ANZ RESEARCH

AGRI FOCUS

DECEMBER 2021

HIGH PRICES FOR CHRISTMAS

INSIDE

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Publication date: 6 December 2021

Farmgate returns for beef, lamb and dairy produce are extremely strong at present, but unfortunately cost pressures are also rising rapidly. This is particularly tough on the sectors where returns are low, like venison, wool and logs.

Inflation is evident in many parts of the economy, but a lot of our costs of production are increasing even more quickly than the general rate of inflation.

Labour and fertiliser costs have risen dramatically and are affecting many producers. This is particularly the case for horticulture, which relies heavily on these two inputs. Our more extensive sheep and beef farms are less impacted, as these farms have become adept at running large numbers of livestock with very few labour units and fertiliser usage is low.

These cost pressures may dissipate when the impacts of the pandemic recede, but some other costs will be here to stay.

Regulations to protect our environment are continuing to be developed. Compliance costs are skyrocketing as the complexity of the consent process means professional help is often required to lodge consents.

The regional roll-out of rules relating to freshwater is occurring at differing rates. The impact on particular catchments and farms varies considerably, and these differences are reflected in farm values.

Interest rates have firmed as monetary policy is anticipated to tighten further. We see some upward pressure on the NZD in the shorter term but this is likely to be limited by monetary policy tightening offshore.

Prices at farm/orchard level relative to 10yr average		
Dairy	Dairy prices are trending higher and our farmgate milk price forecast has been revised up to $8.80/kg MS for this season, and $8.00 for next season.	Milk price  Low High
Sheep	Lamb returns look set to deliver record returns, supported by strong global demand and limited supply.	19kg lamb  Low High
Beef	Beef prices are benefiting from tight global supply, which is expected to support prices throughout this year.	Prime steer  Low High
Forestry	Log prices have dropped sharply at the wharf-gate level as prices ease in China and high shipping costs erode returns.	A-grade log  Low High

ECONOMIC OVERVIEW

FOOD INFLATION HIGH

New Zealand's economy has performed more strongly than anticipated and inflation pressures are strong; hence the need for tighter monetary policy. The impacts of the pandemic have been very mixed, with some parts of our economy really struggling while others are doing well.

Consumer spending has helped keep the economy afloat during the pandemic. Demand for essential goods like food and housing has been very strong. Food demand is strong globally and this benefits NZ as a food-exporting nation.

But businesses reliant on overseas tourists are facing another quiet summer. The lack of backpackers is being severely felt in our horticultural sectors, which rely on seasonal labour. The labour shortage this season is expected to be even worse than last season.

TAs expected, the RBNZ lifted the Official Cash Rate (OCR) by 25bp to 0.75% in November. This move was widely expected as the central bank looks to try to contain inflation pressures. Markets had well and truly anticipated a lift in the OCR, with interest rates lifting ahead of the release of the Monetary Policy Statement. An even bigger lift was expected by some market participants, but with the economy still relatively fragile, a slow and steady approach to monetary policy tightening is considered a much safer strategy.

The major economic implications of the pandemic for NZ thus far have mainly been associated with our closed borders and the difficulties in moving goods around the world.

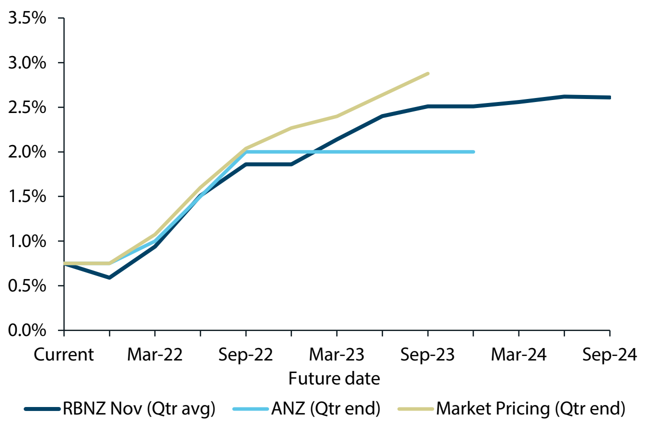
Inflation pressures are huge at present and this is true not only here in New Zealand but also abroad. New Zealand inflation is running at close to 5%. Price rises are evident in most essential goods, with food prices in particular increasing rapidly.

Additional government spending and looser monetary policy have certainly helped the economy avoid the economic recession feared at the beginning of the pandemic. But now with inflation running at 4.9% in the latest quarter and forecast to lift to 6.0%, it is time for tighter monetary policy to rein inflation in.

We expect the RBNZ to continue tightening monetary policy during 2022, taking the OCR up to 2.00%, via a series of 0.25%pts hikes up to, and including, August 2022.

Very short-term interest rates like the 90-day bank bill are expected to lift as the OCR rises to 2.00% over 2022. But with forward interest rate markets already pricing in an even larger rise than that, other key interest rates like the 2-year aren't expected to rise much further.

ANZ FORECASTS AND MARKET EXPECTATIONS FOR THE OCR



Source: RBNZ, ICAP, Bloomberg, ANZ Research

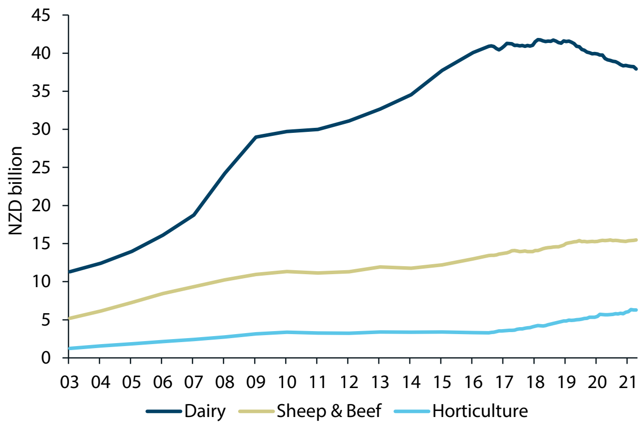
Long-end interest rates continue to be driven by global interest rates – in particular US and Australian bond yields. Neither the US Federal Reserve nor the Reserve Bank of Australia have started lifting their policy rates

ECONOMIC OVERVIEW

yet, but they are planning on pulling back on their quantitative easing programmes. Long-term bond yields have started rising in anticipation of tighter monetary policy. We expect long-term global interest rates to continue trending higher, taking New Zealand long-end interest rates with them.

The amount of debt carried by agricultural businesses has receded a little in recent years. This is particularly evident in the dairy sector. The reduction in debt means these businesses will be better placed to manage the costs of higher interest rates, but there are still a lot of businesses that remain financially vulnerable to rising costs of production.

AGRICULTURAL DEBT BY SECTOR



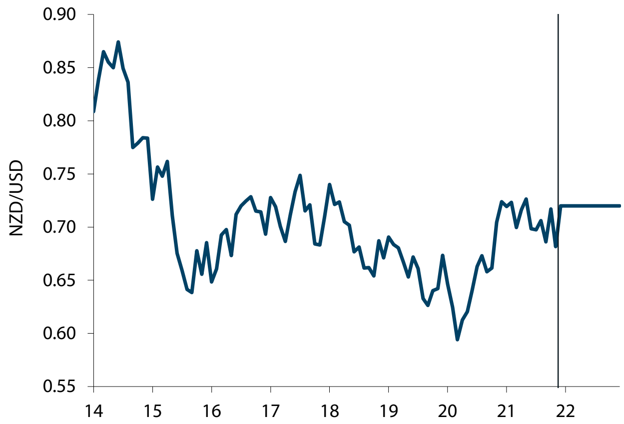
Source: RBNZ

NZ DOLLAR EXPECTED TO LIFT

We expect the NZD/USD will appreciate towards 0.72 before levelling off at this level in 2022. Interest rates are now higher in New Zealand than elsewhere and our terms of trade are rising, which will put some upward pressure on the NZ dollar.

The upside risk to the NZD is somewhat limited by expectation that monetary policy will start to tighten quite quickly in global markets as well. Indeed, even if the RBNZ outpaces other central banks, the fact is, we're a bit player, and USD trends tend to run over any nuance in their path. This has certainly been the case recently.

NZD BUYS USD



Source: Bloomberg, ANZ Research

FOOD PRICES ON THE RISE GLOBALLY

Food prices are lifting globally and this trend is expected to persist. As a food exporter we benefit from this trend through higher prices for the commodities we export.

Higher food prices are partially a function of restricted labour mobility, as a lot of food produced globally relies to some extent on imported labour. The lack of access to immigrants has pushed up labour costs.

High energy costs are also a component and we are seeing this in the massive increase in fertiliser costs. This has pushed up the cost of producing virtually all types of food.

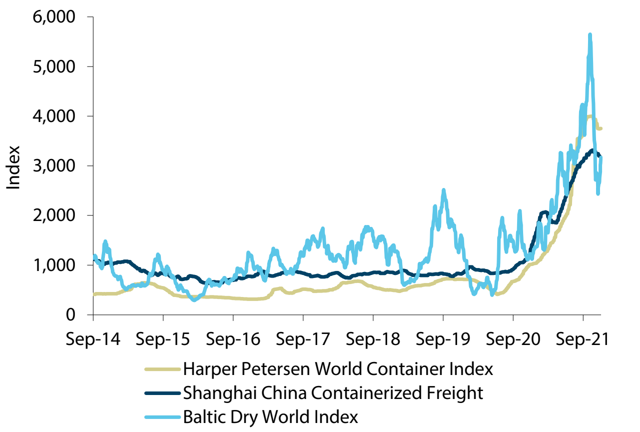
SHIPPING COSTS MAY MODERATE

High shipping costs are also a major factor for goods that are traded globally. The cost of moving goods around the world is currently about three or four times greater than it was prior to the pandemic. There is evidence that global shipping costs may have peaked, but it could take another 18 months before prices stabilise – at levels expected to be higher than prior to the pandemic.

Increasing environmental awareness and costs associated with mitigating environmental impacts of food production are another major factor that is impacting the cost of food production in many countries around the world.

Locally we are seeing much tighter regulations to mitigate the negative impact agricultural and horticultural production can have on water quality. All farms and orchards will soon be required to have environmental plans detailing how farms will be managed to mitigate risks of degradation of water quality. Ideally these plans should also take a more holistic approach to also address other management practices including greenhouse gas (GHG) emissions, animal welfare, health & safety, and financial risks.

SHIPPING COST INDICES



Source: Harper Petersen & Co., Shanghai Shipping Exchange, Baltic Exchange, Bloomberg, Macrobond, ANZ Research

PAYING THE COST OF EMISSIONS

Recently He Waka Eke Noa released a paper that provided some information about how the agricultural and horticultural sectors will pay for emissions.

The paper lacked the detail most farmers are waiting for and more information is expected to be released in February, when consultation on this topic will commence.

The paper made it clear that they are still debating whether emissions should be accounted for at the farm or processor level.

Accounting for emissions at the processor level will be a lot cheaper and easier to administer, with most of the burden of managing the scheme falling on the processors. The main reason why this solution has not been favoured to date is that it is unlikely to provide farmers with direct price signals that encourage on-farm solutions to be developed to mitigate GHG production.

It has long been argued that accounting for on-farm emissions at the processor level will simply be a tax that will result in lower farmgate returns. But this really depends on how processors decide to allocate these costs amongst their suppliers.

It is certainly possible for processors to provide differentiated price signals to their suppliers. We are starting to see evidence of this already, with several processors paying different rates for farm produce on the basis of how it was produced, rather than simply the quality and quantity produced.

Dairy companies are generally in a better position than the meat companies to differentiate pricing at the farmgate level on these metrics, as they tend to hold a lot more information about the on-farm practices of their suppliers.

Monitoring GHG emissions on sheep and beef farms is complex, particularly where farms are regularly trading stock, and there is a lack of uniformity between livestock and management practices.

Under either accounting method there is provision for recognising the sequestration that is occurring on-farm from plantings that are not recognised under the Emissions Trading Scheme (ETS). This includes indigenous regenerating forests, riparian planting, shelter belts, perennial cropland, non-NZ ETS eligible woodlots/tree lots, and scattered exotics. Different methods would be used to calculate sequestration, depending on the vegetation type. This also potentially lays the ground work for soil carbon sequestration to be recognised at a future date when there is sufficient scientific evidence.

Initially the agricultural sector is expected to pay only 5% of their emissions costs, but this portion could quickly increase over time. It can be argued that paying just 5% will not actually achieve the desired outcome of encouraging a reduction in methane emissions, but the counter-argument to that is that there is still a dearth of viable means by which to reduce emissions other than simply reducing production.

Striking a balance that provides a clear incentive to reduce emissions, but doesn't severely impact the financial viability of our farming industries, is going to be a challenge. In particular, emissions prices are directly linked to the price carbon is trading in NZ, which is currently rising at an astonishing pace.

Click here to access our latest forecasts.

MILK PRICES HIGH...BUT SO ARE COSTS

Global markets continue to deliver strong returns, supported by relatively tight global supply. The above average returns for dairy commodities combined with a stable NZ dollar provide reason for cautious optimism for farmgate returns.

As a result we have revised up our milk price forecast for the current season, and are also forecasting strong returns will persist into the 2022-23 season. But unfortunately the value of a high milk price is being eroded by massive increases in on-farm costs.

DDairy commodity prices continue to increase, but there has not been the lift in supply that is typically associated with stronger dairy prices.

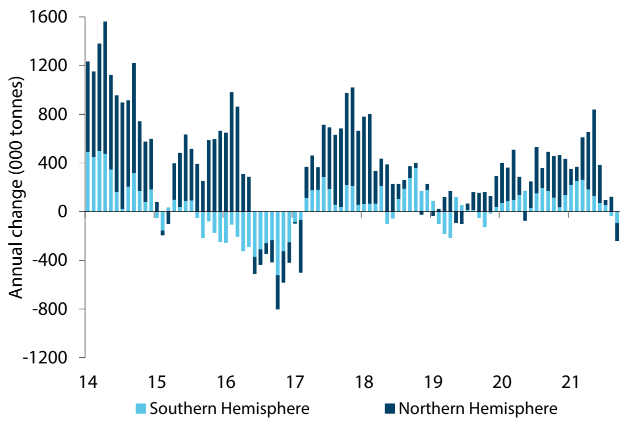
While pasture-based dairy farms take several years to respond to price signals, the grain-fed farms in the Northern Hemisphere have the ability to turn on the milk tap pretty quickly by adding more feed.

But we are not seeing the normal supply response due to environmental pressures, labour shortages and high grain prices.

The lack of growth in milk output is occurring in all of the main dairy-exporting regions. This tightening in supply is helping keep dairy commodity prices elevated.

Global demand for dairy products remains steady. The key risk for ongoing prices is a reduction in demand from China. This could occur due to either consumption falling or domestic milk production rising. There is some evidence the latter is occurring, but China will always be a very expensive place to produce high-quality milk and therefore will remain reliant on imports. There is certainly a risk that consumption could fall as economic growth in this market slows. So far demand for imported product remains robust but the main buying period, which coincides with delivery in the lower-tariff period at the beginning of the year, has now finished. This may mean we see some of the buying urgency dissipate from this market in the coming months.

MILK PRODUCTION – MAJOR DAIRY-EXPORTING COUNTRIES



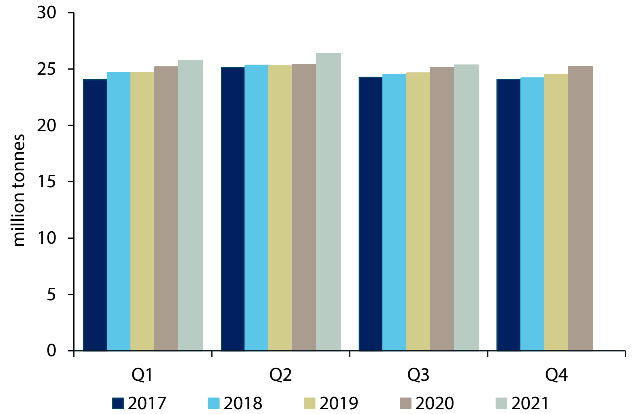
Source: DCANZ, Dairy Australia, USDA, Eurostat, CLAL, ANZ Research

PRODUCTION GROWTH EASES IN US

Milk production in the US grew rapidly during the first half of 2021 but this momentum has fallen away during the second half of this year. High grain costs have resulted in feed being eased back and this has slowed milk output. Milk production in October was less than October 2020 and this trend is expected to persist through to the end of the year.

DAIRY

US MILK PRODUCTION



Source: USDA

CONSOLIDATION PHASE

New Zealand's dairy industry is now entering a consolidation phase. Virtually no land-use change towards dairying has occurred in recent years, but some land previously used for dairying has now been converted to other uses.

Milk production during the peak production month of October was 3.1% less than during the same month last year and 4.2% below the volume produced in October 2018. October production tends to provide a relatively good indicator of growth, as at this time of the season milk output is usually less constrained by pasture production, as there is normally a surplus of feed available.

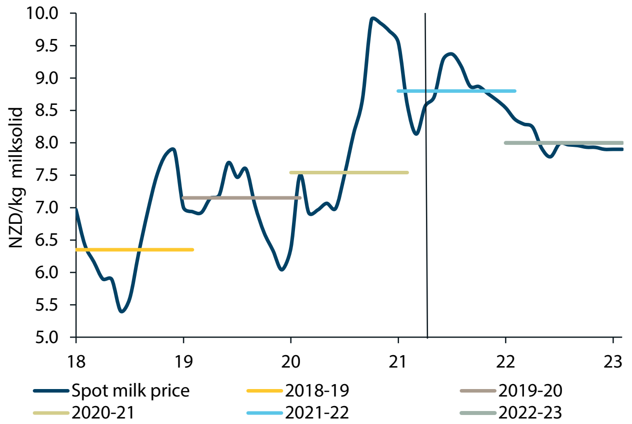
Dairy farms are starting to de-intensify as the use of supplementary feed and fertiliser is starting to be reined in.

Rapidly changing environmental rules designed to mitigate the negative effects of intensive farming practices are limiting intensification on our dairy farms. Changing land-use practises to dairying is now an extremely challenging, and highly consented, process that is unlikely to be granted in most regions.

Labour constraints are also leading to more farms considering reducing their milking frequency earlier in the season than normal, ie milking once a day from Christmas, or simply reducing stock numbers to make the farm easier to manage.

So while we are now forecasting a record milk price for this season of $8.80/kg MS (see milk price update for more details), and Fonterra has also revised up its own milk price forecast for this season to $8.40 - $9.00 (midpoint $8.70/kgMS), the challenge will be to keep costs under control, so that some of that additional revenue is available for debt servicing or investing elsewhere.

FARMGATE MILK PRICE

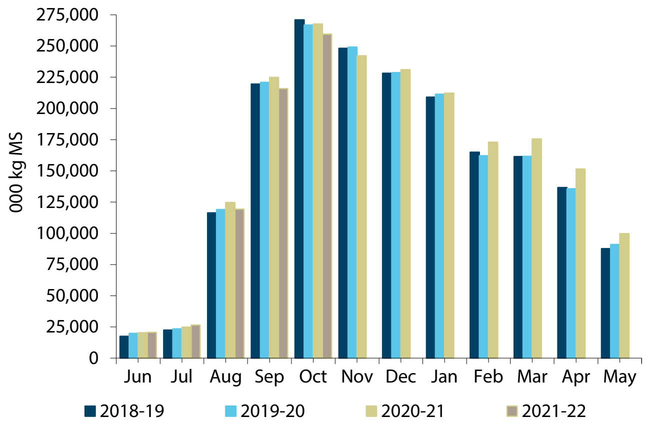


Source: Fonterra, NZX, ANZ Research

This may not be easy to achieve when costs are spiralling upward. Labour, fuel and fertiliser costs have all lifted substantially this season. Some of these increases are pandemic related, such as the high freight costs, but some of these costs reflect underlying trends.

Environmental costs are rising and this is impacting costs of production – not just here in New Zealand but in many other countries as well. We are on a journey to improve our environmental performance and our various regions, regional councils, and individual farms are taking slightly differing paths, but the pace of change is picking up. Regulations are generally more stringent for dairy and dairy support farms than other land-use types.

NZ MILK PRODUCTION



Source: Fonterra, ANZ Research

DAIRY

Many activities now require consents and the consenting process can be quite arduous and costly. Therefore it's very helpful that farmgate milk prices are expected to remain at elevated levels next season.

We anticipate an $8 milk price for the 2022-23 season. While the level of accuracy in forecasts made this far out is not high, at present the outlook for the milk price does look positive due to the supply constraints.

Fonterra are anticipating collecting 1525 million kg MS this season, which is about 1% less than last season. For this to be achieved production will need to improve in the latter half of the season. Milk production has been slow during the first half of the season (June – Oct) with Fonterra's NZ milk intake down 3.2%. This is a smidgen lower than total NZ milk production, which has reduced by 3.1%.

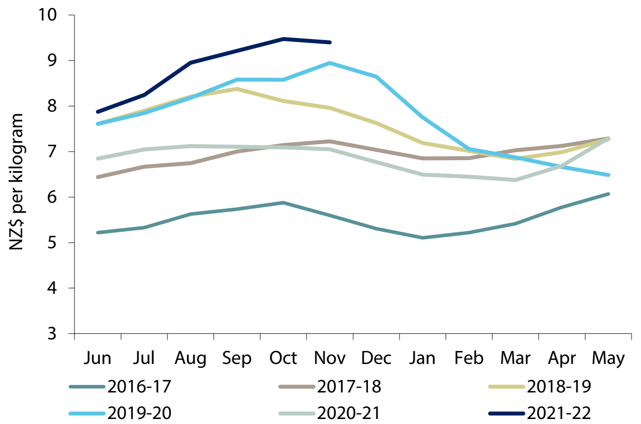
LAMB & WOOL

RECORD PRICES

Farmgate returns for lamb are just starting to ease as more stock become available. International prices remain strong, and record average returns at the farmgate level, are expected to be delivered this season. Mutton prices continue to soar, supported by low supply, but coarse wool prices remain weak.

Processing on new-season lambs is getting underway but it has been a slow start to the season. Poor growing conditions and low pasture covers going into winter resulted in a challenging spring in many regions. The surplus of pasture arrived a little later than normal and this has kept lamb growth rates in check.

LAMB FARMGATE RETURNS (19 KG LAMB)

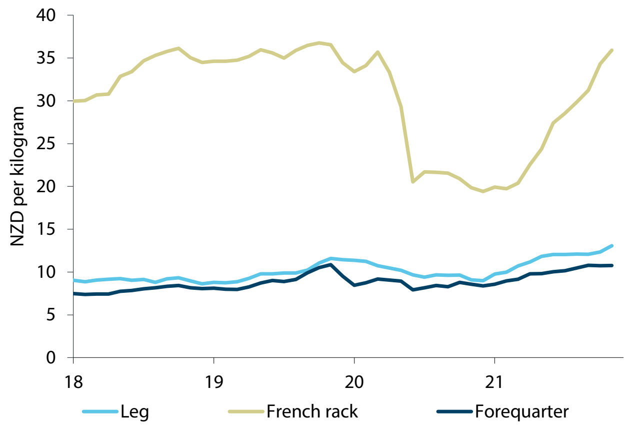


Source: AgriHQ

Schedule prices are still very high, sitting at, or above, $9/kg CW, with stronger prices being paid in the North Island, as is typically the case. Prices are about $2/kg stronger than was being paid at this time last season.

There is no doubt that prices will recede from here as more lambs become available, but overseas prices are strong. Restaurant demand for lamb is gradually improving, but this is still fluctuating based on confidence and lockdowns measures imposed.

LAMB CUT PRICES



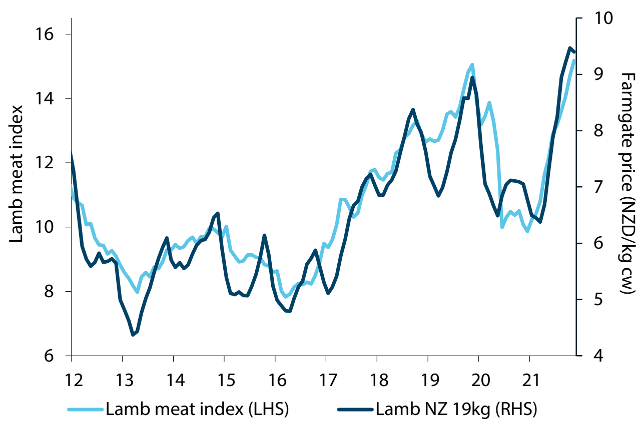
Source: AgriHQ

The price of French Racks has just about recovered to pre-pandemic levels. And at the same time, the price of the lower-value leg and shoulder cuts have also lifted. This puts overseas returns for lamb at record levels.

It also shows that the current farmgate prices are supported by international returns, although it is clear there is a little procurement pressure at work at present too. What is less clear is the impact that the higher shipping costs and freight disruptions will potentially have on farmgate returns.

LAMB & WOOL

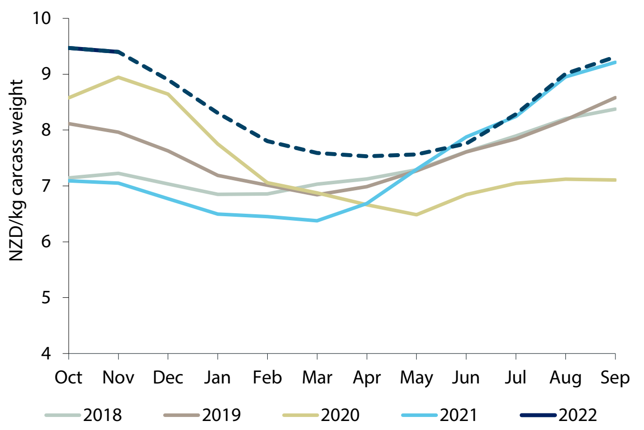
FARMGATE PRICES VS INTERNATIONAL MARKET PRICES



Source: AgriHQ, ANZ Research

International prices are expected to remain firm this season. This is largely due to limited supply available and ongoing strong demand from China for red meat. These factors could change at some point, but this season still looks on track to deliver record average farmgate prices for lamb.

FARMGATE LAMB PRICE TREND AND FORECAST



Source: AgriHQ, ANZ Research

AUSTRALIA STILL IN REBUILD MODE

Australia is still in flock-rebuild mode. Sheep numbers are now back to 2019 levels but further expansion of flocks is limiting the quantity of ewes being culled and a larger number of ewe lambs are being retained as replacements. This is limiting the quantity of stock available for processing.

Meat & Livestock Australia (MLA) expect 21.8 million lambs to be available for processing in the year to June 2022. That is about 6% more than the previous season but still about 1 million less than normal. Meanwhile, the number of ewes being processed remains very low as more sheep are being retained to rebuild herds.

Overall the number of sheep being processed in Australia remain supportive of prices this season. The Australia-UK trade agreement will result in much better access for Australian lamb into the UK once the agreements are ratified (see Insight paper). NZ has not really had to compete with Australian lamb in this market. This is not really a concern in the short term, but additional competitor activity in the market may have longer-term consequences.

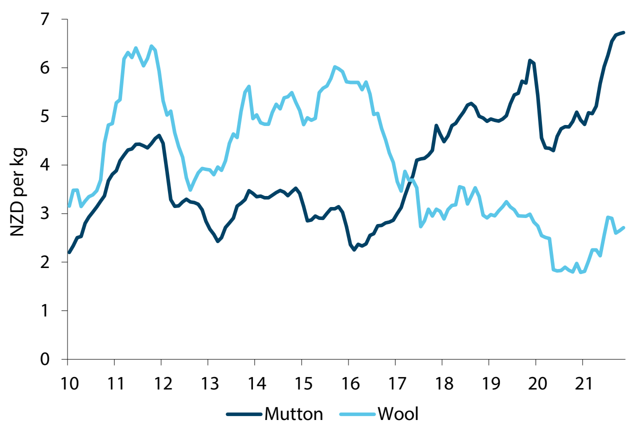
The volume of lamb currently being exported from Australia did lift earlier in the year but is now falling away rapidly. Some meat-processing facilities are running at reduced capacity due to COVID-19 related disruptions, but a lot of the reduction in exports is simply due to less stock being available.

Mutton prices in Australia keep climbing – driven up by the limited supply. Meanwhile the price of lambs traded in the yards has started to slip back but is still high.

MUTTON SUPPLIES LOW – PRICES HIGH

Supplies of mutton from both NZ and Australia have been curtailed this year. This has been very supportive of prices both in the international market and at the farmgate level.

FARMGATE MUTTON PRICE



Source: AgriHQ

LAMB & WOOL

Virtually all of our mutton is sold to China as they value the stronger taste and see value in the larger cuts. This indicates there may be an opportunity to develop this market further for sales of hogget meat.

The farmgate price for mutton, on a per kg basis, is now nearly at the level we were receiving for lamb at this time last year, and higher than it was during the peak processing months. It certainly makes it worthwhile considering fattening up those ewes before culling. That said, many parts of the east coast are now rapidly drying out so reducing stocking rates as quickly as possible is also an important consideration.

WOOL FIGHTING TO DELIVER DECENT RETURNS

Unfortunately wool prices have moved in the opposite direction to the mutton prices in recent years. Wool prices did improve a little earlier this year before easing again. The latest North Island auction did see prices improve again but they are now expected to bob along near current levels for a while.

There are plenty of good initiatives underway that should result in improved returns for wool, but they are yet to really deliver. For now, shearing sheep remains a net cost and in this sort of environment it is difficult to encourage changes to farming practices required to consistently produce higher-quality fleeces.

Good-quality wool remains in demand. The last of the Merino wool offered sold well at the recent Christchurch auction. Finer-grade hogget wool is also being sought by buyers, but there remains limited appetite for coarser wools. This is unlikely to change as pre-Christmas shearing brings larger offerings to the market again.

BEEF PRICES CLIMB

Beef prices in international markets continue to climb and are now knocking on the door of the levels reached in late 2019.

At the farmgate level here in NZ, beef prices have held at elevated levels for the past month. Limited throughput in the processing plants has also helped to keep prices high.

HIGH GLOBAL PRICES

International prices for beef remain strong. The US price for imported beef is very close to the level it was in late 2019 when there was fierce bidding between the US and China for our beef offerings.

The situation is similar again with international market pricing being supported by relatively small offerings. There is less beef coming out of South America – partially due to the previous level of culling being unsustainable. Also the ban by China on importing beef from Brazil. Brazil was by far its largest supplier, accounting for nearly half of the beef that China was importing.

The rebuild of Australia's cattle herd has reduced the volume of beef being exported from this market. Australia tends to be our most direct competitor in international markets, but with so little beef available globally there is little need to focus on competitors.

The US is exporting more beef this year, but this tends to be grain-fed beef, which is positioned in a different market segment to the grass-fed beef produced in NZ. Grain prices are very high this season, which has pushed up the cost of producing beef.

In the US market, the price consumers are paying for beef has risen by 20% over the past year. This is a much larger increase than seen for the price of other proteins such as chicken, fish and pork, which have risen by 9 to 14%. The high cost of beef does mean it is at risk of being priced off the menu at fast food outlets, or at the least these outlets will be pushing their chicken burgers ahead of beef burgers due to the higher profit margin.

But at this point demand for imported beef is not letting up in the US market. Similarly, demand from China is very strong as they look for alternative sources to the beef they had been sourcing from Brazil. More US beef is also entering China, now that trade relationships are more amicable, but given US beef was shut out of this market for so long it is taking time to build market share.

There has also been more US beef exported to other Asian markets such as Japan and Korea. These markets tend to rely quite heavily on supply from Australia, and with supply from Australia lower than normal this has provided an opportunity for more US beef to enter this market.

MORE MARKET OPPORTUNITIES

Over the past decade our export markets for our beef products have changed from having one large market (US) and several smaller markets (Japan, Taiwan, South Korea, Indonesia), to now being primarily focused on two large markets: China and the US. We have become much less reliant on the US market but more reliant on China as our focus on other Asian markets has drifted.

Looking forward, when the NZ-UK free trade agreement eventually comes into play (which will hopefully be some time in 2022), this will also provide an opportunity to sell beef into this market. We have always had concessions for lamb, but not beef, and currently excessively high tariffs keep NZ beef out of this market. Given many of our lamb exporters also export beef, this provides a new market opportunity. NZ is not a large exporter of beef in a global sense, but as we look to increase returns rather than increase volumes, we may want to further reduce our reliance on the US hamburger market. While there are also plenty of opportunities within the US to sell higher-

BEEF

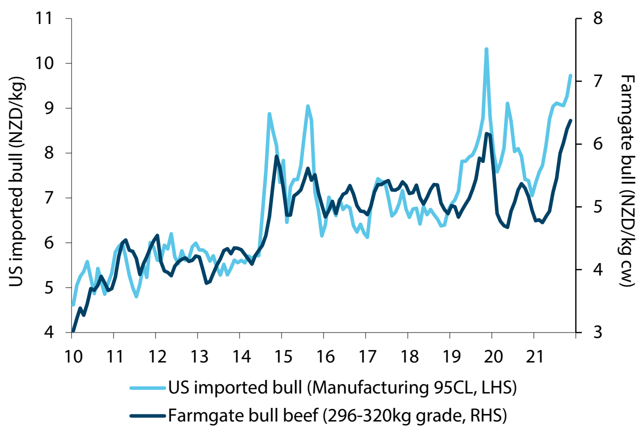
value produce, most of our beef sold to this market is simply blended with local product and used to produce burger patties. This is the type of market that is most likely to be disrupted by lab-grown meats, if they can reduce their cost of production, and alternative proteins.

Therefore it may be wise for exporters to continually look for new market opportunities where consumer values are aligned with the direction NZ farming is heading in.

FARMGATE RETURNS STRONG

This extreme strength in global markets combined with low throughput of stock has kept farmgate price elevated for all grades of stock. When throughput at the processors is low, you can expect higher than normal prices to be paid. And international prices are more than strong enough to justify the current farmgate prices.

FARMGATE BULL BEEF PRICE VS OVERSEAS MARKET PRICE



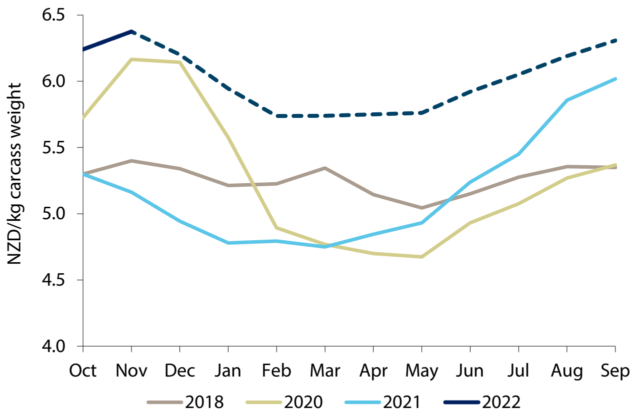
Source: AgriHQ, ANZ Research

At this stage it looks like farmgate returns for bull beef across the 2022 season (to 30 September) will average near $6/kg CW. If achieved this will be a record level.

Demand for cattle is high as farmers fight to keep pasture under control as growth rates accelerate. However, the extremely dry soil conditions in some east coast regions are keeping a lid on store stock pricing. Soil moisture levels are lower than normal in the Wairarapa, Canterbury and some parts of Otago.

Older cattle that can be finished quickly are highly sought-after, but as usual there is less demand for younger cattle.

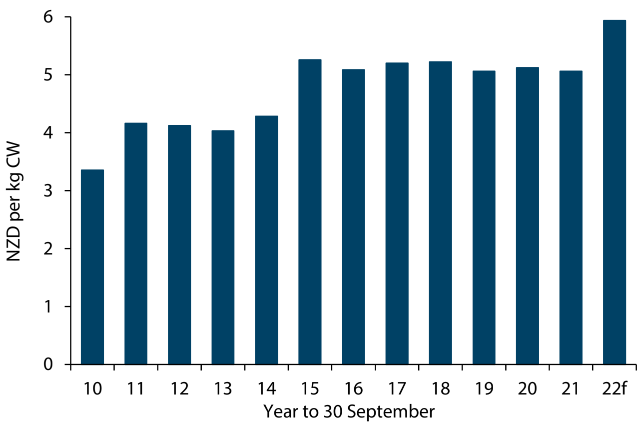
FARMGATE BULL BEEF PRICE TREND AND FORECAST



Source: AgriHQ, ANZ Research

We do expect farmgate prices for cattle to ease from their current levels, but so long as international prices remain strong and the NZD stays in check then farmgate prices will still be higher than the levels seen in recent years.

AVERAGE FARMGATE BULL PRICE



Source: AgriHQ, ANZ Research

Beef returns averaged across the season have been very stable in recent years compared to returns from other industries. This has been one of the main attractions of farming cattle, compared to sheep, along with the lower labour requirements. But as environmental regulations relating to nutrient runoff and water quality increase then sheep may come back into favour – particularly on properties where it is deemed necessary to fence waterways but it is challenging to do so.

FARMGATE PRICES HOLDING

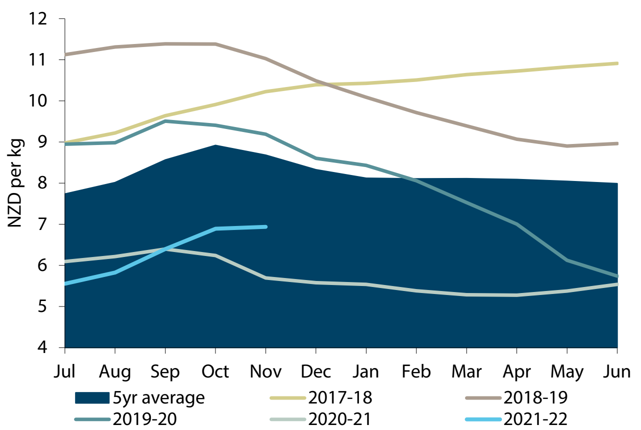
Venison returns eased a little as the production season for chilled product drew to a close. However, the reduction in returns at the farmgate level was much lower than normal, as demand for frozen product remains robust in our major export markets.

Velvet returns have lifted this season, driven up by strong consumer demand for healthy products. Overall the outlook for deer farmers is improving but venison prices still need to lift further to compete with returns for lamb.

The farmgate price for venison has eased a little since the season for chilled production ended but hasn't fallen away as quickly as usual. There is some confidence that prices will be able to be maintained near current levels.

While returns are still much lower than seen previously, this is a big improvement on last season's prices.

VENISON FARMGATE PRICES



Source: AgriHQ, ANZ Research

GAME SEASON GOING WELL

SSales of venison in the traditional European markets are going reasonably well this season, despite ongoing outbreaks of COVID-19 in these markets. This means the stocks of frozen venison that have been held in-market are now being worked through, resulting in increased demand for additional supply.

Promotions of NZ venison in Germany, UK, Belgium and Sweden have helped drum up additional demand.

During the pandemic, a lot of effort was put into developing retail sales channels both in Europe and the US. This strategy is now starting to pay dividends.

The upside is that farmgate prices for venison have only just slipped under $7/kg CW and may not fall much further as the season progresses. Prices usually tend to fall away once the supply period for the lucrative Christmas trade ends. Sometimes this trade is able to be extended by airfreighting product to market, but getting space on planes is very difficult at present, so most of the venison currently processed is being frozen. Some restaurant chains now see frozen product as a more flexible option as it is very difficult to predict demand at present when COVID-19 related restrictions regularly limit patronage.

VELVET PRICES LIFTING

Prices for velvet have lifted 10-15% from the end of last season. Consumer demand for products containing deer velvet remains very strong.

Throughout the pandemic consumers have been seeking products that have perceived health benefits. This has resulted in strong demand for velvet, which is deemed to boost immunity.

Wholesaler demand has also been bolstered by importers looking to stock up so they don't run short of product should shipments be delayed. Freight issues remain a major challenge for both exporters and importers.

GRAIN

GRAINS POSED FOR FURTHER LIFT

Grain prices are rising both in our local market and in international markets. Tighter-than-normal supplies are pushing prices higher.

There are very limited quantities of grain available at present locally, and imported grain is very expensive and not easily sourced.

The most recent Arable Industry Marketing Initiative (AIMI) survey, undertaken in October, indicates that there is less than half the volume of cereal grains available now than there was at this time last year.

Stocks have been quickly run down since winter and now there is very little grain on-farm that is not already accounted for. Last season there was about 7% less grain harvested than the previous season. This was due to a number of factors that resulted in a smaller area of grain harvested and lower yields.

MORE LAND DEDICATED TO GRAIN

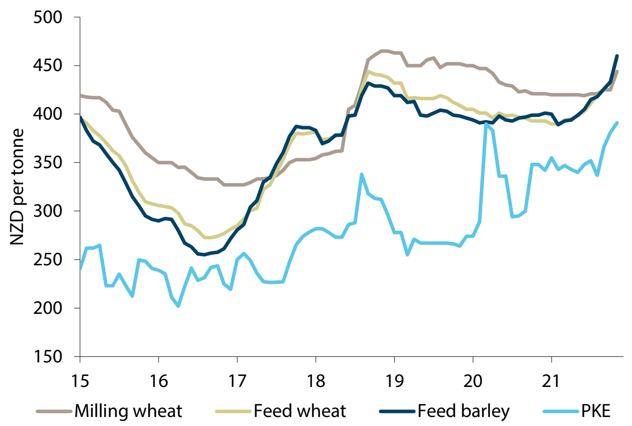
Looking forward, the 2022 grain harvest is expected to be considerably larger. The area intended to be sown this season is 7% greater than last season and 4% more than two years ago.

The area dedicated to feed wheat, feed barley and feed oats has increased this season, while there has been a trend away from the high-value crops intended for human consumption. Last season's debacle with milling wheat contracts has limited the area of land intended for milling wheat this season.

Grain prices have lifted in our local market as a result of the tighter supply, but prices haven't risen as much as international prices. This is partly due to our own grain market operating in relative isolation. The larger users of grain usually source a portion of their requirements from overseas, whereas the smaller users tend to buy from local sources – particularly those in the South Island, where most of the grain is grown.

Feed grain prices are now about 10-15% stronger than they were a year ago, but there are quite large variations depending on the crop and the region.

NEW ZEALAND GRAIN PRICES



Source: NZX

Locally produced milling wheat is still priced lower than similar imported product. High freight costs have made importing grain much more expensive this year.

The sharp lift in production costs, particularly fertiliser and labour, will be impacting margins for arable producers. Nitrogen fertiliser prices have lifted about 65% over the past year. Fuel costs have also shot up, and it is extremely difficult to find skilled labour to drive machinery such as harvesters.

These cost pressures, along with the high global prices for grains, indicate we should see further upside pressure on local grain prices.

GRAINS

The tightness in the market is reflected in the portion of the new season harvest that has already been forward sold. As shown in the table below the portion of the harvest that was already contracted by October this year was considerably higher than last season.

NEW SEASON HARVEST FORWARD SOLD

Crop	2021 harvest	2022 harvest
Milling wheat	46%	50%
Feed wheat	37%	53%
Malting barley	41%	84%
Feed barley	29%	46%
Milling oats	74%	97%
Feed oats	66%	51%
Total	37%	53%

*Portion of new season harvest forward sold as at the prior October, ie 2022 harvest = October 2021

Source: AIMI, ANZ Research

NOT A CHEAP ALTERNATIVE

Palm kernel expeller (PKE) is no longer a cheap alternative feed source. The cost of palm kernel expeller has shot up to about $390/t. The cost increase is mainly due to higher costs of sourcing this product in Malaysia, rather than the elevated costs of shipping.

Demand for PKE has been steady as farmers look to fill gaps in pasture production this spring. But the use of this product is now much more closely scrutinised by processing companies, meaning it is also likely to be used in a strategic manner going forward rather than being part of the diet on an ongoing basis.

GOOD RETURNS FOR AUSSIE GROWERS

A bumper wheat harvest, combined with record prices, has bolstered returns for Australian arable farmers. The quantity of wheat harvested this season is expected to be near record levels.

Unfortunately, the quality of the grain harvested in Australia over the past month has not been as good as initially expected due to heavy rainfall plaguing the harvest. Protein levels are lower than normal, which will reduce the quantity of high-quality wheat available but increase the volume of grain that is downgraded to feed grade. At this point it is estimated that 15-20% of the crop may be downgraded.

Prices for milling-grade wheat have now tightened further due to the expected shortage of high-quality wheat coming out of Australia. Global demand for feed wheat is extremely strong at present, so although there is now more feed grade wheat available this is not expected to negatively impact prices. But the spread between top grade and feed grade wheat has widened considerably in Australia.

This year the world is more reliant than ever on a good harvest from Australia, due to less wheat being produced in other parts of the world. World production of wheat is expected to fall while robust demand is expected to result in stocks being reduced. Production in the Black Sea region has been compromised by drought, as has production in Canada and parts of the US.

Therefore the news that Australia's crop of high-grade wheat is lower than expected has pushed up international prices. The excess wheat that has been downgraded to feed grade will also be readily purchased, meaning the price of imported grains will remain high and will be somewhat supportive of higher prices for locally produced grain as well.

RETURNS ERODED BY SHIPPING COSTS

Log returns at the wharf-gate levels have dropped as excessively high freight prices erode market returns.

The export log market is highly exposed to China and also to movements in freight costs, due to logs being such a bulky commodity. These factors have worked against exporters, but there is some light at the end of the tunnel.

PRICES EASE

In-market prices have eased and freight prices have moved significantly against exporters in the second half of this year. This has resulted in a slowing of the harvest and reduced pressure on exporters, which has resulted in freight prices starting to ease. The question is whether the freight prices will remain low as export volumes increase.

UNPRUNED A-GRADE IN-MARKET PRICE

Source: AgriHQ

The combination of lower prices in China and high freight prices mean returns for export-grade logs at the wharf-gate dropped well under NZ$100/JASm^3. This means returns are lower than they were at the beginning of the pandemic.

In-market log prices within China have dropped by perhaps as much as 20% in recent months, but there is a lot of variation in pricing in the market at present.

The well documented slowdown in property development in China – due to financial vulnerabilities – has resulted in more caution from Chinese log importers. But stocks of logs within China are not really growing, despite off-take from the wharves slowing.

This is mainly because of a reduction in volume of logs being supplied from New Zealand. This does mean demand and supply are relatively balanced, which bodes well for an improvement in market prices in the near future. But any recovery will be highly dependent on demand within China.

FREIGHT COSTS PROHIBITIVE

Freight prices shot up this year but have since moderated somewhat. The elevated cost of shipping logs means a smaller portion of the in-market return makes its way back to our shores.

There are some indications that freight prices in general are easing. The Baltic Dry Index fell 50% from early October to mid-November but has since crept up a little. And a number of indices that measure the cost of moving containers around the world have also eased a little in November.

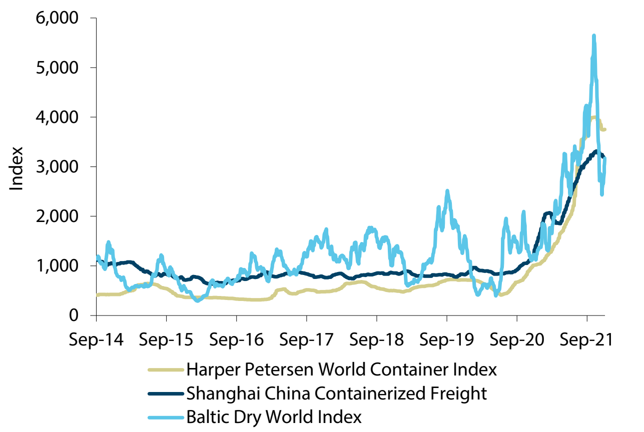
However, freight prices are bobbing around and could certainly rise again, particularly if Omicron – the latest variant of COVID-19 – results in labour shortages at key ports.

Overall we can expect freight costs to remain higher than normal for at least the next 12 months.

FORESTRY

The cost of moving a log from New Zealand to China peaked at about US$75/JASm^3 but looks to have now eased to about US$65/JASm^3. Prior to the pandemic shipping costs were under US$20/JASm^3, so they increased nearly fourfold. The price Chinese importers have been paying for logs is currently about US$150/JASm^3, meaning shipping costs now account for half the value of the log.

FREIGHT INDICES



Source: Harper Petersen & Co., Shanghai Shipping Exchange, Baltic Exchange, Bloomberg, Macrobond, ANZ Research

EUROPEAN SUPPLY TO CHINA EASES

The volume of logs being exported from eastern parts of Europe to China has eased in recent months but this is still a major supply source for China.

Meanwhile the price of lumber sourced from North America has sharply lifted again, after severe flooding in Canada temporarily closed mills. Exports of lumber and pulp from Canada are expected to be curtailed for some time while roads and railway tracks are repaired.

DOMESTIC PRICES ALSO EASE

Prices being paid for logs by mills supplying the local timber market have also eased. The local mill prices do tend to follow the lead of the export markets, but contracts for supply tend to review pricing on a quarterly basis.

Prices being paid for logs supplied during Q4 have tended to be lower than those supplied during Q3, when mills had to compete with elevated wharf-gate returns.

Construction activity in NZ has slowed despite strong demand for housing and new house builds. Issues accessing supplies are slowing the building process, and many builders are now working on multiple projects to keep their staff busy whilst they wait on supplies.

FELLING SLOWS

There has been a reduction in felling activity locally due to the reduction in returns. Owners of large-scale forests tend to continue with their harvesting regime regardless of spot market prices, because there are also costs associated with slowing harvest, and often the logs they are supplying are contracted and therefore they are not as directly exposed to market prices.

But the small-scale forest owners tend to try to time their harvest so that it lines up with favourable returns. This isn't easy to do as the price of logs does fluctuate quite a lot.

The uncertainty in pricing is one of the reasons given by the Government for the need for more regulation in the forestry industry.

MORE REGULATION FOR FORESTRY

There is currently a Government proposal to regulate the forestry industry for the purpose of strengthening the resilience and integrity of the forestry supply chain. At this stage consultation is taking place on a registration system for log traders and forestry advisers.

The Government sees a need for more transparency in the industry, as increases in the supply of logs from small-scale forest owners is expected in the future. At this stage it is not exactly clear how the regulation process will achieve the objectives, which include building a more transparent market for log trading. But it does appear the regulation is part of the Government's broader objectives to encourage additional planting of trees to help manage climate change risks.

CARBON MARKETS

Carbon prices continue to appreciate. As carbon prices rise and log returns fall the economics of harvesting forests versus leaving them standing may change.

At the latest government auction held on 1 December, the New Zealand units (NZUs) on offer traded at $68. One NZU is equivalent to 1 tonne of carbon. Leading up to the auction prices had been trading in the secondary market just below this level.

While there is a general market expectation that carbon prices will remain firm, this market is likely to be subjected to further regulatory changes, which may have an impact on pricing. Additionally there are a large number of carbon credits now in circulation, which could also impact market prices in the future.

HORTICULTURE

LABOUR SHORTAGES WORSEN

Horticultural industries are gearing up for another season of labour shortages. Labour availability is expected to be even worse than last season.

Growers are focussed on producing the best fruit they can for the new season, while processors and packhouses are focusing on getting the last of last season's fruit out the door.

KIWIFRUIT: INDUSTRY CAPACITY TESTED

With the last shipments of kiwifruit for the 2021 now on the water, the industry is focusing on the season ahead. It is expected to be another challenging season as COVID-19 related issues continue to cause logistical and labour problems.

Zespri is anticipating the labour shortage during the peak harvesting period in autumn will be even greater than last season. It expects a labour shortage of 6,500 workers this year compared to the 4,500 shortfall of workers last season.

Backpackers typically make up about 25% of the seasonal work force and there are virtually none in NZ at present. And it will take time for them to return to NZ even once borders are reopened.

The labour shortage is growing worse as the industry expands. Zespri estimate there will be an extra 10-15 million trays of fruit to harvest and pack in 2022.

To mitigate the labour shortages Zespri is making operational changes such as trying to flatten the processing curve by incentivising early-season production, packing more fruit in bulk rather than trays, tweaking taste payments to reduce the incentive to hold back fruit, and shipping fruit earlier to reduce capacity pressure on cool stores.

A shortage of labour is one of the reasons why Zespri revised down the license area planned for release next year. There will now be 350ha of Sungold licenses allocated, rather than the 700ha initially forecast. There will also be 350ha of RubyRed licenses and this is expected to expand to 500ha in 2023.

Zespri recently revised its forecast orchard gate returns (OGR) for the 2021-22 season. Returns for most categories have been revised down a little, although returns for conventional Sungold has been revised up.

FORECAST ORCHARD GATE RETURNS

Fruit type	2021/22 per tray (Nov)	2021/22 per ha (Nov)	2021/22 per tray (Aug)	2021/22 per ha (Aug)
Green	$6.34	$75.490	$6.34	$75.564
Organic Green	$9.54	$66,256	$9.80	$68,256
Sungold	$11.05	$169,303	$10.92	$167,167
Organic Sungold	$12.23	$139,646	$12.86	$146,682
Green14	$7.60	$53,096	$8.27	$57,739

Source: Zespri

Returns for organic fruit have softened, as ongoing supply chain issues have been factored in. Getting fruit to market is particularly challenging for deliveries to North America, as ports remain heavily congested. Unfortunately shipping delays tend to result in over-ripe fruit being delivered, which then must be heavily discounted.

While returns have been revised down from their initial forecasts most categories are expected to deliver the second-highest OGRs on record.

Unfortunately, like many other industries, costs of production are also rising quickly, which does impact overall financial returns. Margins are particular tight for

HORTICULTURE

lower-value varieties such as green, which cost nearly as much to grow as Sungold but are priced significantly lower.

While costs are a major concern, the biggest worry for most growers is simply finding sufficient staff to manage their orchards and harvest the fruit.

The labour shortages that the industry is experiencing are also impacting fruit quality, as not all workers are motivated to go the extra distance required to ensure the fruit they are handling makes its way through the picking and packing process in perfect condition.

Growers will receive an interim dividend of 5c per share on 10 December based on shares held at 3 December. This is the second interim dividend payment for the season following a payment of $1.44 per share in August. The forecast dividend for the full season (to March 2022) is $1.50 to 1.60.

WINE: FREE TRADE AGREEMENT WELCOMED

The wine industry stands to be one of the bigger winners from the NZ-UK free trade agreement (FTA). While the reduction in tariffs is not large for wine, the UK is already a major market for NZ wine so any reduction will be beneficial immediately.

Approximately 25% of $2 billion in export revenue the wine industry earns each year comes from exporting wine to the UK. Wine is actually our highest-value export to the UK by value at present. This is primarily due to significant tariffs keeping our larger export categories such as dairy and beef out of this market.

The industry is currently relatively short of wine due to the poor harvest last season. Prices paid for grapes this year are expected to increase, which is good for growers but not so good for wineries. Wineries are also facing higher labour costs, as they compete for the very limited supply of workers.

Export returns for wine fell 3% last year due to lower export volumes. Prices were slightly higher, but this was not enough to offset the lower volumes. There was less wine to sell domestically as well, with domestic sales for the year falling 2%.

Australian wine exporters also had a challenging year, but for different reasons. Australia's 2021 vintage was of a record size, but stocks were low ahead of the harvest, which impacted export volumes. Wine exports from Australia plummeted, with export volumes dropping 17% and export returns down 24% in the year to September 2021.

Australia was exporting a considerable volume of wine to China, but deterioration in trade relations between the countries resulted in tariffs being imposed by China and exports falling sharply. By volume China was still the fifth-largest export market for Australian wine, and despite a 62% fall in revenue it was still the highest-earning market due to much higher average prices than other markets. Australian wine exports to China were worth an average of AU$13.56 per litre, compared to an average export value of AU$3.56 per litre.

The lack of Australian wine entering China does potentially provide an opening for NZ wine, but this market mainly buys red wines from Australia like Shiraz and Cabernet Sauvignon and various blends, whereas NZ primarily exports Sauvignon Blanc.

Like NZ, the UK is the largest export market for Australian wine. Last year Australia exported 2% less wine to the UK but achieved a higher return than the previous year. Meanwhile exports to the US and Canada fell by 12% and 13% respectively.

Australia exports about 60% of the wine it produces.

RURAL PROPERTY MARKET

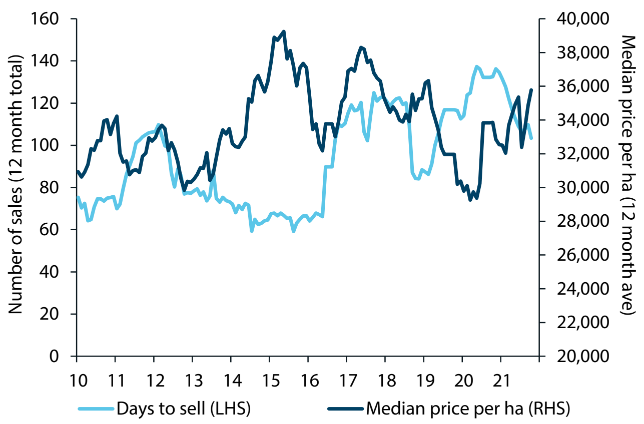
MOMENTUM BUILDS

Activity in the rural property sector is running close to the long-term trend. More dairy properties are trading than we have seen for a while and this has helped increase overall sales volumes, as has ongoing strong interest in properties suitable for planting in forestry for carbon farming.

MORE DAIRY FARMS CHANGING HANDS

There has been an increase in the number of dairy farms changing hands. In the past year 267 dairy farm sales occurred, which is 25% more than the 10-year average.

DAIRY FARM SALES (12 MONTH ROLLING AVERAGE)

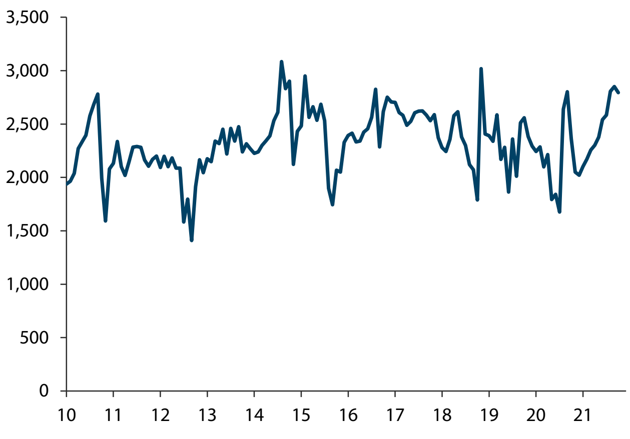


Source: Statistics NZ

The average selling price has also crept up a tad, but this may be because the properties that have traded have been of higher value than the average property, rather than reflecting overall price trends. The REINZ Dairy Price Index, which attempts to account for such differences, actually fell 2% in October. While it's a little early to say prices are falling, it does indicate there is not a clear direction in the market at present. The reality is that while some properties are selling well, others are struggling to find buyers. Demand for high-quality farms has been robust recently but it is much harder to move farms which require significant investment.

Another factor that is becoming a major constraint is the uncertainty surrounding changing environmental legislation. As many regional councils are just starting to develop rules, or are changing rules to ensure they meet the new national freshwater standards, it can be difficult to know if a property use will be compliant in the future.

DAIRY FARM PRICE INDEX



Source: REINZ

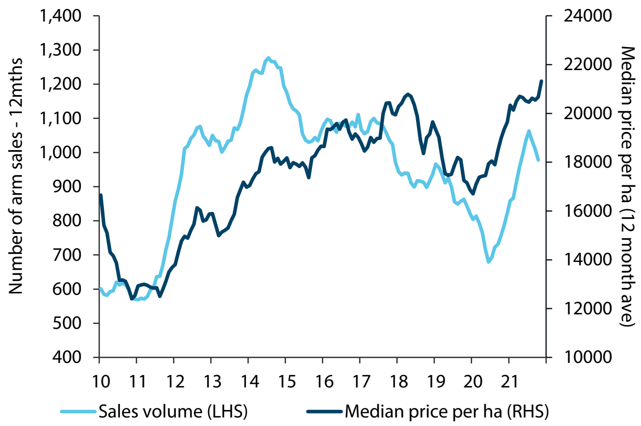
The consenting process can be quite arduous and time consuming, which doesn't always fit well into the process of buying or selling a property. Having all the relevant consents in place prior to marketing a property will certainly assist the sales process.

LIVESTOCK FARM VALUES LIFT

The value of livestock farms trading are certainly rising, but this has not just being driven by the higher farmgate prices for sheep and beef. A massive lift in the value of lower-quality properties that are being converted to forestry is one of the main drivers in this category.

RURAL PROPERTY MARKET

LIVESTOCK FARM SALES (12 MONTH ROLLING AVERAGE)



Source: Statistics NZ

In the past year 943 livestock properties were traded at a median price of $21,325/ha. This was a 10% premium on the median price from the prior 12 months.

HORTICULTURE DEMAND STRONG

Demand for properties that are already being used for horticulture or have potential to convert to horticulture remains strong. But horticultural requirements are very specific, and depend on suitable soils, micro climate, access to water and post-harvest facilities. Additionally, access to seasonal labour is fast becoming a major constraint for some horticultural activities.

Horticultural products tend to provide much higher returns than many other land uses, but there are also higher costs and a greater level of risk involved. These factors are also major constraints.

Despite these challenges, where horticultural properties are changing hands we are seeing strong prices and good buyer appetite.

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	267	119	213	↑	↑
	Median Price ($ per ha)	35,783	33,856	33,965	↑	↑
Livestock	Number of Sales	943	787	1,004	↑	↓
	Median Price ($ per ha)	21,325	19,358	18,091	↑	↑
Horticulture	Number of Sales	193	152	185	↑	↑
	Median Price ($ per ha)	301,500	236,636	196,673	↑	↑
Arable	Number of Sales	42	74	95	↓	↓
	Median Price ($ per ha)	36,475	29,075	35,906	↑	↑
Forestry	Number of Sales	60	57	51	↑	↑
	Median Price ($ per ha)	10,309	11,450	7,604	↓	↑
All Farms	Number of Sales	1,596	1,304	1,568	↑	↑
	Median Price ($ per ha)	28,092	24,050	24,249	↑	↑

Source: REINZ

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Last updated: 3 September 2021

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