MADISON'S Lumber Reporter

PO Box 2486, Vancouver,
British Columbia V6B 3W7 Canada
Tel: 604-319-2266
e-mail: madrep@shawcable.com

March 5, 2018

Please find below the results of our investigation into questions regarding a possible difference between North American softwood lumber prices into USA and those domestically within Canada, in view of the latest US softwood lumber duty.
Further details in the sections that follow:

OVERVIEW OF CURRENT NORTH AMERICAN LUMBER MARKET

The forest industry in North America is integrated, such that the wholesale price of manufactured wood products are quantified in US$ per thousand board feet (US$/mfbm), whether sold in Canada or in the US. Due to the sheer size of the customer base of the latter, the balance of supply-and-demand in the US determines the price of lumber.

Softwood lumber demand within Canada is only 10 per cent the size of the US, thus buyers in that country have little-to-no impact on the movement of prices.

Canada's export market is much larger than is the domestic. In order to tackle the analysis below, Madison's examines the price trend of British Columbia exports of lumber to Japan (i.e. wholesaler import prices of BC wood delivered to port in Japan) for 2017/2018 to help answer the question of what is happening for domestic customers.

Madison's regularly collects information on the market dynamics for players in Canadian (and US) wood products markets. For this request we reached out specifically to, 1) domestic Canadian customers and, 2) Canadian companies operating as exporters to countries other than USA.

A question has arisen:

- why there is apparently no price difference between Canadian sales to domestic markets and sales to US export markets.

The short answer is: because the Canadian market is too small. These customers do not buy in large enough volumes to be able to influence the direction of prices.

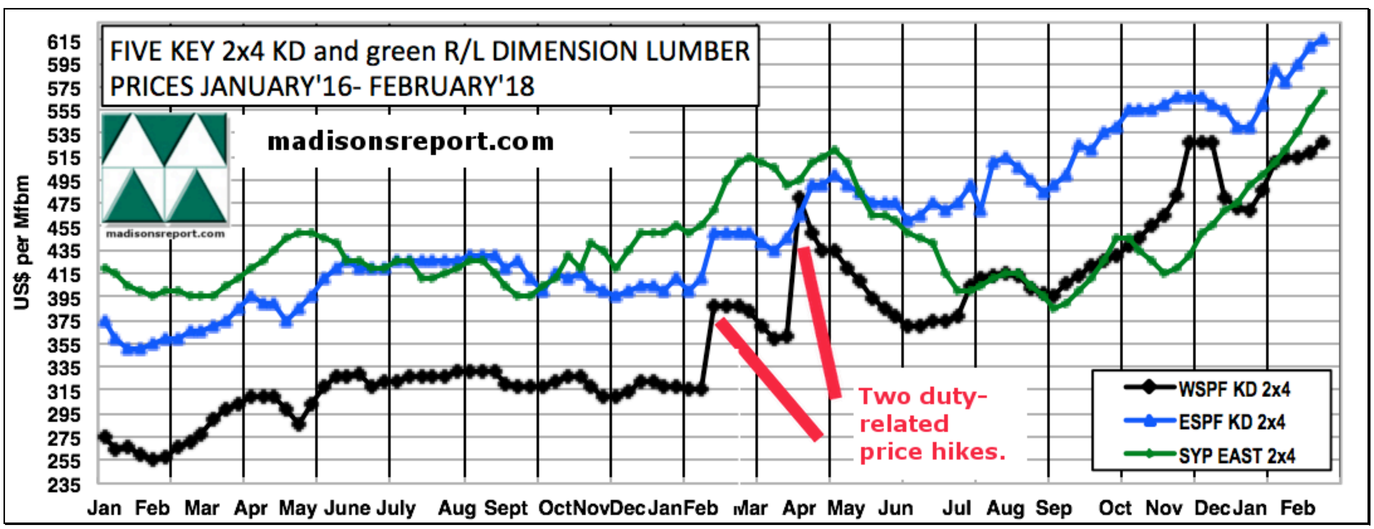
The longer answer is: the established supply chain for the movement of Canadian wood assumes it will be delivered across the US border. Even though exports of Canadian wood to the US have dropped from a stable 85% of total historically to 60% since the US housing crash of 2006, transporters expect this product to move south.
In essence; the producers "don't care where the wood is going" once it leaves their sawmill gate.

Delving deeper into the mechanics of the lumber marketplace; during previous enaction of a duty, the ratio of how much of the attendant price increase for lumber could be passed on to customers, and how much the producers would have to absorb, was dependent on the strength of US demand. In a "normal" lumber market (high sawmill capacity utilization rates, steady lumber sales, good log supply) the established wisdom has estimated the first 5% - 10% of any softwood lumber duty could be passed on to the customer in the form of higher prices. Any duty rates higher than that had to be paid by the operator.

At the beginning of 2017, when the Preliminary Determination of the now-Final US softwood lumber duties was starting to be announced, the demand for wood from the US was very strong, and did not abate as the year continued. The producers tested the market with sharp price increases; specifically on benchmark commodity WSPF KD 2x4 #2&Btr (but also on other species/products, however usually with a lag of a week or two). Over the following weeks producers haggled with customers (counter-offers) and the eventual price settled lower than the intial quotes had been, but much higher than it had been before. This means that demand was stronger than supply, and the majority of customers needed more wood than the sawmills had in stock.

Another such price test came a couple of months later, but over the following weeks was knocked back down almost to where it had previously been (graph below). However, into August and beyond, information on the loss of timber volumes due to wildfires started to be revealed. So that looming threat to supply served to boost prices up to where operators had tried to raise them a couple of months earlier.

At this point it is impossible to determine how much of these price increases are due to strong demand/lowered supply and how much is due to the duty. Canadian customers have little-to-no leverage to even start such a conversation with a sawmill.



The reality in the forestry marketplace right now is that the impact of reduced timber availability in the vital fibre supply baskets of British Columbia and Quebec puts upward pressure on prices even without a duty.

The dual circumstances of, 1) the duty rate being applied and, 2) various sawmills coming to the end of a significant portion of their merchantable timber supply has served to create a seller's market. There is a legitimate feedstock problem for producers, while actual demand for wood for real building projects in the US (not speculation or inventory building) is steadily increasing.

EXPLANATION OF RESPONSES FROM SOURCES

DIRECT ANSWERS FROM MADISON'S WEEKLY LUMBER MARKET SOURCES –

"We're not discounting [as a result of duties] for the Canadian market unless it's a product that's a nightmare to move, and we don't really have any of those right now."

- Suppliers, whether producers or secondary sources (wholesalers, reloads) have had low inventories on most of the usual commodities for about a year, and are not currently much inclined to offer price discounts to anyone.

"Pacific Rim countries and other alternative markets [to the US] are driving prices just as much as US duties. This demand is real, and is strong enough to the point that **prices of low grade items to offshore markets and Canadian markets are at levels much higher than they could get trying to sell the same low grade to the US (even with prices inflated by adding duty percentages)**."

- Support for this explanation is offered by a Canadian sawmill which sells significant volumes of western SPF #3/Utility and #4/Economy grade 2x4 and 2x6 to packaging manufacturers in both Canada and the US (to be used as components for pallets, crating, and other dunnage). Demand for sharply-rising standard grades is overflowing into lower grade commodities and causing price operators to quote their customers at levels too costly to produce and sell pallets. Essentially, the cost of the wood is too high for whatever they might be eventually able to charge buyers for their pallets and crates. These lumber customers are looking to other materials for feedstock (i.e. plastic), or are discontinuing production of packaging for the time being.

The above comment echoes a different source (below) who exports #1/Premium grade (J-grade) from BC to Japan, and who said the price of standard grade #2&Btr 2x4s has risen to match the recent price of #1/Premium grade. He is right now getting quoted from BC sawmills the same price for J-grade as he is for #2&Btr.

Historically, J-grade products would be at an approximately $50 premium to #2&Btr (again FOB mill). Lumber sales into Japan are conducted on a quarterly basis, for the coming quarter. The increase in #2&Btr prices of early 2017 reached the ears of negotiating customers in Japan by third quarter 2017 (tables below).

Madison's source explained that customers in Japan are suspicious of these large price increases that have happened so quickly, and are suggesting they are due to manipulation by the producers, not the reality of market conditions.

LATEST JAPAN IMPORT PRICES OF BC SPF LUMBER VS 2017
(SOURCES: Japan Lumber Reports, Japan Lumber Journal)

February 9, 2018 — Japan Lumber Reports

Market Price Guide

Species, Size, Grade	FOB truck per cubic meter (Actual Volume)	Feb.7	Jan.24	Last Year
Dimension Lumber -- Importers' price				
SPF(B.C.)	2" x 4 - 8" KD 8' - 20' J grade	50,000	50,000	37,200
"	2" x 10 KD 8'-20' J grade	57,000	57,000	42,200

Japan Lumber Journal — Thursday, February 15, 2018

Japanese market Indications — per cubic meter

	2017	2018	
	Feb	Jan	Feb
Dimension Lumber	(Yen; wholesale prices, on truck; green count)		
SPF 2x4~8", KD 10~20' J-grade	45,000	48,700	49,000
SPF 2x10", KD 10~20' J-grade	49,000	53,700	54,000

COMMENTS FROM ADDITIONAL SOURCES MADISON'S SPECIFICALLY ASKED –
"One of the largest operators in BC has said that demand in the North American market skyrocketed in the past two quarters. In Oct/Nov my [export excluding USA] customers noticed that the price of #2&Btr was approaching that of #1/Premium (J-grade)."

IN SUMMARY

This latest US duty on Canadian softwood lumber imports came at a time when demand for wood was very strong and growing, while supply of logs was becoming increasingly threatened. The terrible wildfires of 2017, the actual timber loss of which is still being quantified in the most-affected regions, propelled lumber prices even higher than the duty.
In previous disputes supply was robust and unyielding and the US was purchasing 85% of Canadian lumber production, thus customers were able to negotiate counter-offers among their various suppliers, which lowered the ratio of the duty rate in the selling price of lumber.
This time, lumber customers are having a hard time locating the wood they want from anyone and are not in a position to negotiate price reductions for any particular reason. They need lumber for projects already started and those ongoing.

RESULTS

Current very positive US housing starts and home building/remodelling/renovation activity is expected to continue through the building season of 2018 at least. Thus there is currently no price differential between Canadian lumber being sold to the US compared to any other country (including domestically within Canada).
Madison's would be happy to revist this question again next quarter.

Keta Kosman
Publisher
Madison's Lumber Reporter, est. 1952
Vancouver, BC, Canada
www.madisonsreport.com
604 319-2266