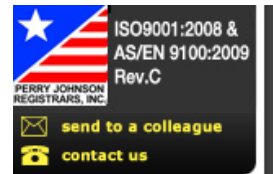




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MetalsOutlook™ September 2000

Publisher's Statement

HOT! HOT! HOT! That's what our economy is!

And our mid-year Metalswatch! supports this statement.

On August 21, 2000, Mr. Greenspan held the credit line steady by not increasing the rate. This should help to continue the economies forward march.

Let's all enjoy the good times.

We all knew the North American economy was hot and the potential for metals demand was strong. But, for steel, the first half was unbelievable!! Almost 43 million tons of steel were shipped into the U.S. and Canadian markets by domestic and foreign mills. That's a record for quarterly tonnage into the North American marketplace. Second quarter shipments and imports into North America may not have been as strong, but probably were close. Considering how strong the motor vehicle market, the appliance market, and the construction sector have been in the first half, it's easy to understand where most of the steel went. Even with an expected slowdown in second half growth by the metalworking sector and the growing likelihood of summertime steel inventory adjustments by end users some analysts still suggest that full-year steel supply in North America will exceed 140 million tons. That would be at least 5% over 1999 market supply, and a new one-year supply record.

Looking at stainless and specialty steel, demand is sizzling even though mill products and processed materials are mighty expensive these days. "From slow growth in demand and over-capacity just a year ago, stainless steel consumption has picked up, prices have risen, and shortages of supply may even be looming if the recent pace of new-order bookings keeps up," says global market researcher Vanessa Davidson at CRU International in London.

The supercharged domestic stainless steel economy, powered by brisk consumer and business spending on durable goods, expanded by an estimated 20% annual rate during the first three months of 2000. Mill and service center business also was strong in the second quarter. There has been some inventory adjustments in this third quarter so sales have slowed. But, buyer surveys suggest that demand will stay healthy for some months to come. In this broadcast, we'll delve deeper into the stainless and specialty steel markets.

In our final segment, our Purchasing Focus, we'll discuss why "supply chain management" may be one of the most deceptive strategic terms of our times. But, first, we'll start this edition of Metals Watch with a look at the North American manufacturing economy based on midyear statistics.

Welcome to Metals Outlook™ September 2000

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I. Cover Story: THE MID-YEAR METAL FORECAST

According to some popular accounts, manufacturing in North America is on the decline, a relic of the old industrial era that's been replaced by the information and service economy. Really? Well, no, not at all. Manufacturing hasn't declined in decades as a percentage of the gross national product. In fact, its contribution to growth during the economic expansion has exceeded that of services. The sector's importance is sometimes slighted by an emphasis on the service and information economy, which provides the jobs and puts bread on the table. But somebody has to make the table and the computers the service and information economy people use and the cars that drive to them and from their jobs. Somebody also has to buy the products of the service and information providers and manufacturing is a very big buyer. So it's been good for the economy that manufacturing rates have increased steadily in the last nine months.

Thus, the full-year economic forecasts at midyear-2000 continue to be revised upward. The consensus of analysts now puts gross domestic product in the U.S. rising by almost 5% this year. Following in the footsteps of its North American neighbor, the Canadian economy also kicked off the new century in high gear. Canada's GDP growth also is running around 5% on a year-over-year basis. Note that just six months ago, most North American economists were projecting 3% GDP growth for the year in both countries. This year's outlook for regional industrial production has also taken an upturn. The current outlook is for 4.8% full-year growth in manufacturing and it was forecast at only 1.8% just six months ago. In the U.S., factories put out 6.5% more products per hour in 1999 boosting to productivity the output per hour worked by almost 4%. Note that the updated economic forecasts for 2000 still show factory growth up another 6%. Finally, the current forecast for this year's nonresidential fixed capital investment in the U.S. is 10.8% growth. In January, the consensus forecast was 4.7% growth. And, remember, all these bullish prognostications are coming after the latest in a series of interest rate hikes by the Federal Reserve Board and new economic indicators that are signaling a probable slowdown in the rate of growth for manufacturing.

Manufacturing is a good indicator of the economy's health. And based on its latest health report, the growth rate of factory employment, new orders, order backlogs, export orders and supplier deliveries have all slowed a little. This means the 10-year-old economic expansion is losing its robustness. Its growth is slowing while not disappearing, and that's seen as a good thing. In fact, Wall Street economists are relieved to find evidence that the gangbusters economy is cooling.

There is virtually no chance for the economy to sink into recession either later this year or in 2001, says Richard Berber, the chief economist at Morgan Stanley Dean Witter. What the slowing economy means, he says, is that the Fed may stay on the sidelines this summer and let market forces rather than interest-rate hikes generate a soft landing this autumn or winter. A slowdown in the U.S. economy will be good for the Canadian economy, as well, says Simon Prevost, chief economist at BLC Securities in Toronto. "Less steam in the U.S. economy," he says, "will cool inflationary pressures in the States and restrain the Canadian economy from overheating as well."

All the Fed tinkering with interest rates has been fueled by a fear that the economic boom and its strong consumer and business spending trends interest rates might accelerate inflation ahead of its recent rate of roughly 2%. However, inflation just may be like red wine: a moderate amount could be better for the economy's health than none at all. In fact, a team of prominent economists at the Brookings Institution has just concluded that inflation of 2% to 3% a year, which Americans have been seeing lately, actually benefits the economy. They suggest that eradicating inflation altogether, a goal of some Federal Reserve officials, may do more harm than good. "If inflation were to fall to zero, worker productivity would decline, unemployment would rise and the overall economy would sag," say William Dickens, an author of the study. "Moderate rates of inflation, probably in the neighborhood of recent experience, allow the economy to operate with low rates of unemployment and are consistent with a policy seeking to maximize prosperity," said the authors.

II. Metal Chips: STAINLESS & SPECIALTY STEELS

Now, let's switch focus to the heartland of North America. It's been a good year so far for stainless and specialty steel suppliers, who have seen sales and prices rise above 1999 levels. David Blitzler, chief economist at rating agency Standard and Poor's in New York, notes that business investment shot ahead by 25% in the first quarter, the biggest surge in this spending in two years, "as companies have been pouring money into expanding production."

This has benefited stainless and specialty sales, since the metal is a staple in the production of numerous automotive, aircraft, and aerospace parts and food handling, chemical processing, pollution control and medical and health equipment.

Now it's true that new-order bookings for the second-half deliveries of stainless steel and other specialty steel grades reportedly have slowed from the booming pace of recent weeks. That's either because:

1. Manufacturers are uncertain about post-Labor Day business and are starting to throttle down. That's because the Fed has boosted its federal funds rate by 175 basis points since last summer in an effort to corral the pace of consumer spending and to keep the economy from overheating further.
2. The market is taking a seasonal breather, as buyers are using the summer to eliminate any excess in-plant inventories and recalibrate manufacturing's actual needs for these high-priced steels in the fourth quarter of this year and the first quarter of 2001.
3. End-users are tiring of seemingly never-ending price escalation four hefty price hikes on sheet since July 1999, for example, plus alloy surcharges and are postponing orders so they can look for cheaper alternative materials, particularly aluminum, composites and plastics.

Independent economist Mark Zandi in New York says "There is considerable uncertainty over the impact of the Fed's belt-tightening and its future monetary policy as it works to deflect inflationary pressures by

decelerating the still-booming economy." As summer heads into autumn, he says, there is a worry that consumer spending could slow, production of durable goods could slip and manufacturing's need for such raw materials as stainless steel could falter. On balance, though, most economists and analysts believe the concerns about second-half demand are being overblown. "There is very strong stainless steel demand in the U.S. and Europe, and continued recovery in demand in Asia," notes analyst Michelle Applebaum at Salomon Smith Barney. That's why world production through March was 11% higher than the first quarter of 1999. "That kind of activity isn't going to disappear overnight," she says.

Specialty steels, a relatively small but distinct segment of the overall steel market, include stainless steels, high-speed and tool steels, electrical steels, high-temperature alloys, magnetic alloys and electronic alloys. Common end uses include jet engines, air frames, electrical energy, automotive, chemical processing, oil and gas, construction and mining, machine and cutting tools, appliances and food equipment, transportation and medical. The market is diverse enough that analyst Martin Squires of Carr Metals in London also is bullish on the future. He says ♦U.S. stainless and specialty steel demand overall is so healthy that substantial growth of somewhere around 10% is likely for the year. That would bring 2000's actual use of stainless to 2.3 million tons, the most ever for a single year. Davidson of CRU International also sees consumption rising this year, by about 9%, and demand staying high next year. "Underlying consumption will remain buoyant," she says.

It is true that stainless prices are up substantially, both because of the pricebook hikes that have taken effect and because of the alloy surcharges caused by higher market prices for nickel, chrome, and molybdenum. Cheap imports battered stainless steel prices down for the past four years. The Bureau of Labor Statistics' producer price index for stainless steels ended 1999 at the lowest level of the past decade.

With nickel costs rising, demand increasing beyond forecasts and lower imports reflecting the impact of some favorable trade cases, mills last year announced two price increases totaling approximately 13% for most stainless steel sheet, strip and coiled plate products. Then, this year, they boosted list prices twice more and added the surcharges. Nickel supplies worldwide are down, also contributing to a first-half effective rise in prices. As demand continued to soar in the first half, stainless steel sheet prices were on a sharp ascent of 14% as the market finally accepted two of the price hikes in one gulp.

In fact, prices for stainless sheet have been rising in every region of the world as the result of strong demand and rising nickel prices, says Salomon Smith Barney analyst Applebaum. In fact, prices in Europe and Asia have been rising at a faster rate than in the U.S. Cold-rolled stainless sheet prices have risen by roughly 60% in non-Japan Asia and by roughly 40% in Europe since the beginning of 1999, compared to roughly 26% in the U.S. and Japan.

Domestic major mills have been boosting Prices since last summer, and the Increases were sticking. Now, U.S. prices re moderating and, for some grades, slipping in line with the summertime demand slowdown. However, a long-term analysis by the WEFA Group says Buyers should look for cold-rolled 304 stainless sheet to grow at an 8% average annual rate of growth over the next five years. ♦ Not surprisingly, buyers have been grousing a lot lately about prices this year. But, they don't seem to be too concerned about supply. Although lead-times have stretched to 4.3 weeks for average delivery from 2.4 weeks this time last year, none of the buyers surveyed last month fear shortages of stainless or such specialty steel grades as electrical steels and tool steels.

In separate polls conducted by PURCHASING Magazine and the National Association of Purchasing Management, buyers note no problems with supply among distributors and see foreign stainless as plentiful. This perception is rooted in fact. Although punitive duties ranging up to 60% were imposed in July 1999 on imports of stainless steel sheet and coiled plate from companies in 10 foreign countries, Commerce data show imports so far this year continue to supply 18% of the sheet market and 40% of the plate market. In fact, foreign suppliers still control 27% of the total domestic stainless and specialty steel markets. Atop that, data from the Steel Service Center Institute showed stockpiled stainless at midyear of 473,000 tons at the end of the first quarter. That's above the record-high level of 447,000 tons at the end of last year.

III. Metal Chips Extra: FORGINGS

Before we leave the metals marketplace, let's take a peek at forgings. North American sales of forged metal rose 4% to 1.99 million tons equal to a record \$6.6 billion worth of these formed metal components and parts. That was due largely to an unexpected surge in shipments of custom impression die forgings to the automotive, commercial aviation, and aerospace industries.

However, sales now looks to slide by 2% this year to 1.95 million tons as the torrid sales pace of the past two years appears to be cooling off. While sales to makers of internal combustion engines and turbines looks sound this year, the overall slippage is coming from reduced sales of impression die forgings to manufacturers of aircraft engines, heavy machinery, machine tools, off-road equipment and railroad and marine equipment. Also, market insiders say second-half demand is uncertain for the custom open-die forgings that go into the equipment used to build steel mills, metal-finishing plants, cement and mining operations, pulp and paper mills, petrochemical plants, and material handling systems.

Upshot: Lead-times are averaging about two months these days ♦as compared with 22 weeks during the 1997 sales explosion ♦and market analysts expect them back to a ♦more normal ♦ 6 weeks in the second half.

IV. Purchasing Focus: SUPPLY CHAIN MANAGEMENT

On the surface, "supply chain management" sounds so simple and straightforward. Only three words summarize the multi-step, multi-task, multi-company process that oversees the transformation of raw materials into manufactured goods for distribution to final customers. It also takes about three seconds to realize "supply chain management" isn't all that simple. Especially since effective "supply chain management" also eliminates time, unnecessary costs and other waste. There much more inter-

enterprise and intra-enterprise cooperation and coordination that must come into play. And, to be effective, it requires solid supervision by the purchasing organization.

In fact, an efficient supply chain would be little more than a theoretical impossibility without the complementary efforts of supply chain partners being guided by an efficient purchasing and materials management organization. Today, anything glacier-like in a company's response to the supply chain will freeze it in time. Rising customer's expectations and the emergence of e-commerce have ensured that. Simultaneously, there has been a fundamental shift in the balance of power within each company's supply chain. The functional silos that we all know so well are an obstacle to progress.

That's because the days are long gone when the professionals in product design, purchasing, manufacturing, warehousing, distribution, materials handling, information technology, plant engineering, and logistics could do their jobs as if they had nothing to do with anyone else inside the organization. Furthermore, their interconnectedness is only going to increase with time. So, getting "supply chain management" from the hypothetical to the functional is sure to be a major preoccupation of metalworking companies for the foreseeable future. It is going to require a mind set change by all involved including their suppliers. No longer will people in the various functions and disciplines inside manufacturing companies be able to look at themselves as the sole pivot point in the supply chain. Instead, they will have to recognize they are one of many pivot points. They will have to come to realize that the supply chain will not run without full participation by each function. Each will have to be optimized for the good of the chain not for its own good. And all will have to understand that purchasing and the members of the supply base will play a key role if the supply chain is being managed properly. This is going to be an interesting balancing act.

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