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MetalsOutlook™ November-December 1999

Publisher's Statement

Welcome to All Metals & Forge, LLC's MetalsWatch!

This is the last edition of MetalsWatch! for this year and for the millenium. These last hundred years have seen the greatest growth of humankind and we're all fortunate to be a part of it.

All of us at All Metals & Forge, LLC and Purchasing Magazine wish you all a safe, happy, healthy and prosperous new year! Have a great new millenium!!

We'll start off this edition of MetalsWatch! with the latest on the robust North American economy. It's so much stronger than expected - both in the U.S. and Canada - this year, that many economists are scratching their heads. None of them expected consumer confidence to remain so strong, for housing starts to reach such peak levels, or for motor vehicle sales to set new records. Nor did they expect consumption of steel, nonferrous metals, chemicals and resins, or other raw materials to be at such high levels as are being reported. In truth, manufacturing fundamentals are so positive that the "R word" hasn't been spoken about in months. Consumer and investment spending will continue to grow for the rest of 1999, and well into next year - although probably at a somewhat more moderate pace than has been the case in the recent past. Moreover, firms are adding to their inventory stocks during the next month or two to avoid being caught short by Y2K related problems. In addition, export sales are picking up as economic growth outside the United States is increasing.

And it's also true that one of the key components of this economic boom has been that North American consumers continue to snap up cars, trucks, minivans, and sport utility vehicles at a blistering pace. This is pushing the auto industry in U.S. and Canada, each month, a step closer to a record year for sales - and keeping production well ahead of earlier forecasts. So, we'll get into a detailed report of the still-sizzling North American automotive market, and the early outlook for next year.

Also improving is the long-term - that is, the five-year outlook for the North American steel market. Now, the outlook is healthy - very healthy. That's the word from market researcher Tom Runiewicz of the WEFA Group economic analysis and forecasting firm. While the near-term could see some demand weakness in some sectors, he says the long-term growth in sales is likely to average 2% over the next ten years. The trend in imports is downward. Last year's record 30% import market share in the U.S. is expected to slowly drop to 18% by 2008. Steel exports overseas probably will never play a substantial role in the North American industry. However, the WEFA analysis anticipates a mild year-over-year export increase over the long term. And so, production should be a bright spot in the North American steel industry's mid-term future. Supplies will become more locally based, resulting in at least a 3% average annual increase in production between 1999 and 2008. In response, melting capacity is expected to grow by better than 1.5% annually. Operating rates have a significant impact on pricing. Obviously, this year's weakish market prices and low operating rate go hand-in-hand. But, as there should be a slow but consistent rise in capacity utilization in the months ahead, there also should be a slow - but consistent - increase in steel prices. We'll talk more about this later.

And, in Purchasing Focus, we'll explain why it's important that raw materials suppliers understand the new strategic thinking within the buying groups at their key-customer companies. The fact is that more and more buying groups are striving to spend less and less time filling out purchasing orders-and more time making and directing supply decisions that will help their corporation become more competitive. The strategy, therefore, is giving purchasing more and more control over what their manufacturing companies spend.

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November-December 1999

I. THE MANUFACTURING ECONOMY

The U.S. has been the cornerstone of the world economy for some months now. The manufacturing sector grew for the eighth consecutive month in September while the overall economy continued to grow for the 101st consecutive month, according to the monthly business survey by the National Association of Purchasing Management. "The overall picture is one of continuing growth in manufacturing activity during September," says Norbert J. Ore, chairman of the Purchasing Association's Manufacturing Business Survey Committee. And it's a key reason that growth in the U.S. gross domestic product is expected to be around 3.5% for all of 1999. GDP may slow a little next year if the Federal Reserve Board boosts interest rates to keep inflation low. Still, growth is growth, and it will come about because of manufacturing's health.

Also, European economists now are moderately bullish about that region's year-2000 economy, triggered by GDP growth in Germany, France, Belgium, the United Kingdom, Italy, and Switzerland. Even Japan's economic prospects have brightened as Asia's largest economy is beginning to benefit from the Japanese government's stimulative measures to boost economic growth. South Korea already is well ahead of the other victims of Asia's deadly economic flu. And the economies of Indonesia, Taiwan, Hong Kong, and Malaysia all look to do better next year as well. South America, on the other hand, may continue to struggle next year, according to global economists.

But, on balance, the global economic outlook has improved dramatically as recession and deflation fears have all but disappeared. In the U.S., not only are monthly new orders and shipments for manufactured goods remaining in excess of $360 billion, Commerce Department data shows deliveries and orders both have increased in twelve of the past fifteen months. In fact, the latest data shows that shipments of durable goods in August were in excess of $200 billion - and that was the thirteenth increase in the last fifteen months.

So, it's little wonder that most corporate economists agree with Joel Naroff of Naroff Economic Advisers, who says "Demand from manufacturing is at a pace that ensures significant production increases for the rest of the year and into 2000." In fact, all kinds of updated manufacturing data, shows ``that demand for U.S. manufactured goods should continue to pick up through the end of the year, " says economist Cliff Waldman of Waldman Associates. Atop that, Merrill Lynch's senior economist, Stan Shipley, notes that "Almost every indicator for the factory sector is firming, which suggests accelerating factory activity in the months ahead." A key point is that as Asian and Latin American economies are recovering from the global financial crisis that began in Thailand in 1997, overseas' demand for U.S. manufactured goods is improving and competition from cheaper imports is easing.

Note that the National Association of Purchasing Management reported that manufacturing grew more than expected in September, the eighth consecutive month of growth. And all of this news comes after the Federal Reserve decided not to raise short-term interest rates while leaving the door open for an increase later this year. The Fed has raised rates twice this year to slow the economy and keep inflation under control. But productivity increases in the U.S. have kept wage gains from impacting heavily on the prices for manufactured goods. In fact, productivity has accelerated dramatically the last two years and has taken center stage as an economic issue. Chairman Alan Greenspan and other Fed governors often cite productivity as key to whether current real growth rates can be maintained or the economy will over-heat, forcing further rate hikes.

New Age economists debate conservatives over whether the current surge is an aberration or here to stay. Still, the good news includes a substantial acceleration of labor productivity since 1996, after low growth earlier, lead by the manufacturing sector. And, manufacturing consistently has lead the rest of the economy in productivity.

So, many economists now believe the growth in manufacturing productivity pushed the overall economy into a brisk annual growth rate of 4% or more in the just-completed third quarter. And they say the economy is likely to grow at a similar rate in the final three months of the year, far above the 3% rate many of the Fed policymakers believe is prudent. Some private economists expect not just one but two more rate increases in coming months as the central bank tries to slow economic growth to a safer speed. "I think that it is in the cards for a rate hike in November, and there is a chance we will see another rate hike early next year, as strong growth continues," says David Jones, an economist with Aubrey G. Lanston & Co. That's partly because with the nation's unemployment rate at a 29-year low of 4.2%, some companies are having a difficult time finding qualified workers to fill vacancies. Those conditions are leading some companies to woo workers with higher wages and benefits. While that's good news for workers, it's worrisome to the Fed because those increased costs could drive up prices and spark inflation. And there now are some forecasts that the Bank of Canada will boost interest rates early next year as well.

Canada's unemployment rate hit its lowest level since June 1990 in September, dropping to 7.5%, as a booming economy has created 173,000 new jobs. Sal Guatieri, senior economist at Bank of Montreal, says this data "Really is the last piece of the puzzle in telling us that Canada's economy really has a lot of momentum behind it." Gauteri says "Canada now is looking at economic growth of upwards to 4% being reported for the third quarter," which raises the probability of a small rate hike by Bank of Canada.

Whether the central banks tinker with interest rates or not, the fact is that manufacturing has done better this year than had been expected by the experts both in the U.S. and Canada. And nowhere is this truer than in the automotive sector.

II. THE AUTOMOTIVE OUTLOOK

As you may recall from our April report, 1998 was a year of go-go automotive sales reports in 1998, when car and light-truck sales in the U.S. and Canada topped 17 million units. That made 1998 the best light-vehicle sales year of the decade. The big question back then was whether the global economic malaise would depress consumer confidence and finally put the brakes to the car business this year. Well, it didn't happen. With a good economy and high customer rebates, industry analysts now expect 1999 to easily break the record for yearly U.S. sales of 16.1 million set in 1986. And, at the current pace, Canadian light vehicle sales well in excess of 1.4 million units easily will surpass all previous years since the record-setting year of 1988. So, we're now talking about 17.5 million units in sales this year.

And it hasn't just been sales of vehicles made in the U.S., Canada, and Mexico. 9-month sales have been stellar for foreign makes, as well. Sales by Asian automakers are up 20% over last year's January-through-September period, while sales of European brands are up 19% for the year.

Analysts have cited increases in such sales incentives as rebates, low interest rates, and attractive consumer and dealer lease rates for the sizzling North American sales activity. And, looking at the fourth quarter, Bob Rewey, Ford's group vice president for marketing and sales, says the industry isn't ready to put the history books on the shelf. "More records will fall before this year is over," he says. In fact, he says he doesn't see anything on the horizon that's going to spoil the U.S. industry's hot sales pace. With September's overall industry sales up 9.5% to more than 1.4 million cars and trucks, the industry posted the fifth consecutive month of sales at an annual pace exceeding 17 million vehicles.

"If the public had listened to some forecasters, the party would have been over long ago," admits Burnham Securities analyst David Healy. Still not quite a believer, Healy insists that rising gasoline prices and interest rates, growing consumer debt, and more attractive used-car prices will cause sales to taper off through the rest of the year from the 17 million unit monthly rate. Most other analysts, however, don't think any dramatic sales slowdown will become apparent until sometime next year. Fahnestock & Co. analyst Richard Hilgert, for example, forecasts that this year's generous consumer incentives may cost automakers later in reduced sales volume in 2000. Then again, many forecasters were wrong about depressed sales activity in 1999. And note that analyst Tom Runiewicz at the WEFA Group still thinks North American sales could rise by yet another 3% next year if the regional economy continues a slow and steady growth rate.

Not surprisingly, North American motor vehicle manufacturing is very healthy - and now looks like it will be at least 12% stronger this year than in 1998. In fact, Canada's automotive manufacturing sector has turned in such an exceptional performance this year that production of light vehicles is climbing by almost 20%.

Now, it's true that Detroit's traditional Big 3 automakers are projecting a slight 1% decline in North American vehicle production during the fourth quarter. But, some of the cutbacks are to allow plants to retool for new models that will be introduced in January. That's especially true at Ford, which is about to the launch a new 2000 Taurus mid-sized sedan and the new Ford Explorer Sport Trac hybrid sport utility/pickup while it phases out the Ford Contour and Mercury Mystique small sedans. Some of the cutbacks are to balance actual assembly of some models with projected sales to keep year-end inventories low. And, it's another reflection of the North American love affair with the light truck. The Big 3, in fact, project a 4% drop in car output while they also see a 2% rise in trucks, vans, and SUVs. So, General Motors, Ford Motor, and the Chrysler brands of Daimler Chrysler now expect combined production in the U.S., Canada, and Mexico to drop slightly to 3.35 million units from 3.37 million produced in the 1998 fourth quarter. Car production is expected to drop to 1.39 million units from 1.44 million, and trucks are seen rising to 1.96 million from 1.93 million.

Looking at 2000, the sales and production forecasts are all over the map. As I mentioned earlier, the WEFA Group says next year's auto market still should see a slight increase in output. TD Bank, on the other hand, contends that a slowdown in the automotive assembly is likely. The WEFA economists in suburban Philadelphia are optimistic because they believe the growth in sales will be slower than this year, but still will continue. The economists at TD Bank in Toronto, on the other hand, say that while the U.S. and Canada's economies will enjoy strong growth again next year, North American light-vehicle sales will peak this year and fall back slightly in the 2000-2001 period to 1998 levels. For the record, Purchasing Magazine's year-2000 forecast for North American automotive is a 2% sales growth to 17.8 million units, and a similar 2% increase in production to 16.9 million units.

Here's why. While U.S. automotive purchasing probably will stumble a little next year, Canadian sales are likely to keep growing. Growth in Canada's real gross domestic product of 3% is being forecast by TD Bank, which suggests that steady manufacturing growth and rising commodity prices will provide a major lift to corporate profits, employment, and consumer confidence next year. "With the economy now firing on all cylinders, and corporate profits rising steadily, all the pieces are in place for an improvement in Canada's job market next year," says the bank. And all these signs auger well for improved purchasing of such key consumer durables as automobiles and light trucks.

III. UPDATING THE STEEL MARKET

During the past 18 months, the North American steel sector has gone through quite some turbulence. Imports reached record levels then fell back; prices have fallen sharply and have just started to rise, and production has been flat-to-down despite healthy end-use markets.

Remember that between 1991 and 1998, North American steel demand increased by an unbelievable 7% average annual rate of growth. The motor vehicle industry was mostly responsible, but the fabricated metals sector, appliance, and machinery sectors also played a major role. In fact, says Runiewicz, you would need to go back to 1960s to find a similar rate of growth where end-use demand was as broad and as strong. However, in the world of business and economics, "changes" do occur, and they can occur swiftly. The steel sector, he says, has moved into a "funk". Between 2001 and 2003, a 2.5% average annual growth rate is forecasted. That's because of what he sees as a general slowdown in growth in several key steel end-use sectors. However, there still remains alot to look forward to, says Runiewicz. The stage, he says, is being set for healthy growth in the longer term. The crisis in Asia has cooled somewhat. Europe is expected to resume a manufacturing growth cycle. The South American economic situation may be slightly better than expected a few months ago.

In fact, the major-tonnage steelmakers have been receiving healthy new-order bookings for late-1999 and early-2000 deliveries. Solid orders have been reported from makers of business equipment, household appliances, automobiles, trucks, non-electrical machinery, metal fabrications, non-residential construction products, and metal packaging. Even in the oil and gas-drilling sector, steel buying is showing some life. There's widespread belief among the analysts that actual steel use in the U.S. and Canada will be right around 1998 levels in 1999 and then rise in 2000. That's because there's widespread optimism about demand from makers of electrical equipment, residential housing materials, and defense and space equipment. Only the farm equipment and machine tools markets look to stay weak again next year. Still, the outlook is rosy enough that analyst Runiewicz at the WEFA Group says, "The stage is set for healthy growth in apparent consumption" next year in both the U.S. and Canada.

Domestic steel demand is dependent on end-use markets. WEFA's overall index that weighs these markets is expected to grow by about 3% this year, slip to under 1.5% in 2000, and then resume a healthy 2.5% annual average growth through 2004.

Here's why: Between 1992 and 1998, the average annual growth in the motor vehicle industry was 7%. Even though the last few years have been relatively flat compared to the double-digit growth seen during 1992, 1993, and 1994, the automobile, truck, and auto parts sector has done remarkably well overall. This year's healthy 5% manufacturing growth comes off a strike-impacted 1998, but Runiewicz says growth in 2000 and beyond will be disappointing. Next year, he forecasts, the motor vehicle market is expected to decline by 2%. And then, between 2001 and 2003, only a 2% average annual growth is expected. In other words, Runiewicz forecasts, the motor vehicle market is moving into a slower growth phase over the longer term.

The fabricated metal industry is another sector that has changed significantly this year. Through most of the 1990s, this sector grew at a 4.4% average annual rate of growth. This year we expect its growth will slow to only 0.5%. Between 2001 and 2003, we look for a moderate 2.6% average annual growth rate. WEFA projects that non-electrical equipment grew at a 6% average annual rate between 1992 and 1998. This year, the forecast is no growth in output. And, for the next four years, a 2% average annual growth is likely. The electrical equipment industry saw an 8.5% average annual growth rate between 1992 and 1998. This year it should be a slower 5% rate, but a 6.5% average annual rate is expected for the four or five years afterwards. In fact, three major end-use segments-fabricated metals, non-electrical machinery, and electrical machinery have been the beneficiary of a strong investment sector.

Real spending on producer's durable equipment grew at an 11% average annual rate between 1992 and 1998. Granted much of that was computer related, but spending on construction, mining and material handling equipment, engines and turbines, and mechanical industrial machinery has been extremely strong also. This year, WEFA looks for producer's durable equipment spending growth to slow a little, just below the earlier seven-year trend. However, between 2000 and 2003, a substantially slower 4% average annual rate is anticipated. The regional economy will be moving into a new slower growth investment phase, Runiewicz forecasts, and this will have significant implications for steel.

From an individual market perspective there is one notable exception to the expected general slowdown in the steel end-use sectors. Growth in real public construction is currently starting to accelerate. After no growth last year, 1999 is on its way to a 3.6% rate of growth. Exceptional is a 6% rate of growth for highway and street construction. Runiewicz says that between 2001 and 2003, a 3.0% average annual growth rate will be seen on real spending on all public construction. A 5% rate of growth is expected for highway spending. Since much of the spending on public infrastructure is steel intensive, Runiewicz looks for a 5% increase in steel shipments to the construction and contractor market this year. The four years after that should see a 6.5% average annual rate of growth. This is significantly faster than the 5 % annual rate experienced between 1992 and 1998.

IV. NEW STRATEGIC THINKING WITHIN BUYING GROUPS

A recent Purchasing Magazine reader survey has found purchasing managers are committed to adopting strategic supply tactics as they go about their management activities. But, first, some background: There is clear evidence of a New Manufacturing Economy in North America where the boom-and-bust production cycles of the past have been transformed into a long period of slow, steady growth. Significant technological change has improved inventory management through better inventory controls and more efficient transportation systems.

Just-in-time purchasing and inventory-control systems-coupled with better forecasting of consumer trends-has taken much of the guesswork out of inventory management. This has kept stockpiles of manufactured goods to a minimum throughout this decade. Thus, when demand has slackened, less of an adjustment in production has been necessary to work off excess inventories. Similarly, when demand has rebounded, there has been little need for a rapid inventory buildup. Milder inventory swings result in more stable production. Stable capacity utilization also means that manufacturers can better plan for expansion and investment in new plant and equipment, taking a longer view for their business rather than reacting to short-term swings in production. Business equipment investment in the U.S., for example, has been expanding at a remarkably stable 10% pace throughout this current nine-year expansion.

Interestingly, these basic business shifts have yet to be understood within the raw materials industries that depend on manufacturing for their existence. Ferrous and nonferrous metals, chemicals and resins, and other key components of manufactured goods continue to suffer from cyclicality in production, inventory, capital investment, employment, and profitability. But, what the makers and the intermediate distributors of these raw materials have to realize is that more and more purchasing managers are aspiring to move their buying groups toward more activities such as JIT - activities that are considered more "strategic" to their company's success than the traditional work carried out by purchasing.

According to the results of a recent Purchasing Magazine reader survey, purchasing managers are committed to adopting strategic supply tactics as they go about their management activities. In fact, they say they are actively trying to move away from such day-to-day transactional activities as order processing, expediting, etc. They are placing more emphasis on efforts and activities that add long-term value to their companies products and services global market analysis, long-term negotiations, sourcing for new product development, to name a few. By doing this, they are striving to spend less time filling out purchasing orders and more time making and directing supply decisions that will help their corporation become more competitive. The strategy, therefore, gives purchasing as much control as possible over what the company spends. And, remember, those purchasing managers surveyed by the magazine note that there has been great progress in the development of strategic supply management and say their success is due to a growing commitment from their company's executive management.

Watch for our next edition of MetalsWatch! where we'll discuss...

THE NORTH AMERICAN STEEL OUTLOOK FOR THE YEAR 2000.

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