

The TFU's regular look at tropical timber markets: bullish market in 2006

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Ask anybody in the trade and they would agree on the recovery of primary tropical timber products prices in 2006. Prices for many of these products matched or exceeded levels seen before the Asian financial crisis of 1997–1998. Higher prices are a reflection of tighter availability of raw materials in tropical producer countries, added costs of implementing sustainable forest management plans and greater control of illegal logging that, if unchecked, exerts downward pressure on prices. Other factors behind the recovery in prices include the emergence of China, India and the Middle East as alternatives to traditional markets in Japan, the EU and the US; a weaker US currency; and rising energy and oil-based raw material costs.

Southeast Asian producers benefited the most

Southeast Asian producers were the worst hit by the 1997–1998 financial crisis when prices for many primary timber products more than halved and remained depressed for several years. Prices recovered gradually from 2001 due to shrinking supply and growing demand from China, India and the Middle East, and picked up sharply in 2005. Acute log shortages were exacerbated by actions in Malaysia to stop the issuance or renewal of licenses for timber concessions and the announcement in Indonesia of a ban on the use of natural forest species for pulp and paper production by 2009 and for wood processing by 2014.

Prices for Southeast Asian products continued to advance throughout 2006 even during holiday seasons in traditional export markets as supply remained restricted. Japan, which imports most of its tropical logs from Southeast Asia, has in recent years lost its position as log and lumber price leader in the region to China and India. Japanese buyers are now regularly outbid by Chinese and Indian buyers. Meranti and keruing logs reached 13 and ten-year highs, respectively, exceeding 1997 Asian pre-crisis levels, while dark red meranti sawnwood prices were at an all-time high in US dollars (six-year high in euros or UK pounds) since ITTO started to track this product in 1998. Meanwhile, prices for dark red meranti plywood were at ten-year highs,

also exceeding 1997 Asian pre-crisis levels, except 9 mm thicknesses which remain depressed. Log and sawnwood prices were beginning to level off in late 2006 as building activities in main markets slowed down as the winter approached, although monsoon rains pushed some prices up as logging operations were hampered. Prices for panels continued to surge in the second half of 2006 as demand picked up in Japan with some plywood products reaching new record highs.

Rubberwood jumps

Rubberwood, once deemed a readily available and relatively cheap material, was also affected by shortages. Latex prices soared to 20-year highs early in 2006, encouraging rubber tapping and undercutting the profitability of rubberwood production. This drove prices of rubberwood up sharply, affecting Southeast Asian furniture manufacturers who depend on this material for 80% or more of their output. Malaysia extended its rubberwood export ban to finger-jointed sawnwood in mid-2006 as harvesting of the species outpaced replenishment, but supply remained tight. Malaysian and Thai furniture producers were seeking rubberwood supplies from Indonesia and Myanmar for their furniture industries.

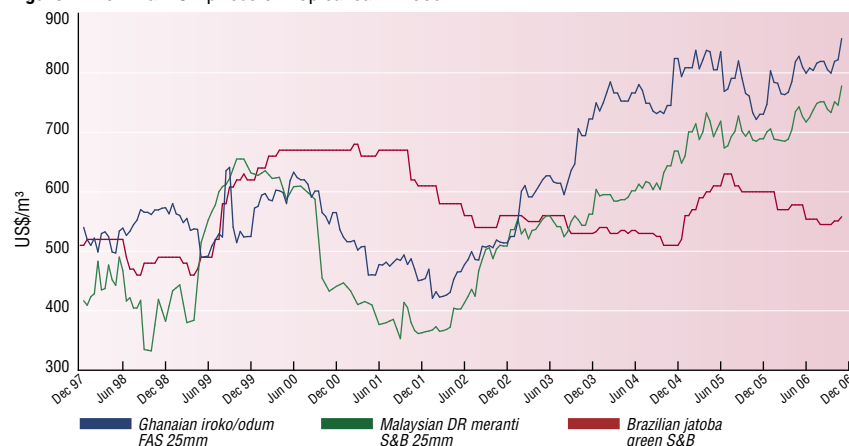
Malaysia consolidates itself as the largest plywood exporter

Malaysia overtook Indonesia as the world's largest tropical plywood exporter in 2004 and as the largest exporter to the key Japanese market in 2005. Malaysia, where plywood mills are technologically better equipped, also assumed price leadership in the export market. Malaysian exporters received another boost on 1 January 2006 with the EU's reduction of import duty on its plywood from 7% to 3.5%. In addition to stimulating import demand, the reduction gave Malaysia a competitive edge over Indonesian and Chinese plywood, on which a 7% import duty is still levied by the EU.

Indonesian panels have failed to benefit from the same price hikes seen in Malaysian panels as buyers have lost confidence in the supply. Several Indonesian panel manufacturers have been unable to fulfil orders amid mill closures, layoffs and declining exports. Additionally, Indonesia's export ban on logs and rough sawnwood brought about an additional level of bureaucracy, hindering the operations of legal exporters. Facing declining plywood supply from Indonesia, European and Japanese buyers have turned to Malaysia to replenish stocks. However, Malaysian mills were reported to be producing almost at top capacity, which has driven prices further up. In late 2006, importing countries took a second look at Indonesia due to worries about the tight supply situation in Malaysia. Chinese plywood also continued to gain market share in Japan and Europe at the expense of Malaysia and particularly Indonesia.

Sawn up

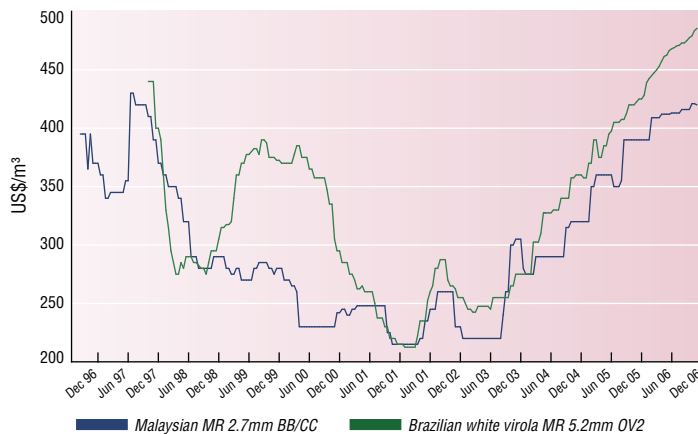
Figure 1: Nominal FOB prices of tropical sawnwood





Ply bounce

Figure 2: Nominal FOB prices of tropical plywood



Asia takes price leadership from Europe in Africa

After initially failing to follow the upward trend in Asian prices, West and Central African timber product prices began edging up from March 2006. Demand from India has been particularly strong as the country faces a huge timber supply deficit, estimated by the World Bank at a record 39 million m³ in 2006. Strong demand from Asia resulted in prices for Asian markets moving ahead of those for Europe, with fewer timber offers for Europe. Over the course of the year, Asian buyers took price leadership from Europe in West and Central Africa. Prices for sapele, which weakened in 2005 after Chinese buyers stepped back from the market, rose in 2006 as these buyers returned. Even during the summer vacation when prices tend to ease as demand slows, prices in West and Central Africa held firm at high levels and prospects for future demand look promising. Although African sawnwood prices were under downward pressure in Europe in late 2006, stable demand from India and China, and the very tight supply for Asian species will probably hold the African market steady through 2007.

Log exports restricted

Cameroon's three-year old policy of phasing out log exports of major species and quickly developing further processing was implemented at exactly the right time given recent market developments. Despite some initial resistance, the new policy has proven highly successful and is now being emulated by Gabon. Chinese demand for African sawnwood has given domestic processing policies in these countries a significant boost. China has been much more active in the sawnwood market with uptake of large volumes of sawn okan and other hard species in strips and squares at Douala and other ports.

Gabon began the establishment of a log export quota system in June 2006, similar to that in Cameroon. The log export quota covers certain premium species and depends on the proportion of sawn/processed volume that the mills produce. The quota system will be implemented in stages, much like the implementation of the free market for okoume and ozigo which was due to come into effect last January. Gabon's SNBG still held a monopoly on okoume and ozigo log sales at the end of 2006.

There has been some speculation on the eventual resumption of Liberian timber exports. After the revocation of all forest concessions and the establishment a Forestry Reform Monitoring Committee (FRMC) in February this year, a new forestry law was approved in October, paving the way for the re-assignment of forest concessions. In June, the UN Security Council lifted

the three-year log import ban from Liberia, conditional on the passing of appropriate forestry legislation. However, the reactivation of logistics and infrastructure was expected to require time before full log harvesting could be resumed in the country. Liberian niangon is certain to reclaim its niche as a favourite species for French buyers.

Brazilian timber sector undergoes sharp slide in exports

Undermined by the sustained strengthening of the *real* and suspension in the approval of forest management plans (FMP), Brazilian exports of solid wood products fell in 2005 and 2006. The suspension of FMPs was due to a crackdown on illegal logging and institutional changes in the forest authority. The 2005 forest law created the Brazilian Forest Service, which assumed some of IBAMA's functions and is responsible for the implementation of the law. Other developments included the September launching of an online timber transport tracking system that replaced the paper-based method of log transport permits to crack down on illegal logging. Strikes by IBAMA and customs workers also hindered exports in 2006.

The plywood and furniture sectors have been hardest hit by declining exports, leading to widespread layoffs. Brazilian exports of plywood plunged in the first half of 2006 as prices fell in the US and Europe and the exchange rate remained unfavourable. The country's furniture sector resorted to imports of cheaper raw materials to mitigate the unfavourable exchange rate and rising production costs in order to compete with Asian producers. In the second half of 2006, the Brazilian plywood and furniture sectors were further affected by the slowdown in the US housing market, pushing prices down further. Although export volumes of tropical plywood declined through 2006, the product was benefiting from higher prices due to low supply in foreign markets.

Mahogany sawnwood prices reach new highs

In Peru, export prices for mahogany sawnwood maintained record highs through the year due to delays in the issuance of CITES certificates and resulting supply disruptions. Peru's INRENA established a 2006 quota for mahogany exports of 23 239.6 m³ and continued its crackdown on illegal logging. Some exporters indicated that as a result of problems associated with the issuing of CITES certificates, customers were looking for mahogany substitutes such as Spanish cedar (*Cedrela odorata*). Peruvian and Bolivian exporters were concerned as their US trade preferences under the Andean Trade Promotion and Drug Eradication Act (ATPDEA) expired at the end of the year. This was compounded by delays in the ratification of the US-Peru free trade agreement by the US Congress.

Prospects for 2007

At the time of writing, markets were heading into the Christmas holidays, bringing to an end the building activity for 2006. The New Year holds promises for tropical timber exporters in terms of continued demand in Chinese, Indian and Middle Eastern markets. This should help prices remain firm. However, concerns about log availability, rising fuel costs, a weakening of the US dollar and the ongoing correction in the US housing sector will likely remain.

In many tropical countries, manufacturers relying on timber from their own forest plantations or concessions are expected to be in a better position to take advantage of market opportunities amid tightening roundwood supply. China will likely continue expanding exports of (semi-) processed products and gaining market share in key export markets, particularly for plywood, solid flooring and furniture.