Containerboard Markets Maintain Steady Course Despite Weak Domestic Box Cut-Ups

Box and containerboard markets continue to exhibit the stability that has characterized the domestic market over the last couple of years. The most notable event in 2012 was the first containerboard price increase in two years. Box demand is expected to remain flat this year but barring a big change in either exports or an unexpected surge in supply the market should continue on an even keel in 2013.

By Harold M. Cody

Over the last twelve months the containerboard market has continued to exhibit the same steadiness we've seen for over two years. While there has been little growth and margins could always be better, producers are in relatively good shape particularly following price increases on both containerboard and corrugated boxes last fall. The most likely prospect for 2013 is for more of the same.

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Last year at this time the outlook wasn't very exciting either but the possibility of a major economic downturn was a major concern. A major worry was the huge cloud hanging over Europe due to the debt crisis and fears it would throw the global economy into a downturn. A major retreat by the weak U.S. economy — a "double dip" — was also cause for concern. While growth has been tepid in the U.S. and Europe in recent quarters a catastrophic downturn didn't occur. And while similar concerns remain about the strength of the economic outlook fear of a major downturn seems to have diminished.

U.S. GDP growth continues to be steady, but the relatively anemic rates of growth seen during much of 2012 were unable to overcome problems such as high unemployment and a weak housing market. GDP posted a solid 3.1% rate of growth in the third quarter of 2012, but this followed just 2% and 1.3% growth in the first and second quarters. Following a strong rebound in 2010, when industrial production ended a two-year slide by rising 5.3%, industrial output had been growing. But after rising just 0.2% in second quarter 2012, IP fell 0.7% in the third quarter.

Stagnant Box Market

As a result of lackluster economic growth, U.S. box shipments are flat. Through November 2012 shipments were 330.9 billion sq. ft. (BSF), a slight 0.2% gain over year earlier levels according to FBA. This remains well below historical levels such as the 390 BSF level in the 2004-2007 period. In turn, there is a surplus of corrugated box capacity.

Mill production was similarly subdued last year. Total containerboard production in November was up 1.0% vs. 2011 but through the first eleven months of 2012 was running just 0.4% over the 2011 level at 31.46 million short tons, according to AF&PA. Linerboard output is down year to date while medium production is up about 2.1% through November compared to a year earlier.

In Europe it's reported that virgin liner has been in tight supply but recycled grades are readily available due to continued weakness in European box demand owing to the weak economies of the region.

Given this rather weak economic performance and flat box demand, the market moved steadily along for most of 2012. And for most of the year there was little serious talk of a price increase being in the cards. However, by late summer 2012 conditions had changed enough that a $50/ton price increase was announced effective in September on containerboard grades. To the surprise of many the increase was quickly enacted bringing 42 lb. grades up to around $600/ton at the high end, according to various sources. Box prices also rose about 8% during the fourth quarter, the first increase in over two years.

The success of the price increase, however, was all about limited supply not driven by improved demand. The constraints were the result of a plethora of planned and unplanned outages during the first half of the year. As a result, while shipments remained sluggish, mills have been able to maintain operating rates. In November, total operating rates were 96.9% and year to date have averaged 95.4%

In addition, a key factor leading to tight market conditions, and a major contributor to the success of the fall 2012 price hike, was low inventories. In October 2012 U.S. containerboard inventories dropped to the lowest level in literally years at 2.01 million tons. In November, the latest data available, they were running at just 3.6 weeks of supply, a slight uptick from the October level of 3.5 weeks. In fact, it's reported that some mills found it better to ship tonnage domestically rather than into the export market due to limited supply.

Overall the November containerboard and box plant data were good news for the industry. Some of the decline in box shipments — November shipments were off 1.2% — may be due to disruptions caused by the big storm in the northeast late last year.

Linerboard exports continue to play a key role in the overall tone of the market. Export linerboard production in November was 294,000 tons, down 3.2% compared to the prior year, bringing year to date export shipments to 3.5 million tons, a modest 1.4% gain over 2011 levels. Production for export in October was 283,000 tons, the lowest level for exports in 2012.

Export pricing has also been improving but the gains varying widely by market. Modest gains were made on export spot prices in some areas such as Asia while gains closer to home in South America, for example, are reported to be larger, with U.S. mills implementing a $50/ton increase.

U.S. Kraft liner export shipments reached nearly 4.5 million tons in 2011 according to the US Dept. of Commerce, nearly a one million ton increase over 2009 levels. By far the largest export markets are Europe and Latin America, which account for roughly half. Mexico has been a big growth area in the last 3-4 years. Thus, while weakness in Asian shipments has occurred other markets have maintained a relatively high level of tonnage overall.

One thing that hasn't been stable in recent months has been input costs, at least for OCC. Starting at very low levels in 2009, OCC prices rose steadily into 2011 in one of the longest such stretches ever seen. However, during spring and summer 2012, OCC prices fell for five straight months, dipping to under $100 in the U.S. for the first time in three years in July. Prices posted a bit of a recovery in late 2012, but so far gains are modest.

Reading the Tea Leaves

The question now is whether the factors that aligned to keep supply and demand in a narrow range of balance will continue in 2013. To a large extent it appears likely that they will.

First, let's examine demand. Most 2013 economic forecasts are subdued and call for continued sluggish growth — assuming the Federal Government navigates the "fiscal cliff" situation and avoids potentially throwing the economy into turmoil. In turn, box shipments at best might grow 1%, following little or no growth last year, and it may continue to just slip sideways and remain at the current level. Until the economy grows at stronger rates — e.g., 3% or more — box demand simply won't post any major gains. Most projections don't call for any large economic gains until 2015 at the earliest.

One thing to watch closely is capacity that will be coming on line this year. A total of 850,000 tpy of recycled capacity based on new/converted machines at Atlantic Packaging and Cascades will come on-line in 2013. And significant capacity is also coming online in China, which is one reason liner exports to China were weak in early 2012. Various sources report that almost 10 million tonnes of containerboard capacity were added during 2011-2012 in China.

Thus, assuming the wheels don't fall off the economic train, the recipe for success will likely continue to work. Capacity control, in conjunction with significant Kraft liner export tonnage should maintain operating rates which in turn sustain pricing and margins. Some weakness in selected export markets may occur but it appears likely this could be offset by solid shipments to other regions. If inventories remain low and producers can work their way through the slow winter months, it's even possible they may be able to take a shot at another price increase. Even if they don't, the status quo isn't all bad. ■

Harold Cody is a contributing writer for PaperAge. He can be reached by email at: HCody@paperage.com.