



## Summary

*The economies of the Finnish forest sector's export markets in Europe began to turn onto a more favourable track in early autumn 2009. The production cuts made in the paper and sawmilling industries brought an end to the decline in prices, and the price of sawnwood, which collapsed in 2008, has picked up since summer 2009. Demand growth in the markets has been slow, however, due principally to the replenishment of stocks. With domestic consumption and exports remaining weak, production in the sawmilling industry for the full year 2009 will be down by about one fifth on the 2008 figures. In paper production and exports, the drop has been even greater, as demand on the export markets has fallen and Finnish-based production units have been closed. On the roundwood market, the forest industry's reduced roundwood need has led to a fall in roundwood sales, commercial fellings, stumpage prices and stumpage earnings. On the positive side, there has been a growth in the energy use of wood, which is expected to have increased the use of wood chips by about one tenth for 2009 as a whole compared with 2008. Roundwood imports are down in 2009 to about half of the previous year's level.*

*In 2010, GDP growth will remain slow and is expected to boost the demand for forest industry products by only a small amount. Despite production cuts, the European paper market will still be experiencing overcapacity, and no increase is expected in the average export prices of Finnish paper in 2010. Production and exports will grow as a result of the slightly improved demand, and profitability will improve following the business efficiency measures undertaken. In the sawmilling industry profitability will be improved by the strengthening export prices and growth in production. Despite the*

*production growth, sawnwood production will remain close to the level of the early 1990s. As the forest industry's need for wood rises, demand will focus more strongly on domestic roundwood, even if Russia abandons the planned increases in its export duties on roundwood. The increase in sawnwood production will push up the price of softwood sawlogs, but with pulpwood stocks remaining high, their prices will remain close to the 2009 level. The sales revenue tax relief on roundwood in force in 2009–2010 is expected to boost roundwood sales. Commercial fellings will be up in 2010, but the volume will be significantly below that prevailing before the current recession.*

*Although the economic outlook is improving, the situation is not about to return quickly to the pre-recession level, and there is a real risk that the projections will be worse than anticipated. The impact of the Government's policy measures for stimulating an economic recovery could weaken and a continued increase in unemployment could result in a steep drop in consumer confidence. On the other hand, it is also possible that confidence in future growth could rise and the recovery could accelerate earlier than forecast here.*

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### Slow Recovery from Recession in Export Markets

Real GDP growth in the world economy weighted according to the distribution of Finnish forest industry exports will be down by more than 3% for the full year 2009. Since summer 2009, a

return to a slow growth track has been evident in the most important markets for the Finnish forest industry, following the global economic recession that began in autumn 2008. Following the sharp fall in the early part of the year, the euro area economies' GDP will show a contraction of over 4% for 2009 as a whole, although during the final months of the year the area's economies are expected to recover slightly and demand to improve. The shrinkage in the German economy will be 5.5%, and in the UK economy 4%. Although the weak krona has allowed Sweden to expand its market share, for instance in the sawnwood market, even Sweden's GDP will be down for the full year 2009, by 5%. In 2010, the slow economic recovery will continue, mainly on account of the growth in trade and exports in the world economy. The euro area economy is forecast to grow by only about 0.5%.

China's GDP growth is expected to be up in 2009 by over 8%, and in 2010 by almost 10%. The Japanese economy will start to grow in 2010, by about 1.5% as against a contraction of almost 6% in 2009. Although in the United States the economic recovery began during the summer, the US economy will have shrunk by about 2.5% in 2009. In 2010, the US economy is forecast to grow by 1.5%. On the sawnwood market, the economies of the Middle East and North Africa will, on average, grow at a faster rate than the rest of the world. Finland's export-driven economy will recover more slowly than the rest of the world. Finnish GDP for the full year 2009 will be down by 7%. With world market demand and exports growing in 2010, the Finnish economy is forecast to grow by about 2%.

### Slight Recovery on Sawnwood Market in Late 2009

The economic crisis and the slowdown in construction have reduced sawnwood demand both in Finland and on the main export markets, and the limits imposed on sawnwood production have continued across Europe. In the first half of 2009, Finnish exports were down to all the traditional exports markets, with the exception of North Africa. Among Finland's competitors, Sweden has, by contrast, increased its exports,

aided by the weak krona. As Finland's exports and domestic demand have fallen, Finnish sawnwood production for the full year 2009 is expected to be down by one fifth from the 2008 level, falling to its lowest level since the 1990s recession. The major Finnish forest industry companies in particular have reduced their sawnwood production. Since spring 2009, sawnwood prices have started to rise as stocks have fallen, signalling a turn for the better. The recovery in construction in 2010 will be slow, however, on both the domestic and export markets. This is why the rise in prices in Europe will also be slow, with the average price of Finnish exports increasing by about 6% on the average for 2009. Sawnwood production is forecast to rise to 8.2 mill. m<sup>3</sup> in 2010. In comparison with the figures for the start of this decade, production quantities have nevertheless slumped by about 40%.

On the plywood market the contraction in demand began later than on the sawnwood market. The drop in export prices has also been less marked than on the sawnwood market. The production and export volumes of Finnish plywood for 2009 as a whole have nevertheless collapsed to half of their levels of a year earlier. The drop in birch plywood production has been particularly sharp. The slump in birch sawlog imports and the decrease in domestic fellings have led to a raw material shortage at the production plants. In 2010, plywood production is expected to pick up, but the recovery will be slow, as in sawnwood production. The average export price of plywood is forecast to rise by about 6%.

### Demand for Paper Starting to Rise Slowly

The recession has reduced the demand for paper and paperboard on the world market. Demand growth has also slowed in China. In Europe, the demand for printing and writing papers was already declining at the start of 2009, as advertising work switched to electronic media. A less marked drop occurred in the demand for paper and paperboard used in consumer packaging. The consumption of tissue and hygiene papers has been least affected by the recession. Printing paper capacity cuts and production

limits in 2009 have continued in Finland and elsewhere in Europe. Production and exports of Finnish paper are expected to be down by almost one quarter on the 2008 levels. Despite the production cuts, there is still oversupply on the European printing paper market, and the export price of paper is declining again, having begun to rise a little in the early part of 2009. The average export price of paper is nevertheless expected to be up by about 2% for the full year compared with the 2008 average. On the world pulp market, the production cuts in softwood pulp have been greater than those for hardwood pulp, and market prices for softwood pulp have risen during 2009, in contrast to those for hardwood pulp. The average price of pulp exports for 2009 as a whole is nevertheless expected to be down by about one fifth on the 2008 figure.

Paper demand in Europe in 2010 is forecast to grow a little and to push up pulp demand as national economies slowly recover. Signs of positive trends are already visible, as the drop in demand for printing and writing papers in Europe has tailed off and consumption has begun to rise gently since the summer. Production and exports of Finnish paper and paperboard in 2010 are forecast to grow by about 5%. With only a slow growth in paper demand, however, the capacity cuts undertaken in Finland and elsewhere in Europe will not be sufficient to push paper prices up significantly. Instead, the average export price of Finnish paper is expected to remain at approximately the 2009 level. On the pulp market, the growth in Asian demand will boost the market price in 2010, pushing up the forecast average export price of Finnish pulp by about 10% on the 2009 average.

### Improvement in Forest Industry Profitability in 2010

The profitability of the wood products industry plummeted to an unprecedentedly low level in 2008 as a result of the drop in demand for wood products, the oversupply on the European market and the decline in export prices. The industry's profitability has remained weak since the start of 2009, and a turnaround is not anticipated until 2010, when the level prevailing at the mid-point

of the present decade is likely to be achieved. As with the wood products industry, a marked deterioration in the pulp and paper industry's profitability began in 2008 and has continued in 2009. During 2009, the price trend in pulp and paper products has improved marginally, but any improvement in the sector's profitability will not be seen until 2010, despite the business efficiency improvements undertaken and the favourable developments in overall costs.

### Focus of Forest Industry's Demand for Wood Increasingly on Finnish Roundwood Resources

The Finnish forest industry's imports of roundwood for the full year 2009 are likely to be just half of the previous year's figure, dropping to below 10 mill. m<sup>3</sup>. Although commercial fellings are also down, to about 40 mill. m<sup>3</sup>, there is sufficient roundwood for the pulp industry. Production is at a low level, and stocks of harvested roundwood have remained high.

Due to the weak demand for sawnwood, softwood sawlog stumpage prices continued to fall in the first half of 2009. However, sawnwood production recovered perceptibly during the summer as stocks were reduced, and this served to boost softwood sawlog demand. Although the drop in stumpage prices is expected to have ceased, these prices for the full year 2009 are expected to be 23% below the 2008 average. The remainder of 2009 will see further downward pressure on all pulpwood stumpage prices as a result of the large stocks of pulpwood and the paper and pulp production cuts. The supply of roundwood is nevertheless expected to improve in the second half of 2009 on account of the 50% roundwood sales revenue tax relief. In contrast to other roundwood categories, the demand for forest energy has been good in 2009, and the use of wood chips for thermal and other power plant use is forecast to be up for the year, to 4.5 mill. m<sup>3</sup>.

In 2010, the slight growth in forest industry production will increase domestic commercial fellings by 15% on their 2009 level, as no major change is expected in the volume of roundwood imports. Nominal stumpage prices of softwood sawlogs will rise by 4–8% as a result of the

growth in sawnwood production. The stumpage price of birch sawlogs is forecast to rise due to the almost total cessation of birch sawlog imports. Pulpwood stumpage prices will remain close to their 2009 levels, when the reduced volumes of imported roundwood and domestic sawmill chips are replaced in the paper industry with domestic pulpwood from thinnings. The demand for forest energy will continue to be good, and thermal and other power plant use is forecast to grow to 5.5 mill. m<sup>3</sup>.

### Forestry Operating Profit Sinks Significantly Below Long-Term Average

As a consequence of the deep recession in the Finnish forest sector, the operating profit from non-industrial private forestry for 2009 as a whole will sink to a level of EUR 42–46/ha. This downward slide will be stopped in 2010, when commercial fellings will increase and sawlog prices will strengthen a little. The operating profit will nevertheless be significantly below the long-term average. In real terms, such a low point was last reached in the recession years 1992 and 1993. In 2010, earnings will rise by about EUR 10/ha, but will still be about 40% below the average for 2004–2008. As a consequence of the recession, 2009 stumpage earnings from forests in non-industrial private ownership will be about EUR 850 million, or almost half of the previous year's level. With roundwood sales and commercial fellings picking up in 2010, stumpage earnings are forecast to be up by 10–15% on the 2009 figure.

### Assumptions and Uncertainties in Forecasting

The aim of this Economic Outlook is to provide information on the current state of the entire Finnish forest sector and the outlook for the sector in the near future. The forest sector forecasts are based on publicly available statistics, world economic forecasts, market information and other forest sector data from different sources, and research conducted by the Finnish Forest Research Institute. The forecasts presented here are based on the principle of derived

demand, according to which fluctuations in GDP growth on the domestic and export markets will, via demand, be reflected in forest industry production and thus the domestic roundwood market. Changes in the forest sector's operating environment and the effects of the Government's economic policy measures are taken into account in making the forecasts. If GDP growth turns out to be below the level forecast, this would mean that export prices, production and profitability for the Finnish forest industry will be lower than indicated in the forecasts given here. 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.

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 based mainly on forest sector information available in late September and early October 2009 and world economic forecasts for 2009 and 2010. 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 in export markets. At the time of writing, in autumn 2009, there are many uncertainties and risks associated with the forecasts for the economy.

### Is the Recession Over Already?

The latest statistical data on a range of economies for the second quarter of 2009 indicates that the contraction in GDP growth has been halted. Since the summer, output in a number of economies – among them the United States,

Japan, Germany and France – has even been growing slightly, and exports have begun to pick up. In their forecasts, economists are particularly united in the view that the recession is over and that growth has begun in autumn 2009. Growth is nevertheless expected to be slow. But is the recession really behind us, and what kind of risk factors are concealed behind the forecasts?

There are primarily two key factors behind the end of the recession. First, since the start of the global recession a number of Governments have introduced substantial recovery packages, focusing on boosting public expenditure. In addition, central banks dropped their central rates and in part also pumped money into the economy by purchasing government bonds and providing direct support for banks that were in difficulty. Such action has gradually started to bear fruit, and confidence in the financial markets has improved. Stocks have also been run down during spring and summer 2009, and production has grown. This has been visible as an increase in world trade and exports.

However, running counter to these recovery signs has been the fear that these signs will be short-lived. Once stocks have been replenished, will production needs fall again to the pre-recession level? There is also a fear of higher taxation, which will be unavoidable when the loans taken to fund the recovery packages have to be repaid. In some countries, there have already been calls for the recovery to refocus on savings. The timing of a turnaround in financial policy will indeed become a key factor in successfully managing the economic turnaround. Tightening public expenditure and taxation too early could push the world economy back into recession. The central banks face a similar problem: when is the moment right to begin raising interest rates in order to manage the upswing?

*Key forecasting variables, 2008–2010.*

Forecasting variables	2008	2009	2010
	% change from previous year		
Sawnwood production	-21	-20	5
Sawnwood export	-15	-15	6
Sawnwood export price	-16	-12	6
Paper production	-9	-23	5
Paper export	-12	-24	5
Paper export price	2	2	0
Commercial fellings	-11	-23	15
Roundwood imports	11	-53	1
Sawlog prices			
Pine	-12	-23	4
Spruce	-14	-23	8
Birch	4	-26	4
Pulpwood prices			
Pine	5	-23	1
Spruce	-5	-26	2
Birch	4	-22	-2

*Price changes are nominal*

A major share of national GDP is made up of private consumption, which is affected not only by the level of disposable income but also to a considerable extent by the expectations of future growth. During the summer and early autumn, the consumer confidence indicators have begun to climb from their rock bottom levels as the housing market slump eased off a little. However, with an increase in unemployment, confidence rests on a knife edge, and even the faintest bad news could adversely affect households' willingness to consume. It is also unclear whether or not the balance sheets of the banks are in good shape. The recession can finally be declared over only after the coming winter has passed, by which time it should be known whether industrial production has continued to rise and whether consumption and investment in Europe are recovering to close to the pre-recession level.