

# MADISON'S LUMBER REPORTER

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## News & Updates

### KD Fir Shaken

One of the basic premises of physics is that a vacuum will be filled, often with the most unexpected contents. In the spirit of something coming from nothing, off shore customers were gradually coming to the realization that wood could be a viable building material if they could acquire it cheaply enough. As their currencies were progressively more valued against the US dollar, they saw an opportunity to buy into northwest saw logs.

By early 2010, when the US home building industry began to see daylight, would-be customers tried to buy back into the KD fir market. What buyers found was that at the price levels where the mills could sell their lumber, they could not replace the logs to make more. Forest operators that the mills had depended on for more cheap logs had gone out of the business. In some cases, the banks that had held the paper on the mega-expensive logging equipment had grabbed the cranes and loaders when the logging companies could keep up their payments. Nobody in North America wanted the specialized forest equipment and, in many cases, the behemoths were dismantled and sold offshore to new competitors of the dying US logging operators. Let's hope their operators' manuals are available in Russian and Mandarin.

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### RBC Economics' Latest Economic Outlook Report

Canada's economy is set for rapid growth in 2010 with real GDP projected to grow by 3.6 per cent reflecting strong domestic demand and increased job creation, according to the Economic Outlook report released June 10 by RBC Economics. Canada's real GDP grew at 6.1 per cent in the first quarter, the fastest pace in over a decade.

The economy should continue to show gradual improvement as businesses rebuild inventories following a sharp reduction during the recession.

Unemployment rates are expected to average 8 per cent in 2010 (down from 8.4 per cent in the previous Outlook) before falling to 7.3 per cent in 2011 (down from 7.7 in the previous Outlook).

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### Japan Housing Starts

April housing starts in Japan rose by 0.6 per cent on an annualized rate compared to 2009, to 66,568 units, marking the first increase in 17 months according to the *Japan Lumber Reports*. Despite this improvement, levels are still lower than in 2008.

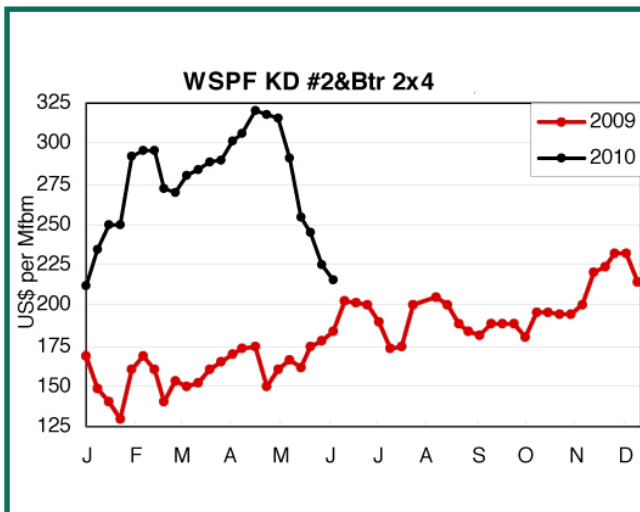
Seasonally adjusted annual starts were at 793,000 units, down 7.1 per cent compared to March.

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### 2010 Forest Products Annual Symposium

This year's Forest Products Industry Annual Symposium, sponsored by Northwest Farm Credit Services, was held at the World Forestry Center in Portland, Oregon on June 10. Readers can find the slideshow of *Madison's* presentation on our website, here <http://www.madisonsreport.com/WFIJune2010Madisons.pdf>

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JAPANESE HOUSING STARTS				
Month	TOTAL	Non-Wood	Wood	%Wood
Mar-10	66,568	32,143	34,425	52
Mar-10	65,008	31,061	33,947	52
Feb-10	56,527	24,412	32,115	57
Jan-10	64,951	30,322	34,629	53
Dec-09	69,298	28,643	40,655	59
Nov-09	68,198	27,416	40,782	60
Oct-09	67,120	28,175	38,945	58
Sep-09	61,181	24,771	36,410	60
Aug-09	59,749	24,992	34,757	58
Jul-09	65,974	28,243	37,731	57
Jun-09	68,268	28,195	40,073	59
May-09	62,805	29,523	33,282	53

Source: Japan Wood-Products Information and Research Center

## Key Prices

	This Week	Last Week	Change	Month Ago	Change	Year Ago	Change
WSPF KD R/L 2x4	216	225	-9	291	-75	184	+32
WSPF KD R/L 2x6	218	225	-7	293	-75	178	+40
WSPF KD R/L 2x8	220	225	-5	290	-70	190	+30
WSPF KD R/L 2x10	260	275	-15	340	-80	212	+48
WSPF KD PET 2x4 Stud	235	245	-10	320	-85	187	+48
Douglas Fir Green R/L 2x4	210	235	-25	235	-25	155	+55
Douglas Fir Green R/L 2x10	270	280	-10	270	0	200	+70
ESPF KD 2x4 8ft Stud	340	350	-10	400	-60	270	+70
OSB Ontario 7/16" (CDN\$)	250	405	-155	405	-155	195	+55

Celebrating our 60th year, a Diamond Anniversary . . . .  
**Madison's Lumber RETROspective**  
 see additional pages in your weekly Madison's Reporter!

## Weekly News

### RBC Forestry Forecast

CONTINUED "Canada's economy continued to surge ahead as domestic demand was backed by increases in consumer, housing and government spending," said Craig Wright, senior vice-president and chief economist, RBC.

RBC expects core inflation rates to remain just below two per cent, as the Bank of Canada slowly reduces the amount of policy stimulus and raises interest rates.

RBC expects US GDP to increase by 3.1 per cent in 2010 and 3.4 per cent in 2011. The report notes that a surge in consumer spending and continued business investment in the US fuelled a 3 per cent increase in the first quarter, at an annualized rate.

BC's economy is on the rebound, and a gradual turnaround in the province's depressed forestry sector is helping.

The report projects the BC economy will grow 3.5 per cent this year, which is the strongest growth rate since 2006.

"The global economic recovery and improving US housing sector are expected to go a long way in helping repair BC's export performance," said Wright.

BC and Quebec will share the same level of growth in 2010, giving the two provinces the country's third-fastest growth rates this year behind Newfoundland's 4.1 per cent expansion and the 3.8 per cent growth foreseen for each of Ontario and Saskatchewan, RBC said.

RBC said the dollar will be close to parity with the US dollar later in the year.

However, it said the loonie could go gradually lower in 2011.

### Home Building, Japan

CONTINUED April building permits were 44,406 units, 10.6 per cent higher than one year ago, a six consecutive months increase.

Homes built for owners increased for six straight months, and condominium building increased for the first time in 16 months, but units built for rent declined for 17 consecutive months, says the *Reports*.

Floor space increased by 5.7 per cent from one year ago, a consecutive two month gain.

Wood based units were 34,425 units, a 51.7 per cent share of the total, down 0.5 points from March due to an increase in condominium building. 2x4 units increased by 0.9 per cent however, a three straight months increase.

### Fireproof 2x4 Buildings

There are currently more than 1,200 fireproof 2x4 units constructed in Japan says the Chair of the Home Builders Association, according to the *Japan Lumber Reports*.

The Association is coping with a law to promote the use of wood for public buildings, and is expanding the variation of fireproof exterior materials. It is possible to use domestic wood for interior and exterior materials if it has enough fire resistance, says the *Reports*.

Currently only 25 such fireproof units are welfare facilities like nursing homes but the number is growing, so demand in the non-residential field seems promising. The Association will help make guidelines for building more such welfare facilities because wood based units are less costly and give a comfortable atmosphere, says the *Reports*.

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BREAKING NEWS ON CANADA'S LARGE VOLUME MILLS, OPERATING STATUS UPDATED MONTHLY!



**MADISON'S**  
MILL WATCH

# Portland, Oregon

## Northwest Farm Credit

Every year, Northwest Farm Credit Services holds a Forest Products Industry Symposium at the World Forestry Center

by Keta Kosman

in Portland, Oregon. Northwest is the leading agricultural lender and crop insurance provider for Washington State, Oregon, Montana and Idaho. This year's event was held on June 10, to a solid turn-out of lumber producers, timberland owners, tree farm operators and other industry specialists.

*Madison's* was invited to speak about the Canadian lumber industry, and give details about the differences between forestry in Canada and the US. Readers can find the slideshow of *Madison's* presentation on our website, here <http://www.madisonsreport.com/WFIJune2010Madisons.pdf>. Other speakers included two RISI economists, whose presentations were cheekily titled "North American Wood Products Markets: Inching Out of the Abyss."

Lynn Michaelis is President of Strategic Analysis for RISI. Michaelis focussed on the US housing starts cycle and projections, and an outlook of the lumber market. The key points to take away from that presentation are:

- The US economy suffered two bubbles in one decade; in the stock market and with home building. As the financial system imploded, the US economy truly approached a depression.

- The recovery of US home building after the recession of the mid-80's came about due to a lowering of interest rates. But the peak of 2005 was not caused by tight funding, it was caused by excesses.

- With a US\$1.4 trillion deficit, the US government is consuming all its credit growth today. It seems to be on the same track as Greece.

- In the past five quarters, US GDP growth has been at about 5-6 per cent. But a large part of that growth for 2Q 2010 is because inventory liquidation grew less slowly.

- Whenever GDP growth reaches 4 per cent, the US Fed raises interest rates the following quarter.

- US housing starts have bounced off the bottom but are effectively staying at those levels. Single-family starts are looking better but the multi-family side is caught up in commercial real estate foreclosures.

- While US home sales are not improving very quickly, home prices have stopped falling.

- 65 per cent of US mortgages owe more than the house is worth. People simply stop making payments.

- The median house price in Detroit is now US\$7,000 while in California house prices have dropped by US\$200,000.

- Foreclosures seem to be peaking and vacancy rates for rent are still high, together making 1.4 million excess units of vacant stock. It will be difficult to drive sustained home building until this inventory is worked through.

- After changes in US policy, there is now effectively no private mortgage system. Mortgages go through Fannie Mae, Freddie Mac, or the FHA.

- With the crash in US home building, a major production decline for the lumber industry was needed. Lumber prices fell to below cost because producers did not shut down capacity fast enough. The unknown here is what happens when production levels decline by such a degree? There will surely be supply issues when demand for lumber returns.

- In Canada it is even more difficult to close a mill, there are usually about 18 months in severance costs. On either side of the border nobody believed demand would fall so far so fast, companies became cash negative.

- 2Q 2010 lumber demand is still not up significantly but inventories are finally down so prices have responded. Customers had to wait for wood for the first time in two years.

- Currently operating rates at the mills are flatlining, the recovery is very slow.

- In Canada lumber costs dropped from about \$270 per mfbm in 2005 to about \$200 in 2009 due to reduced logging and stumage costs and an increase in chip prices. However the beetle kill in BC is affecting utilization, and the high Canadian dollar are taking away some of that improvement.

- Delivered sawtimber prices in the US west and south have suffered in response to the decline of lumber prices. If lumber prices don't sustain highs then log prices cannot sustain either.

- In the near term lumber price recovery will be painfully slow into 2011 due to continued short-term imbalances.

"Don't use price rallies to make business change, at least until after next year," said Michaelis.

- \* In the long term, demand to capacity ratio improvement must come first before lumber prices can recovery properly, likely in 2014.

Bernard Fuller is President of Cambridge Forest Products Associates and Principle Economist, Wood Panels for RISI. Fuller focussed on the outlook for structural panel and LVL, timber markets, and demand out of China.

- With the hard lessons of recent years, the majority of panel producers are

paranoid about responding too quickly to temporarily improving market conditions. Recently 3/8" OSB went from US\$400 per msf to US\$200 in a month.

- Capacity and operating rate numbers are being reworked as panel mills go along.

- North American structural panel consumption fell 43 per cent in 2009 compared to 2005, to 26 billion sq. ft.

- Long term supply of plywood is falling in absolute terms and as a share of the North American structural panel market.

- Capacity is extremely difficult to calculate. How much capacity is lost? It depends on how long a mill is closed, the magnitude of permanent closures is unknown.

- Should housing starts return, data on permanently lost capacity will come out 10 years later. Timber owners will be the last to see improvement.

- While plywood imports from Chile fell drastically immediately following the earthquake, that country has decided to import lower grades from Uruguay and other neighbours while continuing to export good quality Radiata Pine plywood into the US.

- The first western-style OSB mill will open this August in China, mostly for packaging and crating. Likely a new business model to watch out for in the next decade.

- Because log supply is becoming a problem, panel production levels in 1Q 2010 were lower than they would have been.

- Plywood prices in the US south were below cost floors through much of 2009. There was a drop in fibre cost, and a drop in resin cost.

- OSB profitability has struggled back into positive territory in 2010 after three years of losses.

- US softwood sawtimber harvest levels are undercut, there is an excess of timber – close to one year's supply – due to an accumulation of timber that would have been harvested had the market not crashed in the past four years.

- Mills do not see a problem with sawlog availability in the US, just with the price.

- There was a fourfold bounce in log exports from the US west coast into China from 2000, to 136 million cubic meters. in 2009.

- Over the past three years, the amount of Russian log imports into China have dropped from 90 per cent of all logs to 50 per cent on the threat of additional export duties.

- While Russia's share of softwood log imports into China are dropping, New Zealand is coming close to capacity.

- Domestic lumber production numbers in China are unknown.