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MetalsOutlook™ June 2009

Publisher's Statement

Have you ever seen a chicken just after its head gets chopped off? Yes, they really can run around.

Now imagine that view from the perspective of the other chickens. This doesn�t look good. A slow down would be good. Now imagine that same view from the perspective of the chicken processor. A slow down would be bad. It means you have lots of chickens still eating instead of being eaten. Inventory carrying costs rise.

Welcome to Economic Forecasting 101. As Obi Wan Kenobi said in Star Wars Episode IV, "So, you see Luke, I have told you the truth, from a certain point of view." So, now you get to be Luke. What point of view are you looking at? Who is telling you what "truth?"

From the government�s point of view, things might be looking better after they spent trillions of our future dollars. Of course, they are usually behind the curve and off by a measurable margin. From our children�s point of view, we look bankrupt. From the media�s point of view, there isn�t much more to be eecked out of bad news, so we need to find some "needles in the haystacks" good news. From the reader�s point of view, it is difficult to discern where to place your confidence.

New home construction is down. Remodeling is up. Steel demand is down. Steel exports are up. The market is down. The market is up. The recession is still here. The recovery has begun. And the dichotomy of forecasts continues as we wait for answers no one really has today. We have one of those 8-balls. Turn it over and it says, "Definitely Yes."

For more information on the near-term economic outlook, check out the May 2009 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 42.8%

Welcome to Metals Outlook™ June 2009

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June 2009

Tom Stundza's Comments

Welcome to the June 2009 edition of MetalsWatch! This is Tom Stundza, executive editor of Purchasing Magazine and Purchasing.com.

The current recession may be longer and stronger than many economists and executives had been predicting earlier. That means pricing of steel and other commodities could stay weaker for longer. In recent congressional testimony, Federal Reserve Board Chairman Ben Bernanke suggests that the current downturn could end "sometime this year"--as long as there is no relapse of the credit squeeze that has strangled the economy. He also thinks real new growth could begin "sometime in early 2010." But, the truth is that historic expectations of economic recoveries remain imprecise and restless.

That may explain in our Cover Story why most Americans still don�t believe the worst of the economic crisis is behind them. Only 34% of the people surveyed by America's Research Group think the worst of the crisis has passed, while 52% don�t think the worst is over yet and 14% just aren�t sure. They aren�t quite as pessimistic as CEOs, though, since 82% of the corporate leaders say their businesses will face "challenging and difficult times" in the second half of 2009. Other economists and business leaders are less sanguine as well--and some are suggesting that the pickup won�t begin until the middle of 2010.

Dan DiMicco, CEO of Nucor Corp., points out that the domestic steelmaking industry is working at 43% of capacity--"a level no one could have predicted when orders for steel were stronger earlier last year"--because the demand for steel "is virtually nonexistent." Net consumption of steel at 85 million tons in 2008 was 11% lower than in 2007 and 13% off the recent cyclical peak of 2006. Use could fall further in 2009 as low as 58 million tons, analysts have forecast. And DiMicco admits at a press briefing during the American Iron and Steel Institute annual meeting that "there is no clear consensus among steelmakers when there will be an improvement in orders."

Actually, the North American steel industry has been hit especially hard by the global economic meltdown, which has undercut demand and prices for the metal. Steel prices, which had climbed to record heights last summer, have plummeted in recent months. In our Metals Chips segment, we�ll discuss how the decline in steel prices continues to short-circuit the forecasts of steel mills, distributors and market analysts who had expected an end to the slide by now. Not only have steel prices dropped again in April but the bottom probably won�t be touched until June or July, according to buyers who say they have been receiving offers for May and June deliveries at even lower prices.

Mill executives aren�t overly optimistic about sales in this second quarter or for the rest of the year. AK Steel�s CEO, James Wainscott, who also is current AISI chairman, insists that "steel shipments in the U.S. were 13 million tons in the first quarter and even if there was a modest increase, the 2009 figure will be significantly down from the 98 million tons shipped in 2008."

The steel executives also say finished steel mill product imports are entering the U.S. at a 20 million-ton annual rate and already have grabbed 30% of the market this spring. That�s why "most steel mills still are reducing prices and the larger steel distributors are selling off inventory at low prices," suggests Grant Landry, sourcing manager at Energy Alloys in Houston, which processes specialized metal products for the oil and gas industry. So, buyers say benchmark grade hot-rolled steel sheet in coil averaged $420/ton in April, down 11% from March and 61% below the last peak price in July 2008. Market prices probably will be down again in May since some mill prices already have fallen under $400.

Stainless steel prices continued to drop in April since continued weakness in demand is evident so that sheet and plate prices more than 50% below their cyclical peaks of last June. Purchasing of stainless steel dropped by 37% last year and is showing no signs of life so far this year. So, through April, transaction prices have fallen by more than 50% below their cyclical peaks of last June. Yet, stainless steel inventory levels are so low that some producing mills are seeking to raise base prices for flat-rolled steel products by 6% to 9% and for stainless bar products by 5%.

The buyers are questioning the price hikes--noting that stainless mill stocks are in excess of purchases, year-on-year mill shipments are down by 33% and delivery leadtimes from the mills have slipped to around five weeks. Consumption of stainless steel by the motor vehicle, truck and bus industry is described as terrible. The mills admit they aren�t seeing any impact from the government's stimulus measures and there has been no indication of a general stainless-consuming economic recovery in the near term. Yet, executives at stainless mills are optimistic about an improvement in stainless orders that would support higher prices--at some point. However, this has generated some interesting negative reactions from analysts and buyers--based on e-mails to mill sales and marketing executives shared with Purchasing.com.

Analyst Michael Gambardella at J.P. Morgan Securities in New York says that quarterly conference commentary by some stainless industry players suggest that the market is nearing a bottom--but he isn�t looking for a rapid recovery from very low demand levels. Even if that trend reverses, he isn�t convinced that a recovery is at hand.

Meanwhile, the 24/7 news cycle is absolutely blowing up with coverage of the swine flu, actually, the world outbreak of the H1N1 virus. And frankly, if some of the worst case scenarios play out the massive volume of coverage may be warranted. But before panicking--since we have modern vaccines and flu pandemic containment plans--it�s worth taking a step back in Purchasing Focus to assess what we know, what we�ve learned from the recent SARS or severe acute respiratory syndrome and bird flu episodes, and what steps we can take today to help ensure the steady flow of our complex, global supply chains.

I. Cover Story -- Is The Worst Over?

Gross domestic product dropped 6.3% in the fourth quarter of 2008 and then contracted at a seasonally adjusted 6.1% annual rate in the first quarter. The Bureau of Economic Analysis says the output of goods and services in the U.S. reflects reduced exports, lower inventory investment, slowed equipment and software manufacture, and continued cutbacks in nonresidential and residential structures. The Wall Street Journal says first-quarter GDP would have fallen farther if not for improvement in trade: Exports fell but imports dropped even more.

Various economists and government officials report that the recession is plodding along this quarter at about 1% GDP growth because of continued reduced spending on new residential and nonresidential construction projects and contracted overall manufacturing activity. U.S. industrial production retreated a fifth straight month in March, data shows. Over the past 12 months, output was down nearly 13%. Also note that capacity use by industries has receded to 69.3%, a historical low since records began in 1967. Upshot: The panel of economists that generates the monthly Blue Chip Economic Indicators report says it�s now likely that the year-over-year rate of nominal U.S. GDP will dip into negative territory this year for the first time since the late-1950s.

Manufacturing activity has remained weak--as evidenced by business conditions indexes tracked by the Institute of Supply Management and Purchasing magazine...both are still well under 50. "There is a pronounced improvement in key aspects of the surveys, but they remain at levels consistent with steep contraction," says David Hensley, director of global economic coordination at J.P. Morgan Chase & Co. in New York.

Even when the economy does hit bottom, it may take a while before robust growth resumes, suggests Joseph LaVorgna, chief U.S. economist at Deutsche Bank Securities in New York. Inventory building among purchasing groups just isn�t happening, either. The latest diffusion index this month is under 17 where 50 is needed to show growth. "What we�re seeing is the rate of decline in activity is diminishing," says Hensley at J.P Morgan Chase, "and not that the level of economic activity is rising."

Corporations are trimming their capital spending in the face of faltering domestic final demand, softening profits, a tighter credit market, and high energy prices. Manufacturers, retailers, wholesalers, construction contractors, mining firms and the service sector are reducing capital expenditure programs--which do not bode well for domestic demand for machinery and equipment. Production of machinery dropped in 2006, 2007 and 2008. Global Insight economists see further 13% decline in 2009. Reason: The prospects for housing, manufacturing, and wholesale and retail trade have dimmed of late--which will certainly have a negative impact on machinery and equipment spending until the government�s economic stimulus spending kicks in. The key unknown is when that will happen.

II. Metal Chips -- Steel Prices Still Sliding

While only 22% of the steel buyers polled by Purchasing magazine this month expect to increase orders within 30 days, 41% of the end-market steel buyers surveyed by the Institute of Supply Management expect orders to be up in the next 90 days.

However, steel executives are less optimistic than the ISM group and remain uncertain when a real recovery in purchasing will begin. The ISM survey finds 61% saying inventories are too high relative to demand, a view shared by the steel executives questioned at the AISI briefing. "We have not hit bottom in the drop-off in steel demand," says Nucor�s DiMicco. And, although he optimistic about long-term steel purchasing and production, he admits "it will be a long and slow recovery."

Steel executives also say finished steel mill product imports are entering the U.S. at a 20 million-ton annual rate and already have grabbed 30% of the market this spring. That�s why "most steel mills still are reducing prices and the larger steel distributors are selling off inventory at low prices," suggests Grant Landry, sourcing manager at Energy Alloys in Houston, which processes specialized metal products for the oil and gas industry. So, buyers say benchmark grade hot-rolled steel sheet in coil averaged $420/ton in April, down 11% from $471 in March and 61% below the last peak price of $1,068 of July 2008. Market prices probably will be down again in May since late-month mill prices already have fallen to $400 and some service centers and traders are unloading stock as low as $380.

Stainless steel prices continued to drop in April since continued weakness in demand is evident so that sheet and plate prices more than 50% below their cyclical peaks of last June. Stainless steel inventory levels are low so several mills have announced price increases on sheet and bar. Top executives at AK Steel and other stainless mills are optimistic about an imminent improvement in stainless orders that would support higher prices. This has generated some interesting negative reactions from analysts and buyers--based on e-mails to mill sales and marketing executives shared with Purchasing.com. Analyst Michael Gambardella at J.P. Morgan Securities in New York says that quarterly conference commentary by some stainless industry players suggest that the market is nearing a bottom--but he isn�t looking for a rapid recovery from very low demand levels. Even if that trend reverses, he isn�t convinced that a recovery is at hand.

Meanwhile, service center executives say steel market prices will continue to fall in the second quarter in the face of continued weak demand from manufacturing and construction firms. So says the latest survey by UBS Securities in New York, which finds distribution executives planning to continue destocking inventory even though leadtimes from the mills are expected to fall in the April-June quarter. UBS analysts Timna Tanners and P.T. Luther say in a report to clients that 56% of the executives surveyed saw demand stable in the second quarter and 61% still believed their inventory levels were too high. The service center executives don�t plan to boost orders with the mills and also say imports will stay flat.

"We think these views can support a continued destocking through most of the second quarter," they write, "and we think weak demand will suppress any return to buying even when inventories get too lean." The two analysts believe real demand in the steel market is down around 40% while production is down nearly 50%, "so we do not see capacity utilization resurging imminently." The analysts asked distributors what they would need to see for prices to rise, and most referred to a recovery in demand and better credit. "Some cited mill supply containment," she says, �but mill utilization has been steady at 43% and prices have kept falling." Tanners says that "steel prices will be challenged to rise" in the face of excess global capacity and she expects that "inventory restocking to be delayed and muted amid weak underlying demand."

Actually, steelmakers had been hoping the first quarter would be the worst for 2009. As a group, they hoped the housing market would pick up, nonresidential construction would awaken, stimulus programs would gain traction and an auto bailout all would boost consumption in key steel customer segments--and provide clues that the steel market was headed for a turnaround. As analyst Michael Gambardella at J.P. Morgan Securities in New York writes to clients: "Things are still horrible, but the sky is not falling." In fact, as the second quarter has opened, some mill executives still want Wall Street to believe there is an improving outlook.

However, Gambardella also writes that "a major leap of faith is required to expect a robust second half as substantial headwinds, in the near term and medium term, persist." As the market "progressed from September 2008 to March 2009, we have seen business and market conditions worsen each succeeding month," says a more realistic DiMicco at Nucor. "Entering the second quarter of 2009, both the U.S. economy and steel market conditions have continued to deteriorate."

Buyers tend to agree with that appraisal. "The markets we serve are down significantly year on year so steel prices are continuing to decline," says Peter J. Meriam, director of supply chain management for North America at steel fabrications firm at PHC Inc. in Wilmington, N.C. Also, there�s an abundance of skepticism among buyers that only plate, structurals and rebars will benefit from federal bridge and highway reconstruction funding and a pickup in nonresidential projects and, then, not until 2010.

When we come back, in Purchasing Focus, we�ll share the views of Kris Colby of Ariba�s Spend Management Services group on how the swine flu may impact supply chains. But first this:

III. Purchasing Focus -- The Supply Chain Flu

Although there hasn�t yet been a huge outbreak outside of Mexico, Ariba�s Kris Colby says swine flu will have a significant impact on the global supply chain.

That�s because outsourcing to Mexico has become a major component of the sourcing programs at many firms-- particularly those in the high-tech and heavy manufacturing sectors. So, if companies are sourcing in Mexico, they should be planning for supply chain disruptions so that they can mitigate any negative impact on their business.

Next, if there is a pandemic outbreak of the H1N1 flu, the availability of airlines will be a big risk, as they will significantly decrease the aircraft and reduce the air freight capacity being operated. In fact, large shippers may want to begin to spread their freight between commercial and cargo carriers now, as shipments that are completely at the mercy of commercial airlines could be vulnerable.

On the inventory side, companies should monitor where they are sourcing from and adjust their safety stock to be less reliant on hot-spot countries like Mexico. In Europe or the US, there are good systems in place to contain an outbreak if one occurs. Such systems are not in place in Mexico, China and India, which makes it difficult to determine the impact on production.

In Mexico specifically, companies should request additional shipments to keep their stock intact should the Mexican government extend mandatory plant closure or U.S. officials opt to seal the border. Also, supply chain managers should monitor Centers for Disease Control and World Health Organization sites to keep abreast of latest developments and adjust their strategies accordingly.

Colby says Ariba�s customers are not displaying supply chain concern at this time. But, based on what was learned from SARS and Bird Flu, these firms are monitoring the situation closely so that we can be ready to help them avoid any disruptions if and when the outbreak becomes more severe. The bottom line is, it�s not time to panic, but it is time to prepare.

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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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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