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Pacific Rim / Asia Market Dynamics; Logs, Lumber and Manufactured Solid Wood Products

This message is an explanation of the current dynamics in the Asia/Pacific market place for wood products, where demand for logs and wood products has taken a relatively sudden and quantum leap upward.

The result in NZ is that forest owners exporting logs are in a strong position, while downstream wood processors are experiencing both a tightening supply of raw material and upward pressure on raw material prices.

So what forces are at play in Asia/Pacific that has brought about this relatively sudden situation?

One needs look no further than China to get a feel for reasons driving these changes.

The impact of global economic recession saw the Chinese Government take swift action in late 2008 to stimulate economic activity in the form of a US$730 billion stimulus package. These measures are now having an impact as Chinese domestic production and exports resume growth.
This stimulus, and a modest improvement in the global economy, is creating strong demand for wood fibre and in a country that is seriously short of harvestable forests Chinese manufacturers must look to imports for raw material.
The China Society for Forestry estimates that by 2015 China's wood fibre demand in round-wood equivalent (RWE) will reach 350 million m^3, with domestic supply RWE output expected to meet just 200 million m^3 – meaning a short fall of 150 million m^3 (RWG) in 2015.

Much of this demand was until very recent times being met by Russia, however supplies from across China's Northern borders are reducing due to increasing Russian taxes on log exports, uncertainty over Russian government export legislation, some sawmilling operations relocating from northern border to the eastern seaboard and harvesting operations moving to more intractable terrain. As a result the Chinese manufacturers are successfully using Radiata Pine from NZ for veneer, plywood and an array of other high end value added uses.

This in itself may provide the basis for a systemic shift in sourcing patterns from China for NZ's forest product exports.

As a log exporter to China NZ is still becoming a significant player – logs to China this year are estimated to total 5 million cubic metres.
NZ sawmillers selling into China are also experiencing unprecedented demand for kiln dried sawn lumber, and the importers are paying higher prices.

The result in New Zealand is that China has emerged as a benchmark for pricing logs and lumber (in 2009 China imported over 50% of NZ's export logs, and nearly 25% of NZ's export lumber).

The Korean market is showing signs of life, importing 600,000 m³ of logs in the September 2009 quarter and expected to import 2.5 million cubic metres in 2010.

It is anticipated that India will increase its demand for logs in 2010 - forecast to be one million cubic metres.

The US market is more active and while housing starts are still languishing around 575,000 starts per annum (as at Feb.,2010) and building activity is low, the DIY/retail segment activity is lifting. This has been exacerbated by the Chilean earthquake having an immediate impact on prices in mouldings and dressed boards, with advances in price of up to 20% being reported. Large US retailers like Lowes, Home Depot and Maynards are fearful of supply shortfalls so price is unlikely to be as sensitive during 2010 as previous periods.

To add to this fast changing mix, the earthquake in Chile has temporarily impacted it as a supplier to Asia and the USA. While it is uncertain how long the country will be down, it is anticipated that it will take around three months to get infrastructure back in place and because of flow-on effects this could see Chile sidelined from Asian and North America markets for possibly up to six months. With Chilean shortfalls in supply of up to 30 million m³ of wood product, somehow this will need to be replaced in Asia/Pacific markets.

In addition to this demand for logs and lumber from points north of the equator the long awaited upturn in building starts in Australia and New Zealand is starting to bite. The housing Industry Association of Australia have just reported December end starts rising to an annualized level of 160,000 starts. The same sorts of increases may also be expected in New Zealand, contributing to pressure on supply and price.

Over the last two years the wood products industry globally, as a result of economic recession, has rationalized and as a result productive capacity has been reduced world wide.

The reduction of stock in the supply chain is also contributing to shortages as companies get their cash flows back in order and endeavour to ramp-up activity.

All these events - Asian economies quickly bouncing back (excluding Japan) from the global recession, a reduction in Russian wood moving into China, quietly rising US retail demand, Chilean supply uncertainty and a reviving Australasian housing market - it is little wonder NZ log and wood products producers are witnessing an astonishing and rapid increase in demand for their products.

This fast changing scene in Asia / Pacific has already resulted in log and lumber price rises for sawmillers and manufacturers in New Zealand. The speed of change is making it difficult for players through the supply chain to advise their upstream customers with enough lead time to forewarn of impending price increases. Domestic prices for timber in NZ are increasing rapidly as sawmillers pass on log cost increases they have to pay to secure supply to their mills. Downstream manufacturers are receiving price increases with little notice in this fast changing environment, and have no choice but to pass increases on.

Can NZ lift its annual harvest to help relieve domestic pressure on fibre availability and maybe rising fibre price?

Large scale increases are unlikely, as this most often requires pre-harvest roading to be done two years in advance of harvesting, plus the available trucking fleet and operating equipment in Central North Island is operating at capacity. That said New Zealand harvest levels throughout 2010 are likely to lift a little to around 22 million m^3.

Will NZ log exporters look to meet this rapidly rising export demand via domestic log diversion?
While sawmill output was flat for most of 2008 and all of 2009, log exporters in the latter half of 2009 were increasing export volumes, the early explosion in demand in 2010 has caught almost everyone unawares.

The extent to which diversion may occur is uncertain, but hopefully will not be significant as most NZ forest owners understand the strategic importance to have a strong domestic processing and manufacturing base. As commodities are prone to do, at sometime in the future, the current supply shortage will balance out and forest growers are somewhat insulated by its home market.
The wild card in this log export setting for domestic sawmillers and downstream manufacturers are the pure play log traders, that don't own any forest and therefore do not have any vested interest in the maintenance of a strong domestic processing and manufacturing sector.

Log and lumber prices are increasing in NZ and will undoubtedly rise further and as mentioned earlier the indications are that there is a systemic shift afoot in China in terms of wood fibre supply, which hopefully augers well for the forest and wood products industry.

What this means for all wood products manufacturers in the supply chain is the price of wood and wood products is going to rise, so it is important for the entire supply chain to be moving at the same pace, or there will be losers in the process. The challenge in all of this change for wood processors and end users alike of course is to ensure the price of wood products doesn't rise to such a level that other material substitutes take market share as wood prices itself out of its end use market segments.

Which ever way you look at it NZ is in a strong supply position. Boom times are upon the industry – increasing demand and prices should be good for an industry with a history of underinvestment and poor profitability.
At times like this it pays for all involved in the industry to take heed of an old Chinese proverb, which loosely translated states “when there is only one bowl of rice there must be sufficient to feed everyone around the table”.

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