UNECE TIMBER COMMITTEE - SEPTEMBER 2006

UK TIMBER MARKET STATEMENT

1. General economic trends affecting the forest and forest industries sector

The pace of economic activity has quickened in the first half of 2006 giving an annual average of 2.1%. GDP rose by 0.8 % in the second quarter of 2006, compared with 0.7 % in the first quarter. Growth came mainly from services, which increased more strongly than in the previous quarter. As the paperless office has yet to materialise increased service sector growth is good news for the paper and pulp industry.

Household spending, business investment growth and investment intentions have improved within the year. In the United Kingdom 's main export markets growth has remained robust and as a result, over the past few quarters (to quarter 2 2006) GDP growth has been at, or a little above, its long-run average and business surveys point to continued strong growth. The margin of spare capacity in the economy also appears small.

Consumer Price Index inflation picked up to 2.5% in June 2006, and is expected to remain above the 2.0% target for some while. Higher energy prices have led to greater inflationary pressures, notwithstanding muted earnings growth and a squeeze on profit margins. Although the path of energy prices is extremely uncertain, energy price inflation is expected to moderate in the medium term.

In the second quarter of 2006 industrial production fell by 0.1% following a rise of 0.8% in the previous quarter. Within these figures there was a rise of 0.5% in manufacturing, but the overall figure was pulled down by a 3.0 % fall in energy extraction and a 2.8 % fall in energy supply. The forest industries have strong links with manufacturing industry and this bodes well for the remainder of 2006.

The wider forest industries sector (including upstream and downstream activities) supported some 2.5% of the UK economy in 2005, worth 727,154 jobs and a £26.4 billion contribution to Gross Value Added through the direct, indirect and induced effects of the (forest) industries' activities.

The downward trend in the employment rate has levelled off to stand at 74.6% in 3 months to May 2006 (virtually unchanged over the quarter but down 0.2 over the year) while the trend in the unemployment rate continues to increase to stand at 5.4%.

All in all the UK economy is enjoying a period of relative stability but there are clear signs that this may not continue indefinitely.

General economic trends affecting the forest and forest industries sector are summarised in the Annex to this paper.

2. Policy developments potentially affecting trade in wood products

The UK Government Procurement policy for wood products continues to contribute to the sustainable development agenda in the UK and overseas. The assessment of five major forest certification schemes resulted in some of those schemes making changes to their standards so that they complied with UK Government criteria for credible assurance of legal harvesting and well managed forests. A review of all five schemes was started in April 2006 and is expected to be completed later in 2006. This review is being closely monitored by the timber trade worldwide and by the Governments of those countries that are interested in forest management certification schemes because they either export timber or want to purchase products that derive from legal and sustainable sources. In the meantime UK Government procurement officers are advised to continue accepting FSC, CSA, PEFC and SFI certified timber and wood products as legally and sustainably sourced. The MTTC scheme label continues to be accepted as evidence of legal sourcing for the time being. Government Procurement officers are advised to obtain independent third party verification for alternative forms of assurance on timber sources. Any recycled timber or wood product is accepted as sustainable. None of these measures apply as UK import controls.

The Central Point of Expertise on Timber (CPET) has been undertaking the scheme assessments, developing guidance on alternative forms of assurance and raising awareness through its website, training courses and visits to government buyers. CPET is also working with officials in the Governments of some other member states in an attempt to harmonise as far as practically possible the UK policy with the policies of those countries. If successful this would assist the international timber trade in responding to the demand for legal and sustainable timber. CPET is also working with UK Government departments and those local authorities that are pursuing their own policies in an effort to co-ordinate public sector implementation domestically.

The UK Government’s timber procurement policy has now become a matter of interest for the G8, the UN and the EU as a practical measure for tackling illegal logging and improving forest management throughout the world.

The UK Government continues to work actively with the EU to promote the EU FLEGT Action Plan. The EU Forestry Law Enforcement Governance & Trade (FLEGT) Regulation was adopted in December 2005, under the UK's Presidency of the European Union. The legislation provides an innovative means of addressing trade in illegal timber - the EU will only be able to import timber licensed as legal from producer countries that sign up to voluntary partnership agreements. We hope that the first Partnership Agreements will be in place by the beginning of 2007. The UK is leading on negotiations with Ghana. The Commission has been delaying production of a report on additional legislative options to prevent trade in illegal timber.

The UK has continued development co-operation support to major developing timber-producing countries to improve forest governance, particularly in Indonesia, Ghana and Cameroon. In January 2006 new funding of GBP 24 million over 5 years was announced. This will primarily support implementation of FLEGT Partnership Agreements.

The UK has continued to support co-operation with the timber trade, especially in getting messages to the supply chain that legal timber is now a requirement. This has included support to a trade “roadshow” to West and Central Africa in October 2005, preparation for a similar one to SE Asia and preparation and distribution of a DVD for the trade. In November 2005, UK Government and European and African timber producers, importers and end users agreed a set of Government-industry co-operative actions relating to timber procurement, stimulation of forest sector investment, financial support for certification and transparency.

The UK supports the FLEG processes in East Asia and Africa and the recent initiation of a European and North Asia FLEG. The UK has also been working with G8 countries, who as important trading and development partners, can have a significant impact on reducing illegal logging. Illegal logging was one of two topics of discussion at the first ever G8 Environment and Development Ministerial meeting in Derbyshire in March 2005. Ministers' agreed to a range of actions and officials are currently in the process of reporting progress.

3. Market Drivers

As reported in previous years a major programme of home building over the next 20 years is underway. Sustainable construction has a key role to play in this programme which is part of the broader aim to develop new sustainable communities. Social housing is of particular importance in the programme and this offers good prospects for timber frame. Social housing specifiers are already well focussed on the construction benefits of the system and have strong environmental policies.

Looking to the future the Olympics are to be held in London in 2012 and the timber industry is working with partners to ensure that the planners and specifiers are fully aware of the potential for the use of timber in the construction of stadia as well as permanent and temporary buildings.

The impact of increasing energy prices is having a major impact on all areas of the forestry sector, especially on mills processing timber products.

Where appropriate marker drivers are mentioned under specific sectors in Section 4 of this statement, Developments in Forest Product Markets Sectors

4. Developments in Forest Product Markets Sectors

a) Wood Raw Materials

Construction activity increased by 0.5 % in the second quarter of 2006 following a rise of 0.9 % in the previous quarter. The increasing cost of traditional building materials continues to make timber frame housing very attractive and combined with their superior insulation properties this is leading to excellent prospects for the sector. The proportion of timber frame building in new housing starts is steadily increasing at around 20% and is likely to benefit further from the UK policy initiatives for modern methods of construction and sustainable building. In Scotland 70% of new homes are timber frame and in England & Wales the figure is around 11%. The most significant growth has been in England and this is likely to continue to show strong growth in the short to medium term.

The timber industry recognises that the Olympics can act as a catalyst for future development. Modern methods of construction will be to the fore and the influence of sustainability will all be taken into account in the development and creation of the 'Sustainable Games'

b) Wood Energy

In the UK the use of forest products and sawmill products from timber processing as potential sources of renewable energy has increased markedly over the past 12 months. The scale of projects ranges from individual domestic situations through community heating and industrial applications to co-firing. Although the use of biomass as a replacement for coal in existing coal-fired stations is by far the greatest consumer of biomass, the vast majority of co-fired biomass is bought on the global market and imported.

Recent surveys of woodfuel usage in Scotland show that the timber industry itself is the greatest consumer of homegrown biomass where co-product is used to generate process heat and steam; this picture is broadly consistent throughout the UK.

Construction work has started on a dedicated biomass generating station in SW Scotland with an installed capacity of 40MW and an annual consumption of approximately 500,000 green tonnes biomass, much of it sourced from local conifer forests and sawmill co-products. Costs of woodfuel boilers and their installation are substantially greater than their fossil-fuel equivalents therefore there is government assistance to encourage this element of the renewable energy sector.

Biomass projects, such as the E.On plant at Lockerbie which will consume approximately 500,000 green tonnes of sawmill co-products & biomass, and the Sembcorp Plant at Middlesborough which will consume approximately 300,000 green tonnes show the emerging strength of this sector

As the biomass sector develops differences are emerging between and within countries. Northern Ireland has a history of growing willow coppice which has been supplemented in the last year by pellet production at a major sawmill. Scotland and Wales are generally developing supply streams from existing conifer woodlands whereas the focus in England is on accessing supply from privately-owned broadleaved woodland that has a poor thinning history in recent years.

c) Certified forest products

In the market for round and primary processed timber, the requirement for certified material continues to develop and extend. The FSC has retained a virtual monopoly for home grown labelled products but increasing volumes of PEFC labelled imports are appearing in the UK.

The number and range of companies with Chain of Custody Certification has continued to increase (about 12% between 2004 – 2005) steadily but slowly.

Softwood certified sawmills and merchants are reported to be offering slightly higher prices and certainly un - certified wood products are becoming more difficult for growers to sell to major markets.

In the annual UK sawmill survey, sawmills were asked a few questions on certification. 122 sawmills provided data for 2005 with 50 (41%) reported that they held a chain of custody certificate, although this proportion varied from 25% of mills producing less than 5 thousand m^3 of sawnwood in 2005 to 95% of those producing at least 25 thousand m^3 of sawnwood.

Chain of custody certificates [1], 2005

Number of sawmills

	Production[2]			**Total**
	<5	**5 - <25**	**25+**	
Total	**76**	**25**	**21**	**122**
Mills holding certificate	19	11	20	50
Mills without certificate	52	14	1	67
Certification status not reported	5	0	0	5

[1] Sawmills responding in 2005, excluding nil responses. These 122 mills accounted for 80% of the estimated total sawnwood production in 2005.
[2] Categories are based on **total** sawnwood production

The following table shows the percentage of certified input and output volumes for 2002-2005, based on responses received. Certified timber accounted for around three-quarters of sawlog consumption and sawnwood production in 2005. These proportions varied by size of mill, with larger mills generally reporting higher levels of certified timber than smaller mills.

Consumption and production certified[1], 2002-2005

		Production[2]			Total
		<5	**5 - <25**	**25+**	
% consumption certified	2002	11%	38%	79%	67%
	2003	21%	52%	74%	68%
	2004	18%	43%	94%	83%
	2005	29%	48%	85%	78%
% production certified	2002	5%	20%	82%	66%
	2003	4%	29%	60%	52%
	2004	12%	27%	76%	66%
	2005	16%	28%	83%	74%

[1] Sawmills responding in 2005, excluding nil responses.
[2] Categories are based on **total** sawnwood production

d) Value-added forest products and engineered wood products

After a decline in 2005, consumer demand for furniture began to increase in the first quarter of this year, but sales are forecast to remain poor until a hoped for recovery sets in during 2007.

Shop and office furniture saw an increase in demand whilst production of chairs and seats reduced slightly. Kitchen furniture output was higher than a year earlier, but output of other furniture reduced.

As reported in previous Market statements the market for engineered wood products in the UK has been increasing generally. Timber frame manufacturers are increasingly moving towards higher levels of prefabrication, and this uses the more expensive engineered components more efficiently.

UK manufacturers of timber products are increasingly engaging with clients and research providers to deliver innovative customer led solutions. The origin of the timber in those solutions is also of increasing importance as the level of consumer awareness of product origin rises. In response more manufacturers are engaging in demonstrating the environmental profile for their product; this presents a significant opportunity for UK grown timber as a whole but also at a local level where immediate regional benefits such as employment can be captured. The continuing success of re-engineered products such as I-beams and other engineered wood products are testament to this. The emergence of Structural Insulated Panel (SIP) technology when used in combination with conventional timber frame increasing opportunities for timber to feature in housing provision. This will become more significant in the coming years.

e) Sawn Softwood

The repair, maintenance and improvement sector is the main user of sawn softwood materials, accounting for some 60% of total sawn softwood consumption. A reduction in activity in that sector in 2006 is projected to more than cancel out increases in other sectors, giving an overall fall of 3% in consumption.

Despite a slow start demand for carcassing, packaging and fencing has improved throughout the year. Garden furniture, flooring and timber decking have continued to benefit from the fashion for timber products led by lifestyle TV programmes and magazines and this change in the market seems to be well established.

Sawmills consumed a total of 5.3 million green tonnes of softwood in 2005, an increase of 3% from the 2004 figure. The number of sawmills in the UK continues to reduce. It is estimated that there were 228 active sawmills in the UK in 2005. The majority of sawmills (70%) in the UK are in the smaller category producing no more than 5 thousand cubic metres of sawnwood.

f) Sawn Hardwood (temperate and tropical)

2005 figures show a decline from 2004 in the quantity of UK hardwood logs sawn from 93,000 to 73,000 green tonnes. A small increase in imported logs has been reported, giving an overall fall in hardwood logs sawn in the UK from 121,000 to 107,000 green tonnes.

There is still a demand for good quality UK-grown hardwood but European and North American imports are affecting production. Recent press reports indicate that the overwhelming fashion for white oak is the single most important feature of the UK hardwood trade.

g) Wood-based panels

A total of 3.4 million cu m of woodbased panel products were produced in 2005, a decline of 4% from 2004. The majority of this total (75%) was particleboard and oriented strand board (OSB). The outlook is for similar levels in 2006 and 2007.
Although still importing over half of wood based panels in 2005, the trading situation in the UK improved with imports falling and exports rising in both volume and value terms.

A total of 1.5 million green tonnes of UK roundwood was consumed by the wood-based panel products sector in 2005, a slight fall from the previous year. A further 1.7 million green tonnes of sawmill products and 1.0 million green tonnes of recycled wood fibre were also consumed in 2005.

Inputs for woodbased panel products (000 green tonnes)

	2000	2001	2002	2003	2004	2005
UK roundwood	1735	1715	1499	1490	1527	1504
Sawmill products	1871	1675	1669	1686	1778	1734
Imports	14	38	13	22	9	6
Recycled wood fibre	488	675	932	993	1078	1043
Total	4108	4103	4113	4191	4392	4287

- UK roundwood includes all material from forest operations.
- Sawmill products include peeled and unpeeled chips, sawdust, slabwood, shavings, postplant chips and peelings.
- Imports include roundwood, wood products and products from imported wood.
- Recycled wood fibre is wood fibre recovered from both pre- and post-consumer wood waste for use in woodbased panel production.

h) Pulp and paper

Total production of paper and paperboard was 6.0 million tonnes in 2005, 3% down from 2004.

In 2005 three integrated pulp and paper mills used UK roundwood. These mills consumed 500 thousand green tonnes of UK grown soft roundwood in 2005, a 4% increase on 2004.

2006 saw the closure of St Regis Pulp and Paper mill, which took in over 200,000 tonnes of mixed hardwood every year. The mill closure was a result of rising energy costs coupled with market decline. The challenge for the producers was to find alternative markets as quickly as possible. Some of this volume has been diverted to the woodfuel market. In the longer term sustainable markets must be secured to ensure the ongoing management of the woodland resource.

UK Forestry Commission
01 September 2006

Annex

General Economic Trends Affecting the Forest and Forest Industries Sector

Selected economic indicators, UK (% unless otherwise indicated)

	2001	**2002**	**2003**	**2004**	**2005**	**2006 (Forecast)***
GDP growth (GDP at constant (2001) market prices)	2.2	2.0	2.5	3.2	2.0	2.4
Interest rate (base rate at year end)	4.00	4.00	3.75	4.75	4.50	4.50
Consumer Price Index	1.2	1.3	1.4	1.3	2.0	2.2
Unemployment (ILO)	4.9	5.2	5.0	4.8	4.8	5.2
Private housebuilding starts (thousands)	174.85	175.86	179.00	184.61	180.78	

*Average of independent forecasts. Source: HM Treasury, Forecasts for the UK Economy:
A Comparison of Independent Forecasters, August 2005