Third Quarter of 2019

METAL INDUSTRY REPORT

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Summary

METAL PRICES SET FOR MODEST IMPROVEMENT IN SECOND HALF OF 2019 AND 2020

- Global economies will continue to expand despite persistent headwinds in manufacturing weighing on metal demand.
- The outlook for U.S. construction remains solid, while domestic auto sales will recover in the second half of 2019.
- PNC expects the U.S. dollar to depreciate in the near term, a support to metal prices.

Growth in the U.S. remained solid in the first half of 2019, with the economy expanding at 3.2 percent in the first quarter from one year earlier, driven by gains in consumer spending, supported by a strong labor market. China, the world's largest steel producer, is experiencing slower industrial growth coupled with declining exports. The European Union is also facing drags from trade tensions and continued Brexit uncertainty. In other parts of the world, slower growth in China and trade anxiety have led to a decline in business sentiment and weaker growth in business spending. PNC expects the global expansion to continue at least into 2020, with the Federal Reserve cutting interest rates twice in the U.S. in the second half of this year, and monetary and fiscal stimulus supporting growth in foreign markets.

This steady outlook extends to the metal industry as PNC Economics forecasts solid domestic construction growth in 2019 and 2020. Fixed investment in residential and nonresidential structures was flat in the first quarter of 2019 but is set to grow by 2 percent in 2019 (Chart 2). Lower borrowing costs will support both sales of new homes and the ability of builders to fund construction in the second half of 2019. Businesses' investment in capital equipment will also grow a solid 3.3 percent in 2019. Auto sales slowed in the first half of 2019 after extremely strong demand in the past 5 years, rising interest rates and higher prices. However, a healthy U.S. economy, solid consumer balance sheets, low energy prices and lower financing costs from Fed rate cuts should support auto sales in the second half of 2019 (Chart 3).

Global oversupply has pressured metal prices in 2019. Global steel production was the highest in five years in May 2019 and global aluminum capacity in 2019 is forecast to be the highest since 2011, according to Bloomberg. U.S. steel prices fell through mid-2019, with the price of hot rolled coil steel down 34 percent in June from one year earlier, leading U.S. Steel to shut down two blast furnaces in the U.S. and one in Europe. Between when metal tariffs were announced in March 2018 and imports from Mexico and Canada exempted from them in May 2019, U.S. Steel stock lost about 70 percent of its market value. The persistent global manufacturing slump (Chart 1) will continue to pressure metal prices lower going forward.

With tariffs and trade tensions, steel imports made up just 19 percent of the U.S. market, near a decade-long low (Chart 4). In the first half of 2019, total and finished steel imports fell 9.0 percent and 16.2 percent, respectively, from the same period in 2018, according to the American Iron and Steel Institute. The U.S. government's waiver of tariffs on imports of steel and aluminum from Canada and Mexico should reduce aluminum prices as Canada is one of the largest sources of U.S. primary aluminum imports.

At the same time PNC expects the U.S. dollar to depreciate slightly in 2019 and 2020 (Chart 5). A weaker dollar will support metal prices in 2019 and 2020 as the greenback is the benchmark currency for most commodities. Bloomberg consensus forecasts and futures pricing call for modest price increases for hot rolled coil steel in 2019 and 2020 (Chart 6). Such forecasts assume that Chinese economic growth will stabilize and that the economic expansion will continue in countries with high steel demand. Similarly, the forecasts for nickel and aluminum anticipate modest price gains of less than one percent and one percent, respectively, by year-end of 2019 for both metals.

Chart 1: Global manufacturing headwinds continue

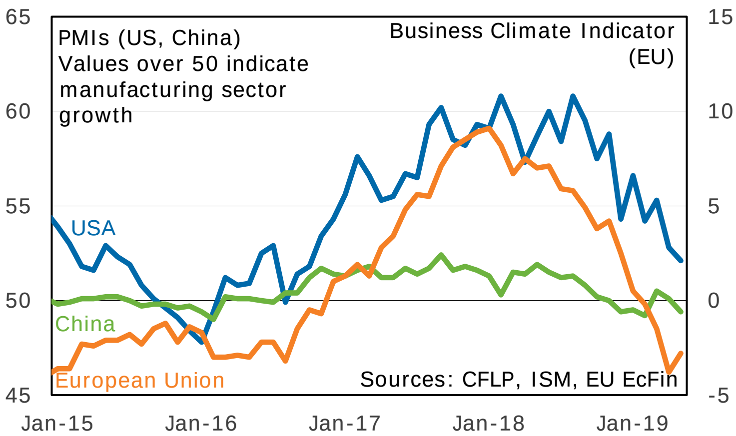


Chart 2: Construction-related steel demand to rise

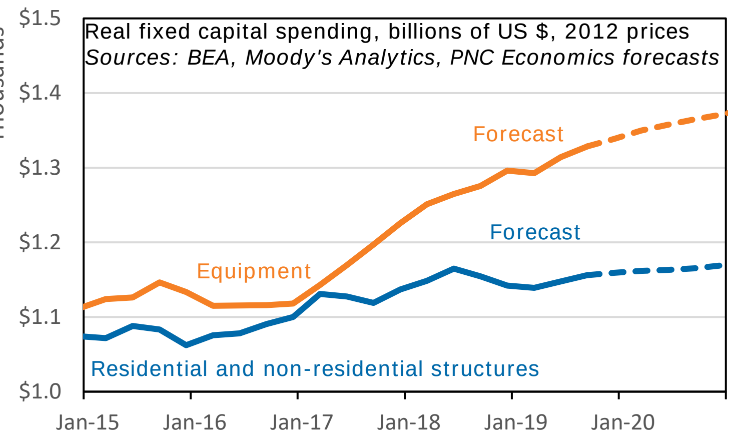


Chart 3: Auto sales decline to continue

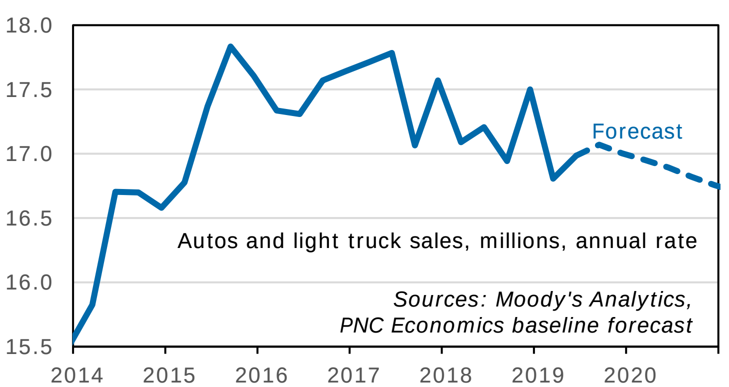


Chart 4: Foreign steel is losing market share

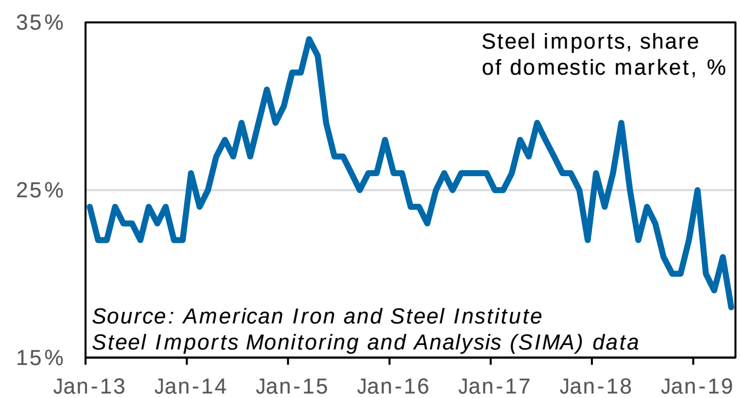


Chart 5: Weaker dollar will support metal prices

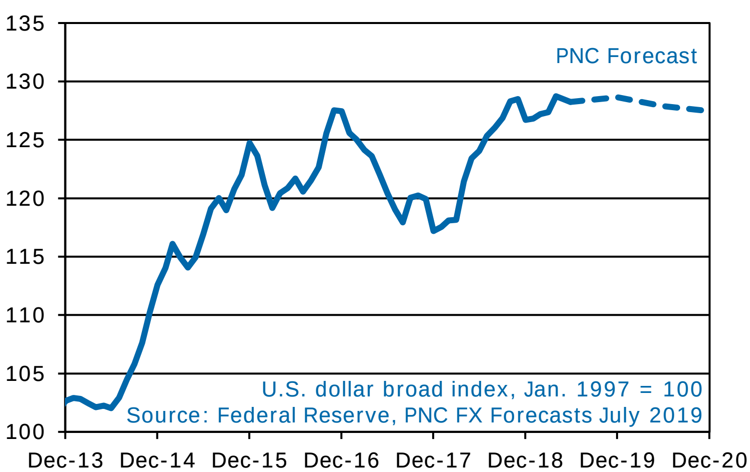
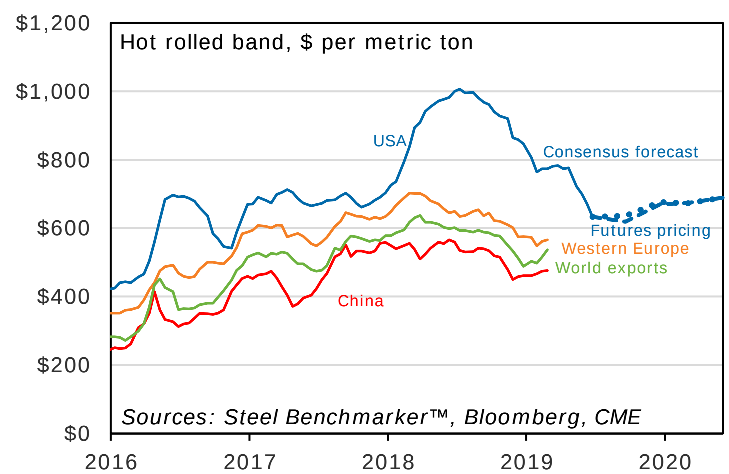


Chart 6: Forecasters predict low steel prices



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