



Uncoated Freesheet Market Fights to Regain Balance against Drop in Demand

North American uncoated freesheet demand contracted further in 2016 and it's expected to shrink further this year. The market was relatively in balance through mid-2016 before weakening and likely requiring additional capacity withdrawals to sustain operating rates. On the bright side, demand for uncoated papers has held up better than other graphic grades.

By Harold M. Cody

North American uncoated freesheet markets haven't really made much noise in recent months so it's really a case of whether you view this segment of the industry from a "glass half full or glass half empty" perspective. The market continues to fight falling demand as technology replaces or steadily reduces many common uses for office and printing papers. However, there were also selected bright spots relating to demand in recent months, and while prices slipped and gave back some gains from last year, mills remain profitable.

Nevertheless, uncoated freesheet demand in North America continued to decline last year, falling 4% in 2016 vs. 2015. This follows on the heels of relatively flat demand in 2015 as use stabilized after a decline of over 5% in 2014.

VARYING DEMAND

The decrease varied by individual sector/use with more modest declines or even flat demand posted for grades such as envelope and offset compared to a larger contraction for business papers and other grades. It's not clear why these uses did better, but likely reasons include economic growth and employment gains. Demand in the largest segment, business grades, which includes cut-size



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paper/copy paper, is estimated to have declined by 4% or more.

Total North American demand is currently about 8 million tons with business papers (cut-size grades) accounting for about 3.8 million tons. Other major segments include: offset, 1.7 million tons; envelope 0.75 million tons; and form bond, 0.5 million tons. The decline in uncoated freesheet demand was better than for grades such as coated and uncoated mechanical papers, while coated freesheet posted a smaller decline.

One key indicator of uncoated freesheet use is U.S. postal mail data which showed some surprisingly good results last year. For fiscal year 2016

(ends September 2016), standard mail volume by weight rose 0.2% compared to 2015, while pieces mailed rose 1.0%. In contrast, first class mail posted declines of 1.3% and 1.9%, respectively, in weight and pieces, compared to 2015. In first quarter 2017 (ending December 2016), standard mail volume was off 3.7% by weight, but the number of pieces rose by 1.3% vs. the prior year. The improvement in standard mail is in contrast to the generally steady decline in all mail volume posted over the last several years.

IMPORT TARIFFS PARTIALLY EFFECTIVE

In our last report we discussed the importance of uncoated freesheet trade

trends and in particular the impact of tariffs imposed on some imported cut size paper. This was a major event, but while the impact has been clear the results have been a bit mixed.

Tariffs have cut import tonnage from some areas and overall. For example, in 2014 and in early 2015 cut size imports rose to almost 25% of demand but they fell back to under 15% due to tariffs. Imports from China and Indonesia, where tariffs were implemented, fell from roughly 750,000 tons in 2015 to under 400,000 tons last year. However, imports from other countries such as Portugal and Brazil rose and partially offset decreases from these areas.

PRICING A MIXED BAG DESPITE CAPACITY CUTS

In first half 2016, capacity shuts, lower imports due to tariffs and steady demand led to moderate improvement and uncoated freesheet prices rose in the

second quarter. However, prices retreated modestly in the September/October period and weakened again in early 2017 as it's reported that prices slipped about \$20/ ton on cut-size grades and offset rolls.

A key reason for the price gains was that U.S. capacity fell by an estimated 2% last year vs. little loss in 2015. This was mainly due to Domtar's \$160 million conversion of PM 64 at the Ashdown mill to fluff pulp as they move assets from a declining market to one showing solid growth. The conversion came online in mid-2016 and reduced uncoated free capacity by 364,000 tpy. The project included a new wet end, upgraded the dryer can section, new reel and winder and a new cutter lay boy and bale handling line.

Uncoated freesheet markets, at least from a mill perspective, were given some other good news last year when

the merger of Staples and Office Depot failed. According to estimates the two firms buy over 40% of the cut size paper sold in the U.S.

With demand expected to decline further in 2017 it's expected that additional capacity shuts will be needed otherwise already weak prices will continue to stumble as operating rates struggle to hit the low nineties. Price pressures, while they may be a bit reduced nevertheless continue, owing to imports from Europe and South America, as offshore mills take advantage of the relatively high prices in the US owing to the strong dollar. The key in 2017 and next year will be matching supply to demand. A 4% decline in use equals roughly 320,000 tons of capacity.

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

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