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Publisher's Statement

OK, everyone: Take a slow, deep breath. The economic sky is not falling. It may feel like everything is going to hell in a handbasket. Sure, painful adjustments are taking place in the world's largest economy--but pessimism about the state of the economy is overdone. In fact, don't say 'recession' until the Fat Lady sings. Most economists are sticking with their forecasts that the U.S.--a powerhouse economy for 10 straight years--will avert a recession this year. What's really happening is that things just look bad because they are being judged against a decade of great economic times. The truth is that the U.S. economy is just slower than it has been. And after the slowdown in the first quarter, most economists expect to see a gradual pickup. In our lead story, we'll try to read the tea leaves about the future of the economy.

Then, we'll highlight the latest news about the important sheet steel market, which appears to be taking the brunt of the slowdown in automotive manufacturing. Plunging motor vehicle sales in the fourth quarter led to mounting inventories at the Big Three automakers as car and light truck manufacturers were caught by the surprising speed with which demand softened. This has translated into reduced purchasing of steel--especially sheet products. The tough times for the automakers are likely to continue in the coming months. For the year 2001 as a whole, North American sales are expected to drop by 7% to 9%. The bulk of the weakness will be in the U.S., where light vehicle purchases are projected to fall by 8% to 10%. Canadian sales should be less hard hit, with less than a 2% decline anticipated. All this is causing a slowdown in assembly and a dislocation of demand and supply for carbon and stainless steel. We'll detail what's ahead.

And then, in Purchasing Focus, we'll discuss how Deere & Co. is changing the way it buys steel.
Not long after he became vice president of worldwide supply management, suppliers told R. David Nelson that Deere was a "poor customer." That was a blow to the corporate ego. But it also was the spark Nelson needed to ignite a corporate re-evaluation of domestic and global purchasing and supply chain management systems at the Moline, Ill.-based world leader in the production of agricultural, construction, industrial and grounds-care equipment.

Welcome to Metals Outlook™ March 2001

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March 2001

I. Cover Story: The Future Of The Economy

Have you ever hear of the National Bureau of Economic Research. It's a private, nonpartisan group--an economic research firm--that has been in business in Cambridge, Mass. for more than 80 years. The National Bureau of Economic Research is a group of economists who track business cycles in the world's biggest economy. And, since 1961, they have been the official agency used by Commerce Department as the official arbiter of turning points in the U.S. economy. And what National Bureau of Economic Research says is that "the U.S. is not in a recession." The economy has not deteriorated to that point, it says. "What we are seeing is a U.S. economy with a slower rate of growth than we had before."

With the economy plunging from an annual growth rate of 6% to 1.4% in the fourth quarter 2000, Wall Street has been screaming ''recession.'' But that's somewhat melodramatic. Federal Reserve Chairman Alan Greenspan went on an interest-rate raising kick from June of 1999 to May of 2000 to slow an overheated economy. This money tightening went too far. It choked growth and snuffed out the greatest bull market in history. Jitters over recession highly publicized job cuts and the stock market's struggle to get back on its feet all have fostered the biggest problem--a change in consumer psychology that the economic world is coming to an end. The more people read about the huge job layoffs, the less confident they felt about their own financial health and the more cautious they act as consumers. So, overall economic growth indeed has slowed--probably to less than 1% in the current quarter. But, thinking there's a recession doesn't make it so.

"There is gloom but not doom," says economist Chris Varvares at Macroeconomic Advisers in St. Louis looks at 2001. He insists the nation's $10 trillion economy is not teetering on the brink of recession. He's confident things will pick up in the second quarter and expects growth to resume at a 2.5 to 3% clip in the second half of the year. And he's not alone. Granted, the U.S. faces a significantly meeker economy until the Federal Reserve's interest-rate-loosening medicine takes full effect," says Bruce Steinberg, the chief economist at Merrill Lynch & Co in New York. "Although growth is sluggish," he says, "we certainly do not believe that we are in a recession." He supports latest the consensus of economists, which projects the economy will grow by 2.1% in 2001.

Between June 1999 and May 2000, the Fed boosted borrowing costs on six occasions in hopes of slowing a galloping economy and corralling inflationary pressures. Rate increases slow the economy by raising borrowing costs, which eat into corporate profits and cause consumers to rethink the big-ticket purchases that bulk up corporate coffers. Right now, the U.S. economy is clearly laboring under the burden of the higher level of interest rates that the Fed engineered in the second half of 1999 and first half of last year. But in the opening month of the new year, with stock prices in the dumpster and the economy sputtering so badly that recession fears reached their greatest peak in a decade, the central bank reversed course. It twice slashed interest rates by a half percentage point--the first time during Fed Chairman Alan Greenspan's 13-year tenure that it cut rates by a whole percentage point in a single month. Rate decreases leave more money in consumer pocketbooks - in essence, giving them more to spend - which is key because consumer spending accounts for two-thirds of all U.S. economic activity.

Interestingly, most of the economists surveyed by MetalsWatch! concur with the view of Canadian Finance Minister Paul Martin, who believes Canada's economy will survive the slowdown at its major trading partner. Of course, there will be side effects for Canada from a temporary slowdown in the U.S. economy. Canada is not immune to the slowing growth in the U.S. The reduced appetite of the U.S. economy for imports will contributed to a temporary decline in Canadian manufacturing production--with autos and parts, primary metals and electronic products feeling the brunt of the impact. Economists are already lowering their estimates for Canadian economic growth this year and the Conference Board of Canada, an independent think-tank, now expects 2001 growth to slow to 2.9%, from 5% in 2000, due to lower consumer spending and slower employment growth. "Economists right across the land continue to say that the Canadian economy is going to be able to weather this storm,'' Martin says. He adds he was pleased to see that the Fed slashed rates by half a percentage point twice in January to prop up the sagging U.S. economy. In a sign of growing government concern over Canada's economic outlook, Martin says he likely will present a fiscal update in the spring. Several economists--including Paul Darby, director of the Conference Board's economic forecasting group--believes Martin will push for a second quarter-point reduction by the Bank of Canada in early March.

The key question is whether U.S. and Canadian manufacturing activity soon will start to pick up --known as a "v-shaped recovery"--as it did after the slowdown in 1995. Optimists list several reasons to bolster their argument that a v-shaped recovery is in the cards:
� First, there's the Fed, which now is ready and willing to slash rates to keep the economy in the black. Financial markets may be looking for a bit more easing a bit faster than the Fed is willing to deliver, but that doesn't mean more rate cuts aren't coming.
� Second, the financial markets are no longer in retreat. That should make it easier for companies to raise cash.
� Third, consumers are healthy. Home sales are rising again with lower interest rates, and auto sales actually rebounded strongly in January--rising to a 17.2 million annualized pace from 15.4 million in December. If the auto sector perks up, then other basic industries could follow.
� Fourth, technology spending, while slower, is still very strong. The high-tech companies that have warned about lower profits have mostly been reducing very optimistic expectations to slightly less optimistic expectations. There's no recession in the high-tech arena.
� Fifth, consumers and businesses could feel the impact of lower taxes and higher government spending in a few months. While the tax cut probably won't be the key factor in keeping recession at bay, any extra stimulus wouldn't hurt.
� Sixth, manufacturers' have responded swiftly to the recent economic downturn - much as they did in the mid-1990s - by reducing labor costs and production.

To be sure, other economists see a half-empty glass. They say consumers are tapped out with high levels of debt and aren't in any mood to borrow to buy more. The corporate sector also is burdened with debt and is worried that further investments in high technology won't reap higher profits and higher productivity. Even without a formal recession, corporate profits are due to decline, which could depress stock prices and lower consumer confidence. Also, they say that energy is a major wild card. Blackouts and brownouts this summer in California and elsewhere could hurt confidence, disrupt business and reduce actual output.

II. Metal Chips: The Sheet Steel Market

The auto sector and its related industries are a significant part of the North American economy. The output from many industries--steel, plastics, rubber, glass and paint--are tied closely to production at auto plants. Economist Gillian Manning at TD Bank in Toronto worries most about the Canadian economy's vulnerability to a slowdown in the U.S. automotive sector. In the same vein, Stephen Slifer, chief economist at Lehman Brothers.in New York, says the recent weakness in the economies on both sides of the U.S.-Canadian border is "largely a Detroit story." He says the consumer spending slowdown can be traced to reduced auto sales. Given the high sensitivity of auto sales to borrowing costs, household wealth and consumer confidence, vehicle producers were one of the first to be hit by the slowing U.S. economy. Business investment also has turned negative--again mostly because investments in transportation equipment have plunged. Still, last year's strong sales generated levels of output that no one should have believed could be sustained indefinitely, says Slifer. Varvares at Macroeconomic Advisers also says that a downward adjustment in the auto sector, no matter how gut-wrenching, is necessary to bring supply back into balance with demand. The downturn in the auto industry will dampen Canada's economic growth in 2001, lead to a narrowing in the current account surplus, act as a significant drag on the Ontario economy and depress steel--and other raw materials--for at least the first half.

Alan Greenspan hopes that the latest interest-rate cuts will prevent the economy from hitting the wall. The reasoning is that lowering the cost of borrowing money will stimulate corporate investment and boost consumer consumption. That's because what's aggravating Corporate America's headaches right now are big inventories of unsold stuff. These bloated inventories are forcing the companies to cut back new production and their work forces. And nowhere is that more evident that in the stainless and carbon sheet steel market.

During much of 2000, along with the North American economy, steel sheet demand was healthy. "However, we have been in a rapidly changing transition period since the fourth quarter, and the stage has been set for a much different 2001," says analyst Tom Runiewicz at the WEFA Group in Eddystone, Pa. The difficult market conditions that emerged late in the fourth quarter of 2000 are expected to continue into the first half of 2001. Automotive's sheet steel demand is likely to drop--since motor vehicle production is being forecast in some economic circles to slip 10%. Other sheet steel-using sectors--including office equipment, appliances, and construction materials--also may not have as healthy a steel appetite as in the past several years. Runiewicz suggests that "it will take time for the industry to work it's way out of the issues of lackluster demand, high import penetration, extreme competition and, therefore, weak prices."

Analyst Charles Bradford at Bradford Research in New York agrees that "steel-customer inventories are too high for projected short-term demand, which is forecast to drop to 8% this year. Several analysts suggest that without a dramatic cutback in mill shipments, imports and a reduction in stocks held by end-users, processors and distributors, the supply excess actually could grow--and keep sheet prices on the skids. On the other hand, analyst Mike Gambardella at J.P. Morgan Securities Inc. in New York believes that "more normalized purchasing patterns among steel consuming industries" may become evident later this quarter. "Since the inventory reduction phase began last May, many steel consumers and producers have worked hard to bring down inventory to more manageable levels, and some companies still are procuring steel on a 'hand to mouth' basis," he explains. "With imports declining and domestic supply thinning out, such purchasing habits aren't sustainable, especially if demand begins to show signs of a recovery for second quarter deliveries."

Last year's U.S. flat rolled steel imports were 4% higher than 1999 levels through the first 11 months of the year. However, during the January to August period, imports were almost 14% above the 1999 level for the same period, with hot-rolled sheet alone up almost 57%. These higher import volumes continued through the summer months, a time when actual steel consumption had already begun to decline. This contributed to the inventory overhang in the market, thereby increasing downward pressure on domestic spot market pricing through the closing months of the year. In Canada, mill flat-rolled steel shipments last year were about even with the year before. However, cheap imports, and lots of them, have pushed down prices and bloated inventory levels. By some accounts, foreign mills last year held a third or more of Canadian flat-rolled supply.

And, there is concern among some analysts that North American stocks will take some months to drop back to a more normal 3.2 months' worth because production still is higher than necessary--as some mills are operating under the protection of bankruptcy courts. Also, the pessimists say the potential exists for slippage in end-user demand patterns if the manufacturing economy doesn't perk up in the second half.

Still, inventories of sheet steel that once choked non-processing warehouses now appear to have been brought back into line with customer demands. As recently as last December, the warehouses were bursting with product awaiting shipment to customers. Now, most of that unsold and unshipped product has been reduced and the warehouses say they even have some excess storage capacity.

Stainless steel sheet demand and prices have been weak for some time. The reason: "New capacity has been added faster than the markets can absorb it," says analyst John Anton at Standard & Poor's DRI in Washington. He points out that a short-lived price rally in 1999 was followed by a steady decline--right into early 2001. Anton projects that use of stainless steel mill products dropped by almost 6% last year to 1.9 million tons, and will be about that level--or slightly lower--this year. Supply of stainless steel sheet in the U.S. is expected to be marginally lower this year from the 1.95 million tons of last year, as imported tonnage is expected to slide from the record-high level of 414,000 tons in 2000. However, sales to the automotive sector will fall, and shipments into other key markets--construction, machinery, and food service equipment--suddenly are uncertain. Few market analyses expect stainless sheet and strip demand to reach the 1.69 million tons of last year. "In a nutshell, the U.S. market is depressed, inventory levels are very high and sales prices continue to tumble," says analyst Chris Sharp at MEPS (Europe) Ltd. in Sheffield, England. She notes that competition for orders "is extremely fierce" because both service centers and mills have high inventories. Cold-rolled sheet consumption is very weak, especially now the automotive sector is slowing down, she says, reporting that producers had to trim price offers for austenitic grades by an average 3% in the first quarter to book orders.

III. Purchasing Focus: The Changes at Deere & Co.

Deere & Co. has made significant changes in the way it approaches supply management, making an effort to coordinate supply chain strategies across the enterprise and implement common strategies to raise quality and improve deliveries.

Is there a person at your company who has command-and-control responsibility of the corporate supply chain? At most companies, the answer is no. And therein lies a great opportunity, reminds one of the deans of American buyers, Dave Nelson, currently the vice president of worldwide supply management at Deere & Co. "In the past 25 years, American companies have made an immense change," he says. "Purchased content used to represent 25%-30% of manufacturing cost. Purchasing was viewed as order takers and there was a lack of trust with suppliers. Today 70-to-80% of manufacturing costs come from outside the company." If you manage your supply chain well, there's a 20-to-30% payback, which you are otherwise leaving on the table. That's many millions of dollars that drop right to the bottom line by managing your supply chain well and buying smart.

Deere & Co. is the world's largest maker of farm equipment, which accounts for more than 40% of its $11.5 billion in annual sales. It also is a leading producer of industrial, construction, forestry and lawn-care equipment. Deere also makes drivetrain components, diesel engines, chainsaws, and lawn trimmers, leaf blowers and snow blowers. Although the firm markets globally now, the U.S. and Canada still account for more than 75% of sales.

At present, Deere has 14,000 suppliers worldwide who provide some $7 billion worth of products and services annually to 80 plants in 17 countries. According to Nelson, "that's probably 13,000 suppliers too many." So the company has created supply management teams who are working with 92 full-time supplier development engineers worldwide to develop a cadre of world-class suppliers, to reduce purchasing costs, and to improve material quality and delivery.

Supply management has to become the key player in cutting costs as well as boosting quality by integrating world-class suppliers into Deere's global business plan. According to Nelson, supply management, therefore, has a place no matter how your company buys--for many plants or a single plant--and whether you're a buyer for production or processing and resale. Nelson says that the supply chain management goals are universal: Remove transaction and handling costs, reduce leadtimes and inventories, reduce the number of suppliers and standardize buying practices.

At Deere, the game plan is still under development, but the firm's commodity procurement teams that soon will be naming a shortened list of preferred suppliers based on criteria weighted 65% toward service and 35% toward price. The broad-based goals include a supply base that delivers on time, commits to annual cost of quality improvements, helps supply management achieve annual total-cost reductions, and assists supply management in reaching annual improvements in productivity.

That's all for Purchasing Focus, and this edition of MetalsWatch! Watch for the next edition of MetalsWatch!

Thanks for your time and hope that you have enjoyed reading MetalsOutlook™. Don't forget to subscribe so that you won't miss an issue.

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