Chapter 2
Economic factors affecting forest products markets in 2000 and early 2001

Highlights

- *The global business cycle peaked in the first half of 2000, and growth rates in both North America and Europe were significantly lower in the second part of the year.*
- *The outlook for 2001 is for much slower growth, with considerably uncertainty.*
- *For the first time in a decade, all UNECE transition economies reported positive rates of economic growth in 2000, although so far only four countries have recovered pre-1989 levels.*
- *GDP growth in Russia was at 7.7% in 2000, but like other transition economies, it slowed in the second half of the year.*
- *Energy prices rose sharply in late 2000, but since then, the trend has been downward. This slowed growth in the region, but helped demand in energy exporters, notably Russia.*
- *Strength in the United States residential construction continued in 2001 and may have kept the country out of recession.*
- *While western European residential construction was declining slightly in 2000, central and eastern Europe was growing*
- *The December 1999 windstorms, which felled 193 million m^3 of roundwood, elevated repair and remodelling expenditures in affected countries.*

2.1 General economic developments

The analysis below is taken from the Economic Survey of Europe[1]. The full text of the Survey is available from the UNECE website[2]. The second part of this chapter focuses on construction developments.

2.1.1 Global overview

The global business cycle reached a peak in the first half of 2000, but there was an unexpectedly pronounced slowdown of economic growth in the second half of 2000. This development reflected to a large degree the abrupt cyclical downswing in the United States, and prompted the Federal Reserve to swiftly cut interest rates in January 2001. The effects of the cyclical downturn in the United States on world output growth were accentuated by the faltering recovery in Japan. These adverse developments have started to feed through via international trade to emerging markets in Asia and Latin America. In Europe, economic growth has held up relatively well so far, but there is also increasing evidence of a slowdown in economic growth in the final months of 2000.

The cyclical weakening in the second half of 2000 is not apparent from the annual figures for world economy. World output rose by some 4.5% in 2000, nearly 1 percentage point higher than in 1999, and the best performance for more than a decade. As in 1999, the United States was again the main engine behind this acceleration in global economic activity. Stronger output growth was accompanied by a more rapid expansion of international trade. World merchandise trade rose in volume by some 10% in 2000, double the rate in 1999. This reflected both the cyclical upturn in western Europe and Latin America and the continued strong demand for foreign goods in North America and in the emerging markets of Asia.

In Japan, a moderate cyclical upturn was not sustained in the second half of 2000. Real GDP fell between the second and third quarters and was only half a percentage point above its level of a year earlier. Industrial production turned increasingly sluggish in the second half of 2000 and unemployment continued to rise. Real GDP is estimated to have increased by about 1.7% in 2000.

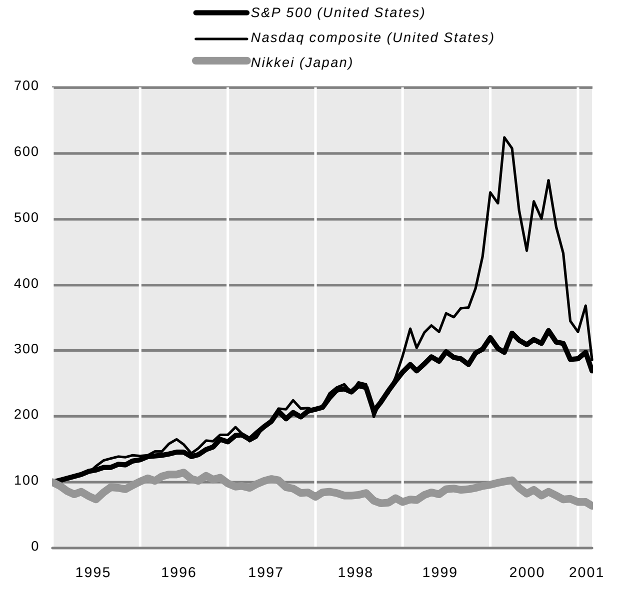
In Latin America and the Caribbean, economic activity picked up in 2000 after the adverse effects on the region's performance of the international financial crises in 1998-1999. Real GDP is estimated to have increased by 4% in 2000, up from a small increase of just 0.3% in 1999.

There was strong economic growth in the east Asian emerging markets in 2000, with annual growth rates of GDP ranging from some 8% in China and the Republic of Korea to some 4% in Indonesia. Exports were the main source of economic growth, reflecting both increased intraregional trade and robust demand from western Europe and the United States.

In the major international equity markets there was a marked shift in investors' sentiment in the second half of 2000. From late summer, the lowering of forecasts of economic growth for 2001 coincided with disappointing announcements of corporate profit developments, notably in the high-technology sector. This highlighted increasing concerns about the extraordinarily high valuation of stocks in this sector and triggered a massive sell-off. In the United States, the NASDAQ[3] had fallen by some 50% in February 2001 from its peak 12 months earlier (graph 2.1.1). Even after their recent fall, however, stock markets still appear to be overvalued when judged on the basis of long-term price earnings ratios.

The pattern of exchange rates among the three main world currencies has changed somewhat in recent months. Against the backdrop of weakening growth expectations for the United States and relatively better

GRAPH 2.1.1
International share prices, January 1995 -February 2001
(Indices, January 1995=100)



Note: Data refers to end of month.
Source: Reuters Business Briefing (www.rbb.reuters.com), 2001.

[1] Economic Survey of Europe, Number 1, 2001. Economic Analysis Division, UNECE, Geneva, Switzerland.

[2] www.unece.org/ead/ead_h.htm

[3] The NASDAQ is a New York Stock Exchange index of technology stocks.

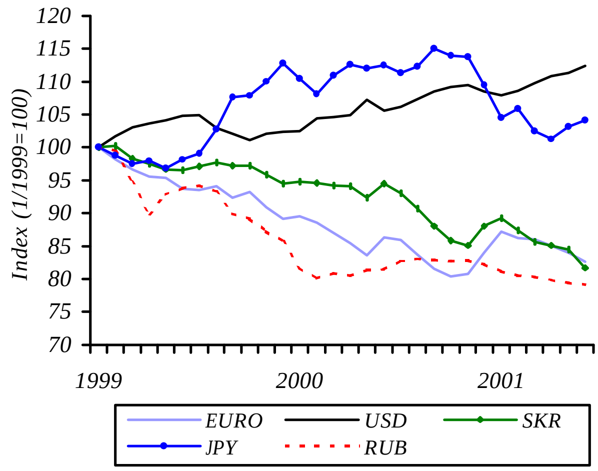
prospects for the euro area, the fall in the euro/dollar rate was arrested and has been partly reversed since late 2000 (graph 2.1.2). In February 2001, the euro had appreciated against the dollar on average by some 7.5% from its recent trough in October 2000. But compared with the average exchange rate in January 1999, there was still a sizeable depreciation of 21%. The euro has strengthened also against the yen in recent months. In February 2001, the euro reached its highest level against the yen since October 1999, a reflection of the worsening economic outlook for Japan. For the same reason, the yen has also depreciated significantly against the dollar since the final months of 2000. The strengthening dollar compared to other currencies in which timber is traded, e.g. euros, yen, Swedish kronar and Russian roubles, affected the timber trade in 2000 and the first half of 2001 (graph 2.1.3).

In the international oil market, the price of Brent crude rose to some $37 per barrel in early September 2000, its highest level in more than a decade (graph 2.1.4). But since then, the trend has been downward, although volatility continued to be high. The average price for the first two months of 2001 was approximately $26.50 per barrel, broadly unchanged from the same period of 2000.

2.1.2 North America

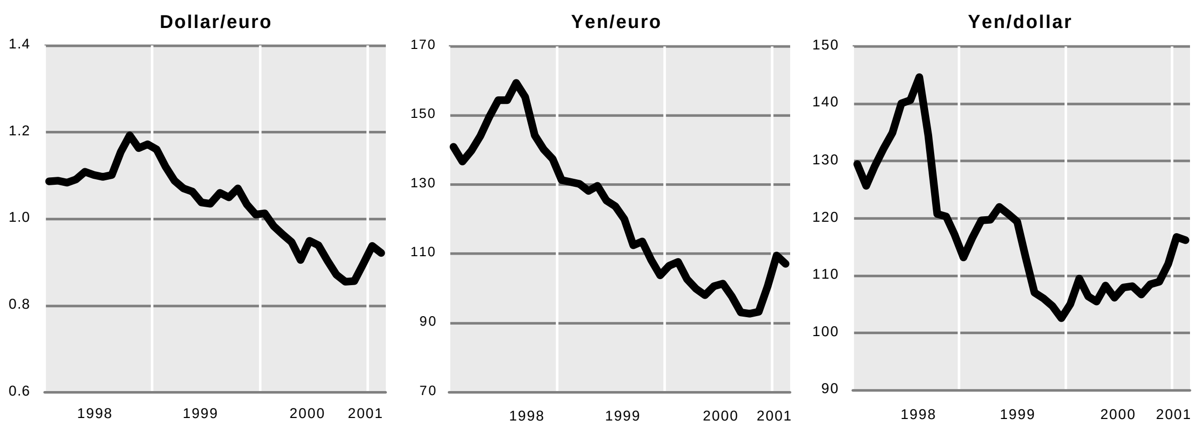
In the United States, real GDP rose by 5% in 2000. This was the highest annual growth rate since 1978, when the increase was 5.5%. But this very favourable outcome for the year as a whole masks a sharp deceleration in the rate of economic expansion in the second half of the year. Real GDP rose by only 0.3% in the final quarter, equivalent to a seasonally adjusted annual rate of 1.4%. This slowdown was mainly due to a considerable weakening of private domestic demand, which was only partly offset by increased government spending.

GRAPH 2.1.3
Real effective exchange rates of selected currencies, 1999-2001



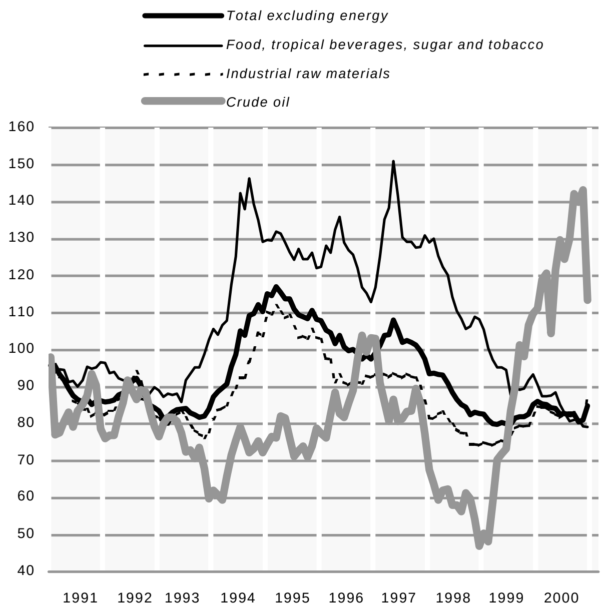
Note : USD is United States dollar, SKR is Swedish kronar, JPY is Japanese yen and RUB is Russian ruble.
Source: International Monetary Fund, 2001.

GRAPH 2.1.2
Bilateral exchange rates between the euro, [a] the dollar and the yen, January 1998 -February 2001
(Dollar, euro, yen)



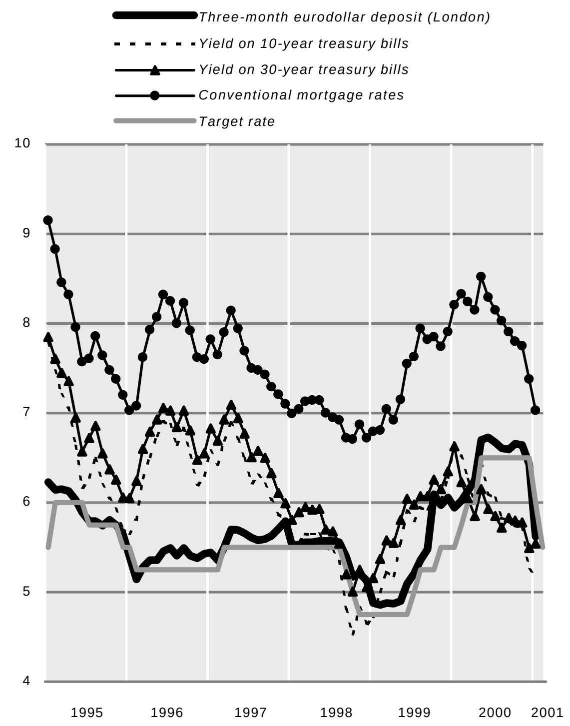
Note: Average monthly exchange rates.
[a] ECU before January 1999.
Source: European Central Bank, 2001.

GRAPH 2.1.4
World commodity prices, January 1991 -February 2001
(Indices, 1990=100)



Notes: Indexes calculated on the basis of current dollar prices. Tropical beverages are coffee, tea and cocoa.
Source: Hamburg Institute for Economic Research, 2001.

GRAPH 2.1.5
Nominal short -term and long -term interest rates in the United States, January 1995 -February 2001
(Per cent per annum)



Source: United States Federal Reserve Board, 2001.

Inflation edged up in 2000 largely because of higher prices for energy. For the year as a whole the consumer price index rose by 3.4%, but core inflation (i.e. without prices for food and energy products) was much lower at 2.4%.

The progressive tightening of monetary policy since mid-1999 continued in early 2000 when the target for the federal funds rate was raised in three steps to 6.5% in May (graph 2.1.5). Monetary policy remained on hold for the rest of the year, but faced with the unexpectedly sharp slowdown in economic activity in the final months of 2000, the target interest rate was cut swiftly to 5.5% in the course of January 2001. Mortgage interest rates fell steadily from spring 2000, from about 8.5% to around 7.0%.

Buoyant growth in federal government receipts by far outpaced growth in its expenditures in 2000. Thus, the surplus on the unified budget rose to $236 billion in fiscal 2000, about twice that in fiscal 1999. The financial surplus of the general government corresponded to 2¼% of GDP in 2000, up from 1% in the preceding year (table 2.1.1). Buoyant domestic demand for most of the year, together with the strong dollar, led to further rise in the merchandise trade deficit to $450 billion in 2000. This is the largest trade deficit on record, corresponding to 4.5% of GDP. The current account deficit was broadly similar and also at a record level.

In Canada, the economic boom continued in 2000 but the sharp slowdown in the United States economy started to have adverse effects on manufacturing activity in the final months of the year. Real GDP rose by 5% in 2000, up from 4.2% in 1999, but, as in the United States, there was a sharp slowdown in the rate of economic expansion in the second half of the year. Exports were the main source of growth, reflecting the expansion of demand in the United States for most of the year and the rising global demand for energy products and other commodities.

2.1.3 Market economies of western Europe

The overall economic performance in western Europe in 2000 was quite favourable if the year is taken as a whole. Real GDP rose by 3.5% compared with 2.2% in 1999. This was the best performance since 1988, when it increased by 3.6%. Robust economic growth led to strong gains in employment and declining rates of unemployment, while inflationary pressures remained very weak despite a sharp rise in oil prices (graph 2.1.6). But the very good average outcome masks a slowdown in the pace of expansion in the second half of the year. In the four major economies, real GDP rose at a quarterly rate of only 0.5% in the last two quarters of 2000,

TABLE 2.1.1

Annual changes in real GDP in western Europe, North America and Japan, 1998 to 2001

(Percentage change over previous year)

	1998	1999	2000 [a]	2001 [b]
France	3.3	3.2	3.2	2.7
Germany	2.1	1.6	3.0	2.1
Italy	1.8	1.6	2.9	2.5
Austria	3.3	2.8	3.3	2.6
Belgium	2.4	2.7	3.9	2.5
Finland	5.3	4.2	5.7	4.0
Greece	3.1	3.4	4.0	4.0
Ireland	8.6	9.8	10.0	7.5
Luxembourg	5.0	7.5	8.1	6.2
Netherlands	4.1	3.9	3.9	3.3
Portugal	3.6	3.0	3.2	2.6
Spain	4.3	4.0	4.1	3.0
Euro area	2.8	2.6	3.4	2.6
United Kingdom	2.6	2.3	3.0	2.5
Denmark	2.8	2.1	2.4	1.8
Sweden	3.6	4.1	3.6	2.5
European Union	2.8	2.6	3.3	2.6
Cyprus	5.0	4.5	4.9	4.1
Iceland	4.5	4.3	3.6	1.3
Israel	2.2	2.3	3.0	3.0
Malta	3.4	4.0	4.3	4.3
Norway	2.0	0.9	2.2	1.5
Switzerland	2.3	1.5	3.3	2.1
Turkey	3.1	-5.0	7.0	–
Western Europe	2.8	2.2	3.5	2.5
Canada	3.3	4.5	4.7	2.4
United States	4.4	4.2	5.0	1.7
North America	4.3	4.3	5.0	1.8
Japan	-1.1	0.8	1.7	1.2
Total above	2.8	2.8	3.8	2.0
Memorandum items:				
4 major western European economies [c]	2.4	2.1	3.0	2.5
Western Europe and North America	3.6	3.2	4.2	2.1

Note: All aggregates exclude Israel. Growth rates of regional aggregates have been calculated as weighted averages of growth rates in individual countries. Weights were derived from 1996 GDP data converted from national currency units into dollars using purchasing power parities.

a Preliminary estimates or forecasts.

b Forecasts.

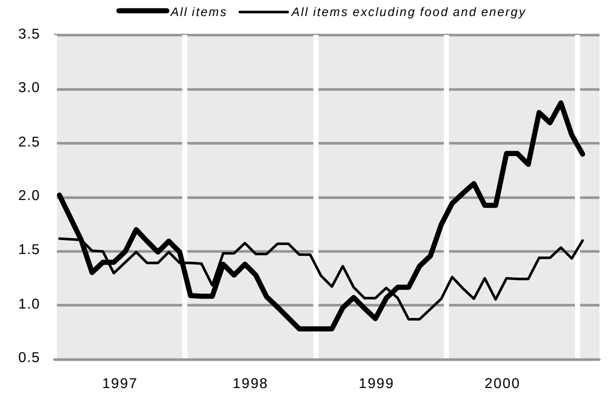
c France, Germany, Italy and United Kingdom.

Sources: National statistics and national economic reports, 2001.

GRAPH 2.1.6

Consumer prices [a] in the euro area, January 1997 -January 2001

(Percentage change over same month of preceding year)



a Harmonized Index of Consumer Prices (HICP).

Source: Eurostat, 2001.

equivalent to a seasonally adjusted annual rate of some 2%. This compares with an average annual rate of some 3.5 in the first two quarters.

Short-term economic prospects have become much more uncertain in early 2001. The outlook increasingly depends on the resilience of domestic growth forces to the deteriorating external economic environment and on western European policy responses. The rate of growth of gross fixed capital formation in construction – a major indicator of the strongest influence on consumption of sawnwood and panels – fell by two percentage points during 2000 for western Europe (graph 2.1.7).

The relatively short cyclical upswing phases for the euro area (and for western Europe) as a whole disguises much longer periods of expansion in some of the smaller economies. Thus, for Finland, Ireland, the Netherlands, Portugal and Spain, 2000 was the seventh consecutive year of a strong economic expansion, probably the strongest boom period in the post-war period. In Finland and Ireland, economic activity continued to be supported by extraordinarily strong growth in the high-tech electronics sector. In Greece, which joined the euro area at the beginning of 2001, there has also been above average growth since 1997. The stronger average annual growth rate of GDP in the euro area in 2000 was due to the growth in real net exports, which more than offset a slowdown in the growth of total domestic expenditures.

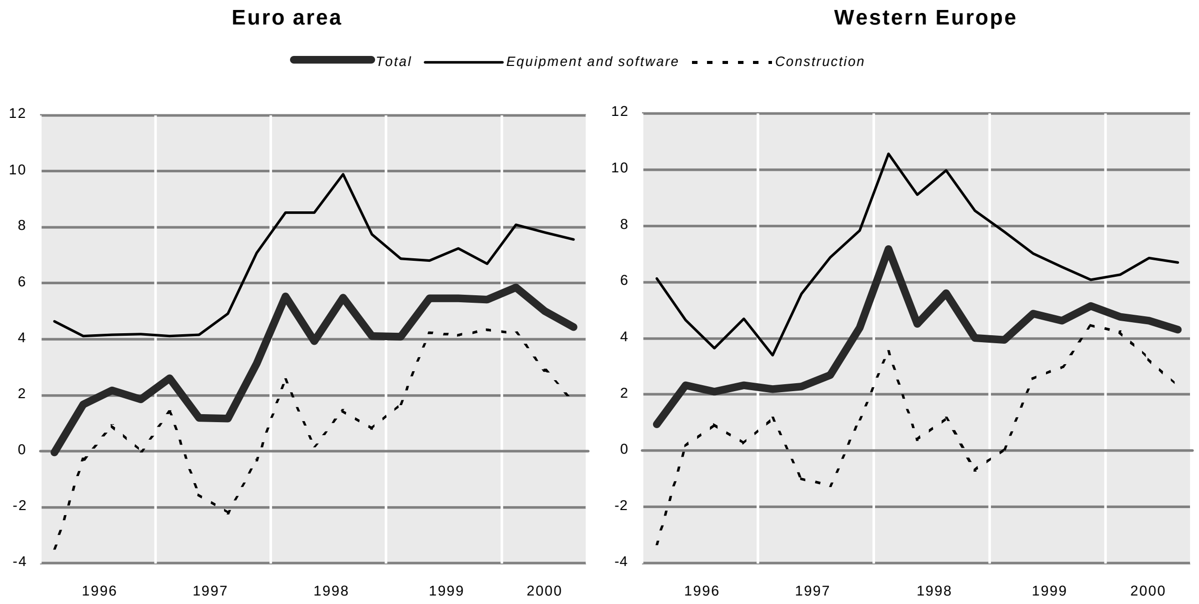
Among the three largest economies in the euro area, the pace of economic activity maintained a high momentum in France in the course of 2000. Robust growth has been accompanied by large gains in employment. Consumer price inflation remained moderate and significantly below the euro area average. Exports and business fixed investment were the most dynamic components of demand in 2000. Residential investment weakened in the course of the year.

In Germany, there was a sharp slowdown in the rate of economic expansion in the final two quarters of 2000. This slowdown reflects to a large degree the dampening

GRAPH 2.1.7

Quarterly changes in real gross fixed capital formation, 1996-2000 (third quarter)

(Percentage change over same period of preceding year)



Note: Euro area: nine countries (excluding Greece, Ireland and Portugal). Western Europe: euro area plus Denmark, Norway, Sweden, Switzerland and the United Kingdom.

Sources: Eurostat; OECD, National Accounts; national statistics, 2001.

effects of the higher prices for energy products on households' purchasing power. Weak construction activity continues to dampen overall economic growth: for 2000 as a whole, construction investment fell by 2.5%, the net effect of declines of 8% in eastern Germany and only 0.5% in western Germany. The sharp fall in construction investment in eastern Germany mainly reflects the large excess supply of buildings created in the aftermath of unification, a process which was stimulated by overly generous government subsidies.

In Italy, the recovery which had started in the second half of 1999 continued in 2000, the improvement entirely due to favourable changes in net exports. Total domestic expenditure growth actually slowed down in 2000, although business investment was relatively buoyant in machinery and equipment.

Outside the euro area, in the United Kingdom, the rate of economic expansion also slowed down markedly in the second half of 2000. The main factor behind this deceleration was a pronounced inventory adjustment. For the year as whole, real GDP rose by 3%. Robust private consumption, supported by a sharp drop in the savings rate, was the mainstay of economic growth in 2000 as a whole.

2.1.4 Transition economies of central and eastern Europe

For the first time in a decade all UNECE transition economies reported positive rates of economic growth in 2000 (table 2.1.2). The very high average rate of GDP growth for the region as a whole was largely due to the unexpectedly strong recovery in Russia; economic growth rates were at their highest in a decade in a number of other countries as well. All transition economies benefited from the strong demand in their major export markets, and commodity exporters had windfall gains from the surge in world market prices and the improvement in their terms of trade. Most CIS economies benefited from the recovery in Russia's domestic demand, which gave a strong impetus to their exports and contributed to a general revival of intra-CIS trade. While the outcomes in 2000 were rather favourable for the transition economies, their very high dependence on external demand and world markets also point to the potential risks of adverse shocks.

TABLE 2.1.2

Basic economic indicators for eastern Europe, the Baltic states and the CIS, 1998 -2001

(Rates of change and shares, per cent)

	GDP (growth rates)			
	1998	1999	2000	2001 official forecast
Eastern Europe	1.8	1.3	3.9	4.2
Albania	8	7.3	8*	5-7
Bosnia and Herzegovina[a]	..	..	10*	7-9
Bulgaria	3.5	2.4	5.0*	5
Croatia	2.5	-0.4	3.7	3-4
Czech Republic	-2.2	-0.8	3.1	3
Hungary	4.9	4.4	5.2	4.5-5
Poland	4.8	4.1	4.1	4.5
Romania	-5.4	-3.2	1.6	4.1
Slovakia	4.1	1.9	2.2	3.2
Slovenia	3.8	5.2	4.8	4.5
The former Yugoslav Republic of Macedonia	2.9	2.7	5.1	6
Yugoslavia[b]	2.5	-19.3	10.0	5
Baltic states	4.7	-1.8	5.0	4.7
Estonia	4.7	-1.1	6.4*	6
Latvia	3.9	1.1	6.6	5-6
Lithuania	5.1	-3.9	3.3	3.7
CIS	-3.0	3.2	7.4	4.2
Armenia	7.3	3.3	6.0	6.5
Azerbaijan	10.0	7.4	11.4	8.5
Belarus	8.4	3.4	5.8	3-4
Georgia	2.9	3.0	1.9	3-4
Kazakhstan	-1.9	2.7	9.6	4
Kyrgyzstan	2.1	3.7	5.0	5
Republic of Moldova[c]	-6.5	-3.4	1.9	5
Russian Federation	-4.9	3.5	7.7	4
Tajikistan	5.3	3.7	8.3	6.7
Turkmenistan	5.0	16.0	17.6	16
Ukraine	-1.9	-0.4	6.0	3-4
Uzbekistan	4.4	4.4	4.0	4.4
Total above	-1.1	2.4	6.0	4.2
Memorandum items:				
CETE-5	3.2	3.0	4.0	4.1
SETE-7	-1.5	-3.0	3.6	4.5
Former GDR	2.0	..	..	..

Note: Aggregates are UNECE secretariat calculations, using purchasing power parties obtained from the 1996 European Comparison Programme. Output measures are in real terms (constant prices). Forecasts are those of national conjunctural institutes or government forecasts associated with the central budget formulation. Industrial output refers to gross output, not the contribution of industry to GDP. Inflation refers to changes in the consumer price index. Unemployment generally refers to registered unemployment at the end of the period (with the exceptions of the Russian Federation where it is the Goskomstat estimate according to the International Labour Organisation definition, and Estonia where it refers to job seekers). Aggregates shown are: Eastern Europe (the 12 countries below that line), with sub-aggregates CETE-5 (central European transition economies: Czech Republic, Hungary, Poland, Slovakia, Slovenia) and SETE-7 (south-east European transition economies: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Romania, The former Yugoslav Republic of Macedonia and Yugoslavia); Baltic States (Estonia, Latvia, Lithuania); and CIS (12 member countries of the Commonwealth of Independent States).

a Data reported by the Statistical Office of the Federation; these exclude the area of Republika Srpska.

b Data for 1999 and 2000 exclude Kosovo and Metohia.

c Excluding Transdniestria.

* Estimate.

Sources: National statistics; CIS Statistical Committee; direct communications from national statistical offices to UNECE secretariat (IMF and World Bank data for Albania), 2001.

These positive economic outcomes suggest that after 10 years of painful reforms, the prolonged and deep transformational recession in these economies has for the most part come to an end. Divergent experiences in coping with this difficult phase, as well as in the deepening and widening of the reform process, has left the region much more heterogeneous than it was 10 years ago. Most central European and Baltic States have already made considerable progress in instituting a functioning market economy and have enjoyed several years of strong economic growth which has placed them among the leading candidates for EU membership. At the same time, in a number of other countries the transformational recession and the process of introducing basic reforms has turned out to be much longer and much more strenuous than initially expected. For some CIS economies 2000 was the first year of positive growth in a decade while in Yugoslavia real market reforms can only now get under way with the new, democratically elected Government.

The strong growth in the transition economies in 2000 is a positive and encouraging outcome; at the same time, however, it must be borne in mind that for a number of countries this represents only a meagre recovery after a long economic slump. In fact, after 10 years of reform only four economies (Hungary in 2000, Poland in 1995, Slovakia in 1999 and Slovenia in 1998) have managed to surpass their levels of GDP prevailing before the start of transformation. On average, the CIS economies are still some 40% below their GDP levels of 1989 and in a number of individual countries GDP in 2000 was less than half of what was being produced a decade ago.

It should also be emphasized that, with the exception of a few central European economies, domestic demand generally remains weak despite its moderate recovery in 2000. This reflects the fact that in a number of countries, especially in south-east Europe, central Asia and Caucasus, large sections of the population suffered considerable impoverishment during the prolonged recession, while investment fell dramatically in the face of *highly uncertain economic prospects. The falls in output and incomes in these economies are of such magnitude that it will probably take many years, if not decades, before the population at large begins to sense the positive outcomes of the reform process.*

Nevertheless, as a result of the sweeping reforms of the past decade, most transition economies have established most of the basic institutions of a market economy and have liberalized their domestic markets and foreign trade (admittedly, to widely varying degrees). With the exception of a few CIS countries, the transition economies can now be considered as open economies that have the potential to benefit from their increased trade with the rest of the world. In fact, the growth figures for 2000 underline the gains from trade that are now possible for these economies.

For the first time since the start of their market reforms, the CIS was the fastest growing regional group among the transition economies: nine out of the 12 CIS economies had rates of GDP growth of 5% or more, resulting in an average of 7.4% for the Commonwealth as a whole. The main engine of the robust recovery in the CIS was the Russian economy where GDP grew by an unprecedented 7.7% in 2000. After a weak performance in 1999, output also recovered strongly in eastern Europe and in the Baltic states, their aggregate GDP increasing by 3.9% and 5%, respectively.

While the strong recovery in the transition economies was a positive and encouraging outcome, their performance in 2000 was largely driven by a sharp and externally driven cyclical component. The UNECE transition economies benefited significantly – although to varying degrees – from the strong and diversified demand in their major markets, in the first place for manufactured goods but also for a wide range of primary commodities and semi-manufactures. Competitive exchange rates and, more selectively, favourable world market price conditions added to this positive impact.

In many transition economies, strong growth in 2000 was accompanied by higher rates of inflation. In most cases where inflation was higher than expected (or higher than in 1999), this was largely due to higher import prices, especially for oil, and the subsequent general rise in energy and fuel prices.

The change of political regime in Yugoslavia has transformed the political and economic situation in the whole of south-east Europe. The new Government is now facing the daunting task of carrying out a plethora of difficult reforms after a decade of delays in the process. Nevertheless, the lifting of the outer wall of sanctions that followed the elections in Yugoslavia last December has improved the outlook for all the neighbouring countries which had suffered their side effects for a number of years. The EU has also signalled that all the successor States of the former Socialist Federal Republic of Yugoslavia, as well as Albania, will now be considered as potential candidates for future EU membership. It is hoped that this clear signal might have the stimulating effect on the policy process in south-east Europe that it has had in the other candidate countries.

There were two main patterns of economic growth among the transition economies in 2000: while output in central Europe and the Baltic States was mainly driven by exports of manufactured goods (with a growing share of technology-intensive products), growth in the CIS economies was mainly supported by increased commodity exports, with the highest growth rates in those countries with oil and natural gas resources

Industrial output and GDP continued to grow strongly in 2000 in the Russian Federation, although there was a marked slowdown in the fourth quarter. By the end of 2000, Russia's GDP had regained its level of 1994, but it was still considerably below its 1989 level. The oil and natural gas sectors played a key role in 2000, generating considerably more income as the dollar price of oil increased by 30% from January to September 2000

2.1.5 Short-term outlook

The short-term outlook for the world economy is surrounded by a considerable margin of uncertainty. Much will depend on whether or not the United States economy moves into recession ("hard or soft landing") and how rapidly the forces of domestic growth will strengthen again. Given the large share of the United States economy in world demand and output, any sharp and extended cyclical downturn is bound to have, directly or indirectly, considerable adverse effects on the rest of the world.

At the end of the first quarter of 2001, the short-term economic outlook for the western European market economies looks much less favourable than in the autumn of 2000. The main factor behind this is the unexpectedly sharp slowdown in economic growth in the United States since the second half of 2000 and the stalled recovery in Japan. Activity in the two largest economies in the world is thus weakening rapidly or continuing to stagnate. This has started to feed through changes in net exports to other regions of the world economy. As a result, there has been a progressive lowering of growth forecasts, especially for the United States, since late 2000.

In the United States, real GDP is now expected to increase by only some 1¾% in 2001, a very abrupt deceleration from an average growth rate of 5% in 2000. In Japan, economic growth is expected to exceed only slightly 1% in 2001, and even that is uncertain given disagreements over economic policy and delays in introducing another economic emergency programme.

Growth forces are seen to hold up somewhat better in western Europe. In the euro area, real GDP is currently forecast to increase by some 2.5% in 2001, down from 3.4% in 2000 and half a percentage point less than was being forecast last autumn. Broadly similar changes are expected for the European Union and for western Europe as a whole. For the world industrialized economies in aggregate, the average rate of economic growth is likely to be only some 2% in 2001, down from 3.8% in 2000 and the smallest annual increase since 1993. As a result, the prospects for economic growth in the central and eastern European economies, as well as the CIS and other parts of the world economy, will also be adversely affected, leading to a mutually reinforcing process which will amplify the direct trade effects of the cyclical downturn in the United States. The result is that world output might now grow by only some 2.5 to 3% in 2001, down from 4.7% in 2000 and considerably less than was expected in the autumn of 2000.

Thus, should the favourable external trends of 2000 be reversed, the transition economies might be subject to a negative external shock which could mirror that in 2000. Indeed, in the closing months of 2000 and the opening months of 2001 there has been a widespread weakening of output in virtually all the transition economies, which is already more pronounced than the current slowdown in western Europe. A further deterioration in the latter is therefore likely to have a considerably amplified effect on economic activity in the transition economies. Should developments in North America and western Europe take such a turn, the currently envisaged rates of economic growth for 2001 may turn out to be very optimistic.

The unprecedented growth of Russia's GDP in 2000 reflected the combination of a low base (which was due to the 1998 economic crisis) and an extremely favourable external environment which is unlikely to be sustained. Indeed, all the indications are that the Russian economy (in particular industrial output) was also slowing down at the beginning of 2001. If oil prices continue to fall, domestic demand in Russia will be negatively affected and the official forecast for the year as a whole (GDP growth of 4%) will be difficult to achieve. The prospects for most of the other CIS economies are conditional both on the outlook for world oil and commodity prices and on the performance of the Russian economy, including the development of rouble exchange rate. Hence, the uncertainties concerning the outlook for Russia are largely translated into uncertainties for the Commonwealth as a whole.

2.2 Construction -sector developments

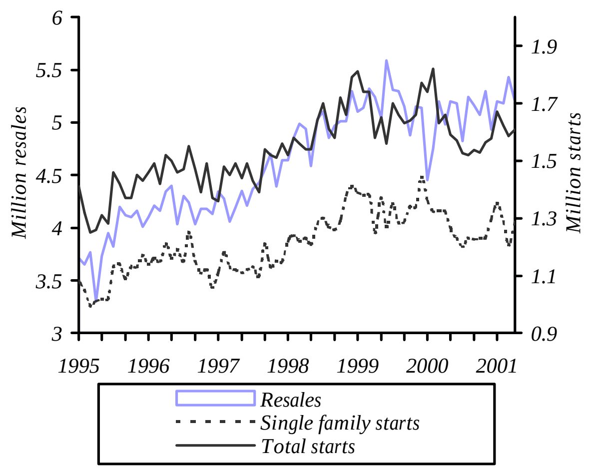
This section presents short-term trends in construction in Europe and North America. In contrast to previous years, the analysis of the Japanese housing developments is not included here, because it is covered in chapter 4 on "Influences on Japanese demand for wood products." The section focuses on new residential construction, plus the repair and remodelling market, because these sectors use the most wood.

2.2.1 North American residential construction [4]

The United States housing boom that began following the recession in the early 1990s, continued in 2000, and despite some pullback in 2001, the residential housing market remains healthy (graph 2.2.1). Single-family starts are the key to wood products demand because single-family units consume over twice as much lumber and panels as multifamily units. Single-family housing construction activity has remained very strong and well above 1 million units annually since 1995 as it now makes up over 80% of conventional housing demand ("conventional" excludes mobile homes and

GRAPH 2.2.1

North American residential construction, 1995 -2001



Sources: National Association of Realtors and United States Bureau of Census, 2001.

[4] For this sub-section, the secretariat is indebted to Dr. Al Schuler, Research Economist, Northeast Forest Experiment Station, USDA Forest Service, 241 Mercer Springs Road, Princeton, West Virginia, United States 24740, telephone +1 304 431 2727, fax +1 304 431 2772, e-mail: aschuler@fs.fed.us and Mr. Craig Adair, Director, Market Research, APA-The Engineered Wood Association, P.O. Box 11700, Tacoma, Washington, United States 98411-0700, telephone +1 253 565 7265, fax +1 253 565 6600, e-mail: craig.adair@apawood.org

United States Department of Housing and Urban Development (HUD) Code homes). Furthermore, today's houses are larger (20% larger than the 1980s) and they have more amenities (multiple garages, extra bathrooms, more bedrooms, etc.). In addition, the resale market has been setting records for the past three years with sales of existing homes ("resales") averaging in excess of 5 million units per year. This is important because residential remodelling and repair markets consume almost as much lumber and panel products as new housing activity, and the resale market is the best single indicator of what is going on in the remodelling market. Furthermore, this market gives good insight into furniture and kitchen cabinet sales, which are other important users of wood products.

Housing activity is important to the United States economy and it is critically important to the wood products industry. This is because 90% of the United States homes are wood-frame compared with 10% in Europe and about 50% in Japan. Housing activity (new housing plus remodeling) accounts directly for more than 5% of GDP. When indirect impacts are included residential construction contributes over 10% to GDP. According to the National Association of Homebuilders the construction of 1,000 single-family homes generates 2,500 full-time construction jobs, $80 million in wages and $43 million in combined federal, state and local revenues and fees.

It is remarkable that in early 2001, housing has managed to avoid the sharp pullback being experienced by the rest of the United States economy. Some analysts believe that the United States would be in a recession in mid-2001 if not for the resilience in housing. For example, United States GDP in 2001 is expected to advance less than half the 5% growth in 2000. Some analysts feel weakness in the United States economy is due to a sharp pullback in business investment spending and the obvious recession in the manufacturing sector. Yet, housing, through May 2001 at least, has been relatively immune to the macroeconomic slowdown. The main reason is that consumer confidence has remained relatively strong thanks to a still healthy employment picture and continued income growth. And, aggressive rate reductions by the Federal Reserve Board have resulted in attractive interest and mortgage rates, by which housing has been a direct beneficiary. The key to the United States economy and the housing market is consumer confidence. But will the Federal Reserve Board rate reductions keep the consumer spending and buying homes, or will lower corporate profits, weaker equity markets, rising unemployment, and slower income growth pull the United States into a recession this year? The consensus forecast is continued strong housing in 2001 and 2002 with only a slight decrease from 2000's 1.6 million houses (table 2.2.1).

TABLE 2.2.1

United States housing outlook, 2001 and 2002

	2001	2002
APA	1.54	1.56
NAHB*	1.56	1.58
RISI*	1.54	1.52
NABE*	1.58	1.55
NAR*	1.59	1.56
Average	1.56	1.55

Sources: APA (APA-The Engineered Wood Association forecast in March, 2001; NAHB – National Association of Homebuilders forecast in May, 2001; RISI – Resource Information Systems forecast in April, 2001; NABE – National Association of Business Economists forecast in May, 2001; and NAR – National Association of Realtors forecast in June, 2001.

The Canadian housing market has improved steadily since 1998 pretty much in tandem with the improving economy. This is not surprising because Canada, as a NAFTA partner with the United States, is heavily tied to the United States economy. In fact exports to the United States account for almost one third of Canada's GDP, and when their southern neighbour has a strong economy, Canada benefits. Of course, the corollary also holds – Canada cannot avoid a weakening United States economy.

Canadian housing starts have improved steadily over the past several years, growing from 137,000 in 1998 to 152,000 in 2000, an 11% increase. Although Canada's housing market is slowing down somewhat in 2001 (as is the economy as a whole), the pullback is expected to be minor if any at all. Canada's economy isn't expected to cool as much as its southern neighbour (because it didn't grow as fast in the past four years and current strong energy demand is benefiting Canada), hence the expectation that housing should remain near last year's total. For 2002, most analysts feel that Canadian starts should approach 160,000 units (as long as the United States avoids a recession).

2.2.2 European construction developments [5]

2.2.2.1 Total construction

According to Euroconstruct, the consortium of research institutions specializing in the construction sector in Europe, the value of construction in their

[5] Information for this section came from Euroconstruct, either directly from their website at www.euroconstruct.com or via the European Panel Federation's Annual Report 2000-2001, 2001.

European country grouping[6] is forecast to exceed 850 billion euros in 2001 or 2002. The European Panel Federation (EPF) Annual Report 2000-2001 states that the overall construction sector output in 2000 was 875 billion euros, up 2.8% from 1999. Euroconstruct forecast increased construction in all of their countries in 2001, with the exception of Germany and Norway. "While Germany remains the single biggest market accounting for around 20% of the total, it is also expected to remain subdued throughout the forecasting period." (Euroconstruct). German construction contracted by 2.5% in 2000 (EPF). The largest contributions to total volume growth are forecast to come from France, Spain, Italy and the United Kingdom.

However, in terms of relative growth Euroconstruct's four central and eastern European countries (CEECs), Czech Republic, Hungary, Poland and Slovakia, are expected to outpace their western European members. The EPF forecast was for equal growth in CEECs and western Europe, at 2.9 and 2.8% respectively.

In 2001 Euroconstruct forecasts a sharp slowdown in total construction in western Europe, with only 1.5% growth. And they forecast the same growth in 2002 with the possibility of slightly higher growth in 2003 at 2%. In contrast, total construction output for their four CEECs is forecast to expand by almost 20% over the three years to 2003 set against a modest 5% expansion for total western Europe. Euroconstruct's 15 western European countries are more mixed. Norway and Germany are the only countries with expected lower construction by 2003. The variation between the other countries is extreme, from 2.5% growth for Denmark to over 12% for Sweden through 2003, partly due to disparities between business cycles. For reference, the Czech Republic is forecast to grow by over 15%.

There are structural differences between the construction sectors in western Europe and Euroconstruct's four CEECs (tables 2.2.2 and 2.2.3). Renovation and modernisation account for more than a third of western European construction output, while CEEC construction activity is overwhelmingly dominated by new non-residential construction and civil engineering.

TABLE 2.2.2

Total construction output in western Europe by type, 1999-2003

(Annual growth rate in %, at 2000 constant prices)

Western Europe	1999	2000	2001	2002	2003
New residential	3.0	2.2	-0.3	-0.5	-0.1
Residential repair and remodelling	2.5	3.0	1.8	2.7	2.6
Non-residential	5.7	2.6	2.5	1.4	2.0
Non-residential repair and remodelling	2.3	4.0	1.9	2.3	1.8
Civil engineering	3.6	2.7	2.8	3.2	3.3
Total construction	3.6	2.9	1.3	1.8	1.9

Note: 2001-2003 are forecasts.

Source: Euroconstruct, 2001.

TABLE 2.2.3

Total construction output in central and eastern Europe by type, 1999-2003

(Annual growth rate in %, at 2000 constant prices)

CEECs	1999	2000	2001	2002	2003
New residential	5.7	7.9	10.2	12.5	9.0
Residential repair and remodelling	3.8	3.4	4.9	3.9	6.5
Non-residential	1.2	1.8	2.3	3.9	6.6
Non-residential repair and remodelling	-0.3	1.2	4.8	1.6	5.4
Civil engineering	-3.0	2.3	5.9	8.9	10.1
Total construction	-0.6	3.2	5.0	6.0	7.2

Note: 2001-2003 are forecasts.

Source: Euroconstruct, 2001.

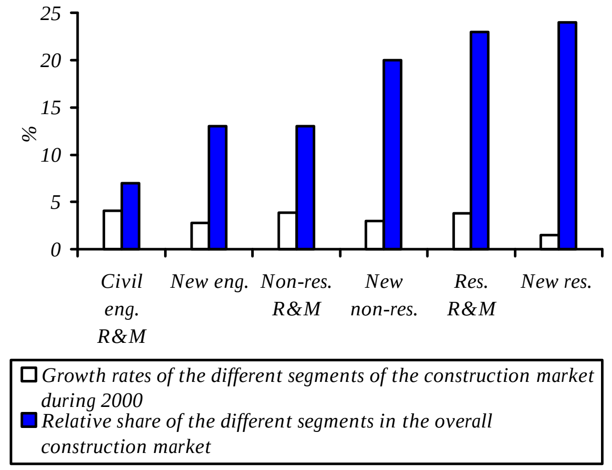
[6] Euroconstruct's 19 countries: Austria, Belgium, Denmark, Czech Republic, Finland, France, Germany, Hungary, Ireland, Italy, Netherlands, Norway, Poland, Portugal, Slovakia, Spain, Sweden, Switzerland, United Kingdom.

2.2.2.2 Residential construction

Of greater interest to the wood products sector is the development of residential construction because of the greater use of wood. Residential construction, including new construction plus repair and remodeling, in Europe totaled over 400 billion euros, or 46% of total construction, in 2000 (graph 2.2.2).

GRAPH 2.2.2

Construction market segments in the Euroconstruct region, 2000



Note: "Res." is residential, "R&M" is remodelling and maintenance and "eng." is engineering.
Source: European Panel Federation Annual Report 2000-2001, 2001.

Euroconstruct, as reported by EPF, forecasts a drop in new housing starts in France, Germany and Norway in 2001 (table 2.2.4).

According to EPF, in 2000 Germany had a 30% share of the residential construction market in western Europe, followed by France, 14%, Italy, 13%, United Kingdom, 10%, and Spain, 8%; these 5 countries accounted for 75% of the market. They forecast that from 2001 to 2003, Belgium, Finland, Ireland, Spain, Sweden, Switzerland and the United Kingdom will have above average growth, while Austria, Denmark, France, Germany, the Netherlands and Portugal will have lower than average growth. Western European dwelling construction shows a declining trend over the 1999 to 2003 period in contrast to growing residential construction in Euroconstruct's 4 CEEC members (table 2.2.5).

Based on the four CEEC members of Euroconstruct, they forecast that residential construction, and especially renovation and maintenance, will become one of the main driving forces for construction. Repair and remodeling is forecast to overtake new construction expenditures by 2003 in other countries too, for example in Finland. Already in Italy the repair and remodelling expenditures are twice those of new residential construction. In Norway the maintenance and renovation expenditures exceed new residential construction.

TABLE 2.2.4

Residential construction forecasts for western Europe, 1999 -2003

	Total value (billion euro) 1999	Percent variation in real terms on previous year				
		1999	2000	2001	2002	2003
Austria	12.8	-3.8	-0.1	-0.1	0.5	0.4
Belgium	12.8	0.9	3.3	2.5	2.8	2.9
Denmark	5.9	0.0	9.4	-9.5	4.5	4.5
Finland	5.6	7.0	5.0	4.0	2.0	0.0
France	53.2	7.5	5.5	-2.7	1.4	1.8
Germany	126.0	-0.2	-3.7	-1.2	0.2	1.0
Ireland	7.6	9.1	9.4	5.1	5.2	3.6
Italy	51.2	5.7	6.0	3.2	1.2	0.0
Netherlands	17.3	1.4	3.6	3.3	-0.7	-1.0
Norway	5.6	5.7	7.4	5.9	3.4	6.6
Portugal	10.1	10.8	7.7	2.2	6.5	-8.5
Spain	30.0	10.5	8.4	2.8	1.8	1.9
Sweden	5.8	9.0	4.8	11.1	7.9	4.8
Switzerland	9.9	-2.5	2.3	2.0	2.3	2.0
United Kingdom	37.8	-4.2	3.5	4.1	3.2	2.0
Total western Europe	391.6	2.6	2.4	0.7	1.2	1.1

Note: 1999 is estimated and 2000 to 2003 are forecasts.
Source: Euroconstruct, 2001.

TABLE 2.2.5

Dwelling construction in Euroconstruct member countries, 1999-2003
(1,000 dwellings)

	1999	2000	2001	2002	2003
Austria	24	21	19	17	16
Belgium	28	30	33	33	34
Denmark	11	10	9	10	11
Finland	10	12	12	13	13
France	188	197	190	190	190
Germany	237	225	210	200	210
Ireland	37	41	43	46	48
Italy	46	44	48	50	52
Netherlands	58	55	58	58	58
Norway	20	22	22	22	23
Portugal	37	38	40	36	30
Spain	160	155	130	110	100
Sweden	5	7	9	11	12
Switzerland	14	15	14	14	14
United Kingdom	143	138	140	139	140
Western Europe	1,018	1,010	977	949	951
Czech Republic	12	14	14	15	14
Hungary	15	18	20	20	23
Poland	39	42	46	50	52
Slovakia	8	9	10	10	10
Central Europe	74	83	90	95	99

Source : Euroconstruct, 2001.

In Denmark, and presumably in France, Germany and Switzerland to some extent, the exceptionally high construction expenditures in 2000, especially repair and remodeling, are linked to the December 1999 windstorms. Overall damage to buildings in Denmark was estimated by Euroconstruct at 1% of GDP. As the repairs were done in 2000, there is negative growth in the construction sector forecast for 2001.

In conclusion, residential construction is expected to fare well in the Czech Republic, Hungary, Poland and Slovakia, which could indicate a general trend in other CEECs; however, statistics were not available to document this assumption. Western European countries have vastly different outlooks for residential construction in the short term. The repair and remodeling segment should be a factor that buoys up stagnant construction in many European countries.