A MUCH Different Picture

INDUSTRIAL MARKETS TAKE UNEXPECTED TURNS

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Editor's Note: The following originally appeared in the March/April 2015 issue of PalletCentral, a publication of the National Wooden Pallet & Container Association. RTA provided Hardwood Publishing Company with its most recent forecast, based on exclusive RTA member surveys, showing the expectation for new wood tie purchases in 2015.

In October 2014, when we last wrote about industrial markets in detail, virtually every market driver seemed to be pointing toward tight supplies and rising prices well into 2015. Crude oil prices were around $90 per barrel; domestic oil exploration, drilling and pipeline construction projects were on the increase; and many expected crane mat and board road supplies for the oil industry to retighten in the winter.

Railroad tie markets were vastly undersupplied, and tie buyers were aggressively raising purchase prices to close the gap. Pallet demand was increasing, and pallet plants were offering higher prices to bolster cant and pallet lumber receipts. Residential and truck trailer flooring plants were buying steady volumes of lumber, and strip-flooring prices were steady. Buyers in China, Vietnam and Mexico were purchasing record quantities of U.S. hardwoods and had shifted their purchasing mixes toward lower grades of lumber. Higher #2 and #3 Common exports worked to limit availability of ties, cants and other industrial items.

Unexpected Turns

The ink had barely dried on our October article when oil prices began to plunge. They have since fallen about 40 percent with huge ramifications for the oil industry and its suppliers.

Between the weeks ending Oct. 31 and Jan. 23, the number of onshore drilling rigs operating in the lower 48 states fell by 16 percent, according to oilfield services firm Baker Hughes. Christopher Smith, managing editor of *Oil & Gas Journal*, forecasts 30 percent less pipeline construction in 2015 than in 2014. Demand for mats and board road has fallen sharply, and mat producers have been double impacted by a glut of used mats in the market.

Also in late October, residential flooring plants announced they would slow or completely halt lumber receipts in November. Not only had their lumber yards filled up, but flooring sales and selling prices had also begun to erode. Truck trailer flooring plants also pulled in the reins on purchasing. Both flooring sectors remain cautious with purchases, with some residential plants again halting receipts in February.

October was a record month for U.S. hardwood lumber exports, but shipments slid 10 percent in November and another 16 percent in December. Declines were most severe in the lower grades, particularly Red Oak and White Oak to Asia. Sellers began to push more #2 and #3 Common Oak into domestic markets just as flooring plants were curtailing purchases, and markets were quickly overwhelmed. Consequently, mills shifted as much #2 and #3 Common lumber production into industrial products as log lengths and markets would allow.

Pricing Impacts

From mid-October through year-end, prices for green 4/4 #2&3A Common Red Oak and White Oak slid $40-$50, and kiln-dried prices fell $50 to $75. Interestingly, green prices have essentially been flat since early January, while kiln-dried prices have fallen another $45 to $60. The shift to industrial products helped keep green #2&3A Common Oak markets from getting completely swamped, and long-term contracts between some flooring manufacturers and mills also kept average prices higher than open market prices.

From mid-October through year-end, the average price spread between switch ties and green #2&3A Common Oak widened from $75 to $136/MBF as #2&3A prices fell. Mills quickly transitioned some #2&3A Common Oak production to switch ties, but the relatively small switchtie market quickly filled up, and prices have declined 7 percent since year-end.

From mid-October through year-end, the average price spread between crossties and green #2&3A Common Oak also widened, from $34 to $85/MBF. Since most crosstie orders are for 8'6" lengths, however, sawmills couldn't transition as rapidly to cutting crossties as to switch ties. Even so, crosstie production bumped up 13 percent from November to December—the first increase for that period in four years—and crosstie inventories rose at the fastest rate in 12 months, according to the Railway Tie Association (RTA). Crosstie prices have fallen 3 percent since year-end as production continues to rise.

Since mid-October, prices for pallet cants and pallet lumber have hardly budged. Pallet manufacturers now have larger cant and lumber inventories, but few have been able to push down prices since they are still low relative to other industrial products. Frame stock prices have fallen 5 percent since mid-October on top of sizeable drops earlier in 2014. Upholstered furniture production has increased, but frame stock supplies have increased faster.

Industrial Markets Outlook

In a relatively short time, several key markets for the center of the log have gone from boom to bust, and even markets that remain healthy are now seeing big supply bumps. Since the markets that slowed in the last four months are unlikely to recover in the months ahead, most industrial products will see additional downward price pressure. However, pallet stock may be an exception.

PALLET STOCK: Pallet sales are gradually expanding in parallel with the economy, keeping cant and pallet lumber supplies from getting way out ahead of demand. Producing pallet stock is still not an "attractive proposition for sawmills—all things being equal—since it sells for several hundred dollars less than most industrial products. As such, most pallet manufacturers won't be able to lower cant and pallet lumber prices to any great extent unless all other markets fill up.

RAILROAD TIES: RTA's most recent forecast has new wood crosstie purchases rising from 24.9 million in 2014 to 26.4 million in 2015. Although the forecast was issued just prior to the collapse in oil prices, we expect that collapse to have little net impact on infrastructure spending by railroads, which is generally done with an eye toward the long term. Tie supplies are rising and markets for mats and board road are faltering, however, which will allow tie buyers to reduce prices somewhat.

MATS & BOARD ROAD: New oilfield activity will remain slow into fall, as will markets for mats and board road. Global demand for oil is still rising, however, and the Energy Information Administration forecasts that crude prices will gradually rebound to an average of $60 per barrel for the year and $75 in 2016. U.S. oil production is expected to pick back up in the fall, as should demand for mats and board road.

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