

Chapter 5

Globalization revolutionizing sawn softwood markets in 2002-2003¹

Highlights

- Globalization is rapidly changing the production, consumption and trade dynamics of sawn softwood as new producers emerge and scale up production, leading to a world oversupply of sawn softwood.
- The recent competitive price advantages that many sawn softwood producing regions have enjoyed in recent years are disappearing as many currencies, notably the euro, appreciate against the United States dollar.
- Demand for sawn softwood products in most regions of the UNECE remains strong, especially in North America, due to a surge in housing construction, but the possible bottoming out of mortgage rates in the United States signals a first warning of a change in conditions.
- The increased international flows of sawn softwood are also fuelling trade disputes, evidenced in 2002 by the United States imposing a duty of 27% on Canadian imports, which led to major disputes and appeals to world and regional trade bodies.
- More than ever, two regions of the world continue to have the potential to significantly influence the global market dynamics of sawn softwood: Russia (on the supply side with record exports) and China (on the demand side with record imports).
- At 8.6 million m³ in 2002, Russia's exports of sawn softwood exceeded those of the entire former USSR for the first time.
- Prices for sawnwood in North America were under pressure in 2002, but have begun to recover in mid-2003 as strong housing boosted demand, while the increasing burden of an appreciating currency dampened the Canadian supply.
- Prices for sawnwood in Europe rose steadily in 2002, but increasing supplies from eastern Europe are making it more difficult for suppliers in high-cost countries to compete, at least on commodity markets.
- Sawn softwood production increased by 6% in the UNECE region, rising in every subregion, and in the EU/EFTA subregional production rose to record levels in 2002, and some of this volume was exported to North America, where imports hit their highest volumes ever.

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Secretariat introduction

We extend our sincere appreciation to the major authors and co-ordinators of this chapter, Dr. Rob Kozak, Associate Professor, University of British Columbia, Canada and Mr. Henry Spelter, Economist, USDA Forest Service. They have previously contributed to the *Forest Products Annual Market Reviews*, and they shaped their statistical analysis to fit within the new policy orientation of the publication. They ensured contributions from other marketing specialists, including Dr. Nikolai Burdin, General Director, NIPPIElsprom, Russian Federation, and former Chairman of the UNECE Timber Committee, Dr. David Cohen, Associate Professor, University of British Columbia, Canada, and Mr. Arvydas Lebedys, Marketing Specialist and independent consultant, Lithuania, who is currently working for the FAO Forestry Department.

5.1 Trends in 2002 and 2003

In the last few decades, the world has become a smaller place. The production, consumption and trade of sawn softwood have been by no means immune from this trend towards globalization. What was a relatively uncomplicated and stable sector 20 years ago has now become a complex network of international players, each operating on razor thin profit margins in the largely commodity-oriented sawn softwood markets. New and emerging producers are having a significant impact on sawn softwood production, which has contributed to an oversupply situation.

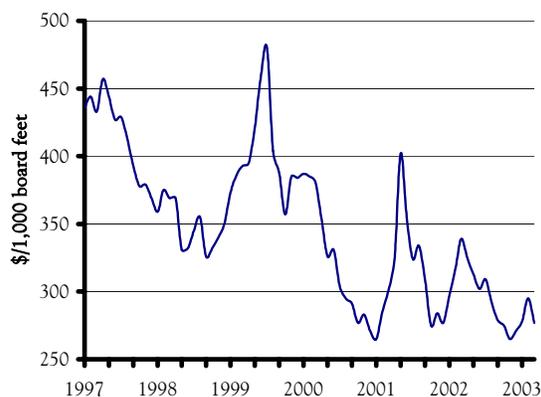
Undoubtedly, global currency rates are one of the most important factors influencing the import and export patterns of sawn softwood. Most notably, the period between 1997 and 2001 saw the currencies of all of the major sawn softwood exporting regions depreciate against the US dollar (see graph in chapter 3)². This has led to distinct competitive advantages, based largely on price, for many softwood-producing regions such as Canada, Europe and Oceania. The dynamics of the resulting trade patterns are complicated, but certainly this general trend in currency rates has led to a strengthening of the competitive positions for many global exporters of sawn softwood in the United States market. This trend may be reversed in 2003 with the fall in the US dollar.

Inevitably, this oversupply situation has created trade tensions. In particular, United States producers initiated a complaint against Canada in 2001 that resulted in the

levying of 27% tariffs on most Canadian sawn softwood exports to the United States in May of 2002. This was expected to curtail Canadian exports, but the tariffs were challenged in world and regional trade bodies. Initial rulings in favour of Canada encouraged Canadian producers to assume that the tariffs would eventually be rescinded and the funds returned; thus they largely ignored the tariffs and increased exports. This led to severely oversupplied sawnwood markets in North America and weak pricing in 2002 that extended into early 2003 (graph 5.1.1). Not until the strengthening of the Canadian dollar in the first half of 2003 did the growth of exports reverse, allowing a partial rebound in prices. In July 2003 the North American Free Trade Agreement (NAFTA) panel reviewing one portion of the tariffs (the 8% dumping component) ruled in favour of the United States. However, a second panel reviewing the larger countervailing duty component (19%) in August made a determination that seemed to favour Canada, but left some ambiguity with respect to how the ^{UNITED STATES} Department of Commerce should recalculate the tariff. Likely appeals, however, could leave the issue in doubt until, possibly, as late as 2006. In the meantime, North America is currently faced with an imminent timber oversupply crisis, as producers in British Columbia scramble to find uses for millions of cubic metres of mountain pine beetle killed softwood that is discoloured, but structurally sound.³

GRAPH 5.1.1

North American composite sawn softwood prices, 1997-2003



Source: Random Lengths Yardstick, 2003.

²Global Currencies – Strong United States Dollar Creates Winners at America's Expense. *WoodMarkets* Monthly, 8(3):1, April 2003.

³ British Columbia Ministry of Forests (2003). http://www.for.gov.bc.ca/hfp/bark_beetles/

With reductions in trade barriers and shipping costs, exchange rates are increasingly becoming decisive in world trade flows. All of the exporting regions whose currencies depreciated between 1997 and 2001 also saw currency appreciation, in some cases significantly, in 2003. To complicate matters even more, major importing regions are also witnessing strengthening currencies. For example, the strengthening of the Japanese yen against the dollar, but not the euro, has currently led to increased exports by North and South American producers at the expense of European producers (who managed to capture significant market share between 1997 and 2001).⁴ These currency upswings appear to be moving unabated into 2003, with significant gains being made against the United States dollar by the Canadian and New Zealand dollars, the Swedish krona and the euro.^{5 6} That said, Chilean and Brazilian currencies are still exhibiting downward trends, the former being of tremendous interest, as large volumes are nearing commercial maturity and expected to come online within the next decade. Meanwhile, the Russian ruble languishes, currently sitting at less than 20% of its 1997 value.

With respect to Russia, the impact of its weak currency is compounded by the sheer abundance of its low-cost coniferous forest resources. The current situation in Russia has the potential to significantly influence the global trade of sawn softwood, especially in neighbouring Europe and Asia. Evidence currently points to an increasing production capacity in Russia and the automation of primary breakdown, value-added and drying processes.⁷ This is especially salient in the light of the fact that Russia's current production levels are well below its annual allowable cut.

Russia's sawn softwood export boom can also be attributed to the growth of China's economy – the volume of sawn softwood exports from Russia to China has doubled in the period from 2000 to 2002.⁸ China represents both an interesting market opportunity for lumber producers around the world as well as a potential future competitor.⁹ For the time being, success in the

potentially huge Chinese sawn softwood market is contingent upon a solid understanding of Chinese business practices, a paradigm shift towards culturally appropriate wooden housing, and building code reform.¹⁰ To date, China is importing roundwood, especially tropical, from many regions, but only Russia and New Zealand have made significant inroads into their sawn softwood market.¹¹

In the rest of the world, demand for sawn softwood products continues to be robust, reflecting in part the United States boom in housing construction. While still early, the efforts of the many generic wood promotional efforts and forest certification bodies around the world may be contributing to increased softwood demand.

5.1.1 EU/EFTA subregion

In Europe, much of the sawn softwood trade occurs within the continent, with the dynamics of the marketplace shifting substantially in recent years. Driven largely by market shortages and low inventories, sawn softwood prices (kiln-dried graded stock) steadily increased within the European continent throughout 2002 (graphs 5.1.2 and 5.1.3).¹² However, western European producers of sawn softwood are finding it more and more difficult to compete in global markets with lower-cost, high output producers in eastern Europe, the Baltics and western Russia.¹³ Companies in western Europe and Scandinavia are responding, in part, by purchasing Russian timber, or actively pursuing joint ventures with and acquisitions of Russian lumber producers.¹⁴ For some time now, western European manufacturers have been moving away from a commodity approach into the production of specialty, value-added and engineered wood products.¹⁵

⁴ Global Market Trends: 2003. Rising Global Output / Stable Demand Yield Buyers' Market. *WoodMarkets Monthly*, 8(3):2-3, April 2003.

⁵ Lumber Market Stalemate. *WoodMarkets Monthly*, 8(4):1, May 2003.

⁶ Currency Slide Could Push Prices Up Further. *TTJ* 19, 26 April 2003.

⁷ Global Market Trends: 2003...

⁸ Burdin, N. (2003). Personal communication, OAO "NIPIEIlesprom".

⁹ Cohen, D. (2003). Personal communication, University of British Columbia –Faculty of Forestry.

¹⁰ Ibid.

¹¹ Global Market Trends: 2003...

¹² Currency Slide Could Push Prices Up Further. *TTJ* 19, 26 April 2003.

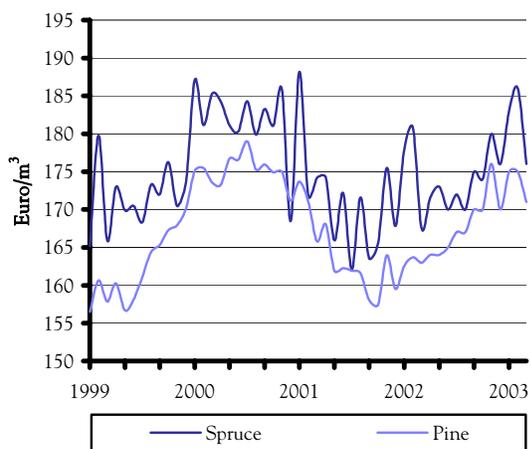
¹³ Global Market Trends: 2003...

¹⁴ Russia's Wood Industry (Part II) –Sawmill Capacity and Lumber Exports to Grow. *WoodMarkets Monthly*, 8(2):4-5, March 2003.

¹⁵ Global Market Trends: 2003...

GRAPH 5.1.2

Export prices for Finnish sawn softwood, 1999-2003

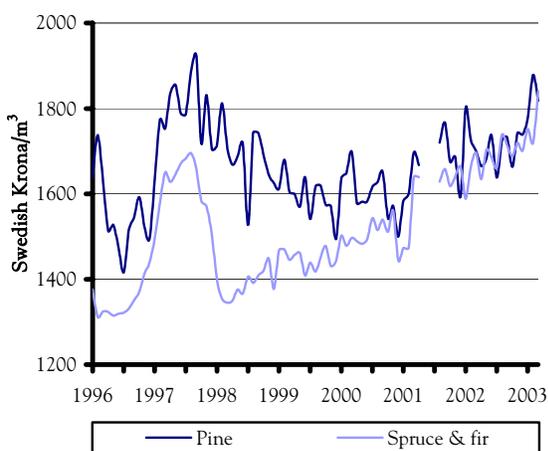


Source: Metinfo, Finnish Forest Research Institute, 2003.

In the EU/EFTA, as in every subregion, softwood production increased in 2002 over the previous year (table 5.1.1). There was a more moderate 1.4% increase in consumption (graph 5.1.4). Meanwhile, exporters were able to develop their markets (+5.5%), although it is not clear whether they will be able to maintain their gains under the new exchange rate.

GRAPH 5.1.3

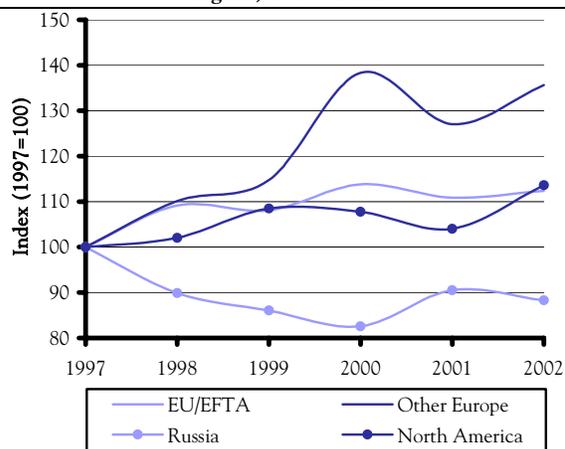
Sawn softwood prices in Sweden, 1997-2003



Source: Swedish Wood Exporters Association, 2003.

GRAPH 5.1.4

Apparent consumption of sawn softwood in the UNECE region, 1997-2002



Source: UNECE/FAO TIMBER database, 2003.

TABLE 5.1.1

Sawn softwood balance in EU/EFTA
(1,000 m³)

	2001	2002	Change 2001 to 2002 %
Production	74 545	76 264	2.3
Imports	34 316	35 435	3.3
Exports	31 898	33 661	5.5
Net trade	-2 418	-1 774	...
Apparent consumption	76 963	78 038	1.4

Source: UNECE/FAO TIMBER database, 2003.

5.1.2 Other Europe subregion

Consumption in the Other Europe subregion strengthened back towards its recent 2000 peak with increases of 6.9% from 2001 to 2002 (table 5.1.2). Production also increased by a similar amount with the notable exceptions of three central European countries – the Czech Republic (-1.7%), Latvia (-3.0%) and Poland (-6.0%). Exports of the subregion remained relatively stable.

TABLE 5.1.2
Sawn softwood balance in Other Europe
(1,000 m³)

	2001	2002	Change 2001 to 2002
			%
Production	17 648	18 734	6.2
Imports	4 004	3 930	-1.9
Exports	8 997	9 142	1.6
Net trade	4 993	5 212	4.4
Apparent consumption	12 655	13 522	6.9

Source: UNECE/FAO TIMBER database, 2003.

In the Baltics, production is becoming more concentrated due to expanding capacities and greenfield projects financed mainly by foreign capital (e.g., Stora Enso, a major Nordic forest products corporation, recently took over the Estonian Sylvester's sawmilling business, and Stora Enso's capacities in the Baltic States now exceed 1 million m³ of sawnwood.¹⁶

Government policies in eastern Europe do not influence the sawmilling business directly and there are no trade tariffs or other restrictions on sawn softwood imports or exports. Investments are driven by relatively low labour costs, good infrastructure, proximity to markets, ample wood resources, and economic and political stability (especially in EU accession countries). Perhaps the main concern for investors is government policy on wood resources utilization and availability.

5.1.3 CIS subregion

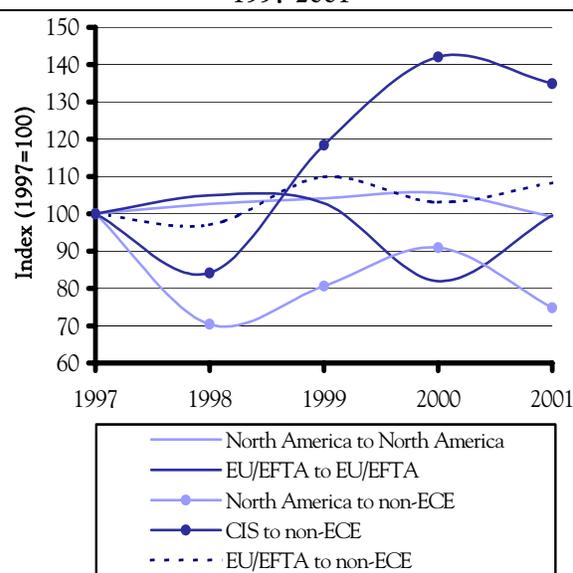
The volume of sawn softwood produced in Russia in 2002 increased by 5.4% over the previous year (table 5.1.3).¹⁷ Apparent consumption paradoxically decreased, which means that exports took a large upward turn of 17.1% to reach 8.6 million m³. At 8.6 million m³, Russia's exports have now exceeded those of the former USSR, which peaked at 8.4 million m³ in 1976 (see discussion of EU/EFTA) (graph 5.1.5).

¹⁶ <http://www.storaenso.com>

¹⁷ Burdin, N. (2003). Personal communication, OAO "NIPIEIlsprom".

GRAPH 5.1.5

Major sawn softwood trade flows in the UNECE region,
1997-2001



Note: Full trade flow table in the electronic annex.

Source: UN COMTRADE/EFI, 2003.

TABLE 5.1.3
Sawn softwood balance in Russian Federation
(1,000 m³)

	2001	2002	Change 2001 to 2002
			%
Production	18 375	19 360	5.4
Imports	10	11	10.0
Exports	7 325	8 580	17.1
Net trade	7 315	8 569	17.1
Apparent consumption	11 060	10 791	-2.4

Source: UNECE/FAO TIMBER database, 2003.

5.1.4 North America

The markets for sawn softwood in North America continue to expand moderately, buoyed by a stronger than normal demand for housing, with continuing growth forecast until 2010.¹⁸ This is contingent upon continued availability of the bargain financing terms that have characterized the recent past.

Consumption in North America is particularly strong, with increases of 9.2% from 2001 to 2002 (table 5.1.4).

¹⁸ United States Housing to Expand – Demographics Driving Longer-Term Demand for New Homes. *WoodMarkets Monthly*, 8(2):1, March 2003.

Production, although at a record level, was augmented by increased imports to satisfy needs. But a decided turn in exchange rates in favour of exporting countries' currencies places further growth on exports to North America under a cloud of uncertainty (see background discussion in section 5.1).

TABLE 5.1.4

Sawn softwood balance in North America
(1,000 m³)

	2001	2002	Change 2001 to 2002
			%
Production	105 454	113 768	7.9
Imports	34 195	36 218	5.9
Exports	36 736	37 555	2.2
Net trade	2 540	1 337	-47.4
Apparent consumption	102 914	112 431	9.2

Source: UNECE/FAO TIMBER database, 2003.

5.2 Trends in 2003 and 2004

(To be written after October 2003 Timber Committee Market Discussions.)

5.3 References

- British Columbia Ministry of Forests (2003). www.for.gov.bc.ca/hfp/bark_beetles/
- Burdin, N. (2003). Personal communication, OAO "NIPIEIllesprom".
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United States Housing to Expand – Demographics Driving Longer-Term Demand for New Homes. *Wood Markets Monthly*, 8(2): 1, March 2003.

5.4 Electronic annex tables for website only

- 5.4.1. Sawn softwood balance in the UNECE region, 1998-2002
- 5.4.2. Sawn softwood production in the UNECE region, 1998-2002
- 5.4.3. Sawn softwood trade in the UNECE region, by volume, 1998-2002
- 5.4.4. Sawn softwood trade in the UNECE region, by value, 1998-2002
- 5.4.5. Major sawn softwood trade flows in the UNECE region, 1997-2001
- 5.4.6. Sawn softwood apparent consumption in the UNECE region, 1999-2002