



14.10.2014

Finnish Forest Sector Economic Outlook

2014–2015

Executive summary

The Finnish forest industry resists the economic downturn

With the exception of paper, the production, export and export prices of Finnish forest industry products have continued to grow in 2014. However, this growth has been slower than last year due to declining growth in demand in several market areas. Uncertainty about economic development has increased alongside the crisis in Ukraine and unrest in the Middle East.

In the first half of 2014, sawnwood exports to Europe and Northern Africa were good, counterbalancing the fall in exports to Asia. At the same time, the export prices of sawnwood have increased. Although the outlook in Europe in particular has worsened during the early autumn, exports of sawnwood will increase in 2014 as a whole, and export prices will increase from the previous year. Favourable export development is expected to continue in 2015, albeit at a lower rate than in the current year. The export volumes and prices of plywood are expected to develop along very similar lines to those of sawnwood. Indeed, this year the wood-product industry's profitability will attain a level close to its 2007 peak. In 2015, the increase in export prices of sawnwood and plywood will slow down, while the entry into force of the sulphur directive will put pressure on freight costs. However, it is expected that the effect of the sulphur directive will remain relatively minor and, considering the steady development of wood costs, the wood-product

industry's profitability is likely to experience only a small dip next year compared to the current year.

In the global market, demand for pulp and cardboard remained healthy in 2014, while both export volumes and prices increased. On the other hand, the downward trend in paper exports continues. Falling demand for paper in the main European market area is levelling out, however and, with the help of the implemented capacity cutbacks, the market situation is expected to recover in the near future. As a whole, profitability development within the pulp and paper industry has been positive in 2014, which is partly due to paper production becoming profitable. In 2015, paper export volumes and prices will continue to fall, albeit at a slower rate than in the current year. On the other hand, the export volumes and prices of pulp and cardboard will increase. The increase in pulp and cardboard export volumes is being limited by the already high utilisation rate of production capacity.

During this and next year, the production volumes of the forest industry's main products will grow, with the exception of paper, while the use of roundwood will remain at a high level. In 2014, fellings of sawlogs will increase, but fellings of pulpwood will decrease, alongside the increased availability of sawmill woodchips and the decrease in paper production. Roundwood imports will also decrease. Due to the high level of domestic commercial fellings, the number of people employed by the forest industry will grow. Ample availability of roundwood will curb the development of the stumpage price, and the stumpage prices of sawlogs in 2014 will remain at the previous year's level, while

the stumpage prices of pulpwood will fall slightly. In 2015, demand for roundwood will remain high and the amount of commercial fellings will increase from the current year, while wood imports will decrease and domestic wood's share of wood use in the forest industry will increase further. The wood supply will remain at a healthy level and stumpage price development will remain even.

Growth in the use of wood for energy will level off in 2014, and no growth is expected in 2015. The low global market price of coal, the low price levels of emissions rights, and cutbacks in subsidies will slow down investment decisions and retard the growth in the use of forest energy.

Numerous uncertainties surround short-term economic development in the domestic market and major export markets. Despite this, the overall outlook for the forest sector is rather positive and the export volumes and prices of most product groups continue to grow steadily. This is building confidence in the future of the industry; other positive indicators include the plans announced by the forest industry for major investments in Finland.

Global economy growing, but Eurozone's growth is sluggish

In 2014, the growth rate of the global economy is expected to remain at last year's level, but during the early autumn downward corrections were made to the spring's optimistic forecasts. The escalation of the crisis in Ukraine and unrest in the Middle East have increased the level of uncertainty, impacting on the general economy through lower confidence among both consumers and the private sector. Weighted for forest industry export shares, the global economy is expected to grow by a couple of per cent. Growth will pick up slightly next year.

Growth in the Eurozone, the forest industry's main market area, is expected to accelerate slightly next year, although it will remain slow, with large country-specific differences. France and Italy, for instance, are finding it difficult to kick-start economic growth, although growth is returning to Germany after the slump early in the year. The gradually improving economic situation in the Eurozone's crisis countries, support measures by the European Central Bank, and the anticipated weakening of the Euro against other major currencies will support the Eurozone's gradual recovery. However, a great deal of uncertainty surrounds the expected growth rates of less than one per cent this year, and one and a half per cent next year.

The economies of non-Euro European countries are growing considerably faster. The British and Swedish economies are expected to grow at a rate of two to three per cent both this year and next year. Russia, however, is in danger of sliding into recession, and is expected to grow slowly in the coming years.

In the United States, the improvement in the housing market, reduced indebtedness among domestic households and rising share prices have improved the situation for domestic households, which is fostering the growth of private consumption and investments. Although problems associated with the federal debt and budget and structural reforms of the economy remain partially unsolved, no major threats to continuing growth are looming. This year, the US economy will grow at a rate of well over two per cent, and even faster next year. In Asia, growth will slow down compared to previous years. In China, however, the economy is expected to grow at an annual rate of around seven per cent both this year and next. At the same time, Japan will see growth of one to one-and-a-half per cent.

For Finland, the current year is the third year of economic contraction in a row. In addition to the decrease in the export of goods to Russia, exports have been reduced by the slower-than-anticipated recovery of the Eurozone and low demand. Exports to countries outside the Eurozone have been hindered by the high value of Euro. According to the latest economic surveys, Finland's economic outlook will not improve much during the rest of the year. Consumption and investment are being curtailed by increasing unemployment, poor earnings development and greater general uncertainty. Next year, increased export volumes are expected to help the economy to grow by around half a per cent.

Growth in demand for wood products is slowing

In early 2014, the revitalisation of demand for sawnwood in Europe and Northern Africa resulted in rapid growth in exports and production of sawnwood in Finland. The increase in export volumes to these markets compensated for dwindling exports to Asia, particularly to Japan. However, uncertainty has increased due to the gloomy economic outlook of the summer and early autumn. Against expectations, construction is on a downturn throughout the European Union, dampening the market outlook for the wood product industry over the coming months. Thanks to healthy development at the beginning of the year, sawnwood exports are expected to grow by three per cent and plywood exports by four per cent in 2014. The unit price of sawnwood exports will rise by around four per cent from last year, and the average price of plywood exports by around one per cent.

Next year, in several European countries the darkening outlook for construction will impact on demand for coniferous sawnwood and plywood, with growth in Finland's exports slowing compared to this year. In Finland, new construction is at an exceptionally low level and growth is expected to be modest next year. With regard to the markets outside Europe, growth is also slowing in Asia. However, there is growth potential for exports in Northern Africa, where the longer-term requirement for the renovation of the building stock, new construction, and improvements to infrastructure will increase demand for sawnwood in 2015 too. Finnish sawnwood exports are forecast to grow next year by one per cent and plywood exports by two per cent. Export unit prices are also expected to increase slightly compared to 2014.

Cardboard and pulp exports are growing, the decrease in paper prices is slowing down

In the pulp and paper industry, demand for pulp and cardboard remains strong in the global market but, with regard to printing paper, demand and prices are continuing their downward trend. However, the fall in demand in Europe is gradually levelling out, although the use of electronic media instead of printing and writing paper is increasing, and demand for printing paper is continuing to decline. In addition to the capacity reductions made in Europe, the market situation is being alleviated by production capacity reductions in North America, which is slowing the decline of market prices. Finland's paper production and exports are forecast to decrease by three per cent in 2014, and by two per cent next year. This year, paper export prices will fall by two per cent over last year, and by one per cent more in 2015.

Global demand for pulp is being maintained by the increasing use of tissue paper, poorer availability of recycled paper due to falling consumption of printing paper, an increased need for dissolved grades of pulp, and the shut down of old pulp capacity in China and Canada. In 2014, both pulp production and exports will increase by two per cent. Next year, growth in production will slow to one per cent, mainly due to the almost full utilisation of current pulp production capacity.

Exports of primary fibre cardboard are being boosted by the increase in eCommerce, poorer availability of recycled fibre, the general tightening of hygiene requirements, and the lightness of folding boxboard as a packaging material. In 2014, Finland's production of cardboard will increase by four per cent over last year. Next year, the increase in production will be curbed by the high utilisation rate of avail-

able capacity, with production increasing by only a couple of per cent. Cardboard exports from Finland will increase by three per cent both this and next year. Export prices of both pulp and cardboard have remained rather steady since 2012 and both are estimated to increase by one per cent this and next year.

Forest industry's profitability improving

In 2014, profitability has improved in both the wood product industry and the pulp and paper industry. In the wood product industry, production, export volumes and prices of sawnwood and plywood have increased, while the roundwood supply has remained at a high level and stumpage price development has remained moderate. This has rapidly increased the sector's profitability figures to almost the level of the 2007 peak experienced during the economic upswing.

After a positive first half, the outlook in the wood product industry worsened during the autumn of 2014. Uncertainty with regard to exports of spruce sawnwood in particular has increased in the main market area, Europe, due to increasing domestic sawnwood production in the region. The sulphur directive entering into force at the beginning of 2015 will reduce the competitiveness of Finnish sawnwood in Central Europe, mainly relative to domestic production in the area, although the directive's impact is otherwise expected to be relatively minor. Indeed, next year the profitability development of the wood product industry is likely to deteriorate only slightly compared to this year.

In the pulp and paper industry, the profitability of pulp production has remained at a high level for several years, which has boosted the average profitability of the entire sector. In 2014, the profitability of pulp production has fallen slightly from last year, but this has been offset by the positive profitability development for cardboards and papers. The pulp and paper industry has been implementing efficiency programmes for several years. This has begun to show results within the sector, for example in the form of a decrease in fixed costs and as improved profitability, even in the long-troubled paper production sector. Plans for major investments in Finland are also indicative of the brighter outlook for the pulp and paper industry. The export outlook for pulp and cardboard is considered to be bright, and the sector's profitability will continue its favourable development in 2015.

The downward trend in the Finnish forest industry's value added ratio that began in the early 2000s has halted over the last couple of years and has even given way to a slight upward turn. This means that the sector's prospects for employment, investment

and generating a profit will slowly improve. While there are major differences between subsectors, the direction of overall development within the sector is encouraging.

Increasing employment in forestry

In 2013, the number of forest industry employees fell by 2 per cent compared to the previous year, to total 40,700. Within the sector, employment increased in the sawmilling and, in particular, the board industries and in the manufacture of paper and cardboard products, but decreased in the carpentry industry and in the manufacture of pulp, paper and cardboard. In 2014, the number of employees is expected to decrease again to 38,400, with layoffs targeted at the carpentry industry in particular. In 2015, the total number of forest industry employees is expected to remain roughly the same as in the current year.

In 2013, 24,300 people were employed in forestry. Based on the good employment situation during the first half of the year and the steady development of commercial fellings, it is estimated that 24,800 people are employed by the forestry this year. In 2015, no major changes are expected in commercial felling and wood chip harvesting, and the number of employees is likely to remain at around 25,000.

Steady period in the roundwood market

For 2014, it is estimated that the domestic commercial fellings will total around 55.4 million cubic metres. The commercial fellings of sawlogs will increase by three per cent, as sawnwood production increases. However, the commercial felling of pulpwood will decrease by four per cent due to the increased availability of sawmill chips and as paper production continues to decrease. In 2015, commercial fellings are forecast to increase to 56 million cubic metres, as wood product industry's production and the production of pulp and cardboard continue to grow, while the decline in paper production slows. In the current year, imports of roundwood will fall to 9.6 million cubic metres and further in 2015 to 9 million cubic metres.

Despite the increase in the commercial fellings of sawlogs, it is estimated that their stumpage prices in 2014 will remain at the previous year's level, since the roundwood supply has remained at a healthy level. In the current year, the stumpage price of pine pulpwood will remain at the previous year's level due to healthy demand for softwood pulp, but the stumpage price of birch pulpwood will fall by one per cent due to the fall in hardwood pulp prices. The stumpage price of spruce pulpwood will decrease by three per cent

Key forecasting variables 2014–2015.*

Forecast variables	2013	2014f	2015f
	% change from previous year		
Sawnwood production	11	2	1
Sawnwood exports	11	3	1
Sawnwood export price	3	4	2
Plywood production	7	5	3
Plywood exports	6	4	2
Plywood export price	0	1	1
Pulp production	4	2	1
Pulp exports	13	2	2
Pulp export price	1	1	1
Paper production	-4	-3	-2
Paper exports	-2	-3	-2
Paper export price	-2	-2	-1
Cardboard production	7	4	2
Cardboard exports	8	3	3
Cardboard export price	0	1	1
Commercial fellings	9	-1	1
Roundwood imports (including chips)	11	-11	-6
Stumpage prices of sawlogs			
Pine	3	0	2
Spruce	5	0	2
Birch	0	0	2
Stumpage prices of pulpwood			
Pine	2	0	2
Spruce	2	-3	1
Birch	2	-1	0

*prices changes are nominal

due to the reduction in paper production. In 2015, stumpage prices of sawlogs and pine pulpwood are anticipated to increase by two per cent, as production of sawnwood and softwood pulp increases. The stumpage prices of spruce and birch pulpwood will remain at the current year's level.

Halt in growing use of forest chips

Growth in the use of forest chips is expected to grind to a halt in 2014, and no growth is expected in 2015. The low global market price of coal, low price levels of emissions rights, and cutbacks in subsidies will slow investment decisions and retard growth in the use of forest energy. In the second quarter of 2014, the plant price of forest chips was EUR 21.35 per megawatt hour, which was nearly four per cent higher than the year before. In 2015, the average plant prices of wood chips are expected to rise to EUR 21.5 per megawatt hour. Domestic production of wood pellets will increase to around 270,000 tons in 2014 and to 330,000 tons in 2015, due to new domestic production investments. Most growth in production will be directed towards usage by heating and energy plants.

Changes in taxation, subsidies and regulations in the bioenergy market are having a rapid and powerful effect on the use of renewable forms of energy. The European Union is preparing several directives related to the use of solid and gaseous biomass sources in energy production. Uncertainty over emissions trading and the final contents of the directives are hampering the planning of investments in bioenergy.

Business result per hectare in forestry is 100 euros

In forestry, investments in wood production in private forests are expected to increase to EUR 235–245 million in 2014 and 2015. Although commercial fellings are increasing and nominal prices of roundwood will rise next year, the real gross stumpage income for private forestry will remain at around EUR 1.6 billion both this and next year. The business result per hectare in forestry remains at EUR 100 in 2014 and 2015.

Forecast basis and risks

The annual report, the Finnish Forest Sector's Economic Outlook, provides an analysis of the current year and forecasts for the coming one. These forecasts are based on public statistics, global economic 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 such forecasts, according to which fluctuations in GDP growth in domestic and export markets are assumed to have an impact on forest industry production and the domestic roundwood market via demand for forest industry products. Changes in the forest sector's operating environment and the effects of the government's economic policies have also been factored into the forecasts. If GDP growth turns out to be below the forecast level, this will mean lower export prices, production and profitability for the Finnish forest industry, than given in the forecasts presented here. The effects would also spread from the forest industry into the roundwood market, to employment in forestry and to the profitability of private forestry, as demand for wood declines. In such a case, the development of the Finnish forest sector would remain weaker than in the forecasts presented here.

Views on GDP growth in the world economy and export markets have been formulated on the basis of forecasts made by a number of organisations, such as the OECD, the IMF, the Research Institute of the Finnish Economy (ETLA), Nordea, and the Bank of Finland. The forecasts in this overview are based on information on the forest sector covering the period

from September–October 2014 and on forecasts of the global economy's performance in 2014–2015. The forest sector's forecasts correspond to the views of researchers on the development most likely to occur. These are point forecasts based on export market growth forecasts and other background assumptions about the development of the markets.

The most significant risk concerning the forecasts presented lies in the possibility of GDP growth in the global economy and the central market areas of the forest industry being lower than forecast. This will be heavily dependent on political decisions and the forthcoming stages of the Ukraine crisis in particular. Any escalation of the crisis and the extension of economic sanctions to energy products, for example, could have a sharp effect on the confidence of companies and consumers in the Eurozone. The already sluggish economic growth may then fall back into recession. Any spread of the unrest in Syria and Iraq to the entire Middle East might impact on the development of the global economy and demand for sawnwood. Should the price bubble threatening the Chinese housing market burst, in the worst-case scenario this may cause China's economic growth to stall, thereby impacting on demand for, say, cardboard and pulp.

Editors

Jari Viitanen
Antti Mutanen

Translation

Semantix

Technical editing

Sari Elomaa

Further information

Jari Viitanen
Finnish Forest Research Institute
PO Box 66
80101 Joensuu
Phone: +358 29 532 3033
e-mail: jari.viitanen@metla.fi

The executive summary is a translation of the summary of the Finnish original publication, and is based on information available in early October.

Available at

www.metla.fi/julkaisut/suhdannekatsaus/index-en.htm

ISBN 978-951-40-2493-1 (PDF)

ISSN 1798-3037

