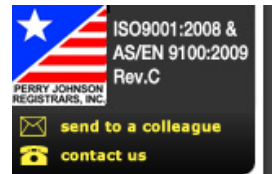




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September 1997

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I. COVER STORY

Like the current bull market on Wall Street, it has become increasingly difficult to predict when the economic good times will end. Manufacturing activity continues to be healthy, according to government data. Atop that, the purchasing managers' factory index rose to 57% in May and remember, an index reading of 50 or above means U.S. and Canadian manufacturing is expected to expand for at least three more months. That would keep factories humming through what usually is a seasonally slack time. Simply put, "There still are no expectations of an economic downturn this summer," comments Economist, John Anton at DRI-McGraw-Hill.

He points out that there are no real danger signals of an imminent manufacturing collapse. Not with low unemployment, low inflation, and high productivity. Sure, automotive sales are somewhat slower than in 1995 and 1996. But major appliance sales are higher. Machine tool and other heavy equipment shipments are robust. In fact, if business continues at its current rate, North American machine tool shipments will exceed last year's 38,000 units. Rising production at metalworking plants in Europe and Asia has translated unexpected strong demand for new capital equipment made in North America. Similarly, industrial equipment and energy equipment production is strong. In addition, says Paul Darby, the Conference Board's Director of Economic Services, the offshore demand for North American - made manufactured goods in foreign nations continues to drive manufacturing activity here.

In addition, construction activity is astonishing the experts. In fact, Commerce says the pace of overall U.S. construction spending continues to average \$600 billion. According to the latest forecasts, U.S. housing starts look to be shooting for the fourth consecutive year of more than 1.4 million units. In Canada, meanwhile, housing starts are anticipated to rise past 150,000 units this year - a sharp increase over the 125,000 starts recorded in the past two years.

The worry-warts seem to be most concerned because U.S. car and light - truck sales have slowed for the past couple of months. "We're reaching a saturation point in demand," says Analyst, John Casesa at Schroder Wertheim & Co. Still, first half sales in the U.S. are running at a seasonally adjusted annual rate of about 15.2 million units. The nervous nellys also fail to note that motor vehicle sales continue to surge in Canada. "More and more Canadians are feeling positive about the state of the economy," says David Conlon, GM Canada's VP of Marketing. So most automotive economists now expect Canadian motor vehicle sales at least 10% higher than in the past two years - and very near the 750,000 units sold in 1994.

With new models of sport utilities and minivans still outselling sedans, it's easy to see why the analysts still forecast that U.S. and Canadian car and truck sales will be somewhere between 16 and 16.5 million

units again in 1997.

Thus, it doesn't look as if automotive manufacturing is on the verge of collapse. Motor vehicle production in the U.S. at midyear is running ahead of forecast. Even with the recent spate of short-term labor disruptions at General Motor and Chrysler plants, midyear U.S. and Canadian assembly is 2.5% ahead of last year. Upshot: North American assembly will be above 14 million units for the third consecutive year.

Also note that the North American oil and gas exploration and transmission industries are thriving. In fact, they're operating at levels that haven't been recorded in more than a dozen years. Drill rig activity in the U.S. and Canada is in excess of 1100 rigs, and destined to grow even more, according to energy industry insiders. Just recently, Bank of Canada Deputy Governor Chuck Freedman told reporters the Canadian central bank wants to duplicate the U.S. experience, in which the economy is operating at full capacity without sparking inflation pressures. He believes both the Bank of Canada and the U.S. Federal Reserve Board will continue to adjust interest rates just enough to tame inflation without jeopardizing manufacturing activity.

And here's another good news indicator. The inability of companies to find employees they needed earlier this year is leading to the strongest third - quarter hiring plans since 1988 for construction, manufacturing, and services workers. Mitchell Fromstein, Chief Executive of the Manpower Temporary Services firm, says the job outlook is the brightest in the Midwest and adjacent Canadian provinces.

II. METAL CHIPS

The easiest way to describe the midyear steel market is that it is trying to find a comfort zone. It has to. The steel economy surged to such an extent in the first quarter that the annualized rate of U.S. and Canadian consumption was in excess of 140 million tons. This superheated activity calmed down somewhat in the second quarter. But, at midyear, apparent consumption is still running in excess of 120 million tons. Most economists expect no-growth in consumption in the second half of this year, but that still will mean full-year use matching last year's North American use of 125 million tons.

Many market mavens are now expecting steel price volatility sometime this half. I'm sure most of you saw the recent Wall Street Journal article which proclaimed that, after holding steady for several months, sheet steel prices appear poised to head lower. The analysts interviewed by the Journal remain convinced that an abundance of steel - created by a wave of low-cost mini-mills and no apparent slippage in imports - will soon drive supply well beyond demand. This view, of course, is very welcome within steel - consuming circles.

But the truth of the matter - at least, from my perspective - is that supply will remain relatively tight in the third quarter - especially if the eight-month strike at Wheeling-Pittsburgh Steel continues through summer. It's well known, for example, that coated sheet stock supply is extremely tight in the U.S. and Canada alike. "The real story is that things have been holding up better than most of us analysts had predicted," says Richard Aldrich, a Steel Analyst himself, at Lehman Brothers. He points out that, "The new supply has come on considerably slower than expected, demand is better than expected, and you have a strike. Who could have foreseen the strike would last this long?" Aldrich asks.

Sheet mill products contributed the largest amount to the 1996 rise in apparent consumption among finished products. The continued strength of the automotive, appliance and housing markets have been the biggest elements of continued surprise in 1997. Apparent consumption growth so far this year is 10% stronger than a year ago. This rate probably won't continue in the second half. But, the drop-off may not be extreme. At least not extreme enough to meet the earlier expectations of a 2% - 3% drop in use from 1996 volume. That's because mill sales execs. report that orders for third quarter delivery have been on par with second quarter bookings. It's now also obvious that the mavens are adjusting end use demand upwards when you realize that the apparent end use of light shapes, medium structural, and plate are far healthier this year than was expected earlier in the year. So also has been the consumption, at least so far this year, of rails, bars, tool steels, pipe, and tubing.

The key to the second half may just be imports into North America. Domestic prices are still high relative to the rest of the world, and there is still an excess of steel capacity abroad. But, imports aren't likely to stay at the first-half annualized rate of 35 million tons, which is almost 28% of supply. Steel demand in Europe, Asia, and even South America is strengthening - finally. So, according to Analyst, Ken Hoffman at Prudential Securities, there will be less reason in coming months for overseas steel makers to send their products to the U.S. and Canada. And don't forget, there are pending U.S. dumping duties against some offshore plate that could dry up supply in the fourth quarter.

Now, let's talk a little about the North American steel industry's direct appeal to automobile and home buyers in a new \$100 million advertising campaign aimed at expanding business over the next five years. The campaign is unusual for the industry, which is going over the heads of its traditional manufacturing customers and taking its case to people who aren't in the habit of buying I-beams and rolled sheets of steel. The ads include network television commercials that show a child in a safety seat as traffic rushes past the car on either side, hurricane-force winds toppling buildings, and a diver protected by a cage from a shark. In each commercial, the industry hopes to remind consumers of the strength, durability and security of steel in hopes they will demand it when buying a car or van, having a home or addition built or making other purchases. The campaign is also aimed at educating consumers about the environmental progress steel makers have made in producing steel and how it can be recycled. "The New Steel...Feel The Strength" is the theme of advertising being launched this month by a coalition of 78 North American steel producers, raw materials suppliers, and related steel-using businesses calling themselves The Steel Alliance. Over the last 15 years, the industry has invested \$50 billion on building new production facilities and technology, thus bringing down the cost of making steel, and causing less damage to the environment than a decade ago. However, the industry still faces an awareness problem. Consumers don't know as much about steel as they do about such alternative materials as lumber, plastics and aluminum.

Roy Spence Jr., President of the GSD&M Advertising Agency which created the ad campaign, says consumer research showed ``latent sympathy'' for the steel industry and ``fondness'' for its role in

economic history. What consumers need to be taught, Spence says, is that the industry no longer can be considered an inefficient producer of low-quality metals.

Now, this venture dovetails with other efforts by the steel industry in the U.S. and Canada to find new uses for sheet and other forms of metal. Long overdue efforts at marketing partnerships are being attempted by the steel mills and the service centers who process and distribute large amounts of the tonnage. Approximately 35% of all North American steel mill shipments are handled by service centers. In fact, almost 45% of all flat-rolled steel ultimately goes to market through distribution. Now the American Iron and Steel Institute has offered to include members of the Steel Service Center Institute on the ANSI flat-rolled market development committee and marketing task forces attuned to such flat-rolled markets as automotive, appliance, and construction. The reasons were discussed at the annual SSCI convention by a panel of mill and service center execs. at a meeting of the Flat-Rolled Committee. I recorded what became a lengthy panel discussion highlighting an eventual ANSI/SSCI marketing partnership that will change the way steel is marketed to service centers and end users alike.

You'll be presented now with views about this pending mill-service center partnership from the following execs: David Waugh of Dofasco in Hamilton, Ontario; John Ewing of USS-Posco in Pittsburgh, Calif.; Bill Ristau of Midwest Coil Processing in Chicago; and Tom Nelson of Fullerton Metals in Northbrook, Illinois.

First, here's the view of Dofasco's Dave Waugh: The advantages to the service center industry that I think would be forthcoming from participation in the ANSI would include enhanced market knowledge on all fronts, a broader understanding of the major issues that affect the future of steel (including competitive materials), as well as an opportunity to have a first-hand look at new market developments for steel and leading-edge technology. In my opinion, I think this is very important. It provides an opportunity for cultivation and more expansive relationships with key mill personnel. From the steel mill standpoint, I think having SSCI involved with ANSI would result in a more informed distribution/service center network on all major steel developments. I also see an advantage for the steel mills to solicit SSCI cooperation on major opportunities and threats. Again, it provides that opportunity for closer relationships which I think are going to be vital as we go forward.

And here's the opinion of John Ewing of USS/Posco: For the first time, we might have a common voice as people dealing in steel. It just disturbs me to no end when you take a look at competing with other materials like the lumber industry, the cement industry, the plastics industry. They are united on what it is they want to do. They have very focused objectives and goals, and all march together toward that. We are a little bit fragmented in the way that we are organized, and I believe that the ANSI and SSCI organizations getting together and getting to know each other will provide us that opportunity to really become a much bigger voice here in North America than we've currently been.

And here's the opinion of Bill Ristau of Midwest Coil Processing: You can look around the integrated. There's been a tremendous reduction in just people in the field making sales calls...Most every integrated mill has lost a tremendous amount of sales coverage because of cost pressures. What we have here is a service center industry with I don't know how many more sales people representing the steel industry than the integrated steel people. And as the upstarts and the mini-mills come on, of course, we all know that sales coverage is much more spread out and much more geographic in nature. So, the opportunity to do market development as an industry, I think, is going to fall more and more in the laps of the service center people. The sales people at the service center level will have to get more and more in touch with real market development, and look at new applications for steel instead of just getting orders. We, as an industry have to develop training through the AISI and really change the focus a little bit from a short-term order-taker kind of an industry.

Partnering is a much overused concept. It's been around for a number of years. And yet, it's felt that few service center operators have really bought into the concept of becoming a supply partner with OEM end-user customers or with their mill suppliers. It's also felt that not all service centers clearly understand what partnering entails. Now, I'm not saying this. That's the message that has come out of a segment of the Flat-Rolled Committee meeting.

Here is Tom Nelson of Fullerton Metals: I'm convinced that partnering is a very difficult concept. Having been on both sides of the street, not only in partnering between the service centers, the mills, and the suppliers, but as a service center supplier to an OEM or a mill supplier to an OEM, I see partnering as a very, very difficult venture ... unless both sides are willing victims to open up those P&Ls and let each other know where the real opportunities are...that you're not really a partner. You may think you're a partner but when push comes to shove, it will be that last transaction price that will dictate who's going to win for that particular day.

One of the examples that's been used for years of a good partnership is the partnership that exists between the Whirlpool Corporation and Emerson Electric. Emerson Electric, for a number of years - it's probably going on 10, maybe even 15 now - provides for the Whirlpool Corporation every motor for every appliance that company makes. And they make an awful lot of appliances. You look at, taking it back to the P&L again, the earnings records for Emerson Electric that Chuck Knight and his people have delivered. The line is a slope upward and it's not been broken for I don't know how many quarters. By the same token, it has not been at the expense of the Whirlpool Corporation because if you look at their performance, vis a vis their domestic competitors and/or even European competitors, they are making above-average profits compared to the people they compete against. So, it can work and it does work.

And, finally, again, Bill Ristau: I think maybe it's fair to say that this definition that we're all looking for in a box called partnership maybe isn't defined yet. Maybe each situation is unique unto itself. It may be electronic data transfer in one case and something completely different in another situation. I'm not so sure that there is a pure definition. I think it's everything. It's all the opportunity that's out there.

The upshot of these, and other comments from the Flat-Rolled Committee's round table held in Maui, was a strong message that the SSCI should take the lead in educating the distribution industry by providing training at all levels on partnering through joint service center-mill seminars, focus groups with the OEMs, and joint distributor-mill-end-user workshops.

III. FORGING NEWS

For months now, buyers of forgings have been among the busiest of sourcing professionals. According to suppliers surveyed by PURCHASING, metal parts buyers also are among the most exacting, constantly pushing for highest quality parts at the lowest total costs. And, the suppliers don't expect to see a let-up in purchasing selectivity - or end-use demand, for that matter - this year and next. In fact, purchasing of forgings and castings hasn't yet peaked in this economic cycle, and should continue growing into 1999, according to most analyses. Mill shipments of forged parts set records in 1996. Also, while the rate of growth may slow this year and next, sales still look to keep breaking records in the months ahead. The invigorated global competitiveness of North American manufacturing has fostered a wave of capital spending on new and modernized machinery that make, process, and fabricate raw materials into the downstream parts that are assembled into industrial, commercial, and consumer products for domestic and international markets. "Increased demand for the various metal parts used to make industrial, construction, electrical, non-electrical, and transportation machinery is way ahead of expectations," says Analyst, Joshua Billings at the Freedonia Group. "Manufacturers just keep retooling to make end-product improvements and to attain even higher manufacturing productivity." Economist, John Anton at DRI/McGraw-Hill also points out that "Domestic demand for metals-bearing products is firm, and export demand hasn't fallen off despite the recent appreciation of the dollar."

Forgings, by and large, are driven by capital investment activity. Sales of forged steel, aluminum, titanium, and high-temperature alloys improved by an annual average of 12% since 1993 so that last year's sales were a record \$4.68 billion, says the Forging Industry Association. Sales growth by the 250 custom-forging firms in the U.S. and Canada is slowing to a 6% rate this year, but that still will mean North American industry shipments of almost \$5 billion this year. And the early perspective for 1998 is further growth to \$5.1 billion. A very healthy North American manufacturing sector is boosting sales of forged metal parts as is the resurgence in commercial aerospace production. Since the domestic forging shops have initiated and completed major quality-improvement, production-efficiency, and value-added machining expansions, the heavy forged parts out of North American mills are globally competitive. Also, such technological advances as computer-aided design and manufacturing are becoming widespread. Lead times from most independent impression-die and open-die forgers are out 10 weeks or so, while a sizable amount of custom-designed parts take between 20 to 24 weeks. It's little wonder that buyers are searching service-center warehouses for stocks of forgings. "Production of heavy machinery, machine tools, off-road equipment, railroad hopper cars, and even large freighters continues at a solid level, and boost the demand for forgings," notes Steel Market Analyst, Bernard Lashinsky at AUS Consultants.

A decade ago, the forging industry had 40% excess and inefficient capacity. No longer. The industry has trimmed inefficient capacity while raw materials cost-control measures have been introduced. New-technology processes have been installed, productivity has improved, and firms have begun to emphasize niche-marketing, concentrating either on high-volume work or on specialized low-volume products.

The chief competition for forgings is such substitute materials as powder metal parts, castings, plastics and ceramics. They all sell parts for transportation products (passenger cars, trucks, buses, trailers, motorcycles, bicycles, airplanes, and trains); aerospace (aircraft engines, guided missiles, and space vehicles); stationary engines; off-highway vehicles, heavy construction vehicles, and mining equipment; agricultural implements; military ordnance; industrial, petrochemical, and commercial machinery; industrial and commercial refrigeration and air conditioning; pumps, compressors, steam engines and turbines, mechanical power transmission, and specialty hardware.

Earlier forecasts had suggested a sales drop off in 1998 and beyond, but this assumption no longer holds. The Forging Industry Association now sees long-term growth from commercial aviation and another round of new-business opportunities from the second wave of automotive "transplants" when European-owned domestic auto plants accelerate the purchase of power train (engine and transmission) components from domestic forgers. "There's about \$2.5 billion in annual forged parts for automotive applications alone that are being imported that domestic mills will be supplying," suggests the Forgings Industry Association. That's why market analysts at Frost & Sullivan think industry sales will be \$6 billion soon.

IV. PURCHASING FOCUS

This issue's Purchasing Focus is a discussion on market data and sales forecasts. That's because good market information and sales forecast information are a benefit to OEM and service center purchasing operations alike. But, most buyers say the information they currently receive is only somewhat accurate and could be vastly improved. Nearly all of the 1000 purchasing operations that Purchasing Magazine recently surveyed, say they do receive market and sales forecast information from their customers or downstream manufacturing and sales arms. But - and it's a big but - the vast majority of the buyers - 59%, in fact - say the information is only somewhat accurate. 23% say the information is not so accurate. Only 18% say data and forecasts are on target. This is a problem because it puts buyers on the spot when they're trying to source materials for actual manufacturing. Incomplete market data and ineffective sales forecasts destroy purchasing's ability to negotiate effectively. No one in a purchasing operation wants to constantly be playing "catch up". Yet, without good market data and sales forecasts, buyers have to scramble to make adjustments.

Most of the market and sales information comes from their own or their suppliers' sales and marketing groups. But buyers say the information is weak, and not very good. Some buyers say that sales forecast information usually is overly optimistic and seems to lag actual market conditions, which affect manufacturing decisions. The buyers grouse that the information they get is weak because the information is limited and given out very reluctantly. In fact, those few buyers who do get their market data and forecasts from plant managers say it is actually better than the data from sales and marketing. And, those buyers who get their data and forecasts from planning or operations, or from upper management, also say the information is more accurate than that from sales. However, the biggest problem in sales forecasting may not be who does it, or even how it is done, but the frequency of its arrival and how much purchasing must scheme in order to get it. Some buyers admit to eavesdropping on internal sales and manufacturing department conversations to get a more accurate reading on what's going on in the marketplace.

The need for improved information is clear. Buyers point to a few targets of changes in forecasting that they need to see. The top requirement is more realism - in other words, "pie-in-the-sky forecasts" don't help buyers buy better. Improved communication is one way to forecast better. Another target for improvement is a more regular schedule for forecasts. Buyers would like reports more often, with details covering trends and more seasonal variations.

Buyers would like to see market updates at regular intervals, and they would also like to see more timely forecasts. Remember that inappropriate inventory levels and increased supply problems are the main results of inaccurate forecasting. Very often this results in increased costs, and money being spent unnecessarily. Buyers have to adjust their own plans to balance out what they know the forecasting problems are. Most often, buyers make some adjustments on the basis of their own experiences. They admit that's not very efficient or cost-effective.

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