

## RISI ECONOMISTS: Are we nearing the end of the current downturn in North American softwood lumber consumption?

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BOSTON, MA, Aug. 8, 2008 (Viewpoint) - Total North American softwood lumber consumption is nearing its cyclical bottom. True, we expect consumption will decline cyclically through the first quarter of 2009, but after that it will begin to edge higher with growth accelerating through 2010. There are several reasons for this outlook.

First and foremost, we believe we are nearing the cyclical bottom in the US residential construction downturn. New home inventories have begun to fall at a substantial clip: after slipping around 10,000 units per month for the past year, they dropped almost 25,000 units in June. This rate of decline will continue as we are now completing homes from the 1.00 million-unit (SAAR) start rate of the first quarter 2008. (This compares to completions in 1H08 from a start rate of 1.20-1.30 million units in 2H07, as it takes almost 7 months to complete a house.) Moreover, we are currently building substantial pent-up demand. Total housing production (housing starts plus mobile home production) is currently just over 1.10 million units, well below even the most conservative estimates of underlying demand.

Second, US mobile home production will also be on the rise in 2009. We are currently producing around 100,000 units, well below historical averages (roughly 200,000-250,000 in each of the past 10, 20, 30 and 40 year time periods). The low relative price of mobile homes combined with recent troubles afflicting conventional housing markets will result in a surge in production in 2009-2010 to more "normal" levels.

Finally, growth in US industrial markets will accelerate in 2009. We expect the US recovery to begin to build steam next year. This will increase domestic demand for manufactured goods. Meanwhile, the weak US dollar will hamper import growth and facilitate further growth in exports. These factors will combine to drive industrial production up more than 2% in 2009 (a substantial improvement over the 0.4% growth expected in 2008).

Weakness in repair and remodeling and nonresidential construction expenditures markets will limit growth. However, we still expect the year-over-year decline in US lumber consumption will moderate to 5% in the fourth quarter of 2008 and 2% early next year (down from around 15% in the first half of this year). Beginning in the second quarter of 2009, we do expect to see some (albeit modest) cyclical growth (Figure 1).

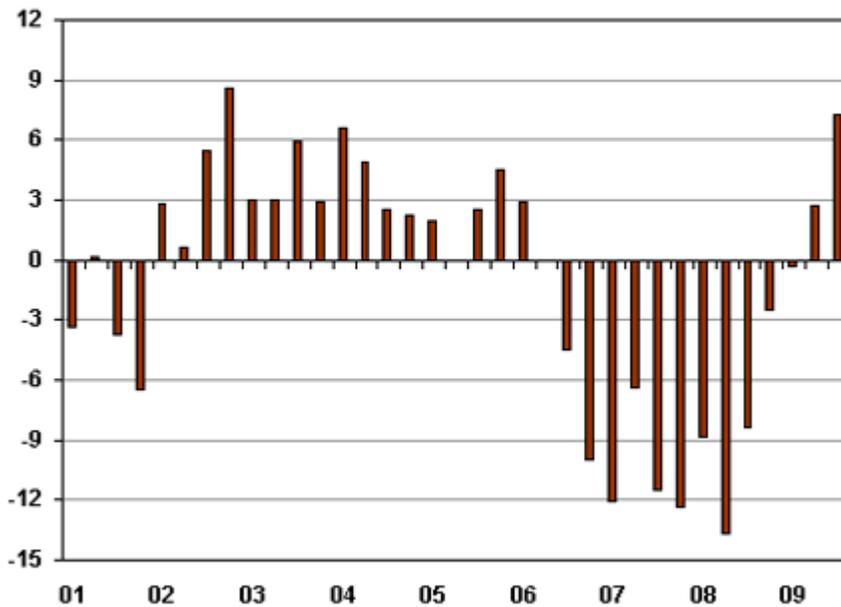
Canadian domestic lumber consumption will not change much over the forecast, and will therefore have little impact on growth in total North American softwood lumber consumption. In the near term, the Canadian economy (and lumber consumption) is expected to suffer from weakness to the South, however, significant oil revenue will allow the domestic economy to withstand most of the slowdown in the US. And, as North American economic activity accelerates in the latter half of 2009, Canadian lumber consumption will again be on the rise.

Continued upward pressure on timber prices in Europe, the result of increases in Russian log export taxes and record ocean freight rates, pushed offshore imports an estimated 34% below year-ago levels in the second quarter. While we expect the rate of decline will not be as severe over the next several quarters, imports will continue to fall into early 2009. This prognosis is based on several factors including: 1) continued US dollar weakness; 2) additional (and more dramatic) Russian log export taxes; and 3) further weakness in North American lumber prices and consumption

Meanwhile, offshore exports, while slipping year-over-year, have not fallen as much as imports. And, with global markets searching for alternatives to the expensive Russian fiber, we expect this decline will reverse and exports will grow through much of 2009.

Putting it all together, we expect total North American softwood lumber consumption will drop an average 5% below year-ago levels over the next two quarters. The cyclical decline will slow to 0.3% in the first quarter. Year-over-year growth will resume in the second quarter of 2009 and accelerate to 7% in the third quarter (Figure 1). While total North American softwood lumber consumption will remain low in 2009, the markets will be rebounding and growth accelerating (especially towards the end of the year. This should set 2010 up to be a good for lumber markets.

Fig 1  
Total North American Softwood Lumber Consumption  
Year-Over-Year Percent Change, Quarterly



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