STRUCTURAL BUILDING COMPONENTS MAGAZINE (FORMERLY WOODWORDS)
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Economic Environment

"New Economy, Old Problems: Excess Capacity in Solid Wood Products (& lots of other commodities)" by Al Schuler

We have a great new economy based on new industries, increased productivity and the like. But, we still have some of the problems inherent in the old economy. During the past four years, the U.S. economy averaged four percent or more real economic growth (GDP), led by massive business investments in productivity enhancing technology like computers and telecommunications. At the same time, the rest of the world saw limited economic growth, and in an effort to deal with domestic weakness, they added capacity for steel, autos, semiconductors, computers, furniture, etc. with one goal in mind—export to the USA!

Back home, these were also great times for the North American forest products industry as record U.S. residential construction activity drove demand for building materials providing higher prices and profits. And, as in the past, the industry ploughed much of these profits into new capacity. Unfortunately, we may have added too much capacity too quickly as is evidenced by Figures 1 and 2, and it will take another year or two before demand and supply come into a better balance.

CLICK ON IMAGES FOR LARGER VIEW

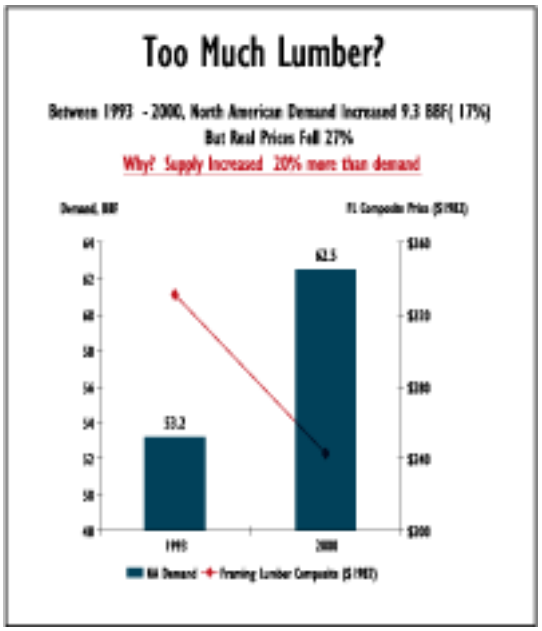

FIGURE 1
OVER-CAPACITY IN SOFTWOOD LUMBER MARKETS

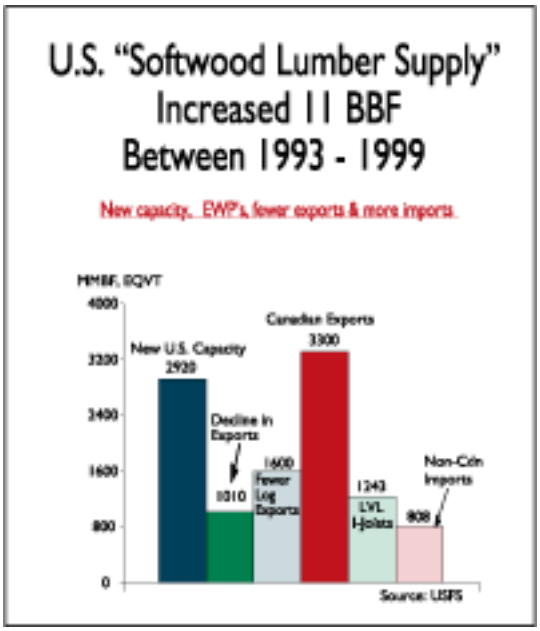

FIGURE 2
THE MANY SOURCES OF SOFTWOOD LUMBER SUPPLY

How did globalization, increased domestic capacity and weak export markets impact lumber supply? (Figure 2) Every country wants to export to the U.S. Non-Canadian exports are up 800 million BF while Canadian exports are up 3.3 BBF. A strong U.S. economy encouraged U.S. producers to increase capacity almost 3 BBF, while weak off shore economies and a strong U.S. dollar reduced overseas demand for U.S. logs and lumber almost 2.5 BBF. In addition, efforts to serve customers with better products such as Engineered Wood Products (EWPs such as LVL and I-Joists) increased supply another 1.25 BBF. Even EWPs have over-capacity problems as is evidenced by the margin erosion currently being experienced by the MSR industry (WOODWORDS June/July 2000). Finally, over-capacity is also becoming a problem for OSB. One answer to over-capacity is creating demand with new or enhanced products designed to make customers more profitable (more on this to follow).

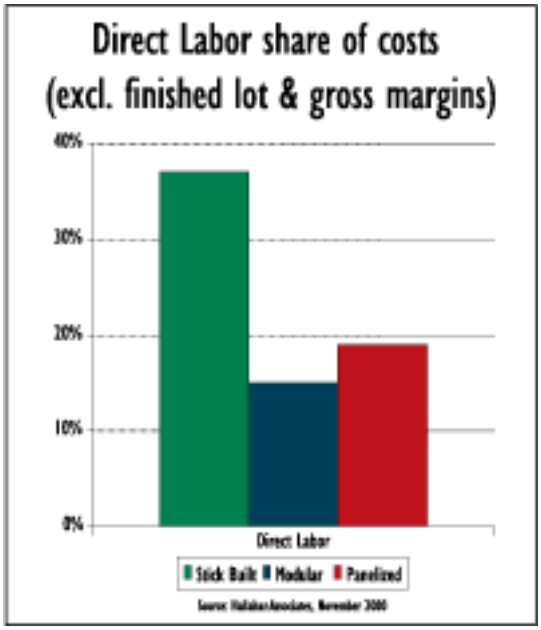

FIGURE 3
LABOR COSTS ADVANTAGES OF MANUFACTURED HOUSING

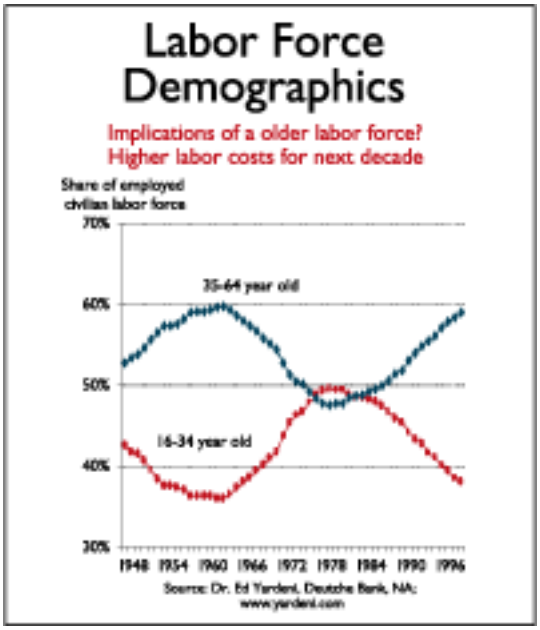

FIGURE 4
LABOR SUPPLY PROBLEMS WILL BECOME MORE ACUTE IN FUTURE

LOOKING FORWARD

The situation today is potentially ominous because all three major world economies, Japan, the U.S. and Europe are either in recessions, or pulling back. In the past, when the U.S. economy slowed after excessive growth, Japan was there to take up the slack. This isn't the case this time as Japan's economy has been in funk for a decade, and that means little help from the export side, which could further exacerbate the excess capacity problem here at home. Since, over the next six to 12 months, the world economy is expected to get worse before it gets better, Asia will try harder to export to the U.S. using currency devaluation as a primary tool.

Excess capacity isn't just a problem with the forest products market. The recent Nasdaq correction is a reflection of companies and investors realizing that “what goes up, also comes down.” We built too much new world capacity for computers, chips, fiber optics and telecommunications, while at the same time we have too much “old world capacity” like autos, steel, aluminum and other metals.

IMPLICATIONS FOR THE BUILDING COMPONENTS INDUSTRY

Periods of excess capacity are a way of life (i.e. capitalism) and we need to learn how to deal

with them. Fortunately, we have a vibrant housing industry in the U.S., and looking forward, the industry's growth prospects look strong. Here's why: demographics, including immigration, are very favorable for new housing and vacation homes; the aging housing stock (120 million strong) needs lots of repair; and productivity and global competition will keep a lid on inflation thus keeping mortgage rates very attractive for the next decade.

So, how to deal with over-capacity? Figure out how to make your customers more profitable and demand will take care of itself! The National Association of Homebuilders (NAHB) regularly conducts surveys to identify the issues and problems facing its members, and year after year, shortages of skilled labor are at the top of the list, in addition to declining lumber quality. In order to manufacture top quality homes, cost effectively and profitably, they have to reduce labor content and automate the construction process. (Figure 3). We know from demographic studies that labor problems will only get worse over the next decade, so here is an opportunity for the building components industry (wood, steel, concrete, etc.) to work with your main customer, the housing industry, in order to develop viable solutions (Figure 4). In essence, they are adopting a “new business model” or “paradigm” with engineered building systems for the wall, roof and floor as a key part of the strategy. On the nonstructural side (e.g. architectural moldings, trim, fireplace mantels) the housing industry is already well into the transition as much of this material is now being supplied by manufacturers specializing in the production of rough, semi and fully finished parts or components.

A new, more competitive business model is also being adopted by the domestic furniture and kitchen cabinet industries. Automation is being used with more semi- and fully-finished components in the assembly of furniture and kitchen cabinets in order to reduce costs and compete with cheap imports. The auto industry switched to components and focused on car assembly in lieu of manufacturing a car from scratch in order to compete with imports from Asia about twenty years ago. Some industries, such as textiles and shoes, failed to make the switch to a more competitive business model and have ceased to exist in this country.

Components and engineered systems are the future. Figure out how to help your housing customers, including repair and remodeling customers, remain competitive and profitable because if you don't, they will find other supplier partners who will, or even worse, some of your customers may disappear completely.

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