

UNECE TIMBER COMMITTEE – October 2014

UK Timber Market Statement

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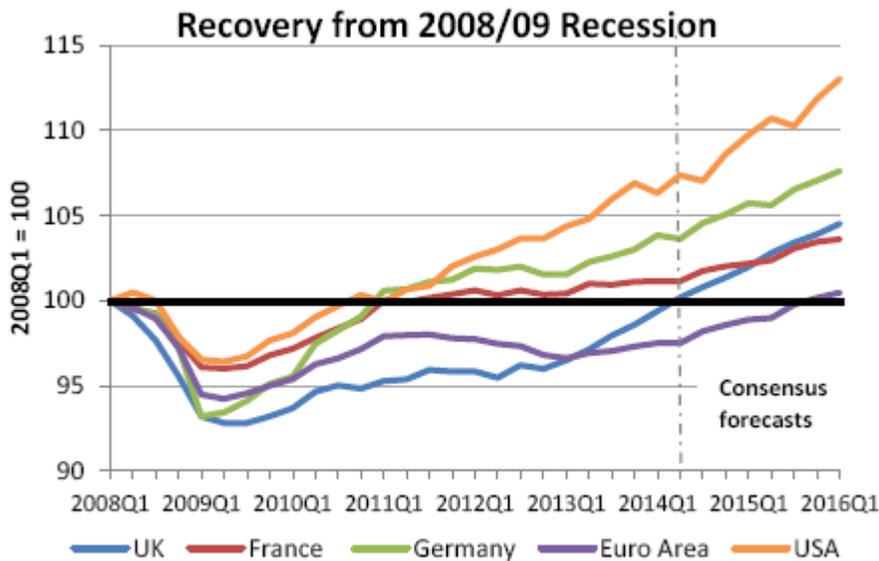
1. General Economic Trends affecting the Forest and Forest Industries Sector

Overview

Following a major economic downturn in 2008/9 and a smaller downturn in 2011/12 the UK economy has now been growing steadily for over a year and in November 2013 there was a consensus amongst Monetary Policy Committee (MPC) members that the UK had entered a sustained economic recovery. In 2014 Q2, after more than 6 years the UK finally surpassed its pre-downturn level of GDP and is now the fastest growing G7 economy with the International Monetary Fund (IMF) forecasting growth of 3.2% in 2014. Although, as chart 1 shows a number of other economies did recover earlier and remain above the UK. In addition to continued improvements in GDP, unemployment has shown strong improvements over the past year, falling to 6.4% from 7.8% at the same time last year.

The economic recovery continues to broaden domestically with increased spending by businesses and households being supported by lower uncertainty and improved credit conditions. The key exception in the recovery remains productivity growth which is yet to show signs of sustained improvement. Despite moderate improvements in 2013 productivity growth stood at 16% below its pre-crisis level in June 2014 and is currently anticipated to only pick up moderately.

Chart 1: Recovery from the 2008/9 recession



Source: Eurostat & OECD; Updated 14th August 2014 (Quarterly)

The MPC has followed a policy of issuing forward guidance since summer 2013 in order to provide more clarity and assurance to the market over future long term interest rates. The MPC announced conditions that the economy, and its indicators, should meet before they expect to increase interest rates. In February 2014 the MPC issued fresh guidance that there remained spare capacity in the economy, that interest rates would be unlikely to rise until this had been absorbed and that when interest rates do rise a return to 'normal' rates of 5% would be unlikely in the medium term. The domestic recovery continues to be

accompanied by a strengthening labour market with the employment rate standing at 73.0%. Although the strengthening labour market figures are in contrast with continued weakness in wage growth.

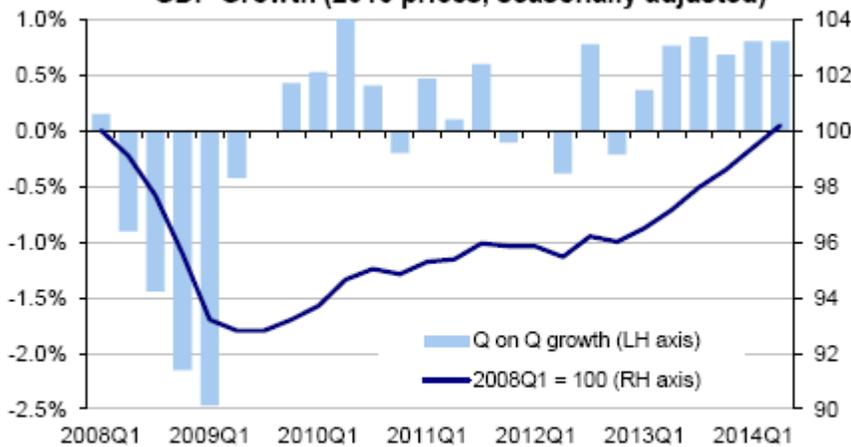
In light of the economic outlook the MPC voted at its most recent meeting to maintain interest rates at their historical low of 0.5% and to maintain quantitative easing (QE) purchases at £375bn. There remains a great deal of uncertainty over the economic outlook and the precise level of spare capacity in the economy however Bank of England (BoE) Governor Mark Carney has announced that the UK economy has moved closer to the point where interest rates will need to rise.

GDP Growth

Gross Domestic Product (GDP) is estimated to have risen by 0.8% in 2014 Q1 and Q2 quarter-on-quarter according to data released by the Office for National Statistics (ONS) and after more than 6 years the UK has finally surpassed its pre-recession level and is now the fastest growing G7 economy with the International Monetary Fund (IMF) forecasting growth of 3.2% in 2014. The economic recovery continues to broaden domestically with increased spending by businesses and households being supported by lower uncertainty and improving credit conditions. The recovery does remain unbalanced to an extent with the services sector now above pre-crisis levels and manufacturing and production still somewhat lacklustre.

The quarterly development of GDP over the last six years is shown in chart 2.

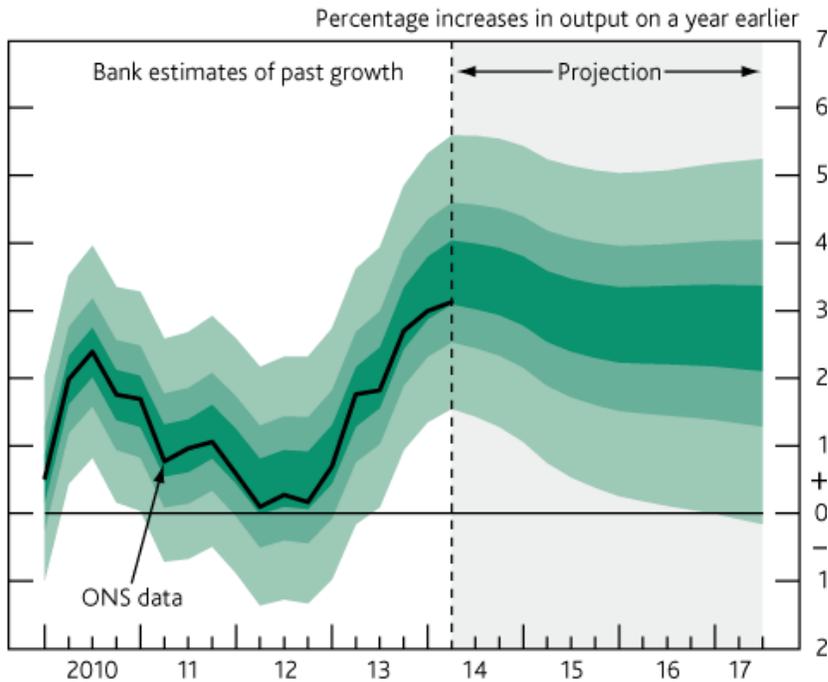
Chart 2: Gross Domestic Product Growth by Quarter, 2008-2014
GDP Growth (2010 prices, seasonally adjusted)



Source: ONS GDP Second estimate, Updated 18th August 2014 (Quarterly)

Growth is expected to moderate somewhat in the second half of 2014 as the boost from pent up demand fades. Moving into the medium term growth is projected to fall back towards pre-crisis levels as shown in the fan-chart below. Domestically the projections are sensitive to the assumption that productivity, which has shown few signs of recovery so far, will gradually begin to grow. Internationally the projections assume that global growth remains steady. There are also risks from the euro area which is going through a period of weak inflation and low growth, which could serve to destabilise debt again. Growth projections are demonstrated by the wide band of future possibilities in chart 3 below.

Chart 3: Gross Domestic Product Growth by Year, 2008-2018



The relatively wide band around the ONS published estimates is due to the different methods used in the estimation of GDP and in the timing of these estimates. Different estimates are made at different times and as circumstances change, estimates change accordingly. Despite these constant changes over time, there is a consistency in the scale and direction of movement.

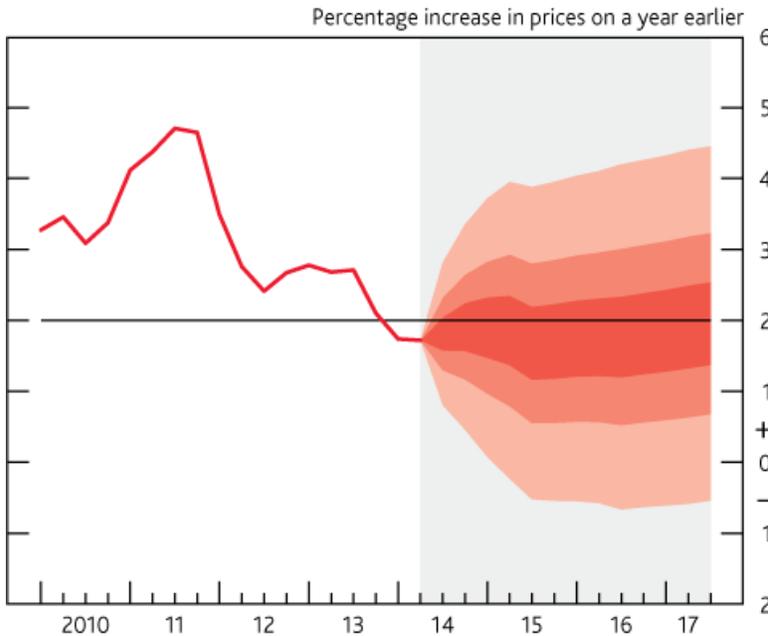
Inflation

The Consumer Price Index (CPI) of annual inflation, which measures a 'typical' basket of household goods, stood at 1.6% in July 2014, down by 0.3pp (percentage points) from the month before and 1.2pp from the previous year. In the Monetary Policy Committee's (MPC's) best collective judgement the interest rate will fall slightly in the coming months, as the appreciation in sterling bears down on import prices, before rising broadly in line with the Government's 2% target for the remainder of the forecast period, which ends in 2017. Chart 4 below shows the Bank of England inflation projections until 2017. The MPC anticipates, that as the spare capacity in the economy is absorbed in the near term, wage growth will pick up and bring inflation in line with the target. There are risks on both sides of the forecast. If recruitment pressures intensify then wage growth could rise faster than expected. Alternatively, wage pressures could remain weaker for longer if labour supply growth remains strong.

The RPIJ - a wider measure of inflation that includes housing costs and an improved variant of the Retail Prices Index (RPI) – stood at 1.8% in July 2014, down from 2.0% in the previous month and 3.1% on the year before. The ONS started producing the RPIJ in February 2013. The improved method, known as the Jevons index, uses a geometric, rather than arithmetic, mean, in order to meet international standards.

The Bank of England projections for UK inflation to 2017 are shown in chart 4.

Chart 4: Inflation: CPI 2010-2013, projections 2013-2017



Source: Bank of England

The Government's long-term inflation target of 2% - around which the various projections are centred in the chart above - has been a key influence in the MPC voting in favour of maintaining the interest rate at 0.5% and quantitative easing (QE) purchases at £375bn at its August 2014 meeting. By meeting the 2% target rate of inflation in the medium term, the MPC consider that this will help sustain growth and employment in the economy. Voting over the past year has typically been unanimously in favour of maintaining interest rates at 0.5%, but a 7-2 vote in July coupled with an announcement recently made by Governor Mark Carney suggests the UK is moving closer to the point where interest rates will need to rise. Minutes of the August meeting, to be released in mid-September, will be closely scrutinised for any further indications of when interest rates are likely to change.

Through QE, the Bank purchases financial assets, such as government and corporate bonds, thereby increasing the volume of money in circulation. The aim is to increase the supply of credit, which should, in turn, help to stimulate the economy. The most recent change to the size of the QE programme was an increase of £50bn to £375bn in July 2012. The MPC have indicated that the level of QE will not change until after the first rise in interest rates at the earliest.

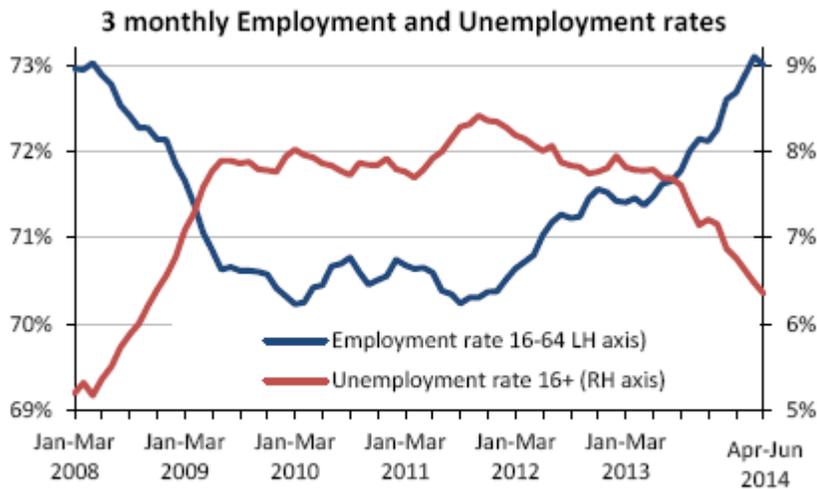
Employment

The UK labour market showed resilience in both recent downturns and has grown strongly over the past year with continued improvements in employment and unemployment figures. The employment *rate* stood at 73.0% in the three months to June 2014, consistent with its pre-recession rate, 0.3 percentage points higher than the previous three months and 1.5 percentage points higher than last year. The employment level stood at 30.60 million in the three months to June 2014, 0.17 million higher than the previous three months and 0.82 million higher than the previous year.

The unemployment rate fell to 6.4% in the three months to June 2014; the lowest since late 2008. The unemployment *level* stood at 2.08 million in the three months to June 2014, 132,000 less than the previous three months and 437,000 less than the previous year.

However, strong employment figures are in contrast to continued weakness in wage growth. In the April to June period wages including bonuses were 0.2% lower than the previous year, though 0.6% higher excluding bonuses. Weaknesses in wages will partly be due to productivity growth remaining subdued. Labour market surveys are showing that wage levels being offered for new recruits are growing and if more people start to move jobs, and as new wage settlements are negotiated, wages could be expected to grow more strongly again.

Chart 5: Employment and unemployment rates 2008-2014



Source: ONS Labour Market; Updated 13th August 2014 (Monthly)

In summary, the earlier tentative signs of recovery appear to have been replaced by a more solid economic recovery. On the key headline measures the UK recovery looks relatively robust, with strong GDP growth, stable inflation and a falling unemployment rate. However, there are still strong headwinds for the UK economy, such as weak productivity growth and weak wage growth. Further, public sector net debt (excluding financial interventions) remains on an upward trend, reaching 76.5% of GDP in July 2014 and there are also weaknesses in the UK's main export markets (in particular the EU).

2. Policy Developments potentially affecting Trade in Wood Products

Due Diligence

Organisations placing timber on the market for the first time in the European Union are required by law to conduct due diligence on their supply chains to mitigate the risk of importing illegally-felled timber.

The two main sources of timber supply in the UK are from its own forests (15 - 20% of supply by volume) and from exportation from the many countries of the world to the UK. The majority of imported wood products are sourced from the EU where legislation recognises that existing national systems, which fulfil the requirements, may be used as a basis for exercising due diligence. The Forestry Commission, the Northern Ireland Forest Service and Natural Resources Wales are the government bodies for forestry and the Timber Trade Federation represents the interests of importers and merchants. These organisations have systems which either through regulation, standards or industry best practice help UK forest owners and importers address issues of due diligence in the supply of timber products.

For supply from UK forests, sustainable management to the UK Forestry Standard can be verified through approved forest plans or Felling Licences. To help woodland owners and managers address the requirements of the European Union Timber Regulation (EUTR) an addendum to the felling licence has been developed which identifies the risk factors associated with domestic production. Independent certification, which is in place for about 85% of UK timber production, can be used to provide further assurances of responsible management.

For imported timber and wood-based products, the Timber Trade Federation (TTF) introduced a mandatory due diligence process known as the Responsible Purchasing Process, or RPP, for members as part of its Environmental Code of Practice. The RPP provides a framework and set of management tools to help TTF members objectively and formally analyse the risk of products being from an illegal source of supply. Due diligence is conducted at product level, and products from risk managed sources are effectively screened out at an early stage and classified as negligible to low risk. This allows members to focus their resources on undertaking due diligence on products where risk is not formally managed, and to assign a risk assessment score (low to high risk) against that product.

The TTF system allows members to develop an overall risk profile of all products in their supply chain, allowing them to prioritise actions and resources on those products and suppliers where risk is highest, with the dual aim of preventing the import of illegal timber and of improving the supply chain risk profile.

The EU Timber Regulation (EUTR) came into effect in March 2013. The Regulation requires those who first place timber on the market in the EU to have a due diligence system in place to minimise the risk of the timber being illegal. It also requires those who trade in timber to keep records and makes it an offence to sell timber that is illegal. Whilst the great majority of organisations in the UK are compliant to the regulation, some other EU states have yet to implement systems able to provide evidence of compliance.

The TTF's suite of Due Diligence tools is being continually updated and refreshed in order to provide Members with the ability to keep informed of and where appropriate use the information in their Due Diligence processes. Part of this communications brief is a monthly issue of news and information entitled the Risk Information Update, providing useful data on supply issues and events from countries around the world that supply timber products to the UK.

Plant Health Issues

Phytophthora ramorum (*P. ramorum*) infection of Japanese larch (*Larix kaempferi*) trees continues to be the major plant health issue affecting the market in the UK. *P. ramorum* also occasionally infects European larch (*Larix decidua*) and hybrid larch (*Larix x eurolepis*). The National Forest Inventory report on standing timber volume for coniferous trees in Britain gives a total of 126 thousand hectares for all larches at March 2012.

P. ramorum is a fungus-like pathogen that kills many of the trees that it infects. It was first found on Japanese larch trees in south west England in 2009, and further outbreaks were identified in south Wales, the Peak District, Lancashire, Cumbria, Northern Ireland and south and west Scotland in 2010, with widespread infection in all ages of Japanese larch.

By January 2014 an estimated 10,000 hectares of larch infected with *P. ramorum* had been identified in the UK, and required felling. It was estimated that further action would be required to treat an additional 7,000 hectares of larch for which felling has not been prescribed. Most of these were in the vicinity of previously known infections in south west Scotland and Wales. Extensive helicopter surveillance during the summer of 2013 allowed identification of symptomatic stands at an early stage of disease. It is likely that the large increase in area infected is due to the cooler and wetter summer in 2012, which was considered to be more favorable to sporulation and disease dispersal than in the previous two years. Surveys in 2014 show a significantly decreased level of new infections, and this is believed to be due to the exceptionally dry summer.

The extensive damage observed in Wales and Scotland contrasted with the south west of England where the woodlands are smaller and larch woodland is less contiguous. Unfortunately there were a small number of new infections in the northwest of England where woodland blocks are more contiguous and of concern is the possibility that the EU2 strain in Scotland, which is perceived to be more aggressive, will spread to England. To date only the EU1 strain has been recorded in England.

A Phytophthora outbreak management team continued to be chaired by the Forestry Commission, and there was close liaison with stakeholders in the four UK countries to encourage a consistent approach to disease management.

The 2009 discovery was the first time in the world that a commercially grown conifer species had been found with *P. ramorum* infection. Acting on scientific advice, notices to fell infected trees on public and private forest land have continued to be served by Plant Health Authorities (outwith the areas in Wales and south west Scotland where felling has not been prescribed) to try to contain the disease.

The Forestry Commission and the Forest Service are continuing to work with timber processors and others to ensure biosecurity measures are in place to allow logs from the infected trees to be taken to mills for conversion into timber. A protocol for composting

bark to kill the pathogen has been developed, and this will ensure the trade in bark can continue safely.

Biosecurity measures are in place to minimise the spread of infection in soil or on larch needles, people, vehicles, equipment and timber.

While the felling of all larch within 100 metres (or any other distance set by Plant Health authorities) of infected trees is mandatory, this isn't required for species which are not susceptible. With the dramatic increase observed in 2013 in the area of infected larch principally in south Wales and Galloway, this approach was reviewed again to determine if the current restrictions on movement were still proportionate or whether they could be relaxed, in some situations, to allow material from other conifer species within 100m (or any other distance set by Plant Health authorities) of infected larch could be treated as uninfected. The justification for controlling material from other non-infected conifer species is primarily that it may be contaminated by infected larch needles. As a result of this review non-infected other conifer tree species are no longer placed under statutory control, the proviso being that a high level of biosecurity is applied to the handling of the material and that it is extracted and stacked separately to infected larch.

National Forest Inventory

The National Forest Inventory of Great Britain (NFI) provides a record of the size and distribution of forests and woodlands in Great Britain and information on key forest attributes. This information, together with Forestry Commission growth and yield models, is used to forecast softwood and hardwood timber availability.

In 2012 the NFI published 25 year forecasts of softwood growing stock, increment and removals under a range of different management scenarios.

In 2014, in order to provide a more comprehensive picture of the potential evolution of softwood and hardwood growing stock, increment and removals, 50 year forecasts were published. The scenarios demonstrate the impact of a range of thinning, clear-felling and restocking practices and have attracted considerable interest from the forestry sector and politicians.

Work is ongoing to evaluate the effect of current and potential afforestation programmes and to broader 'current state' reporting metrics to include habitat condition.

Forestry Policy in the United Kingdom

Responsibility for forestry in the UK is divided between a number of parts of government. Certain functions, such as international forestry policy, are undertaken by the UK Government whilst further functions, (known as cross-border functions) are done on a UK-wide basis by agreement; these include forestry research and national standards. However, for the most part forestry policy is undertaken at country level in England, Scotland, Wales and Northern Ireland.

The Forestry Commission is the non-Ministerial government department responsible for advising on and implementing forestry policy. It does this directly by serving as the forestry department for the UK Government, for England, and for the Scottish Government in Scotland. The Welsh Government created a single environment body called Natural Resources Wales in 2013, which manages the national forest estate in Wales. Forestry

policy in Wales is a matter for the Welsh Government. Forestry in Northern Ireland is undertaken by the Forest Service, an agency within the Department of Agriculture and Rural Development. All the countries co-operate in commissioning forest research, and to a varying extent in the supply of technical advice and the provision of various other services.

Both the UK Government and devolved administrations are committed to the concepts of sustainable forest management, as articulated in the Forest Europe Ministerial agreements. The UK approach to delivery is set out in the UK Forestry Standard, (2011).

The Government published a “Forestry and Woodlands Policy Statement” for England, early in 2013. This has led to the Woodland Policy Enabling Programme (WPEP) to tackle three strands of work over the period 2013 – 2017. These include the setting up of a new management organisation for state owned forests in England, and consideration of how cross border functions and shared services can best be delivered.

In England, forestry policy has been influenced by the recent report of an independent panel. Amongst a range of recommendations, the panel called for increased tree cover and greater use of domestically produced wood and wood products.

In Scotland, a referendum held in September 2014 decided that Scotland would remain as part of the UK. Consequently, there would be no immediate change to how forestry policy is delivered.

In Wales, new arrangements for forestry are bedding in after coming into effect in April 2013.

Over the last year, increased attention has been focused on pests and diseases; these have resulted in increased areas of sanitation felling. Work aimed at quantifying the risks associated with the forest resource has been undertaken through the National Forest Inventory (NFI). The results of this work are being utilised across the forest sector, particularly in relation to bio-security, to assess the risks and undertake contingency planning. Other areas of policy development have been in relation to the increasing use of woody biomass for renewable energy and appropriate criteria of sustainability.

Policy and Initiatives – Carbon Reduction

Private sector investment in woodland creation is continuing to increase, helped by the Woodland Carbon Code. The Woodland Carbon Code, launched in July 2011, sets out requirements of voluntary woodland creation projects in the UK wishing to make claims about the carbon they sequester. Documentation was revised in July 2012 following the first year of operation and a scheme for groups of projects to be certified together is currently being piloted by 5 project groups. This should allow more cost-effective certification for smaller projects from spring 2013. Documentation is revised annually.

The following developments have occurred since the last Market Statement:

- Group scheme certification was incorporated in 2013, allowing more cost-effective participation for smaller projects
- The UK Woodland Carbon Registry was launched at Markit in 2013, allowing for transparent issuance, transfer and retirement of carbon credits, bringing assurance to the marketplace.

The UK government announced in June 2012 that carbon reporting would become mandatory for all quoted companies from April 2013. Additionally, companies are able to report verified Woodland Carbon Units in order to compensate for their gross emissions. It is possible this will be extended to all large companies in 2016. As companies can report following Defra's Environmental Reporting Guidelines, it is now possible for verified Woodland Carbon Units to be used in claims of 'Carbon Neutrality' of an organisation's activities, products, services, buildings, projects or events as set out in the British Standards Institute's PAS2060:2014 Specification for the Demonstration of Carbon Neutrality for greenhouse gas emissions reporting. These companies can report the benefits of their investment in a Woodland Carbon Code project. It is believed that this will drive further private sector investment in woodland creation.

Carbon Markets in the Forest Sector

The Woodland Carbon Code has generated much interest among landowners and investors alike since it was introduced in July 2011. As of 30 June 2014, 201 projects have registered with the Code; together they will create 15,390 hectares of new woodland and are predicted to sequester 5.7 million tonnes of carbon dioxide equivalent over their lifetime (up to 100 years). Of these projects, 87 are now validated (checked by an independent certification body), representing 20% of the area and 26% of the predicted carbon sequestration. A proportion of the revenue of each project comes from private sector investment, mainly from companies considering their Corporate and Social Responsibility.

The Woodland Carbon Code was one of four finalists in the 'Best initiative from government or public services' category of the Climate Week 2014 awards, (<http://www.climateweek.com/awards>) and was ranked 3rd in the world in the 'Best Voluntary Carbon Standard' category of Environmental Finance's Carbon Market Survey 2014, (<https://www.environmental-finance.com/> - see Market Survey 2014) beating other longer-established voluntary carbon standards.

Further information can be found on the Forestry Commission website:
<http://www.forestry.gov.uk/carboncode>

3. Market Drivers

Construction, Manufacturing and Distributive Trades

As described in the section of this Statement on the UK economy, recovery has begun, with the highest GDP growth rate in the EU and this better performance is being reflected in many key sectors.

UK manufacturing output was 1.4% higher in 2013 and construction output was higher by 1.6% compared to 2012.

Housing starts in the UK in 2013 were 18% higher than in 2012. The volume of repair, maintenance and improvement work (all sectors) rose by 2.3% in 2013, but the housing sector (housing RMI) only managed a very small increase in activity, up by 0.3%.

The Office for National Statistics provide data on the value of output by manufacturers of wooden pallet production and this was reported to have risen by 20% in 2013, following a 14% increase in 2012 over 2011. As mentioned a little later in the section of the Statement, this is probably overstated, in terms of the value of new pallet production.

Although no official statistics are available for output in the fencing and outdoor products markets, it is known that demand for fencing in 2013 was strong and outstripped supply.

In summary, the most important markets for timber products in 2013 exhibited encouraging signs of recovery.

Construction

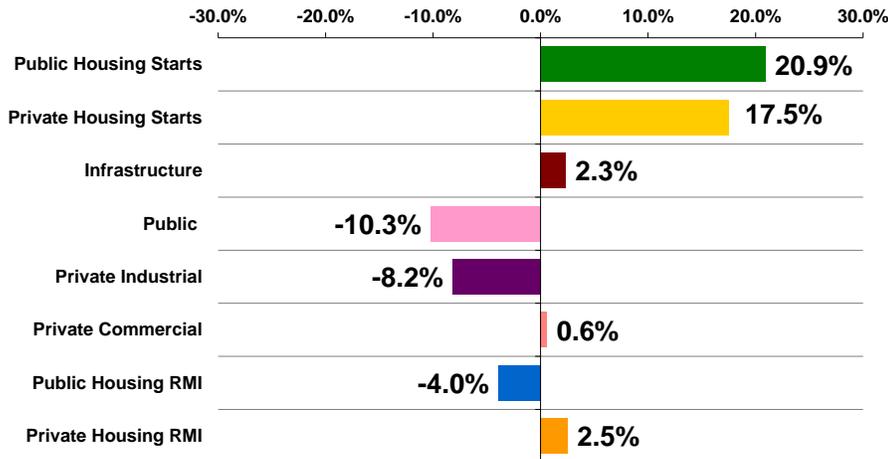
The return of growth to construction output in 2013 was driven by the housing sector. Output of private new housing grew strongly and, with many public housing projects benefitting from funding requirements linked to private sector developments, public housing starts were better than industry forecasts, but elsewhere, public sector activity was lower than in 2012.

Government austerity measures have reduced funding for many public sector projects and as construction output in total recovers, the non-new housing public sector (industrial, commercial and infrastructure building works) continues to act as a brake on growth.

Despite the better performance in the private sector in 2013, there is much ground to recover if output is ever to return to the most recent peak year of 2006. Private sector housing in 2013 was 29% below the 2006 level and in the larger housing RMI sector, volume remained 10% below 2006.

The growth rates by leading construction sector in 2013 compared to 2012 are shown in chart 5 below.

Chart 5: Construction Industry Sector Output, 2013/2012



Source: DCLG & Office for National Statistics (ONS)

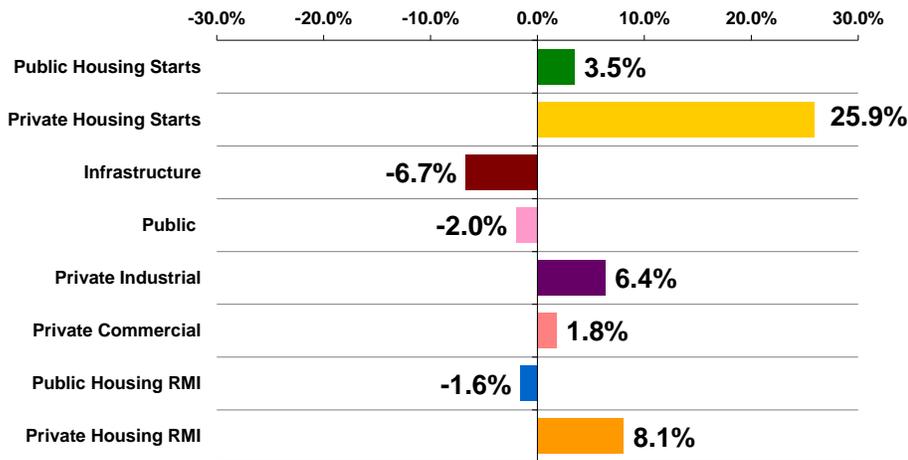
NB: Housing starts, provided by the Department of Communities and Local Government (DCLG), are measured in numbers – all other sectors are measured at constant prices (2010).

The improving, but mixed performance in 2013 is confirmed in chart 5 where five of the eight construction sectors exhibited growth while the other three lost ground compared to 2012.

The signs for continued expansion are present however and in the first two quarters of 2014 over the same period in 2013, improvement in some of these weaker public sector markets is evident. One example, which is important for the sales of timber products, is the public sector RMI housing market where volume reductions over the last five quarters have decreased (improved) to a position where output in this market sector in Q2 2014 was only 1% below the corresponding quarter in 2013 and as shown below, only 1.6% lower in the first half of 2014 over the first half of 2013.

With an improving economy, less restrictive lending policies by banks and building societies and continued low interest rates, it is the private new housing sector that has grown robustly in the first half of 2014 and this growth has outstripped all other sectors as shown in chart 6 below.

Chart 6: Construction Industry Sector Output, 1st Half 2014/ 1st Half 2013



Source: DCLG & Office for National Statistics (ONS)

NB: Housing starts, provided by the Department of Communities and Local Government (DCLG), are measured in numbers – all other sectors are measured at constant prices (2010).

The housing starts data in chart 6 are only for England. However, England accounts for around 80% of all starts in the UK and for the full year for the whole of the UK, housing starts are likely to be substantially higher in 2014.

Public housing starts have slowed in England, compared to 2013, as funding for affordable homes is further reduced and housing associations compete for funds in open financial markets.

For similar reasons to the expansion of private housing starts, private RMI housing has grown well in the first half of 2014, recording growth of just over 8% over the same period in 2013.

Private industrial output too has recovered in the first half of 2014 with exceptionally strong growth in Q2 2014, up by 17%.

Elsewhere, infrastructure spending has fallen back in 2014 to date, although output in this sector tends to be relatively volatile with large variations often dictated by the scale of projects under construction.

The Construction Products Association forecasts point to continued growth in construction in 2014 of around 5% with a similar level of growth to 2015. This confirms the belief that with a relatively stable economic background, UK construction in 2014 is experiencing a second and improving year of recovery.

Manufacturing and Distributive Trades

Recovering from the depths of recession in 2008 and 2009, manufacturing output in the UK rebounded to reach growth levels of over 5%. Of course, these growth rates were matched against very weak output in 2008 and 2009 and these relatively high percentage increases achieved in 2010 were soon revealed as just a modest 'bounce' as output began to stabilize during 2011 and the first half of 2012. By the end of 2012 and the first

part of 2013, negative growth rates again emerged as the true extent of the weakness in manufacturing was confirmed.

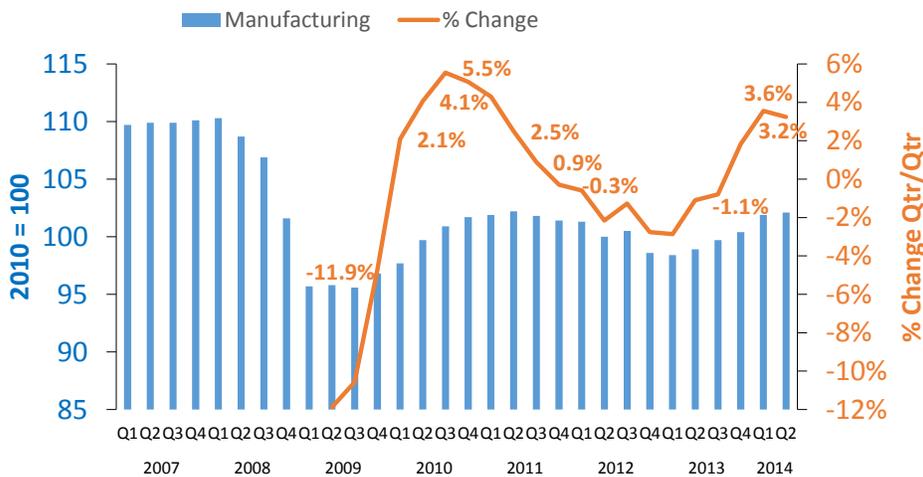
As shown in chart 7 below, from Q4 2011 to Q2 2013, manufacturing output remained weak with output below the level of previous years.

However, by Q3 2013, improvement was evident and growth in the ensuing five quarters to the latest data available at Q2 2014 was achieved.

The turnaround in fortune is further marked by comparing the monthly output year-on-year which has shown that in the last ten months to June 2014, growth has been achieved in each of those months, but prior to September 2013, manufacturing output had contracted in each of the previous twenty months.

The quarterly development of manufacturing output is shown below in chart 7.

Chart 7: Index of UK Manufacturing, Q1 2007 - Q2 2014



Source: Office for National Statistics (ONS)

Growth in manufacturing and distributive trades usually heralds growth for the wooden pallets and packaging industry.

This relationship would appear to have continued in 2013 and into 2014, but not quite as official figures might indicate.

Pallet production in the UK is measured through the ProdCom data series as provided by ONS.

According to the ProdCom data, the number of new pallets manufactured in the UK rose from just over 45 million in 2011 to nearly 69 million in 2013. The growth rates for these levels of output were 22% in 2012 and 24% in 2013.

These official data do not concur with the sentiment of industry or alternative available data.

As previously reported in UK Market Statements, it is believed that ONS has been including the measure of repaired pallets within the totals of newly manufactured pallets.

This would help to explain the disparity between the ProdCom output numbers and industry experience.

The Wood Packaging Study, conducted for the pallets and packaging confederation, TIMCON, and for the Forestry Commission considers a more realistic measure of newly manufactured pallets in the UK to be in the region of 30 million with a further 40 million or more pallet repairs taking place. New pallet production reduced following the recession in 2008 and beyond as pallet using companies sought to reduce costs and buy fewer new pallets while extending the life of existing pallets. This led to a rapid increase in the number of repairs conducted.

The probable mis-counting of newly manufactured pallets in the UK has been recognised by ONS and for the ProdCom Inquiry in 2015, the measuring of newly manufactured and repaired pallets will take place.

Despite the doubt over new pallet production as published by ProdCom, it is likely that new pallet production will be seen to have increased in 2013 as manufacturing and associated activities have grown. The ProdCom data from 2007 is shown in chart 8 below.

Chart 8: UK Pallet Production 2007-2013



Source: ProdCom

A number of factors have conspired to provide a stimulus to the fencing and outdoor use markets in the UK.

Storms in the early part of 2013 caused damage to properties and other amenities which raised the demand for fencing and associated products. The usual seasonal demand in the spring, when households tend to begin to maintain their properties, was augmented by storm and weather-related damage, which created a demand that suppliers found difficult to meet.

New home building in the UK was also recovering in the early part of 2013, which created further demand that had previously been relatively weak.

The home improvement market over the last few years has benefitted from the squeeze on incomes in the UK during the years of economic austerity. This has also stimulated demand for fencing products as many households have forsaken holidays away from home and instead have spent overall smaller budgets on the home.

It is understood that these influences have raised the amount of softwood used in the fencing and outdoor markets from around 1.2 million m³ in 2008 to over 1.5 million m³ in 2013.

Energy Markets

Key Facts:

- Total energy consumption in the UK fell by 0.6% in 2013
- Growth of renewables for electricity generation grew by 22%
- Growth of renewables for heat generation grew by 19%
- Within the 19% growth of renewables for heat, the growth of both domestic wood and industrial wood in 2013 was 18%.

In 2013, total UK overall primary energy consumption was 0.6% lower than in 2012.

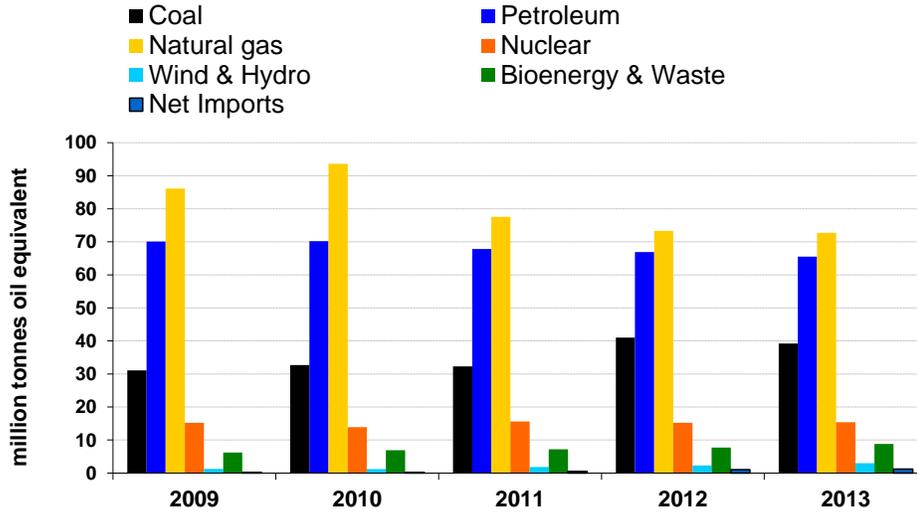
On a temperature corrected basis (to remove the impact a hot or cold year has on energy consumption) primary energy consumption in 2013 was at its lowest since 1985.

By user sector, Industry and Services increased energy usage in 2013, higher by 0.7% and 0.3% respectively. The transport sector and energy consumption for domestic use was lower in 2013; both sectors consuming 1.2% less energy than in 2012.

The UK has a wide range of fuels supplying its energy needs, although around two thirds of all supply is accounted for by natural gas and petroleum.

The changes in consumption by the main types of fuel used for energy generation is shown in chart 9 below.

Chart 9: Inland consumption of primary fuels and equivalents for energy use 2009-2013

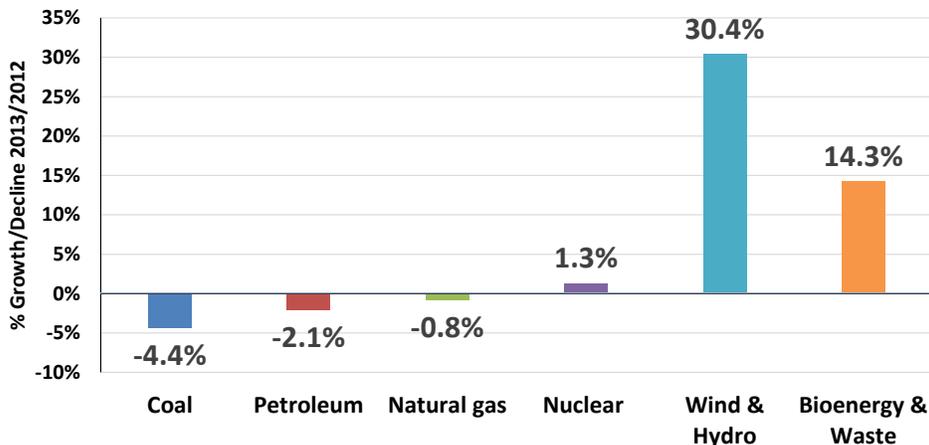


Source: Department of Energy and Climate Change (DECC)

The dominance of natural gas and petroleum, along with the still significant usage of coal is seen in chart 9, but less of each of these fuels was consumed in 2013 with the quantity (million tonnes of oil equivalent) of natural gas 0.8% lower, petroleum 2.1% lower and coal usage down by 4.4% compared to 2012.

Consumption of renewables remains small in comparison to other forms of energy provision, but has continued to grow over a six year period from 2007 when energy consumption in real terms has fallen. The increases in renewables in 2013, along with other fuels is shown in chart 10.

Chart 10: Percentage Change in Use of Primary Fuels for Energy Consumption, 2013 / 2012



Source: Department of Energy and Climate Change (DECC)

The growth of wind and hydro combined with the growth of bioenergy and waste raised the share of these fuels to 5.7% of the total on 2013, compared to 4.8% in 2012.

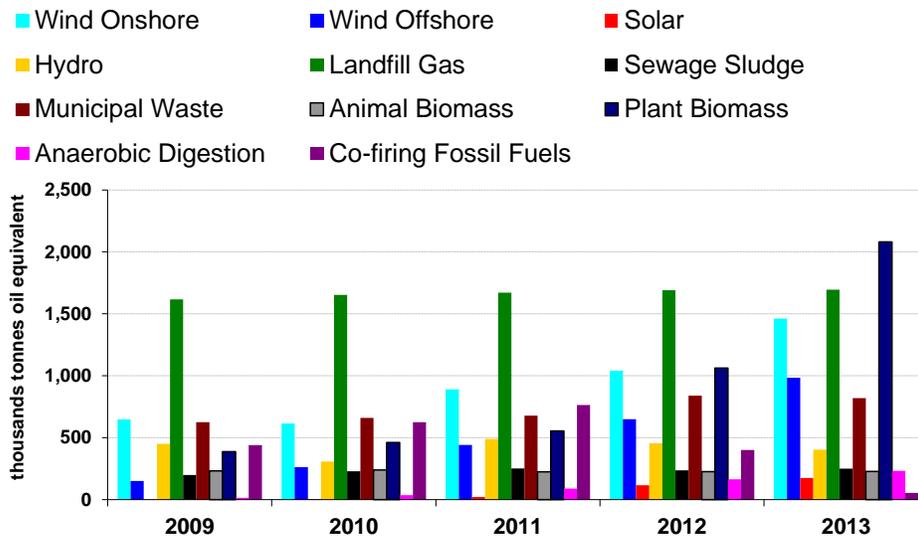
Although the share of renewables is growing, around 95% of the energy consumed in the UK is generated from fossil fuels.

Consistent with the overall reduction in energy consumption in 2013, less electricity was consumed in 2013, down by 0.2%.

Specifically for electricity generation, fossil fuels and nuclear remain the major source of supply. Coal, natural gas and nuclear power accounted for 85% of the electricity generated in the UK in 2013. Although petroleum is a major energy product, very little is now used for electricity generation in the UK at less than 1% of the total.

Renewables account for the majority of the remainder and the quantities of renewables used, in thousands of tonnes of oil equivalent, for electricity generation from 2009 is shown in chart 11.

Chart 11: Renewable sources used to generate electricity, 2009-2013

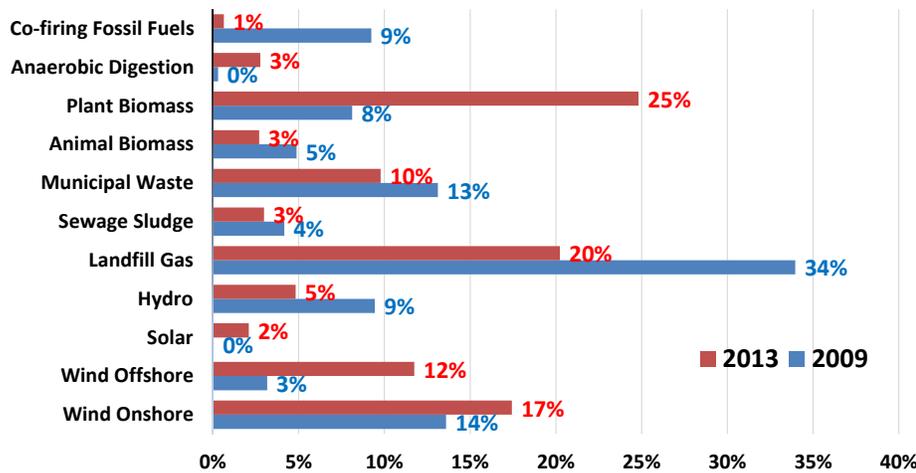


Source: Department of Energy and Climate Change (DECC)

In 2013, the most rapid changes in the use of renewables came with a 96% increase in the use of plant biomass, a 52% increase in offshore wind generation and a 51% increase in the use of solar power.

The overall increase in the quantity of renewable fuel supply for electricity generation in 2013 was 22%.

Chart 12: Changes in the Share of Renewable Electricity Generation by Product, 2009-2013



Source: Department of Energy and Climate Change (DECC)

The share of plant biomass has risen from 8% of the total in 2009 to 25% in 2013. Offshore wind generation, the other fuel supply achieving high growth in 2013, increased its share between 2009 and 2013 from just 3% to 12%.

Renewables losing ground over the period are landfill gas, municipal waste and the co-firing of fossil fuels which accounted for less than 1% of the total in 2013.

The growth in plant biomass was driven by the burning of woody biomass, including pellets, often to replace the burning of coal.

In 2013, a former coal-fired power station at Tilbury in Essex was converted to burn pellets and along with other installations, became a significant user of biomass.

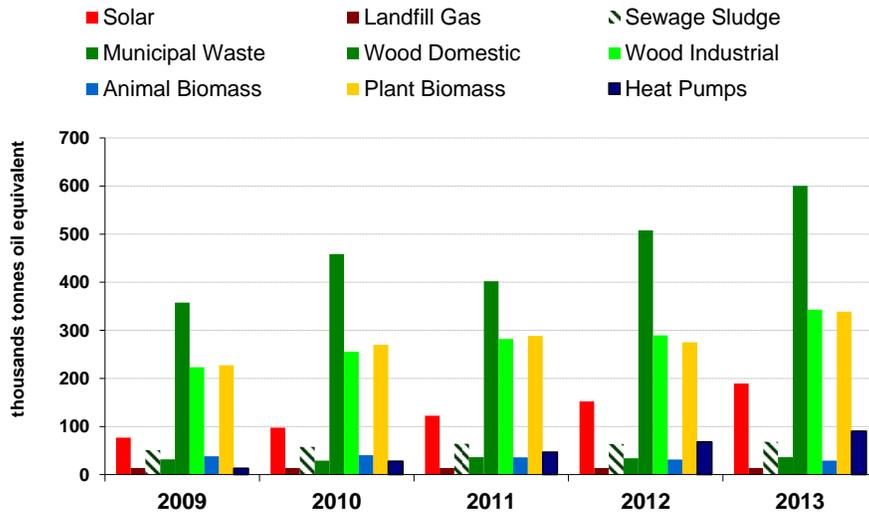
Conversion of the Drax plant in Yorkshire also contributed to the high growth of plant biomass in 2013, however, growth is expected to slow in future years because of the removal of subsidies for biomass usage.

The impact of this has already been felt in 2014 with the closure of the pellet-burning plant at Tilbury.

Offshore wind generation has been increased through the commissioning of more wind farms and greater numbers of onshore wind farms under construction and planned will substantially increase the amount of electricity generation from this source.

The usage of renewables for heat generation in the UK has also grown over the last few years and as with electricity generation, much of this growth has been generated by increased usage of woody biomass.

Chart 13: Renewable sources used to generate heat, 2009-2013



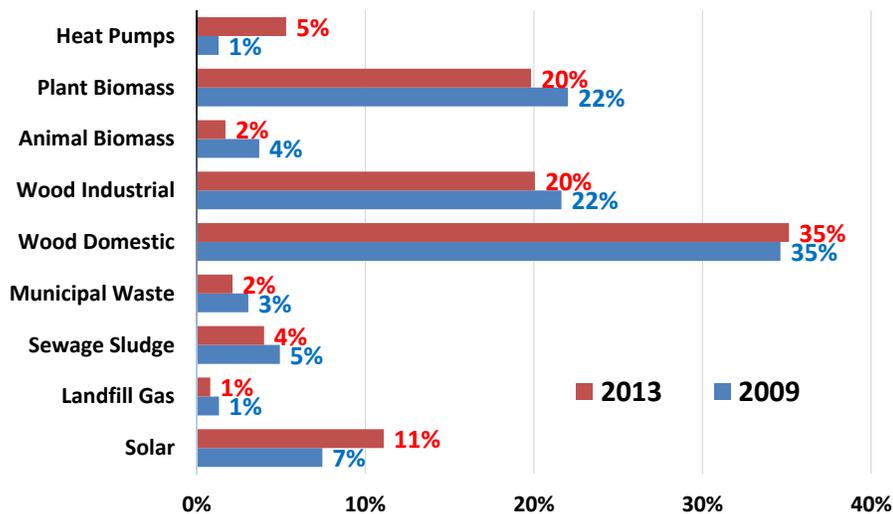
Source: Department of Energy and Climate Change (DECC)

All heat generated from renewables grew by 19% in 2013, following a (revised) 11% growth in 2012. This growth was led by a 33% increase in the output provided by heat pumps, a 24% increase in solar power and a 23% increase in the usage of plant biomass.

The share of heat generation by these three sources has increased each year over the last five, collectively accounting for 36% of all energy generated in 2013 from 30% in 2009.

The largest source of heating from renewables in the UK is through the use of wood and for both industrial and domestic use, wood accounted for 55% of heat generation in 2013. The shares by source over the last five years are shown in chart 14 below.

Chart 14: Changes in the Share of Renewable Heat Generation by Product, 2009-2013



Source: Department of Energy and Climate Change (DECC)

Wood for heating grew by 18% in 2013 which resulted in minor changes in the share of renewables used for heating, but because of the faster growth rates in 2013 for heat pumps and solar power, the combined share of these two sources has doubled from 6% in 2012 to 12% in 2013.

Wood for all forms of renewable energy consists of cut logs, brash, wood chips, off-cuts, recycled wood waste, charcoal and imported wood. Pellets, that can be used for heat generation and for other uses (such as animal bedding and cat litter) are a relatively new form of renewable and according to Forestry Commission estimates, around 301,000 metric tonnes were produced in the UK in 2013, up from 278,000 metric tonnes in 2012.

Imports of pellets, much of which was used for electricity generation, grew sharply in 2013 with nearly 3.4 million metric tonnes imported, compared to around 1.5 million metric tonnes in 2012.

Solar heating installations have continued to grow as the costs of solar installations have reduced in recent years because of technological advances and through the increased rates available to support feed-in-tariffs at the end of 2012.

Solar and other forms of renewable energy for heating are expected to continue to grow as a result of stimulus from financial incentives, through a new 'feed-in-tariff' for larger rooftop installations and the continued development of large-scale arrays. The majority of solar installations are small-scale, often for domestic heating and electricity generation, but despite a weakening in Government support measures for large scale solar farms, the development of large-scale arrays capable of making significant contributions to the decarbonisation of the UK's energy markets is expected to continue.

Central to the UK Government's renewables policy is the Renewable Heat Incentive (RHI) tariff scheme.

Designed to encourage the use of renewable heat technologies through the provision of financial incentives, the UK Government expects the RHI to make a significant contribution towards having 12 per cent of heating coming from renewable sources by 2020.

There are two phases to the introduction of the RHI:

Phase 1 saw the introduction of the RHI for non-domestic installations in the industrial, business and public sectors.

Phase 2 is the introduction of the domestic RHI which is expected to significantly increase the number of new installations seen under the Renewable Heat Premium Payments scheme (RHPP).

In July 2013 the Government published its response to the consultation on the domestic RHI – alongside the policy statement – 'Renewable Heat Incentive: the first step to transforming the way we heat our homes'.

The policy statement outlined the design of the scheme, including details of eligible technologies and applicants, tariff payments and other qualifying criteria. The scheme links to DECC's Green Deal and applicants are required to complete a Green Deal Assessment

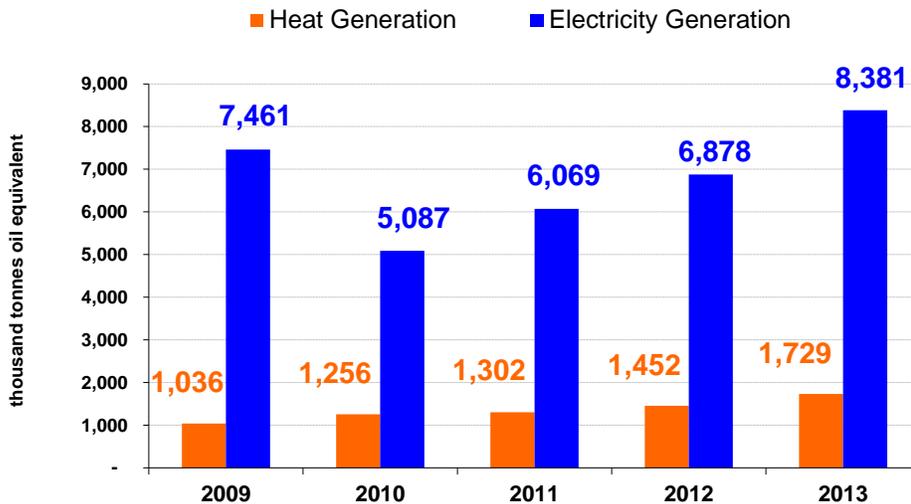
before submitting their application. The tariffs have been set at a level that reflects the net cost of renewable heat generation over 20 years and are designed to compensate households for some of the risks of installing renewable heating systems, which may otherwise act as a barrier.

The driver of these developments is the Government’s policy to decarbonise heat supply in the UK. Renewable heat is expected to make an important contribution to meeting the EU renewable energy target in 2020. By 2050 the UK needs to have decarbonised heat in buildings almost completely and reduced industry emissions by up to 70% through a combination of efficiency improvements, demand reduction, and fuel and technology switching options.

However, concern remains among non-energy wood users in the UK that the renewables policy could adversely affect raw material supply and distort supply and demand in existing markets.

Whilst part of this concern has been ameliorated through the Government's Electricity Market Reform Delivery Plan, which recommends the ending of subsidies for existing power stations converted to burn biomass by 2027, the continued and enhanced incentives for biomass combined heating and power plants is, in the opinion of many non-energy wood processors, creating undesirable supply and cost pressures.

Chart 15: Renewables Used for Electricity and Heat Generation, 2009-2013



Source: Department of Energy and Climate Change (DECC)

As reported above, renewables used for electricity generation grew by 22% in 2013 and for heat generation, 19%. The overall growth of 21% is a further acceleration from the 13% growth achieved by renewable sources in 2012 over 2011.

The quantities forming these growth rates are shown in chart 15 above whilst providing an indication of the relative sizes of the renewable markets for electricity and heat generation.

4. Developments in Forest Product Markets Sectors

a) Wood Raw Materials (Softwood)

“Public sector removals” relates to the removal of timber from woodlands owned or managed by the Forestry Commission (in England, Scotland and, until March 2013, Wales), Natural Resources Wales (in Wales from April 2013) and the Forest Service (in Northern Ireland). “Private sector removals” relates to the removal of timber from all other woodlands.

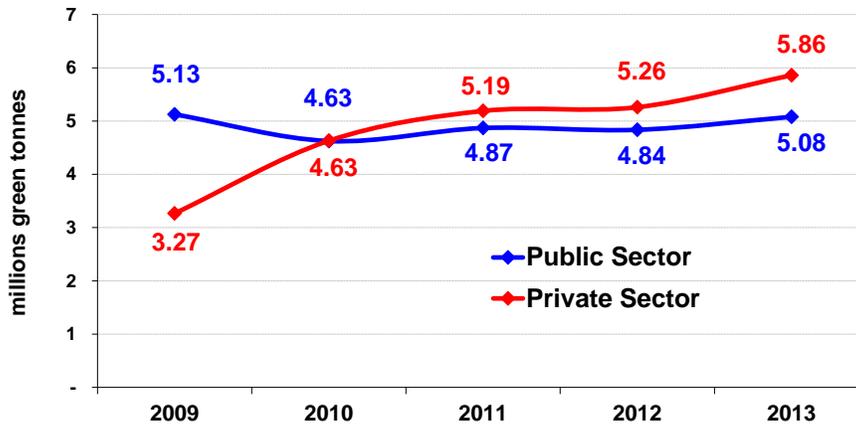
In 2013, removals of softwood from UK forests very nearly reached 11 million green tonnes, an increase of 8.4%.

Private sector removals rose to 5.9 million green tonnes, a rise of 11.4% and public sector removals increased by 5.1% to 5.1 million green tonnes.

In the ten years from 2003, the share of softwood removals from the private sector has grown from 39% of the total to 54% in 2013.

These changes in the source of supply from UK forests over the last five years are shown in chart 16 below.

Chart 16: Softwood Removals from UK Forests by the Private and Public Sectors, 2009-2013

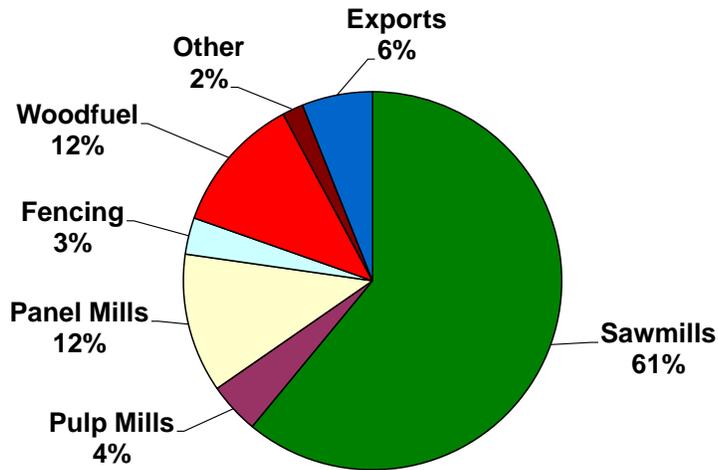


Source: Forestry Commission

Increased deliveries of coniferous roundwood, removed from UK forests, were made to sawmills (+5%) and pulp mills (+1%), but lower volumes were delivered to panel mills (-0.5%) and fencing contractors (-2%). Strong growth in deliveries for woodfuel (+25%) and in exports (+19%) was realised in 2013, augmented by an increase (+24%) in deliveries for other uses.

The relative size of the various markets for UK produced coniferous roundwood is shown in chart 17.

Chart 17: Deliveries of Coniferous Roundwood from UK Forests to User Industries, 2013



Source: Forestry Commission

b) Wood Energy

Wood used for energy generation includes sawmill products, such as wood chips and sawdust, bark, recycled wood and wood pellets. UK production of wood pellets continued to grow in 2013, by 8%, to reach a total of 0.30 million tonnes while the supply of pellet imports rose in 2013 by 128%, to a total of 3.39 million tonnes.

c) Certified Forest Products

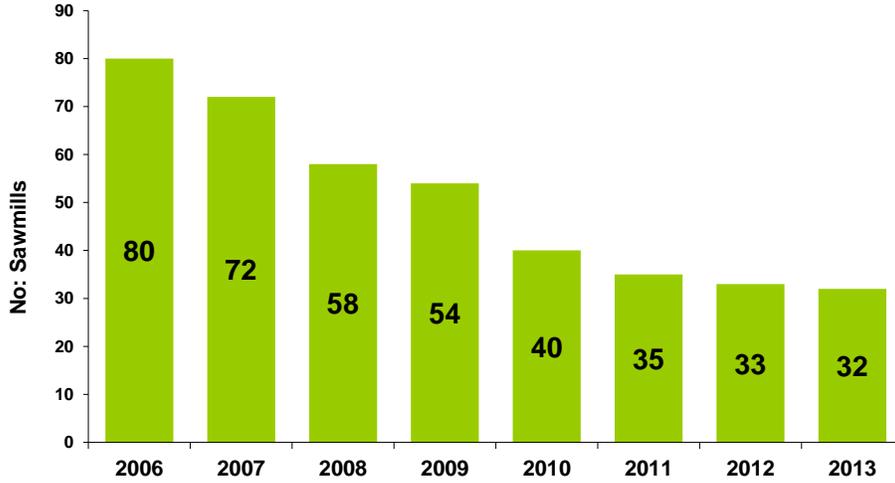
Nearly all removals from publicly owned forests are certified and over the last few years, an increasing proportion of the output from privately owned woodland has become certified.

The certified development of sawmill production has also been positive over the last ten years. A measure of this development is the reducing number of sawmills in the UK without chain of custody certificates.

In 2006, 80 mills were known to operate without a chain of custody certificate and by 2013 this had reduced to just 32. These were mostly small mills, of which 27 produced less than 5,000m³ of sawnwood with the other 5 mills producing between 5,000m³ and 25,000m³.

This overall development is shown in chart 18.

Chart 18: Number of Sawmills Operating in the UK without Chain of Custody Certificates, 2006-2013



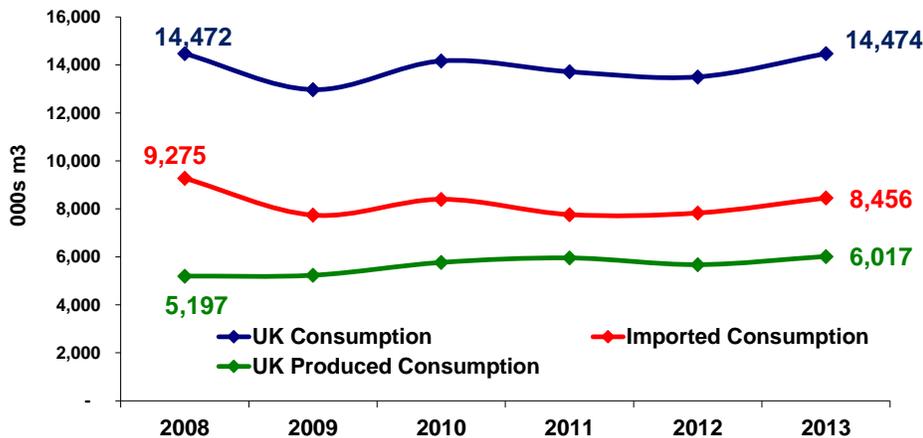
Source: Forestry Commission

d) Consumption of Timber and Panel Products in the UK

As reported previously in this Statement, the second half of 2013 witnessed a strong recovery in demand for timber and panel products resulting in overall growth for the year.

Total consumption in 2013 rose by 7% over 2012, with imported consumption higher by 8% and domestically produced consumption higher by 6%. The development of UK consumption of the main timber and panel products since 2008 is shown in chart 19.

Chart 19: Consumption of UK Timber and Panel Products, by Source, 2009-2013



Source: Forestry Commission; Timber Trade Federation, Wood Panel Industries Federation; *timbertrends*

UK consumption of timber and panels in 2013 reached the level last achieved in 2008. That was the year that consumption of timber and panel products fell from 18 million m³ in

2007. The mix of these totals in 2013 was very different to 2008 however. Imports have declined, falling from around 9.3 million m³ in 2008 to 8.5 million m³ in 2013, a fall of 9%. In comparison, UK produced consumption has recovered from the recessionary year of 2008, rising to 6.0 million m³ in 2013, 16% higher than in 2008.

This performance may have been better had UK produced consumption not fallen in 2012, by nearly 5%. This was mainly due to the reduction in particleboard capacity with the closure of the Sonae plant in Knowsley.

e) Value-added Forest Products and Engineered Wood Products

Volumes of all imported sawn and planed softwood were higher by just over 6% in 2013. Within this total, further processed (value-added) softwood imports, such as planed, square-edged and finger-jointed grew by 2% in 2013 while rough sawn varieties increased by 10%.

The volume of imported planed goods increased from 1.77 million m³ in 2012 to 1.80 million m³ in 2013. Rough sawn volumes rose from 3.00 million m³ in 2012 to 3.30 million m³ in 2013.

Data on the volume of further processed goods from UK producers are not available, however, the trends noted in the import sector are believed to be reflected in the domestic production sector also.

Further processed goods, as a proportion of all imported sawn softwood, fell from 37% in 2012 to just over 35% in 2013.

Volumes of manufactured timber products (engineered wood products) have almost certainly increased once more in 2013, although there is little published data available to confirm this. Anecdotal evidence suggests that modified wood products, such as Accoya and cross-laminated timbers and I-joists are growing rapidly in popularity, particularly in construction.

f) Sawn Softwood

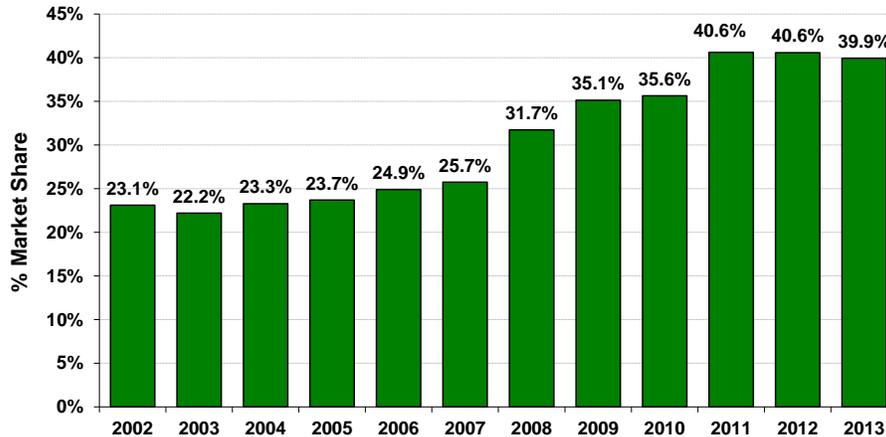
Before the most recent recession in 2007, imported softwood provided around 75% of total softwood consumption in the UK. The importance of specific markets for imported and domestically produced softwood tend to differ with the great majority of imported softwood consumed by construction, while domestic producers have a high market share in the pallets and packaging and fencing and outdoor markets.

During the recessionary years between 2008 and 2009 and in the ensuing three years to 2012, the construction industry experienced a greater downturn than many other markets and softwood imports suffered as a consequence. The pallets and packaging industry also suffered during this time, but importers saw demand from construction reduce dramatically at the same time as losing market share in the pallets and packaging industry to UK producers.

UK producers continued to enjoy a price advantage over imported softwood and this, combined with the changes in end user markets, enabled UK producers to achieve modest volume growth and robust market share growth over this period.

The market share of domestically produced sawn softwood from 2003 is shown in chart 20 below.

Chart 20: UK Producers Share of Sawn Softwood Consumption, 2003-2012



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

The many years of rapid market share growth for UK producers ceased in 2013 however as construction markets began to recover.

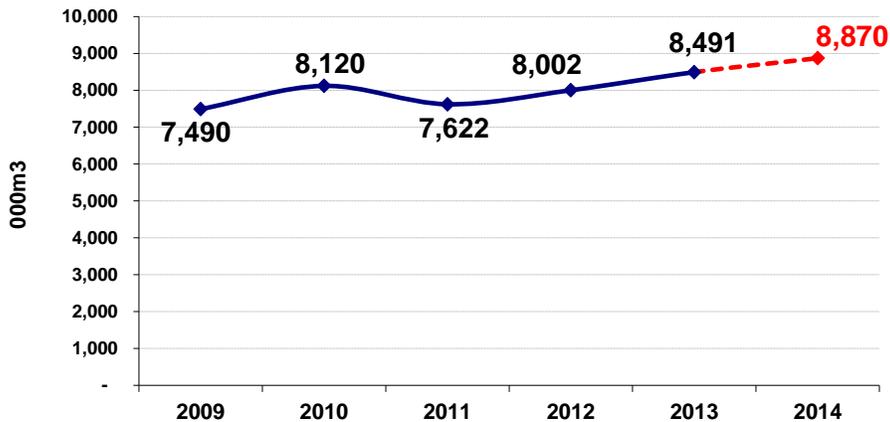
The National Softwood Division (NSD) of the Timber Trade Federation produce an estimate of softwood imports mid-way through each year for the second half and a forecast for the following year. This forecast for 2013 proved be inaccurate because of the surge in demand from September 2013, especially from the new home building market. This could not have been easily predicted and the strength of this turnaround rendered any forecast made before that time redundant. For 2014, the provisional forecast of the NSD predicts that softwood import volume will rise from 5.10 million m³ in 2013 to 5.35 million m³, an increase of around 5%.

A forecast for UK production for 2014, based on the advice of the Forestry Commission's Expert Group on Timber and Trade Statistics indicates that output from UK sawmills will rise by around 4% to a reach a level of 3.67 million m³.

From these forecasts, the consumption of softwood in the UK for 2014 is projected to rise by 4.5% to 8.87 million m³.

The change in UK sawn softwood consumption is shown in the chart below.

Chart 21: UK Sawn Softwood Consumption 2009-2013 & Forecast 2014



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

g) Sawn Hardwood

Sawn hardwood consumption in the UK in 2013 fell by around 3% to 0.43 million m³.

The great majority of sawn hardwood consumed in the UK is imported, accounting for over 90% of all hardwood consumed, with a very wide variety of products demanded for many different uses.

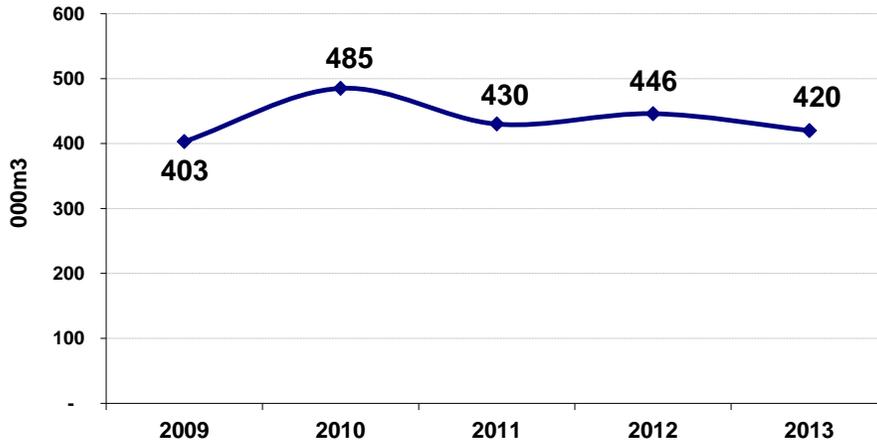
UK production of sawn hardwood decreased in 2013 to 0.046 million m³, a 5% decline over 2012 as hardwood imports decreased by 7% to around 0.39 million m³.

The year 2013 saw the introduction of the European Union Timber Regulation, as described above in Section 2. The greater element of risk is associated with hardwood from African and Asian countries and where doubt might exist over the legitimate source of tropical hardwoods, import volumes have fallen. Tropical hardwood imports fell by 12%, but temperate species also experienced reductions in 2013, down by 5%.

Export volumes in 2013 amounted to only 0.019 million m³, a decrease of just over 25%, following a 21% decline the year before.

The development of sawn hardwood consumption since 2008 is shown in the chart below.

Chart 22: UK Sawn Hardwood Consumption, 2009-2013



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

h) Wood-based Panels

Particleboard, OSB and MDF are produced in the UK and imported, but all plywood and fibreboard is imported.

UK produced consumption of panel products rose by 8% in 2013 while imported consumption increased by 13%. A contributory factor to the strong growth in imports was the replacement of some of the former UK produced particleboard volume from Sonae by imported particleboard.

Exports of Particleboard and OSB (combined) fell sharply in 2013, down by 31%. Part of this lost volume was due to UK producers switching production to meet increased demand at home. Higher volumes of both imported and domestically produced MDF were consumed in 2013, up by similar amounts at around 4.6% overall.

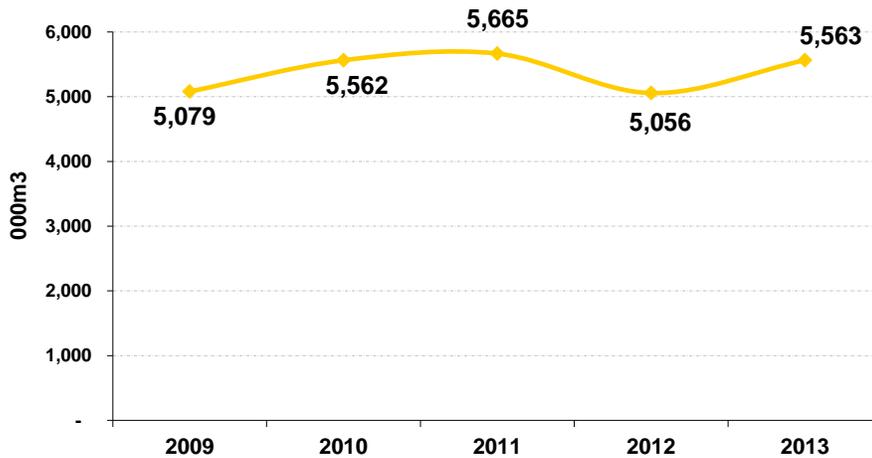
Plywood imports grew by around 7% in 2013 to 1.37 million m³ in 2013. Plywood re-exports were also higher in 2013, by a very similar growth rate.

The total volume of imported panel products grew to a level of approximately 2.96 million m³ in 2013, returning to the levels of 2011 and higher than the 2.65 million m³ in 2012.

Consumption of UK produced panel products, after taking into account exports, was higher at 2.60 million m³, from 2.41 million m³ in 2012.

Volumes of exports and re-exports of panel products were 0.43 million m³ in 2013, down from 0.60 million m³ in 2012.

Consumption of UK produced panel products at 2.60 million m³ in 2013 accounted for 43% of all UK produced timber and panels consumption in 2013, up from 42% in 2012.

Chart 23: UK Panel Products Consumption, 2009-2013

Source: Forestry Commission; Timber Trade Federation; Wood Panel Industries Federation; *timbertrends*

i) Pulp and Paper

Consumption of wood pulp in the UK in 2013 was 1.30 million tonnes, up from 1.21 million tonnes in 2012. This 2013 total was 7.1% higher than and was driven by a 7.8% increase in imports.

UK pulp production increased by 2.7% in 2013 to 0.23 million tonnes. This includes an estimate for small chemical pulp which does not include the use of wood fibre.

UK consumption of paper and paperboard fell again in 2013, down by 1.5% to 9.86 million tonnes.

UK production of paper and paperboard in 2013 rose by 1.8% to 4.56 million tonnes from 4.48 million tonnes in 2012.

UK imports of paper and paperboard fell by 3.6% in 2013, down to 6.39 million tonnes compared to 6.63 million tonnes in 2012.

Please note there are minor differences to pulp and paper statistics in other publications and the figures shown above. The figures above are the latest revisions to earlier data for 2013 and 2012 and post-date some current publications in circulation.

j) Innovative Wood Products / Housing and Construction

Development of Timber in Construction

The development and acceptance of innovative timber products continues to gain momentum. Hard data is scarce on volumes sold in the UK, but significant advances have been made over the last two years with engineered and modified timber products being increasingly used in construction projects.

One such is an eight-storey development in London using cross-laminated timber (CLT) where building time and carbon saving proved better than using steel and concrete.

Laminated Veneer Lumber (LVL) is extensively used for structural beam and I-joint production and a leading company, Steico, aims to increase production of LVL at a dedicated new line in Poland in the next two years. Softwood has been the core product in the development of LVL over the last three years, but hardwoods, providing even greater strength are now also in production.

Chemically modified wood products are also winning market share over competitive materials and the potential for such products was recently highlighted through the agreement by Solvay, a large Belgian chemicals company, to establish Accoya production plants in Europe to service parts of the European construction market.

The trend of increased usage of innovative wood products is likely to continue as the strength, faster build-time and environmental superiority over competitive materials becomes ever more recognised by specifiers, developers and construction companies.

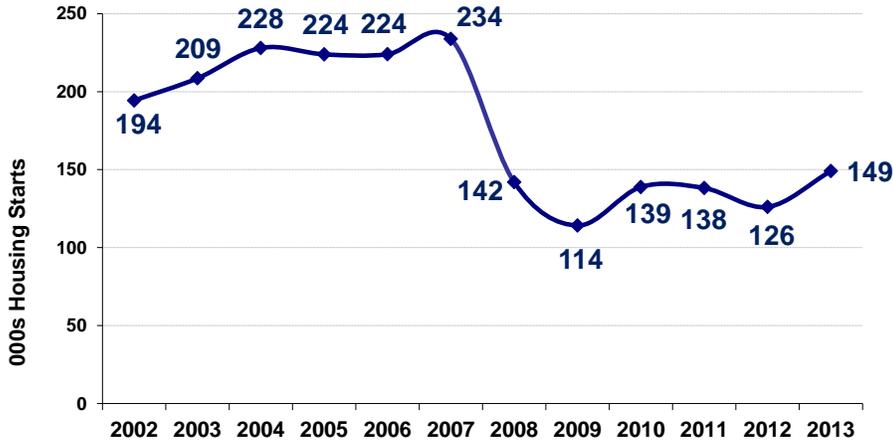
Housing Demand

As has been reported elsewhere in this Statement, the final few months of 2013 saw an unprecedented rise in new home building in the UK.

Confidence returned to the housing market with house prices rising; the economy improving; finance for home purchase easing after many years of constraint, continuing low interest rates and government sponsored incentive schemes all contributing to this recovery.

In total, housing starts reached a level close to 150,000 in the UK, the best year since the downturn in 2008. The longer-term development of housing starts in the UK is shown in chart 24 below.

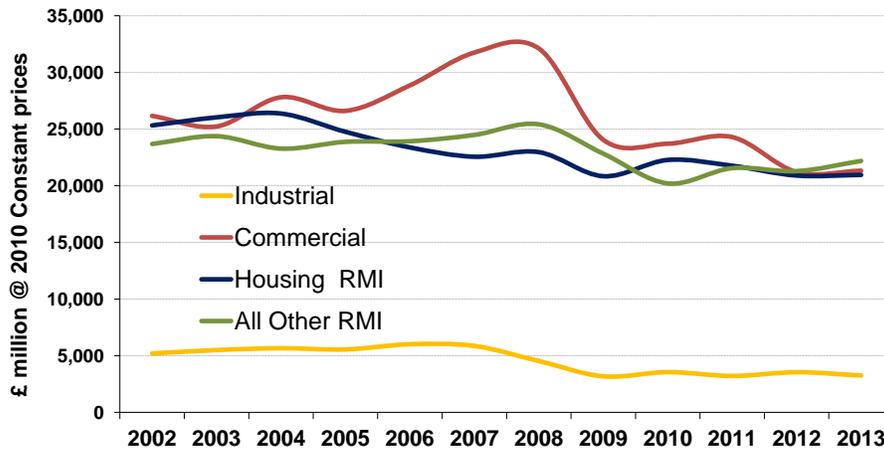
Chart 24: UK Housing Starts, 2002-2013



Source: Office for National Statistics

The extent to which recovery in construction was due to the new home building market can be seen in chart 25, which plots the development over the same period of the other main construction segments: industrial building, commercial building, housing repair, maintenance and improvement (RMI) and all other RMI building work.

Chart 25: Development of Other UK Construction Market Segments, 2002-2013



Source: Office for National Statistics

As shown in chart 25, the growth in 2013 of these other construction market segments was weak or non-existent. Output of industrial building was 8% lower in 2013, compared to 2012.

Commercial building achieved very little growth in 2013, higher by just 1%. Housing RMI activity was virtually the same as in 2012, recording no growth and the only sector to show any meaningful growth was the ‘all other’ RMI market (all RMI other than housing RMI) which grew by 4% in 2013.

The continued weakness of these non-new home building markets is brought clearly into focus when compared to the 18% growth of housing starts, as shown above.

5. Tables

UK Economic Indicators (% unless otherwise indicated)

	2009	2010	2011	2012	2013	2014
GDP growth¹ (at constant 2010 prices)	- 5.2	1.7	1.1	0.4	1.8 ²	3.2 ²
Interest Rate (Base Rate at year end)	0.5	0.5	0.5	0.5	0.5	0.5 ²
Consumer Price Index	2.2	3.3	4.5	2.8	2.5	1.8 ²
Unemployment (ILO)	7.8	8.0	8.2	8.1	7.8	6.4 ³
UK Housebuilding Starts (000s)	114.2	138.9	137.5	124.5	149.1	173.0 ³

¹GDP growth is measured on a chained volume basis current year compared to previous year

²HM Treasury, Forecasts for the UK Economy: A Comparison of Independent Forecasts, September 2013

³*timbertrends*