Log prices crash

In-market prices for logs in China, our largest export market, have dropped significantly in recent weeks. While some softening of prices is not unusual at this time of the year the scale of the correction was unexpected. The drop in pricing will make the harvest of some woodlots unprofitable. Harvest activity in New Zealand is being slowed with some harvesting crews being laid off.

The price of an A-grade log landed in China has fallen from US$130/JASm³ in early June to approximately US$105/JASm³. The current price level is difficult to quantify as the market has been moving rapidly downwards and in this environment buyers are unwilling to commit to pricing. While some exporters are optimistic that the bottom in the market may have already been reached this seems unlikely given the quantity of logs sitting on wharves in China is expected to increase.

There are a number of ships currently on the water, destined for China carrying logs without letters of credit. Sales are typically negotiated on a CRF basis where the buyer is responsible for the freight costs. This means for a portion of the logs on the water the sales process has not been completed.

A substantial improvement in prices is not likely to occur in the short-term and it may take six months for a marked lift in price, as existing stocks need to be worked through and buyer confidence needs to rebuild.

Figure 1. Pinus radiata log price (A grade in-market)

Source: AgriHQ, ANZ Research

Over supply driver of lower prices

A lift in the supply of logs and lumber into China relative to current demand is the main reason why log prices have corrected. Underlying demand still appears to be steady with logs moving from the wharves at normal rates. It is typical to see usage of logs decrease at this time of the year as construction activity slows during the hot summer months.

What is different this year is the quantity of logs that have been imported into China in recent months is more than normal. New Zealand has steadily increased its share of the China log market in recent years to become the largest supplier of logs to China. New Zealand held 27% of the market in 2018,
while Russia has at the same time decreased its market share to 16%. Other major suppliers of logs to China include Australia and the Pacific North West (Canada and United States).

China’s total log imports during the first quarter were on-par with last year. But New Zealand exports this year to date have increased by 22%.

Figure 2. New Zealand log exports to China by volume

Source: StatsNZ

An extra 1.35 million m³ of logs were exported from New Zealand during the first five months of 2019. This is equivalent to about one additional month worth of supply. China’s demand for logs has been growing recently but some of the previous demand for New Zealand logs has come at the expense of other markets where market share is decreasing.

Figure 3. New Zealand log exports to China – cumulative volumes

Source: StatsNZ

More logs on wharves

The quantity of logs sitting on wharves in China has lifted to about twice the normal level. However this in itself is not unusual for this time of the year. In summer the uptake of logs is lower than normal therefore logs stocks tend to build. At present the quantity of logs on wharves in China equates to about 40 days usage. This figure is likely to grow due to the quantity of logs that are currently on the water.

The volume of logs exported in June is estimated to be similar to that exported in May meaning stocks will continue to build as uptake from wharves in July is typically low.
The strong supply of logs from New Zealand has been supplemented by additional supply from South America. It is only feasible to ship logs from Uruguay to China when prices are strong. Therefore once the current shipments are landed this supply is expected to be shut off. The volume of logs and lumber coming in from Russia and lumber from Europe are not likely to slow.

China’s belt and road initiative has opened up rail links between China, Russia and eastern Europe. Freight on the return trip back into China is typically very low as more goods are transported in the opposite direction. It is primarily lumber rather than logs that are coming in from eastern Europe. The price of lumber is typically more expensive than raw logs.

The quantity of lumber being imported by China hasn’t changed markedly in the past couple of years, albeit there are significant seasonal fluctuations. The price of imported lumber has however been trending down for at least the past 12 months. Lumber prices have eased by 15-30% during this time period.

The lower prices are partially a function of cheaper lumber being available out of Europe. Infestations of bark beetle in many European forests mean spruce trees are being felled to stop the infestation spreading. This felling isn’t being driven by market returns therefore obtaining a decent return for this timber is not a priority.

A slowing in construction in China has been a risk for some time. This has been heightened recently as China’s economic growth slows and the impact of the current trade wars take a toll on confidence levels in its financial markets. Any slowing in building appetite from private sector has thus far been offset by ongoing investment in government infrastructure developments. The fiscal stimulus provided by the government has been reliable to date. While the risk of a structural slowing in construction activity can’t be overlooked, at present it is the extra supply that is primarily responsible for the correction in the price of imported logs.

While the weaker lumber prices are having some bearing on log prices, the primary driver of the current downturn is the over supply situation in the log market.

**Harvesting activity slowing**

Harvesting activity is slowing in New Zealand as a result of the lower returns. Some harvesting crews have been laid off while others are having restrictions on volume placed on them. The drop in harvesting is expected to primarily occur in the smaller woodlots due to the one-off nature of this revenue. The larger forest owners are more likely to continue harvesting as lower returns from the current spot market will be offset in some cases by contracts already in place, and will be more readily absorbed due to receiving continuous revenue from harvesting. The risk of disrupting harvesting activity and associated costs also need to be taken into consideration. Therefore a reduction in felling rates in the range of 10-15% in the coming months appears feasible. Any slowing of felling activity will help the oversupply situation and therefore will assist the China market to recover, or at the least reduce further price falls.

**Limited alternative markets**

Diverting a portion of the logs destined for China to other markets would also be beneficial. The quantity of raw logs exported to markets other than China has fallen away in recent years. This is primarily due to these markets not being able to match the prices being offered by Chinese buyers.
The drop in pricing may now help other markets be more competitive. But it will still be a challenge to divert a significant volume of logs into other markets given that China currently accounts for approximately 80% of all the logs exported from New Zealand. The fall in pricing will be beneficial for domestic mills who have had to pay the equivalent of export prices to obtain supply. The reduction in prices should allow these timber processors to regain some margins and we may see a small increase in demand for raw logs from mills. At present the export market accounts for over half of the logs felled in New Zealand.

Harvesting crews and small woodlot owners who are fully exposed to the current movement in the log price are wearing the brunt of the impact thus far. The appetite for further investment in forestry ventures may wane for those ventures which the income streams rely on harvesting logs. Log returns have been elevated for a number of years and it is often these figures which forecast log returns are based on.
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