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STEEL INDUSTRY REPORT

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Summary

Trade restrictions on steel aim to boost U.S. producers' market share

- The Trump Administration aims to reverse U.S. producers' loss of market share by levying tariffs under the authority of Section 232 of the Trade Expansion Act of 1962.
- Targeted restrictions are unlikely to be effective as market forces weigh on U.S. competitiveness and China's importance as a source of imports diminishes.
- Broad tariffs would support domestic producers but could drive up consumer costs and squeeze profits for downstream industries.
- Steel prices will likely be stable in the second half of 2017 and rise modestly in 2018; moderate economic growth will support demand.

On April 19, 2017, President Donald Trump signed a memorandum prioritizing an investigation into the use of Section 232 of the Trade Expansion Act of 1962 to levy tariffs on imported steel. Invoking Section 232 would restrict imports on the basis of national security. The investigation is just one of a series of efforts to reverse the unusually high market share imports have claimed in the past three years. At the time of this report's writing in mid-July, the Administration was expected to be nearing its decision.

Independent of the use of Section 232, steel tariffs have been ramping up for over a year. In the first half of 2017, the U.S. levied higher duties on Japanese, South Korean, Mexican, Spanish and Turkish steel that were being sold below the cost of raw materials and normal steel profits. The largest duties were imposed on Japanese steel rebar and Spanish carbon steel flanges which saw increases of 206 percent and 18 to 24 percent, respectively. These increased duties followed a raft of levies in 2016 that included a massive 522 percent duty on cold-rolled Chinese steel and duties ranging from 57 to 193 percent on Chinese stainless sheet and strip.

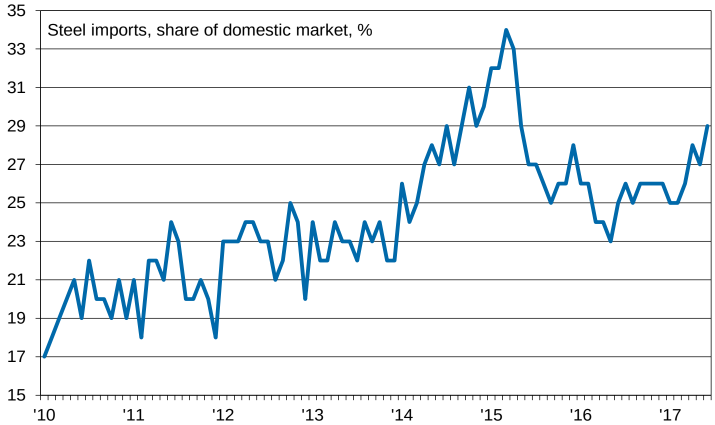
Although the cumulative effect of such levies have given U.S. producers some relief, policymakers are swimming against a strong tide of market forces that will make it difficult for domestic producers to completely regain their lost market share. Imports still claim a relatively high share of the domestic market (see Chart 1). On average, imports claimed 28 percent market share in the second quarter, down from a peak of 34 percent in 2015 but well above the 23 percent average from 2010 to 2014. A strong dollar underpinned by continued U.S. economic growth and rising interest rates continues to make foreign products less expensive in the U.S. (see Chart 2). Moreover, steel is still oversupplied globally and this could lead to a widening difference between U.S. prices and global prices (see Charts 3 and 4).

Another complicating factor in the Administration's efforts to shift the advantage to domestic producers is that the sources of imports are shifting. As part of a plan to shift economic drivers from heavy industries to services, the Chinese government plans to reduce steel production capacity by 100-150 million tons by 2020, with about 50 million of those tons being cut in 2017 alone. As a result of the production cuts and increasing tariffs on Chinese goods, China has gone from being the fifth-largest source of U.S. steel imports in 2015 to the ninth-largest source in 2016, and that share is set to fall further (see Chart 5). In its place, other countries such as Mexico and Canada are becoming increasingly important sources of imports. If import restrictions are to effectively increase U.S. producers' market share, they would have to be global rather than targeted at any particular country.

The impact of import restrictions on the rest of the economy will ultimately depend on the size and scope of the Administration's final decision. If tariffs are broad, overall consumer prices are likely to increase because nearly 30 percent of utilized steel would be affected. If the tariffs are large enough, domestic steel producers could even raise their selling prices. This would boost steel producers' revenues, but it would also dampen consumer spending and possibly squeeze profit margins for users further down the production chain if they are unable to pass along the higher costs. The manufacturing industries with the highest exposures to imported steel include fabricated and primary metals, motor vehicles and transportation equipment, machinery, electrical equipment, appliances and furniture (see Chart 6).

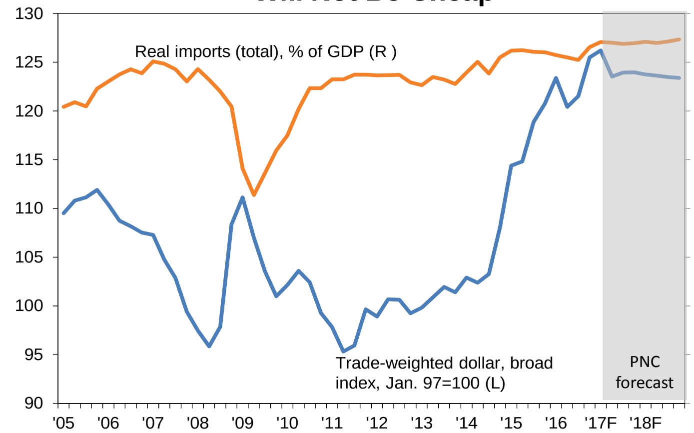
Independent of the Administration's decisions, market fundamentals point to a positive 12-18 months ahead for U.S. steel producers. The Bloomberg consensus expects hot-rolled coil prices to be stable in the second half of 2017 with moderate increases expected in 2018 (see Chart 7). Domestic demand is set to rise 3.0 percent in 2017 and 2.9 percent in 2018, according to the World Steel Association. With the U.S. economy on track to grow 2.3 percent in 2017 and 2.5 percent in 2018, non-residential construction, real estate development, energy production and aerospace manufacturing will keep steel demand growing (see Charts 8, 9, 10, and 11). With slower sales in 2017, auto production has softened, but sales should recover with the economic expansion.

Chart 1: Foreign Steel Claims Significant Market Share



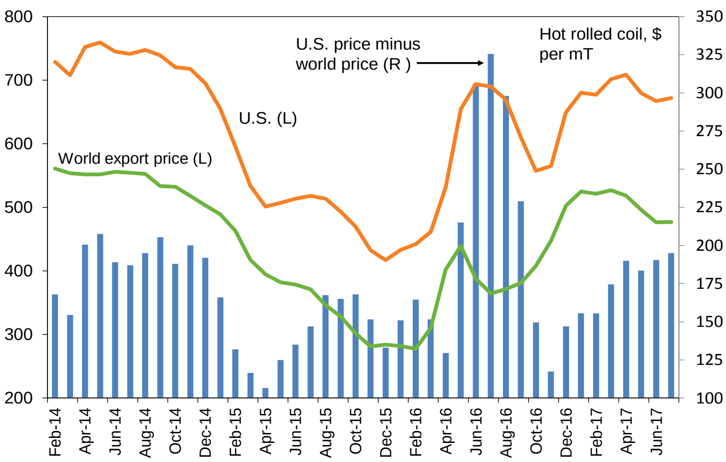
Source: American Iron and Steel Institute

Chart 2: The Dollar's Run-up May Be Over But It Still Will Not Be Cheap



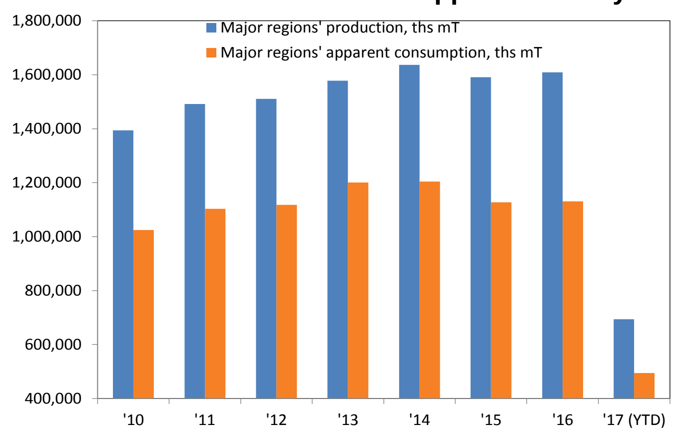
Sources: Bureau of Economic Analysis; Federal Reserve; PNC

Chart 3: U.S. Price Competitiveness Is Weakening



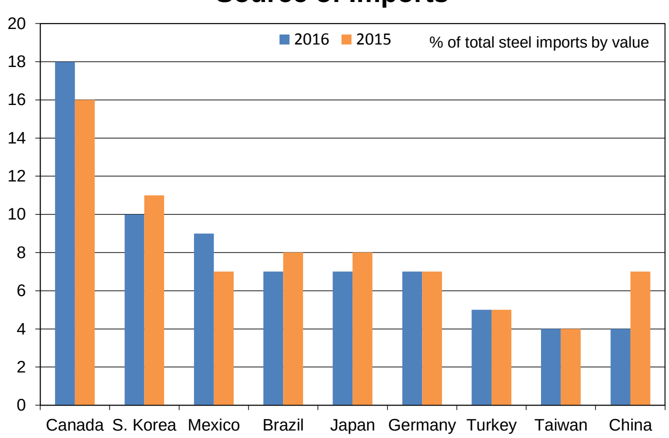
Source: SteelBenchmarker™

Chart 4: Steel Is Still Oversupplied Globally



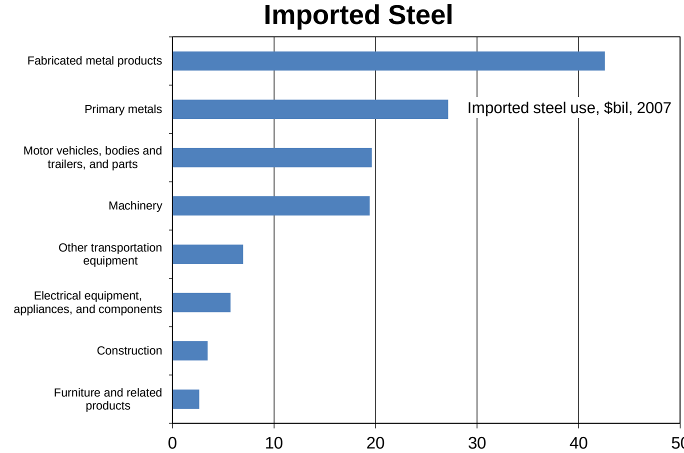
Sources: WSA; Japan Ministry of Finance; IABr; U.S. Dept. of Commerce; Eurofer; MICE
Note: Major regions include China, Japan, U.S., Brazil, EU and Russia

Chart 5: China Is Becoming Less Important as a Source of Imports



Source: Census Bureau

Chart 6: Downstream Industries Most Exposed to Imported Steel



Source: Bureau of Economic Analysis (2007 Economic Census)

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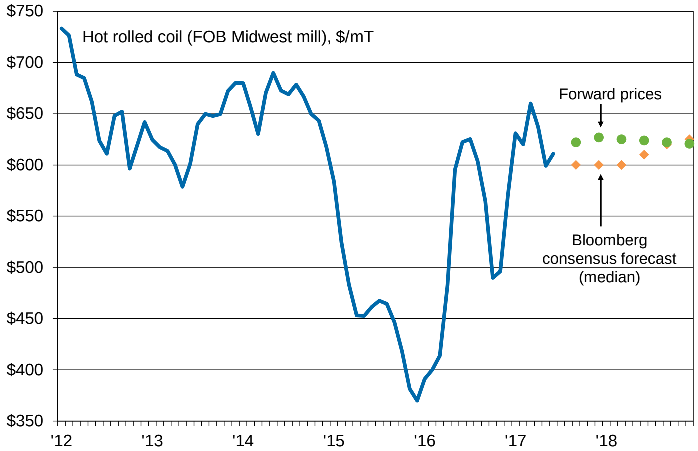
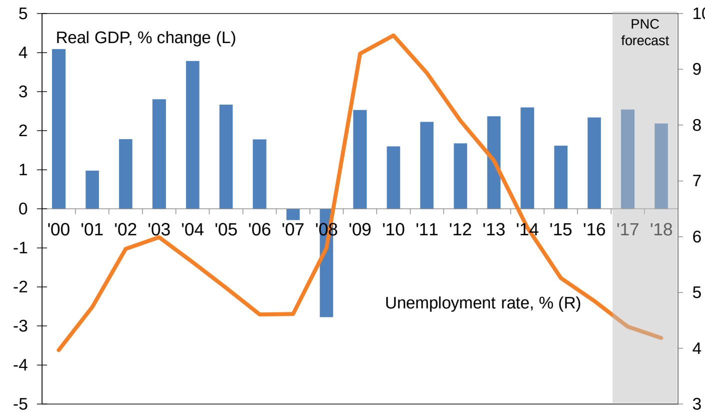
Chart 7: Steel Prices Likely Stable in the Near Term



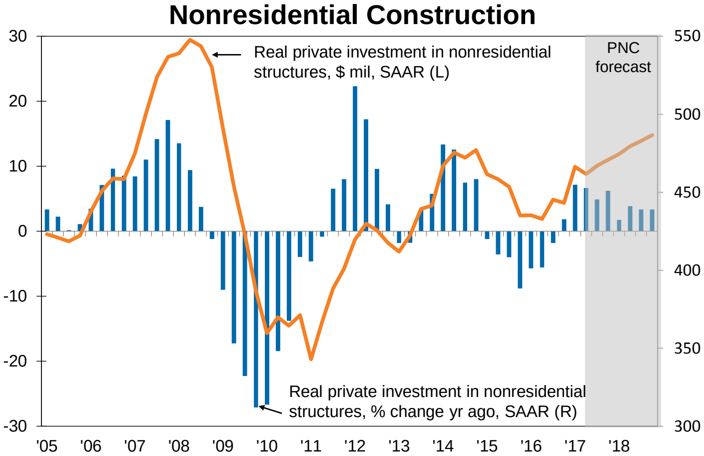
Sources: The Steel Index, Ltd.; Bloomberg Survey

Chart 8: Economy on Track for Moderate Growth



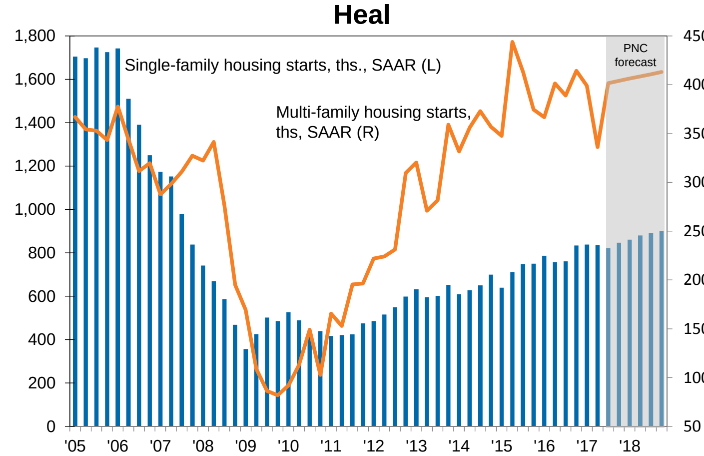
Sources: Bureau of Labor Statistics; Bureau of Economic Analysis; PNC

Chart 9: Economic Expansion Will Boost Nonresidential Construction



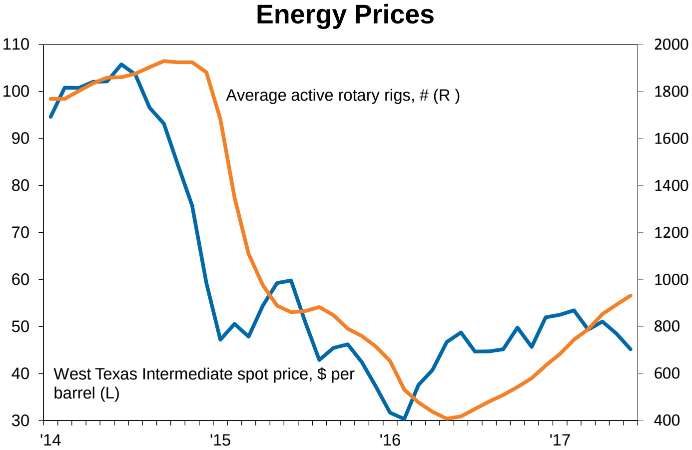
Sources: Bureau of Economic Analysis; PNC

Chart 10: Residential Real Estate Will Continue to Heal



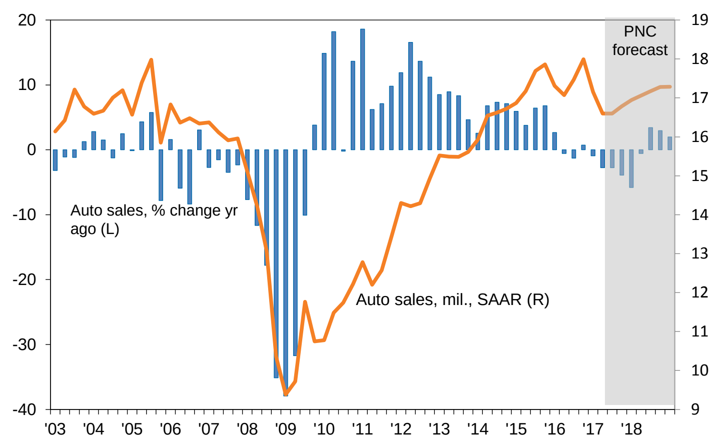
Sources: Bureau of Labor Statistics; Bureau of Economic Analysis; PNC

Chart 11: Drilling Continues to Rise Despite Low Energy Prices



Sources: Energy Information Administration; Baker Hughes Incorporated

Chart 12: Auto Sales Hit A Bump But Will Soon Rise



Source: U.S. Bureau of Economic Analysis; PNC

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