First Quarter of 2018

STEEL INDUSTRY REPORT

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Summary

FASTER REAL GDP GROWTH TO SUPPORT STEEL SHIPMENTS AND STABLE PRICES IN 2018

- US real GDP growth will pick up to 2.7 percent in 2018 from 2.3 percent in 2017, a tailwind to steel demand.
- The outlook for construction and business capex is upbeat, while auto sales' growth prospects are more modest.
- US producers' share of the domestic market is likely to hold stable in 2018, as are steel prices.

The backdrop for American steel is favorable in 2018 (See chart 1). The tax cuts enacted for 2018 are boosting stock prices and disposable incomes, and a tighter labor market is supporting wage gains; collectively, these developments are supportive of another solid increase in consumer spending in 2018. Business capex, energy production, and exports are also improving, supported by higher oil prices and a weaker US dollar. PNC Economics forecasts for these growth drivers to lift US real GDP growth to 2.7 percent in 2018 from 2.3 percent in 2017.

This upbeat outlook extends to the sectors driving steel demand. PNC Economics forecasts solid construction growth in 2018, fueled by a 2.9 percent increase in real investment in residential and nonresidential structures (See chart 2). 2018 will mark a second consecutive year of near 3 percent growth in this sector, which purchases over 40 percent of domestic steel shipments. Investment in nonresidential structures is set to grow 3.5 percent in 2018, outpacing the 2.4 percent growth of investment in residential structures—residential construction faces bottlenecks from shortages of construction workers and of buildable land in major metropolitan areas. Businesses' investment in capital equipment will also grow a solid 4.5 percent in 2018, with the energy sector a notably bright spot: The Energy Information Agency's weekly estimate of domestic crude production in December 2017 reached the highest level since comparable data began in 1983, and Baker Hughes' tally of oil-drilling rigs operating in North America jumped 39 percent from a year earlier in January 2018. The outlook for auto manufacturing demand is more mixed. PNC Economics cautiously forecasts only 1.0 percent growth in vehicle sales in 2018, restrained by higher interest rates and more stringent underwriting of auto loans (The Federal Reserve's senior loan officer survey shows underwriting standards tightening since the second half of 2016). After a 1.6 percent drop in sales in 2017, 2018's auto sales will likely undershoot 2016's record. On balance, US steel demand will likely grow 2.3-2.8 percent in 2018. An infrastructure spending plan seems possible but unlikely; if enacted, steel demand growth could substantially overshoot our forecast.

US producers' market share is likely to hold stable in 2018 (See chart 5). Imports gained market share during spring and summer 2017 after the domestic steel price premium widened in the first quarter of the year (See chart 6). But global prices subsequently rose, the domestic price premium narrowed in the rest of 2017, and the foreign share of the US market retreated. In 2018, foreign steel prices will be supported by higher prices of foreign oil (the premium for Brent crude above the domestic US benchmark WTI widened in 2017), broad-based global economic growth (again see chart 1), including strong manufacturing output in most global economies. The consensus of economic forecasters predicts US steel prices will hold mostly stable in 2018 from 2017, as do financial futures markets. Steel prices could rise if the US government imposes new tariffs on imports – the Commerce Department submitted its Section 232 investigation of steel imports' effect on national security to the White House on January 11, giving the President 90 days to act on its findings (China is the world's largest net exporter of steel, but most US steel imports are from close allies, complicating any effort to protect domestic producers). Opposition from domestic steel consumers, and the risk of allies retaliating against US exports or reducing strategic cooperation against geopolitical threats, will likely dissuade the US government from changing the trade status quo.

Chart 1: The global expansion is broadening

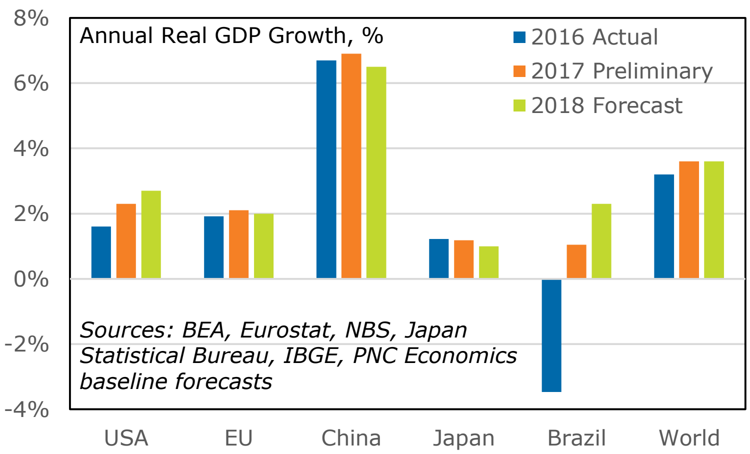


Chart 2: The outlook for construction & capex is bright

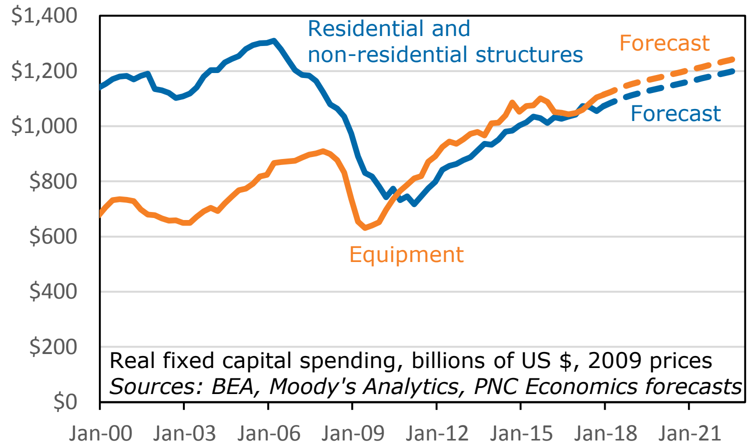


Chart 3: Auto sales face modest growth prospects

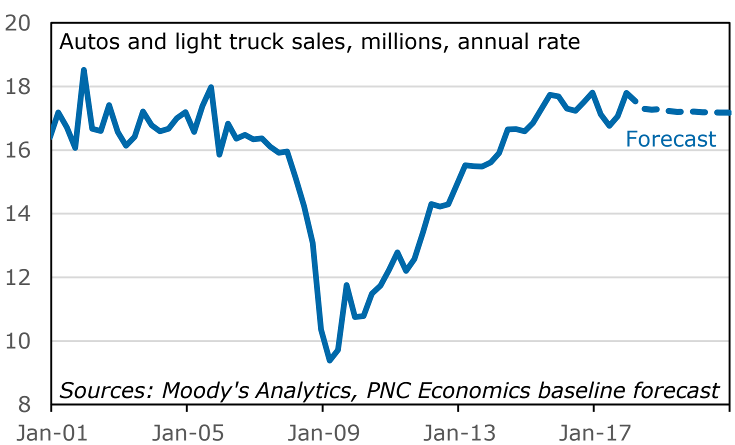


Chart 4: Higher capacity utilization can continue

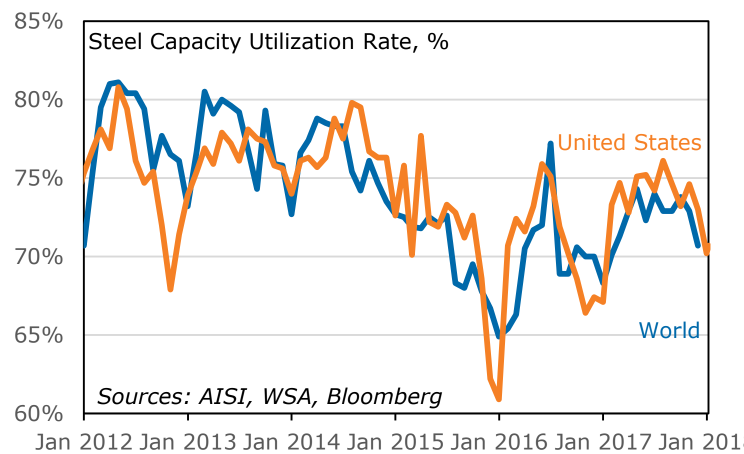


Chart 5: Steel imports gained market share in 2017

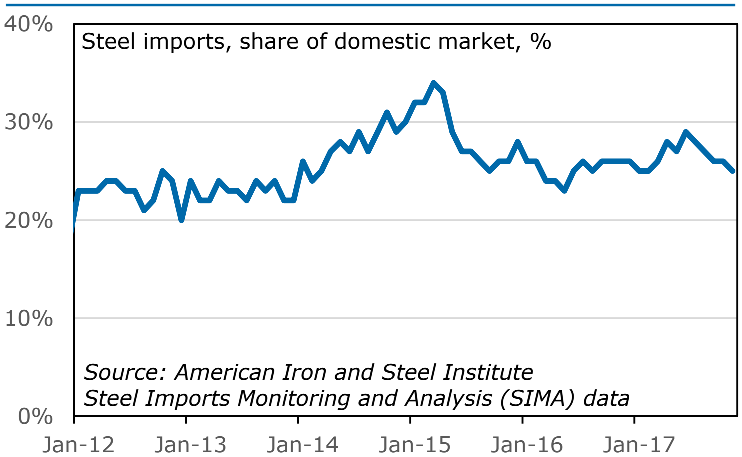
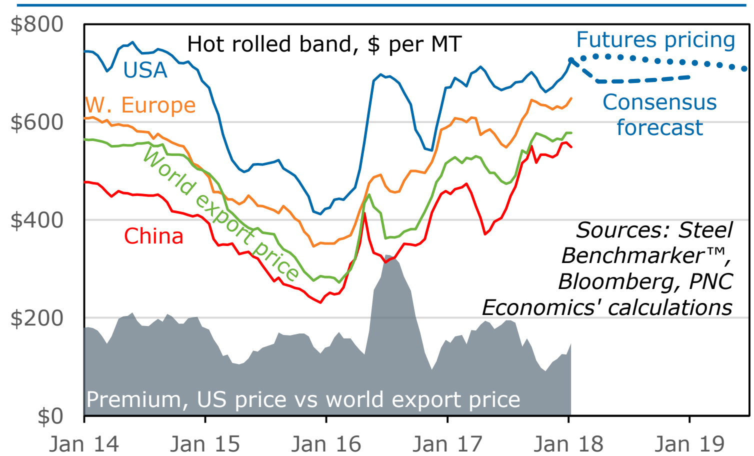


Chart 6: Forecasters and futures predict flat steel prices



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