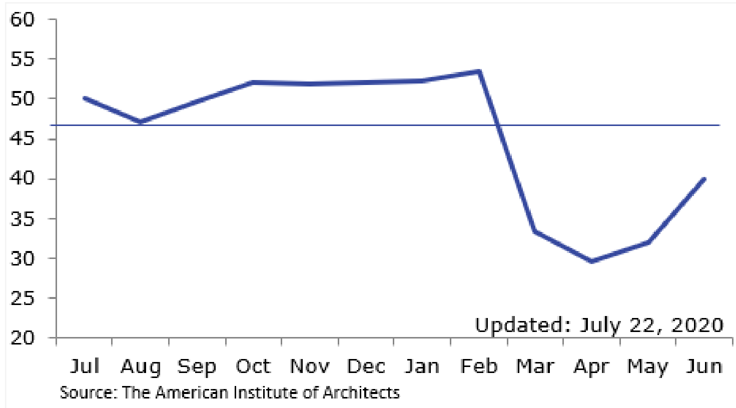
Elsewhere, the jobless rate improved by a greater than expected margin to 10.2% in July from 11.1% in June. However, the unemployment rate remained above the the Global Financial Crisis peak of 10.0%, and more than double the 3.5% rate from February before the spread of the pandemic in the U.S.

Average hourly wages unexpectedly rose on a month over month basis by 0.2%, following a revised 1.3% decline in June. Consensus economists had expected to see average hourly earnings moderate and decline 0.5% on a monthly basis, due to compositional effects as low-wage workers reentered the workforce following shutdowns.

As had been the case since the start of the pandemic, the dispersion among estimates for July's change in non-farm payrolls was elevated. **Continue reading: Yahoo! Finance, August 7, 2020.**

KEY ECONOMIC INDICATORS

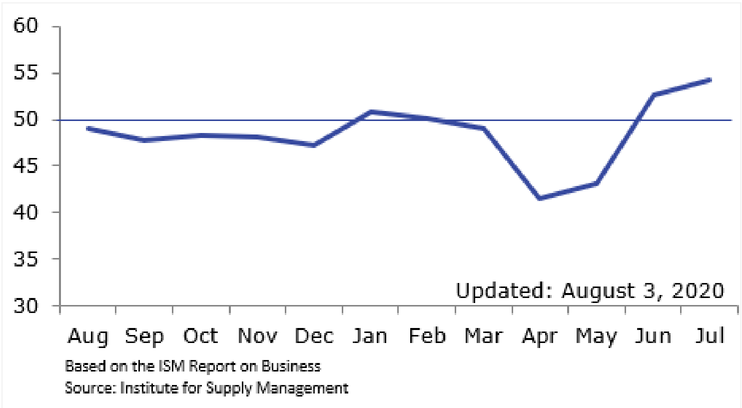
Architecture Billings Index (ABI)



Business conditions at architecture firms continued to stabilize in June, following their peak declines in April. While the ABI score of 40.0 for the month means that the majority of architecture firms still saw their billings decline from May to June, the pace of that decline slowed significantly. Inquiries into new work nearly returned to the positive in June, as clients began trying to restart projects. However, the value of new design contracts still lags behind, as many potential clients are price shopping to multiple firms but will ultimately only select one to work with. Firm backlogs also began to tick back up, rising from an average of 5.0 months in March to 5.3 months in June. While business conditions remained fairly soft at firms across the country, the pace of the decline in billings slowed at firms in all regions except the West, where billings declined at about the same pace as in May. By firm specialization, there was more of a disparity though, as firms with a commercial/industrial specialization continued to report very soft conditions, while firms with a multifamily residential specialization saw encouraging conditions, and came closer to seeing growth for the first time since January.

The **Architecture Billings Index (ABI)** is an economic indicator for nonresidential construction activity. An index score above 50 indicates an increase in firm billings, and a score below 50 indicates a decline in firm billings. *Source: **American Institute for AIA, 7/22/2020***

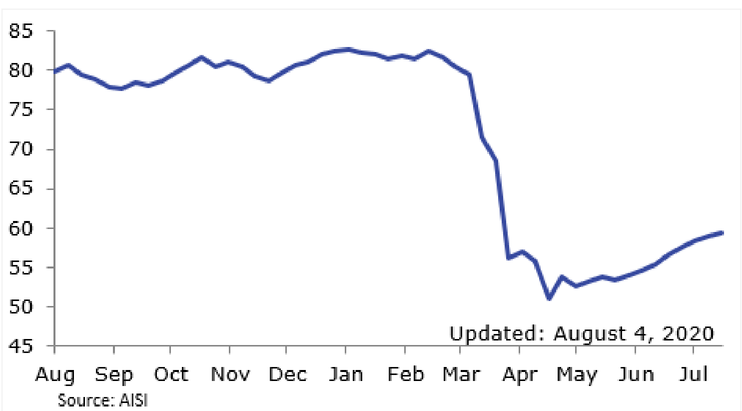
Purchasing Managers Index®



The July PMI® registered 54.2 percent, up 1.6 percentage points from the June reading of 52.6 percent. This figure indicates expansion in the overall economy for the third month in a row after a contraction in April, which ended a period of 131 consecutive months of growth. The New Orders Index registered 61.5 percent, an increase of 5.1 percentage points from the June reading of 56.4 percent. The Production Index registered 62.1 percent, up 4.8 percentage points compared to the June reading of 57.3 percent. The Backlog of Orders Index registered 51.8 percent, an increase of 6.5 percentage points compared to the June reading of 45.3 percent. The Employment Index registered 44.3 percent, an increase of 2.2 percentage points from the June reading of 42.1 percent. The Supplier Deliveries Index registered 55.8 percent, down 1.1 percentage points from the June figure of 56.9 percent. The Inventories Index registered 47 percent, 3.5 percentage points lower than the June reading of 50.5 percent. The Prices Index registered 53.2 percent, up 1.9 percentage points compared to the June reading of 51.3 percent. The New Export Orders Index registered 50.4 percent, an increase of 2.8 percentage points compared to the June reading of 47.6 percent. The Imports Index registered 53.1 percent, a 4.3-percentage point increase from the June 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, 8/3/2020***

Raw Steel Production



In the week ending on August 1, 2020, domestic raw steel production was 1,328,000 net tons while the capability utilization rate was 59.3 percent. Production was 1,846,000 net tons in the week ending August 1, 2019 while the capability utilization then was 79.3 percent. The current week production represents a 28.1 percent decrease from the same period in the previous year. Production for the week ending August 1, 2020 is up 0.6 percent from the previous week ending July 25, 2020 when production was 1,320,000 net tons and the rate of capability utilization was 58.9 percent.

Adjusted year-to-date production through August 1, 2020 was 46,102,000 net tons, at a capability utilization rate of 66.2 percent. That is down 19.9 percent from the 57,553,000 net tons during the same period last year, when the capability utilization rate was 80.9 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, 8/4/2020***

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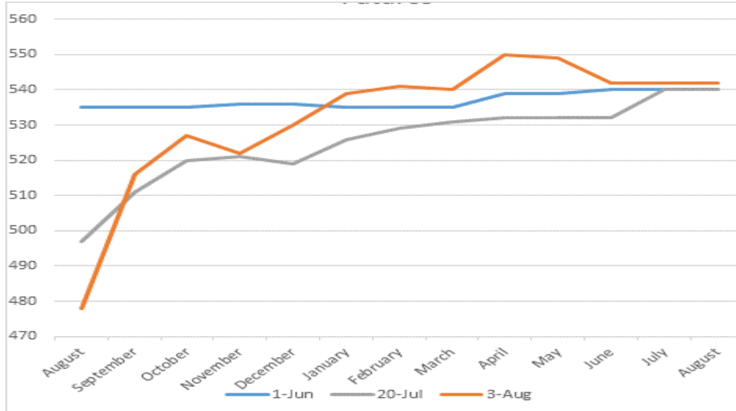
KEY ECONOMIC INDICATORS

FUTURES

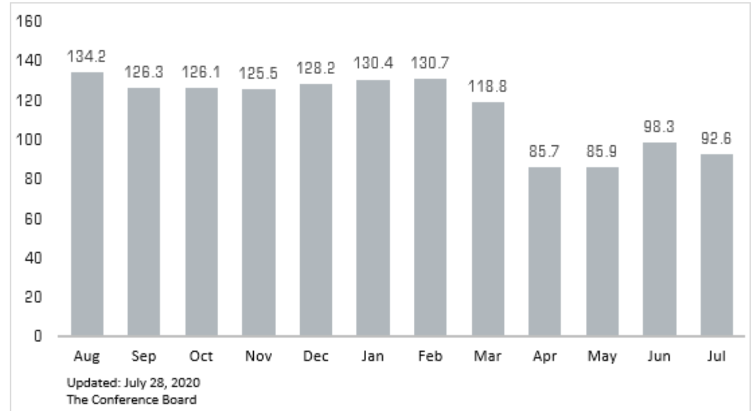


Hot Rolled steel price have approached a four year low in late July. While there is contention about whether or not the market has hit a low, it may depend on how the August scrap market settles, with preliminary trading suggesting that the market may settle down as much as $20 on prime grades.

Capacity utilization increases have outpaced demand increases and the COVID induced market collapse struggles to get back on its feet. Mill lead times are as low as 2 to 3 weeks on some EAF mills while integrated mills with idled blast furnaces have lead times stretching into mid-October.

Demand for construction remains a bright spot, and there is plenty of pent up demand in the auto sector, but assembly plants are trying to sort out international supply chain problems and are thus running well below capacity. This demand is sorely needed if the price of hot rolled is going to reverse course. U.S. Steel and other integrated producers did try to implement a $40 price increase but it fell flat as no EAF producers got on board. Additionally, U.S. prices have slipped below Chinese export prices causing some speculation of export opportunities.

CONSUMER CONFIDENCE



The Conference Board Consumer Confidence Index® decreased in July, after increasing in June. The Index now stands at 92.6 (1985=100), down from 98.3 in June. The Present Situation Index – based on consumers' assessment of current business and labor market conditions – improved from 86.7 to 94.2. However, the Expectations Index – based on consumers' short-term outlook for income, business, and labor market conditions – decreased from 106.1 in June to 91.5 this month.

"Consumer Confidence declined in July following a large gain in June," said Lynn Franco, Senior Director of Economic Indicators at The Conference Board. "The Present Situation Index improved, but the Expectations Index retreated. Large declines were experienced in Michigan, Florida, Texas and California, no doubt a result of the resurgence of COVID-19. Looking ahead, consumers have grown less optimistic about the short-term outlook for the economy and labor market and remain subdued about their financial prospects. Such uncertainty about the short-term future does not bode well for the recovery, nor for consumer spending."

The monthly **Consumer Confidence Survey®,** based on a probability-design random sample, is conducted for The Conference Board by Nielsen, a leading global provider of information and analytics around what consumers buy and watch. The cutoff date for the preliminary results was May 14. ***Source: The Conference Board, 7/28/2020***

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INDUSTRY NEWS

Finished steel imports plummet 26.2% in first half of year

Finished steel imports plunged 26.2% in the first half of 2020 after the worldwide coronavirus pandemic gutted demand.

The United States imported 1.39 million tons of steel in June, which was down 23% as compared to May, according to preliminary U.S. Census Bureau data. Finished steel imports fell 12.7% to 1.31 million tons.

Through the first six months of the year, steel imports have fallen 20.8% to 12.3 million tons, according to the Washington D.C.-based trade association American Iron and Steel Institute. Finished steel imports have plunged 26.2% to 8.6 million tons during that period as compared to the same time in 2019.

The United States is on pace to import 24.8 million tons of steel this year, including 17.3 million tons of steel that would require no further processing in America, such as at service centers or the steel companies operating at the Port of Indiana-Burns Harbor.

Steel imports have captured 19% of the U.S. market share so far this year, including 21% in June, according to the American Iron and Steel Institute.

In June, imports of line pipe rose by 30% and sheets and strip hot dipped galvanized by 23%.

The largest offshore suppliers of steel in June were South Korean, Japan, Turkey, Taiwan and Germany. So far this year, imports have fallen 23% from South Korea, 40% from Japan, 39% from Germany, and 36% from Taiwan. ***Source: The Times, August 4, 2020***

Section 232 likely to stay after US election

Section 232 tariffs on steel and aluminium imports into the United States will be difficult to unwind no matter who wins the presidential election in November, following domestic steelmakers' plans for new capacity that seeks to displace imports, according to a top executive at ArcelorMittal.

"From the American perspective, [Section 232] has been successful because it has spurred a lot of investment in the US steel industry, so to backtrack so quickly... would be difficult for either candidate in the White House," president and CFO Aditya Mittal said during the company's second-quarter earnings call on Thursday July 30. "In terms of our business, clearly we believe we're very cost competitive… and our focus remains to retain market share."

That extra capacity could pressure the Luxembourg-based steelmaker's margins, Mittal conceded.

That's a fair comment," he said. "But at the same time, as we mentioned earlier, we're very focused on making structural fixed cost savings, so clearly we will be reducing the cost base of our business, and so that should offset some of those pressures."

But it is difficult to "variabilize" fixed costs in the United States-Mexico-Canada Agreement due to the company's union employees, who have defined benefits such as pensions and healthcare, according to Mittal.

"Nevertheless, I do expect that, in the third quarter, the fixed-cost-per-ton rates in [the USMCA] will be stable," he said.

The world's largest steelmaker produced 3.7 million tonnes of crude steel in North America in the second quarter of 2020, down 33.8% from 5.59 million tonnes in the second quarter of 2019. It shipped 3.8 million tonnes of steel in the region, 30.2% lower than 5.44 million tonnes in the same comparison.

Quarterly average selling prices in the region dropped 6.3% year over year to $670 per ton ($33.50 per hundredweight) from $715 per ton, while quarterly sales plummeted 45.2% to $2.77 million from $5.06 million.

"When we look on a historical basis, spreads are very low," Mittal said about prices worldwide. "We've seen in the past that these levels of spreads do not last very long, but today we can see that these spreads are prevalent in the markets in which we operate."

He declined to provide guidance on which furnaces the company would bring back online following Covid-19-related idlings beyond those already announced.

The company expects demand to improve in the second half of this year following one of the most difficult periods in its history in the first half.

ArcelorMittal USA will indefinitely lay off 454 employees at its Cleveland operations beginning August 1, on top of furloughs announced earlier. ***Source: Yahoo! Finance, July 31, 2020***

U.S. oil & gas rig count holds steady at record low -Baker Hughes

U.S. energy firms kept the number of oil and natural gas rigs unchanged at a record low as the rig count fell for a fifth straight month, although July marked the smallest monthly decline due to a recovery in prices.

The rig count, an early indicator of future output, steadied at the all-time low of 251 in the week to July 31, according to data on Friday from energy services firm Baker Hughes Co going back to 1940.

Before this week, the count had hit all-time lows for 12 straight weeks. In July, drillers cut 14 rigs, putting the count down for a fifth month in a row, albeit the smallest cut since February before the coronavirus crisis hit oil demand.

U.S. oil rigs fell by one to 180 this week, while gas rigs rose one to 69. U.S. crude oil production plummeted a record 2 million barrels per day in May to 10 million bpd, the government said in a monthly report.

Exxon Mobil Corp slashed capital spending 30% this year to around $23 billion, and Senior Vice President Neil Chapman said it expects to spend less than $19 billion in next year. That would be the lowest spending for the company since at least 2005.

Even though U.S. oil prices are still down about 35% since the start of the year due to coronavirus demand destruction, U.S. West Texas Intermediate (WTI) crude futures have jumped 112% over the past three months to around $40 a barrel on Friday on hopes global economies and energy demand will snap back as governments lift lockdowns.

Analysts said higher oil prices will encourage energy firms to slow rig count reductions and possibly start adding some units later this year. ***Source: Reuters, July 31, 2020***