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Publisher's Statement

Recession � fact or factoid? Everyone is nervous. The media uses the �R� word more. But is a recession caused by actual market forces or created by the fear factor. As it reads the tea leaves and uses the �R� word more these days, is the mainstream media fueling a fear factor in the minds of business executives and consumers that creates a self-fulfilling prophecy. Is this the power of the press?

Negative tends to be the majority of content and context in the news. Good news doesn�t sell well. Maybe we should take a lesson from Joe Friday, the police sergeant on the 1960�s TV show, Dragnet: �Just stick to the facts��. But perception is more the reality than the facts seem to be, and the facts are that the overall economy is doing fine. But consumer fear can be fanned into flames where the economy gets burned because people get nervous and begin to �cut back� on their consumer spending that drives two-thirds of the economy. Then, a recession sets in and media factoids transform, in retrospect, into facts.

Although we see fluctuations in metal pricing and demand from month to month, we don�t see them as the harbinger of recession. Don�t get in the lemming line just yet. Just stick to the facts.

Also, check out the September 2007 Manufacturing ISM Report On Business� from the Institute of Supply Management (formerly the NAPM, or the National Association of Purchasing Managers � Purchasing Manager�s Report) based on the latest ISM number of 52%.

Welcome to Metals Outlook™ October 2007

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October 2007

Tom Stundza's Comments

Welcome to the October 2007 edition of MetalsWatch! This is Tom Stundza, executive editor of Purchasing Magazine and Purchasing.com.

Demand for industrial metals�especially carbon and stainless steels�depends on strong global economic growth, including sturdy manufacturing and construction industries. Entering the final quarter, the steel suppliers and buyers alike are anxious�as the market has large inventories and weak prices caused by reduced demand in a slow-growth economy. Citigroup metals analyst John Hill points out that low carbon steel prices have come from slack demand amid a slowdown in automotives and the housing markets. Stainless steel prices are starting to slide because an earlier price spike drove many buyers to alternative materials. And now, nickel metal, a key ingredient in stainless steel, is in a pricing freefall because of high inventories and slackening sales. Will these trends continue in the fourth quarter? We�ll investigate in this edition�s Cover Story on the metalworking economy�s impact on pricing of key industrial metals.

Back in May, the International Stainless Steel Forum of Brussels suggested that stainless crude steel demand in 2007 would boost production higher than the record-level of production in 2006. Stainless steel accounts for two-thirds of nickel usage and demand did appear to be strong enough earlier this year for nickel to average more than $20/lb through June. So, stainless steel cold-rolled sheet sold for an average $4,900 net ton in the U.S. through June, as compared with just below $2,700 on average for the previous 18 months. But, demand for nickel has been dropping because stainless steelmakers are trying to reduce a global glut. And that�s causing mills to start cutting the price of flat-rolled products, an issue we�ll address in this edition�s Metals Chips segment.

And finally, in Purchasing Focus, we�ll look at a new study from Aberdeen Group in Boston, which reports that many industrial purchasing organizations agree that supply risk exists from uncontrollable marketplace events. Yet, more than half of American manufacturing has yet to implement programs that can adjust internal raw materials inventory targets based on fluctuations in delivery leadtimes�sometimes which they have caused when faced with changes in end-product order bookings.

I. Cover Story � Economy�s Impact on Pricing

That dastardly "R" word -- recession -- is slipping into analyst conversations about money and markets. Blame it on the housing slump, mortgage mess and credit crunch that have roiled Wall Street investments. Some economists say it's enough to sink consumers' spirits, crimp business investment and stall growth. Others see a speed bump, not a recession. The Federal Reserve�s latest beige book report, for example, says that recent distress in financial markets has deepened the housing slump�but the overall economy has seen little impact so far. The beige book briefing, which covers mid-July through late August, indicates that the economy is continuing on a pace of modest expansion and that overall price pressures remained under control. The report also noted that manufacturing grew at a slower rate than in previous months.

On the other hand, non-government economists say it may be too early to reveal all of the collateral damage from subprime credit distress that intensified in August. Jean-Philippe Cotis, the chief economist of the Organization for Economic Cooperation and Development in Paris, downgraded second-half U.S. growth to 1.9% from 23.1% predicted earlier, warning that �downside risks have become more ominous.� No matter the view of the second-half economy, there's little doubt that the metalworking economy has slowed. That�s because buyers in manufacturing have trimmed orders for parts and components, suggesting they expect weak production of cars, trucks, major appliances and other steel-using durable goods to continue in the coming weeks.

Only 35% of Institute for Supply Management�s Steel Buyers Forum surveyed in July expected orders to increase over the succeeding three months while 32% of the buyers polled by Purchasing magazine in August expected orders to increase in the following 90 days. This reflects the view that �the steel market is far more chaotic than normal this year,� says analyst John Anton at Global Insight�s offices in Washington. Generally, there are �overriding cyclical trends,� Anton says, that pull all products in a common demand and/or price direction�with variance only in the degree of movement. �Yet this year, products are showing widely differing cycles� with some soft and others healthy. So, �a chaotic steel industry will be harder to predict,� he writes to clients.

Several demand indicators continue to show a mixed picture�with strength from the non-residential and energy markets but weakness from automotive, major household appliances, residential construction, ship building, electrical and material handling equipment and industrial, metalworking and construction machinery sectors. Steel demand has been growing from the farm machinery and lawn care equipment and power transmission equipment sectors; however, demand has weakened this summer from producers of commercial laundry and vending machines and forestry equipment.

Analyst Charles Bradford at Bradford Research in New York writes that �world steel usage has been quite strong all year, but that is not the case in the U.S., where major markets for steel have been flat to down�and lately largely weak.� The U.S. Census Bureau announced in late August that seven-month new orders for manufactured durable goods of $1.49 trillion was barely 1.2% ahead of the year-earlier total�a gain traced mostly to a 44.6% increase in orders for non-defense aircraft and parts that rely more on titanium, aluminum, copper and nonmetallic materials that steel.

Many steel analysts expect a seasonal demand uptick to begin, as usual, in November. Aldo Mazzaferro at Goldman Sachs Group, for example, says a recovery in steel purchasing is likely to be sparked by supply that �is coming down faster� than demand. He notes that demand is down a couple percent while supply inventories are down 5% to 6%. He also says he senses that service centers may be beginning to restock inventory. But, there hasn�t been any of the usual seasonal upturn for sheet products by end users or service centers, whose stock levels have gone from excessive to about normal for this time of the year.

Steel prices appear to be bottoming out, says Mazzaferro, who expects transaction levels�now hovering around $500 per ton for benchmark hot-rolled sheet, to rebound in the fourth quarter and hit $600 by spring 2008�a price last seen in October of 2006. The low U.S. steel prices have put a crimp on imports as global supply is being diverted to higher-priced markets in Europe (around $625) or where lower shipping costs offset low steel prices in places such as China (about $482 a ton). Foreign-made steel usually accounts for nearly 30% of U.S. supply but imports are down roughly 20% this year. That should help boost prices when demand improves, Mazzaferro says.

Also, the top three U.S. steel companies of ArcelorMittal, U.S. Steel and Nucor control 65% of the market today compared to 20% six or seven years ago, giving them more defensive power amid turbulent conditions, says Mazzaferro. So, most major U.S. steel mills are aiming to hike prices by an average $30 per ton for October deliveries of hot-rolled, cold-rolled and galvanized sheet. Analyst Timna Tanners at UBS Investment Research in New York writes to clients that the mills pushing the higher prices are �citing limited import through year end, service-center inventories positioning for restocking, and rising raw material costs.�

Actually, 2007 steel demand is down 8% from last year and that is what has kept inventories higher than expected by analysts and the mills. Also, a growing number of independent economists are forecasting that growth in durable goods manufacturing will decelerate in the fourth quarter. And that could keep steel demand depressed�and pricing weak�for some time to come. Buyers are in this corner. A majority of the steel buyers polled by Purchasing in August projected continued weak demand trends ahead and reported reduced midsummer need for numerous carbon steel products�including all the sheet products, coiled plate, merchant and special quality bars, carbon steel reinforcing bars, pipe and tubing�and stainless steel sheet and plate. Looking ahead, buyers obviously don�t reckon the mills will be able to boost transaction prices very much in the months ahead either. However, buyers say in various surveys that they aren�t planning to roll over and accept any immediate flat-rolled price hikes in a marketplace where overall demand is lackluster. In that August survey of buyers, less than a third�actually only 31%�expected steel prices to rise through November.

II. Metal Chips � Mills to Start Cutting the Price

A good indicator of imminent demand and pricing chaos could be the stainless steel marketplace. Stainless steel buyers are getting fed up with high-priced metal caused by what they consider exorbitant nickel surcharges�especially since demand is off by 7% on an annualized rate. With nickel prices setting record all year, stainless steelmakers have been very vocal about the loss of business to buyers switching to lower-nickel grades.

The stainless mills have been lobbying the nickel industry to lower prices so the mills could reduce the alloy surcharges being passed on to their customers. These surcharges, based mostly on average nickel prices two months prior to delivery and designed to pass on steelmaking raw material costs, have just started to fall, reversing almost straight-line gains over the past 12 months. Based on information from some buying groups, Type 304 cold-rolled sheet could slide to $5000/ton in September from $5,700 to $5,800 in the previous two months. Yet, the year-to-date average price still is 24% higher than the 2006 average.

Mac McAninch, CEO of Universal Stainless & Alloy Products in Bridgeville, Pa., says he expects �lower nickel prices to encourage our service center customers to rebuild their inventories.� As for end-use sectors, he believes that aerospace, power generation, petrochemical and heavy equipment markets �hold enormous opportunity� for expanded future sales�as long as nickel costs keep falling. But, many buyers report they will keep waiting to see how far the surcharge falls before ordering more cold-rolled and plate stainless steel.

Meanwhile, in China, a stainless steel executive recently took the offensive against nickel speculators, claiming that their manipulation on the London Metal Exchange was the real reason stainless steel prices worldwide got so high this spring that many buyers began abandoning the metal. Chai Zhiyong (ZHI-YONG), president of Taigang Stainless Steel Co. told an international stainless steel congress in Shanghai that �high and fluctuating nickel prices have led to high profits for speculative funds and nickel suppliers in the short term but have increased costs for stainless steel mills, pushed up stainless steel prices, led to a wave of inferior stainless steel products and prompted the development of stainless steel substitutes.� He�s upset that many stainless steel users have begun to turn to plastic and aluminum products. This has resulted in cutbacks in stainless smelting at several existing plants in Asia and the suspension of some new-technology mill projects.

There has been a lot of activity by purchasing/engineering sourcing teams to adjust specifications to allow more use of reduced-nickel and no-nickel stainless grades. The record high nickel prices have triggered a wave of substitution to non-nickel stainless steels, says analyst Jim Lennon at Macquarie Research in London, who says that the global stainless market has been saturated by too much production, especially in China. �We are seeing quite a lot of weakness in the stainless steel production over the next few months with a few extended shutdowns of mills in Europe and elsewhere,� Lennon forecasts. And, according to Chai, the Chinese steelmaker, �none of these events are healthy signs for the stainless steel industry in the long run.�

When we return, in Purchasing Focus, we�ll discuss why a supplier performance measurement and risk management program can help buyers manage inventory in the event of unforeseen marketplace events that cannot be controlled. But, first this:

III. Purchasing Focus � Supply Risk Programs

Supply chain consultants at the Aberdeen Group say purchasing organizations need to take control of their supply risk programs to ensure that they are effectively protected from supply disruptions and that internal customers are buffered from negative supply chain events.

Aberdeen research analyst William Browning says purchasing groups must develop supply risk programs that are capable of measuring as much of their supply base of possible. He points out that standardized measurement processes used by single buyers or buying groups or cross-functional management teams has enabled Best in Class enterprises to capture supply risk information from virtually the entire supply base. And that can keep unwelcome supply issue surprises to a minimum.

Browning writes this summer that Best in Class purchasing organizations not only capture risk data on their supply base, but also expand their measurement beyond traditional supplier performance criteria�that is, quality of goods, on-time delivery and price�to include such key risk factors as supplier financial viability, credit ratings, supply disruptions and supply concentration. That allows them to develop a comprehensive program for supply risk measurement and mitigation.

Best in Class supply chain groups have not stood pat but have taken steps to expand their supply-risk program coverage to include tracking the root causes of either positive or negative results. Additional energy has also been expended to measure performance and assess risk across all different types of suppliers�from Tier One firms downward to subcontracted processors.

Note that Browning�s study discovered that Best in Class companies tend to measure supply risk beyond just suppliers for direct materials used in manufacturing. He says they also address risk issues for indirect goods, transportation and logistics, and such business services as legal, temporary and contract workforce solutions.

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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