

CHAPTER 4

EFFECTS OF THE ASIAN CRISIS ON ECE REGION FOREST PRODUCTS MARKETS

Highlights

- The Asian crisis is being felt worldwide, in many sectors, including the ECE region's forest and forest industry sector.
- The entire forest and forest products sector has felt the shocks and by necessity, made initial strategic adjustments.
- Industries dependent on Asian trade have found alternative markets and cut production.
- Structural changes in economic systems must precede recovery in forest products markets.
- Reduced forest products exports to Asia have created oversupplies and in some cases forced prices down.
- European sawnwood exports made up 17% of Japan's sawnwood imports in 1997, but in mid 1998, market share growth stalled with the downturn in demand.

4.1 Global impact

At this time, mid 1998, it is impossible to overlook the significant impact the downturn in Asian economies is having on world forest products markets, including those in the ECE region. The Asian crisis is complex and multi-causal: its final outcome is by no means clear as of mid 1998 (see chapter 2). The aim of this chapter is to identify and, to the extent possible, quantify the consequences of these macro-economic developments for the forest and forest products sector, and in particular for forest products markets in the ECE region. Since the Asian crisis centers around Japan, the largest consumer of tropical forest products, some additional information is presented here on Japanese forest products trade and production in 1997 and 1998. Indonesia is highlighted to illustrate the situation of an Asian producer.

The features of the Asian crisis which appear most relevant to the forest and forest products sector include:

- shrinkage of many economies, including the largest, Japan, reduced disposable income and weak demand for housing;
- major currency fluctuations, including a weak yen and catastrophic falls for the currencies of many of the

so-called "tiger" economies, including the Thai baht, the Malaysian ringgit and the Indonesian rupiah;

- chaos in the financial sector, including bank closures, difficulties for trade financing, high interest rates and reluctance of foreigners to invest in the region, because of the high risks involved;
- structural reform programmes, in some cases led by the IMF, intended to change the inefficient and sometimes corrupt political/economic systems previously in place;
- in a few countries, notably Indonesia, profound and rapid political and social change;
- the sense of confidence, indeed euphoria, as regards the long term economic and social outlook for Asia has disappeared.

These developments translate in general terms into the following features of forest products markets:

- reduced demand for all products in all Asian markets, domestic and importing. In particular, the drop in Japanese and Korean import demand for sawnwood and plywood has major consequences for world trade patterns for forest products;

- changes in the price competitiveness of exporters, inside and outside Asia; those whose currencies move together with the dollar have found their products relatively more expensive on Asian (and other) markets than those whose prices and costs are denominated in the devalued south east Asian currencies.

- producer countries however have frequently not been able to benefit from their improved price competitiveness, because of the institutional and financial turbulence, as well as the much increased cost of imported inputs.

It is of course desirable to measure and monitor these developments: however it is not always clear what indicators are the appropriate ones for use by analysts. The following trends, which are presented in more detail below may be considered symptoms of the above mentioned broad developments:

- lower volumes of consumption and imports in Asian markets;
- changes in market share of suppliers;
- reductions in shipments by some south-east Asian producers, despite devalued currencies;
- new government regulations to influence trade and production, including log export bans, and forced changes to export associations/cartels.
- production cutbacks, closure of capacity and bankruptcies in the forest products industries.

Price changes do not transmit a very clear message as they are the net result of opposing factors: weak demand and supply constraints in some way balance each other out, with the result of undramatic price movements (but at much lower volumes).

A number of exporters, including Canada, United States, Russia, New Zealand and Chile, are major suppliers both to Asia and to other regions. One possible consequence of the Asian crisis and the reduced levels of imports would be for these suppliers to "divert" supplies intended for Asia to other markets. It is not clear yet to what extent this has occurred. A major influence in this global balance equation has been the continued strength of European and, above all, North American forest products markets, which so far, do not seem to have been unduly affected, in terms of price or trade pattern by "diverted" supplies from Asian markets.

Anecdotal evidence seems to indicate that one consequence of the generally weak demand has been a steep decline in illegal logging and trade.

4.2 Specific impacts on the ECE region

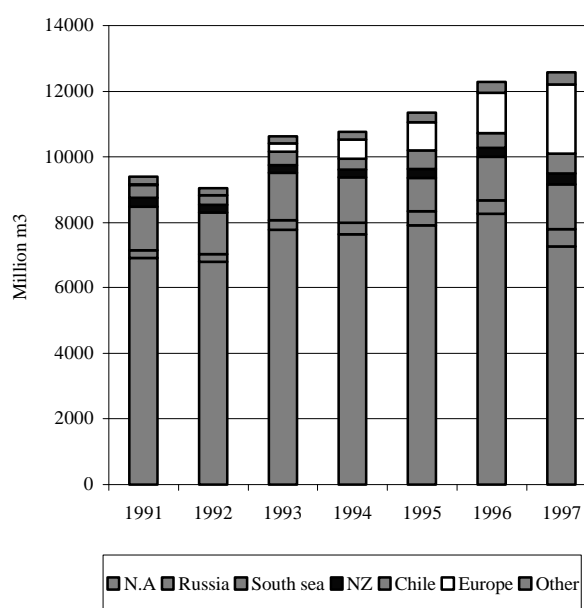
The overall increases in ECE region forest products exports to Asia recorded for 1997 mask the sharp decrease in forest products imports which occurred in the second part of the year, notably, after the Timber Committee met in October. Indeed it was not until first-quarter 1998 statistics became available that the profound extent began to unfold of the inter-related and complex problems which originate in political, economic and monetary systems and which penetrate throughout Asia, including forest products manufacturing.

All parts of the ECE region have been touched: North America, especially the west coast exporters; new exporters to Asia from Europe; and eastern Russia, with its mills, ports and ships geared for the Japanese and Korean markets. It is too early to weigh the full impacts on the ECE forest products trade, but some examples have appeared.

By all accounts the drive for increased market share in Japan by European sawnwood producers mentioned in the 1994 *Review*, has been a success as measured by the 17% market share of all sawnwood imports in 1997 (graph 4.2.1). In 1997, Europe became the number 2 supplier to Japan, with 2.1 million m³, displacing the south east Asian region,

GRAPH 4.2.1

Japanese sawnwood imports by country, 1993 to 1997



Source: Japan Wood Products Information and Research Center, 1998

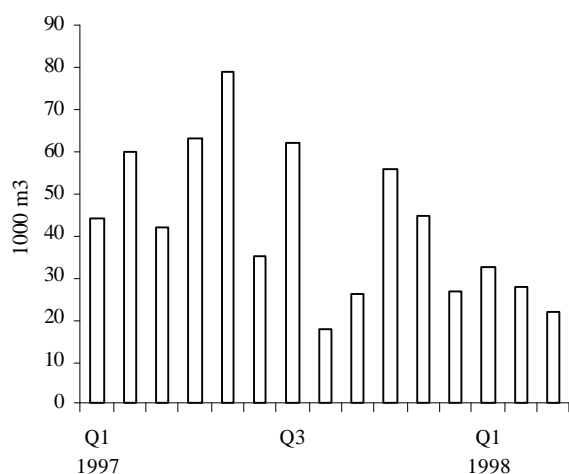
which had 1.4 million m³ although still well below North America. Europe's growing market share, rising from 2% in 1993, appears to have come at the expense of North America, however there was not direct substitution as the total volumes imported have increased by 18.5% over this 5-year period.

In the first five months of 1998, with all Japanese sawnwood imports reduced, including those of Europe (down 61%), the market shares were reduced for European sawnwood by 3 percentage points (16.7% to 13.5%).

In the first quarter of 1998, the exports of sawnwood from Finland to Japan have decreased by 42% from the same quarter of 1997 and could be 50% less for the year (graph 4.2.2). The Finnish Sawmill Association stated in an article published on the *Taloussanommat* website that other European countries' exports to Japan are also down. A decrease of 10% in the price of sawnwood sent to Japan has not improved Finnish exports. At least in the first quarter of 1998 the decrease in shipments to Japan have been compensated by increased shipments to Europe according to the article.

The Asian crisis has had long reaching effects and the trade press has had included isolated stories. For example in early 1998, two pulp mills in the southern State of Alabama (United States) idled 700 workers when they were forced to shut down temporarily when their Indonesian market collapsed: with weakened currency and difficulties in establishing credit, the Indonesian paper mills which needed the softwood pine pulp, could not afford it.

GRAPH 4.2.2

Finnish sawnwood exports to Japan, 1997 to 1998

Source: Finnish Forest Industries Federation, 1998.

4.3 Impacts on the radiata pine trade and other forest products

The strong trade between the main radiata pine suppliers, New Zealand and Chile, and the main Asian buyers, Japan and Korea, has been weakened. In 1998, companies in New Zealand were cutting costs through production reductions, layoffs and restructuring of operations according to *Random Lengths Exports*.

New Zealand's log exports to Japan fell 40% in the fourth quarter of 1997, compared to the same 1996 quarter, leaving the annual total down by 17%. In the first two months of 1998, log exports to Japan fell 34%. Exports to New Zealand's larger export market, Korea, held up in 1997, but prices were forced down by 30 to 40%.

The newer trade channels to Asia from suppliers in Africa and South America, not only for logs, but also for sawnwood and plywood, have been interrupted. Some trade reports indicate that logs for delivery to Malaysia and Japan have not been shipped. Some African veneer and sawlogs were left in the forest when markets collapsed. Brazilian plywood production has slowed, as have all exports from Brazil to Asian destinations.

4.4 Japan's forest products production and trade

(i) Introduction

Japan imports approximately 80% of its forest products consumption and has widened its sources to all forested continents in the 1990s. Accordingly, projections for 1998 imports of forest products show a fall of 28% from last year according to the ITTO *Market News Service*. The scale of the decreases in demand has apparently made forecasting 1998 raw material imports difficult and traditional information sources were not publishing forecasts out more than one or two quarters in early to mid 1998.

As the Japanese housing market turned down in 1997, following the April rise in sales tax from 3% to 5%, housing starts fell from a pre-1997 average of 1.5 million units, to 1.4 million; the forecast in early 1998 was for a decrease to 1.3 million units. Indeed this is a serious downturn, but not as sources have claimed, a "total collapse." In an attempt to revive the demand, the Public Housing Loan Corporation under the Ministry of Construction dropped housing loan interest rates again in April, down to 2.75%. During the last years an antiquated housing stock which was rather temporarily built following the WWII, has been being

replaced. A large renovation and remodelling market exists too for those homes not being replaced.

Of the new homes, about 45% are wood-based and each home uses about 23 m³ of sawnwood, about 25% less than a larger American house, but much more than most European houses. To meet sawn softwood demands, which are almost totally consumed by housing construction, Japan imports an increasing share, 38% in 1997, of its sawnwood requirements. As Japanese sawmills continue to close, especially the small- to medium-sized mills, a trend which could escalate in 1998, a greater percentage of sawnwood will be imported.

The recent sharp fluctuations in the value of the yen have affected importers. Compared to the dollar, the yen fell below 140 in the summer of 1998 and this resulted in the suspension of many import negotiations. The weak yen has pushed import costs up sharply.

The Japanese imports continue to shift from the primary raw materials of sawlogs and veneer logs, to sawnwood, plywood, other panel products, engineered wood products and secondary manufactured products. Increasing labour and manufacturing costs in Japan will continue to shift manufacturing offshore and to increase processed forest products.

The downturn in the Japanese market is negatively affecting the world trade of sawnwood. About 70% of North American overseas exports go to Japan. At the other extreme of the ECE region, only 11% of Russian sawnwood exports went to Japan in 1997. In between were Europe's 25% of overseas exports which went to Japan (most European exports do not go "overseas"). Additionally the United States has shipped up to 75% of its log exports to Japan and

Russia has shipped 7% of its logs to Japan. For comparison, New Zealand has shipped 30 and 35% of its sawnwood and log exports respectively to Japan.

(ii) Sawnwood production and imports

Domestic production of sawnwood in Japan faces increasing costs of manufacturing, raw materials and labour. Sawmills sharply reduced production in early 1998 as demand for sawnwood slackened. There were over 370 bankruptcies of sawnwood-related enterprises in Japan in 1997, which was about 70 more than in 1996. Closures continued in the first half of 1998 too.

Japanese sawnwood imports in 1997 increased by about 12% in volume over 1996, but only 1% in value¹ (table 4.4.1). (It should be noted that annual 1997 data cover both strong market conditions in early months and weaker conditions later on.) Sources of supply keep diversifying and Russian sawnwood imports keep increasing (but are still less than one-tenth of log import volumes from Russia) (graph 4.4.1). But in early 1998 Russian sawmills exporting to Japan were cutting production by up to half; prices for spruce and fir logs were \$350 per thousand board feet, less than half the cost of United States imports according to *Random Lengths Exports*.

In the first five months of 1998, total sawnwood imports were at 3.3 million m³, roughly half of the equivalent 1997 period according to the Japan Wood-Products Information and Research Center (JWPIRC). Sawnwood traded in dollars was hurt by the dollar's strength compared to the yen in 1997 and the first half of 1998. Sawn softwood from Canada, the largest supplier, was down almost 1 million m³ according to the JWPIRC.

TABLE 4.4.1
Japanese sawnwood imports, 1996 and 1997

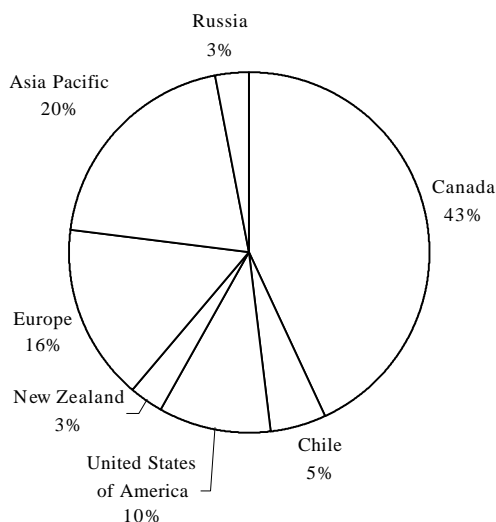
	Volume (1000 m ³)		% change	Value (in million \$)		% change
	1996	1997	1997/1996	1996	1997	1997/1996
North America	7,267	7,263	-0.1	3,051	2,765	-9.3
Asia Pacific	2,335	2,640	13.1	1,311	1,386	5.7
Europe	1,235	2,109	70.8	415	645	55.6
Russian Federation	407	524	28.8	97	123	26.9
Latin & South America	32	43	35.7	21	26	21.5
Africa	5	8	54.8	3	4	30.2
Total	11,281	12,587	11.6	4,899	4,950	1.1

Source: Japan Lumber Journal, 1998

¹ In these times of inflation and currency devaluations the reporting of import "values" can be rather inaccurate.

GRAPH 4.4.1

Japanese worldwide sawn softwood import sources, 1997



Note: This graph is only softwood.
 Source: Japan Lumber Journal, 1998.

Sawnwood traders in Asian currencies in the first half of 1998 had not increased their share of the Japanese sawnwood market. Again figures based on only the first five months of 1998 may change with the full year's statistics (table 4.4.2).

TABLE 4.4.2

Market shares of Japanese sawnwood imports, 1997 and 1998

	1997	1998
North America	57.7	59.4
Europe	16.7	13.5
Southeast Asia	10.9	10.7
Chile	4.9	5.9
Russia	4.2	4.3
New Zealand	2.7	3.0
Others	3.0	3.0
Total	100	100

Note: 1998 figures based on first 5 months only.
 Source: Japan Wood-Products Information and Research Center, 1998.

Japan's imports of sawn temperate hardwood in 1997 were up 8.8% to 400,000 m³ (small compared to softwood and tropical hardwood). United States sawnwood registered a 4% increase over 1996, but did not regain the 1995 level. Imports of all hardwood

sawnwood, including tropical, were 40% lower in the first quarter of 1998, down to 0.3 million m³ in comparison to the first quarter of 1997 according to the JWPIRC.

From the United States, western spruce-pine-fir 2x4s² fell from \$600 per thousand board feet (MBF) in 1997 to \$440 per MBF in 1998. Prices are delivered to Japan according to *World Wood Review*. The difference would have been smaller if expressed in yen. European sawnwood is being imported dry in contrast to some of the North American sawnwood.

(iii) Log imports

The complexion of Japanese log imports changed dramatically in 1997, falling by 9% in volume and by 22% in value (table 4.4.3). Imports of lower-priced Asian logs and Russian logs were maintained or increased at the expense of North American logs which had the highest total value in 1996. Competition by log imports from other sources, for example Russia, where Japanese investors have helped build mills and export facilities, and New Zealand, which also has some Japanese investments, have had the effect of driving down North American timber prices. During 1997, Douglas fir log prices fell 45%, from \$1200 per MBF to \$650 per MBF according to *World Wood Review*.

Japanese imports of logs, both softwood and hardwood, were 31% lower in the first five months of 1998 as compared to the same months of 1997. Softwood log imports were down 18 percent in the first quarter: Russian logs down 30%, Radiata pine from New Zealand and Chile was down 15%; and North American logs were down 33%. On much lower volume levels, European-sourced logs were unchanged from 1997.

With falling prices for Asian-sourced logs, high-priced stocks had to be drawn down before new imports. For example, the highest quality meranti logs from Sarawak fell from \$240 per m³ in mid 1997 to \$102 in mid 1998, a 58% reduction in price. In addition to falling prices, another reason for delaying log purchases were the lower tariffs and taxes coming from exporters. In an effort to increase sales to Japan and other destinations, Malaysia reduced its export tax to 10%, but sales were still suffering.

With decreasing log exports from the United States in 1997, Russia now supplies the greatest volume of softwood logs to Japan; in fact, Russia now

² A 2x4 is a board that is nominally 2 inches by 4 inches in cross section, but which is actually 1.75 inches by 3.5 inches. Their most common use is in residential construction.

TABLE 4.4.3
Japanese log imports, 1996 and 1997

	Volume (1000 m ³)		% change	Value (in million \$)		% change
	1996	1997	1997/1996	1996	1997	1997/1996
North America	7,043	4,757	-32.4	2,150	1,302	-39.4
Asia Pacific	7,999	7,655	-4.2	1,511	1,329	-12.0
Russian Federation	5,421	6,137	13.1	593	659	11.2
Africa	667	662	-0.8	152	143	-5.4
Europe	203	155	-23.7	37	30	-18.8
Latin & South America	6	2	-65.1	3	2	-34.7
Total	21,339	19,368	-9.2	4,446	3,466	-22.0

Source: Japan Lumber Journal, 1998

supplies more logs than any country alone, and with a decrease in log exports forecast for 1998 from the Asia Pacific region, Russia could supply more than any region too. A meeting of the "All Japan Russian Logs Dealing Association" in 1998 cited weak imports in 1998, forecast at 4.3 million m³, over 40% less than the 6.1 million m³ imported in 1997. Stating that Russian timber is indispensable for the Japanese market, continued Russian imports were anticipated by the Association because of low price and high quality.

(iv) Plywood production and imports

On account of the 16-month decline in housing starts as of June 1998, the plywood market has been seriously depressed. As mills are facing tough price competition from imported plywood, production has been going down and more Japanese plywood makers are closing (graph 4.4.2). In contrast, most other panel products maintained production in 1997.

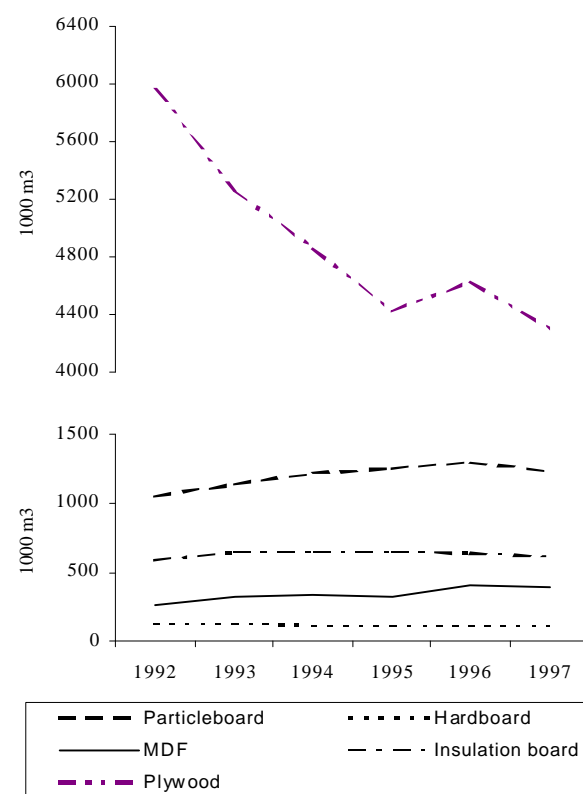
Japan Lumber Journal forecast a 30 to 35% drop in domestic manufacturing in 1998 and in March, one major manufacturer announced a 50% production cut. In the first five months of 1998, all plywood production was down 23% from the same months in 1996 according to JWPIRC. The production of softwood plywood in the first quarter of 1998 was 293,000 m³, down about 30%. Softwood plywood represents about 34% of domestic production.

Imports of plywood were flat in 1997, following a steep rise in 1996 (graph 4.4.3). In the first five months of 1998 plywood imports were down one-third. Other panel products like MDF and particle board showed increases in 1997, but may fall back in 1998.

The majority of plywood was imported from

Indonesia in 1997, but Malaysian plywood continues to erode market share (graph 4.4.4). A number of other countries were increasing market share in 1997, but this picture could well change in 1998 (graph 4.4.5), notably, with the dismantling of the APKINDO sales organization (see below).

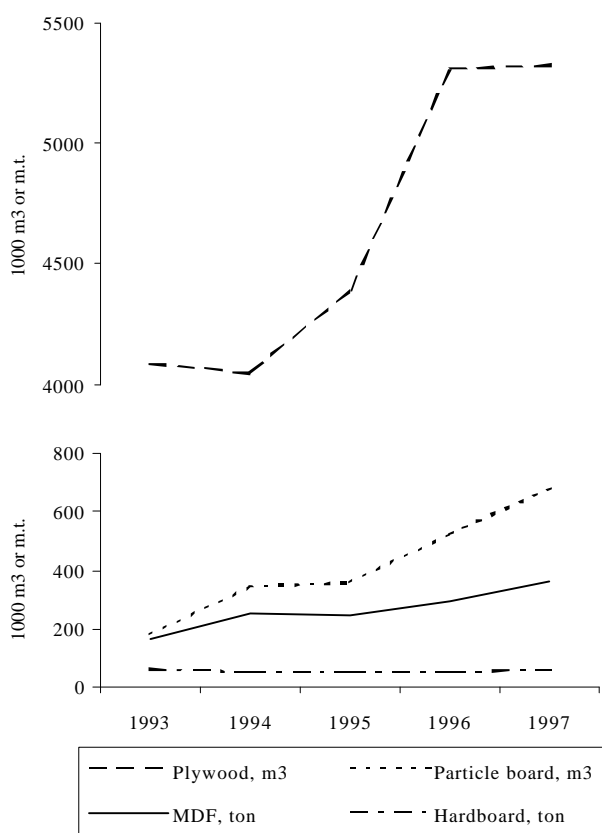
GRAPH 4.4.2
Japanese production of panel products, 1992 to 1997



Source: Japan Lumber Reports, 1998.

GRAPH 4.4.3

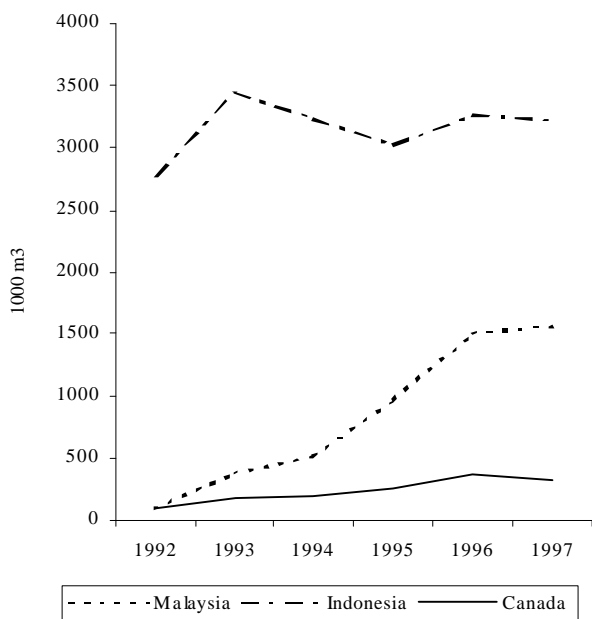
Japanese imports of panel products, 1993 to 1997



Source: Japan Lumber Reports, 1998

GRAPH 4.4.4

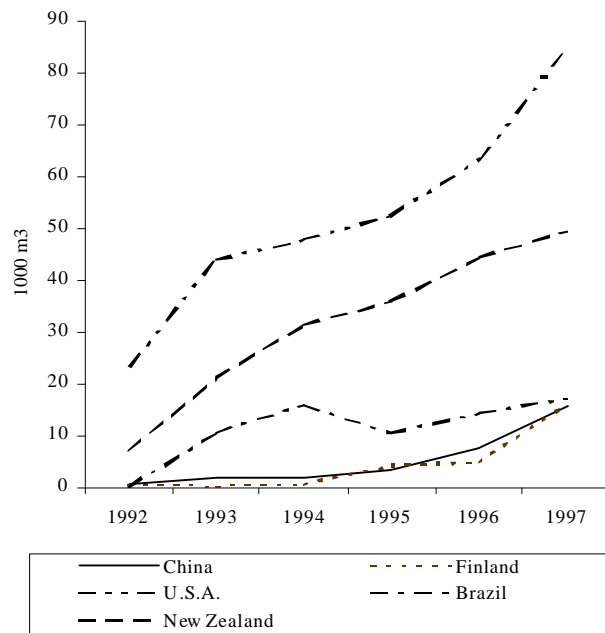
Japanese plywood imports, 1992 to 1997



Source: Japan Lumber Journal, 1998.

GRAPH 4.4.5

Japanese plywood imports, 1992 to 1997



Source: Japan Lumber Journal, 1998.

4.5 Indonesia's forest products production and trade in 1997 and 1998

World attention was again drawn to the tropical forests in 1997 and early 1998 when as a result of droughts caused by the El Nino weather cycle, large areas of forest burned in Indonesia as well as in Malaysia, Brazil and Mexico. Certainly lack of rain was a critical factor, but these fires were not the result of spontaneous combustion. Indonesian fires were blamed on land clearing for oil palm plantations, forest concession clearing before replanting and subsistence farming. Regardless of the cause in Indonesia, heavy smoke caused health and safety hazards in Indonesia and surrounding countries. International efforts to stop the fires were dampened by the announcement by the former Indonesian government to clear even greater land areas for rice farming to feed the burgeoning population.

Indonesian fires were extinguished in May 1998 with the heavy rains, but that did not put out the burning economic crisis. An International Monetary Fund (IMF) Assistance Package in April 1997 included \$7 billion and far reaching conditions that, among others, eliminated various bans on exporting forest products, reduced or eliminated export tariffs and the disbanded of the production and export marketing cartels for sawnwood and paper as well as the plywood cartel called APKINDO.

The full implementation of these requirements has not yet occurred and the full effects of these sweeping reforms in forest and forest industry sector policy have not yet been felt in mid 1998. For example, lacking alternatives, the former marketing and transportation structure of APKINDO remained in place, despite the departure of its head, who went on to become Minister of Trade before the change of regime.

While tariffs were lowered to a maximum of 10%, and export taxes were eliminated or reduced to meet IMF requirements, in order to discourage over exploitation of Indonesian forests, beginning in March 1998, a system of resource rent taxes was imposed.

The Indonesian Ministry of Forestry predicts that even with the reduction of tariffs, quotas and other restrictions on wood exports, the current drop in Asian demand for forest products will result in 25% less wood-based exports in 1998 than in 1997, down from \$8.3 billion to \$6.2 billion. Since July, 1997, the Indonesian rupiah has fallen from below 2,450 rupiah to the dollar to over 10,000 in mid 1998. While a devaluation would be good for exporters if payment was in stronger currencies, the currencies of many Asian importers have likewise devalued. For Indonesia, which is dependent on exports to Japan and Korea where Indonesian plywood is used mostly for construction, a sector particularly hard hit by the recent crisis, the result has been catastrophic.

Pulp exporters have benefited from the devaluation. Indonesian pulp production has risen steeply in the 1990s, due to the combination of abundant fibre and low manufacturing, labour and energy costs. Even before the crisis, Indonesia was one of the lowest cost pulp producers in the world according to CIFOR.

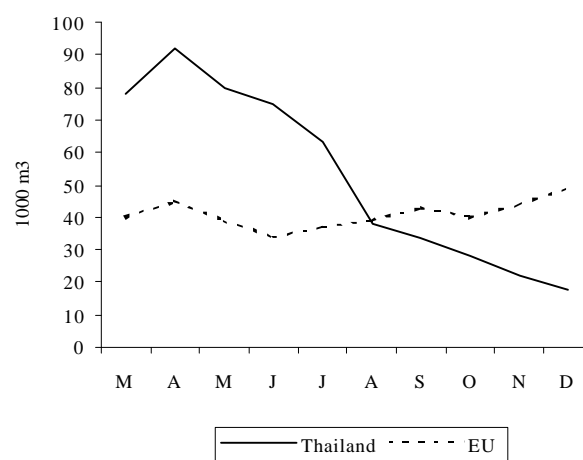
The broad economic reforms imposed by the IMF loan could eventually relieve the problems, but currently the high interest rates have made access to necessary working capital difficult for the forest industry. This is aggravated if companies had debts with foreign investors in dollars, as repayment in rupiahs is difficult, especially with decreased domestic sales revenues.

In the short term Indonesian forest products companies have not benefited fully from the devaluations in their exports outside Asia because of increased shipping costs plus a more mechanical problem, that of a lack of shipping containers resulting from a lack of imports. Indeed, most forest products companies have reduced production and some have closed, at least temporarily to await stabilization of markets. Companies are faced with high-priced stocks

and with falling product prices, sales can be unprofitable. Large, integrated companies, e.g. some of the pulp companies mentioned above, are having profitability dragged down by other weaker sectors.

While it is difficult to generalize between countries, an example of Malaysia's exports of sawnwood to Thailand and to the European Union clearly illustrates the difference between intra-Asian trade and trade outside of Asia (graph 4.5.1)

GRAPH 4.5.1

Malaysian export of tropical sawnwood, 1997

Note: October-December estimates based on partial figures.

Source: ITTO, 1998

4.6 Future

Forestry has an inherent long-term perspective, but in forest products markets a year can be an eternity. For exporters from the ECE region, 1998 will be exceptionally long. And it will be an even longer year for the Asian traders and timber-based industries.

With an average demand for housing at 1.5 million units, and a downturn in 1998 to perhaps 1.3 million units, the Japanese housing market is going to consume substantial timber-based materials now, and even more whenever the economy rebounds.

All exporters were forced to cut prices to maintain sales. But now with the deep recessions and devalued Asian currencies, many importers are faced with high priced stocks and lack of demand.

Those companies which survive the crisis will be more efficient. The combination of low raw material and labour costs combined with efficient technology and management, could make these revived companies more competitive on world markets.

Some investments in Asian businesses are starting, indicating that western companies believe in a profitable future. Some companies are hedging their bets by minimizing initial investments, but still seriously making a long-term commitment. In the pulp and paper sector, a few Nordic and North American pulp and paper producers were acquiring capital assets in mid 1998 (at prices made attractive by Asian currency devaluations). Currency devaluations resulted in reduced production costs and with continued instability and future production efficiencies, production costs were forecast to fall further by *Papermaker*. The downside of the political and economic instability is that high dollar debts are becoming increasingly burdensome to Asian companies. Morgan Stanley Dean Witter has predicted that only 37% of proposed capacity increases in Asia will actually be built over the next 2 years, which would be the slowest growth rate in the last 15 years. However with two-thirds of the world population and increasing standards of living, eventually greater forest products processing capacities will be required.

In summary it is impossible at this point to either measure or predict the full effects of the Asian crisis. Unfortunately as mentioned in the economic background chapter Japan and other economies have entered into deep recessions. Although the consequences of the recessions are hardest on Asian nations, they are being felt worldwide.