

Timberland Market Update

Global Consulting Alliance

Quarterly Edition - December 2019

Economic Developments

- United States (US) economic growth slowed considerably in Q3 2019 to approximately 1.9% (down from 3.1% in Q1 2019) but remains relatively firm. Consumer spending is slightly softer but still solid and is expected to continue to prop-up economic growth. Job growth remains on a slowing trend but is still growing fast enough to further tighten the labour market with unemployment at a fifty-year low. Business confidence is weakening and is negatively impacting on investment. Manufacturing sentiment is also weakening.
- US Residential investment numbers in 2018 and early 2019 were sluggish but housing permits and starts strengthened as the year progressed. However, September saw a sharp drop to a seasonally adjusted annual rate of 1.256 million, 9.4% below the August estimate of 1.386 million but 1.6% above September 2018. The Federal Reserve (Fed) eased rates by a further 25 bps on 30 October, the third cut for 2019, in an effort to stimulate the economy with the expectation of further rate cuts to come.
- According to the American Hardwood Export Council, in the 12 months since tariffs on U.S. hardwood were announced in July of last year, lumber exports to China were down USD615 million compared with the previous year.
- There are some concerns about the Fed's decision to extend its overnight funding operations through to January 2020 coinciding with its second rate cut of 2019 to a target lending rate of 1.5 – 1.75%.
- The European economy has slowed notably in 2019. It is expected to remain soft with exports affected by uncertainty in global markets, particularly the sharp slowdown in China and increasing trade tensions. Household spending is still reasonably strong, and companies haven't significantly slowed down new capital spending. Growth is expected to remain around the low 1% level as in 2019.
- The European Central Bank (ECB) has unveiled several stimulating actions for reviving growth and inflation, for example, by cutting deposit rates even further. The euro has remained weak over the past months, especially against the US dollar, and is not expected to strengthen before the latter part of next year.
- In Australia, the Reserve bank reduced interest rates to 1% in July and to 0.75% in October in an attempt to stimulate the economy, support employment and wage growth and to lift inflation to within the bank's target range.

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- The Australian housing market weakened significantly in 2019, both in terms of house prices as well as new dwelling commencements. There are mixed signals following the interest rate cuts due to thin sales volumes. Australians have the world's 2nd largest level of household debt (120% of GDP), which implies limited opportunity for future credit growth.
- New Zealand's (NZ) official cash rate (OCR) was held at an all-time low of 1% in the 25 September announcement after the surprise 50bps cut in August. The economy faces headwinds with GDP growth slowing to 2.0%. Despite net migration holding up and unemployment at an 11-year low of 3.9%, further easing is likely to low as 0.25% by mid next year.
- Some easing of NZ's pent up housing demand is beginning to occur with house price inflation slowing to 2.6%yoy from a peak of 17.2% in 2015. Housing unaffordability remains a major issue with domestic debt at an uncomfortably high level of 164.4% of disposable income.
- South Korea, Indonesia, Singapore, India and Brazil have seen interest rate cuts in recent months. In the Euro area interest rates remain near zero, with Japan and Switzerland experiencing negative rates at -0.1%- and -0.75% respectively.
- In South America, a significant decrease in primary wood products prices (US\$/unit) occurred in Q3¹ compared to Q2, except for lumber, which remained stable (+0.4%). Pulp prices fell by 15%, plywood -by 11.1% and, mouldings by 2.5%. For the period 2018 to 2019F, the impacts were even more significant, except for mouldings (+ 4.6%). Pulp fell by 23%, plywood by 29.6%, and lumber by 10.3%. As the 2019 forecast shows, the quantity exported will be similar to last year. The significant price drop observed so far will mean much lower profitability for Brazilian companies in 2019.
- The World Bank's African Pulse Report has estimated economic growth in the sub-Saharan Africa region at 2.6% for 2019 (the lowest since 2016). It also indicated that growth will improve to 3.1 percent in 2020 and 3.2 percent in 2021. This average hides the performance of non-resource intensive countries where growth is projected at 4.2 percent for 2019, and 5.0 percent in 2020 and 2021.
- According to the World Bank Group's "Doing Business Study", African countries continue to improve their business environments with Nigeria earning a place among the year's top global improvers. Along with Togo, Kenya, Rwanda and Zambia. Nigeria was ranked amongst the top ten countries for starting a business and obtaining credit. It takes on average 20 days and costs 34% of per capita income to start a new business in these countries.
- General elections will be held in Uruguay on 27 October 2019. If no presidential candidate receives a majority in the first round of voting, a runoff will take place on 24 November 2019. In an October 29 poll, Martínez (Left Hand Official Party Frente Amplio) held 36 percent, Lacalle Pou (National Party) polled at 23 percent, and Talvi (Colorado Party) came in third place with 12 percent.

¹ quarterly weighted average

Asia-Pacific

- China's aggregate import of hardwood woodchip in Q3 2019 declined to 3.183 million bone dry metric tonnes (BDMt) from 3.377 million BDMt in Q3, 2018, i.e. an 5.7% volume decline. Vietnamese exports of chip to China declined by 6.81% and Australian exports were down by 13.0%. Imports from Chile increased by some 20% while China's imports from Thailand dropped by 22%. Compared to Q2 2019, China's imports dropped by 12.1%, Vietnam supply was down by 11.6% and Australia by 13.0%.
- Aggregated Australian hardwood chip prices peaked in May 2019 at USD166.80/BDMt FOB but declined to USD155.60/BDMt FOB in August 2019.
- Japan's aggregate import of hardwood chip in August 2019 increased to 1.021 million BDMt from 0.880 million BDMt in August 2018, a 16% increase. Japan's CNF import prices appeared to hold steady at around USD200/BDMt CIF over the period June to August 2019. Australian CIF prices eased slightly from USD 224.70/BDMt in June and July 2019 to USD222.81/BDMt in August. Vietnam's prices peaked in May 2019 at USD172.79/BDMt but declined to USD168.45/BDMt in August 2019.
- Australian exporters of hardwood chip are reporting increasing port inventory levels.
- Bleached hardwood kraft pulp (BHKP), prices dropped from highs around USD750 per air dried tonne (ADt) to ~USD460/ADt CIF China. Most Chinese pulp mills rely on imported chip, and at current price levels, many mills are likely operating at breakeven or below. There is a risk of Vietnam increasing export chip duties that will further exacerbate the situation.
- Hardwood pulp inventories in China remain high, reportedly with about 1-years worth of surplus inventory.
- NZ pine exports to China increased to 3.851 million tonnes in Q2 2019, compared to 3.259 million in Q2 2018. China imported an aggregate of 9.548 million tonnes of log in Q2, up from 8,900 during the same period in 2018. Russian softwood log exports to China declined to 1.342 million tonnes from 1.703 during the same quarter the year prior. US exports to China were 0.748 million tonnes, in Q2 2019, down from 1.256 million tonnes during the same quarter in 2018. Canadian exports remained flat between Q2 2018 and Q2 2019. German softwood logs exports increased sharply from almost zero to 0.416 million tonnes.
- Total Australian softwood log exports increased to 1.114 million m³ in Q2 2019, up from 0.983 million m³ in Q2 2018.
- At the end of Q2, softwood log prices into China suffered a -21% price reduction driven by US/China trade dispute uncertainty, building stock levels and easing of construction demand coming into the summer hot season. This has subsequently flowed through to other Asian markets. Many suppliers,

particularly high costs suppliers, have been adversely affected with reduced volumes now going to China.

Europe

- Global uncertainty is affecting pulp and paper products markets; however, household spending is still holding up and companies haven't slowed down investments. Next year's outlook is uncertain, especially concerning the pulp market. The darkest clouds are looming over wood products exports from the Nordics affected by the slump in the Chinese timber market and the uncertain situation due to Brexit.
- China has become the largest single export market for spruce sawn timber. Egypt, together with other countries in the Middle East and in North Africa, remain the largest export market area for pine timber.
- China has reduced its sawn timber purchases, and prices have been decreasing due to the weakening exchange rate and demand uncertainties. Moreover, the political and economic instability in the Middle East and in North Africa may continue to pose challenges for pine timber exports in the future. In the short-term, decreased exports of sawn timber to the Chinese market have led to an increase in inventory levels of Nordic sawmilling companies in general. The uncertainties related to the UK market have particularly affected Swedish producers, which have traditionally held strong footholds in this market. In Finland, domestic consumption has been negatively affected by reducing numbers of building permits and building projects. The situation for the Nordic pulp industry is expected to improve more swiftly.
- The challenges in pulp and timber products markets have negatively affected the wood markets in the Nordics, which will further weaken towards the end of 2019. The wood market outlook in Finland looked quite promising in the beginning of the year but towards Q3 2019, the pace of wood sales slowed to a lower level than Q3 2018. As a result, imports of wood have decreased. During Q3 2019, the price of sawn wood declined more rapidly than the price of pulpwood, as demand for pulpwood has remained stronger. However, the rapid rise of pulpwood prices in the Baltics has moderated, which is likely to lower sales in the region.
- In Sweden, the prices for both saw logs and pulpwood have decreased during Q3 2019, in fact for the first time since 2016. The decrease was mainly in the southern parts of the country. Sawn timber prices had already decreased in the previous quarter, but the decline has continued in the south during Q3 2019. The pulpwood price remains unchanged or slightly increased during quarters one and two in 2019 but is now showing signs of reducing.
- Nordic producers, especially Sweden, continue to show strong interest in acquiring forest land assets in the Baltics to secure future wood flow. In Finland the average prices of forest holdings are higher than last year in almost all provinces. Acquisition prices as high as €6 000 per hectare have been realised in the most attractive regions in Finland. In Sweden, Holmen has reported it will write-up the value of its forest holdings to at least SEK 20 billion, based on the decision to change the accounting of forest holdings to be based on transaction values in the location of their forest areas.

Africa

- The President of Ghana commissioned a new timber processing factory in Drobonso on the Sekyere Afram Plains in the Ashanti Region in October. The Miro Forestry Ghana Limited factory will process a variety of wood species and is one of nearly 200 projects selected by the Ministry of Trade and Industry, under the 'One District, One Factory' (1D1F) initiative.
- In South Africa, York Timbers have reported that its financial performance for the year ending June 30 was significantly affected by a National Union of Metalworkers of South Africa (Numsa) strike. The strike resulted in 239 lost production days. The company also indicated that they lost export contracts due to the strike
- At the recent UN Climate Action Summit in New York, many countries made promises to help in the fight against climate change. Some of Africa's promises had a strong focus on afforestation and reduction in forest degradation. These include:
 - Sierra Leone to plant 2 million trees by 2023.
 - Youth employment programmes in Nigeria to plant 25 million trees.
 - Kenya promising to plant 2 billion trees by 2022.
 - Ethiopia continued to commit to planting 4 billion new trees a year.
 - Congo DRC committed to stabilize its forest cover at 60%.
- Ethiopia confirmed that they are serious about their tree planting programme. In July a record-breaking 350 million trees were planted by Ethiopians in just one day.
- Afforestation and re-afforestation projects driven by tree planting pledges by multi-national companies (e.g. oil companies) for carbon purposes, seem to be growing in Africa.

South America

BRAZIL

- *Pulp Industry:* As the pulp inventory is at 50% above the historical average and market recovery isn't expected until the second two quarters of 2020, Brazilian companies are working hard to minimize their losses. Actions include prioritizing stock reduction, production cost-cutting, investment postponing, and price stability/recovery. The BHK prices CIF China are ranging from US\$ 450 to US\$470/ADt.
- *Charcoal Industry:* With the growth in the Brazilian economy at a disappointing 8% annual base in 2019, and the US/China trade conflict, the steel industry has been spinning its wheels. As a result, the charcoal and eucalyptus forestry industries in Minas Gerais remain without clear signals for the next

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two quarters. Wood prices should remain stable, ranging from BRL35 to BRL55 /m³ stumpage, depending on the transport distance and forest productivity.

- *Composite Panel Industry:* The slump in the Brazilian real estate market continues and consequently reduced demand continues to impact panel production capacity (-15% to -20%). This in turn presents the industry with profitability challenges. To address these, companies are focusing on cost reduction, closing capacity, postponing investments and trading part of their forest assets.
- *Sawmills and Plywood Industry:* Both industries are facing a challenging market, with production cuts of 50% to 60% and many small mills closing until the market recovers. This is not expected to continue in the next two quarters. *Pine lumber* exports have remained fairly stable in terms of volume (-1%) compared to 2018, but with a drop in prices of around 10.1% in USD and 6.1% in BRL. However, compared to Q2, exports fell 25% by volume, but prices stayed stable (+ 0.4%). *Exports of pine plywood* YTD decreased in volume by 6.9% and 29.6% in price in USD (-26.3% in BRL) compared to the same period in 2018. Analysing the change from Q2 to Q3, there was a 9% decrease in export volume and 11% reduction in price.
- *Wood Prices:* Since January 2019, the pressure to drop log prices by 5% to 15% has increased for both Eucalyptus and Pine. The hardwood pulp industry crisis together with its usual bargaining power explains the pressure for lower eucalypt log prices. This is the case despite the recent demand increase to supply Klabin's new pulp mill. The challenging situation affecting the lumber, plywood and composite panel industries along with the current oversupply of sawlogs, explains the downwards price trend for pine logs.

URUGUAY

- *Pulp Industry:* Last August, UPM announced its investment decision to construct a 2.1 million ADt/a greenfield eucalypt pulp mill near Paso de los Toros in central Uruguay. The mill is scheduled to start up in the second half of 2022. During September, UPM began work on the port of Montevideo to build the docks and infrastructure to facilitate the export of pulp through this port. A new railroad system is also to be installed and the company Vía Central has already begun work to dismantle the old railway prior to the construction of the new railroad.
- Both UPM 1 and Montes del Plata (MdP) pulp mills continue to operate at full capacity despite the downward international pulp price cycle. Both pulpmills continue to drive demand for eucalypt pulplogs from all Uruguayan regions.
- *Woodchip Exports:* Demand from Portugal remains strong, and Uruguay will export around 900 000 cubic metres (m³) of *Eucalyptus globulus* woodchips during 2019. FOB price for this product is USD160/BDMt (~USD91/m³). As of the end of September, the total exported volume was close to 850 000 m³.
- *Plywood Industry:* During 2018, Uruguay's plywood exports were close to 240 000 m³. As at mid-2019, exported volume was less than 90 000 m³ while by the end of September it was close to 155.000 m³.

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The FOB price for this product is around USD270/m³, nearly 15% lower than 2018. During August 2019, Lumin, the only plywood manufacturer in the country, announced an investment of USD30 million to build a second line in their plywood mill located in Tacuarembó (in northern Uruguay).

- *Sawmills:* Pine saw wood volumes dropped from 10% to 20% between 2018 and September 2019 even though the average FOB prices between September 2018 and September 2019 remain similar. Uruguay expects to export a similar volume of eucalypt sawn timber in 2019 compared to 2018 and at similar price levels.

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