



By Harold Cody

Is Market Pulp Rally The “Real Deal”?

Rally in pulp prices takes hold despite unusually dismal numbers for many key indicators. The two exceptions that are making a difference are a plunge in pulp inventories and a surge in export demand from Asia. With underlying fundamentals such as printing and writing paper demand and pulp shipments still poor due to the lingering impact of the most severe economic plunge in memory, the big question is whether this rebound will have legs enough to carry forward.

Pulp producers and many pulp customers must be pinching themselves to see if this – the rebound in pulp prices that began in June – is just a dream or if it’s in fact for real.

The current recovery in prices certainly has to go down as a remarkable comeback from a drastic plunge of about \$300/tonne in pulp prices that began in mid-2008 and hit bottom in early-2009. The plunge mirrors the fall in recent months in many commodity pulp and paper markets driven by a severe global economic recession which has simply killed demand for a wide range of pulp, paper and paper-board grades.

A combination of factors came into play that led to the turnaround and producers have been jumping on the bandwagon with glee. The plunge in pulp markets was, as noted, initiated by demand for printing and writing grades simply falling off a cliff over the last two years. Demand has shown some sign of improvement recently with year over year demand posting gains in recent months.

Demand Still Relatively Weak

But global demand remains weak, off by an estimated 15% for the first three quarters of 2009 vs. the same period of



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2008. The widespread economic downturn depressed demand across all industries, causing massive job losses and huge cuts in marketing and advertising expenditures on all forms of print media. The two major consumers of market pulp are printing and writing

and tissue mills. Tissue demand is much more stable even in downturns, while the drop in printing and writing demand has been of unprecedented severity and scope.

As demand for pulp simply evaporated, pulp inventories spiked up to

extremely high levels, triggering a sharp decline in pulp prices. The signs of the impending downturn were certainly there, but were masked a bit by large amounts of producer downtime that stabilized prices for much of 2008 despite the mostly weak market fundamentals. The price downturn ended an unusually long upward trend in pulp prices that began in early 2006 and carried through 2007, peaking at nearly \$900/tonne on NBSK, where they remained as noted for much of 2008.

Running Down Inventories

However, a turn in direction began rather quickly when pulp inventories fell dramatically during 2009. In the face of the precipitous drop in pulp demand, mills cut back sharply on output with massive downtime and widespread mill closures. This resulted in pulp inventories falling for eight months straight. By October, inventories had fallen to just 26 days of supply according to the Pulp and Paper Products Council (PPPC). Pulp stocks have been falling since February and are down significantly from the 50-days-of-supply registered in January. Stocks on a tonnage basis are the lowest in years according to published reports. Global pulp shipments also posted modest gains recently, rising 10% vs. the prior year in September, an improvement from a drop registered in August of a little under 2%, PPPC reported.

As mentioned, an added key factor behind the price recovery has been a rebound in pulp shipments, driven by a surge of shipments to China. Shipments to China have started to slow some, for example, May shipments were down 25% from April's record level of 970,000 tons, according to PPPC. However, through the first five months of 2009, shipments to China were up 65% at 1.5 million tonnes.

A rapid tightening of pulp supply meant producers didn't have enough pulp to ship, resulting in a rebound in prices that began in early summer and

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continues into fall. A round of price hikes has followed, the most recent of which was effective with orders for November. The increase of \$30-\$50/tonne was on several grades if enacted and would raise NBSK prices to over \$800/tonne. Other grades are following in turn. Pulp prices in third quarter 2009 are reported to have risen about \$90/tonne on average over second quarter 2009. In contrast, average prices fell about \$30/tonne from the first quarter to the second quarter 2009. Average prices (list) for NBSK in third quarter 2009 were about \$730/tonne vs. \$645/tonne in second quarter 2009.

Can Gains Be Sustained?

The challenge and question for pulp producers is whether the push behind the recent price gains can be sustained. The concern is simple: the recent rebound was driven mostly by tight supply, not a fundamental rebound in demand. The two major factors providing underpinning to the upturn – rising export demand and massive capacity shutdowns – could continue well into next year. This would keep momentum squarely behind producers.

However, there are questions about export demand. First, the actual status of inventories and demand in China, the key export market, are always hard

to pinpoint, so orders could fall off. What is known is that if prices stay up, production at mills in Asia will resume and that could end the export boom.

Of similar concern is that we are seeing a few signs of pulp mill capacity coming back on line in response to the significant improvement in prices and the modest rebound in demand. At the same time, while demand for printing and writing grades is improving compared to prior months, demand remains well below last year's levels. Certainly some rebound in paper use will occur during the holiday promotion season, but there's a good chance demand in areas such as North America will never regain pre-recession levels.

One path forward would be for recent gains to initially carry forward into next year, but for the gains to be hard to sustain a couple of quarters down the road. If demand fails to post an adequate rebound in key markets such as North America and Europe, and Asian buying falters, then what we may have seen was a "fake" recovery and one that will slip away.

On the other hand, most economic indicators point to a "modest" economic rebound in 2010. If the job market finally improves at least to the point that consumers start spending again, advertising could rebound. In turn, this could re-ignite paper demand sufficiently to maintain pulp demand and pulp markets could remain healthy if producers resist the urge to bring back too much capacity.

So far it appears that the "fall back" scenario is a bit more likely. But then again the recent rebound was probably even more unlikely, so picking a clear path forward at this point remains elusive. ■

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