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THIS ISSUE:

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> **“…the residential construction sector has outperformed the rest of the U.S. economy by a wide margin since the pandemic erupted in the spring…”**

Northeast Forest Products Industry Review & Outlook

Written by Paul Jannke, Forest Economic Advisors

Volatility in both consumption and pricing defined North American wood products markets in 2020. As pandemic-related lockdowns brought the economy to a halt in March, mills cut production from 10 to as high as 50 percent, in some cases.

Lockdowns hit pulp markets hard, reshaped by new trends in paper products. Most notably, the pandemic accelerated the decline of graphic paper consumption. The economic contraction led to a rapid shift toward electronic media, fewer paper advertisements, and a decrease in mail volume. However, more time spent at home caused demand to surge for tissue and hygienic products. Similarly, increased e-commerce has elevated paperboard and packaging consumption.

On the softwood lumber side, government stimulus and a precipitous decline in interest rates left many Americans with cash on hand. Stuck at home, homeowners’ expenditures on residential improvements surged. That, coupled with the inclusion of construction as “essential work,” led to a massive increase in demand for wood products. With production already cut and mills hesitant to rapidly restart, dealer inventory plunged to record lows and prices skyrocketed. Production was slow to resume, and COVID-related labor restraints prolonged the shortage, thereby keeping prices elevated.

Still, the residential construction sector has outperformed the rest of the U.S. economy by a wide margin since the pandemic erupted in the spring, and it is expected to continue to do so over the next few years.

Pulp Outlook

Consumption levels for graphic paper are unlikely to return, much like the 2009 recession when consumption dropped 18.4%. Demand for household tissues and hygienic products are expected to decline from their peak during lockdowns, but they are likely to remain elevated in the near term. Paperboard and packaging will remain more robust, trending higher in the near term.

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Our current forecast shows paper consumption dropping to 24 million tons (18%) and slipping lower to 23.7 million tons in 2025 despite a recovering economy. In the long term, consumption is expected to continue to fall, albeit at a lower rate.

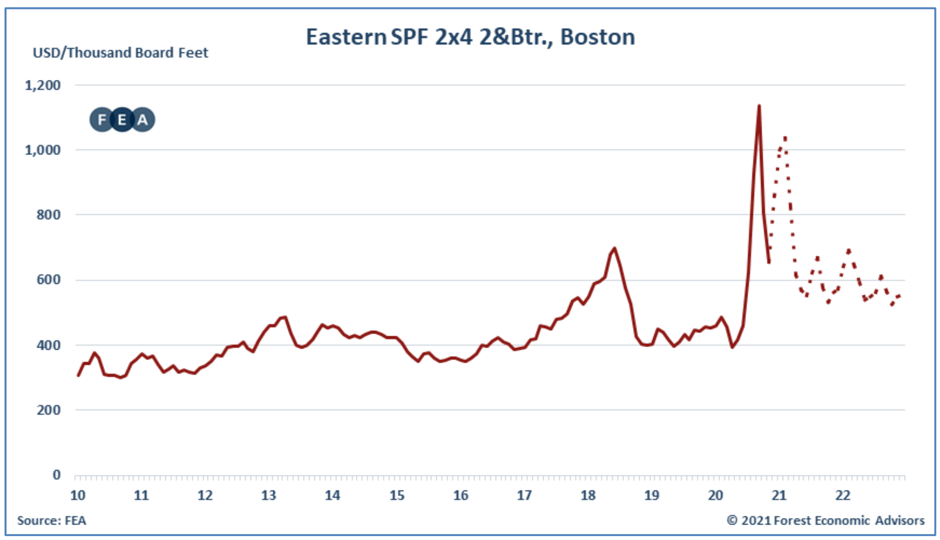
Conversely, paperboard and packaging production will trend higher over the long term. Despite falling 3.8% in 2020, demand will push upward to 47.4 million tons by 2025. Production is expected to track consumption patterns, increasing nearly 53.4 million tons by 2025, or 8.7% above 2020's level.

In the Northeast, pulp production challenges — including labor challenges due to COVID-19 — have been exacerbated by the loss of Pixelle's mill in Jay, Maine. The mill's digester exploded in April 2020, and the company has announced that it will not rebuild the pulp mill and will permanently idle one of the facility's paper machines. The other two paper machines will continue to operate using pulp sourced from other pulp mills. The mill represented roughly 20% of Maine's operational pulp capacity.

Nationally, pulp production continues to fall. Production is expected to decline 8.5% in 2020, then recover over the next two years before it plateaus near 50 million tons. Weaker consumption of paper and expanding capacity in the Southern Hemisphere will limit production.

Softwood Lumber Outlook

Lumber prices will remain high in 2021. Demand will be strong, inventories are at record lows, and production will continue to be hampered by fiber supply shortages. As a result, we expect prices will increase for the year.



While we expect high prices in 2022 relative to historical levels, they will fall from record 2021 levels. The decline is not because of weak demand, rather, we assume mills will increase production to meet rising demand and take advantage of high profitability. With production moving in line with demand in 2022, prices will fall back toward more "normal" profit levels.

Residential construction accounts for 70−75% of U.S. softwood lumber consumption. The two main components of residential construction are new construction and residential-improvement expenditures.

We expect new home construction will be strong in 2021−22. There are a number of reasons for this, including historically low interest rates, decent income growth (especially among potential home buyers), strong demographic tailwinds due to a population bulge just now entering their prime home-buying years, high pent-up demand after a decade of underbuilding, and a low inventory of homes for sale.

In addition, residential-improvement expenditures will remain strong. The average age of the housing stock in the U.S. is 42 years and the average home size of the U.S. housing stock is 1,700 square feet, while the average new home size is nearly 2,500 square feet. The older stock relative to newer homes provides significant incentive to improve and/or add on to a home to bring it up to more modern standards. This is especially true given the high level of equity homeowners currently have.

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With end-use market activity remaining strong, we expect domestic consumption will grow 4% per year in 2021−22.

Meanwhile, production will have difficulty keeping up with demand in 2021 as fiber-supply constraints in British Columbia and the U.S. West Coast combine with a lack of residual markets in Eastern Canada to limit potential production growth in regions other than the Southern U.S. Recent investment in new southern capacity will bolster North American production, but it will not be enough to meet demand.

Finally, dealer stocks are at historically low levels. Over the past 20 years, stocks have ranged from a low of 1.12 months' supply to a high of 2.57 months' supply. Currently, stocks are a little over half (0.63) a month's supply. We expect dealer stocks will remain low in 2021 as mill production struggles to meet the anticipated rise in demand. Increased production in 2022 as new southern mills become operational should allow dealers to rebuild their stocks to more "normal" levels.

With demand remaining strong, production having difficulty meeting demand and inventories low, we expect softwood lumber prices will remain elevated relative to historical levels.

2021 Green Industry Outlook

Written by Dr. Charlie Hall, Texas A&M University

It didn't take long after releasing last year's green industry outlook for the predictions to be sidetracked by COVID-19. The COVID-19 pandemic left a wake throughout the business community that is still being wrestled with today, with some industries being COVID winners and others COVID losers. It just happened that the circumstances played out favorably for the green industry for several reasons, but not without a few hiccups along the way.

Early in the spring season when COVID-19 first hit, decisions were being made across the country as to which businesses were going to remain open in the face of the pandemic; in other words, which businesses were essential. In most states, green industry firms ended up being considered essential, causing many firms to breath a collective sigh of relief. But this was not the case in all areas of the country and those firms that were not deemed essential early on (but eventually were), found themselves playing catch-up to capture as much of the missed time as possible.

There was also an early advantage for green industry growers that grew for the box store market. Since box stores like Home Depot, Lowes, Walmart, Menards, etc. were all open during the pandemic, consumers were able to access plants and other lawn and garden products without interruption. Independent lawn and garden retailers (garden centers) thought the worst was going to happen in that they would not be deemed essential and their box store competitors would steal the entire spring 2020 season. But they recuperated nicely after the slow start and ended the year with double-digit comps (YOY sales).

This above-average performance of the lawn and garden retail sector was brought about by the "staycation effect" promulgated by folks working from home during shelter-in-place restrictions. More time at home led to increased home improvement spending and this included landscaping their yards and decorating the interior of their homes with plants. It is estimated that several million new lawn and garden consumers were created during this increased time at home. Retailers thus experienced increases in their gross sales that resulted from the increased store traffic count and the increased dollars per average ticket.

But retailers had to work hard for those dollars because COVID-19 created many challenges for handling face-to-face sales. Retailers had to be creative with social distancing measures and remote (curbside) pickup procedures. The same could be said of all firms, up and down the supply chain, in the green industry.

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Interestingly, landscape firms were one of the few service-related industries that were not only able to stay open (being outside aided in social distancing requirements), but experienced the same shot-in-the-arm from more people being at home and wanting to improve the aesthetics of their surroundings. Landscape sales were up YOY, with many landscapers experiencing a backlog of several months' worth of projects because they simply couldn't keep up with demand.

Growers in the industry also experienced a very good year in 2020, for the most part. My own benchmarking efforts across the grower sector revealed that about 75% of growers experienced sales increases ranging from 5% to 25%, while the remaining 25% of growers were down YOY from the sales they had in 2019. These growers also experienced much lower shrink than normal since many retailers were scrambling to find enough product to sell during the extended spring season in June and July. Thus, growers were able to sell most, if not all, of their available inventory.

On the flip side, many of the growers that were down YOY were either located in states where all firms were shut down (e.g., Michigan), or their retail or landscape customers were shut down, or they were selling into markets where there was substantial slowdown because of the economic downturn (e.g., green infrastructure projects, conservation projects, etc.).

All of this trickled down to a good year for the allied trade sector as well. There were fewer delinquent accounts payable than they had experienced historically at the close of the season and many have expressed that pre-bookings for the 2021 season are higher than they have been since the great recession (particularly for young plants like tissue culture, plugs and cuttings). However, going into 2021, it is anticipated that input costs will be 2-3% higher due to trade war effects and other inflationary pressures resulting from higher commodity prices.

Going into 2021, the economy is still suffering under the weight of COVID-19. While some vaccines are already released, states have experienced many challenges in distributing and administering them. In the meantime, the number of cases, hospitalizations and deaths continue to set new daily records. This continues to be disconcerting because I have said more than once over the last year that the "shape of the economic recovery is correlated with the shape of the COVID-19 curve."

That being said, if folks continue to stay at home more in the 2021 spring season, there is at least the opportunity for them to spend more again this year on plants and other lawn and garden products. The litmus test for the retail sector is whether or not the new lawn and garden consumers will come back for more this year. If they serviced them appropriately and made them successful last year, then that will likely happen. Time will tell.

If the weather cooperates, the stage is set for another good year across the green industry. The housing sector is still performing well (though I am keeping my eye on it since prices are above where they were before the bubble burst during the great recession). Most of the lawn and garden consumers are in the mid-to-upper income level category and that category has mostly recovered from any COVID-19 job losses. Further stimulus payments will also bolster consumer spending. Will we see the same YOY percentage increases of 2020? Not likely, but I am advising firms to plan on a 5-10% increase and any more than that is icing on the proverbial cake. From the banking perspective, firms are entering 2021 in a much better working capital position than I have seen in decades.

CONTACT INFORMATION

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