European economic confidence severely dented by the banking crises

Widely reported measures by national government's to bail-out failing banks, involving a massive injection of state money amounting to partial nationalisation of leading retail banks in several countries, has quelled the worst fears of European investors and depositors of an imminent and disastrous economic collapse. Steps have also been taken to kick-start national economies through a significant reduction in interest rates by several central banks including the euro area's ECB and the Bank of England in a move co-ordinated with the American Fed. Nevertheless, economic confidence in Europe has taken a severe beating over recent weeks, a fact reflected in weakening currencies and forecasts that Europe may be facing its worst recession since the early 1990s.

In the UK the scale of the bank rescue plan has been particularly dramatic, the government having pledged £400 billion ($500 billion) to guarantee that no UK bank fails. However the very need for such drastic measures seems only to have underlined how bad things have become. By putting its full weight behind the banks, the government has signalled its determination to avoid a worst-case outcome. But confidence has been shaken to the core, while concerns are now being raised over the severe fiscal risks associated with such a large input of public money. The government is now deeply in debt, leaving no wriggle room for increased public sector spending to tide the economy over the bad times and holding out the prospect of tax increases which will further dampen private sector spending.

UK confidence was ebbing away even before the real scale of the banking sector crises became clear in early October. Business surveys of purchasing managers for both manufacturing and the services sector touched record lows in September. Construction is wilting as homebuilders put projects on hold and lay off workers. As much of the UK's recent growth had been driven by the City, and based on a financial model whose defects have now been brutally exposed, expectations are that the nation's economy will be particularly hard hit. The UK economy now seems certain to have entered a recession during the second half of 2008. This has led to a rapid fall in the value of sterling against other currencies.

Economic conditions in other European countries are less dire, but still the outlook is not good. Due to relatively tight regulation of the banking sector and relatively strong retail banking networks, France has had to bail out just one bank, Dexia, a small Franco-Belgian lender. This was intended merely as a precautionary, confidence-boosting measure. Nor have the French been on a huge credit binge. The household savings rate remains high. Nevertheless third-quarter GDP figures are likely to show that the French economy is already in recession and the IMF forecasts growth of just 0.2% in 2009.

Germany's bank rescue package is backed by a state guarantee of €400 billion with the aim of ensuring that no "system-relevant" bank will fail and no depositor will lose money. Nevertheless indications are that Germany will not avoid a slowdown. The IMF expects no growth at all next year. Germany has sounder public finances, less indebted enterprises and more competitive wages than others. Yet it is more dependent on exports, so will be hit harder by a global slowdown.

Italy's banks have not been so exposed to the global crises as those in other parts of Europe partly because, as the nation's Finance Minister recently admitted to parliament, they are "less advanced and sophisticated". The government is still forecasting GDP growth of 0.5% in 2009 but this is now a minority view. The employers' federation, Confindustria, expects the economy to shrink by 0.2% this year and 0.5% next.

Spain's banks lack liquidity but none has needed rescuing thanks to the Bank of Spain's tight regulation and the prudence of Spanish bankers. But Spain is worse off than many others on the broader economic front. The banking crises has further undermined confidence already reeling from the effects of a burst housing bubble. The IMF now expects the economy to shrink by 0.2% next year and unemployment is rising.

Tropical hardwood sawn markets take a hit

Judging by the comments of European agents and importers, the effects of the banking crises on demand for sawn hardwood have been immediate and fairly dramatic. One major supplier to the UK notes that "our sales of sawn hardwood were doing reasonably well until the first week of October when the panic over the stability of the banks came to a head. During that week the phone didn't ring at all. Demand picked up a little the week following the announcement of the bank bail-outs, but its gone quiet again now".

Overall consumption of hardwood sawn lumber in the UK has taken a hit from the rapid decline in new residential construction. This has particularly affected demand in the mass production joinery and window manufacturing sector. This in turn has fed through into particularly weak demand for commodity tropical hardwood species including sapele and meranti.

FOB prices for sapele quoted to UK importers have remained soft in recent weeks. However agents suggest that these prices may have hit a floor as margins amongst African exporters are already extremely tight and production levels have been sharply curtailed. Much reduced forward purchasing of sapele during 2008 also means that UK grounded stocks are now low and there are gaps in some areas. In the credit crunch the pressure to buy little and often has intensified.

Meanwhile weakening of sterling against the dollar has meant that sterling prices for meranti have been rising and are now less competitive against sapele. Demand for iroko in the UK has held up reasonably well, however the market for framire/idigbo is described by one agent as "dire".

To some extent the decline in UK demand from new residential construction has been off-set this year by continuing consumption in the renovation sector. With house prices falling and credit tightening, less people are moving house but they have been spending money on improvements. The concern now is that increased nervousness over the banking crises will undermine even this source of demand while tightening public finances will reduce demand from public sector projects. For example, due to budget cuts in the wake of the credit crunch, the Olympic Delivery Authority for the

London 2012 Olympics has already been forced to cut the number of housing units in the Athletes Olympic Village from 3,500 to 2,800.

Demand in the Benelux countries also remains very subdued. One agent in the region contacted for this report suggested that importers are still carrying very high stocks of standard items. For example, sales of tropical hardwood decking fell well short of expectations this year and stocks remain very high at a time of year when they should be low. This will inevitably feed through into much reduced orders for the spring 2009 season. Given the current stock position and the obvious desire in the current market situation to avoid holding excess stock, this agent was told by one of his leading buyers not to expect any new orders for at least 3 months.

Reports are coming through of slow sales of hardwood to the Italian furniture and flooring sectors. Many Italian furniture and flooring factories are now only operating three or four days per week and several have closed permanently. This reflects both declining domestic consumption and intense competition in export markets as manufacturers from all regions are now chasing declining orders. Hardwood orders from Spanish and Portuguese manufacturers have also been declining, with the signs of particular stress in the Spanish door industry.

Changing face of European plywood hardwood market

The credit crunch and economic slowdown has meant that European plywood importers are very reluctant to commit to purchasing in any volume while stock holdings are seen more and more as a liability. However there may be a few opportunities to find buyers before the year is out. According to a plywood trader quoted in the UK's TTJ "the biggest factor in the UK and European markets at the moment is fear….Stock reduction is running ahead of demand reduction and, as we run into autumn and winter, we will see some shortages. The trade has still got some buying to do before the New Year".

European imports of Chinese plywood have been declining due to recent consolidation of the Chinese plywood sector, combined with rising costs of raw material, labour and energy, and the downturn in European consumption.
The same TTJ article notes that despite recent consolidation in the Chinese plywood manufacturing sector, UK buyers continue to receive huge numbers of offers of plywood from mills in China. This suggests that there is still excess supply in the pipeline, a fact also reflected in a slight softening in prices for poplar/bintangor plywood from China. In addition to slow consumption, reluctance amongst many European importers to buy Chinese plywood reflects continuing concerns over variable quality of product.

Meanwhile there are signs that the price differential between Malaysian and Indonesian tropical hardwood plywood on offer to EU importers is narrowing. Relatively high prices for Indonesian plywood in recent times have meant that Malaysia has been the main beneficiary of partial shift away from Chinese plywood in the EU market. However, according to the German trade journal EUWID, prices for 4X8ft BB/CC grade Indonesian plywood for shipment in October/November stand at Indo96 +32% to +34%, a decline from Indo96 +37% at the end of August. Meanwhile, over the same period Malaysian prices have risen from Indo96 +19% to

+20% to Indo96 +24% to 25%. The price gap for European importers is expected to narrow further next year when EU import duties on Indonesian plywood are due to be lowered from 7% to 3.5%, equivalent to the duty currently imposed on Malaysian plywood.

Proposal for new EU illegal logging legislation announced

On 17 October the European Commission finally published its long anticipated proposal to introduce new legislation designed to minimise the risk of illegal wood entering the EU market. As noted in earlier ITTO Market Reports, the proposal is that individual operators engaged in the trade and production of wood products in the EU would be required to implement a "due diligence" management system to reduce the risk of any illegal wood entering their supply chains.

A significant change from earlier drafts of the proposal is that it would apply only to operators who place timber and timber products "for the first time on the Community market". There has been some confusion amongst European trade organisations of precisely which operators would be captured by this definition (some interpreting it to include European forest owners). However, an EC official made clear the intent of this definition at the International Timber Trade Federation meeting hosted by the EC-funded Timber Trade Action Plan in Geneva on 27 October. The EC official noted that the measure was directed specifically at EU based importers and primary processors (e.g. sawmills, plywood mills, panel products mills, pulp mills).

The scope of the products covered by the proposed legislation is extremely wide covering all products included in the existing FLEGT Action Plan (logs, sawn, plywood, and veneers) together with:

- Pulp and paper of Chapters 47 and 48 of the Combined Nomenclature, with the exception of bamboo-based and recovered (waste and scrap) products;
- Wooden furniture of CN code 9403 30, 9403 40, 9403 50 00, 9403 60 and 9403 90 30;
- Prefabricated buildings of CN code 9406 00 20;
- Fuel wood, in logs, in billets, in twigs, in faggots or in similar forms; wood in chips or particles; sawdust and wood waste and scrap, whether or not agglomerated in logs, briquettes, pellets or similar forms of CN code 4401;
- Builders' joinery and carpentry of wood, including cellular wood panels, assembled flooring panels, shingles and shakes, wood (including strips and friezes for parquet flooring, not assembled) continuously shaped (tongued, grooved, rebated, chamfered, V-jointed, beaded, moulded, rounded or the like) along any of its edges, ends or faces, whether or not planed, sanded or end-jointed of CN code 4418;
- Particle board, oriented strand board (OSB) and similar board of wood whether or not agglomerated with resins or other organic binding substances of CN code 4410;
- Fibreboard of wood or other ligneous materials, whether or not bonded with resins or other organic substances of CN code 4411;
- Densified wood, in blocks, plates, strips or profile shapes of CN code 4413 00 00;

- Wooden frames for paintings, photographs, mirrors or similar objects of CN code 4414 00;
- Packing cases, boxes, crates, drums and similar packings, of wood; cable-drums of wood; pallets, box pallets and other load boards, of wood; pallet collars of wood; coffins of CN code 4415;
- Casks, barrels, vats, tubs and other coopers' products and parts thereof, of wood, including staves of CN code 4416 00 00.

Green groups have already been critical of the proposals on the grounds that they do not go far enough in defining procedures for legality verification and in setting out specific penalties for operators that might be found to be trading in illegal wood.

On the other hand, the EC has been conscious of the need to avoid imposing excessive new bureaucratic requirements on the trade in timber from areas where there is little risk of illegal logging. After all, even the most pessimistic assessments suggest that only perhaps 20% of existing EU wood imports derive from illegal sources while the level of domestic supply from illegal sources is likely to be significantly lower. So it makes absolutely no sense to subsume the existing 80% of legal wood supply in new systems and procedures – particularly as this would only increase the costs of legal operation, providing an additional perverse incentive to operate illegally and undermining competitiveness of wood against other less environmentally beneficial materials.

Hence the new legislative proposal is carefully targeted focusing specifically on the risk assessment systems of companies operating at that point in the trading chain where there is most leverage to take proactive measures. No new requirements would be imposed on those suppliers where there is high confidence that there is low risk of illegal logging. The proposal also has the strong benefit of building on and integrating with existing systems of due diligence that have been developed by trade associations and NGOs in several countries.

The proposal must now be considered by both the European Parliament and European Council of Ministers. The earliest conceivable date on which it could come into force is April 2009. The proposal includes a provision for the "due diligence" requirements to be phased in over a period of 2 years, so individual operators would have to demonstrate compliance from April 2011 onwards. However, there are still many obstacles to full implementation and it is possible that a European Parliament vote on the issue cannot be scheduled until well after the June 2009 parliamentary elections.

A full copy of the proposal is available at:
http://www.illegal-logging.info/uploads/flegttimberproposaloct08.pdf