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Lumber Wakes From Its Slumber

By LIAM DENNING

Lumber's jacked. This month, the January Chicago Mercantile Exchange lumber contract has surged 28% in just 12 trading days.

You might wonder what has fueled such optimism. After all, the contract slipped back slightly Wednesday after Commerce Department data showed an unexpected fall in housing starts last month. Home construction accounts for about half of U.S. lumber consumption. Weekly rail-car loadings of lumber and forest products year to date have averaged about 8,000, compared with more than 10,000 for the same period in 2008.



The real construction story for lumber lies less in suburbia and more in the financial edifice going up in downtown Washington, D.C. The latest breakout in lumber futures, with prices moving decisively above the 50-day moving average, began Oct. 28. Details of the extension to the home-buyer tax credit, signed off on Nov. 6, emerged that day.

If that provided a spark, loose monetary policy has provided fuel. This looks like a classic momentum trade. Volume in the historically sleepy lumber-futures market has jumped. Almost 2,700 contracts were traded on Tuesday, compared with an average daily volume of about 1,550 through the first 10 months of both this year and 2008.

As futures prices rise, further fuel is added by short sellers scrambling to cover positions and investors playing the carry trade of buying cheap physical lumber and selling it forward.

The increase in lumber prices is a measure of how cheap money has pushed investment dollars out of cash and into the farthest reaches of the commodities markets. Policy makers might cheer their own genius in that respect. But they shouldn't forget the inflationary portents. Nor, if those housing starts data are anything to go by, should they assume that an overheated printing press can fix a fundamentally battered economy.

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