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Welcome to Metals Outlook™ September 2006

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Tom Stundza's Comments

Welcome to the September 2006 edition of MetalsWatch! This is Tom Stundza, executive editor of Purchasing Magazine and Purchasing.COM.

The manufacturing economy has slowed as consumers have tightened their belts under the toll of high energy prices and borrowing costs. But, the economic expansion, which began in late 2001, still has staying power although growth will be sluggish through the rest of the year. At least that�s what business economists predict. In fact, our Cover Story finds that the latest forecast from the National Association for Business Economics, or NABE, has gross domestic product growing at a 2.6% annual rate in both the current July-September quarter and in the final three months of the year. While these new projections are somewhat weaker than previous forecasts that had called for the economy to expand at a 3.1% pace in the third quarter and then a 3% pace in the fourth quarter, �the economy is by no means going dormant,'' says Carl Tannenbaum, chief economist at LaSalle Bank and president-elect of NABE.

In the April-to-June period, gross domestic product, or GDP, the value of all goods and services produced in the United States, increased at a 2.9% pace. That marked a sizable slowdown from the first quarter's 5.6% growth rate, the fastest spurt in 2 1/2 years. For all this year, the economy is expected grow by 3.4%, the NABE forecasters now say. That's only slightly less than its previous estimate of 3.5% growth. If proved correct, the new projection still would be an improvement from the 3.2% growth logged last year. Next year, though, the forecasters expect the economy to lose some steam and expand by 2.7% That new forecast also is down from a previous forecast of 3.1% growth for all of 2007. We�ll explain why�and what it may mean to stainless steel pricing in coming months.

After dipping in the final six months of 2005, transaction prices of hot-rolled stainless steel sheet and plate in coil in the U.S. have climbed steadily on a monthly basis so far this year by an average 24% for the 304 grade. Cold-rolled stainless sheet has risen by 38% since last December. Our Metals Chips segment notes that base-price values have gone up significantly but a great deal of the positive movement has been due to soaring alloy surcharges. Twelve months ago, business was slow so the mills began to regulate output after months of full production that did nothing but build inventories throughout the supply chain. At the turn of the year, end-user and service center purchasing activity improved. Currently, supply is extremely tight and service center stocks have been depleted by 18% from the 2005 levels. Atop that, the mills currently are running very late on cold-rolled sheet deliveries especially. That�s why transaction numbers for flat-rolled look poised to escalate further in the final quarter, suggests analyst Katrina Dixon at MEPS (International).

And, finally, in Purchasing Focus, we�ll discuss why the current state of global supply chains is causing financial and corporate risk to manufacturing companies. Procurement research by the Aberdeen Group shows that this strain on global supply chain organizations needs to be addressed for companies to reap the full benefits of global low-cost country sourcing.

I. COVER STORY

Let�s start with our Cover Story about some issues impacting a slowing economy. There's no recession in sight and no burst of unemployment to fear--unless you're in the home-building business, which is suffering from higher mortgage rates and fading interest from investors and speculators. But exports are strong, and manufacturing, commercial construction and finance are doing fine, so Standard & Poor's chief economist David Wyss and other seers expect the U.S. economy to merely downshift, not stall. In fact, the economy grew overall from mid-July to late August, the Federal Reserve says in its latest Beige Book summary of economic conditions. The central bank also says there were widespread price increases for energy, metals and other commodities, but these did not appear to be triggering more general consumer inflation. "Widespread increases in the prices of energy and certain other commodities persisted since the last report, though most of these increases do not appear to have passed through to finished consumer goods," the Fed report says.

Actually, the slower economic growth rate will prompt the Federal Reserve to finally stop raising interest rates, says economist Wyss. Actually, the Fed in early August halted a campaign that had steadily pushed interest rates up for two-plus years. That left a key rate controlled by the Federal Reserve at 5.25%. The central bank did, however, leave the door open to future rate increases in case inflation proves tenacious. Forecasters at NABE, the National Association for Business Economics, also believe there will not be any more rate increases�either at the Fed's next meeting later this month or through the rest of this year. In fact, the forecasters predict the Fed will cut rates next year.

Still, these forecasters believe inflation will turn out to be higher this year than previously thought. Consumer prices now are expected to rise by 3.6% this year, up from a previous forecast of a 3% rise. Last year, consumer prices went up by 3.4%, the most in five years. Next year, consumer prices should moderate, rising by 2.6%, the forecasters said. Yet, that is still up from a previous forecast of a 2.4% rise in 2007. Also, two-thirds of the investment fund managers polled this month see the global economy "a little weaker" by this time next year�and only 10% foresee improvement. The International Monetary Fund has just predicted a "continued smooth ride" for the global economy. However, the IMF�s managing director, Rodrigo de Rato, cautions that there are signs of potential trouble ahead after several years of brisk growth. �There are more clouds on the horizon today than we saw a year ago," he says, pointing to such headwinds as higher interest rates and rising fuel costs. Back in the U.S., numerous forecasters now rank high energy prices as the biggest risk to the economic expansion. But even here there could be a reprieve ahead. In the wake of incremental progress in European nuclear talks with Iran and a calmer storm season than expected in the Gulf of Mexico where hurricanes crippled oil infrastructure last year, premiums on the price of crude oil are beginning to be unwound. All the while, the continued flow of new oil has been swelling inventories and easing fears of a supply crisis. That�s may be why global fund managers are keeping a defensive posture about where they put their money these days. The energy sector had been attracting capital in recent weeks but lately the energy sector's popularity has waned.

II. METAL CHIPS

Now for our Metals Chips discussion, in which stainless and specialty steel purchasing looks to be increasing by a robust annualized rate of 12% this year. Even with imports accounting for almost a third of supply, North American mills are running full-out this year. Still, analyst Katrina Dixon at MEPS (International) Ltd. suggests it is far from clear whether the North American market has room for new domestic supply of up to 1 million tons of additional capacity. But that�s just what ThyssenKrupp is considering for the Midwest. That building plan, which could include 4.5 million tons of carbon steel, has buyers cheering for the German steelmaker�s new-construction plan�and against its possible takeover of Dofasco in Canada.. Here�s some background: After Allegheny Ludlum acquired J&L Stainless in 2004, there were expectations that this would lead to capacity cutbacks. Instead, Allegheny Ludlum is running all its stainless capacity in western Pennsylvania and continues to operate the former J&L Stainless melt shop at Midland, Pa., and the cold-rolling sheet mills there and at Louisville, Ohio. Moreover, less than 200,000 tons per year of melting capacity was eliminated from the market with the bankruptcy of Canada�s Atlas Stainless a couple of years ago. But, North American Stainless�part of the Spanish Acerinox group�has continued to expand its works in Kentucky. North American Stainless has increasingly come to dominate the market for 304 and other commodity grades of stainless, while Allegheny and AK Steel attempt to focus more on special qualities. North American Stainless already is working on plans to boost melting capacity by 40% to 1.4 million tons per year. Some of the extra supply will go into stainless long products. The company will also increase cold-rolled strip output by adding a fifth Z-mill. So, if ThyssenKrupp plans to produce mostly commodity grades at its new stainless plant, then it will be competing head-on with North American Stainless. Of course, the timing of the proposed installation is unclear. It may be that the additional capacity would be brought on stream in stages. But, there is certainly a risk that oversupply would be created. But, that�s long-term. In the short term, analysts such as Dan Brebner at UBS Securities, sees a big problem with pricing in coming weeks since alloy surcharges are set to reach record levels even though the stainless market is its traditionally slow-demand demand period. With nickel prices remaining at high levels so far this year, a reported absence of excess distributor stocks and still-robust mill orders through this month, prices will remain high in the fourth quarter,� he says. However, his view also suggests that speculative over-stocking will take place sooner or later simply because the price of nickel has remained elevated for so long. Looking ahead, he doubts that the rate of price increases in the U.S., or Europe for that matter, that have occurred in 2006 will be sustainable into the first half of 2007. �The possibility that big customers have implemented an advanced buying policy, to offset future nickel price increases, may cause a big decline in stainless steel purchasing as we enter 2007,� Brebner says. Also, he adds that record price levels are putting a huge financial burden on small-volume end users.

When we come back, Purchasing Focus will discuss how a growing number of buyers at domestic industrial operations say they have joined with manufacturing personnel more frequently�sometimes as often as weekly�to reevaluate sourcing needs and to find such solutions as new suppliers or alternative commodities to materials inflation and delivery bottlenecks. But, first this:

III. PURCHASING FOCUS

Welcome back to Metals Watch and this edition�s Purchasing Focus.

A new study of purchasing organizations by the Aberdeen Group of Boston finds that large corporate international supply chains are only 50% as automated as their domestic supply chains. While most firms report they�ve been trying to get by with homegrown software, only 18% plan to invest in internal development going forward. A third is planning to use on-demand applications.

Here are some other findings: ☐ 9 out of 10 enterprises have global supply chain technology that�s inadequate to provide the corporate finance group with the timely information it requires. This information includes accurate costing and delivery dates for budget and cash flow planning and management; this information gap forces companies to hold more cash and increases Sarbanes Oxley compliance risks.

☐ Fully 87% of large enterprises and 64% of all respondents say their company�s staffing for managing global supply chain and trade compliance processes is inadequate. This is triggering increased attention on how to leverage business process outsourcing, managed services, and logistics service provider expertise for specific tasks.

☐ 82% of companies are concerned about supply chain resiliency to disruptions, but just 11% are actively managing this risk. This action gap is one of the greatest weaknesses of current corporate global supply chain strategies; it threatens business continuity and erodes gross margins.

Basically, Aberdeen Group�s research is showing that companies need to devote more information technology support, better leverage external expertise, and change their collaboration and risk management mindsets. More actionable recommendations from Best in Class supply management practitioners to immediately improve your procurement and supply management performance will be available at this year�s Chief Procurement Officer�s Summit. Sponsored by Aberdeen Group and Purchasing Magazine, the meetings will held November 16 and 17 at the Westin Waterfront Hotel in Boston. More details are available at Purchasing.COM.

Well, that�s all for this Purchasing Focus and this edition of Metals Watch! This is Tom Stundza, executive editor of Purchasing Magazine and Purchasing.COM. Good day.

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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