MetalsOutlook™ December 2009

Publisher's Statement

At this point in the recovery, everyone is wondering, "Which way is out?" The assumption is that the recession is over, and few businesses feel like they have their feet on the road to recovery.

Government stimulus spending can only impact 1/3 of the economy, at best. While it may have stopped us from crashing and burning, the government does not drive the economy to sustained growth. Only consumer spending, which makes up the remaining two-thirds of the economy, can drive down unemployment and drive up growth. But this leaves everyone wondering how?

The boom economy of the Reagan years was driven by consumer credit card debt. During the Clinton years, it was driven by home equity loans. In Bush II, it was fueled by a little of both. Now, real estate equity has been erased, credit cards are topped out, and there is a virtual chokehold on new credit of any kind, whether consumer or business. Consumer spending may rise as savings rises, home equity stabilizes, credit card debt declines, and people use cash instead of borrowing for their needs and discretionary wants. Welcome back to the 1950�s, a simpler time when people saved and then used cash to buy a house, car, durable goods or other necessities, and luxuries were, well, luxuries that most could not afford.

What does this mean for metals and the metalworking industries? Steady growth for many years to come, with a slow start in 2010 and a long tail into 2016 or 2017 before we face the next economic downturn. And, just as consumers need to clean up their balance sheets, businesses need to clean up theirs -- which will also take time this time around.

Welcome to Metals Outlook™ December 2009

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December 2009

Tom Stundza's Comments

Welcome to the April 2010 edition of MetalsWatch! This is Tom Stundza, executive editor of Purchasing Magazine and Purchasing.com.

The economy's recovery continues to follow a V-shaped growth trajectory. For the year, the Blue Chip consensus anticipates a 3.1% expansion in gross domestic product followed by 3% growth in 2011. U.S. industrial production continued in February even though the growth rate was held back by severe winter storms that slammed parts of the country. Federal Reserve report showed that industrial output edged up 0.1% last month after increasing 0.9% in January.

In addition to inclement weather, industrial production last month was curbed by a steep drop in motor vehicle output-likely a reflection of the auto recalls by Toyota Motor Corp.'s U.S. assembly plants that depressed demand for the company's cars. Stripping out vehicle assembly, though, manufacturing rose 0.1%. In this environment, economists haven't altered their views of a rebound in industrial production in March-and a factory-led economic recovery for the first quarter. "The minor setback in February is expected to be followed by strong makeup gains in March," says Daniel Meckstroth, chief economist at Manufacturers Alliance/MAPI in Arlington, Virginia,

Traditionally the backbone of the economy, consumer spending fell for the first time since 1938 by 0.6% in 2009 and will remain anemic, according to the Blue Chip consensus, growing by 2.1% in 2010 and 2.6% in 2011. So, in this edition's Cover Story, we'll discuss the economy's underlying industrial strength. Economists report that while U.S. manufacturing output fell 0.2% in February, it rose outside of the auto sector, mining activity posted a strong 2% gain and utilities increased 0.6%, leading overall industrial output to rise slightly. Capacity utilization, a measure of slack in the economy, inched up to 72.7% in February, the highest since December 2008, and up from 72.5% in January. "This is positive for the economy and does indicate that the factory sector will make a positive contribution to growth in the first quarter," says economist Kenneth Kim at Stone & McCarthy Research Associates in Princeton, New Jersey.

The steel marketplace likely will continue to be challenging in 2010, says analyst Mike Willemse at CIBC World Markets in Toronto, although he and other analysts expect to see some growth in market demand for the first year since 2006. The early-2010 expansion in carbon and stainless steel purchasing has been inventory restocking at the serviced centers-so end -market demand trends won't become evident until warmer weather months when and if purchasing expansion becomes evident in North American industries beyond automotive. In Metals Chips, we'll discuss whether steel demand will continued its slow and steady recovery-and which key end-markets will show even greater diversity in the strength of their recovery. Construction still is the laggard, says economist John Anton at Global Insight's Washington office, with the declines expected for nonresidential construction now stretching into 2011.

How can buyers control and manage accurate inventory levels? Eliminate stocks completely. At least that's what the proponents of this business practice believe. They say that advanced Lean Six Sigma can streamline purchasing and inventory control processes so manufacturing gets what's needed when it's needed without the expense of any inventory. So, our Purchasing Focus segment will discuss what began three decades ago as just-in-time inventory management has been evolving into an amalgam of JIT inventory control and Lean waste-reduction programs with a smattering of Six Sigma total quality management. The mantra heard over and over is that effective supply chain management has to be "easier, faster and cheaper" in its implementation-yet resulting in the delivery of quality materials on the factory floor with few or no pit stops at the warehouse.

I. Cover Story -- Climbing Out of the Production Hole

Manufacturing is leading the economy out of the most severe downturn since the 1930s. The Federal Reserve Board's latest report shows the amount of the nation's industrial capacity in use hit 72.7% in February, the highest level in more than a year. Even more heartening, new orders and shipments soared from the prior month, while the average workweek lengthened markedly and the backlog of orders grew.

"You're seeing a clear evidence of a V-shaped recovery in the manufacturing sector, partly because it shrank so rapidly during the recession but also because there are a lot of positive fundamentals," says economist Zach Pandl at Nomura Securities International in New York. Daniel Meckstroth, chief economist at Manufacturers Alliance/MAPI in Arlington, Virginia, adds that "the fundamentals are strong for continued manufacturing recovery driven by pent-up consumer demand, repair and replacement of business equipment, and exports." "We continue to see signs of strengthening industrial and manufacturing activity and we look for this recovery to continue through all of 2010," says John Herrmann, senior macro strategist at State Street Global Markets in Boston. "We expect to see both inventory growth and business capital spending growth."

And there are indications that consumers-usually the main engine of the economy-also are starting to participate in the recovery after lagging for several months. February's snowstorms, for example, had a minimal effect on retail sales as people whose shopping had been impacted or delayed headed to the malls after the blizzards. Production of consumer goods fell in February as factories built fewer cars, appliances and other durable goods. When production of consumer products rises, it will indicate consumers are spending again - a necessary condition for robust economic growth. High unemployment and stagnant wages have prevented a consumer-driven rebound.

Still, major headwinds remain that could frustrate the recovery. Winter storms in the Northeast and South slowed new home construction in February, with housing starts sliding 5.9%, the latest blow for a housing market that remains strained by foreclosures and tight credit. The decline highlighted the challenges facing builders as they struggle to emerge from the worst housing slump in decades. The March sentiment of home builders also has fallen for the fourth time in six months, the National Association of Home Builders says, hit by lack of credit for new projects and a flood of foreclosed properties. And now, building permits-an indicator of future construction that is less susceptible to weather than housing starts-fell 1.6% in February from January, to a seasonally adjusted annual rate of 622,000. That is 11.3% above year-earlier levels, but still extremely low by historical standards. "We've gotten to the bottom, but there is little evidence of demand growth yet for a lasting recovery to take form," says economist Tim Quinlan at Wells Fargo Securities in Charlotte, North Carolina. No big rebound will occur in 2010, agrees Reed Construction Data economist Jim Haughey in Waltham, Massachusetts, who says "non-residential building construction starts will average steady to slightly down for most of the year."

As economic conditions and confidence improve, business investment will recover, growing 1.7% in 2010 before accelerating 6.7% in 2011. Manufacturing companies are now running on extremely lean inventories of raw materials and produced goods. So, as the recovery gains traction and demand strengthens, firms soon will be rebuilding inventories across the supply chain, says Kevin Swift, chief economist at the American Chemistry Council in Arlington, Virginia. Manufacturing production, which first turned around last summer, continues to advance. Leading indicators of manufacturing activity are pointing to further improvements in demand. Following two consecutive years of decline, industrial production is expected to increase 4.8% in 2010 and 4.3% in 2011. Although projected growth rates for most industries appear positive in 2010, they must be viewed in the context of the exceptionally sharp declines seen in 2008 and continuing into 2009. Moreover, it may take years for activity to recover from these steep declines and reach past peaks.

II. Metal Chips -- Mill Pricing Undulates for Next 6 Months

As the factory environment shows some improvement, so does the steel marketplace. U.S. steel mills shipped 6.58 million net tons in January, a 9% increase from the 6.03 million shipped in December. More importantly, the tonnage was a 43.8% increase from the 4.58 million tons shipped in January 2009. Meanwhile, February shipments of steel from U.S. metals service centers increased 3.3% over January tonnage-and rose 10.4% above shipments for the same month in 2009, marking the first time since April 2008 that year-over-year shipments have been higher.

Analyst Michelle Applebaum at Steel Market Intelligence in Chicago believes that the strengthening of shipments is more meaningful than it appears given the ongoing stream of disruptive weather in the month throughout the Northeast, Midwest and Middle Atlantic states which comprise an estimated 70% of the market in the monthly Metals Service Center Institute survey.

Led by hot-rolled, cold-rolled and hot-dipped galvanized sheet, most products –except for beams-have showed some pickup in shipments. However, inventory in tons rose by 3.6% in February to 6.5 million tons, leaving months' supply unchanged from January at 2.4 months on hand. That means that demand growth still is somewhat muted. Some analysts say the steel demand recovery is limping along; others say steel recovery in the U.S. continues to be fragile.

All that fits with Purchasing magazine's survey of buyers, whose steel-buying index at 44.0 in March is up from an average 42.0 in the previous three months but still under the 50.0 mark needed to show growth. Since demand remains somewhat frail, sales-transaction discounts still are readily available from list prices. Steel mills continue to try to leverage low inventories and low import competition so as they seek to pass through higher costs for such inputs as scrap, iron ore and coking coal. Yet, buyer caution and resistance is anecdotally increasing too at the new, higher steel price levels. The buyer and supplier infighting may dissipate as the year progresses, though. That's because, looking further ahead, economists say carbon steel use could rise by 35% to 40% as the year moves along-as compared with a 49% collapse in 2009. The forecast for stainless steel demand recovery is as much as 20%, according to the economists who watched end use drop by more than 30% in 2009.

The automotive sector, which had been among the weakest markets a year earlier, continues to surprise economists to the upside. Even considering Toyota's recalls, Global Insights has increased its light-vehicle production forecast for 2010 from 10.3 million units produced in North America to 10.6 million. Wells Fargo Securities is more bullish, expecting 10.7 million autos and light trucks assembled in the U.S., Canada and Mexico. While the year-over-year difference is not that large, it is important to note that in 2009 there were a mere 8.6 million cars and light trucks produced in North America.

The Recreation Vehicle Dealers Association projects that shipments to dealers from manufacturers will increase 27% in 2010, rising to 203,000 units from 159,500 in 2009. That will boost demand for carbon and stainless steel and other industrial metals since RV sales nose-dived in 2008 and 2009 when gasoline prices soared and consumer credit contracted. Another area where steel and aluminum demand should perk up somewhat this year is the assembly of truck trailers. Registrations of new units in the U.S. dropped by more than 50% in 2009 to 66,400 units, which ACT Research describes as the worst 12 months for trailer sales since 1975 and well below the early forecasts of 70,000. Industry insiders such as Craig Bennett, senior vice president of sales and marketing for Utility Trailer Manufacturing, now see a 10% demand improvement to 73,000 full-size and pup trailers in 2010.

Business investment is expected to stabilize, at least for equipment, early in the year with capital goods orders expected to turn around more convincingly as the year progresses. With industrial manufacturing utilization still low, capacity expansion is not needed, but businesses are flush with cash, and increased spending on replacement investment should pull equipment purchases higher. So, for 2010 overall, analysts foresee a 9.8% increase in equipment spending. Meanwhile, drilling activity in the energy sector rebounded sharply in the fourth quarter of last year and another big increase is occurring in this first quarter.

The need to "lean down" inventories has manufacturing firms eliminating warehouse floor space packed with large quantities of raw materials and work-in-process stocks. We'll delve into this supply chain activity when we come back, but first this…

III. Purchasing Focus -- Supply Chain Disruption

The principal at Lean management consulting firm R. Michael Donovan & Co. in Framingham, Massachusetts, says that the old ways of managing raw materials inventory required too much working capital, and contributed to erratic and longer leadtimes for finished-product deliveries.

The goal now, he says, is to link Lean operational improvements with best-in-class supply chain methods to deliver bottom line results for manufacturing firms. "There will be a lot more 'leaning out' of the whole supply chain transactional processes and systems--from purchasing to order tracking to parts delivery to materials management," agrees John Bishop, vice president of strategic sourcing at the Sikorsky Aircraft, the helicopter manufacturing company in Stratford, Connecticut. "That will allow expanded use of third-party supply management firms who will be responsible for materials and parts deliveries."

At the same time, there will be new supply-chain responsibilities and operations beyond companies switch from buying and stocking parts and materials to coordinating plant-floor deliveries of preassembled modules. The logistics may be hard to implement at first but will be cost-effective over time, says Bishop. For example, he actually is coordinating the construction of manufacturing plants in India, Poland, Turkey and Japan that will make and ship next-generation helicopter components to Sikorsky production plants with no pre-assembly warehousing.

So, "there will be expanded development of factories without warehouses with materials, parts and components delivered just in time from suppliers or third-party logistics providers," agrees Charlie Jacobs, director of continuous improvement at the APL Logistics supply chain management services firm in Phoenix, Arizona. His firm already has implemented 202 Lean-related projects that have eliminated almost $11.5 million in clients' warehousing costs through training in waste-elimination, time-study analyses, cost-and-effect analyses, solution brainstorming and stock-reduction implementation programs.

Jacobs says that the more factories without warehouses will put more pressure downstream on suppliers and logistics providers. "Manufacturing firms will be working to get their plant-level capacity utilizations as close to 100% as possible with inventories as close to zero-percent as possible," he says. And that will cause logistics providers to expand beyond freight forwarding and warehousing and distribution services to manufacturing support.

And that concludes our Purchasing Focus and this edition of Metals Watch! Read more of where Lean is going in supply chain management on Purchasing.com. 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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