LATVIA

MARKET STATEMENT 2008

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

High economic growth has been observed in Latvia during 2005-2007, which is characterised by annual average increase of gross domestic product (GDP) by 11%. Since the mid-2007, the **growth rates have started to decline.** In 2007 the GDP on average increased by 10,3%, in the first half of 2008, the GDP has increased only by 1,6% compared to the respective period of the previous year.

The main factor influencing economy **is the rapid fall of domestic demand.** Among external factors, **decrease in the growth rates of the world economy** has to be noted as well, which was first determined by instability in the financial markets, as well as rise in prices for fuel and food products. It had a negative impact on the main export markets of Latvia.

Decrease of domestic demand left a direct impact on different industries. **Decrease of manufacturing (i.a., forest based industry) output** in the first half of 2008 was determined not only by the decrease of domestic demand, but also by weaker demand in our trade partner countries, and a gradual decrease of Latvian competitiveness, which is related to rapid rise in labour costs.

Forest sector export in Latvia in the first half of 2008 dropped by 12% in terms of money. The most significant impact was left by the rapid decrease in sawnwood export, and there was a decrease in the income by 35,9%. Since sawnwood export till now had the biggest share in the export of the sector (approximately 1/3 from total income), the decrease reduced the performance indicators of the sector.

2. POLICY MEASURES INFLUENCING TIMBER TRADE AND MARKETING (over the last 18 months)

One of the **main objectives of economic development policy** in Latvia is to create an effective and competitive industry which should ensure high and stable growth rates. The **industrial policy** in Latvia is developed in cooperation with industry stakeholders taking into account the EU policy development areas, at the same time identifying and addressing issues relevant to the national industrial companies. The industrial policy has close links with innovation, business, education and other policy areas. In 2007, **Programme for Promotion of Entrepreneuership Competitiveness and Innovation in 2007-2013** was approved. The Programme includes measures to promote innovation, business, development of small and medium-sized enterprises and industry sectors.

The government of Latvia plans to implement new programmes aimed at promotion of cooperation between industry and research sectors, such as support for competence centres, facilitation of technology transfer, support for business incubators, as well as the continuation of implementation of programmes to support innovations in the private sector.

In the beginning of 2008 a new policy planning document of the construction sector **Guidelines for Development of Construction Sector for 2009–2013** was elaborated. The Programme provides for the underlying principles and directions of development of the sector for the next 5 years. The main objective of the guidelines is to ensure a stable development of competitive, sustainable and efficient construction sector which will leave a significant impact on the growth of the forest sector in the future.

In order to ensure a competitive development of the forest and energy sectors in the context of sustainable development of Latvian national economy and climate change, and to implement the EU and international commitments in energy production from renewable resources, elaboration of Programme for Rational Use and Mobilisation of Forest Resources Potential was started in 2008.

3. MARKET DRIVERS

The forest sector occupies an important and stable positition in the national economy of Latvia, contributing significantly to the stabilization of the external trade balance. The forest sector involves 8% from all the enterprises registered in Latvia, and employs approximately 5% from total employment.

Share of forest sector production in gross domestic product constitutes ~5%, in 2007 the production value reached 1,4 billion LVL (~2 billion €). Approximately 70% of the production is exported, which constitutes almost 25% of the total export value of the country.

Over the last years the forest sector had to work under rapidly changing economic conditions. The development of the sector was significantly influenced by the **macroeconomic factors.** This particularly refers to the rise in wood prices and transport services. In order to remain in the market, representatives of the timber industry have to seriously consider elaboration of new, competitive products since cheap production from expensive raw materials is not cost-effective.

Over the last years there has been **a replacement of equipment, technologies and products** in the timber industry of Latvia, aimed at complex use of various tree species and of small size sawlogs. Small and medium-sized enterprises which constitute the major part of enterprises of the forest sector, produce *niche* products (garden products, decoration materials, wood packaging, joinery etc.), whereas big enterprises mainly concentrate on the production of possibly high value added products (construction materials, impregnated products, building materials). The primary wood processing sector in general is based on modern technologies, which comply to the requirements of the world market both in terms of productivity and quality of the production. Hence the production of primary wood processing has become a stable base both for export and development of further processing and production of higher value added products.

In comparison with developed wood processing countries where the added value production from one cubic metre of wood reaches 400–600 EUR, Latvia with average index of 160 EUR/cubic metre **has the development potential of** at least twice or three times. This can be achieved by introducing knowledge and latest developments in the technologies, intensification of production, raising the productivity of labour and developing new products.

Other factors which will contribute to the development prospects of the forest sector in the nearest future are as follows: **available investment** for the development of high value added products and production technologies, **development of the power sector**, and also the positition and importance of the forest sector in the regional development.

In order to maintain the competitiveness of Latvian forest sector enterprises, there has to be a significant increase not only in the **funding for science, education and training of employees, but also in renewal of fixed assets and improvement of power sector activities** to make the most effective use of local wood resources.

Geographical location and network of logistics which till now have facilitated the import of wood resources and export of production, have to be taken into consideration as well.

Latvian timber industry will be significantly influenced by the **decision of the Russian Federation to increase export duty on roundwood.** According to the data provided by Central Statistical Bureau, import of non-processed roundwood in 2007 in Latvia constituted 72,7 mln LVL, from which 44,3 mln LVL or 61% were imported from Russia.

4. DEVELOPMENTS IN FOREST PRODUCTS MARKETS SECTORS

A. Wood raw materials

Roundwood is mainly used for production of sawnwood, wood-based panels, turned and planed products, fuelwood, charcoal, etc. Also, roundwood is exported as fuelwood or pulpwood.

Roundwood export in 2007 increased by ~8% by volume, and 99% by value, in comparison with 2006. In the first half of 2008, in comparison with previous year, there was a decrease of 0,9% in the exported volume, while the timber value was decreasing. Almost 80% of the roundwood export constitutes pulpwood, which is mainly exported to Sweden, Estonia and Finland.

Over the last years due to the rapid development of production of wood-based panels and fuelwood, there has been a significant increase of small size sawlog utilization. A producer of wood-based panels „Bolderāja Ltd" has become the largest purchaser of pulpwood. By increasing production capacity in 2008 and 2009, this enterprise will be able to process into higher value added products approximately a half of exported pulpwood volume.

The import of roundwood is dominated by sawlogs and it increased by ~39% by volume .In 2007 import of sawlogs amounted to 1,7 mln cubic metres. In the first half of 2008, volume of imported roundwood decreased by ~63%. In 2007 almost 70% of wood was imported from Russia Federation, which significantly increased export duty on non-processed roundwood. This has resulted in the decrease of 94% in roundwood import from Russia in the first half of 2008, in comparison with the respective period of 2007.

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

Taking into account the climate conditions, production of thermal energy traditionally constitutes the biggest share (64%) of the energy balance of Latvia. Fuelwood is the most important local fuel in Latvia and its share in the fuel balance is 24%. Major consumers of fuelwood are households – 48%, heat supply companies – 22%, industry (mainly wood-woorking enterprises) and other consumers – 30%. In Latvian timber industry production of fuelwood (pellets, chips, fuel wood, briquettes) becomes more important.

Export of fuel wood in 2007 has increased by 18,4 % reaching 100 mln LVL, which constitutes 9,8% of the total export of the sector. There are increasing prospects for using fuelwood on the site.

Till now Latvia has quite seldom used logging residues, brushwood and stumps for energy production, which could promote the independence of the power industry of Latvia.

By finding complex solutions to issues of power industry in state and municipality levels, it is possible to establish a power sector which would be powerful and based on the use of local renewable resources, also providing for new opportunities in the rural and regional development.

Use of renewable resources in the power industry is basically associated with new technologies – replacing fuelwood and chips with a fuel made from biomass which is easy to use and require lower transport and storage expenses. By finding an optimal use of local renewable resources, the share of the heat can be changed from the current 24 % to ~35-40 % in total energy consumption.

C. Certified forest products

In Latvia forest management and timber chain-of-custody certification are performed under FSC (*Forest Stewardship Council*) and PEFC (*Programme for the Endorsement of Forest certification schemes*).

Currently more than 50% of the forests of Latvia, including all state owned forests have been granted a **FSC** certificate which, in fact, means an international recognition that forests in Latvia are managed according to the internationally acknowledged standarts of good forestry. More than 100 forest sector enterprises have certified their timber chain-of-custody systems in compliance with the requirements of FSC.

The **PEFC** Latvian scheme has been evaluated as compliant with the PEFC compliance evaluation programme. On January 1 2007, almost 100 hectares of forests were managed in compliance with PEFC scheme, and ~50 Latvian forest sector enterprises have certified their timber chain-of-custody systems. Since the beginning of 2008, **PEFC** Latvian scheme has been stopped for re-evaluation.

D. Value-added wood products

Over the last five years, the share of higher value added products has developed rapidly and the variety of production has increased: furniture and furniture components, joinery and carpentry production, prefabricated wooden constructions, garden furniture and palisades, toys of wood and other production in high demand on the market. However, due to the decrease in the growth rates of the world economy in the beginning of 2008, demand for furniture has decreased both in domestic and foreign markets.

In 2007 export of furniture was 80,7 mln LVL in terms of value, which is by 7,4% less than in 2006, and in the first half of 2008 due to considerable decrease in the trade with Denmark and Great Britain, there was a decrease by 21,9% in terms of value.

Import of furniture in 2007, in terms of money increased by 37,5%, to compare with 2006. In the first half of 2008, there was a decline of furniture import by 23,6%. In the last six months there has been a fall in the import of furniture from Italy (by 49,9%) and Poland (by 27,1%), whereas import from China has increased by 24,1%, in comparison with the respective period of previous year.

Wood packaging materials are manufactured with comparatively small investment and simple technologies. In Latvia these materials are mainly manufactured by several small or medium-size enterprises, basically using non-coniferous low-grade sawnwood. There are approximately 10 enterprises in Latvia which manufacture high quality wood packaging materials complying to the requirements of the EU.

In export of higher quality packaging materials there was an increase of 24,2 % by value in 2007, in the first half of 2008 manufacture and export of wood packaging has decreased.

In order to develop manufacturing of modern carpentry – wooden window frames, doors and building materials, there has been a considerable investment made in several Latvian enterprises. This development was to great extent promoted by the boom of domestic and European construction market over the last years, however there has been a decrease of production rates and export volume in 2008.

E. Sawnwood

The production of sawnwood in 2007 decreased by ~20%, in comparison with 2006. 3,46 mln cubic metres of sawnwood were produced and 2,10 mln cubic metres (61%) of the production were exported. Mostly, further processed sawnwood ready for use in construction or manufacturing of furniture or other materials in other industrial sectors is produced and exported. Export and import of sawnwood decreased both in the first half of 2008 and in 2007, in comparison with the previous year.

Export of sawnood from Latvia was considerably influenced by the decrease in the largest market – Great Britain, where ~51% from all the sawnwood was exported. There has also been a considerable decrease in the export of timber to Ireland and Japan.

The major importer of sawnwood remains Russia Federation - 79% of all imported sawnwood. However, due to the changing export policy of Russia, already in the first half of 2008, the import of coniferous sawnwood from Russia has decreased by 67,4 % in terms of money, in comparison with the previous year.

Due to the significant investment in modern production units, there has been an increase in production of higher value added products (dried, sorted, planed and impregnated sawnwood).

F. Wood-based panels (particle board, fibreboard etc.)

One of the most significant forest industry branches in Latvia, due to the investment, is the production of wood-based panels, particularly plywood. In 2007 production of wood-based panels constituted 13,3% from the total export value of the sector. Latvia is the largest plywood producer in the Eastern Europe. Recently there has been great investment made in the production of particle boards, oriented strand boards (OSB) and MDF.

There is a continuous increase in the value of the plywood. In comparison with 2006, the value of exported plywood in 2007 increased by 34,1 %, reaching 102,3 mln LVL. Plywood is mainly exported to Germany, Italy and France.

There has been an increase in the domestic consumption of plywood, mainly used in construction. Production of specific plywood products, for example, oversized plywood is increasing.

In 2007 and the beginning of 2008 there has been a rapid increase in the production and export of particle boards, because of the great investment made in the sector and production of higher value added products. Export of particle boards in 2007 has increased by 46,6 % in terms of money, similarly to the first half of 2008.

The new production unit of the joint-stock company „Bolderāja Ltd" has started production of OSB from coniferous small size timber. The new products are light and durable and can be excellently used in construction, besides the special processing technology ensures that they can be used in different constructions without additional processing.

Positive trends can also be observed in the fibreboard sector. Over the last two years, owing to the investment by the company „Jeld-Wen", export of this production in 2007 increased by approximately 70% in terms of money.

G. Pulp and paper

In comparison with the previous year, in 2007 there was a small increase in production volume and domestic consumption of paper and paperboard. Export of these products in terms of money has increased by 33,4%. The main markets for these products are in Lithuania and Estonia, the prospects of expanding to the markets of other EU Member States can be considered low.

5. TABLES

Key Indicators of Economic Development, Latvia

	2004	2005	2006	2007	2008 f
(growth compared with preceding year, per cent)					
Gross domestic product	8.7	10.6	12.2	10.3	2.2
Private consumption	9.8	11.2	21.2	13.9	2.1
Public consumption	2.1	2.7	4.9	4.8	2.3
Gross fixed capital formation	23.8	23.6	16.4	8.4	4.2
Exports	9.4	20.3	6.5	11.1	1.2
Imports	16.6	14.8	19.3	15.0	-8.0
Consumer prices	6.2	6.7	6.5	10.1	16.5
(per cent of GDP, unless indicated otherwise)					
Central government budget fiscal balance	-1.0	-0.4	-0.2	-0.04	0.1
Central government debt	14.9	12.4	10.7	9.7	9.2
Current account balance	-12.8	-12.5	-22.3	-23.0	-15.0
Foreign direct investments received within a year in Latvia	4.6	4.5	8.1	7.0	7.0
Employment rate (% of economically active population, 15-64 years)	62.3	63.4	66.3	68.4	68.5
Unemployment rate (proportion of job seekers % of economically active population, 15-74 years)	10.4	8.7	6.8	6.0	6.5

f – forecast of the Ministry of Economics

Source: *Ministry of Economics*

Forest sector production exports from Latvia

HS code	Production	units	2006		2007	
			1000 (units)	1000 (LVL)	1000 (units)	1000 (LVL)
3605	**Matches**		**-**	**1301.3**	**-**	**1064.5**
44	**Wood and articles of wood**		**-**	**708345.8**	**-**	**874021.7**
4401	**Fuelwood:**	**(t)**	**3169.0**	**84358.5**	**2715.9**	**99872.2**
44011	Fuelwood (round)	(t)	304.4	10012.7	338.4	10778.5
44012	Chips	(t)	2287.2	38403.2	1693.0	46980.9
44013	Sawdust and other wood residues	(t)	577.4	35942.7	684.5	42112.8
4403	**Roundwood:**	**(m^3)**	**3418.7**	**85041.8**	**3689.6**	**168926.0**
44032	Coniferous	(m^3)	1583.6	38188.7	1712.1	80858.2
44033…	Non-coniferous	(m^3)	1835.1	46853.1	1977.6	88067.7
4407	**Sawnwood:**	**(m^3)**	**2572.0**	**306861.3**	**2098.1**	**319588.8**
44071	Coniferous	(m^3)	2162.2	262022.8	1762.4	273071.9
44072…	Non-coniferous	(m^3)	409.8	44838.5	335.7	46516.9
4408	**Veneer sheets**	**(m^3)**	**13.8**	**8633.0**	**10.5**	**8183.4**
4409	**Further processed sawnwood**		**-**	**12489.6**	**-**	**16143.7**
44091	Coniferous		-	7631.1	-	9851.5
44092	Non-coniferous		-	4858.5	-	6292.2
4410	**Particle board**	**(m^3)**	**178.8**	**21383.2**	**235.7**	**31340.7**
4411	**Fibreboard**	**(m^2)**	**652.8**	**1392.3**	**1125.1**	**2358.0**
4412	**Plywood**	**(m^3)**	**206.4**	**76296.9**	**247.7**	**102295.7**
4415,(16)	**Wooden wrapping and packing equipment**		**-**	**30972.1**	**-**	**38481.3**
4418	**Joinery and carpentry**		**-**	**56583.4**	**-**	**63814.0**
44…	**Other articles of wood**		**-**	**24333.6**	**-**	**23018.0**
47	**Pulp of wood, recovered paper**	**(t)**	**41.0**	**1916.9**	**38.0**	**1867.0**
48	**Paper and paperboard, articles of paper**		**-**	**39859.1**	**-**	**53257.0**
94…	**Furniture**		**-**	**87119.2**	**-**	**80663.4**
9406	**Prefabricated buildings**			**7769.6**	**-**	**10459.5**
	Total			**846311.9**		**1021333.1**

Source: *Central Statistical Board*

Forest sector production imports to Latvia

HS code	Production	Units	2006		2007	
			1000 (units)	1000 (LVL)	1000 (units)	1000 (LVL)
3605	**Matches**		**-**	**106.0**	**-**	**39.6**
44	**Wood and articles of wood**		**-**	**154867.8**	**-**	**254214.4**
4401	**Fuelwood:**	**(t)**	**74.2**	**3496.2**	**140.3**	**9897.1**
44011	Fuelwood (round)	(t)	1.4	25.8	7.6	401.3
44012	Chips	(t)	22.5	583.3	19.9	600.6
44013	Sawdust and other wood residues	(t)	50.2	2887.1	112.9	8895.1
4403	**Roundwood:**	**(m^3)**	**1215.9**	**40237.9**	**1687.7**	**81561.1**
44032	Coniferous	(m^3)	744.9	24787.5	1043.5	49596.9
44033…	Non-coniferous	(m^3)	471.0	15450.4	644.2	31964.2
4407	**Sawnwood:**	**(m^3)**	**481.1**	**45694.3**	**601.9**	**71874.1**
44071	Coniferous	(m^3)	450.8	40498.1	555.4	64553.1
44072…	Non-coniferous	(m^3)	30.3	5196.2	46.5	7321.0
4408	**Veneer sheets**	**(m^3)**	**2.4**	**2026.3**	**4.7**	**3236.3**
4409	**Further processed sawnwood**		**-**	**2651.3**	**-**	**4801.9**
44091	Coniferous		-	1485.2	-	3150.1
44092	Non-coniferous		-	1166.1	-	1651.8
4410	**Particle board**	**(m^3)**	**107.8**	**18505.8**	**126.5**	**24139.4**
4411	**Fibreboard**	**(m^2)**	**5687.5**	**11289.9**	**5408.3**	**11612.0**
4412	**Plywood**	**(m^3)**	**25.7**	**5957.6**	**41.7**	**10639.6**
4415,(16)	**Wooden wrapping and packing equipment**		**-**	**3564.7**	**-**	**5302.7**
4418	**Joinery and carpentry**		**-**	**16380.0**	**-**	**24265.5**
44…	**Other articles of wood**		**-**	**5064.0**	**-**	**6884.7**
47	**Pulp of wood. recovered paper**		**7.6**	**654.7**	**4.7**	**486.5**
48	**Paper and paperboard. articles of paper**		**-**	**130828.9**	**-**	**148944.5**
94…	**Furniture**		**-**	**55007.0**	**-**	**75660.6**
94…, 95	**Prefabricated buildings and toys of wood**		**-**	**2843.3**	**-**	**2731.4**
	Total			**344307.7**		**482077.1**

Source: *Central Statistical Board*

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