Box Demand Remains Weak, and While Glimmer of Hope Emerges about Pricing Gains, 2010 Will be a Tough Year

By Harold M. Cody

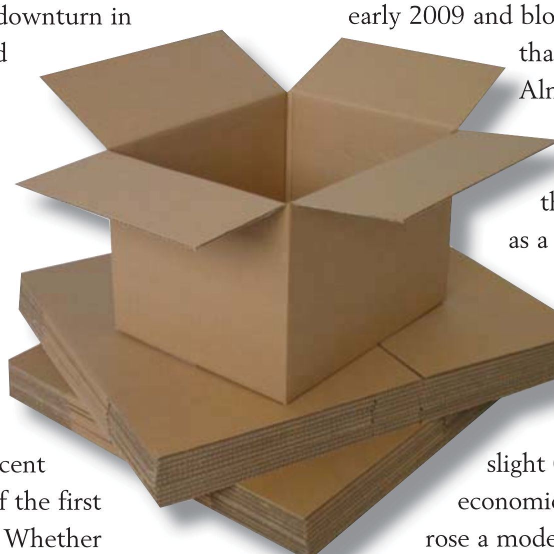
Key economic benchmarks including industrial production and GDP and market indicators such as operating rates, box cut ups and paperboard shipments should post modest gains in 2010 over historically depressed 2009 levels. These gains combined with massive capacity reductions will lead to some improvement this year possibly including modest gains in box and board prices. However, with underlying demand remaining very weak and showing little sign of a significant recovery this year, any gains are likely to be marginal and the market for containerboard challenging.

To say that the last 12 months have been challenging for the corrugated box and containerboard business is an understatement to say the least. Demand, output, pricing, financial returns and just about any measure you choose to evaluate plunged to historically low levels last year driven by the worst economic downturn in memory. The only period that could be used as a comparison would be the energy induced recession in the mid-1970s and it's still even worse than that.

That said there is some – at least maybe a little – hope that while "normal, healthy" market conditions are nowhere in sight conditions should improve a little in 2010 and going forward. The most notable indication of this was the recent announcement by most producers of the first increase in pricing in many months. Whether or not it's successful and sticks is another story.

Setting the Stage

First let's review the big picture since our last containerboard report (*PaperAge*, Jan./Feb. 2009).



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To put things in perspective, 2009 was a bellwether year no matter what industry, trade or social-economic sector or area you evaluate, not just for the pulp and paper industry. But it was a notably BAD year. The economic downturn that started in early 2008 really hit hard in late 2008 and early 2009 and bloomed into a historical, global recession that carried through most of last year. Almost all key measures posted record setting declines including four straight declines in GDP beginning in third quarter 2008 and thus qualifying as a recession (after two negative quarters). GDP plunged precipitously in late 2008 and early 2009, falling 5.4% and 6.4%, respectively, in fourth quarter 2008 and first quarter 2009, before finally posting only a slight 0.7% drop in second quarter, 2009. The economic slide ended "statistically" when GDP rose a modest 2.2% during third quarter 2009.

Industrial production, which is the key indicator for corrugated box and containerboard demand fared even worse, plunging 19% and 10%, respectively, on an annual rate basis in the first two quarters of 2009.

In response, the corrugated box business collapsed as orders and business evaporated in late 2008 and during most of 2009. Box shipments in 2009 fell about 9%, which follows on the roughly 4% drop in 2008. This means the U.S. economy consumed less square footage than it did in the 1980s. The 2008 level is about the same as in 1995.

Containerboard prices fell as well throughout much of 2009, but were restrained from totally collapsing by massive capacity reductions and downtime by producers trying to just survive. Among these was the late 2009 announcement by Smurfit-Stone (which is in bankruptcy), the No. 2 producer, to close two mills (Missoula and Ontonagon) with almost 900,000 tons of containerboard capacity, bringing total industry shutdowns and withdrawals to an estimated 3 million tons.

Glimmer of Hope or Mirage?

Despite a U.S. economy that remains fragile due to continued job losses and a weak housing market, some hope for improvement has emerged. First, the economy grew in third quarter 2009, as shown by a modest increase in GDP and recent improvements in home sales, which however, remain weak and unpredictable. Industrial production (IP) has begun to move in the right direction as well and rose 6.1% in the third quarter 2009, following precipitous declines in the first and second quarter of 19% and 10%, respectively.

In November, IP rose 0.8% vs. the prior month, the sixth straight increase if you include a zero percent change in October. IP began a nose dive in early 2008 and plunged steeply until mid-20009. Of course, IP remains at very low levels compared to historical norms.

The Purchasing Managers Index, another widely watched measure also rose for the eighth straight month in December, and at 55.9% is at the highest level since April 2006.

In turn, box shipments have begun to show signs of life – although small and tentative – as shipments rose for the first time in over a year in November by posting a 2.8% increase on an actual basis from a year ago and were at the highest monthly level for the year. However, shipments remained similar to the deeply depressed levels from late 2008 when the economic downturn hit hardest and thus year to year comparisons have to be made with caution. Year-to-date box shipments through November 2009 were down 8.6% actual and 7.8% average week from last year.

Another small but positive sign is that exports have improved in recent months and provided a boost to shipments and operating rates. Export production in November jumped 4.6% and reached 336,000 tons, the highest level since 2006 and almost 50% above the prior year level.

These factors combined with a push provided by higher energy prices and rising fiber and transportation costs led to an attempt to push through a modest price increase early this year. Late last year a wide range of mills, including the major producers (IP, SSCC, etc.) announced a $50/ton increase (on the East Coast) on linerboard effective with January shipments and a planned increase on boxes as well. Indeed it's obvious this is a supply and/or cost driven increase and has absolutely nothing to do with strong demand.

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In contrast, it's reported that containerboard markets have begun to tighten up some and various mills reported their order books were good in early 2010.Certainly this is one result of the will brought to bear on the supply side by producers who painfully cut output to match plummeting demand and led to a drop in box and containerboard inventories to the lowest level in years in tonnage terms and the lowest weeks of supply, at 3.7 weeks, since mid-2007, according to FBA data.

So Where Does This Leave Us?

While there is impetus for an increase in prices, the weakness in box cut ups may offset the positive impacts currently being felt of low inventories and improved exports as we go forward. While 2010 should be better than 2009, it seems fairly certain the recovery will be painful and longer than has been experienced in prior recessions. Linerboard and containerboard production is off almost 9% — and that's compared to 2008! — and operating rates remain low, at under 90% for linerboard in November and under 85% year to date for key grades.

These levels will have to improve considerably for pricing gains to stick. Everyone underestimated how bad the downturn was and I'm afraid the same will be said for predictions of a recovery. Therefore it appears there is a greater risk that prices and markets could weaken rather than get better as the year goes on. In that case, the current glimmer of hope we see could be just a mirage masking another tough year of challenges for corrugated box and containerboard businesses. ■

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