Forestry Trends in a Global Marketplace: Logs, Lumber and Woodchips

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Agenda

• China’s imports of softwood logs and lumber: historical summary and RISI’s new forecast, outlook by supply source (speed version)

• International woodchip markets:
  ▪ Looming supply shortage in the Asian hardwood chip market
  ▪ New export terminals for North American woodchips

• Update on US-China trade in forest products
Over the past 20 years, China’s total need for imported wood has grown 14% annually, with the pulp and paper sector accounting for half of demand.
Since 2000, imports of softwood logs have grown 11% (CAGR) while softwood lumber imports have increased 26%
Drivers of Chinese softwood timber imports

• Demand in China
  ▪ Domestic construction
  ▪ Production of products for export
• Supply – Availability of
  ▪ Softwood logs
  ▪ Softwood lumber
• Demand in competing countries, e.g. India, USA
• Other factors
  ▪ Government regulations (e.g. log export restrictions)
  ▪ Freight rates
  ▪ Exchange rates
China Demand Outlook

- Wood products exports: no longer such an important driver for log and lumber imports, due to:
  - Rising labor rates and raw material costs
  - Trade barriers and other government policies
- Construction activity: major correction and slowing of activity, due to:
  - Demographic factors
  - Rapidly growing debt levels, including shadow banking sector
  - Anti-corruption campaign
  - Major new efforts to control pollution
China’s total exports of wood products surged to more than US$14 billion in 2014, but have since reduced.
China’s rapidly growing urban population has been a driver of wood demand, but the rate of urban growth is slowing.
China’s population has been aging fast, and the working age population is falling

Rate of Change in China's Population

- 15-64
- 65+

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China’s overall levels of debt have been a concern to analysts for years, with many China “bears” convinced that a future crisis is likely
Corruption at local and provincial levels has fostered excessive construction activity, but will reduce

- Why do government officials promote wasteful construction projects?
  - Efforts to boost local GDP figures
  - Grandiose government buildings to boost prestige
  - But mainly corruption, because construction projects offer numerous ways to increase an official’s private bank account:
    - Taking land and selling to developers
    - Facilitating building permits, regardless of underlying demand, or need to protect the environment
    - Encouraging local banks to finance projects

- Future will be different: in 2017, 530,000 people in China were “punished” due to anti-corruption campaign, including 58 at provincial or central government level.
After years of talking, the Chinese government has been seriously cracking down on environmental polluters

• Impacts on wood products industry include:
  ▪ Closure (temporary?) of half the plywood mills in China last year, until investments are made in emissions control equipment.
  ▪ Relocating sawmills/wood-working industry farther from major cities, e.g. Taicang.
  ▪ Problems trying to get air quality permits to run dry kilns near ports, which is likely to encourage greater imports of kiln-dried lumber
  ▪ Sprawl of cities may be somewhat more controlled, due to efforts to preserve natural areas but more importantly to preserve farmland.
We are projecting that Chinese softwood log imports will decline 21% over the next decade, but softwood lumber imports will increase 28%.
The Russian log export tax shifted exports to more lumber, opening the door for other log suppliers.
US softwood log exports to Asia are down 20% from 2013, with stronger domestic demand in US
The big surprise in US log shipments to China has been a surge in US SYP, which now accounts for 22% of the total.
All log exports from the US South are via container; to date, this freight has been less expensive and less risky than bulk shipping.
Almost all of the log exports from US South are from a narrow band close to the Southeast Coast.
New Zealand log exports hit a record 18.8 million m\(^3\) in 2017, but future growth will be tougher.
Australian softwood log exports were also at record levels in 2017, but are limited by age classes.
Canadian log exports are subject to controls which favor domestic processors; volume to China is now less than Australia’s.
Japan has emerged as a supplier of softwood log exports, thanks to generous government subsidies.
Uruguay has emerged as a significant new supplier of softwood logs to China

China: Softwood Log Imports from Minor Suppliers

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Due mostly to the log export tax, Russian softwood exports to China were 9% lumber in 2007, but 73% in 2017.
But total Russian softwood exports have not really increased at all, simply a greater share directed to China.
After setting new record volumes for seven years in a row, Asian woodchip import markets took a breather in 2017
92% of the Asian woodchip imports are hardwood and only 8% are softwood
Strong pricing for eucalyptus market pulp is helping to support demand for hardwood chips in Asia
Hardwood chip supply for Asia has become more concentrated, and we are anticipating shortages in some countries.
Hardwood chip exports from Australia and Chile are at all-time record levels, but may not be sustainable in the future.
Vietnam continues to be the largest hardwood chip supplier, but exports from other Southeast Asian countries have been falling.
Even with very optimistic assumptions on hardwood chip supply, a significant shortage of at least 2.0 million BDMT is likely.
From 1996-1998, the US South was the largest supplier of hardwood chips to Asia: is a come-back in the cards?
The softwood chip trade is much smaller than the hardwood trade, and prices have fluctuated widely in the past.
In addition to woodchip trade for pulp production, demand for biomass chips is also increasing, in Japan and possibly Europe.

**Japan: Imports of Biomass Woodchips by Source, 2017**

- **Australia**: 39%
- **USA**: 30%
- **Canada**: 9%
- **South Africa**: 15%
- **Vietnam**: 7%
In March 2018, a vessel of hemlock chips was loaded for China in Port Angeles: the first woodchip exports from this port since 2001.
The chip exporter from Port Angeles, a Dutch trading firm called Nollen Trading, believes he will have a sustainable business exporting to China, and plans to begin exports from the port of Bellingham as well.
Exports from Port Angeles are beginning with minimum investment in port infrastructure, at least for now
At the Keystone Terminal in Jacksonville, the Turkish company Kastamonu has made significant investments and improvements in the woodchip handling and loading.
US Trade With China
US forest products exports to China were at a record $7.3 billion in 2017, and were more than double the value of 2009 exports.
The US has a huge overall trade deficit with China, but forest products trade is relatively balanced (not including furniture)
China accounts for one-third of US wood products export value, and nearly 30% of wood pulp export value
China’s share of US forest products export value is now equal to Canada’s, about 21.4% in 2017
Historical Comments on Trade

• Why do we have the WTO and the current global trade framework?
  ▪ Dates from 1948 and establishment of GATT; the USA was the leading producer of almost everything (following WWII), and American business did not like having to face protective tariffs that blocked us from many overseas markets.
  ▪ WTO was established in 1995, following decades of progressively reducing tariffs under the GATT framework. During most of this period, the USA led the effort to rationalize and expand the global trading system. The US government pursued these policies because American business wanted to expand trade opportunities.
  ▪ Remember the riots in 1999 in Seattle, when extreme leftists/radicals tried to shut down the meeting of the WTO? For decades, opposition to increasing world trade was led by the extreme left, anti-business lobby. It has only been in the last decade that the Tea Party and Fox News commentators have decided that trade is a bad deal for Americans.
Why the current situation with China?

• Beginning in the late 1980s, both Republicans and Democrats agreed that it would be better to integrate China into the global trading networks (i.e. eventually into WTO) than to isolate the country. Most western China experts believed that as business relationships developed with other countries, as Chinese people learned the truth about living conditions in the West, as incomes increased in China, that over time the Chinese people would force the Communist Party to increase freedoms and democratic reforms. This did not happen, but keep in mind that during most of the past 25 years, it was American businesses who kept promoting the idea that doing business with China was the right course to pursue.

• President Trump is absolutely correct that we have many issues to resolve with China regarding trade (as does every other country in the world trading with China). Obama’s strategy was in part the Trans Pacific Partnership, a trade agreement with the 12 leading economies in the Pacific region but specifically excluding China. By aligning most of China’s leading trading partners, it was believed that the TPP could bring enough pressure to force changes from China. After President Trump pulled the US out of the TPP, the other 11 nations finalized the agreement, but only after dropping most of the elements that US trade negotiators had spent years demanding, including protection of intellectual property rights.
My prediction of the outcome of a “trade war” with China?

• There won’t be a trade war, but negotiations will get much more serious.
• The Chinese have read President Trump’s book, in fact they have been practicing The Art of the Deal for about 1,000 years. They understand that they will have to give President Trump a “victory”, some major concession that he can talk about. If they give him a victory prior to the mid-term elections, it is worth a lot more to him; what would he be willing to give up for this?
• While I disagree with President Trump on a lot of things, when it comes to China and their trade practices, he is absolutely correct that if no one holds them to account, they will continue to do what they’ve always done. They will take advantage of any opportunity (example from Lumber Liquidators case).
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