Wood Pulp & Paper Prices Continue to Rise

By Jesse Chiang

Packaging producers can guard against projected growth in their wood pulp & paper costs by capitalizing on favorable economic trends.

In 2015, global wood pulp prices climbed past the previous peak from 2011, which was the highest price point in more than 30 years. Unfortunately for manufacturers that rely on the material as an input, especially paper-based packaging manufacturers, higher wood pulp prices have been increasing their production costs. According to IBISWorld, the price of wood pulp is forecast to rise even further at an annualized rate of 5.1% in the three years to 2019. The rising price of wood pulp will also be reflected in the domestic price of paper, which is projected to grow at an annualized rate of 3.2% in the next three years.

Paper-based packaging producers and suppliers will have ways of counteracting rising input costs, though. For instance, growing demand for paper-based packaging products will allow packaging producers to continue passing on some of these costs to buyers. Sustained growth in e-commerce activity and increases in consumer spending power will drive growth in demand for paper-based packaging products. Heightened industrial production activity and government spending will also boost demand for packaging products.

Higher Consumer Spending Power
Increasing consumer spending will propel growth in demand for various discretionary and nondiscretionary goods, which are often shipped using paper-based packaging. This rise in consumer spending will be driven by several factors. For one, IBISWorld expects that the national unemployment rate will remain at prerecession levels during the three years to 2019. Improving economic activity will encourage more businesses to open and existing businesses to increase hiring.
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creating more jobs. In addition, consumer confidence, as measured by the consumer confidence index, is forecast to rise at an annualized rate of 3.2% in the next three years, which reflects improving consumer attitudes about the economy.

With stable unemployment and higher confidence in the economy, consumer spending is anticipated to grow at an average annual rate of 3.3% from 2016 to 2019. Lastly, the US population is projected to expand at an annualized rate of 0.8% during this time, which will slowly drive up demand for food items and other essential goods that require paper-based packaging.

**Sustained Growth in E-Commerce**
The growing number of broadband internet connections and mobile internet connections is expected to further drive e-commerce sales and demand for packaging products, particularly those used in commercial shipping applications. E-commerce sales are expected to account for an estimated 10.6% of all retail sales in 2019, an increase of 2.6 percentage points from 2016. Meanwhile, consumers have become more willing to invest in faster internet service, contributing to growth in the number of broadband connections; this metric is forecast to rise at an annualized rate of 3.9% in the next three years. Stronger internet capabilities will enhance the speed and convenience of e-commerce purchases, driving up demand for various packaging products used to deliver online purchases. Furthermore, the number of mobile internet connections is expected to increase at an annualized rate of 5.0% in the three years to 2019. Strengthening use of smartphones and tablets will further propel the growth in the number of mobile internet connections, meaning more consumers will be able to make purchases from almost anywhere, further supporting demand for paper-based product packaging and shipping materials.

**Heightened Industrial Production & Business Activity**
The industrial production index, which measures output from the mining, manufacturing, electric and gas industries, is forecast to increase 2.4% per year on average through 2019. Growing industrial activity is anticipated to drive up demand for paper-based packaging products due to their widespread use to transport various items necessary for production and distribution purposes.

In addition to heightened industrial production, the number of businesses is expected to grow during the three years to 2019 at an annualized rate of 0.8%. This trend will boost demand as businesses purchase and distribute various goods in paper packaging products. Corporate profit is also anticipated to rise at an average annual rate of 2.5% in the next three years. Expanding profit margins will allow corporations to increase their purchases overall, as well as place orders for
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purchases they delayed during the economic downturn. Renewed corporate spending will drive up demand for packaging products, as many of these goods are shipped with paper-based packaging.

Rising Government Spending
Lastly, rising government spending will also contribute to increased demand for packaging products via increased orders for general office supplies, which includes pens, pencils, office paper, folders, binders and more. The government is responsible for various public construction efforts in addition to healthcare and military spending, which contribute to demand growth for paper packaging products in those downstream industries. In the three years to 2019, government consumption and investment, which includes federal, state and local government spending, is forecast to grow at an annualized rate of 1.8%. Sustained economic growth will widen the tax base, allowing the government to spend more during the period, increasing their needs for packaged products.

Leveraging Your Buyer Power
Growing demand stemming from higher consumer spending, strong e-commerce sales, increasing industrial production activity and rising government spending will allow paper-based packaging suppliers to protect themselves from higher wood pulp prices by passing on such costs to buyers.

Beyond raising prices, vendors of paper-based packaging products can strive to protect their bottom line in other ways. According to IBISWorld, domestic wood pulp buyers have a moderate amount of leverage when negotiating with wood pulp providers because products do not vary much across the market, reducing risks associated with quality and limiting the research costs necessary to determine if a vendor is a good fit. As such, buyers can more easily switch between wood pulp suppliers if necessary. Buyers gain leverage from low switching costs because they can either seek better value from a new vendor or negotiate from a stronger position with an existing provider.

Even though wood pulp prices are expected to reach historical highs in the coming years, it’s not all bad news. Paper-based packaging manufacturers are in a strong position to protect their profit margins, with rising demand for packaging products and solid negotiating leverage.
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