

## **ECONOMIC COMMISSION FOR EUROPE**

Timber Committee

FINLAND

September 2006

### **MARKET STATEMENT**

#### **1 GENERAL ECONOMIC TRENDS**

In 2006, Finnish economy is expected to grow about 4.5 percent in year-to-year terms. This exceptionally high growth rate above its long-term mean is due to two main reasons. First, labour dispute in paper industry in 2005 reduced the volumes of industrial output, and this low reference level accelerates temporarily GDP growth in 2006. Second, Statistics Finland has changed the calculation methods of Finnish national accounts due to the general harmonisation work of national accounts in the EU. This revision increased the volumes of GDP as well as its subcomponents.

In spite of these technical reasons, Finnish economy is growing faster than the euro area in average. GDP growth in Finland in 2006 is driven mainly by increase in domestic private consumption, private investments and exports. Along with the improved employment, modest tax reduction, low inflation and wage drifts in some industrial sectors, households' real disposable income is increasing. This boosts private consumption to increase 3.6 percent in 2006. Low interest rates have promoted especially housing construction and civil engineering which boost total private investments to grow about 7 percent. The improved economic development in euro area, in Sweden and, especially, in Russia has been the main reasons for increased exports from Finland. In 2006, the total export, driven especially by technology sector, is expected to increase 12 percent. Also, both the Finnish business tendency survey and the consumer confidence indicator indicate strong confidence for Finland's economy.

The outlook of other macroeconomic fundamentals for 2006 reveals also strong economic performance. Along with the acceleration of economic growth, financial position of local government becomes stronger. Increase of collected taxes and income from dividends imply that the surplus of government finances is estimated to be 3 percent of GDP in this year. However, the public investments will increase only slightly. Even though the structural unemployment will remain high, unemployment rate decreases to 7.9 percent. Current account surplus is expected to increase to 9 billion euros, and annual inflation rate accelerates to about 1.5 percent.

Even though Finnish economy will not attain as high growth rate as in 2006, the scenario for 2007 seems also rather optimistic. GDP is predicted to grow 3 percent in year-to-year terms. Due to the increasing interest rates and indebtedness of households, private consumption growth is less than 2.5 percent. Rising interest rates, regional shortages of building land and skilled labour will constrain housing construction, but still private in-

investments are increasing over 3 percent. Finnish exports will perform fairly strong growth also in 2007. 5 percent export growth is based on the resurgent markets in Europe and constant economic growth in Russia. Annual inflation rate will remain between 1.5 – 2 percent and unemployment rate will decline slightly above 7 percent.

The uncertainties which can threaten the positive outlook for Finnish economy are related to the development of main export areas, such as euro zone, Russia and Sweden. Increase and uncertainty of crude oil price development has not affect Finland as strong as many other industrial countries, but still it is an important cost factor. Some industrial sectors are also confronting labour shortage problems and increasing input costs. The final effect of increasing interest rates remains somewhat uncertain, and together with other economic factors, such as development of housing prices, may affect consumers' confidence for future, private consumption and investments.

## **2 RECENT POLICY MEASURES**

As from March 1, 2005, a 1% border inspection sample has been taken from imported softwood in order to minimize the risk of harmful pathogens or pests spreading to the European Union. This new border control is working well.

New rules for good silviculture became effective August 1, 2006. More flexible criteria for regeneration and thinnings open up new alternatives which can be applied for improvement of the profitability of forestry. They have an increasing effect on allowable cut.

## **3 Market drivers**

Current high economic growth in euro area affects positively forest products markets.

## **4 DEVELOPMENTS IN FOREST PRODUCTS MARKETS**

### **A. Raw wood**

In 2005, the use of industrial roundwood amounted to 59.7 mill. m<sup>3</sup> u.b. In addition, 1.0 mill. m<sup>3</sup> of roundwood was exported. The total roundwood use was about 7 million mill. m<sup>3</sup> below the previous year's figure due to a 6 week lock-out in pulp and paper industry. In the turn of the years 2005/2006, the transition period in the Finnish forest taxation system from old site-productivity taxation to forest income taxation, which had boosted especially the supply of sawlogs in the market, ended, and it was quiet in the timber market during the spring 2006. However, as trade volumes picked up during the early summer

with increasing prices, market adjustment to this structural change occurred with a relative ease. Year 2005 was a record for wood imports, which totalled 19 million m<sup>3</sup> u.b.

The statistics for the domestic roundwood harvests in January-July 2006 shows a same level than in the previous year. Also wood from inventories of felled wood was exploited particularly in early 2006. The imports of roundwood and chips in the first half of 2006 have maintained the same high level than last year. Inventories of felled wood and chips in forest industries decreased by 4 percent by the end of June 2006 and end-of-year inventories are foreseen to decrease by one fifth as compared to record level of last year.

Overall, the industrial roundwood consumption in Finland increases in 2006 by 8 percent as compared to last year, totalling about 64 mill. m<sup>3</sup> u.b. Domestic roundwood removals will account close to 47 mill. m<sup>3</sup> in 2006. It is forecast that the total imports of roundwood and chips will be about 18 mill. m<sup>3</sup> u.b. this year, i.e. slightly below record volume in year 2005. Consumption of main articles, i.e. coniferous sawlogs and pulpwood will be 23 and 24 mill. m<sup>3</sup> u.b. in 2006, respectively.

Due to increase in wood consumption and harvests, the stumpage prices for roundwood have increased in January-August 2006 in comparison to the respective period in 2005. Pine and spruce sawlog and spruce pulpwood prices have experienced increases of 2-4 % over previous year.

Roundwood removals are expected to rise by about two percent in 2007 to 47.4 mill. m<sup>3</sup> due increasing production of pulp, paper and plywood. Removals of coniferous sawlogs will remain at the level of 20 mill. m<sup>3</sup> u.b, whereas removals of coniferous pulpwood will increase to over 21 mill. m<sup>3</sup> u.b. Total imports of roundwood and chips will remain at about the level 18 mill. m<sup>3</sup> u.b., but incorporate a new record in imports of wood chips.

## **B. Wood energy**

Wood-based energy accounts for 20% of all energy consumed in Finland and 60% of the Finnish forest industry's energy consumption (black liquor from the pulp industry, tree bark, sawdust, etc.). The Government's aim is to make all forms of renewable energy, mostly bioenergy, competitive on the open energy markets. The following support measures are employed:

- a carbon-based environmental fuel tax
- support to electricity production when based on renewable sources
- aid for investments aiming at develop and promote utilization of renewable energy
- support for the production of forest fuels
- public financial support to development and commercialization of technology

Along with industrial roundwood, fuelwood to be used in industrial power plants and district heating plants has become a new type raw wood. In 2005, 2.6 mill. m<sup>3</sup>s of felling residues, small-sized trees and stumps were used for energy purposes in Finland. This type of fuelwood is mainly logged in spruce-dominated clear-felling areas in coordination

with industrial roundwood logging. The logged volumes have been growing year by year. Small stumpage is nowadays paid for forest owners for this type of fuelwood. The prices at plant yard have been rising to present EUR 22–23 per cum solid. In addition, household firewood, a part of which consists of felling residues, has maintained its volume (6 mill. m<sup>3</sup>/yr). The Finnish pellet production is annually about 300 000 tonnes, most of which is exported to Sweden.

### **C. Certified forest products**

About 95 % of Finnish forests, or 22 million hectares, are certified under the national Finnish Forest Certification System (FFCS). The FFCS is endorsed by both Pan-European Forest Certification Council (PEFC) and the Dutch Keurhout Foundation.

Demand for ECO-labelled products is growing. Forest industry companies have acquired certified chain-of-custody systems in order to obtain PEFC-logo usage right. According to the Finnish Forest Certification Council, there are today 88 PEFC logo licence holders among Finnish forest industries. These licenses cover the major share of wood procurement, sawnwood and panels production as well as paper and paperboard production.

### **D. Value-added wood products**

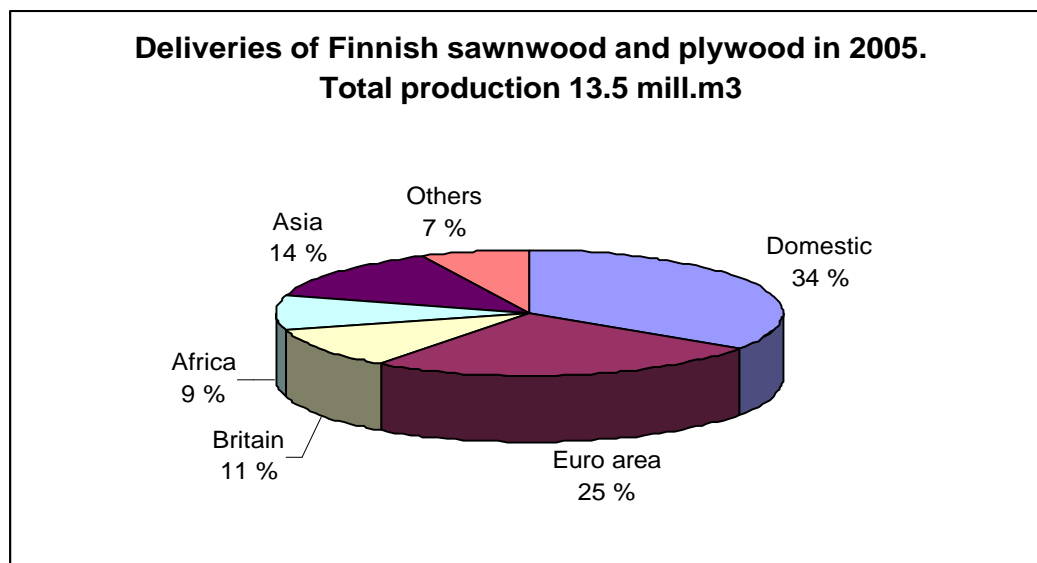
#### **E. Sawn softwood**

In the whole Finnish woodworking industry, sawnwood and plywood are the main products accounting for 49 % and 23 % of the industry's export value in 2005, respectively. The rest of 29 % is divided by particle board, wooden furniture, fibreboard, wooden pre-fabricated houses, etc.

In Finnish sawnwood industry sawn softwood is the main product. About 60 % of sawnwood production is exported and 40 % is domestically consumed. Europe is the main export market for Finland (especially UK, Germany, France and the Netherlands) accounting for 60 % of the exports in 2005. Due to increasing market competition and downward price development in Europe, sawnwood export growth in recent years has concentrated outside Europe, e.g. to Japan who's share in the Finnish exports increased to 15 % in 2005. The share of Africa increased to 16 % due to the rising redwood exports to Egypt last year.

In 2005, sawnwood exports went 8 % down to 7,7 mill.m<sup>3</sup> of which planed goods and finger jointed products accounted for about 11 %. Production decreased (9 %) totalling 12.2 million m<sup>3</sup>. This was due to the spring and summer 2005 production lock-out in the Finnish pulp and paper mills. Production was halted in several sawmills due to difficulties in selling their chips. Also weak profitability, caused by the unfavourable relationship between sawlog and sawnwood prices has led to production shrinkages in sawmill industry.

In Finnish sawnwood production redwood accounted for 48 %, whitewood about 51 % and hardwood (mainly birch) less than 1 % in 2005. Domestic market is important to the Finnish sawnwood industry. In 2005 about 40% (5.1 mill. m<sup>3</sup> from domestic production ) went to domestic market. During the last 10 years, the growth in housing construction and repair has boosted considerably domestic sawnwood consumption and per capita figure increased from 0,5 m<sup>3</sup> to about 1 m<sup>3</sup> in 1995 to 2005.



### **Outlook for years 2006 and 2007**

After many years of reasonably high global growth there are some signs that economic slowdown could be underway. The US economy is losing momentum which probably shall spill over to the other economies including Europe in 2007.

In 2006 European sawnwood markets are affected by several developments that naturally reflect also to Finnish sawnwood industry. New residential construction activity is reducing in the USA and signs of cooling can also be seen in several European countries including Finland. This indicates a slight weakening of sawnwood consumption for 2007. Exports to offshore markets (USA and Japan), where Europe has strengthened its market share has become more challenging because of the strength of the euro. All this together with rising production quantities of e.g., Germany and Sweden and increasing export supply from Russia strengthens the existing oversupply of sawnwood in Europe. So competition is expected to increase in the next coming year. It is only competition from Baltic countries that is reducing. Their log-prices are converging with European and Finnish prices lowering Baltic producers' profitability in the European exports. In sum, it is very probable that the current price increases in European sawnwood market shall not continue in 2007 at the same rate as in the current year.

It is estimated, that Finnish sawnwood production will not reach the 2004 level in 2006 totalling about 12,6 mill. m<sup>3</sup>. Sawnwood production has suffered from scarcity of sawlogs, especially spruce, and weak profitability of production. In the first quarter of 2006 production amounts were under the figures of the same period last year. In the second quarter, rising sawlog prices loosened the tight rawmaterial supply and rising sawnwood export prices offered better views, which led to increased production compared to last year's figures. However, tightness of spruce sawlog supply continues and price relationship between rawmaterial and end product in whitewood production has not improved. In the first 7 months of 2006 spruce sawnwood production was about 2 % below last years figures.

Exports of sawn softwood in January–June 2006 were at the same level than in the same period last year. Whitewood exports were 3 % under last year's figure, but redwood exports were slightly over the last year's volume. In redwood production, price relationship between raw material and end product has improved gradually since beginning of 2005. Instead, profitability of whitewood production has decreased and improvements in the near future are not very probable.

Sawnwood prices are assumed to rise moderately towards the end of the year, which shall bring some improvement in the weak profitability of sawnwood production and exports. To the main market area, Europe, Finnish exports have continued to decrease but export quantities have grown to Asia (especially Japan) and Africa, where Algeria substitutes for decreased exports to Egypt. Exports to USA show a decrease, but its share in Finnish sawnwood exports is quite small anyway. For the whole year, Finnish export deliveries are estimated to stay about the same level as in 2005 (8.0 mill. m<sup>3</sup>). Domestic consumption will stay at the high level, apparent consumption being 5.1 mill. m<sup>3</sup>.

For the year 2007, prospects for the export demand of Finnish sawnwood seem much the same or slightly gloomier than in 2006. A moderate rise in export prices cannot improve the profitability considerably in 2007. The cooling construction activity in export and domestic markets lowers sawnwood consumption. This will increase competition in the European market and dampen sawnwood price development resulting smaller price rises than in the current year. We estimate Finnish sawnwood production to decrease to 12.5 mill. m<sup>3</sup> due to shut-down and re-arrangements of production in a few smaller sawmills. Instead, there are plans to enlarge sawing capacity in some of the Russian units owned by Finnish firms.

## **F. Sawn hardwood**

Sawn hardwood is a minor product in Finland, with a share of less than 1% of the total sawnwood production.

## **G. Wood-based panels**

Plywood is the most important product category in Finnish wood-based panels industry accounting for 70 % of panel production. During the past 10–15 years, plywood industry has invested new capacity especially in softwood plywood. At present, Finland is Europe's main plywood producer with about a 30 % share of the total European output.

Plywood production stagnated last year in European union (EU25) due to consumption decreases in major European plywood consumers, UK, Germany, Italy and Netherlands. In spite of decreasing consumption, Russia, Baltics and China expanded their supply for birch plywood in Europe. In addition, China was active also in softwood plywood exports especially to Germany.

In Finland the production reduction was about 3 % to a level of 1.305 mill. m<sup>3</sup> in 2005. In exports the decrease was 5%. The shares of birch-faced and softwood plywood in the Finnish total production are approximately 40% and 60%, respectively. Plywood is an export product for Finland, where domestic consumption accounts only for 15 % of production.

Finnish particle board and fibreboard production represent a small share in Finnish woodworking industry production. Production quantities have been relatively stable in recent years and new plans for capacity enlargements have not been presented. Last year particle board production amounted to 0.45 mill. m<sup>3</sup> and fibreboard production 0.15 mill. m<sup>3</sup>. Although production amounts are small particle board and fibreboard are also exported the main export countries being the UK, Sweden and Denmark.

Domestic apparent consumption accounts for nearly 60 % of particleboard production. In the case of fibreboard, domestic consumption is larger than production and imports are needed to fulfill the gap.

### **Outlook for years 2006 and 2007**

In 2006, Finnish plywood production and exports are expected to rise slightly over the level of 2004. A relatively strong export demand and moderately rising export prices boost production to 1.4 mill. m<sup>3</sup> and exports to 1.25 mill. m<sup>3</sup>. Next year a slightly gloomier development of international economy is expected to decline the activity of new residential construction, furniture demand and trade in the European market slowing plywood consumption. However, Finnish production and exports are expected to stay about at the same level as in 2006. In 2007, production will be vary near to the full capacity in plywood industry.

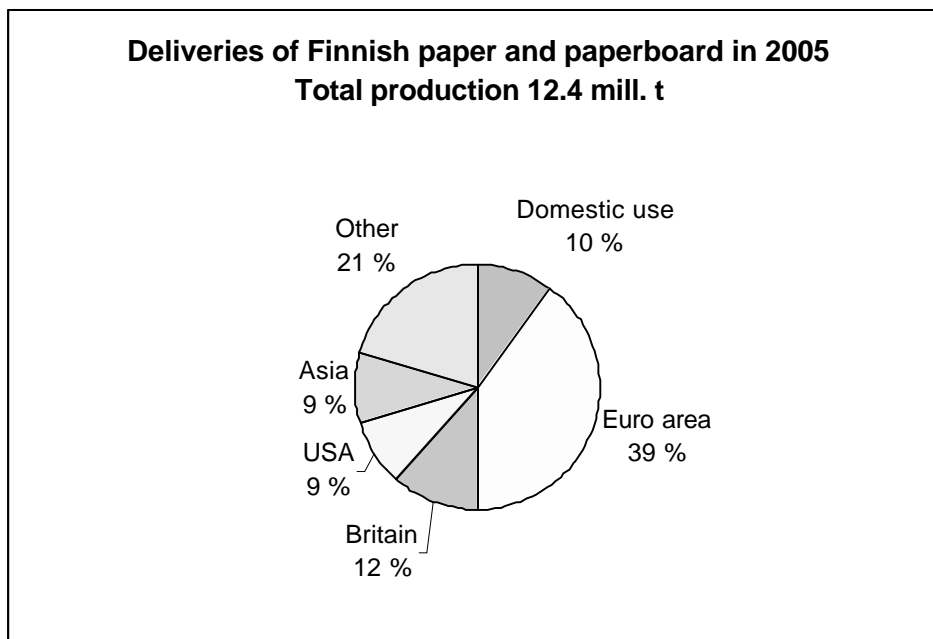
For particleboard and fibreboard no significant capacity increases are announced for 2006 and 2007. So, no significant changes in their production are estimated.

## H. Pulp and paper

### Situation in 2005

The production in the Finnish pulp and paper industry was exceptionally low in 2005. This was due to the long-lasting labor dispute which kept the mill gates closed for about seven weeks. Production of paper and paperboard fell by 12% to 12.4 million tonnes. The relative decrease in pulp production was of the same order. Chemical pulp production amounted to only 6.8 million tonnes, while the total pulp production came to 11.1 million tonnes.

As to exports, the persistent decreasing trend in paper export prices finally evened out during the year. In December, the average price for Finnish paper exports was slightly above its January level. However, following the decrease in production, the export quantities dropped significantly. In 2005, the Finnish export volume of paper and paperboard totalled 11.1 million tonnes, roughly 90% of the production. Both the quantity and the value of paper and paperboard exports dropped by 12% from 2004.



## **Outlook for years 2006 and 2007**

In the first half of the year 2006, the demand in the export markets was relatively good, and the paper and paperboard production in Finland set a new record. According to the Finnish Forest Industries Federation, the growth in production was partly due to mills' continued operation during the Midsummer holiday, which was possible for the first time in Finland thanks to the collective agreement that was concluded in 2005. This opportunity was utilized by almost all the pulp mills and some 40% of the paper mills.

Due to the exceptionally low production levels in 2005, it is more reasonable to compare the production figures to year 2004, which was previous record year. Chemical pulp production increased in the first six months by 1.4%, paper production by 2.1%, and paperboard production by 4.9%, compared to the respective figures in 2004.

The prospects for the rest of the year 2006 look positive as well. Finnish production of paper and paperboard are forecasted to be around 14.3 million tonnes. Hence, it is expected that a new production record will be made despite of the capacity shutdowns finalized during the summer. UPM-Kymmene shut it's Voikkaa mill with an annual capacity of 400 000 tonnes of coated magazine papers. The company also closed two paper machines in other mills producing 100 000 tonnes of sack paper and 130 000 tonnes of coated fine paper. The company aims to redirect the production in the closed units to it's other units.

The Finnish chemical pulp production is forecasted to reach almost 8 million tonnes in 2006, with the exports growing. Perhaps the most interesting news in Finland concerning pulp is the Stora Enso's decision to stop hardwood pulp production in Oulu and to use the ideled capacity for softwood pulp production. The reason for this is that imported eucalyptus pulp will be substituted for birch pulp at the Oulu paper mill. The amount of birch pulp produced at the mill has been around 150 000 tonnes.

In the year 2007, the market prospects for paper are expected to continue improving, given that the relatively favourable economic growth forecasted in the Western Europe materializes. The demand is picking up in the main export markets for the Finnish pulp and paper industry. At the same time, the capacity shutdowns are helping to reduce the overcapacity in the printing and writing paper markets. Because the shutdowns made in mid 2006 now affect the entire year, the Finnish production and export quantities of paper and paperboard are likely to drop slightly in 2007. The production of paper and paperboard is forecasted to be 13.9 million tonnes. Instead, the chemical pulp exports are expected to remain close to the 2006 level.

## 5. TABLES

### A. Economic indicators

Key economic indicators	2004	2005*	2006e	2007f
Gross domestic product growth, %	3.5	2.9	4.4	2.7
Consumer price index change, %	0.2	0.9	1.7	1.6
Wage and salary earnings change, %	3.8	3.9	2.8	2.6
Unemployment rate, %	8.8	8.4	7.9	7.4
Current account surplus/GDP, %	7.8	5.1	5.5	5.3
Industrial output change, %	5.3	-1.9	9.0	4.0
Three month EURIBOR, %	2.1	2.2	3.3	3.6

Source: Nordea, Economic Outlook 4.9.2006. Due to the changes in calculations of Finnish national accounts, data released earlier than 1 March 2006 are not in all respects comparable with the data in this Table.

### B. Production and Trade in 2004–2007

1. Forest industry production in Finland					
Product	Unit	2004	2005	2006e	2007f
	1000				
Sawn softwood	cum	13 460	12 190	12 600	12 500
Plywood	cum	1 355	1 305	1 400	1 400
Particle board	cum	448	452	450	450
Fibreboard	cum	147	149	143	143
Mechanical pulp	tonnes	4 836	4361	5050	5000
Chemical pulp	tonnes	7 783	6773	7950	7900
Pulp, total	tonnes	12 619	11 134	13 000	12900
Printing & writing paper	tonnes	10 024	8816	–	–
Magazine paper, newsp	tonnes	6 843	6090	–	–
Fine paper	tonnes	3 181	2727	–	–
Other paper	tonnes	1 154	1026		
Paper, total	tonnes	11 178	9842	11400	11000
Paperboard	tonnes	2 858	2549	2850	2900
Paper & Paperboard total	tonnes	14 036	12 391	14 250	13900

Source: Finnish Forest Industries Federation (2004, 2005), Finnish Forest Research Institute (2006, 2007), Finnish Forest Industries Federation (woodworking industry 2006, 2007)

<b>2. Exports of Finnish Forest Industry Products</b>					
	Unit	2004	2005	2006e	2007f
Product	1000				
Sawn and planed goods	cum	8 226	7 664	8000	7 900
-Coniferous	cum	8 209	7 649	8000	7 900
Plywood	cum	1 234	1 173	1 250	1 250
Veneer sheets	cum	77	71	70	70
Particle board	cum	242	230	250	250
Fibreboard	cum	74	82	70	70
Mechanical pulp	tonnes	112	87	200	200
Chemical pulp	tonnes	2 247	1950	2300	2400
Pulp, total	tonnes	2 359	2 037	2 500	2600
Newsprint	tonnes	573			
Magazine paper	tonnes	5 803			
Uncoated	tonnes	2 392			
Coated	tonnes	3 411			
Fine paper	tonnes	3 093			
Uncoated	tonnes	1 132			
Coated	tonnes	1 961			
Kraft Paper	tonnes	408			
Other Paper	tonnes	341			
Paper, total	tonnes	10 218	8973	10400	10000
Paperboard	tonnes	2 461	2163	2420	2470
Paper & Paperboard, total	tonnes	12 679	11 136	12820	12470

Sources: National Board of Customs (2004, 2005), Finnish Forest Research Institute (2006, 2007), Finnish Forest Industries Federation (woodworking industry 2006, 2007)

<b>3. Imports of Forest Industry Products</b>					
	Unit	2004	2005	2006e	2007f
Product	1000				
Sawn and planed goods	cum	404	511	570	570
-Coniferous	cum	341	448	500	500
Plywood	cum	76	96	100	100
Veneer sheets	cum	10	11	15	15
Particle board	cum	53	52	50	50
Fibreboard	cum	142	154	90	90
Mechanical pulp	tonnes	13	26		
Chemical pulp	tonnes	154	257		
Pulp, total	tonnes	167	283	340	340
Newsprint	tonnes	63			
Magazine paper	tonnes	23			
Uncoated	tonnes	13			
Coated	tonnes	10			
Fine paper	tonnes	75			
Uncoated	tonnes	45			
Coated	tonnes	30			
Kraft Paper	tonnes	20			
Other Paper	tonnes	12			
Paper, total	tonnes	192	258	330	330
Paperboard	tonnes	225	206	240	240
Paper & Paperboard, total	tonnes	417	464	570	570

Sources: National Board of Customs (2004, 2005), Finnish Forest Research Institute (2006, 2007)