



Wood price hikes are temporary

New residential construction in the U.S. dipped by about 4% in August, following three months of strong and accelerating activity. Housing starts remained fairly high at over 1.8 million dwelling units, on a seasonally adjusted, annualized basis (SAAR). Builders remain optimistic thanks to continuing low mortgage rates and low inventories of unsold new homes. Residential building permits increased almost 5% in August (seasonally adjusted), suggesting builders will keep constructing new homes at a robust pace over the near term.

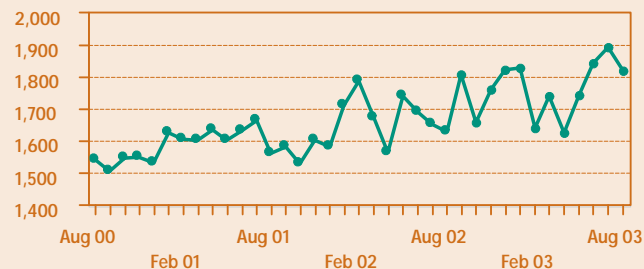
Housing construction, both new and renovated, is the main source of demand for solid wood products manufactured in British Columbia. With high and rising residential investment spending in both the U.S. and Canada, demand for B.C.'s wood production is solid. However, U.S. imposed trade barriers on softwood lumber, the falling U.S. dollar and rapidly expanding global production have decimated prices and total revenues for most solid wood products manufactured in B.C. so far this year.

Market conditions shifted somewhat this summer, as forest fires in B.C. and in the U.S. Pacific Northwest slowed or temporarily halted logging activity. This led to current and anticipated near-term reductions in output from B.C. sawmills short on logs. Reduced lumber supply in the face of strong lumber demand led to a dramatic rise in U.S. dollar lumber prices in August and September. Even allowing for currency exchange, Canadian dollar prices for lumber exports to the U.S. are currently at their highest level since March 2002.

U.S. housing starts dip but remain high

U.S. Housing Starts: Total Privately Owned
Seasonally Adjusted Annualized Rate (SAAR)

Thousands of Units



Source: U.S. Bureau of Census.

Now that the forest fire situation has abated, timber harvesting and saw-milling in B.C. are expected to return to the robust levels seen earlier this year and in 2002. Higher production will almost certainly lead to lumber price declines over the near-term. Looking ahead, producers are expected to remain focused on efficiency gains from raising output quantity and quality, as well as from lowering unit costs. Total revenues from lumber production in B.C. are expected to continue to ebb over the short term.

Canadian dollar rising again

The Canadian currency is rising once again against its U.S. counterpart, after dropping following the Bank of Canada's rate cut in early September. The rise since early September is about two cents U.S. to just over 74 cents U.S. in mid-day trading on September 19. A rising currency amounts to monetary tightening even if interest rates remain unchanged, and further tightening in Canada is not the right prescription to promote economic growth.

The Loonie is rising partly because of weakness in the U.S. dollar and partly because of the Bank's statements, following its September 3 rate-setting meeting, that interest rates are sufficient to support stronger growth ahead. The market interprets that to mean there will be no further rate cuts by the Bank and that the short-term interest rate spread between the two countries will remain fairly wide and favouring Canada's currency. The problem, particularly if the trend continues, is that this jeopardizes prospects for growth of Canada's exports, which is the country's main growth engine.

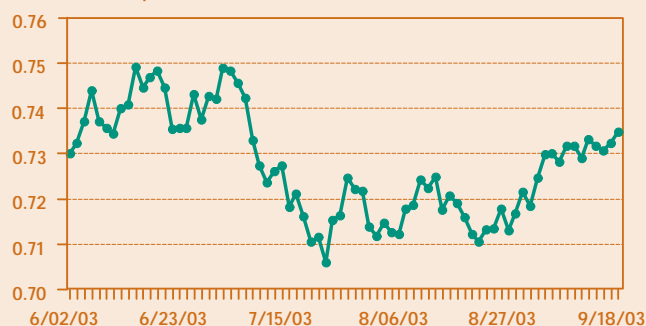
Canada's growth depends largely on its export performance. That's because other sectors are either lagging and waiting for better growth or have already been performing at a high level for some time and will contribute only small cyclical growth.

Personal expenditure and residential investment are the country's main spending sectors for growth, accounting for about 80% of the economy's growth in 2001 and 2002. Government spending contributes a lesser amount to growth and there is some expectation of gains here. Business investment spending is the laggard and awaits improved profitability and market conditions, as well as some elimination of excess capacity, before it can contribute strongly to growth. The trade sector is becoming a drag on growth and its only hope is for a sustained strong pick-up in external demand.

Heading in the wrong direction

Canada-US Exchange Rate, Daily

Canadian dollar per US dollar



Source: Bank of Canada.

The sharp rise in the Loonie in such a short period will make the adjustment by exporters to this stronger currency more difficult than if it were a more gradual rise. Observers point to the fact that Canada's exporters have faced a 70-plus cent U.S. dollar before, in the mid-1990s, and managed to survive. However, the Loonie did begin to depreciate in 1997 and exports were a strong growth contributor back then, thanks to a strong U.S. economy. This time around, the currency is heading in the wrong direction and any increase in U.S. export demand will be tempered by the higher exchange rate.

The Bank of Canada needs to cut rates soon to head off further appreciation in the Loonie, since U.S. currency fundamentals still point to further depreciation ahead. The Bank's next rate-setting meeting is on October 15. It's hoped that it will be clear to the Bank and the market that a rate cut is warranted.

