

UNECE TIMBER COMMITTEE – SEPTEMBER 2009

UK Timber Market Statement

1. General Economic Trends affecting the Forest and Forest Industries Sector

The UK economy entered into recession in 2008 as economic growth, as measured by Gross Domestic Product (GDP), became negative and the economy began to shrink.

For the entire year 2008, GDP grew by just 0.7%. By Q2 2008, the economy had effectively ceased to grow and by Q4 2008 the downturn had developed into a recession.

By Q2 2009, the UK economy had shrunk by 5.6% compared to the same quarter in 2008.

Gross Domestic Product

% Change



Source: Office for National Statistics (ONS)

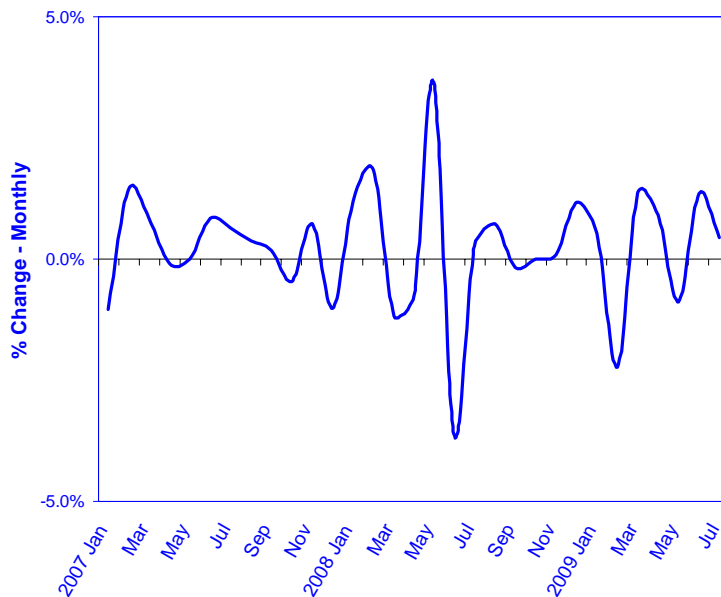
GDP fell dramatically in Q1 2009 as a result of a 5.5% fall in manufacturing output. Recently revised data indicates that manufacturing output fell again in Q2 2009, but less dramatically, down 0.3%.

Output of services fell by 1.6% in Q1 2009 and declined further by 0.6% in Q2 2009.

In comparison, output in the construction sector fell by 6.1% in Q1 2009 and by 2.2% in Q2 2009.

Retail Sales

Percentages



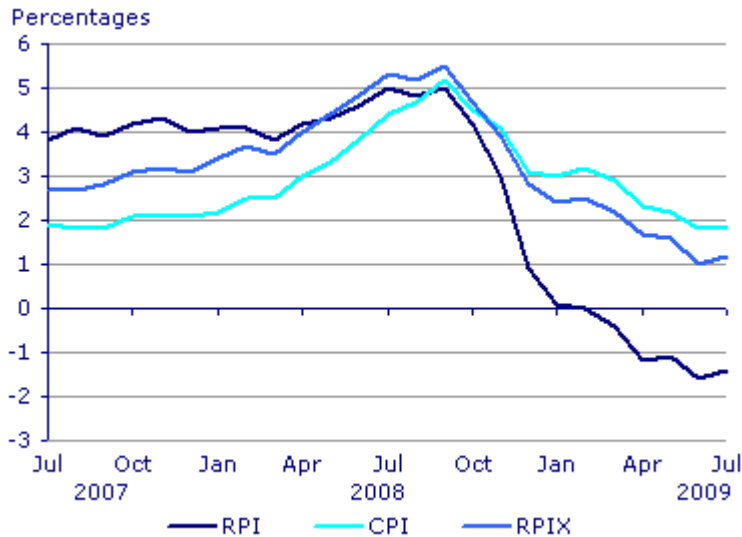
Source: Office for National Statistics (ONS)

The volume of retail sales has generally recovered since the large fall in July 2008. A year later, in the month of July 2009, retail sales were 3.3% higher than in July 2008. Two factors underpinning this growth have been the fall in interest rates from 5% in July 2008 to 0.5% in July 2009 and inflation (CPI) which, in July 2008 stood at 4.4% and had fallen to 1.8% by July 2009.

Activity in the retail sector appears to have held up more strongly in the recession. Seasonally adjusted data for the month of July 2009 compared to July 2008 shows that food stores reported an increase in sales of 2.0% and non-food stores increased sales by 3.4%. Over the same period, within the non-food store sector, non-specialist stores increased sales by 5.6%, and sales in textile, clothing and footwear stores increased by 10.3%, driven by clothing sales.

Household goods stores reported a decline of 0.1% in July 2009 compared to July 2008 mainly due to lower demand for hardware products, and non-store retailing and repair increased by 12.9 per cent over the same period.

Price Inflation



Source: Office for National Statistics (ONS)

Consumer Prices Index (CPI) annual inflation – the Government’s target measure – has fallen over the past year to a level of 1.8 per cent in July 2009, unchanged from June 2009.

The largest downward pressure affecting CPI annual rate came from food and non-alcoholic beverages. This was principally due to prices of some meat, fruit and fresh vegetables falling in 2009. There was a small downward effect from bread and cereals, where prices rose by less than a year ago.

There was also a large downward pressure from restaurants and hotels where prices rose by less than a year ago.

The only large upward pressure affecting the change in the CPI annual rate came from recreation and culture, particularly in the games, toys and hobbies markets.

RPI annual inflation was (minus) -1.4 per cent in July 2009 compared to a year earlier. This compares to a fall of 1.6% to June 2009.

The RPI includes a number of housing costs and with falling house prices and depreciation costs included in the composition of the RPI, this index became negative in 2009.

RPIX inflation – which includes all items present in the RPI excluding mortgage interest payments – exhibited a rise of 1.2% in July 2009, up from 1.0% in June 2009.

As an internationally comparable measure of inflation, the CPI shows that the UK inflation rate in June, at 1.8 per cent, was above the provisional figure for the European Union as a whole of 0.6 per cent.

Many of the economic conditions that formed the background to the 2008 UK Market statement have changed considerably in 2009.

Energy costs have been (generally) falling in 2009 as the oil price which 'ballooned' to over \$134 a barrel for Brent Crude in July 2008 has fallen to less than half of that number. Most recently, oil prices have been rising again.

Fuel costs for industry (electricity, gas and coal) have not fallen however and remain stubbornly high, adding to industry's cost base. However, overall input prices (which includes raw materials) for industry in the UK have begun to fall rapidly from double-digit increases (29.9%) in the middle of 2008 to a **decrease** of 8.7% by the end of Q2 2009.

Industry input prices had fallen further by July 2009 to stand 12.2% below the level of July 2008.

With inflationary pressures receding rapidly in the latter part of 2008, the Monetary Policy Committee of the Bank of England reduced UK base rates to 0.5%, the lowest level since the outbreak of the Second World War. The Bank has also injected additional money into the economy, a mechanism known as quantitative easing. These actions increased money supply up to Q2 2009, but M4, the Government's main measure of the growth in money supply, stalled in Q2 2009 and further liquidity is expected to be introduced to the economy through quantitative easing.

The purpose was to stimulate the economy through creating an environment conducive to investment and growth, while simultaneously facilitating additional liquidity into money markets in order to support and encourage bank lending.

The economy in the first half of 2009 has continued to experience a reluctance by banks to lend to industry and individuals.

However, one of the positive effects of very low interest rates can be seen with the rise in retail sales in the three months to July 2009, as debt repayment eased.

Whilst interest rates are low and as the economy struggles to grow, the fear of inflation is considerably less. A major concern for policy makers however is the lack of growth in the economy and the resultant shortfall in revenues from taxation. Coupled with increased costs associated with unemployment and direct Government support to industry, public sector borrowing is rapidly increasing to levels previously unknown in peacetime.

Government budget deficits will require rectification and the balance drawn between reducing this deficit and stimulating the economy will be a key determinant of how the UK economy performs over the medium-term.

2. Policy Developments potentially affecting Trade in Wood Products

In last year's UK Timber Market Statement, it was noted that the EU was proposing the introduction of EU legislation to adopt a due diligence approach to timber supply for all countries of the EU. This was to ensure that all necessary steps are taken to eradicate the purchase and use of illegal and unsustainably produced timber. This proposed legislation, European Commission proposal 5036/09 is entitled, "Proposal for a Regulation of the European Parliament and of the Council laying down the obligations of operators who place timber and timber products on the market (known as the Due Diligence Regulation)".

The proposal was published by the European Commission in October 2008, and aims to put in place a new risk-based approach to tackling the illegal timber trade, through a requirement of due diligence to be applied by operators placing timber or timber products on the EU market for the first time

The two main sources of timber supply in the UK are from its own forests and from importation from the many countries of the world that export to the UK.

The Forestry Commission is the UK Government department for forestry. The Timber Trade Federation represents the interests of importers and merchants. Both organisations have developed systems designed to help UK forest owners and importers address issues of due diligence in the supply of these products.

For supply from UK forests, the UK Forestry Standard and the issuing of Felling Licences are the methods by which the Forestry Commission ensures compliance to national standards of good forest management. Work has been carried out by the Forestry Commission and the Department for the Environment, Food and Rural Affairs (DEFRA) to explore using the existing framework of controls and standards to deliver the requirements of the proposed new Regulation.

The intended objective of the current EU legislative proposal under the FLEGT Action Plan is to reduce the volume of illegal timber entering the EU, and to change operator behaviour in sourcing timber products. This requires operators to check that the products they sell have been legally harvested. Whether or not forest owners become operators as defined in the Regulation, they will need to be able to provide access to evidence of compliance with applicable legislation that the Regulation asks for - either for their own due diligence system or for that of the processor or trader to whom logs are sold.

Work conducted by Proforest and DEFRA has confirmed that a Felling Licence would provide the necessary evidence of legality for UK forest owners. Additionally, work between the Forestry Commission and DEFRA has determined that there is scope for providing the basis for evidence of compliance with applicable legislation using a risk-based approach i.e. showing that the risk on non-compliance with legislation is acceptably low.

The Forestry Commission would be pleased to discuss in detail the UK's assessment and approach for private woodland owners with representatives from other countries – contact Jonathan Taylor of International Forest Policy, the Forestry Commission in Edinburgh, e-mail jonathan.taylor@forestry.gsi.gov.uk.

In the construction of the EU Proposal, a number of options were considered and investigated, but the option of due diligence was preferred.

The UK Timber Trade Federation (TTF), representing the importing sectors of the industry, has been proactive in the development of a due diligence tool the “Responsible Purchasing Policy” (RPP). The RPP is a tool that assists TTF members to implement the Environmental Code of Practice in the TTF Code of Conduct. This states that ‘Members are committed to sourcing their timber and timber products from legal and well-managed forests’ and complements the UK/EU global policy objective of addressing illegal logging.

The RPP became mandatory for all members from June 2008 and has been designed to help buyers objectively assess the risk of illegal and unsustainable wood products entering their supply chains. This process encourages continual improvement by members towards the sustainable sourcing of timber products.

The RPP simply records timber purchased from recognised third-party environmental certification systems for wood products such as FSC and PEFC and verified legal schemes such as OLB and SGS TLTV. However, where such schemes are not present, members are required to investigate the timber sources further and assign a risk assessment score against that product. To help members achieve this, the TTF has designed a risk assessment flowchart that refers to specific country guidance to help them make a best judgment as to the risk of that particular product.

A supplier located in a low risk country can be high risk if they are sourcing from a high risk country and vice-versa. Where material coming from sources where forest governance is poor and forest management is not always considered to be responsible, proof of claims will need to be routinely requested and, if found to be inadequate, independent verification required. Consequently, underpinning the RPP is the requirement for all members to exercise ‘due diligence’ in their purchasing processes.

The TTF would be pleased to discuss in detail the RPP with representatives from other countries – contact Rachel Butler, Head of Sustainability, Timber Trade Federation, The Building Centre, 26 Store Street, London WC1E 7BT - e-mail rbutler@tff.co.uk.

3. Market Drivers

The main markets for timber and wood-based products remain: construction, the pallets and packaging industries, furniture, fencing and outdoor-use markets and a wide selection of other markets, ranging from the manufacturing of kitchen utensils, picture frames, toys, ladders, transport components and a host of other manufactured items.

It was noted in the 2008 UK Market Statement that the development of **energy** markets for timber products, on a domestic and industrial scale, was beginning to gather momentum. This continues with estimates from the Forestry Commission indicating that supply of forest-based products from UK sawmills to the bio-energy market increased rapidly in 2008. These were in the form of roundwood, wood chips, pellets and other sawmill products, while firewood sales to the domestic market also increased substantially in 2008. Volumes remain relatively small however. The volumes of wood chips, pellets and other sawmill products produced in 2008 was around one million oven dry tonnes of these materials.

Whilst the woodfuel market prospered in 2008, the major markets for timber and wood-based products experienced severe reductions in demand as the UK economy entered into recession.

In the first six months of 2009, all of the main market indicators continue to show lower activity compared to the same period in 2008.

Some of these indicators may improve during the second half of 2009, but the extent of the improvement is likely to be limited and insufficient to offset the weak demand experienced in the first half of 2009.

Consequently, for the full year 2009, each of the main market measures is expected to be lower than in 2008.

This will have a direct impact on the consumption of timber and wood-based products.

Softwood imports in 2009 are likely to be in the region of 14% lower than in 2008.

These main market measures reflect the level of demand, which in **construction** are driven by consumer spending on home improvements, housing starts, public sector procurement and, to a lesser degree, industrial and commercial building and refurbishment programmes.

Similar drivers affect the development of **fencing and outdoor use markets**, such as decking, landscaping, garden products and infrastructure projects, such as motorway fencing.

In the **pallets and packaging** markets, manufacturing output and consumer spending are important drivers of demand and in **furniture** markets, consumer spending and business investment have a direct impact on sales.

A further and increasingly important driver of greater usage of timber products is the ability to re-use and recycle in all of the above-named markets.

The construction industry in the UK has been particularly badly affected by the recession.

In 2008, total construction output was lower by 0.4% with the volume of new work down by 2.2%. Within these totals the new housing market suffered sharp reverses in volume. The number of new housing starts in the UK in 2008 was 140,500, a reduction of 35% on 2007. The timber frame sector of the new housing market was not immune to this lowering of demand, although its impact on new timber frame units built was less than for masonry and other materials. This relatively better performance than for other methods of construction enabled the timber frame industry to increase market share to an estimated 25% in 2008, up from 22% in 2007. A significant contribution to this growth in market share came from the social housing sector – where timber frame has enjoyed much success. The 35% reduction in all housing starts comprised a **41% decline** in private sector housing starts and a **16% increase** in social sector starts in 2008.

The repair, maintenance and improvement (RMI) sectors of construction fared better than the new work sector in 2008 and in 2009 to date.

As the output of all new work fell by 2.2% in 2008, RMI output increased by 1.8%.

More timber and wood-based products are used in the housing sectors of RMI markets than in the non-housing sectors, such as industrial, commercial and infrastructure projects and the relative performance of housing RMI in 2008 opposite non-housing RMI helps to explain the substantial decline in timber and wood-based products consumption in 2008. Total housing RMI output **fell by 16%** in 2008 while non-housing RMI output **increased by 4%**.

The decline has continued into 2009. The latest data available for Q1 2009 reveals **public** sector housing RMI was 4.7% lower than Q1 2008 and **private** sector housing RMI lower by 9.6%.

The second half of 2009 is expected to witness an improvement on these negative output data. Consumer spending in the whole economy was 3.2% higher in July 2009 compared to July 2008, indicating that an upturn in the purchasing of goods and services is taking place. Credit remains tight and although some improvement in mortgage approvals has been detected during the summer of 2009, the number of property transactions was 11% below the level in 2008. Consequently, the 'improve rather move' destination for discretionary spending should benefit timber and wood-based product volumes in the second half of 2009. However, any improvement, much as in the consumption of softwood as noted above, will be insufficient to offset the decline in output experienced in the first half of 2009.

In the medium to longer-term, especially in the new house building market, the prospects for growth are good. The demand for new homes exists, although credit with which to buy homes is not as accessible as required to convert this demand into home sales. However, interest rates are at historically low levels (and likely to stay low over the next twelve months to encourage growth and investment in the economy) and therefore any easing of credit restrictions is likely to stimulate demand and hence building activity. A medium-term constraint on this happening is increasing levels of unemployment and insecurity over the permanence of existing employment.

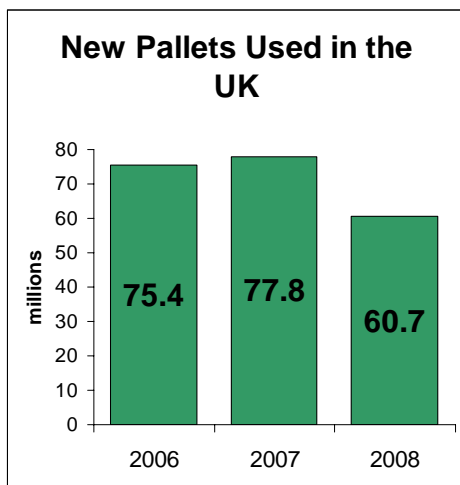
Longer-term, Government initiatives are intended to drive new building and refurbishment programmes aimed at creating better quality housing stock which is more energy efficient and therefore less expensive to heat and which will support the Government's carbon emissions reduction targets.

If these initiatives prove effective, timber and wood-based products should benefit, in terms of increased volumes used.

**Main Indicators
Construction**

	2008	2009 td	Comment 2009
UK Housing Starts	-35.2%	-8.8%	England to Q2
RMI Housing Output	-16.8%	-7.9%	to Q1
New Housing Orders	-38.4%	-38.8%	to Q2
Property Transactions	-37.9%	-46.0%	Eng & Wal to Q2
Mortgage Approvals	-58.2%	3.4%	to Q2

The decline in the number of pallets used in the UK in 2008 was consistent with the general downturn in the economy. Although only provisional data, the change in the number of pallets used in the UK in 2008 was as shown in the chart below.



The reduction in use amounted to a fall of 25%.

There is some debate over the definition of new pallets, but it would appear that in 2008, a lower number produced and imported was accompanied by a greater amount of re-use and repair. This is indicated by the performance of the industry sectors where pallets are most used.

UK manufacturing output in 2008 was 2.8% lower than in 2007 and 1.2% lower in distributive trades, where pallet re-use is often more prevalent.

This belief that there was a greater incidence of re-use and repair is further supported when viewing the breakdown of activity within the distributive trades sector. Wholesale output was lower by 3.8% in 2008, but retail output (and potential pallet re-use) was **higher** than 2007 by 3.7%.

The demand for pallets and other packaging materials continues to look weak in 2009. UK manufacturing output in June 2009 was 11.7% lower than in June 2008 and for the same period, wholesale output in distributive trades was 10% lower, whilst retail output continued to grow, but only at a rate of 1.3%. This moderate growth in retail output is however consistent with the rise in consumer spending noted previously.

Main Indicators

Manufacturing & Distribution

	2008	2009 td	Comment 2009
Manufacturing Output	-2.8%	-11.7%	at Jun 09 / Jun 08
Wholesale Output	-3.8%	-10.0%	at Jun 09 / Jun 08
Retail Output	3.7%	1.3%	at Jun 09 / Jun 08

Of all main timber consuming market sectors, fencing and related outdoor markets have performed the least badly. Benefiting from the higher activity in home refurbishment markets and the agricultural and motorway and public amenity markets, the fencing, decking and garden products production has fared better than construction and other manufacturing.

Demand from the domestic market for fencing and garden products has been relatively strong in the first half of 2009, but for industrial and landscaping uses, a degree of uncertainty has entered the market. Some of these projects have either been postponed or cancelled due to the shortage of investment funds and the need to reduce costs. This is in part confirmed by the 12% drop in the volume of new orders for public works.

New domestic decking projects in 2009 to date are around 40% lower than in the first few months of 2008, according to industry sources, but the refurbishment market has fared better. The Timber Decking Association confirms the trend towards deck refurbishment and extension and indicates that this activity in 2008 accounted for up to 12% of total turnover of its members. This trend has continued into 2009.

Although volumes are currently very small, a developing trend in the decking and other outdoor products market is the use of modified wood products. Modified softwoods, are thought to offer greater durability and lower maintenance and are likely to stimulate further the decking and other outdoor products market.

4. Developments in Forest Product Markets Sectors

a) Wood Raw Materials

In 2008, for the first time in the current decade, private sector softwood removals declined.

All softwood removals in 2008 were lower by 6.6%, with the private sector lower by 8.2% and removals from the public sector down by 5.1%. It should be noted however, that the volume of removals in 2008 returned to the levels of 2006. Removals in 2007 were at record levels.

Although the 6.6% scale of decline amounted to around 600,000 tonnes less being available in 2008, the reduction was considerably less than was initially feared for 2008.

The largest falls in deliveries of UK grown softwood in 2008 were to sawmills and panel producers. Supply to pulpmills, fencing contractors and to woodfuel markets were higher in 2008 compared to 2007.

Optimism for better all-round performance in 2009 from UK growers is low and this sentiment is supported by the first half 2009 volumes of imported coniferous roundwood, which are 48% lower than in the first half of 2008.

b) Wood Energy

The volume of UK grown softwood delivered to woodfuel markets in 2008 was estimated to have increased by a half, to 300,000 green tonnes.

As mentioned earlier in this statement, wood chips, pellets and other sawmill products consumed in 2008 amounted to around one million oven dry tonnes.

Once the preserve of a very small number of users outside of the domestic firewood market, the interest in and application of 'woody biomass' materials is continuing to grow.

The types of woodfuel in use include short-rotation coppice, arboricultural arisings, forest arisings, brash and sawmill co-products. These products are being used in small domestic to community heating systems, but also by timber producers themselves to provide energy for their wood processing operations.

It was noted in last year's statement that larger installations - on an industrial scale - would become increasingly significant and this is happening.

The 50 MW combined heat and power plant at the UPM Caledonian 'Targe' paper mill has successfully started, ahead of schedule, and is expected to consume around 400,000 tonnes of woody biomass materials in the course of a year. The plant will supply half of the mill's electricity needs and all its process steam requirements and will also contribute to the Scottish government's target to have 50% of all energy consumed from renewable sources by 2020. It has been estimated that CO² emissions will be reduced by 75,000 tonnes, by not using fossil fuels

Having begun generating electricity in December 2007, the E.ON Steven's Croft plant at Lockerbie is the biggest biomass plant in Scotland. Generating electricity for the equivalent of 70,000 homes, the plant is fuelled entirely by biomass material. It is estimated that of the 480,000 tonnes of fuel needed to power the station every year, 60% consists of sawmill co-products and small roundwood, 20% short rotation coppice (willow) and 20% is obtained from recycled fibre.



The E.ON plant at Lockerbie

The Semcorp installation in Middlesbrough also commenced operations in 2007 and at full capacity is predicted to generate sufficient electricity for 30,000 homes. An important outcome from this activity will be a saving of 200,000 tonnes of CO² emissions compared with conventional fossil fuel-burning power stations. The materials supplied to fuel the power station are small roundwood, recycled wood - supplied in the form of chips, sawmill co-products and a growing crop of willow, also to be supplied as chips.



Semcorp biomass plant in Middlesbrough

Other recent developments include a £250m biomass and waste-fuelled power station to be built at Tilbury Docks. Tilbury Green Power Ltd plans to import 90% of the biomass – wood chips – from Europe and the US, with the intention of securing the majority of its needs from UK sources within five years. The plant is planned to generate 60MW of electricity.

The Pontrilas Timber Group plans to develop a 10MW biomass power plant over the next 12-24 months in a £35m joint venture with Belgian company Renogen. Approximately 120,000 tonnes of wood waste a year will be processed from the company's Pontrilas site and its pallet business. At present, wood waste is sold to panel

manufacturers and other biomass users. The plant will supply all of the company's electricity needs – around 1.5MW – and the rest will be sold to the grid. It will also supply heat for the kilns, which currently consume 600,000 litres of kerosene a year.

Perhaps one of the most ambitious biomass projects to date is for the development of three biomass power stations costing around £2bn, to be operated by Drax. Plans for power stations in Immingham and Hull have been approved by the company with a third site to be decided. The plants are expected to consume a mix of roundwood, wood chips and pellets, most of which will be imported. Each of the planned biomass-fired plants would generate 300MW. According to the company, once all three plants are operational some time after 2015, Drax would be responsible for supplying at least 15% of the UK's renewable power and up to 10% of total UK electricity.

Biomass developments have continued despite the recession in the UK, although many of the developments were underway before the current economic downturn. There have been casualties however. The Forscot project at Invergordon has been scrapped due to funding difficulties. Originally planned as an integrated pulp, paper, sawmill and biomass plant in the Highlands, ambition was restricted to pulp and energy production before lack of funding sealed its fate. This facility has been supplanted by a pellet production plant operated by Balcas and is due to open in 2009. The material supplied is estimated to amount to 200,000 green tonnes. Another pellet manufacturer, Puffin Energy, has commenced manufacturing in Aberdeenshire.

As electricity generation and other heat and energy capacity grow, it has spawned new developments in the supply of materials and equipment. Timber companies, such as Clifford Jones, Balcas and JELD-WEN, are now producing pellets or briquettes, while there are, as mentioned previously, other timber processors and users reducing energy costs by using their own wood waste to heat their premises. A British boiler manufacturer (Talbot's Biomass Energy Systems Ltd) has reported a steady demand from its established customer base of furniture manufacturers and timber processors for burning wood waste. These developments are not just unique to the timber industry however as increasing levels of sales of wood burning boilers have been made to schools, hospitals and country estates in the last year.

c) Certified Forest Products

The positive development of certification in the UK continues. Once more, in 2008, the proportion of UK sawmills holding chain of custody certificates grew, to 43% of the total. Fewer mills operated without certificates, down from 80 in 2006 to 73 in 2007 and 60 in 2008.

Chain of Custody Certificates, 2008

	With certificates	Without certificates	Not reported	Total
Sawmills				
< 5,000m ³ sawnwood	9	51	5	65
> 5,000m ³ and < 25,000m ³ sawnwood	14	8	1	23
> 25,000m ³ sawnwood	26	1	0	27
All sawmills	49	60	6	115
Round Fencing Manufacturers	15	25	15	55

Despite consolidation in the industry over the last few years, the UK sawmilling sector is still populated by many smaller firms, the majority of which do not have chain of custody systems in place. A total of 43% of mills hold certificates, but as shown below, 75% of UK sawmill production and 81% of sawmill consumption is certified. As these numbers suggest, chain of custody supply chain verification is mostly practised by the larger sawmills in the UK.

Percentage of Volume Certified, 2008

Year	Private Sector Removals (softwood)	Saw Consumption (softwood and hardwood)	mills Production (softwood and hardwood)	Round Fencing Manufacturers Consumption (softwood)
2003	54	67	50	36
2004	74	80	63	58
2005	69	76	71	53
2006	67	81	64	46
2007	74	78	65	54
2008	65	81	75	66

Differences in the percentage of volume certified between years need to be viewed with caution as changes in demand for sawn goods from different markets – particularly from the larger mills - can alter the proportion of production that is certified from year to year.

d) Value-added Forest Products and Engineered Wood Products

The sharply lower volumes of softwood consumed by the construction industry in 2008 have - at least temporarily – halted the advance of further processed (value-added) goods.

Volumes of all types of softwood fell in 2008, but the scale of decline of further processed goods, such as planed, square-edged and finger-jointed softwood was greater than for sawn softwood. Imports accounted for around two-thirds of all softwood volume consumed in 2008 and the proportion of further processed softwood fell from 29% of the total in 2007 to 26% in 2008. In volume terms, further processed softwood declined by 36% while other sawn softwood fell by only 23%.

The newer forms of engineered wood products have not been immune to the ravages of the recession. Volumes of I-joists, flooring cassettes and wall panels, most of which are manufactured in the UK, are all probably lower in 2008 (sales not reported) and imports of glued laminated timber fell by 25% in the six months to June 2009.

The fortunes of modified wood products have also been mixed in 2008 and 2009, with the opportunity to grow sales limited by low levels of building in the UK.

The potential for significant volume sales has been recognized by a number of forward thinking companies which have entered into distribution agreements with manufacturers of these products or are distributing varieties of modified wood manufactured by parent companies.

Modification of softwoods through heat, impregnation or acetylation greatly enhances the original properties of the softwood used, providing users with increased durability, consistency and stability in service. The number of varieties of modified wood products in the UK market is indicative of the belief that substantial volumes will be won in years to come. Currently, products available include, Kebony, Plato Wood, Lignia, Accoya, Indurite and Thermowood.

Although distributors report growing levels of sales, it is considered that volumes are still fairly small. Nevertheless, the inherent performance advantages, coupled with the environmental advantages over competitive products (UPVC, steel) bode well for future growth.

The ability to present a complete marketing proposal by distributors may well be instrumental to the success of these products as there will be a need to convince potential users of the long-term cost-benefits compared to traditional wood-based or competitive materials.

e) Sawn Softwood

The year 2008 witnessed lower volumes produced by UK sawmillers and the lowest volume of softwood imports for over 50 years.

In 2008, UK production of softwood was 11% lower as imports fell by 31%. It should be noted however that UK production in 2008 returned to similar levels as seen in 2005 and 2006. Also, the year 2007 was a record year for UK sawmill output.

As predicted in last year's Timber Market Statement, UK production in 2008 fell below the 3 million cubic metres mark, reached for the first time in 2007, and softwood imports were below the 6 million cubic metres, down to a level of 5.5 million cubic metres.

In comparison to imported softwood supply, UK producers have fared better, at least in volume terms, as fencing and pallet manufacturers have sourced increasing quantities of softwood from UK mills. Shortage of some grades from importers, coupled with pressure on import prices from a falling exchange rate in 2008 and into early 2009, has enabled UK sawmillers to increase market share.

In 2009 to date, market conditions have yet to experience any real improvement, although it is believed that continued shortages of some imported material has continued to benefit UK producers in the lower value markets such as fencing and pallet making.

The area of greatest weakness - the market for carcassing - has in the first half of 2009 shown little sign of improvement which, in turn, has lowered the overall value of products coming from UK sawmills.

Output of other sawmill products, (sawmill chips, sawdust, bark etc), by virtue of lower production of sawnwood was also lower in 2008. With increased demand for woody biomass feedstocks unable to be fully satisfied from these other sawmill products, a potential shortfall of wood fuel has been avoided due to greater use of previously under-utilised arboricultural arisings, fuel-grade recycled wood and woody green-waste material.

Co-firing with domestic sawmill products at coal-fired generating plants continued at nominal levels throughout the year, with a greater consumption of imported wood pellets preferred to wetter sawdust, wood fibre and chips.

Traditional bark products for use as ground cover and mulches continue to come under increasing pressure from recyclates and processed green-waste from local authority recycling operations.

Softwood imports in 2009 were 27% lower for the first six months, but since the low point in volume imports in December 2008, the rate of decline in softwood imports has slowed.

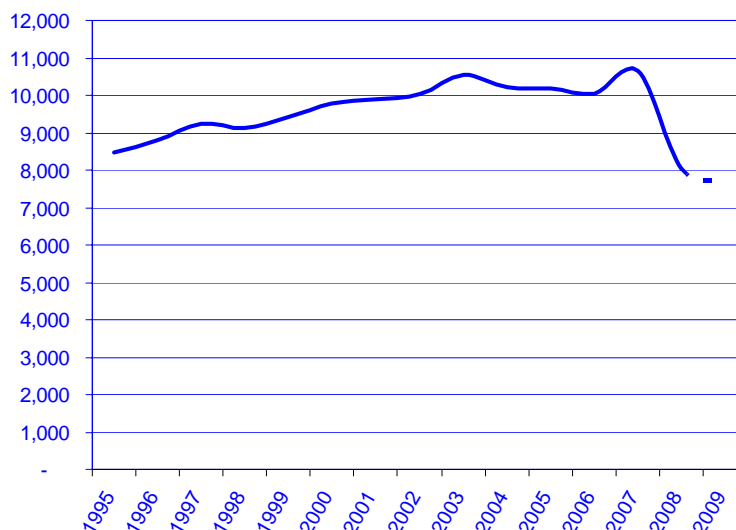
The final quarter of 2008 was one of the worst quarters on record for imports and with a continued improvement for the second half of 2009, the overall deficit on volume by the end of the year promises to show an improvement on the shortfall in the first half of the year.

The National Softwood Division of the Timber Trade Federation produce an estimate each year for the second half and a forecast for the following year. For 2009, the NSD predict that softwood import volume will be around 14% lower, followed by a recovery of similar proportions in 2010.

Forecasts for UK production for 2010, based on the advice of the Forestry Commission's Expert Group on Timber and Trade Statistics, are available as shown in the UNECE Timber Committee tables. For 2009, based on existing sentiment in the market for UK produced softwood and exports, plus the most recent NSD forecast, a projection of consumption for softwood in the UK to the end of 2009 can be made. This is given in the chart below.

UK Sawn Softwood Consumption

000s m³



Source: Forestry Commission; Timber Trade Federation; *timbertrends*

Levels of consumption are predicted to fall once more in 2009 to 7.7 million cubic metres, a fall of 4.5% over 2008.

f) Sawn Hardwood

UK production of sawn hardwoods has stabilized over the last few years with volume at around the 45,000 cubic metres level. This has reduced from a volume of nearly 150,000m³ in 1997.

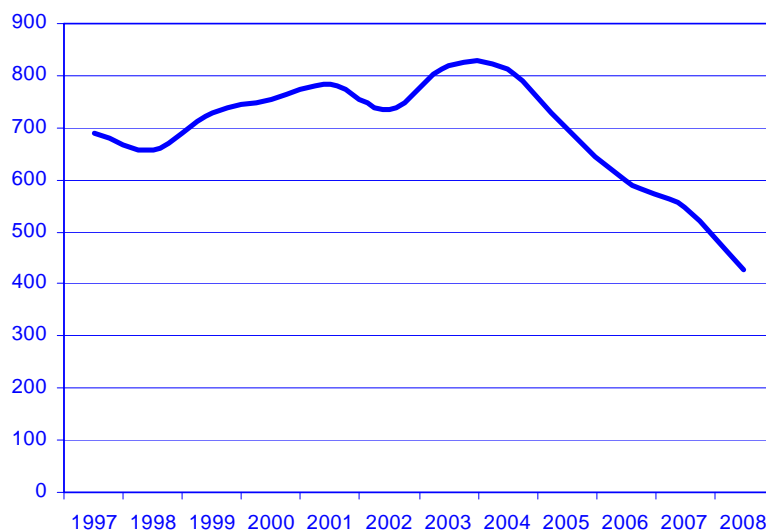
Hardwood imports have also been declining in recent years, falling from over 700,000m³ in 2003 to just under 400,000m³ in 2008.

Export volumes are relatively small and do not materially affect the level of consumption in the UK, but with export volumes included, the apparent consumption of hardwoods in the UK in 2008 fell by roughly equal measure to the fall in softwood consumption, down by 22% over 2007.

The development of hardwood consumption since 2003 is shown in the chart below.

UK Sawn Hardwood Consumption

000s m³



Source: Forestry Commission; Timber Trade Federation; *timbertrends*

Forecasts for UK hardwood production for 2010, based on the advice of the Forestry Commission's Expert Group on Timber and Trade Statistics, are available as shown in the UNECE Timber Committee tables.

g) Wood-based Panels

In common with other product areas, demand for all wood based panel types slowed significantly during the first three quarters of 2008 culminating in a dramatic fall in the fourth quarter as merchants destocked in response to significantly lower demand particularly from the construction sector. To reduce growing stock levels, panel manufacturers were forced to cut back production, with quarter four of 2008 particularly affected.

Reduced shift patterns were implemented by manufacturers during the first half of 2009 with consequential job losses.

Restocking in the early part of 2009 provided encouragement, but sales levels were between 20 to 30% lower than for the same period in the previous year.

The only direct benefit of poor economic conditions in the UK economy was the weakness of Sterling which helped to restrict imports to the benefit of the domestic producers.

Markets other than construction declined but at different rates and to differing degrees. A decline in furniture sales can be attributed to the collapse in consumer confidence and a tightening of consumer credit. There have been some indications of stabilization in the domestic house building market at the start of quarter three 2009 along with an increase in renovation and maintenance activity, but any recovery in activity will probably be insufficient to forestall further losses in volume by UK panel manufacturers in 2009.

Wholesale gas and electricity costs reduced in the first half of 2009, along with a reduction in the cost of resins, driven in general by lower oil related commodity prices and significantly weaker demand. However, these favourable movements mask an underlying problem that may hinder the industry's long-term growth. Subsidised biomass energy production capacity is increasing at a rate which is creating a significant imbalance between wood supply and demand and as a consequence wood prices are likely to increase significantly over the next few years. This will severely affect the industry's ability to remain profitable.

h) Pulp and Paper

Consumption of wood pulp in the UK in 2008 was just over 1.55 million tonnes, lower than in 2007 by just over 5%. The forecast made in last year's Timber Market Statement was accurate, predicting consumption of 1.56 million tonnes. This reduction in consumption came as a result of a reduction in imports of 106,000 tonnes, or 7.7% below the level in 2007.

UK pulp production in 2008 was higher than in 2007, by 13,000 tonnes, but effectively, between them, the two pulp mills in the UK placed an increased volume of 23,000 tonnes into the domestic market, with imports lower in 2008 by 10,000 tonnes.

For 2009 and 2010, according to advice provided by the Expert Group on Timber and Trade Statistics, activity levels are expected to be very similar to those in 2008 and no increase in import volume or production is anticipated in the short-term.

Paper and paperboard production fell by 4.7% in 2008 to stand at around 5 million tonnes. Imports fell even further, down to 7.4 million tonnes from 7.9 million tonnes in 2007, a decrease of 5.9%.

Total paper and paperboard consumption in the UK in 2008 finished 6.4% lower, at 11.4 million tonnes.

In 2009, both imports and production are predicted to be lower once more, resulting in a lowering of consumption to just over 10 million tonnes in 2008, a fall of 10%.

An improvement is anticipated in 2010 however, with consumption predicted to return to a level of around 10.6 million tonnes, an increase of 3.3%.

i) Carbon Markets in the Forest Sector

The UK forest sector is not currently a participant in compliance (i.e. Kyoto) markets for carbon. However, a significant voluntary market in forest carbon has developed in recent years, based almost entirely on forest carbon projects for corporate social responsibility purposes. The Forestry Commission is developing a Code of Good Practice to increase market confidence in the capacity of woodlands to sequester and store carbon. It is hoped that the Code will help to stimulate investment in forestry.

The Forestry Commission has issued a consultation document that sets out its view of how the Code could be applied. This can be read at:

[http://www.forestry.gov.uk/pdf/CodeofGoodPracticeConsultationDoc9.pdf/\\$FILE/CodeofGoodPracticeConsultationDoc9.pdf](http://www.forestry.gov.uk/pdf/CodeofGoodPracticeConsultationDoc9.pdf/$FILE/CodeofGoodPracticeConsultationDoc9.pdf)

It is expected that much debate will take place about the proposals for the Code and the wider issue of forestry's potential role in future compliance markets.

5. Tables

UK Economic Indicators (% unless otherwise indicated)

	2004	2005	2006	2007	2008	2009 (est)
GDP growth¹ (at constant 2003 market prices)	1.8	1.8	2.9	3.0	0.7	- 4.3 ²
Interest Rate (Base Rate at year end)	4.75	4.5	5.0	5.0	2.0	0.5 ²
Consumer Price Index	1.3	1.9	3.0	2.1	3.1	1.2 ²
Unemployment (ILO)	4.8	4.8	5.5	5.2	6.3	7.5 ³
UK Housebuilding Starts (000s)	227.2	227.2	230.5	216.8	140.5	110.0 ³

¹GDP growth is measured on a current quarter compared to the same quarter of the previous year

² HM Treasury, Forecasts for the UK Economy: A Comparison of Independent Forecasts, August 2009

³*timbertrends*