Supply and Exports Remain Key to Sustaining Containerboard Market Gains

Despite continued weakness in key sectors of the economy, containerboard markets staged a remarkable recovery during 2010. Producers again demonstrated their expertise in managing supply and this coupled with improved box cutups and solid export demand allowed mills to implement two price increases — the first gains realized since 2008. With markets stabilizing during the second half of 2010, the challenge will be to sustain these gains in 2011.

By Harold M. Cody

After surviving the 2008-2009 economic downturn, containerboard markets staged a remarkable comeback in 2010. Mill profitability reached the point that capital spending projects even began to be announced that largely targeted cost reduction and conversion projects, not new capacity. Nevertheless, 2010 was a roller-coaster year for the industry, with tight containerboard supplies leading to a strong recovery in prices in the first half, followed by a transition during the second half of the year to a more balanced market.

The turnaround was driven by improved domestic demand for containerboard, cost pressures such as rising OCC prices and strong export linerboard shipments, which combined to move operating rates to high levels for much of the year. And producers carefully controlled supply to match demand by shuttering considerable capacity in 2009 in response to the unprecedented 8% plummet in U.S. box demand in 2009 and a 13% drop registered since the recession induced downturn began in 2006.

Of all the factors that contributed to the rebound, certainly nothing was more critical than a long awaited improvement in underlying demand by the US economy for corrugated boxes. Despite continued weakness in key sectors such as housing, and painfully high unemployment levels that remain over 10%, the overall economy has bounced back following the recession aided by gradual inventory rebuilding throughout the economy.

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A major contributor to improved box demand was a rebound in consumer spending, which finished the year on a positive note. Total consumer spending over the 50-day holiday shopping period rose 5.5% compared to the same of 2009, which was the biggest gain since a 4.9% increase in 2007. Real GDP, the broadest measure of economic activity, grew 2.6% in the third quarter.

Improved Shipments, Production

These factors combined to produce the first rise in US corrugated box shipments since 2006. Shipments for the year appear likely to be up around 3.4% vs. 2009 which would be the biggest rise since the early 1990s. While this would only make up part of the 13% cumulative decline in shipments over the 2007-2009 period it's nevertheless a notable improvement. The slump in box demand began with a gradual trend down in shipments in the second half of 2007, followed by a plummet in demand in mid-2008 as shipments fell by by10-15% vs. the prior year level from third quarter 2008 to mid- 2009.

Corrugated box shipments held up well into late-2010 although the rise in demand began to taper off late in the year. Shipments were 28.6 billion ft² (bsf) in November, up 5.4% from a year ago on an actual basis, but when compared on an average week basis, they only registered just a 0.1% increase according to the Fibre Box Association.

Through 11 months box shipments are 3.4% higher than the prior year at 327.7 bsf on actual and 3.0% on an average-week basis, adjusted for an extra shipping day this year.

On an annualized basis, shipments for the year are estimated at 357 bsf. To put this volume in perspective, 2006 shipments were 395 bsf and then as the downturn intensified they fell steadily to 374 bsf in 2007, before bottoming out at 344 bsf in 2009.

Total containerboard production has also recovered and is up 7.8% at 30.98 million short tons through November, according to AF&PA. Linerboard production over the same period is up 8.6%. Operating rates recovered as well, running at 95.8% year to date. Production for export, at 2.96 million tons, is up 5.4% through November compared to the same period in 2009. Production levels have eased however, as containerboard production in November was 2.76 million tons, up 1.2% over the prior year level.

Pricing Power

Driven by these favorable conditions, mills finally regained pricing power following a steady fall in prices that started in late 2008 when prices fell to the mid-$500 level where they remained into mid-2009. Prices bottomed out in late 2009; however, as conditions improved mills for the first time in four quarters were able to implement a $50/ton price increase in January 2010 and quickly followed with a $60/ton rise in April that moved prices up to about $640/ton. Producers attempted an additional increase, but as the market tightness eased an increase announced in the fall for $60/ton failed.

The recovery in prices, at least to the degree it occurred, was somewhat surprising. Demand was expected to improve in 2010 in large part because it simply couldn't get any worse, but the initial gains were stronger than expected given the mixed economic news. Also, it wasn't certain that exports, which had been a key in sustaining the market during 2010, would be sufficient to propel the level of improvement that occurred. However, exports continued to divert volume from the domestic market as they continued to grow. Export liner production for the year is up 5.4% through November. And even more importantly, producers acted aggressively to closely match supply to demand.

Looking Ahead

So now the question is: Will 2011 be more of the same or will conditions weaken such that producers give back their hard won gains? Certainly inventories will bear watching if mills are to avoid a major relapse on pricing. At 2.27 million tons, or 3.8 weeks of supply, US containerboard inventories in November were in the range that normally indicates market stability. However, following very tight levels last spring, inventories have risen for the last 6 months. It is important that either domestic or export demand growth, or possibly downtime, occur in order for inventories to remain in balance near-term.

Export demand remains a key factor. Latin America accounts for the largest portion of US kraftliner exports and based on the outlook in this region it appears shipments to the area will remain steady. The biggest questions are Europe, Asia and the Middle East, which are far more volatile. Given the recent weakness in export pricing, it appears that Europe and Asia are pulling back some on tonnage. If demand by these regions slips significantly, whether driven by increased local supplies or buyers holding back in anticipation of better pricing ahead, it will be tough for the domestic market to make up the difference even if box demand continues to grow.

The overall outlook is cautiously optimistic if the prevailing winds continue to blow in the same direction as they did for much of 2010, i.e. if export demand remains solid and producers continue to closely monitor supply. Many market observers are predicting that containerboard markets will see additional improvements this year. The major downside risk is that it will be hard to once again duplicate all the good things — rising exports, expanding demand, big increases in fiber costs — that combined to produce such a strong recovery in 2010. ■

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