



TD Economics

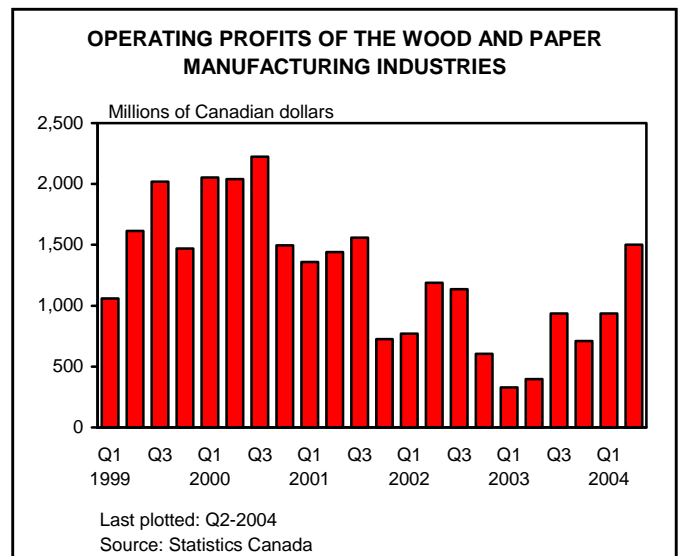
Special Report

September 2, 2004

RECENT TRENDS & OUTLOOK FOR CANADA'S FOREST PRODUCTS SECTOR

Canada's forest products sector has faced a number of serious challenges in recent years, including punishing U.S. duties on softwood lumber exports, an unprecedented rise in the Canadian dollar and sky-high energy prices. However, the sector has prevailed and 2004 is turning out to be a surprisingly good year. Prices and shipments – with the exception of newsprint – have risen significantly, while the pace of appreciation in the Canadian dollar has slowed. Together these factors have dramatically improved profitability at many firms. While some companies are still experiencing losses, total operating profits for the sector reached \$2.44 billion in the first half of 2004, which surpassed the \$2.37 billion realized for the full year of 2003. Wood manufacturers have led the way, with profits totaling \$1.5 billion in the first half of this year – a far cry from the meagre \$2 million recorded during the same period a year earlier. Profits achieved by paper manufacturing (including pulp) were \$0.9 billion in the first half of this year, a 28 per cent increase over the same period in 2003.

Looking ahead, the forest products sector will face a new set of hurdles. Lumber and pulp prices are expected



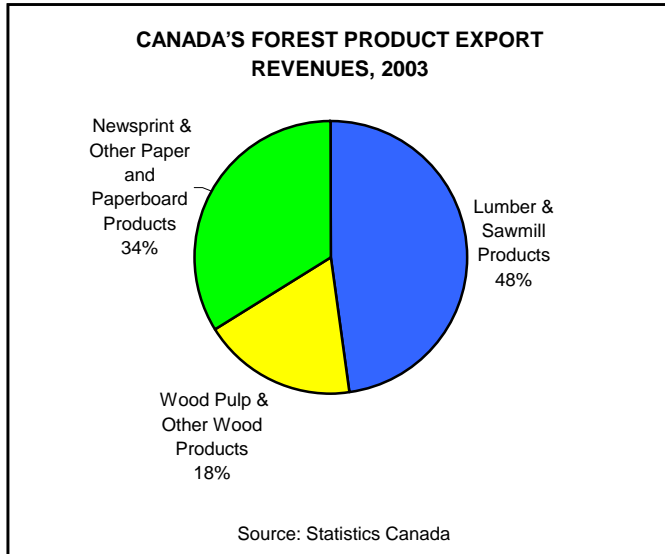
to experience a pullback, but are likely to remain at healthy levels. Meanwhile, newsprint is anticipated to eke out modest price gains. A rising interest rate environment will dampen residential construction, constraining lumber demand in the coming year, while slower world economic growth points to a softening in pulp demand. Higher interest rates may also lead to increased debt service costs. A slightly stronger Canadian dollar will also constrain revenue growth. Nevertheless, while these trends suggest a more challenging year in 2005, the outlook is for aggregate operating profits to remain in the black.

Economic importance of forest products

Before delving into a discussion of recent trends and the outlook, it is worth spending a moment explaining the importance of the sector. The forest products industry –

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encompassing logging, wood products manufacturing and pulp and paper manufacturing – represents roughly 3 per cent of Canada's economy. Moreover, the sector has directly employed between 240,000 to 285,000 workers annually since 1990, equivalent to about 15 per cent of total employment in the manufacturing sector (including logging). And, these figures mask some of the significance. For example, the forest products industry is disproportionately important to certain provincial economies, like British Columbia, which accounts for nearly half of Canada's softwood output.

Section I. Recent Trends and Forecasts

Lumber

Recent Trends

Punishing duties imposed by the United States on Canada's softwood lumber exports have not deterred Canadian lumber output or exports. Nor have the duties marred the splendid financial performance of the lumber industry this year.

The duties were first imposed on a preliminary basis starting with a countervailing duty (CVD) of 19.3 per cent in August 2001. This was followed by an anti-dumping duty (ADD) of 12.6 per cent in October 2001. When the final rates were set in April 2002, the CVD rate was lowered to 18.8 per cent and the ADD rate was reduced to 8.4 per cent. Even with the reductions, the rates were still punitive, totaling 27.2 per cent. Those rates became effective on May 22, 2002 and created concerns about the

Special Mention: Oriented Strand Board (OSB)

OSB is one of the greatest success stories in the wood products industry. It has already surpassed plywood in the housing market. OSB is a structural panel product made from wood strand flakes or wafers bonded with exterior-grade adhesives. It is widely used in residential construction and is gaining acceptance in the commercial construction industry. Its applications include subflooring, underlayment, roof sheathing, wall sheathing and exterior siding.

There are presently 25 OSB mills in Canada, almost double the number that existed in 1987. This is in stark contrast to the number of plywood mills, which shrank to 11 in 2004 from 18 in 1987. A similar shift transpired in the United States where the number of OSB mills expanded to 39 from 24, while the number of plywood mills dwindled to 68 from 121 over the same period. Further expansion in the OSB industry is expected over the next few years although its growth rate will likely slow as the industry matures. Last year, an OSB mill started in Meadow Lake, Saskatchewan. A new OSB plant is scheduled to start up in Fort St. John, British Columbia in September 2005 while another project is planned to begin production in Bearn, Quebec in late 2005 or early 2006.

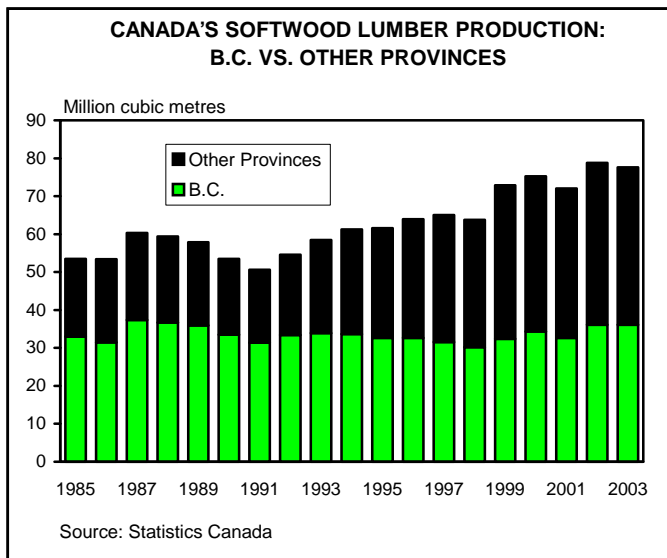
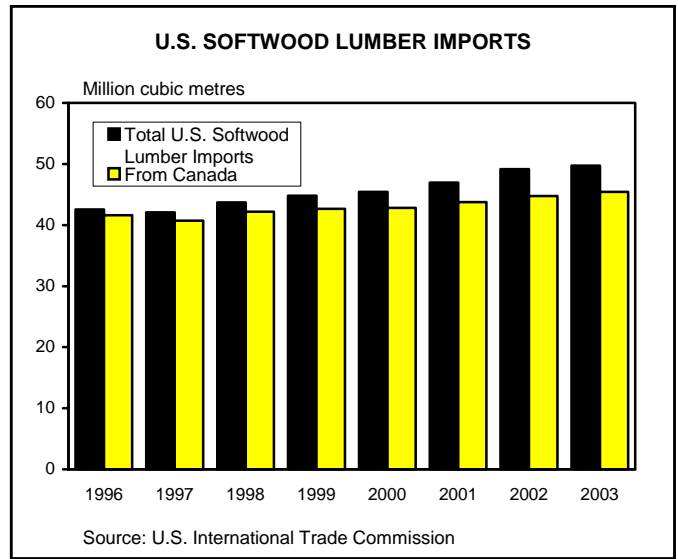
OSB had a magnificent price run last year when prices for the benchmark 7/16-inch product manufactured in the U.S. North Central region more than tripled in the nine months to September 2003 and stayed at those lofty levels for the next two months. Although prices dropped abruptly in December, they subsequently regained their footing and resumed their rising trend until April 2004 before retreating. OSB benefits disproportionately more than plywood in a strong housing market, as a single family home in the United States is estimated to utilize 13,000 square feet of structural panels, of which 74 per cent is OSB and 26 per cent is plywood.

prospects of the lumber industry.

Despite these fears, the volume of Canada's annual softwood lumber production surged by 9.4 per cent in 2002 before falling by 1.5 per cent in 2003. However, the decline in 2003 proved to be quite limited, as it left the level of Canadian lumber output at the second highest on record. The pullback in 2003 was partly due to forest fires in British Columbia, which reduced lumber harvests for several months during that year. And, the retreat proved transi-

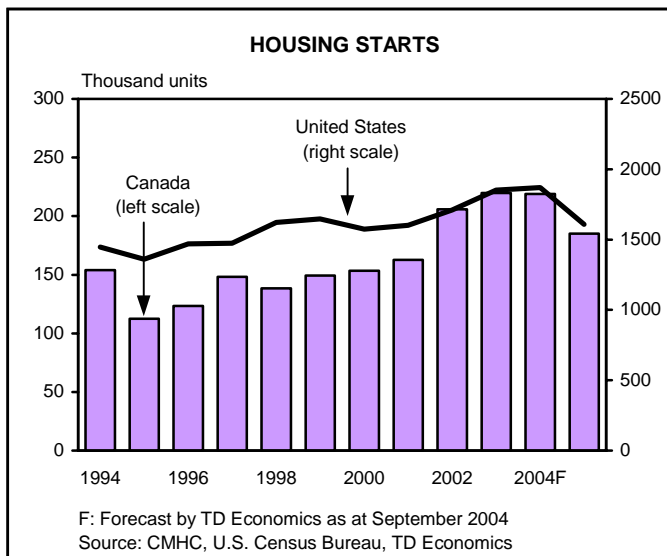
tory, as Canadian lumber production rose 1.4 per cent in the first five months of 2004 relative to year-earlier levels.

The increased production this year has been fuelled by strong domestic and U.S. demand for lumber that can be traced to booming residential construction. U.S. housing starts, which ran at 1.6 million units a year from 1998 to 2001, leapt to 1.7 million units in 2002 and climbed to 1.9 million units in 2003. For the first seven months of this year, the annualized rate rose to 1.94 million units. In Canada, housing starts jumped to 206 thousand units in 2002 and 220 thousand units in 2003 – well above the annual average of 151 thousand units in the preceding four-year period. From January to July this year, Canadian housing starts were running at an annualized 230 thousand units.



sand units. The main driver behind this strong residential construction activity is the highly stimulative stance of monetary policy in both the United States and Canada in recent years, which resulted in record low mortgage rates and high levels of housing affordability.

The strong demand supported exports and fuelled a remarkable rally in lumber prices. The volume of Canada's softwood lumber exports to the United States rose by 2.3 per cent in 2002, a further 1.6 per cent in 2003, and almost 7 per cent in the first four months of this year. Prices increased by 30 per cent over the twelve-month period to December 2003 and gained another 55 per cent over the next eight months. Prices for the benchmark western spruce-pine-fir soared to US\$470 per thousand board feet in late August 2004, a level not seen since 1993.

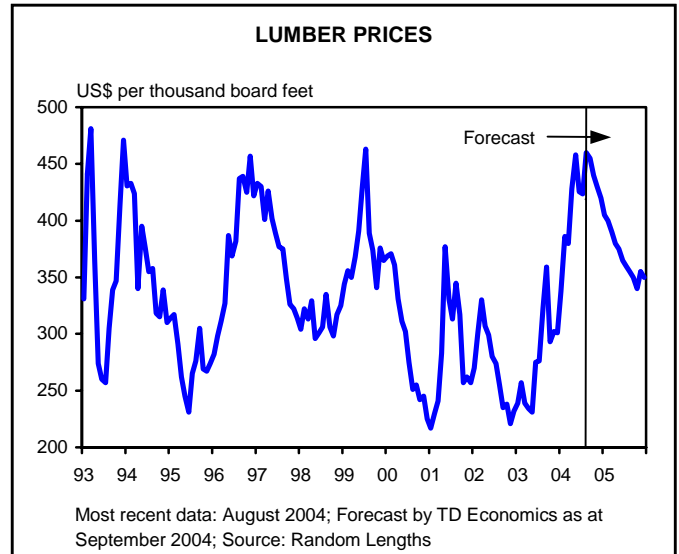


Despite this positive performance, the negative impact of the duties can be seen in the gradual erosion of Canada's share in the U.S. market. Although Canada remains the dominant lumber exporter to the United States, its share of the U.S. import market has fallen from 98 per cent in 1996 to 90 per cent in the first four months of this year. Conversely, offshore suppliers, who are not subject to the same punitive duties, are gaining an increasing foothold in the U.S. market, increasing their share of the total U.S. import volume to 10 per cent this year, from just 2 per cent in 1996. Thus, while Canadian softwood lumber exports to the United States have risen in recent years, it can be argued that exports would have been greater if the tariffs had not been imposed.

Outlook

A key hurdle for the lumber sector going forward will be a rising interest rate environment. The U.S. Federal Reserve and the Bank of Canada are expected to gradually tighten monetary policy over the course of late 2004 and 2005. This will lead to higher mortgage rates, which will dampen demand for new homes and lead to lower housing starts. Due to the strong performance in the first half of this year, housing starts in the United States for 2004 as a whole will likely be even higher than last year's record level of 1.8 million units. Next year, however, housing starts will likely fall to about 1.6 million units, a decline of 14 per cent. Even so, this will still be a comparatively high level. A similar trend is expected in Canadian housing starts. The tally for this year will likely stay close to last year's 15-year high of 220,000 units, but it is expected to fall by about 16 per cent in 2005. The anticipated 185,000 units will still be considerably above the levels in the years prior to the extraordinary leap in 2002 and will be modestly above the estimated demographically-supported level. Furthermore, expenditures on repair or upgrading of old houses will likely continue to lend support to demand for lumber. Consequently, while a pullback in residential construction will lead to a retreat in lumber prices, they are still likely to end this year 40 per cent higher than in December 2003. Prices are then vulnerable to a sharp correction in 2005, with an expected decline of about 17 per cent over the next twelve-month period. Despite this drop, prices will remain almost 60 per cent above their recent trough of November 2002 and will remain profitable to the industry.

A key question mark to the outlook is the eventual resolution of the softwood lumber dispute. The outcome will likely be either significantly lower duties, the negotiation of a stipulated duty-free export quota, or no duties at all. In a preliminary administrative review released in June of this year, the U.S. Department of Commerce proposed to slash the duties on Canadian softwood lumber. The countervailing duty would be cut from 18.8 per cent to 9.2 per cent, while the general anti-dumping duty would be reduced from 8.4 per cent to 4.0 per cent. Then on July 30, the DOC proposed to further reduce the CVD rate to 7.82 per cent. The ADD rates may also be lowered. The World Trade Organization (WTO) issued a ruling on August 11 that indicated that it did not agree with the U.S. method of ignoring certain sales in calculating the duty.



As a result, the WTO required that the ADD be recalculated. Even without a revised calculation for the ADD, the total duties are already poised to drop substantially, from the current 27.2 per cent to 11.8 per cent. Until the new rates are finalized, however, Canadian producers are still subject to the higher rates. A duty-free quota, somewhat similar to the softwood lumber agreement that expired in 2001, has been discussed by both parties, but there has been no progress on this front.

The possibility of no duties has been increased by a NAFTA panel ruling handed out on August 31, which ruled, for the third time, that the U.S. International Trade Commission (ITC) has not proved its contention that lumber imports from Canada have threatened the U.S. domestic industry. This ruling goes to the core of the case, as it means that the United States has no basis for collecting the duties. Nevertheless, the dispute will still drag on, as the NAFTA panel is sending the case back to the ITC for a third time and gives it ten days to make a determination consistent with the NAFTA ruling. Moreover, the United States has also the right to launch an extraordinary challenge of the NAFTA panel. Some U.S. officials contend that there is a conflict of interest involving one member of the NAFTA panel. Regardless, until the legal process is exhausted, Canadian exporters will have to continue to pay the duties.

As an aside, references to the impact of China on commodity markets and on lumber have been made. However, China is only a minor market for Canadian lumber and will likely remain so for several years. Despite a nearly

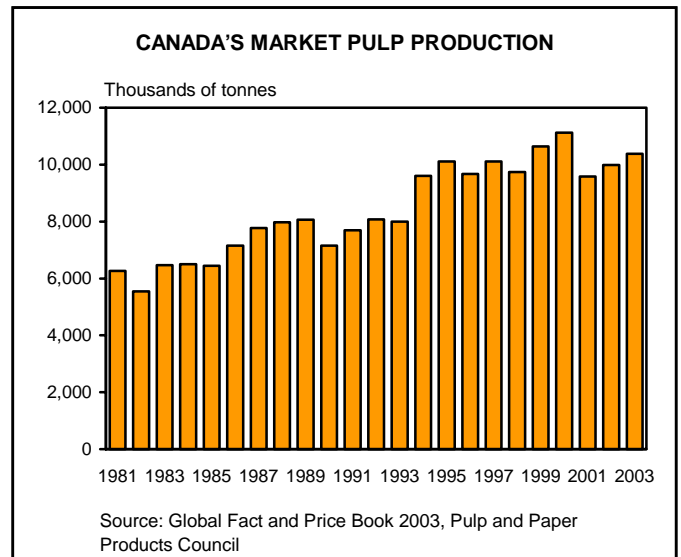
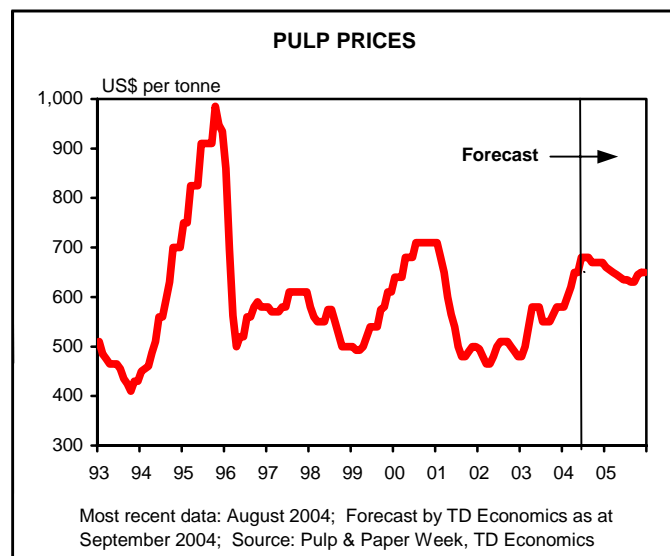
ninefold increase in the past five years, Canada's exports of lumber to China were valued at only \$66 million in 2003, representing just 0.7 per cent of Canada's total export revenues from lumber in 2003. As a result, China is not expected to play a major role in the near-term prospects of the lumber industry.

II. Pulp

Recent Trends

Among the three major forest products, pulp is the most globally traded between producing and consuming regions. Canada, the United States, Sweden and Finland are the largest market pulp producers, accounting for more than half of total world pulp production and deliveries. In recent years, Brazil, Chile, Indonesia and Russia have also emerged as important producers.

Following a sharp 14 per cent drop in 2001, Canada's pulp production rebounded in 2002 and 2003. However, output in 2003 was still some 7 per cent short of its 2000 level. Canadian numbers are no longer being published as of the end of last year. Based on the aggregate world data, which cover about 85 per cent of global capacity, Canadian output likely continued to advance this year because of stronger global demand. World shipments of pulp rose 6 per cent in the first seven months of this year compared to their year-earlier levels, and output increased by 5 per cent. Capacity utilization, globally, was also running higher this year than last year. Capacity usage was at 98 per cent in July of this year, compared to 96 per cent a year ago.



The inventory situation, however, suggests that production may be running ahead of demand. Producers' inventories, globally, have deteriorated recently, rising to 3.78 million tonnes in July, or a 34-day supply equivalent, up from a 31-day equivalent in March. Higher inventories explain the recent slight downward pressure on prices in the spot market. The spot market price of the benchmark Northern Bleached Softwood Kraft edged down to US\$678.87 per tonne in mid-August, about US\$1 lower from the prior week. The list price of pulp was at US\$680 per tonne in August, representing a US\$100-per-tonne, or 17 per cent, increase since last December.

While the demand/supply balance for softwood pulp remains relatively good, it is a different matter for the hardwood variety. The list price for hardwood pulp fell by US\$10-20 per tonne for the month of August. If prices for hardwood pulp continue to fall, softwood pulp may follow, as there is some degree of substitutability between softwood and hardwood. Some papermakers have the capacity to modify their fibre furnishes, varying the mix between hardwood and softwood in response to changes in supplies and relative prices. Although the number of companies that can do so is relatively few, even small alterations in demand can change market conditions.

Outlook

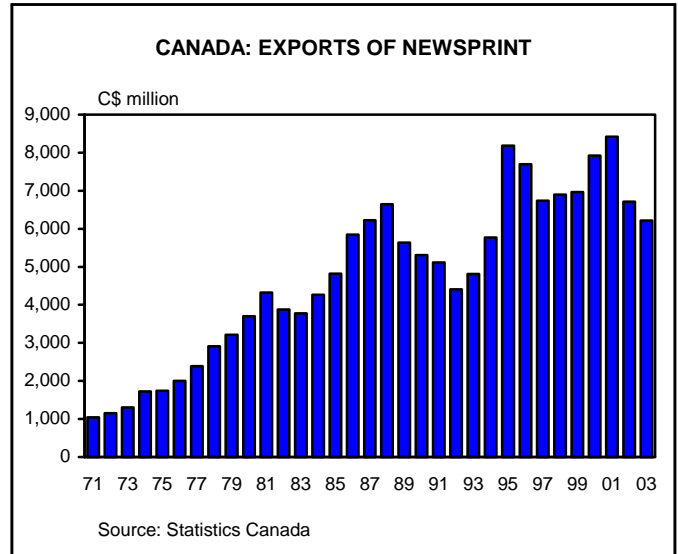
Demand for pulp essentially reflects the demand for paper and paper products, which is very sensitive to economic growth. Consequently, pulp demand is expected to soften slightly next year. World economic growth is expected to dip from 4.5 per cent in 2004 to around 4 per

cent in 2005. In particular, U.S. real GDP is expected to moderate to 3.5 per cent in 2005 from 4.3 per cent this year. Canada's economy is expected to deliver a similar performance in 2005, with real GDP rising by roughly 3.5 per cent as well. All told, these growth rates are not booming, but are solid. For the world economy, it will be the best back-to-back performance in two decades, while in North America, the pace of growth will be close to the long-term potential pace for the U.S. and Canadian economies. Accordingly, demand for pulp may dip, but the pullback should prove limited.

On the supply side of the equation, new capacity investments in South America and Asia will present a challenge to North American producers. It is estimated that from 5-7 million tonnes of new capacity – representing more than 10 per cent of the entire market – will come on stream by 2006. While those new investments are primarily in hardwood and eucalyptus varieties and the impact will be felt most in hardwood pulp, softwood pulp will be adversely affected, because there is some substitutability between softwood and hardwood.

Demand from China will likely continue to support the world pulp market. China has accounted for three-quarters of the growth in world pulp demand since 2000 and the country is still in the midst of expanding its new paper and paperboard capacity. The country's five-year plan for 2001 to 2005 calls for expanding its paper and board capacity by 14 million tonnes, more than half of which are scheduled to come on stream this year and next year. Moreover, in its long-term plan for its forest product sector, China aims to raise the wood fibre content in paper production to 60 per cent, from the current 23 per cent. Presently, China relies heavily on recovered paper and non-wood pulp (mainly, straw) for paper production, with these two raw materials accounting for about 44 and 33 per cent, respectively, of total raw material consumption.

Over the foreseeable future, pulp imports will likely continue to feed China's new papermaking capacities. Domestic supplies are being limited by the country's efforts to protect its natural forests in response to the Yangtze River flooding in 1998. Timber production is being reduced to allow its degraded natural forests to recover. Thus, the country's annual logging quota for the period 2001-2005 was set lower than the allotment for the previous five-year period. Moreover, the country has been shutting down its numerous small environmentally unsound



non-wood pulp mills, further increasing the need to import. Furthermore, China has an ambitious plan to develop 13.33 million hectares of fast-growing high-yielding plantation forests (as opposed to natural forests) between 2001 and 2015. Although this programme may eventually result in lower pulp imports, this is not likely to take place in the next five to eight years. According to a recent study of the American Forest and Paper Association, the plantation programme is developing at a slow pace due to limited capital and China's gradualist ad hoc approach in implementing certain reforms. For example, land ownership rights and the reform of taxation for plantations and timber cutting have been carried out slowly and unevenly throughout the country. Canadian pulp exporters, therefore, will continue to find a lucrative market in China over the foreseeable future. Pulp is a key Canadian export to China, earning \$834 million in 2003 and representing 18 per cent of Canada's shipments to that country.

Given the above, we expect the benchmark price for pulp to decline only slightly to about US\$650 per tonne by December of 2005 from the current level of US\$680 per tonne.

III. Newsprint

Recent Trends

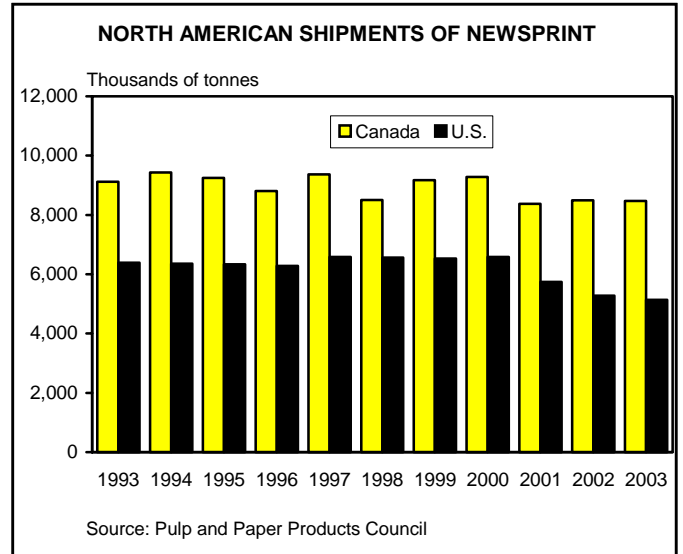
Newsprint dominates Canada's exports of paper and paperboard products, accounting for 53 per cent of the total value in 2003. Apart from newsprint, the paper and

paperboard products category also includes printing and writing papers, sanitary tissues, and packaging products such as kraft papers, container boards and box boards.

Market conditions continue to be difficult to North American newsprint producers. Canada's shipments were down almost 4 per cent in the first half of 2004 from a year ago, with all three major destinations – domestic, the United States and overseas – exhibiting a decline. Shipments to the domestic market were 1.6 per cent lower, those going to the United States were down by 3.8 per cent and those destined overseas suffered the most, falling by 4.3 per cent.

Demand for North American newsprint has been weak in recent years for several reasons. Firstly, newspaper publishers in both Canada and the United States have failed to grow their circulation. There has been a long-term decline and it appears that the situation is slightly worse in the United States than in Canada. Canada's average daily newspaper circulation has been stuck at around 5 million in recent years, after dropping from 5.8 million in 1990. In the United States, the average daily circulation for newspapers (excluding the Sunday editions) has been steadily dropping since the late 1980s, dropping from 63.3 million in 1987 to 55.2 million in 2003. The Sunday newspaper, which gained popularity initially, has also suffered in recent years, with its average daily circulation declining from 62.6 million in 1990 to 58.5 million in 2003.

Secondly, the increase in media alternatives, particularly the Internet, explains some of the weakness in newspaper circulation. Newspaper publishers probably con-



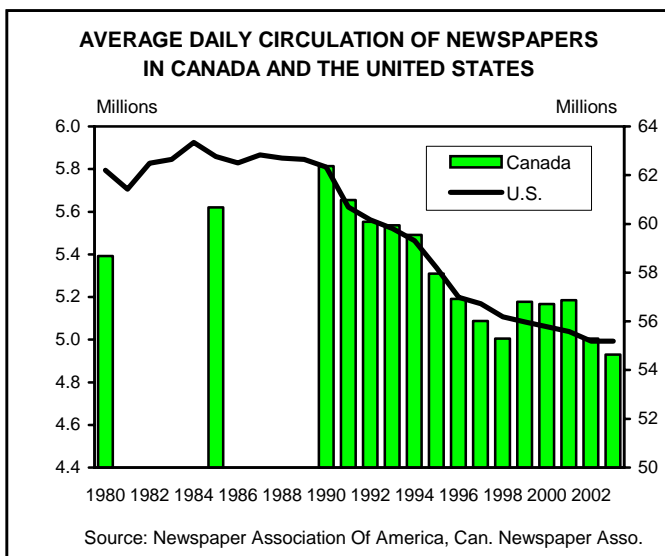
tributed to this trend, as they promoted their "online" presence with online subscriptions or providing free news on the web.

Thirdly, demand for advertising linage (the total amount of space taken up by advertising), which was sapped during the 2001 recession, has not recovered partly due to the substitution of non-paper alternatives.

Fourthly, newsprint capacity has increased in other countries, thus limiting the export opportunities for North American producers. For instance, China is now virtually self-sufficient in newsprint, and Canada does minimal exporting of newsprint to that country. Moreover, as the overseas producers expand their newsprint capacity, they also export and have become competing suppliers in the North American market.

Lastly, old newspaper (ONP) has become increasingly important as raw material in both North America and overseas. In particular, overseas export of newsprint is being replaced with increased trade of ONP.

To adjust output in the face of lacklustre demand, North American newsprint producers have been restraining production, operating at between 91-95 per cent of capacity in the first half of this year. Consequently, newsprint inventories at both Canadian and U.S. mills are relatively low. Based on performance in the first half of this year, Canadian production, which accounts for about 60 per cent of the North American total, will likely total about 8.2 million tonnes for the whole of 2004, which will be about 3 per cent lower than last year. In the United States, newsprint output will likely amount to 5.2 million tonnes in 2004, which will be close to last year's total.



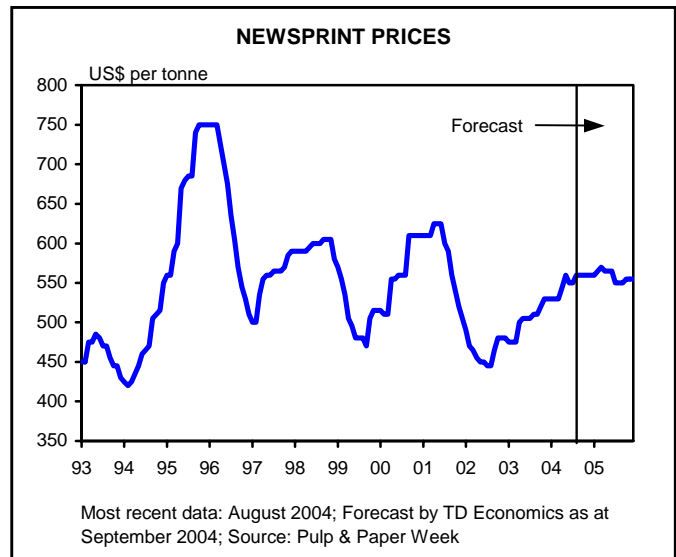
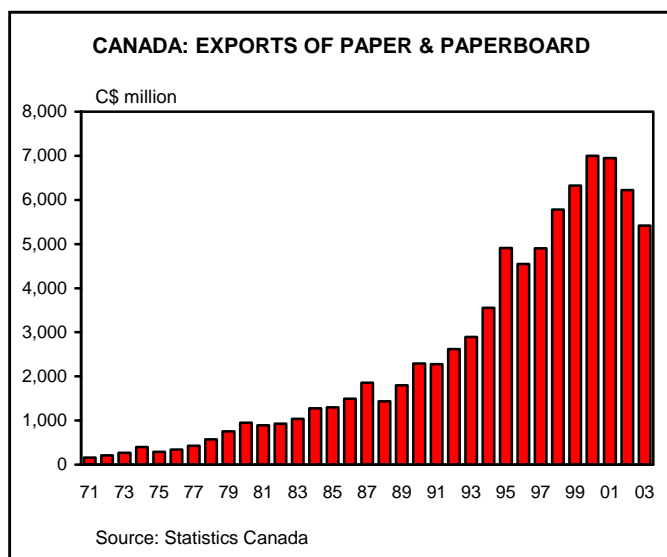
As a further move to adjust production to demand and to support newsprint prices, some mill capacities had been shuttered. Newsprint capacity in Canada was estimated at 9.2 million tonnes in 2003, nearly 10 per cent lower than in 1991. In the United States, capacity was estimated at 6.1 million tonnes last year, down 5 per cent over the same period.

Reflecting the relatively weak demand, newsprint prices have gained the least among forest products this year. Prices were at US\$550 per tonne in August, a US\$20-per-tonne higher or a mere 4 per cent gain since December.

Outlook

Newsprint producers in North America continue to face several difficulties. One challenge is the lack of growth in the mature North American market. In contrast, markets in Asia and other developing countries are growing, but the needs for newsprint in these countries are increasingly being met by newly-installed local capacities. Thus, the export outlets for North American newsprint are also being constrained.

Another challenge faced by North American producers is the lack of new modern capacity in order to be competitive with the emerging new producers in other countries who have the latest technology and enjoy low labour costs. However, there is excess capacity in North America and this has been a disincentive in installing new capacity. Most of the capital spending by North American companies has been devoted to conversions to value-added paper grades.



While new producers in the developing countries have several advantages over their North American counterparts, they have one big disadvantage. Most of the Asian countries are not self-sufficient in fibre and they have to import this raw material. The world competition for fibre has resulted in rising prices for pulp. Thus, these producers do not always have complete control over their costs.

Based on these considerations, newsprint prices will likely rise to US\$560 by December and US\$570 by March 2005, before falling gradually to US\$555 per tonne by the end of next year.

IV. Other Paper and Paperboard Products

Printing and writing paper (including tissue and specialty paper) have done very well in terms of demand. Over the five-year period 1999-2003, Canada's printing and writing paper industry recorded a 14 per cent increase in volume shipments, while tissue and specialty paper witnessed a 12 per cent gain. Rising demand for these products has continued into this year. However, intense competition among suppliers led to a very difficult pricing environment, with flat prices over the last few years. Prices did increase this year, but this was largely due to rising costs reflecting higher fibre and energy costs.

On the other hand, both the container board and kraft paper are struggling. Over the same five-year period, Canada's shipments of container board dropped by 8 per cent in volume, while that of kraft paper fell by 7 per cent. While kraft paper is experiencing a slight rebound this year, that of container board has continued to fall. This

falling trend for the latter can be traced to the expansion of container board capacity in China. As China sought to produce its own container boards, it reduced its need for the imported product.

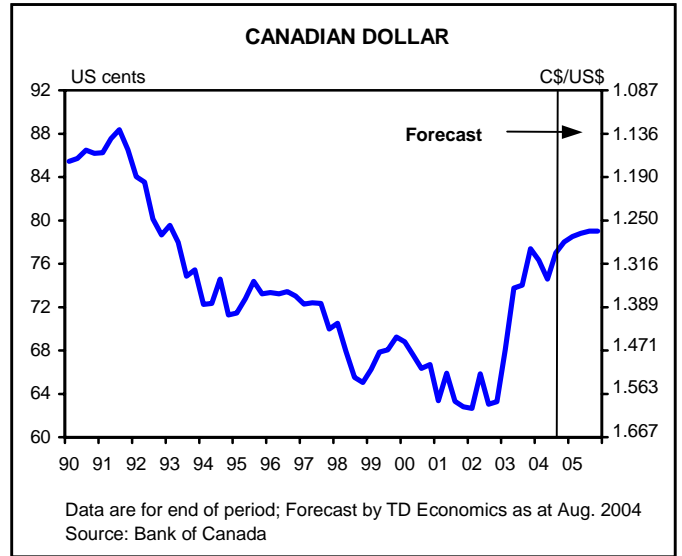
Section II. Revenue & Cost Factors

Besides the supply-demand mix for the various commodities, there are a vast number of other factors that influence the profitability of the industry. Below, we will discuss three factors that are likely to be in the spotlight in the coming year.

Exchange Rates

Exchange rates impact the sector in a variety of ways. Since forest products are priced in U.S. dollars, a stronger Canadian dollar results in lower revenues when translated into the domestic currency. For example, the industry estimates that each one-cent gain for the Canadian dollar reduces revenues of Canadian forest products companies by \$528 million. Moreover, the industry estimated that it sustained an export revenue loss of \$3 billion due to the currency swing in 2003. But, there can be an important offset from lower debt service costs, reflecting the fact that many companies issue their debt in U.S. dollars. To illustrate, Statistics Canada reported that the sector had a gain of \$1.8 billion in 2003 due to the translation of foreign currency assets. Moreover, a stronger currency reduces the cost of imported machinery and equipment. On balance, however, it is still clear that the negative impact on revenues is the dominant effect.

Looking forward, we expect some further appreciation

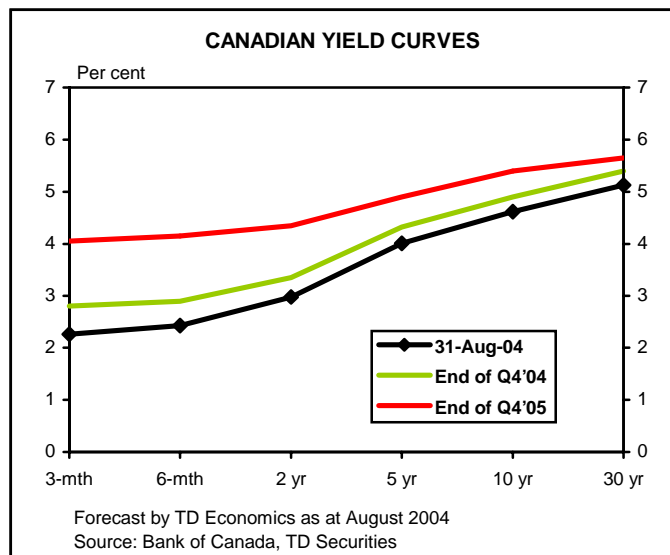


of the Canadian dollar, but the increase will not be as steep as in 2003. We expect that the loonie will rise from the current level of around 77 US cents to 79 US cents by the end of next year. As a result, the sector may lose around \$1 billion in revenue from the currency appreciation.

The Canadian dollar-euro exchange rate also matters, as the European Union is an important market to Canadian producers, accounting for 22 per cent of Canada's export revenues from pulp and 9 per cent from newsprint in 2003. Given the expected movement of the U.S. dollar versus the euro, the Canadian dollar will likely appreciate versus the euro for the remainder of this year before depreciating in 2005. In the third quarter of this year, one euro bought 1.623 Canadian dollars. By the end of 2005, we expect that the exchange rate will be 1.646 CAD per euro.

Interest Rates

Based on Statistics Canada data, the forest products industry has short-term debt of about \$1.9 billion and long-term debt of about \$30 billion as of mid-year 2004. Regrettably, there is no information as to how much of this debt is in foreign currencies. About \$22.2 billion, or 70 per cent, of the total debt is attributed to the paper manufacturing sector and the balance is owed by the wood product manufacturing sector. About 98 per cent of the debt incurred by the paper sector is long-term and only 2 per cent is short-term. On the other hand, of the \$9.7 billion debt owed by the wood product manufacturing sector, about 84 per cent is long-term, with the short-term portion being relatively high at 16 per cent.



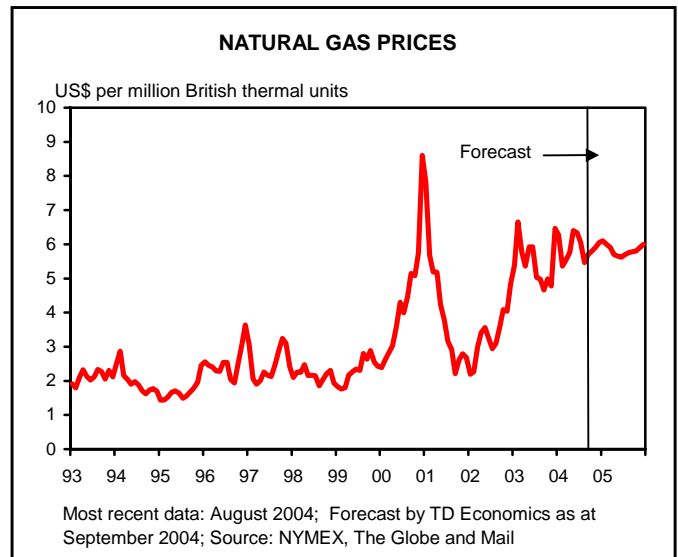
The industry is facing higher servicing costs on those borrowings if companies have not locked the low rates that prevailed in recent years. We anticipate that Canada's overnight target rate will double from the current level of 2 per cent by the end of 2005, and there will be increases in yields across all maturities of bonds. For example, we expect that the three-month treasury bill rate, which stood at 2.25 per cent on September 1, 2004, to reach 4.00 per cent by the end of next year. Meanwhile, the yield on five-year government bonds is anticipated to rise from 3.98 to 4.90 per cent, while 10-year bonds increase from 4.60 per cent to 5.40 per cent over the same time frame.

While this will lead to higher debt service costs by the industry, the impact should prove limited. A stronger Canadian dollar will reduce the interest payments on U.S. dollar denominated debt. And, interest rates will remain low by historical standards.

Natural Gas

Although the forest products industry, especially pulp and paper manufacturing, is energy-intensive, it generates about 60 per cent of its own energy needs. It uses wood chips, bark, sawdust and the black liquor from pulping operations to produce steam and electricity. Nonetheless, the industry still uses a lot of natural gas. In 2003, natural gas provided about 20 per cent of the energy consumed in Canadian wood manufacturing and 12 per cent in the case of paper manufacturing.

Unlike crude oil prices, which have risen tremendously this year, natural gas prices have been declining in recent months as a result of the cool summer weather across much of North America. There has been reduced demand for air conditioning this summer and this has allowed inventories to build up comfortably in preparation for this coming winter. Thus, natural gas prices had fallen by 16 per cent in August compared to their last December level. Prices, however, are still high compared to their historical levels, running at almost double their average of the 1990s. We expect natural gas prices for the near-month NYMEX contract to average US\$5.90 per million British thermal units for 2004 as a whole, about 7 per cent higher than in 2003, before falling by about 1 per cent in 2005. As a result, the forest products industry will benefit from lower energy prices, but the decline is expected to be quite modest.



Section III. The Bottom Line

To sum up, the rapid run-up in lumber prices this year has produced spectacular results in the financial performance of the wood manufacturing sector, more than offsetting the continuing burden of the softwood lumber duties. Next year will not be as good, as an expected decline in residential construction is likely to cause lumber prices to retreat. Demand from China has been very supportive to world demand and prices for pulp, and will likely continue to be so at least for the next five years until the country is able to reap the yields from its aggressive plantation programme. The newsprint segment continues to be buffeted by changes taking place within the industry, such as the increasing use of recovered paper and the negative impact of the Internet on newsprint demand. On the cost side of the equation, although not dealt with in the above text, wages and salaries are expected to rise at only a modest pace in the coming year. Interest payments will increase, but debt service on U.S. dollar denominated debt will receive an offset from a stronger Canadian dollar. A further modest appreciation in the loonie will constrain revenue growth in Canadian dollar terms. And, energy prices will trend lower, but remain high by historical standards. Overall, 2005 is going to be a more challenging year for the Canadian forest products sector, but firms will adjust to the changing times.

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