

# Coated Free Sheet Market Balanced, But U.S. Outlook Dependent on Consumer Spending Remaining Strong Enough to Sustain Advertising



Coated free sheet producers started 2008 on an upswing, coming off price improvements in 4th quarter 2007. The weak dollar has helped US exports while holding down imports thus contributing to a balance of supply and demand. Underlying economic weakness, which could pull down demand, is the main uncertainty in 2008 while cost pressures remain a key challenge.

By Harold Cody

Overall, last year wasn't too bad of a year for coated fine paper producers, with the North American market in fairly decent shape and finishing the year on an upswing. Prices fluctuated, first drifting down but then rising later in the year. And while demand wasn't robust it was good enough to support the price gains. Prices rose due to significant cost pressures, supply constraints and modestly improving demand.

European markets were weaker and the industry there continued to undergo considerable restructuring and mill and machine closures, with about 400,000 tons each of coated wood free and coated groundwood capacity closed last year, following smaller capacity decreases for both coated grades in 2006. Europe also saw a significant rise in coated fine paper imports from Asia, which contributed to weaker pricing, although the level of imported tonnage remains minor.

Coated fine paper mills everywhere continue to face the challenge of rising costs for fiber and raw materials and in particular the continuing increase in energy prices due to record setting oil prices.

The outlook for the remainder of 2008 is generally positive for U.S. mills—operating rates are projected to remain good and demand is expected to be steady. Of concern, of course, to all printing and writing grades including coated free sheet is the macro economic situation, where extremely weak consumer confidence derived from the housing mess is having a negative impact on consumer spending. Coated free sheet demand closely tracks overall advertising activity (e.g. magazine advertising, catalogs and other promotional activity) and if consumer spending falters advertising could take it on the chin and if that happens, demand will falter as well.

The coated paper business experienced some very notable events last year, with some far reaching changes occurring. Early in 2007 coated paper trade was the major news item as tariffs were initially imposed on coated fine paper imports into the US from Asia. However, the tariffs (countervailing duty) on coated printing papers were subsequently rescinded in the 4th quarter. When initially imple-

North American Printing/Writing Paper Statistics				
December 2007 (000 tonnes)				
	DECEMBER 2007	% CHG. YEAR AGO	YEAR-TO-DATE 2007	% CHG. YEAR AGO
<b>COATED FREESHEET</b>				
Shipments	375	-2.0	4,511	-3.5
Operating rate	95	91 (1)	95	94 (1)
Imports	97	-21.2	1,252	-23.3
Demand	457	-6.7	5,540	-9.2
<b>COATED MECHANICAL</b>				
Shipments	432	7.3	5,278	5.4
Operating rate	99	87 (1)	96	92 (1)
Imports	77	49.9	917	8.8
Demand	499	12.7	6,016	5.0
<b>TOTAL PRINTING &amp; WRITING</b>				
Shipments	2,216	0.4	27,379	-0.8
Operating rate	91	87 (1)	93	92 (1)
Imports	253	-0.2	3,298	-11.3
Demand	2,378	0.0	29,457	-3.0

MILL INVENTORIES					
(000 tonnes)	DEC. 2007	NOV. 2007	DEC. 2006	Tonne change from	
				Month Ago	Year Ago
Uncoated mechanical	286	296	222	-9	64
Uncoated freesheet	1,222	1,167	1,314	66	-92
Coated freesheet	472	479	584	-7	-111
Coated mechanical	155	142	259	13	-104
Total printing & writing	2,135	2,084	2,378	51	-243

1. Shipments/capacity. Actual figure, not a percentage change.  
r = revised.  
Source: Pulp & Paper Products Council.

mented it was speculated that the tariffs would have a considerable market impact, leading to tighter markets and benefiting producers with higher prices and increased output in the domestic US market. However, as noted the tariffs were later repealed, and even during the period they were in place the impact was minimal, as will be discussed below in more detail.

Ownership changes and the continued restructuring of the coated paper business were other key developments last year that will have far reaching implications. The merger of NewPage and Store Enso North America in December, when fully implemented sometime this year if approved by regulatory agencies, will result in North America's largest coated free sheet producer. NewPage will have about 40% of North American capacity, followed by SAPPI with about 25%. Following the merger, NewPage announced the closure of 317,000 tons of coated mechanical and 130,000 tons of coated free sheet capacity, but reported that actual output would increase due to better use of other production lines. The merger increases industry concentration considerably and bodes well for improved supply restraint and should lead to cost savings as well.

### Have Imports Really Declined?

While the market ended the year on a good note with the rise in prices, the news wasn't all good. North American coated free sheet shipments fell 3.5% in 2007 vs. the prior year with demand falling 9% as imports dropped 23% according to the Pulp and Paper Products Council (PPPC). However, while growth was lackluster, data indicate that demand and supply fundamentals improved during the second half of the year. Also, it appears that official coated free sheet import data likely overstate the decline in imports by a large amount as it is believed that a considerable portion of imports from Asia were simply re-classified as coated groundwood in order to avoid import duties. Import data clearly show that Asian coated groundwood imports spiked immediately following the imposition of duties in early 2007, while coated free sheet imports dropped to essentially zero at exactly the same time. What all this means is that demand was likely only down modestly and it was improving later in the year and appeared to be running ahead of longer term trend line demand.

US imports of coated fine paper have been trending down since early 2006 and are at the lowest levels,

according to AF&PA data, since the 2000-2001 periods. This is obviously due to the weakness in the dollar, making imports more expensive and less lucrative to off-shore mills such as those in Europe. The huge rise in the Canadian dollar, which was up 60% in late 2007 from early 2002 levels when

it began to strengthen, is also having a major impact. This surge has led to extreme competitive problems for almost every Canadian paper mill and led to significant capacity closures. In coated papers, this has mostly been seen in coated groundwood grades but also has affected coated free sheet capacity.

---

**Coated free sheet demand  
closely tracks overall  
advertising expenditures  
and thus paper demand would  
suffer if advertising slumps.**

---

### Outlook

As noted, coated mills benefited from improved coated free sheet prices during the second half of last year. Prices finished the year on a strong note as they rose to about the \$970/ton level for 60 lb roll grades in December. Prices had been down for much of the year, but the current level is the highest since the last price peak nearly 10 years ago. It at least partially offsets the strong rise in costs.

While supply, demand and operating rate data indicate 2008 should be a good year, there are some warning signs. Demand has been improving but gains have ranged from negative to slightly positive and as noted ended the year down from 2006, so underlying demand isn't robust. And the Achilles heel for producers will be the economy. The retail market and the wider economy is beginning to feel the impact of the housing and mortgage crisis and in turn of weak consumer confidence and gas prices are also pinching consumers. Store closures are increasing and year-to-year sales comparisons are looking worse. Coated free sheet demand closely tracks overall advertising expenditures and thus paper demand would suffer if advertising slumps.

On a global basis, coated paper markets look solid. The Olympics should provide a boost to demand, particularly in Asia and there are signs of improvement in the lackluster European coated fine paper market. One blip on the horizon is a surge in coated free sheet capacity expected next year in Asia with the startup of two major new production lines (China and Japan) that will be hitting the market. This tonnage will find a home somewhere, including the export market, where it could impact pricing. ■

---

*Harold Cody is a contributing writer for PaperAge. He can be reached by email at [HCody@paperage.com](mailto:HCody@paperage.com).*