



UNECE Timber Committee Statement on Forest Products Markets in 2010 and 2011

Adopted on 14 October 2010

The Committee reviewed developments in forest products markets as reported in the *Forest Products Annual Market Review, 2009-2010*, as well as experts' presentations, country market statements and forecasts.

UNECE Region Forest Products Markets Rebound – Innovative Wood Products and New Market Opportunities Lead the Way

I. Overview of forest products markets in 2010 and 2011

The forest sector in the UNECE region is recovering from the greatest decline in consumption of forest products since the oil crisis in the 1970s, dropping 12% overall from 2008 to 2009. The Timber Committee forecasts an upturn in wood and paper products markets in 2010 and 2011. The improvement is strongest in Europe and Russia. In North America the housing crash in the United States starting in 2006, which was the main cause for the downturn, may have bottomed out in 2009. In North America, without this main driver for wood products, all forest products markets fell in 2009, and were forecast to rise only slightly in 2010. Full recovery of UNECE region forest products markets will need US housing starts to recover to a more sustainable level near. Capacity reductions for processing meant that when demand increased in 2010, prices generally rose for roundwood, sawnwood, panels and paper. Unemployment in the forest sector rose during the downturn.

The dramatic downturn in forest products markets, and the subsequent restructuring of forest-based industries, is a cause of the structural change which has occurred in the forest sector. Another reason is the escalation of wood energy: in 2009 the one major exception to the downturn in markets was wood energy which was buoyed by governments' policies for renewable energy sources. A third factor is globalization of forest products production and trade. Finally, the international control of sources of wood to ensure legality and sustainability affects timber producers, traders, users and consumers alike and drives the demand for CFPs.

Policies affecting forest products markets

The economic stimulus measures introduced by many countries, including export financing support for small and medium enterprises, appear to have had little measurable impact on the forest products sector. The US and Canada implemented initiatives to spur home buying. British Columbia started the "Wood First Initiative" while France set up the "Wood Industry Strategic Fund." The 2010 "Eco-Innovation" call launched by the European Commission under the Competitiveness and Innovation Programme identifies construction products and related processes that reduce consumption of resources, carbon intensity and production of by-product wastes as a priority area for funding. It also supports the development of more environmentally friendly construction materials and innovative manufacturing processes.

International climate change policies will affect the forest sector. In the Copenhagen COP-15, countries agreed to reduce emissions from deforestation and forest degradation (REDD+) and supported the mobilization of financial resources to advance REDD+. Agreement needs to be reached by countries on the accounting for carbon in harvested wood products.

Support for green building is growing, as reflected in public funding and endorsement of green building projects and initiatives in the EU and the US. The absence of commonly agreed definitions or standards makes it difficult to compare the treatment of timber in green building policies

throughout the region: developing such common standards would benefit the green building movement. The forest sector should use life-cycle assessment to seize the opportunity of the green building movement.

Efforts to stem illegal logging continue throughout the region. The 2008 amendment to the US Lacey Act, evolved further requiring documentation of legality for complex wood products. The EU continues to develop the FLEGT process including legislation to combat illegal logging and voluntary partnership agreements. At EU level, a compromise text on the Due Diligence Regulation (DDR) was ratified by the Council on 11 October 2010. The DDR sets a baseline for legality but does not seek to lower standards for voluntary sustainability schemes. The text of the regulation provides for verifiable information on the legal origin of wood and its derived products. In this context, certification schemes could logically help to provide some or all of that information. Preparations to implement the regulation are starting with a knowledge gathering phase. The US-Russia Bilateral Presidential Commission aims to strengthen collaboration in sustainable forest management and in stopping illegal logging.

Corporate Social Responsibility (CSR) is likely to grow in importance in the forest sector, driven by ISO 26000 which has now become a final draft international standard. The top 100 global pulp, paper, and packaging producers often include sustainable forestry among the CSR activities mentioned as before in financial and sustainability reports.

Innovative products and processes

The Timber Committee supports innovation in wood and paper products and their manufacture as a means to insure optimum use of wood resources and market growth. Wood's versatility to meet society's current and future needs was shown convincingly by the research and development highlighted by the Society of Wood Science and Technology, which held joint Market Discussions in Geneva.

The Forest-Based Sector Technology Platform in Europe, including Russia, promotes enhancing, strengthening and supporting R&D and innovations. The Platform's Innovation Report will be the basis of a promotional campaign in 2011. Interest in renewable materials is rising. Wood's sustainable production and recyclability enable it to compete with substitutes. Innovative solutions provide opportunities for the sector to rebound from the economic downturn. Innovation needs to be at the core of a company's vision and strategy driven by committed leadership. With increased demand for wood-based energy, companies are diversifying into energy production. Engineered wood products allow efficient construction of multi-storey buildings, factory-built houses and broad spans. In Quebec, furniture manufacturers compete with low-cost offshore producers by deploying new technologies to achieve enterprise agility and move towards profitable mass customization. To reach the goal, business innovation and marketing strategy must complement innovation at the product and technology levels.

Certified forest products markets

The area of forests certified for sustainable management increased between 2009 and 2010 by 8% to reach 355 million hectares globally, with the main increase occurring in North America and the Russian Federation. The roundwood supply from certified forests totalled 472 million m³ in 2009, representing more than 26% of the world's industrial roundwood supply. The continued lack of certified forest area in tropical regions remains a concern.

While the economic downturn might have been expected to result in a slowing of growth in expansion of the certified forest area, in practice this has not been the case. Businesses recognize the marketing advantage that certified timber offers as evidenced by escalating number of chain of custody (CoC) certificates. Greater understanding is necessary of the needs of industry sectors which are the main users of CoC.

Looking to the future, there is optimism that certification and the use of CoC certificates will continue to grow. However, continued growth is likely to become more difficult without measures to

make certification more attractive and less costly for the myriads of non-industrial and small private landowners. There are good examples of group certification that have addressed this, with the UK and Wisconsin, US cited specifically, but there are still many areas where this type of development is lacking. Legislation implemented by the US and EU to ensure legality and sustainability of traded wood will further drive certification.

II. Economic and construction developments

With the global economy still reeling from the most significant downturn since World War II, the forest industry has suffered from the largest year on year fall in demand for its products since UNECE/FAO began collecting data in 1964. Currency exchange rate fluctuations have only added to the turmoil. GDP is predicted to grow modestly across the UNECE region in 2011, leading to the expectation of a revival in demand. However, recent data suggest that the economic recovery will be weak and far from uniform across the region.

The dramatic fall in new housing starts has been the primary factor influencing demand. All three subregions have been affected, with North America witnessing the most dramatic collapse: the United States has seen housing starts fall from a peak of about 2.2 million in 2005 to a low of under 0.5 million in 2009 to a forecast 0.6 million in 2010. There has been an effect on all sectors of the industry with falling demand leading to rationalization of capacity and plant closures. Compounding the situation, the US is suffering from 19 million vacant property units: the current recorded vacancy rate at 13.4% is the highest ever seen in US history. There is in addition a further stock of 'shadow' housing i.e. properties that are potentially eligible for foreclosure but which have yet to be repossessed and put up for sale. By contrast, Canada's economy has proved more resilient and is currently the strongest among the G8 group of countries. Canadian housing starts were expected to recover to 2007 levels of about 200,000 in 2010.

The picture in Europe is gloomy, with high levels of sovereign debt and several countries embarking on a series of austerity measures to reduce the scale of debt. The effects of such measures remain uncertain and there is anxiety that the impact could be to stifle any early recovery. Housing in the CIS has been less affected by the downturn.

The outlook is not entirely bleak: there are indications that renovation and re-modelling of properties will become a more significant user of wood products. Wood's green credentials may also offer a competitive advantage against other construction materials but will require sustained effective promotion on the part of the industry. However, while customer and business confidence remains fragile throughout the region, there seems little prospect of any significant recovery in demand in the immediate future.

III. Market sector developments

Wood raw materials

The Forest Resources Assessment 2010 reveals that the UNECE region contains 41% of the world's forest and that, together, three countries account for 35% of the total: Russia with 20%, Canada at 8% and the United States with 7%. In terms of the distribution of forest that is available for wood supply in the UNECE region, the picture is more balanced with 42% of the total in North America, followed by CIS (40%), and Europe (18%). In all three UNECE subregions, the volume of wood that is harvested has been consistently lower than the annual increment of growth: North America 79%, Europe 64% and CIS 36%.

In 2009, the total harvest of industrial roundwood was estimated to be 880 million m³ – the lowest figure since UNECE/FAO began to collect data in 1964. The level of wood removals is expected to increase in Europe and in the CIS by about 6% annually in 2010 and 2011, as markets begin to rebound. In contrast, over the same period, a decline of about 1% is foreseen in the United States.

The global financial crisis has reduced demand for all forest products. Consumption of wood raw material fell in 2009 for the second consecutive year. The total timber harvest for the UNECE region

in 2009 (including both industrial roundwood and fuelwood) was 1.1 billion m³, a fall of 300 million m³ from 2007 levels. The largest fall was in North America and the CIS, where removals were down 14% from 2008.

The substantial rise in demand for woody biomass for energy generation, including forest residues, urban wood, sawmill co-products and smaller logs that has occurred in Sweden, Germany and Canada is a trend that is likely to be replicated in many other countries.

Sawmills and pulp mills generally are paying almost 17% more for their wood in 2010 than in 2008 in spite of which, in general, prices are still lower than before the onset of the financial crisis. The strong pulp market, particularly in China, pushed wood fibre costs upward around the world, with an increase of more than 11% in the first quarter of 2010 compared with the first quarter of 2009, which continued to rise thereafter.

The impact of the Russian log export tariffs on global roundwood markets has been significant despite the postponement until 2011, or possibly later, of the proposed increase from 25% to 80% that had been planned for 2010. Russian wood exports have fallen by 30% in volume due to the combined effects of the export tax and the global economic slowdown. The continuing recession makes it difficult to assess the effectiveness of the Russian export tax in stimulating growth in wood products investment within the Russian Federation.

Wood energy

Biomass energy can contribute to mitigating climate change while improving energy security and supporting the local forest economy. A sustainable energy strategy should rely on a policy mix based on three pillars, namely legal measures, financial measures and promotion activities. The main policy instruments for biomass heating include driving the market through standards, adoption of renewable energy mandates, awareness campaigns, education and training, and support of biomass heating manufacturers. Public acceptance is critical to the success of biomass programmes. It is also necessary to establish fuel standards and fuel supply chains, while deploying high efficiency burning equipment, with low emissions and user convenience similar to oil or gas systems.

For instance, the results in Austria were mainly attributable to the policy mix of investment subsidies coupled with fiscal measures on fossil fuels. Austria also has emerged as a major exporter of pellets. Out of a total production of 700,000 metric tons (m.t.) in 2009, 40% goes to export, mainly to Italy. Nevertheless, there is still room for growth as the total potential production capacity is estimated at around 1.2 million m.t. in 2010. In 2009, energy policy measures have led to biomass surpassing oil to become the number one source for energy generation in Sweden now accounting for 33% of total energy consumption. In the United Kingdom, a drive to generate electricity from biomass reflects concern about potential shortfalls in electricity generation capacity due to the decommissioning of nuclear and coal-fired power plants and the availability of feed-in tariffs for renewable energy. In addition, utility companies are keen to present green credentials to consumers by co-firing biomass in existing plants and constructing dedicated biomass plants.

Elsewhere in the UNECE region, wood energy use and pellet production levels are also increasing. In the Russian Federation, the federal and regional governments are implementing policies on energy efficiency and renewable energy supply. The United States has emerged as the world's leading producer of wood pellets at 4 million m.t. through the construction of a number of the world's largest pellet plants. Meanwhile, the export-oriented Canadian wood pellet industry is evolving with increased utilization of non-traditional raw materials and growing domestic demand. There is, however, increasing concern that the incentives promoting biomass throughout the UNECE region might lead to market distortions currently giving preference to wood for energy rather than as an industrial raw material.

Carbon markets

The world carbon market reached 8.7 billion m.t. of CO₂ equivalent in 2009, which was 80% more than in 2008. The economic crisis eroded carbon prices to the extent that the transaction value grew

only 6% to \$144 billion in 2009. The European Union Emissions Trading Scheme (ETS) is the only major carbon cap-and-trade scheme in the compliance market. Trade in European Union Allowances (EUA) more than doubled to 6.3 billion m.t. CO₂ equivalent in 2009.

Clean Development Mechanism (CDM) has approved 17 afforestation/reforestation projects but these have not yet issued carbon credits to the market. Forest carbon markets while growing remain small and are mostly confined to voluntary carbon market (VCM). Large corporate off-setters prefer forest carbon projects for their wider range of eligible activities, carbon credits certified against recognized standards, and benefits in CSR reporting.

Carbon markets have been created largely by political processes. The UNFCCC COP-16 and COP-17 are crucial for a wider inclusion of forest carbon in the solution for climate change mitigation. REDD+ has potential of becoming the overarching platform of forest carbon. Expanding the scope of CDM, carbon in Harvested Wood Products (HWP) and new rules governing the carbon accounting on forest management are the most important innovations that the climate negotiators and forest sector will need to consider.

Sawn softwood

Sawn softwood markets passed through a challenging year in 2009 in all the UNECE subregions. In aggregate the UNECE region faced a consumption downturn of 13.8% to 155.3 million m³. This will be overturned by an expected recovery by 7.5% in 2010 and 2.2% forecast in 2011 of 170.7 million m³.

In Europe output is expected to reach 98.2 million m³ in 2010 (up 7.9%) and 100.3 million m³ in 2011. Consumption will be 91.2 million m³ in 2010 (up 9.8%) and 93.2 million m³ in 2011. Exports to the North African and the Middle East markets keep growing steadily. In contrast, exports to the United States have dropped to the levels of 1999. The growing market for bio-energy at many European sawmills has been a stabilizing factor, helping sawmills pass through the most difficult period.

North America's sawn softwood industry fell dramatically until 2009, i.e. output was reduced by 45% since the peak of 2005 including, between 2008-2009, a fall of 20%. Capacity utilization rates hit record-low levels of 50% in 2009. The year 2010 looks to produce a strong rebound for Canada, with both production and consumption growing by 16% and 14%, respectively. The US softwood market is wrought with uncertainty, and production falls 3.5% in 2010, and continues at zero growth in 2011. Canada looks set to pass the United States in sawn softwood production temporarily in 2011. Canada is forecast to produce 40.7 million m³ and the USA 39.1 million m³. Canada's sawmills will benefit from extensive salvage logging of the forests infected by the mountain pine beetle and higher exports to China.

In Russia sawn softwood production is forecast to move up by 5.5% annually in 2010 and 2011, but the official volumes underestimate the small producers' output drastically.

Sawn hardwood

After a long decline, sawn hardwood consumption is forecast to improve in the UNECE region. Demand is greatest in North America, which after falling again in 2009, is forecast to rise in 2011 by 3.7% to reach 16.4 million m³. In Europe, after minor change in 2009, consumption and production are forecast to rise by 3.2%, to 13.5 and 13.1 million m³ respectively. The weak demand in North America means that producers are seeking offshore markets, for example in China, and exports are forecast to increase sharply in 2011, by 12.1% to 2.4 million m³.

The declines in the United States hardwood markets were due in part to substitution by cheaper products, offshore manufacturing and lower awareness of forest landowners. The reduced demand for hardwood products has resulted in the forest resource, which has doubled in the last 50 years, being seriously underutilized.

In Europe and North America, green building rating systems promoted by climate change-related policies, continue to be a market driver for hardwoods that can provide proof of legality and sustainability.

Panels

Demand for and production of most panel products is expected to increase across the region in 2011, with consumption forecast to rise by 3% in North America, 9% in Europe and to show significant improvement in Russia also. This is in contrast to the falls recorded in all three subregions in 2009 when North American consumption fell by 17.9%, continuing a decline that started with the housing collapse. Europe fared better, recording a fall of only 3.2% while the fall in the CIS was 19.2%.

The fall in demand in the US has led to the closure or mothballing of factories. The utilization of manufacturing capacity was 53% for OSB, and 66% for plywood: the lowest recorded levels for 25 years. Federal government subsidies offered through the Biomass Crop Assistance Program, which allowed bio-fuel producers to pay high prices for sawmill co-products, have made an already difficult situation almost untenable. The government has recently promised withdrawal of the subsidies for sawmill co-products.

Europe has been affected by a reduction in wood availability, reflecting in part, lower sawnwood production and consequently the co-products which form a key source of fibre for the panel sector, as well as growing competition from the burgeoning wood energy sector.

Russian exports of plywood increased in 2009, in spite of weak construction activity in Europe. Domestic demand for MDF and particleboard fell because of a collapse in furniture production but was partly compensated by higher exports.

Rising prices for raw material are a genuine concern for manufacturers but factors other than bio-energy subsidies are at play. In Europe at least, storm damage produced lower prices in past years. Prices have gradually adjusted to pre-storm levels, as the market impact of extra wood supplies has diminished. The recovery in demand for wood based panels has been accompanied by modest rises in panel prices, providing some relief for manufacturers.

Paper and pulp

China has overtaken the United States to become the world's largest paper and paperboard producer and consumer with 95 million m.t. This signals a shift of growth in the sector to Asia, while production levels out and declines in Europe and North America.

The UNECE region's paper and paperboard consumption is forecast to rise to 175 million m.t. in 2010 (up 2.2% from 2009). The 2011 growth rate is forecast to moderate to 0.9%. Wood pulp consumption will grow 3.5% in 2010 and 2.6% in 2011 to reach 110 million m.t. Exchange rate fluctuations play a major role in trade and competitiveness between the subregions. Despite industry restructuring, Finland has increased its production as a result of improved production efficiency in the remaining mills.

Europe's consumption of paper and paperboard is expected to rebound by 4.9% in 2010 to 91 million m.t., followed by a return to slower growth in 2011 (+1.2%). Europe's wood pulp consumption is expected to jump by 10% in 2010 to 45.5 million m.t., and then level off to 1.4% growth in 2011. North America's paper and board consumption is forecast to continue falling by 0.8% to 75.8 million m.t. in 2010, and remain unchanged in 2011.

Growth in Russia's paper and paperboard consumption is forecast to accelerate from 2.8% in 2010 to 5.6 % in 2011. This will raise consumption to 6.2 million m.t. in 2011. Russia will record 5% growth in pulp production in 2010, to 5.3 million m.t. Russia has a trade deficit in paper and paperboard (\$2 billion) because it exports mostly low-value grades but imports high-quality printing paper, packaging and tissue grades. There are large investment opportunities in refurbishing the existing mills in Russia.