Serbian Market Report 2008

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European Forest Week

Rome, 20-24 October 2008

Belgrade, September 2008

1. General economic situation

Serbia recorded a considerable growth in GDP in the period from 2001 – 2008. Judged by its, growth rate, Serbia is the leader in South Eastern Europe. In 2007, GDP growth rate was 7.5%, and its growth by 7.4%, and reaching of the value of 34.7 billion EUR, or 4.709 EUR per capita, is expected in the year 2008.

External debt stood at EUR 17.5 billion, accounting for 62% of GDP at end-January 2008. For 2007, private and public sector external debt accounted for 41% and 21% of GDP, respectively.

Labour market conditions remained difficult and employment continued to decline during the fourth quarter by 1% year-on-year, a trend which continued during the first two months of 2008. However the number of unemployed persons also declined during the same period to a rate of 18.9% of the total number of work force.

Retail price inflation accelerated to 9.1% year on-year during the fourth quarter 2007., from 6.5% during the third quarter 2007. This trend continued during the first three months of 2008 when inflation accelerated to 11.3% year-on-year, mostly driven by strong gains in prices for food stuff, related to the local drought as well as growing priced for crude oil derivatives in world markets.

Monetary tightening which had started end-December 2007 continued during the first quarter of 2008. The National Bank of Serbia (NBS) increased the main policy rate by 75 basis points twice in February, followed by a somewhat surprisingly strong 300 basis points hike on 13 March. The objective is to stem rising inflationary pressures, and also to counter a somewhat looser fiscal policy stance and to help support the local currency in the foreign exchange market, which had come under pressure in February.

The euro-dinar rate rose by 5.8% from 79.24 at end-December to 83.83 at end-February prompting the NBS to intervene in the market to support the dinar. The exchange rate recovered to 80.22 by middle-October.

2. **Policy measures taken in Serbia over the past 18 months**

Serbia is the only country outside the Commonwealth of Independent States (CIS) which has signed the Agreement on Free Trade with the Russian Federation, which has opened free access to the market with about 150 million consumers. The Agreement sets that the importing country regulates the regulations on the origin of goods pursuant to the principles of the World Trade Organization. This Agreement is the first of such kind which Russia has signed with a country outside the Commonwealth of Independent States (CIS). Within the Agreement on Free Trade with the Russian Federation, most wood products from Serbia are fully customs free in the Russian Federation, which has additionally increased their competitiveness compared to the wood products imported on this market from other countries. Pursuant to the stated Agreement, customs on wood products imported from Serbia include the following product categories: wooden upholstered seats (9401.61), wooden office furniture (9403.30), wooden kitchen furniture (9403.40), wooden bedroom furniture (9403.50) and other wooden furniture (9403.60). Customs on other wood products imported from Serbia are free. Because of the benefits of the mentioned Agreement, six companies from Italy and Sweden invested in furniture and wood flooring production in Serbia during the period 2005-2007. About 90% of their current production is exported into the Russian Federation and the rest is distributed into the European Union and on Serbian market.

3. Developments in forest products markets sectors (major emphasis)

3A. Wood raw materials

Trend of round timber production growth from 2006 continued in 2007 and 2008 as well. The production of round timber increased by 12.3% in the period I-VII 2008 compared to the same period the previous year. The biggest growth rates were achieved with the production of logs for sawing oak and beech, as well as logs for veneer.

Prices of certain assortments have been slightly increased during the first six months of 2008 because of the increased demand on domestic market and as the result of bigger participation of bidding as a form of wood sale. The problems which existed in previous years have been mostly solved, which has had impact on the increase of financial effects first of all. However, compared to some neighbouring countries (e.g. Romania), the effects are still quite lower.
Logs and other wood are mostly imported from the neighbouring countries, Bosnia and Herzegovina and Montenegro. Import value of logs and other wood was 6.8 million US$ in 2007.

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

Participation of renewable energy sources in Serbia in 2002 was 1.5%. The objective is to reach the amount of 4.5% until 2010. For the purpose of that the Government has adopted:

- new law on energetics which has enabled the introduction of energy from small hydroelectronic power plants and energy based on renewable resources into the system of electric power production and distribution;
- also the Energy Efficiency Agency was established for the purpose of encouraging development of energy production based on renewable resources. The second important task of this Agency is the increase of energy efficiency first of all in industry as the biggest energy consumer and then in households and other consumers.
- the Strategy of Forestry Development has also been adopted where big importance is given to the production of wood biomass.

Estimated amount of wood biomass in Serbian forests which could be used as fuel is 1.65 million m3 per year. Forest biomass, left over after extracting forest wood assortments, usually remains to decompose in the forest. Its energy potential is estimated at 15.6 million GJ/annually.

Wood is mostly used by rural households. Firewood is burnt in open fireboxes or inadequate stoves with poor energy efficiency.

There around 778,000 rural households in Serbia which mostly use wood as energy substance for heating during winter months. The usage of wood biomass as fuel for small or middle-sized boilers for households or centralized heating comes down to individual examples only.

Public Enterprises for the management of state owned forests as well as private forest owners produce and sell firewood to consumers in the lengths of 1.0 m and from november 2007 of 25cm and 33 cm. Consumers cannot buy chopped wood of the abovementioned dimensions in supermarkets or on petrol stations like in the developed countries in the West.

Usage of briquettes in bigger cities (Belgrade, Novi Sad) is popular and constantly growing. Also, the price is rising, but because of limited amounts and absence of appropriate fireboxes they are not serious competition to fossil fuels or electric power. The amount of briquette from wood processing will not rise a lot, regardless of the “good" price.

Restrictive factors are scope of production and expected orientation of wood processing companies to fulfill own needs for thermal energy by, first of all, burning wood refuse.

Pellets production stared only by the end of 2006 in Serbia. At the moment, only two companies is engaged in pellet production. Annual capacity of those companies is 35,000 t.

Pellets are mostly produced from wood refuse from own production of beech sawn timber. The company also takes free of charge certain smaller amounts of sawdust from private saw-mills located nearby.

Households in Serbia do not use pellets for heating at the moment. The reasons are multifold:

- inadequate promotion of this product and effects achieved by using pellets,

- stoves and installations using pellets are still very expensive for most of the population,
- there are no strong companies offering adequate boilers and heating systems that use pellets.

Only several small companies are engaged in the production of wood chips and only occasionally depending on the orders from Croatia where the wood chips is exported.

There is no organized production in bigger amounts because there is only one factory for producing chipboard in Serbia which is supplied with wood from the Public Enterprise Serbia Forests and it is not so interested in wood chips.

At the moment, there are two heating plants using wood biomass. But there are no the production of electric power based. There are discussions of local authorities in certain towns with the Government representatives concerning projects dealing with that subject, but so far, there are no serious prospects that they are going to be realized in near future.

During that time, the process of town gasification in Serbia continues as the Government priority, offering the households natural gas imported from Russia instead of developing the production of energy based on wood biomass.

3C. Certified forest products

The process of forest certification in Serbia started in the second half of the year 2007. The first FSC system certificate was issued to a state owned territory of 39.357 ha. The process of certification was intensively continued in the second half of 2008, and it is expected that most of the state owned forests will have been certified, through the FSC system (over 180,000 ha), by the end of this year. According to the plans of public companies and the Ministry of Agriculture and Forestry, a part of the state owned forests, as well as the largest part of private forests, will be certified using the PEFC model in the year 2009.

The demand of the domestic market for final wood products, which originate from certified forests, is still not as distinguished as in the countries of the European Union. However, in recent years, the requests of the companies in wood processing for logs from certified forests are becoming more common because of the sawn wood, furniture elements and floors export to the markets of the countries of the European Union.

3.D. Value-added wood products

The most important categories of value-added wood products in Serbia, in the volume of production and exports, are furniture and wooden floors. These two product categories are also the most important, when direct foreign investments are concerned. During 2006 and 2007, the investment in the biggest multi layer parquet factory in South Eastern Europe, with a capacity of 6.5 million m^3 per year, was completed. As a result of this investment, Serbia considerably increased its parquet export. In 2007, the total parquet export reached the value of 43.5 million US$ with 55% of the total export to the Russian Federation. Such a high value of floor exports to the Russian market is the result of a specific free trade agreement between the Russian Federation and Serbia, in which floors are free of customs duties. Countries which follow Serbia in floor exports are Sweden, the Ukraine, Romania and the USA. The export of wooden floors from the Ukraine is the result of a great distributive centre, owned by a Serbian wooden floors producing company in that country, from which the floors are exported to all CIS countries.

In 2007, furniture export reached the value of 135.5 million US$, and the share of seats export was 55.7 million US$ or 41.1%. From other furniture categories, the second biggest in furniture export volume was office furniture (4.7 million US$), followed by kitchen (1.3 million US$) and bedroom furniture. In 2007 the most important countries for value added products export were Montenegro (46.7 million US$), Italy (43.3 million US$) and Bosnia and Herzegovina (37 million US$).

The total furniture import in 2007 was 71.1 million US$, and the import of office furniture was in the first place with a value of 12.5 million US$. From other furniture categories when import volume is concerned stand out kitchen furniture, living room furniture and dining room furniture.

The Government has also significantly contributed to the increase of export competitiveness of domestic furniture by decreasing import custom rates for woodworking machines and devices as well as by decreasing income tax of the companies to 10%.

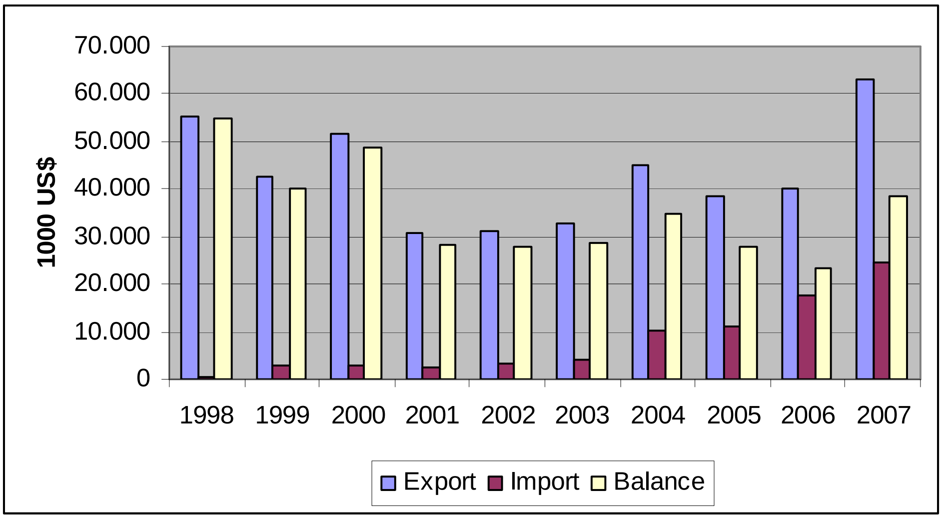
3E. Sawn softwood

In 2007, soft sawn wood production grew by 11.5% and it reached the level of 146.000 m^3, which was only 27% of the total production (535.000 m^3). The remaining 389 thousand m^3 were imported. In comparison to the previous year the value of import grew by 20.7% to the value of 64.1 million US$. The most important countries from which soft sawn wood was imported were Bosnia and Herzegovina, Montenegro and Romania.

3F. Sawn hardwood

The growth trend in the production of sawn hardwood continued in 2007. In comparison to the year 2006, the production grew by 26% reaching the level of 456.000m3. Such intense production growth is the result of the increase in sawn log production which encourages the companies in the wood processing sector to believe that the problems of forestry are starting to be solved. The largest part of the produced sawn hardwood is processed in Serbia into semi-final and final products because of the great demand which is the result of growth in the production of parquet, furniture, windows and doors. The domestic production of sawn hardwood from wood species such as oak, walnut, cherry and maple cannot fully meet the domestic demand, and consequently there is a growing import of sawn wood from these species. As a result of the demand of the greatest parquet factory in South Eastern Europe, large quantities of parquet frieze from oak, walnut, cherry as well as the tropical species meranti and teak are being imported.

In spite of the growth in domestic production, sawn hardwood export grew by 46.5% in the year 2007. (Graph 1).

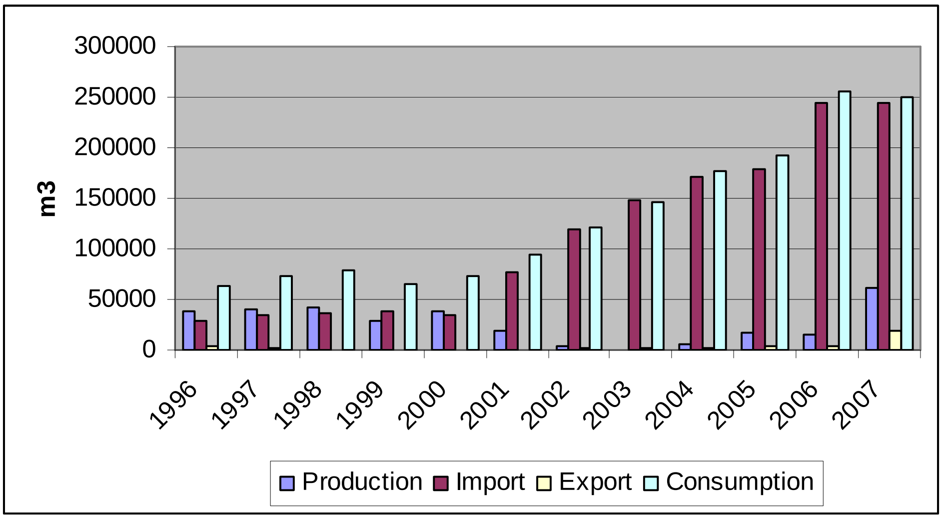


Graph. 1. Export, import and balance of Serbian hardwood sawn timber

The sawn hardwood export is mainly the result of the growth in beech sawn wood export (26.5 million US$) to Italy, Slovenia and Greece.

3G. Wood-based panels

Despite the fact that during the last years a lot of different types of boards have appeared, particleboards are still holding the leading position in the production of wood-based panels in Serbia. The most significant area of particleboard usage is furniture production. Consumption of particleboards in Serbia was constantly increasing in the last ten years (graph 2) with the exception of 2007 when a decrease was marked for the first time in the observed period.



Graph 2. Production, import, export and consumption of particleboards in Serbia

The record level of particleboard consumption was achieved in 2006 reaching 255,004 m³ and in 2007 a slight decrease of 2% to the level of 249,466 m³ occurred. The increase of particleboard consumption is the result of numerous companies dealing with furniture production (especially small and middle-sized enterprises). Kitchen furniture represents the main category of furniture for which particleboards are used, followed by office furniture, wardrobes and desk panels.

The increase of furniture consumption predominantly made of particleboards results from their relatively low prices compared to the furniture made of solid wood, which most consumers accept because of relatively small earnings. Particleboard consumption mostly depends on imports, which accounted for 75% in total consumption of 2007.

The most important country from which particleboards are imported into Serbia is Hungary with about 40% of the imports, followed by the Czech Republic with 23% and Austria with 13%. Among other countries, Croatia and Bulgaria have a significant participation. Pursuant to Government regulations for the area of particleboards trade, every company that imports particleboards is obliged to attest them in view of formaldehyde content. Attesting shall be performed by accredited local laboratory (foreign attests are not be accepted).

The market situation for MDF boards is similar to that for particleboards. Consumption of MDF boards has been continuously increasing for several last years, where the total consumption is satisfied by imports. Namely, Serbia does not have any factories producing MDF.

With the exception of 2007, when imports slightly decreased in the amount of 3%, in all other years in the period 2000-2007, imports were increasing. Forecasts for 2008 show the continuation of consumption as well as imports will increase for about 10%. MDF boards are mostly imported from Romania (31%), followed by Slovenia and Hungary.

OSB consumption is on a strong upward path in Serbia. In 2007, the increase was about 60% (18.8 thousand m^3) compared to the previous year, and the forecasts for 2008 show the continuation of increase for about 30%. Namely, because of all their benefits, OSB boards are predominantly used in civil engineering in the production of prefabricated houses as the basis for wood flooring and formwork.