MetalsOutlook™ March 2005

Welcome to Metals Outlook™ March 2005

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Tom Stundza's Comments

This is Tom Stundza, executive editor of Purchasing Magazine. Welcome to the March 2005 edition of Metals Watch! Economic activity continued to expand at a moderate pace in late January and February, the Federal Reserve said earlier this month, with U.S. businesses reporting retail prices generally steady or slightly higher as some companies actually were able to pass on higher costs. All 12 Fed districts reported economic activity increased in early 2005. But, the pace varied with relatively brisk growth in the New York and San Francisco districts, some acceleration in the Dallas district and some deceleration in the Richmond, Va., district. We�ll kick off this edition of Metals Watch with a Cover Story summarizing economic activity throughout the country as reported by the Fed�s latest "beige book" report.

Flat-rolled steel product prices now have been in decline for five consecutive months. With ore and coke suppliers demanding substantial price hikes in latest settlements, however, economists reckon the mills will make every effort to recover some of these extra costs. Some analysts suggest the price decreases can be expected to halt soon and, maybe, even be put into reverse. Other analysts disagree, suggesting that the current level of steel prices�still at historic highs�are not sustainable. We�ll look into this debate�and discuss the overall steel market�in this edition�s Metals Chips.

In Purchasing Focus, we�ll look at the Handy & Harman Global Procurement Council�s game plan for 2005, which is to retake the cost-control initiative lost to the 2004 price spike in raw materials. That's why supply management professionals gathered recently at corporate headquarters in Rye, N.Y., to reinvigorate cost-reduction strategies that include cooperation commitments from suppliers that go beyond simple price-reduction efforts.

I. Cover Story

Let�s start with our Cover Story, �The Fed�s View of the Economy.� The nation's employment climate improved, stores rang up sales and factories boosted production in recent weeks, fresh signs the economy is chugging ahead at a respectable pace. That is the snapshot of economic activity presented in the Federal Reserve's latest survey of business conditions. "The economy has continued to expand at a moderate pace," according to the survey, based on information collected in late January and February. Overall, manufacturers reported solid expansion in most districts, but the pace of growth generally hasn't increased since the last report, which covered December and early January. "However, many districts noted particularly strong gains in durable goods manufacturing," according to report, which is named for the color of its cover. There is robust defense-related production in the Boston, Atlanta, Kansas City and Dallas districts, solid machine-tool output in several districts and a continued high level of vehicle production mainly owing to demand for heavy trucks.

The Fed survey also finds that retail prices are "generally flat or up modestly," but suggested more impact developing on product prices from higher input costs.

Some companies, affected by higher prices for fuel, steel and other raw materials, actually appear more inclined to pass along some of these input costs to customers. And manufacturers in districts including Boston, Cleveland, Kansas City and Dallas said they have been finding it "increasingly easy to pass along price increases." Producers in the Philadelphia district expect to have greater ability to pass along costs "in the near future." In the Cleveland and Atlanta districts, truckers have been using surcharges to offset rising fuel costs since crude oil prices have escalated more than 20% since the start of the year.

Construction materials were also reported in high demand. Steel shipments softened in the Cleveland district, but were reported as solid in the Chicago district. "Sustained increases in the cost of energy, steel and other materials were widespread," the Fed report says. Some moderation in input cost increases was seen in the New York, Philadelphia and Cleveland districts. But faster cost growth was reported for the Richmond district. Regarding currency fluctuations, the Atlanta Fed District said the weaker dollar has boosted tourism in Florida, with the number of European and Canadian tourists up from a year ago. Contacts in the Boston district expect the weak dollar to help tourism, while the region's manufacturers are concerned about the declining purchasing power of the dollar in international markets.

Banks reported steady to somewhat stronger lending in early 2005, with the Philadelphia, Cleveland and Richmond districts recording overall loan demand growth. "Business lending also strengthened in a number of districts, but the reports on household loan demand were mixed, suggesting little change, on balance, for both consumer loans and residential mortgages," the Fed says. Credit standards were unchanged throughout the country, and loan quality was widely reported as steady and strong. Since last summer, the Federal Reserve has been raising interest rates with an almost mechanical reliability. Will Alan Greenspan use this latest Beige Book to take a breather? No, according to 56 economists who participated in a Wall Street Journal survey. They reckon the Fed will continue lifting rates until its target for the federal-funds rate, the bank's primary monetary-policy instrument, reaches 3.75%, up from 2.5% today.

II. METAL CHIPS

Now, let�s go to Metals Chips, a Review of Steel Marketplace. After a year of distress about prices and unforeseen confusion about supply, steel buyers are hoping 2005 will be less chaotic. To be sure, U.S. manufacturing consumed 16% more steel at 92.5 million tons in 2004. But the marketplace moved from tight supply in the late spring to excess in early winter, and closed the year with stockpiles at a two-year high of 15.05 million tons. Manufacturing forecasts suggest robust activity will gain traction as the year progresses. So the steel outlook highlights for 2005 are: One, demand is poised to increase 3% to 95.5 million tons; Two, supply shortages are less likely with the supply chain replenished.

Three, imports could back off from late-2004 levels, as the dollar continues to weaken, but will remain an important supply factor. Four, contract buyers may pay as much as 20% to 30% more that they did in 2004, as the benefits of signing up before the 2003-2004 price spike has ended.

And, five, (the most controversial point), while international pricing may rise, domestic spot prices may decline off 2005 highs�which were 44% higher than the year before�but could remain as much as 35% to 40% above historical levels. With industrial production stagnant well into the first quarter and market pricing in a five-to-six-month funk, there still is no true consensus among steel market economists when a demand and price rebound might occur.

Looking back at 2004, several unusual factors shaped market conditions that allowed for the record-setting spike in spot steel prices. First, a wave of bankruptcies and consolidation introduced a supply discipline not seen in the industry ever before. Second, strong global demand, centered in China, tightened supply and boosted costs for steel�s raw materials. Third, despite the tightness in supply of pricey raw materials, steelmakers set a record by pouring 1.05 billion metric tons of new steel. Fourth, even with global output strong, supply was dislocated, yet world steel selling prices increased by as much as 80%. So, looking at 2005, the early forecasts of continued recovery in the global economy at a healthy 3.1% growth rate should help keep world steel demand firm�even if China�s growth ratchets down from the double-digit rate of 2004.

Global steel demand has picked up along with the global economy in the aftermath of the Asian financial crisis and the terrorist attacks of September 11, 2001. Demand is particularly strong from China, where steel-consuming sectors have been growing by more than 15% annually. Demand also has been strong in Central and Eastern Europe, as market reforms and entries into the European Union have allowed manufacturing and construction to take off. Interestingly, what�s happening overseas isn�t impacting the North American marketplace.

U.S. and Canadian steelmakers already are cautioning analysts that steel shipments will decline in the first quarter due to seasonal weakness and to the high level of customer inventories. Steel firms now are admitting that fourth-quarter shipments were unseasonably high because service center customers, especially, built inventories in anticipation of higher spot prices in the first quarter. But, with all the excess in the pipeline, the uniform upward price movement of most of 2004 has come to an end. Also, scrap prices have been falling since December, and that�s been undercutting surcharges. A new report from the MEPS (International), a review of supply/demand conditions in the U.S. sheet steel market finds high stock levels at the distributors, sluggish demand as manufacturing has slowed and easy availability of both imported and domestically produced material. Activity also is down in the Canadian market, according to MEPS� analysts. Customers appear to be very cautious about placing orders, inventories are high and consumption remains dull.

Upshot: �Transaction values are suffering a negative trend,� as U.S. and Canadian mills are discounting transaction prices. �It is difficult to foresee a quick recovery,� says chief MEPS analyst Sidney Fish.

Growth in fourth quarter real gross domestic product (GDP) recently was revised upward to 3.8%, bringing full-year growth at 4.4%, which was better than the 3% growth registered in 2003. Exports were revised sharply higher by the Bureau of Economic Analysis, and there were upward revisions to business investment (both equipment and structures), inventories, residential investment and government purchases. The experts expect real GDP growth generally to be close to 4% over the four quarters of 2005. So, a new poll of market seers suggests that the so-called steel chew-up�i.e., actual use�will continue growing for the next two to three years. Total U.S. industrial production saw 4.4% growth in 2004. It was the length, not the depth, of the 2001�2003 industrial recession that caused so much economic pain. Consequently, last year provided the industrial sector with much-needed relief.

Purchasing Magazine�s monthly Future Business Indicator, a poll of future business activity within the manufacturing sector, has been showing continued growth ahead. Looking ahead, buyers at manufacturing firms are very optimistic about 2005 and steel demand is expected to be the best in seven years. However, the jury still is out since high energy costs are causing lower rate-of-growth expectations than had been predicted earlier. And there�s uneven purchasing from steel-using sectors�caused by such events as the recent production curbs by the automakers and some major appliance producers in the face of high inventories and a midwinter slowdown in durable goods orders.

When we come back, in Purchasing Focus, we�ll discuss how such economic realities as the 2004 price spike of steel commodities are forcing companies such as Handy & Harman to make purchasing more cost efficient. But, first this -----

Welcome back to the March edition of Metals Watch.

"We have to buy better than the competition," says Bob Murphy, who heads the Handy & Harman purchasing council. "We have to work harder to source quality materials, goods and services at the most competitive cost advantage." While that's easy to say, it will take work, he admits in a Supply Chain Solutions story, �Managing costs in a high-price era,� that was published in the February 17, 2005, issue of Purchasing Magazine--and is now online at Purchasing.com. "We have to have all the buyers on the same page, striving to deliver 5% to 6% in cost reductions," says Murphy. "It is essential we secure support of key suppliers in an effort to reduce costs up and down the supply chain."

Handy & Harman's business segments manufacture wire, cable and tubing products fabricated from stainless steel, carbon steel and specialty alloys; electrogalvanized metal products.

One of Murphy's goals is to get purchasing managers to improve buying through a better understanding of market economics that impact end products and materials supply. With annual sales of $500 million, Handy & Harman's purchase spend is an estimated $250 million. The supply management team now has visibility to all levels of spend from an aggregate of all business units down to the detail of each location. Access to such information has allowed Handy & Harman to assess areas of synergy and target areas of opportunity. As a specific 2005 initiative, its OMG Inc. unit will hold a summit meeting with top suppliers "to present a strong message to the supplier community that long-term partnerships need to be redeveloped that go beyond price�and again are win-win relationships," says Murphy, whose corporate duties include being corporate vice president of steel purchasing. This initiative will serve as a pilot.

Handy & Harman's family of companies are big buyers of steel, nonferrous metals, precious metals, chemicals and plastics resins and corrugated packaging materials�many of which have become highly volatile commodities. The individual companies have to manage costs from national contracts for freight services, travel costs, office products and other MRO (maintenance, repair and operations) goods. So, Handy & Harman's Global Procurement Council was created in 1998 to optimize corporate-wide procurement leverage. "What upper management wanted was purchasing to create a sense of community, a focus on buying excellence, within a decentralized business environment," explains Murphy. The firm's 16 companies operate as individual entities and vary widely in size; so, purchasing personnel per unit ranges from one to seven. That's why the Handy & Harman's Global Purchasing Council has a new challenge: To sell cost-reduction ideas, to sell revised purchasing programs to decentralized manufacturing operations, and then to sell them to the supply base. "It's a team effort across all business units which require continual communications and reinforcement of strategies and goals," says Murphy. "The issue is more than price; cost is the big problem�so, we need to legitimize cost pressures to be able to reduce them." One goal for the Global Procurement Council's small staff is to keep accurate and timely marketplace information in front of the company's purchasing personnel since, Murphy believes, "knowledge is power in negotiating prices." He also wants to develop and maintain what he calls lots of purchasing talent. "We need people who understand purchasing pressures and the need to drive prices/costs down. These are difficult times. It is essential we have purchasing professionals who grasp the issues and possess the tools to impact the business in a positive way. Quite simply, there is no room for those who don't," Murphy says. "We don't want clerks; we need strategic thinkers who can execute and are not afraid to roll their sleeves up and dig for opportunities. That's a mantra that was made clearer by the recent steel pricing crisis."

Well, that's all for this edition of Metals Watch. This is Tom Stundza, executive editor of Purchasing Magazine. Good day.

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