

MARKET SNAPSHOT  
**FOREST PRODUCTS**



March 31, 2019

**Executive Summary**

**Drivers** for the forest products industry include subdued housing starts, modestly improving lumber prices and tariffs.

- Minimal growth is expected for 2019 housing starts due to supply and affordability headwinds.
- Lumber prices are slowly improving in anticipation of the spring building season, yet margins at mills remain below 2018 highs.
- Chinese tariffs are significantly affecting exports.

**12-Month Profitability Outlook**



Northwest FCS' 12-month outlook calls for profitable margins for timberland owners and slightly profitable margins for forest products manufacturers. Timberland owners' profits are stronger as log price declines in Q4 2018 were not as severe as lumber markets. Processors' margins are squeezed from high-priced log inventories.

**Housing Market**

**Softwood Lumber Consumption**

Changes in demand for softwood lumber is heavily influenced by housing starts. Although the repair and remodel sector is the largest use of softwood lumber, growth year to year is typically flat.

Single-family housing starts accounted for 27 percent of 2018 domestic softwood lumber consumption, compared to 44 percent at the peak in 2005.

Average single-family home size also influences lumber consumption. New single-family home size peaked in 2015 near 2,650 square feet on average. Homebuilders have begun to shift to more affordable, smaller homes, and the average size of a new home is now 2,550 square feet. Although smaller homes use less lumber, smaller, more affordable homes could improve home sales. The increased demand might compensate for lower lumber use in smaller houses.

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### Domestic Lumber Consumption

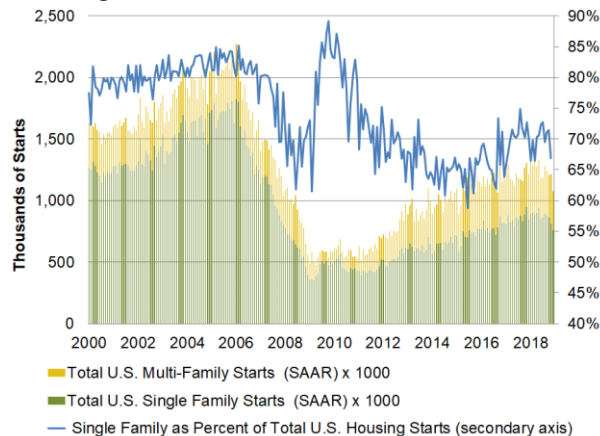


Source: Forest Economic Advisors

### Housing Market and Affordability

Though the 2018 housing market improved with 1.245 million starts, growth was lower than expected. Single-family units comprised 70 percent of starts, just below the 10-year average of 71 percent.

### Housing Starts



Source: U.S. Census Bureau

A healthy economy, including unemployment at the lowest point seen in decades, would typically prime the housing market for significant growth. However, pressures on both the supply and demand sides are constraining progress. Supply limitations are due to lack of construction workers, a shortage of buildable lots and substantial increases in regulatory costs and restrictions. Over the last five years, regulatory costs alone

have increased 29 percent according to Forest Economic Advisors (FEA).

The National Association of Home Builders' fourth quarter 2018 Housing Opportunity Index fell to a 10-year low. Only 56.6 percent of homes sold were affordable to families earning the median income of \$71,900. Existing home prices appreciated 4.7 percent on average in 2018 while wages grew 3.2 percent.

Though home mortgage rates remain low by historical standards, rates are higher than the primary new-home-buying population has experienced. Changes in 15- and 30-year interest rates influenced 2018 home sales. The 30-year mortgage peaked at 4.95 percent in November and was followed by sluggish housing starts in December. At the end of March, Freddie Mac reported the 30-year interest rate at 4.06 percent, the lowest in about a year, which bodes well for spring home-buying season. Freddie Mac's 30-year rate outlook for 2019 is 4.27 percent.

### Housing Outlook

2019 projections are tempered compared to those of past years and forecasters are predicting approximately 1.3 million total starts. FEA predicts total 2019 housing starts at 1.273 million, with 0.902 million single-family and 0.370 million multi-family starts. Affordability and supply challenges are expected to be the biggest restrictions on growth.

The 2020 housing forecast by industry economists varies, indicating growth between 2 and 8 percent. Without a breakthrough in supply constraints, slow, steady growth is expected to be the trend for housing starts for the next several years, despite growing demand.

## Tariffs

### Canada

Duties of 20.23 percent have been imposed on Canadian lumber since the December 2017 U.S. International Trade Commission ruling that Canadian lumber imports injured the U.S. lumber industry. Canadian producers were somewhat insulated from the impact of the duties for the first half of 2018 as high lumber prices were sufficient to cover the duties and still yield a positive margin.

Recently, a binational panel was formed, consisting of three Canadian and two U.S. appointees. The panel will review the injury decision previously rendered and NAFTA's Chapter 19 dispute-resolution protocols. This will likely be at least a two-year process.

### China

In August 2018 China implemented tariffs on several wood products, including Southern Yellow Pine logs. In late September, additional tariffs were enacted on several Western wood products. China was the largest importer of U.S. logs through September 2018, accounting for 54 percent of exports.<sup>1</sup> The U.S. South and U.S. West are most exposed to the tariffs with 84 percent and 59 percent of each region's log exports destined for China, respectively.

According to Forest2Market, 2018 Pacific Northwest total log exports declined 15 percent and exports to China alone were down 21 percent. Forecasters predict tariffs on U.S. logs will remain in place, keeping exports expensive for foreign buyers in 2019. China is securing replacement volumes from

other sources such as New Zealand, South America and Western Europe. It may be difficult for the Pacific Northwest to regain lost market share if log prices remain strong compared to alternative log providers, even with resolution of the trade dispute.

Although exported log volume to China has reduced because of the tariffs, growing domestic demand for lumber has absorbed the lost export volume. Ultimately, strong relationships with end users remain key for U.S. log producers with no certainties for trade resolution on the horizon.

## Log Markets

Domestic log demand in the Pacific Northwest drove prices to record highs for most of 2018. Domestic log prices decreased in late 2018 due to extreme lumber market volatility.

2019 opened with strong log supply at mills providing market stabilization. Mills resumed normal operating hours after imposing market-related curtailments in late 2018. Most mills worked through their excess log inventory from last fall and some indicate modest improvement in domestic log prices in certain areas. However, prices are not expected to repeat 2018 first-quarter price levels.

Late winter weather in the Pacific Northwest has limited logging ability and created a tightening of log supply in February. However, mills will attempt to temper any log price increase because lumber prices remain low and margins are thin.

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<sup>1</sup> Forisk Blog, "Tariffs and Trade: New Path Forward in the New Year?" Dec. 27, 2018 by Andrew Copley

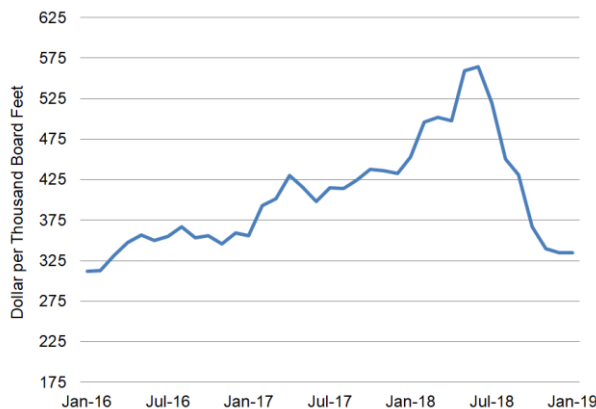
## Lumber Market

Forest2Market reports 2018 lumber prices declined at a much greater rate than log prices on a percentage basis. From peak prices, Douglas fir and Hem-fir log prices dropped 22 percent and 18 percent, respectively, while lumber prices dropped 49 percent.

Since the price declines, lumber margins at mills have fallen sharply. Compressed margins and wet winter weather in the West led to some closures and curtailments at the end of the year. Most mills are back to regular operations.

Extended winter weather, including wet weather in California, dampened building activity and lumber consumption, which has kept prices pressured. Prices slowly picked up in late February; modest increases are expected as field inventories decline and distributors prepare for spring's building season. Random Lengths' framing lumber monthly average price for February was \$374 per thousand board feet, compared to the all-time high of \$564 per thousand in June 2018. Forecasters expect prices will remain flat through April before seasonally increasing in May and June.

### **Framing Lumber Composite Price**



Source: Random Lengths

## Additional Information

Northwest FCS Business Management Center  
[www.northwestfcs.com/Resources/Industry-Insights](http://www.northwestfcs.com/Resources/Industry-Insights)

Forest Economic Advisors (FEA)  
[www.getfea.com](http://www.getfea.com)

Random Lengths  
[www.randomlengths.com](http://www.randomlengths.com)

Fastmarkets RISI Log Lines  
[www.risiinfo.com](http://www.risiinfo.com)

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