



Global Economy and Demand Pose Challenges to Coated Freesheet Markets

The last year has been a struggle for coated freesheet mills as U.S. demand slipped again after rising in 2010. The market outlook for the remainder of 2012 is uncertain as demand remains weak and the real possibility of a severe economic downturn in Europe casts a shadow over the global economy and the coated paper market.

By Harold M. Cody

The old adage “What goes up will come down” accurately depicts the state of the market for printing and writing grades over the last year. It also certainly can be used to describe what’s been going on in the coated freesheet sector over the same period.

As reported in last year’s column (*PaperAge*, May/June 2011), coated free sheet and most major grade segments, including other printing and writing papers, staged a solid recovery in 2010 from the unprecedented 2008-2009 downturn caused by the U.S. recession. Overall North American printing and writing paper shipments posted a 3% gain in 2010, according to the Pulp and Paper Products Council (PPPC). Coated groundwood and freesheet shipments rose while shipments of both uncoated freesheet and uncoated groundwood slipped. Total North American apparent consumption of coated papers grew by about 11% in 2010 with extremely strong gains posted by coated freesheet. U.S. coated paper shipments for full-year 2010 posted a solid 12.8% gain over weak 2009 levels. Coated freesheet shipments posted the strongest gains of any major printing and writing grade, with shipments rising by 15% to 4.2 million tons, vs. 3.6 million tons in 2009.

Mill operating rates posted significant improvements as well, rising from 80% in 2009 to 96% in 2010 for coated freesheet and coated groundwood. This set the stage for a turnaround in coated free sheet prices which rose from under \$900/ton in early 2010 to about the \$975/ton range for No. 3 web grades by the end of the year following successive price increases. Prices remained in that \$975-1075/



Developments in offshore markets and trade are likely to have a big impact on the direction of the coated freesheet market for the remainder of 2012.

ton for most of 2011, exhibiting a steadiness that was in sharp contrast to most other market indicators such as the direction of production or demand.

Wavering Demand in 2011

But signs of trouble were evident by early 2011. Coated paper demand, and for that matter, North American demand for all printing and writing papers, began to fall behind prior year levels even as early as late in

2010 and this continued into 2011. This was particularly worrisome since even with the gains in 2010, demand lagged far behind historical levels. Unfortunately, what happened was that following a recovery that was partially driven by the need to rebuild vastly reduced inventories, demand again contracted in the face of fundamental structural changes in advertising and paper use and continued lackluster economic growth.

By the end of 2011, U.S. shipments of coated free sheet had decreased year-over-year for thirteen straight months, following thirteen consecutive months of year-over-year increases, according to AF&PA. Total printing and writing paper demand fell 5.2% in North America last year to 24.2 million short tons, as reported by PPPC. The largest decline in demand was posted by uncoated mechanical and coated mechanical grades, which fell 7.8% and 8.6%, respectively. Coated freesheet demand declined 2.8% in 2011 vs. 2010, dropping to 4.9 million tons, as shipments slipped 4.1% vs. the prior year to 3.96 million tons. Coated freesheet imports into North America rose 3.1% to 964,000 tons.

Pricing Remains One Bright Spot

Pricing has been one bright spot for producers as coated freesheet prices remained largely stable in 2011 following on the solid gains posted in 2010. Fourth quarter 2011 prices were about even with fourth quarter 2010 prices. One reason for price stability has been a rise in costs, which were up about 4% in 2011 for coated freesheet grades, according to company reports. Cost increases were driven early in the year by increases for coating binders and other chemicals, energy costs and fiber costs. Energy costs present a mixed picture, as costs for transportation and other oil related fuel costs have risen but have been offset by a plummet in natural gas prices, and mills have moved to take advantage of this as much as possible.

Despite some easing of costs due to lower market pulp prices late in 2011, producers started pushing for a price increase during second quarter 2012. It's somewhat hard to see what mills used to justify the increase and thus there is some skepticism it will succeed. Demand remains weak, but with capacity being fairly concentrated it may succeed — if not right away then later in the year if markets improve.

A \$30/ton increase has been announced by mills that account for almost 90% of coated wood free capacity in the U.S. and Canada. Published reports credit the push to improved order backlogs and indications that the US economy is improving. The implementation date for the increase varies. For example, Sappi, the number two producer with about 25% of North American capacity, is reported to be setting a \$30/ton increase for deliveries on or after June 1. Other producers such as Appleton Coated and West Linn announced a \$30/ton increase effective for May 1 and May 29 shipments, respectively.

Global Developments Key to Outlook?

So will the falling demand/solid pricing scenario continue to play out? Developments in offshore markets and trade are likely to have a big impact on the direction of the coated freesheet market for the remainder of 2012. One issue is trade, where it is reported that duties imposed on Chinese coated imports into the U.S. market may be rescinded. If this occurs, the oversupplies of coated wood free in China will likely result in an increase in exports to North America and this could undermine pricing. The duties, which were imposed in late 2010, effectively cut Chinese mills out of the U.S. market for coated freesheet. It should be noted that while Chinese imports fell dramatically, imports from other regions, notably from South Korea and Japan and from Western Europe replaced them to a large extent.

European coated freesheet markets are also struggling with extremely weak demand and in turn oversupply. Overall coated freesheet shipments fell 7% in 2011 vs. 2010, while coated groundwood output decreased by around 0.5%. With demand falling, further capacity reductions in Europe have continued, including the closure last year of a 200,000 tpy coated wood free line at the M-Real Anekoski mill. However, if the European economy is pulled into a deep recession by the debt-induced economic crisis, mills will look to move additional tonnage offshore and that could impact the U.S. market.

There is a ray of hope that might help as advertising could improve later this year due to two major events: the Olympics and the U.S. Presidential election. Traditionally this was the case, but it's unclear in today's world how big of an impact, if any, this might have. As noted, U.S. magazine advertising, which is one indicator of coated paper demand, fell drastically in the fourth quarter of 2011, down 8.0%, following a 5.6% drop in the third quarter, according to MPA. Magazines continue to struggle against losses in readership and advertising revenues to the internet and devices such as tablets and smart phones.

And while global developments are important, we can't ignore the importance of the masterful job that producers have done in matching supply with demand. Industry observers speculate that some producers may not be as willing to take downtime or shutter capacity owing to severe financial constraints, e.g. operating in bankruptcy. Further capacity reductions will be required as demand continues to shrink, so this will bear watching.

On a final note, sluggish economic growth has also contributed to weak paper markets. U.S. GDP rose just 2.2% in the first quarter 2012, down from the 3.0% gain posted in the fourth quarter of 2011 and 1.8% in the third quarter. GDP growth slowed in 2011 to a 1.7% annual rate following the 3.0% gain posted in 2010.

If a bump in demand occurs during the second half of 2012, driven either by stronger economic output in the U.S. and/or an improvement in advertising and promotion expenditures, then prices may rise a bit during the second half of this year. But this assumes Europe doesn't implode economically and pull the U.S. economy down with it. If demand continues to plummet, it will all depend on how rapidly supply can be reduced, which is just normal operating procedure for the industry in today's world. ■

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