

HardwoodMarkets April 2004

News Summaries

Impact of EU enlargement

Ten countries will be joining the European Union from 1 May 2004. This expansion will have an immediate impact on the wood industry by reducing transit times and transaction costs on cross-border trade between Eastern and Western Europe.

However, the more important changes will be gradual. Economic growth is expected to be significantly boosted in the accession countries, generating new domestic demand for lumber products. This may eventually decrease wood products available for export. Rising costs of legal conformance and labour in the accession countries is also likely to reduce the price competitiveness of manufacturers in the long term. Eastern European wood product manufacturers will have to move upmarket to avoid loss of market share to Asian competitors.

Log shortages anticipated in China

The log trade between Africa and the Far East has been disrupted by exchange rates. The strength of the euro against the Chinese yuan has meant that African shippers have been under tremendous pressure from Chinese buyers to reduce prices. However shipping problems and delayed purchases by Chinese buyers have meant that log stocks in China are now much reduced and there is talk of major shortages just around the corner. In Europe, after a reasonably positive start to the year, there were signs of a return to more sluggish market conditions for African logs in March. Limited availability has meant that demand for certain species like iroko and afzelia has exceeded supply, but overall consumption has remained subdued.

African sawmills active, but not making much money

African sawmills are generally active and have fairly full order books for the next three months. Domestic log supply is tight but reasonably well balanced with current levels of demand so that forward prices have been stable in recent weeks. Nevertheless, African sawmills continue to struggle to make money.

Meranti prices stable

The fine balance between limited supply and restricted demand is being maintained in the Malaysian meranti sawn lumber market. Continuing poor weather, increased control of harvesting operations, restrictions on the wood trade with Indonesia, and increased diversion of logs to plywood mills, have meant that available log supplies to Malaysian sawmills remain very limited. However, due to subdued demand, C&F Europe prices for dark red meranti have yet to show any significant gains. Only marginal price increases were reported during March in response to increased freight rates.

India: frustrated potential

For the hardwood sector - as for so many other industries - India remains a country of vast potential which is frustratingly difficult to realize. Import tariffs are high, the importing and sawmilling sector is extremely fragmented, timber knowledge is heavily geared towards teak and a limited range of other tropical hardwoods, and importers suffer from lack infra-structure. Nevertheless the

emergence of a new middle class combined with problems in tropical log supply is beginning to open up new opportunities for alternative hardwood suppliers.

US market supply-led

The US economy continues to improve and sectors relevant to hardwood demand are performing well. The US hardwood market is now supply-led following a long period of reduced production. American hardwood lumber prices are generally firm.

US export demand improving

Indications are that export demand for American hardwood lumber is improving. Despite the recent marginal strengthening of the dollar against the euro, the exchange rates are still favourable for US exporters. Demand for American hardwood in mainland China is good and expanding, while demand is also improving in North-east Asia, Thailand and Malaysia. European demand is more patchy, although importers in some markets have been encouraged to restock by fears of future supply shortages.

Italian innovation and design skills see off the competition

The Italian furniture sector is under increased pressure from overseas competitors, particularly now that the euro is so strong. However, many commentators believe product diversity and design and production innovation will help Italian manufacturers. The recent Saiedue show in Bologna suggests they have reason to be confident.

2003 EU import highlights

Tropical log imports into all the leading EU countries declined during 2002 and 2003. This reflects increased restrictions on log exports in supply countries, increased diversion of African logs to the Far East, and a shift to added value processing in tropical countries.

- During 2003, Spain overtook Italy as the leading EU importer of tropical sawnwood.
- Italy is the main import market for sawn beech in the EU, with most of the volume coming from the former Yugoslavia. Italian beech lumber imports declined during the last 2 years. Spanish beech lumber imports rebounded in 2003, with volumes increasing from Germany, France and Ukraine.
- Spain remains the largest EU market for oak sawn lumber, however volumes have been declining. Meanwhile Italian oak sawn lumber imports have been rising, coming close to Spanish imports in 2003.
- UK and Belgian imports of Indonesian plywood have been declining due to supply problems, to be replaced by imports from Brazil, Malaysia and China.
- Imports of tropical hardwood veneer have increased significantly into France and Italy since 2001.
- UK imports of wood furniture have risen steeply during the last 2 years to reach over 2.5 billion euro.

Editorial: EU Enlargement

This issue focuses heavily on Europe, a reflection both of the global significance of the EU hardwood market and the profound changes currently underway in the region. The accession of 10 new members on 1 May will change the nature of the EU, redefining its political, economic and cultural balance.

The effects are explored in our lead article. The movement of manufacturing activities from western to eastern Europe is likely to become more deeply entrenched; and the pace of economic development in eastern Europe should pick-up. The shift in the balance of demand for hardwood primary products from western to eastern Europe is likely to continue.

Meanwhile, there will be mounting pressure on Western European manufacturers to respond to the competition through investment in higher value and more cost-efficient production that is directly responsive to customer demands.

This theme is explored in more detail in our article on the Saiedue show in Bologna (page 9). Saiedue provided an opportunity for the Italian wood processing and furniture industries to showcase their exceptional expertise and innovative ability. It was as if Italian industry designed the show to send out a challenge to their competitors - 'if you want to compete, then match this'.

At such a time of rapid change, it becomes even more important for the hardwood trade to monitor significant trends. Hence our efforts to bring you the latest EU trade data and to continuously improve analysis. 2003 hardwood import data for all EU countries is subject to thorough review on pages 10-15.

Rupert Oliver

EU Enlargement Implies Big Changes for the Wood Sector

From 1 May, 70 million people in Eastern Europe will become citizens of the European Union. Eight countries in the region, along with Cyprus and Malta will become the EU's newest members.

From that date, European laws will take precedence over national laws and customs codes will be replaced by the rules of the European single market.

There will be some immediate impacts on the wood industry. Border controls between East and West Europe, which have created long delays and raised transaction costs, will be removed overnight. And once the acceding countries become members of the EU, they will be obliged to adopt the EU's external trade regime with third parties. This will have potential implications for the cost of wood raw material from Ukraine and Russia.

However most of the changes associated with the EU's expansion will not be so sudden. Governments and firms have been planning for this moment since communism collapsed in 1989-91. Most barriers to trade in goods between the EU and the new members have already fallen, leaving only a few to go in May. These last restrictions cover only about 5% of total trade by value, mostly farm products.

Big economic adjustments in the private sector of accession countries have already taken place. Privatisation and trade liberalization measures in the past decade have meant that foreign direct investment (FDI) has poured into accession countries in the past decade. The new investors have been drawn by a combination of low wages and guaranteed access to EU markets.

In the hardwood sector, FDI has been particularly significant in Poland. Poland's wood processing sector has been substantially privatized and German investment has helped develop it into one of the four largest in Europe. Poland has also benefited more than other acceding countries through inward investment in furniture manufacturing. In the last decade Poland has emerged as one of the world's leading furniture producers.

Future impact

For historical reasons, the industries in the acceding countries were initially more fragmented than in the E.U. However the progressive opening of the EU market and increased exposure to global competition, notably from China, have driven consolidation in the region's wood products sector.

Major changes have been made in anticipation of the EU accession. But that is not to say that the process of transformation in accession countries is anywhere near complete.

At present levels of per capita wood consumption in the accession countries are low compared to the EU. However this gap is expected to close as economic growth in the acceding countries is boosted with free access to the EU's internal market and easier access to capital and EU development aid. Construction sector activity is expected to rise. This combined with rising consumer wealth is expected to increase the volume of wood products consumed domestically by accession countries and to reduce availability for export. The European Parliament's Economic and Social Committee has predicted that sawnwood consumption in the accession countries could double in the next few years.

Meanwhile, wood products manufacturers in the region will have to face up to new challenges. Many still have more to do to comply with EU laws, regulations and standards, particularly those to

do with labour and the environment. Moves to implement these laws, combined with rising wage rates associated with economic growth, will tend to undermine price competitiveness.

This implies that the main wave of new factory-building in accession countries may even now be passed its peak, particularly as competition from China has intensified. Manufacturers in the accession countries will now be under growing pressure to move up the value chain and to avoid getting locked into low value-added activities.

Nevertheless, manufacturers in the accession countries will continue to have significant advantages over their Asian rivals. Productivity is higher, tariff and border problems are disappearing, shipping costs are lower, and the business environment is more familiar. As for medium-sized firms in western Europe that want to cut costs but lack the resources to cope with exotic business environments, Eastern Europe will offer a very reassuring option for investment and outsourcing once it is within the EU.

These factors, combined with ready availability raw material and an emerging domestic demand, suggest that European sawn lumber and processed timber production is likely to continue its shift eastwards for some years to come.

Implications for EU forestry

EU enlargement will have a major impact on the structure of the EU's forest resource base. Collectively the acceding countries have around 23 million hectares of forest, compared to 113 million hectares in the EU-15. However, whereas a large proportion of forests in the EU 15 are unavailable for wood supply, the vast majority of forests in acceding countries are available. Enlargement will increase the total area of production forest in the EU by around 50%.

5.65 million hectares of forest in the new accession countries, around a quarter of the total area, are of hardwood. Poland and Hungary possess the largest hardwood resources in the accession countries.

A relatively high proportion of forest land in accession countries remains in public ownership. Comprising relatively large areas under central control, state forests in accession countries have been well adapted to forest certification . Large areas have been certified to the FSC in Poland and in the Baltic States.

Private forest ownership has increased in the accession countries as a result of an ongoing land reform process. There are around 2.9 million new private owners each with an average of around 2 to 3 hectares. Ensuring profitable and sustainable management of these forests by inexperienced owners presents a major challenge for the forest authorities of the accession countries.

This article draws on a paper by PriceWaterhouseCoopers 'The Impact of EU Enlargement on the Forestry, Forest Products and Paper Industry' available at:

http://www.pwc.com/gx/eng/about/ind/forest/forestry_report_5.pdf

India: Emerging middle class creates new opportunities

It is usual these days to draw comparisons between India and China. With a population of just over 1 billion, India comes close to matching China's population of around 1.3 billion. As in China, the Indian government has embarked in recent years on a program of trade liberalization. This has served to boost economic growth. The Indian government is forecasting 8.1% growth this year, which would surpass China's expected growth of 7% this year. At first sight, these comparisons have raised expectations that India may be the next Asian 'tiger economy', sucking in manufacturing industry by virtue of its limitless supply of cheap labour.

A different prospect from China

However, the data may be misleading. India is a very different prospect from China. For all its recent success, India remains a poor country, with a per capita income of about USD480 - roughly on a par with Senegal. Half of all Indian children are undernourished and nearly half of the women cannot read. For a variety of reasons - poor infrastructure and corruption usually top the list - India has so far been unable to emulate China's success in attracting massive foreign investment. In 2001, India recorded just USD4 billion in foreign direct investment, compared with USD47 billion in China, according to data compiled by the U.S. Embassy in New Delhi. Unlike China, much of India's recent economic growth has been built on service industries such as information technology, banking, insurance, and health care, rather than on manufacturing. In fact manufacturing as a share of the Indian economy has actually decreased over the last decade, to about 24 percent.

Frustratingly difficult market

For the hardwood sector - as for so many other industries - India remains a country of vast potential which is frustratingly difficult to realize. An immediate problem is the series of high and confusing tariffs applied to sawn lumber and other processed wood products, combined with the strong prevailing culture of log imports. Imports of sawn lumber and other processed products are subject to various duties, including a 'basic' duty, a Countervailing Duty (CVD) and 4% Special Additional Duty (SAD).

These barriers are being eroded, but only slowly out of necessity. India's log supply problems are mounting as greater restrictions on log exports are being imposed by major supplying countries and as larger log volumes are now being diverted to China. In January this year the Indian Government agreed to remove the 4% Special Additional Duty on hardwood lumber products. At present hardwood lumber is subject to a total of 20% import duty and hardwood veneer is subject to a 39.2% duty.

Fragmented wood industry

Identifying new market opportunities for hardwood products in India remains difficult. The nation's wood industry is very fragmented. For example, the average sized sawmill in Bangalore, of which there are 100, employs 10 people. While there are many regional sawmill owners associations, there are no national timber trade associations.

Indian importers and carpenters are currently geared towards the use of a limited number of dark tropical hardwoods supplied mainly in log form. India's furniture sector is dominated by small craftsmen that supply custom-made products using lumber from small sawmills. Teak is by far the dominant species derived both from domestic plantations and imported mainly from Burma. Other

species that are widely used include merbau (mainly from Indonesia); rubberwood (from domestic plantations); rosewood (domestic and imported from Thailand); and honne, from Australia. This strong preference for tropical hardwoods partly reflects their natural durability in Indian conditions. India's climate does not favour temperate hardwoods and many importers do not have covered space to store them.

New middle class

Nevertheless, opportunities for market expansion of other hardwood products do exist. The recent development of service industries in India is driving an unprecedented and long-awaited expansion in the ranks of the middle and upper classes. According to research by the National Council of Applied Economic Research in New Delhi, which recently completed a survey of Indian consumption patterns based on interviews with 300,000 households, the 'middle class' of India, defined by the ability to afford electrical appliances, has grown from 310 million in 1990 to 550 million in 2000. The 'very rich' of India, defined by the ability to afford a car, has grown from 2.5 million people in 1990 to roughly 33 million in 2000.

This expansion of the Indian middle classes has led to the development of a strong residential construction market in the larger cities such as Mumbai (Bombay), Delhi, and Calcutta. The growth of the middle class raises the prospect of strong expansion in domestic furniture and interiors demand. The new middle classes are adopting a new modern lifestyle, in smaller family units and more interested in contemporary design. Much of the construction for the new middle classes comprises high rise and condominium apartments. Often the interior design, installation and furniture are provided as a package. The new rich are already moving from the traditional dark wood styles (teak and rosewood) and towards imported furniture, kitchen fitments and engineered hardwood flooring in lighter colours (including beech, oak and maple). Inevitably this is beginning to encourage the production of similar furniture in India for the domestic market.

Move to temperate hardwoods

Already there are signs that traditional sawmills and importers are moving towards light coloured temperate hardwoods. At present this new demand is heavily oriented towards European beech. Prices for this species have been competitive during the last two years, and Indian importers have preferred to purchase waney-edged lumber which is cheaper than square-edged and allows the sawmills to add value to the product. European hardwood suppliers have benefited in the Indian market from a flexible approach to grading and pricing and from the perception of relatively cheaper freight from Europe.

The growth in hardwood demand in India is unlikely to follow the path of China. It is likely to be more organic resulting from the relatively gradual expansion of the nation's middle class rather than the rapid development of a massive furniture export industry.

Indiawood 2004

A good opportunity to explore new market opportunities is provided by Indiawood, the nation's leading woodworking trade show held every two years. At the latest show in early 2004, about half of all exhibitors came from overseas and many of the Indian exhibitors were representing foreign companies. Hardwood lumber exhibitors came from Denmark (beech) and Italy (European and American hardwoods). The veneer industry and veneer distributors were better represented than sawn lumber. The show is organised by EUMABOIS (The Federation of European Woodworking

Machinery Manufacturers), co-organised by PDA, India and is supported by India's Wood News journal.

African hardwood

Disruptions to Asian trade in logs

China is now the main destination for African logs with business shifting from peeler logs to a wider range of species and supply sources. However the trade between Africa and the Far East is currently disrupted by exchange rate and shipping problems.

The relative strength of the euro against the Chinese yuan has meant that African shippers have been under tremendous pressure from Chinese buyers to reduce prices.

Meanwhile freight rates from Africa to the Far East have continued to rise and availability of shipping capacity has remained restricted. The problems are so bad that there have been reports of logs being shipped to French ports before being trans-shipped to containers for Asian destinations.

The combination of low African log stocks in China, limited shipping opportunities, and restricted supply of alternative logs from the Far East, have raised the prospect of serious shortfalls in tropical hardwood supply in China this year.

European trade cools

In Europe, after a reasonably positive start to the year, there were signs of a return to more sluggish market conditions in March. Limited availability has meant that demand for certain species like iroko and afzelia has exceeded supply, but overall consumption has remained subdued. Indications are that the long-term decline in African log exports to Europe will continue this year. In 2003, tropical log imports into all the major European markets (France, Italy, Portugal, Spain and Germany) declined dramatically.

Freight rates between Africa and Europe have been rising, although most reports indicate that shipping is now reasonably regular. However there have been changes in the destination patterns of ships arriving in Europe which has led to overstocking in some ports and shortages in others. For example, Nantes and la Rochelle are reported to have good stocks, while Sete, Caen, Antwerp and Delfzyl have not been well served.

Much of the focus of log production and exports on higher value African redwood species in recent years has been on Congo-Brazzaville. However due to recent tax increases, the country is now probably the most expensive for forest operations in Africa. The new tax regime has contributed to a feeling of uncertainty over log supplies, particularly for sapele which dominates production in the country. Some companies have responded to the slow market demand for sapele in traditional manner by restricting log production. However, because the new tax levels are largely based on the area of concession rather than the level of production, other companies have responded to declining margins on sapele by increasing production.

Political problems in CAR

At present, political issues are seriously hindering log production and exports from the Central African Republic. According to local press reports, the CAR government is implementing a range of measures with the aim of improving fiscal returns from the nation's timber industry and stabilizing the national economy. In March, CAR timber firms were required to sign an agreement with the government including a commitment to repatriate all their profits from sales abroad and to conduct all their transactions through local banks. Soon after seizing power from President Patasse on 15

March 2003, CAR's President Bozize suspended all timber activities pending audits in firms and national conferences to define the country's new forest sector policy. In January 2004, the government established special armed brigades to fight corruption in the sector. However timber exploitation activities have not yet officially resumed.

Log supply problems in Cameroon have now eased to some extent with the issue of logging licenses and improved logging conditions.

Cameroon forestry review

Since early March, the Cameroon Ministry of the Environment and Forestry have been engaged in a consultation exercise with stakeholders to review progress towards sustainable forest management and assess the contribution of the forest sector to national development. So far the results, perhaps inevitably, have indicated that progress towards SFM continues to be hampered by insufficient human, material and financial resources for forestry control activities and legal enforcement. Problems of enforcement, combined with bureaucratic delays in the allocation of logging licenses, have meant that illegal logs continue to form a significant component of log supply in Cameroon. Trade sources estimate that perhaps 5000 m³ of logs from illegal sources may be arriving at Douala each month.

Coup attempt in Congo-Kinshasa

There was an attempted coup in the Democratic Republic of Congo (DRC) on 28 March, during which four military bases around Kinshasa, the capital, were attacked by armed assailants. Although this does not seem to have had any direct impact on forest sector operations, it has contributed to the feeling of uncertainty surrounding the long-term future of the existing regime.

Meanwhile forest operations in the DRC are beginning to open up again. One European operator in the country reports that they have succeeded in opening their sawmill this logging season and to obtain log supplies from their own concession. However such was the level of destruction during the civil war years, this has proved a lengthy and difficult process. Transport to Matadi port is also beginning to improve, partly assisted by provision of EU-funds for reconstruction of the road to the port.

African Sawn Lumber: Sawmills active, but not making much money

African sawmills are generally active and have fairly full order books for the next three months. Domestic log supply is tight but reasonably well balanced with current levels of demand so that forward prices have been stable in recent weeks.

Nevertheless, trading conditions for most mills remain extremely difficult. Costs of production and distribution have risen as log prices and freight have increased. The weak euro and sluggish demand in the main European markets have meant that opportunities to increase prices and improve margins remain limited.

Market problems are particularly pronounced for the entandrophragmas - sapele and sipo - which dominate production in the Congo Basin. European interest in buying these species on a forward basis is constrained by the high euro. Due to intense competition in end-user markets, there are reports of European importers continuing to sell their existing stocks of sapele at below replacement price.

Limited supplies and lack of alternatives have meant that market conditions have been more favorable for a few west African species - such as iroko and khaya.

The strong euro is reported to be dampening demand for African tropical sawn lumber in the Middle East. However, there are signs of growing interest in African sawn lumber in the Far East, particularly heavier flooring timbers such as danta, denya and dahoma, but also including lighter joinery woods like sapele.

African Hardwood Species Notes

Apa: European demand for apa flooring strips remains good.

Acajou/khaya/n'gollon/mahogany: logs are mainly being exported to Spain and Turkey, and to a few buyers in France. Underlying interest in khaya sawn lumber from west Africa remains strong in the United States due to lack of availability of South American mahogany. Khaya FOB sawn lumber prices on offer from West Africa are tending to rise as supplies are now very restricted. However, at present the volume of trade is very confined as American buyers have been deterred by the strength of the euro against the dollar.

Afzelia/pachyloba/doussie blanc: log prices have increased in recent weeks as the species has been in good demand in Italy, Germany, Portugal and Greece at a time when arrivals from Cameroon have been declining.

Agba/Tola: demand for logs remains stable in Portugal, but there are now very few sales of slicing grades to France. Traders anticipate increased availability from DRC (former Zaire) this year, which may undermine prices.

Ayan/Movingui: European demand for logs is steady but volumes involved are limited and only fresh cut large diameters are selling. Demand has benefited from problems in supply of pau amarello from Brazil.

Ayous/wawa/obeche: ayous log prices from Cameroon were tending to firm at the start of 2004. However, in more recent weeks ITTO reports that euro prices for B grade logs which are destined mainly for Asia have been weakening under pressure from Chinese buyers. Supplies for wawa sawn lumber from Ghana have loosened up a little in recent weeks after a period of limited availability earlier in the year. South Africa and the United Kingdom are buying wawa lumber in steady volumes. Prices have firmed a little this year. In the UK kiln dried wawa sawn lumber is being offered at around

Malaysian Sawn Lumber: Quiet market

The fine balance between limited supply and restricted demand is being maintained in the Malaysian meranti sawn lumber market. Continuing poor weather, increased control of harvesting operations, restrictions on the wood trade with Indonesia, and increased diversion of logs to plywood mills, have meant that available log supplies to Malaysian sawmills remain very limited.

There are reports that kiln plants in the Klang area of Peninsula Malaysia are working well below capacity and that shippers are having difficulty building up an unsold stock position. As a result, shipping times to Europe are expected to become more extended in coming weeks.

However, due to subdued demand, C&F Europe prices for dark red meranti have yet to show any significant gains. Only marginal price increases were reported during March in response to increased freight rates.

Dutch market slow

The key Dutch market for dark red meranti remains very slow. Economic conditions have yet to show any signs of improvement and activity in the construction sector remains slow. In January and February, intense competition between importers meant that onward sales prices for dark red meranti to manufacturers were under a lot of pressure. This pressure eased somewhat in March as the dollar strengthened a little against the euro, which served to push up replacement prices, and with the growing realization on the part of importers that the Malaysian supply situation is extremely tight. Lack of log supply has meant that shippers have been making very few offers in the sizes and grades which are popular in the Netherlands, such as 3x5 meranti bukit. And because Dutch importers have been unwilling to commit forward in recent months, stocks on the ground in the Netherlands have been falling and there is now very little wood in transit to the country.

In contrast to meranti, sales of merbau have been reasonably active in the Netherlands in recent weeks. This reflects lack of availability of iroko and doussie, competing African species. However volumes involved are small compared to meranti.

Limited forward buying in UK

Trading companies with meranti stock on the ground in the UK report consistent buying of dark red meranti at the relatively low levels that have come to characterize this market in recent years. Agents report only limited forward demand from UK importers at present, with most now content to buy when necessary from the larger stockists in the U.K. and on the continent. Although overall meranti supplies in Malaysia are very restricted, UK agents report that spot offers are coming through on meranti tembaga which is preferred in the UK and this product may be obtained for fairly quick shipment. However Sabah seraya majau - a premium product comprising a single species of seraya with consistent colour and density - is very difficult to obtain.

UK importers are now experiencing significant difficulties obtaining adequate volumes of keruing lumber for the truck floor trailer business. Shippers have been unwilling to supply UK importers with keruing boards in their preferred sizes, instead insisting that buyers take a mixture of thick and thin boards. In practice, Malaysian shippers are finding it more cost-effective to divert their available keruing lumber production to less demanding markets in the Far East.

Reports from Germany indicate only slow forward demand for Malaysian meranti sawn lumber at present. Existing landed stocks are reported as generally sufficient to meet current levels of subdued demand.

Active decking market

The European market for balua/bangkarai decking has been active this year and prices have been firm. C&F prices are tending to rise due to increases in freight rates. Although prices for Brazilian decking are often more competitive, shipping problems from Brazil have encouraged many European buyers to rely on the Malaysian product.

New EU Tariffs: Retaliatory measures

On March 1, 2004, the EU began to impose retaliatory trade sanctions on a number of U.S. products, including a range of wood products, as a result of the WTO ruling that the FSC/ETI provisions of the U.S. Internal Revenue Code constitute a prohibited export subsidy and are in violation of WTO rules. The United States' FSC/ETA legislation is designed to ensure that US companies are not disadvantaged by the differences between US and foreign tax laws.

After years of litigation, in May 2003, the WTO Dispute Settlement Body authorized the EU to impose sanctions on USD4.043 billion worth of U.S. exports, if the United States fails to comply with the WTO decision. The U.S. Administration and Congress are currently working towards repealing the FSC/ETI provisions in order to achieve U.S. compliance with the WTO ruling.

Although the EU is authorized to retaliate on USD4.043 billion of U.S. exports, it has chosen not to implement retaliation on the full amount at once. Instead, the EU is phasing in the trade sanctions. The EU will initially impose an additional duty of 5 percent on 1,608 U.S. products. The duty will rise automatically by 1 percentage point each month until it reaches a ceiling of 17 percent in March 2005. At that point, the EU will decide on its next course of action if the United States still has not complied with the WTO ruling.

The list of product codes subject to sanctions includes 93 codes from chapter 44 of the harmonized system list covering wood products. While lengthy, the list has been developed to target products that may be directly substituted by EU production. It tends to exclude products for which there is no direct European equivalent. Logs, rough sawn lumber, and veneers of the majority of American hardwood species are not in the list. However birch sawlogs and beech sawlogs and sawn lumber are included, so too are a wide range of tropical sawlogs, lumber and veneer products. A wide range of softwood products are also in the list, including all coniferous sawlogs, poles, and fir rough sawn lumber.

All U.S. plywood, blockboard, particleboard (including OSB), and fibreboard (including MDF) supplied to the EU are subject to the tariff, as well as a wide range of further processed products including all sawn lumber that has been sanded, planed or finger-jointed, mouldings, and other machined wood, parquet panels, windows and their frames, doors and their frames, kitchenware and marquetry.

North American Hardwood Supply: Productions levels down

Production levels have remained well below historical levels in recent months. Long term problems are restricting log availability. Many mills are having difficulty finding loggers due to high workers' compensation insurance rates and poor returns on investments in the logging profession. Obtaining trucks for log transport at reasonable prices has become another severe problem in many areas. Kiln drying capacity in the United States has also declined in recent months as some exporters shut down kilns in response to low margins.

The weather has been unpredictable and generally unfavourable for logging for the last year or so. There continue to be localized problems. For example, in the Lake States region warmer weather conditions coupled with heavy rains resulted in a rapidly melting snow pack and generated significant flooding in several areas.

Spring weather brings relief

However, warmer spring weather is now bringing relief in some regions and allowing log decks to be rebuilt. Sawmill production is also improving, although kilning continues to be hampered by the relatively high moisture content of winter-cut stock. Nevertheless, most analysts suggest production is unlikely to be sufficient to allow a significant build up of inventory levels before the second half of 2004.

In northern regions, buyer interest is currently focused on the regionally important maple species. Buyers are keen to obtain the last remaining winter-cut stocks which are valued for their lighter more consistent colour.

Relatively restricted availability of logs has meant that the rising level of log exports from the United States is becoming a more controversial issue. Most log exports are destined for Canada, but there are also reports of a significant increase in demand for American hardwood logs in China and Italy during the first quarter of 2004. This demand has focused particularly on red oak, walnut, and poplar logs used for production of both veneer and sawn lumber.

North American Export Markets: Improving demand

Indications are that export demand for American hardwood lumber is improving. Despite the recent marginal strengthening of the dollar against the euro, the dollar-euro rate remains favourable for US exporters. The Japanese yen and Canadian dollar have also remained strong against the dollar. Since the yuan is pegged to the dollar, exchange rates are less of a factor in exports of hardwood to China, except indirectly as the weak yuan has provided a strong boost for exports of Chinese manufactured products.

The European market for American hardwood remains patchy, but demand in East Asia has been good, driven particularly by the strength of the Chinese economy. For many exporters, a significant problem has been to secure adequate volumes of certain North American hardwood items - such as white oak in thicker sizes - to fulfill orders. Limited availability and steady demand has meant that dollar export prices for most species and grades have remained firm. U.S. suppliers have also been frustrated by overseas buyers increasing demands for higher specification material which has not always been combined with a willingness to pay more. With U.S. domestic consumption rising and intensifying competition overseas, U.S. producers are tending to reduce their dependence on export markets.

European buying of American hardwoods improved during January and February due to the weak dollar, low stock position of most importers, and concerns over future availability. This was particularly true of southern Europe and Germany. Some European contacts suggest that continuing economic uncertainty combined with slight strengthening of the dollar led to a slowdown in purchases during March. However, U.S. exporters are generally more upbeat about the European market, suggesting that demand is slightly ahead of last year. All contacts agree that the European market remains intensely competitive and that many importers have been reluctant to pay higher dollar prices for American hardwoods despite evidence that supplies are restricted.

Euro pressurises European exports

The strong euro means that manufacturers throughout Europe are under intense pressure from overseas competitors, notably in Asia. Cost-cutting efforts continue. Western European manufacturers have tended to shift to purchases of wood components on a just- in-time basis. Manufacturers are now more inclined to demand tighter specifications for width, length, colour and grain, while demand for random width lumber has tended to decline. These trends have inevitably benefited local dimension mills, many of which rely on European hardwoods, and undermined markets for American hardwood in Europe. The accession of 10 new countries to the E.U. in May, mainly from Eastern Europe, is likely to intensify this trend with the removal of the remaining barriers to the flow of eastern European lumber products into Western Europe.

From 1 March 2004, the E.U. imposed retaliatory duties on a range of further processed wood products, although most American hardwood log and rough sawn lumber products have been excluded (see following article).

U.K. market comes to life

Considering individual E.U. markets, reports from the UK suggest increased buyer interest during March and early April in response to low stocks and increasing concerns over lack of forward availability. UK agents suggest that lack of supply of American hardwoods may encourage a further switch to European hardwoods in coming weeks. Some reports suggest a recent resurgence in U.K. demand for American ash lumber, although it remains to be seen whether this will be sustained.

After a good start to the year in Germany, American hardwood lumber sales slowed again in March. Demand for American hardwoods in Italy has remained reasonably buoyant, notably for white oak and alder. There has been steady demand for American hardwoods in Spain, although buyers are becoming more demanding in terms of specification with little willingness to pay more. Spain is tending to import more American tulipwood and less American white oak.

Chinese demand growing

Most reports indicate that American hardwood lumber demand in mainland China remains strong and is growing. This is partly at the expense of exports to Taiwan, Hong Kong and other parts of South East Asia where manufacturers are struggling to compete against their Chinese competitors. Chinese demand has also been undermined to some extent by the threat of a U.S. anti-dumping duty on imports of wooden bedroom furniture from China. The U.S. International Trade Commission (ITC) is due to issue a preliminary ruling on the duty on 28 April.

Nevertheless, many American hardwood exporters are currently reporting full order files for China and suggesting that the main factor limiting sales is lack of supply rather than demand. There has

been particularly good demand in mainland China for flooring blanks of red oak, white oak, and hard maple. Demand for sawn lumber of walnut, white oak, tulipwood and cherry has also been good. Much Chinese demand is focused on 4/4 in the common grades.

The Chinese market remains highly competitive, but exporters have been able to edge prices higher in recent weeks. Most exporters expect sales and shipments into China to remain robust in coming months.

The North-east Asian markets have become more active in recent months. The Japanese economy has been improving, while the stronger yen is also helping to boost interest in American hardwoods. The South Korean market has also been more active, particularly for ash.

Reports from South-east Asia are mixed. Demand in Thailand has improved, particularly for tulipwood. Prospects in Malaysia are also improving as the country's economy is growing strongly once again while supplies of domestic hardwoods and rubberwood are becoming more restricted. However demand in Indonesia remains sluggish.

Stable shipments to Canada

Sales and shipments from the U.S. to Canada have remained reasonably stable, with supply being the major constraint for increased exports. The strong Canadian dollar has meant that U.S. lumber suppliers have been more competitive than domestic Canadian lumber producers. Canadian manufacturers that rely heavily on exports of finished goods to the U.S. have benefited from the economic recovery, however the strength of the Canadian dollar has meant they have been less price competitive.

Good volumes of red oak and smaller volumes of white oak, tulipwood and soft maple are being shipped to Mexico. Mexican manufacturers are benefiting from the recovery in the US. Increased freight rates from the Far East are tending to improve the competitive position of Mexican manufacturers in U.S. finished goods markets.

North American Domestic Market

Improving prospects

Prospects for the U.S. economy improved in March with the news that non-farm payrolls surged by 308,000 during the month, the biggest leap in employment in four years and nearly four times most economists forecasts. This news helped alleviate one of the most significant concerns about the current economic recovery, that it has generated far fewer jobs than previous recoveries. The strong March jobs figures lifted the dollar to a four-month high of USD1.20 against the euro. The Economist's Poll of Forecasters in April indicates that U.S. economic growth is expected to be a sturdy 4.7% this year.

At present interest rates are at the lowest levels for 46 years and this is helping to boost consumer spending and to feed a boom in the housing market. Most economists reckon that rates will remain low at least until the end of the year, not least because it would be politically provocative to significantly increase rates in the run-up to a presidential election.

Although the strong growth outlook for the United States is encouraging in the short term, doubts remain over it's long-term sustainability. One threat to the economy is soaring oil prices which hit a 13-year high of over USD38 a barrel in mid-March. High fuel prices are hurting many US industries and are cutting into household real incomes.

Housing boom goes on

For the time being, economic sectors important to the hardwood industry are performing well. The U.S. Census Bureau reported total housing starts during February 2004 were down 4.0% from January 2004, but were up 13.1% on February 2003. The decline in February compared to the previous month reflected inclement weather in some parts of the country, particularly the south and west. Building permits for February 2004, an indicator for future activity, were down 1.5% compared to the previous month but 6.6% compared to February 2003.

The strong housing sector has continued to boost demand for solid wood flooring and wood cabinets. According to NOFMA: The Wood Flooring Manufacturers Association product sales through February 2004 were up 11% compared to the previous year. Prices for hardwood flooring products have continued to rise, although there are signs that these prices may be near their peak. Further increases may begin to stimulate loss of market share to imported hardwoods and other competing products

The Kitchen Cabinet Manufacturers Association reports that their members sales increased 17.8% during the first two months of 2004 compared to the same period last year. Domestic U.S. manufacturers have successfully staved off overseas competition in this sector by delivering custom and semi-custom products to customers quickly and efficiently. Most reports suggest there is high degree of confidence that this sector will continue to perform well.

Furniture sector more stable

After three years of serious upheaval, hardwood lumber demand from the US furniture industry is now considerably reduced compared to the late 1990s. Nevertheless there is still significant furniture production capacity in the country, and most analysts seem confident that furniture sector demand will be more stable this year. Furniture plants are likely to continue to close, but at a slower

rate than in 2001-2003. The remaining manufacturers are benefiting from improved consumer demand, although there is intense competition from imported products.

Against this background, hardwood lumber suppliers continue to report continuing good sales of key species and grades. Prices for most items are firm as demand is at least equal to current levels of production.

Saiedue Show

Italian innovation and design skills see off the competition

It is a time of significant change for hardwood markets in Europe. Globalisation has dramatically changed the way wood products and materials are traded and where they are sourced from.

Western European wood product manufacturers are under increased pressure from imports, particularly from China and Eastern Europe. The European furniture industries are undergoing dramatic structural changes. In parts of north western Europe, including the U.K. and Germany, overall production capacity has tended to decline. Throughout Europe, manufacturing companies have had to cut costs by increasing their purchases of semi-finished components and by the use of new materials and production processes. European manufacturers have also sought to remain competitive through greater investment in product design and innovation.

Outstanding wood expertise

Nowhere has this trend been more in evidence than in Italy. Judging by the products on display at the recent Saiedue show in the historic Northern Italian city of Bologna, the Italian wood processing industry has good reason to believe that its future is assured. Everywhere there was clear evidence of outstanding expertise in wood processing and finishing and creativity in product design.

There must be few exhibitions in Europe where you can see so many different hardwood species being used from durable tropical species such as iroko to the fashionable grains of cherry and oaks to more unfamiliar species such as gum, koto, and tulipwood, often stained to be something else.

Builders suppliers' showcase

Saiedue is a showcase for products and materials for the building sector, but wood products and wood based materials feature strongly. This year's show attracted 122,000 visitors, the majority were Italian with around 9,000 from abroad. Total visitors were up from 2003 by 3.5%. The five day show is aimed at building professionals, including architects although the exhibition was open to the public on the final day.

Over the years Saiedue has evolved in response to market changes. One aspect of this has been the creation of themed shows within the main exhibition. Two in particular are of interest to the wood sector, Naturpolis which showcases environmental and sustainable building products and Floorexpo with its strong focus on wood flooring.

Special flooring exhibition

For 2004, a special exhibition of flooring was created as part of Floorexpo, put together by a team of designers it showcased, through a series of wall and floor displays, over 100 different types of floor coverings from the traditional to the innovative. Wood was well represented and a wide range of hardwood species both temperate and tropical provided a strong visual impact for a number of the displays. Historically, darker tropical woods have tended to dominate the Italian domestic flooring market, but the displays confirmed market reports that interest in lighter species such as maple and oak has been rising. Products ranged from pre-finished engineered products to a generic display of seven US hardwood species put together by the American Hardwood Export Council, who also had a stand in Naturpolis.

Major challenges to overcome

While the Italian manufacturing sector's renowned creativity and wood processing expertise may be helping to counter overseas competition, the industry still has some major challenges to overcome. These challenges were the subject of a seminar held at Saiedue organised by the trade magazine Il Legno. The seminar was chaired by the journalist Almerico Ribera and speakers included consultant Paolo Gardino, Maurizio Colella president of the Italian timber trade federation, Fedecomlegno and representatives of leading agents and importers from the main trading regions in Italy.

In his overview of timber import and distribution in Italy, Gardino highlighted the extent of fragmentation in the Italian wood industry. Gardino noted that the top ten major importing companies in Italy accounted for annual imports of only around 420,000 m³. This amounts to only around 5% of Italy's total annual import trade of 10-11 million m³. This compares with the Netherlands, where the top 10 importers account for 3.8 million m³, and Germany where the figure is around 1.3 million m³. There are numerous small distributors in Italy working on low profit margins, which means there is insufficient money needed to invest in research development and promotion.

Italy's small joiners under pressure

Gardino commented that Italy has about 1.2 million joiners (compared to 800,000 in France) and raised the question 'will they exist in the future?' Collectively this sector is a very important consumer of wood products but increasingly exports from industries in China and eastern Europe are eroding their activity. In addition Italy is importing more and more dimension products and added value components.

The other speakers also referred to the break down in the traditional timber supply structure in Italy that has seen small distributors become importers, manufacturers become importers and importers become manufacturers. The traditional role of importers is changing and many now put more focus on services and distribution of finished products. The number of foreign companies from other EU markets trading with manufacturers and distributors in Italy is also increasing, adding to the competitive pressure.

Italian Furniture Sector

The Italian furniture sector is under increased pressure from overseas competitors, particularly now that the euro is so strong. However, many commentators believe product diversity and design and production innovation will help Italian manufacturers to maintain their lead in the global marketplace.

According to Centro Studi Industria Leggera (CSIL) based in Milan, The EU and North America are still the major export markets for Italian furniture. The USA is the number one destination, where Italy is currently the third largest supplier behind China and Canada. Germany is the second most important export market for Italian furniture. Italian exports to Germany peaked in 2000, but then fell dramatically in 2001-2002. Italian manufacturers have faced increased competition in Germany from furniture exporters in Poland and the Czech Republic. In 2002 Italy was the leading supplier of imported furniture to France and UK. Other important markets where Italy has increased its market

share over the past five years are Russia and Spain. In the case of Russia, Italian furniture accounted for 59% of Russian imports in 2002 compared to 48% in 1998.

Italian Flooring Sector

Flooring is a very important sector for hardwood consumption in Italy. According to the Italian wood industries federation - Federlegno-Arredo, wood flooring accounts for 37% of Italy's imports of timber construction products and about 16% of exports.

The value of flooring exported in the period from January to November 2003 was 43 million Euros, with the main export markets being Germany (24%), France (12 %) and Switzerland (11%). The value of imported flooring to the Italian market for the same period was 155 million Euros, with the main supply countries being Indonesia (10%), Austria (9%), France, Croatia and Ivory Coast (all on 8%).