Economic Collapse Ends Strong Pulp Market Run

The severe downturn in the global economy that began this fall has effectively ended the nearly three year long bull pulp market. The spreading economic crisis has led to a contraction in paper demand and in turn pulp consumption.

By Harold Cody

Last fall we commented that the bull pulp market looked likely to run well into 2008. At that time, there was some concern that economic growth might slow, and in fact paper demand in the developed economies was in fact growing very slowly but this was somewhat offset by continued more rapid growth in Asia. It appeared at the time that rising energy costs and higher fiber costs would sustain the pulp price surge that had lasted for almost two years. Prices did in fact continue to hold steady at very high levels into 2Q 2008.

Skip forward to 4Q 2008 and how the world has changed. Unfortunately, very few observers including almost all professional economists that are paid to forecast the U.S. and global economy foresaw the worst economic downturn in decades. A confluence of factors has resulted in a major economic downturn that began in the 3rd quarter and is worsening in the fourth quarter. A global recession now appears to be a reality.

As noted, the U.S. economic outlook for late 2008 and 2009 had been fraught with uncertainty for some time owing to the ongoing mortgage crisis that began in 2007. But a series of major events has resulted in the current dire economic crisis. The first shock to the economy in 2008 was a huge surge in energy prices, as gas prices hit over $4/gallon. In response, consumers reined in spending, which accounts for about 70% of consumption and the economy began to weaken noticeably. With just filling up the tank becoming a major cost, it also fueled a worsening of the mortgage crisis. The credit collapse and crisis on Wall Street was the third strike for the economy, which went into a tailspin, with GDP down and job losses accelerating.

This cascading crisis quickly undermined both U.S. domestic and export demand for paper. U.S. shipments of printing and writing grades were off 4.3% through September vs. the prior year level but began to worsen quickly. John Faraci, CEO of International Paper, the world's largest paper producer, is reported to have commented that a "sharp decline in demand" occurred in late September and he noted that the "world changed in the third quarter."

With global paper demand contracting, lead by a rapid shrinking in printing and writing paper demand, pulp demand plummeted. While tissue demand, the other major pulp consumer, held up better, it's not enough to offset a severe decline in other grades.

PULP, PULP EVERYWHERE

Most importantly, the result was in a huge surge in pulp inventories. Stocks surged, rising from 41 days of supply in August to 44 days in September, vs. just 29 days of supply in September 2007. Hardwood pulp inventories rose to unheard of levels. Observers report global pulp inventories are likely at the highest tonnage level ever following a nearly one million ton increase in just three months. This was despite a fall in September shipments to 3.2 million tons, a 4.5% decrease from 2007, according to the PPPC (Pulp and

NBSK Price Trend 2008 (in USD)

Date	In the U.S.	In Europe
Jan.	864	871
Feb.	880	880
March	880	880
April	880	880
May	880	900
June	880	902
July	890	901
Aug.	887	887
Sept.	873	867
Oct.	849	828
Nov.	823	760

Source: FOEX

Paper Products Council).

Pulp prices responded quickly and predictably to the weakness, and began to fall in the U.S. market in September, ending a nearly 3-year long run that saw list prices for benchmark NBSK hit $880/tonne. The free fall in prices was lead by a quick drop in export pricing. During October, pulp markets were very chaotic and producers around the world began to lower prices in response to the collapse in demand. Discounts of nearly 25% were reported in September and by early October spot prices had fallen to under $700.

Overall, the market looks to be weak for most of 2009. Producers will have to work hard to control supply because a demand driven recovery is unlikely anytime soon and not before late 2009 at the earliest. And that timeframe is probably optimistic with considerable downside risk.

The only good news is a huge amount of pulp downtime has been implemented or announced. This should begin to turn inventories in the right direction, which is a necessary first step in halting the price collapse. In addition, when prices fall to the mid-$600 range, it's close to the manufacturing cost of the higher cost mills. Thus, prices may bottom in 1Q 2009 as these mills close, adding further to the downtime already announced. By mid-November North American mills had announced nearly 475,000 tons of downtime from September to year-end and over 1.2 million tons had been announced outside of the U.S. and Canada.

Some NBSK tonnage had been reported at $650/tonne in mid-November. It's hard to pinpoint the floor on prices, but while energy cost pressures have eased, high costs for wood in selected global markets may help keep prices from falling much further in the current cycle. With some additional new capacity slated to come online next year, producers will have to bite the bullet on downtime—both permanent and temporary—to have a chance of turning things around in 2009. If stocks can be pulled down, prices could turn the corner later in 2009. However, the risk of things getting even worse economically in early 2009 remains a challenge and poses a downside risk to such a price recovery scenario. ■

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