

Perspective

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SPECIAL ON THE FORESTRY SECTOR

The rules of the game are changing,
and so is the forestry industry...

No time for nostalgia



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Economic Studies



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NOTE TO READERS: In this text, the symbols **M** and **B** are used respectively to refer to millions and billions of dollars.

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EDITORIAL

The forestry industry is changing

Forestry's problems are no secret. An exceptional combination of cyclical and structural factors has hit the industry like a ton of bricks over the last few years. The damage cannot be assessed in terms of job losses alone. Nor is it confined to the resource regions. All of Québec is affected when tax revenues decline and money must be set aside to provide benefits to struggling former workers.

All industry stakeholders agree that a real effort has to be made; the status quo is no longer an option. The rules of the game are changing, and so is the industry. Some steps have already been taken to guide the change the industry must undergo. However, while limits have been set on logging potential and a new way of allocating resources was tabled in the framework of the Québec government's Green Paper, a myriad of uncertainties remains. The benchmarks are not yet well enough defined to guide the action of forestry companies and mills. There is a lot of hesitation, which creates inertia. The industry would like to have emerged from the restructuring process once demand firms up.

Québec is not the only one with problems: the other Canadian provinces are also subject to the market's dictates and have had to slow the pace in the last few years. Comparison is not always very comforting, but it does have the advantage of helping to identify potential sources of improvement. Of course, Québec's industry will never be like British Columbia's: tree sizes and species are different. Also, a look at the Scandinavian industry's success helps to grasp strategies for carving out a good place in the forestry industry. Ingenuity, a culture of excellence and a fighting spirit characterize the industry in northern Europe, and can be a source of inspiration.

The forestry sector is looking for solutions. To find them, many researchers are working at all levels of the production chain: from fibre to delivering products to customers. Avenues include a better use of the properties of wood, optimization of logging and cutting costs along the entire production line. There is no shortage of ideas. However, they must be well received by potential buyers, as well as being profitable. Along with these actions comes a desire by all stakeholders, from municipal and provincial governments, the regions, the industry, First Nations, universities, recreational organizations, and private owners, to name but a few, to restore the value of Québec's forests, regardless of how they are used. This is a delicate balancing act, which will require careful handling and a solid consensus.

Despite the hesitation that characterizes the industry's current restructuring, some companies have bet on success. They have instituted strategies by developing products based upon their customers' needs and interests. Contrary to what the overall mood suggests, not all plants are on the verge of closure. Most of the facilities that are still in business have abandoned commodity products, where they were not competitive, to focus their efforts on specialty products. They have opted to work together in order to infiltrate the giants in the materials trade.

Clearly, this is not the time for nostalgia in the forestry industry. The industry must simultaneously remove the blot from its escutcheon and show some daring in developing solutions to keep the current slump from becoming permanent.

François Dupuis
Vice-President and Chief Economist

THE SITUATION IN QUÉBEC

We have not bottomed out yet

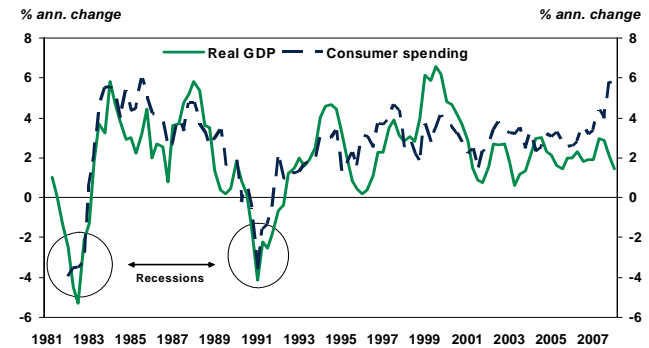
As in North America as a whole, in Québec, the economic outlook has darkened somewhat since the spring. The American economy, which will take longer than expected to forecast due to the ongoing housing slump and skyrocketing oil prices, will sap growth on this side of the border. Foreign trade, already in poor condition, will continue to deteriorate and will put the brakes on the province's real GDP growth. Given that the recovery by exports has been put off until the second half of 2009, strong domestic demand and consumers' contribution in particular is essential for avoiding a contraction by real GDP. Consumer spending did well in the first quarter but could slow, as surging gas prices have lately shaken consumer confidence to the core. In this context, the risk of a recession remains high, at 40%. Québec should escape it due to the scope of the tax relief and the infrastructure investment plan. The government's contribution is well timed and will make it possible for economic growth to match the national average this year, at 1.0%. Next year, the American economic recovery and the boost it gives to exports will help the real GDP to grow 1.7%.

WILL CONSUMERS HOLD UP?

Although consumer resilience seemed to be a sure thing due to the scope of the tax cuts extended to households early this year and the improved job market, the outlook is now uncertain. For one thing, the increase in prices at the pump really shook consumer confidence in May. Confidence fell below its historic average for the first time since hurricanes Katrina and Rita hit, propelling gas prices up at the end of the summer of 2005. If fuel prices take some time to come down, consumption is almost certain to run out of steam. The kind of drop in spending seen during the recession in the early 80s and 1990 is not very likely this time. The tax and GST cuts, low interest rates and low jobless rate will help consumers get through this tough period.

Gas prices, however, will take a big bite out of consumers' budgets. The tax relief could be partially or even completely wiped out, depending on how prices at the pump behave over the next few months. According to our calculations, if fuel prices fall to an average of 125 cents a litre this year as forecast, consumers' shortfall will total \$2.7B. This bite would eat up the equivalent of 85% of the tax relief extended in 2008 (\$3.2B). If gas prices instead stay over an average 140 cents a litre this year, the extra gas costs would completely

Graph 1 – Support from consumers is needed to stave off a recession

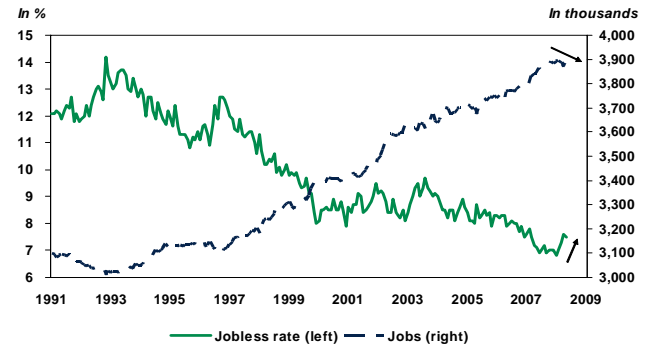


Sources: Institut de la statistique du Québec and Desjardins, Economic Studies

wipe out the tax relief. Although the benefits of the tax and GST cuts could be neutralized by prices at the pump, they will help keep consumers from running aground.

The labour market should also be kept under a close watch in Québec. Employment has been bumpy for the last few months and, at 7.5% in May, the jobless rate is moving off the 6.8% low it reached in January. As the last few months did not live up to our expectations and the economic outlook is getting darker, our forecasts have been adjusted accordingly. Job creation will total only 45,000 this year, and 60,000 next year. This means the jobless rate will stay above the 7% mark for a longer time. However, it is still historically low and also quite far from the levels that usually characterize a recession.

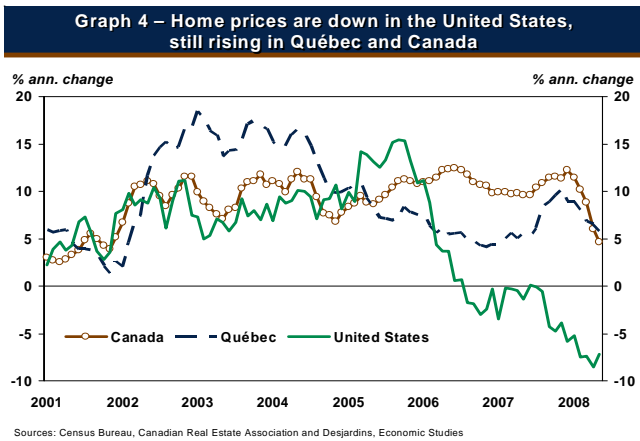
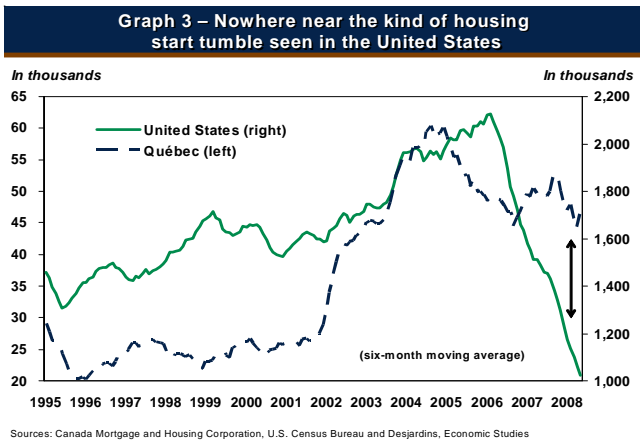
Graph 2 – The jobless rate is climbing and Québec job creation is teetering



Sources: Statistics Canada and Desjardins, Economic Studies

HOUSING WILL NOT COLLAPSE

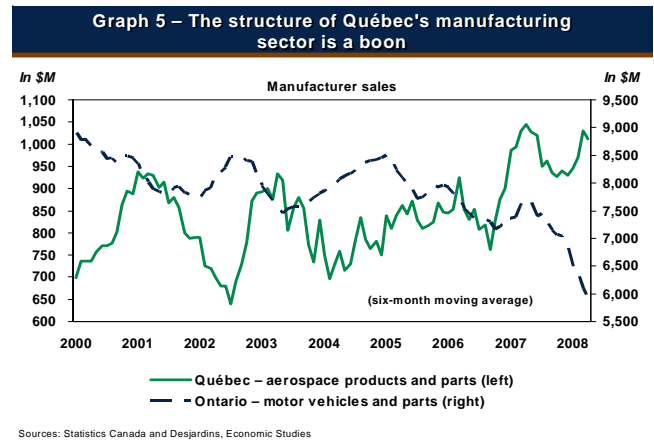
Contrary to the United States, the residential real estate market is still fairly solid on this side of the border. Starts have edged down in Québec since the year began, but there is no comparison with the collapse in the United States. Given the increase in construction costs, the demand for new homes is shifting toward more affordable market segments. Semi-detached and row houses are now in vogue, while single-family dwellings are losing popularity, leading to the drop in construction. As for resales, the market is nowhere near a surplus situation, which is still propitious for price increases that are higher than inflation. This is a boon for Québec households, whose real estate assets continue to appreciate. There is no risk that Québec will see confidence plummet as abruptly as it has in the United States, to a historic low. The housing sector is expected to see somewhat of a lull this year, as price increases will slowly moderate activity. Sales of existing homes will drop 5.4% this year, while starts will total 45,000 units, compared with last year's 48,553 units.



Detailed forecasts are on page 21.

FOREIGN TRADE WILL TAKE SOME TIME TO IMPROVE

The clouds have gathered over international exports. Not only has the down trend kept expanding, but the recovery has been pushed back to mid-2009, when the U.S. economy should turn around. As aerospace constitutes a big part of Québec's shipments and it is less sensitive to the swings in the U.S. economy, it is an asset for the province. In addition to deliveries of whole aircraft, there are many engine and parts suppliers in Québec. They are part of the global integration chain and a number of them even participate in building the huge A380 aircraft. Just as Ontario is being hurt by the troubles in the automotive sector, Québec is benefiting from the aerospace sector's solid performance.



Hélène Bégin
Senior Economist

THE SITUATION IN ONTARIO

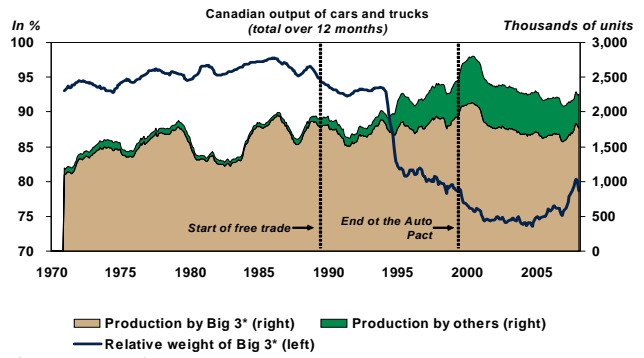
The manufacturing sector puts Ontario into a recession

The chances that the Ontario economy will be in a recession in the first half of 2008 are increasingly materializing. Note that Ontario's economic growth has systematically been below the national average in recent quarters. With Canada's economy currently close to a recession, it seems clear that Ontario is already in one.

The problems in Ontario's economy are not only due to the magnitude of its trade with the United States, but also due to the automobile industry's dominance in the province's manufacturing sector. This industry is hard hit by serious structural and economic problems, including GM, Ford and Chrysler's decline in market share, Canadian plants' loss of competitiveness due to the loonie's strong appreciation, and domestic production that is mainly focused on big engine vehicles in the context of rising gas prices. These difficulties have recently been exacerbated by a cyclical slowdown in American demand. The automotive sector has thus trimmed about 0.6% on average from Ontario's economic growth over the last two years.

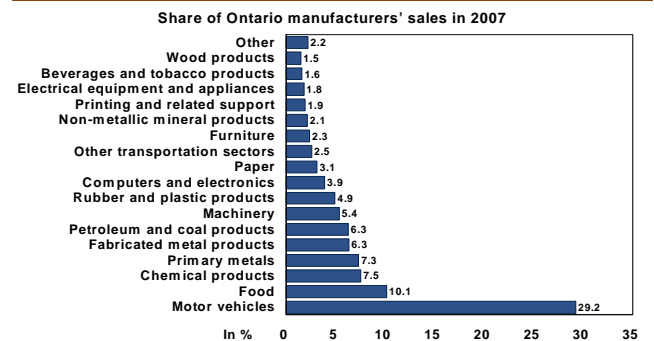
The increase in gas prices has also had repercussions on the entire Ontario economy. According to Statistics Canada, domestic gas sales stood at about 16 billion litres in Ontario for all of 2007. Every increase of 10¢ a litre represents a potential additional expense of \$1.6B for Ontario consumers and businesses. If these price increases were to last, the resulting substitution effect could eventually cause a drop in other consumer expenditures.

Graph 7 – Motor vehicle output has been declining since 2000



Ontario consumer confidence has deteriorated substantially in recent months. Ontario is even the region in Canada with the biggest decline in its confidence index from January 2007's cyclical peak. No doubt the province's major economic problems and the spectre of a recession have played a big role in Ontarians' pessimism. If this trend continues, the drop in Ontario household confidence could well rein in consumer spending growth.

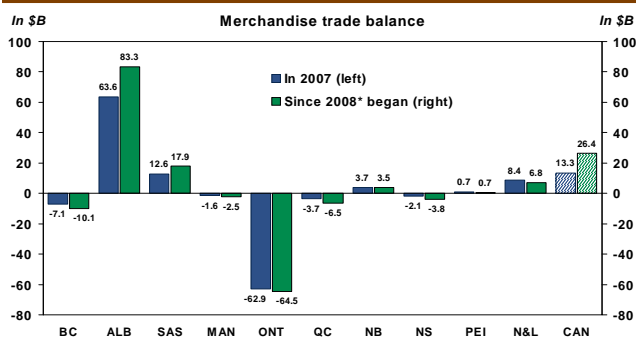
Graph 8 – The automotive industry is very important in Ontario



Our new scenario has not changed much, although the balance of risks is tilted to the downside. We still expect the Ontario economy to be in recession, with two quarterly real GDP contractions in the first half of 2008. Economic growth of just 0.5% is thus forecast for this year. A slight rebound is forecast for 2009, with a real GDP increase of 1.3%.

Benoit P. Durocher
Senior Economist

Graph 6 – Ontario is still the hardest hit by the deterioration in the trade balance



* January to April 2008
Sources: Statistics Canada and Desjardins, Economic Studies

Detailed forecasts are on page 21.

REPORT: THE CHALLENGES

The rules of the game are changing, and so is the forestry industry...

Since the early part of this decade, Québec forests have been in the headlines many times. At one and the same time, the forest is caught up in the issue of jobs, the issue of collective heritage, and the issue of survival for more than 200 Québec communities. This makes it a heart-felt matter for Québec's resource regions. The forestry industry is also an important part of Québec's economy which has been deteriorating since the decade opened. Can we look beyond the current gloom to glimpse some solutions? This issue of Perspective will try to answer the question by looking at where the industry is, how it got there, and what opportunities it has.

IS THE FORESTRY INDUSTRY AS IMPORTANT AS IT IS TOUTED TO BE?

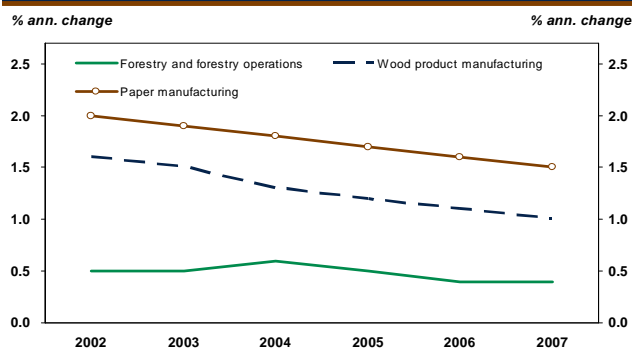
The forestry industry is a major player in our economy. It accounted for 2.9% of Québec's real GDP in 2007 (operations and management: 0.4% of total GDP; wood product manufacturing: 1.0% of GDP; pulp and paper: 1.5% of GDP). Once we add in furniture manufacturing and activity at forestry and industry research centres, the industry's percentage exceeds 4%. Even at close to 3%, the sector is more important than transportation equipment, including aerospace (2.7% of Québec's real GDP), accommodation and food services (2.3%) or computer system design (1.3%).

The industry's weight in Québec's economy has declined. In 2002, the combined GDP of the forestry operations, wood product manufacturing and pulp and paper sectors accounted for 4.1% of Québec's real GDP, with each sector making respective contributions of 0.5%, 1.6% and 2.0% (Graph 9). Each sector is posting a decline that can be noted in terms of both its cash value and its percentage.

THE CARNAGE CAN BE MEASURED IN TERMS OF EMPLOYMENT, THE NUMBER OF BUSINESSES, AND THE VALUE OF SHIPMENTS

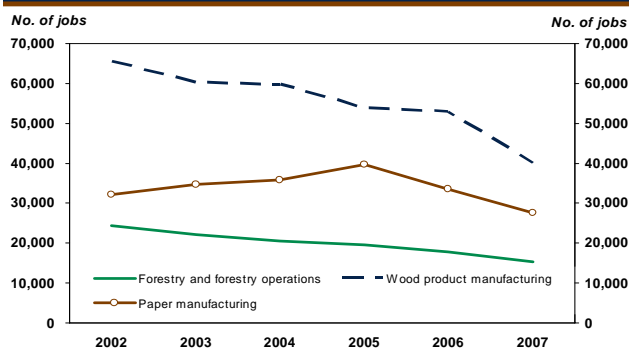
Graph 10 shows that the employment down trend has affected all of the sectors. In forestry alone, Statistics Canada estimates

Graph 9 – Evolution of forestry's GDP in terms of Québec's total GDP



Sources: Statistics Canada, Institut de la statistique du Québec and Desjardins, Economic Studies

Graph 10 – Employment is down substantially in Québec since 2002



Sources: Statistics Canada, Institut de la statistique du Québec and Desjardins, Economic Studies

that the number of Québec workers involved in operations and management went from 24,400 in 2002 to 15,300 in 2007: down 37.3% in just five years! In wood product manufacturing (sawmills, plywood, veneer, wood structural members, wood doors and windows, etc.), the number of jobs fell from 65,500 to 40,100 during the same period. It is, without a doubt, the hardest hit sector. The reduction totals 25,400 jobs, or 38.8% of the workforce. In pulp and paper, the workforce declined from 32,200 in 2002 to 27,700 in 2007, an eradication of 4,500 jobs. And it seems the carnage is not yet over: the final closures of the Belgo plant in Shawinigan and the paper mill in Donnacona in early 2008 will inflate these sorry statistics.

The media have covered business closings so widely that we can well ask if there are any plants that are still in operation. The Statistics Canada's Business Register helps us compare the situation in June 2002 with the situation in June 2007 (Table 1). As could have been expected, all of the sectors were hit. Forest operations and management lost 14.5% of their businesses, which dropped from 2,662 to 2,276. In wood products, there were 1,187 firms in 2002 and only 1,046 in 2007, an estimated loss of 11.9%. In passing, note that the number of sawmills fell 23.1% in just five years. Paper manufacturers saw their numbers dwindle from 198 to 170, down about 14%.

Similarly, sales volumes have crumbled since the decade began, as shown by Graph 11, which depicts the real value of shipments, eliminating price effects. Clearly, Québec's production is losing ground.

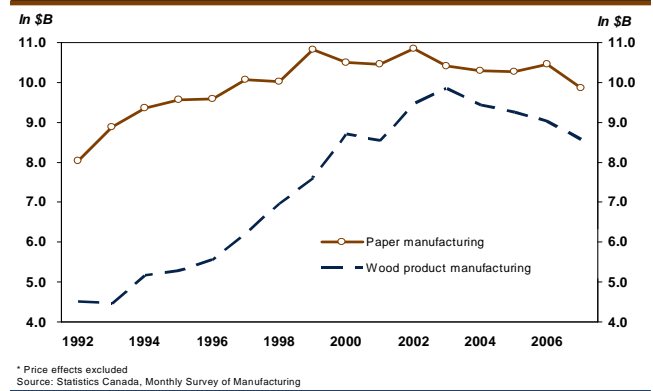
QUÉBEC AS A WHOLE LOSES

The damage goes beyond the number of job losses and plant closures. In addition to lost jobs, there is the decline of the villages and small municipalities which were mainly or wholly dependent on forestry operations or a sawmill. This is often the end of the line for many of the subcontractors associated with a local plant (sawmill, paper manufacturer, etc.). Lost wages (graph 12) are replaced by employment insurance benefits and, a while later, by employment assistance payments (social assistance). Families see their buying power wane and, in turn, local businesses throw in the towel.

Municipalities also get hurt. The closings eventually deprive them of tax revenues, as some plants challenge their property assessments because the facilities are obsolete. Some even go so far as to invoke "economic obsolescence," a vague term that the courts are currently examining. The Québec Union of Municipalities (UMQ) estimates that some municipalities have seen their tax bases slashed by 15 to 40%. Governments are also hurt as personal and business tax revenues decline. Transfer payments (employment insurance and employment assistance) and special assistance programs (assistance programs for older workers, for instance) run up expenses that do not generate any direct economic activity—they act as band-aid measures rather than creating employment.

It could be argued, of course, that new jobs are being created parallel to this. In fact, from 2002 to 2007, 411,600 net jobs were created in Québec. If we look at the overall situation, Québec is still managing to do well in terms of the labour market. However, for workers in the regions and the areas they live in, the situation is otherwise. Between layoffs and the appearance of new jobs, there can be a considerable waiting period. The skills sought do not always match the

Graph 11 – Real shipments* are down in Québec



skills of the workers who have been laid off (e.g., some have turned into mining workers, particularly in Abitibi). Moreover, the new jobs that open up are not necessarily in the regions affected by the forestry crisis. And that's exactly where the biggest price is being paid.

HOW DID THIS HAPPEN?

An unusual conjunction of negative factors helped to weaken the position of Québec's forestry industry. Analyzing the economic parameters sheds some light on the situation.

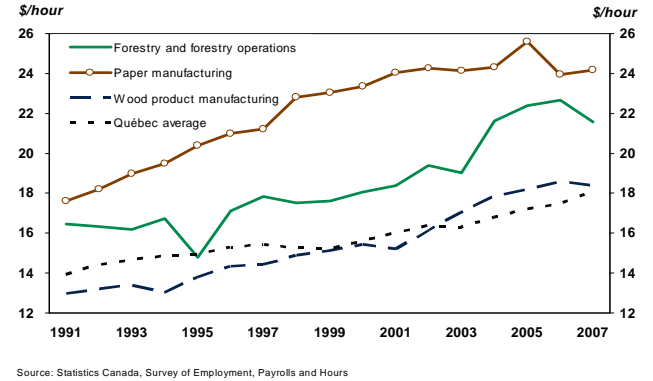
In terms of demand, lumber shipments underwent a big boom until 2004, as housing starts peaked in the United States, Canada, and Québec. At the beginning of the decade, prices appreciated. Since then, the need for lumber has fallen off a lot, especially south of the border. The U.S. housing market collapse has triggered a pullback in the new home market. Graph 13 depicts the situation in the United States: there, along with the huge number of existing homes on the market, an impressive number of new houses are not finding takers. What's more, sales of materials at U.S. renovation and garden centres are lagging. The American market is an enormous one, and its repercussions are reaching us.

**Table 1
Change in Number of Firms**

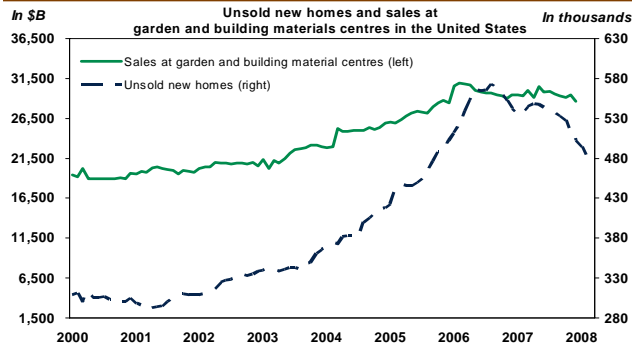
	June 2002	June 2007	2002 to 2007 (% change)
Forestry and forestry operations	2,262	2,276	(14.5)
Wood product manufacturing	1,187	1,046	(11.9) overall (23.1) for sawmills
Paper manufacturing	198	170	(14.1)

Sources: Statistics Canada, Business Register and Desjardins, Economic Studies

Graph 12 – Average hourly earnings for hourly paid employees



Graph 13 – Wood products: demand is declining



Source: Datastream

Prices for lumber quickly deteriorated. The drop in lumber demand is not the only contributing factor. The trade dispute over lumber, the skyrocketing Canadian dollar and the problems created on Canada's west coast by pests (pine beetle) added to the problems the industry was already dealing with. British Columbia had to engage in mass felling to limit the losses being caused by the insects. The North American market was literally swamped, which helped limit price increases. Québec producers' access to U.S. customers was limited by the lumber trade dispute, making it easier for competitors to get into the U.S. market (e.g., Brazil, European countries, etc.).

In this context, Québec plants quickly dropped under the break-even point because of their size, especially for conventional lumber products (Graph 14). Our plants were also running at low speeds, in a context in which their supply costs were high compared with all their competitors. In other words, the resulting carnage was not surprising. The current low price situation will not help the industry, which has been below the shutdown point for some time now.

In pulp and paper, growth is occurring outside of North America. Demand, supply and investment are all increasing elsewhere, not on this continent. American newsprint demand fell by over one third from 2000 to 2007 (see Graph 15). In fact, the Canadian industry's capacity is concentrated in the products with the fewest prospects for growth. Media mergers mean that there is an increasingly small number of newsprint buyers, giving a handful of buyers some bargaining power. Newspaper publishers are also looking for savings, cutting down on newsprint use. Parallel to that, the competition in pulp and paper is growing, particularly from South America (Brazil with eucalyptus pulp) and China.

IS THE SUPPLY SITUATION JUST AS WORRISOME?

To briefly summarize the world situation, we could say that supply is declining in North America and increasing elsewhere, especially Asia and South America. This observation applies to lumber and pulp and paper, to varying degrees. In lumber, some of the Canadian industry's production is dedicated to exports for pulp and paper production. But there is already excess capacity worldwide: Russia and South America are in the process of consolidating their positions.

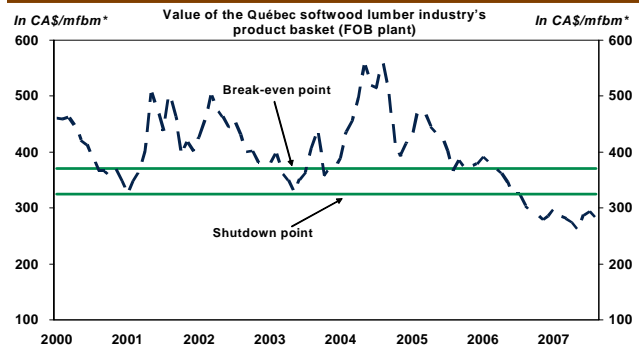
In the pulp sector, producers in North America and Scandinavia (Finland, Sweden and Norway) are cutting their commercial pulp production capacities. Simultaneously, new projects are emerging in South America and Asia, where markets are developing at full speed (see Table 2).

For paper, weak demand and anaemic returns are leading to disinvestment in North America. Increasingly, the fibre supply is coming from South America because of eucalyptus' properties for producing paper. For the paper industry's needs, it takes about seven years to grow eucalyptus, while it takes about 70 to grow black spruce.

In Canada and Québec, production capacity is focused in low-growth products, such as newsprint, printing paper and packaging.

The U.S. housing market collapse has brought lumber prices down with it. Despite the ongoing rationalization in lumber, prices did not do better at the beginning of 2008. Graph 16 clearly depicts the drop in prices for conventional products such as planks. Pulp and newsprint prices have gone up due to a drop in supply throughout North America.

Graph 14 – Current prices cannot sustain the industry



* mfbm: 1,000 Foot Board Measure
Source: Québec Forestry Industry Council

THE CHALLENGES FACING QUÉBEC’S FORESTRY INDUSTRY

One of the first challenges facing Québec’s forestry industry is that of cleaning up its image. The industry’s image has been smirched over the last 10 years, to the point that any intervention in the forest, even reforestation, seems illicit.

Among the challenges facing all industry sectors is the decrease in allowable cuts. In the wake of the Coulombe Commission’s recommendations, the Chief Forester cut the Québec harvest area by over 20% for 2008 to 2013. From billets to chips, all types of production are affected. Harvest areas are increasingly remote, tree diameters are smaller and smaller which, along with the always problematic issue of government royalties, make buying expenses high. Increasingly, raw materials are coming from the United States for hardwood (lumber, construction and furniture components). In forestry, quality logs are said to be increasingly scarce. Note also that transportation costs have gone up as gas and diesel prices have increased. Add to this the fact that plants are not operating at full steam.

In wood product transformation, such as sawmills, Québec plants are much smaller than the plants of its closest competitors. The competition can thus distribute its fixed costs (financial, insurance, administration costs, etc.) over a greater volume, helping achieve economies of scale. The situation is similar in pulp and paper: competitors in Europe and South America have plants that produce two to three times as much.

The labour issue is a problem, especially in the forest and in forest products. The sector has gotten such bad press that it is sometimes necessary to look outside the country to find people willing to work in the forest. In Abitibi, the mining sector offers competitive wages, causing forest workers to defect.

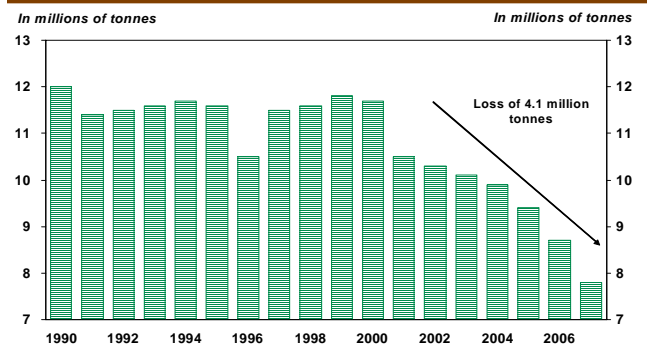
The Canadian industry’s concentration in declining products (commodity lumber, softwood pulp, newsprint, etc.) is limiting investment. Stable or declining demand for wood and paper products puts us at a disadvantage. Every investment abroad (South America or Asia) reduces our own competitiveness.

Table 2 – Non-NORSCAN Producers Get Bigger*

<i>Production capacity</i>	1990	2012
North America / Nordic nations	19.8 MT	24.5 MT
Other regions	13.3 MT	39.2 MT
Total	33.1 MT	63.7 MT

* North America and Scandinavian countries
Source: Pulp and Paper Products Council

Graph 15 – Newsprint: U.S. demand is down



Source: Pulp and Paper Products Council

The increase in production costs, combined with a drop in supply volumes, is cutting into profit margins. The increase in freight costs over the last few years for delivering output to Canadian and American markets requires an extra financial effort. Add to this the dismal financial condition of many companies (AbitibiBowater made the headlines on this issue in early 2008), and we cannot be surprised about the drop in capital spending.

Still-shrinking profit margins are leading to rationalization in both pulp and paper and wood products. This process is ongoing. We can expect, over the medium range, that the major firms will dominate the markets and focus on commodity products. Among materials dealers, the wave of consolidation illustrates this phenomenon in wood products. Retailers are huge compared to their sizes 10 or 15 years ago. They tend to give preference to major suppliers who can meet their needs. Several players band together and gain extra bargaining power; this leans toward a small number of major producers or argues in favour of pooling the strengths of small producers to supply them.

Smaller firms still have their place and they will excel in secondary and tertiary manufacturing, where custom manufacturing is becoming the standard and the service offering is specialized. Some firms are already successfully filling these niches. The second file will take a look at this issue.

SOLUTIONS FOR THE INDUSTRY

The clear-sightedness the forestry industry is showing is an asset in and of itself. In forestry operations, lumber products and pulp and paper, industry people are not pulling any punches in their analyses. They are not trying to minimize the problems. All sectors are showing a will to act. Many actions are being taken to find solutions. Here, over 650 researchers are working to improve the industry’s performance at every level: from fibre to product merchandising. The researchers

are scattered across many research centres. The most well known of these are FERIC¹ for forestry, the Canadian Wood Fibre Centre, in basic wood research, FORINTEK,² in lumber, and PAPRICAN,³ in pulp and paper. However, research is not limited to these places: at universities, faculty researchers are also experimenting with new methods for Québec forestry. Other teams are striving to improve procedures along the entire production chain, as is the case with FORAC⁴ at Université Laval. Others seek to fine-tune new products. SEREX⁵ is an example. There may be many problems, but there are many remedies as well. This is why potential solutions will be looked at in terms of the various facets of the forestry industry, from supply, wood fibre, business strategy and production processes to policy and environmental action.

TAKING A DIFFERENT VIEW OF SUPPLY

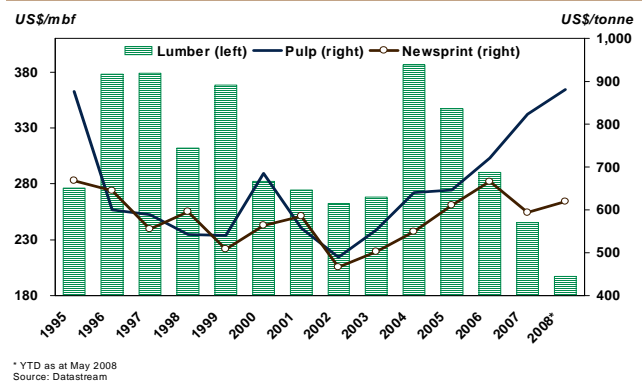
The first factor to consider is supply. To offset the decrease in allowable cuts, we must get more yield from the fibre that is currently being harvested. The goal is to maximize—even optimize—the use that will be made of every tree that is cut. We also need to look at supply sources other than those that we have privileged to date: willow and alder, which grow fairly quickly in comparison with black spruce, are now being tested. It is a matter of finding out whether they will be good substitutes. Experiments have already been carried out with producing straw panels, which are harder and lighter than wood panels. Another way to change our methods is to intensify forest management to provide some security over the medium range. However, in the short term, it will be necessary to make greater use of private forests.

The acceptability of harvesting and cutting depends on adopting international environmental standards. There are now certificates that make it possible to give environmental guarantees. These are not “extras,” or a passing fancy. They are new practices that will help increase the legitimacy of logging operations. Canadian forestry companies’ adoption of these standards will help the wood industry spruce up its public image and thus get more consideration from consumers.

AT THE HEART OF FIBRE

Some researchers have taken a closer look at the tree and its properties than at how it is used. They are exploring the properties of wood fibre. Mention is being made of the possibility of eventually producing spruce fuel and biodiesel using the branches left by the wayside on forest roads. Although not all of the barriers to production have been removed, plants are already being built in the Sherbrooke area. Other attempts to turn forest waste into fuel are using trembling aspen and willow. In December 2007, the Conférence régionale des élus(es) du Bas-Saint-Laurent (CREBSL) adopted a strategy involving the construction of 10 central forest biomass boiler plants by 2010 in communities and public institutions in the region.

Graph 16 – Lumber product prices are freefalling



Beyond its energy potential, efforts are being made on “breaking down” fibre, to work at the micro-level. That is what is happening at FPInnovations,⁶ which is looking at the potential of “nanocrystalline cellulose.” This sub-component is raising incredible possibilities for the automotive, printing and biomedical sectors.

THE ANCHOR FOR BUSINESS: INNOVATION

We must first seek to stand out from competitors through the quality of customer service with existing products. Investing in manufacturing new value-added products is another avenue. One example of this is fine-tuning pre-assembled structural elements for building homes. The components are already assembled before they leave the plant. This method requires less work from a joiner who would have had to design and build that structural component on site. Builders who want to cut their construction costs are looking for cost-saving solutions. Currently, companies that manufacture construction components (structural members, trim, windows, for instance) are doing better than sawmills. In fact, exports of these products are growing. Similarly, local firms are selling more and more factory-built housing, which is then put up on the buyer’s foundations in one day.

Other projects are underway to produce sawdust pellets that would be plasticized, and could be used as an industrial fuel, where facilities permit. Moreover, attempts are being made to develop panels made of ground bark set in recycled plastic. This new material could eventually be used to develop counters and decorative elements. These initiatives are the fruit of joint work by a number of research teams in Abitibi-Témiscamingue and firms.

Other work is being done to change businesses’ internal methods, as well as business-to-business approaches. Research is, in fact, going on simultaneously to introduce new technologies, as well as models for e-business, wood harvesting and product deliveries.

**ACTION THAT IS PUBLIC, ECOLOGICAL,
EVEN POLITICAL**

The strategy that aims at giving the forestry industry a shot in the arm goes beyond simply the main stakeholders. A declaration was tabled at the Summit on the Future of the Québec Forest Sector, held in December 2007. Of the 16 promising actions, two deserve attention. The first is worded as follows: “implement a strategy to intensify forest management so as to double the total values produced in constant dollars by Québec’s public and private forests over the next twenty-five years” The second, which is designed to promote constructing public, institutional and commercial buildings out of wood, has just been implemented. At the end of May 2008, the Québec government announced that it intended to invest \$16 million by 2014 to promote the use of wood in constructing public buildings. These actions will not do all of the work on their own, but they put pressure on players who are not solely involved in the industry.

The industry is honing its environmental weapons. Increasingly, wood tends to be presented as the material of the future, with the boast that it is non-toxic, recyclable and biodegradable. Emphasis is put on the fact that wood takes more carbon dioxide out of the environment than it emits.

Moreover, the LEED standard (for Leadership in Energy and Environmental Design), which is a certification process associated with sustainable construction and environmental protection, is gaining more and more fans in the public building construction sector, thus encouraging the construction of buildings out of wood.

There is hope, but in the meantime, there are still a lot of uncertainties and they are slowing down the changes the industry must make. Economically speaking, the Canadian dollar will not give the industry a break, staying close to parity throughout 2008 and 2009. Wood prices will remain low until the U.S. housing market emerges from its torpor. The issue of the supply and distribution of wood, as put forward in the Green Paper on forests drafted by the Ministère des Ressources naturelles et de la Faune du Québec, is controversial and will not be settled by year’s end. Meanwhile, some firms are continuing to show their mettle and innovating. We must hope that they prod others to follow in their footsteps. The industry is about more than closures: this is why we must avoid throwing the baby out with the bathwater when looking at what is happening in the forestry industry.

Joëlle Noreau
Senior Economist

¹ FERIC: Forest Engineering Research Institute of Canada.

² FORINTEK: Canada’s Wood Products Research Institute.

³ PAPERICAN: Pulp and Paper Research Institute of Canada.

⁴ FORAC: The FORAC Research Consortium is a centre of expertise for the advancement of the forest products industry. It brings together competencies in the fields of forestry engineering, industrial engineering, mechanical administration and management sciences such as operational and decision systems, management, etc. FORAC’s efforts focus on two sectors: research and knowledge transfer.

⁵ SEREX: Forest product processing research and expertise service in Amqui.

⁶ FPInnovations brings together FERIC, Forintek, Paprican, and the Canadian Wood Fibre Centre of Natural Resources Canada.

REPORT: THE REGIONS AND ACTIONS

No time for nostalgia

We can liken Québec's forestry industry to a mosaic, in which each region appears in a different colour. However, the industry's problems and the remedies that are needed are such that we must give up any idea of restoring the mosaic to its original condition. The economic situation will not give it any respite before the end of the decade and we can expect the industry to continue to rationalize in 2008 and 2009. The search for solutions extends beyond Québec's borders: that is why we need to look at what is happening elsewhere. Could we draw on the Europeans' experience and know-how for inspiration? We must also take a look at the practices of local businesses that are doing well. First, however, we must profile forestry activity in the regions.

REGIONAL ROOTS

As Table 3 shows, the forestry industry does not have the same impact in Abitibi-Témiscamingue and Outaouais. We can use the sector GDP to measure the value of one sector's production in the whole economy. No measurement is perfect, and the sector GDP does not claim to capture all of the nuances. However, it is a fairly widely accepted tool. Given the volatility of regional data, we used the average of the last five years for which figures were available (2001–2005). It is easy to guess that, with the many closings announced in 2006, 2007 and 2008, forestry's relative weight has fallen in each of the regions.

The overview shows that about 12% of Mauricie's economy relies on forest activities, wood product manufacturing and pulp and paper. In Saguenay–Lac-Saint-Jean, the percentage is just over 11% of its GDP while, in Abitibi-Témiscamingue it is about 9%, and close to 8% in Bas-Saint-Laurent.

Forest activities are interwoven. The whole regional industry is impacted when part of the chain is affected. A paper plant that closes reduces demand for chips, which affects sawmills and the demand for wood. Conversely, reducing the allowable cut has repercussions on the activities of regional sawmills and paper manufacturers.

MEASURING THE FORESTRY SECTOR'S REGIONAL IMPORTANCE

Three regions dominate in terms of harvesting and management activities (forest work): Abitibi-Témiscamingue, Nord-du-Québec and Gaspésie-Îles-de-la-Madeleine. In Abitibi-Témiscamingue, forest activities play a bigger role in the region's economy; their share is 4.7%. In Nord-du-Québec, year-in and year-out, forest work represents 4% of the region's economy, whereas it is 3.6% in Gaspésie-Îles-de-la-Madeleine.

The ranking changes for wood products (lumber and other wood products): Bas-Saint-Laurent region leads the way; the industry's relative share of the regional economy is 6.2%. Chaudière-Appalaches is close behind, with 5.9% of its GDP associated with sawmills and wood products such as doors and windows, kitchen cupboards, hardwood floors, etc. In Abitibi-Témiscamingue, 4.7% of the economy is based on wood transformation.

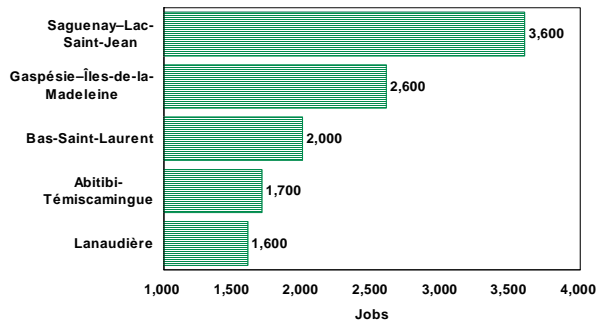
In the pulp and paper sector, there are also three regions in which it has an especially important role in the economy. Saguenay–Lac-Saint-Jean heads the pack with about 8% of the region's economic activity stemming from the industry. Mauricie is close behind, with 7.4% of its GDP. This percentage will be down in 2008, however, with the closure of the Belgo plant. The third region is Estrie, with 4.2% of its economic activity based on pulp and paper.

Table 3 – GDP: Each Sector's Relative Weight in Regional GDP (2001-2005 Average)

Forestry	%	Lumber	%	Pulp and paper	%
1. Abitibi-Témiscamingue	4.7	1. Bas-Saint-Laurent	6.2	1. Saguenay–Lac-Saint-Jean	8.0
2. Nord-du-Québec	4.0	2. Chaudière-Appalaches	5.9	2. Mauricie	7.4
3. Gaspésie-Îles-de-la-Madeleine	3.6	3. Abitibi-Témiscamingue	4.7	3. Estrie	4.2
4. Côte-Nord	1.8	4. Centre-du-Québec	3.8	4. Centre-du-Québec	3.3
5. Mauricie	1.8	5. Mauricie	2.7	5. Outaouais	3.3
6. Bas-Saint-Laurent	1.7	6. Lanaudière	1.9	6. Capitale-Nationale	1.8
7. Saguenay–Lac-Saint-Jean	1.5	7. Saguenay–Lac-Saint-Jean	1.7	7. Lanaudière	1.7
8. Outaouais	1.5				

Sources: Statistics Canada, Institut de la statistique du Québec and Desjardins, Economic Studies

Graph 17 – Saguenay–Lac-Saint-Jean in the lead for number of forestry jobs in 2007



Sources: Statistics Canada, Institut de la statistique du Québec and Desjardins, Economic Studies

This quick picture provides an overview, but does not give us much in the way of nuance. If we could break down the sector GDP's data for the RCMs, we would see that, in some of them, forest activity accounts for more than 30% of GDP. This figure is over 50% for some.

EMPLOYMENT, AN INDICATOR OF THE DEMAND FOR WORKERS

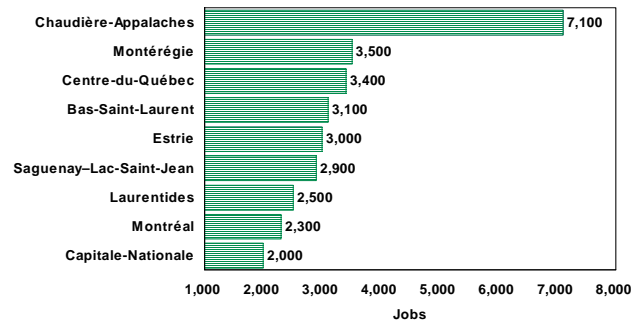
The employment data presented in the previous file on the changes in the industry showed that employment in the whole forestry channel is down in recent years. All of the regions have clearly been hit. What remains of the forestry industry in the regions? It is interesting to see how workers are distributed in the territory. Graphs 17 to 19 break down employment according to sub-sector.

In 2007, the Saguenay–Lac-Saint-Jean and Gaspésie–Îles-de-la-Madeleine regions dominated in terms of forestry jobs. Chaudière-Appalaches was in the lead for wood products, with Montérégie, Centre-du-Québec, Bas-Saint-Laurent, Estrie and Saguenay–Lac-Saint-Jean far behind. Lastly, in pulp and paper, the Montréal area ranks first, as numerous paper manufacturers have their head offices on the Island of Montréal. There are also two plants (Kruger, Norampac). Note that Mauricie ranked second.

LOCATION QUOTIENTS: A BAROMETER OF INDUSTRY DEPENDENCE

While the employment level is an indicator of how important these activities are in the regions, there is a more accurate tool for measuring the concentration of some activities in the region's economy. Location quotients make it possible to calculate whether one activity (for instance, wood products) has a greater representation in the region's economy than the provincial average. By extension, we can get an idea of a region's dependence on or vulnerability to an economic activity.

Graph 18 – Chaudière-Appalaches well ahead in employment in wood products in 2007



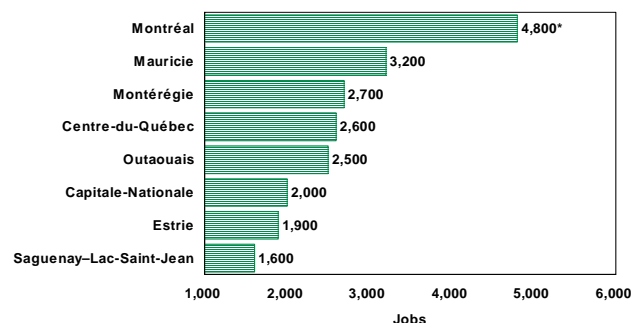
Sources: Statistics Canada, Institut de la statistique du Québec and Desjardins, Economic Studies

If the quotient is equal to 1, the given activity uses the same proportion of workers in the region as in Québec as a whole. If the quotient is greater than 1, the proportion of workers in the given activity in the region is greater than the Québec average.¹ Table 4 shows where the concentrations are the highest. However, the table is not complete due to the confidentiality rules that govern the use of some Statistics Canada employment data. Figures are not available for years in which the number of jobs is less than 1,500, and it becomes impossible to do the calculations for the location quotients. This is why the data for some regions do not appear in the table.

Unsurprisingly, in 2007, the Saguenay–Lac-Saint-Jean (7.16), Abitibi-Témiscamingue (6.4) and Bas-Saint-Laurent (5.57) regions are especially sensitive to changes that impact forest work (management and harvesting).

Location quotients are lower in wood products. The Chaudière-Appalaches (3.28) and Bas-Saint-Laurent (3.27) regions lead the way, followed by the Centre-du-Québec (2.79) and Abitibi-Témiscamingue (2.69) regions, the large Côte-Nord / Nord-du-Québec (2.25) region and Saguenay–Lac-Saint-Jean (2.18).

Graph 19 – Pulp and paper: Montréal the winner in terms of pulp and paper industry head office jobs in 2007



* Plants: Kruger in Lasalle, Norampac in Saint-Laurent and Montréal
Head offices: AbitibiBowater, Domtar, Tembec, Papiers Masson, etc.
Sources: Statistics Canada, Institut de la statistique du Québec and Desjardins, Economic Studies

**Table 4 – Location Quotients:
 Another Vision**

	<i>Forest</i>	<i>Wood</i>	<i>Paper</i>
Bas-Saint-Laurent	5.57	3.27	n/a
Saguenay–Lac-Saint-Jean	7.16	2.18	1.73
Capitale-Nationale	n/a	0.55	0.77
Mauricie	n/a	1.34	3.78
Estrie	n/a	1.95	1.79
Montréal	n/a	0.23	0.70
Outaouais	n/a	0.73	1.85
Abitibi-Témiscamingue	6.40	2.69	1.77
Côte-Nord and Nord-du-Québec	n/a	2.25	n/a
Gaspésie–Îles-de-la-Madeleine	n/a	n/a	n/a
Chaudière-Appalaches	n/a	3.28	n/a
Laval	n/a	n/a	n/a
Lanaudière	n/a	0.44	n/a
Laurentides	1.48	0.87	n/a
Montérégie	n/a	0.47	0.52
Centre-du-Québec	n/a	2.79	3.08

Note: Due to the confidentiality rules governing the use of Statistics Canada's data on employment, some calculations cannot be performed.

Sources: Statistics Canada, Institut de la statistique du Québec and Desjardins, Economic Studies

Lastly, the Mauricie (3.78) and Centre-du-Québec (3.08) regions are clear leaders in pulp and paper. They are followed, in an almost dead heat, by Outaouais (1.85), Estrie (1.79), Abitibi-Témiscamingue (1.77) and Saguenay–Lac-Saint-Jean (1.73).

In some regions, a few factors help to mitigate the negative impacts of the forestry industry's decline and gradually reduce their vulnerability to heavy blows. This is true of Abitibi-Témiscamingue, where the boom in the mining sector is partially offsetting the pullback in forestry activity. Demand for labour in the mining sector is so strong that forestry workers are finding work there. Similarly, in Saguenay–Lac-Saint-Jean, big projects like the Eastmain 1-A dam and major worksites (overhaul of Highway 175, pilot AP50 plant for Rio Tinto Alcan) are gaining importance, overshadowing forestry work. However, not all of the regions have alternatives, which is why measures to support the industry were undertaken.

SUPPORT MEASURES WITH CONDITIONS

How to survive the upheaval that is simultaneously shaking the industry and the regions? Aside from reorienting production, there are shorter-term support measures. They are designed to lessen the repercussions of the decline in forestry activity. Although there are many of them, they cannot offset all of the negative impacts noted since the decade began.

The various tiers of government have instituted four measures for workers. These programs have been in effect since November of 2006, and agreements between the parties gave them a lifespan of two years: this means they will end on October 31, 2008, unless the agreements are renewed. The first measure thus aims to enhance income support during training of laid-off workers, while a second is designed to help forestry workers aged 55 to 64 find personalized support in getting back into the job market. A third measure involves increasing the financial incentive to encourage early retirement, in a context in which a company cuts its workforce by resorting to that measure. There is also a fourth option for people aged 55 to 59 who are laid off or fired and cannot find a new job. This measure is called the “Financial Support Program for Older Workers Who Have Lost Their Jobs in the Forest Industry.” There are eligibility criteria for the measures. Added to that is the “Employment Pact” developed in 2008. It has several goals, including facilitating access to the job market and meeting regional labour needs.

Companies have not been overlooked. Industry support known as the “Support for the Forest Industry” program is administered by Investissement Québec, with a budget envelope of \$425M. It involves loans that are earmarked entirely for the forestry industry and equipment manufacturers. The amounts loaned must go toward investments, working capital, or bridge financing for tax credits. As a cash shortage is one of the problems facing the industry, the loans help to bail companies out temporarily. Other measures are designed to reduce irritants, as is the case with credits for the forest road system.

Other initiatives have been created since the end of 2007. In the Shawinigan area, the closure of the Belgo plant prodded the Québec government to add \$1M over three years to the \$450,000 fund created by the city of Shawinigan to support job creation. Moreover, workers at the Belgo plant will be able to take advantage of a \$5M fund managed by Emploi-Québec to reorient themselves. In Gaspésie, the federal and provincial governments have put \$1.7M on the table for the re-entry of 100 workers who are over 55, many of them from the forestry industry.

The list is not complete, but it shows that the support provided will not be enough on its own to solve all of the problems facing an industry whose real GDP (in 2002 dollars) is estimated to be about \$7B in 2007, whereas it had been over \$9B in 2002.

CAN WE DRAW ON THE SCANDINAVIAN EXPERIENCE FOR INSPIRATION?

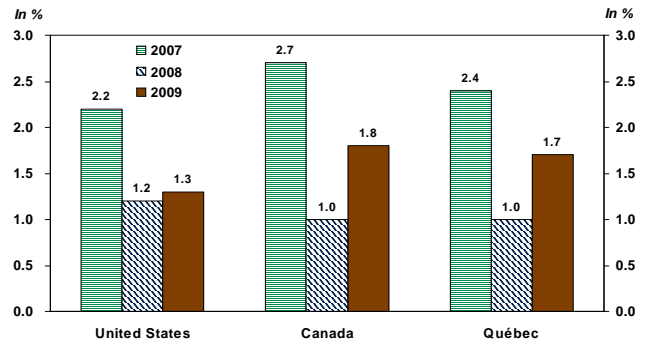
Scandinavia’s know-how calls for admiration. But answers are not thick on the ground. Wood prices have been high in Finland, Sweden and Norway for a long time. The Scandinavians have been cultivating forests for over a hundred years. In the 1970s, they underwent a major transition: they completely restructured the industry, creating production giants. Since that time, 80 to 85% of output has been concentrated in a handful of plants. Scandinavia has literally taken the technological lead, especially in paper. The continuous improvement culture is entrenched in all operations, from forest management to the search for optimal yield from forest fibre, the creation of added value and new product development. In Sweden, in particular, they put a lot of work into brand recognition and brand image, usually called “branding” in marketing circles. They comply with recognized standards, especially standards that are related to the environment and their associated norms. As much effort is put into branding as into products and optimizing fibre use.

Despite this, the Scandinavians are not immune from market upsets. They seem better equipped to deal with them because their industry is built on a more solid foundation. They must also deal with their currency going up against the U.S. dollar and with the drop in European and North American demand for newsprint. The cost of wood, especially Russian imports, is another obstacle. In Finland, work is being done on highway infrastructures to facilitate access to wood from Finland’s cultivated forests, which will help reduce dependence on Russian imports. Rising energy prices are also affecting them. In the short run, their strategy involves cutting production, as North American producers are doing. Over the medium range, they are working on partnering with paper manufacturers in South America’s emerging markets. However, even though they are ahead technologically, they will continue to cut production costs further to maintain their lead and maintain their ground.

Moreover, in Europe, wood tends to be promoted as an ecological material. “The forest is great at capturing carbon” is an argument that influences many decision makers, in a context in which carbon emissions are on trial. The strategy seems to be bearing fruit as the steel and concrete lobbies are on the warpath, publically trying to refute the claims of wood product promoters.

Of course, not all of the solutions developed in Europe can be transplanted to North America. However, the search for excellence and concern with continuous improvement are enviable, inspiring qualities.

Graph 20 – Real GDP growth promises to improve in 2009

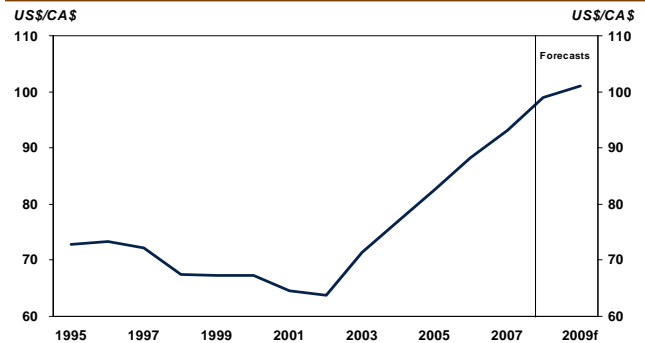


Sources: Datastream, Statistics Canada and Desjardins, Economic Studies

THE MYRIAD OF UNCERTAINTIES CONTINUES TO CURB ACTION

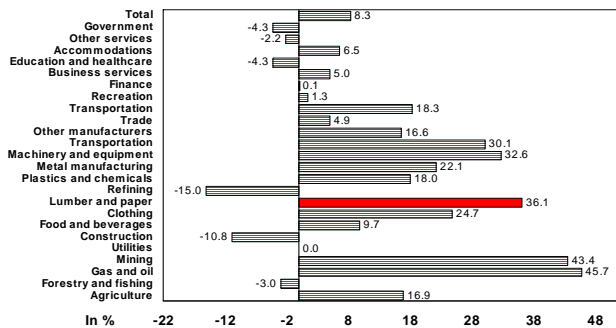
Québec’s industry does want to change its methods, but there are still many uncertainties that limit its elbow room. Economically, times will not be easy from now until the end of the decade. North America’s economies should regain strength next year (Graph 20). This economic situation will not be enough to firm up demand for all forest products. Canada’s currency should remain high (see Graph 21). Too many elements are now operating to support the loonie and keep it close to parity with the greenback. Oil prices that are well above historic levels, when Canada is a net oil exporter, the Canadian government’s enviable financial situation and rate spreads with the United States are all factors that will support the Canadian dollar. The wood and pulp and paper industries are among the Canadian sectors that are most vulnerable to Canadian dollar fluctuations (see Graph 22), and the industry’s openness to the entire U.S. is there to stay.

Graph 21 – The Canadian dollar will remain high: no breaks there



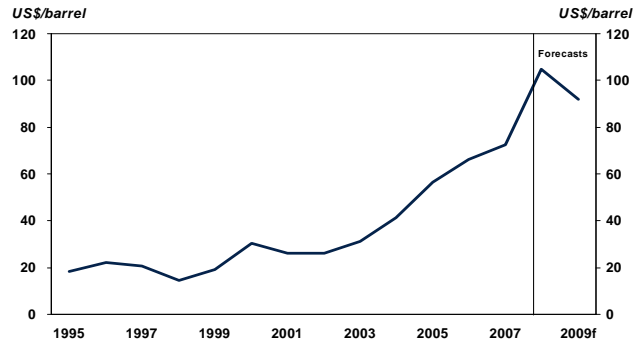
Sources: Bank of Canada and Desjardins, Economic Studies

Graph 22 – Difference between export share and import share (%)



Sources: Statistics Canada, Canadian Economic Observer, March 2008 and Desjardins, Economic Studies

Graph 23 – Oil prices will remain above the average for recent years (WTI)*



* West Texas Intermediate
Sources: Datastream and Desjardins, Economic Studies

Oil prices will also remain higher than historical prices (see Graph 23). The rapid surge in global demand in recent years is fuelling fears of a shortage and making prices climb. Given how slowly the supply is increasing, this dynamic will be very much with us over the years to come.

The U.S. housing market has not recovered from the shakeout it underwent in the summer of 2007, and it will take time for it to recover. Parallel to that, the Canadian and Québec markets are decelerating. Demand for lumber will be softer than it was at the start of the decade, or mid-way through it. The outlook for starts is not very promising. Demand for newsprint will be down and competition will continue to increase in pulp production. These topics were dealt with extensively in the previous article.

Beyond economic and market conditions, some ambiguities are hindering decision making. The Québec government tabled its Green Paper in February 2008. In it, a variety of changes were promised, with the terms still to be defined. The allocation of public forest harvest areas will be handled using rules that are different than the rules used over the last twenty years.

Since 1986, timber supply and forest management agreements (TSFMAs) gave plants some stability in terms of their wood supply. A completely new regime is being put forward, which will not come into full effect until 2013. For now, a “priority right” or sort of priority access will be given to those who currently have TSFMAs. This right would represent 75% of the volume of timber they have had access to for over twenty years. The remaining 25% will be offered on the open market through a “wood exchange,” in which wood prices will be set by the market.

No one is asserting that wood will be even more expensive than it is now. Everything still remains to be seen in this area. The operation’s feasibility and details are now being examined; no consensus has been reached. Many in the industry are wondering how to orient their strategies, given that they do not know how much wood they will have access to.

Among the other changes listed in the Green Paper is the decentralizing of operations. Responsibility for the objectives, action and management plans and awarding of contracts will be entrusted to the regions rather than to the Ministère, which will still be responsible for defining policy orientations, determining forest capacity and assigning resource rights. Some entrepreneurs are worried that an increase in decision-making bodies will make the decision-making process more unwieldy.

A parliamentary commission would study the Green Paper as soon as Parliament reopens this fall. The department wanted to have a final version of the new forest regime adopted in December of 2008, but a consultation has been announced for the fall. Meanwhile, the forestry industry has decided to order impact studies immediately to find out the expected repercussions of the new forest regime. Will we see a war of numbers? Possibly.

WHICH WAY DOES SUCCESS LIE?

There is no recipe for success. The wood products companies that are currently doing well are Chantier Chibougamau (in Chibougamau), Uniboard (Matapédia Valley), Ultratec (Laurier-Station), Maibec (Saint-Pamphile), Bestar (Lac-Mégantic), Beaubois (Saint-Georges-de-Beauce), to name just a few. In general, these companies developed a vision and equipped themselves with a plan that covers several years.

Their actions do not stem from a panicky reflex, nor are they improvising. Their outlook extends well beyond the products they make: they take a market angle rather than using a product approach. Their strategy can be summed up in a few words: “to produce, you have to sell.”

This leitmotiv is the opposite of what made the industry successful in the past: delivering a quality product, regardless of the market. This principle has had its day in the wood industry, as in the manufacturing sector and even the service industry. Now, the client or market you choose to serve is the priority. The product is tailored to the customer’s needs. This approach requires more flexibility from companies and workers. It also assumes links with research milieus to optimize the production chain, minimize losses, and reduce costs. Despite the additional effort this kind of approach requires, some firms have derived renewed momentum from it, along with the kind of profitability that ensures survival.

Companies that find support from lenders are firms that do not work in isolation. Very few firms are able to go it alone. Networking is essential. Materials buyers have become the giants in the wholesale and retail trade. These are environments that are hard to get into by knocking on doors, and easier to access when introduced by someone who knows the territory. These marketplaces are usually located outside of the resource regions, but this does not mean they are inaccessible. Some companies instead opt to associate themselves with the reputation of an established firm, which acts as a “launching pad.”

In pulp and paper, the time is still right for pooling strengths and controlling North American output. Here, the mergers of the last few years have helped create increasingly large companies and cut the number of plants in operation. Smaller entities use a different strategy: serving highly specific markets with niche products. The recycled paper niche or hygiene product niche are venues that are currently paying off. Their success relies on innovation. In a sense, companies are condemned to either win out in conventional products or innovate constantly to stand out.

With supply costs that are among the highest in the wood product and pulp and paper industry on the continent and even worldwide, it is difficult to compete with the new competitors. If the loonie were to plummet well below parity—which our scenario does not anticipate—Québec’s forest industry would still be in a tough situation. There is no one solution, or any quick fixes.

There are many avenues to work on. Improvements are possible on all fronts: from a better use of fibre to delivering products to clients. Luckily, many researchers and entrepreneurs are hard at work. However, there is still work to be done in secondary and tertiary processing. Parallel to that, there will still be players in primary processing: it seems clear that there will be fewer of them. Similarly, in pulp and paper, industry consolidation will result in a handful of big corporations. Around them will gravitate smaller companies that are flexible, on the cutting edge of product design and in the lead in identifying needs. This is clearly no time for nostalgia: what is called for is daring and networking.

Joëlle Noreau
Senior Economist

with the collaboration of Louis Gagnon
Economist

¹ E.g.: calculation for the location quotient for wood products in Bas-St-Laurent

= $\frac{\text{(number of wood product jobs in Bas-St-Laurent)} \div \text{(number of jobs in Bas-St-Laurent)}}{\text{(number of wood product jobs in Québec)} \div \text{(number of jobs in Québec)}}$

INTERPROVINCIAL SHOWCASE

Forestry sector is at a low ebb from coast to coast

The forestry industry's problems are not the sole purview of Québec or Ontario. The year 2007 was tough for all of the provinces, which saw forestry activity slow, primarily due to the collapse of the American housing sector. While British Columbia seemed to be the big winner in the last few years, it is still not invincible... A nationwide glance at the forestry industry nuances the situation.

THE FOREST: PUBLIC OR PRIVATE?

About 77% of Canada's forest cover belongs to provincial authorities. This percentage, however, ranges from 29% in Nova Scotia to 95% in British Columbia. Table 5 details the differences among some of the provinces. In British Columbia, Ontario and Québec, approximately 90% to 95% of the forests are state-owned; this figure is under 50% in New Brunswick and Nova Scotia.

Management of the resource is not uniform from the Atlantic to the Pacific—far from it. Some methods of management, including British Columbia's, could even influence Québec. In the wake of the 2003 lumber dispute, British Columbia started to overhaul how it allocated timber by taking back about 20% of the timber volumes granted to major concerns (with compensation). Half of the repatriated volumes was distributed among the First Nations, municipalities and forestry companies. The other half was auctioned off through a public body. The article on pages 13 to 18 reports on the reform of Québec's regime for allocating timber volumes: TSFMA (Timber Supply and Forest Management Agreements). Based on the initial drafts, current TSFMA holders would be given a "priority right," or sort of priority access. This right would represent 75% of the volume of timber they have had access to for over twenty years. The remaining 25% would be sold on the open market, in a "timber exchange." This exchange would set timber prices, in a manner similar to British Columbia's auctions.

Table 5 – Distribution of Canada's Forest Land

Provinces	Prov.	Fed.	Private
British Columbia	95%	1%	4%
Alberta	89%	8%	3%
Ontario	91%	1%	8%
Québec	89%	0%	11%
New Brunswick	49%	2%	50%
Nova Scotia	29%	3%	68%
Canada (total)	77%	16%	7%

Source: Natural Resources Canada, 2006

THE INDUSTRY HAS MORE WEIGHT IN NEW BRUNSWICK'S ECONOMY

It is hard to compare the forestry industry's relative importance in each province's economy. However, the method for calculating the real GDP (GDP excluding price effects) makes it possible to compare them. In 2007, the province in which operations and development activities had the biggest economic weight was New Brunswick. British Columbia dominates in the lumber products industry, with 2.9% of the province's real GDP. Québec is the province that is the most reliant on the pulp and paper industry, which constitutes 1.5% of its real GDP. Combining the three industries reveals that New Brunswick is in the lead, with 7.5% of its economy dependent on forestry in 2007. British Columbia lags well behind with 3.9%, followed by Québec (2.9%) and Ontario (1.2%).

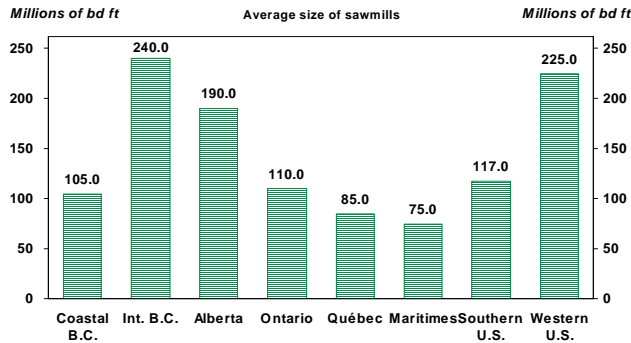
Note that the forestry industry's share of real GDP has been declining in all provinces for a few years now. Although it had held on until 2006, British Columbia collapsed in 2007 in all of the above-mentioned areas of the forestry industry, even though it had seemed to be in the best position to handle tough times.

DROP IN CAPITAL SPENDING

Except for British Columbia, planned investments in forestry operations and development will continue to stagnate in 2008. In Canada's westernmost province, they will edge up this year after declining for three straight years. In wood product manufacturing, the spending outlook will also be down in Québec, Ontario and Alberta this year, whereas it will be stable on the west coast.

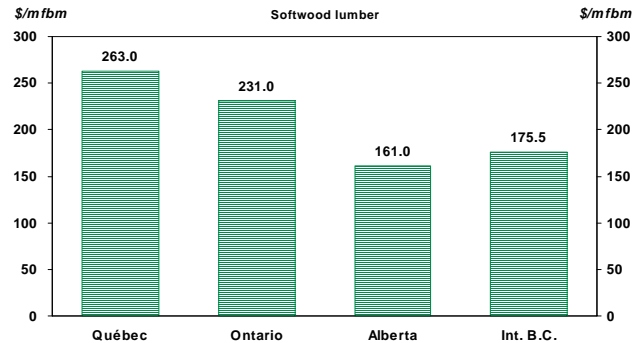
Against the backdrop of declining demand for newsprint and excess production capacity for both pulp and paper, it is easy to see that investment will decline or remain fairly steady across Canada in comparison with 2007. However, capital spending levels have been declining since 2004 in this sub-sector, which is subject to tough foreign competition.

Graph 24 – Québec and the Maritimes are lagging



Source: Wood Markets Group/PricewaterhouseCoopers/Beck Group, 2007

Graph 25 – The cost of wood substances ranges widely across Canada



Source: Wood Markets Group/PricewaterhouseCoopers/Beck Group, 2007

Why is British Columbia different? For one thing, it is in a very unusual position. Infestation by a pest called the pine beetle is reaching levels in excess of previous epidemics. The control of forest fires over the last 100 years has fostered the growth of mature pine trees, which these insects love. Climate change has also led to warmer winters, helping the parasite to proliferate. At this time, the best way of fighting the spread of pine beetles is to harvest infested trees. As pine trees are the province's most logged species, efforts have been redoubled in the last few years to recover as much timber as possible. The provincial government even decided to raise allowable cuts so as to harvest the trees that were under attack. Intense activity followed. British Columbia, which seemed to be having an easier time than the other provinces in riding out the economic storm (high dollar, declining demand, freefalling prices for lumber) was fighting another threat: pine beetles. We can expect this period of frenzied activity to be followed by a pullback in the near future.

AN UNEVEN PLAYING FIELD

Whether we like it or not, the provinces are competing to serve the Canadian and American wood product and pulp and paper markets. They are clearly not on an even playing field. In lumber, for instance, there are large disparities among the mills. Aside from the Maritimes, Québec has Canada's smallest plants (see Graph 24). Ontario is not far behind. What is surprising is the size of the Alberta and British Columbia facilities (those that are in the province's interior, not on the west coast). The advantage of large-capacity facilities is that fixed production costs (financing, insurance, administration costs, etc.) can be distributed over greater volumes, a clear competitive edge.

The mfbm¹ cost of wood substances for softwood lumber is much higher in Québec than in the rest of the country. Harvesting expenses are the primary differentiating factor in Québec, followed by timber royalties, which vary from province to province. Added to this is the average size of softwood saw logs. According to PricewaterhouseCoopers/Beck Group calculations (Graph 25), British Columbia heads up the pack while Québec is at the tail end. Québec logs are also smaller when compared with the southern and western United States. It is hard to compete under these circumstances. Smaller logs (size and diameter) limit the array of products supplied and cause production to be concentrated. Increasing the size of Québec's plants would not, on its own, solve all of the industry's competitiveness problems, but it could help lower production costs.

Over the next two years, economic conditions will not be good for the lumber and pulp and paper markets anywhere in Canada. This does not mean, however, that there is no point in continuing with efforts to cut production costs due to anaemic demand. We have to be ready when the markets start to bounce back. The years 2008 and 2009 will be characterized by austerity and restructuring. There will be more sawmill closures, as well as closures in pulp and paper. There will be less demand for forestry workers and activity will not be as heated on the west coast. However, those who look to the markets and court customers with products that are developed according to their needs will do well. This is what many companies who are currently innovating Canada-wide are betting.

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Economist

¹ board foot (bd ft) = one piece of lumber that is 12" long, 12" wide and 1" thick.
1,000 bd ft of softwood = 9.06 stacked cubic metres

FORECAST TABLES

Table 6
Canada: Major economic indicators

	2005	2006	2007	2008f	2009f
Annual average in % (except if indicated)					
Real gross domestic product*	2.9	3.1	2.7	1.0	1.8
Personal consumption expenditures	3.7	4.3	4.5	4.8	4.5
Residential construction	3.4	2.2	3.0	-0.5	1.0
Business fixed investment	12.1	9.9	3.5	4.5	5.4
Inventory change (\$B)	12.8	10.8	13.2	3.7	12.4
Public expenditures	2.7	4.1	4.2	4.7	3.6
Exports	1.8	0.6	1.0	-4.2	-3.4
Imports	7.1	4.6	5.5	3.5	4.7
Final domestic demand	4.4	4.8	4.2	4.3	4.0
Other indicators					
Real disposable personal income	2.6	5.5	4.1	4.0	2.9
Weekly earnings	3.2	3.0	3.2	3.0	2.6
Employment	1.4	1.9	2.3	1.7	1.4
Unemployment rate (in %)	6.8	6.3	6.0	6.1	5.9
Housing starts (in thousands)	225.5	227.4	228.3	216.8	197.0
Corporate profits** (1)	10.5	5.8	3.3	2.8	1.1
Personal savings rate (in %)	2.1	3.1	2.7	2.4	2.5
Total inflation rate (1)	2.2	2.0	2.2	2.2	1.5
Core inflation rate*** (1)	1.6	1.9	2.1	1.5	1.3
Federal gov't balance (\$B) (2)	2.1	10.2	15.4	6.4	10.8
Current account balance (\$B)	26.5	20.2	13.6	9.7	-14.7

f: forecasts

* 2002 \$ ** Before taxes *** Excluding food and energy (1) Annual change (2) National accounts

Sources: Statistics Canada, Canada Mortgage and Housing Corporation and Desjardins, Economic Studies

Table 7
Québec and Ontario: National accounts

	2005	2006	2007	2008f	2009f
Annual average in % (except if indicated)					
Québec					
Real gross domestic product	2.0	1.7	2.4	1.0	1.7
Personal consumption expenditures	3.1	3.0	4.6	3.9	3.4
Residential construction	-0.8	-1.1	5.1	-0.4	-1.6
Business fixed investment	-3.0	7.6	7.1	7.5	5.5
Inventory change (\$B)	2.9	1.5	1.5	2.0	2.7
Public expenditures	2.0	2.8	4.1	5.0	3.7
Exports	3.0	1.7	0.3	-2.0	-0.7
Imports	4.4	3.2	4.7	4.2	3.1
Final domestic demand	1.9	3.0	4.7	4.6	3.5
Ontario					
Real gross domestic product	2.9	2.1	2.1	0.5	1.3
Personal consumption expenditures	3.6	3.5	3.9	5.1	4.1
Residential construction	1.8	1.1	1.8	1.2	0.0
Business fixed investment	7.8	11.0	5.9	6.3	4.7
Inventory change (\$B)	3.6	3.3	3.1	1.4	4.5
Public expenditures	3.1	3.7	2.2	4.2	3.1
Exports	2.2	-0.2	0.9	-2.7	-1.4
Imports	3.9	2.7	3.1	2.3	3.3
Final domestic demand	3.7	4.1	3.6	4.8	3.7

f: forecasts

Sources: Statistics Canada and Desjardins, Economic Studies

Table 8
The regions: GDP growth in current dollars

	2005	2006	2007f	2008f	2009f
Annual average in %					
Bas-Saint-Laurent	2.4	3.6	3.8	2.6	2.6
Saguenay—Lac-Saint-Jean	2.2	4.1	5.0	3.3	2.1
Capitale-Nationale	4.8	4.2	4.8	3.5	2.6
Mauricie	4.3	3.4	2.2	2.0	2.0
Estrie	2.8	3.4	3.1	3.7	2.5
Montréal	3.3	4.6	3.4	3.4	3.8
Outaouais	3.9	4.5	3.5	2.6	3.1
Abitibi-Témiscamingue	6.8	2.6	7.1	8.5	3.9
Côte-Nord	9.2	2.8	0.4	2.6	2.3
Nord-du-Québec	6.8	2.5	18.3	4.5	4.3
Gaspésie—Îles-de-la-Madeleine	1.1	3.4	3.9	5.4	2.2
Chaudière-Appalaches	3.4	3.3	5.0	2.3	2.1
Laval	4.8	4.7	4.0	2.8	3.6
Lanaudière	6.1	4.1	3.9	4.3	4.1
Laurentides	6.0	4.7	4.1	3.4	3.0
Montérégie	3.9	4.4	5.1	4.4	3.6
Centre-du-Québec	5.0	3.7	4.2	2.6	2.8
Total Québec	4.0	4.2	4.1	3.5	3.3

Note: Data for 2007 will not be available until the fall f: forecasts
 Sources: Institut de la statistique du Québec and Desjardins, Economic Studies

Table 9
Canada: Major financial indicators

End of period in %	2007				2008				2009			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
Key rates												
Overnight funds	4.25	4.25	4.50	4.25	3.50	3.00	3.00	3.00	3.00	3.25	3.50	4.00
Prime rate	6.00	6.00	6.25	6.00	5.25	4.75	4.75	4.75	4.75	5.00	5.25	5.75
Mortgage rates												
1-year	6.40	6.80	6.95	7.25	7.00	6.30	6.25	6.10	6.25	6.45	6.50	6.60
5-year	6.50	7.25	7.15	7.55	7.15	7.10	7.05	6.80	7.00	7.10	7.20	7.25
Treasury bills												
3-month	4.18	4.43	3.98	3.83	1.88	2.50	2.85	2.80	3.10	3.55	3.75	4.15
Federal bonds												
5-year	4.01	4.56	4.21	3.87	2.91	3.46	3.45	3.20	3.60	3.90	4.30	4.60
10-year	4.11	4.55	4.34	3.99	3.43	3.74	3.80	3.75	4.05	4.15	4.40	4.70
Canadian dollar												
American dollar (CAD/USD)	0.8669	0.9389	1.0056	1.0021	0.9748	0.9797	1.0000	1.0250	1.0000	0.9800	1.0200	1.0500
Canada												
S&P/TSX index	Result: 13,833 (+7.2%)				Target: 14,600 (+5.5%) (range: from 14,000 to 15,200)				Target: 15,475 (+6.0%) (range: from 13,975 to 16,475)			

f: forecasts
 Sources: Datastream and Desjardins, Economic Studies

Table 10
Canada: Major economic indicators by provinces

	2005	2006	2007	2008f	2009f
Annual average in % (except if indicated)					
Real GDP growth*	3.1	3.1	2.7	1.0	1.8
Atlantic	1.0	2.2	3.5	1.0	2.0
Québec	2.0	1.7	2.4	1.0	1.7
Ontario	2.9	2.1	2.1	0.5	1.3
Manitoba	2.7	3.2	3.3	1.2	2.0
Saskatchewan	3.5	-0.4	2.8	2.5	2.3
Alberta	5.3	6.6	3.3	2.3	2.5
British Columbia	4.5	3.3	3.1	1.5	2.5
Inflation rate*	2.2	2.0	2.2	2.2	1.5
Atlantic	2.6	1.9	1.8	2.0	1.0
Québec	2.3	1.7	1.6	2.0	1.6
Ontario	2.2	1.8	1.8	1.9	1.2
Manitoba	2.7	2.0	2.0	2.5	1.5
Saskatchewan	2.2	2.1	2.8	3.0	2.0
Alberta	2.1	3.9	5.0	3.0	2.0
British Columbia	2.0	1.7	1.8	2.5	1.8
Employment growth*	1.4	1.9	2.3	1.7	1.4
Atlantic	0.2	0.5	1.4	1.0	0.3
Québec	1.0	1.3	2.3	1.2	1.5
Ontario	1.3	1.5	1.6	1.8	1.3
Manitoba	0.6	1.2	1.6	1.5	1.4
Saskatchewan	0.8	1.7	2.1	1.3	1.8
Alberta	1.5	4.8	4.7	2.5	2.0
British Columbia	3.3	3.1	3.2	2.0	1.8
Unemployment rate*	6.8	6.3	6.0	6.1	5.9
Atlantic	10.3	9.8	9.1	9.5	9.0
Québec	8.3	8.0	7.2	7.2	6.9
Ontario	6.6	6.3	6.4	6.4	6.3
Manitoba	4.8	4.3	4.4	4.2	4.1
Saskatchewan	5.1	4.7	4.2	4.2	3.8
Alberta	3.9	3.4	3.5	3.5	3.3
British Columbia	5.9	4.8	4.2	4.4	4.2
Retail sales growth*	5.6	6.4	5.8	5.5	5.1
Atlantic	2.8	5.6	6.2	5.9	4.3
Québec	5.1	5.1	4.3	4.3	3.9
Ontario	4.8	4.1	4.0	5.5	4.7
Manitoba	5.9	4.5	9.4	9.5	5.5
Saskatchewan	5.2	6.5	12.9	10.5	6.0
Alberta	11.8	15.6	9.0	5.5	7.0
British Columbia	4.4	6.8	7.1	5.0	6.0
Housing starts* (thousands of units)	225.5	227.4	228.3	216.8	197.0
Atlantic	12.1	12.0	12.4	12.4	9.9
Québec	50.9	47.9	48.6	45.0	41.0
Ontario	78.8	73.4	68.1	69.6	59.4
Manitoba	4.7	5.0	5.7	6.5	4.5
Saskatchewan	3.4	3.7	6.0	6.3	6.8
Alberta	40.8	49.0	48.3	40.0	40.5
British Columbia	34.7	36.4	39.2	37.0	35.3

f: forecasts

* Data for Canada.

Sources: Statistics Canada, Canada Mortgage and Housing Corporation and Desjardins, Economic Studies



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