

## UK TIMBER MARKET STATEMENT – AUGUST 2000

### 1. General Economic Trends Affecting the Forest and Forestry Industries Sector

#### 1.1 Economic Growth

GDP growth in 1999 was 2%. In the second quarter of 2000 GDP grew by 0.9% and was 3.1% higher than a year earlier marking the continuation of the strong expansion that began in the first half of 1999. The strong growth was broad-based across the major sectors of the economy; output of the production industries expanded after falling the previous quarter, while services grew at a stronger rate than in the previous quarter.

GDP is expected to be 2<sup>3</sup>/<sub>4</sub> -3<sup>1</sup>/<sub>4</sub>% in 2000, before moving to 2<sup>1</sup>/<sub>4</sub> -2<sup>3</sup>/<sub>4</sub>% in 2001.

#### 1.2 Labour Market

Labour market conditions remain buoyant with more people than ever before in work. The ILO unemployment rate has fallen with the rate at 5.5%, its lowest level since the series began in 1984. Despite continued falls in unemployment, indicating a further tightening in the labour market, average earnings growth has recently been falling and now stands at 4.1% for the second quarter of 2000.

#### 1.3 Prices

Underlying inflation (i.e. excluding mortgage interest payments) stands at 2.2% in July 2000, slightly under the Government's 2.5% target. The inclusion of mortgage interest payments increases the rate to 3.3% over the same period.

Due to increases in the price of crude oil, fuel prices have increased by 14% in the last twelve months. The UK tax on petrol and diesel remains the highest in Europe, as do the prices paid at the pump. In remote areas petrol prices are 4.4% higher than the average for the UK. Tax accounts for 80% of the price of fuel. This is partly due to the tax escalator which was applied to fuel for environmental reasons at a rate of 5% above inflation every year. The escalator has, for the time-being, been dropped. Transporting timber from rural areas to road and sea transport is currently limited, but is being developed.

#### 1.4 Interest Rates

The Bank of England is solely responsible for interest rates and it has been made clear that interest rates will be set to keep inflation on track to meet the 2.5% target. In August 2000 the rate was 6%, unchanged from the previous month, but it is not yet clear whether they have peaked or not.

## 1.5 Public Expenditure

The Public Sector Net Borrowing requirement, excluding windfall taxes, in 1999/00 was a surplus of £17.3bn or around 1% of GDP and is estimated to be in surplus by £6bn in 2000/01. The current budget moved into a surplus of £19.9bn in 1999/00 and has been estimated to be £14bn for the fiscal year 2000/01.

## 1.6 Exchange Rates

Sterling has remained strong against international currencies, especially the Euro, reaching a peak in May 2000, whereas it has fallen slightly against the dollar. In June 2000, the Sterling Exchange Index fell to 104.6 from 108.5 in May 2000 and was 0.1% lower than a year earlier.

## 1.7 Housing Starts and Completions

In terms of housing starts, 176,500 new dwellings were started in 1999, 0.6% down on 1998 due to a fall in social landlords. The first quarter in 2000 has seen an increase of 1.8% on the previous quarter and an increase of 5.0% on the first quarter in 1999.

There were 167,400 housing completions in 1999 representing a 1.4% reduction on 1998, again due to a fall in social landlords. However the first quarter in 2000 is up by 1.6% on the previous quarter and up 5.6% on the first quarter in 1999.

In July 2000 the number of mortgage approvals totalled only 93,000, the lowest since February 1999 and combined with stabilising house prices suggests a slowdown in the housing market.

## 1.8 Manufacturing Output

Exports and manufacturing recovered strongly in 2000 with manufacturing output up 0.4% in the three months to June and 1.8% on a year earlier. Productivity was up by around 4.5%. Unit wage costs were 0.2% lower than in the previous three months and unchanged on a year earlier.

## 1.9 Investment

Gross fixed capital formation (investment) fell 1.1% in the first quarter of 2000, the first fall since 1994 and was only 1.7% higher than a year ago. Business investment fell by 0.7% in the first quarter of 2000, but was up 2.0% on a year earlier. As a share of GDP it was pushed to a record high of 14.5% in 1999. Manufacturing investment rose by 5.3% in the first quarter of 2000 and was up 3.2% on a year earlier. However, this strong recovery in manufacturing investment is unlikely to be maintained with manufacturers' confidence having fallen over the first half of the year due to the weakness of the euro.

## **United Kingdom Market Developments in 2000 and Prospects for 2001**

### **General**

1. The market for timber and timber products in the UK remains difficult, with global market effects compounded by the strength of Sterling. Even where demand is good the timber prices remain stubbornly low, though they may have stopped falling. During this difficult period there has been considerable investment by the industry in order to improve product and competitiveness - a sign of confidence in the longer term.

### **Pulp and paper**

2. Paper and Paper board production and demand for the UK mills have been in line with mainland European demand, although the weakness of the Euro to Sterling continues to suppress UK sales prices and profit margins. In the first half of the year, the demand for newsprint rose 5% in Europe and about 1% in the United States. The growth in demand for Super-called paper was 9% in Europe and roughly 17% in the United States. Demand for Lightweight-coated paper rose 12% in Europe and around 7% in the United States.

3. Despite the buoyant market, prices in Europe for newsprint and Super-called paper are forecast to remain at the present low levels until the end of the year. The sales prices of Lightweight-coated paper in Europe started to rise July. In the United States there was an upward trend in the prices of magazine papers in the second quarter. However these and forecast price rises will not compensate for the 54.3% increase in chemical pulp prices since March 1999.

4. Global pulp and paper demand has been strong and this is forecast to continue to remain strong for the rest of this year and into 2001. The price of long-fibre chemical pulp continued to rise and reached USD 710 per tonne in July.

### **Roundwood including pulpwood**

5. Wood supply to softwood pulp mills - as sawmill chips and roundwood - has been in balance or in excess of production for all mills during recent months. This has resulted in some mills reducing intake or closing gates for 2-3 weeks during the summer sawmill holiday period in an attempt to reduce high stock levels.

6. Prices for conifer roundwood have reduced further, particularly for particleboard, resulting in curtailment of certain forest operations, particularly early thinnings which are no longer economically viable. The sawmill co-products sector has experienced further price reductions from one major processor due to a reduction in production of particleboard. This has had an adverse impact upon many in the sawmilling sector. Similarly, the increasing use of recycled fibre by some processors continues to displace virgin fibre. There has been better news for producers of hardwood pulpwood, with an increase in consumption of virgin fibre requiring extra supplies of hardwood roundwood.

7. The UK roundwood market has yet to experience any significant impact by the windblow in Europe. However it is likely that cheap roundwood on the Continent will lead to very competitively priced square edged timber and panel production being exported to the UK.

### **Softwood (sawnwood and logs)**

8. A review of conditions within the UK sawn softwood sector presents a varied picture, largely dependent upon the particular products being considered.

9. Within the construction sector, whilst demand for sawn timber is reported to be good, price competition from imported softwood, from Sweden and the Baltic States (especially Latvia and Estonia), is fierce although prices appear to have stabilised. Customers are also becoming increasingly discerning. Price, availability and quality of service remain the key factors in achieving sales.

10. Within the fencing and timber garden products sector conditions appear to be mixed, although there has been the usual seasonal upturn through the Spring and Summer. Demand for timber decking does not appear to have lived up to some expectations and here too, inroads have been made by imported decking.

11. The pallet sector continues to face extremely difficult trading conditions as they struggle to compete with low priced imports, substitution by other materials, and increased recycling of pallets.

12. The softwood sawmilling industry continues to minimise its operating costs and to invest to further improve efficiency. Despite some producers going out of business a new mill is expected to open in South Scotland later in 2000, strategically placed to exploit the rapidly rising timber harvest from forests in that area.

13. It remains extremely difficult to predict prospects for the remaining months of 2000 in the softwood sector with any degree of certainty. UK producers are collaborating with the Nordic importers in a promotional campaign to increase the market share for softwood sawn timber in the UK compared with competing materials. The campaign will be launched in Autumn 2000.

### **Hardwood (sawnwood and logs)**

14. The adage 'quality sells', is particularly appropriate to the UK hardwood industry at present, whether one is referring to either round or sawn hardwood.

15. Whilst some merchants and sawmillers have sourced material from the Continent to maintain continuity of supply and consistent quality, demand for good quality UK grown hardwood continues to be very healthy. Interest in the pale coloured hardwoods continues, with Ash retaining its popularity for furniture, trim and shop fitting.

16. For the most part there has been a reduction in activity since the already low level of 1999, with nothing to encourage marketing by private owners. Demand for sawnwood remains steady but unspectacular and few log parcels are being offered for sale. A very undesirable trend is that sawmills are becoming more reliant on the Forestry Commission for hardwood timber than from the much larger resource in the private sector. A consequence could be that smaller local sawmills, concerned that the timber they need will not be made available by growers, might begin to rely excessively on imports or purchase ready sawn from other larger UK producers. While the current situation may be a historic low point in hardwood log prices, industry observers have pointed out that private growers withdrawing from the market are unlikely to help improve the situation. The problem of how to utilise lower quality hardwood, in an economically viable way remains a problem to be resolved and it undoubtedly represents a significant challenge.

17. Because there are many other opportunities for employment in the hardwood growing areas in the south of England reliable and competent harvesting contractors are becoming a scarce resource. Most of the hardwood volume is produced motor manually. The drift away from forest work has been exacerbated by the availability of work in Europe, particularly in France where business won through travelling to help harvest the windblow could also lead on to long term employment.

18. Prospects for the second half of the year and 2001 are uncertain but good demand in the quality hardwood sector should bring some comfort to private growers in the South despite the French windblow. If Sterling remains at its current level demand should remain stable into 2001!

### **Wood-based panels (particleboard including OSB, fibreboard including MDF, plywood) and engineered wood products**

19. Conditions within the market for wood based panel products in the UK have remained largely unchanged over the past six months or so. The market remains extremely difficult, both in terms of price and volume. However, order levels are reported to be good in this sector, with prospects looking relatively bright, although there is recognition that the market remains volatile. The impact of the continued strength of Sterling remains a problem for UK producers for whom attempts to increase domestic sales and to develop export markets are increasingly difficult.

20. The market for engineered wood products in the UK has been increasing, but sawn softwood producers have begun to react to potential loss of traditional markets through improved drying, preparation and marketing of product for specific applications.

21. There remains little optimism within the UK sector for the remaining months of this year. Recent capacity increases for particleboard and MDF have been made against a background of high capacity in Europe.

## **Certified forest products**

22. Forest certification in the UK has taken a big step forward with the certification of all woodland owned by the State forest services in Great Britain and Northern Ireland to the UK Woodland Assurance Scheme Standard. Large areas of private sector woodland are also now certified or in the process of certification. A number of sawmilling and wood-processing companies have achieved or are going through the process of FSC certification for Chain of Custody.

23. The UK forest products industries have produced an Industry Standard Code of Practice for wood chain of custody for sawmilling and sawmilling co-products from virgin wood, recycled wood for use in panelboards, woodpanel boards from virgin and/or recycled timber, and for assembled products of these materials. It gives the criteria and organisational requirements for the process control, materials assessment and percentage claims documentation for labelling purposes, and is intended to complement to any recognised forest certification scheme or forest territory which, while not participating in such a scheme, is not classed as a controversial source.

24. The market requirement for certified material continues to develop and in some instances softwood sawmills and merchants are reported to be offering a modest premium to stimulate supply.

25. In the market place the FSC is still the only label of its type available in the UK. However there is considerable interest among growers and some processors in PEFC and a UK governing body has now been established and is expected to apply fairly soon for PEFC membership.