First Quarter of 2019

METAL INDUSTRY REPORT

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Summary

WEAKER DOLLAR TO SUPPORT METAL PRICES AS ECONOMY SLOWS IN 2019 AND 2020

- US real GDP growth will cool to 2.6 percent in 2019 from 2.9 percent in 2018, and steel demand grow modestly.
- US metal producers' shipments will likely be flat on the year in 2019 as imports gain market share.
- The US dollar is forecast to depreciate, supporting metal prices.

Growth in the US and global economies shifted down a gear at the end of 2018 (Chart 1). In China, tight monetary policy, expiring subsidies for car purchases, and trade war fears have slowed growth. In the European Union, Brexit uncertainties, the Italian budget standoff, production disruptions in the German auto industry, and political turbulence in France and Italy fueled the slowdown. Elsewhere around the world, multinationals are delaying capex plans due to uncertainty about trade policy. In 2019, PNC expects many of these international headwinds to abate. Fiscal stimulus in the US, UK, France, Italy, China, and potentially Germany will keep the global economy expanding, albeit at a slower pace than in 2018.

In the US, demand from metal-intensive industries is set to grow, but more slowly than in 2018. Business capex growth has moderated after the one-off boost from the corporate tax cut faded, and after the drop in energy prices in late 2018, capital spending in energy extraction and support industries is falling. Business surveys by the Federal Reserve and private research companies show businesses tightly integrated into global supply chains are delaying capital spending plans until the outlook for US trade policy becomes clearer. In construction, both residential and nonresidential activity slowed in 2018, on the one hand held back by higher interest rates, which restrain demand, and on the other hand by higher construction costs and labor shortages, which limit supply (Chart 2). Auto sales are expected to dip again in 2019 from near-record levels in 2017 and 2018: Higher interest rates and lenders' less permissive credit standards will limit consumers' car buying power (Chart 3). The partial government shutdown will also reduce real GDP growth in the first quarter, but will affect metal demand less than real GDP, since most government activities are services-producing and not goods-producing. US real GDP growth will moderate to 2.6 percent in 2019 from 2.9 percent in 2018; demand for steel, aluminum, and nickel will likely grow by a similar amount.

However, metal imports will likely gain market share in 2019, keeping American steel producers' shipments flat in 2019 after growth of 4.7 percent in the year through November 2018, according to the American Iron and Steel Institute's statistics (December data were delayed by the government shutdown). Steel imports fell to 20 percent of total US demand in October and November 2018, the lowest since December 2012, as tariffs discouraged steel buyers from bringing foreign product onshore (Chart 4). But the premium of US steel prices above international export prices, at nearly 75 percent, is so wide that a rise in the import share of US steel consumption is extremely likely.

At the same time, the US dollar is forecast to depreciate by mid-single digits in 2019 and 2020 (Chart 5). Larger US fiscal deficits will in turn fuel a larger trade deficit—the fiscal and trade deficits are so closely linked that economists refer to them as the "twin deficits," and increasing trade deficits are often a driver of currency depreciation. Slower US economic growth as fiscal stimulus fades, and the end of the Fed's rate hike cycle, will also tarnish the dollar's 2018 glow. This may be why metal forecasters' expectations for realized steel prices in 2019 are above futures prices (Chart 6). Similarly, the consensus forecasts for nickel and aluminum prices anticipate price gains of 15-21 percent by year-end 2019, much more than the 2-4 percent price increases implied by futures contracts.

Chart 1: Global manufacturing began to slow in 2018

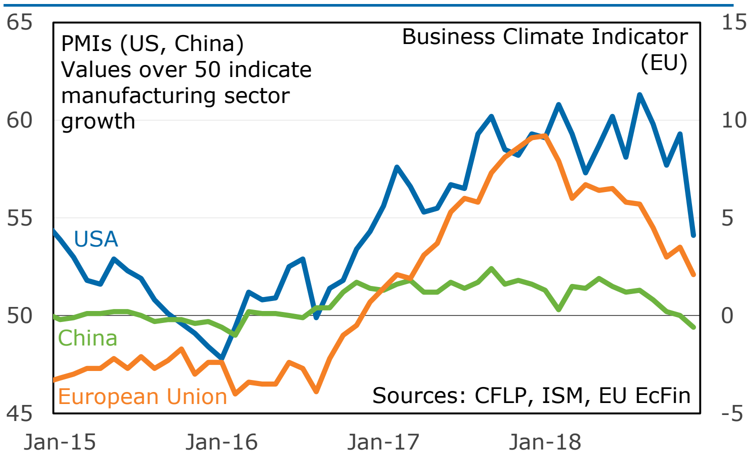


Chart 2: Construction and capex demand moderating

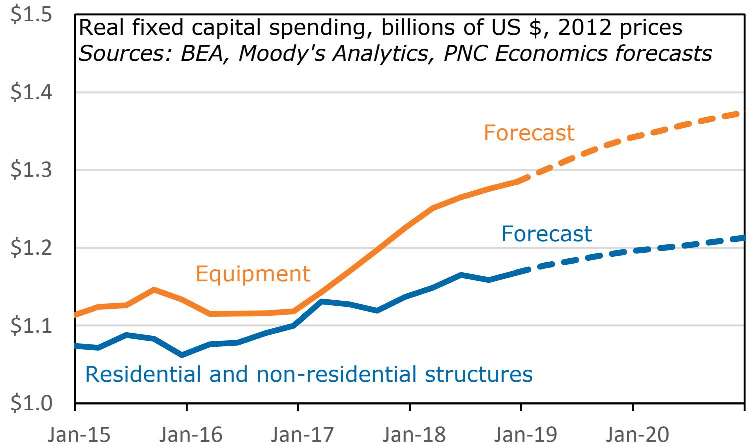


Chart 3: Auto sales headed lower

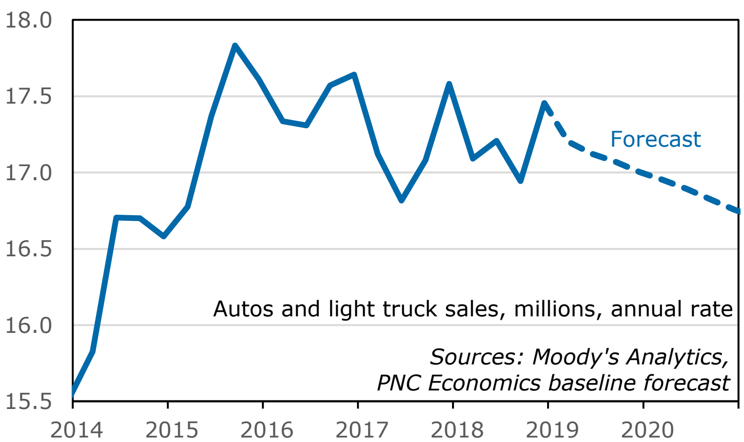


Chart 4: Steel import market share to normalize higher

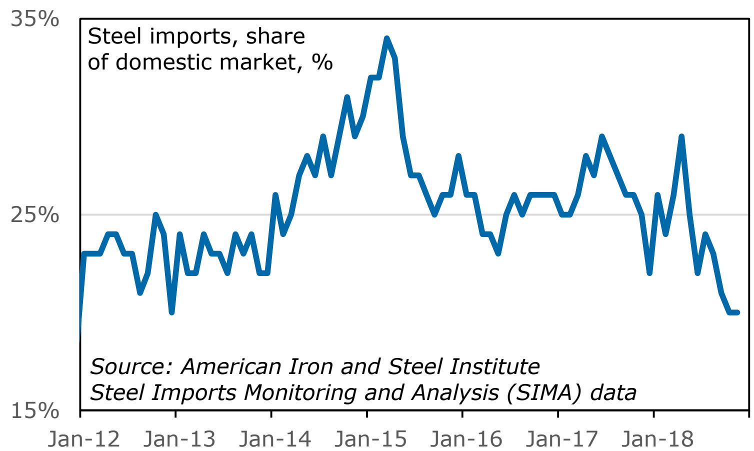


Chart 5: A weaker dollar will support metal prices

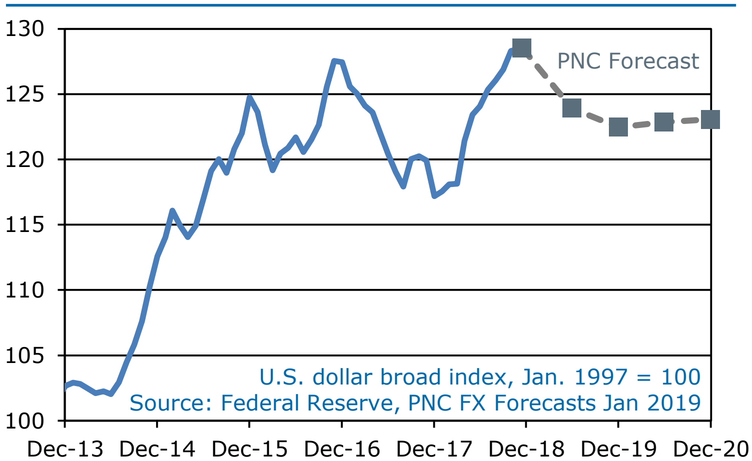
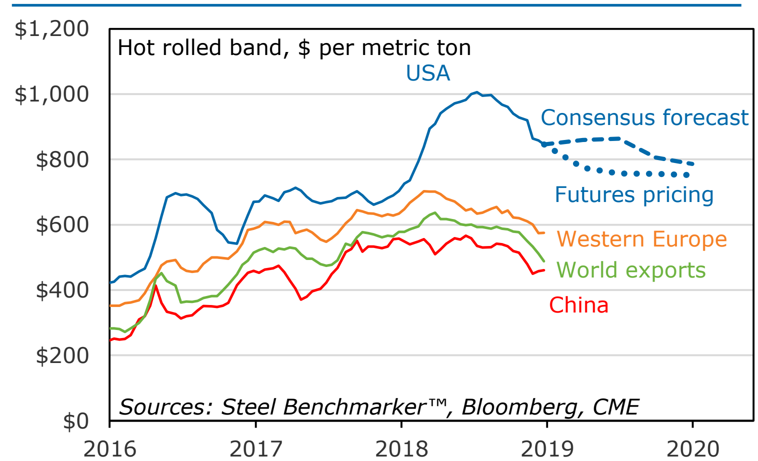


Chart 6: Forecasters and futures predict stable steel prices



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