

## 2011 Lumber Market Wrap-Up and January 2012 Analysis

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### OVERVIEW

The lumber market hung on this autumn with no perceptible motivation except for putting one foot in front of the other. The goblins kept their tricks to themselves and offered no alternative for entertainment. Toward the close of the year, JIT buyers and those looking to fill inventory gaps were forced to order from lumber producers. Sawmill order files grew to a week or three weeks depending on the commodity and region, and stayed that way right to the end of the season. All sides of lumber market participants expect the New Year to pick up exactly where 2011 left off; severely depleted lumber inventories, zero wood available through the supply chain, and all orders going directly to sawmills.

Once seasonally curtailed mills come back online during the first week in January, the scope of the lack of inventory will become more clear. There is a very real likelihood that the small uptick in demand experienced during December will continue unabated. Should sawmill order files stretch out beyond three weeks, lumber prices will naturally rise accordingly.

- **China's market is sleeping, not dead. Expect bottom to be hit within a few weeks.**
- **There is a use for humans after all, machines aren't doing a very good job of predicting the market.**
- **Its no surprise that ESPF low grades stick or slip slightly in price at this time of year.**
- **No one disputes that cedar makers will take a plunge in log supply this spring.**

*Madison's* predicted in 3Q 2011 that without the large volume lumber buying by China of the past two years in November, there would more bankruptcies and permanent mill closures. In mid-December a larger, private, Quebec lumber producer filed for creditor protection. Groupe Cedrico, with four mill operations and 440 employees, is asking the Quebec government for a 30 day loan extension. While that extension will probably be granted, the likelihood of the company pulling through intact seems small. At best it will successfully restructure, closing its less efficient mills. It is more likely, however, that a buyer will swoop in to take over Cedrico operations at a discount, with particular view of gaining access to the significant timber supply attached to those mills.

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### MONTHLY RECAP

- At the end of November it was apparent there would be no long-awaited surge of buying from China as has been in the past two years. Large volumes of freshly-delivered wood imports were still being digested in distant regions of that country. At that time US customers bought in enough volume to drive dimension lumber prices up.
- It is not only China, but Japan, the Middle East, as well as Korea, Taiwan and other Asian nations, that were either entering into or getting back in the lumber game in 4Q 2011.
- In China the low grades were ordered, while customers in Japan value every North American white wood J-grade stud as the quality item it is.
- Traders noted in early December that the market was very close to bottom, and that Chinese customers would not wait for the bounce, they were poised to buy. As a result, sellers were quoting prices only one week at a time.
- In mid-December the increase in buying from China showed a change in customer focus. Smaller orders of higher grades have become the norm, rather than massive low

grade orders. Meanwhile, US, consumers have figured out that "buy American" may in fact be a good idea

### SHORT TERM ANALYSIS

Customers in China have changed their preference, to using commodity studs as they are rather than putting more labour into putting low grades through their mills again. The Chinese have found that the investment in cash is just about the same and they end up with a better product when ordering the item in completion from North America.

In the last full work week of December, one large central interior BC lumber company was the recipient of a huge order for western spruce into China. The request was mainly for low grades but the sheer volume of the one-time order affected all grades and, to a certain degree, all species.

Taiwan is now following China's early lead of two years ago by going with low grade studs. The Middle East, not having the milling infrastructure present in China and Taiwan, is now buying the full blown high grades. As money is no object to the Middle East, they can buy whatever suits them in any time period.

Price negotiations for studs heading to Japan are already in full swing for 1Q 2012, thanks to the desire for J-grade lumber in that country.

Some sources say Canadian makers are selling to off shore customers at less than that for which they are processing orders to the US, which has American buyers unhappy with the current state of affairs. It possible the Canadian mills are doing what they can to secure Asian customers who will be making large regular orders in the future. Also, a looming additional duty on only BC wood going into the US under the 2006 Softwood Lumber Agreement would become a deterrent for BC producers to ship to that country in a tight market.

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### MONTHLY RECAP

- Always more volatile and predicated on emotion than the cash market, lumber futures seem to be settling into the regular activity of years past. At the close of the November contract was the exit of several funds, with another approximately 21 funds that had short lumber positions exceeding 25 contracts.
- Lumber wholesalers were pleased with themselves at having predicted the close of November futures accurately, and enjoyed the spike in cash prices.
- By mid-December, lumber producers realized the floor on prices had been attained. The long-planned extended curtailments for this winter were correcting the supply-demand balance in favour of sellers.
- One continued mystery is KD Douglas fir. Prices on that commodity should be doing much better than they are given current market conditions.

### SHORT TERM ANALYSIS

Into December, the lumber supply pipeline emptied, customers had nothing on hand and they were beginning to panic. Mills well know this scenario and it is becoming increasingly difficult to get any sellers to listen to counter offers. Buyers are losing their edge in price negotiations, a situation which will surely continue in the first two weeks of January at least.

Wides, used predominantly in multi-family building, were the best seller. 2x10 is already impossible to find and that means value. Given the serious log shortage, the obvious question for the New Year is: where does everyone think the wider, and longer, dimensions will come from when the only timber left in the yard is spindly leftovers from the most recent sizable harvest?

The issue for Douglas fir, both KD and green, in large part stems from the seemingly unquenchable hunger of offshore buyers for logs. Barely surviving fir mills on the west coast of the US are finding fibre costs, even after a recent log price correction downward, prohibitively expensive for running lumber at current those price levels.

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### **MONTHLY RECAP**

- At November end, Eastern sawmill order files of only minutes, plus or minus one week, meant there was plenty for prompt delivery depending on the item. However, a lack of stock in the field meant buyers had nowhere else to turn but lumber producers to replenish inventories.
- By mid-December, order files were approximately ten days at most Eastern mills but that was on specific items only. The common items were available for prompt shipment without even being listed.
- Eastern inventory managers watched the lumber stocks dwindle as December waned, and brought new stocks in on a controlled basis.
- As seasonal curtailments arrived toward the end of December, there were no big needs noted by Eastern traders and not much was booked for next year as yet.

### **SHORT TERM ANALYSIS**

It would seem that anyone who wants to order should get on the ball. With inventory levels this low, even a small uptick in demand as the New Year ramps up will sent an alarm through the ranks of buyers. This scenario happened twice in 2011; suddenly within one week retailers and stocking wholesalers called the mills at once, each thinking their small order to fill inventory gaps was no big deal. But added together the volumes were significant and some mills reported order files raced out to six weeks. Lumber prices firmed as a result. Once production reached levels to satisfy the surge in demand, order files shrank back down and prices softened. However not to previous low levels.

Each time this scenario has unfolded in the past 18 months the price of lumber settled higher than it had been before. As spring approaches and the beginnings of US home building recovery materialize, lumber prices will continue in their upward direction.

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### **MONTHLY RECAP**

- 1Q become a major cause of discussion before December was even half over, especially when it came to timbers.
- At the close of December, cedar producers declared 1Q 2012 as "looking good", with many customers coming in early for nibbles.
- Cedar log supplies were drying up but there wasn't much floating in the river to draw into the mill yard either. Cedar producers were confident that they would have enough materials to go around when they gear up in January.
- By December end it was the rough timbers that were hot, not the highly processed products. The unfortunate result is that bigger logs are needed for the timbers and nobody has those.
- The spring buy is shaping up well. Makers will take a plunge for domination in materials.

### **SHORT TERM ANALYSIS**

Cedar log supply on the west coast of BC has finally diminished to nothing, coinciding with the lack of need for more production on the year end schedule. The cedar business normally tapers off to year end but now the decline is sharply marked.

Cedar traders said they would have liked to keep the mills humming right up until the Christmas weekend but were discouraged by the total lack of logs. The only choices left to cedar mills as the New Year gets going is either: not paying more for logs; or, being more careful with their utilization. As program buyers confirm 1Q 2012 orders pencilled in through December, mills will have to look seriously at investing in logging for the spring. Timber prices will likely rise in January, with channel and bevel siding and almost certainly shakes and shingles following suit a few weeks later.