

Commodity forecasts

	2018E	2019E
Oil (WTI \$/bbl)	67.77	75.91
Natural Gas (\$/mmBtu)	3.00	2.85
Gold (\$/oz)	1,309	1,300
Copper (\$/lb)	3.22	3.25
Corn (\$/bu)	3.80	4.00
Wheat (\$/bu)	4.95	4.90

Source - RBC Capital Markets forecasts (oil, natural gas, gold, and copper), Bloomberg consensus forecasts (corn and wheat)

Peak lumber

Lumber soared by almost 200% from fall 2015 to an all-time high in the spring of this year. Then came an abrupt decline—down 30% to \$440 per thousand board feet in just three months.

The record high price was posted during a period of comparatively anemic new house construction. Yes, U.S. housing starts, 1.3 million units in May, were up a long way from the ultra-depressed 480,000 unit low in the Great Recession. But every housing peak back to the 1950s has typically been either side of 2 million units. Why this unprecedented surge in lumber prices in a period of cyclically disappointing housing starts?

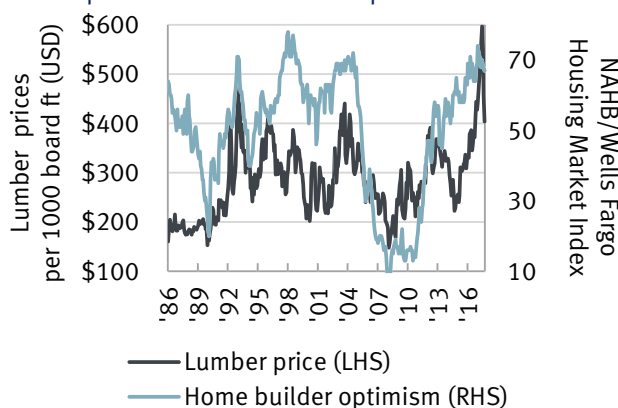
At least three factors are not visible in the housing start data. Because the square footage of the average home has been rising steadily, 1.3 million starts today might consume as much lumber as, say, 1.6 million starts 20 years ago. Second, because affordability has worsened with rising home prices, spending on upgrading existing dwellings has risen sharply. Lumber used in repair and remodeling, a big part of lumber demand, has surged independent of new house construction.

Supplies of timber have also become constrained and more expensive. The annual allowable cut in British Columbia, a very large source of lumber for the U.S. market, has been permanently reduced. And finally, the tariff imposed on Canadian softwood lumber sold into the U.S., in a period of relatively tight supply, allowed all producers to raise prices by the amount of the duties.

Now the sales of homes are well off their peaks of last year. Inventories of unsold homes are up, while housing starts and permits have rolled over as has home builder optimism. Meanwhile, surging lumber prices brought smaller, less efficient sawmillers back into production.

Lower prices plus time will eventually right-size the supply of lumber, in our opinion. But falling lumber prices won't improve home affordability, which is worsening as mortgage rates rise. Lumber prices should establish some new equilibrium range. But it looks like the May peak, which itself was almost 50% higher than any prior peak in at least 30 years, will stand as the high water mark for this cycle.

Lumber prices vs. home builder optimism



Has the cyclical peak come and gone?

Richard Tan
Toronto, Canada
richard.tan@rbc.com

Source - RBC Wealth Management, Bloomberg and National Association of Home Builders; data through 8/30/18