



While Facing Challenges Containerboard Market Appears Likely to Remain Stable

Despite only modest economic growth, containerboard prices have remained solid for most part. And while box shipments only grew a minor amount, the containerboard market remained in overall balance. However, the underpinnings to this stability — notably continued solid exports and high operating rates — may face challenges in 2016 including pressure on export price and growing capacity.

By Harold M. Cody

2015 was a decent year for containerboard mills, but what began on a very positive note ended with some doubt about the outlook for 2016. Markets entered 2015 on a roll following a strong showing in the manufacturing sector in late-2014 helped by improved consumer spending buoyed by the steep decline in energy costs, which freed up cash for consumers to spend. The downturn in energy prices, of course, has negative impacts on some sectors of the economy, but the good news is that these sectors typically are not major consumers of corrugated boxes.

However, despite this good sendoff, the economy did not continue to post good growth in all sectors last year and thus box growth while positive was relatively weak. Owing to an extremely cold first quarter, industrial production started poorly, falling in both the first and second quarter 2015, down 0.3% and 2.3%, respectively, on an annual basis. In the third quarter industrial production rebounded by rising 2.9%. Industrial production for food and tobacco products, which are the key



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sector for boxes, performed better, growing 1.3% and 4.9% in the second and third quarters of 2015, following zero growth in the first quarter.

DEMAND SLUGGISH BUT STEADY

Box demand has been sluggish in recent years, growing only nominally in 2013 followed by a gain of just under

1% in 2014. While this isn't very exciting, it's better growth than for many grades of paper and board. Unlike many other segments of the industry such as printing and writing grades, the packaging industry is supported by relatively stable demand for its key product: corrugated boxes. Similarly, slow growth occurred in 2015 as shipments are estimated to have grown about 1% or a little under. This was disappointing given that in early 2015 some analysts projected box demand to grow in the 1.5% to 2% range.

With domestic demand sluggish, Kraft liner exports continued to be the safety valve allowing producers to maintain production levels. Export liner prices have been under pressure over the last couple of years owing to the roughly 20% appreciation of the dollar. The euro fell from about 1.4 Euro/dollar in early 2014 to 1.1 Euro/dollar by early 2015. However, over the last 12 months the Euro has remained in about the same range. Liner exports are quite diversified by region which has helped sustain shipments and prices. Markets and approximate share include: Europe (21%); Mexico/South/Central America (44%); Africa/Middle East (12%); Far East (8%); China (8%).

In contrast, Canadian mills have seen the Canadian dollar continue to fall from about 90 cents to a low of 70 cents in early 2016. This has provided Canadian mills with added incentive to ship products to the U.S., and as a result, imports of containerboard from Canada have risen. While the strong dollar has made Kraft liner more expensive in other markets and reduced returns on overseas sales so far, it has not led to a decline in exports. Part of the reason for this is that virgin linerboard is a premium product and the U.S. is well positioned with low cost mills even though the change in currency and slippage in export prices in some areas has taken away a good part of this advantage on a cost basis.

CAPACITY GROWTH

Capacity growth has also been a concern in trying to forecast the market for 2016 as U.S. containerboard capacity is projected to grow 1.9% in 2015 following a 1.4% increase in 2014. However, most of this increase is for recycled grades and corrugating medium. In stark contrast, Kraft liner capacity was flat in 2015 while recycled liner capacity rose 4.1% two years in a row. Recycled medium posted an even larger 8.8% gain in 2015 while semi-chem fell slightly. Thus, Kraft supply remains tight while recycled grades are more available — one result has been lower prices on recycled grades.

Containerboard capacity is rising a bit in Europe and its possible this could slow Kraft exports, but at this point it's assumed this impact will be minimal.

SHIPMENTS/PRODUCTION

Based on data through October, it's clear that the overall market continues to be balanced but sluggish. October inventories fell about 3.5% from September to 2.57 million tons. Box shipments posted mixed results in October, falling 2.8% on an actual basis but rising 1.6% on an average week basis. Shipments were 32.4 billion sq. ft., bringing total shipments year to date to 308.6 bsf or an increase of 0.8%. Operating rates were about 94%, but down a bit from rates seen in the prior 2-3 months.

U.S. containerboard production over the January to October 2015 period is up 1.8% over the prior year level. As noted, a key factor sustaining production and operating rates is continued solid export shipments. U.S. containerboard exports in October 2015 were off 1.9% from 2014, but year to date exports are running 2% ahead of 2014.

BALANCED MARKET

The bottom line is that packaging markets were in overall balance last year and there is a good chance that this could continue to be the case for 2016 despite tepid box growth, uncertainty on the global market, and downward pressure on export prices.

The continued consolidation of the business — the latest being the huge combination of RockTenn and MeadWestvaco to form WestRock — should only help the industry to manage inventories and control shipments. In fact, WestRock announced plans in October to idle two machines and it's reported they may cut output further. The willingness and ability of producers to manage supply means that most forecasts assume U.S. Kraft liner prices will remain stable in 2016.

Of course there is downside risk if export prices continue to falter and uncertainty on the strength of the global economy, including China, could undermine demand, and finally result in weaker exports. The growth in recycled capacity also poses some risk that this could undercut Kraft liner prices since recycled prices have fallen and the gap has increased.

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