ANZ RESEARCH

AGRI FOCUS

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OPPORTUNITIES AND CHALLENGES AHEAD

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INSIDE

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Both opportunities and challenges will be abundant in 2023. As we start the year, global economies are feeling the negative impacts of inflation, slower economic growth and tighter monetary policy. But forecasts of global growth are generally now being revised up rather than down, with more resilience than expected in European growth, in particular. And in terms of the impact of the pandemic, the worst of the health, labour and supply chain issues are now likely to be behind us.

We are now learning to manage the risk posed by COVID-19 without using lockdowns. This is allowing for greater mobility of labour and fewer businesses having to close. It is also helping with logistics as ports, shipping schedules and freight prices are now normalising. China has abruptly abandoned its COVID-zero policy, which is causing a degree of short-term chaos, but which will help normalise supply chains over the medium term with the country rapidly re-opening both internally and externally.

Prices for our main export commodities have eased, but the situation should improve later in the year when demand, primarily from China, is expected to lift. Fertiliser prices are now trending down; one of the few inputs where prices aren't still rising. Operating margins have tightened considerably.

The situation on farm varies considerably across the country. The recent heavy rains in northern regions have severely affected some properties. Meanwhile, most southern regions are rapidly drying out and would welcome some gentle rain.

Overall pasture levels are better than normal for this time of the season, underpinning the price of livestock. Unfortunately, the frequent rain is making harvest grass for silage or hay particularly challenging this season.

2023 will definitely deliver challenges, but as the year progresses, commodity prices should gradually improve and this will help producer returns.

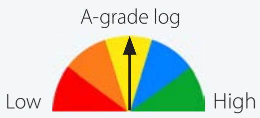
Prices at farm/orchard level relative to 10yr average

Dairy — Dairy commodity prices have weakened recently but are now starting to improve. Our milk price forecasts have been revised down to $8.50/kg MS for the current season and $8.75/kg MS for next season.

Sheep — Lamb returns at the farmgate level have fallen sharply but it's a good growing season for lambs, so higher weights will help offset lower prices.

Beef — Beef prices have been under pressure but are starting to stabilise. This trend should continue as demand from China increases.

Forestry — Log returns at the wharfgate are weak at present but are forecast to lift as demand starts to rebuild.



ECONOMIC OVERVIEW

LIGHT AT THE END OF THE TUNNEL

The Reserve Bank's battle with inflation is far from over and prices are still rising rapidly, but signs are tentatively emerging indicating the pace at which prices are rising will decelerate.

Further tightening of monetary policy will be required in the first half of 2023, but we now expect rates won't have to go quite as high as we previously forecast.

Global economic growth is expected to be lacklustre in 2023. China's demand for our export goods should start to improve later this year once the impact of the removal of the zero-COVID policies starts to flow through their economy. This should help farmgate returns in the latter part of 2023.

INFLATION BATTLE NOT OVER YET

Battling inflation continues to be the focus this year for the Reserve Bank of New Zealand (RBNZ) and most other central banks.

We expect the RBNZ will need to lift the Official Cash Rate (OCR) a further 1%, taking it to a peak of 5.25% in May. We forecast a 50bp lift in February followed by a further two 25bp lifts. This pace of increase is a little slower than we had previously forecast.

There are now signs that higher interest rates are impacting consumer demand and therefore seeing inflationary pressures start to ease. However, inflation and inflation expectations are both currently far too high, meaning the RBNZ is justified in tightening monetary policy further.

Particular pressure is evident in food prices and labour costs. Employment rates are still very high and many businesses are struggling to find workers. In some regions this is resulting in a reduction in production activity and reduced services, with businesses such as cafes being closed or operating with reduced hours, and meat-processing plants operating below capacity.

SUPPLY AND DEMAND SUBDUED

Global demand for high-value food products is expected to be relatively subdued. Tighter monetary conditions and reduced spending power mean many consumers will exercise greater caution when considering how to spend their money.

But at the same time we are not seeing strong growth in the supply of food products, as the rising cost of production is not encouraging additional production. The relatively tight global supply of many products will help underpin prices to some extent.

REGULATORY CHANGE AND CONSUMER PREFERENCES

The need to produce food in an environmentally sustainable manner is increasingly being recognised by both producers and regulators. This adds to per-unit costs in some cases, and therefore to the price consumers pay for food. People have to eat, but they can and will substitute towards cheaper options if food price inflation continues to outpace growth in incomes. But what's also evident is an increasing willingness on the part of many consumers to pay a premium for sustainably produced food. This is a growing trend and is gaining traction worldwide. To capitalise on these trends rather than be run over by them, we need to provide greater transparency so consumers know how their food is being produced. This is one of the reasons why it is important that we measure and report not only on-farm emissions, but also other social and environmental factors.

As well as higher costs, regulatory change brings uncertainty, and this uncertainty is reducing confidence in investing in farms and other food production systems.

ECONOMIC OVERVIEW

Livestock sectors are at the front line of regulatory change, and decreased production seems the likely endgame. Any reduction in production in meat and milk will impact the volume we have available to export, rather than result in domestic shortages. And reduced export volumes will impact export returns if we are not able to generate higher prices in our international markets.

Our ability to increase international prices will vary considerably from market to market. Where consumers prefer New Zealand goods we stand a chance of attaining higher prices but in markets where consumers are not aware of where their food is sourced from, it will be much harder to extract premiums.

It does mean it is very important that we do continue to seek out global consumers whose values are closely aligned with our pasture-based farming systems.

Just prior to Christmas the Government announced that it will review agricultural emissions pricing every five years. This is good news as the longer timeframe will provide more certainty. As yet we do not know what the prices will be. The Government has said the emissions price will be advised in early 2023 and legislated in mid-2023. They have also said the emissions levy will be priced only as high as needed to achieve outcomes based on New Zealand's 2030 and 2050 emission targets. Ministers will be responsible for setting the emissions price based on advice from the Climate Change Commission.

EGG SHORTAGE, A SIGN OF THE TIMES

The recent egg shortage is an example where changing regulations (including unanticipated decisions at the retail rather than government level), combined with unsustainably low returns to egg farmers, resulted in a lack of confidence to invest in new production facilities that meet the new cage-free regulatory requirements. This is the main reason for the current egg shortage. It is now clear that returns to egg producers need to be higher than they have previously been, in order to encourage additional investment into the industry. Profits have been hampered by the large rise in grain prices in recent years, which was not reflected in increased consumer prices.

Retail prices for eggs have now increased sharply but producers will need to be confident that egg production will remain profitable in order to justify the investment required.

CHINA DEMAND KEY

China is a key market for most of the food and fibre products we export. How quickly China's economy recovers, now that the zero-COVID policy has been abandoned, will dictate the strength of demand for many of our export products.

We are very reliant on China for the sale of logs, mutton and many lamb cuts, and to a lesser extent beef and dairy products. China's demand for infant formula has waned as China's birth-rate has continued to decline in recent years. Births dropped even further during the pandemic as the health scare and the economic impact made couples think twice about having children.

There may be a post-COVID catch-up, not just for infant formula but also foodservice demand, but demand for high-value products such as imported infant formula and highly priced meats is likely to be subdued until economic conditions meaningfully improve. Policymakers appear to have a renewed focus on the near-term outlook with China's economy forecast to grow by 5.4% in 2023, well above the world average of 2.4%. But medium-term growth challenges remain considerable, including demographics and geopolitical tensions.

In good news for New Zealand's tourism industry, Chinese showed they were confident to travel again. During the Lunar New Year holiday period inter-province mobility reached record levels.

Growth in emerging Asian markets is also expected to rebound in 2023 to 4.9% (compared to an estimated 3.4% in 2022).

STEADY IMPROVEMENT IN COMMODITY PRICES

Overall market demand for our export goods is expected to improve in the year ahead. But the improvement is likely to be gradual and therefore we may not see any significant lift in farmgate prices until the second half of the year. Improving prices are also conditional on global supply from competing nations remaining subdued.

However, muting the benefit of higher prices, production costs remain elevated, particularly for fuel and labour. Fertiliser prices are starting to recede a little but remain high. Cash-flow will be tight for many NZ primary sector businesses during 2023 but cost pressures should ease later in the year, by which time production prices may also have improved a little.

Click here to access our latest forecasts.

DAIRY

PRESSURE ON RETURNS

Dairy commodity prices have been relatively weak in the past few months but are beginning to improve. The outlook is heavily dependent on China's economic recovery. Global milk supplies are increasing in the Northern Hemisphere but are still contracting in the Southern Hemisphere. This dynamic is impacting individual dairy commodities differently but on balance, it has prompted us to make a small downward adjustment to our milk price forecasts for this season and next.

Dairy commodity prices are being supported by buyers who see value at current levels. Buyers are acutely aware that dairy prices can change rapidly and the overall fundamentals do point to stronger prices ahead. But there are a lot of factors still at play that will make pricing volatile in the months ahead.

The key factor that will determine demand for New Zealand dairy products is how quickly consumption picks up in China. China is expected to increase its buying volumes as demand for dairy products rebuilds as the economy bounces back from COVID-zero. However, it is not clear how long it will take for this to occur as dairy is a luxury good for many Chinese consumers. They will need to feel positive about their financial position before we see a meaningful impact on demand.

It is also not clear exactly how much product is currently in-market, nor how much additional whole milk powder (WMP) is currently being produced within China. There are reports of increased domestic milk production, with much of this additional milk reportedly being manufactured into milk powder.

Farmgate milk prices in China are still quite high but are starting to fall. A continued fall in farmgate prices would be a more reliable indicator of an oversupply of milk than official milk production records. At current WMP prices it would be cheaper to import milk powder than to try to produce extra milk in China. China's dairy farms are reliant on imported feed supplies, which means they are not able to produce milk cheaply.

At present, demand from China for milk powder is steady, but we are yet to see any significant lift in buying activity. There are, however, plenty of buyers from other regions who see value at current prices. These buyers are currently supporting the market as they build inventory.

SKIM MARKET LESS BULLISH

The market for skim milk powder (SMP) is not quite as bullish as the market for WMP. There is currently an oversupply of SMP within the European markets and this is weighing on international prices for the product. That said, there has been some improvement in prices for SMP trading on the EEX. This is an encouraging sign that market pricing may have bottomed out.

At the latest Global Dairy Trade event, WMP traded at an average price some USD500/t higher than SMP – much larger than the normal margin of USD100-200/t. In the past year European producers have put less milk into WMP and a little more into SMP. SMP has a longer shelf life than WMP, and is therefore often the product of choice when the demand outlook is uncertain.

HIGHER PRICES AHEAD

We anticipate that dairy commodity prices will gradually appreciate during 2023. While this is unlikely to be all one-way traffic, we do expect the overall trend to be positive.

Deteriorating global economic conditions will weigh on overall consumption. But for many consumers in developed nations, dairy products are a staple part of their diet, meaning they are not likely to significantly change consumption habits even if their financial

DAIRY

positions weaken. Where we are likely to see weaker demand in these markets is in higher-end dining, which may impact demand for milkfat products such as butter.

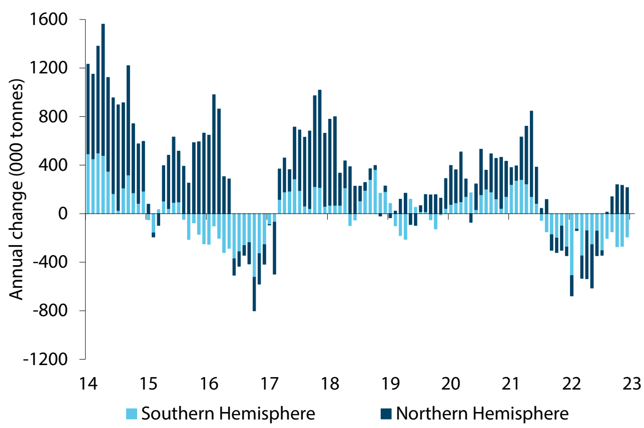
MILK SUPPLY TRENDS DIFFER

Milk supply in the Northern Hemisphere is expanding again, whereas milk production in the Southern Hemisphere continues to shrink.

Milk production in the United States expanded in the second half of 2022. Across the full 2022 year, output expanded just 0.2%, but a growth rate of 1% was recorded in the final quarter of the year. The number of cows in milk at the end of the year was up 27,000 head (+0.3%). Farmgate milk prices in the US eased a little in the second half of the year but are still at historically strong levels. Despite the high milk prices, the high cost of feed means the milk to feed ratio is not particularly high, but it did lift a little towards the end of 2022.

European milk production also lifted during the latter months of 2022. Across the full calendar year milk intakes were similar to the previous year. Output by country was mixed, but most of the big milk-producing nations such as Germany, France, the Netherlands and Italy all produced less milk. The only exception was Poland, which managed to expand its output. Feed supplies have been tight and feed prices high. This limited milk output last season but that situation is starting to change.

MILK PRODUCTION GROWTH FOR MAJOR EXPORTERS



Source: DCANZ, Dairy Australia, EuroStat, USDA, CLAL

Milk production in Australia continues to be very weak. In the second half of 2022 milk intakes fell a massive 6%. Production was down in all states particularly NSW (-11.9%), Queensland (-9.6%) and Victoria – the largest milk-producing region (-7.5%). Floods early in the season resulted in severe damage to pastures in many regions. The second half of the season should be better than the first, but nevertheless it will be a very poor season for Australian dairy farmers.

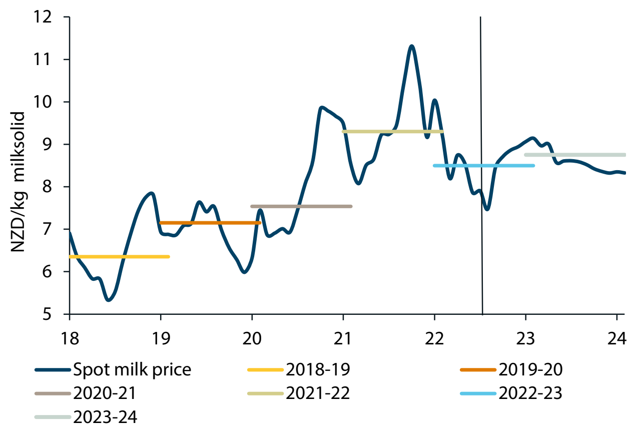
Milk production is also constrained across most of South America. There has been a little bit of growth in Uruguay but production has eased in Brazil, Argentina and Chile.

Milk production in New Zealand is down 2% for the season from June to December. Pasture conditions are now better than average so some ground is expected to be made up through the summer/autumn months. However, production will need to be exceptional during this time to make up the ground lost in the first half of the season.

MILK PRICE FORECASTS REVISED DOWN

Our milk price forecast for the 2022-23 season was recently revised down 25c to $8.50/kg MS. The recent rise in the NZD, alongside dairy commodity prices being weaker than expected in recent months, has pushed our forecast down. This forecast is now at the lower end of Fonterra's $8.50-$9.50/kg MS forecast range. See our latest milk price update for more details.

FARMGATE MILK PRICE HISTORIC AND FORECAST



Source: Fonterra, ANZ Research

Looking ahead to the 2023-24 season, we have also trimmed 25c from this forecast and now expect a milk price forecast of $8.75/kg MS. This forecast assumes a small improvement in dairy commodity prices across the forecast period.

LAMB & WOOL

LAMB PRODUCTION SLOWS

The throughput of lambs at the processors has slowed considerably since Christmas, as excess feed is encouraging farmers to hold onto stock for as long as possible.

Farmgate returns for lamb and mutton have also dropped sharply as international demand remains lacklustre. This situation is expected to improve as demand from China gradually rebuilds.

Store prices remain elevated relative to schedule prices due to the extra feed on-hand pushing up demand for stock.

EUROPEAN MARKETS SOFT

Although Europe has fared much better in the winter energy squeeze than feared, our main European markets for lamb are still struggling from an economic point of view and this is making it hard to sell high-priced cuts.

Sales of chilled lamb for the Easter market are virtually complete as the shipping deadline looms. Market demand is relatively weak so it is unlikely that much product will be air-freighted this year for the European event.

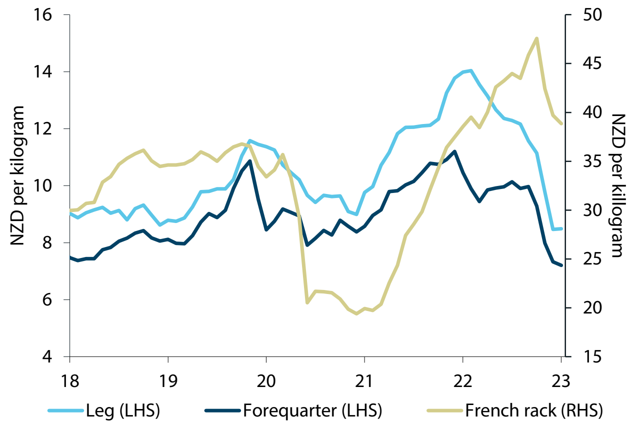
Exporters are reporting that product is moving but they are not always achieving the prices that they would like. This is not particularly surprising given both the UK and the EU are struggling as high inflation erodes consumers' spending power.

CHINA DEMAND IMPROVING

Demand from China has been very weak as the lockdown measures that were put in place to prevent the spread of COVID meant most restaurants that buy lamb were not open.

This situation has now changed following the abrupt abandonment of the zero-COVID policy. The reopening of China will bolster demand for lamb but any existing stocks of lamb held in-market will need to be worked through first.

LAMB CUT PRICES



Source: AgriHQ, ANZ Research

The lack of demand from China has been particularly noticeable in the mutton market as virtually all of this grade of product is currently exported to China. Before China purchased our mutton it was mainly sold into Middle Eastern markets and to the Pacific Islands. Exporters have been trying to rebuild connections in alternative markets to reduce their reliance on China for mutton sales.

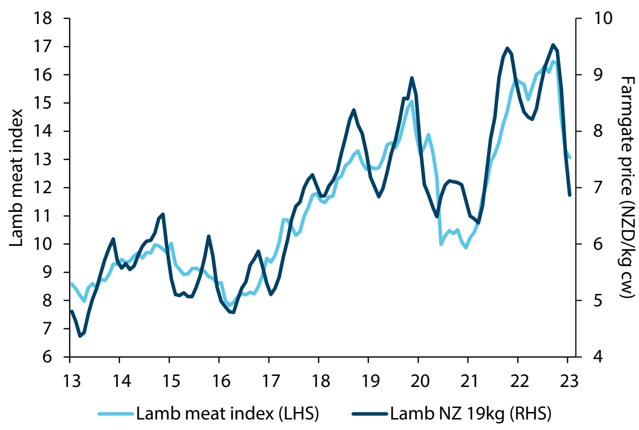
Interestingly, returns for Frenched Racks, one of the most expensive lamb cuts, have held up quite well. This cut tends to be exported to the US and Europe for consumption in high-end restaurants. Consumers that tend to dine in these establishments are usually wealthy and may not have been impacted as much by inflation and the recent economic downturn.

LAMB & WOOL

FARMGATE PRICES FALL

The recent movement in farmgate prices has been closely aligned with changes in in-market prices. The recent strengthening of the NZD has also put further downwards pressure on farmgate prices.

FARMGATE PRICE VS OVERSEAS MEAT PRICES



Source: AgriHQ, ANZ Research

Farmgate returns for lamb and mutton have fallen much more sharply than normal in recent months. Lamb schedules dropped by more than NZD2 from the start of November to early January.

Prices are now stabilising as the numbers of lambs available for processing starts to ease up. The excessive volume of feed available means farmers are in less of a hurry to sell stock. Processing weights for lamb are up about 300gms on average across the first three months of the season (October to December). The number of lambs processed during this time is also up about 5% on the previous season by

GRASS KEEPS LAMBS ON FARM

Strong pasture growth in the North Island has resulted in lambs being held on farm a little longer than normal. This is reflected in higher kill weights and also the higher schedule prices on offer in the North Island.

Lamb processing space was relatively tight up until Christmas but the situation has now changed dramatically. Meat-processing companies are now having to compete a little harder to secure lambs in the North Island, meaning schedule prices haven't dropped quite as quickly as they have in the South Island.

Some parts of the South Island are starting to dry off, creating more urgency to reduce stocking rates. Meanwhile in the North Island an excess of rain means pasture conditions are better than normal, particularly in the lower eastern regions. However, the recent heavy deluge of rain in the northern part of the country has caused severe damage on some farms and infrastructure. Overall it won't have a major impact on lamb production.

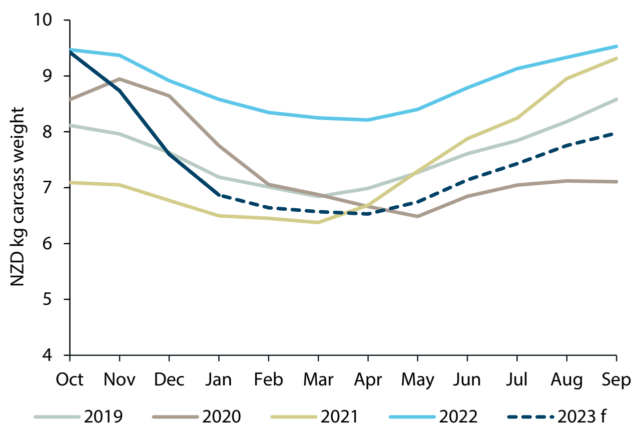
The additional pasture also means more of the large stations that normally sell lambs to the store market have opted to finish them instead. This has tightened the supply of store lambs at a time when overall demand for lambs is stronger than normal. Hence, the store market for lambs is currently generating healthy prices, relative to schedule prices.

WHERE TO FROM HERE?

Farmgate prices have dropped faster than we anticipated. We did expect a relatively sharp fall in pricing this season, but the drop has been quicker than we had forecast.

At present pricing has stabilised, largely due to procurement pressures. Further easing in pricing is expected as the season for chilled lamb (for the Easter markets) ends.

FARMGATE LAMB PRICE TREND AND FORECAST



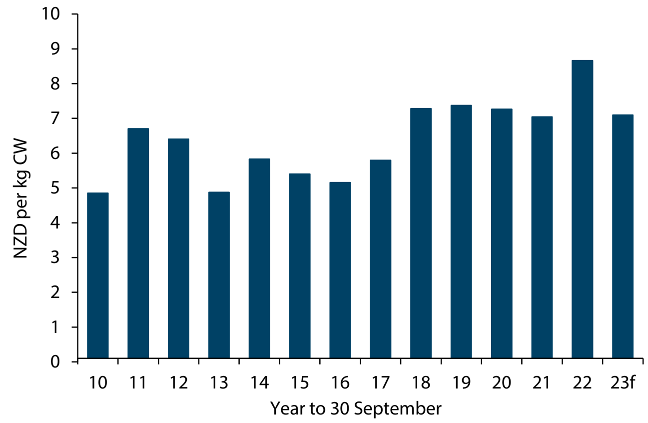
Source: AgriHQ, ANZ Research

On a positive note, we do expect to see demand from China rebuild in the coming months. This is unlikely to impact prices immediately, but may help farmgate prices recover in the autumn.

We now anticipate schedule prices to bottom out at about \$6.20 - \$6.50 per kg CW in March/April. This will put the weighted average price of lamb for the 2022-23 season at \$7/kg CW, which is about 40c below the 5-yr average.

LAMB & WOOL

WEIGHTED AVERAGE FARMGATE LAMB PRICES



Source: AgriHQ, ANZ Research

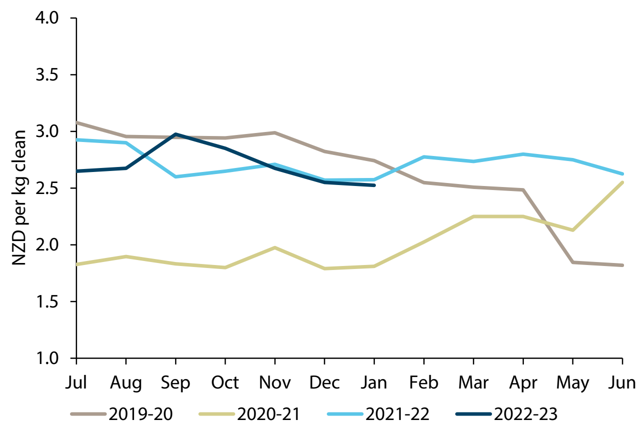
WOOL MARKETS STILL STRUGGLING

Wool prices remain lacklustre and will need to lift considerably to contribute positively to farm profits. While there are plenty of initiatives under development for new uses for wool, most ideas are still some way off large-scale production and are yet to impact farmgate prices.

The wet weather has made it extremely challenging to get sheep shorn this summer, but with plenty of flies about there is a real incentive to get sheep shorn. The weather is also increasing the proportion of wool that is being downgraded due to poor colouring.

The ongoing challenges the industry is facing are making farmers consider alternative breeds that require less or even no shearing. It is also making farmers consider the effort put in to classify wool, although wool merchants continue to advise that time spent sorting wool does pay off. Better-quality wool of all grades continue to be easier to sell.

COARSE WOOL PRICES



Source: PGG Wrightson, ANZ Research

BEEF

INTERNATIONAL PRICES IMPROVING

Global beef demand is starting to improve but farmgate prices are expected to fall further before improving later in the year. US remains the market of choice, but demand from China is expected to pick up again soon.

Demand for store cattle remains very strong and this is likely to be the case for some time, due to the large quantities of feed on-hand in the North Island.

PRICES LIFTING A LITTLE

There is steady demand for beef from the US market. This is helping to push up beef prices a little, in USD terms, stalling the downward pricing trend that has been in play largely since demand from China eased due to the lockdowns.

Unfortunately, the higher in-market prices in the US are not feeding back to the producer as the strengthening NZD has offset these gains.

The US market is generally paying better prices than China. This situation may change once demand in China rebuilds, but for now the US market is favoured by exporters.

Within the US, recent rains have been welcomed in drought-struck areas, but the rains have not really done enough to change the overall situation, which continues to drive destocking on US farms. This is contributing to plenty of beef available in the US market in the short term, reducing demand for imported beef.

There are also ample supplies of beef moving from both Brazil and Australia into the US. This means we are unlikely to see a substantial increase in beef prices in this market until later in the season once the quota from Brazil is filled.

US domestic beef supply is also expected to slow later in the year as there is now 3.5% less stock on feedlots than a year ago.

International demand for NZ beef should lift in a few months' time as China demand rebuilds and US beef stocks start to wane. This will coincide with the seasonal lift in manufacturing cow production in New Zealand as dairy and beef cows are culled during autumn. This lift in our beef supply is likely to offset any increase in international demand, meaning prices are unlikely to improve substantially in the first half of this year.

Also contributing to the overall picture are movements in freight rates and the NZD. Freight rates are falling, which is positive for farmgate returns. However, the stronger NZD is not helping the situation, particularly given a lot of meat is traded on a spot basis, meaning foreign exchange hedging policies tend to be limited.

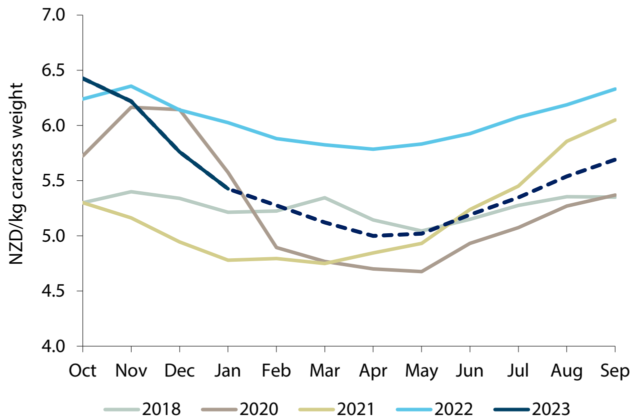
Overall beef returns are expected to lift in the second half of 2023.

FARMGATE RETURNS EASING

At the farmgate level beef prices are expected to ease as more cattle become available for processing. At present the large quantities of feed available, particularly in the North Island, mean schedule prices have stabilised as processors are not finding it that easy to fill their plants.

BEEF

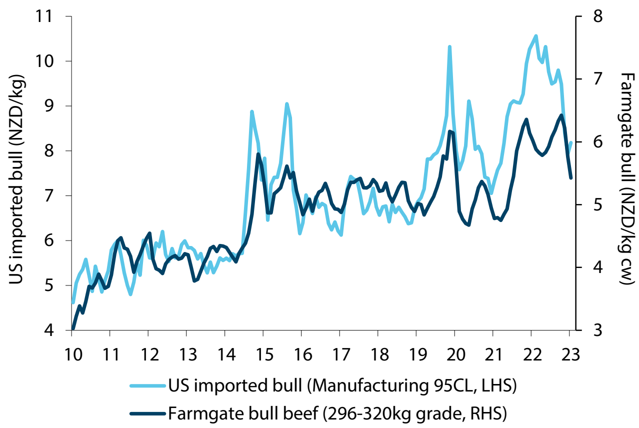
FARMGATE BULL BEEF PRICE TREND AND FORECAST



Source: AgriHQ, ANZ Research

Drier conditions in the South Island mean cattle availability is better. We have therefore seen schedule prices soften a little there.

FARMGATE BULL BEEF VS OVERSEAS MARKET PRICE



Source: AgriHQ

STORE MARKETS STRONG

Store prices for all grades of cattle remain strong relative to schedule prices. Many farms have excess pasture and are therefore keen to secure more cattle. Demand is strong across most grades of stock, with beef bred yearlings and 2-yr olds particularly sought after.

The market for dairy cross weaners remains robust.

DEER

RETURNS IMPROVING

Farmgate prices for venison have stabilised. Returns have steadily improved in recent years and confidence in the industry is improving again. The number of breeding hinds in NZ is expected to stabilise following a period where deer numbers decreased.

Velvet remains a lucrative product that is highly sought after in the Asian markets. Farmers continue to focus on improving the quantity and quality of the velvet they are producing.

The focus for venison exporters is currently on frozen production, which provides more flexibility in terms of shipping times etc. Exporters continue to work to diversify from traditional European markets, which are currently impacted by tight economic conditions.

Demand from other markets such as the US is a little stronger, and more progress is expected to be made in China now it is reopening, allowing for more travel and dining out occasions.

Overall it has been a challenging few years for the industry as the pandemic severely impacted the restaurant trade. The industry has adjusted by focusing more on retail opportunities and markets outside of Europe.

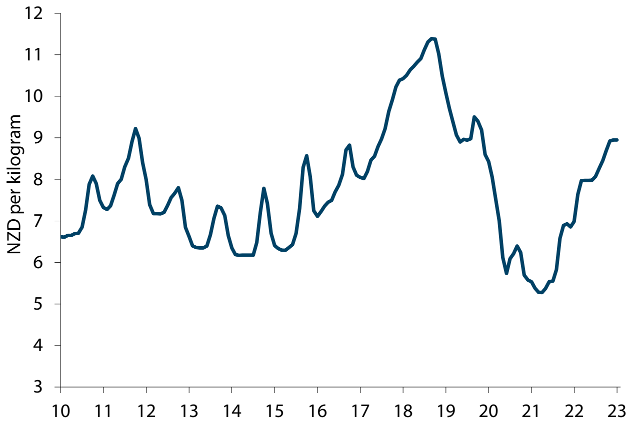
However, returns have been lower than normal in recent years and this has resulted in a decrease in the number of deer farmed in NZ. Deer numbers tend to decrease when returns are low, further adding to the supply of venison in the short term. Hind numbers are now expected to stabilise, which will reduce the volume of venison being processed.

The industry is in the process of launching a new strategy to further diversify markets and return greater value at the farmgate level.

FARMGATE PRICES STABLE

Farmgate prices for young stags have stabilised at about $9/kg CW, which is about 10% above the 5-year average.

FARMGATE VENISON (YOUNG 60KG STAG)



Source: AgriHQ

VELVET RETURNS STILL STRONG

Velvet returns remain strong. This has encouraged some deer farmers to focus on velvet production rather than venison. There is plenty of confidence in the velvet industry, which has been fostered through several seasons of good returns to producers.

GRAIN

GRAIN PRICES STABILISE

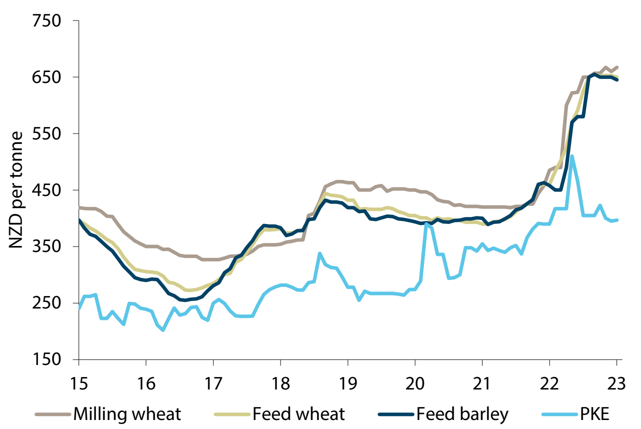
Grain prices have stabilised at high levels in New Zealand, whereas global prices have retreated quite sharply. Grain production domestically has been impacted somewhat by the recent wet weather but most of the main growing regions have not been badly impacted.

GRAIN PRICES STABILISE

Grain prices have plateaued in recent months in our local market. Some grains have eased in price slightly, but overall prices of all types of grain remain at elevated levels.

The recent heavy downpours will have done some damage to arable crops but the major cropping regions escaped the worst of the damage. Maize is expected to be impacted the most due to much of this crop being grown in northern regions.

NEW ZEALAND GRAIN PRICES



Source: NZX

The wet conditions have made it extremely challenging to harvest grass for silage and even more so for hay, as the window of opportunity while the sun has been shining has been very limited. This has put contractors well behind, and arable farmers will be hoping for much more settled weather later in the season for harvesting grain crops.

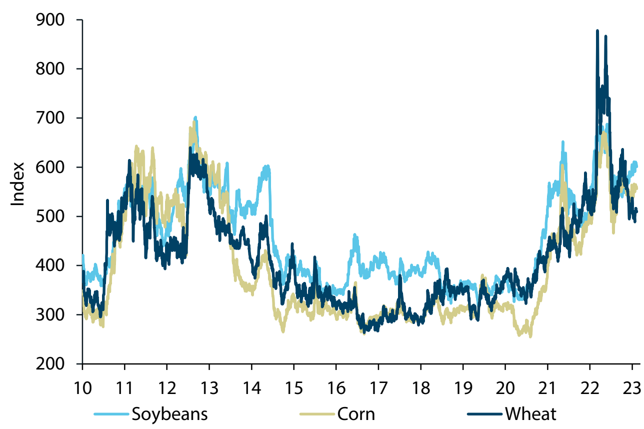
The wetter summer will bolster yields where the rain has not been so excessive as to have caused damage. However, hot warm weather is also a recipe for fungal infections.

GLOBAL PRICES EASE

The price of grain in international markets is normalising following the sharp lift seen as a result of the supply issues caused by the Russian/Ukraine conflict.

Global grain supply this season is expected to be a little lower than the previous season but still relatively high. The supply concerns that have plagued the markets in recent years have dissipated somewhat. But as the Ukraine situation is yet to be resolved, this remains a risk to supply. US production of grain, particularly corn, is expected to be lower than normal due to ongoing challenges with both drought and floods.

WORLD GRAIN PRICES



Source: SPDJI, Bloomberg, ANZ Research

FORESTRY

DEMAND EXPECTED TO IMPROVE

Demand for logs from China is weak at present but there are hopes this situation will reverse once their economy cranks back up following the Chinese New Year holiday break.

Locally, harvesting and milling activity has slowed this summer. This has been partially due to inclement weather, but has been driven mainly by lower demand. Domestic demand for timber has slowed as the construction outlook eases and builders cast a critical eye over their inventories.

Carbon prices have also eased. The guide prices for the quarterly auctions of New Zealand Units have been increased this season but by a much smaller degree than recommended by the Climate Change Commission.

WAITING FOR CHINA DEMAND TO RESUME

Demand for export logs has been weak over the past few months but signs are emerging that the market should improve soon.

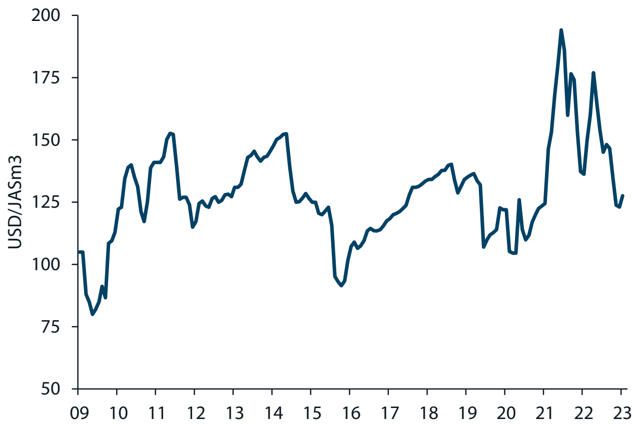
Demand from China is often weak during the Chinese New Year holiday break as factories shut down and workers take their main annual holiday. In the months leading up to the festive season this year demand was also very weak due to the lockdown measures that were in place to prevent the spread of COVID-19.

This year the holiday period occurred relatively early. Chinese New Year fell on 22 January, with the extended holiday period running through to the Lantern Festival on 5 February.

There is now hope that with lockdowns and the festive period behind us demand will start to build from here on, but it may be some time before this demand actually materialises.

Therefore, we may see some ongoing weakness in wharfgate prices for a while yet, but the situation should improve as the year progresses.

UNPRUNED A-GRADE IN-MARKET PRICE



Source: AgriHQ

SHIPPING COSTS EASE

The cost of moving logs has dropped significantly. The supply chain issues that caused delays at many ports across the globe should be largely behind us – touch wood (so to speak). Labour shortages were the main factor causing the delays, and now that COVID restrictions have been removed virtually everywhere, these issues are unlikely to reoccur at the scale previously experienced.

The other major factor influencing supply chains is the reduction in demand for consumer goods, relating to tighter economic conditions in most parts of the world. This has reduced the demand for shipping services, contributing to lower prices. At the same time, some new ships have now come on stream.

FORESTRY

DOMESTIC DEMAND SLOWS

Domestic demand for timber has also slowed up. Higher interest rates and falling house prices are reducing demand for new housing and home renovations. We expect further weakening in home prices in the coming months. House prices have eased by 15% since November 2021, which is about two thirds of the 22% peak-to-trough decline we expect (see Property Focus for more details).

The recent damage to thousands of houses in the Auckland area is expected to result in a surge in construction activity. However, it may be some time before the extent of the damage is fully known and decisions are made around the suitability of some sites to build on.

At present there is a surplus of timber available and demand from mills for raw logs has slowed. Some mills opted to shut down for longer periods than normal through Christmas and into January due to the lack of demand for timber. The extended break may have also helped with the labour situation, as like all industries attracting and retaining quality workers is a challenge for mills.

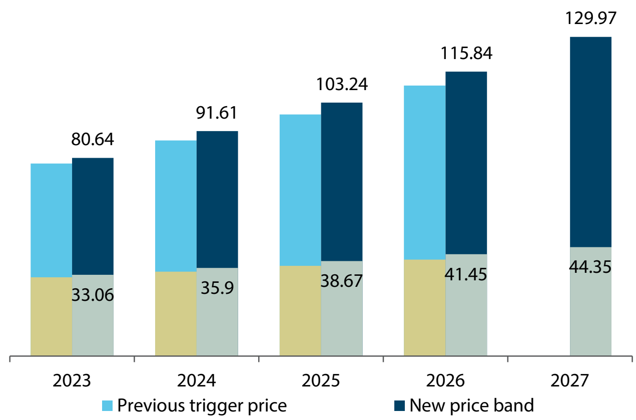
Similarly, we did see some slowing of harvesting through the summer break. Excessively wet conditions will also be impacting harvesting in some of the northern regions, while in other regions the extra rain is simply helping to reduce fire risk.

The wet conditions will have also slowed some domestic building projects. This is particularly the case for DIY projects, which tend to occur in a flurry during summer holidays.

CARBON PRICES EASE

Carbon prices have eased back to near $72/t CO_2e, having peaked at over $85 near the end of 2022. Earlier in 2022 the Climate Change Commission recommended lifting the trigger price above $170 in 2023. This is the price that triggers the release of additional units from the cost containment reserve at the quarterly auction of New Zealand Units (NZU's). In December the Government announced it had adopted a lower trigger price of $80.64 for 2023, which is still higher than the $70 price which applied last year. Minimum selling prices have also been lifted a little and both prices will trend higher in the future.

CARBON AUCTION FLOOR AND TRIGGER PRICES



Source: MfE

The volume of units that will be released in 2023 has been reduced, but not by as much as the CCC had recommended. In 2023 there will be 17.9 million units available, compared to 19.3 million units released in 2022.

The Government has acknowledged that the high volume of units in circulation poses a risk to both the stability of the market and to achieving its emissions budgets. As at 30 September 2022 there will 159 million privately held units in circulation.

Some of these units may be held to offset future obligations, but many of these units will have been purchased as a speculative investment.

HORTICULTURE

FLOODS HIT VEGETABLE PRODUCERS

Quality issues relating to fruit harvested last season have pulled late-season prices down. But growers are now focused on the season ahead.

Late frosts did cause issues for some crops. There was some impact on kiwifruit, but other crops such as blueberries were impacted to a much greater degree.

INDUSTRY STRATEGY

The recently released Aotearoa Horticulture Action Plan titled "Growing Together 2035" is a collaborative effort from the horticultural industry, Māori, research providers and the Government. The strategy aims to double grower returns to $12 billion by 2035.

Some of the challenges acknowledged in the plan are climate change, labour availability, access to capital, and economic sustainability. The plan also acknowledges that access to water is critical for any horticultural developments and indicates that co-investment in regional water storage and infrastructure will be required for the industry to grow sustainably.

The plan aims to increase Māori participation in high-value horticulture three-fold by 2035.

The plan also aims to increase the scientific efforts and access to resources for the so-called "Tier 2" crops that currently generate less than $100m in export returns but have the potential to return more.

At present the three large-scale horticulture crops that generate the largest export returns are kiwifruit ($2.9b), wine ($1.9b), and pipfruit ($865m). Vegetable exports collectively account for a little over $600m annually, with potatoes (including frozen chips), and onions the two largest contributors.

Other varieties of fruits that are exported in significant quantities include avocados, cherries and blueberries. Hops are another important export crop for New Zealand.

IMPACT OF FLOODS

The recent widespread heavy rains have had a significant impact on some horticultural enterprises. This is particularly the case for vegetable producers in the Pukekohe region (read more here).

There was damage to onion crops that had already been lifted and were drying prior to the rains occurring. However, the overall impact on the total onion crop is not expected to be significant. Green vegetable growers were also hit hard by the floods and some crops will be abandoned due to crop damage and the health risks posed by the floodwaters.

The Northland/Pukekohe/Waikato/Bay of Plenty regions account for approximately 55% of NZ's onion production and 30% of potato production. Quality issues with potatoes grown in the flooded regions may arise later in the season once the crop is harvested.

There have also been concerns about infrastructure – particularly road access in key growing regions. This could become a greater issue in the future but it will be highly dependent on how quickly roads are able to be repaired.

FOCUS ON SEASON AHEAD

Fruit growers around the country are working hard to improve fruit quality for the upcoming season. The recent rains do set orchards and vineyards up for good yields this season, but too much rain is a concern for some growers. The hot wet conditions bring their own challenges in terms of fungal diseases.

HORTICULTURE

Kiwifruit growers recently received the unwelcome news that there will be a further downwards revision in the price paid for green kiwifruit harvested in 2022. A price of $6.13/tray was forecast in November, but this is likely to be revised down by about 60c (roughly 10%). This puts the 2022-23 price well below the 5yr forecast of $6.50 - $8.00 for this variety.

In-market quality issues are the reason for the downgrade in pricing. This also means there will be no monthly payment to growers of Green varieties in February, which will have cash-flow implications.

A recent industry note provided by Craigs Investment Partners says it expects licence prices for SunGold will ease from the median price of $801k/ha paid in 2022. They do, however, expect demand for licences to remain strong, with both the cutover pool and the unrestricted pool to be fully subscribed at the next auction, scheduled to occur in late April/early May.

RURAL PROPERTY MARKET

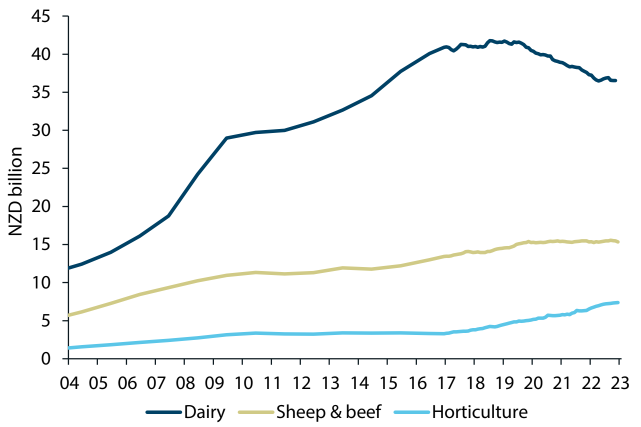
PROPERTY SALES VOLUMES EASE

The property market is starting to show signs of oversupply relative to demand. This is putting downward pressure on prices. High-quality properties are still attracting buyers, but properties where there is uncertainty as to future productive potential, or poor quality infrastructure, or which are located in less desirable regions are finding it increasingly difficult to attract buyers.

During 2022 fewer rural properties were traded than in the previous year, and the median price fell. While the quantity of properties fell for every property type, price movements were mixed. The median sale price lifted for dairy, horticulture and forestry properties while the median price of arable and livestock properties fell.

Meanwhile the latest REINZ price indices for dairy show prices in December were 4% lower than the same month the previous year, while the drop across all farm types was even larger at 15% when considered on a per hectare basis.

AGRICULTURAL DEBT BY SECTOR



Source: RBNZ

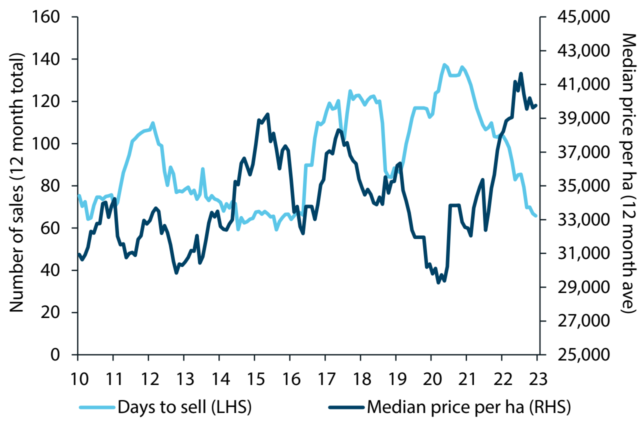
These statistics provide only part of the story and it is clear that there is considerable variation from property to property.

It is, however, clear that buyers are becoming more cautious and it is unlikely that all the farms currently on the market will change hands this season. The general decrease in operating margins across most sectors, as well as higher interest costs, are contributing to making buyers a little more cautious. There continues to be a degree of uncertainty as to how farms will be able to operate in the future and this is weighing on the minds of potential investors.

DAIRY DEBT STILL A BURDEN

Farmers that are carrying high debt levels are becoming increasingly concerned about rising interest rates. We have experienced the quickest lift in rates since the OCR was introduced in 1999. We are picking the OCR will peak in May, but this will be highly dependent on how quickly inflation dissipates.

DAIRY FARM SALES (12 MONTH ROLLING AVERAGE)



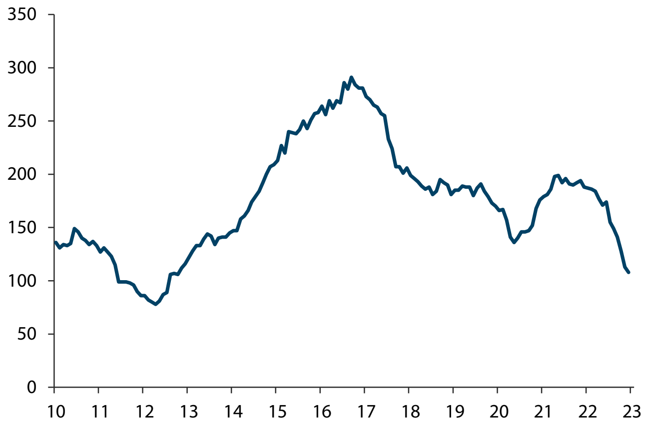
Source: REINZ

RURAL PROPERTY MARKET

Farms that have paid off additional debt in the past few years will be pleased to have done so. The quantity of surplus funds available for voluntary debt repayments is expected to be considerably lower this season for many farming operations.

The quantity of horticultural properties traded in the past year has dropped away substantially. At the same time, prices have firmed. However, the price for horticultural land varies considerably depending on the enterprise and the level of improvements, which means that the median price doesn't provide much guidance as to the likely change in value for any given property.

HORTICULTURE SALES VOLUME



Source: REINZ

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	230	296	226	↓	↑
	Median Price ($ per ha)	39,755	37,933	34,864	↑	↑
Livestock	Number of Sales	774	935	993	↓	↓
	Median Price ($ per ha)	20,775	20,892	18,896	↓	↑
Horticulture	Number of Sales	108	188	194	↓	↓
	Median Price ($ per ha)	498,800	301,000	231,202	↑	↑
Arable	Number of Sales	38	59	94	↓	↓
	Median Price ($ per ha)	35,933	47,200	38,681	↓	↓
Forestry	Number of Sales	46	67	53	↓	↓
	Median Price ($ per ha)	14,333	10,896	8,648	↑	↑
All Farms	Number of Sales	1,269	1,635	1,590	↓	↓
	Median Price ($ per ha)	28,300	29,500	25,643	↓	↑

Source: REINZ

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Last updated: 1 September 2022

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