



Good year 2018 for Russia, and changes ahead

2018 a very positive year for Russian forest industry sector • 2019 sector likely to be confronted with new restrictive policies • Discussed restrictions: 100% export ban and 100% RFID control for round wood, 100% merchandise exchange trade for exports of round and sawn wood • Federal Forestry Agency started review of all forest lease agreements • Nevertheless: Overall projections for 2019 mostly positive

GOOD YEAR 2018...

In 2018, there was an increase in the production of all main wood-based products in the Russian forest industry complex in natural units, as well as an increase in prices. The total increase of the output of the forest industry in Russia was at approximately 24% in nominal Roubles (RUB), which corresponded to 16% increase in nominal US Dollars (USD) – based on early Russian statistics committee data and StepChange calculations:

- **Roundwood:** total harvesting – 238 million m³/year, an increase of about 8% compared with 2017; export fell by 2.1% to 19 million m³,

while the average price increased by 3.5% to 78.2 USD/m³ in nominal USD (here and further export prices are given as reported, i.e. exc. VAT & inc. part of transportation);

- **Lumber** (softwood and hardwood) production of 41 million m³/year, of which export 32 million m³/year; export growth by 6.7%; average export price increase by 7% to 140 USD/m³, with large amount of low-price green lumber;
- **Chipboard/OSB:** production of about 8 million m³/year, growth of 16%, the highest growth rate was seen for OSB boards, where production in 2018 reached app. 1.2 million m³/year;

Figure 1: Russian forest industry in 2018

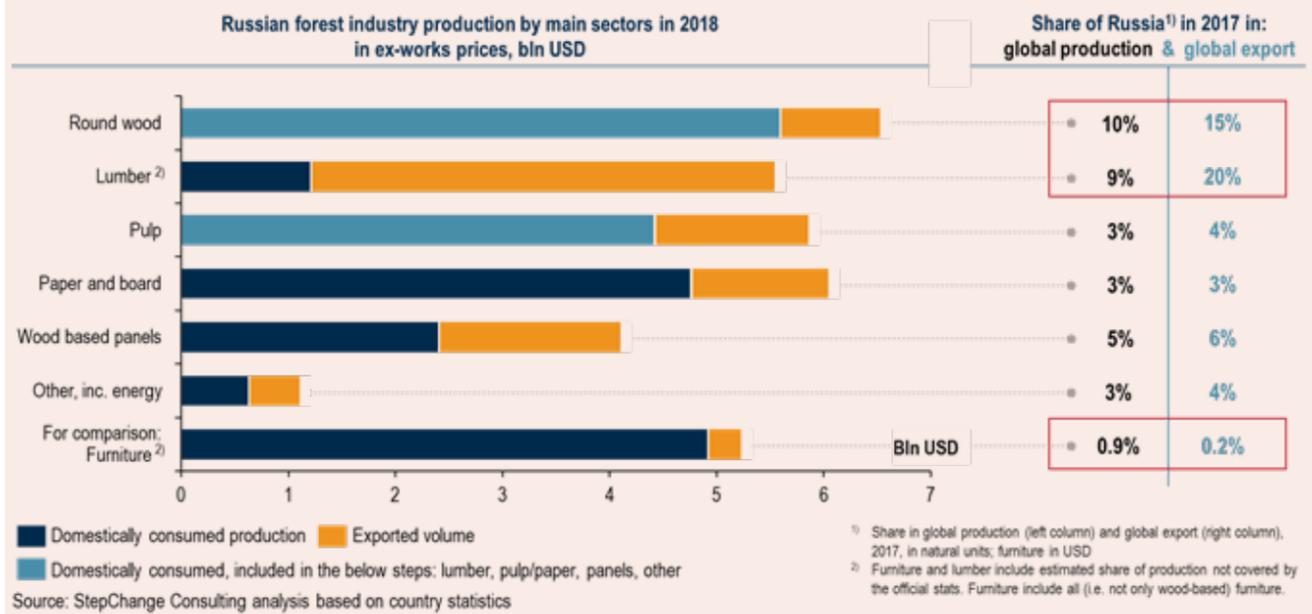


Figure 2: Sales of personal cars in Russia, 2008 – Feb 2019, 1,000 units per month



- **MDF/Fiberboard:** production of about 3 million m³/year, an increase of about 8% due to an increase in utilization of existing capacity (MDF) and re-launch of part of previously idle capacity (fiberboard); MDF/HDF dominate this segment, with about a third of the production going to the production of laminate flooring;
- **Plywood/LVL:** production volume was about 4 million m³/year, production growth by 7%; exports of almost 2.7 million m³/year, export growth by 8.7%; increase in export prices by 13.1% to 505 USD/m²;
- **Pulp:** production volume of about 8.6 million m³/year, production growth by 2% compared to 2017; export over 2.1 million t/year, export growth by 0.8%; price increase by 36.1% to 709 USD/t;
- **Paper and board:** production volume was at 9 million m³/year, production growth by 5.3%; export over 2.1 million tons/year, export growth by 1.6%; export growth for newsprint by 3.4% (to 1.16 million tons in 2018) with prices rising by 35% to 562 USD/t
- **Furniture:** furniture production in Russia grew by 4.6% in nominal rubles, which corresponds to 2% decline in nominal USD; the volume was at USD 3.7 bln, exc. production not covered by the official statistics and some production which goes into the statistics as services; furniture imports grew by about 15%, to USD 1.9 billion; furniture exports remained low – five times lower than the imports.

share was seen in sawmilling: Russia produces about 9% of global lumber, while share of Russia in global international trade of lumber is at 20% (i.e. one of each five cubic meters of internationally traded lumber originates in Russia).

Higher value products have more modest presence in the global context: Russian pulp and paper production stood at 3% of the global, with export of 4% and 3% for pulp and paper respectively (all in natural units). Production of wood-based panels was at 5% of the global, with export at 6%. Further downstream in the value chain, there is a further decrease in share of Russia: furniture production in Russia (in monetary terms, with estimated volume outside of the official statistics) was at 0.9% of the global in 2017, with exports at mere 0.2%.

In other words:

- Russia's share in the global furniture production is one tenth of its share in round wood and lumber production (0.9% vs. 9–10%) and
- Russia's share in global furniture export trade is approximately one hundred times smaller than its share in lumber export trade globally (0.2% vs. 20%, see the numbers in Figure 1 in red boxes).

It shows both a large potential for the Russian producers, and a potential to improve the investment climate in the forest industry sector in particular.

The most relevant macroeconomic outcome of 2018 for Russia was overcoming the prolonged crisis of 2014–2017 and starting growth. The growth is slow, but it is growth nevertheless. Indicators like car sales in Russia, shown in Figure 2 support this statement. Comparing car sales in the crisis year of 2009 with the period of 2015–2018, it can be observed that at the end of 2017 and throughout 2018, the level of sales (almost) returned to 150 thousand cars per month, excluding traditionally lower levels in January – which almost corresponds to the post-crisis 2010 figures.

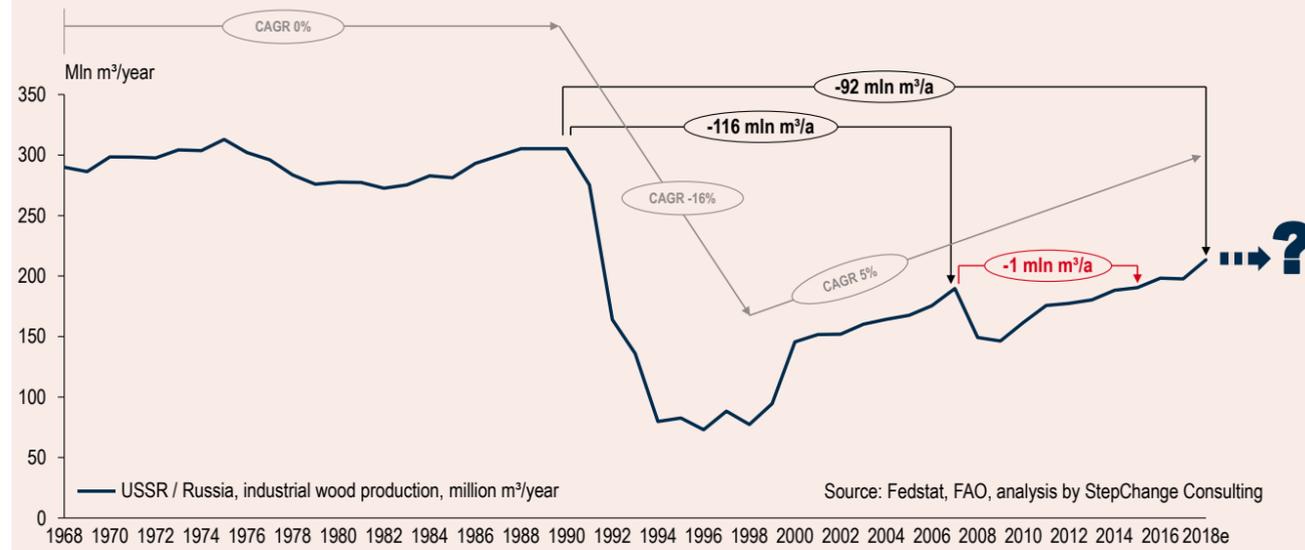
However, the protracted nature of the crisis of 2015–2017, and a rather uncertain growth so far in 2017–2019, might indicate an overall slow recovery from the crisis, with possible periodic downturns in the coming years. Especially if external or internal conditions suddenly deteriorate.

Total manufacturing of forest industry products in the Russian Federation is estimated to be at USD 20 billion, in ex-works prices, excluding VAT, transport as well as value-adding operations like furniture production, construction/interior elements production, printing/packaging etc.

The share of the pulp and paper sector was at about 40%, sawmilling contributed 30%, and wood-based panels added further 20%. Total exports were at 53% of the total production. Imports were noticeable in paper (more than half of exports) and in furniture (five times higher than exports). Projections for the coming years are mostly positive, especially for export-oriented products.

The share of Russia in round wood production globally was at 10% in 2017, in natural units (the 2018 data globally is not yet available), with share of global export at 15% (Figure 1, column to the right). A similar

Figure 3: Russian industrial wood production, last 50 years (1968-2018e)



...AND CHANGES AHEAD

In 2018 and early 2019, Russia's forest industry sector has been in the spotlight. Drastic policy changes for the industry are expected. Just as an example, in a span of just eight days in February 2019, three top Russian officials proposed:

- **100% export ban** for round wood
- **100% RFID control** for all round wood cut in Russia and organization of work on the preparation of a **new version of the Forest Code** of the Russian Federation
- **100% of export sales** of sawlogs and lumber **via Mercantile Exchange**

Such proposals, even if only partly implemented, would lead to drastic changes in the forest industry in Russia, directly or indirectly affecting both domestic and international buyers of Russian wood and wood/fiber-based products. The likely winners of the changes within Russia would be large (integrated) holdings, able to spend resources to affect the changes, and to accommodate to the new rules fast, whatever the new rules end up being. And the greater the changes, the greater this effect is likely to be.

It is interesting to note that, as part of the ongoing measures, the Federal Forestry Agency, together with the bodies of the Prosecutor General's Office of the Russian Federation, have already begun to verify all (around 8000) forest lease agreements in Russia, starting with the largest wood harvesting regions: North-West, Siberia, and the Far East.

"Today in many regions there is a situation when forest lease holders do not have their own processing facilities and resell timber at high prices to processing facilities. The priority for raw material supply should be given to enterprises that have their own processing, and to those which ensure reforestation of the harvested areas" – said the head of the Ministry of Natural Resources of Russia Dmitry Kobylkin (citation by Press Service of the Ministry of Environment of Russia, 11 March 2019). According to the Russian Federal Forestry Agency, there are 35 forest lease holders in Russia with annual allowable cut (AAC) of over 1 mln m³/year, and 294 with AAC ranging from 100 to 500 thousand m³/year. The central office of the Federal Forestry Agency will examine the largest forest lease holders, while the smaller ones will be delegated to the local agencies.

Among possible consequences of various proposed and already ongoing measures, there are temporary declines in overall round wood production in Russia in the coming years – as one of likely scenarios. In recent Russian history significant changes of similar nature were seen at the end of 2006, with introduction of the current Forest Code. Industrial round wood production in Russia dropped from 190 mln m³ in 2007 to 146 mln m³ in 2009, as a combined effect of new export barriers and the global financial crisis – and it took until 2015 to reach the 2007 level again (Figure 3, 2006–2015).

In today's situation, however, there might be a drop of a smaller magnitude, mainly due to the following reasons:

1. The current level of round wood export from Russia is around 19 mln m³/year. Even in case of a complete export ban, the drop in exports would be at those 19 mln m³/year, while in 2006–2009, the drop of the export volumes of round wood from Russia was 29 mln m³/year (Figure 4).
2. The 2007–2009 drop was accompanied by the worst global financial crisis in recent history – which (hopefully) is not going to be the case with the currently discussed changes. However, growth in major global economies (US, Europe, China) is expected to slow down, which might 2021 invoke a recession in the next years.

Share of exported wood in total industrial round wood production in Russia returned recently to 8–10%, dropping by 20 percentage points from the level seen in 2006 and earlier in the late 1990s (Figure 5). Export volumes of Russian round wood in absolute numbers have stabilized recently at a level of 19–20 mln m³/year, which is not far from the Soviet-time export levels (Figure 6): some 15.9 mln m³/year were exported on average in 1968–1988.

In 2006, there was a peak in the Russian share of global round wood exports: with over 50 mln m³/year of round wood exported from Russia in 2006. Two of every five cubic meters of internationally traded round wood originated in Russia. Since then, the share has been declining on average by two percentage points per year. At the same time, the share of Russia in global production of industrial round wood remained relatively stable: an increase of just 1 percentage point between 2006 and 2018 (Figure 6).

Figure 4: Russian round wood export, last 50 years (1968-2018e)

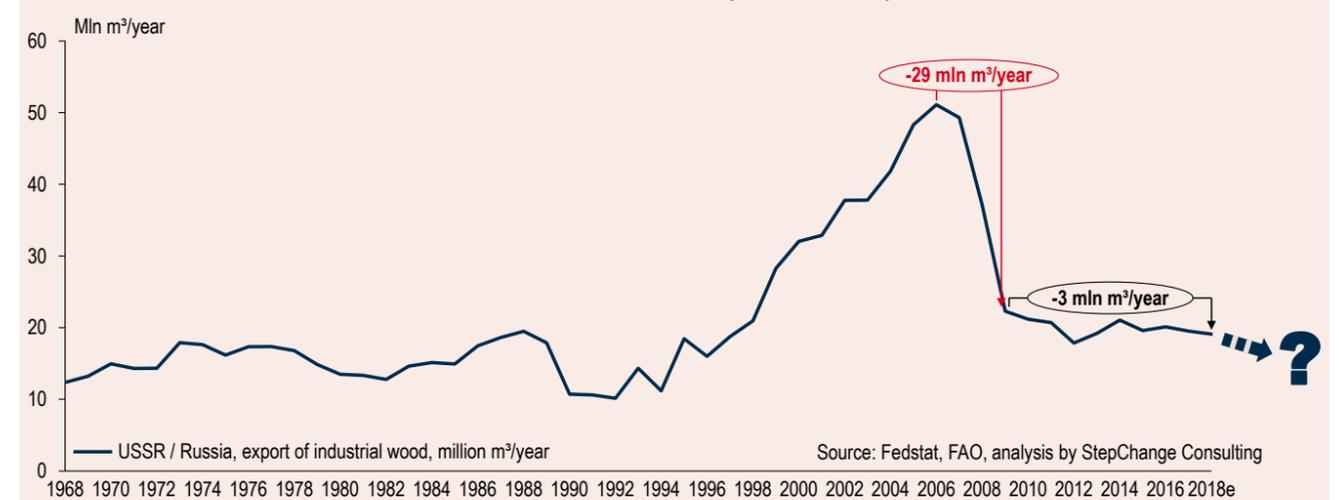


Figure 5: Share of exported wood in total industrial round wood production in Russia, last 50 years (1968-2018e)

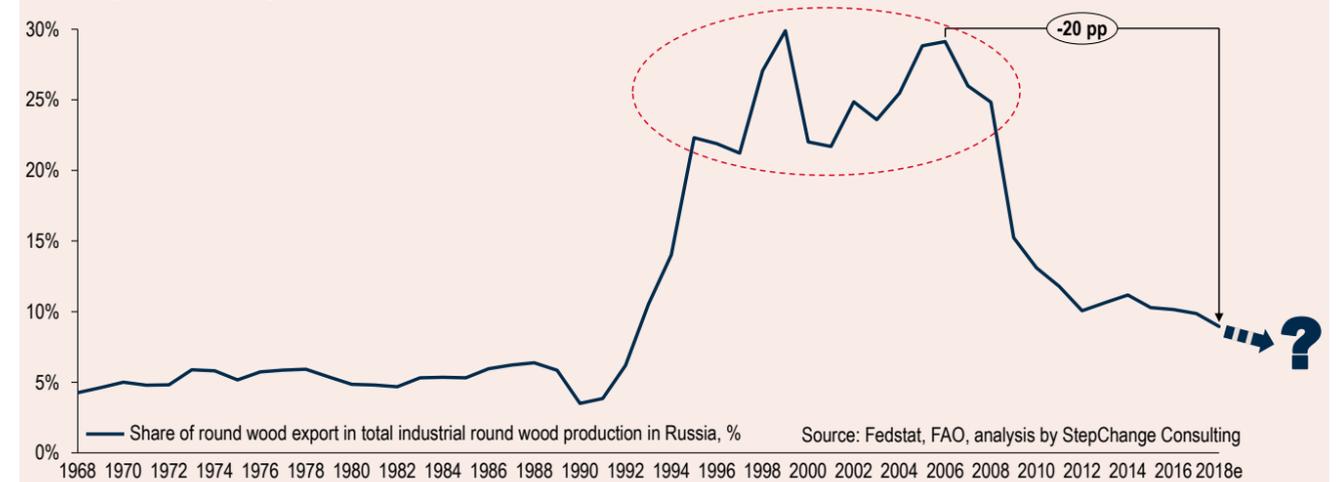


Figure 6: Share of Russia in global industrial round wood production and export, last 50 years (1968-2018e)

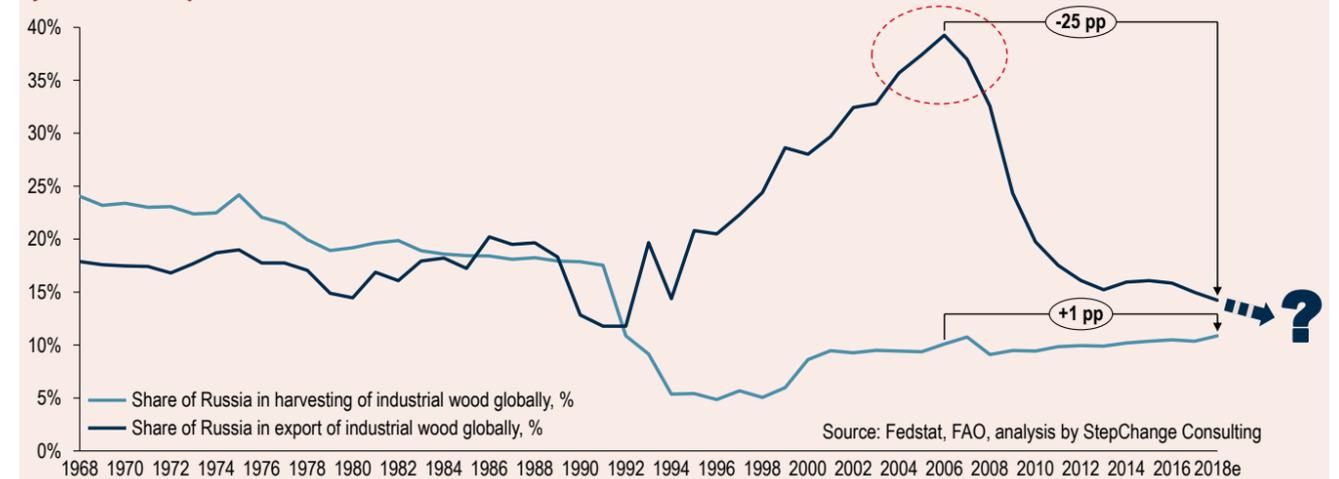
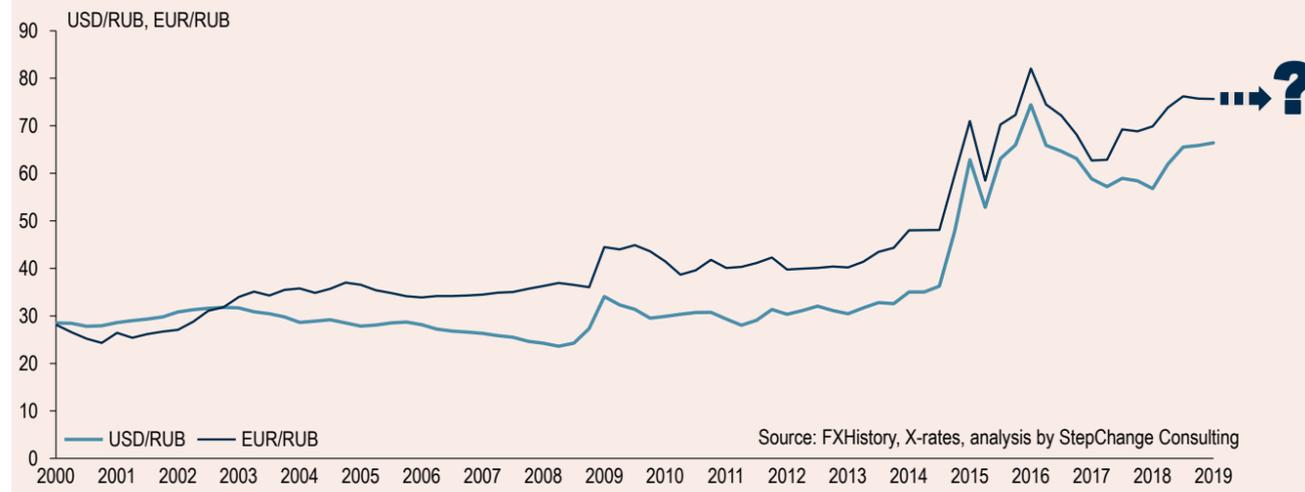


Figure 7: Exchange rate development since 2000, quarterly



Independently of future changes, a drop in volumes of round wood (and wood chips) exports from Russia is one of the possible scenarios. On a positive side, domestic manufacturers consuming low grade wood might find themselves in a better position – with more round wood forced to stay in the country.

However, the situation is not one sided. Lower demand for sawlogs and plylogs (due to possible and already enforced export restrictions) might lead to overall lower harvesting volumes for all assortments, thus affecting consumers of low-grade wood in the country.

OPPORTUNITIES FOR RUSSIA

The forest industry sector has become one of the strategically important sectors for the state in Russia. This means a potential increase in subsidies, a possibility of rapid development of certain sub-sectors, and a higher unpredictability in general. Partly related to this point, the positive news of 2018 was that the probability of new pulp projects in Russia has increased.

The state (at least as represented by the top officials of the Ministry of Industry and Trade) spoke in favor of targeted support for the most likely projects – including the creation of special economic zones for these new greenfield pulp projects. The most likely projects as of today are Sveza (Vologda Oblast, Roschino), Segezha (Krasnoyarsky Krai, LDK-1 site), and Kraslesinvest (Irkutsk region, Boguchany). Additionally, there are several further projects in Siberia and the Far East.

New projects (if realized) would lead to growth in processing of sawlogs and plylogs in the respective regions. In case those large projects are not implemented (due to various reasons, among which is higher CAPEX per

unit of installed capacity in Russia as a result of high requirements in construction norms), the overall regional impact is likely to be even negative. Utilization of forests “reserved” for such projects will be lower and there are likely to be imbalances of demand for various wood assortments in the respective regions, for example, much higher demand for sawlogs and plylogs vs. lower grade wood.

Export opportunities remain the most likely locomotive for short and mid-term growth of the forest industry in Russia. Here the key “support” (as well as the key risks) come from the oil prices and the ruble exchange rate: with Brent oil prices around USD 60 per barrel, the exchange rate is likely to remain close to what it is today (Figure 7). However, rise of prices to USD 80–90 per barrel or fall to USD 30–40 per barrel remain “not-unlikely” scenarios, with possible shocks to the RUB exchange rate. The unpredictability of oil prices carries risks for the ruble exchange rate, and hence the investment attractiveness of the Russian Federation and, accordingly, the long-term competitiveness of production assets in the Russian Federation.

An additional factor are the developments of the EU/US sanctions, their effect on the ruble exchange rate and the perceived investment climate in Russia – affecting further both the short-term and the long-term competitiveness of the country’s production assets.

The overall hope (and goal) for the Russian forest industry complex is that there can be a way to build a strong, modern, and well-balanced forest industry asset base, with a comfortable investment climate, large forest resource base, and modern forestry practices. That would allow for capitalization on potential increases in global demand for wood products. The Russian forest industry can play a much larger role in the global economy, to the benefit of Russia and while additionally supporting global economic growth.

About the authors

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