



Uncoated Freesheet Demand Stabilizes (Finally), But Outlook Beyond 2010/2011 Remains Uncertain

By Harold M. Cody

After a record setting fall due to the global recession uncoated freesheet demand appears to have stabilized. But underlying structural changes are likely to have permanently changed the U.S. market for uncoated fine paper (and other grades) and demand may never recover to pre-recession levels, making the mid-term outlook uncertain.

About one year ago, i.e. in early 2009, uncoated fine paper mills were standing at the edge of a cliff looking down into a bottomless chasm and strong economic tail winds were trying to push them over the edge. Similarly, the economy was at the brink of collapse, but with the help of massive government aid infusions around the world the U.S. and global economies avoided a total meltdown.

Uncoated freesheet mills actually did see demand fall off the proverbial cliff as the economy struggled through a difficult period that resulted in huge job cuts and a massive loss of wealth (in stocks and real estate), all contributing to the worst decline in advertising in memory.

In late 2008 and early 2009, freesheet demand plummeted sharply, such as the 30% drop registered in January 2009 and similar declines in other months vs. the prior year. The market remained very weak all year, although producers managed to maintain margins during the second half of the year via downtime and capacity reductions. However, beginning in late 2009 signs emerged that the market might be at an inflection point. The most recent indication was January 2010 U.S. uncoated freesheet output, which posted a modest gain over 2009, although year earlier levels were very weak. Nevertheless, this is the second month of such gains, following a similar year-over-year gain posted in December.

Looking forward, the general consensus is that the world economy will post modest gains this year as the U.S. economy slowly expands. In turn a rebound in all forms of marketing and advertising related spending, including print

advertising and direct mail are expected, but gains are at best expected to be modest.

Certainly, some of the decline in demand over the last couple of years was simply a cyclical response to economic troubles. Inventories were pulled down in a number of channels, and as noted above some end-uses felt a recession-induced cut in advertising that will recover to some degree. As a result, a post recession bounce in demand is likely in 2010 and 2011, but it's projected that printing and writing grades will gain only about 1% to 2% over the next two years.

What Happens After 2010?

A bigger problem facing printing and writing paper mills is that the huge contraction in demand in the U.S. and in Europe in the last two years may be permanent and not just cyclical. While the demand collapse was propelled by the economic crisis, it appears it was also the result of fundamental changes in the use of printed products. These changes appear to have been underway for some time but began to become more noticeable as early as 2007, which preceded the economic malaise that began in late 2008.

The magnitude of the demand contraction, which is simply staggering, helps support the idea of a more permanent change. U.S. printing and writing paper demand fell almost 10 million short tons in the last three years, or a drop of about one-third. Total printing & writing shipments in 2009 were 17.1 million tons compared with 20.3 million tons a year earlier. This was a 16% drop in just one year.

Uncoated freesheet shipments in December 2009 of 752,300 tons were 5.3% higher than November and 1.2% ahead of last year. For the year, shipments were 9.0 million tons, off 11.6% from 2008. Bond and writing (cut size) shipments in 2009 declined by 9.8% to 4.4 million tons, while offset grades were at 2.2 million tons or 14.2% lower. Shipments of uncoated freesheet papers to office reprographics finished the year at 4.0 million tons, down 9.3%, while volumes to commercial printers at 2.0 million tons were down 16.2%. Shipments to envelope converters declined 14.7% to 1.0 million tons and business forms fell 18.0% to 1.2 million tons according to the AF&PA.

Demand Drivers Change

By comparison to the declines posted in paper demand, real GDP fared much better; GDP actually rose 0.4% in 2008 before plummeting 2.4% in 2009. Thus, the double digit declines posted for printing and writing grades seem to point to something more fundamental. One demand indicator that can be clearly measured and used as one yardstick to assess if fundamental change has occurred is U.S. Postal Service mail volume. Direct mail is a key use for offset and envelope grades. Total USPS mail volume fell 4.5% and 6.1% in 2008, respectively, as measured by piece count and weight. In 2009 even more substantial declines of 12.7% and 14.9%, respectively, occurred. The largest percentage drop was for Standard Mail, which accounts for the bulk of the volume by weight, i.e. uses the most paper, and includes most direct mail. First class mail volumes are down as well.

Short Term Gains Likely

Given that mills have tightly controlled production and capacity to closely match demand, and in turn kept inventories at low levels, it appears that some improvements will occur in the short term. The apparent halt to the fall in demand and rising costs led to the attempt to boost prices. Fiber costs have been rapidly rising due to fiber shortages, which are expected to be compounded by the impact of earthquakes on Chilean pulp mills. Pulp prices were already up 20% over last year.

Pricing is typically weak early in the year and prices had drifted down some compared to early last year. Various sources report prices on 50-lb offset at about \$850/ton, or about 5% below last year's levels, while standard 20-lb cut-size copy/laser paper prices were running about at \$1,050/ton or about 4% lower. The announced increases on uncoated freesheet cut size paper and offset rolls of 4% to 5% or \$40/ton (\$2/cwt) were to take effect in late February.

One other factor to watch is trade. U.S. uncoated freesheet imports from Europe could rise due to Portucel's new machine in Portugal that ramped up last fall, but imports fell last year from almost all regions, with the total through 11 months at 855,600 tons or 16.2% below 2008. U.S. exports last year fell 5.9%. Another factor is a major surge in Asian capacity, where 5.1 million tons – including 2.2 million tons are uncoated woodfree paper – will come online in China in the next two years.

In summary, the recent price initiatives stand a good chance of sticking if demand improves as expected, driven by stock rebuilding and as advertising spending pulls itself out of the worst downturn on record.

The challenge going forward is what happens when demand in the U.S. and Europe remains flat, or falls even further after the initial bump in demand in 2010 and 2011. Things could get ugly as mills around the world scramble to see who can best supply these markets. ■

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