LATVIA

MARKET REPORT 2011

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

The economic downturn is suspended in Latvian since the end of year 2009 and the economic growth has resumed. Since the lowest point of the economic in end of year 2009 gross domestic product - GDP has increased by 12% in beginning of 2012. Taking into account that growth resumed from a very low point GDP in total in year 2010 was 0.3% lower than in 2009. While the GDP in year 2011 already over the previous year by 5.5%. The increasing risks in foreign markets, particularly in the eurozone, in the second half year 2011 and at the beginning of 2012, have not a significant impact on the Latvian economy. GDP continues to grow rapidly.

While the year 2012 started with the positive trends in the economy, however, remains the external global economic fluctuation risks related to future developments in the euro area. Due to slowing growth rates of our major trading partners, Latvia's exports may become more moderate and positive effect on the economy as a whole may be reduced. **Overall in general the GDP growth will be higher than previously expected and may reach up to 5 per cent in year 2012.**

Export has become the driving force for the economy in recent years. Goods and services exports now reached historical highs. The Latvian goods and services exports grew by 12.6% in year 2011. Despite the tight economic situation in the EU, exports rose by 9.9% in beginning of year 2012 compared to the previous year. Export future development opportunities will affect not only changes in external demand, but also the competitiveness of Latvian producers. The Latvian competitiveness improvement was primarily driven by labour costs until now, but in the future the ability to increase productivity will have a crucial role.

Positive trends can be seen in the domestic market. Employment and gradual increase in wage growth contributes to an increase in private consumption. Private consumption in year 2011exceed the 2010 level by 4.4% and it continues to grow in year 2012.

Investments a rapidly growing in terms of EU structural funds, including public investment in infrastructure and business investment in manufacturing equipment. The investments increased by 27.9% in year 2011. While investment in the first quarter of 2012 increased by 39% compared to the previous year's first quarter. Investment growth is largely influenced by investments in sectors such as energy, wood, metal products. Low bank lending rate is still one of the limiting factors in investment. Despite the substantial increase investment is still in relatively low level. It can be noted that after the significant foreign direct investment flows decline in year 2008 and 2009 their growth resumed since year 2010.

Both - intermediate goods demand in the manufacturing sector and **an improvement in the internal market contributes to the increase in imports**. The growth of imports overtakes export growth in year 2011, and thus the foreign trade export-import deficit rose to 3.9% of GDP. The rapid increase in imports is mainly determined by an increase in investment. At the same time, the goods and services import volumes are still far below the pre-crisis level.

A continuing positive trend in exports continues to grow manufacturing output. The Manufacturing output was 11.7% higher in year 2011 than a year earlier, but in beginning of 2012 rose by 16.5% compared to the corresponding period of previous year. Production volume increases in almost all manufacturing sectors, especially woodworking, metalworking, electronics, machinery and equipment. Overall, the manufacturing sector was provided on average ¼ of total economic growth in year 2011.

Latvian economy has changed the paradigm of development - the economy has shifted from domestic demand-led growth to exports, while the overall increase in revenue from exports contribute to the development of other sectors of the economy. The tradable sectors increased role in the economy indicates the sectoral structure of value added. Even before the crisis in year 2007 the agriculture, forestry, industry, transport and services sectors accounted for only a quarter of the total value added, while in year 2011 the share of these sectors have already reached 37% and growth of these four sectors accounted for half of all economic development. In 2011 the output increased also in agricultural and forestry sectors. **Forest's total export value in 2011 reached its highest level in the industry's history** after Latvian independence was recognized.

Increased income from export has also a positive impact on the industries, which is based on the domestic market. Provided services in the commercial sector increased by 9.6% in year 2011. After the massive downturn during the crisis in 2011 the growth resumed in the building sector that increased by 12.4% during the year. Sector continued to grow rapidly in 1st quarter of the 2012 (by 28.5% compared to Q1 2011). While building volume has gradually growing, it has achieved only half of the pre-crisis level. The building industry has been able relatively well shift to foreign markets during the crisis. Latvian builders work amount abroad in 2011 was exceed the year 2008 level more than 4 times. Considering the number of given building permits issued and the dynamics of the ongoing or planned investment projects, it can be concluded that in 2012 the whole building industry growth will be rapid and can exceed 10 percent.

The registered unemployment rate in the end of April 2012 achieve lowest levels since May 2009 and was 11.3% - or 127.8 thousand unemployed people which is by 30 thousand less than in April 2011. It is expected that the situation in labour market will continue to improve in the coming quarters, however, the main risks associated with global economic trends that may affect the situation in the Latvian labour market. Overall, in 2012 the **number of employees is likely to increase by 1.5% and the average annual unemployment rate to fall to 13.8 percent.**

Economic growth in the medium term will largely depend on two factors. First, on the solutions what the euro area countries will be able to adopt for solving the financial sector current tensions to avoid a possible economic stagnation. Second, how effective will be the Latvian government's structural policy for improvement of economic competitiveness within the limited funding, including State budget availability conditions.

Latvian growth rates could achieve steady growth of 5% per year in faster growth scenario. While in the slower growth scenario, with the remaining weak growth in Europe and not being able to improve the competitiveness of the tradable sectors, the consequences of Latvia's economy recovering from the crisis would have been much slower. [1]

[1] Ekonomikas ministrija **Ziņojums par Latvijas tautsaimniecības attīstību** http://www.em.gov.lv/images/modules/items/2012_jun.pdf

2. POLICY MEASURES INFLUENCING THE FOREST PRODUCT MARKET (over last 18 months)

The positive trends in the development of the Latvia's economy will enable Latvia to gradually stabilize and promote economic development. **Latvian Convergence Program is developed** in the spring of 2012. It is characterized Latvian fiscal policy in years 2012 - 2015 and focuses on a strong and sustainable fiscal policy and macroeconomic stability. Government has taken a series of measures to achieve the objectives set out in the program – fiscal consolidation in budget process in 2012, strengthening of fiscal management, measures to combat the underground economy and improve financial sector stability, the promotion of EU funds, as well as promotion of economic growth. On the basis of the principles set out in the program, the government has developed a draft budget for 2013, which planned increase in funding for priority actions and new policy initiatives after several years of interruption.

Climate change. Latvia has ratified the Convention and its Kyoto Protocol, thereby assuming the obligations established in these international documents. Latvia is taking measures to fulfil the obligations established in the Convention and the Kyoto Protocol by implementing the international, EU, and national climate policy. Latvia has fulfilled its obligations – the obligation established in the Convention to stabilise the greenhouse gas emissions by year 2000 and the obligation established in Kioto Protocol to reduce the national greenhouse gas emission levels by 8% between years 2008 and 2012, as compared to year 1990 (the current inventory data show that Latvia has decreased its emissions by more than 55%).

Latvia continues to actively participate in the Kyoto Protocol's flexible mechanisms (emissions trading) in this Kyoto period. Funding from state-owned stated amount assets selling are invested in Latvia's development through measures for improving the energy efficiency of buildings in the public and private sectors, for technology development for renewable energy use promotion, and implementation of integrated solutions for reducing greenhouse gas emissions.

The decision taken in Climate Change Conference in Durban (COP 17) of the second period of the Kyoto Protocol on terms of Land use, land use change and forestry sector and the approved reference level in the sector may result in an additional burden for Latvia due to the significant contribution of the forest sector to GHG emission / removal balance. The CO_2 sequestration caused by the forest sector exceeds the total volume of the greenhouse gas (GHG) emissions created by all other sectors in Latvia (transport, power engineering etc.).

Latvian energy policy key development objectives and directions are included Latvian Sustainable Development Strategy until 2030. Within development of the Energy Development Guidelines for 2007 to 2016 the further Latvian energy policy is planned for the period up to 2016. However, these guidelines have been developed, based on 2006 consumption forecast, which is radically changing now. In order to provide the Latvian power supply system flexible and effective integration into the region and the EU energy markets, in 2012 guidelines for energy policy planning in the period up to 2030 is developed. Their main aim - to promote the positive impact of the energy sector in the Latvian economy as a whole, with two subordinate goals - to increase energy security and promote energy sustainability. As one of the indicators for energy security and sustainability is determined the broadest possible use of renewable energy to increase the proportion of renewable energy resources in heat, power and transport sectors.

EU Structural Funds provides the opportunity to realize projects that provide longterm investment in the development of innovation and positive effect on the economy in future. **Development of Forest** industry **competence centre** is a crucial step for innovation promotion based on the basic science and mutual close cooperation between science and industry. The newly established forest sector competences to centre which founded by leading forest industry companies and research institutions, was launched in April 2011. Research is being carried out in two directions - wood products with advanced and innovative features and forest capital development and management.

EU structural support for 11 newly established clusters in different sectors of the economy also will contribute to Latvia's economic breakthrough. The cluster program for three years, bring together more than 350 companies, research institutions, universities, non-governmental organizations and local authorities. Its objective is to strengthen co-operation between the different profiles of one industry, to develop new products and acquire the export market. One of the approved projects is Latvian construction cluster project "Development of Latvian wood building exports and competitiveness". The project will promote Latvian wood construction producers participation in export markets and increasing forestry and woodworking industry return to national economy.

In 2011 the discussion about changes in forest management in Latvian is completed. **The Law on Forests is updated and supplemented** in order to simplify the procedures of public services, their costs while increasing service availability and quality. As well as to determine the sustainable management of forests and stabilize carbon sequestration for Latvian commitments to reduce climate change.

3. MARKET DRIVERS

After government cost sharp reduction in 2009 and stabilization in 2010, consumption in Latvia has shown minor growth. As a result same trend is was reflected in local building market, also showed signs of revival. This have stabilized wood construction materials local consumption. But as local building market is small (1500-2500 dwellings annually), this have left only minor influence on wood product market in Latvia. Export activities are main market driver for most forest products. In 2011 total income from forest product export reached historically highest ever level of 1,7 bn EUR. Still stable demand from European building and Scandinavian pulp industries helped to keep industry activity in high capacity levels, export revenue growth reached by additional capacities of wood energy and and softwood board products.

First steps in influence on the local market has been made from local wood bioenergy sector. In addition to growing capacities of condensed wood energy product (pellets etc.) producers, starting from year 2011 number of local consumption renewable energy generation projects have been approved or went into realization phase. In period until 2015 wood energy production capacity rapid increase could be one of the main forest products market drivers in Latvia.

According to „Forest and Wood Products Research and Development Institute" one of latest researches, un next 4 year period at least 25 installations will start to generate heat and electricity using woody biomass products like forest chips, pellets and firewood. Total consumption of wood for industrial type energy generation (CHP and DH/local heat plants) will increase by 70-80%. This make changes not only in local wood product market, but also will influence wood product export structure - decreasing fuelwood availability for export.

4. DEVELOPMENTS IN FOREST PRODUCTS MARKET SECTORS

4.1. Wood raw materials

Forest felling volumes in 2011 helped forest industry to be stable and keep high production levels. Total log volume harvested was 12,7 milj. m3, only for 260 thous. m3 less comparing with previous year figure. Minor decrease in harvesting volumes was happened due to more moderate felling activity in state forests, but this was partly compensated by higher activity in private forests. No decrease in forest industry supply with raw materials was occurred.

Export of industrial roundwood (pulpwood and sawlogs) in 2011 increased by 2% comparing with year 2010. Different trends in softwood and hardwood logs were noticed - softwood log export increased by 19%, while hardwood log export dropped by 10%. Main export markets, like in previous years were Sweden, Finland and Estonia, average price of exported logs increased by 9%. Import of roundwood decreased by 2% (0,4 milj. m^3) with main partners Lithuania and Belarus.

4.2 Wood energy

In 2011 new District Heating CHP projects were approved by government with guarantied electricity feed-in prices. No major increase in wood energy generation noticed yet, most of projects are planned to start operations in 2012/2013. According to Statistical Office data, total amount of CHP capacities installed in Latvia reached 83 (70 in 2010) with total electricity power 963 MW. New DH stations in conjunction with DH modernization projects (partly supported by EU Funding) and power plants, replacing natural gas in industrial use will increase woody biomass consumption by 1 milj. solid m^3 during next 3 years.

Wood energy products (chips, pellets, briquettes) has very strong positions in export structure. In 2011 Latvia increased production and export of pellets by 8%, exported volume reached historically high 860 thousand tonnes. Share of wood energy products in wood industry export was 12%.

4.3 Forest Certification

Forest certification is ongoing process in Latvian forests, state forest company JSC „Latvijas valsts meži" (LVM) has finished certification under PEFC and FSC schemes. In 2011 JSC „Latvijas valsts meži" has changed type of FSC certification scheme - instead of one FSC certificate for all state forest, company was re-certified each of 8 forestries and finished this process in 2012. Several independent international certification organizations carried it out in Latvia's state forests – "Certification Systems", "Soil Association Woodmark" and "SGS South Africa (Pty) Ltd". They concluded that LVM manages state forests in accordance with the highest standards.

4.4 Value added products

Production of value-added wood products in 2011 increased faster than raw material processing. According to export statistics (main market of value added products), net income from carpentry products increased by 6%, furniture export increased by 5%. Value added products production growth rates in 2011 were not so high as in 2010 (+28%), but year before high increment was noticed as recovery after very low results in 2008 year crisis. In 2011 and 2012 we can see gradual and stable increase in value added production.

4.5 Sawn softwood and hardwood

After very high growth rates in 2010, also sawn-wood production has increased in more calm pace. Export of sawn-wood in 2011 increased by minor 2.5%, total volume of sawntimber exported was 2.2 mil. m^3. Due to changes in harvested raw material deliveries, higher availability of hardwood logs was available on the local log market. As result production and export of hardwood sawn timber (mainly packaging materials) in 2011 was increased with higher rates comparing with softwood sawntimber production: hardwood sawntimber export increased by 7%, while softwood - only by 2%. Main markets for packaging materials were Netherlands (70.4 th. m^3), Germany (65.2 th. m^3) and UK (65.7 th. m^3).

In 2011 Latvia exported 1.9 mil. m^3 of softwood sawntimber. Stagnation Central European and much lower consumption on South European (Spain, Italy) construction markets was also one of the factors, that did not allow expend revenues from softwood sawnwood export. Average price of exported sawntimber increased only by 0.4% and this was a result of further-processed products higher share. Main markets of softwood sawntimber was Europe with 1.3 mil. m^3 sawntimber sold. On the second place were Asian markets; Africa region was on the third place.

4.6 Wood-based panels

Wood panel export was one of wood product export segments with very good positive dynamics. Two product types are produced in Latvia in this segment: birch plywood and softwood boards (chipboard and OSB). Both segments performed well in 2011, but higher growth rate was achieved in plywood export. Volumes increased by 8% and reached 234 th. m^3, mainly thanks to positive sales results on European and Asian markets. Softwood board export was on the same level as in 2010, but average price increase helped to increase export revenues by 6%. Main export market of these products was CIS countries, Lithuania and Poland.

5. TABLES

Key Economic Development Indicators in Latvia

	2008	**2009**	**20010**	**2010**	**2012f**
(changes in comparison with the previous year, %)					
Gross domestic product	**-3,3**	**-17,7**	**-0,3**	**-5,5**	**5,0**
Private consumption	-5,8	-22,6	0,7	1,1	0,9
Public consumption	1,6	-9,4	-7,9	1,1	0,9
Gross fixed capital formation	-13,8	-37,4	-18,1	27,9	24,0
Exports	2,0	-14,1	11,5	12,6	5,8
Imports	-10,8	-33,3	11,5	20,7	7,0
Consumer prices	15,4	3,5	-1,1	4,4	2,5
(% of GDP unless indicated otherwise)					
Export - import balance	-13,6	-1,5	-0,8	-1,1	-5,2
Changes in the number of employed (aged 15 - 74 years)*	*0,5*	*-12,2*	*-4,6*	2,5	1,5
Unemployment rate (share of job - seekers in economically active population aged 15 - 74 years, %)*	*7,5*	*16,9*	*18,7*	16,2	13,8

f – forecast
* – data since 2011 has been recalculated according to the Population Census. Recalculations of 2008–2010 will be available in the second half of 2013. Until then, all data after 2011 cannot be compared with the previous periods

Forest Sector Products Export from Latvia

HS code	Products	2010			2011		
		thsd (unit)		thsd (EUR)	thsd (unit)		thsd (EUR)
3605	**Matches**	**-**		**125,7**	**-**		**115,7**
44	**Wood and articles of wood**	**-**		**1 270 417,7**	**-**		**1 441 774,4**
4401	**Fuelwood:**	**3 714,4**	**(t)**	**199 877,2**	**3 539,3**	**(t)**	**210 082,4**
44011	Fuelwood (round)	999,3	(t)	50 065,1	649,4	(t)	36 994,7
44012	Chips	1 911,7	(t)	66 754,5	2 024,2	(t)	81 290,3
44013	Sawdust and other wood residues	803,4	(t)	83 057,6	865,7	(t)	91 797,4
4403	**Roundwood:**	**4 157,8**	**(m3)**	**200 270,3**	**4 400,7**	**(m3)**	**230 142,2**
44032	Coniferous	1 842,0	(m3)	89 054,4	2 218,5	(m3)	118 353,4
	- sawlogs	361,7	(m3)	20 635,8	348,1	(m3)	22 987,2
	- other	1 480,2	(m3)	68 418,6	1 870,4	(m3)	95 366,2
44033…	Non-coniferous	2 315,8	(m3)	111 215,9	2 182,2	(m3)	111 788,8
	- sawlogs	387,1	(m3)	23 824,7	81,9	(m3)	10 043,1
	- other	1 928,8	(m3)	87 391,2	2 100,3	(m3)	101 745,7
4407	**Sawnwood:**	**2 148,7**	**(m3)**	**397 357,8**	**2 247,7**	**(m3)**	**420 389,8**
44071	Coniferous	1 836,9	(m3)	347 970,3	1 906,0	(m3)	362 373,4
44072…	Non-coniferous	311,8	(m3)	49 387,5	341,6	(m3)	58 016,3
4408	**Veneer sheets**	**6,6**	**(m3)**	**2 117,5**	**1,9**	**(m3)**	**1 356,1**
4409	**Further processed sawnwood**	**-**		**27 045,2**	**-**		**25 588,7**
44091	Coniferous	-		19 972,2	-		17 323,3
44092	Non-coniferous	-		7 073,0	-		8 265,4
4410	**Particle board**	**583,3**	**(m3)**	**115 503,6**	**578,9**	**(m3)**	**122 266,1**
4411	**Fibreboard**	**540,8**	**(m2)**	**2 013,9**	**549,0**	**(m2)**	**2 451,6**
4412	**Plywood**	**216,0**	**(m3)**	**116 168,0**	**234,1**	**(m3)**	**143 652,2**
4415, 4416	**Wooden wrapping and packing equipment**	**-**		**51 449,6**	**-**		**69 229,0**
4418	**Builder's joinery and carpentery**	**-**		**86 329,5**	**-**		**104 607,3**
44…	**Other articles of wood**	**-**		**72 285,0**	**-**		**112 009,1**
47	**Pulp of wood, recovered paper**	**-**		**5 893,7**	**-**		**8 084,4**
48	**Paper and paperboard, articles of paper**	**-**		**80 125,0**	**-**		**108 291,6**
94…	**Furniture**	**-**		**83 754,8**	**-**		**88 861,3**
94…, 95	**Prefabricated buildings and toys of wood**	**-**		**10 710,4**	**-**		**14 099,6**
	Total			**1 451 027,4**			**1 661 227,0**

Forest Sector Products Import to Latvia

HS code	Products	2010		2011	
		thsd (unit)	thsd (EUR)	thsd (unit)	thsd (EUR)
3605	**Matches**	**-**	**508,0**	**-**	**483,3**

44	**Wood and articles of wood**	**-**		**134 504,2**	**-**		**162 331,6**
4401	**Fuelwood:**	**24,7**	**(t)**	**1 940,2**	**70,1**	**(t)**	**4 441,8**
44011	Fuelwood (round)	1,2	(t)	171,5	5,7	(t)	362,2
44012	Chips	11,7	(t)	450,6	37,3	(t)	1 493,9
44013	Sawdust and other wood residues	11,8	(t)	1 318,1	27,0	(t)	2 585,7
4403	**Roundwood:**	**436,6**	**(m3)**	**19 280,4**	**441,0**	**(m3)**	**22 805,0**
44032	Coniferous	322,6	(m3)	15 002,8	311,3	(m3)	17 568,0
	- sawlogs	134,3	(m3)	8 355,9	190,4	(m3)	12 741,5
	- other	188,4	(m3)	6 646,9	120,9	(m3)	4 826,5
44033…	Non-coniferous	114,0	(m3)	4 277,6	129,7	(m3)	5 237,0
	- sawlogs	20,7	(m3)	1 321,5	4,6	(m3)	589,8
	- other	93,3	(m3)	2 956,1	125,1	(m3)	4 647,2
4407	**Sawnwood:**	**201,2**	**(m3)**	**31 957,4**	**178,0**	**(m3)**	**30 571,6**
44071	Coniferous	190,7	(m3)	28 381,1	167,2	(m3)	26 581,7
44072…	Non-coniferous	10,5	(m3)	3 576,3	10,8	(m3)	3 989,9
4408	**Veneer sheets**	**69,4**	**(m3)**	**8 612,1**	**91,0**	**(m3)**	**12 112,9**
4409	**Further processed sawnwood**	**-**		**2 876,9**	**-**		**3 164,5**
44091	Coniferous	-		1 590,6	-		2 195,7
44092	Non-coniferous	-		1 286,3	-		968,8
4410	**Particle board**	**31,8**	**(m3)**	**7 697,7**	**37,2**	**(m3)**	**9 584,9**
4411	**Fibreboard**	**3 946,4**	**(m2)**	**10 198,4**	**3 790,5**	**(m2)**	**9 560,5**
4412	**Plywood**	**37,1**	**(m3)**	**11 271,2**	**47,7**	**(m3)**	**19 057,0**
4415, 4416	**Wooden wrapping and packing equipment**	**-**		**4 496,7**	**-**		**5 119,4**
4418	**Builder's joinery and carpentery**	**-**		**14 975,2**	**-**		**19 705,6**
44…	**Other articles of wood**	**-**		**21 198,2**	**-**		**26 208,4**
47	**Pulp of wood, recovered paper**	**-**		**1 123,2**	**-**		**1 630,2**
48	**Paper and paperboard, articles of paper**	**-**		**209 605,5**	**-**		**245 795,3**
94…	**Furniture**	**-**		**41 208,4**	**-**		**38 354,2**
94…, 95	**Prefabricated buildings and toys of wood**	**-**		**389,4**	**-**		**515,7**
	Total			**387 338,6**			**449 110,4**

Data source: Ministry of Agriculture of Latvia, Central Statistical Bureau of Latvia