Publisher's Statement

Seems that everyone these days is talking about a recovery -- but where is the action? It seems that all the signs are pointing up, but into thin air.

It appears that we have a constipated economy and a laxative shortage. Stimulus funds would have helped, but only 15% or so has actually been spent by the government. Some of the bailout funds are being held back while some banks are paying back TARP funds. GDP growth forecasts don’t seem to be translating into orders.

The media, which nearly killed itself with unrelenting and unabashed articles of gloom and doom, have dropped the “R” word like a hot rock. Newspapers, in particular, were hard hit by their emphasis on the recession and unemployment. Now you are starting to read about the “jobless recovery” -- same stuff you read in 1991. The reality is that job growth is a laggard indicator. Jobs follow a recovery, they don’t lead it. Even the federal government has stated that jobs won’t pick up significantly until 2010.

Regardless of this forecast or that fact, the reality is that the economy will begin to grow at a lukewarm pace as we head toward 2010. Since 1960, there have been 7 recessions that lasted an average of 1 year, give or take a quarter. Each recovery began slowly and picked up steam until they crested about six years later, on average.

Given that brief history, it is reasonable to assume that 2010 will be a good year and the economy will hum along until about 2016, give or take a year. The only curious difference now is consumer spending. In the last two expansions, consumer spending was fueled by debt, either credit card borrowing or equity extracted from their homes. But with tight credit markets, real estate devaluations, and the highest savings rate in 50 years, no one is clear on what will fuel future consumer spending.

Lewis A Weiss
Publisher

For more information on the near-term economic outlook, check out the October 2009 Manufacturing ISM Report On Business from the Institute of Supply Management (formerly the NAPM, or the National Association of Purchasing Managers) and the latest ISM number of 52.6%.

Welcome to Metals Outlook™ October 2009

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Welcome to the October 2009 edition of MetalsWatch! This is Tom Stundza, executive editor of Purchasing Magazine and Purchasing.com.

Recent data revisions have shown us that the recession was deeper than first thought, with a 3.9% decline in real U.S. gross domestic product from the second quarter of 2008 to the second quarter of 2009. Lately, though, the overall economy is beginning to show signs of improvement. Many economists now are asserting the worst is past and are pointing to funnel hundreds of billions of dollars into the economy appear to be helping the U.S. climb out of the worst recession in decades. And now, it also appears that manufacturing grew in August for the first time in more than a year.

In our Cover Story, we’ll discuss today’s somewhat healthier manufacturing sector, which is spurring changes to GDP forecasts for the third quarter—as economists start to see stronger GDP growth throughout the second half. So, while the economic analysts still expect the recovery to be a slow one, the incoming evidence suggests that the pick-up in growth in the second half of the year will be more rapid than anticipated. Nigel Gault at Global Insight, for example, has raised his growth forecast for the second half to an average 2.2% pace, as opposed to negative growth in the first half.

With increasing signs and confidence that the metalworking economy soon may recover from the severe downturn, analysts also are revising price forecasts higher for steel. It’s true that the worst likely is over, but expectations for purchasing and pricing for the remainder of 2009 may be too high. The first half of the year was a terrible period for steelmakers, marked by minimal production volumes, low shipments and declining prices. At present, demand for steel is recovering slowly but more among distributors than end users. Looking ahead, the business environment will be better in the fourth quarter. First, steel buyers are paying slightly more for many steel products. One analyst points out that the steel prices are on a paradoxical upswing despite no real sign of resuming demand and no vision into a manufacturing or construction recovery for months to come. In the Metals Chips segment, we’ll discuss why the mills may be overreaching with announced price increases.

Supply chain leaders are constantly assessing and dissecting information to identify critical factors, trends, performance characteristics, and indicators to improve their decision making about the supply base. Many rely heavily on data and metrics to run formulate their opinions and ultimate judgments. Some use a mix of qualitative and quantitative methods to construct their actions plans. Others use more of a relationship approach anchored with significant human interaction, communication and behavioral analyses to plot their course. The process one uses is important, but the underlying assumptions are vital to the quality of your judgment. We’ll discuss those in this edition’s Purchasing Focus.

I. Manufacturing Uptick

U.S. factories saw output rise on a monthly basis in August for the first time since January 2008—another sign the recession is coming to an end. Regional manufacturing indexes from Federal Reserve banks in Philadelphia and New York both turned unexpectedly positive since 2008. Purchasing’s business conditions index for August was 53.6—up from 48.0 in July and 42.2 in June. Then, the Institute for Supply Management reported that its manufacturing index for August came in at 52.9—up from 48.9 in July and 44.8 in June. Numbers over 50 indicate growth.

Actually, after bottoming last December, the manufacturing sector has been on a steady path toward that 50 growth index number for much of this year. The slow-paced recovery of this hard-hit arena has buoyed confidence among economists that the rest of the economy is emerging from the worst recession of the post-war period. “The year-and-a-half decline in manufacturing output has come to an end, as 11 of 18 manufacturing industries are reporting growth,” says Norbert Ore, who directs ISM’s survey. “The growth appears sustainable in the short term,” he adds, “as inventories have been reduced for 40 consecutive months and supply chains will have to re-stock to meet this new demand.”

At the end of July, forecasters polled by research firm Macroeconomic Advisers estimated that the value of goods and services produced by the U.S. economy would grow at a 1.6% annual rate in the current quarter, ending Sept. 30. This month, their GDP estimate for this third quarter has nearly doubled to 2.9%. Economists at Goldman Sachs & Co. are even more bullish and predict the U.S. economy will show growth in the July-through-September timeframe. Reason: Various manufacturing sector reports are pointing to a solid turnaround in industrial activity this quarter. RDQ Economics writes in a research note, for example, that summertime increases in factory orders points to probable increases in business equipment spending throughout the entire second half.

Economists say the stimulus money already out the door -- combined with the expectation of additional funds flowing soon -- is fueling growth above where it might have been without any government action. Some economists say the 1% contraction in second-quarter economic activity would have been far worse, possibly as much as a 3.2% decline, if not for the stimulus funds. Spending is just beginning to trickle through the economy, with spending expected to peak sometime later this year or in early 2010. The government has funneled about $60 billion of the $288 billion in promised tax cuts to U.S. households, while about $84 billion of the $499 billion in spending programs has been paid. About $200 billion has been promised to certain projects important to steel and other metals, such as infrastructure, transportation and energy projects.

Some economists say a big driver of growth in the second half of the year will be the turn in the inventory cycle. Firms will, at first, cut their inventories less rapidly, and then by the fourth quarter begin to add to them. The success of the “Cash for Clunkers” program has accentuated the cycle in the automotive sector, as the surge in demand depleted supplies of popular vehicles and manufacturers raised their production plans in response.

In addition, compared with earlier forecasts, the upturn in residential investment, business equipment spending and exports now is expected to begin in the third and fourth quarters rather than 2010. But, most of the forecast profiles remain U-shaped and the economists expect it will take until 2011 and 2012 for the industrial economy to move into higher gear.
According to the National Federation of Independent Business, corporate access to credit remains deeply impaired, which is discouraging as financial market conditions have improved measurably since the beginning of the year. Plans to reduce inventories picked up in August, after moderating the previous months. The survey is consistent with a slower pace of decline in real business inventories, which have fallen in excess of $100 billion at an annual rate in consecutive quarters. Companies are also cautious on capital expenditure plans. The percent of firms planning capital expenditures in the next three to six months fell to 16% from 18%, matching its record low.

Consumers could remain the weak link in the recovery. Incomes have taken a beating from declining employment, low wage increases or wage cuts and short working hours—while debt burdens remain high. Spending fell 1.2% in the second quarter, and although it is expected to rise 2.5% in the third, that is almost all due to the Cash for Clunkers program. Excluding new vehicles, economists expect spending to edge up just 0.6%. Thus, it remains difficult to make a case for a robust consumer recovery.

II. Steel Demand is Everybody's Guess

In such an overall economic environment, steel demand remains wobbly—actually described as "generally anemic" by some analysts. Almost every end-use sector has been in decline—with consumer durables the worst and energy suffering the least. Carbon steel purchasing has dropped by 44% when compared with 2008 and stainless steel demand has fallen sharply by 41% so far this year. Looking ahead, the mills and the purchasing community are split: The mills suggest a dramatic pickup in demand off a very low base while buyers believe purchasing will stay soft for the rest of 2009 and much of 2010. Analysts fall into both camps.

"Mills slashed production earlier to match supply with consumption, allowing a period of inventory destocking," says economist John Anton at IHS Global Insight. "Inventory tonnage is very low, so demand from mills is now increasing. This is not a fundamental upturn, just a substitution of new tonnage for inventory." On the other hand, Mark Parr at Key Bank Capital Markets says "positive domestic steel fundamentals appear increasingly intact over the near term (as) service center inventories remain well below normal levels, and operational issues with capacity restarts have pushed integrated steelmaking order books out to the November-December time frame." Manufacturing activity this summer season has been almost 20% less active than a year earlier. In fact, metalworking activity has been stuck at 62% of rated capacity for several months now. Also, non-residential construction spending has fallen back to 2007 levels and continues to run 4% below the 2008 average. And, fourth, buyers aren't gearing up in many manufacturing sectors for a strong fourth quarter.

So, the average price for a baker's dozen of steel mill products tracked by Purchasing.com increased by 3% this month—after rising by 4% in July off the cyclical bottom—but still is 47% below the cyclical peak of last summer. Demand has ticked up only slightly, but the mills are asking for major price increases anyway. Some mills want the hot-rolled price to be $580 to $600 by Thanksgiving. "They're trying to compensate for months of steep cuts," says Global Insight's John Anton. "But the slight recovery in third quarter pricing should not be taken as a sign of strength from the producers." He says that with excess capacity and weak demand, the mills simply aren't likely to get all the increases sought.

Stainless prices will remain below 2006-2008 levels through at least 2010, and probably through 2012, according to the mavens. In Europe and the U.S.—where stainless steel mills operated at less than 50% of capacity so far this year—demand remains weak as only service centers are slowly rebuilding their inventories. J.P. Morgan Research suggests that German, South Korean and U.S. stainless steel melt shops have succeeded in raising prices slowly to offset the rising costs of nickel and other alloys—even though end users haven't begun to restock stainless steel inventories.

The brokerage says: "Stocks are quite low in Europe and the U.S. after three consecutive years of liquidation and some re-stocking is likely during the fourth quarter." That's why, looking ahead, J.P. Morgan forecasts that, after declining by at least 8.5% in 2009, global stainless steel output should rise by 10% in 2010—believing that business capital spending will begin to recover. In the near term, though, with domestic demand for stainless down 33% from year-ago levels, idle furnace capacity remains in play. In such overcapacity situations, price hikes are almost impossible to impose." In fact, prices for such commodity grades as 304 and 316 have seen strong declines.

So, there is considerable debate among buyers at OEM plants how much more they may be willing to pay for stainless or carbon steel products this autumn. While 38% of the buyers polled in industry construction and distribution say they paid more for steel in August than in July, fewer than half (48%) expect to pay more for steel through October. All this fits with the latest Steel Market Update report that sentiment among buyers of flat-rolled steel products has deteriorated because of a feeling that the recovery is taking longer than anticipated and business levels are flat.

III. Supplier Analysis

Thomas Roberts, a director at the Corporate Executive Board, points out that supply chain executives don't buy the successful product-sourcing launch, the right supplier-buyer joint venture or whatever the desired outcome is from critical analysis. He says that "we buy the assumptions, indicators, internal biases, methodology and the inputs used to forecast, analyze, and evaluate the project or situation."

That's why, he says, best supply chain leaders:

- Understand their internal customers' behaviors, choices, thought processes, and experiences and expectations.
- Consistently identify the core success drivers within their business segment without chasing fads or tangential ventures that do not fit their business model
- Understand the business they are in, beyond the conventional label
- Look closely at targeted, historically significant, compelling and accurate indicators, not every available indicator
Understand the obvious and subtle risks associated with their industry, their company and their link in the supply chain better than their competitors
Gather information, advice, and insights from a multitude of sources, industries, and markets beyond the confines in which they compete
Identify, evaluate, and monitor the human behaviors that drive the financial metrics that most precisely reflect the health of their business operations
Investigate every activity in their service or product delivery experience to isolate areas of trapped value, hidden costs, and undiagnosed bottlenecks
Routinely evaluate and challenge internal business assumptions

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.

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