
FISHER INTERNATIONAL

BY MARCELLO COLLARES

VP LATIN AMERICA,
FISHER INTERNATIONAL
: mcollares@fisheri.com

THE PERFECT STORM: FOREIGN EXCHANGE, SHIPPING RATES, OIL PRICES, AND THE PULP AND PAPER INDUSTRY

Fisher International has just completed a study of the dramatic change in the cost of trade – a "perfect storm" gathering on the horizon that has the potential to hit U.S. shores with disruptive effect.

A perfect storm requires three coinciding forces that reinforce each other. In this case, they are a glut of ships, low energy costs, and a strong U.S. dollar. Taken together, non-U.S. suppliers face an unprecedented opportunity to increase their exports to the U.S.

Shipping Glut

A few years ago, demand for Chinese goods was still high and apparently growing without limit. Shipping was tight so shipping companies built mega ships (made all the more feasible by the widening of the Panama Canal). As in the case of paper machines, in the world of ocean shipping, bigger is always better. More ships times bigger ships yielded way more capacity than the world needed especially as global demand for exports from China declined. The result, container ships are available at phenomenally low shipping rates - near or at their lowest points in the last five years.

Energy Prices

An important variable cost for ocean shipping is fuel, typically bunker fuel or marine diesel oil (MDO), the prices of which have also plummeted, falling precipitously in the second half of 2014 and trending even lower since then. Low operating costs have further driven the cost of logistics down. It is important to note that paper is a low-value product relative to its bulk and weight. Historically, this meant that shipping costs were a significant barrier to moving paper around the world. Now, with low-cost shipping, however, anyone with low-cost papermaking can effectively compete anywhere in the world, no longer just in their home market.

Currency

Most people don't need to be told that the U.S. dollar is strong today. The consequence of currency relationships is that a paper company in the Eurozone exporting to the U.S. has seen the cost of its products drop in the last five years. Any papermaker who was offered a project to lower manufacturing costs that much would hardly believe it possible but currency fluctuation has made it so.

The Impact

So, has the storm touched U.S. shores yet? Is it likely to come ashore further?

Australia is the second largest exporter of containerboard to the U.S. Its exports grew more than 200%, coinciding with the strengthening of the U.S. dollar against the Australian dollar and the drop in shipping costs.

While U.S. printing and writing paper imports have been declining for some time, their share of the U.S. market has been increasing, indicating that these imports have become more competitive. As U.S. demand fell, domestic capacity closed even faster and imports took up some of the slack causing the share of imports to soar.

The increase in the competitiveness of imports is correlated with the fall in shipping costs and changes in foreign exchange rates. The trade case won by uncoated freesheet producers may protect further erosion, but it has to overcome the logistics and currency forces arrayed against it.

As an example, the cost curve from Fisher*Solve*™ shows that low-cost producers in one region are now able to sell throughout the world. Russian and Portuguese uncoated freesheet positions on the cost curve are particularly strong. *(This cost curve shows copy paper and offset grades within uncoated freesheet only.)*

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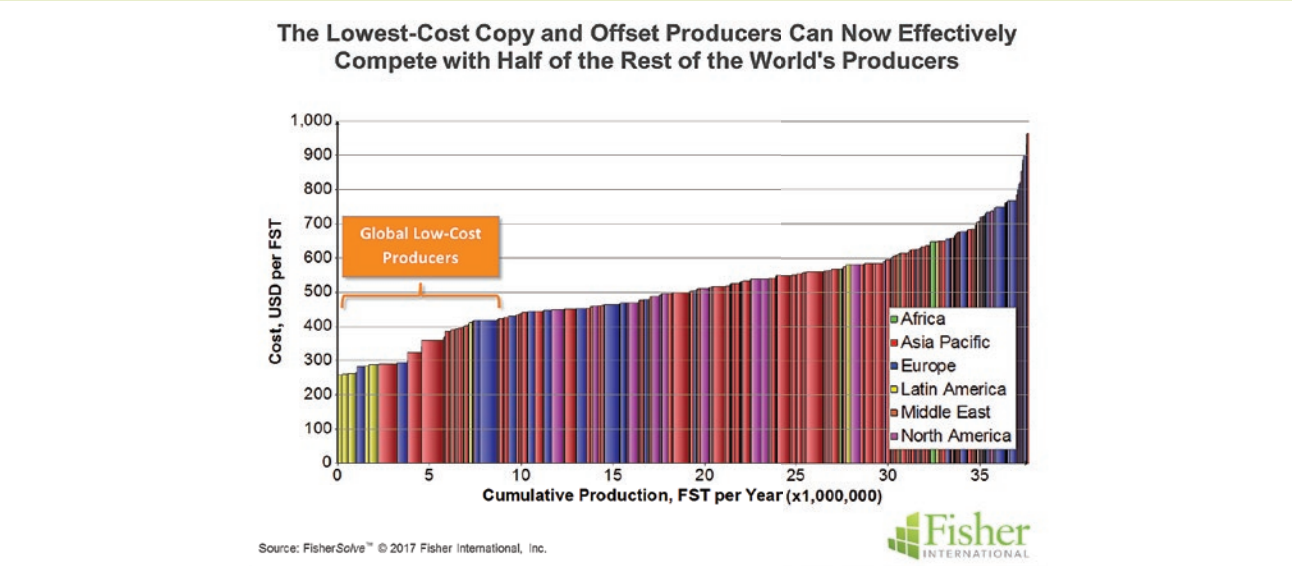
Outside the U.S., currency exchange rates and shipping costs affect the trading of pulp and paper products. China imports a considerable quantity of Northern Bleached Softwood Kraft (NBSK) pulp. Between 2012 and 2014, while the exchange rate between the Canadian dollar and Chinese Yuan was flat, the NBSK imported from Canada to China was also relatively flat. However, starting in 2014, the Chinese Yuan became stronger against the Canadian dollar and that triggered Canadian imports to grow in China. It's noteworthy that the NBSK export peak in 2015 correlates with the rock bottom shipping rates.



Conclusion

While the storm may be "perfect" with respect to U.S. producers – who suffer from both lower global logistics costs *and* the high dollar – the rest of the pulp and paper industry also faces a new dynamic. As shipping costs trend lower, the traditional barriers around each region are falling. No longer are producers limited to serving mainly their home markets.

Today, any company with low costs can export to any region and supplant any company with high costs. The paper industry has just become more global.

Look at a cost curve for any paper product and make it global. See if there's a $200 or greater difference between a major low-cost producer with plenty capacity and the top half of the cost curve and you will find a papermaker who is positioned to capitalize on the recent globalization of the paper industry. ■