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MetalsOutlook™ December 2008

Publisher's Statement

The recession is upon us. Nothing the U.S. Government does will change GDP from the two consecutive negative quarters that define a recession. However, there may not be four quarters of back-to-back negative GDP because of various bailouts in countries around the world. There are two sides to this coin in the U.S.: stabilizing bank and business balance sheets on one side and stimulating consumer spending on the other. If the coin lands on its edge, we've got it made.

Short of that, some U.S. manufacturing sectors will fair well while others get bludgeoned. In our October issue, we identified the sectors that will do well as aerospace, energy, nuclear, oil and gas exploration, and defense. Those industry sectors that will bump along bottom in 2009 are automotive, any sector heavily reliant on housing, some electronics, most machine shops and assemblers, fabricators and manufacturers of consumer durable goods or industrial products. The global downturn will also result in a slowdown in U.S. exports, exacerbating the manufacturing downturn.

Mill delivery times will shorten and steel inventories will rise somewhat. However, certain alloys previously available will become very scarce. Mills will focus on common and popular alloys and try to avoid the production of alloys with lower demand where economies of scale are lost and cost per produced pound rises. This may cause a price increase in certain alloys even in the face of a recession, although stagflation across the metals industry is not seen in the most recent tea leaves.

So, the MetalsWatch! takeaways for this issue are to shift focus from the downturn sectors to the strong sectors, and tighten up every expense category through 2009 until signs of improvement begin to materialize. This is an economic correction; albeit, one that may be more harsh than previous recessions. However, it isn't an economic collapse and those who manage business well will do well when the inevitable upturn comes in late 2009 or early 2010.

For more information on the near-term economic outlook, check out the November 2008 Manufacturing ISM Report On Business from the Institute of Supply Management (formerly the NAPM, or the National Association of Purchasing Managers Purchasing Manager's Report) and the latest ISM number of 36.2%

Welcome to Metals Outlook™ December 2008

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Tom Stundza's Comments

Welcome to the December 2008 edition of MetalsWatch! This is Tom Stundza, executive editor of Purchasing Magazine and Purchasing.com.

The latest indicators point to a recession world economy that may get much worse than had been feared initially. Economists generally agree that the recession will run through 2009 and won't turn into a weak

recovery until 2010. It won't be until 2011, they say, before the world economy returns to solid growth. Our **Cover Story** will focus on North America, where consumer durables are being hammered as household confidence declines along with housing prices--and as fears of job losses abound. North American vehicle sales and production have been weak in 2008 and will decline further in 2009--forcing automakers to already announce production cuts for 2009.

Construction is faltering: Residential construction in the U.S. and Canada could fall to the worst levels in six decades while commercial and industrial construction has begun to deflate as reduced auto and consumer goods output will mean less need for business investment and factory expansion. Machinery manufacturing also is weakening. Likewise, construction equipment spending and off-road machinery will not thrive during a severe building downturn. The only strong sector in the economy will be energy. Even as the economy weakens, it will support petroleum prices near \$90 per barrel, keeping most drilling and pipeline projects active.

The implications for North American steel demand will be severe on the downside, says economist and steel market analyst John Anton at Global Insight. That's the spotlight of our **Metals Chips** segment, where sheet steel purchasing--whether carbon or stainless--will be particularly hard hit well into next year. Bars geared to machining and other end-product fabrication also will show reduced buying. Growth may occur for rebar and structurals but the tone will be significantly weaker.

Plate will retain strength on grades being converted to pipe but sales into other end-markets will falter. Forgings, castings and mill products of specialty metals--ranging from super stainless to superalloys to titanium--will be sustained by production of new-generation jetliners. Boeing, Airbus and other plane builders have substantial backlogs of ordered jets that will keep metals purchasing and delivery active for some time to come.

Against all odds, Ford Motor Co. has staged a turnabout in supplier relations in 2008. The improvement is as instructive as it is surprising, according to a Supplier Business Report from the Global Insight economic and financial analysis and market intelligence house. Two studies of Ford suppliers corroborate the trend of improvement at a time when auto industry and supplier relations overall have been getting worse. Ford sources say that CEO Alan Mulally, a much-lauded supply chain thinker in his previous business life managing Boeing airplane manufacturing operations, has had a profound impact on the process.

A nearly absolute rule of thumb has been that OEMs struggling in the marketplace -- and thus cutting production and squeezing costs -- result in a decline in supplier goodwill. So, Ford's improvement is in many ways groundbreaking--if the trend continues. We'll discuss this in detail in this edition's **Purchasing Focus**.

I. Cover Story ♦ The U.S. Outlook for 2009

The U.S. economy, weakened by slow consumer spending, contracted at a seasonally adjusted 0.3% annual rate in the third quarter, beginning a discernible slump that many economists now believe could turn into a deep, long-lasting recession. "The outlook for the fourth quarter and beyond is grim, dominated by a tapped-out consumer, ongoing weakness in housing, and an incipient downturn in capital spending that promises to gain momentum," says Joshua Shapiro, chief economist at global economic and market analysis firm MFR Inc. in New York.

The Conference Board's latest economic forecast that negative growth rates for the U.S. economy in the third quarter will continue through the fourth quarter--and result in further contraction into the first half of 2009. Bart van Ark, chief economist of the New York-based business research group, says that "the economic environment in the U.S. and abroad is much grimmer than even a few weeks ago (since) markets are not reacting as hoped to the various government rescue plans ♦ and that feared global contagion has begun to materialize."

Orders placed with U.S. factories in September declined 2.5% to \$432 billion after a 4.3% drop in August, the Commerce Department has reported. Orders for non-durables fell 5.5%, the most in two years, and bookings for durable goods, those meant to last at least three years, climbed 0.9% mostly because of bookings rebounded for aircraft and new models of motor vehicles--but remained under \$209 billion. So, excluding orders for transportation equipment, which tend to be volatile, bookings fell steeply.

"There's not a lot of hope on future orders and production," says Guy Lebas, chief economist at Janney Montgomery Scott in Philadelphia. "The economy was on the edge of a precipice, and the credit crisis gave it a shove. Manufacturing will weaken because of slowing exports." That's because the global economic outlook is deteriorating. Manufacturing and construction in South America, Western Europe and industrialized Asia outside China are weakening rapidly. Monetary and fiscal stimuli should limit total economic damage through 2009, economists suggest. But they agree that demand for steel, nonferrous metals and other commodities will be soft in the developed countries and will grow slowly in developing nations.

Economist Ernesto Aleman at Well Fargo Economics in Minneapolis points out that "the mighty U.S. consumer doesn't seem that mighty anymore" as adjustments are being made to the new economic and credit environment. It is clear, he says, that the mighty U.S. consumer has finally given up.

A report from the Conference Board showed that consumer confidence hit a record low in September. Further proof is that personal consumption expenditures dropped 3.1% during the third quarter of the year after improving 1.2% during the second quarter, which was helped by the administration's tax rebate. So, the 3.1% decline in consumer spending actually subtracted 2.25 percentage points from the gross domestic product and contributed to the 0.3% GDP decline.

The two latest key Purchasing Managers Index reports didn't do anything to help improve the economic outlook. The Institute of Supply Management's index of manufacturing activity fell to a 26-year low--actually sliding into recession territory--at 38.9 in October, down from 43.5 in September and the 49.9 in August. A number below 50 is considered to be a sign of business contraction at U.S. factories. The October ISM reading was the lowest since September 1982, when it registered 38.8. Economists had

expected the October index to fall since the Purchasing magazine index of business conditions from buyers was 35.6 in October, down from 42 in September and 41.9 in August.

Meanwhile, a Federal Reserve Board survey finds that banks continue to tighten lending terms for the nation's consumers and businesses, hamstringing the economy and raising the risk of a protracted recession. Some 95% of banks in the U.S. said they tightened price terms on commercial and industrial loans to large and midsize firms in the past three months, according to the Fed survey. A total of 85% tightened lending standards, compared with 60% in the previous three-month period, which ended in July.

Roughly 60% of U.S. banks tightened lending standards on credit-card loans and other types of consumer loans, while about half said they raised the minimum required credit scores for such loans. The survey, which was conducted in October, found that the moves were driven by more pessimistic views on the U.S. economy as well as rising loan defaults in recent months. "This means the downturn is likely to be deep and will last longer than anything we've seen in a long time," says Michael Darda, chief economist at Stamford, Conn.-based MKM Partners. "There's still a lot of pain in front of us," he adds.

II. Metal Chips ♦ North American Steel Demand

Looking at the traditionally cyclical steel market, the recent uncertainties in the credit markets and a much weaker economic environment means no strengthening in important end-use markets. A somewhat sobering review of the 2007-2008 steel market finds that demand has been less robust than previously anticipated. Steel use last year was down 11% and looks to be sliding by another 5% or more this year. The end-product consumers--the people who buy the stuff made from steel--have spent the past two years straining under the combined weight of housing gloom, high energy bills, rapidly climbing food costs and a tougher market for consumer credit.

That's why analyst Anton at Global Insight says carbon and stainless steel prices have passed their peak. That's also why analyst Chuck Bradford at Bradford Research/Soleil Securities expects total mill shipments for this year to be closer to 100 million net tons than the 105 million tons of 2007--and then to fall to less than 95 million tons next year.

Meanwhile, Gary Stern, president of the Minneapolis Federal Reserve, suggests that "the bulge in energy and commodity prices is apparently behind us." And that's probably true for steelmakers. With producers reducing smelting operations by 20% to 25% this quarter, the need for scrap has fallen--and so have scrap costs. Purchasingdata.com calculations show that U.S. prime scrap steel prices have fallen nearly 60% since early September to about \$400/gross ton. And, as analyst Peter Marcus at World Steel Dynamics has been saying, "We aren't near the bottom yet."

Bob Garino, Purchasing.com columnist and commodities guru at the Institute of Scrap Recycling Industries, reports that scrap prices "are changing fast and only in one direction--down." That's because domestic demand for ferrous scrap is nonexistent as steel mills work off inventory in the face of falling scrap prices and continued soft demand for finished steel. And that has affected demand and mill prices of stainless steel as much as carbon steel grades.

As the global economic slowdown crimps demand for virtually every commodity metal, nonferrous metals sales and prices are in a fourth quarter decline. Nickel sales are down because demand for stainless steel has crumbled during the global economic crisis. At the start of the year, GFMS Metals Consulting had expected a rebound in stainless steel markets by midsummer. "This has, of course, not happened and instead the global stainless steel sector has worsened," writes the London-based research house.

So, the International Nickel Study Group's October market review concludes that "any recovery in stainless steel production and primary nickel demand is not anticipated for until well into 2009." Nickel demand had been expected to increase by 5% this year and another 4% in 2009. Instead, nickel use is sliding by at least 6%, according to the INSG report, which also says the 2008 decline in world stainless steel production now is expected to continue well into 2009.

A review of North American stainless and superalloys markets finds a mixed bag. The already weak automotive sector has deteriorated further as consumer demand has declined significantly. There has been purchasing growth of specialty metals from makers of industrial gas turbines and wind turbines being marketed in the U.S. and Middle East. But, purchasing by the aerospace market has dropped somewhat-- mostly because of the cumulative impact of production postponements of Boeing 787 and Airbus A380 airliners and delayed deliveries of new plans to domestic U.S. and Canadian fleets.

Purchasing of stainless and superalloys for general industrial applications has been erratic and now is slipping. Buying of these specialty metals for medical applications have been flat this year, even though raw material prices are substantially lower--especially for titanium. Looking ahead, CEO Anne Stevens at key supplier Carpenter Technology cautions that as the domestic and international economies soften, there is the potential for an even steeper downturn in overall market conditions.

A company's supplier satisfaction results typically come from measuring such parameters as willingness to share technology, confidence in business prospects, pressure to reduce prices and improve quality, profit opportunities, the ability to recover material cost increases and overall trust. Of course, the success is relative and it takes a while for supplier partnership offensive to gain momentum. The Aligned Business Framework at Ford Motor is a three-old-old strategy initiated by Tony Brown, the group vice president for global purchasing. The aim was to reduce the number of suppliers and to generate elements of collaborative Japanese-style purchasing with the companies that remain. We'll discuss this in Purchasing Focus when we return, but first this.

III. Purchasing Focus ♦ Supplier Goodwill

Certainly, Ford is still no match for Toyota, Honda, BMW and a few others when it comes to supportive and efficient supplier relations. But the improvement made in 2008 has been striking. Even companies

with a history of working well with suppliers have seen relations suffer this year as sales and production has declined in North America. But Ford--while closing plants and slashing production--has moved in the opposite direction in terms of supplier satisfaction scores.

In the latest Supplier Business Report survey, fewer supplier respondents were reconsidering doing business with Ford because of OEM financial problems than those rethinking whether to keep supplying General Motors or Chrysler. To be sure, Ford's number was still much higher than Toyota, Honda or Volkswagen--the other companies measured in the survey. But it was a lower percentage than General Motors and far better than Chrysler.

Ford ranked about even with GM in the survey in terms of how suppliers regard the OEMs' long-term prospects. But it was significantly better than Chrysler on that score. One outstanding area of Ford improvement is in the level of trust that parts makers have in the OEM. In response to the survey question: "How highly do you trust the commercial partnerships?" Ford outscored both Chrysler and GM, with far fewer suppliers citing a "poor" trust level with Ford. And compared with GM, many more called Ford's trust level "good".

Ford's payment terms were rated even with GM's and much better than Chrysler's. Indeed, Ford's score for payment terms was nearly even with Volkswagen -- a huge improvement over the past five years. Ford also separated itself from GM in terms of how poor market conditions in North America have affected promptness of payments. A significantly higher number of suppliers say Ford is not paying less promptly than either GM or Chrysler.

Ford now has 65 preferred suppliers. Tony Brown says the preferred-supplier initiative is working and has improved Ford's relationships with parts makers. These suppliers have said that Mulally's pro-active involvement in the supply chain and the transfer of Paul Stokes, Ford's head of European purchasing, to Ford's U.S. headquarters in Dearborn, Mich., has had a constructive impact on Ford's supplier relations. Stokes picked up many of his notions about purchasing while serving as the procurement chief at Mazda before taking the top purchasing job at Ford of Europe.

And that concludes our 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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