Pulp Markets Hit Bump in Road as Prices Slip on Weaker Demand

A strong pulp market led to a nearly two-year run up in prices that peaked at record levels in June. Since then, however, prices slipped on weaker markets for five consecutive months. Whether the weakness is temporary or continues for 2012 is harder than ever to predict due to the huge uncertainty hanging over the outlook for the global economy.

By Harold M. Cody

Pulp markets weakened substantially during the third quarter 2011, precipitated by seasonally slower demand during the summer as well as weak underlying demand in key markets such as Western Europe and the U.S. due to sluggish economic conditions around the world. The weakness in demand was compounded by a fall off in shipment levels to China. Strong Chinese pulp buying was a key driving force behind the extremely bullish market conditions prevalent for the first two quarters of 2011.

At the present time it appears that markets will likely remain weak at least into early 2012. The larger issue is whether the pulp market will continue to unravel under the weight of a weak global economy or if the recent imbalance in supply, demand and inventories will be corrected and markets regain an upward trajectory.

While the current weakness is certainly unwelcome news for pulp producers they nevertheless have been enjoying robust market conditions for some time. The downward shift in direction, which began early this past summer, at least for now ended what has been a 24-month-long strong pulp market that began way back in the spring of 2009. As reviewed in our last report (PaperAge Nov/Dec. 2010, p. 14), the pulp market rebounded following the near collapse in prices and demand caused by the economic recession in 2008. After hitting the bottom in April 2009 — when NBSK list prices fell to under $600/tonne — prices rose steadily and reached a new peak in summer 2010.

The initial recovery from the depths of the 2008 recession was primarily demand driven, as printing and writing paper demand, which had also collapsed, staged a solid if not stellar recovery beginning earlier in 2009 and which continued into 2010, aided by inventory restocking throughout the supply chain. The improvements were led by strong growth in emerging markets such as China. Although growth in U.S. and European markets wasn't as robust, they nevertheless saw a solid recovery in demand as well. The recovery was also aided by shuttering almost 3 million tonnes of pulp capacity in North America alone in 2008-2009 as many mills were simply forced out of business as prices and demand collapsed.

However, beginning in the summer of 2010 the pulp market weakened after the recovery had been underway for a little over a year. It appeared at the time that the strong pulp market had been quite short-lived. However, beginning in late-2010 and lasting until late in the second quarter 2011, extremely strong demand, in large part fueled by a huge surge in pulp shipments to China, tipped the balance in favor of producers. They were able to enact a series of price increases that resulted in record prices by June 2011.

At the peak, list prices for benchmark NBSK reached $1,030-1,040/tonne according to various sources, and the average delivered price for NBSK to the U.S. market was

$1,025/tonne. This established a new record unadjusted for inflation. At that point, global softwood inventories remained balanced due to steady demand and reduced supply resulting from maintenance downtime. Softwood inventories were at about 28 days of supply, with 27-30 days considered a "balanced market."

However, it all began to unravel late in the second quarter, and the market remains mired in a slow downward spiral. Several factors caused the shift, including excess production as some mills built stocks in preparation for maintenance downtime, seasonally slower demand and destocking in China.

The global economic malaise that has lasted for most of 2011 has also resulted in a slowing in underlying demand. Most notably, world printing and writing paper demand decreased about 1% in the Jan. to Aug. 2011 period, compared to the same period in 2010, according to PPPC data. More recently, North American printing and writing papers shipments posted very weak results in September, declining 7% vs. the prior year level. This drop represents an acceleration of the shrinking in demand as N.A. demand is off 5.6% through the first nine months compared to 2010. According to various market forecasters, printing and writing paper demand is expected to continue to decline on the order of at least 2% over the next couple of years in North America and Europe.

The importance of this can't be overlooked as printing and writing grades are by far the major use for market pulp. They consume about 75% of all market pulp shipments, with about two-thirds of that consumed by fine papers mills, and the remainder by publication papers such as SC grades and lightweight coated. Tissue, which remains a key and more stable end use, consumes about 15 – 20% with the remainder consumed by packaging and other uses.

Chinese Market the Swing Factor

Without doubt, wild swings in pulp demand by China has been a key factor behind first the surge in prices in first half 2011 and the subsequent downward movement over the last few months. As noted earlier, the beginning of a pulp market correction began in the summer of 2010 but it didn't continue into 2011 because of the frenetic pace of Chinese pulp purchases. Deliveries of pulp to China approached one million tonnes per month by last December. China accounted for almost 82% of the total 981,000-tonne jump in global pulp shipments through May. However, shipments dropped to 622,000 tonnes in May from a recent high of 962,000 tonnes in March. Part of the dramatic growth in softwood demand in China is reportedly due to demand for dissolving pulp. However, this surge is believed to have eased since May. Shipments to China rebounded in August to 770,000 tonnes, but Chinese pulp buying has eased considerably in recent months and most expect it to last through year end.

One major result of the weakness in demand and downward shift in shipments to China has been a surge in pulp inventories, which in turn led to the price slippage. While inventories declined 8% in September, PPPC World-20 statistics show softwood markets remain slightly oversupplied, according to the PPPC. Worldwide chemical market pulp producer inventories had increased in August to 41 days of stock, the third consecutive increase and a gain of eight days-of-supply over the June to August period. At 41 days stocks were well above the 34-day level in August 2010. By comparison, stocks were at 33 days last April when the market was balanced and pricing strong. The August level is the highest since early 2009.

Economic Dark Clouds Make Outlook Unpredictable

So where does this leave us for 2012? There are several major questions regarding the likely direction for pulp prices in 2012 and all of them are harder to answer than ever. First of course is the outlook for demand. Major end-uses such as tissue continue to expand on a global basis and even in developed markets, where demand for other products has languished, tissue demand continues to slowly expand. However, as discussed the outlook for printing and writing papers varies widely from very good to bad. Demand in the developed areas will continue to shrink into next year. In contrast, demand in Asia may be weak in the short term but it's expected to recover and continue expanding at a strong pace. It doesn't appear that excessive pulp capacity growth will be a problem, at least in 2012, as growth in likely to be moderate. There may be some growth in capacity due to closures of paper capacity, allowing captive pulp to shift to market pulp at mills in North America. This does bear watching.

Producers may be able to bring things into balance and avoid a major collapse in pricing next year if the global economy can maintain, or even improve upon recent albeit erratic growth. Nevertheless, given the looming debt crisis in Europe, it's anybody's guess what will happen. If Europe goes into a serious tail spin it will drag the U.S. and the world economy, and the pulp and paper market, down with it. Over the long term, global pulp demand will continue to expand, but getting through the next 6-12 months may be the hard part. ■

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