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Finnish Forest Sector Economic Outlook 2017–2018

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Summary

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The demand for Finnish forest industry products remains good in the world markets both this year and next year, with the exception of printing and writing papers. The production and export volumes of wood products, pulp, and cardboard increase, whereas the average unit prices of exports remain mainly close to the last year's levels. Only the export price of pulp is expected to rise more rigorously this year.

In 2018, development will be rather similar to this year, although the growth in the production and export volumes of Finnish forest industry is forecast to slow down slightly from this year. The revenues from paper exports continue to decline, but the decline is counterbalanced by the export earnings from sawnwood, plywood, cardboard and pulp. The sharp growth in pulp production and export volumes are attributable to the full implementation of new production capacity in Finland in the coming year. The exports prices of forest industry products are not expected to change significantly.

In wood products industry, the production and exports volumes of sawnwood and plywood will grow from last year. The Finnish sawnwood exports will be record high again this year, and the exports will continue to grow next year as well. This year, China will become the main target country for Finnish sawnwood exports, both in terms of volume and value. In addition to spruce sawnwood, the exports of pine sawnwood are growing to China, to which pine sawnwood flows have been directed from the troubled North African market. Although the decline in the export price of pine sawnwood is expected to gradually fade, the difference between the export prices of pine and spruce sawnwood will remain substantial this year, which is reflected negatively in the profitability of pine sawnwood production. In 2018, the production and exports of plywood will grow from the current year, which is due to the continued growth in construction in Europe and investments especially in LVL production in Finland.

Although paper account for more than one third of the export earnings of the Finnish forest industry, the declining trend in paper production and export volumes will continue this year and next year. This is mainly attributable to the falling demand for printing and writing paper in the world markets and reduced production capacity in Finland. Instead, the demand for other paper assortments is growing in packaging as well as in hygiene and household use. The positive drive of the global economy and trade increases the need for packaging, which enhances the demand for cardboard. The growth in production capacity in Finland enables the expansion of cardboard production and exports both this year and next year. Despite the increase in demand, the export price of cardboard will rise only slightly. The introduction of new capacity and the conversions of paper machines into cardboard production will inflate supply in Europe and create pressure on the market prices.

With the new capacity, the production and exports of pulp will grow this year and next year. Growth will be more pronounced in 2018, when the new investments will be in full production. The importance of China as export destination for Finnish pulp is growing year-on-year and China's share of pulp exports is already one third. The unit price of Finnish pulp exports fluctuates strongly along with world market prices, and according to price development in the first half of this year, the export price of pulp is to rise this year after a fair drop experienced last year. Next year, the export price of pulp is expected to fall slightly as softwood and hardwood pulp production is expanding worldwide. As the prices of the main raw materials are expected to develop moderately, the profitability of the pulp and paper industry is expected to remain at a good level both this year and next year.

The growth in the production and export volumes of the forest industry products will increase the commercial fellings to 63.6 million cubic metres this year and to 65.0 million cubic metres next year. The growth in the use of roundwood in Finland is mainly satisfied by expanding the use of domestic wood. Roundwood imports are expected to decrease below 9 million cubic meters this year but to grow again next year. Due to the healthy demand for spruce sawnwood, the stumpage price of spruce sawlogs will rise most strongly this year. The increasing use of spruce and pine pulpwood in cardboard and pulp production will raise their stumpage prices this year. No major changes in stumpage prices are expected to occur next year.

In non-industrial private forestry, the gross stumpage earnings rose to EUR 1.8 billion last year and they are estimated to grow to EUR 1.9 billion this year, thanks to the increasing fellings and rising stumpage prices. Also next year, the stumpage earnings are expected to rise. In non-industrial private forestry, the operating profit per hectare is EUR 126 in 2017 and EUR 129 in 2018.

The use of forest energy is still far short of laid goals. The cheap emission allowances, the low world market price of coal, and the uncertainty related EU policies that may affect the profitability of forest biomass in energy use will shift investment decisions to the future and hamper the greater growth in forest energy. On an annual level, weather conditions also have a strong influence on the use of forest energy. In 2017, the use of forest chips is estimated to grow by two per cent, and next year, the use is expected to increase further to 8.5 million cubic meters. This year, the average purchase price of forest chips at plant will remain at last year's level and next year the price will rise only slightly. The production of wood pellets in Finland will recover this year after the sharp decline in production volumes last year.

Although production volumes in both the wood products and pulp and paper industries are projected to increase this year and next year, the number of employees in the forest industry will decrease according to the statistics on the beginning of this year. Although there are sectoral differences, automation and general growth in productivity will reduce the need for labour, and employment in the forest industry will decline by a couple of per cent this year. In forestry and despite the growth in commercial fellings, the employment is also expected to decline this year. The introduction of e-commerce in wood trade, the overcapacity in harvesting, and the use of foreign labour in forest management will decrease the demand for domestic labour. In 2017, employment in forestry is estimated to fall to 21,000. Next year, both in the forest industry and in the forestry, the number of employees will remain at this year's level.

Extensive growth in global economy

The growth in world economy as weighted by the export shares of Finnish forest industry in 2016 is expected to grow by 2.7 per cent this year. The growth is exceptional because all the OECD economies are growing at the same time. Moreover, the growth in numerous countries is occurring in many sectors and not just in one. The growth of a couple of percent in the euro area is driven by private consumption, investment, and exports. Among the major export destinations of the Finnish forest industry, the German economy also grows by two per cent, while in the UK, the economic growth rate is slowing due to the uncertainty surrounding Brexit. In China, economic growth will continue at almost same pace as experienced during the recent years. The Russian economy will start to grow again after a few years of decline. The US economy is projected to continue to grow, although doubts of a downturn have intensified in the recent months. Next year, the growth in global economy growth will continue, but slower than this year.

Sawnwood exports to a new record again

Sawnwood exports are projected to grow by 5 per cent to 9 million cubic meters this year. This is a new all-time record. At the same time, China will become, both in terms of export volume and export value, the most important destination country for Finnish sawnwood exports. The domestic consumption of sawnwood is growing, but on a slower pace than the exports. The decline in the export price of pine sawnwood is expected to gradually discontinue, but the level difference between the export price of pine and spruce sawnwood is still significant. The average export price of sawnwood strengthens slightly from last year.

Sawnwood production is predicted to continue to grow to 12 million cubic meters in 2017. The drive of export and the incipient growth in domestic consumption have encouraged the firms to investment in the production of sawnwood and engineered wood products. Plywood exports and production will also start to strengthen in 2017, both rising by 4 per cent from last year.

In 2018, exports of sawnwood will grow slower than this year, as the pace of construction growth in Europe will slow down and competition in the Chinese market will intensify. Nevertheless, the exports of sawnwood are projected to increase to 9.2 million and production to 12.3 million cubic metres. The projected slowdown in construction growth in Europe is also reflected in the production and exports of plywood, which will continue to grow in 2018, but slower than this year.

Exports of pulp and cardboard booming

In 2017, the exports and production of cardboard will grow by 7–8 per cent. Enhanced economic growth in Europe has increased the demand for packaging and simultaneously, there is more cardboard production capacity in Finland than before. Next year, the growth in exports and production will continue but slower than the current year, as the economic growth in Europe is slowing down slightly. Although the demand for cardboard is growing, the price development will remain flat this year and next year due to a significant increase in supply in Europe.

The decline in Finnish paper production and export volumes will continue this year and next year, as printing and writing paper production capacity has been reduced in Finland and consumption continues to trend downwards in the export markets. In the first half of 2017, the market prices of papers, excluding magazine paper, had been rising following the price trend of pulp. Correspondingly, the average unit value of Finnish paper exports also strengthened. However, due to the downward trend in prices last year, the average export price of paper for the whole year of 2017 will remain below last year's level. Next year, the overcapacity in Europe will put pressure on the price development of paper.

Pulp production is estimated to grow by about 3 per cent this year. Growth will pick up next year and the volume of exports will increase, thanks to increased production capacity. China has become an important target for Finnish market pulp, and its export share has already increased to about one third of total pulp exports. The average export price of pulp follows the fluctuations in world market prices. In the first half of 2017, the export price of pulp was 4 per cent higher than last year at the same time, and the average export price for the whole year of 2017 is expected to rise from last year. Next year, the growth in softwood and hardwood pulp capacity globally will bring downward pressure on market prices, which will also affect prices of Finnish pulp exports.

Profitability varies within forest industry

The profitability of sawmilling industry will remain virtually unchanged this year and next year. Sawnwood production is growing, but no major changes are expected in the export prices. The slight increase in cost inflation will weaken the positive impact on the profitability due to growth in sawmilling volumes. The profitability of sawmilling, and in particular the production of pine sawnwood, is driven by the exchange rate of Euro, which has strengthened by more than 10 percent against the US dollar this year. The profitability of production of plywood and structural wood products remains good.

The profitability of pulp and paper industry is expected to remain at a good level this year and next year. Major investments especially in pulp and cardboard capacity during the recent years, have an impact on the profitability. The growth in pulp and cardboard exports will increase revenues, but export prices of printing papers will continue to fall steadily. Although the prices of some individual inputs, in particular chemicals, will rise, the prices of the main raw materials, i.e. roundwood, labour, and minerals, are expected to develop moderately. The same applies to the prices of capital and energy.

Commercial fellings also to a new record

Due to the growing raw material demand by the Finnish forest industry, commercial fellings will grow by 3 per cent to 63.6 million cubic metres this year. The fellings in non-industrial private forests will grow by 3 per cent, while the combined fellings by companies and Metsähallitus will grow by one per cent. The good demand for final products in the world markets and the correspondingly increasing exports increase the demand for coniferous timber assortments in particular and stumpage prices.

In 2018, the volume of commercial fellings is expected to increase to 65.0 million cubic metres, as sawnwood, plywood, pulp and cardboard production will increase. Roundwood imports are expected to rebound to around 9.5 million cubic metres in 2018. In response to the growth in demand, the increase in the supply of roundwood is expected to keep stumpage prices at almost this year's level. The growth in sawnwood production will bring more sawmill chips for the industry, and supply in the roundwood markets is expected to increase temporarily, because farmers are suffering from a crop failure this year.

Other factors such as taxation, diversified forest legislation and more versatile wood trade practices also affect supply growth. In addition, the gradual growth in harvesting possibilities due to accelerating increment of forests will increase roundwood supply in the longer term.

Increasing fellings improve operating profit in forestry

In 2016, the gross stumpage earnings in non-industrial private forestry increased to 1.8 billion. As a result of increased fellings, the earnings are projected to grow to EUR 1.9 billion this year and to increase slightly in 2018 as well.

The operating profit in non-industrial private forestry will improve this year by 8 per cent due to increased fellings this year. The operating profit of EUR 126 per hectare has not been as high since the peak year of 2007. The growth in operating profit is expected to continue slower in 2018. The pressure to invest more in forest management and forest improvement increases due to growing fellings and accumulated areas of young stands requiring nursing. The real rate of return on wood production will rise to 6 per cent this year, but will fall to 3 per cent next year due to the lame development of stumpage prices.

Number of employees decreases in forest sector

In 2017, the number of employees in the forest industry is estimated to fall to 38,600 people from last year's figure of 39,500. Employment is expected to decrease in sawmilling and wood-based panel industry as well as in pulp, paper and cardboard production, whereas the number of employees in the construction carpentry industry and in the manufacturing of paper and cardboard products increases. According to a cautious estimate, in 2018, the total number of employees in the forest industry will grow slightly from this year's level.

The decrease in energy wood harvesting and the long-term change in the labour structure will reduce the number of employees in forestry to 21,000 in 2017. In 2018, commercial fellings are expected to increase from this year's level, but the effects on employment are expected to remain low. The overcapacity in harvesting, the use of foreign labour in forest management work and the introduction of e-commerce in roundwood trade are expected to lower the demand for forestry labour. On the other hand, the removing of Kemera's payment problems and the related commence of outstanding forestry works will temporarily improve the demand for labour. The combined impact of the before-mentioned factors on the employment of forestry workers is, that in 2018, the number of employees is assumed to remain at the same level as in 2017.

Use of forest chips growing slowly

Weather conditions have a strong impact on the use of forest chips, which is forecast to grow slightly this year due to the cooler beginning of the year in 2017 than in 2016. The low world market price of coal, the cheap emission allowances and the uncertainties in EU policy making, however, slow down investment decisions and impede the growth in the use of forest energy. The consumption of forest chips is expected to increase this year by two per cent and next year by three per cent to 8.5 million cubic metres. In Finland, pellet consumption has risen steadily since last year, and new pellet mills have entered into production while more are being built.

Basis and risks of the forecast

The Finnish forest sector economic outlook provides information on the current situation and the future prospects of the Finnish forest sector. The forecasts are based on public statistics, world economic development forecasts, forest sector market information from various sources, and studies by the Natural Resources Institute Finland. The forecasts are made using the derived demand principle, which means that the fluctuations of the economic outlook in Finland and the export markets are expected to be reflected in the demand for forest industry products and, consequently, to forest industry production and domestic wood market. Changes in the operating environment of the forest sector and the impact of the Government's economic instruments are also considered when the forecast is prepared. If the economic growth were to be slower than expected, the export prices, production and the profitability of the Finnish forest industry would be lower than this forecast.

The understanding of the economic development of the world economy and export markets is based on projections made by different organizations (e.g. OECD, IMF, ETLA, Nordea, Bank of Fin-

land). The forecasts for this review are based on the data from the forest sector in September and October 2017 and forecasts for the development of world economy for the years 2017–2018. The forest sector forecasts describe the most probable development as assessed by the authors. They are point estimates, which are based on export market growth forecasts and other underlying assumptions related to market development.

The major uncertainties affecting world trade and the economy during the rest of the year and next year are largely the same as in the past. The Brexit negotiations between the European Union and Britain may lead to an increase in uncertainty. In particular, the effects on the UK economy may be significant. Simultaneously, the US economic policy remains still unstructured. The implementations of financial and monetary policies and the possible change in trade policies towards protectionism are open questions. Concerns about the possible outbreaks of debt and wealth bubbles in China, Sweden and the United States have also grown. North Korean nuclear and missile tests have become a recent source of uncertainty parallel to previous geopolitical conflicts. Together or alone, these risks can affect the global economic development and the demand for forest industry products. Moreover, falling into a deadlock in labour negotiations in Finland during this autumn and early winter can, at worst, affect the production volumes of forest industry and hamper the exports.

Key forecasts 2016–2018f.*

Forecast variable	2016	2017f % change	2018f
Sawnwood production	8	5	3
Sawnwood exports	9	5	2
Sawnwood export price	-4	1	1
Plywood production	-1	4	2
Plywood exports	-4	4	2
Plywood export price	0	0	0
Pulp production	5	3	6
Pulp exports	10	2	10
Pulp export price	-13	4	-1
Paper production	-6	-2	-3
Paper exports	-8	-2	-3
Paper export price	0	-2	-2
Cardboard production	9	8	3
Cardboard exports	8	7	3
Cardboard export price	-3	1	1
Commercial fellings	4	3	2
Roundwood imports (including chips)	3	-5	7

*price changes are nominal

Sources: Finnish Forest Industries, Finnish Customs, and Natural Resources Institute Finland.

Average stumpage prices (over bark) in non-industrial private forestry 2016–2018f.

Roundwood	2016 €/m ³	2017f €/m ³	Change %	2018f €/m ³	Change %
Pine sawlogs	53.3	54.5	2	54.8	1
Spruce sawlogs	55.3	57.2	3	57.2	0
Birch sawlogs	41.5	41.8	1	41.4	-1
Pine pulpwood	15.5	15.9	3	16.0	1
Spruce pulpwood	17.3	17.8	3	17.8	0
Birch pulpwood	15.2	15.3	1	15.1	-1

Source: Natural Resources Institute Finland.

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