



Summary

The slowdown in economic growth worldwide has weakened the export growth prospects of the Finnish forest industry. Real growth in the world economy weighted according to the distribution of Finnish forest industry exports will fall back this year to less than two per cent, in comparison to last year's figure of over three per cent. The sluggish demand on export markets also means a drop in production in the Finnish forest industry. The average export prices of sawnwood and pulp this year will fall. By contrast, the average price of paper will rise as result of the favourable price trend in the early part of the year and the paper industry's long-term supply agreements. Commercial fellings and stumpage prices will, however, remain below last year's levels.

Only a slight increase in GDP growth is forecast for the world economy next year. The changes expected in Finnish forest industry production and exports and in commercial fellings and stumpage prices will be less marked than this year. Although production and exports of sawnwood and paper will increase somewhat, they will remain considerably below the records set in 2000. Despite the small increase in demand for Finnish paper industry products in 2002, export prices are expected to fall on account of the expansion of supply in the industry. Considerable uncertainty surrounds the forecasting of economic trends in the United States and their impact on the world economy. If the downturn in the US is prolonged and deepens, the outlook for the Finnish forest sector in 2002 will be less favourable than anticipated.

Economic Operating Environment

The marked economic downturn in the United States at the end of 2000 has quickly spread to Europe and Asia. This year, slower GDP growth has been evident in the Finnish forest industry's key export markets, especially Germany. The impact of the slackening demand for forest industry products has been particularly strong in the markets for sawnwood, market pulp and fine paper.

Growth in the world economy in 2002 is forecast to be about the same or slightly above this year's level, provided that the US economy begins to recover in the second quarter of the year. In the euro area, fairly low unemployment, relatively high consumer confidence about personal finances, and low interest rates should all help to stimulate economic growth and the demand for forest industry products next year to a certain extent, even without the aid of the US economy. In Finland too, GDP growth has slowed down in the current year but is forecast to pick up again in 2002 as exports recover.

Exports, Production and Prices in the Finnish Forest Industry

The slowdown in the construction industry has reduced the demand for sawnwood on Finland's European export markets. This year, both the export and production of sawnwood are forecast to drop by five per cent. The average export price of sawnwood is expected to be six per cent below last year's

figure on account of the weak demand for sawnwood and the oversupply in Europe.

Growth in the European construction sector will continue to be sluggish in 2002, and so there is little prospect of a major increase in the demand for sawnwood. Production and exports of Finnish sawnwood are nevertheless projected to grow next year by two per cent and the average export price by about one per cent.

The subdued demand for paper on the export markets has hit the production of fine paper and pulp in Finland particularly hard. Finnish paper production will shrink by about seven per cent this year, largely due to the drop in demand for fine paper. Although the price of fine paper has fallen this year, the favourable trend in other paper grades in the early part of the year means that the average price of paper will rise this year. Pulp prices have been falling until late september, and the average price for the whole year will be almost 20 per cent below the high reached in 2000.

Production and exports of paper in 2002 are forecast to be up by two per cent, and paperboard by about one per cent. Capacity utilisation rates, however, will continue to be fairly low because of the meagre growth in demand and the introduction of additional pulp and paper capacity. Supply will increase by more than demand, leaving the average export price of paper products next year almost two per cent below the current year's level, in spite of the boost in high value-added products. Average export prices of paperboard are forecast to drop by about four per cent. A revival in the pulp markets is expected next year, but this will not be sufficient to lift the export price of pulp above its 2001 level.

Costs and Profitability in the Finnish Forest Industry

The trends in forest industry costs this year will not be uniform. Labour costs and electricity prices will rise whereas the mill price of timber will fall and prices of chemicals and non-metallic minerals will

remain unchanged. The contraction in demand for end products will mean a sharp drop in the Finnish forest industry's capacity utilisation rates this year. In the pulp industry the rate will sink to 83 per cent, and in the paper and paperboard industry to 88 per cent. Utilisation rates have not been this low since 1996. Due to the lower export prices and the low capacity utilisation rates, profits in the Finnish forest industry in 2001 will be down by around one third on last year's record figures. The hardest hit areas will be sawnwood and fine paper production. Magazine paper and newsprint production will fair better, largely due to the price increases introduced earlier in the year.

Only a slim improvement can be anticipated in forest industry markets in 2002, and so capacity utilisation rates will remain below 90 per cent. The domestic forest industry's profits next year should nevertheless not be far short of this year's figures, provided that there is only a moderate rise in raw material and labour costs.

Roundwood Markets

The downturn in forest industry production is also reflected in commercial fellings, which will decline this year to a total of 52.5 million cubic metres, about six per cent down on last year. The sawlog harvest, in particular, will decrease as sawnwood demand falls on export markets. With the exception of birch sawlogs, stumpage prices are also expected to fall: softwood sawlog prices by 2–4 per cent and pulpwood prices by 4–7 per cent on last year's average. Roundwood imports are forecast to rise this year to a new record of 15 million cubic metres.

In 2002, commercial fellings will increase by one per cent and roundwood imports by two per cent as forest industry production picks up slightly. Domestic roundwood demand will increase very little and no significant change is anticipated in supply. Consequently, nominal stumpage prices will remain more or less unchanged from 2001.

Investment and Profitability in Non-Industrial Private Forestry

Investment in timber production in non-industrial private forestry will rise to a new record this year, to almost FIM 1.1 billion (EUR 1 = FIM 5.94573). The increase on last year is because more forest owners have applied for state subsidies and are thus also committed to investing more of their own resources in timber production this year.

The funding conditions for the National Forest Programme subsidies have been amended in order to stimulate the take up of the subsidies. The funding basis has also been widened with broader eligibility criteria. However, the decrease in stumpage prices and harvest volumes will affect the finances of forest owners and hence their scope for investing money in timber production. This year, stumpage earnings will fall to FIM 8.9 billion from last year's FIM 9.8 billion.

Although the economic setback is also clearly evident in private forest owners' earnings per hectare, their earnings this year are nevertheless expected to be more than 10 per cent above the average for the 1990s. Expenditure on forestry, however, will reflect the higher costs of regeneration on nutrient-rich land as a result of the high volume of final cutting in spruce stands in earlier years in Southern Finland. The changes in state funding conditions are also expected to increase the use of these subsidies and thus the expenditure by forest owners themselves, which will show up as an increase in total costs.

Labour Force

The drop in forest industry production means a reduction in employment this year to 69 000 man-years. Employment in the wood products industry will fall by about three per cent and in the pulp and paper industry by five per cent.

In 2002, labour productivity growth and, to an extent, the outsourcing of certain functions will further reduce the number of jobs in the Finnish forest

industry to 67 000, despite the minor increase in production. The unemployment rate for the sector as a whole will be about five per cent both this year and in 2002.

Employment in forestry both this year and next year is forecast to remain at the 2000 level, at about 28 000 man-years, despite the drop in commercial harvesting. Balancing this, there are more jobs in silviculture, environmental management and other, largely non-mechanised forestry work. The unemployment rate in forestry this year and in 2002 will fall to less than 10 per cent, about the same level as in the Finnish economy at large.

Basis of Forecasts and Risk Scenario

The forecasts set out in this *Economic Outlook* are based on forecasts of the world economy by the International Monetary Fund (IMF), the Research Institute of the Finnish Economy (ETLA), Merrill Lynch and others, and on publicly available statistics, market information from various sources and research conducted at the Finnish Forest Research Institute (METLA). The world economy forecasts and the forest industry product market statistics used here were the latest available at the time of writing, in early October 2001.

The forest sector forecasts are based on the assumption that the recovery in the US economy will begin in the second quarter of 2002. If this does not occur, the growth in the US economy for next year as a whole could even be negative. The effect on forest industry product markets would then be felt in the form of dwindling demand and intensified competition. The weakening export markets would have an adverse impact on forest industry profits, employment rates and roundwood markets, and on the profitability of forestry activities. The performance of the Finnish forest sector would then fall short of the forecasts made here. The effects of this risk scenario on the Finnish forest sector are discussed in more detail in the first chapter.