

January Lumber Market Analysis

By Kéta Kosman

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OVERVIEW

The disconnect between the usual variables that impact the lumber market, the normal effect of those, and the resulting realities of shifting lumber prices, is upon us. Not anymore can traders look at the weather, road conditions, log supply, the exchange rate, housing starts, and sawmill order files, to determine what they can expect for the business of making lumber in the coming months. The industry has lost knowledgeable veterans to retirement and bankruptcy, and at the same time has welcomed new players and new markets never before involved in the selling and buying of North American solid wood.

A stark example this past January stands out clearly as an indicator of increasingly complex market conditions that are even more difficult to call than in previous years: the loss of a single plywood plant to wildfires in Chile. One radiata pine plywood operation burning down, and a specialty producer at that, should not have had the slightest effect on standard plywood prices. However, uncertainty reigns the solid wood market and the supply-demand balance across commodities and species is so delicate that players hardly know how to react to the unexpected.

That US plywood prices leapt up \$100 per thousand square feet in the weeks immediately following that fire then quickly recovered to previous levels speaks volumes about how volatile lumber and panel prices will be this year. The wholesale destruction of a medium-sized SPF dimension lumber mill in BC, however, and a major fire at another in Ontario, just one week apart in January, made absolutely no difference to prices in that commodity group.

- **The lumber market holds its collective breath, hoping this good weather will last.**
- **All eyes are on certain commodity groups as prices take unusual pre-spring jumps.**
- **Chinese New Year festivities will be felt in the lumber market for weeks to come**

Something important to keep in mind is that there are fewer panel producers, both plywood and OSB, than dimension lumber. As well, panel producers are traditionally more disciplined, in terms of curtailing production in response to weak demand. Its possible that US panel producers themselves induced a temporary state of panic in that market to take advantage of the limited loss of production in Chile.

It would not be the first time panel makers pounced on any opportunity to hike prices..

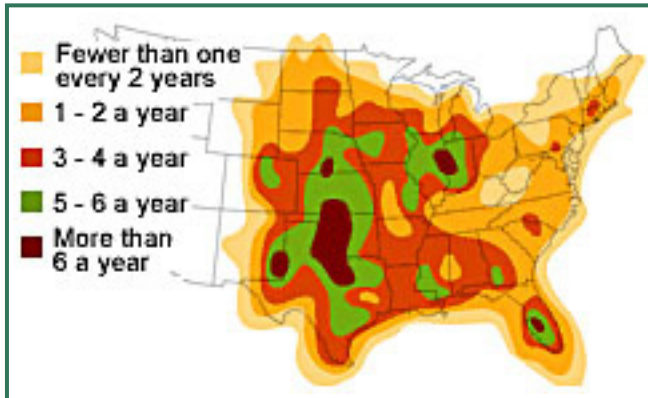
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MONTHLY RECAP

- The hot lumber market in the last two weeks of December helped this January kick off in high gear. Western spruce sawmills were working though order files that had been built during busy pre-Christmas lumber trading.
- As January progressed, all talk eventually turned to the weather. How long would these unusually excellent conditions for the processing and transporting of logs and lumber continue?

SHORT TERM ANALYSIS

As spring in North America rapidly approaches, the traditional wisdom that there must still be come cold winter weather to come seems to ring increasingly false. The latest



weather reports out of the US northeast point to continued warm temperatures and little precipitation. Timber harvesters and home builders alike are encouraged to make investments and ramp up operations, as April is just around the corner. A short-term cold snap between now and then will not be enough to put a damper on business operations.

As with everything there is a flip-side. For this rarely seen entire winter of mild weather the flip-side is: storms and tornadoes in spring. The

terrible US storm season of 2011 razed entire towns, including the homes and building within them. Lumber orders for rebuilding efforts did indeed spike, however almost all wood was sourced from within the US. At that time there was enough southern yellow pine capacity either running or waiting to come online that reconstruction and renovation efforts did not have an impact on Canada's western and eastern spruce lumber prices.

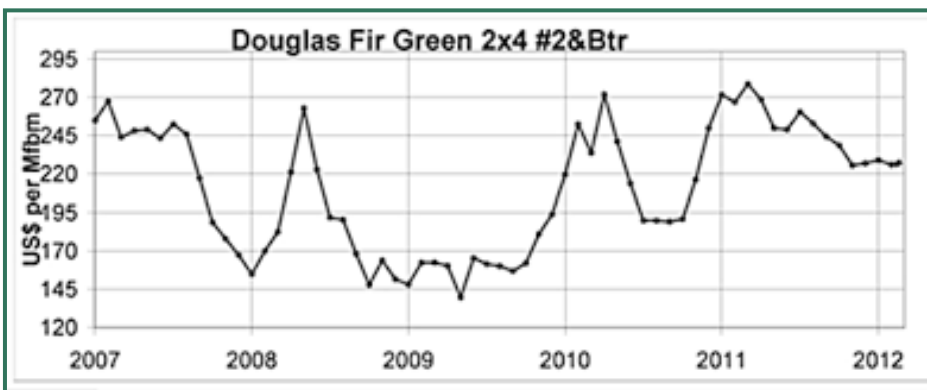
AccuWeather is projecting that the worst of this year's tornado season will most likely target the Ohio Valley and mid-Mississippi Valley. Iowa and Nebraska could end up with a more typical year. In some years, the season in the Midlands gets an early start in March, said Dan Kottlowski, a senior AccuWeather meteorologist, on February 21. Tornado activity in the Midlands picks up in earnest in April and peaks in May and June, he said.

Currently most sawmills in North America are still running at approximately 70 per cent capacity, however many were already expecting to ramp up production this spring to meet renewed demand from the US. Should there be significant severe storms, flooding, tornadoes, and hurricanes again this year, its quite possible there will not be enough wood available domestically within the US to supply the surge in demand for immediate rebuilding.

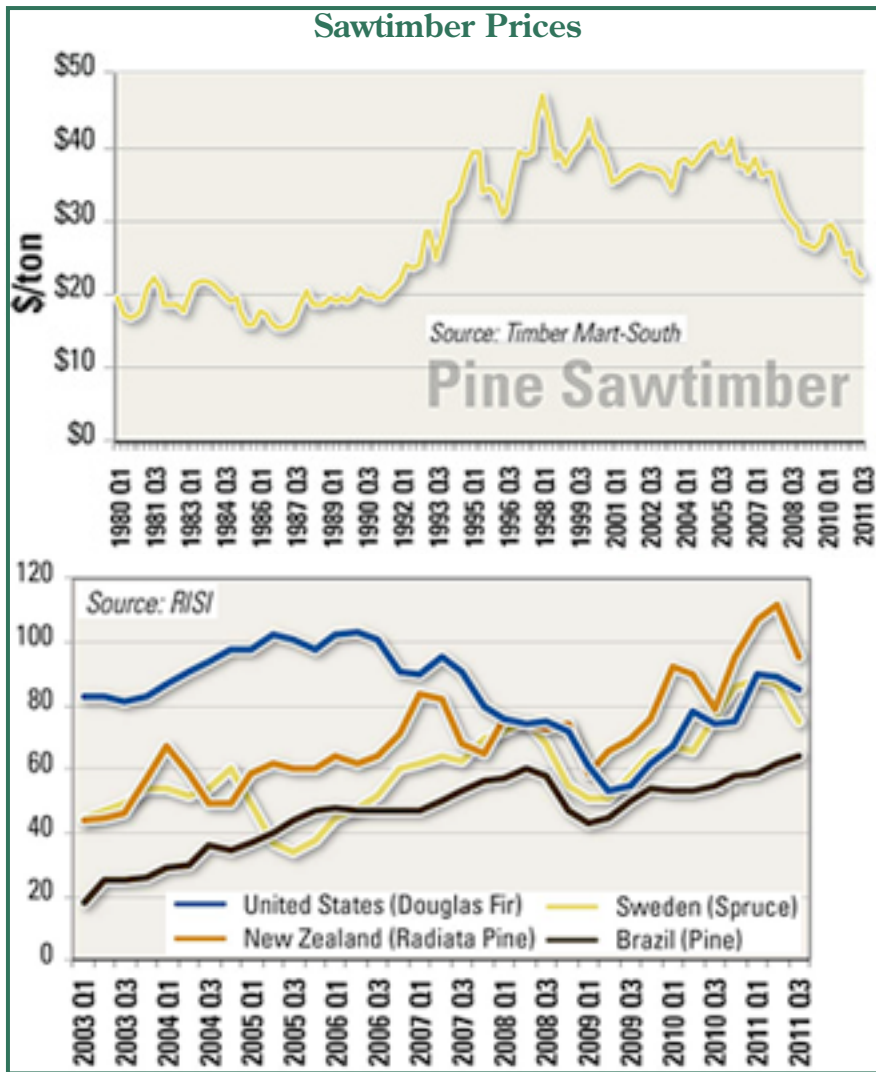
All eyes are on certain commodity groups as prices take unusual pre-spring jumps.

MONTHLY RECAP

- As with the WSPF dimension lumber mix, strong demand for western Studs through the end of December carried over into the beginning of January. Most buying was coming from customers in Japan looking for appearance, or J-grade, studs. Inquiry for this specialty product was high enough to drive up prices on standard and utility grades.
- In the second week of January, buyer attention turned to WSPF 2x6 in the #3/Utility grade and to 2x10 dimensions. Prices for both commodities jumped by around \$40, a huge leap during one week after such a sustained soft market.



- Meanwhile in green Douglas fir, despite continued abysmal market conditions, traders declared the first two weeks of January as the biggest weeks in sales they have seen for the past two years.
- The preposterous example of US standard grade plywood prices temporarily skyrocketing in the aftermath of one medium-sized high grade



panel mill being lost to fire in Chile in mid-January only further indicates how uncertain even established lumber players are about this tenderly recovering market.

- Toward the end of January, the increasingly tenuous balance between Douglas fir log exports and lumber production became even more pronounced when fir producers admitted to running little to no 2x12 boards. When there are no large logs available, the possibility of cutting the widest, or longest, dimensions, disappears.

SHORT TERM ANALYSIS

Japan's housing market has been more underbuilt, and for longer, than that in the US. Japan's Ministry of Land, Infrastructure and Transport is forecasting almost 1 million new homes built for each fiscal year of 2011 and 2012. Japan's fiscal year ends in April. That country had documented well over 800,000 new housing

starts in 2011 to December, so expectations are that the government forecast will bear out. It is no surprise, then, that when builders suddenly realize they need the quality studs required by Japan's stringent building codes, the price for that commodity group jumps in North America.

Due to ongoing sawmill curtailments and low inventory levels throughout the supply chain, even a short term spike in demand for a particular grade is enough to drive up prices across all grades. While almost all North American studs going to Japan are produced on the west coast, at these restricted production levels mills in eastern Canada benefitted from the run on western studs.

Indeed, savvy managers realized the situation as it was happening and instructed their sales people not to sell off too much volume of the higher grades in expectation of further panic-induced price hikes.

This scenario will play out continually throughout 2012. In some cases it will be demand from China that will cause a shortage in availability of western species, thereby resulting in a price increase in ESPF and southern yellow pine products. In other cases a spurt of demand will come from the US. As a result, western mills will have a terrible juggle on their hands: of trying to retain as many of their new Chinese customers as they can while serving a return in buying from south of the border. Either way, tight supplies will cause all kinds of price fluctuations in the months to come.

The \$44 jump enjoyed by WSPF 2x10's in mid-January, for no apparent reason, is a perfect illustration of this situation.

During this extended downturn of US home building, Douglas fir lumber producers have suffered with particular acuteness. While Douglas fir logs are much desired in China, when it comes to lumber . . . not so much. The traditional customers for Douglas fir are builders in the US northeast, who are extremely loyal to that product. The sudden jump in Douglas fir trading activity in mid-January may bode well for this troubled commodity group in the waning days of winter.

It would appear that the difficult times for Douglas fir producers are behind us. Enough mills have gone bankrupt and closed that capacity, not to mention production, currently meets demand. The balance will soon shift in favour of producers. As Douglas fir lumber prices return to healthy levels, domestic buyers will be better able to fend off log buyers from offshore. Once fir mill revenues start showing in the black for a month or two, investments will be committed once again.

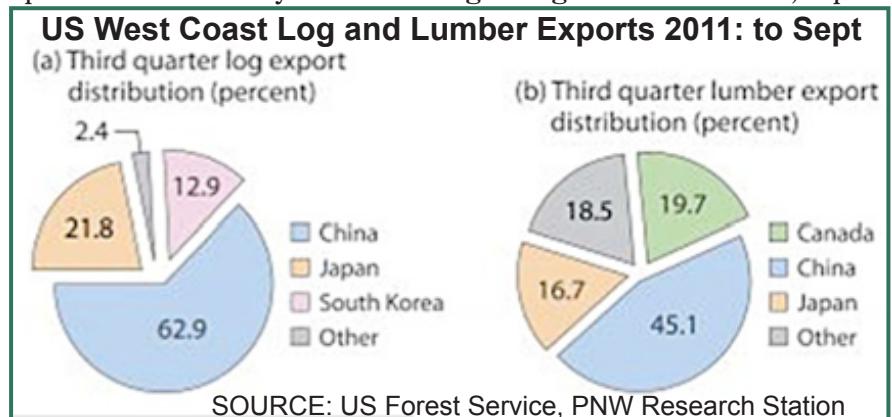
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MONTHLY RECAP

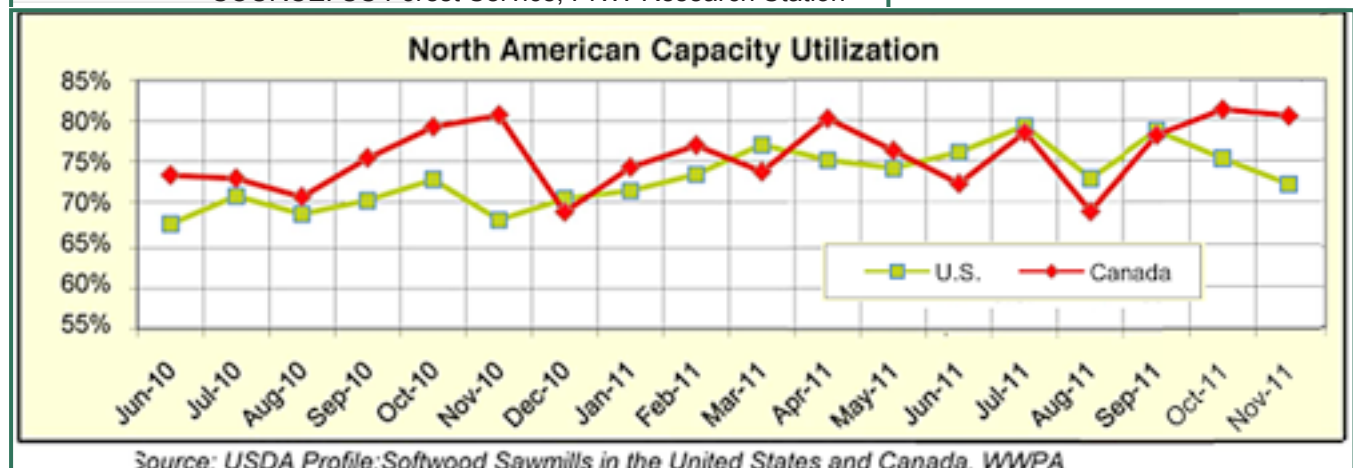
- Weak demand from China in 3Q 2011 continued through the beginning of January, with muted ordering from that country in advance of the Chinese New Year break. A good run on #3/Utility 2x4's toward the end of January translated into stronger prices in the standard construction grades.
- Chipping whole logs is at best a short term solution to survive a temporary drop in demand. Mills need to digest logs somehow, particularly when the harvest is running well. That Quebec ESPF mills in mid-January resorted to sending logs straight to the chipper then to the pulp mill indicates a lull in demand. Thankfully the supply/demand balance was restored the following week and logs again went to Eastern dimension lumber mills

SHORT TERM ANALYSIS

Some lumber analysts, relative newcomers to the scene, in mid-2011 declared China's large volumes of lumber buying in November a "trend" and based future projections on that assumption. At *Madison's* the opinion was that two years is not long enough to make a trend, especially with a brand-new customer. And



a not-very-well understood one at that. Sure enough, significant levels of lumber buying did not materialize from China this past November. Decreased demand from that country continued right up until Chinese New Year, a traditional time to halt business and visit with family.



Without that off-season demand of 2009 and 2010, North American mills were on the verge of very extended seasonal downtime only to be saved by spurts of ordering from the US. In the same way, it was US and Canadian orders for wood that kept mills running through January. This development is massive indication of a recovering US market, illustrated by the stark difference between this January and the past four. Previously, there would not have been enough need for wood from the US to sustain mills through a six-month lull in China's buying.

CONCLUSION

Ongoing unsettled lumber trading activity through January suggests rocky times ahead for producers, at least into 2Q, when seasonal demand from the US will firm up. Uncertainty about the weather has made planning for investment in the timber harvest difficult. With no proper winter freeze in the north, the spring road ban will go into effect much earlier than usual. Sloppy, slushy dirt roads leading up steep inclines are not conducive to cumbersome trucks carrying heavy loads. On the other hand, if indeed this mild weather lasts until spring, the summer dry-out will also come sooner, thus allowing trucks back into the woods before the fire ban takes effect in late summer.

Sawmills across North America struggle with the question: To build up log supply now and avoid missing out on business later? Or to save money and log only when order books are filled up, but risk missing the seasonal harvest window?

Operator response will depend on their stake in the land base. Those with private timber holdings will feel more flexibility due to their ability to sell logs into other regions and markets. Operations which rely on public lands for their access to fibre will make decisions based strictly on their outlook for lumber prices going forward.

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