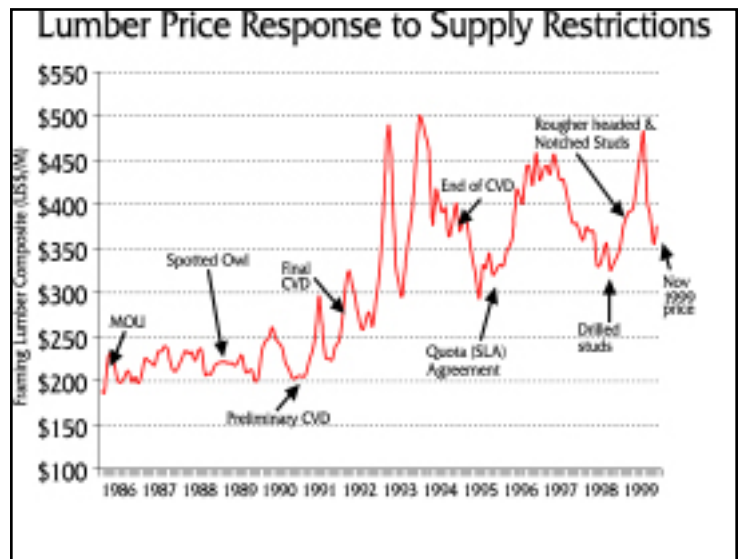


Economic Environment

"Falling World Trade Barriers to the Rescue" by Al Schuler

There are various types of supply restrictions, most of which result in higher costs and lower profits for users of the restricted product. One type of restriction includes "managed trade" such as non-tariff trade barriers (e.g. building code restrictions); duties (e.g. CVD); and import volume caps (e.g. softwood lumber agreement [SLA]). Another category is environment related restrictions (e.g. "Spotted Owl"). Often, dynamic markets will adjust over time, thereby negating the desired results of those promoting the restrictions. For example, as lumber exports from restricted Canadian provinces were held in check by SLA, unrestricted exports from non quota provinces increased 42 percent and non Canadian imports increased 300 percent.

For all restrictions, market impact will vary with the importance of supply being restricted, availability of viable substitutes and demand. The larger the volume restrictions (relative importance of supply being restricted) the bigger the price response. Remember the oil crisis in the 1970's? The Arab states, at the time, controlled half the free world's oil supply, so it wasn't surprising to see world prices increase 300 percent within the first year of the Oil Embargo. There were simply no alternative world supplies large enough to compensate. Softwood lumber is a similar case in point. In reference to the SLA, Canada supplies roughly 33 percent of U.S. demand, accounting for 96 percent of the 18 BBF imported each year. So, the SLA had to impact price. Similarly, the Western U.S. supplied 40 percent of U.S. lumber before the "owl crisis," so when fiber supply was cut 50 percent, lumber production was reduced significantly, and yes, prices went up.



It is difficult, if not impossible, to quantify the price impact of supply restrictions because there are numerous other factors that simultaneously influence the market. During the past three years, the U.S. housing market has been phenomenal (positive price impact); western fiber restrictions have effectively increased lumber production costs by about \$75/M (raises price); and the Japanese recession cut export demand about 40 percent (reduces price). In addition, the trend to direct shipments to many retail customers along with JIT inventory management has increased price volatility by lessening the buffering impact of wholesalers. The chart above

clearly shows that various restrictions, in conjunction with strong housing demand, have driven prices higher and significantly increased volatility.

Looking back to the 1980's, or the pre-Owl era, the MOU (6.5% duty on Canadian lumber exports to U.S.) had little impact on price level or volatility. The reason is that at the time, the U.S. had sufficient excess domestic production capacity to compensate for Canadian cutbacks. That, of course, is no longer true.

FUTURE OUTLOOK

Globalization trends will continue as competitive forces encourage countries to remove trade barriers of all kinds. Recently, wood-starved China moved a step closer to joining the WTO (World Trade Organization), a move that would bring 1.2 billion people into the free trade organization. Also, the U.S. and member APEC countries (Asia Pacific Region) recently agreed to accelerated tariff liberalization in the forest products sector. The U.S., under various regional agreements (e.g., NAFTA), and WTO already has zero tariffs on lumber, logs, pulp, newsprint and furniture. According to NAHB, lumber and wood products account for one third of the material costs to build a home. It is my feeling that trade liberalization will continue, and this will help to ensure that lumber prices, a major cost to truss manufacturers and home builders, will remain competitive.

For instance, if domestic prices increase too much, lumber users will substitute. Although most observers feel that SLA will continue (probably in the form of another CVD), ultimately, trade liberalization will prevail as there is no viable alternative. Freer trade is good news for truss manufacturers and all other lumber users.

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