

European Market Report – 15 May 2009

Some weak signals of economic improvement

Indicators of EU economic conditions in the EU for the first quarter of 2009 - just now being published - were dire. However various “softer” survey-based indices of business confidence suggest that the pace of contraction may have slowed in the second quarter. Two of the most closely watched, Germany's Ifo business confidence and the eurozone purchasing managers' indices, suggest a marked deceleration in the pace of economic contraction in coming months.

But there is great uncertainty over whether the European economy really has hit bottom or whether the recent slightly more positive surveys are just a temporary blip as de-stocking has been extensive recently, allowing industrial production to rebound briefly without necessarily leading to a sustained recovery.

Industrial production in the 16 countries sharing the euro was 20.2 per cent lower in March than the same month in 2008 - the steepest year-on-year drop since records began in 1991, according to Eurostat, the European Union's statistical office. The level of production in March was the lowest since November 1997.

While March eurozone production data suggest very poor conditions throughout the euro-zone, some areas were much more badly afflicted than others. The figures were dragged particularly low by weak Italian, French and Spanish performances. Gloomy conditions have also set in throughout much of Eastern Europe with the Baltics taking a particular pounding. The collapse of the Spain's construction sector with the bursting of a large property bubble has also left that country particularly exposed. Spanish unemployment has soared to more than 17 per cent of its labour force - the highest for more than a decade.

On the other hand, German industry appears closer to returning to growth - helped by a pickup in demand for its exports. Indeed, a contraction of just 0.4 per cent in German industrial production in March compared with February meant the eurozone fall over the same period, of 2 per cent, was the smallest since August last year.

In line with the production data, Eurozone first quarter gross domestic product figures due to be released on 15 May are expected to show a significantly faster pace of contraction than the already steep 1.6 per cent fall reported in the final three months of 2008. Economists predict a fall in excess of 2 per cent - significantly larger than in the US. Outside the euro-zone, on 14 May the Bank of England cut its growth forecasts for the UK on the back of the weaker-than-expected first quarter. The consensus view among institutions such as the International Monetary Fund and European Commission is that Europe will not see recovery until 2010 - and even then it will be only gradual.

Short-term increase in hardwood orders

Mirroring the economic conditions, the vast majority of European hardwood traders contacted for this report – many of which were visiting the Interzum show in Cologne for suppliers to the furniture industry – reported very bleak market conditions. There

are reports of large scale closures of furniture and joinery companies, with those still operating now only working short shifts. Lack of credit due to the restricted lending policies of the banks has added to the difficulties created by declining consumption. Another pernicious problem is the severe difficulties now experienced by many European wood-based companies to obtain credit insurance. The absence of such insurance, designed to protect businesses from the risk of customers defaulting on payments, effectively makes it too risky for companies to provide goods on credit. The result is that more companies are insisting on trading on a cash-only basis or introducing much more restrictive payment terms, further discouraging consumption.

There are a few reports of a brief flurry of forward orders for hardwood sawn lumber during late April and early May as some importers, concerned about reports of extremely low logging levels and mill closures in key supply regions and having bought very little over the last six months, took the opportunity to restock. However the volumes involved are relatively small with few operators willing to make speculative purchases and most focused merely on riding out the storm by reducing stocks and operating costs.

Is the credit crunch encouraging a switch away from real wood?

One Italian importer interviewed at the Interzum show in Cologne suggested that one disturbing impact of the credit crunch is that it seems to be encouraging some European furniture and joinery manufacturers to switch away from real wood products in favour of alternatives. The long lead times between ordering of some wood products (particularly from the tropics) combined with the current difficulties of assessing future consumption levels, means that ordering these products is seen as particularly risky under current market conditions. So manufacturers are being encouraged to switch to materials which can be more easily supplied on a little-and-often basis and more easily adapted at short notice to changing consumption patterns. So for example, Italian kitchen furniture manufacturers are being encouraged to switch away from solid hardwood surfaces in favour of laminates.

However this trend is not necessarily universal. For example in North-western Europe, where the hardwood importing sector is more consolidated, the presence of companies operating very large concentration yards, particularly in the Benelux region, has helped to mitigate the problem of long lead times for manufacturers. And in Italy itself, one message from the recent Milan Salone de Mobile show was that the European furniture sector is, if anything, increasing its emphasis on high quality, high value design-led production as a means of countering the emerging threat from Chinese and other non-European manufacturers. The continuing use of high quality solid hardwood lumber and real wood veneer seems to be very much part of this high end strategy for many manufacturers, given the strong fashion now for “natural materials” and for products that are more “timeless” and durable. In Milan, if something looked like wood, it really was wood. There was little or no use of wood look-a-like products.

Interzum provides a snapshot of market trends

The Interzum show in Cologne Germany also provided a useful snapshot of current trends affecting the European hardwood market. Interzum press releases suggest that

the show this year is at least as large as the previous show in 2007 and the organisers were also optimistic numbers would hold up well. However there was a strong feeling amongst exhibitors interviewed on the first couple of days of the show that visitor numbers this year were down and that new business opportunities were much more limited than usual. There were 7 Halls at the show, the hardwood sector, particularly sliced veneers, dominating Hall 5 devoted to “Natural Materials”.

Interviews with veneer manufacturers at Interzum suggested that oak is still hugely dominant in the European sliced market, accounting for over 50% of sales. Tropical hardwoods, which were widely displayed in Hall 5, are believed to account for perhaps 10-15% of the market. Amongst tropical hardwoods, various species of Rosewood are currently particularly popular for surfacing high end furniture products. These species are valued for providing a richly coloured and strong and interesting grain. It was noted that veneer manufacturers tend to respond to client requirements – so the key to increasing demand for tropical hardwood sliced veneers is to engage directly with designers.

The design oriented approach to marketing was particularly well illustrated by the American Hardwood Export Council (AHEC) at Interzum. AHEC had a large stand at the show, a key focus of which was to illustrate a wide range of architectural and furniture projects where world-renowned designers had made copious use of American hardwoods, showing off their strengths and influencing design and fashion trends. An example is Sclera Pavillion designed by David Adjaye in American tulipwood for the London Design Festival.

Unlike in Milan, there was very heavy promotion of FSC and PEFC certification at Interzum. Most of the leading veneer manufacturers and lumber suppliers at the show made a point of prominently displaying one or other logo on their stands. A well attended press conference organised by FSC-Germany and Inter-African Forest Industries Association highlighted the recent significant progress to expand FSC certification in the Congo Basin.

One particularly interesting anecdote from the Interzum show – which might be an indication of where the international veneer sector is headed in the furniture – is that Turakhia Overseas Pvt. Ltd, one of India’s largest decorative veneer manufacturers participating at the show for the first time, won an Interzum Award for High Product Quality. It seems that European manufacturers – that have traditionally dominated the world’s decorative veneer sector – face mounting competition from new emerging supply sources.

European politicians ponder illegal logging legislation

On 23 April 2009, the European Parliament voted in favour of proposals to introduce a law designed to reduce of risk of illegal wood entering EU supply chains. There are still several hurdles before the proposal eventually becomes law. The legislation still faces the more challenging prospect of having to be endorsed by the European Council of Ministers. Should this process eventually come to fruition, the law could have a profound impact on the European wood supply chain and to alter the relative competitiveness of different supply regions.

The European Parliamentary vote followed on from European Commission proposals released in October 2008 for a law that would require individual European operators engaged in the trade and production of wood products to implement a “due diligence” management system to minimise the risk of any illegal wood entering their supply chains.

Prior to voting on the law, the European Parliament’s Environment Committee made very far-reaching alterations to the text which, taken together, completely alter the proposed scope and nature of the controls that would be imposed on the European wood trade.

The original proposal issued by the European Commission would require European companies to first implement a risk assessment system and then to introduce extra measures to verify the legality of products only from those suppliers considered high risk from the perspective of illegal logging. The risk assessment procedures were seen as proportionate to a situation in which only around 5% of wood consumed in the EU is at potential risk of being derived from an illegal source. The aim was to focus limited time and resources only on those supply regions where illegal logging is deemed to be a problem, to give a market incentive for adoption of FLEGT Voluntary Partnership Agreements in these regions, and to avoid imposing extra costs and bureaucracy on suppliers in areas that are low risk with respect to illegal logging.

The risk assessment procedures were also intended to avoid the profound difficulties associated with “proving legality” in the wood supply chain which often involves considerable mixing and recombining of wood raw material from numerous supply sources during grading, processing and manufacturing. These difficulties are particularly pronounced when raw material derives from small non-industrial forest owners.

In contrast, the legislative text agreed by the European Parliament introduces a new requirement that “operators shall ensure that only legally harvested timber and timber products are made available on the market”. This amounts to a reversal of the burden of proof, implying that prosecutions could be brought against European wood trading companies because they are unable to prove the legality of a timber product. Furthermore, the Parliamentary text proposes that, in order to prove legality, operators would have to employ a full traceability system and third party verification. This requirement would be imposed irrespective of the level of risk of illegal wood supply.

The Parliament’s text also proposes that if an operator is “presumed to have infringed these requirements”, government authorities should have powers to seize timber products and to order the operator to immediately cease commercial activities pending a full investigation. Therefore, according to this text, an operator may be closed down on the basis of a suspected failure to meet its obligation to demonstrate the legality of all wood supplies.

Unlike the European Commission’s text, the Parliament’s text proposes that the requirements be imposed immediately. A two-year bedding-in period proposed by the Commission is dropped, with no time to be allowed to develop the necessary competence, capacity or procedures.

The legislative proposal, including both the EC's original text and the Parliament's amendments is due to be put before the European Council of Ministers in the next few weeks. The Swedish government which holds the European Presidency during the second half of 2009 is likely to be primarily responsible for navigating the legislation through the Council. Quoted in a recent Euractiv.com article, Swedish government officials say they are hoping to finalise the new timber legislation during their EU presidency but that the negotiating difficulties are considerable.

Another member-state source told EurActiv.com that the Council are taking a very different line compared to the Parliament, being more concerned with the technical issues in the draft text, such as how to make the monitoring and compliance systems work. This source also noted that "the Parliament's approach is more ideological" and also acknowledged that the obligation for all operators to check the origin of their timber would place a heavy burden on the industry.