

## Status and Future of Wood Product Markets

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## Pennsylvania's Forest Products Industry

- Typically 1+ BBF Hardwood Lumber production
- Ranked #1 in Hardwood Lumber Production & Hardwood Product Exports
- Annually \$16 Billion in Sales; \$27 Billion in economic impact; 80,000+ jobs - Accounts for 1 of 9 manufacturing jobs in Pa. (2007)
- Pa is major producer of: cabinetry, components, millwork, flooring, pallets, specialty papers
- Forest base is 71% private; 700K+ landowners
- "Black Cherry Capital of the World"

## Post-lunch Provocative Question

What will the Hardwood Wood Products Industry look like in the next decade?...

...Assuming that there will be one.

## Pre-Recession Industry Trends

- Globalization – Impacts on furniture & lumber production
- Changing consumer tastes – away from oak
- Transformation of sawmill sector
  - Growing capacity/efficiency in larger mills
  - Declining number of small mills
  - Fewer Loggers
- Overall Declining Production
  - 2007 demand was 20% less than production high of late 1999's
  - Continued contraction of Paper Sector
- Land divestments by Industry & rise of TIMOs and REITs

## The Great Recession – What Happened ?

- Declining lumber demand for 3 years prior
- Consumer shift away from red oak - mid-00s
- Housing Bubble begins to burst – mid-2006
- \$4.00+/gal gas – summer '08
- Crisis in financial markets – fall '08
- U.S. government actions (TARP, auto bailouts, stimulus)
- Stock market hits to 10-yr low – Feb. '09
- U.S. Consumer Confidence Index hits all-time low – Feb. '09
- Loss of 6.6 million jobs; unemployment approaches double digits – fall '09
- Loss of nearly \$14 trillion in U.S. HH wealth in two yrs
- FY 2009 fed budget deficit triples previous record
- Impact is Global

## What Happened to Lumber & Wood Products Industry?

- Market was already softening by 2006
- Demand & price freefall in 2008
- Mills significantly reduce production (30-50% reduction) and reduce inventory; prices of HW lumber bottomed out by spring of 2009 as supply and demand begin to balance
- Mills make the best of low grade and residual market opportunities
- While production is down and some facilities close, most production *capacity* is still available

## Outlook – U.S. Economy

- The recession has probably hit bottom
- Slow recovery – ‘shallow U’
- Employment and real income expected to lag
- Core economic problems still exist – housing, toxic assets, tight credit markets
- Risk of a slip back into recession
  - Federal legislation (taxes, healthcare, climate cap/trade, pro-union, protectionism)
  - Future energy costs
- Future of the US consumer-based economy?

## Short-term Outlook – Lumber and Wood Products Industry

- WP will lag in recovery as the economic factors impacting WP are still in bad shape – housing, credit markets, income and wealth gains, consumer confidence
- Housing recovery will be in smaller, cheaper homes
- Exports will be more important
- Expect little/no increase in demand of WP in 2010
- Credit availability to companies remains a challenge
- Access to affordable raw material supply is a growing issue
- For 2010, the focus of mills will still be survival - Expect attrition of sawmills to increase in 2010
- Cash management, productivity and profitability (not production) is key to individual company survival

## The New Norm

- Most in industry expect that wood product demand will require production of only 8BBF to 9BBF of HW lumber/yr. over the next decade
- Log prices will not return to previous levels anytime soon
- Temporary shift to less costly species?

## Issue - Supply

- Will sawmills be able to accommodate the recovery?
  - Production capacity is still out there
  - Timber scarcity at profitable pricing; private owners holding back; less volume related to development; more reliance on public lands
  - Loggers: Decline of 30% or more do to recession and more attractive opportunities
  - Regulatory costs continue to rise level
  - Finances: Mills are cash and credit short
  - **What if recovery is too ‘hot’?**

## Issue – The New Green Wave

- Increased demand for 3<sup>rd</sup>-party certified wood products
  - Non-certified material becoming less attractive
  - NIPF landbase limits production
- Green Buildings - LEED Program discriminates against wood
- Corporate USA says ‘cutting trees is bad’
- Competition to wood markets on environmental benefits

## Issue – Wood Energy

- On-going push for greater utilization of mill and forestry residuals for energy production
  - Wood Pellets
  - Institutional and community scale projects
  - Utility-scale electricity generation
  - Cellulosic Ethanol
- Possible source of new revenue to help sustain loggers and mills
- Still have to face regulatory environment
- Government subsidies pick winners and losers in the marketplace

## Issue – Ecological Payments

- Carbon Markets have potential to provide opportunity for forestland owners
  - Impacts of federal/state rules
  - Best actors will see smallest benefits
  - Mills own little land, so they will see little benefit
  - Reduce in commercial harvesting
- Other ecological markets possible, but constrained by recession
- These payments won't challenge timber/development revenue opportunities

## Issue – Taxes and Regulatory Challenges

- Potential increase in taxes & regulations will challenge WP companies to compete in global marketplace
  - Fed/state income and capital gains taxes
  - Water quality regs (fed. Chesapeake watershed TMDLs)
  - Air regs
  - Transportation regs & costs
  - Personnel costs (wage, healthcare, pro-union)

## Conclusion

- Eastern Hardwood WP industry still have many competitive advantages (quality of product, proximity to supply & markets, etc.)
- Housing boom masked true demand norm
- Future success of industry relies upon ability of companies to be productive and tax/regulatory environment to compete in global marketplace

## Thank You

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