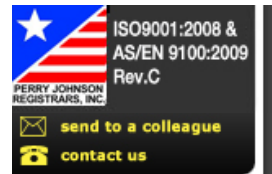




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Tom Stundza's Comments

This is Tom Stundza, executive editor of Purchasing Magazine. Welcome to the September 2005 edition of Metals Watch! Hurricane Katrina, the most destructive natural disaster in U.S. history, has caused more than \$125 billion in damage along the Gulf Coast and southern Florida. Recovery from the hurricane is likely to slow growth and boost inflation pressures for several months to come. Just weeks after landing and cutting a swath across six states, Hurricane Katrina already is exacting an immediate economic toll. There are near-record energy prices, snarled shipping traffic, lost jobs, wrecked businesses, broken supply chains and disjointed manufacturing. The full affects of Katrina are not yet known, though, and it will be quite some time before they can be measured ♦ much less remedied. Any forecasts made now are subject to a degree of uncertainty much greater than usual. These early forecasts are apt to change as more facts become known. Yet, the consensus prediction of economists already points to high energy prices as a tax that will reduce economic growth for the rest of this year, at least, and possibly stunt manufacturing growth next year, as well. Since the national economy is revolving around the Hurricane Katrina aftermath, that ♦s where we ♦ll take our Cover Story this month. The impact of Katrina on metalworking and downstream industrial manufacturing is unclear. A few bullish researchers believe the national economy could receive a modest boost early next year amid recovery efforts. Raw steel production actually rose after the hurricane struck Florida and Louisiana. Steelmakers who produce construction-grade plate, structural and bar products, the aluminum extrusion and home-siding mills, and the makers of copper fixtures and nonferrous metals wiring all expect a short-term lift from the massive regional reconstruction of housing, commercial businesses, manufacturing plants, hotels and restaurants, hospitals and jails, ports and warehousing complexes. And then there is the damage to crude oil and natural gas rigs, refineries and chemicals and resins plants that has to be either repaired or replaced. All this demand is expected to come upon the scene slowly, but it could trigger a 2006 shortage in oil country tubular goods, specialty heavy steels, stainless steels and various anti-corrosive superalloys. That issue will be addressed in this edition ♦s Metals Chips segment ♦since buyers of specialty alloys already are preparing for months of headaches caused by concerns about supply, quality, delivery and price. Superalloys are used to make products for the petrochemical, nuclear energy and medical industries, but commercial aviation and aerospace consume almost 60% of these metals. And that high-flying manufacturing sector already is in a cyclical upswing. That ♦s why market insiders already are telling the press that there is a supply crisis of epic proportions brewing in aircraft alloy steels, titanium, super stainless, the nickel alloys and aviation-grade aluminum.

Finally, in our Purchasing Focus segment, we ♦ll explain why buyers and sellers need to pay attention to the news stories bound to emanate from an upcoming meeting between General Motors and its suppliers. "If there are ways to improve our competitiveness and theirs, we are more than happy to do that," GM ♦s chief executive, Rick Wagoner, tells the media. The automaker has launched a turnaround plan to make its North American operations and has begun negotiations with unions to slash healthcare

benefits. Wagoner, formerly the chief buyer for the firm, says GM also is keeping a watch on materials prices. So, imminent discussions with suppliers are aimed at finding ways for the world's largest automaker to spend less on parts.

I. COVER STORY

Although crude oil prices have backed off their recent peaks and are heading back to pre-Katrina levels, Cover Story finds that gasoline still tops \$3 a gallon in many markets. Airlines, some are on the brink of bankruptcy reorganization, continue to be plagued by high jet-fuel prices. Most truckers are paying near-record diesel prices and rearranging delivery programs. Now, it's true that some over-the-road trucking firms had a bump in demand tied to Katrina when the Federal Emergency Management Agency paid some truckers for roundtrips to quickly get supplies to the Gulf Coast. But, overall, the storm has choked road and rail transportation and shipping--and the rapid early-September increase in diesel prices has put smaller trucking companies out of business. The Port of New Orleans and the Port of South Louisiana, which handle roughly 25% of the country's international trade, are weeks if not months away from a full recovery. It is not yet clear how many river barges sank during the storm or how many are gone for good, but shipping rates are already higher in anticipation of tighter capacity. Barges that used to rate \$200-\$400 a day for a 30-day trip between New Orleans and Pittsburgh now are commanding as much as \$800-\$1,000 if operators can be found to run them.

Thanks to Congress' quick approval of \$62.3 billion in federal disaster aid, economists say the immediate financial consequences may not be as dire as originally feared though, longer term, they worry about the dent Katrina will leave on the federal budget. And, the energy price spike has led some pundits to trim expectations for economic growth. Morgan Stanley economist Stephen Roach in New York, for example, has raised his baseline crude-oil price assumption for 2006 to \$64 from \$45, triggering a cut in growth expectations for U.S. gross domestic product growth to 3.5% from 3.8% this year and to 3.3% from 4% for next year. Neither Roach nor the other economists adjusting their post-Katrina forecasts anticipate a recession, but they all warn the economy could be in for a "growth scare" over the next six months at least. Consumers including car and truck fleet managers in many regions are going to be paying more for gasoline than they have in the past. And, home, office and factory heating costs are expected to soar this winter. The extra energy tab to U.S. consumers could reach \$140 billion over the next year, according to economist Keith Hembre at U.S. Bancorp Asset Management in Minneapolis. "The historical pattern is for shocks of this nature to initially be absorbed roughly equally between lower savings and lower purchases for other goods and services," Hembre says.

Slower economic activity in the months ahead means more caution on the part of businesses around the country to hire, many economists now predict. And that may explain why consumer confidence tumbled in early September. Simply put, Hurricane Katrina has made people feel increasingly anxious about the economy's prospects and their own financial well being in the months ahead. The RBC Financial Group's CASH Index, the Consumer Attitudes and Spending by Household gauge, comes from a monthly national survey of consumer attitudes on the current and future state of local economies, personal financial situations, savings and confidence to make large investments. The survey, which has been in existence since 2002, shows that consumer confidence sank to 61.5 in September. That's the lowest since early March 2003, when confidence dropped to 61.4 when a nervous country was hunkering down for the start of the Iraq war. This month's decline the third straight month that confidence has fallen followed a reading of 72.6 in August.

Consumer spending accounts for a big slice of economic activity in the U.S. That's why consumer confidence is monitored by economists seeking indications about the public's willingness to spend. Since consumers' confidence has deteriorated, the analysts predict that high energy prices will crimp spending by both consumers and businesses, slowing economic growth. Even before Katrina hit, retail sales had dropped 2.1% in August. "There is a great deal of fear and uncertainty out there," says one of those economists--Ken Mayland, president of ClearView Economics in Cleveland. "On the one hand, it's sad to see peoples' lives disrupted and destroyed," he says. "On the other hand, people are worrying about how they are going to pay their gasoline bills and their home heating bills this winter." Overall, he adds: "It makes for a pretty bleak view of the future."

II. METAL CHIPS

What isn't bleak, we find in our Metals Chips segment, is the business outlook for superalloys because Boeing, rival Airbus and smaller jetliner makers who expanded assembly over the past 18 months--and now expect aircraft deliveries to be robust through 2008. Of course, this is making life difficult for buyers of materials and components used to make the commercial aircraft and their engines. On the one hand, they are happy to be busy again after almost four years of stagnant aircraft industry activity. On the other hand, leadtimes for necessary metal and composite materials have extended. In fact, some specialty metal mill products won't be delivered for a year and half after order. Atop that, even the buyers expect prices to increase and remain high by historical standards. What's happening? Well, globally, the recent growth in airline traffic has outpaced fuel-efficient jetliner capacity. That has triggered a turnaround in demand for new-generation, long-distance commercial airliners. In fact, aviation manufacturing's latest rebound could last throughout this decade, if the military aerospace market comes out of its current funk and if the world's airlines are able to restructure operations to absorb new higher jet fuel costs. "Anything with a wing has problems with today's fuel prices," says Michael Boyd, president of the Boyd Group, an aviation consulting firm based in Denver. Even though bankruptcy reorganizations are prevalent, the country's five biggest carriers--or many of the smaller low-cost airlines--will fail over the next few years, he suggests. So, there's no reason not to believe aircraft building will continue to prop up the market for superalloys, the high-performance specialty metals containing at least 30% nickel and cobalt. There are about 400 different mixes of superalloys available for use in the aerospace and aviation industry for use in airfoil turbines and airframes, in the industrial gas turbines used in power generation and pumping stations, in the automotive industry for turbo wheels and in medical products and prostheses. However, aerospace and aviation is the largest end-use segment for superalloys--60% by some estimates. Superalloys makers are seeing strong new-order bookings because commercial jetliners require long leadtimes--at least two years--from order to delivery. Buyers have to remember there is a need for continuous improvement of supply-chain efficiencies to keep

costs down for the specialty metals mill products to their parts and components customers control costs. That's because it takes quite a while for complex engines, myriad parts and blue-printed components to be manufactured and delivered to meet aircraft production schedules. Note that some superjumbo A380 aircraft won't be delivered by Airbus to the buyer, United Parcel Service, until 2009 and beyond. And that's after some new Boeing 747-400 jet freighters with their new General Electric-made turbine engines get delivered to UPS between June 2007 and the end of 2008. The average modern jetliner consists of millions of pieces, parts, and sub-assemblies; the most important metal raw materials tend to be heat-treated aluminum, titanium and the various superalloys. The average jetliner serves a useful life of more than 20 years. That is described by Boeing engineers as a very efficient use of raw materials. However, getting timely deliveries has become a problem, buyers report. Suppliers have become busier and the availability of specialty alloys material has become an issue, says the supply chain management director for a jet engine components maker. Superalloys supply is tight with deliveries out a year or more because of limited global supply. In fact, monthly buyers surveys by PURCHASING show that buyers have been accelerating their sourcing--and keeping the limited number of nickel, cobalt and titanium-based specialty metals busy of late. For example, Allegheny Technologies' chief executive, L. Patrick Hassey, tells Wall Street analysts that sales in the second quarter ended June 30 increased 57% for the Pittsburgh-based company's high-performance metals segment to almost \$302 million. By product group, shipments increased 14% for nickel-based and specialty steel alloys, 11% for titanium alloys, and 7% for exotic alloys. And this has occurred despite the cost-inflation impacting superalloys. Note that Allegheny Ludlum this summer announced price increases of as much as 10% for nickel-based superalloys and various other super stainless steel and high strength specialty alloys. Commercial executives at the Allegheny Technologies unit say the action on strip, sheet and plate was necessary because of the continuing rise in nickel costs and fact that cobalt and tungsten have risen by more than 100% in the previous year. So, in adjusting the alloys surcharge for superalloys and other specialty alloys, the firm added tungsten and cobalt to the surcharge calculations that already include nickel, chrome, molybdenum, titanium and iron. Volumes are picking up and plant utilization is improving it's not yet at pre-9/11 levels but it will be by the end of the year, says Mike Askew, divisional managing director for aerospace at Doncasters, which fabricates and machines superalloys in Melbourne, England.

Askew tells PURCHASING's sister publication FLIGHT INTERNATIONAL of London that the rapid rebound in commercial aerospace has brought many supply-chain challenges. The market remains very competitive and the recovery has been dramatic in some areas we're struggling to get capacity back in place quickly enough, he says, although the situation is generally better, although demand still is outstripping supply. The recently updated forecasts for materials demand ahead by the commercial aircraft industry supports our belief that the titanium industry is in the early stages of the business cycle and that the current uptrend will likely continue through 2006 and beyond, says the most-recent report by management of producer Titanium Metals Corp. in Denver. Over the past several quarters, the company has seen the availability of raw materials tighten, and, consequently, the shortage in raw materials (which include sponge, scrap and alloys) is likely to continue throughout 2005 and into 2006, which could limit the company's ability to produce enough titanium products to fully meet customer demand. When we come back, in Purchasing Focus, we'll discuss GM's new strategy to press suppliers to open more factories in low-cost countries and become more competitive on individual parts prices. The problem is that the plan could raise the ire of a supply chain already bitter over cost-cutting programs by Detroit's Big Three and the transplants.

III. PURCHASING FOCUS

Welcome back to the September edition of Metals Watch, and our Purchasing Focus. In Detroit, a spokesman for General Motors insists the company's purchasing organization has been using supplier feedback to prepare for the upcoming meeting with 250 of its top auto parts producers. The meeting, announced earlier this year, will outline a three-year plan that begins in 2005 and replaces the previous cost-cutting scheme initiated in 2003.

GM has been criticized for dictating changes and price targets to its 3,200 suppliers, rather than including them in the vehicle design process and determining a profitable price for both parties. But, Bo Andersson, the purchasing chief, tells a late-August meeting with investors and analysts the company is looking to implement a more "proactive supplier management process" in the future. That's because of a long list of challenges already pressuring established supply chains in the U.S. and Western Europe. Those challenges include high material and labor costs and cut-rate competition from suppliers operating in emerging markets. Andersson says that's why GM is eyeing more cost-effective production bases in China, Korea and Eastern Europe--and is pulling supply from under-performing firms who don't meet GM's purchasing standards. One manager at a large Detroit-based supplier has told the media that GM probably will focus much of its emphasis going forward with traditional suppliers on reducing warranty costs, which are hard to budget given the unpredictable nature of recalls and various repairs covered under the warranty GM provides new-car buyers. GM has confirmed that warranty costs will be on the forthcoming restructuring agenda--saying the company's target in 2005 is to spend \$22.50 per vehicle in warranty costs after six months of service, down from \$24.90 in 2004. The company has not released future warranty targets.

"What they need to do is work more with their suppliers earlier in the vehicle 'ideation' and design process," says Kevin Mixer, an automotive analyst at Boston-based AMR Research, in reference to dropping warranty costs. He says GM could better reduce costs by freezing vehicle designs earlier in the two-to-four-year product development routine. That would assign responsibility for various things that could go wrong well before the components are actually designed, produced and fitted in a vehicle. Mixer estimates that GM's Japanese competitors tend to freeze vehicle designs when 70% of the cost decisions are yet to be made. In contrast, U.S. automakers are known to shift on components and design elements when 90% of the cost decisions have been made. That's why the domestic automakers have to add investment to make necessary changes on the plant floor or in dealership service bays. Truth is that wrangling over warranty costs has led to much of the bad blood between suppliers and Detroit's Big Three, according to the supplier manager, who manages warranty issues. He says U.S. automakers often point the finger back at the supplier and demand a fix and big cost concessions when something goes wrong. And that's why lots of suppliers want to hear what GM has to say about resolving this issue.

Well, that's all for this edition of Metals Watch. This is Tom Stundza, executive editor of Purchasing Magazine. Good day.

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