



April Lumber Market Analysis

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OVERVIEW

Credit worries: may I pay you Tuesday for a hamburger today?

Players called April a “terrible” market, drifting aimlessly with no support from buyers. No demand came in from Asia to help out the foolish feeling growing among sellers. Even bargain shoppers were not in evidence as the phones stayed quiet.

The North American market waits for China to insert the price bottom under the drop, putting domestic buyers behind the curve in perpetual catch-up mode. But when China is building houses, planning to spend US\$1.97 billion on low cost home construction this year, it has the dollars and the demand to play the market on its own terms.

There are multiple reasons for US buyers to hold off, the first and most important being a lack of confidence in the recovery of housing. A prevailing belief in a double-dip drop in home values, especially in the northeast, has made home builders extremely shy of running out ahead of the pack. Sources say opinion on the street is that the recovery from the economic recession has not started, that any upswing after autumn 2008 was an anomaly that ultimately caused further pain within the housing industry. The much touted improvement in US unemployment numbers has initiated more skeptical scowls than optimistic smiles.

- **Credit worries: may I pay you Tuesday for a hamburger today?**
- **Conditions were “tough sledding” as demand dropped off.**
- **US Builders must keep the margins low and steer clear of depressed areas.**
- **Significant government resources have been allocated to rebuilding after US storms.**

As lumber futures continued to slide and cash sales were minimal, traders worried about how to salvage the second quarter of 2011. Order files at sawmills were down to zero as nobody could be pushed, pulled or cajoled into buying at any price.

Conditions were “tough sledding” as demand dropped off.

MONTHLY RECAP

- Western spruce was the place to shop for bargains. Mills and wholesalers quoted two tiers but when negotiations got going, numbers were closer together than the lists would indicate. Counter offers went as deep as \$20 mfbm and many were seriously considered.
- There was inconsistent pricing from one producer to the next. Smart makers are reducing production and not offering deep bargains.
- Buyers are confident they can pit one maker against another to get better deals. Cyber buyers are in a quandary where no one is guiding them to make the right deals. It's the experienced people who operate on facts and instinct that usually buy when conditions are right.
- In the wings for May is heavy demand from Asian customers foreshadowed by a surge of inquiry late in April. Makers quoted orders that will go into production this month.
- Continuing to quote massive shipments to the Pacific Rim and Middle East gave stud makers confidence to keep running.

SHORT TERM ANALYSIS

Due to high levels of uncertainty and confusion, players in the lumber market are looking backward rather than making true assessments of the coming US building season. Almost everyone will be caught by surprise, certainly on the west coast in terms of log supply, when long-awaited spring 2011 demand finally materializes. Producers and customers alike are extremely conservative and unwilling to build inventories until they see real evidence of lumber buying. Finished lumber supply will seriously lag demand this summer due to minimal log supply.

Fear stemming from the last four years of unprecedented collapse of US home building has the industry tied up in knots, so hammered are they by a seemingly endless litany of challenges. Making investments in log supply or recalling workers is delayed until proof of recovery is in evidence.

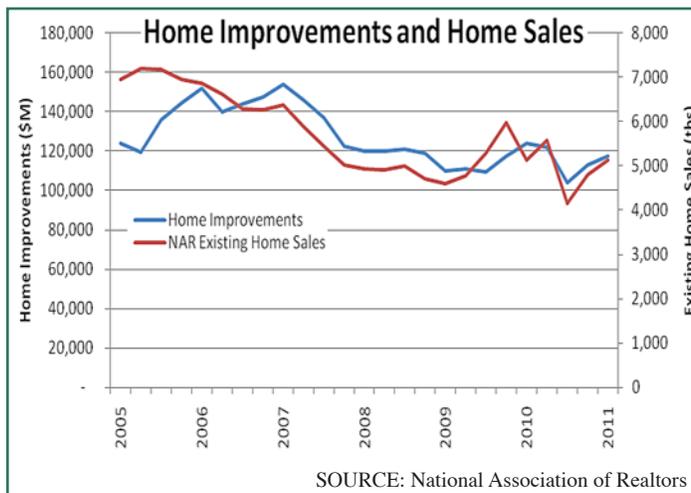
Even traditional seasonal rhythms of production and purchasing are not to be trusted. For the past two years it is Asian demand that has kept the North American lumber industry going, along with the US remodelling and renovation market.

As summer progresses and the projected slight increase in US new home building materializes, producers will be caught short on inventory and a scramble for logs will ensue.

US Builders must keep the margins low and steer clear of depressed areas.

MONTHLY RECAP

- The key is avoiding depressed areas where home values continue to dip.
- Although builders should proceed with caution, small speculative building projects may be tolerated in the market.

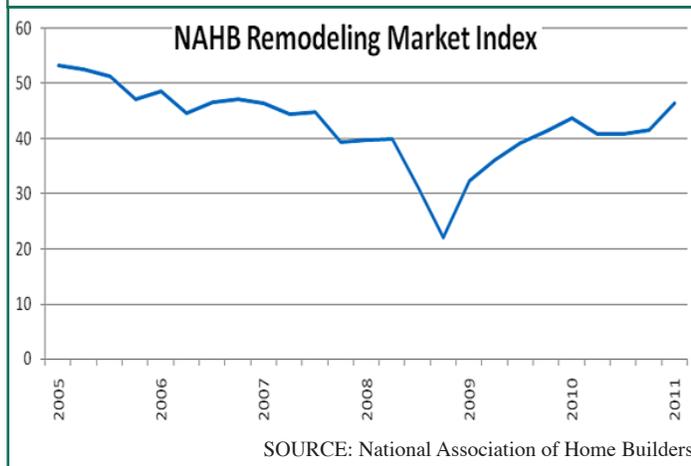


- Home building companies that drastically pulled in their horns and waited out the worst of the downturn are on the verge of starting up again.
- There was cautious optimism among investors regarding a rebound in housing. With 2011 US housing starts projected to hit roughly one-third those of the good old days in 2005, improvement is coming. Mortgage rates are projected to rise and rumblings foreshadow increases in required down payments for home buyers.

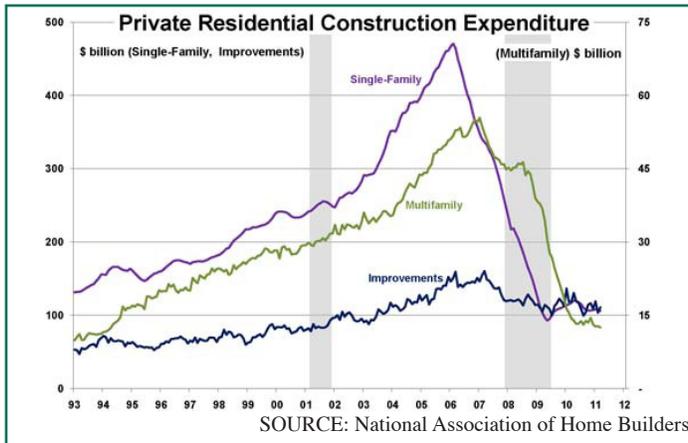
SHORT TERM ANALYSIS

In 2010 the bulk of US demand for lumber came from the remodelling and DIY market. While this aspect of home building will continue to bolster US demand for wood products in 2011, there are also solid indications that new home building is headed for recovery.

39 per cent of US DIYers said making a major home improvement is the best long-term investment they can make, according to a recent survey by *Mintel Oxygen Reports*, and 61 per cent of consumers said they've completed a DIY-project in the last 12 months, with the average respondent having undertaken a little over four projects. Mintel forecasts growth to accelerate in 2011 and, presuming a stabilization of the housing market, to remain positive through 2015.



The National Association of Home Builders Remodeling Market Index, released April 28, increased to 46.5 for 1Q 2011 from its previous reading of 41.5 at the end of 2010. This is the highest level for the RMI since the end of 2006.



The latest US Home Improvement Retailer Satisfaction Study by JD Power and Associates, released May 4, states that the average customer has spent US\$1,650 at home improvement retailers within the past 12 months and that customers are spending 72 per cent of their overall annual expenditure at their primary home improvement store, up from 68 per cent one year ago.

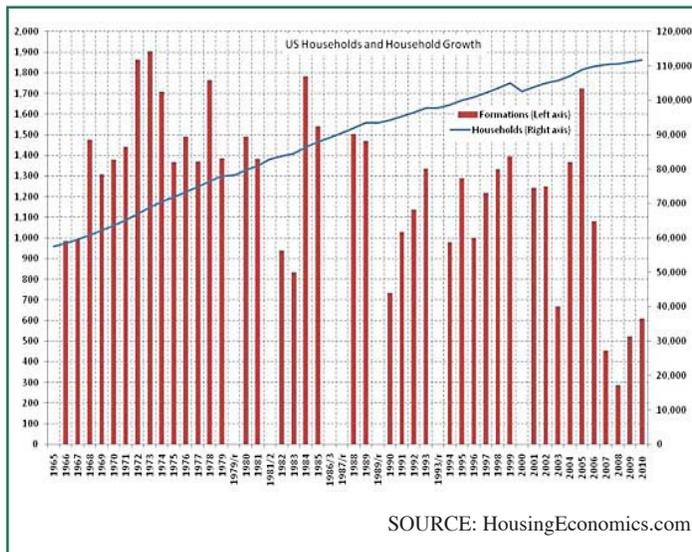
March home improvement expenditures rose 7 per cent to US\$110.7 billion, according to a US Census Bureau statement May 2. February home improvement spending was revised down to US\$103.5 billion from US\$109.8 billion. Total

private construction spending in March was up 2.2 per cent to US\$476.1 billion. Overall, total construction spending was up 1.4 per cent to US\$768.9 billion in March.

New household formation data shows that home buying in the US has decreased significantly compared to population rates. Since 1965, the number of households in the US has grown at an average annual rate of 1.5 per cent, adding an average of roughly 1.3 million new households per year, according to the Census Bureau's Housing Vacancy Survey. Formations averaged 421 thousand annually from 2007 through 2009,

roughly a third of the long term average. In this analysis a baseline is constructed using trend growth in households and pent-up demand is estimated as the deviation from that trend in the observed formations, according to the NAHB. Subtracting the Census Bureau's 2010 estimate of households from the baseline yields an estimate of 2.1 million household formations that have been postponed for economic reasons.

The perceived current excess home supply reflects or embodies significant pent-up demand, implying that recovery in the housing market will come more quickly as the economic recovery makes progress and pent-up demand turns into realized demand, absorbing vacant units in the existing stock and adding pressure for the construction of new units.



Significant government resources have been allocated to rebuilding after US storms.

MONTHLY RECAP

- In a May 7 press release FEMA stated that 6,850 people have registered with the agency for state and federal disaster assistance, and 3,810 damaged homes have been inspected.
- 5,700 structures, including 4,800 homes, were significantly damaged or destroyed in Alabama. Insurance commissioner for the state of Alabama Jim Ridling said May 4 that early insurance industry estimates put the damage across the South at US\$2 billion to US\$5 billion.
- US\$10 million in grants from the US Department of Labor will be used to hire temporary workers to clear debris and start rebuilding in Alabama, the governor of that state announced May 5.

- US\$2.9 million has been slated for temporary housing and home repairs in North Carolina, and US\$1.2 million has been approved in North Carolina by the US Small Business Administration for low-interest disaster loans to homeowners, renters and businesses.
- The effects of rebuilding in the US will be felt in North America's lumber market more quickly than that of Japan.

SHORT TERM ANALYSIS

Cleanup efforts in Japan are hampered by severe damage to infrastructure. Getting heavy equipment to the affected areas of the northeast has proved challenging. Building materials destined for 60,000 temporary and emergency shelters in Japan have arrived and are quickly being erected. Towns destroyed by the tsunami are still in the process of removing debris. Memorial services for those killed but whose bodies have not been recovered are being held.

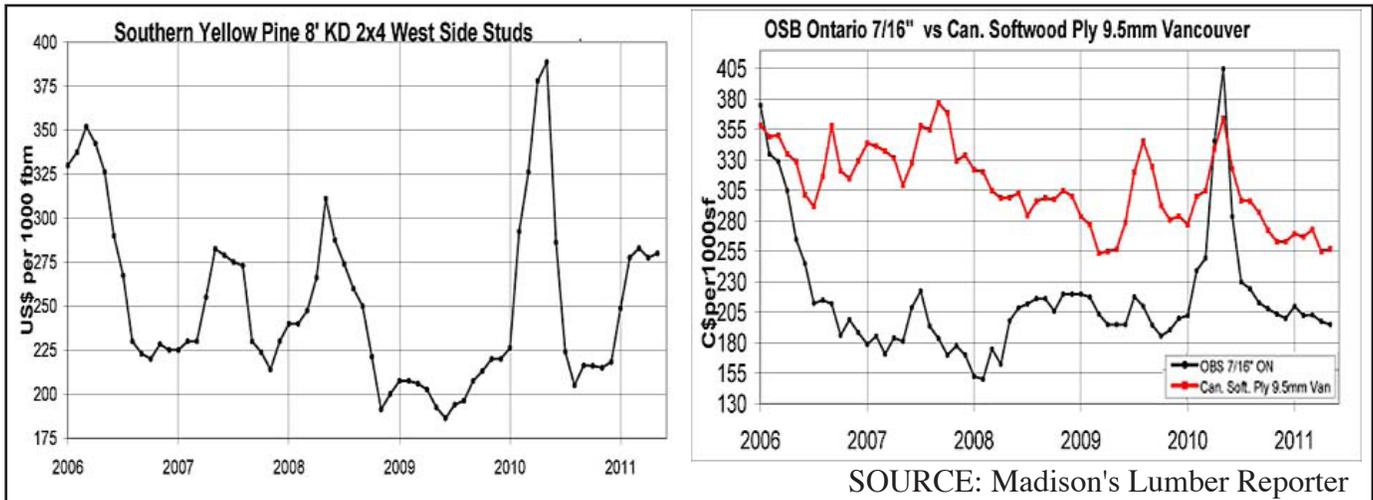
Action to repair and rebuild homes in the US after the series of tornadoes will be much faster than in Japan. For once FEMA is being applauded for quick action in assessing damage claims and processing funding. Damage to roads and rail lines in the US have been minimal, and the supply chain is well prepared to handle the large volume of lumber and panel products needed for construction.

EFFECTS

Panel producers, OSB and plywood will be needed both to rebuild roofs blown off homes still standing and for flooring, roofing and possibly walls of homes that must be completely rebuilt.

Georgia-Pacific, LP Building Products, Ainsworth, Norbord

Dimension lumber producers will also see an increase in orders, specifically for studs and other structural products.



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