

**Trends and Prospects**  
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## CANADA

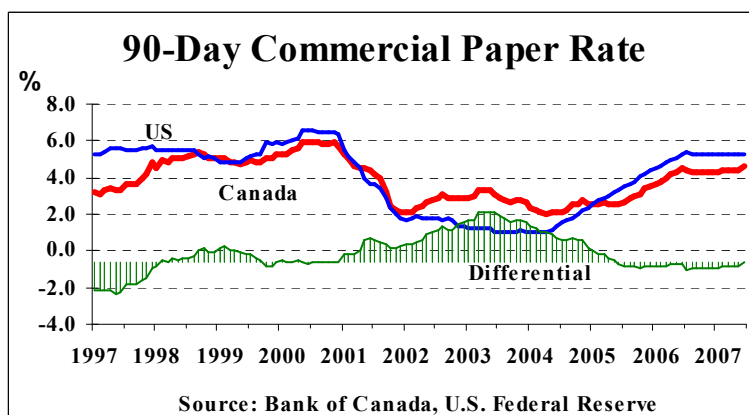
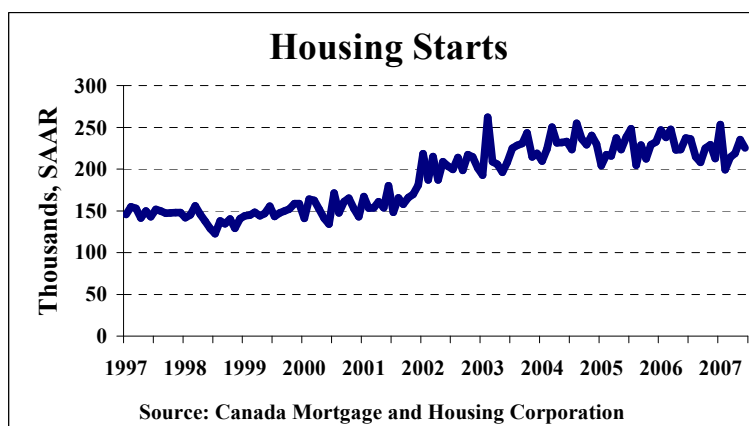
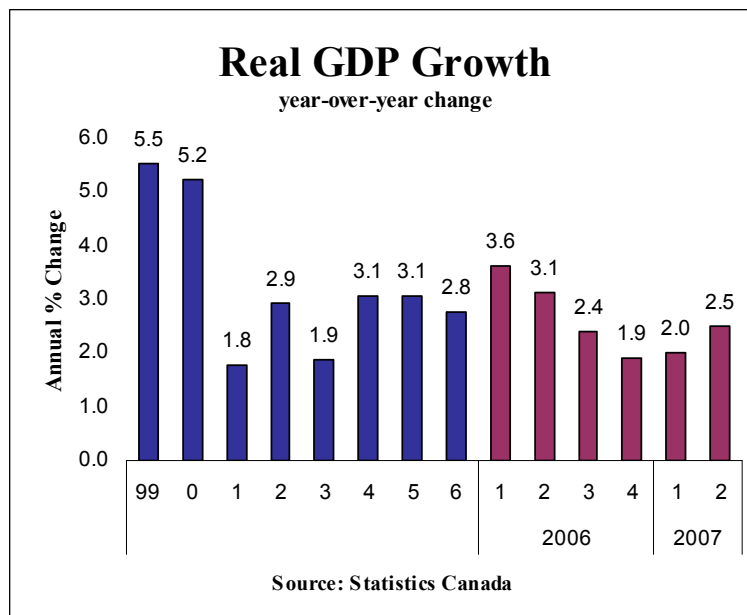
## I. An Economic Overview

*General Economic Conditions*

The *Canadian economy* started strong in 2006 posting 3.6% year-over-year growth in the first quarter, up from 3.2% in the previous quarter. Thereafter, the economy steadily declined, reaching a low of 1.9% growth for the fourth quarter. Overall annual growth was 2.8% in 2006. Going into 2007, the economy rebounded, with 2.0% growth in the first quarter and 2.5% growth in the second.

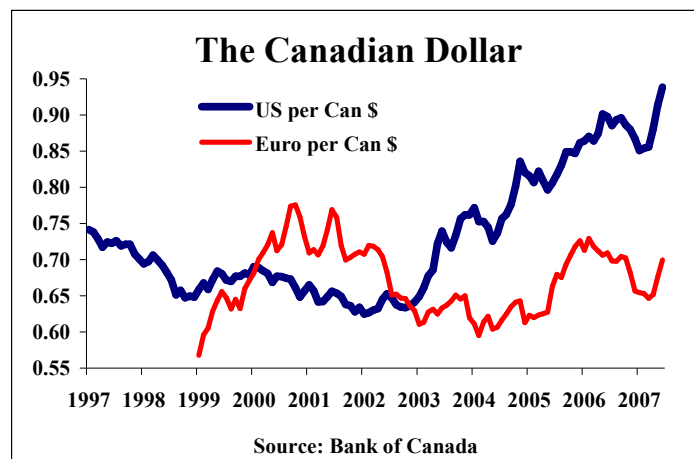
Housing starts were up 1.8% in 2006 compared to 2005, reflecting a relatively robust market that was only 1.9% below 2004 - a record year for housing activity. The 5-year mortgage rate climbed from an average of 6.0% in 2005 to 6.7% in 2006. During the first 6 months of 2007, the average mortgage rate climbed further, up to 6.9%. Although this is still quite low by historical standards, year-to-date housing starts for the first half of 2007 didn't keep pace with 2006, falling by 4.9%. However, the market remains healthy as the Canadian housing industry is coming off a record high for the first quarter of 2006. Moving into the remainder of 2007, housing starts will continue at a moderate pace, tempered between the downward effect of gradually rising interest rates due to inflationary pressures in the economy and on the other hand, healthy housing starts in Alberta and Saskatchewan where strong commodity prices and income levels continue to boost demand in the industry.

The Bank of Canada target overnight rate is now at 4.5%, up 25 basis points from its level at the beginning of the year. The rate was increased in July 2007 due to higher than expected Canadian economic growth

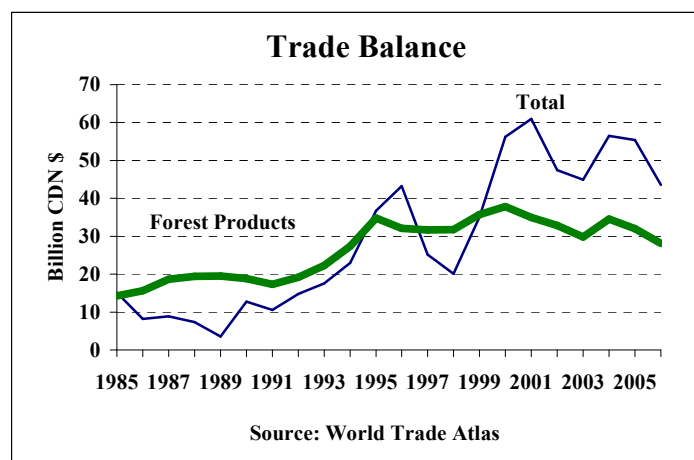


and inflationary pressures within the economy. The target overnight rate is expected to increase slightly as inflationary pressures are expected to persist for the remainder of the year. On the upside, household demand could be greater than expected while on the downside, activity in the subprime mortgage market could push the U.S. economy into a downturn with spillover effects into the Canadian economy. In the first 6 months of 2006, the target for the U.S. Federal Funds rate increased by 75 basis points. It remained flat until September 2007 when it declined by 50 basis points. As the overnight rate is likely to increase slightly, the Canadian 90-day Prime Corporate rate is expected to increase somewhat. Hence, the differential between the Canadian 90-day Prime Corporate rate and US Commercial Paper rate will likely shrink through the remainder of 2007.

Amid occasional flutters, the Canadian dollar has steadily appreciated against the US dollar since 2002. In August 2007, the Canadian dollar reached an average of US\$0.95. The appreciation was due to rising prices of exported Canadian commodities, specifically for crude oil and metals. Canada's largest export market for crude oil is the US while for numerous metals it is China. Both US and Chinese demand for these exports has remained relatively inelastic while prices have risen, thereby pressuring the Canadian dollar upwards as well. Relative to the Euro, the Canadian dollar has not experienced the same level of appreciation. This is in part due to reasonable EU-area export growth and steady European Central Bank rate hikes providing support for the Euro since the end of 2005.



Canada's forest products trade balance declined steadily from 2000 to 2003. Following a jump in the trade balance in 2004, it fell in 2005 and again in 2006, to \$28.1 billion - below its 2003 trough. Historically, forest product exports have represented the largest component of Canada's positive trade balance. However, from 2001 to the present, forest product exports have consistently been the second largest component, after oil/fuel exports. The largest contributors to the positive 2006 forest products trade balance were softwood lumber, pulp and newsprint with net exports of \$8.7 billion, \$5.0 billion and \$4.9 billion. The largest forest products trade surplus in 2006 was with the US at \$21.9 billion, followed by Japan at \$1.8 billion and China at \$0.6 billion\*.



\* Trade surplus calculations do not include furniture products.

## II. Policy Measures in Canada Impacting Forest Management and Forest Product Trade

### 1. National Forest Strategy

Canada's current National Forest Strategy, *A Sustainable Forest: The Canadian Commitment (2003-2008)* will expire in May 2008. The Canadian Council of Forest Ministers (CCFM) is now leading the development of the new strategy that will replace the current one.

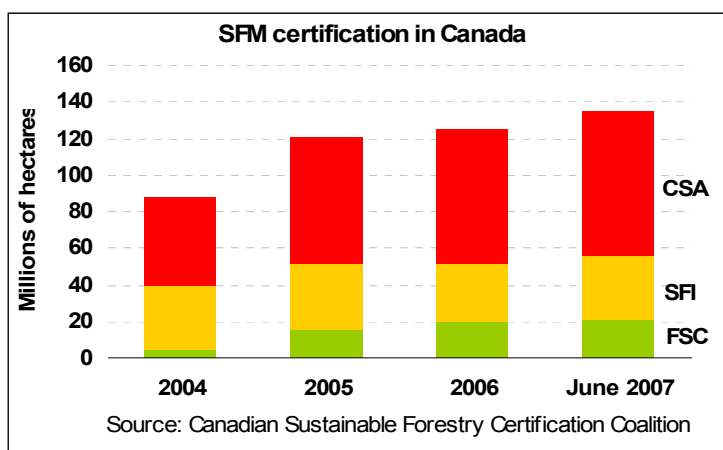
The CCFM is comprised of all federal, provincial and territorial ministers responsible for forests. Established in 1985, it provides a forum where governments work co-operatively to address areas of common interest. The CCFM stimulates the development of policies and initiatives to strengthen the forest sector. It also provides leadership, addresses national and international issues, and sets the overall direction for the stewardship and sustainable management of Canada's forests.

The CCFM's overall objective for the new strategy is to provide a vision for Canada's forests, define national-level priorities, and integrate initiatives concerned with sustainable forest management that are in line with priority issues. Canada needs such a strategy to provide a framework for defining its overall forest interests and communicating its intentions towards forest sustainability.

### 2. Initiatives to Encourage the Use of Sustainably Produced Timber Products

The different levels of government, and the various forestry and wood products associations, have various programs and policies in place that promote the efficient use of wood both domestically and internationally, whether at the harvesting, manufacturing or consumption level. For example, many provincial governments have policies and guidelines requiring that the pulp and paper sector use existing wood fibre, available through primary manufacturing plants such as sawmills and other wood processing mills, before being granted a tenure licence. Such a procedure ensures that existing fibre is used efficiently before new harvesting areas are opened up.

Environmental issues are, more than ever, a growing concern in the marketplace, and demand for certified forest products continues to increase. Recognizing the growing global interest in certified forest products, i.e., those that originate from sustainably managed forests, the Canadian forest products industry has implemented forest certification as a way of improving its forest management practices and demonstrating its commitment to sustainable forest management. Canada now has the largest certified area of sustainably managed forests in the world. As of June 2007, 134.6 million hectares have been certified under one of the three forest-specific certification systems available in Canada,



representing an annual allowable cut of over 112 million cubic metres. The distribution under the three systems is as follows — Canadian Standards Association (CSA) 79.29 million ha, Sustainable Forestry Initiative (SFI) 34.89 million ha, and Forest Stewardship Council (FSC) 20.53 million ha<sup>†</sup>. Both the CSA and the SFI have been endorsed by the Programme for the endorsement of forest certification schemes (PEFC). Canada accounts for half of the PEFC endorsed certifications world-wide, and almost one quarter of all FSC certification worldwide.

### ***3. Innovation, Research & Development***

Canada's forest sector has a significant and extensive innovation system from the forest cover to consumer and industrial products. From stewardship and stand management in the forest, to computerized technologies in the mill, and up to product offerings in the market, innovation has been key to the sector's progress. As competition in the global forest industry increases, many are realizing the importance of focusing Canada's research capabilities to support common goals. Two complementary initiatives to harness this research effort are the creation of the Canadian Wood Fibre Centre in March 2006 and FPInnovations which began operations in April 2007.

Launched by Natural Resources Canada, the Canadian Wood Fibre Centre focuses on improving forest productivity and fibre quality as well as increasing the value of the forest resource. While staffed by researchers from the Canadian Forest Service (CFS) of Natural Resources Canada, its direction comes from both CFS and FPInnovations. FPInnovations formed when Canada's three forest research institutes (Forintek Canada Corp., Pulp and Paper Research Institute of Canada (Paprican) and the Forest Engineering Research Institute of Canada (FERIC)) merged. FPInnovations was created to harmonize forest research, integrate innovation along the value chain and establish a basis for industry renewal in the short term and diversification in the long term. Combined with the Canadian Wood Fibre Centre (the fourth division), FPInnovations is the largest public/private forest research institute in the world.

The Government of Canada is providing \$55 million to allow for new investments in forest innovation that will harness the capacity of FPInnovations and meet the long-term innovation challenges facing the sector. The funding will provide for pre-competitive, non-proprietary research to address the development and adaptation of emerging and breakthrough technologies, in areas such as forest biomass, forest biotechnology and nanotechnology. Working collaboratively with universities, provinces and industry, FPInnovations will help stimulate the research and development and innovation needed for building on Canada's forest resource.

### ***4. Climate Change***

In April 2007 the Government of Canada announced its regulatory framework for air emissions, which is the cornerstone of its broader efforts to address both greenhouse gases and air pollutants ([www.ecoaction.gc.ca/turning-virage/index-eng.cfm](http://www.ecoaction.gc.ca/turning-virage/index-eng.cfm)). Mandatory air pollution reduction targets for wood products and pulp and paper companies will enter into force as early as 2012. Pulp and paper companies also will need to comply with greenhouse gas emission reduction targets starting in 2010 and options for meeting these targets will include emissions trading and credits from offset

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<sup>†</sup> If a forest area has been certified to more than one standard (ISO, CSA, FSC, SFI), the area is only counted once, hence the grand total of certifications may be less than the sum of the individual totals.

projects in non-regulated sectors. The scope of the offset system, including what types of forest carbon projects will be able to participate, has not yet been decided.

Canada's sustainably managed forest has been a carbon sink in most years since 1990. Recent analysis shows that increasing insect infestations and the on-going risk of fires make it very likely that it will switch to being a carbon source. Because of this, in early 2007 the Government of Canada decided to not include forest management in Canada's accounting under the Kyoto Protocol. Canada must still account for afforestation/reforestation (creation of new forests) and deforestation (conversion of forests to other uses such as agriculture). The role of Canada's forests, forest products and wood energy in helping to address climate change is the subject of on-going assessment. As well, governments in Canada are focussing on how climate change may affect the forest in decades to come and how forest management may need to adapt.

Climate change is a global issue that requires long-term cooperative action with participation by all developed countries and major greenhouse gas-emitting countries, in a way that reflects national circumstances. Canada believes that negotiations under the United Nations Framework Convention on Climate Change must lead to a new global agreement on climate change by 2009. The Government of Canada has set a long-term target for greenhouse gas emission reductions of 60-70 percent below the 2006 level (approximately 50-60 percent below the 1990 level) by 2050.

## ***5. Wood Energy Policy***

About six percent of Canada's total secondary energy use (energy produced and used by the same plant) now comes from forest biomass sources. The production of heat and electricity with cogeneration technology using forest biomass feedstocks is already widely practised in the sector. The forest sector receives more than 50% of its energy needs from forest biomass.

Canadian bioenergy policy has advanced in recent years in response to the increases in fossil fuel prices, a troubled rural economy, and international efforts to curb greenhouse gases. The Clean Air Act (2006) is expected to combat greenhouse gas emissions and other air contaminants by setting emission targets and blended transportation fuel mandates. The Act will stimulate the use of renewable energy, including forest bioenergy.

Recently, as part of the Government's ecoAction plan to help execute the Act, Budget 2007 contained 20 initiatives to help improve environmental outcomes in Canada. These include \$1.5 billion in production incentive (1 cent per kilowatt-hour) for the EcoEnergy for Renewable Power program that is designed to produce 4000 megawatts of new clean electricity from renewable sources including biomass.

The Federal Government will also provide Sustainable Development Technology Canada with \$500 million to invest with the private sector on the production of next generation (cellulosic) renewable fuels. There could be some spillover benefits to the forest sector from these investments as the recipients of these grants, such as energy companies, work closely with forest companies.

Finance Canada administers a key federal tax incentive designed to encourage investment in renewable energy, Capital Cost Allowance Class (CCA) 43.1/43.2. A 50% accelerated CCA is provided under class 43.2 and 30% under Class 43.1. The equipment that qualifies includes cogeneration equipment that generates heat and electricity from wood waste and spent pulping

liquor (Budget 2006). Budget 2007 extended the list of fuels to include primary and secondary wastewater sludges, de-inking sludge, tall oil soaps, crude tall oil, and turpentine. Also, the Budget extended the eligibility for Class 43.2 to assets acquired before 2020.

Budget 2006 allocated \$400 million to help the forest sector in its adjustment and promote long-term competitiveness. As part of that package, it was announced in early 2007 that \$127.5 million will be invested in innovation and investment, expanding markets, and developing a pest strategy. This amount will include \$70 million for promoting forest sector innovation, including \$55 million for research and development of “transformative technologies” with a focus on forest bioenergy.

## **6. Trade Policy**

### ***Canada-U.S. Softwood Lumber Agreement***

The Canada-U.S. Softwood Lumber Agreement, signed on September 12, 2006 entered into force in October, 2006. Under the terms of the Agreement, U.S. countervailing and anti-dumping duty orders were fully and completely revoked and more than US\$4.5 billion in duties was returned to Canadian softwood lumber producers. Canada has implemented region-specific border measures that become more restrictive as softwood lumber prices fall. Since the Agreement came into effect, lumber prices have been low and, depending on the option selected by each province, to date Canada has imposed the maximum export charges and most restrictive quota limits provided for under the Agreement on shipments of softwood lumber to the United States. The revenues generated by the export charges are being collected by the Canadian government and will remain in Canada.

The Agreement also has established a range of consultative mechanisms to ensure the orderly and commercially viable operation of the Agreement, and to enhance binational cooperation and the development of a more integrated North American lumber industry. The Agreement is extremely complex to administer and includes a dispute settlement mechanism that was invoked in 2007 to resolve differing interpretations of certain technical provisions of the Agreement by Canada and the United States.

### ***WTO – Doha Round***

Canada is a trading nation, and international commerce is the lifeblood of our economy. Canada is among the most open of the globe’s major economies. Exports account for almost 40% of our economy, with forest products being a significant contributor to Canada’s balance of trade. It is with this background that Canada welcomed the renewal of the WTO – Doha Round and is working with like-minded nations in the Non-agricultural Market Access talks to achieve freer trade in forest products.

### ***Regional/Bilateral Initiatives***

While Canada’s trade interests are being pursued multilaterally, we are also pursuing improved market access and commercial relationships with countries through regional and bilateral initiatives. In the near term, Canada is working to conclude free trade negotiations with the Caribbean Community, Columbia and Peru, the Dominican Republic, Korea, and Singapore.

## **7. *Phytosanitary Measures***

Canada has demonstrated leadership in the area of phytosanitary measures through the development of a national heat treatment certification program for solid wood products, which signifies that its wood packaging materials for export satisfies the requirement of ISPM-15.

Through the Canadian Food Inspection Agency (CFIA), Canada has been consulting with industry on some proposed “international” phytosanitary standards including: Classification of Commodities into Phytosanitary Risk Categories, A Strategy to Reduce or Replace Methyl bromide for Phytosanitary Purposes, A Supplement Defining Debarked and Bark Free.

Canada has pursued its efforts on advancing its implementation of a national heat treatment standard for solid wood products. Canadian efforts have also been devoted to improving the scientific basis behind the treatment options, as well as on the significance of bark on wood packaging material in service. The CFIA recognizes the Canadian Lumber Standards Accreditation Board (CLSAB) as the accrediting agency for this domestic program.

Canadian experts continue to take an active role in international fora related to phytosanitary measures, including North American Plant Protection Organization (NAPPO), International Plant Protection Convention (IPPC) and International Union of Forest Research Organizations (IUFRO) activities.

## **8. *Federal Mountain Pine Beetle Program***

British Columbia is experiencing a mountain pine beetle outbreak beyond any beetle epidemic recorded in North American history. This infestation is killing unprecedented numbers of lodgepole pine, the province’s most abundant commercial tree species. It is also threatening the well-being of about 180 B.C. communities. There is concern that the infestation will spread eastward into the jack pine stands of Canada’s northern boreal forest and other pines in eastern Canada.

Because of the vital role the forest industry plays in Canada’s economy as a whole, and the growing threat the beetle poses to forests throughout Western Canada, the Government of Canada has identified the infestation as an issue of national importance and is leading a national response. It is working closely with the Province of British Columbia, other provinces and territories and communities to deliver an effective response to the beetle infestation.

The federal Mountain Pine Beetle Program announced in January 2007 is investing \$200 million in measures to address both the short-term and long-term impacts of the beetle infestation. The federal Mountain Pine Beetle Program is supporting efforts to control the spread of the beetle, recover as much economic value as possible from timber destroyed by the beetle, and protect forests and communities from the risk of wildfire. Recognizing that the impacts of the beetle will be felt for many years, the program is also investing in measures that will help diversify the economic foundation of forest-dependent communities and contribute to their long-term stability.



## ***9. Competitive Initiatives***

In February 2007, the Government of Canada announced its Forest Industry Long-Term Competitiveness Initiative, a \$127.5 million initiative to address sectoral priorities such as product and market diversification, innovation and human resource challenges.

Provincial governments are also taking action. In 2005 and 2006, Quebec announced measures totalling \$1.4 billion over five years to help the forest sector address challenges and to contribute to the sector's revitalization. British Columbia (BC) is taking a market-oriented approach to the sector and has introduced policies to remove unnecessary barriers to competitiveness. As well, BC's Forest Innovation Investment Ltd. is spending \$11.5 million on marketing initiatives to expand access to new markets. Since June 2005, Ontario has announced a series of measures totalling more than \$1 billion over five years to help restore the forest sector's competitiveness and to assist rural and northern communities.

## ***10. Public Procurement Policy***

The Government of Canada has a Policy on Green Procurement that came into effect April 1, 2006 for federal government departments and agencies. This is to ensure that the government is *cost effective in its procurement*, operates and disposes of its assets in a manner that protects the environment and supports sustainable development objectives. This policy is intended to make the government a global leader in integrating environmental considerations into all aspects of our procurement system.

While the policy does not explicitly mention criteria for the purchase of wood and paper products, these products are covered by the policy. The Government continues to incorporate green criteria into the broader procurement process, including consideration of various criteria for forest products such as forest certification, recycled content, emissions reductions and energy usage. A government-wide training program is available on-line for government departments and agencies.

## ***11. Emerging markets for wood products***

As traditional wood markets mature, Canada must remain innovative in its approach to wood products market development. In an effort to diversify Canada's wood products markets and take advantage of emerging markets the Canadian government supports the following programs: the Canada Wood Export Program (CWEP) and the North American Wood First Initiative.

### ***Canada Wood Export Program***

Initially established in 2002 as a five year initiative, CWEP was renewed for an additional two years in February 2007 as part of Forest Industry Long-Term Competitiveness Initiative. CWEP will continue to build on its initial accomplishments, seeking partnerships with Canadian wood product associations and various provincial governments to promote Canada's wood products in offshore markets.

Since its inception, CWEP, through its network of Canada Wood Offices, has been especially active in emerging markets such as China and South Korea with offices in Beijing, Shanghai and Seoul. CWEP has raised the profile of Canadian wood products, influenced the development of residential construction codes and standards, assisted in the establishment of foreign marketing agents for a number of major Canadian wood producers and stimulated wood exports. In fact,

since 2001, Canadian exports of wood products have increased by more than 367% to China and 315% to South Korea, with 2006 wood product exports totalling \$121 million and \$100 million respectively.

In 2007-2008, CWEP will further expand its activities through the support of exploratory missions and trade show participations in areas such as Vietnam and the Middle East where demand for Canadian wood products have been on the rise in recent years.

However, as these emerging economies gain momentum, they are also becoming successful competitors. China for example, despite its limited domestic supply of industrial roundwood, has emerged as one of the key players in the wood products industry. China's proximity to Russia as a large fibre supplier, its huge investments in infrastructure to facilitate overseas trade and its access to a colossal and inexpensive work force are only few elements that have contributed to China's emergence as a competitive supplier in most wood products markets. Over the course of a decade, China: has become the largest plywood producer in the world; is reported to have a medium density fibreboard (MDF) capacity larger than all of Europe; dominates the wooden furniture market; and is expected to become a major competitor in value-added products such as doors, frames, mouldings and flooring.

### ***The North American Wood First Initiative***

This initiative is a newly created two-year program, delivered through North American wood products associations, is aimed at expanding opportunities for the use of wood products outside the traditional residential housing market. It will seek to address challenges facing wood usage in commercial applications in North American markets (such as in shopping centres, schools, hospitals, etc.).

### **III. Market Drivers**

As a result of a number of market factors, Canada's forest sector is undergoing a significant period of restructuring and change. The traditional Canadian forest industry model of producing large volumes of commodity products based on low cost energy, and plentiful, high-quality, cheap wood is gone. Energy prices are high, the Canadian dollar is up, and foreign competition has become increasingly aggressive. These factors have caused industry to downsize, merge, shift production and restructure to meet the changing market environment. The industry has responded through consolidation, rationalization of high cost production, and efforts to develop new markets and products.

#### ***Emerging Opportunities***

While many traditional markets for Canadian forest products are mature or in decline, there are growth opportunities which the sector is pursuing. These include: bioenergy and bio-products; value-added wood and paper products; increasing wood use in non-residential construction; and expanding offshore export opportunities for Canadian wood products.

#### ***Global Competition***

Aggressive foreign competitors have emerged, driven by technological advancements, cheaper wood, faster-growing trees, lower labour costs, and lighter regulatory burden. These competitors have weakened the Canadian forest product export position in many markets, and in some cases, aided by the strong Canadian dollar have managed to penetrate the North American market. In recent years, North America has become a net importer of softwood lumber, resulting from increasing US imports and declining offshore exports. Some analysts predict that North America will also become a net importer of paper and paperboard within the next ten years.

#### ***Energy Prices***

The increased price of oil has had significant impacts on the Canadian forest industry. The pulp and paper industry has been particularly impacted by higher energy costs. In addition, Canada's increasing oil and energy exports have contributed to the appreciation of the Canadian dollar, further weakening the Canadian forest industry's global competitive position. That said, the high price of oil may also provide opportunities for the industry in bio-energy and bio-fuel production.

#### ***US Housing Market***

The US housing market, the primary driver behind softwood lumber and wood panel markets in North America, began showing signs of weakness by mid 2006, and it is expected that this weakness will keep wood product prices low in 2007-2008. In the longer term, North American demand growth for wood products will continue to be healthy, due to a strong residential construction market. Strong demand, along with fibre supply shortfalls in Canada, is expected to support North American wood products prices after the current downturn.

***Shifting Global Demand for Paper***

The long-term picture for pulp and paper products is less rosy than for wood products, as demand growth is not keeping pace with economic expansion. Online media are eroding paper consumption in North America, and demand growth is expected to be well below that experienced in Asia over the coming decade and beyond.

***Exchange Rates***

Exchange rates will continue to play a driving role in determining the prosperity of the forest industry, as most Canadian forest products are exported and sold in US-dollar terms. The Canadian dollar averaged \$0.95 to the US dollar in August 2007, and this strength will be a key determinant of the profitability of Canadian forest products firms in the near term.

## **IV. Developments in Forest Products Markets Sectors**

### ***Wood Raw Materials***

The vast majority of Canada's forest resources are publicly owned. As such, the Canadian Annual Allowable Cut (AAC) regulations are governed by provincial legislation, and although there is a high degree of consistency in policies, the details vary considerably from province to province. The AAC levels, which are applied to provincial (Crown) lands, are set using forest inventory projections, and are generally based on a policy of non-declining future wood supply.

Following a recommendation from the *Commission to Review Public Forest Management in Quebec*, a 20% reduction in the annual allowable cut for softwoods has recently been imposed in the province. The reduction, which was announced in 2006, is being implemented over a period of three years. Conversely, in response to the Mountain Pine Beetle epidemic in British Columbia, the AAC has been further increased to allow salvage operations in the most severely affected areas.

### ***Value-added Wood Products***

In the Canadian context, the value-added wood products group includes wood windows and doors, factory-built homes, millwork and joinery products, shingles and shakes, containers and pallets, engineered wood products (EWP) such as I-beams, roof trusses, and other structural products. In the last decade, this group gained tremendous momentum in Canada. However, growth slowed in 2005 when sales grew by a mere 0.5 percent compared to 2004, to an estimated \$11.2 billion. Sales of Canadian value-added wood products represent approximately 36 percent of the total value of Canadian wood products.

Market acceptance of EWPs, the shift from larger dimension lumber to EWPs and the shift from stick-built homes to factory-built homes, all contributed to the phenomenal growth of this segment. In 2005, 73% of this production was consumed domestically while the remainder was exported, almost exclusively to the US market (94%). In 2006, total exports of value-added wood products totaled \$3.23 billion, a decline of 9.4% over 2005. Between 2005 and 2006, imports of value-added wood products increased by 2.5%, to \$1.22 billion. The increase of Canadian value-added wood product imports from China, the second largest non-domestic supplier to Canada, accounted for the majority of this growth.

Though Canada has developed some special niche markets within this product group, Canada faces increased competition from Asia, particularly China. China is quickly becoming a world leader in the manufacture and export of many value-added wood products, including mouldings, engineered wood flooring, and laminated lumber.

### ***Sawn Softwood***

Canadian sawn softwood production decreased by 2.4% in 2006 to 79.2 million cubic metres. While the domestic housing market remained robust and Japanese housing starts continued to rise for the fourth consecutive year, a weakened U.S. housing industry more than offset these factors, contributing to an overall decline in Canadian sawn softwood demand. Rising U.S. interest rates in the first half of the year, a slowing U.S. economy and rapidly rising U.S. home prices were the main reasons behind the softened U.S. housing market.

The Canadian sawn softwood industry is heavily reliant on the U.S. market. Over the last few years, U.S. duties on Canadian sawn softwood and the appreciation of the Canadian dollar have weakened the competitive position of Canadian producers and made it possible for offshore competitors to further penetrate the U.S. market. With a new seven year Canada-U.S. softwood lumber agreement now in place, Canadian producers can hope for U.S. market access under a stable and predictable tariff regime. However, the downturn in the U.S. housing industry has scuttled U.S. demand for Canadian sawn softwood as well, precipitating a fall in Canadian sawn softwood exports to the U.S. in 2006, by 6.1%. The fall in sawn softwood demand has also produced a decrease in North American sawn softwood prices, by 15.6% in 2006 compared to 2005. While Canadian producer margins shrank in face of these price declines, the returns for offshore producers, particularly those of Europe, were hurt sufficiently to spark a significant retreat from the U.S. marketplace. Specifically, in 2006, U.S. sawn softwood imports from Austria, Sweden and Germany fell by 50.1%, 38.2% and 8.1% respectively.

Present conditions in the U.S. housing market suggest that demand for sawn softwood will likely remain weak in 2007. While U.S. interest rates are anticipated to remain flat, the U.S. housing sector has softened due to tightening credit standards imposed in the marketplace, a fallout of flutters experienced in the U.S. subprime mortgage market in the summer of 2007. Slow-to-moderate paced expansion in the U.S. economy is also unlikely to boost U.S. housing driven sawn softwood demand in any significant way.

### ***Coniferous Logs***

In 2006, both imports and exports of softwood logs have decreased relative to the previous year. Imports decreased by nearly 1.5 percent, to 3.243 million cubic metres, while exports declined by 9.7 percent to 4.293 million cubic metres.

With the current slowdown in the North American wood market, the first two quarters of 2007, are not showing signs of any improvements, with softwood logs imports and exports both declining by 27 percent and 21 percent respectively. Based on the current trends in the industry, we can expect that the effect of the slowing US housing market will lead to a continued decline in the processing of logs.

### ***Sawn Hardwood***

Production of sawn hardwood slowed again in 2006, down 4.4% from 2005 to 1.64 million cubic metres. Exports, which had been fairly flat for three years running, fell by more than 20% to 1.08 million cubic metres in 2006. Meanwhile, imports declined to their pre-2000 level, at just over 1.0 million cubic metres.

For the remainder of 2007, both production and exports are expected to be below their 2006 levels as a result of reduced US demand.

### ***Hardwood Logs***

Hardwood log imports have declined again in 2006, decreasing by 14.7% to 1.6 million cubic metres. Exports are also down 4.3% from the previous year to 199 thousand cubic metres, the lowest level since 1997. At mid-year, both imports and exports are lower than their 2006 mid-point, and this trend is unlikely to change for the remainder of 2007.

### ***Plywood***

Canadian plywood consumption increased by 10.0% in 2006, while imports grew by 13.9%. This was in part driven by a robust Canadian housing market which has benefited from solid employment and income levels, high consumer confidence and a relatively strong economy. However, healthy demand from non-residential, industrial and repair and remodelling markets also boosted plywood consumption.

The U.S. housing industry is the main driving force behind North American plywood demand. In 2006, US housing starts fell 12.5% compared to 2005. This trend continued with US housing starts declining by 26.8% in the first half of 2007 compared to the same period in 2006. A slowdown in the U.S. economy and corrections in the housing market from excess inventory precipitated this first half decline, filtering into diminished U.S. demand for Canadian plywood as well. The net result was that Canadian exports declined by 15%, and Canadian production dropped 3.1% despite the aforementioned growth in domestic consumption.

With Oriented Strandboard (OSB) continuing to substitute for plywood in the structural panels market and Canadian plywood producers facing increased competition from low-cost Chinese plywood mills, who are increasingly becoming certified according to North American standards, U.S. demand for Canadian plywood is expected to remain weak. Another wildcard is Brazilian plywood entering U.S. markets. In 2006, reduced U.S. imports of Brazilian plywood were largely the result of a strengthened Brazilian real, which appreciated by 12.0% in 2006, and an 8% tariff tacked onto Brazilian plywood imports, originally implemented in July 2005, which made its full impact felt through the course of 2006. If Brazilian producers can overcome the challenges imposed by the exchange rate and higher costs placed by the tariff, Canadian plywood producers will likely face stiffer competition from these producers in the U.S. market.

### ***Oriented Strandboard (OSB)***

Canadian consumption of OSB increased by 11.6% in 2006 compared to 2005. OSB consumption in 2006 and into 2007 was boosted significantly by strong Canadian housing demand while OSB success in substituting for plywood in U.S. markets ensured Canadian OSB exports to the U.S. also rose (1.7%) despite a softened U.S. housing market. OSB prices remained low due to sluggish U.S. demand. Low OSB prices will likely persist through the remainder of 2007.

### ***Hardboard and Medium Density Fibreboard (MDF)***

After two years of increases, 2006 Canadian production of hardboard/MDF declined by 13% to 1.518 million cubic metres. Similarly, midway through 2007, year-to-date production of hardboard/MDF failed to keep pace with the previous year's output, down 4.7% to 793 thousand

cubic meters. In 2007, exports and imports both lost ground relative to their levels over the same period last year. Exports fell by more than 14% while imports declined by more than 24%. In contrast, Canadian consumption remained relatively unchanged at 393 thousand cubic metres.

Coupled with a softening of the US market and the emergence of competitors such as China, Canadian production of MDF is expected to continue to decrease in 2007.

### ***Particleboard***

In 2006, particleboard production was down 17% from 2005 level, at 2.39 million cubic metres. Exports declined by 27% to 771 000 cubic metres and imports decreased by 6.6% to 352 000 cubic metres. This can be attributed to increasing competition from offshore suppliers, the strong Canadian dollar, and a slowdown in the US housing market. Over the first 6 months of 2007, particleboard production declined by 8% compared to the same period last year while particleboard imports increased by nearly 70%.

### ***Paper and Paperboard***

In 2006, Canadian consumption of paper and paperboard decreased by 8.5%. This almost matched the decline in consumption from the previous year, of 8.6%. Much of this drop in consumption can be sourced to the fall in demand for newsprint and printing and writing papers, comprising 72.8% of Canadian paper and paperboard production. The North American markets for paper and paperboard products, to which the vast majority of Canadian products are destined, are reaching maturity. This is partly caused by the online media sources which have taken ad revenues away from newsprint based media sources. As a result, paper and paperboard products as a group has undergone a dramatic decline in consumption.

As Canadian producers continue to face increasingly high fibre and energy costs as well as an appreciating Canadian dollar, the already shrinking profit margin is expected to persist in 2007.

### ***Pulp***

Though pulp exports remained robust, growing by 2.2% in 2006, Canadian consumption plummeted by 14.0% and overall Canadian production declined by 7.3% in 2006. As with paper products, the high value of the Canadian dollar, high energy costs and escalating wood fibre costs have hurt producer margins, sparking rationalization activity within the industry and causing numerous capacity reductions of high cost production. While decreased demand for paper in North America has filtered into reduced demand for pulp (for paper production), reflecting the relative maturity of North American pulp markets, growth of pulp demand on a global scale has shifted away to Asian markets. In 2006, while Canadian exports to the U.S. and Europe declined, exports to China, Japan and the rest of the world increased. In fact, pulp accounted for nearly 15% of all Canadian exports to China - Canada's main export product to China. The driving forces behind the rise in exports to China were increased pulp demand for paper production and lost non-timber pulp supplies from closed domestic mills, shut-in due to pollution problems. With Chinese demand for paper expected to grow appreciably in the coming years, the demand for pulp as an input will also grow. However, with growing low cost South American capacity and pulp supplies



located closer to the demand source, China, Canadian producers can expect to face stiff competition if market share is to be won in these new markets.

## Appendix

### *Statistics and Prospects*

#### Sawn Softwood (000 Cubic Metres)

	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007 (Jan-June)</b>
<i>Production</i>	82,774	81,172	79,228	37,853
<i>Stocks</i>	7,968	7,740	8,079	8,422
<i>Consumption</i>	28,836	26,994	26,958	13,262
<i>Imports</i>	655	900	698	359
<i>Exports to Europe</i>	394	333	394	368
<i>Exports (Total)</i>	55,056	55,306	52,629	24,607

#### Coniferous Logs (000 Cubic Metres)

	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007 (Jan-June)</b>
<i>Imports</i>	3,094	3,291	3,243	1,403
<i>Exports</i>	3,497	4,752	4,293	1,869

#### Sawn Hardwood (000 Cubic Metres)

	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007 (Jan-June)</b>
<i>Production</i>	1,816	1,717	1,642	748
<i>Stocks</i>	95	99	54	46
<i>Consumption</i>	1,885	1,943	1,655	832
<i>Imports</i>	1,408	1,578	1,043	551
<i>Exports to Europe</i>	120	108	105	63
<i>Exports (Total)</i>	1,368	1,348	1,075	475

#### Hardwood Logs (000 Cubic Metres)

	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007 (Jan-June)</b>
<i>Imports</i>	2064	1898	1617	670
<i>Exports</i>	223	208	199	56

#### Plywood (000 Cubic Metres)

	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007 (Jan-June)</b>
<i>Production</i>	2,344	2,323	2,252	1,105
<i>Imports</i>	678	689	785	400
<i>Exports (Total)</i>	1,027	1,118	950	394

**Oriented Strandboard (OSB) (000 Cubic Metres)**

	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007 (Jan-June)</b>
<i>Production</i>	9,825	9,883	10,141	4,947
<i>Imports</i>	130	130	164	56
<i>Exports</i>	8,557	8,776	8,925	3,698

**Hardboard and Medium Density Fibreboard (MDF) (000 Cubic Metres)**

	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007 (Jan-June)</b>
<i>Production</i>	1,700	1,746	1,518	793
<i>Consumption</i>	680	864	719	393
<i>Imports</i>	381	462	449	187
<i>Exports</i>	1,401	1,344	1,248	587

**Particleboard (000 Cubic Metres)**

	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007 (Jan-June)</b>
<i>Production</i>	2,947	2,887	2,393	1,026
<i>Imports</i>	382	377	352	316
<i>Exports</i>	1,202	1,060	771	316

**Pulpwood Exports (000 Cubic Metres)**

	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007 (Jan-June)</b>
<i>Exports (US)</i>	142	256	108	54
<i>Exports (Total)</i>	180	274	146	59

**Wood Chip Exports (000 Cubic Metres)**

	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007 (Jan-June)</b>
<i>Exports (US)</i>	268	415	305	101
<i>Exports (Japan)</i>	444	493	1,164	666
<i>Exports (Total)</i>	1,043	1,014	1,961	957