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PRECARIOUSLY BALANCED THUS DELICATE CHOICES

On January 31, we witnessed the end of an era, as Alan Greenspan retired from his post as head of the Federal Reserve Board. (Greenspan is not, however, entering retirement; he has set up a consulting firm and has already developed a good deal of business. For the sake of his paying customers, one hopes that his advice to them will be less enigmatic than his periodic reports to the Congress and the public at large.)

Ben Bernanke, Greenspan's successor is in an unenviable position. On top of having to follow a class act, he is confronted with a singularly difficult economy that he will play a large role in regulating. The budgetary problems caused by huge expenditures unforeseen before 9/11 (homeland security, Iraq and Katrina, to name the largest), by reduced taxes and by new programs have made the economic outlook extremely hard to predict. Thus, for example, rising energy prices are inflationary, but they also act as a constraint on business expansion. The task for Bernanke will be making the very delicate choice between raising interest rates, which could result in a serious slowdown or letting them alone and risking unacceptable inflation. (His preliminary statements suggest that he will be raising rates.)

One thing that will further complicate Bernanke's job is whether the financial markets and the corporate decision makers will have the confidence needed to make the new investments necessary to a growing economy. We have had serious economic problems in the past, but most of the time, people came to the belief that the economic future was bright and justified buying new plant and equipment. (Remember 1992, when most economists predicted that the country would be mired in deficits as far as the eye could see. Confidence was restored, and the economy boomed, when investors and corporate spenders began to accept that Washington was serious about bringing revenues and expenses into balance.)

The present situation leaves the financial and corporate communities in doubt. We shall always be confronted with the unexpected, but now there seems to be the perception that the government is not able to cope, even with those events that are expected (like Katrina). We shall always have those in Congress that wish to spend more and tax less, but people are concerned when the President, unlike any of his predecessors, has not vetoed a single spending bill in five years in office. We have been incurring large trade deficits for decades, but we have not seen an international trading system in such disarray since before World War II.

Thus, to Mr. Bernanke one can only wish luck and success. It appears that it may fall to him to be our best hope of restoring the confidence critical to our economic well being. For that, he will have to out-Greenspan Greenspan.

Now to the specifics for this month:

- Scrap and Pig Iron. Prices for #1 dealer bundles and #1 busheling (Chicago) jumped back up again last month, to $280 and $278 per mt, respectively. The yo-yoing of prices over the last few months, in the $40 to $50 range, probably reflects some market uncertainties. The Brazilian spot market for pig iron (cif New Orleans) also rose, from $235 to $250 per mt. Nonetheless, Brazilian producers have curbed production by 40 to 50%, blaming declining prices caused by competition from Russia.

- Freight Rates. The Baltic Capesize Index declined significantly, from 4300 to 2865, the lowest level since last August, and the second lowest since July, 2003. Cheaper freight rates translate into cheaper imported products.

- Natural Gas. While crude oil prices have seesawed since December, due to unrest in the Middle East, Nigeria and Venezuela, natural gas has declined substantially over that time. At the beginning of this month, the Nymex contract price was at $7.85 per mcf, down almost $2 from January and $5.70 from December. These drops are said to be due to the high levels of natural gas in storage, which, in January, were 16% above the most recent five year average.

- Exchange Rates. As of this writing, the euro stands at $1.19 (down 3¢), the pound at $1.74 (also down 3¢) and the Canadian dollar at 87¢ (up 2¢).

- China. Some interesting numbers: In 2005, China imported 27.1 million mt and exported 27.6 million mt of steel products. These are huge numbers, showing that even a slight swing in domestic demand could alter international market conditions enormously. China produced 349.4 million mt, up 24.6% over 2004, accounting for 31% of world production. China will be spending almost $100 billion over the next five years to upgrade its electricity network – more reliable power, more steel.

Please let us have your feedback. As always, we shall post this letter on our website www.coreysteel.com and on the international site www.steelonthenet.com.