



Shrinking Demand Remains Major Hurdle for Uncoated Freesheet Markets

The plummet in uncoated freesheet demand was arrested last year as advertising-driven markets recovered and replenishment of inventories provided a boost to demand. However, high unemployment and technology-driven losses continue to undermine long term demand for key grade segments.

By Harold M. Cody

The overall North American market for printing and writing grades has certainly posted a big turnaround from the steep three-year downward spiral that finally hit bottom in 2009. Demand for full year 2010 will post an increase for the first time in several years and significant price gains were posted for almost all grades and sectors.

The rebound has been particularly strong for grades that rely upon advertising to a significant degree, notably coated papers, high quality uncoated groundwood grades and some uncoated fine paper grades. Nevertheless, while demand for uncoated freesheet grades has improved relative to the crash in demand experienced over the 2007 to 2009 period, nagging concerns about the future remain.

As noted, a recovery in the overall U.S. economy in 2010 resulted in a positive change in direction for printing and writing paper markets including uncoated freesheet grades. The U.S. economy grew strongly in the fourth quarter as real Gross Domestic Product (GDP) rose 3.2%. Market analysts had expected growth to be somewhat under that level, but holiday retail spending ended the year on a solid note, helping to drive up overall growth. Growth in third quarter GDP was revised up to 2.6%, and for 2010 U.S. GDP grew 2.9% from 2009, compared to 2009's negative 2.6% level.

North American printing and writing paper shipments rose by 3.0% in 2010 over shipments in 2009, the Pulp and Paper Products Council reported. Total U.S. paper production rose 3.7% in 2010 according to AF&PA, with production of printing and writing grades posting a strong 4.8% gain to 20.3 million tons, aided by inventory restocking up and down the supply chain.

In contrast, while U.S. uncoated freesheet shipments improved from the depths of the downturn, they finished the year down about 2% compared to 2009 at 9.5 million tons (see table). Exports and imports also rose but remain

fairly minor in terms of the overall market. Imports rose about 11% as mills around the world targeted tonnage at the relatively high U.S. price levels. Imports rose substantially from Europe, notably due to the new machine in Portugal (Portucel).

It may seem odd to view a decrease in shipments in a positive light, but nevertheless it represents a significant improvement compared to the huge demand losses endured in the prior two years. Even more importantly, the "recovery" in demand coupled with continued capacity adjustments resulted in a shift in pricing power back to producers who pushed through a series of price increases that raised prices back near previous highs.

There Are Concerns

However, worrisome signs began to emerge about the true direction of uncoated freesheet demand even as markets improved. One red flag is that gains on a monthly basis compared to prior year levels weakened and began to look worse as the year progressed. The trend continued into early 2011, as U.S. shipments of uncoated freesheet grades in January were 785,100 tons, an incremental gain of just 0.1% from December and 3.7% lower than in January 2010. This continued a series of year-over-year declines posted during 2010, according to AF&PA. Inventories also rose to 931,400 tons marking the highest level since January 2010 and the fourth consecutive increase. Mill operating rates were also weak at 87%.

Central to the problem facing uncoated freesheet producers is that while demand ceased to plummet, it continues to be tepid despite solid growth in the economy that historically would have led to expanded demand. The fundamental problem is that demand continues to falter for a wide range for uses and grades, including two of the largest grade

segments: bond and writing and envelope grades. These two sectors account for 55% of shipments, with bond and writing alone the largest single segment, accounting for 44% of total shipments at just over 5 million tons. Office papers, i.e. cut size grades such as copy, laser and inkjet papers continue to be hurt by stubbornly high unemployment levels in the 9% to 10% range, which includes white collar workers, as well as continued shifts in technology that result in reduced paper use per capita.

Similarly, envelope grades continue to be battered by ongoing losses to other forms of communication. In addition, envelope use declined due to the severe drop in advertising, which includes direct mail, in the last few years. The other large segment is offset printing grades, which account for about 22% of shipments, and which are used for a wide range of direct mail and other printing. Offset shipments posted a solid gain last year with shipments rising 7% over 2009 levels.

Price Recovery in 2010 Was Big News

As indicated, without doubt the best news for producers over the last year or so is that the combination of improved demand and tighter supplies as producer's carefully trimmed capacity provided them with the leverage necessary to raise

prices. Prices climbed significantly across the board for almost all printing and writing grades, and for that matter most pulp and paper products. The increases were the most widespread gains enacted in recent memory.

Uncoated freesheet paper prices rose for much of 2010 before they reached a peak in the fall following the successful implementation of most of a \$60/ton increase that was officially effective in May. This was the third increase in prices since late 2009, when prices bottomed out during the collapse in demand that occurred during the worst of the economic downturn. By late 2010, prices had rebounded to the same range as the last peak in prices, which occurred in 2008, when cut size grades hit about \$1,100/ton and offset hit the \$950/ton range.

Producers would likely be struggling to avoid a retrenchment in prices if supply and demand were the only factors involved. However, part of the equation behind the increases and an important factor going forward as well was the cost push to prices provided by high fiber and other input costs.

Pulp prices remain high and even though some correction may occur in 2011 it appears likely that pulp prices will remain reasonably high this year and not post a significant decrease. Pulp capacity growth is limited and rising input costs continue to bear on manufacturing costs. The recent spike in oil prices due to unrest in Libya is a factor to watch and likely will provide further cost pressures that will avoid a serious fall in paper prices. In fact, there are already rumblings being felt about a second quarter price increase on some graphic grades including coated papers.

Putting it all together we have a somewhat mixed but overall positive picture for 2011. Printing paper demand in both North America and Europe has weakened substantially recently, after posting a solid recovery in late 2009 and for most of 2010. Although near-term demand trends may be weak, global demand is expected to post modest gains and it appears pricing will remain at profitable levels. However, the recovery in demand for printing papers, including uncoated freesheet, is muted by historical standards. One reason is that developments in technology are accelerating and, more importantly, they are being adopted more quickly by consumers than was the case in the past. A number of these developments could reduce paper use even further and bear careful scrutiny. ■

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2010 U.S. UNCOATED FREESHEET PROFILE		
(000 tons)		Change%
TOTAL SHIPMENTS	9500	-2.1
SHIPMENTS BY GRADE		
Bond and writing	4190	-4.6
Offset	2093	7.0
Envelope	1060	-3.9
Forms Bond	714	-0.5
Carbonless	407	-0.6
Tablet	204	11.7
Text/Cover	149	-6.2
Other	683	-12.7
SHIPMENT BY MARKET		
Office Reprographics	3897	-2.0
Printing	2211	10.1
Business Forms	1106	-7.7
IMPORTS	954	11.5
EXPORTS	868	11.0
NEW SUPPLY	9587	-

Source: American Forest & Paper Association