



Groundwood Markets Remain Challenging As Demand Shrinks

Demand data through the first half of 2016 confirm that the U.S. market for both coated and uncoated groundwood papers continues to shrink. After posting a modest decline early in the year prices appeared to stabilize during the second quarter but additional declines in July have brought prices down to very low levels. The outlook remains challenging as key markets continue to shrink making additional capacity shuts likely in order to just stay even.

By Harold M. Cody

Groundwood paper markets continue to bump along on a pretty rough road through the three-quarter mark of 2016. Market conditions for coated and uncoated groundwood remain “challenging” as one major producer noted in their second quarter report. Demand in the U.S. continues to contract with the most recent data for the second quarter of 2016 confirming that underlying demand for almost all grades continues to shrink.

North American demand for coated groundwood dropped 6.1% in the second quarter compared to year earlier levels, while demand for coated freesheet fell by 5.4%, according to published reports. Demand for uncoated mechanical grades, which includes supercalendered (SC), machine finish and lightweight directory grades, fell by a similar but slightly lesser amount, dropping 4.5% vs. the second quarter of 2015. Lower advertising expenditures in key print media as well as lower retail page counts are major contributors to the decline.

SHRINKING DEMAND

Year-to-date, through the first half of 2016, North American demand for coated groundwood grades is off by 7.7% vs. 2015, at 1.46 million tons, while uncoated demand was down 4% at 1.6 million tons.

In 2015, demand declined for all major grades. Coated freesheet slipped 4.4% to 4.3 million tons while coated groundwood posted a much larger drop of nearly 10% to 3.2 million tons. Uncoated groundwood consumption also fell significantly, off about 10% to 3.5 million tons.

Inventory levels have also been rising for coated groundwood in recent months which is a further indication of weak fundamentals.

Canadian mills have also been impacted by the Canadian dollar and exchange rates continue to be a key factor. During the second quarter of 2016, a stronger Canadian dollar was

a negative factor vs. first quarter 2016, but compared to the second quarter last year it was a positive impact as it was weaker than a year ago.

Recent data on U.S. mill shipments were a little more balanced, but not by much. June coated freesheet shipments increased 1% compared to June 2015. Imports of coated freesheet dropped 21% in May with exports down 8% year-over-year. In contrast, coated mechanical shipments plummeted in June vs. the prior year, falling 19%, while imports posted a 6% gain in May compared to May 2015 with exports down 41%. Coated imports from Europe rose 14% in the second quarter 2016 compared to 2015. Shipments of uncoated groundwood increased slightly in June, up just under 1% vs. June 2015 levels, the first year-over-year increase in a year and a half. Uncoated imports were down 7% in May while exports decreased 23% compared to the previous year.

The decline in groundwood paper demand is, as noted, due to several factors. One is the continuing challenges faced by magazines, which are a key use for coated grades and in particular for coated groundwood.

One indicator of magazine volume and, in turn, of paper demand is the USPS’s Periodicals Class mail volume data. Over the last 15 years volume has dropped by almost one half, demonstrating the long term secular decline of printed magazines. Recent data show a similar trend. For example, periodical volume declined 6%, 5%, and 4%, respectively in 2013, 2014 and 2015 (using USPS fiscal year). The rate of decline is slowing according to these data, but that’s about the only good news.

WEAK PRICING FOR GROUNDWOOD GRADES

In line with poor and declining demand, prices have also weakened recently on most groundwood grades. In contrast,

freesheet grades and newsprint prices have posted modest gains recently. While the declines have been relatively modest — \$20/ton in July on coated groundwood — it continues a downward trend that has brought prices for both SC and coated groundwood grades to the lowest levels since prices last hit bottom in 2010. The declines in late summer followed stable prices for most of the second quarter. Weak demand combined with supply from Europe aided by the strong dollar contributed to the declines. Prices have been trending down more or less steadily since early 2014 on SC grades and for about 12 months for coated groundwood.

Prices are now at very low levels and margins are under extreme pressure. The strong dollar has also been a factor by limiting exports, although groundwood papers have not historically been a major U.S. export product, while aiding imports from offshore and Canada. On the bright side, weaker prices may have contributed to a pullback, or at least a leveling, in coated imports recently. Coated groundwood imports surged last year rising over 15%, but so far this year imports are up only modestly year-to-date.

The SC paper market has also been buffeted by external factors notably the imposition of countervailing duties on Canadian imports of SC paper. The rate was set at an average of just under 19% in October 2015. An additional major development was that SC capacity in the U.S. posted a major decline this year following the late May closure of the 240,000 tpy UPM/New York Times Madison Paper SC mill. It came as a bit of surprise given the recent action on tariffs. Following its closure, Canadian mills will supply almost two-thirds of U.S. SC demand, which is now roughly estimated as a 2-million-ton market. Europe supplies just over 300,000 tons to the U.S. and Verso's Duluth, Minnesota mill supplies about 15%.

OUTLOOK

The outlook is expected to remain challenging. Prices may bounce back some since they are at what would appear to

be unsustainable levels that will, combined with plummeting demand, lead to additional capacity closures and possibly further industry consolidation. However, unless an external factor such as a major exchange rate shift comes into play unexpectedly, the pressure from imports combined with slipping demand will likely lead to additional closures and keep groundwood markets under pressure. Prices may improve some when the closures occur and shortly thereafter, but the overall picture is for tough times to continue.

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