Office and Plant:
2800 South 61st Court
Cicero, Illinois 60804-3091

(708) 735-8000
(800) 323-2750

Mailing Address:
P.O. Box 5137
Chicago, Illinois 60680-5137

Facsimile:
(708) 735-8100

December 18, 2009

Bringing Back Manufacturing

In some of our recent letters, we have called for national policies to restore the manufacturing sector. We believe that those policies need not involve a handout to companies, a burden on government budgets or protectionist measures against imports. Certainly, there would be no central planning or "picking winners and losers." Mostly, those policies would require little more than bringing common sense to domestic and foreign affairs.

Over future months, we would like to set out some of these policies – not to suggest that we have all the answers, but to offer our thinking and, perhaps, to stimulate your own.

We begin by addressing China. We are all well aware of what has happened over the past decade – that country's exports to the U.S. have grown and grown, as have our borrowings to cover the cost of our purchases. (In 2008, our imports from China were over $337 billion; our trade deficit was $268 billion. The recession caused a moderation of those numbers this year, but the monthly totals have recently returned to the old levels. China now holds $2.273 *trillion* in foreign exchange reserves, about 65% of which are in dollar denominated obligations.) China has become the equivalent of the smiling corner store owner, willing to sell to us on the cuff as our tab mounts.

It takes no special expertise to know that this state of affairs cannot continue forever. Not only are the trade balances unsustainable, the effects on American manufacturing have been devastating. One can only speculate what will happen if the Chinese launch a major invasion of the U.S. auto market, displacing sales not only from the Big Three, but from U.S. transplant facilities of foreign based producers.

So, what could be done? First and foremost, the Chinese should allow their currency to appreciate; its present undervaluation drives out competition in the U.S. market from both domestic and other foreign suppliers. Some steps have been taken towards this end. Between 2006 and mid 2008, the value of the yuan increased by 21% against the dollar; however it hasn't changed since then. Of course, a stronger yuan reduces the value of the dollar denominated debt held by China, something they are loath to do. Nor would they want to see the prices of their exports to America increase.

There are other steps that the Chinese could take to alleviate the chronic trade imbalance, which bring so much pain to American manufacturers. Foremost among these would be an increase in domestic consumer buying. Today, Chinese consumers account for only about 35% of the country's gross domestic product, about half of the U.S. rate. Moreover, Chinese consumer spending has been in decline as a share of GDP for the last ten years.

The potential of the Chinese domestic market is enormous. China is now the world's largest automobile and "white" appliance market. The country's prosperity has created huge numbers of people able to afford goods. Why don't they buy the goods?

The answer seems to be a combination of tradition – the intangible value placed on saving – and government policies. The savings rate among Chinese families is about 25%. Much of this seems to be due to the surprising fact that, in the Communist system of China, few workers have unemployment insurance and health care insurance is both meager and not widespread. Thus, workers are reluctant to spend for non-essentials or to take on debt.

The Chinese government has said that they understand the need to build consumer spending, but their efforts have, so far, had limited effect. Last year's stimulus package to counter the downturn in exports due to the worldwide recession was aimed mostly at public works projects and investment in plant and equipment, not at improving wages or liberalizing consumer credit. Many of the projects benefiting from that stimulus package look to be wasteful and lacking in any profit potential.

It appears that the national government has begun to recognize these problems, particularly the great disparities in income between the city dwellers and the vast rural population. Credit has been loosened, so much so that the regulators are becoming concerned about future bad debt problems. (Only about 25% of cars are financed, but that is twice the figure of last year. One in eight Chinese have a credit card; in the U.S. the figure is two for every man, woman and child.)

What can we in the U.S. do about all this? Probably not much in the way of a direct frontal assault on Chinese exports. But we can continue to pressure China on the value of its currency, we can take measures against their violations of international trade rules and we can encourage other countries to do the same. China may seem to enjoy an impregnable position, protected by its massive foreign exchange reserves, but, like any other producer, it is dependent on the health of its customers. As that country begins to confront the consumer demands from its domestic population and to satisfy its international obligations, we might just see a tempering of its relentless push to export and some relief for U.S. manufacturers.

Some specifics on cost factors:

- Scrap and Pig Iron Prices for #1 dealer bundles and #1 busheling (Chicago) jumped by $80 (30%) to $340 and $345 per mt, respectively. This may suggest improvement in steel market conditions, but one has to be cautious in this climate of misleading indicators. Pig iron was also up somewhat. The spot price for Brazilian material (cif New Orleans) increased from $310 to $355 per mt.

- Natural Gas Given the renewed interest in using natural gas (e.g., Exxon's planned purchase of a major producer), it is not surprising that prices have almost doubled over the last three months. The Nymex contract price is now $5.10 per mmbtu[1], compared with $2.72 in September.

- Ocean Freight The Baltic Capesize Index was virtually unchanged this month at 5948. Basically, that level marks a return to the situation that prevailed in July and August, before a dramatic drop occurred.

- Foreign Exchange The dollar did some substantial strengthening this month. At this writing, the euro is at $1.43 and the pound is worth $1.61, both down six cents from last month. The Canadian dollar lost a cent to $0.93.

[1] One thousand cubic feet of natural gas (mcf) equals about 1.03 million btu (mmbtu). Thus, the difference between the two measures is about 3%.

This is the time of year for summing up and for good cheer. Can we do both in 2009? We at Corey think so. It has been a trying year. The measures we have had to take to resist the economic storm have been painful and onerous on our employee family. Yet we are optimistic that the worst is now over and that we are positioned to come back strong with
the improving economy. Among the strengths that we see is a loyal customer base, for which we thank you. And we wish you, your families and your company the very best of holiday seasons and a prosperous New Year.

Copyright © 2009 Corey Steel Company
All rights reserved