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January-Febuary 1996

I. COVER STORY: Metalworking Manufacturers are Upbeat

North American consumers pulled out the plastic and charged some $120 billion between Thanksgiving and Christmas, 1995. That's the word from RAM Research Group, a Frederick, Maryland, company that tracks credit card usage. While the growth in sales this past holiday season may not be as explosive as it was the year before, it was healthy, according to the RAM researchers. "What's that got to do with our metalworking outlook?" you might ask. Well, based on our surveys of buyers and manufacturers, steady growth -- not flashy, but steady growth -- is our forecast for metalworking in the months ahead.

As Mike Niemira, senior economist at Mitsubishi Bank in New York, suggests -- "We've got an overall economy right now that doesn't have any dramatic strengths or dramatic weaknesses." In other words, the consumer sentiment is another indicator that growth -- even if it's slow by economists' standards -- will continue for months to come. The nation's manufacturers agree. They are hopeful about where the economy is heading. They also believe their profits will rise in 1996.

If you thought the third-quarter slowdown was descent for landing, you were wrong. The manufacturing economy is climbing into a fourth consecutive year of prosperity. What's ahead for metalworking is more orders, expanding markets, growing product lines, and additional productivity advances. Remember that 1995 was a very solid year overall for the global economy -- even if Japan's problems cut industrial production growth in the seven major industrialized countries to 2.5%. With Japan's economy improving, the outlook for the G-7 is 2.7% growth in 1996. Although this rate of growth is slow by economists standards, it is solid and sustainable growth nevertheless.

Economists also expect North American growth again to be between 2.6% and 2.7% -- slow, maybe, but it's still renewed growth from a very high level of 1995 activity.

Most manufacturing CEOs also are optimistic. In one survey of 250 manufacturing execs, 73% gazed into their crystal balls and foresaw another year of sales expansion and additional capital-equipment buying. Another 18% believed 1996 will behave economically much like 1995. And just 9% thought business conditions will worsen in 1996. Another survey of a different 250 CEOs found 67% of them describing their outlook for the U.S. economy as optimistic. Only 24% were uncertain about prospects for 1996. And just 9% were pessimistic.

Another auspicious indicator is that 65% of the manufacturing CEOs in both surveys expected that profits would continue to rise in 1996. That's because most manufacturers report strong demand for their products. As long as demand is high and their customers are buying, there's good reason for them to be encouraged. In fact, 51% of the manufacturers in both surveys said orders have recovered from the summertime malaise and increased in the last three months of 1995. And just over two-thirds of the CEOs now anticipate this upward sales trend will continue through 1996.

Another key indicator, Paine Webber's index of activity in 15 steel-using industries, is 4% stronger than last year. Even the nation's purchasing managers paint a portrait of hearty manufacturing. The National Association of Purchasing Management's survey, shows that purchasing is continuing to get inventories in line with anticipated sales.

As you all know, manufacturers struggled through much of 1995 to reduce bloated stocks of unsold goods. That's because excess inventories of such intermediate products as steel and aluminum mill products -- and such end products as cars, appliances, and machinery -- slow the metalworking economy -- force companies to cut back on production. That's why metals buyers, as a group, spent most of 1995 reducing stockpiles purchased in 1994. Evidence of that is the Purchasing Magazine Steel Buying Optimism Index, which fell steadily this year and averaged just 41 through September. Now, however, there's much anecdotal evidence of renewed fourth quarter buying in the major steel and nonferrous production metals. For example, the Purchasing Magazine index jumped in December to 57 -- indicating stronger buying patterns in the months ahead.

NAPM STEEL BUYING PLANS.
DIFFUSION INDEX, % EXPECTING TO BUY MORE

1992	1993	1994	1995
40.0	60.0	62.5	46.0
49.0	69.5	64.0	56.0
48.5	66.0	53.0	50.0
53.0	60.0	62.0	45.5
57.5	58.5	63.5	43.0
52.5	48.5	57.0	36.5
51.5	43.5	58.0	35.0
61.5	45.0	61.0	32.0
47.5	43.0	58.5	33.0
41.5	47.5	42.5	32.5
39.5	56.5	42.0	47.5
40.5	62.5	55.5	57.0

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Economists and CEOs agree that the U.S. economy will grow 2.6% in 1996, while the Canadian economy could show an even stronger 2.7% growth. In both countries, manufacturing will keep humming at near capacity. Forecasters are divided, but we believe this year's U.S. industrial capacity utilization rate of 84% will be sustained in 1996. Even better news is the expectation of subdued inflation. Economist Saul Hymans at the University of Michigan, for example, expects that the Federal Reserve Bank won't raise interest rates anytime soon to tighten the U.S. money supply.

That's particularly hopeful for car and truck sales, home starts, durable goods orders, and other segments of the North American economy that depend on time payments and are tied closely to interest rates charged for loans.

U.S MOTOR VEHICLE SALES
(MIL., CARS & LIGHT TRUCKS)

1984	14.2
1985	15.4
1986	16.1
1987	14.9
1988	15.5
1989	14.8
1990	14.1
1991	12.6
1992	13.1
1993	14.0
1994	15.3
1995/f	15.1
1996/	14.9

People will keep buying cars, minivans, and light trucks again. But, we tend to agree with economists who predict North American motor vehicle sales will decline slightly -- by about 200,000 units to 15.9 million cars and all type trucks in 1996. That may lead to a slight decrease in production rates by about 2% to 14 million units. The key question here is whether North Americans will slow the buying binge for minivans and light trucks. If they don't, output and sales might actually stay even with 1995.

MAJOR APPLIANCE SHIPMENTS
(MIL., FACTORY UNITS)

1984	41.56
1985	44.02
1986	47.59
1987	50.65
1988	50.03
1989	49.46
1990	45.62

1991	43.11
1992	46.17
1993	48.52
1994	51.29
1995/f	52.41
1996/f	52.82
1997/f	50.32

People also will keep buying ovens, refrigerators, washer-dryer combinations, and air-conditioning units. But since 1995's levels of sales and production were boosted by a totally unexpected explosion in midsummer air conditioning system sales, we think production of steel-intensive major appliances could slip a bit -- maybe 2% -- to 38.7 million units in 1996.

On the other hand, we also accede to those who submit that machinery and electrical equipment production both will soar by 12% or so. There hasn't been such a sustained period of growth in production in a quarter century, according to a market analysis by Mark Ulmer at DRI/McGraw-Hill. But, industry continues to retool worldwide, and buyers still are sourcing new lathes, metal-cutting tools, cranes, industrial boilers, and all those other forms of machinery and capital equipment. And, it looks as if private building investment, which grew by 10% in 1995, now will grow by another 7% in 1996.

Just look at machine tools. Thanks to the weaker dollar, machine tool shipments in 1995 climbed an unheard of 45% to $4.5 billion. Even if demand only grows by the forecasted 10%-to-11% in 1996, that still will mean a $5-billion sales year.

News reports regularly discuss the ups and downs of housing construction, but often overlook the very healthy non-residential construction underway throughout the U.S. and Canada. If our forecasted growth occurs in 1996, residential and non-residential investment will pass the $1-trillion-market for the first time ever.

Then there's a market we haven't talked much about in recent years -- aviation and aerospace. Production definitely is lifting off the launchpad. Based on new-order booking at Boeing, McDonnell Douglas, and Airbus Industries, it now appears that jetliner production will rise by at least 7% in 1996.

Purchasing Magazine's panel of market analysts also see expanded production of such other metals-consuming goods as railcars and ships; oil and gas rigs and machinery; and mining, lumbering, and quarrying equipment. Miscellaneous manufacturing, as a group, is forecast to expand output by 4%. That's because people still are buying new equipment such as furniture, backyard swing sets, and those other commercial and consumer products made from metals.

Here's some evidence: A trade group you probably never heard of, the Conveyor Equipment Manufacturers Association, reports that its members shipped $4.8 billion worth of equipment in 1995 for the second consecutive year. And orders already on the books for 1996 suggest no production drop-off ahead.

One key factor to remember is that the U.S. trade deficit has narrowed to $8.35 billion. That's because offshore sales of cars, computers, machine tools and other heavy machinery are pushing American exports to an all-time high. That's good news, says Lawrence Chimerine. The Chief Economist at the Economic Strategy Institute in Washington explains that a shrinking trade deficit leads to an expanding domestic economy. And international economist Jay Lawler at DRI/McGraw-Hill says the Canadian economy will profit next year from the voter rejection of Quebec's annexation proposal. "After all," he says, "the Canadian industrial economy already is benefiting from low inflation and healthy offshore sales."

II. METAL CHIPS: Fearless Steel Forecast is Upbeat, too

The strong global competitive position of U.S. and Canadian manufacturing translated into a North American steel-use year of close to 123 million tons in 1995. The 1996 chew-up in the U.S. and Canada will be around 122 million tons. That's a decline of less than 1%. Simply stated, the overall steel demand outlook in North America is highly favorable. In the U.S. alone, steel mill use of 11 million tons in 1994 and 1995 will only fall to an average 108 million tons in 1996-1997.

U.S. STEEL USE (MILLIONS OF TONS)

1990	96
1991	88
1992	93
1993	100
1994	111
1995/f	111
1996/f	107
1997/f	109

In recent weeks, mill reports have shown a resurgence in forward orders from domestic and offshore sources. At the same time, imports have continued to decrease. And, because of low world steel prices, there is some question about the availability of foreign-made steel for next year. We reckon that distributors and end users will continue to look homeward for 1996 supply. This should enable the market to absorb most of the scheduled new annual sheet-steel capacity -- highlighted by the 2-million-tons-plus now in startup by Gallatin Steel and Steel Dynamics.

During 1995, metalworking used more steel than people expected. In fact, service centers were able to find enough buyers to draw down an enormous springtime glut of metal to a more-manageable three-month-level in just two quarters. Still, service center inventories ended the year 2% higher than a year earlier, and equalled close to three months of supply. Our view of the service center business suggests a 5% gain in 1995 shipments to around 29 million tons. Less-bullish projections from industry insiders say 28 million tons, but that's still 2.5% growth. Looking at 1996, the preliminary consensus forecast is at least a 28-million-ton shipping year.

Dave Roland of the Steel Service Center Institute agrees that "some slight easing" in the metalworking economy should be expected in 1996. But he also counts himself among those looking for healthy steel demand to continue. He says that U.S. distributors are looking to the automotive and industrial construction sectors to continue demanding a great volume of steel. Canadian distributors, on the other hand, believe consumer products and the housing market will keep them busy in 1996.

SHIPMENTS BY STEEL DISTRIBUTORS (MILLIONS OF TONS)

1987	23.202
1988	23.501
1989	23.736
1990	23.889
1991	21.705
1992	22.378
1993	24.951
1994	27.446
1995/f	28.818
1996/f	27.377
1997/f	26.009

A key point in the outlook for 1996, says Bob Hageman of Oppenheimer & Co., is that the increased competitiveness of North American steel-using industries is translating into even more transplant factories. And that means even more steel is being required by metalworking manufacturers here for products that will be exported. This already is evident in the machine tool industry, where 70% of orders these days are foreign bound.

The strange thing about all this optimism is that 1995 use of all carbon and stainless steel sheet actually was flat with the level of consumption in 1994. That's evident in that sheet leadtimes from the mills are 15% shorter than a year earlier. So, it's obvious supply is catching up with demand.

In 1995, the heavier grades did the growing. That's because demand is related to the capital goods-driven parts of the economy. The use of pipe and tube rose by 8%, plate products application rose 6%, and use of bars and heavy structurals both increased by 3.5%. Looking ahead, we expect a slight dip in sheet offtake, but probably the same level of use of plates, bars, structurals, and tubing. However, market analysts like Hageman think steel sheet order trends may bounce around a bit in the near term. Good orders are being reported from some end-users, but weaker orders from others. Part of the problem was an end-of-year inventory correction among the OEM.

The big issue for 1996 appears to be sheet steel pricing, which should stay competitive. In 1994 and early 1995, steel prices in the U.S. and Canada rose substantially even though supply rose 20% from 1993 levels. Then, as exports began to rise and imports began to fall, sheet prices plummeted. The analysts say it was caused by market psychology, seasonal factors, and users' inventory swings. Analyst Peter Marcus at Paine Webber says sheet prices fell because of the time it took to correct the glut of local inventory.

We now expect spot sheet prices to remain somewhat weaker in 1996 than they were in 1994 and early 1995. That because of the new supply coming on stream. And, because many major mills have booked contract orders for future delivery at reduced prices. Of course this outlook can be made obsolete in a heartbeat; you all know how volatile this corner of the steel market can be.

Another Strong Stainless Year

There's no decline ahead in the use of stainless steel and other specialty alloys. Stephanie Anderson, Inco's Director of Market Research in Toronto, says world stainless steel output will grow by 2% to 16.6 million tons next year. In the U.S., the consensus forecast is a 15% gain to 2.3 million net tons. As for consumption, it now appears that demand, which grew 5% this year to 2.6 million tons, will rise another 3% to 2.7 million tons. Also note that we now expect North America's double-digit consumption growth of this year to be repeated in 1996 in what had been long-dormant product areas of the specialty-alloys, foundry castings, and the superalloys.

During 1995, stainless sales to automotive were healthy, but purchasing by construction and general industrial accounts was saw-toothed all year long. In fact, fourth quarter flat-rolled stainless demand took a nosedive, and dragged prices down with it. Stainless sheet leadtimes ended the year only 6% longer than the same time the previous year.

Stainless bar and stainless plate leadtimes from the mills at the end of 1995 were 40% more extended than at the end of 1994. Then, there's stainless steel pipe and tube mill products. Shipments and leadtimes were more than 20% stronger than at the end of 1994. That's because consumption is 11% stronger than in 1994. And, since the foreign tubular mill onslaught of past years has slowed, the demand pickup is really putting the pressure on domestic mills to perform. However, service center inventories of all stainless grades ended 1995 12% higher than the year earlier, and are close to five months of supply. Looking ahead, we expect a solid, but steady year for stainless sheet offtake, along with a chance that spot tags may slip by 3-to-5% next year. But, there's also a chance of stronger sales and higher tags for stainless and specialty plates, bars, structurals and tubing.

Hageman explains that the commodity-driven austetic sheet markets are particularly susceptible to price decline because of marketplace conflict. Again, good orders are being reported from some end-users, but weaker orders from others. Overall, however, the analysts suggest that ferritic and austetic sheet grades both will show slow and steady growth in demand in 1996. In fact, there's a product-mix change already taking place in the stainless steel sheet market. Researchers at CRU International tell me this demand switch is centering on hot-rolled sheet product. CRU's Peter Simon explains that today's rolling mill technologies produce hot-rolled stainless sheet and coiled plate with sufficiently good flatness and surface characteristics that it is displacing cold-rolled sheet in some applications. He says this product-switch is becoming evident in both North America and Europe.

III. PURCHASING FOCUS: It's Really a Quality Focus

The economy cannot be described just by adding up how many tons of rebar it makes, how many machine tools it sells -- or how much wood its woodchucks would chuck if its woodchucks could chuck wood. All these count but, in the final analysis, what matters is how well an economy satisfies its customers' needs and wants. And how are your final end-product customers these days? Are they happy? Are they restless? Will they come back tomorrow? Whether you're in purchasing or marketing, the answers to these questions profoundly affect your business. The latest answers might surprise you.

That's because there's good news and there's bad news about the quality of North American manufactured products. The good news is that some key metalworking industries -- most notably domestic automobile makers -- have made significant gains in customer satisfaction. The bad news is that U.S. and Canadian companies overall are satisfying their customers less well than before. That's the latest customer satisfaction update from the University of Michigan's business school and the American Society for Quality Control.

After eight years of Baldrige Awards and after so much corporate attention to quality that TQM is an acronym that no longer needs to be spelled out, you might ask: "How can end-product buyers be less satisfied?"

The study suggests that many businesses have made a key wrong turn in their drive to improve quality during this period of reengineering. In other words, industry's obsession with reengineering has been so cost-conscious that firms have cast materials and end-product quality aside as a given. Thus, there's been much misconceived penny-pinching when sourcing raw materials and operating factories. Also, many firms are so concerned about reducing purchasing and production costs that they have been unaware of their customers' rising expectations for even-higher-quality products.

Yet, quality is too important to companies and to the economy to be measured only by inference. After all, it wasn't lower prices from improved productivity alone that allowed the Big Three to win buyers back. And, it is repeat business that's the ultimate measure of customer satisfaction -- and product quality.

It is obvious that QS-9000, the U.S. Automotive version of ISO-9000, has had and will continue to have a major impact on U.S. auto producers bottom lines. ISO-9000 Quality Programs, as well, is making major inroads in all U.S. manufacturing sectors and will probably continue to do so, as long as the economy continues to grow.

The consumer satisfaction survey is important because it is the only quality indicator of its kind. Most other economic indicators are concerned with price and productivity. But, these indicators don't -- and cannot -- truly measure quality.

The Bureau of Labor Statistics tries to take account of quality improvements in calculating the consumer price index. For example, if a carmaker raises a price but the new model includes new features like airbags or has better fuel economy, the BLS will subtract the estimated retail value of the improvements from the price before calculating the CPI. But the BLS makes these quality adjustments for only a few industries.

Productivity statistics come closer, but again not close enough. Efficiency is at best an incomplete and indirect way to measure quality. Some of the cost of poor work shows up in lower productivity figures. And we all know that shoddy work usually means lower prices, which also leaves its traces in measures of productivity.

But in both these indicators, there is no direct feedback from customers, the final arbiters of quality.

Corporations that take total quality management seriously, long ago realized that quality pays for itself. Eliminate defects and you eliminate rework, cut back or cut out inspection, reduce inventory, and other drains on working capital. It's less clear that companies recognize that happy end-product buyers also pays dividends. That's because the rewards of eliminating defects show up directly -- in reduced costs. Pleasing customers only shows up in sales growth.

We hope you have enjoyed this edition of Metals Watch!

Watch your mail for future editions.

OUR NEXT EDITION WILL COVER:

"THE STAINLESS STEEL MARKET"

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