Third Quarter of 2020

METALS INDUSTRY REPORT

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Summary

MIXED OUTLOOK FOR METALS IN SECOND HALF OF 2020; OVERSUPPLY TO KEEP ALUMINUM COOL, WHILE GLOBAL ECONOMIC RECOVERY SUPPORTS OTHER METALS

- The Viral Recession will cause U.S. real GDP to contract 4.8 percent in 2020, constraining demand for metals.
- Surplus and oversupply continues to be the dominant theme in aluminum markets.
- Demand for other metals is expected to recover into 2021.

The U.S. economy entered a severe recession in February. With shelter-in-place and consumer restrictions enforced by most governments, the Viral Recession caused a historic plunge in economic activity globally. Manufacturing output plummeted (Chart 1) as most governments sharply limited business activity to contain the virus; the domestic steel industry's capacity utilization rate reached a 9-year low in May (Chart 2). PNC's baseline economic outlook for the U.S. foresees a recovery beginning in the second half of 2020 with economic growth well above its pre-recession trend in the second half of 2020 and throughout 2021. Economic prospects are currently more upbeat in China and the Eurozone as both regions began recovering from the Viral Recession and easing restrictions before the rest of the world.

Iron ore prices have been surprisingly strong during the global pandemic, rising 12.5 percent in the first half of the year. The relatively quick recovery of Chinese demand on the one hand, and supply disruptions caused by Brazil's Vale dam disaster and surging coronavirus cases on the other, have kept iron ore prices solid. PNC Economics expects the resiliency in iron ore prices to continue into 2021 as the Chinese economy recovery steams ahead and improved homebuilding in the U.S. (Chart 4) supports steel demand in the second half of 2020. After a decline in global steel demand in the first half of 2020, economic recoveries in China (the world's largest steel consumer), the U.S., and Eurozone should support steel demand and prices in the second half of the year. Higher energy prices in the second half of 2020 will also support steel demand; 52 percent of U.S. steel consumption is used in building and infrastructure, according to the World Steel Association. PNC economics forecasts a 49 percent gain in crude oil prices from June 2020 to June 2021. However, competition from imports is resurfacing as a challenge to the industry: The import share of finished steel demand rose in the first half of 2020 and reached 23 percent in May, the highest level since January 2019 (Chart 3).

In the aluminum industry, longstanding oversupply challenges became even more pronounced during the pandemic as many aluminum smelters remained in operation as downstream consumers paused; monthly global aluminum production of 5.5 million metric tons in May 2020 was just shy of the 20-year high. Even as demand recovers in the second half of 2020, surging production in recent years will maintain an overhang of supply, keeping aluminum prices low into 2021. Demand for base metals is poised to fall 5 to 6 percent in 2020, the deepest decline since the global financial crisis, according to Bloomberg. However, if the $1.5 trillion infrastructure package approved by the House of Representatives on July 1 also passes the Senate, it would represent meaningful upside for demand and prices in the short- to mid-term.

A weaker dollar (Chart 5) in 2020 and 2021 will provide additional support to metal prices since 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 2020 and 2021 (Chart 6). However, risks are heavily weighted to the downside as a resurgence of the virus could bring economies back to a halt.

Chart 1: A historic global manufacturing slump

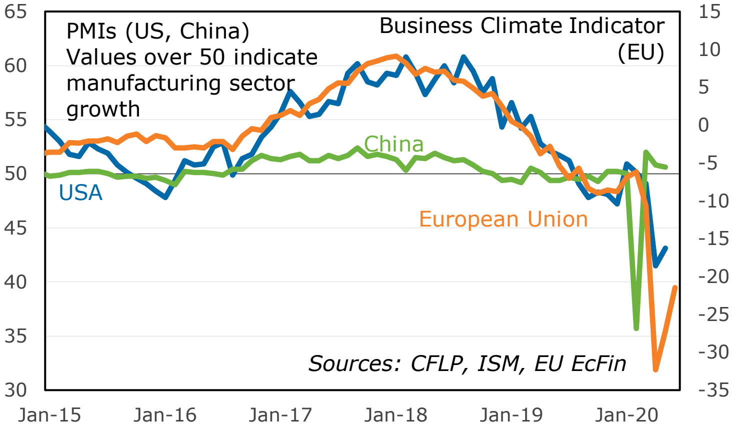


Chart 2: Steel capacity utilization rate at 9-year low

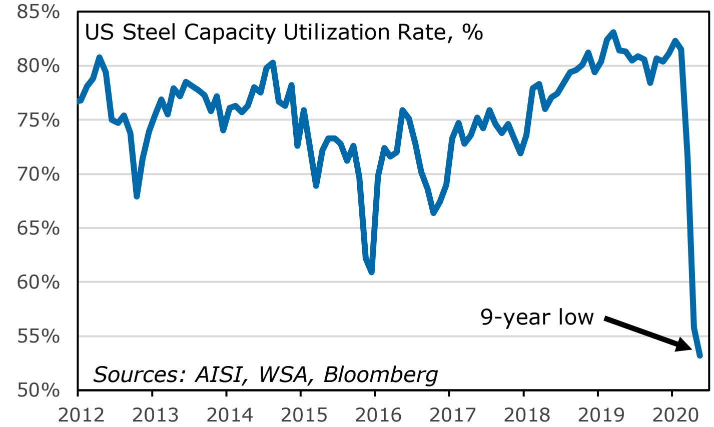


Chart 3: Finished steel imports trending upwards

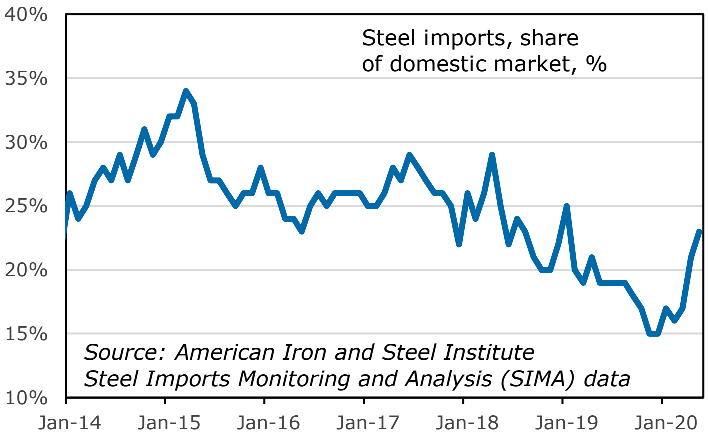


Chart 4: Housing to lead the recovery

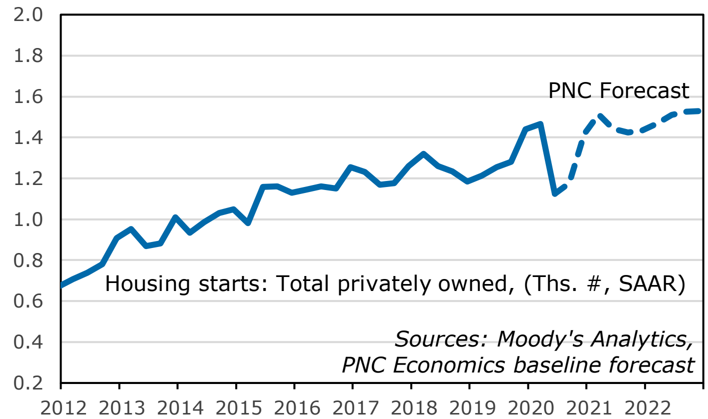


Chart 5: Weaker dollar to support metal prices

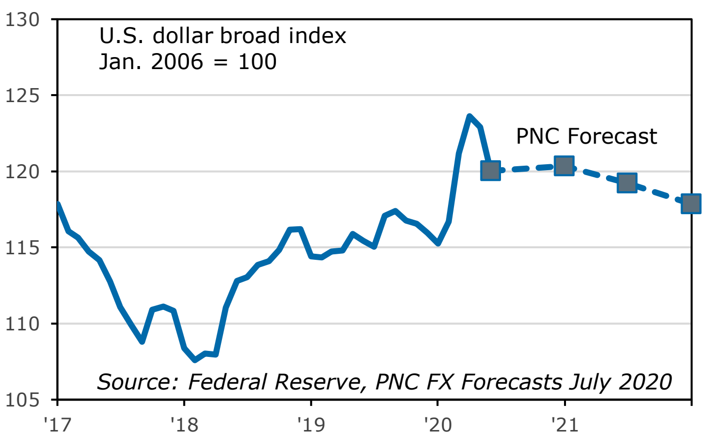
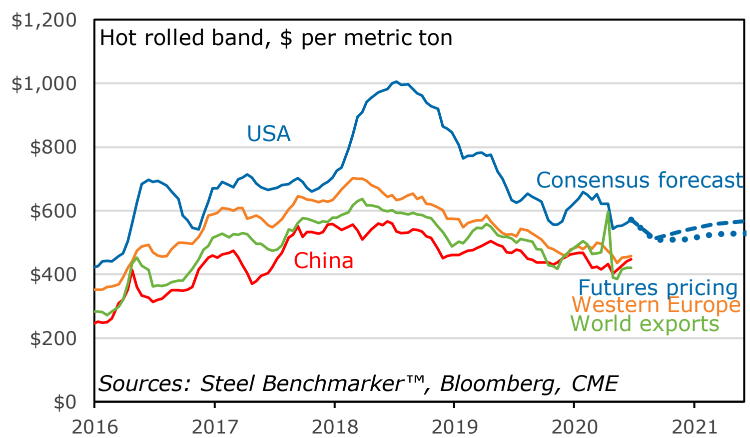


Chart 6: Forecasters predict higher steel prices



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