

January Lumber Market Analysis

By Kéta Kosman
February 21, 2013

OVERVIEW

The dismal state of the past five years of making and selling solid wood in North America blew away in December. The stubborn resolve of customers to continue their practice of just-in-time buying reared up to bite them in their very-surprised tushies. Equally mired in the market doldrums set upon in autumn 2006, producers could barely believe this reversal had actually happened and continued to run their operations very conservatively.

Everyone was waiting for the post New Year's week: if the seemingly impossible circumstance of continued strong demand occurred then lumber producers would consider adjusting their capacity. As prices held their high ground in the second week of January, celebrations quietly broke out among North American solid wood traders.

Apart from a brief levelling-off after mid-January as the supply chain absorbed this new, more expensive, wood, those celebrations have continued. Indeed they have increased in intensity.

Key ideas for January 2013 lumber and panel markets:

- **The New Year brought a mixed bag of interest. However prices were up across the board.**
- **Pricing remained firm even though inquiry continued the previous week's wane.**
- **An arctic outflow brought temperatures way down across North America, stalling all outdoor activity.**
- **Prices dropped precipitously, by mid-week such volumes were sold that the correction was immediate.**

So what is to come of this seeming new reality for the forest products industry? Short term memories being what they are, players are slow to understand that these price levels are not exceptionally high. It only seems that way when compared to the past five years, that being the most epic slowdown for the making of lumber in history. Naturally things would not remain depressed forever.

Key Prices				SOURCE: Madison's Lumber Reporter			
February 01, 2013 <small>Prices are in U.S. dollars per 1,000 fbm.</small>	This Week	Last Week	Change	Month Ago	Change	Year Ago	Change
WSPF KD R/L 2x4	370	380	-10	362	+8	255	+115
WSPF KD R/L 2x6	370	390	-20	386	-16	255	+115
WSPF KD R/L 2x8	362	385	-23	362	0	250	+112
WSPF KD R/L 2x10	394	400	-6	368	+26	314	+80
WSPF KD PET 2x4 Stud	300	325	-25	325	-25	260	+40
WSPF KD PET 2x6 Stud	285	315	-30	305	-20	305	-20
Douglas Fir Green R/L 2x4	360	355	+5	300	+60	230	+130
Douglas Fir Green R/L 2x10	355	355	0	328	+27	330	+25
ESPF KD 2x4 8ft Stud	395	410	-15	390	+5	330	+65
OSB Ontario 7/16" (CDNS)	380	380	0	335	+45	203	+177
CSplywood Toronto 3/8" (CDNS)	437	437	0	410	+27	319	+118

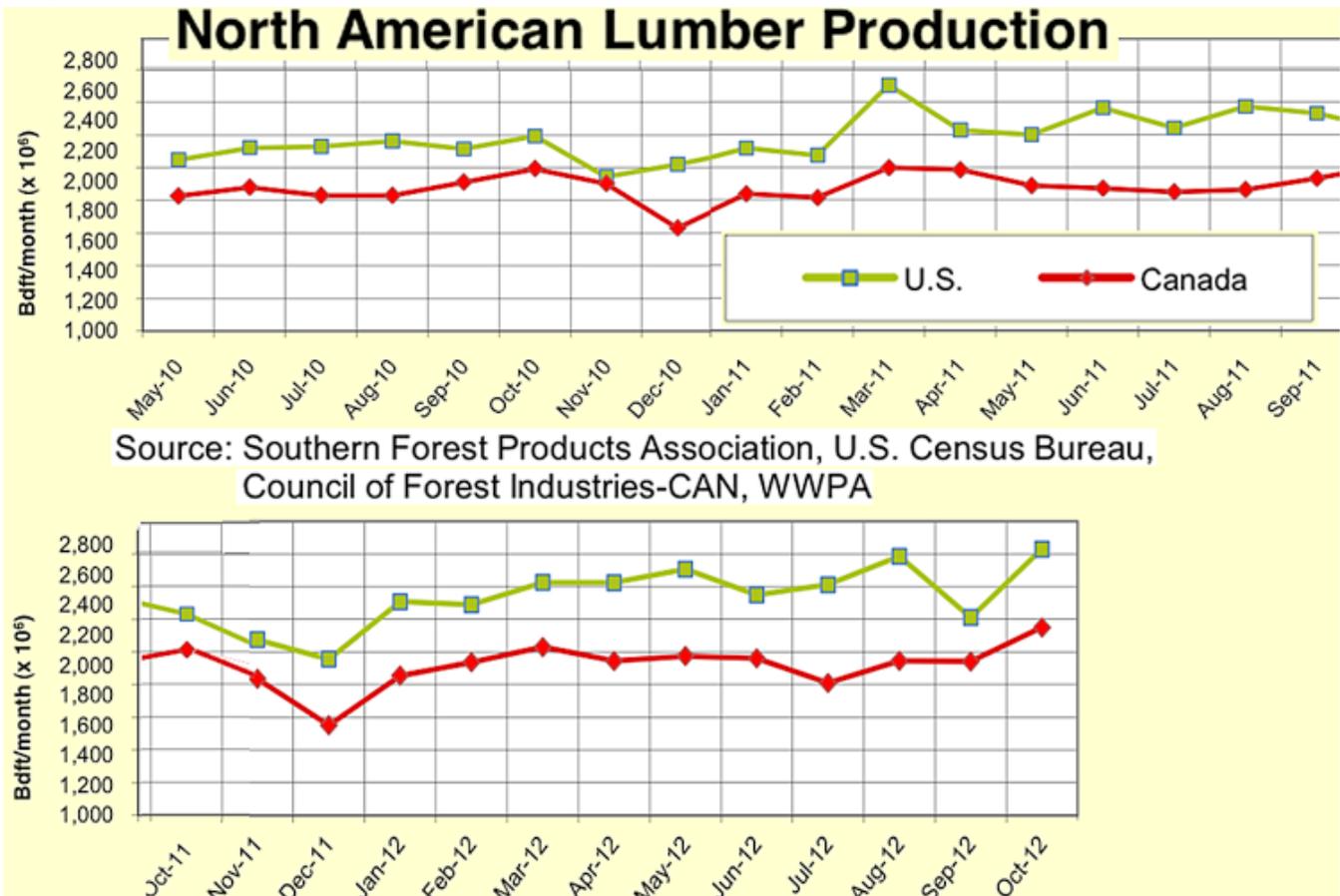
The foolish and short-sighted thought the overbuilding of homes in the US of the mid-2000s would never end. Most of these are out of the game, either through attrition, bankruptcy, retirement, or plain old permanent closure. In the same regard people had become so accustomed to the depressed market they somehow forgot how business used to be done. This is a dangerous lapse in memory.

A monumental shift will get under way during the next two years. As the supply chain eventually becomes replenished, the old practice of customers playing lumber producers against secondary suppliers – namely reloads, stocking wholesalers, and wholesale yards – will start up again. And the reverse is also true: lumber producers will play end-user customers against the secondary suppliers.

Things are about to get very, very interesting. Those who are relatively new to this complex business are about to witness shenanigans the likes of which they have never seen.

Newer participants will find out what happens when an actual two-tier market develops: when producers are able to hold on to price increases while distributors/wholesalers have a mad sell-off at discounted prices. Or the reverse: producers suddenly find themselves with plenty of wood they want to clear out of their yards and, in a desire to make room for fresh production, ruthlessly undercut secondaries.

The outcome of these circumstances is never cut-and-dried; some players may do quite well even as their colleagues take a bath. With all customers buying directly from sawmills for the past five years, the formerly common two-tier market phenomenon may have disappeared from some memories. Once distributors and wholesalers actually start carrying inventory again, the two-tier reality will come rushing back. With the usual messy results.



The New Year brought a mixed bag of interest. However prices were up across the board.

MONTHLY RECAP

- At the very start of this New Year a strong undercurrent of demand from just-in-time WSPF buyers who simply couldn't avoid transacting, even as they were persistently gripped by unending sticker shock, caused prices to relentlessly trudge ever upward.

- Supply remained below demand, and prices moved upward accordingly.
- Eastern-Spruce-Pine-Fir commodity products soared in price in the first week of January. Demand was again well above supply and producers couldn't find enough wood in their yards to fill the steady stream of orders coming in.
- Over the holiday break 2x4 #3/Utility green Douglas fir boards shot up a dizzying \$83, to US\$308 mfbm.
- Studs producers on the west side were moving wood at price levels they would normally not dream possible at this time of year.

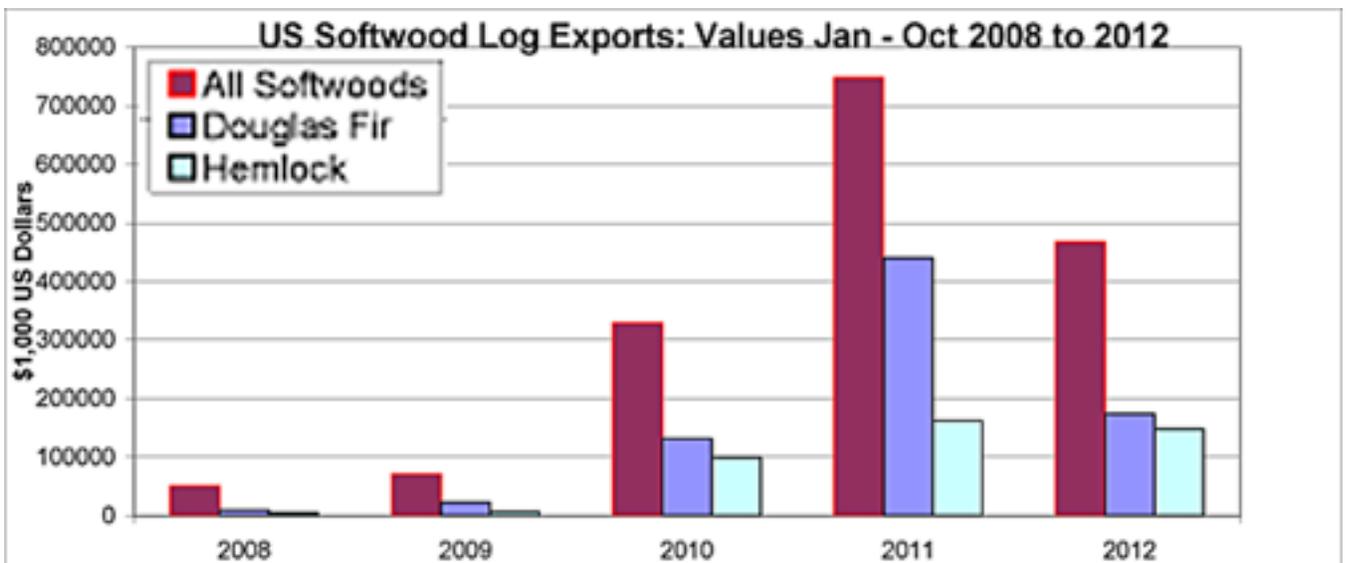
SHORT TERM ANALYSIS

As a new January dawned, order files on some Western stud-items were as far out as the first week of February. With so little on offer, studs producers delicately throttled the rate at which they were chewing through their log decks. Customers still refused to see the writing on the wall: the days of depressed demand and starving producers are over. Supply is currently barely able to meet demand, and it's not even spring yet. Solid wood commodity prices are not going to go down. Even with the latest capacity increases and mill reopening announcements, production is not going to eclipse buyers' needs in the short term.

The supply chain has not been replenishing inventory. So there is still a lot, a LOT of room for secondary suppliers to absorb production. Until wholesale yards, reloads, and retailers report they are stocking a month's supply of wood, lumber and panel prices will at least remain flat.

Starting the New Year off with a bang, Kiln Dried Douglas Fir 2x4s and 2x6s jumped \$25, each ending the first week of January at US\$405 mfbm. According to traders, both of those bread and butter dimensions were nearly impossible to source. Specialty items are going to become rare indeed as home building in the US sputters back to life. Builders very loyal to Douglas fir in the US northeast have been jockeying for every stick of the western wood that comes available. In January the other set of usual buyers of this species; those in California, suddenly made their presence felt. Given the number of Douglas fir sawmills in Washington State and especially Oregon which have gone out of business since 2007, it is clear there will not be enough production to meet demand this spring.

Add to that the seemingly never-ending hunger in China for Douglas fir logs, and you have some serious supply constraints looming.



In panels, both plywood and OSB mills must have been making a lot of direct sales, since they keep raising prices which then stick, confounding everyone. Panel producers are notoriously disciplined. OSB and plywood prices never fall below cost-of-production the way dimension prices can; panel mills simply go off the market, refusing to sell until they get the price they want. Benchmark OSB 7/16" Ontario flatlined at C\$210 msf for almost all of 2008 to 2011. However, the recent record-high for that commodity, for several weeks in late spring 2003, was C\$703 msf. The average from January 2001 to December 2004 was C\$365 msf.

Pricing remained firm even though inquiry continued the previous week's wane.

MONTHLY RECAP

- Shocked by the previous week's price gains, WSPF customers dug in their heels as much as they could in the second week of January, desperately trying to avoid transacting at those high prices.
- Supply of Western spruce was just too pokey. Even as demand dropped off a jot, pricing flattened rather than falling off.
- ESPF mills continued to sell direct at ever-increasing prices as buyers feverishly scoured the marketplace for better deals.
- In the second week of January, Douglas fir mills up and down the west coast collectively eyed their disappearing log decks nervously as non-stop demand kept pushing green Douglas fir lumber prices up.
- Eastern panel traders watched prices climb higher that week on both OSB and plywood.

SHORT TERM ANALYSIS

In what, a few weeks later, would prove to be a fatal mistake, there was still enough pessimism among customers that a steady current of reluctant just-in-time business kept prices afloat. People can only feed off their standing inventories for so long.

Competition for raw logs among West Coast Douglas fir sawmills in the US was apparently fierce toward mid-January. No one wanted to give an inch in a market where one more stem means big bucks. Canadian mills, not having as much of a problem sourcing that specialty fibre, snapped up as many orders displaced from their US counterparts as they could.

Demand for both types of panel was steady as home-builders snapped up load after load to sheath their projects. OSB and plywood mills had their order files too far out to bother counting.

An arctic outflow brought temperatures way down across North America, stalling all outdoor activity.

MONTHLY RECAP

- As January passed the half-way point, wily customers in the west switched from mixed loads to specified. While R/L prices drifted downward slightly that week, those of specified lengths popped up significantly on almost all sizes.
- Meanwhile in the east, the combined cold weather and softening demand caused prices to drop but traders were unwilling to say by how much.

SHORT TERM ANALYSIS

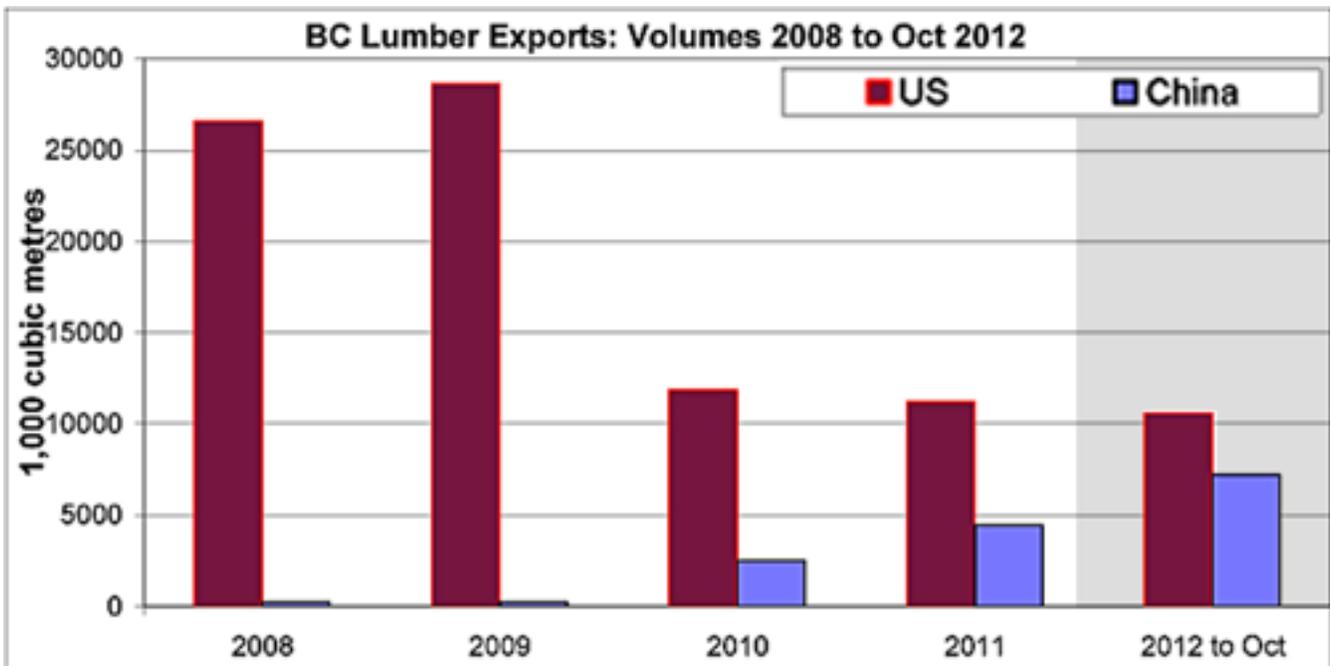
The spate of frigid weather systems all over the continent in the middle of January added torpidity to lumber trading, as consumers from all regions hunkered down. But in the

end, field inventories were still too low. A strong undercurrent of demand pulsed through the market regardless, and inventories everywhere were low enough to make their owners nervous.

Last year at this time, trading was downright dead. Players are too slowly adjusting their business to the new reality. Come spring everyone is going to be caught short and there will simply not be enough wood to satisfy immediate needs. Prices will react accordingly. In the west there remained a subset of buyers whose inventories were just too strapped to avoid buying. In mid-January, sellers wisely chose to hang tight to quotes rather than sell at lower prices.

Douglas fir buyers from California sent the market for that commodity running "like a speckled-ass ape". Green 2x6s were nearly impossible to find, as were #3/Utility 2x4s. As certain sizes were sold out to February, March, and in some cases even April, sawmills worked hard to fill already-booked orders. Yet the phones kept ringing from more and more buyers making inquiries.

One large Canadian western studs producer was actually off the market on nearly all of their items for a few days in mid-January. There was enough demand that any size they brought back for sale was snapped up by the endless line of eager-beaver buyers.



Prices dropped precipitously, by mid-week such volumes were sold that the correction was immediate.

MONTHLY RECAP

- After a slow start to the last week of January, the pace of Western-Spruce-Pine-Fir trading quickened after mid-week. Impressive volumes were being moved with wild abandon.
- The export market was the cause as overseas buyers came in heavily, forcing some North American customers to take the plunge and buy as well for fear of prices being pushed up even higher the following week.
- In the east, prices at the mill-level were strong as ever, with no indication of softening.
- Prices on western studs items dropped enough to trigger large volumes of buying.

SHORT TERM ANALYSIS

Late in the last week of January demand had whipped up into a frenzy described as "intense", causing prices to bounce violently off a bottom of about US\$355 mfbm on WSPF KD 2x4 #2&Btr. A huge proportion of customers found prices they were comfortable buying at during this debacle. Sales were consequently feverish.

As *Madison's* source at FC Stone so eloquently put it, "Evidently the same folks that didn't need wood in the \$340's desperately need it in the \$380's."

CONCLUSION

At the very end of January it happened, what everyone was waiting for. A sign that solid wood prices will not drop lower. This trigger came in the middle of the last week of January, prompting such a flurry of buying that prices popped right back up to their strongest of this winter. Actually there were two signs; the other was lumber futures going up-limit four days in a row. Players were encouraged and mollified to see futures prices FINALLY matching cash, for almost the first time in four years. Futures have consistently been at an approximate \$20 discount to cash since 2007 so this correction makes a big statement about sentiment in the marketplace.

And so what is next?

At *Madison's* the expectation is that benchmark WSPF KD 2x4 prices won't go much higher than US\$410 mfbm in the first half of 2013. As prices on that commodity rise and supply remains tight, people will switch to other species, grades, and sizes. It already happened, toward the end of January. There was a huge run on straight lengths in the west because buyers got so fed up with the strong prices of mixed loads. Specified lengths prices are still low in comparison to the more highly-traded randoms. In early February southern yellow pine – which had relatively flat pricing for a few weeks – popped by \$25 on narrows and \$40 on wides. Lumber buyers are notoriously disloyal, they will switch species, sizes, grades, at the drop of a hat.

The undeniable indication will be when WSPF 2x8 prices jump. When the market gets really hot and 2x4s are scarce and expensive, buyers will remanufacture 2x8s down. The end product is smaller than a standard 2x4 but it still meets the building code.

The switch to 2x8s will happen before 2x4 prices get much higher, for this year.



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