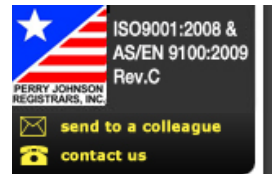




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## MetalsOutlook™ February 2010

### Publisher's Statement

We've now seen two quarters of GDP growth -- supposedly, and things should be going great. However, we're not seeing it! Are you?

After you read our story, tell us your story. We'd like to hear about your experiences in the current metals market, whether you are in purchasing, procurement, production or processing. Management, marketing, business owners -- we'll lend you our ears. Are you placing orders? Is your company booking orders? Are your customers stuck in neutral? Is your bank lending? What is happening in your backyard?

You watch the news, listen to the pundits, and read the numbers. You are an intelligent businessperson with real world experience. It's time to have your say! You tell it to your vendors, your colleagues, your spouse, your friends -- now tell it to over 70,000 readers in the metals industry. Make your voices heard!

So, let's do a reader's survey. E-mail your up, down, sideways or backwards business direction story and we'll do a compilation of the comments, and then send them out to everyone. Keep it pithy and polite. Please don't slay the messenger, but comment to [publisher@steelforge.com](mailto:publisher@steelforge.com). We will only identify you by first name and industry, so please share that with us.

We'll take the first 1,000 comments, review them, edit them for brevity, and publish a special edition -- MetalsWatch! The Reader's Perspective. We'll even send a copy to our elected representatives in Washington -- for all the good it will do. Are we all hearing facts or pure fiction -- You Tell Us!!

For more information on the near-term economic outlook, check out the January 2010 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 58.4% Do you believe it?

### Welcome to Metals Outlook™ February 2010

Lewis A Weiss  
Publisher

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### February 2010

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### Tom Stundza's Comments

Welcome to the January 2010 edition of MetalsWatch! This is Tom Stundza, executive editor of Purchasing Magazine and Purchasing.com.

After two recession-plagued years in 2008 and 2009, the economic recovery has taken on a brighter hue. Various manufacturing indexes already are showing escalating action. So, 2010 could see such commodity markets as steel off to the races. "The manufacturing economy has a lot of momentum right now'a good sign that we're turning a corner," says economist Zach Pandl at Nomura Securities. That's probably why a growing number of steel producing, processing and distribution companies surveyed in

North American foresee higher demand in 2010. Already there is a midwinter cost-push industrial environment where prices of various raw materials' steel mill products, especially, have turned upward. This edition's **Cover Story** will discuss why the Blue Chip consensus and other economic gurus forecast gross domestic product growth ahead.

The outlook for the North American steel and nonferrous industry in 2010 also is now looking very positive, says Peter Fish of metals consultancy MEPS (International), who sees demand perking up in numerous metalworking sectors. Nonferrous metals price inflation is due to a combination of speculative interest in the metals and tight global supply. Most of the steel price bullishness from the mavens comes from the need of producers to offset expected increases in the cost of scrap, iron ore, coking coal and ferroalloys. Our **Metals Chips** segment will address the brightening outlook for the metals marketplace. We will look at various metal-consuming durable goods markets that look to show growth this year for the first time in some time.

Here's a tip from the **Purchasing Focus** segment: Data from the past four recessions show that bankruptcies persist for at least a year after a downturn ends. Of the many risks this raises, one is that you can't rely on your suppliers to have reached safety yet. So, Doug Eckstein, head of procurement research at the Corporate Executive Board, says buyers who are preparing for the recovery must continue to monitor supply risk.

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## I. Cover Story -- Gross Domestic Product Growth!

The consensus of economic forecasters polled to prepare the latest Blue Chip Economic Indicators report for the U.S. expect 2010 to be a year of modest economic growth -- just about 3% -- which is much better than the previous two years. But then there's, Dean Maki, chief U.S. economist at Barclays Capital, who predicts that gross domestic product will increase by 3.5%. Maki proved the most accurate forecaster for 2009 gross domestic product projections among 60 economists polled by the Bloomberg news service. "As firms turn to expansion mode rather than survival mode, they will start raising both employment and investment spending in a similar way," Maki says. He sees unemployment falling back to 9% by the end of 2010, allowing consumers to purchase more as the year progresses. So, faced with growing demand and dwindling inventories of manufactured goods, companies soon will become confident the expansion will be sustained, Maki says.

Actually, the government's industrial production index has been improving since July, reflecting stronger manufacture of fabricated metal products, machinery and electrical equipment, appliances, and cars, light trucks and transportation equipment other than airplanes. At the start of this year, the gurus project 3.9% growth in manufacturing, the strongest rate of growth in some time. Staff economists suggested at the Federal Reserve Board's December meeting that a recovery in economic activity is gaining momentum.

Importantly, the industrial production last quarter sustained the broad-based expansion that actually began in late summer. After expanding briskly in the third quarter, industrial production increased further in October and November, according to notes of the Fed meeting. The gains continued to be broad based but were particularly strong for consumer durables and the materials needed to make them. Business surveys suggested that factory output would advance further in the coming months. Moreover, monthly surveys of business conditions, sentiment and capital spending plans pointed to a moderate rise in business spending going forward.

One dark cloud on the horizon is that U.S. construction spending contracted between 12% and 15% in 2009 and will fall another 5% to 6% in 2010, before rebounding in 2011. This isn't good news for suppliers of plate, structurals, rebar and other building materials. Note that annualized 2009 nationwide new-housing production averaged 574,000 units through November, according to the U.S. Commerce Department. "Home builders remain very cautious about starting new homes," notes David Crowe, chief economist of the National Association of Home Builders. That's because credit for new housing production remains extremely difficult to obtain by builders.

Also, spending on nonresidential construction was down across the board in 2009, with commercial down 35%, lodging down 36.5%, offices down 31% and amusements down 29%. The outlook for private nonresidential construction over the next year and a half is grim because of past overbuilding, the collapse of the securities market, tight credit, plunging real estate prices, rising vacancy rates and unemployment at 10% of the available workforce. Economists expect nonresidential construction expenditures in 2010 of \$312 billion to decline 17% from the estimated 2009 figure of \$375 billion.

Still, there are leading indicators of the overall strength of the general economy coming from the Institute for Supply Management, or ISM, and Purchasing Magazine. Both indexes entered growth territory as 2009 ended. It now appears that the manufacturing sector is showing sustained activity, according to both organizations' Business Conditions surveys. December was the fifth consecutive month that the ISM index indicated the manufacturing sector was growing, and the eighth consecutive month of overall economic growth. Except for minor blips, the magazine's index has grown steadily since December 2008. "Overall, these are very strong reports, and they suggest that the recovery in the U.S. manufacturing sector is gaining further traction," writes economist Millan Mulraine at TD Securities.

Purchasing Magazine's 90-day Buying Plans Index registered 62.6% in January, the seventh of the past eight months that purchasing expectations have been in a growth mode. The metals-buying index also has been in expansionary since last June. The Census Bureau says that a New Orders Index above 48.8%, over time, generally is consistent with an increase in manufacturing orders. So, the Purchasing index and the Institute of Supply Management's New Orders Index of 65.5% in December don't surprise the economists at J.P. Morgan Securities. They have forecast that U.S. industrial production will increase 4.7% this year and 3.9% next year and cause metals buying--especially steel buying--to increase over the next 24 months.

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## II. Metal Chips -- Durable Markets Buying

Metals demand in North America peaked in 2006 with strong declines through 2009. In fact, 2009 steel demand was less robust than even the most pessimistic analysts had anticipated; actual steel use looks to have dropped 49% when all the numbers are crunched. Last year, end-product consumers—the people who buy the stuff made from metals—strained under the combined weight of housing gloom, high energy bills, rising food costs, a tougher market for consumer credit and huge unemployment rolls. Things will look better for consumers who are working this year and recovering manufacturing will boost OEM and distributor purchasing of steel by at least 25%.

But, with durable goods orders up for three of the last four months of 2009, the stage is set for expanded demand for aluminum, copper and steel mill products in 2010. Fitch Ratings director Monica Bonar says purchasing in the first half of 2010 will be indicative of the strength and sustainability of demand recovery. She offers a caution that the steel mills must calibrate steelmaking carefully, though, noting that excess production could pressure still-recovering domestic markets in North America. Declining imports and a working down of stocks have allowed capacity utilization to improve from a low of 36% in January 2009 to about 62% currently. Fitch Ratings expects capacity utilization of between 70%--75% for the U.S. on average in 2010.

Fabricated metal production growth averaged 5% annual growth early in this decade but metalworking activity moved from down in 2007-2008 to total collapse in 2009. Now, in 2010, with improved orders for U.S.-made machinery, major appliances, motor vehicle, auto parts and capital goods equipment, metalworking activity for the end products and their components are bound to recover. Economists say that the turn in the inventory cycle that began at the start of the fourth quarter of 2009 will proceed rapidly.

A key trade group, the Precision Metalforming Association of Cleveland, says its members remain a little gun-shy about forecasting a strong pickup on the near-term horizon. Bill Gaskin, the group's president, says the latest Business Conditions poll reported only 28% expected business conditions to increase in the first quarter while 50% saw business ahead as steady. However, more-bullish economists at Moody's Economy.com and Global Insight.com suggest core orders for metalworked goods will track annualized increases of 20% in 2010 as Corporate America is likely to loosen its grip on the purse strings.

Automaking capacity in North America shrank to 16.5 million units in 2009 from 17.3 million units in 2008--and will continue to decline to 14.9 million units by 2013. In this environment, Ward's Automotive Group reports that North American automaking dropped to 8.8 million units in 2009, a 33% decline from 12.9 million in 2008. The car and light truck production forecasts for 2010 suggest assembly rebounding by as much as 20% to 10.3 million units--but that's still well below the 15.4 million units assembled in 2007. So, even the bullish forecast of 20% growth in motor vehicle deliveries to 12.4 million this year from Sean McAlinden, chief economist at the Ann Arbor, Michigan-based Center for Automotive Research, leaves the door open, so to speak, for about 2.1 million imported cars and light trucks.

Also, a key question still remains to be answered: Just how much steel, aluminum, copper wiring and other production materials will automotive need in 2010? This is important to the domestic stainless and specialty steel market, which collapsed at an annualized rate of 17% last year to 1.47 million net tons from 1.77 million in 2008 and 45% below the cyclical high of 2.66 million in 2000. Stuck in what an analyst calls "a lackluster demand environment," stainless steel use alone is projected to have dropped 15% to 1.22 million net tons last year from 1.44 million in 2008 and 42% below the 2.11 million in 2000.

Atop that, many auto parts companies are finding that managing the 2010-2011 upturn may be more difficult than weathering the 2008-2009 downturn. There is still too much capacity to meet the dramatically reduced demand for cars and trucks. And, with auto makers looking to ramp up production as the economy rebounds, many suppliers are finding it challenging to secure the necessary raw materials at reasonable prices, obtain the crucial credit and working capital required to restart production or find qualified workers willing to return to jobs they lost previously. Castings and forgings were two markets where demand collapsed last year and recent shutdowns have littered the Midwest with closed foundries and casting plants.

On a brighter note, hundreds of laid-off workers have been called back to their jobs at the Whirlpool side-by-side refrigerator and ice maker manufacturing facility in Fort Smith, Ark., a sign an increase in demand is boosting production. The decline in new housing starts and housing renovation projects reduced purchases of major appliances last year by 11%--or more than twice the drop that was forecast. Cooking, refrigeration, home laundry, dishwashing, heating and cooling, residential water heaters and commercial water heaters all declined in sales as consumers remained cautious about spending, especially on big-ticket items like major appliances. White goods manufacturing companies say sales backlogs have started to improve agree with economists that a projected 5% pickup in 2010 and 8.5% growth in 2011 shipments will require expanded production over the next two years.

You know, now is good time to improve select supply relationships for 2010 and beyond, even if concerns still exist about the future viability of some key suppliers. Procurement teams can deepen supplier relationships in two ways: One, work with important suppliers to drive supply chain efficiencies; two, source new innovations from a select group of suppliers. We'll delve into these supply chain issues when we come back, but first this...

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### III. Purchasing Focus -- Monitoring Supplier Risk

Welcome back to Metals Watch! and this edition's Purchasing Focus. Companies will continue to face big supplier risks for the foreseeable future. If history is a guide, Eckstein at the Corporate Executive Board says we can expect as many suppliers to go bankrupt in 2010 as in 2009, and this only represents part of the risk of supplier financial distress since there also are such issues ahead as product line and facility closures and even reductions in quality.

Unfortunately, the solution to the supplier-risk problem is tricky. Consider the experience of the average procurement organization. Nationally, buying groups have increased the amount of time staff spends

monitoring suppliers by 130% over the past 2 years--at the same time their budgets have decreased 25%. However, these companies still only have visibility into a little more than half of the suppliers that they monitor. So, while these companies are likely nearing the limit of how much time they can spend monitoring suppliers, big gaps in their visibility still remain.

There is a silver lining, though, according to Eckstein. Best-in-class companies--those organizations that are called "Intelligence Magnets"--are able to get better visibility into the health of their supply base, without having to throw more resources at the problem. These Intelligence Magnets draw supplier insight towards them by making it easy and desirable for stakeholders and suppliers to share, rather than focusing on better ways to gather supplier intelligence.

Actually, the results are compelling: Intelligence Magnets have visibility into 40% more of their supply base, spend less than half the time that average companies spend monitoring suppliers, receive earlier warning of impending supplier issues, and pay a much lower premium to resolve supply issues that do materialize.

Many procurement groups took advantage of the past year to drive some deep cost cuts with their supply base. While this was a necessary short-term tactic, driving costs down further and further will not serve any company well in the long term. In fact, Eckstein buying groups should start rebuilding any fractious relationships now, as the earlier you make yourself a "customer of choice" with your best suppliers, the more likely they will treat you well as competition for their time and products increase.

By showing suppliers now that you are not looking to pass cost cuts on but instead eliminate them from the supply chain entirely will endear buying groups in the eyes of suppliers and make them more likely to stay involved across the long-term. Also remember that there are suppliers in supply chain networks who have excellent ideas about the products made from their materials; so, of course, they have a vested interest to show how they can help. Then, it's up to your purchasing group to transfer those ideas into the corporate R&D process as efficiently as possible.

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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