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## ***STEEL MARKET ANALYSIS & FORECAST - JANUARY 9, 2009 -***

For the first quarter of 2009, we expect secondary steel to be in short supply and at increasing cost. The main drivers will be ...

- tightening distributor stocks
- limited availability at mills and extending lead times due to capacity cutbacks
- renewed order bookings following 2008 yearend inventory adjustments

While steel demand is obviously thin, supply is even thinner. Our findings and forecast are based upon the following context and factors ...

### **ECONOMIC CONDITIONS & INDICATORS**

The economic meltdown has caused historic commodity price deflation. The values of carbon steel, stainless, scrap, aluminum and copper have all significantly declined in the second half of 2008. Last month, Chicago purchasing managers reported that most major metal prices had fallen to their lowest levels since 1949.

Since peaking in May 2008, the Standard & Poor's Index of steel companies dropped 65% through the end of the year. Between 7/1/08 and 12/22/08, the stock prices of US Steel and ArcelorMittal fell 79% and 70% respectively. In July, shares of US Steel peaked at \$196; by late December the price had plummeted to \$36.

Economists expect US gross domestic product (GDP) to remain negative through the first half of 2009. However, improved bank liquidity, recovering credit markets, and the impending federal economic and infrastructure stimulus packages should engender improving demand and inventory rebuilding in the latter part of 2009. Several authoritative stock analysts have recently presented more bullish guidances on certain steel stocks.

### **DEMAND**

The historic 3Q08 collapse of the U.S. financial markets quickly engulfed the rest of the economy (and the world). The industrial sector was especially hard hit. By November 2008, the U.S. Midwest factory index had sunk for the fourth consecutive month and to its lowest level since January 1997. According to the latest Institute for Supply Management (ISM) survey, the U.S. manufacturing sector has fallen to its lowest point since 1980. Car and light truck sales fell to a 10.2 million annual rate in November, the lowest in 26 years. The forecast isn't encouraging -- new orders have contracted since December 2007 and are at their lowest level since 1948. Chicago Purchasing Managers report that order backlogs are at a 28-year low.

Steel demand has fallen in tandem with the US economic and industrial decline. Between January and September of 2008, domestic mill operating rates hovered 83%-90% of capacity. Between October and December, production continually fell from 81.4% to 33.5%. December's steel production represents the lowest capacity utilization since the early 1930s. Many analysts expect 2009 worldwide steel production to fall by 10%-14%. At these levels, it would mark the biggest year-on-year global decline in over 60 years.



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**SUPPLY**

**Mill Production**

The domestic mills have slashed output by about 50% since last September, mainly due to plummeting automotive, construction and appliance demand. Beginning in late August, when US mill output was at 89.1% of capacity, production steadily fell to 33.5% in late December. Globally, steel production began its descent in September and has fallen consistently since then. Practically every mill across the world has curtailed current output by 10%-50%, responding to weak demand.

**Inventory Levels**

With collapsing demand, credit restrictions and worsening cash-flow pressures, most OEMs and distributors depleted their inventories before yearend. At the end of November, U.S. steel service center inventories fell to their lowest levels in eleven years. But many OEMs and distributors take physical inventories at yearend. As shortfalls are found, buyers are expected to place orders for replacement stocks.

**Secondary Steel Market**

As the first quarter of this year unfolds, secondary steel will be less available and costlier. The mills are producing much less, and even fewer orders from which secondary is typically generated (i.e., auto, appliance, office furniture). Moreover, most mills are withholding shipments to credit-marginal distributors. Most steel resellers purged inventory before the close of 2008, especially to generate cashflow against a backdrop of tightening credit. And many have been unable or reluctant to purchase new stocks, fearing weak demand and slow turnover.



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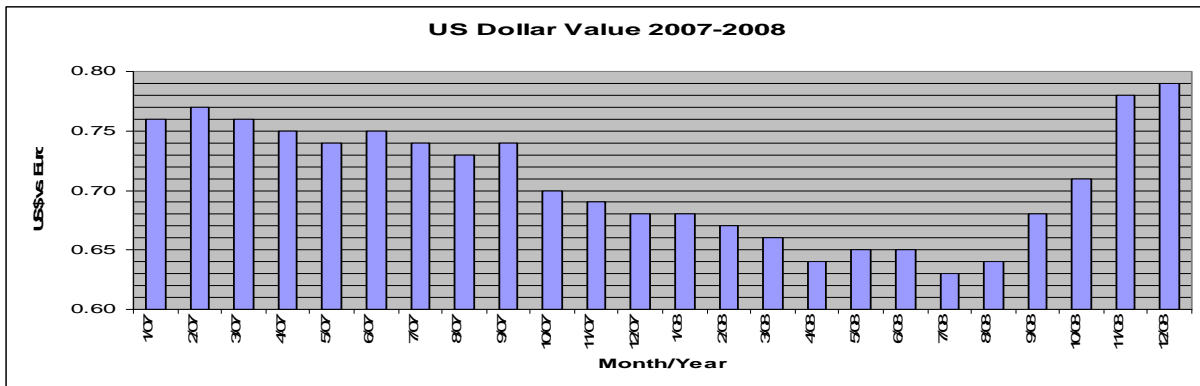
**Imports**

2008 imports registered a drop of approximately 2% compared to 2007. In terms of flat-rolled, compared to 2007 figures, activity was approximately: Hot Rolled Sheet +6.3%, Cold Rolled Sheet -17.6%, Galvanized -7.9%. For the last two years overall imports were sparse, mainly due to the relatively low US dollar value and strong demand from other world regions.

First-half 2009 imports are expected to remain small, especially given weak demand, unclear need projections, risk aversion, exacerbated Just-In-Time (JIT) requirements, relatively low domestic pricing, and severely tightened credit standards.

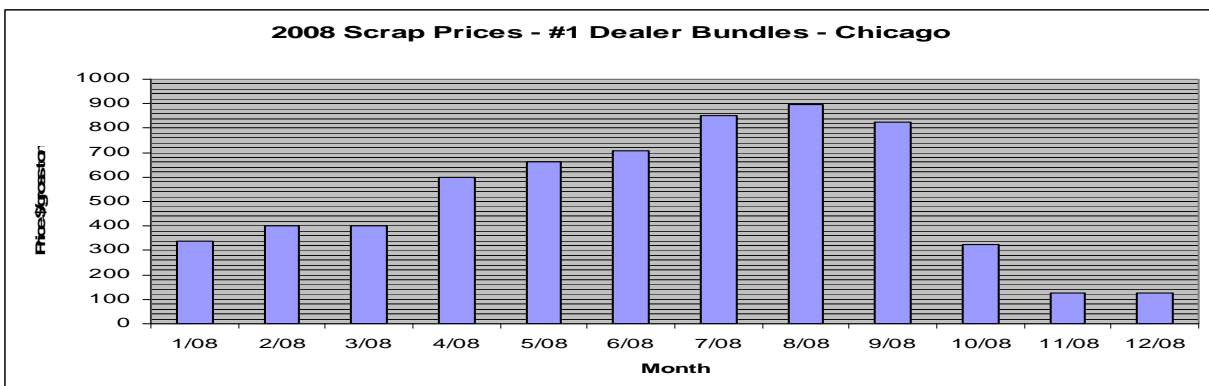
**Exports**

Since last August there has been a significant increase in the value of the US dollar versus other foreign currencies (i.e., Euro). This portends minimal US steel exports, compounded by very low demand across almost all world markets.



**SCRAP MARKET**

As discussed in Essex’s 2008 client newsletters, there was a huge surge in scrap (and other steelmaking raw materials) costs between last March and August. This inflation contributed to steep increases in steel prices. But in September/October, with a weakening economy and shrinking mill order books, scrap prices (#1 dealer bundles Chicago) began to collapse -- falling from \$825 to \$325. Steel prices quickly followed suit. In November-December, prime scrap was down to \$125.



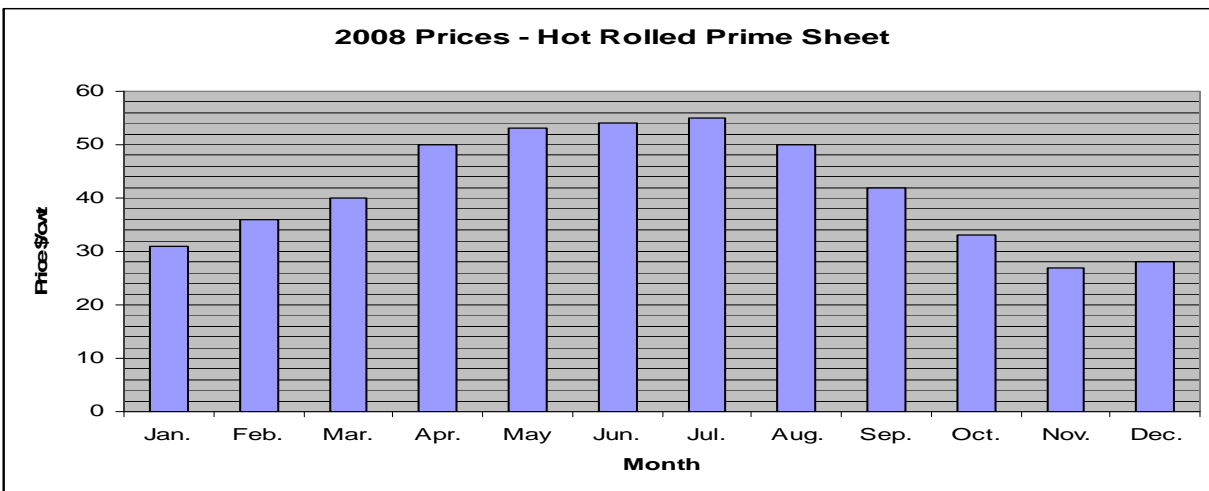


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Prime scrap grade prices increased from \$125 in early December to \$250 in early January. In response to the cost hike, Nucor raised its steel price surcharge by \$90/net ton. With very weak demand from the mills, but minimal scrap inventories in the market, we expect scrap prices generally tracking sideways for January-February. There are also signals of a slight rebound in foreign demand, with an uplifting effect on scrap prices.

**STEEL PRICES**

In 2008 the U.S. experienced an enormous upsurge in pricing through July. As addressed in Essex’s newsletters last year, the momentum mainly resulted from rapidly increased raw material costs, an absence of imports, strong global demand, and the domestic mills’ market dominance. In the third quarter the economy severely worsened, domestic and global demand shrunk, and raw material prices rapidly fell. A precipitous steel price decline quickly ensued, as represented by the following chart ...



**CONCLUSION**

There’s much uncertainty in terms of the economy, industrial activity and steel demand for 2009. Nevertheless, looking closely at industry dynamics, we believe the steel market has bottomed out and is poised for a modest recovery. With indicators pointing to some demand growth, very disciplined mill production practices and low distributor inventories, we expect steel prices to begin a moderate ascent. Particularly in terms of first-half 2009 secondary flat-rolled transactions, given current and near-term industry inventory levels, price increases of 10-15% are quite possible.

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As always, Essex Trading Company will do its utmost to supply you with qualified steel at the lowest prices and top-level service. We appreciate your trust and patronage and extend our best wishes for a happy, healthy and prosperous 2009.