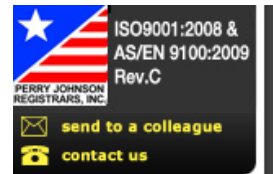




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MetalsOutlook™ February 2009

Publisher's Statement

Okay, so we're in a recession. Now what? Clearly there are opportunities in a recession. Here are just a few.

The Obama administration will spend hundreds of billions of dollars on the sorely needed infrastructure projects to rebuild highways, dams, bridges, tunnels, power and society support components that made the U.S. an economic powerhouse (defined not just by making goods, but also by being able to move goods).

This means that metalworking companies need to become adept at pursuing government contracts or tie in with major contractors who need component parts made from steel for their infrastructure repairs. The steel industry itself recognizes this, as they lobby Washington and shift their output projections into feeding government projects instead of traditional manufacturing. In fact, this is a good time for government to make these investments, since declining prices and an abundance of labor are reducing overall project costs.

Defense projects may get a boost or a reallocation of resources as the federal government rebuilds the depleted stock of military armaments and winds down the war in Iraq. Again, government projects will be the source of orders versus traditional manufacturing.

The savings government can achieve from long-term contracts at lower prices would also benefit manufacturing. This is another opportunity that should be captured early in this down cycle before state and federal infrastructure steel demand causes prices to rise. It is an opportunity for smart buyers with a long-term view.

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 Managers Report) and the latest ISM number of 35.6%

Welcome to Metals Outlook™ February 2009

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Tom Stundza's Comments

Welcome to the February 2009 edition of MetalsWatch! This is Tom Stundza, executive editor of Purchasing Magazine and Purchasing.com.

Manufacturing activity in North America and around the world fell sharply in December, suggesting that the U.S.-led recession will extend well into 2009 and possibly into 2010.

Two broad indexes of change in U.S. manufacturing activity--tracked by the Institute for Supply Management and Purchasing Magazine--fell at the end of the month to their lowest levels in years. Manufacturing is a key component of any country's gross domestic product, and the **Cover Story** will focus on the data that often serves as a barometer of future economic growth. We will also try to explain why not one of the 18 industries surveyed in December reported manufacturing growth.

Also, new orders by buyers, a gauge of future activity, sank in November and December. This downturn in demand for manufactured goods, as calculated by the U.S. Census Bureau, is prompting companies of all sizes to lay off workers, shut down plants and reduce production of such key products as steel, chemicals, plastics and other basic components. The long-awaited fiscal-stimulus package being developed by President-elect Barack Obama "cannot come soon enough," says economist Nigel Gault at economic and financial researcher IHS Global Insight in Lexington, Mass.

Interestingly, the struggles of the steel companies in North America are particularly troubling to economists. That's because the steel industry's health now is considered an early indicator of how other basic industries are faring. And, in the U.S., the mills that produce raw steel ended 2008 working at only about 43% of capacity. Combined with low imports and declining inventories, the supply side is getting close to offsetting one of the weakest demand environments ever seen. By year's end, weekly production had collapsed to half of what the industry was producing a year earlier. Analysts at Goldman Sachs Group estimate that two-thirds of domestic blast furnaces have been idled while mini-mills are running at a 50% utilization rate.

Economic growth declined in the third quarter at the fastest rate since 2001 as unemployment rose and home values, housing starts, auto production and consumer spending fell. So, economists at Morgan Stanley and JPMorgan Chase & Co. have downgraded forecasts, now predicting a contraction in gross domestic product of about 6% in the fourth quarter--which would be the biggest three-month decline in 26 years.

The **Metal Chips** segment will center on why the steel industry itself is turning to government for orders that, until the September collapse, had come from manufacturers and builders. Its executives are waiting anxiously for details of President-elect Barack Obama's record stimulus plan to prevent the recession from deepening. The steel CEOs are adding their voices to pleas for a huge public investment program -- from \$775 billion up to \$1 trillion over two years or more -- intended to lift demand for steel to build highways, bridges, electric power grids, schools, hospitals, water treatment plants and rapid transit systems.

The tremendous volatility in commodity prices is ebbing as the recession tightens its grip on motor vehicle assembly, appliance and equipment production and heavy machinery manufacturing. Analyst Kuni Chen at Merrill Lynch & Co. writes that "steel prices are forecast to decline 30% in 2009" So, we'll discuss in detail in this edition's **Purchasing Focus** why, after years of being beaten up over commodity prices, there is a huge opportunity for direct materials procurement professionals to take advantage of this year's strategic and savings opportunities. In fact, that's Goal Number 1 for this year, saving the organization money. Goal Number 2 is to minimize the risk of supply chain interruptions. Goal Number 3 is to help key suppliers weather the storm--and thus solidify the buyer/supplier relationships.

I. Cover Story - Future Economic Growth

"The recession that began in December 2007 is going to be long and drawn out." So says Sherry Cooper, chief economist at BMO Capital Markets. "The current downturn is likely to be far longer and deeper than the garden-variety recession," says Janet Yellen, president of the Federal Reserve Bank of San Francisco. And now we learn that Federal Reserve Board policy makers saw "substantial" risks to the slumping economy in December when they cut the benchmark interest rate to a record low and pledged to expand emergency loans if necessary. Central bank officials believed "the economic outlook would remain weak for a time and the downside risks to economic activity would be substantial," according to minutes of the Dec. 15-16 Federal Open Market Committee meeting recently released in Washington. Some officials saw "the distinct possibility of a prolonged contraction" stemming partly from stresses in financial markets.

Since then, the outlook for industrial production through the end of 2008 and into 2009 has worsened, according to the economists at Briefing.com. Why? Well, orders to factories fell for a record fourth straight month in November, the latest available data. In fact, the Commerce Department says orders have been falling since August, including a 6% plunge in October and declined by 4.6% in November.

The latest weakness reflects a big drop in demand for such steel-containing products as commercial aircraft, motor vehicles, machinery, defense communications equipment, heating and air conditioning products. Atop that, orders for auto parts have continued to crumble; in fact, parts suppliers have been clobbered by the recent downturn in automobile demand as the automakers who buy their products slash production. So, it's small wonder there has been reduced purchasing of steel mill products.

Interestingly, the simultaneous woes of manufacturing in rich countries and poor countries are something new in the global economy. In the past, weaknesses in U.S. and European manufacturing meant a windfall for developing economies, which took up the slack. However, new surveys of purchasing organizations in North America, Europe, Japan, India and China "underscore the depth of the global recession, which we believe will prove to be the worst in the post-war era," says economist Gault at IHS Global Insight. That's why he estimates that U.S. gross domestic product declined at a 5.6% annualized rate in the fourth quarter. And "with no evidence that the rate of contraction is moderating, we expect declines almost that large in the first quarter of 2009," he adds.

The spreading and deepening manufacturing slump has some experts worried that the global economy in 2009 won't fare much better than last year. J.P. Morgan's global manufacturing index, compiled from surveys in 19 countries, reached a new low in December, consistent with a "severe" 17% annualized contraction in global activity. J.P. Morgan estimates global output declined 4% in the last three months of 2008 compared to the previous quarter, reflecting reduced spending and available financing on autos,

housing and capital equipment. Manufacturers around the world have already begun layoffs to conserve cash and reduce production, but many more are expected this year. The job cuts are coming across borders with layoffs announced by virtually every type of business enterprise in the U.S. and Canada. And then, there's the reduced construction activity worldwide caused by the global financial crisis.

II. Metal Chips - Moving Steel to Infrastructure

In this environment, steel producers around the world have embarked on unprecedented production cuts. This massive supply response came as demand for steel weakened sharply since August 2008. Steel production in the U.S. has been declining since August and is currently at less than 50% of capacity utilization. Output for the industry was up to 2.1 million tons/week at the end of August, the American Iron and Steel Institute reports, but output had fallen to 1.02 million tons/week by the end of December. Overall, U.S. steel production dropped by 6% last year and analysts Monica Bonar and Sean Sexton at Fitch Ratings in New York expect that "the current sharp contraction in steel demand to continue to weigh on steel production and pricing through the first half of 2009."

Purchasing magazine estimates that U.S. steel purchasing will have dropped 8% in 2008 when final statistics are tallied. And now, analysts Bonar and Sexton at Fitch Ratings forecast at least another 5% decline in buying in 2009. That means production will stay weak. The United Steelworkers union expects 20,000 workers to be furloughed in 2009--as the decline in demand for steel will continue through the first half of this year and any prediction of a strong midyear rebound in demand could be optimistic. Here's why:

Economists at Bank of America Securities expect that housing construction, which has been in a slump for two years, will continue to struggle for the rest of this year. Most economists also see slippage ahead in nonresidential construction. Also, the Blue Chip Economic Indicators has written off a recovery in the U.S. market for cars and light trucks until 2010 and now forecasts 11.6 million in 2009 sales--down from new-car sales of 13.2 million units in 2008 and 16.1 million in 2007.

Global Insight economist Kenneth J. Kremer also is not so optimistic about commercial truck sales ahead. For Class 3-8 truck sales in 2009, he sees 372,100 units sold, a 14% drop from 2008. And, farm equipment makers now expect flat to 5% lower sales in 2009 for tractors, combines and other agricultural machinery in North America as the recession erodes demand. In fact, manufacturing in the U.S. Midwest has fallen to its weakest level in almost 12 years as steel, chemicals and plastics, pulp and paper, wood products, non-metallic minerals and regional machinery production all have dropped, the Chicago Federal Reserve Bank reports.

Sal Tharani, an analyst at Goldman Sachs, says that reduced steelmaking, low imports and declining inventories means that the U.S. supply side is getting close to offsetting, what many believe, is one of the weakest demand environments ever seen. Tharani suggests that, as the gap between apparent market supply and final end-user demand closes--meaning inventory destocking by distributors and end users comes to an end--he expects steel prices to move up sharply off the bottom. But, when will that happen? Some economists believe that prices will remain depressed until there is some meaningful change in demand in late 2009 or early 2010. Fitch Rating's says "there will be little cost push or demand pull through most of 2009."

Most purchasing departments aspire to be "strategic." They seek to minimize their tactical tasks and spend more time on strategic ones to save money when buying, minimize the risk of supply chain interruptions and solidify the buyer/supplier relationships. We'll discuss this in Purchasing Focus when we return, but first this.

III. Purchasing Focus - Save and Minimize Risk

Welcome back to Metals Watch! and this edition's Purchasing Focus.

Charles Dominick, the president and founder of Next Level Purchasing, has published 10 characteristics of strategic, in contrast to tactical, purchasing to help buyers achieve key goals. These unique strategic areas to be addressed are.

Spend Analysis: Strategic purchasing teams should examine the amount of money they spend in each category of goods and services and use this analysis to identify opportunities for improvement.

Supplier Relationship Management: Strategic purchasing teams should measure supplier performance and regularly spend time meeting with their most important suppliers to implement improvements.

Technology Implementation: Strategic purchasing teams must frequently update and add technologies that measurably reduce costs, decrease cycle time, and make the purchasing process more efficient.

Developing Project Plans: Strategic purchasing teams can use project management practices to map out both recurring activities and one-time projects.

Enterprise-wide Contracts: Strategic purchasing teams should consolidate spend across all parts of their organizations and enter into contracts with a limited supply base to serve the needs of the entire organization.

Forecasting: Strategic purchasing teams can regularly document changes that they foresee in price levels, availability, and markets to ensure a competitive advantage for their organizations.

Involvement in Spec Development: Strategic purchasing teams should get involved at the early stages of specification development, lending specialized knowledge in material availability, cost drivers, standard parts, and reliability of supply.

Development of Productivity Tools: Strategic purchasing teams must develop tools (such as standardized

request-for-quote templates) so repetitive tasks can be done more quickly and error-free.

Supplier Development: Strategic purchasing teams can't blindly accept the suppliers and products that are currently available. They must work with suppliers to develop new capabilities or products that will improve cost or quality.

Work Responsibility Refinement: Strategic purchasing teams have to constantly identify ways to automate, delegate, or eliminate tactical, non-value-added work.

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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