



As Demand Stabilizes Groundwood Markets and Prices Improve

Groundwood paper demand has posted a modest recovery from the unprecedented low levels reached during the recent collapse. The gains have been driven by a tentative rebound in advertising/direct mail along with the need to build depleted inventory. Improved shipment levels and supply reductions have produced better operating rates, which have led to price improvements for most grades.

By Harold M. Cody

Basic Economics 101 is at work in the North American uncoated groundwood paper market. Despite lackluster growth in the U.S. economy and sluggish growth in key printing paper markets there has been definite improvement in groundwood paper industry fundamentals, notably reduced supply, rising order backlogs and higher operating rates. Printing paper markets in general have improved overall as North American demand has stabilized, exports have remained solid and paper inventories remained relatively low. In turn, prices have been rising for most grades.

The turnaround is a notable change from the depths of what is probably the worst downturn ever.

Spike in Shipments, Hike in Prices

Another clear indication of the overall improvement in uncoated groundwood market for supercalendered (SC) grades and machine-finish groundwood printing papers is a double digit surge in shipments, which are up about 20% through July. Historically, gains of this magnitude would be cause for celebration, but the improvements posted so far in 2010 need to be kept in perspective as they are measured against or compared to extremely bad shipments levels that occurred during record setting declines during the first half of last year.



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The market’s new-found strength has let producers push through two price increases this year including increases in July that raised prices \$45/ton on SC grades and \$30 ton on MF grades. Producers now have a third hike slated for implementation following announcements in August by most North American printing and writing paper mills. They include increases effective in September/October on SC grades, including SC-A, SC-A+ and SCB and light-weight coated grades of \$60/ton, with some heavier weight grades rising by \$75/ton.

As noted, big gains have been registered in mill output in recent months, e.g., U.S. uncoated mechanical shipments in July were 7.4% higher than July 2009 although they decreased 8% from the prior month. For the January to July period, uncoated groundwood shipments were 1.04 million tons, a nearly 21% increase over last year. Total printing and writing shipments in July rose a modest 1% over July 2009, but U.S. apparent consumption declined 1% in July while printing and writing paper inventories rose 3% from June levels.

It appears inventories must be a key factor in the rebound as well. Most if not all paper consumers sharply cut inventories as business evaporated during the plunge in demand during 2009, as they worked to conserve cash. Both mill and printer inventories reached the lowest point in years and for both to be at such low levels at the same time is highly unusual. As a result, as demand improved, output quickly ramped up with printing and writing paper shipments by U.S. mills rising for eight straight months, after paper and writing data posted negative results for almost two years prior to that.

The rise in shipments has been mirrored by an ongoing round of capacity withdrawals as mills have been bleeding red ink, particularly in Canada. This contributed significantly to the higher operating rates in recent months and subsequent gains in pricing. Reductions in SC paper capacity include major changes such as the closure of St. Mary's Sault Ste. Marie mill in the first quarter (250,000 tpy) and Kruger's Trois-Rivieres mill (170K CGW, 130K SC), as well as reductions in machine finish grades such as the recent closures by Catalyst on the West coast.

Uptick in Demand

The improvement in demand has been driven by some life coming back into print media. Overall U.S. ad spending has improved following the recent record declines. However, the gains remain extremely tepid by any historical measure given the gains posted in the overall economy and not all areas are healthy. For example, magazine advertising in the second quarter 2010 ended a 2½-year span (nine consecutive quarters) of negative or no growth by rising 0.8%. Through the first half of the year ad pages are down 4% due to a poor first quarter result. While tepid, the gain is in stark contrast to excessively large double digit declines that had become common in recent quarters.

Another key indicator of graphic paper demand, direct mail volume, has also posted gains recently. Overall, standard mail volume, which includes catalogs and direct mail, was up 4.2 % as measured by weight in the April to June 2010 period, according to the USPS.

North American uncoated mechanical paper demand rose 3.1% for the January to July period over 2009 levels, according to the Pulp and Paper Product Council. Demand was 2.89 million metric tonnes, with shipments rising 2.2% to 2.7 million tonnes and imports into North America surging nearly 16%. As noted, aided by some inventory buildup by users, market conditions have tightened significantly, particularly for SC papers. Mill inventories are also at very low levels and in July fell again.

Imports have also begun to play a larger role and going forward may help ease supply issues. With the development of the Euro/dollar exchange rate, deliveries from European mills have increased, in part because of poor European groundwood paper demand. CEPIPRINT reports shipments of SC paper to regions outside of Europe were up by 13.2% during the first five months of the year vs. the same period in 2009. For coated mechanical web grades, exports were up by one-third and European demand

for coated mechanicals rose 9.5% in the same period. However, demand for SC grades in Europe continued to shrink, down 3%, according to the association.

Avoiding Excess "Euphoria"

It now appears graphic paper demand may post a modest gain — let's say 1% — this year. This is great news for producers who earlier in the year were looking at the prospect of another drop in demand. North American demand, including newsprint was about 14.8 million tonnes in 2009. A shift from about a -2% drop to a 1% gain, or a 3% change is huge. It means that instead of a 200,000 ton decrease in demand, a 200,000 ton increase will occur. While newsprint demand continues to shrink, it appears now that demand for uncoated groundwood grades will rise modestly. At the current level of supply and demand, markets are tight — operating rates could be over 96% this year for uncoated MF grades and at or even above 100% for SC grades. Instead of looking at operating rates of under 90%, which appeared to be possible early in 2010 and the need to close more mills, producers have a bit of room to operate.

There are Concerns

However, there is a contrarian viewpoint on the current market as well. This view is that current market tightness and price gains are largely artificial and driven by print buyers replenishing inventories and making purchases in advance of price hikes. This view holds that with underlying demand still relatively flat that the market will stabilize and then give back much of the gains after the seasonally strong fall period.

One indication of fragileness of paper demand is ongoing problems with one big sector of advertising — newspaper advertising — which continues to shrink. NAA reports newspaper print advertising was down 5.6% in the second quarter. While this is the first single digit decline in the past 10 consecutive quarters, it underscores the struggle for print materials.

Going forward, the overall strength in the U.S. economy remains a concern. A major economic decline, i.e. a double dip recession does not appear to be the most likely path forward according to economists, but the lack of job growth is holding back the rate of recovery below historical rates.

The U.S. and world pulp and paper industry have posted a modest but definite recovery from the unprecedented declines of late 2008 and first half 2009, but underlying U.S. economic growth remains sluggish. One cloud on the horizon for groundwood paper markets is that a 2011 USPS rate hike of 8-20% is possible on magazines and catalogs. Such an increase, if coupled with rising paper prices, might be a recipe for disaster next year. Hopefully, that won't occur since producers in the second quarter did something important: posted higher margins. This was a notable improvement given that first quarter 2010 margins were at rock bottom levels. ■

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