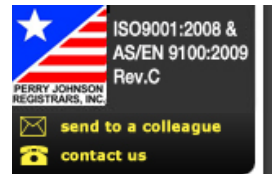




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MetalsOutlook™ October-November 1995

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October-November 1995

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I. COVER STORY

Metalworking Will Use a Lot of Steel for Months to Come

At present, the steel market is fluid, with lots of cross-currents. True, demand from service centers has weakened somewhat, but that's mostly because some distribution firms have excess sheet steel inventories. Overall sales to metalworking industries are as strong as they've been for the past several quarters. In fact, the latest data from the mills shows that new-orders remain at the same level as this time last year. That's because industrial production still is healthy in the U.S. and Canada and key steel-consuming industries remain energetic.

As we enter the autumn of 1995, the economy is definitely on the mend after a somewhat rocky summer. Latest data shows that manufacturing is recovering, the swelling of finished-good inventories is going down, employment is up, housing construction is back to normal temperature, inflation is low, consumer spending is holding firm, and consumer confidence is healthy. All that will translate into a steady metalworking market in coming months. And, of course, that will mean continued healthy activity in the steel marketplace.

Production still is strong, for example, for off-road equipment manufacturers, machinery builders, and other large-tonnage steel users. Shipments of major appliances are exactly 1% lower than last year, (and remember, appliance manufacturing last year was at an all-time high.) Then there's year-to-date demand for domestic machine tools, which is 18% ahead of this time last year. Higher machine tool orders suggest factory managers still want to refurbish their equipment to satisfy growing demand. Also, export orders have more than tripled to offset any slippage in domestic machine tool sales. In fact, the lower value of the dollar has made a broad range of North American heavy steel-using manufacturing equipment more affordable to foreign buyers.

Even the ballyhooed summer slowdown in automotive wasn't all that deep a slide. Production continues close to last year's pace. Through Labor Day, North American automotive output was less than 1-percent lower than at this time last year. True, summer sales were off, but again, not that much. U.S. sales of new cars and trucks continue to average 15 million annual units. That's only 2% lower than sales in 1994. And, remember, last year's total sales of 15.3 million new cars and trucks was the best since the 15.5 million sold in 1988. So, even if sales stay at 15 million units, 1995 will be the second-best sales year this decade.

Of course, it is true the overall North American economy is growing at a slower pace than last year. It is also a fact that corporate purchasing executives expect economic growth will slow this autumn. That's really not surprising, considering the Federal Reserve's campaign to check inflation. Seven interest rate increases since February of 1994 has made borrowing more expensive, and slowed demand for costly

durable goods. So, it's not surprising that the rate of new factory orders has fallen, or that manufacturing growth has stalled into the unspectacular range.

However, as economist Jeff Thredgold of KeyCorp in Columbus, Ohio, says -- "This slowdown may turn into a blessing for many firms still racing to keep up with last year's overheated growth in orders." Thredgold tells MetalsWatch! that "You need to recognize that we're coming down from a very high level of performance." He continues that "When you're driving down the road at 60 miles per hour, and suddenly you're going 50, you're still going fast. It just doesn't seem nearly as fast as it was before." The key point is that manufacturing still is the healthiest in several years, and a slight production slowdown simply allows firms to catch their breath.

Looking at the numbers, overall economic growth throughout North America has slowed to an annual rate of just under 3%. That's about half the booming expansion that closed out last year. Still, forecaster Charles Renfro at Alphametrix in Bala Cynwyd, Pa., tells me that "The crucial issue is that the economy continues to move forward." Remember, despite all the scary-news headlines, new orders for durable goods still are at an annual rate of \$156.5 billion. Atop that, orders for nondurable products are at a very healthy rate of \$137.5 billion.

Economists zero in on manufacturing performance because that sector represents about 20-percent of total business. And, as far as manufacturing is concerned, total output so far this year has risen at an annual rate of 3.3%. While that is slower than last year, it's still growth, and manufacturing productivity has continued to grow by close to 3.5% this year. None of this data justifies a view that a downward economic spiral has begun, and I'm not alone in this opinion. Economist Matthew Shapiro at the University of Michigan now believes the "Second quarter slowdown was an aberration." True, sales didn't match projections, inventories built up, and companies trimmed production. The former senior economist for the President's Council of Economic Advisors now says, "It was just one of those automatic adjustments the economy goes through periodically."

The problem is that the reported data of a slowing business cycle created a self-feeding feeling of bad news. However, it's evident any feeling of a collapse in manufacturing -- and steel -- is unwarranted. After all, year-to-date North American steel output is close to 93-percent of capacity. At this time, a year ago, capacity utilization was 90-percent. And, after years of retooling, spending billions of dollars on capital investments, in boosting productivity, and in cutting fat, steelmakers are enjoying their best financial year since 1979. At this year's annual meeting of the American Iron and Steel Institute, Tom Usher of USX Corp. made the comment that "Steel is alive, on the move, and hungry." After all, last year's North American use of almost 120 million tons set records. Looking at this year, the consensus forecast still shows 118 million tons of end use in the U.S. and Canada. Diane Swonk at First National Bank of Chicago is just one of several senior economists who tell us that the rest of this year and the start of next year will show strength in overall steel demand.

II. METAL CHIPS

Demand Booms for Stainless Mill Products

Robust is the word used by Allegheny Ludlum CEO Art Aronson to describe 1995 sales of stainless steel mill products. "Demand continues to grow," agrees CEO Claude Kronk of J&L Specialty Steel. But don't let these low-profile comments fool you. These guys are ecstatic about this year's sales and profits. So are the CEOs of other stainless and specialty steel companies whose order books also are full, even at current elevated prices.

Apparent consumption of all specialty steel products is 11% over this time last year. Use of stainless steel sheet and strip, the largest product line, has risen by 10%; stainless plate has advanced 14%; and stainless bar has gained 4%; tool steel consumption has skyrocketed 30%; and electric steel use is 11% higher. At this rate, specialty steel use this year will rise to a record 2.65 million tons.

Mill deliveries now are taking an average six weeks, as compared with four-week leadtimes this time last year, and the market analysts still insist that mill buyers will find supply this tight well into next year. The quickest deliveries are coming from service centers, who are holding almost five months of supply.

The J&L Specialty and Allegheny Ludlum CEOs say demand growth has been fueled by the cyclical rise in capital goods production. Execs at Armco and Carpenter Technology also point to strong sales of automotive-grade and aerospace-oriented stainless products. And, officers of North American Stainless report unexpected increased sales to makers of industrial boilers, pulp and paper machinery, chemical-processing equipment, and large-diameter pipe fabricators.

A market analysis by Arthur D. Little says the 75% growth in use of stainless by the automotive sector since 1991 can be pinned to new-technology emission-control systems. And there has been a concerted effort by specialty steel mills to replace carbon steels and superalloys in construction and process-equipment applications. Credit also can be given to the stainless industry for marketing stainless' life-cycle cost advantage over carbon steel products.

Even if the recent growth rate of specialty steel sales slows in coming years, a recent CRU International study suggests that annual stainless demand -- especially sheet demand -- will outpace supply early next decade. But, that's not a view held by the Arthur D. Little economists. In fact, they suggest that buyers will see expanded supply. Ironically, the driver will be the mini-mill invasion of the carbon flat-rolled sector. As the mini-mills move to capture an estimated 30-percent of the carbon sheet business by decade's end, integrated mills will seek out new value-added niche opportunities. And, they see the carbon steel thin-slab mini-mills enlarging their mix to include stainless.

Most of the technology making stainless flat-rolled steel is mature, but three emerging technologies could alter the supply landscape. The first is the same thin-slab casting already being used to make carbon sheet. (Remember that Nucor already is testing the waters by thin-slab casting of Type 409 stainless steel on a swing basis). Then, there's thin-strip casting, which is being developed to reduce capital and manufacturing costs, and cycle time. The third technology is new basic oxygen furnace-based melting

technology, which would allow integrated mills to swing between stainless and carbon steels depending on market conditions.

Service Centers See Slower Second Half

Summer has slowed business for distributors. Still, "An unexpectedly strong rate of steel shipments by distribution through midyear should offset an anticipated soft landing projected for the second half," and keep full-year shipments at the 26.5 million-ton level of 1994, predicts David Roland, President of the Steel Service Center Institute (SSCI). "Business has been excellent for most steel service centers," Roland says, as shipments by members are 7.5% stronger than the January-to-July period of 1994. "However," he adds, "distribution will see a slower second half."

The SSCI's Business Conditions Report at midsummer shows shipments 15% stronger for stainless steel products than through July of 1994. Shipments were 17% improved for alloy steel products, 13% better for carbon steel tubing, and 12% higher for carbon steel bars. Other categories also showed gains: Up 10% for steel plate, 6% better for structurals, and 3% for sheet mill products. However, only 57% of the SSCI members surveyed in August projected business as good or better in the second half; two months earlier, 67% had expressed such optimism.

Shipments in the second half will be slower, Roland agrees, because of seasonal adjustments and demand cutbacks in such product segments as flat-rolled. In fact, business already is sliding: Second-quarter shipments through distribution were 3.4% slower than shipments in the first quarter. "Several industries produced a record steel-consuming year in 1994, which obviously impacted well on service centers," Roland says. "But, while many of these industries are predicting healthy business in 1995, very few feel they will match the end-product volume manufactured last year."

And, there still is concern within the distribution industry about the level of stockpiled steel. Latest SSCI data shows midsummer inventories still at 7.9 million tons. That's equal to 3.5 months' of supply. "Distribution companies already are slowing purchases and depleting existing stock" because 64% of them indicated in July their inventories were too high, says Roland. "Steel buyers at service centers now project steady or slower incoming orders through the third quarter, which should lead to lower inventory levels." Still, end-use buyers should continue to see plentiful stocks and short delivery leadtimes from distributors through the fourth quarter, he adds.

Service Center Steel Stocks (Million Tons)

Jan	6.28	Jan	7.36
Feb	6.36	Feb	7.40
Mar	6.49	Mar	7.73
Apr	6.55	Apr	7.80
May	6.62	May	7.95
Jun	6.66	Jun	7.89
Jul	6.92	Jul	7.85
Aug	6.95	Aug	????
Sep	7.03	Sep	????
Oct	7.08	Oct	????
Nov	7.08	Nov	????
Dec	7.28	Dec	????

Stainless Propels Nickel Use

"The nickel market will continue to see declining inventories and higher prices on average over the next three years," says analyst Bob Hageman at Oppenheimer & Co. "That's because nickel demand from strong stainless steel and high-performance alloys markets should grow faster than any new capacity expected in the next three years." He and other nickel market observers have raised expectations of demand growth, limited expectations of world supply increases, and boosted expectations of declining stockpiles. Most 1995 market analyses expected supply and demand to be roughly in balance or leaning toward a slight deficit between new supply and demand. Now, they're all abuzz about a six-month drawdown of close to 60,000 metric tons. Although analysts expect that inventories will rebuild somewhat in the second half, there still will be a full-year inventory drawdown of close to 45,000 tons. That's why the average New York dealer price is expected to average \$3.80/lb this year, up from \$2.93 last year.

Global stainless steel production rose 12% higher last year, and is rising by the same rate this year to 14.5 million tons. North American end-use demand grew a surprising 16% last year and will grow by at least 8% this year to 2.6 million net tons. Since 60% of all nickel units go into stainless steel, stainless steelmakers are consuming a lot of refined nickel and nickel-bearing scrap (which also is in tight supply and expensive to obtain worldwide). That's why world nickel use rose 12% last year to 730,000 metric tons while refined production, however, rose by less than 5% in 1994 to 603,000 tons (with the shortfall offset with Russian imports and stockpile reductions). This year, nickel use is rising another 10% to 803,000 tons, but production will rise only 6% to 644,000 tons. And, since Russian imports are dropping by 11-12%, even more of the deficit will have to be offset through stockpile reduction.

The early outlook for next year is sustained strong demand from stainless steel and specialty alloy producers putting an even further squeeze on stocks. Stainless steel output worldwide could get as high as 15 million tons because of new capacity in the Far East and South Africa. Nickel production may rise another 5-7% because of capacity expansions in Canada, but major capacity expansions will come later in the decade -- RTZ's new nickel project in Brazil doesn't come on line until 1998 and Inco's much-touted Voisey Bay nickel project in Labrador won't come into production until the turn of the century. Upshot: Prices next year will rise well past the \$4 mark. Peter Marcus of PaineWebber Inc., in fact, sees nickel at \$5/lb.

*As nickel use climbs, stocks fall
(in thousands of tons)*

SOURCE: Oppenheimer & Co.

Steel-Buyer Satisfaction Just 90%

YEAR	USE	STOCKS
1990	660	110
1991	664	135
1992	628	198
1993	650	248
1994	730	251
FORECAST	USE	STOCKS
1995	803	206
1996	847	171
1997	872	133
1998	890	120

U.S. steel buyers are only 90% satisfied with the performance of their steel suppliers, with service centers marginally better than mills. That's the result of a survey of more than 1,900 buyers by steel industry consultants Jacobson & Associates of Rochester, N.Y. Suppliers were rated according to product quality, service, and price. A 90% quality score went to domestic mini-mills, integrated mills and specialty steel mills both received 89% scores, and foreign mills (including Canadian plants) got a 96% rating. Service centers got a 91% quality performance score, while processors (finishing plants) rated only 86%. Among the Big Six integrated mills, U.S. Steel ranked highest in product quality, LTV Steel ranked best in service, and National Steel ranked first in price. Ranked by product quality, buyers were most satisfied with pipe and tube, plate, structurals, and cold-rolled sheet.

Specialty Steel Forgings Demand is Continuing

A rebound in commercial jetliner and business jet production is triggering a recovery in inquiries and actual orders for specialty steel forgings. Also, forgings destined to become parts of military planes and missiles are selling better than the previous two years, according to the Aerospace Industries Association. Still, because the forging shops remain cautious, leadtimes have shrunk only slightly. Mill delivery still takes as long as 20 weeks for 74% of the buyers surveyed by Purchasing Magazine in August; in June, 20-week leadtimes were reported by 80% of the buyers.

"There's still plenty of room for improvement in the aerospace and aviation business," says marketing executive Lee Flowers at Inco Alloys International in Huntington, W.Va.. "In the meantime though, demand has been picking up from such other markets such as trucks and buses, off-road equipment, heavy machinery and machine tools, and flue-gas desulfurization units for power-generation systems..." In fact, land-based gas turbines have turned into a sales mini-bonanza for specialty steel forgings makers. These are power-generation heavy-duty turbines and aero-derivative turbines, ranging in size from 50 megawatts to 30,000 megawatts.

"The industry still is working to reduce its dependence on the aerospace market," says Tom MacDonald at Special Metals, which says forgings will continue to push sales into the energy, chemical, petrochemical, and heavy machinery markets. The Commerce Department, for example, sees expanded marketing by forgers into the environmental control and waste treatment equipment, equipment for urban and regional transportation systems, machinery for electric power generation and new-generation processing equipment for petroleum, chemicals, plastics, and primary metals production.

However, the forgings remain pricey, and cost has been affected last year and this by the surcharges attached to specialty forgings containing nickel, molybdenum, cobalt, vanadium, and chrome. The surcharges, in turn, have been making the "sell" of all specialty products somewhat harder in 1995, admits Dick Santoro, sales VP at Carpenter Technology in Reading, PA. "Cost of the alloys still puts specialty steel products at somewhat of a competitive disadvantage," agrees industry consultant James Redmond at Technical Marketing Resources in Pittsburgh. However, there is light at the end of the tunnel. Some firms now plan to reduce and blend the surcharges into standard prices in 1996.

III. PURCHASING FOCUS

Honda of America

Let's drive over to Marysville, Ohio, to present Honda of America with the 1995 Medal of Professional Excellence in Purchasing from Purchasing Magazine. Here's why: Honda of America makes fine cars in Marysville and East Liberty, Ohio. Honda makes pretty fair motorcycles, as well. What's the secret? Well, according to the CEO, Takeshi Yamada, "Honda's quality is the sum of our suppliers' quality and the quality of our assembly." That's why this edition's Purchasing Focus will detail why Honda of America's long-term development of world-class suppliers was a key element in receiving this year's Medal of Professional Excellence in Purchasing.

Honda's 300 purchasing professionals don't just find world-class suppliers. They develop partners in their cost-reduction, quality-improvement, and best technology-development programs. That's important because Honda's 322 supplier associates provide materials that account for 80% of the cost of the motor vehicles built in Marysville, Ohio, and it might surprise you that 80% of Honda's suppliers are North American firms.

This year, the plant will make close to 500,000 cars - and export one-fifth of them. Purchasing buys all the raw materials - steel, aluminum, chemicals and plastic resins, textiles, electronics, electrical systems, and paint. Purchasing also sources all the original equipment parts, service parts, and accessory parts. The buyers also source production support items and services, plus the machine tools and in-plant manufacturing equipment, and plant construction materials. The annual materials bill is 3.2 billion dollars. If you add transportation and various other plant services, purchasing spends more like 5 billion dollars a year. As Dave Nelson, the Vice President of Purchasing, puts it: "We work with suppliers in many different ways." Here are some specifics:

* In cost reduction, Honda sets target costs for parts. If a supplier has trouble meeting the target, Honda helps the supplier develop productivity increases to cut costs - and shares the profit savings with that supplier.

* In quality improvement, purchasing aggressively attacks quality problems at the supplier level - even to the extent of helping organize quality circles at the supplier's operation. That's because Honda has a zero-defect goal, but it has no incoming inspection.

* In new-product research and development, suppliers get involved in new car model development years before the product hits the plant floor. Suppliers are encouraged to question old designs and constantly challenge conventional design thinking. Honda personnel expect suppliers to develop leading-edge technologies. So, purchasing acts as the facilitator between Honda research and suppliers throughout the development process.

The crux of Honda's approach is to teach self-reliance to the supply base so the suppliers understand the Honda manufacturing system so well that no further help from purchasing is needed. It's working. Honda was just recognized as the top-ranked auto producer in the U.S. by the J.S. Power and Associates quality study, which reported only 70 problems per 100 Honda cars. And remember, the North American industry average is 103 problems per 100 cars.

What Nelson and his team are working for are long term, mutually beneficial relationships. So, Honda's purchasing personnel - along with the company's 200 quality workers and 300 manufacturing and production engineers - commit effort and resources to help suppliers reach desired performance levels. Nelson explains that "Three bids and a cloud of dust is not our way; we look to the heart of the supplier company." So, it shouldn't be a surprise that the interaction between Honda and its suppliers is continuous, with much movement of people between plants and engineering centers.

OUR NEXT EDITION WILL COVER: "THE 1996 MARKET OUTLOOK"

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