

State of play for tropical timber

After several years in the doldrums, what are the short-term prospects for tropical timber exports?

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IT IS NOW seven years since the tropical timber trade suffered the trauma of a global decline in commodity prices precipitated by the Asian financial crisis of 1997–98. Free-on-board (FOB) prices for tropical timber are only now showing signs of clawing their way back. But rising shipping costs are eating into the profit margins that exporters might otherwise be seeing from recovering prices.

Price trends

Figures 1–3 show long-term price trends for some tropical logs, sawnwood and plywood. The prices are shown as an index, with January-1997 prices serving as the base. If the line is above 100 then prices have increased above those in January 1997; if the line is below 100 then prices have fallen.

The graphs show that the impact of the events of 1997–98 was severe on the tropical timber trade. This was particularly so in Asia; prices for Asian logs, sawnwood and plywood plummeted in the aftermath of the financial crisis.

The market for West African redwood timbers such as African mahogany, sapele and utile, consumed mainly in Europe, was less affected by the crisis but suffered from weak economic performance and slowing housing starts across Europe, most notably in 2000–02.

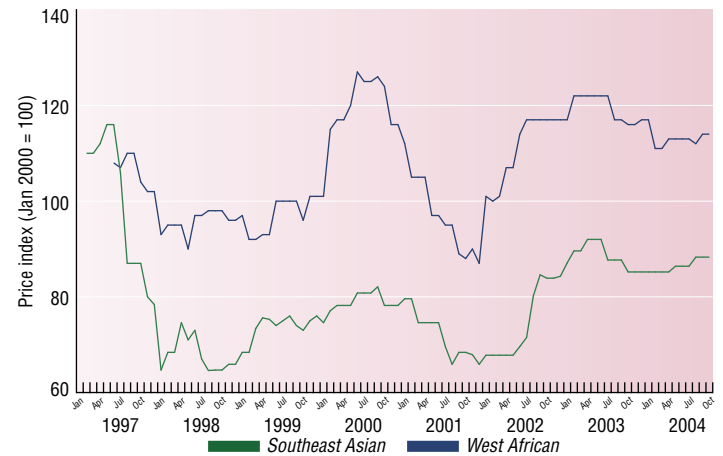
Plywood hit hard

The 1997–98 Asian financial crisis whacked plywood markets around the world. Prices for tropical plywood nose-dived and, at their lowest, were some 40% below pre-crisis levels. After many false starts towards recovery in 2000–01, tropical plywood prices are now inching towards 1997 parity.

Latin American exporters have benefited from the us housing boom, which has sustained growth in the plywood industry in the region. Historically low interest rates in the us have meant that homeowners could borrow cheaply

Doldrums

Figure 1: FOB price trends for Southeast Asian and West African sawnwood, 1997–2004



to rebuild or buy anew, even while the us economy was otherwise stagnant or in recession.

Plywood producers in tropical Asia, notably in Indonesia and Malaysia, trade mainly with Japan, Korea and, in recent times, China. The Japanese economy has turned the corner from a long recession and, as consumer confidence returns, the housing market has steadied. With this, and a shortage of logs for plywood manufacture, FOB prices have been rising.

Wholesale prices in the Japanese market have lagged behind movements in export prices for logs and plywood, and Japanese importers have had difficulty maintaining on-selling margins. This situation has been aggravated by the move to use more imported softwood plywood and softwood logs for plywood manufacture.

Competition from China

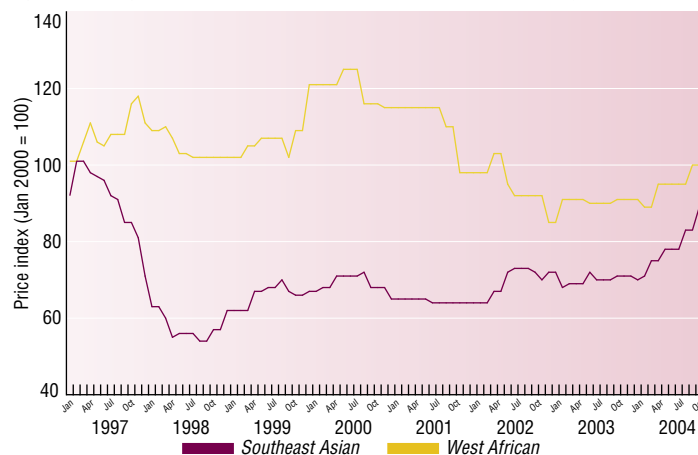
The plywood story would not be complete without mentioning the startling performance of Chinese producers. Until about three years ago China imposed hefty duties on imported logs and wood products, including plywood, which had significant and often unintended consequences for the trade.

China's 1998/99 decision to cut back drastically on the domestic harvesting of logs (because of killer floods in the Yangtze and Yellow river basins) deprived local mills of raw materials. Recognising this, the Chinese government established new import rules, including the abolition of import duties on logs.

These new rules have completely altered the trade in wood products. China has shifted from being a major importer of tropical plywood to being only a minor player. In tandem with the tariff changes, the country has quickly become a massive consumer of logs and, in a few short years, has developed its plywood manufacturing sector to the extent that Chinese exports of plywood now rival those of Indonesia and Malaysia in terms of volume and quality.

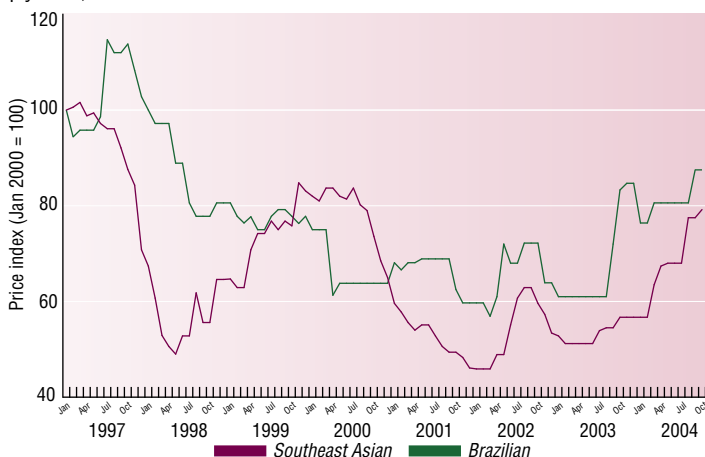
Towards recovery

Figure 2: FOB price trends for Southeast Asian and West African logs, 1997–2004



Languid recovery

Figure 3: FOB price trends for Southeast Asian thinly and Brazilian virola plywood, 1997–2004



Such was the daring and efficiency of the Chinese plywood manufacturers that they penetrated the European market for okoume plywood by importing okoume logs from Africa, making the plywood in China and shipping it to Europe at competitive prices. Today China is a leading (if not the world's biggest) plywood exporter.

Shipping costs increase

Despite improving prices, the going has been hard for tropical timber exporters in the face of rising ocean freight costs, especially over the past 18 months. These have been driven up by high fuel costs and by a shortage of freight opportunities brought about by Chinese importers, who are filling up available shipping space. Importers trading FOB are facing increased shipping costs from West Africa, Southeast Asia and South America.

For example, in January 2004 exporters in Gabon and Cameroon reported serious shortages of freight space and very limited northbound sailings because of the re-routing of vessels due to demand from Chinese importers. Container freight opportunities remained available but at higher costs. However, it was the reduction of available cargo space that was of greatest concern, and log and lumber stocks at ports rose fast. This problem added to the already difficult financing situation for exporters; banks remained reluctant to advance finance in what they viewed as a high-risk business. The net result was that some producers had to slow production and lay off workers.

West African shippers reported that ocean freight rates for Europe moved up by about €10/m³ within the space of just one month. Making matters worse, exporters reported that shipping opportunities for Asia were 'catastrophic', with very limited immediate availability and delays of up to two months for shipments to Asia from Gabon. Freight rates for Asia shot up by a further US\$23–30/m³ (liner terms) for most logs and by US\$14/m³ (charter terms) for okoume logs. The situation had not improved by late 2004.

It is not only the exporters who are feeling the pressure of rising ocean freight costs. In Japan, rising charter rates and bunker oil prices have pushed up transport costs.

Shipping companies began asking Japanese importers for a US\$3–4/m³ increase in freight charges for March 2004 shipments from Sarawak. On top of this, freight costs from Papua New Guinea (two ports loading and three ports discharging) were quoted at a record US\$38/m³. Towards year-end ocean freight charges increased again, bringing the rate to US\$35/m³ for Sarawak loading.

Analysts of the Japanese log market have commented that the fleet of log-hauling vessels is aging and that there are now fewer log-carriers on the high seas.

The sharp increase in tropical log FOB prices has made sales' negotiations with Japanese plywood mills—which use the imported logs in their mills—very difficult. In the first half of the year importers had to cut margins to secure sales and even, at times, to sell below cost to generate turnover in Japan's very dull plywood market. Fortunately, the plywood market did pick up later in the year and the better wholesale panel prices meant that plymills could pay slightly more for logs.

On the other side of the Pacific Ocean in South America, Brazilian and Peruvian exporters face many of the same problems as exporters in other regions. Freight and container rates rose so fast over a short period (see Figure 4) that Chinese importers of Peruvian timber complained that the rates were so high that they had begun to impact on trade-flows.

Brazilian timber exporters, who earned almost US\$5 billion for the country in 2003, faced the additional problem of delayed shipments resulting, they say, from poor administration of the ports. According to data from the Port of Itajaí (State of Santa Catarina), for example, wood product exports of 110 866 tonnes accounted for 26% of the port's total exports in 2003 and goods could be cleared from the export warehouses in around ten days. However, now it is taking about three weeks to get shipments away.

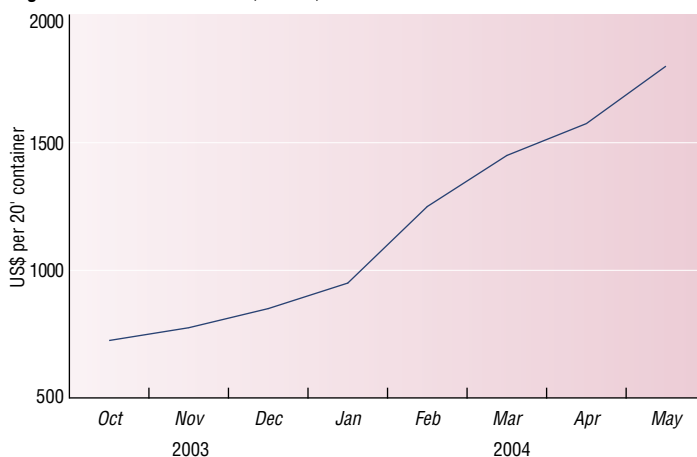
This results in higher export costs that cannot easily be passed on to overseas buyers. The industry reports that some export orders have been cancelled due to delays caused by the logistical problems in this port.

Impact of house-building activity

Prospects for growth in timber import markets are mixed. Figure 5 shows trends in US housing sales and US house prices. Sales of new single-family

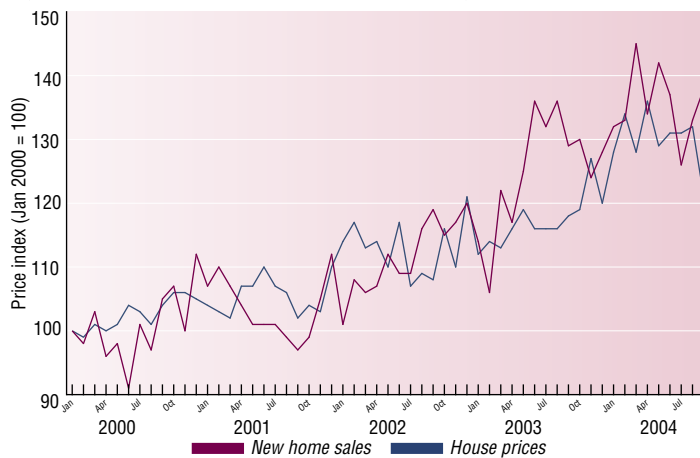
Uncontained costs

Figure 4: 20' container costs, Callao, Peru to China



Housing boom

Figure 5: Indices of US new-housing sales and house prices, 2000–2003



homes have been rising strongly since 2003 and house prices have increased substantially. The us Commerce Department reported that new-home sales rose to a seasonally adjusted annual rate of 1.21 million units in September 2004, a 3.5% increase over the month before. This rate was 7% above the sales pace seen in September 2003.

Economic conditions in the us, low interest rates (and hence low home-loan rates), employment growth and solid house-price performance continue to invigorate demand for housing and this is spurring the consumption of building materials. Exporters of wood products to the us market have seen volumes and prices grow steadily for the past 24 months or more. However, the firming prices for lumber and panel products could moderate in coming months in response to a forecast cooling of housing starts and the increasing supply of wood products.

South American plywood manufacturers have invested heavily in production capacity to take advantage of the rising demand and prices in the us. Perversely, this increased capacity, coupled with the forecast slowing of building in the us, could, say analysts, lead to a decline in plywood prices of up to 15% in 2005.

Japan

Southeast Asian and Pacific Island exporters of tropical wood products rely heavily on the Japanese market, and movements in the Japanese house-building industry have a direct impact on export volumes and tropical timber prices.

2003 was a relatively good year for housing starts in Japan and the year-end figure of 1.16 million units represented an increase of almost 1% over 2002 and the first year-on-year increase in three years.

The trade press in Japan suggested that a boost was given to starts in 2003 by the fact that a special tax break on housing loan interest was set to expire at the end of that year. However, to the delight of the building industry, the Japanese government announced at the end of 2003 that this tax break would be extended to the end of 2004 in order to further stimulate housing development. From 2005 the tax break will be cut in increments.

European Union

After bottoming out in the first half of 2003, the economies of the larger European countries began to strengthen in the second half of the year. The average growth rate for the EU in 2003 was a modest 0.8%. A rebound to

average growth rates of 2% for the EU is projected for 2004, reaching a predicted 2.4% in 2005.

The rebound in 2003 was driven by a surge in the growth of exports, while there was virtually no contribution to growth from domestic demand. However, rising oil and other commodity prices have dampened global growth, which in turn will affect economic growth in the EU. The sharp appreciation of the euro against the us dollar is also beginning to weaken growth prospects in the euro-area manufacturing sector.

Forecasts presented at the 57th EUROCONSTRUCT Conference in Stockholm suggest an improved performance of the construction sector for 2005 and 2006, with growth rates of 1–2% annually. The segment with the strongest growth prospects is civil engineering, which is forecast to grow by 9.6% in the period 2003–06. The non-residential segment could increase by 4.4%, while the residential segment is expected to experience the weakest growth in these years.

Prospects?

At the time of writing, builders in the western consumer markets were starting to head for their Christmas holidays, bringing to an end building activity for 2004. The new year holds no great promise of improvement for tropical timber exporters, with currency woes adding to the difficulties brought about by greater competition and rising shipping costs. The us dollar could well decline by up to 20% against major currencies; this will slow growth in Europe, putting at risk the stuttering recoveries in Germany and France and keeping the economy of the Netherlands in the doldrums. All this means the likelihood of slowed housing activity in that market.

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The Chinese government has already taken steps to cool the Chinese economy and the measures are having an impact, but no one in the tropical timber trade should read this as a sign that trading conditions will ease. Chinese producers are and will remain the major competitors for tropical timber product exporters and will continue to make deep inroads into the markets for added-value timber products.