

# 1998 LUMBER FORECAST

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Good morning, I appreciate the opportunity to join you for the 50<sup>th</sup> anniversary of the Western Dry Kiln Association. Much has changed in this industry over the past five decades. Through the last fifty years, however, there has been one constant for our mills: the responsibility to produce a quality lumber product that customers want and expect.

Organizations such as this play a significant role in helping our industry meet those commitments. The fact that the Western Dry Kiln Association has been making these contributions for a half-century is commendable and worth celebrating.

My chief assignment is to bring you the WWPA lumber forecast for the coming year. As the Association's Assistant Quality Standards Director, most of my responsibilities have to do with the lumber while it is still at the mill; where it goes from there is somewhat a mystery to me. After receiving your invitation, I turned to the people at the Association who DO know the lumber markets and I prevailed upon them to put together the information in a form I could understand. Unfortunately, it is difficult to deliver a presentation from a comic book.

Still, as you know, we lumber inspectors are nothing, if not persistent. With comic book in hand, I have hopefully developed some remarks worthy of presenting here this morning. Now that I have sufficiently lowered your expectations, let's move into our lumber forecast for the coming year.

We should start with a quick review of 1997. Although it was somewhat of a surprise, last year the U.S. set an all-time record for lumber consumption with 50.7 billion board feet. This volume was up almost 2 percent from 1996 and exceeded the previous record of 50.6 billion feet set in 1987.

This should have been the cause for celebration for lumber mills. But, as we all know, lumber prices fell throughout the year and ended below 1996 levels. The story was the same for all major Western species. Average prices for Douglas-fir and hem-fir both saw steady declines from last spring on and for ponderosa Pine producers, the drop was even more pronounced.

The markets of 1997 make it quite clear that our industry can no longer look for improvements in economic performance or lumber demand to drive up lumber prices. By any historic measure lumber prices should be high (FIGURE 1). But I doubt if there are many mills in the West pleased with prices at current levels. For the answers, we must direct our attention to the supply side of the equation to understand what has happened. Logs and wood products from Chile, Brazil, Mexico, New Zealand, Russia and Europe are finding their way into world markets and are

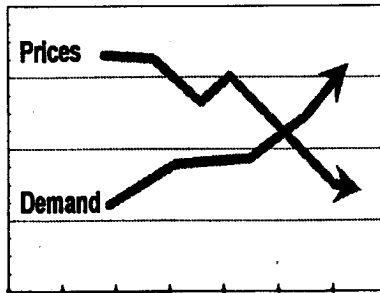


FIGURE 1. Vexing problem for lumber.

permanently shifting the supply/demand relationships. Those changes are beginning to ripple into our domestic markets.

Also, other construction materials are now available to our customers. Composite wood products, steel and plastic are all vying for a share of lumber's traditional markets.

These products have higher manufacturing costs and trade at higher prices than lumber, but are carving out their market niche anyway. They all compete for the same construction dollar as do our products and as we are starting to see, these products have established a ceiling above which lumber prices will not go.

After years of concerns about future lumber supplies, we now find ourselves in a situation where there is more than enough wood to satisfy demand. That fact was made abundantly clear this past year and it's the reason why prices reacted – or didn't react – as they did. These factors have set the stage for a solid, but slightly slower year for lumber demand in the U.S. in 1998. The strength of last year's record demand should carry us into 1998, though we don't believe we'll see a repeat of last year's high volumes.

Overall, we are expecting a 2 percent decline in consumption, still a very respectable demand year. Residential construction is our largest market segment, comprising 37 percent of all domestic lumber consumed.

We expect lumber use in this market to decrease by 2.5 percent this year to 18.5 billion board feet. That call is based on our forecast that housing starts in 1998 will decline by 2.8 percent to 1.435 million. The mix of residential and multifamily units should return to historic proportions, so residential lumber consumption should fall at near the same rate as starts (FIGURE 2).

The second largest segment is Repair and Remodeling. Changes here tend to lag changes in existing home sales by six to nine months. We feel that in 1998 the segment will decline to 14.8 billion feet, a change of 3.2 percent.

FIGURE 2. 1998 U.S. Lumber consumption in million board feet.

Markets	1998 Forecast	Percent chg. from '97
Housing	18,518	-2.5%
Repair/Remodeling	14,835	-3.2%
Non-Residential	7,332	-0.7%
Materials Handling	4,813	+ 2.5%
Other	4,202	- 2.7%
TOTAL	49,700	- 2.0%

The categories of Non-Residential and Materials Handling generally track changes in economic growth. We feel that lumber consumption in Non-Residential Construction will be the same as 1997 and that lumber consumed in the Materials Handling segment will increase by 2.5 percent. Other lumber uses, largely for furniture and cabinets will decline by 2.7 percent.

Despite the decline, domestic lumber consumption of 49.7 billion board feet in 1998 will still be one of our best years, exceeded only by demand in the two previous years and 1987.

Let's now turn to the supply side of the equation. Here in the West, the industry enjoyed a good year in 1997 -- given that in the 1990s, any year you can avoid a decline must be considered good. Western mills posted a 2.4 percent increase in production, with 16.59 billion board feet produced. It was only the third time in the past 11 years that mills have increased output from the previous year. Mills on the Coast and in California Redwood regions paced the increase, while Inland production was slightly above 1996 totals.

Looking ahead to 1998, Coast producers will enjoy a new timber source, as log shipments previously destined to Japan find their way into Western mills. We estimate that production at Coast mills this year will stay even with 1997 levels at 8 billion feet.

The KD markets historically supplied by the Inland region will feel increased competition from Coast lumber as well as Canadian and Southern production. As a result, we anticipate Inland production will decrease by 2.5 percent. In the California Redwood region, we foresee a 2 percent decline in production.

Taken together, Western lumber producers are expected to beat the odds and improve overall market share this year. Western lumber production will decrease by only 1.4 percent from 1997 levels. In all, the West will supply 16.4 billion feet to domestic and world markets.

During much of this decade, the elimination of the Western timber sale program from national forests allowed Southern pine production to increase and

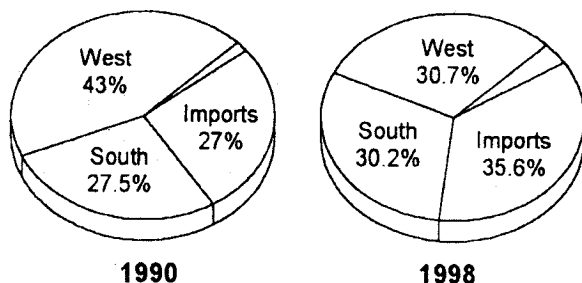


FIGURE 3. Lumber supply changes as a percent of the U.S. market.  
Source: Western Wood Products Association

replace Western lumber (FIGURE 3). The record year for that region was 1997, producing almost 16 billion board feet.

In 1998 we expect pine log prices, reduced timber sales from Southern National Forests, weather-related harvest curtailments, and an increased emphasis on compliance to new harvest restrictions to reduce Southern log supply. As a result, the string of increases in Southern pine production is expected to stop, with lumber production falling by 3.1 percent to 15.4 billion board feet. This will still be the second highest production year for that region.

The biggest slice of the supply pie in 1998 will come from lumber imports. When we say "lumber imports" we are talking about Canada. Canada supplies 97 percent of all lumber shipped to the United States and is now the country's dominant supplier.

When the Canadian lumber quota was established, U.S. producers anticipated a rollback in Canadian lumber shipments. But that hasn't happened. Canadian log supply and U.S. lumber prices were such in 1996 and 1997 that Canadian producers chose to ship in surplus of the quota and willingly pay the associated penalties.

We believe that in 1998 this will change. Because of log supply issues in British Columbia and domestic lumber prices, Canadian producers will be less willing to pay penalties. As a result they will stick closer to quota volumes and reduce exports to the U.S. to 17 billion board feet, or a 2.5 percent decline.

However, imports from non-Canadian countries have grown rapidly in recent years (FIGURE 4). Although they represent a small part of the supply picture, we expect these volumes will grow again in 1998. This will offset some of the decline from Canada. Total lumber imports to the United States should be reduced by 2.3 percent, to 17.69 billion board feet.

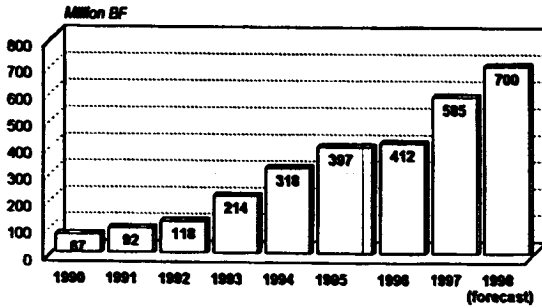


FIGURE 4. Imports of lumber from countries other than Canada.

Our experiences in the U.S. lumber market underscore the challenges facing Western mills today. We cannot rest our hopes on further demand improvements or economic growth to improve the industry's profitability. Instead, we must find ways to improve margins and control costs. And you can be sure that attention will be focused on lumber drying to meet those challenges.

As strong as domestic markets for lumber were in 1997, the opposite was true for exports. The Asian economic problems and competitive changes in Japan have decreased American lumber export volumes last year, and our outlook for 1998 offers no respite from the decreasing volumes.

Exports totaled 1.83 billion board feet in 1997, a 6.4 percent drop from the previous year. All of the decrease came in Asia, most notably Japan where shipment volumes were down by almost a third. Since Japan traditionally comprises about 40 percent of the export lumber purchases, its decline masked some good growth for American exports to Europe and Mexico. What's interesting is that the decline in Japan was due to a shift in supply rather than a market downturn. We're seeing more volumes from Europe coming into the Japanese market and that has begun to erode both the U.S. and Canada shares of the lumber trade. For 1998, we're not expecting any improvement in the Japanese trade and exports should dip another 9 percent to 1.67 billion board feet. Volumes to other countries should remain close to 1997 levels.

Although foreign markets have reduced purchases of American lumber, there are still many Western mills doing good business in exports, often in the high-end lumber products. That's why at WWPA, we have developed a number of certification programs to help keep trade doors open for Western lumber.

Recently, we developed a Kiln Drying Documentation program for Secondary Manufacturers. We just received the final approvals from the U.S. Animal and Plant Health Inspection Service (APHIS), and have started registering companies into the program.

We developed this certification in response to expanded plant health regulations in Europe, which have increasingly required heat treatment or kiln drying for all imported wood products. As with our other cooperative programs with APHIS, the Secondary KD certification creates the procedures to gain federal phytosanitary certificates, or phytos, for the exported wood products. Foreign countries, in most cases, require export certificates issued by other governments and are reluctant to accept documentation from individual companies or associations. However, government agencies don't always have the personnel or the expertise to do the required inspections.

For lumber and wood products, inspections are best done during the production and grading process. That's also where WWPA performs many of its inspection services for mills. So it made sense to have WWPA conduct the necessary inspections at mills and develop the procedures to give APHIS the information needed to issue phytos. The partnership between APHIS and WWPA has worked well and has allowed us to broaden the program as new needs emerge.

The new KD documentation is unique in the sense that WWPA has extended beyond primary solid-sawn lumber and into secondary products. With the growing interest and promotion of secondary wood manufacturing, this program keeps important foreign markets open. The objective of the program is simple: Confirm that the wood in the secondary product has been kiln dried. Obviously, that is not difficult to do, so the process for issuing certificates is fairly easy for a secondary manufacturer.

We've outlined three requirements for documenting the kiln drying. First, the lumber used must be purchased as kiln dried, a fact easily confirmed by the invoice. Second, the moisture content of the wood must be monitored at some point in the remanufacturing process so pieces exceeding 20 percent MC are rejected. And third, there must be some kind of monitoring of the moisture content of the final product.

The requirements are normally met as part of the standard practices for secondary manufacturers. Most kiln dried lumber is bought from mills, as company's prefer the stability that comes from controlled drying. They also monitor the moisture content of the wood before it is remanned as part of normal quality control. While remanners don't normally check the MC after manufacturing, that can be easily accomplished with a moisture meter.

Each company registered in the program signs an agreement with WWPA that authorizes company personnel to issue the necessary documents. The agreement notes that if the lumber does not meet requirements, the company will be responsible for the costs of fumigation or other corrective measures. It may also lead to revocation of the authorization to issue certificates.

WWPA provides the forms for documenting the kiln drying. The form is filled out for the shipment, signed by the authorized personnel, then forwarded to WWPA for final approval. After a review of the form, we will immediately return it to the manufacturer or, if requested, forward it according to the company's instructions. We also keep a file of the approved forms. Should the documentation be lost in transit, WWPA can issue a copy and attest to its authenticity.

Shipments covered under a certificate must also be marked accordingly. We provide stencils which must be placed on the upper right corner of one side of the bundle. These stencils include the WWPA grade logo as well as company identification. Association lumber inspectors will make periodic checks to assure the integrity of the certifications. APHIS personnel may also conduct inspections. However, they have come to rely on the integrity of our certification program and inspection activities.

It's clear that heat treatment or kiln drying has become a requirement for wood products exported into foreign markets. As an industry, we must be prepared to meet those requirements or risk losing profitable markets for some. At WWPA, we're confident that our long-standing partnership with APHIS and the integrity we have built in lumber quality control will allow us to respond to future challenges and restrictions in export markets. The lumber produced here in the West represents some of the best wood products in the world. We'll continue our effort to make sure these products can compete, no matter where they are sold.