UK TIMBER MARKET STATEMENT - SEPTEMBER 2003

General Economic Trends affecting the Forest and Forest Industries Sector

1. Economic growth in the UK has continued to be weak, reflecting conditions in other European and major world economies. Growth in GDP for Q1 and Q2 of 2003 was 0.1% and 0.3% respectively, and is expected to be around 1.8% for the year as a whole. This follows GDP growth for 2002 at 1.9%. Manufacturing output has been generally flat and was 0.1% higher in 2003 Q2 compared with a year earlier. Inflation has remained close to the Bank of England's target of 2.5%, and interest rates have reached their lowest level in the UK since 1955. Unemployment has remained low by recent historical standards, with the unemployment rate in June 2003 at 5.0%. The housing market (buying and selling) has continued to show strong activity, although more recently there have been signs of a moderation in the market. Private housing starts have remained at just below the 20-year long-run average.

Policy developments potentially affecting trade in wood products

2. In the run up to last year's World Summit on Sustainable Development in Johannesburg, the Prime Minister invited business and environmental leaders to work with government to promote sustainable development in a number of key sectors, of which one was forestry. This resulted in a UK Forest Partnership for Action. The Partnership has agreed a number of key priority programmes (UK Forest Partnership for Action, 2002). These include international efforts to combat illegal logging; the requirements for government departments to source timber products from legal and sustainable sources; developing an international partnership on forest restoration programmes; promotion of greater uptake of the certification of forest management and the delivery of certified wood to the marketplace; and the development by the UK forest industries of a sustainability strategy. Other areas that affect timber markets include the further implementation of policies for renewable energy, materials recycling and sustainable construction. These issues are picked up in this report where appropriate.

Wood Energy

3. In the UK the recognition of forest production and wood residues from timber processing as potential sources of renewable energy has increased considerably over the last 12 months. There may be price implications in this for the existing markets for small roundwood and wood chips. However timber growers and sawmillers have seen recycled wood availability bring about price and market volume declines for virgin material and strongly welcome the potential new market. The changed prospects for wood-fuel are now being reflected in capital grant support for heating, for combined heat and power installations and for the development of supply chains. All these are starting from an exceptionally low base in the UK.

4. The possibility of using wood (in addition to energy crops) as a resource for energy generation including co-firing with coal is also being examined and is currently the subject of consultation with the generators, panelboard industry, growers and sawmillers. The debate will be further informed by the imminent publication of a new GIS based study of the resource potential from forestry and wood processing. The study will add to existing quantification of recycled wood.

Wood Raw Materials

5. Good weather in 2003 helped UK growers but the continued low prices for timber have kept production below potential, particularly in the private sector. Sawmill closures - some in the larger categories - have caused supply chains to stall. Despite investment at other mills they are often geographically too far removed to describe what is happening in terms of rationalisation in the sector although this could apply in the cases of closure of smaller mills. Hardwoods are mostly privately owned and with the exception of better quality stands import competition has caused a further reduction in hardwood felling from the already low level compared with potential. In the south of England reliable and competent harvesting contractors are becoming a scarce resource.

6. The problem of how to utilise small roundwood (softwood and hardwood) and lower quality logs in an economically viable way remains a problem to be resolved and it undoubtedly represents a significant challenge.

7. The UK Government's policy for sustainable development has given a major boost to investment for recycling. As a consequence one of the four UK integrated pulp and paper mills is converting to 100% recycled fibre (newspapers and magazines etc) by 2004. As a result softwood pulpwood export markets established at the end of 2001 has continued to grow. The consumption of recycled wood by the panelboard industry has also continued to increase volume, mainly at the expense of roundwood intake and prices for roundwood and sawmill woodchips. EU and UK targets for packaging recovery are set to stimulate further increases in recycling although the details are still under consultation.

8. Low timber price accentuates concerns in some parts of the country that the imposition of weight restrictions, or other restraints, by local authorities on some rural roads results in loss of production potential. The underlying problem is that of insufficient funding by local authorities for rural road maintenance. However, in some rural areas where the economic significance of forestry production is greatest, some very constructive and novel approaches to haulage and road engineering are now being taken forward by the industry, working in partnership with local planning and highway authorities.

9. Elsewhere, particularly in the more highly populated parts of the country, the environmental and social benefits of forestry are being found to be so large that the economic benefits from timber production in such areas have become marginalised despite the benefits of managed forests to most of these other services. New mechanisms to reward owners for the cost of management to provide these other services will be crucial to maintaining timber production resources at a realistic level.

Value-added forest products and engineered wood products

10. The market for engineered wood products in the UK has been increasing generally and is the focus of much of the forest product research effort. Timber frame manufacturers are increasingly moving towards higher levels of prefabrication, and this uses the more expensive engineered components more efficiently. Traditional construction (of all types) continues to suffer from a lack of skilled on-site trades and this trend is expected to continue. The proportion of timber frame building in new housing starts is steadily increasing.

11. While many producers of preservative treated timber have implemented a change from CCA to alternatives, the industry remains extremely concerned about the impact of the EU Directive on its product markets. The lack of a fully tested and equally effective alternative to CCA for treatment of wood in ground contact applications is a major concern, as reduced service life will militate against timber.

Implications of Forest Law Enforcement Governance and Trade (FLEGT) on Markets

12. UK regulation is such that there is little concern about illegal production and trade from UK forests. Although security issues do arise from time to time the development of certified chains of custody is a deterrent. However, timber importers are having to take these issues very seriously in order to protect their reputation and to maintain access to the considerable proportion of the market represented by public procurement (estimated as up to 40% of the UK market). The main representative body for timber importers - the Timber Trade Federation (TTF) - operates an Environmental Code of Practice which commits members to sourcing their wood from legal and well managed forests. The TTF is revising their framework for responsible sourcing to increase transparency along the wood chain to support the UK Government's procurement policy and the EU Forest Law Enforcement and Governance and Trade (FLEGT) Action Plan. While until now tropical hardwoods have had the highest profile, the greater volume where evidence of legal and preferably sustainable sourcing will be required is in softwood. Ability to supply the necessary independently verified evidence is likely to become a key issue for wood product importers, especially those who do not have the convenience of a credible certification chain of custody to support their claims.

13. The successful *wood. for good.* campaign in the UK seems to have achieved some success in improving the environmental perceptions about timber with the public and more significantly with the building professionals. The importance of this type of promotion to improve market “pull” has to be recognised as an essential complement to the international effort to improve the situation in supplier countries through FLEGT and other initiatives.

Certified forest products

14. In the market for round and primary processed timber the 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. It is becoming more difficult for growers to sell uncertified softwood because certified mills are having some difficulty in achieving the percentage intake they need to meet the chain of custody requirements for percentage based claims. However this is not universal and some certified sawmills have been very disappointed in the failure of their market to provide the expected demand for certified wood products. It seems clear that certification requires considerably more promotion, although this can only be effective once supplies can easily be located in the quantities required by the buyers.

15. As part of a recent survey of UK sawmills they were asked whether they held a chain of custody certificate, the percentage of input volume from certified sources and the percentage of output volume sold as certified in 2002. Excluding nil responses 28% reported that they held a chain of custody certificate, although this proportion varied from just 10% of mills producing less than 5 thousand cubic metres

sawnwood in 2002 to over 90% of those producing 25 thousand cubic metres sawnwood or more. Certified timber accounts for almost two thirds of consumption and around 60% of sawnwood production. These proportions varied by size of mill, with larger mills generally reporting higher levels of certified timber than smaller mills.

Sawn Softwood

16. Despite the lack of the long awaited increased activity in housing starts demand from the construction sector for sawn timber is good in 2003 and should continue in 2004. Indeed, evidence from an independent assessment of market share in construction carried out for the w*ood. for good.* campaign seems to indicate that timber has done rather better than other materials over the last 3 years.

17. Within the fencing and garden products sector conditions saw the usual seasonal upturn through the Spring and Summer of 2003 and have undoubtedly benefited from the good weather and the agricultural sector recovery from Foot and Mouth Disease. Garden furniture and timber decking were clearly beneficiaries of fine weather and a fashion for timber products led by lifestyle TV programmes and magazines.

18. UK sawmill closures are, at present, thought to be more than compensated in total volume terms by the ability of others to increase throughput. However the closures have caused some significant regional marketing problems and extra haulage cost. A weakening of the pound against other currencies has undoubtedly assisted UK sawmills, as has some difficulties in export for the Baltic States, but this has not resulted in significant price movement for growers.

Sawn Hardwood (temperate and tropical)

19. So far 2003 shows only a further decline in the market conditions in 2002. Price and availability dictate that many former customers for UK logs and sawn timber have turned to imports or purchase ready sawn from other larger UK producers. However, there is still a demand for good quality UK-grown hardwood. UK-grown production is being displaced by European and North American imports.

20. There have been further reductions in the number of UK hardwood sawmills.

21. The scale of tropical imports is largely unchanged but, as reported above, sustainable sourcing is a major issue for the main trade association and many companies have taken action to address the issue of responsible sourcing.

Wood-based panels (particleboard including fibreboard including MDF, OSB, plywood)

22. This is possibly the most technically innovative part of the wood processing sector, partly due to the ultra-competitive situation in the market but also because of the opportunities for new engineered products. The last two years have seen major investment in production technology at some of the key sites with new products and increased production efficiency supported by the development of various forms of product quality assurance. The outlook remains extremely competitive for all products although particularly strong upward movement is reported in OSB prices. In contrast MDF prices are weak, possibly due both to weak demand in the furniture industry as well as the recent history of the development manufacturing capacity in

Europe and elsewhere. Some rationalisation occurred within the UK industry during 2003 with the closure of a particleboard mill and the sale of its equipment.

23. UK Government policy on sustainable development is steadily increasing the volume of packaging and other wood diverted from landfill or burnt as waste. The availability of recycled wood fibre as a feedstock for the panel products sector continues to assist its competitiveness but the industry feels threatened by the potential of emerging woodfuel markets to compete for its raw material, sawmills co-product (chips) and recycled wood.

Pulp and paper

24. As elsewhere this industry is focussing on improvements in efficiency rather than new capacity investment during a period of relatively weak demand associated with the general global economy. However this has not precluded ongoing change in the proportion of recycled fibre being used, and increase to 100% recycled in one of UK's four pulp and paper mills has resulted in a steadily increasing export of pulpwood. This in turn has maintained the extreme pressure on prices and market availability to growers. The possibility of increased paper making capacity affecting pulpwood supply to any of the remaining roundwood mills remains elusive.

UK Forestry Commission
17 September 2003

Annex A

Selected economic indicators, UK (% unless otherwise indicated)

	2000	2001	2002	2003 (Forecast) *
GDP growth (market prices in real terms)	3.1	2.1	1.9	1.8
Interest rate (base rate at year end)	5.83	4.05	3.95	4.01
Whole economy productivity (year-on-year growth)	*1.6*	*1.1*	*1.5*	
Retail (consumer) price index	3.0	1.8	1.7	2.5
Unemployment (ILO)	5.7	4.9	5.2	
Private sector housing starts (000s)	157.8	162.8	140.1	
Production in wood-using industries (compared to year earlier)				
Sawmill	*-0.4*	*2.2*	*0.2*	
Wood-pulp	*-8.3*	*3.8*	*0*[1]	
Paper and paperboard	*0.4*	*-6.1*	*0.2*	

*Average of independent forecasts Source: "Forecasts for the UK Economy" HM Treasury August 2003

[1] Figures for wood pulp for 2002 were unavailable, so were estimated as unchanged from 2001.