MetalsOutlook™ June 2002

Publisher's Statement

METALSWATCH IS BACK!!!

We owe you readers a great big THANKS!!! So here it is...THANKS, for letting us know how much you missed **MetalsWatch�***. We stopped publishing the end of 2001 but due to the overwhelming requests from our subscribers, we have brought* **MetalsWatch�** *back. The only difference is that due to rising cost we have elected to publish only an email and online version. We are now publishing every other month with the possibility of every month by the end of 2002.*
Again, Thanks for your support.

Welcome to Metals Outlook™ June 2002

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June 2002

Tom Stundza's Comments

The nation's wobbly economy is showing signs of strength as the halfway point in the year approaches. The National Association of Purchasing Managers Index May report shows 55.7% which corresponds with many economists views that the country has emerged from recession, however they expect only slow growth for the months to come. The economy of late 2002 and 2003 will not mirror the late 1990s, which cruised at breakneck speed with a soaring stock market and jobs for everyone. The economists warn that those anticipating a quick return to the euphoric era of the last decade will be sorely disappointed. "You can kiss that era goodbye. It is gone, it is not coming back," says Richard Berner, chief economist at Morgan Stanley in New York. "This is going to be an era of single digits in the markets and lower growth expectations." Salomon Smith Barney economist Chris Wiegand in New York, also believes "we are going to get at best a very tepid recovery, which is going to look like no recovery."

Still, listeners to the conference calls held by steel companies in recent weeks are excused for wondering whether this is the same industry that a few months ago was warning that its very survival was at risk. Richard M. Wardrop Jr., chairman and chief executive of AK Steel, based in Middletown, Ohio, tells people tuned in to his company's presentation: "We may be moving closer to being in the driver's seat than at any time since 1995." John Mayberry, chief executive of Dofasco Inc., the Canadian producer that does business in the U.S., observes that "market conditions have improved much more quickly than we had anticipated." The main event between the dire warnings of a few months ago and the conference calls of recent weeks has been the Bush Administration's decision to impose tariffs of 8 to 30 percent on most steel imports. Though those tariffs did not go as far as some steelmakers would have liked, they have lifted the mood of these executives. So, we'll look at today's North American steel mart.

And, finally, we'll discuss the results of new Purchasing Magazine survey in this edition's Purchasing Focus, where supply, sourcing, and purchasing professionals in numerous companies reinforce the view that stronger supplier partnerships are critical for competitive corporate performance. This new reader poll by Purchasing Magazine also found, however, that recognizing a need and filling it aren't necessarily synonymous. While purchasing pros are emphatic about the need for closer supplier relationships, many are less enthusiastic about the merits of their own supplier partnering programs. And that means that sales and marketing personnel can expect to see crossed signals from purchasing pros while North American manufacturing firms struggle to rebound from the current recession.

I. Cover Story: The nation's economy is really sluggish

The nation's economy "is really sluggish," notes Charles W. McMillion, chief economist at MBG Information Services, a Washington business analysis firm. The Federal Reserve Board essentially agrees with that assessment-as evidenced by its recent decision to leave the benchmark interest rate at its 40-year low of 1.75 percent. "The Fed is hedging against the downside risk of a double-dip slowdown," says Diane Swonk, chief economist of Bank One Corp. in Chicago. That's because consumer. spending makes up two-thirds of the economy, and people have spent mightily during the recession. But, before the Fed boosts rates, it wants to see businesses begin to expand and the economy rely less on the consumer.

Chairman Alan Greenspan and the other Fed governors aren't looking for large gains In business investment, she says "but they want to see at least some re-balancing of the economy occur before they take back the insurance policy of lower interest rates they had given us after Sept. 11." In truth, there is a big debate among economists about the future of business spending. Wiegand of Salomon Smith Barney argues that companies should be ready very soon to boost capital spending again. But other economists say the global economy is still plagued by overcapacity. So, despite the lowest interest rates in four decades, many companies will have difficulty getting fresh financing because of less-than-spectacular first-half profits. Some experts also argue that the economy is in such delicate condition that it could stumble and shrink by posting a quarter of negative growth even after the growth rate in gross domestic product surged 5.8 percent in the first three months of the year. Stephen S. Roach, chief economist and director of global economic analysis at Morgan Stanley, expects such a "double-dip." He sees consumers pulling back on spending, and a fall off in residential construction, which has soared because of the unseasonably warm winter in what he calls a demand relapse. "Traditional sources of pent-up demand have been spent," Roach says. "Moreover, there is the legacy of structural excesses that built up during the boom - sub-par saving, record debt loads, lingering excess capacity, and a massive current-account deficit. "The result is a shaky economy that is susceptible to the slightest of shocks." But Roach and other double-dippers are in the minority. Most economists believe that the country has climbed out of recession for good. They expect the economy to grow in the 2 percent to 3 percent-range in the second quarter, and some see it speeding up to about 4 percent toward the end of the year. The key to growth, in part, will be how much consumers spend. Consumer spending grew a brisk 7 percent annual rate during the past six months, Berner says. That compares to an average annual rate of 3.75 percent during the past 10 years. Consumers have bought cars, houses, furniture, appliances and electronic equipment. Berner expects consumer spending to slow to a more normal range of about 3 percent this year. "The double-dippers think that the consumers have yet to pay back for all of the sins in that exuberant period and retribution time is around the corner," Berner says. "I think we will see solid growth. The fundamentals for consumer spending are OK."

Corporations are also showing signs of recovery. Productivity jumped to its highest level in 19 years in the first quarter as companies turned out more goods with fewer workers. "The productivity number was huge," says John Silvia, chief economist at Charlotte, N.C.-based Wachovia Corp. "It would suggest good economic growth with the ability of companies to increase output without any workers,:" he says. "It signifies continued expansion with lower than expected inflation and probably slower than expected employment growth." Alan D. Levenson, chief economist at T. Rowe Price Associates Inc., a Baltimore-based mutual fund company, believes that a recovery is well under way. "The job-creating cycle is already in place, corporate profits have been expanding pretty strongly for two quarters in a row, productivity is up huge ... and you have got a lot of government spending in the pipeline," Levenson says. But there are problems with this economy. Some economists worry that the wobbly economy could be derailed by an escalation in the fighting in the Middle East, another terrorist attack and rising oil prices. Also, the nation's unemployment rate was 6 percent in April, its highest level in nearly eight years, fueled in large part by a flood of new job-seekers. There is also a question as to when businesses will begin expanding and hiring in a meaningful way. The recovery is "not entirely jobless. It is going to feel as if it is jobless," says Wachovia's Silvia.
Some sectors are still reeling, such as the telecommunications industry. " I have written off the telecom sector for this year," says Sung Won Sohn, chief economist at Wells Fargo & Co. in Minneapolis. "I am not really counting on them to increase jobs this year so the rest of the economy will have to pick up the slack." It could be the end of the year or even 2003 before a strong job recovery takes hold, economists say. ''We're looking for the unemployment rate to continue to rise through the fourth quarter,'' says Christine Chmura, president of Chmura Economics & Analytics in Richmond, Va. ''We're probably going to be hanging around the 6 percent mark for another six, seven or eight months,'' agrees Steven Wood, chief economist at FinancialOxygen, a financial-services company in Walnut Creek, Calif. That's because "businesses will continue to push productivity gains at the expense of hiring more workers," he says. Wall Street brokerage Goldman Sachs agrees that the number of jobs created this year will lag other post-recession periods, and doesn't expect much improvement until 2003. ''The evidence does point to very slow rehiring,'' Goldman Sachs says. The fact is that manufacturing firms still are nervous. All the economic data in the world could tell CEOs that the economy is on the mend, but until they see their balance sheets improve, businesses are going to be reluctant to hire. This is especially the case now because worker productivity is soaring. Productivity rose 8.6 percent in the first quarter, the fastest gain in nearly 20 years. That means firms are squeezing more output from their workers and can hold off hiring until they feel more confident. But not every sign is gloomy. Macroeconomic Advisors economist Ken Matheny notes the number of temporary workers is up, a good sign the worst may be over.

II. Metal Chips: Steel prices have been climbing steeply this year

According to surveys of steel buyers by Purchasing magazine, the average spot-market price of hot-rolled steel sheet, the bellwether grades used for motor vehicle bodies and major appliances, has climbed from $215 late last year to $310 this month. And some producers have announced additional increases for this summer. Prices of other types of steel-including specialty grades-also are moving up. So, steel stocks have performed better than many other sectors in recent months. Investors appear to be shrugging off some unpleasant facts: more than two dozen steel companies are in some form of forced restructuring, others are still posting losses, and demand remains soft. "Everybody is looking up from the bottom of the hole," says chief investment officer Warren Isabelle at Boston's Ironwood Capital Management. The good news for steel producers and investors has come mostly from the supply side. Prices had begun to rise for several months before President Bush approved the import tariffs in early March. The spate of bankruptcies and reorganizations over the last year has curtailed capacity. According to the American Iron and Steel Institute, production of raw steel in 2001 was 11.5 percent lower than the previous year. One of the biggest casualties, LTV Steel, was a big producer of sheet steel. LTV, which shut its mills in December and was bought by an investor group, accounted for 8 percent of North American output. The tariffs, which Isabelle describes as "a little bit of gravy," have had the effect of choking off low-priced foreign supplies, making it easier for domestic producers to raise prices. According to the AISI, steel imports fell to 2,034,000 tons in March, down 39.4 percent from February. Meanwhile, the domestic industry's capacity utilization has risen from 77.8 percent in early January to 87.5 percent in the week ended April 27. In addition, steel distributors' inventories are low. If spot prices stay at current levels, steelmakers are sure to start pressing for better terms in long-term contracts with their customers. Referring to contract negotiations for 2003, Wardrop of AK Steel wants 6 to 8 percent increase in contract prices. Christopher Olin, analyst at Midwest Research in Cleveland, forecasts that contract prices for the coming year will rise 5 percent. "We're pretty bullish on steel," Olin says.

Rising prices have helped not only the steel industry in the United States, but also producers in Canada and Mexico, which are exempt from the new duties and rely heavily on trade and investments in the United States. For instance, Ipsco, based in Regina, Saskatchewan, produces about two-thirds of its steel at plants in Iowa and Alabama. Other Canadian producers are big suppliers to the auto industry. "The North American steel industry is very much integrated," agrees Anna Sorbo, a steel analyst at CIBC World Markets in Toronto. The Canadian and Mexican authorities are also taking steps to protect their producers from offshore competition, creating what analyst Randy Cousins at BMO Nesbitt Burns in Toronto, calls "fortress North America." Several countries have complained to the World Trade Organization about the American tariffs. The European Union is threatening to retaliate by imposing additional duties on imports from the United States worth about $300 million a year.

The brighter mood in the industry does not mean its troubles are over. The problem of legacy costs - health care and other benefits for retirees, which are estimated at more than $10 billion - continues to hamper industry restructuring. Wardrop complains that delays in completing bankruptcy proceedings were holding up his company's plans to bolster profitability by acquiring more capacity to produce coated steel, which has a protective layer. While Canadian and Mexican companies are typically burdened by lower legacy costs than American producers, analysts say that American companies are restructuring or finding other ways to lighten their legacy cost burdens. Plant closures and tariffs have reined in supply and tighter cost controls have brought down operating costs, but few would dare pronounce the industry firmly on the road to recovery until there is a sustained increase in demand. That has yet to happen. Still, James Alfano, chief executive of Stelco Inc., the biggest Canadian producer, said, "We expect to see steel demand increase as the North American economy strengthens." Executives at U.S. Steel says that second-quarter orders for sheet steel were strong, with stable demand from the automotive and appliance sectors. General Motors has said that it plans to raise new car and truck production by 4 percent in the second quarter, compared with a year ago. But, according to U.S. Steel, demand for steel plate, widely used in construction and shipbuilding, remained flat. In addition, the market for specialty steel pipes, used for oil and gas drilling and transportation, was soft, bridge-building was threatened by cuts in government spending and the rail-car market was about half its normal level.

Specialty steel was impacted in the first half of 2002 by lower demand from two large markets--commercial aerospace, which is in a severe down cycle, and electrical energy, where there have been significant cancellations for natural gas-fired land-based turbines. Commercial aerospace orders remain soft and demand for power generation turbines has fallen substantially. A significant improvement in demand for specvialty steel and forgings will be dependent on resumption of capital spending in its key markets. However, industrial users of specialty steel and forging products are expected to operate much better in the second half. The tariffs imposed by President Bush on imported stainless steel rod, bar and wire products and an improving economy are expected to result in stronger second-half growth in the sales of tool steel plate products to the service center market and billet sales to the forging and reroll markets.

Supply, sourcing, and purchasing professionals recognize the need for stronger links with key suppliers, but have trouble determining the best ways to develop more closely-knit supplier bases. We'll discuss this in greater detail in Purchasing Focus.

III. Purchasing Focus: Marketers should be aware when evaluating suppliers

Welcome back to MetalsWatch! and this edition's Purchasing Focus. Marketers should be aware that while buyers are always trying to spot and evaluate potentially good suppliers, there seems to be a general unease within the purchasing community about the best ways to find and develop the best partners for supplier partnering programs.

There appears to be a split among purchasing professionals on the effectiveness of current programs that recruit--and foster the use--of preferred suppliers. Once a prospective new supplier has gotten the ear of a buying exec, the actual selection process can take a number of forms. In some cases the process is almost perfunctory, in others it's a slow sizing up procedure. In many cases the procedure varies by the relative importance that purchasing puts on the subject supplier and commodity. These are several processes, buyers tell us. These are that:

� Technical evaluations are performed as soon as a potentially good supplier is spotted-without a specific job in mind.
� Potentially hot supplier's names are added to request for bid lists once technical evaluations are made.
� Potential supplier's names are added to the bid list and a technical evaluation is made after bids come in.
� Technical evaluations are made on a supplier followed by a limited amount of business to test

performance in a production situation.
Of course, in addition to these basic approaches to new supplier selection, many companies use variations on the theme. And that has to be frustrating for suppliers and potential suppliers.

One striking anomaly in the survey of purchasing professionals is the fact that while 44 percent of the companies represented in the poll have rating systems for evaluating current suppliers, a smaller percentage of programs for helping suppliers to improve their performance. Many of those polled, in fact, see this as a major failure of many corporate supplier-partnering programs. A substantial number of survey participants, in fact, remark on the irony of their companies freely issuing report cards to suppliers but failing to develop programs that lead to problem elimination and/or improvement of performance.

The reaction among purchasing professionals questioned on this issue can only be described as mixed. Some buyers feel strongly that supplier efforts at improvement need to be supported by quality and engineering groups and that the purchasing groups should to be open to process improvement suggestions submitted by the suppliers. For many purchasing professionals, however, the idea of helping suppliers fix their problems is not a great idea. Many feel that it's not the customer's responsibility to solve supplier problems. However, even they tend to agree that if the supplier requests help, the purchasing department should offer it.

Well, that's all for this Purchasing Focus, and for Metals Watch. Look for MetalsWatch in the beginning of August 2002.

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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