Steady EU hardwood trade despite uncertain political situation

There are signs that the upturn in the eurozone economy in the last 2 years will be short-lived and growth is stagnating again. Meanwhile, the trade war between USA and China has stirred fears of a new global recession and EU countries are anxiously awaiting the outcome of Brexit negotiations with the UK. None of which is good for market stability.

The latest economic forecasts suggest that the eurozone will be marked by significantly lower growth in 2019. An FT survey of 24 economists at the end of last year, gave forecasts of eurozone GDP growth across a wide range, from 0% to 3%, a sign of the high level of uncertainty. The majority forecast eurozone growth close to the middle of this range, at around 1.5%.

With signs that economic growth slowed at the end of last year, IMF forecasts issued in January 2019 suggest that growth in Germany will slump to 1.3% in 2019, down from their 1.9% forecast in October. Italy's GDP is now forecast to grow only 0.6% in 2019, down from the previous IMF forecast of 1%.

The IMF is now slightly more optimistic about the UK economy, forecasting growth of 1.5% in 2019, 0.1% higher than the October forecast, but this is dependent on the UK securing an agreement to leave the EU. Brexit aside, the UK economy appeared to be in quite good shape at the end of last year. Employment is at historically high levels, and wages have been rising which should prop up consumer spending at least for a time. However, indicators show that UK consumer and business sentiment dipped in December amid heightened Brexit uncertainties.

Despite these rather ominous signals, the hardwood sector in the EU continues, for now, at a steady, albeit slow, rate. To some extent this is merely a reflection of industry structure. Compared to the softwood sector, which deals in large volumes with rapid stock turnover, the hardwood sector is a small volume business with very long lead times, particularly for tropical products. Much of the product is used in high-value, often bespoke, applications, which are irregular and difficult to forecast.

In these circumstances, hardwood traders are naturally cautious about building stock, extremely wary of being caught out by currency fluctuations, and inclined to focus on a limited number of well-known and favoured species which have traditionally offered the best margins.

It maybe that significant change is just around the corner, or already underway, driven by larger social and political forces. But this is taking time to filter through into readily observable trends in a highly conservative industry.

Feedback from EU hardwood importers suggests that African supply has become more stable in recent weeks, with fewer hold-ups at the Cameroon port of Douala. This may be partly due to a recent slowdown in Chinese demand, helping to free up shipments to Europe.

Prices for African hardwoods of interest to European buyers are generally stable, with signs of increase for sapele and sipo, which are in particularly strong demand. Demand for 3rd party certified iroko is also good and currently in excess of supply. European imports of Ivory Coast framire are in decline with only very limited supplies of the legally verified material required for EUTR conformance.

Although African hardwood importers and agents continue to report reasonable business in Europe, there is recognition that this may be partly due to shrinkage of the overall industry. The declining presence of large operators such as Rougier has meant that the remaining traders are picking up more business than in the past.

UK importers report that their imports of Malaysian meranti and keruing are currently constrained by limited supply of the PEFC certified material preferred for EUTR conformance and other green procurement requirements.

Despite FLEGT licensing, there are no clear indications yet of any significant rise in European trade in bangkirai decking and other solid hardwood products from Indonesia, with traders suggesting that FLEGT-licenses have yet to achieve any real market traction.

Some companies and trade associations, notably in the UK, are now more regularly flagging up Indonesia's FLEGT status. Research by the FLEGT Independent Market Monitor (IMM), an ITTO project, also suggests good awareness in the European trade that FLEGT licenses, which require no further due diligence under the terms of EUTR, greatly simplify and reduce the costs of conformance to the regulation

However, there remains a need for more effective market development efforts for FLEGT licensed products which are less dependent on "avoiding a negative" (i.e. EUTR sanctions and links to illegal logging) and instead emphasise positive messages and commercial benefits.

The European Forestry Institute, which manages the EU FLEGT facility, is contributing to this more positive approach with the launch of a new online resource to help timber buyers to communicate the FLEGT scheme to their own customers at www.timberbuyers.flegtlicence.org.

This is a start, but traders are advising that policy-led communication initiatives of this type, in isolation, will be insufficient to drive any real transformation in the European market towards FLEGT licensed products, or to encourage greater engagement with the tropical timber industry.

A more pressing challenge is to ensure importers and their customers have strong commercial reasons to purchase the product on a regular basis. For this, they need assurances of likely long-term availability, competitive pricing and potential to achieve good margins, quality and technical performance, and delivery times, alongside assurances of legality and sustainability.

In practice this highlights the need for more product-specific business-to-business market development efforts, based on solid data on supply and demand, targeting specific end-uses and niche markets, and ensuring conformance to customers technical requirements.

Messages about FLEGT may be integrated into this process, but cannot be the only, or even the leading, hook to drive market demand.

Brexit impacts on hardwood trade

The 29th March, the date scheduled for the UK's departure from the EU, is now fast approaching. But there is considerable uncertainty over the exact form Brexit will take on that date, or even if it will happen at all.

In early January, for example, JP Morgan concluded there was only a 45% probability of Brexit in March with a deal close to the one that has been negotiated between the EU and UK government. However, so far the negotiated agreement has fallen well short of a majority in UK parliament.

JP Morgan also suggested a 25% probability of a second referendum on EU membership, a 15% probability of a general election, a 10% probability of an extension of "article 50" (the EU procedure by which the UK is leaving the EU) into the second half of the year, and a 5% chance of a disorderly no deal Brexit.

JP Morgan's assessment is a couple of weeks old, and already by the end of January the equation has shifted. The UK political process is in stalemate while there is little sign that the EU will budge to make the negotiated deal more palatable to UK parliament. The chances of the deal being agreed have diminished while the chances are rising both for a disorderly no deal and for the scenarios leading either to a delay or even a reversal of Brexit.

The political and economic situation in the UK is balanced on a knife edge. If there is a lack of progress during February and it looks like a "no-deal" UK exit from the EU is becoming even more likely, the negative impact on the economy will be magnified. Alternatively, if it looks ever more likely that a "no-deal" exit will be averted, some of the uncertainty may ease, although it is unlikely to disappear completely until it is absolutely guaranteed there will be a deal.

As in other sectors, the politics of Brexit creates a significant headache for the hardwood trade. However, unlike other more fast-moving industries, the hardwood sector has not been able to do much to mitigate the commercial risks, only to sit it out and wait and see.

According to the TTJ, the softwood industry in the UK has been building up landed stock to pre-empt anticipated customs and port disruption after 29th March. But this has not happened in the hardwood sector due to lengthy lead times and concerns about fluctuations in the sterling exchange rate, which could go either way depending on the outcome of negotiations.

Brexit uncertainty led sterling to weaken sharply against other major currencies at the end of last year. Hardwood importers are reluctant to build stock now as they are concerned that, if a deal is agreed, sterling could regain ground, leaving them sitting on a lot of over-valued stock.

Of course, events might go the other way, and a short-term effect of a no deal Brexit could be a further fall in the value of sterling. But how far and how fast sterling might fall is unknown as the extent to which markets have already factored in the likelihood of a no deal is not clear.

The immediate effect of all this uncertainty is to increase the tendency for UK hardwood importers to buy little and often. While trade remains quite steady, there is no sign of growth in the UK market at present.

And as the chances of a no deal Brexit have risen, there's increasing interest in, and speculation about, what the effects of this outcome would be on the hardwood trade.

From a policy perspective, in theory a no deal Brexit would "level the playing field" for UK direct imports of hardwoods from the tropics and other non-EU countries relative to imports from the EU.

Last year, as part of efforts to limit the potential fallout, the UK government issued a series of guidance notes on the implications of a possible no-deal outcome for business. The guidance states that a no deal Brexit would result in "businesses having to apply the same customs and excise rules to goods moving between the UK and the EU as currently apply in cases where goods move between the UK and a country outside of the EU".

A no deal Brexit would have little or no immediate impact on UK tariffs imposed on imports from EU countries of mouldings (HS 4409) and rough sawn products since these are already duty free for all EU imports regardless of their species or source.

However, in a no-deal scenario, UK imports of some planed and sanded hardwood products from the EU would become subject to a 2.5% import tariff. Depending on species and degree of working, a variety of tariffs would also be imposed on UK imports from the EU of veneers (3% to 6%), plywood (7% to 10%), MDF and particleboard (7%-10%), and joinery products (3% to 6%).

While the EUTR would cease to apply in the UK in a no-deal scenario, the law will be replaced with a UK law imposing equivalent due diligence requirements to demonstrate wood is legally harvested. This will apply to all timber placed on the UK market. This means imports of hardwood from the EU into the UK would, like imports from the tropics, be subject to due diligence requirements.

Similarly, in the event of a no deal, all wood packing material moving between the EU and the UK would need to be ISPM15 compliant (treated and marked), as is currently required for imports from non-EU countries.

Imports of timber into the UK from the EU would also be subject to phytosanitary regulation in the same way as imports from non-EU countries. However, UK government guidance states that "to deliver a smooth transition when we leave the EU, in a 'no deal' scenario the Government has decided that the majority of plants and plant products are low-risk and should continue to enter the UK from the EU freely, as they do now".

Of course, in the event of a no-deal scenario, these changes in the tariff and regulatory environment which might benefit non-EU suppliers of hardwood products into the UK, may well be overshadowed and offset by the wider economic impacts.

According to an analysis by the Bank of England last year, in the event of a no deal, UK GDP in five-year's time may be up to 8% smaller compared to forecasts in which a deal is assumed.

Similarly, the IMF estimates that Britain could lose about 5% of GDP in 5 years in the event of no deal, while the Netherlands, Denmark and Belgium, which have strong trade links with the UK, could see GDP losses of 1% or more, and Ireland's economy would stand to lose 4% over the same period.

These are worst-case scenarios for a so-called "disorderly no deal" and still seem unlikely, although the chances are rising with every day that the UK parliament resists accepting the deal on the table. It's possible that there will be a Brexit deal, or a delay, or a referendum, or an election, all with unknown outcomes. As things stand, it is simply impossible to predict how the UK, or indeed the wider EU hardwood market, will evolve this year.

More US hardwood likely to be diverted to Europe

While Brexit is a preoccupation in the EU, the impact of events in other regions may be just as profound for the hardwood trade in Europe this year.

Particularly significant is the on-going trade dispute between the US and China which may well lead to an increase in tariffs on US hardwood imports into China (which currently accounts of over 50% of all US hardwood exports) from the current 10% to 25% from March onwards.

The trade dispute combined with signs of slowing economic growth in China, has contributed to a sharp decline in the value of the Chinese renminbi against the US dollar. This coupled with a desire by traders to ensure shipments do not arrive in China either over the new year holiday period or after the new higher tariffs become due on 1st March, led to a sharp fall in US hardwood exports to China in the last quarter of 2018.

Against this background, US hardwood importers are once again turning their attention to the opportunities presented by the European market. The full impact has yet to be felt, since heavy rain reduced US hardwood production last year and thereby helped underpin prices even as Chinese demand waned.

However, felling has picked up again in the US this winter. European buyers now expect that availability of US hardwood will rise significantly during 2019, while prices are expected to soften. So far, the most affected species has been red oak, the US' most abundant commercial hardwood species and also the largest exported hardwood to China.

Europe has never been a strong market for red oak, always much preferring white oak. However, prices for red oak are now 40% below those for white oak (and at a similar level to those for meranti), and red oak's price competitiveness may increase even further if there is no change in the China tariff situation.

The American hardwood industry is now gearing up for a major market push in Europe, particularly focusing on the technical, logistical and environmental benefits of using red oak.

There have been several attempts to encourage greater use of American red oak in the European market in the past, with only limited impact. But there's a feeling that this time round it may be different.

This is due not only to the exceptional situation with respect to price and availability of red oak, but also by recent interest in the species shown by high profile developers and designers in Europe, notably in the new Bloomberg headquarters in London last year.

The US hardwood sector is also looking to expand applications for red oak in Europe, for example it is identified by the American Hardwood Export Council as a species which responds well to thermal treatment which would allow it to be used more widely in external applications.

Nevertheless, these efforts by the US hardwood industry to promote red oak in Europe may not yield immediate results, and European traders are likely to remain hesitant until there are clearer signs of the long-term situation in relation to price, availability and end-user demand.

In the meantime, there is also likely to be more availability of the other temperate hardwoods which are already popular in Europe with the decline in Chinese demand, such as American white oak, tulipwood, walnut and ash.

Although not subject to the same tariff situation, there are signs that the very tight supply situation for European oak has also eased slightly this year in response to slowing Chinese demand. Until last year, rising demand from China and other Asian markets and a strong fashion for oak in Europe, combined with limited production volume and tightening export controls in Croatia and Ukraine, led to record prices for European oak logs and lumber.

However, first reports in 2019 suggest that availability of European oak has improved and prices are stable at the higher level.

Wood flooring sales slow

Based on information obtained from its member companies and national associations, FEP – the European Federation of the Parquet Industry - estimates that overall European consumption of parquet flooring (i.e. with a real wood face) fell by around 2% in 2018.

This is a preliminary forecast based on best estimates provided by member country representatives at the recent FEP Board meeting held at the BAU fair in Munich and may be subject to change following analysis of complete market data to be published at FEP's annual General Assembly, due to be held in June in Lisbon, Portugal.

FEP note that the fall in consumption in 2018 came after three years of moderate growth or stabilisation and despite a generally good start to the year.

FEP also highlight that there was some variation from country to country, with the market contraction occurring in Germany, Switzerland, the Nordic countries (Denmark, Finland and Norway), France and Belgium. In contrast, consumption improved in Austria, Italy and Poland during 2018, and was stable in Spain and Sweden.

The FEP Board of Directors fear that the overall negative trend will continue in the first half of 2019, particularly highlighting the intense competition from "wood like" flooring solutions, especially Luxury Vinyl Tiles (LVT).

On the other hand, FEP welcomed the increasing recognition by the EU authorities of the positive contribution of wood products, including parquet, to fight climate change and to support the "circular economy" and sustainable development.