Slowing pace of EU tropical timber imports

Latest trade data shows that the rising trend in EU import value of tropical wood products that began in the second half of 2014 levelled off in the first five months of this year. No trade data is yet available for the period after May when the effects of the UK vote to leave the EU might become clearer. Early indications are that it will lead to a significant slowdown in European tropical wood imports in the second half of 2016 in response to currency movements and economic uncertainty in the UK, currently the largest European market for tropical wood products.

Charts 1 to 3 below show the monthly trend in imports of tropical wood products into the EU to May 2016 using 12 month rolling totals. This is calculated for each month as the total import of the previous 12 months. The data removes short-term fluctuations due to seasonal changes in supply and shipping schedules and provides a clear indication of the underlying trade trend.

Chart 1 shows total EU € import value of all wood products listed in Chapter 44 of the HS codes sourced from tropical countries. Total imports in the 12 months to May 2016 were €2.29 billion, only slightly above €2.26 billion recorded for the 12 months of 2015. The sharp increase in imports of tropical decking and mouldings recorded in 2015, notably from Brazil and into the UK and France, has slowed dramatically in 2016. Imports of tropical flooring products have also slowed this year. However, European imports of tropical sawnwood, veneer, logs, energy wood and joinery products such as LVL continued to rise between January and May 2016. After recovering in 2014, European imports of tropical plywood remained static between January 2015 and May 2016.

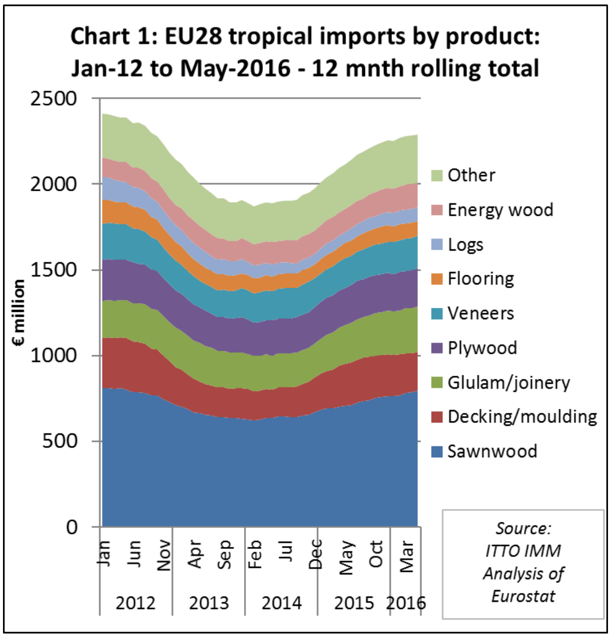


Chart 2 shows how European imports from the major tropical supply countries developed between 2012 and May 2016. After rapid growth in 2015 and the first quarter of 2016, European imports from Indonesia (dominated by decking, doors, plywood and LVL) stabilised at the higher level in April and May this year. Imports from Malaysia (mainly sawnwood, plywood, doors, and LVL) remained static at a relatively low level between mid-2015 and May 2016. Imports from Cameroon (almost all sawnwood) were rising sharply in the year to May. However, imports from Brazil (mainly sawnwood and decking) fell rapidly between September 2015 and May 2016.

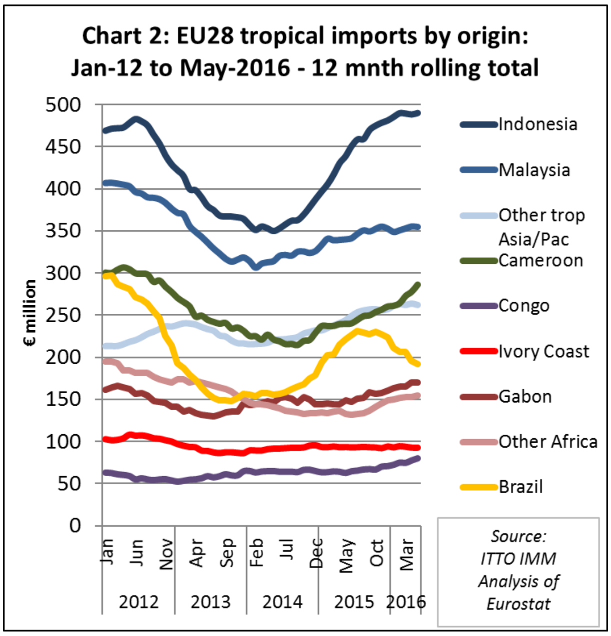
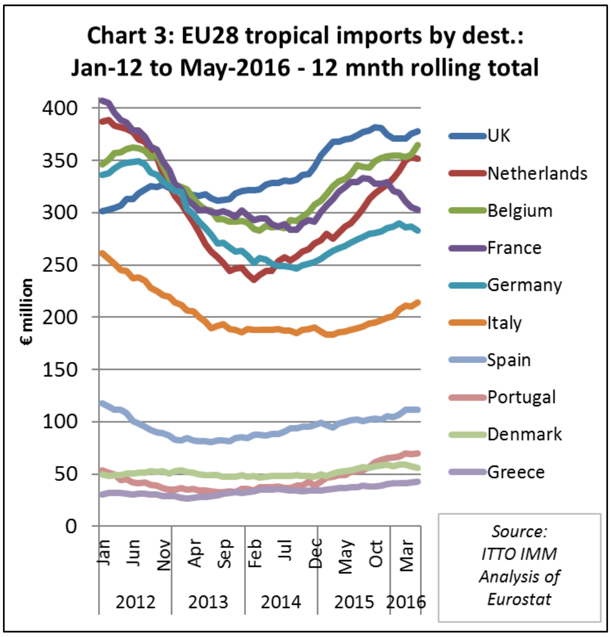


Chart 3 shows the recent trend in tropical wood imports into the main EU consuming countries. The pace of growth in imports into the UK (the leading EU market which takes mainly doors, plywood and sawnwood) was already slowing in the early months of 2016 before the Brexit vote. Imports into Belgium (mainly sawnwood and decking) and the Netherlands (mainly sawnwood, LVL and decking) continued to rise in the first five months of 2016, narrowing the gap with the UK. Imports have also continued to rise this year into Italy (mainly sawnwood and veneer), Spain (mainly sawnwood and veneer) and Portugal (mainly sawnwood, logs and chips).

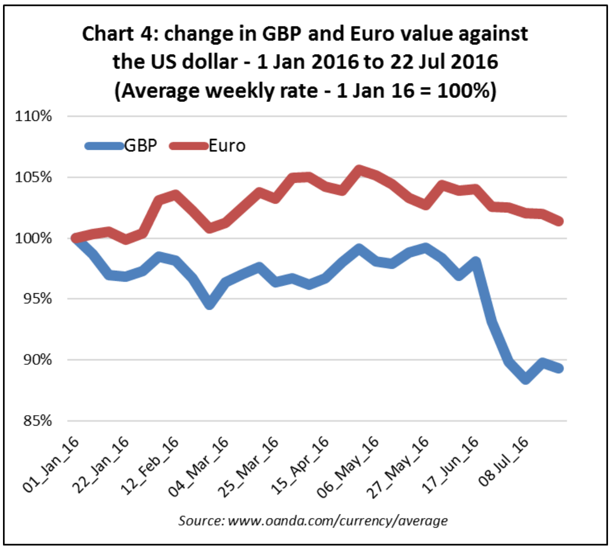
In contrast, imports into France (mainly sawnwood, decking and veneer) were declining during the first five months of 2016, due to weakening imports from Brazil. Imports into Germany (mainly decking and sawnwood) also dipped a little in April and May this year.



Lower European imports expected in second half of 2016

The fall-out from the Brexit vote on 23 June, combined with challenging economic conditions in other parts of the Europe, particularly Italy, is likely to lead to a downturn in European imports in the second half of 2016.

Feedback from UK timber importers in the aftermath of the Brexit referendum vote on 23 June is that their most immediate concern is the exchange rate. The value of the British pound, which increased from 1.41 to 1.50 against the US dollar in the days leading up to the referendum on the expectation that "Remain" would win, fell sharply to a 30-year low of $1.29 on 6 July after the result. By 22 July it had recovered only slightly to $1.31. The euro, already low against the US dollar after a dramatic fall in late 2014 and early 2015, also weakened following the referendum from $1.14 on 22 June to €1.10 on 22 July (Chart 4).



UK import prices for hardwoods, particularly when invoiced in dollars, have therefore increased sharply since the referendum and a prolonged hiatus in purchasing is now expected. Merchants and manufacturers already appear to be hunting for landed stock before looking to order from overseas. The extent to which prices for stock already landed in the UK now also rise depends on availability and the extent to which consumption slows in response to wider economic uncertainty.

For now, UK importers report there is good availability of landed stock of most of the key commercial hardwoods. Overall there is probably enough stock on the ground to tide the bulk of the UK market over the summer months. There's therefore likely to be a sharp slowdown in orders from UK importers at least until September and probably longer.

UK importers report that sales to manufacturers and merchants did not dry up after the referendum, although buying was quiet for the last week of June when there would usually be an uptick in activity. There are reports of some UK customers, while not placing new orders, sending out long lists of requirements. As one agent commented, "it looks like they are fishing for new price structures as nobody is yet sure where the market will settle".

No one yet knows what the real economic impact will be of the Brexit vote. But of course markets generally don't like change or uncertainty and the Brexit process means that the period of uncertainty will be prolonged. Some major investors will delay decisions, while tens of thousands of smaller investors will also wait to see what happens. Government tax receipts and spending are likely to be curtailed. This is likely to dampen economic growth in the UK over the next couple of years or more.

Early indications are that the short-term economic impact of Brexit has been severe in the UK. Following the referendum, major house builders in the UK suffered initial blows to their future forecasts and analysts are predicting a slowdown in the market along with increased costs of 10-12% for major construction projects, leading to more being put on ice.

The UK Purchasing Managers Index (PMIs) compiled by Markit dropped to 47.7 in July from 52.4 in June, the sharpest one-month drop on record and a decisive shift from expansion to contraction (50 being the threshold value). Both services and manufacturing recorded sharp declines, with a small silver lining being an apparent increase in new export business, helped by the steep drop in the British pound.

But there are some reasons for optimism. The indexes stand in contrast to a report published on 20 July by the Bank of England based on interviews with businesses around the UK saying there had been no clear evidence of a sharp slowing in activity, although uncertainty had risen. And the PMI may have been coloured by political uncertainty that has decreased with the relatively rapid appointment of a new British Prime Minister on 13 July.

No sign yet of Brexit contagion

There is also no sign yet of any significant contagion from the Brexit vote in other European markets. The Markit Flash Eurozone Manufacturing PMI came in at 51.9 in July, down from 52.8 in June but only slightly below market expectations of 52. Although Eurozone export growth slowed in part due to lower sales to the UK this was offset by increased export orders to other markets due to the weaker euro.

In Germany, the widely watched IFO business climate index dipped to 108.3 in July from 108.7 in June. That was both better than expected and the second-highest outcome this year. In other words, business expectations slid, but only marginally.

The French economy has shown signs of improvement this year with latest GDP data to end March 2016 registering the strongest annual expansion since 2011. Even after the British vote to leave the EU, both the finance ministry and the International Monetary Fund (IMF) maintained their forecasts for France to show growth of 1.5% in 2016. However, the strength of economic recovery is still uncertain. The Markit composite PMI for France stood at 50 in July, the threshold that divides expansion from contraction. The data suggests a continued slump in French manufacturing output which is erasing a return to growth in services.

Apart from Brexit, weakness in the Italian economy remains the primary concern in the EU. Italy's economy is unlikely to return to pre-crisis levels for close to a decade, according to the IMF. Italian banks now have an estimated €360 billion of non-performing loans, reflecting around 20% of Italy's GDP and 15% of all its banking system's loans (which compares to around 5% in the U.S. during in the 2008-09 banking crisis). The problem is not a real estate bubble, but low growth, deflation, and lack of competitiveness — exacerbated by a euro exchange rate which is over-valued from the perspective of Italian manufacturers.

Exchange rate will also be the key concern of the European timber trade in the months ahead. Forecasting the euro dollar exchange rate is extremely difficult given political and economic uncertainty on both sides of the Atlantic. But drawing on the recent better-than-expected economic signals in Germany and with no signs yet of any change in ECB monetary policy, most forecasters suggest relative stability in the euro-dollar rate for the time-being.

However, the UK Financial Times is reporting that the majority of analysts they follow are forecasting a notably weaker British pound in the months ahead. There is a widespread expectation, fed by public statements of the Governor of the Bank of England about the need for market stimulus, that the UK interest rate will be cut from the current 0.5%, at least to 0.25%, perhaps even to zero in the next few months. In addition to a hoped for boost in spending, this would tend to reduce inflows of foreign capital into the UK and create further downward pressure on the exchange rate. Therefore, it might be some time before UK importers are encouraged back into the tropical timber market in any volume.