

Economic Environment

Globalization & the Wood Products Industry by Al Schuler

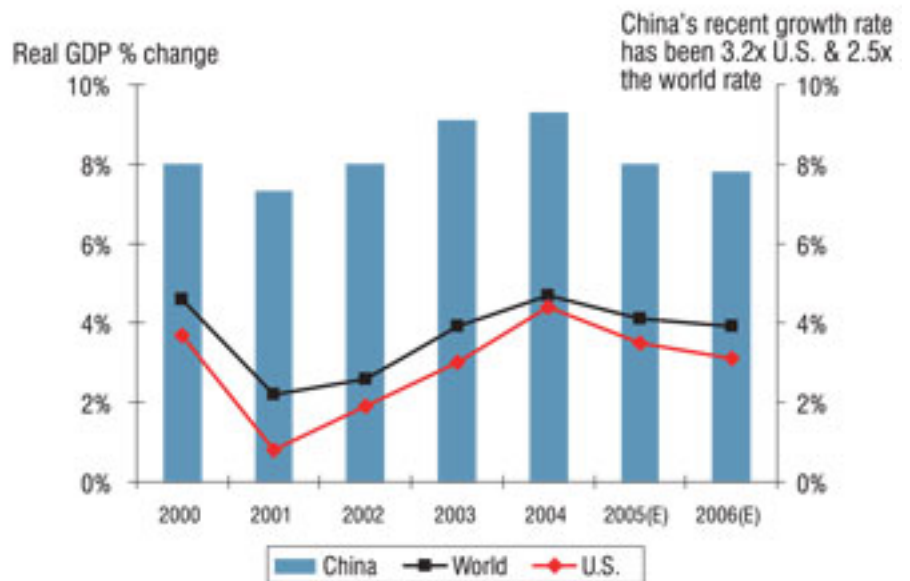
How do global markets influence component manufacturers' business decisions?

In the January/February issue of SBC, exchange rates were discussed, including an analysis of how they can affect component manufacturers (CMs) through their impact on the economy, interest rates, housing activity and international trade flows. Exchange rates are just one of many factors that provide an economic linkage between the U.S. and other parts of the world. In this article, that investigation is extended, showing that global markets rather than local or regional developments increasingly influence the U.S. wood products industry. The moral of story is that to be successful in business today, CMs need to be more aware of international developments to create a successful business plan.

Figure 1 indicates that economic growth in China during the past five years has far outstripped growth in the U.S. and the rest of the world. Today, China's share of the world's gross domestic product (GDP) (at purchasing

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World GDP Trends



WTCA_March_2005

Source: TD Economics, RISI

FIGURE 1. CHINA'S PHENOMENAL GROWTH OUTSTRIPS THE U.S. AND REST OF THE WORLD.

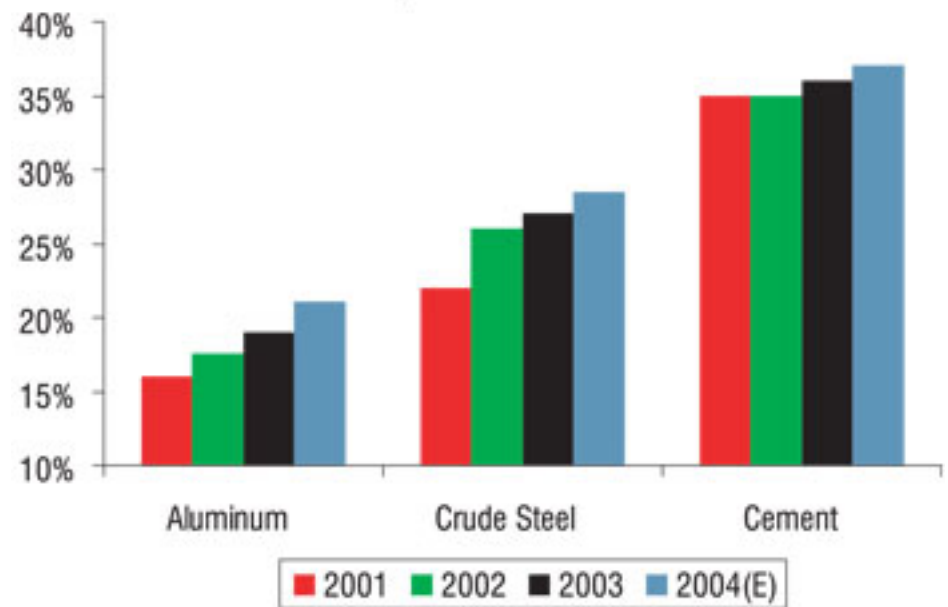
power parity—see last month’s SBC article) is 13 percent, compared with 21 percent for the U.S., 6.8 percent for Japan, and 18.6 percent for Europe including the U.K. Many analysts suggest that within ten years, China’s economy will equal that of the U.S. This is good news because today China is more a competitor by exporting low cost textiles, furniture and electronic products to the U.S. As China’s standard of living grows, Chinese consumers will become a large potential market for some of our wood products—residential building materials for example.

IMPACT OF CHINA’S GROWTH ON CONSTRUCTION MARKETS

China, with 1.3 billion people, coupled with its massive growth rate, has become a formidable force in building material markets (see Figure 2). In 2004, the Chinese economy consumed 36 percent of the world’s cement, 28 percent of the steel and 22 percent of the aluminum. By contrast, the U.S. consumes 13 percent of the world’s steel and only 5.2 percent of the world’s cement. China’s demand for raw materials has helped boost worldwide prices for aluminum, copper and tin by 19, 48 and 53 percent respectively (Bloomberg). With steel, China’s growth spurred 79 percent of the growth in global demand in

The China Impact

China's Share of Global consumption

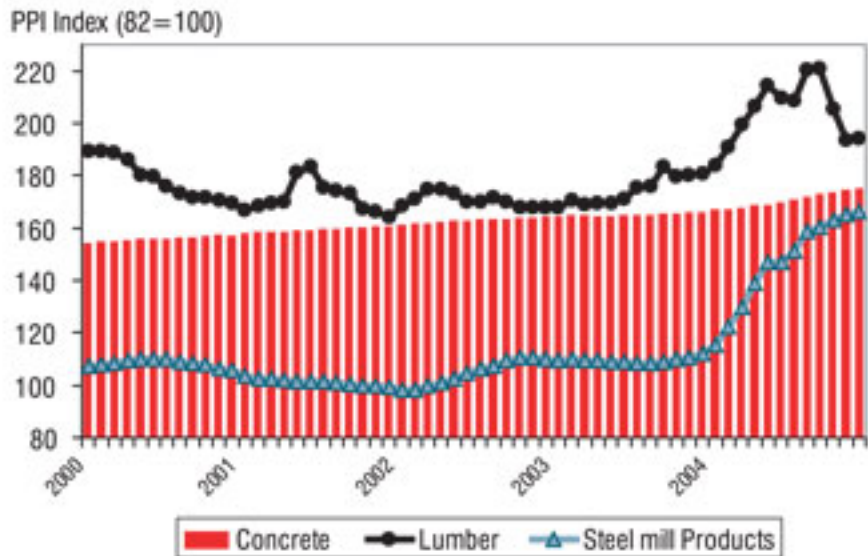


Source: Alliance Bernstein, December 2004, Toronto

FIGURE 2. CHINA’S IMPACT ON RAW MATERIALS CONSUMPTION.

Building Material Price Trends

Concrete & Steel Price Increases due primarily to International Factors - i.e., China demand



Source: U.S. BLS

FIGURE 3. BUILDING MATERIAL PRICE TRENDS. PRODUCER PRICE INDEX (PPI) COMPARES PRICES TODAY TO A BASE PERIOD. IN THIS CASE, THAT BASE PERIOD IS 1982. FOR EXAMPLE, DECEMBER 2004’S LUMBER PRICE INDEX WAS 194, WHICH INDICATES THAT THE DECEMBER 2004 LUMBER PRICE WAS 94 PERCENT HIGHER THAN THE AVERAGE LUMBER PRICE IN 1982.

2003 and this had a big impact on prices (see Figure 3). But this can change. China's leaders are attempting to slow the economy to avoid overheating. Furthermore, China is increasing steel production capacity (as are other countries), and China may become a net exporter of steel products, thus contributing to an oversupply of steel (and weaker pricing) by 2006. China's massive cement consumption also caused problems in the form of shortages (U.S. South, particularly Florida) by competing with the U.S. for available worldwide supply (the U.S. imports about 30 percent of its cement consumption). In fact, some housing starts in Florida and elsewhere in the South were delayed due to the cement shortage.

Domestic Share of U.S. Wood Products Consumption

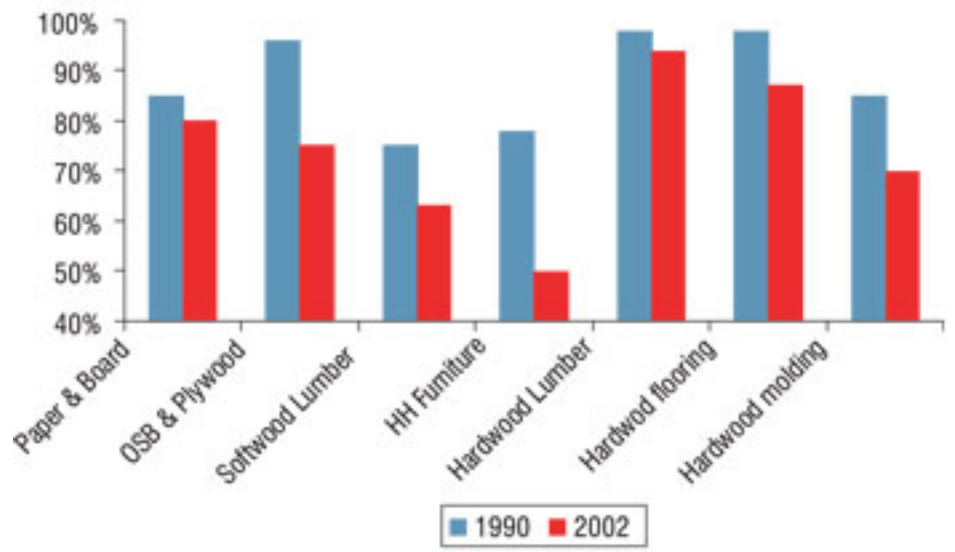


FIGURE 4. DOMESTICALLY PRODUCED SHARES OF THE U.S. MARKET HAVE DECLINED FOR MOST WOOD PRODUCTS— IS THE U.S. LOSING ITS COMPARATIVE ADVANTAGE?

The U.S. can't blame lumber price volatility or price increases on the Chinese, but international globalization issues such as the softwood lumber wars with Canada are playing a role. Almost 35 percent of domestic softwood lumber consumption comes from Canada and the 27 percent duty on those imports is impacting prices, availability and volatility.

GLOBALIZATION & WOOD PRODUCT MARKETS

The U.S. wood products industry may be losing its competitive position in many wood products sectors (see Figure 4 on page 26). Perhaps the forest products industry is going down the same road as the U.S. manufacturing sector. Manufacturing share of GDP has fallen from over 30 percent to less than 14 percent in the past two decades. In order to compete better, both the North American and European lumber industry are consolidating to take advantage of scale economies. For example, the top ten producers in North America controlled 29 percent of the lumber production in 1996, but that grew to 38 percent in 2002. In Europe, production share by the ten largest manufacturers grew from ten percent to 24 percent over the same period. As China's economy grows, that could provide good markets for U.S. wood products, but there will be plenty of competition from low-cost producers in Russia, Eastern Europe and Southeast Asia. Russia, in particular, has an annual allowable cut (AAC) equal to North America's AAC, and it is four times existing harvest levels in Russia. That means they are harvesting only 20 percent of potential. Russia may become a very formidable player in international wood products trade. In fact, Russian companies and joint venture partners are investing heavily in lumber production capacity as are their counterparts in Eastern Europe.

Consolidation in structural panels is also taking place. The top two U.S. plywood producers have a 42 percent production market share, while the top three OSB producers have 51 percent market share. In the U.S. supply chain, consolidation came first to the DIY markets with Home Depot and Lowes in control of over half. Today, consolidation is starting to happen at the Pro Dealer/Contractor Yard level and at the same time, more and more Pro Dealers are focusing on engineered wood products, wall panels, trusses and other installed sales activities. As dealers, both the Pro/Contractor Yards and Big Box/DIY sectors get bigger and develop more market clout, which can make life more difficult for some of their suppliers. At the same time, it may offer opportunities for suppliers (e.g., smaller CMs) to develop innovative sales and marketing agreements.

SOME IMPLICATIONS FOR CMS

Remaining profitable today means keeping abreast of what is happening outside your region or country as international activities can have major impacts on material costs and markets for products. China's impact on worldwide steel prices and cement availability in the U.S. South are excellent examples. Although Canada supplies most of the U.S. lumber imports, almost 1.3 BBF of framing lumber came from Europe and another 1 BBF of industrial lumber was imported from the southern hemisphere in 2004. Although consolidation is happening everywhere, it is particularly rapid in Western Canada's lumber industry, and this has implications for component manufacturers. As noted in the February 4 issue of Random Lengths, "with the consolidation, there are sure to be changes in the Western SPF market ...selling and distribution methods of acquiring companies may be different from the companies they acquired...this will present both opportunities and challenges to their customers (e.g., CM) as they attempt to solidify or expand their relationships with these suppliers." These globalization trends are certainly changing the business environment for CMs.

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