ANZ RESEARCH

AGRI FOCUS

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ALL THAT GLITTERS IS GOLD

INSIDE

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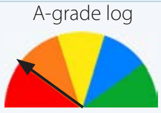
Global uncertainty is unprecedented. While much of the world continues to deal with the day-to-day health issues associated with battling COVID-19, those countries who have managed to contain it are now focusing on their economic recovery, while keeping a nervous eye out for second waves of infection.

These uncertain times are providing plenty of challenges, but also some opportunities, for our primary producers. We rely on export markets to sell the vast majority of our produce and in the same way many countries rely on New Zealand producers to help sustain their people.

The outlook for some of our export products is very much at the whim of how the economies of particular countries perform. For example, returns in the forestry industry are closely linked with construction activity in China. Luckily China boasts one of the few economies that are expected to grow this year, albeit at a much slower pace than normal.

In this environment luxury items are much more challenging to sell than lower-priced food products, as consumers find sufficient funds to fill the fridge but are more reluctant to eat at restaurants, either because of the cost or health risks. This trend means it will be a slow start to the government's 'Fit for a Better World = Accelerating our Economic Potential' roadmap which is designed around shifting the focus from production growth to value add –a journey that many companies have already embraced.

The kiwifruit industry continues to be a standout example of how to add value by restricting volume. At the moment we are not only seeing investors clamouring to invest in the security of gold; we are also seeing kiwifruit producers paying record high prices for the rights to grow SunGold kiwifruit.

Prices at farm/orchard level relative to 10yr average		
Dairy	Dairy markets have firmed sharply with prices now back to pre-COVID-19 levels. We have upped our forecast milk price to $6.50/kg MS for the 2020-21 season.	
Sheep	Lamb prices at the farmgate level are being supported by the limited number of lambs available for processing, but international prices for most cuts of lamb continue to dive.	
Beef	Beef returns at the farmgate level have eased but are currently supported by the strength of underlying global meat markets. However, manufacturing-grade beef continues to be easier to move than prime steaks.	
Forestry	Log prices have fallen from their recent highs and wharf-gate prices are now at a level where some forest owners are electing to delay the harvest of their forests until market conditions firm.	

ECONOMIC OVERVIEW

YEARS OF SLOW GROWTH TO COME

Global economies continue to suffer at the hands of COVID-19. There has been a lift in case numbers in many countries, providing clear evidence this pandemic is far from under control.

New Zealand has done a better job of getting the disease under control than most counties – helped no doubt by our relative isolation and being an island nation with a clearly defined border. Our status of being free of COVID-19 in the community is enhancing the image of the products we are exporting, but it is also bolstering our exchange rate, which is not such good news for our exporters.

Even once the pandemic is under control it will take years for economies to get back on track. The pandemic has also provoked renewed nationalism, with countries starting to turn their back on global trade.

Shipping goods around the world has become much more challenging, although the trade routes from New Zealand to Asia are still being well serviced. There hasn't been a lot of disruption in getting product to these markets but moving product into the US and Europe is more problematic. Air freight options are virtually non-existent too, which all but eliminates the option to fly high-value products to market.

Food-exporting countries are generally outperforming countries that are more reliant on the service sector. The latter requires more face-to-face interactions, which is simply not possible in many countries.

New Zealand has both, of course. Our primary sector has become a bright spot in the economy, while our tourism sector is really suffering from the lack of international visitors.

Unemployment levels in New Zealand are increasing, but the rate of increase and where it will peak is difficult to predict. For now, many jobs are being protected by the government subsidies but as these fall away we expect to see more jobs lost and more businesses close their doors.

We are seeing more New Zealanders looking for employment in the primary sector – an option many may not have seriously considered until now. This is extremely positive for our primary sectors, but a labour shortage is still likely at critical times of the year. Dairy farms are now in their peak labour demand period and many farms are operating with fewer staff than they ideally would.

The lift in unemployment is expected to have negative consequences for the housing sector in time (see latest ANZ Property Focus). At present property prices are holding up but weakness is likely to spread beyond tourism-dependent regions as economic conditions worsen.

In the rural real estate market we are starting to see clear downward pressure on property prices but sales remain limited. The future value of a property will depend largely on whether it can support a sustainable farming system, ie whether it is sustainable from an environmental, financial and social point of view. Farms that require heavy investment to meet tighter environmental standards, or those that can only support a low level of output, will be discounted.

Farms will be subjected to more regulatory oversight in the future. This oversight does have the potential to provide the proof that goods have been produced in a sustainable manner, which is what consumers are starting to demand.

Monetising the ability to link on-farm practices with consumer preferences is going to be a real challenge for our primary sectors over the next decade. To make this transition successful farmers must accept that they will

ECONOMIC OVERVIEW

be paid differential prices by processors based on not just the quality of the produce that leaves their farm, but also the values that went into its production. This is already happening to some degree, but will need to become the norm if we are to monetise and reward good on-farm practices.

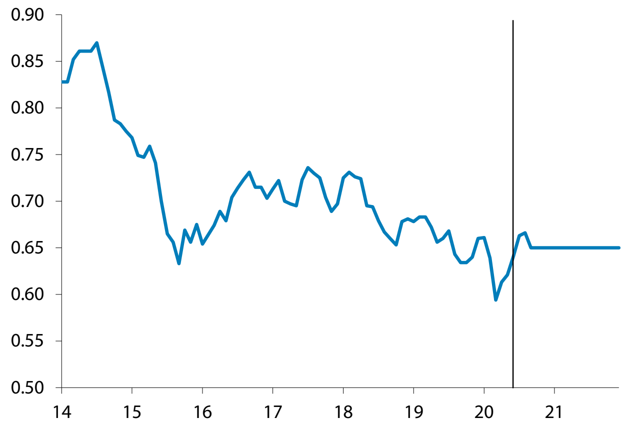
New Zealand's economy has rebounded from the massive shock of the lockdown. At the moment we are in a relatively sweet spot as a resurgence in spending is occurring whilst the worst-affected businesses are still supported by government subsidies. Only when these subsidies end will the true economic consequences emerge.

NEW ZEALAND DOLLAR TO REMAIN STRONG

While the export sector is the bright spot at present, returns are being curtailed by the strong NZD.

The NZD is expected to trade near the USD0.65 level well into 2021, which is taking the shine off commodity price returns. It's unhelpful, but the fact is, New Zealand is a relative good news story, and the exchange rate reflects that.

NZD BUYS USD



Source: Bloomberg, ANZ Research

We anticipate GDP to fall by 7-9% this year with the economy not expected to return to pre-COVID levels until the middle of 2022, although it could take even longer than this. How long it takes for the rest of the world to get the pandemic under control will determine when we can reopen our border. The recent upsurge in cases in Melbourne has ruled out the opportunity for a trans-Tasman bubble.

For our latest economic and FX forecasts please refer to our Weekly Data Wrap (click here to view latest).

DAIRY DISPLAYS RESILIENCE

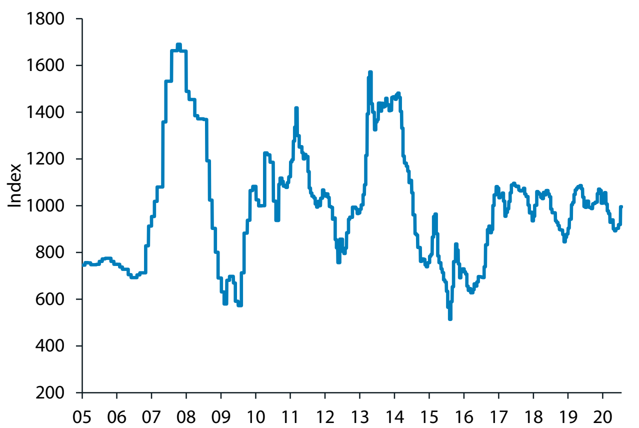
Dairy markets continue to defy expectations. Market prices have been supported by US and European government support programs, a desire by consumers to stock up on staples like milk powder, and ongoing demand for basic everyday products such as liquid milk.

The recent lift in commodity prices means we are now more confident that the farmgate milk price will land somewhere near its long-run average of $6.50/kg MS. But massive uncertainty remains. There is a lot of dairy product that needs to be sold into countries whose economies are very subdued.

GLOBAL MARKETS DO BETTER THAN EXPECTED

Global markets for dairy products have outperformed expectations over the past few months. The prices attained for the dairy commodities we have been exporting generally trended down over the first half of 2020. The first GlobalDairyTrade (GDT) event held in July resulted in a 8.3% lift in the GDT Price Index, primarily driven by whole milk powder (WMP) prices.

GDT PRICE GRAPH



Source: GlobalDairyTrade

This effectively took prices back to the level they were trading at in February – before COVID-19 really started to impact markets outside of China.

Prices were supported to some extent by ongoing demand for milk powder. Demand for instant-grade product has been underpinned by households stocking up through lockdown periods (post-lockdown handy tip: it makes great custard). Demand for liquid milk has also remained robust in most markets as supply side issues have meant the milk didn't always make it to consumers and some additional milk was dried.

Cheese and butter demand has been hit harder. Cheese consumption is closely linked to takeaway and cheaper restaurant products like hamburgers and pizzas. This demand has reduced somewhat as changed behaviours have seen more meals eaten at home. Many gatherings, such as sporting events, have also had to be cancelled and this has also impacted demand for cheese.

Butter demand has been variable. Butter for home use has lifted due to a surge in home baking whilst people are confined to their homes, but demand from bakeries and the restaurant trade has waned. Overall this has resulted in a softening in the price of dairy fats relative to proteins and this appears to be a trend that will stick around for some time.

The US and Europe are the largest domestic markets for cheese. The majority of the cheese they each consume tends to be produced locally and both countries are net exporters of cheese. However, prices in these internal markets do have an influence on global market prices as exporters will push less cheese into the international markets when better prices are be obtained in their local markets and vice-versa.

The US cheese market has been on a roller coaster ride over the past few months. Initially when COVID-19 hit this market, and processors were struggling to use all the milk they were receiving, cheese price tumbled.

DAIRY

US CHEDDAR BLOCK PRICES

Source: CME Group

Then the US government announced it would buy dairy products as part of its food box program to distribute food to the needy. The quantity of dairy products they indicated they would purchase was substantial and when buying started there was insufficient product available. This resulted in cheese prices hitting record highs. Prices have now retreated a little but still remain elevated.

This strength in the US cheese market, although artificially driven by government policy, has positively impacted the wider global dairy markets.

PROTEIN NOT FAT PLEASE

Protein-based products have been better supported than fat products. This reflects the fact that the fat market is primarily driven by demand from developed countries, whereas the fat-based products tend to mainly fall into the luxury food category. Croissants and cakes aren't a necessity like infant formula is.

Infant formula is certainly a product you don't want to run short of, so any families with the means to do so will have a couple of extra cans in the cupboard to safeguard against potential future supply disruptions.

STRONGER START TO SEASON

Global dairy markets are currently in a much stronger position than we previously expected. Sales of the production utilising the milk that will be delivered by farmers in the 2020-21 season are really just getting underway. Until this product is actually sold there remain massive risks that the milk price could swing away from current forecasts.

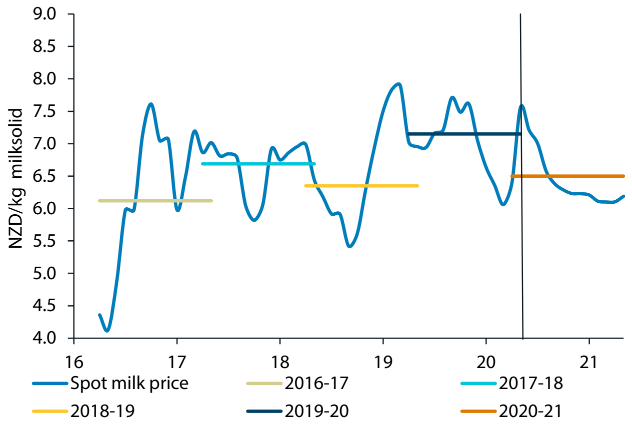
The good news is that the market is currently in a much stronger position than it was a few months back and this bodes well for those negotiating forward contracts.

Many contracts are linked to the prices attained at the GlobalDairyTrade events so this has become an extremely important barometer for the industry. These prices also feed directly into the farmgate milk price calculation that Fonterra uses to establish its milk price.

MILK PRICES FORECASTS FIRM

We continue to take a slightly cautious approach to the future direction of global dairy prices. However, even with our more cautious outlook combined with an expectation the NZ dollar will remain firm for the majority of the current dairy season, we see a respectable $6.50/kg MS milk price for the season ahead. (See latest Farmgate Milk Price Forecast for more details).

MILK PRICE – HISTORIC AND FORECAST



Source: Fonterra, NZX, ANZ Research

Fonterra also appears to have taken some confidence from the recent strength in the global dairy market and have increased their milk price forecast for the 2020-21 season and narrowed their forecast price range. Fonterra now forecasts a milk price in the range of $5.90 - $6.90/kg MS, with payments to farmers being based on the mid-point of the range, $6.40/kg MS. Previously Fonterra had forecast a wider range of $5.50 - $6.90/kg MS which had a mid-point of $6.15/kg MS.

Fonterra's milk price forecast for the 2019-20 season was narrowed to $7.10 - $7.20/kg MS, with 10c pulled off the top of the range resulting in the mid-point forecast reducing 5c to $7.15/kg MS.

Milk prices have been considerably more stable in the past few years than we have previously experienced. It will be quite a feat if this trend can be maintained for the next few seasons given the uncertainty that currently exists in global economies.

LAMB & WOOL

UNDERLYING MARKETS ARE WEAK

Lamb prices at the farmgate levels are being supported by low seasonal supply but underlying market prices are weak and suggest downside to current prices.

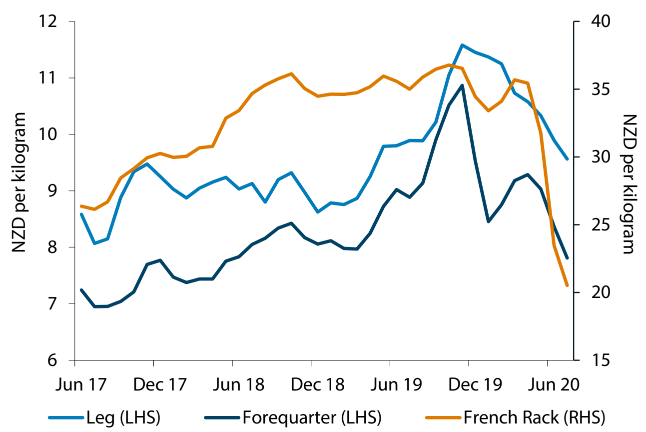
Unless we see an improvement in the underlying market or a reduction in the NZ dollar then it is inevitable that farmgate prices for lamb will ease once there is a substantial lift in lamb numbers. From now until Christmas prices will largely be supported by limited supply.

OVERSEAS PRICES TRENDING DOWN

Lamb prices are trending down in overseas markets and the strong NZ dollar is exacerbating this trend when returns are priced in local currency.

The higher-value lamb cuts such as French Rack have suffered the most, but even prices for the lower-value cuts that tend to head to China are being impacted. Lamb flaps prices have lifted but are still well down on the prices attained in recent years.

LAMB CUT PRICES

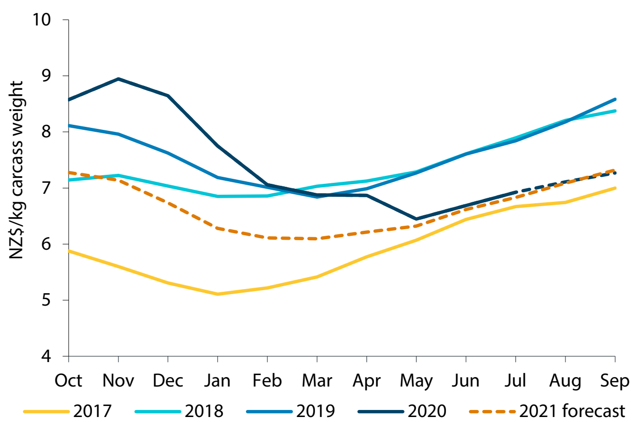


Source: AgriHQ

To understand this, it's worth remembering that even the lower-value cuts are still an expensive item for the average Chinese household to purchase. And much of the demand in this market has traditionally come from the restaurant trade, which remains subdued.

Farmgate returns have lifted as we have moved into winter but the lift has been relatively modest. Average farmgate prices are not expected to exceed $7 this winter, but we could see higher premiums paid for new-season lambs when they become available.

FARMGATE LAMB PRICE TREND AND FORECAST



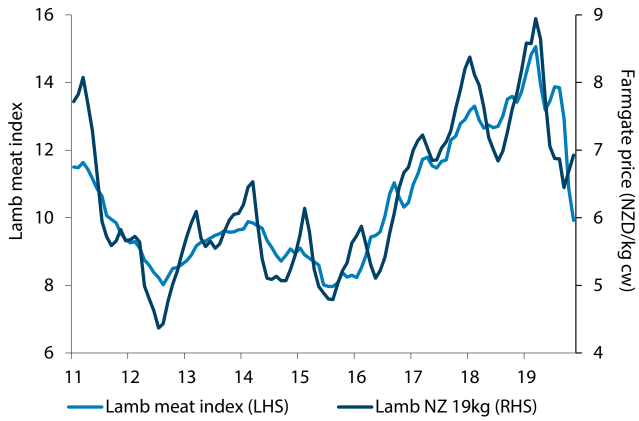
Source: AgriHQ, ANZ Research

Farmgate prices are not only influenced by the underlying market trends and exchange rates but also by procurement factors. Higher prices tend to be paid for lambs when supply is low, while lower prices are paid during the peak processing season.

The graph below shows underlying market prices are continuing to soften, with the Meat Index now at its lowest level since March 2017. Procurement factors are supporting farmgate prices at present, as is typically the case during the winter months.

LAMB & WOOL

FARMGATE PRICE VS OVERSEAS MEAT PRICES



Source: AgriHQ, ANZ Research

SUPPORT FOR STORE LAMBS

Store lamb prices are starting to see a little more support in the North Island. Forward lambs have seen renewed demand at similar prices to those on offer from the processors. This leaves relatively little margin for finishers unless they can rapidly add weight to these lambs. In the South Island store prices are relative steady, reflecting the slightly lower schedule prices on offer and the later growing season.

Store prices in both islands are well shy of the levels that were being paid at this time last season but aren't far off the 5-yr average.

WOOL – HIT THE BOTTOM YET?

Wool returns remain at dismal levels. Prices for coarse wool are at their lowest level in over 20 years. This situation is unlikely to change in the near future as the supply chain is clogged. End user demand is weak and this means the wool simply doesn't have anywhere to go.

Wool is backed up in wool buyers stores and more wool is starting to be stored on farm as farmers elect to hold wool until prices improve, or simply haven't been able to find a buyer.

Given the scale of this issue it is really difficult to see prices rising significantly from current levels any time in the next 12 months. Most farms won't have the space to store wool from more than one shearing, meaning there are risks with simply storing wool in the hope of a higher price occurring in the next few months.

Eventually the outstanding natural attributes associated with wool will be recognised, but for now there is nothing on the horizon that will deliver a substantial improvement in prices.

Commitments to using wool products such as that recently made by Cavalier carpets are a step in the right direction, but at the end of the day if the consumer demand is not there then it won't make much difference.

In the current economic climate consumers will be watching their pennies, so it is going to be a challenging environment for premium products to operate in. At the same time, we are seeing more emphasis being put on sustainable consumption. This may eventually result in less frivolous purchasing with buyers opting for a lesser number of higher quality purchases.

Even the fine wool, which has been the darling of the wool trade, is facing some challenges. There hasn't been a lot of fine wool traded lately but prices are definitely softening.

Demand for high-end suits has definitely waned as more business people are working from home, either by choice or due to lockdowns. This is allowing for more casual dress and therefore less demand for suits. Economic considerations are also playing into these decisions.

STRONG WOOL (>35MM)

Source: NZWSI, PGG Wrightson

Prices increased slightly at the latest sales held in both Napier and Christchurch. However, there is no indication that this trend will persist. The higher prices were supported by low volumes offered, good-quality offerings, and buyers who needed to secure certain quantities of wool to meet their own contracted commitments.

BEEF

MIXED MARKET SIGNALS

Market signals are mixed, with reasonable demand occurring in the traditional US market while Chinese demand for NZ beef has eased due to plenty of meat on offer from alternative suppliers.

The COVID-19 situation continues to cause disruptions in processing capacity, logistics, and end-user demand globally. High-value cuts are difficult to move; this is the reason why there is not a lot of appetite from processors for prime stock.

FARMGATE PRICES TREND DOWN SHARPLY

Farmgate prices have ticked up in the past couple of months but the degree of the lift in schedule prices is minor.

The price of bull meat imported into the US has long been the bellwether for the market. This price has fallen about 20% since its peak prior to Christmas, but it still remains well above the 5-year average.

Underlying demand from this market has held even as their own processing facilities come back on-stream. This is partially because the US needs our lean meat to blend with their fatty cuttings to get the optimal mix for a hamburger pattie.

In some instances there were delays in getting stock processed in the US, which has added further fat to their domestic supplies.

However, prices are certainly not as strong as they were late last year and this is primarily due to the US not having to compete as hard with China to secure product.

China is sourcing more meat from South America, and this seems to be sufficient to offset a reduction in supply from other regions. There isn't a lot of beef coming out of Australia at present due to that market being in a herd rebuilding phase, so China's bans on supply from a number of Australia's processing plants isn't having a major impact on supply.

China has also banned supply from several Brazilian processors, as well as a number of processor in other countries, including Canada, the US and the EU. These may not all relate to concerns about COVID-19 but meat processing plants have certainly had more than their share of COVID-19 outbreaks. Sanitary conditions in many international meat processors are nowhere near the standard of New Zealand's processing plants.

So far consumers don't appear to be avoiding meat consumption simply because there have been numerous cases of COVID-19 in meat plants, but there is always a risk that this could happen.

China has increased testing of imported meat, fish and seafood at the border in an attempt to keep COVID-19 at bay. Whilst there is little scientific evidence that COVID-19 can persist on meat products, Chinese authorities have found instances of COVID-19 present on salmon imported from Canada and shrimp imported from Ecuador, and are taking no chances.

The process of getting product through Chinese borders tends to be a relatively lengthy process at the best of times, with this additional testing adding to delays. NZ shipments don't seem to be getting the same degree of scrutiny as product from some other regions, but this situation could easily change. Political motives can influence the speed at which product is cleared.

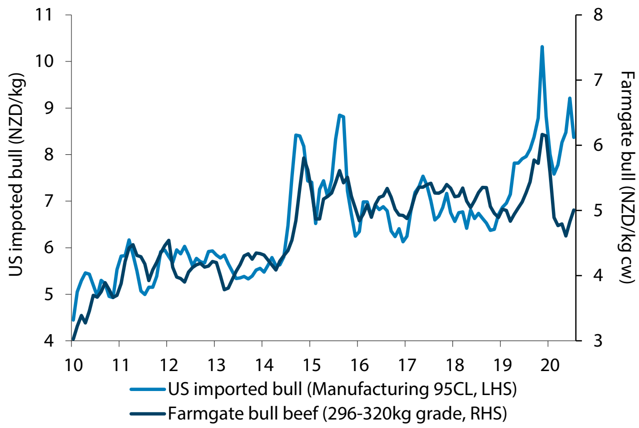
CHEAPER CUTS EASIER TO SELL

Higher-value cuts of meat are more challenging to sell in the current market than the lower-value cuts. This trend is present across many food types as demand for sustenance remains intact but demand for luxuries is severely curtailed.

BEEF

The graph below suggests some potential for farm-gate beef prices to lift from current levels. However, this is based on the price of manufacturing grade beef – if the higher value beef isn't selling, then processors won't be able to lift schedules as much as this graph indicates would be possible in normal times.

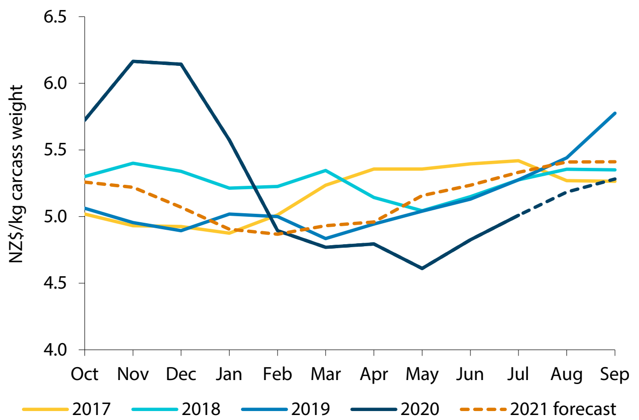
FARMGATE BULL BEEF PRICE VS US MARKET PRICE



Source: AgriHQ

We nonetheless anticipate that we will see some upward movement in beef schedule prices in the coming months. It is typical for prices to lift in the spring when the supply of beef is at its seasonal low.

FARMGATE BULL BEEF PRICE TREND AND FORECAST



Source: AgriHQ, ANZ Research

Store markets remains subdued, although there has been a slight lift in pries in the past month. Cattle feed is still in relatively short supply in both islands, meaning we are yet to see the typical lift in store prices that normally occurs a little later as spring delivers better conditions for pasture growth. While the weather is starting to feel spring like in parts of the North Island it will still take a little time for pasture growth rates to exceed demand and a noticeable surplus of feed to grow.

VENISON STRUGGLING, VELVET DOING OKAY

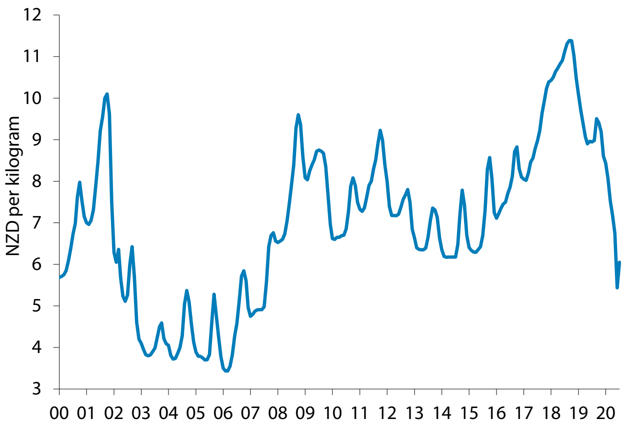
Venison markets are extremely challenging at the moment and this is reflected in schedule prices dropping to their lowest level in over a decade.

Venison is highly exposed to the European restaurant trade and the industry is scrambling to move more products into the retail space in order to reduce reliance on the food service sector.

Velvet, on the other hand, is doing quite well. It has suffered from some logistical challenges but overall consumer demand has remained robust. This is due primarily to the perception that velvet has immune-boosting properties, which are valued by the Koreans who are the main consumers of velvet.

Farmgate prices for deer may have ticked up a tad in recent weeks but prices haven't been at such low levels for over a decade. It is a real blow for an industry that was doing so well and had appeared to have moved away from the volatile cycles of boom and bust that have long plagued the industry.

FARMGATE VENISON PRICE (60G STAG)



Source: AgriHQ

International markets have been severely disrupted. The high farmgate returns in recent years were driven by selling higher-valued chilled venison. This product is heavily reliant on the restaurant trade in key European countries such as Germany and Belgium.

This year buyers are reluctant to commit to forward orders as they fear a second wave of COVID-19 could shut down these outlets, leaving them carrying product.

Getting chilled venison to Europe is also challenging. Shipping delays are occurring and there is virtually no options for air freight. The logistics of getting product to Asia are much better, primarily due to the large quantities of dairy products and other meats heading to Asia, which provides a more compelling business case for ships to continue to sail these routes.

Very small quantities of venison are currently sold in China, but this market has plenty of potential.

The industry is trying to produce more retail-ready products for European customers. The investment in this area could well pay off in future years, but for now it is a lot of extra work with no guarantee this will deliver value back to the producers.

More venison packaged for retail is also being sold into our domestic market, with a noticeable increase in the number of venison products being stocked in local supermarkets.

Farmgate prices typically lift during the spring as product is procured in time to meet the European Christmas trade – a time when venison is traditionally on the menu. However, this year, with the high level of market uncertainty there is not guarantee that we will see a significant lift in schedule prices.

DEER

SMOOTHER MARKET FOR VELVET

While venison may be struggling, velvet is doing considerably better. Velvet is used primarily as a health supplement or in health remedies, with South Korea the major end market. Some product is also further processed in China and this is also quite a substantial end-market for velvet.

In-market stocks of this product are reported to be relatively low as demand for velvet remained strong throughout the COVID-19 outbreaks in South Korea and China. Some users believe that velvet has immune-boosting properties, so it is not surprising that demand for this product has remained robust.

Whether or not the tightening economic conditions in these countries will limit the uptake of this product or not remains to be seen.

The perception of New Zealand being a clean, green country that is free from COVID-19 is also a plus when selling products into the Asian markets.

To help position New Zealand velvet as a quality, sustainable product a traceability system is being developed to help certify the origin of NZ velvet. This will be particularly valuable given that some of the processing of New Zealand velvet occurs in China where velvet from other sources is also processed.

GRAIN

LIMITED STOCKS COULD BOOST PRICES

Local grain prices have eased while imported PKE has fallen but still remains expensive. The smaller than normal differential between PKE and feed grains should result in more demand for barley or wheat at the expenses of PKE.

Maize grain is virtually non-existent with supplies going out the door as quickly as they were harvested last year.

Many farms have minimal reserves of hay and silage on farm at present, which means we may see a spike in demand for feed grain this spring, particularly if weather conditions are not favourable.

MAIZE GRAIN YIELDS EXCEED EXPECTATIONS

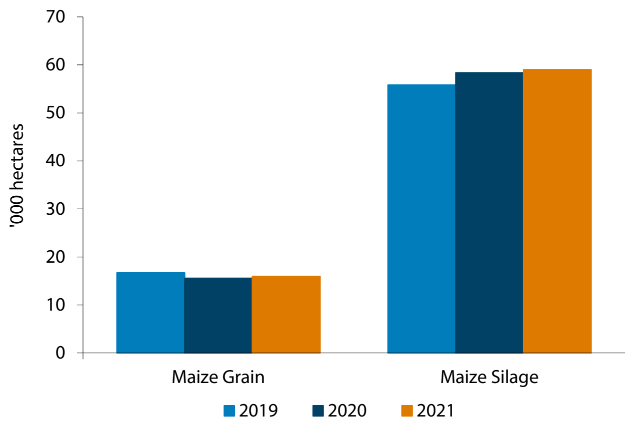
Maize grain yields were stronger than anticipated this season. The AIMI survey revealed maize grain yielded 11.7t per hectare. This was very closely aligned with the previous seasons' yields despite the dry season making growing conditions more challenging.

Maize silage yields were lower, however, with the summer drought blamed for the poorer harvest. But the lower yields were virtually offset by a lift in the area planted, resulting in just a 1% net reduction in the volume of maize silage harvested.

Demand for both feed types has been exceptionally strong due to the widespread drought severely reducing pasture production. This means the grain was quickly snapped up as soon as it was harvested. As at the beginning of June there was just a minute amount of maize silage that hadn't already been sold or used.

The quantity of uncommitted maize silage at the beginning of June was down on last season, but still aligned with normal levels for this time of the season. However, maize silage can't easily be moved from region to region like maize grain can be.

ESTIMATED AREA PLANTED (YEARS BASED ON HARVEST TIMING)



Source: AIMI Survey (June 2020)

The area intended to be planted in maize grain this year is similar to last, while a small increase in maize silage area is anticipated. Maize silage has traditionally been mainly grown in the North Island but as new hybrids are developed that can handle colder conditions we are gradually seeing production move further south. The area grown in the South Island is expected to continue to lift in the coming years.

EXCELLENT YIELDS FOR CEREALS

The 2020 harvest of cereal crops delivered excellent yields with final estimates from the AIMI survey indicated a 17% increase in yield. This more than offset the 6% reduction in area planted. The total quantity of milling wheat harvested was up 36% while feed wheat lifted 17%. This extra volume does mean there is more wheat still available than in previous seasons.

The feed barley harvest was smaller than previous years and strong demand for this feed means there isn't much left to sell.

GRAINS

MORE WHEAT TO BE PLANTED

The total area intended to be planted in 2020 (either winter or spring) for harvest in 2021 is marginally higher than last season. Slightly more ground is expected to be allocated to wheat, feed barley, and milling oats while a smaller area is expected to be used for malting barley and feed oats.

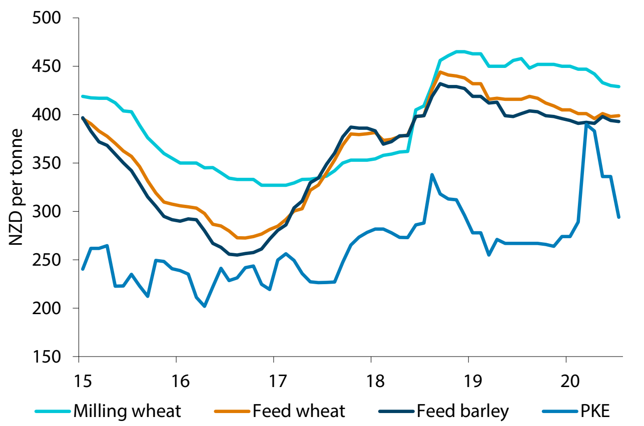
ON-FARM FEED RESERVES MINIMAL

On-farm supplement reserves are estimated to be well down due to much of the supplements destined for winter feed having been already used in the autumn. Luckily this winter has been relatively mild thus far, but early spring weather can be extremely variable. September regularly delivers severe storms, torrential downpours and snow, so farmers are not out of the woods yet in terms of the depleted feed situation.

GRAIN PRICES SOFTEN

Grain prices have eased marginally in recent months. The spot price for milling grain sits at about $430/t, while feed barley and feed wheat are trading between $390 and $400/t.

NZ GRAIN PRICES

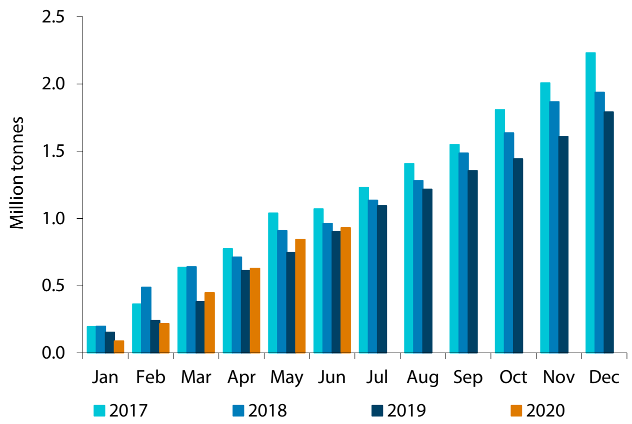


Source: AgriHQ

The price of imported PKE has eased following the spike in March but is still trading at elevated levels. This is partially due to dairy demand being strong at the end of last season, and also some additional demand from beef farmers in drought-stricken regions.

Imports of PKE have not increased and general usage of this product appears to be easing. This is partially being driven by dairy companies providing variable pricing that penalises high use of PKE.

PKE IMPORT VOLUMES – CUMULATIVE



Source: StatsNZ

The recently released freshwater regulations limit the quantity of nitrogen that can be applied on pastoral farms to 190kg N/ha (although reporting usage is initially required only by dairy farmers). This is a national guideline and regional councils may impose, or in some cases have already imposed, stricter regulations or regulations that encompass a wider land uses.

The nitrogen cap won't be imposed on arable or horticultural properties. But regulations are tightening up on reporting on water usage for irrigated properties which will require real-time transfer of usage data to councils.

At present it is estimated that 20% of dairy farms exceed the nitrogen limits. Nitrogen is often the cheapest way to grow additional feed. The nitrogen cap is part of a host of new rules designed to reduce excess of runoff of nutrients into streams. While most of the rules are output-based, the Government has elected to impose some input-based rules such as the nitrogen cap. The government has made it clear that the cap could be reduced further if it does not get the outcomes it intends.

It is likely that some dairy farmers will increase their use of supplementary feed to offset any reduction in pasture production caused by the nitrogen cap. Whilst this isn't really the solution the Government is looking for, it is a highly probable outcome. This could result in more demand for feed grains, forage crops, hay, silage and imported PKE.

At present there is no restriction on the use of PKE. However, if we do see a massive tick-up in demand for this product we may well see a regulatory response from the Government to limit its use.

FORESTRY

HUGE VOLATILITY IN PRICING

Forestry returns are easing in the global market but remain strong locally. There is strong demand in the domestic market for timber as house builds get back on track, but we fear there will be an easing in the local housing market later in the year as the labour market weakens. Export returns have eased now that stocks have rebuilt in China. Global demand for logs is expected to wane – building, manufacturing and export activity is subdued due to the detrimental impact of COVID-19 on the economic health of global economies.

WHARF-GATE LOG PRICE EASE

Wharf-gate returns for logs have eased as weaker global demand, higher shipping costs, and a strong NZD all work against exporters.

The volume of logs in stock on wharves in China has grown and prices have eased as a result. Supply to China ramped up again once NZ's forestry industry was able to resume work when lockdown conditions were eased to level 3 in late April.

LOG PRICE (UNPRUNED A GRADE)

Source: AgriHQ

This resulted in surge in logs being exported from New Zealand to China, which quickly alleviated the previous shortfall. But now the level of offtake of logs from China's wharves has eased and prices have too. This reduction in demand is a normal seasonal trend that occurs when construction activity slows during the hot summer months.

The supply of logs into China from Eastern Europe remains strong. These are spruce logs that are being rapidly harvested in order to stop the spread of a spruce beetle infestation that has already devastated many forests in Eastern Europe.

The in-market log price has now fallen 12% below the 5-year average. Pricing is no longer sufficient to attract logs from Uruguay and Argentina as the higher shipping costs from South America to China make the trade unprofitable.

Supply from New Zealand is also likely to be restricted a little due to harvesting slowing in the winter months, as access to some sites becomes more challenging, and some smaller lot owners elect to delay harvest until returns are higher.

Some land owners have contracted prices which will support felling in the near term but once these deals expire we expect to see further slowing in harvesting of small lots. Harvesting of larger forests tends to continue regardless of the current spot market price, as these owners are large enough to manage the ups and downs.

LONG, BUMPY ROAD TO ECONOMIC RECOVERY

Given the weak outlook for most economies it is difficult to envisage a lift in log export prices occurring any time soon. There is no doubt there has been a significant rebound in economic data for most countries as the initial lockdowns eased but as COVID-19 is still a significant (and growing) health crisis in many countries

FORESTRY

and a vaccine remains some time away, the road to full global economic recovery is going to be long and bumpy.

Physical distancing restrictions in our main log markets are generally easing, at least for now. This is the case in China, Japan and Korea. Unfortunately, the same can't be said for India, where COVID-19 continues to work its way through the country's vast population. But even the countries that have managed to contain the spread of COVID-19 and continue to successfully do so won't escape the economic impact of this disease due to the interconnectedness of global economies.

In China, demand for goods manufactured and shipped globally has fallen due to consumers becoming more conservative in their spending habits. Nationalism is also running hot in some parts of the world, which has resulted in trade tensions erupting between several key nations.

As demand for China's exports wanes, they require fewer pallets to move these goods on, and that means reduced demand for soft timbers like the pinus radiata sourced from New Zealand.

NZ logs are also used to make furniture in China, and domestic demand for home furnishings remains robust. Boxing for concrete construction is another major use of pine.

CONSTRUCTION ACTIVITY UPBEAT FOR NOW

So far the construction sector remains upbeat in China but the questions remain as to how long this will be sustained. An overpriced housing market has long been regarded as an economic risk in both China and South Korea. The risk of a housing bubble burst is heightened now that global economic activity has slowed.

WARNING – HOUSE MARKET RISKS

The housing market bounced back rapidly in many countries once lockdown restrictions were eased and New Zealand has been no exception. Pent-up demand for real estate resulted in a lift in transactions occurring once New Zealanders were able to get back to open homes and more easily complete the paperwork required to access funding and buy a house.

At present there is strong demand from the local construction industry for milled timber for use in new home builds and other construction.

This is supporting local lumber prices and mills are reporting that in some cases they are struggling to meet demand.

The extended period of time spent in homes during the lockdown has also stimulated some demand for home renovations, particularly smaller DIY jobs. There has been a step change in attitudes towards working from home, which has meant many workers are now enjoying working from home for at least part of their working week. This is likely to have stimulated some demand for home renovations to make the home offices more workable.

HOUSING MARKET TO SLOW LATER THIS YEAR

New home construction activity has also rebounded, but these projects would have commenced or been at least well through the planning stage before COVID-19 hit. We anticipate we will see a slowing in the housing market in New Zealand as the labour market weakens but this may not eventuate until nearer the end of the year. . See the latest ANZ Property Focus for more details. As demand for homes falls so too will demand for new builds, and hence timber.

In New Zealand and many other developed economies thus far consumers have been spared the worst of the economic fallout due to government packages to support jobs, deferrals on home loan payments, and the general economic stimulus being delivered through central bank stimulus and government spending programs. But as these programs are wound back the underlying economic situation will be revealed, and this is when we expect to see a reduction in demand for homes and new builds.

STRONG DEMAND FOR POLES

The domestic market for posts and poles is strong. Pole demand is underpinned by growth in the kiwifruit industry (see Horticulture section) where they are used to support vines.

Demand for posts is also expected to be strong over the next few years as more waterways are fenced on beef, deer and dairy support properties.

PLANTING ACTIVITY STRONG

Planting of replacement and new forests is currently occurring, as winter is planting season. Expansion of forestry land is being driven by investors looking to reap potential income streams from carbon, and companies looking for direct offsets.

FORESTRY

The carbon price has recently firmed and is currently trading near \$33 per tonne CO_2 (NZU). The Climate Change Response (Emissions Trading Reform) Amendment Act was passed into law in June. At this time the fixed price option was increased from \$25 to \$35/NZU. This effectively provides a cap to the market, and is the reason why the spot market has recently lifted. The spot market can trade above this level, and certainly did trade above \$25 before the cap was raised.

The fixed price option will be replaced by a "cost containment reserve" when the government commences auctioning of NZUs. No specific date has been set yet for the first auction to occur.

The containment reserve will effectively limit the value of NZUs to a price range of \$20 to \$50 in 2021. The minimum price will then lift by 2% per annum so by 2025 the minimum price will be \$21.65/NZU.

HORTICULTURE

STRONG EARLY SEASON EXPORTS

The horticultural sector has managed extremely well through the challenging times it has faced as the harvesting of our main export crops coincided with tight lockdown restrictions.

Early-season sales of both apples and kiwifruit have been extremely good, resulting in export returns tracking ahead of last season. Market conditions are becoming more challenging as the season progresses, but returns at the orchard gate level are still looking good.

KIWIFRUIT: GOOD AS GOLD

The kiwifruit picking and packing season is progressing well, with the harvest tracking ahead of normal due to the hot summer bringing forward maturity dates.

Export demand has remained robust, which is a credit to Zespri's sales team being able to market the health benefits of the fruit. Sales in Japan for SunGold have gone very well. Export returns for fruit sold to Japan were up 40% y/y in the three months to June.

Orchard gate return (OGR) forecasts for the current season have been revised up and final payments for last season were stronger than forecast.

Green kiwifruit achieved a record OGR of $67,295/ha while SunGold also set a record at a massive $161,660/ha.

Forecast returns for the current season have also been revised up and ranges narrowed – the level of market uncertainty has subsided now that a good portion of fruit has been successfully delivered to market. Grower expectations have been positioned a little lower than the record levels attained last season but healthy returns are still forecast.

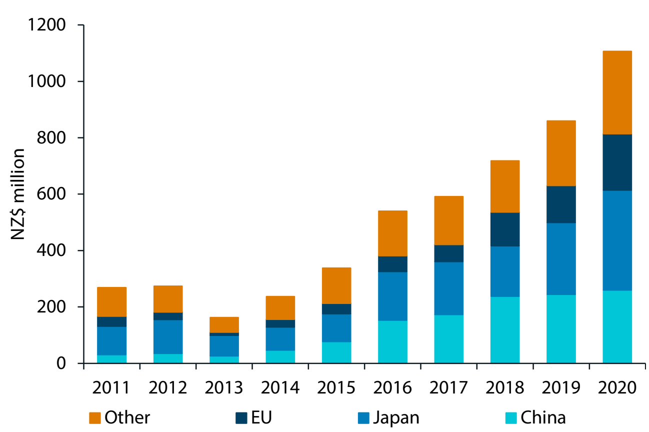
ZESPRI ORCHARD GATE RETURN FORECASTS AS AT 18 JUNE 2020

Variety	2020 season (June forecast)	2020 season (April forecast)	2019 season (final)
Green	$5.40 - $6.90	$5.00 - $6.50	$6.67
Organic Green	$7.90 - $9.90	$7.50 - $9.50	$9.88
Gold	$10.50 - $12.00	$9.50 - $11.00	$11.86
Organic Gold	$12.50 - $14.50	$11.00 - $13.00	$11.86
Green14	$7.50 - $9.00	$5.75 - $7.75	$7.66

Source: Zespri

Exports have certainly got off to a strong start this season. Export returns from March to June for SunGold are up 29%. Half of this increase was due to higher volumes being exported, due to the harvestable area of fruit lifting and early maturity this season, but the rest was down to strong market prices.

GOLD KIWIFRUIT EXPORT EARNINGS (MAR-JUN)



Source: StatsNZ

HORTICULTURE

Early-season returns from Japan have been excellent, with returns for the first four months of the year exceeding last year's full-season returns. This season to date, Japan has accounted for 32% of total export revenue for SunGold, while China has accounted for 23% of export revenue.

The volume of green kiwifruit exported this year is on par with last year but export returns are tracking 6% higher. No doubt it will be challenging to continue the strong returns achieved earlier in the season as global economic conditions remain extremely challenging, but the season is certainly off to a very strong start.

Nelson growers achieved excellent yields this season. Whilst most of the recent expansion in the Nelson/Motueka region has been in apples, this region has proven it is also an ideal region for kiwifruit.

The confidence in the industry was reflected in the exceptionally strong prices paid by growers for licenses. A median price of $400,023/ha was paid for SunGold licenses, with only growers who bid at or above $378,900 being successful. In total 1,660 ha of licenses were bid for, but only 700ha was allocated between the 216 successful bidders.

SunGold organic licenses also attracted higher prices but the number of bidders competing was down on last year. The organic licenses attached a median price of $219,565/ha, although a bid of $172,600/ha was sufficient to be granted a license for some of the 50ha allocated.

Licenses for 150ha of Zespri Red was also allocated this year. The new variety attracted 157 bidders, of which 103 were successful. The median license price of $62,500/ha makes the license fee for this variety considerably cheaper than SunGold, but this also reflects that this variety is more difficult to grow and store. Zespri Red is well liked by consumers so this does minimise market and price risks, despite it being a new product.

Zespri shareholders received a sold investment return on their shares. A final dividend of 19c will be paid to shareholders, bringing the full season dividend for the 2019-20 season to 94c. This is 2c more than was paid in dividend last season, although this year 20% of earnings were retained versus 15% last year.

An interim dividend of 95c has been approved for the new season, which will be paid in August. This is 80% of forecast returns, the mid-point of the policy to pay a dividend of 70-90% of profit. This mainly reflects the funds generated from the grower licenses issued.

In order to guarantee year-round supply Zespri continues to expand the area of kiwifruit being grown outside of New Zealand. An additional 451 ha have been planted across Italy, France, Japan and Korea in SunGold. The amount of SunGold now planted in the Northern Hemisphere exceeds 3,300 hectares.

APPLES: MARKET CONDITIONS BECOMING CHALLENGING

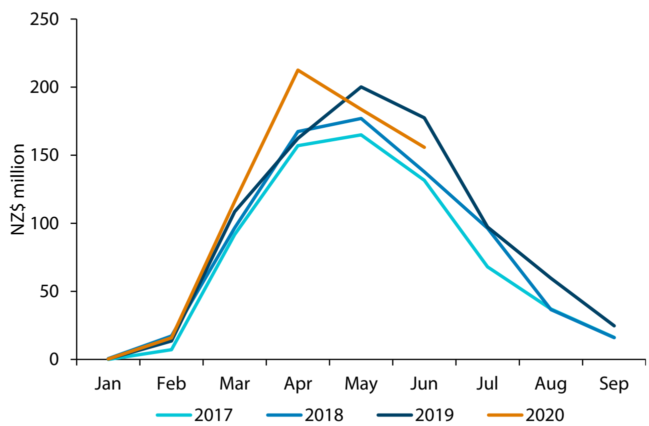
Apple exporters have had a challenging season with the level-4 lockdown occurring right in the thick of the picking season. But the apples and pears were picked and packed, and exporters managed to source sufficient containers to get product to market.

Export returns for the season to June are ahead of last season, with high volumes shipped earlier in the season. This early shipping was driven by the harvest being slightly earlier, strong demand from some markets for healthy foods, and a desire by exporters to move as much fruit to market as quickly as possible in order to avoid potential shortages of storage space and access to shipping containers.

Thus far logistics have held up well, and NZ exporters have been able to access sufficient containers and shipping space to get fruit to market in a timely manner.

Export volumes have now easing as they typically do at this time of year, but some exporters are nervous that selling fruit will become much more challenging as the year progresses.

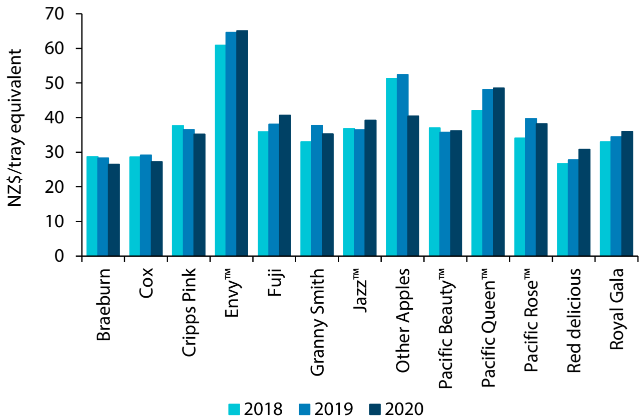
APPLE EXPORT RETURNS



Source: StatsNZ

Export prices for the month of June were stronger than last year for many varieties, but some apples have failed to deliver the returns achieved last season, based on export prices. Reported export values are the value that is placed on the product when it is shipped, but in some cases prices are not finalised until product is on the water, or are renegotiated at a later date. This must be kept in mind when viewing this data.

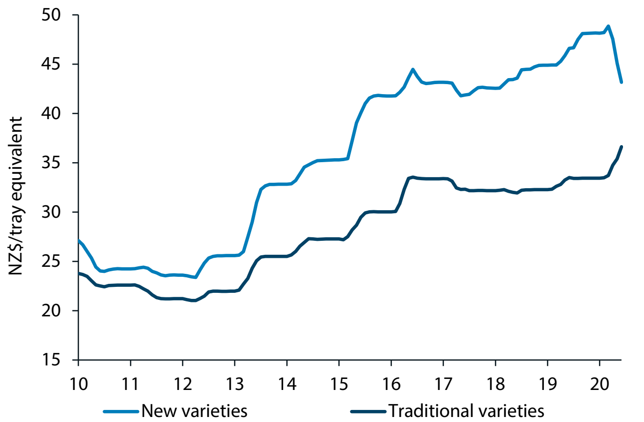
APPLE EXPORT PRICES – JUNE



Source: StatsNZ

The newer varieties of apples continue to attract a sizable price premium over the older varieties, but access into some markets has been much more challenging this year, which has limited returns.

APPLE EXPORT PRICES – 12 MONTH ROLLING AVERAGE



Source: StatsNZ

This has been the case for fruit exported to the US, for which pre-inspection processes have not been able to take place due to US officials not being able to travel to New Zealand to do this role.

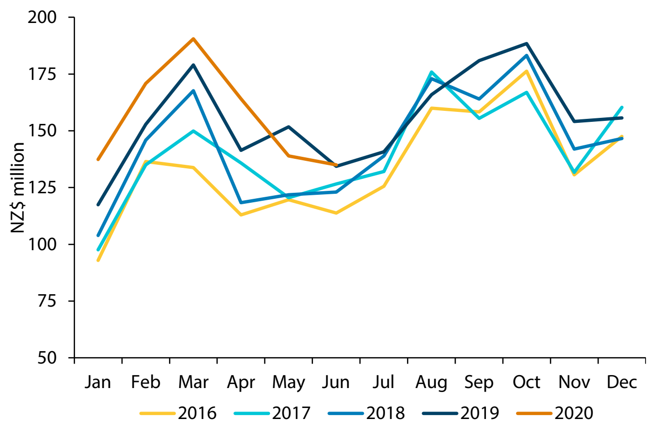
Overall, exports are running ahead of last season in both volume and value terms. Demand from China has been steady but other Asian markets have been more challenging.

VITICULTURE: INNOVATIVE WINE TASTINGS

Wine export markets have been challenging this year as COVID-19 related restrictions have resulted in temporary shutdowns of many places where wine is consumed such as restaurants, bars, conference/wedding venues, airport lounges etc.

While there has been a pick-up in wine being sourced through supermarkets and online channels for consumption at home, this has not fully offset the disruptions seen in other distribution channels.

WINE EXPORT RETURNS



Source: StatsNZ

Despite these challenges, the volume of wine exported this year to date is 6% ahead of last year. Encouragingly, this increased volume has not come at the expense of lower prices, with export returns in the first half of 2020 7% higher than the same time last year.

But it certainly hasn't been easy for exporters. In an industry renowned for hands-on experiences as part of the sales process, innovative solutions have had to be found. Some wineries have opted to interact with their clients through online tastings, where the wine is sent to the taster in advance and then the sales team or winemaker provides insights into what is being tasted online. In some cases, this has allowed more team members to be involved in this process, and for the overseas buyers to enjoy a more personalised experience.

Online channels have also become a much more important channel then previously. Luckily, New Zealand wineries who rely on cellar door sales have been able to reopen. A recent surge in domestic tourism into the regions is supporting sales – particularly during the weekends, but tourist numbers still remain subdued during the working week and this situation won't change for the foreseeable future.

RURAL PROPERTY MARKET

DOWNWARD TREND TO PERSIST

A downward trend in the value of rural land prices is evident and shows no sign of letting up. The number of properties changing hands is tracking well below the 10-year average for all sectors except forestry, indicating further downward correction in prices needs to occur to attract more buyers.

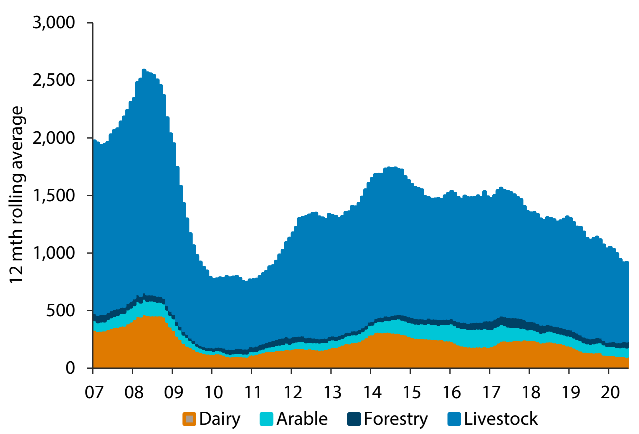
DAIRY LAND STILL LACKS BUYERS

Dairy farm sales have halved in the past 12 months relative to the 10-year average.

The value of dairy farm land has also fallen, with the median sale price easing 7% in the past 12 months.

There is little evidence to indicate we have reached the bottom of the market, with prices expected to ease further from here. We expect it will take a few more years before we see a more balanced market in terms of the number of buyers relative to sellers, and until this occurs we will not see a general increase in dairy land prices.

FARM SALES BY SECTOR



Source: REINZ

REGIONAL OPPORTUNITIES

The area of land used for dairying in expected to gradually trend down in the coming decade. Land values will be impacted differently, depending on the potential for alternative land uses.

Land use change tends to be driven by opportunities for higher returns for alternative uses or for lifestyle factors.

We expect some of the highest-quality land currently used for dairying will move into alternative uses such as horticulture, or sheep/goat milking, providing there is sufficient industry confidence and access to capital for this to occur.

Moving to horticulture uses is most likely to occur in the regions where there is already the infrastructure available for this, or in adjacent regions, such as Waikato, Bay of Plenty, Northland, Hawke's Bay and Nelson.

Changes to sheep or goat farming will be limited to regions where there is processing capacity, which is primarily the Waikato and the regions within reach of these facilities.

The ability to move to many alternative land uses is limited due to these industries restricting supply to what is deemed to be a level that can deliver sustainable returns for all participants. For instance, Zespri issues a limited number of new licenses each year for new supply, and the goat and sheep milking industries also limit new intakes.

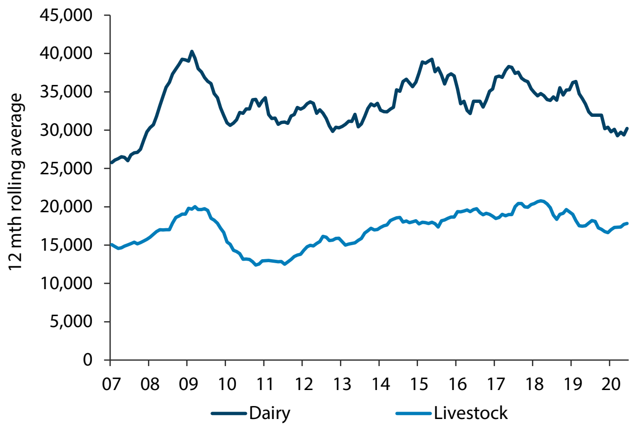
In regions that lack the opportunity to move to a substantially higher land use, we may see farms move out of dairying into less labour-intensive uses, such as beef, when the difference in the marginal returns between the uses can be justified by the lifestyle gains attained. Such changes often occur without a change of ownership but when these farms eventually make their way to the market they tend to be priced lower.

SHEEP

The differential between the value of grazing properties and dairy properties has halved in the past decade. The median per hectare price for dairy land is still 70% higher than the median price for grazing properties, but the gap between the two has decreased as returns for dairying have eased, whilst returns from meat production have lifted. The median price for grazing properties is currently 35% higher than it was a decade ago, whilst the price of dairy returns has softened.

More marginal grazing land has also been supported by demand for land to plant trees for timber, harvest carbon credits, or provide a habitat to support honey production.

MEDIAN PRICE PER HECTARE BY SECTOR



Source: REINZ

NEW ENVIRONMENTAL RULES EXPECTED TO DRIVE REFRESH IN LAND OWNERSHIP

The recently released National Policy Statement for Freshwater and the National Environmental Standards for Freshwater provide some clarity around future environmental expectations, but actual rules to be imposed at the regional and catchment level are still to be defined for most regions.

Some catchments may face significantly tighter rules than the minimum national standards. Therefore a high degree of uncertainty still remains. However, it is clear that the new rules will impact cattle farming more than many other land uses, and dairying will be subjected to tighter specific regulations – particularly during the interim period whilst councils develop region-specific plans.

The regulations make it clear that all farmers will be expected to be able to prove that they comply with all regulations. This will involve a more formal planning process, which will be auditable. This will be quite a step change for some farmers who have relished operating a business in an environment which is market driven and not overly regulated. The extra office-bound duties required to comply with the new regulations may result in a further wave of farmers looking to exit the industry – not because they don't believe in the intent of the new regulations, but simply because this isn't what they signed up for when they entered farming.

FARM SALES BY FARM TYPE

Annual average/total		Past 12 months	Previous 12 months	10 - Year Avg.	Chg. Y/Y	Chg. P/10yr
Dairy	Number of Sales	103	146	206	↓	↓
	Median Price ($ per ha)	30,229	32,378	33,806	↓	↓
Livestock	Number of Sales	681	855	967	↓	↓
	Median Price ($ per ha)	17,817	17,883	17,193	↓	↑
Horticulture	Number of Sales	138	180	179	↓	↓
	Median Price ($ per ha)	223,364	224,750	180,040	↓	↑
Arable	Number of Sales	81	75	91	↑	↓
	Median Price ($ per ha)	23,333	56,150	35,241	↓	↓
Forestry	Number of Sales	52	50	50	↑	↑
	Median Price ($ per ha)	9,076	10,380	6,804	↓	↑
All Farms	Number of Sales	1,132	1,321	1,497	↓	↓
	Median Price ($ per ha)	22,692	24,433	23,402	↓	↓

Source: REINZ

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