Housing market becoming more of a worry

The optimist's view of economic conditions in the EU can be summed up in a few sentences. Banks in the EU have avoided America's subprime follies and are in better shape than their US counter-parts. Average euro-area unemployment stands at 7.1%, the lowest level in almost 20 years. The euro is resurgent and there is no sign of a recession. Manufacturers in some European countries – especially Germany – have responded to the high euro by increasing efficiency and, as a result, have managed to maintain healthy levels of exports. The European Commission plans to trim its economic forecasts later this month, but euro-area growth is likely to stay close to 2% this year.

Unfortunately these positive sentiments are beginning to be overshadowed by more negative reports. There are increasing concerns over inflation which has picked up to 3.5% in the euro-zone, the highest in the euro's nine-year existence. Economic problems in the euro-zone's two biggest export markets - recession in America and slowdown in Britain - are starting to bite. Although the impact of the strong euro has been moderate so far, it is a delusion to suppose that euro-area exports can continue to barrel on regardless of their cost.

Meanwhile the housing market is becoming more of a worry. While Europe might have avoided the American subprime mess, in several countries house prices have been even bubblier than in America. They are already falling in Spain and Ireland, and are starting to do so in Britain. This will have a strong impact on the construction sector and on the wider economies of countries heavily dependent on this sector (which accounts for 15% or more of Spanish and Irish GDP, for example).

Spain has been particularly vulnerable to problems in the housing market. An expected soft landing has suddenly become more hard and painful. Underlying economic weaknesses that were hidden by the construction boom are being exposed, among them low productivity growth. The IMF estimates that last year's growth of 3.8% will fall to 1.8% this year, and get worse in 2009. These would be the slowest growth levels in Spain since 1993. House prices are predicted to fall by up to 15% over three years. Completed house sales in Spain dropped by 27% in January compared with a year earlier. The most recent data show building permits for housing falling even more sharply. The Socialist government recently announced a €22 billion ($35 billion) fiscal-stimulus package.

House prices have yet to plunge in the UK, but the signs look ominous. Some of Britain's biggest house builders say that over the past six weeks reservations - buyers put down a small deposit to reserve the home they want - have fallen by 50% compared with a year ago. A big problem is that banks have become very conservative in their lending policies, particularly on newly built homes. Banks now demand down payments of as much as 40% on newly built flats, freezing many out of the market and deterring first-time buyers in particular. Realisation has at last dawned in the UK construction sector that a serious bubble has been created in the buy-to-let market as too many apartments have been constructed with an eye to selling to investors rather than to home-buyers. Many of the UK's the largest builders are now stuck with huge inventories of unsold houses. They are also stuck with significant land banks, in some cases the equivalent of ten years-worth of building. These were accumulated during the boom years but are now a depreciating asset. Market observers warn that UK house building may fall by at least 50% unless house prices and credit markets recover faster than most expect.

Germany is another country where the construction sector is struggling, although in this case it is hardly news. German construction has been in the doldrums for a decade. German house prices declined 4.7% in the year to the end March 2008. Planning permits for new construction were down 4.6% in January 2008 compared to the same month in 2007. A poll of member companies of the Central Association of the German building trade held in March 2008 indicated that demand for building services remains static at low levels.

Hardwood demand slow overall

With the economy so uncertain, reports from across the European continent suggest that hardwood buying is almost universally slow. Spanish importers are struggling with high stocks of sapele and are not interested in the forward market. Portugal is slow, but some reports suggest it is holding up better than Spain. The Italian market is very slow, with wood products manufacturers struggling against the high euro and intense competition from East Asian producers in export markets. Ayous stocks in the country are reported to be quite high. The Greek market is cautious as construction activity is reckoned to have slowed 20% this year on the back of an increase in the VAT rate on construction materials together with the global credit crunch. North West European buyers are also cautious and holding sufficient stocks to meet current levels of demand and few are now looking to buy significant volumes in advance of the summer holiday season. According one West African shipper quoted in a recent TTJ report, the UK market is currently “a disaster” - very little sawn lumber is being bought forward with those importers needing to fill holes in stocks now turning to the large yards on the continent. Belgium is one of the steadier markets, with importers there benefiting from the trend towards just in time ordering in other parts of the continent. France is reported to be well stocked with sapele, makore, and movingui. Some reports suggest that hardwood buying has been holding up reasonably well in Scandinavia.

Veneer industry

According to the German trade journal EUWID, the European sliced veneer sector continues to suffer from weak sales and narrowing margins. Sales prices have come under pressure at a time when operating costs are rising and log prices have remained largely stable. Problems in the housing market in several European countries are feeding through into weak sales to door manufacturers. While sales to the interior remodelling sector are holding up reasonably well, there has been a major loss of sales to high volume manufacturers selling product into the new-build sector. The high euro is also affecting sales of veneers to the European furniture sector which has been struggling in export markets.

In some markets wood veneer producers continue to lose market share to other surfaces including glass and plastic. German veneer producers suggest that some customers that previously used up to 60% wood veneer have now reduced this share to below 20%.

With the main west and central European market saturated, European veneer manufacturers are seeking to expand sales in other regions, notably the Eastern Mediterranean and Middle East. However these markets are becoming increasingly competitive, particularly with the recent expansion of processing capacity in Romania and Turkey.

Central European manufacturers are responding to the tough market conditions by curtailing output. Inventories of standard veneers remain very high and prices for these grades have been falling. However there are reports of supply bottlenecks for some exclusive higher quality products. Economic uncertainty is encouraging buyers to delay purchasing until the last minute. But veneer quality logs of higher value species such as hard walnut and some tropical woods can be difficult to obtain at short notice, particularly with strong competition for raw material now coming from China.

Joinery sector hints at more positive trends

Despite the gloomy economic news, there are some positive signs for tropical hardwood emerging from sections of the European joinery industry. A recent TTJ market report on the UK joinery sector noted that while orders from the large house-builders have been falling in recent weeks, demand from the bespoke domestic replacement and contractor-led project sector has remained reasonably good. There is also good activity at the top end of the market, for example legal/financial office fit-outs and high-end retail projects. Furthermore, in this sector, clients are showing a marked preference for darker timbers. Although black walnut is most frequently mentioned as a fashionable species, the trend is also helping boost sales of certain tropical species.

Wood windows are also making something of a comeback, helped along by a new concern for energy efficiency and greenery and backed by solid marketing campaigns. One mass producer of joinery products in the UK interviewed by the TTJ reported that sales of wood windows were up 20% on last year, an improvement attributed to the social housing sector, among others, opting increasingly for timber over PVCu on environmental grounds. The TTJ also suggested that the recent launch of a range of timber and aluminium composite windows by the steel windows giant Crittal Windows is a sign of a current fashion for wood windows in the country.

Elsewhere in Europe, German window manufacturers report that demand for energy efficient window frame systems is rising rapidly. To date this has not led to any significant change in the overall market share of wood and composite wood/aluminium window frames compared to plastic alternatives. The real change has been to increase demand for new triple glazed units. However longer term, wood window manufacturers are hoping that greater interest in energy efficiency will help boost demand for wood windows, particularly for renovation and refurbishment work.

Potential impact of economic problems on green policy measures

The economic slowdown is likely to have broader repercussions for the forest sector than just a temporary drop in timber demand. It is, for example, likely to become harder for the continent’s politicians to sell ambitious plans to tackle environmental problems such as climate change and illegal logging. Demands that industry cuts CO2 emissions are less likely to be heeded in a faltering economy. House builders suffering from declining sales and tightening margins may be less inclined to pursue energy efficiency programs. Timber industry operators seeing their markets shrink may become more determined to resist laws requiring greater “due diligence” as a measure to prevent illegal wood imports, particularly if they perceive these laws as discriminating unfairly against timber products in relation to competing non-wood products. Advocates of such measures will need to focus heavily on highlighting their potential benefits to the European private sector as a way to expand share in a declining market.