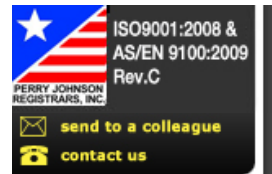




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Tom Stundza's Comments

Welcome to the May 2006 edition of MetalsWatch! This is Tom Stundza, executive editor of Purchasing Magazine and Purchasing.COM.

Output at U.S. factories, mines and utilities rose to a greater-than-expected 81.9% in April, as capacity use rates climbed to the highest since July 2000, according to a new Federal Reserve report. Total industry capacity utilization has been above the 1972-2005 average of 81% for three months in a row now. Manufacturing's capacity utilization rose to 80.8% in April, the highest since June 2000, putting it above its long-term average of 79.8% for the sixth month in a row. What does all this mean? Simple: the economic boom will continue as far as the eye can see. This edition's Cover Story will explain why the economy in general and manufacturing in particular are continuing on an upward track that started in May 2005. Actually, manufacturing output would have been higher except for somewhat depressed production of motor vehicles and parts. Economic growth in the U.S. surged to an annual rate of 4.8% in the first quarter, its best performance in more than two years. The strong GDP advance came from a snap-back in economic activity from a weak fourth quarter, when GDP rose by just 1.7% when the world's largest economy still was grappling with the after-effects of the Gulf Coast hurricanes of last summer. The strong rise in GDP in the first three months of this year came on the back of higher personal spending, equipment and software expenditure, exports and federal government spending. Economists believe economic growth for the second quarter will clock in at an annualized pace no lower than 3%.

No one can honestly say they projected anywhere near the surge in nonferrous metal prices over the past eighteen months. All commodity analysts have been forced to regularly raise price forecasts for copper, aluminum, nickel and other nonferrous metals in an attempt to catch up to surging prices--and yet they are still significantly below spot prices and the London Metal Exchange futures prices. Large industrial metal consumers have been caught short of their metal requirements and have refused to hedge believing the peak had come, which hasn't yet happened. So, the prices being paid are triple or quadruple what they were 18 months ago. While metal demand growth from China and other developing countries has been well documented and understood, metal supply disruptions have generally been underestimated. Many of these supply constraints have been unplanned and actually triggered by metal companies overworking production capacity without adequate maintenance programming. Another factor is the lack of sufficient modern capacity expansions over the last decade--partly because of heightened environmental regulations and partly because of insufficient profits to finance construction. Most analysts and managements had expected steel pricing to continue declining this year, but prices have risen lately. In this edition's Metals Chips segment, we'll explain why steel prices which had slumped in 2005 and early 2006 lately have increased and for totally different reasons that what's impacting nonferrous metals.

And, finally, in Purchasing Focus, we'll discuss a new report on how companies that outsource parts of the supply chain can get back in touch with such critical data as product changes and cost levels. A new report by McKinsey & Co. suggests that recapturing critical data is needed for companies to improve their choice of suppliers.

I.

This edition's Cover Story is today's economic boom--spurred by lower tax rates, huge profits, big productivity, plentiful jobs, and an ongoing free-market capitalist resiliency. The economy hasn't lost much steam in this second quarter because of considerable momentum in manufacturing and the service sector. Personal income also continues to grow at a solid clip, a good sign for consumer spending. Atop that, the U.S. economy will continue to grow in the second half of 2006, the nation's purchasing and supply management executives have concluded in a semi-annual economic survey released by the Institute for Supply Management early this month. Manufacturing revenue is expected to grow 6.6% in 2006, while non-manufacturing revenue is expected to be up 6% during that period. The latest ISM survey is stronger than the previous semi-annual economic outlook.

"There's no sign that manufacturing is slowing in this economy," says senior economist Drew Matus at Lehman Brothers in New York. And that may be why an upturn in gas prices is not stopping the economy the way it did three decades ago. Still, a big question is whether consumers will continue to take elevated gasoline prices in stride. That's because a big rise in energy costs pushed U.S. producer prices up by almost a full percentage point in April. Still, when stripped of volatile food and energy costs, producer prices barely moved at all, rising one-tenth of one percent. That means that (one) productivity gains have kept inflation depressed and (two) raw materials costs aren't hardly being passed up the chain to finished goods. In fact, Treasury Secretary John Snow, who has a doctorate in economics as well as a law degree, now believes the U.S. economy can expand faster than the 3% rate most economists think is possible without spurring inflation. What's needed? He says its continued strength in capital spending, continued technological innovation and more Americans rejoining the workforce. As for the economy's energy angst, crude oil pricing may have peaked. Crude oil futures are retreating, dropping well under \$70 a barrel in New York this month from concerns that rising global interest rates will slow economic growth and curb fuel consumption. And just this month, Persian Gulf producers admitted they have been oversupplying the market, with as much as 2 million barrels a day "floating" around in search of a home.

Since mid-2003, there's been an especially healthy rate of expansion for durable goods that has kept machinery and equipment humming, grown activity within the transportation sector and spurred expansion among warehousing and storage companies. "The industrial side of the economy continues to expand at solid rates," Brian Bethune, an economist at Global Insight in Lexington, Massachusetts. "For many manufacturers, this is really the sweet spot of the expansion." New orders for manufactured goods have been elevated as businesses invest in new equipment to meet expanding demand. Firms are using growing profits to replace outmoded equipment and add factory space. North American industry headed into the spring with a full head of steam. Industrial production that is, output at factories, mines and utilities--increased in April for the sixth time in seven months as manufacturers benefited from growing demand at home and abroad. Industrial strength has been broad-based lately: Machinery, clothing, consumer appliances, furniture and carpeting, computers and business equipment all have posted production gains. Looking ahead, even with seasonal midsummer slippage, the industrial production index will be setting records for the rest of the year.

II.

The North American steel market is heating up and Metals Chips finds that prices are quickly heading north despite a sharp increase in imports. In fact, the regional steel market has been surprisingly strong this spring, boosting transaction prices back to about where they were early last year. Steel supply and demand in North America slipped 4% in 2005 due to reduced buying by automotive, major appliances, machinery, industrial equipment, containers, packaging products and electrical equipment. So far this year, increased metalworking activity and nonresidential construction have accelerated steel purchasing activity at an overheated 13% annualized rate--just as price-depressing stockpiles have been worked off and lead times have extended.

The steel market early this spring actually had found a rhythm of slightly improved purchasing and gradually higher pricing. But, as the second quarter has progressed, buyers have increased reports of spot market shortages as mill leadtimes have extended into the third quarter and imports have become harder to secure. Spot prices of benchmark grade hot-rolled sheet have continued to rise and there are expectations of June-July pricing at \$600-to-\$610/ton. A very strong summer for the steel market could be shaping up, suggests analyst Mike Gambardella at J.P. Morgan Securities in New York. And it's not just carbon and alloy grades; buyers have reported that some stainless mill products are on allocation and the mills want higher prices in coming weeks.

Also, steel inventories have not been rebuilt, despite the best efforts recently of many distributors. Analysts think many distributors and processors under-bought versus requirements, because of an expectation of lower prices, and are now seeing some short supply issues. The most-recent price inflation, particularly for flat-rolled steel prices, has gained traction from improving fundamentals in the North American market caused by ever-strengthening domestic steel demand. And, just as buyers are picking up the purchasing pace, import activity may be declining due to rising global steel prices and the weakening U.S. dollar. Steel prices also are being inflated by continued production discipline in the supply base, and a continued rise in scrap prices, which typically act as a leading indicator for steel prices. The ability of the steel producers to manage production and steel buyer expectations appear to be improving. Additionally, recent disruptions to the North American supply base have included (one) an outage at Mittal Steel USA's #3 melt shop at the company's Indiana Harbor plant in East Chicago, Indiana, (two) the labor lockout at AK Steel's Middletown, Ohio, facility, (three) a blast furnace outage at CSN in Brazil, a major supplier of slabs for North America and (four) a slower-than-anticipated ramp-up of the #14 blast furnace at U.S. Steel's Gary Works in Indiana.

The scrap price increase is fueled primarily by the demand from the domestic mills, while the export activity (which had previously been a major player in pushing scrap prices up) is relatively calm. Were the global orders for scrap to rise considerably in the coming months, we could see domestic mills scraping for (no pun intended) scrap, further boosting the materials' prices. Several steel buyers now expect strong markets through year-end. Upward pressure on domestic steel prices should intensify if lower-than-anticipated import activity reduces overall supply in the second half. That's because buyers have indicated that import offer prices are now equivalent to domestic pricing; so, the relative attractiveness of buying imports has diminished. And, since the gap between the domestic and imported prices has narrowed significantly, analysts such as Aldo Mazzaferro at Goldman Sachs in New York believe that domestic mills have the pricing power in the near term. Michael Willemsse at CIBC World Markets in Toronto agrees that as long as inventories can be managed through the summer months, pricing should remain strong.

And it doesn't appear that higher prices are slowing steel demand growth within key steel-using sectors. Corporate America remains flush with cash and the pressure to improve productivity and efficiency remains intense. So, shipments of industrial machinery and other forms of heavy equipment increased by 10% in 2005 and double-digit growth is possible again this year. Most analysts also expect domestic demand for metalworking machinery, construction machinery, farm machinery, lawn and garden equipment and mining and lumbering equipment to post increases in 2006. In fact, the long-awaited recovery in nonresidential building construction are bolstering spending on elevators, moving stairways, conveyors, and other types of material handling equipment. Even HVAC (heating, ventilating and air conditioning equipment) and commercial refrigeration equipment is having another solid growth year.

Interestingly, the health of the domestic appliance industry has been a big question mark. But, the merger of Maytag into Whirlpool is about to trigger additional equipment installation, laundry manufacturing and home appliance assembly in North America. Steel buying in the second half now is expected to increase to support expanded appliance production scheduled to begin before the end of the year. Automotive is another question mark. The problems of the North American Big Three automakers are well known -- high costs for raw materials such as steel and plastic along with heavy pension and other labor expenses, in the face of declining market share as foreign-based manufacturers increase their sales. This situation for Ford, General Motors and Chrysler "will remain dismal" this year, according to the Conference Board business research firm. But, the new domestics will do well so ScotiaBank economists believe overall sales will slip only slightly to 16.2 million units from 16.3 million in 2005. And, even if the Big Three and their parts suppliers reduce the steel tonnage they are buying this year, the new domestics are expanding their purchases.

It has never been simple to manage the information that flows through the supply chain. Companies must work closely with suppliers, logistics providers, distributors, and retailers to collect and manage information about customer demand, sales orders, distribution schedules, production planning, manufacturing, sourcing, and product design. But this task has become even more complex because outsourcing has stretched supply chains around the globe. We'll discuss why this has to be done better when we return with Purchasing Focus--but first this.

III.

Welcome back to Metals Watch and this edition's Purchasing Focus. Companies not only buy more of their raw materials, components, design services, and manufacturing from far-flung third parties but also rely on contractors to coordinate the manufacture and movement of their goods. Both trends reduce costs, but purchasing executives have given up something valuable: easy access to critical data such as details about quality, supplies on hand, and manufacturing capacity that could help raise productivity.

For example, a company's supply planner, trying to meet a spike in demand for certain products, needs capacity and inventory information from several suppliers and/or several contract manufacturers, but the data may be locked up in the IT (information technology) systems or spreadsheets of a dozen or more companies. Likewise, a manufacturer seeking to reduce warranty costs may want to connect data at the far ends of its supply chain, from field service technicians making repairs to components suppliers trying to keep their costs low.

Reconnecting the dots isn't easy, given the widening range of players in the supply chain and their divergent interests and incentives. But without access to accurate and timely data, companies will struggle to adapt their supply chain networks to support newer products, geographies, and changes in the supplier base. They also will find it burdensome to comply with regulatory requirements, such as Sarbanes-Oxley, as well as with international tax laws when they have fiscal responsibility for materials and transactions occurring beyond their organizational walls. Finally, if the supply chain is poorly integrated, the partners will duplicate their investments in business processes--reducing the efficiency of the whole chain.

Each supply chain partner typically collects and monitors data at its stage of the process and then passes on information about volumes, prices, and dates for components and products. So, purchasing managers have to identify which types of information are critical and then consolidate the relevant data for easy access.

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

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