



Finnish Forest Sector Economic Outlook 2010–2011

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Summary

The production and export of Finnish forest industry products began to grow quickly during the first half of 2010 as demand recovered in the main export markets and on the domestic market. The profitability of production was enhanced by a weakened euro, which improved the price competitiveness of exports, and especially by the higher export prices for sawnwood and pulp. The price trend on the paper market, however, has been more moderate on account of the overcapacity in Europe. The forest industry's increased roundwood need during 2010 has been met through an increase in commercial fellings in Finland and by importing more wood. Domestic roundwood sales have picked up significantly from 2009, and prices of softwood sawlogs in particular have risen.

Europe's GDP growth is forecast to slow down in the latter part of 2010 and in 2011, as the various government stimulus packages gradually come to an end. This will also reduce the demand growth for Finnish forest industry products, and indeed the rise in sawnwood and pulp export prices has already tailed off.

The forest industry's production and exports are forecast to grow more slowly in 2011 than in 2010. Sawnwood production will rise to about 9.8 mill. m³ and paper and paperboard production to approximately 12.8 mill. tonnes. The upward trend in the forest industry's profitability will lose momentum. The industry's roundwood demand and commercial fellings will both be up a little in 2011, but roundwood supply will fall as a result of the discontinuation at the end of 2010 of the tax relief on income from roundwood sales. Stumpage prices of softwood sawlogs and pine and birch pulpwood are forecast to rise in 2011, though more moderately than in 2010. Russia's policy of export duties on roundwood is

nevertheless creating uncertainty in the market. If Russia's export duty increases come into effect at the start of 2011, there will be a decrease in Finnish imports of Russian roundwood compared with 2010. The use of forest chips is expected to grow in 2011 to about 7 mill. m³ when new subsidies and energy taxes are introduced.

Although the world economy has already passed the worst of the recession, it is entering a period of slower growth, overshadowed by uncertainties over the future course of the United States economy and the debt-ridden economies of the euro area. Rapid and unforeseeable changes in exchange rates are also a source of uncertainty. There are real risks that the situation will differ in one direction or another from the forecasts given.

Lower GDP Growth on Export Markets in 2011

GDP growth in the Finnish forest industry's main export markets has been slowing since the spring and summer of 2010 as stock replenishments are completed and fiscal policy stimulus packages are gradually brought to an end. Growth in 2011 will vary widely among countries and regions and will increasingly rely on private consumption. Real GDP growth in the world economy weighted according to the distribution of Finnish forest industry exports will be up by about 2.6% for the full year 2010, and by slightly less than this in 2011.

GDP growth in the euro area, the most important market for the Finnish forest industry, is

being driven by the German economy and will be almost 2% for 2010. In 2011, the euro area economy will grow at a slightly slower rate. Growth in the United Kingdom economy will be in step with the euro area, while Sweden's GDP growth will exceed this in both 2010 and 2011 despite the strengthening krona's impact on export price competitiveness, for example in the sawnwood market. In the United States, GDP growth is forecast to be 2.5% for 2010, but 2011 will see slower growth. With the exception of Japan, Asia's economic growth figures for 2010 and 2011 will again be strong, fuelled by the almost 10% growth in China's GDP. Japan's growth will be held at around 2% as a result of the strengthening yen, the low level of domestic demand and the country's structural problems. Finland's GDP growth for 2010 will be higher than forecast, due to the success of exports, but growth will be lower in 2011. Housing construction in Finland will see a further increase in 2011.

Slowing of Rapid Rise in Sawnwood Prices

With demand picking up during 2010 Finnish exports of wood products have increased, especially to Europe and Africa. The profitability of exports has improved as a result of a rise in market prices. The weakened euro in the first part of 2010 meant improved price competitiveness outside the euro area, but in September/October the euro was once again strengthening. Sawnwood demand in Finland has risen, especially due to the growth in detached housing construction. Sawnwood demand will slacken in the latter part of 2010 and in early 2011, as a result of construction slowing for the winter season in both the domestic and European markets. The rise in sawnwood market prices will also tail off. The average export price of Finnish sawnwood in 2010 is expected to be up by about 13% year on year. The increase in domestic consumption and in exports will boost production to approximately 9.4 mill. m³. Although sawnwood consumption in 2011 is expected to grow in Europe, market price rises will be kept in check by tougher competition as European production grows. The average price

of Finnish sawnwood exports is forecast to rise in 2011 by about 3%. The increase in domestic consumption and in exports will boost production in 2011 to approximately 9.8 mill. m³.

Market prices of plywood are rising more slowly than those for sawnwood. The average export price of Finnish plywood for 2010 is expected to be up by only about 1% on account of the weak price trend for hardwood plywood. Rising demand in Germany and the United Kingdom in particular has boosted the total volume of Finnish plywood exports, which will be up in 2010 by about one fifth on the 2009 figure. In 2011, plywood consumption in Europe will grow further as a result of an increase in construction and world trade. However, the improving price level will also lead to an increased supply of plywood and tougher competition. The growth in exports and domestic demand will boost total annual plywood production for 2010 and 2011 to close to 1 mill. m³. Birch plywood will account for only about one third of total production.

Paper Industry Export Volumes Boosted by Demand Recovery

The demand for paper and paperboard has improved significantly in Europe, North America and Asia during 2010. The greatest increase in demand has been in packaging papers and paperboard. With demand picking up and with export price competitiveness improving due to the weakening euro, export volumes of Finnish paper rose by almost one fifth in the first six months of 2010. By contrast, the trend in export prices has been less marked. Despite the cuts in production capacity there is still overcapacity in Europe, and this has kept price rises in check. With the exception of newsprint, paper prices have nevertheless started to rise gently since the spring. The average price of paper exports in 2010 is forecast to be up by 3%, and production and exports by 12%, in comparison with 2009.

The growth in paper demand in Europe will level off in 2011, and the increase in market prices will also slow down as GDP growth in general slackens off. The price of pulp has already begun to fall. Production and exports of

Finnish paper will grow at a slower rate than in 2010. The overcapacity affecting Europe's paper markets and the slow growth in demand will limit any significant price rises. In 2011, the average price of Finnish paper and paperboard exports is forecast to rise by about 2%. The production volume is forecast to grow to 12.7 mill. tonnes, or by about 5% on the 2010 figure.

Significant Improvement in Forest Industry Profitability

The Finnish forest industry's profitability was at rock bottom in 2009, when the wood products industry recorded losses and the pulp and paper industry's profitability approached zero. Profitability in 2010 has clearly improved, however. In the sawmilling industry a major factor in this has been the sharp rise in sawnwood export prices and volumes. The pulp and paper industry's profitability has also risen with the increase in world market prices for pulp, although for many paper grades the trend in world market prices has again been weak. The forest industry's profitability will improve in 2011, though at a slower rate than in 2010. The rise in export prices in the wood products industry will slacken off, and higher stumpage prices will push up roundwood costs. Profitability is nevertheless expected to remain a little above the post-2000 average. While the outlook for demand and prices in the pulp and paper industry varies significantly from one product to another, the capacity cuts already made and the recovery in key export market economies suggest that a further improvement will occur in the sector's profitability in 2011.

Commercial Fellings Boosted by Forest Industry's Growing Need for Roundwood

Commercial fellings in Finland will be up in 2010 by 19% year on year, to almost 50 mill. m³, due to the improved demand for sawnwood and pulp on the world market. The late July/early August storm damage accounted for 4–5 mill. m³ of the fellings. The 2010 sawlog harvest is up by more than that of pulpwood,

and imports of industrial wood are also up on the 2009 figure by about a quarter, to 9.5 mill. m³. The growing roundwood need is also pushing up domestic stumpage prices. Pine and spruce sawlog stumpage prices will be up by 17–18% for the full year 2010, whereas stumpage prices for birch sawlogs and pine and birch pulpwood will be up by 9–13%. The stumpage price for spruce pulpwood will remain almost unchanged. The use of forest chips has been growing at a much more modest rate than in 2009, and will reach 6.3 mill. m³ for 2010.

In 2011, the demand growth for sawnwood, pulp and paper is forecast to level off in export markets, which will also retard the growth in commercial fellings. Imports of industrial wood in 2011 will reach 9.7 mill. m³, provided that Russia's roundwood export duty increases are again postponed. Domestic commercial fellings are forecast to rise to 51 mill. m³. However, roundwood supply will be adversely affected by the discontinuation at the end of 2010 of the tax relief on income from roundwood sales. Domestic stumpage prices for sawlogs and pulpwood will rise more modestly, by 5–8%, than in 2010. Political decisions favouring renewable energy are contributing to the growing use of energy wood and forest chips, which will rise to 7 mill. m³.

Higher Stumpage Prices in Forestry Improve the Operating Profit from Timber Production

In forestry, higher stumpage prices and an increase in felling volumes mean that the 2010 stumpage earnings of private forest owners in Finland will be up by more than one third. In 2011, stumpage earnings will rise to EUR 1.5 billion. Thanks to the improved state of the economy, the operating profit from non-industrial private forestry in 2010 will grow to approximately EUR 80/ha, and in 2011 this is expected to rise to EUR 90/ha. With higher stumpage prices the investment return on timber production in 2010 will increase to 16%. In 2011 the percentage return will fall a little, but will still be at a high level. Annual investment in timber production in private forestry in 2010 and 2011 will exceed EUR 220 mill., of which government subsidies

account for EUR 60 mill. A major share of the government subsidies is for the tending of young stands. In addition, the government is providing EUR 12–13 mill. in subsidies for energy wood harvesting and chipping.

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 short-term outlook for the sector. The forest sector forecasts are based on publicly available statistics, world economic forecasts, forest sector market information 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 policies 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 and would affect 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 2010 and world economic forecasts for 2010 and 2011. 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 and exchange rates may occur in export markets. Regarding the level of growth in export market economies, the risks and uncertainties focus on the future course of the United States economy, possible new debt crises emerging in Europe, and the wider impact of these. The world economy shifted to a slow growth track in the summer of 2010, but there is no certainty as to the strength or continuity of this growth. The principal factors behind the economic improvement have been the replenishment of stocks and the additional public spending in different areas as part of the government stimulus packages. However, the impact of these actions is already diminishing steadily. If growth is to be on a sustainable basis, the focus will need to be shifted more towards foreign trade, consumption and investment. However, the scope for this may be limited by unfavourable changes in monetary policy, exchange rates, unemployment and general consumer and business confidence in the economy.

Key forecasting variables, 2009–2011.

Forecasting variables	2009	2010	2011
	% change from previous year		
Sawnwood production	-18	18	4
Sawnwood export	-13	14	3
Sawnwood export price	-10	13	3
Paper production	-21	12	5
Paper export	-20	12	6
Paper export price	1	3	2
Commercial fellings	-20	19	3
Roundwood imports	-63	27	2
Sawlog prices			
Pine	-20	17	8
Spruce	-19	18	7
Birch	-27	9	6
Pulpwood prices			
Pine	-19	10	7
Spruce	-20	1	5
Birch	-16	13	7

Price changes are nominal