

MARKET STATEMENT 2009

1. GENERAL ECONOMIC TRENDS AFFECTING THE FORESTRY AND FOREST BASED INDUSTRIES

High economic growth was observed in Latvia during 2005-2007, which was characterised by annual average increase of gross domestic product (GDP) by 10%. Since mid-2007, the growth rates started to decline, and in the 3rd quarter of 2008 they became negative. With the expansion of the global financial crisis, recession in Latvia continued in the second half of 2008, and negative growth rates are projected for 2009 as well.

According to the information of the Central Statistical Bureau, the total added value in the 1st quarter of 2009 decreased by 16.2% in comparison with the corresponding period of the previous year. The reduction in domestic and external demand contributed to a decline in both goods and services sectors (by 22.4% and 14.2% respectively). The recession was observed in almost all sectors, but the biggest overall decline rate was attributed to trade (5.9 percentage points), manufacturing industry (3.1 percentage points), transportation, storage and communications (2.1 percentage points) and construction (1.8 percentage points).

The reduction in external demand led to a drop in the volume of exports of goods. The decrease in external demand was caused by the global economic slowdown.

In June, the production sector showed a slight increase in monthly output. According to seasonally adjusted data, the industrial output index, compared to May, grew by 1.4%, which was accounted for by a significant increase in power industry (11.5%) and a small increase in manufacturing industry (0.9%). Compared with the corresponding month of the previous year, the industrial production continues to experience a substantial decline, reflecting the difficult situation in the sector, yet stabilization tendencies gradually begin to take shape.

The ebbing financial inflows resulted in a rapid reduction in private consumption and investments, as well as substantial economic adjustments, which manifests as the improvement of the export-import balance of goods and services along with the decline of economic activities upon the decreasing domestic demand. The domestic demand in 2008 was by 10.2% lower than the previous year. One of the factors of the economic slowdown was decline in the manufacturing output, which is the main export industry. It was determined not only by a lower domestic demand and a weakening demand in the trade partner countries, but also a gradual decrease in the competitiveness of Latvia's industry due to high inflation in the previous years and sharp increases in labour costs. Manufacturing production in 2008 was by about 6.5% lower than the previous year.

In the first half of 2009, forest sector exports in Latvia dropped by 40% in terms of money. The most significant impact was left by the rapid decrease in sawnwood export, which is the major export product in the forest sector, accounting for a quarter of the total exports in the sector. Sawnwood exports in terms of value dropped by 39.5%, while the reduction in terms of volume was only 21%.

2. POLICY MEASURES INFLUENCING TIMBER TRADE AND MARKETING (over the last 18 months)

Given the current economic slowdown trend in the world and in Latvia, the government acts to prevent a further fall in the economic activity, stabilize and revitalize the financial system, improve the efficiency of public administration by reducing its costs and restructure Latvia's economy by increasing its competitiveness.

The government of Latvia, in cooperation with the European Commission (EC) and the International Monetary Fund (IMF), has developed Latvia's Economic Stabilization and Growth Revival Programme, which was approved by the Parliament (Saeima) in

December 2008. The Programme aims to provide structural changes for the sustainable economic development. The government has approved specific proposals of financial assistance instruments to improve economic competitiveness.

Deterioration in global financial markets has reduced the creditworthiness of the banking sector, which has a negative impact on investment both directly, by restricting the external sources of investment financing for businesses, and indirectly, *i.e.* the drop in demand leads to deterioration of companies' financial situation, limiting the internal sources of investment financing.

Since 2004, the positive investment behaviour remained in the timber and building materials manufacturing industries. During the period between 2006 and 2007, the annual investment growth rate, compared with the previous two years, was more rapid. In 2007, investment in these sectors accounted for 58.1% of the total investment volume. Like in other industries, investment in the timber sector reduced in 2008.

In 2008, the levels of the accumulated foreign direct investment (FDI) increased in all sectors in general, suggesting that investors, despite the decline in economic activity, did not significantly adjust their plans. Foreign direct investment growth in manufacturing industry by 10.7% in 2008 and by 22% in the 1st quarter of 2009 indicates that the crisis has had little impact on the foreign investors' interest in this sector. The most attractive manufacturing sectors for foreign investors are food industry, timber industry and other non-metallic mineral products industry. The accumulated FDI in these sectors at the end of March 2009 accounted for 74% of all accumulated FDI in the manufacturing industry. Over the last four years, most investment in the manufacturing industry has been made by investors from Denmark, Finland, Germany, Sweden and Ireland.

In 2009, representatives of interest groups of Latvia's forest sector, in cooperation with the Ministry of Agriculture, developed specific proposals for the forest sector's recovery plan by suggesting integration of such proposals into the overall country's stabilization plan. At the end of 2008, the government supported the increase of the maximum permissible volume of tree felling in the state forests.

The proposals approved and implemented by the government have enabled the industry to maintain the production potential at the level of 2008 and keep the position in export markets.

3. MARKET DRIVERS

In some manufacturing sectors in Latvia, including the timber industry, which has a significant share in Latvia's industry, growth has resumed after a period of slowdown. This means that after the prolonged recession some sectors have managed to stop the further decline and to stabilize production, using a variety of opportunities to expand sales. Forest industry has managed to increase volumes for several consecutive months by diversifying and adapting to the requirements of market outlets.

According to entrepreneurs, the main obstacles for industry rehabilitation still are weak domestic and external demand, as well as financial difficulties. The limited opportunities for product sales and credit availability reduce the working capital required for production, therefore further development is highly dependent on both the improvement of the global situation and on the government's ability to support business in this situation.

The forest sector occupies an important and stable place in the national economy of Latvia. Timber industry is the second largest manufacturing sector in Latvia, with a total turnover amounting to EUR 1,906 mln in 2007. Timber industry in the value-added structure of manufacturing industry amounted to 23% in 2007, employing 28% of the total number of those employed in manufacturing industry and exporting 65.3% of its output.

Several development programmes have been launched using financing from the EU Structural Funds, such as *Manufacturing Application of New Products and Technologies*,

the Competence Centres Programme, Support for Technology Transfer Contact Points and the Development Programme for Innovation Centres and Business Incubators, which are focused on the promotion of knowledge-intensive economic development and higher added value production.

The biggest impact on the increase in consumer prices in 2008 was attributed to the rise in prices on housing-related goods and services by an average of 31.6%, accounting for more than one third of the total increase in prices. A rapid growth was observed in service prices on heat (+51.9%), electricity (+39.2%), gas (+57.2%) and housing management (+32.4%). Since mid-2008, the consumer price growth rate has gradually decreased following a reduction in domestic and external demand. The 12-month inflation in the six months of 2009 has fallen to 3.4% (it was 10.5% in December 2008). It is expected that over the coming months, inflation will continue to decline, and the 12-month inflation will be negative in autumn.

The Central Statistical Bureau's information on round timber purchase prices shows a continuing decline in prices in 2008. Comparing round timber purchase prices in 2008 and 2007, it should be noted that purchase prices of pine sawlogs on average reduced by 8-16%, of spruce sawlogs – by 19-29% and of deciduous sawlogs – by 15%. Birch veneer log purchase prices dropped by 11%.

Reduction in economic activity is increasingly affecting employment figures. In the first half of 2009, along with the slowdown in economic activities, the share of the employed population continued to decrease: the number of employees in the 1st quarter of 2009 was by about 8% less than in the 1st quarter of 2008.

Latvia's timber industry has been significantly influenced by the decision of the Russian Federation to increase export duty on roundwood. Import of non-processed roundwood in 2008 in Latvia dropped by 90% in comparison with 2007. The 2009 half-year figures show that non-processed roundwood from the Russian Federation is not imported at all.

4. DEVELOPMENTS IN FOREST PRODUCTS MARKETS SECTORS

A. Wood raw materials

Roundwood in Latvia is mainly used for production of sawnwood, wood-based panels, turned and planed products, wooden houses, palisades and garden furniture, fuelwood, charcoal, etc. Also, roundwood is mostly exported as pulpwood.

In 2008, roundwood export decreased by ~14% in terms of volume, while the value of exported timber dropped by 26%, in comparison with 2007. In the first half of 2009, in comparison with the respective period of the previous year, there was a decrease of 57% in the value of the exported round timber and a decrease of 37% in the exported volume of the same. Almost 81% of the roundwood export is pulpwood, which is mainly exported to Sweden, Finland and Estonia.

Over the last years, due to the rapid development of production of wood-based panels and fuelwood, there has been a significant increase in small size sawlog utilization locally. A producer of wood-based panels "Bolderāja Ltd" has become the largest purchaser of pulpwood. By increasing production capacity in 2008 and 2009, this enterprise will be able to process approximately half of the exported pulpwood volume into higher value added products.

The import of roundwood is dominated by sawlogs, which are processed in Latvia into higher value added products. In 2008, the volume of imported roundwood decreased by ~67%, amounting to 0.6 mln cubic metres only. In the first half of 2009, the volume of the imported roundwood dropped by ~93%.

In 2007, nearly 70% of all imported wood came from the Russian Federation. Due to a significant increase in the export duty on non-processed roundwood, the import dropped to 36% in 2008, and no roundwood was imported from the Russian Federation in the first

half of 2009.

B. Wood energy, with a focus on government policies promoting wood energy

Taking into account the climate conditions, production of thermal energy traditionally constitutes the biggest share (64%) of the energy balance of Latvia. Fuelwood is the most important local fuel in Latvia, and its share in the fuel balance is 25%. Major consumers of fuelwood are households – 65.4%, heat supply companies – 15.1%, industry (mainly wood-working enterprises) and other consumers – 19.5%. Fuelwood is used evenly across all regions.

Production of fuelwood (pellets, chips, fuel wood, briquettes) is becoming more important in Latvia's timber industry. Until now, however, logging residues have been used relatively seldom. Felling residues, parts of small wood, green mass and stumps, remaining in the forest after the felling operations can be used expediently as additional energy resources, thereby promoting the independence of the power industry of Latvia.

In 2008, fuelwood exports decreased by 5.6% in terms of value, amounting to EUR 133.9 mln and accounting for 11.4% of the total exports in the sector. The drop in exports in terms of volume was 11.5% in 2008. There was an increase in the local utilization of fuelwood.

The government of Latvia has embarked on an efficient utilization of forest resources and the potential mobilization programs, in addressing the complex energy issues in national and local level can create strong energy sector, based on local renewable resources and provide new opportunities for regional development.

The government of Latvia has embarked on developing the Programme for Rational Use and Mobilization of Forest Resources Potential. By finding complex solutions to issues of power industry at state and municipality levels, it is possible to establish a power sector which would be powerful and based on the use of local renewable resources, also providing for new opportunities in the regional development.

In 2009, the Cabinet approved the amendments proposed by the Ministry of Economics facilitating the conditions for EU Structural Funds Programme *Measures Regarding the Increase of Efficiency of Centralised Heat Supply Systems*, which aims to significantly increase the efficiency of heat supply production, reduce losses of heat energy in the transmission and distribution systems and foster the replacement of fossil fuel with renewable fuels or other types of fuel.

C. Certified forest products

Up until 2008, forest management and timber chain-of-custody certification in Latvia was performed under both forest certification schemes, which are widely recognized in Europe and in the world: FSC (*Forest Stewardship Council*) and PEFC (*Programme for the Endorsement of Forest Certification schemes*).

Currently, more than 50% of forests in Latvia, including all state owned forests, have been granted a **FSC** certificate which means that such forests are managed according to the internationally acknowledged standards of good forestry. More than 100 forest sector enterprises certified their timber chain-of-custody systems in compliance with the requirements of FSC in 2008.

The **PEFC** Latvian national scheme has been evaluated as compliant with the PEFC compliance evaluation programme. In 2007, almost 100 hectares of forests in Latvia were managed in compliance with the PEFC scheme, and about 50 Latvian forest sector enterprises have certified their timber chain-of-custody systems.

On 1st January 2008, the PEFC Latvian national scheme was discontinued. The process of approval of the revised version of this scheme is currently underway.

D. Value-added wood products

Over the last five years, the share of higher value added wood products in Latvia has developed rapidly and the variety of production has increased: furniture and furniture components, joinery and carpentry production, prefabricated wooden constructions, garden furniture and accessories, toys of wood and other production in high demand on the market. However, the decrease in the growth rates of the world economy in the beginning of 2008 has had an adverse effect on the growth in this sector: both domestic and foreign markets are dominated by the share of low value added products, and demand for furniture has decreased.

In 2008, export of furniture was EUR 94.8 mln in terms of value, which is by 17.4% less than in 2007, and in the first half of 2009, due to a considerable decrease in the trade with Germany and Denmark, there was a drop by 29.5% in terms of value.

In 2008, import of furniture decreased by 25.9% in terms of money in comparison with 2007. In the first half of 2009, there was a decline in furniture import by 60.2%. In the last six months there has been a fall in the import of furniture from Poland (by 69.8%), China (by 69%) and Lithuania (by 67.8%), in comparison with the respective period of previous year.

The biggest share in the group of carpentry products is attributed to laminated products, which account for more than a half of the total volume. Despite the fact that carpentry production volumes have decreased, they account for more than 6% in the total forest sector exports in the recent years.

The main products in the group of wood packaging materials are pallets, which make 85% of the total volume. The value of exported wood packaging materials in 2008 increased by 0.4%, but in the first half of 2009 the volume of wood packaging materials production and exports declined by 41.6%.

To develop manufacturing of modern carpentry products, such as wooden window frames, doors and prefabricated buildings, considerable investments have been made in many Latvia's enterprises in recent years. This development was to a great extent promoted by the boom of domestic and European construction market over the last years, however in 2008 it was affected by changes in the global economy, leading to a reduction in the return on investments and also in new investments. In 2009, the declining investment trend is still continuing.

E. Sawnwood

In 2008, the production of sawnwood decreased in comparison with 2007, reaching only 73.5% of the volume produced in 2007. In 2008, Latvia's enterprises produced 2.45 mln cubic metres of sawnwood, of which 1.5 mln cubic metres were exported. Mostly, processed sawnwood ready for further use in construction and manufacturing of furniture or other materials was produced and exported.

Export of sawnwood from Latvia has been considerably influenced by the reduced demand by almost 50% in the largest market – Great Britain. There has also been a considerable decrease in the export of timber to Ireland and Japan.

Import of sawnwood has dropped by 61%. The imported volume of sawnwood in 2008 was only 0.23 mln cubic metres, of which 62% came from the Russian Federation. The data of the first 6 months of 2009 show that import of sawnwood from the Russian Federation continues to decline. In the first half of 2009, the decrease was by 88% in comparison with the respective period of 2008.

F. Wood-based panels (particle board, fibreboard, etc.)

One of the most significant forest industry sectors in Latvia, due to large investments, is the production of wood-based panels. In 2008, export of wood-based panels increased by 4% in comparison with 2007 and accounted for 17.3% of the total export value in the sector. Latvia is the largest plywood producer in the Eastern Europe. Recently considerable investments have been made in the production of particle boards, oriented

strand boards (OSB) and medium density fiberboards (MDF).

In 2008, the value of exported plywood, in comparison with 2007, decreased by 16.8%, accounting for EUR 121.1 mln, while the export volume of plywood dropped by 36.8%. Plywood is mostly exported to Germany, the Netherlands and Lithuania.

There has been an increase in the domestic consumption of plywood and other panels, mainly used in construction.

In 2007 and the beginning of 2008, there was a rapid increase in the production and export of particle boards due to large investments made in the sector and production of higher value added products. Export of particle boards in 2008 has increased by 80% in terms of money, yet, unfortunately it dropped by 47.4% in the first half of 2009. In terms of volume, export increased by 84.1% in 2008 and decreased by 36.8% in the first six months of 2009.

The new production unit of the company "Bolderāja Ltd" manufactures oriented strand boards from coniferous small size timber. The boards are light and durable, and a special processing technology ensures that they can be used in different structures without additional treatment.

G. Pulp and paper

In comparison with the previous year, in 2008 there was a decrease in production volume and domestic consumption of paper and paperboard in Latvia. Export of these products in terms of money has decreased by 7.4%. The main markets for these products are Lithuania and Estonia, while the prospects of expanding to the markets of other EU Member States are low.

5. TABLES

Key Indicators of Economic Development, Latvia

	2005	2006	2007	2008	2009 f
(growth compared with the previous year, per cent)					
Gross domestic product	10.6	12.2	10.0	-4.6	-18.0
Private consumption	11.2	21.2	14.8	-11.0	-21.0
Public consumption	2.7	4.9	3.7	1.5	-9.5
Gross fixed capital formation	23.6	16.4	7.5	-13.2	-24.0
Exports	20.2	6.5	10.0	-1.3	-12.0
Imports	14.8	19.4	14.7	-13.6	-29.0
Consumer prices	6.7	6.5	10.1	15.4	2.8
(per cent of GDP, unless indicated otherwise)					
Central government budget fiscal balance	-0.4	-0.5	-0.4	-4.0	-9.0
Central government debt	12.4	10.7	9.0	19.5	30.0
Current account balance	-12.5	-22.5	-22.5	-12.6	2.0
Foreign direct investments received within a year in Latvia	4.5	8.1	7.0	4.0	0.5
Employment rate (% of economically active population, 15-64 years)	63.4	66.3	68.4	68.6	64.0
Unemployment rate (proportion of job seekers in % of economically active population, 15-74 years)	8.7	6.8	6.0	7.5	15.7

f – forecast of the Ministry of Economics *Source: Ministry of Economics*

Forest sector production exports from Latvia

HS code	Production	Units	2007		2008	
			1000 (units)	1000 (EUR)	1000 (units)	1000 (EUR)
3605	Matches		-	1514.6	-	183.1
44	Wood and articles of wood		-	1243620.8	-	995083.6
4401	Fuelwood:	(t)	2 715.90	142105.3	2 402.30	134077.4
44011	Fuelwood (round)	(t)	338.4	15336.4	354	16073.6
44012	Chips	(t)	1 693.00	66847.8	1 556.70	66743.4
44013	Sawdust and other wood residues	(t)	684.5	59921.1	491.6	51260.4
4403	Roundwood:	(m ³)	3 689.60	240360.0	3 192.60	178911.3
44032	Coniferous	(m ³)	1 712.10	115050.9	1 606.40	88270.8
44033...	Non-coniferous	(m ³)	1 977.60	125309.0	1 586.10	90640.5
4407	Sawnwood:	(m ³)	2 098.10	454733.9	1 543.90	283729.0
44071	Coniferous	(m ³)	1 762.40	388546.3	1 313.10	241399.0
44072...	Non-coniferous	(m ³)	335.7	66187.6	230.7	42330.0
4408	Veneer sheets	(m ³)	10.5	11643.9	7.7	8530.3
4409	Further processed sawnwood:		-	22970.4	-	19577.4
44091	Coniferous		-	14017.4	-	9572.5
44092	Non-coniferous		-	8953.0	-	10004.9
4410	Particle board	(m ³)	235.7	44593.8	434	80285.3
4411	Fibreboard	(m ²)	1 125.10	3355.1	1 068.20	2503.8
4412	Plywood	(m ³)	247.7	145553.7	156.4	121092.8
4415, 4416	Wooden wrapping and packing equipment		-	54754.0	-	54975.6
4418	Joinery and carpentry		-	90799.1	-	78654.5
44...	Other articles of wood		-	32751.7	-	32745.8
47	Pulp of wood, recovered paper	(t)	38	2656.5	38.5	3320.3
48	Paper and paperboard, articles of paper		-	75777.9	-	70203.6
94...	Furniture		-	114773.7	-	94796.0
9406	Prefabricated buildings		-	14882.5	-	14156.0
	Total:			1453226.1		1177742.6

*Prepared by: Department of Forest, Ministry of Agriculture
Source: Central Statistical Bureau*

Forest sector production imports to Latvia

HS code	Production	Units	2007		2008	
			1000 (units)	1000 (EUR)	1000 (units)	1000 (EUR)
3605	Matches		-	56.3	-	432.0
44	Wood and articles of wood		-	361714.5	-	184351.3
4401	Fuelwood:	(t)	140.3	14082.3	148.4	6348.0
44011	Fuelwood (round)	(t)	7.6	571.0	1.2	237.8
44012	Chips	(t)	19.9	854.6	80	1698.2
44013	Sawdust and other wood residues	(t)	112.9	12656.6	67.2	4412.2
4403	Roundwood:	(m ³)	1 687.70	116051.0	566.2	42158.0
44032	Coniferous	(m ³)	1 043.50	70570.0	229.4	12405.5
44033...	Non-coniferous	(m ³)	644.2	45481.0	336.9	29752.5
4407	Sawnwood:	(m ³)	601.9	102267.6	231.6	39426.5
44071	Coniferous	(m ³)	555.4	91850.8	197.9	31791.4
44072...	Non-coniferous	(m ³)	46.5	10416.8	33.7	7635.0
4408	Veneer sheets	(m ³)	4.7	4604.8	4.4	3414.9
4409	Further processed sawnwood:		-	6832.5	-	4042.9
44091	Coniferous		-	4482.2	-	1517.8
44092	Non-coniferous		-	2350.3	-	2525.2
4410	Particle board	(m ³)	126.5	34347.3	65.6	17237.9
4411	Fibreboard	(m ²)	5 408.30	16522.4	4 496.80	15602.6
4412	Plywood	(m ³)	41.4	15138.8	36.6	16181.8
4415, 4416	Wooden wrapping and packing equipment		-	7545.1	-	5337.0
4418	Joinery and carpentry		-	34526.7	-	23507.1
44...	Other articles of wood		-	9796.0	-	11094.3
47	Pulp of wood, recovered paper	(t)	4.7	692.2	5.1	850.0
48	Paper and paperboard, articles of paper		-	211928.9	-	203186.4
94...	Furniture		-	107655.3	-	79761.6
9406	Prefabricated buildings		-	3886.4	-	2250.1
	Total:			685933.9		470831.4

*Prepared by: Department of Forest, Ministry of Agriculture
Source: Central Statistical Bureau*

Prepared by: Department of Forest, Ministry of Agriculture