LATVIA

MARKET STATEMENT 2006

1. GENERAL ECONOMIC TRENDS AFFECTING THE FOREST AND FOREST INDUSTRIES SECTOR

Reforms implemented in Latvia and integration in the EU have left a positive impact on economic development of the country. In the period of 2001 – 2005 **gross domestic product (GDP) growth** of Latvia was on average 8,2 % annually, 10,2% - in 2005. The high growth rates are achieved due to the stable dynamics of domestic demand and increase in exports, therefore in 2005 there has been a considerable growth of business profit, salaries and the taxes collected by the state.

Almost 80% of GDP growth was ensured by the development of service sectors. The greatest investment was from the trade, transport and communications sector. Rapid rise in investment has a favourable influence on **development of construction.** The construction sector grew by 15,5% in 2005, in comparison with 2004. Construction of residential and commercial buildings, hotels, streets and roads, industrial and other objects grows fast. The construction sector is expected to maintain high development rates also in future. The rapid growth of the construction sector over the last years has a favourable impact on forest industry. There is a growing demand in the domestic market for joinery and carpentry production manufactured by Latvian enterprises. In 2005, the amount of realization of joinery and carpentry production of Latvia in financial terms has trippled, in comparison with 2003.

Industrial sectors with a comparatively smaller relation to export had a more rapid growth in 2005. Output in manufacturing in this period has increased by 6%, due to the more moderate development in one of the main export sectors of Latvia – **forest industry** which constitutes a share of 22% in the output of industrial production. Changes in the amount of woodworking production came to +2,6%, wood-pulp and paper industry +8,9%, furniture manufacturing +3,2%, compared to 2004.

Investment growth rates in Latvia remain steadily high for several years already. This is affected by several factors, especially such as financial stability, continuous improvement of business environment, high domestic demand, rather low real interest rates, inflow of foreign capital, etc. Fixed investments in Latvia in 2005 were twice bigger than in 2000, i.e., they have annually increased by 15.7% on average in this period. There has been a more rapid rise in investment in fixed assets of the forest sector - in 2005 the investment in fixed assets trippled in comparison with 2000 (it doubled in the forest industry). In the sectoral structure of accumulated foreign direct investments (FDI), invesments in energy sector, financial services and communication made a bigger share. The major investors in 2005 came from Sweden, Germany, Estonia and Russia.

In 2005 most of **Latvia's foreign trade turnover** was made up by trade with Germany – 13% (from total foreign trade turnover), Lithuania – 13%, Estonia – 9%, Russia – 8%, Sweden and Poland – 6%. The biggest share in the export structure is constituted by export of forest sector production - (30%), export of metal and metalwork production (13%), export of agricultural goods and food commodities – 12,2%.

High **inflation** rate was observed in 2005 due to the convergence of regional prices in the European Union, also the increased development of mortgage lending, rise of administratively regulated prices (electricity, gas), and increase in fuel prices.

Rapid economic development in the recent years makes a positive impact on the situation in the Latvian labour market. Although the population of working age continues

diminishing, the number of economically active persons increases and the **employment rate** grows. Unemployment rate at the end of 2005 was 7,4%, which is notably lower than in the previous year (8,5%). The number of unemployed people decreases not only due to the increasing employment rate. In the last years labour outflow takes place to some old EU member states, e.g., Ireland, Great Britain and Sweden, which has resulted in shortage of labour force in several sectors in Latvian labour market.

2. POLICY MEASURES INFLUENCING TIMBER TRADE AND MARKETING

In 2005 ***National Lisbon Programme of Latvia for 2005 – 2008*** was elaborated and approved. The Programme defines the measures to be implemented in order to create prerequisites for the development of knowledge-based economy of Latvia. The most important priorities in the industry are - the orientation to high value added production, increasing share of hi-tech in the export structure and facilitation of efficiency level. The aims and tasks set in *National Lisbon Programme of Latvia* will be taken into consideration when elaborating *Support Programme by European Agricultural Fund for Rural Development (EAFRD) for 2007– 2013*. Industrial policy is closely linked to innovation, entrepreneurship, education and other policy areas.

In order to facilitate global climate change reduction, implementing UN Framework Convention on Climate Change, its Kyoto Protocol and requirements of the legislation of the European Union in the field of the climate change reduction, ***Programme for Climate Change Reduction for 2005 – 2010*** was elaborated and approved in 2005. The Programme establishes the state policy in the field of climate change reduction.

Guidelines for Energy Industry Development for 2006 - 2016 were approved 27 June 2006. They include the basic principles of Latvian government's policy, aims and required action regarding the energy industry for the period of next ten years, as well as outline long term directions of development. The aim of the guidelines is to diminish the dependance of Latvia on the imported energy resources and advance the safety of energy supply.

3. MARKET DRIVERS

The forest sector is one of the most active sectors in the national economy of Latvia, having a significant contribution to the stabilization of foreign trade balance of Latvia. Forest industry has a positive export and import balance due to **the use of renewable forest resources.** The forest sector contributes significantly to the GDP of Latvia and employs ~ 8% from the total employment in the economy sector.

In 2005 there was remarkable increase in **the investment in modernisation of production**, which creates prerequisites for raising competitiveness of the forest sector and its contribution to the GDP. The amount of non-financial investments in the actual prices of the forest sector has doubled in comparison with 2004. In 2005 there was a sharp increase in the investments in the wood working and furniture manufacturing, where the growth in the actual prices reached 99% and 73% respectively. It is envisaged that with increased investment in the development of production of wood-based panels and production of energy from renewable resources, there will be growth in use of small-size roundwood in the Latvian domestic market.

Foreign investments were of great importance in the development of the forest sector in 2005. They contributed to the distribution of efficient production units, access to modern technologies, improvement of the production quality, and they also facilitated the access to foreign market.

Over the last years in Latvia there have been an intense concentration of sawing capacity and decrease in the number of enterprises. It is explained by **the considerable growth of competitiveness in the use of forest resources, and increasing costs of labour force and energy resources.**

At the same time, there is an ongoing process of **improvement of production technologies in the enterprises** – the biggest enterprises have installed drying, sorting, planing and impregnation equipment. There are new solutions sought for adding the value to a product, specializing in the production of planed and impregnated articles. Small and medium-sized saw mills produce *niche products* and non-coniferous sawnwood components. For forest industry enterprises 2005 has been a successful year owing to the considerable increase in net turnover. This was achieved due to the investment in new technologies, production of articles of wood with higher value added, increase in production and realization volumes, and broadening the market opportunities.

At present all over the world in the cycle of production of woodworking products storages are not commonly used, and **production depends on *right-time* supplies.** The favourable geographic location has allowed Latvia position itself as a stable, accurate and long-term partner in *right-time* supplies for EU production enterprises, including DIY (*Do It Yourself*) chains and construction companies.

The storm of January, 2005 had a negative impact on the forest sector, and it caused serious damage to 6,9 mln cubic metres of forest in all the region. As a result, there was a sharp fall of ~40 % in the prices of coniferous sawnwood and an increase of 40 - 45 % in the prices of harvesting and transport services, due to the satiated market of coniferous wood in Latvia and the rest of Norhern Europe. There was a huge demand and shortfall in the harvesting and the transport sector. In the first half of the year there was a shortage of non-coniferous roundwood, resulting in the losses in the market of non-coniferous sawnwood.

4. DEVELOPMENTS IN FOREST PRODUCTS MARKETS SECTORS

A. Wood raw materials

Over the last years **the timber harvesting volumes** in Latvia's forests have stabilized. The annual increment is 16,5 mln cubic metres, and approximately 12 mln cubic metres of timber are harvested. In 2005 ~ 43 % from the total harvesting volume were harvested in the state forests and 57% in the private, local municipalities and other owners' forests. The total harvesting volume in the state forests in 2005 has increased by 10% to compare with 2004, due to the more intensive logging of wind-thrown and broken trees after the storm in January 2005.

In roundwood **utilization** in 2005 the most considerable share is constituted by the production of sawnwood (54,2%) and the roundwood export (fuelwood, pulpwood) (30%), as well as production of plywood, matches, log houses, palisades, piles, poles, wood charcoal, pellets etc.

In 2005 Latvia **exported** 3,92 mln cubic metres of roundwood, ~90 % of which was pulpwood not utilized in Latvia. The pulpwood market is significantly influenced by the wood-pulp and paper industry enterprises of the Nordic countries. Mainly the pulpwood is exported to Sweden, Finland, Estonia and Norway (a little amount – to Great Britain). The most rapid increase in export of pulpwood was to Estonia - from 29 thousand cubic metres in 2004 to 222,4 thousand cubic metres in 2005. The export volume of non-coniferous roundwood in 2005 has decreased by 14 %, but export of energy chips has increased by 8,4%, by volume.

The prices of wood resources in Latvia have converged with the prices in all the region, which lets Latvian entrepreneurs increase the **import** volume of roundwood and primary processed wood products from Russia and Belarus.

Roundwood import in 2005 has increased by 35,2%, and it exceeds one million cubic metres. In roundwood import the most considerable share is constituted by sawlogs which are processed in Latvia into products with higher value added. The import of non-coniferous roundwood in 2005 reached 488 thousand cubic metres, it has nearly doubled – with the increase of 83% in comparison with 2004. Roundwood is mainly imported from Russia, Lithuania and Belarus. The most rapid growth has been in the export of non-coniferous roundwood from Belarus (from 27 thousand cubic metres in 2004 to 107 thousand cubic metres in 2005).

The volumes of coniferous roundwood import in 2005 increased by 11%, 593,8 thousand cubic metres of coniferous roundwood were imported with the biggest share (78%) from the Russian Federation. The import from Belarus has increased by 67%, reaching 69,9 thousand cubic metres, and there has been a decrease of 52% in the share of coniferous roundwood supply from Lithuania.

B. Wood energy

Production of heat energy constitutes the biggest share (64%) in the energy balance of Latvia, similarly to the Nordic countries.

Wood is the most important local fuel, its share in the balance of primary energy resources of Latvia is ~30% from the total consumption of energy resources. In the households (consuming ~70% from the fuelwood) stove or central heating using wood and wood processing byproducts are still popular, and there is an increasing use of briquettes and pellets. In the countryside – small towns and villages - in the centralized heating systems mainly there is obsolete, ineffective heat production equipment in use – with fossil fuel or fuelwood used.

Industry, mainly forest industry enterprises, consume approximately 16% of fuelwood – mainly wood processing byproducts, in order to ensure the technological process and required heat supply. Small and medium-sized enterprises produce heat energy for self-consumption using ineffective heat production equipment.

In 2006 there are *Guidelines for Use of Renewable Energy Resources for 2006 - 2010* elaborated in Latvia. The expected outcome of the implementation of these guidelines is the broadening of use of renewable resources, including wood. The aim of the policy of renewable energy resources is to create an institutional and normative environment which could contribute to an increasing use of renewable energy resources. In order to reach the set aim, it is necessary to introduce new market solutions, create favourable support conditions for the energy production technologies which promote the competitiveness of renewable energy resources, and to invest in training of specialists and research. There is an investment required for heat energy production equipment in towns and rural villages, changing their orientation to an environmentally friendly fuel or increasing their energy efficiency.

Till now, there has been a little use of wood residues in Latvia. Remains of forestry and forest harvesting amount to approximately 15 – 25% and constitute ~2,5 mln cubic metres of fuel. The analysis of the biomass resources available in Latvia shows that currently approximately 5 mln cubic metres of fuel wood are not used. From such an amount ~24 PJ, or 6.7 GWh of heat energy could be produced a year.

There has been a fast growth in the import of fuelwood (particularly chips and sawdust) - 19 500 tons of fuelwood were imported in 2005 which is by 164% more than in 2004. The value of fuelwood has increased by 260,9%, reaching 694,4 thousand LVL. Fuelwood was imported in Latvia mainly from Lithuania, Belarus and Poland.

Export of fuelwood in 2005 has a slight increase of 7,3% by volume and 21,3% by value. Fuelwood was exported to the EU countries for the greatest part, mainly to Sweden, Denmark and Finland.

C. Forest certification

In Latvia forest management and timber chain-of-custody certification are performed under Forest Stewardship Council (FSC) and Pan European Forest Certification (PEFC) schemes

All state owned forests in the country with the total area of 1,62 mln hectares have been certified according to the **FSC** scheme**.** FSC certificate has also been granted to Riga City forests in the area of 57 thousand ha and to more than 3000 ha of private forests. In 2005 more than 100 Latvian forest sector enterprises have certified their timber chain-of-custody systems.

PEFC Latvian scheme has been evaluated as complying with the PEFC provisions and demands, wherewith all the PEFC certified forests in Latvia have been acknowledged as sustainably managed. The management conforms to the criteria, indicators and strategy guidelines accepted in the Ministerial Conference on the Protection of Forests in Europe (MCPFE). According to the PEFC Latvian scheme, private forest owners are granted "Confirmation'' for entering the PEFC system and "Logo Licence" for their forests.

As to 1 September, 2006, 95 385 ha of forests were managed (20 000 ha in 2003), according to the demands of PEFC scheme, but the number of the enterprises that have received the PEFC timber chain-of-custody certificates has grown to 48 enterprises.

D. Value added wood products

In Latvia the manufacturing and trade of high value added woodworking products has developed rapidly over the last five years, which is shown by the increasing share of this sector in the forest industry, also by the increasing variety of the production. There is manufacturing of furniture and furniture components, joinery and carpentry production, prefabricated wooden constructions, garden furniture and palisades, toys of wood and other production of demand in the market.

Over the last five years the most rapid growth in output has been in the manufacturing of furniture and wood and articles of wood with the double increase in output since 2000. By investment in modern technologies, there has been a development of manufacturing of solid wood furniture of pine, birch and black alder, as well as manufacturing of glue-shaped furniture and components. There is an increase in manufacturing of upholstered furniture and production of laminated and veneered particle board. Due to the construction boom in Latvia, furniture manufacturers pay more attention to the demand in domestic market. In 2005 furniture in the amount of 58 mln LVL was sold (38 mln LVL in 2004).

In comparison with 2004, the export of furniture in terms of money has risen by 2,4% (it constitutes 81 mln LVL in 2005), but import by 33,4% (37 mln LVL). Furniture is mainly exported to Denmark, Germany and Great Britain, but imported from Poland, Lithuania, Italy and Russia. There has been a very rapid growth in the import of furniture from the third countries, particulary from China (from 0,1 mln LVL in 2003 to 0,85 mln LVL in the 1st half of 2006).

Over the last years there has been a fast growth of joinery and carpentry production, (wooden window frames, doors, building materials, glue laminated timber). Import and export value of this production has risen – export value by 13,8 % in comparison with 2004

and import value – by 45,9%. Due to the construction boom, there has been an increase in the domestic consumption.

Wood packaging materials are manufactured with comparatively small investment and simple technologies. They are mainly produced by small or medium-sized enterprises, basically using non-coniferous sawnwood of low or average quality, inapplicable for other production. Over the last 3 years there has been an increase in the number of enterprises which manufacture wood packaging and wooden pallets complying to the requirements of the EU, for the domestic and European market.

Import of packaging articles in Latvia has increased by 50,9% in 2005, but the export has increased by 19,1%, in comparison with the previous year.

In 2005 the export volume of further processed profiled sawnwood in terms of money has increased by 87,1%, but export of prefabricated wooden constructions and toys of wood has increased by 19,7%. There has been a decrease in import of this production in terms of money to compare with the previous year.

E. Sawnwood

The production of sawnwood in 2005 has increased by 6 %, in comparison with 2004. 4,2 mln cubic metres of sawnwood were produced and 2,8 mln cubic metres of the production (67%) were exported. Despite the fact that in 2005 there was a smaller volume of export of sawnwood (-5,1%), there was an increase in the income from the export (+4,1%). It can be explained by the increase in the quality and price of sawnwood of Latvia. For the greatest part, further processed sawnwood ready for end-users - in the construction or manufacturing of furniture or other materials - is produced and exported. The major cooperation partner in 2005 was Great Britain and 61 % from all the exported sawnwood in 2005 was exported to this country.

There has been a rapid growth in the development of the domestic market of sawnwood. The domestic use of sawnwood in 2005 was 1,6 mln cubic metres, and the consumption has increased by 38% in comparison with 2004. Major consumers of sawnwood in the domestic market are the manufacturers of furniture and furniture panels (32%), producers of building materials (windows, doors, flooring, etc.) (46%), producers of carpentry and household products, including producers of packaging materials (22%).

The storm of 8 January 2005 had an impact to the forest industry and caused the lack of qualitative timber. As there was a more intensive logging of the wind-thrown coniferous trees, there was a significant decrease concerning the non-coniferous logging. This fact can be testified by volume of export of non-coniferous sawnwood in 2005 which has increased by 126% in comparison with the previous year. The major importer countries of sawnwood are Russia, Belarus, Estonia and Ukraine, the import of non-coniferous sawnwood from Russia in 2005 has increased by 178,5%, in comparison with 2004.

F. Wood-based panels (particle board, plywood etc.)

One of the most significant forest industry branches in Latvia is the production of wood-based panels, particulary plywood. Latvia is one of the largest plywood producers in Eastern Europe, furthermore, the value of the plywood produced over the last 10 years has increased by more than five times, which was mainly due to the increase of the added value of the production.

The volume of plywood production in Latvia in 2005, in comparison with 2004, has increased by 14%, the export by volume has increased by 10,2%, the export by value has increased by 19,4%, amounting to 66,4 mln LVL. Plywood was mainly exported to Germany, Great Britain and France, the main import of plywood was from Russia, Belarus and China. The volume and value of the plywood imported from China has quadrupled

within a year. There has also been an increase in domestic consumption of plywood, mostly it is used in the construction, however there is a constant increase in the production and consumption of plywood of common consumption.

Recently there has been significant investment in the production of MDF. The production of OSB is planned to develop considerably. In 2005 the production of these boards has increased by 7%, there has also been an increase in the domestic consumption and export of the particle boards. A large part of these boards are surfaced, thus increasing the value of the boards. It is envisaged that in future the production of surfaced boards and the components produced of them will increase.

G. Paper and articles of paper

In Latvia 39,000 tons of articles of paper have been manufactured in 2005, it is by 2,6% more than in 2004. The use of paper and cardboard has increased by 5 %.

In 2005 the import of paper and articles of paper has increased by 40 %, the import has increased by 5 %. The import of pulp and recycled waste paper in terms of money has increased by 41,6 %. In 2005, the import of paper and cardboard was imported into Latvia from Sweden, Finland, Germany, Poland and Lithuania, pulp and recycled waste was imported from Finland, Lithuania, Ukraine and Estonia.

4. TABLES

Table 1

Key Indicators of Economic Development

	2002	2003	2004	2005	2006 p
	(increase over the previous year. in per cent)				
Gross domestic product	6.5	7.2	8.6	10.2	11.0
Consumer prices	1.9	2.9	6.2	6.7	6.0
	(% of GDP)				
General government budget fiscal balance	-2.3	-1.6	-1.1	-1.2	-1.5
Central government debt	13.5	14.4	14.6	12.0	11.0
Current account balance	-6.6	-8.1	-12.9	-12.4	-12.5
Exchange rate LVL per euro	0.583	0.645	0.671	0.703	0.703
Unemployment rate (rate of job seekers as % of economically active population, aged 15-74 years)	12.0	10.6	10.4	8.7	8.0

p – forecast of the Ministry of Economics

Source: *Ministry of Economics*

Table 2

Forest sector production export from Latvia

HS code	Production	units.	2004		2005	
			1000 (units)	1000 (LVL)	1000 (units)	1000 (LVL)
3605	**Matches**		**-**	**1440.6**	**-**	**1727.3**
44	**Wood and articles of wood**		**-**	**636582.1**	**-**	**692385.5**
4401	**Fuelwood:**	**(t)**	**2153.3**	**55166.2**	**2311.3**	**66916.3**
44011	Fuelwood (round)	(t)	293.2	5421.5	260.5	6167.0
44012	Chips	(t)	1403.3	33653.8	1521.2	37098.2
44013	Sawdust and other wood residues	(t)	456.8	16090.8	529.5	23651.1
4403	**Roundwood:**	**(m^3)**	**4135.7**	**99257.8**	**3919.1**	**103116.4**
44032	Coniferous	(m^3)	1853.4	47663.2	1954.4	46730.1
44033…	Non-coniferous	(m^3)	2282.3	51594.6	1964.8.	56386.3
4407	**Sawnwood:**	**(m^3)**	**2988.4**	**300300.4**	**2835.5**	**312678.3**
44071	Coniferous	(m^3)	2425.8	252486.3	2462.4	272709.2
44072…	Non-coniferous	(m^3)	562.7	47814.1	373.1	39969.1
4408	**Veneer sheets**	**(m^3)**	**14.7**	**9117.4**	**15.3**	**7757.0**
4409	**Further processed sawnwood**		**-**	**6497.4**	**-**	**12158.3**
44091	Coniferous		-	4170.2	-	6595.9
44092	Non-coniferous		-	2327.2	-	5562.4
4410	**Particle board**	**(m^3)**	**141.3**	**11491.6**	**161.3**	**15392.5**
4411	**Fibreboard**	**(m^2)**	**252.3**	**522.6**	**381.1**	**764.0**
4412	**Plywood**	**(m^3)**	**163.6**	**55630.0**	**180.3**	**66436.3**
4415,(16)	**Wooden wrapping and packing equipment**		**-**	**20560.5**	**-**	**24495.5**
4418	**Joinery and carpentry**		**-**	**52160.3**	**-**	**59371.6**
44…	**Other articles of wood**		**-**	**25877.9**	**-**	**23299.3**
47	**Pulp of wood. recovered paper**		**-**	**1748.7**	**-**	**1794.4**
48	**Paper and paperboard. articles of paper**	**(t)**	**56.0**	**34785.6**	**78.4**	**50151.1**
94…	**Furniture**		**-**	**79525.5**		**81417.4**
94…. 95	**Prefabricated buildings and toys of wood**	**(t)**	**7.6**	**3711.1**	**8.3**	**4442.7**
	Total			**757793.6**		**831918.4**

Source: *Central Statistical Board*

Table 3

Forest sector production import to Latvia

HS code	Production	units.	2004		2005	
			1000 (units)	1000 (LVL)	1000 (units)	1000 (LVL)
3605	**Matches**		**-**	**125.4**	**-**	**51.3**
44	**Wood and articles of wood**		**-**	**113076.5**	**-**	**137561.8**
4401	**Fuelwood:**	**(t)**	**7.4**	**192.4**	**19.5**	**694.4**
44011	Fuelwood (round)	(t)	3.8	65.7	30.2	218.2
44012	Chips	(t)	2.8	53.1	8.1	189.8
44013	Sawdust and other wood residues	(t)	0.7	73.7	8.2	286.4
4403	**Roundwood:**	**(m^3)**	**800.5**	**16505.0**	**1082.4**	**37035.5**
44032	Coniferous	(m^3)	534.4	17171.8	593.8	20102.7
44033…	Non-coniferous	(m^3)	266.1	9333.2	488.6	16932.8
4407	**Sawnwood:**	**(m^3)**	**688.0**	**54272.1**	**616.0**	**53610.5**
44071	Coniferous	(m^3)	674.8	52355.3	586.1	49406.7
44072…	Non-coniferous	(m^3)	13.3	1916.8	29.9	4203.8
4408	**Veneer sheets**	**(m^3)**	**1.2**	**955.9**	**1.2**	**1397.8**
4409	**Further processed sawnwood**	**(m^3)**	**5.9**	**1115.8**	**-**	**1264.6**
44091	Coniferous	(m^3)	5.2	782.5	-	619.8
44092	Non-coniferous	(m^3)	0.7	333.4	-	644.7
4410	**Particle board**	**(m^3)**	**55.1**	**9094.4**	**91.2**	**14931.7**
4411	**Fibreboard**	**(m^2)**	**4478.8**	**7090.8**	**4889.0**	**8825.1**
4412	**Plywood**	**(m^3)**	**10.5**	**1929.7**	**12.5**	**2907.8**
4415,(16)	**Wooden wrapping and packing equipment**	**(t)**	**-**	**2170.8**	**-**	**3275.0**
4418	**Joinery and carpentry**	**(t)**	**-**	**6507.7**	**-**	**9492.6**
44…	**Other articles of wood**	**(t)**	**-**	**3241.8**	**-**	**4126.9**
47	**Pulp of wood. recovered paper**	**(t)**	**-**	**442.4**	**-**	**626.3**
48	**Paper and paperboard. articles of paper**	**(t)**	**182.9**	**108332.0**	**192.9**	**119774.2**
94…	**Furniture**		**-**	**27445.0**	**-**	**36618.3**
94…. 95	**Prefabricated buildings and toys of wood**	**(t)**	**1.6**	**937.2**	**1.5**	**834.2**
	Total			**250358.4**		**295466.2**

Source: *Central Statistical Board*