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Finnish Forest Sector Economic Outlook

2013–2014

Executive summary

Improving Prospects for the Finnish Forest Sector

The production, exports and the export unit prices of the Finnish forest industry are increasing in 2013 thanks to the positive development at the start of the year; with the exception of paper. As the year draws to a close the demand for forest industry products will be supported by the end of the recession in the euro area. Next year, the growth of the production and exports of the forest industry will continue to be slow as the economy of the euro area gradually starts to revive.

In the wood product industry, it has been possible to compensate for the weak demand in Europe by increasing exports outside Europe to the markets in Asia and the Middle East. The exported amounts and export unit prices of both sawnwood and plywood are increasing in 2013. The demand for pulp on the global market as well as the growth in demand for packaging material are increasing the production and export of paperboard and pulp. The export unit prices are also increasing. In contrast, the demand for paper in the main market area, the euro area, continues to fall, causing a decline in Finnish paper production, exports and export prices.

Next year, the production of sawnwood will increase to 9.9 million cubic metres thanks to domestic construction and the slowly increasing demand in the euro area. The production and export of plywood, paperboard and pulp will also increase slightly. The production and export of paper will continue to diminish

due to weak demand and the overcapacity that plagues the sector.

In the roundwood market, the growth of production in the forest industry has been visible during the start of the year in the almost unprecedented amount of commercial fellings. However, this will flatten out over the rest of the year and the annual total will remain at a little over 53 million cubic metres. The growing demand for wood will increase the stumpage prices of coniferous sawlogs by 2–4 per cent for the full year, and those of pulpwood by one per cent, compared to last year. The amount of commercial fellings and the level of stumpage prices in 2014 will remain close to those of previous year. In 2013 the increase in commercial fellings will also increase employment in forestry, whereas in 2014 the employment will stay unchanged. The imports of roundwood will increase both this year and the next.

In the bioenergy market, the changes in taxation and subsidies during the start of the year have influenced the profitability of the use of peat and forest chips in energy production. However, the total usage of forest chips will continue to grow to 8.9 million cubic metres during the current year and 9.6 million next year. The average energy plant gate price of forest chips will also increase. The domestic consumption of wood pellets will increase slightly next year; production will remain at the current level, however. In the bioenergy market, uncertainty surrounding the final form of regulations on taxation and subsidies is slowing down the implementation of investments planned for the sector.

The growth of production amounts and exports in the forest industry is visible as an improvement in the profitability of the forest industry both this year and the next. However, the improvement will be faster in the wood product industry compared to pulp and paper industry, where the poor profitability of paper manufacture weakens overall development. Total employment in the forest industry will decrease slightly, but in forestry the increase in commercial fellings and energy wood harvesting improve the employment slightly. In private forestry, the rise in commercial fellings and stumpage prices will increase the gross stumpage earnings to €1.5 billion both this year and the next. The operating profit per hectare for private forests will increase to almost €90 per hectare.

The economy in the euro area is starting to improve

The global economy and international trade is expected slowly to revitalise despite several uncertainty factors. The economic outlook in the developing countries has clearly improved in the first half of 2013, and growth is expected to continue during the rest of the year as well as next year. Global economic growth weighted with the Finnish forest industry's export share will reach roughly one per cent this year, but growth next year will increase to a few per cent. According to statistics, the recession in the forest industry's main market area, the euro area, ended in the second quarter of the current year. Despite a further decrease of roughly half a per cent this year, several forecast indicators show that the economy will slowly revive during the rest of the year. Next year the economy throughout the euro area will grow by roughly one per cent, although differences between individual countries remain large. The British and Swedish economies will grow faster than the euro area. However, the Russian economy will grow more slowly this year than anticipated, returning to a growth level of three per cent only next year.

The political struggle over federal debt may momentarily slow down the economy of the United States that has begun to grow, but the final effect is likely to be minor. The growth of private consumption and investments is supported by the improving housing market, increasing employment and decreasing debt. This year, GDP growth in the United States is expected to be around two per cent, with one additional per cent next year. In China, a country capable of quick decisions on economic policy, GDP growth is stabilising at 7.5 per cent. With a change in its eco-

omic policy, the economy of Japan is growing by a little under 2 per cent, with next year's growth slightly slower than in the current year. GDP growth in North Africa and the Middle East continues, but the potential spread of unrest creates uncertainty in the area.

Although the economy probably bottomed out in Finland during the summer, and is anticipated to start growing slowly during the rest of the year, the Finnish economy will decline by roughly half a per cent in 2013. Weak demand in export countries and issues related to competitiveness limit the growth of export. Private consumption and investment in Finland is limited by increased unemployment, weak development of purchasing power, a large amount of free industrial capacity, and a low level of confidence in the economy and the future. Thanks to the gradual revival in demand in key export markets, however, slow export growth and an increase in domestic investment will result in the Finnish economy expanding by roughly 1.5 per cent.

Growth spurt in production and exports of wood products

A low level of activity in the construction business has decreased the exports of Finnish sawnwood to Europe, but exports to the markets outside Europe in Asia and the Middle East have clearly increased. The exports of Finnish sawnwood has increased particularly to China, where demand has been maintained through the country's GDP growth. Chinese imports from European countries such as Finland and Sweden have increased since the Canadian trade turned to satisfy the growing demand of sawnwood in the United States. During the rest of the year, no large improvements are expected in the demand for sawnwood in Europe, but demand outside Europe will continue strong. In 2013, exports of Finnish sawnwood is anticipated to increase by 7 per cent, and export unit prices by roughly 2 per cent for the full year. In Finland, the decline in construction lowers the demand for sawnwood, but thanks to good export performance the production of sawnwood is forecast to grow in 2013 by 5 per cent, to 9.8 million cubic metres.

Next year, growth in the demand for sawnwood is expected to slow down slightly in Asia, although there will be a corresponding rise in demand in Europe as construction slowly begins to grow. In North Africa, the market situation will remain uncertain. The mild growth in Finnish construction plays its part in increasing the demand for sawnwood. In 2014, production and export of sawnwood will increase by one per cent and export unit prices by a few per cent at annual level.

The exports and production of Finnish plywood are also anticipated to grow both this year and the next. Exports to Europe is assisted by the dearth in the supply of plywood, with several other competitor countries directing their export into the growing United States market, and Russia consuming an increasingly large share of its own production. In 2013, production and exports of Finnish plywood will increase by 4 per cent and by 1–2 in per cent the next year, as export unit prices increase slightly.

Demand decreases for paper, increases for paperboard and pulp

The paper and pulp industries have a dual outlook for the near future. In Europe, consumption and demand for printing and writing paper continues to decline, as the structural change involving replacement of paper by electronic media is emphasised by the recession. Certain marks of the same development are also visible in the developing countries. European manufacturers have aimed at reducing overcapacity by shutting down production units. However, demand for packaging material is growing as global trade slowly revitalises, and demand for tissue continues to grow. Global demand for pulp is maintained particularly by China's increasing need for fibre. Weak European demand is anticipated to cause a decline of 5 per cent in Finnish paper production and exports this year compared to last. Paper export unit prices will also decrease slightly. Production and export of pulp will increase by 2–3 per cent and of paperboard by 5 per cent. Export prices of both paperboard and pulp will increase slightly compared to last year.

Next year, the development trend and global market demand for pulp and paper industry products appear to be very similar to the current year. Despite the anticipated slow growth of the euro area economy, demand for printing and writing paper in Europe will continue to decline, reducing Finnish paper production and exports by 4–5 per cent. Demand for packaging materials will remain high, which will increase production and exports of paperboard by 4 per cent. Production and exports of pulp will also increase slightly compared to the current year. With the exception of paper, export unit prices are anticipated to increase by a few per cent at annual level.

Forest industry profitability improving

The profitability of both wood products and pulp and paper industries is improving in 2013 compared to last year. Profitability in the wood products industry will improve more rapidly by comparison when the

amounts of plywood and sawnwood exports increase and export unit prices rise. Pulp and paper industry profitability is improving through healthy demand in pulp and paperboard, the rise of export prices and moderate pulpwood price development. Profitability of paper production nevertheless remains poor, with even a negative development during 2013.

Forest industry profitability in 2014 will flatten out as the growth of export slows down. Export unit prices in the wood products industry will continue to increase from the current year's level, while the euro area revival and that of the domestic economies will increase demand for wood products. At the same time, however, slowing down of the growth in demand and price development in Asia will hold back the development of wood product industry profitability. Profitability of the pulp and paper industries is improving through increases in the amounts of pulp and paperboard exported as well as in export unit prices. In comparison, the decline of profitability in paper production will continue as the export prices go down.

Increasing employment in forestry

The number employed in 2012 by the forest industry decreased by 11 per cent compared to the previous year, to total 41,600. The wood products industry share was 22,600 and that of the pulp and paper industry 19,000. The decrease was accounted for particularly by the number of people working in paper manufacture. The total employed in 2013 is estimated to drop to 40,200, again largely due to the numbers involved in paper manufacture. By contrast, the number of employees in the wood products industry will increase slightly as production increases. In 2014, the total number employed is anticipated to remain at the same level as in the current year.

The number employed in forestry in 2012 was 23,200, nearly three per cent more than the previous year. This year, increases in the harvesting of energy wood and in commercial felling are increasing the number of people employed in forestry by close to a further three per cent, to total 23,800. Next year the total number of people employed will remain close to the level of the current year.

Busy time in the roundwood market

The amount of commercial fellings during the first half of the current year has been almost unprecedented. The demand for sawlogs has increased through growth in wood products industry exports outside Europe, and pulpwood demand through strong global market

demand for paperboard and pulp. However, growth in fellings will flatten out during the rest of the year, with commercial fellings during 2013 anticipated at over 53 million cubic metres, three per cent more than last year. The increased demand for wood is also visible as an increase in stumpage prices. Stumpage prices for coniferous sawlogs are anticipated to increase by 2–4 per cent for the full year, and those of pulpwood by one per cent compared to last year. The stumpage prices for birch sawlogs will remain at the same level as last year. After clarification of the administrative issues and customs procedures related to Russia's membership of the WTO, the imports of roundwood will increase to 11 million cubic metres.

Growth of the wood products industry's exports from Finland will continue in 2014, visible in a growth of a few per cent in commercial fellings of sawlogs and 1–2 per cent in stumpage prices. Even with growth in production and exports of pulp and paperboard, the decline in paper production limits the total use of pulpwood, and its commercial fellings will slightly decrease compared to this year. Pulpwood stumpage prices will remain close to the same annual level as in the current year. The imports of roundwood will increase to over 12 million cubic metres.

Increases in bioenergy use

The demand for domestic fuels in energy production is increasing, along with their price as fuel for energy plants. Apart from its poor availability, the profitability of peat will be reduced by the tax that came into effect at the start of the year, while electricity produced with forest chips will be affected by a reduction in subsidies. The low price of emission allowances has increased the demand for fossil fuels, such as coal for energy production. The total use of forest chips is nevertheless anticipated to continue its growth during 2013, reaching 8.9 million cubic metres. Even though market prices for emission allowances continue low and thus encourage the use of other fuels than wood, increase in commercial fellings and opening of new energy plants will expand the use of forest chips. Use of forest chips in 2014 is anticipated at 9.6 million cubic metres, with average energy plant gate prices rising to €21.50 per megawatt hour. In 2014, the domestic production of wood pellets will remain at the same level as in the current year at approximately 270,000 tonnes, while domestic consumption will increase slightly to 205,000 tonnes. Most of the growth in consumption will be directed towards usage by heating and energy plants.

Changes in taxation, subsidies and regulations in the bioenergy market may produce a rapid and power-

Key forecasting variables, 2012–2014.

Forecasting variables	2012	2013	2014
	% change from previous year		
Sawnwood production	-4	5	1
Sawnwood exports	5	7	1
Sawnwood export price	0	2	2
Paper production	-8	-5	-4
Paper exports	-7	-5	-5
Paper export price	6	-1	-1
Commercial fellings	-2	3	0
Roundwood imports	-5	16	10
Sawlog prices			
Pine	-3	2	1
Spruce	-5	4	1
Birch	-2	0	2
Pulpwood prices			
Pine	-2	1	1
Spruce	-7	1	0
Birch	-2	1	1

Price changes are nominal

ful effect on the use of renewable forms of energy. The European Union is preparing several directives on the use of solid and gaseous biomass sources in energy production. The uncertainty over emissions trading and the final forms of the directives creates difficulties for investment and investment planning.

Forestry operating profit improves

In 2013, the increase in commercial fellings and stumpage prices will increase the gross stumpage earnings from private forests to €1.5 billion. The earnings will also remain at the same level next year. Investments in wood production in 2013 are anticipated to remain at last year's level of €213 million, and increase slightly next year. Forestry operating profit will increase to almost €90 per hectare both this and next year. The return on investment of wood production will remain at 2–4 per cent.

Forecast basis and risks

The annual report Finnish Forest Sector Economic Outlook provides an analysis of the current year and forecasts for the coming year. The forecasts are based on public statistics, global economy development forecasts, forest sector market information from various sources, and research conducted at Metla. The so-called 'principle of derived demand' is used in making the forecasts, according to which fluctuations in GDP growth on the domestic and export markets will through demand be reflected in forest industry production and the domestic roundwood market.

Changes in the forest sector's operating environment and the effects of the government's economic policies have also been taken into account in making the forecasts. If GDP growth turns out to be below the level forecast, this would mean that export prices, production and profitability for the Finnish forest industry will be lower than in the forecasts presented here. The effects would also spread from the forest industry into the roundwood market, the employment in forestry and the profitability of private forestry as the demand of wood declined. In that case, the development of the Finnish forest sector would remain weaker than in the forecasts presented here.

Views on GDP growth of the world economy and the export markets have been formulated on the basis of forecasts made by a number of different organisations, such as OECD, IMF, the Research Institute of the Finnish Economy (ETLA), Nordea, and the Bank of Finland. The forecasts in this overview are based on the information on the forest sector from September–October 2013 and on forecasts of the development of the global economy for 2013–2014. The forest sector's forecasts correspond to the researchers' views on the most likely development. These are point forecasts based on export market

growth forecasts and other background assumptions about the markets.

The most significant risk concerning the forecasts presented here is that GDP growth of the global economy and the central market areas of the forest industry will be lower than forecast. Even though the economy in the euro area is rising from its lowest point after the summer, growth will remain slow and has a tenuous basis. There has been time to draw breath in the debt crisis during the start of the year, but the emergence of new crises or political conflicts in the euro area would quickly have the effect of diminishing the confidence of consumers and companies in the economy. In the United States, the political struggle over the federal budget and the debt ceiling may at worst paralyse economic development. This would for example affect global trade flows of sawnwood via the housing market, leading to an effect on Finland. The expansion of the conflicts in Syria and Egypt may have an effect on the development of the global economy if energy and raw materials become more expensive. Any potentially occurring regional natural catastrophes, such as the earthquake in Japan and its after-effects, may have widespread global effects on the global trade and economy.

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