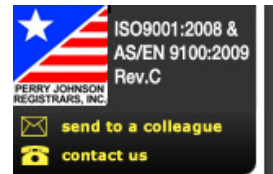




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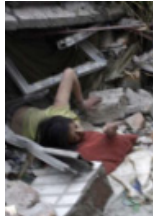
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MetalsOutlook™ June 2008

Publisher's Statement

In past issues, I have written about metals industry concerns in this Publisher's statement, and we have kept this e-mail list private and strictly for the use of MetalsWatch!. In this issue, I want to discuss a concern of a very different, urgent matter.



My wife and I recently returned from a sightseeing trip in China that was planned months before the recent earthquakes. We had to reschedule our visit to the southern regions of China due to aftershocks. However, the greatest aftershock now is the human suffering there. The loss of life has been devastating. Over 7,000 schools collapsed during school hours. Most of those precious young lives were lost.

The earthquake damaged almost all the roads into the hardest hit areas. By now, those buried under the rubble are also lost. The death toll may rise above 100,000. Over 350,000 were injured and several million are homeless. Getting food, clothing, shelter, water and medicine to the survivors is the immediate focus. There is manpower to do it, but many supplies will be needed to help these people. The Chinese government has made a direct appeal for tents so displaced people will have some kind of shelter and privacy.



All Metals & Forge is making a substantial contribution to the recovery effort. Even in these uncertain financial times, our difficulties are miniscule by comparison. So, in a significant departure from previous Publisher's statements, I am asking you to help through an immediate, direct donation to any of the following organizations:

U.S.-based organizations

- [Chinese Philanthropy Global Partnership](#)
- [Global Giving: China](#)
- [World Vision](#)
- [Mercy Corps](#)
- [Save the Children](#)
- [Half the Sky Foundation](#)
- [Other U.S.-based organizations](#)

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Also Include: Name and Address Info of the person(s) donating

We recognize that there is also a great need in Myanmar, and you may be moved to make a contribution intended to help those people. Whatever contribution you make will help lift up the lives of these people at their time of greatest need. I want to personally thank you for the opportunity to present this to you in lieu of my usual commentary before you read Tom Stundza's remarks or the ISM information. Thank you for your understanding and concern.

For more information on the near-term economic outlook, check out the May 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 49.6%

Welcome to Metals Outlook™ June 2008

Lewis A Weiss
Publisher
Comments to Publisher: publisher@steelforge.com

All Metals & Forge Group, LLC
330 Changebridge Road
Pine Brook, NJ 07058
USA

Phone: 1.973.276.5000
 Fax: 1.973.276.5050
 Toll Free: 1.800.600.9290
<http://www.steelforge.com>
 E-mail: info@steelforge.com

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Tom Stundza's Comments

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



Many analysts think that the country has already toppled into a recession. However, while recent data makes it clear that the economy is struggling, it's still unclear whether the economy is in a full-blown recession. That's because overall economic growth, as measured by the gross domestic product, eked out a tiny 0.6% rate of increase in the first three months of the year, the same anemic pace as the final three months of last year. At the same time, there was a 2.2% rate of productivity growth in the first quarter that was up slightly from a 1.8% increase in the fourth quarter of last year.

Tom Stundza In our Cover Story segment, we'll discuss why some economists believe that increased productivity in a weakened manufacturing economy will dampen inflation pressures from higher wages and other labor costs. However, the sharp industrial slowdown is occurring at the same time that energy and raw materials prices continue to inflate. Steel export orders are rising as imports are falling so there are tight steel supplies from the mills. So, buyers at numerous metalworking companies say steel mills continue to aggressively raise prices and now are even slapping surcharges as high as \$250 a ton on some orders being shipped to contract customers.

This is the first time in recent history that the North American steel market has muddled along at today's record-high prices. So, in our Metals Chips segment, the discussion will home in on the fact that despite the economy's woes two-thirds of companies surveyed by the National Association for Business Economics paid more for raw materials during the first three months of 2008. Many of these firms expect higher prices to persist especially for steel. Steel is the biggest pricing problem for end-user and service center buyers because transaction prices have skyrocketed in North America by 35% from last summer's lows for the 11 grades tracked monthly by Purchasingdata.com. The rising tide of regional steel prices has steelmakers seeking \$1,000 for May spot sales of hot-rolled sheet and \$1,100 for cold-rolled sheet. Those prices would be 107% higher than their prices at their lowest cyclical point last August.

The rise in steel prices has been so sharp and rapid that some buyers still are uncertain about whether to buy all they can this quarter or hold off on some purchases until the second half. That's because some buyers still believe prices could weaken in the second half if poor demand continues or worsens in the current manufacturing downturn. Few market economists see this scenario unfolding, though. That's why stainless steel sheet prices, which have been relatively flat for some months despite higher costs of energy and raw materials, are expected to begin increasing this month in the start of a rebound toward last autumn's cyclical peak.

The pressure to reduce cost puts tremendous stress on procurement officers. But procurement isn't simply about getting more for less. There are cost-cutting methods that can be used to improve a purchasing team's competitiveness. That's why sustainable procurement programs actually attach a dollar sign to every initiative to let buyers and suppliers alike know about the savings involved. Another key is to communicate goals with suppliers to get insights into where opportunities exist to cut costs. That's why we'll discuss in Purchasing Focus why purchasing departments need to analyze the entire end-product lifecycle for the purchased materials and the associated supply chain.

I. [Cover Story](#) ♦ [Is it a Recession?](#)

♦The economy is weak but not collapsing,♦ says Bank of America economist Lynn Reaser. ♦A recession can't be ruled out, although the stars are not lined up at this point to definitively say one way or the other.♦ Still, risks to the economy remain decidedly to the downside. Problems in the housing market, which are the root of what ails the broader economy, continue unabated. Home sales, housing construction, and, most importantly, house prices continue to slide. Nationally, housing prices are now down nearly 15% from their peak two years ago. Adding to pressure on prices are surging foreclosure sales, which now account for approximately one-fourth of all home sales nationwide. Foreclosed properties are being sold for as little as half their previous sales prices, forcing homebuilders and other sellers to slash their own prices.

Economists such as Mark Zandi at Moody's Economy.com suggest that a self-reinforcing negative cycle has kicked in: Foreclosures are sending house prices lower, which in turn triggers more foreclosures. An

estimated 8.5 million homeowners are now underwater—that is, their mortgage debt is greater than the value of their homes—and risk severe credit problems if they experience any income disruptions. Even a minor financial problem can be a calamity for a household with an underwater mortgage. A job loss—or lost overtime, or even a fender-bender or busted water heater—could push these households over the edge.

The weaker economy is affecting a broad array of industries, but manufacturing very clearly reflects weakening consumer consumption patterns. Manufacturing revenue growth in 2007 is estimated to have nearly matched the pace of 2006, but expansion has slowed substantially in the early part of this year. Already, industrial production has peaked. Among the major groups for which the Federal Reserve reports industrial production, activity remains weak in the production of consumer goods, business equipment, construction supplies, business supplies and materials. New orders are falling, with most of the slide concentrated in durable goods. In addition, inventories are rising steadily, setting the stage for further cuts in production.

Capacity utilization for manufacturing has fallen to 78.5%, its lowest reading since April 2005. Yet, there has been a rise in productivity this year as the number of hours worked has declined at an annual rate of 1.8%. This reflects layoffs that have been occurring as businesses have cut their payrolls in the face of an economic slowdown that has been triggered by a steep slump in housing and a severe credit crunch that has resulted in billions of dollars of losses for financial firms. Productivity for all of 2007 rose by 1.8%, up a bit from the 1% gain in 2006. Still, both of those increases are far below the growth levels of the past decade when productivity's growth was reflecting all the investments made in such productivity-enhancing equipment as computers. And, with average hourly earnings rising at only a 3.7% rate this year, most workers have not been keeping up with inflation.

Also, while output is hitting the brakes and goods-producing revenues are decelerating, cost pressures for material inputs continue unabated. The Purchasingdata.com index of industrial raw materials elevated to the highest level in April since the indicator was created in January 1992. So, the relatively flat economy is not only burdened by weak demand, but also by these continually rising costs. This contrasts sharply with the cost environment that accompanied the last national economic downturn. Lower producer prices coincided with the beginning of the 2001 recession; persistent price increases are thus far a feature of the current slowdown. That's why Comerica Bank chief economist Dana Johnson, says the recent inflation news has been bad for manufacturing. And that brings us to the steel market where prices have spiked and are unlikely to go down anytime soon.

II. Metal Chips ♦ The Paradox of Pricing

High steel prices often mean good times for producers and users alike, signaling that the metalworking economy is strong and expanding. But with a possible recession looming and steel prices are at all-time highs ♦ and apparently with room to go even higher ♦ one could be forgiven for a strong suspicion that we've entered unknown territory. Many buyers are wondering how their firms are going to collect the rising charges for steel from their customers. In fact, more metals industry foreclosures and bankruptcies are expected this year amid tightening credit terms, higher metal prices and weaker order books in several sectors.

The conventional wisdom suggests that the dramatic rise in North American steel prices in 2008 relates to reduced supply, particularly from a sharp drop in steel from overseas. While production levels have been elevated at 90% of capacity of late versus 86% last year, imported tons have fallen sharply and inventory levels are near 10-year lows. Despite high steel prices, the US market outlook varies from product-to-product. And unusually, continuing global market strength and a weak dollar have combined to deter imports and make exports an increasingly attractive activity for North American mills. Slim supplies among steel service centers and from foreign sources have kept the steel-short U.S. market in tight supply.

There has been some recent commentary on Wall Street suggesting that domestic steel companies are raising prices in excess of their cost increases. However, prices have been pushed up primarily by supply side factors: high raw material costs, a weak dollar keeping imports out and encouraging exports, lower inventories and steel mill consolidation. Raw material factors still are the primary contributor to the sharp rise in steel prices ♦ especially since iron ore costs are up 65% year over year, coking coal costs have tripled, scrap prices are jumping by double digits, energy costs are high, freight fuel charges have escalated and there are inflationary transportation vessel shortages. Domestic demand for mainstream steel products has been mixed and generally lackluster and there appears to be even more demand-related weakness to come, putting both service centers and end-use buyers at a disadvantage.

Global mills are doing a much better job at controlling the global steel price by becoming more vertically integrated. Large integrated mills (which make steel from coke, iron ore, etc in large blast furnaces) are extensively acquiring global mines to better sure up their supply chain of steel-making raw materials. And mini-mills ♦ those smaller, more nimble mills predominantly making steel by melting down scrap steel in electric arc furnaces ♦ now are acquiring scrap dealers in an attempt to better control their raw materials supply and pricing volatility.

Some analysts believe global steel pricing could stabilize over the next month or two because of home-government attempts to curb inflation. This could even trigger a moderate decline in second-half world steel prices ♦ and, conversely, further increases in U.S. prices. Note that India has taken similar steps as China in attempting to control escalating home-market steel prices by imposing duties on steel exports and cutting duties on steel imports. India and China accounted for about 17% of U.S. steel imports in 2007 ♦ 14% from China and 3% from India.

♦ Given global steel cost pressures, we would still expect other countries to take similar steps in the future, ♦ suggests analyst Michael Gambardella at J.P. Morgan Securities. In a note to clients, he says: ♦ We view this move by India, as well as the potential for other countries to follow suit, as very positive for U.S. steel producers as it will likely lead to greater export opportunities and cut down on U.S imports, further restricting supply and allowing U.S. steel producers to raise prices. ♦

Speaking during a roundtable discussion at the recent joint meeting of the American Iron and Steel Institute and the Metals Service Center Institute, domestic steel executives were in agreement that increasing global demand for raw materials and steel are only likely to intensify in the future even as they are making for volatile times for their domestic customers. That's especially true since sheet demand appears to be on the verge of sharp declines. Automotive, major appliance and machinery manufacture is sinking fast this year. In fact, North American auto production looks to be the worst in a decade and appliances are being stifled by collapsed housing construction.

Still, bullish analysts are saying that continued increases in steel scrap prices likely will lead to much higher surcharges and steel prices. Note that the closely watched auto factory scrap bundles auction price for May deliveries is at a new record of \$690a gross ton, setting the stage for shredded scrap averaging \$565 in the Midwest and No. 1 heavy melt at \$515. Analysts believe the substantial auto bundle hike was due to limited availability of prime scrap since the strike against auto parts maker American Axle & Manufacturing strike has closed numerous auto plants, there has been weaker metalworking manufacturing output overall and there are high prices for such scrap alternatives as pig iron and hot-briquetted iron.

Prices have been high in the stainless steel marketplace, as well, even though they peaked last July before moderating in following months. Now, many sources are expecting substantial price hikes in May on the back of increased raw material costs, tight supplies and low import levels. That view is supported by North American flat-rolled stainless producers who believe service center buyers will start a purchasing surge this quarter to refill regional inventories

According to International Stainless Steel Forum, global stainless steel production was 27.6 million metric tons in 2007, a decline of 2.9% compared to 2006. The decrease in production occurred in most stainless steel producing regions except Asia. There had been a strong increase in stainless steel production during the first half of 2007, which was followed by a collapse in stainless steel production during the third and fourth quarters. The collapse occurred in the aftermath of the burst in the nickel price bubble. Interestingly, there was healthy basic demand for stainless steel, which continued to increase globally during the second half of 2007. Demand in early 2008 isn't as robust, however, with buying now on an as-needed basis. Purchasing worldwide is solid from the aerospace, energy and medical market sectors but down dramatically in the larger industrial, automotive and consumer goods sectors.

Yet, market economists anticipate further increases in North American stainless steel prices, perhaps even back toward the record levels of last summer, even if supply outweighs demand. That's because regional prices remain well under global averages. Note that the moderation in alloying-metal surcharges that have restrained the price inflation in North American stainless steel is about to come to an end. Ferrochrome is rising again and now is 25% higher than at the end of December while nickel is 10% more expensive. Atop that, stainless steel scrap supply is tight (because of reduced industrial activity and expanded exports) and prices have increased by at least 5% recently. Upshot: Cold-rolled sheet, Type 304, looks to be rising 10% in May, which will bring the projected \$4270 price 18% higher than it was in December.

Corporate standardization of procurement procedures and systems remain top challenges when looking to reduce costs. But there are other cost-cutting methods that can help firms compete in today's increasingly complex global economy. We'll discuss them in Purchasing Focus when we return, but first this.

III. Purchasing Focus ♦ Collaborative Supply

You know, purchasers constantly are searching for ideal buyer/supplier relationships because such marriages won't lead to extra costs. When buyers form good strategic partnerships with their suppliers, they also get visibility into the supply chain way beyond those suppliers, according to Sanjay Argawal of Deloitte Consulting. ♦The more visibility you have in the supply chain, ♦he tells buyers, ♦the more influence and control you're able to have to prepare for supply disruptions." That, in itself, saves money. So, it's a good idea to track savings for your firm and the suppliers.

But, remember, that once there is such a collaborative relationship, the job is only beginning. Buyers need to get full disclosure about certain charges that the buyer may be expected to pay, such as the cost of goods transportation. Other examples include costs of packaging, service calls, training, associated supplies and financing, if any. To avoid unexpected fees, "everything must be negotiated and checked," says the American Purchasing Society.

Also remember that the price of non-conforming materials can run 7% to 15% the cost to manufacture, according to the Association for Manufacturing Excellence. So, rather than scouring the earth for ultra-low-cost suppliers, maybe the best place for buyers to begin achieving cost efficiency is to find money hidden in inventories, inappropriate quality and reprocessing throughout the manufacturing process. And it's also a good idea to remind sales and marketing colleagues to apply at least as much effort to selling more as the procurement organization is focusing on eliminating waste with the objective of cutting costs.

And that concludes our Purchasing Focus and this edition of Metals Watch! This is Tom Stundza, executive editor of Purchasing Magazine and Purchasing.COM.

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All Metals & Forge Group, LLC.
75 Lane Road
Fairfield, NJ 07004 USA

Toll Free: 800-600-9290 Fax: (973) 276 - 5050