2 The Finnish Forest Industry

2.1 Exports and Production in the Sawmilling and Plywood Industries

Growth in housing construction has boosted the demand for sawnwood in Europe in 2006 by a greater amount than expected, and sawnwood prices have risen significantly. The supply of sawnwood in the first half of the year was limited because of export growth to markets outside Europe and the temporary shortage of sawlogs in many producer countries. A rise in sawlog prices in the second half of 2006 may stimulate an increase in sawlog supply, and higher sawnwood prices are expected to boost Europe’s sawnwood production. In 2007, the growing supply of sawnwood together with a slightly weaker trend in residential construction will mean tougher competition on the export market, which will in turn keep price rises in check.

The nominal unit price of Finnish sawnwood exports in 2006 is expected to be up by almost 7% for the full year, whereas in 2007 it will be up by just 2%. Production and exports of sawnwood in 2006 are estimated to be up by about 2% but will be considerably below their 2004 level because of the reductions in production capacity in recent years. The rise in export prices will only mean a slender improvement in the profitability of sawnwood production because at the same time costs have risen. Production and export volumes in 2007 are expected to be down slightly on account of lower growth in residential construction on both the domestic market and the principal export markets.

On Europe’s plywood market, the unexpectedly high level of demand has pushed up the export price of birch plywood in particular. With tougher competition, the rise in the nominal unit price of plywood exports will slow to an annual figure of about 2% in 2007 from 3% in 2006. Plywood production and exports for the full year 2006 will be up by about 6%, and in 2007 the growth will be lower than this.

Higher Demand in Western Europe in Early 2006 Pushes up Sawnwood Prices

Demand for sawnwood in Western Europe in the first half of 2006 has been high on account of the growth in residential construction, and this has raised the price of sawnwood. Higher prices have also been the result of a relative shortage of sawlogs, which restricted production growth in the first part of the year. A scarcity of sawlogs was also apparent in many of Europe’s largest sawnwood producer countries, leading to a rise in sawlog prices not only in Finland but also in Northwest Russia, the Baltic countries, Sweden, Southern Germany and Austria. The supply of spruce sawlogs in particular has been low. In Finland, sawlog supply was adversely affected in the first part of 2006 by the end of the forest taxation transition period, while in Austria, for example, the supply was affected by a reduction in the import of German sawlogs. Russia, too, has
experienced problems with sawlog availability, and its exports to Estonia, for instance, fell in the first half of 2006. In Central Europe, where the sawmilling industry has expanded, it is possible that the sawlog availability problems will worsen over the longer term and lead to further rises in raw material costs.

**Decline in Residential Construction in Many Western European Countries and the US in 2007**

According to the June 2006 forecast by Euroconstruct, housing repair and maintenance in Western Europe will continue to increase in 2007, whereas there will be almost no growth in the production of new housing. There are naturally differences from one country to another. In the United Kingdom and the Netherlands, for example, construction of new dwellings will increase, whereas in Germany and France a decrease is forecast. The export dependence of Western Europe’s sawnwood producers means that the achievement of a balanced market will be sensitive to fluctuations in demand outside Europe. Thus, the reduction in residential construction in the United States represents a particular challenge for Western European sawnwood producers both in 2006 and 2007. Forecasts indicate that US housing construction will fall by a total of 13% in the period 2006–2007 in comparison with 2005. In Japan, however, the demand for construction products is rising, and the number of new housing starts in January–August 2006 was up by 4% on the same period a year earlier. The growth in starts on new timber-framed buildings was about 3%, and these types of dwelling accounted for about 44% of all housing starts, which is close to the long-term average in Japan. In Eastern Europe, too, construction growth is raising the demand for sawnwood.

**Greater Supply Will Limit Price Increases in 2007**

In January–August 2006, the nominal unit value of Finnish pine sawnwood exports was up by 12% and export volumes by 7% on the same period the previous year. This export growth was attributable in part to an increase in exports to Algeria and Japan. The export price of spruce sawnwood rose by a smaller amount, 4%, and export volumes were below the level of a year earlier, due to a decrease in exports particularly to France, Germany and the Netherlands. Since there has been a scarcity of spruce sawnwood on the European market due to availability problems, its price is expected to continue rising slightly in the latter part of 2006. The nominal unit price of Finnish sawn softwood exports is therefore expected to be up by almost 7% for the full year 2006.

The principal factors affecting European sawnwood prices in 2007 will be the lower growth or even contraction in residential construction in some countries, and the oversupply of sawnwood. The rising sawnwood prices of 2006 will lead to an increase in sawnwood production, provided that the sawlog availability problems are overcome. How-
However, with a reduction in demand being anticipated, such an increase in sawnwood production will mean tougher competition. Although supply from the Baltic countries and Finland is not likely to increase much, production is expected to increase in Central Europe, and Swedish sawnwood supply will also be up slightly. Supplies from Russia are expected to remain high, although the country’s domestic sawnwood consumption is growing. A proportion of the growth in Russia’s sawnwood exports will be destined for markets in China and for further processing in the Baltic countries. In Europe, supply may also increase slightly because of a reduction in exports to the United States for reasons of profitability, as US sawnwood prices are forecast to decrease further in 2007. With tougher competition, the rise in the nominal unit price of Finnish soft sawnwood exports can be expected to be about 2% in 2007.

**Finnish Sawnwood Production and Exports in 2007 Close to 2006 Levels**

In relation to sawnwood export prices, the changes in raw material prices in recent years have become increasingly unfavourable for producers, leading to a deterioration in profitability within the sector. As a consequence, there has been no investment in expanding basic sawnwood production in Finland in recent years. Instead, Finnish-owned companies have, for instance, acquired capacity in the Baltic countries and Russia, amounting to an annual production volume of about 2 mill. m³. This has brought additional opportunities not only in raw material procurement beyond Finnish borders but also in production planning, as Finnish-based production can be substituted with production in units based abroad.

As Europe’s oversupply has led to declining sawnwood prices in recent years, and it has proved difficult to achieve any further significant increases in productivity, the raw material price has become a critical factor in the sector’s profitability. Raw material costs account for well over half of turnover in the sawmilling industry. The ratio of raw material price to final product price for pine sawnwood has improved since the start of 2005, with the strengthening of the export price. The trend in the same price ratio for spruce sawlogs and spruce sawnwood has been weaker, however. Spruce sawnwood prices are nevertheless expected to rise in the latter part of 2006, which will improve production profitability.

The higher sawnwood price anticipated for both 2006 and 2007 will not significantly improve the sector’s average profitability, however, because production costs are also rising. Annual production and export volumes are expected to be below the 2004 level both in 2006 and 2007, because of the reductions in production capacity in recent years. The 2006 figures for sawnwood production and exports will nevertheless be up by about 2%, but in 2007 they will fall back a little as competition intensifies on Europe’s sawnwood market.

**Demand on Domestic Sawnwood Market Still High**

In relation to sawnwood export prices, the changes in raw material prices in recent years have become increasingly unfavourable for producers, leading to a deterioration in profitability within the sector. As a consequence, there has been no investment in expanding basic sawnwood production in Finland

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*Volume and unit value of sawnwood exports, 1995–2007 at 2005 prices (wholesale price index).*

![Graph showing volume and unit value of sawnwood exports, 1995–2007 at 2005 prices (wholesale price index).](image-url)
changes in stocks. With an increase in residential construction, domestic sawnwood consumption for the full year 2006 is expected to be up by 2–3% on the previous year’s figure. Forecasts by the Research Institute of the Finnish Economy indicate that growth in residential construction will slow down to 2% in 2007 from almost 6% in 2006. If this transpires, the growth in demand for domestic sawnwood will be lower than in 2006.

### Slower Rise in Plywood Prices

The growth in residential construction in Europe and the associated demand for furniture and fittings have fuelled the demand for plywood and led to rising prices in the last couple of years. In 2005, a total of 4.1 mill. m³ of plywood was produced in the EU, meeting an estimated 60% of demand. Finnish production accounts for about one third of all plywood produced in the EU.

Only about one tenth of Finnish plywood production remains in the country, the rest being mainly exported to markets in the EU. Birch plywood, which is higher in price than softwood grades, comprises about 40% of the production and export of Finnish plywood, the remainder being softwood plywood. Germany and the United Kingdom account for the biggest share of Finnish plywood exports, together taking about one third of Finnish production. Production and export volumes of Finnish plywood for the full year 2006 will be up by 6% following the slight setback in 2005, and the nominal average price will be up by about 3%, due to the favourable price trend in birch plywood.

The slower growth in residential construction in 2007 will reduce the growth in demand for plywood, especially softwood plywood, on the European export market. An increase in supply is expected to lead to tougher competition and to limit any rise in plywood prices. The increase in plywood supply in 2007 will include expanded production in Eastern Europe. In particular, the supply of birch plywood...
from Russia and the Baltic countries is expected to increase further, despite growing domestic consumption as housing construction expands. China is also expected to continue increasing its supply of birch and softwood plywood to Europe and is already the second largest source of plywood imports to the United Kingdom. Imports of tropical plywood from Indonesia, Malaysia and Brazil have been on the decline.

Although China already accounted for 15% of Germany’s imports of non-tropical hardwood plywood at the start of 2006, Finland was still Germany’s biggest supplier, with a share of about 20%. The competitiveness of Finnish producers of high-quality birch plywood is expected to remain good in the years to come. Chinese birch plywood is not yet a serious rival to birch plywood from Finland, Russia or the Baltic countries in many of the main areas of use, because of differences in quality and other properties. Due to the intensified competition on the European market, the nominal average price of Finnish plywood exports in 2006 is forecast to rise more slowly than in 2006, the year-on-year increase being about 2%. Production capacity will start to limit the growth in production, while exports are expected to grow by about 1%.

2.2 Exports and Production in the Pulp and Paper Industry

The demand for paper on Finland’s main export markets in Western Europe has risen slightly in 2006. The increase is difficult to estimate, however, because the 2005 figures were affected by the labour market dispute in the Finnish paper industry, which lasted almost two months. The industry’s production and export figures for 2006 will therefore show an exceptionally high year-on-year growth, averaging 15%. The long decline in paper prices came to a halt in autumn 2005, although the price trend in Finnish paper exports in 2006 shows only a modest rise because of the oversupply situation in magazine and fine papers. The rise in prices will be sufficient to cover the increase in production costs. The 2006 export price of paper will be only about 1% higher than the average for 2005, whereas the average export price of pulp will be up by about 16%.

Paper consumption in Western Europe in 2007 will continue to rise by a modest amount, provided that the forecasts of relatively good GDP growth are borne out in practice. Higher demand will improve the opportunities for passing on the increase in production costs to the prices of paper and paperboard. In Finland, paper production and exports are expected to be 3% down in 2007, due to the production unit closures undertaken in 2006 and planned for 2007. The drop in paper production and the increase in market pulp production will allow more pulp to be exported. A further incentive for exporting pulp in 2007 will be its price, which is expected to be above the 2006 average. The average export prices of paper and paperboard are forecast to rise by 2–3% in 2007.

Oversupply and Higher Costs Have Led to Production Capacity Closures in Western Europe

In the past five years the consumption of paper on the Finnish paper industry’s main markets has grown very slowly. Estimated consumption of paper and paperboard in Western Europe in 2005 was only less than 1% above its 2000 level, according to the FAO. As paper producers had prepared themselves for a greater increase in demand, and had thus added substantially to their production capacity since 2000, the entire paper industry has experienced oversupply for a number of years. This oversupply situation has been eased by the additional exports to Asia and the rapid growth in paper demand in the still modest paper markets of Eastern Europe. Western European paper exports to markets outside Western
Europe have increased by about 14% in the period 2000–2005, according to the FAO. However, it will be difficult to increase exports of printing and writing papers to Asia beyond their present volumes because of the emerging oversupply situation there too. In China, particularly, dependence on imports has been declining, and the country’s own paper exports are on the increase.

The four-year decline in paper prices came to a halt in 2005, when prices began to rise a little. The increase in costs, especially energy costs, has, however, largely or completely eroded the benefit gained from the slight rise in prices. On account of the strong euro and rising costs, producers have decided to close a number of production units in Finland in order to improve their profitability. These closures, taking place in 2006 and 2007, mean a total reduction of about 740,000 tonnes of annual paper production capacity.

**Advertising and the Demand for Printing Papers Have Picked Up in 2006**

The demand for printing papers is affected by the level of consumer income, reading habits and the demand for printed advertising, which is closely linked to the state of the economy. The recovery in the German economy, for instance, has led to a growth in magazine advertising. According to the German magazine publishers’ umbrella organisation (Verband Deutscher Zeitschriftenverleger), the number of advertising pages in German magazines increased by over 4% in the period January–October 2006 compared with the same period the previous year. Germany accounts for about one third of all magazine paper consumed in Western Europe. In the five largest Western European economies, the value of all printed advertising is forecast to be up in 2006 by about 1.5% on the previous year’s figure. In addition, the growth in newspaper advertising has been faster than average (Ad Barometer).

Figures from the Association of European Publication Paper Producers (Cepiprint) and the European Association of Fine Paper Manufacturers (Cepifine) indicate that in January–September 2006 the estimated European consumption of printing and writing papers was up on the previous year’s figures as follows: newsprint 2.7%, uncoated magazine paper 5%, coated magazine paper 1.3%, uncoated fine paper 0.7% and coated fine paper 1.9%. Consumption of containerboard and folding boxboard in Western Europe has also grown in comparison with the same period in 2005. Estimation of the real

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<th>The Finnish pulp and paper industry, 2005, 1000 tonnes.</th>
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<td>Production</td>
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<td>Domestic use*</td>
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<td>Exports:</td>
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<td>Russia</td>
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<td>Other</td>
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* Estimated domestic use = production – exports
Sources: Statistics 2005 (Finnish Forest Industries Federation) and Finnish Forest Research Institute
growth in consumption in most product groups is, however, difficult because of the long labour market dispute in 2005 in the Finnish paper industry, which led to a substantial reduction in the supply of paper and paperboard.

Paper prices have risen modestly in the wake of cost increases, but prices have fallen short of the paper industry’s targets. Price monitoring by Foex Indexes Ltd shows that in the period from January to mid-November 2006 the price of newsprint rose the most among paper prices, by 6%. However, newsprint forms only a small proportion (about 5%) of Finnish paper exports. The price trend for Finland’s most important grades – coated magazine and fine papers – has been weaker: in mid-November the prices of these grades were at their January level. Prices of folding boxboard have remained unchanged, whereas prices of containerboard, lining and especially fluting are significantly above their 2005 year-end level.

In North America, demand weakened for all printing paper grades in the first half of 2006, according to information from producers. Nevertheless, prices have been above those of a year earlier. The PIX price for newsprint in mid-November 2006 was 3% higher than at the start of the year. A major contributory factor in the price rises has been the cut in supply, as producers have gradually closed down their older machines, and the capacity cuts have continued in 2006. The American Pulp and Paper Product Council estimates that newsprint capacity in North America will shrink by almost 5% in 2006, and by a further 1% in 2007. Coated magazine paper capacity has also been reduced significantly since 2005.

In Asia, demand for printing and writing papers has continued to grow in 2006. As a result of increases in production capacity, however, there is now an oversupply of coated printing papers in Asia. Fine paper prices in the first half of 2006 were at the previous year’s level, according to information from producers.

Record Production in Finnish Paper Industry in 2006

Finnish paper production reached an all-time record in the first half of 2006. The industry’s new collective agreement allowed paper production to continue over the Midsummer holiday for the first time. Information from the Finnish Forest Industries Federation shows that 40% of paper mills and almost all pulp mills were operating at Midsummer. Demand for printing and writing papers is likely to remain fairly high in the remainder of 2006. Although the paper machine closures in June will affect the production figures for the second half of the year, Finnish paper and paperboard production for the full year 2006 is forecast to rise to a new record, 14.1 mill. tonnes. This represents a substantial increase of 14% on the exceptionally low production in 2005.

The increased costs in the paper industry are adding to the pressure on prices. Labour costs are rising steadily and the high price of oil is affecting both materials and transportation costs. In Finland, the price of pulpwood also began to rise in the first half of 2006. In addition, the high pulp price is adding to costs for those producers who rely on purchased pulp. Pulp production is in fact currently more profitable than paper production. The PIX price of long-fibre pulp (softwood pulp) in mid-
November 2006 was about EUR 570/tonne, or 12% above its January level. The price of hardwood pulp has also risen slightly, by about 4%. Hardwood pulp production capacity has increased with the introduction of new mills in South America and China, but higher demand has prevented the emergence of an excess of supply. The average export price of Finnish paper and paperboard in annual terms is forecast to be up by about 1% in 2006, and for pulp by as much as 16%.

**Finnish Companies Expanding in South America and China**

The focus of new investments in the pulp and paper industry is currently in South America and China, where consumption is growing rapidly and production costs are low. In Western Europe and North America, excess capacity and the slow growth in paper demand do not favour new investment. Paper industry investment in Western Europe and North America is instead directed mainly at maintaining existing machines.

Finnish producers have been actively involved in investment projects in both Asia and South America. In 2005, a eucalyptus pulp mill in which Stora Enso has a 50% holding was opened in Brazil, and Metsä-Botnia is currently constructing a similar mill in Uruguay with an annual production capacity of about 1 million tonnes. The latter project, which has met with strong opposition from many Argentinians, is likely to be completed in the latter half of 2007. In China, UPM introduced a new fine paper machine in 2005, and both UPM and Stora Enso have a number of Chinese investment projects in progress or planned, including the production of self-adhesive laminates, liquid packaging board and pulp. For more on the Chinese market, see the Featured Topic at the end of this publication.

**Paper Production in Finland Will Be Down in 2007 but Prices Will Rise**

The GDP growth forecast for Europe in 2007 will mean a slight increase in both consumer demand and advertising, but the growth in demand for paper in an already mature market will remain modest. According to the Association of European Publication Paper Producers (Cepiprint), the European market for printing papers will still suffer from oversupply in 2007, with coated fine and magazine papers affected the most. In 2006 and 2007, UPM, Stora Enso and Myllykoski will close down a total capacity of about 1.2 million tonnes of coated and 0.5 million tonnes of uncoated printing papers in Western Europe. In addition, M-real is considering closing down 0.5
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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<td>7950</td>
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<td>1950</td>
<td>2350</td>
<td>2450</td>
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<td>17</td>
<td>-1</td>
<td>-13</td>
<td>20</td>
<td>4</td>
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<tr>
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<td>11000</td>
<td>8973</td>
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<td>2163</td>
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Forecasts of export prices for pulp and paper products (as percentage change from previous year)*

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<th>2005</th>
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<td>Chemical pulp</td>
<td>(407 €/tonne)</td>
<td>16</td>
<td>6</td>
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<tr>
<td>Paper</td>
<td>(591 €/tonne)</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Paperboard</td>
<td>(677 €/tonne)</td>
<td>0</td>
<td>2</td>
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* Export prices are nominal unit values.

mill. tonnes of its fine paper capacity in 2007. The full elimination of oversupply is a particular challenge, as the sector’s smallest producers are ready to fill the market gaps left by the larger companies. The production capacity of each unit is also rising continuously as de-bottlenecking and learning make operations more efficient.

The oversupply of paper is expected to fall as consumption increases and production units are closed. Producers will also be forced to increase prices as a result of cost pressures, including higher prices of energy, roundwood, chemicals and pulp. Many companies already announced price rises during autumn 2006. M-real, for instance, announced that it intends to introduce a 5% increase in paper and paperboard prices, and Stora Enso has also announced price increases for paperboard. Among producers of coated fine paper, Sappi and Burgo have also announced price rises to take effect in Europe from late 2006. Efforts to raise prices will be supported by the high price of market pulp in 2007, which will compel even small producers that rely on purchased pulp to raise their prices.

The export price of Finnish paper in 2007 will depend to a great extent on the price negotiations conducted at the end of 2006 to determine the price level of longer term supply agreements. Provided that the relatively favourable forecasts of growth in the world economy materialise, the conditions for a rise in prices will be better than they were in 2006. The average export price of paper is forecast to rise in 2007 by about 3%, and paperboard by about 2%. The export price of pulp is forecast to be about 6% above its 2006 average. Although the production capacity of both softwood pulp and hardwood pulp will increase in 2007, the growth in market demand may prevent oversupply from emerging. The price forecasts given are based on the assumption that no significant changes will occur in the euro’s exchange rate against the dollar or against other currencies of importance for exports. Any weakening of the euro would push up average export prices in the Finnish paper industry, while a strengthening of the euro would have the opposite effect.

The trend in prices will be strongly dependent on the level of growth in the world economy, about which there is significant uncertainty. If, for instance, GDP growth in the United States slows by more than expected, this would add to the growth in oversupply on the paper market, as the US would reduce its imports of paper.
Finnish paper and paperboard production in 2007 will be affected by the closures of mills and machines taking place in 2006 and early 2007. Exports of paper and paperboard are expected to be down by about 2% in 2007. The drop in paper production will, however, allow more pulp to be exported, and a further incentive for this will be the price of pulp, which is expected to be above the 2006 average. Exports of bleached sulphate pulp are forecast to be up by about 4%.

2.3 Costs and Profitability in the Finnish Forest Industry

The relationship between income and costs in the Finnish forest industry has improved in 2006 as a result of the higher prices for forest industry products and the growth in demand. Profitability in the sector will therefore be up slightly compared with the previous year. Despite this, production costs remain high and some cost elements are continuing to rise. In the wood products industry roundwood costs are the biggest challenge, whereas in the pulp and paper industry the high costs of other raw materials, such as minerals and chemicals, also have a major impact on costs. The prices of forest industry products will continue to rise in 2007, although lower production and export volumes will limit the extent of income growth in the sector. The rise in costs will at the same time slow down, however, and so profitability in all forest industry sectors in 2007 will remain at least at the level of 2006.

Short-Term Profitability Outlook More Favourable Than in Recent Years

In 2006, profitability in the section of the wood products industry owned by the major Finnish forest industry corporations has been higher than at any time since 2000, measured in terms of operating profit as a percentage of turnover. Operating conditions have improved due to the more favourable market for forest industry products, the rise in prices and higher delivery volumes. At the same time, improvements in operating efficiency have been sought through rationalisation measures, especially in the major forest industry corporations.

Considerable fluctuations in forest industry profitability have occurred in the current decade, both annually and by sector. The financial figures for ‘operating result as a percentage of turnover’ for small, medium and large-sized enterprises in the wood products industry (financial statements database maintained by Statistics Finland) and for ‘operating profit as a percentage of turnover’ for the wood products business of the three major forest industry corporations all show a similar trend in the period 2000–2003. In 2004, however, there was a significant difference between these two groups of companies. According to the Statistics Finland database, which contains data on companies that vary quite considerably in size, profitability in the wood products industry in 2004 was negative, whereas in the same year the figure for operating profit as a percentage of turnover reported by the wood products businesses of Finnforet, Stora Enso and UPM rose to more than 3%. The latter figures are unadjusted balance sheet items, while the Statistics Finland figures are adjusted balance sheet items. Data for 2005 were not yet available from Statistics Finland, but the 2005 profitability figures for the major forest industry corporations indicate a degradation back to the level of 2001. Business profitability in 2006 and 2007 is expected to improve again in both the major corporations and the smaller wood products companies, partly as a result of income growth and partly due to the efficiency drives being undertaken, especially in the major corporations.

The profitability of pulp and paper industry products in 2006 has been aided by the favourable demand situation in the sector and the corporate restructuring undertaken to improve competitive-
ness. This situation is expected to continue in 2007 as a result of the improved market and the efficiency programmes planned for the near future.

A return to the profitability levels seen in the pulp and paper industry in 2000, however, would require a significant change in the operating conditions for the industry, whose profitability has been very low in recent years. This is illustrated in the accompanying figure, which shows the financial performance of the major forest industry corporations in terms of operating profit as a percentage of turnover for the period 2000–2006. This was in excess of 16% in 2000 but subsequently fell steadily year by year, descending to a level of only just a little over 2% in 2004. In 2005 the figure rose slightly, and in 2006 it will be just below 4%.

In countries with high costs, forest industry companies have only limited scope for reducing their production costs, and their ability to influence world market prices for bulk products is virtually non-existent. By further processing their products, producers can manufacture higher priced products that are better able to cover the costs of the production factors needed to make them. This has not yet happened in the Finnish forest industry, however, as the degree of gross value added in relation to turnover has in fact fallen in the last ten years in all sectors of the industry, which has led to a situation where, at industry level, manufacturing costs have risen by more than the income obtained from the products sold, thus contributing to poor profitability.

**Roundwood Costs Are a Major Challenge in the Wood Products Industry, While the Pulp and Paper Industry Is also Affected by Other Raw Material Prices**

Roundwood costs in the wood products industry are the most significant individual cost item, comprising about one third of the sector’s total costs. Most of the industry’s roundwood, which is mainly procured domestically, is processed by the sawmilling and plywood industries. Roundwood costs have risen in 2006 due to the 6–8% rise in softwood sawlog prices, which particularly affects the profitability of sawmills but also that of plywood producers who use spruce and birch. In 2007, the sawmilling industry’s roundwood costs will rise by a lesser amount because the increase in softwood sawlog prices will be lower than in 2006.
The wood products industry is unlikely to ease its long-established problem of high raw material costs by resorting to the use of imported roundwood, because imported sawlog prices are on the increase. The average price of imported sawlogs at the start of 2006 was 2–3% above the same figure a year earlier. Following Russia’s imposition of higher duties on its exported softwood in June 2006, and with another rise planned for summer 2007, it is possible that further increases could occur in the coming years.

In the pulp and paper industry, roundwood costs account for about one sixth of total costs. Approximately three quarters of the industrial wood used in the sector is of domestic origin, the rest being imported. Some 20% of the sawmill chips used are imported. The prices of all pulpwood species are expected to be up by 4% for 2006 as a whole, and the prices of both domestic and foreign sawmill chips have also risen in 2006. The industry’s roundwood costs will thus be up slightly in comparison with the previous year. In 2007, it is forecast that the prices of industrial wood consumed by the pulp and paper industry will rise by less than in 2006, the increase being 2% for all pulpwood species.

The minerals and chemicals used in the production and bleaching of pulp and in the manufacture and coating of paper, and the other raw materials needed in production, together comprise about one fifth of costs in the pulp and paper industry. The world market prices of the minerals and chemicals used are affected by the price of the raw materials, energy and fuel needed in their production and processing, and by the level of demand for them. The rise in mineral and chemical prices in the past few years has been the result of a rise in the costs of producing them and the increased demand globally, which has been growing even faster than consumption of printing and writing papers. The reasons for this have included the expansion of the pulp and paper industry into new markets and various changes that have occurred in the production of different paper grades. The rise in market prices of minerals and chemicals in the pulp and paper industry has been high both in real terms (about 8% in the period 2002–2004) and in relation to other costs. Due to the growing demand for minerals and chemicals and the high costs of producing them, their prices on the world market are expected to show a further rise both in 2006 and 2007.

Labour costs represent about one sixth of total costs in both the wood products industry and the pulp and paper industry. Under the wage policy agreement in force until September 2007, forest industry pay was raised by 1.9% in June 2006, in addition to the 2.5% increase introduced in March 2005. Labour costs in 2007 are forecast to be at about the same level as in 2006. Labour productivity in the pulp and paper industry will show an improvement in 2006 as a result of the opportunity to keep mills running during the Midsummer and Christmas holidays, as negotiated in the industry’s collective agreement.

Direct energy costs account for approximately one tenth of total costs in the pulp and paper industry, whereas energy costs in the wood products industry form a much lower proportion of total annual expenditure. Indirectly, fuel and electricity nevertheless affect almost all cost items through their impact on manufacturing and transportation costs. Oil prices will remain high in 2006 and energy prices will be up on the previous year’s figures, and this is expected to continue in 2007. In the pulp and paper industry, however, the rise in energy costs will be balanced out by energy self-sufficiency, as about half of the electricity used in the sector is produced by power plants owned by pulp and paper producers themselves. The rise in energy prices has led to a focus on the energy efficiency and self-sufficiency of production units in the forest industry, which has been evident as an increase in energy investments by companies in recent years. There are nevertheless considerable differences between companies in their self-sufficiency in electricity: UPM has the highest level, with 100% self-sufficiency in its Finnish operations and 70% in its international production.
Higher Product Prices Mean Improved Conditions for Doing Business

The unexpectedly favourable trend in housing construction in Europe has boosted the demand for sawnwood and raised both spruce and pine sawnwood prices. The unit price of exported sawn softwood is expected to be up by about 7% for the full year 2006, and plywood by 3%. In 2007, price rises are forecast to be no more than about 2%, due to tougher competition.

The price of pulp is expected to be up by a total of 16% in 2006. This large increase is a result of both a growth in demand and the delay in completion of a number of mill projects internationally. The demand for paper and paperboard has grown slightly in the key markets for Finnish companies. The demand and price trends in newsprint have also been good, though this is of lesser importance for the Finnish industry. The average prices of paper and paperboard grades – which are more important for business – will be up by only 0–1% in 2006. Export prices for pulp in 2007 are expected to be above the 2006 average, while export prices of paper and paperboard are forecast to rise by 2–3%, which is higher than in 2006.

The price of the wood raw material used in the sawmilling and plywood industries and the other raw material costs in the pulp and paper industry are forecast to remain either unchanged or, in some cases, to rise slightly in the near future. Electricity and energy costs are forecast to rise further, with a direct impact on the pulp and paper industry in particular, and indirectly on the entire forest industry.

Despite production costs remaining high, the conditions for growth in the Finnish forest industry in 2006 have been more favourable than in the past couple of years. In the wood products industry the improved price trend for its products has balanced out the adverse profitability impact of higher production costs, whereas in the pulp and paper industry in particular, efforts have also been made to improve profitability by corporate restructuring aimed at boosting efficiency.

Although forest industry product prices will rise in 2007, the growth in corporate income in the industry will slow down as a result of a drop in production and export volumes. Based on production volumes and product prices, the increase in income that can be expected in 2007 will nevertheless be a little greater than the rise in direct costs. This is because improved capacity utilisation will reduce the impact of changes in total costs. As a consequence, profitability in both the wood products industry and the pulp and paper industry in the coming year will be at least as good as in 2006.