

Lumbering Along

The US economy slowed sharply in the fourth quarter of 2000 (1.2% annual growth) and the first quarter of 2001 (2.0% annual growth). The stock market suffered a *large* correction. Softwood lumber prices reached a ten-year low and hundreds of mills across the continent curtailed production for weeks or months. A few mills were “permanently” closed.

SOFTWOOD LUMBER PRICES RECOVERING

The past two years have not been good for softwood lumber producers. Prices peaked in the summer of 1999. Except for a brief respite in the fourth quarter of 1999 and the first quarter of 2000, they fell from July 1999 through January 2001. The monthly average price in January 2001 was the lowest since October 1992.

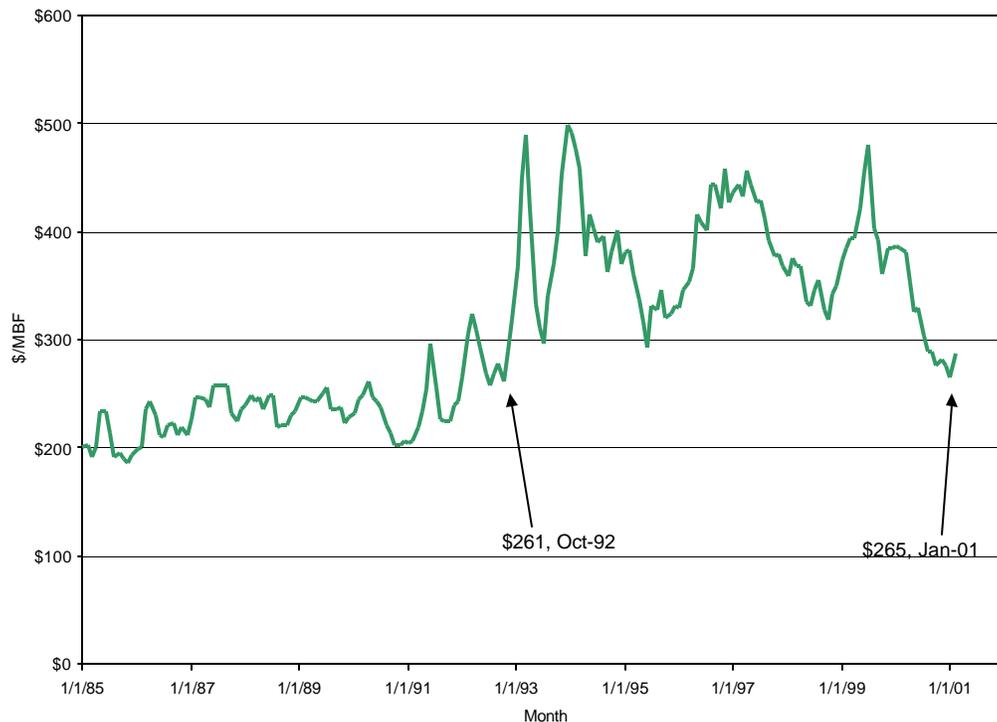


Figure 1. Softwood Lumber Prices, 1985-2001—Random Lengths Framing Lumber Composite Price¹

¹ Framing Lumber Composite Price from Random Lengths. Used by permission.

In terms of real (inflation-adjusted) dollars, the picture is even less pretty. Figure 2 shows the Framing Lumber Composite Price deflated using the Consumer Price Index (1982-1984 = 100). This shows that the prices in January 2001 and October 1990 were the lowest real prices since 1985.

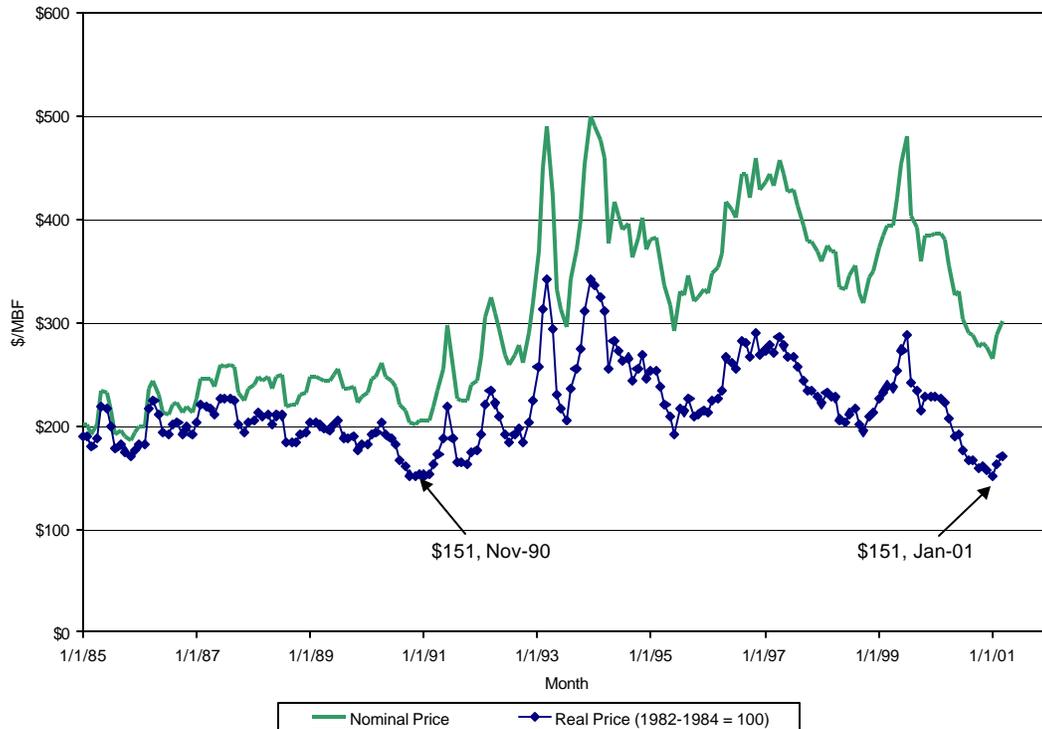


Figure 2. Nominal and Real Lumber Prices, 1985-2001—Random Lengths Framing Lumber Composite Price.

However, both charts clearly show that prices have bounced off the bottom since January.

The Wall Street Journal publishes weekly spot prices for Spruce-Pine-Fir (SPF) 2x4s as reported by Random Lengths and Crow's, and daily lumber futures prices. Figure 3 shows the average of the two weekly spot price series and Friday lumber futures prices. The chart shows both spot and futures prices at the beginning of May are over \$100/MBF higher than they were in January.

What happened? 1999 and 2000 saw the highest lumber production volumes in the last 10 years, just after demand peaked. Housing starts² rose fairly steadily from the lowest level in 40 years in January 1991 (0.8 million units) to a high of 1.8 million units in January 1999 (Figure 4). By October 2000, starts had dropped to 1.529 million units—still above the 52-year average of 1.512 million units. However, the change from *continuous growth* in housing starts to the sharpest *slowdown* in housing starts since 1995 caught the industry by surprise. Production curtailments and mill closures in 2000, along with a recent strengthening in housing starts, appear to have brought lumber supply in line with demand.

² Housing starts reported by the US Department of Commerce.

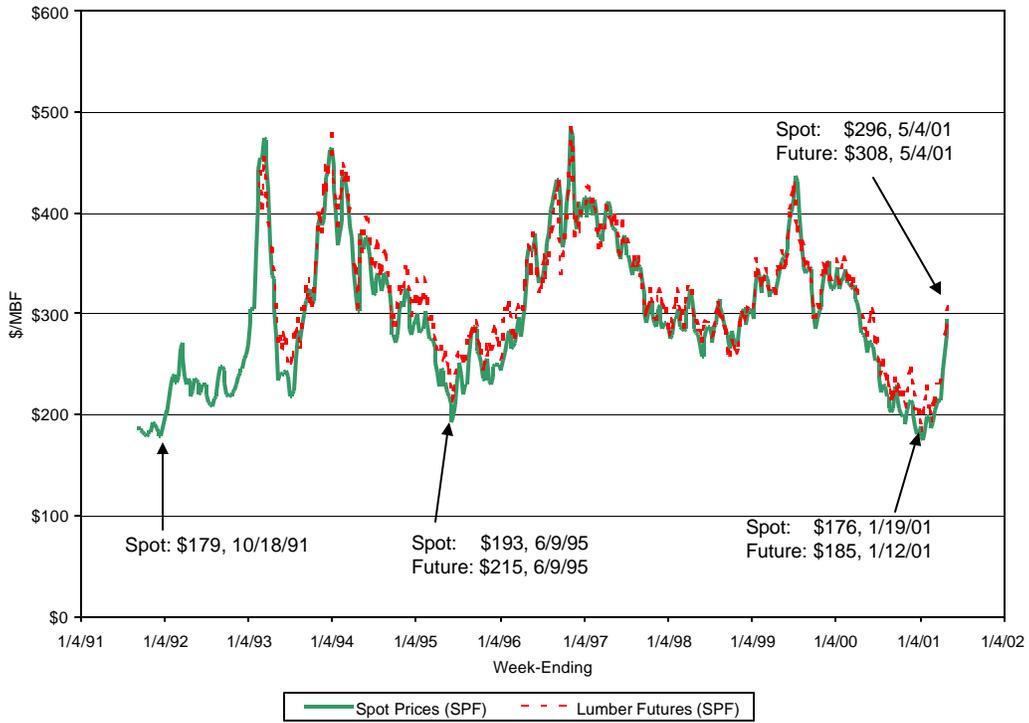


Figure 3. Weekly Softwood Lumber Prices

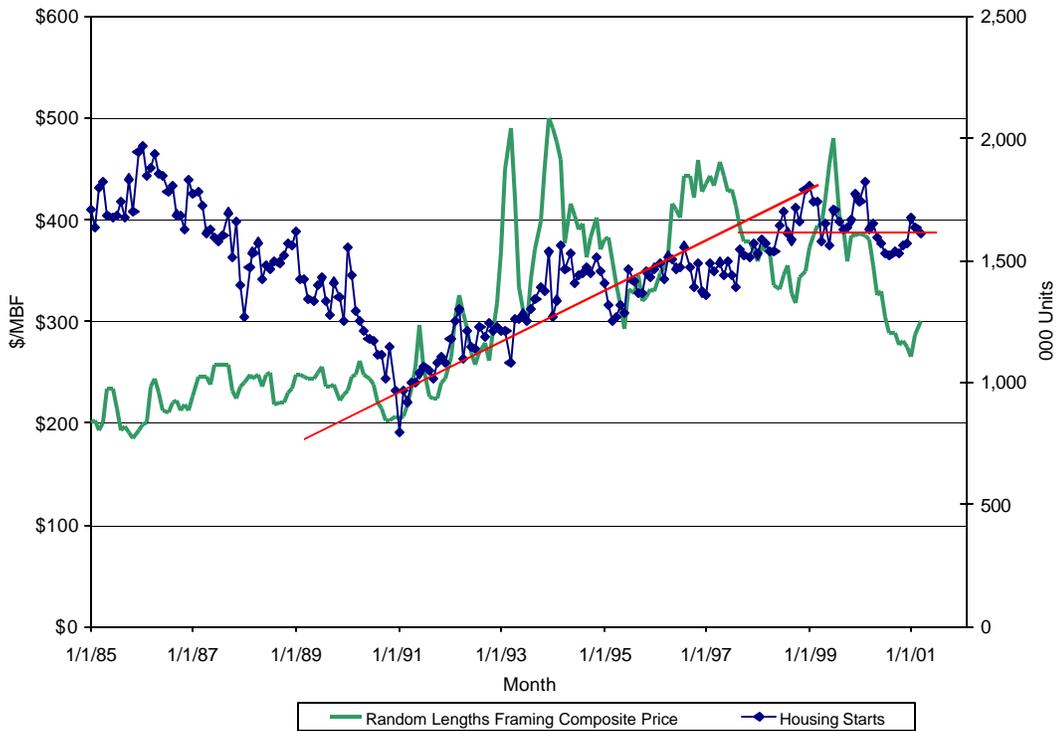


Figure 4. Softwood Lumber Prices and Housing Starts

Lumber prices don't need to keep climbing indefinitely for timberland investors to benefit. In fact, prices somewhere above \$400/MBF will promote the substitution of steel studs for wood. And, increasing lumber prices may not translate immediately into higher log and stumpage prices because the supply of logs available to sawmills can grow much faster than the demand for those logs over a short time period. However, we are more likely to see higher log prices when lumber prices are rising.

Two factors could drive lumber prices back down because they would increase the supply of lumber beyond the recent increase in demand.

First, Canadian mills might increase shipments to the U.S. because the 5-year Softwood Lumber Agreement (SLA) expired in March. So far, Canadian mills have resisted the temptation to increase shipments even in the face of rising lumber prices. This is due in part to the Countervailing Duty (CVD) case before the U.S. Department of Commerce. Random Lengths notes that it will be December before a CVD is applied, if at all (www.randomlengths.com).

Second, even if there is no surge of Canadian lumber into the U.S. until 2002, some of the "permanently closed" mills might decide to reopen and mills that reduced hours or eliminated shifts might decide to operate at full speed again.

PULP AND PAPER NOT SO GOOD

While lumber prices are improving, the paper industry is weakening. Prices have been falling for market pulp, newsprint, corrugated medium, linerboard and coated papers, according to headlines in recent press releases. Companies are still closing mills.

The industry has consolidated and closed millions of tons of capacity over the past two years, but it is *still* struggling. The current slowdown is directly related to the slowing U.S. economy. Newspapers are reporting less employment and product advertising, so demand for newsprint is down. Demand for corrugated cartons is down as shipments of goods slowed with the economy. Maybe the next thing the paper industry needs is a weaker US dollar.

Weakness in the pulp and paper industry means timberland owners should not expect an improvement in pulpwood prices in the near future. The South is still working through thinning volumes, pine beetle damage and ice storm damage. Over the next few months, it may be necessary to think in terms of pulpwood prices paying for the cost of removing material from the stand, rather than providing significant income. Famous last words: "It has *got* to get better some day"!

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