



Capacity Growth Could Undermine Recent Gains in Market Pulp Grades

During the first half of 2016 strong demand for both softwood and hardwood grades led to a more balanced market and improvements in softwood prices. China's strong buying of both hardwood and softwood in recent months was a major factor. Over the next year or two significant capacity growth will occur, in particular for hardwood but also for softwood, that may set the stage for weaker pricing.

By Harold M. Cody

Pulp markets are currently in fairly good shape overall as rising demand in Asia, i.e. China, led to modest improvements in softwood prices in North America and China during the first half of 2016. Hardwood markets were more mixed as prices are under more pressure, but gains were also seen on hardwood as well. The recent gains offset the steady downward trend that had seen softwood prices in North America fall steadily last year. Similarly, prices in China had fallen steadily for softwood and hardwood last year before turning up modestly earlier this year.

The strong demand in China led to world market pulp shipments being stronger than expected with shipments up over 3% through June with the most surprising growth for softwood grades. Early in the year this growth was in part driven by some substitution as the price differential vs. hardwood had narrowed, but the gap has returned and this effect has diminished. Over the longer term, market pulp demand is rising about 1% annually globally and thus recent growth is much higher than that.

Overall world demand for market pulp continues to steadily expand, driven by several factors with a major driver being growth in tissue demand. Tissue grades are estimated to account for about half of market pulp demand in North America, about one third in Europe and one quarter in China. In contrast, demand from the largest historical use for market pulp — printing and writing



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grades — continues to be poor as global demand for these grades is projected to drop about 1% to 1.5 % annually due to losses in Europe and North America.

CHINA DRIVING DEMAND

As noted, the majority of the growth in pulp demand has been driven by Chinese consumption where deliveries jumped about 12% in the first five months of 2016. Chinese demand has been rising rapidly since about mid-2014 and grew by over 1.5 million tonnes last year alone. In contrast, pulp shipments fell last year to North America and Latin America and were flat to West Europe and Japan. China's demand for softwood Kraft pulp has grown from about 6.5 million tonnes in 2013 to just over 7.5 million tons in 2016, while hardwood demand rose from about the same level in 2013 to the 8-million-ton level by last fall.

The factors driving demand for pulp in China are widespread. Large amounts are consumed in tissue (the fastest growing market), wood free papers (the largest use) and specialty papers. Paperboard and other uses are smaller segments. Growth has also been driven by a “substitution” effect due to the shutdown of significant capacity at small, old mills which often used straw or other fiber. In contrast, new mills are based on wood pulps.

World chemical market pulp demand posted a solid gain in 2015, rising in excess of 2.5% to an estimated level of 61 million tonnes, nearly double the rate of growth posted in 2014, according to estimates. Demand reached 19 million tons in China, about the same size as Europe, with the two markets now accounting for 60% of demand.

An improved level of demand in turn helped boost market pulp operating rates to the 94% range for softwood during the first half of 2016 and resulted in successive price increases on softwood grades in North America and some improvement in export prices as well. In contrast, growing capacity depressed the global hardwood operating rate to 87% in the January to May period leading to price erosion in some markets. However, there were spot improvements in hardwood prices too.

FUTURE CAPACITY

While markets improved in 2016, new capacity over the next couple of years is likely to have quite an impact. Capacity

growth is widespread ranging from softwood capacity from new lines planned for Sweden and Russia to significant gains in hardwood capacity based on new pulp lines in South America and Asia. Estimates vary depending on exactly when new capacity hits the market, but about 1.7 million tonnes of softwood pulp, 1.2 million tonnes of fluff pulp and 6.4 million tonnes of hardwood pulp will be added over the 2016 to 2018 period. NBSK capacity is projected to rise about 700,000 tpy in 2017 and 1.1 million tonnes in 2018. Other softwood pulp capacity growth is projected to be modest, with about 650,000 tpy net increase in 2017 with little beyond that.

Capacity concerns are more profound in hardwood market pulp where large expansions are likely to contribute to significant excess capacity in the 2017 to 2019 period. This includes two 1.4 million tpy lines in Indonesia and Klabin (1.5 million tpy) in Brazil. However, it's unclear just when the capacity in Indonesia will hit the market. It's been assumed one line will be online this fall, but it's unclear when the second line will start. In softwood, almost 3 million tons of capacity are expected over the next couple of years, which would be about double the expected growth in demand. Softwood/fluff pulp projects include IP (Riegelwood, 360,000 tpy), Domtar (Ashdown, 330,000 tpy) and Sodra (Varo mill).

CONCLUSION

Many analysts expect that the rapid growth in demand will slow somewhat in coming months and in fact some pullback has been seen from the strong levels of early 2016. With the rise in capacity, softwood prices are likely to weaken by year-end, falling off from the recent highs set during the 2nd and 3rd quarter of 2016. This is likely to continue during the first half 2017 before rising demand catches up and allows prices to recover somewhat later in the year.

The outlook is a little more negative for hardwood. Prices are similarly expected to dip into next year. However, rising capacity could limit the ability for prices to rebound and they could stay weak for some time. As noted, hardwood prices will to some extent depend on the timing of new capacity.

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