

Republic of Latvia MARKET STATEMENT

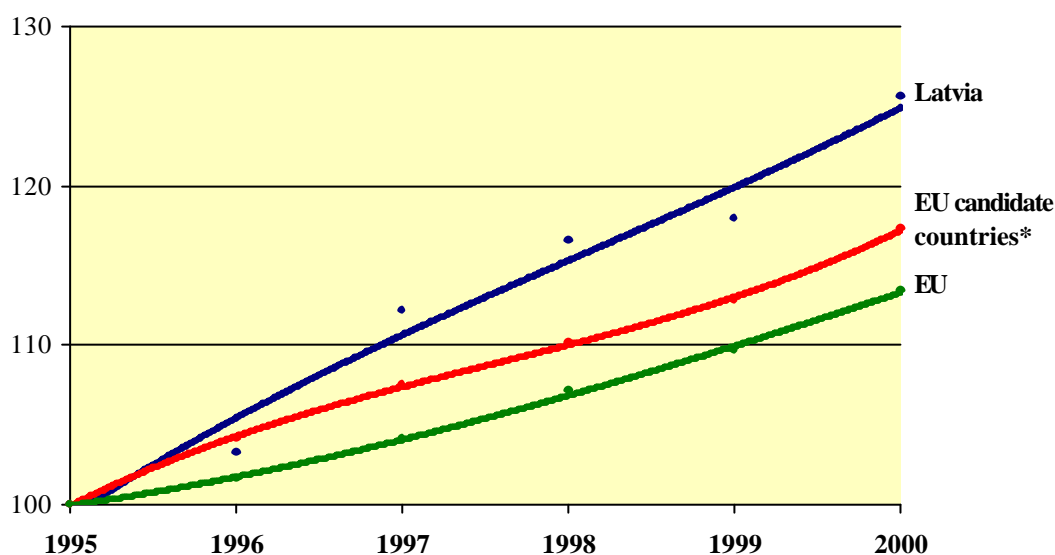
1. General economic trends affecting the forest and forest industries sector

Still the main factor in countries with economies in transition influencing the economic activity and production is the ability of the state to carry out activities aimed at the creation of a stable and business friendly environment.

To characterise the macroeconomic development in Latvia thus describing the internal factors affecting the development of forest industries in the country there are described the growth rate of Gross domestic product, inflation rate and stability of national currency.

1.1. Macroeconomic Development

Since the middle of 1990s economic activity is going up in Latvia. GDP, between 1995 and 2000, has gone up by 25.6% or by 4.7% in the average per year (see Fig.1.1).



* 10 Central and Eastern European EU candidate countries

Fig. 1.1. Growth of Latvian Gross Domestic Product between 1995 and 2000 (1995=100)

Development was especially successful between 1996 and 1998 when average growth rates of GDP equalled to 6%. Such growth was basically ensured by the dynamic development of manufacturing where outputs in this period went up by 31 percent.

Economic crisis of Russia in the second half of 1998 and in 1999 influenced the development rate of the Latvian economy, the same as economies of many other countries. Due to the Russian crisis exports, except wood products' exports of Latvia went down. It must be noted that growth of activity in forest industries, construction and several sectors of services compensated the industrial and agricultural decline caused by the crisis. Thus GDP continued going up although growth rates in 1998 and 1999 were more modest – 3.9% and 1.1 percent, respectively.

GDP in 2000 went up by 6.6% proving that Latvia has overcome difficulties caused by external circumstances. Gross domestic product in the first half of 2001 went up by 8.2% (see Table 1.1 and 1.2). In the last two years Latvia has shown the fastest growth among the Baltic States and in 2000 – also among EU candidate countries.

Growth at the moment is observed in almost all basic sectors of National Economy. Manufacturing outputs in 2000 went up by 5.7% and in the first quarter of 2001 – even by 11.3%. Production continues expanding in sectors of wood processing, metal processing and

textile industry. Construction develops at a steady rate basically ensured by increase of repair and reconstruction works, building of trade and administrative buildings. Also industrial buildings are built or reconstructed

Because of growth of transit (ports, railway, shipping) services in the sector of transport and communications the value added of the sector in 2000 went up by 7.2% and in the first quarter of 2001 – by 10.6%.

1.2. Inflation

Inflation in Latvia for already several years is among the lowest in the group of transition countries. Average annual inflation in 2000 was 2.6%, yet the core inflation (excluding administrative prices, indirect taxes and oil prices) was below 1%. Though, due to the administratively regulated prices (electrical and heat energy, public transport, housing rent, etc.) a bigger decline of inflation is not predicted for the nearest years.

Since 1994 the lats (LVL) is stable against SDR currency basket. This eliminates uncertainty, reduces currency risk and provides businesses a stable base for planning and price determination. Fluctuations of the LVL rate against individual currencies of the basket are solely dependent on the fluctuations in the world currency market.

The value of the EUR since the beginning of 1999 is going down and USD goes up. This has caused essential losses to certain sectors of National Economy exporting their products to countries of the EUR zone. At the same time the winners are the sectors that where USD dominates in payment transactions. Taking into consideration the fact that 45% of all Latvian exporters settle their payments in USD and approximately one third – in euro zone currencies and the domination of USD in the services export is even more explicit (70% of all payments) – the Bank of Latvia considers that there is no good reason for the change of the currency rate policy.

1.3. Growth of Investment

The potential of economic growth may be best of all described by growth of investment. From 1995 to 2000 investment every year went up in the average by 18.8%. Such fast growth of investments was promoted by several factors: inflow of foreign investments mainly because of successful privatisation, reduction of interest rates and stabilisation of the banking sector, increase of the general economic activity and formation of positive future expectations, etc. Thanks to the dynamic growth of investment, the share of total fixed capital formation in GDP has reached 25%. It is expected that investment will keep the same high levels also in the nearest future.

Latvia has come close to those transition economies of Central and Eastern Europe that are leaders in terms of attraction of foreign direct investments. The trust of investing in Latvia is promoted by credit ratings awarded by the sovereign agencies Standard & Poor's, Moody's and Fitch IBCA which are among the highest in countries of Central and Eastern Europe and correspond to the so-called investment grade.

Denmark, the United States, Germany, Sweden, United Kingdom and Russia have made major investments. Three priority sectors – main recipients of investments are transport and communications, finances and industry.

It is anticipated that in the nearest future more foreign direct investments will be made into sectors where Latvia has a comparative advantage, that is, in sectors linked with the favourable geographical position, available natural resources and in sectors with cheap, yet relatively well-trained workforce.

An important project for Latvia is the pulp-mill project (the planned capacity is 600 thousand tons of pulp per year). If the project is implemented it will result in growth of GDP by 1-2%. The Swedish *Sodra*, Finnish *Metsaliitto* and the government of Latvia established the joint stock company *Baltic Pulp*. The task of the newly established company is to address

questions of design, construction and operation of the pulp-mill. It is planned that the plant would start operating in 2005.

1.4. Foreign Trade

Latvia was the first from the Baltic countries accepted as full member to the World Trade Organisation on February 10, 1999. It opens the opportunity to extend external economic activity on the basis of the most favoured nation treatment with the member states of WTO.

Latvia's foreign trade turnover in the first five months of 2001 totalled 1 383.7 mln lats, which is 15.2% more in nominal terms than in the same period of the previous year. The value of exports amounted to 529.3 mln lats (up by 14.2%), but the value of imports to 854.4 mln lats (up by 15.8%). Imports grew faster than exports.

The main trading partner of Latvia is the European Union. Trade with countries of the European Union steadily goes up since the regaining of independence in 1991 and nearly 60% of total exports and imports of Latvia are linked with these countries. Trade with Germany (16.2% of total turnover), Russia (8.9%), Sweden (8.3%), United Kingdom (8.1%), and Lithuania (7.6%) constituted the biggest share in foreign trade turnover of Latvia in 2000.

At present, Latvia exports to Russia only 4% of total exported goods (16% in the middle of 1998) which is approximately 1/4 of what Latvia used to export to this country before the crisis. Still exports to Russia started to go up again. In the first quarter of 2001 compared to the respective period of the preceding year, exports of goods to Russia have gone up by 33.5% (total commodity exports – by 11%).

Latvia's main export partners in the first five months of 2001 were Germany — 17.5% of total value of exports (16.8% in the same period of 2000), the United Kingdom— 15.2% (18.1%), Sweden— 10.3% (11.9%), Lithuania — 8.0% (7.2%) and Estonia — 6.1% (5.2%). The most significant import partners were Germany— 16.6% (15.8%), Russia — 10.0% (11.0%), Finland — 7.9% (9.1%), Lithuania — 7.6% (7.7%) and Sweden— 6.3% (7.5%).

2. Development in forest products markets

The forest utilization has increased considerably as the result of the land reform and increased economic activity. This increase is especially high in other ownership (private and local community) forests (see Table 2.1) The volume of fellings in state owned forests is stable, greatly due to the annual allowable cut there determined by law (Fig.2.1.).

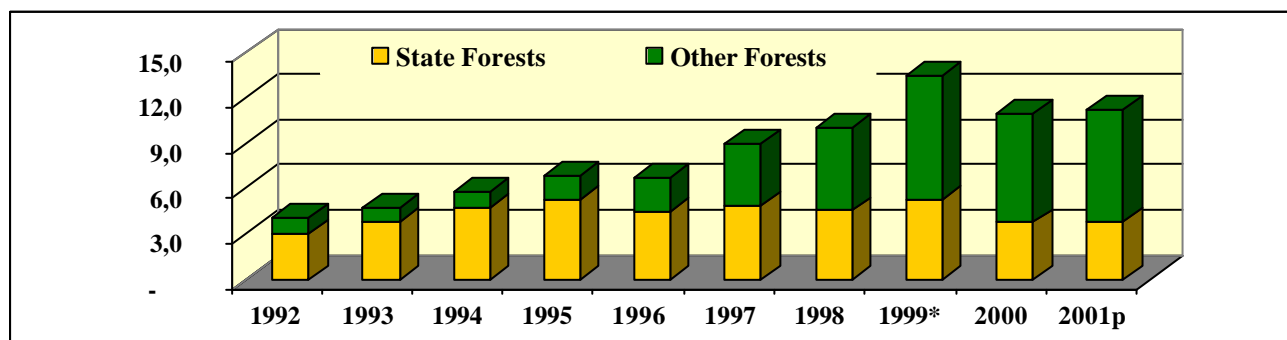


Fig. 2.1. Dynamics of Harvesting Volumes in Latvian Forests (mln.m3)

Harvested timber is mainly used for sawn wood production within the country. Depending on the fluctuation of pulp prices in the market, about 30 % of total annual felling volume is exported as round wood, 90% of that as pulpwood (see Table 2.2.).

The round wood export volumes varies considerably (see Fig. 2.2). The softwood/hardwood ratio remains relatively stable with the trend to increase of hardwood (see table 2.3.).

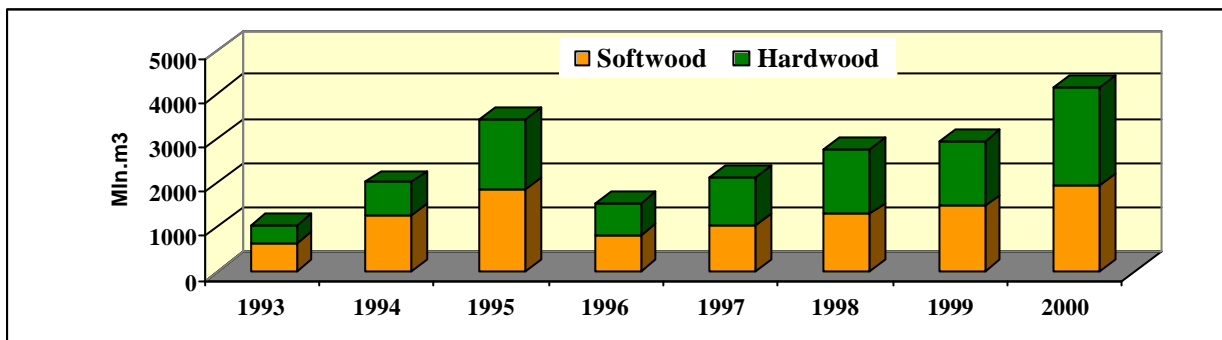


Figure 2.2. Round wood export

Forest and Forest Industries

Latvian forest industries, based on national renewable, expanding by area forest resources had fast and continuing development. Vertical integration of forest management with the forest industry is under way, thus creating a stable raw materials basis for the processing sector. The average annual fellings between 11 and 12 million m³/yr. provide the forest industry with the raw material, necessary to meet the demands of the domestic market and the export. However, the production capacities and the structure of the timber processing and woodworking sectors fail to ensure a full utilisation of the wood harvested in Latvian forests, since the country has no its own pulp industry. Furthermore, there is no national policy for the energy sector that would promote the use of waste wood as fuel. It creates a situation, where huge amounts of round wood are exported. Local utilisation of this resource potential in a rational way would considerably enhance the efficiency of the national wood industry, increasing its input to the budget revenue.

The main product groups produced by Latvian forest industry and their share in the total output during 1994-2001 are shown in Table 2.4, Fig. 2.3 and Fig.2.4

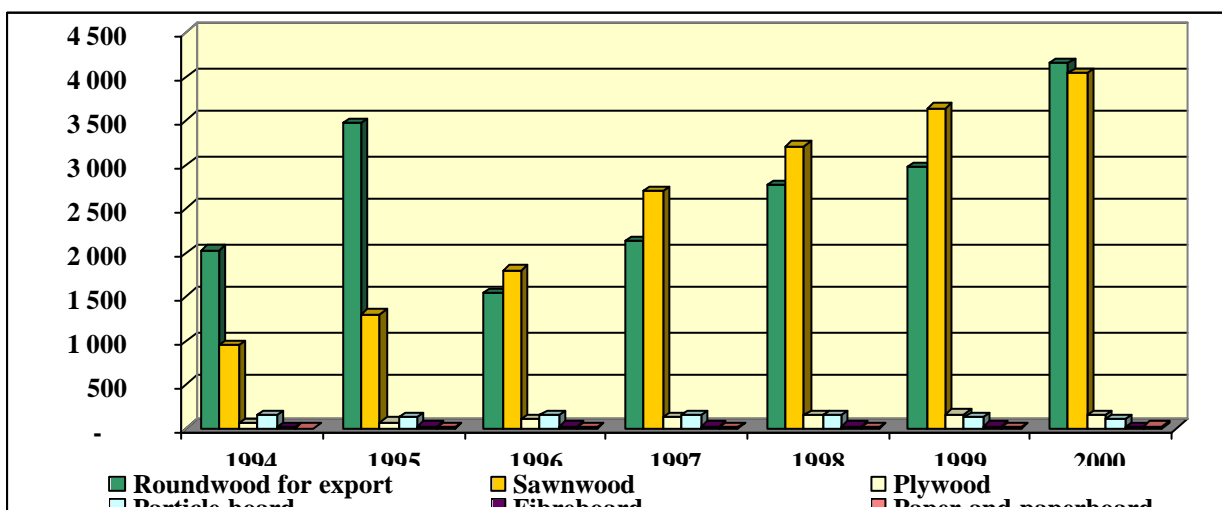


Fig. 2.3 Dynamics of Forest Industry (thsd.m3)

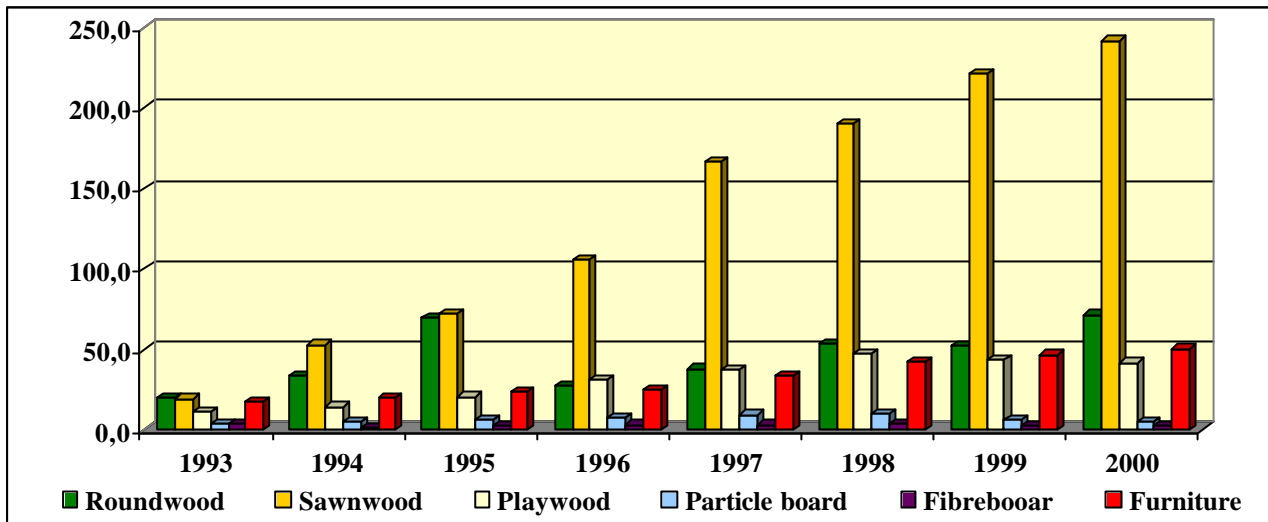


Fig. 2.4. Forest Industry Production in Terms of Value (mln.LVL)

Sawmilling

The sawmilling and wood processing industry in Latvia comprises many small- medium sized enterprises, with only a few being of international scale. At present this is the most important forest industry segment for the Latvian economy. In 2000 the Latvian sawmilling industry produced around 4 million m³ of sawn timber with a total value of some 240 million LVL, most of which was exported.

The leading companies are investing to become major players in the sawn timber markets whilst others are approaching the future through a strategy aimed at the production of added value timber products. Currently two sawmilling companies have an annual output in excess of 100,000m³ per annum with several others expected to reach this level in the very near future. About 20 medium sawmills have production capacity between 10,000 and 50,000 m³/yr. The level of technologies and efficiency is differing at these sawmills. Several hundred small sawmills each produce between 500 to 10,000 m³/yr. of unseasoned or partly dried sawn wood. The small sawmills, in their turn, stay competitive by local, customised orders, by mutual cooperation, or by cooperating with the big manufacturers to make joinery or some speciality products (fencing, turning-made components, flower boxes, wooden cabins, log houses, furniture and items for improving amenities in the parks and gardens, etc.). Competition for the resources and difficulties in marketing the sawmill by-products have made the small and medium sawmills strive for the maximum yield of sawn products (the log-scale factor is by some percent higher than in the Nordic countries), making unconventional assortments and using non-traditional wood species.

The installed capacity of Latvian sawmills is quite high. The possible annual output of sawn wood exceeds 5.7million m³/yr., when working in one shift. The consumption of sawlogs is close to 10 million m³/yr. It exceeds the local resources of saw logs, and that is why the competition for resources is tough. To retain a competitive edge, the medium and big sawmills introduce saw log grading (including strength grading); debarking, drying and further processing. Specialised processing lines are introduced for small-size logs. These activities create preconditions for improving the product quality and achieving higher sawmilling efficiency. Wood waste is increasingly used for energy (fuel chips, briquettes and pellets made at sawmills).

The Latvian sawmilling sector is at a stage in its development where the viability of many of small and medium sized mills is unsustainable. The process the industry is going through at present, with the larger companies going for volume production and medium sized for speciality production, has been mirrored in many other countries producing softwood sawn timber. The loss of small inefficient sawmills which have not or cannot acquire the required capital

investment to reach the next stage of development is an inevitable outcome of industrial development.

Latvian sawn timber export continues to increase, growth rate last years has declined(see Fig. 2.5).

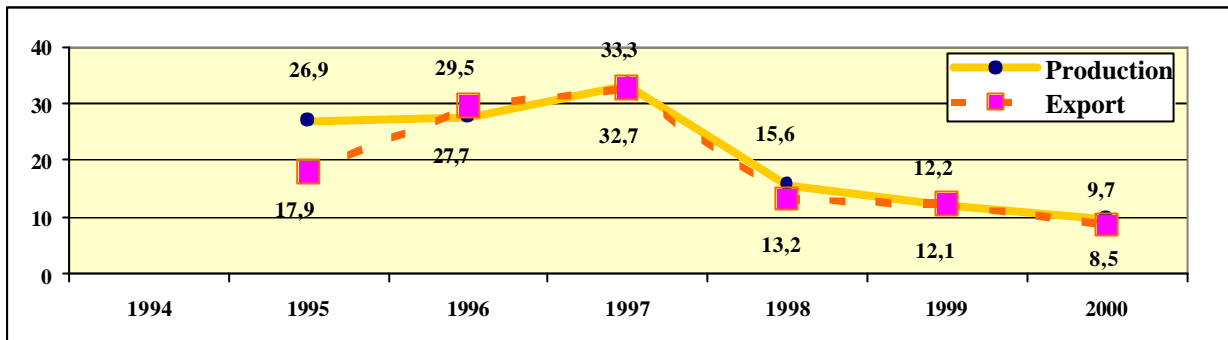


Fig. 2.5. The growth of Sawn Wood Production and Export (% to previous year)

Thus, as it is shown in Fig.2.5 the growth of production and export volume of sawn wood gradually slows. At the same time the local consumption of sawn wood is increasing. At present about 23.5% of total sawn wood production is used in the country, mainly for furniture production (see Table 2.5).

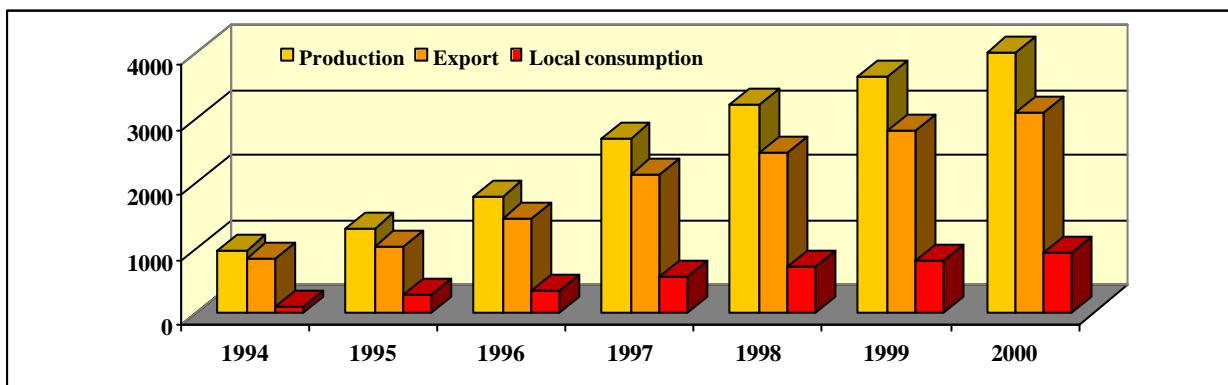


Fig. 2.6. The growth of Sawn Wood Production, Export and Local Consumption (% to previous year)

Expansion of sawn wood export is linked with the growth of share of hardwood proportion in the total exported volume. Since the 1996, the share of hardwoods has increased from 6% up to 14%. (see Fig. 2.7.)

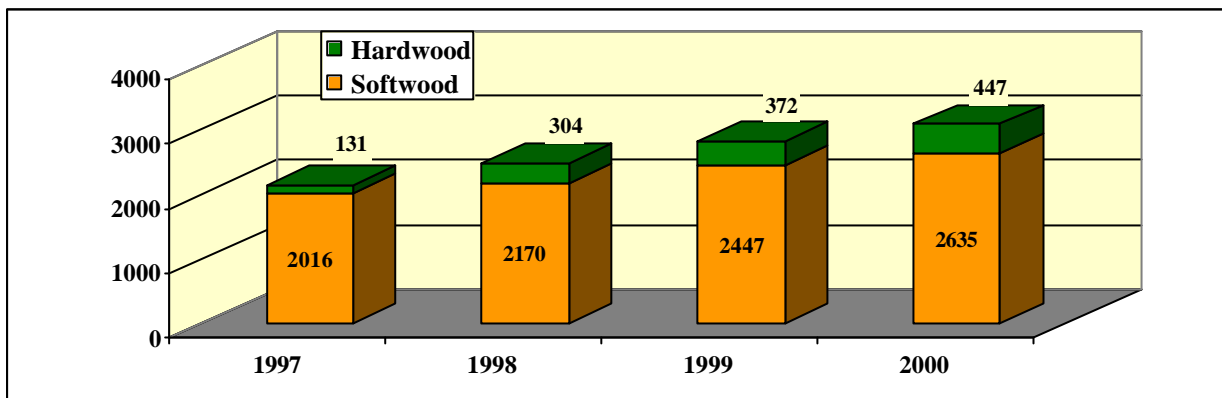


Fig. 2.7. The Export of Sawn Timber (thsd.m3)

By additional investments and raw material import (especially from Russia and Belarus) the Latvian sawmill industry will be in a position to retain the current level of export and the market share captured.

During the past two years the import of sawn wood from Russia and Belarus has been on the increase. In 2000, the import of sawn wood to Latvia totalled 135,200 m³, of which softwoods were 127,100 m³, hardwoods – 8,100 m³. The increase against the previous year is 8.1%. The material brought to Latvia is processed further to add value to the products, a part of them are exported.

The future prospects of the sawmill industry depend on the projected pulp mill in Latvia and a modern board manufacturing facility, which would provide for a more complete and efficient utilisation of raw material or selling of sawmilling by-products.

Wood Based Panels

The wood based panel industry in Latvia currently produces plywood; particleboard and glue laminated solid wood panels. Until recently there was a production of fibreboard but this has now ceased.

Latvia has long-standing traditions in veneer and plywood manufacturing. The volume of output in 2000 was as follows: 153,000 m³ of plywood, including 124,000m³ of large-size plywood, and 42,000m³ of laminated plywood, as well as 14,300m³ of glued-bent components (Table 2.4).

Production of particleboard in Latvia in 2000 was 102,000 m³ and has been declining in recent years. The most valuable production there is playwood which comprise about 90 percent of total production value (see Fig. 2.7)

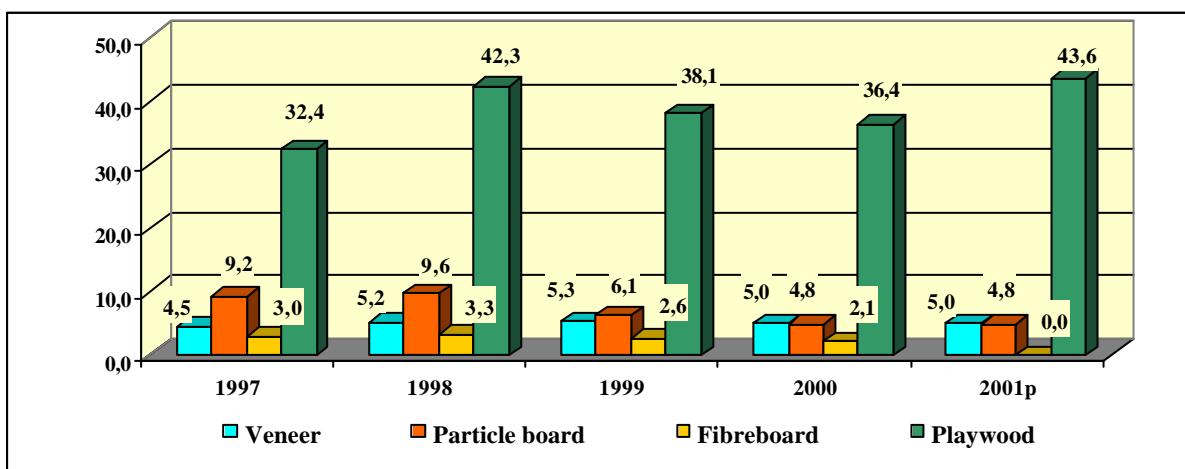


Fig. 2.7 Output of Wood Based Panels in Terms of Value (mln. LVL)

The export of plywood has remained on the level of previous year, with a slight reduction to 128,000 m³ (in 1999 -- 132,700 m³). 30% of the export volume went to Germany, 24% - to the UK, followed by Sweden, Netherlands and Austria, with the export share 5, 4 and 3%, respectively.

In 2000, the export of particle board was 78,700 m³, which is by 27.5% less than in 1999. The export of fibreboard in 2000 was 5.7 million m² - by 19% less than in 1999.

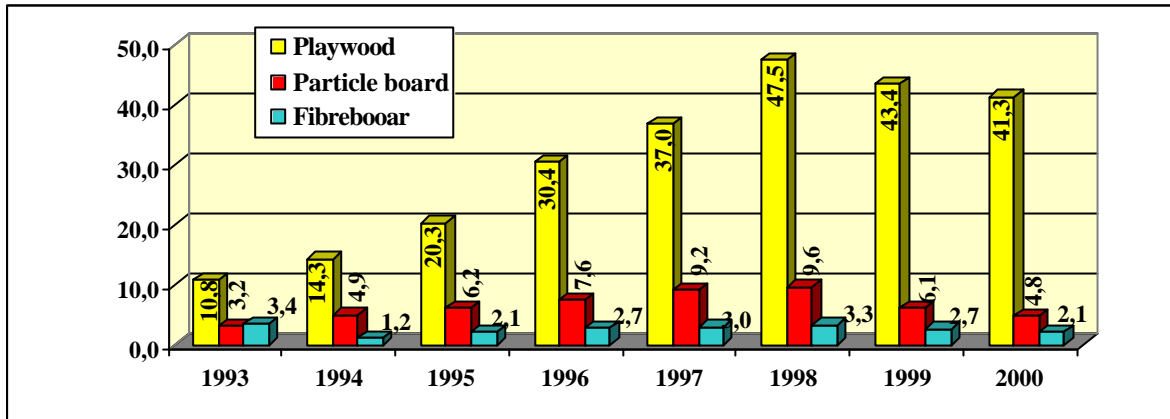


Fig.2.8 *Export of wood based panels (mln LVL)*

Other wood based production

Additionally to sawmilling production and wood based panels, furniture and joinery production develops fast. That proves the ability of the forest industry sector to add value in the country (see Fig. 2.9 and 2.10) thus contributing to solving unemployment problem and total export value.

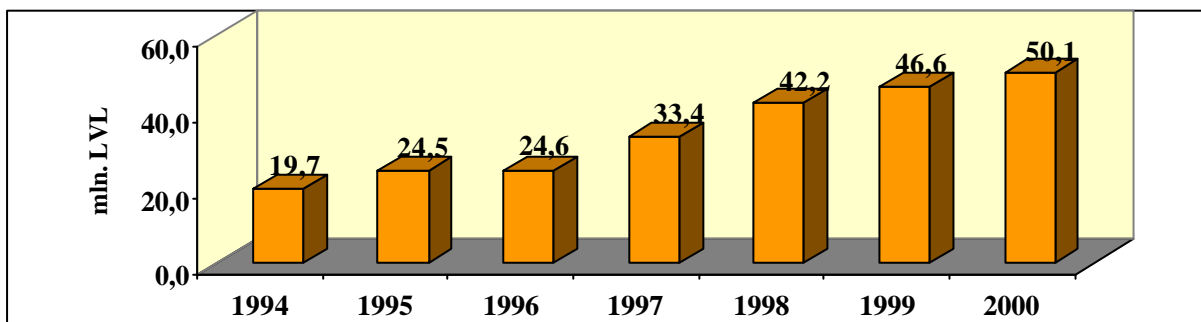


Fig. 2.9 *The growth of Furniture Export*

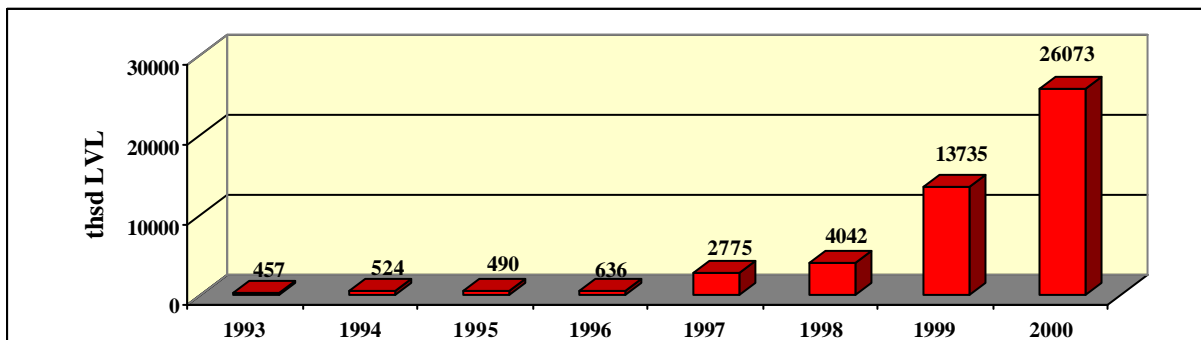


Fig. 2.10 *The growth of Joinery Production (thsd. LVL)*

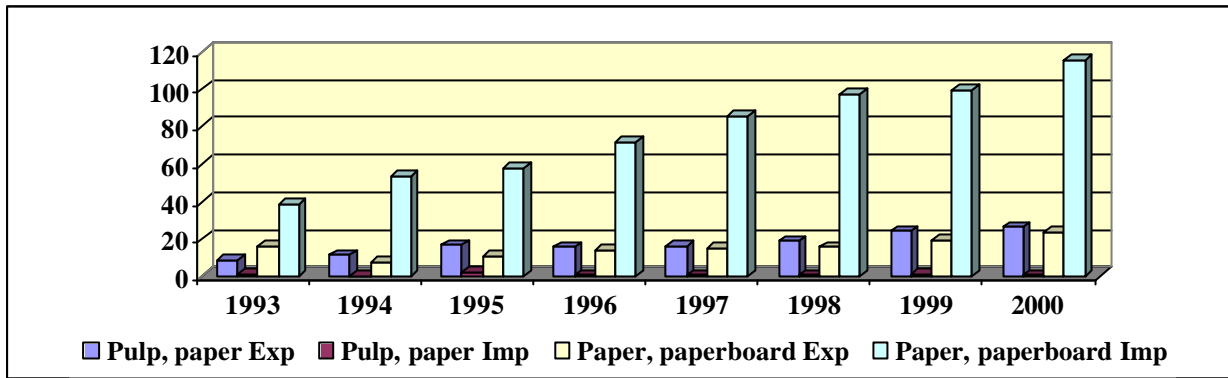


Fig. 2.11 *Dynamics of Paper and Paper board Import and Export* (1000 T)

Forest Certification and Certified forest products

FSC:

An informal taskforce to develop the National FSC Standard was set up in 1997 following the initiative of WWF Latvia, involving the state authorities, NGO's, educational and research organisations, as well as the wood industry representatives. The aim was to work out following the FSC principles a national standard for forest certification by balancing out the frame of reference on forest management of all the forest sector interest groups, ensuring at the same time sustainable forest utilisation and the preservation and propagation of the nature's values.

The second draft of the Latvian FSC Standard was ready by mid-2000. And the final version is supposed to be available by the middle/end of 2001. There are plans to establish in 2001 an independent public non-profit organisation and achieve its official recognition by FSC.

By 01.10.2001, in Latvia 2,700 ha of private forests are certified following the FSC scheme. State Stock Company "Latvijas Valsts Meži" has certified 203,000 ha of state-owned forests in the Austrumvidzeme Forestry. Pre-assessment is started in 600,000 ha of of state-owned forests in the Ziemeļlatgale and Vidusdaugava Forestries. By the same date, FSC chain-of-custody certificate has been granted to 5 Latvian woodworking enterprises and 7 more enterprises are inc certification process. 57,000 ha of Riga City forest are certified as well.

PEFC:

The PEFC Latvian Council was founded on 21.10.99. following the initiative of CO "MAA", as provided by the statutes of the PEFC Council. Different interests forest sector groups and stakeholders were represented at the constituent assembly – trade unions, state authorities, farmers' organisations, NGO's, including environment protection oriented ones, forest owners and managers, representatives from the wood industries and trade. The PEFC Latvian Council is now a full-fledged member of PEFC.

The PEFC Latvian Scheme is worked out following the 6 Helsinki criteria and 27 indicators that are tailored to the Latvian forest management traditions and the achievements of the national forest science. The Latvian PEFC Scheme in forest management, based on the ideas of sustainability, incorporates the principles of economic viability, the preservation and enhancement of forest's ecological functions, and ensuring the functioning of forest as a social environment.

On 26.01.2000., the said scheme was submitted to the 4th PEFC General Assembly for an international assessment. On 6.02.2001. PEFC formally announced the submission of the PEFC Latvian Scheme and announced an international tender for its assessment. The PEFC Board of Directors will choose by a secret ballot the organisation going to evaluate the Latvian scheme. In the meantime PEFC will work with the respective working groups and act to promote the PEFC Latvian Scheme. By 01.10.2001, in Latvia 1500 ha of private and community forests are certified following the PEFC.

3. Tables

3.1. Economic indicators

Table 1.1 Key Indicators of Economic Development (growth rates in percent)

	1996	1997	1998	1999	2000	2001 p
GDP	3.3	8.6	3.9	1.1	6.6	7.0
Private consumption	10.3	5.0	6.2	5.1	5.6	8.0
Public consumption	1.8	0.3	6.1	0	-2.9	0.5
Consumer prices	17.6	8.4	4.7	2.4	2.6	2.5
Foreign trade balance	-15.6	-15.1	-18.5	-15.4	-14.9	-15.0
Foreign direct investment (flows)	7.4	9.3	5.8	5.2	5.7	5.0
Registered unemployment rate (%, end of period)	7.2	7.0	9.2	9.1	7.8	7.5
Exchange rate of LVL against SDR (end of period)	0.7997	0.7997	0.7997	0.7997	0.7997	0.7997

p – projection

Table 1.2. Gross Domestic Product (mln.LVL)

	1995	1996	1997	1998	1999	2000	2001
I-XII	2349.2	2829.1	3275.5	3589.5	3897.0	4333.0	
I-III	537.3	623.8	685.1	837.9	902.1	972.7	1079.4
IV-VI	592.6	702.2	806.2	907.2	963.5	1066.0	1192.6
VII-IX	577.8	725.0	853.3	915.8	979.4	1079.9	
X-XII	641.5	778.1	930.9	928.6	1052.0	1214.4	

3.2. Forest products production and trade in 1998, 1999 and 2000.

Table 2.1 Felling volumes in Latvian forests (mln.m3)

	1992	1993	1994	1995	1996	1997	1998	1999*	2000	2001 p
State Forests	3,1	3,8	4,7	5,3	4,5	4,9	4,5	5,3	3,7	3,8
Other Forests	1,0	1,0	1,0	1,6	2,3	4,1	5,5	8,1	7,3	7,4
Total	4,0	4,8	5,7	6,9	6,8	8,9	10,0	13,4	11,0	11,2

* 15 month
p projection

Table 2.2. Use of Harvested Timber in year 2000

	mln.m3	%
Sawn wood	7,8	59,5
Round wood for Export	4,2	32,1
Plywood, veneer and matches	0,6	4,6
Log houses, similar articles	0,4	3,1
Charcoal	0,1	0,8

Table 2.3. Dynamics of Round_wood Export

	Softwood, mln m3	Hardwood, mln m3	Total, mln m3	Share of softwood, %
1993	622	435	1057	59
1994	1252	775	2026	62
1995	1881	1583	3463	54
1996	825	708	1533	54
1997	1066	1058	2124	50
1998	1299	1461	2760	47
1999	1477	1476	2954	50
2000	1969	2221	4190	47

Table 2.4. The Volume of Main Forest Industry's Production

	1994	1995	1996	1997	1998	1999	2000
Roundwood for export, (thsd.m3)	2 026	3 463	1 533	2 124	2 760	2 965	4149
Sawnwood , (thsd.m3)	950	1300	1800	2700	3200	3640	4030
Plywood, (thsd.m3)	63	73	103	120	150	155	153
Particle board, (thsd.m3)	148	130	143	149	152	129	102
Fibreboard (mln.m2)	17	23	22	27	26	24	17
Paper and paperboard, (1000T)	2	7	8	15	18	19	24

Table 2.5 The Production, Export and Local Consumption of Sawn wood (1000 m3)

	1994	1995	1996	1997	1998	1999	2000
Production	950	1300	1800	2700	3200	3640	4030
Export	840	1023	1446	2147	2474	2819	3082
Local consumption	110	277	354	553	726	821	948
Local consumption, % of production	11,6	21,3	19,7	20,5	22,7	22,6	23,5

Table 2.6 Dynamics of Import and Export of paper and paper Board Production (1000 T)

	Pulp, recycled paper		Paper and paperboard	
	Export	Import	Export	Import
1993	8,6	1,1	16	38,8
1994	11,4	0,2	7,6	53,4
1995	16,7	2,2	10,7	58
1996	15,5	0,6	14	72,1
1997	16,2	0,5	15	85,5
1998	18,7	0,4	15,4	97,5
1999	24,2	1,4	19,4	99,5
2000	26,1	0,5	23,3	116