



US Housing Starts Collapse...to Long-Term Average Levels

It was only a few issues ago that we asked how long US housing starts could keep increasing.

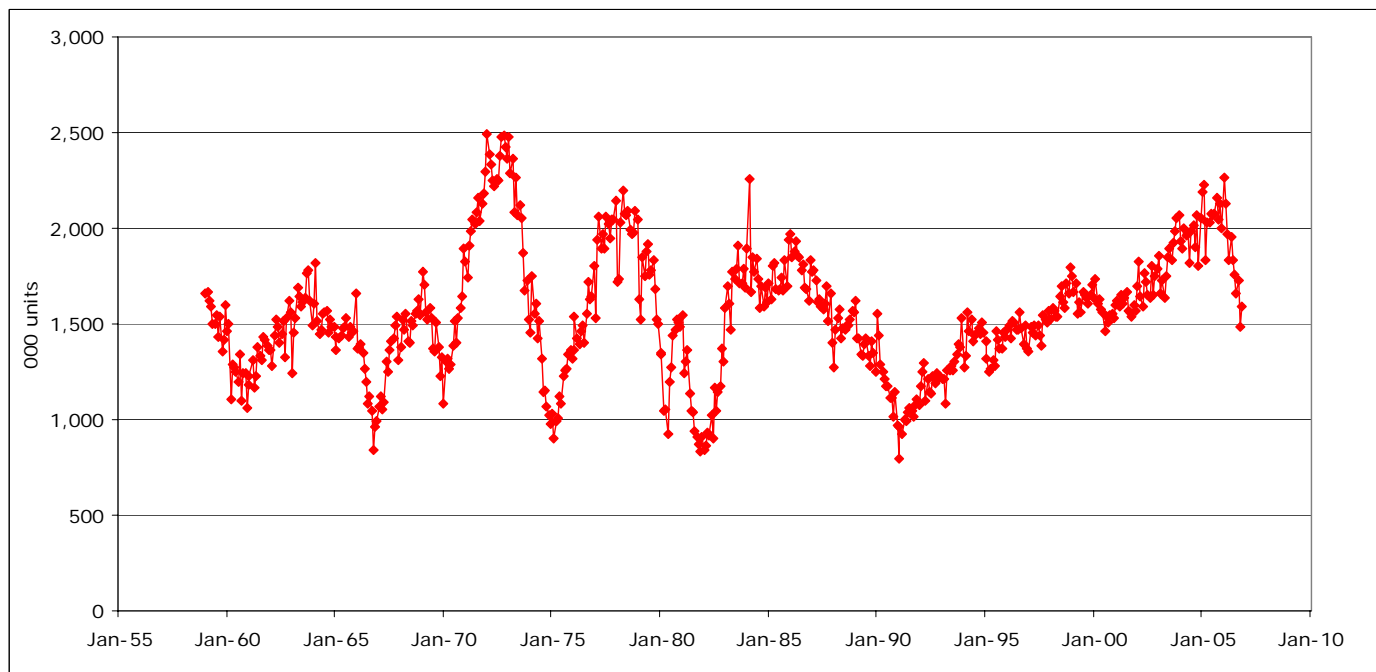
Now we know.

In January 2006, the seasonally adjusted annual rate (SAAR) of housing starts in the US hit 2.265 million units. This was the highest total since the 2.266 million SAAR starts in May of 1973. That was the good news in housing starts for the year. Between January and October, housing starts plunged 34 percent to 1.488 million starts, and then they rose slightly to 1.588 million starts in November (Figure 1).

It is difficult to put a positive spin on this. On the one hand, the great collapse has merely brought the housing start rate down to the long-term average of around 1.5 million starts.

On the other hand, lumber producers and home builders had become used to steadily increasing demand for fifteen years, and the steep drop in housing starts caused mills across North America to cut shifts or shut down (at least temporarily) during the year. (And what are the chances that the November bounce actually signals the end of the housing bust?)

Figure 1. US Housings Starts, seasonally adjusted annual rate



Source: US Department of Commerce

Random Lengths reports lumber production figures for the US South, US West and Canada. At this time, US West numbers are available through November 2006 and the numbers for the other two regions are available through September 2006.

Figure 2. Housing Starts and Lumber Production

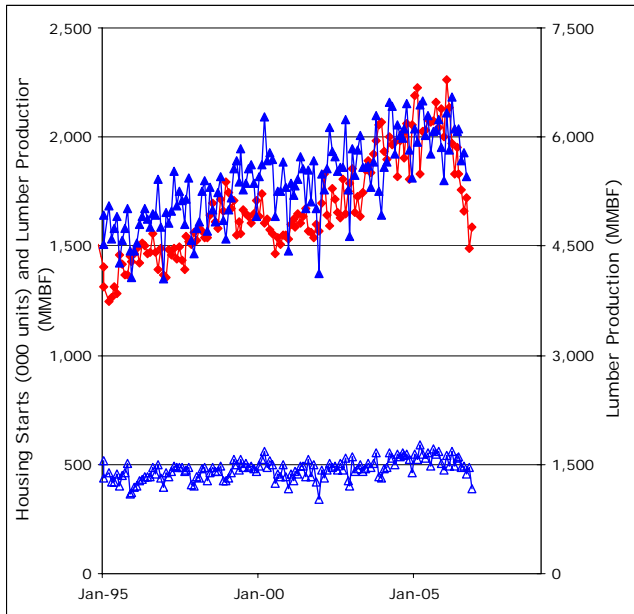
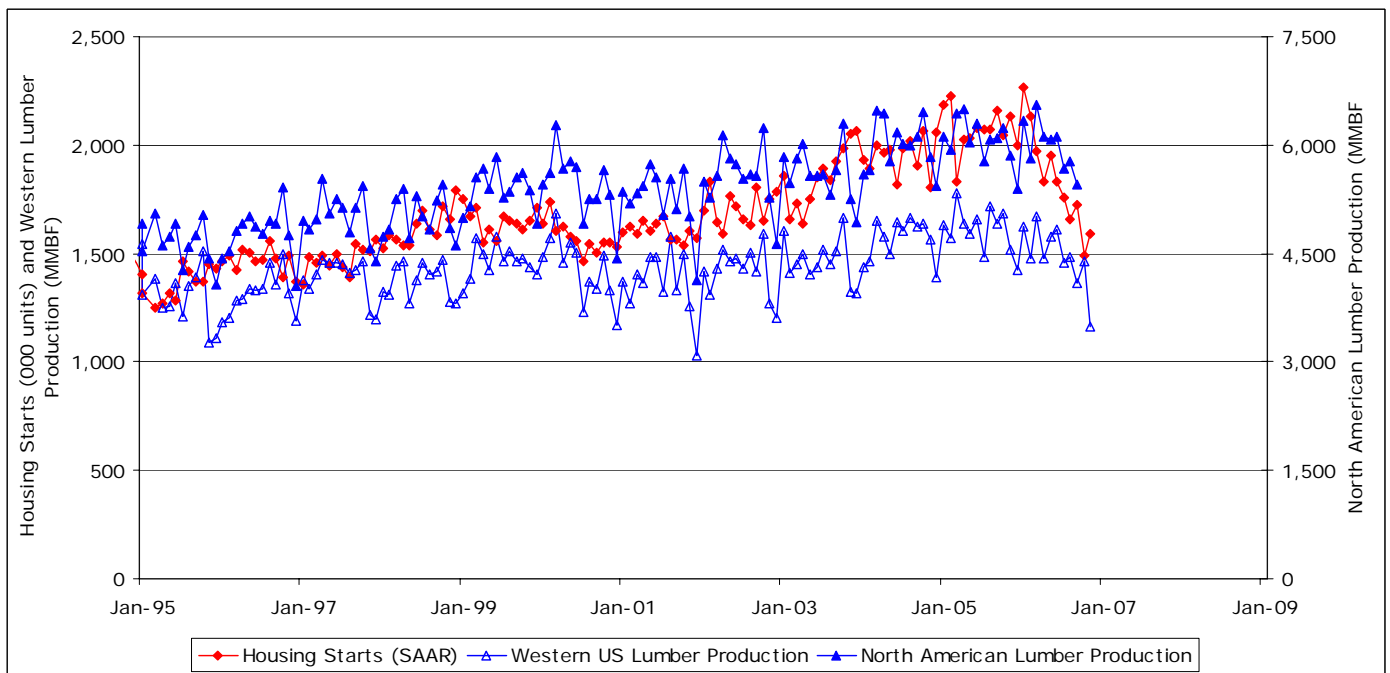


Figure 2 graphs housing starts, US western and total North American housing starts since 1995. It is clear that North American production rose and fell with housing starts over the past ten years. As we noted two years ago, the correlation coefficient for housing starts and North American lumber production is not perfect. It was about 60% back in January 2005, but has increased to about 68% in November 2006.

The scale makes it a little challenging to compare the US West production to housing starts and North America production, but we can get creative with our chart. By plotting US West production on the left-hand axis, we can get a clearer picture of how it has responded to housing starts (Figure 3).

The chart shows that US West production stayed relatively more level than North America production since 1995. In fact, the US West accounted for about 30% of North America production in 1995, but that share fell to about 25% in 2006.

Figure 3. Housing Starts and Lumber Production (watch the axis!)



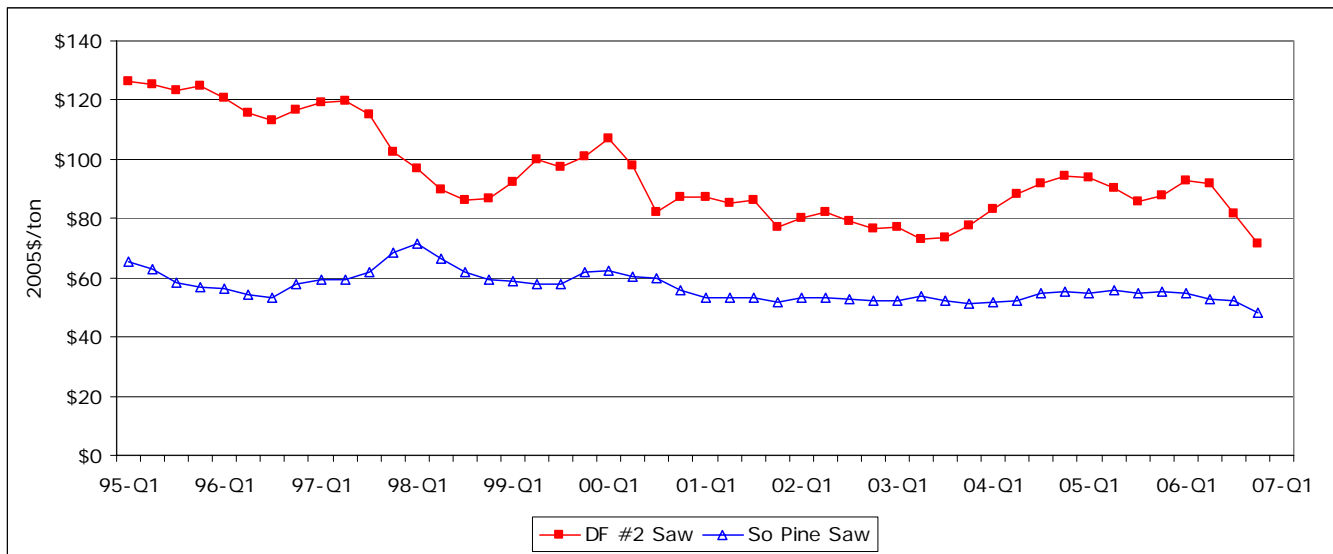
Source: US Department of Commerce and Random Lengths

It is clear from these charts that housing starts are down and lumber production is down. And that is not great news for timberland owners who are selling sawtimber.

Figure 4 shows delivered log prices in the US West and South since 1995. Real (2005\$) western #2 sawlog prices fell sharply as 2006 progressed, while southern pine log prices declined more gradually. Both series are lower than they were in 1995.

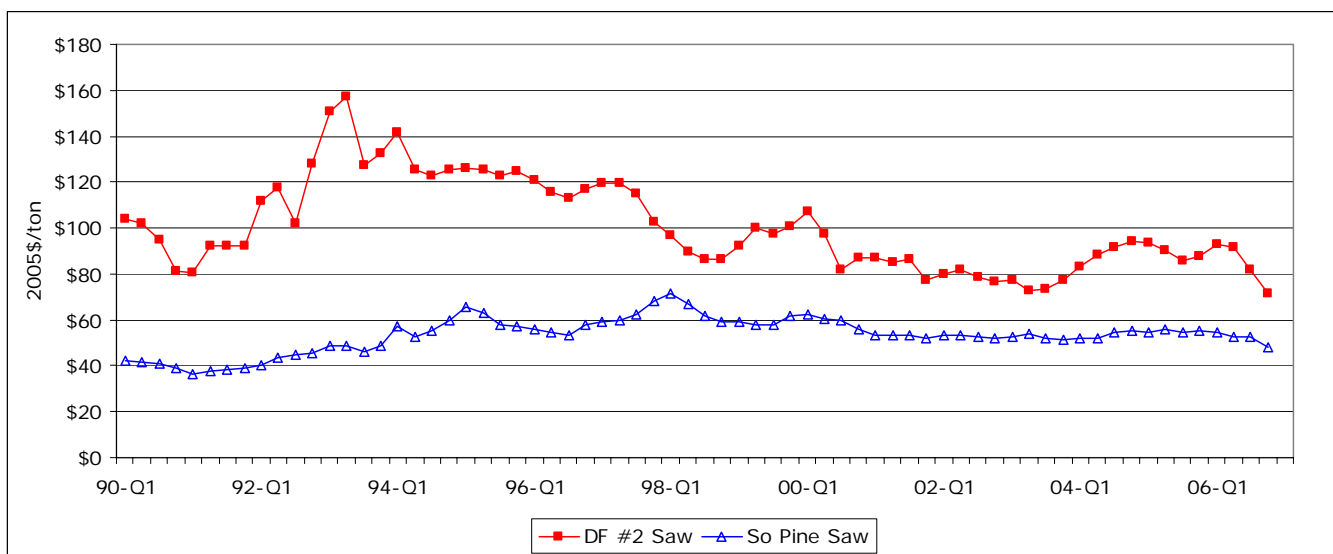
But, as always, our view of the situation may change if we look at a different time period. Figure 5 shows the same data series going back an additional 5 years to 1990. In this case, we can see that southern pine prices are actually still higher than they were in 1990. And western prices had been higher than 1990 prices until 2006. Again, log prices are not great, but not historically terrible.

Figure 4. Delivered Log Prices, 1995-2006 (2005\$/ton)



Sources: *Log Lines, Pacific Rim Wood Market Report, Timber Mart-South*

Figure 5. Delivered Log Prices, 1990-2006 (2005\$/ton)



Sources: *Log Lines, Pacific Rim Wood Market Report, Timber Mart-South*

So falling housing starts have contributed to falling lumber production, and falling lumber production appears to have contributed to falling sawlog prices.

Many economists are predicting that the housing bust will not cause the economy to crash. If this is the case, a relatively strong economy may keep housing starts from dropping as low as they have in past busts. (In a 12/28/06 press release, the Western Wood Products Association is predicting an additional 10% decline in housing starts in 2007.) We'll take a quick look again in the 2nd quarter of 2007.

Coming Events

I will be making presentations at two up-coming events. (It gets me out of the Maine woods.)

US Pensions Summit

In mid-March, I will make a presentation on timberland investing at the US Pensions Summit at the Broadmoor in Colorado Springs, CO. This is one of the marcus evans Institutional Investment Summit Series. I have been asked to provide an overview of timberland as an alternative asset class and its impact on returns when held in a portfolio. It will be geared towards investors who are not very familiar with timberland.

For additional information, call the marcus evans office at (246) 417-5442, or look at the web site:

www.uspensions-summit.com

The conference runs from Sunday, March 11 through Tuesday, March 13.

Executive Education in Forestry

In late March and early mid-April, I will be participating in two week-long programs at Yale University's Global Institute of Sustainable Forestry. The first week, March 25-30, is entitled *Executives Learning About Forestry*, and is geared towards experienced executives who need to learn more about forests. The second week, April 15-20, is entitled *Foresters Becoming Executives* and is geared

towards forest managers who are moving into executive positions.

The first three days of each session have similar content, but with different emphasis. The sessions will be led by Yale faculty and guests that include Dr. Roger Sedjo, Senior Fellow and Director at Resources for the Future in Washington, DC, Dr. John Perez-Garcia, Associate Professor, CINTRAFOR, College of Forest Resources, University of Washington, and me.

I will be working on a session with Lloyd Irland, and we will be looking at timberland investment and global timberland ownership.

The web site says registrations are due today (January 16), but there are still a couple of openings on a first come, first served basis.

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Or apply online at:

www.yale.edu/gisf/exec_course.htm

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