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FOREST PRODUCTS OUTLOOK

Henry Spelter
Timber Demand and Technology Assessment
USDA, Forest Service, Forest Products Laboratory[1]
Madison, Wisconsin 53705–2398

General Economic Trends

When the 1994 budget was unfolding, two contrasting opinions about the economic outlook were voiced. One viewed the effects of the budget's tax increases and spending cuts as restrictive, causing the economy to slow or stagnate. The other viewed the lower interest rates, stemming from reduced deficits and stable inflation, as providing the thrust for an economic rebound that would offset any drag from fiscal policy.

How have these views been affirmed or negated by events in 1993?

- Long-term nominal interest rates have fallen to levels last experienced in the 1960s.
- Inflation has moderated to a range of 2% to 3%.
- Residential construction has revived, fulfilling its traditional role of drawing the economy back from recession.
- A strong automobile sector has lifted industrial production.
- Orders for durable goods have been consistently higher than 1992 levels, indicating more robust consumer spending.
- Gross domestic product (GDP) growth has risen steadily from a feeble 0.7% rate in the first quarter of 1993 to 2.8% in the third. An even stronger rate of growth is expected in the fourth quarter (Fig. 1).

One area of weakness has been the labor market, where job growth has been relatively slow and the unemployment rate has remained high. Many companies, unable to raise prices in a sluggish rebound, have invested heavily in labor-saving technology and/or have reduced their workforce to improve productivity and cut costs. Growth in manufacturing jobs has been notably weak.

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The debate about the effects of the administration's fiscal policies is continuing. However, as we approach 1994, the following signs indicate that economic growth will gain momentum:

- An expansive monetary policy and continued low interest rates. Throughout 1993, monetary policy has been stimulative as indicated by the growth in the monetary base. While long-term rates may not fall below the 1993 low, the continued prospects for moderate inflation and an economy that is well within its limits should support interest rates at comfortably low levels.

- Improved consumer and business balance sheets. The reduced interest burden, coupled with refinancing and slower borrowing, has reduced the proportion of income and earnings that must be set aside to service debt. This has set the stage for future increases in consumption and investment spending as consumer cash flows improve.

- Improved prospects for job growth. In response to the increasing demands for goods, firms are hiring more workers rather than scheduling overtime.

- A booming stock market and capital spending surge. The stock market is signaling the growth in economic strength. The surge in business investment spending also points to confidence about the future. As economic gains become evident, the momentum generated will become self-reinforcing, encouraging people to spend on discretionary, large-ticket items that they might have hesitated to buy before.

- A strengthening economy worldwide. Potential worldwide demand is growing as East Europe, the former USSR, Latin America, and especially the far East and China have adopted economic policies oriented toward the free market. In Europe, to the extent that falling interest rates stimulate recovery, the demand for American goods will increase.

In this context, the relatively restrictive budget, coupled with an accommodating monetary policy, could benefit the economy in the long run by helping to avoid business cycle extremes. The stage may be set for a period of sustainable economic growth, resembling the 1950s during the Eisenhower era, when restrained government fiscal policies set the tone for moderate demand growth while an accommodating monetary policy provided the low interest rates to fuel investment. Another parallel to the 1950s is found in demographics. Population growth is occurring mainly in the middle-age groups, which have high disposable income and savings.

Housing Trends

Housing provides the focal point for many wood products. Housing demand is driven principally by population growth (demographics) and credit market conditions.

The growth in population among younger adults has slowed within the past decade. As a result, the annual number of new households has been declining—from about 1.5 million in the 1970s to 1.0 million in the 1990s (Fig. 2). For another decade, this trend will put a damper on housing demand. Nevertheless, in the near term, households who postponed buying a home in the eighties because of high costs are now buying housing. This back-logged demand has been estimated to be as high as three million units. Results from home builders' surveys also indicate a rise in housing recovery for the remainder of 1993 (Fig. 3).

A key element in affordability is financing costs. A sharp rise in long-term interest rates would dampen housing prospects. Such an outcome is unlikely in 1994, however, because of the reasons I've discussed: low inflation, moderate and sustainable economic growth, and accommodative monetary policies.

Given the likelihood that many renters will take advantage of the opportunity to buy homes, the demand will continue for single-family houses. Vacancy rates in apartments are currently high and unlikely to fall in 1994, giving little reason for improvement in that sector. Overall housing starts are projected at 1.4 million units in 1994, including about 1.2 million single-family units.

Wood Products Outlook

Softwood Lumber

Most 1993 data point to a consumption level of slightly over 45 billion board feet of softwood lumber, about the same as that in 1992.[2] The economic and housing outlook is likely to support an increase of one to two billion board feet (Fig. 4). How does softwood lumber supply measure against this robust demand?

The timber supply situation on the West Coast is well known, and its impact on wood products supply is evident in the data. For 1993, western lumber production is on a pace of 17.5 billion board feet, down 7% from 1992 and 8% from 1991. Underlying forces point to continued restrictions in the region:

- The backlog of uncut Federal timber under contract in Oregon and Washington is shrinking and has been reported at 3.1 billion board feet compared to 4.4 in 1992.
- Timber prices have risen, continuing a trend begun in 1991 (Fig. 5).
- Timber price increases have had a predictable effect on supply from private nonindustrial holdings. Recent harvests from this source have approximately doubled (Fig. 6), but the size of this sector is too small to make up the shortfall from traditional Federal sources. Moreover, private industrial forest owners have evidently been unable to increase their supply significantly.

These trends suggest that western lumber mills will find it difficult to increase output in 1994, at least until the administration's "option nine" timber compromise proposal is put into effect. In this plan, the amount of timber harvested each year from Federal lands is set at 1.2 billion board feet. This amount falls 77% short of the 5.2 billion annual average cut from 1985 to 1989 and 65% short of the 3.6 billion cut from 1980 to 1984. However, the export of logs, primarily from the Pacific Northwest, has fallen by 1.5 billion board feet since 1989, moderating the effect of the Federal timber loss. Nevertheless, it seems unlikely that western lumber mills will be able to increase lumber output. Therefore, the increase in demand will have to be met from other regions.

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[2] 1 board foot = 0.0024 m^3.

In the South, production is on a pace to slightly exceed the 1992 level of 14.1 billion board feet. Maximum capacity is estimated at 16-17 billion board feet, but such a level of output is likely only under optimum conditions. An increase in production of 1 billion board feet is considered attainable if prices for logs increase sufficiently to draw the needed timber on the market.

The remaining shortfall in supply would have to be obtained primarily from Canada, as indeed it has been in 1993. Canadian production through the first 8 months of 1993 rose by 6.7%, while exports to the United States are projected to be 9.7% higher than a year ago.

Prices for lumber have followed a roller coaster path in 1993: they doubled and reached new records in the first quarter, collapsed in the second, rose again through most of the summer and fall, and are approaching earlier high levels as the end of the year approaches. This pattern is not new or unusual to the lumber market in an expanding, housing-led economic recovery. What is different is the extent, rapidity, and suddenness of the swings. Normally, such swings are experienced only during strikes and similar anomalies.

Annual figures offer a better perspective (Fig. 7). Compared to 1992, the price of dimension lumber increased by about 40% in 1993. Given the likelihood of increased demand, we could expect a higher price in 1994. The rise could be aggravated by a doubling of the tariff on Canadian lumber imports, as recently recommended by the Department of Commerce.

Hardwood Lumber

Through the first 7 months of 1993, hardwood lumber consumption was slightly below consumption at the same time in 1992. However, for 1993 as a whole, consumption is expected to increase by about 2%, to about 10.7 billion board feet. Anticipated growth in the important hardwood markets, notably furniture and cabinetry, suggests that a rise in production and consumption is likely in 1994.

Structural Panels

For all of 1993, structural panel consumption is projected to rise by 3%. In 1994, 2% growth is anticipated. This change masks an important shift in regional shares of production. Western plywood production, which was 6.2 billion square feet as recently as 1990, is projected to be 3.2 billion square feet in 1994 (Fig. 8). Oriented strandboard production, on the other hand, is projected to rise from 7.2 billion square feet in 1993 to 8 billion square feet in 1994. This increase would have been greater except for the low profitability of the early nineties, which discouraged construction of new mills. The rise in oriented strandboard production will be boosted by the construction of three new mills in 1994 and another three mills in 1995. The mills are expected to add 2 billion square feet of capacity.

Nonstructural Panels

Problems affecting western plywood production have influenced and will continue to influence markets for nonstructural panels as well. Most of the lost plywood capacity will affect higher grade, sanded plywood that is slated for industrial and manufacturing uses. This loss has created opportunities for substitute products, such as particleboard and medium density fiberboard. Industries for both of these products have enjoyed a banner year in 1993, and 1994 is likely to follow suit. Plans to build new mills, which were shelved during the nineties, are being dusted off in light of the improved economics. The one flaw in the otherwise bright scenario is the shortage of fiber in the West. As a result of the reduction in lumber output, some mills have had difficulty procuring enough wood shavings. As a result, some mills have been operating on the basis of 5 days per week, and the western industry as a whole is reported to be functioning at 84% of capacity compared to 91% elsewhere in the country. Mills have resorted to innovative solutions to the shortage of wood fiber, including the use of straw (up to 8% of product content) and demolition debris (in mills located near cities).

Pulp and Paper

From the viewpoint of profitability, 1993 has been a year to forget for the pulp and paper sector. Despite modestly increasing demand for their products, most papermills have been reported to be operating at little better than break-even or even at loss as a result of their inability to raise prices in a soft market. The year has been marked by many mill shutdowns and downtime, but these have failed to turn the market.

Pulp prices have been mired at their cyclical lows throughout most of the year and only toward the end of the year have some increases been announced. At the same time, however, pulpwood prices have been steady to rising.

The outlook for 1994 is mixed. Some producers forecast an end to the industry's chronic profit weakness, but not until the end of the year or even into 1995, depending on the amount of economic growth.

A continuing development in the paper industry is continued user pressure on companies to supply products with higher recycled-fiber content. The administration issued an executive order in the fall that set targets for recycled-fiber content in government-purchased paper. According to the paper trade association, 38.5% of the nationwide paper consumption has been recovered for domestic recycling or export in 1993 to date. The association's 40% goal is expected to be met in 1994 and to climb to 42% in 1995.

Summary

In general, the prospect for the wood products industry looks favorable for 1994. The outlook for 1.4 million housing units appears conservative, and stronger housing production would guarantee a very robust year. The industry is faced with local problems of timber supply, but growth in capacity where timber is more freely available will ameliorate the supply outlook nationwide. Supplies of wood products should be adequate, although prices are likely to rise.

A strong economy will benefit most segments of the wood sector, but particularly those that own and grow timber. Stumpage prices for species such as aspen and southern pine have risen substantially since 1991. If sustained, these higher prices will provide a strong stimulus for increased investment in forestry and timber management, increasing the long-term supply of wood fiber.

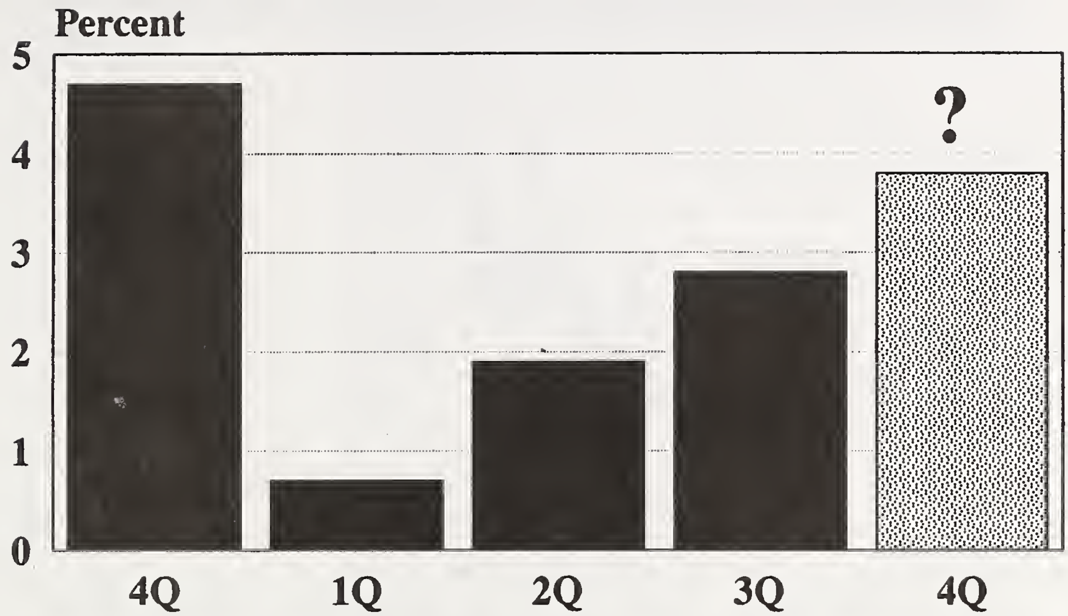

Figure 1. Real gross domestic product growth from 4th quarter of 1992 to 3d quarter of 1993. Projected growth for 4th quarter of 1993.

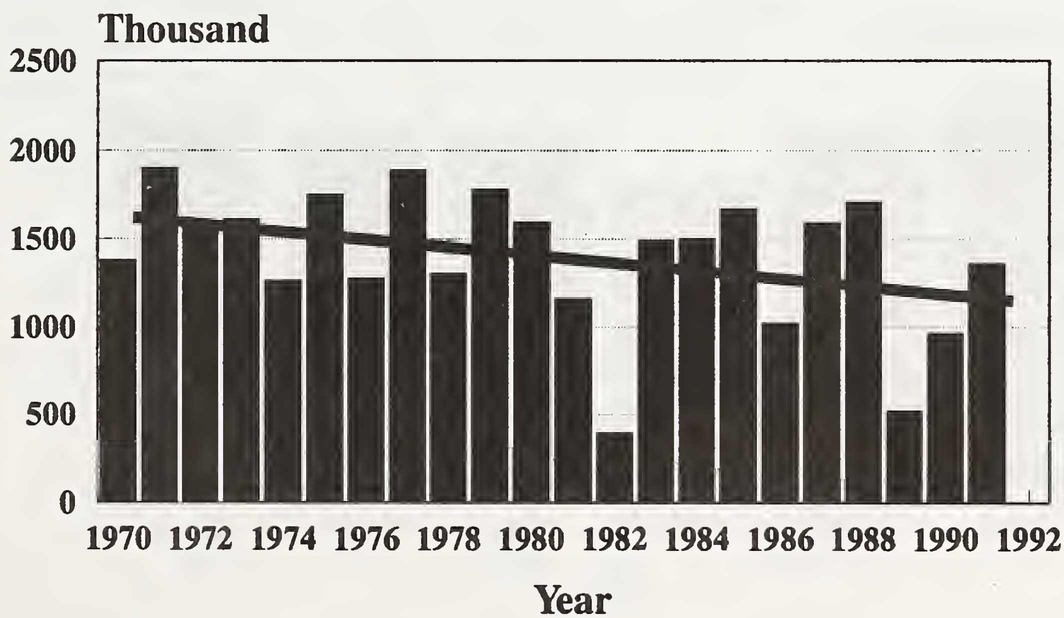

Figure 2. Change in number of new households from 1970 to 1991.

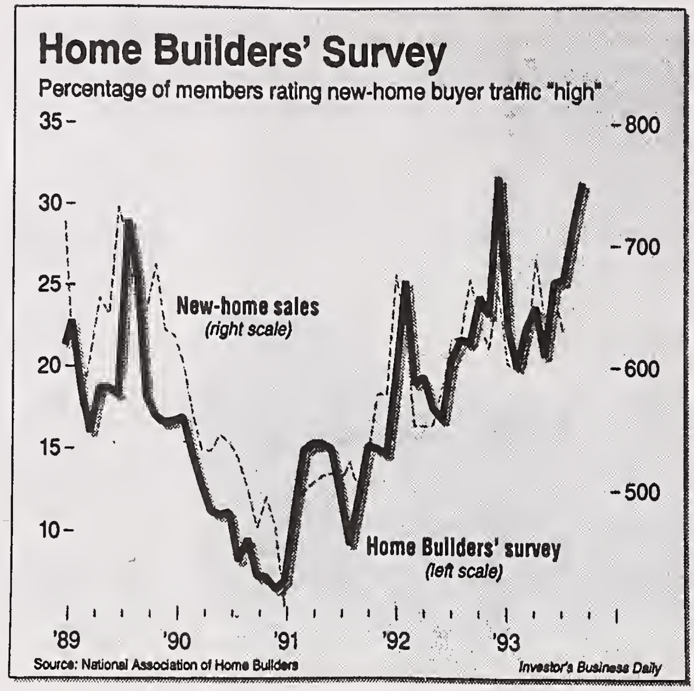

Figure 3. Results of home builders' survey on demand for new homes.

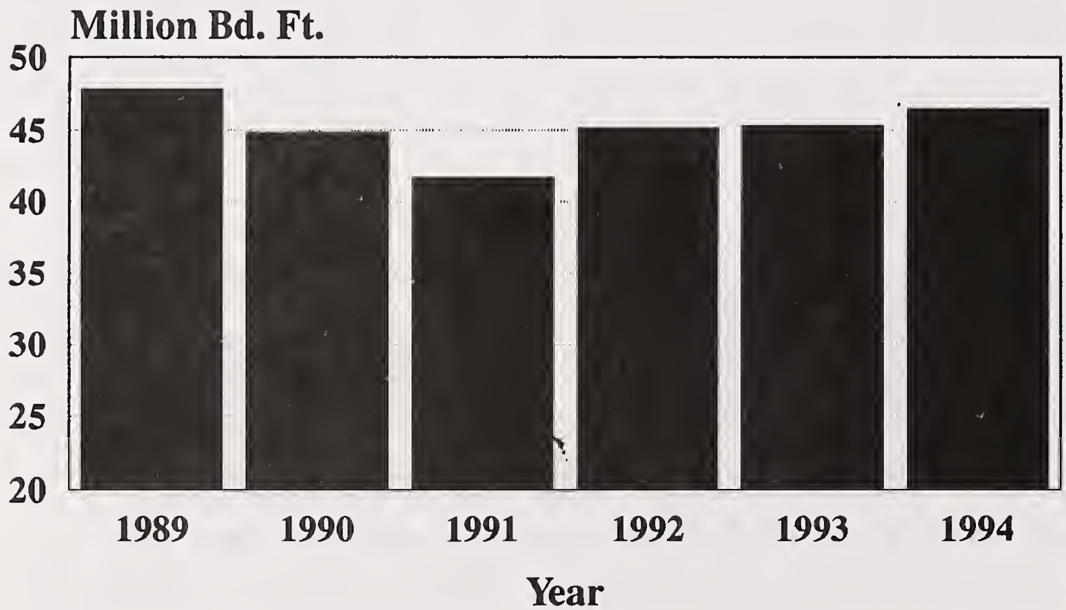

Figure 4. Softwood lumber consumption. 1 board foot = 0.0024 m^3.

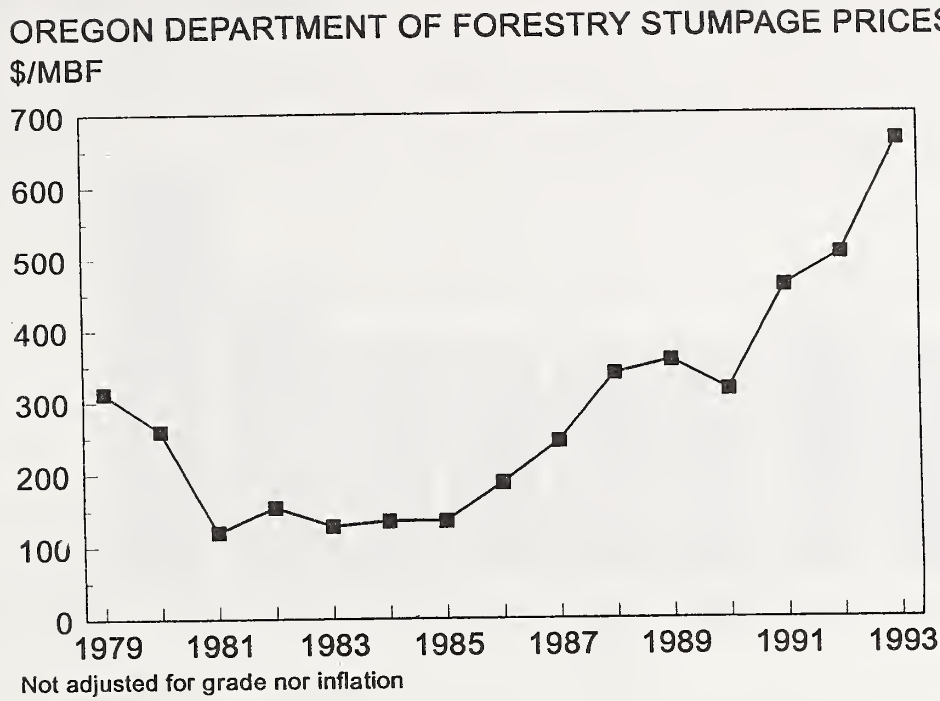

Figure 5. Trend in Oregon timber prices since 1979.

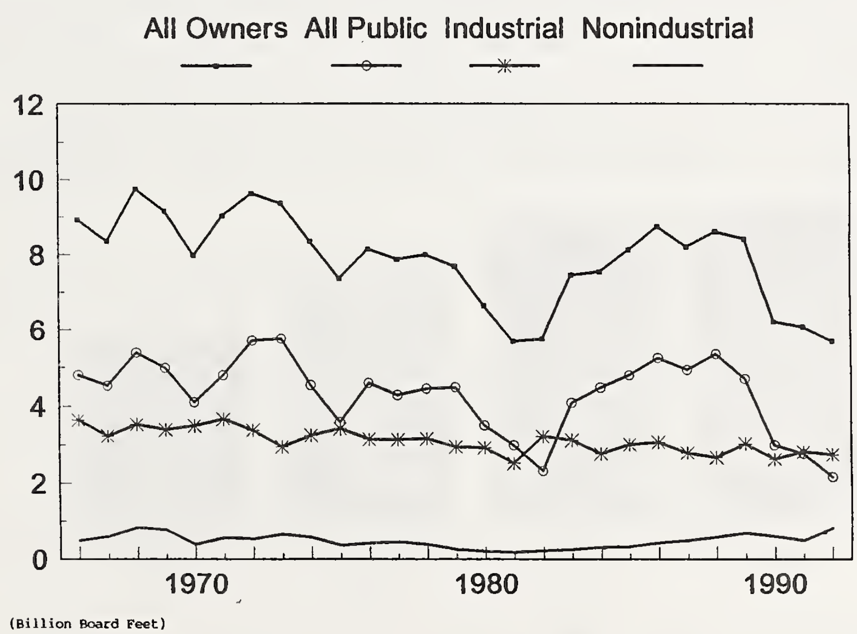

Figure 6. Timber harvests in Oregon, 1966–1992.

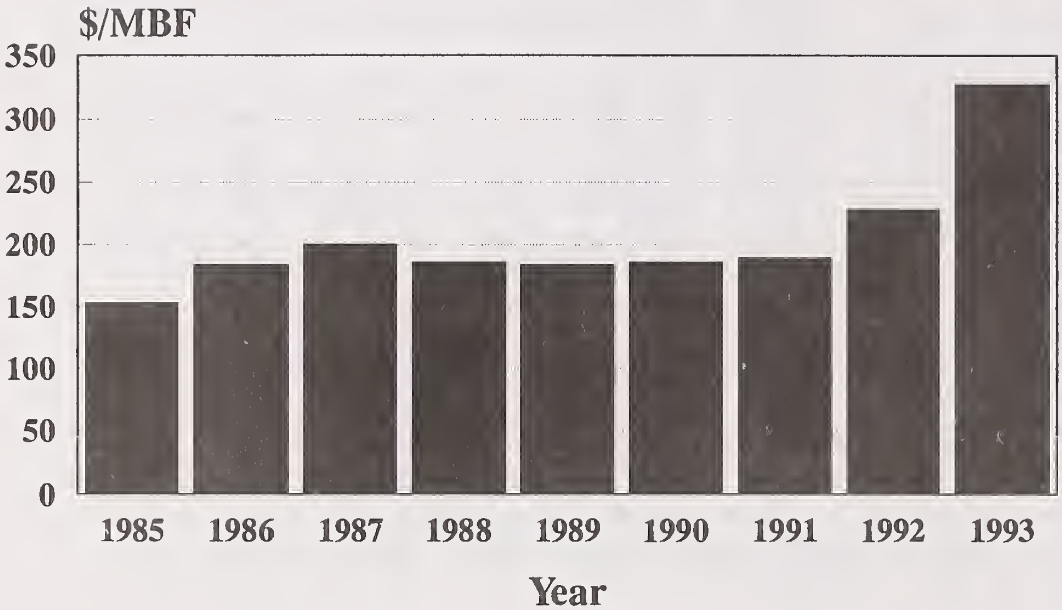

Figure 7. Annual prices of Spruce-Pine-Fir dimension lumber.

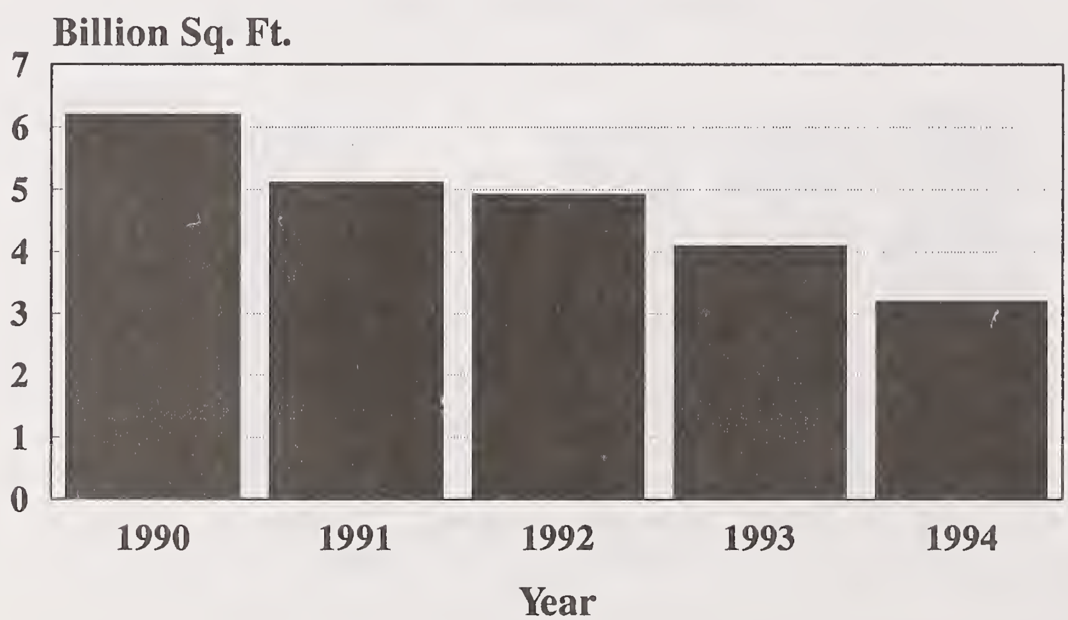

Figure 8. Projected trend in western plywood production.