



# Uncoated Free Sheet

With the continued fall-off in North American demand, producers have aggressively managed capacity in hope of better prices in 2006.

By Harold M. Cody

Through 2005, the uncoated free sheet paper sector remained under siege as demand progressively shrank. However, continued supply side management on the part of producers kept operating rates at levels that have allowed producers to prevent pricing from plummeting.

Despite an unsuccessful attempt to boost prices by \$40/ton in September, another move is underway to increase prices going into 2006. This increase, driven by rising costs, some firming of U.S. demand, and lower end-user inventories, stands some chance of success, but the outlook for 2006 is anything but rosy.

The root of the problem facing U.S. and Canadian mills is that North American demand through October 2005 is down 4.1% vs. 2004 levels, with shipments off about 4%, although the drop in output is in part due to capacity withdrawals. Imports over the same period were up about 8%. U.S. uncoated free sheet production was down 3.7% over the same period vs. prior year levels. This fall-off in demand, while not particularly surprising given the downward trend that began in 1999, is particularly ominous following the modest 0.5% increase posted in 2004, which reversed a five-year slide.

Even though the 2004 increase was dismal by “normal” or historical standards for growth in demand during a period of economic growth, there was hope that demand would also post an incremental gain in 2005. The thinking was that the gains in 2004, and the hope for gains in 2005, were a result of the economy expanding and some easing of competitive losses.

The drop merely highlights the fact that fundamental underlying demand is losing ground to electronic information systems and to competitive grades. Imports of finished products such as books, cards, etc., have also been rising and also contribute to lower demand for paper used to produce these products domestically.

## Challenge in 2006

The challenge for producers is that 2006 is likely to be a tougher year than 2005 for all printing and writing papers due to a rise in U.S. postal rates, higher costs, and uncertainty about the strength of the economy. Demand is very likely to contract again. Compounding this is growing global capacity for uncoated free sheet, notably in Asia, where capacity is set to rise by more than 1 million tons in 2006-2007.

NORTH AMERICAN PRINTING & WRITING PAPER STATISTICS (000 metric tons)					
	10/05	% Change Year Ago	Year-to-Date 2005	% Change Year Ago	
<b>Uncoated Free Sheet</b>					
Shipments	1,050	-1.7%	10,402	-3.9	
Operating rate	87	90 <sup>1</sup>	88	93 <sup>1</sup>	
Imports	38	-21.3	375	7.9	
Demand	1,061	-3.4	19,507	-4.1	
<b>Total Printing &amp; Writing</b>					
Shipments	2,432	0.3	23,358	-2.0	
Operating rate	91	93 <sup>1</sup>	90	93 <sup>1</sup>	
Imports	264	-21.8	2,641	-3.4	
Demand	2,619	-2.5	25,137	-2.2	
MILL INVENTORIES					
	10/05	9/05	10/04	Tonnage Change Month Ago	Year Ago
<b>Uncoated Free Sheet</b>	1,292	1,295	1,230	-3	62

1. Shipments/capacity for latest period and year ago.

r = revised.

Source: Pulp and Paper Products Council, American Forest & Paper Assn.

Therefore, unless producers continue to aggressively manage capacity by facing up to continued and painful machine and mill closures, prices are likely to be under pressure during 2006 despite the cost driven need to raise them. IP and Weyerhaeuser—the two largest producers with 45% of North American capacity—have begun to close significant amounts of capacity.

The No. 3 North American producer, Domtar, closed all or most of two printing paper mills in Ontario in November. These closures total about 4% of capacity, and thus if demand contracts in 2006, further closures are likely.

Prices on other printing and writing papers were raised successfully in the second half of 2005, partly in response to escalating energy costs. Uncoated free sheet mills were only partially successful in implementing fuel and energy surcharges.

However, with the shutdowns, despite any real sign of a seasonal pickup, uncoated free sheet prices stabilized at published prices under \$700/ton for offset rolls grades and under \$800 for cut-size grades, with transaction prices about \$40/ton less. The latest increase, announced by IP, and effective for January, would increase prices \$50-\$60/ton, excluding cut-size papers. ■

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