

# Forest products taken to the woodshed

*The housing slump has had a big impact on the industry that provides building materials*

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Earlier this year, Ainsworth Lumber Co. Ltd., a leading Canadian forest products company, announced the permanent closing of mills in Cook and Bemidji in northern Minnesota. The mills produced oriented strand board (OSB), a structural wood panel used as sheathing in walls, floors and roofs for residential and commercial construction. The company had already closed its mill in Grand Rapids the previous August.

Company president and CEO Rick Huff, in a press release, said that market conditions since the third quarter of last year and the housing outlook going forward, especially in the United States, “do not warrant making the additional investments that would be required to make the two mills economically viable.”

The news for other wood products businesses was equally bad elsewhere in the Ninth District. In a Montana survey of the sector this year by the Bureau of Business and Economic Research (BBER) at the University of Montana, two-thirds of executives indicated that production, sales and profits in 2008 had decreased from a year earlier. Another 20 percent said business was about the same, leaving only a sliver of respondents whose businesses grew last year.

The forest products industry is not a big one compared with other major industries at the national level, representing just 1 percent of gross domestic product. But the industry is relatively more important in the Ninth District, cumulatively representing 2 percent of gross state product across district states (not including Michigan). The industry provided \$9 billion in total output in the district in 2007 and 120,500 jobs as of April 2009, the latest government figures for both measures.

But throughout the district and country, companies in the forest products industry are struggling to keep chainsaws buzzing and sawmills open, mostly because of the downturn in housing. The forest products industry is categorically composed of two sectors—wood products and paper—and is regionally concentrated in the district in northern Wisconsin, the Upper Peninsula of Michigan, northeastern Minnesota and western Montana.

Both sectors are strained, but for different reasons. The wood products industry—the focus of this article—includes logging, sawmills, millwork, wood containers and wood buildings and is highly dependent on the housing market, which is suffering a severe contraction.

The smaller paper industry, which accounts for about 30 percent of all wood harvested in the United States, has been consolidating for years as it tries to come to grips with production overcapacity. The district also has a big presence in this sector; Wisconsin has been the top pulp and paper producer in the United States for more than 50 years, but the industry continues to struggle. Ohio-based NewPage Corp., which has four paper plants in central Wisconsin, reported a 39 percent drop in sales in the first quarter of this year and said it would reduce production by 150,000 tons by taking downtime at its mills during the second quarter.

## Crumbling castles

It's no secret that a key factor for the wood products industry is the housing market. Home construction traditionally accounts for more than 50 percent of all lumber and manufactured wood products in the United States each year. Housing units authorized, a key market indicator, peaked in 2005 and began decreasing for both the United States and the Ninth District. From April 2005 to April 2009, housing units authorized in both the United States and the district decreased by about three-quarters (see Charts 1-2).

That trend, in turn, unleashed a cascade through the wood products industry: Demand for wood products in the construction of new homes dropped, which led to decreases in prices for wood products. North American demand for both lumber and OSB was down over 60 percent from respective peaks in 2005. The nationwide composite lumber price, which is designed as a broad measure of price movement in the lumber market, decreased almost 50 percent—from \$386 to \$198—from May 2005 to May 2009. Price declines appeared to

be fairly uniform; for example, both the nationwide composite and the north central prices for OSB dropped by 50 percent over this period (see Chart 3). Prices received by many producers in the north-central region (which includes Michigan, Minnesota and Wisconsin) also are often lower to boot. For example, the OSB price in the north-central region maintained a 15 percent to 20 percent discount of the national price during both the boom and the subsequent decline.

The dual drop in demand and prices has translated into a large drop in sales for many wood products companies. For example, U.S. and Canadian structured wood panel production totaled 5.4 billion square feet in the first quarter, 14 percent below the fourth quarter of 2008 and 33 percent below the first quarter of 2008, according to the latest Engineered Wood Association quarterly production report.

Though recent statewide data for wood products sales are not available, sales among a few major firms in the district show a sharp drop. Norcraft Cos., based in Eagan, Minn., manufactures cabinetry and other wood products and is the largest wood products manufacturing company headquartered in the district. The company saw a 30 percent drop in revenue (to about \$61 million) during the first quarter of this year from one year ago and a 44 percent drop from the first quarter 2006, when the district housing boom was in full swing. The company also reported a \$4.3 million loss in the first quarter.

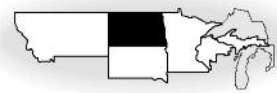
Many other multinational forest products corporations with operations in the district are also struggling. Louisiana Pacific, a leading manufacturer of basic building products, has siding plants in Hayward and Tomahawk, both in northern Wisconsin. Those plants reported a 41 percent drop in sales in the first quarter of 2009 compared with the previous year.

With lower sales, wood products companies have cut production, leading to layoffs across the industry. From April 2005 to April 2009, the number of employees in the wood products industry in both the United States and the Ninth District has dropped about 30 percent (see Charts 1-2).

Plum Creek Timber Co., the largest private timber owner in the United States, has its largest acreage in Montana, and additional timberland and operations in Wisconsin. The company, based in Seattle, Wash., provides a diverse line of lumber, plywood, medium-density fiberboard and raw materials. Due largely to the housing slump, the company reported losses from the wood manufacturing business of \$30 million in 2008 and \$18 million in the first quarter of this year.

The company has responded with a series of layoffs at Montana plants this

NORTH DAKOTA



## Bismarck Island

In today's economic gloom, Bismarck is a beacon of light. So says an index by Moody's economy.com.

The site classifies the economic status of 381 metro areas based on six-month growth figures. Every metro in the country—save one—is classified as in recession. The loner is Bismarck, which has been helped by rebounding energy prices in the nearby Williston Basin, not only helping private activity in that part of the state, but also proping up tax revenue at the state capital.

Bismarck is close to losing its special status; the online site lists the city as “at risk” for falling into recession and notes that slowing growth of personal income might pull the city into an official contraction, but one that would not likely be very deep, or prolonged.

## A sunny day for farm insurance

The federal government has long been involved in providing insurance to farmers to help them when Mother Nature doesn't cooperate.

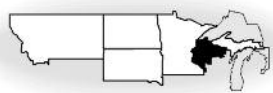
For example, in June the insurance program for sunflower farmers was expanded by the federal Risk Management Agency to include guarantees for both seed yields and prices, the latter being particularly relevant because prices have fallen considerably in the past year. The other half of the story is that prices spiked in 2007 and 2008, rising to about \$22 per hundred pounds, and remained above average over the past decade, according to data from the U.S. Department of Agriculture. All of this bodes well for growers in North Dakota, the nation's leader in sunflower production.

State farmers are also hoping for better government-subsidized insurance policies for hay and rangeland. The current program for forage insurance began in 2007 to help livestock farmers deal with drought. It uses either a rainfall or vegetation index—but not both—to determine when losses occur. North Dakota uses a rainfall index, and the state's ag secretary petitioned the RMA to give farmers there access to the vegetation index as well because the state has a limited number of rainfall reporting stations, which can skew local rainfall results—hypothetically, at least. According to an Associated Press report, the program paid out on 85 percent of policies in its first two years without the vegetation index.

—Ronald A. Wirtz

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### WISCONSIN



## Dropping all the way to #1

Wisconsin recently became the nation's number one state for manufacturing, but it might be forgiven for not feeling very celebratory because it assumed the throne somewhat by default.

According to federal data, 15.6 percent of the state's workers are employed in manufacturing—just a shade over the 15.4 percent rate for Indiana, the former champion. Wisconsin grabbed the top spot despite shedding more than 61,000 manufacturing jobs—almost 13 percent of all jobs in the sector—from the most recent May-to-May period.

That job loss cut manufacturing's share of jobs down from 17 percent, but demonstrates the job devastation in the Hoosier state, where manufacturing once enjoyed a rate of 17.8 percent.

## Go ahead, hit me

Drivers in Wisconsin might feel both better protected and poorer next summer, when a new state law goes into effect mandating car insurance for all residents.

Starting in June of next year, it will be a crime for state drivers to go without car insurance, complete with a \$500 fine. However, some might be willing to roll the dice, as the only enforcement mechanism is a check by police during a traffic violation. Drivers will be expected to carry proof of insurance; a small fine of \$10 will be doled out for those who have insurance but no proof. The law doesn't yet specify how exactly police will be able to determine who has insurance but isn't carrying it and who is simply lying. Drivers will also be required to carry underinsured motorist coverage.

The new law might feel like a drastic step, but Wisconsin is simply catching up: 48 other states currently mandate car insurance. New Hampshire is now the lone holdout.

Critics argue the new law hurts low-income drivers, who can't afford the hundreds of dollars in new insurance and are likely to continue doing without. Ironically, the law might do little to provide universal insurance protection. In 2007, 15 percent of drivers in Wisconsin were uninsured, according to the Insurance Research Council. That was only a shade less than the 13.8 percent for those states with mandatory insurance laws.

—Ronald A. Wirtz

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year. In March, for example, the company permanently shuttered a plant in Fortine, affecting 74 workers; in June, a total of 150 people were laid off when mills closed at Pablo and Kalispell, and another 23 were laid off in Columbia Falls when operations there were scaled back.

Wood products companies have tried to diversify into new markets to dilute their risk in any one sector. Some large companies produce paper and allied products in addition to housing-related wood products. Some, like Plum Creek, have started to leverage their forest and other land holdings for revenue through real estate development, tourism or other activities. Still other companies are doing research into biomass applications for wood products and byproducts. Logging companies are also looking at different types of end users for their forest products.

But none of these markets is large or lucrative enough currently to overcome the impact of the housing slump. For example, most of Montana's industry executives are pessimistic about 2009, based on the BBER survey. More than 90 percent anticipate that production, prices and sales will be about the same or worse in 2009 compared with 2008.

In Minnesota, total industrial wood consumption (defined as in-state harvest plus imports minus wood exports) is expected to hit bottom at approximately 2.8 million cords this year, according to a report by Don Deckard, state forest economist at the Minnesota Department of Natural Resources. This compares with 3 million cords in 2008 and a peak of 4.3 million cords in 2005.

This industry will be largely tethered to the pace of recovery in the housing market. In general, though the rate of decline has slowed, housing market indexes do not yet show clear evidence that housing markets have bottomed out. The decline in monthly and quarterly housing units authorized from a year earlier in the Ninth District and United States has held relatively steady since January; worse, the trend line on housing authorizations (see Charts 1-2), combined with expected economic conditions in the near term, does not suggest a quick reversal.

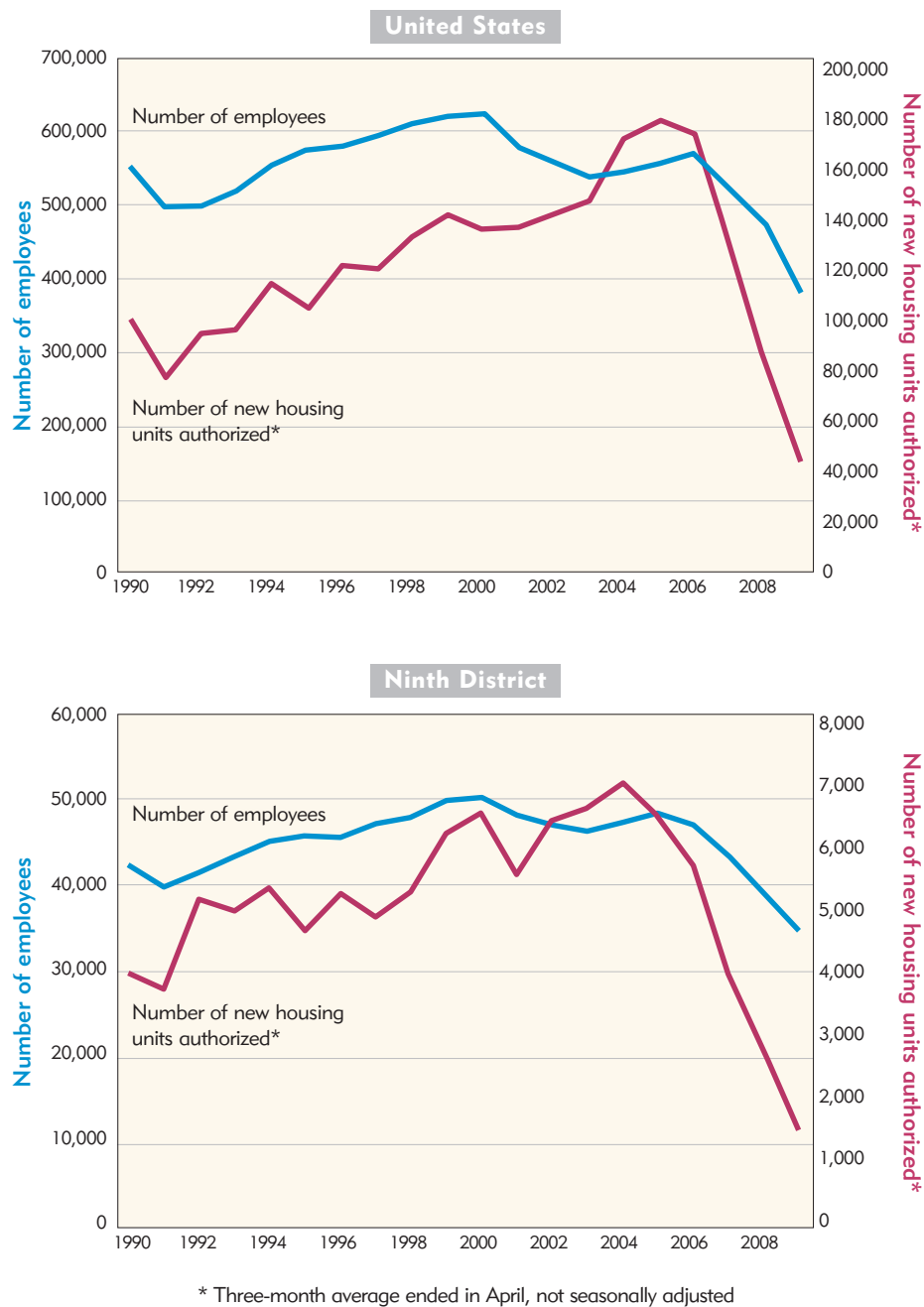
The latest projections for housing unit authorizations by the Minneapolis Fed predict continued decreases from most district states through the fourth quarter of this year. (For more forecast details, go to [minneapolisfed.org](http://minneapolisfed.org).)

The good news is that the forecast calls for a strong recovery of at least 15 percent among all district states in 2010. The bad news: Authorizations in district states next year will still be 30 percent to 65 percent below peak levels of the housing boom. So despite the expected upturn next year, many firms in the wood products industry will have to work hard to avoid the woodshed. **f**

Charts 1-2

### Wood products employment follows housing slump

Industry employment and housing units authorized (Month of April)

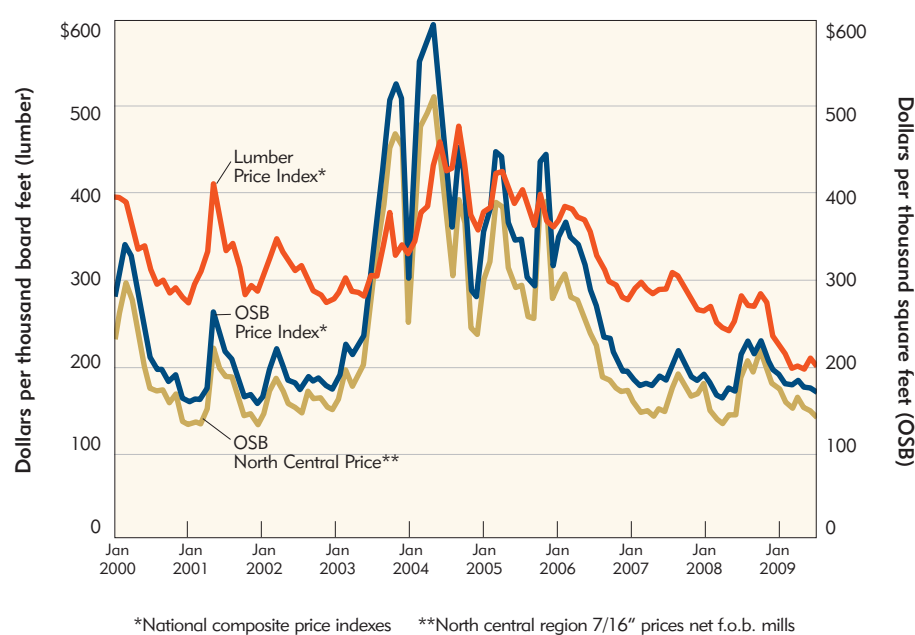


Sources: Bureau of Labor Statistics; U.S. Census Bureau

Chart 3

### Wood products prices are falling

Lumber and oriented strand board



Source: Randon Lengths Publications