



2018 U.S. Steel Market Outlook

Executive Summary

2017 has been a far superior year for U.S. steel manufacturers than the past few years. A pickup in global demand trends, particularly around Europe and developing nations, coupled with underlying industrial strength in the U.S., has led to stronger U.S. steel prices YoY. We believe the vast majority of the U.S. market's relative stability in 2017 is attributable to robust domestic demand in China being driven by strong investment in China's infrastructure and property markets. Evident in Figure 35, Chinese domestic hot-rolled coil (HRC) is ~20% higher YoY, a constructive sign for the global steel industry considering China represents 50% of global production despite its domestic market consuming only approximately 43% of that steel produced. Capacity utilization has also improved with the U.S. market registering higher than 70% since January 2017. With 2017 behind us, we are seeing directional trends emerge as we await Q4-2017 earnings. Here are some key themes to think about heading into 2018.

- U.S. prices have increased YoY. Generic domestic HRC prices are currently up 14% YoY, CRC prices are up 8% and hot-dipped galvanized (HDG) steel prices are 6% higher YoY. Meanwhile Chinese steel prices are strong, with domestic HRC currently up 19% and domestic CRC trending up 10% YoY.
- China is restricting steel production in three major cities over the winter to reduce pollution; we are optimistic that this could lead to a supply squeeze in Asia (supportive of global steel prices) as we begin the first few months of 2018 *assuming* that China's domestic demand trends remain intact.
- Steel input costs, both for oxygen furnaces and electric arc furnaces (EAFs), have increased and are highly likely to rear their ugly head in Q4-2017. EAF manufacturers are seeing higher scrap prices, electrodes and other inputs while integrated steelmakers are coping with higher costs for many of their materials including more opaque alloys such as chrome and nickel.
- Numerous U.S. manufacturers have recently announced price increases for different classes of steel products that appear to be sticking in the market and are likely to offset any input cost pressure witnessed in Q4-2017.
- Capacity utilization has oscillated between 70-75% in 2017, a good sign for blast furnace steelmakers dependent on capturing economies of scale.
- U.S. steel demand appears stable with strength in some industries working to offset industries that are peaking, such as automotive production.
- The potential passage of U.S. corporate tax reform should improve U.S. steelmakers' competitiveness versus other nations already benefitting from lower relative tax rates and may lead to increased M&A given the positive long-term structural implications of lower taxes.
- Post tax reform, the presidential administration may shift its efforts to more protectionist efforts such as levying additional duties or Section 232.
- Economists following China closely are calling for slower growth in 2018 and beyond; considering China's massive steel complex, should demand weaken after the Chinese New Year, the U.S. market could see elevated levels of imports enter the country once again should Chinese steel prices deteriorate relative to U.S. prices. More, we believe the potential for policy reform makes it even more important to watch China closely considering that small changes in supply and demand have serious global implications.