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Brazil

Solid Wood Products

Annual Report

2007

Approved by:
Beth Autry, Agricultural Attache
U.S. Embassy

Prepared by:
Joao F. Silva, Agricultural Specialist

Report Highlights:

Strong economic fundamentals including an expanding GDP at an annual rate of five percent, lower unemployment, stable inflation, and declining interest rates have created the conditions for increased solid wood demand in the domestic market. Despite a housing deficit of over 11 million homes in Brazil, annual housing starts are at their highest level in 2007, and likely will continue strong in 2008. The overall growth rate of the construction industry is estimated at 7 percent in 2007 and is expected to reach 11 percent in 2008. Although the value of exports in 2007 is estimated to increase by four percent, the valuation of the Brazilian currency continues to affect the profitability of lumber exporters.

Includes PSD Changes: No
Includes Trade Matrix: No
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Executive Summary

A favorable economic outlook for 2007-08 is keeping the Brazilian overall industry production capacity at high levels to meet increasing domestic and foreign demand. Strong economic fundamentals including an expanding GDP at an annual rate of five percent, lower unemployment, stable inflation, and declining interest rates have created the conditions for increased solid wood demand in the domestic market. Despite a housing deficit of over 11 million homes in Brazil, annual housing starts are at their highest level in 2007, and likely will continue strong in 2008. In addition, housing renovation, a vital part of the housing industry, has been on an upward trend since last year. The overall growth rate of the construction industry is estimated at 7 percent in 2007 and is expected to reach 11 percent in 2008. Although the value of exports in 2007 is estimated to increase by four percent, the valuation of the Brazilian currency continues to affect the profitability of lumber exporters. The United States remains the main market for Brazilian solid wood exports, and represents 42 percent of the value of all Brazilian forest products exports estimated for 2007.

Forest Situation Report/Outlook

Note: Brazil remains without a reliable inventory of its forest resources, mostly in the Amazon region, which makes it difficult to estimate the exact forest area. There is no official data on solid wood production. Information provided in this report is derived from interviews with industry leaders and unofficial data furnished by our contacts in the sector.

Brazil is currently ranked second in world forest area coverage. Estimates indicate that total forest area is approximately 483 million hectares, of which nearly 447 million hectares are native forests and the other 6 million hectares are planted forests. The country also has 62 million hectares of federal conservation area under total protection (46 percent) and sustainable use (54 percent) regimes.

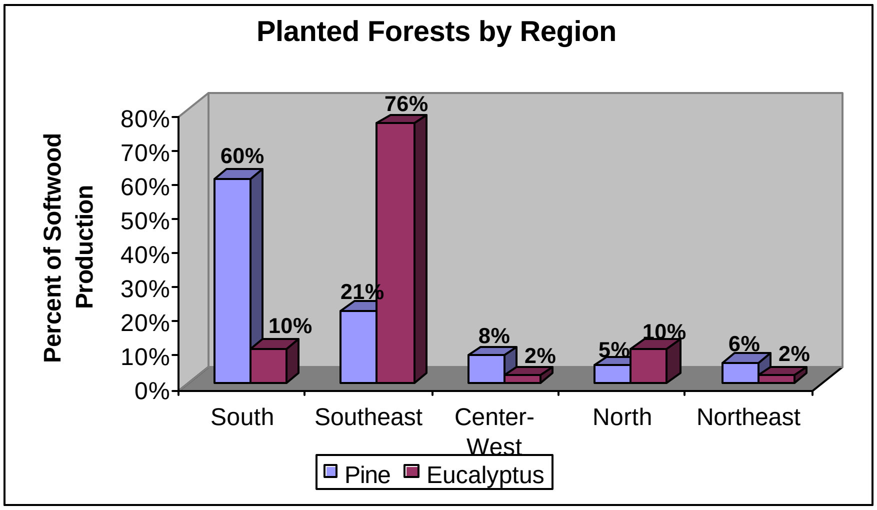
Native Forests

Native forests in Brazil are under both private and public ownership. Production of wood products in public forest conservation areas under sustainable use regimes is minimal. However, private production areas reached 242 million hectares in 2006, corresponding to 51% of total native forest area. Private forests are the major source of tropical wood production, distributed mainly in the Northern (Amazon) region of the country. The states of Amazonas (79 million ha), Pará (71 million ha), and Mato Grosso (29 million ha) are the top resource base for wood products. The remaining inventory of native forests is destined for conservation units and indigenous lands.

Planted Forests

Of the 6 million hectares of planted forests, 65 percent are eucalyptus, and the remaining 35 percent are pine plantations. The majority of the planted forests were established in the late 1960s, with the creation of Law 5,106/66, which created incentives for forest plantations.

The South and Southeast regions of the country are the main sources of planted forests (pine and eucalyptus). However, the pressure for increased supply of raw materials has expanded plantations to other areas of the country.

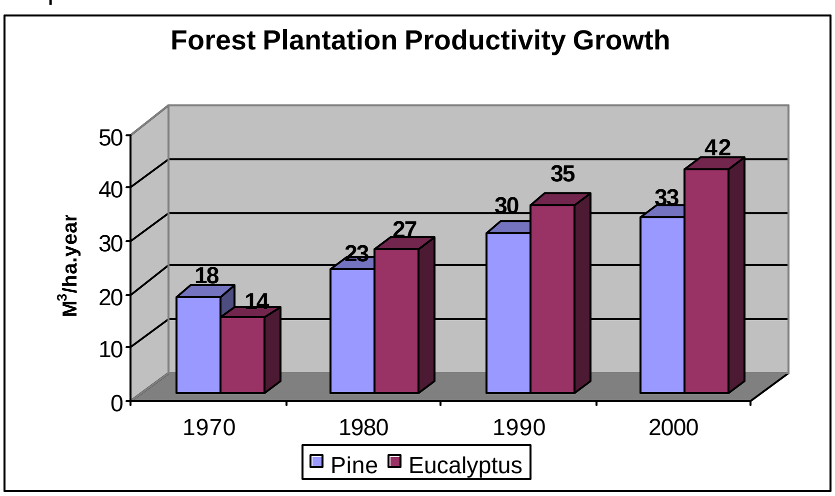


Due to the presence of large cellulose industries in southern Bahia, land prices have skyrocketed, increasing 266.6 percent since 2004 to R$4,400/hectare. These industries account for approximately 500 thousand hectares of forest area. Another new frontier for forest plantations is the state of Piaui (northeast). The local government has released a forest development program that is drawing industry attention to that area. A total of 3.7 million hectares were identified as suitable for forest plantations, and land prices are among the lowest in the country.

Forecasts indicate a tendency for increasing softwood (planted forests) production between 2009 and 2022. Current social and environmental pressures, unfavorable exchange rates and increasing land and technology costs are major constraints to softwood supply, especially in relation to pine wood production. Eucalyptus projections are more favorable, due to increasing investments by the cellulose industry in new plantations in the northeast region of Brazil.

Sustainable Production Capacity

The sustainable production capacity of Brazilian forests is elevated, estimated at approximately 390 million cubic meters (m^3) per year. From this total, planted forests account for 179 million m^3 per year, of which 72 percent are eucalyptus wood and 38 percent are pine wood.



Illegal Logging & Certification

Approximately 60 percent of tropical wood production comes from predatory sources, 43 percent of which are from illegal logging. According to the Ministry of Environment (MMA), between 2006 and 2007, approximately 11,224 square kilometers were deforested in the Amazon, which is 20 percent less than the period 2005-2006. This is the lowest rate of deforestation since 1991. The states of Para and Mato Grosso account for 72 percent of all deforested area in the Amazon. As a comparison, the area deforested during 2006-2007 is equivalent to the territory of Jamaica.

Approximately 58 percent of the non-protected areas of the Amazon have ownership irregularities. In this region, 24 percent of the land is under private ownership. Industry sources state that land ownership issues are the second major constraint to the development of the wood industry, behind the delays in stewardship plan approvals. In fact, this delay is largely related to the ownership irregularities.

These issues are serious setbacks to the growth of certified forests in Brazil. Currently, Brazil has 5.1 million hectares (in 17 states) of certified forests under the Forest Stewardship Council (FSC) scheme. Nearly 55 percent of the certified forests are located in the Amazon region (2.8 million ha) and the remaining 45 percent are planted forests (2.3 million ha).

Another forest certification scheme used in Brazil is the Brazilian Forest Certification (CERFLOR) scheme. Recognized by the Program for the Endorsement of Forest Certification Schemes (PEFC) and regulated by the Brazilian Standards Institute (INMETRO), the CERFLOR scheme has 882,000 hectares of certified planted forests. Nearly 133,000 hectares of planted forests and 73,000 hectares of native forests are in the process of obtaining certification.

Only 2 percent of the tropical wood produced is derived from certified forests. Due to unsustainable forest production, wood production has an estimated deficit of approximately 200,000 hectares per year.

Solid Wood Production Situation / Outlook

Tropical Hardwood Logs

The production of tropical hardwood is among the main economic activities of the Northern region of Brazil. The states of Pará, Amazonas and Mato Grosso together add up to nearly 95 percent of the total hardwood logs production. Post estimates production at 24.5 million m^3 for 2007, a three percent increase from the previous year. The increase in production is attributed to higher demand from the construction industry.

Tropical Hardwood Lumber

Production of hardwood lumber is estimated at 15 million m^3 for 2007, showing an increase of 3 percent from the previous year mostly due to higher demand from the construction industry. However, exports of tropical hardwood lumber are estimated to decline in 2007 by approximately 5 percent, mostly because of the valuation of the Brazilian currency.

Although production has continuously increased over the past 5 years, environmental pressure has become a significant contributor to the decrease in the relative participation of tropical (native) wood in total lumber production. Other major restraints are the large distances to major consumers in the state of São Paulo, the increasing acceptance of softwood lumber, and the constraints in the acceptance of stewardship plans.

Softwood Lumber

The production of softwood lumber continues to rise as productivity and new plantations increase. Post estimates 2007 production at 9.7 million m^3, rising 5 percent from 2006. Consumption continued to grow, pushed by the rise of the construction sector demand. For 2007, softwood lumber exports are estimated to reach the same level as of due to the negative impact of the valuation of the Brazilian currency.

Government incentives for the production of softwood are on the rise (see policy section below), as the industry struggles to prevent what specialist call "forest blackout", the deficit in supply of the raw materials. Currently, estimates indicate that the production deficit is around 8 percent. Estimates for 2007 production suggest that the expected increase in pine and eucalyptus plantations, as well as an increase in industry productivity will boost production and consumption of softwood lumber.

Brazilian softwood lumber has a competitive advantage due to a faster maturing period than Northern Hemisphere producers and favorable climate and soil conditions. Brazilian pine has a maturation period of 14 years, while eucalyptus needs only 7 years. The cost of production of softwood lumber in Brazil is estimated at R$18 (approximately US$ 10) for eucalyptus and R$35 (approximately US$ 19) for pine. Currently, the average annual productivity rates for softwood is between 30 and 40 m^3/year for eucalyptus and 25 to 30 m^3/year for pine trees, depending on the region.

Softwood Plywood

Post estimates production of softwood plywood in 2007 to remain at the same levels of last year because of a drop in exports. Since softwood plywood is mainly sold overseas, the valuation of the Brazilian currency is affecting exporters' profitability.

According to industry sources, the plywood industry is composed of approximately 500 plants, of which 62 percent are medium and large-scale companies, and 38 percent are small-scale companies. The installed production capacity of the plywood industry in Brazil is estimated at 3.8 million cubic meters, of which 45 companies account for 60 percent of this capacity. The breakdown of plywood production in Brazil is distributed as follows: furniture (45 percent, construction (34 percent), packaging (17 percent), and all others (4 percent).

Trade

Exports of Brazilian solid wood and other forest products (Chapter 44 of HTS) totaled US$ 3.2 billion in 2006, slightly over the previous year. The United States was the largest importer of Brazilian forest products in 2006, accounting for nearly 50 percent of the total value exported by the country. The European Union follows the United States as the second largest importer of Brazilian products. On the other side, imports of solid wood and other forest products totaled US$ 110 million, of which Argentina and Paraguay accounted for 70 percent. The United States supplied only 6 percent of Brazilian imports under this category.

Industry sources estimate exports of solid wood and other forest products to increase by three percent in 2007, reaching US$ 3.2 billion. However, mostly of the important solid wood products will show some decline in volume. On the other side, imports of solid wood products are expected to increase by 20 percent due to an increase of 164 percent imports from China. The United States remain with a market share of 6 percent.

Although solid wood production is destined primarily for the domestic market and has competitive advantages compared to foreign competitors, Brazilian wood products have shown a slow down in exports over the past 2 years due to the impact of the valuation of the real against the dollar.

Policy

As of December 2007, the Brazilian Congress is still debating Draft Bill Number 6,424 which makes important changes in the current Brazilian Forest Code. The current Code establishes a legal reserve area in properties of 80 percent for the Amazon region, 20 percent for the Cerrados region, and 20 percent for other regions of the country. The proposed new Code calls for a reduction in the legal reserve area in the Amazon region from 80 to 50 percent for each rural property.

In 2004, the National Forest Program (PNF) launched by the Ministry of Environment had two major strategic actions to be completed by 2007: the expansion of the planted forest resource base and the regeneration of degraded areas, through a) Plantation of 800,000 hectares in small and medium size properties; b) Plantation of 1.2 million hectares through industrial-size sustainable programs; and, c) Recuperation of 200,000 hectares of degraded forests.

Expansion of forest stewardship areas associated with the protection of high-value areas for conservation: Add 15 million hectares of natural forests for sustainable production to supply 30 percent of the industrial demand; Assure that 1/3 of sustainable forest production is originated from social forests, produced by local communities and family farmers; Guarantee the protection of 2 million hectares with high ecological value in areas destined for forest stewardship.

President Lula sanctioned on March 2, 2006, the Public Forest Management Law (11,284/06), establishing a regulatory milestone for the management of public forests in Brazil. Although the Public Forest Management Law was a large step towards the prevention of illegal logging and sustainable forest stewardship, the benefits are yet to be seen by the wood industries and NGOs.

The publication of the new legislation initiated a transition period that is significantly compromising the rate of logging. The approval and inspection of Forest Stewardship Plans (PMFs), which was previously done by the Brazilian Environment Institute (IBAMA), was transferred to State Environment Offices (OEMA), which lack appropriate infrastructure and personnel for the approval of new PMFs. In order for PMFs to be approved, the owner of the stewardship plan is required to sign a contract with the Ministry of Environment (MMA).

In the context of the United Nations Conference on Climate Change in Bali, Indonesia, Brazil announced the creation of a voluntary fund to protect the Amazon jungle region, and its decision to adopt national targets to curb deforestation. The Fund for the Protection and Conservation of the Brazilian Amazon will be voluntary and will be launched in the first half of 2008 with an initial sum of 150 million dollars, to be deposited at the National Development Bank (BNDES). One hundred million dollars will be contributed by Norway. The Fund will be administered by a consultative council made up of representatives of the federal and state governments, non-governmental organizations (NGOs), Brazilian and foreign scientific researchers and delegates of companies. It is estimated that deforestation and forest fires are responsible for nearly 75 percent of Brazil’s greenhouse gas emissions.

Credit Lines

The main source of financial resources for the forest sector is the Bank for Social and Economic Development (BNDES). In 2006, total BNDES disbursements totaled R$52.3 billion, 11 percent higher than the previous year. From this amount, the agricultural sector was responsible for R$ 3.4 billion, of which less than R$ 200 million for the forest sector, not including the major cellulose and pulp companies.

Program for Commercial Planting and Recuperation of Forests (PROPFLORA): A credit program under the BNDES directed to pine and eucalyptus plantations, at subsidized annual interest rates of 8.75 percent with a loan limit per farmer of R$150,000 (about US$ 68,000), with a grace period of 8 years and payment in 12 years. In 2005/06, investments using the PROPFLORA reached R$ 60 million, distributed to approximately 800 farmers. PRONAF-Florestal program: Grants credit lines at a 4 percent annual interest rate. The grace period is also 8 years and payment in 12 years. In the 2005/06 crop year, loans totaled R$ 15 million, reaching over 2,800 contracts.

The FNO-Floresta, FCO-Pronatureza and FNE-Verde are credit lines with annual rates of 6, 8.75 and 10.75 percent respectively, for financing sustainable forest management projects, reforestation for energy and lumber purposes, recuperation of degradated areas, and environmental projects. Grace and payment periods vary according to each credit line, having a minimum of 6 to 20 years respectively for FNE-Verde, 9 to 16 years for FNO-Floresta, and 10 to 20 years for FCO-Pronatureza. Low credit limits and lack of information have caused little demand, and government resources remain unused. While both FNO-Floresta and FCO-Pronatureza granted a little over R$2 million each, loans under the FNE-Verde reached R$ 64 million in 2005 (no information is available for 2006 and 2007).

Marketing

The Brazilian Export Promotion Agency (APEX-Brazil), created by the federal government in 1997, is responsible for coordinating and financing up to 50 percent of the cost of promoting Brazilian products overseas and attracting more small and medium sized companies into the export business. APEX has two programs related to the forest sector, which are similar to the FAS Market Access Program: The Brazilian Association of Furniture Industry (APEX/ABIMOVEL), and The Brazilian Association of Mechanically Processed Timber (APEX/ABIMCI).

The APEX/ABIMOVEL (Brazilian Furniture) is a cost-sharing market promotion program valued at US$ 8.5 million (50 percent paid by APEX and 50% by industries from the furniture sector associated to ABIMOVEL) to promote Brazilian furniture in targeted markets, such as the United States, Europe and Mexico. The goal is to increase furniture exports by 19% per year and increase the current total export value of the sector to over US$ 1 billion. Promotional activities include: market research, trade shows, trade missions, reverse trade missions, advertising in specialized media, and publication of catalogs. The Brazilian furniture sector is composed of more than 70,000 firms, mostly small companies, with a total gross income of US$ 4.1 billion.

The APEX/ABIMCI is also a cost-sharing market promotion program, but has not been fully implemented. In 2006, APEX-Brazil financed 30 percent of Brazilian trade missions to research market opportunities for Brazilian plywood. ABIMCI is now proposing a major market promotion program valued at US$ 8 million to double Brazilian exports of plywood within four years. According to ABIMCI, market promotion efforts are targeted at high-value products, and will include activities in the most important world trade shows.