



## Groundwood Market Buffeted by Trade Winds and Secular Demand Decline

U.S. coated and uncoated groundwood demand continues a secular decline in 2015. After rising modestly early in the year following significant capacity reductions prices were mostly stable for several months although some grades saw a bit of slippage owing to low priced imports. Further increases will likely be tempered by the strong U.S. dollar although exchange rates have stabilized.

By Harold M. Cody

The overall picture of the groundwood paper market three quarters of the way through 2015 isn't real pretty as it's plagued by oversupply and a fall in domestic demand for all grades. Nevertheless, things have settled down some following a tumultuous 12 month period that saw one of the largest restructurings in recent memory as a result of the Verso and NewPage mega merger coupled with the sudden emergence of Catalyst as a major player in coated groundwood grades.

These changes had resulted in a lot of uncertainty on grades and price levels in the early part of 2015.

The current weakness in demand isn't unexpected and is simply a continuation of the secular decline in demand for all grades of graphic papers used in magazines, newspaper inserts and catalogs, which are all key markets for coated and uncoated groundwood grades.

### SHIFT IN EXCHANGE RATES

However, complicating the outlook and making it more uncertain from the standpoint of the producer side is a shift



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in trade trends driven by a major movement in exchange rates since early 2014 as well as the recent imposition of duties on imports of SC grades. The strong U.S. dollar has become a key factor for all commodities including the grades making up the graphic papers market. Both The Euro and Canadian dollar have fallen 20-25% from peak levels reached in early 2014 and this has made mills in Canada and Western Europe very competitive in the U.S. market.

In turn, the price gap between Europe and N.A. has ballooned to

\$200 on some grades as U.S. prices became the highest in the world for these mills. However, after falling steadily for several months last year from a level of about 1.4 USD/Euro in early 2014, the Euro has stabilized in recent months at about 1.10, although the Canadian dollar slipped to 0.77 in July. As noted, an additional factor relative to Canadian mills occurred in July 2015 when countervailing duties were imposed on imports of Canadian SC paper.

Given the strong upward movement in the dollar in 2014, an increase in imports was expected and North American coated imports spiked beginning in April when they jumped

20% vs. prior year levels. It's likely they will continue at somewhat higher levels, particularly for coated groundwood, into next year.

### DEMAND OFF, CAPACITY CUT

As mentioned, the overall tone of the market continues to be driven by shrinking demand. Based on data through July, North American demand for uncoated groundwood papers is off 12% vs. the same period last year while coated paper demand is running 6% behind 2014 levels over the same period. During the second quarter, N.A. coated groundwood demand fell 9.6% vs. the second quarter of 2014. Operating rates improved to 92% for coated groundwood mills in first half 2015 due to capacity reductions. North American mill output is suffering a bit as well owing to an 8% increase in coated groundwood imports. Uncoated groundwood imports were actually down 15%.

Reacting to the rapid shrinkage in coated paper demand industry leader Verso Corp. cut significant capacity last year including closure of the 350,000 tpy coated groundwood Bucksport mill in Jay, Maine. It also cut an additional 430,000 tpy via the closure of one paper machine at the Androscoggin mill in Maine and shuttering of the Wickliffe, Kentucky mill, although much of this was coated freesheet capacity. Catalyst also reduced coated groundwood capacity via the shutdown of No. 12 machine at the Rumford mill in Maine.

In total about 15% of North American coated groundwood capacity was closed in late 2014, setting up hope that rising operating rates would lead to a significant improvement in pricing.

Demand for uncoated grades is also off, particularly for lower quality SC-B and soft nip grades. Producers responded by cutting capacity for these grades via Resolute's closure of the Laurentide mill and Catalyst's shut down of the No. 9 machine at Powell River in late 2014.

The fall in demand follows similar declines posted in 2014 when total North American printing and writing paper demand fell 4.1% to 21.4 million tons according to the Pulp and Paper Products Council. Coated mechanical demand fell by nearly 5% to 3.5 million tons, while uncoated groundwood demand was off just under 5% to 4.2 million tons. However, SC demand did better in 2014, as it took market share in some applications from coated groundwood.

The biggest drops in demand were for lightweight directory papers and lower quality machine finish and SCB grades. U.S. coated groundwood imports last year were about 800,000 tons, a drop of about 15% vs. 2013 levels, and reflecting the drop in demand. Through April 2015, North American printing and writing paper demand was off just over 5% vs 2014 levels at 5.9 million tons. Coated and uncoated mechanical demand was down 5.3% and 12%, respectively, over the same period. As noted, the reduction in capacity has helped to boost coated operating rates which averages 96% over the January to April period.

### PRICING REMAINS OK

Despite all of the restructuring on the producer side and potential upheaval caused by a rise in imports, prices have remained relatively stable although some minor slippage has occurred due to the rise of competitively priced imported paper, with prices dropping on average about \$10/ton in the second quarter. Early in the first quarter of 2015, prices on No. 5 grades moved up about \$30 per ton over late-2014 levels and SC prices also moved up but only about \$15-\$20 per ton. Since so much high quality SC paper is made in Canada and Europe — and these mills have benefitted a lot from the strong dollar — prices on SC grades may not go up as much as coated grades if prices rise as producers seek to use their lower cost as an advantage to gain additional market share from LWC grades.

### OUTLOOK

The outlook depends a lot on how much pressure imports apply to the domestic market. At the least, they are likely to reduce additional price increases on coated grades or push back increases that were hoped for this fall or in 2016. Early in the year most observers thought that an additional increase beyond the gains posted in the first quarter on prices would be a slam dunk after the late 2014 capacity reductions in coated groundwood. The fact that exchange rates vs. the Euro have held steady for the last few months may have given producers some breathing room, but prices could fall back further if imports continue rising. A final wild card is the import duties on SC grades and whether that will have any impact on pricing.

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