Summary

The 2006 figure for growth in the world economy will be higher than expected, and forecasts indicate that growth in 2007 will again be fairly high, although a slowdown in the United States economy will have an adverse impact on growth elsewhere in the world. The demand for paper on the main European markets will be up slightly for the full year 2006, but prices will be little changed from 2005. By contrast, sawnwood prices will be up considerably due to the growth in housing construction. The demand for domestic roundwood will be up in 2006 as a result of increased production in the forest industry and the lower level of roundwood imports. This will push up average stumpage prices for the year.

In 2007, GDP growth in Europe will still be relatively good, which will ensure continued modest growth in paper consumption. Higher demand will improve the opportunities for passing on the increase in production costs to the prices of paper and paperboard. Consequently, there will be a moderate rise in the average export price of Finnish paper. Paper production is nevertheless expected to be slightly down in 2007 as a result of the production unit closures undertaken in 2006 and planned for 2007. Besides this drop in production, the closures will also mean a slight decrease in exports of paper. Pulp exports will, however, be up on the 2006 figure. Production and exports of sawnwood will be adversely affected by tougher competition on the Western European market due to lower growth in housing construction in many export markets. Demand for domestic roundwood will remain high in 2007 because production in the forest industry will fall only slightly, and because there will be no increase in imports. In annual terms, the rise in stumpage prices is forecast to be lower than in 2006.

GDP Growth on Export Markets Still Relatively High

GDP growth in the euro area economy for the full year 2006 will be higher than the previous year, but in 2007 it is expected to slow down a little. Among the Finnish forest industry's key export markets, Germany's economy has been improving, although its annual GDP growth for both 2006 and 2007 will be below the euro area average, by about half a percentage point. The United Kingdom economy continues to be on a steady growth track, with GDP growth of about 2.5% forecast for 2006 and 2007. The rise in interest rates in the euro area will probably continue at least in the first half of 2007, impeding growth in housing construction. In the United States, no additional interest rate rises are anticipated, but construction is expected to decrease further. Russia's GDP growth will continue to be strong, and growth in China's economy will again be around 10%. Japan's economy will grow by more than 2%.

The main uncertainty in growth forecasts for the world economy is again the prospect of a slowdown in the US economy. Although its GDP growth is expected to slow in a controlled manner, there is a risk that a sharper fall may occur if house prices collapse, if indebted households' confidence in their personal finances drops and if crude oil prices are high. A possible sharp drop in private consumption as a result of these factors could lead the US economy into recession, which would quickly have an impact on the entire world economy in 2007.

Modest Rise in Pulp and Paper Industry Export Prices

The demand for paper on Finland's key export markets in Western Europe has picked up slightly in 2006. The long decline in paper prices came to a halt in autumn 2005, but the oversupply of magazine and fine papers has prevented anything more than modest price increases in Finnish paper exports in 2006, though these have been enough to cover the rise in production costs. Nominal prices of paper and paperboard exports will exceed the average 2005 level by only 1%. The average export price of pulp, on the other hand, will be up by about 16%.

In 2007, a continuation of the relatively high GDP growth in Western Europe will ensure moderate growth in paper consumption, which will encourage producers to transfer the rise in production costs to paper prices. The production unit closures in Finland in 2006 and those planned for 2007 will be evident in the production and export figures, which are forecast to be down by 3% in 2007. The drop in paper production and an 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. Average prices of paper and paperboard exports are estimated to rise by 2–3%.

Sawnwood Price Increases Will Be Limited Due to Greater Supply on Export Markets

The demand for sawnwood has increased in 2006 in Western Europe on account of the unexpectedly high growth in housing construction. Along with the increase in demand, sawnwood prices have also risen significantly since the start of the year, due to the scarcity of supply. This scarcity has been due not only to the low availability of sawlogs but also because the major sawnwood producer countries have been focusing attention on export markets outside Europe.

The nominal unit price of Finnish sawnwood exports for the full year 2006 is expected to be up by almost 7%. Production and exports of sawnwood will be up by 2% but will nevertheless be significantly below their 2004 level because of the decrease in production capacity in recent years. In 2007, competition is expected to be tougher on the Western European export market. Sawnwood price increases will be kept in check because of higher sawnwood production and a weaker trend in construction. The rise in the unit price of Finnish sawnwood exports in 2007 is forecast to be lower than in 2006, at about 2%, and at the same time the volume of production and exports will fall slightly.

Rise in Prices Brings Only a Small Improvement in Forest Industry Profitability

Production costs in the forest industry have continued to rise in 2006 as in previous years, but the increase in final product prices and the rising sales volumes will mean a slight improvement in profitability in the sector compared with 2005. For the wood products industry, roundwood costs are the biggest challenge, whereas the pulp and paper industry's costs are also affected by the high price of other raw materials, such as mineral and chemicals. The rise in forest industry product prices will continue in 2007, but a drop in production and export volumes will inhibit income growth in the sector. The increase in costs is expected to slow down, however, which will mean that profitability in all sectors of the forest industry in 2007 should be at least at the level of 2006.

Roundwood Prices Rise and Sales Focus Is on Pulpwood

The increase in production in the paper industry has boosted fellings of domestic pulpwood in 2006. The volume of sawlog fellings will be down, however, despite slightly higher sawnwood production, because the industry's roundwood need has been largely met from stocks of harvested roundwood. Roundwood imports will be down by about 3%. Overall, domestic commercial fellings will be about the same as in 2005, at almost 53 mill. m^3. Softwood sawlog prices have risen briskly in 2006 due to the restricted supply caused by the change in forest taxation at the start of the year. Average prices of spruce and pine sawlogs will be up by 6–8% for the year as a whole, while pulpwood prices will be up by about 4%.

In 2007, a drop in production volumes in both the paper industry and the sawmilling industry will mean a slight reduction in their roundwood needs. Roundwood imports are not expected to exceed the 2006 level, and will total about 20 mill. m^3. The focus of demand will shift towards domestic roundwood supplies, and the volume of fellings will be up as a result of the reduction in stocks in 2006. Fellings of pulpwood are forecast to be up by about 5%, and average stumpage prices to rise by 2% for the full year. Pine and birch sawlog prices will rise by 3–5% on account of the favourable demand and price trends for pine sawnwood and birch plywood on the export markets. The most significant uncertainty on the roundwood market in 2007 will be the availability and price of wood imported from Russia.

Further Cut in State Subsidies for Timber Production

The overall investment in timber production in non-industrial private forestry for the full year 2006 will be more than EUR 175 mill., which is an increase on the previous year's figure. The level of investment in 2007 is expected to be slightly higher still, though this will require an increase in the amount of financing by the private forest owners themselves, to a total of almost EUR 120 mill. This is because the Government's budget proposal incorporates a cut of almost 10% in the funds intended for securing timber production. The subsidies available for this in 2007 will be approximately EUR 58 mill.

The 2006 figure for per-hectare net earnings in non-industrial private forestry will be down by 3%, to EUR 86/ha. This is primarily attributable to the drop in sawlog fellings and the forest industry's use of its record stocks of harvested wood. In 2007, an increase in fellings is expected to raise net earnings to over EUR 90/ha. The overall return on timber production in 2006 will rise to 9%, and in 2007 it will be almost 6%, which is still significantly above the ten-year average.

Assumptions and Uncertainties in Forecasting

The aim of this *Economic Outlook* is to present clear and consistent information and analysis on the current state of the entire Finnish forest sector and the outlook for the sector in the near future. The forecasts for the forest sector are based on publicly available statistics, world economic forecasts, market information, other forest sector data, and research conducted by the Finnish Forest Research Institute. The views of GDP growth in the world economy and in export markets have 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 2006 and 2007 and are based mainly on information available in late September and early October 2006.

The forest sector forecasts presented here are the views of researchers about the most likely course of events. They are point forecasts and are based on export market GDP forecasts and other background assumptions about the markets. The greatest uncertainty in the forecasts is that unexpected changes in GDP growth may occur. Once again this concerns particularly the performance of the United States economy and the price of crude oil. The uncertainties in the US economy could affect currency markets and jeopardise the level of world GDP growth and therefore also growth in the euro area. If GDP growth in the main export markets 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 prevailing over-supply, forcing down prices. If there is an unforeseen weakening of the US dollar against the euro, this would hamper European export prospects and increase the pressure on purchasers to obtain supplies from countries outside Europe.

If the GDP growth in export markets is below the forecasts given here, this will affect export prices, production and profitability in 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.

Key forecasting variables, 2006–2007.

Forecasting variables	2006*	2007*
	% change from previous year	
Paper production	15	-3
Paper export	15	-3
Paper export price	1	3
Sawnwood production	2	-1
Sawnwood export	2	-1
Sawnwood export price	7	2
Commercial fellings	1	3
Roundwood imports	-3	0
Sawlog prices	3–8	1–5
Pulpwood prices	4	2

*price changes are nominal