

By Thais Santi



A NEW SCENARIO IN THE PULP AND PAPER MARKET

Still growing, but at a slower pace not exceeding 3% of GDP in 2013, emerging markets will continue being important for global economic development. Meanwhile, the United States has become stronger through its industry, favored by cheap energy, while Europe has begun to show major disparities between the north and south regions, and signs of becoming weaker. China, in turn, continues dividing optimistic with pessimistic opinions in an attempt to answer whether the country's growth is sustainable or a risky economy. In view of this macroeconomic vision of the global market that was presented at the RISI 8th Annual Latin American Pulp & Paper Outlook Conference, where does the pulp and paper sector stand globally and, particularly, in terms of Latin America? What factors will influence decisions in this industry and what segments deserve greater attention? To answer these questions, *O Papel* magazine spoke with Kurt Schaefer, vice president of fiber and pulp market specialist, and Derek Malhburg, economist specializing in paper, both of whom work at RISI, during the event held August 6-8, in São Paulo, SP.

O Papel - With regards to global demand for pulp, do you believe we may face overcapacity?

Kurt Schaefer - There is a big issue regarding the amount of pulp that will enter the market. It started with Eldorado in December 2012, when they put 1.5 million tons into the market. There is also Montes del Plata in Uruguay, which will produce an additional 1.3 million tons and will probably start up next months, and then there is the Suzano project in Maranhão with another 1.5 million tons. There's also an additional 700 thousand tons from a factory in China that could start up at any time. So, we have a total of 3.5 million tons of pulp entering the market before year end, and that's simply too much capacity for the market to absorb. On the softwood side, this awkward capacity situation is much more balanced, since a mill will be closing down in Norway, which is going to take out 300 or 400 thousand tons of softwood and maybe a little bit of hardwood. By the end of this year and into early 2014, we see the market weakening substantially. The Chinese will be reluctant to pay a high price when the forecast is prices going down, so they'll try to wait as long as they can. Prices are already slipping in China and this will probably continue until the end of the year.

O Papel - Do you have any idea how much prices may drop?

Schaefer - Certainly more than 75 dollars. It can reach up to 150 dollars, but not for very long. Depends on what production costs are, and how weak the market gets, but it shouldn't be too bad for too long. So, what we will see is the market rebounding, as the Chinese resume operations and build inventory, given their high purchasing power. In this case, when they can buy at a low price, they build huge inventories. Also, cheaper pulp means they will use more wood pulp and less non-wood pulp, and that helps the market get stronger. In summary, the market will not be very good throughout all of 2014, but the worst period will be the first quarter. After this period, we will see mills close down and inventory building, which could strengthen the market again in the second semester. So, what we have is a short-term problem that is highly associated to the start-up of two mills almost at the same time.



Kurt Schaefer

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O Papel - A lot has been said about consolidation in the pulp sector due to the current investment scenario. In your opinion, what is going to happen, especially in Brazil?

Schaefer: When talking about consolidation, it does seem very likely. The structures of some mills are very familiar. Therefore, people must be prepared to negotiate their operations in order for consolidation to occur, but I do not think this will happen in the short term.

O Papel - The conversion of a pulp mill to produce specialty pulp was recently announced in Brazil. What are the main markets of interest and how is the specialty pulp market doing worldwide?

Schaefer: The demand for specialty pulp shall continue growing between 9% and 10% per year, worldwide. Most of this demand will come from China. At present, Brazil produces 485 thousand tons of specialty pulp, I believe that this new mill will have to export its production or at least a major part of it. And this production will probably be earmarked for the Chinese market. But it may just happen that it is commercialized outside this market and China ends up purchasing from

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Derek Mahlburg

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other countries such as Canada. It's important to stress that there's a limit for this expansion, as there's more than enough capacity for 2013 and there is also a lot of capacity for 2014. So, if more companies announce entry into this market, there will be excess supply for a long time. In other words, for a 5 to 6 million ton-market, there exists the need for 500 to 600 thousand additional tons per year. A lot of this additional capacity will be converted from plants that produce pulp for paper.

O Papel - With the GDP growth slowdown in China, there are rumors that many Chinese mills may break. Should we be start becoming worried about this?

Schaefer: Pulp demand will continue to rise in China. Paper production is increasing and the economy is still growing, but at a slower pace. So, instead of having a GDP growth rate of 10 or 11 percent a year, we will probably see this indicator growing between 7% and 8% in official numbers, which in real numbers represent 5% or 6%. I can say that there exists a risk if this drops even more, especially because the country is undergoing economic transition, reducing investments in exports in order to increase expenses with internal consumption, which is risky. So far, it seems to be working, but it definitely means slower growth on the economic side. As such, RISI reduced its production forecast for China to approximately 4% to

4.5% per year, while the average for the last 10 years has varied between 9% and 10%. This constitutes a significant drop in growth percentage, in view that China represents the point of equilibrium in the global market, since paper consumption has been dropping in Europe and North America. Besides, the tissue segment has maintained its expected growth rate, that is, a key market will not be capable of absorbing all the pulp production that was expected, calling for adjustments in planning. Hence, if China were to continue growing at the rate it was in the past, it would be possible to sell a lot more pulp in the next 2 to 5 years, which is not going to be the case.

O Papel - What are the perspectives in relation to the paper market in China?

Derek Mahlburg: Over the past two to five years, the global market has been through major cyclical changes, with various situations of economic problems around the world. We are starting to see the US economy recover and China looks like it will stabilize at the official growth rate mentioned previously. Within this scenario, demand for printing and writing paper in China seems to be growing, but at a slower pace. For each percentage-point increase in GDP growth, we are seeing less than one percentage point increase in demand for these papers. It is important to mention that Chinese demand was once more than 10% and now is between 3% and 4%. In other words, the big question in the global market is whether regions where demand is still growing, such as China and Latin America, is sufficient to put the world back on the path of growth for these papers following this retraction we saw in the last few years.

O Papel - You mentioned Latin America. Were you talking about growth in Latin America in general, or just Brazil?

Mahlburg: Both are growing. Brazil has grown a little less than some of the main countries, such as Mexico. Much of this is due to Mexico's recent economic strengthening. These regions, including Chile, are the areas that will feel the effects of digital media first. Higher incomes and existing infrastructure in these areas will allow this transition to occur in these regions first.

O Papel - Do you see Brazilian paper consumption growing, as consumption is considered low?

Mahlburg: Yes, Brazil is still a growing country, with still a lot of potential for increasing income and improving literacy rates. Factors such as these usually lead to increases in consumption per capita. I believe that these trends are even stronger than digital media trends, but we cannot ignore their growth, particularly newsprint, where demand this year in Brazil shall suffer a drastic drop in consumption regarding this type of paper. Newsprint is basically a victim of these media. In the United States, newspapers were the first to be affected by digital media. Therefore, it is no surprise that this also occurs in Brazil.

O Papel - Newspapers are migrating to digital media. How long do you think printed newspapers will resist?

Mahlburg: That's a big question. Right now, all we know is that just in the last year there has been

a significant decline. In countries such as Mexico and Chile the same is happening. Therefore, it is even more difficult to estimate at what stage this transition is at or whether demand is just a little more volatile.

O Papel - With regards to the printing and writing market, is Brazil growing just as much as Mexico and other countries, for example?

Mahlburg: We can classify the main graphic paper markets in Latin America according to their economic outlook. Chile and Mexico are the countries most likely to experience strong economic growth over the next few years. Brazil is also expected to grow but at a slower pace, while Argentina is facing serious economic problems. Demand for printing paper basically grows because publications are very closely related to advertisements, so they'll follow these trends very closely. What we expect to see is massive demand growth in Chile and Mexico, moderate growth in Brazil and very weak in Argentina. ■

Pulp demand will continue to rise in China. Paper production is increasing and the economy is still growing, but at a slower pace

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