2.1 Exports and Production in the Sawmilling and Plywood Industries

 Slack demand on Europe’s sawn softwood markets at a time of production growth has led to oversupply during 2003. The trend in exports of Finnish sawnwood to European markets differs greatly from one country to the next. For example, exports to Germany have continued to decline, while those to the United Kingdom have increased. Exports to markets outside Europe have been hampered by the strengthening of the euro. The continued weak state of Europe’s construction sector means that Finnish sawnwood exports for the year will be more or less unchanged from 2002. Despite the fall in export prices in the first part of the year, the average export price for 2003 as a whole will be slightly above the previous year’s level. Exports of plywood in 2003 will be up by about eight per cent, due to the additional production capacity, although the average unit price will be down by about three per cent.

 Construction Recovery in Europe Still Awaited

 In contrast to the autumn 2002 forecasts of an imminent recovery in the world economy, the reverse has in fact happened in Germany, for instance. With 2003 growth in the euro area little changed from the previous year, at less than one per cent, demand growth for sawnwood is very low. Euroconstruct’s June 2003 forecast indicates a growth in construction output of only 0.2 per cent, concentrating mainly on renovations of existing buildings. The forecast also indicates that the awaited revival in the EU construction sector will not occur until 2005.

 In Germany, construction output for the whole of 2003 is expected to be down again, by 1.6 per cent. This will clearly affect the demand for sawn softwood, as the German market accounts for one fifth of Europe’s construction output. The United Kingdom, by contrast, is one of the few countries in which construction is still on the increase: new housing construction in 2003 will be up by seven per cent, and renovations by three per cent. The minor level of growth achieved in Europe’s construction sector has been attributable not only to the UK but...
also the positive trend in several of the forthcoming EU member countries, namely the Czech Republic, Hungary, Poland and Slovakia. Indeed, FAO figures show that the growth of about two million cubic metres in Europe’s sawn softwood consumption in 2002 was particularly centred on the countries of Eastern Europe.

**European Markets Troubled by Oversupply**

The weakness in demand on Europe’s sawn softwood markets in relation to the growing production has led to a situation of oversupply. Consumption of sawn softwood within the EU grew by only 1.4 per cent in 2002, whereas production was up by 2.3 per cent. In Germany, production of sawn softwood was up by almost seven per cent, and this growth has continued into 2003. Sawn softwood production in the other big producer countries – Sweden and Finland – has continued at a high level, and output in the Baltic countries, Russia and other Eastern European countries has also been rising. An exception has been the United Kingdom, where demand and supply have been fairly balanced, thanks to the growth in construction.

The strengthening of the euro against the US dollar has affected trade in sawnwood and increased supply on European markets in the early part of 2003. European exports of sawnwood to North America have fallen, while Canadian exports to Europe have correspondingly increased. From a high in May 2003 (1.19), the euro weakened during the summer, before strengthening again in late September (1.16). Provided that the value of the euro does not appreciate significantly, supply from North America is not expected to increase in the remainder of 2003.

Russia’s sawnwood exports have grown since 1998, aided by the devaluation of the ruble, and have already reached the level of the Soviet era. Exports in 2002 amounted to 8.6 million cubic metres. Russia’s biggest export markets are China, the United States and Egypt. In 2003, exports have increased to China, in particular, but also to the European Union countries. The biggest proportionate increase has been in exports to Japan.

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**The Finnish sawmilling and plywood industries, 2002 (1 000 m³)**

<table>
<thead>
<tr>
<th></th>
<th>Sawnwood</th>
<th>% of production</th>
<th>Plywood</th>
<th>% of production</th>
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<tr>
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<td>1 240</td>
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<tr>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
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<tr>
<td><strong>Total</strong></td>
<td>199</td>
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<td>24</td>
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</tbody>
</table>

The plywood figures comprise birch plywood, softwood plywood and laminated veneer lumber (LVL).

* Estimated domestic use = production – exports

Sources: Statistics 2002 (Finnish Forest Industries Federation) and Finnish Forest Research Institute
Finnish Sawnwood Exports Unchanged from 2002, and Prices Affected by Oversupply

Despite the weak trend in the European construction sector, exports of Finnish sawnwood in the first part of the year continued at the high level of recent years. The one per cent decrease in exports of the more expensive pine sawnwood in January–July was counterbalanced by a four per cent increase in exports of the lower priced spruce sawnwood, in relation to the 2002 figures. This increase was due to higher demand in Japan and Europe. In Europe, the trend in Finnish sawnwood exports differs considerably from one country to the next. For instance, exports to Germany have continued to decline, whereas those to the United Kingdom have grown by about 10 per cent. Although the UK has traditionally purchased pine, the export growth in the early months of 2003 focused on spruce sawnwood. The competitiveness of exports to destinations outside Europe has declined due to the strengthening of the euro against the US dollar, which began in 2002. As a consequence, Finnish sawnwood exports to Africa and North America have fallen. Exports to Japan, on the other hand, have grown by 23 per cent, despite the strengthening of the euro against the yen. This was attributable to the high quality of Finnish sawnwood, established customer relationships and the improvement in the Japanese economy. In the latter part of 2003, Finnish forest industry exports are again overshadowed by the uncertain outlook for the world economy, the stronger euro and the weak construction sector in Europe. These factors will conspire to ensure that Finnish sawnwood exports in 2003 are unchanged from the previous year’s level.

The oversupply situation in Europe and the stronger euro are reflected in the export prices of Finnish sawnwood. Although the average export price in euros for January–July 2003 was about three per cent higher than for the same period a year earlier, the month-by-month export price trend has been a declining one. This declining trend applies to both pine and spruce, despite the fact that the average January–July 2003 prices were still higher than the price levels for the same period in 2002, by four per cent in the case of pine sawnwood, and five per cent in the case of spruce sawnwood. The average price is not expected to rise in the remainder of 2003, because supply is running high and no significant demand growth is foreseen in Europe. Pressures to reduce prices are most evident for spruce sawnwood due to the tougher competition as a result of increased supply. If sawnwood export prices remain at about the level of the second quarter for the rest of 2003, the average price of Finnish exports for the year will be about two per cent above the previous year’s figure.

Domestic Markets Continue to Grow in Importance

Estimated sawnwood consumption in Finland grew to a little over five million cubic metres in 2002. This was a higher level of growth than that in construction output, indicating that the use of sawnwood as a building material has increased. At the same time, the importance of the domestic market to the Finnish sawmilling industry has grown: in 2002, almost 40 per cent of sawnwood production went to the domestic market.
Low interest rates are still helping to support the level of housing construction in Finland, and forecasts by the Research Institute of the Finnish Economy indicate that investment in housing construction will be up again in 2003. The construction confidence indicator of the Confederation of Finnish Industry and Employers also moved upwards in September, and the economic state of the construction sector was declared to be stable. In addition, the Confederation of Finnish Construction Industries forecasts that renovations will be up by about three per cent in 2003. Domestic sawnwood consumption will therefore also be up, by an estimated two per cent, and sawnwood production by almost one per cent; no increase in exports is expected.

**Tough Competition on Sawnwood Export Markets to Continue in 2004**

Oversupply on European sawnwood markets will continue in 2004. Euroconstruct forecasts a growth of 0.5 per cent in construction output for the EU in 2004. Renovations will increase, but new housing construction will contract by almost two per cent. Without a considerable economic recovery, the growth in sawnwood consumption in Europe will again be very modest in 2004, and competition will intensify on the sawnwood markets as supply increases from Eastern Europe and Russia.

The accession of new Member States to the European Union in May 2004 can be expected to increase the supply of sawnwood in the EU to a certain extent during the year. As Russia expands its production capacity, in part due to foreign investments, its sawnwood export potential to European and Japanese markets will further rise, which will bring tougher competition to Finland’s export markets. Production in the Baltic countries will also increase when a new Latvian sawmill comes on stream in 2004, following the additional capacity already introduced in Estonia earlier in 2003.

A positive factor for the demand-supply balance in the European market is the improvement in the Japanese economy. Sawnwood demand has picked up in Japan following a six per cent increase in building permits for timber-framed houses in the first half of 2003, the increase being particularly noticeable in June (Japan Lumber Journal). If the forecast high level of wooden housing construction starts for 2004 materialises, the extent of sawnwood demand will allow continued European exports to the Japanese market.

In the United States, low interest rates have stimulated construction quite considerably in view of the economic situation, such that new housing starts in January–July were up four per cent on the corresponding period the previous year. In addition, North American sawnwood prices are forecast to rise in 2004 (Bank of Montreal, August 2003), which will not tempt Canadian producers to increase their supplies to European markets. Canadian exports to Europe have been running at only about 0.5 million cubic metres per year, which means that it would take a substantial percentage rise before Canadian exports would affect the balance in the European market. European sawnwood exports to North America will continue, provided that the euro does not gain too much in value. The demand for European exports will be aided by the continued customs duty dispute between the US and Canada, and by the roundwood availability problems following the forest fires in British Columbia and the wet weather in southern states of the US.

The outcome of Sweden’s September referendum on membership of the European Economic and Monetary Union (EMU), namely to reject membership, will continue to allow Sweden a competitive edge over Finland and the other euro countries if there is a weakening of the Swedish krona. Such a weakening is not, however, anticipated in 2004; on the contrary, forecasts indicate a slight strengthening against the euro.

Although the increase in sawnwood supply from Eastern Europe will heighten competition on Finland’s export markets, the improvement in the Japanese economy and the construction growth in North America will do something to alleviate the oversupply situation. Nevertheless, oversupply will continue
in Europe during 2004, adding to the pressure on sawnwood prices. With only very modest growth expected in Europe’s sawnwood consumption, the nominal average export price for Finnish sawnwood in 2004 will rise by no more than one per cent on the 2003 level. Export volumes are also forecast to grow by almost one per cent. In the longer run, Finland’s export opportunities could be increased significantly if European sawnwood consumption per head could be raised above its present level. Annual per capita consumption of sawnwood within the EU is only 0.2 cubic metres, compared with 0.4 cubic metres in Canada, 0.3 cubic metres in the United States and almost one cubic metre per capita in Finland.

**Domestic Demand Will Boost Sawnwood Production Again in 2004**

Housing construction investment in Finland is set to grow by about two per cent in 2004, according to the Research Institute of the Finnish Economy. Figures from the Confederation of Finnish Construction Industries indicate that this growth will include an increase in the number of new construction starts on detached houses, which are the biggest users of sawnwood. The growth in construction is expected to boost domestic sawnwood consumption in 2004 by about two per cent, which will mean an increase in sawnwood production to an estimated 13.45 million cubic metres; export growth will be less than one per cent.

**Strong Growth in Finnish Plywood Exports**

Plywood consumption in Western Europe fell by one per cent in 2002, due to the weak state of the economy and the construction sector. By contrast, plywood production was up by two per cent, exacerbating oversupply and increasing competition within the EU. Competition was due especially to the major increase in production capacity for oriented strand board, used as a substitute for softwood plywood.

Following recent additions to its plywood production capacity, especially softwood plywood, Finland now produces about one third of the EU’s plywood. In 2002, softwood plywood accounted for 58 per cent of Finnish plywood production. Russian plywood production also increased significantly in 2002, by 14 per cent, although the impact on the European market has been lessened by the 17 per cent increase in Russia’s own plywood consumption. The oversupply on export markets pushed down export prices in Finland as elsewhere, despite the growth in export volumes. Finnish plywood exports to Europe increased by 11 per cent in 2002, and to Asian and North American markets by an even greater percentage.

The increase in the capacity utilisation rate for Finnish plywood production has helped plywood export growth to be maintained at around 10 per cent during the first half of 2003. The growth in exports of softwood plywood has been greater than for birch plywood. However, the average export price for Finnish plywood fell by four per cent in the January–July period. The export price of birch plywood fell even more sharply, because the supply growth in Russia and other Eastern European countries has reduced prices in Europe.

The growth in Finnish plywood exports in the second half of 2003 is expected to slow down some-
what, due to the weak price trend, bringing growth for the full year to an estimated eight per cent. The export unit price in the second half of 2003 is expected to remain at around the level of the first six months. The average export price for 2003 will thus be some three per cent below the previous year’s figure.

Given the 2004 forecasts for construction and economic growth, the demand for plywood in Europe is not likely to grow significantly, and so prices will again be under pressure due to the oversupply. It is also expected that the supply of birch plywood from Russia and the other Eastern European countries will increase further. In contrast to the European markets, demand for plywood in the United States has been growing faster than output, which has pushed prices up since summer 2003.

The export opportunities for Finnish plywood in 2004 are expected to be slightly better than for sawnwood, because the export demand for plywood is less reliant on construction growth. Other important end-users of plywood include the transportation and packaging industries. Most European countries can only cover a proportion of their plywood consumption through domestic production. Their need to import plywood is thus an essential factor in the success of Finnish plywood in Europe. European plywood consumption per capita is only one quarter of the North American level, which leaves considerable scope for increasing plywood use in Europe. In 2004, exports of Finnish plywood are forecast to increase by a further three per cent. However, the unit value of plywood exports will continue to fall, by about one per cent. If the forecast export growth materialises, plywood production should grow by three per cent in 2004, resulting yet again in a new Finnish production record.

### 2.2 Exports and Production in the Pulp and Paper Industry

The market for paper products in Europe has remained weak during 2003. Paper consumption has grown only marginally, and prices have fallen due to the price competition brought about by producer overcapacity and the weakening of the US dollar. Production and exports of Finnish paper and paperboard in 2003 will be 2–3 per cent up on the previous year’s figures, but the average export price will be down by about eight per cent. Pulp production will be up by about four per cent, due to the increase in exports and domestic demand. Although the dollar price of pulp has been rising, the average export

Forecasts of production and exports in the sawmilling and plywood industries (1000 m³); percentage changes from previous year are shown below the respective volumes

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<tr>
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<td>13 280</td>
<td>13 350</td>
<td>13 450</td>
<td>8 187</td>
<td>8 200</td>
<td>8 250</td>
</tr>
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<tr>
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Forecasts of export prices for sawnwood and plywood (as percentage changes from previous year*)

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<td>Plywood</td>
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<td>–3</td>
<td>–1</td>
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</table>

* Export prices are nominal unit values
price in euros for 2003 will be down by an estimated three per cent on the 2002 level, due to movements in exchange rates.

As economic growth picks up, the demand for paper in 2004 is expected to improve in Western Europe, increasing Finnish paper exports by about three per cent. Growth in production capacity in Europe will be quite low, and so capacity utilisation will improve slightly. With an improved demand-supply balance, paper prices are expected to start rising, bringing Finland’s average export price for paper in 2004 up to the 2003 level. Production, exports and export prices of paperboard are also likely to rise somewhat during 2004. Pulp production capacity and pulp exports will increase further during the year. Pulp production is expected to rise by about three per cent and export volumes by five per cent. The growth in demand is expected to push up pulp export prices by about five per cent.

Tough Competition Has Reduced Export Price of Paper

The principal export markets of the Finnish pulp and paper industry are in Western Europe, where economic growth has continued to be very weak during 2003. The demand for printing papers is heavily reliant on advertising volumes, but forecasts indicate that in Europe these volumes may even be down in 2003 in real terms. Consequently, the anticipated growth in consumption of paper grades that are dependent on advertising may turn out to be rather weak. The oversupply situation caused by excess production capacity for coated printing papers that has troubled the European market for the past couple of years has not, in fact, been alleviated to any significant extent, and so the drop in prices has continued. Added to this, the fall in the value of the US dollar has sharpened competition on the world market, which has also reduced consumer prices of paper industry products.

Intensified competition in the first half of 2003 had the effect of reducing export prices and the value of exports of Finnish paper and paperboard. The fall in prices was also due in part to the strengthening of the euro against the US dollar. This has affected pulp prices directly, while paper prices have been affected indirectly through the tougher competition. Finland’s export volumes, on the other hand, have risen slightly as demand has crept up. Paper exports were up in January–July by about three per cent, and pulp exports by over six per cent, on the same period in 2002. Production increased accordingly, and the increase was particularly sharp for magazine papers. Pulp production rose in the first half of 2003 by over three per cent.

Paper production has also been increasing elsewhere in Europe. In Sweden, for example, paper and paperboard production rose by three per cent in the second quarter of 2003 in comparison with the same period the previous year. The highest proportionate growth was in magazine papers and packaging board. In Germany, production of printing and writing papers was up by over six per cent in the first six months of 2003, which was slightly above the overall growth in the country’s paper and paperboard production. Europe’s forest industry also succeeded in increasing its exports to markets outside Europe, despite the adverse effects of exchange rate movements on the competitiveness and profitability of exports.

With the exception of the early autumn price increases for pulp, there are not yet any foreseeable signs of an upturn in the forest industry’s economic indicators in Europe. The situation for Finnish paper production and exports is therefore likely to be unchanged in the remainder of 2003. Paper exports and production volumes for the full year are expected to be about three per cent higher than in 2002, while production and exports of paperboard are expected to be at the 2002 level.

The average export price of Finnish paper in 2003 is expected to be down by about 10 per cent on the previous year’s figure. Paperboard prices have been more stable, and the average paperboard export price will be down by only about two per cent on the 2002 level.
Dollar Price of Pulp Risen, but Euro Price Fallen

Despite slow growth in the paper market, the price of bleached softwood sulphate pulp began to rise in early 2003, when there was a shortage of pulp on the world market on account of the roundwood supply problems of North American mills. After this situation returned to normal, demand was restrained by factors such as the Asian SARS epidemic, and pulp prices again began to rise. In January–September 2003, the PIX price of softwood pulp in US dollars (its pricing currency) was an average of 11 per cent higher than the same period a year earlier. However, with the weakening of the dollar, the equivalent price in euros was about eight per cent lower than the same period in 2002. The movement in hardwood pulp prices has been of the same order.

Pulp producers increased the price of softwood pulp in Europe at the start of September 2003. This was possible because of the buoyant demand for pulp in Asia and the higher dollar price of pulp in North America compared with European prices. The price of eucalyptus pulp also rose. Pulp producers introduced further pulp price increases in October.

The average export price of Finnish bleached sulphate pulp in 2003 is nevertheless expected to be about three per cent down on the 2002 level. Pulp exports are projected to grow by nine per cent, and production by four per cent, on the previous year’s level.

Large Increases in World Production of Market Pulp

World pulp production is currently growing most rapidly in South America. Towards the end of 2003, the Chilean company Arauco is bringing on stream a pine and eucalyptus pulp mill with an annual production of 0.7 million tonnes. It was little more than a year ago that the Brazilian company Aracruz inaugurated a new eucalyptus pulp line of a similar capacity. There are also other South American pulp mills planned for the near future, based on the use of plantation wood. The continent’s paper production has been increasing only slowly, and the new pulp mills have so far been targeting their production at export markets.

The considerable growth in supply brought by the additional hardwood pulp capacity may affect pulp buyers’ price expectations and stockpiling behaviour. Aracruz, at least, has tried to prevent oversupply in...
2003 by stockpiling some of its pulp production. Competition on the hardwood pulp market will probably increase in 2004, as new capacity is introduced, unless there is a noticeable increase in demand. Any price reduction in hardwood pulp would also be reflected in the softwood pulp market.

Pulp capacity has been increasing in recent years in Finland too, and this is set to continue in 2004, when the modernisation of UPM-Kymmene’s Pietarsaari pulp mill is completed. Exports of pulp can be expected to increase further, because Finnish production capacity for making pulp-based paper is not due to increase to any great extent in the near future. Exceptionally, Germany will be introducing a new mill to make market pulp from softwood sulphate in late 2004, which is likely to reduce German imports of pulp in the future.

**Market Slow to Absorb Europe’s Overcapacity in Printing Papers – Are Further Capacity Increases Due Soon?**

Consumption of newsprint has been on the decline in Western Europe for the past three years. In 2002, European newsprint producers’ deliveries in Western Europe were down by about 10 per cent (900 000 tonnes) on the high achieved in 2000, according to the Confederation of European Paper Industries. However, producers have succeeded in increasing their exports to markets outside Europe, although at the same time newsprint is also being imported to Europe, principally from North America.

In Europe, the most significant investment in additional newsprint capacity in 2003 was the newsprint machine – the world’s largest – inaugurated in Belgium by Stora Enso during the summer. Newsprint production capacity in Finland has been reduced in recent years.

There was considerable growth in Europe’s coated magazine and fine paper production capacity during the years 2000–2001, which is continuing to fuel the oversupply situation. The average PIX price of coated printing papers in January–September 2003 fell by almost 10 per cent on the same period the previous year. The growth in printing and writing paper capacity has been fairly moderate in 2003 and will remain so in 2004, which should produce a slight improvement in the demand-supply balance in the European market during 2004. This will be short-lived, however, because in September 2004, coated magazine paper capacity is set to increase again, with the introduction of a new LWC paper machine by the small German producer Leipa. The Confederation of European Paper Industries forecasts that deliveries of coated magazine papers in Western Europe in 2003 will be below the figure recorded for 2000.

The overcapacity and price competition in coated grades has also been reflected in the market for uncoated grades, such as SC papers, because some of the demand switches between coated and uncoated grades, depending on their respective prices.

The market for printing papers is fairly concentrated, however, which means that an increase in demand will bring opportunities for the larger producers to influence prices. In 2002, Finland accounted for over one third of all European production of magazine papers, and almost one fifth of Europe’s coated fine paper production. The Western European production capacity of the forest industry corporations headquartered in Finland would have been sufficient to manufacture about 60 per cent of

**Volume and unit value of pulp exports, 1992–2004 at 2002 prices (wholesale price index)**

- Export volume
- Unit value EUR/tonne
- Source: National Board of Customs

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<tr>
<td>04</td>
<td>2.1</td>
<td>600</td>
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</tbody>
</table>

The Finnish Forest Industry
the total 2002 production of these printing papers.

On the paperboard market, substantial new production capacity has increased competition, especially between producers of waste-paper-based containerboard. In Germany, for example, prices have fallen by 13–17 per cent, depending on the product group in question, during the 12 months since August 2002. Although export prices of pulp-based containerboard manufactured in Finland have fallen rather more gently, it has proved necessary to limit production. In other paperboard grades produced in Finland, the balance between demand and supply has remained comparatively good, and the price level has been fairly stable.

**Paper Demand to Pick Up in 2004**

Demand growth in the paper and paperboard industry is closely tied to the fortunes of the wider economy. Even if economic growth were to accelerate in Europe, which is the main market for Finland’s paper industry, growth in the pulp and paper markets is also dependent on North America and Asia.

The demand for printing and writing papers is especially dependent on magazine circulations and the thickness of magazines and on growth in printed advertising. In September 2003, the London-based media communications agency Zenith Optimedia Group forecast that 2004 will finally see real advertising growth in Western Europe, after two successive years of decline. According to the forecast, growth in the main advertising media, including newsprint and magazine papers, will be 2.2 per cent in 2004. A number of major events that should boost the consumption of printed media will also be taking place in 2004, notably the Athens Olympic Games and the US Presidential elections.

The outlook for the Finnish paperboard industry appears stable. About 15 per cent of its exports are to Asia, where economic growth is strong. The Asian paperboard market is currently one of the fastest growing markets for forest industry products in the world. Approximately one sixth of Finland’s paperboard production is consumed domestically, and about a half goes to Western European markets. Competition in Europe will continue to be tough, especially in waste-paper-based paperboard grades, for which yet more capacity is on the way.

The eastward enlargement of the EU is expected to produce some improvement in export opportunities for the paper industries of existing Member States, once the demand for paper in the new Member States picks up as economic growth accelerates. The enlargement will have very little impact
The Finnish Forest Industry

Forecasts of production and exports in the pulp and paper industry (1000 tonnes); percentage changes from previous year are shown below the respective volumes

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<tr>
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<td>2 790</td>
<td>2 310</td>
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</table>

Forecasts of export prices for the pulp and paper industry (as percentage changes from previous year*)

<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
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<td>–15</td>
<td>–3</td>
<td>5</td>
</tr>
<tr>
<td>Paper</td>
<td>–8</td>
<td>–10</td>
<td>0</td>
</tr>
<tr>
<td>Paperboard</td>
<td>–4</td>
<td>–2</td>
<td>2</td>
</tr>
</tbody>
</table>

* Export prices are nominal unit values.

on the market in 2004, however.
In all, production and exports of Finnish paper are expected to grow by about three per cent in 2004. Whereas the production of newsprint could well continue to decline, production of coated printing papers will increase. Nevertheless, even coated printing paper capacity will still be under-utilised to an extent. By contrast, paperboard production capacity is already utilised fairly efficiently. Paperboard production and exports are forecast to grow slightly in 2004, by about two per cent. The production of pulp will increase further, due to growth in domestic consumption and in exports: pulp production is forecast to rise by about three per cent, and exports by five per cent, in 2004.

No significant new paper production capacity is to be introduced in Europe in 2004. The utilisation rates for existing printing paper capacity are expected to rise slightly. Although the demand-supply balance will still only improve a small amount in the producers’ favour, prices are expected to start rising. This is because the considerable concentration in the sector gives producers the scope to influence prices, and because the production costs of non-integrated producers will rise due to the higher pulp prices. Fluctuations in buyers’ stocks could hasten any price increases as the market improves. With prices no longer expected to fall, buyers may increase their stocks.

The average export price of Finnish paper in 2004 is expected to be almost unchanged from 2003 as the drop in prices is turned around into an increase. The paperboard export price is forecast to rise by about two per cent, and the average pulp export price by about five per cent. The prices of pulp and paper industry products will be affected by movements in exchange rates, though these are difficult to predict. It is assumed that the euro rate against the US dollar will remain at its late September level (1.16). However, if the dollar were to strengthen, this could bring marked increases in the euro-denominated prices forecast for 2004.
2.3 Costs and Profitability in the Forest Industry

Cost trends in the Finnish forest industry in 2003 have been rather mixed. In comparison with 2002, labour, energy and transportation costs have risen, pulpwood mill prices have fallen and softwood sawlog mill prices have remained unchanged. In the paper industry, the capacity utilisation rate is again low and a significant drop in prices has weakened profitability. By contrast, the capacity utilisation rate remains high in the sawmilling industry. Although slightly improved on account of the marginal rise in sales volumes and prices, the industry’s profitability remains poor.

In 2004, the fall in paper prices is expected to be turned around and the capacity utilisation rate to rise slightly. Paper industry profitability is thus forecast to improve towards the end of 2004. The market will, however, continue to be tough for the sawmilling industry. Its profitability is forecast to remain at the 2003 level, as prices and production costs will remain stable and there will be comparatively little growth in production.

Paper Industry Profitability Weakened by Decline in Prices

In 2002, the Finnish forest industry’s export income fell and profitability deteriorated; this was evident in both the paper and the wood products industries. The 2002 combined profits of the three largest Finnish forest industry corporations – Stora Enso, UPM-Kymmene and Metsäliitto Group – was approximately EUR 0.8 billion (before extraordinary items), compared with the previous year’s EUR 2.7 billion. The combined profit for 2002 includes a non-recurring depreciation item of about EUR 1 billion, without which the combined profit would have been EUR 1.8 billion. The forest industry corporations’ profitability continued to deteriorate in the first half of 2003, with a combined profit of about EUR 0.6 billion (before extraordinary items), as against the equivalent figure of EUR 0.9 billion for the first half of 2002.

The profitability trend in the paper and sawmilling industries is shown by product group in the accompanying diagrams. The diagrams cover the entire world production of Finland’s forest industry corporations. However, the assessments presented below concerning the production costs and profitability of the Finnish forest industry in 2003 and 2004 deal only with domestic production.

Paper industry profitability weakened in the first six months of 2003, due to the drop in paper prices. Despite the increase in export volumes, the value of Finnish pulp and paper exports fell by about five per cent on the corresponding period a year earlier. Capacity utilisation rates were also low. In the paper and paperboard industry, the capacity utilisation rate was only 88 per cent, according to the Finnish Forest Industries Federation. The relatively low level of paper production meant that pulp production capacity also remained under-utilised.

Despite the increase in domestic sawnwood production and the three per cent rise in export prices in the first six months of 2003 compared with one year earlier, profitability in the sawmilling industry is still poor. For example, the operating profit of the Metsäliitto-owned Finnforest Solid Wood was less than three per cent of turnover in January–June, while its return on capital invested was about five per cent. The sawmilling industry’s capacity utilisation rate has remained high, however, at about 97 per cent. Preliminary figures show that the value of exports of the entire Finnish wood products industry for January–June 2003 was about two per cent above the figure for the equivalent period in 2002; the export value of sawnwood was up by three per cent.

Profitability in the plywood industry has improved slightly during 2003, although the average export price of plywood is expected to show a drop of about three per cent. The profitability improvement has been due in part to the marked rise in the capacity utilisation rate as a result of increased production (up by about eight per cent), and in part to
the fall in the price of birch sawlogs (down by three per cent). Following major capacity investments, the plywood industry’s capacity utilisation rate in 2002 was less than 70 per cent. The capacity utilisation rate for 2003 is expected to be 74 per cent.

**Fall in Stumpage Prices Reduces Roundwood Costs in 2003**

Wood raw material costs comprise about one third of total manufacturing costs in the wood products industry, and about 14 per cent in the pulp and paper industry (data for 2000). These figures include the manufacture of processed products and all other sections of these industries. In particular segments of the wood products industry, wood raw material costs can account for a considerably higher proportion of total manufacturing costs: in sawmilling, for instance, they account for over half of total costs. The Finnish forest industry’s roundwood costs are made up of the stumpage, harvesting, transportation and procurement costs of domestic roundwood, plus the costs of foreign imported roundwood. In the wood products industry, stumpage costs represent the biggest single cost item.

The stumpage price of softwood sawlogs increased during the first half of 2003 but then began to fall again in July. The average stumpage price for the full year is expected to be around the previous year’s level. The price of birch sawlogs is expected to show a decrease on the 2002 figure. Pulpwood stumpage prices remained at around the previous year’s level during the first part of 2003, but then began to decline in the summer. Average pulpwood stumpage prices for the full year are expected to be down on the 2002 figures by about 4–6 per cent, depending on the tree species.

In July 2003, unit costs of roundwood harvesting and transportation were about 2.5 per cent higher than one year previously, according to figures from Statistics Finland. The upward pressure on harvesting and transportation costs was due to the increase in labour costs (caused by pay outstripping labour productivity) and especially the rise in fuel prices. However, the drop in interest rates helped to keep down the overall rise in costs.

The sawmilling industry’s roundwood costs are expected to be almost unchanged from the 2002 figures, while in the paper industry roundwood costs for 2003 are expected to have fallen somewhat, once all the cost items are accounted for.
Forest Industry Pay Settlement Perpetuates the Trend of Recent Years

In 2002, labour costs represented about 14 per cent of the pulp and paper industry’s total output. In the wood products industry this share was about two percentage points higher.

Under the new two-year wage policy agreements that apply up to March 2005, wages and salaries in the Finnish forest industry will rise both this year and in 2004. Pay in the different contractual sectors of the forest industry was increased by 2.6–2.8 per cent at the start of March 2003. A further increase of 2.2 per cent will be made in March 2004. In practice, forest industry pay is finalised at plant level, where local site-specific increments are added to the negotiated contractual increases. In recent years these local increments in the various sectors have been in the range 1–1.5 per cent.

Labour productivity increased by 6.6 per cent in the pulp and paper industry and the wood products industry in 2002, according to figures from Statistics Finland. Labour productivity is expected to be up in 2003 by as much as about nine per cent in the pulp and paper industry and three per cent in the wood products industry, due to growth in production and the labour force reductions.

Despite rising pay levels, the effect of job losses is such that total labour costs in the pulp and paper industry in 2003 are expected to be about three per cent below the previous year’s level. However, in the wood products industry, labour costs are expected to increase by about seven per cent.

Large Fluctuations in Energy Prices

Energy costs accounted for about nine per cent of production costs in the Finnish pulp and paper industry in 2000. The industry’s high degree of self-sufficiency has a stabilising effect on its energy costs, as the major forest companies obtain a significant proportion of their electricity and heat from their own power plants and production processes. Any temporary fluctuations in the price of market electricity, however large, will therefore have a comparatively minor impact on the Finnish paper industry’s energy costs. UPM-Kymmene, for example, reports that it covers all the electrical power needs of its Finnish mills from its own power production or that of its associated companies.

Many sawmills are also self-sufficient in thermal energy. For drying wood and for heating premises, they obtain the energy they need from bark and from sawing and trimming waste. In 2000, the energy costs of the entire Finnish wood products industry were less than three per cent of total production costs.

The average price of market electricity in the first half of 2003 was EUR 41 per MWh, and futures quoted on Nord Pool (the Nordic power exchange) indicate a year-end price of over EUR 30 per MWh. The average price of market electricity for the full year is expected to be approximately EUR 36, an increase of about 25 per cent on the 2002 figure. This increase has been due to the record low temperatures of winter 2002/2003 and the low level of Nordic water reserves. After a warm summer, water reserves are about 25 per cent below their usual level. In terms of electricity, this is equivalent to about six per cent of the Nordic countries’ annual power consumption.

Among the fossil fuels, natural gas is used the most by the Finnish forest industry in its own power and heat production. The price of natural gas in the first quarter of 2003 was about eight per cent higher than in the same period the previous year. The forest industry also uses peat and heavy fuel oil as energy sources. No major changes are anticipated in the price of peat.

The price of crude oil has fluctuated greatly during 2003. Nordea Bank forecasts that the average price for the year will be USD 28 per barrel, which would mean an increase of about 12 per cent on 2002. There are several reasons for the rising oil price, and these have varied through the year. Prices were firstly raised by the threat of a war in Iraq and have subsequently been affected by factors such as problems with oil production in Iraq.
Oil Prices Indirectly Reflected in Forest Industry Costs

The rise in crude oil prices mainly has an indirect effect on forest industry costs via its impact on freight and other transportation costs, the prices of chemicals and pigments, and harvesting costs. The increase in costs of imported inputs in 2003 has been limited by the strengthening of the euro.

Sea freight prices rose sharply in the last months of 2002 and continued to rise at the start of 2003 as oil product prices increased. Higher demand for sea freight was another factor in the price rises. The Baltic Dry Index (BDI), measuring dry cargo spot prices on the busiest shipping routes, rose by about 30 per cent between January and early September 2003, and should remain at the same level to the end of the year. In annual terms, the index has risen about 75 per cent.

Oil price fluctuations are reflected in the prices of pigments and forest industry chemicals via their impact on manufacturing costs. In making pigments, energy is needed in mining activities, refining and transportation. Manufacture of forest industry chemicals is typically also energy-intensive. In addition, oil is used as a chemical raw material, for example with latexes used as coatings.

The increase in pigment and chemical prices in 2003 has been contained, however, by a stronger euro and relatively low paper production levels. Imports account for over 65 per cent of pigment consumption by value. All the kaolin and half the ground calcium carbonate are imported, usually from outside the euro area. Kaolin, for instance, is imported from the United Kingdom and the United States.

In the first half of 2003, the prices of basic chemicals increased by approximately four per cent. Chemical prices are expected to remain at present levels for the rest of the year, and so prices will have risen by about three per cent for the year as a whole.

Chemicals and pigments accounted for about seven and three per cent, respectively, of production costs in the Finnish pulp and paper industry in 2000. Chemicals are of considerable importance not only in paper but also pulp manufacturing. In the paper industry, pigments are used as fillers and coating materials, especially in the production of magazine and fine papers.

Moderate Increase in Costs in 2004

No significant production cost increases are forecast for the Finnish forest industry in 2004. The euro is expected to remain at its present value or to strengthen slightly, which will stabilise prices of imported goods. Oil prices are expected to fall, which will reduce the price rises in a number of the factors of production. The sluggish economic growth in the euro area will also keep inflation under control.

The most significant area of rising costs for the Finnish forest industry will be wages and salaries. The contractual increments and local wage adjustments will together mean an increase of about 3.5 per cent in 2004. The increase in labour productivity will, however, ensure that the impact of the pay increases on labour costs is neutral in the wood products industry, and of the order of 1.5 per cent in the pulp and paper industry.

Stumpage prices are forecast to remain at their 2003 level or even to fall. Roundwood harvesting and transportation costs are likely to remain unchanged, because energy costs are projected to fall again and low interest rates will keep capital costs stable. In addition, the impact of the pay increments on forestry labour costs will be partially contained by even a small rise in labour productivity. Mill prices of roundwood are therefore not expected to rise in 2004.

Crude oil prices are forecast to decrease in 2004, to about 10 per cent below the 2003 average. Both Nordea and the Research Institute of the Finnish Economy predict that the average oil price in 2004 will be USD 25 per barrel. This assumes stabilisation of the situation in the Middle East. Chemical and pigment prices are not expected to rise until there is
The price of market electricity will be heavily dependent on water reserves in the Nordic countries and the level of power consumption in the coming winter. Future prices on Nord Pool indicate that the price of electricity in 2004 will be EUR 40 per MWh, due to the low water reserves. They also indicate that the price of market electricity for the year as a whole will be EUR 30 per MWh, which would be about 15 per cent lower than the figure for 2003.

Pulp and Paper Industry Profitability to Improve Later in 2004

The capacity utilisation rate in the paper and paperboard industry is expected to rise to about 90 per cent in 2004, as paper production increases and capacity remains almost unchanged. In the sawmilling industry, the capacity utilisation rate will remain high.

Profitability in the Finnish forest industry will be affected most of all by the prices of end products. As world GDP growth accelerates, paper industry product prices are expected to start rising in 2004. Together with an increase in the capacity utilisation rate, this will improve Finnish pulp and paper industry profitability and company profits in the second half of 2004.

Profitability in the sawmilling industry in 2004 will either show a slight improvement or will remain unchanged, as no major shifts are anticipated in costs or end-product prices, and production growth will be small. Profitability in the plywood industry is forecast to remain at the 2003 level, despite production volumes rising by about three per cent, because the average price of plywood is expected to drop by about one per cent.