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# Steel Middlemen Keep Wary Eye on the Canary

By Tom Balcerek

PITTSBURGH, Aug. 16 --

In economics, the steel industry sometimes is compared to a canary in a coal mine--among the first to suffer when the toxic fumes of recession are sniffed. Conversely, steelmakers often are the first to benefit when the economy recovers.

That is why Federal Reserve Board Chairman Alan Greenspan, a former steel industry consultant and arguably one of the most powerful men in the world, acknowledges keeping an eye on scrap prices as an important economic indicator. He knows that if mill demand for scrap is high, demand for steel must be on the rise as well. And that means the country's manufacturing sector is on the move, building the vehicles, appliances and infrastructure needed for a growing economy.

It may be a little unsettling to consider that "as goes scrap, so goes the U.S. economy" and, obviously, it is not that simple. But as a recent downturn in economic indicators prompts speculation about the possibility of a "double-dip" recession, it may be instructive to hear how the middlemen in the steel industry are viewing this economy.

A recent survey of these key players revealed unvarnished concerns about the economy and all the negative issues affecting it: the scandal-impacted stock market slump and its influence on consumer spending; the lack of corporate spending due to cash constrictions; a lack of confidence and wary capital markets; expected reductions in government spending due to current deficits; and the prospect of more deficits to come after the recent round of saber rattling for a costly war with Iraq.

But, as one middleman put it, if people need the steel, they'll pay the price. "It's like this," he explained. "Someone calls up and I tell them I want $400 a ton for hot rolled. They say '$380.' I say 'sorry.' They hang up. Two days later they call me back and say 'yes' to the $400." This same source, whose observation would have been totally foreign just a year ago, was not as confident as his comment suggests. "It's a very scary market," he confided.

Sheet steel availability went from a glut late last year to a near shortage this year as domestic mill closures and import restrictions dovetailed, creating a panicky atmosphere among steel distributors and end-users. Having some desperate customers over a barrel may not be enough to ensure profit margins, especially if demand stays flat or decreases.

Chicago-based Ryerson Tull Inc. has much at stake. The country's largest service center and distributor, whose recent annual sales have approached $3 billion, suggested that there had been no material change in its attitude about the market since it issued a gloomy outlook about the current quarter late last month.

"We have not yet seen any sustainable improvement in underlying market demand," said Neil Novich, Ryerson's chairman, president and chief executive officer, when his company reported a second-quarter net loss of $10 million.

While the loss was due largely to substantial unusual charges against earnings, Ryerson also was impacted by a nearly 6-percent decline in both sales and average daily shipments from the same period a year ago. Ryerson added that a typical decline in third-quarter volume relative to first-half levels was likely to be exacerbated this year by extended plant shutdowns among customers.

Terence Rogers, Ryerson's treasurer and vice president of finance, said it would be improper to update the company's outlook without making another Securities and Exchange Commission filing, but noted that the information held in last month's press release was "a pretty strong statement." He said Ryerson kept a close eye on the markets it served by monitoring the ordering patterns of its largest customers as well as business conditions at its many service centers throughout North America. "Today, we look at what we sold yesterday and we can see the day-to-day trends," Rogers said. "We are able to get a pretty good feel."

There is apprehension across the board. Jim Ayers, president of CTL Steel Co. of Columbus, Ohio, which buys hot-rolled coils and processes them for service centers, said that demand was not strong and the current stakes for steel buyers could climb higher if demand weakened further.

"We are watching our inventories very closely," he said. "In the first five and a half months of this year, when there was still some cheap steel around, if someone needed 20 tons, they bought 40; now they buy 20. Some of our customers had a soft July and they are hoping things are going to pick up."

Ayers noted that late last year hot-rolled sheet prices were projected to go up about $50 a ton by the middle of this year, but instead rose by $160 a ton. "Now, before a guy orders, he thinks, 'Do I really need this?' I call it the 'twitch factor'."

Ayers and others surveyed said they believe hot-rolled sheet prices already have hit their peak. Some even noted that prices had come off slightly in recent weeks.

Steel distributors, processors and traders are keeping a sharp eye on both the supply and demand side of the steel equation and may be uniquely positioned to read the economic tea leaves or--reverting to the previous canary cliché--keel over in the coal mine.

Their problems on the supply side have been well documented: reduced flat-rolled steel availability due to the closure of LTV Steel, Trico Steel, Acme Steel and others; unfair-trade cases that have reduced imports from offshore suppliers; and, finally, President Bush's imposition in March of Section 201 tariffs on imports of many steel products.

The government action may save the domestic steel industry, or at least keep it chugging along until the next presidential election, but it has thrown the middlemen for a loop.

Deflation may be a concern in some sectors of the U.S. economy, but not in steel; at least, not at the moment. Prices on sheet steel, the bulk of steel products, have shot up more than $100 a ton and in some cases have nearly doubled. For this reason, all eyes are trained on the critical issue of steel demand.

If the middlemen can pass on these price increases to their customers for an extended period, everybody would be happy--except, of course, the end-use customer. Manufacturers are facing opposite--deflationary--pressures for the markets they sell into, a problem that many distribution executives said has both short- and long-term implications for the future of American manufacturing and, by way of extension, their businesses as well.

Getting hit from both sides, the middlemen are being asked to accept much higher prices from mills while attempting to keep up with the cost-cutting zeitgeist of the customers they serve. Those falling prices at Wal-Mart are no joke.

"Places like Wal-Mart that purchase goods made out of steel want a 3- to 5-percent price decrease every year. If not, they go to China. We are going to see the impact of that in about three years," steel trader Peter Brebach, president of Iron Angels of Colorado Inc., Manitou Springs, Colo., said.

In the short term, sources said, domestic end-use demand must stabilize or improve to keep prices--and some middlemen--from falling off a cliff. "Demand is shaky. If it doesn't solidify, it's going to crumble," Brebach said. "It could be the summer doldrums. We may have to wait until mid-September to know."

For now, caution is the order of the day, and not just because of high prices on some steel products. Many buyers are reluctant to commit to large volumes of steel buys for another reason: the economy, and the possibility of a double-dip recession.

"People are waiting for the other shoe to drop," said Leon Goldenberg, president of Fremak Industries Inc., a New York-based steel trader. "Everybody has been cautious. No one is taking a big position. The customers just don't want to get caught with high-priced steel. People are being cautious. Banks are being cautious. Everybody is trying to keep their inventories low."

Despite this assessment of current conditions, Goldenberg said he remained optimistic. "I don't see a recession, I don't see a double dip--just caution."

Another New York-area trader, who sells both foreign and domestic steel to distributors, said strong demand for flat-rolled steel was still in evidence.

"The demand is still there. Will it taper off three months from now? That's conceivable. We are concerned because we feel we are at the peak of the market. You only have to look at the stock market. Demand is good currently, but I'm a bit nervous."

The New York-area trader said demand for plate was "so-so," the merchant bar market was weak but improving and rebar demand was good, but not reflected in the price. "Big construction is hurting, but home construction is still high. Because the economy is so uncertain, certain structurals could be weak," he added. "The chains (stores and restaurants) keep expanding, but I think there will be a falloff. Public works projects continue, but we're in a deficit again and they are already pulling some projects."

An offshore mill representative in Houston specializing in long products said the rebar business had been steady but could fall due to a decline in public works projects going forward. Nevertheless, he said he was encouraged by current demand levels. "Once we put out a rebar offer, it's snapped up in two days," he said.

Looking at the big picture, industry analysts have mixed outlooks on demand. "I sense there is some improvement, but it doesn't seem terribly strong," said Charles Bradford of Bradford Research Inc., New York. "The steel service centers are shipping more, but only slightly more. I don't think demand is all that good. I think some of the pricing information is overly optimistic."

Bradford added, however, that a recent survey of steel-using manufacturers on demand for their products was encouraging. "It shows some improvement in sentiment," Bradford said of the Institute for Supply Management (ISM) survey. He added that there seemed to be some improvement in steel inventory levels lately. "The big problem area is commercial construction. Look at the price of beams. Beam imports were off (in June), even though they are not covered under the Section 201 case."

Late last month, the U.S. Commerce Department reported that the nation's economic output grew an anemic 1.1 percent in the second quarter on the heels of a 5-percent growth rate in the first quarter. It was sobering news for an economy purported to be on the mend from last year's recession. It was a particularly bad report for the steel sector.

Commercial construction was off 14 percent in the second quarter and spending by state and local governments shrank by 1.1 percent.

The depressing news came during a stock market swoon, a development which had economists worrying that the stamina of American consumers, who have kept the economy afloat for so long, would finally give out. Consumer spending slowed to a 1.9-percent improvement in the second quarter, down from a 3.1-percent growth rate in the first quarter.

"The consumer is still the hero, but even that is taking a beating right now," said a New York-based trader. "From a personal standpoint, I don't have a lot of disposable income right now." He added that after observing market psychology at work, he believed a double-dip recession was possible. "If people think about it, it happens."

At the same time, however, many surveyed reported steady demand from such major steel-consuming sectors as automotive, home building and construction. Sheet prices may be high, but buyers are paying them. Prices on long products are up much less dramatically, but demand for the products--particularly rebar and rod--has been stable, and, in the words of one rebar distributor, a healthy level of business is more or less "continual."

However, a decline in new commercial construction projects and cutbacks in private and public contracts for construction projects have dimmed the outlook for long products. Some sources even cited the recent rash of corporate scandals as contributing to an eventual fall-off in steel demand related to new office building construction. "There could be a lot of office space available," one observer said. "How many people do you think are left in the Enron building?"

Meanwhile, the beat goes on for higher sheet prices. "The mills are arrogant. They don't care. It's take it or leave it. That's it," said one buyer. "If demand picked up we'd be in a major shortage."

But another had a hunch the heat was about to dissipate, suggesting that the extreme tightness in the sheet market may not be all it's cracked up to be. "I'm getting more mill (salesman) visits lately, offering me allocations," he said. "The fact that they are coming around makes me wonder."