

## MARKET STATEMENT 2014

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

**Since the end of 2009, the economic recession in Latvia has stopped and growth has resumed.** In 2011 and 2012, the GDP has increased by more than 5%, but in 2013 – by 4.1%. The growth continues also in 2014. In the 1st quarter of 2014, the GDP increased by 2.8%, compared to the respective period of the previous year. Although the economy of Latvia has been growing in the recent years, the GDP is still by 9% lower than before the crisis – at the end of 2007.

**Exports of Latvian goods and services have been growing fast since 2010 and have become the driver of the economy.** Export volumes have already exceeded the pre-crisis level by 20%. However, the low demand on external markets has affected the increase in exports and it has become moderate. In 2013, export volumes were by just 1% higher than a year ago, but in the 1st quarter of 2014 by 2.3%, compared to the respective period of 2013. In 2013, the overall growth of exports of goods was positively influenced mainly by the increase in export volumes of machinery production, wood and timber products, as well as by agriculture and food products.

Further growth opportunities of exports will be affected not only by changes in external demand but also competitiveness of Latvian producers. It should be taken into account that the improvement of Latvian competitiveness so far has been achieved mainly due to the cuts of labour costs, however, further improvement of competitiveness will depend on the ability to raise productivity.

During the crisis, import volumes shrank rapidly along with the dropping domestic demand. Recently, the gradually increasing economic activities on the domestic market have caused a gradual increase in demand for imports as well. However, in 2013, import volumes decreased by 1.7%. Furthermore, in the 1st quarter of 2014, compared to the 1st quarter of 2013, imports have dropped by 1.7%. It has been mainly due to the decrease in certain product groups like mineral products and transport vehicles.

In 2013, external trade balance of goods and services has been at 1.9% of GDP, i.e. slightly lower than a year ago. The improving export-import balance has a positive influence on the current account of payment balance. The current account deficit in 2013 has been at 0.8% of the GDP. **It should be noted that Latvia has showed a low current account deficit since 2010, thus proving external balance of Latvian economy.**

**Positive tendencies are observed also in the domestic market.** An increase in employment and a gradual rise in wages foster an increase in private consumption. In 2013, private consumption has been by 5.4% higher than in the corresponding period a year ago. However, in the 1st quarter of 2014, compared to the 4th quarter of 2013, private consumption increased at a slower pace – only by 0.2% (according to seasonally adjusted data) and it was by 2.1% higher than a year ago even despite the rapid growth in salaries during this period (by 7.7%). Private consumption growth in the 1st quarter of 2014 was influenced by the transition to the euro currency, thus, according to the latest data on retail sale, it started to grow faster.

The improving budget situation fosters an increase in public consumption. In 2013, public consumption was by 3.6% higher than in 2012.

Investments in the Latvian national economy are increasing since the end of 2010, however, the dynamics slowed down over the recent years. In 2011, investment volumes

were by 27.9% higher than in 2010, while in 2012, the increase was considerably more moderate – 8.7%. While in 2013, investments in the Latvian national economy were by 4.3% lower than a year ago and constituted 21.1% of GDP. The decrease in investments in 2013 was related to trends in specific sectors of the manufacturing industry, such as wood processing and metal processing, as well as the basis effect – completion of large investment projects launched in the energy sector in 2012. In the 1st quarter of 2014, the investment amount in the Latvian national economy was by 2.2% higher than a year ago.

The low level of bank lending is still one of the factors hindering investments. It should be noted that the state plays a major role in the investment process. Under weak lending circumstances, the state provides a significant support for private investments through the EU structural funds co-financing.

**Wood processing is one of the largest manufacturing sectors, and it constitutes 23% of the total output and provides nearly 1/5 of all jobs in manufacturing.** About 3/4 of the total production in the sector are exported, and the EU-15 countries are the largest export market.

Wood processing was one of the first sectors to resume growth after the huge decrease in manufacturing.

In late 2012 and in the first half of 2013, there was a weak demand in the largest trade partner countries. It was observed also in the wood processing output indicators. In the 1st half of 2013, the production volumes were behind the level of the corresponding period of the previous year. However, the situation in the sector tended to improve gradually in the rest of the year, and thus the production volumes in 2013 increased by 2.7%. In the four months of 2014, production volumes in the wood processing industry were by 7% higher than a year ago.

The significant increase in the turnover of the sector over the past few years was based on the increase in producer prices. In 2013, the turnover increased by 7.2%. Sales volumes in the domestic market and exports increased at a similar pace. In the four months of 2014, the turnover was by 10.6% higher than a year ago. Apart from the stable increase in exports, the growth of the turnover was fostered also by the increase in revenues from products sold in the domestic market.

Comparing to the increase in production volumes, the number of jobs in the industry growth at a slower pace – in 2013, it increased only by 2 per cent.

**Before the crisis, paper production and publishing industry was focused on the domestic market.** During the crisis, the improved competitiveness and the weak domestic demand became stimuli for re-focusing of the industry to foreign markets. Over the past few years, export opportunities shall be considered the grounds for the industry growth. In 2013, nearly 60% of the production manufactured was exported.

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

## 2. POLICY MEASURES TAKEN IN LATVIA

Current positive development of forest industry products consumption in Latvia is mainly based on decisions in renewable energy sources (RES) politics, taken into force in years 2007-2011.

During the last 18 months there were no major changes in RES utilization politics, but there were minor changes in taxation for RES projects. According to new rules, approved on 6th November 2013, from the 1st January of 2014 new tax was introduced, named “subsidized energy tax” (SET). Additional taxation for CHP plants introduced for

three years and scheduled to be cancelled in 2017, and will be paid from income, received for electricity sold to public electric power distribution networks. For wood biomass CHP plants tax level is 5% if installed capacity does not exceed 4 MW, and 10% - if capacity above 4 MW. Licenses for new CHP plants, allowing companies to sell electricity to electric power distribution networks, will not be issued until 2016.

From 1st October 2014 new building code has come into force, bringing a period of changes in construction industry in Latvia. In next month regulations and rules has to be modified according to new building code.

### 3. MARKET DRIVERS

Starting from the 1st January of 2014 Latvia has joined Eurozone. One of the actual current positive results is slightly lower interest rates, now based on historically lower Euribor rates and ECB monetary politics.

Local market of forest products is influenced by significant increase of solid wood biomass consumption in energy sectors. In years 2012 and 2013 number of new large scale power and electricity generation projects were taking over from construction stage into full capacity-running operation stage. Similar activities, started to be implemented in Lithuania, and this drives further increase of solid wood biomass consumption in all Baltic countries region.

Also some warning trends are noticed: decrease of pulpwood demand in export markets (share in export: 9,9%) and increase of pulpwood (industrial) wood consumption in Latvia. Pulp and paper industries in Nordic countries are decreasing pulp production capacities, as a result reducing pulpwood import from Baltic countries. In middle and long term lower competition creates better opportunities for industrial wood users (wood based panels and wood biomass chemical industries) in Latvia. Stable situation in European construction sector is the reason of moderate sawnwood demand (share in export: 27,3%). Stagnation in Central European residential and lower building activities in Southern Europe are leading to higher competition in building material supply sector. Higher export sales in North Africa and Levant markets helps to balance situation. Increasing demand for premium and industrial pellets in EU increases pellet production activities in Latvia.

Short time negative impact of EU-RF (Russian Federation) sanctions implementation is noticed in Baltic&Eastern Europe transport sector, resulting a lower demand for wood packaging products (share in export: 3,6%). Further situation development is uncertain, but in general, EU-RF trade disputes doesn't directly impact Latvian forest industry competitiveness, as trading operations with Russian Federation has a minor role and more than 95% of forest industry trade is focused on in EU, North Africa and Asia region.

### 4. DEVELOPMENT IN FOREST PRODUCT MARKET SECTORS

#### 4.1 Wood raw materials

Forest felling volumes in Latvia have been stabilized on level slight below 12 mill. m<sup>3</sup>. According to the State Forest Service report .in 2013, 11,66 mill. m<sup>3</sup> roundwood harvested, reaching historically average levels after high results in years 2010-2012. Year 2014 started with unusually warm winter and roundwood deliveries from forests where below normal levels. In 3rd decade of January cold weather finally reached territory of Latvia, but freezing was without snowfalls - harvesting conditions were good, log

deliveries reached seasonal levels. Lack of cold weather in beginning of winter did not allow making winter log-yard storages. But in second and third quarter situation was back to seasonally normal levels.

In 2013, Latvia exported 3,7 mill. m<sup>3</sup> of pulpwood, mainly to Nordic countries and Germany. Demand decreased by 9% due lower consumption of pulp industries. In the same time, Latvia increased import of roundwood from Baltic countries. Import of softwood sawlogs increased by 87%, and total volume of imported logs was on level of 1 mill. m<sup>3</sup>. In year 2014 local hardwood log market highly affected by buyers for China, especially in birch sawlogs assortments market - in first two months of year 2014 birch export to China exceeded volume of whole year 2013. For eight months hardwood (birch) export to China was 148 th. m<sup>3</sup>.

#### **4.2. Wood energy**

Woody biomass demand is one the main forest product market drivers in 2012, and continued to increase in 2013. Increase in woody biomass consumption still is going on both 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 2013 expanded by 40% and continued to increase with slow pace also in 2014. After 2015 wood biomass consumption is forecasted to be stabilized, as there are no new additional capacities starting operations.

For export markets positive trend is a pellet export. In year 2013 Latvia extended pellets deliveries by 5%, reached record level of 1 018 000 tones and has become one of the 3 leading EU suppliers (including 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 2014 due new large scale pellet mill started operations in north part of country.

#### **4.3 Forest Certification**

All forests managed by JSC „Latvijas valsts meži” (LVM) are certified in accordance with the internationally approved FSC® Principles and Criteria. Since 2011 JSC "Latvian State Forests" is 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.

#### **4.4 Value added products**

Share of value added and semi-finished wood product export extended in 2013 and 2014. Intensive changes are noticed in prefabricated wood (panel) / modular house production industry, export increased by 12%. Production capacities are focusing 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. In 3rd quarter of year 2014 first in Latvia large scale thermowood production mill has test started production.

Investments were made in large scale structural wood, namely cross laminated timber (CLT) and glue laminated timber (GLT), production units. These companies are expected to start up production in 2015.

#### 4.5 Sawn softwood and hardwood

Export of sawn-wood in 2013 increased by 5%, volume of sawn-timber exported was 1.8 mill. m<sup>3</sup>. Export of softwood sawn-timber to traditional EU markets increased by 2%, but share to Asian markets extended by 18%. Positive growth is reached despite lower availability of sawlogs from Latvian forests. To keep production rates, companies increased share of imported logs. For 8 months of year 2014 preliminary data of softwood sawntimber export again indicates increase (+7%).

Export of hardwood sawntimber in 2013 increased by 24%, and for year 2014 foreign trade statistics shows still high growth rates (+15%). Changes are result of higher availability of hardwood logs. China!

#### 4.6 Wood-based panels

Birch plywood production and softwood wood-panel production were keeping on high levels. In year 2013 export of plywood and softwood panels increased by 8%. For year 2014 forecast is also positive - preliminary OSB and particleboard export volumes increased by impressing 18% (546 th. m<sup>3</sup> in 8 months). Leading plywood producer in Baltic region with national capital - "Latvijas Finieris" - has extended production network in Baltics with purchase of plywood mill site in Finland (Sastamala).

### 5. TABLES

#### Key Economic Development Indicators in Latvia

	2009	2010	2011	2012	2013	2014f	2015f
(changes in comparison with the previous year, %)							
Gross domestic product	-17,7	-1,3	5,3	5,2	4,1	3,5	4,0
Private consumption	-22,6	2,3	4,8	5,8	5,4	3,2	4,2
Public consumption	-9,4	-7,9	1,1	-0,2	3,6	2,3	2,1
Gross fixed capital formation	-37,4	-18,1	27,9	8,7	-4,3	1,2	2,2
Exports	-13,1	12,5	12,4	9,4	1,0	3,3	3,9
Imports	-31,7	11,8	22,3	4,5	-1,7	2,0	3,5
Consumer prices	3,5	-1,1	4,4	2,3	0,0	1,0	2,5
(% of GDP unless indicated otherwise)							
General government sector balance	-9,1	-8,1	-3,5	-1,4	-0,9	-0,9	-0,9
General government debt	36,9	44,5	42,0	40,8	38,1	39,0	33,0
Export-import balance	-1,5	-1,4	-4,8	-3,9	-1,9	-1,1	-0,7
Changes in the number of employed (aged 15-74 years, compared to the previous year)	-13,9	-6,4	1,3	1,6	2,1	1,1	1,0
Unemployment rate (share of unemployed persons to the economically active population aged 15-74 years, %)*	17,5	19,5	16,2	15,0	11,9	10,1	8,9

f – forecast

Data source: Ministry of Economics of Latvia

#### Forest Products Production and Trade in 2013-2015

Product Code	Product	Unit	Historical data	Estimate	Forecast
			2013	2014	2015
1.2.1.C	SAWLOGS AND VENEER LOGS, CONIFEROUS				

	Removals	1000 m <sup>3</sup>	5 097	4 800	4 800
	Imports	1000 m <sup>3</sup>	522	788	600
	Exports	1000 m <sup>3</sup>	259	184	200
	Apparent consumption	1000 m <sup>3</sup>	5 360	5 404	5 200
1.2.1.NC	SAWLOGS AND VENEER LOGS, NON-CONIFEROUS				
	Removals	1000 m <sup>3</sup>	1 539	1 600	1 600
	Imports	1000 m <sup>3</sup>	18	27	25
	Exports	1000 m <sup>3</sup>	159	260	250
	Apparent consumption	1000 m <sup>3</sup>	1 397	1 367	1 375
1.2.1.NC.T	of which, tropical logs				
	Imports	1000 m <sup>3</sup>	0	0	0
	Exports	1000 m <sup>3</sup>	0	0	0
	Net Trade	1000 m <sup>3</sup>	0	0	0
1.2.2.C	PULPWOOD (ROUND AND SPLIT), CONIFEROUS				
	Removals	1000 m <sup>3</sup>	172	200	200
	Imports	1000 m <sup>3</sup>	210	227	220
	Exports	1000 m <sup>3</sup>	189	200	200
	Apparent consumption	1000 m <sup>3</sup>	193	227	220
1.2.2.NC	PULPWOOD (ROUND AND SPLIT), NON-CONIFEROUS				
	Removals	1000 m <sup>3</sup>	3 133	3 000	3 000
	Imports	1000 m <sup>3</sup>	236	106	170
	Exports	1000 m <sup>3</sup>	1 770	1 398	1 400
	Apparent consumption	1000 m <sup>3</sup>	1 599	1 708	1 770
3	WOOD RESIDUES, CHIPS AND PARTICLES				
	Domestic supply	1000 m <sup>3</sup>	4 385	4 000	4 000
	Imports	1000 m <sup>3</sup>	108	90	100
	Exports	1000 m <sup>3</sup>	1 954	1 717	2 000
	Apparent consumption	1000 m <sup>3</sup>	2 540	2 372	2 100
1.2.3.C	OTHER INDUSTRIAL ROUNDWOOD, CONIFEROUS				
	Removals	1000 m <sup>3</sup>	730	800	800
1.2.3.NC	OTHER INDUSTRIAL ROUNDWOOD, NON-CONIFEROUS				
	Removals	1000 m <sup>3</sup>	313	250	250

1.1.C	WOOD FUEL, CONIFEROUS				
	Removals	1000 m <sup>3</sup>	259	300	300
1.1.NC	WOOD FUEL, NON-CONIFEROUS				
	Removals	1000 m <sup>3</sup>	999	1 000	1 000

Product Code	Product	Unit	Historical data	Estimate	Forecast
			2013	2014	2015
5.C	SAWNWOOD, CONIFEROUS				
	Production	1000 m <sup>3</sup>	2 788	2 700	2 700
	Imports	1000 m <sup>3</sup>	259	425	400
	Exports	1000 m <sup>3</sup>	2 085	2 249	2 250
	Apparent consumption	1000 m <sup>3</sup>	962	876	850
5.NC	SAWNWOOD, NON-CONIFEROUS				
	Production	1000 m <sup>3</sup>	602	620	638
	Imports	1000 m <sup>3</sup>	11	8	8
	Exports	1000 m <sup>3</sup>	347	409	422
	Apparent consumption	1000 m <sup>3</sup>	267	218	225
5.NC.T	of which, tropical sawnwood				
	Production	1000 m <sup>3</sup>	0	0	0
	Imports	1000 m <sup>3</sup>	0	0	0
	Exports	1000 m <sup>3</sup>	0	0	0
	Apparent consumption	1000 m <sup>3</sup>	0	0	0
6.1	VENEER SHEETS				
	Production	1000 m <sup>3</sup>	0	0	0
	Imports	1000 m <sup>3</sup>	127	121	125
	Exports	1000 m <sup>3</sup>	2	4	4
	Apparent consumption	1000 m <sup>3</sup>	126	117	121
6.1.NC.T	of which, tropical veneer sheets				
	Production	1000 m <sup>3</sup>	0	0	0
	Imports	1000 m <sup>3</sup>	0	0	0
	Exports	1000 m <sup>3</sup>	0	0	0
	Apparent consumption	1000 m <sup>3</sup>	0	0	0
6.2	PLYWOOD				
	Production	1000 m <sup>3</sup>	285	280	280
	Imports	1000 m <sup>3</sup>	32	49	50
	Exports	1000 m <sup>3</sup>	250	253	260
	Apparent consumption	1000 m <sup>3</sup>	68	76	70
6.2.NC.T	of which, tropical plywood				
	Production	1000 m <sup>3</sup>	0	0	0
	Imports	1000 m <sup>3</sup>	2	2	2
	Exports	1000 m <sup>3</sup>	0	0	0
	Apparent consumption	1000 m <sup>3</sup>	2	2	2
6.3	PARTICLE BOARD (including OSB)				
	Production	1000 m <sup>3</sup>	872	900	900

	Imports	1000 m <sup>3</sup>	38	40	40
	Exports	1000 m <sup>3</sup>	731	791	790
	Apparent consumption	1000 m <sup>3</sup>	179	149	150
6.3.1	of which, OSB				
	Production	1000 m <sup>3</sup>	553	560	560
	Imports	1000 m <sup>3</sup>	7	8	8
	Exports	1000 m <sup>3</sup>	451	557	550
	Apparent consumption	1000 m <sup>3</sup>	109	11	18
6.4	FIBREBOARD				
	Production	1000 m <sup>3</sup>	0	0	0
	Imports	1000 m <sup>3</sup>	28	30	30
	Exports	1000 m <sup>3</sup>	8	9	9
	Apparent consumption	1000 m <sup>3</sup>	20	21	21
6.4.1	Hardboard				
	Production	1000 m <sup>3</sup>	0	0	0
	Imports	1000 m <sup>3</sup>	6	10	8
	Exports	1000 m <sup>3</sup>	1	2	2
	Apparent consumption	1000 m <sup>3</sup>	5	8	6
6.4.2	MDF (Medium density)				
	Production	1000 m <sup>3</sup>	0	0	0
	Imports	1000 m <sup>3</sup>	14	14	14
	Exports	1000 m <sup>3</sup>	2	1	2
	Apparent consumption	1000 m <sup>3</sup>	12	12	12
6.4.3	Other fibreboard				
	Production	1000 m <sup>3</sup>	0	0	0
	Imports	1000 m <sup>3</sup>	7	7	7
	Exports	1000 m <sup>3</sup>	5	5	5
	Apparent consumption	1000 m <sup>3</sup>	2	1	2
7	WOOD PULP				
	Production	1000 m.t.	0	0	0
	Imports	1000 m.t.	0	0	0
	Exports	1000 m.t.	0	0	0
	Apparent consumption	1000 m.t.	0	0	0
10	PAPER & PAPERBOARD				
	Production	1000 m.t.	48	45	45
	Imports	1000 m.t.	190	182	190
	Exports	1000 m.t.	34	28	30
	Apparent consumption	1000 m.t.	204	199	205

Data source: Ministry of Agriculture of Latvia