



Natural resources and
bioeconomy
studies 50/2018

Finnish Forest Sector Economic Outlook 2018–2019

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Natural Resources Institute Finland, Helsinki 2018



METSÄMIESTEN SÄÄTIÖ

Ihminen ja metsä

Metsämiesten Säätiö Foundation has funded the Finnish Forest Sector Economic Outlook.



Viitanen, J. and Mutanen, A. (eds.). 2018. Finnish Forest Sector Economic Outlook 2018–2019. Natural resources and bioeconomy studies 50/2018. Natural Resources Institute Finland, Helsinki. 8 p.

ISBN: 978-952-326-636-0 (Print)

ISBN: 978-952-326-637-7 (Online)

ISSN 2342-7647 (Print)

ISSN 2342-7639 (Online)

URN: <http://urn.fi/URN:ISBN:978-952-326-637-7>

Copyright: Natural Resources Institute Finland (Luke)

Authors: Jari Viitanen and Antti Mutanen (eds.)

Publisher: Natural Resources Institute Finland (Luke), Helsinki 2018

Year of publication: 2018

Cover photo: Erkki Oksanen, Luke.

Printing house and: publishing sales: Juvenes Print, <http://luke.juvenesprint.fi>

Executive summary

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Year 2018 will be a major economic peak in the Finnish forest sector. Forest industries' production and export volumes are growing, industrial roundwood fellings are increasing, stumpage prices are rising, and operating profit in non-industrial private forestry is improving. Current cyclical peak is driven by growing world economy, which has increased the demand for forest industry products. Political decisions, such as restrictions on the import and use of recycled fibre and the closures of polluting mills in China, have contributed to the development of Finnish forest exports.

In 2019, the growth in the world economy is expected to slow down. Uncertainty in export markets for forest industry products is maintained by, e.g. the Brexit and problems related to the accumulating debts in China and Italy. Despite the slowdown in the global economic growth, the Finnish forest sector is not expected to face a strong downturn. In 2019, the growth in production and export volumes of forest industry products will slow down for most products and the upward trend in export prices will level off. With regard to market pulp, the export price will decrease from the record high level of 2018.

World economy slowing down

The world economy will grow this year almost at the same pace as last year. However, the economic growth is slowing down in the key market areas of the Finnish forest industry. In the euro area, the average growth rate will decrease to about two per cent annually. In Germany, the largest single export country for the Finnish forest industry, the growth rate is the same as the euro area average. In the UK, the Brexit creates uncertainty and the economy is growing by one and a half percent. In China, economic growth is slowing down as expected earlier, and the Japanese economy will return to the traditional growth path of one per cent. The United States is at the peak of the business cycle and in 2018, the economic growth will still accelerate mainly due to expansive fiscal policy. In 2019, the growth of national economies as well as the world economy is projected to continue but clearly slower than in 2018.

The expectations on the timings of central banks' interest rate hikes affect currency exchange rates. The European Central Bank is not expected to raise its interest rate until the end of 2019. Consequently, in the coming year, the euro is expected to reevaluate slightly against the dollar but weaken against the Swedish krona.

Sawnwood - increasing export price, decreasing export volume

Due to the strong demand in many export destinations, the average unit price of Finnish sawnwood exports will rise significantly in 2018 compared to 2017. Instead, the export volume will fall slightly as sawnwood exports to China contracts from last year. The decline in exports to China is, however, mostly compensated by the growth in exports to other market areas. The market situation in North Africa has improved, which has raised the export volume and price of pine sawnwood while reducing the gap between the exports prices of pine and spruce sawnwood. In volume terms, Egypt will again become the largest export destination of Finnish sawnwood.

Poor logging conditions in Finland and the consequent problems in sawlog acquisitions limited the sawnwood production in early 2018. These problems were soon eased, and for the whole year

2018, sawnwood production is projected to rise by 2 per cent to 12 million cubic meters. Domestic consumption of sawnwood is growing gradually.

After a strong rise in the export price of sawnwood, the price development is expected to stabilise in 2019, while the export and production volumes of sawnwood will grow moderately. A sharp economic downturn is not expected as the growth in demand for sawnwood in the main export markets is on a more stable footing than in the previous boom of 2007. Production and exports of plywood will increase in 2018 and 2019, as the export demand is remaining strong and investments, especially in laminated veneer lumber (LVL), boost the production volumes in Finland. The average export price for plywood will remain in 2018 and 2019 at the 2017 level, while the share of softwood plywood having a lower unit value than hardwood (birch) plywood increases in the total Finnish plywood exports.

Production and exports of pulp and cardboard continue to grow

Pulp production is estimated to grow by 8 per cent this year, while the exports of pulp are projected to increase by as much as 13 per cent. High production and export volumes are explained above all by the growth in production capacity in a good market situation. The demand for pulp is also affected by the Chinese restrictions on the imports and use of recycled fibre, which has led to the replacement of recycled fibre by pulp. The unit price of Finnish pulp exports will also pick up briskly this year. Globally, the price of long-fibre pulp has continued to rise, as supply is low in relation to the growth in demand. The market situation for long-fibre pulp will continue strong in 2019, and Finnish exports and production will continue to grow slightly. The export price of pulp, however, is expected to drop by 4 per cent from the peak of this year.

Although the demand for paper has continued to decline in Europe this year, prices for many paper grades have risen. The average unit price of Finnish paper exports has also risen compared to last year. The rise in paper prices is affected by the cost increases, especially the high price of pulp. Despite the decline in demand in Europe, paper exports from Finland have grown. The growth has been affected, among other things, by capacity closures in Europe and by the competitive advantage of Finnish paper producers due to the high price of market pulp. The Finnish paper exports and production are expected to grow by 3 per cent this year. Next year, the export and production volumes will slightly decrease, but the decline will be slower than the decline in demand. The average price of Finnish paper exports is expected to rise by 3 per cent this year and will continue to rise slightly next year.

The strong growth in Finnish cardboard production and exports continues this year. The export price of cardboard will also increase significantly. Demand for cardboard is increasing globally due to economic growth, changing consumption patterns and the expansion of internet commerce. In addition, replacing plastics with bio-based raw materials in packaging also raises demand for cardboard. As a result of increased demand and capacity, cardboard production has increased in Finland in recent years. The production, exports, and export prices of cardboard will also increase in 2019 but more moderately than this year.

Profitability of the Finnish pulp and paper industry at top level

As far as profitability is concerned, the year 2018 is the peak year for the pulp and paper industry. In 2019, global economic growth is projected to slow down and pulp prices are expected to decline slightly. Neither the price development of papers nor cardboard will improve the profitability of the pulp and paper industry next year. The profitability of fine and specialty papers as well as cardboard production will be weakened by the high cost of pulp and the continuation of other cost inflation. The market situation for printing and writing papers continues to be tight, although closures of least cost-efficient plants can balance the industry. Fluctuations in paper prices continue to have a huge impact on the operating result of the Finnish pulp and paper industry.

The profitability of the sawmill industry will remain unchanged or only slightly improve this year as the rise in wood costs will undermine most of the positive impact of the rise in sawnwood export prices. The profitability of pine sawnwood production will improve slightly more than the profitability of spruce sawnwood production. This brings a relief for pine sawnwood exporters who have suffered from low profitability for years. The low profitability has been attributable to problems in main export markets of pine sawnwood especially in North Africa. These problems were largely related to the collapse of the oil price in the fall of 2014 that affected the economies of main export countries.

Booming roundwood markets

Due to good demand for end products and executed new investments in forest industry, the demand for roundwood has grown broadly both in the wood products industry and in the pulp and paper industry. Fellings in private forests will increase by 9 per cent this year. When both the forest companies and Metsähallitus, the state-owned enterprise responsible for the management of state forests, increase their felling at the same rate, the total fellings of industrial roundwood will grow by 9 per cent to 68.3 million cubic metres. The increased export prices of pine and spruce sawnwood and the growing demand for sawnwood increase the average stumpage prices of pine and spruce logs by 9–10 per cent. The growth in pulp, paper and cardboard production will increase the stumpage prices of pine, birch, and spruce pulpwood by 8–11 per cent. The stumpage price of birch logs will rise by 6 percent. Roundwood imports will grow by a quarter from the level of 2017.

The Finnish roundwood market is projected to experience the peak of business cycle in the current year. During 2019, industrial roundwood fellings and stumpage prices will level off due to the slowdown in economic growth. Due to the increased production of the pulp industry and the growth in the demand for pine sawnwood, the demand for pine roundwood is projected to continue to grow, while the demand for spruce roundwood will be slightly reduced. The demand for birch logs and birch pulpwood as well as imports of roundwood are projected to remain in 2019 at the current year's level.

Operating profit in non-industrial private forestry rising to over 150 euros per hectare

The peak of business cycle and increased fellings are reflected in the operating profit of non-industrial private forestry. In 2018, gross stumpage earnings will rise to around EUR 165 per hectare, and totalling well above EUR 2 billion in 2018 and 2019. Increased fellings will increase investment in forest renewal and forest roads. In 2017, the investments amounted to EUR 16 per hectare (EUR 215 million including the estimated value of own work by forest owners). Investments are expected to rise to EUR 230 million in 2018 and EUR 240 million in 2019. The operating result was EUR 126 per hectare in 2017, with real growth of 7 per cent compared to 2016. In 2018 and 2019, the operating profit is projected to rise to over EUR 150 per hectare. The calculated return on investment in wood production will rise to more than 10 per cent in 2018, but will fall close to the 10-year average of 4 per cent in 2019.

Employment in the Finnish forest sector improving slightly

In 2018, the number of employees in the forest industry is expected to rise to 41,500 people. The employment in construction carpentry and in pulp, paper and cardboard production is expected to improve. The number of employees in the woodworking industry and paper and cardboard processing industries will remain at their previous levels, but the number of employees in the sawmill industry will fall slightly from the level of 2017. According to a cautious estimate, in 2019, the number of employees in the forest industry will remain at current year's level.

Record high fellings will not increase the number of employees in forestry in 2018. Poor weather conditions, in particular the drought during spring and early summer, have reduced employment in forestry and the number of employees is expected to fall to 21,000, which is about 500 people less than in 2017. In 2019, fellings are expected to remain almost at the level of 2018, and the finishing of forest management works dating from year earlier are expected to restore the number of employees to 21,500.

Increasing prices of emission allowances improves the profitability of using forest chips

The use of solid wood fuels grew to a new record last year. The growth was mainly due to the increase in the use of by-product and waste wood from the forest industry, as the use of forest chips decreased slightly. Also consumption and production of pellets grew again, reaching a new record. Emission allowance prices have risen almost threefold over the past year, supporting the competitiveness of forest chips, bark, and sawdust in heat production. The use of forest chips is expected to increase by 3 per cent in 2018 and again by a couple of per cent to 8.2 million cubic metres in 2019. The price of forest chips is expected to remain at last year's level in 2018, and to rise slightly next year. Consumption of pellets will increase slightly this year and next year.

Basis and risks of the forecast

The Finnish Forest Sector Economic Outlook provides information on the current situation and the future prospects of the Finnish forest sector. The forecasts are based on public statistics, world economic development forecasts, forest sector market information from various sources, and studies by the Natural Resources Institute Finland. The forecasts are made using the derived demand principle, which means that the fluctuations of the economic outlook in Finland and the export markets are expected to be reflected in the demand for forest industry products and, consequently, to forest industry production and domestic wood market. Changes in the operating environment of the forest sector and the impact of the Government's economic instruments are also considered when the forecast is prepared. If the economic growth were to be slower than expected, the export prices, production and the profitability of the Finnish forest industry would be lower than this forecast.

The understanding of the economic development of the world economy and export markets is based on projections made by different organizations (e.g. OECD, IMF, ETLA, Nordea, Bank of Finland). The forecasts for this review are based on the data from the forest sector in September and October 2018 and forecasts for the development of world economy for the years 2018–2019. The forest sector forecasts describe the most probable development as assessed by the authors. They are point estimates, which are based on export market growth forecasts and other underlying assumptions related to market development.

This year the outlook for the world economy is overshadowed by several uncertainties. The expansion of global trade barriers, geopolitical tensions, debt-related problems, the deadline for the Brexit negotiations between the European Union and Britain in March 2019 and the content of the future EU-Britain agreement are the most important factors in maintaining uncertainty. Although none of these would be realised on a large scale, the uncertainty surrounding them will, for example, affect investments and the general mood of the economy. Indebtedness and possible bursts of bubbles in housing and stock markets have often resulted in recession. Concerns about the indebtedness of households, the financial sector and the states have once again risen especially in the cases of China and Italy. Together or separately, uncertainties affect the exports and production of the Finnish forest industry via changes in demand for forest industry products, exchange rates, and competitiveness.

Key forecasts 2016–2019f.*

Forecast variable	2017	2018f % change	2019f
Sawnwood production	3	2	1
Sawnwood exports	9	-1	2
Sawnwood export price	2	8	0
Plywood production	9	3	3
Plywood exports	11	3	3
Plywood export price	0	0	0
Pulp production**	3	8	1
Pulp exports	5	13	2
Pulp export price	7	19	-4
Paper production	-2	3	-1
Paper exports	-2	3	-1
Paper export price	-3	3	1
Cardboard production	9	5	3
Cardboard exports	9	5	3
Cardboard export price	1	4	2
Fellings of industrial wood	2	9	-1
Roundwood imports (incl. wood chips)	-15	26	1

*Price changes are nominal.

**Production figures refer to total pulp production, export figures refer to bleached sulphate pulp.

Sources: Finnish Forest Industries, Finnish Customs, and Natural Resources Institute Finland.

Average stumpage prices (over bark) in non-industrial private forestry 2017–2019f.

Roundwood assortment	2017 €/m ³	2018f €/m ³	Change %	2019f €/m ³	Change %
Pine sawlogs	54.9	59.6	9	60.3	1
Spruce sawlogs	57.8	63.3	10	62.6	-1
Birch sawlogs	42.7	45.4	6	45.2	0
Pine pulpwood	15.9	17.3	8	17.5	1
Spruce pulpwood	17.7	19.7	11	19.5	-1
Birch pulpwood	15.3	16.6	8	16.6	0

Source: Natural Resources Institute Finland.

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The executive summary is a translation of the summary of the Finnish original publication, and is based on information available in early October 2018.

Available at: <http://urn.fi/URN:ISBN:978-952-326-628-5>



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