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Engelberg, 2-6 November 2015

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#### **Forest Ecosystem Services and financing Sustainable Forest Management**

### Food and Agriculture Organization

#### European Forestry Commission

Thirty-eighth session

Engelberg, 2-6 November 2015

## Forest products market discussions

### Note by the Secretariat

#### *Summary*

This document provides a brief overview of Forest Products Markets in the UNECE Region for the period of 2014 and the first half of 2015, and will serve as a starting point for developing a Market Statement during the market discussions and subsequent drafting committee meeting.

1. The present document has two purposes, it provides: 1) an executive summary for the Forest Products Annual Market Review 2014-2015; 2) a starting point and guide for drafting the Market Statement.
2. Delegates are invited to review the information contained in this document and note possible revisions to be incorporated into the final Market Statement. These revisions will be made at the drafting committee meeting, the timing of which will be announced at the start of the Market Discussions in the morning session of 3 November 2015.
3. Key points from the Country Market Statements, as provided by countries prior to the meeting, and the Market Discussions will be integrated into this document, along with revisions from the meeting, to form the final Market Statement (which will be an annex to the final report of the meeting). The tentative schedule for the Market Discussion is listed below:

**Tuesday, 3 November 2015**

- 09:00 - 09:10    Opening
- 09:10 - 09:30    European market overview
- 09:30 - 09:50    Statements by countries and regional associations followed by discussion
- 09:50 - 10:10    Commonwealth of Independent States' market overview
- 10:10 - 10:30    Statements by countries and regional associations followed by discussion
- 10:30 - 10:50    North American market overview
- 10:50 - 11:10    Statements by countries and regional associations followed by discussion
- 11:10 - 11:40    Inspiring presentations on "pushing limits in building with wood - better, taller, more standardized?"
- 11:40 - 11:55    Questions and Answers
- 11:55 - 12:00    Summing up and closure

4. Countries are invited to make statements from the floor regarding the main issues and developments in their forest product markets. The secretariat invites countries to specifically address the following questions of the country market statement:

- a. The effects of fluctuation of currency exchange rates on forest products markets at the national level and whether any specific policy action is in place or envisaged.
- b. The current status of trade restrictions on unprocessed industrial roundwood, the main objectives of these measures and the effects on wood mobilisation, prices and processing.

5. The Drafting Committee will have the following text of the draft market statement at its disposal. The final version of the Market Statement will be available in the morning of 4 November, in English.

**I. Overview of forest products markets in 2014 and 2015**

6. The general condition of forest products markets in the UNECE region continued to improve in North America and Europe in 2014, which is substantiated by the overall positive economic developments, upward trends in housing and construction, and increasing consumption of roundwood (raw materials) and wood products.

7. The CIS experienced mixed results, with growth in industrial roundwood and pulp and paper consumption in 2014, however, sawnwood and panels consumption contracted, each by more than 4%. Production, however, was up for all the major product categories of the CIS, with exports increasing, supported by a much weakened Russian rouble.

8. In fact, currency fluctuations are impacting forest products trade across the UNECE region. A strong US dollar and Chinese Renminbi against weakened Russian rouble, Canadian dollar, Brazilian real and Euro have and will continue to influence trade flows.

9. Structural changes in the pulp and paper sector are likely to have wide-reaching ramifications. People are changing the way that they correspond, read media and books, and pay bills, which is having profound effects. Consumption of paper and paperboard has fallen by about 10% in North America and 5% in Europe over the last four years.

**Economic developments with implications for the forest sector**

10. In the ECE region, there were also sharp variations in current growth rates and economic prospects across its members. The decline in oil prices has supported the global recovery but also contributed to the growth divergence. For a number of energy-exporting economies in the Commonwealth of Independent States (CIS), notably the Russian Federation, weaker oil prices represented a significant shock.

11. In the European Union (EU), countries outside of the Eurozone have experienced rapid growth. This is a pattern that will continue in 2015-2016. The improvement of economic performance in the new EU member States in Central Europe has been driven by the new dynamism in the euro area, stronger domestic demand and the use of EU structural funds.

12. Countries with economies in transition have fared comparatively worse. In South and Eastern Europe, structural factors continued to hold back the recovery. Falling oil prices was the main factor affecting economic performance in the Russian Federation but Western economic sanctions increased financing costs and undermined confidence. Diminished economic prospects in the largest economy in the CIS had a negative impact on other countries in this subregion through the trade, investment and remittances channels. In Ukraine, the conflict in the East and contractionary policies are severely depressing economic activity. As a result of these negative influences, output in the CIS will contract in 2015 and stage only a limited recovery in 2016.

13. Employment growth has accelerated in advanced economies, in particular in the US. However, unemployment remains elevated in many countries, in particular in the Eurozone, where unemployment is expected to remain high, which will limit income growth.

14. Construction spending in the US bottomed out in 2011 and has continued to climb since then, but it remains well below pre-crisis levels. In the European Union, the decline of the construction sector was deeper and more protracted but in 2014, the sector initiated a recovery, making a positive contribution to employment growth for the first time since the financial crisis. Housing prices have been growing well above inflation in many countries in the region.

15. A weaker Euro to US dollar exchange rate has contributed to the improved outlook for the euro area. Currencies in the CIS weakened sharply in late 2014 and early 2015, as a result of lower energy prices, capital outflows and the transmission of shocks across this subregion.

16. Overall, investment in advanced countries has gained little traction, despite accelerating growth and a supportive financial backdrop. This depresses current demand but also undermines long-term growth prospects.

17. Economic prospects in the ECE region are mixed. Activity is expected to accelerate further in the advanced countries but significant fragilities remain from the legacies of the global financial crisis. In the CIS, geopolitical tensions are having a dampening effect on activity, despite some limited recovery in commodity prices.

**Policy and regulatory developments affecting the forest products sector**

18. The use of wood and the management of the forest resource from which it is derived have influence across policies, markets and economies. The EU Forest Strategy, which was adopted on 20 September 2013, responds to the challenges facing the forest sector and key policy developments in the EU. As of 2015, the EU Forest Law Enforcement, Governance

and Trade (FLEGT) Action Plan has been in force for 12 years. As of May 2014, six exporting countries had voluntary partnership agreements (VPAs). The EU Timber Regulation (EUTR) has been in effect for two years and a recent assessment concluded that its implementation remains challenging and inconsistent across EU member states.

19. The Transatlantic Trade and Investment Partnership (TTIP) trade agreement between the EU and the US is still under negotiation. Negotiations began in July 2013 and are expected to continue through 2015. A separate agreement between the EU and Canada was published in September 2014. Wood and wood products were in the media and policy spotlight in Belarus, Bulgaria, Romania and Ukraine in early 2015.

20. Wood export bans are under consideration or have been adopted in a number of countries in eastern Europe. The world's total certified forest area as of May 2015 was about 439 million hectares, which is 10.9% of the total global forest area. The growth of certified forest area is slowing and it may be time for diversification and new approaches to certification, including opportunities to address regulatory needs for monitoring and providing accountability benefits.

### **Institutional forestland ownership**

21. Worldwide, financial investors hold close to 24 million hectares of timberland, at an estimated value of close to \$100 billion. This group of forest owners represents a growing share of the world's industrial timber supply. Financial investors have changed the way in which the forest industry operates; forest industries in the US no longer control their raw material sources, and the same is happening in other regions.

22. The institutional ownership of forestland is still limited in Europe, where state ownership and small-scale private ownership (family forestry) are the dominant ownership types.

23. There are four basic types of financial investment in forestry:

- **Timberland investment management organizations (TIMOs)** – companies that acquire and manage forests on behalf of institutional investors.
- **Real estate investment trusts (REITs)** – companies in the US that pass at least 90% of their income to investors, and which earn at least 75% of their income from the sale of raw.
- **Direct investment by institutional investors** – which can take several forms.
- **Retail” investment companies** – which offer individual investors the opportunity to invest in forests at a very small scale.

24. Forests have several characteristics that distinguish them from other asset classes, and analyses of return drivers for forestry investments show that 65-75% of returns are derived from biological growth. A second distinguishing factor affecting returns on forest investments is variation in timber prices, typically ranging between 25% and 30% of the total return. Finally, changes in forestland prices contribute 2-5% of overall investment returns. It is logical to argue, therefore, that forests grow and produce returns even if economic and market circumstances are challenging, as they have been in the last few years.

25. The impacts of timberland investment on forest products markets vary by region and the type of forests. In general, financial investors in North America adjust their harvest levels in response to market demand. A high level of timberland ownership among financial

investors reduces the tendency of some integrated companies to continue harvesting and processing timber, even in weak markets, and the misallocation of logs (e.g. sawlogs being processed in integrated company pulpmills) is mostly avoided.

## II. Summary of regional and subregional markets for key forest products

### Wood raw materials

26. Of the total roundwood removals in the UNECE, approximately 16% of the logs were used for fuel. The 201 million m<sup>3</sup> of fuelwood was consumed predominantly in Europe, which accounted for almost 60% of the total fuel consumption in the UNECE. Although the data for roundwood volumes removed from forests for fuel are highly unreliable, it is clear that a fairly large share of forest removals are used for energy purposes.

27. Total consumption of roundwood in the UNECE continued its upward trend to reach 1.26 billion m<sup>3</sup> in 2014. This was an increase of 1.1% from the previous year, and was more than 5% higher than in 2010. The biggest relative increase was in the CIS subregion.

28. The usage of the roundwood component in the CIS subregion reached 182 million m<sup>3</sup>, which was almost 20% higher than in 2010.

29. In Europe, the total log consumption, including industrial roundwood and fuelwood, was up 2.4% in 2014 from the previous year with hardwood log usage by the forest industry increasing the most.

30. North America increased log consumption the least of the three UNECE subregions, only 0.7% from 2013 to 2014. The major reasons for the limited growth in North America as compared to the other two subregions included a decline in log usage by the pulp industry in the US and practically no change in the demand for sawlogs by the sawnwood sector in Canada from 2013 to 2014.

31. Global trade of softwood roundwood in 2014 remained practically unchanged from 2013 at approximately 84 million m<sup>3</sup>, according to estimates by Wood Resources International. However, trade slowed down towards the end of the year and log shipments have continued to be slow during the first five months of 2015. The biggest declines in importation this year have been by China and Japan, where import volumes during the first five months were down 23% and 30%, respectively compared to the same period in 2014.

32. The UNECE region is a major net exporter of logs with Asia being the major destination for wood raw-material. In 2014, net exports to destinations outside of the region of softwood logs reached 28 million m<sup>3</sup>, while hardwood log net exports were close to two million m<sup>3</sup>. The major trade flows of logs all involve shipments of softwood logs to China with New Zealand, Russia, the US and Canada being the largest supplying countries in ranking order.

### Sawn softwood

33. As in the previous year, 2014 continued on a slow and unsettled trend of improving economic results. Recovery was ongoing in North America and the first increase in consumption in four years occurred in Europe. The CIS countries suffered a setback in 2014 as economic conditions and depreciating currencies negatively impacted sawn softwood demand. Sawn softwood consumption increases in 2014 were 4.6% in North America and 2.5% in Europe (table 5.1.1), while the CIS countries recorded a decline of

3.7%. Volatile currency exchange rates impacted countries differently; however, all regions posted gains in production: North America (3.5%); Europe (3.0%); and the CIS (0.9%).

34. The European market reported an apparent consumption of 86.4 million m<sup>3</sup> (+2.15 million m<sup>3</sup>) where results were mixed depending on the country. The Nordic countries, and particularly Sweden, contributed more than half of the net European consumption increase (1.2 million m<sup>3</sup>). Strong domestic and export markets allowed European production to grow by 3% in 2014 reaching 100.9 million m<sup>3</sup> - the highest level since 2011. Prices increased in euros for European sawn softwood in some overseas markets, whereas prices dropped in Japan and remained stable in Europe. Middle East and North African markets experienced some price appreciation.

35. Sawn softwood consumption in the CIS region decreased by 3.7 percent (to 17.63 million m<sup>3</sup>) over 2013, while gains in production were 0.9 percent as compared to the previous year totalling 36.11 million m<sup>3</sup> in 2014. The dramatic devaluation of the rouble in early 2015 made exports of sawn softwood from Russia extremely attractive. Although the rate of growth has slowed, China remained the largest export market for sawn softwood from Russia. In 2014 Russian sawn softwood shipments to China were 8.4 million m<sup>3</sup> - an increase of 11 percent compared to 2013. Aided by a weakening rouble, Russian producers enjoyed a weighted average price increase of 24 percent (in rubles per m<sup>3</sup>) during 2014 as compared to 2013.

36. The slow and steady improvement of new residential housing starts and repair and remodelling activity continued in North America. North American sawn softwood consumption increased by 4.6 percent in 2014. US consumption rose to 72 million m<sup>3</sup> (+6.4 percent) while Canada's apparent consumption decreased for the second straight year to 14.4 million m<sup>3</sup> (-3.6 percent). US sawn softwood production grew by 5.4 percent in 2014 reaching 53.8 million m<sup>3</sup> while Canadian production gained 1.1 percent to 41.9 million m<sup>3</sup>. Production gains outpaced growth in demand in domestic and export markets and prices suffered on most products. Currency swings favoured Canadian producers.

37. Despite a difficult first quarter in 2015, there is some optimism in most UNECE countries that market conditions will improve in the second half of the year.

### **Sawn hardwood**

38. Total apparent consumption of sawn hardwood in the UNECE region increased to 34.4 million m<sup>3</sup> in 2014, a 3.3% rise compared with 2013. This was the second consecutive year of increase, a sign that the upward trend may be sustainable.

39. Sawn hardwood production in the UNECE region increased by 5.8% in 2014, to 39.1 million m<sup>3</sup>. Production had increased in the CIS and North America in 2013 and declined in Europe, but it increased in all three subregions in 2014.

40. The downturn in sawn hardwood imports in the UNECE region in 2012 and 2013 ended in 2014 when imports increased by 7.7%, to 6.7 million m<sup>3</sup>. The UNECE region exported 11.4 million m<sup>3</sup> of sawn hardwood in 2014, up by 15.2% over 2013, with exports increasing in all three subregions.

41. China continued to dominate the global sawn hardwood trade in 2014. Its sawn hardwood imports increased by 32% in 2014, to \$4.2 billion, and its share of total global trade value increased from 33% to 39%. The continued rise in Chinese consumption was the major factor driving sawn hardwood supply shortages and price increases in 2014, especially in the first half of the year. There were signs of a slowdown in the growth of

demand in China towards the end of 2014, and these signs were also evident in the first quarter of 2015.

42. European oak prices rose in 2014. In addition to strong overall demand, this was driven by price hikes for competing American white oak assortments. French sawn oak prices climbed by 1-13%, depending on specification, in the first seven months of 2014 (EUWID, 2014c). Prices for European sawn beech also increased in 2014 after stagnating for most of 2013.

43. Prices for kiln-dried US hardwood increased sharply between October 2013 and June 2014, triggered by strong demand, particularly in Asia and domestically and intensifying due to weather-related shortages in the 2013-2014 winter.

#### **Wood-based panels**

44. 2014 saw continued growth with North America, driven largely by the US, while economic growth in the EU and the CIS region remained stagnant. Consumption of wood-based panels exhibited moderately strong growth in both North America (+5.0%) and Europe (+4.7%) although it declined by 4.4% within the CIS region. Plywood consumption increased by just 1.2% across the region although it grew by an impressive 3.9% in the EU region. Particleboard consumption grew by just 2.1% across the region and was up by 8.5% within North America and down by 8.3% within the CIS region. In the case of OSB, consumption growth was strong across all three regions growing by 7.6%. Finally, fibreboard consumption growth, while strong in North America (+4.2%) and in Europe (+6.6%), was down within the CIS region (-1.0%).

45. Wood-based panel production in the UNECE region increased by 3.5% in 2014 and it is projected to increase by 1.3% in 2015. While production volumes increased across all panel types, both plywood and particleboard experienced quite low increases (1.0% and 1.8%, respectively). In contrast, both OSB and MDF exhibited strong growth in production (5.4% and 3.4%, respectively). Looking forward to 2015, plywood, particleboard and MDF are projected to display stagnant growth in production volumes ranging between 1.0% and 1.3%. In contrast, the rapidly emerging OSB industry in Russia will propel growth of OSB production within the UNECE region at a strong 10.1% rate of growth in 2015, although OSB production in the other regions is projected to display healthy growth.

46. Both the US and the CIS region reported panel trade deficits in 2014, while Europe showed a slight trade surplus (although this was down substantially from 2013). In the case of North America, the trade deficit in wood-based panels increased by 62% whereas the trade deficit in the CIS region actually declined by 39.1%. UNECE projections suggest that all three regions will report trade deficits in 2015.

#### **Paper, paperboard and woodpulp**

47. The pulp, paper and paperboard market was once again in flux, as large concentrations of graphic paper capacity continued to be rationalized in Europe and North America – a development that has persisted for well over a decade now. South America expansions of chemical market pulp capacity continued to affect UNECE producers, with tonnage easily absorbed by first the tissue and packaging segments, and second by consumers wanting to reduce their use of higher-cost softwood kraft grades. Southeast Asia remained the favoured target market, despite a marked slowdown in the level of investment into new paper and paperboard installations to serve rapidly growing economies. The ramifications of these and other changes are being felt on a global basis.

48. Despite significant capacity closures across several graphic paper grades in Europe, Japan and North America in 2014, excess production capacity remains when measured against falling or static demand; as a result, prices have deteriorated. Apparent consumption in Europe rose in 2014 aided by stronger economic activity, but fell in North America due to on-going negative impacts of the growth in electronic media which affected graphic papers. Graphic paper and chemical woodpulp output fell across Europe and North America. In the CIS, both production and apparent consumption increased due to on-going investment in capacity.

49. While global demand for pulp and paperboard grew in 2014, graphic paper consumption fell. Electronic communication continued to play a major role in the evolution of the pulp and paper segments, while paperboard actually benefitted from increased on-line shopping.

50. In the pulp sector, expansions of bleached hardwood kraft capacity in South America continued to be by far the most important factor influencing the market in 2014 and 2015. In the paper sector, the current trend continues to be to convert production to paperboard and packaging grades.

51. Prices in the pulp sector corrected in general in 2014, while hardwood kraft grades rebounded on a significant price advantage over higher-priced softwood-based pulps; by mid-2015, pulp prices appeared to have stagnated on poor pricing of end-use products downstream – in particular graphic grades – and unfavourable currency plays against the rising US dollar; however, weaker currencies have provided export opportunities and improved margins for pulp and paper producers.

### **Wood energy**

52. Wood energy markets are developing strongly and wood remains the single-most important source of renewable energy in the UNECE region. But the contribution of wood to renewable energy portfolios is decreasing because wind and solar energy are developing faster.

53. Data from the Joint Wood Energy Enquiry (UNECE/FAO, 2015) show that the forest-based industry is the largest consumer of wood energy (43.9%), followed by the residential (35.8%) and power-and-heat (17.3%) sectors. Wood for energy (by volume of wood used) in 2013 was derived mainly from wood-processing co-products (57.8%) and direct (36.4%) sources, including trees in and outside forests.

54. The wood-pellet manufacturing sector is the most dynamic and underwent important organizational restructuring in 2014, including downstream expansion into retail and distribution. The JWEE 2013 indicates that per capita wood-pellet consumption in the UNECE region increased significantly between 2011 and 2013, from 25.9 kg to 38.8 kg. Pellet market expansion is supported by standardisation and the International Organization for Standardization issued standards for solid biofuels directly relevant to wood energy under ISO 17225 (ISO, 2014). Expected growth in wood-pellet demand, which some estimate will reach about 50 million tonnes by 2024, drives investments in new manufacturing capacity.

55. Public policy plays an important role in the current use and future expansion (or contraction) of wood energy markets as issues including legality assurance of fibres, minimum combustion efficiency and maximum levels of particulate matter or net greenhouse-gas emissions are incorporated into regulatory frameworks at national and regional levels.



### Value-added wood products

56. The value of global furniture production was estimated at \$480 billion in 2014, an increase of almost 10% over the previous year. The global economic recovery led by the US is fuelling construction demand, which, in turn, is the major driver of increased furniture consumption. Furniture manufacturing is increasingly taking place inside the UNECE region as the benefits of producing furniture in lower-cost countries decline.

57. BJC markets are recovering swiftly in Germany and the US, but other markets in Europe are flat. German imports grew by 9.5% in 2014, and the US market experienced a third consecutive year of solid growth. BJC markets are typically local, and manufacturing abroad is not as profitable as it is for wooden furniture. Nevertheless, about one-third of UK and US imports originate in Asia.

58. Profiled-wood markets continue to recover in the US. Import growth increased by 58% from 2010 to 2014, concentrated in a few producer countries with comparative advantages. Profiled-wood markets in Europe, which are more local, continued to stagnate in 2014.

59. Global wood laminate flooring production increased from 925 million m<sup>2</sup> in 2013 to 940 million m<sup>2</sup> in 2014. The largest producers of this product were China, which accounted for 27% of production in 2014, and Germany, which accounted for 25%. Turkey's production is growing in importance, accounting for 10% of global production in 2014, replacing the US as the world's third-largest producer of this product.

60. The consumption of engineered wood products (I-beams, finger-jointed sawnwood, glue-laminated beams, laminated veneer lumber and cross-laminated timber) in North America has recovered modestly, following the trends in housing construction of housing and other buildings) since the bottoming of building construction activity. Unfortunately data for most engineered wood was not available for Europe this year, but information on cross laminated timber (CLT) was available.

61. About 90% of CLT production worldwide is located in Europe, with a total production volume of 560 thousand m<sup>3</sup> in 2014, forecast to increase to about 630 thousand m<sup>3</sup> by the end of 2015. The global distribution of CLT production is likely to change, however, with new planned capacity in, for example, Japan and North America. National CLT production volume is not necessarily proportional to national consumption – the central European timber industry is strongly export-oriented, supplying other parts of Europe as well as overseas markets. CLT has become an important material in urban multistorey residential and public buildings.

62. Worldwide, the use of CLT as a building product is expected to grow at rates in the double digits. Within the next decade, CLT could become as important as glue-laminated timber, and CLT is likely to extend the limits of tall wooden buildings upwards. The current record holder is “The Tree” in Bergen Norway at 14 storeys.

### Housing

63. The housing construction sectors in North America and Europe are improving, but have yet to fully recover from the global financial crisis of 2008. The Russian housing sector is improving steadily, with record of units put in place in 2014. All the regions' construction sectors are affected by tepid or declining aggregate economies.

64. The Euroconstruct areas housing is still hindered by sluggish economies. All subsectors of housing construction are forecast to remain steady through 2017. In order,

Germany, France, Italy, United Kingdom and Spain are projected to have the largest combined new construction and remodelling markets (value basis) through 2017.

65. In North America, the United States housing market has yet to fully recover; primarily a result of a tepid economy. Multifamily housing continues to exceed average permit and start levels for the past 20-years; single-family housing starts are about 60% of their historical average. New housing sales have improved but remain at some of the lowest levels recorded since the early 1980's. Total residential construction spending has improved: single-family has increased the most since 2013, and remodelling and multi-family construction appears to have levelled off. The United States forecast is for incremental improvement through 2016. Canada's housing market has remained steady and projections are for a gradual improvement in starts (graph 1.2.2) and sales through 2016.

66. Housing completions in the Russian Federation reached record levels in 2014, with a total of 1,080,300 new residences completed, a year-over-year increase of 20.3%. Residential floor area put in place increased 18.6% more than in 2013. The number of residences put in place and their total floor space were both the highest in Russian history. Additionally, residences put in place from January to May 2015 were nearly 25% greater than in the same period in 2014.

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