

## MARKET STATEMENT 2010

### *1. GENERAL ECONOMIC TRENDS AFFECTING THE FORESTRY AND FOREST BASED INDUSTRIES*

Although at the end of 2009 the situation in the external markets began to recover slowly, in 2009 the development of Latvia's economy was affected more by the rapid fall of the domestic demand. In 2009 gross domestic product (GDP) decreased by 17.5%. The major factor that determined the reduction of GDP was the continuing decline of the domestic demand, due to decreases in all of the following areas: private and public consumption, as well as investments.

Due to domestic demand that remained low, during the 4<sup>th</sup> quarter a significant growth was reached by the exporting manufacturing sectors, but the growth of wood production and production of wood articles could be observed throughout the year. The volume of the goods and services exported from Latvia during the 1<sup>st</sup> quarter of 2010 increased by 4.6% in comparison with the 1<sup>st</sup> quarter of 2009. At the same time import decreased by 2.7%. The export-import balance of Latvia has become more stable and the deficit has remained at 0.2% level of GDP.

The low demand and downfall of manufacturing costs at the end of 2009 and at the beginning of 2010 contributed to continued reduction in consumer prices. In January 2010 the price level was 3.1% lower than in the corresponding period of the previous year. It resulted from decreased labour force cost per unit for the third consecutive quarter, while gradually renewing the economic competitiveness of Latvia.

The only component of domestic demand that continues to decline in 2010 are investments. It is mainly affected by the production capacity, which still remains low, as well as the highly cautious crediting of enterprise by the banks. Along with the recovering world economy and growing external demand, in the 1<sup>st</sup> quarter of 2010 the output within the processing industry has increased by 6.8%, within the transport and communications sector – by 2.3%. Within the majority of service sectors the output still remains slightly lower than the level of the 1<sup>st</sup> quarter of 2009, especially within the sector of public services. A better situation can be observed in the trade sector. Improvement is proven by the growing turnover of retail trade within the first months of 2010.

Expansion of export opportunities are the basis for continued growth of the processing industry output. In April 2010 the sector output was 10.7% higher than in comparison with the corresponding month of 2009. Since May 2009 when the lowest point of processing industry was observed, within a year the output has increased by almost 1% every month. Since the beginning of 2009 gradual improvement of the competitiveness of processing industry can be observed – mainly due to the reduced labour costs. But recovery after crisis in the processing industry is irregular. Significant growth in the output within the four months of 2010 can be observed in wood processing, paper manufacturing and printing as well as in the production of transport vehicles.

Along with the stabilization in the domestic demand, the situation in retail trade is gradually improving. According to seasonally adjusted data, turnover of retail trade in May is by 5.5% higher than in December 2009. Although in comparison with the corresponding period of the previous year, turnover of retail trade still remains negative, since the second half of 2009 the decrease rate of turnover has been gradually slowing down.

Still, along with the growing of export, a rapid increase of import cannot be expected; it is still limited by the low domestic demand and its structural changes. The demand for luxury goods and non-expendable goods that are mainly manufactured outside Latvia has decreased.

The dynamics of the processing industry in 2010 will be still affected by the low

domestic demand and the recovery is expected to be gradual. In the manufacturing of wood articles, the recovery rates are expected to be faster, because good results have been achieved in the export markets already now.

As the development of construction mainly depends on the domestic demand, the construction volume has decreased pursuant to the decreased investments in national economy. During 2009 it reduced by almost 40%. Although the rate of downfall has declined significantly, still in the 1<sup>st</sup> quarter of 2010 in comparison with the corresponding quarter of the previous year, the production volumes of construction are by 43.4% lower.

According to statistics, the economic downfall in Latvia has been halted. The evaluation of GDP of the 1<sup>st</sup> quarter of 2010 shows increase by 0.3% in comparison with the previous quarter according to seasonally adjusted data.

The export of forest sector production in 2010 in terms of money has increased by 43%, in comparison with the same period of the previous year. It was determined mostly by the growth in sawnwood export. It was the most important forest sector's export production, forming more than one fourth of the total sector export. Sawnwood export in terms of value has increased by 63.8%, while in terms of volume – by 39.6%.

## ***2. POLICY MEASURES INFLUENCING TIMBER TRADE AND MARKETING (over the last 18 months)***

Within within the Program for *Stabilization of Latvia's Economy and Re-establishment of Growth* that the Parliament (Saeima) adopted on 12 December 2008 and activated in 16 June 2009, the main activity guidelines have been set to stabilize and revitalize the financial system, improve the efficiency of public administration by reducing its costs and restructure Latvia's economy by increasing its competitiveness.

The Program for *Stabilization of Latvia's Economy and Re-establishment of Growth* in total provides inflow of 600-700 million lats into the economy of Latvia in the form of entrepreneurship support. Several financial instruments have been launched, as a result of which credits are available for the improvement of producer's competitiveness, as well as enterprises can receive guarantees for the improvement of competitiveness. Also support for risk capital and transfer of technologies are planned, as well as for the programme of high risk credit, for initiation of self-employment and business activities. A significant recovery instrument of economy is the export credit guarantee system introduced since 1 June.

The business environment has been improved by optimising the VAT administration system (by introducing the "cash register principle" for micro-entrprises, by cancelling invoices with the number assigned by the State Revenue Service, by simplifying the preparation procedures of the transit customs declarations and by accepting the print-outs of payments made through Internet banks as payment documents).

To motivate the economically active people, who have become unemployed, to begin their own small businesses and to return them to the economic activity, the procedure that provides every resident the opportunity to initiate his own small entrepreneurship administrative burden is simplified. To support those, who initiate business activities, in 2009 the *Mortgage and Land bank of Latvia* issued credits, provided grants and supported their projects, including those projects implemented in the forestry, wood processing and furniture production sectors.

To support the cooperation of the Technology Transfer Contact Points with merchants and research institutes and higher educational institutions and to provide commercialisation of the research results, in 2009 implementation of the programme *Technology Transfer Contact Points* was continued. To motivate the local merchants to invest into the projects of high knowledge and technologies, as well as to attract foreign investments in high added value sectors, merchants had the opportunity to use the funding of *High Added Value Investments*.

To improve the competitiveness of small and medium enterprises, to stimulate the economic activities, to promote the development of the industry sectors and to increase productiveness, in 2010 support is provided to those, who undertake business activities by providing grants and credits, as well as financial availability to SME is provided, by providing guarantees of competitiveness and export, along with continued issue of credits.

### **3. MARKET DRIVERS**

The development of Latvia's economy in the 2<sup>nd</sup> half of 2009 was mainly affected by significant downfall of the domestic demand, however the positive trends started in the second half of 2009 a continued to develop also at the beginning of 2010.

The domestic consumption was negatively affected by the decrease in the incomes of the residents and the high level of unemployment. But in terms of supply, the growing efficiency of labor along with the actual reduction of the wages continued to reduce the labour costs, thus retaining a downward pressure on the prices. In 2010 the proportion of the prices for energy resources in the basket of consumer goods of Latvia has significantly increased in comparison with the previous year, thus expanding the effect of the shifting prices for energy resources on the total price index.

In comparison with the corresponding period of the previous year, the private investments in the nominal, as well as in the real expression fell by more than one third. Currently the proportion of private investments in the GDP is twice as small as the level before crisis. But the dynamics of the investments in the 1<sup>st</sup> quarter have improved slightly, and it can be expected that positive trends have remained in the 2<sup>nd</sup> quarter as well. The current level of investments is too low, and it should grow, to provide the development of Latvia's economy in medium period. Retention of a definite level of investments is provided by EU funding and state guarantee programmes, while additional support to the private investments in future could be provided by improvement of the international evaluation of the country economy. The comparatively low costs in construction and manufacturing creates favourable environment for the development of manufacturing. Currently the main obstacle to new investments is still the uncertainty of tax policy related to State Budget consolidation.

Direct foreign investments in Latvia decreased mainly from Estonia, Finland, Sweden, Lithuania and Denmark, , but increased mostly from Netherlands, Ireland and Norway..

Along with the high proportion of delayed credit payments, the attitude of banks towards crediting was cautious, therefore the balance of credits issued to the private sector continued to decline. Although the positive trends of economy development stabilized the money supply, no significant increase can be observed yet.

Despite separate positive aspects in the labour market, incomes of the residents continued to decrease in the 2<sup>nd</sup> quarter. Decrease of the held incomes mainly resulted from the decrease of the total wages. In July the registered level of unemployment continued to decline for already the fourth consecutive month (to 15.3% of the economically active residents).

The main driving force of the economic recovery has become the processing industry, which shows significant rate of growth. In the 2<sup>nd</sup> quarter the output in accordance with seasonally adjusted data was 7.9% higher than the level of the previous quarter, growing by 12.0% within a year (according to data corrected by the number of working days). The output of wood and wood articles industry grew by 11.4%.

Timber industry is the second largest processing industry sector in Latvia, the total turnover of which in 2009 was **663.2 million LVL** (943.6 million EUR). The output of timber industry formed 23.3% of the total processing industry output.

Several development programmes have been launched using financing from the EU

Structural Funds, such as Support for New Products and Technologies development, the Programme to Support Competence Centres development, Support for Technology Transfer Contact Points and the Development Programme for Innovation Centres and Business Incubators, which are focused on the promotion of knowledge-intensive economic development and higher added value production. In 2009 the financing of operating programmes increased for such activities as the training for employed persons, high added value investments for enterprises, guarantees for improving the competitiveness of merchants, acquisition of external markets, measures for heat insulation of multi-apartment buildings and the development of the renewable energy resources cogeneration power plants.

#### **4. MARKET DEVELOPMENT TRENDS IN WOOD AND WOOD PROCESSING PRODUCT SECTORS**

##### **A. Wood raw materials**

Roundwood in Latvia is mainly used for production of sawnwood, wood-based panels, turned and planed products, wooden houses, palisades and garden furniture, fuelwood, charcoal, etc. Also, roundwood is mostly exported as pulpwood.

In 2009 roundwood export in terms of volume decreased by about 22% in comparison with 2008, while the value of exported timber dropped by 44%. In the first half of 2010, export of roundwood in terms of value has increased by 93%, but in terms of volume – by 79%, in comparison with the first half of the previous year. 81% of the roundwood export is pulpwood, which is mainly exported to Sweden, Finland and Estonia.

Over the last years, due to the rapid development of production of wood-based panels and fuelwood in Latvia, there has been a significant increase in small size sawlog utilization locally. A producer of wood-based panels *Bolderāja Ltd* has become the largest purchaser of pulpwood.

Although in 2009 the total export volume of roundwood decreased by 21% in comparison with 2008, the export of sawlogs grew by 25%. This trend of growth has remained also in the first half of 2010, and it has increased by 18% in comparison with the first half of 2009.

In 2009 the amount of imported roundwood continued to decline, and in terms of volume it dropped by 79%, reaching only 120.3 thousand cubic metres, of which the volume imported from Russian Federation was less than 6%. Before the increase of the significant export duties, in 2007 almost 70% of the whole imported timber was imported from Russian Federation. The volume of roundwood imported in the first half of 2010 has increased almost twice in comparison with the total amount of roundwood imported in 2009. 48% of roundwood were imported from Belarus, but almost 41% - from Lithuania. One third of the imported roundwood was sawlogs.

##### **B. Wood energy, government policies promoting it**

Taking into account the climate conditions, production of thermal energy traditionally constitutes the biggest share (64%) of the energy balance of Latvia. Fuelwood is the most important local fuel in Latvia, and its share in the fuel balance is 25%. Major consumers of fuelwood are households – 65.4%, heat supply companies – 15.1%, industry (mainly wood-working enterprises) and other consumers – 19.5%. Fuelwood is used evenly across all regions.

Production of fuelwood (pellets, chips, fuelwood, briquettes) is becoming more important in Latvia's timber industry. Although the use of logging residues is increasing,

still mainly in the private forests logging residues remain in the forests.

In 2009 fuelwood export in terms of volume has increased by 20.4%, but in terms of value – by 6%. Fuelwood export formed 14.9% of the total forest sector export. Majority of fuelwood structure is formed of chips and pellets export.

With the support of the EU Funds, in 2010 for the implementation of power industry projects activities are undertaken within the project *The Improvement of Efficiency of Centralised Heat Supply Systems*, providing support to the reconstruction of heat sources and heat supply networks, including procurement and instalment of technological equipment, as well as for construction of heat sources and heat supply networks and within the project *Development of Renewable Energy Resources Cogeneration Power Plants*, providing support to construction of a new renewable energy resources cogeneration power plant and reconstruction of the current boiler house into a cogeneration station of renewable energy resources.

The further development in renewable energy policy has been continued in cooperation with all the involved sectors. In 2010 the third *Green Energy Forum* took place providing profound discussion on wider consumption of the green energy in Latvia's economy, focusing on the utilization of biomass in the production of energy.

The Ministry of Economics has drafted *Law on the Renewable Energy*, which has been developed in close cooperation with the experts and all stakeholders involved.

### **C. High added value wood products**

Although the output has fallen due to the crisis, no major changes can be observed in the production structure. The manufacturing of high added value timber industry production in Latvia has continued, and the increasing variety of production has remained the same as before crisis – furniture and furniture components, joinery and carpentry production, prefabricated wooden constructions, garden furniture and accessories, toys of wood and other production in high demand on the market is still manufactured. In 2009 reduction could be observed in all high added value product groups in terms of volume in comparison with 2008. Data of the first half of 2010 show that manufacturing of those products has increased, that are targeted at export, because the domestic demand still remains low.

In 2009 the export of furniture was LVL 55.1 million in terms of value, which is 17.3% less than in 2008. Although in comparison with the first half of 2009 reduction of export can be still observed, in the first half of 2010 it is slowing down and according to comparison of the current month to the previous month, growth can be observed.

As the demand of domestic market has plummeted due to the crisis and furniture import was mainly used to provide the domestic market, in 2009 furniture import reduced by 56%. The largest decrease, more than 60% could be observed from China, Poland and Lithuania. Data of the first half of 2010 prove that despite the fact that in 2010 an almost 5% decrease can be observed in comparison with 2009, furniture import has stopped falling. It is especially evident in relation to furniture imported from China, the import volume of which has increased significantly.

The biggest share in the group of woodwork products is attributed to laminated products, which account for more than 60% of the total volume. Despite the fact that carpentry production volumes have decreased and in 2009 in comparison with 2008 their export decreased by 1/5, they account for more than 6-7% of the total forest sector exports in the recent years. In the first half of 2010 export of these materials has increased by 21% in comparison with the first half of 2009.

The production volume in the group of wood packaging materials in 2009 decreased significantly. The main product was pallets - , they form 83% of the total volume. In

comparison with 2008 the volume of exported wood packaging materials in 2009 decreased by 31%. But data of 2010 show that in the first half of the year export of wood packaging materials has increased by 22% in comparison with the first half of 2009.

#### **D. Sawnwood**

In 2009, the manufactured volume of sawnwood has decreased by almost 4% in comparison with 2008, reaching 2520 thousand cubic metres. The decrease of coniferous sawnwood was 1.7%, but of non-coniferous sawnwood – 17%. The small decrease of sawnwood production volume resulted due to almost 6% of increased export. 65% of the produced sawnwood were exported. Sawnwood export within the first half of 2010 in terms of volume has increased by 40%, but in terms of value – by 64% in comparison with the first half of 2009. In 2009 the local market demand for sawnwood dropped by 23.6%, along with the production of furniture and production of carpentry production and packaging materials. Along with the decrease in construction sector, also consumption of sawnwood decreased in this sector. Mostly, processed sawnwood ready for further use in construction and manufacturing of furniture or other materials was produced and exported.

Due to the downfall in sawnwood export to Great Britain in 2009 new markets have been found. Significant increase was in the sawnwood export to Germany, Japan and Egypt. Data of the first half of 2010 show that sawnwood export to Great Britain has begun to increase as well.

In 2009 import of sawnwood dropped by 51%. The imported volume of sawnwood in 2009 was only 0.11 millions of cubic metres, of which 28% were imported from the Russian Federation. Import of sawnwood in the first half of the year has increased by 2.4 times in comparison with the first half of 2009 (0,043 millions of cubic metres) and the volume of it is 0,10 millions of cubic metres. 32% of sawnwood have been imported from the Russian Federation, 25 % - from Estonia and 23% - from Belarus.

#### **E. Wood-based panels (particle boards, plywood, etc.)**

One of the most significant forest industry sectors in Latvia, due to large investments, is the production of wood-based panels. Although the total export of wood-based panels in 2009 in terms of money decreased by 21% in comparison with 2008, several products of wood-based panel group in terms of volume have even increased. Export of wood-based panels in the total export structure of forest sector production formed 17,5%. The major product in this group is plywood. In the first half of 2010 export of wood-based panels has increased in terms of volume, as well as in terms of value.

Latvia is the largest plywood producer in the Eastern Europe. Recently considerable investments have been made in the production of plywood, particle boards, oriented strand boards (OSB) and medium density fibreboards (MDF).

In comparison with 2008, the volume of the exported plywood in 2009 increased by 5.6% and formed 8.8% of the sector's export. In the first half of 2010 export of plywood has increased by 44%, reaching 9% of the sector's export and becoming the second most exported forest sector product. Plywood is mainly exported to Germany, Great Britain and France.

It should be noticed that export of particle boards in terms of volume continued to increase in 2009 as well, when the export volume of the majority of wood articles decreased. The reason for it is the large investments made to this production segment. In the first half of 2010 export of particle boards in terms of volume has increased by 12.5%, but in monetary terms – by 33.7%.

Joint Stock Company *Bolderāja Ltd* plans to launch production of eco-pallets that do not contain formaldehyde resin.

#### **F. Pulp and paper**

In comparison with the previous year, in 2009 there was a decrease in production volume and export of paper and paperboard in Latvia. Export of these products in terms of money has decreased by 20%, but the production still comprised 6% of the sector export. In the first half of 2010 export of this production, although it has not reached the level of the previous year, has increased by 24%. The main markets for these products are Lithuania and Estonia.

## 5. TABLES

### Key Indicators of Economic Development in Latvia

	2005	2006	2007	2008	2009	2010 f
(growth compared with the previous year, percent)						
Gross domestic product	10.6	12.2	10.0	-4.6	-18.0	-3.0
Private consumption	11.2	21.2	14.8	-11.0	-24.0	1.0
Public consumption	2.7	4.9	3.7	1.5	-9.2	-6.5
Gross fixed capital formation	23.6	16.4	7.5	-13.2	-37.3	-30.3
Export	20.2	6.5	10.0	-1.3	-15.5	5.0
Import	14.8	19.4	14.7	-13.6	-35.5	5.9
Consumer prices	6.7	6.5	10.1	15.4	3.5	-1.6
(percent of GDP, unless indicated otherwise)						
Central government sector balance	-0.4	-0.5	-0.4	-4.0	-9.0	-8.5
Central government debt	12.4	10.7	9.0	19.5	36.1	55.1
Export-import balance		-21.5	-20.2	-13.6	-0.7	-0.8
Changes in the employment rate (15-74 years)		5.0	2.9	0.5	-12.2	-6.5
Unemployment rate (proportion of job seekers in % of economically active population, 15-74 years)	8.7	6.8	6.0	7.5	16.9	17.0

f – forecast of the Ministry of Economics Source: Ministry of Economics

### Forest sector production exports from Latvia

HS code	Production	Units	2008		2009	
			1000 (units)	1000 (EUR)	1000 (units)	1000 (EUR)
<b>3605</b>	<b>Matches</b>		-	<b>183.1</b>	-	<b>35.9</b>
<b>44</b>	<b>Wood and articles of wood</b>		-	<b>995083.5</b>	-	<b>809823.9</b>
<b>4401</b>	<b>Fuelwood:</b>	(t)	<b>2402.3</b>	<b>134077.4</b>	<b>2893.2</b>	<b>142657.5</b>
44011	Fuelwood (round)	(t)	354.0	16073.6	786.7	30981.8
44012	Chips	(t)	1556.7	66743.4	1448.5	46014.4
44013	Sawdust and other wood residues	(t)	491.6	51260.4	658.0	65661.3
<b>4403</b>	<b>Roundwood:</b>	(m3)	<b>3192.6</b>	<b>178911.4</b>	<b>2502.6</b>	<b>100551.4</b>
44032	Coniferous	(m3)	1606.4	88270.9	1335.4	53129.9
44033...	Non-coniferous	(m3)	1586.1	90640.5	1167.2	47421.5
<b>4407</b>	<b>Sawnwood:</b>	(m3)	<b>1543.9</b>	<b>283729.0</b>	<b>1631.5</b>	<b>251463.4</b>
44071	Coniferous	(m3)	1313.1	241399.0	1411.2	219902.9
44072...	Non-coniferous	(m3)	230.7	42330.0	220.4	31560.5
<b>4408</b>	<b>Veneer sheets</b>	(m3)	<b>7.7</b>	<b>8530.2</b>	<b>4.7</b>	<b>3692.5</b>
<b>4409</b>	<b>Further processed sawnwood:</b>		-	<b>19577.5</b>	-	<b>17171.1</b>
44091	Coniferous		-	9572.5	-	10321.9
44092	Non-coniferous		-	10005.0	-	6849.2
<b>4410</b>	<b>Particle board</b>	(m3)	<b>434.0</b>	<b>80285.3</b>	<b>491.1</b>	<b>77788.9</b>
<b>4411</b>	<b>Fibreboard</b>	(m2)	<b>1068.2</b>	<b>2503.9</b>	<b>780.4</b>	<b>2240.1</b>
<b>4412</b>	<b>Plywood</b>	(m3)	<b>156.4</b>	<b>121092.8</b>	<b>165.1</b>	<b>83768.5</b>

4415, 4416	Wooden wrapping and packing equipment		-	54975.6	-	37995.4
4418	Joinery and carpentry		-	78654.5	-	67188.9
44...	Other articles of wood		-	32745.9	-	25306.1
47	Pulp of wood, recovered paper	(t)	38.5	3320.3	37.3	2452.4
48	Paper and paperboard, articles of paper		-	70203.7	-	57059.3
94...	Furniture		-	94796.0	-	78395.8
9406	Prefabricated buildings		-	14155.9	-	7204.8
	<b>Total:</b>			<b>1177742.5</b>		<b>954972.0</b>

Prepared by: Department of Forest, Ministry of Agriculture  
Source: Central Statistical Bureau

### Forest sector production imports to Latvia

HS code	Production	Units	2008		2009	
			1000 (units)	1000 (EUR)	1000 (units)	1000 (EUR)
3605	Matches		-	432.0	-	543.6
44	Wood and articles of wood		-	184351.3	-	80094.3
4401	<b>Fuelwood:</b>	(t)	148.4	6348.0	27.9	1449.0
44011	Fuelwood (round)	(t)	1.2	237.7	4.8	186.2
44012	Chips	(t)	80.0	1698.1	6.7	269.0
44013	Sawdust and other wood residues	(t)	67.2	4412.2	16.4	993.9
4403	<b>Roundwood:</b>	(m3)	566.2	42157.9	120.3	4014.1
44032	Coniferous	(m3)	229.4	12405.4	51.0	2102.0
44033...	Non-coniferous	(m3)	336.9	29752.5	69.3	1912.1
4407	<b>Sawnwood:</b>	(m3)	231.6	39426.4	112.5	17010.2
44071	Coniferous	(m3)	197.9	31791.4	103.6	14214.5
44072...	Non-coniferous	(m3)	33.7	7635.0	8.9	2795.6
4408	Veneer sheets	(m3)	4.4	3415.0	51.9	7108.9
4409	<b>Further processed sawnwood:</b>		-	4043.0	-	1979.9
44091	Coniferous		-	1517.7	-	821.6
44092	Non-coniferous		-	2525.2	-	1158.2
4410	Particle board	(m3)	65.6	17238.0	27.2	6627.9
4411	Fibreboard	(m2)	4496.8	15602.7	3424.3	9633.2
4412	Plywood	(m3)	36.6	16181.8	32.7	10017.0
4415, 4416	Wooden wrapping and packing equipment		-	5337.1	-	3826.3
4418	Joinery and carpentry		-	23507.1	-	12027.3
44...	Other articles of wood		-	11094.3	-	6400.5
47	Pulp of wood, recovered paper	(t)	5.1	850.1	5.2	647.7
48	Paper and paperboard, paper articles		-	203186.3	-	149345.2
94...	Furniture		-	79761.6	-	35356.0
9406	Prefabricated buildings		-	2250.2	-	840.0
	<b>Total:</b>			<b>470831.5</b>		<b>266826.8</b>

Prepared by: Department of Forest, Ministry of Agriculture  
Source: Central Statistical Bureau