MetalsOutlook™ August-September 1999

Publisher's Statement

Welcome back from a long, hot and very, very dry summer. Hopefully we'll get some very needed rain this fall.

Looks like our economy just keeps rollin' along. Al Greenspan has just increased the interest rate again in August. Hopefully that will do the trick to satisfy his anti-inflationary mentality. So, let's read on about the economy and the steel outlook in general.

Designer Alloys (tm), a new service of All Metals & Forge, LLC has been well received by the market. See our article in section IV and "READ ALL ABOUT IT!"

Well, according to economists, the slowdown in second-quarter U.S. growth may only have been temporary. U.S. gross domestic product growth eased to a 2.3% annualized rate in the second quarter from 4.3% in the first quarter. Consumer spending cooled to 4% growth in the second quarter after a blazing 6.7% jump in the first quarter. Rising mortgage rates, for example, dampened the housing market, with spending on new homes and apartments growing by 5.1%, much slower than the 15.4% rate in the first quarter. However, investment by American businesses - that is, spending on new equipment and plants - grew by 10.8% from April through June, compared to 8.5% growth in the first three months of the year. U.S. personal income, one of the economy's driving forces, rose in June at the fastest pace in seven months, setting the stage for further consumer spending and economic growth. And note that orders to factories advanced in June for the 10th increase in the last 13 months as the manufactured goods segment was lifted by demand for cars, trucks and electronic equipment.

Atop that, the index of leading economic indicators rose in June for the second straight month. And, reports from the National Association of Purchasing Management show the U.S. manufacturing sector grew for the sixth consecutive month in July. It also is known that Canada's economy expanded in May for the 10th straight month, and probably grew in June and July as well, as the American economy continued to bolster growth across most Canadian industries. In fact, TD Bank says Canada's economic growth for this year is on track to hit 3.5%, which will marking the third straight year of plus 3% annual growth in the economy. That's a feat not seen in Canada since the booming mid-1980s.

So, it will come as no surprise that key steel-using industries have done better than expected. We'll discuss all this in our midsummer look at North American manufacturing. Then, we'll take a look at the steel market. We'll update what's happening in steel-mill activity, and take a look at the steel distribution industry. And, we'll detail some of the latest short-term forecasts from the metals mavens. And, finally, in Purchasing Focus, we'll discuss why many firms are giving their purchasing organizations more central control. What does that mean? It means more and more central purchasing groups have been getting the authority to make - and enforce - corporate purchase agreements for anything from paper clips to sheet steel coils.

Welcome to Metals Outlook™ August-September 1999

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August-September 1999

Industry Favorably Reacts!

I. Cover Story: The Economic Outlook

GDP, the nation's total output of goods and services, grew by $44 billion from April through June in the U.S. to an inflation-adjusted $7.8 trillion. And the U.S. manufacturing sector is shaping up for "very strong' performance in the second half," projects Norbert Ore, Chairman of the National Association of Purchasing Management's Survey Committee. "The manufacturing sector has enjoyed six consecutive months of recovery," Ore says, "and looks to be on solid footing to go forward."

In line with that view, executives from North American manufacturing and construction industries anticipate solid growth in the July-September quarter. The manufacturers' survey by Dun & Bradstreet showed not only optimism about continued strength, but also found few signs of inflationary pressures. The June survey of 1,000 manufacturing executives reported rises in production and new orders and expectations of continuing solid growth.

David T. Kresge, Chief Economist for Dun & Bradstreet, says that "Low prices, particularly from foreign suppliers, together with productivity gains are expected to hold pressures on manufacturers' unit costs at all-time low levels." Kresge says that as Asian and European economies begin to recover later on, "Manufacturers will be in an excellent position to expand their presence in those markets." The construction industry reported its strongest results in orders and prices in the latest survey since the business-information company began such tallies in 1990. Kresge says that "Order books in the construction industry are bulging, and expectations are for continued growth into the fall." The survey of 200 U.S. construction executives showed that recent increases in mortgage rates have been more than offset by high levels of consumer confidence, employment growth, and stock market gains.

In fact, the North American economy appears to be headed for a record period of growth, according to the Conference Board. The private research groups widely watched Index of Leading Economic Indicators - which is a measure of future economic activity - rose again in June. "This points to the second-longest expansion in U.S. history being firmly on track through early 2000," says Michael Boldin, Director of Business Cycle Research at the Conference Board. And just recently, a senior Treasury Department official has forecast that the economy will continue to grow moderately in the third quarter. "There are signs in the recent statistical record that the third quarter is opening at the same moderate pace at which the second quarter ended," says John Auten, director of Treasury's Office of Macroeconomic Analysis."

Here are indicators of why everybody still is so bullish on the U.S. economy:

Indicator Number 1.
Consumer spending accounts for about two-thirds of the nation's output of goods and services. Consumer spending in June was at a healthy seasonally adjusted annual rate of $6.17 trillion. Rising wages has been the reason behind consumers' willingness to spend over the last several years. The Commerce Department says consumer spending now has risen for six straight quarter at a 4% annual rate or higher.

Indicator Number 2.
But, more importantly, incomes were at a higher $7.49 trillion as the Employment Cost Index showed U.S. workers' pay and benefits rose 1.1% in the quarter ended in June. Rising incomes and stock prices have helped fuel demand for goods and services. disposable income, or the money left over after taxes, increased again in June. And, "it's quite clear that a wealth effect has been an important source of stimulus for the consumer,'' says Economist David Greenlaw at Morgan Stanley Dean Witter.

Indicator Number 3.
Sales of single-family new homes rose 3.1% in June to a seasonally adjusted annual rate of 929,000, up from a revised rate of 901,000 in May. The housing market peaked in November of last year when mortgages were near the lowest rates in 30 years and new-home sales surged to 985,000. Despite rising mortgages, new-home sales have only dipped below 900,000 once this year.

Indicator Number 4.
Sales of previously owned homes set a record in June of 5.53 million at an annual rate, even as mortgage rates increased, according to the National Association of Realtors. In recent months, economists have predicted the housing market would slow from its red-hot pace in the second half of the year, although recent data has yet to back that up. In fact, "There seems to be no end in sight for the screaming residential real estate market," says Joel Naroff of Naroff Economic Advisors.

Indicator Number 5.
Never has the Auto industry enjoyed such a sustained cycle of healthy U.S. sales. Industry sales increased 21% in July compared with July 1998, though the comparison was skewed by the United Auto Workers strikes that virtually halted North American production at General Motors Corp. last summer. This year's sales of cars and light trucks are expected to easily exceed the record of about 16.1 million vehicles set in 1986. That would be an unprecedented sixth consecutive year of strong sales. July's results were described as "nirvana" by James P. Holden, Executive Sales VP for Daimler Chrysler's U.S. operations. "It's a competitive cycle that's good for the consumer and good for us."

Meanwhile, Statistics Canada has been reporting the Canadian economy has continued to quietly forge ahead. And, in reviewing the data, economists at TD Bank say this growth should strengthen the ailing Canadian dollar, which has been falling of late over fears the U.S. Federal Reserve Board might again raise interest rates to guard against inflation in the U.S. economy. Mining production and natural gas production have been generally stronger in Canada than in the U.S. this year, although crude oil output has been weak in both countries. Construction activity has been edging up in Canada; in fact, May's numbers showed the seventh consecutive monthly advance. And Canada's total factory output has been advancing steadily since the mid-1998 strike-induced slump ended 10 months ago. As in the U.S., Canada has seen very strong output of transportation equipment this year.

Total North American motor vehicle output-including heavy trucks-through July was in excess of 10 million vehicles. That's an increase of almost 14% from the assembly in the first seven months of last year. U.S. vehicle output alone through July was almost 7.5 million units - almost 12% more than the 6.7 million built through July of 1998. Canadian motor vehicle production of 1.76 million units through July was up 22% from the number of vehicles produced in the first seven months of last year. Economists at the WEFA Group say that "With a blistering first half already on the books, U.S. motor vehicle sales will surpass 16 million units, and assembly could exceed projections of 12.5 million." For the U.S. and Canada, WEFA Analyst George Magliano still sees production of 15.85 million cars and all trucks this year, up from 15.13 million in 1998.

Sales of all types of machinery are on pace to achieve yet another sales-growth year in 1999. The rate of growth will be slow, however, because the machine tool business nose-dived earlier this year. That's because of troubles in the North American and export markets for metalworked equipment used in agriculture, mining, and aerospace. Even with the strong sales spurt reported for May, the year-to-date total of $2.2 billion is down 41% (as of August), compared to the same period in 1998. Still, this early-1999 slowdown in sales comes after six straight years of explosive growth. And, there are plenty of industry insiders who are optimistic about a second half recovery. One of them is Bob Cole, Sales VP for Applied Machinery, a machine tool builder company in Bell, California. Cole notes that commodity-grade machine tools slowed at the end of last summer, and specialized high-productivity tools held their own until late last year when sales slowed for all types of metal-cutting and metal-forming machinery. Cole says "That's because you can buy only so much stuff and get it into production so fast. You can't absorb all the machines and get all the systems working right when you consume machines so fast. You gotta take a breather." Cole foresees the second half showing "very strong" sales as metalworking manufacturers start buying again. Industry analysts also note that there are such trends as the continuing race to increase productivity that will eventually refuel machine tool orders. "Manufacturers are increasingly outsourcing and demanding low prices," Cole says, "so people will have to buy better machines in the months and years ahead to get manufacturing costs down."

Growth is being reported by the makers of major household appliances, railcars, heavy trucks and buses, and material handling equipment. All these are significant users of steel. However, sales of agricultural equipment are sliding this year.

The Equipment Manufacturers Institute's mid-year outlook sees a sales decline of 5% for farm tractors, along with a 37% collapse for self-propelled combines, a slight 1% dip in farm-field machinery, and an anemic 5% growth in farmstead equipment. Atop all that, within the farm field machinery group, negative retail sales are projected for rectangular balers, forage harvesters, grinder mixers, manure spreaders, chisel plows, windrowers/swathers, field cultivators, and disk harrows. The demand for round balers, mower conditioners, and farm loaders is flat-to-down. Sales of other farmstead equipment, such as beef and hog mechanization equipment, also is down for this year, although dairy mechanization equipment and milking machines has a projected sales increase of 10% for this year. But "ag" equipment purchasing remains a low priority among farmers. A new survey shows almost 80% expressing a negative attitude toward buying equipment. The key reason: 92% of the farmers surveyed say crop prices are too low and 60% believe equipment prices are too high for the current farm economy.

II. Metal Chips: The Steel Outlook

Despite the demand woes in the "ag equipment" and "oil country" sectors, there's been overall healthy steel use so far this year in both the U.S. and Canada. And, after getting help from their governments in shutting down the chief foreign sources of underpriced dumped imports, U.S. steelmakers are taking the lead in seeking higher North American prices big-volume flat-rolled products by as much as 9%. Unless something untoward happens to the industrial economy in the coming weeks, there's now a chance that actual steel use in the U.S. and Canada will be right around 1998 levels in 1999. The significant inventory of steel mill products that glutted the market from last August through January has been sliding gradually every month since February. And there was noticeably lower importation of the metal into North America in the first half-a trend that will only accelerate this half.

So, regional steel producers appear to be getting help in increasing prices by a sharp economic rebound in key parts of Asia's Pacific Rim, which is starting to soak up steel that earlier had been shipped into the U.S. and Canadian markets. Most major steel consumers- companies that make vehicles, appliances, heavy equipment and other durable goods-so far have been shielded from the price increases because they buy supplies under long-term contracts. But industry analysts predict these big consumers could be forced to accept price increases when they renegotiate contracts this autumn because a barrage of unfair trade complaints has choked off foreign supplies. "Strong order backlogs may give the domestic producing mills the upper hand in the negotiations for the year-2000 automotive, appliance, and capital-goods industry supply contracts," says Analyst Michelle Galanter Applebaum at Salomon Smith Barney. She forecasts that contract prices, which account for about half of annual sales, will go up 2 to 3% from those set last autumn. Steel company executives we've talked with concede they're not sure whether all the announced spot price increases will stick. But the industry's all-out war against low-priced imports clearly has bettered producers' chances by curbing foreign supplies next year. Responding to industry complaints, the governments of the U.S. and Canada have essentially blocked imports of hot-rolled steel, cold-rolled steel, and plate from some countries who had been selling aggressively in North America.

Last year, demand in such stainless-steel-intensive industries as automotive and construction collapsed throughout Asia, softened in Latin America, and have become uncertain in Europe and North America. Now, the improved economic data that has been seen in parts of Asia, and forecasts of continued strong end-use demand in North America and Europe, has caused an upward revision in forecasts for global smelting of stainless and specialty steels. Heinz H. Pariser at HHP Market Research now puts world stainless production at 17.28 million metric tons, up from 16.36 million tonnes in 1998. And he projects 17.89 million tons of production next year. "Even at that level," he says, "production will be marginally below year-2000 demand," allowing the marketplace to absorb any surplus metal produced in 1998-1999. Martin Squires at Rudolph Wolff & Co. agrees, noting that "Stainless steel has been in the doldrums, as all industrial commodities, but with signs of an improving construction climate worldwide, stainless has the potential to see double digit growth in consumption in 2000." Also note that demand for nickel-based superalloys for jet aircraft engines hasn't fallen off as much as the naysayers had predicted earlier. Atop that, the U.S. demand for nickel-based superalloys used in land-based power turbines has been growing rapidly, and has more than offset some reduced short-term sales to makers of equipment used by the process industries.

III. Purchasing Focus: Centralized Purchasing

Why has North American manufacturing companies made concerted efforts to centralize purchasing during the past five years?

Studies by industry consultants have confirmed Purchasing Magazine surveys that metals are the most popular commodities these days for centralized purchasing. In general, purchasing professionals appear to favor centralization. 70% of readers surveyed say they're satisfied with the way their company organizes purchasing. Among those who are not satisfied, nearly all say greater centralization - rather than less - would improve their buying capabilities.

Sometimes, spending is completely centralized with corporate dollars spent by the central purchasing groups, including commodity teams or councils. Sometimes, the corporate dollars are spent by purchasing personnel residing at diverse factory locations, but have to clear their buys with corporate purchasing. What's disappearing is the ability of local plant buyers making metals buys, for example, with no input from corporate purchasing councils or with no guidance from corporate purchasing agreements. In fact, only 11% of the reader's just surveyed on centralization by Purchasing Magazine say they're working in a completely decentralized environment with no corporate purchasing function in existence.

The most frequently cited benefit of greater purchasing centralization is leverage - also known as buying power. Other perceived benefits include:

- More rapid decision-making.
- Consistency of quality, delivery, and other supplier performance gauges. Paperwork reduction.
- Common measurement capabilities. Greater opportunity for specialization among purchasing personnel.
- Better utilization of purchasing talent and expertise.
- Greater opportunity for systems integration.
- Greater opportunity for integrated supply chain management.
- Ease of implementing e-commerce solutions.
- Product standardization.
- More influence with key suppliers to insure better problem solving.
- Elimination of redundant activities.
- Lower freight costs.

Centralization of purchasing authority typically translates into bigger contracts with fewer national suppliers. But, while purchasing pros generally favor such consolidations of major spending, it is not nirvana. There are negative effects of poorly executed central purchasing decisions. One could be the inability of the local manufacturing and purchasing team to respond quickly to unforeseen circumstances that often generate rush orders or emergency orders. Still, it appears that Corporate North America's preoccupation with bottom-line efficiencies will expand - rather than contract - central purchasing decision-making in the years ahead.

IV. DESIGNER ALLOYS (tm) TAKES OFF...!
Industry Favorably Reacts!

Have you ever required a particular material and your local service center supplier laughed and said "Are you kidding?" Have you ever called the producing mill for a particular chemistry and they said "Sure, I can melt that, I need a melt quantity of 50,000 lbs." Or how's this one "Oh, that's an obsolete grade. We can't melt that." Or this one, "We can't melt a controlled chemistry. We only melt the 'regulars'." Or, "We don't vacuum melt this grade." We've heard all of these and more!

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• Extrusions - Bar - Shapes - Tube - Pipe
• Wire

From Flat Cast Slab:
• Plate
• Sheet
• Strip
• Flat Bar

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