



February Lumber Market Analysis

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OVERVIEW

February 2012 was the month all players in the North American lumber market realized that depleted solid wood inventories throughout the supply chain are going to be a huge problem going forward. Producers crowded as prices on some items shot up by as much as \$70 mfbm within one week. Suspicions are that, with demand resuming in earnest, sizable volumes of specific dimensions are being ordered once again, causing significant price adjustments as mills dust off long-unattended price lists.

From the perspective of a long-time industry watcher, some of the price spikes didn't make sense. There is a puzzling combination of circumstances going on; customers have for so long been accustomed to just-in-time buying that the concept of actually stocking up on wood has escaped them completely, while producers are looking at empty log yards knowing well that there are only fewer workers available to call back into the forest to resume timber harvesting in earnest.

These opposing scenarios are going to collide into a lumber and panel supply crunch this building season not previously seen on this continent. At least not in recent memory.

- **One Studs seller was determined to drag prices up, "kicking and screaming if need be".**
- **Utility grade items continued their price climbs this week.**
- **Panel products firmed up in price as customers were shocked at how scarce many items were.**

The strong upward movement in panel prices forecast in the previous issue of your *Madison's Investment Rx* have become a reality. Even at writing, the relentless increase in OSB and plywood prices show no signs of slowing. With standard grades and sizes already in high demand before spring even gets going, it is not difficult to determine what will happen following the Easter long weekend. Not to mention specialty panel items and sizes; these will be almost impossible to source.

Expect panel producers across North America to jack prices up as close to previous historic highs as they can for the rest of this year, and to express great glee while doing so. It was only early summer 2009 that OSB 7/16" Ontario crested C\$410 msf for several weeks running. While an improvement over the break-even \$190 average for the past two years, the current price of \$225 is barely a trifle compared to price levels coming soon.

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MONTHLY RECAP

- In the first week of February studs mills noted a growing order file, which gave traders confidence to hold prices firm.
- Preposterously good early February weather in the east of North America prompted studs producers to continue running wood while the supply chain was problem free.
- While the pleasant weather held, transportation presented no problems, also unusual for the season.
- In mid-February, studs producers reported mill order files to the end of March.
- By the end of February, stud mill managers gazed at almost empty log yards with fear.

SHORT TERM ANALYSIS

In keeping with other aspects of the business of lumber, the nature of US home building has undergone a significant shift, which will become the norm through 2014. New multi-family housing will lead the building recovery in America. Not until 2015, when demographic pressures, new household formations, and improving economic conditions meet, will total US housing construction again approach one million annualized units.

In the meantime, builders have shifted their focus to multi-family units, as retiring baby-boomers downsize, existing home-owners are pushed out of foreclosed properties, and renting becomes increasingly more attractive while real estate prices remain depressed.

The weight-bearing characteristics and structural integrity of different types of studs, as well as machine-stress rated lumber and other engineered wood, is changing the balance of demand for these commodities. As spring moves on and the 2012 US building season commences in earnest, it is straight lengths, specifically 8' and 9', and 2x6 studs, that have leapt up in prices most.

Its still too early to tell what impact this desire for new commodity mixes will have on the overall market. So far it seems eastern stud mills, as well as those that focus on more than the standard WSPF PET 2x4's, will be the first to benefit.

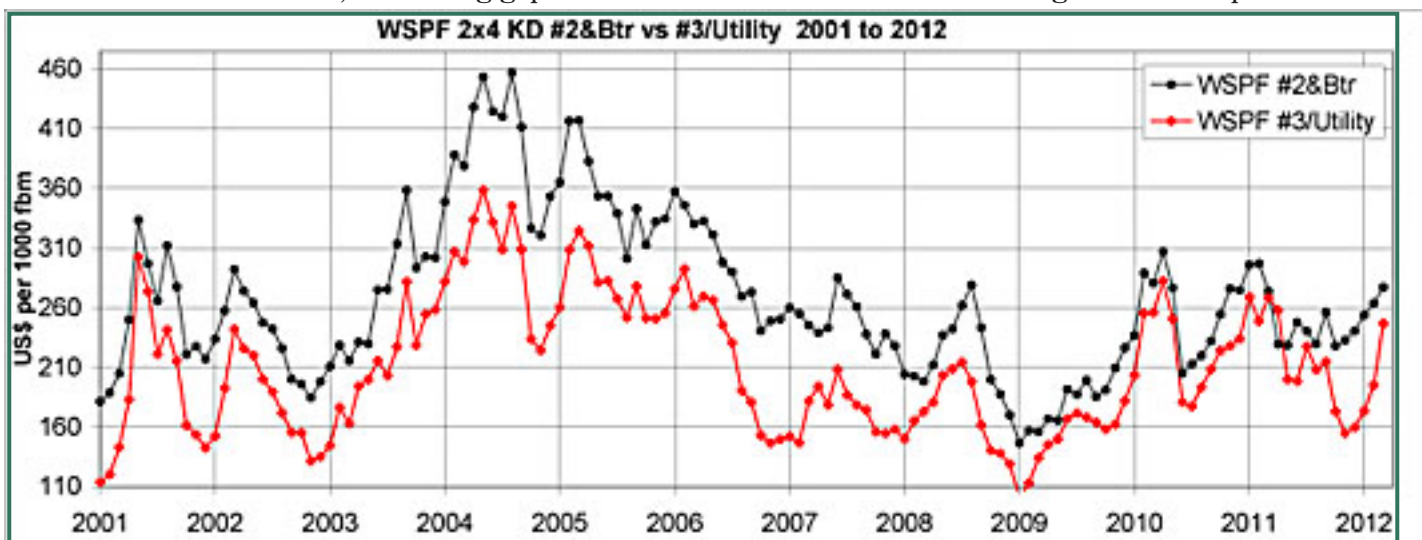
Utility grade items continued their price climbs this week.

MONTHLY RECAP

- In all species, low grades ruled the market.
- Immediately following the end of Chinese New Year celebrations, customers from that nation once again bought in large volumes.
- In mid-February, steady demand for standard construction grades brought producers happiness, while skyrocketing buying of low grades made them positively giddy.
- As February drew to a close, a spurt of such intense buying occurred that traders barely had time to close one deal before attending to the next. The recently hot demand for low grades was translating into other commodities.
- At February end, evidence of sustained interest in low grades materialized even in green Douglas fir, a species not normally associated with China's value buyers.

SHORT TERM ANALYSIS

As has already happened twice since Chinese lumber buyers became a force in the business of selling North American lumber, the closing gap between #2&Btr standard construction grade lumber prices and



its #3/Utility counterpart will bring a shift in China's buying. In late 2009 and again in spring 2011, a run-up in low grade lumber prices foreshadowed a switch to the standard grades by Chinese customers.

Always looking for a value, these new players will once again surely notice that #2&Btr lumber, across all species this time, is at a discount compared to the low grades. Competition will be fierce as domestic buyers try to outbid each other for orders. Producers will delight in playing customers against each other.

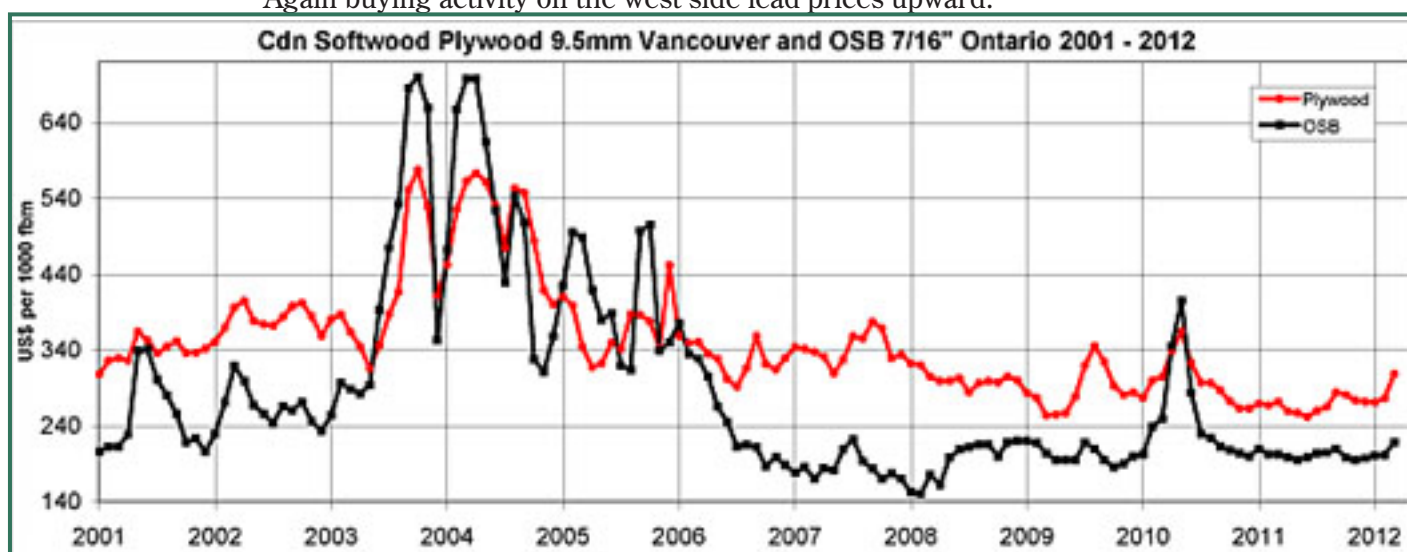
With each successive phone call to discuss counter-offers, sawmill price lists will be only higher.

Whichever customer is first to commit and 'show the money', will be the one to accept actual delivery. Everyone else will have to wait for fresh logs to be put through the mills.

Panel products firmed up in price as customers were shocked at how scarce many items were.

MONTHLY RECAP

- Bizarre price fluctuations in January for no logical reason resulted in February's higher settlements, for both plywood and OSB.
- In mid-February, emboldened west side panel producers held prices firm despite slightly weakening demand.
- Panel customers were back to buying only a few weeks' supply at a time in the third week of February, but producers were having none of it. Counter offers were ignored as OSB and plywood prices kept an even keel.
- By the end of February, panel buyers finally figured out that there wasn't going to be enough wood to go around and tried to hide their sense of panic when phoning mills. Again buying activity on the west side lead prices upward.



SHORT TERM ANALYSIS

It is inevitable that there will not be enough panel products to go around for what will admittedly be a short US home building season this year. While it is true that OSB and plywood mills across North America have been kept warm and have undergone regular maintenance by owners, there will still be a time lag between an increase in demand and the ramp-up of production. This lag will, in part, be deliberate.

The other part of the reason for low panel supplies will be that producers fully intend to keep their growing numbers of Asian customers satisfied. Unlike their dimension lumber counterparts, panel is indeed used almost exclusively for building in China. The manner of this building, however, is unlike that in North America.

Plywood is used for concrete forming, in residential buildings yes but also for elevated rail line towers, noise-reducing walls and other types of barriers, plus various industrial and commercial purposes. These types of projects are performed on a massive scale, with long term outlooks, and under the management of government. The usual North American issues like building season, economic cycles, weather, etc, will not come into play as the government of China rushes to complete projects already started.

Buyers in North America will find their orders slotted in between runs of plywood and OSB headed for waiting containers to go offshore.

CONCLUSION

The 2012 Easter long weekend will be a game-changer for anyone involved in the North American solid wood industry. As April rolls along, players will look back and ask, "Why couldn't we see what was coming?"

Already in March the reality of restricted log supply is dawning on producers. Many have called around to their former logging contractors and truck loggers to find either the phone not in service or the operator doing business in another sector. Spring snow melt and rains are almost upon us; mills without decent log decks will have to wait until the roads dry out in early summer before they can send heavy equipment into the forest.

By then their customers, in the habit of keeping zero lumber inventory on hand, will be panicked at delivery delays. All customers will be able to do is wring their hands and wait for the supply chain to be replenished.

That, and helplessly watch lumber prices climb ever higher.

