

October Lumber Market Analysis

By Kéta Kosman

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OVERVIEW

The epic storm, a confluence of three damaging events, which hit the eastern seaboard of North America at the end of October caused a fundamental shift in an already undecipherable solid wood market. Dubbed, alternatively, "Frankenstorm" and "SuperStorm Sandy", this disastrous event wreaked such havoc that the final tally was not yet available at time of writing.

It is not simply a matter of counting how many homes were damaged or destroyed and figuring out how much lumber and panel will be needed to rebuild and repair. Serious questions are being asked about the location of the worst-hit homes, and whether building there should ever take place again. In the meantime, the damage to one hundred-year-old infrastructure, and the interruption to supply chains due to transportation problems, are severe.

The last of these factors will affect the North American solid wood market for several months to come, if not longer. Some industry insiders dismissed suggestions that Sandy will have a significant effect on real lumber pricing, using Katrina as an example. This is not an equal comparison. There are almost no similarities between Katrina and Sandy. If drawing a conclusion about how lumber prices will react to the recent disaster, one would do well to look at the series of tornadoes which hit the Midwest in spring 2011. More on that to follow.

Key ideas for October 2012 lumber and panel markets:

- Prices inched further downward as trading volumes stabilized.
- Strong buying from China helped prices remain flat instead of trundling further down.
- Prices increased; most commodities were trading strongly thus gained ground.
- Futures bounced up, driving some buyers to cover longer term needs.

COMBINED U.S. AND CANADIAN RAIL TRAFFIC: OCTOBER 2012*							
(5 weeks ending November 3, 2012)							
Commodity	Oct 2012	Oct 2011	Oct 2010	Difference		% Change	
				'12-'11	'12-'10	'12-'11	'12-'10
Forest products	88,841	87,179	84,816	1,662	4,025	1.9%	4.7%
Primary forest products (3)	15,134	15,652	14,894	-518	240	-3.3%	1.6%
Lumber & wood products	30,052	26,754	23,092	3,298	6,960	12.3%	30.1%
Pulp & paper products	43,655	44,773	46,830	-1,118	-3,175	-2.5%	-6.8%

(3) - wood raw materials such as pulpwood and wood chips
 *Data are originations and are not seasonally adjusted. Source: AAR Weekly Railroad Traffic November 8, 2012

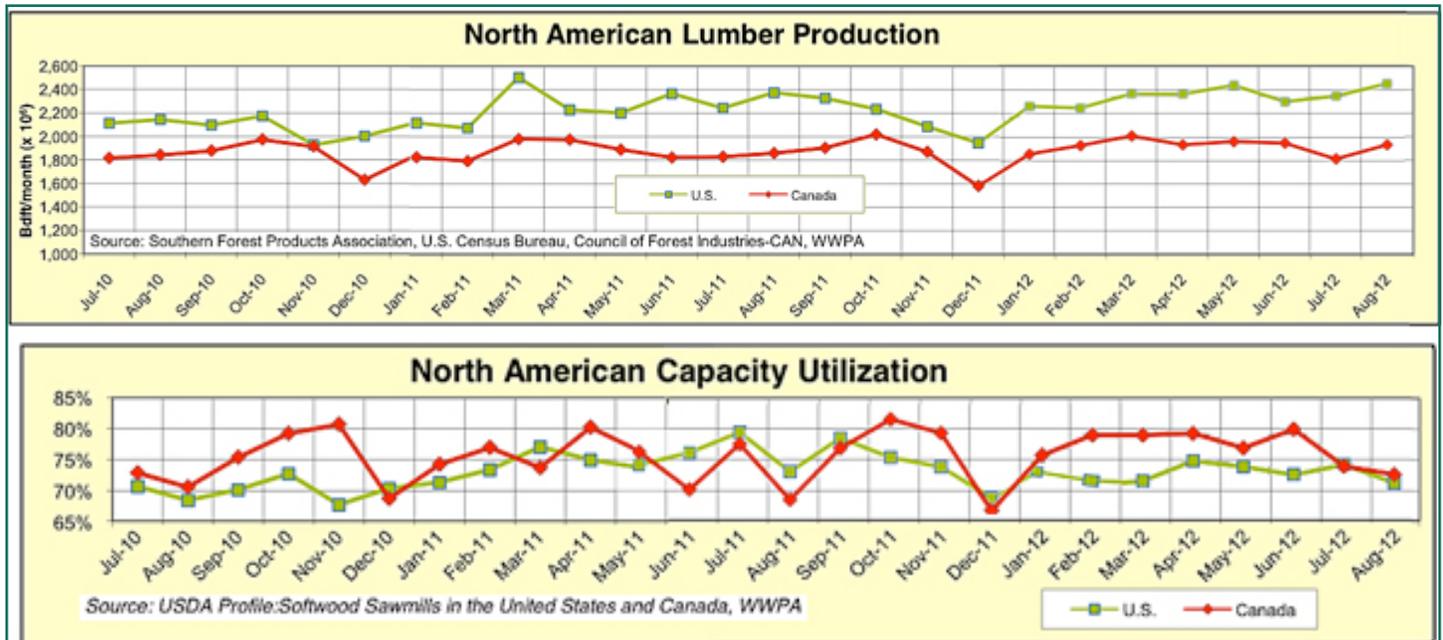
Prior to the devastation of Sandy, lumber and panel prices were wavering higher at a very unseasonal time of year. These price levels were buoyed by US buying, not that from China, a critical point which cannot be overstressed.

Industry watchers tend to look for easy answers; they want to point at a single event or circumstance which determines market movement. But, as with most things, the dynamics and supply and demand in the solid wood industry are subject to a combination of factors.

Strong lumber prices in October were a function of: severely reduced field inventories; a shift in sentiment due to sharply improved US home building and home sales; and, several large volume sales to customers in China. Weather events generally do have an impact on lumber and panel prices, either beforehand for protection or afterward for reconstruction. The scope of Sandy's effects is signified more by its location and the dense population levels than by actual damage to wood-framed homes.

It is very important for the northeast of the United States that business return to normal quickly. Ports, roads, railways, fuel delivery, and more, must come back online as soon as possible. Whatever cleanup, shoring up, fixing up, and rebuilding that will take place will make use of all manner of materials.

In the months to come, it might not be so easy to point at forest products and say any shift in market conditions is the result of one single event or another. The reality for lumber producers and consumers currently is that any increase in demand will be immediately felt at the sawmills.



Prices inched further downward as trading volumes stabilized.

MONTHLY RECAP

- Sales of Western-Spruce-Pine-Fir were again muted in the first week of October.
- With the demand flattening out, ESPF producers breathed a sigh of relief as some pressure was eased. Customers got more comfortable at these slightly lower prices, and were snapping up any items they liked the look of.
- Green Douglas fir trading got a shot in the arm; 2x8s, 2x10s, and 2x12s all jolted up in price and inquiry
- The big Chinese buys of dimension and framing lumber that happened Friday the previous week percolated into further inquiry for studs. On Monday of October's first week, traders saw some encouraging hustle.
- All Western panel prices came off hard in this week. Players hoped that with such drastic drops in price, the market would settle at a bottom soon.

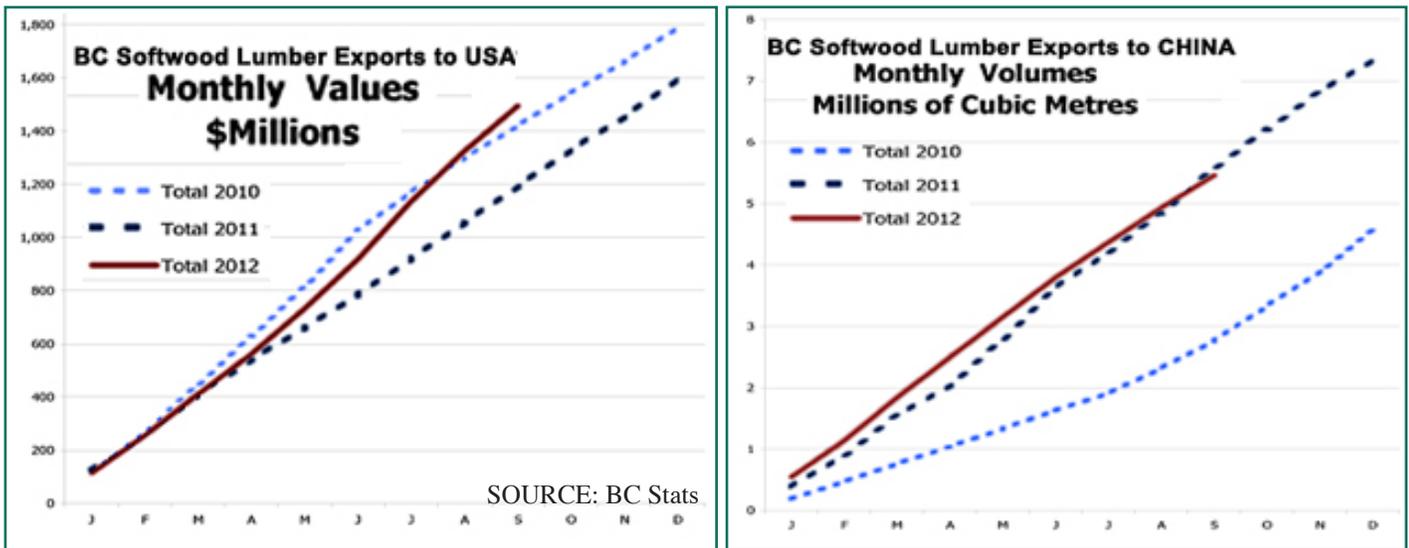
SHORT TERM ANALYSIS

In all, business was greatly improved over this time in 2011. Sentiments expressed by buyers and sellers were bullish, albeit framed by surprise. The small but relentless uptick in demand from the US culminated in improvement across successive quarters for the first time since 2005.

Players from both sides of the border referenced the importance of big offshore purchasing just before the close of October's first week. Chinese buyers came to the table in force and

caused a stir throughout the market. Everyone was cautiously excited for that momentum to continue the following Monday, but it did not carry through.

However, as the days and weeks progressed the volumes sold to China in October were nothing to sneeze at.



Strong buying from China helped prices remain flat instead of trundling further down.

MONTHLY RECAP

- In the second week of October, Chinese customers raided the North American lumber supply. One trader even went so far as to say that the market was being driven almost entirely by buying from that populous country.
- Supply of green Douglas fir 2x10s was almost perpetually shy of demand since there are so few sawmills producing that size.
- Chinese buyers again took advantage of the seasonally slowing market in North America, buying big in what would normally be a softening market.
- Southern Yellow Pine 2x10s were significantly easier to source, and their delivery was more timely as well.
- Panel prices in the East and West continued to stagger downward.

SHORT TERM ANALYSIS

Large volumes of studs were snapped up by overseas customers in mid-October as they entered the fray and bought in full force. According to one seasoned WSPF player, 75 per cent of the transactions from Chinese buyers were in framing lumber and the remaining 25 per cent were in studs. These customers from the far East bought loads of studs not for immediate consumption but for storage.

Following the previous week's inability of Kiln Dried Douglas fir producers to meet demand for 2x10s, much of their business was co-opted by the Southern species. Such is the lumber game: there is no loyalty. Customers will switch, at the drop of a hat, to a more plentiful or less expensive commodity. Even if that means accepting a significantly poorer quality product.

After enjoying recent record-high prices, OSB and plywood prices fell off rapidly into October. The only comfort in such rapid drops of panel prices was that every step down brings more customers to the table. When panel prices waffle on a weekly basis, it indicates that players are struggling to find an acceptable price level. How long will this struggle last? The odds, and historical prices, say that come February customers will be on the losing end as OSB and plywood prices will begin their usual seasonal climb in advance of the usual US home building season.

Prices increased; most commodities were trading strongly thus gained ground.

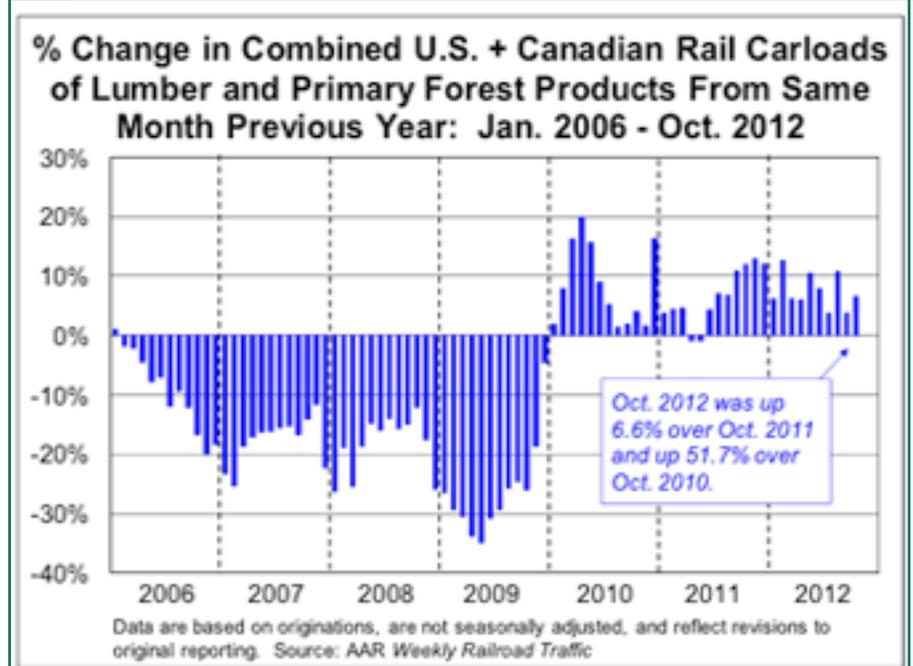
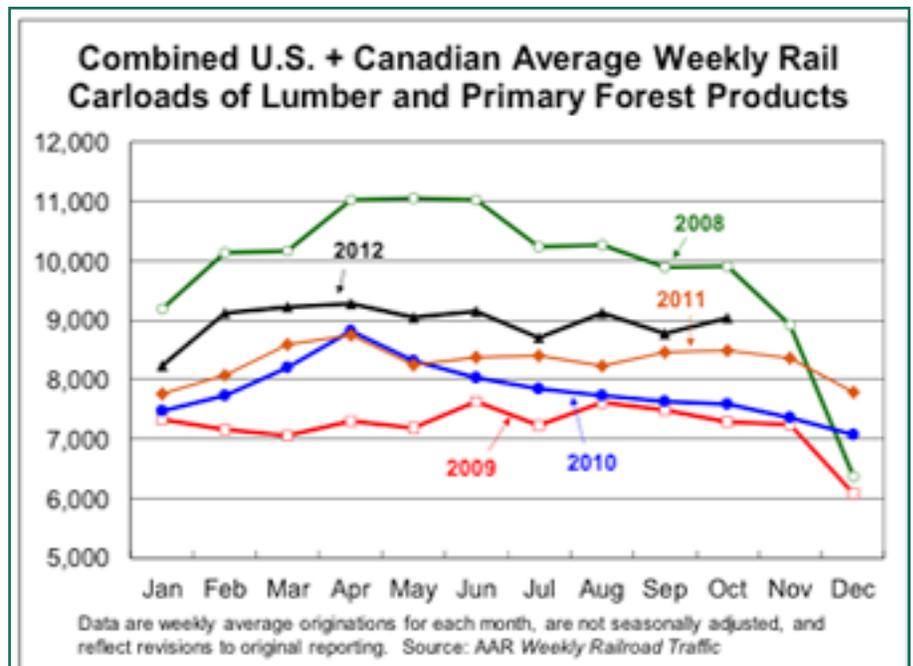
MONTHLY RECAP

- In the third week of October, traders from both sides of the border moved huge amounts of construction grade Western-Spruce-Pine-Fir 2x4s .
- In green Douglas fir, the number of buyers exceeded the supply.
- All lengths of WSPF studs were fervently sought after in the third week of October.
- While Oriented-Strand-Board in the east firmed up \$15 on regular sizes and \$30 on thicker panels, eastern plywood tanked again.

SHORT TERM ANALYSIS

Where in the previous week impressive inquiry and buying of studs from China whipped up a maelstrom of sales, the third week of October had American buyers snapping up every stick they could find. Sawmills expressed surprise at this untimely buying, but did not question. They merely booked as much wood as they could and watched their order files grow ever longer.

Kiln Dried Douglas fir was signified by light field inventories. Many downstream buyers had tried to "live off the land" until the third week of October, but their stocks had gotten to a desperately low point. They were forced to return to the table and do some purchasing, even if they didn't like current price levels.



Futures bounced up, driving some buyers to cover longer term needs.

MONTHLY RECAP

- At the end of October, sales of WSPF were pretty steady until Wednesday, at which point traders got increasingly swamped with inquiries.
- ESPF producers comfortably quoting into November were now looking further forward to push their order files into the New Year if possible.
- The buying momentum of studs continued unabated as North American business was at the table, along with overseas purchases from China.
- Kiln Dried Douglas fir producers were busy, busy, busy in the last week of October.
- Oriented-strand-board prices in the east bounced up finally, and customers responded in waves of deals.

SHORT TERM ANALYSIS

Apart from Sandy, the weather has been very kind this season across almost all of North America. Mindful that winter, in the end, will indeed come, ESPF Inventories in the field appeared to be tight, as customers came in and bought to try and stay ahead of the winter curtailments looming on the horizon.

Not unexpectedly in a hot market, KD Douglas fir mills apparently got too excited at the end of October and upped their prices too aggressively in the face of increased buying. Vendors lamented they should have been building their order files instead. The delicate supply-demand balance is still too tenuous to pin down. Producers must remember not to jump the gun. The days of two-month order files are not that far behind us (READ: 2003). Its just that so many remember only the heydays of 2005 and 2006 and nothing else.

It is for suppliers to remain patient and secure ordering into the future BEFORE pumping up prices too much. Lumber buyers are notorious for blanching at price increases they consider too steep. Better to go incremental and have a good reason to show for the ever-climbing rates..

CONCLUSION

The word out of BC Forestry Innovation Investment after the series of tornadoes in the US midwest last year in the spring was that all of the rebuilding and repair in that area was served by local lumber producers. At that time, no one needed to order wood from Canada to fix up or rebuild their home. In spring 2011 the lumber market was in a much worse state than it was in October 2012.

Due to continued severely depressed buying from the US and a year-and-a-half lull in significant buying from China, lumber producers at that time were desperately seeking customers. Sawmill capacity was low enough that mills adjacent to the tornado-affected areas had no problem filling the spike in demand.

Fast forward to this October and the situation is almost exactly reversed. Lumber and panel inventories across North America are seriously depleted while demand is marching staunchly higher. Sawmills have already ramped up production, as the WWPA graphs on Page 1 demonstrate. It is reasonable to expect that again locally-situated mills will be asked first for wood to rebuild and reconstruct the US east coast.

However this time, when that existing capacity is sidelined from regular, hungry, customers, inquiry will reach further across the continent.

With inventories as low as they are now and the supply chain – from reloads to wholesalers to retailers to box stores – relying on sawmills to supply all their wood, the next few months will show a rush of buying from producers.

Order files are already two to three weeks depending on the region and commodity. It is due to this that prices remain high. Come February, when still no one will have stocked up on inventory, sawmills will be enjoying demand at least as strong as it is now, if not stronger. Order files will stretch out even further, and prices will naturally respond by going up.

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