2 The Finnish Forest Industry

2.1 Production and Exports in the Sawmilling and Plywood Industries

The market for sawn softwood in Western Europe has weakened considerably, as the effects of the economic downturn in the US housing market are felt in Europe. Housing starts in Western Europe in the first half of 2008 were down significantly on the same period the previous year. This has had a significant adverse impact on sawnwood demand and prices, and the Finnish market too is experiencing a drop in sawnwood demand as a result of the reduced level of housing construction. Production cuts are nevertheless expected to reduce producers’ sawn softwood stocks in the second half of 2008, which will curtail the fall in prices. The average export price of Finnish sawnwood for the full year 2008 is expected to be down by about one fifth, and both production and exports are expected to be down by the same percentage. A fall in production of a similar magnitude last occurred in 1981–1982.

Finnish sawnwood exports to the euro area in 2009 will be slightly down again, by about 3%, due to the further decline expected in euro area sawnwood consumption as a result of the decline in housing construction. Production costs will remain high, and this is likely to limit sawnwood production in Europe, which will reduce the oversupply on the European market. The absence of Russian roundwood on the world market could also reduce the oversupply, leading to a slight strengthening of sawnwood prices in Europe in the latter half of 2009. China and Japan, both major importers of Russian wood, may meet some of their roundwood needs by importing more processed and converted products, such as sawnwood. No significant rise in prices can be expected before a revival in Europe’s construction sector, however. The average export price of Finnish sawnwood in 2009 is expected to be below the average for 2008.

The cyclical trend on the plywood market has been less pronounced than on the sawnwood market. The average unit price of plywood exports in 2008 will be up by about 6% on the 2007 figure, due to the relatively favourable price trend for birch plywood. The volume of exported plywood will be down in comparison with 2007, due to the lower growth in plywood consumption on the Western European market as a result of the trend in the construction sector. In 2009, plywood consumption in Western Europe is expected to decline further, which will in turn reduce the volume and price of softwood plywood exports in particular.

Housing Construction Outlook Still Weak in 2009

European consumption of sawn softwood in 2007 was up by almost 5% on the previous year’s total, due primarily to the high level of construction in the first half of the year. In 2008, demand has fallen on account of the slowdown in construction. Euroconstruct’s June 2008 forecast indicates that new housing construction in Western Europe will be down for 2008 as a whole by over 8% on the 2007 total, and that in 2009 the year-on-year decrease will be 5%. The growth in building renovations will be close to zero in both 2008 and 2009, which will
The Finnish Forest Industry do nothing to aid the demand for sawnwood. In North America and Japan, too, sawnwood demand and consumption are falling. In the United States, the sawmilling industry has adjusted itself to the fall in demand and to lower sawnwood prices by instituting significant cuts in capacity. Demand will continue to fall in the remainder of 2008, and will remain low in 2009. In Japan, there was a slight setback in the demand for sawnwood due to certain problems related to the granting of building permits in 2007. Although the construction sector is faring better in the latter half of 2008 than in the first half of the year, the weakening economic trend will probably reduce the level of construction in 2009.

In Finland, the number of housing construction permits granted in January–June 2008, in terms of cubic metres, was down by about a third on the same period the previous year. According to forecasts by Euroconstruct, there will be a further reduction in new housing construction in 2009. With the forecast growth in building renovations only partially compensating for the drop in sawnwood demand in new construction, consumption in both 2008 and 2009 will be down by 2–3% on the 2007 figure of 5.1 mill. m³.

In the first half of 2008, sawnwood demand was growing in Eastern European countries with active infrastructure programmes, especially Russia, and in the oil-producing countries of North Africa and the Middle East, as well as in China. Economic growth in Russia and in African oil-producing countries is dependent on the price of crude oil, which is on a declining trend according to various assessments.

Slowdown in Housing Construction Keeps Prices in Check

The decline in construction seen on Western European markets towards the end of 2007 led to oversupply in the sawnwood market and a rapid drop in sawnwood prices. This has continued during 2008 with a further decline in construction. In the near future, the pressure for a decrease in prices will focus particularly on construction sawnwood. The falling level of world trade accompanying the deterioration in economic trends is creating downward pressure on the price of packaging grades, whereas the supply of weaker sawnwood grades is plentiful because storm-damaged wood is still being milled in Europe. The profitability of exports to markets outside Europe has fallen as a result of the rising shipping costs and the strong euro.

Export prices of Finnish sawnwood have been falling in 2008. Figures for January–July 2008 show that the year-on-year fall in export prices was 12% in the case of spruce sawnwood and 15% for pine sawnwood, and the nominal export prices for sawn softwood returned to their summer 2006 level. According to the HWWA index of sawnwood prices, the prices of sawnwood in Europe were still on the decline in August 2008. This decline is likely to slow in

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<tr>
<th>Sawnwood</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>EU</td>
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<td>Russia</td>
<td>9</td>
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<td>Other</td>
<td>165</td>
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*Estimated domestic use = production – exports

Sources: Finnish Forest Industries Federation and National Board of Customs.

![Graph: Volume and unit value of sawnwood exports, 1997–2009 at 2007 prices (wholesale price index).]
the latter half of the year, when production limits begin to result in lower sawnwood stocks. The unit price of Finnish sawn softwood exports for the full year 2008 is expected to be 18% below the average for the whole of 2007.

The volume of Finnish sawnwood exports has fallen significantly during 2008, down by 18% in January–July compared with the same period the previous year. The fall in export volumes has been particularly marked for spruce sawnwood, both to Europe and to non-European destinations. The supply of spruce sawnwood in Europe has been plentiful because of supply of storm-damaged wood in early 2007. Sweden, a key competitor country for the Finnish forest industry, has been able to increase its exports of spruce sawnwood on account of the volume of storm-damaged wood and the favourable exchange rates. Finnish exports of pine sawnwood fell by less than those of spruce sawnwood. More than half of Finland’s pine sawnwood exports went to markets outside Europe, especially Egypt, Algeria and Israel, whose combined share of all sawnwood exports rose to one fifth. Sawnwood demand on the main European markets will continue to be weak in the latter half of 2008, bringing the drop in Finland’s sawnwood exports to about 18% for the year as a whole in comparison with 2007.

Gentle Rise in Sawnwood Prices in 2009?

The main factors affecting the sawnwood export market in 2009 will be the reduced level of GDP growth and housing construction in Western Europe and, indirectly, the increases in Russia’s roundwood export duties. The economic outlook will also remain poor in North America and Japan. Although economic growth in the Middle Eastern and North African countries will continue to be good, exports to these markets will not be sufficient to compensate for the decrease in Finland’s exports to markets in Europe.

The fall in sawnwood prices in Europe has reduced the profitability of sawnwood production, and this has led producers in Finland and elsewhere to issue warnings of possible further cuts in production before the end of 2008. In Canada, sawnwood production was down in January–May 2008 by 23%, and in the United States by 16%, in comparison with the same period a year earlier. In the first half of 2008, the production cuts turned the US sawnwood price trend back onto a rising track, following its decline since 2006.

The production cuts made in Europe and North America are expected to slow the fall in sawnwood prices in the near future. A further factor affecting prices will be Russia’s increase in its roundwood export duties at the start of 2009, which is likely to bring an end to exports of Russian roundwood. In Finland, the efficiency of roundwood procurement has been improved in anticipation of the end of sawlog imports from Russia, whereas the Japanese wood products industry and China’s massive furniture industry are dependent of imports of Russian wood because of the scarcity of their own forest resources. China has attempted to reduce its import dependency by investing in Russia’s wood products industry.

With Russian roundwood no longer available on the world market in 2009, some of Japan’s and China’s roundwood needs will probably be met through increased imports of processed and converted products, such as sawnwood and plywood. This is likely to increase the demand for products of the North American, Russian and European wood products industries, which would lead to a slight rise in sawnwood prices in Europe too during 2009. Russia’s scope for expanding its supply of sawnwood exports to any significant degree is limited in the short term, as the country’s current programmes for promoting housing construction will increase the need for wood products on its domestic market. However, with construction expected to slow further in Europe during 2009, the rise in sawnwood prices will not be significant. Finnish export prices are expected to follow the strengthening price trend in Europe in the latter part of 2009. The rise in prices will nevertheless be so gentle that the average price of Finnish exports will still show a fall in 2009 in comparison with 2008, and the volume of exports is forecast to be down by about 3%.

Most forecasts indicate that GDP growth and the construction sector will not begin to pick up significantly in Europe and the United States until 2010. The sawnwood market may
then see a rapid increase in prices similar to that experienced in the economic upswing that began in summer 2006. Besides demand, a key factor in the cyclical trends in the sawnwood market in recent years has been the fluctuations in raw material availability. In addition to Russia’s export duties, the volume and price of wood raw material available could be affected considerably by factors such as the amount of storm damaged wood on the market.

**Decline in Profitability Reduces Sawnwood Production**

The profitability of Finnish sawnwood production has fallen significantly during 2008 on account of falling sawnwood prices and high raw material costs, and the situation is rather similar in the Baltic countries and in Central Europe. The increase in Russia’s roundwood export duties at the start of 2009 will mean that the import of Russian roundwood will no longer be profitable. With this in mind, imports principally of spruce sawlogs from Sweden, Germany and elsewhere have already begun in order to bridge the shortfall.

The drop in sawnwood prices has meant an unfavourable trend in the price relation between softwood sawlog and sawn softwood for the Finnish forest industry in the first half of 2008. Sawmilling profitability has also declined elsewhere in Europe as sawnwood prices have fallen. Given the current cyclical decline in demand, there is a need for production limits in Europe in order that the imbalance in demand and supply can be redressed.

With the decrease in sawnwood demand and prices, Finnish production was down in January–July 2008 by one fifth on the previous year’s figures. The drop in spruce sawnwood production was 29%, and in pine sawnwood production 14%. Finnish sawnwood production for the full year 2008 is estimated to be approximately 9.9 mill. m³, or about 20% below the 2007 total. A relative reduction in sawnwood production levels of the same magnitude was seen in 1981–1982, when export price competitiveness was improved by a devaluation of the Finnish markka.

**Two-Track Plywood Market**

As with sawnwood, the market for plywood varies greatly from one part of the world to another. In North America, plywood consumption has fallen with the contraction in the construction sector,
and production has been cut. This trend will probably continue in 2009 as well. In Europe, plywood consumption grew by 8% in 2007, and plywood production by a similar level. In 2008, this growth is expected to tail off in the markets of Western Europe, however, and a reduction in consumption is forecast for 2009, due to the weakened state of the economy and the construction sector.

The construction downturn in Europe is having an adverse impact on the demand for softwood plywood in particular, resulting in a drop in softwood plywood prices in Europe. This is already evident in the price of Finnish softwood plywood. The monthly average price of exports has been declining slightly since the end of 2007, but export volumes in January–June 2008 are more or less unchanged from the same period a year earlier. By contrast, monthly prices of birch plywood have been higher than in 2007: in January–June 2008, the export price was an average of 17% higher than a year earlier. Production of high-quality birch plywood in Europe is relatively small, and so the growth in demand, which has been greater than the increase in supply, has raised the price.

The main competitors on the market are Finland, the Baltic countries and Russia, though China has also increased its supply of birch plywood to Europe in recent years.

The deteriorating economic conditions have nevertheless begun to adversely affect the demand for birch plywood, and exports of Finnish plywood to the main markets in Western Europe began to decline in the first half of 2008. The drop in exports is also due to the cuts in birch plywood production because of raw material availability and especially the higher price of imported birch sawlogs. In January–June 2007, birch plywood accounted for 48%, and in January–June 2008 for 44%, of all plywood exports. The total volume of plywood exports in 2008 will be about 6% below the 2007 level on account of the drop in exports of birch plywood. The average unit price of plywood exports in 2008 will be up by about 6%, due to the upward price trend for birch plywood in the first half of the year.

In birch plywood production, there will be a problem with raw material availability when Russia raises its export duties on roundwood in 2009. Imported softwood sawlogs accounted for about 10% of the Finnish plywood industry’s softwood sawlog consumption in 2007, and imported birch for about 29% of the birch sawlog consumption. In birch plywood production in particular, the proportion of imported birch has fallen markedly in comparison with earlier years: in 2005, imported sawlogs accounted for more than 45%. The full replacement of imported Russian birch sawlogs with imports from other sources may prove to be very difficult if not impossible, which will inevitably mean a reduction in birch plywood production in Finland. In 2009, a further contraction in the amount of construction activity and in GDP growth will lead to lower demand for both softwood and birch plywood on the domestic market and on export markets. Finland’s production and exports of all plywood are thus forecast to decrease in 2009 by 5%.

Finland is the largest plywood producer supplying the Western European market, though a considerable volume of plywood is supplied by Russia, and smaller amounts by the Baltic countries. The supply of less expensive construction grades from China and from South America has increased in recent years too. China’s growing plywood production has been reliant on imports of Russian sawlogs, and so the imposition of Russia’s export duties in 2009 will have the effect of reducing the supply of China’s plywood to Europe. The growth in construction in
central parts of Eastern Europe and in Russia has boosted plywood demand. In Russia, for example, the consumption of plywood was up by almost one third in 2007. Russia has increased its production of wood-based panels substantially since 2000, and in plywood production the increase has been about 40% since 2003. A significant proportion of this production growth has been based on raising the utilisation rate of existing capacity as far as possible. Russia has also invested considerably in plywood production in recent years, and with the completion of new production facilities its plywood production volumes are expected to further double by 2010. Finnish companies too, such as UPM and Koskinen, are investing in plywood production in Russia. In 2009, plywood prices are expected to fall as demand declines in Western Europe. The greatest fall in prices is expected to be in softwood plywood, which means that the average price of Finnish plywood exports will also fall in nominal terms by about 1%. High-quality birch plywood grades will be subject to less downward pressure on prices than softwood plywood, due to scarcer supply. In Russia, the focus on housing construction will ensure that consumption growth continues in 2009, eliminating the prospect of any growth in Russian plywood supply to Western Europe in 2009.

2.2 Production and Exports in the Pulp and Paper Industry

Paper industry capacity has been cut in Finland and elsewhere in Europe in recent years as a result of the protracted period of oversupply and the weak trend in prices. Despite this, new mills have come on stream in Europe and the sector is still affected by oversupply in relation to the level of demand. The significant reduction in GDP growth and the attendant weakening in the demand for paper have led Finnish forest industry companies to announce further closures of production facilities and machines in autumn 2008, to take effect at the end of 2008 and in 2009. With substantial cuts in production capacity, Finland’s production and exports of paper are expected to be down by about 6% in 2008, and production and exports of paperboard by about 2%, compared with the previous year’s figures. Although export prices of paper and paperboard in 2008 have risen a little on a month by month basis from the levels they reached at the end of 2007, the average nominal price for the full year will be about the same as in 2007 because of the weaker demand.

The declining GDP growth in export markets will weaken the demand for paper in 2009. With the forest industry making further cuts in its production capacity in Finland, production and exports of paper and paperboard will experience a further decrease. Production and exports of paper are forecast to be down by about 4%, and paperboard by about 3%. Despite significant cuts in capacity in the paper industry, the impact on prices will be small because of the declining demand. Nominal average export prices of Finnish paper and paperboard in 2009 are forecast to remain at around their 2008 levels.

Oversupply of Paper and Paperboard on European Market Since 2000

Growth in paper consumption on the main European markets for the Finnish paper industry has been very slow since 2000. Although there have been capacity closures in Europe, capacity has grown overall because new production facilities have also been opened. The paper industry in Finland and elsewhere in Europe has suffered oversupply throughout the period since 2000. In 2007, paper consumption in Europe was up by an average of 2.3%, although the growth in paper consumption in the member countries of the Confederation of European Paper Industries (CEPI) was only 1.2%. At the same time, consignments from Europe to non-European markets fell by 1%, although imports to Europe from such markets were up by about 20% in 2007, adding to oversupply in the market. Imports of paper and paperboard from Asia were up by
almost 100%, accounting for 13% of the imports of the CEPI countries.

According to the Association of European Publication Paper Producers (Cepiprint) and the European Association of Fine Paper Manufacturers (Cepifine), the estimated consumption of newsprint and fine paper in Europe during January–July 2008 was down by 3%, and uncoated magazine paper by 1%. By contrast, consumption of coated magazine paper rose by about 2%.

In the United States, the reduction in the consumption of newsprint and other printing and writing papers has led to cuts in production capacity since 2000, and growth has occurred only in the consumption and production of packaging and other papers. Substantial cuts have been made in newsprint capacity. Between 2000 and the start of 2008, the reduction in capacity amounted to about 30%, from the 2000 figure of 6.8 mill. tonnes. The reductions in capacity have permitted an increase in paper prices, but prices have also been affected by the weakening of the dollar. In 2007, US paper and paperboard consumption declined by 2.5% and production by 0.6%, whereas prices of pulp, paper and paperboard products were at a historical high. Prices continued to rise as the US dollar weakened in the first half of 2008, despite the impact of the economic slowdown on demand.

In Asia and Eastern Europe, the growth in paper demand has been extremely high, in contrast to other regions. Demand for printing and writing papers in Asia has continued to increase during 2008. In China, the demand for paper has grown by at an annual rate of about 13% in recent years, and the country is now the world’s second largest producer and consumer of paper, exceeded only by the United States. The growth has been so high that China’s need for imported paper will long continue, despite the increase in its domestic production. As production capacity has increased, Asia has experienced oversupply in coated fine papers, and paper has been exported to European markets and elsewhere. China is no longer a net purchaser of coated fine papers but has instead become a net supplier.

In Russia and in the other CIS countries, the consumption of paper and paperboard in 2007 grew by 7%, but production was up by only 1.5%, with imports up by 10%. Russia’s own production of paper, paperboard and pulp has grown steadily since the late 1990s but at a slow pace, which has meant that the need for imports has remained. Russia imports primarily the more expensive processed and converted paper and paperboard grades.

Substantial Cuts in Paper Industry Production Capacity

In 2007, with the trend in paper prices continuing to be weak and costs rising, Finnish companies introduced cuts in their paper and paperboard capacity in order to improve profitability. Capacity was reduced in Finland by a total of about 200 000 tonnes, and 100 000 tonnes of magazine
paper production was converted to produce specialised papers. In 2007, Finnish companies closed considerably more production capacity at their sites in other countries.

Production facility closures have continued in Finland during 2008. In January, Stora Enso closed its Summa paper mill (capacity: 80 000 tonnes p.a. magazine paper, 270 000 tonnes p.a. newsprint), and in March it closed the PK 2 machine at Anjala (155 000 tonnes p.a. magazine paper). UPM took the decision to close its PK 4 machine at Kajaani (capacity: 240 000 tonnes p.a. newsprint) in February 2008 until the end of the year, and M-real closed its PK 2 machine (100 000 tonnes p.a. coated magazine paper) at Kangas from the start of 2008. The closures mean a reduction in the paper industry’s annual production capacity in Finland of about 800 000 tonnes. In addition, Finnish companies have taken decisions to close mills and introduce production cuts at sites abroad.

In September 2008, UPM and Stora Enso announced further major closures of paper industry capacity. The reason given for the cuts in paper industry production is poor profitability due to the continuing overcapacity in Europe and the exceptionally high price increases in roundwood, energy and fuel over the past two years. In addition, the companies are preparing for the cessation of roundwood imports from Russia. UPM aims to close its entire paper mill at Kajaani (capacity: 640 000 tonnes p.a. newsprint and magazine paper) before the end of 2008. Stora Enso, for its part, aims to close its Corenso core board machine (110 000 tonnes p.a.) at Varkaus before the end of 2008, and one of its paperboard machines (180 000 tonnes p.a.) at Imatra by the end of 2009. Stora Enso is also cutting its paper and paperboard production capacity abroad by a total of about 300 000 tonnes. At the start of October 2008, M-real announced the sale of its European magazine and fine paper mills to the South African corporation Sappi Limited. According to the announcement, the Finnish-based paper mills at Kirkniemi and Kangas, which are among those being sold, will continue production as normal despite the change of ownership.

Slower GDP Growth Worsens Paper Market Outlook in Late 2008

More than half (2007: 57%) of the paper exported from Finland is magazine paper. A number of attempts have been made to raise prices over the past three years, but with little success. Prices of magazine paper and newsprint have now risen somewhat, but this falls far short of the rise in production costs and the wishes of paper producers. The state of the market varies considerably from one paper grade to the next. The demand for magazine papers continued to be relatively good in the first half of 2008, and Finnish exports were up in January–July by about 0.5% on the same period in 2007. Although the monthly average export price has risen since the end of 2007, the average price in January–July 2008

![Graph](image1)

Source: National Board of Customs

**Volume and unit value of paper exports, 1997–2009 at 2007 prices (wholesale price index).**

![Graph](image2)

Source: National Board of Customs

**Volume and unit value of paperboard exports, 1997–2009 at 2007 prices (wholesale price index).**
was nevertheless almost 1% lower than a year earlier. The demand for newsprint and fine paper was already on a downward track in the first half of 2008, following the slackening of growth in export market economies. The average price of newsprint exports in January–July was down by 5% on the same period the previous year, and the volume of exports plummeted by 24%. In fine paper exports, the average price in January–July 2008 was unchanged from a year earlier, although the volume of exports fell by 3%.

The average unit price of Finnish paper exports as a whole for January–July 2008 was similar to the figure for the same period a year earlier, and was almost 2% higher than the average price for the full year 2007. Taking into account the falling demand for paper on export markets as GDP growth declines towards the end of 2008, the average export price for 2008 is forecast to be up by only 1% on the 2007 average. The average price of paperboard rose in the first part of 2008 by about 2% and is expected to be up for the year as a whole by about 1%.

Finnish paper production and exports in the full year 2008 are forecast to shrink by about 6% on the 2007 figure, due to the cuts in production capacity. Paperboard production in the first half of 2008 was down by 3% and export volumes were at approximately the same level as the first half of 2007. The deteriorating economic situation has nevertheless begun to be felt in the packaging industry’s production, with a consequent fall in the demand for paperboard. Paperboard production and exports are forecast to be down by about 2% in 2008.

**Pulp Demand and Prices Up, But Production and Exports Down**

Although paper mills have been closed in Europe, paper production and pulp demand remained more or less unchanged in 2007. Europe’s pulp production was down by about 1%, due to the closure of a number of smaller pulp mills. However, figures from the Confederation of European Paper Industries (CEPI) show that pulp capacity decreased in Europe in 2007 by only about 0.2%, despite the drop of 2.4% in the number of mills. Pulp exports from the

CEPI countries were down by 5% and imports to these countries by about 1%. Some 50% of the imported pulp was from South America and 40% from North America.

The demand for pulp on the European market has been good during 2008 and the price of pulp has risen. New pulp capacity has nevertheless been brought on stream on the world market. A new pulp line (900 000 tonnes p.a.) was opened in Brazil in autumn 2007, and Metsä-Botnia’s pulp mill (capacity: 1 mill. tonnes) in Uruguay has started operations successfully, producing 430 000 tonnes in January–June 2008. The majority of production from these new pulp mills is intended for export to Europe.

Among the Finnish corporations, Stora Enso closed its Kemijärvi pulp mill (235 000 tonnes p.a. bleached softwood pulp) at the end of April 2008, and M-real closed its Lielahti CTMP mill (105 000 tonnes p.a.) during the year. In September, UPM announced that it is to close its Tervasaari pulp mill (210 000 tonnes p.a.) by the end of 2008.

The euro PIX price of softwood pulp in mid-September 2008 was about 4% higher than at the start of the year, and the PIX price
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of hardwood pulp about 10% higher. No further price increases are anticipated during 2008, since the demand for paper is on the decline due to the economic downturn. The average export price of Finnish pulp in the first half of 2008 was about the same as the average price for the full 12 months of 2007. Pulp prices are expected to rise in the latter part of 2008, bringing the average price for the full year to a level 1% above the 2007 figure.

Pulp production was down in the first half of 2008 by 1% on the same period in 2007. The closure of the Kemijärvi mill will further reduce total pulp production in the second half of 2008, and the full-year production is expected to be down by 3% on the previous year’s total. Pulp exports were up by 6% in the first half of 2008, but the drop in production will reduce export volumes in the latter half of the year. Pulp exports for the whole of 2008 are forecast to be down by 6%.

Production and Exports Also Down in 2009

On the mature European markets, the growth in paper and paperboard consumption has been small and is now set to be even lower due to the economic downturn. The Finnish forest industry aims to improve profitability by cutting production capacity in 2009 as well. With the cuts in capacity, Finnish paper production and exports are forecast to be down by about 4% in 2009. Production and exports of paperboard are forecast to be down by 3% as the demand on export markets weakens.

Capacity cuts in pulp production will reduce the production total in 2009 by about 2%. Exports will be down by 5% on the 2008 figure, as pulp will be used principally for domestic paper production, following the end of Russian pulpwood imports. The production and export forecasts for the paper industry are based on the assumption that the timing of the production cuts already announced will be as stated and that no significant new production cuts will be made in 2009.

Profitability in the paper industry has been weak for a number of years already and has further deteriorated during 2008. Besides low prices, the paper industry’s poor profitability is also attributable to the high roundwood costs in 2008 as well as the price of pulp and the high cost of energy and transportation.

The rise in costs has led many companies to announce price increases during 2008. Success in raising paper and paperboard prices is essential for the profitability of the entire paper industry. With major capacity cuts planned in Finland and elsewhere in Europe, the right conditions are in place for an increase in prices, but the current economic climate in the paper industry’s main export markets will not permit this. The average export prices of paper and paperboard in 2009 are forecast to remain at around their 2008 levels. The export price of pulp is also forecast to remain at the 2008 level. The price forecasts are based on the assumption that there will be no significant change in the euro and dollar exchange rates.

2.3 Costs and Profitability in the Finnish Forest Industry

The profitability trend in the Finnish forest industry is on a downward track in 2008. Among the various subsectors, the greatest deterioration in profitability is in the wood products industry. This is especially due to the disproportionate trends in sawnwood and wood raw material
prices. With the continuing fall in sawnwood prices, the decrease in domestic sawlog prices has diminished and imported sawlogs have risen significantly in price. No real relief is expected for the profitability trend in the wood products industry until 2010, when construction activity is likely to pick up on both the Finnish market and export markets.

In the pulp and paper industry, profitability is down only slightly on the 2007 level, despite the trend in product prices being weaker than anticipated. Contributory factors in this are the production cuts and cost-saving measures aimed at raising profitability, which have gradually redressed the demand-supply imbalance for certain paper grades in Europe. The stronger US dollar has also improved the sector’s competitiveness and profitability. For some paper grades there is nevertheless still overcapacity on the market. The continuing deterioration in the economic outlook is also jeopardising the prospects of successfully raising export prices of paper, which is essential for profitability. No significant improvement is expected in the pulp and paper industry’s profitability in 2009.

Russia’s decisions on its roundwood export duties will have a significant impact on the operating environment of the Finnish forest industry in 2009. Imposition of the increases in export duties will lead to considerable changes in the Finnish forest industry’s roundwood procurement. Finding alternative raw material sources may prove difficult and so further cuts in production capacity are likely. The cessation of Russian roundwood exports, especially softwood sawlogs, will hamper raw material availability not only in Finland but also in many other European countries, and particularly in China and Japan too. This will reduce the supply of sawnwood and could raise sawnwood prices on export markets by more than expected, which would have a favourable effect on the wood product industry’s profitability in 2009. For the Finnish-based pulp and paper industry, the roundwood duties will have a purely negative effect.

Substantial Decline in Profitability in the Wood Products Industry

Based on the figures for operating profit as a percentage of turnover presented in the financial statements of the major Finnish forest industry corporations (Metsäliitto, Stora Enso and UPM), profitability in the wood products industry rose in 2007 by more than in any other year of the present decade. However, the profitability trend had already turned onto a downward track at the end of 2007 and the decline has been sharp in the first half of 2008. The biggest single reason for this is the substantial drop in sawnwood export prices following the end of the cyclical upswing on the sawnwood export markets. Figures for January–July 2008 show that the nominal unit price of pine sawnwood exports fell by 15%, and spruce sawnwood by 12%, on the same period the previous year. By July 2008, the drop in prices from the autumn 2007 peak had reached as much as 29% for pine sawnwood and 24% for spruce sawnwood. By contrast, wood raw material prices remained relatively high: the stumpage price for domestic pine sawlogs in January–July 2008 was only 6.6% lower, and for spruce sawlogs 8.9% lower, than a year earlier. The drop in stumpage prices from their autumn 2007 peak levels had nevertheless reached almost 20% for both pine and spruce sawlogs. Some of the highest stumpage prices in 2007 did not become evident in costs until 2008, however, because of the difference in timing between roundwood sales, felling and final payment.

The price of imported sawlogs was up in the first half of 2008 by 20%, for both pine and spruce. Besides imported sawlogs, the costs of wood harvesting and transportation are also key elements of wood raw material costs, which altogether account for an average of about 30% of total costs in the wood products industry and over 50% in the sawmilling industry. Harvesting and transportation costs have risen with the increase in fuel prices, thus pushing up wood raw material costs. The disparity between sawnwood unit export prices and wood raw material cost trends has turned the profitability of the major Finnish forest industry corporations’ wood products businesses into a loss in 2008.
Based on the financial statements database maintained by Statistics Finland, which also includes small and medium-sized companies, and the figures for operating result calculated using this database, the profitability trend in the wood products industry has accorded with what might be expected on the basis of operating profits for the wood products businesses of the three largest forest industry corporations. The operating result is based on adjusted financial statements, and the operating profit (less extraordinary items in the accompanying figure) on unadjusted financial statements, and so they are not fully identical as profitability indicators in terms of their accounting basis. In addition, the data from Statistics Finland includes only the operations of Finnish-based production units, whereas the data from the major forest industry corporations’ financial statements also includes operations outside Finland, which in certain subsectors can be significant. The decrease in sawnwood prices has particularly affected major export-oriented sawmills, and estimates suggest that the profitability of small and medium-sized sawmills focusing on the domestic market will be better in 2008 than that of export-oriented sawmills. The drop in construction activity is also having an adverse impact on sawnwood prices in Finland, and so profitability will begin to fall for small and medium-sized sawmills too.

Among the subsectors of the wood products industry, the profitability of plywood production has remained reasonably good in 2008 despite the rise of 5.2% in the stumpage price of birch sawlogs (raw material in high-quality plywood) and the huge 65% rise in birch sawlog import prices during January–July 2008 compared to the previous year. In the same period the unit price of birch plywood exports nevertheless increased by 17%, which explains the positive profitability trend for plywood. The downturn in construction in Europe has been evident in the gentle decrease in the export price of softwood plywood, which has nevertheless not yet weakened the profitability of plywood production to any great extent. The favourable situation for plywood production has almost no effect on the average profitability of the wood products industry, however, because plywood and other wood-based panel production accounts for only about 16% of the industry’s turnover. Export demand for plywood is expected to start declining in Europe before the end of 2008, which will adversely affect the profitability of plywood production. In 2009, birch plywood production will also be threatened by the availability of wood raw material as Russia raises its roundwood export duties at the start of the year. Russian birch sawlogs have at times accounted for over 40% of the total consumption of birch sawlogs in plywood production, and in 2007 the figure was still more than 25%. Finding raw material sources to replace Russian imports may thus be difficult.

**Pulp and Paper Industry Profitability Remains Weak**

Paper export prices have been falling throughout almost the whole of the present decade, even though economies have been booming on the main export markets. This has weakened the profitability of the pulp and paper industry. To break this cycle and bring demand and supply into balance on the paper market, the major Finnish forest industry corporations have introduced various efficiency and cost-cutting programmes, which have also included production unit closures. Despite these measures, a deterioration
in the sector’s profitability is again looming in 2008, and substantial new cuts in capacity are being planned.

The profitability trend in the pulp and paper industry does nevertheless conceal differences within the industry. The profitability of magazine paper production is up in 2008, as demand has risen slightly in Europe and prices have increased. By contrast, demand has fallen in North America, although dollar prices of magazine paper have risen. On other export markets too, the prices of magazine papers in their invoicing currencies have been on the increase. Paperboard demand, the prices of paperboard and the profitability of production have remained above the average for the sector.

The sluggish market for newsprint and fine papers has been a key factor in the decreasing profitability of the pulp and paper industry in 2008. The decrease in profitability has affected newsprint production in particular. Newsprint demand in Europe and North America has weakened and prices have fallen, whereas demand has continued to grow in Asia. The strong euro is nevertheless adversely affecting exports to destinations outside Europe, which is suffering overcapacity. The market for fine papers is very similar to that for newsprint. The poor profitability trend for newsprint and fine papers will reduce profitability in the pulp and paper industry by more than the profitability increase arising from the improved profitability of magazine papers. However, a positive feature in the sector is that a change has finally been brought about in the profitability trend for magazine paper production.

Roundwood costs in the pulp and paper industry, which account for more than 13% of total costs, remain high in 2008. In January-July 2008, the stumpage prices of domestic pine and birch pulpwood were up by 6.6% and 5.4%, respectively, whereas the stumpage price of spruce pulpwood was down by more than 4% in comparison with the same period in 2007. However, in August 2008, the stumpage prices for all categories of pulpwood were below their levels of a year earlier. A major factor in the rise in roundwood costs in the pulp and paper industry in 2008 is the significant increase in the costs of imported roundwood. Import prices of pine and spruce pulpwood at the border in January-July 2008 were more than 30% higher than for the same period the previous year. The price of imported birch pulpwood was up by almost 50%. At the same time, the volume of imported pulpwood grew by almost 40% as the sector prepared itself for Russia’s proposed increases in roundwood export duties at the start of 2009. For this reason, the sum paid by the pulp and paper industry at the border for imported roundwood is for the first time exceeding the stumpage costs paid for domestic roundwood. Wood raw material nevertheless accounts for a fairly small (just over 13%) proportion of the pulp and paper industry’s costs, and the price trend for other raw materials has a greater effect on costs.

The non-roundwood raw material costs account for a significant proportion of the pulp and paper industry’s costs, currently about a quarter of the total. The production costs of these different minerals, chemicals and other materials, which are needed mainly in pulp production and bleaching and in paper making and coating, have risen considerably as a consequence of the rise in oil prices. The cost item comprising these other raw materials is, however, very heterogeneous, and gaining a detailed picture of trends in this cost item from publicly available information sources is very difficult.
Rapid Rise in Energy Costs

The costs of energy purchased from extra-industry sources account for about 3% of total costs in the wood products industry, and a little under 10% in the pulp and paper industry. Energy costs have accounted for a growing share of total costs in the forest industry in recent years, and in 2008 the increasing cost of energy has been cited more often than the price of wood raw material as the reason for the deteriorating profitability trend. Electricity constitutes the largest component of energy costs, and its price trend in 2008 has been fairly moderate due to the mild winter and the favourable status of the water resources in Scandinavia. There are nonetheless pressures to increase electricity prices again, for instance to meet the targeted cuts in emission allowances. The price of market electricity has tripled since 2005, and estimates of the increases for 2009 are even as high as 30–40% or more. The forest industry’s self-sufficiency in energy, and especially in the pulp and paper industry, is high, however, in terms of power and heat, which helps reduce the cost impact of fluctuations in the market price of electricity. On average, power generation by the Finnish forest industry accounts for more than 40% of the industry’s electricity consumption, and a significant proportion of the purchased electricity is from energy companies owned in part by the Finnish forest industry corporations. The rising cost of electrical energy is thus felt more acutely by the small and medium-sized companies in the industry.

The biggest single reason for the increase in energy costs in 2008 has been the rise in the price of crude oil. The crude oil price has been at a record high for some time and this has been evident in the prices of oil-based fuels and heating produced using oil. In summer 2008, the price of crude oil (Brent, USD/barrel) was double the price of a year earlier. Forecasts indicated a continued rise in oil prices, but the global economic slowdown has curbed the rise in prices during autumn 2008. In the forest industry, efforts have been made to use biofuels as a replacement for fossil fuels, and wood-based fuels now account for a larger share of all the energy consumed. However, the trend in oil prices tends to be reflected in the prices of alternative fuels too.

Besides energy prices, the oil price also affects the forest industry’s costs via many other cost items. These items include roundwood harvesting and transportation costs, other raw materials (especially chemicals, transportation and manufacturing costs) and freight costs for final products. In the pulp and paper industry in particular, the indirect effects of the oil price on total costs are considerable. Sea freight charges (BDI), for example, were almost 30% higher at the start of 2008 than a year earlier. By contrast, the year-on-year change in freight charges levelled off during the summer, despite the considerable rise in crude oil prices. This was due to the slowdown in the global economy and the associated drop in demand for freight. Freight charges have fallen rapidly during autumn 2008, which is good news for the competitiveness of Finnish forest industry products on export markets.

Product Prices Play Key Role in Profitability Trend

The Finnish forest industry has sought to reduce production costs through continuous improvements in the efficiency of production processes and operating methods. In real terms, production costs have in fact fallen, although at the same time production volumes have been rising until recently. The profitability trend has nevertheless remained weak, especially in the pulp and paper industry.

Raw materials and products whose prices are determined on the world market constitute a major share of the pulp and paper industry’s costs, and the forest corporations have no scope for influencing those prices. The reason cited for the deterioration in profitability has most often been the price of roundwood, usually without specifying whether price refers to domestic stumpage prices, the border price of imported roundwood or even the mill price. By contrast, much less attention has been given to the long-established imbalance between the growth rates of production volume and demand, and the
consequent unrelenting fall in product prices on the paper market. There may even have been an expectation that this trend would change. Only now, with the uncertainty over the future of roundwood imports, is there an awareness of the inevitability of structural change. The capacity cuts announced in 2008 and for 2009 are painful, but are essential for the future of the sector. Finland is situated far from the main export markets of the pulp and paper industry, which means that production can be profitable only in the most efficient and most favourably located production units, especially in the case of standard products.

The pulp and paper industry has been accused of conducting too little research and development work and of being prejudiced towards new product innovations. Publicly proclaimed strategies and concrete action to improve profitability through new products such as smart paper and especially biofuels, are likely to be indicative of a change in outlook, however. Even though new product innovations will not bring a quick solution to the sector’s current problems, the focus on these is a sign of the faith in the future of the industry. For years, the wood products industry has sought to increase the output of higher value added products by shifting away from low value added sawnwood and plywood products to laminated wood beams, interior boards and joinery products. This partially explains the sector’s relatively favourable long-term profitability trend compared with that of the pulp and paper industry.