

UNECE TIMBER COMMITTEE – OCTOBER 2011

UK Timber Market Statement

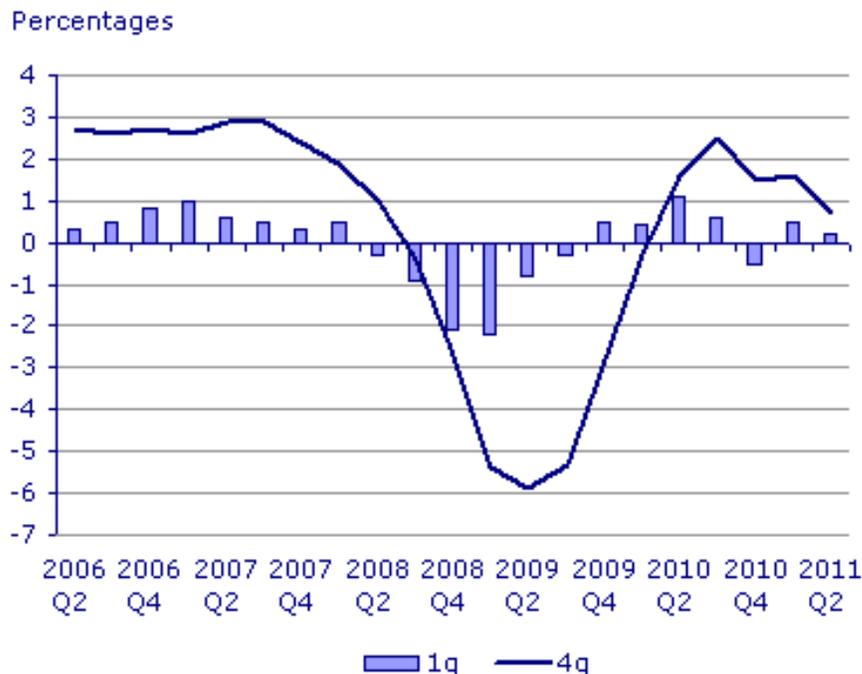
1. General Economic Trends affecting the Forest and Forest Industries Sector

GDP Growth

Gross Domestic Product (GDP) is now estimated to have increased by 2.7% over the period from the end of the 2008-09 recession, compared to a 6.4% contraction during the recession, according to recent data released by the Office for National Statistics (ONS). The ONS has suggested that this recovery has been more moderate than the recovery from the 1980s recession, which was similar to this one in terms of the extent of the downturn.

Recent growth figures from the ONS show GDP to have increased by 0.2% over 2011 quarter 2, down from 0.5% in the first quarter.

Chart 1: Gross Domestic Product by Quarter, 2006-2011



Source: Office for National Statistics

Expansion of economic output in quarter 2 was primarily due to an increase in service sector activity, of 0.5%, with 'business services and finance' making the largest

contribution to total sector output. Construction sector output also increased by 0.5%, following a 3.4% decline in quarter 1. Total production sector output, however, which includes the manufacturing sector, had a negative effect on growth, contracting by 1.4%. Within this, manufacturing declined by 0.3%, after growing by 0.7% in the previous quarter.

ONS have cautioned that a number of 'special events' may have contributed to the low growth rate in 2011Q2. For instance, it is possible that the effects of the royal wedding, the Japanese tsunami, the record warm weather in April and ticket sales for the London Olympic Games combined to reduce growth below what it would have been; although the actual effect of these events on the growth rate in the second quarter is subject to considerable uncertainty.

On the demand side, the most recent ONS quarterly data, for 2011Q1, showed a sharp decline in private and business demand but a boost from government spending and net trade at the start of the year.

From the Bank of England's Quarterly Inflation Report for August, the slump in household consumption in the first quarter is expected to have been largely due to falling real incomes (which are adjusted for inflation). Since quarter one, however, retail sales volumes, an important component of household demand, have increased, by 0.7% on the month in June 2011, according to the ONS, after falling by 1.3% between April and May, which, again, may have been partly due to one-off events such as the royal wedding boosting sales in April, with the effects wearing off in May. Meanwhile, less volatile 3-monthly data show sales volumes to have risen by 0.2% in the three months to June compared to the three months to March.

In the latest report on lending to individuals, published by the Bank of England, it was revealed that lending to individuals increased by £0.4bn in June, which was less than half the previous six-month average increase of £1.2bn.

Business investment fell in the first quarter; although this is likely to be due, in part, to orders for aircraft having been brought forward at the end of last year, before the VAT increase came into effect in January, and therefore falling out of the investment figures for the first quarter of this year.

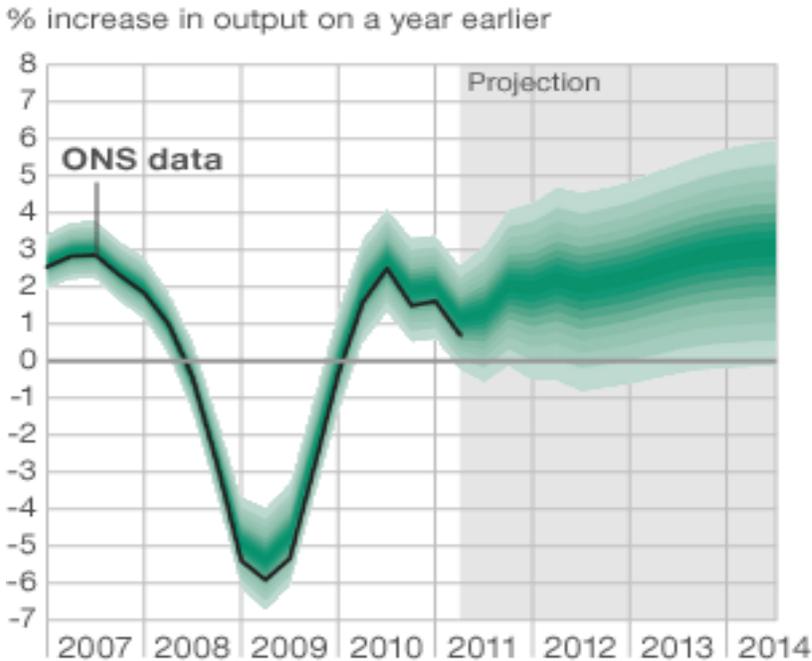
In the first three months of the year, net exports made a strong contribution to growth, but that was partly due to the orders for imported aircraft being brought forward to 2010. Prior to the start of this year, net exports had been weak, actually making a negative contribution to growth in five out of the six previous quarters, which, according to the Bank's latest Inflation Report, is surprising, considering the depreciation of sterling since mid-2007. More recent trade data, also from the ONS, showed the deficit to have widened in June, by £0.4bn to £4.5bn, due to goods and services exports declining by more than imports. These results were reinforced in the less volatile 3-monthly measure, where the total trade deficit widened to £11.3bn in the three months to June, from £8.5bn in the previous three months.

For 2011 as a whole, the Monetary Policy Committee (MPC) of the Bank of England has revised down its growth projection for 2011, from 1.8% to 1.5%, with Mervyn King, Governor of the Bank, warning that Europe's debt crisis and a possible contraction in the US could have a serious impact on the UK economy. Although growth will remain 'sluggish' in the short term, the Bank does predict that the economy will start to pick up

thereafter, driven by a recovery in business investment and rising net exports. These views are broadly in line with the latest (August 2011) HM Treasury Forecast for the UK economy which provides an average GDP forecast of 1.3% growth for 2011.

Chart 2: Gross Domestic Product by Year, 2007-2014

GDP forecast



Source: Bank of England

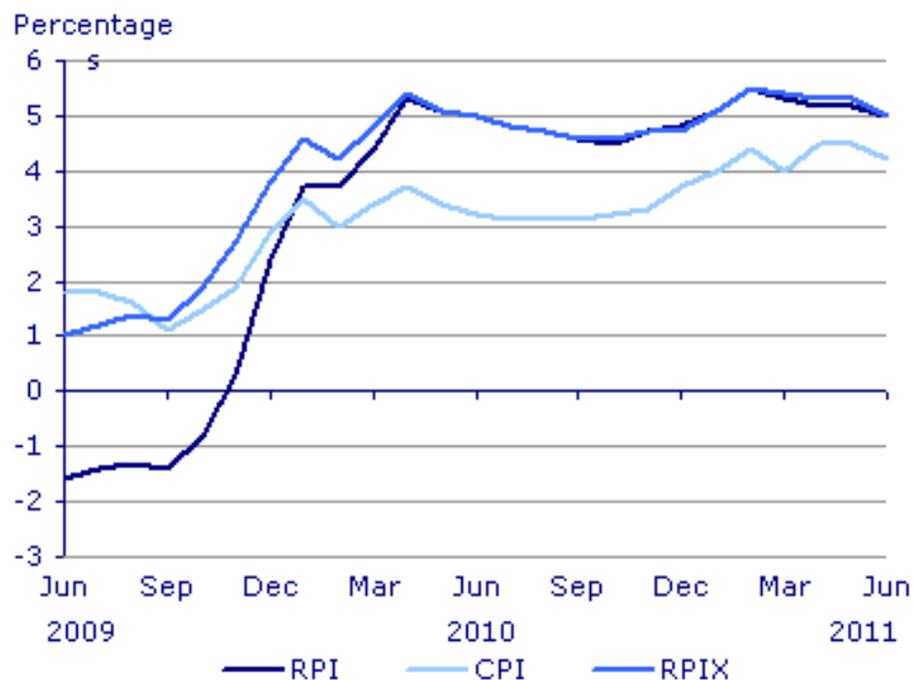
Source: Bank of England

The Bank's inflation report was prepared before the recent (August 2011) turmoil in stock markets, and it is possible that recent events could impinge on the Bank's figures. There has been a dramatic sell-off in shares worldwide, due to concerns about the ongoing sovereign debt crisis in the Euro zone, and about growth in the US. Markets are nervous about the possibility of the debt crisis spreading, and about the ability of European governments to deal with this. The cost of borrowing for Spain and Italy has been rising and is now close to the unsustainable levels that recently forced Greece, Ireland and Portugal to seek bailouts. The European Central Bank has confirmed that it will buy Spanish and Italian government bonds to attempt to reduce borrowing costs in those countries. Looking to the US, Standard & Poor's downgraded the country's credit rating from AAA status to AA+, citing concerns that the deficit reduction plan passed by the Congress at the start of August fell short of expectations. There are also worries that the country has been growing more slowly than expected. Markets fell again following rumours that France could also be downgraded; although the three main credit agencies have re-affirmed France's AAA rating.

Inflation

Consumer Prices Index (CPI) annual inflation – the Government’s target measure – rose to 4.4% in July, up from 4.2% in June, after falling from 4.5% in May. Inflation has now been above the Government’s 2% target for seventeen consecutive months.

Chart 3: Inflation: CPI and RPI, 2009-2011



Source: Office for National Statistics

No single factor drove the rise in inflation in July 2011; instead, inflationary pressure came from a number of areas, including miscellaneous goods and services, and particularly from mortgage arrangement fees, which rose this year but fell a year ago. A further upward influence came from clothing and footwear. Prices fell this year, which is normal for a June to July period, due to summer sales, but by less than between June and July last year. This was also the case for furniture, household equipment and maintenance, where prices fell by less in the summer sale this year than in 2010. Housing rent for social housing also contributed to the upward movement in prices.

The largest offsetting downward pressure on inflation came from food and non-alcoholic beverages, where prices rose by less this year than the same two months a year ago. Prices fell across a range of products, particularly fish, fruit, and mineral waters, soft drinks and juices. Bread and cereals, however, had an upward effect on inflation, with prices rising by more than last year.

The Retail Prices Index (RPI) – a wider measure of inflation that includes housing costs – was 5% in July, unchanged from June.

According to the Bank of England's latest Quarterly Inflation Report, there is a 'good chance' that inflation will rise to 5% later in the year, driven by utility price increases and the continuing effect of past increases in VAT, oil and other import prices. It is projected, however, that inflation will start to slow in 2012 and 2013, as the rate of current price increases is not considered likely to repeat, while weak demand in the economy will ensure that a degree of spare capacity in the labour market persists. The Bank has cautioned that the likely fall in inflation and its timing are subject to considerable uncertainty however.

The Monetary Policy Committee (MPC) of the Bank of England voted, at their 4th August meeting, to leave the base rate unchanged at 0.5%. The MPC also voted to maintain its Quantitative Easing (QE) programme at £200bn. Through QE, the Bank purchases financial assets, such as government and corporate bonds, thereby increasing the volume of money in circulation. The aim is to increase the supply of credit, which should, in turn, help to stimulate the economy. The latest change in the Bank Rate was a reduction of 0.5 percentage points to 0.5% on 5th March 2009, and the most recent change to the size of the QE programme was an increase of £25bn to £200bn on 5th November 2009.

In conclusion, while the Bank of England's growth forecast for the UK economy for the rest of 2011 has been revised downwards, with a number of downside risks impinging on this figure - emanating largely from Europe, where there are concerns that the sovereign debt crisis will spread, and the US, which has been growing more slowly than projected - it is expected that growth will start to pick up from 2012 onwards, boosted by business investment and net exports. Inflation is predicted to start to fall in 2012 after increasing during the rest of 2011; although it is highly uncertain when and to what extent this will occur.

2. Policy Developments potentially affecting Trade in Wood Products

Update on the EU Timber Regulation and FLEGT

The European Parliament published its legislative resolution on the EU Due Diligence Regulation in July 2010 which details the obligations of operators who place timber and timber products on the market. Both the EU Timber Regulation and the EU FLEGT Regulation support the UK government's continued commitment to tackle illegal logging, sustainable forest management and support responsible timber procurement.

In the UK, there are already effective sectorial due diligence systems in operation and the EU due diligence legislation recognises that any voluntary chain of custody mechanism and existing national systems which fulfils the requirements may be used as a basis for exercising due diligence.

The two main sources of timber supply in the UK are from its own forests and from importation from the many countries of the world that export to the UK.

The Forestry Commission is the UK Government department for forestry and the Timber Trade Federation represents the interests of importers and merchants. Both organisations have systems which either through regulation, standards or industry best practice help UK

forest owners and importers address issues of due diligence in the supply of timber products.

For supply from UK forests, sustainable management to the UK Forestry Standard or the issuing of Felling Licences are the methods by which the Forestry Commission ensures compliance to national standards of good forest management.

The UK government will be consulting on the implementation of the EUTR to identify measures for effective implementation and the appointment of the Competent Authority. The EU Timber Regulation provides a coherent approach by specifically identifying FLEGT-licensed timber as fully meeting its requirements. This provides a strong incentive for timber exporting countries to agree Voluntary Partner Agreements (VPAs) with the EU.

Until 2015, the UK Government's Timber Procurement Policy will accept FLEGT-licensed timber products. The UK Government's Timber Procurement Policy requires central government departments, their executive agencies and non departmental public bodies only to procure timber and wood derived products originating from either legal and sustainable or FLEGT licensed or equivalent sources. Local government is encouraged to comply.

For imported timber and wood-based products, the Timber Trade Federation (TTF) operates a mandatory due diligence process (the RPP) for members as part of its Environmental Code of Practice. The RPP provides a framework and set of management tools to help TTF members objectively and formally analyse the risk of products being from an illegal source of supply.

Due diligence is conducted at product level, and products from risk managed sources are effectively screened out at an early stage and classified as negligible to low risk. This allows members to focus their resources on undertaking due diligence on products where risk is not formally managed, and to assign a risk assessment score (low to high risk) against that product.

The overall exercise allows members to develop an overall risk profile of all products in their supply chain, allowing them to prioritise actions and resources on those products and suppliers where risk is highest, with the aim to improve their risk profile over time.

In 2010, the first year of mandatory compliance, 92% of TTF members implemented due diligence into their businesses. The annual RPP shows that there has been some progress in members purchasing towards risk managed sources, however given the statistical base this can only be seen as indicative rather than conclusive. It is envisaged the real impacts on trade flows from this policy may not be seen until the 3rd and 4th quarters of 2012 onwards, as the secondary legislation associated with the EUTR is finalised and published.

The TTF would be pleased to discuss in detail the RPP with representatives from other countries – contact Anand Punja, Timber Trade Federation, The Building Centre, 26 Store Street, London WC1E 7BT - e-mail apunja@tff.co.uk

EU FLEGT Regulation and Imports

COMMISSION REGULATION (EC) No 1024/2008 of 17 October 2008 “laying down detailed measures for the implementation of Council Regulation (EC) No 2173/2005 on the establishment of a FLEGT licensing scheme for imports of timber into the European Community” comes into force at the end of 2011, when the first Voluntary Partner Agreement (VPA) country is expected to be listed in the Annex of the regulation.

In practice however, this policy will have little impact on trade flows as FLEGT Licensed Timber is not expected on the ground until at least late 2012/ early 2013.

UK Bioenergy Strategy

Bioenergy is expected to play a key role in the cost effective delivery of the UK Government’s renewables and carbon emission reductions targets both to 2020 and beyond. However it is widely recognised that there are limits to the amount of sustainable biomass that can be made available. This requires government to develop a policy framework that supports the most cost-effective uses of the available resource based on objectives such as carbon emission savings, impact of economic growth and competing uses.

To provide the strategic framework for future policy development the Department of Energy and Climate Change (DECC) is working with other government departments, devolved administrations, government advisory and delivery bodies as well as stakeholders outside of Government to develop a UK Government strategy for sustainable bioenergy to 2020 and beyond.

In particular the strategy will look to address three key questions:

- What are the potential levels of sustainable feedstocks that could be available to 2020 and beyond?
- How should these feedstocks be used in the bioenergy sector?
- What are the potential impacts of bioenergy demand on other sectors that use competing feedstocks (e.g. food, construction, and bio-chemicals)?

The aim of the strategy is to provide a clear framework for policies that the UK Government should pursue going forward to achieve the cost effective delivery of our 2020 goals in a way that is consistent with other objectives across the economy and longer term bioenergy ambitions to 2050. The strategy will also inform decisions on incentives for bioenergy such as the Renewables Obligation banding review.

Government departments will be engaging with stakeholders over the coming months in order to gather all the available evidence to help inform the strategy.

Increasing demand for Renewable Energy

On 10 March 2011, the government announced the details of the Renewable Heat Incentive (RHI) policy, to revolutionise the way heat is generated and used.

This is the first financial support scheme for renewable heat of its kind in the world. The RHI will provide a valuable revenue stream for those wishing to produce renewable heat. It will also provide an important opportunity to help overcome previous financial barriers to

the installation of woodfuel systems. It is expected to significantly increase the demand for biomass.

The RHI provides a continuous income stream over twenty years to any organisation that installs an eligible renewable heating system, ensuring that it becomes more commercially attractive than fossil fuel alternatives.

The scheme will be introduced in two phases.

In the first phase, long-term tariff support will be targeted in the non-domestic sectors, at the big heat users – the industrial, business and public sector – which contribute 38% of the UK's carbon emissions. Under this phase there will also be support of around £15 million for households through the Renewable Heat Premium Payment.

The second phase of the RHI scheme will see it expanded to include more technologies as well as support for households. This transition will be timed to align with the government's Green Deal, which is intended to be introduced in October 2012.

Revision of the UK Forestry Standard (UKFS) and its supporting Guidelines

The UKFS and its supporting guidelines have recently been revised. The UK Forestry Standard (UKFS) is the practice code for sustainable forest management in the UK and details the conditions that must be met when felling trees, carrying out woodland operations, and receiving grants. It has been developed by the Forestry Commission and the Northern Ireland Forest Service - in consultation with a wide range of interests. It applies to all woodland, irrespective of who owns or manages it.

The Standard ensures that international agreements and conventions on areas such as sustainable forest management, climate-change, biodiversity and the protection of water resources are robustly applied here in the UK.

For forest managers, the new Standard encapsulates all the various requirements of sustainable forest management and spells out what they mean in practice. For the first time it includes principles of forest management for carbon benefits, which is a UK government carbon plan commitment. The UKFS also provides the basis for the new Woodland Carbon Code that gives assurance that woodland projects for carbon capture provide the benefits claimed for them.

The Forestry Commission's series of environmental guidelines for forestry dates back to 1988 with the publication of the Forests and Water Guidelines. The UK Forestry Standard was first published in 1998 and revised in 2004. The standard incorporated the various guidelines and set out the UK's approach to sustainable forest management in response to commitments made at the Rio Earth summit.

This third edition clarifies and strengthens the relationship between the Guidelines series and The UK Forestry Standard to improve the consistency of approach. It also defines requirements and guidelines in a more explicit way.

The UK Forestry Standard plays an important role for independent forest certification in the UK. By defining UK forestry practice, it underpins the UK Woodland Assurance Standard. This is endorsed by both certification schemes operating in the UK: FSC (the

Forest Stewardship Council) and PEFC (The Programme for the endorsement of Forest Certification Schemes).

For more information on any of these issues, for forestry please contact Jonathan Taylor of EU and International Branch, the Forestry Commission, e-mail jonathan.taylor@forestry.gsi.gov.uk and for information on imported timber, please contact Anand Punja, Sustainability Executive, the Timber Trade Federation, e-mail apunja@tff.co.uk.

Government Spending Review

The purpose of the Comprehensive Spending Review, published in October 2010, was to effect a reduction in the budget deficit (government expenditure exceeding revenues) over the period from 2011 to 2015. One of the main ways this is being done is by reducing public spending. Departmental budgets will be cut by an average of 19 per cent over the four years of the Review.

The outcome of the review, approximately nine months after its publication, has been the promised cuts in government expenditure which is beginning to be felt in many sectors of the economy. Cuts in government departmental budgets have resulted in lower public sector activity in many areas.

Plant Health Issues

Phytophthora ramorum infection of Japanese larch trees continues to be the major plant health issue affecting the market in Great Britain.

New outbreaks have continued to be identified in 2011, but the great majority has been close to or contiguous with previously known infected woodland in South West England and South Wales. Only a small number of outbreaks have been identified in new regions this year, in central and North West England and on the island of Mull in western Scotland. Aerial surveillance is continuing into the early autumn to ensure that any late outbreaks are identified.

Overall, the number and area of new outbreaks identified has been significantly down on the previous two years, leading to a reduced flow of material coming to market from affected forests.

In addition, measures taken in conjunction with the industry to manage the flow of larch logs coming to market have helped to achieve a modest increase in prices.

P. ramorum is a fungus-like pathogen that kills many of the trees that it infects. It was first found on Japanese larch trees in South West England in 2009, and further outbreaks were identified in South Wales and western Scotland in 2010, with widespread infection in all ages of Japanese larch.

The 2009 discovery was the first time in the world that a commercially grown conifer species had been found with *P. ramorum* infection. Acting on scientific advice, notices to fell infected trees on public and private forest land are being served by the Forestry Commission in all three countries in Great Britain to try to contain the disease.

Biosecurity measures are in place to minimise the spread of infection in soil or on larch needles, people, vehicles, equipment and timber.

Extensive felling of the affected larch trees continues, and the Forestry Commission is working with timber processors and others to ensure biosecurity measures are also in place to allow logs from the infected trees to be taken to mills for conversion into timber.

The disease does not sporulate on bark or timber, so no restrictions on movement of logs within GB have been imposed.

National Forest Inventory

Over the next few months the British forestry sector will benefit from a step change in the quality of forest resource estimates available. The National Forest Inventory of Great Britain has already established an upwards (8%) revision of woodland area and is currently analysing results from field survey work to generate statistically robust estimates of softwood growing stock. These will then be combined with published Growth and Yield Models and a range of management intervention scenarios to illustrate how this is likely to change over the next 25 years.

Accurate, up-to-date information about the size, distribution, composition and condition of our forests and woodlands will be made available to help develop and monitor the policies that guide sustainable forestry management in Great Britain.

The advanced techniques used in developing the National Forest Inventory will provide a record of key information about our forests and woodlands. Users of inventory data include the forestry and timber industries, organisations concerned with nature conservation, ecology and biodiversity, those working to protect our forests and woodlands from pests and diseases, government and non-government agencies formulating forestry policies, public and private investors in the countryside, and anyone interested in finding out more about Britain's forests and woodlands.

3. Market Drivers

Construction, Manufacturing and Distributive Trades

In 2010, the main markets for timber and wood-based products experienced a degree of recovery, following the recession and its aftermath in 2008 and 2009.

All of the leading timber markets: construction, the pallets and packaging industries, furniture, fencing and outdoor-use all enjoyed higher levels of demand in 2010 compared to 2009, but as the year 2010 continued, doubts over the sustainable nature of this recovery surfaced and in the first months of 2011, the increased demand for timber products of 2010 had all but evaporated. A fall in construction output in 2011 has been accompanied in the wider economy by export growth which has failed to meet expectations and a continued increase in unemployment that has helped to dampen business and public confidence in the growth prospects for the economy in 2011 and 2012

However, in 2010, the main timber using markets experienced a return to growth. New home building returned to the levels of 2008 in 2010, with housing starts at around

131,000. This was an increase of 22.5% over 2009. Housing repair, maintenance and improvement (RMI) activity also rose in 2010, up by 6.4%. In the fencing and outdoor products markets, demand from all sectors improved in 2010. The agricultural fencing and roadside fencing markets recovered strongly from the weak demand present in 2009. The pallets and packaging market also witnessed an increase in activity with volume of new and recycled pallets higher by around 9%.

Construction

Construction is driven by consumer spending on home improvements, housing starts, public sector procurement and, to a lesser degree, industrial and commercial building and refurbishment programmes.

Construction output in 2010 increased by 8.1% over 2009, but by Q1 2011, growth over the same quarter in 2010 had slowed to around 5% and by Q2 2011, construction output was nearly 2% lower than Q2 2010.

The 8.1% growth in output in 2010 comprised a number of sectors with a raised level of output:

- a 22.5% increase in housing starts,
- a 6.4% increase in housing RMI output,
- an increase of around 19% in industrial construction output (e.g. warehouses, schools, healthcare, agriculture) and
- a 26% rise in the output of infrastructure projects

and two sectors where output decreased in 2010

- private commercial output was 2.1% lower and
- non-housing RMI was lower by 11.6%.

The growth in housing starts in 2010 was driven by a number of 'mothballed' developments being resurrected, an increasing number of mortgage approvals (albeit from a position in 2009 where lending had virtually come to a standstill) which stimulated the number of transactions and an increasing, but fragile, level of confidence returned to the housing market as interest rates were kept at historically low levels.

This upturn in the housing market in 2010 was mainly a feature of the first half of the year with activity in the second half slowing substantially as consumer confidence waned. The proposed cuts in government spending, including public housing, weakness of house prices, poor demand for and supply of mortgage funds and many consumers preferring to reduce debt rather than spend were factors behind the slowdown.

Housing starts were 22.5% higher in 2010 over 2009, but this growth was divided into a 46% increase in the first half of 2010 and only a 2% increase in the second half of the year.

Housing RMI also grew in 2010 with 6.4% increase in output, but output in non-housing RMI declined by 11.6%. Combining the activity of all RMI sectors, output fell by 3.7% in total in 2010.

The main indicators of activity in the UK construction market, comparing the years 2010 with 2009 and the first six months of 2011 with the first six months of 2010 are shown in table 1 below.

Table 1: Main Indicators - Construction

**Main Indicators
Construction**

	Annual 2010/2009	Half-Yearly 2011/2010 to Jun	2011 Note
UK Housing Starts	22.5%	-7.9%	England 6 months 2011 vs 1st 6 months 2010
RMI Housing Output	6.4%	-2.7%	UK 6 months 2011 vs 6 months 2010
New Housing Output	24.4%	8.3%	UK 6 months 2011 vs 6 months 2010
Property Transactions	3.8%	-4.3%	UK 6 months 2011 vs 6 months 2010
Mortgage Approvals	-3.6%	-4.0%	UK 6 months 2011 vs 6 months 2010

A very clear pattern with all indicators emerges from table 1. The recovery in 2010 over 2009 is apparent, although the tight availability of credit was also apparent in 2010. In the first half of 2011, all indicators reveal a worsening of activity. The only indicator showing growth in 2011 to June is new housing output.

The better performance of housing sectors in 2010 resulted in an increase in the volume of softwood consumed by construction.

The estimated volume of softwood consumed by all construction markets in 2010 was 5.5 million m³, up from 5.0 million m³ in 2009, an increase of 9%. Softwood consumed by all RMI markets (housing and non-housing) rose by 8% in 2010 and 24% more softwood was consumed in the new housing market.

Manufacturing and Distributive Trades

A similar trend to that seen in construction has taken place in manufacturing and the distributive trades. Growth rates achieved in the first six months of 2011 compared to the same period in 2010 were lower than the annual growth rate of 2010 over 2009, however, unlike construction, the growth rates remain positive.

Table 2: Main Indicators – Manufacturing & Distribution

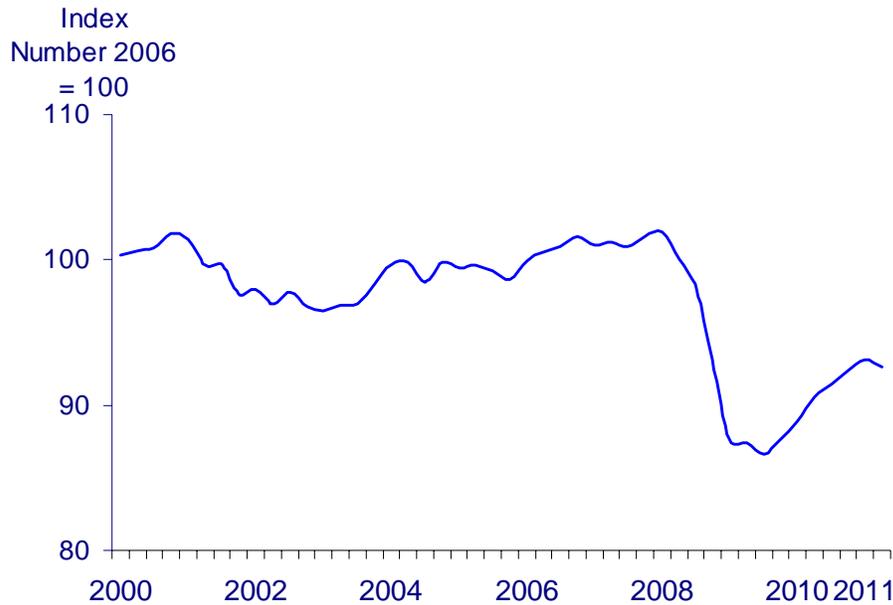
Main Indicators

Manufacturing & Distribution

	Annual 2010/2009	Half-Yearly 2011/2010 to Jun	2011 Note
Manufacturing Output	3.6%	2.3%	Q2 2011 vs Q2 2010
Wholesale & Retail Output	2.8%	1.6%	Q2 2011 vs Q2 2010

The chart below illustrates the recovery in manufacturing output from the recent recession, but also demonstrates the strength of recovery is relatively weak.

Chart 4: Index of UK Manufacturing, 2000-2010



Source: Office for National Statistics (ONS)

The recovery of manufacturing and the wholesale and retail distribution trades provided the packaging and pallets industry in the UK with higher levels of demand than in 2009 and this is confirmed by the greater number of pallets and other packaging produced in 2010.

The number of pallets produced in the UK in 2010, according to the official statistics supplied by ProdCom through the Office for National Statistics, rose from 57.9 million to 59.7 million in 2010. The production of pallets in 2010, although higher than in 2009, remained below pre-recessionary levels. This development is shown below in chart 5.

Chart 5: UK Pallet Production 2006-2010

Source: ProdCom

In the pallets and packaging markets, manufacturing output and consumer spending are important drivers of demand. As shown in chart 5, according to data from ProdCom, published by the Office for National Statistics, the number of pallets produced in the UK in 2010 rose slightly to around 60 million (59.7 million).

As reported in the UK Market Statement for 2010, these volumes of pallet production do not truly reflect manufacturing and recycling activity in the UK. Independent research, conducted to measure activity in 2010, has confirmed a higher level of recycling and re-use of packaging materials and pallets than is indicated by the ProdCom data.

This work, jointly commissioned by Timcon, the pallets and packaging confederation in the UK and the Forestry Commission, determined that a sizeable proportion of recycling (the repair and remanufacture of pallets) is not being quantified by ProdCom, although the extent of recycling is not as high as originally reported in last year's UK Market Statement.

Less timber is used in recycling than in the manufacture of new pallets and the continuing trend of lower levels of manufacturing and the shift towards greater recycling has reduced the volume of softwood used in the pallets and packaging industry in 2010. The revised total for 2009 is 1.22 million m³ and in 2010, the volume of softwood consumed was 1.20 million m³, a reduction of 1.9%.

In the fencing and outdoor use markets, such as decking, landscaping, garden products and motorway fencing, volumes of softwood consumed are estimated to have risen by 13% to around 1.2 million m³.

Good weather in the spring of 2010 helped to lift demand for fencing in all markets, including the domestic market. As has been seen in other markets, the raised levels of demand for domestic fencing were not maintained and although demand weakened in the second half of the year, sales to households were better than anticipated. The agricultural fencing market also enjoyed a brisk start to the year and although demand reduced in the second half, sales to this market generally held up better than in other areas.

Higher levels of sales of softwood and other timber products to the garden and landscaping markets were achieved in 2010, once again helped by the good weather in the early part of the year.

It was reported in last year's UK Market Statement that the decking market outperformed virtually every other related sector and this continued in 2010. The Timber Decking and Cladding Association confirmed that sales of decking of all types returned to pre-recessionary levels in 2010 and further growth is forecast for 2011.

The mix of decking applications has changed over the last two years however, with a growing proportion of industry sales taken by commercial decking projects, particularly in the leisure industries. Domestic decking sales are thought to have weakened a little since the high growth period in the mid 2000's, but have benefited from upgrading and new installations where homeowners have opted to improve existing homes, rather than attempt to move.

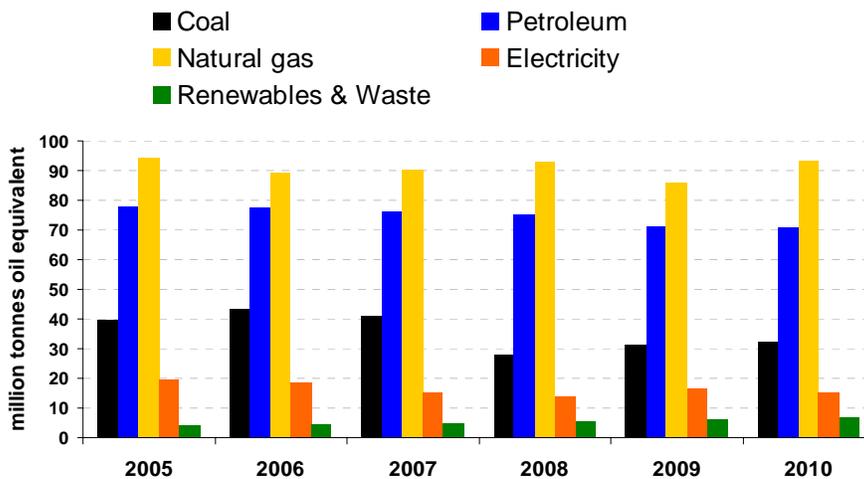
Energy Markets

The proportion of renewables (including waste) consumed in the UK for energy use doubled between 2004 and 2010, rising to 7 million tonnes (oil equivalent). This represented 3.5% of all energy consumption.

As reported in previous UK Market Statements, the development of renewables for energy markets, which includes the use of timber products, was accelerating. Total energy consumption grew by 3.3% in the UK in 2010 within which, the use of renewables grew by 12.9%.

This relatively small, but faster growing penetration into energy supply is shown in chart 6 below.

Chart 6: Inland consumption of primary fuels and equivalents for energy use 2005-2010



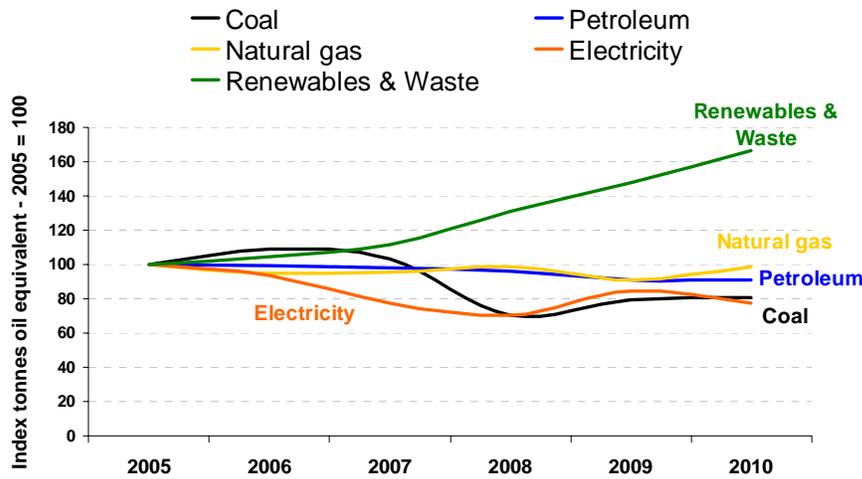
Source: Department of Energy and Climate Change (DECC)

In 2010, 75% of all energy consumption consisted of natural gas and petroleum. This proportion has stayed fairly static over the last ten years (73% in 2000), as reductions in coal and electricity consumption have been accompanied by increases in natural gas and renewables.

Although renewables claimed a relatively small share of the energy market in 2010 (3.5%), the growth compared to other forms of energy has been robust.

Chart 7 demonstrates this much faster rate of growth of renewables since 2005.

Chart 7: Indexed Growth Rates of inland consumption of primary fuels and equivalents for energy use 2005-2010

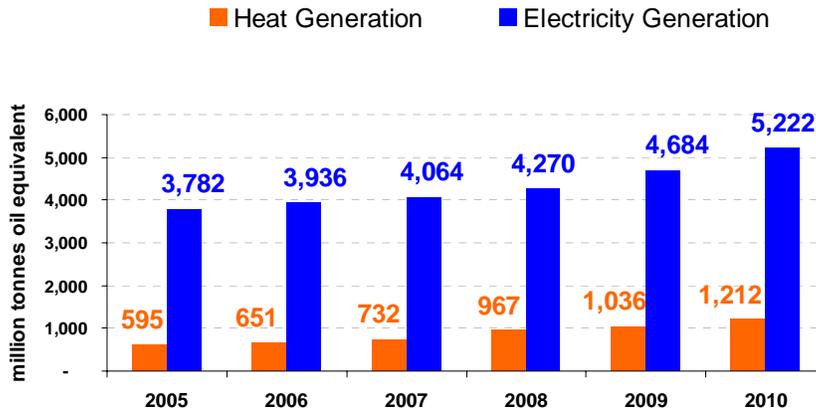


Source: Department of Energy and Climate Change (DECC)

There are a variety of renewable solutions available to meet the increasing demand for energy in the UK. These include solar, hydro, wind, animal biomass and plant biomass (including wood and wood waste), in addition to landfill gas and municipal waste which accounts for the bulk of biomass material used in electricity generation.

Of all renewables consumed in 2010, 81% were used for electricity generation. The amounts used, in millions of tonnes of oil equivalent, for electricity and heat generation since 2005 is shown in chart 8.

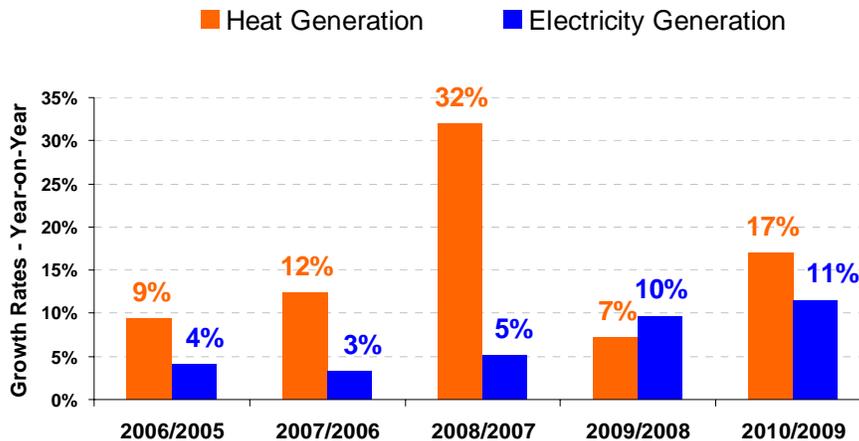
Chart 8: Renewables Used for Electricity and Heat Generation, 2005-2010



Source: Department of Energy and Climate Change (DECC)

However, the rate of growth of renewables used for heat generation has generally outstripped the use for electricity generation. The comparative use of renewables for electricity and heat generation is shown in chart 9.

Chart 9: Growth Rate of Renewables Used for Electricity and Heat Generation, 2005-2010



Source: Department of Energy and Climate Change (DECC)

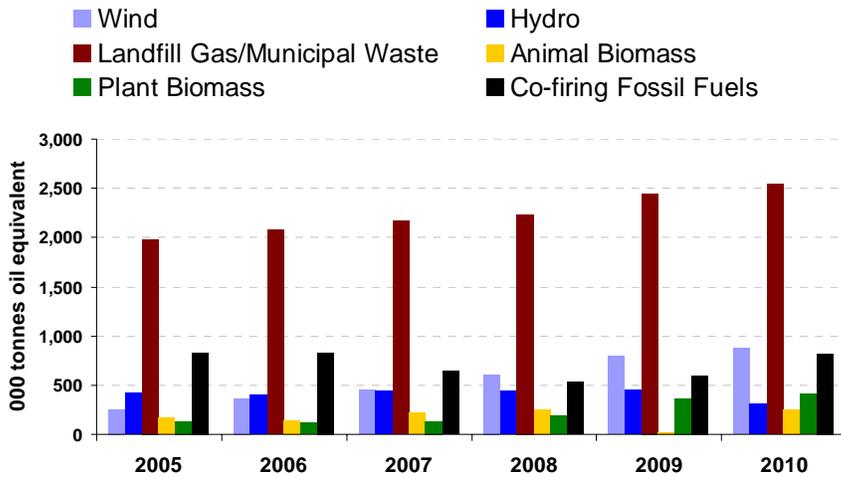
With the exception of the recessionary period in 2008-2009, the growth of renewables for use in heat generation has clearly outstripped the use for generating electricity.

It is noticeable however that the growth rate of renewables for use in generating electricity has risen steeply over the last two years, achieving double-digit growth in 2009 and 2010.

This trend is set to continue and accelerate as more electricity generators turn to renewable solutions, in preference to fossil fuel and nuclear alternatives.

As indicated, landfill gas and municipal waste are the most widely used renewable in the generation of electricity and the range of leading renewable alternatives for this purpose are shown in chart 10 below.

Chart 10: Renewable sources used to generate electricity, 2005-2010

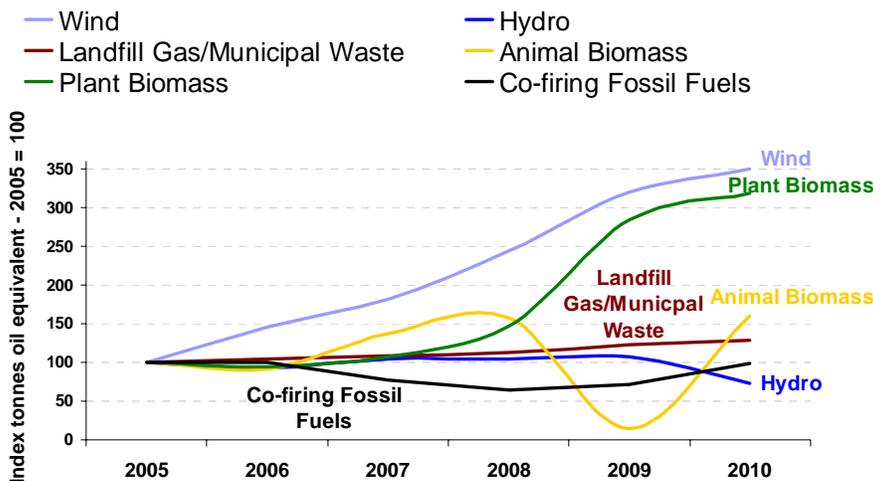


Source: Department of Energy and Climate Change (DECC)

Plant biomass, which has grown from just 4% of all renewables consumed in 2002 to 8% in 2010, includes electricity from straw and energy crops, but also an increasing volume of wood products from the forest.

The relative growth rates of renewables for electricity generation is shown in chart 11.

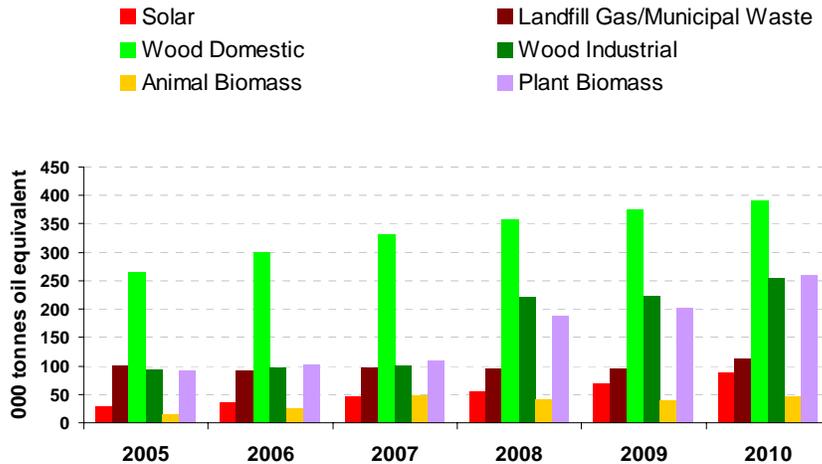
Chart 11: Indexed Growth Rates of renewable sources used to generate electricity, 2005-2010



Source: Department of Energy and Climate Change (DECC)

The growth of wind power and plant biomass has been significantly faster than for other renewable electricity generating solutions between 2007 and 2010. Both sources of power appear to have been unaffected by the recession in 2008, whereas demand for other renewables generally weakened.

Chart 12: Renewable sources used to generate heat, 2005-2010

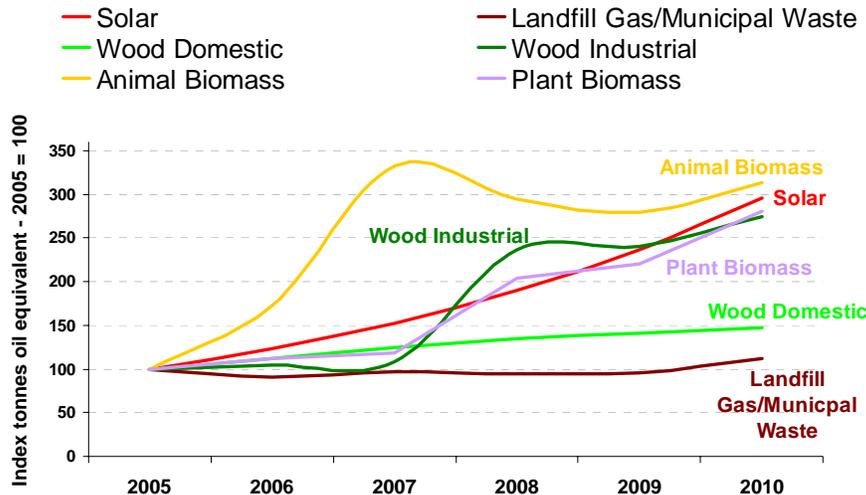


Source: Department of Energy and Climate Change (DECC)

Firewood burnt for domestic heating continues to be the most used renewable material and this consists of many different forms of wood, including cut logs, brash, wood chips, off-cuts, recycled wood waste and imported wood. Since 2008, wood used to heat industrial premises has emerged as an important material in the overall mix of renewables.

The growth of each of the main types is shown in chart 13 below.

Chart 13: Indexed Growth Rates of renewable sources used to generate heat, 2005-2010



Source: Department of Energy and Climate Change (DECC)

Growth of renewables for generating heat has been generally positive since 2005, if a little inconsistent, with exception of solar energy which has grown steadily, tripling in usage, although still only accounting for 7% of all renewable sources used in 2010.

Policy and Initiatives - Renewables

Policy incentives have helped to stimulate growth of renewable heat generation and by 2012 a two-phase Renewable Heat Incentive (RHI) scheme aimed at both domestic and non-domestic users will provide financial support to generate heat from renewables.

As previously reported in section 2 of this Statement on “Policy Developments”, in the first phase of the RHI, long-term tariff support will be targeted in the non-domestic sectors, at the big heat users – the industrial, business and public sector – which contribute 38% of the UK’s carbon emissions. Under this phase there will also be support of around £15 million for households through the Renewable Heat Premium Payment.

The second phase of the RHI scheme will see it expanded to include more technologies as well as support for households. This transition will be timed to align with the ‘Green Deal’, which is intended to be introduced in October 2012. The ‘Green Deal’, a provision within The Energy Bill introduced to Parliament on 8 December 2010, aims to establish a framework to enable private firms to offer consumers, businesses and other organisations the ability to improve the energy efficiency of homes, businesses and community spaces at no immediate cost. Costs are later recouped through payments made in instalments on the energy bills.

If plans to assist the better insulation of homes and thereby reduce energy consumption in 3.5 million homes by 2012 succeeds, it is estimated that around 107 million tonnes of carbon dioxide emissions would have been saved from a current (2010) total of 934 million tonnes of carbon dioxide emitted from domestic and industrial premises, transport and commercial and public building in the UK. These incentives, in addition to ‘feed-in’ tariffs where excess generation of heat or electricity is sold to the grid, are expected to create increased demand for solar panels, wind generation and wood-fuelled boilers.

Although providing positive benefits for the environment, the panel sector report that the current drive towards renewable forms of energy has negatively impacted the UK panel industry.

Policy and Initiatives – Carbon Reduction

The Launch of three new initiatives in the UK provide a framework and opportunities for increased private sector investment in woodland creation:

A new Woodland Carbon Code, launched in July 2011 and developed by the Forestry Commission and sector representatives, sets out requirements of voluntary woodland creation projects in the UK wishing to make claims about the carbon they sequester. It provides clarity and transparency to potential investors about just what their money should buy them;

- It sets out clear carbon accounting methodologies
- Projects are scrutinised by an independent certification body
- The Forestry Commission maintain an online register of all UK woodland carbon projects.

At the same time, the Department for Environment, Food and Rural Affairs (Defra) published guidance on how organisations should report greenhouse gas removals and emissions from UK woodland planting where a project meets the requirements of the Woodland Carbon Code. This provides a standard way for companies to report the benefits of their investment in woodland carbon sequestration alongside their emissions and investment in Kyoto compliant carbon offsets.

In August 2011, the UK Carbon Reporting Framework was launched. The framework will act as a matchmaker between carbon reduction projects in the UK and organisations wishing to support such projects. The framework was developed in a partnership between BRE, British Airways, Deloitte and Forum for the Future. The Framework will include a wide range of carbon reduction projects in the UK, and projects will have to use agreed standardised carbon accounting methods. For woodland creation, this will mean meeting the requirements of the Woodland Carbon Code mentioned above. Woodland carbon sequestration is currently one of the only types of project with a developed standard for carbon accounting and the Framework will promote further private sector investment into such projects.

4. Developments in Forest Product Markets Sectors

a) Wood Raw Materials (Softwood)

Removals of timber from UK forests are undertaken by the public sector, under the auspices of the Forestry Commission (in England, Wales and Scotland) and the Forest Service (in Northern Ireland) and by the private sector, as represented by the many private woodland owners and managers.

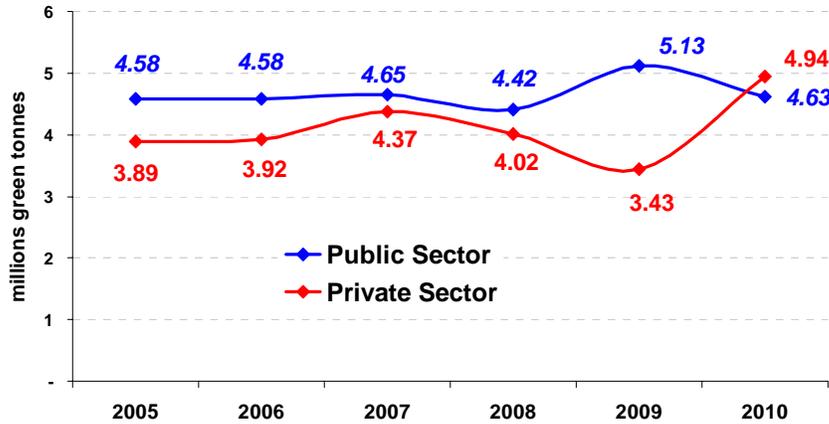
In 2010, following two years of decline, private sector removals of softwood increased by an unprecedented 44%. Greater volumes of softwood were removed from private sector woodlands as prices of standing timber and logs rose rapidly in 2010 and an element of uncertainty existed over the supply of timber from public forests, following the threatened sale of forests managed by the Forestry Commission.

It was estimated that removals from the private sector were around 4.94 million green tonnes, compared to 4.63 million green tonnes extracted from the public estate.

The rise in private sector removals of 44% was accompanied by a fall of 10% in softwood removals from FC/ FS woodlands, resulting in an overall increase of 12%, with all softwood removals totaling 9.57 million green tonnes.

This switch in the source of supply from UK forests is shown in chart 14 below.

Chart 14: Softwood Removals from UK Forests by the Private and Public Sectors, 2006-2010



Source: Forestry Commission

The greater volumes of softwood removed from UK forests were consumed in greater quantities by UK sawmills and panel mills and substantially higher volumes were used for woodfuel.

Sawmill consumption rose by 9% to 5.62 million green tonnes and panel mill consumption rose 21% to 1.38 million green tonnes.

Removals in 2011 are predicted to increase once again, by around 3% over 2010. Should this transpire, softwood removals in 2011 would reach 9.85 million green tonnes, exactly in line with the availability of softwood forecast in the 2005 UK Forecast of Softwood Availability produced by the Forestry Commission.

b) Wood Energy

Consumption of softwood roundwood for woodfuel rose by 62% to an estimated level of 1.1 million green tonnes in 2010.

As reported in last year’s Market Statement, the volume of UK grown softwood delivered to woodfuel markets has increased rapidly since 2007. Rising from an estimated level of 0.2 million green tonnes in 2007, to 0.3 million in 2008, to 0.65 million in 2009, deliveries exceeded the million green tonnes mark in 2010.

These estimates are for woodfuel derived from stemwood and also include wood for making charcoal.

Sawmill products, such as wood chips and sawdust, are supplied for heat generation and recycled wood and wood pellets are being increasingly consumed to supply heat.

c) Certified Forest Products

A measure of the positive development of certification in British forestry is the trend in the number of sawmills reported to be operating without chain of certificates. In 2006, 80 sawmills operated without chain of custody certificates; this fell to 72 in 2007 and fell again in 2008 to 58. In 2009, the number of sawmills operating without chain of custody certificates had fallen to 54 and in 2010, only 40 mills, 33 of which were of the smallest size (producing less than 5,000m³).

Table 3: Chain of Custody Certificates, 2010

	With certificates	Without certificates	Certification status unknown	Total
Sawmills				
< 5,000m ³ sawnwood	8	33	84	125
> 5,000m ³ and < 25,000m ³ sawnwood	16	7	14	37
> 25,000m ³ sawnwood	23	0	4	27
All sawmills	47	40	102	189
Round Fencing Manufacturers	12	16	37	65

The larger sawmills account for the greater part of the volume of sawnwood produced in the UK (sawmills producing >10,000m³ provide 93% of UK produced softwood in 2010, 92% in 2009) and most possess chain of custody certificates. In total, 85% of larger mills have chain of custody certificates, compared to 43% of the medium-sized mills that produce between 5,000m³ and 25,000m³ of softwood annually. The smaller mills, that account for a very small proportion of all production, mostly remain without chain of custody certification with just 6%, or 8 from 125 of such sawmills having certificates.

The trend of increasing certification is shown in table 4.

Table 4: Percentage of Volume Certified, 2003-2010

Year	Private Sector Removals (softwood)	Total removals (softwood)	Saw Consumption (softwood and hardwood)	mills Production (softwood and hardwood)	Round Fencing Manufacturers Consumption (softwood)
2004	74	89	80	63	58
2005	68	85	76	71	53
2006	66	85	81	64	46
2007	76	88	78	65	54
2008	64	83	82	75	62
2009	68	87	83	77	51
2010	72	85	83	78	62

Differences in the percentage of volume certified between years need to be viewed with caution as changes in demand for sawn goods from different markets - particularly from the larger mills - can alter the proportion of production that is certified from year to year. Nevertheless, despite a dip in the proportion of certified removals from the forest in 2008, the trend of certification is upward. By 2010, a record 78% of sawmill production was certified.

d) Consumption of Timber and Panel Products in the UK

Following two years of decline from 2007, the year 2010 witnessed a recovery in the volumes of timber and panel products consumed.

Apparent consumption of the main timber and panel products in 2010 rose 9% to 14.1 million m³, but remained well below the 18 million m³ consumed in 2007.

e) Value-added Forest Products and Engineered Wood Products

Volumes of further processed (value-added) softwood imports consumed in the UK in 2010 bounced back from a weak 2009, An increase of 28% in the volume of further processed goods, such as planed, square-edged and finger-jointed softwood compares to a 1% rise in sawn softwood. A total of 1.5 million m³ of softwood imports were consumed in 2010 compared to 1.2 1.5 million m³ in 2009. Planed whitewood exhibited the greatest increase in 2010, up by 53%.

Data on the volume of further processed goods from UK producers is not available, however, the trends noted in the import sector are believed to be reflected in the domestic production sector also.

Further processed goods, as a proportion of all imported softwood, rose to 29% in 2010, up from 25% in 2009.

Consistent with lower volumes of softwood imported, manufactured (or engineered wood products) are also thought to have increased by volume in 2010.

Increased activity in construction (the largest market for these goods) was higher in 2010 than 2009, indicating that sales of engineered wood products are also likely to have risen in 2010.

The development of modified wood products in 2010 was positive, with new partner agreements signed with suppliers in the UK and these products were beginning to be used in a wide variety of applications, from decking to window frames.

Cross-laminated lumber is another relatively new product that is believed to be making inroads into markets that traditionally use solid wood products.

f) Sawn Softwood

Softwood consumption in the UK in 2010 increased over 2009 by 8.4% to reach a volume of a little over 8.1 million m³.

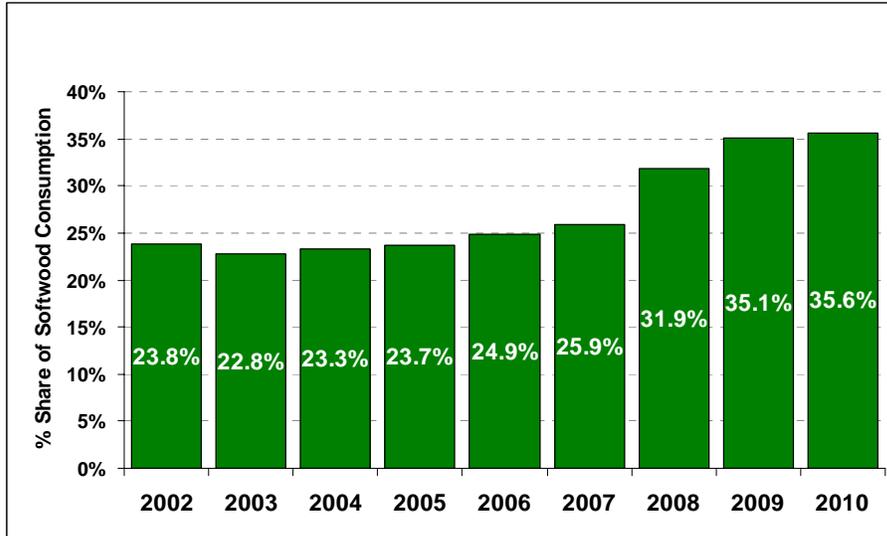
UK production of sawn softwood was 8.7% higher in 2010 which was substantially higher than the revised 1.9% increase in softwood imports in 2009.

A continuing weak £ against the € and other currencies provided UK producers with the opportunity to maintain some of the gains in market share made against imported softwood in 2009, but as demand from construction markets improved in 2010, softwood import volume improved. UK producers increased penetration of fencing and outdoors markets and gained volume at the expense of importers in the pallets and packaging markets. The growth of 8.7% of UK produced sawn softwood compared with the 7.6% growth in imports.

The slightly higher growth rate achieved in 2010 by UK producers has enabled a further small increase in market share by the domestic sector.

The market share of domestically produced softwood from 2002 is shown in chart 15 below.

Chart 15: UK Producers Share of Softwood Consumption

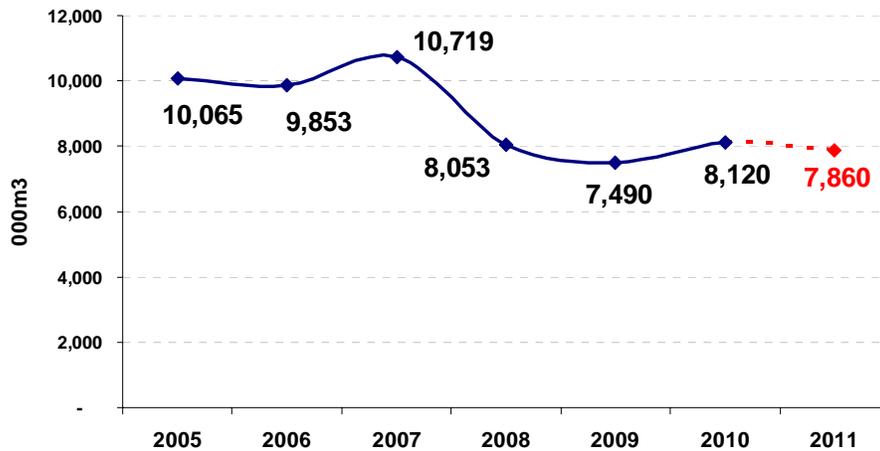


Source: Forestry Commission; Timber Trade Federation; *timbertrends*

The National Softwood Division (NSD) of the Timber Trade Federation produce an estimate each year for the second half and a forecast for the following year. For 2011, the provisional forecast of the NSD predicts that softwood import volume will be 4.83 million m³. This is a decrease over 2010 of 7.7%.

A forecast for UK production for 2010, based on the advice of the Forestry Commission's Expert Group on Timber and Trade Statistics, indicates that output will have increased in 2011 by approximately 3%, to a little over 3.1 million m³. From these forecasts for 2011 and an estimate of softwood exports for 2011, a projection of consumption for softwood in the UK for 2011 can be made. This is given in the chart below.

Chart 16: UK Sawn Softwood Consumption 2005-2010 & Forecast 2011



Source: Forestry Commission; Timber Trade Federation; *timbertrends*

Despite an estimated 3% increase in softwood produced in the UK for 2011, overall consumption is predicted to decline in 2011 as imports are forecast to fall.

g) Sawn Hardwood

Hardwood consumption in the UK increased by nearly 20% in 2010 as imports recovered from the post-recessionary slump. A wide variety of sawn hardwood imports are used for many types of applications, from high quality furniture making to lower value uses, such as packaging. In 2010, increases in many of the different varieties took place. Oak imports from the USA, France and Italy rose, as did a number of tropical species from African and Asian countries and strong growth was also registered for imports of birch, aspen and other species from the Baltic States.

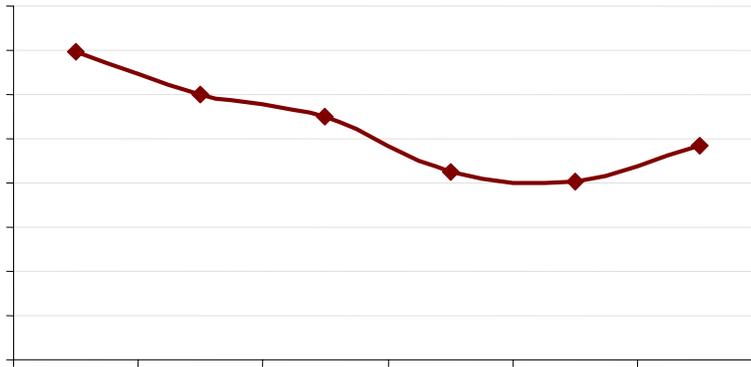
Consequently, sawn hardwood imports increased to 0.47 million m³, a 23% increase over 2009

Export volumes, although relatively small, rose by 21% to 31,000m³ and UK production of sawn hardwood totaled 48,000m³.

The apparent consumption of hardwoods in the UK in 2010 was 0.49 million m³.

The development of hardwood consumption since 2005 is shown in the chart below.

Chart 17: UK Sawn Hardwood Consumption, 2005-2010



Source: Forestry Commission; Timber Trade Federation; *timbertrends*

h) Wood-based Panels

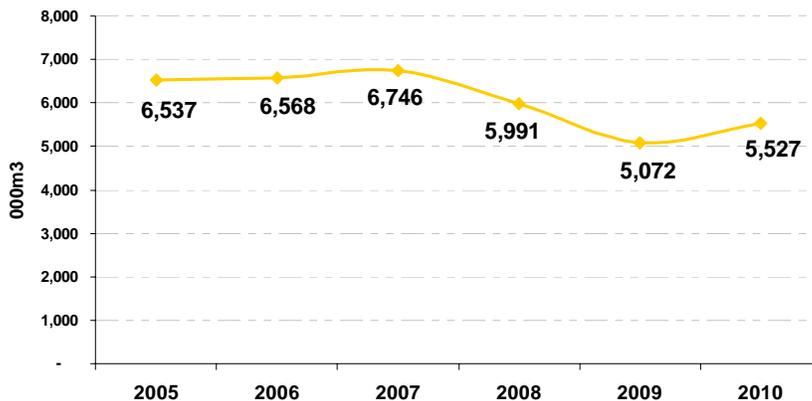
Particleboard, OSB and MDF are both produced in the UK and imported, but plywood and fibreboard are imported.

Volumes of UK produced particleboard, including OSB, rose in 2010 by 9.5% to nearly 2.6 million m³. MDF production in the UK grew by nearly double the percentage rise of particleboard, up 17.6% to reach a volume of 0.78 million m³.

Volumes of imported panel products increased in 2010, by 7.6% to 2.7 million m³.

Volumes of exports and re-exports of panel products were 0.52 million m³ in 2010 which resulted in UK produced panel products accounting for 54% of consumption and imports 46% of UK panel products consumption.

Chart 18: UK Panel Products Consumption, 2005-2010



Source: Forestry Commission; WPIF; Timber Trade Federation; *timbertrends*

For both the UK producers and importers, the improvement in demand in 2010 generated volume growth for the first time in two years. There are many concerns within the panel

sector over the immediate future as poor economic growth, depressed consumer and business spending, the effect of government austerity measures and the perceived unfair competition from the subsidised biomass energy sector are expected to dampen growth prospects for 2011 and 2012.

However, demand for panel products in the first half of 2011 was stronger than many anticipated. Panel imports in total were around 7% higher in the first half of 2011 and estimates from UK producers indicate that the volume of UK produced panels could rise by around 5% in 2011.

i) Pulp and Paper

Consumption of wood pulp in the UK in 2010 was 1.26 million tonnes, a rise of 7.7% on the 2009 total.

The increase in consumption was entirely as a result of a 17.5% increase in imports which rose to over a million tonnes once again to a level of 1.07 million tonnes.

UK pulp production fell substantially in 2010 by around 20% to a level of 218,000 tonnes.

UK consumption of paper and paperboard fell once again in 2010, by a little over a half a million tonnes to 9.91 million tonnes, a decline of 5%.

UK production of paper and board remained virtually unchanged in 2010 at 4.3 million tonnes and exports, although smaller in comparison with imports and production, were higher by 36% at 1.22 million tonnes. The reason behind the 5% decline in paper and board consumption in the UK in 2010 was the approximate 200,000 tonnes fall in imports, down to 6.83 million tonnes, a fall of nearly 3% over 2009.

j) Carbon Markets in the Forest Sector

The Woodland Carbon Code is generating much interest among landowners and investors alike. To date, 13 projects appear in the register and all are awaiting the outcome of their validation exercise.

These projects total 610 hectares and are predicted to sequester 315 thousand tonnes of carbon dioxide equivalent over their lifetime (up to 100 years). The first projects will be certified very soon. At least a proportion of the revenue of each project comes from private sector investment, mainly from companies considering their Corporate and Social Responsibility. As many projects again are likely to appear on the register over the coming weeks.

The work is focused on England but is considered to be relevant for all Great Britain. Further information can be found on the Forestry Commission website: <http://www.forestry.gov.uk/carboncode>

5. Tables

UK Economic Indicators (% unless otherwise indicated)

	2006	2007	2008	2009	2010	2011 (est)
GDP growth¹ (at constant 2006 market prices)	2.9	3.0	0.7	- 4.9	1.3	1.3 ²
Interest Rate (Base Rate at year end)	5.0	5.0	2.0	0.5	0.5	0.5 ²
Consumer Price Index	3.0	2.1	3.1	2.4	3.7	4.5 ²
Unemployment (ILO)	5.5	5.2	6.3	7.8	7.9	8.3 ²
UK Housebuilding Starts (000s)	230.5	216.8	140.5	106.8	130.9	142.4 ³

¹GDP growth is measured on a chained volume basis current year compared to previous year

²HM Treasury, Forecasts for the UK Economy: A Comparison of Independent Forecasts, August 2011

³*timbertrends*