

Uncertainty overshadows positive outlook

Brexit is now a certainty; but what it means to the UK and the wider economy is definitely not. Certainly the forecasts of the impact on exchange rates have very much delivered in terms of the weakening pound Sterling, but what is not so evident is that the historic inverse relationship between the Sterling/Euro exchange rate to log prices in the UK is maybe not as strongly correlated as previously. The reason for this seems to be that the Swedes and other importers are differentiating their product into C16 and C24 rather than mixed grades and the C16 imports are priced to compete directly with the UK sawn product. In addition, the Irish continue to bring in timber to the UK at extremely competitive prices that undercut UK domestic products.

Despite this somewhat differing picture on imports sawmills are busy and running full shifts with generally good order books. Demand for logs is good and prices are positive. The graph below is an index and plots a mean UK green log price from a representative sample of the private sector supplies across most markets. The chart plots the mean log price trend and the individual mill variants. The range in price indices data points is as a result of size (dbh), length and location. It reflects the upturn in log price seen coming through at the end of 2016. What is not so certain is that this price will continue upwards.

Competitive imports

Interestingly, on the continent things are developing differently and add to the likelihood of continued competitive imports coming in despite the exchange rate shift in the UK. The European Sawlog Price Index reached its lowest level in six years in the third quarter of 2016 because of lower sawn timber demand and reduced prices in both domestic and export markets, as reported in the Wood Resource Quarterly. Over the past two years, sawlog prices have fallen more in Europe than in any other region of the world. The index has trended downward for the past few years and in 2016 has been at its lowest level since 2010. Much of the recent decline has been the result of reduced demand for sawn timber in some markets and generally lower prices in both domestic and export markets. During the past two years, sawlog prices (in Euro terms), have fallen the most in Finland, Norway, Poland, Austria and Estonia, all countries that are major exporters of softwood logs or lumber. The slowing demand for sawn timber in Europe has also resulted in a decline in log trade on the continent. WRI estimates that total trade of softwood logs will be down about 12% in 2016 as compared to the previous year and that shipments will be at their lowest level since the global financial crisis in 2008 and 2009. Some of the biggest declines in trade this year has been in exports from Norway, France, Ukraine and Latvia.

Small roundwood is currently slightly less exciting



TILHILL FORESTRY
TIMBER MARKET
REPORT

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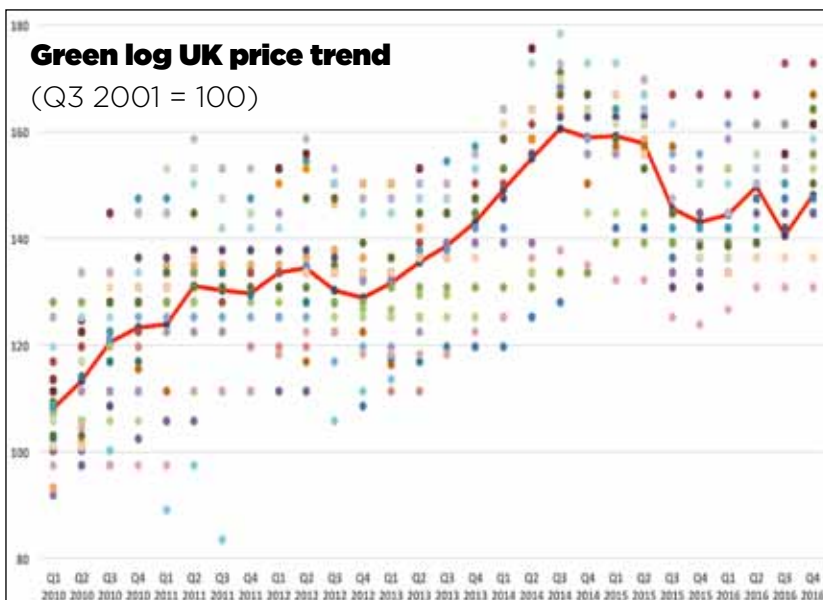
in the domestic market with most users being well supplied and Kronospan's woes not yet resolved and unlikely to be before the spring. So it appears that across the country there is a plentiful supply of small roundwood for biomass, pulp and chip. Again this mismatch in demand for logs and srw is a pattern that is repeating itself and one that was evident a couple of years ago when log demand was high and srw was difficult to move.

Standing sale prices have remained high and grower expectations continue to rise. There has been an increase in off market negotiations and this has impacted on the amount of timber coming to the open market which is not helpful to the trade in general. The usual early spring flush of standing sales is poorer than previous years and woodland owners would do well to present timber to the market whilst demand is up.

Looking ahead there are positive signs on house building activity and the UK construction industry enjoyed the fastest growth in new orders in almost a year in December, according to a survey, but the weaker pound has driven up firms' material costs to their highest in five-and-a-half years. The construction purchasing managers' index rose to 54.2 in December 2016 from 52.8 in November, signalling stronger expansion. Improving order books and a general rebound in business conditions helped lift construction output to the highest level since March, the report said. Housebuilding was the main driver behind construction growth again and grew at the fastest rate since January 2016.

The overall outlook on balance has to be considered positive, but the many uncertainties and changing market dynamics will ensure that successfully forecasting ahead remains a challenging task.

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A shifting scene across markets

Global demand

2016 saw a steady increase in global demand for timber which resulted in a substantial increase in volumes traded compared to 2015. Increased demands for wood products in China and the USA have been the driving forces of increased trade. Whilst domestic production in the USA has increased steadily over the last 12 months the increased demand has seen a steady increase in imported volumes. China has seen record levels of imported timber in quarters 2 and 3 of 2016. There have also been modest increases in European and Asian demand.

Meanwhile, there has been a two-year period of readjustment of log prices worldwide; significant trends have been increasing log prices in the USA and Canada whilst prices in Europe and Scandinavia have fallen.

By the close of 2016 it appeared that this period of readjustment had concluded and log prices had stabilised in most areas and were starting to increase as global demand improved.

Whilst the wider world becomes more attractive for the Scandinavian and European producers the UK remains core business for many of them and despite adverse currency movements they are fighting hard to retain market share in the UK.

UK situation at the close of 2016

After the lull caused by the Brexit vote the UK market has steadily improved throughout the last six months.

The weak pound is beneficial to most wood using businesses as improved manufacturing and construction activity stimulates demand for wood products from pallet and packing material, fencing and carcassing timber through to board products.

The UK producers have experienced a definite upturn in demand over the last six months with a noticeably reduced seasonal slowdown in winter. January 2017 has seen most sawmills busy and actively seeking raw material.

Whilst demand for sawlogs has been excellent the small roundwood market has been severely impacted by the problems at Kronospan and whilst Kronospan are gradually increasing their roundwood requirement it is still well below normal levels.

This has caused a nationwide build up of stocks of small roundwood leading to reduced prices in Scotland and the North of England and static prices in the rest of England where the relentless increase of biomass consumption has maintained competition for supplies.



TIMBER AUCTIONS MARKET REPORT
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Where are we now?

England and Wales

January 2017 sees high stocks of small roundwood nationwide but strong demand for sawlogs and pallet wood.

Log supplies from the forest have steadily improved over the last six months to the point where in England supply is starting to balance with demand. Prices for standing timber in England and Wales remain excellent and good quality spruce / Douglas fir harvester / forwarder parcels in Wales and the Borders are now topping £40 per tonne standing. Prices for larch and mixed conifer logs lag behind by £5 to £10 per tonne depending on specification and location.

There is strong competition to buy from processors and still plenty of contractors looking for work which translate through to excellent standing prices for growers.

Spring 2017 would be an excellent time for growers to look to bring awkward and difficult sites to the market provided they have good sawlog content. Growers may wish to hold parcels with a high small roundwood content back for 3 to 6 months until the Kronospan situation has eased.

Currently the biomass market is holding demand and consequently prices for the small roundwood market up in England but as this demand declines in the spring we may see a readjustment of prices.



Scotland and North England

In the North increased production from the forest is easing the sawlog supply situation but there is still strong demand. The Irish mills have returned to UK market strongly and are very active along the West Coast of Scotland seeking supplies of sawlogs which has caused a steady increase in standing prices over the last six months.

Prices for standing crops appear to have risen more sharply than product prices, especially in the Scottish Borders and North England where there is intense competition to buy and prices of over £40 per tonne standing in some cases.

In some areas there has been a shortage of parcels being offered to the market for working in the spring at a time when processors are especially keen to secure raw material for the seasonal upturn in demand.

Sawlog prices, especially those for spruce, have increased steadily over the last six months and are hovering around £60 per tonne delivered for UK mills and £50 per tonne at quayside for export material to Ireland. Haulage costs and log specification can cause substantial variation in more remote areas and can make export an attractive option.

Export enquiries for other markets in Scandinavia and Europe may also emerge at current exchange rates especially when the seasonal upturn in mill activity starts to put pressure on supplies.



Manufacturing and construction activity stimulates demand for wood products

Outlook for spring 2017

There is a mood of quiet optimism; the world appears to be coming to terms with Brexit without significant disruption to the UK economy. There is a school of thought that the UK government will try to keep the pound weak so they can reduce debt levels and the balance of trade deficit. A weak pound is beneficial to primary producers in the timber industry and it appears that the next six months will have good trading conditions for UK processors.

The reaction of the main importers to the UK is interesting; the Scandinavian mills are now using specification pricing to counter the competitive advantage of the UK mills in the C16 market. The Irish approach is much less subtle, it appears the pricing of sawlogs in the Irish Republic takes into account the Euro to GB £ exchange rate so that the Irish mills can remain competitive in the UK which is their primary export market. Whether this constitutes state support is a matter for Mrs May to resolve in the Brexit negotiations but it may prevent true market forces operating in the sawn timber market.

This has meant that the price for KD C16 carcassing has remained around the £165/m³ mark over the last three to four months whilst the KD C24 carcassing from European and Scandinavian producers has increased to over £200m³. The UK mills are fighting hard to achieve modest price increases, but it is hard won and small gains a bit at a time.

January 2017 has seen a renewed round of negotiations as the mills seek to increase sawn timber prices to catch up with recent increases in log prices.

£ per tonne delivered to customers in Wales, central and south England

Product	Lower price	Upper price	Trend
Log 18	£58.00	£63.00	↑
Bar 14	£45.00	£50.00	=
SRW	£38.00	£42.00	= ↑
Fencing	£48.00	£52.00	↑
H Wood firewood	£43.00	£48.00	↑

£ per tonne delivered to customers in north England and Scotland

Product	Lower price	Upper price	Trend
Log 18	£55.00	£65.00	↑
Bar / pallet 14	£40.00	£45.00	= ↓
SRW	£35.00	£40.00	= ↑
Fencing	£48.00	£52.00	↑
H Wood firewood	£40.00	£45.00	↑

These prices are for guidance purposes only and are based on historic market information.

Summary

Despite the uncertain times the background conditions appear set for a good spring and early summer season. It is uncertain how long the price increases of the last six months will continue as adjustments in the log prices in Europe and Scandinavia have now largely countered the currency movements. Imported timber will continue to determine the UK prices and we will have to react to these. In many parts of the country standing timber prices are approaching recent peak prices of early 2014 and growers would be well advised to bring their timber to the market early in the year whilst the demand and prices remain strong.