



June Lumber Market Analysis

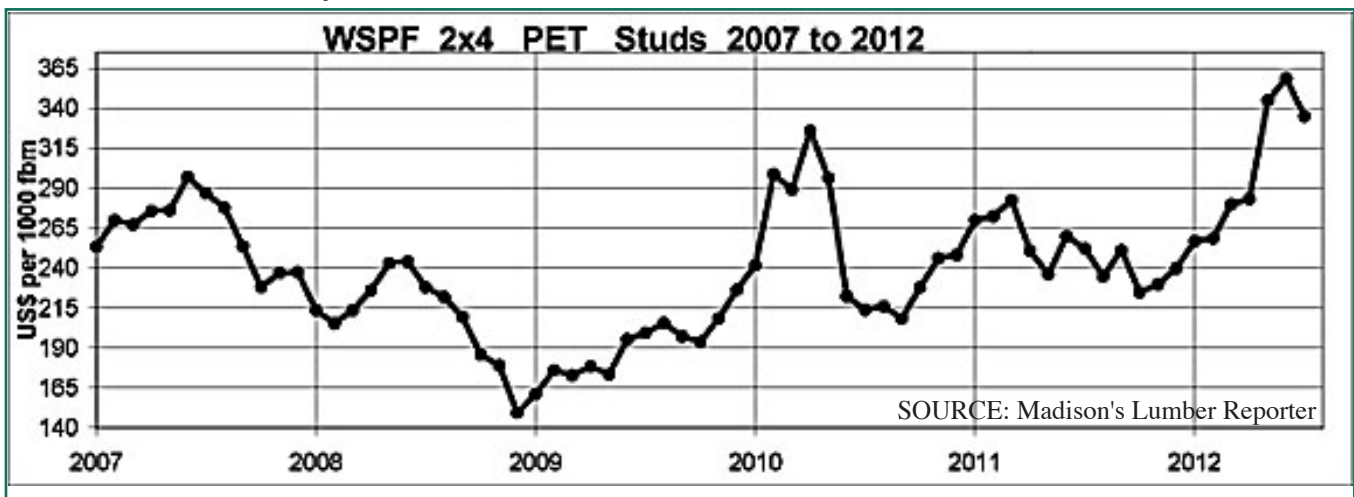
By Kéta Kosman

July 17, 2012

OVERVIEW

June 2012 marked the first time in the history of the 2006 Softwood Lumber Agreement that the export tax was reduced by two increments in consecutive months. Starting June 1, British Columbia and Alberta paid 10 per cent tax instead of 15 per cent, while Ontario, Quebec, Manitoba, and Saskatchewan paid 3 per cent instead of 5 per cent. On July 1 those amounts were 5 per cent and 2.5 per cent respectively.

Judging by the rate of softening lumber prices since mid-June, it is reasonable to expect that for August 1 the tax will return to the June rates.



Traditionally the national holidays of Canada and the US throw a wrench into the business of selling and buying lumber. Either the celebrations are an unwelcome interruption to trading activity, or the market is already so slow that players treat themselves to extended vacation time. Anticipation of the dual holiday, and how it will effect the lumber business, is always a hot topic as June draws to a close.

This year was no exception. What was different was that opinions varied as much as the individual. 'Your guess is as good as mine,' was the mantra. As this continuing recovery for the North American lumber industry stumbles along, even the most veteran traders are unsure of its format and pacing. Everyone is discovering this strange new world at the same time: as it happens. While many might pine for the bare-approximation of stability of recent years, this recovery is welcome regardless of its clumsy form.

- **Eastern species lead the lumber market with sharp price increases.**
- **Stubborn customers lost the waiting-game battle as prices refused to come off.**
- **Panels continued their hot streak of late, while the dimension market sagged.**
- **Transaction levels remained high even as lumber prices softened significantly.**

For now producers are celebrating prices not seen since 2006, while wholesalers are astonished that customers keep coming back for more and more wood. And in higher volumes than they have needed for the past four years. In the past, lumber prices have lead US new housing figures. In February and March, the big builders place their orders for May and June building. Not so in the past few years, both because the rate of new home building was so low and because customers could get whatever wood they wanted within three days. So why stock up?

That deplorable supply/demand situation is now firmly in the rear view mirror. Already customers are changing their buying habits to adjust to the new reality, or return to the old reality depending on one's point of view. Should demand drop off by the end of summer, as it most likely will, the requisite drop in lumber prices shouldn't be as severe as it has been in recent autumns.

Eastern species lead the lumber market with sharp price increases.

MONTHLY RECAP

- As May ended, ESPF buyers did their best to resist the inexorable price gains, but many found themselves looking at bare inventories. These simply had to bite the bullet and buy.
- In the first week of June, eastern producers sold at slightly lower volumes than the previous few weeks, but were able to maintain strong prices regardless.
- A big dip in Southern Yellow Pine prices in the second week of June attracted notoriously disloyal lumber buyers to that species.
- By the third week of June inconsistent buying began to affect producers. Some still could barely run enough wood to fill their orders while others had more inventory on hand than they knew what to do with..

SHORT TERM ANALYSIS

While it is becoming increasingly difficult to project the rate and details of this recovery, one thing is beyond question: the rise in lumber prices this year is due to growing demand from the US. Eastern SPF producers have been poised for improved business, and were quick to leap when American customers came calling.

The transportation routes of old, along the St. Lawrence Seaway and through southern Quebec and Ontario, began to again carry trucks and rail cars full of lumber headed south.

Lumber prices in eastern Canada behave differently than in the west. There is less volatility with ESPF, in general due to a more risk-averse culture among producing companies. Also, the constraints of seasons are more pronounced, which makes log supply a more tricky game, especially during spring and at the height of summer. Primary lumber producers in Quebec and secondary remanufacturers in Ontario are accustomed to the full-time shutdown of forest and sawmill operations as the summer months heat up.

This year, it seems US customers may begin to flounder as July wears on and August temperatures hit. Eastern Canadian mills that did not sufficiently stock up on logs in advance of the Canada Day long weekend will run out of fibre by September. Previously this would not be an issue because US builders, reloads, and retail yards would have stocked up on lumber by the national holidays.

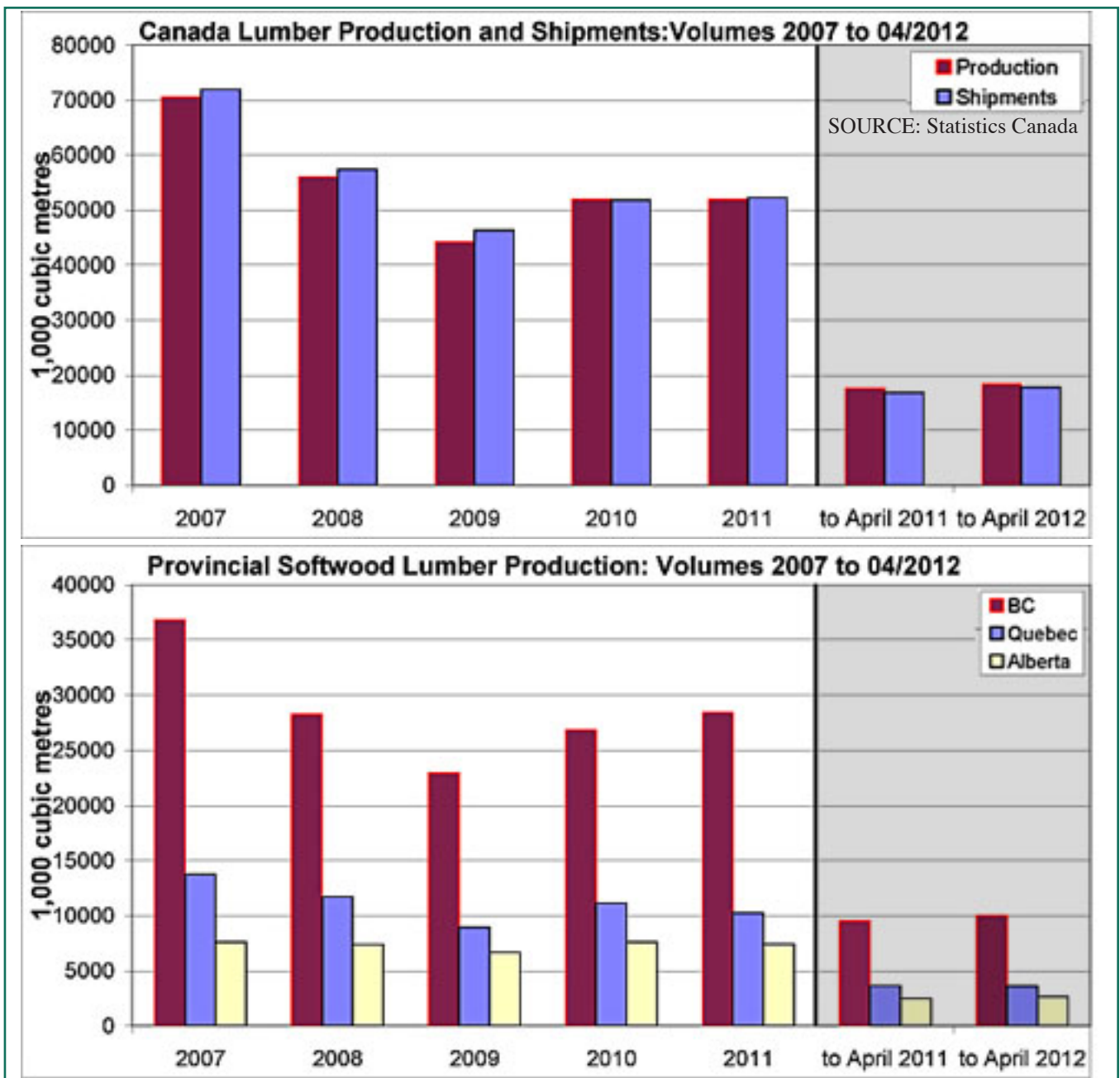
However this year, players have chosen to continue the practice of just-in-time buying, returning to the sawmills sometimes more than once a week to order for immediate needs. August is not a time to break ground for new home building, but it is a month to complete construction already started. Those not carrying inventory in August may not find the wood they need from suppliers in eastern Canada.

Stubborn customers lost the waiting-game battle as prices refused to come off.

MONTHLY RECAP

- At the end of May, strong demand from the US kept dimension lumber sellers busy on phones selling wood.

- As the first week of June drew to a close, WSPF sellers noticed a discernible slowing of inquiries.
- By mid-June, lumber traders were spending more time closing up previous transactions than booking new orders. Prices, naturally, dropped to reflect the weaker demand.
- In the third week of June, skittish customers awaiting a 'wall of wood' from Canada to hit the US border held off buying on the expectation that increased supply would drive prices lower.
- June ended with enough trading to keep everyone busy. The looming combined Canada Day/Independence Day holidays had players wondering what the beginning of July would bring.

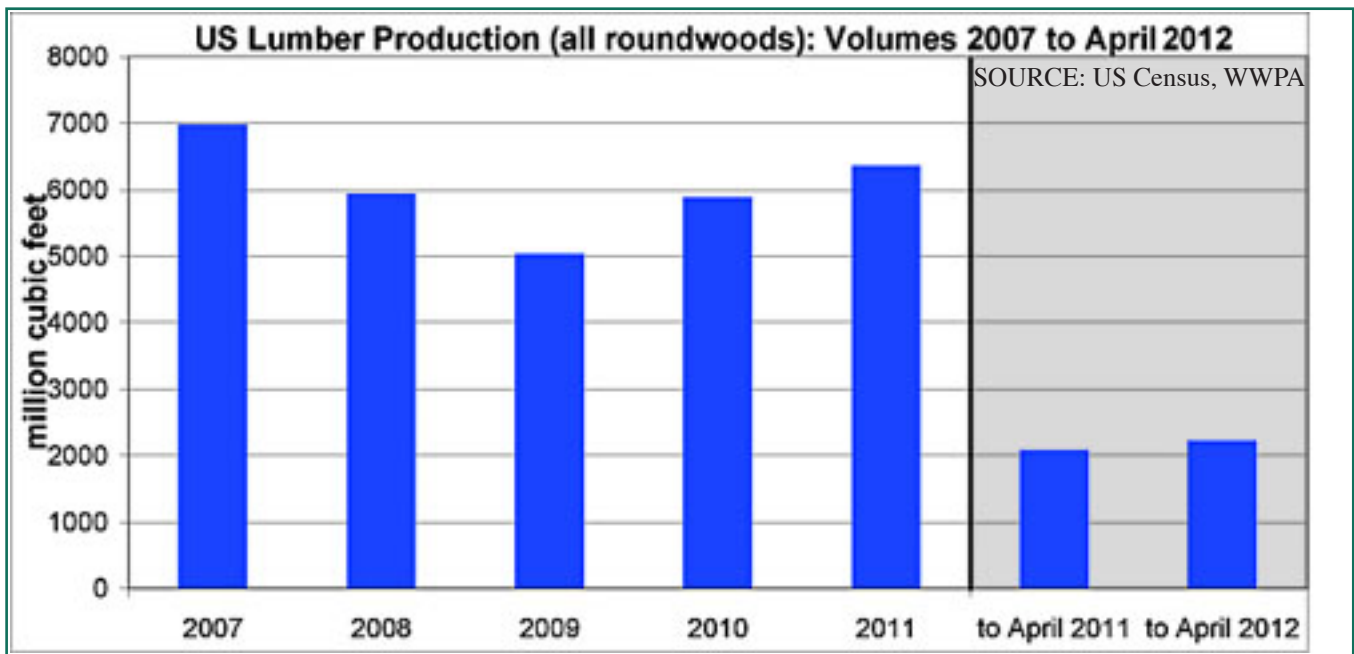


SHORT TERM ANALYSIS

The peak of lumber prices so far in 2012, in fact for 2011 and 2012, was at the start of June. Those levels held relatively firm until the third week of that month, then prices started to soften. The efforts of customers to push back on producers worked, if only a little bit, to bring prices off recent highs.

The two previous experiences, however brief, when the tax rate on Canadian softwood lumber shipped to the US was reduced fostered complacency with jaded customers. Expectations of a repeat of producer overshipments were as unfounded as they were misguided. Regardless, customers put the brakes on buying in the hopes that surplus supply would force prices lower.

No such 'wall of wood' materialized this time, however.



Panels continued their hot streak of late, while the dimension market sagged.

MONTHLY RECAP

- On the very first day of June, inquiry and purchasing of panel products – especially in the east – increased to such a degree that one and all were caught by surprise.
- At the close of the first week of June, order files at panel mills grew to five weeks. Glee-ful sellers put prices up accordingly.
- Despite lumber prices falling in mid-June, hot demand for panel kept OSB and plywood prices up. At this point western mills were getting as many calls as their eastern coun-terparts had been enjoying all month.
- By the third week of June, either panel customers had finished placing their necessary orders or the increasingly softening dimension lumber market was translating to panels.
- At the end of June, plywood prices remained firm but their sexy cousin, OSB, did not fare as well. This could bode for lower plywood prices in the coming weeks.

SHORT TERM ANALYSIS

Panel producers are very disciplined. There are fewer OSB and plywood mills than di-mension lumber mills, and fewer companies focussed on that product mix. While panel products seldom experience sickening price drops – because mills are quick to curtail or even go off the market – price surges are much more frequent. Panel sellers are expert at imbibing a sense of panic with customers. So often in the past plywood prices

have absolutely gotten away from buyers. And at great margins. One only needs to experience a \$100 msf price spike over the course of a week once to become very gun shy.

Even the slightest perception of constricted panel inventories sends customers to the phones placing orders for advance needs.

Transaction levels remained high even as lumber prices softened significantly.

MONTHLY RECAP

- At the end of June, the looming combined Canadian and US national holidays put their usual drag on lumber prices.
- As June closed, beleaguered US west coast mills finally got some relief when green Douglas fir prices popped.
- Eastern stocking wholesalers reported "good activity" at the end of June, but delivered Douglas fir prices were stagnant.

SHORT TERM ANALYSIS

Continually troubled Douglas fir producers did not benefit from the upswing in framing lumber prices. US west coast mills followed up on their warnings of curtailment, bringing a much-needed correction to the supply-demand balance. Green fir mills have not been running at full capacity for a long time, which has allowed them to constantly perform the maintenance work that most mills have to shut down entirely to accommodate.

However, volatility prevailed even in this market segment. As summer came on in full force, specialty mills on the west coast were no closer to understanding where this year was going to take them than they had been in January. Painful days on end with no worthwhile phone calls were followed by days of relentless ordering. For example, on a Monday a particular trader was lamenting the abundance of KD fir in his yard then was jumping for joy Thursday after selling it all, but one car of the dried wood.

The sharp ups and downs of this roller-coaster recovery makes it very difficult for mills to plan, and to put into play much-needed investment. As the hot summer months come on, sales books and balance sheets will show a clearer picture of where companies stand.

CONCLUSION

This sustained run on solid wood products has caught almost everyone except *Madison's* regular readers by surprise. Significant customer resistance to rapidly climbing prices, combined with vague suspicions that the reduced export tax would result in large volumes of wood crossing the US border, managed to reverse the rising trend somewhat. The basic fact of supply-demand prevails in the end, however. Despite what futures speculators and bearish observers might suggest, the secondary market for wood products in North America is dangerously understocked.

One significant forest fire, transportation problem, labour dispute, or other such major event will thrust buyers into panic.

Traditionally, home completions and renovations in the US do not slow down until after the Labour Day long weekend. And depending on the weather can continue well beyond that. Players with minimal wood on hand at this point will surely get caught short. When it becomes apparent that there are only a few sources for wood, the rising price cycle of early June will repeat. At even higher levels, most likely.