

A new ITTO report suggests that attempts must be made to control price volatility if the industry is to regroup

THE serious plight of the tropical plywood sector has been noted in previous editions of this newsletter (eg *TFU* 13/2, page 18). Falling prices and changes in health and safety standards for imported plywood in Japan and the European Union have all exacted a toll on the bottom lines of tropical plywood producers.

The seriousness of the situation and the growing risk of significant job losses and slowed economic development in tropical countries has not been lost on the International Tropical Timber Council, which commissioned an analysis of the sector in 2002. The *ITTO Study to identify measures to bring increased transparency to the tropical hardwood plywood trade and analysis of the causes of market fluctuations and price instability* was prepared by Lamon Rutten and Tan Seng Hock and reviewed by the Council during its session last May.

This study is a must-read for plywood manufacturers, traders and international trade policy-makers. It clearly fingers price volatility and inadequate price discovery mechanisms as major handicaps in the international trade in tropical plywood, thereby pointing the way to a potential lifeline for the industry. This article presents a brief overview of the report.

Under threat

The tropical plywood sector is under threat from other plywood and wood-based panels. Total world plywood production increased by 19% between 1991 and 2001 and total production of wood-based panels increased by 50%, but tropical plywood production fell in this period. Problems with log supply certainly played a role in this, but it is likely that demand-side factors, including issues related to tropical plywood price risks and lack of market transparency, also played a role.

The tropical plywood industry is witnessing major changes in many of the producer and consumer countries. The plywood sectors in Brazil, China, Indonesia and Japan have

all seen major upheavals in recent years and in China and Indonesia the situation has not yet stabilised. The industry is in search of a new equilibrium: if markets are disrupted in the process of reaching it, some risk-averse end-users (and most are likely to be risk-averse) may decide to shift to alternatives or substitutes.

China's stellar performance

Developments in China's plywood sector have been most dramatic and clearly have not yet played out. China's production and consumption of plywood have been rising steadily: not long ago it was a major plywood importer but it has now become the world's third-largest tropical plywood producer, second-largest consumer and third-largest exporter. In contrast to the declining international trade seen in the plywood industry in many other countries, China's industry is growing and is likely to continue its fast growth given the competitiveness of its prices in international markets; its plywood exports may soon overtake those of Malaysia.

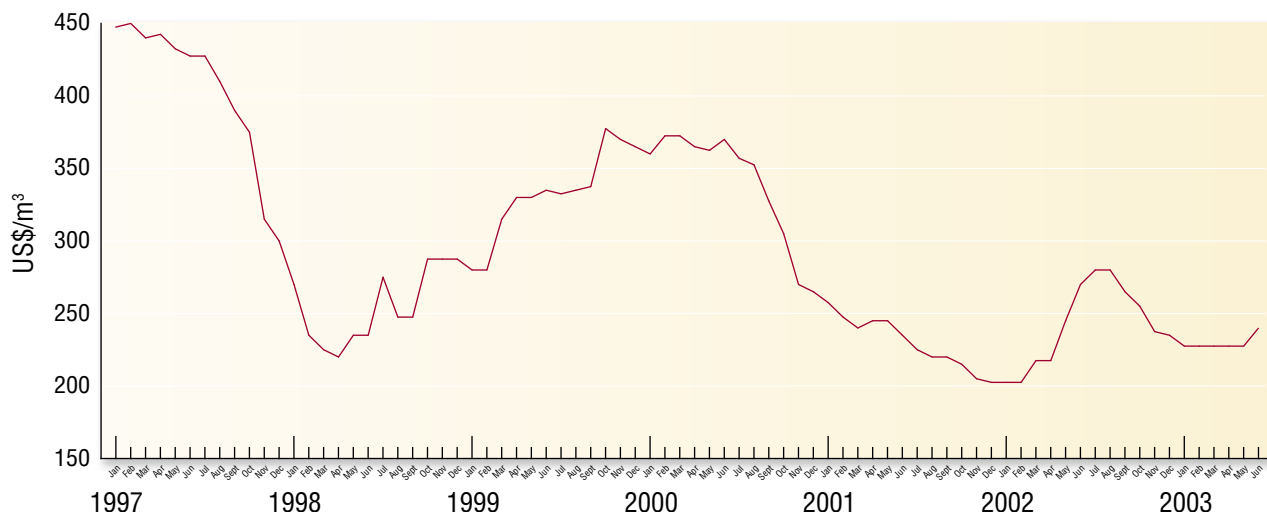
These developments and changes in trading practices have led to a greater role for international traders, particularly those dealing in Chinese and Indonesian plywood, to the detriment of direct relations between producers and importers. For example, industry consolidation has been fast in a country like Japan, where volatile markets and declining margins have led importers, wholesalers and distributors to merge operations; producers are therefore having to deal with importers and not with the end-users.

The competition

Meanwhile, producers of temperate hardwood and softwood plywood and of other wood-based panels are moving decisively to promote their products through their well-organised associations. They not only use conventional publicity but also work with regulatory authorities in major consuming countries, including China and Japan. This cooperation ensures that their panels can meet new, stricter

Slumped

Prices for Indonesian 2.7 mm plywood, FOB Indonesian ports, January 1997–June 2003 (US\$ per m³)



Source: ITTO Market Information Service

regulatory requirements and, moreover, gives them a say in the development of new building standards that allow more of their products to be used. Tropical plywood producers need to find ways of working together to create active and viable industry associations to spearhead promotion and trade in the same way their competitors have done.

Price volatility

In addition to strategic uncertainties, tropical plywood mills face significant day-to-day worries. Tropical plywood prices are very volatile. Most other markets that have high price volatility have futures' markets where operators can reduce their price risks. But since APKINDO, the Indonesian Plywood Manufacturers' Association, abandoned its price leadership role, the price discovery system in the international tropical hardwood plywood market has become a guessing game, leaving market operators with difficulties in negotiating prices.

The *figure* shows prices since January 1997 for Indonesian 2.7 mm plywood, the largest single category of plywood traded internationally; it illustrates how volatile the market has been. In 1997 prices were at around US\$450/m³ FOB; in early 2003 they were below US\$250. Prices were higher still in the five years prior to 1997, at one time hitting US\$780/m³.

The extent of tropical hardwood price volatility can be seen in price changes over a six-month period, a fairly short time from the perspective of a plywood producer and certainly too short for him to make much change to his cost structures. Also, as producers generally do not sell more than 1–2 months ahead, there is currently no way in which they can protect themselves against such volatility.

The *table* gives further evidence of volatility. It shows that in a staggering two out of three cases, the price obtainable for Indonesian 2.7 mm plywood in a given month in the period 1997–2002 was more than 10% different from that of six months' earlier and, in one out of three cases, the difference was more than 20%. Price differences can be positive or negative, of course, but the direction of price changes is not readily predictable and, given the general decline in the market, was predominantly negative over the surveyed period. The consequences for plywood companies have often been calamitous: a 20% price decline over a six-month period has a major impact on company cash flow and, unless the company has large financial reserves or easy access to bank finance, could well limit its ability to finance its operations and plan its investments—and could send it bankrupt.

Volatility indices are measured as the average percentage deviation of average monthly prices from their exponential trend level for a given period. These indicate that the volatility of tropical plywood prices is higher than that of many other commodities, including vegetable oils and most metals (see the full report for data supporting this statement). For many of these other commodities, the industry actively uses a futures' market to control its risks. Given the extent of the volatility of plywood prices, an argument can be made for a plywood futures' market mechanism that would allow market participants to 'lay off' (transfer or hedge) their price risks.

Conclusions

The lack of transparency in the tropical plywood sector and the difficulties that operators in these markets have in managing high market volatility and price risks are, of course, not the only problems facing the sector. But these are important problems and it would be a mistake to focus only on,

Vaporising

Frequency distribution of tropical plywood price changes (for Indonesian 2.7 mm plywood, FOB Indonesian ports) from one month to the next, and compared to six months earlier, January 1997 to October 2002

Percentage price change	0%	0–5%	5–10%	10–15%	15–20%	>20%
Compared to previous month						
Frequency of price increases	21%	16%	3%	6%	1%	
Frequency of price decreases		40%	7%	3%	3%	
Compared to six months earlier						
Frequency of price increases		6%	7%	10%	6%	14%
Frequency of price decreases		9%	7%	12%	7%	21%

Source: ITTO Market Information Service

say, the problem of the sustainability of log supply and leave the problems of transparency and price volatility for later. Tropical plywood has already seen its market share decline precipitously and this decline is likely to continue unless the industry formulates a coordinated response. While cooperation has so far proved difficult for the tropical plywood industry, the fact remains that strong leadership is needed for the lobbying and promotion that would enable the sector to compete more effectively with other wood-based panels. Producers of softwood and temperate plywood panels are well organised and engage in an active promotion of their sector: to date, the tropical plywood industry has not been able to match their levels of organisation or activity. It is only through cooperation that the tropical plywood industry will be able to sell itself in the face of not just environmental concerns but also active efforts from softwood plywood producers to capture their markets.

There is no magic bullet that will solve the problems of the tropical plywood industry. Rather, a carefully considered set of measures and practices must be implemented to strengthen the industry and help it face its challenges. Some actions can be implemented by individual companies, others via cooperation between companies through associations at the country level; others may need an expansion of ITTO's activities. A full set of recommendations can be found in the report.

The 'ITTO Study to identify measures to bring increased transparency to the tropical hardwood plywood trade and analysis of the causes of market fluctuations and price instability' by Lamon Rutten and Tan Seng Hock (2003) can be obtained from: ITTO Division of Economic Information and Market Intelligence; eimi@itto.or.jp

This article was adapted by the ITTO Secretariat from the Rutten and Tan study.