

## **European market report 29 January 2009**

### **Economic indicators trending downwards**

Economic problems continue to mount in Europe. The UK, Spain and Ireland were hit hard early on by the collapse of their respective property markets. The UK's economy, with its heavy dependence on financial services, has also suffered more profoundly than other economies from the crises in the banking sector. Now contagion has set in and conditions are deteriorating rapidly throughout the EU.

Germany, France and Italy, the euro area's three biggest economies, have experienced a rapid decline in industrial production in recent months as the strong euro and weakening global demand has hit exports hard. Germany's industrial output fell at annualised rate of 15.1% in the three months to November compared with the previous three months; in France it fell by 14.5% and in Italy by 19.5%. Domestic consumption is also being squeezed throughout the euro zone. Although the area's consumers have relatively high savings and low debt by rich-world standards, they are becoming more nervous as unemployment is rising. Consumer confidence in the euro-zone has sunk to a record low – falling particularly dramatically in Spain and Ireland.

Policy makers are trying desperately to avert the crises, so far with little success. The Bank of England has reduced interest rates to 0.5%, their lowest ever. The European Central Bank (ECB) cut its key rate by 50 basis points to 2% on January 15<sup>th</sup>. Fiscal policy is being loosened aggressively in a few countries, leaving the UK in particular with a huge budget deficit.

Signs are that the European economy will remain depressed for at least the rest of 2009, with tentative hopes of a recovery in 2010. In January 2009, the Economist Intelligence Unit forecast that euro area GDP would contract by 2% in 2009 - a substantial downgrade from December's forecast of minus 1.2%. Much of this is due to the deteriorating outlook for Germany, which is likely to contract by more than 2% in 2009. Prospects in the UK may be even worse, the IMF forecasting that the nation's economy might contract by 2.9% in 2009.

Until only a few months ago, reports indicated that Eastern Europe might escape the worst impacts of the global downturn. But economic conditions in the Baltic States have taken a serious turn for the worse. This has raised concerns that the downturn might spread into other parts of Eastern Europe. Industrial production in November 2008 in Latvia, Estonia and Lithuania fell respectively by 14%, 17.5% and 7%. In mid January, the IMF and other foreign lenders had to step in to bail-out Latvia's economy imposing tough austerity measures as a condition of the rescue package. Attention is now focusing on Poland, the biggest regional economy, which until recently seemed fairly safe. Industrial production in the country has nose-dived in recent weeks. The central bank has cut interest rates sharply in response but it's too early to say whether this will halt the slide.

### **Sawn lumber market in the doldrums**

Overall the European market for tropical hardwood sawn lumber remains extremely depressed. There is very little forward purchasing as importers focus on offloading

existing landed stock at a time when consumption has slumped and prices are weakening. Agents report only a slight pick-up in orders during the week immediately following the end of the Christmas vacation, but these tailed away very quickly in the following weeks.

Due to the extremely low level of forward sales, it remains very difficult to obtain consistent and accurate price information. There are a lot of very cheap offers around but still buyers are not being tempted. Overall the feeling is that landed stocks have been whittled down over recent months with so little forward buying. But the serious lack of confidence in levels of consumption this year - combined with the widely held perception that prices will remain weak and availability relatively prompt - is deterring any move to build stocks.

This situation seems to apply across the board to the full range of species, although the problems are most obvious in the larger volume species. The market for African sapele is particularly depressed as some large European importers are selling on to manufacturers and other buyers at well below replacement prices in their efforts to offload excess stocks. Similarly US\$ CIF Northern Europe prices for white oak – such a staple of the European furniture and joinery sectors – are reported to have fallen by 30% in the last 8 weeks. Malaysian meranti US\$ CIF Northern Europe prices have plummeted due to weak consumption and efforts by Malaysian shippers to generate cash flow in advance of the Chinese New Year.

Freight rates from the Far East into Europe have also fallen by around 50% since early December – a particularly visible sign of the abrupt decline in European trade volumes over the last 3 months.

### **Plywood trade stagnant**

European plywood importers have greatly reduced forward purchases and remain focused on stock consolidation. There is much inter-importer trade, particularly in the UK due to the weakness of £ sterling. With the currency so weak it makes sense for UK importers to buy existing landed stock that was bought forward by other importers in the middle of last year when £ sterling was stronger. There's very unlikely to be any significant upturn in forward buying until sterling recovers some of the ground it has lost to other currencies, particularly the US dollar.

One large UK plywood importer interviewed in late January notes “our sales levels in the UK are around a third less than the same time last year. Plywood is being consumed and there will come a time when we need to restock and buy more on a forward basis. However we are not in that position yet, nor are we likely to be for several months”. This same importer noted that his company may be performing better than many competitors due to its ability to supply more specialist products such as large panels and marine plywood which are in relatively short supply. It's those importers that rely more heavily on large volume commodity products that are really struggling.

This importer also notes that they are now buying little or no Chinese plywood with a poplar core. This is due both to continuing quality concerns and the fact that prices for

Chinese hardwood-throughout plywood have come down to such an extent that the price of lower-quality poplar core product is much less attractive.

Another significant impact of the downturn has been to narrow the price differential between FSC and PEFC certified and uncertified plywood products on offer to European importers. As the overall market has contracted, the relative availability of certified material has increased and shippers have responded by reducing their certified prices in an effort to maintain their market share. Those shippers with access to material from certified forests are aggressively marketing their products emphasising that they can provide environmentally certified product at little or no price premium.

Although end user demand for FSC and PEFC labelled plywood remains restricted in the UK, importers suggest that more enquiries for these products are coming in, particularly from the public sector. The UK authorities seem now to be imposing more effectively the central government procurement policy favouring “verified legal and sustainable” timber. At the same time, the public sector is becoming a relatively more important market as private sector construction has declined. For this reason, together with other factors such as ease of stock control, brand protection and rising availability of certified product at little or no premium, more UK plywood importers are taking a strategic decision to shift over to sourcing 100% FSC or PEFC labelled product.

### **EU garden furniture sector**

The garden furniture sector remains a major source of demand for tropical hardwood products in the EU. Data on the size of the sector in the various European countries is not readily available, but anecdotal reports indicate that Germany, France, Italy and the UK are the four largest consumers of garden furniture products roughly in order of importance. The market picture is complicated by the fact that a significant proportion of the Top Quality Grade A Teak imported into the Italian market is not used for garden furniture but rather as decking for the luxury boat building industry.

The European garden furniture sector is unusual for its relatively high level of interest in environmental certification. High profile environmental campaigns, combined with the sector’s obvious dependence on environmentally sensitive tropical hardwoods and the relatively large volume of product sold through big name retailers, have meant a very strong emphasis on certified product. Many retail buyers in the EU will no longer directly or indirectly purchase or offer uncertified timber or wood products. With very few exceptions, FSC is essentially the only brand of certification recognised in the sector.

While big-name retailers have become more dominant in the sector in recent years, there is still quite a high degree of fragmentation. Huge volumes are sold through companies like Metro in Germany, Carrefour in France, B&Q, Homebase, and Tesco in the UK. But significant volumes also find their way to final consumers through smaller garden centres and internet firms.

Large retailing companies often buy a significant proportion of finished products direct from the Far East. Direct buying normally generates a much higher margin for a

retailer. However there are also risks associated with buying direct and paying for goods well in advance of delivery. Therefore a proportion may also be bought from EU branded companies who can offer stock support in the EU with a quick repeat order delivery time.

There are a large number of European “pseudo manufacturers” who are now in effect importers and wholesalers supplementing the large retailers’ supplies and also acting as a major source of goods supplied to the smaller garden centres and retailers. Pseudo manufacturers usually operate by supplying a design to a Chinese or SE Asian producer who then makes the furniture under the brand name of the pseudo manufacturer. Occasionally the factory design is used. Quite often a pseudo manufacturer acts on behalf of a retail buyer.

There are only a very few garden furniture companies actually manufacturing products in the EU and most use materials other than wood. For example Kettler still produces steel garden furniture in the EU while importing their wooden furniture from SE Asia.

Teak is generally the preferred species in the garden furniture sector, although lack of availability of this species combined with the strong emphasis on ensuring products are FSC certified has meant the sector now utilises a wide range of alternatives. Of tropical species these include iroko, eucalyptus, acacia, balau, meranti, keruing, shorea, sindana, and couboril. Lack of availability of FSC certified teak from Myanmar and Indonesia has contributed in recent times to a shift in sourcing of wood raw material to other regions, for example from teak plantations in Central America, eucalyptus plantations in South Africa, acacia plantations from Vietnam and other SE Asian countries, and couboril from Brazil. In addition a lot of FSC certified pine from Russia, Northern Europe, North America and New Zealand is now pressure treated to extend its life for outdoor use.

Until the start of last year, the EU garden furniture sector was generally expanding. However in 2008 the wet summer in north-west Europe undermined demand. The worldwide economic downturn then severely dented confidence. Many retailers continue to hold excess stocks over from the 2008 season and, lacking confidence in a significant recovery this year, have drastically reduced forward ordering for the 2009 season.

Another effect of the economic downturn has been to contribute to growing interest in lower priced products especially lower grade plantation teak, acacia and eucalyptus. With cost becoming an even bigger driver of demand in difficult trading times, there is growing concern amongst manufacturers over the continuing price differential that exists between FSC certified and uncertified raw material suitable for garden furniture manufacture. Concern is particularly pronounced as the downturn also seems to be encouraging more interest in relatively cheap non-wood products including no or low maintenance aluminium, steel and mixed material furniture mainly from China.