

Norwegian market statement 2016

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General economic trends

Norway set for economic shift following oil industry slump

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The standstill in the second half of last year has been replaced by a weak increase in growth in the mainland economy this year. A reduced decline in oil investments coupled with growth in house-building activity and exports may lead to an upturn in the economy from early next year, assuming no further reduction in interest rates.

Oil prices have risen significantly from very low levels early in 2016, but the negative impulses from the petroleum sector continue to dominate. The fall in oil prices that began in summer 2014 has exacerbated the downturn in petroleum industry investments, which had already begun before the end of 2013. The downturn that followed may now be coming to an end. A weaker krone, low interest rate levels and an expansionary fiscal policy have counteracted the effects of the fall in demand from the Norwegian and international petroleum industries. Our calculations suggest that unemployment has peaked, but will only see a slight fall over the next few years.

Higher exports

Despite the sharp improvement in cost competitiveness, the traditional exports of goods fell during the first half of the year. Along with some temporary factors, the fall in demand from the international petroleum industry is assumed to have contributed to this development. Lag effects of the improvement in cost competitiveness, strengthened by a slightly higher growth in the global economy, will push exports up going forward. The improved competitiveness will also stimulate the activity in Norway by curbing imports in favour of Norwegian production.

Investment decline in the petroleum industry to slow in 2017

So far this year, the investments in the petroleum industry have fallen by 34 per cent from the peak in 2013. The downturn in the 2nd quarter of this year was 3.7 per cent, which followed a fall in the preceding four quarters of over 5 per cent on average. In our calculations, we assume that oil prices will gradually increase from just under USD 50 per barrel in the first half of September to USD 60 per barrel by the end of 2019. Cost cuts in the wake of the drop in oil prices mean in isolation that several field developments will be profitable. Several developments will stimulate demand from the industry, while cost savings in isolation will reduce demand. We assume that the decline in petroleum investments in terms of volume will be curbed considerably in 2017, and that the volume of investment will increase slightly in 2018 and 2019.

Stable low interest rate

The key policy interest rate has been at a record low over the past year and was last reduced in March, to 0.5 per cent. We believe that the interest rate has bottomed out and that Norges Bank will not change interest rates again until 2019. Mortgage rates have dropped slightly in the first half of the year, but are unlikely to change much in the future. Interest rates on credit lines secured on dwellings as an annual average are therefore expected to be 2.5 per cent in 2017 and 2018, down from 3.2 per cent in 2015.

Weak krone

Measured by the import-weighted exchange rate, the krone appreciated by 5 per cent from the turn of the year to 13 September. However, it is still 23 per cent weaker than the peak level in February 2013, and 15 per cent weaker than the average in the decade before the fall in oil prices. A slight rise in oil prices going forward implies a stronger krone, while relatively high inflation in Norway will have the opposite effect. The interest rate differential with the euro area is expected to remain as it is today, and overall our calculations give a roughly unchanged krone exchange rate going forward.

Expansive fiscal policy to continue in 2017

There has been a marked increase in the budget deficit in the last two years. For 2017, we assume a slightly lower growth in public demand than this year, when excluding the purchase of fighter planes, but the growth in the real value of transfers to households will see a clear increase. It is assumed that the scope of net tax concessions will be about NOK 6 billion in both years. Thus, the fiscal policy will be roughly as expansive in 2017 as in 2016. For 2018 and 2019, we assume a slight contractionary fiscal policy.

Temporary high price growth

The depreciation of the krone has pushed up inflation over a long period of time. An abnormal increase in electricity prices after February this year pushed up growth in the consumer price index (CPI) further, and in August, inflation was at 4.0 per cent. We now expect CPI growth to be 3.4 per cent this year. The effects of the depreciation of the krone will gradually be less significant, and together with low wage growth, will reduce the underlying inflation. We assume that energy prices overall will grow roughly in line with other prices going forward, and the slight increase in environmental taxes is expected to lead to CPI growth of around 2.0 per cent in the next few years.

Marked fall in real wages in 2016

The economic downturn has slowed wage growth. The annual wage growth of 3.9 per cent in 2013 fell to 2.8 per cent in 2015. We now expect the employment decline in highly paid oil-related industries to contribute to growth in annual earnings of 2.3 per cent this year, which is slightly lower than the ceiling for the industry of 2.4 per cent. Average real wages will therefore fall by 1.1 per cent, according to our calculations. Improving economic conditions and clearly lower CPI growth will subsequently contribute to a positive and weak increase in real wage growth.

Moderate consumption growth

Reduced employment and a fall in real wages will contribute to a very modest growth in real disposable income for households this year, despite lower interest rates and tax concessions. Changes in income gradually lead to higher consumption. We therefore expect consumption growth of 1.9 per cent this year, which is only marginally lower than the growth last year. As income growth improves, growth in consumption will increase, reaching 2.6 per cent in 2019.

High activity in the housing market

Aided by steadily falling interest rates – a situation that is expected to continue – house prices have continued to rise markedly in 2016. With the prospect of improved economic conditions, we expect house prices to increase further going forward, but at a slightly slower pace. As an annual average, price growth is set to rise to just over 7 per cent this year and slightly more than 5 per cent next year. The sharp rise in house prices in 2014 and 2015 has contributed to marked growth in house-building activity last year and this year to date. Consequently, the increased supply of housing will curb the growth in house prices in 2018 and 2019.

Our projections generally entail a degree of uncertainty, particularly with regard to house prices. If interest rates were to increase or the criteria for granting credit were to be made much more stringent, the prices could fall.

Moderate increase in investment in mainland industries

There has been little movement in investments in the mainland industries over the past eighteen months. Growth in the second quarter is currently registered as 2.1 per cent. We believe this represents the start of a very cautious recovery, but it is not until 2018 that growth is expected to pick up to any great degree. This year it is especially the investments in manufacturing and power generation that will pull investment up. Eventually, growth in service industries will make a clearer contribution to the upturn.

Slight increase in activity growth will lead to modest decline in unemployment

Two years of an economic downturn have pushed up unemployment by 1.5 percentage points to 4.8 per cent, as measured by the Labour Force Survey (LFS). Most of the rise in unemployment took place in the early stages of the downturn, and the increase this year has so far only been 0.2 percentage points.

Economic growth has picked up throughout this year, and from early 2017 we expect mainland Norway's GDP to increase more than trend growth, which is estimated at approximately 2 per cent.

Our calculations show that employment has fallen slightly over the last three quarters, and will pick up slightly in the second half of this year. Unemployment as an annual average is set to reach 4.7 per cent in 2016, subsequently falling slightly as employment picks up. The fall in the LFS unemployment is, however, expected to cease towards the end of 2017, when labour supply will also start to pick up. This calculation puts unemployment at around 4.3 per cent.

-Statistics Norway, September 2016

Policy measures taken over the past 18 months, which might have a bearing on trade and markets of forest products or forest management.

Support for sustainable forestry and the development of the forest industry sector

In the recently presented proposal for the national budget for 2017, the Government has mostly continued but also made some changes to the main measures aiming at sustainable forest management as well as developing competitive industries in Norway. Focus in the Government's policy is on transportation infrastructure, research and development and tax reliefs.

The Forest Fund is a tax-relief scheme for forest owners providing incentives for setting aside incomes from forestry for long term investments in forest production and infrastructure such as forest roads. The Forest fund has for several years been central in providing public support for long term sustainable management of private forests in Norway. The scheme has been continued under the present government.

Improvement of infrastructure for effective transport of raw materials and products has been a priority of the present government. This includes support for construction of new forest roads and terminals for transport by boat, as well as maintenance of existing roads. Public support for these activities has been increased in the last two years, and is also proposed to increase further in 2017..

The Government has continued its support to activities aiming for increased use of wood and bioenergy. The purpose of the public funded Bioenergy scheme is to promote the production and utilisation of bioenergy by farmers and foresters. The scheme is one of the main instruments for increasing the production and use of bioenergy in Norway.

The public Wood-based Innovation scheme has been going on for 15 year, and is funded throughout 2016. The objective of the scheme has been to increase the use of wood and added value in the entire value chain. In the proposal for national budget for 2017, the Government expect the industry to take the responsibility for specific wood innovation activities, and will prioritise the more general innovation schemes in the public funding agencies. These will also be available for the forest and wood industry.

The Government has proposed to strengthen the research activities related to bioeconomy by increasing the funding of the Research Council of Norway with NOK 50 million in the national budget for 2017. The purpose is to enable the research council to better facilitate a knowledge based bioeconomy in Norway.

For 2017 the required amount of biofuel in the fuel mix for transportation is proposed by the Government to increase from 5,5 per cent to 7 per cent. Of the biofuel proportion the proposed increase of 1,5 per cent should be "advanced" biofuel, coming waste, residues or forest resources. The proposal from the Government includes a plan for gradually increasing the share of biofuel to 8,5 per cent until 2020.

In 2013, NOK 500 million was set aside for investments in the forest sector to be managed by Investinor, a public owned investment company. Investinor invests in start-up and in expanding new ventures on the same terms and conditions as private investors, with a clear exit strategy for all investments. Due to lack of projects meeting the

requirements of Investinor, less than NOK 100 million has been invested in forest related industries. The government has recently proposed that Investinor should be allowed to invest in mature companies in the forest industries. This will increase the availability of risk investment capital for established companies in the sector, and is also expected to mobilise private investment capital.

New target for forest protection

In 2016, the Norwegian Parliament set a new target for forest protection. The new target is to set aside 10 percent of the forest area for strict protection. The target is to be reached by protecting state-owned forests, key habitats and by reaching voluntary agreements with private forest owners on establishment of new nature reserves. It is not set a date for when the target is to be reached.

EU Timber regulation

The EU Timber regulation laying down the obligations of operators who place timber and timber products on the market was implemented in Norwegian legislation at Mai 1. 2015.

SKOG22/FOREST22 – National strategy forest the wood and forest industry

The forest and wood industry in Norway has undergone major changes in recent years as regards structural rationalisation, increased productivity and loss of industrial capacity. At the same time, there is a great potential for further industrial growth and forests are seen as playing an important role in regulating the climate. This formed the basis for the Ministry of Agriculture and Food's strategic initiative SKOG22 in autumn 2013. A strategy group was appointed with representatives from the whole value chain and national R&D environments. SKOG22 was tasked with preparing an overall national strategy to contribute to the short-term and long-term development of a competitive forest industry. SKOG22 should identify the challenges and opportunities facing the forest and wood industry and where new know-how, new solutions and measures are required to boost the industry's capacity for growth and value creation.

In January 2015 SKOG22 presented its report with a national strategy for the wood and forest industry together with a set of recommendations for achieving its targets.

SKOG22 found that The forest and wood industry has the potential to generate an annual turnover of at least NOK 180 billion, or more than four times the level achieved in 2012, which was NOK 43 billion. The industry's greatest sales potential is in building and construction. SKOG22 also pointed at a potential for increasing the the annual harvesting of timber from Norwegian forests to at least 15 million m³. This corresponds to an increase of 35 per cent compared with the average for the period 2008–2012, including timber for fire wood and own use (household needs).

For realising the potential, SKOG22 stressed the importance of public framework conditions for developing a competitive industry, R&D efforts, markets for renewable products, economic viable forestry among others. Among the recommendations are strengthened efforts in constructing and improving transportation infrastructure in forests and from forest to processing industries, use of tax incentives for mobilising wood, stronger emphasis on life cycle assessments when considering different building options, support for R&D activities

aimed at developing new bio-based products, support for pilot and demonstration facilities, and policy for promoting renewable energy solutions.

White paper to the Storting (parliament) on the forest policy of the Government

On October 14. 2016 the Government presented a white paper on the forest policy to the Storting (parliament). The white paper has a value chain approach, addressing opportunities and challenges broadly, from forest management to forest based products. The strategy of the forest and wood industry sector, SKOG22, has been a central input for the policy process, and the white paper addresses the potentials represented by the sector.

The white paper represents a continuation of the main lines of the Norwegian forest policy as shown in previous white papers on the same subject and the annual budget allocations decided by the Storting. The white paper is also based on the consensus on the Norwegian climate policy established by the Storting, previous decisions balancing the considerations of industry and the environment, and the Government's policy for developing an adaptable and diverse industry.

Based on the present state and predictions of future development of the forest resources in Norway, the white paper addresses sustainable forest management, effective logistics for transporting timber from forests to sawmills and wood processing plants, competitive and value adding industries and research and development in the forest sector.

The white paper points at the benefits of active utilisation of the forest resources, and addresses measures for value adding activities and a transition to a green economy where bioeconomy is central.

The measures include a continuation of the efforts to further develop the transportation infrastructure in forestry, mapping and of bottlenecks for transportation of timber on public roads, better availability of capital for industrial investments, active use of the forest for reaching climate change policy targets, and public private cooperation in order to strengthen environmental considerations in sustainable forestry.

Market drivers

Increased focus on bioeconomy, and the need for a transition of the economy in a more green direction, has put the forest and wood industries on the political agenda. The sector enjoys a higher level of attention, and are expected to contribute with sustainable products and solutions that can contribute to overall welfare as well as play a role in tackling global challenges. Several political processes are taking place at the moment, and the Government is expected to present a bioeconomy strategy later this year.

The focus on sustainable building practice and environmental aspects in the building sector is still increasing. There is also an increased focus on the use of wood as a renewable and climate friendly solution. This represents an opportunity for the forest sector. The requirements for energy efficiency in new buildings are also a potential market driver for extensive use of wood in buildings.

There is an ongoing development of new products and applications of wood based alternatives where other materials have been preferred earlier. Increased focus on energy efficient solutions and indoor climate enhances the use of wood in several applications and

constructions. Old buildings need repair and maintenance and new facades made of wood elements is a preferred solution.

Public purchasers and builders are increasingly tending to focus on environmental aspects in their purchase and contracts. There are several public buildings projects and processes in the major cities of Norway which defines environmental specifications connected to building projects. This includes e.g. CO₂-emissions which enhance to an extended use of wood. The major builder in Norway, Statsbygg, has carried out a review on how governmental building projects can enhance the use of wood as an action to reduce CO₂-emissions from the building sector.

An increasing number of large buildings in massive wood has gained attention, and works as showcases for the benefits of using more wooden constructions in the building sector. The use of massive wood in buildings have seen an increase in schools, kindergartens, special care homes and student dormitories.

Developments in forest products markets sectors

Sources: Norwegian Forest Owners Federation, The Norwegian Sawmill Industries Association, Norwegian Pulp and Paper Association, Wood Focus

Wood raw materials (e.g. roundwood: sawlogs, pulpwood and fuelwood)

Roundwood removals in 2015 was 10,37 mill m³. This is an increase by 7 per cent compared to the already large figures from 2014. Around 75% of the volume is spruce. The shutdown of pulp and paper industries in southern Norway has led to a significant change in the trade of roundwood. Norway is now a net exporter of roundwood, and nearly 40 per cent of the roundwood removals was exported in 2015. Although there has been a challenging situation in the domestic market for pulpwood, with relatively low prices as a consequence, the removals are expected to remain high both in 2016 and 2017.

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

Increased use and production of bioenergy from wood is a goal in government policies. Measures for increased production of bioenergy have also been included in different stimulus packages.

Certified forest products

Most of the forestry in Norway is certified through PEFC. A minor percentage of the forest area is also certified through FSC. This includes both pulpwood and sawlogs. The interest for certified forest products is also increasing in the building sector due to the introduction of the BREEAM-scheme. This scheme sets chain of custody certification of forest products as mandatory. This has raised an increased certification activity throughout the entire value chain, with a special focus on the retailers.

Value-added wood products

There has been an increase in development and production of construction elements and other prefabricated products made from wood. This is an ongoing trend and replaces production on the building site. The development has initially started for new buildings, but are now also realized for repair and maintenance of older buildings, e.g. according to energy efficiency.

As the domestic wood based building element prefabrication industry is not sufficiently developed to meet the market demand, the import of these commodities has increased. This

represents a challenge to the traditional sawmilling industry. There is, however, increased focus on industrialization by the funding agencies, in the industry and by entrepreneurs.

Sawn softwood

For sawn softwood, the situation is closely linked to the construction and renovation activity. The distribution channels for pulpwood and sawmills' cellulose chips and other residues have changed dramatically following the closedowns in the pulp and paper industry through 2011 – 2013. This development represents severe implications for the Norwegian sawmilling sector. Availability of sawlogs is somewhat unstable, due to exports and fluctuations in various markets. Increased export of pulpwood has led to increased sawlog exports as well. The sawlog availability for the domestic industry has worsened with price increases as a consequence.

The total production of soft sawnwood are stable. Sawn softwood production was 2.44 mill. m³ in 2015, a 1.5 per cent increase from the year before. Production in 2016 is expected to be on the same level or slightly above as in 2015.

The total export of sawn softwood was 560 000 m³ in 2015, a 8.5 per cent increase from the year before.

The total import of sawn softwood was 979 000 m³ in 2015, a 1 per cent increase from 2014.

Pulp and paper

The pulp and paper industry has over the last years faced challenges related to overcapacity globally, vulnerable product mix and high transportation costs. The Norwegian pulp and paper industry is rather exposed according to a shift in mega-trends from paper based to electronic media. This is especially visible in the newsprint sector.

Production is estimated to increase after a few years of lower production due to a weaker market for paper (especially graphics). The production of wood pulp is estimated to 1 billion metric tonnes, while production of paper and paperboard is estimated to 1.1 billion metric tonnes in 2016. This development is due to capacity closures across Europe the last few years, combined with a weaker Norwegian currency. Estimates for 2016 is based on data for the first half of 2016, and is expected to be a relatively accurate estimate. This forecasts an increase of approximately 10 per cent both for wood pulp and paper compared to 2015. For paper, the expected increase will be exported.

Tables

1. Key figures for the Norwegian economy. Percentage change from previous year. The national budget 2017

	2015	2016	2017
Private consumption.....	2,1	1,4	2,3
Public consumption.....	2,1	2,6	1,7
Gross fixed investments	-3,8	0,0	1,6
Of which: Public sector.....	3,0	5,3	5,1
Petroleum extract and pipeline transp..	-15	-14	-10
Demand from Mainland Norway ¹	1,8	2,5	2,6
Exports.....	3,7	-0,3	-0,4
Of which: Traditional goods.....	5,8	-1,5	4,6
Imports.....	1,6	-0,5	3,0
Gross domestic product.....	1,6	1,2	0,6
Of which: Mainland Norway.....	1,1	1,0	1,7
<i>Memorandum items:</i>			
Consumer price index (CPI).....	2,1	3,4	2,0
Underlying inflation (CPI-ATE).....	2,7	3,0	2,1
Annual wage	2,8	2,4	2,7
Three-month money market rate (pct.).....	1,3	1,1	1,0
Employment growth.....	0,3	0,2	0,7
Unemployment rate (LFS).....	4,4	4,7	4,6
Oil price. NOK per barrel	430	371	425
Current account balance (per cent of GDP).....	6,4	3,1	3,0

¹ Excluding inventory changes.

Sources: Statistics Norway and Ministry of Finance.

2. Forest products production and trade in 2015, forecasts for 2016 and 2017

			Unit 1000	2015	2016	2017	
Industrial roundwood	Removals	Saw and veneer logs	m ³	5 700	5 700	5700	
		Production	Pulpwood	m ³	4 670	4 660	4 660
			Other industrial roundwood	m ³			
	Total		m ³	10 370	10 360	10 360	
	Imports	Saw and veneer logs	m ³	100	100	100	
		Pulpwood	m ³	270	250	250	
		Total	m ³	370	350	350	
	Exports	Saw and veneer logs	m ³	1 350	1 200	1 000	
		Pulpwood	m ³	2 610	2 600	2 600	
		Total	m ³	3 960	3 800	3 600	
Sawnwood	Production	m ³	2 444	2 500	2 500		
	Imports	m ³	1 003	1 025	1 025		
	Exports	m ³	560	650	650		
Wood pulp	Production	Mt	900	1 020	1 020		
	Imports	Mt	84	92	92		
	Exports	Mt	335	350	350		
Paper and paper board	Production	Mt	979	1 100	1 100		
	Imports	Mt	480	466	466		
	Exports	Mt	915	1 018	1 018		

Sources: Statistics Norway, Norwegian Forest Owners Federation, The Norwegian Sawmill Industries Association, Norwegian Pulp and Paper Association