
ASA MATERIALS MARKET DIGEST

MARCH 5, 2008

EDWIN SCOTT, JR., EDITOR

Published Monthly by the American Supply Association Web: www.asa.net; Email: info@asa.net

MARKET OVERVIEW

Carbon Steel. At the latest count, operations in U.S. mills were at 90%-plus of capacity, the highest since 2006. With demand strong, flat-rolled prices have been rising sharply, and some price boosts have been in triple digits. Helping to drive up the price of finished steel are rising costs of ferrous scrap, iron ore and ferroalloys. And after a year of falling prices, even oil country tubular goods have come to life with increases ranging from \$75 per ton to \$200.

Stainless Steel. During February nickel rose 17% to a recent London Metals Exchange price of \$31,150 per tonne. Ferroalloy costs are also on the rise because of reduced production in South Africa, a key source for ferromanganese, ferrochrome, ferrovanadium, etc. South Africa is experiencing a severe shortage of electric power, requiring plants to trim production schedules. To make matters worse, two major explosions in production areas forced additional curtailment of output. Not surprisingly, ferroalloy prices rose steadily, and were quickly reflected in stainless flat-rolled surcharges.

Copper. In trading on the LME the red metal hit a peak of \$8,540 per tonne at the end of February. This 17% price jump was driven largely by investor actions rather than increased user demand. In the copper and brass scrap market, a severe shortage has developed, especially in the higher grades such as No. 1 ingot makers. The scarcity reflects reduced operations of U.S. brass mills plus renewed and often frenetic buying from China, by far the largest destination for U.S. exports of copper and brass scrap.

Resins. As has been the case for some months, resin demand from foreign buyers continues strong while the pace of domestic purchasing is lackluster. In this mixed-message market, producers find it difficult to raise prices except in cases such as polystyrene where higher feed-stock costs forced producers to increase prices.

CARBON STEEL

OPERATIONS AND PRICING. *Production.* February production of raw steel in U.S. mills picked up the pace where January left off. In the latest full month of activity, domestic production ran at a 90.5% operating rate, the highest since 2006. For the current year, two-month mill output topped 2007 by 6.7%.

At the distributor level, January shipments by steel service centers exceeded the year-ago pace in all product categories except flat-rolled, where volume slipped 6.1%. This decline reflected decreasing demand from the automotive sector as well as the ongoing slump in home

building. But despite weakness in sheet steel, service center operators remain strongly bullish. Reports from a recent meeting of the Metal Service Center Institute were decidedly upbeat, and among warehouse operators, low inventories were of more concern than flagging demand.

Pricing. With the mills roaring and warehouse operators smiling, steel prices have had only one way to go. And in February the “up” escalator continued to function as smoothly as in January. Early on, AK Steel announced another \$30 per ton hike in flat-rolled products. It was quickly followed by Nucor, which upped the ante to \$60, outpacing other mills’ boosts of \$30 to \$50. AK quickly tacked another \$30 on its price sheets to keep pace with Nucor. When the dust settled, the April price for hot-rolled sheet was \$730, for cold-rolled, \$810 and for hot-dip galvanized \$940. But in a stunning display of one-upmanship, California Steel outdid all of its Eastern and Midwestern counterparts by issuing an April price sheet up \$110 per ton for hot-rolled and galvanized sheet and an eye-popping \$130 for cold-rolled.

Where will it end? No one really knows, but Peter Marcus, a respected steel market analyst, sees the current steel shortage ending some time this year. If so, he suggests, steel prices will come under pressure as early as the second quarter of 2008.

RAW MATERIALS. In announcing the price increases discussed above, steel mills attributed the boosts not only to strong demand, but also to a steady stream of price increases on steelmaking materials. This latter factor has indeed spread not only to charging and alloying steel ingredients, but also to energy, transportation and virtually every other significant cost that goes into the price of finished steel. Items:

Ferrous Scrap. After a sharp \$95 per long ton runup in early January, the price of factory bundles eased \$10 in the first February auction. But shortly thereafter the bundles price recouped that lost \$10 and lifted *American Metal Market’s* Factory Bundles Index to a lofty \$393. The increase reflects strong competition for scrap between U.S. mills and overseas buyers, especially with respect to bundles and other premium grades.

Iron Ore. Contract prices for 2008 ore supplies are still being negotiated by a large number of mills in the U.S. and elsewhere. Several major steelmakers have settled with a Brazilian mining company at a 65% increase over last year’s price. And while talks continue, there is widespread concern that the Brazilian price will set an industry-wide pattern. But other key ore supplying countries—India, Australia, etc.—have yet to be heard from.

Meanwhile, something of a Sword of Damocles has appeared over the roofs of U.S. steelmakers getting huge shipments of ore from the northern Great Lakes Region. These sources ship their ore through a canal that connects the northern ore mines with their mill customers on the Lower Great Lakes. A crucial lock in this canal, commonly known as the “Soo,” is located in Sault St. Marie, Michigan.

The Soo and its mechanisms are now 40-years old and showing their age. Hence there is growing concern that extensive repairs—or replacement—may be required in the foreseeable future. Either remedy would require a prolonged outage of the canal which would be catastrophic not only for the steelmakers who rely on it, but also for the moribund Michigan

economy. Estimates of the lock's replacement cost begin at \$341 million, all of which must be appropriated by Congress. To date the legislators have provided a mere \$2 million for an engineering study of remedial options, a pittance compared to the funds needed to rebuild the lock.

Ferrous alloys. As reported in a preceding issue, the global supply of ferroalloys is being impaired by a severe electric power shortage in South Africa. Initially, some reports indicated that the problem could be fixed in six weeks or so. But then reality set in, and the current consensus is that the shortage will persist not for weeks or months, but for several years.

The initial impact on ferroalloy production has been a cutback on industrial power usage, reducing alloy plant operations to 90% of normal or less. But in recent weeks the problem has been greatly exacerbated by explosions. The first was in the Cato Ridge Alloys ferromanganese plant that killed five workers and had to be shut down. Within days the price of high-carbon FeMn jumped \$100 per ton to \$2,395 and further increases appear likely.

This explosion was followed by one at the Samancor Chrome ferrochrome plant, which had been a major source for U.S. stainless steel mills and other steelmaking venues. No less than 60% of all ferrochrome used by U.S. mills comes from south Africa and roughly a third of that had been supplied by the now shuttered Samancor. Even when the damaged plants get back on stream, the uptrend in ferroalloy prices is likely to last a long time.

TUBULAR PRODUCTS. *Operations.* Oil and gas drilling work continues apace in both the U.S. and Canada. American drilling activity involves 1,771 sites, a near-capacity pace little changed during February. However, north of the border Canadian operations increased 11% to a count of 647 active sites. No slowdown is in sight for either country's drilling operations.

Prices. After a year of soft pricing, the oil country tubular goods (OCTG) market staged a dramatic turnaround early in this year. After weathering a flood of imports and top-heavy distributor inventories, the pendulum has swung to the upside of the pricing charts. Early in February Vaorec and Mannesmann Tubes, an OCTG specialist, announced price boosts on virtually its entire product line. The increases ranged from \$75-100 per ton for carbon steel products to \$100-200 for alloy-based items. Other representative price increases include:

- Ipsco Tubular – ERW carbon pipe, \$80 per ton;
- Lakeside Steel - \$75 for the same product line;
- U.S. Steel - \$75 to \$200 over a broad range of products;
- ArcelorMittal - \$100 for highly processed seamless tubing.

These husky boosts reflect not only higher mill costs, but also strong ongoing demand from the energy industry. Additionally, there has been some slowing of OCTG imports, this resulting from soaring ocean freight rates and the weak U.S. dollar.

STAINLESS STEEL

Closing prices for the three-month nickel contract on the London Metals Exchange, per tonne (metric ton):

Open (Jan. 31)	\$27,900.00
High (Feb. 29)	\$31,150.00
Low (Feb. 6)	\$26,705.00
Close (Feb 29)	\$31,150.00

As these figures show, February nickel prices closely paralleled those of the copper cathode market (see next section). As with copper, the late-February price jump had little to do with demand levels, but rather reflected external factors relating to investor sentiment. Toward the end of February stock markets in both the U.S. and overseas were faltering. When such conditions prevail, investors often opt out of “paper” and into “stuff”—gold, silver, crude oil, grains...and base metals. In the last-named category nickel is a favored commodity because of its high dollar value per pound, kilo or tonne. And in the last few days of February commodity funds were heavy buyers of nickel and thereby inflated the price 17% from the low reached earlier in the month.

The surge in nickel comes at a time when stainless steel mills are dealing with rising costs all across the materials spectrum. Early in February, when the nickel market was still quiescent, the Big Three stainless producers were hiking their materials surcharges. Driving these increases was not nickel but rather ferrochrome (FeCr), a key alloying metal used in many stainless formulations. As noted in the section on Raw Materials (page 2), production of ferrochrome and other ferroalloys has been seriously impacted by power shortages and plant explosions in South Africa from whence the U.S. stainless mills get 60% of their needed ferrochrome. With this supply source threatened, ferroalloy prices are on the rise and with them these stainless steel surcharges:

Allegheny took the lead with increases on all of its flat-rolled stainless products including 11.29 cents per pound for Type 315, 14.52 cents for Type 316, and 14.08 cents for Type 321. North American Stainless quickly followed suit with numbers closely paralleling those of Allegheny, and a few days later AK Steel got on board. Given the recent pattern of *carbon* steel prices, it seems inevitable that stainless prices will continue to rise, especially if nickel remains at or near its end-of-month price.

In other stainless steel news:

- In 2007 U.S. stainless imports were down 7.6% from the preceding year, according to Specialty Steel of North America, a trade group. Incoming shipments in most product categories were down, but plate imports bucked the trend with a 28.6% increase. In the sheet and strip sector, imports fell 18.2% and total U.S. usage was off 17.7%. This product category, widely used in appliances, kitchen sinks, etc., remains a major victim of the ongoing housing slump.
- After much foot-dragging, the Michigan Department of Natural Resources knuckled under and approved plans for a new nickel mine in the state’s economically depressed Upper Peninsula. Sources indicate that the Department came under heavy pressure to issue the necessary permits because of the desperately thin job market in the U.P.

COPPER

Closing prices for the three-month copper cathode market on the London Metals Exchange, per tonne (metric ton):

Open (Jan. 31)	\$7,165.00
High (Feb. 28)	\$8,540.00
Low (Jan. 31)	\$7,165.00
Close (Feb 29)	\$8,400.00

As this table shows, copper cathode posted a net price increase of 17.2% during February. But this surge did not reflect any sudden jump in demand. To the contrary: U.S. copper consumption continues to falter as a result of an anemic housing market, slumping auto production and widespread materials substitutions in such homes as are still being built.

Offsetting these problems in February were several developments largely unrelated to how much of the red metal is produced and sold in the U.S. China was one factor, as during February its domestic copper industry was plagued by electric power outages and transportation snafus, both the resulting from winter storms of unexpected ferocity. These curtailed the operations of Chinese smelters, put heavy demand of overseas sources and helped to drive copper's price higher. Additionally, the jump in offshore demand caught many copper traders with short positions that had to be covered before the month end. Similarly, a number of investment funds opted to "dress" their portfolios as copper emerged as one of the speculators' star performers.

In the copper and brass scrap market, serious shortages have developed. Production cutbacks among American brass mills have sharply reduced the availability of top grade scrap. Additionally, widespread storms in many parts of the U.S. impaired scrap collection. And as has been the case for more than a year, the housing slowdown has limited teardowns and the demolition scrap they normally provide. To make matters worse, the car companies are switching radiator materials from copper to aluminum in order to reduce weight and comply with ever-tightening CAFE standards.

Coupled with frenzied Chinese buying, these factors have helped to push copper and brass scrap ever higher. Toward the end of February, No. 1 ingot maker's copper scrap was quoted on the New York Comex at \$3.65-3.66, a ten-cent increase from the preceding week. Even at this price level, few observers see increased supplies in the copper scrap market any time soon.

In other copper news:

- Mueller Industries, a major supplier of copper plumbing tube and related products, is toughing out the housing slump better than many expected. The firm's sales for the final quarter of 2007 rose 14.2% to \$621.7 million on higher copper prices and a recent acquisition. Full year earnings fell 22.4% to a still healthy \$115 million.
- The long story of Grupo Mexico's Cananea mine strike has added another chapter. At the behest of management, the legality of the walkout was referred to the Mexican Labor Board,

which found for the company on a legal technicality. But the union quickly appealed to the federal courts which, after a month's delay, found for the workers. This meant that the strikers couldn't be fired during the walkout, pending the company's appeal to a higher court. A decision by this forum, perhaps final, will be forthcoming in two to three months.

RESINS

In most categories, resin prices for March are holding even. According to *Plastics Technology (PT)*, domestic demand is weak, and export markets have softened in some regions. Following are specifics for key resins:

Polyethylene. Price increases announced for January and February have not yet been implemented and are unlikely to become effective any time soon. Export volume remains quite strong and is helping to offset price pressure from domestic buyers.

Polypropylene. Demand fell sharply in January and February, quashing any attempt to raise prices. Increases announced but never implemented total 9 cents per pound and have scant likelihood of ever being implemented. With producers' operating rates down to 80-85%, the next move in PP prices could well be downward.

Polystyrene. Demand in February and the early days of March was unremarkable. Nonetheless, because of higher costs for feedstock and monomer, price increases in the 3- to 5-cent range were reluctantly accepted by the market. A key factor in this was the jump in benzene to \$3.80 on the spot market.

Polyvinyl Chloride. Domestic demand continues to be slack, especially in the piping sector which relies heavily on new home construction. Exports remain strong, but acceptance of modest (2 to 3 cents) price hikes remains in doubt.

Engineering Resins. Prices continue to rise, led by DuPont's Elvax (up 9 cents) and Delrin (up 15 cents) and followed by comparable boosts by other producers of nylons, acetals and related products.

PRODUCER PRICE INDEXES – KEY INDUSTRY PRODUCTS

The table below is extracted from the Bureau of Labor Statistics' monthly report on the Producer Price Index or PPI. The Producer Price is defined as the price at which a given commodity or product is sold at its *first* sale after being manufactured, mined, refined or otherwise produced.

	Latest 01/08	Previous 12/07	Year Ago 01/07	² Yrs Ago 01/06
PIPE, VALVES & FITTINGS:				
Copper & copper-alloy tube	287.4	284.4	257.5	206.8
Steel pipe & tube	170.9	167.1	169.4	159.9
Plastic pipe and fittings	203.6	203.6	194.1	229.4
Industrial valves – metal	177.3	176.7	166.8	148.7
PLUMBING FIXTURES:				
Vitreous china fixtures	96.6	96.5	101.6	101.3
Fixture fittings & trim	229.0	227.7	218.2	203.0
HVAC EQUIPMENT:				
Warm air furnaces	127.6	125.7	120.3	116.6
Unitary air conditioners	141.7	140.3	139.2	133.9
Cast iron heating boilers	135.7	135.7	128.2	122.4

NOTES: 1) Sources: Bureau of Labor Statistics, US Department of Labor; compiled for the American Supply Association; 2) Data for 2008 are subject to revision by BLS.

China Update: Losing Its Edge?

A recent report by the Associated Press suggests that China is losing its edge as the low-cost producer of myriad products ranging from stuffed animals to automobile parts. After years of free-wheeling operations with low-cost labor, cheap raw material and abundant energy, Chinese manufacturers are having to March to a decidedly different drummer.

In the labor sector, China has an abundance, indeed a surplus, of unskilled workers. But in the skilled labor market demand far outweighs supply. As a consequence, wages are rising at a 10-15% annual rate. Additionally, new legislation calls for stronger labor contracts that will add cost to budgets for human services.

With regard to materials, Beijing has no immunity from the current rapid escalation of raw materials worldwide. Nor are the Chinese exempt from the industrial world's ongoing surge in energy costs—everything from crude oil and natural gas to uranium yellowcake.

Additionally, though the AP doesn't mention this, China's Communist-style bureaucracy weighs heavily on the cost of doing business, imposing administrative expenses far above those of other Pacific Rim countries.

All of which, the AP notes, is sapping China's once formidable competitive edge, even with the advantage of manipulated currency. And according to AP, for U.S. manufacturers sourcing in China, the outlook is not promising. Thus a recent survey by the American Chamber of Commerce in Shanghai paints a bleak picture: Three-quarters of the poll's respondents believe that China's habitual price advantage is fast fading. The AP report also tells of many U.S.-based users of Chinese industry that are "voting with their feet," shifting their outsourcing away from China in favor of emerging industrial newcomers such as Vietnam, Indonesia and even India.

Ed Scott
Editor

Copyright, 2008, American Supply Association. All rights reserved.

This report is published as a member service of the American Supply Association. Its contents are solely for informational purposes and any use thereof or reliance thereon is at the sole and independent discretion and responsibility of the reader. While the information contained in this report is believed to be accurate as of the date of publication, ASA and the author disclaim any and all warranties, express or implied, as to its accuracy and completeness.