

# Spring Material Market Pressures

*What's causing the escalating prices and surcharges and when can springmakers expect them to level out?*



**A**t its Spring Convention in May 2004, the Spring Manufacturers Institute hosted a panel of wire suppliers to provide springmakers insight into the current climate and what might be expected in the months ahead. The panel included Dan Gutos, vice president of Leggett & Platt Inc. in Carthage, MO (representing commercial-grade materials); Steve Kraft, marketing manager of Precision Steel Warehouse in Franklin Park, IL (representing warehousing and distribution); Kirk Manning, vice president – sales and marketing of Haldex Garphyttan Corp. in South Bend, IN (representing ferrous valve-quality materials); Dave Shollock, product manager of Sandvik Materials Technology in Clark Summit, PA, (representing stainless and nonferrous materials); and Bill Snyder, vice president – commercial of American Spring Wire in Bedford Heights, OH (representing general spring materials).

Snyder opened the discussion with an explanation of the factors that contributed to the rising costs, decreased availability and surcharges on material springmakers have experienced for the past six months or so.

First, he pointed to the shaky domestic steel industry. “The U.S. steel industry is roughly 100 million tons. Of that, 56 million is currently in bankruptcy or has been in bankruptcy over the last 10 years,” he said. “So, over half the industry has been in bankruptcy. In addition to the bankruptcies, there have been a number of closings, so the production capacity has dramatically gone down as well.”

The weakened dollar is another factor. Steel is a product that transports very easily. When the dollar was stronger than other currencies, the U.S. was a very attractive place to import product; now it's not.

Added to that are tariffs. “With nine countries that have a dumping order on them, it makes it very difficult to go and buy product from those countries because they would have to pay a tariff of about 10 to 15 percent to sell product here,” said Snyder.

Furthermore, steel consumption is up, and there aren't enough raw materials to meet the demand. One reason for this is China's rapid growth and increased material consumption. “China is in the process of building 15 cities the size of Columbus, OH,” explained Snyder. “From 2000 to 2004, China added more steelmaking capacity than we are able to produce in this country. Yet, even though China is

rapidly growing its steel industry, it cannot keep up with its internal demands. This is putting a pinch on the supply side of the issue, and a lot of our raw materials, instead of being available for manufacturers in the United States are now going to China.” Though not as dramatically as China, consumption is also up in other countries, such as the U.S. where industries like agricultural equipment, heavy construction and Class A trucks are up 15 percent. This further adds to the steel shortage.

There are two types of raw material used to make wire rod, and both are in short supply. In the U.S., steel producers generally use electric furnaces, which use scrap to make wire rod. Offshore producers often use blast furnaces, which melt iron ore, coke and limestone into pig iron to make wire rod. Scrap and the materials to make pig iron are in short supply. As a result, prices for these raw materials have jumped considerably. Snyder gave an example: “Scrap used to be \$80 to \$150 per ton. It peaked in 2003 at about \$300 per ton. Yesterday [May 3, 2004], it was \$240 to \$250 ton.”

To make matters worse, the cost of the energy steelmakers need to run their furnaces has also gone up, and ocean freight costs have tripled.

“In talking to a lot of the steel people, they've said that at no time in the history of the steel business have they seen a point when all three of the primary drivers of steel prices – metallics, energy and transportation – have all gone up at the same time,” says Snyder.

Because of these cost pressures, “Steel producers are taking a very strong position with us,” Snyder states. “If wire makers want steel, they have to get current on their invoices because the steelmakers are busy. They're no longer absorbing the extent of the cost increases.”

“Put simply,” says Snyder, “the extremely favorable steel market we once knew – excess supply and weak demand, which resulted in continuously falling prices – is gone.”

After Snyder concluded his presentation, panelists were introduced, and attendees invited to ask questions. The first was, “Did the Bush 201 tariffs on steel contribute to the current problem?”

Kraft said that the tariffs actually helped the U.S. steel industry, bringing about consolidation in some cases, and helping steel mills in bankruptcy to become healthy again

in other cases. "I'd hate to think what the situation would be today without some of those suppliers," he said. "In effect, 201 did have some positive impact just because there are more suppliers and more capacity available today."

Shollock, on the other hand, said, "The tariff had very little or no effect on 302 stainless material, the bread and butter of stainless steel for spring manufacturers."

Panelists agreed that duties on rod coming in from other countries, such as Trinidad, Canada, Mexico, Brazil and Europe, have had a greater impact on the current material situation than the 201 tariffs.

Regarding surcharges, one panelist explained that surcharges on raw materials, such as nickel and scrap, are generally set according to whatever the cost was two months prior, so the cost in May will dictate the surcharge for July.

In light of escalating material costs, spring manufacturers are concerned about their ability to honor the pricing structures spelled out in their ongoing contracts with customers. Panelists reported that no wire rod suppliers are entering into any contracts with them beyond a two-month period. Because raw materials are in such short supply, some panelists have been put on allocation for wire rod. One said that his rod suppliers are currently sending up to 30 percent less than what was ordered, and there is no negotiation on price. The exception is stainless steel, which is not as scarce, so there have been no allocations on that material, and none are expected.

Because of the current uncertainty, material is generally purchased according to the price in effect at time of delivery, not at the time of order, said one panelist.

Wire suppliers have helped spring manufacturers communicate the situation to their customers, and even automotive companies have eased up on their cost-down demands. Communication and customer education will remain important during this uncertain period in the material market.

Looking at the future, what, if anything, can be done to alleviate the material shortage?

China banned the export of scrap and coke from their country. The World Trade Organization (WTO) filed suits against China for doing this. India, foreseeing the material shortage, restricted the export of steel from their country and

subsidizes companies that make parts from steel and export them. The WTO will get involved in cases that violate trade regulations, which will help ease some of the global need for raw material.

In addition, bankrupt wire rod producing facilities coming back on line, such as Georgetown, which was recently purchased by International Steel Group, will help ease the material shortage.

At the time of the panel discussion, there were indications that material prices may have peaked. Here is what panelists were experiencing, as of early May:

"I see demand increasing for stainless steel. I see alloy surcharges slightly decreasing," said Kraft. "I see lead times going out, though, on 302 stainless. Therefore, I predict another base price increase this year, but a slight surcharge decrease on 302 stainless this year before leveling out."

"As steel mills look at their product mix, they're going to focus on the areas that are the most profitable," says Gutos. "Historically, wire rod hasn't been one of those areas, so those prices may not go down as quickly as raw materials go down, just because of where their focus is."

Shollock said, "Swedish mills aren't coming to us anymore wanting to sell product in the U.S. because of the currency situation. In addition, Europe is picking up a lot, with Germany being the engine. Therefore, I don't see 302 stainless coming down in price for the next 12 months."

"We saw a decrease in the scrap surcharge from one of our suppliers," says Manning. "However, they increased the base price twice the amount of the decrease in scrap."

So, what does all of this mean?

Many factors have converged to put pressure on the material market. The rapidly growing Chinese economy has been one of them, but not the only one. The soft dollar, troubles in the U.S. steel industry, rising utility and transportation costs, and the recent gains in the U.S. economy have all played a role. The good news from panelists is that they do see an eventual leveling out of prices and easing of the material shortage. However, springmakers hoping for a return to the favorable pricing of the '90s, will be disappointed. That won't be happening anytime soon, and certainly not this year. ❖