MetalsOutlook™ October 2002

Publisher's Statement

The summer has come and gone and we have survived another September.

The pundits are claiming that the metalworking and manufacturing sectors are gaining ground toward the positive.

This morning's October 1st National Association of Purchasing Managers report came in at a weak 49.5%, which tends to disprove what the pundits are saying. In any case, significant growth probably won't happen until Quarter 1 or Quarter 2 of next year, so tighten your belts and get out there and sell something!

Welcome to Metals Outlook™ October 2002

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Tom Stundza's Comments

Welcome to the October edition of MetalsWatch! And welcome to the autumn edition of the 2002 economic malaise.

The best that can be said about the economy is that it's growing-even if barely. GDP, the gross domestic product, posted a 3% annualized gain in the first half of the year. The gurus say the overall economy will fall measurably short of that in the second half. The industrial economy, especially, still is waiting for something-some trigger--before it resumes its long-awaited strong expansion. Maybe it's far-reaching global peace. Maybe it's corporate recognition that capital spending is a good thing. Maybe it's consumer recognition that more personal debt is okay. Who knows! What is known is that there's unpredictability about industrial America these days. Want some evidence? Orders for U.S. manufactured goods-especially machinery--surged in July at the fastest rate in nine months. But, overall manufacturing barely grew in August--and companies actually hiked the number of planned layoffs. While there were sharp new-order increases in many durable goods sectors in July, almost all of them had reported sharp decreases the month before. Businesses are just as hesitant to invest in new equipment now as they were months ago. And all of this is stoking worries that the economy's already weak recovery may stagnate more in coming months. We'll discuss the latest macroeconomic outlook for the rest of the year. And we'll put the metalworking economy into perspective, update you on the state of the steel market, highlight what's ahead for stainless steel pricing, and close with a look at supply chain management issues.

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I. Cover Story: Disappointed with the recovery? Blame the mild recession

Disappointed with the recovery? Blame the mild recession. Because the 2001 recession was one of the shallowest on record, it created little in the way of pent-up demand to propel the recovery--as had been the case in past upturns. So, the economy is like a boat navigating choppy waters: It still appears the ship has enough ballast to stay afloat, but unlike many past recoveries, the coming voyage may not be a smooth one.

For example, housing and vehicle sales did extremely well in 2001, and overall consumer spending never declined--the first time that has happened in a recession. But now, consumer demand isn't showing the typical recovery burst--which fuels output growth and new jobs. As a result, this recovery isn't very strong. And without the usual recovery surge to lift spirits and embolden companies to spend and hire, a moderate recovery raises risks for the next few quarters, since it makes the economy vulnerable to shocks--such as the stock market's drag, geopolitical events, or rising oil prices. Little wonder, then, that the economy seems to be hesitating instead of roaring ahead.

Consider the latest mish-mosh of economic data. Consumers still are spending, especially for autos. Housing is holding up, thanks to low mortgage rates, although potential for further gains is limited. Most recently, though, manufacturing has hit a dry patch. Even though commercial aerospace and railroad production are down, strong automotive production patterns have bolstered activity in the Transportation Equipment category. However, the three-month moving average growth for key steel-consuming sectors of Fabricated Metal Parts, Machinery and Electrical Equipment categories are showing only 2-3% growth.
Atop all that, the trade deficit continues to subtract from economic growth. On the financial side, fewer commercial banks are tightening their lending standards, but the terms of loan agreements are stricter. These diverse trends explain why investors are contemplating another interest-rate cut by the Federal Reserve in late September. Those expectations have risen since revisions show that real GDP grew at only a 1.1% annual rate in the second quarter--raising questions about the recovery's sustainability.

Interesting, a recent Fed survey shows that business loan demand remains weak. That reflects the modest recovery, not a credit crunch. Business loans typically are used to finance inventories and other short-term business operations. Now that companies have slowly begun to restock their shelves, loan demand may also pick up gradually. Business inventories began to increase back in May, the first increase in more than a year. And that inventory readjustment helped boost factory output in the first half. But recent data raise questions about manufacturing's strength in coming months. Industrial output has been rising slightly since July. But, excluding automobiles and light trucks, production actually is down a smidge. In effect, factory output is no greater than it was a year ago. In addition, the Fed has second-quarter output data. The new numbers show output of computers and office equipment grew at an annual rate of 4.9% last quarter, a far cry from the 20.4% clip originally reported. That means the tech rebound is weaker than first thought, and the sector may not add much to real GDP growth going forward. Another disappointment is that while motor vehicle sales has held up through August; other retail buying has been sluggish.

Post-recession growth in manufacturing has been lackluster in 2002, and so has the consumption of commodity metals, whether steel or nonferrous. Revised six-month data shows a 3% annualized decline in actual U.S. carbon steel mill product use. Slippage also is expected for stainless steel and nonferrous metal mill products, as well. So, it's no surprise that Purchasing Magazine's latest survey of buyers at steel-consuming firms finds second-half demand trends looking shaky for all types of mill products. Suspicions of continued weakness in the metalworking sector are being confirmed by reports of declining optimism about a swift manufacturing recovery among steel buyers. Of the 500 metals buyers polled in August, planned purchasing activity slipped for the third straight month.

II. Metal Chips: It's safe to say the romance between the steel industry and the Bush administration is over

It's safe to say the romance between the steel industry and the Bush administration is over. I'm quoting Nancy Kelly, here, the Washington bureau chief for amm.com, who says: "In a one-two punch that left it buckle-kneed, the steel industry took an uppercut to the jaw with the last round of Section 201 exclusions. In the final count, more than 700 steel products were exempted from the 30% steel tariffs imposed by President Bush in March. And still staggering from the tariff exclusions that left the Section 201 trade remedy looking more like Swiss cheese than trade relief, the U.S. International Trade Commission connected with a right hook when it told U.S. cold-rolled steel producers to take a hike. Although cold-rolled imports from most countries are covered by the 30% Section 201 duties, domestic producers continued to claim injury as a result of imports. However, that dog didn't hunt for four of the five commissioners, a bipartisan board nonetheless swayed by political winds. Whatever the reason, the ITC now has left little doubt that its patience with the steel industry was at an end, handing down four negative injury determinations in every steel case vote since March."
In fact, the 727 exemptions brought the amount of steel excluded from the high tariffs to 3.2 million metric tons, nearly a quarter of the 13.1 million metric tons of foreign steel covered by the original tariff order. And now, President Bush plans to relegate those controversial steel tariffs to the scrap heap by mid-2003--after the World Trade Organization declares them illegal and U.S. steelmakers come up short in their efforts to convince him they need import protection so they can regroup. And end to tariffs will lead to lower steel prices in 2003--because imports will increase and some idled U.S. mills will be back in operation, raising U.S. output. Upshot: Buyers can expect the price of bellwether hot-rolled sheet around $300/ton by the end of 2003. It's now $380.

Steelmakers, led by U.S. Steel, are making a strong pitch to keep duties of up to 30% on steel imports in place for the full three years, as was planned when they were instituted in March 2002. The tariffs were supposed to give them cover while they consolidated and shed old, excess capacity. However, the steelmakers have argued that restructuring can't occur without unions granting major concessions and without Uncle Sam assuming $20 billion in pension and health insurance costs for current and retired steelworkers. Chances of either occurring are nonexistent; making it unlikely that steelmakers will be able to keep their consolidation pledge. Politically, dropping the tariffs may be a net gain for Bush. The move is sure to bring howls from steelworkers and their congressional representatives in Ohio, West Virginia, Pennsylvania and elsewhere. But, metalworking firms and their employees, who outnumber steelworkers, will welcome it. The duties were somewhat of a sleight of hand on Bush's part to begin with, a move he felt he needed to make to get lawmakers from steel-making states to vote to give him new trade negotiating powers, called the President's Trade Promotion Authority, which Congress finally passed this summer.

Contrary to what you may hear from the steel mills, Bush was not scheming all along to end the duties as soon as Congress granted trade promotion authority. He has become upset of late that the big, integrated steel mills-known as Big Steel-and organized steelworkers have not lived up to their end of the bargain. Charles Bradford, an industry consultant, notes that the only U.S. mills that have improved their competitiveness are "mini-mills, and they're the most competitive in the world anyhow." As for the steelworkers union, "it told the White House it would support the GOP in 2002 elections if (Bush) granted the import duties," Bradford says. But now that Bush has granted some exemptions to the tariffs, "the union is waffling," he adds.

A miffed Bush sent Commerce Secretary Don Evans and other administration officials to warn steel industry executives this summer the import tariffs would be ditched unless the companies started shedding older, inefficient steel-making capacity and began consolidating operations. In fact, the opposite is happening. Old LTV Steel mills are being geared up to produce 8 million annual tons of hot-rolled sheet. And shuttered Trico Steel facilities will be restarted soon as Nucor Decatur to crank out another 2 million tons a year. That will hike U.S. steel production to 120 million tons a year starting in 2003---and that's 10% more than what it was before the steel tariffs took effect. Michael Gambardella, global metals team coordinator for J.P. Morgan Securities in New York, forecasts that steel prices will start declining in the U.S. market around the end of this year owing to the resumption of operations at former LTV Steel operations in Ohio, Indiana and Alabama. "Weaker macroeconomic data lately, and recent surges in monthly steel import volumes, suggest price weakness could arrive sooner than expected," says Gambardella.

Producers, distributors and service center executives are not expecting any big swings in demand--up or down--in the stainless flat-rolled market through the end of this year. So, with stainless steel selling prices reasonably steady for the past six months, buyer feedback suggests spot-market prices will remain firm well through the final quarter. Distributors handle about half of stainless supply and several service center executive interviewed don't expect much fluctuation in prices through the balance of 2002.This period of stability could prove to be highly beneficial to the supplier segments of the market. Customers reports they are "somewhat more comfortable" specifying stainless steels over competing materials for major long- term construction projects and product-manufacturing campaigns.

Most service center execs hope there will be sales improvement this autumn. However, real end-user consumption of flat-rolled stainless steel, which weakened last summer, has failed to recover. As import volumes dropped early this year, supply tightened and the mills made a number of attempts to raise basis values. None proved very successful because order intake did not pick up sufficiently to support major base price hikes. As for plate, demand has remained depressed as few major projects are underway. The number of players in the market went up, thus increasing competition and keeping prices flat. Market analyst Mark Parr at McDonald & Co. Securities in Cleveland, agrees that renewed attempts this month to hike sheet and plate prices don't appear to be resulting in much success. Alloy surcharges may have risen a bit-but these tend to move up or down, depending on the level of commodity exchange nickel and cobalt spot prices. The base levels for stainless mill products, however, remain flat. Parr says the marketplace needs a much stronger demand environment before higher tags can become a reality.

III. Purchasing Focus: Companies need competitive pricing and attractive features, at a minimum!

In a business environment characterized by unpredictability, a company that needs to be competitive must deliver a product or service that has attractive features, high-perceived quality, and reasonable pricing. That's a bare minimum! And to meet such demands in today's competitive business environment companies require a superior supplier base.

For most companies, having a superior supplier base is a real problem. That's because many procurement professionals readily admit they don't have a sharp picture of what makes a first class supplier. One method used with success by a growing number of top performing buying professionals is so simple and direct that it seems laughable. Still a large number of purchasing professionals swear by the effectiveness of this technique. When searching out new supplier prospects they make checklists of the qualities they expect from potential suppliers. In most cases the lists are relatively short, but the follow-up questions accompanying them often cover broad areas.
Purchasing executives at companies using them say checklists are nothing more than a very simple way to focus their staff members' attention on what's important. Respondents to a recent survey of checklist users cite nearly a score of specific points they cover with potential suppliers. Most of the points fell into one or more of the following categories:
� Specifications: Tell us about our specs. Are the specs we use to produce this product, component, or subsystem realistic? What modifications would you make? Why?
� Design: What are the design alternatives to our product? Are our design ideas manufacturable? Do you have some better ideas? Would you be willing to talk about them in more detail?
� Function: Has the supplier been asked to look at functional requirements? What does each component do? What can be eliminated and/or improved?
� Special requirements: Is a severe environment involved? Are there new materials that should be looked at? Are there substitutes available that ought to be considered?
� Fabrication: Are we using the best processes for our purposes? Are there operations being done in-house that could be done better by your firm?
� Doing business: Do you have better ideas for handling our transactions? Are there better ways to meet out needs? Are there compatibility problems with our transaction systems?
� Moving things: What can a smart transportation specialist and/or carrier do to make our business more competitive?
� Inventory: What can you do to reduce it? Of the many inventory and stocking programs around which

ones would be worth considering for us?
� Costs: Do you see waste in our operation that you, perhaps, could help us clean up? How would your recommendations affect our cost of ownership?
For the majority of purchasing execs polled, the most important factor in using the checklist system is communication. "Good ideas often come from our long established suppliers," says a purchasing manager at an Indianapolis electronics firm. "It isn't because they're particularly worried about losing out to another firm, but because they know we will give them a listen. That's the message we want to get across to potential suppliers."

Well, that's all for this Purchasing Focus, and for Metals Watch. This is Tom Stundza, executive editor of Purchasing Magazine. See ya, December Issue!

Thanks for your time and hope that you have enjoyed reading MetalsOutlook™. Don't forget to subscribe so that you won't miss an issue.

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