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## Economic Optimism: A Recent World History

Here we present a *highly* simplified view of recent world economic history as it applies to timberland, timber and the forest products industry.

### PRE-1997

Prior to 1997, North America was a significant exporter of forest products to the world. This export business included logs and lumber from the west coast to Asia - especially to Japan, Korea and China. Southern pine products, including paper and paperboard, were exported often to Asia. Hardwood logs and lumber were exported to Europe from the East. Canada has historically exported significant quantities of products to the United States, including newsprint and softwood lumber. On the softwood lumber side, there has been a long-running trade dispute between the two countries, with the US claiming that Canada subsidizes its lumber industry to an unacceptable level. There have been various duties, taxes and quotas imposed on Canadian lumber producers during the past 10 years as Canadian lumber has come to account for over 30% of the lumber consumed in the United States.

Other regions of the world had been planting trees in anticipation of entering this business. Brazil, Chile, New Zealand and Australia are but four examples of counties that were developing their forest products industries.

In 1992, timber harvesting was virtually halted on the western US National Forests in an effort to protect the habitat of the endangered northern spotted owl. Timber prices in the US Pacific Northwest shot up rapidly (Figure 1).

The rise in prices in this region had impacts around the world. Wood buyers that depended on Douglas-fir and whitewoods from the west coast of North America scrambled to find cheaper sources of wood. The radiata-growing countries increased their exports. US southern pine prices rose (though not as rapidly as PNW prices).

US PNW prices peaked in the second quarter of 1993 (Figure 1). Douglas-fir log prices remained fairly high and steady through late 1997. Whitewood prices (primarily western hemlock) remained fairly steady through 1995, then dipped a little.

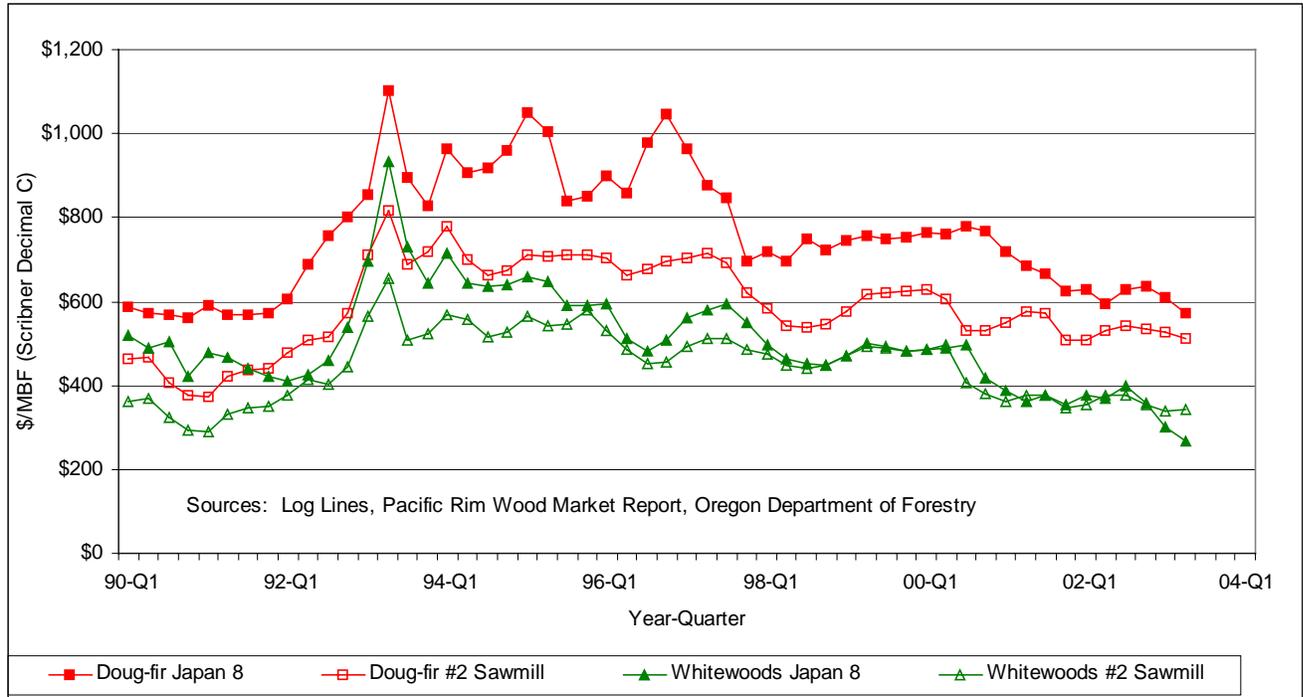


Figure 1. US PNW Delivered Log Prices (nominal \$)

#### POST-1997

In August 1997, several countries in Southeast Asia ran into severe economic crises. On July 2, 1997, the Thai Central Bank allowed the baht to float, whereupon it immediately sank. It fell 17% against the US dollar and 12% against the yen in a matter of hours. By November, the baht was down 38% against the US\$.<sup>1</sup> The Philippines, Malaysia and Indonesia also saw their currencies fall. Taiwan devalued its dollar 15% in October, the Korean won fell 22% by November. Only China, Hong Kong and Singapore managed to stave off devaluation of their currencies.

The chief outcome was a severe economic downturn in the region. Demand for wood products in Southeast Asia fell sharply. As a result, those countries exporting wood to the region faced sharply reduced demand. Wood that formerly had been shipped to Asia now had to find new markets.

But finding other markets for this wood was not easy. Other economies suffered in the following years. Russia went through a period of economic crisis. Europe has struggled with lackluster growth. The US tech stock market (NASDAQ) bubble popped early in 2000. The Dow held on for most of a year and the S&P 500 remained nearly level through mid-2001, but all three indices fell during most of 2002. The economy went into recession in 2002, and has struggled to recover through 2003.

<sup>1</sup> Czinkota, Michael R., Ilkka Ronkainen and Michael Moffett, 2003, *International Business: Update 2003*, Thomson, South-Western, Mason, Ohio

In short, the global economy has been lackluster for the past six years. Demand for wood products has not been strong. Except in the United States.

In spite of the stock market downturn (or perhaps because of it?) and the recession, housing starts in the United States have remained at high levels since 1998 (Figure 2). The average annual rate since 1955 has been 1.52 million units (with considerable variability), while the average annual rate since 1998 has been about 1.64 million units. These strong numbers continued through the recession and the period of relatively high unemployment that has followed.<sup>2</sup> This has meant consistently high demand for lumber and panel products in the US.

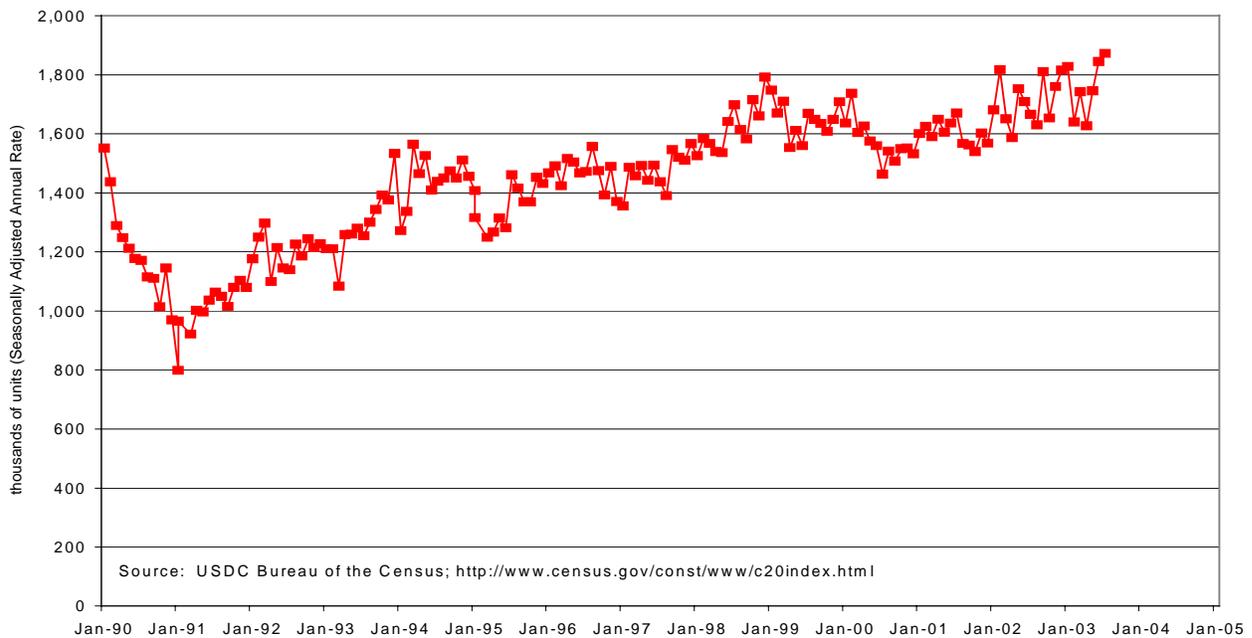


Figure 2. US Housing Starts

In spite of the strong pace of housing starts, softwood lumber prices have not reflected the same strength. In fact, prices for some lumber products in January 2001 were as low as prices for those products in 1991.

Unfortunately for US timber growers and wood products producers, the rest of the world has been trying to ship its wood products into the United States to meet that demand. Many countries have been helped in this effort by the strength of the US dollar relative to other currencies. The Brazilian real lost value sharply in 1999 and again in 2002. The Chilean peso lost value sharply in 2001. Argentina unpegged its peso in January 2002 and the peso dropped from 1 peso/US\$ to almost 3.5 peso/US\$ within six months. The Canadian, Australian and New Zealand dollars lost ground against the US dollar well into 2002.

<sup>2</sup> How can housing starts be so high when so many people don't have jobs?

The strong dollar has a double impact - it makes wood being shipped into the US cheaper than it otherwise would be, and it makes wood being shipped out of the US more expensive than it otherwise would be.

In summary, since 1997, we have seen weak demand for wood around the world, with a weak US economy a key target market for world wood producers. A strong US dollar has made imports cheaper and exports more expensive. The result has been moderately strong demand for lumber and panels in the United States with a very strong supply. Weak economies have reduced demand for paper and paperboard products. Industry consolidation has resulted in the closure of millions of tons of annual production, but the remaining worldwide capacity and production still exceed demand for most products. In the face of a surplus of available forest products, timber prices have fallen.

#### **CURRENT OUTLOOK**

We may now be looking at an improved situation.

This is not a time for unbridled optimism, because many of the improvements are slight. However, it looks like some slight increases in demand for wood in other parts of the world, coupled with a weakening US dollar, will ease the volume of wood being shipped into the US. Along with a strengthening US economy, this should be good news for US forest products and timber producers.

Stronger economic growth is expected worldwide in 2004. In some countries, this stronger growth might be very weak, but any increase in economic growth and demand for wood products can shift wood headed to the United States to those markets.

It is possible that western timber prices, particularly Douglas-fir, have leveled off (Figure 1). All three stock market indices have generally climbed through the year. Housing starts have remained strong, and could even moderate somewhat without a severe impact on softwood lumber demand (Figure 2). Lumber (and panel) prices have surged in the second half of 2003. It is unlikely that the current level of panel prices can be maintained and lumber prices have already begun to ease off their recent highs. Finally, the dollar has weakened against a number of wood-producing currencies in 2003.

In the US, it appears as though consolidation in the forest products industry might have slowed. This means further decreases in demand for pulpwood should slow. In addition, the 5-year drought in the South may be over, thus limiting access to some wood and reducing available supplies.

In summary, an improving global outlook and a weakening US dollar should reduce wood imports into the United States.

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