

Finnish Forest Sector Economic Outlook 2002–2003

Assistant editor

Maarit Kallio

Editor of featured topics

Yrjö Sevola

Technical editing

Tommi Salonen (layout)

Veli Suihkonen (graphs)

MESU database

Jarmo Mikkola

Translation

Peter Ovell

Editor-in-Chief

Riitta Hänninen

Subscriptions

[http://www.metla.fi/julkaisut/
suhdannekatsaus/index-en.htm](http://www.metla.fi/julkaisut/suhdannekatsaus/index-en.htm)

The Economic Outlook is published (in PDF format) annually in December.

ISBN 951-40-1867-2

The forecasts presented are based on statistical information available in early October.

December 2002

Finnish Forest Research Institute
Vantaa Research Centre

Contents

Summary <i>Riitta Hänninen</i>	5
---	---

1 World and Finnish Economic Outlook

1.1 World Economy <i>Tapio Pohjola</i>	9
1.2 Finnish Economy <i>Tapio Pohjola</i>	13

2 The Finnish Forest Industry

2.1 Exports and Production in the Sawmilling and Plywood Industries <i>Anne Toppinen and Riitta Hänninen</i>	16
2.2 Exports and Production in the Pulp and Paper Industry <i>Maarit Kallio</i>	22
2.3 Costs and Profitability in the Finnish Forest Industry <i>Johanna Pohjola</i>	28
<i>Featured Topic: Cost Structure of the Forest Industry</i> <i>Johanna Pohjola</i>	32

3 Forestry in Finland

3.1 Utilisation of Wood Resources <i>Yrjö Sevola</i>	36
3.2 Roundwood Markets <i>Jussi Leppänen</i>	38
<i>Featured Topic: Stumpage Price Index and Forest Product Export Price Index</i> <i>Pekka Ollonqvist</i>	43
3.3 Investment and Profitability in Non-Industrial Private Forestry <i>Jukka Aarnio and Esa Uotila</i>	44

Featured Topics

The European Union's Eastward Enlargement and the Forest Industry <i>Raija-Riitta Enroth and Ritva Toivonen</i>	49
Restructuring Forest Ownership in the Forest Industry <i>Jussi Leppänen and Pekka Ollonqvist</i>	52
New Tools for Improving the Profitability of Roundwood Production <i>Kari Hyytiäinen and Olli Tahvonen</i>	55

Contributors

Jukka Aarnio, M.Sc.(For.), M.Soc.Sc., researcher

Pertti Elovirta, M.Soc.Sc., researcher

Raija-Riitta Enroth, M.Soc.Sc., Lic.Sc.(For.), researcher

Kari Hyytiäinen, M.Sc. (For.), researcher

Riitta Hänninen, D.Sc.(For.), researcher

Maarit Kallio, D.Sc. (Econ.), researcher

Jussi Leppänen, M.Sc.(For.), researcher

Pekka Ollonqvist, D.Sc.(Econ. & Bus.Adm.), professor

Johanna Pohjola, Lic.Soc.Sc., researcher

Tapio Pohjola, Lic.Sc. (Econ.)

Yrjö Sevola, Lic.Sc.(For.), research specialist

Olli Tahvonen, D.Sc.(Econ.), professor

Ritva Toivonen, Lic.Sc.(For.), Pellervo Economic Research Institute

Anne Toppinen, D.Sc.(For.), researcher

Esa Uotila, M.Sc.(For.), researcher



Summary

The 2002 figure for GDP growth in the world economy weighted according to the distribution of Finnish forest industry exports will be about 1.5 per cent, little changed since 2001. The sluggish growth in export markets has slowed growth in the Finnish forest industry this year to such an extent that the only sector to show robust growth has been pulp production, where new capacity has been brought on stream and exports are doing well. Slack demand and abundant supply in the export markets have affected prices, and indeed the nominal export prices of both paper and pulp will be down this year compared with 2001; by contrast, the nominal export price of Finnish sawnwood will be higher than in 2001. The growth in pulp production has increased roundwood consumption and thus commercial fellings of pulpwood. The domestic sawlog harvest is also up this year, although the higher demand for sawlogs is mainly being met by increased imports.

Growth in the world economy will pick up slightly in 2003. This will boost production and exports in the Finnish forest industry, although, with the exception of plywood, pulp and paperboard, the figures will remain below the record levels of 2000. As the demand for paper picks up, export prices will gradually rise. However, the average nominal price of paper exports for the year as a whole will change little, due to the low starting point. Increases in the export price of sawnwood will be restrained by slow growth in the European construction sector. Increased production in the Finnish forest industry will raise roundwood demand, and stumpage prices will reach the level of 2000. The rise in pulpwood demand will be met largely from higher imports of pulpwood and chips. The sawlog harvest will increase as more domestic roundwood is offered for

sale, and sawlog imports will correspondingly fall.

The greatest forecasting uncertainty concerns the level of GDP growth in the United States and its effect on the world economy. The prospects for recovery in the Japanese economy also remain uncertain. Other significant risks to growth in the euro area include the faltering German economy and slow growth in the euro area's other main economies, France and Italy. If growth in export markets falls short of expectations, this will also mean that growth in the Finnish forest sector will be lower than anticipated.

Economic Operating Environment

The continuing impact of the sharp downturn in the world economy that started in the United States in the last quarter of 2000 will ensure that world GDP growth is still low in 2002. Although the bottom of the cycle has already been passed, economic recovery in export markets has been very slow. In the euro area export markets important to the Finnish forest industry – not least Germany – both the economy in general and the construction sector in particular have been weak. Growth in the construction sector is of prime importance to Finnish wood product exports.

In 2003 GDP growth in the euro area is expected to gather pace as the world economy picks up. In Finland growth will be export-led in response to the more vigorous demand in export markets. Considerable uncertainties will nevertheless overshadow the improved export prospects, in the forest industry as elsewhere. If growth in the United States starts to fade, due to a drop in consumer confidence for

example, the recovery of the entire world economy would be in jeopardy. Moreover, there is still considerable uncertainty over the future of the Japanese economy, and the possibility of a prolonged period of high oil prices following any intervention in Iraq. An additional concern in the euro area is that growth in the largest economies – Germany, France and Italy – may lag behind the other euro countries. A poorly performing German economy is a particular threat to growth in the Finnish forest industry, both directly through the effect on Finnish exports and indirectly through the effect on the European economy.

Exports, Production and Prices in the Finnish Forest Industry

European demand for wood products in 2002 will be only a little higher than last year, due to the sluggish growth in the construction sector. Production and exports of Finnish sawn softwood will be up by about one per cent, and the proportion of exports destined for non-European markets will be higher than last year. The nominal unit price of sawnwood exports in 2002 will be up by about two per cent, having been rising steadily throughout the year.

Growth in Europe's construction sector and in the related demand for wood products will continue to pick up slowly in 2003. Construction growth in Finland will boost sawnwood consumption, and together with export growth this will raise sawnwood production by two per cent. Prices are also expected to improve, though the increase will only be marginal because of the abundant supply. The export price of Finnish sawnwood is forecast to rise by about two per cent.

In paper product markets, those grades reliant on advertising and publishing have suffered particularly badly from the slow growth in the economy in 2002. Production and exports of Finnish paper and paperboard will be up by about two per cent overall on the 2001 figure, although the average nominal export price will be down by about seven per cent. Spurred on by exports in particular, pulp production

will be approximately 9 per cent above the 2001 level, whereas the average export price will drop to about 14 per cent below last year's average.

Growth in the demand for paper is expected to start picking up in 2003, raising Finnish paper exports by about five per cent. With the rise in demand, paper prices are expected to begin creeping upwards. However, the average export price will remain little changed from this year, due to the low starting point. 2003 will also see a rise in production and exports of paperboard and an increase in the paperboard export price. Pulp exports are forecast to remain more or less unchanged, whereas the increase in domestic consumption will raise pulp production by about two per cent. Market prices for pulp are expected to rise gradually as demand grows.

Costs and Profitability in the Finnish Forest Industry

Production costs in the Finnish forest industry in 2002 will be higher than last year because of the increased labour costs and higher stumpage prices; the costs of other inputs will either be almost unchanged or will be lower. The rise in labour costs will nevertheless be lower than in 2001, and the increase in stumpage prices will be relatively small. The forest industry's capacity utilisation rate will be only slightly higher than last year, due to the slow growth in demand for end products. In the paper and paperboard industry, for example, the capacity utilisation rate will rise this year by one percentage point, to 89 per cent. Higher costs and the drop in export prices in the paper industry mean that the forest industry's profitability and results for 2002 will be down on last year's figures. The profitability of magazine papers and sawnwood will be lower than for other product groups.

Stumpage prices and labour costs will continue to rise in 2003. The recovery in demand and possible higher oil prices will also add to the pressure to raise the prices of pigments and chemicals used in the pulp and paper industry. Despite the rise in costs,

the Finnish forest industry's profitability is expected to improve as production increases and export prices rise. In the paper and paperboard industry the capacity utilisation rate will remain comparatively low, rising to 92 per cent.

Roundwood Markets

Production in the Finnish forest industry has been picking up in 2002, raising the demand for roundwood. Commercial fellings will be up by two per cent, to 54.2 million cubic metres, and imports of roundwood will be up slightly, reaching approximately 15.5 million cubic metres. Sawlogs will account for a higher proportion of imports than previously. The growing roundwood consumption in pulp production will increase commercial fellings of pulpwood this year, and imports will be down on 2001. The higher demand for sawlogs, on the other hand, will be mainly covered by imports. Stumpage prices will be an average of 1–3 per cent above last year's level, due to the increased demand for roundwood.

In 2003 the forest industry's growing roundwood needs will increase both commercial fellings and roundwood imports by two per cent. Commercial fellings will rise to 55.1 million cubic metres, and imports to 15.8 million cubic metres. More domestic sawlogs will be offered for sale in 2003, raising the sawlog harvest by three per cent and consequently reducing the proportion of sawlogs in roundwood imports. Imports of pulpwood and chips will be up next year because little increase is anticipated in the supply of domestic pulpwood. The growing demand for roundwood will push up average stumpage prices by 2–4 per cent, depending on the roundwood category.

Investment and Profitability in Non-Industrial Private Forestry

Total investment in timber production in Finnish non-industrial private forests in 2002 will rise to

over EUR 190 million. Private forest owners have been investing more of their own resources, which this year will account for over 70 per cent of the total investment in non-industrial private forestry. The improvement in state funding criteria has been the principal reason for this. Together with the expansion of the funding basis, this prompted an increase in the take up of state funds in 2001 to such an extent that the subsidies for tending of young stands were insufficient to meet the demand. It is likely that demand for the subsidies will again exceed the funds available, despite the increase in funding. Due to the higher level of investment in timber production and last year's reduction in stumpage earnings, the investment rate (total investment as a percentage of gross stumpage earnings) in non-industrial private forestry has risen to over 12 per cent this year. In 2003 the total investment in roundwood production in non-industrial private forests will increase by almost two per cent, and the proportion invested by the private forest owners themselves will remain more or less at this year's level.

The increase in commercial fellings and the moderate rise in stumpage prices will raise the 2002 gross stumpage earnings in non-industrial private forestry to over EUR 1.5 billion, bringing earnings per hectare to EUR 113. Following the substantial amount of final cutting and the campaign to improve young stands at the beginning of the decade, the total costs of forest regeneration are still high this year. Nevertheless, the rise in total costs may be as little as 1–2 per cent, leaving net earnings at EUR 97 per hectare, up on last year's figure. In 2003 stumpage earnings in non-industrial private forestry will rise to about EUR 1.6 billion, due to the increase in fellings and stumpage prices. Provided that costs do not increase by more than they did this year, net earnings per hectare will rise to EUR 104. Although gross stumpage earnings for 2002 and 2003 will be considerably less than in the peak years, in real terms they will be about 20 per cent higher than the average for the 1990s.

Labour Force

Production in the Finnish forest industry has increased relatively slowly in 2002, and the same is forecast for 2003. As a result, employment in 2002 is unchanged from last year, at 70 000 jobs, and no change is anticipated in 2003. Exceptions to this are the joinery and wood pulp industries: jobs have been lost this year in the joinery industry but gained in the wood pulp industry (due to higher production). The major export-oriented forest industry companies did not reduce their labour force in 2001 in response to the decline in demand, probably because the downturn was expected to be short-lived and there was concern about having a sufficient supply of labour in the longer term. The unemployment rate in the sector as a whole has fallen to about four per cent, which is considered in practical terms to be full employment.

In forestry, the reduction in sawlog harvesting work meant a drop in employment. Employment has continued to fall in 2002, declining to 26 000 people. The improved economy in 2003 is expected to lead to a slight increase in roundwood harvesting, bringing a halt to the loss of jobs. Employment in forestry next year will thus remain at the 2002 level. This stabilisation affects wage-earners in particular, whose work input has declined considerably in recent years while the input of entrepreneurs has risen. The unemployment rate in forestry has fallen to a level representing the average for all sectors in the Finnish economy: about nine per cent.

Basis of Forecasts and Risk Scenario

The forecasts set out for the forest sector in this *Economic Outlook* are based on a wide range of information: publicly available statistics and forecasts about the world economy; market information and other data on the forest sector from various sources; and research conducted by the Finnish Forest Research Institute (METLA). The view of GDP growth in the world economy and export markets is formulated

on the basis of forecasts made by a number of different organisations, among them the International Monetary Fund (IMF), the Research Institute of the Finnish Economy (ETLA), Merrill Lynch and Dresdner Bank. The forecasts given in this publication are for the years 2002 and 2003 and are based mainly on information available in late September and early October 2002.

The forest sector forecasts presented here are point forecasts. They represent the views of researchers about the most likely course of events, given the export market growth forecasts and other background assumptions about the markets. The greatest uncertainty in the forecasts is whether or not the growth will be lower than expected. Of particular concern is the growth in the US economy, which is forecast to pick up in 2003. Any delay in this would retard GDP growth in the world economy and cut the demand for forest industry products. A sharp rise in oil prices as a result of the Iraq situation would threaten growth further if the rise were to be prolonged. In Europe an additional concern is the uncertainty over growth prospects for the German economy, which has implications for growth in the Finnish forest industry: Finnish exports are directly affected by the state of the German economy, and indirectly affected via Germany's influence on the entire European economy. If economic growth in Europe fails to match the forecasts, the demand for forest industry products will be lower than anticipated and price competition will intensify. Competition on Europe's export markets would also become tougher if the US dollar weakens significantly against the euro. This would hamper exports from Europe and would increase the supply from outside Europe. If the growth in export markets is below the forecasts given here, this will affect the export prices, production and profitability of the Finnish forest industry. With falling demand for wood, the adverse impact would spread from the forest industry to roundwood markets, forestry employment and the profitability of non-industrial private forestry. Growth in the Finnish forest sector would then fall short of the forecasts presented here.