Federal Reserve Bank of San Francisco

April 20, 1973

Business & Financial Letter

Comeback for Steel?

Cyclical industries, almost by definition, suffer seriously when the economy is in the doldrums, but conversely, when business turns around, their prospects become rosy indeed. Consider the outstanding example of steel. Industry profits jumped 37 percent in 1972, to $759 million, after two straight years of recession-level earnings, and they are almost certain to register another very large gain this year.

Profits will not regain the peak level of $1.07 billion reached in each of the Vietnam boom years, 1965 and 1966, but the improvement from recent depressed levels will be substantial nonetheless. The credit for the present rosy picture goes principally to the nation's industrial boom, but the bright prospects for the future also reflect the stemming of the import challenge and the signing of an agreement which promises prolonged labor peace.

The steel industry historically has been subject to wide swings in demand, generated not only by cyclical movements in general economic activity but by a boom-and-bust cycle of inventory accumulation and liquidation associated with the industry's pattern of labor negotiations. During the 1970-71 period, the industry experienced serious production losses as a result of both of those factors.

Production reached a record 141 million tons in 1969, but then fell sharply in 1970 when activity slowed cyclically in several of its key consuming industries. Output soared during the first half of 1971 under the influence of strike-hedge buying, only to plunge downward again when customers liquidated excess inventories following a peaceful labor settlement in the industry. For 1971 as a whole, production totaled only 120 million tons.

Why the boom?

The first three quarters of 1972 did not look especially strong in comparison with the year-before inventory-accumulation period, but business for the year as a whole was quite healthy, especially in view of the upsurge in orders from two of the industry's largest customers—the auto and appliance industries. Production during 1972 rose nearly 11 percent above the 1971 level to 133 million tons, while shipments of finished steel increased by 6 percent to almost 92 million tons. But neither production nor shipments regained their record 1969 levels.

The import tide meanwhile receded, because of the quota agreement reached with foreign producers in May, together with the growing world-wide demand for steel. Imports dropped to 17.7 million tons, below the record level of 18.3 million tons reached during the strike-hedge buying period of 1971. As a result, the share of the market supplied by foreign producers declined slightly from 18 to 17

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percent. The product mix was heavily weighted in favor of high-value products, however, so that the dollar value of these imports, at $2.8 billion, was the highest on record.

Steel prices increased by an average of 6 percent in 1972, reflecting a first-quarter boost in quotations for most sheet and strip products. Prices remained stable during the remainder of the year, however, as the nation's producers voluntarily agreed not to raise prices again before January 1973. Yet even with the relatively modest improvement in sales, earnings jumped 37 percent, in large part because of very determined cost-cutting efforts throughout the industry. Today, the industry is using 8 percent fewer employees to produce more steel than it did at the 1971 peak.

Further momentum

This year the recovery has gained further momentum. Weekly steel production has risen almost without interruption since the beginning of the year, and early this month was running at a record annual rate of 154 million tons. During the first quarter, steel producers poured about 37 million tons of raw steel. Production was 20 percent higher than output during the comparable period of 1972, and 7 percent above the tonnage achieved during the stockpiling period of first-quarter 1971.

The steel boom started with an upsurge in orders from the auto and appliance industries, and was thus centered initially in the sheet market. But orders from the construction and machinery industries have picked up in recent weeks, so that delivery times have now lengthened for plates, pipe, bar, tube and other products as well. With business plant-equipment expenditures projected to rise about 14 percent this year—the largest gain in capital outlays since 1966—the outlook for continued strength in these markets is good.

Based on the heavy flow of orders, industry officials are now revising their earlier estimates upward. Assessing overall business prospects, it now seems reasonable to expect expenditures for durable goods and structures in real terms to increase at least 11 percent for the year, which would generate record steel consumption in the neighborhood of 113-114 million tons—up from 105 million tons in 1972. U.S. consumers also may try to add at least 2 million tons to their inventories, so that total domestic demand could reach as much as 116 million tons.

How much imports?

Whether or not this range of steel demand will seriously tax the domestic industry's capacity will depend upon the level of imports. Imported steel in 1972—at 17.7 million tons—accounted for 16.6 percent of total supply. But this year there is reason to believe that foreign steel will fall substantially below this level, despite the fact that imports during the January-February period were 21 percent higher than a year earlier. February's dollar devaluation, along with price increases posted by a number of foreign producers, have substantially narrowed (and in some instances eliminated) the price differential between domestic and imported products.

If imports fall as low as 14 million tons, as predicted by some analysts, U.S. firms could find it necessary this year to furnish as much as 102 million tons of finished product for the domestic market, plus another 2 million tons for export. This level of output undoubtedly will strain the industry's basic and finishing capacity.

Costly expansion

During the 1970-72 period, the domestic iron-and-steel industry spent an average of $1.6 billion annually for new plant and equipment—about 22 percent less than it spent annually during the 1965-69 period. Spending for plant modernization and additional capacity in real terms dropped off even more, since prices increased overall, while outlays for anti-pollution equipment accelerated markedly to the point where they now equal 10 to 15 percent of the industry's total capital outlays.

Steel executives estimate that they should be spending $2.0 billion a year if they are to acquire the additional 22 million tons of capacity required to meet the nation's 1980 level of demand for steel. They claim that they must spend about $1.4 billion a year on replacement and modernization just to remain competitive in world markets. In addition, the Council on Environmental Quality estimates that the industry will have spent as much as $3.5 billion on air-and water-pollution abatement equipment by 1976 to meet Federal standards.

Since a long-term debt of $5 billion has left the industry with little unused borrowing power, raising these vast sums could pose quite a problem. As one step towards raising the necessary capital this year, the industry undoubtedly will seek price relief. It has agreed to hold the line on sheet and strip pieces until June 1, but after that date, producers are leaving their options open.

While 1973 is shaping up as a very good year for steel, industry officials see no reason why 1974 shouldn't be strong also, particularly in view of the likelihood of labor peace. The steelworkers union recently signed an historical and innovative agreement to avoid the threat of a nationwide strike when the current contract expires on August 1, 1974. The new agreement calls for a basic wage increase of 3 percent per year, plus a $150 bonus per worker in return for a no-strike pledge and binding arbitration of disputes not settled by April 15, 1974. But the real gain, for workers as well as their employers, is the elimination of the strike threat that leads to hedge buying and heavy importing, followed by a slump in orders when customers liquidate their excess stockpiles.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 4/4/73	Change from 3/28/73	Change from year ago Dollar	Change from year ago Percent
Loans adjusted and investments*	71,145	+ 70	+8,830	+14.17
Loans adjusted—total*	53,653	+117	+9,567	+21.70
Commercial and industrial	19,427	+ 29	+3,239	+20.01
Real estate	15,607	+ 52	+2,586	+19.86
Consumer instalment	8,056	+ 14	+1,442	+21.80
U.S. Treasury securities	6,371	+129	— 527	— 7.64
Other securities	11,121	—176	— 210	— 1.85
Deposits (less cash items)—total*	69,789	+642	+8,322	+13.54
Demand deposits adjusted	21,211	+420	+1,169	+ 5.83
U.S. Government deposits	1,152	—198	+ 298	+34.89
Time deposits—total*	46,056	+ 55	+6,760	+17.20
Savings	18,137	— 18	— 139	— 0.76
Other time I.P.C.	19,039	+ 94	+4,397	+30.03
State and political subdivisions	6,303	— 1	+1,650	+35.46
(Large negotiable CD's)	8,576	+159	+3,588	+71.93

Weekly Averages of Daily Figures	Week ended 4/4/73	Week ended 3/28/73	Comparable year-ago period
Member Bank Reserve Position			
Excess reserves	70	1	33
Borrowings	43	109	0
Net free (+) / Net borrowed (—)	+ 27	—108	+ 33
Federal Funds—Seven Large Banks			
Interbank Federal funds transactions			
Net purchases (+) / Net sales (—)	+325	— 91	—888
Transactions: U.S. securities dealers			
Net loans (+) / Net borrowings (—)	+ 85	+ 24	+411

*Includes items not shown separately.

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