Chapter 2
Economic Factors Affecting Forest Products Markets

Highlights

- *During 1999, fears that the world economy would slide into recession receded, and in the second half of the year, business confidence, real activity and expectations for 2000 all improved steadily.*
- *At end 1999, the western European economies were growing at an annual rate of about 3.5%, with similar growth expected for 2000.*
- *Western European construction rose by 3% in 1999, and further growth, but at a lower rate, is expected for 2000 and 2001.*
- *The United States economy continued to expand, for the 108th consecutive month, the longest upswing on record. For the third year in succession, growth was over 4%.*
- *The United States housing boom continued in 1999 and early 2000. However there are signs that the end of the boom may be in sight as starts fell, quite significantly, in March and May 2000.*
- *Eastern Europe grew slower than forecast, by 1.4% and the Baltic countries went into recession.*
- *The Russian economy grew by more than 3%. Construction output rose by 5.4%, the first rise after three successive falls.*
- *The Japanese economy fell in both the third and fourth quarters of 1999, despite fiscal measures to stimulate performance.*
- *Japanese housing starts stagnated in 1999 at a relatively low level.*

2.1 General economic developments

The analysis below is taken from the Economic Survey of Europe, number 1 of 2000, prepared by the Economic Analysis Division of the secretariat of the Economic Commission for Europe. The full text of the Survey is available from the ECE website.

2.1.1 Global overview

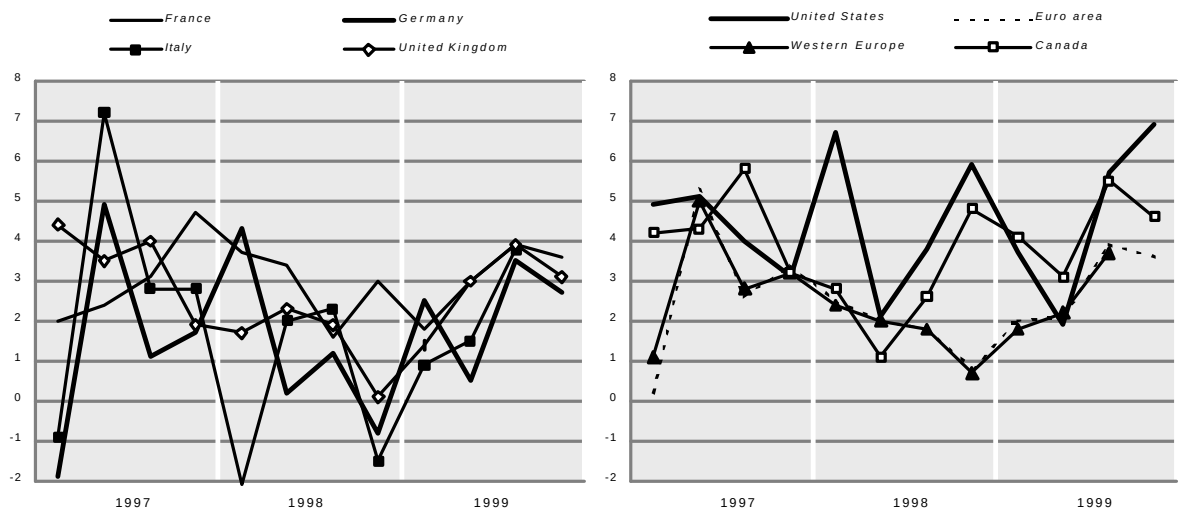
The negative effects of the financial crises in Asia in 1997 and Russia in 1998 were still depressing real economic activity in much of the ECE region, including international trade, until the early months of 1999. However, during 1999, fears that the world economy might slide into recession receded as stability was restored to the international financial markets, helped to a large degree by the temporary loosening of monetary policy in the United States, harsh adjustment measures in Asia and other developing countries, and by the continued strong growth of the United States economy.

By the middle of 1999 the situation in most parts of the world economy had stabilized and in the second half of the year business confidence, real activity and expectations for 2000 were all improving steadily. In western Europe economic growth received a strong boost from exports to the rest of the world, not least from the strong import demand of the United States economy, and, by the third quarter, GDP was rising at its highest annual rate since before the Asian crisis. In the transition economies of central Europe the worst effects of the Russian crisis were receding in the second half of 1999 and they were starting to benefit from the revival of domestic demand in western Europe. In Russia there was a significant recovery in output for the first time in a decade, and, although the extent to which the underlying factors provide a basis for sustainable growth over a longer period is uncertain, this has nevertheless had a positive effect on most other members of the CIS.

These widespread improvements in the economic situation are not reflected in the annual figures for performance in 1999, which for the most part show a marked deterioration on those for 1998, but they are seen in the quarterly and monthly indicators for late 1999 and early 2000 and, above all, in the current forecasts for 2000 (graph 2.1.1). For the first time since 1990, average GDP growth in western Europe is likely to exceed 3%; for the transition economies of eastern Europe growth should return to an average of 4% or more in 2000, and the Baltic economies should emerge from recession with an average growth rate of some 3%. After a much better than expected outcome in 1999, growth is also likely to continue in Russia and the other CIS countries, although here the prospects are much more problematic and uncertain. This much improved outlook for the European economies is also set against a background of more optimistic forecasts for other parts of the world economy and, not least, for continuing growth in the United States

GRAPH 2.1.1

Quarterly changes in real GDP in western Europe and North America, 1997-1999
(Percentage change over preceding quarter, seasonally adjusted at annual rates)



Note: Data for western Europe cover 13 countries (Austria, Belgium, Denmark, Finland, France, Germany, Italy, the Netherlands, Norway, Spain, Sweden, Switzerland and the United Kingdom). Data for the euro area exclude Ireland and Portugal.

Source: National statistics.

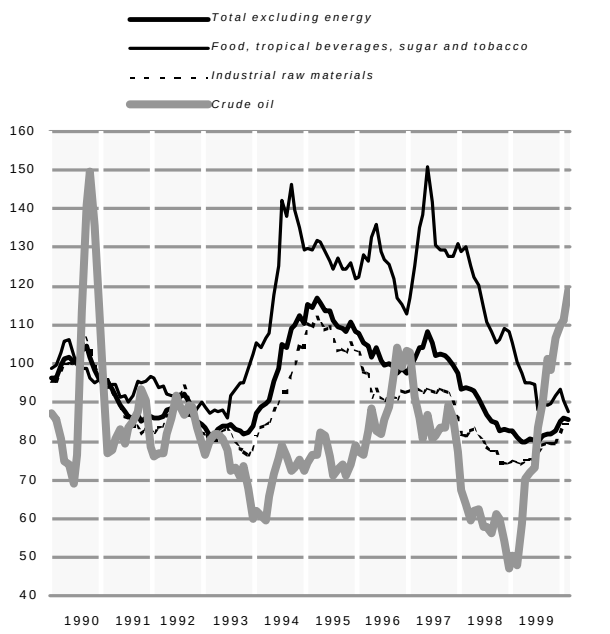
where, although a slowdown is currently forecast, GDP is still expected to increase by some 4% in 2000.

However, it is important to stress two points: first, there is always a distribution of risk surrounding any forecast and although the Survey believes the balance is now more favourable for growth in Europe this does not mean that the downside risks are negligible; the possibility of a crash in overvalued equity prices in the United States is a serious risk to the current outlook, and there are uncertainties over the course of oil prices and of monetary policy in the EMU. Secondly, not all the economies of the region enjoy the same prospects and there are especially large differences among the transition economies. In particular much of the region of south-east Europe is still beset by severe structural problems and the consequences of several armed conflicts which have made the process of transition to a market economy much more difficult than in central Europe. The fact is that for the past decade these countries, the poorest in Europe, have continued to fall further behind both western and central Europe rather than catch up.

In the international oil markets there was a sharp rise in the price of crude oil in 1999, which has continued in early 2000 (graph 2.1.2). This was, in general, the main source of upward pressures on the still relatively moderate rates of inflation in the industrialized countries. In early March 2000, the spot price of Brent crude was around $30 per barrel, compared with $9.9 in early February 1999. The March price was the highest level since the 1991 Gulf war. This surge reflects in the main the adherence to the supply quotas agreed by the oil exporting countries in March 1999 and intended to reverse the depressing effect on prices of excess supply and abundant stocks. The more rapid rate of economic expansion in the course of 1999, moreover, led to an increase in oil demand, which was only partly met by the available new supply. As a result, oil stocks in the industrialized countries in the final quarter of 1999 fell at their highest rate in a decade. When measured in real terms (i.e. relative to the unit value index of manufactured exports of the developed market economies), the price of oil in early 2000, however, was still some 40% below the average during 1980 to 1985, the last sustained period of high real oil prices. More recently there have been growing concerns about the potential inflationary effects of further increases in the price of oil and calls by industrialized countries for oil producers to raise output. The more rapid expansion of global economic activity has also tended to support the prices of industrial materials, which started to rise in the second half of 1999, although for the year as a whole there was still a small decline. Persistent excess supply has led to further sharp declines in the prices of agricultural commodities, notably food and tropical beverages (coffee, tea and cocoa).

GRAPH 2.1.2

World commodity prices, January 1990-February 2000 (Indices, 1990=100)



Note: Indices calculated on the basis of current dollar prices.
Source: Hamburg Institute for Economic Research (HWWA), 2000.

The millennium date change (the so-called Y2K problem) did not have any significant adverse impact on macroeconomic developments in early 2000.

In Latin America, real GDP stagnated in 1999, the first time in the 1990s that the region as a whole did not experience positive economic growth. Nevertheless, even this performance was still better than expected earlier in the year and it is largely accounted for by the moderate recovery in Brazil, where real GDP rose by about 0.5% compared with 1998.

In the five Asian emerging markets most directly affected by the financial crisis of 1997, there was an unexpectedly strong recovery from the depression of economic activity in 1999. The cyclical upturn partly reflects the global recovery in demand for electronic products and partly the impact of expansionary economic policies. Also, progress in structural reforms, such as the rehabilitation of the financial sector, and the strong yen have contributed to this performance. In the Republic of Korea, real GDP rose by 10% in 1999, more than offsetting the decline of 5.8% in 1998. Aggregate output increased by some 5% in Malaysia and Thailand and by 3% in the Philippines. In contrast, Indonesia remained mired in deep crisis. Outside these five economies, there

was robust growth in Taiwan Province of China and Singapore. In China, expansionary economic policies helped to maintain economic growth at a high rate of some 7% in 1999.

In Japan, hopes that the economy might be on the way towards a gradual, sustained recovery have been disappointed. Real GDP fell in both the third and fourth quarters of 1999 (over the preceding quarters): technically, the economy has therefore moved back into recession. This occurred despite massively expansionary fiscal packages and, since February 1999, a zero-interest rate policy of the central bank. The strong yen restrained exports, but there was also a conspicuous weakening of private consumption and public investment in the final quarter of 1999. For the year as a whole, real GDP rose by only 0.3%. There are also mounting concerns about the rapid deterioration of the public finances: a succession of large budget deficits have led to a significant rise in the general government's gross financial liabilities, which corresponded to about 105% of GDP in 1999.

2.1.2 Market economies of western Europe

The economic prospects for western Europe now appear to be better than at any time in the last decade. In the second half of 1999 the region finally shook off the sluggishness of activity which had marked 1998 and early 1999, and by the third quarter (and probably the fourth as well) GDP was growing at an annual rate of around 3.5% (table 2.1.1). Exports to the rest of the world had helped the process of recovery earlier in the year, but given the high levels of interdependence of the European economies this quickly had multiplier effects on demand throughout most of the EU. Business and consumer confidence strengthened considerably. Monetary policy has been expansionary and relatively low levels of interest rates have helped to boost consumer expenditure and investment. Rising levels of employment and gains in real income, boosted in some countries by rising asset values, have also supported confidence and consumer spending. Business fixed investment was also rising through 1999, with above average increases in machinery and equipment – better prospects for sales, lower costs of financing, better profits, and perhaps some stimulus from the need to prepare for the Y2K problem, were the main influences behind this improvement.

The improvement in output led to rising levels of employment during the year, by some 1.5% on average between the fourth quarters of 1998 and 1999. The level of unemployment in western Europe has also fallen, from 9.1% at the end of 1998 to 8.4% in the last quarter of 1999 (9.6% in the euro area). Despite a wide range of schemes to reduce joblessness among particular groups, the problem of youth unemployment remains acute (16.8% in the EU at the end of 1999) and the long-term unemployed, nearly one half of total unemployment in the EU, have yet to benefit significantly from the cyclical upturn in activity.

Despite the rise in import prices in 1999, due to higher oil prices and the weakness of the euro, the impact on west European rates of inflation has been quite modest. Intense competition has forced some absorption of higher producer prices in lower margins, but there have also been offsetting price falls for other products and in services where liberalization has been important. Labour cost pressures also remain mild, and although the annual

TABLE 2.1.1

Annual changes in real GDP in western Europe and North America, 1997-2000
(Percentage change over previous year)

	1997	1998	1999 [a]	2000 [b]
Western Europe	2.8	2.7	2.0	3.2
4 major countries	2.1	2.3	1.9	2.9
France	2.0	3.4	2.7	3.5
Germany	1.5	2.2	1.5	2.8
Italy	1.8	1.5	1.4	2.5
United Kingdom	3.5	2.2	2.0	3.0
17 smaller countries	4.1	3.4	2.4	3.5
Austria	1.2	2.9	2.2	2.8
Belgium	3.5	2.7	2.3	3.2
Cyprus	2.5	5.0	4.5	4.1
Denmark	3.1	2.7	1.3	2.0
Finland	6.3	5.0	3.5	4.5
Greece	3.4	3.7	3.3	3.7
Iceland	5.3	5.1	6.0	2.9
Ireland	10.7	8.9	8.3	7.5
Israel	2.9	2.2	2.0	3.5
Luxembourg	7.3	5.0	5.1	4.3
Malta	4.8	3.1	4.8	4.8
Netherlands	3.8	3.7	3.5	3.5
Norway	4.3	2.1	0.8	2.7
Portugal	3.5	3.5	3.1	3.3
Spain	3.8	4.0	3.7	3.7
Sweden	2.0	3.0	3.8	4.0
Switzerland	1.7	2.1	1.7	2.5
Turkey	7.5	2.8	-2.3	4.6
North America	4.5	4.2	4.1	4.0
Canada	4.0	3.1	4.2	3.9
United States	4.5	4.3	4.1	4.0
Total above	3.6	3.4	3.1	3.6
Japan	1.6	-2.5	0.3	0.7
Total above , including Japan	3.3	2.5	2.6	3.1
Memorandum items:				
European Union	2.6	2.7	2.3	3.1
Euro area	2.3	2.8	2.3	3.1

Note: All aggregates exclude Israel. Growth rates of regional aggregates have been calculated as weighted averages of growth rates in individual countries. Weights were derived from 1991 GDP data converted from national currency units into dollars using purchasing power parities.

[a] *Preliminary estimates or forecasts.*

[b] *Forecasts.*

Source: OECD national accounts; national statistics and national economic reports, 2000.

rate of inflation in the euro area in February 2000 was 2%, most forecasters expect the impulse from higher import prices to die away during the coming months.

Against this general improvement in the economic indicators economic growth in western Europe in 2000 is expected to average slightly more than 3% and, with most of the revisions tending to raise rather than lower the national forecasts, the outcome could perhaps be closer to 3.5%.

The acceleration in economic activity was broadly based across countries, but there was notably a marked simultaneous strengthening of economic activity in the four major economies. Within the euro area, the degree of cyclical divergence between the smaller member countries and the larger ones diminished somewhat in the course of 1999

Viewed from the supply-side, the current cyclical upturn reflects the reversal of the weakening of industrial activity that occurred in the second half of 1998. In fact, output had fallen sharply in the final quarter of 1998, largely reflecting the direct and indirect effects of the crises in Asia and other emerging markets on west European exports. But activity started to recover after the first quarter of 1999, with export demand stabilizing and, in most countries, strong growth of consumption and fixed investment, and the rundown in stocks coming to an end. For the year as a whole, industrial output rose, but only by 1% (against 3.3% in 1998) and manufacturing output increased by 1.3%. The decline in manufacturing capacity utilization rates since late 1998 started to be reversed in the final months of 1999 when, in fact, they were close to their long-term (1989 to 1998) average.

Viewed from the demand side, the recovery in 1999 was largely export-led. But domestic demand proved, in general, to be quite resilient to the deteriorating economic environment in the second half of 1998. Exports were supported by the improved price competitiveness deriving from the strong dollar and the revival of domestic demand in emerging markets. Exports also benefited from the stronger than expected economic growth in the United States and Canada. The strengthening of demand from outside the European region then fed through to domestic demand which, in turn, stimulated intra-European trade. This kind of virtuous circle is well known from previous upswings. Although increased exports and strengthening domestic demand led to rising imports, changes in real net exports supported economic activity after the first quarter of 1999. For nearly two years net exports, on average, had been a drag on domestic activity. In addition, domestic demand continued to be supported by the expansionary stance of monetary policy and the increases in income due to rising levels of output and employment. Low interest rates stimulated the demand for interest-sensitive expenditure items, such as consumer durables and investment goods, including housing.

For 1999 as a whole, private consumption was the mainstay of economic growth in western Europe. Household expenditures rose on average by 2.5% compared with 1998, but consumer spending was more buoyant in a number of smaller economies. The general background to this was a marked rise in consumer confidence to its highest level in the 1990s. Confidence was bolstered by the improving situation in the labour markets and, partly related to this, to gains in real income in a context of continued moderate inflation. Household spending was also stimulated by rising net wealth due to increases in the prices of shares and, in some countries, real estate. This wealth effect, together with favourable financing conditions, led many households to finance purchases of "big ticket" items by means of borrowing. In many countries falling savings ratios supported private consumption in 1999. Government consumption expenditures rose somewhat more strongly in 1999 than in 1998, a reflection of reduced pressure for fiscal consolidation.

Fixed investment strengthened in the course of 1999, although for the year as a whole the increase was only about 4¼%, down from 5.5% in 1998. There was a somewhat stronger growth of expenditure on machinery and equipment than on construction, but it is noteworthy that construction – both residential and public infrastructure – picked up in 1999, after rather sluggish growth in the two preceding years. Apart from favourable financing conditions, business investment was supported by improved sales expectations and relatively high and rising capacity utilization rates, all factors which have tended to increase profitability. To some extent business investment in machinery was also stimulated by the need to ensure Y2K compliance of electronic data processing (EDP) equipment. Changes in inventories had little impact on economic activity in 1999.

In the euro area, economic conditions generally remained buoyant in most of the smaller economies (Finland, Ireland, Luxembourg, Netherlands, Portugal, Spain) with strong domestic demand offsetting the temporary weakness of exports. These countries had rates of economic growth significantly above the European average and it is evident that they are at a more advanced stage of the business cycle than France, Germany and Italy, with attendant risks of overheating. But the underlying strength of the business cycle also continued to differ among the three larger economies, with a stronger upturn in France compared with the other two countries. This reflects, to a large degree, the asymmetric trade effects of the Asian crisis, which hit France much less than Germany and Italy. To some extent, the current

boom in Ireland, Portugal and Spain also reflects the considerable monetary stimulus that these economies received in the run-up to EMU in 1998, when there was a substantial reduction in interest rates This was accentuated by the further lowering of interest rates by the European Central Bank in April 1999, although it was hardly appropriate for these countries in view of their cyclical position. (The same holds mutatis mutandis for Finland and Luxembourg.)

Outside the euro area, the six-year expansion in the United Kingdom ended in the final quarter of 1998, when real GDP stagnated compared with the preceding period. But fears that the economy might move into recession did not materialize; instead, economic activity gathered considerable momentum in the course of 1999, provoking a renewed tightening of monetary policy in the second half of 1999, which continued in early 2000. Among the remaining economies, rapid growth in Greece, Iceland and Sweden contrasts with the more sluggish performance in Denmark, Norway and Switzerland. In Greece, the government aims to join EMU at the beginning of 2001, a formal application being submitted in early March 2000. Stringent fiscal consolidation led to a fall in the general government deficit to some 1.5% of GDP in 1999, down from 7.4% in 1996. Among the other Mediterranean countries, there was continued strong growth in Cyprus and Malta. In contrast, real GDP fell in Turkey in 1999, largely a consequence of the earthquake in the Marmara region in August. In Israel, economic activity picked up in the course of 1999, partly reflecting the improved export performance associated with the more favourable global economic developments

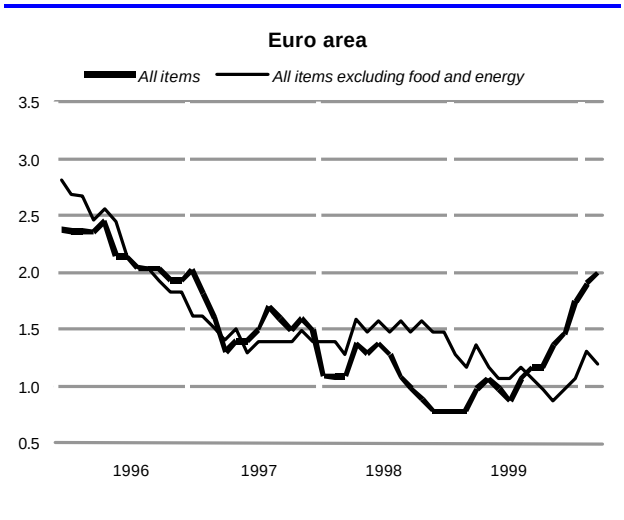
Consumer price inflation in the euro area started to edge upwards in the second half of 1999 (graph 2.1.3). This rise, however, is not reflected in the average annual inflation rate which was unchanged from 1998. In February 2000, the annual inflation rate was 2%, which is the upper limit of the (asymmetric) inflation target of the European Central Bank. In the main, the upturn since the second half of 1999 reflected the pass-through of the sharp rise in oil prices and the general upward pressure on import prices due to the depreciation of the euro. Labour cost pressures, however, remained relatively moderate. But the rise in non-energy commodity prices has also added to the pressure for higher prices. At the producer level, these pressures were reflected in a rapid rise of intermediate goods prices, which in January 2000 were 7.4% higher than in the same month of 1998. In contrast, final goods prices rose by less than 1% over the same period, which points to the limited scope for raising prices in the face of intense competitive pressures. These are also reflected in the still modest rate of core inflation: the consumer price index excluding food and energy was only 1.2% higher in February 2000 than a year earlier. The downward pressure of increased competition on prices was especially notable in the services sector where liberalization has led to large price cuts for telecommunication products. Similarly, the liberalization of the electricity market in several countries has lowered the price of electricity, a development which has partly offset the impact of higher oil prices on the overall inflation rate. There continue to be sizeable differences between the countries of the euro area, a reflection of both cyclical and structural factors: in February 2000, inflation ranged from 1.5% in France and the Netherlands to 4.6% in Ireland.

Outside the euro area, inflationary pressures have also remained generally moderate. In the United Kingdom, the strong pound and intense competition in the manufacturing and retail sectors led to a fall in goods prices in the second half of 1999. This contrasts with continued large increases in the prices of services reflecting the buoyancy of demand as well as cost pressures stemming mainly from rising labour costs.

Monetary conditions in the western market economies changed in the course of 1999 and in early 2000 towards a tightening of monetary policy. In the euro area, increases in short-term interest rates have partly offset the expansionary effects of the depreciation of the exchange rate. In contrast, in the United Kingdom and the United States, higher interest rates have accentuated the restraining effects on demand of their strong currencies.

GRAPH 2.1.3

The Harmonized Index of Consumer Prices of the euro area, January 1996-February 2000
(Percentage change over same month of preceding year)



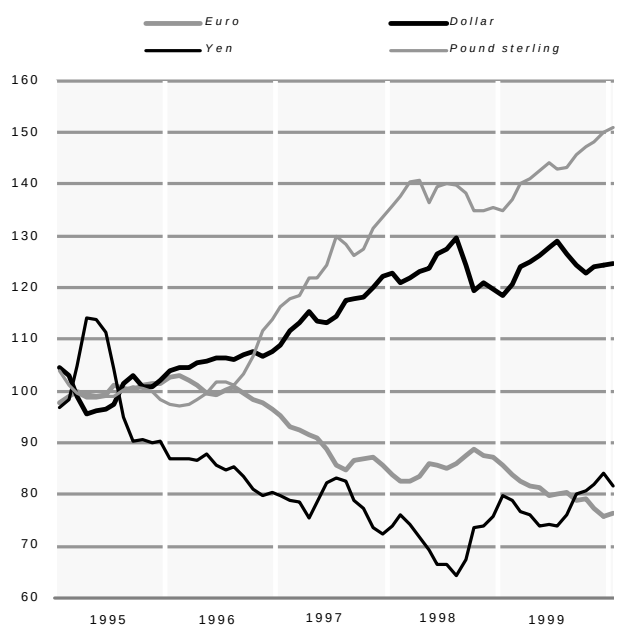
Note: Tobacco and alcohol are also excluded from the "All items excluding food and energy" index.

Source: Eurostat, 2000.

In the euro area, the stance of monetary policy began to be tightened in November 1999. The main refinancing rate was increased by 0.5 percentage point, to 3%, thus fully reversing the reduction in April. The European Central Bank argued that the move was designed to contain the medium-term risks to price stability against a backdrop of strengthening economic growth, rising oil prices, a rapid expansion of credit to the private sector and a growth of money supply significantly above the reference value of 4.5%. This policy was continued in early February and in mid-March 2000, when the main refinancing rate was raised successively by a quarter of a percentage point to 3.5%. In addition to the factors already noted, this decision also reflected concerns about the sizeable depreciation of the euro and its potential inflationary impact on domestic inflation via rising import prices, but it may be surmised that concerns about investors' confidence in euro-denominated financial assets also played a role (graph 2.1.4).

GRAPH 2.1.4

Real effective exchange rates, January 1995-January 2000
(Indices, 1995=100)



Note: Based on relative unit labour costs. The real effective exchange rate for the euro before January 1999 is based on the so-called "synthetic euro", i.e. a trade-weighted average of the bilateral exchange rates of the participating EMU countries against the dollar using their national conversion rates vis-à-vis the euro. For more information see the source.

Source: IMF, International Financial Statistics (Washington, D.C.), March 2000.

In a similar vein, in the United Kingdom, strong growth in domestic demand and increasing pressures in the labour market and on productive capacity led to fears that inflation would rise above the 2.5% inflation target. Consequently, there was a progressive tightening of monetary policy between September 1999 and early February 2000, the repo-rate being increased in stages by a full percentage point to 6%.

2.1.3 North American developments

In the United States, the economic expansion entered its 108th month in February 2000 – starting from a cyclical through in March 1991, this has been the longest upswing on record. Economic growth accelerated markedly in the second half of 1999, reflecting in the main the combined impact of faster rates of inventory accumulation and export growth in the presence of continued robust growth of private consumption and business fixed investment. The result was that real GDP rose by 4.1% in 1999, the third consecutive year in which annual growth exceeded 4%.

Against a background of improved foreign demand, manufacturing activity strengthened in the second half of 1999, and for the year as a whole increased by 4¼%, down from 4.25% in 1998. Within the average, there was a much stronger growth of durable than non-durable goods. But there still appears to be relatively large margins of slack in the manufacturing sector. Capacity utilization rates edged upwards only slightly in the course of the year, reflecting the continuing strong growth of capacity which in December 1999 was estimated to be some 4.5% larger than a year earlier

Private consumption in 1999 continued to be supported by further gains in real disposable incomes, reflecting in turn a combination of increases in real hourly earnings and employment. Against this backdrop, consumer confidence remained strong and in January 2000 reached its highest level in the 32-year history of this index. In addition, spending was stimulated by favourable lending terms and by further increases in wealth due to rising share prices and house prices. This is also mirrored in a further decline of the household savings ratio which was only 1.9% of disposable incomes in the final quarter of 1999, down from 3.5% a year earlier. The debt burden (the ratio of total debt service payments to family income) has risen above its previous record level in 1989.

Government spending also contributed to higher output levels in 1999. Fixed investment in equipment, notably information and communications technology and software remained one of the main driving forces of economic growth. Residential investment slowed down in the second half of the year under the impact of rising

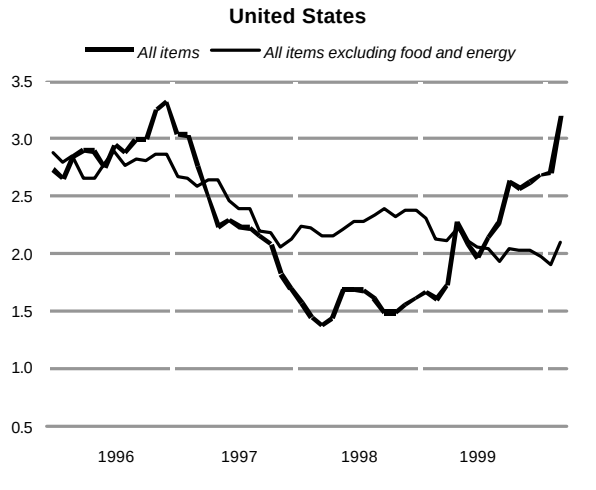
mortgage rates while outlays on business structures fell in each quarter of 1999.

Export growth strengthened in the second half of the year, the restraining effects of the strong dollar being offset by the revival of demand in western Europe and other regions of the world economy. On the other hand, buoyant domestic demand led to continued rapid growth of imports. Changes in real net exports subtracted 1.3 percentage points from annual economic growth in 1999, the same as in 1998. The merchandise trade deficit rose to $347 billion, up from $247 billion in 1998. Combined with another decline in the surplus in services and the deficit in transfers, this translated into the current account deficit of some $339 billion in 1999, equivalent to about 3.7% of GDP and 1.2 percentage points more than in 1998.

A striking feature of the United States economy is the moderate inflation in the face of very tight labour markets. Core inflation remained broadly stable at 2% during 1999, and continued to do so in the first two months of 2000 (graph 2.1.5). This compares with an overall inflation rate rise of 3.2% in February 2000, the difference being solely due to the impact of the sharp rise in oil prices. Labour cost pressures remained moderate in the face of strong productivity growth. Hourly compensation in the non-farm business sector in the final quarter of 1999 was 4.3% higher than the same period of 1998, but unit labour costs were only 0.7% higher. This average outcome, however, is strongly influenced by favourable developments in the durable goods sector of manufacturing.

GRAPH 2.1.5

Consumer price indices in the United States, January 1996-February 2000
(Percentage change over same month of preceding year)



Source: United States Bureau of Labor Statistics, 2000.

Rapid economic expansion led to further substantial gains in employment in 1999. For the year as whole it increased by 1.5%. The gains have continued in early 2000, although there was a slowdown in non-farm payrolls in February. As in previous years, most of the additional jobs were in the services sector, where employment rose by 2.8% in the 12 months to January 2000. Increased construction activity also led to some rise in employment, but on the whole the number of persons employed outside the service sectors has remained broadly stable. The decline in manufacturing employment in 1998 petered out in the course of 1999, and although there were small gains in January 2000 (compared with the preceding month), mostly in construction related activities, it was still 1.2% lower than a year earlier. The rise in total employment increased the employment/population ratio to a record level of 64.8% in January 2000.

In the United States, the continued economic expansion at a rate above the trend rate of output growth and increasingly tight labour markets have raised concerns about the increasing risk of upward pressures on costs and prices. As a result, the Federal Reserve has reversed the easing of monetary policy which occurred in the second half of 1998 in response to the threats of international financial turbulence: the target for the federal funds rate was raised in three steps from 4.75% to 5.5% between June and November 1999, and in early February 2000 there was a further increase to 5.75%.

In Canada, the cyclical upturn continued strongly in the course of the year, supported by consumer demand and fixed investment. Against a background of rising employment and real income gains, household confidence strengthened markedly. Business investment was stimulated by the prospect of improved sales and by rising capacity utilization rates. Exports benefited from the strength of demand in the United States, the major trading partner, but also from the strengthening recovery in overseas markets. Exports helped to sustain activity in the manufacturing sector, while primary industries were stimulated by the rise in commodity prices in the course of 1999. In sum, real GDP rose by 4.2% in 1999, up from 3.1% in 1998. Rising prices for energy and services put upward pressure on the inflation rate, but this was partly offset by the dampening effect of a stronger exchange rate on import prices.

2.1.4 Countries with economies in transition

There are 27 member countries of the United Nations Economic Commission for Europe which, since the early 1990s, have been described as having "economies in transition"; that is, they are in the process of transforming the institutions, incentive systems and economic structures of central planning into those appropriate to a

market system of decentralized decision making, largely, by private agents. This is a massive and complex task and very few of them have got anywhere near completing the process. The legacy of the command economy is still strong in many parts of the CIS, and in south-eastern Europe the process has been set back by a series of external shocks and by the effects of the various wars in the area. But in general the progress in institution building and structural change has been considerable even if it varies greatly among individual countries. Nevertheless, while some of the leading reformers in central Europe now have the capacity to handle such shocks with relative ease, many other transition economies remain highly vulnerable to external shocks, such as the Asian and Russian crises of 1997-1998 or the Kosovo conflict of 1999. Although the leading reformers are now, as a result of successful restructuring and integration with western markets, more sensitive to changes in domestic demand in western Europe – nearly three quarters of eastern Europe's merchandise trade is now with the European Union and for most of them Germany is the largest single trading partner – they succeeded in maintaining domestic demand and relatively high rates of GDP growth.

Economic growth slowed down very sharply in virtually all the transition economies at the beginning of last year and the outcomes were generally much lower than the forecasts made at the start of the year. Instead of growing by some 3%, as forecast, eastern Europe only managed 1.4%, while the Baltics plunged into a sharp recession. Only the CIS moved in the opposite direction, partly under the influence of Russia where GDP increased unexpectedly by more than 3% when most of the forecasts, official and unofficial, had been predicting another large fall in output.

This weak performance in 1999 to a large extent reflected the carry-over from the second half of 1998 of the after-effects of the general turmoil created by the Asian and Russian crises, aggravated for some economies by the Kosovo crisis last spring and by the slowdown in west European import demand. The Russian crisis had particularly severe consequences for the Baltic economies with massive cuts in their exports to Russia leading to a severe deterioration in output and employment. However, the unwinding of these various factors in the course of 1999 led to a marked improvement in central Europe in the second half of the year and a more moderate one in the Baltic states. The recovery in western Europe was particularly important for central Europe, while for the Baltic countries stronger west European import demand was not sufficient to offset the losses in the CIS markets. Economic growth in three of the leading reformers, however – Hungary, Poland and Slovenia – was least affected by the various shocks of 1998 and 1999: all three have reported rates of GDP growth for 1999 of more than 4%. (More information on Poland's economic developments may be found in special chapter 4.) Despite their dependence on the EU market for their exports, domestic demand, consumption and investment, including construction in Hungary and Slovenia, remained strong but, more generally, the performance of these countries reflects their economic "maturity" and the ability of their economic institutions to handle external shocks more easily.

The biggest surprise in 1999 was the recovery of output in Russia, GDP rising by over 3% instead of an expected fall of 2.5%. The factors behind this were the sharp rise in oil prices from the spring, which boosted profits and the government's tax revenues, a real depreciation of the exchange rate by nearly 50% since the August 1998 crisis, and a fall in real wages. The latter two factors enabled local producers to win back a significant share of their domestic market. Although GDP is expected to rise again in 2000, it is still difficult to be confident about the outlook for Russia because of the lacunae in the institutional framework and the limited progress made in microeconomic restructuring.

Nevertheless, the recovery in the Russian economy, together with higher world prices for oil and non-ferrous metals, had a favourable impact on the other members of the CIS with output continuing to fall only in Ukraine and the Republic of Moldova.

The economies of south-east Europe were obviously greatly affected by the Kosovo conflict and its aftermath for much of the year, although the direct impact on the neighbouring economies appears to have been less than feared. Reconstruction work in Kosovo itself has helped to raise industrial production in the region as did the recovery in west European import demand. But Romania remained in severe recession (GDP falling over 3%) and in Yugoslavia, with its infrastructure severely damaged by NATO bombing, GDP and industrial output are estimated to have fallen some 20% and more. There was, however, modest growth in Bulgaria and The former Yugoslav Republic of Macedonia (just over 2.5%) although in the former, industry remains in severe recession.

The setbacks to activity in the transition economies in 1999 checked the gradual improvement in employment that had taken place in the previous two years and, apart from Hungary and Slovenia as well as Russia and a few other members of the CIS, there was a general fall in the first three quarters of the year. In several countries in eastern Europe, especially Poland, the fall in employment was also due to a more intense rate of industrial restructuring. Unemployment, already high at the start of the year, reached an average 14.6% of the

TABLE 2.1.2

GDP growth rates for the ECE transition economies, 1997-2000
(Rates of change, %)

	GDP				
			1999		2000
	1997	1998	Ex-ante forecast	Actual	official forecast
Eastern Europe	2.1	1.8	2.9	1.4	4
Albania	-7.0	8	8	8	8
Bosnia and Herzegovina [a]	..	..	..	..	12
Bulgaria	-7.0	3.5	3.7	2.6	4
Croatia	6.8	2.5	1.5-2	-0.3	2.6
Czech Republic	-1.0	-2.2	-0.8	-0.2	1.5
Hungary	4.6	4.9	5	4.5	5
Poland	6.9	4.8	4.5	4.1	5.2
Romania	-6.1	-5.4	-2	-3.2	1.3
Slovakia	6.5	4.4	3	1.9	2
Slovenia	4.6	3.9	4	4.9	3¾
The former Yugoslav Republic of Macedonia	1.4	2.9	6	2.7	6
Yugoslavia	7.4	2.5	7	-19.3	14
Baltic states	8.4	4.5	4.5	-1.7	3
Estonia	10.6	4.0	4	-1.4	3.8-4.0
Latvia	8.6	3.9	4	0.1	3.5
Lithuania	7.3	5.1	5	-3.0	2
CIS	1.1	-3.0	-1.1	2.9	2¼
Armenia	3.3	7.2	4	3.0	5.6
Azerbaijan	5.8	10.0	9	7.4	8
Belarus	11.4	8.4	4-6	3.4	2-3
Georgia	11.3	2.9	8	3.0	4.2-4.8
Kazakhstan	1.7	-1.9	1.5	1.7	3
Kyrgyzstan	9.9	2.1	2.8	3.6	4-5
Republic of Moldova [b]	1.6	-8.6	-3	-4.4	2
Russian Federation	0.9	-4.9	-2.5	3.2	1.5-2.5
Tajikistan	1.7	5.3	..	3.7	..
Turkmenistan	-11.4	5.0	..	16.0	12
Ukraine	-3.0	-1.7	-1	-0.4	1
Uzbekistan	5.2	4.4	4.4	4.4	5
Total above	1.6	-1.1	0.7	2¼	3
Memorandum items:				..	
CETE-5	4.5	3.2	3.6	3.1	4.1
SETE-7	-3.4	-1.6	1.3	-2.9	3.6
Former GDR	1.7	2.0	..	..	..

Note: Aggregates are UN/ECE secretariat calculations, using PPPs obtained from the 1996 European Comparison Programme. Output measures are in real terms (constant prices). Forecasts are those of national conjunctural institutes or government forecasts associated with the central budget formulation. Industrial output refers to gross output, not the contribution of industry to GDP. Aggregates shown are: Eastern Europe (the 12 countries below that line), with sub-aggregates CETE-5 (central European transition economies: Czech Republic, Hungary, Poland, Slovakia, Slovenia) and SETE-7 (south-east European transition economies: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Romania, The former Yugoslav Republic of Macedonia and Yugoslavia); Baltic states (Estonia, Latvia, Lithuania); and CIS (12 member countries of the Commonwealth of Independent States).

[a] *Data reported by the Statistical Office of the Federation; these exclude the area of Republika Srpska.*

[b] *Excluding Transdniestria.*

Source: National statistics; CIS Statistical Committee; direct communications from national statistical offices to UN/ECE secretariat, 2000.

roughly 7.6 million people. In the Baltic states unemployment averaged just over 9% at the end of 1999, compared with 7.3% a year earlier. In Russia the unemployment rate was just over 12% at the end of the year, about a point lower than at the end of 1998.

The other setback last year was a general check to the decline in rates of inflation which had been underway for several years and had gathered momentum in 1998. The factors behind this – and the extent of the reversal – vary between countries, but the most important single reason was the external shock of the rise in commodity prices and the appreciation of the dollar against most currencies. Nevertheless, given the weak state of the labour market in most countries, and the generally prudent stance of macroeconomic policies, this upturn in prices seems likely to be no more than a temporary setback to the process of lowering inflation rates.

With a recovery of output underway since the second half of last year and with the prospect of a relatively strong recovery in western Europe, growth in all the transition economies in 2000 is expected to average 3%, with GDP in eastern Europe rising 4%. Hungary and Poland should again have the highest rates of expansion, of 5% or more, and depending on the rate of growth in western Europe these forecasts could be raised. As mentioned already, the Russian economy remains fragile and vulnerable to any external shock such as a sharp drop in the price of oil. Nevertheless, the government is expecting growth of up to 2% and some officials are forecasting more than that. All the other CIS countries expect a return to, or an acceleration of, growth in 2000, although some of these expectations are highly contingent (for example, on the avoidance of a debt crisis in Ukraine and on a major policy adjustment in the Republic of Moldova).

It was mentioned above that only a small group of former command economies are approaching the state of "normal" market economies. One particular subset of transition economies that has lagged far behind in the process are the (seven) economies of south-east Europe. Although these are not the only economies making slow progress, attention has been focused on them in the aftermath of the Kosovo conflict and by the subsequent efforts of the international community to draw up proposals for the economic regeneration of the region and, it is hoped, thereby strengthen the prospects for peace and general stability in the area.

Although, as noted earlier, the direct economic impact of the Kosovo conflict on south-east Europe was less than feared earlier in 1999, the damage was still significant and the economies of south-east Europe moved from modest GDP growth in 1998 (1.3%) into recession (about -3%). The improvement forecast for 2000 is largely a recovery from this recession rather than the first signs of sustained economic growth. The macroeconomic situation in most of these countries is still relatively fragile. In general the main success has been in reducing inflation, in several cases to very low rates. Current account deficits have been large and persistent, with a consequent build-up of foreign debt. Unemployment rates average nearly 17%, much higher than in central Europe. In conjunction with widespread job insecurity and discontent with living standards, this makes it difficult to implement reforms that might worsen the social situation still further in the short run. Domestic investment remains weak and foreign investment is not attracted to the region in any significant quantity.

2.1.5 Short-term outlook

Forecasts of world economic growth in 2000 have been revised upward after a better than expected performance in 1999. World output is estimated to have increased by 3% in 1999 about ¾ of a percentage point more than expected in the spring of 1999. Current forecasts are for an annual increase in world GDP by 3.5% in 2000 (compared with 1999). The strengthening of global economic activity in 1999 was accompanied by an upturn in world trade which had slowed down markedly during 1998. The volume of merchandise trade is estimated to have increased by 5% in 1999, the same as in 1998, and current forecasts are for an acceleration to 7% in 2000.

These optimistic short-term forecasts for the global economy, however, are conditional on a number of important assumptions, notably that there will be no financial crisis in the major emerging market economies, that the rise in oil prices will peter out and possibly be partly reversed in 2000, and that the United States economy will achieve a "soft landing".

Against a background of improving economic conditions in other regions of the world economy, the short-run economic outlook for western Europe and North America is now quite favourable. In western Europe, the cyclical recovery is expected to gain further momentum in the course of 2000, with real GDP currently forecast to increase by slightly more than 3% in 2000. This would be the largest increase since 1990, when there was a growth rate of 3.4%. In fact, in the absence of the downside risks discussed below and a somewhat stronger rate of growth than currently expected in Germany and Italy, the outcome could be even better, possibly closer to 3.5%. Performance in the euro and non-euro areas of western Europe is expected to be similar.

In western Europe, the main factor behind the strengthening recovery is likely to be the more rapid expansion of exports. Apart from rising intra-regional

trade, this largely reflects the stronger demand from emerging markets and developing countries where the rate of economic expansion is also forecast to accelerate. Such a favourable export performance will contribute to the strengthening of domestic demand. Private consumption will be supported by rising real incomes, in turn the result of further gains in employment and higher real wage rates. Business investment should be stimulated by rising capacity utilization rates and improved sales prospects. Changes in stock building will also make a small contribution to higher output growth. The stronger growth of domestic demand, however, will lead to a rising demand for imports and the change in real net exports should be broadly neutral in its effect on economic growth in 2000. (In 1999 net export subtracted half a percentage point from GDP growth.) Among the four major economies, France and the United Kingdom are likely to develop the strongest cyclical momentum, but growth is also accelerating in Germany and Italy, where the business climate improved markedly in early 2000. Italy, nevertheless, is expected to continue to grow more slowly than most of the other west European countries. The rate of economic expansion will remain quite strong in the smaller west European economies.

In the United States, the consensus of forecasts is for the cyclical expansion to slow down from the high rates of the final two quarters of 1999. Average annual growth in 2000 could still be some 4%, which includes, however, a significant statistical carry-over effect from 1999. Broadly the same outlook is forecast for Canada. These forecasts imply a significant narrowing of the growth differential between North America and western Europe in 2000. This benign scenario could continue into 2001, especially if the cyclical upturn in the various regions of the world economy leads, via the foreign trade channel, to a mutually reinforcing process of economic growth.

In the United States, robust private consumption and business fixed investment are likely to remain the mainstays of economic growth, partly supported by continuing positive wealth effects. Exports are expected to strengthen as a result of the more favourable international economic environment. A slowdown in employment growth and less favourable financing conditions associated with the tightening of monetary policy, however, should tend to dampen household expenditures and fixed investment. Import demand should remain strong but the changes in real net exports is likely to be considerably less of a drag on domestic activity in 2000 than in the two preceding years. In view of the continuing strength of economic growth, the unemployment rate should stay close to 4%. Inflationary pressures are still expected to remain rather moderate, given the assumptions about developments in the oil markets and that increases in productivity should continue to largely offset increases in labour costs. The slowdown in the rate of expansion in the course of 2000 should bring the growth of demand somewhat closer to the lower rate of potential output growth. This gradual "soft landing" has already been forecast for the last few years, but the continuing strength of the cyclical upturn has been systematically underestimated.

There remain, however, a number of downside risks which, if not contained, could lead to less favourable or even quite bad outcomes. A major uncertainty hanging over the international economy is the future direction of oil prices and its effects on inflation and growth. In the United States, the rate of expansion may not slow down sufficiently in time to avoid overheating. Important downside risks, moreover, continue to be attached to the possibility of a sharp downward correction of the high level of United States stock prices and to the sustainability of the record United States current account deficit.

The short-term prospects for the transition economies at the beginning of 2000 are now considerably better than they were in the middle of last year. Both domestic conditions (notably the recovery of output and the improvement in domestic demand) and the external environment (dominated by the cyclical upturn in western Europe) are much more favourable than they were in 1999. The available official forecasts suggest that the governments in practically all the transition economies expect positive GDP growth in 2000 and in most cases an acceleration of the economic recovery. GDP in the ECE transition economies as a whole should increase on average by some 3% in 2000, which would represent a record rate of growth for the region as a whole. Growth in eastern Europe is expected to average close to 4%. In the Baltic states the expectation is for an average 3%. And in the CIS countries as a whole, GDP could increase by more than 2%. As the forecasts are, in most cases, based on draft budgets, prepared in late 1999, they may be somewhat conservative.

In any case, strong and steady economic growth can be expected to continue in Hungary, Poland and Slovenia, and these economies are likely to preserve their leading positions in the ranking of east European growth rates. The expected 2% GDP growth in Slovakia reflects the continuation of a cautious adjustment effort after the authorities abandoned an unsustainable expansionary course in late 1998. The authorities in Croatia and the Czech Republic expect positive rates of GDP growth in 2000, although these are likely to remain relatively low. An economic upturn is expected in the three Baltic states as well, but their rates of growth are unlikely to return to those prevailing before the Russian crisis.

After a generally weak performance in recent years, the governments in a number of south-east European transition economies (Albania, Bosnia and Herzegovina, Bulgaria, The former Yugoslav Republic of Macedonia and Yugoslavia) expect relatively high rates of GDP growth in 2000. But even if these forecasts materialize, in most cases they will only reflect recovery from a very low base; the return of this region to sustained and high rates of economic growth still requires major restructuring and large-scale new investment. In Romania, economic activity is likely to remain weak in 2000 (the government expects only 1.3% GDP growth).

The current recovery in Russia hinges on a fragile equilibrium which is based on the post-crisis gains in competitiveness (thanks to a large depreciation in the real exchange rate and a fall in real wages) coupled with favourable external conditions (in the first place, high oil prices). However, the economy remains highly vulnerable to a reversal in any of these conditions (for example, a fall in oil prices); hence, the short-term economic outlook for Russia still remains rather uncertain. Nevertheless, at present the Russian authorities are quite optimistic as regards the short-term economic outlook. According to the budgetary projections, GDP is expected to grow by some 1.5 to 2% in 2000, although some Russian officials have recently suggested that the rate of growth could be even higher.

Recovery in Ukraine has been underway since the third quarter of 1999 and has continued during the first months of 2000 although the uncertainties regarding the short-term outlook are probably even greater than in Russia. In Belarus, after the setback caused by the Russian crisis, the authorities have set a relatively modest growth target for 2000, which they hope to support with a new, export-oriented policy. The return of the Republic of Moldova's economy to growth will largely depend on the success of a policy adjustment initiated by the government.

In general, the authorities in most of the other CIS countries have set rather ambitious targets for 2000: GDP growth is envisaged to accelerate in all the Caucasian economies as well as in most of the central Asian CIS countries.

2.2 Construction sector developme nts

This section presents trends in the construction in Europe, North America and Japan, as construction is the single largest market for sawnwood and panels. It concentrates on new residential construction and repairs and maintenance, as these are the sectors which are the most intensive users of wood.

2.2.1 Overview

In two of the world's three major markets, 1999 saw strong construction activity. In the United States, housing starts rose further from the already high level of 1998 to a seasonally adjusted annual rate just below 1.8 million units in spring 2000. The housing boom is fuelled by rising real incomes, falling unemployment, still moderate mortgage rates, and the "wealth effect" caused by the strong rise in the stock markets. In Canada, housing starts rose all through 1999 and early 2000, to reach an annual rate of 170,000 in March. Since then, they have fallen sharply, partly because of a truckers' strike in Greater Toronto.

In Europe total construction in western Europe rose by 3.0% in 1999 after three years of slow or even negative growth. Further growth is expected for 2000 and 2001. Similar trends are expected for the two components of most importance for forest products, new residential construction and repairs and maintenance. Rather slower growth is recorded for the aggregate of four east European countries, but there are strong differences between countries.

Japanese housing starts however stagnated around a rate of 1.2 million units, about 25% less than in 1996. Just over 46% of these were wood frame units.

In Russia, construction output rose by 5.4% in 1999, the first rise after three successive falls, some of which were very steep. In general construction activities in transition economies were rather volatile, and no regional trend is visible.

2.2.2 Construction in Europe

This section is based on data kindly supplied by Euroconstruct, a consortium of research institutes specialising in the construction sector. Euroconstruct divides the construction sector into four parts: new residential construction, non-residential construction, civil engineering and residential renovation and modernization.

In most west European countries, construction (total) grew by 3 to 5%, although in Ireland and Spain, the rates were above 10% (table 2.2.1). However, it fell in Denmark (-3%), Norway (-5%) and Switzerland (-3%). In Germany it fell marginally, but this slight fall represented a significant improvement on the series of declines which had been recorded since the end of the boom associated with reunification.

Moderate growth is forecast by Euroconstruct for total construction output in 2000 (+2.6% for western Europe) and 2001 (+1.6%). In both years, German construction output is expected to grow by just over 1%. Despite this recovery in the construction sector of western Europe, growth will continue to be slower than that of GDP, so

that the share of construction in the economy will continue to decline, as it has for the past decade.

The four eastern European Euroconstruct members record contrasting developments for 1999 in total construction: growth of 5 to 7% for Hungary and Poland, and a drop of nearly 7% for the Czech Republic. Slovakia expects a very steep decline, 27%. However, growth in the 5 to 10% range is expected for Hungary, Poland and Slovakia in 2000 and 2001, with marginal growth in the Czech republic.

From the point of view of forest products markets it is more relevant to focus on trends for new residential construction and for repairs and maintenance than on developments for aggregate construction.

For new residential construction, 1999 saw growth, compared to 1998, of over 10% in France (+13.6%) and a small group of mostly Iberian and Nordic countries (Portugal, Spain, Finland, Sweden, Ireland). However, there were marked drops in Austria, Denmark, Switzerland and the United Kingdom, and little change for Italy and a group of neighbouring countries in north-west Europe (Belgium, Netherlands and Germany). The 2.8% growth recorded for the group as a whole is therefore an average of very different tendencies in different areas. Likewise in transition countries, Poland and Slovakia recorded growth of more than 10%, while falls were reported by Hungary (-5%) and the Czech Republic (-14.4%, after three years of uninterrupted strong growth).

The outlook for new residential construction in 2000 also varies strongly between groups:

- *Very strong growth (mostly 10% or more in 2000) in the Nordic countries and Ireland;*
- *Moderate growth, mostly around 2 to 3% per annum, for the other west European countries, including France (2.5%, contrasting with the double digit growth registered in 1999), Italy (2.1%) and United Kingdom (3.0%);*
- *Continued decline or stagnation in Austria, Denmark and Germany; and*
- *Double digit growth in Hungary, Poland and Slovakia, but a drop in the Czech Republic for the second successive year.*

For 2001 and 2002, slower growth is forecast (considerably less than 1% for the region as a whole in

TABLE 2.2.1

Developments and outlook for the construction sector in Europe, 1998-2002
(% change over previous year)

	New residential construction					Renovation				
	1998	1999	2000 f	2001 f	2002 f	1998	1999	2000 f	2001 f	2002 f
Austria	-5.8	-7.2	-3.4	-1.6	-0.6	30.7	3.4	1.1	2.4	2.2
Belgium	2.2	-0.5	2.0	1.0	2.0	4.0	3.0	3.0	3.0	3.5
Denmark	8.4	-6.6	-5.0	0.0	0.0	0.5	5.7	2.0	0.0	2.0
Finland	12.0	13.0	12.0	5.0	0.0	6.0	1.0	1.0	2.0	5.0
France	4.1	13.6	2.5	-5.5	-2.9	1.8	2.5	6.0	1.5	2.5
Germany	-6.7	-0.6	-0.5	0.5	1.0	0.5	0.5	0.8	1.0	1.5
Ireland	9.0	12.8	9.7	2.8	0.1	-5.4	2.7	-4.7	3.1	3.1
Italy	-6.0	1.2	2.1	1.9	2.3	4.6	8.0	3.4	-1.4	0.9
Netherlands	-2.5	-0.3	5.3	1.3	0.8	1.5	2.2	2.2	2.8	2.6
Norway	-1.7	4.6	20.1	-0.3	-10.3	-8.5	4.0	7.0	2.0	2.2
Portugal	9.1	11.0	5.0	1.0	-5.0	8.0	8.0	4.0	5.2	5.1
Spain	7.5	12.5	7.5	1.0	0.0	6.3	6.0	6.0	6.0	6.0
Sweden	1.4	21.8	14.0	14.6	12.7	1.5	4.3	4.8	6.2	5.5
Switzerland	2.8	-1.5	1.1	2.0	1.5	6.2	-3.0	1.4	5.0	4.5
United Kingdom	-0.2	-6.2	3.0	2.6	0.5	-1.6	-3.2	5.0	5.1	0.0
Western Europe (EC-15)	-1.4	2.8	2.5	0.4	0.2	2.1	2.3	3.1	1.8	1.9
Czech Republic	8.9	-14.4	-2.4	0.6	-0.8	0.5	-3.4	-0.9	5.8	9.3
Hungary	-15.0	-5.0	12.0	12.0	12.0	10.0	10.0	10.0	10.0	10.0
Poland	13.3	12.8	10.0	12.0	15.0	0.5	2.5	0.0	1.5	3.5
Slovak Republic	11.1	11.5	19.3	27.0	21.5	10.3	15.0	17.0	25.0	23.0
Central Eastern Europe (EC-4)	3.0	3.9	9.7	11.9	13.3	2.0	3.4	1.9	3.8	5.6
Euroconstruct Europe (EC-19)	-1.3	2.8	2.6	0.6	0.5	2.1	2.3	3.1	1.9	2.0

f = Euroconstruct forecast.

EC = Euroconstruct.

Source: Euroconstruct, 2000.

both years), with only Sweden, Hungary, Poland and Slovakia expecting strong growth, and many forecasting drops. Germany however forecasts slow growth (1% or less) for both years.

For many years, the rate of growth for residential renovation and modernization, has been higher than that for residential construction, but for the Euroconstruct western Europe region in 1999, growth was slower for renovation (2.3%) than for new residential construction (2.8%). Growth was strong in Italy, Portugal and Spain, but this was counteracted by sluggish growth elsewhere, notably Germany (0.5%) and falls of over 3% in Switzerland and the United Kingdom. There was double digit expansion in Hungary and Slovakia, but a fall in the Czech Republic.

The outlook is for a recovery in residential renovation and maintenance in 2000, with regional growth over 3% (slightly higher than for new residential investment), followed by growth around 2% in 2001 and 2002. Most countries are expected to show similar growth rates over the period, with faster than average growth in Iberia, Ireland, Hungary and Slovakia. The rate of growth in Germany will be between 0.8% and 1.5% in the three years, while France should see 6% growth in 2000, followed by rates around 2% in the next two years.

2.2.3 Construction in North America

The longest ever housing boom in the United States continued for another year in 1999. The United States housing starts, from their low point in 1991 of about 1 million, have risen strongly to reach an annual rate in February 2000 of 1.8 million units (graph 2.2.1). The figure for the whole year 1999 was 1,665,000 units, the highest total since 1986. Furthermore, 1,333,000 of these (80%) were single family units, the most intensive users of wood, the highest figure since 1978. Among the reasons cited for the long boom, which has in fact in recent years been the most important influence on world forest products markets, are:

- *The strong expansion of the economy as a whole, which has raised incomes, and consumer confidence;*
- *Reasonably low interest rates, in absolute terms (although, they are not negligible in real terms, given the very low rates of inflation);*
- *The rise in share prices, which has created a "wealth effect" i.e. that even if the gains in share prices have not been realized, share owners feel richer and are thus more willing to invest in a house;*
- *Low unemployment; and*
- *Easy availability of land, materials, and a strong, efficient, construction sector.*

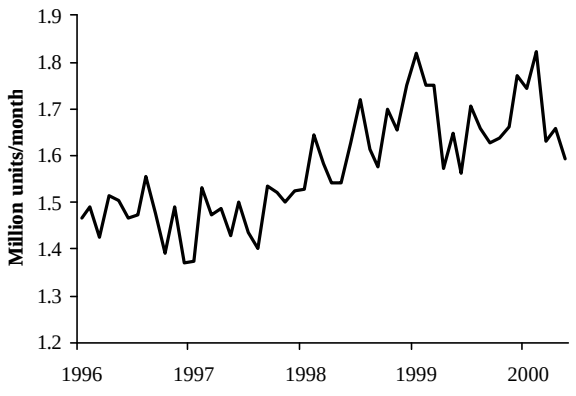
In recent months, United States interest rates have risen several times: in June 2000, the average rate on a 30-year fixed rate mortgage was 8.5%, up from 7.15% in May 1999. As mentioned above, the Federal Reserve is trying to prevent overheating of the economy and encourage a "soft landing". Furthermore, many high-tech stocks saw their prices fall dramatically in May 2000, which had an effect on confidence. Both these factors seem to be having an effect on the housing market, which fell quite sharply in March and again in May (after a minor recovery in April). In May 2000, the United States housing starts were at a rate of 1.59 million units, the lowest level since June 1999. The 3.9% drop in May was sharper than expected by analysts. Professional associations in the housing area expect housing starts and home sales to drop in the second half of 2000, but note that this is a fall from historically high levels, and that activity is still rather strong. New building permits, a leading indicator for the housing market also fell in May 2000, by 4.3%, faster than expected.

The figures for May 2000 also show differences between regions and types of housing: starts fell in the West and Midwest, but rose in the North-east and South. Single family housing fell by 5.4%, while other starts (multi-family, apartments, condominiums) actually rose by 2.1%.

It remains to be seen whether these events mark a definite slowdown in the housing market, and, if so, how sharp and long the fall will be. (Last year's Review noted a similar fall in spring 1999, which was reversed within a few months). However, the signs are that the end of the long-term boom in United States housing is in sight. (Additional information on the United States housing situation may be found in chapter 11 on engineered wood products.)

GRAPH 2.2.1

Housing starts in United States, 1996-2000
(Seasonally adjusted annual rate)



Source: United States Census Bureau, 2000.

In Canada, housing starts rose steadily from mid 1998 to February 2000. In 1999, nearly 150,000 houses were started, 9.1% more than in 1998. However, as in the United States, a downward trend became evident from March 2000. Between February and May 2000, Canadian housing starts fell from a rate of 170,000 units to 142,000, a fall of over 15% in three months. However, there may be special factors: a strike by concrete truck drivers in the Greater Toronto area significantly slowed housing starts in Ontario (the Province with the most construction activity), and some analysts expect activity to recover in June.

2.2.4 Construction in Japan

Japan reported an increase in housing starts in 1999, to 1.21 million units, 1.3% more than in 1998, a year of economic crisis (graph 2.2.2). However, 1999 starts were still 429,000 (26%) less than in 1996, so the small increase recorded in 1999 did not go far in compensating the falls in 1998. Furthermore, this increase took place against a background of incentives put in place by the Japanese government to stimulate consumption. Presumably without these measures, the performance of the construction sector would have been even weaker. The fall in the housing market since 1996 reflects no doubt the general lack of dynamism of the Japanese economy as well as the insecurity which arises from changes in the functioning of the traditionally very stable employment patterns in Japan.

Some structural factors may also be behind these developments in the housing market, notably the ageing of the population and the limited availability of constructable land. Japanese home owners are also now tending to build higher quality, longer-lasting houses, often demolishing the old building and replacing it with a new one on the same site. This would tend to reduce the number of starts as the population is stable and each house has a longer useful life.

In 1999, 565,000 Japanese housing starts were for wood-framed houses, 46.6% of the total (graph 2.2.3). This includes both traditional Japanese post-and-beam methods, which account for over 80% of wood frame starts, and North American style "platform frame" or "2x4 type" construction, which is increasing its share of the wood frame construction market

2.2.5 Construction in the transition economies

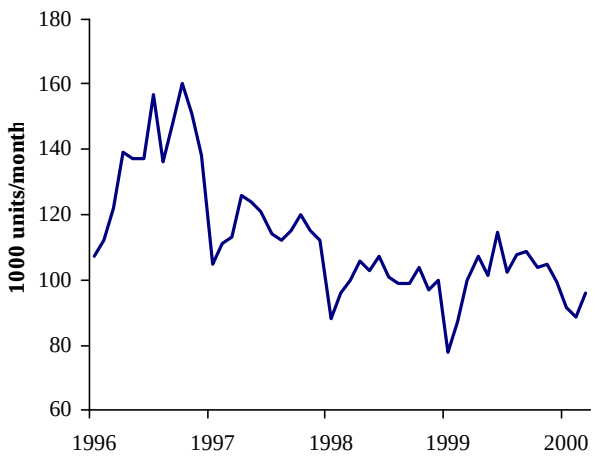
Table 2.2.2, extracted from the Economic Survey for Europe and based on several different types of information[1] (see footnote to the table), demonstrates the extreme volatility of the construction sector in transition economies and the lack of a single regional trend, as national factors influencing the construction sector predominate. There is nevertheless a tendency (by no means universal) for construction growth to be stronger in those countries where the transition process is more advanced.

Four groups can be identified, on the basis of developments in 1999:

- *Strong growth: includes Hungary, Slovenia and*

GRAPH 2.2.2

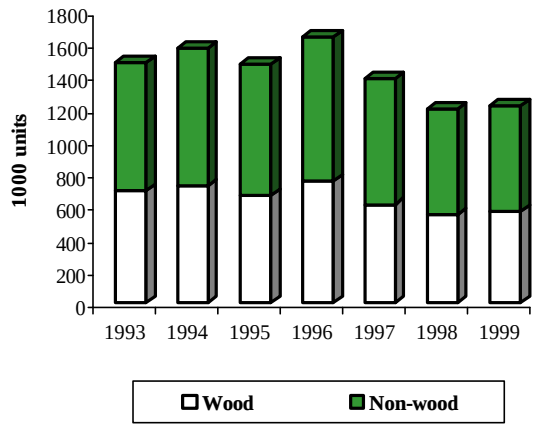
Housing starts in Japan, 1996-2000



Source: Japan Wood-Product Information and Research Center, 2000.

GRAPH 2.2.3

Share of wood and non-wood housing in Japan, 1993-1999



Source: Japan Wood-Product Information and Research Center, 2000.

[1] *For that reason the figures are not exactly the same as those provided by Euroconstruct for its four transition country members, although the direction and intensity of change coincide well.*

Latvia, in all of which there has been sustained growth over several years, and Kazakhstan, where the 26% rise in 1999 only partially corrected steep falls over the previous three years;

- *Moderate growth/stability: includes Poland, whose growth slowed somewhat after two years of strong growth, Russia, where the 5.4% growth rate started to counteract the drops over the past three years, and Belarus, where a slight fall followed two years of strong expansion;*
- *Moderate fall: includes Bosnia and Herzegovina and Croatia, where construction activity slowed down after post-war growth, as well as the Czech Republic and The former Yugoslav Republic of Macedonia, where the construction sector has been contracting for several years;*
- *Steep falls : includes Slovakia and Lithuania, where construction contracted sharply after a period of expansion, and Romania and Yugoslavia, where construction activity has been falling sharply for some time.*

TABLE 2.2.2

Gross construction output [a] in the ECE transition economies, 1996-1999
(Annual percentage change)

	1996	1997	1998	1999
Bosnia and Herzegovina ..			17.5	-8.4
Bulgaria	17.5	-4.4	-15.5	..
Croatia	9.0	16.7	0.7	-7.7
Czech Republic	5.3	-3.9	-7.0	-6.5
Hungary	-0.1	9.7	13.1	6.1
Poland	4.6	17.1	11.0	3.2
Romania	3.7	-24.4	-0.6	-19.5 [b]
Slovakia	4.4	9.2	-3.5	-25.8
Slovenia	-2.5	-5.2	1.7	10.7
The former Yugoslav Republic of Macedonia .	2.0	-16.0	-9.0	-7.0 [c]
Yugoslavia	-9.0	-3.0	-6.0	-21.0
Estonia	21.0	15.0	..	..
Latvia	5.3	8.2	16.5	7.8
Lithuania	-7.2	12.3	22.6	-14.2 [d]
Belarus	-2.0	15.0	16.0	-1.0
Kazakhstan	-36.0	-4.0	-17.6	26.4 [e]
Kyrgyzstan	-31.0	14.0	-47.7	..
Republic of Moldova	-13.0	-12.0	..	..
Russian Federation	-14.0	-6.0	-5.0	5.4
Ukraine	-31.0	-9.9	2.7	..

[a] *In Croatia, Slovenia, the former Yugoslav Republic of Macedonia and Yugoslavia construction refers to effective working time. In Poland work abroad and by enterprises not classified in construction is excluded. In Estonia construction refers to sales of construction work. In Latvia, Lithuania, Belarus, Kazakhstan, Kyrgyzstan, Republic of Moldova, Russian Federation and Ukraine construction refers to the volume of work done by construction enterprises and companies.*

[b] *January-June.*

[c] *January-July.*

[d] *January-November.*

[e] *January-September.*

Source: National statistics; CIS Statistical Committee; direct communications from national statistical offices to UN/ECE secretariat, 2000.