ANZ Research

New Zealand Forestry Update

8 July 2019

Contact

Susan Kilsby
Agriculture Economist
Telephone: +64 4 382 1992
Susan.Kilsby@anz.com

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

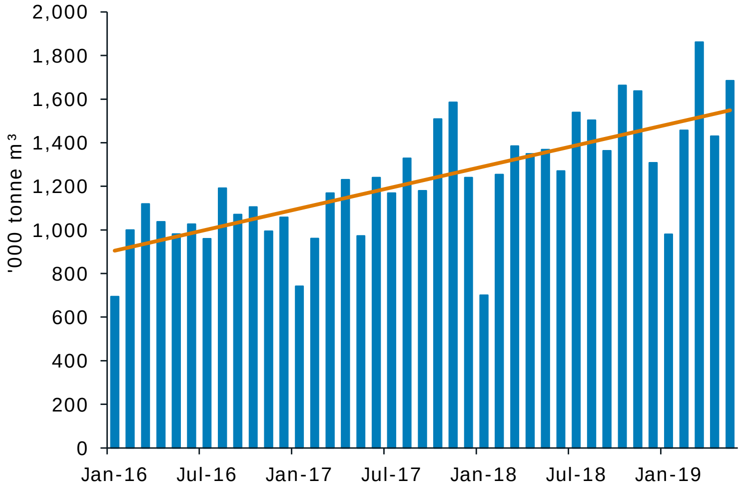
Over supply driver of lower prices

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%.

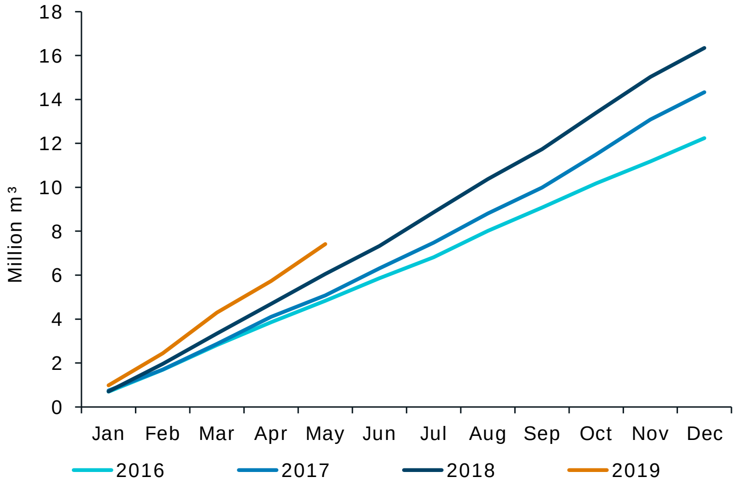
Figure 2. New Zealand log exports to China by volume



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 siginificant seasonal fluctutations. 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 bettle 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 infrastucture 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.

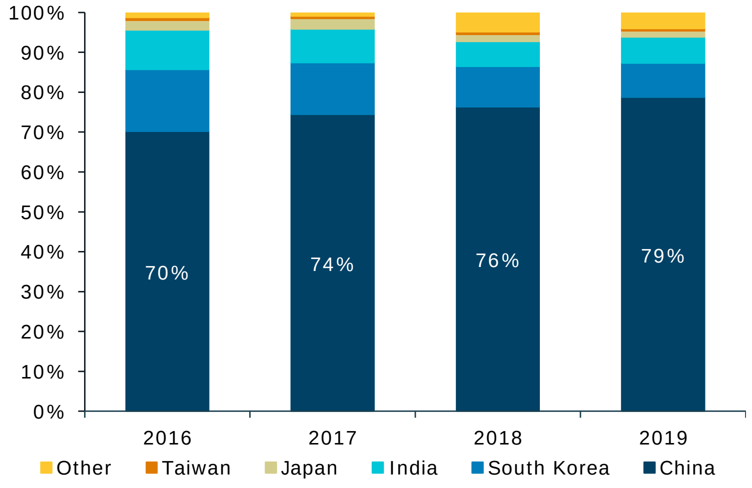
Harvesting activity slowing

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.

Figure 4. New Zealand log exports by destination



Source: StatsNZ

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 wan 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.

Important notice

This document is intended for ANZ's institutional, professional or wholesale clients, and not for individuals or retail persons. It should not be forwarded, copied or distributed. The information in this document is general in nature, and does not constitute personal financial product advice or take into account your objectives, financial situation or needs.

This document may be restricted by law in certain jurisdictions. Persons who receive this document must inform themselves about and observe all relevant restrictions.

Disclaimer for all jurisdictions: This document is prepared and distributed in your country/region by either: Australia and New Zealand Banking Group Limited (ABN11 005 357 522) (**ANZ**); or its relevant subsidiary or branch (each, an **Affiliate**), as appropriate or as set out below.

This document is distributed on the basis that it is only for the information of the specified recipient or permitted user of the relevant website (**recipients**).

This document is solely for informational purposes and nothing contained within is intended to be an invitation, solicitation or offer by ANZ to sell, or buy, receive or provide any product or service, or to participate in a particular trading strategy.

Distribution of this document to you is only as may be permissible by the laws of your jurisdiction, and is not directed to or intended for distribution or use by recipients resident or located in jurisdictions where its use or distribution would be contrary to those laws or regulations, or in jurisdictions where ANZ would be subject to additional licensing or registration requirements. Further, the products and services mentioned in this document may not be available in all countries.

ANZ in no way provides any financial, legal, taxation or investment advice to you in connection with any product or service discussed in this document. Before making any investment decision, recipients should seek independent financial, legal, tax and other relevant advice having regard to their particular circumstances.

Whilst care has been taken in the preparation of this document and the information contained within is believed to be accurate, ANZ does not represent or warrant the accuracy or completeness of the information Further, ANZ does not accept any responsibility to inform you of any matter that subsequently comes to its notice, which may affect the accuracy of the information in this document.

Preparation of this document and the opinions expressed in it may involve material elements of subjective judgement and analysis. Unless specifically stated otherwise: they are current on the date of this document and are subject to change without notice; and, all price information is indicative only. Any opinions expressed in this document are subject to change at any time without notice.

ANZ does not guarantee the performance of any product mentioned in this document. All investments entail a risk and may result in both profits and losses. Past performance is not necessarily an indicator of future performance. The products and services described in this document may not be suitable for all investors, and transacting in these products or services may be considered risky.

ANZ expressly disclaims any responsibility and shall not be liable for any loss, damage, claim, liability, proceedings, cost or expense (Liability) arising directly or indirectly and whether in tort (including negligence), contract, equity or otherwise out of or in connection with this document to the extent permissible under relevant law. Please note, the contents of this document have not been reviewed by any regulatory body or authority in any jurisdiction.

ANZ and its Affiliates may have an interest in the subject matter of this document. They may receive fees from customers for dealing in the products or services described in this document, and their staff and introducers of business may share in such fees or remuneration that may be influenced by total sales, at all times received and/or apportioned in accordance with local regulatory requirements. Further, they or their customers may have or have had interests or long or short positions in the products or services described in this document, and may at any time make purchases and/or sales in them as principal or agent, as well as act (or have acted) as a market maker in such products. This document is published in accordance with ANZ's policies on conflicts of interest and ANZ maintains appropriate information barriers to control the flow of information between businesses within it and its Affiliates.

Your ANZ point of contact can assist with any questions about this document including for further information on these disclosures of interest.

Country/region specific information: Unless stated otherwise, this document is distributed by Australia and New Zealand Banking Group Limited (**ANZ**).

Australia. ANZ holds an Australian Financial Services licence no. 234527. For a copy of ANZ's Financial Services Guide please click here or request from your ANZ point of contact. If trading strategies or recommendations are included in this document, they are solely for the information of 'wholesale clients' (as defined in section 761G of the Corporations Act 2001 Cth).

Brazil, Brunei, India, Japan, Kuwait, Malaysia, Switzerland, Taiwan. This document is distributed in each of these jurisdictions by ANZ on a cross-border basis.

Cambodia. This document is distributed in Cambodia by ANZ Royal Bank (Cambodia) Limited (**ANZ Royal Bank**). The recipient acknowledges that although ANZ Royal Bank is a subsidiary of ANZ, it is a separate entity to ANZ and the obligations of ANZ Royal Bank do not constitute deposits or other liabilities of ANZ and ANZ is not required to meet the obligations of ANZ Royal Bank.

European Economic Area (EEA): ***United Kingdom.*** ANZ is authorised in the United Kingdom by the Prudential Regulation Authority (**PRA**) and is subject to regulation by the Financial Conduct Authority (**FCA**) and limited regulation by the PRA. Details about the extent of our regulation by the PRA are available from us on request. This document is distributed in the United Kingdom by Australia and New Zealand Banking Group Limited ANZ solely for the information of persons who would come within the FCA definition of "eligible counterparty" or "professional client". It is not intended for and must not be distributed to any person who would come within the FCA definition of "retail client". Nothing here excludes or restricts any duty or liability to a customer which ANZ may have under the UK Financial Services and Markets Act 2000 or under the regulatory system as defined in the Rules of the Prudential Regulation Authority (**PRA**) and the FCA. ANZ is authorised in the United Kingdom by the PRA and is subject to regulation by the FCA and limited regulation by the PRA. Details about the extent of our regulation by the PRA are available from us on request.

Fiji. For Fiji regulatory purposes, this document and any views and recommendations are not to be deemed as investment advice. Fiji investors must seek licensed professional advice should they wish to make any investment in relation to this document.

Hong Kong. This publication is issued or distributed in Hong Kong by the Hong Kong branch of ANZ, which is registered at the Hong Kong Monetary Authority to conduct Type 1 (dealing in securities), Type 4 (advising on securities) and Type 6 (advising on corporate finance) regulated activities. The contents of this publication have not been reviewed by any regulatory authority in Hong Kong.

India. If this document is received in India, only you (the specified recipient) may print it provided that before doing so, you specify on it your name and place of printing.

Important notice

Myanmar. This publication is intended to be general and part of ANZ's customer service and marketing activities when implementing its functions as a licensed bank. This publication is not Securities Investment Advice (as that term is defined in the Myanmar Securities Transaction Law 2013).

New Zealand. This document is intended to be of a general nature, does not take into account your financial situation or goals, and is not a personalised adviser service under the Financial Advisers Act 2008 (**FAA**).

Oman. ANZ neither has a registered business presence nor a representative office in Oman and does not undertake banking business or provide financial services in Oman. Consequently ANZ is not regulated by either the Central Bank of Oman or Oman's Capital Market Authority. The information contained in this document is for discussion purposes only and neither constitutes an offer of securities in Oman as contemplated by the Commercial Companies Law of Oman (Royal Decree 4/74) or the Capital Market Law of Oman (Royal Decree 80/98), nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in Oman as contemplated by Article 139 of the Executive Regulations to the Capital Market Law (issued vide CMA Decision 1/2009). ANZ does not solicit business in Oman and the only circumstances in which ANZ sends information or material describing financial products or financial services to recipients in Oman, is where such information or material has been requested from ANZ and the recipient understands, acknowledges and agrees that this document has not been approved by the CBO, the CMA or any other regulatory body or authority in Oman. ANZ does not market, offer, sell or distribute any financial or investment products or services in Oman and no subscription to any securities, products or financial services may or will be consummated within Oman. Nothing contained in this document is intended to constitute Omani investment, legal, tax, accounting or other professional advice.

People's Republic of China (PRC). This document may be distributed by either ANZ or Australia and New Zealand Bank (China) Company Limited (**ANZ China**). Recipients must comply with all applicable laws and regulations of PRC, including any prohibitions on speculative transactions and CNY/CNH arbitrage trading. If this document is distributed by ANZ or an Affiliate (other than ANZ China), the following statement and the text below is applicable: No action has been taken by ANZ or any affiliate which would permit a public offering of any products or services of such an entity or distribution or re-distribution of this document in the PRC. Accordingly, the products and services of such entities are not being offered or sold within the PRC by means of this document or any other document. This document may not be distributed, re-distributed or published in the PRC, except under circumstances that will result in compliance with any applicable laws and regulations. If and when the material accompanying this document relates to the products and/or services of ANZ China, the following statement and the text below is applicable: This document is distributed by ANZ China in the Mainland of the PRC.

Qatar. This document has not been, and will not be:

- lodged or registered with, or reviewed or approved by, the Qatar Central Bank (**QCB**), the Qatar Financial Centre (**QFC**) Authority, QFC Regulatory Authority or any other authority in the State of Qatar (**Qatar**); or
- authorised or licensed for distribution in Qatar,

and the information contained in this document does not, and is not intended to, constitute a public offer or other invitation in respect of securities in Qatar or the QFC. The financial products or services described in this document have not been, and will not be:

- registered with the QCB, QFC Authority, QFC Regulatory Authority or any other governmental authority in Qatar; or
- authorised or licensed for offering, marketing, issue or sale, directly or indirectly, in Qatar.

Accordingly, the financial products or services described in this document are not being, and will not be, offered, issued or sold in Qatar, and this document is not being, and will not be, distributed in Qatar. The offering, marketing, issue and sale of the financial products or services described in this document and distribution of this document is being made in, and is subject to the laws, regulations and rules of, jurisdictions outside of Qatar and the QFC. Recipients of this document must abide by this restriction and not distribute this document in breach of this restriction. This document is being sent/issued to a limited number of institutional and/or sophisticated investors (i) upon their request and confirmation that they understand the statements above; and (ii) on the condition that it will not be provided to any person other than the original recipient, and is not for general circulation and may not be reproduced or used for any other purpose.

Singapore. This document is distributed in Singapore by the Singapore branch of ANZ solely for the information of "accredited investors", "expert investors" or (as the case may be) "institutional investors" (each term as defined in the Securities and Futures Act Cap. 289 of Singapore). ANZ is licensed in Singapore under the Banking Act Cap. 19 of Singapore and is exempted from holding a financial adviser's licence under Section 23(1)(a) of the Financial Advisers Act Cap. 100 of Singapore.

United Arab Emirates (UAE). This document is distributed in the UAE or the Dubai International Financial Centre (**DIFC**) (as applicable) by ANZ. This document does not, and is not intended to constitute: (a) an offer of securities anywhere in the UAE; (b) the carrying on or engagement in banking, financial and/or investment consultation business in the UAE under the rules and regulations made by the Central Bank of the UAE, the Emirates Securities and Commodities Authority or the UAE Ministry of Economy; (c) an offer of securities within the meaning of the Dubai International Financial Centre Markets Law (DIFCML) No. 12 of 2004; and (d) a financial promotion, as defined under the DIFCML No. 1 of 200. ANZ DIFC Branch is regulated by the Dubai Financial Services Authority (**DFSA**) ANZ DIFC Branch is regulated by the Dubai Financial Services Authority (**DFSA**). The financial products or services described in this document are only available to persons who qualify as "Professional Clients" or "Market Counterparty" in accordance with the provisions of the DFSA rules. In addition, ANZ has a representative office (**ANZ Representative Office**) in Abu Dhabi regulated by the Central Bank of the UAE. The ANZ Representative Office is not permitted by the Central Bank of the UAE to provide any banking services to clients in the UAE.

United States. Except where this is a FX- related document, this document is distributed in the United States by ANZ Securities, Inc. (**ANZ SI**) which is a member of the Financial Regulatory Authority (**FINRA**) (www.finra.org) and registered with the SEC. ANZSI's address is 277 Park Avenue, 31st Floor, New York, NY 10172, USA (Tel: +1 212 801 9160 Fax: +1 212 801 9163). ANZSI accepts responsibility for its content. Information on any securities referred to in this document may be obtained from ANZSI upon request. This document or material is intended for institutional use only – not retail. If you are an institutional customer wishing to effect transactions in any securities referred to in this document you must contact ANZSI, not its affiliates. ANZSI is authorised as a broker-dealer only for institutional customers, not for US Persons (as "US person" is defined in Regulation S under the US Securities Act of 1933, as amended) who are individuals. If you have registered to use this website or have otherwise received this document and are a US Person who is an individual: to avoid loss, you should cease to use this website by unsubscribing or should notify the sender and you should not act on the contents of this document in any way. Non-U.S. analysts: Non-U.S. analysts may not be associated persons of ANZSI and therefore may not be subject to FINRA Rule 2242 restrictions on communications with the subject company, public appearances and trading securities held by the analysts. Where this is an FX-related document, it is distributed in the United States by ANZ's New York Branch, which is also located at 277 Park Avenue, 31st Floor, New York, NY 10172, USA (Tel: +1 212 801 916 0 Fax: +1 212 801 9163).

Vietnam. This document is distributed in Vietnam by ANZ or ANZ Bank (Vietnam) Limited, a subsidiary of ANZ.

This document has been prepared by ANZ Bank New Zealand Limited, Level 10, 171 Featherston Street, Wellington 6140, New Zealand, Ph 64-4-382 1992, e-mail nzeconomics@anz.com, http://www.anz.co.nz