ANZ RESEARCH

AGRI FOCUS

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INSIDE

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Global economic trade is slowing but this has not impacted the volume of product being exported from New Zealand. Attaining top prices is extremely challenging in the current economic climate, however. Food products are doing okay but high-value goods are difficult to move, although products deemed healthy are still doing relatively well.

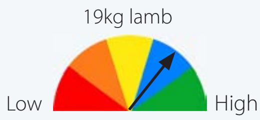
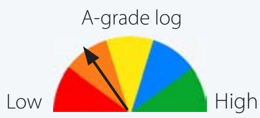
Dairy returns are also holding up relatively well given offer volumes are at their seasonal peak. Milk production has been very strong during the early production months. Combined with a small lift in production in other exporting countries, this could put pressure on prices in the months ahead.

Meat prices are generally holding up in international markets, while returns at the farmgate are currently supported by procurement pressure. We expect both beef and lamb prices will ease further as more stock becomes available for processing.

There has been a small improvement in returns from logs and wool over the past month. Log uptake has lifted in China and local demand is also strong. Wool prices are now heading in the right direction, although coarse wool has a very long way to go before it will be make a meaningful contribution towards farm returns.

Border closures show just how reliant we have become on overseas labour to pick our fruit, shear our sheep, drive our tractors and milk our cows. Unsurprisingly, Kiwis have opted for more permanent and less physically demanding roles. As unemployment levels rise we will see some drift back to seasonal work, but this option will suit only a small number of people. Therefore, there will still be labour gaps to fill.

This is particularly the case for the horticultural sector, which is not able to offer year-round employment and therefore has limited appeal to locals. Being able to work abroad for part of the year has become an economic lifeline for many Pacific Islanders. The economies of these islands have been hit hard by the lack of tourism. Getting the recognised seasonal employer (RSE) scheme back into action would be of mutual benefit from an economic and wellbeing perspective.

Prices at farm/orchard level relative to 10yr average		
Dairy	Dairy markets continue to display resilience, which is supportive of our milk price forecast of $6.50/kg MS for the 2020 21 season.	
Sheep	International prices have stabilised while farmgate returns have been steady, but we anticipate prices will soften considerably as a large number of new-season lambs become available.	
Beef	Beef returns are starting to ease at the farmgate level and a similar trend is occurring in international markets.	
Forestry	Log prices are trending up again. There has been a lift in demand from China and plenty of competition from local mills for logs as well.	

ECONOMIC OVERVIEW

GLOBAL RECESSION IN PLAY

Across the globe strong support from fiscal policy and central banks has taken the sting out of the current crisis. Monetary policy has been deployed in a variety of formats, but these tools can only do so much. Global trade is slowing but NZ exports are still doing very well considering the global recession is starting to bite. But returns at the farmgate level are expected to be more modest this season. The relatively strong NZD is also reducing returns for our producers...

GLOBAL TRADE IS SLOWING

Global trade has slowed considerably this year. The World Trade Organisation (WTO) now predicts a 9.2% reduction in trade of goods across borders in 2020, with a partial recovery forecast for 2021.

New Zealand exports are bucking the trend. Export volumes are elevated for many classes of goods, and returns are holding up incredibly well considering we are in the midst of an enormous global recession.

Across the globe we have seen central banks take quick and decisive action to soften the impact. And many governments are implementing fiscal stimulus packages designed to keep their economies ticking over and as many people employed as possible. However, in some cases, getting politicians to make timely decisions is proving difficult. There are also questions about the sustainability of it all, given already-high fiscal debt loads in many countries.

NEGATIVE RATES ON THE CARDS

In New Zealand the Reserve Bank is looking for new ways to support the economy beyond the quantitative easing measures already in play. A negative OCR is certainly on the table and we expect this will be deployed in April 2020. In addition we expect the RBNZ will also look to further support the economy with a bank Funding for Lending Programme. This program is likely to precede negative rates and is likely to be deployed by the end of the year. See RBNZ Monetary Policy Review.

FISCAL SUPPORT NEEDED

Monetary policy alone won't be enough to get our economy back on track and further fiscal stimulus would certainly help. The Government support through the wage subsidy was very effective in helping people stay in their jobs through the initial lockdown period, but the policy is not sustainable over the longer term and it has now run its course. Fiscal policy now needs to pivot to ways to support the economy through enabling growth in the private sector. With the election just around the corner we won't get further clarity as to how exactly this will play out until the new Government is formed.

HOUSING MARKET STILL STRONG... FOR NOW

The housing market is looking very resilient at present. This is partially being driven by a lack of supply, with new listings low. Funds previously earmarked for overseas travel are also being diverted into home renovations and rates of home building remain high, which is keeping the tradies busy. Low interest rates have also made housing more affordable for some, and the suspension of the LVR restrictions is clearly being seen by some as a window of opportunity. But as job security starts to become a bigger issue we expect this will also reduce confidence in the housing market.

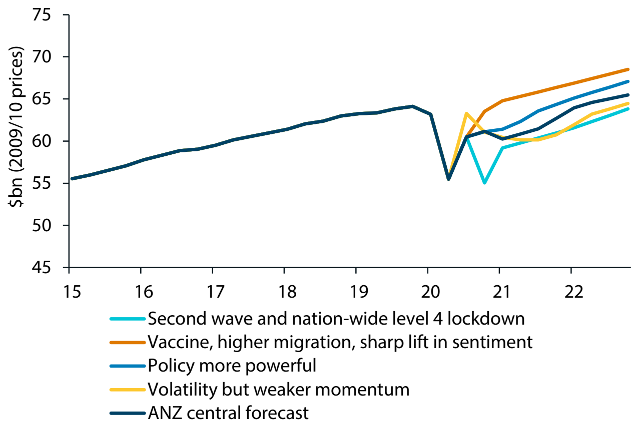
CHALLENGING TIMES AHEAD

The New Zealand economy has bounced vigorously out of the lockdown measures and business confidence and activity indicators have recovered strongly. But with the wage subsidy running out and the lost summer of tourism upon us, we anticipate that unemployment levels will soon lift and will peak just under 10% by the middle of 2021.

ECONOMIC OVERVIEW

New Zealand's economy is expected to take several years to get back to 2019 levels. We anticipate GDP will contract by 4.6% in the 2020 calendar year. But exactly how long it takes for the economy to get back on track really depends on how long it takes for the pandemic to be brought under control globally or mitigated by a vaccine, which will determine when our borders can reopen.

GDP FORECAST AND HIGH-IMPACT SCENARIOS

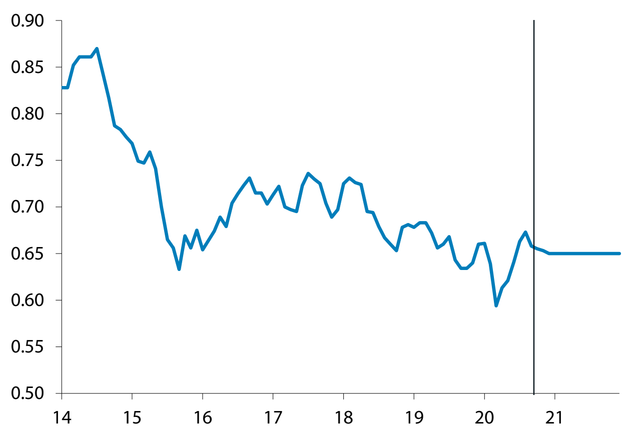


Source: Statistics NZ, ANZ Research

NEW ZEALAND DOLLAR PERSISTENTLY STRONG

Relative strength in the NZD is limiting returns back to the farm gate. We don't expect this situation to change any time soon with our forecast sitting at USD0.65 through the remainder of 2020 and right through next year as well. 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

RESILIENCE

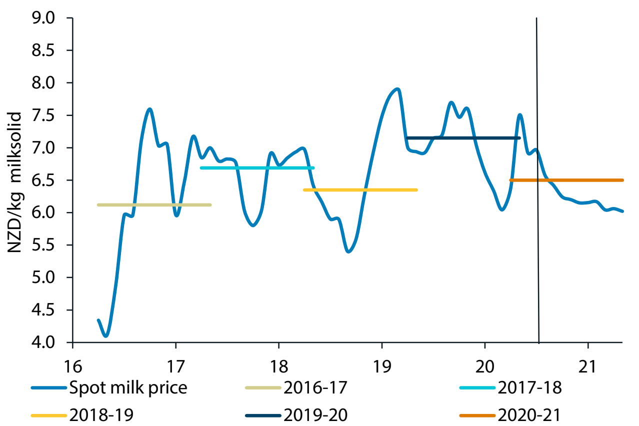
Dairy markets have held up well despite current global economic challenges. Returns at the farmgate level this season are expected to moderate to levels near the long-run average. We continue to forecast a milk price of $6.50/kg MS this season, which is a little weaker than the $7.14/kg MS price paid by Fonterra in the 2019/20 season.

GLOBAL MARKETS HOLDING UP

Global markets for dairy products have performed well in the past few months. Prices attained for product sold on the Global Dairy Trade platform have been stronger than expected. The first auction in October delivered a solid 2.2% lift in the GDT Price Index, despite offer volumes being near their seasonal peak.

Growth in early-season milk production in New Zealand and strong milk flows in other parts of the world have – thus far – not dented buyer confidence. But as milk volumes lift and global economic conditions deteriorate, risks continue to be skewed to the downside.

MILK PRICE – HISTORIC AND FORECAST



Source: Fonterra, NZX, ANZ Research

For now we maintain our milk price forecast of $6.50/kg milksolid (MS) for the 2020/21 season. Our forecast allows room for commodity prices to soften further from current levels but a major deterioration in prices would put downward pressure on this forecast.

At present we forecast the NZD will remain near USD0.65 throughout the dairy season. Given some hedging will have already occurred at the lower rates previously available, this equates to an effective FX rate of USD0.64 in our milk price calculation.

The NZD has persistently traded above USD0.65 over the past month and if the Kiwi remains strong in the coming months, this will put downward pressure on the farmgate milk price. A 1 cent lift in the NZD can reduce the farmgate milk price by about 15c/kg MS.

It's still early in the season but we are starting to see a narrowing in the range of milk price forecasts. Milk price futures for the Sep 21 contract (2020/21 season) have traded back up to $6.70/kg MS, while contracts for the 2021/22 season have recently traded at $6.60/kg MS. This price is above the long-run average milk price and provides an opportunity to reduce the uncertainty associated with income streams. Uncertainty is extremely high at present and it is clear that the economic fallout from the current pandemic is far from over. Therefore opportunities to gain certainty are definitely worth considering.

The biggest current risk to returns is a significant lift in global milk production while demand subsides. There is evidence of both of these trends in play at present so we will be watching these closely.

GLOBAL MILK SUPPLY LIFTS

Milk production across the globe is starting to strengthen. New Zealand has had a particularly strong start to the new season, but growth rates are expected to ease during the peak production period that occurs in late October/early November.

DAIRY

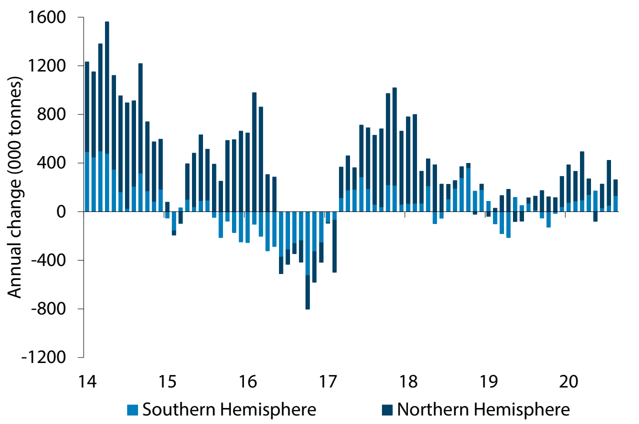
The kind weather through the winter and early spring has supported production. Cows and pastures are in excellent condition, which should also help with conception rates as the mating season gets underway.

Despite the kind weather, the strong milk price paid for last season and the reasonable outlook for the current season, farmer confidence levels remain low and there is limited appetite to invest in the sector at present.

GLOBAL DEMAND

Demand for dairy products is reasonable at present but not outstanding. Given weak global economic conditions, we would expect to see some softening in demand. At the same time we are seeing milk volumes lift a little quicker in the main dairy-exporting regions than we have seen in recent years. This includes Europe and the United States. However output from smaller exporting nations such as Australia, Argentina and Uruguay isn't growing so quickly. There has been some growth in output in Russia but this country is still not self-sufficient in milk.

MILK PRODUCTION GROWTH MAIN EXPORTING COUNTRIES



Source: DCANZ, Dairy Australia, Eurostat, USDA, CLAL, ANZ Research

FONTERRA RESULTS

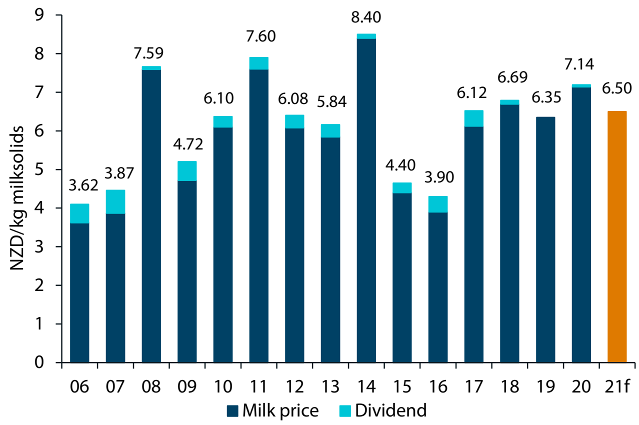
Fonterra produced a positive financial result for FY 2020, achieving its profit targets. A relatively large portion of the profit was derived from the sale of DF Pharma.

The Co-op remains focused on debt reduction, having attained its short-term target in terms of reducing its gearing ratio. Funds from asset sales were primarily used to pay down debt. This focus on debt reduction and a revised dividend policy resulted in a dividend of just 5 cents per share being paid.

More recently, Fonterra has announced it has sold its China farms. The Ying and Yutian hubs have been sold to the Inner Mongolia Natural Dairy Co. – a company whose ownership was recently split away from China's dairy giant, Yili Group.

DPA Brazil remains for sale. It's likely the current economic environment will make offloading this asset more challenging. There were no further write downs of these assets beyond what was signalled in the interim results. Fonterra's shareholding in Beingmate is progressively being reduced. The value of these shares has lifted since earlier in the year but is still well below the price Fonterra paid for them.

FARMGATE MILK PRICE



Source: Fonterra, ANZ Research

The final farmgate milk price paid of $7.14/kg MS for the 2019/20 season was very close to our final forecast of $7.15/kg MS.

Dividends have been skinny in the past few seasons and we expect it will take the Co-op a little longer before we see a significant lift in returns to shareholders.

That said, the milk price paid in FY20 was one of the highest on record, and the variance has been relatively low across the past four seasons.

SYNLAIT MARGINS SQUEEZED

Synlait delivered a 9% smaller profit than the previous year. Synlait is buying assets – a reflection that the company is in a very different stage of development to Fonterra. Strategic investments made by Synlait during the year included Dairyworks and Talbot Forest Cheese.

Synlait paid its suppliers a base milk price of $7.05/kg MS plus incentive payments averaged 25c/kg MS. This means on average suppliers received $7.30/kg MS and payments for milk were very competitive.

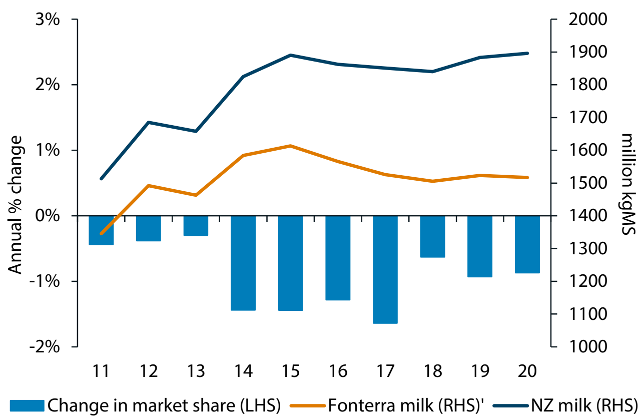
DAIRY

STRONG COMPETITION FOR SUPPLY

Competition for supply is strong in the regions where more than one dairy company operates. Many farmers don't have a choice as to who they can supply, but an increasing number do.

The portion of milk being collected by Fonterra is steadily being eroded but they still process about 80% of milk produced. Fonterra has lost about 1% of its milk intake each year for the past few years due to growth in the independent milk-processing sector.

FONTERRA'S SHARE OF MILK SUPPLY



Source: Fonterra, DCANZ, ANZ Research

We are starting to see dairy companies offer more tailored milk prices with a range on incentives (and penalties) offered. This trend is expected to continue as dairy processors try to more closely align customer requirements with on-farm practices.

Fonterra plan to drop their incentive payments for milk supplied in the shoulder months of the season from next season onwards. Capacity constraints through the peak milk supply months are no longer a concern for the Co-op. This will make it less viable than otherwise to bolster spring and autumn milk production through supplementary feed or by using nitrogen to accelerate pasture production. Both the use of nitrogen and supplementary feeding may still make economic sense during these times. But without the extra milk payments for supply at these times of the season, there will be a higher bar to clear.

LAMB & WOOL

AVERAGE SEASON AHEAD

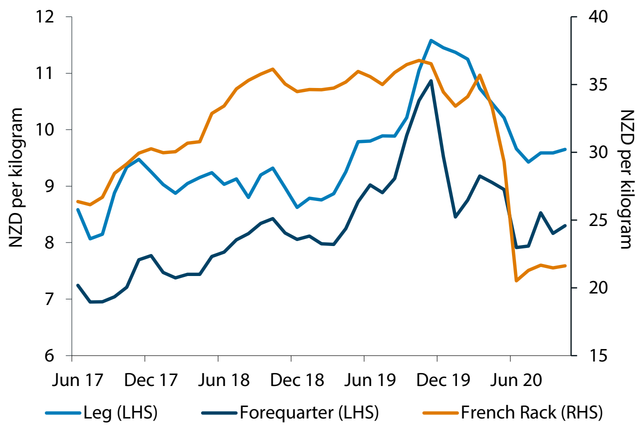
Lamb prices at the farmgate level have been relatively steady for the past couple of months. International prices have stabilised but we expect downward pressure on schedule prices once large volumes of new season lambs become available.

INTERNATIONAL PRICES HAVE FLATTENED

International prices for lamb meat have stabilised following the significant correction earlier in the year. The low throughput of lambs at this time of the season is allowing processors to steadily move any stocks that built earlier in the year. This will put them in a better position to sell the new-season product as it becomes available.

French racks continue to trade at a heavy discount versus long-run prices but the drop in other items has been less pronounced. There is still good demand from China for lamb, but only at the right price. It simply isn't a market that places high value on cuts like French racks.

LAMB CUT PRICES

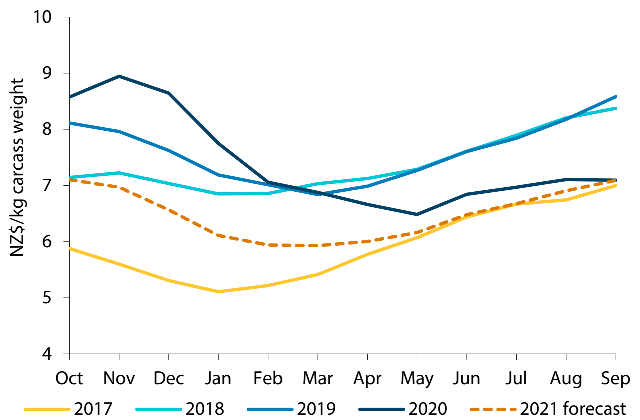


Source: AgriHQ

Farmgate returns for lamb held their own during August and September. As we expected there was no lift in returns despite throughput being at its seasonal low point. We have now officially entered the new processing season, meaning last season's lambs will now be discounted down to mutton price levels (except where processors offer a separate price for hogget). Over the next few weeks we will still see lambs born late last season classified as lambs – as long as their adult teeth haven't emerged.

We may see some premiums paid as small quantities of genuine early new-season lambs start to come forward for processing, but we expect to see downward pressure on farmgate returns as lamb numbers lift. Post-Christmas we expect the schedule will have softened back to about $6/kg CW.

FARMGATE LAMB PRICE TREND AND FORECAST



Source: AgriHQ, ANZ Research

Interestingly, the average farmgate price paid in September this year was very closely aligned with the 5-year average for this time of the year.

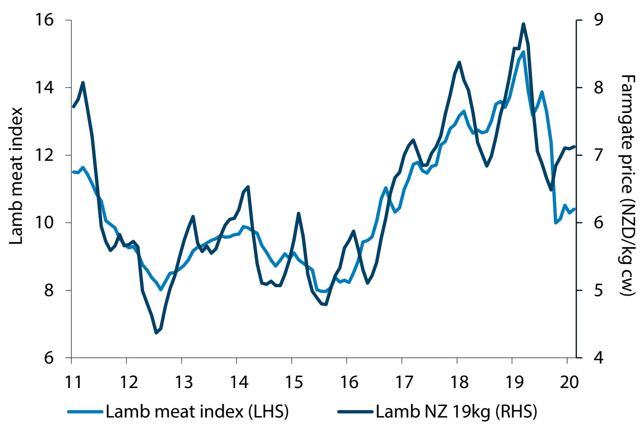
LAMB & WOOL

International markets for lamb products are currently returning about 30% less than they were a year ago. Based solely on international market prices for some of the main cuts, schedules are currently overvalued by about $1/kg CW.

Currently our indicator shows that a schedule price of nearer $6/kg CW is where market pricing is currently at, and we expect this is about the level we will see for farmgate returns later in the season.

The strength of the NZ dollar is not helping either. We anticipate the NZD/USD will trade near $0.64c for the rest of the season. At present the exchange rate is slightly higher than this levelt, which is eroding returns in local currency terms.

FARMGATE PRICE VS OVERSEAS MEAT PRICES



Source: AgriHQ, ANZ Research

GOOD EARLY SEASON WEIGHT GAINS EXPECTED

The mild autumn and early spring has been beneficial for early-season pasture production and lamb survival rates. Unfortunately the severe storms that occurred in late September had a devastating impact on some farms in southern regions and high-altitude farms where lambing is timed to start later in order to avoid the worst weather.

But overall lamb survival rates are expected to be reasonably good, which will help offset the impacts of lower conception rates due to ewe condition being negatively impacted by drought at mating time.

The combination of slightly fewer lambs on the ground, good early-season pasture growth, and reduced stock numbers on many farms should result in excellent growth rates for lambs. This means we may see good numbers of lambs becoming available for processing early on.

With schedule prices expected to soften pretty quickly this also acts an incentive to quit more lambs early.

In the store markets prices are quite soft – and rightly so. The uncertainty in the international markets means an air of caution should be heeded. Store lamb prices are back about 15-20% on year-ago levels.

It has mainly been ewes with lambs at foot in the yards at recent sales. Demand for these ewes and lambs has been limited with prices back considerably on recent years, reflecting the uncertainty in the underlying markets.

WOOL – TURNING POINT

Wool returns have crept up but are still at very low levels. Returns need to lift in order for the industry to become economically sustainable. At present the cost of shearing exceeds returns from cross-bred wool.

Strong wools have lifted in price a little in recent weeks but wool is still worth about 30% less than it was a year ago. The best news is that wool has continued to trade despite really difficult conditions in the international markets.

New Zealand wool is still moving through the supply chain and we do have opportunities to sell our wool, albeit at low prices.

STRONG WOOL (>35MM)

Source: NZWSI, PGG Wrightson

However, there is an air of optimism as prices have lifted slightly at recent sales. Prices for fine wool have been driven up by improving prices in the Australian market. This has resulted in the price of merino and mid-micron wool lifting by 8-10%.

BEEF MARKETS SOFTER

Global markets for beef are not particularly strong. In-market prices have been trending back and that is putting downward pressure on farmgate prices.

Store stock prices are also back on last year due to a lack of confidence in future returns. This market has also been impacted by slower pasture growth on farms that were severely impacted by drought in the autumn, and by concerns another dry summer may lie ahead of us.

FARMGATE PRICES TREND DOWN SHARPLY

International markets for manufacturing-grade beef have weakened a little over the past couple of months. When combined with a strong NZD/USD, that has further eroded returns.

New Zealand product is still moving into our major markets – the United States and China – but selling product is not particularly easy.

Prices trended up a little though August and September at the farmgate level due to limited volumes of stock available for processing. Numbers are expected to remain low now that pasture growth rates are really starting to pick up.

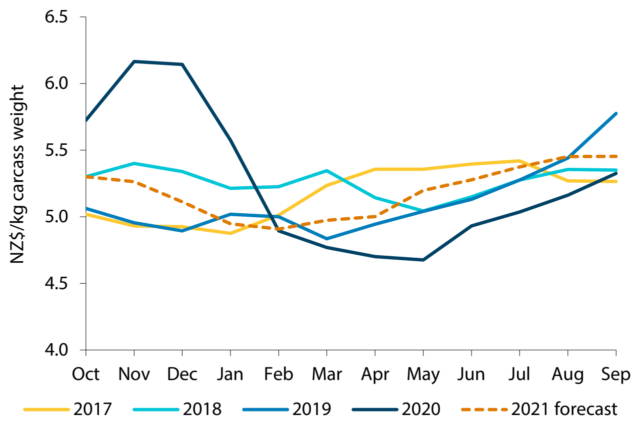
FARMGATE RETURNS EASING

Farmgate returns are now starting to be pulled back again in order to retain margins at the processing level.

Farmgate prices for nearly all categories of stock are still hovering around 5-year averages. The only stock class that is priced slightly below this is South Island prime steers and heifers.

We anticipate schedule prices will continue to soften from now until the end of the calendar year. Our modelling indicates schedules will soften by about another 50c per kg CW over the next few months.

FARMGATE BULL BEEF PRICE TREND AND FORECAST



Source: AgriHQ, ANZ Research

But exactly how far market retreats will depend on what happens in the international markets. We do anticipate beef prices will continue to be somewhat supported by pork still being in short supply. This has been the main factor driving China's demand for beef.

That said, New Zealand exporters are only a small player in this market, with much larger volumes being supplied by the big beef-producing nations such as Australia, Argentina, Brazil and the United States.

China indicated in its 14th five-year plan that it will increase the amount of cool store space available for meat by 70% or 10 million tonnes. It is not known when this extra capacity will be put in place. Extra space may help mitigate risks of supply shortages or they may be looking to build resilience in the face of ongoing political challenges. Or it may be that this additional space is simply required to keep up with their expected lift in demand for imported meat.

BEEF

STORE MARKET SLOW TO KICK INTO GEAR

The store market has been slow to get moving this season. Many East Coast properties that were badly impacted by drought in the autumn are simply not growing the volumes of pasture you would normally expect at this time of the season, despite stocking rates being relatively low.

The resultant lack of feed on hand, combined with fears of another dry summer ahead has kept a lid on store cattle prices. There has recently been a small uptick in pricing for stock in recent weeks but prices still lag behind the levels seen this time last year.

The discount on younger stock is larger than that for older stock. A lack of confidence about having sufficient high-quality feed on hand to grow out younger stock may be a limiting factor, as well as the greater market uncertainty due to the much longer time period required to get this class of stock to processing weights.

The lack of confidence is also playing out in the market for weaner calves. There have been fewer beef-dairy cross-bred calves raised this season as the demand from finishers has been weak. Margins for calf-rearers have also been weak in recent years, which is also a contributing factor.

DEER

SHORT CHILLED SEASON EXPECTED

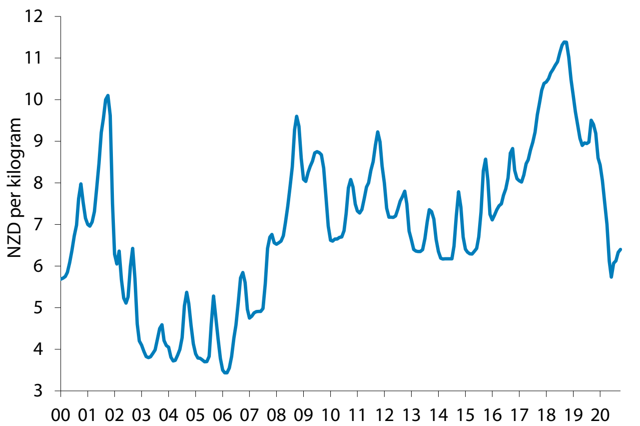
Venison markets continue to be under pressure as opportunities for high-end dining remain compromised in Europe and the United States. Farmgate prices are currently benefitting from premiums available for chilled product, but the chilled production season is expected to be short this year.

Farmgate prices for venison have ticked up a tad, but that is being influenced by the higher returns on offer for chilled product rather than any improvement in the underlying markets.

Meat processors have advised that the chilled season is likely to be short this year, with stock needing to be processed before the end of October in order to reach the European markets in time for the pre-Christmas trade.

This is how the markets have traditionally worked, with farmgate prices dropping considerably once the opportunity to supply the Christmas trade ceases.

FARMGATE VENISON PRICE (60G STAG)



Source: AgriHQ

However, in recent years, ongoing strength in the European markets combined with more product being sold into North America has meant higher prices have been paid for stock well into the New Year. This has allowed stock to be grown out to heavier weights, which has also been supportive of returns. This year it will be back to processing as much as possible early in the season.

The underlying markets for frozen venison remain weak. Dining out occasions in Europe continue to be compromised by ongoing outbreaks of COVID-19. Germany and Italy are the latest countries to report a lift in case numbers. There are also fears that case numbers might lift as the Northern Hemisphere moves into winter.

The low returns on offer have prompted some farmers to take the opportunity to expand breeding herds, and some are now growing out young hinds that may previously have been destined for slaughter this year.

It may take some time for the industry to get fully back on its feet. The industry desperately wants to avoid returning to the boom-bust cycles that have plagued it in the past.

GRAIN

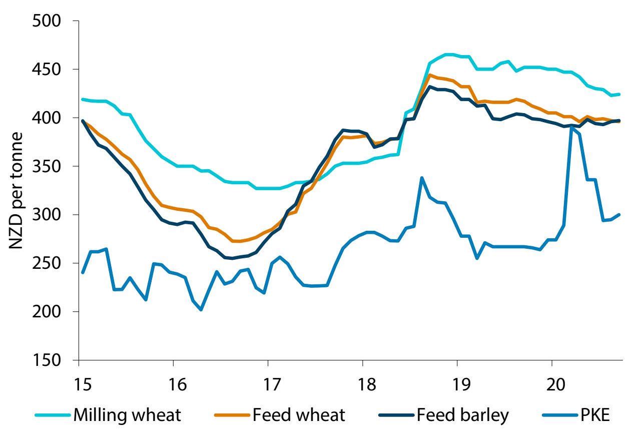
SPRING PLANTING ON TRACK

Arable farmers are concentrating on spring plantings at present. Weather conditions were favourable earlier in spring but the recent cold spell has presented some challenges. On the whole, spring sowing is generally on track but contractors are very concerned about finding sufficient labour for harvesting.

Prices are back on last season for the main cereal crops – wheat, barley, oats and maize. There is renewed interest in planting maize from dairy farmers in order to reduce the risk of a dry summer. Soil moisture levels are lower than normal in many northern and eastern regions.

Spring plantings are generally on track. Warmer and drier conditions through winter and early spring have helped get new-season crops into the ground. However, the patch of cold wet weather (including snow in southern regions) that occurred at the end of September has now delayed some crop planting.

NZ GRAIN PRICES



Source: AgriHQ

SOIL MOISTURE LEVELS LOW

Soil moisture levels are generally lower than normal in the Waikato and further north, and across the eastern regions of both islands. There has been sufficient rainfall to moisten the top of the soil, but further down the soil is still quite dry. Water tables are still very low in some eastern regions, as they are yet to fully recover from the extensive drought earlier in the year. Good snowfall in the mountains will bolster the quantity of water available for irrigation for the Canterbury water schemes that source water from snow-fed rivers.

Peas are going in the ground now, if they have not already planted, as are radishes and some high-value small seed crops such as grass seed and carrot seed.

GOOD DEMAND FOR SMALL SEED CROPS

Demand for small seed crops is very strong and seed companies are continually looking for new ground to plant these high-value crops. Seed companies are now growing a larger portion of these high-value seeds in the North Island, whereas a few years back most of the crops were in Canterbury. The search for new growing regions has been driven by the risk of contamination from other crops, which is reduced by growing in other regions.

MORE MAIZE PLANTED FOR SILAGE

Feed oats are also going into the ground now, while barley will be planted a little later. Maize planting is in full swing in the North Island and is on track despite the recent cold snap pushing some planting back. The area planted in maize grain is expected to be similar to last season as prices are simply not high enough to encourage any expansion. However, more maize for silage is being grown by dairy farmers looking to mitigate the risk of another dry summer. Contract growers have also increased maize silage plantings this year, although the exact area planted won't be confirmed until it is in the ground.

GRAINS

Prices on offer at present for the major cereal crops are all above the long-run average, but have eased over the past year. Wheat prices are about 10% stronger than the 5-year average while feed barley is about 12% higher.

Grain prices in Australia are currently tracking 10- 20% below year-ago levels, depending on the type of grain. Australian barley is now priced at its lowest level in three years due after China's 1 September announcement of a partial ban on imports of barley from Australia after previously hiking tariffs to 80%. China is a major market for Australian barley, accounting for about half of all of their barley exports. Wheat exporters are also concerned about access after China's customs department advised it will apply "enhanced inspection" efforts on shipments of Australian wheat.

FEED GRAINS LOOK MORE ATTRACTIVE

The price of palm kernel expeller (PKE) is on the rise again, while the price of locally produced grains is falling. This may result in some demand for supplementary feed for the dairy industry shifting towards local grain. However, the use of supplementary feed by the dairy industry is expected to ease generally as some farms look to reduce stocking rates in order to reduce nutrient output.

PKE sourced from Malaysia is now 25% more expensive than it was a year ago. Locally, PKE prices are up about 12%, but could lift further. The relatively mild winter and spring (excluding the cold snap at the end of September) means most farms are in a good position in terms of pasture on hand and therefore demand for spot deliveries of PKE is relatively low.

NEW CROPS BEING INVESTIGATED

Hemp plantings are expected to take place from late October onwards. Interest in growing this plant is increasing and new varieties are being developed. It remains a challenging crop to harvest, but techniques are continually being refined. Hemp is one of six crops that have been identified as having potential in a report commissioned by Our Land & Water. Other crops identified in the report include soy, chickpeas, oats, buckwheat and quinoa. All of these crops can certainly be grown in New Zealand, but it may be difficult for local production to compete with imported product on price. The locally grown product would therefore need to have other marketable attributes to make production both environmentally and financially sustainable.

LACK OF MACHINERY OPERATORS

Contractors are very concerned about finding sufficient skilled labour to drive the sophisticated machinery used for planting and harvesting. Harvesting requires the largest volume of labour and typically some roles are filled by Northern Hemisphere workers who work the seasons alternately. Some airline staff have been redeployed into the agricultural industry and training initiatives will help, but the skills required to operate some of these machines can't be learned overnight.

The industry hopes it may be able to attract drivers who have moved into other roles, or moved into semi-retirement, back into the industry. However, there is a real risk that contractors will be faced with some extremely long days harvesting. Long days are normal for the industry – particularly if the weather shortens the harvest window – but working excessive hours for a long period of time is not sustainable.

FORESTRY

LOG PRICES FIRM

Forestry returns have improved over the past couple of months as end-user demand in China and locally has been relatively strong. This has resulted in a lift in log prices. A reduction in the volume of logs being harvested has also supported prices. Working against the sector is higher shipping costs and a strong NZ dollar, which is eroding local currency returns.

STRONG DOMESTIC DEMAND

International and domestic markets for logs have strengthened. Domestic demand for timber for home-building and general construction remains strong despite the economic downturn. Many of the houses currently being built were planned long before the pandemic hit and therefore the current economic conditions have not impacted the decision to build these homes. This is underpinned by the fact that New Zealand still has an accommodation shortage, which will in turn help support demand for timber.

We have also seen funds previously destined for overseas holidays being diverted into home renovations.

Mills have been operating at higher levels than we have seen for some time. Extra shifts have been put on by some operators in order to keep up with demand.

The domestic market for logs is currently very competitive with international market returns.

INTERNATIONAL RETURNS LIFT

The international log market has lifted on the back of increased demand from China. Demand from secondary markets such as India remain weak.

Uptake of logs from Chinese ports has increased. This is not unusual for this time of the year, when construction activity tends to be higher. Temperatures are ideal for working outside, whereas in the hot summer months and very cold winter months, construction activity reduces.

The additional demand from China has pushed prices back to more sustainable levels. Prices for A-grade export logs are now a little higher than they were this time last year, but still about 15% lower than prices were two years ago.

Unfortunately, the higher returns available in China mean it is now again becoming viable to ship logs from South America. This additional source of supply will cap any increase in pricing in the short term, as will the continual supply of logs entering China from the forests in Eastern Europe which are being cleared to limit the spread of spruce bark beetle.

LIFT IN SHIPPING HITS WHARF-GATE RETURNS

Prices at the wharf for logs have been eroded by higher shipping costs. There has been an uptick in demand from China for a wide range of inputs – such as iron ore – and this is putting upward pressure on shipping costs. Delays in getting ships unloaded in Chinese ports is also reducing the number of ships on the water.

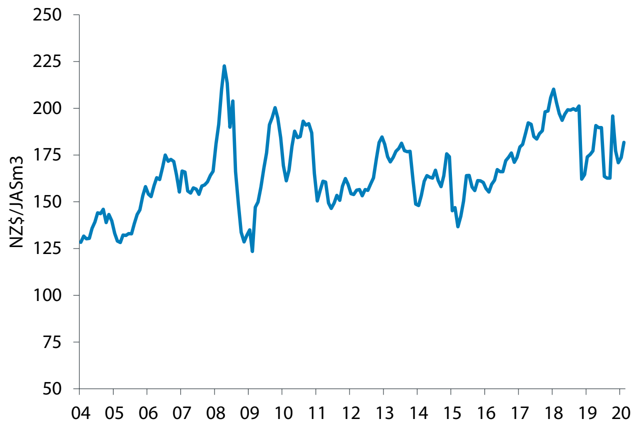
The stronger NZ dollar is also eating into returns in local currency terms. Overall returns at the wharf-gate have still lifted, but certainly by not as much as international returns.

The quantity of timber currently available for harvest has also slowed in some regions, which is also supporting prices. Site access is more difficult during winter, so fewer logs tend to be harvested. However, conditions are now rapidly drying out, which will allow access into more sites soon.

The weaker returns have also meant some smaller lot owners have elected to delay harvest until returns are higher. Harvesting of larger forests tends to continue regardless of the current market price, as for these owners continued supply to markets, income flow and utilisation of machinery and staff have a larger bearing on long-run economic returns than the current price.

FORESTRY

LOG PRICE (UNPRUNED A GRADE)



Source: AgriHQ

CARBON PRICES FIRM

Carbon prices continue to firm, having crept up to just under $35 per tonne CO_2 (NZU). This is close to the fixed price option of $35/NZU. This tends to act as a cap for the market, but there is no reason trading can't happen above this level. But those who have the option of buying at a fixed price of $35 will do so if the market price goes higher.

The current strength in carbon returns certainly makes forestry plantings on farm attractive – particularly where it is suitable to plant forests for both carbon and timber. However, once the carbon revenue is realised the land then needs to remain in trees (trees can be harvested but must be replanted). This limits future changes of land use unless carbon credits are repurchased

HORTICULTURE

LABOUR SUPPLY THE TOP CONCERN

The horticultural sector is extremely worried about finding sufficient labour to pick and pack the new season's harvest. The ability to access critical workers through the Recognised Seasonal Employer (RSE) scheme remains very uncertain and there will be significantly fewer backpackers looking for work this summer.

There is little doubt that more New Zealanders will be employed, but it is extremely unlikely there will be sufficient locals available to fulfil these physically demanding roles. Therefore this is a very high risk that some fruit – particularly summer fruit – won't be able to be picked.

Meanwhile viticulturists have more pressing concerns as they try to assess the damage caused by the recent cold snap. Vineyards without frost protection are expected to have incurred major losses and even those with the ability to fight frost are unlikely to have gotten off scot-free.

APPLES: PICK ME PLEASE

Most growers are fully focused on the season ahead as the apple-exporting season draws to a close. The main concern is finding sufficient labour for the busy harvest period. The industry is lobbying the Government to allow RSE workers back into the country. Many of these workers come from nations in the Pacific that are free of COVID-19 and therefore there is no health risk to letting these workers into the country (although there is a risk of workers carrying the disease back to their home nations).

A decision on whether the RSE scheme will operate this season seems unlikely ahead of the NZ election. If the wheels are put in motion soon after the election workers could be here in time for the main harvest, which kicks off in late February, but they won't be in the country early enough to assist with early-season orchard management tasks.

Even if RSE worker numbers are allowed into New Zealand in similar numbers to last season, the industry will still be severely short of workers given there will be very few backpackers – who have traditionally been a major labour source – in the country.

Apple growers don't currently have sufficient labour to manage early season tasks like thinning. This means the industry will be more reliant on chemical thinning – a process used to stress the tree so that it drops a portion of the fruit it is bearing. This approach means the fruit that are thinned are not able to be selected for quality, resulting in a much wider range of fruit sizes and quality (colour etc) when it comes to harvest. Without hand-thinning, it is therefore likely that the overall value of next season's crop will be negatively impacted.

If there are not sufficient pickers at harvest, then fewer picks of each tree will occur. One reason why the standard of New Zealand fruit is generally very high is because each tree is picked three or four times, with only the ripest fruit being harvested each time. If there is not sufficient labour available, orchards may only be picked once, meaning not all apples will be picked at the optimum time, or a portion of the fruit will simply be left on the trees.

The 2020 exporting season for apples has been reasonable, considering the global economic conditions. But anecdotes suggest that selling fruit in international markets has generally been pretty hard work. As a result, prices received for fruit exported have eased a little, even if the overall level of prices has been reasonable.

Prices in Asian markets were generally a little weaker, whereas prices in the European market were better than expected. Returns for Braeburns in Europe were stronger than the weak prices received at the end of last season.

HORTICULTURE

Despite the lift in Braeburn returns, the area planted in this variety continues to contract as trees are removed in favour of varieties that have greater market potential.

Grower confidence has waned a little. This is partially due to orchard gate returns generally easing – although returns varied, dependent on the fruit variety, quality, timing of sales, and market. The lack of clarity around the RSE scheme has also been a factor.

Access to water is also getting a little more challenging, which may impact some existing growers, but it is more likely to simply limit any change in land use towards apples due to their higher water requirements than some other horticultural uses.

KIWIFRUIT: BIGGER IS BETTER

The kiwifruit fruit industry is in a similar position to the apple industry in terms of uncertainty as to whether they will have sufficient labour to pick and pack next season's crop.

The current season has gone much better than many expected, with very strong prices being achieved in many of the major export markets.

However, there is a clear trend that most consumers prefer larger fruit. Zespri says the optimum size for gold is 27.4, a number calculated based on the number of fruit that fit in a standard tray. The optimum size for green kiwi is slightly smaller at a count of 30.5.

Analysis from Zespri shows that the smaller size of fruit in the 2020 harvest (29.7 count) versus the preferred count size of 27.4 negatively impacted orchard gate returns by 25-35c per tray equivalent.

Zespri is still considering how it will respond to SunGold fruit being grown illegally in China. Options include negotiating commercial arrangements with the existing growers, and/or pursuing legal action. Legal action is difficult to execute on in China without the support of local authorities. Therefore some sort of win-win deal could well be the best path to take.

Kiwifruit markets continue to deliver excellent returns. In terms of pricing, the most valuable markets are Japan, China and Taiwan, with these three countries taking top honours for both gold and green fruit.

China accounts for the largest numbers of gold kiwifruit exported from New Zealand, while Europe continues to be the largest market for green kiwifruit.

In terms of export volumes, the split between gold and green is relatively similar but the volume of gold fruit now slightly exceeds that of green. But in terms of export returns, the higher-priced gold fruit delivers nearly two-thirds of total export returns.

As the kiwifruit export season draws to a close, more reliance will be placed on fruit supplied by Zespri's Northern Hemisphere growers to enable year-round supply for markets. The volume of fruit grown outside of NZ is forecast to increase by about 22% to 23 million trays this year.

VITICULTURE: FROST A MAJOR CONCERN

Harvest labour is also an issue for the wine industry, but the more immediate concern is protecting buds from frost so that there are actually some grapes to harvest.

Vineyard operators have had many sleepless nights in the past few weeks as they battle severe frosts associated with the recent cold snap.

It has been all hands on deck with the numbers of helicopters descending on Marlborough looking more like an airbase preparing for war.

Despite the huge numbers of helicopters, wind machines, water sprinklers and other frost-fighting tools deployed, it was not sufficient to protect all vines due to the severity of the frost. Earlier-flowering varieties such as Chardonnay and Pinot are expected to be impacted the most.

It is too early to know what the impact on yields will be, but it is likely that even some of the later-flowering varieties may not yield as well as they normally do. Vineyards in the Waipara district and parts of the Wairau valley have already reported heavy losses.

It is therefore likely we will see a reduction in the volume of wine produced this season. The reduction in volume is expected to be supportive of prices for grapes that are not already contracted – although there won't be a lot in this situation. It may also support the overall value of this season's vintage.

Wine export volumes were at a monthly record levels in August, putting New Zealand on track to reach record export returns in 2020. There has been solid growth in exports to Australia and the UK. Unfortunately the average prices paid for New Zealand wine exported to these two markets is relatively low. North American markets deliver substantially better returns than either Australia or the UK do.

RURAL PROPERTY MARKET

RURAL LAND MARKET STICKY

The rural land market remains challenging, and the number of properties changing hands remains low. Better-quality properties are still easier to sell than properties that require investment or are located in marginal areas. A lack of access to water is limiting land-use change to higher-value uses in some regions. Water is a key input and if existing rights don't exist or there is a high change these rights won't be renewed, then the value of properties is compromised.

DAIRY CHALLENGES

Dairy land sales remain subdued. There has been a lift in the median price of dairy land traded but this data also includes support blocks, and therefore is not robust enough to definitively say the market has turned. Sales volumes remain low and there remains a distinct lack of confidence in the sector.

Farms with strong productive characteristics such as good soils, located where the weather is favourable for growing quality pasture, good infrastructure, and the necessary consents to farm, are changing hands more readily that those located in marginal areas or where there is a high level of uncertainty as to how the property will be able to be operated in the future.

The areas where the national freshwater regulations will impact dairy farms the most will be winter grazing, nitrogen limits, irrigation rules, and the additional reporting that is generally required. Fencing of waterways is complete on most dairy units, although this may not be the case for run-off and wintering properties.

Dairy farms may be a step ahead of sheep and beef farms in terms of managing nutrient emissions, but are on a similar playing field when it comes to limiting methane emissions. Exactly how this will play out is not yet clear, but it has the potential to add considerable cost to farming operations. Farms with low output, in terms of milk, meat and fibre production, relative to stock numbers are expected to be impacted the most by the GHG emission rules. Inefficient livestock have the potential to become a liability, so to speak.

However, it is not yet clear exactly how the freshwater rules will be applied and the GHG rules remain up in the air. It is this uncertainty which is making it difficult for investors to assess future returns and therefore we are seeing a limited number of farms changing hands.

The number of dairy farms (including support blocks) traded in the past 12 months was half the number that have typically changed hands over the past 10 years.

MORE INTEREST IN HORTICULTURE

The number of horticultural properties traded in the past two years has exceeded dairy properties. Interest in the horticultural sector remains heightened due to returns for apples and kiwifruit being consistently high over the past few years.

While returns may be exceeding other land uses, the risks are also higher, due to the extra capital required to develop horticultural blocks, the relatively long lead time until orchards reach maturity, the precision required to grow high-quality fruit, and the high labour requirements.

As the saying goes – it takes more than just money to develop and successfully operate a horticultural investment.

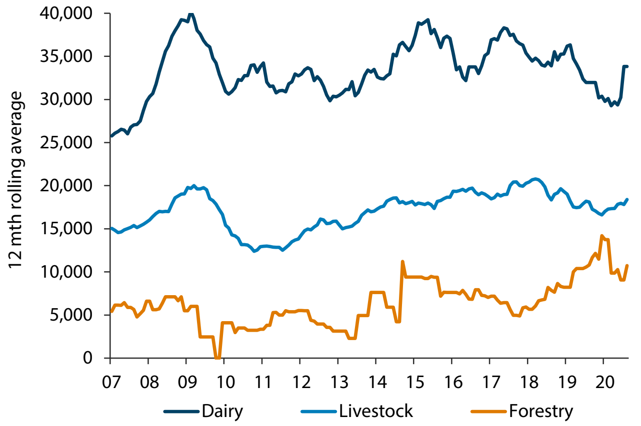
FORESTRY VALUES CATCHING GRAZING LAND

Prices of grazing properties eased from 2015. This was driven more by the downturn in the dairy sector than changes within the sheep and beef sector. Dairy returns have underpinned prices of grazing properties as many of these properties graze dairy stocks as well, or else grow

RURAL PROPERTY MARKET

crops for the dairy sectors. The opportunity to convert grazing properties to dairy farms also drove values up but there have been very few dairy conversions in the past five years.

MEDIAN PRICE PER HECTARE BY SECTOR



Source: REINZ

More recently, the value of some sheep & beef farms has been driven by the opportunities to derive higher returns from forestry than from farming. While there have been some farms fully planted in trees, in most cases, farmers are opting for a mix of trees and grazing on their properties. This allows grazing to continue on the better country and allows a much higher potential return to be realised from the more marginal country. Forestry blocks that have potential income streams from both timber and carbon generally provide the highest returns. However, once the carbon revenue is sold it tends to lock land permanently into trees, as the opportunity cost of changing land use at a future date is likely to be relatively high.

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	105	141	206	↓	↓
	Median Price ($ per ha)	33,838	31,963	33,824	↑	↑
Livestock	Number of Sales	721	856	969	↓	↓
	Median Price ($ per ha)	18,392	18,100	17,278	↑	↑
Horticulture	Number of Sales	145	191	179	↓	↓
	Median Price ($ per ha)	230,818	224,667	181,636	↑	↑
Arable	Number of Sales	83	79	92	↑	↓
	Median Price ($ per ha)	27,744	50,333	35,140	↓	↓
Forestry	Number of Sales	51	48	50	↑	↑
	Median Price ($ per ha)	10,736	10,793	6,913	↓	↑
All Farms	Number of Sales	1,205	1,331	1,502	↓	↓
	Median Price ($ per ha)	23,017	24,775	23,475	↓	↓

Source: REINZ

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