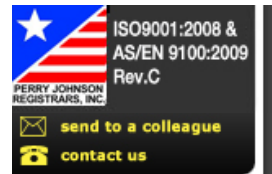




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MetalsOutlook™ December 2003

Publisher's Statement

The Institute of Supply Management (formally National Assoc. of Purchasing Managers) issued their manufacturing index for Nov. 03 (issued Mon. Dec. 1 @ 10:00AM) at 62.8.

This is the first time since January ♦03, that all of the indicators are pointing straight up.

Not only are they pointing up, but this month is highest index number since December 1983! WOW! If this is a precursor for 2004 business climate♦ BRING IT ON!!!

Tom Stundza of purchasing Magazine and other gurus are seemingly all in agreement, that the infamous turnaround is differently here.

Inflation? What♦s inflation? Read on and rejoice.

Welcome to Metals Outlook™ December 2003

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December 2003

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Tom Stundza's Comments

Good news! The old, gritty, dirt-under-your-fingernails economy that went out of vogue in the late 1990s is sexy again. Ever-increasing signs that industrial production has begun to improve foretells better supply-and-demand balance for such commodity materials as metals. Sustained growth in manufacturing next year will boost demand for steel, copper and aluminum. And probably zinc and nickel as well. Much about the impact of higher demand on the cost of metals depends, though, on just how strong the manufacturing recovery turns out to be. Still, optimistic end-use forecasts for 2004 have lifted basic industrial metals futures prices out of a long funk. The reasoning of the speculators is that since the supply of metals--especially nonferrous grades--isn't as elastic as demand, the outlook for a continued global recovery in demand could tighten supply as 2004 progresses. That would propel prices higher for industrial metals.

"We believe the ingredients are in place for a classic metals cycle through 2004-2005," says analyst John Hill at Smith Barney. The combination of growth--first in the U.S. and China, and then in Europe and the rest of Asia, followed by other regions--in an environment that's seen "10 years of structural underinvestment in the production side of the business" should drive 2004 metals prices higher, says Hill. "We have just begun a phenomenal commodity price cycle," agrees analyst Chad Williams at investment bank Westwind Partners in Toronto. "We're in the very early stages in what I think will amount to much higher prices," he says. In fact, metal-using manufacturers' forecasts for future business conditions have been bullish for four of the past five months now. November's business conditions survey indicates a hopeful future, according to the Precision Metalforming Association. The group's survey of 155 metalworking firms found 41-percent projecting increased economic activity in the succeeding three

months and 46-percent foreseeing increased orders ahead.

Actually, a spate of new data shows there's no longer any doubt that the U.S. economy is poised for a healthy rebound. Importantly, numbers from the Federal Reserve show the long-suffering manufacturing sector grew in October for the fifth straight month. "There's no question that American manufacturing is beginning to benefit from the ongoing recovery in consumer spending," says economist Robert Gray at Commerce Bank Securities. He adds: "Sales are improving, they're raising production and they will be raising production, in my view, for numerous more months because inventories are so lean all up and down the pipeline."

Josh Feinman, chief economist at Deutsche Asset Management in New York, agrees "the industrial production numbers available so far this quarter are consistent with the continued modest turnaround in the manufacturing sector." Manufacturing capacity use crept up to 75-percent in October from 74.9-percent in September, the highest level in eight months. "We've now had about five months in a row of increases in manufacturing output," Feinman says. "It's not blockbuster growth, but its growth, which is something we haven't seen in manufacturing for quite a while."

Still, Feinman says it will take some time for manufacturers to get back up to operating at its full potential. "Obviously the rest of the economy doesn't have as much unused capacity, but it does have slack," Feinman says, adding: "I think that's why the first signs of above-trend growth that we've started to see should be embraced. This economy needs to grow above trend for a while to take up the slack." Joel Naroff, president of Naroff Economic Advisors, notes the production gains have steadily broadened in recent months. "When you go through the different industries, some data has bounced around, but you're seeing more and more of them post gains for two or three months in a row," Naroff says.

So, in this edition of MetalsWatch!, we'll discuss what's ahead for manufacturing and metalworking. Then, we'll look at the current and expected market for steel, forgings and other production-grade metals. And, finally, we'll use our Purchasing Focus segment as a vehicle to update you on the Section 201 steel tariff controversy-which may be coming to a close in coming weeks.

Comments to Tom Stundza: stundza@reedbusiness.com

I. Cover Story: The Manufacturing Economy

2004 is looking better and better

Just this month, U.S. Treasury Secretary John Snow tells reporters: "The fundamentals for a sound economic recovery, for solid growth, look good." He suggests the 7.2-percent rise in consumer spending in the third quarter and the 8-percent rise in capital spending by industry are signs that the economy is recovering solidly. "There is a growing sense of confidence among American business people and American consumers that this recovery is for real, that it's got muscle and that it's sustainable," Snow says. He admits 7.2-percent rate of growth in the third quarter gross domestic product "surprised everybody," and adds that "7.2-percent is not a sustainable number." Snow says he agrees with private economist estimates of GDP growth between 4- and 4.5-percent in 2004. "That's a good growth rate for an economy the size of the U.S.," he says. "With the growth rate at that level we are going to see a lot of jobs created and a lot of prosperity created."

Snow says he agrees with the view of St. Louis Federal Reserve Bank President William Poole that "there are few signs that inflation is set to rear its head." In an interview this month after a speech to the Association for Investment Management Research, Poole suggests that "even with all the uncertainties of forecasting, my view is for an inflation environment that remains benign." Poole doesn't see any sign of accelerating price pressures. "The stock market has expectations going forward that inflation will remain low and stable and I think that's the right expectation to have, because when the risk arises the Federal Reserve will react to make sure the risk does not realize," Poole says.

He promises that the Fed will act preemptively at any sign of sustained inflation pressure. "The whole point is to head off inflation," Poole says. "if we already see inflation then that's evidence we acted too slowly." He also sees the economy growing around 4- to 4.5-percent without generating price pressures, "since the economic downturn in 2001 and 2002 created considerable slack in the economy that is still being absorbed." In another speech this month, San Francisco Federal Reserve President Robert Parry agrees that with the unemployment rate still above 6-percent and excess production capacity in the economy, "there's still room for some pretty strong growth before the risk of inflationary pressures becomes a primary concern."

Metalworking activity is down 2.3-percent this year after falling 2.4-percent last year. But, with factory orders starting to rebound this autumn, suppliers hopefully predict that 2004 purchases of fabricated metals parts will rebound in line with a 3-5-percent full-year expansion in metalworking activity. And, since 53-percent of the metals buyers polled in October see expanded purchasing ahead, there is support for the projected 3.3-percent resurgence in the 2004 metals parts market. But the analysts say suppliers won't be able to boost prices-which have fallen about 10-percent over the past two years-until a demand surge takes hold in 2005. Metal parts fabricators agree: Too much supply has been chasing too little demand. So, delivery leadtimes have dropped 10-percent from this time last year, and pricing competition has heated the marketplace. Last year, purchasing of metal parts declined 1.6-percent to a revised 15.1 million tons. This year, the buy is on pace to decline another 1-percent to 14.9 million tons, the lowest one-year buy since the revised 14.1 million tons in 1993.

Steel and nonferrous metals castings and forgings are used in just about every metalworking sector-from automotive to major appliances, from machine tools to material handling equipment, from construction materials to process industry machinery. North America is the largest metals parts market on the globe, consuming a 40- to 45-percent share of global output. But, the fabricated metals products are made to order, rather than for inventory, so they are ordered as needed. It's no surprise that demand for metals parts has fallen for five straight years since metalworking activity has fallen for five of the past six years. The metalworking malaise since 2000 has been longer than expected. Capital goods, heavy machinery and large equipment producers have faced an extremely tough operating environment.

The majority of the Federal Reserve districts reported a pickup in autumn manufacturing activity: Machine tool orders strengthened in the Atlanta and Chicago Districts; semiconductor producers noted a pickup in demand in the San Francisco District; and high-tech manufacturers in the Dallas District indicated gains. On the downside, Richmond reports a contraction in its manufacturing sector, and contacts in Boston report weak demand and a decline in revenues. The Minneapolis District notes only slight gains, and the Dallas and Cleveland Districts report mixed activity. Kansas City, Boston, and St. Louis report a decline in activity in the aerospace industry, and several districts indicate marked deterioration in the textile industry. Activity in the transportation equipment industry was mixed, with declines noted in the Philadelphia District, little change in Chicago, but increases in St. Louis.

In this environment, Corporate America has been reluctant to launch major capital spending programs, so production of new machinery has been fairly weak; in fact, monthly shipments of equipment have been 10.7-percent weaker in 2003 than in 2000--and that has impacted demand for metal parts. Look first at forgings, a piece of metal that has been hammered, pressed, or rolled under great pressure--the technical term is "plastically deformed"--into a specified shape that will maintain strength, toughness and reliability when subjected to loads and stresses.

II. Metal Chips: Forgings and Castings

Even this group is looking much better for 2004

Purchasing of forgings dropped 3.7-percent last year and another 1.7-percent this year. Revenues collapsed by 10.7-percent last year to \$5.26 billion, and have been dropping another 13.8-percent this year to \$4.53 billion. That's the lowest since \$4.42 billion in 1984. Analysts project a minimum 3-percent pickup in 2004 purchases of forgings because of a spending rebound in the assembly of machinery and equipment of all stripes. Note that forgings are used for a wide variety of gears, sprockets, levers, shafts, spindles, ball joints, wheel hubs, rollers and yokes in passenger cars, trucks, buses, trailers, ships and barges, trains, guided missiles and space vehicles. Custom impression and open-die forgings also have been in demand from makers of stationary engines, off-highway vehicles, heavy construction vehicles and mining equipment.

The biggest metal parts arena is castings, and that sector has taken the biggest hit from the metalworking slowdown. The dramatic decline in shipments of metal castings actually began in 1999 and has continued its slide so that this year's projected 2.2-percent drop will bring purchasing to 11.63 million tons. That's the lowest since the 11.64 million tons of 1990, according to Purchasing Magazine calculations. "Some castings suppliers say they haven't seen business this bad in 40 years," says Neil Chaudhry, chief operating officer of buyCASTINGS.com, a business-to-business electronic marketplace. "Many foundries are closing up or consolidating; the ones with deep pockets are acquiring others while the majority are fighting for survival."

Demand for castings used to make metalworking, industrial operations, farming, mining, quarrying, lumbering and material handling machinery has been depressed for the past five years, says Thomas E. Woehlke, president of U.S. operations for Auburn Foundry in Indiana. Castings demand also has fallen among buyers in the automotive, appliance and heating, air-conditioning and ventilation markets.

The future looks brighter, though, with the market mavens suggesting that purchases of iron, steel and nonferrous castings will perk up by 2.5-3.5-percent next year. "As the economic recovery broadens and deepens over the next two years, the metalworking industries will begin to boost their own capital spending," says economist Kenneth Kremar at Global Insight Inc.'s New York offices. Look for the appliance, machinery, motor vehicle, fabricated metals, and primary metals industry to take the plunge first. The motor vehicle industry will provide the biggest boost with a doubling of new model and model redesign programs between now and 2006 that will require significant investment. Commercial aerospace will be the last of the metalworking industries to recover."

III. Purchasing Focus: World trade organization rules against us for illegal trade tariffs

As you probably all know by now, the World Trade Organization ruled on November 10 that steel tariffs imposed by the U.S. in March of 2002 violated international trade treaties. The WTO ruling exposes U.S. exporters to more than \$2.2 billion in sanctions by the European Union unless the U.S. agrees to end this trade policy. A White House decision on the steel import tariffs probably won't come down until mid-December, says Joseph Bogosian, deputy assistant secretary of Commerce.

As is typically the case in trade disputes, much of the discussion of the tariff policy has been its political impact. The Bush Administration now must choose whether to respect international laws--laws the U.S. has led the way in advocating, or seeking political advantage, in steel-industry states such as Pennsylvania and West Virginia. Whatever the political gain from the steel tariffs, they have not stanchied the woes of U.S. steel manufacturers. U.S. production has continued to fall despite the fact that imports also are down sharply over roughly the same period. The tariffs also hurt U.S. companies that buy steel.

Here's the background: On March 5, 2002, President Bush imposed tariffs ranging up to 30-percent in 10 different steel product categories for three years, with the top rate dropping to 24-percent in year two and to 18-percent in year three. Bush's decision ignited an international furor. Both the European Union and Japan threaten to retaliate unless the United States "compensates" them for lost trade. The United States refuses, saying WTO rules allow countries to impose safeguard restrictions when there is a dramatic surge in imports. So, the EU challenged the tariffs at the World Trade Organization, and later is joined by Japan, South Korea, China, Switzerland, Norway, New Zealand and Brazil.

In a move aimed at delaying retaliation and easing supply concerns for domestic steel-consuming manufacturers, the Bush administration began excluding some foreign steel products from the tariffs in June. The exclusions continued on a more or less weekly basis through the end of August. No one was completely happy and the EU moved forward on legislation to retaliate on \$2.2 billion worth of U.S. exports -- equal to the amount of EU steel originally affected by the U.S. tariffs. But, in late September 2002, the EU decided to hold off on retaliation on its politically sensitive targets, such as Florida citrus

products, farm equipment and cigarettes, until the final WTO ruling.

At about the same time, the White House reaffirmed the tariffs as a way to insure time-the so-called breathing space-for U.S. steel industry restructuring. However, the U.S. International Trade Commission ruled against the industry in its claim that certain non-U.S. manufacturers were "dumping" steel here. Still, steel-industry leaders continued to urge defiance, painting themselves as the vanguard of defense of all U.S. industry. "The steel industry is a test case for problems facing all sectors of U.S. manufacturing," proclaimed Daniel DiMicco, president of steelmaker Nucor Corp. "The way to send a clear message that the U.S. is truly committed to a level playing field for domestic manufacturing is to keep the president's steel tariffs intact. This is the tip of the iceberg and all of America is watching."

The war of rhetoric between the AISI, the American Iron and Steel Institute, and the Steel; Task Force of CITAC, the Consuming Industries Trade Action Coalition, has continued since then. It intensified in September, when the U.S. International Trade Commission, in a pair of midterm reports on the tariffs, said the U.S. steel industry has used the protection to restructure as Bush had intended. But critics also found evidence in the reports the duties have harmed small and medium-sized manufacturers.

Steel industry-sponsored public opinion polls have been reported as showing overwhelming bipartisan support for keeping the steel tariffs in place for the intended three-year term. Steel consumer-sponsored market research reports have been reported as showing overwhelming economic damage probable by keeping the steel tariffs in place. We'd like to read your opinions on this subject. Go to Purchasing Magazine's website--www.purchasing.com--where we have the Section 201 Steel Tariffs Discussion Center. We have posted some recent stories to let you catch up on the news and the opposing views. Let us know what you think and we'll post your views online.

That's, that's all for this special Purchasing Focus, and for this edition of Metals Watch. Next issue Feb. '04.

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