

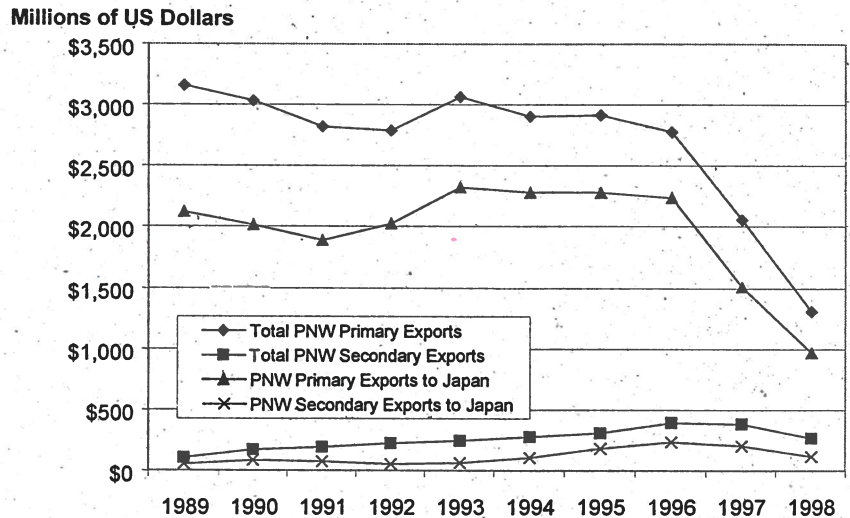
Asian Crisis Hits PNW: Export Revenues Down 27% Between 1997-1998

Washington State is the leading US supplier of forest products to Japan. The State's forest sector produces over \$12 billion in business income annually with roughly one-fourth derived from exports. Japan has been the region's leading consumer, purchasing 75% of the solid wood exports and over 60% of all forest products. Prior to the Asian financial crisis, revenues from secondary manufactured wood exports increased more than 50% per year over a several year period.

Between 1996-1998, wooden housing starts in Japan declined 28%, and Japan's total housing starts dropped below the number of US housing starts for the first time in several years. As a consequence, almost all US forest sector exports declined substantially. In contrast, US demand for wood products continues to increase, creating a role reversal where US imports from Asia are increasing while exports to Asia are declining.

Japan's imported log volume declined 29% during the past two years, with log exports from the US to Japan down 33%. Most other log suppliers to Japan have been impacted similarly, with the exception of radiata pine suppliers. Low cost radiata pine is becoming more widely used in Japan as a substitute for other species commonly used for non-structural uses such as pallets and packaging. Log prices may have bottomed out over the summer as the price of fir, the most desirable construction wood, increased about 3% in recent months. In contrast, hemlock, which competes more directly with sugi and in some applications, radiata pine, continues to reflect weak prices. The price premium that Asian consumers paid for US logs in response to harvest declines in the Pacific Northwest (PNW) has almost totally disappeared.

Pacific Northwest Total Exports and Exports to Japan, 1989-1998
 1st-3rd Quarter (annualized)



The two-year decline in log prices and revenues has resulted in timber revenue declines for Washington exporters of nearly \$1 billion per year. Given similar, but smaller declines in other global markets and for other products, total exports of forest products from the PNW to all countries are down \$2 billion since 1996.

Japan's lumber imports had been increasing rapidly with the global shortage of logs but declined almost 40% in 1998. The two-year decline in North American lumber exports to Japan is even greater, with a decline of 43% as a consequence of increased consumption of European lumber. However, the most recent decline in the flow of European lumber to Japan is even greater than from North America, a consequence of the much longer distribution channel to import goods from Europe.

On a positive note, 2x4 housing's share of the total housing market remained stable during the past two years and increased almost every year during the past decade. Revenues from secondary products to Japan, which includes prefabricated wood buildings and wood-based building materials, have declined more than 40% between 1997 and 1998. However, the relative strength of 2x4 housing suggests imported wood-based building material exports will

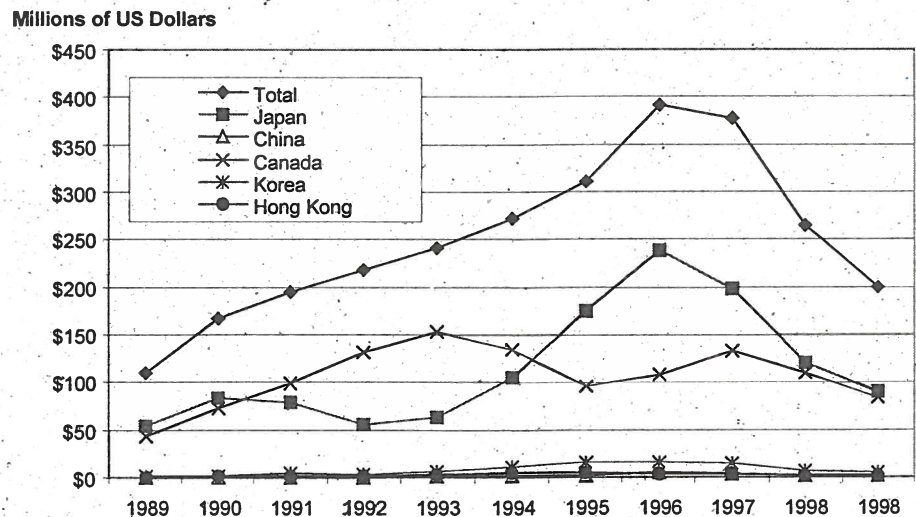
rebound once the economy recovers. Since the cost of construction in Japan remains much higher than the cost of construction in the US, there is a great opportunity to more effectively use US 2x4-construction technology and materials to reduce housing costs.

Prices for US timber have adjusted dramatically with the decline in the worldwide demand for wood products. Timber prices in the PNW declined to below \$400/mbf (\$100/cum), little more than half of peak values, even as Southern US timber prices continued to rise, eliminating the traditional premium that western wood has received in serving export markets. The strong US housing market has maintained high prices for wood from the US South. Southern pine lumber prices now exceed fir prices in US markets, which suggests that the US South has replaced the West as the high cost-producing region. The high number of US housing starts has prevented regional product prices from falling further. Much of the surplus wood in world markets has been diverted back to the strong US market but has not yet produced any major decline in Southern production or Southern timber prices.

The most significant area of growth in forest products trade in recent years has been in secondary manufacturing. Deregulation in Japan's construction sector stimulated demand for imported wood-based building materials as a way to lower home construction costs. Export revenues from secondary processed wood products shipped to Japan increased more than 50% per year between 1993-1996, but declined 17% in 1997, and almost 40% in 1998. Revenues from secondary wood products in 1998 are still 100% above 1992 levels even though they are only half of the revenues earned in 1996.

The PNW has been the leading supplier for Japan's market for secondary products in almost all product categories. As the Japanese economy recovers, exports of secondary wood products from the US to Japan should recover and continue to grow. However, the economic recession has resulted in substantial declines in the very sectors that had previously experienced high growth. Japan's imports of structural wood members, doors, flooring and cabinets have declined over 70% during the last two years. Prefabricated buildings, joinery, wood windows, and office furniture have declined over 40%. Mouldings and wood household furniture have fared somewhat better but are down 25-30%. As a result, many PNW producers that focused on the Asian export market over the domestic market have been severely impacted.

Leading Export Destinations for Secondary Processed Wood Products from the PNW, 1989-1998,
 (1st-3rd Qtr. annualized)



While exports to Canada partially offset the impact of losses in the Japanese market in 1997, export revenues from primary and secondary wood products to Canada declined approximately 30% as a result of the decline in the purchasing power of the Canadian dollar compared to the US dollar.

While increasing trade flows have contributed to lower costs to consumers and rising standards of living around the world, the Asian recession has taken away many of these gains and has not necessarily rewarded the best producers where distribution channels have protected local suppliers. At least exporters that do survive will be among the strongest and best in terms of product quality and service. These companies will be ready to support increasing demands when the Asian economies recover.