

Finnish Forest Sector Economic Outlook 2003–2004

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Summary

The economic indicators all suggest that GDP growth in the world economy should be starting to pick up. There is already evidence of this in the United States and Asia, but in Europe – the main export market for the Finnish forest industry – the recovery in demand is still awaited. The effects of sluggish demand for paper in Europe, combined with plentiful supply and a strengthening euro, have been reflected in prices, resulting in a significant drop in the export prices of Finnish paper since 2002. Sawnwood export prices also began to fall in the first months of 2003, although the average price for the full year will still be slightly above the 2002 figure. Despite falling prices, overall production in the Finnish forest industry has been rising in 2003. With the end of the forest taxation transition period drawing nearer, the supply of domestic roundwood has been increasing. Commercial fellings are also up in 2003, but stumpage prices have begun to fall as a result of the abundant supply. The additional demand for roundwood in the forest industry has largely been met through increased imports.

In 2004, growth in the world economy will accelerate. Weighted according to the distribution of Finnish forest industry exports, world GDP growth is forecast to rise to 2.5 per cent from its 2003 level of 1.5 per cent. With a recovery in the demand for paper in Europe, export prices are expected to start strengthening. Growth in sawnwood demand, on the other hand, will still be restrained by low growth in the European construction sector. Sawnwood export prices are expected to rise very little, due to tough competition. The demand for roundwood will be up slightly because of an overall growth in production in the Finnish forest industry. However, pulpwood harvesting will decline in response to the increase in imports of pulpwood and chips, and the drop in pulp-

wood stumpage prices will continue. Sawlog fellings will be up and sawlog imports down slightly.

Economic Operating Environment

Contrary to the expectations of autumn 2002, the growth outlook for the Finnish forest industry has remained weak in 2003. Although economic growth has picked up significantly in the United States and Asia, growth in Europe – Finland's main export market – has continued to be weak for the third year in succession. Most forecasts indicate that 2003 GDP growth in the euro area will be no more than about 0.5 per cent. The strengthening of the euro has been one factor restraining growth, as it has hampered exports from euro area companies. Among the key export markets for the Finnish forest industry, growth has been particularly weak in Germany.

In 2004, the acceleration in GDP growth in the world economy is expected to improve the economic outlook for the euro area as well. The strengthening of the US and Asian economies, in particular, will boost exports, and this, together with low interest rates and a gradual revival in consumption, will raise GDP growth in the euro area to almost two per cent. There are, however, some considerable uncertainties that cast a shadow over the prospects for this brighter outlook. The extent of indebtedness in the United States economy and among US households is a key uncertainty that could affect growth in the US economy and create uncertainty on the currency markets. Another factor is this year's renewed standstill in the euro area's biggest economy, Germany. Together with the stronger euro, this will serve to dampen demand and jeopardise the prospects for an acceleration in GDP growth in the euro area.

Exports, Production and Prices in the Finnish Forest Industry

In 2003, domestic consumption has stimulated some growth in sawnwood production. No growth has occurred in sawnwood exports, however, because of the weak state of the construction sector in Europe, the main export market for the Finnish forest industry. The sluggish demand for sawn softwood in relation to its increased production has led to oversupply in Europe. This caused average export prices of Finnish sawnwood to decline in the first months of 2003, reversing the previous year's trend. For 2003 as a whole, however, the export price will be about two per cent above the 2002 figure.

Forecasts by Euroconstruct indicate that the recovery in the European construction sector will be delayed until 2005. With only modest demand growth for sawnwood in 2004, the growth in exports of Finnish sawnwood will also be low. The average export price of Finnish sawnwood is not expected to rise above its 2003 level, due to the very competitive market as a result of continued oversupply in Europe. Further growth in housing construction in Finland will mean greater consumption of sawnwood in 2004. According to the forecasts, this could boost sawnwood production to almost 13.5 million cubic metres.

Europe's demand for paper products has increased only a little in 2003, and prices have fallen considerably on account of the price competition caused by overcapacity and the weakening of the US dollar. Production and exports of Finnish paper and paperboard will be up by 2–3 per cent in 2003, but the average export price will be down by about eight per cent. Pulp production for the year will show an increase of about four per cent, due to the increase in pulp exports and domestic demand. Although the dollar price of pulp has risen, the average export price in euros for 2003 will be about three per cent below the previous year's average, as a result of the movements in exchange rates.

In 2004, the demand for paper is expected to start picking up in Western Europe, and exports of Finn-

ish paper are forecast to increase by about three per cent. With only a minor increase in capacity anticipated in Europe, this will mean an improvement in the utilisation of existing capacity. The improved demand-supply balance will facilitate a rise in the average export price of Finnish paper, ensuring that the average price for the year is about the same as in 2003. The outlook for paperboard exports will also be improved, and the production and export of Finnish paperboard and export prices are all projected to rise a little in 2004. Pulp production is forecast to increase by about three per cent, due to the additional capacity and a rise in exports. With stronger demand, the market price of pulp is forecast to improve too. This is expected to produce a rise of about five per cent in the export price of Finnish pulp in 2004.

Costs and Profitability in the Finnish Forest Industry

The cost trends in the Finnish forest industry in 2003 have been mixed. Labour, energy and transportation costs have all been increasing, pulpwood mill prices have been falling and sawlog mill prices have remained unchanged (except for birch sawlogs). In the pulp and paper industry, profitability has weakened during 2003, in spite of the moderate cost trend. This is due to the considerable drop in export prices and because the capacity utilisation rate has been just 88 per cent. By contrast, the capacity utilisation rate in the sawmilling industry remains high, although the industry's profitability is still low despite the improvement during the year as a result of the slight rise in average export prices.

In 2004, pulp and paper prices are expected to pick up as demand improves, and the capacity utilisation rate will rise. With costs remaining almost unchanged, profitability in the paper industry is expected to improve in the second half of the year. In the sawmilling industry, domestic demand will lift production levels, and the capacity utilisation rate will be very high. Export deliveries will only increase a little, however, and price increases will be limited by the tough competition in Europe. With

costs remaining stable, the industry's profitability in 2004 is expected to be at around the same level as in 2003.

Roundwood Markets

Commercial fellings will be up in 2003 to a total of approximately 55 million cubic metres. This increase applies to pulpwood more than sawlogs, because the increased production in the forest industry has been mainly in paper production. Roundwood imports have also been rising, and the figures are expected to show that the industry's growing demand for wood has been met mainly through imported roundwood. Roundwood imports are likely to have grown in 2003 to over 17 million cubic metres. As the end of the forest taxation transition period draws nearer (as of 2006, all forest owners will be subject to taxation based on roundwood sales), the supply of wood on domestic roundwood markets appears to be growing more rapidly than the industry's demand for it. In addition, lower export prices for paper industry products are also affecting pulpwood prices, which are expected to be down in 2003 by 4–6 per cent. The stumpage prices of softwood sawlogs have also begun to fall, although the rising trend in the early part of the year should mean that average prices for the year will probably be at their 2002 levels.

In 2004, approximately the same volume of wood will be harvested in Finland as the previous year, and the volume of imported wood will continue to rise. Production growth in the Finnish forest industry will again be concentrated in the paper industry, which will increase the need for pulpwood, in particular. However, domestic pulpwood fellings will decrease as pulpwood imports rise and stumpage prices fall (by a further 3–4 per cent) in response to the plentiful domestic supply. The growing demand for sawlogs to meet the slight increase in sawnwood production will be met from domestic fellings. This is expected to keep prices of domestic sawlogs at about the same level as in 2003.

Investment and Profitability in Non-Industrial Private Forestry

In 2002, there was a drop in the amount invested in timber production in non-industrial private forestry in Finland, due to a reduction in artificial regeneration. By contrast, the level of investment in 2003 will be up by about six per cent, to over EUR 195 million. This is because there are substantial clearcut areas to be regenerated in order to meet the statutory regeneration obligations, and the regeneration of such areas has required additional investment from forest owners in 2003, which will again be the case in 2004. Non-mandatory investments by private forest owners during 2003 have been stimulated by the sustainable forestry funding allocations in the Government's supplementary budget. The Government's commitment to the National Forest Programme should ensure the effective implementation of measures to secure sustainable roundwood production in 2004.

Per-hectare gross stumpage earnings in non-industrial private forestry will be down in 2003 by about one per cent, due to the drop in stumpage prices. Costs will be up by almost five per cent. More state subsidies have been taken up in 2003 than in the previous year, and so the costs paid by the forest owners will also have risen. Per-hectare net earnings in non-industrial private forestry will be down in 2003, to EUR 97 from the previous year's EUR 99, on account of the rise in costs and the fall in gross stumpage earnings. This is below the level of the late 1990s but is still higher than the average for the past 10 years. In 2004, the increase in sawlog fellings will raise per-hectare gross stumpage earnings. With costs down a little, net earnings are expected to return to EUR 99 per hectare.

Labour Force

By the end of 2003, the number of people employed in the Finnish pulp and paper industry is expected to be 3000 fewer than in 2002, due to the slowdown in production growth and weaker profitability. At the

same time, labour productivity is expected to have risen by as much as nine per cent, due to restructuring in the labour force. The contraction in the labour force appears to have had little effect on the unemployment rate in the industry, however. In the sawmilling industry, employment is more or less unchanged from 2002, while the joinery industry has seen an additional 1000 jobs, attributable to the growth in renovations and housing construction. Labour productivity is expected to be up in the wood products industry as a whole by an average of about three per cent. In the sawmilling industry, production growth will continue to be low in 2004, which could mean a slight decline in employment. Production growth in the pulp and paper industry will be slightly higher in 2004, which should reduce the decline in employment levels quite significantly. In 2004, labour productivity in the wood products and paper industries is forecast to increase by 3–4 per cent. The total number of jobs in the Finnish forest industry in 2003 is approximately 69 000, and is forecast to be about 68 000 in 2004.

The growth in the number of forestry jobs in 2003 has been greater than that needed to meet the growth in commercial fellings. These extra jobs are in artificial regeneration, tending of young stands and increased harvesting of firewood and wood chips. The number of employees in the sector in 2003 is up by about 1000, while the number of office personnel and private entrepreneurs is unchanged. The unemployment rate is unchanged from the previous year, at about 10 per cent. No major changes are expected in the employment situation in 2004, because the volume of commercial fellings will be about the same as in 2003. A slight increase in labour productivity will be recorded in 2003 and 2004. The total number of jobs in Finnish forestry in 2003 is about 26 000, and this will be unchanged in 2004.

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. The view of GDP growth in the world economy and export markets has been formulated on the basis of forecasts made by a number of different organisations, among them the Organisation for Economic Cooperation and Development, the International Monetary Fund and the Research Institute of the Finnish Economy. The forecasts given in this publication are for the years 2003 and 2004 and are based mainly on information available in late September and early October 2003.

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 GDP 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 trend in the US economy, as GDP growth in the United States is expected to drive up growth in the euro area too. Delayed growth in the euro area would also limit the improvement in demand for forest industry products. Uncertain growth in the German economy also continues to be of concern, as this has a direct impact on Finnish exports and on the entire European economy. If GDP growth in Europe turns out to be weaker than expected, the demand for forest industry products will be lower than forecast. This would further exacerbate the already intense competition in Europe and force down prices. Competition in Europe will also be intensified if the US dollar weakens further against the euro, as this would hamper European export prospects and add pressure to obtain supplies from countries 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.