

# UNECE TIMBER COMMITTEE – OCTOBER 2012

## UK Timber Market Statement

### 1. General Economic Trends affecting the Forest and Forest Industries Sector

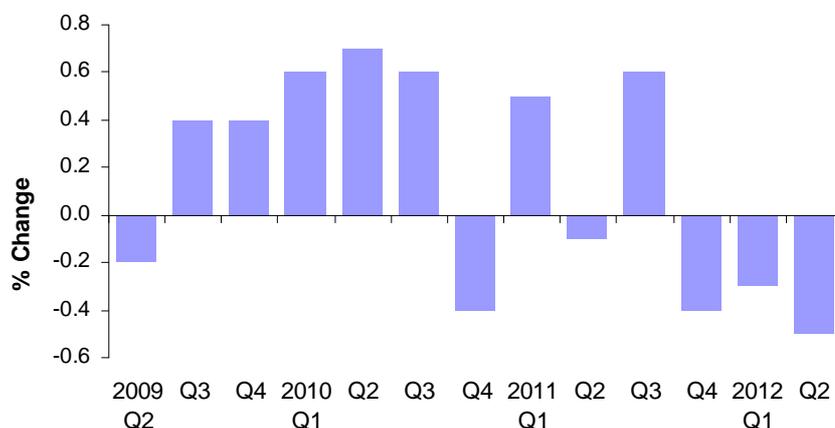
#### GDP Growth

Gross Domestic Product (GDP) is estimated to have fallen for three consecutive quarters according to data released by the Office for National Statistics (ONS), meaning the UK is back in recession, although the extent of the fall in GDP is believed to have been magnified by a number of factors that are not expected to persist. GDP has remained broadly flat over the last two years and still lies below its peak prior to the 2008/9 recession. ONS data suggest that the recovery from the 2008/9 recession has been more modest than previous recessions and output is unlikely to surpass its pre-recession level until 2014.

Recent growth figures from the ONS show GDP to have fallen by 0.5% in 2012 Q2, considerably more than the 0.3% contraction in 2012 Q1.

The quarterly development of GDP over the last four years is shown in chart 1.

**Chart 1: Gross Domestic Product Growth by Quarter, 2009-2012**



Source: Office for National Statistics

The Bank of England's (BoE) quarterly report and the ONS have both suggested that the larger than expected contraction of output in 2012 Q2 may reflect a temporary reduction in activity due to the additional bank holiday for the Diamond Jubilee as well as an unusually large decline (5.2%) in output in the construction sector. However, considerable uncertainty surrounds the actual effects of public holidays on output.

On the demand side, the BoE's latest quarterly report points to weak growth in the Eurozone and further afield as factors in holding back UK export growth. Factors within the UK are also constraining demand. These include fiscal consolidation, tight credit conditions and a squeeze on household real incomes (incomes not rising as fast as inflation).

Growth in the Eurozone, the UK's most important trading partner, has been flat over the past year. This in part reflects the impact of the significant challenges of addressing the imbalance of competitiveness within the euro area and reducing indebtedness in some countries. Even if the challenges facing the euro area are addressed in an orderly fashion with a credible and effective set of policies, the scale of the necessary adjustment is likely to weigh heavily on demand in the most vulnerable economies for a prolonged period. And an associated period of heightened uncertainty could continue to depress demand elsewhere in the euro area and beyond, including the UK. Recent weak export growth may also reflect an adverse shift in global demand away from activities in which the United Kingdom specialises, such as business and financial services.

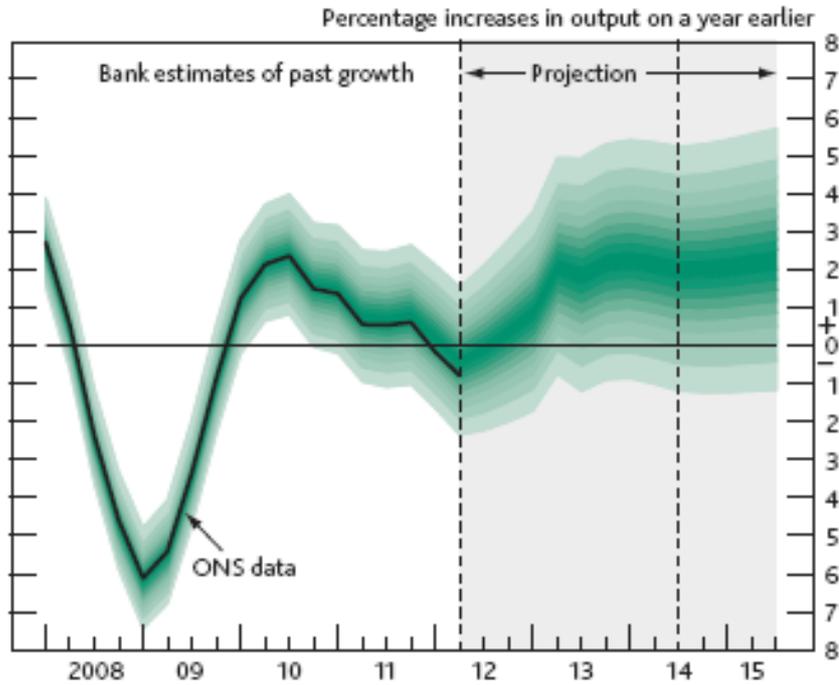
Business investment growth was above average in 2012 quarter 1 and has recovered somewhat over the past couple of years although still lies well below pre-2008 levels. The above average growth reflected, in part, investment in water, gas and electricity which rebounded after falling in 2011.

Household spending growth was weak in 2011 quarter 4 and 2012 quarter 1 and still remains 6% below its pre-2008 peak. It is likely that weak income growth in real terms has been the key driver in subdued household spending growth. Since 2007 post tax income has barely grown in real terms. Real household income growth should begin to strengthen again, followed by household spending as inflation falls back and pressures from VAT increases and import price increases begin to relax.

The Office for Budget Responsibility's (OBR) growth target for 2012 of 0.8% now looks unlikely given the contractions in quarters 1 and 2. Growth is expected to resume in the remainder of the year but meeting the target would require quarter 3 and 4 growth in excess of 2%. The BoE highlights three main factors hampering growth – challenges in the Eurozone, tight credit conditions and a fall in real household incomes. The BoE suggests that a gentle recovery in real incomes, as inflation falls, should lead consumption and GDP growth to strengthen gradually although the outlook for growth is unusually uncertain.

This is demonstrated by the wide band of future possibilities in the chart below.

**Chart 2: Gross Domestic Product Growth by Year, 2008-2015**

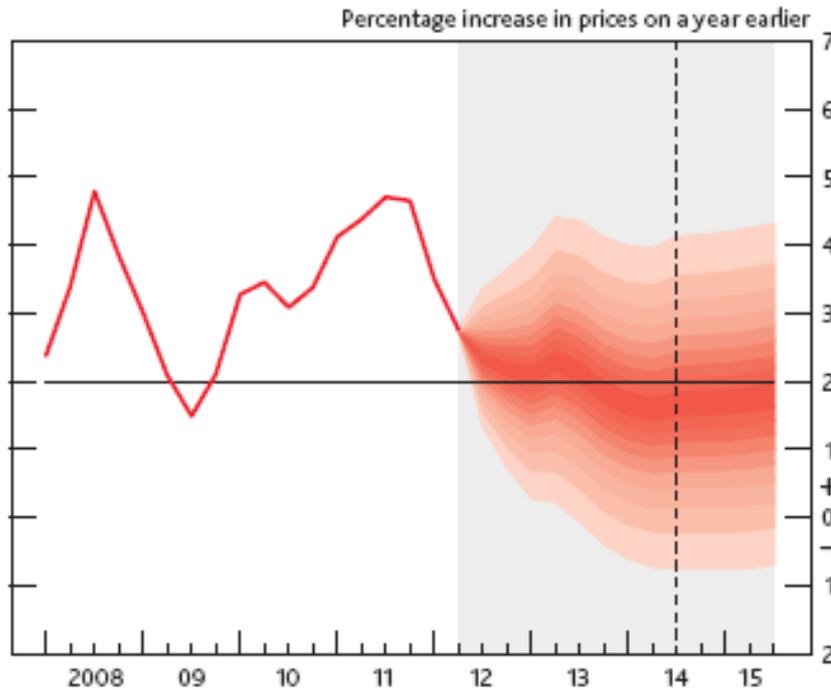


Source: Bank of England

### Inflation

The Consumer Price Index (CPI) of annual inflation, which measures a 'typical' basket of household goods, rose to 2.6% in July, up from 2.4% in June, after falling steadily from a peak of 5.6% in September 2011. Inflation has now been above the Government's 2% target for over two years but is estimated to fall to, and at times a little below, the Government target.

**Chart 3: Inflation: CPI 2008-2012, projections 2012-2015**



Source: Office for National Statistics

According to the Bank of England’s latest Quarterly Inflation Report, inflation is a little more likely to be below than above the 2% target for much of the second half of their forecast period (up until 2015), as the impact of external price pressures wanes and domestic cost pressures ease. The Bank has cautioned, however, that the likely fall in inflation and its timing are subject to considerable uncertainty.

No single factor drove the rise in inflation in 2011; instead, inflationary pressure came from a number of areas, including transport, housing & housing services, alcohol & tobacco and food and non-alcoholic beverages. The largest upward pressures on the change in the CPI rate came from transport (particularly air fares) and housing & housing services which rose by 1% and 0.4% respectively. The largest downward pressure came from clothing and footwear and furniture and household goods which fell by 2.6% and 1.1% respectively. A fall in these categories is normal for the June to July period, due to summer sales.

The Retail Prices Index (RPI) – a wider measure of inflation that includes housing costs – stood at 3.2% in July, up from 2.8% in June.

The Monetary Policy Committee (MPC) of the Bank of England voted unanimously, at its August 2012 meeting, to leave the base rate unchanged at 0.5%. The base rate has remained unchanged since it was reduced to 0.5% in March 2009 and current expectations suggest it will remain unchanged until 2015. The MPC also voted to maintain its Quantitative Easing (QE) programme at £375bn. Through QE, the Bank purchases financial assets, such as government and corporate bonds, thereby increasing the volume of money in circulation. The aim is to increase the supply of credit, which should, in turn,

help to stimulate the economy. The most recent change to the size of the QE programme was an increase of £50bn to £375bn in July 2012.

### **Exchange Rates**

One of the most critical factors determining the continued success of the domestic timber sector is its ability to respond to exchange rate changes. Recent strengthening of the Pound against the Euro has caused concern amongst UK softwood producers. Further strengthening of the Pound is likely to result in reduced demand for UK produced softwood, as buyers find imported softwood prices more attractive. This assumption is based on imported softwood prices not rising and indications in mid-2012 suggest that imported softwood prices are falling, rather than strengthening.

In conclusion, the UK economy has been broadly flat since the 2008/9 recession and although back in recession this is not expected to continue. Current expectations are for sluggish growth with a large degree of uncertainty. Inflation is predicted to continue to fall in 2012 towards the long term target of 2% and eventually dip slightly below this in coming years although a high degree of uncertainty remains around the timing of these estimates.

## **2. Policy Developments potentially affecting Trade in Wood Products**

### **Update on the EU Timber Regulation and FLEGT**

The EU Timber Regulation (EUTR) will come into effect in March 2013. This will require those who first place timber on the market in the EU to have a due diligence system in place to minimise the risk of the timber being illegal. It will also require those who trade in timber to keep records and make it an offence to sell timber that is illegal. Both the EU Timber Regulation and the EU FLEGT Regulation support the UK government's continued commitment to tackle illegal logging, sustainable forest management and support responsible timber procurement.

The legislation will be implemented by what is termed a "Competent Authority" and the National Measurements Office (NMO) will perform this function across the UK. Defra, who take the lead on the EUTR, will hold a consultation on the detail of the how the legislation will be implemented and enacted in the UK later in 2012.

The EU legislation recognises that existing national systems which fulfill the requirements may be used as a basis for exercising due diligence. The two main sources of timber supply in the UK are from its own forests (15 – 20% of supply by volume) and from importation from the many countries of the world that export to the UK. The Forestry Commission is the Government department for forestry in Great Britain and the Timber Trade Federation represents the interests of importers and merchants. Both organisations have systems which either through regulation, standards or industry best practice help UK forest owners and importers address issues of due diligence in the supply of timber products.

For supply from forests in Great Britain, sustainable management to the UK Forestry Standard can be verified through approved forest plans or Felling Licences from the Forestry Commission or, in the coming months, from the Forest Service in Northern

Ireland. Independent certification, which is in place for about 80% of UK timber production, can be used to provide further assurances of responsible management.

For imported timber and wood-based products, the Timber Trade Federation (TTF) operates a mandatory due diligence process the Responsible Purchasing Policy (RPP) for members as part of its Environmental Code of Practice. The RPP provides a framework and set of management tools to help TTF members objectively and formally analyse the risk of products being from an illegal source of supply.

The overall exercise allows members to develop an overall risk profile of all products in their supply chain, allowing them to prioritise actions and resources on those products and suppliers where risk is highest, with the aim to improve their risk profile over time.

The annual RPP report confirms improvement has been made by TTF members companies in the management of risk when procuring timber products.

For 2011, the proportion of timber purchases that may contain some form of risk that the goods were sourced from illegal practices is forecast to fall below 10% for the first time.

This does not suggest that this percentage of purchases has been sourced from illegal activities – it declares that the risk that such activity has taken place has been quantified and steps taken to mitigate such risk.

With the introduction of the UE Timber Regulation in March 2013, TTF members, through the RPP, have the tools and mechanism to demonstrate due diligence has been conducted on their timber purchases and compliance with the regulation made.

The TTF would be pleased to discuss in detail the RPP with representatives from other countries – contact Anand Punja, Timber Trade Federation, The Building Centre, 26 Store Street, London WC1E 7BT - e-mail [apunja@tff.co.uk](mailto:apunja@tff.co.uk).

### **EU FLEGT Regulation and Imports**

European COMMISSION REGULATION (EC) No 1024/2008 of 17 October 2008 “laying down detailed measures for the implementation of Council Regulation (EC) No 2173/2005 on the establishment of a FLEGT licensing scheme for imports of timber into the European Community” is now in force. Voluntary Partner Agreement (VPA) countries will be listed in the Annex of the regulation. The EU Timber Regulation also recognises that FLEGT-licensed timber will meet the requirements for companies to have conducted due diligence on their timber supply. This provides a strong incentive for timber exporting countries to agree Voluntary Partner Agreements (VPAs) with the EU.

### **UK Bioenergy Strategy**

The UK Government considers bioenergy to be an important part of the energy mix which will allow the UK to meet its energy and climate change objectives, including the 2020 renewables targets and 2050 carbon reductions targets. Paramount in this development is the contention that only bioenergy from sustainable sources is used to achieve this.

Published in April 2012, the Government's Bioenergy Strategy describes a framework of principles for future policy development and sets out a broad hierarchy of uses in energy while considering non-energy sectors, but does not set policies and delivery measures and does not dictate how biomass must be used.

In order to inform this strategy, evidence was gathered on:

- the availability of sustainably-produced biomass feedstocks to UK users
- the likely carbon impacts of bioenergy compared to possible alternative uses of the biomass resource

and

- the role of biomass in the energy system compared to other choices for low-carbon energy.

The principles which will act as the framework for future Government policy are:

- Policies that support bioenergy should deliver genuine carbon reductions that help meet UK carbon emissions objectives to 2050 and beyond.
- Support for bioenergy should make a cost effective contribution to UK carbon emission objectives in the context of overall energy goals.
- Support for bioenergy should aim to maximise the overall benefits and minimise costs (quantifiable and non-quantifiable) across the economy.
- At regular time intervals and when policies promote significant additional demand for bioenergy in the UK, beyond that envisaged by current use, policy makers should assess and respond to the impacts of this increased deployment on other areas, such as food security and biodiversity.

This principle-based approach to strategy has been developed because, as outlined in the framework, *“The aim of these principles is to provide stakeholders with clarity on the circumstances in which Government is likely to be willing to support bioenergy. They will assist policy development and decisions where there are uncertainties and trade-offs. Unlike targets and rules, this principles-based system is flexible enough to remain valid in the face of evolving evidence and technological development and innovation”*.

The strategy framework also outlines a number of ‘deployment paths’ which are intended to allow the Government to meet its decarbonisation targets and renewable objectives in the four areas of wastes, heat, transport and electricity generation.

Whilst the strategy has flexibility built-in, to evaluate preferred options as and when technological, environmental and economic developments take place, there exists a number of Government sponsored activities either planned or underway. Some of these are:

- Promoting cost and carbon efficient biomass electricity: through the Renewables Obligation Banding Review consultation, Government has set out proposals to support biomass-to-coal replacement, while also signalling a cautious approach to the creation of new dedicated biomass capacity in the 2013-17 banding period.
- Maximising industrial heat deployment: the introduction and development of the Renewable Heat Incentive is the key policy measure to achieve this aim.
- Maximising energy recovery: consistent with the waste hierarchy the Government's waste policies promote the re-use and recycling of materials where appropriate, with energy recovery only when other uses are exhausted or it forms the best environmental outcome.
- Making capital funding available: The UK Green Investment Bank is a new programme of direct Government investment in green infrastructure. The Green Investment Bank's mission is to provide financial solutions to accelerate private sector investment in the UK's transition to a green economy. It will work towards a 'double bottom line' of both achieving significant green impact and making financial returns. It has made available £100 million to invest in small waste infrastructure projects (typically in the size range of £15-25 million), on a fully commercial basis.
- Supporting innovation in energy crops, biofuels and biomass for power and heat: Government will support bioenergy innovation research, development and demonstration through a number of different organisations including DECC, ETI, TSB, Carbon Trust and Research Councils UK. These organisations and others come together under the umbrella of the Low Carbon Innovation Coordination Group. The Low Carbon Innovation Coordination Group (LCICG) aims to maximise the impact of public sector funding of low carbon energy technology innovation in order to deliver affordable, secure, sustainable energy for the UK, deliver UK economic growth and capabilities, knowledge and skills.

Specific developments in energy provision in the UK are covered later in this Market Statement in section 3. Market Drivers, under "Energy Markets".

### **Government Spending Review**

Mention was made in last year's Market Statement of the Government's Comprehensive Spending Review which was aimed at reducing the budget deficit (government expenditure exceeding revenues) over the period from 2011 to 2015. One of the main mechanisms has been to reduce public spending.

The success of the Review and other austerity measures put in place to reduce the budget deficit has been hindered by lower than forecast economic growth and this has placed pressure on Government tax revenue targets and debt servicing charges.

Consequently, deficit reduction target timetables will need to be further extended and tight fiscal prudence will ensure that austerity, rather than growth will prevail during the remainder of 2012 and into 2013.

The lack of growth in the economy in the short-term will continue to have a depressing effect on the wood sector's largest market - construction.

A less visible, but highly important consequence of austerity in the UK is its impact on plant health.

Tree pests and diseases are becoming an increasingly serious problem and not just from an environmental perspective. The economic impacts of dealing with plant health issues may have serious consequences if forest cover is further reduced through an inability to reduce or eradicate disease. Any lack of funding to address these issues may prove to be counter-productive as the economic cost of the aftermath of infection, transport, sale or disposal and replanting may outweigh any cost savings made through spending cuts.

The specific issue of larch infection is considered below.

### **Plant Health Issues**

Phytophthora ramorum infection of Japanese larch (*Larix kaempferi*) trees continues to be the major plant health issue affecting the market in the UK. *P. ramorum* also occasionally infects European larch (*Larix decidua*) and hybrid larch (*Larix x eurolepis*). The National Forest Inventory report on standing timber volume for coniferous trees in Britain gives a total of 133 thousand hectares for all larches at March 2011.

*P. ramorum* is a fungus-like pathogen that kills many of the trees that it infects. It was first found on Japanese larch trees in south west England in 2009, and further outbreaks were identified in south Wales, the Peak District, Lancashire, Cumbria, Northern Ireland and south and west Scotland in 2010, with widespread infection in all ages of Japanese larch.

As of July 2012 about 3000 hectares of larch trees in infected or suspected infected stands have been felled or are to be felled in the UK. Overall, the number and area of new sites of infection was lower in 2011 compared with the previous two years, and most infections were close to or contiguous with previously known sites. In 2012 Wales and Scotland appear to be suffering a higher incidence of new infection with England showing a slight decrease in confirmed new sites.

Biosecurity measures are in place to minimise the spread of infection in soil or on larch needles, people, vehicles, equipment and timber.

The 2009 discovery was the first time in the world that a commercially grown conifer species had been found with *P. ramorum* infection. Acting on scientific advice, notices to fell infected trees on public and private forest land are continuing to be served by Plant Health Authorities to try to contain the disease.

Extensive felling of the affected larch trees continues, and the Forestry Commission and the Forest Service are working with timber processors and others to ensure biosecurity measures are also in place to allow logs from the infected trees to be taken to mills for conversion into timber.

While the felling of all larch within 100 metres of infected trees is mandatory, this isn't required for species which are not susceptible. However, should an owner or manager choose to fell such trees then this must be carried out under notice and authorisation is made for movement. The subsequent processing and movement of timber and co-products from all material felled under notice is authorised in the same way. The justification for controlling material from non-susceptible species is that it may be

contaminated by infected larch needles and the proportionality of this approach is currently under review with representatives from Forest Research and the forest industry.

### **National Forest Inventory**

The National Forest Inventory (NFI) is an on-going programme of work aimed at quantifying the size, distribution, composition and condition of forests and woodlands in Great Britain (GB).

The NFI has generated transparent estimates of the current conifer resource in Great Britain expressed in terms of timber, biomass and carbon. These estimates are broken down in a range of different ways including by species, geography, and timber assortment.

The purpose of the NFI is to help develop and monitor the policies that guide sustainable forestry management in Great Britain.

The impact of different management scenarios on this growing stock and on timber production over the next 25 years has been quantified. This is a change to the historical approach which focussed on trying to predict the pattern of future timber removals without reference to growing stock changes and placed a heavy reliance on expert judgement.

A number of additional outputs and analyses will be delivered and published through the NFI programme over the period 2012 – 15, but some of the key findings are:

- The current GB conifer growing stock to 7cm top diameter (td) is 336 million cubic metres overbark standing (m<sup>3</sup> obs). This is 20% more than previous estimates derived from NIWT data e.g. Global Forest Resources Assessment (FRA) 2010.
- Current annual increment of conifers across GB is 16.3 million m<sup>3</sup> obs.
- Total (cumulative) coniferous timber production over the next 25 years is likely to be in the order of 350 million m<sup>3</sup> obs. This is significantly more than previously forecast and, in part, reflects the new conifer growing stock estimate.
- A range of scenarios have been run to illustrate the impact of different management assumptions on both the timing and nature (timber assortments) of production.
- At GB and individual country levels, the current conifer growing stock may undergo a substantive (>10%) reduction by 2036; more work is needed to substantiate this.

Importantly, the 2012 NFI outputs mark the start (not the conclusion) of the new approach to informing the many wide-ranging components of forest policy.

### **Forestry Policy in Great Britain**

Forestry policy in Great Britain will continue to be determined on a devolved basis.

The Forestry Commission in Scotland will continue to determine policy in Scotland where the balance between commercial and non-commercial uses of the forest is considered to be appropriate.

In Wales, the amalgamation of Forestry Commission Wales into the new Single Environmental Body is underway and the impact of this remains to be seen. A concern expressed by some is that the balance between different interests, which is a feature in Scotland, might not be repeated in Wales

In England, there are significant questions following the recent review of the future of the ownership and management of the public forest estate. Following strong resistance to the Government proposal to sell off much of the public forest estate in England, the Government established the Independent Panel on Forestry to advise it on the future of forestry in England. The Final Report of the Panel was published on 4 July; it was widely applauded as being comprehensive, positive and thought-provoking. It made 31 recommendations, amongst which were calls for increased tree cover in England and greater use of domestically produced wood and wood products.

The Government welcomed the report and has stated that the public forest estate will stay in public ownership, although new management models may be required. The Government will provide its formal response to the Report in January 2013.

## **3. Market Drivers**

### **Construction, Manufacturing and Distributive Trades**

Doubts over the sustainability of the recovery of timber sales in 2010, following two years of falling demand, were expressed in last year's Market Statement.

These doubts were based on weak demand in timber using markets in the early months of 2011, the lack of growth in the wider economy and a credit famine that was limiting business investment and had dampened consumer borrowing, especially in the important housing market.

These doubts were well-founded.

Housing starts in the UK in 2011 were 2.2% lower than in 2010. The volume of repair, maintenance and improvement work in the housing sector (housing RMI) fell by nearly 3% and the value of output by manufacturers of wooden packaging and pallets fell by 7.7% in 2011.

### **Construction**

From the turn of the century to the beginning of the recession in 2008, the construction industry had enjoyed a period of growth and over this time output had grown by 20%.

This growth had been fuelled by a buoyant housing market, strong growth in the private industrial and commercial building sectors and even stronger growth in infrastructure and publicly funded construction projects.

The low point in construction output came in 2009 with output nearly 16% lower than in 2007.

It had taken just two years to return to similar levels of output that had prevailed in the year 2000.

From 2009 to 2011 output improved and an 11% increase in construction output was recorded, however, these levels were still 7% below the peak of activity in 2007.

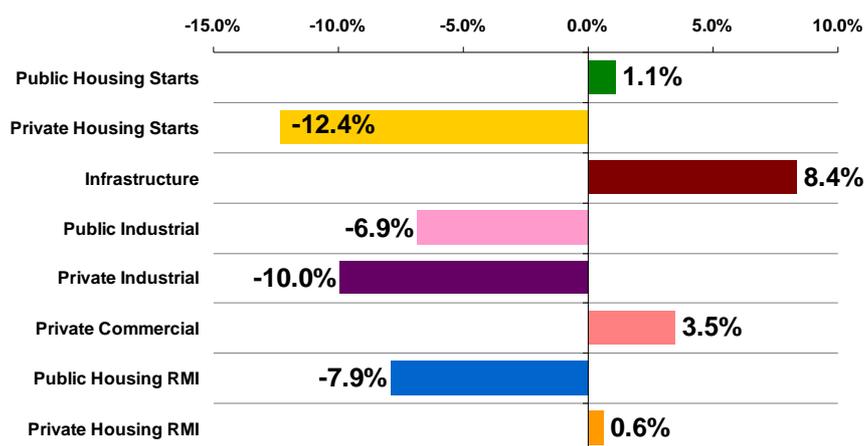
As reported in last year's Market Statement, a recovery in activity took place in 2010, which was largely responsible for the improvement between 2009 and 2011, but during 2011 output began to slow and by the year-end, many sectors of construction experienced declining output.

Despite a surge in social housing completions in 2011, the cuts in public spending announced in the Government's Spending Review of October 2010 had already been felt in the social housing sector with social housing starts lower by 12% in 2011.

Other publicly funded construction was also adversely affected with industrial output down by 7% and public housing repair, maintenance and improvement (RMI) lower by 8%. A mixed picture existed in the private sector, with private housing output higher, but private industrial work lower.

The development of construction sectors most pertinent to timber sales is shown in chart 4.

**Chart 4: Construction Industry Sector Output, 2011/2010**

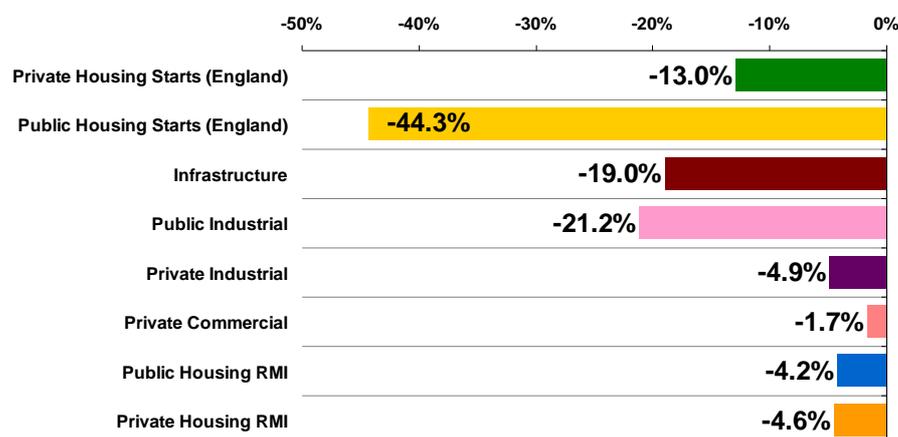


Source: DCLG & Office for National Statistics (ONS)

NB: Housing starts are provided by DCLG are measured in numbers – all other sectors are measured at constant prices.

The sector development in chart 4 above for 2011 describes a faltering construction industry, however, a worsening of activity is developing for 2012, as shown in chart 5.

**Chart 5: Construction Industry Sector Output, 1<sup>st</sup> Half 2012/ 1<sup>st</sup> Half 2011**



Source: DCLG & Office for National Statistics (ONS)

NB: Housing starts are provided by DCLG are measured in numbers – all other sectors are measured at constant prices.

Housing starts data for the UK will not be available for many months, but the first half starts in England have been included in the chart above. Housing starts in England regularly represent about 80% of UK starts, therefore a good indication of UK starts is provided.

The UK economy entered a second recession in 2012 (the second time since 2008 that the UK has experienced two consecutive quarters of reducing Gross Domestic Product) and the construction industry has been one of the worst affected.

As shown in chart 5 above, all selected sectors exhibit lower output than at the same time in 2011.

### **Manufacturing and Distributive Trades**

For the most of 2011, manufacturing output in the UK was higher than in 2010. In Q1 2011, manufacturing output was 4.6% higher than Q1 2010 and by Q2 2011 was 3.4% higher but by Q3 2011, growth had slowed to just 1.6% above the same quarter in 2010.

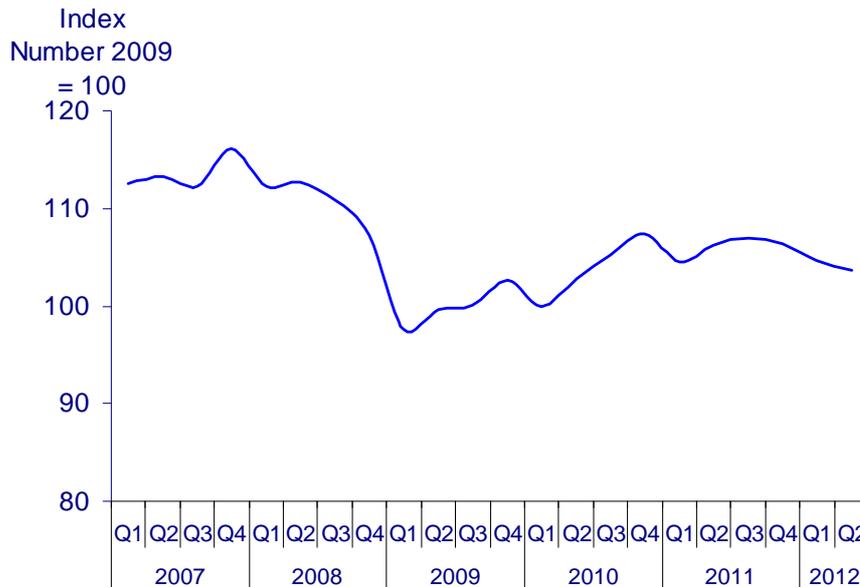
By Q4 2011, manufacturing output had fallen below the level of Q4 2010.

Reports that manufacturing output had improved by over 2% in 2011 were therefore accurate, but failed to describe a worsening situation.

Manufacturing output in the first quarter of 2012 was virtually identical to Q1 2011 but by Q2 2012, output had fallen by 2.5%.

The improved output in 2011 and the falling output to date in 2012 is shown in chart 6 below.

**Chart 6: Index of UK Manufacturing, Q1 2007 - Q2 2012**



Source: Office for National Statistics (ONS)

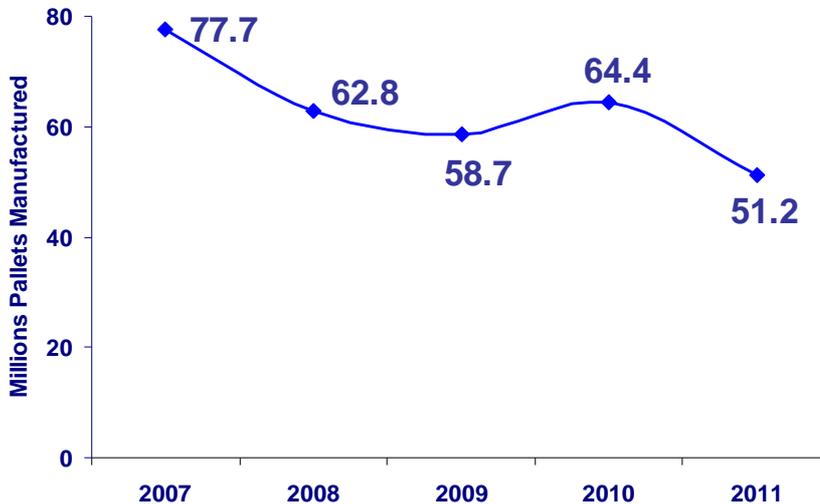
Lower levels of activity in construction, a reducing level of activity in manufacturing and little growth in distributive trades in 2011 provided a weak background for sales and renting of packaging materials and pallets.

The number of pallets produced in the UK in 2011, according to the official statistics supplied by ProdCom through the Office for National Statistics, fell from a revised total of 64.4 million in 2010 to 51.2 million in 2011.

The 20% decline in pallet production, although directly affected by the downturn in demand from user markets, is not wholly due to weak demand.

Another 'side-effect' of the last recession in 2008 and the most recent in 2012 is the need for companies to reduce costs and this feature of current commercial activity has resulted in a need for companies to reduce pallet buying and renting costs. This, in turn, has led to an increase in the proportion of recycled pallets, as opposed to newly manufactured pallets, being used by manufacturing and distributive trades.

**Chart 7: UK Pallet Production 2007-2011**



Source: ProdCom

This downturn in new pallet production and higher levels of recycling has reduced demand for timber products in the packaging and pallets industry as less timber is used in recycling than in the manufacture of pallets. The volume of softwood used in the pallets and packaging industry in 2011 is not yet known at time of writing, but based on softwood consumption in 2010 at the level of production for that year, it is likely that softwood consumption by pallet makers in 2011 will fall below the million m<sup>3</sup> mark.

In contrast to the packaging and pallets market, the fencing and outdoor use markets in the UK, such as decking, landscaping, garden products and motorway fencing have fared significantly better.

Estimates of usage in these fencing and outdoor markets indicate a rise in usage in the region of 9% taking the volume consumed in 2011 back to the levels of 2007 at a little less than 1.3 million m<sup>3</sup>.

### **Energy Markets**

Key Facts:

- Energy consumption in the UK fell by 7% in 2011
- Within the 7% overall decline, renewable energy grew by 20%
- Growth of renewables for electricity generation grew by 23%
- Growth of renewables for heat generation grew by 7%
- Within the 7% growth of renewables for heat, the growth of domestic wood in 2011 was 8% and the growth of industrial wood was 10%

In 2011, a reduction in the three largest forms of energy use, coal, natural gas and petroleum, were the main contributors to the 7% fall in all energy consumption.

Coal consumption was down by 1%, natural gas down by 17% and petroleum down by 3%.

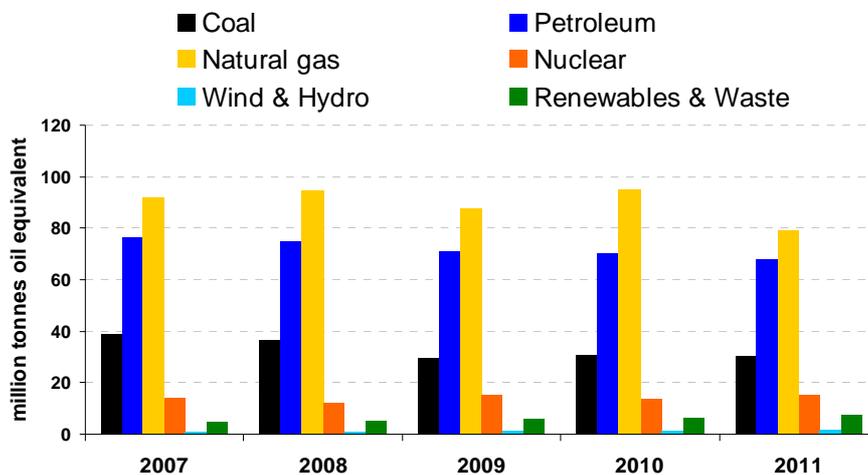
In contrast, consumption of nuclear generated energy was higher by 12%, renewables by 20% and wind/hydro up by 55%.

The use of renewables (including waste) has been rising each year over the last decade and has risen by 60% over the last five years, since 2007.

Consumption of renewables amounted to 7.5 thousand tonnes (oil equivalent), representing 3.7% of all energy consumption in 2011.

The consumption of each primary fuel between 2007 and 2011 is shown in chart 8 below.

**Chart 8: Inland consumption of primary fuels and equivalents for energy use 2007-2011**



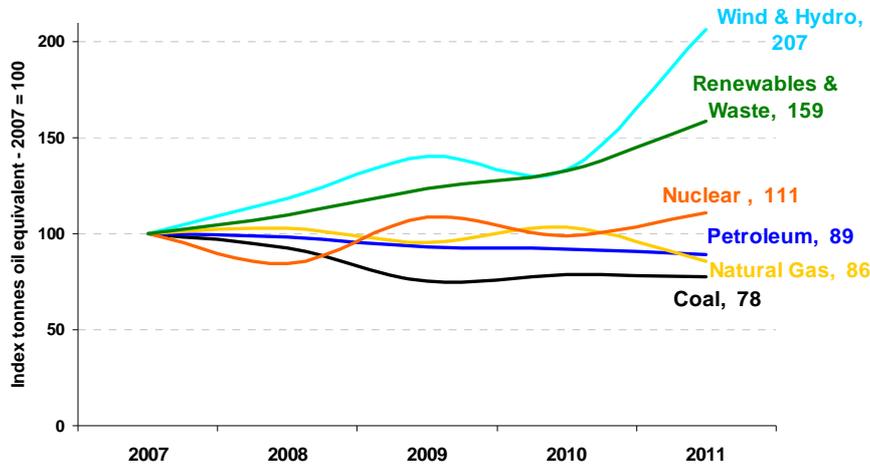
Source: Department of Energy and Climate Change (DECC)

The reductions in consumption of the three largest forms of energy supply in 2011 and over the period from 2007 can be viewed in the chart above.

Consumption of renewables remains small in comparison to other forms of energy provision, but has continued to grow during a time of lower overall energy consumption.

Chart 9 demonstrates this faster rate of growth of renewables from 2007.

**Chart 9: Indexed Growth Rates of inland consumption of primary fuels and equivalents for energy use 2007-2011**

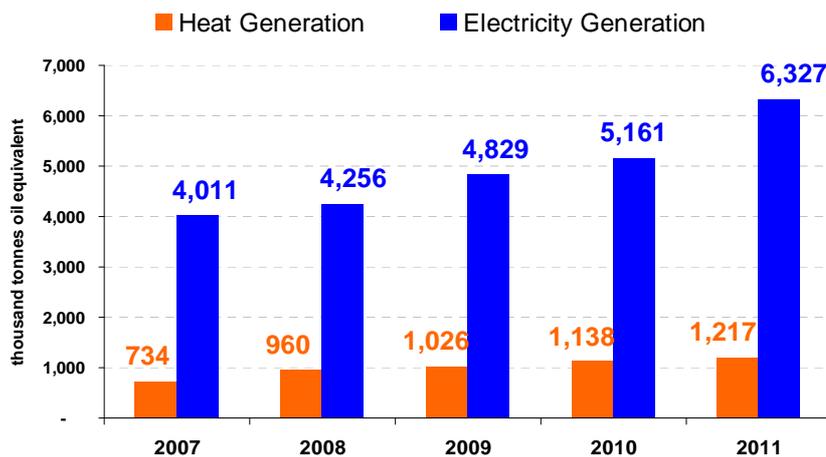


Source: Department of Energy and Climate Change (DECC)

The variety of renewable solutions include solar, hydro, wind, animal biomass and plant biomass (including wood and wood waste), in addition to landfill gas and municipal waste.

It was reported in last year's Market Statement that electricity generation accounted for 81% of all renewables consumed and this has subsequently been revised to 82%. The proportion in 2011 rose to 84%. The quantities of renewables used, in thousands of tonnes of oil equivalent, for electricity and heat generation from 2007 is shown in chart 10.

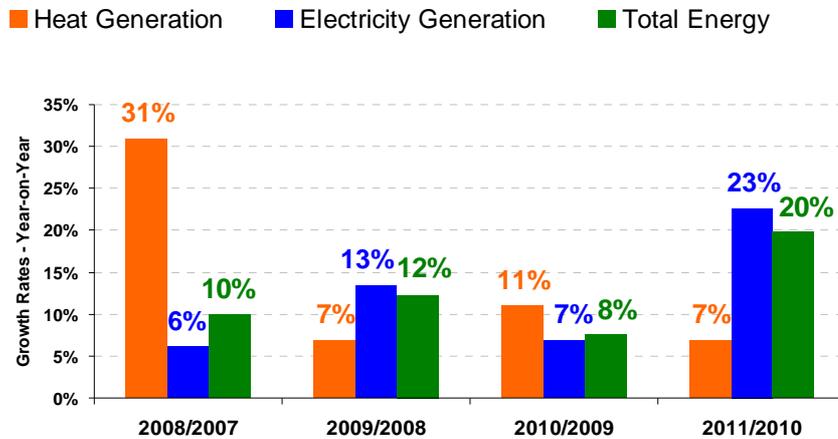
**Chart 10: Renewables Used for Electricity and Heat Generation, 2007-2011**



Source: Department of Energy and Climate Change (DECC)

The fastest-ever rate of growth of renewables used for electricity generation took place in 2011. The comparative growth rates of renewables for electricity and heat generation is shown in chart 11.

**Chart 11: Growth Rate of Renewables Used for Electricity and Heat Generation, 2007-2011**

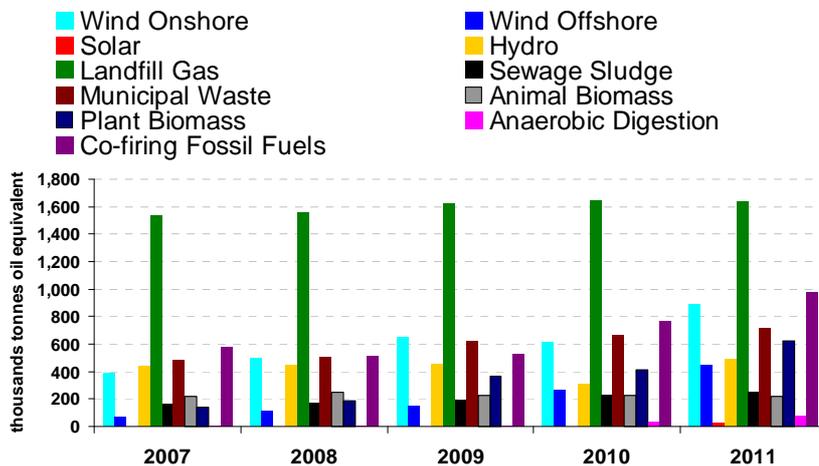


Source: Department of Energy and Climate Change (DECC)

The strong rate of growth of renewables used for electricity generation in 2011, driven in the main by Government subsidy, has raised the overall rate of growth of renewables for all energy use to 20%. Landfill gas and municipal waste remain the most widely used renewable in the generation of electricity, but over the last four to five years, growth in the use of co-fired with fossil fuels and wind generated electricity has taken place.

The range of leading renewable alternatives for electricity generation is shown in chart 12.

**Chart 12: Renewable sources used to generate electricity, 2007-2011**

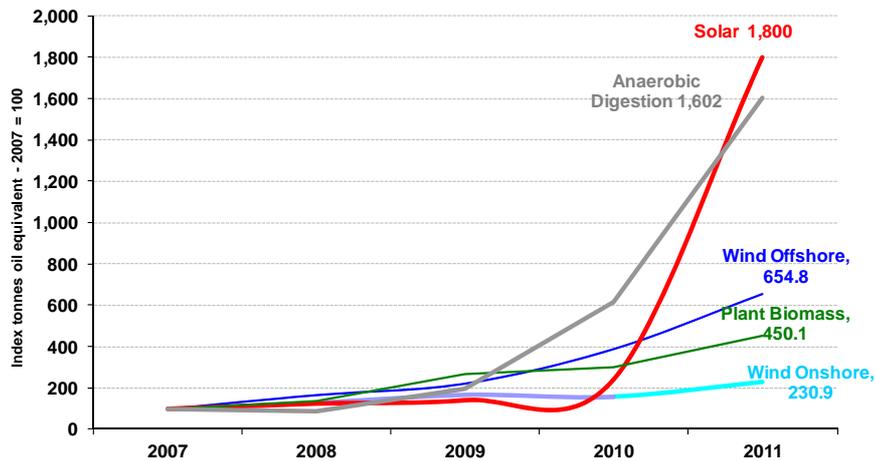


Source: Department of Energy and Climate Change (DECC)

In the five years from 2007 to 2011, plant biomass has grown from 3% of all renewables consumed to 10% in 2011, increasing by a factor of nearly 3.5. However, this strong performance in generation from plant biomass has been surpassed by the growth in wind power (and offshore wind power in particular) which has increased by a factor of 5.5 in these five years.

The growth rates of renewables for electricity generation have been indexed for the ease of comparison and are shown in two charts below. The highest growth renewables are shown in chart 13 and remainder of the group of renewables is shown in chart 14.

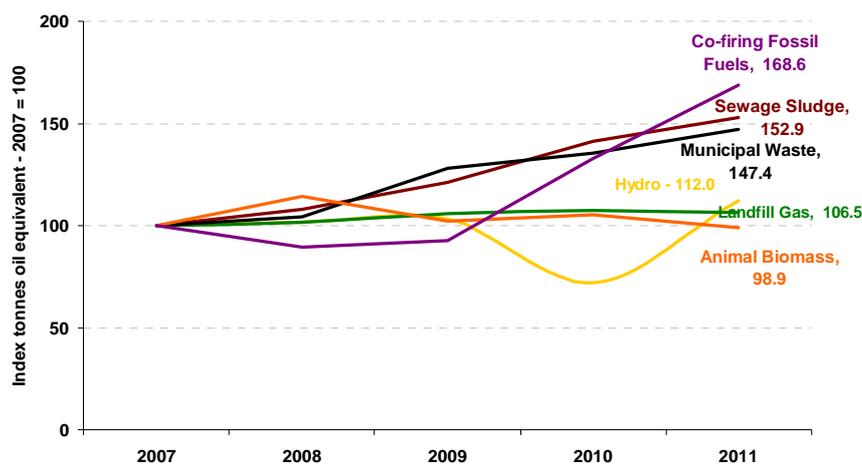
**Chart 13: Indexed (Highest) Growth Rates of Renewable Sources used to Generate Electricity, 2007-2011**



Source: Department of Energy and Climate Change (DECC)

Solar energy and anaerobic digestion as forms of renewable energy contribute a very small proportion of the total energy mix (collectively 1.5% - see chart 12), but the rates of growth in 2011 have been exponential, as shown above. Wind accounts for 21% of the total of all renewable electricity generation and plant biomass 10%, each growing rapidly over the last five years, as described above.

**Chart 14: Indexed (Other) Growth Rates of Renewable Sources used to Generate Electricity, 2007-2011**

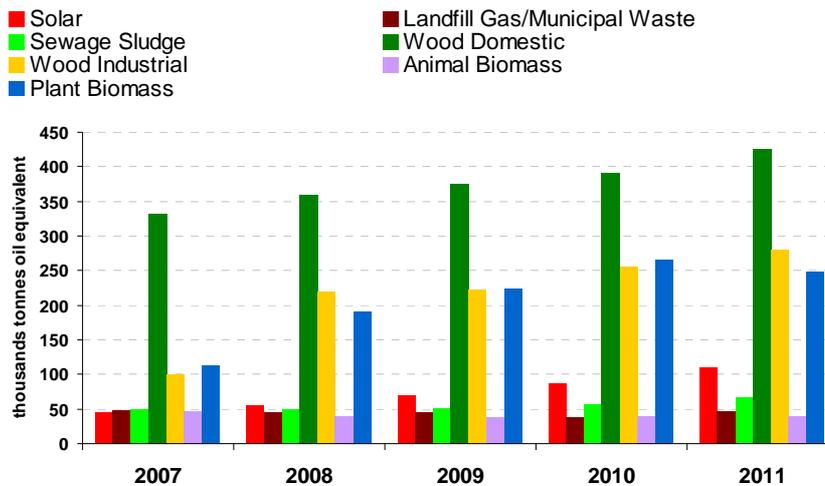


Source: Department of Energy and Climate Change (DECC)

The growth of co-firing with fossil fuels to generate electricity has also been strong over the last two years because of Government subsidies, the lower capital cost of converting existing facilities and the ability to rapidly implement such solutions. Referring to chart 12, co-firing of fossil fuels became the second most used form of renewable solution to electricity generation in 2010 and 2011.

As previously determined in this section, the proportion of renewables used for heat generation in 2011 was 16% of the total of all renewables consumed. The main product types and the scale of use in heat generation is shown in chart 15 below.

**Chart 15: Renewable sources used to generate heat, 2007-2011**

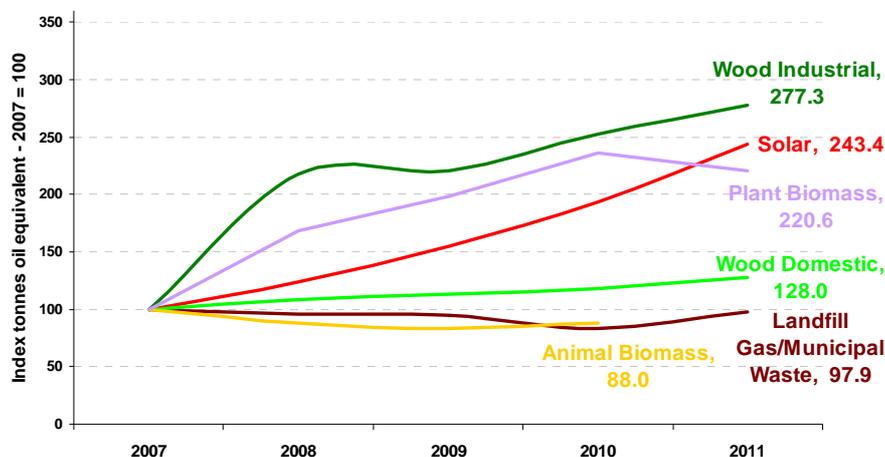


Source: Department of Energy and Climate Change (DECC)

The quantity of firewood burnt for domestic heating grew a further 8% in 2011 and wood used for industrial heating grew by 10%. For both uses, wood accounted for 58% of all forms of renewable energy used for heat in 2011. The category broadly described as ‘wood’ consists of cut logs, brash, wood chips, off-cuts, recycled wood waste, charcoal and imported wood. Usage of pellets for heat generation (also used for electricity generation) is a relatively new renewable and according to Forestry Commission estimates, around 244,000 metric tonnes of pellets were produced in the UK and a further million metric tonnes imported for generating heat.

The growth of each of the main renewables, as defined by DECC in chart 15, is shown in the chart below.

**Chart 16: Indexed Growth Rates of Renewable Sources used to Generate Heat, 2007-2011**



Source: Department of Energy and Climate Change (DECC)

NB: It should be noted that data for animal biomass for 2011 was not available at time of writing. An estimate, using the data for 2010 has been inserted elsewhere in this section to provide consistency in reporting.

Solar heating has grown rapidly since 2007 and accounted for 9% of all renewable forms of heating in 2011. The reduction in the rate of feed-in tariffs in 2011 and 2012 will, it is believed, slow the rate of growth in solar energy provision in the short-term.

Other forms of renewable energy for heating are expected to continue to grow as a result of stimulus from financial incentives. The UK Government's renewables policy involves the launch of the Renewable Heat Incentive tariff scheme (for industry, commercial premises and the public sector), and the Renewable Heat Premium Payment Scheme (for households).

The Renewable Heat Incentive opened for applications on 28 November 2011 and a number of projects have received approval, including applications from the UK timber processing sector. The scheme provides tariffs for commercial, industrial and community renewable heating installations. The expectation by Government is that this scheme will raise renewable heat as a proportion of all energy supply for heating and save 44 million tonnes of carbon by 2020.

The Renewable Heat Premium Payment scheme was launched in August 2011 to householders and social landlords, and provided a one-off payment to support the purchase of renewable heat technologies. Between the scheme launch and the end of 2011 there were 883 installations across all the technologies, with a total capacity of around 4.5 MW. Of these, 326 were air source heat pumps with a total capacity of 1.7 MW; there were also 102 biomass boilers (total capacity 1.3 MW), 147 ground source heat pumps (0.8 MW), and 308 solar thermal panels (0.8 MW). The RHPP scheme was extended in April 2012 to run until the end of the 2012/13 financial year.

In August 2011, the Government launched a £3 million scheme to help install eco-heaters in the homes of social housing tenants. Heating equipment including biomass boilers,

solar hot water panels and heat pumps will be available under the new scheme. Registered Providers of social housing, such as local authorities and social housing associations, will be able to bid for a share of the £3 million, part of the £15 million Renewable Heat Premium Payments.

The driver of these developments is the Government's policy to decarbonise heat supply in the UK. Renewable heat is expected to make an important contribution to meeting the EU renewable energy target in 2020. By 2050 the UK needs to have decarbonised heat in buildings almost completely and reduced industry emissions by up to 70% through a combination of efficiency improvements, demand reduction, and fuel and technology switching options.

There is concern among non-energy wood users in the UK that the renewables policy could adversely affect raw material supply and distort supply and demand in existing markets. Partial recognition of this was made in the section of the UK Bioenergy Strategy<sup>1</sup> that outlines the challenges in changing land use and is reproduced below:

*The contribution of UK forestry resources is however expected to remain relatively small and focused on fuelling the renewable heat market given the competing uses for these resources and high volumes required to power electricity generation plants. DECC supply scenarios imply between 1.8 and 6.1 Million odt of UK forestry resources by 2020 – though the upper end of this range is equivalent to the entire current UK harvest and so will require substantial interventions to bring these resources into the market. It is important to ensure that the use of wood for energy does not lead to the displacement of wood for non-energy uses, as this could lead to significant emissions.*

#### Policy and Initiatives – Carbon Reduction

Private sector investment in woodland creation is continuing to increase via the Woodland Carbon Code. The Woodland Carbon Code, launched in July 2011, sets out requirements of voluntary woodland creation projects in the UK wishing to make claims about the carbon they sequester. Documentation has been revised in July 2012 following the first year of operation and a scheme for groups of projects to be certified together is currently being piloted by 5 project groups. This should allow more cost-effective certification for smaller projects from spring 2013.

The UK government announced in June 2012 that carbon reporting would become mandatory for all quoted companies from April 2013. It is possible this will be extended to all large companies in 2016. Companies can report following Defra's Guidelines for greenhouse gas emissions reporting – so these companies can report the benefits of their investment in a Woodland Carbon Code-certified woodland creation project alongside their gross emissions and investment in Kyoto compliant carbon offsets. It is believed that this will drive further private sector investment in woodland creation.

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<sup>1</sup> A cross-Government framework document to define Government policy on low-carbon bioenergy.

## 4. Developments in Forest Product Markets Sectors

### a) Wood Raw Materials (Softwood)

Removals of timber from UK forests are currently undertaken by the public sector, under the auspices of the Forestry Commission (in England, Wales and Scotland) and the Forest Service (in Northern Ireland) and by the private sector, as represented by the many private woodland owners and managers.

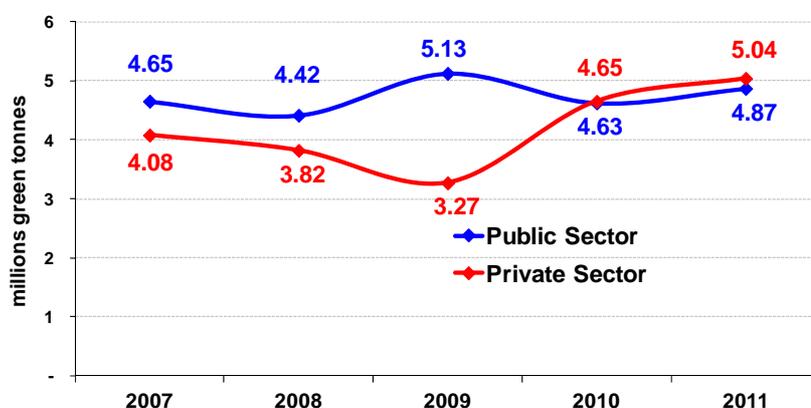
In 2011, removals from UK forests reached a modern-day record of nearly 10 million green tonnes. Private sector removals exceeded 5 million green tonnes for the first time, growing by 8% over the 2010 total. Removals from Forestry Commission (FC) and Forest Service of Northern Ireland (FS) woodland increased by 5% in 2011 to 4.87 million green tonnes.

In the ten years from 2002, all removals from UK forests have risen by around 2.5 million green tonnes and 1.5 million of this increase was realised between 2009 and 2011.

Removals from the private sector specifically have grown rapidly since 2009, increasing by just over 1.75 million green tonnes.

These changes in the source of supply from UK forests over the last five years are shown in chart 17 below.

**Chart 17: Softwood Removals from UK Forests by the Private and Public Sectors, 2007-2011**

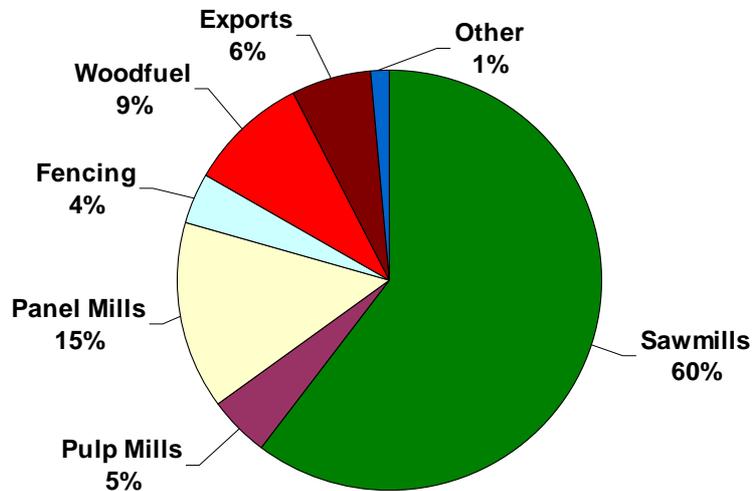


Source: Forestry Commission

Increased deliveries of coniferous roundwood removed from UK forests were made to pulp mills (+6%), sawmills (+4%) and panel mills (+3%) in 2011. An increase of 4% in deliveries was also made to fencing contractors. Exports of coniferous roundwood increased in 2011 by 25% to a level of just over a half a million green tonnes but deliveries for wood fuel declined in 2011 by 14%.

The relative sizes of the recipient industries for UK produced coniferous roundwood is shown in chart 18.

**Chart 18: Deliveries of Coniferous Roundwood from UK Forests to User Industries, 2011**



Source: Forestry Commission

**b) Wood Energy**

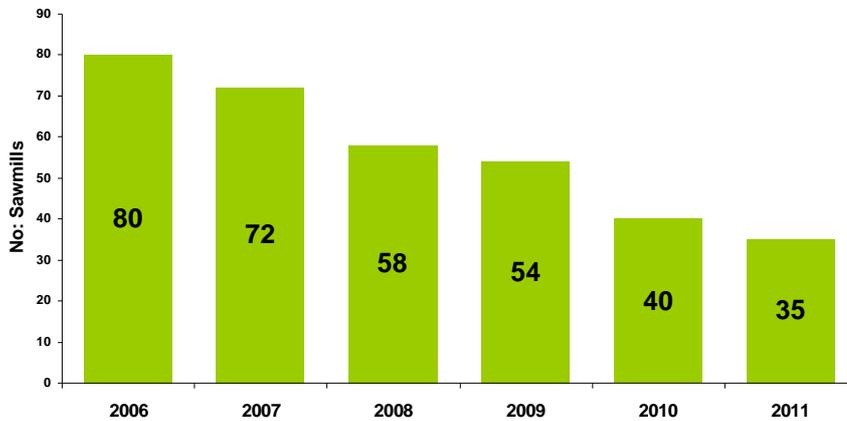
Wood used for energy generation includes sawmill products, such as wood chips and sawdust, recycled wood and wood pellets. UK production of wood pellets in 2011 grew by around 24%, but this increase could not match the rise in pellet imports which almost doubled in 2011.

**c) Certified Forest Products**

Removals from all publicly owned forests are certified and over the last few years, an increasing proportion of the output from privately owned woodland has become certified.

The certified development of sawmill production has also been positive over the last ten years. A measure of this development is the number of sawmills in the UK without chain of custody certificates. This development is shown in chart 19.

**Chart 19: Number of Sawmills Operating in the UK without Chain of Custody Certificates, 2006-2011**



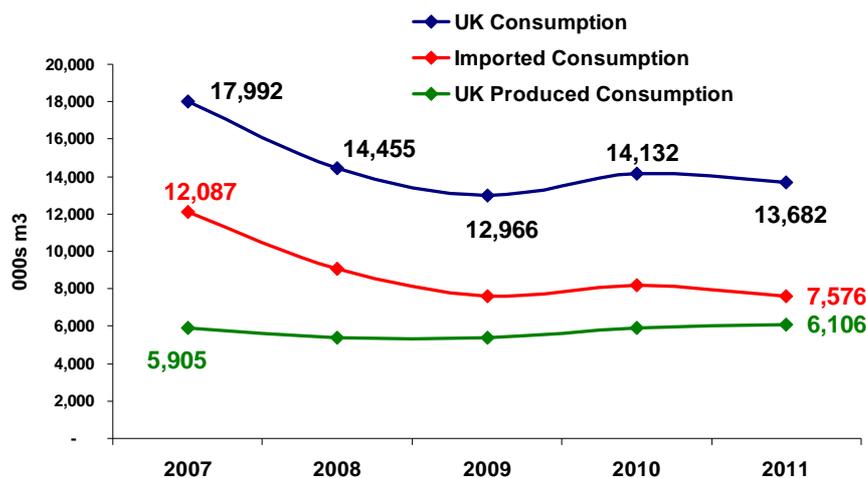
Source: Forestry Commission

d) Consumption of Timber and Panel Products in the UK

The UK Timber Market Statement of last year reported that, for the first time in two years, a recovery had taken place in the volumes of timber and panel products consumed. This recovery was not sustained in 2011 however and consumption fell once more, by 3%.

The development of UK consumption of the main timber and panel products since 2007 is shown in chart 20.

**Chart 20: Consumption of UK Timber and Panel Products, by Source, 2007-2011**



Source: Forestry Commission; Timber Trade Federation, Wood Panel Industries Federation; *timbertrends*

UK produced consumption (UK production less the majority of exports) is marginally higher in 2011 than at the height of the last period of strong economic growth. This is in contrast to the steep decline in imported timber and panels since 2007.

In 2011, UK produced consumption grew by 3% whilst imported consumption fell by around 8%.

e) Value-added Forest Products and Engineered Wood Products

Further processed (value-added) softwood imports, such as planed, square-edged and finger-jointed grew by 5% in 2011, but rough sawn varieties declined by 21%. This resulted in volumes of all softwood imports falling in 2011 by nearly 14%.

The volume of imported planed goods rose to 1.61 million m<sup>3</sup> in 2011 from 1.54 million m<sup>3</sup> in 2010. Rough sawn volumes fell from 3.69 million m<sup>3</sup> in 2010 to 2.90 million m<sup>3</sup> in 2011.

Data on the volume of further processed goods from UK producers is not available, however, the trends noted in the import sector are believed to be reflected in the domestic production sector also.

Further processed goods, as a proportion of all imported softwood, rose to 36% in 2011, up from 29% in 2010.

Manufactured timber products (engineered wood products) are thought to have increased in 2011, although there is little data available to confirm this. Despite lower activity in the construction market in 2011 - the largest market for manufactured or engineered wood - circumstantial evidence exists which points to an increase in the volume of such products sold into construction in 2011.

Modified versions of traditional wood products are increasingly coming to market with a modified MDF product (Tricoya) launched in 2011 and new developments in the manufacturing of cross-laminated timber in 2011 indicate a positive sales trend over the short-term.

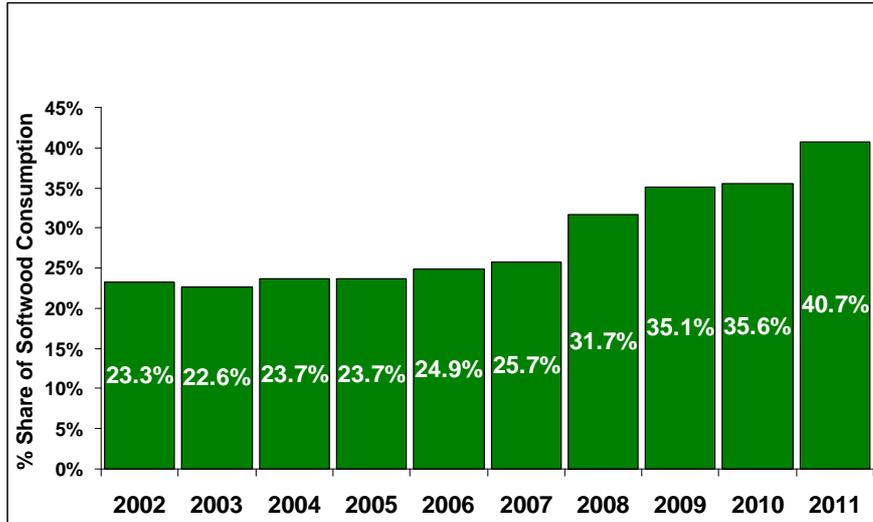
f) Sawn Softwood

Softwood remains the single largest volume product in the range of timber and panel products and lower consumption in 2011 was a main contributor to the overall 3% decline in all consumption in the UK. Softwood consumption in the UK in 2011 was 6% lower than in 2010 with imports down by nearly 14% (as reported in the section above) as UK produced consumption increased over 2010 by 7%.

UK producers continued to benefit from a relatively favourable exchange rate against the €, although a strengthening of the £ during 2011 tended to reduce this advantage. Exchange rate advantages were somewhat aided by a real increase in the price of imported softwood in the early part of 2011 which further helped UK producers to improve market share in selected markets, notably the fencing and outdoor uses market and in the supply of softwood for the packaging and pallet industry.

The market share of domestically produced softwood from 2002 is shown in chart 21 below.

**Chart 21: UK Producers Share of Softwood Consumption, 2002-2011**

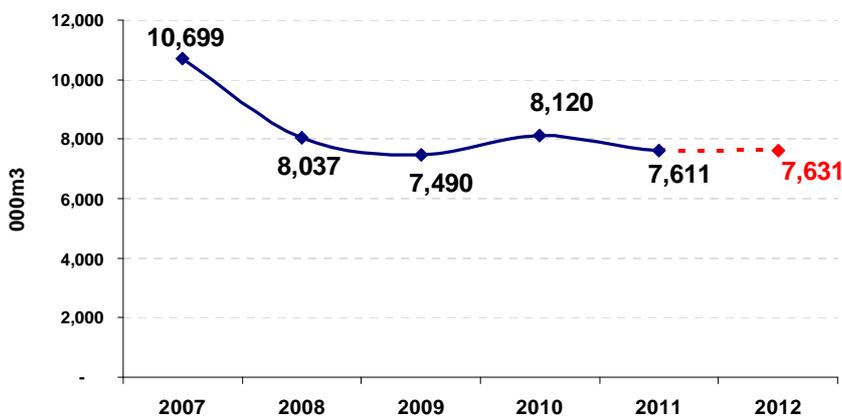


Source: Forestry Commission; Timber Trade Federation; *timbertrends*

The National Softwood Division (NSD) of the Timber Trade Federation produce an estimate mid-way through each year for the second half and a forecast for the following year. For 2012, the provisional forecast of the NSD predicts that softwood import volume will be 4.51 million m<sup>3</sup>, the same as in 2011.

A forecast for UK production for 2012, based on the advice of the Forestry Commission’s Expert Group on Timber and Trade Statistics, indicates that output from UK sawmills will also be at the same level as in 2011. From these forecasts for 2012 and an estimate of softwood exports for 2012, a projection of consumption for softwood in the UK for 2012 can be made. A further decline in sawn softwood exports predicted for 2012 has the effect of slightly raising consumption (ignoring stock changes) by 0.3%. The changes in UK sawn softwood consumption is shown in the chart below.

**Chart 22: UK Sawn Softwood Consumption 2007-2011 & Forecast 2012**



Source: Forestry Commission; Timber Trade Federation; *timbertrends*

g) Sawn Hardwood

An 11% fall in sawn hardwood consumption in the UK in 2011 followed a 20% rise the year before.

This pattern of rise and fall between 2009 and 2011 is common across many timber product groups and in the wider economy, but in the hardwood sector, this higher degree of volatility is not solely due to changes in the economy. A very wide variety of sawn hardwood products (mostly imports) are used for many types of applications, but often in relatively small quantities, especially when measured against sawn softwood and panel products consumption. Therefore, fairly small changes in volumes imported can bring about relatively large rises or falls in volume.

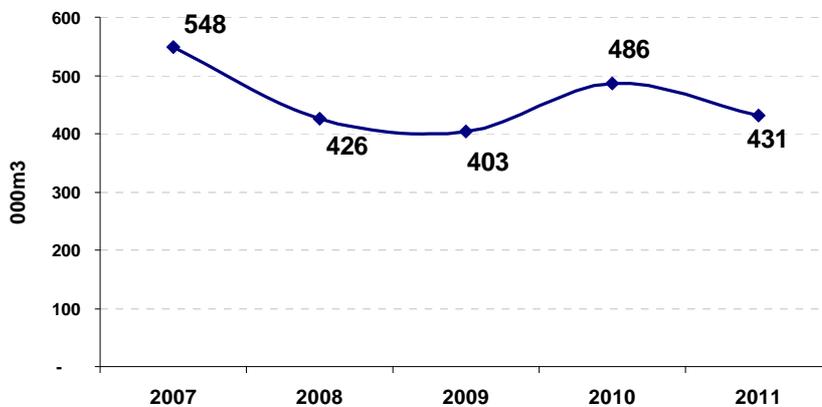
UK production of sawn hardwood increased in 2011 to 0.052 million m<sup>3</sup>, an 8% increase over 2010, but hardwood imports fell by over 12% to around 0.41 million m<sup>3</sup>. Tropical hardwood imports fell by 9% in 2011 and temperate species fell by 14%.

Export volumes, although relatively small, rose by 2% to 0.032 million m<sup>3</sup> in 2011.

The apparent consumption of hardwoods in the UK in 2011 was 0.43 million m<sup>3</sup>.

The development of hardwood consumption since 2007 is shown in the chart below.

**Chart 23: UK Sawn Hardwood Consumption, 2007-2011**



Source: Forestry Commission; Timber Trade Federation; *timbertrends*

h) Wood-based Panels

Particleboard, OSB and MDF are produced in the UK and imported, but plywood and fibreboard are imported.

UK consumption of panel products grew in 2011 by 2%.

Exports of OSB and MDF from the UK were buoyant in 2011. OSB and MDF exports are the largest of all panel exports and therefore have a significant effect on overall consumption in the UK.

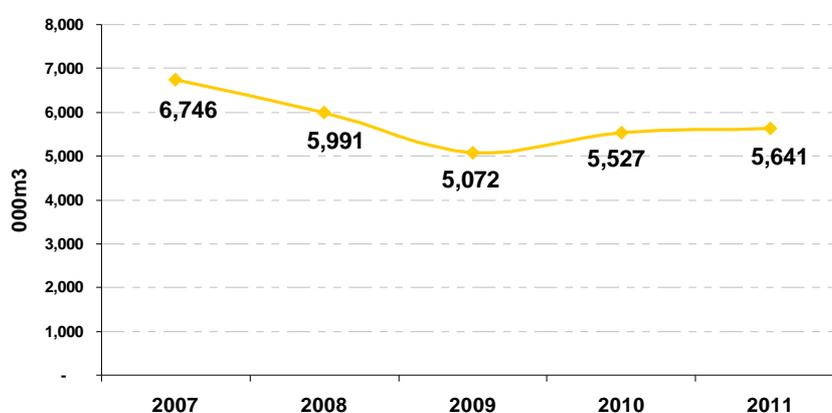
Imported consumption was higher in 2011 by 5% with all product types sharing increases in volume. Plywood imports, at 1.30 million m<sup>3</sup> rose by 4% in 2011.

Total volumes of imported panel products increased to 2.80 million m<sup>3</sup> as UK produced panel products were at very similar levels to 2010 at 3.38 million m<sup>3</sup>.

Volumes of exports and re-exports of panel products were 0.55 million m<sup>3</sup> in 2011.

UK produced panel products accounted for 53% of consumption in 2011, down from 54% in 2010.

**Chart 24: UK Panel Products Consumption, 2007-2011**



Source: Forestry Commission; Timber Trade Federation; Wood Panel Industries Federation; *timbertrends*

**i) Pulp and Paper**

Consumption of wood pulp in the UK in 2011 was 1.20 million tonnes.

The fall in consumption was as a result of a 7% decrease in imports which resulted in imports falling below the million tonnes level at 0.99 million tonnes.

UK pulp production increased slightly in 2011 by 3% to a level of 234,000 tonnes.

UK consumption of paper and paperboard also fell in 2011, by approaching a half a million tonnes to 10.25 million tonnes.

UK production of paper and board rose a little in 2011 to 4.34 million tonnes and exports, although smaller in comparison with imports and production, were higher by 5% at 0.97 million tonnes. The largest contribution to the decline in paper and board consumption in the UK in 2011 was the fall in imports to 6.89 million tonnes, a decline of just over 5% over 2010.

j) Carbon Markets in the Forest Sector

The Woodland Carbon Code has generated much interest among landowners and investors alike over its first year of operation. As of 30 June 2012, 58 projects have registered with the Code; together they will create over 2,782 hectares of new woodland and are predicted to sequester 1.30 million tonnes of carbon dioxide equivalent over their lifetime (up to 100 years). Of these projects, 17 are now validated (checked by an independent certification body), representing 39% of the area and 37% of the predicted carbon sequestration. A proportion of the revenue of each project comes from private sector investment, mainly from companies considering their Corporate and Social Responsibility.

The Woodland Carbon Code and the emerging voluntary carbon market has also been recognised in two global reports; Developing Dimension – State of the voluntary carbon markets 2012 and Bringing it home – Taking stock of government engagement with the voluntary carbon market.

Further information can be found on the Forestry Commission website: <http://www.forestry.gov.uk/carboncode>

## 5. Tables

### UK Economic Indicators (% unless otherwise indicated)

	2007	2008	2009	2010	2011	2012 (est)
<b>GDP growth<sup>1</sup> (at constant 2009 market prices)</b>	3.0	0.7	- 4.9	1.3	0.7	- 0.3 <sup>2</sup>
<b>Interest Rate (Base Rate at year end)</b>	5.0	2.0	0.5	0.5	0.5	0.5 <sup>2</sup>
<b>Consumer Price Index</b>	2.1	3.1	2.9	3.3	4.2	1.8 <sup>2</sup>
<b>Unemployment (ILO)</b>	4.9	5.7	6.7	7.9	8.4	8.5 <sup>3</sup>
<b>UK Housebuilding Starts (000s) – Revised 2012</b>	233.8	141.9	114.2	138.9	135.9	115.0 <sup>3</sup>

<sup>1</sup>GDP growth is measured on a chained volume basis current year compared to previous year

<sup>2</sup>HM Treasury, Forecasts for the UK Economy: A Comparison of Independent Forecasts, August 2012

<sup>3</sup>*timbertrends*