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# Research Brief

## Timber Markets - Post Election 2016

The policy goals and priorities of the Trump Administration are slowly coming into focus following Donald Trump's upset win of the Presidency and the Republican's holding onto majorities in both chambers of Congress. President elect Trump's limited statements to date on the policy agenda for his first 100 days have opened a small window onto where his more immediate efforts will be focused, and four areas clearly have the potential to directly impact on North American timber markets:

1. Economic Growth
2. Financial Sector Regulation
3. Trade
4. Immigration

The first two areas, economic growth and financial sector regulation have the potential to boost demand for wood products and timber by energizing housing markets. A more restrictive trade policy could have negative repercussions for the overall economy, but is likely in the near-term to favor the interests of the U.S. solid wood product sector and their suppliers of timber through tougher sanctions on the trade in softwood lumber with Canada. Finally, changes in immigration policy and the resulting constriction in labor availability could be a restraining factor in the current recovery in residential construction activity and could result in temporary and localized operational disruptions for timberland owners.

Following from his campaign slogan of "Make America Great Again", President elect Trump has very sketchily outlined his intentions to apply a Keynesian program of infrastructure construction and tax cuts to stimulate the overall economy and to increase the rate of job creation. The degree that these goals can be met will be limited by Congress's willingness to provide the funds for an ambitious public works program in the face of once again increasing federal budget deficits. However, an infrastructure program funded by investment tax credits rather than direct grants is a very likely possibility. In addition, the Republicans with their control of Congress would be primed to seize this rare window of opportunity to enact both personal and business tax cuts. Consequently, a substantive Trump stimulus package has a reasonable probability of enactment in the first half of 2017, and would definitely enhance growth prospects over the next two years. Even New York Times economist Paul Krugman begrudgingly acknowledged on 11/14/16 that "a Trump administration might actually end up doing the right thing for the wrong reasons.....But an accidental, badly designed stimulus would still, in the short run, be better than no stimulus at all. In short, don't expect an immediate Trump slump".

The injection of meaningful economic stimulus in the next year would support further job creation at a point in the recovery when we are already at a 4.9 percent unemployment rate. Additional employment demand in a labor market with dwindling slack has a strong probability of being accompanied by real gains in wages and personal income. Financial markets have already recognized the potential for stronger U.S. economic growth in the next two years and have translated this view into the post-election bounce in the U.S. stock market, significant increases in bond yields, and a rebound in the U.S. dollar.

Residential construction, the key driver of U.S. timber values, will directly benefit from these Trump initiatives to boost economic activity. Strong job markets, higher labor participation rates and rising wages will all help enable potential first-time home-buyers, who have been side-lined by economic considerations, to move into the housing market. Rising mortgage rates, which will accompany the bump-up in economic growth and wages, will act to moderate a resurgence in housing activity, but rising interest rates are not likely to cancel out the benefits to housing of stronger economic growth. Mortgage rates are currently near record historical lows and the Federal Reserve is likely to remain cautious in moving in the direction of tighter credit conditions, given the still weak global economy, the strong recent rebound in the U.S. dollar and the still extremely high level of global political and financial uncertainty. In addition, the positive impacts of improved economic growth on U.S. housing should be amplified by a second Trump policy area impacting timber, Financial Sector Regulation.

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Donald Trump has stated his intent to reduce the level of federal regulation impeding economic growth and business formation, and has specifically targeted the roll-back or down-sizing of the Dowe-Frank legislation passed under the Obama administration. An easing of banking regulations could encourage banks to broaden their mortgage lending beyond their current narrow focus on just the most creditworthy borrowers and those seeking jumbo loans (>\$417,000). In addition, credit availability for the housing market would also positively respond to a shift away from the aggressive approach the current Justice Department has taken against the past mortgage practices, which has resulted in big banks largely abandoning making mortgage loans insured by the Federal Housing Administration. Greater access to credit, particularly for new entrants to the housing market, could generate a strong tail-wind for home construction.

More restrictive international trade policy was another key campaign issue for Donald Trump, accompanied with promises to renegotiate existing trade agreements (such as NAFTA) and to be more confrontational with perpetrators of unfair trade practices (such as alleged currency manipulation by China). Implementing tariffs and quotas could have a chilling effect on U.S. international trade (particularly combined with an even stronger U.S. dollar), and result in a headwind to overall growth in the U.S. economy. The degree to which the Trump administration will pursue this avenue and the particular trade issues they plan to address have yet to be delineated.

For U.S. timberland owners, the most impactful trade issue is the current effort to renegotiate a softwood lumber agreement with Canada. The last trade agreement, which effectively limited Canadian exports of softwood lumber to the U.S., expired just over a year ago, and subsequently, Canadian shipments of softwood lumber have increased strongly. The U.S. Foreign Agricultural Service report that Canadian softwood lumber exports to the U.S. in the first three quarters of 2016 were up 30 percent from the same period a year earlier. The imposition of quotas or duties on Canadian softwood lumber exports to the U.S. would result in higher softwood lumber prices and more demand diverted to U.S. sawmills, both of which would translate into stronger markets and prices for U.S. softwood sawlogs.

The U.S. Lumber Coalition is currently in the process of preparing to file a petition with the Department of Commerce (DOC) seeking the placement of duties on Canadian imports. The investigation of the countervailing duty (CVD) case will be conducted concurrently with the on-going negotiations on a new softwood lumber trade agreement between the U.S. and Canada. The Department of Commerce will oversee the CVD case and determination of damages will be the responsibility of the U.S. International Trade Commission (ITC). The CVD case will be somewhat insulated from the results of the recent election, since the DOC staff who will be working on the case are largely career employees and the ITC consists of six members (always three Republicans and three Democrats) who serve nine-year terms. Negotiations on a new treaty were initiated by the Obama administration last year, but Trump will be appointing a new U.S. Trade Representative, who will take on direct responsibility for the negotiations next year. Canadian officials have already expressed concern that Trump's administration will be less accommodative in their approach to trade negotiations than Obama.

Tighter immigration controls were also a high-profile component of the Trump campaign message and have been highlighted as a priority issue for the new administration. A more restricted labor pool could have some negative implications for timber markets. A more limited migrant labor force could result in operational difficulties and constraints for U.S. timber owners, increasing competition for and the price of labor for harvesting, planting and transporting timber. A more restricted pool of labor in the construction trades could also slow the future expansion in residential construction activity and add to the price of home construction. These negative labor effects though are more likely to be regionally limited and temporary in their ability to broadly disrupt timber markets.

In summary, President elect Trump's intentions to bolster the pace of economic growth and employment through a combination of infrastructure spending, tax cuts, and deregulation of the financial sector should bolster the forward momentum in U.S. housing markets, at least over the next year or two. Trump policies are also likely to put upward pressure on interest rates, but the moderating impacts of rising mortgage rates should be off-set by corresponding gains in real income and expanded access to credit for home buyers. A more restrictive trade policy coupled with a stronger U.S. dollar will be a problem for some export oriented segments of the forest product sector, such as market pulp and the export of West Coast sawlogs, but the key value component of U.S. cross-border trade in forest products is imports of Canadian softwood lumber, and U.S. timberland values would benefit at least in the short-term from the re-imposition of trade restrictions. Even with the possibility of higher labor costs in both timber operations and in down-stream construction markets, the Trump administration's initial policy agenda is in balance a positive influence on the outlook for timber markets in 2017.