

Splintered Wood: Assessing B.C. Forestry Sector Conditions

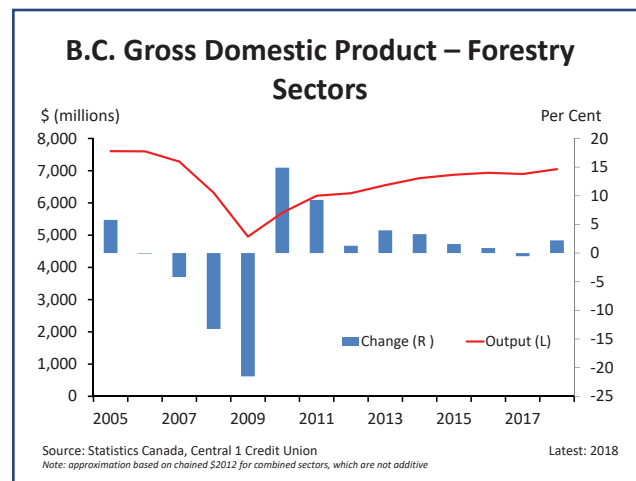
B.C. forestry sector has experienced a sea change in market conditions over the past year. Following solid expansion for most of 2018, the bottom has fallen out of the proverbial barrel. Weaker export demand, lower lumber prices, ongoing softwood lumber tariffs and timber availability constraints has led to a downturn in the sector. At least five mills in the province have announced, or already shutdown permanently in 2019, including Canfor's Vavenby mill, West Fraser's 100 Mile House operations and Norbord OSB, also in 100 Mile House. A raft of other lumber and pulp mills have taken downtime or curtailed the number of hours or shifts.

This note provides a snapshot of the current state of the sector and potential impacts of the downturn going forward.

Current forestry sector trends

B.C.'s forestry sector recorded solid growth in 2018. Gross domestic product (GDP) in the sector, including logging, related support, and wood and paper manufacturing, expanded by about 2.2 per cent. This was an improvement from a slight contraction in 2017, with gains led by logging, paper manufacturing and support activity. The environment was characterized by elevated prices, solid lumber production and increased harvest activity.

Conditions have rapidly deteriorated since late-2018. Excess lumber inventory following a price-



driven surge in global production has pulled down prices. Broader economic uncertainty and persistent underperformance of the housing market in the U.S. continues to drag on the sector. U.S. housing starts have gained only mild traction despite a strong labour market and low mortgage rates.

Deterioration in conditions is evident in manufacturing data which has shifted markedly lower since late 2018. Year-over-year production has declined 16 per cent through the first four months of the year. Similarly, dollar-volume wood product manufacturing sales was down a similar degree through May, although this also reflects product prices. Eroding exports demand from the U.S. and Japan have contributed to the decline although demand from China has increased. Lumber prices have slumped sharply with declines of more than 40 per cent from peak and back to 2016 levels. This is particularly impactful for Canadian and B.C. producers who are still in the shadow of countervailing and anti-dump tariffs imposed by the U.S. government.

Permanent Closures

	location	Natural Resource District	Capacity
Lumber Mill			
Canfor	Vavenby	Thompson Rivers	216 million board feet
Tolko Quest Wood	Quesnel	Quesnel	197 million board feet
West Fraser	Chasm	100 Mile House	226 million board feet
OSB			
Norbord OSB	100 Mile House	100 Mile House	668 million sq. feet, 3/8' basis
Louisiana-Pacific OSB	Fort St. John	Peace	364 million sq. feet, 3/8' basis

Source: Canadian Forest Industries Wood Business

Stronger market conditions blunted tariff impacts when they were introduced as prices rose in lockstep with tariff amounts. At the same time, log prices have remained elevated, creating further cost pressures and less residual from sawmills is negatively impacting pulp production. Current pricing is pushing some producers out of the market and forcing others to curtail production.

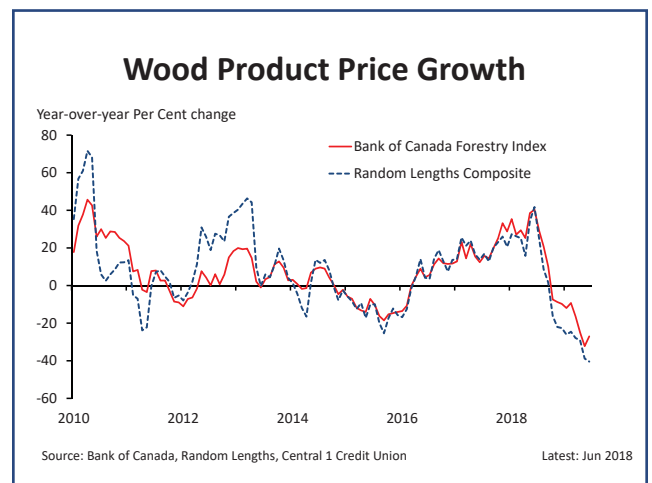
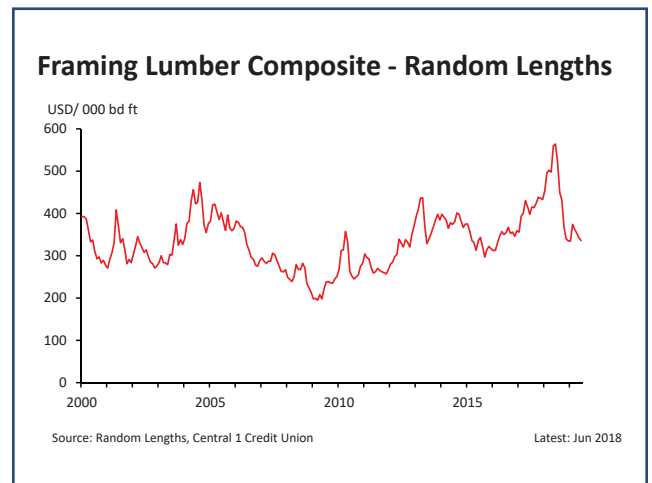
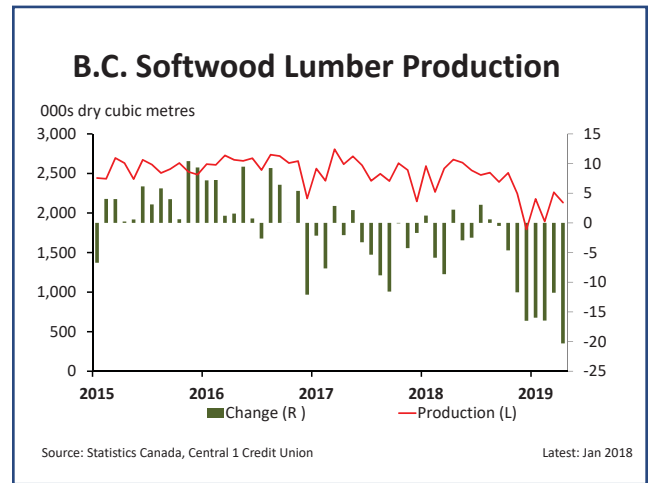
Timber harvest levels have declined. Following a near eight per cent gain in 2018 led by growth in southern B.C., harvest is down nearly eight per cent through the first five months of 2019. Southern B.C. harvest is down 13 per cent, with other parts of B.C. recording declines of five to eight per cent.

Producers continue to adjust to supply constraints that continue to play out in B.C. The mountain pine beetle (MPB) epidemic from the late 1990s through early 2000s has come home to roost. It is estimated that the MPB attacked about 20 per cent of B.C.'s land base, and 57 per cent of the merchantable timber was infested. The annual allowable cut (AAC) was lifted over the past decade to facilitate harvesting of beetle-killed wood while it was still commercially viable (although market conditions held harvest below these levels). With impacted beetle-killed wood at the end of its lifecycle, as well as other factors—such as wildfires in recent years impacting the harvestable landbase—harvestable timber will continue to be reduced. In some areas, producers have swapped timber licenses and shuttered operations to ensure sufficient supply for one operating mill in the area. Insufficient future supply is a key driver of mill closures and represents long-term business challenges for producers.

Employment still steady.

Recent weakness in the forestry sector is slowly working through the labour market although recent curtailments and shutdowns have yet to hit the numbers. According to Statistics Canada's Survey of Employment, Payroll, and Hours (SEPH), forestry-related sectors including forestry and logging, wood product manufacturing, paper and pulp manufacturing and support industries averaged 52,900 persons in 2018 which was steady from 2017. Year-to-date 2019 employment through April was in line with same-period 2018 near 50,700 persons. Employment in the sector is seasonal.

While employment has been steady in recent years it is still a shadow of its former self. Forestry sector



employment declined from more than 65,000 persons in 2005 to a low of about 46,000 persons in 2008/09 reflecting the impacts of the U.S. residential downturn and subsequent global financial crisis. Employment has moved slightly higher over the past decade but was still 10 per cent below 2008 levels. Employment is about two thirds of the early 2000s when previous lumber and tariff wars wiped out thousands of B.C. sector jobs, leading to consolidation in the sector.

The 2006 Softwood Lumber Agreement provided stability to the sector but preceded the end of the U.S. housing boom and subsequent bust. Pulp and paper manufacturing employment declines have driven the decline, although forestry and logging and wood product manufacturing employment shrunk by more than a quarter over the past two decades. Forestry downturns have previously triggered weaker labour market conditions in interior B.C. markets. In addition to direct sector employment, jobs losses also negatively impacted downstream industries and other local businesses.

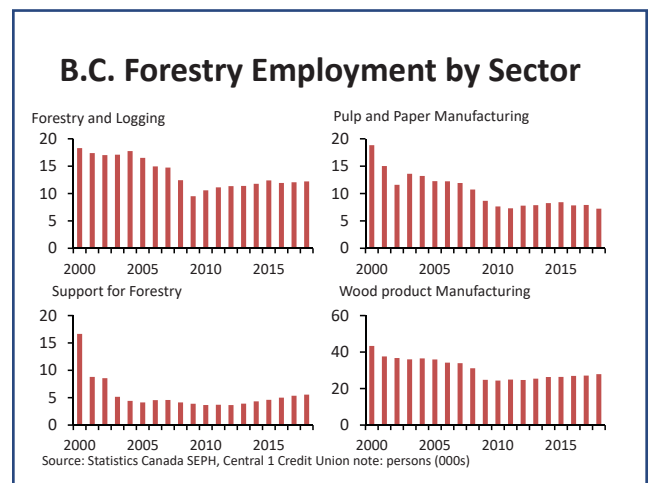
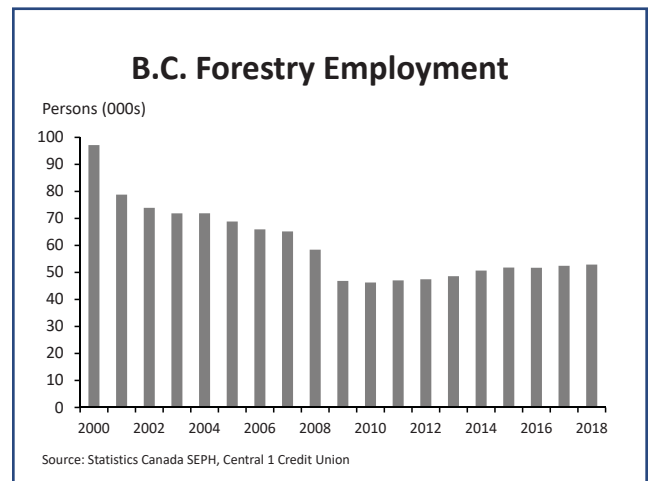
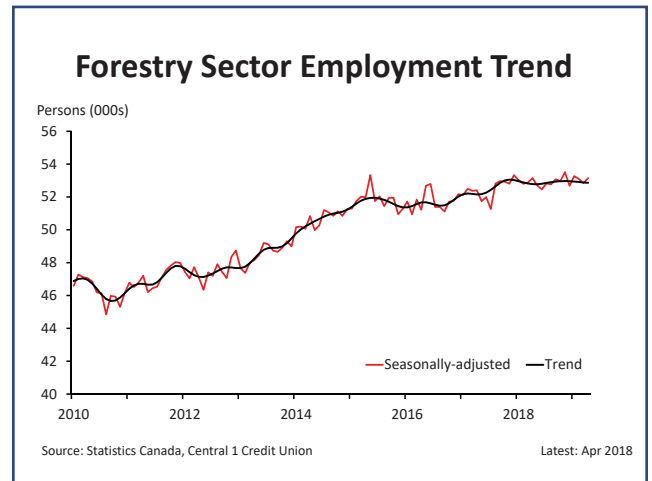
Sector labour market conditions have reflected the sector's economic cycle. Real forestry output in the province has slowly rebounded since the 2008/09 recession but has not returned to mid-2000 levels reflecting lower export demand from the U.S. relative to that period. Employment growth has also been restrained by improved technology.

As a share of total B.C. employment, forestry has declined from more than four per cent to about 2.3 per cent in recent years as the rest of the economy has continued to expand. That said, forestry remains a significant economic driver for many small and rural markets in the interior which depend upon the industry as a direct employment driver and source of income for spending in the local economies. Forestry employment is a high-value industry with significantly higher wages than the provincial average. While estimates are dated, areas with economies tied closely to forestry have historically been in Cariboo, Nechako and pockets of the interior such as North Thompson, Merritt among others. Some of these markets have seen mills shuttered in recent years.

Outlook

A significant short term rebound in B.C.'s forestry is not anticipated. U.S. housing starts reached 1.25 million units in 2018 and while this was the highest since the 2007, it still marks a relatively mild pace. Despite lower long term mortgage rates in the U.S., there is little upside coming. Consensus forecasts currently have housing starts trending between 1.25 to 1.30 million over the next two years. Increased lumber capacity in the U.S., including investments by Canadian firms, means supply should remain ample. Over the five-to-ten-year period, constrained timber supplies in B.C. will be a natural constraint to B.C. production although prices will likely rise as demand improves.

Given long-term supply constraints and mill closures, the current contraction in the sector market is more



permanent than temporary. Estimating the impact of the contraction in the forestry sector on the economy and labour market is challenging an imprecise. Producers adjust to a weak demand, low price and tariff-constrained environment in numerous ways dependent if it is deemed a temporary or persistent trend. Mill closures, reduced shifts and technology are ways to adapt. While prices will be firm and improve sector profits, timber supply will limit any rebound in the sector.

Central 1 simulates a persistent negative forestry related export shock. Our macro-economic model of the provincial economy estimates declines of roughly 10 per cent in log exports and 15 per cent in wood exports relative to 2018 to align with current trends. This would cut forestry and logging GDP by six per cent and wood products by nine per cent in 2019, before holding steady thereafter. Unsurprisingly, the impact on provincial GDP is negligible as the sector comprises about three per cent of the provincial economy. A decline in related economic output could shave off about 0.2 percentage points from GDP growth in the first year, with a flat performance thereafter.

Tying this negative and persistent shock to employment counts in the sector, we estimate cumulative job losses of up to 2,000 jobs over the next three years, marking a drop of about four per cent of total sector employment. This may be low and does not include impacts of shift reductions and fewer hours for some workers. Losses will be concentrated in B.C.'s interior and have negative impacts to local communities and their economies through loss of wages and spending. Less diversified economies that are heavily tied to forestry could also experience sharp retrenchment in housing markets.

Depending on transferability of skills, the impact of closures on incomes may be lessened as worker shift to other sectors. This is particularly of note given major project construction anticipated over the next five years, including the liquefied natural gas plant in the north, the Transmountain pipeline and public works projects. That said, some individuals may need retraining while others may find alternative opportunities but at a lower pay scale.

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