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Publisher's Statement

Every economic downturn does one thing for sure--it turns. The question is, "which way?"

There is great debate whether the American Recovery and Reinvestment Act will create a recovery or not. What is clear is that the infusion of federal funds will result in the consumption of metal from both mills and service centers. This will reduce service center inventories and drive subsequent mill orders to replenish that stock.

As that process begins to develop, it remains to be seen if it will be sustainable. That will become apparent somewhere during the third quarter--but not because of federal demand. We should have a good read of whether or not an economic recovery is in motion by then. If not, this could get ugly because the federal government cannot continue to pour money into the economy endlessly.

There are other signs of recovery that are far more encouraging. Consumer spending has taken an uptick the past few months. Since consumer spending accounts for 70% of all economic activity, this is a better sign of potential recovery.

However, it is all a wait-and-see game.

For more information on the near-term economic outlook, check out the November 2008 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 36.3%

Welcome to Metals Outlook™ April 2009

Lewis A Weiss
Publisher
Comments to Publisher: publisher@steelforge.com

All Metals & Forge Group, LLC
330 Changebridge Road
Pine Brook, NJ 07058
USA

Phone: 1.973.276.5000
Fax: 1.973.276.5050
Toll Free: 1.800.600.9290
http://www.steelforge.com
E-mail: info@steelforge.com

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April 2009

Tom Stundza's Comments

Welcome to the April 2009 edition of MetalsWatch! This is Tom Stundza, executive editor of Purchasing Magazine and Purchasing.com. The World Bank says the global economy is likely to shrink this year for the first time since World War II. The bank forecasts that global industrial production by the middle of 2009 could be as much as 15 percent lower than the levels in 2008. The fact that the U.S. economic activity that makes up gross domestic product fell at a 6.2-percent annual rate in the fourth quarter of 2008 underscores how quickly the economy has soured and portends a further deep decline in the first quarter. In fact, our **Cover Story** centers on a Federal Reserve Board assessment that the reduction in U.S. economic output deepened in the first two months of this year with no turnaround expected anytime soon. Business buyers and everyday consumers are rapidly becoming thriftier as the current recession deepens, forcing painful readjustments in the activity of manufacturing industries and construction firms. This decline has raised pessimism among many economists about a rebound this year of the economy in general and industrial production in particular. Note that the Federal Reserve Board has reported that industrial production declined 1.8 percent in January with production in the manufacturing sector down 2.5 percent because of a plunge in motor vehicle, auto parts and major appliance production and broad-based declines among other industries that use steel and nonferrous metals.

In fact, there is very limited demand visibility in all of steel�s end-use markets now and in the immediate future. Non-residential construction--which is 35 percent of steel demand--and autos--another 20 percent--and machinery and equipment--yet another 20 percent--are all expected to remain anemic or even weaken further as the year progresses. Analysts are watching weekly steelmaking utilization rates and shipments out of service centers for any signs of positive change. A positive trend in service center shipments would provide an indication of improving demand. The analysts feeding our **Metals Chips** segment with data also believe that steelmaking utilization rates would tick up even if demand doesn�t grow because service centers at some point will have to start rebuilding inventories.

In the meantime, market prices for the benchmark steel grade, hot-rolled steel sheet in coil, appear to have breached the $500 per ton level for the first time in 42 months with offers in the mid- to high $400's being made. Stainless steel cold-rolled sheet also is being sold by mills at the lowest levels in 36 months. These are some of the first signs that supply discipline may not be able to stop a further slide in prices. It�s a marketplace where neither buyers nor suppliers are sure that the cyclical bottom has been reached. Market mavens also say they are becoming concerned that weakening balance sheets may force some mills to produce for cash rather than earnings. At these price levels and current low utilization rates, even mini-mills could have difficulty staying profitable unless scrap prices decline. And, unless coal and iron ore prices drop, the integrated mills almost certainly won�t be profitable this quarter.

So, in a nod to steel manufacturers and labor interests, the folks in Washington ignored the wants of steel-using industries and inserted a "Buy American" provision into the economic stimulus legislation. The Buy American rule requires that only U.S.-made iron, steel, and other manufactured products be used in the $150 billion of infrastructure projects funded by the American Recovery and Reinvestment Act. But in a last-minute concession to the large steel-using business interests, the clause was adopted with several key caveats. In our Purchasing Focus, we�ll look at the exceptions to Buy American.

I. Cover Story � Limited Demand

Reports in the latest so-called Beige Book from the Fed's 12 regional banks "suggest that national economic conditions deteriorated further" in January and February because of the lower levels of business and consumer spending. "Looking ahead, contacts from various districts rate the prospects for near-term improvement in economic conditions as poor, with a significant pickup not expected before late 2009 or early 2010," according to the survey. The report found that nearly every pillar of the economy has been shaken by the recession. Fed districts reported "steep declines" in manufacturing and financial services in addition to weak farming conditions and a substantial slowdown in natural-resources extraction, as demand for even basic products and industrial building blocks has collapsed in the U.S. and overseas.

Businesses and consumers are in full-scale retrenchment mode. And Fed policy makers have largely written off any hope that the economic downturn will end in the first half of this year. "We're in the ugliest part right now," says Charles Plosser, president of the Federal Reserve Bank of Philadelphia. "I'm anticipating that at least in the second half of the year we might see some inklings of positive growth, but it won�t be anything to get excited about." Even the eventual recovery, he adds, "depends a lot on how the financial institutions recover and how the financial sector recovers and also about housing." Separately, chief financial officers at U.S. companies expect the recession to persist for another 14 months, according to a quarterly survey of 1,268 finance chiefs. Only 35% of respondents to the Duke University/CFO Magazine Global Business Outlook expect the economy to begin recovering in 2009.

The downward revision to fourth quarter real GDP to that negative-6.2 percent annual rate of change was the result of widespread downward revisions of many other business and economic indicators. Importantly, real personal consumption was dropped to a 4.3 percent annual rate of decline from an originally reported decline of 3.5 percent. There also was a significant downward revision to net exports, which subtracted 0.5 percent off GDP compared to an originally reported increase. Inventories were also revised lower.

The trend in business investment is even worse than the downtrend in consumer spending. Business investment in equipment and software plunged at a 28.8 percent annual rate. Investment in business structures turned negative for the first time this cycle, dropping at a 5.9 percent annual rate. It will probably drop much more sharply in the quarters ahead. The housing market, meanwhile... Well, you know how that is.

Economists note that cheap and easy credit in recent years fueled not only the housing boom but also Americans' insatiable spending, which has now come to a screeching halt. These economists also say the key to righting the ship is for the government to restore confidence so that consumers and particularly businesses have renewed faith in the intermediate-term outlook. It is critically important that the credit markets function properly and that the banking system is stabilized. That, of course, will be no easy task.

While they are waiting a rebound in demand, metalworking companies are continuing to buy just enough steel to operate at around 69 percent of capacity. But--with a 15 percent drop in fabricated metal production activity over the past year--there still is a definite lack of expanded steel-buying demand from original equipment manufactures. Also, buyer surveys this month find only 16 percent planning to increase orders this month and virtually none building any inventory. At the same time, even with their in-house stocks lowered, service centers and distributors remain skittish about placing more than perfunctory orders with the mills.

II. Metal Chips � Where is the Bottom?

Lower steel demand from manufacturing and construction, combined with the collapse in the world automotive sector, have pushed back estimates for an industry recovery well past this year. Lakshmi Mittal, head of the world�s largest steelmaker ArcelorMittal, recently says global steel markets won�t fully return to normal "until 2010, maybe 2011."

In the U.S., with automobile sales very soft and inventories quite large at more than 100 days worth of sales, the automakers have sharply reduced their output of light vehicles this year. It is assembly that determines steel deliveries to the automakers. Lately, steel shipments to the auto companies (and their parts suppliers) have been quite minimal, says analyst Charles Bradford at Bradford Research Inc. in New York Looking ahead, he says the mills "still face a huge drop in business from their largest customers." So, there have been draconian production cuts worldwide. In the U.S., the domestic steel mills that made major production cuts in the fourth quarter, have kept output at a capability utilization rate average of 44 percent well into February. That compares with a two-month capability utilization rate of 91 percent in the early weeks of 2008.

Statisticians at the Federal Reserve Board have reported that production at U.S. factories, mines and utilities fell 1.8 percent month-over-month in January, following a 2.4 percent decline in December. This was the third consecutive monthly decline so, on a year-to-year comparison, industrial production in January was down 10 percent from January 2008. The December level had been down 8.2 percent from the year before. Many economists suggest the current quarter will be the worst of the recession that began early last year. The economy contracted at a pace of 3.8 percent in the fourth quarter and they say it probably is shrinking at a pace of 5 percent or more.

Thus, looking U.S. steel market, the belief is widespread among economists that domestic steel shipments in 2009 will decline 18 percent--to about 80 million net tons from 98 million tons in 2008. That�s pinned to a decline in the largest product segment--the light-gauge flat-rolled bare and coated carbon and stainless steels used by the consumer segment of the economy, such as the automotive, appliance and consumer goods makers.

However, the fiscal stimulus package released in January provides about $27 billion for highway investments and, possibly, increased steel usage. Analyst Sal Tharani at Goldman Sachs Group estimates that every $100 billion in highway spending boosts steel demand by 9.1 million tons. Other investments that could lead to increased steel consumption include $9.3 billion for rail transportation and more than $33 billion for various energy efficiency and renewable energy programs.

However, getting a handle on how much steel really will be required has proven elusive. The term infrastructure spending, as apparently being used in Washington, includes more than just highways and bridges, but includes schools, hospitals and mass transit. Except possibly for road resurfacing work, most of these projects contain steel. Highways and bridges are mostly built using concrete reinforcing bars, or rebars, with some beams and plate. Buildings can be more inclusive with heating and cooking systems using light flat rolled galvanized steel for ductwork and for the heating and cooling systems themselves.

The big issue for the steel industry involves non-residential construction in general, which includes office, shopping centers and factory buildings, large users of both rebars and beams. This market looks to us to be weakening now and likely to remain very soft well into next year as office vacancies increase rapidly.

Past months have seen a lot of support from the U.S. steel industry for a "Buy America" clause in the economic stimulus package and a lot of opposition from users at home and markets abroad. A majority of buyers answering an online poll on Purchasing.com oppose the "Buy American" requirement in the $787 billion economic stimulus package, even though the final requirement will open the door for more offshore materials than earlier versions. We�ll discuss the brouhaha when we come back, but first this.

III. Purchasing Focus � Buy American

The battle over the Buy America provision of the American Recovery and Reinvestment Act hasn�t ended, even though the legislation is now the law. The new provisions have a threefold condition for suppliers under which the would not apply if: (1) it is inconsistent with public interest, (2) the relevant materials are not produced in U.S. in sufficient and reasonable available quantities and of reasonable quality, and (3) using raw materials produced in the U.S. would increase the cost of overall project by more than 25%.

But there is a fear among steel buyers that the measure isn�t equitable. First, the provision must not cause a violation of existing trade agreements. This means that imports from 38 countries with U.S. trade agreements will be allowed. However, China, India, and Brazil are major U.S. trading partners that would be subject to the provision.

Second, even for those countries without U.S. trade agreements, imports will be allowed if sufficient quantities of U.S.-manufactured products are not available. A prime example is in the area of clean energy as the U.S. imported 70 percent of its 14,000 wind turbines.

Third is that cost efficiency exception, allowing imports if American products would increase the total cost of a project by over 25 percent--a threshold that could be difficult to meet, of course depending on the definition of "project." Opponents also suggest that infrastructure construction projects will be delayed while American-only suppliers of steel and other construction materials are found.

Fourth, imported products can be used if their prohibition "would be inconsistent with the public interest". Vague statements like that, and the question of how much domestic content makes a product "American," will require clarifying regulations. Many look forward to guidance that is quick--to avoid holding up infrastructure projects--and quieting--to avoid protectionist backlash from other countries.

Finally, in an e-mail to Purchasing.com, analyst Bradford asks: How are steel users and steel equipment (and auto) buyers to know if foreign steel is in what they are buying? Last year, 20 percent of all steel imports were slabs, which ended up in the flat-rolled products of the integrated steelmakers and the cars and trucks that used their steel. Furthermore, a huge portion of the parts that go into motor vehicles are made overseas. The same is true of the major construction equipment producers, who either make parts themselves overseas or buy parts from overseas parts producers. In addition, will the Buy America keep foreign-made construction equipment out of the U.S.

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.

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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 Site Map

All Metals & Forge Group, LLC.
75 Lane Road
Fairfield, NJ 07004 USA

Toll Free: 800-600-9290 Fax: (973) 276 - 5050