



Pulp Rally Finally Hits the Wall

Pulp price rally that began in 2009 soared to new records before the 15-month-long run finally showed cracks. The adjustment was initiated when shipments to China, which had surged in 2009, slowed as buyers ceased stocking up. In turn, rises in pulp inventories caused prices to flat line and then dip slightly. The question now is: how much momentum has been lost?

By Harold M. Cody

Following a record setting plunge in 2008 that continued into mid-2009 and led to widespread closures and huge financial losses, pulp and paper markets have for the most part recovered. Demand has posted a respectable recovery and prices for most grades have risen strongly from their low points to, in some cases, record levels. The rebound was led by a steady recovery in key raw materials including market pulp. The rally in pulp was big and rapid but hit the wall in July, and now it's to be seen where it goes from here.

How We Got Here

To recap, the pulp rally was driven by a rebound in demand, but it also received a big boost from factors that limited supply. Undoubtedly, a key push was provided by the recovery in demand for printing and writing grades, which are the major consumer of market pulp (tissue is the other). Following a plunge in demand of unprecedented scale, world printing and writing paper demand has grown steadily through the third quarter 2010. Demand in the developed regions has been tepid, although improving, but this has been offset by more robust demand growth in developing areas, notably China. Through August, global demand has posted an 8.5% improvement versus the same period of 2009. A major contributor to the rebound was rebuilding of inventories up and down the pipeline, as paper consumers rebuilt stocks slashed to next to nothing during the steep downturn.



By the end of the third quarter 2010, pulp inventories of bleached softwood had risen to 27 days of supply vs. a 21-day level as recently as June ...this is still a very low level historically and indicates a balanced market.

(Photo courtesy of Domtar.)

In response, pulp demand improved and operating rates rebounded. Adding fuel to the fire was a sudden constriction in the pulp supply pipeline (earthquakes, mills going out of business, labor disruptions and other unforeseen problems) which tightened up the market far beyond anything demand alone would have accomplished.

With a tailwind behind them, prices began a long rally in 2009 that peaked in July 2010 before posing a modest decrease in August of \$20/tonne. During the boom, global pulp inventories fell to very low levels. This provided producers the leverage needed to implement successive price increases.

Prices for benchmark northern bleached softwood Kraft (NBSK)

market pulp stood at a record \$1,020/tonne in June – an increase of over 50% vs. the June 2009 level. Eucalyptus prices were at \$950, up almost 70% vs. the prior year level, while northern hardwood Kraft was up 73%. The NBSK peak price exceeded the last major peak which occurred in 2008, just before prices collapsed during the economic crisis. By early 2009, NBSK prices had fallen to under \$600/tonne.

As noted, modest price slippage during the summer of 2010 had been signaled by an increase in pulp inventories due to reduced demand for bleached softwood and hardwood pulp. Inventories had reached very low levels during the first half of 2010 but began to rise following the reduction in demand from China, coupled with a seasonal

slowdown during the summer months. By the end of the third quarter 2010, pulp inventories of bleached softwood had risen to 27 days of supply vs. a 21-day level as recently as June. It should be noted that this is still a very low level historically and indicates a balanced market.

Writing on the Wall

The writing had been on the wall as far as signaling that an adjustment to the rally was coming. It was clear by looking at data on pulp demand in and shipments to China that a bubble was developing. Data showed that beginning in early 2009 pulp demand had surged well above trend line or “normal” levels. For example, over the 2007-2008 periods, Chinese mills typically purchased 400,000 to 500,000 tonnes per month of various Kraft pulps. However, by mid-2009 this had shifted dramatically to the 1,000 tonne per month level.

While China’s demand for pulp had certainly increased during this period, notably due to a surge in printing paper capacity, it seemed likely that pulp purchases were unsustainably high. The ramp-up in buying coincided — and in fact was partly caused by — the steep drop in pulp prices, which fell as low as \$350/tonne for bleached short fiber and under \$500 for bleached softwood in the first quarter of 2009. The correction also appears to have been delayed because so many other factors “masked” this over-buying, i.e. supply shortages, etc.

Rosy Outlook May Continue

Going forward, the outlook appears to be relatively positive, barring any type of major economic relapse. Prices may have slipped just a bit but supply and demand remains well balanced. Days of supply are historically low at well under 30 days. The current pulp rally is also fairly short, at least by recent standards, meaning there is precedence for prices to remain high. Most bets are that prices will drift down further in 2011, but won’t plunge like a train going downhill. If this is true, margins will continue at relatively strong levels and producers will be in for a fine time.

The clouds on the horizon, and they’re certainly within view, concern overall growth going forward. As noted in our reports on grades such as newsprint and printing papers, one of the surprises in the current market rebound is that the gains are at odds with the scale and pace of general economic recovery in the U.S. and in other developed economies. North American and European economic growth is muted, although stronger gains posted in South America and Asia have contributed to the broad rebound in pulp and paper markets. One key worry is paper demand. It’s contracting in Europe and while U.S. demand has improved, fundamental changes in con-

sumption have occurred – permanent loss of paper demand, shifts in advertising from print, etc. — and they’re not good.

For many grades such as newsprint, containerboard, and boxboard, the growth in exports from areas such as North America to Asia and South America has been a key underpinning to sustain the market. The same has been true for market pulp and these markets will continue to shoulder most of the burden for growth. Pulp demand in China should remain at normal levels because even if global printing and writing paper demand continues to lag in the developed countries, it appears China’s domestic demand will continue to expand.

The pause in the pulp rally could be the precursor of a larger plunge if demand comes in on the low side of expectations.

However, there are also several reasons that the next few months and into 2011 could be bright. First, pulp capacity growth is limited outside of China. The restart of mills that have been idle, such as the restarted Terrance Bay mill, needs to be closely monitored, as others are looking to restart following pulp price going north of \$1,000.

And finally, while demand growth may slow, it’s expected to continue to be positive for the next few quarters. ■

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