

Forestry & Logging Industry Update

GTSF Investments Committee | October 25, 2022



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Effects of Covid-era

Rising interest rates have taken an ax to one of the pandemic's hottest commodities. Wood prices crashed in the early days of the 2020 lockdown but later exploded that summer when Americans stuck at home increased their home improvement projects. 2x4 prices tripled the pre-pandemic record in an early sign of the inflation and broken supply chains that would hinder the economy reopening.

When the pandemic set in, sawmills shut down like a variety of other businesses. The housing market immediately took a dive, and people started shorting lumber futures. No one thought there was a housing boom coming. Due to early attractive low mortgage rates, demand for lumber drastically increased from fixer-uppers, hobbyists, and new homeowners. Soon, dimensional lumber started flying off shelves, and Lowe's and Home Depot's share prices reaped the benefits. Sawmills reacted by ramping up capacity but couldn't keep up with demand due to supply chain issues and covid-inflicted protocol. Southern sawmills saw a drastic increase in profits but further up the supply chain, timber growers didn't luck out.

Growers supply mills with logs and mills turn logs into dimensional lumber. Usually, prices for logs and lumber move in unison, but lately, prices have diverged, which caused southern timber growers seeing no increase in log prices. The problem is that there are so many trees. Between 1980 and 2020, the volume of wood per acre timberland in many southern counties has more than quadrupled. This is due to the government paying people to plant more trees in the 1980s as an effort to control the supply of corn and soybeans to

Lumber futures price, weekly

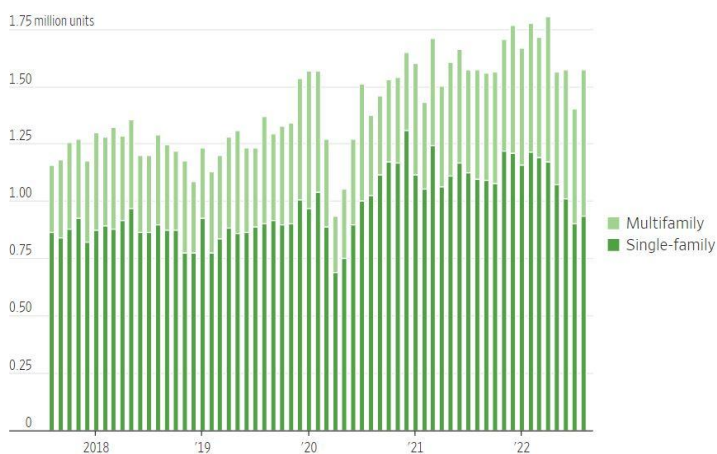


Note: Continuous contract
Source: FactSet

remove farmland from circulation. Currently, supply and demand are unbalanced. Lumber is in excess demand, while logs are in excess supply. Experts suggest it will take a decade to correct itself.

More recently, lumber prices have fallen to their lowest level in more than two years, bringing 2x4s back to what they cost before the pandemic building boom & pointing to a sharp slowdown in construction. As of October 7th, 2022, lumber futures are at \$445.60 per thousand board feet, down about 1/3 from a year ago & more than 70% from their peak in March, when the Fed began raising interest rates to fight inflation.

U.S. housing starts



Note: Seasonally adjusted annual rate
Source: U.S. Census Bureau via St. Louis Fed

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Outlook on the Industry

Now that supply issues have eased and the highest mortgage rates in more than a decade have slowed home sales, buyers are no longer hoarding lumber for fear of it running out. The rate at which new U.S. housing is being built is down about 13% from April, when residential construction activity hit its highest level in more than a decade, according to the Census Bureau. The increase in multifamily buildings has offset a sharper decline in the construction of single-family homes, which typically use about three times as much lumber per unit as apartments.

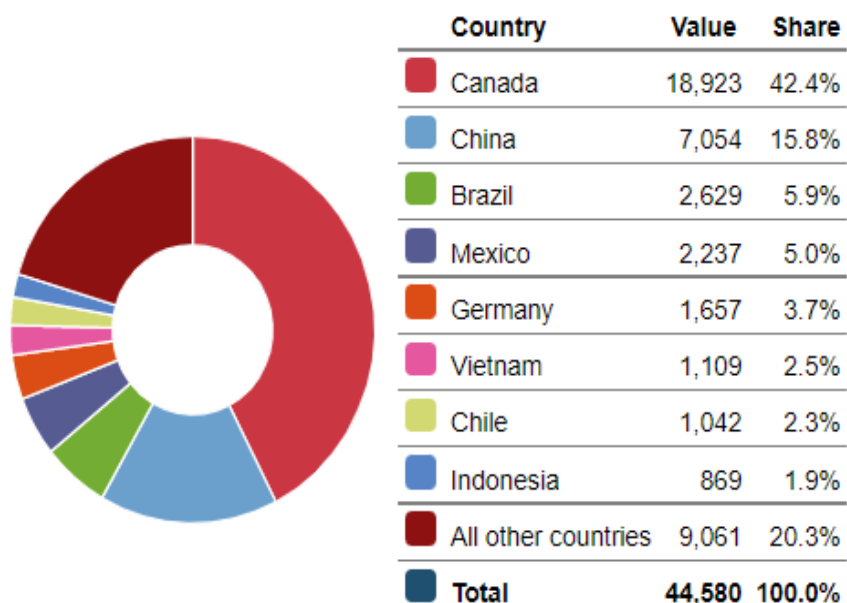
Global Outlook

Canada, China, and Brazil are the largest exporters to the U.S. for forestry products. Since peaking in 2018, U.S. forestry imports have decreased by ~7%. Canada, Mexico and China are the largest importers of U.S. forestry. The U.S. maintains strong relationships with Canada and Brazil, but growing tensions with China could cause trading relationships to be harmed. Global unrest and worsening economic conditions following the pandemic have resulted in imports and exports decreasing.

As political tensions grow between China and Taiwan, there is the potential of a Chinese invasion of the island state, which would result in counteractions from the U.S. A restriction on trading would likely be a part of these counteractions, greatly reducing the number of forestry products being imported and exported by the U.S.

China remains the world's largest exporter of wood, holding 12.8% of the global market share, with Canada remaining the second largest exporter of wood, with 12.3% of global market share. The continued strength of Canada's forestry economy is vital for the U.S.'s forestry-dependent industries. Canada's forestry industry is a large exporter of newsprint, which has seen more than a 65% fall in demand since 2000, weakening the overall industry. Worldwide demand for forestry products is expected to stay constant at post-pandemic lows until economies emerge from their current positions or until a global conflict arises, which could impact trading relationships and increase short-term demand for forestry products.

U.S. Forestry Imports



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