

Stark divergence of financial and real economy holds down tropical timber exports

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In none of the recovery periods during past economic crises affecting tropical timber markets has the divergence between the financial economy and the 'real' economy been so stark. In global financial markets there is growing optimism that the stability now achieved will open the way to economic growth and this has encouraged the flow of money into equities, pushing up stock prices. As is usual, equity market trends are always far ahead of activity in the real economy, which is why, despite relief that the worst of the current downturn may be over, tropical timber markets remain as dull as they were 12 months ago.

Grim import trends

In 2012, EU imports of all major tropical timber products fell by at least 13% (tropical sawnwood), up to a massive 30% drop in log imports from tropical suppliers. US imports of tropical wood products in 2012 fared a bit better than for the EU, with modest growth in hardwood plywood imports, up 9% from 2011 levels. However, the US data does not separate tropical and temperate hardwoods, so caution must be exercised when interpreting this figure. US imports of hardwood mouldings declined 8.5%, while furniture imports grew by over 8% (although, again, the tropical component of furniture imports is difficult to determine from available statistics).

In Asia, Japan's imports of plywood (-4%), sawnwood (-6%) and logs from tropical countries all declined in 2012 compared to levels in 2011, with the steepest drop being recorded for tropical log imports which were down by more than a third. To cap the gloomy picture, imports by China of both tropical logs (-10%) and tropical sawnwood (-4%) fell in 2012 compared to levels in 2011.

The story behind the economic indicators

A brief look at trends in construction and house building activity, an indicator closely correlated with demand for wood products, provides clues as to why demand for wood products is flat and when recovery might be expected in the market for tropical timber.

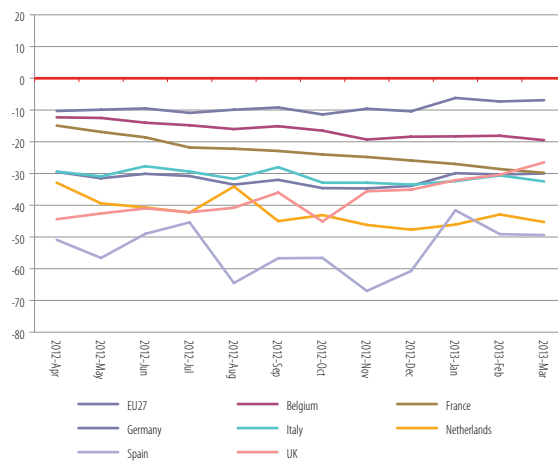
EU housing, five years of uninterrupted decline

For the last five years, the Eurostat construction index for both the EU27 and euro-area group of countries has fallen consistently, with only an occasional short-lived reversal. In the first quarter of 2013, EU-27 construction activity reached new lows, dropping 5.2% compared to the same quarter in 2012, and down 2.8% compared to the previous quarter (Figure 1).

Particularly worrying is that the downturn in construction is now almost universal across the continent. Comparing the first quarter of 2013 with the same period in 2012, construction production was down in Czech Republic (-11%), Germany (-3.7%), France (-3.3%), Netherlands

(-8.2%), Poland (-15.9%), Portugal (-20.8%), Romania (-3.9%), Slovenia (-2.4%), Slovakia (-10.9), Sweden (-0.4%), and the UK (-7.4%). These declines are only partly offset by gains in Latvia (+9.8%) and Hungary (+4.8%). After five years of almost uninterrupted decline, construction activity across the EU is at 75% of the all-time peak in 2007.

Figure 1. EU construction index (% change on previous year)



Source: Eurostat

No end in sight to recession in EU construction sector

Euroconstruct, a network for construction, finance and business forecasting in Europe, has reported that high unemployment, stagnant economic growth as well as strained public sector finances suppressed European construction activity throughout 2012. In June last year, a 2% decline in construction activity during 2012 was forecast. However in December 2012 it became clear that the decline was worse at around 4.7%. Euroconstruct now forecasts a further decline of around 1.6% for 2013 and only a minor improvement of 1% in 2014 and 1.9% in 2015.

The debt-ridden EU member states have the most severely affected building sectors. Spanish construction output fell by over 30% during 2012, following double-digit declines in 2009, 2010, and 2011. A further 23% decline is forecast for the Spanish housing and construction sectors this year. Portugal and Ireland also experienced double-digit declines in construction output in 2012 and prospects for a rapid recovery are slim.

However, moderate growth is forecast for some key EU member states. Germany is Europe's largest construction/housing market and growth in German construction is expected to resume this year. Low single-digit growth is also forecast in 2013 for Denmark, Norway, Sweden and Switzerland.

Japan 2012 housing starts - sixth lowest since 1965

While there has been some recovery in housing starts in Japan, total starts in 2012 were 882 797, the sixth lowest level since 1965. In March this year housing starts were

... Market trends

71 456 units, 7.3% more than in March last year marking seven consecutive monthly increases. If this rate is sustained the seasonally adjusted annual starts would be 904 000 units for 2013, still a long way from a *Japan Forest Products Journal* forecast of 920 000 annual 2013 starts. Even this forecast, based on a survey of major house builders in Japan, represents less than 5% growth in housing starts from 2012, hardly sufficient to light a spark under Japanese tropical wood product imports.

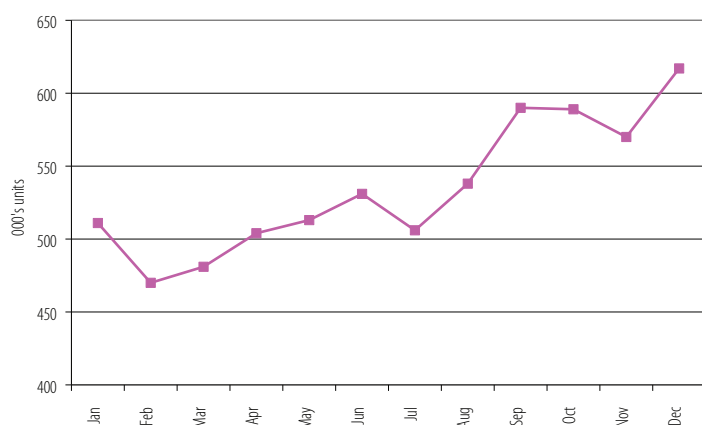
Recovery of US housing market

A rare example of good news on the global housing front is from the US where the recovery of the housing market picked up in the second half of 2012 with unsold inventories dropping and new starts on the rise. In December 2012 US builders started work on homes at the fastest pace in four years and finished 2012 with the best performance since the housing market began to collapse in late 2006 and 2007 (Figure 2). Improvement in home building in 2012 has boosted construction spending. Spending on private residential units increased in eight months in 2012, rising to a 4-year high and nearly 33% above the worst levels recorded during the third quarter of 2010.

Building permit data remains positive, although there was little monthly change in permits issued in December 2012. The total number of permits issued in 2012 was 813 400, 30% above 2011. The number of building permits issued in March this year was 902 000 (seasonally adjusted annual rate), down 4% from February. The number of permits issued is usually an indicator of future building activity.

Annualized US housing starts passed the 1-million mark in March 2013 for the first time since 2008. The number of total starts rose to 1.036 million homes in March (seasonally adjusted annual rate), up by 7% from February. Multi-family starts increased by 31%, while single-family starts fell by 5%. The share of single-family homes in total starts declined to just 60%. Builders of single-family homes have difficulty keeping up with demand because of increasing material costs and worker shortages.

Figure 2. 2012 US monthly housing starts*



* single family units, approximately 70% of total units

Source: US Department of Commerce, US Census Bureau, Foreign Trade Statistics

China achieves solid 2012 real estate sales

Chinese residential real estate sales in 2012 grew 14.9 percent according to the National Bureau of Statistics of China. Continued growth in demand for homes is good news for the domestic wood product manufacturing sector and for exporters supplying timber to the Chinese market. However,

the growth in real estate sales slowed markedly over the year as the government sought to put a brake on markets.

Sales of commercial buildings in China, a major driver of demand for joinery products and office furniture, increased in 2012. The total floor area of office buildings sold in 2012 increased 12.4 percent. Preoccupation with the prevalence of Chinese-produced wood products in the international markets distracts attention from the rapidly developing domestic market for wooden building materials and added-value wood products. The expansion of domestic demand in China serves to balance declines in exports such that demand for timber raw materials will continue to grow.

Where to in 2013?

It is encouraging that there are fewer negative trends visible in available first-quarter import statistics of tropical wood products (Table 1) but the markets have a long way to go to recover to the pre-crisis levels of 2006/7.

EU still second largest importer

Demand in the EU remains weak and continued declines in imports of tropical plywood, sawnwood and logs have been reported. European demand for African hardwood remains quiet, with orders in northern European markets similar to last year and demand very weak in southern Europe. However, low demand is balanced by restricted supply.

The market for tropical hardwoods in Italy also remains weak. Many large Italian wood manufacturing companies are believed to be in serious financial difficulty as domestic demand has crashed. In Spain, sawn hardwood imports last year suffered a 37% fall compared to the previous year and were less than a quarter of the volume that prevailed before the economic crisis. For 2013 Spanish importers foresee no improvement in market conditions.

Market conditions are slightly better in parts of northern Europe. The UK has been one of the more robust markets in Europe for tropical wood. UK importers are experiencing reasonable demand so far this year with most expecting sales for 2013 to be similar to last year. Demand for tropical timber in Germany has been reasonably consistent and importers say that demand in the first half of 2013 is likely to be firm.

EUTR offers both risks and opportunities

A key issue for tropical wood suppliers to the EU is the effectiveness, efficiency and equity of enforcement of the new EU Timber Regulation (EUTR) that entered into force in March. It's hard to imagine a worse time than the present for introduction of the EUTR. The economic downturn in Europe has reduced EU consumption of tropical hardwoods by about 50% in the last five years. Many EU importers are, with justification, concerned that while they become increasingly discriminatory in their procurement practices, tropical wood trade flows will simply be diverted to other markets. At the same time, the economic downturn means that both government authorities and the private sector in EU member states often lack the resources to implement the regulatory and due diligence procedures required by the EUTR.

The challenges of the EUTR and related FLEGT VPA processes are profound and made all the more challenging by the current market environment in the EU but it is worth remembering that even with the downturn the EU remains the world's second largest importer of timber products (after China), accounting for around 17% of the global import value.

Table 1. Change in 2012-2013 first quarter import volumes (selected tropical timber products, major markets)

EU imports	% change Qtr1 2012- Qtr1 2013	US imports	% change Qtr1 2012- Qtr1 2013	Japan imports	% change Qtr1 2012- Qtr1 2013	China imports	% change Qtr1 2012- Qtr1 2013
Hardwood plywood	-2.5%	Tropical sawnwood	-10%	Plywood	5%	All logs	5.7%
Tropical sawnwood	-15.7%	Hardwood plywood	31%	Tropical sawnwood	-12%	Tropical logs	6.5%
Tropical logs	-25.7%	Furniture	6%	Tropical logs	-46%	All sawnwood	3.4%
						Tropical sawnwood	-4.7%

Can US growth continue?

US economic data released in June 2013 shows continued strength in private consumption despite income growth weakness; the question worrying analysts is just how long this can be sustained. Sentiment up to mid 2013 was driven by the improving housing market and a strongly rising stock market. One serious concern for US economic growth is the slow pace of business investment.

US imports of hardwood plywood (which includes tropical plywood) surged in the first quarter by over 30%, but it is unlikely this growth will continue. In sharp contrast, imports of tropical sawnwood fell 10% in the first quarter. On the other hand, imports of wooden furniture recorded a modest gain in the first quarter (6%).

The US housing market has been struggling to rise from the depths of recession for several years but the rebound in demand over the past twelve months, during which home building has improved to just over a million units (annualized rate), has lifted sentiment. Continued expansion in house building and more investment in home improvement bodes well for tropical timber suppliers.

Japan's tropical log imports forecast to fall

In early 2013 the Japan Foreign Timber General Supply and Demand Liaison Conference (JFTGSDLC) released forecasts for timber imports in 2013 (Table 2). While total demand for logs in 2013 is forecast to be much as it was in 2012, demand for tropical logs is expected to fall by around 40% largely because of the closure of one of Japan's major tropical plywood mills. The change in first quarter imports shown in Table 1 above largely bears out these forecasts. Japan continues to import significant volumes of tropical plywood and demand in 2013 is forecast to be higher than in 2012 as a result of expected increased activity in the construction and house building sectors.

China rebalances international trade

China's 2012 imports of logs and sawnwood fell short of the levels in 2011 but first quarter 2013 data shows that this downward trend has been partly reversed. Imports of tropical logs expanded in the first quarter (Table 1).

Efforts are being made by China's policy makers to address the country's trade imbalance and plans to accelerate

imports and to transform the structure of China's foreign trade have been prepared. Measures include adjustments to tariff structures, strengthening the range of information services and increasing transparency and coordination between the private sector and government agencies.

China's foreign trade has grown robustly over the past 10 years and the country has established itself as a major trading nation but still, analysts say, quality and industrial efficiency remain problems. The current development model for China's foreign trade, which relies on low cost resources such as energy and labor, is considered unsustainable. The competitiveness of labor intensive industries in developing countries has improved to such an extent that exporters in such countries can compete very effectively with Chinese exporters. Reports from Chinese government agencies say a decision has been made to restructure trade so as to ensure it drives economic and social development in the country, which could signal greater opportunities for exporters of added value wood products for the domestic market in China.

Table 2. Forecast change in Japan's imports

Product/source	2012/2013 % change
Logs	
Tropical	-38
for plywood	-42
for sawnwood	-23
N. American	3.6
Russian	1.9
Radiata	-0.4
EU	no change
All log imports	-0.5
Sawnwood	
Tropical	2.2
N. American	0.2
Russian	8.6
Radiata	-0.6
EU	3.2
All sawn imports	1.1

Source: JFTGSDLC

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