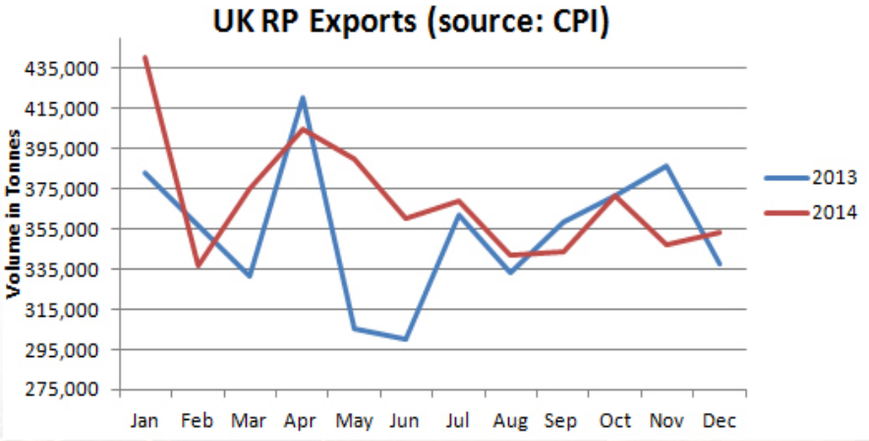
General Market Analysis *by Tom Rickerby*

A brief look back at the t2e pricing trend in 2014 shows 2 periods of volatility and falling prices bookending a long period of price stability from March to September. Despite consistent reports of a slowdown in China (see article on page 3) and increasingly stringent quality and moisture demands, OCC prices held up relatively well in the mid-£80s in the 2nd and 3rd quarters of the year. This stability was helped by a weakening Pound against the US Dollar, helping to offset the fall in the CIF delivered price to China.

To this period of price stability ended at the start of the 4th quarter with the introduction of a $100-300 freight rate increase. OCC export prices fell £3 in reaction to this. Weak demand from China coupled with a general inertia within the market has done little to lift the mood amongst UK sellers. Confidence in China appears to be falling, reflected by the release of economic data showing growth rates in China at a 24 year low. Overcapacity and falling prices has meant Chinese mill buyers have become increasingly selective over the quality and origin of their recovered material. This has negatively impacted on the UK market where the wet winter months tend to coincide with reduction in quality and a rise in moisture claims. Both OCC and mixed paper prices have fallen as a result, with the demand for the latter falling dramatically as Chinese buyers scale back their buying activities. According to CPI data UK recovered paper exports fell 10% in November compared to the previous year. The timing of Chinese New Year has compounded this period of weak demand in the latter stages of the quarter.



Several Chinese mills have also scheduled extended maintenance shut downs following Chinese New Year, citing weak demand for finished product as their motivation for this. This indifference towards securing tonnage has been a prominent feature of the final quarter of 2014 creating what has now become a string buyers' market, something that the UK market will be ill-accustomed to, having enjoyed sustained periods of buoyant prices and seemingly unfettered demand.

Domestic prices for OCC have tracked the decline in the export price. With OCC prices falling as low as £74, many traders have raised fears that current prices are close to the threshold where the value of the material does not cover the cost of collection and processing. High or fixed price collection costs may be providing some false resistance to the falling value of OCC and may be preventing a more dramatic price correction within the market. OCC Prices in continental Europe are reported to be as much as $10 below UK prices.

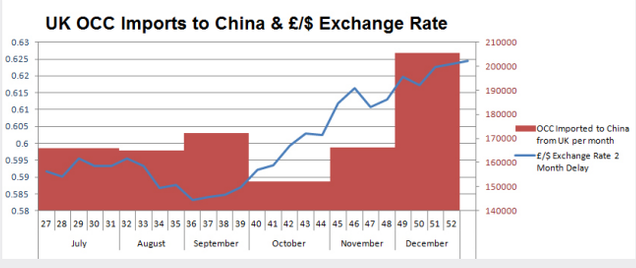
Managing Director's Comments

As I write this article the European Recovered Paper Market have been reeling under two significant blows. Firstly the announcement that Aylesford Newsprint's mill in the United Kingdom is to cease operating and secondly that the European Commission's circular economy proposals have been dropped from the legislative package for 2015/16. Concurrently the downward pressure on all commodity prices continues. Given how dependent all commodities are on oil for extraction there is some logic in this but it is possible that other issues are involved.

With the demand for newsprint in the United Kingdom in freefall and that in Western Europe not much better many viewed that the closure of one or more newsprint mills was inevitable. Ultimately cheap Russian imports are being blamed for the demise of Aylesford. There are accusations of dumping but with, the rouble plummeting against all the major currencies (the £ has increased 107% against the rouble in the last two years!) and oil and gas widely available within Russia, the low price of finished product can be attributed to the low costs of production in comparison to the £ or the Euro rather than any anti-competitive selling below production price. Within the United Kingdom the loss of a third of the ONP market is inevitably going to have a downward pressure on its price in the short run however the global desire for secondary fibre and in particular the shortage of secondary newspaper fibre as global newspaper sales drop will see any surplus tonnage being absorbed relatively quickly. Additionally under the circumstances whether Shotton decide to maintain the planned closure of their paper machine remains to be seen.

Disappointment has been expressed by all parties about the withdrawal of Europe's circular economy package. This is in some ways mildly surprising since there are so many interpretations of what the proposal involved or meant that to many it must be difficult to identify any consequences of the package let alone of its withdrawal! Nevertheless the Commission have provided assurances that the package will return into the legislative agenda next year "better and more ambitious". Within the waste and recycling sector this appears to mean that the targets are going to be retained all be it that those nations that are struggling to achieve them will be given longer to do so. Of far greater significance is the desire to see definitions harmonised which might mean that different nations are going to measure the same thing and therefore become more comparable! The greater ambition seems to be focused on eco-design and improving re-use.

It is at this stage unclear how the impact of the new targets will fall however there is an aspiration to facilitate the free operation of global secondary raw material markets, a suggestion of global accreditation of mills has been floated, and transfrontier shipment enforcement is being tightened. Also there seems to be a growing belief amongst municipalities that a significant financial burden is going to land on them. From a paper perspective the biggest issue lies around how the proposals and subsequently the courts interpret separate collection and end of waste.



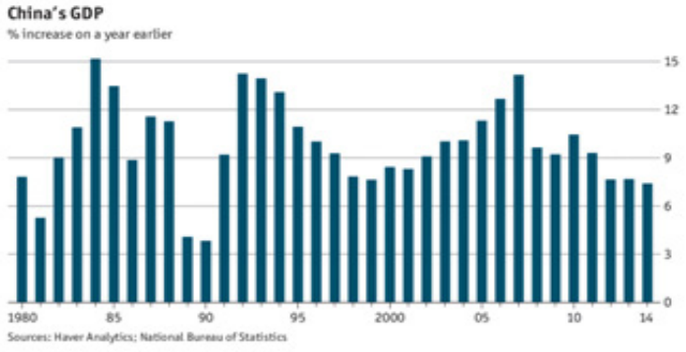
Given the on-going global demand for Recovered Paper the on-going downward pressure on Recovered Paper prices seems unsustainable. While closures will undoubtedly impact on local demand, Recovered fibre is still the basic staple of Far Eastern and European mills. Despite the fact that there are 705 mills in Europe that between them manufacture cardboard sufficient in area to cover Switzerland, 85% of which is from recycled fibre, the Chinese continue to be the global price setters. Here exchange rates remain a key ingredient, the Remimbi is losing value against the US$, as are the £ and the Euro but the Euro is falling significantly faster than the £ so UK Recovered Paper is relatively more expensive than European Paper. So when Chinese buying returns after its traditional mid-year lull European Paper has looked more attractive. Additionally there remains a belief in some quarters that more primary material is required in the input mix and what better time to do that than when energy prices are low? So nothing is certain. We are in uncertain times. Mills and merchants are trying to discover sustainable prices within a fast changing political and financial background. Surely the future should contain forward trading within a regulated forum?

Once again thank you for your support this quarter and to Simon Weston for his contribution. I wish him every good fortune in his new role.

Angus Macpherson
Managing Director
The Environment Exchange

Review of Chinese Market Growth

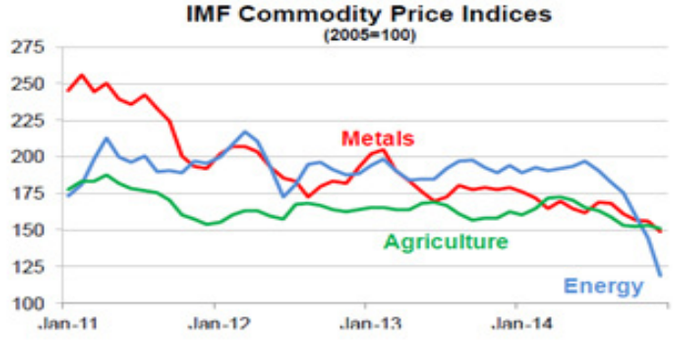
For the past 2 decades China's meteoric economic growth has helped to drive the global economy. International trade has benefited from China's seemingly insatiable demand for commodities to fuel its double digit growth. UK Recovered paper exports are no exception here; RP volumes exported to China have increased 14 fold in the past 20 years. However the most recent release of economic data suggests that China's influence in global economic growth may be on the wane.



GDP figures show that China's growth slowed to 7.4% in 2014, its slowest pace for 24 years. This is the first time China has missed its annual growth target since 1998.

Early 2015 data has been equally gloomy. In January, Chinese factory output data unexpectedly shrank for the first time in 2 ½ years. In the same period, exports fell by 3.3% and imports dropped by a staggering 19.9% compared with 2014 data. The HSBC manufacturing PMI remains below the 50 threshold, indicating contracting output conditions. Economists have downgraded China's 2015 growth forecast to between 6.8 and 7%. Whilst western economies can only dream of 7% growth, the knock on effects of China's slowdown are potentially severe.

It is no coincidence that China's falling demand has coincided with falling commodity prices. From Iron Ore to Oil to Recovered Paper, commodity prices have weakened in 2014 prompting fears of sustained deflation. China's Producer Price Index (prices paid to domestic producers for their output) has fallen for 33 consecutive months reflecting the falling input costs. This threat of deflation prompted China's Central Bank to reduce interest rates in November 2014 for the first time since 2012. Lower interest rates have also helped to reduce some of the mounting debt burden on Chinese industries.



Chinese Authorities have been keen to stress that the deceleration in growth is consistent with a willingness to tolerate slower, more sustainable growth under what is being called the "New Normal" approach. Under this approach, measures are being taken to rebalance the economy, encouraging growth in domestic consumption and a movement away from excessive reliance on investment and imports. This shift is evident within the data; since 2009 investment has been falling year on year and last year domestic consumption accounted for a record 51.2% of growth. In 2013 services contributed more to China's GDP than manufacturing for the first time. China's growth is no longer about building infrastructure; it is about consumption spending and efficiency. This fundamental change will form a key part of the restructuring process and will see policy makers shift resources from the public to the private sector in order to reduce some of the chronic overcapacity that exists within China's manufacturing industry. The slowing economy has exposed these inefficiencies, especially within the state sector, where companies are being kept 'artificially alive' despite running at significant losses. Not only has this created overcapacity, it has also diverted credit away from the private sector and left provincial governments with precarious levels of debt. Despite large numbers of mill closures in recent years, the Chinese paper making industry continues to show signs of overcapacity as newer mills come online. A glut of finished product has driven down the price of liner board in China, consequently placing downward price pressure on the value of imported recovered paper. Under the "New Normal" approach further restructuring and bankruptcies are inevitable within the sector.

China's slowest growth rate in nearly a quarter of a century will have reverberations throughout the global economy, but is it as bad as some commentators are making out? China's economic output hit $10 trillion last year. Previously only the USA could boast about reaching that financial milestone. Due to the increase in China's economic size, last year's reduced growth of 7.4% generated a similar amount of demand as it did when growth was running at 14.2% in 2007. When placed in this context it seems a little early to be writing off the world's second largest economy.

Challenges Facing the Recovered Paper Industry

Simon Weston, Director of Raw Materials at the Confederation of Paper Industries (CPI)

I am delighted to have been asked to contribute to the t2e Paper Market Quarterly Report in this, my new role of Director of Raw Materials at the Confederation of Paper Industries (CPI). Confidentially, this is my first public utterance in the role so I am very aware of the risk of over promising and under delivering! It is an exciting time to join the paper industry's leading trade association because there is so much going on, both within the industry and in the world at large. My role is to represent the interests of the industry and particularly our Recovered Paper Sector Members, both to government and to the public, and to lobby on its behalf. In practice, this has meant an immense amount of reading and a busy round of meetings so I can get my "head around" the key issues. My first couple of weeks in Swindon have reminded me of the sheer breadth of challenges facing our industry.

The world economy appears to have reached a point of incertitude as the US economy seems to be recovering whilst China and the European mainland may be faltering. Add the uncertainties of political instability in Ukraine, international terrorism, crashing oil prices and a forthcoming election in the UK with the threat of deflation, and we have all the elements for a decent each way bet on economic progress in the next 18 months. One thing is clear; a lack of demand is having a depressive effect on commodity prices, recovered fibre included, and I wonder what impact long term low(ish) prices will have on collection infrastructure and recovery systems into the future. One of the topics to be examined by the Government's recently convened Advisory Committee on Packaging (ACP) is local authority access to PRN funds, which in their current straitened circumstances is not surprising. The shadow of future residual waste infrastructure capacity also looms over the Paper Industry if pricing and demand for material remains soft.

Quality is an enduring topic. It is early days with the new MRF reporting requirements, but pressure from other quarters may drive this issue in a particular direction anyway. The true meaning of 'separate' and 'TEEP' seem to me still open for proper judicial definition, but whatever, the view of the Paper Industry remains that, in general, separate collections provide a cleaner more acceptable raw material. China and other markets continue to drive a quality agenda and there is talk of developing a global standard for recovered fibre. Since all paper mills face the same cost pressures, a common standard is entirely logical. Overlying all of this is a growing realisation that the planet's resources are not inexhaustible. The need to consider a 'Circular Economy' is now gaining traction amongst politicians, with calls for an Office of Resource Management in Westminster. Effective circularity for paper is founded in a requirement to deliver appropriate raw materials back to recycling mills.

So what place t2e in all of this? It is my opinion that, in these uncertain times, the recovered fibre market could do with a credible electronic trading platform providing transparent prices upon which all observers can rely. A transparent primary market provides the possibility for derivatives and the opportunity for stakeholders, ranging from local authorities to the board rooms of major waste management and paper businesses, to hedge one of their major costs/revenues. They do it for energy so why not recovered fibre?

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