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MetalsOutlook™ April 2004

Publisher's Statement

This is our 10th anniversary issue! What an exciting 10 years it has been. I think we've almost seen all of the business cycles that exist (except depression, which we can do without).

We have received many comments, suggestions and thoughts of our many readers, now at 32,500 globally, and we wish to thank them for their participation.

And now for MetalsWatch....

Welcome to MetalsWatch! April 2004

The Institute of Supply Management (formally National Assoc. of Purchasing Managers), issued their Manufacturing Index for the month of April 2004, issued today Thursday April. 1, 2004 at 10:00 AM. Again the report shows the economy is very strong with an Index of 62.5.

The institute of supply management has never had five straight months over 60.0 index. So, if even if it doesn't feel like the economy is booming, the stats say otherwise.

Welcome to Metals Outlook™ April 2004

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April 2004

Tom Stundza's Comments

This is Tom Stundza, executive editor of Purchasing Magazine. Welcome to the April 2004 edition of Metals Watch!

The last recession officially ended in November 2001. And in recent months, with corporate profits surging and economic indicators improving, the nation's broadest measure of economic output, gross domestic product, has been on a tear. Real GDP grew at an average annual rate of 6% in the second half of last year and probably has slowed only slightly in the first quarter. Business spending is rising, as are U.S. exports, and low interest rates and federal tax cuts have added plenty of juice to the economy. The U.S. economy will grow 4.7% this year, according to this month's Blue Chip Economic Indicators, an influential poll of economists.

So, with industries enjoying a solid recovery, first quarter adjusted-for-inflation revenues appear to be well on their way toward returning to peak 2000 levels. More importantly, profits are rising, setting the stage for stronger business spending and investment, which will help sustain the recovery of the U.S. economy. Mark McMullen, is a senior economist at Economy.com, says the contribution of investment spending to economic growth is expected to grow from 22% in 2003 to 29% this year. Meanwhile, consumer spending is expected to remain resilient. "Economic activity continued to expand in January and

February," says the Federal Reserve's latest Beige Book survey, closely watched overview, drawn from reports by the central bank's 12 districts and released eight times a year. Growth was "moderate," "firm," or "sound" in nine of the districts, and appeared to be accelerating in the regions of New York, Richmond and Dallas, said the central bank report.

The only fly in the ointment is that prices for such key manufacturing materials as carbon-grade steel mill products have jumped by as much as 50% in less than two months--and continue to rise with such frequency that suppliers can't predict them from week to week. This has been causing buyers to stockpile supplies, scrounge for less-expensive alternatives and look for other ways to offset rising costs. The steel price increases, which comes amid rising prices for many other raw materials, is causing havoc for distributors, buyers and contractors down the supply chain. It comes at a delicate time for those who buy and bend steel, from appliance makers to toolmakers to commercial construction companies, whose businesses were just beginning to pickup. With the economic recovery still uneven, many steel users find they must absorb the costs because their customers refuse to accept higher prices.

Steel customers didn't expect this outcome when they successfully lobbied President Bush last year to drop tariffs on imported carbon and alloy steel. Economists and industry experts point to a weakened dollar, which makes foreign products more expensive and has helped keep imports at bay, and consolidation among U.S. steelmakers. Other factors boosting prices in both the U.S. and many global steel markets include increased demand for steel and its raw materials, largely owing to China's booming growth.

The issue of outsourcing jobs to foreign countries, according to Robert Reich, economist, is only a drop in the bucket and nothing to worry about unless of course you lost your job and are now flipping burgers at McDonalds.

Now onto MetalsWatch...

Economists say that, broadly speaking, rising steel prices alone won't derail budding economic growth. But, inflation is cutting into margins of those metal-using manufacturers who still struggling to emerge from the sector's three-year slump. And it can't help these metalworking firms that nonferrous metals are forecasting substantial increases in 2004 market prices of aluminum, copper, nickel, zinc, lead and tin because of acute supply shortages globally.

Meanwhile, there has been a $22% price increase on flat-rolled stainless steel since January, supported by all the major U.S. mills. Market demand has been showing improvement, and the domestic mills entered the year with virtually no excess stocks. Delivery leadtimes have stretched to an average 13 weeks from mills. There have been market reports that some steelmakers are threatening to put customers on allocation for April and May deliveries. Service centers had stainless stocks available at the start of the year, but became very busy in February and early March. So, availability of some stainless grades has become tight and, all in all, buyers have had no choice but to accept the producers' recent basis price proposals. Making it even tougher for buyers are the skyrocketing alloy surcharges-already up 60% since December-- that will be even higher when March and April calculations are made.

One obvious lesson that can be drawn from today's metals marketplace is that world commodity markets are interconnected. What happens in one country-let's say China and its rapacious appetite for copper-- affects the markets of another-let's say the U.S., where supply is tight and prices have exploded. As a result, imprudent capitalization practices and overheated infrastructure building projects in the Far East will eventually affect the price-supply outlook in the U.S. and Canadian marketplace. Less obvious, but perhaps more significant, is the observation that free market economies tend to be undone when wastes are allowed to run rampant in the system. In this edition's Purchasing Focus, we'll show how a classic Inside Purchasing column by the magazine's retired chief editor has as much relevance today as it did in 1998.

Comments to Tom Stundza: stundza@reedbusiness.com

I. Cover Story:The Economy is really beginning to boom and the steel industry is in chaos

Wall Street economists and government data crunchers agree: Manufacturing activity is on an upward trend with February and March activity the strongest since March of 2001. High-technology industries are rallying strongly, with first quarter orders for computers and communication equipment up almost 17% versus a year ago. On the other hand, traditional manufacturing is just beginning to turn around, with year-to-date orders for low-tech durable goods up a paltry 0.7% over year-earlier levels. It has been a rough three years for traditional manufacturing; still, industrial economists believe the future looks bright. Since a false start early in 2002, production in this sector has ebbed and flowed, finally losing some additional ground. While consumers have done a yeoman's job at keeping the U.S. economy afloat, businesses have been stingy about spending on anything other than technology. Overseas markets have remained sluggish, and inventories have been kept under control all along the pipeline.

However, traditional manufacturers are about to experience something they have not enjoyed in three years: expanding sales and production. "The consumer is still in the game, and business is beginning to raise spending on machinery and equipment, as well as other more traditional types of capital goods," says economist Tom Runiewicz at Global Insight. "Lastly, signs of life are emerging in key foreign markets, and the dollar has weakened considerably, setting the stage for a rebound in export-related production. Adding some inventory building to the brightening demand picture provides the makings of a decent recovery in traditional manufacturing." However, manufacturing began the year buying raw materials sporadically.

Then, prices began rising dramatically, across most steel-product lines. Despite the termination of the steel tariffs in December, which was expected to result in stable steel prices and supply for 2004, U.S. steel consumers have experienced massive price increases in the past few months, as well as major supply disruptions. William E. Gaskin, president of the Precision Metalforming Association. In addition, the cost of scrap steel, nickel, copper and aluminum has risen sharply as well. Now, consulting firms have been predicting that transaction prices will be at an eight-year high during March and April. The steel mills in recent months have added surcharges that they say reflect rising costs of such raw materials as steel scrap and iron ore, and transportation services. There is a shortage of raw materials, as steel-hungry China consumes more world supply. A worldwide steel scrap shortage, largely created by massive Chinese demand, is creating "havoc" for US industries and forcing emergency action to cap prices in parts of Asia.

Weirton Steel Corp., whose assets will be acquired out of U.S. bankruptcy-court protection by International Steel Group Inc., idled a blast furnace recently because of a shortage of coke, the processed coal used to make steel. The international coke price has now reached $450 ton, according to sources at Hong Kong-based raw materials supplier Noble Resources. There is a severe shortage of coke on the global markets at present, driven by booming demand throughout the world and a reduction in supply from China. Lately, a group of steel consumers and producers is considering petitioning the federal government to limit exports of steel scrap, which is used as a raw material to make new steel products. Several analysts expect steel market prices to keep rising into summer, when supplies of raw materials expand and offshore steels start returning. Wayne Atwell, a managing director at Morgan Stanley, estimates scrap prices will peak in one to two months, driving steel prices down beginning in mid-2004. "If the marketplace is permitted to work, we believe steel prices will be meaningfully lower in six to 12 months."

Still, letters, faxes and printed e-mails from steel providers listing new prices continue to pile up on the desks of purchasing executives at services and manufacturing companies across the country. The commercial building industry is feeling the pinch, but the small and medium-sized companies and service centers have been the most vulnerable to these price increases. Past tactics, such as threats of switching to a new vendor for a more-competitive price, have flopped. A handful of companies -- among them makers of mattresses and gym equipment - are asking customers to absorb the increased steel costs. But, most manufacturers are trying to push steel-price jumps to other companies down the supply chain, transferring the tension between steel producers and their biggest customers down to processors, fabricators and small-volume end-use buyers. American steel-consuming industries pleaded for the government to suspend all anti-dumping and anti-subsidy tariffs on imports, meeting swift and sharp opposition from the U.S. steel industry. Some companies that use steel have sought help from the House Small Business Committee, a congressional panel that is looking into sharp increases in metals prices. Other buying groups have been looking urgently for legal ways to protect themselves against the higher prices. They appear to have found a friend in Saginaw, Mich., County Circuit Court. A judge there has issued restraining orders forcing steel suppliers to ship ordered materials to automotive equipment maker Delphi Corp. under preexisting contracts at agreed-upon prices.

Delphi of Troy, Mich., purchased steel parts under contract from NSS Technologies and Republic Engineered Products, who later threatened to stop shipping them if Delphi would not pay the new higher price. Delphi's major customers, the automakers, like other major-tonnage steel users, have refused to pay any steel surcharges to the mills or to parts suppliers and are fighting the basis price increases as well. So, Delphi asked for legal relief in court, where documents show that several of Delphi's plants in Saginaw and elsewhere could be idled in as little as one day if the shipments of steel parts were halted. Delphi resolved its pricing-and-supply dispute with Republic Engineered Products but issues remain with other steel suppliers. Since, this situation is far from resolved, we'll watch these and other legal high jinks.

Meanwhile, the stainless steel marketplace is in chaos, as well. The domestic flat-rolled stainless steel industry has suffered from weak demand, high imports and over capacity for several years, according to analyst Mike Gambardella at J.P. Morgan Chase & Co. Demand may be expanding but nobody's sure at what rate of speed. Still, Gambardella is one of those analysts who believes Allegheny Ludlum's planned acquisition of J&L Specialty Steel would benefit the producers. It would consolidate consolidating the stainless flat-rolled industry and increasing Allegheny Ludlum's share to 32% from 19%. Moreover, Gambardella believes that the "new" Allegheny Ludlum would have greater purchasing power with its suppliers, especially for stainless steel scrap, which could lead to increased savings during this period of rising raw material costs.

Indeed, stainless steel prices are rising now more because of explosive material-cost explosions than any surge in demand. Nickel and chrome prices have risen by more than 200% over the past year because alloying metal production is failing to keep pace with rising world demand, so surcharges are forecast to stay high. In fact, the pace of price increases in the flat-rolled stainless steel market is becoming ever more frenetic. Steel industry analyst MEPS International reckons, for example, that a "landmark" development in stainless pricing did occur this March if the expected alloy surcharge of in the U.S. exceeds the base price for grade 304 hot-rolled sheet. Since the surcharge has risen by 1800% since the start of 2002 from 6�/lb to 55� while the basis price has budged just 9% from 48� to 53�, it's clear that market demand isn't driving sales values.

Still, buyers of stainless steel sheet, plate and bar products continue to hear from Allegheny Ludlum, North American Stainless and other mills that higher basis prices are coming, and higher raw material surcharges soon will reflect "iron charges," new fees designed to recoup rising costs for steel scrap. Iron surcharges have never occured.

II. Purchasing Focus: Plug in the holes of corporate waste

Jim Morgan is editor emeritus and still an occasional contributor to Purchasing Magazine. He wrote a column six years entitled, "It's waste that eventually causes economic crises," that showed how it was relatively easy to link poor productivity and quality problems in the U.S. of the 1980s and early 1990s to the unwise expansion and investment planning in the Far East in the late 1990s. Waste in the supply management stream, he wrote, led to later market disruptions. In the long run, Jim added, a freely functioning market economy cleanses itself. Some unproductive firms were forced out of business, unwise business practices were revised or eliminated, and the pressure to compete forced market players to clean up the wastes that caused all the trouble. How true! Today, even after a tough recessionary period, quality and productivity in the U.S. have soared back to better-than-world-class levels. Still, there are some hidden thorns amongst the roses.

So, this also is probably a very good time for supply managers to see how much waste buildup they're still living with. Especially, it's wise to check out these areas:
* Transaction systems. Inappropriate transaction systems are the bane of many corporate procurement departments. Instead of speeding up transaction processing, many poorly thought-out systems are creating new levels of bureaucratic waste.
* Inventory policies. Unclear and/or illogical inventory policies continue to cause waste in corporate supply chains. The problem is more than the need to add equipment or tracking software. Lean manufacturing had many firms demanding no inventories, until the economy perked up and there was nothing in the larder to use to make their widgets. In many firms the real need is to rethink policies, and make them practical.
* Teamwork. In many companies, cross-functional teaming is an ongoing joke. Teaming doesn't exist, corporate silos are rampant and manufacturing-led purchasing decisions continue to be based on premises that haven't been valid for decades.
* Training. Many heads of procurement and their staffs continue to lack the background needed to make basic cost-effective decisions--about corporate needs, products, suppliers.

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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