



## QUARTERLY MACRO ECONOMIC REVIEW AND PRICE UPDATE FIRST QUARTER, 2008

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### HIGHLIGHTS

- Economic Activity – The Federal Reserve Bank reduced its key Federal Funds target rate by 200 basis points in response to increasing evidence of an economic slowdown. The target rate now stands at 2.25%.
- US Housing – Housing market activity will begin to recover once the excess unsold inventory of new and existing houses is worked off. For this to happen, house prices will need to decline substantially. The availability of credit for mortgage lending also will be crucial in determining how quickly the excess inventory will be worked off. When will we turn the corner?
- Currency – US dollar to weaken further.

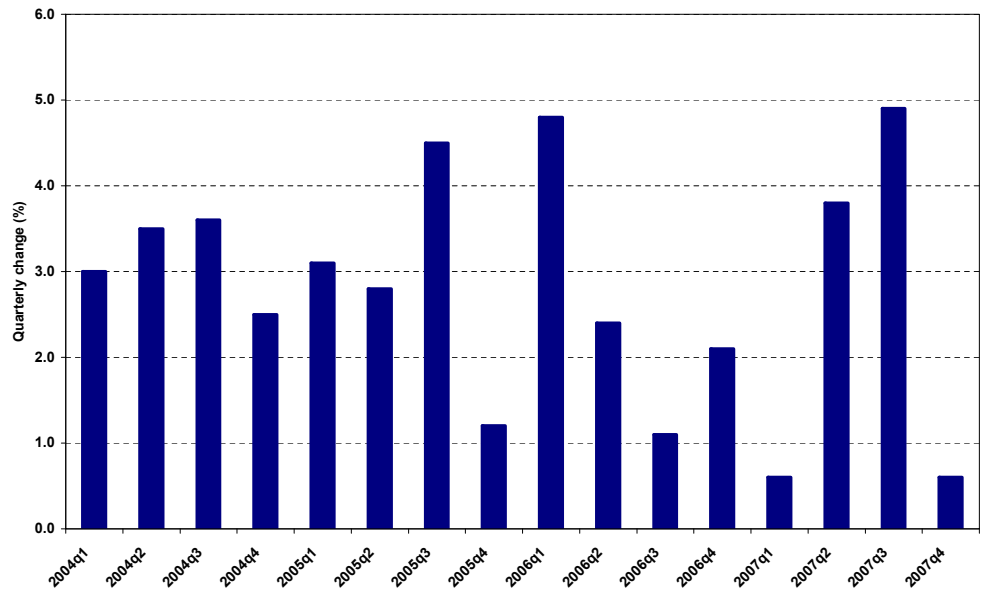
### WOOD PRODUCT HIGHLIGHTS

- Lumber Production – Declining with reduced residential construction demand.
- Log & Lumber Prices – Lumber prices reflect relative strengths of regional markets, with green Douglas-fir lumber especially weak on account of its high dependence on residential construction in the over-valued Pacific Southwest region. Log prices in the US West continue to adjust to declining lumber prices. In the US South the stumpage adjustment may be further advanced, with the movement of log sellers to market sidelines.
- Key Indicator to watch – When will house prices decline sufficiently to work off the accumulated unsold inventory? And just when will the effects of declining lumber prices be fully reflected in log prices and stumpage?
- TCG Area Reports – Pulpwood prices are a bright spot, and afford a forest management opportunity to increase forest asset value by converting low quality stands to high quality plantations. The drop in sawlog prices was anticipated, being an inevitable consequence of a protracted period of low lumber prices. Looking forward, further sawlog price weakness is expected over the next quarter, and through into 2009. The key to a sustained improvement in log prices is a recovery in residential construction recovery. Interest in utilizing woody biomass for energy continues to grow.

**US ECONOMIC CONDITIONS**

Growth in real gross domestic product (GDP) slowed in 2007 to an average rate of 2.2% compared with 2.9% in 2006. The growth largely reflects the net effect of increases in export returns, government spending, personal consumption expenditures, inventory accumulations, spending on nonresidential construction, equipment and software, private inventory investment, reduced spending on residential construction, and increased spending on imports (a deduction in the calculation). Real GDP in the fourth quarter of 2007 grew at a seasonally-adjusted rate of 0.6%, compared with 4.9% in the third quarter.

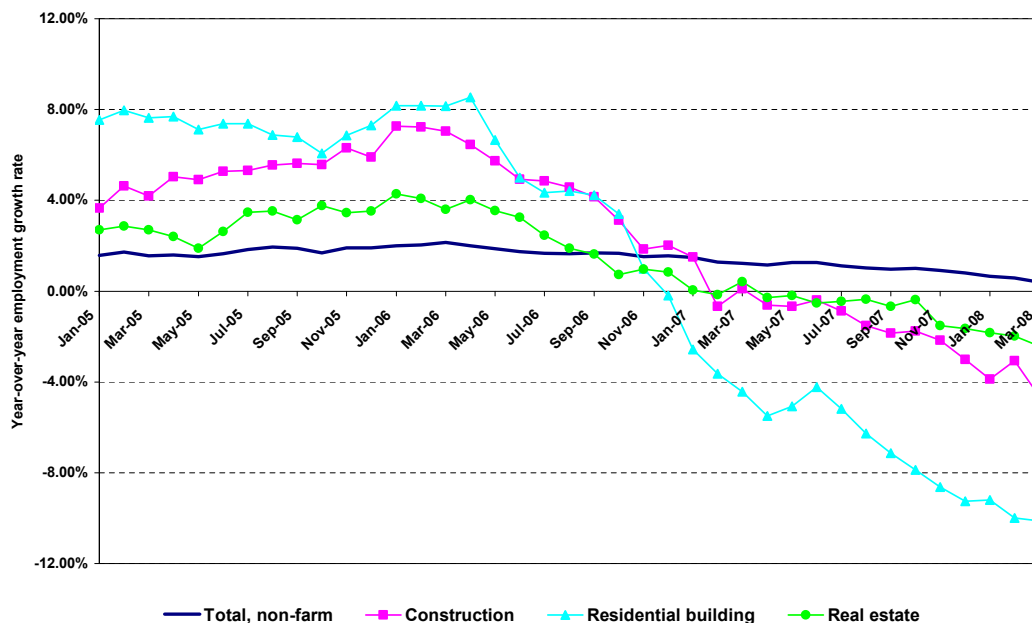
**Real US GDP growth (seasonally adjusted basis)**



On a year-over-year (yoy) basis, the aggregate industrial production index rose 1.3% through February, continuing a steady upward trend dating back to about 2003. Growth during this period was driven largely by production of business equipment (i.e., transit equipment, information processing equipment, and industrial and other equipment). The industrial production index for the wood products sector declined 6.3% over the yoy December 2007 period.

Capacity utilization has decreased slightly since February 2007: -0.6% yoy. As might be expected given current housing market conditions, capacity utilization in the wood products industry declined 6.3% from December 2006 to December 2007 as mills curtailed production (or closed) in line with reduced prices. However, this decline in capacity utilization was still less than the declines experienced in late in 2006 and early in 2007.

**US employment growth by selected sectors**



Growth in employment has slowed over the last year, from a yoy rate of 1.3% in February 2007 to just 0.4% a year later in February 2008. Employment in sectors associated with housing has been contracting over this same period at rates ranging from -2.4% in real estate, to -4.6% in construction (in general) to -10.1% in residential construction. Nationally, the unemployment rate has begun to creep upward reaching 5.1% in March 2008 (seasonally adjusted) compared with 4.4% a year earlier.

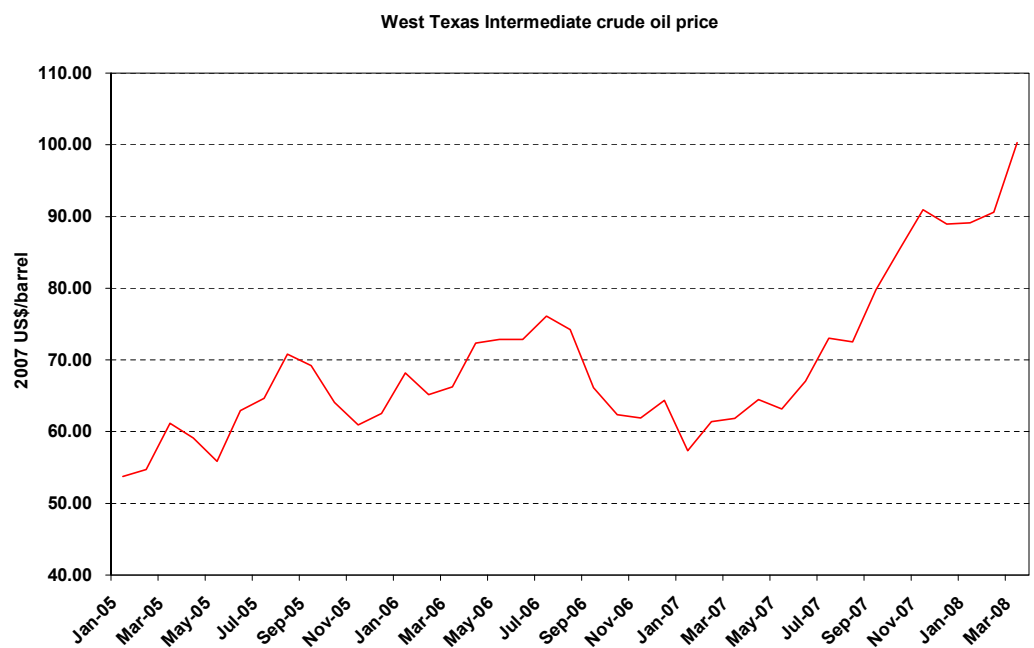
Consumers remain willing and able to spend according to recent consumption, income and savings data. Real personal consumption expenditures (PCE) increased by 2.3% (yoy) from the third to the fourth quarter of 2007, down from 2.8% in the third quarter. Since then real PCE has slowed further, to a (yoy) rate of 1.7% in February 2008. Meanwhile, real personal disposable income growth has slowed from 3.7% in the third quarter of 2007 to 2.2% in the fourth quarter, and is likely to decline further should unemployment continue to increase. In the fourth quarter of 2007, savings were estimated at 0.0% of disposable personal income, down from 0.4% (revised) in the third quarter. On an annual basis, savings as a share of disposable personal income remained constant at 0.4% in 2006 and 2007, but these rates are substantially lower than 2003-04 (about 2.1%).

Corporate profit growth continues to slow. In 2006 corporate profits grew 13.2% on a gross basis. Year-over-year, gross corporate profits grew by just 2.5% in the fourth quarter of 2007.

Oil prices continue to be a source of significant inflationary pressure. After easing in late 2007, crude oil prices surged again in early 2008. The benchmark West Texas Intermediate grade of crude breached 2007 US\$100 per barrel in March of 2008, and set an all-time record in the process. While the fundamentals have contributed to the trend increase in oil prices (e.g., constrained supply, strong demand from Asia and industrializing countries), other factors are increasingly regarded as the key drivers, such as uncertainty associated with geopolitical instability (especially in the Middle East and Nigeria).

The depreciating US dollar has played a role here also; some buyers have been regarding oil as a currency hedge, while oil producers have been reluctant to see the US-denominated value of their oil sales erode.

Of substantial concern is the effect of this run-up in oil costs on the wider economy. In addition to having an inflationary impact, rising oil prices act as a surrogate consumption tax and potentially slow economic activity by reducing the discretionary income available for spending on other goods and services. One notable effect of the recent run-up in these costs has been a renewal of policy and entrepreneurial interest in substitute energy sources, including biofuels of various types.



## Inflation & Interest Rates

The personal consumption expenditures (PCE) index, an inflation measure favored by the Federal Reserve Bank (FRB), increased at a yoy rate of 3.4% through December 2007, up from 1.9% in December 2006. At a yoy rate of 2.1% in December 2007, the 'core' index (i.e., excluding food and energy expenditures) decreased slightly from 2.3% for December 2006. In contrast, inflation as measured by the US consumer price index (CPI-U) has started to surge, breaching the 4% mark in 2008 compared with an average of 2.9% for 2007. Most of this surge appears to be the result of increases in the food and energy price components.

Inflation at the industrial level has increased noticeably also. The US producer price index for industrial commodities has surged to a yoy rate of 9% for the year ending February 2008. Since core inflation rose at 4.2% over the same period, a little over half this increase is attributable to rising food and energy prices. Increasing prices for other industrial commodities (e.g., metals) are also contributing significantly to inflationary pressures at this level of the US economy.

The FRB was extremely active policy-wise in the first quarter of 2008. In January the Federal Reserve Open Market Committee (FOMC) reduced the key Federal Funds target rate by 125 basis points. In March the FOMC followed that up with a further 75 basis point reduction, so the target rate now stands at 2.25%. Discount rate reductions also accompanied these reductions in the Federal Funds target rate. The FRB also took some significant steps to improve liquidity in the economy, which included providing investment banks with access to the reserve banks lending facilities (a privilege usually reserved for commercial banks), and accepting mortgage-backed securities as collateral for these loans. As if these measures were not enough, the FRB was also instrumental in brokering the sale of a major investment bank facing imminent collapse.

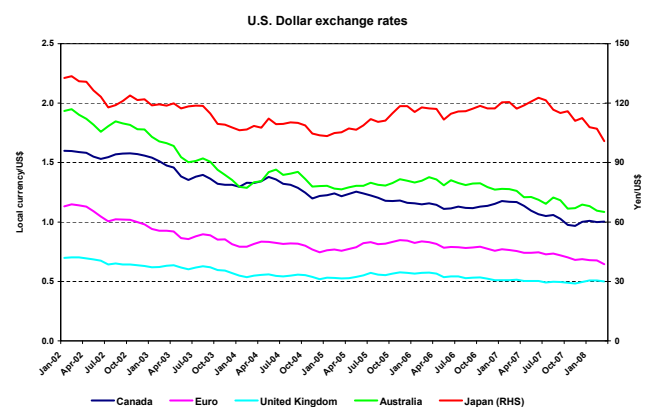
The prospect of a recession provided the FRB with motivation for these actions. The measures themselves indicated the FRB was willing to risk accelerating inflation in the near-term in order to achieve this goal. From a housing perspective, the interest rate reductions are likely to assist refinancing adjustable rate mortgages and thus diminish the flow of foreclosed properties into the inventory of unsold houses. Interest rate impacts on housing are discussed in further detail below.

Of potentially greater significance for housing is the acceptance of mortgage-backed securities as collateral for loans. In taking this step, the FRB is seeking to facilitate interbank lending, in credit markets by reducing so-called 'counterparty risk' arising from lender difficulties in accurately assessing the financial health of prospective borrowers—including other banks. In effect, the FRB is helping lenders remove 'bad' loans from their books. However, improved credit availability in the credit markets supporting mortgage lending will be offset to a degree by the tightening of mortgage lending criteria that is underway.

## Exchange Rates & Trade

The depreciating US dollar is having a significant impact on the US forest products economy, particularly the US-Canadian dollar rate. As the Canadian dollar appreciates against the US dollar, production costs for Canadian forest products manufacturers increase in US dollar terms, making it harder for Canadian imports to compete in the US market (which is the principal market for much of the Canadian industry). In fact, the Canadian dollar has strengthened sufficiently to make it worthwhile now for US lumber producers to export product to Canada, a reversal of the historically usual trade flow. The appreciating Canadian dollar also makes it cheaper for Canadian investors to buy US assets. The reasons for the strengthening Canadian dollar against the US dollar are varied, and include the strength of Canada's commodity and energy sectors, the strong fiscal performance of the Canadian Federal government, and the size of the US current account deficit.

The weakening of the US dollar against the Euro also benefits US producers since it insulates them from European competitors in the US domestic market (in the same way as for Canadian competitors). It also makes Europe (the Euro zone) a more attractive proposition to US exporters. Furthermore, the strengthening Euro makes it more difficult for European exporters of forest products to sell into the US, and trade in this direction has been falling.



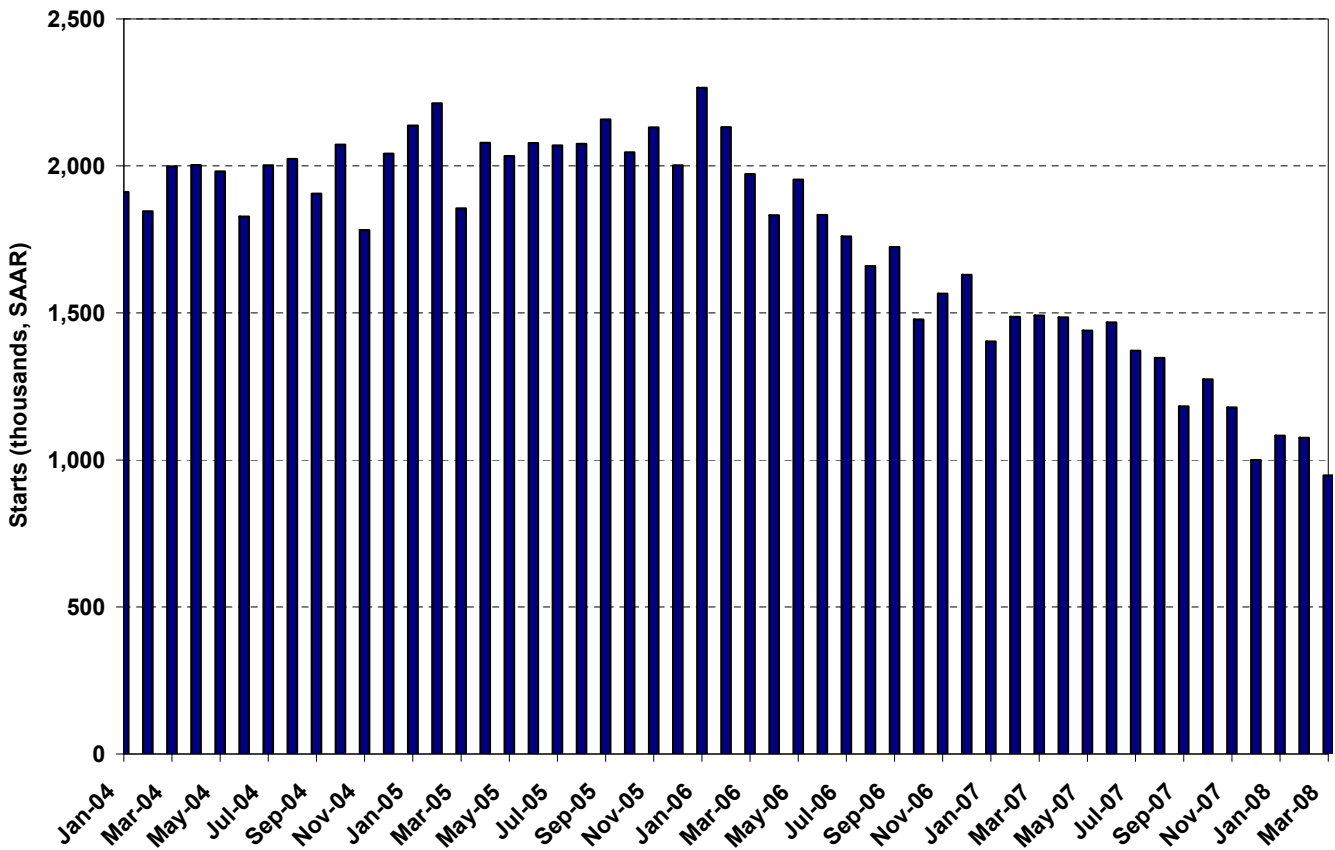
**WOOD PRODUCTS**

**Housing**

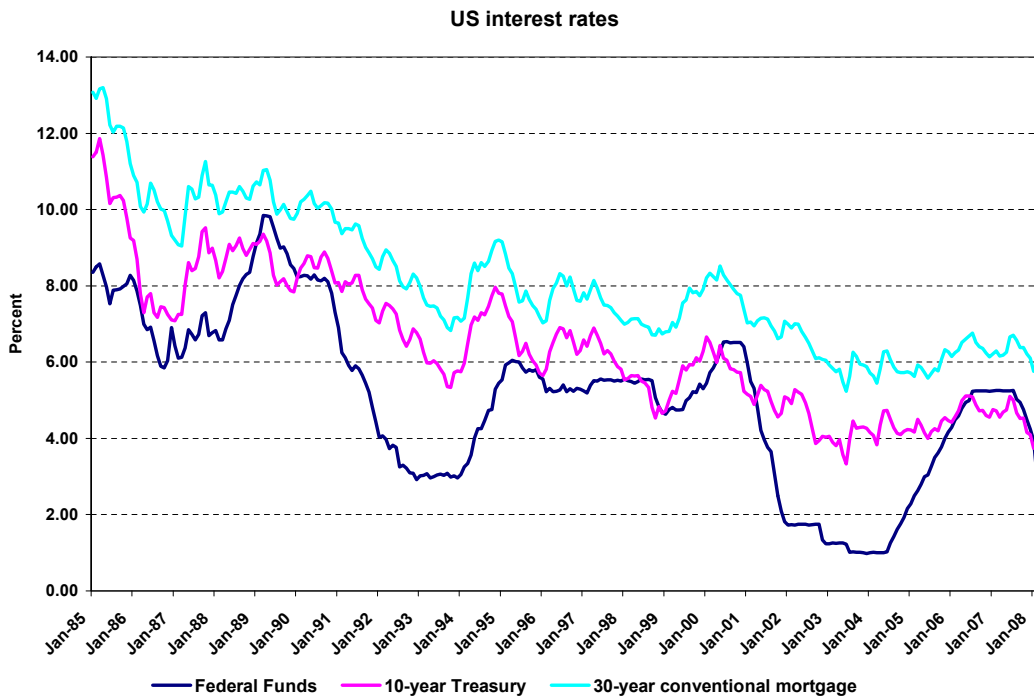
Residential construction consists of new housing and repair and remodeling, and accounts for about 70% of softwood lumber consumption in the US. The key long-term demand drivers are household formation and income growth. On a trend basis, the outlook for these drivers is very positive for the US, implying favorable prospects for both housing growth and softwood lumber consumption.

US new home construction faltered in 2006, although the 1.80 million new home starts for this year was high from a historical perspective. Housing starts averaged 1.35 million in 2007, but this data point masks the underlying picture: By March 2008 house construction activity had weakened dramatically, with starts at a seasonally adjusted annual rate of 0.95 million. This decline in housing starts is cyclical in nature, rather than a more fundamental structural change in the market.

**Monthly U.S. housing starts, seasonally-adjusted**



Home-buying affordability will not necessarily improve as a result of FRB efforts to influence short-term interest rates. Instead, mortgage rates are driven off ten-year bond rates, rather than the short-term Fed Funds rate. If buyers of these ten-year bonds view the Fed Funds rate decreases as inflationary in nature, then they may well seek higher returns on the ten-year bond to compensate, thus discouraging downward adjustment of mortgage rates.

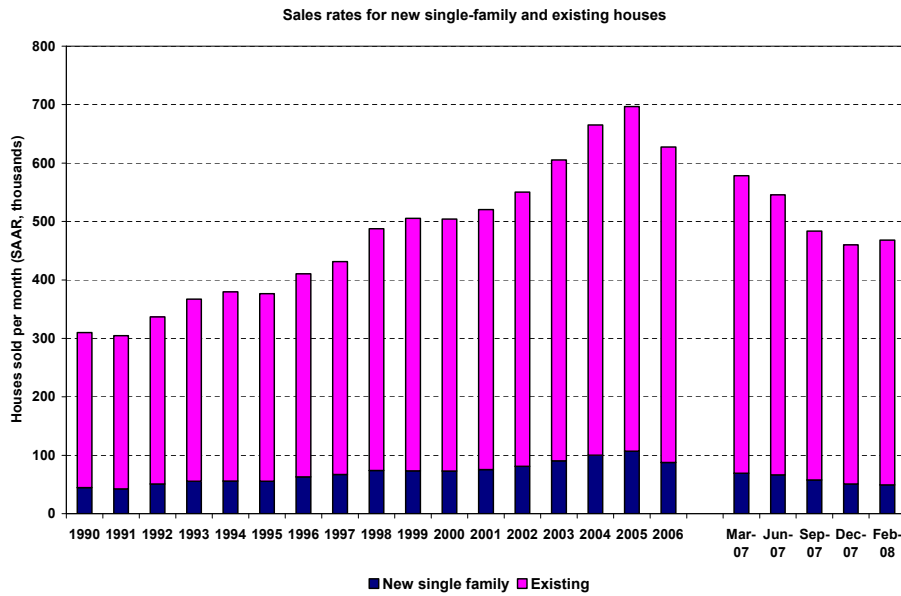


Changes to mortgage rates impact housing affordability and housing demand. However, the key issue in the US housing market lies on the supply side, in the form of the very large inventory of unsold new and existing homes. As houses become more affordable, sales rates will increase, and the inventory will be worked down. However, this notion assumes adequate credit to support mortgage lending, and adequate numbers of buyers with sufficient income to meet increasingly stringent lending criteria. In an environment of rising unemployment, income could become constraining.

The availability of credit in the mortgage market is an important factor. Credit availability in this market has diminished markedly as the various participating banks and lenders assess their risk exposures to mortgage-backed securities, anticipated losses, and the value of these securities. The confidence of participants in this market has taken a battering in recent months, and recent steps taken by the FRB to reduce counterparty risk and ease the flow of credit is proving helpful in this regard. However, certain other factors affecting mortgage lending will take longer to resolve (e.g., litigation, uncertainty regarding the linkages between security ownership and ownership of the underlying properties, and criminal investigation of subprime lending practices).

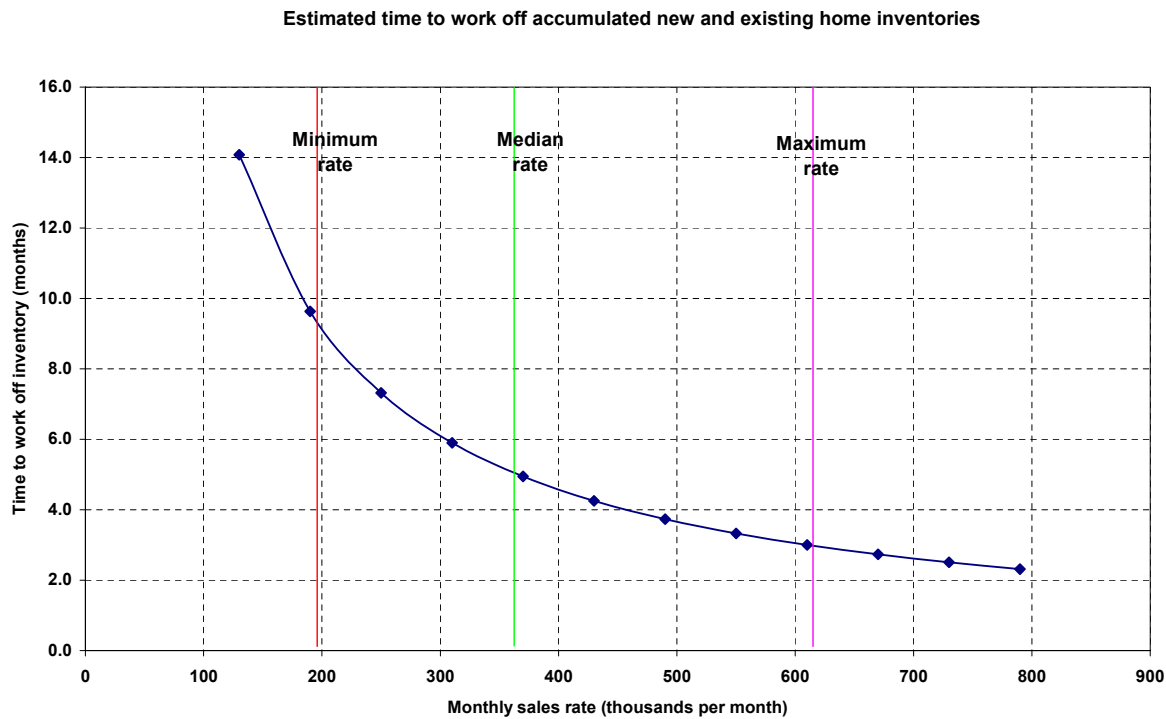
As can be seen below, the magnitude of the unsold housing inventory accumulation is significant, and it may increase more as a result of foreclosure.<sup>1</sup> Furthermore, lending standards have been tightened in the wake of the credit crisis affecting the secondary mortgage market, implying the inventory will likely be worked off more slowly than might otherwise have been the case. Thus, time will need to pass and home prices will need to adjust downwards for supply and demand to balance in the housing market. While this inventory adjustment process occurs, housing starts will be soft. The question remains: "How much time will be required for this to happen?"

<sup>1</sup> At February 2008 sales rates, there was 9.6 months supply of existing homes for sale and 9.6 months supply of new single-family homes, compared with more usual levels of 4.0 to 4.5 months

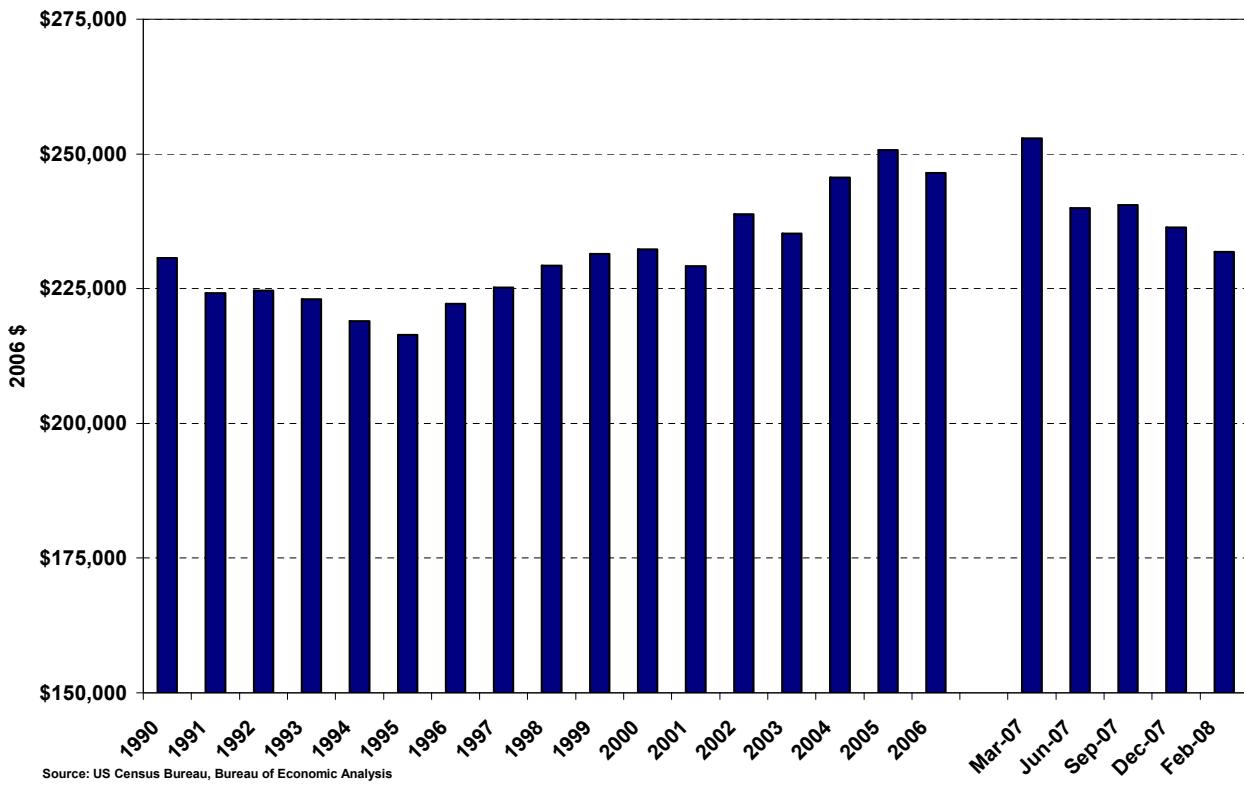


The answer to this question depends upon the sales rate, which in turn depends upon the rate at which prices for new and existing houses adjust downward. With the inventory accumulated since 2004 (more representative of a historical level) through to the end of February 2008, it would take a little over five months to work off the ‘surplus’ inventory of approximately 1.83 million homes at the median sales rate (but it could take as long as ten months or as little as three months at the minimum and maximum sales rates, respectively). The sales rate averaged about 468 (new and existing) houses per month in February 2008, down from an annual average of 540 houses per month for 2007.

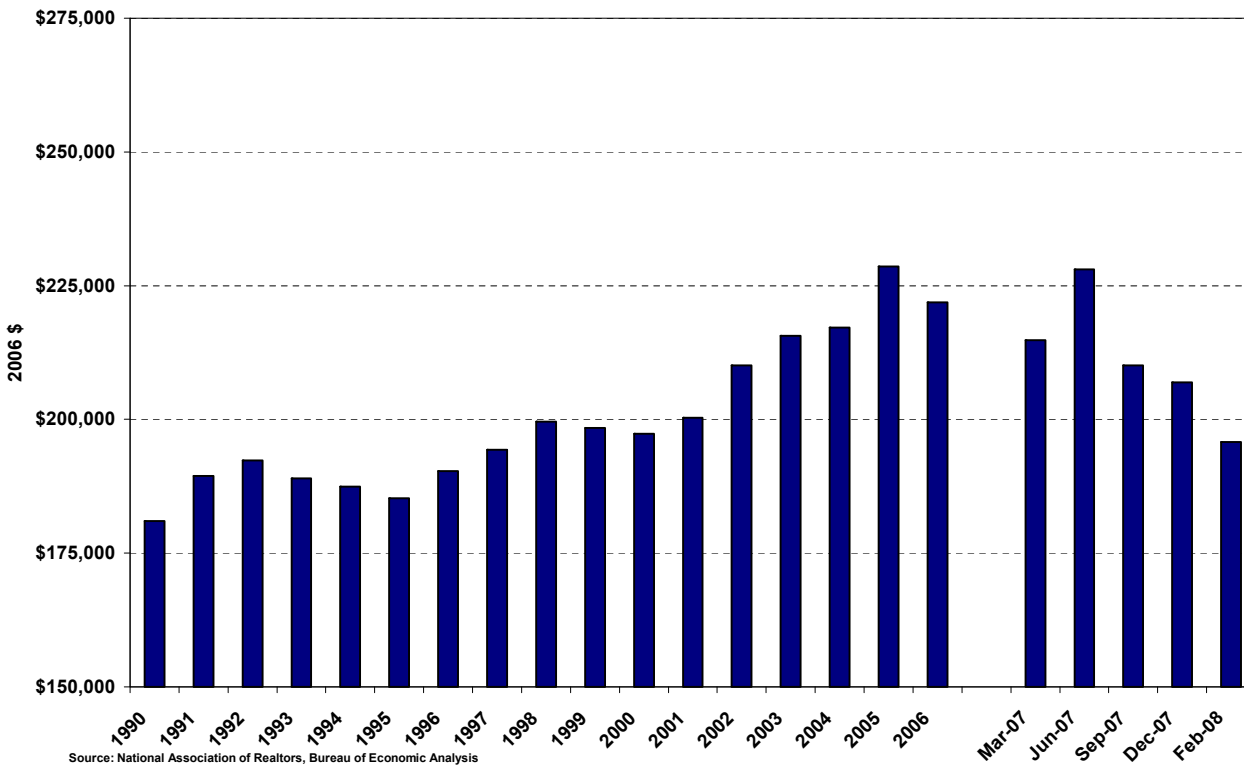
The characteristics of new and existing houses differ. Price adjustment is likely to occur more quickly in new rather than existing housing because existing home owners typically take some time to accept the fact that their homes may be worth less than they thought. Also, house builders typically face high pressure to sell the houses they build particularly if they need the working capital for other purposes. For the excess unsold inventory to be worked off, the monthly sales rates need to fall until house prices decline to more affordable levels encouraging the return of buyers to the market. Median prices of new and existing homes have declined over 2007, and through February 2008.



**Real median price of new homes sold in the US**



**Real median price of existing homes sold in the US**



## US Housing Summary

The foreclosure process will continue to add to the inventory accumulation but at potentially lower rates than previously anticipated. Tightened mortgage lending criteria will tend to reduce the rate at which inventory drawdown occurs, but the key factor to watch is the speed of price adjustment in the markets for new and existing houses. There are signs suggesting price adjustment is already leading to reductions in the inventory, outweighing the combined effects of foreclosure and tightened lending criteria.

Rapid house price adjustment will lead to the unsold inventory being drawn down relatively quickly since it will improve affordability relatively quickly. However, the bulk of the accumulated inventory consists of existing houses, and price adjustment for these is likely to be slower relative to new houses. Further, the size of the unsold inventory accumulated over and above 2004 year-end levels (1.83 million) is roughly equivalent to one year's single-family housing starts. Collectively, these factors suggest the sales rate will decline further and perhaps even drop below the median rate before picking up again. From this perspective, it is not unreasonable to expect the 'surplus' unsold housing inventory to take as long as a year to work off. The risk here is that working off the inventory will take longer if credit availability constrains mortgage lending.

## Softwood Lumber Production

In 2007 softwood lumber production was substantially lower than 2006. Lumber production in the US West in 2007 was about 15.8 bbf, down from nearly 18.0 bbf in 2006 (-12.4%). In the US South 2007 lumber production totaled 16.9 bbf, down from 18.7 bbf in 2006 (-9.4%). Canadian lumber production was also down in 2007 compared with 2006, by 10.8% (29.9 bbf in 2007 compared with 33.6 bbf in 2006).

Obviously these production declines reflect slowing US residential construction, but there is more to it than that. Reduced lumber production is largely taking the form of sawmill curtailments and indefinite closures, especially in Canada. Permanent closures, where they have occurred, have also tended to occur mostly in Canada, especially Eastern Canada. The key driver of this regional distribution of downtime is the strong Canadian dollar, which both increases local production costs and reduces mill returns. In addition, the duties many Canadian lumber producers pay on

lumber they ship into the US market in effect increases their production costs. It is likely that further capacity adjustment in the North American sawmilling industry will be required to bring lumber demand into line with supply. More permanent closures can be anticipated as part of this process, probably from the ranks of those mills that have announced indefinite closures. For reasons outlined below, the market forces underlying North American softwood lumber production suggest that most of the lumber production adjustment will occur in Canada.

## Softwood Lumber Dispute

In April 2007, US and Canadian officials held formal consultations regarding differing interpretations of the new Softwood Lumber Agreement (SLA). The parties' differing interpretations were not resolved in these talks, and the disagreement was referred to the London Court of International Arbitration (LCIA). The LCIA has ruled that British Columbia and Alberta correctly followed the terms of the Softwood Lumber Agreement, but eastern provinces did not. Thus BC and Alberta will continue to operate as they have since the agreement went into effect in October 2006. However, the LCIA is expected to reduce the quota for Ontario, Quebec, Manitoba, and Saskatchewan in line with its ruling that these provinces did not correctly apply the so-called "surge mechanism" when the SLA was first implemented. When those quota change, and for how long, will be determined by the LCIA likely by July

The US has filed a second request for arbitration, this time questioning the legitimacy of six programs set up by the governments of Ontario and Quebec to address forestry and forest industry issues. The Ontario programs that are the subject of the request are the Forest Sector Prosperity Fund, the Loan Guarantee Program and a forest access roads program. Canada asserts the Ontario programs that the US reviewed in consultations with Canada pre-date the Softwood Lumber Agreement and are actually quite similar to US federal and state programs. So far no date has been set for hearings and deliberations.

### The lumber/log price adjustment process: Details of the Dynamics

Against this backdrop then, what might the price adjustment process look like that will bring commodity lumber supply into balance with demand, as ultimately dictated by reduced US residential construction activity? The stages of this adjustment process include:

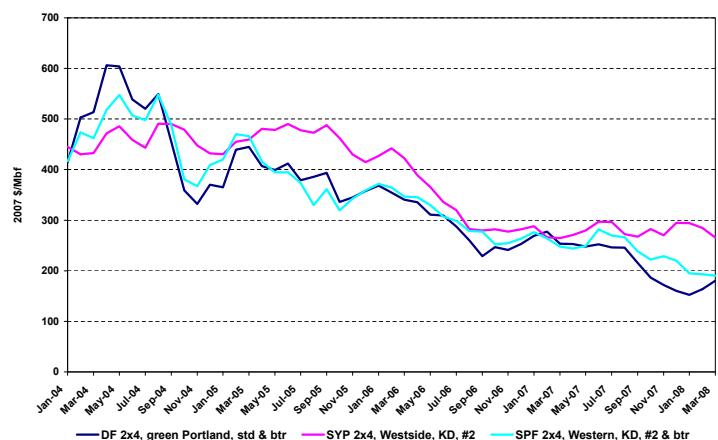
- (1) Lumber demand contracts and lumber price falls.
- (2) Lumber production declines to balance supply and demand in the lumber market.
- (3) Sawmill margins are squeezed as lumber prices decline.
- (4) Sawlog prices adjust downwards with a lag, as log suppliers face reduced demand from sawmillers.
  - a. Declining log prices may prompt log suppliers to withhold logs from the market to the degree they are able, i.e., depending on whether they need the cash from selling logs, or can afford to delay harvest.
  - b. The ability of log prices to adjust downward is limited by the relative size of the stumpage component of delivered log costs, i.e., where the stumpage component is small relative to harvest and haul costs (as is typical in much of Canada) then less adjustment may be expected. Conversely, where the stumpage component is large relative to harvest and haul costs then log prices can adjust substantially. Because Canadian log prices are relatively less flexible than those in the US, it is likely that most of the sawmill downtime associated with the current housing downturn will eventually end up being experienced in Canada.
- (5) Lumber production rises as sawmill margins are restored with declining sawlog prices.
- (6) Sawlog demand is (partially) restored and log prices rise.
- (7) Sawmill margins are again squeezed as sawlog prices rise.
- (8) Lumber production declines to balance supply and demand in the lumber market (i.e., back to step (2)).
- (9) Then to step (3), etc until sufficient log price adjustment has occurred to realign log prices with prevailing lumber prices.

While the stages outlined above provide a useful index to assess observed trends against the adjustment process, in practice these stages may not be as clear-cut as the above description implies. Stages may overlap each other to some degree, and occur with different timing in different market areas. In addition, regional markets may be in different phases of the adjustment process, given the strength and dynamics of those individual markets.

### Softwood Lumber Prices

Softwood lumber prices have declined with the decline in housing starts. Consequently, sawmill margins are under pressure, resulting in both temporary production curtailments and some permanent closures. Lumber prices are likely to rebound when demand improves and/or log prices adjust down to a level consistent with the lower lumber prices.

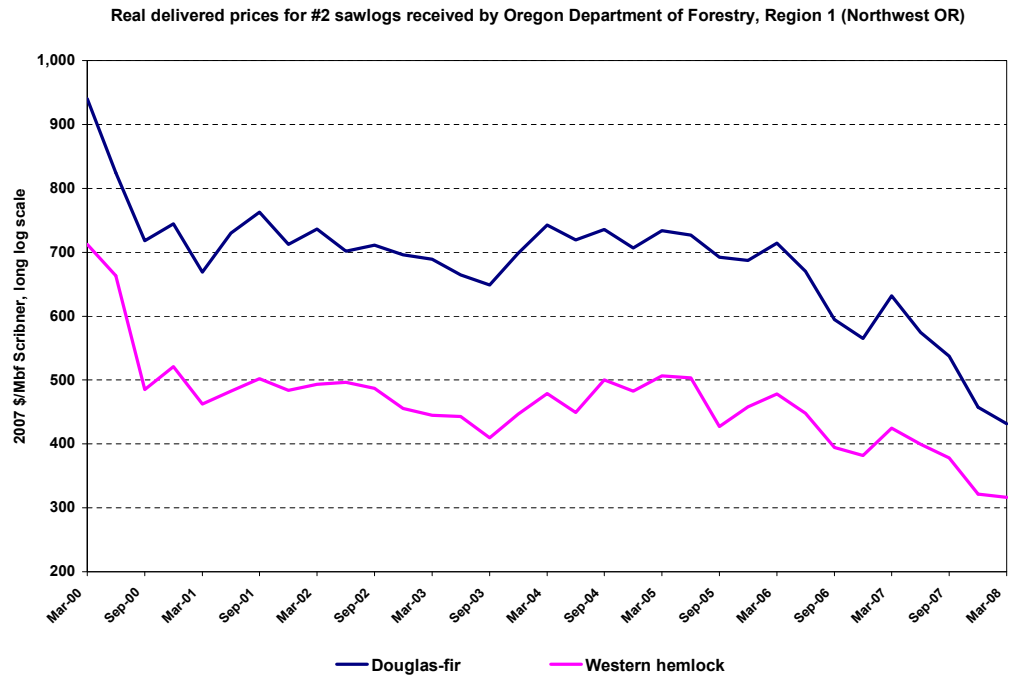
Key softwood lumber real price indicators for the US West Coast (Douglas-fir), the US South (Southern Yellow Pine), and Canada (Spruce-Pine-Fir in Interior British Columbia)



A feature of the above chart is the recent separation of the lumber price trends. Green Douglas-fir lumber has fallen well below Canadian SPF, which in turn is less than the indicator Southern pine commodity lumber price. The low Douglas-fir lumber price largely reflects the degree to which new home building in the US Pacific Southwest region has slowed (i.e., California, Arizona, and Nevada), given the high dependence of construction in this region on green Douglas-fir. In contrast, the SPF and southern pine lumber prices have held up relatively well, possibly suggesting construction in the areas served by these products is faring better than in the US Pacific Southwest.

## Log Prices & Stumpage

In the US West Coast region, log price adjustment is well underway. In addition, certain log sellers in the region—particularly TIMOs—are withholding volume from the market. Ongoing adjustment is anticipated as log prices realign with reduced lumber prices. Competition in the West Coast log market is intense, given recent investments in new, highly efficient processing capacity capable of processing small logs. Exactly when—or even if—inefficient sawmilling capacity is likely to close in response to low lumber prices is an unknown. Just how low log prices can go depends upon where sawmills breakeven at the prevailing lumber price.

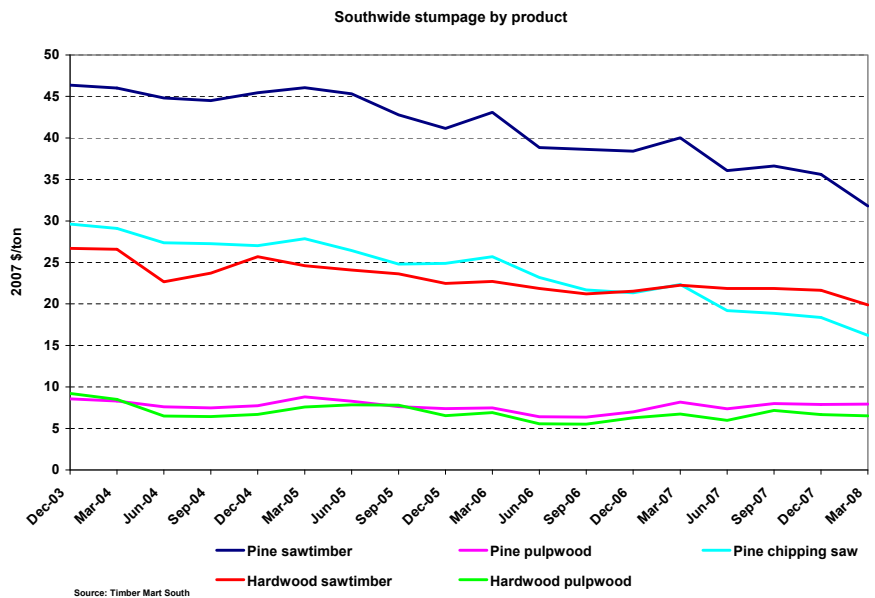


A December 2007 windstorm will also likely boost local log supply, at a time when sawlog prices are already soft. Much of the timber to be salvaged is likely to be of pulp quality however. Fortunately, wood chip markets are relatively strong at present, given lumber production curtailments and strong pulp prices.

Another factor contributing to the declining log prices in the US West is the relatively weak export market—this, despite weakness in the US dollar. Japan is the major export market for US sawlogs, where they are sawn to produce lumber for use in house construction. The Japanese house construction industry is now recovering from a recent change in the laws governing the housing permitting process. Japan's long-term housing start outlook remains unfavorable though, given declining birth rates and an increasingly aging population.

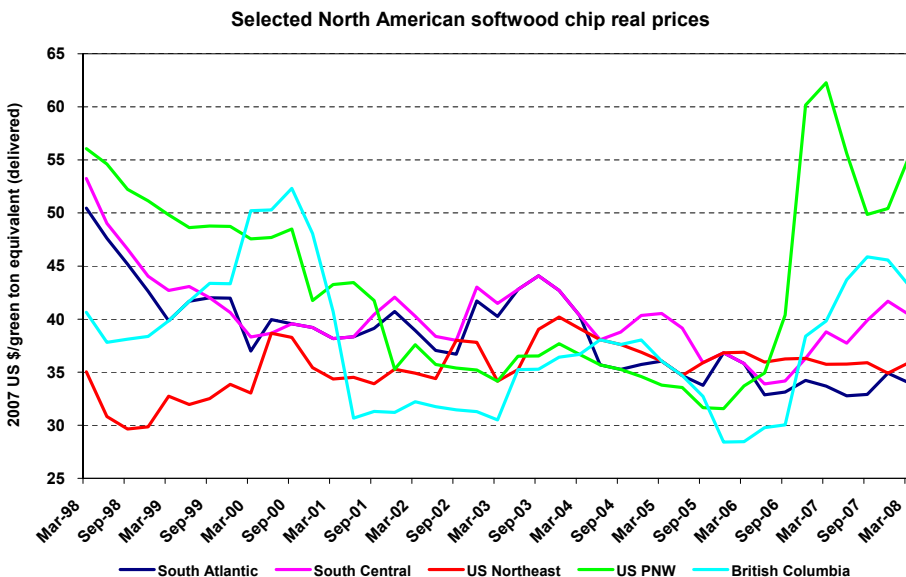
As might be expected, stumpages in the US South have been following much the same adjustment path as in the US West. The adjustment process has been somewhat less dramatic since many southern lumber producers have lower exposure to overbuilt and overvalued markets than their western counterparts. Also southern plywood manufacturers have been somewhat insulated from the housing market downturn since they are more strongly dependent upon nonresidential than residential construction activity. Compared with residential construction, nonresidential construction has held up relatively well, but there are signs of a decline emerging in the sector now.

In the US South, pine sawtimber and chip-n-saw (CNS) stumpages<sup>2</sup> tend to move together, and prices for both products are continuing to decline. Compared with the US West, these adjustments tend to be smaller because non-industrial private owners are the dominant ownership group in this region. These owners are less inclined to offer timber for sale when prices decline and many are standing on the sidelines watching and waiting until prices improve or they need the cash flow offered by harvesting their tracts. A further implication of this ownership pattern is that southern stumpages tend to display less volatility than log prices in the US West.



In contrast, softwood and hardwood pulp prices are strong at present. Consequently pulpwood prices are experiencing support.

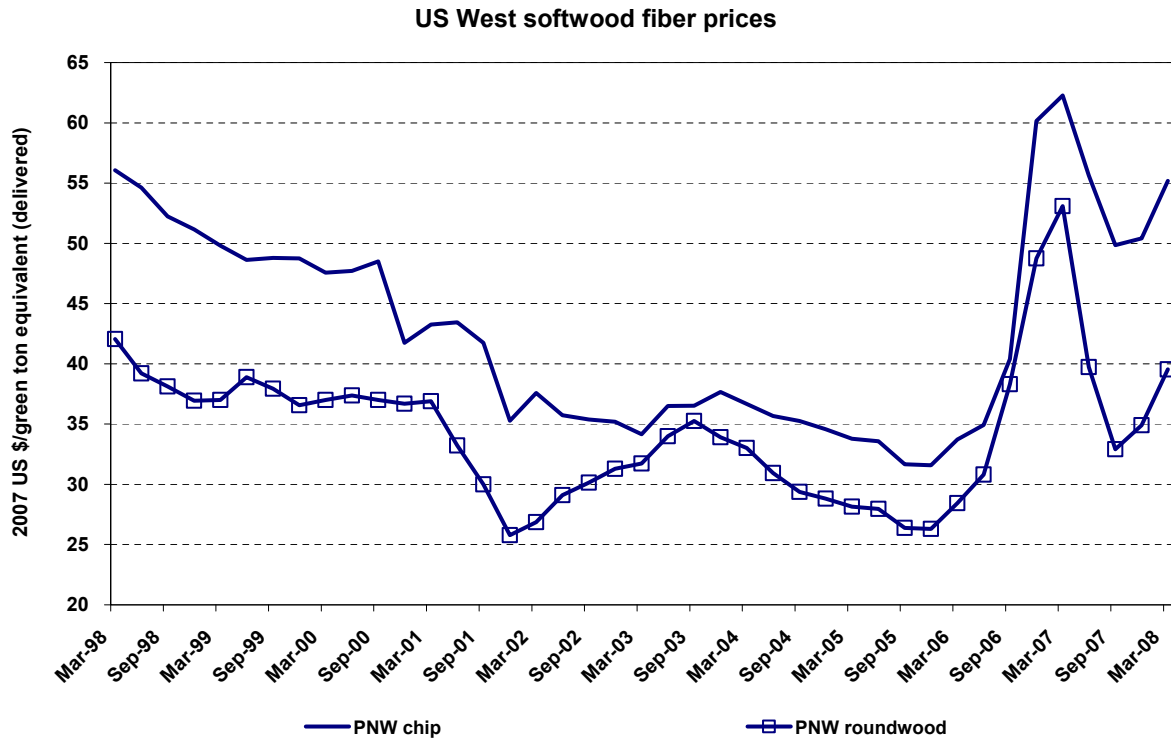
Other factors playing into firm pulpwood prices in the region are limited availability of sawmill residuals (on account of production curtailments in the lumber industry), production curtailments in the oriented strandboard industry (which may compete for the same pulpwood raw material resource), and limited availability of recycled fiber. At present pulpwood prices are particularly buoyant in the West South Central Region of the US South (i.e., Texas, Louisiana, Arkansas, and Oklahoma), reflecting seasonal supply restrictions. There is an interesting interaction here between pulpwood and CNS demand. In the face of strong softwood pulp prices and limited supplies of alternate raw materials, pulp producers are turning to low-quality CNS logs to meet their raw material needs, thereby bolstering the CNS price.



Compared with recent historical norms, recent softwood chip prices are relatively high in the Pacific Northwest, British Columbia, and the South Central region of the US. Two key contributing factors here are buoyant pulp prices and reduced softwood lumber production. Rising pulp prices have enabled pulp producers to bid up raw material prices, while with sawmills curtailing lumber production, the supply of residuals to the pulp industry has diminished. In the absence of alternate supply, chip prices have risen accordingly. Chip prices may not return to previous levels until lumber production expands, other sources of fiber supply emerge (e.g., in-woods chipping) and/or pulping capacity adjusts.

The effect of sawmill curtailments on sawmill residuals and pulpwood prices can be seen in the chart below. As sawmills in the US Pacific Northwest began curtailing production in earnest in late 2006, wood chip prices increased. Pulpwood prices also increased, with little perceptible lag.

<sup>2</sup> Stumpage is the price of standing timber.



**Key Indicators to Watch**

- Housing market activity will begin to recover once the excess unsold inventory of new and existing houses is worked off. For this to happen, house prices will need to decline substantially. The availability of credit for mortgage lending also will be crucial in determining how quickly the excess inventory will be worked off.
- Supply–demand balance: Decreases in US lumber production should continue into the 2008.
- Lumber price/Log price/Stumpage adjustment: Just when will the effects of declining lumber prices be fully reflected in log prices and stumpage? Watch sawmill production and capacity for this story.

## TCG Area Reports

Pulpwood prices continue to be the major bright spot this quarter, benefiting from sawmill curtailments and the associated reduction in the supply of residuals at a time of strong pulp prices. These strong pulpwood prices offer a significant forest management opportunity. In the (slightly abridged) words of one area manager:

“We small town loggers have figured out it is wise to sell more of a product when the price is high. Mixed hardwood chip prices have risen 48 percent. This price improvement along with increased contractor availability has enabled us to log low volume per acre hardwood stands. Now we are able to convert these stands to good fully stocked plantations at no out-of-pocket cost. The bottom line is these conversions increase the value of the asset, and at lower chip values we would be unable to do this. We are also able to bring in and sell more conifer pulpwood as we harvest and rehabilitate these stands, at prices 40-60 percent higher than several months ago.”

While the strong pulpwood market has been valuable in the respect described above, there is potential for pulpwood prices to decline through 2008 as supply increases.

Sawlog prices in the domestic market continue to be soft. Pine CNS logs in the US South have been particularly hard-hit, and in some areas low quality CNS logs are being used to augment the pulpwood mix. It is likely that log prices in parts of the US West will also come under pressure as salvage operations gear up in the wake of a December windstorm. The export log market in the US West is reportedly picking up, although trade data have yet to reflect this. In the meantime, log inventories at log decks and in mill decks vary widely, but even with modest inventories log buyers are still reluctant to meet asking prices and, in some cases, even to buy. Increasingly log sellers (including TIMOs) are sitting on the market sidelines, withholding volume where they can.

Sawmills dependent on the residential construction market continue to curtail production, with curtailment generally taking the form of reduced schedules or temporary closures. While numerous mills have announced indefinite closures, so far there have still been relatively few permanent closures announced in the US West and US South.

Two other factors are emerging which have a potential impact on log prices. As the construction downturn continues, demand for the services of logging contractors is decreasing, raising the attractive possibility of reduced harvest costs—at least in the near term. Meanwhile, significant increases in diesel prices are having an adverse impact on both harvest and haul costs. At this stage, the net effect of these changes on the return to the stump is unclear.

The decrease in log prices was not unexpected, being an inevitable consequence of a drop in lumber prices followed by a protracted period of low lumber prices. Looking forward, further log price weakness is expected over the next quarter, as log prices continue adjusting to low lumber prices. The key to a sustained improvement in log and stumpage prices is a recovery in residential construction activity.

Interest in utilizing wood (especially logging residues) for bioenergy continues to grow, particularly in the US South.



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