MetalsOutlook™ June 2003

Publisher's Statement

We are entering into the second half of 2003, this is when the economists say business will turn around.

After reading this issue, it will be hard to believe that the turnaround is upon us.

ISM's (Institute of Supply & Management) June Index Numbers (Released June 2) is 49.4 which indicates further erosion of the manufacturing economy ....even though it wasn't as bad as April's numbers (45.4).

Welcome to Metals Outlook™ June 2003

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June 2003

Tom Stundza's Comments

Tom Stundza's Comments (Executive Editor of Purchasing Magazine)

This is Tom Stundza, executive editor of Purchasing Magazine. Welcome to the June 2003, edition of Metals Watch!

The Battle of Iraq is over--and the nation is now focusing on the economy. President Bush is trying to prevent the economy from repeating what happened when his father was president: a nosedive after the Gulf War of 1991 ended. What eventually got the jobs machine humming again was a big surge in capital spending as CEOs gave the green light for spending on high-tech machinery and computers. The telecom business swelled as entrepreneurs started laying cable and dot-com businesses made instant millionaires out of college grads. Economists are hoping that business responds again this time. One important factor: Inventories are so lean that any pickup in demand will translate quickly into higher production. In fact, factory orders for March were up 13%. If business improves, business may start to think about using an investment tax credit that expires in 2004. "If they don't use it, they lose it," says Jay Bryson, an economist at Wachovia Securities in Charlotte, N.C.

Still, even if Fed Reserve Board Chairman Alan Greenspan is correct that an economic pickup will start to be evident later this year, don't look for a sharp upturn. What holds the key to the future may just be the consumer. The Conference Board has reported its April consumer confidence index rebounded sharply, helped in large part by the conclusion of major hostilities in Iraq. And in coming weeks, consumers' incomes will be bolstered some by lower prices at the gas pump. Since the battle has ended, the price of oil is down about $12 per barrel. The price of gasoline on the futures markets is down as well. But that improvement in sentiment has yet to translate into actual sales. Last week, automakers reported April sales were down about 6%, despite the return of zero-percent financing. "Automotive consumers appear to be tapped out. There is little pent-up demand," says Sung Won Sohn, chief economist at Wells Fargo &

Co. in Minneapolis.

So, it's little wonder that steel prices weakened slightly in April: There is feeble demand from construction and manufacturing segments at a time when supply was being expanded by restarts of idled capacity. Steel distributors anticipate further slippage in coming weeks, and so do buyers. The recovery in the North American steel economy continues to be deferred. Optimists had their fingers crossed, hoping that the rapid end to the Battle of Iraq would herald a full-fledged economic expansion after over two years of mediocre growth. But, various gauges of manufacturing conditions have continued to sink this spring, dashing hopes for a swift post-warfare industrial recovery. That's because the overall economy still is mired in such structural problems as overcapacity, high consumer debt, and "weakish" corporate profits that make reinvestment difficult.

Dr. Sohn, the chief economic officer at Wells Fargo Bank will be trying to gauge "How Strong Will the Economy Be?" when he addressed the Forging Industry Association's annual meeting in Albuquerque, New Mexico, (May 17-20). His views are of much interest because the forging market has had a tough couple of years. Sales peaked back in 1998 and have been sliding since for forgings-which are near-net shapes of metals-sold mostly to aerospace, national defense, automotive, and agriculture, construction, mining, material handling, and general industrial equipment. Sales have been especially slow to the producers of metals, petrochemicals, other commodity materials and power.

In this edition's Purchasing Focus, we'll address the basic elements of a supply chain strategy-that is, the plan's goals and objectives. A supply chain strategy is about using all of the elements involved in the sourcing and procurement of goods and services to produce better results for the company. Typically, this integrated strategy is aimed at achieving such objectives as pushing a new product development faster, improving the use of technology, bringing products and services to market faster, improving the use of technology, minimizing resource investment, and reducing specific costs and response/cycle times. All such goals and objectives are achieved through better use of internal and supplier and customer capabilities.

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I. Cover Story: The Manufacturing Economy

The end of fighting in the Middle East has lifted a burden of uncertainty from the stock market. Oil prices are down. A burden of uncertainty should be lifting from consumers. But, the job outlook remains bad; in fact, the unemployment rate just hit 6% in April. So, while the U.S. military has been resoundingly successful in meeting its objectives in the Middle East, the main casualty of that conflict has been the U.S. economy. In a nutshell, an already slack economy appears to be standing pat-if not getting weaker. So, the Bush Administration has new goal: to develop enough momentum that business feels confident hiring new workers. Despite the U.S. military victory in Iraq, economic indicators have dropped to levels that sometimes presage some form of economic contraction. The manufacturing sector is already in a recession and in April had its largest job loss since January of 1992, which was a recession year. "It's pretty disappointing, the momentum is not in the right direction," says Bob Brusca, chief economist at Native American Securities in New York.

That's why President Bush has been lobbying Congress and has passed a $550 billion tax cut. And that's why Federal Reserve policymakers have kept U.S. interest rates steady at 1961 lows The Fed officials kept the trend setting federal funds rate for overnight loans between banks at 1.25%, where it has been since a cut last November. But, they also warn of a possible "unwelcome substantial fall in inflation," saying this means the economy is in danger of weakness ahead. The Fed governors have made it clear they still hope a lagging recovery will gain steam now Iraqi hostilities have ended. Fed Chairman Alan Greenspan even told Congress he expects a healthier pace of expansion ahead, provided business spending gathers steam. But, Fed officials now admit it isn't clear when a robust recovery will come. The Fed still is looking for signs that business profits and spending on new capital equipment -- trends that are intertwined and vital for growth -- will pick up. "The premise is that if the economy does respond and growth accelerates, corporate earnings will improve dramatically," says Bill Sullivan, an economist at Morgan Stanley Dean Witter in New York.

More than 2 million U.S. jobs have vanished since President Bush took office. Economist Lara Rhame of Brown Brothers Harriman in New York says Fed policymakers "had to acknowledge the fact that the economy is quite vulnerable because of those job losses." Recent economic signals have been varied, with signs consumers remain willing to spend but with distinct softness on the job-creation front. "The economic data the Fed officials have seen so far have been much weaker than expected, especially in manufacturing and the labor market," says economist Sohn at Wells Fargo.

II. Metal Chips: The Steel Market

That's probably why 90% of the sheet buyers polled in April expected to see flat or weaker pricing through July. In fact, all flat-rolled steel mill products were conspicuously missing from April's month's price risk list--PURCHASING's list of commodities for which sellers wield greatest pricing power. That's probably because even some steelmakers now expect the second quarter to be "equally challenging" to the first, where price increases flopped and stockpiled steel rose. Buyers suggest there's no surprise that steel industry earnings remain depressed in an environment of declining spot sheet selling prices, weak demand trends, and relatively high energy costs.

PURCHASING's view is that prices for flat-rolled steel products in the U.S. will continue to slide in early summer, with producers and distributors now agreeing with buyers that the recent price declines largely are due to restarts of idled capacity at a time when demand has stayed soft. Earlier, there were a spate of price increases being announced for flat-rolled products, with virtually all U.S. and Canadian mills announcing increases of $20-to-$30 per net (short) ton. It has been the same in Europe, with several mills announcing an increase of �10 per metric ton on all strip products after April 1. However, the speculative buying bubble burst in China. So, with trading activity in Mainland China very low, traders say North America is looking increasingly attractive as an alternative market. That's because demand in Europe remains too weak to accept much tonnage or a price hike. In the U.S., prices benefited only briefly from the Chinese buying boom and it is apparent that announced increases in sheet prices of $20-30/ton have been unsuccessful.

Hot-rolled sheet in coils sold to end-user buyers averaged $280/net ton for the third straight month in April. Buyers say the price is bound to slide in May and later months--possibly bottoming at $240 at the OEM level in August. End-user buyers reported cold-rolled sheet in coil at $400/ton for the third month in April, but buyers at processing distributors reported sales for May deliveries at $380/ton. Some mill executives have predicted an August nadir price of $340/ton. As the slowdown in automotive assembly went into gear in April, the spot-market price for hot-dipped galvanized sheet dipped $20/ton to $420. It is forecast to be $360 in August. Jim Alfano, president of Stelco Inc., Hamilton, Ontario, says: "There are some low-ball prices out there coming particularly out of U.S. mills. In steel markets, low-ball prices start to set the prices and that's the worry. We would certainly like to see better discipline out of some of the players in the North American market, but it shows how desperate people are with the lower level of demand. Prices have fallen very rapidly, and other mills just continue to quote lower prices." Dan DiMicco, chief executive officer of Nucor Corp., admitted to analysts in early May that softer flat-rolled steel prices will continue to be "definitely a negative" for the Charlotte-based steelmaker and its supply peers in coming weeks. Steel demand is soft and growth will be slow in both the U.S. and Canada. This is becoming a year where steel prices and demand haven't met earlier expectations of improvement in North American markets. He agrees that "flat-rolled prices went up too fast after the Section 201 tariff decision (in 2002) by President Bush, but they have fallen too quickly as well. There were mill people who abused the system, but there were people on the distribution side that abused the system as well," he says.

III. Metal Chips: The Forgings Market

Steel, castings and forgings markets that suffered the most in recent months have been related to business investment--and they may have bottomed out. Markets that remained strong despite the manufacturing slowdown--consumer markets such as autos and appliances--have run out of gas, and will show modest declines in 2003. That's why forging purchases are seen slipping for the fifth straight year to 1.9 million tons.

Impression die forgings are being hurt this year because the chief market is parts for the automotive sector-and there is a concerted effort to reduce inventories of unsold passenger cars, light trucks and sports utility vehicles. Also not buying a lot of forgings this year are the manufactures of such aerospace products as engines, aircraft parts, auxiliary equipment and non-military space vehicles. Equipment producers for construction, mining and materials handling is the largest market for open die forgings, followed by aircraft and parts and then steel works, blast furnaces and rolling and finishing mills. None of these markets are in recovery yet. Aerospace engines and engine parts account for the majority of seamless rolled rings produced, so it's no wonder purchasing is off-especially since the second-largest sales market is aircraft auxiliary equipment and missiles, space vehicles and parts.

You know, for many involved in competing in global markets, the words integrated supply chain strategy are beginning to take on the hollow sound of some latter day business jargon. This is unfortunate because supply chain strategies are a lot more than some gobbledygook cooked up by some consultants to ensure full employment.

IV. Purchasing Focus: Supply Chain Management

Many in the business world are vaguely confused by the apparent interchangeability of the terms "supply chain management" and "supply chain strategies." One reason for confusion is that many companies began a drive to improve competitiveness in the early 1990s by working on supply chain management concepts. The problem was that they no clear idea about supply strategies or even about the strategic significance of the supply function. For many companies, supply chain management became a new version of the relatively unsuccessful materials management approach to supply in the 1970s and 1980s. Materials management failed in most cases because it created new functional silos but never got very far in terms of creating strategies of organizations around them.

In an effort to put a tangible handle on strategic sourcing and the overall strategy of supply chain management, let's use some very plain talk to describe this new concept. For starters, think of supply chain management as the recognition of a direct link between leadership and control of the supply function to the ultimate end customer and corporate competitiveness. Supply chain management is based on the premise that such traditional areas for developing competitive strategies as marketing, finance, production, and design are yielding progressively declining results in terms of winning competitive advantage. Supply chain management, on the other hand, has been relatively unexploited as a competitive resource.

In simplest terms, an integrated supply chain is a connected series of organizations, resources, and activities involved in the creation and delivery of value in the form of either finished products or services to paying customers. Management of this connected series (supply chain) involves the integration of all decisions and information that affect the design and flow of purchased items/materials/services into and through a company or corporate entity to finished products/services. Under management of this supply chain, internal and external materials decisions become part of a single set of sourcing strategy decisions aimed at winning customers and increasing competitiveness.

Harkening back to the need for companies to compete on a global basis, the purpose of the supply strategy and the management of the supply chain is to bring about integration of the processes required to deliver value to customers. For many companies integration may well prove to be the most severe challenge of supply chain management. Integration of processes, for instance, involves going all the way from determination of the product or service that the customer wants and needs to creating that new product or service. In most cases a company achieves this integration through a new product development process and then delivers that product or service anywhere in the world through an efficient order fulfillment process. The order fulfillment process, itself, often also links into multiple tiers of suppliers. Finally, after-sale service is often critical to the competitive success of a firm.

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

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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