
ASA MATERIALS MARKET DIGEST

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MARKET OVERVIEW

Carbon Steel. The year-end slowdown in steel operations arrived on schedule as demand softened and service center buying all but dried up. Notwithstanding these factors, January 1 saw a \$30-40 price increase on flat-rolled products take effect. A few mills have announced an additional boost for February 1, but there is some uncertainty regarding the acceptance of this second round of increases.

Tubular Goods. Oil and gas drilling in December reached the highest level of activity since the current energy boom got under way. With demand for oil country tubular goods strong, several manufacturers announced price increases in the \$50-100 per ton range. The new prices held for a while, but toward year-end a flood of OCTG imports, mostly from China, drove prices back to pre-December levels.

Copper. Domestic demand for the red metal has been hard hit by the housing slump, especially among producers of copper water tube. Exacerbating the home building industry weakness is widespread substitution of plastic pipe in residential plumbing lines. Despite these adverse factors, copper pricing has been relatively stable, primarily because of brisk speculative buying on the metals exchanges. In part this activity reflects ongoing global demand for the red metal, demand which in the first three quarters of 2007 had led to a worldwide copper deficit of 265,000 metric tons.

Stainless Steel. December nickel prices fluctuated narrowly in the \$26,000-27,000 range, well below the preceding month's close. The lower cost of the key alloying metal led producers to trim surcharge increases sharply. Irrespective of easing nickel prices, the trend in the final quarter of last year appears to indicate a global slowdown in stainless steel demand.

Resins. Rising monomer costs, coupled with strong export demand, are currently driving resin prices higher. Monomer costs, in turn, reflect the impact of soaring crude oil costs, which recently broke through the \$100/bbl barrier.

CARBON STEEL

PRODUCTION & OPERATIONS. Raw steel production in the U.S. slowed to the lowest weekly level since April 7 of last year. The pour for the week ending December 1 was 2.024 million tons, reflecting an operating rate of 84.9%, somewhat below the 2007 average of 86.0%. The pace picked up in the following week as output rose to 2.064 million tons and the operating

rate to 86.5%. Raw steel production through December 15 came to 102.351 million tons, just 2.3% below the last year's pace. Statistics for the balance of 2007 have been delayed because of production cutbacks during the traditional Christmas slowdown.

Buying by steel service centers, which represents the largest single block of mill purchases, was unusually low in the closing months of 2007. According to the Metals Service Center Institute, inventories at its member warehouses hit a 12-year low in November, with stocks 27% below the year-ago level. The decline resulted largely from the centers' reluctance to restock at a time when their sales levels have been persistently below normal. The centers' November shipments, for example, were 7.8% below the year-ago level, and the 11-month total for the year just ended trailed 2006 by 7.0%.

Few steelmakers expect a major surge in buying any time soon. For one thing, demand has been adversely affected by a severe slump in the housing-related appliance sector. Additionally, the news from Detroit has been all bad. Ford and General Motors have already announced first quarter production cutbacks of 7.4% and 10.6% respectively, and little better news is expected from Chrysler. Indeed, a consensus forecast for U.S. light-vehicle production in 2008 is 14.5 million units, down 400,000 from a none-too-exciting 2007.

News such as this has stirred doubts about worldwide steel production in 2008. As late as October the International Iron & Steel Institute was predicting that global steel production would increase by 6.8% in the year ahead. But just last month a spokesman for World Steel Dynamics, a highly respected consulting firm, described the IISI forecast as "probably not achievable." This view was based on the above-noted problems of the U.S. industry as well as higher raw materials and energy prices and slower growth in the Chinese steel industry.

PRICING. Late last year U.S. mills announced price hikes of \$30 to \$40 on flat-rolled sheet for January delivery. Despite some early reservations, the increase has held and indeed emboldened U.S. mills to announce another \$30 boost for February deliveries. Arguing in support of this second round of increases were (a) support by such steel giants as AK, U.S.S. and ArcelorMittal, (b) extremely slow service center inventories, (c) rising costs of iron ore and scrap, and (d) a sharp slowdown in steel imports (see "*Exports*" below). The announced increase would raise hot-rolled sheet to \$580 per ton, cold-rolled to \$680, and hot-dip galvanized to \$810.

In early January there remained some uncertainty regarding the viability of the proposed February increases. The two major West Coast mills were among the last to announce higher February prices, and there are already reports indicating that these mills will roll the January boosts over into February and hope for a more receptive climate in March.

Meanwhile, two major mills have announced \$30 price increases on plate, driven they say by higher production costs rather than stronger demand. If accepted by the market, these increases will price both coiled and cut-to-length plate at \$830 per ton.

IMPORTS. The closing months of 2007 have shown a marked change the pace of steel imports from China. While tubular products including oil country goods, standard pipe and line pipe continue to pour in, flat-rolled exports to the U.S. have all but vanished. Several factors are operative: (1) soaring freight rates, which in recent months have seen ocean shipping charges rise

from \$34-40 to \$95 per ton, with \$100 shipping widely expected in the near future; (2) strong demand for finished steel in China's domestic market, with prices rising accordingly; and (3) increased export taxes and tariffs intended to slow the flow of strategic raw materials away from Chinese shores. Included in these new constraints are metal ores, coke and coal, crude oil and a wide range of finished steel products.

These latest moves by Beijing are dually motivated. For one thing, the government wishes to conserve strategic materials such as alloy agents and energy products. Additionally, production cutbacks could help abate China's pervasive and mephitic air pollution problem. If not remedied, Beijing's foul air will be a source of extreme government embarrassment and loss of face when the upcoming Olympics get under way.

RAW MATERIALS. One factor driving higher steel prices is the cost of scrap. The first monthly auction of factory bundles took place in early December. To the surprise of many, the winning bids in these offerings were up an average of \$15 per long ton, a reversal from the preceding auction where the bidding was off \$25. According to a report from *American Metal Market (AMM)*, successful bidders in the latest auction included integrated steelmakers as well as mini-mills. The publication noted that low inventories in the mills' scrap yards, plus uncertainties about future scrap supplies, resulted in the higher bids.

Even more surprising was what followed that followed the bundles auction, when the spotlight switched to scrap dealer sales. This market normally follows factory bundles pricing, but barely a week after that offering dealers were asking—and getting--\$40 a long ton more for premium scrap and \$35 for lesser grades such as No. 1 heavy melt.

Another factor in higher scrap prices is the likelihood that factory bundles will become scarcer in 2008. As noted above (page 2, paragraph 3) Ford and GM have already reduced production for early 2008, and Chrysler is expected to make even more drastic assembly line cuts. Fewer new vehicles means fewer factory bundles, and if this scrap supply is seriously curtailed, prices will inevitably rise not only for bundles, but across the entire spectrum of ferrous scrap.

TUBULAR GOODS

Drilling. For U.S. oil and gas drilling, December 2007 was the busiest month of the current energy boom. During that period the U. S. rig count varied from a high of 1,828 active sites to a low of 1,809, 5-6% over comparable months of 2006. Canadian operations were more variable, with December counts fluctuating from a high of 419 units to a low of 372. The tally in Canada trailed the year-ago count by 15.7% to 17.2% during December.

Pricing. Early in December *AMM* cited "market sources" reporting that major oil country tubular goods (OCTG) manufacturers had planned increases of \$50 to \$100 per ton in the near future. The publication explained that the pending increases were based on higher value added-taxes on Chinese OCTG and that these hikes would translate into export taxes of 5-15%. The reports were so credible that a number of major OCTG producers—including industry giant U.S. Steel—announced substantial price increases to become effective early in December.

The new prices held for a while. But in late December they hit rough water. According to the highly regarded consulting firms of Pipe Logix, Inc. and its affiliate Spears & Co. the December monthly average price for all OCTG fell \$8.00 per ton. Declines in specific product sectors included ERW off \$11 or 0.8% to \$1,289 per ton and seamless down \$6.00 or 0.4% to \$1,425.

This late December price erosion came as a surprise to most market observers. They attributed the downturn to excessive distributor buying plus an ongoing flood of Chinese OCTG. This latter factor is confirmed by Customs Bureau figures for November, the latest available. Imports from all sources for that month came to 173,473 metric tons, an increase of 46.3% from October. Of the November OCTG total, no less than 57.7% came from China.

The accompanying table, also from Pipe Logix, shows *average* monthly market prices for December, reflecting both the month's early increases and the later price cuts.

| Product | Dec 2007 | Nov 2007 | Nov-Dec % Chng |
|------------------------|---------------------|---------------------|---------------------------|
| Tubing: Carbon ERW | \$1,289 | \$1,296 | -0.5% |
| Tubing: Carbon seaml's | \$1,459 | \$1,484 | -1.8% |
| Tubing: Alloy ERW | \$1,636 | \$1,666 | 0.4% |
| Tubing: Alloy seamless | \$1,760 | \$1,799 | -2.2% |
| Casing: Carbon ERW | \$1,065 | \$1,064 | 0.1% |
| Casing: Carbon seaml's | \$1,202 | \$1,200 | 0.2% |
| Casing: Alloy ERW | \$1,378 | \$1,391 | -0.9% |
| Casing: Alloy seamless | \$1,536 | \$1,516 | 1.3% |

Source: Pipe Logix, Inc.

COPPER

Prices. In November the London Metals Exchange price for copper opened at \$7,760 per tonne and closed at \$6,840. Thereafter, the trend was steadily downward until mid-December, with the red metal hitting a low on the 18th. Thereafter there was a modest rally bringing copper within hailing distance of the November close.

| | |
|----------------|------------|
| Open | \$7,020.00 |
| High (Nov. 30) | \$7,020.00 |
| Low (Dec. 18) | \$6,340.00 |
| Close | \$6,771.00 |

The mini-rally in copper that developed after the December 18 low was driven more by speculative buying than any sharp increase in demand. Indeed, if current demand were the sole driver of the copper market, a lot of cathode would currently be on the market at bargain basement prices.

Demand. A sharp decline in copper buying normally develops toward year end, but 2007 the seasonal slump was especially severe. Typically, consumers of the red metal curtail buying in the closing weeks of the year and rely on existing inventories to supply their production needs. This year there was little inventory for the brass mills to work off, and in any case most of them had throttled production schedules to the point where immediate needs for refined copper were minimal.

The principal problem, of course, continues to be the deeply depressed home building market. The near-collapse of this industry has hit copper producers with a triple whammy, to wit:

- The sharp decline in home building has severely limited the need for copper water tube and copper wire for residential electrical service.
- Materials substitution has hit hard, with such homes as are still being built increasingly equipped with plastic plumbing lines rather than copper; and
- The dearth of housing starts has all but wiped out residential teardowns, historically a strong source of the highest quality copper scrap.

Supply. While the U.S. copper market continues to be slack, global demand for the red metal is brisk. Testifying to this fact is the latest report from the International Copper Study Group. According to this well regarded source, the first nine months of 2007 saw a copper *deficit*—consumption minus production—of 265,000 tonnes. In the same period of 2006 copper was in a *surplus* mode, with production outpacing consumption by 21,000 metric tons. In fact, the current deficit is probably well in excess of the figure reported by ICSG, as that organization does not factor in Chinese usage and production because the figures provided by Beijing are unreliable.

One circumstance possibly buttressing the price of copper is the long strike at Grupo Mexico's vast Cananea mine. This walkout is now in its fifth month, but thus far has had little impact on the price of copper. Most of the issues in the labor dispute have been resolved. However, the sticking point involves the status of the former union leader, one Napoleon Gomez. As leader of the miner's union, Gomez enjoyed the almost fanatical support of the rank and file. But the labor ministry ousted him for alleged corruption, and indeed impelled him to flee to Canada to avoid arrest. Now a major if unwritten demand of the strikers is that Gomez be reinstated and guaranteed immunity by the controlling government officials. And until this issue is settled, there appears to be little chance of restarting production at Cananea.

Scrap. Throughout December, copper and brass scrap prices closely tracked the up and down of Comex quotes for cathode. This has been especially true for the best grades of scrap. Early in December, for example, the Comex price for finished copper jumped to \$3.20 per pound. Within the same trading day the Comex quotes for both No. 1 and No. 2 ingot maker's scrap rose 10 cents per pound, No. 1 scrap going to \$2.95-2.96 and No. 2 to \$2.74-2.75.

Despite market fluctuations, scrap demand from China remains close to inexhaustible. For the first ten months of 2007, U.S. exports of cuprous scrap amounted to 730,556 tons, an increase of 13.9% over the comparable 2006 period. Of the total export amount, the destination for 574,827 tons or 69.1% was China. With plans to electrify rural areas where close to a billion of its people still live, Beijing's hunger for copper scrap is likely to remain voracious for years to come.

STAINLESS STEEL

Nickel. Prices for nickel, the principal alloying agent in stainless steel, continued to erode in December. In November, from a high of \$33,760 per tonne on the LME, the price fell to \$28,150 by month end. This pattern continued in December with the following results:

| | |
|----------------|-------------|
| Open | \$26,800.00 |
| High (Nov. 30) | \$27,005.00 |
| Low (Dec. 4) | \$25,805.00 |
| Close | \$26,700.00 |

Market watchers are not looking for a return of nickel prices to the \$34,000-36,000 range that prevailed earlier in 2007, let alone to the all time peak of \$54,000. As noted below, stainless demand growth is sluggish and almost no one expects a nickel deficit in 2008.

Prices. Despite the weakening cost of nickel, stainless steel prices in the U.S. have continued on the upside, but probably not for much longer. After hitting bottom in October, stainless surcharges have risen for three consecutive months. The latest increase, which took effect with January deliveries, was only a fraction of earlier boosts. For example, the January increase for Type 304 averaged 1.67 cents per pound, raising the surcharge to \$1.477. Comparable figures for other alloys are: 3.39 cents for Type 316, bringing the surcharge to \$2.4484 and 1.19 cents for Type 321 to \$1.6064. By contrast previous recent surcharge increases for these alloys were generally in the range of 9 to 12 cents per pound.

Supply and Demand. A number of reliable indicators point to a slowing of stainless steel demand in the closing months of 2007 and probably through much of 2008. Items:

- The International Stainless Steel Forum reports that worldwide production of stainless steel inched up a mere 0.4% in the final three months of 2007. This minuscule gain contrasts sharply with double-digit increases posted globally in the first two quarters of 2007. Notwithstanding the tiny production gain in the latest three months, the Forum issued a statement asserting that "there is generally a healthy demand for stainless steel."
- Reports out of Beijing tell of plans by Chinese mills to cut stainless steel production by 40% and reduce prices by 6% or more. These moves, according to a report by *AMM*, reflect the need to stimulate demand after several dull months of sales.
- Stainless steel imports to the U.S. declined in October after gaining consistently for much of 2007. Among market watchers, there is a growing consensus that fourth quarter will show comparable declines of incoming stainless shipments. The import

slowdown covers a broad spectrum of products, including a 31.6% decline in cut-to-length plate and a 7.1% drop in cold-rolled stainless sheet.

On the demand front, stainless steelmakers will have a new source of nickel next year if current plans for a mine in Michigan's Upper Peninsula are realized. The facility will be near Marquette and will be the only operating nickel mine in U.S. territory.

The \$300 million venture is a project of Kennecott Minerals Co., a wholly owned subsidiary of the mining giant Rio Tinto. To be known as the Eagle Mine, the facility is expected to produce 16,000 metric tons of nickel over a seven-year period beginning in 2009. The facility is also expected to yield commercial quantities of copper, cobalt, palladium and platinum. The Rio Tinto project will be the first of a number of new mines planned for Michigan's Upper Peninsula and Minnesota. Other proposed mines scheduled for completion within the next five years will produce copper, nickel, cobalt and several precious metals of the platinum group.

RESINS

Plastics Technology (PT) magazine reports that rising monomer prices, coupled with strong export demand, have combined to push up prices on a broad spectrum of resins. Items:

Polyolefins. A 5-cent increase in polyethylene prices has been implemented, and producers are gearing up for another 6 cents within a month or so. Ethane costs have nearly doubled within the last few months, pushing up the cost of PE monomer. Similarly, propylene costs are reaching record levels as crude oil hits \$100/bbl and PP monomer fractions rise accordingly.

Polyvinyl Chloride. Although PVC remains the resin hardest hit by the housing slump, prices are being forced up by soaring raw materials. As in the case of PE, the surge in ethylene feedstock is currently the pricing driver, and another increase in the 4-6 cents per pound is looming.

Polystyrene. Benzene prices appear to be stabilizing, but as in the case of PE and PVC, the soaring cost of ethane-based monomer continues to rise, and *PT* reports that another 2-cent boost for polystyrene resin is expected.

Other Resins. Among other price increases by one or more resin producers are:

Polycarbonates – 9 cents per pound

Polyesters – 12-15 cents per pound

ABS and ABS/Nylon – 4-5 cents per pound

Vinyl esters and gel coats - 4-8 cents per pound

Urethane polyols - 8 to 11 cents per pound

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 11/07 | Previous 10/07 | Year Ago 11/06 | Yrs Ago ² 11/05 |
|-------------------------------------|-----------------|-------------------|-------------------|----------------------------------|
| PIPE, VALVES & FITTINGS: | | | | |
| Copper & copper-alloy tube | 301.3 | 321.2 | 272.5 | 194.6 |
| Steel pipe & tube | 165.7 | 167.3 | 170.5 | 158.9 |
| Plastic pipe and fittings | 198.2 | 194.0 | 205.5 | 220.9 |
| Industrial valves – metal | 176.6 | 176.3 | 164.6 | 147.4 |
| PLUMBING FIXTURES: | | | | |
| Vitreous china fixtures | 96.5 | 98.0 | 101.4 | 101.2 |
| Fixture fittings & trim | 227.7 | 228.1 | 214.8 | 202.3 |
| HVAC EQUIPMENT: | | | | |
| Warm air furnaces | 125.7 | 125.7 | 119.2 | 116.5 |
| Unitary air conditioners | 140.3 | 140.3 | 139.2 | 137.5 |
| Cast iron heating boilers | 135.3 | 133.8 | 128.2 | 122.0 |

NOTES: 1) Sources: Bureau of Labor Statistics, US Department of Labor; compiled for the American Supply Association. 2) Data for 2007 are subject to revision.

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