MetalsOutlook™ July 2010

Publisher's Statement

For nearly 20 years, All Metals & Forge Group has provided timely information about metals in the manufacturing industry with a publication called MetalsWatch! Past issues of MetalsWatch! can be found by clicking here.

This issue marks the birth of a new publication that brings you information about metals plus a forecast for the industry. Published every other month, Metals Outlook! will give you in-depth and useful insight into the economy, manufacturing, metalworking, and our exclusive Metals Outlook forecast.

As we move through the summer of 2010, the ISM number is coming off near-record highs in the spring, with a general trend towards continued growth. Unemployment is still at its highest levels since the Depression and hiring remains soft. This points to a fairly typical recovery; albeit, one that is coming out of a deep economic trough. There are ups and downs, with some volatility in the markets as nearly everyone tries to determine the trajectory of the recovery.

Most media are trying to find traction in a story direction, either the double-dip downward yarn or the undulating upward narrative, but no one really knows. However, after nearly two years of fatiguing uncertainty, most of us are willing to put our faith in any sliver of sunshine and believe that a partly cloudy forecast is the new sunny.

Nonetheless, a recovery is slowly brewing, led by manufacturing, which has led the economy out of every recession. It is the leading economic indicator, and the ride is often bumpy in the first year, although we typically remember only back as far as the last few boom years. Take heart -- weak sectors have existed in previous recoveries.

Next steps: look to your marketing budgets and begin planning your campaigns. Companies that launch early in recoveries have historically shifted market share from the timid and the meek. It is just a matter of time, somewhere in the next 12 months, before the linguists will shift from "recovery" and begin using "expansion" to describe the economy.

You just can't keep a great country down.

Welcome to Metals Outlook™ July 2010

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July 2010

Tom Stundza's Comments

The manufacturing recovery continues with new orders averaging $414 billion monthly this year, up from $371 billion in 2009. According to the Institute for Supply Management, the manufacturing index reported by purchasing executives edged down slightly to 59.7 in May from 60.4 in April but there were no significant movements in such survey components as production or orders. A new report from the Commerce Department shows that orders to U.S. factories for big-ticket manufactured goods rose a brisk 2.9% in April, this increase was fueled largely by commercial aircraft orders -- but are extremely volatile from month to month due to the large-dollar size of transactions. Outside of non-defense aircraft, new orders actually fell by 1% in April, the second decline in the past three months. This decline was driven by either outright declines in orders in areas such as machinery, primary metals and electrical equipment or more moderate increases in areas such as computers and electronics and fabricated metals. Outside of aircraft, the bulk (88%) of the decline in new durable orders last month was caused by a 5.9% drop in machinery, which in turn is a major purchaser of both primary and fabricated metal products. With the positive effects from the recently expired homebuyer tax credit likely to diminish in the months ahead, more economic growth will have to come from other areas including business investment, consumer spending and exports if the manufacturing recovery is to maintain its current trajectory, according to independent economists. They also point out that, due to the monthly volatility of most durable goods orders, several more months of data will be required to ascertain if a sustained manufacturing slowdown is in the making.

Trying to put a positive spin on less-than-stellar May employment news, Christina Romer, the chair of Obama's Council of Economic Advisers, writes in her blog that "the fact that the unemployment rate fell and private employment rose are obviously encouraging signs that recovery continues." However, even she cautions that "it is important not to read too much into any one monthly report, positive or negative (since) the monthly employment and unemployment numbers are volatile and subject to substantial revision. Emphasis should be placed on persistent trends rather than month-to-month fluctuations." There still 8 million fewer workers on private payrolls than when the recession began in December, 2007. And "businesses are still very hesitant to hire," says J.P. Morgan economist Michael Ferolis. "The risk is that we never really make that turn into seeing big full-time hiring and unemployment stays elevated."The joblessness rate was just under 10.1% in the fourth quarter of 2009 and slipped to 9.7% in the first quarter of 2010 before the jump in April. "It's a very, very grudging labor market," says Joshua Shapiro, chief economist for MFR Inc. Economist Brian Bethune of IHS Global Insight says the jobs recovery could be painstakingly slow. Small businesses, worried about the effects of health-care legislation and the overhaul of financial regulation, are reluctant to hire. And employers overall remain cautious after cutting expenses ruthlessly during the recession. "Once businesses have reset capacity, they need a compelling reason to change that," Bethune says.

Here's some detail: The underlying employment numbers showed that almost all of the May growth came from the 411,000 workers hired by the federal government to help with the Census. Most of those jobs will end in a few months. By contrast, the private sector created 41,000 positions, far short of economists' expectations for 150,000 to 180,000 jobs. And the number of long-term unemployed, those Americans out of work for 27 or more weeks, remained at its highest level since the Labor Department began collecting such data in the 1940s. Still, a sliver of hope could be found in the May report as manufacturers hired 29,000 workers that month, and both hours worked -- 40.5 hours a week -- and wages increased. Factory employment has risen steadily, by 126,000 jobs over the last five months, with fabricated metals and machinery particularly strong.

To a considerable extent, the U.S. economic recovery in gross domestic product (GDP) since last summer was driven by an unprecedented degree of federal fiscal stimulus, a massive rebound in business inventories and resurgent growth in exports. However, economists expect stimulus spending to peak this quarter and then decline in the second half of this year, becoming a drag on the GDP growth rate. The sharp rebound in business inventories, which accounted for more than half of the growth in GDP during the fourth quarter of 2009 and the first quarter of 2010, has run its course.

As a result, inventories will contribute much less to GDP growth in the second half of this year and in 2011. John E. Silvia, chief economist at Wells Fargo Securities, projects that "real GDP is expected to slow to a mere 2% pace during the second half of 2010." Remember that consumer spending accounts for two-thirds of the U.S. economy. So, Brian Bethune, chief U.S. financial economist for IHS Global Insight, like other economists, believes that improved economic conditions will continue to boost spending on durable and nondurables alike as 2010 and 2011 progress. Still, they all caution about getting super-excited about projected 2.2% growth in 2010 and 2.6% in 2011. While this outlook is good, consumer spending growth has been better as consumer expenditures grew by an average 3% in 2005-2007 before collapsing in 2008-2009.

The sharp rise in the value of the U.S. dollar, particularly versus the Euro, coupled with slower than expected growth in Europe and perhaps China, suggests export demand may undershoot prior expectations, producing a sharper widening of the net export deficit that subtracts from GDP in the remainder of this year and next. Still, things are generally better in the U.S. than around the world, Goldman Sachs analyst Abby Joseph Cohen has told CNBC. "The U.S. economic recovery, even though it's in fits and starts and even though we're disappointed at the rate of the increase in jobs creation, is doing better than most of the other developed economies, including those in Western Europe and Japan," says Cohen, president of Goldman's Global Markets Institute. This meshes with the view of the Group of 20 finance chiefs who believe the global recovery, if not derailed, is at least stalling. Meeting in Busan, South Korea, on June 4 to 5, the G20 finance chiefs failed to agree on steps to ensure the economic recovery will strengthen, and said the global rebound faces "significant challenges." The global economy looks likely to avoid a relapse into recession, although the next six months may be anemic, with three main causes for concern: Europe's festering debt troubles, disappointing U.S. employment data and a. cooling of China's red-hot economy.

I. Manufacturing News: The Recovery Continues

The manufacturing recovery continues with new orders averaging $414 billion monthly this year, up from $371 billion in 2009. According to the Institute for Supply Management, the manufacturing index reported by purchasing executives edged down slightly to 59.7 in May from 60.4 in April but there were no significant movements in such survey components as production or orders. A new report from the Commerce Department shows that orders to U.S. factories for big-ticket manufactured goods rose a brisk 2.9% in April, this increase was fueled largely by commercial aircraft orders -- but are extremely volatile from month to month due to the large-dollar size of transactions. Outside of non-defense aircraft, new

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II. Metals News: Growth Across the Spectrum

In the current economic environment, purchasing of ferrous and nonferrous metals is growing by about 20% from last year's levels. Preliminary estimates from the American Iron & Steel Institute and American Institute of International Steel indicate that steel demand increased 21.3% in the first quarter to an annualized 86.4 million tons while the Aluminum Association says aluminum demand expanded by 17.6% to an estimated 19.6 billion pounds. Reason: New orders for manufactured durable goods increased in April for the fifth consecutive month, expanding by $5.2 billion or 2.8% to $193.8 billion, the U.S. Census Bureau reports.

Metalworking manufacturing has continued to gradually improve across all twelve districts of the Federal Reserve Board. Increased factory production, shipments and new orders has boosted demand for steel and other metals. That's why steel producers and metals manufacturers this month reported moderately higher production in Cleveland, Chicago, St. Louis and Dallas. Automotive and parts production increased in the Cleveland, Richmond, and Chicago districts. Increased housing construction raised demand for construction equipment and building materials in the Philadelphia, Richmond, Chicago, Dallas, and San Francisco districts. Chicago-area manufacturers also noted that demand from Asia and South America for heavy equipment continued to be robust. The output of medical equipment has remained strong in Boston and Chicago, as has high-tech manufacturing requiring more specialty metals in Boston, St. Louis, Kansas City, and San Francisco. Food processing increased in Dallas and San Francisco.

Industry shipments of titanium, titanium alloys, nickel-based alloys and superalloys increased in the January-March period from fourth-quarter 2009 levels, due primarily to improved demand from the jet engine supply chain. (Boeing management sounded a positive tone on commercial aircraft orders at a recent investor conference, saying they sees the beginning stages of a new upcycle as order momentum is so strong the company is now oversold on production through 2013.) Shipments of exotic alloys decreased, however, due to delays in projects in the defense and petrochemical processing markets.

U.S. steel producers used an estimated 74% of available mill capacity to make steel in early June, compared with just 46% in the same timeframe a year ago when the industry was struggling with collapsed demand. Key reasons include renewed buying of sheet metal by the automotive and major appliance industries. The years 2008 and 2009 proved more disastrous for sales of light-vehicles than had been expected. Even the "cash for clunkers" promotion was only marginally successful as consumers have continued to tread lightly when it comes to big-ticket acquisitions such as cars and light trucks. So, demand for light vehicles in the U.S. last year plummeted to levels not seen since 1962. Automakers are seeing slow recovery in motor vehicle sales this year. G. Mustafa Mohaterem, chief economist at General Motors, projects that motor vehicle sales will increase by 13% to 13 million units -- which will require almost 12 million in assembly of North American-made cars and trucks. Ford Motor Co. has increased its second-quarter production forecast by 2.4% to 640,000 units of cars, sport utility vehicles and trucks, says George Pipas, U.S. sales analysis manager, during the Dearborn, Mich.-based automaker's monthly sales update. Meanwhile, shipments of white goods shipments are on pace to rise 9% or more in 2010 after four years of decline, according to the Association of Home Appliance Manufacturers. That group's president, Joseph McGuire, says cash rebate programs appears to be getting consumers to buy more energy-efficient appliances. The state rebate programs, funded through the American Recovery and Reinvestment Act, consist of about $300 million in total customer rebates ranging from $50 to $200 per transaction. The U.S. Department of Energy estimates that the programs will spur approximately $1.3 billion in consumer spending of white goods.

Full-year demand for carbon and stainless steel, aluminum and copper-based metals -- will fall short of 2008 totals, though, as uncertainty about the direction of transaction prices has encouraged consumers, processors and distributors to keep 2010 purchases to a minimum. Edgardo Gelsomino of Metal Bulletin Research says such a strategy "will minimize the risks of being caught with overpriced stocks" in the event of second-half price weakness. That's because excess steel capacity operations, shorter delivery leadtimes and lower scrap prices -- sprinkled with a little competition between mills -- has caused May and June prices to decline off the cost-push heights of the first quarter.

III. Metals Outlook: Things Improve Slowly

The World Steel Association forecast in late April that apparent global steel use would increase by about 11% to 1.24 billion metric tons in 2010 after contracting by nearly 7% in 2009. In 2011, the forecasters see world steel demand growing by 5% to reach a historical high of 1.31 billion metric tons. However, this outlook was made before increased volatility of raw material prices -- especially iron ore and coking coal -- and downgraded production in China became evident. Independent analysts now are suggesting that 2010 growth in world steel use will be closer to 6%. Chinese steelmakers are likely to cut production in the third quarter because of "weak" demand from auto and appliance makers. Slower demand may prompt smaller makers to default on iron ore contracts in the third quarter, Baosteel Group Corp.'s chairman. Xu Lejiang, tells the Bloomberg BusinessWeek Green Business Summit in Shanghai. "Steel demand from automotive and home appliance industries has become weak. Iron ore costs will be the highest in the third quarter."

Steel 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 dropped 49% to 44 million tons when all the numbers were crunched. That compares with an annual average in excess of 92 million tons in 2000-2008. The early forecast for 2010, based on first quarter data, was a rebound to 60 million tons of net use. However, various surveys show that the number of metals-producing companies across North America expecting an increase in demand over the next three months has fallen sharply. For 2010 analyst Timna Tanners at UBS Securities sees capacity utilization averaging 72% from slightly better than 50% in 2009. "Better utilization is expected to be primarily a function of the end of destocking in the automotive and service center supply channels," she writes. Tanners and other metals mavens think non-residential construction as an end market can continue to weaken into 2010 but show improvement a year from now.

Steel shipments by the service centers have been below 5 million tons/month for almost two full years -- a sure sign of weak end-user demand. The steel service centers supply 40-45% of all steel products into the U.S. metalworking economy. So, even though the U.S. and Canadian shipment volume for the month of March of 3.73 million tons is better than it has been, it still suggests to analyst Paul D'Amico at TD Securities that there is plenty of validity to weak end market demand -- which explains why steel buyers remain cautious in purchasing material. Analyst John Anton at Global Insight says he "doesn't expect an astonishing recovery for any of the major steel end markets in 2010," gradual improvement should become evident in service center shipments in coming months -- maybe to around 3.75 million tons/month.

The ISM Steel Buyers' Forum reports that while inventories still are at relatively low levels, less than a quarter of those polled in late May plan to increase stockpiled steel levels over the next six months. "However, the bad news was that for the first time in nearly a year, not a single buyer reported that current receipts are ahead of current shipments," says Chicago-based independent analyst Michelle Applebaum, adding, "this is a key forward-looking metric that has been steadily deteriorating for the last few months." Other buyer surveys show that stocks of stainless steel, aluminum and copper and brass also will see no buying-to-inventory surges in coming months. First among the base metals is copper, which slipped 26% on an annualized average last year -- and is down another 19% so far this year to $2.86/lb. Several aluminum industry CEOs are cautious on the outlook for pricing, which already has dropped 17.5% so far this year to 87�/lb on world markets. Analysts agree, noting that significant additions to aluminum production capacity in 2010-2011 are projected to be more than sufficient to satisfy growth in aluminum consumption. Stocks at the mill level are projected to rise gradually, which is expected to lead to further decline in aluminum prices.

Mills have announced price hikes aimed to bring benchmark hot-rolled sheet in coil to $740/ton but actual transaction prices appear to be souring, according to market sources. Expectations of higher steel prices also have fallen. In fact, U.S. sheet prices have been falling to as low as $660/ton this month -- from as high as $690 in April -- as many buyers are waiting on the sidelines for the market to sort itself out. Tanners at UBS writes to clients that she expected even lower second-half prices lower due to downward pressure from new and restarting capacity underway -- "as we think oversupply is a risk." The *Steel Business Briefing* online newsletter says "everyone seems to be waiting to see what happens to prices and see how far they are going to fall; they're certainly not going up." Market sources attribute the decline to a seasonal slowdown and too much capacity coming back on line too soon. (Note that Severstal North America will stop production for 30 days later this month at its 3 million ton/year Sparrows Point, Md., mill due to "weakened demand and a need to better balance inventories.") Activity in the steel plate and bar markets also is lethargic, as credit for construction and machinery still is difficult to get. "It's a confused, chaotic market," a corporate procurement source in the Midwest tells the *Platts Steel Daily* newsletter. "The mills are talking a good game, maintaining that this downturn will be short-lived, maybe just 30-45 days."

Buyers of all metals, he adds, are not so sure and sense a possibly protracted period of decline, which is why they are hesitant to buy now. Buying of commodity stainless steels from the mills also have ground to a halt as buyers await price cuts from prohibitively high list prices. For June, Type 304 coil is selling, surcharges included, for about $1.91/lb, fob mill. Type 316 is hovering near $2.65/lb, while type 430 is near 88�/lb. Market sources report that an anticipated 15% drop in the surcharge for benchmark Type 304 sheet for July plus an expected 14% drop in Type 316 and as 6% dip in Type 430 are putting the brakes on June buying. One major distributor tells *Steel Business Briefing* that both June shipments and inquiries will most likely decrease as buyers will defer to July or August to take advantage of the imminent surcharge decreases.

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