



# Finnish Forest Sector Economic Outlook 2011–2012

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## Summary

*Production and exports in the Finnish forest industry grew at a quicker pace in the first six months of 2011 than in the same period a year earlier. However, the demand for forest industry products in the second half of the year will be adversely affected by the heightened uncertainty over the world economy since the summer, especially regarding the immediate future of the euro area and its debt crisis. The impact of this will be seen most clearly as a slowdown in the growth of sawnwood production and exports, and as stalled growth in export unit prices. Plywood and paperboard demand in the second half of 2011 will still be fairly strong though. The demand for different paper products in the latter part of the year is forecast to weaken slightly, which will keep price increases at a modest level.*

*Sawnwood production for the full year 2011 is expected to rise to 9.6 mill. m<sup>3</sup>, while the combined production of paper and paperboard will remain close to the previous year's level. Domestic commercial fellings are forecast to rise to 53 mill. m<sup>3</sup> for 2011 as a whole. The increase in roundwood demand will also mean that 2011 prices for different roundwood categories will be up by several per cent year on year. Profitability for 2011 in both the wood products industry and the pulp and paper industry will be up year on year, due to the positive trend in the first six months. The increase in stumpage prices and felling volumes will boost gross stumpage earnings in non-industrial private forestry to EUR 1.5 billion.*

*The demand for Finnish forest industry products will remain weak in the first half of 2012, due to the problems in the world economy, even if a euro area financial crisis is successfully averted. Demand is only expected to pick*

*up in the second half of the year as the general economic situation improves. Construction in 2012 is nevertheless expected to remain sluggish in Europe, and so Finnish sawnwood production and exports are forecast to fall slightly in comparison with the 2011 figures. The forecast demand growth in the second half of 2012, however, will keep paper and pulp production, exports and export unit prices at the 2011 level. By contrast, paperboard exports and unit prices will increase a little. The weakened demand for end products will also be visible as a reduction in roundwood demand and commercial fellings in comparison with 2011. Average 2012 prices for sawlogs and pulpwood will be slightly down year on year. Profitability in both the wood products industry and the pulp and paper industry in 2012 is expected to be almost at the 2011 level. By contrast, profitability will be down slightly in non-industrial private forestry.*

*The forecasts assume that a new financial and economic crisis will be averted. A recession would entail a downward revision of all the forecasts in this Economic Outlook.*

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### Growing Uncertainty on Export Markets

The demand for end products on the Finnish forest industry's key export markets is overshadowed by the uncertainty over how far the euro area debt crisis will spread and its effects, and the growth slowdown in the world economy. GDP growth in the world economy weighted according to the distribution of Finnish forest industry exports is expected to slow to just over 2% for

the full year 2011, and to be about 2.5% in 2012. Euro area growth is slowing considerably in the second half of 2011, and this will continue in the first half of 2012. The onset of a new recession is possible if the debt crisis expands to become a banking and financial crisis affecting the entire euro area. Provided that such a crisis can be averted, the euro area's GDP growth for the full year 2011 will be 1.5%, and in 2012 about 1%. Among the forest industry's key export markets and competitor countries, GDP growth in both Germany and Sweden is forecast to outperform the average euro area growth, but the growth rate will slacken in 2012 in these countries, too. Growth in the United Kingdom economy for the full year 2011 will be only about 1%, but slightly higher growth is forecast for 2012.

In the United States, private consumption growth will remain flat for 2011 as a whole, and the public sector deficit will have grown despite the programme of spending cuts. Growth in the US economy is expected to remain weak well into 2012. US GDP growth is forecast to be approximately 1.5% for 2011, and the forecasts for 2012 vary in the range 1.6–2.5%. China is becoming the driving force behind GDP growth in the world economy, and the country's rapid GDP growth will slow only a little in 2011 and the coming years. Japan's economy is picking up in the second half of 2011, but this will not be sufficient to compensate for the effects of the earthquake in the early part of the year and the strong yen and slowdown in world trade, and so the country's economy is expected to contract by about 0.5% for the full year. Japan's GDP in 2012 is forecast to grow by 2–3%. GDP growth in North Africa and the Middle East will also be higher in 2012 than in 2011. The changes in the euro area economy will be reflected in the Finnish economy as well, with growth slowing in the second half of 2011. The anticipated weakening of the euro against other key currencies will improve the price competitiveness of Finnish forest industry exports outside the euro area in the second half of 2011 and in 2012, and the low interest rates will boost investment. In 2012, the Finnish economy is forecast to grow by 1–2%, provided that the entire euro area does not slide into recession as a result of the financial crisis.

## Faltering Demand for Wood Products

The growth in sawnwood and plywood demand in Europe in the first half of 2011 resulted in an increase in Finnish export volumes. Sawnwood demand was also up in Asia, which further boosted Finnish exports, especially with demand picking up in Japan. Plywood demand in Europe was supported by growth in the transportation industry and in retailing. In both these sectors, the export unit prices of wood products rose in the first six months of 2011, but the increase in sawnwood prices was already tailing off in the spring. On the domestic market, sawnwood consumption was boosted by an increase in detached housing construction.

The slower GDP growth since the summer is expected to adversely affect the growth in housing construction in Finland and in Europe as a whole in the second half of 2011, which will in turn weaken the demand for wood products and affect the price trend, too. Plywood demand will also be hit by the slower GDP growth in the world economy, as this affects the transportation sector. Sawnwood production and exports for 2011 as a whole are expected to be up by 2%, but the unit price of exports for the year is estimated to fall by about 2%. Plywood exports and the average export price will be up by about 7% for the full year 2011, on account of the strong growth in the early part of the year.

Construction growth in 2012 is forecast to slow in Finland and elsewhere in Europe. The political turmoil in North Africa and the Middle East and the prospect of Japan's reconstruction being spread out over a number of years will ensure that growth in Finnish exports to these regions remains small. Although export competitiveness will be slightly improved by the projected weakening of the euro, sawnwood production, exports and export unit prices are forecast to decrease by about 2% in 2012 from the 2011 figures. Lower GDP growth in Europe will also reduce the demand for plywood. Finnish plywood production, exports and export unit prices are forecast to drop by about the same percentage as for sawnwood.

## Dip in Paper Demand

Having started to grow in 2010, the demand for paper and paperboard products then slackened off in the first half of 2011 in both Europe and the United States. As a consequence, export volumes of Finnish paper and paperboard began to fall in the second quarter of 2011. With demand remaining low in the second half of 2011, production and export volumes of Finnish paper are forecast to be down for the full year by about 1%. By contrast, paperboard production and export volumes will be up by 2%, due to the growth in world trade in the first half of the year. Pulp exports are forecast to be up by 5% and pulp production by 2%. Average export prices for paper and for paperboard products continued to rise in the first half of 2011. The rise in prices is, however, expected to tail off in the second half of the year, bringing the full-year increase in the export unit price of paper to 5% and paperboard 8%, compared with the figures for 2010.

The dip in demand for paper products is expected to continue in the first half of 2012. With demand expected to start climbing slowly again in the second half of 2012, production and exports of Finnish paper for the full year are projected to be similar to the 2011 figures. The lacklustre demand will mean that the price trend for paper and paperboard products in Europe remains moderate. In 2012, the average price of Finnish paper exports is forecast to rise by about 1%, while the paperboard price will rise by slightly more than 1%.

## Forest Industry Profitability Improves

The Finnish forest industry's profitability improved significantly in 2010 with the rise in export volumes and prices in the wood products industry and the pulp and paper industry. This positive trend continued in the first half of 2011 in the wood products industry, due to the increase in sawnwood and plywood export volumes and export unit prices. Although the slacker demand in the second half of 2011 will affect exports and domestic production, the wood products industry's profitability will nevertheless be better than in 2010. In the pulp and paper industry, the

rise in the demand for end products and higher average export prices have boosted the industry's profitability, which has also been sustained by the moderate cost trend. The pulp and paper industry's profitability for the full year 2011 will show a year-on-year improvement, despite the deteriorating economic outlook and the end of the rising trend in export product prices.

The most immediate impact of the economic uncertainty on key export markets and the domestic market in 2012 will be evident in sawnwood and plywood demand and prices. Paper prices are also expected to drop slightly in the first half of 2012, although there will be significant differences between products. Efforts have been made to counter the effects of the declining demand, which is partly structural, through capacity cuts. The profitability of pulp and paperboard production is likely to remain high. The price trend for raw materials, especially roundwood, is forecast to be moderate, which will serve to support profitability. Profitability in both the wood products industry and the pulp and paper industry in 2012 is expected to be at almost the 2011 level.

## No Major Change in Roundwood Prices

The rising trend in softwood sawlog prices in the first half of 2011 was reversed into a decline after the summer, due to the deteriorating outlook in the sawmilling industry for the second half of the year and the heightened uncertainty on the end product markets. Pulp demand is nevertheless forecast to remain high, which will help maintain pulpwood demand. On account of the favourable trend in the first half of 2011, the volume of commercial fellings for the full year is projected to be 53 mill. m<sup>3</sup>, which is a little above the 2010 figure. Imports of industrial wood and chips are expected to be up by 7% to 12.3 mill. m<sup>3</sup>. Annual average stumpage prices for softwood sawlogs are expected to be up for the full year 2011 by 3%, and for pulpwood by 2–5%.

Commercial fellings will decrease to 50 mill. m<sup>3</sup> in 2012, due to the slight drop in sawnwood and plywood production. The reduction in fellings is expected to be principally in forests under non-industrial private ownership. Sawlog

stumpage prices in 2012 will be down slightly year on year, on account of the weaker price trend in sawnwood and plywood. Pulpwood prices will remain at about the 2011 level, as pulp and paper production is forecast to be unchanged from 2011. The demand for energy wood continues to be good in 2011 and will remain so in 2012, and the amounts used in thermal and other power plants are forecast to grow further. The energy plant gate prices of energy wood will also rise a little.

### Higher Stumpage Prices and Felling Volumes Improve the Operating Profit in Forestry

The operating profit from timber production in Finland will improve in 2011 from the previous year's figure. The growth in stumpage prices and felling volumes will boost gross stumpage earnings in non-industrial private forestry for 2011 to EUR 1.5 billion. In 2012, earnings will be lower, at EUR 1.4 billion, due to slightly lower stumpage prices and felling volumes. The per-hectare operating profit from non-industrial private forestry for the full year 2011 will rise to EUR 92/ha. This is 4% up on the 2010 figure, but 10% below the post-2000 average. The moderate rise in stumpage prices means that the investment return on timber production will be around 7%. The operating profit in 2012 will decrease to just under EUR 90/ha, and the small drop in stumpage prices will reduce the investment return to less than 1%. Investment in timber production will rise to EUR 215 mill. for 2011, following the dip in 2010, and will reach EUR 220 mill. in 2012. The amount of financing and work input by private forest owners covers about 70% of the total timber production investment, the remainder being funded by the Government.

### 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 on 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

Key forecasting variables, 2010–2012.

Forecasting variables	2010	2011	2012
	% change from previous year		
Sawnwood production	18	2	-2
Sawnwood export	11	2	-2
Sawnwood export price	16	-2	-2
Paper production	10	-1	0
Paper export	11	-1	0
Paper export price	4	5	1
Commercial fellings	25	2	-6
Roundwood imports	52	7	3
Sawlog prices			
Pine	17	3	-2
Spruce	18	3	-2
Birch	8	9	-1
Pulpwood prices			
Pine	11	5	-1
Spruce	1	2	-1
Birch	15	3	-1

Price changes are nominal

Economy. The forecasts given in this publication are based mainly on forest sector information available in late September and early October 2011 and world economic forecasts for 2011 and 2012. 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.

Currently the biggest risk in the forecasts is the debt crisis affecting the euro area. Even though the latest statistical data on Finland and the euro area is already indicating that GDP growth has almost come to a standstill and that confidence has weakened, the economic forecasting institutions are nevertheless still generally of the view that GDP growth will slow considerably in the latter half of the year and then begin to improve slowly in the second half of 2012. However, if the crisis were to spread and turn into a banking and financial crisis affecting the entire euro area, this would trigger an economic recession that Finland, with its export-sensitive economy, could not avoid. Political decision-making to steer through a crisis would take time, and conditions in the world economy would also be severely hampered by the US economy's debt and growth problems. The realisation of the recession scenario in the forest sector would mean a reduction in paper and sawnwood demand and in prices. There is also a risk that the demand for paper would not return to its former level after such a recession, and that the overcapacity problem which the paper industry is already experiencing would simply get worse. A recession would entail a downward revision of all the forecasts in this Economic Outlook.