The Trade War Threat Looms

By Graeme Rodden, *Paper360°*

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Trade issues and pulp dominated discussions during the final two days of RISI's annual North American forest products outlook conference, held in San Francisco, CA, in October.
After opening with a look at the future of the wood products market, day two's theme was: Cost and Supply Chain Challenges for Pulp, Paper, and Beyond.

Lasse Sinikallas, RISI's director of macroeconomics, noted that the global economy is still growing, but moderately, and faces heightened risks. All economies (developed and emerging) have done well in the past few years and this should continue. However, inflation has gone up recently mostly due to higher oil prices, which are at their highest in four years.

Politics is an increasing concern. Economic policy uncertainty is elevated globally, Sinikallas said. The US economy has grown, he added, but faces continued uncertainty with President's Trump's policies, which pose a "serious concern." He also noted that US labor productivity is low. With very low unemployment levels, he fears a tightened labor supply could promote inflation.

In China, the transition continues. There is concern about the level of debt and the fear of an all-out trade war with the US adds an additional risk. The industrial side of China's economy is settling and there is not likely to be significant growth. Sinikallas expects China's economy will decelerate slowly and he does not expect a "crash landing". But, he warned, there is always a level of doubt in the truthfulness of any statistics released by the government.

In Europe, geopolitical concerns (such as Brexit) may cause chaos. Inflation also poses a challenge. Is there a loss of momentum, e.g., falling retail sales?

Overall, Sinikallas said the world economy will look the same in 2018 and 2019. The US should perform well with some concerns. China is moving to consumer-led growth.

CHINA STILL THE STORY

RISI's Dave Fortin, vice president, fiber, gave the outlook for the global pulp market. Recent conditions have had a severely unsettling affect. Foremost among these are the "aggressive" import policies of China. This affects virgin pulp as well as recycled, Fortin said. It also affects trade flows. With the global economy improving, this means price hikes.

Fortin explained that China plans to ban all recovered paper (RCP) imports by 2020, although there is still some debate as to whether this will happen. Still, on March 1 of 2018, China imposed a maximum contamination level of 0.5 percent on all RCP imports. This compares to the traditional 1.5 percent level previously in effect. Since May, China has been inspecting all RCP containers coming from the US.

Another concern is the ongoing trade war between the two countries. This has global ramifications, Fortin stressed. He said that, given an estimated 85 percent yield from RCP, this mean 11.6 million metric tons of pulp will need to be replaced (Fig. 1). How? Virgin pulp is one solution. Others include increased imports to China of paper and board or increased domestic collection of secondary fiber. Its recovery rate is 64 percent now but quality is low and the supply chain is stretched.

The result has been an increase in RCP prices in China—but elsewhere in the world prices are low, so this RCP needs to find a new home. China has become a high-cost producer of recycled paper and board.

Elsewhere, in the virgin pulp sector, unexpected downtime (natural disasters, mill incidents, startup delays, etc.) has offset new capacity. RISI has started tracking this unexpected downtime. For example, through Q3 2018, there has been 1.8 million metric tons of downtime among pulp producers.

Pulp inventories are low across the board, while paper and board markets are entering their traditionally strong season. Pulp prices are high, while paper and board prices are increasing. The price differential between dissolving pulp and bleached hardwood kraft remains narrow, bringing swing capacity back to paper grade.

In summing up, Fortin said that world production of paper and board is growing, albeit slowly. Most of this growth is in the packaging sector with a modest effect on pulp. The decline in graphic papers is slowing and tissue demand is growing, which has a positive effect on pulp. Even high-cost mills, hardwood or softwood, are now making money. The global supply of pulp is tightening as supply grows by 2 percent but demand climbs by 3 percent (Fig. 2). He sees markets conditions continuing to tighten in 2019. There are some major consolidations in the works, e.g., Suzano and Fibria, but even these won't offset pricing.

There were several panel discussions sprinkled through program. One looked at Trade Exposure and Trades Cases. Bonnie Myers, King & Spalding, was a featured panelist.
It was shown that there have been US$500 billion in tariffs imposed on Chinese goods as of 2019. This is for all sectors, not just forest products. This is equal to the total amount of goods imported.

Myers said the trade policies of the current US administration are confusing for many people, even "erratic and perhaps dangerous." She said that President Trump has made good on the promises he made in the 2016 campaign and added that he will be even "more aggressive" to gain concessions from trade partners.

What has led to this path? Myers pointed to four factors:

- The belief that trade deficits are a bad thing and need to be addressed. It does not matter if the trading partners are friends or foes.
- A preference to "buy American; hire American".
- Bad trade deals need to be re-negotiated or scrapped such as the trans-Pacific deal.
- Trade laws need to be strongly enforced.

Myers added that the president has signaled he intends to use "every trade remedy device in the toolbox". There is no doubt that President Trump has not been shy about taking on the traditional international trade order, i.e., the WTO. He believes the WTO dispute mechanism is broken.

Going forward, Myers advised, "Fasten your seatbelts; it's going to be a bumpy ride."

One delegate asked about the recent spate of Chinese purchases of North American pulp and paper assets. It relates back to China's need for fiber, which "trumps" tariffs and duties. But an all-out trade war brings recessionary factors into play, so demand could drop.

If a company gets involved in a trade case, what recourse does it have? Myers said it depends upon the importance of the trade to the company. It is worthwhile to defend yourself if the market is important. Get good counsel, she stressed.

GRADE OPPORTUNITIES

Turning back to specific grades, RISI's vice president, global packaging, Ken Waghorne, said although there were a lot of issues in play in the market in 2018, the North American containerboard and boxboard industries enjoyed a renaissance.

Domestic demand has grown steadily and there are new opportunities for growth. He noted that the trade balance is shifting dramatically for both sectors. The industrial production of processed food and other non-durable goods has rallied since 2016. E-commerce is boosting the impact of the rally in manufacturing although Waghorne added that it is difficult to determine exactly how large an effect it has had because data are hard to find. Still, one estimate shows that e-commerce is estimated to have added 23 billion board feet of corrugated box demand over the past five years.

Waghorne did say the boost from e-commerce will slow as overpackaging abates, citing Amazon's "frustration-free" packaging. Opportunities will arise from the decline, with paperboard already replacing plastics in numerous applications.

What does this mean for US domestic demand? Waghorne said to expect continued growth for containerboard and boxboard producers as long as the US economy remains strong. He is looking for a 3 percent increase in boxboard shipments in 2019 with a slight increase for containerboard.

Waghorne also wondered if China will be able to ban all RCP imports by 2020. He sees a decline in Chinese boxboard production of about 200,000 metric tpy between 2018 and 2020. Also, containerboard changes will dwarf boxboard changes. The loss of OCC will have a "devastating" impact on Chinese production.

In North America, the trade balance is shifting in the packaging producers' favor. US imports will still grow but more slowly. Exports will rise. Waghorne said there will be a strong increase in US containerboard exports. Already, through the first seven months of 2018, kraftliner exports rose by 30 percent. The total should reach 8 million metric tons by 2020, up from 6 million in 2018.

He also told delegates to expect more announcements of Chinese investments in offshore assets because of the RCP ban.

In terms of investments, Waghorne said seven large expansion projects in the containerboard sector will add more than 2 million tons of capacity in the next two year, but that even more is planned. Boxboard changes are more limited with two mill closures and one conversion project (Sappi).

The demand:supply balance is not expected to loosen before 2020. There should be exceptionally high operating rates for containerboard because of the great growth of exports to China.

Although it continues to decline, there have been some interesting twists in the graphic paper sector, according to John Maine, vice president, graphic papers and one of the founders of RISI.

Believe it or not, newsprint is the most profitable graphic paper grade to make in North America right now. Yet Maine expects this profitably to slide significantly beginning in 2019. This does not hide what seems to be a terminal decline in newsprint demand in North America, from 14 million tons less than 20 years ago to about 3 million tons now. Maine sees it falling further to perhaps 1 or 1.5 million tons.

What happened recently was that capacity closure led to operating rates in the 95 percent range. The tight supply also led to increased prices, which led to some restarts of mothballed capacity. However, with a 10 percent annual drop in demand, operating rates in 2019 should reach 90 percent at best.

The printing and writing paper decline trend is improving. For example, uncoated freesheet demand is down 1.7 percent in 2018 but this will worsen next year. Copy paper demand in 2018 has been good thus far but demand will decline to traditional levels seen over the past few years. For printing and writing papers, it depends on the specific grade. The biggest decline is on the mechanical side. Woodfrees are doing better. For 2018-2020, Maine sees an overall decline of about 1.3 percent annually or a total tonnage drop of 3.9 million tons.

Magazine circulation is sliding—about 1 percent last year—but single copy sales have dropped 16 percent annually. Free magazines now make up about 10 percent of the market. Magazine ad pages have declined even more sharply than newspaper advertising. Maine said he believes there it will be another four to five years before this collapse ends.

Catalogs, “junk” mail, and commercial printing have all fallen, albeit at a slower rate that what the industry has seen. Printed book have improved, up 2.3 percent/yr since 2013, and Maine sees more improvement in 20918.

In trade issues, US tariffs imposed in 2010 on coated freesheet from China and Indonesia remain. Tariffs imposed on SC paper from Canada in 2015 have been rescinded and all money collected refunded. Tariffs on Canadian newsprint and other uncoated mechanical grades have been dropped and refunded.

The biggest tariffs that remain on uncoated freesheet are on European producer Navigator, and even these have fallen to less than 2 percent from 37 percent.

Maine noted that in 2014, the US imported 800,000 tons of cut-size copy paper. With the tariffs, this fell to 200,000 tons in 2017. With the tariffs dropped, he says the country will see an increase in imports.

The only sector seeing major capital expansion on a global basis is uncoated freesheet, yet demand continues to drop. Global operating rates will fall, but not in the US. On the coated side, there are no expansions, only shutdowns or conversions.

The global increase in pulp prices is squeezing non-integrated mills. The five-year trend in declining costs in North America ended in 2017 and costs are on their way up again.

THE TAKE ON TISSUE

Well-known tissue expert Esko Uutela said recent growth in the sector has been strong, growing 1-1.4 million tpy. Tissue consumption is growing more than 3 percent annually. China leads the growth but South America is also becoming a strong market.

In North America, the away-from-home (AfH) sector has benefited from a strong economy and lower gas prices. US tissue imports are growing, now about 1 million tpy. Canada is still the main exporter but China is catching up. But, Uutela asked, will a trade war change the supply pattern?

If tariffs on Chinese tissue do hit 25 percent in 2019, it will cut imports, and other sources may not be able to replace this supply (320,000 tons). However, not all tissue categories will be affected by the tariffs so not all Chinese imports may stop.

In the US, online sales have increased but not to the same scale seen in places like China. The private label share of the US market continues to grow. By 2026, Uutela said it could reach 36 percent, up from 30 percent at present.

In Latin America, Brazil and Mexico dominate the market. There are big variations in growth because of economic and political turmoil. By the end of 2019, expect more than 250,000 tons of new capacity to hit the Latin American market. The tissue market in Asia is now more than 13 million tons with China accounting for more than half of it.

Globally, consumption is benefiting from improving economic growth worldwide, about 3 percent per year. However, too much capacity is coming online. Global overcapacity is the name of the game, Uutela said. As tissue becomes more global and dynamic, cost issues are playing a more important role.