



New Paradigm: Newsprint Demand Falls, Prices Soar

Despite a steady, five-year decline in demand, newsprint publishers have kept operating rates and prices up by strategically removing or converting capacity.

By Harold M. Cody, Contributing Editor

Lately, the newsprint market resembles a marathon boxing match where desperate fighters somehow hold on despite unending blows to the body. And as with a boxing match, it will be easy to determine winners in the newsprint market. They will be the ones still standing at the end.

North American newsprint consumption continued its steady five-year decline last year and newspaper publishers faced similar difficulties. In early 2006, demand continued to drop at an accelerating rate. But producers continue to fight the fight as evidenced by the almost hard-to-believe fact that prices are now reaching the highest levels in five years in spite of all this.

Continuing the boxing parallel, these prolonged tribulations clearly illustrate just how adept U.S. and Canadian newsprint producers really are at fighting. They have been able to quickly and decisively cut supply in response to these challenging conditions, masterfully reducing capacity via either shutdowns or conversions to other grades.

The closure of 3.5 million metric tpy of newsprint capacity since 2001 has kept operating rates for the most part above 95%, fueling the steady increase in prices from a bottom of about \$475/mton in 2002 to more than \$650/mton or higher on lightweight grades by early 2006. Consolidation has also had an impact, as the top five newsprint producers control nearly 75% of capacity, and maybe even more importantly, the top three hold more than 50%.

Producers are now pushing for an additional \$40/metric ton increase, originally targeted for February. Recent indications are it will take hold despite being seemingly close to failure early in the year due to poor reports on consumption in January and February. The increase is expected to follow the path taken by a series of increases, i.e. it is likely to be phased in over a period of

months depending on the buyer. Unfortunately, despite the run-up in prices, producer profits remain at dismal levels, as high raw material, energy, and shipping costs have combined to constrain margins.

Producers Need a Consistent Hand

For 2006, there is some hope that the fall-off in consumption may slow, at least a bit. It would be good news if demand only fell half as much as the decline posted in 2005, when North American demand tumbled more than 5% for all uses (see Newsprint Statistics table), with consumption by dailies falling by about the same amount. Daily newspaper consumption of newsprint has fallen 1.5 million metric tons or about 15% in the past five years, while total U.S. newsprint consumption has shrunk almost 2.4 million metric tons since 2001. More than 90 daily newspapers closed from 1994 to 2004, while U.S. daily newspaper circulation declined 8% and shed nearly 4.7 million readers the past 10 years, according to the Newspaper Association of America.

However, while continued weak U.S. newsprint demand has certainly been caused by a confluence of trends including weak newspaper advertising, declining circulation, and substitution by other uncoated mechanical grades, the move by publishers to aggressively control costs by cutting consumption has also been a big factor. By some estimates, the growing use of lower basis weight

grades, such as the shift to 45 g/m² that gained ground in 2005, and a reduction in page size combined to cut demand by 2%. If the impact of these factors lessens in 2006 and operating rates continue strong, prices may gain even more into the second half of the year as producers fight to improve their habitually poor margins.

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Another key factor impacting the outlook is exchange rates. This impact can be clearly seen in the pricing of newsprint in U.S. dollars, which has risen nearly 45% since the price trough in mid-2003, while at the same time prices in Canadian dollars have risen less than 10%. This is really squeezing Canadian mills and will certainly influence the future direction of prices, i.e. tend to drive them up.

After the spring price increase that, as noted, should be implemented eventually, the outlook becomes murky. It's to be expected that producers will continue to match capacity to demand and this combined with cost pressures and a strong Canadian dollar (which hit U.S. \$0.87 in February), could keep prices on an upward trajectory.

A key factor that has to play out, however, is the projection by some economists that economic growth will slow by the second half of 2006. In turn, this would likely accelerate the drop in demand, and in that case it's hard to believe prices can continue going up. If the Canadian dollar were to also weaken later in 2006, and price pressures ease, the spring price gains may be the last in 2006.

Nevertheless, prices have been going up steadily since 2002, no matter what demand does. So as the fight continues, with no end in sight, the question is: Who will be left standing? ■

NEWSPRINT STATISTICS - December 2005 (000 metric tons)

	Current month		Year-to-date	
	2005	% change 2005/2004	2005	% change 2005/2004
NORTH AMERICA				
Production	1,031	-3.2	12,661	-4.6
Operating rate, %	96	-	95	-
Shipments to U.S.	760	-3.3	9,095	-6.1
Shipments to Canada	92	4.8	1,090	1.1
Overseas exports	186	-5.5	2,489	0.3
Imports	14e	-24.6	194p	-12.9
Total demand	866p	-2.9	10,379p	-5.6
Mill inventories	315	-4.3	-	-
UNITED STATES				
Production	397	-1.6	4,892	-4.0
Operating rate, %	96	-	95	-
Shipments to U.S.	358	-4.4	4,345	-5.8
Overseas exports	39	11.1	515	10.1
Imports from Canada	402	-2.3	4,750	-6.3
Imports from overseas	14e	-23.3	191p	-13.8
Total demand	774p	-3.7	9,286p	-6.3
U.S. dailies consumption	614p	-7.3	7,563p	-5.4
Other U.S. consumption	162	14.1	1,812	-3.7
p=preliminary.				
Sources: Pulp and Paper Products Council, Newspaper Assn. of America.				