

## MARKET STATEMENT 2015

### 1. GENERAL ECONOMIC TRENDS AFFECTING THE FOREST AND FOREST INDUSTRIES SECTOR

Since the end of 2009, the economic recession in Latvia has been stopped, and the growth has resumed. From 2011 to 2013, the GDP increased on average by 4.7% annually, and it was one of the most rapid economic growths in the EU. In 2014, the GDP increased by 2.4%. The decrease in the growth rate was determined by external tendencies: growth in the EU was not as rapid as expected, as well as the economy of Russia became weaker. Although the economy in Latvia has been growing in recent years, the GDP is still by 5% lower than it was before the crisis in 2007.

Since 2010, exports of the goods and services from Latvia have increased rapidly, and it has been the main driving force of the national economy. The amount of exports currently exceeds the level of exports before the crisis for more than 25%. However, the low demand in the foreign markets of the recent years has affected the dynamics of the exports, and it has become moderate. In 2013, the amount of exports increased only by 1.4%, but in 2014 – by 2.2%. In 2014, the increase was mainly determined by the increase of exports of goods, but the amount of exports of services decreased.

Further development of exports will be affected not only by the changes in the global demand, but also by the competitiveness of the Latvian manufacturers. It has to be taken into account that the improvement of the competitiveness of Latvia so far has occurred due to cuts in labour costs; however, further improvement of competitiveness will depend on the ability to raise productivity.

During the crisis, the amount of imports rapidly dropped due to decrease in the domestic demand. The demand for imports grows along the increase in economic activities in the domestic market. Yet, the dynamics of imports has become rather moderate since the middle of 2012. In 2014, imports increased only by 1.6 percent.

The external deficit on trade of goods and services in 2013 and in 2014 was 2.9% of the GDP. The current account deficit in 2013 was 2.3% of the GDP, but in 2014 – 3.1%. It shall be noted that current account deficit in Latvia has been low since 2010 that gives evidence of the external balance of the economy in Latvia.

Domestic demand has contributed much to the growth. The increase in employment and gradual increase of wages fosters the growth of the private consumption. In 2013, the amount of private consumption increased by 6.2%, but in 2014 – by 2.3%. In the 1st quarter of 2015, the total amount of private consumption was by 2.6% higher than a year ago. Like the overall growth of the economy, the dynamics of the growth of private consumption has become moderate.

As the situation in the budget has improved, the public consumption has started to grow. In 2013, the amount of public consumption increased by 2.9%, but in 2014 – by 3.4%. Similar rate of increase was observed also during the 1st quarter of 2015.

In recent years, the dynamics of investments in Latvia have been rather unstable. During the crisis in 2008-2009, the investments decreased considerably, while in 2011-2012 they increased significantly. In 2013, the amount of the investments in the national economy of Latvia decreased again – by 5.2%. In 2014, the dynamics of the investments were moderate, and the amount of investments was by 1.3% higher than a year ago. The level of investments still is significantly lower than during the years before the crisis.

Increase in the economic activities has a positive impact on the situation in the labour market: the unemployment rate caused by the crisis falls, while the employment rate rises. The unemployment rate in 2014 decreased to 10.8%, which was by 1.1 percentage points less than in 2013, but the employment rate increased by 0.9 percentage points – up to 59.1%. The number of employed people in 2015 may increase by 0.2%, but the unemployment rate may be close to 10 per cent.

Further development of the national economy in Latvia still will be closely related to export possibilities; therefore, the major risk of the development of Latvia is related to the development of the global economy.

**Wood processing** is one of the largest manufacturing sectors. The sector exports  $\frac{3}{4}$  of all produced goods, and the largest export market is EU-15 Member States. Wood processing was one of the first sectors that resumed growth after the crisis. In 2012, the production volumes in the sector exceeded the level of 2007 by more than 40% already. At the end of 2012 and in the first half of 2013, the weak demand in the largest trade partner states slowed down the growth of the sector.

Since the end of 2013, a steady growth has been observed in the sector. In 2014, the production volumes were by 6.9% higher than a year before, but in the four months of 2015, the production volume was by 8.2% higher than a year before.

In 2014, the turnover in the wood processing sector increased by 9.7%. Sales volumes both in the domestic market and export increased at a similar pace. In January-April 2015, the turnover was by 10.4% higher than a year before. The turnover of the export production increased by 14.2% in the said period.

In comparison to the increase in the production volumes, the number of jobs in the sector increased more moderately. It gives evidence of the increase in productivity. In 2014, the number of occupied posts increased by 1.8%. In the 1st quarter of 2015, the number of jobs was even a bit smaller than a year before.

*Data source: Report on Economic Development of Latvia (Ministry of Economics Republic of Latvia).*

## 2. POLICY MEASURES TAKEN IN LATVIA

According to quantitative targets of Europe 2020: the European Union strategy for growth and employment Latvia has to reach 40% share of renewable energy sources (RES) in total energy consumption in 2020. The strategy in state ensures stable development in RES sector for next 5 years. Latvia is expanding renewables share in district heating (DH) systems. According to latest energy balance data, in 2014 energy wood share in DH sector increased up to 28%. This helps making more sustainable development in forestry and forest industry, now providing massive and stable demand also for low quality wood resources and byproducts.

There have been no major changes in RES utilization politics during last 18 months, but in next period some changes are expected. In 2017 “subsidized energy tax” (SET), introduced in year 2014 will be cancelled - tax is paid from feed-in revenues. For wood biomass CHP plants tax level is 5% if installed capacity does not exceed 4 MW, and 10% - if capacity is above 4 MW. No new licenses for new CHP plants will be issued until 2016. In 2018, there will be the end of 10 year subsidized period (guaranteed feed-in) for CHP plants built in 2007-2009. They mainly were operating on natural gas fuel.

Last year the new building code came into force followed by modifications of regulations and rules according to the new building code. The changes were made to create a contemporary and modern legal framework for construction process that would harmonize national legislation with laws of EU and would promote the development of construction sector, as well as the opportunities for public participation in decision-making process.

### 3. MARKET DRIVERS

Local market of forest products is influenced by significant increase of solid wood biomass consumption in wood energy production and consumption sectors. In 2014 large scale heating and CHP plants increased wood consumption to 1,657 million m<sup>3</sup>. Starting from 2016, similar rapid wood consumption increase, implemented in Lithuania, that increased solid wood biomass consumption in Baltic countries. Wood biomass products production also is impacting forest industry strongly - increasing demand for premium and industrial pellets in EU increases pellet production activities in Latvia.

Trading operations with Russian Federation has a minor role and more than 95% of forest industry trade is focused on in EU, North Africa and Asia region. As a result, EuroAsian Economic Community currency (RUB, BYR, KAZ) exchange rate adjustments didn't have direct negative impact on Latvian forest industry. According to Central Statistical Bureau data, basically softwood panels (share in forest industry export: 6,7%) are exported to EuroAsian Economic Community region. In despite of political problems, export of this product in first 7 months of 2015 increased by 4,5%. Indirectly sanctions impacted wood packaging sector. Significantly reduced EU-Russian Federation trade caused Baltic & Eastern Europe transport companies to decrease demand for EUR pallets (share in export: 3,8%). However, strong intra-EU trade helped to keep demand in general on high levels and retain Latvian revenues from packaging export in the same level. Otherwise, stronger USD exchange rates in 2015 increased revenues from export on markets of North Africa and Asia.

No political limitations have been noticed in log import or export operations. Since beginning of 2015 Latvia markedly increased log import from EuroAsian Economic Community, mostly from Belarus (+211%). Some warning trends are noticed in trade with Scandinavian countries. Pulp and paper industries in Nordic countries are decreasing pulp production capacities, as a result reducing pulpwood import from Baltic countries (in first 7 months of 2015 log export decreased by 26%). In long term period it creates better opportunities for industrial wood users (wood based panels and wood biomass chemical industries) in Latvia.

### 4. DEVELOPMENT IN FOREST PRODUCT MARKET SECTORS

#### **4.1 Wood raw materials**

In 2014, Latvia exported 3,8 million m<sup>3</sup> of roundwood, mainly to Nordic countries and Germany. During the first 7 months of 2015 export decreased 25%, due to Demand decrease by 9% due to lower consumption of pulp&paper industries. In the same time, Latvia increased import of roundwood from Baltic countries and Belarus. In 2014 Latvia imported 1,3 million roundwood, and in current year imports have been expanded by 27%. In 2014 hardwood log market was highly affected by buyers for China, 0,3 million m<sup>3</sup> of birch sawlogs were exported.

## **4.2. Wood energy**

Wood biomass demand was one of the main forest product market drivers in 2014, and continued to increase in 2015. Increase in woody biomass consumption still happens both local and export markets.

Local market consumption of woody biomass products continue to gain momentum, powered by fossil district heating systems (DH) alternation to wood chips and green electricity market development with new cogeneration (CHP) capacities starting operations. Local consumption of wood chips in 2013 expanded by 40% and in 2014 – by 16%. After 2015 wood biomass consumption is forecasted to be stabilized, as there are no new additional capacities starting operations.

For export markets positive trend is a pellet production segment. In 2014 Latvia extended pellets deliveries by 22%, reached new record level of 1,3 million tonnes and has become 3rd leading EU supplier (after Germany and Sweden). According to annual biomass market research, made by “Forest and Wood Products Research and Development Institute”, pellet production will continue a moderate expanding in 2015-2016 as 2 new large scale pellet mills are going to start operating during next 12 months.

## **4.3 Forest Certification**

All forests managed by JSC Latvian State Forests („Latvijas valsts meži”) are certified in accordance with the internationally approved FSC® Principles and Criteria. Since 2011 JSC "Latvian State Forests" are also certified according to the PEFC scheme. PEFC certificates have been granted to all 8 of LVM forest management regions. The PEFC forest management certification was performed by leading certification bodies within Latvia namely: BM Trada Latvija and SIA "SGS Latvija Ltd.". Certified areas in private forests are increasing, but with slow pace.

## **4.4 Value added products**

Share of value added and semi-finished wood product export extended in 2014. Intensive changes are noticed in prefabricated wood (panel) / modular house production industry, export increased by 25% in 2014 and by additional 20% in first 7 months of 2015. Production capacities are focusing on growing demand in North European countries. Prefabricated house production expansion also is making positive influence for carpentry industry, including wood door/window production and glue-laminated timber production. Investments were made in large scale structural wood, namely cross laminated timber (CLT) and glue laminated timber (GLT) production units.

## **4.5 Sawn softwood and hardwood**

Export of softwood sawn-wood in 2014 increased by 9%, volume of sawn-timber exported was 2.3 million m<sup>3</sup>. Export of softwood sawn-timber to traditional EU markets increased by 2%, but share of Asian markets extended by 18%. To keep the production in high rates companies increased share of imported logs. For 2015 forecasted export volumes are 2,4 million m<sup>3</sup>.

Export of hardwood sawn-wood in 2014 increased by 19% to level of 0,5 million m<sup>3</sup>, and for 2015 foreign trade statistics show still high growth rates (+13%). Changes are a result of higher availability of hardwood logs.

#### **4.6 Wood-based panels**

Birch plywood production and softwood wood-panel production is keeping on high levels. In 2014 export of plywood remained at rate of 0,25 million m<sup>3</sup>, and softwood panels increased by 4% (0,7 million m<sup>3</sup>). For 2015 forecast is also positive - OSB and particleboard export volume change is positive.

### 5. TABLES

#### **Key Economic Development Indicators in Latvia**

	2010	2011	2012	2013	2014	2015f	2016f
(changes in comparison with the previous year, %)							
Gross domestic product	-2.9	5.0	4.8	4.2	2.4	2.0	3.0
Private consumption	3.1	2.9	3.0	6.2	2.3	2.2	2.7
Public consumption	-8.1	3.1	0.4	2.9	3.4	2.8	0.7
Gross fixed capital formation	-20.0	24.2	14.5	-5.2	1.3	0.4	2.2
Exports	13.4	12.0	9.8	1.4	2.2	1.6	2.6
Imports	12.4	22.0	5.4	-0.2	1.6	1.5	0.5
Consumer prices	-1.1	4.4	2.3	0.0	0.6	0.9	2.0
(% of GDP unless indicated otherwise)							
General government sector balance	-8.1	-3.3	-0.8	-0.7	-1.4	-1.5	-1.2
General government debt	46.8	42.7	40.9	38.2	40.0	37.0	40.0
Export-import balance	-1.5	-5.0	-4.4	-2.9	-2.9	-2.3	-1.7
Changes in the number of employed (aged 15-74 years, compared to the previous year)	-6.4	1.3	1.6	2.1	-1,0*	0.2	0.5
Employment rate	52.0	54.0	56.1	58.2	59.1	60.0	61.0
Unemployment rate (share of unemployed persons to the economically active population aged 15-74 years, %)*	19.5	16.2	15.0	11.9	10.8	9.8	8.7

f – forecast

Data source: Ministry of Economics of Latvia

### Forest Products Production and Trade in 2014-2016

Product Code	Product	Unit	Historical data	Estimate	Forecast
			2014	2015	2016
1.2.1.C	SAWLOGS AND VENEER LOGS, CONIFEROUS				
	Removals	1000 m <sup>3</sup>	5021	4850	4850
	Imports	1000 m <sup>3</sup>	811	1030	1000
	Exports	1000 m <sup>3</sup>	194	255	250
	Apparent consumption	1000 m <sup>3</sup>	5638	5625	5600
1.2.1.NC	SAWLOGS AND VENEER LOGS, NON-CONIFEROUS				
	Removals	1000 m <sup>3</sup>	1900	1900	1900
	Imports	1000 m <sup>3</sup>	24	35	30
	Exports	1000 m <sup>3</sup>	301	361	350
	Apparent consumption	1000 m <sup>3</sup>	1623	1574	1580
1.2.1.NC.T	of which, tropical logs				
	Imports	1000 m <sup>3</sup>	0	0	0
	Exports	1000 m <sup>3</sup>	0	0	0
	Net Trade	1000 m <sup>3</sup>	0	0	0
1.2.2.C	PULPWOOD (ROUND AND SPLIT), CONIFEROUS				
	Removals	1000 m <sup>3</sup>	2420	2000	2000
	Imports	1000 m <sup>3</sup>	257	261	250
	Exports	1000 m <sup>3</sup>	1927	1356	1400
	Apparent consumption	1000 m <sup>3</sup>	750	905	850
1.2.2.NC	PULPWOOD (ROUND AND SPLIT), NON-CONIFEROUS				
	Removals	1000 m <sup>3</sup>	1203	1000	1000
	Imports	1000 m <sup>3</sup>	210	206	200
	Exports	1000 m <sup>3</sup>	1414	1200	1200
	Apparent consumption	1000 m <sup>3</sup>	0	6	0
3	WOOD RESIDUES, CHIPS AND PARTICLES				
	Domestic supply	1000 m <sup>3</sup>	3404	3400	3400
	Imports	1000 m <sup>3</sup>	115	110	110
	Exports	1000 m <sup>3</sup>	1625	1600	1600
	Apparent consumption	1000 m <sup>3</sup>	1893	1910	1910

1.2.3.C	OTHER INDUSTRIAL ROUNDWOOD, CONIFEROUS				
	Removals	1000 m <sup>3</sup>	731	730	730
1.2.3.NC	OTHER INDUSTRIAL ROUNDWOOD, NON-CONIFEROUS				
	Removals	1000 m <sup>3</sup>	311	300	300
1.1.C	WOOD FUEL, CONIFEROUS				
	Removals	1000 m <sup>3</sup>	186	200	200
1.1.NC	WOOD FUEL, NON-CONIFEROUS				
	Removals	1000 m <sup>3</sup>	1113	1000	1000

Product Code	Product	Unit	Historical data	Estimate	Forecast
			2014	2015	2016
5.C	SAWNWOOD, CONIFEROUS				
	Production	1000 m <sup>3</sup>	2768	2832	2750
	Imports	1000 m <sup>3</sup>	452	552	550
	Exports	1000 m <sup>3</sup>	2276	2440	2440
	Apparent consumption	1000 m <sup>3</sup>	944	944	860
5.NC	SAWNWOOD, NON-CONIFEROUS				
	Production	1000 m <sup>3</sup>	890	890	890
	Imports	1000 m <sup>3</sup>	18	23	20
	Exports	1000 m <sup>3</sup>	513	565	560
	Apparent consumption	1000 m <sup>3</sup>	395	348	350
5.NC.T	of which, tropical sawnwood				
	Production	1000 m <sup>3</sup>	0	0	0
	Imports	1000 m <sup>3</sup>	0	0	0
	Exports	1000 m <sup>3</sup>	0	0	0
	Apparent consumption	1000 m <sup>3</sup>	0	0	0
6.1	VENEER SHEETS				
	Production	1000 m <sup>3</sup>	0	0	0
	Imports	1000 m <sup>3</sup>	125	129	130
	Exports	1000 m <sup>3</sup>	3	2	2
	Apparent consumption	1000 m <sup>3</sup>	122	127	128
6.1.NC.T	of which, tropical veneer sheets				
	Production	1000 m <sup>3</sup>	0	0	0
	Imports	1000 m <sup>3</sup>	0	0	0
	Exports	1000 m <sup>3</sup>	0	0	0
	Apparent consumption	1000 m <sup>3</sup>	0	0	0
6.2	PLYWOOD				
	Production	1000 m <sup>3</sup>	250	240	250
	Imports	1000 m <sup>3</sup>	54	75	70
	Exports	1000 m <sup>3</sup>	247	240	250
	Apparent consumption	1000 m <sup>3</sup>	57	75	70
6.2.NC.T	of which, tropical plywood				
	Production	1000 m <sup>3</sup>	0	0	0

	Imports	1000 m <sup>3</sup>	3	3	3
	Exports	1000 m <sup>3</sup>	0	0	0
	Apparent consumption	1000 m <sup>3</sup>	3	3	3
6.3	<b>PARTICLE BOARD (including OSB)</b>				
	Production	1000 m <sup>3</sup>	882	926	972
	Imports	1000 m <sup>3</sup>	43	47	45
	Exports	1000 m <sup>3</sup>	782	826	868
	Apparent consumption	1000 m <sup>3</sup>	143	147	150
6.3.1	<b>of which, OSB</b>				
	Production	1000 m <sup>3</sup>	570	599	627
	Imports	1000 m <sup>3</sup>	9	9	9
	Exports	1000 m <sup>3</sup>	525	552	578
	Apparent consumption	1000 m <sup>3</sup>	54	56	58
6.4	<b>FIBREBOARD</b>				
	Production	1000 m <sup>3</sup>	0	0	0
	Imports	1000 m <sup>3</sup>	33	30	30
	Exports	1000 m <sup>3</sup>	8	10	10
	Apparent consumption	1000 m <sup>3</sup>	25	20	20
6.4.1	<b>Hardboard</b>				
	Production	1000 m <sup>3</sup>	0	0	0
	Imports	1000 m <sup>3</sup>	13	12	12
	Exports	1000 m <sup>3</sup>	1	0	0
	Apparent consumption	1000 m <sup>3</sup>	12	12	12
6.4.2	<b>MDF (Medium density)</b>				
	Production	1000 m <sup>3</sup>	0	0	0
	Imports	1000 m <sup>3</sup>	13	13	13
	Exports	1000 m <sup>3</sup>	0	0	0
	Apparent consumption	1000 m <sup>3</sup>	12	13	13
6.4.3	<b>Other fibreboard</b>				
	Production	1000 m <sup>3</sup>	0	0	0
	Imports	1000 m <sup>3</sup>	7	7	7
	Exports	1000 m <sup>3</sup>	5	5	5
	Apparent consumption	1000 m <sup>3</sup>	2	2	2
7	<b>WOOD PULP</b>				
	Production	1000 m.t.	0	0	0
	Imports	1000 m.t.	0	0	0
	Exports	1000 m.t.	0	0	0
	Apparent consumption	1000 m.t.	0	0	0
10	<b>PAPER &amp; PAPERBOARD</b>				
	Production	1000 m.t.	40	40	40
	Imports	1000 m.t.	185	180	180
	Exports	1000 m.t.	30	30	30
	Apparent consumption	1000 m.t.	195	190	190
4.1	<b>WOOD PELLETS</b>				
	Production	1000 m.t.	1280	1500	1550
	Imports	1000 m.t.	88	123	100
	Exports	1000 m.t.	1290	1546	1570
	Apparent consumption	1000 m.t.	77	78	80

Data source: Ministry of Agriculture of Latvia