

GENERAL DISRIBUTION

MARKET OUTLOOK

Winter 2008-2009

By Don Deckard, Forest Economist

Recession continues. Real economic activity fell sharply during fourth quarter 2008, producing a sharp drop in employment, manufacturing output, and consumer spending. More than 1.5 million jobs were lost during the period and total hours worked plummeted at a 7.7 percent annual rate. The economy started the new year on weak footing as Americans retrenched further, forcing retailers to ring up fewer sales and factories to cut back production.

Sales of new homes tumbled at an estimated 40% annual rate and sales of existing homes declined at roughly a 25% rate. New home construction plummeted late last year with further declines expected in the first quarter of 2009. Additionally, the troubles of domestic motor vehicle manufacturers are a serious concern as the suddenness of the correction in motor vehicle sales caught virtually everyone by surprise.

While these declines and others are significant and painful, they are not without precedent, nor is the magnitude of the decline, which is expected by many analysts to be similar to what occurred in the 1980/81-82 recession (Figure 1). The length of this downturn is a function of the time needed to unwind excesses built up in housing inventory, stabilize financial services, and restore consumer confidence.

Housing & Mortgage Markets

At the peak, housing starts were >2 million units per year as compared to <1 million starts in 2008 (Figure 2). The consensus expectation is to bottom out in 2009 at <800,000 starts with a slow rebound anticipated. No significant improvement can be expected until the backlog of foreclosed homes are resold.

Credit markets seem to be thawing out after months in a deep freeze. In an unprecedented move last month (December), the Fed ratcheted down its rate to hover between zero and 0.25 percent. The Fed is expected to keep rates in this range for much, if not all, of this year. The Fed also has pledged to use other unconventional tools to revive the economy.

Figure 1. Change in Real US GDP, Billions 2000 Dollars.

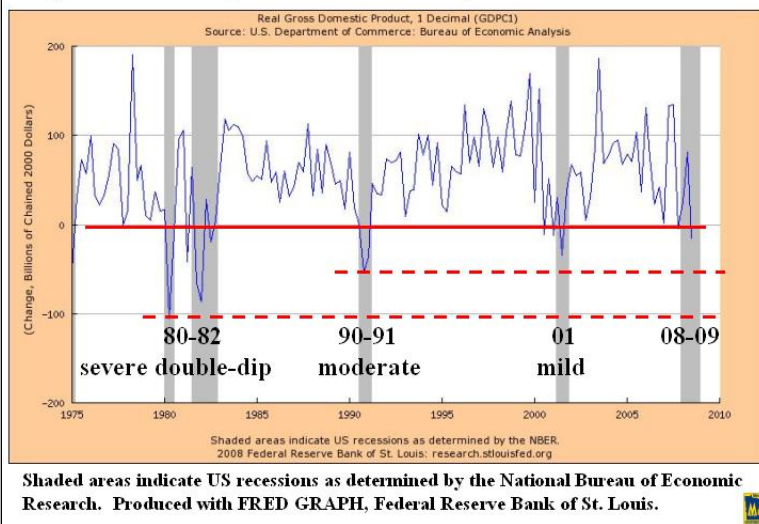
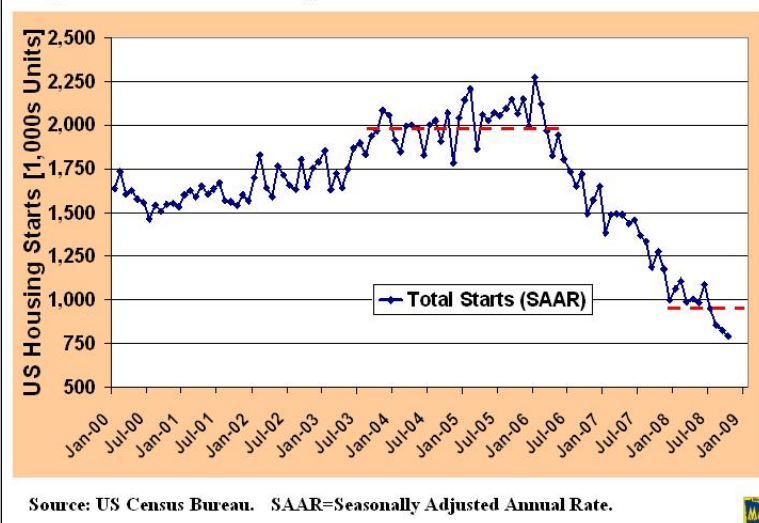


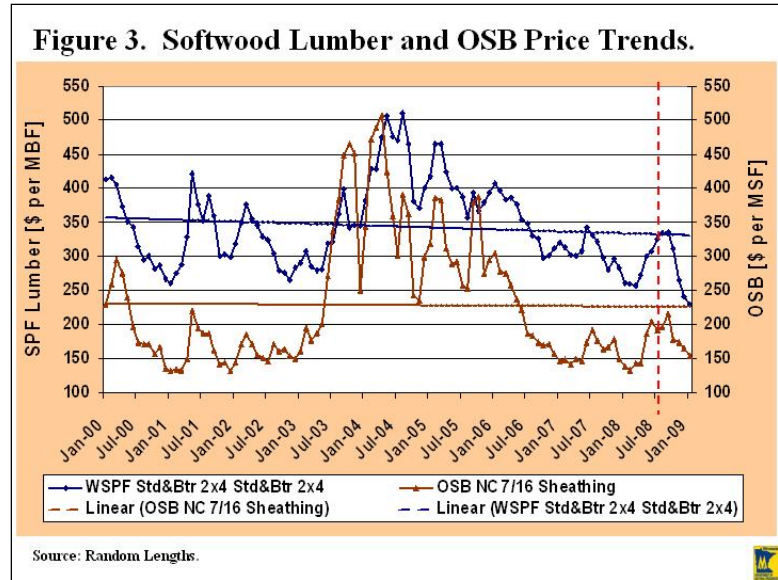
Figure 2. U.S. Housing Starts.



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Lumber and Engineered Wood Panels

Prices: Domestic softwood lumber and engineered wood panel prices plummeted during fourth quarter CY08. For January, the reported price of random length kiln dried western spruce-pine-fir (SPF) Std.&Btr. 2x4s was \$228 per thousand board feet (MBF), delivered to Chicago, as compared to \$312 per MBF in July, a 27% decrease. January North Central 7/16" oriented strandboard (OSB) sheathing was reported at \$153 per thousand square feet (MSF), f.o.b. mill, as compared to \$195 per MSF in July, a 22% decrease (Figure 3).



Production: For CY08, North American structural wood panel (plywood and oriented strand board) production totaled an estimated 31.3 billion square feet (3/8" basis), down 19% percent from CY07 and 27 percent from the record 43.1 billion square feet produced in CY05, according to APA--The Engineered Wood Association. Panel production is forecast to fall another 8 percent to 28.8 billion feet in CY09. The outlook is based on the expectation that the U.S. economy will continue to contract through the first half of CY09.

Exports: Although prices were down significantly, domestic OSB export volumes increased 89% in CY08 as compared to CY07. However, domestic hardwood log and lumber exports declined 2% and 17% respectively (Table 1).

Table 1. Selected U.S. Forest Product Exports, 5-Year History.

Product	2004	2005	2006	2007	2008	2007-08
	(quantities in cubic meters)					Change %
Hardwood Logs	1,980,618	2,234,899	1,837,849	1,859,926	1,825,155	-1.9%
Hardwood Lumber	2,805,889	2,801,196	2,897,543	2,560,712	2,135,444	-16.6%
Softwood Logs	6,172,241	6,269,084	6,413,782	6,509,423	6,257,795	-3.9%
Softwood Lumber	1,412,352	1,568,484	1,687,932	1,772,069	1,915,785	+8.1%
OSB/Waferboard	159,916	131,655	150,094	205,737	388,798	+89.0%

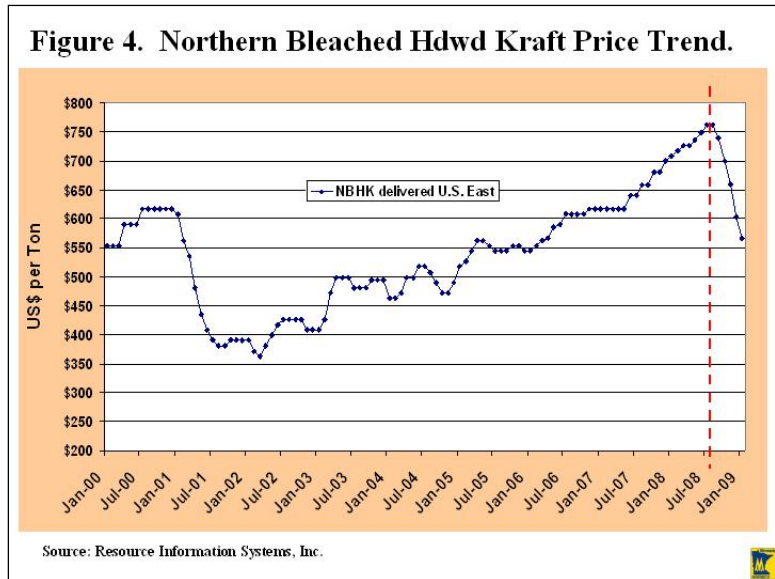
Source: U.S. Dept. of Commerce, Census Bureau, Foreign Trade Statistics.

Pulp & Paper

Regional Markets: Through the last quarter of 2008, Minnesota's timber industry struggled demand for grades of paper made by many of Minnesota's paper mills began to falter. Over the quarter, market prices for pulp & paper and prices paid for delivered timber dropped. Boise and VERSO took market related downtime. Across the border, Abitibi-Bowater announced market related downtime at both the Thunder Bay and Fort Frances, ON mills. And, Domtar permanently shut its 150 metric ton/year Dryden, ON converting mill. Price declines and downtime were attributable to oversupply and weak demand. At this point in time, uncertainty surrounds slowdowns in paper demand combined with the most recent Ainsworth Bemidji shut with respect to potential impacts on statewide harvest levels through CY2009-10.

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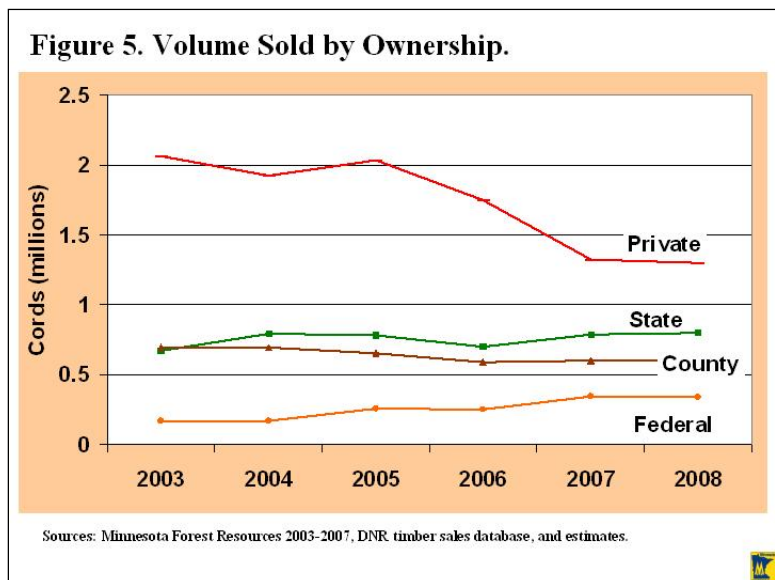
Prices: In January, pulp & paper contract prices continued the downward trend that started in September. Contract prices opened 2009 down ~20% from the July 2008 peak with spot prices ~30% below the July peak. In January, benchmark northern bleached hardwood kraft (NBHK) continued to decline, opening at \$565/ton on a net delivered basis in the U.S. East or 22% below the July peak (Figure 4). Southern bleached hardwood kraft (SBHK) opened the year at \$562/ton, also 22% off the July peak. Contract northern bleached softwood kraft (NBSK) slipped to the \$640/ton range, down from \$805/ton in July. Southern bleached softwood kraft (SBSK) dropped to the \$612/ton range, down from \$766 in July. Prices may now be near the cash delivered costs of many North American producers (RISI, Pulp & Paper News).



Production: The fourth quarter 2008 financial and economic problems had a negative effect on demand for printing and writing papers. For 2008 U.S. printing & writing paper shipments were down ~6.6% (est.) from 2007 (American Forest & Paper Association). The biggest impact has been on coated papers because of the link to consumer driven end-uses such as magazines, catalogs and retail inserts. Magazines are reeling from a sharp cut in ad spending, particularly from the automobile industry. Catalogs and retail insert printing is down because customers are not buying as much. These end-uses posted large declines in late 2008 that will continue into at least the first half of 2009.

Woodfiber Prices & Availability

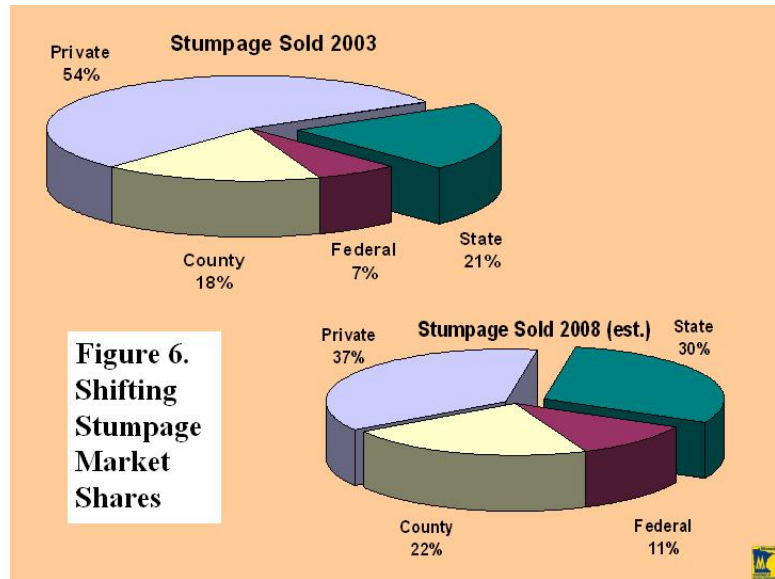
Prices: Many Lake States pulp mills went into the fourth quarter with plenty of inventory on hand and cut back on deliveries as the quarter progressed. In fourth quarter 2008, Lake States average delivered mixed hardwood pulpwood prices decreased \$12 per cord to \$81 per cord or 13% as compared to third quarter 2008 while average delivered softwood pulpwood prices remained flat. In Minnesota, the delivered price of aspen pulpwood decreased by \$10 per cord to \$79 or 11% and Wisconsin delivered aspen decreased by \$14 per cord to \$80 or 15% for the quarter (RISI, IWR, December 2008). These price reductions reflect quarter-to-quarter drops in diesel prices, product prices, and equilibrium adjustments in quantity demanded.



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Supply/Demand: From a fiber supply standpoint, Minnesota is in decent shape primarily because of the continuing availability of public land sourced stumpage and the flexibility of public land managers to sell at current market prices. The total volume sold by Minnesota's public agencies increased from 1.5 million cords in 2003 to an estimated 1.7 million cords in 2008 (Figure 5). Over the same time period, in-state industrial consumption decreased as over one (1) million cords of manufacturing capacity was idled. As a result of reduced consumption, harvest levels decreased from 3.6 million cords in 2003 to an estimated 2.8 to 3 million cords in 2008 and net imports decreased significantly from the 2005 peak 600,000 cords. In addition to lower harvest levels, a significant side effect of cumulative OSB shuts has been aspen availability. Aspen went from being relatively scarce at 4.2 million cords consumption to being in near balance with industrial demand at 3.1 million cords consumption. This change in equilibrium quantity has also had the effect of marginally lowering both delivered and stumpage prices.

Changing Market Shares: As the total stumpage market pie got smaller, private land stumpage sold decreased from 54 percent in 2003 to an estimated 35-40% in 2008 while public stumpage sold increased from 46% in 2003 to an estimated 60-65% in 2008 (Figure 6). Although private stumpage remains a tremendously important segment of total industrial wood supply with an estimated 1.2 million-cord harvest, public stumpage has become a larger share of the total supply for Minnesota's forest industries with an estimated 1.7 million-cord harvest.



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Note: This article contains forward-looking statements with respect to forest products and stumpage markets. These statements reflect the author's views and are subject to risks and uncertainties that could cause actual outcomes to differ substantially from those expressed or implied in these statements.