

## UNECE TIMBER COMMITTEE - SEPTEMBER 2007

### UK TIMBER MARKET STATEMENT

#### 1. General economic trends affecting the forest and forest industries sector

There has been continued growth in the UK economy over the past year - at an average of 3.0% - although the rate of growth has dropped slightly in the second quarter of 2007. GDP has increased over 59 consecutive quarters, the longest unbroken expansion on record. Services have continued to show the strongest growth, although manufacturing has also performed well over the past year.

There have been significant inflationary pressures in the past year although these have eased since spring 2007. Consumer price inflation reached 3.1% in March 2007, significantly above the Government's 2% target, and has since fallen to 2.5%. This fall has come most strongly from housing and household services, with gas and electricity prices continuing to fall from record levels earlier in the year.

Given the Government's inflation target, the Bank of England's Monetary Policy Committee feels that the outlook for inflation remains on the high side. The official Bank of England interest rate has risen steadily since August 2006. The rate is currently set at 5.75%, its highest level for over 6 years, and a further 0.25% increase is expected in the next few months.

Despite the interest rate increases, there has been little evidence of a slowdown in household spending. Business investment growth remains firm and business confidence remains broadly upbeat. The CBI's latest Monthly Trends survey indicates that manufacturer's expectations of output growth have strengthened in the past few months.

The interest rate increases have contributed to a strengthening of Sterling, which rose to a 26-year high against the dollar in July 2007. The strengthening of Sterling is creating concern among UK exporters and the value of UK exports of goods and services has fallen a little in spring 2007.

Recent employment data show a mixed picture for the UK labour market. Unemployment has remained steady at or around 5.5% over the past 12 months. However, the working age economic inactivity rate has risen over the past year and employment growth, at 0.3%, is at its lowest rate in 13 years. The forestry sector has an increasing number of skilled and semi-skilled migrant workers now actively seeking employment.

The forest industries sector is relatively small in the context of the whole UK economy, accounting for 0.56% of Gross value Added (GVA). Nevertheless, this amounts to £6.1 billion GVA and supports 173,000 jobs.

Overall, the UK economy continues to enjoy a period of relative stability although concerns exist about the margin of spare capacity in the economy. The strong performance of the manufacturing sector bodes well for forest industries, which have strong links to this sector. Continued growth in services is also helpful to forest industries, such as pulp and paper manufacturing.

General economic trends affecting the forest and forest industries sector are summarised below.

**Selected economic indicators, UK (% unless otherwise indicated)**

	2002	2003	2004	2005	2006	2007 (Forecast)*
GDP growth (GDP at constant (2001) market prices)	2.0	2.5	3.2	2.0	2.7	2.8
Interest rate (base rate at year end)	4.00	3.75	4.75	4.50	5.0	6.0
Consumer Price Index	1.3	1.4	1.3	2.0	3.0	2.0
Unemployment (ILO)	5.2	5.0	4.8	4.8	5.5	5.5
Private housebuilding Starts** (thousands)	176.2	190.0	207.4	204.1	205.0	207.0

\*Average of independent forecasts. Source: HM Treasury, Forecasts for the UK Economy: A Comparison of Independent Forecasters, July 2007

\*\* Private housebuilding start source: DCLG & *timbertrends*

**2. Policy developments potentially affecting trade in wood products**

The UK Government has announced that from April 2009 its central departments will purchase only timber and timber products that derive from sustainably managed forests or are licensed under a FLEGT agreement. From April 2015 only sustainably produced timber will be purchased. This will be a step change from the current policy, which is to demand legally harvested timber as the minimum requirement. Consultation with stakeholders on impacts and implementation will close on 27 September 2007 and be followed by an open discussion.

The Central Point of Expertise on Timber (CPET) is working with construction companies under contract with central government to improve compliance by sub contractors and site supervision. CPET is also working with construction contractors on developing improved performance reports.

Harmonising timber procurement policies with other consuming countries remains a prime objective. Interest within the EU has grown and Germany has proposed a workshop for member states in 2008. Within the UK the Government is developing a new promotional strategy that will encourage local authorities to adopt timber procurement policies. The Sustainable Buildings Code and the Olympic Development Authority's procurement policy recognise the merit of responsible timber purchasing.

The UK Government continues to work actively with the EU to promote the EU FLEGT Action Plan. The EU Forestry Law Enforcement Governance & Trade (FLEGT) Regulation was adopted in December 2005, under the UK's Presidency of the European Union. This allows the EU to enter into bilateral Voluntary Partnership

Agreements with developing countries and provide them with assistance to tackle illegal logging. This assistance will include help to establish a system to identify legal products and license them for export. Unlicensed products from partner countries will not be given access to the EU market once these systems are in place.

We hope that the first Partnership Agreements will be in place by mid to late 2008. The UK is leading on negotiations with Ghana and Indonesia. The original FLEGT Communication (2003) recognised the limitation of the VPAs, in that they only apply to trade with those countries that enter into agreements with the EU. Therefore there was a commitment to explore and develop additional legislative options to exclude illegal timber from EU markets. The European Commission recently launched a public consultation on a number of potential additional measures, and they are currently undertaking an assessment of the impacts of alternative options. These will form the basis of draft proposals, which they have indicated that they will present early in 2008.

The UK has continued development co-operation support to major developing timber-producing countries to improve forest governance, particularly in Indonesia, Ghana and Cameroon. In January 2006 new funding of GBP 24 million over 5 years was announced. This will primarily support implementation of FLEGT Partnership Agreements.

The UK has continued to support co-operation with the timber trade, especially in getting messages to the supply chain that legal timber is now a requirement. This has included support to a trade "roadshow" to West and Central Africa in October 2005, preparation for a similar one to SE Asia and preparation and distribution of a DVD for the trade. In November 2005, UK Government and European and African timber producers, importers and end users agreed a set of Government-industry co-operative actions relating to timber procurement, stimulation of forest sector investment, financial support for certification and transparency.

The UK supports the FLEG processes in East Asia and Africa and the recent initiation of a European and North Asia FLEG. The UK has also been working with G8 countries, who as important trading and development partners, can have a significant impact on reducing illegal logging. Illegal logging was one of two topics of discussion at the first ever G8 Environment and Development Ministerial meeting in Derbyshire in March 2005. Ministers' agreed to a range of actions and officials are currently in the process of reporting progress. The FLEGT initiative has received considerable interest on the G8 stage, and the US and Japan have been considering similar measures with their own trading partners. We are working with the Japanese Presidency of the G8 to take this forward.

### **3. Market Drivers**

Timber frame housing starts continue to increase with further growth predicted for 2006. Timber frame housing had just an 8% share of new housing starts in 1998 and this has risen each year since, accounting for over 20% in 2006.

The Code for Sustainable Homes was introduced in England in April 2007 to drive a step-change in sustainable home building practice. It is a standard for key elements of design and construction which affect the sustainability of a new home. It will

become the single national standard for sustainable homes, used by home designers and builders as a guide to development, and by home-buyers to assist in their choice of home. It will form the basis for future developments of the Building Regulations in relation to carbon emissions from, and energy use in homes, therefore offering greater regulatory certainty to developers. And, in this era of environmental awareness amongst consumers and increasing demand for a more sustainable product, it will offer a tool for developers to differentiate themselves. It is encouraging to see that Timber certification is recognised as a mechanism in ensuring responsible sourcing of materials for the construction process.

A proposal has been announced by the Government Communities Secretary that all new homes in England will have to be carbon neutral by 2016. The scheme includes tightening building and planning rules, and a star rating system that reveals a property's energy efficiency to potential homebuyers.

In July 2007 the Government published its Housing Green Paper, setting out proposals to deliver the homes Britain urgently needs today and for the future. The demand for homes to buy or rent is growing faster than supply, and homes are becoming less affordable as a result. The paper identifies that 3 million new homes are needed by 2020 - and they aim to deliver 2 million of these by 2016.

Sustainable construction will continue to have a key role to play in this programme which is part of the broader aim to develop new sustainable communities. Social housing is of particular interest and this offers good prospects for timber frame. Social housing specifiers are already well focussed on the construction benefits of the system and have strong environmental policies.

Influential strategies were published in 2007 - the UK Biomass Strategy and the England Woodfuel Strategy- to promote the use of woody biomass at the small-medium scale for space and process heat. The Biomass action plan for Scotland sets out a coordinated programme for the development of the biomass sector in Scotland

Looking forward to the 2012 Olympics the wood industry has come together to campaign for a greater use of wood products on the Olympic site, particularly in its stadiums, village and legacy housing to help the Games meet its overall sustainability targets, whilst staging a successful event. The outcomes sought from the campaign are to:

- Maximise the use of wood in the Olympics highlighting the renewable nature of wood as a building material and reinforcing understanding of the benefits of using wood, including in mitigating climate change
- Highlight the benefits that can be derived from using wood in terms of increased skills levels and employment among the local and national workforce
- Influence the Government and ODA to implement a timber procurement policy that is both environmentally responsible and responsive to the needs of the industry.
- Create an exemplar project using wood on the Olympic site
- Contribute to a successful Olympics and subsequent legacy and provide a catalyst for more industry growth, reinforcing the industry's standing with key stakeholders

## 4. Developments in Forest Product Markets Sectors

### a) *Wood Raw Materials*

2007 has proved to be a very buoyant year for UK forest products sector. Demand from all market sectors has been exceptionally high – not because demand for timber in the UK has increased significantly, but because of supply problems from Scandinavia and the Baltic States. The supply problems have primarily been due to the very significant demand from China, coupled with harvesting difficulties due to a very mild winter.

2006/2007 has seen major investment increasing the capacity and the modernisation of GB's biggest sawmills.

The new home building market in the UK continued to grow in 2006, with rapid expansion in the public sector (social housing programmes). Although a much smaller sector, the social housing sector grew by 23% by volume in 2006. Private housing activity was higher too, showing a 2% improvement over 2005.

Repair, maintenance and improvement (RMI) sectors within construction were all lower in 2006. Private housing RMI, the largest sector, was lower by 3%, and the public sector RMI was down by a similar amount. Non-housing RMI was also lower in 2006.

### b) *Wood Energy*

As reported last year the UK use of forest products and sawmill products from timber processing as potential sources of renewable energy continues to increase. The scale of projects ranges from individual domestic situations through community heating and industrial applications to co-firing. Although the use of biomass as a replacement for coal in existing coal-fired stations is by far the greatest consumer of biomass, the vast majority of co-fired biomass is bought on the global market and imported.

Biomass projects, such as the E.On plant at Lockerbie which will consume approximately 500,000 green tonnes of sawmill co-products & biomass, and the Sembcorp Plant at Middlesborough which will consume approximately 300,000 green tonnes, much of it sourced from local conifer forests and sawmill co-products. During the late summer of 2007 SembCorp completed building and trial burns were underway.

The site works for UPM Caledonian Paper is underway for a c 50MW combined heat and power plant due to be completed mid 2009. Consumption will be approximately 370,000 green tonnes of biomass of which 45% will be forest brash and very small dimension roundwood 10% recycled fibre and 45% low quality sawmill co-products.

The UPM Shotton Paper 50MW plant is now fully operational after a 12-month start up and fine tuning period. Consumption is 250,000 tonnes made up of 20% forest arisings, 40% sawmill low value co-products and 40% arboricultural arisings and other woody biomass.

Construction is underway by Balcas Ltd of biomass project in the North of Scotland. The facility at Invergordon, north of Inverness will include a combined heat and power plant generating energy that will be supplied direct to the grid as well as production of c100,000 tonnes per annum of wood pellets.

There are 400 heat-only installations for medium/small industrial/commercial applications across GB with an installed capacity of 135MW (2006 data) and an estimated usage of 84 thousand oven dry tonnes. In 2007, the most recent Public Opinion Survey of 4000 representative people across Britain showed that the number of domestic wood-using applications has stayed around 8-9% households. More detailed surveys, albeit of a small number of individuals, indicated that this represents a usage of about 3 million oven dry tonnes annually.

*b) Certified forest products*

In the annual UK sawmill survey, sawmills provided the following responses in relation to Chain of Custody Certificates.

**Chain of custody certificates, 2006**

	Mills holding certificate	Mills without certificate	Certification status not reported	Total
<b>Sawmills</b>				
<5 thousand m <sup>3</sup> sawnwood	16	67	8	91
5 - <25 thousand m <sup>3</sup> sawnwood	15	11	1	27
25+ thousand m <sup>3</sup> sawnwood	26	2	0	28
All mills	57	80	9	146
<b>Round fencing manufacturers</b>				
All mills	12	31	4	47

Note:

1. Mills responding for 2006. This accounts for almost 90% of total production of sawmills and almost 80% of total consumption by round fencing manufacturers.
2. Size categories are based on total (softwood + hardwood) sawnwood production, in cubic metres.

The following table shows the percentage of certified input and output volumes for 2002-2006, based on responses received. These proportions varied by size of mill, with larger mills generally reporting higher levels of certified timber than smaller mills.

**Percentage of volume certified, 2002-2006**

Percent volume certified

Year	Removals Softwood from non-FC/ FS woodland	Sawmills		Round fencing manufacturers Consumption (softwood)
		Consumption (softwood and hardwood)	Production (softwood and hardwood)	
2002	40	65	62	14
2003	54	67	50	36
2004	70	80	63	58
2005	69	76	71	53
2006	67	80	62	46

*c) Value-added forest products and engineered wood products*

The different sectors of the UK furniture manufacturing market experienced mixed fortune in 2006. Demand was inconsistent with shop and office furniture 9% lower than the 12 months before (to the end of Q3 2006), while production of chairs and seats fell by 4%. Reflecting the higher activity in the new build construction markets in 2006, kitchen furniture output was 2% higher than a year earlier. However, output of other types of furniture dropped by 4%. Furniture imports continued to grow, but encouragingly for UK-based furniture makers, exports are expected to have expanded by over 12% in 2006.

Growth in the domestic wood flooring market is believed to have slowed in 2006, following a number of years of rapid expansion. In contrast, the industrial flooring market has experienced robust growth in 2006, rising in value by over 10%, although timber products have a relatively low presence in this market.

The timber frame manufacturers continue to move towards high levels of prefabrication as competition from other European manufacturers, especially Germany, supplying into the UK market grows. Innovative design and the use of lightweight engineered components and Structural Insulated Panels (SIP) are increasingly integrated into housing focussing on customer led solutions.

The sustainability of timber is of paramount importance as consumer awareness of product sustainability, chain of custody and source of origin rises. The sustainability drive through instruments such as The Code for Sustainable Homes published at the end of 2006 will encourage the active demonstration of certified environmental profiles for timber products; this presents a significant opportunity for adding value to UK grown timber. The timber window and joinery sector is particularly engaged in demonstrating sustainability benefits. It is expected that other product sectors will progress rapidly in 2007. The continuing success of re-engineered products such as I-beams, glue laminated timber and other engineered wood products are testament to value of environmental profiles. The emergence of new added value technologies

such as wood modification occurred in 2006. Alongside this the delivery of service life requirements and enabling the adoption of appropriate innovative technologies will become more significant in the coming years.

d) *Sawn Softwood*

In response to extraordinarily high levels of demand for a wide range of UK sawn softwood products, UK producers have been utilising sawmilling capacity to the full since the start of the year. There appears to have been some slowing of the market in late July/early August, due to a combination of the Summer holiday period, severe wet weather, increasing interest rates and reduced stock holding as alternative supply becomes more readily available from abroad.

The fencing market saw a strong level of demand following storm damage to domestic fencing during the winter. This demand grew over the summer & remained strong through to the end of August when the market flattened considerably. Prices also built with demand, the consensus being that over the year increases of around 30% were applied.

The reduction of imports of fencing quality timber from the Baltic had a major influence on the UK market over the year, allowing UK providers to increase market share through their ability to supply quality material to specification and on time. Regarding 2008 prices look to remain constant. The current major world market influences of China, and further development of Eastern Block countries appear set to continue, so it seems likely that the UK market should remain buoyant with strong demand.

The following table shows the steady increase in consumption and production of softwood over the period 1997 – 2006

**Consumption of roundwood and production of sawnwood by sawmills, 1997-2006**

Year	Consumption of Softwood (Thousand green tonnes)			Production (Thousand m <sup>3</sup> )
	UK grown	Imported	Total	
1997	4,079	254	4,333	2,382
1998	4,152	246	4,398	2,387
1999	4,450	227	4,677	2,531
2000	4,469	234	4,703	2,514
2001	4,586	239	4,825	2,581
2002	4,656	235	4,891	2,614
2003	4,784	225	5,009	2,661
2004	4,916	226	5,142	2,711
2005	4,885	272	5,157	2,716
2006	5,171	266	5,438	2,850

e) *Sawn Hardwood (temperate and tropical)*

The number of UK hardwood sawmills has continued to reduce, specialist hardwood suppliers in the UK increasingly stock imported hardwoods alongside UK sourced material. Oak continues to be popular, although a large proportion of that supply is of European and American origin. A small proportion of jobs demand UK material, especially in the conservation sector.

As reported in previous years, markets for lower quality UK hardwoods remain difficult, exacerbated to some extent by the closure of St. Regis.

The following table shows the steady decline in the production of hardwood sawnwood by consumption and production over the period 1997 - 2007

**Consumption of roundwood and production of sawnwood by sawmills, 1997-2006**

Year	Consumption of Hardwood (Thousand green tonnes)			Production (Thousand m <sup>3</sup> )
	UK grown	Imported	Total	
1997	297	6	303	147
1998	255	8	263	128
1999	228	7	235	120
2000	200	11	211	108
2001	192	70	263	130
2002	163	18	181	91
2003	139	18	158	81
2004	93	28	120	61
2005	73	34	107	53
2006	65	22	86	45

e) *Wood-based panels*

UK producers of wood based panel products report that demand has been strong throughout most of the year. Rising energy and resin costs continued to have a significant impact across the panel sector in 2006 and into 2007.

The first phase of a new particleboard plant by Egger UK at Hexham has been complete, representing an investment of over £100 million.

Imports to the UK were at a relatively low level of activity, due largely to the strength of Sterling and strong continental demand for panel products.

f) *Pulp and paper*

A press release in January 2007 from the Confederation of Paper Industries (CPI) reports that Preliminary figures from CPI analysis of UK mill returns show a continuing decline in domestic paper and board manufacturing, and a related decline in the usage of recovered paper. In 2006, the UK produced just under 5.6 million tonnes of paper and board, a 7.5% reduction on the 2005 total. In terms of raw material input, UK paper and board mills used just under 4.2 million tonnes of recovered paper, a decline of 8.2% against 2005 usage. Later in the year CPI report an improvement in the use of recovered paper but acknowledge the need for a strong export market.

Eight paper mills closed in the UK through 2006, representing around 600,000 tonnes of capacity, with many quoting significantly increased energy costs as a key factor in the decision to cease production. Only two UK woodpulp mills are currently in production but during 2008 a new 60,000 tonne tissue machine is due to open, and a further three large newsprint machines are in the early stages of development.

UK Forestry Commission

September 2007