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Publisher's Statement

While the economic forecasts continue to look gloomy, especially in light of the condition of the financial markets, there are industry sectors that appear strong because of their long product development cycle. Those industries are aerospace, energy, nuclear, oil and gas exploration, and defense.

The materials used by these industries will remain in demand for several years as they ramp up in view of orders in hand or new opportunities driven by electrical energy demand and the expiration of the ban on offshore oil drilling. Those materials include nickel, titanium, and steel, along with materials outside the metals industry, from carbon composites to concrete. As an example, the orders for Boeing and Airbus aircraft for commercial use will keep titanium demand high through 2012.

To the extent that readers can shift their customer base from industries that will struggle, such as housing, general manufacturing and automotive, to these long cycle industries, they will buffer themselves against the impact of an economic downturn.

There has been some GDP stability driven by U.S. exports, although the dollar looks to gain strength as we approach year end which may cause exports to diminish slightly. So far, we haven�t seen two consecutive quarters of negative GDP (the �official� definition of a recession). Real GDP is forecast to rise by 0.8% this year and by 1.1% in 2009, but the housing market is not expected to recover until 2010. So, now is the time to diversify your customer base and focus on the manufacturing sectors showing growth.

For more information on the near-term economic outlook, check out the September 2008 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) and the latest ISM number of 43.5%

Welcome to Metals Outlook™ October 2008

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October 2008

Tom Stundza's Comments

Welcome to the October 2008 edition of MetalsWatch! This is Tom Stundza, executive editor of Purchasing Magazine and Purchasing.com.

The U.S. economy is being whipsawed by a wide range of influences at home and abroad. Economists say these influences include wild fluctuations in energy prices, extreme volatility in national and global financial markets, the deepening housing contraction and important charges to economic policy. Add to all that the fact that manufacturing is weak and the economic roadway promises to be even rougher in the second half of the year. Buyers apparently agree with this analysis since those answering Purchasing magazine�s latest monthly survey report an overall industrial activity reading of about 42 on an index where expansion requires an appraisal of 50. That�s the lowest reading since 39.5 in February 2002. For the third month in a row, business activity is reported to be in a slump by buyers at electronic-consuming companies, chemicals-using companies and metal-using firms.

As we will discuss in our Cover Story, reports are prevalent of persistently weakening demand from the manufacturing and building industries. Even Federal Reserve Board officials have downgraded their economic forecast at their last policy-setting meeting, and now expect inflation to fall in coming months. Atop all that, steel supply is rising: A Bank of America steel-market analysis shows that demand is down almost 5% this year while production is increasing at more than 5% growth. And now, the latest Beige Book from the Federal Reserve has reinforced what private economists have been reporting--that the pace of economic activity overall has slowed dramatically this summer. Consumer spending is concentrated on food, staples and other necessary items while business purchasing has economized to as-needed materials and products. So, it�s little surprise that borrowing by consumers slipped in July to the weakest pace in seven months, reflecting a big slowdown in demand for car loans.

And that�s probably why the North American steel sheet market is entering a declining price environment: Flat-rolled transaction prices have slipped this summer as second and third-tier mills have been undercutting the major producers. In our Metals Chips segment, we�ll discuss why the major-tonnage steelmakers have rescinded increases announced earlier for September and October deliveries. Weak demand in the appliance, automotive and equipment sectors especially has resulted in buyers taking a �wait and see� attitude about purchasing this summer. So, announced price increases in carbon flat-rolled haven�t been achieved--and the already declining market prices for stainless sheet have continued to slide.

�The reason for the steel price crash is an amazing, and perhaps unprecedented, buyers� strike,� writes consultant Peter Marcus at World Steel Dynamics in Englewood Cliffs, N.J. And that probably will impact prices soon for bars and structurals. These products have been boosted because of increased scrap prices, continued low imports and supply tightness in the domestic market after a recent rise in exports. However, demand at home will remain sluggish, especially for bar products, as non-residential construction sees postponements spilling over from the housing market and most analysts now expect prices to ease in the coming months. In our Cover Story and Metals Chips segments, we�ll take a closer look at the current and expected industrial economy and the impact on the carbon and stainless steel markets. And, in Purchasing Focus, we�ll discuss a McKinsey & Co. report, which asserts that supply chain risk is rising sharply--but supply chain management isn�t keeping pace. The consulting firm says companies aren�t meeting strategic goals for supply chain management, and relatively few have acted on the global trends with the most influence over supply chains.

I. Cover Story � Weakening Demand

Economists were surprised by 3.3% growth in U.S. gross domestic product in the second quarter but they point out that nearly all of the gain (3.1 percentage points) came from strength in U.S.-made goods sold overseas. Domestic GDP growth was just 0.2%--which is even weaker than the 0.6% rate of increase in the first three months of the year. As for steel, all this has translated into reduced purchasing, increased domestic supply, the highest inventories in seven months, a sudden increase in steel imports and the presence of low-priced future-delivery offers from import houses.

Typically, when summer vacations end, North American metalworking companies have higher expectations for improved orders, shipments and general economic conditions. But, not this year. Metals processing companies this year now anticipate weak business to continue well after Labor Day. That�s according to the 1,200 metalworking firms who answered the latest business conditions survey for the Precision Metalforming Association of Cleveland. The results actually match the pessimism from the 1,045 buyers who answered Purchasing�s monthly survey and said that buying plans would be reduced nationally this autumn.

Here�s what William E. Gaskin, president of the trade group, has to say: �The U.S. market for steel seems to be softening at the moment, with shipments of metal stampings and fabrications down 5% versus the first seven months of 2007, with low expectations for a significant increase in demand in the fourth quarter due to slack demand from construction and manufacturing markets. Metalforming companies anticipate unusually soft incoming orders for the next three months,� he adds, saying that expectations �appear to be softer than normal, with reduced volumes for suppliers to the automotive, appliance and home-building industries.�

Indeed, there has been a steep decline in motor vehicle sales in recent months. The gasoline crunch has buyers favoring more fuel-efficient cars and shunning pickup trucks, sport-utility vehicles and large cars powered by gas-guzzling V-6 engines. In a nutshell, gasoline-conscious consumers continue moving to more fuel-efficient small cars. So, automakers are continuing to reduce assembly in the U.S. to ensure they don't overload lots with inventory. Too much inventory forces dealers to reduce prices, thereby undercutting profitability. Still, there has been declining retail sales for individual dealerships caused by lower consumer spending. A major motor vehicle recovery isn't expected anytime soon, says research firm J.D. Power & Associates--which has cut its 2008 forecast for new light-vehicle sales to 14.2 million units, the lowest level since 1992.

Some forecasters have predicted 2009 vehicle sales will be even with final weak 2008 results or perhaps slightly lower. And even auto executives have warned it may still take months, or even a few quarters, before signs of a recovery in sales and production emerge. Not only does she see her industry�s assembly operations reduced for some months to come but Ford Motor Co. economist Ellen Hughes-Cromwick also says it is likely to take �several more months� for the housing and credit markets to improve. New forecasts from Moody�s Economy.com say that U.S. consumption growth will slow through the first half of 2009.

Analysts also say credit constraints lately have been limiting purchases of steel and other production metals from distribution customers and smaller end-use companies. Even the large-tonnage buyers with supply contracts are holding off releases for new-metal deliveries. Consequently, several mavens are rejecting mill projections that sales and prices will rebound in the October-December fourth quarter. This view was buttressed by the fact that overall U.S. economic activity has weakened and lingered at recession-like levels all summer, according to a study from the Federal Reserve Bank of Chicago that blends data from several economic sectors.

Previously, those industries that rely more heavily on the domestic economy had been more exposed to the slowdown than those with significant international exposure, given expectations that the global economy would still expand at a healthy pace while the domestic economy languished. But now, Mike Helmar, senior economist at Moody�s Economy.com, says globalization is no longer as great an asset--especially for those firms making products in major developed economies. Growth in many developed nations is slowing and the risk of recession rising. The dollar is no longer declining relative to many currencies, Helmar adds, so the impact of exchange rates on dollar-denominated revenue is no longer increasing.

And now, the Conference Board says its employment trends index has been on a year-long decline and suggests that even more softening will come to the labor market. �The Employment Trends Index continues to rapidly deteriorate, suggesting there is little likelihood of a turnaround in the job market anytime soon,� says Gad Levanon, senior economist at business research firm.

II. Metal Chips � Steel Tops Out

Now looking at the steel marketplace, it has become evident that analysts Chuck Bradford at Bradford Research has been correct all along: U.S. demand is close to recessionary and the general economic slowdown overseas has begun to reduce the ability of domestic mills to continue the high rate of export of steel products that was evident in the first half.

The dollar has strengthened enough in recent weeks to bring some imported steel back into the U.S. In fact, steel supplies are high enough not to be an issue for most buyers. That�s why they don't expect to see prices move back up again until next year--especially since the market is on the verge of the typically soft-demand fourth quarter. So, North American producers of carbon flat-rolled steel are looking to reduce production in coming weeks in the face of tepid demand for their products. Steelmaking cutbacks haven�t helped shore up the stainless sheet marketplace. Yet, significant carbon steel production cuts are expected this autumn as those mills will try to hold the line on suddenly sinking prices.

This demand malaise also has struck the stainless steel marketplace--as evidenced by the turbulence that has buffeted the stainless steel market and sliced transaction prices during past year. Since the peak in July 2007, transaction values in North America for cold- rolled sheet in coil, Type 304, have dropped by approximately 29%, or almost $1,700 per net ton.

Similar declines have been reported in the European Union and Asian markets--and for hot-rolled sheet as well, which is 25% lower than this time last year. A steep descent in the cost of nickel on the London Metal Exchange has been cited as the main cause of the price decreases. However, weakened economic conditions worldwide have negatively affected the demand for stainless steel across almost all markets--including the aviation, aerospace, appliance and process-industry sectors. So far this year, purchasing is down by almost 10% from 2007 tonnage, which was 14% lower than in 2006.

Consumption is expected to remain low in the near future so producers are expected to keep reducing sales prices in an attempt to fill depleted order books. However, mavens believe buyers will restrict stainless purchases until the end of the year as they await even deeper slippage in nickel prices--which already have declined 34% from last year�s annual average. Credit constraints are also predicted to dampen end user demand further. Even recent cutbacks by mills to reduce world oversupply haven�t been enough to avoid further downward pressure on transaction prices.

U.S. stainless sheet and plate prices are forecast to continue falling to the end of 2008. In fact, stainless steel selling values are forecast to reach the bottom of the current price cycle by the end of the year when the transaction figure for cold-rolled coil Type 304 is likely to fall 41% from the last peak in July 2007.

Nearly 80-percent of global executives surveyed by McKinsey & Co. say that the amount of supply chain risk faced by their companies has increased in the past five years. Few executives, however, say their companies translate the importance they place on risks such as increasing complexity of products and services, rising energy prices, or increasing financial volatility into corporate action. We�ll discuss this in Purchasing Focus when we return, but first this.

III. Purchasing Focus � Costs and Customer Service

Welcome back to Metals Watch! and this edition�s Purchasing Focus. Supply chains are increasingly global and complex, as companies aspire to support a variety of strategies, such as entering new markets, increasing speed to customers and lowering costs. Supply chain risk is rising sharply, according to the executives polled. They point to the greater complexity of products and services, higher energy prices and increasing financial volatility as top factors influencing their supply chain strategies.

Relatively few respondents, however, say that their companies are translating the importance they place on these factors into corporate action. Nor do executives express confidence that their companies are meeting the top strategic goals: reducing costs, improving customer service, and getting products to market faster. In addition, for all the public attention paid to environmental concerns, including global warming, executives report that such issues have little influence on supply chain strategies. What�s more, survey results suggest that most companies tend toward centralization, not local management, in running their supply chains and that this tendency has increased in recent years.

Interestingly, reducing costs is important for companies either manufacturing or simply sourcing in developing markets. McKinsey analysts suggest that companies in countries such as China are trying to anticipate the effect of rising costs--including labor costs and appreciating currencies--on the competitive advantages they currently enjoy as low-cost buyers and/or manufacturers. Against a backdrop of sharply rising supply chain risk, including the prospect of higher energy prices, McKinsey analysts believe companies are likely to take a harder look at their manufacturing and supply footprints. In some cases, companies could even consider localizing elements of their operations now managed in remote�including offshore�locations.

Operations executives were found to be as committed as purchasing executives to generally stress costs and customer service. Marketing executives, not surprisingly, put new products to market faster as a top priority. Executives of all stripes, through, say that their companies aren�t meeting their strategic supply chain goals well these days. McKinsey personnel say that successful cross-functional collaboration will increasingly differentiate companies that meet the full range of their strategic goals from those that don�t. Companies that can ensure closer partnerships between operations and groups such as sales and marketing, for example, will be able to respond more quickly to changing trends and will have the edge in turning strategic trade-offs (say, speed versus cost) into sources of advantage.

And that concludes our Purchasing Focus and this edition of Metals Watch! This is Tom Stundza, executive editor of Purchasing Magazine and Purchasing.COM.

Good day

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