

# MADISON'S LUMBER REPORTER

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## News & Updates

### Madison's Timber Preview

Abysmal 4Q 2008 results from West Fraser and Canfor are the focus of this week's issue of *Madison's Timber Preview*. Both companies production levels are examined against benchmark WSPF 2x4 prices. Contact us any time for a subscription.

### Catalyst Closures

Catalyst Paper was forced to indefinitely close its pulp mill in Crofton and the No. 2 and No. 5 paper machines at its Elk Falls paper mill due to poor market condition.

The pulp mill curtailment will remove approximately 400,000 tonnes of annual pulp capacity and affect approximately 375 employees. The indefinite curtailment of all three paper machines at the Elk Falls mill removes 526,000 tonnes of newsprint and uncoated mechanical paper capacity on an annualized basis, and affects 350 employees.

Catalyst has made repeated demands to municipal governments on Vancouver Island to cut taxes substantially this year, claiming the high tax rate was set when pulp prices were much higher, as were production levels.

### Canadian Tarrif Charge

The London Court of International Arbitration has decided that eastern Canadian lumber mills have breached the 2006 Softwood Lumber Agreement between the US and Canada by failing to calculate quotas properly during the first six months of 2007. The tribunal said Canada must provide a compensatory remedy for violating the agreement.

The duty for these mills to export to the US will go up by 10 per cent on March 25 until \$68 million is extracted from the industry. This could take five years at the current rate of business. [READ MORE](#)

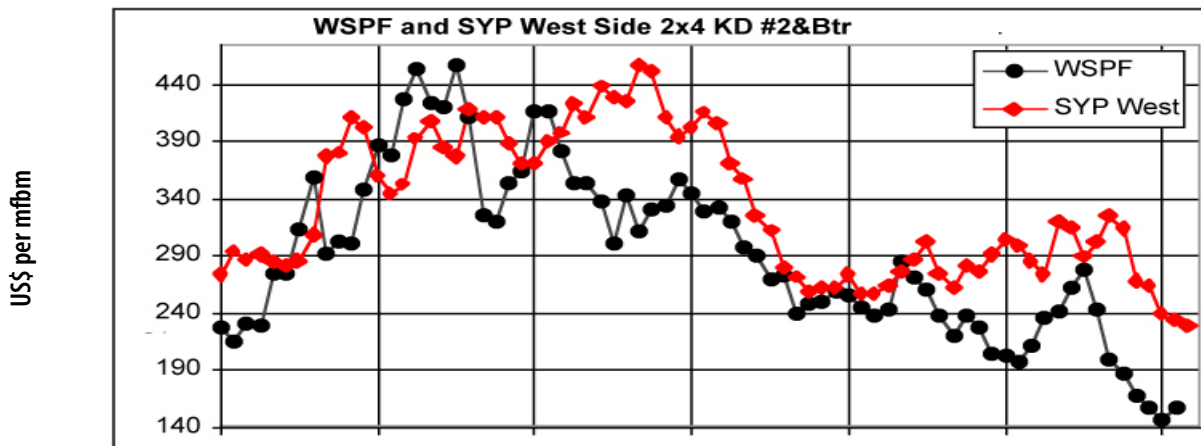
### US Existing Home Sales

Home resales fell by 5.3 per cent to an annual rate of 4.49 million in January, the National Association of Realtors said this week, and were off 8.6 per cent year-on-year. The median price of an existing home fell 14.8 per cent on the year to \$170,300. The glut of housing inventory eased in January, as the number of existing homes for sale fell 2.7 per cent to 3.6 million, a two-year low.

The results were worse than economists expected and came after a surprise bounce the month before, when home resales jumped by 6.5 per cent. [READ MORE](#)

### Chip Supply

Chips, sawdust and hog fuel, collectively known as byproducts of lumber production, are an essential part of the entire supply cycle for both pulp and for paper production. Primary mills rely on the credit from the sale of byproducts to keep their lumber production costs down, while pulp mills require a steady supply of chips to operate efficiently. [READ MORE](#)



Prices are in U.S. dollars per 1,000 fbm.

## Key Prices

	This Week	Last Week	Change	Month Ago	Change	Year Ago	Change
WSPF KD R/L 2x4	140	160	-20	130	+10	200	-60
WSPF KD R/L 2x6	135	162	-27	126	+9	200	-65
WSPF KD R/L 2x8	132	150	-18	124	+8	215	-83
WSPF KD R/L 2x10	150	162	-12	135	+15	294	-144
WSPF KD PET 2x4 Stud	165	165	0	155	+10	210	-45
Douglas Fir Green R/L 2x4	160	160	0	145	+15	175	-15
Douglas Fir Green R/L 2x10	185	200	-15	220	-35	220	-35
ESPF KD 2x4 8ft Stud	230	230	0	200	+30	280	-50
OSB Ontario 7/16" (CDN\$)	215	215	0	220	-5	166	+49

## Weekly News

### Softwood Lumber Dispute

CONTINUED Significant mill closures in eastern Canada are expected as mills will likely not be able to bear the added cost

The ruling is final and cannot be appealed, John Allan, secretary of the Canadian Lumber Trade Alliance, said.

The Coalition for Fair Lumber Imports claims that Canada continues to violate the trade agreement by circumventing those commitments through additional subsidies and related ac-

tions, including recent SLA-inconsistent stumpage price manipulations in British Columbia.

### US Real Estate

CONTINUED The pace of sales of existing homes in the US tumbled to a 12 year low in January as prices plunged and buyers delayed purchases ahead of a government economic stimulus package.

The impact of the stimulus pack-

age and lower interest rates could boost home sales by 900,000 units this year, NAR estimates, but for now buyers remain anxious.

According to Lawrence Yun, NAR chief economist, 45 per cent of transactions in January were distress sales at discounted prices, as buyers hunted for bargains

The median national home price declined 14.8 per cent from a year ago to \$170,300, the lowest since a \$169,400 level seen in March 2003.

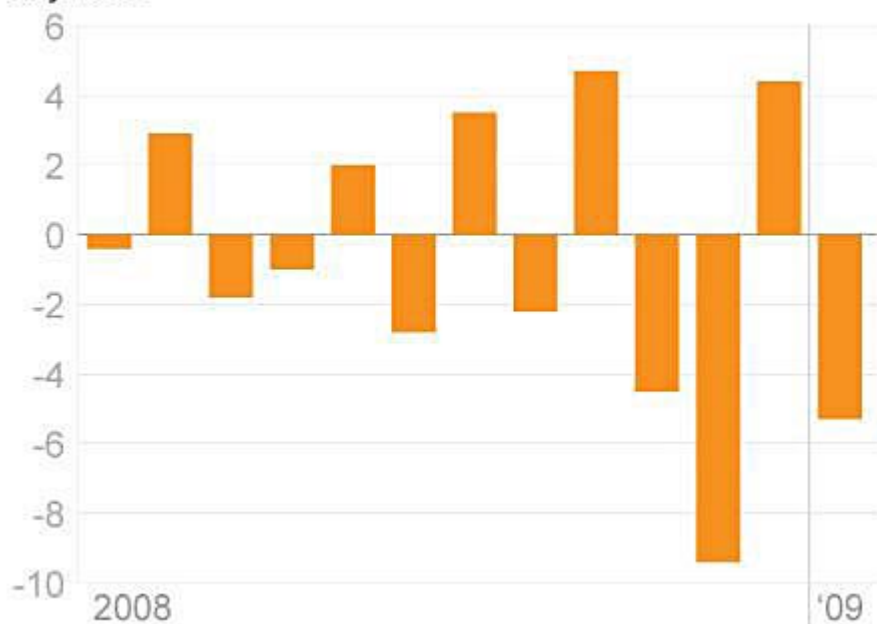
The Realtors said they expect a recent federal stimulus package and other rescue measures to spur 900,000 home sales this year. Still, some economists don't expect Washington's encouragement or the home-price slide to quickly restore the confidence of prospective buyers.

Inventories are falling because builders have put the brakes on for quite some time now. They are severely under-building relative to population growth and household.

One analyst suggests that housing inventories have peaked and will continue to move downward as we move forward in time. At least 500,000 and probably closer to 700,000 homes will be removed from the housing supply by year's end. The analyst maintains that sales do not need to increase to reduce housing inventory. Supply is already shrinking for both new and existing homes based on our current tight financial market. Even at the current trends, at some point our supply-demand balance will shift and we will have pressure on prices.

### EXISTING HOME SALES

Month-over-month percent change, seasonally adjusted



Source: U.S. Department of Commerce

# Pulp & Paper

## Supply Cycle

In the summer of 2008 pulp mills would have been celebrating the spike in European market pulp prices to US\$855

by Kéta Kosman

per metric ton for NBSK and US\$792 per metric ton for

BHK, if it were not for a critical shortage of chips. While nowhere near today's levels, sawmill closures had caused such a reduction in chip supply that several pulp mills had to close. Regardless, that price peak did not hold, European NBSK list price before discounts was down to US\$671 per metric ton at the end of 2008, and stands at US\$584 this week, according to FOEX, down almost US\$40 from the beginning of this year.

Despite significant pulp mill closures globally, January 2009 pulp inventories in European ports is 43 per cent higher than one year ago (at 1.72 million metric tons), but 2.4 per cent below December 2008 supply (at 1.76 million metric tons) according to europulp.net. With such levels of oversupply, current market pulp prices are likely unsustainable and will have to fall until supply matches demand. In contrast, January 2009 shipments to China were 563,000 tons, up 62 per cent from last year's 348,000 tons but were down 38 per cent from December's 904,000 tons, according to PPPC. China generally orders significant quantities before year end in preparation for a slow down in business for Chinese New Year. However, the fact that pulp inventories in Chinese ports are currently very high, and a portion of December orders have yet to reach customers, the slow down is expected to continue. Given that the lowest net delivered US spot price for NBSK is currently hovering at about \$480 (after discounts), both hardwood and softwood kraft prices are expected to be pushed to new lows.

The fall in market pulp prices was not unexpected given severely decreasing paper demand globally. Newsprint and coated paper demand has dropped sharply since 3Q 2008, and will likely remain low into the middle of 2010. Many factors need to change before paper demand returns to healthy levels; the economies of several key countries, such as the US, EU and China, need to recover, the balance sheets of large companies need to start showing profits, and consumers need to get back to shopping. Only then will advertisers return to the print media, bringing back thicker and bigger format newspapers and magazines.

But the supply cycle is not that simple. Just as paper mill activity relies on a robust publishing industry, keeping pulp mills

running full time, primary sawmills rely on pulp mill demand for their chips as a secondary profit centre. No customers for by-products drives up the cost of lumber production, as sawmills can normally count on a credit of about \$80 per mfbm for those by-products. When the supply cycle stagnates as it has now, there is downward pressure on prices of all the related byproducts.

Recent, and indeed ongoing, sawmill curtailments have so impacted chip supply that some pulp mills are resorting to chipping more whole small sawlogs than they normally do, which is much more expensive than using chips. Currently both lumber producers and wholesalers report record low inventories across the range of all wood products. As the balance of supply and demand for primary wood is corrected, prices will firm. Expectations are that into spring there will be a nominal increase in lumber demand. Those few mills still operating may well realize difficulty in immediately meeting an increase in demand, which would cause a short term spike in prices. Soon after that, balance will be achieved, likely at very close to production costs.

The difficulty for pulp mills located in the north is that winter is not the season to curtail or shutdown. An organized tapering off through autumn would allow time to deplete stocks of dangerous chemicals and to ensure the mills are winterized for an extended shutdown. Pulp prices have fallen so dramatically, some pulp mills are having to close in the middle of winter which is very costly. In most cases, all avenues are explored prior to making the difficult decision to close in winter, but with no storage space at Lynterm and record levels of pulp inventories in ports globally, there is nowhere to put excess product. This week's indefinite closure of Catalyst Paper's kraft pulp mill in Crofton and paper mill in Elk Falls, both on Vancouver Island, BC, adds

to the long list of pulp and paper mill closures globally since the beginning of this year. Unlike the dimension lumber and panel market, so closely tied to US home building, the paper industry does not enjoy regular seasonal highs and lows, making predictions of recovery much more difficult.

Canadian annual mechanical pulp production rose from 10.5 million metric tons in 1990 to 11.6 million metric tons in 1995. For the next five years production wavered between these levels. An average of 9.9 million metric tons was produced annually between 2000 and 2005, before coming back to 10.5 million metric tons in 2007, according to the UN's FAO statistics. It is clear these numbers will be significantly lower for 2008, and even less for at least the first half of 2009. US pulp production shows a similar trend, ranging from 5.8 million metric tons in 1990 to 5.2 million metric tons in 2000, but dropping more sharply by 2007, to 3.9 million metric tons.

The simple fact is that with pulp prices expected to remain weak for the balance of the year (if not longer), lumber producers can no longer count on byproduct credits as is traditional. Lumber production will only continue to decline in the short term due to both record low demand and record low revenues from by products. In the US, sawmills have already had to close because they could not find customers for their byproducts, a situation that could easily develop in BC as well. Prices will increase because there is not enough production on line and/or stock piled to fill immediate demand. It would take a month or two of sustained demand to rebuild the infrastructure to service the hump in demand. During that time, prices would increase but flatten out again when demand and supply come back into balance.

