

MARKET STATEMENT 2016

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

The Latvian national economy is tightly integrated into international markets.

As of the end of 2010, the recession stopped in Latvia, and growth has resumed. From 2011 to 2013, the GDP grew by 4.4% per year on average. In 2014, GDP grew by 2.4%, while in 2015 – by 2.7%. The slowdown of growth in the last two years was determined by the trends in the external environment – slower growth in the EU than expected, as well as weakening of the economic situation in Russia. Even though the economy of Latvia has been growing in recent years, GDP is still by almost 5% lower than before the crisis in 2007.

In Q1 2016, the GDP grew by 2.1% compared to the corresponding period of the year before. This year investment volumes dropped significantly in Q1, mainly as the acquisition of the EU structural funds slowed down. A gradual drop in export volumes for four quarters in a row should be mentioned as a negative factor. In 2016, similarly to the previous year, growth rates will mainly be driven by the development of the internal demand. It will be facilitated by wage growth and unemployment reduction. Investments are important for further development of economy. The dynamics of private investments is very moderate, while public sector investments are tightly linked to the cyclic nature of acquisition of the EU structural funds in the programming period.

If there are no new, significant shocks in the external environment, then we will most probably see faster GDP growth in the second half of this year and in 2017. Currently available forecasts on growth of external trade partner countries and the EU funds acquisition cycle plan evidence of that. The experts forecast that, in total, the GDP growth rate might be within 2.8% in 2016.

Since 2010, the exports of Latvian goods and services have grown very quickly, and it is the main drive of economic development. Currently, export volumes exceed the pre-crisis level by more than 25%. However, in recent years, the low demand in external markets has affected export dynamics, and it has become more moderate. In 2015, export volumes grew by 1.4%, while in the first quarter of 2016 exports dropped by 1.9 per cent.

Economic problems in Russia have affected the Latvian export opportunities. In 2015, Latvian exports to Russia reduced by 24% (at actual prices), of which 16% were related to the import embargo imposed by Russia and 84% – to the drop in exports of other goods to Russia due to weak demand. At the same time, exports of goods to EU countries increased by 1.5% (the biggest export increases were to the Netherlands, Lithuania, Denmark, France, the Czech Republic, etc.), and to third countries (mainly Algeria, Saudi Arabia, the United Arab Emirates, Turkey, the United States, etc.) – by 23.5% meaning that Latvian businessmen are gradually entering new sales markets.

During the crisis, with the domestic demand decreasing, import volumes fell sharply. With the economic activities in the internal market increasing, the demand for imports is growing. However, since mid-2012, import dynamics have become more moderate. In 2015, imports grew by only 1.8%, while in the first quarter of 2016 – by 5 per cent.

The current account deficit in 2015 was 1.2% of GDP. It should be noted that the current account deficit has remained low in Latvia since 2010, which gives proof of the external balance of the Latvian economy.

An increase in employment and a gradual increase in wage contribute to growth in private consumption. In 2015, private consumption grew by 3.3%, while in the first quarter of

2016 – by 3.7%. Growth rates of private consumption are also facilitated by a low inflation in addition to the above mentioned factors.

In recent years, the weak demand in export markets has been hindering the growth of the manufacturing industry. In 2015, output volumes of the manufacturing were by 4.3% higher than in 2014. Wood-processing, manufacture of basic metals, production of computers, electrical and optical equipment, as well as machinery and equipment manufacturing had the greatest positive contribution to the growth of the manufacturing. In its turn, output volumes in the food industry were much lower than in 2014. Russia-European Union economic relations had a significant impact on the development of the industry. Production volumes also decreased in light industry, production of other non-metallic mineral products and in chemical industry.

A moderate inflation can be observed in Latvia in recent years. The average inflation in 2015 was 0.2%. A very moderate increase in prices continues also in 2016, largely influenced by global oil and food price dynamics. In May 2016, the annual average inflation was negative – -0.2%. In the second half of 2016, inflation will still be influenced by global oil and food price dynamics. After a considerable drop in prices in 2015 and at the beginning of this year, since February global prices show an increase; however it was influenced by different short-term factors and their further rapid increase is not anticipated. Total expenses will remain low due to the price drop of the previous period, which will keep prices in the majority of consumer goods categories at a low level, therefore, generally, the annual average inflation in 2016 might be close to zero.

Increasing economic activity has a positive impact on the labour market situation – high unemployment rate caused by the crisis is falling, and the employment rate is rising. At the same time, the improvement of the situation is less felt by some population groups, especially people with low level of education and qualification, older people, as well as young people.

It is expected that the situation in the labour market will continue to improve, but more slowly than in the previous years. It will be affected by a higher base effect in the labour market, on the one hand, and negative demographic trends, on the other hand. The number of the employed is expected to increase by 0.8% in 2016. In the meantime, the unemployment rate might drop to 9.4% on average in 2016.

Further development of the Latvian economy will still be closely linked to export opportunities, therefore the main risk for growth of Latvia is related to the global economic development.

Further development of the EU's common economic space, as well as improvement of the geopolitical situation caused by the Ukrainian crisis are of particular importance. The economic benefits of Latvia in the medium term will be mostly based on the macroeconomic stability achieved, resulting in improved credit ratings of Latvia, as well as on the efficiency of the planned support programs of structural funds and improvements in the business environment.

During the crisis, with the costs going down, the competitiveness of the Latvian producers improved. This facilitated the development of the manufacturing. From 2010 to late 2012, the output of the industry experienced a rapid increase, and the manufacturing contributed significantly to the total development of the economy.

Reduction of the competitive advantages acquired during the crisis, as well as the weak demand in export markets have slowed down the growth of the manufacturing. At the same time, development trends in the sub-sectors of manufacturing differed considerably. In 2014, total output volumes of the manufacturing were by 0.3% lower than a year before. They were affected by trends in the foreign markets – slower than expected economic growth in the EU, as well as the weak economic situation in Russia.

The manufacturing output grew by 4.3% in 2015. Wood processing, production of basic metals, production of computers, electrical and optical equipment, as well as production of

machinery and equipment had the greatest positive contribution to the growth of the manufacturing.

Production volumes were growing steadily in the largest industrial sector – wood processing in 2015 (by 7.1%).

Data source: Report on Economic Development of Latvia (Ministry of Economics Republic of Latvia).

2. POLICY MEASURES TAKEN IN LATVIA

Policy Baselines for Forest and Related Sector Development 2014-2020 were accepted by the government on September 2015. The Guidelines are a mid-term policy document, in which the strategic (development policy) objectives for the development of the forest and related sectors, problems hindering the achievement of such objectives, the development policy guiding principles and the results of the policy, directions of action for achievement of the policy objectives are defined.

Objectives of the Forest and Related Sector Development Policy are: 1. Management of Latvian Forests is Sustainable and Internationally Recognized; 2. Production of the Latvian Forest Sector is Competitive with a High Added Value and Complies with the Needs of the Client, 3. Educational and Scientific Potential and the Level of Skills of the Human Resources are Adequate for the Achievement of the Strategic Objectives of the Forest and Related Sectors.

3. MARKET DRIVERS

Local market of forest products is positively influenced by increase of solid wood biomass consumption in wood energy sector and wood pellet production industry. In 2015 scale heating and CHP plants increased wood consumption from 1,657 million m³ (2014) to 1,786 million m³ (2015). Wood pellets production also increased from 1,381 to 1,577 million tons in Latvia.

With growing demand trend stable and sufficient wood biomass supply is very important. In this area some additional market requirements, called Sustainable Biomass Partners (SBP) have appeared on the market. In 2015/2016 Sustainable Biomass Partners (SBP) certification requirement came into force for industrial pellet suppliers. Those additional requirements, requested from 2017, will negatively impact sawdust traditional suppliers. In general, SBP will not change availability of wood biomass. According to latest available information, further increase in pellet production on local district heating capacities are forecasted in 2017/2018.

4. DEVELOPMENT IN FOREST PRODUCT MARKET SECTORS

a) Wood raw materials

Wood biomass supply for Latvian wood industry in 2015 was then sufficient, Latvia still is exporting significant pulpwood amount. In the same time, local demand for low quality logs is increasing in Latvia, partly replacing roundwood export. In 2016 (6 months), softwood panels industry increased production and export by 20% and plywood export – by 7%.

In 2015, Latvia exported 2,8 million m³ of roundwood (-22%), mainly to Nordic countries and Germany. During the first 7 months of 2016 export decreased by 19%, due to

lower consumption of pulp&paper industries. Negative trend affected by situation in softwood market. Export of hardwood logs remains in previous levels, with growing share of export to China.

b) Wood energy

Wood biomass demand was one of the main forest product market drivers. Increase in woody biomass consumption noticed both on local and export markets. Local market consumption of woody biomass products continue to gain momentum, powered by fossil district heating systems (DH) alternation to wood chips and green electricity market development with new cogeneration (CHP) capacities starting operations. Local consumption of wood chips in 2014 expanded by 16% and in 2015 – by 7%. In 2016 wood biomass consumption is forecasted to be stable, with forecast to increase in 2017.

For export markets positive trend is a pellet production segment. In 2015 Latvia extended pellets deliveries by 20%, reached new record level of 1,5 million tones and has become 3rd leading EU supplier (after Germany and Sweden). According to annual biomass market research, made by “Forest and Wood Products Research and Development Institute”, pellet production will continue a moderate expanding in 2016/2017. According to preliminary data for 2016 (6 months) pellet export increased by 18%.

c) Certified forest products

All forests managed by JSC Latvian State Forests („Latvijas valsts meži”) are certified in accordance with the internationally approved FSC® Principles and Criteria. Since 2011 JSC "Latvian State Forests" are also certified according to the PEFC scheme. PEFC certificates have been granted to all 8 of LVM forest management regions. The PEFC forest management certification was performed by leading certification bodies within Latvia namely: BM Trada Latvija and SIA "SGS Latvija Ltd.". Certified areas in private forests are increasing, but with slow pace. SBP requirements for wood biomass are impacting energy wood biomass suppliers for pellet production, as more detailed information about forests cutting areas is requested.

d) Value added products

Share of value added and semi-finished wood product export is stable. Intensive changes are noticed in prefabricated wood (panel) / modular house production / CLT industries. Production capacities are focused on growing demand in North European countries. Prefabricated house production expansion also is making positive influence for carpentry industry, including wood door/window production and glue-laminated timber production. Investments were made in large scale structural wood, namely cross laminated timber (CLT) and glue laminated timber (GLT) production units.

e), f) Sawn softwood and hardwood

Export of softwood sawn-wood in 2015 increased by 7%, volume of sawn-timber exported was 2.41 million m³. In 2016 (6 months) export of softwood sawn-timber increased by +4%. Sales to traditional EU markets increased by 15%, sales to Asian markets extended by 7%. Markets in North Africa and Middle East countries now are problematic, and export to this

region decreased by 28%. To keep the production in high rates companies increased share of imported logs. For 2016 forecasted sawn wood export volumes on a level 2,6 million m³.

Export of hardwood sawn-wood in 2015 increased by 8% to level of 0,6 million m³, but for 2016 foreign trade statistics show negative trend (-18%). According to market players information, hardwood sawn wood market (mainly packaging wood grades) now are not in the best shape due lower EU-CIS trading and Brexit results..

g) Wood-based panels

Birch plywood production and softwood wood-panel production is keeping on high levels. In 2015 export of plywood remained at rate of 0,282 million m³ (+14%) and softwood panels increased by 9% (0,855 million m³). For 2016 forecast is also positive - OSB and particleboard export volume change is positive.

4. TABLES

a. Key Economic Development Indicators in Latvia

	2010	2011	2012	2013	2014	2015		2016f	2017f
Gross domestic product (at current prices, billion euro)	17.9	20.2	21.8	22.8	23.6	24.4		25.0	26.0
	increase compared to the previous year, per cent								
Gross Domestic Product	-3.8	6.2	4.0	3.0	2.4	2.7		2.8	3.5
Private consumption	2.8	3.0	3.2	5.1	2.3	3.3		3.4	3.4
Public consumption	-8.1	3.0	0.3	1.6	4.9	3.1		2.3	3.3
Gross fixed capital formation	-19.8	24.1	14.4	-6.0	0.5	2.7		-6.5	5.0
Exports	13.4	12.0	9.8	1.1	3.1	1.4		-1.4	2.8
Imports	12.4	22.0	5.4	-0.2	0.8	1.8		1.4	3.1
Consumption prices	-1.1	4.4	2.3	0.0	0.6	0.2		0.0	1.2
	as a percentage in relation to the GDP, unless indicated otherwise								
General government sector balance	-8.1	-3.4	-0.8	-0.9	-1.6	-1.3		-1.0	-1.0
General government debt	47.5	42.8	41.4	39.1	40.8	36.4		40.0	38.0
Export-import balance	-1.5	-5.0	-4.5	-3.2	-2.2	-1.4		-0.8	-1.0
Changes to the number of the employed (15-74 years of age, % compared to the previous year)	-6.4	1.3	1.6	2.1	-1.0*	1.3		0.8	0.9
Employment rate	52.0	54.0	56.1	58.2	59.1	60.8		62.1	63.4
Unemployment rate (job seekers, % of the economically active population, 15-74 years of age)	19.5	16.2	15.0	11.9	10.8	9.9		9.4	8.6

f – forecast

Data source: Ministry of Economics of Latvia

b. Forest Products Production and Trade in 2015-2017

Product Code	Product	Unit	Historical data	Estimate	Forecast
			2015	2016	2017
1.2.1.C	SAWLOGS AND VENEER LOGS, CONIFEROUS				
	Removals	1000 m ³	52 12	53 00	52 00
	Imports	1000 m ³	9 94	9 90	9 90
	Exports	1000 m ³	2 94	3 00	3 00
	Apparent consumption	1000 m ³	59 12	59 90	58 90
1.2.1.NC	SAWLOGS AND VENEER LOGS, NON-CONIFEROUS				
	Removals	1000 m ³	18 21	19 00	20 00
	Imports	1000 m ³	34	53	50
	Exports	1000 m ³	3 57	3 87	3 80
	Apparent consumption	1000 m ³	14 98	15 65	16 70
1.2.1.NC.T	of which, tropical logs				
	Imports	1000 m ³	0	0	0
	Exports	1000 m ³	0	0	0
	Net Trade	1000 m ³	0	0	0
1.2.2.C	PULPWOOD (ROUND AND SPLIT), CONIFEROUS				
	Removals	1000 m ³	21 03	21 00	21 00
	Imports	1000 m ³	2 97	3 09	3 00
	Exports	1000 m ³	12 00	8 98	9 00
	Apparent consumption	1000 m ³	12 00	15 11	15 00
1.2.2.NC	PULPWOOD (ROUND AND SPLIT), NON-CONIFEROUS				
	Removals	1000 m ³	9 17	9 00	9 00
	Imports	1000 m ³	2 34	2 73	2 50
	Exports	1000 m ³	11 51	8 23	8 00
	Apparent consumption	1000 m ³	0	3 50	3 50
3	WOOD CHIPS, PARTICLES AND RESIDUES				
	Domestic supply	1000 m ³	40 62	40 00	40 00
	Imports	1000 m ³	2 84	2 88	2 80
	Exports	1000 m ³	13 30	16 07	16 00
	Apparent consumption	1000 m ³	30 15	26 81	26 80

1.2.3.C	OTHER INDUSTRIAL ROUNDWOOD, CONIFEROUS				
	Removals	1000 m ³	731	7 31	7 31
1.2.3.NC	OTHER INDUSTRIAL ROUNDWOOD, NON-CONIFEROUS				
	Removals	1000 m ³	311	3 11	3 11
1.1.C	WOOD FUEL, CONIFEROUS				
	Removals	1000 m ³	2 00	2 00	2 00
1.1.NC	WOOD FUEL, NON-CONIFEROUS				
	Removals	1000 m ³	10 00	10 00	10 00
5.C	SAWNWOOD, CONIFEROUS				
	Production	1000 m ³	28 09	28 65	28 00
	Imports	1000 m ³	5 66	7 40	7 00
	Exports	1000 m ³	24 47	26 52	26 00
	Apparent consumption	1000 m ³	9 28	9 53	9 00
5.NC	SAWNWOOD, NON-CONIFEROUS				
	Production	1000 m ³	6 70	6 50	6 50
	Imports	1000 m ³	25	26	26
	Exports	1000 m ³	5 57	4 72	5 00
	Apparent consumption	1000 m ³	1 39	2 04	1 76
5.NC.T	of which, tropical sawnwood				
	Production	1000 m ³	0	0	0
	Imports	1000 m ³	0	0	0
	Exports	1000 m ³	0	0	0
	Apparent consumption	1000 m ³	0	0	0
6.1	VENEER SHEETS				
	Production	1000 m ³	0	0	0
	Imports	1000 m ³	1 29	1 37	1 35
	Exports	1000 m ³	3	4	4
	Apparent consumption	1000 m ³	1 26	1 33	1 31
6.1.NC.T	of which, tropical veneer sheets				
	Production	1000 m ³	0	0	0
	Imports	1000 m ³	0	0	0
	Exports	1000 m ³	0	0	0
	Apparent consumption	1000 m ³	0	0	0
6.2	PLYWOOD				
	Production	1000 m ³	2 80	2 95	3 20
	Imports	1000 m ³	75	90	80
	Exports	1000 m ³	2 86	3 12	3 00
	Apparent consumption	1000 m ³	69	73	1 00
6.2.NC.T	of which, tropical plywood				
	Production	1000 m ³	0	0	0
	Imports	1000 m ³	4	1	1
	Exports	1000 m ³	0	0	0
	Apparent consumption	1000 m ³	0	1	1
6.3	PARTICLE BOARD (including OSB)				

	Production	1000 m ³	9 91	9 90	9 90
	Imports	1000 m ³	49	1 04	1 00
	Exports	1000 m ³	8 56	9 27	9 30
	Apparent consumption	1000 m ³	1 84	1 66	1 60
6.3.1	of which, OSB				
	Production	1000 m ³	5 98	6 00	6 00
	Imports	1000 m ³	8	60	60
	Exports	1000 m ³	5 37	5 52	5 60
	Apparent consumption	1000 m ³	69	1 08	1 00
6.4	FIBREBOARD				
	Production	1000 m ³	0	0	0
	Imports	1000 m ³	35	43	40
	Exports	1000 m ³	16	16	16
	Apparent consumption	1000 m ³	19	27	24
6.4.1	Hardboard				
	Production	1000 m ³	0	0	0
	Imports	1000 m ³	17	13	13
	Exports	1000 m ³	11	0	0
	Apparent consumption	1000 m ³	1	12	13
6.4.2	MDF/HDF (Medium density/high density)				
	Production	1000 m ³	0	0	0
	Imports	1000 m ³	13	18	15
	Exports	1000 m ³	1	4	2
	Apparent consumption	1000 m ³	12	14	13
6.4.3	Other fibreboard				
	Production	1000 m ³	0	0	0
	Imports	1000 m ³	6	13	13
	Exports	1000 m ³	5	12	12
	Apparent consumption	1000 m ³	6	1	1
7	WOOD PULP				
	Production	1000 m.t.	0	0	0
	Imports	1000 m.t.	1	0	0
	Exports	1000 m.t.	0	0	0
	Apparent consumption	1000 m.t.	1	0	0
10	PAPER & PAPERBOARD				
	Production	1000 m.t.	45	45	45
	Imports	1000 m.t.	1 81	1 80	1 80
	Exports	1000 m.t.	33	30	30
	Apparent consumption	1000 m.t.	1 93	1 95	1 95
4.1	WOOD PELLETS				
	Production	1000 m.t.	16 00	18 00	15 00
	Imports	1000 m.t.	1 29	1 30	1 30
	Exports	1000 m.t.	16 05	16 00	16 00
	Apparent consumption	1000 m.t.	1 24	3 30	30

Data source: Ministry of Agriculture of Latvia