ANZ RESEARCH

AGRI FOCUS

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KEEPING AFLOAT

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INSIDE

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OVERVIEW

Global economic conditions are challenging, and export returns have taken a turn for the worse.

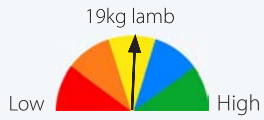
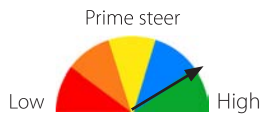
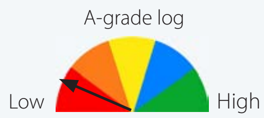
Demand has eased in many markets, but it is the muted level of demand from China that is having the biggest impact on farm incomes in New Zealand.

Farmgate returns for most industries are dropping rapidly, while interest rates are rising and other farm costs are stubbornly high.

Conditions on farms vary considerably. Many regions are wetter than normal, but the winter has generally also been milder.

September weather tends to vary hugely year-to-year, and what we are dealt this year will have a major impact on lamb survival rates and spring pasture production.

Farm cashflows will be severely impacted this season by soft farmgate prices. Keeping on top of cashflows will be imperative to managing through this downturn. This is not the first downturn our primary sectors have encountered, and it is unlikely to be the last. Working out what options are available and having a variety of plans to manage through this period will be vital for success.

Prices at farm/orchard level relative to 10yr average[1]		
Dairy	Dairy commodity prices have fallen sharply, with Fonterra revising down its milk price forecast twice in a fortnight. Our milk price forecast for the current season is now $7.15/kg milk solids (MS), with downside risk.	
Sheep	Lamb returns at the farmgate level have eased in line with a fall in international prices. Due to the lack of demand from markets, processors are not competing hard for lamb at the farmgate.	
Beef	Beef prices have dropped, with both New Zealand and Australia trying to sell more product into the US market to offset reduced demand from China.	
Forestry	Log returns remain very weak. There has been a minor improvement in wharfgate prices, but no substantial improvement is expected in the near term.	

[1] All prices are in New Zealand dollars, except where otherwise indicated.

ECONOMIC OVERVIEW

THE MACROECONOMIC BACKDROP

Economic conditions continue to tighten, although persistent inflation in New Zealand's economy means interest rates are likely to be higher for longer.

This is having an uneven impact across the economy, with primary sectors hit hard by rate rises because of relatively high debt levels.

China's economy is struggling, and this is being felt by exporters, particularly those targeting the China market.

CHALLENGES AHEAD

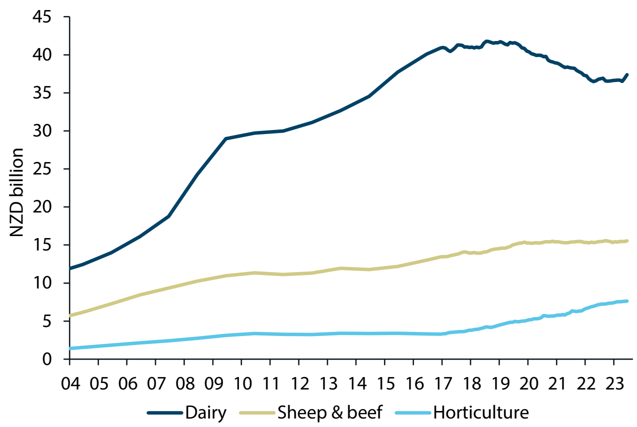
The monetary policy tightening cycle is nearing its end globally. Central banks are slowing hikes or pausing, but it's not clear if they have reached the top yet.

The Reserve Bank of New Zealand's (RBNZ) latest Monetary Policy Statement indicated that, while the Official Cash Rate (OCR) is currently on hold, it may yet have more work to do. The statement's overall tone was that rates will be higher for longer, but it's unclear whether that will need to include further rate rises. Inflationary challenges persist, which is why ANZ Research is forecasting a further 25bp hike in November. But the economy is definitely cooling.

Higher interest rates don't affect everyone in the same way. The higher the level of debt, the more a rate rise will hurt – and the agricultural sector generally carries high levels of debt. So, rises tend to impact primary producers on a different scale to homeowners.

This becomes a real burden when interest rates are high and returns are low. Unfortunately, this is currently the situation for most dairy, sheep, beef and arable farmers.

AGRICULTURE DEBT BY SECTOR



Source: RBNZ

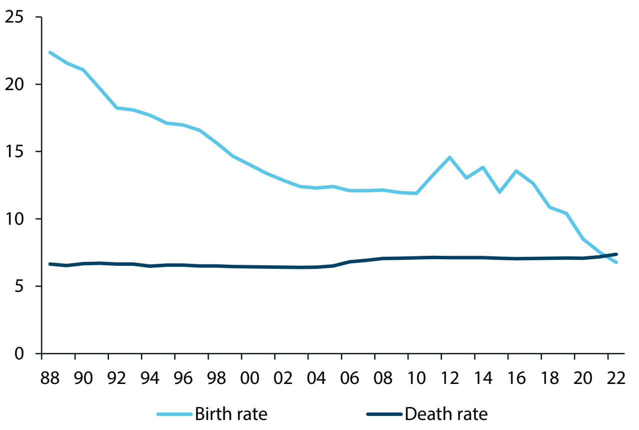
The global economic downturn has suppressed demand for dairy and meat products and is exacerbated by a fall in demand from China. The lack of urgency from Chinese buyers, as they assess consumer demand, has seen the price of our export commodities plummet. China has still been buying relatively large volumes of product, but just not enough to push prices up.

China is facing some structural changes to its economy. Economic growth rates tend to ease when economies move into the middle-income bracket, which is where China now sits. It faces demographic challenges around an aging population, falling birth rates and stalling population growth.

This has direct implications for sales of products, such as infant formula, but also puts greater financial pressure on a smaller working-age population to support and care for the older members of the community.

ECONOMIC OVERVIEW

CHINA DEMOGRAPHICS

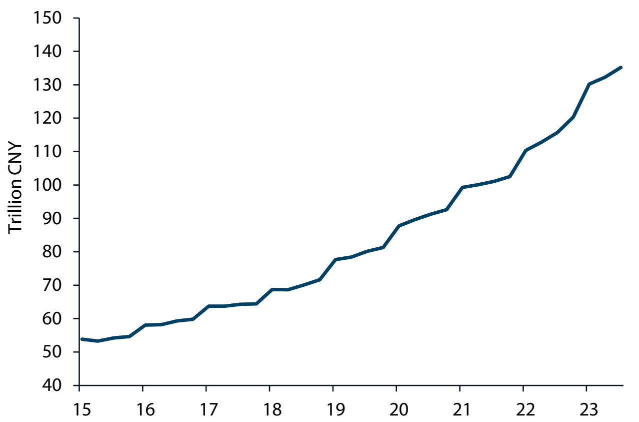


Source: NBS

A prolonged slowdown in the property market and associated financial wobbles are also having wealth and confidence effects in a country where a very large proportion of household wealth is tied up in the sector.

The sharp increase in youth unemployment is also a concern and another reason why those who are earning money are tending to save rather than spend, even as overall unemployment remains low.

CHINA HOUSEHOLD DEPOSITS

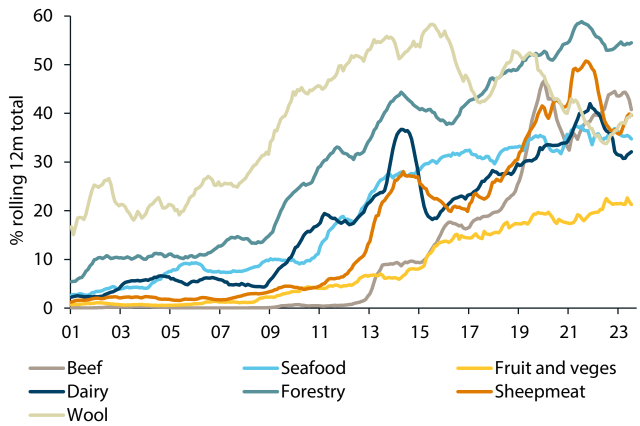


Source: PBoC, NBS

If consumer confidence picks up in China, we could see demand for our export products rise, but this is unlikely to happen until 2024. China's economy will struggle to grow as quickly as it has done in the past, so we are unlikely to see demand for imports increase as it has previously. That said, China has a very large population but does not have sufficient natural resources to economically meet domestic demand, so it will remain reliant on imported food.

China accounts for such a large share of New Zealand's exports that many sectors struggle to replace any drop it its demand in a timely fashion, and this has a widespread impact on export and farmgate prices.

SHARE OF NZ EXPORTS SENT TO CHINA



Source: StatsNZ

Most countries are experiencing relatively low economic growth this year, so consumers are being conservative when it comes to buying higher-value items. This unfortunately includes many of New Zealand's food exports.

In this environment, lower-priced proteins, such as dairy and manufacturing beef, are expected to do better than higher-priced proteins, such as lamb and venison.

Globally, the US market is a bright spot that is proving extremely resilient and its demand for both beef and lamb products is steady.

NEW ZEALAND DOLLAR WEAKNESS

One factor buffering New Zealand against weak global markets is the fact that the NZ dollar (NZD) is relatively weak. A low NZD helps bolster farmgate returns. It's not a free lunch, however, as a lower currency also boosts the cost of imported inputs such as fuel and fertiliser.

The NZD has struggled in recent months, losing ground against the USD, but it's not alone. The Australian and Canadian dollars have also struggled. Along with the NZD, these are often collectively referred to as the commodity currencies.

New Zealand's high interest rates do not appear to have made a great deal of difference to the NZD. Normally, a higher rate of return results in increased investment, stimulating demand for NZD. However, the pace at which central banks across the globe have been lifting rates is

ECONOMIC OVERVIEW

quite similar, so we are not seeing a lot of extra demand for NZD coming from the RBNZ's interest rate rises. Policy rates in the US and New Zealand are very similar, but New Zealand, as a small, export-dependent country at the end of the world, is seen as a riskier, less liquid place to park your money.

The USD is currently seen as overvalued, relative to other currencies, versus its long-run fair value. If the value of the USD retreats, this would push up the value of the NZD. At the same time, though, a drop in the price of NZ's export commodities and the elevated current account deficit could push the NZD lower. These cyclical dynamics appear to be dominated structural considerations at present.

Our forecast is for the NZD to firm a little over the remainder of this calendar year, but this depends on what happens globally, so there is a high degree of uncertainty around that forecast.

Click here to access our latest forecasts.

DAIRY

BUCKLE UP

The global market for dairy products is extremely weak presently, with prices in free fall. Global Dairy Trade's (GDT) Price Index has fallen by over 50% in the past 18 months, and dairy prices are now the lowest in nearly five years.

The sharp fall in returns is having a significant impact on farm profitability with most dairy farms expected to incur losses this year.

WHAT'S DRIVING PRICES DOWN?

The biggest driver of the price fall is China's slowing growth. For several decades, China's growing middle class has meant strong demand for dairy products. But Chinese consumers are currently saving rather than spending, so there isn't sufficient consumer demand to push prices higher.

That said, China is still by far the largest importer of dairy products and is buying roughly the same volumes as in the past. But as it now has plenty of stock on hand, there is less urgency to secure additional product, so buyers aren't bidding up prices.

Other markets also have plentiful stockpiles and subdued consumer demand and have similarly low incentives to buy. Buyers have defaulted to a 'hand-to-mouth' strategy, buying only what they need. When the market gets a whiff that prices may rise, that strategy is likely to change, and buyers will start bidding to secure product ahead of it, but that may not be until 2024.

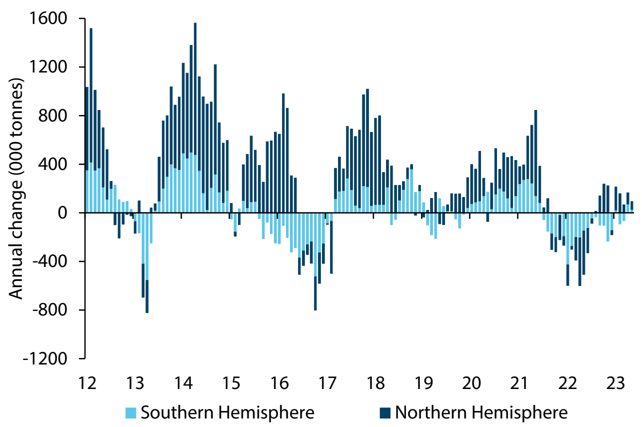
GLOBAL MILK SUPPLY SUBDUED

Global milk supplies are subdued and very likely to contract further, as farmers globally are not making money at current farmgate prices. Any tightening in supply will help rebalance the market, but we are now heading into peak seasonal supply for the Southern Hemisphere dairy-exporting nations.

Of dairy exporters, New Zealand has the biggest variance in its monthly milk supply volumes, from virtually nothing in winter to rapidly increasing output up to peak production in late October before easing into season-end in May.

Other countries, even those operating pasture-based production, such as Australia and Argentina, operate a flatter production curve. They calve a greater proportion of cows outside the spring period, primarily to provide enough liquid milk to meet domestic demand.

MILK PRODUCTION GROWTH FOR MAJOR EXPORTERS



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

New Zealand's spike in milk supply unfortunately means there will be more product to sell in the near term, while the market is still weak.

Fonterra recently increased its forecast for the volume of produce it expects to sell via GDT by the end of 2023.

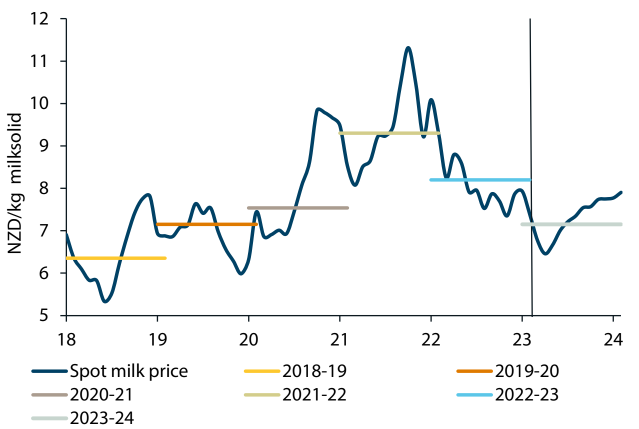
DAIRY

In the past couple of years, the volume of product offered via GDT has been lower, presumably due to an increase in supply contracted directly with buyers. This season's GDT volume has lifted back to a level last seen in the 2020-21 season. It's not that New Zealand has more product to export this year overall, but rather that a bigger share of product is for sale via the GDT platform, with volumes set to lift significantly in the coming months. In the current weak environment, it is therefore hard to see price increases anytime soon.

Fonterra revised down its milk price forecast twice in August. It is now forecasting a milk price of $6.00–7.50/kg MS, with a mid-point of $6.75/kg MS. It is highly likely Fonterra took into consideration that it would need to sell more product on GDT when it downgraded its milk price.

It is too early in the season to provide an accurate forecast for the year ahead; but, based on the sharp downturn in the dairy markets in August, ANZ Research's forecast of $7.15/kg MS currently carries more downside than upside risk. We will continue to monitor markets and revise forecasts accordingly.

FARMGATE MILK PRICE HISTORIC AND FORECAST



Source: Fonterra, ANZ Research

Dairy farmers face a challenging year in terms of both cashflow and profitability. The breakeven point varies from farm to farm, but achieving a profit will require careful cost management and efficient expenditure relative to production, and for many farmers, will be beyond reach even then. Dairy markets typically go through these cycles, but focusing on what can be done, asking for assistance from advisors and keeping cashflow forecasts updated will be imperative.

Dairy farmers across the globe will be finding the current environment challenging. New Zealand does have greater volatility in farmgate milk prices than most other countries due to its higher exposure to global markets. Domestic prices tend to be more stable, and in countries with large domestic markets such as the US, Europe and to a lesser extent Australia, domestic sales buffer exporters to some degree against fluctuations in farmgate prices. But New Zealand farmers can generally produce milk more cheaply than in those countries. The low prices will mean global milk production eases, which will help rebalance the market, although not quickly.

LAMB & WOOL

LAMB MARKETS UNDER PRESSURE

New Zealand's high exposure to the slowdown in China's consumer demand is directly impacting returns, particularly for mutton.

The new season for lamb is likely to start with schedule prices relatively low, but this will hopefully improve before the main processing season in the New Year.

CHINA DEMAND WEAK

Almost all New Zealand's mutton has been sold to China in recent years, with sales to that market having steadily increased over the past decade.

Chinese consumers appreciate mutton's strong taste, and its buyers have tended to pay a premium compared to other markets. Consumers there have also been prepared to pay more for many lower-priced lamb cuts, such as shoulders and flaps, for use in cuisine such as hot-pot.

This has left New Zealand's exporters highly exposed. Processors are now finding it very difficult to sell lamb and mutton into China, where consumers are lack the confidence to spend on nice-to-haves, particularly relatively expensive sources of protein such as lamb.

Our other major markets for lamb are the European Union (EU), the UK and the US. The EU market is still relatively subdued, as its member economies suffer slower economic growth and high inflation. This has made selling conditions relatively tough in recent years. The US market is doing a little better with strong marketing campaigns helping lamb to carve out a niche amongst consumers who favour lean, grass-fed protein.

SCHEDULE PRICES WAY DOWN ON LAST YEAR

Schedule prices for lamb and mutton have fallen by about 30c/kg over the past month. The lamb schedule is now below $7/kg CW, and further downward pressure is expected. This price for lamb is 25% below last season, while the mutton price has plummeted by 46%.

Farmgate prices for lamb and mutton have dropped sharply in recent months, which is unusual for this point in the season. Typically, as the number of lambs available declines in winter, processors pay more. This season prices held through late summer and autumn, when most lambs are processed, but started to drop heading into winter. The drop in Chinese demand is the main reason for that fall.

There are not a lot of lambs being processed at present and only minimal numbers of cull ewes, but meat companies are not competing hard for available supply. Instead, they are concentrating on selling the product they already have in their freezers.

Some of the slowdown in supply to processors is related to the low prices. Given that prices are unlikely to improve in the near term, however, the remaining old-season lambs are likely to trickle into the market as feed availability decreases and lambs get closer to cutting their teeth and therefore being reclassified as mutton.

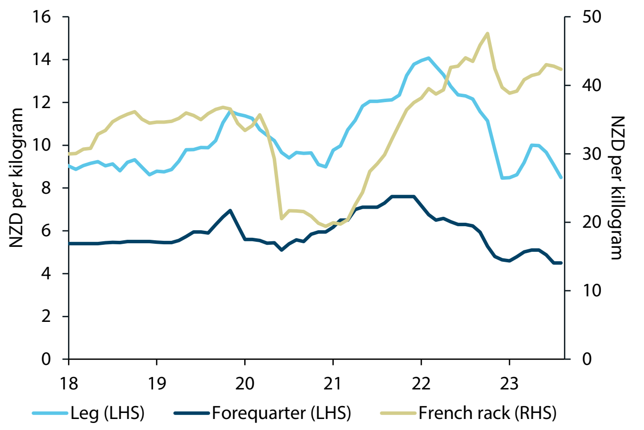
The mutton schedule price is currently $3-4/kg CW, depending on location and processor, but most processors are buying near the bottom end of that range.

Mutton has been hit particularly hard due to its high exposure to China. This season to date, 86% of NZ's mutton exports have been sold to China and 50% of lamb exports, measured by volume.

Space at processing plants can be constrained at this time of the season due to a portion of chains being dedicated to bobby calves. But at present most processors are not reporting any bottlenecks for lamb or mutton.

LAMB & WOOL

LAMB CUT PRICES



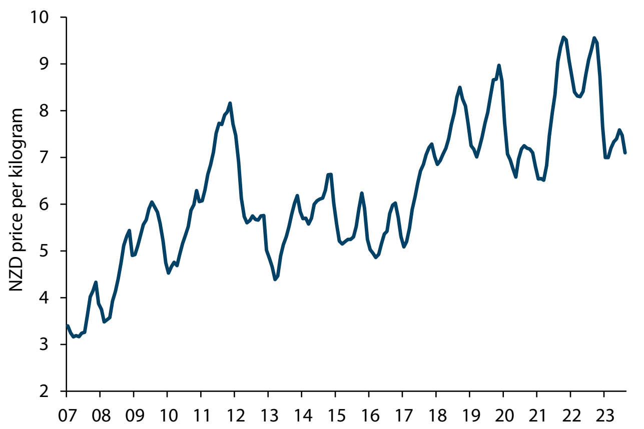
Source: AgriHQ, ANZ Research

FARMGATE PRICES STILL TRENDING LOWER

Farmgate prices are expected to continue to trend lower as the year progresses. No doubt there will be some bounce in pricing once we move into the new season, but overall prices are expected to remain subdued through to Christmas, at least. Whether prices then improve depends on how quickly the China market recovers.

Stocks of lamb in-market have built up, and export figures indicate local stocks may also be building. These will need to clear before there can be any significant improvement in pricing.

FARMGATE LAMB PRICE (19KG LAMB)



Source: AgriHQ, ANZ Research

Lamb's current schedule price is substantially lower than the contract price for winter supply offered by processors earlier in the year. At this point winter lamb finishers will wish they had contracted greater numbers of lambs, whilst processors will wish they had contracted fewer lambs unless they have back-to-back contracts with overseas buyers.

STORE AND FINISHED LAMB DEMAND FALLS

Soft schedule prices and uncertainty around the future price are impacting demand for store lambs, but the price hasn't plummeted as much as for finished lambs. Store lamb prices are $3.00-$3.50.

Prices are generally stronger in the South Island where feed is less of a concern, with some farms needing more stock to help keep pasture covers in check.

Those who hold winter contracts tend to underpin pricing in this market at this time of the season.

BOGGY CONDITIONS FOR LAMBING

Extremely wet conditions in many regions this winter are making farming difficult. Finding a dry piece of land for lambing ewes isn't easy. Lamb losses are expected to be higher than normal, but actual losses will depend on the weather over the next couple of months.

The wet weather favours farming sheep over cattle, and we may see some farms tweaking their sheep:cattle ratio in favour of more sheep as they look to avoid carrying heavy stock through wet winters, particularly if these become more prevalent.

BEEF

EXTRA SUPPLY PUTS PRESSURE ON PRICES

Relatively large volumes of New Zealand and Australian beef are being sold into the US market due to weakness in other markets.

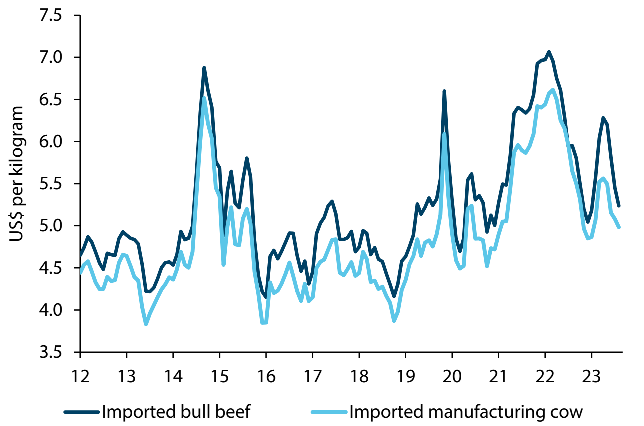
This means New Zealand's farmgate prices have eased this winter, which is contrary to what typically happens. During autumn prices held at higher levels than normal.

GREATER VOLUMES OF BEEF GOING TO THE US

Global prices for beef remain under pressure due to supply increases in the face of subdued demand. New Zealand and Australia are both exporting larger volumes of beef, which has put downward pressure on prices.

It is not unusual for prices to ease when volumes increase. Typically, this occurs earlier in the season –April or May – when the annual cull of dairy and beef cows lifts the volume of processing. This season, pricing has been strong throughout the autumn but has now softened.

US IMPORTED BEEF PRICES



Source: USDA, AgriHQ

Beef prices have eased about 15% over the past three months but the relatively weak NZD has cushioned some of the impact. Generally, beef prices are holding up better than lamb. This is not unusual because in economic downturns cheaper proteins such as beef tend to do better than more expensive choices like lamb.

Globally, the market for lamb is a fraction of the size of the beef market, which tends to be the more stable of the two.

The US economy is also preforming a little better than other markets, which is helping support its demand for imported beef. In recent months, exporters in both New Zealand and Australia have been pushing more product towards the US, because demand from Asia is weaker than normal.

Despite weakening growth, China is still importing relatively large volumes of beef, particularly from Brazil. Underlying demand persists, but China's buyers are no longer prepared to pay more than other markets to secure product.

Australia typically sells a lot of beef into Japan and South Korea. At present Japan's demand is weak as the economy is struggling. Stocks of beef in Japan are also building, which will curtail demand in coming months. This means Australia will also be redirecting the beef that would normally go to Japan to other markets such as the US.

CATTLE NUMBERS FALL IN NORTH AMERICA

The US domestic beef market has been diminishing due to higher-than-normal levels of culling. This has increased US beef production in the past couple of years, but herd numbers are likely to stabilise. This will mean the US will be producing less beef in the year ahead than we have

BEEF

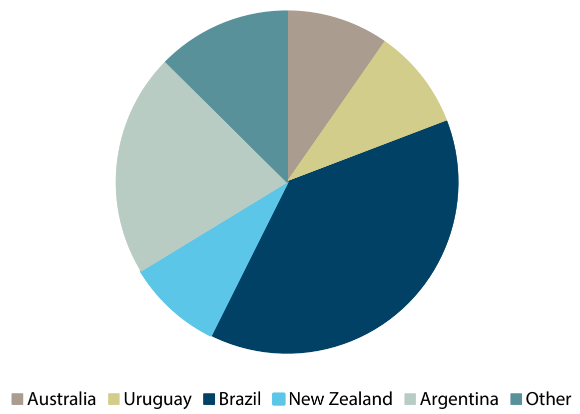
seen recently, which will help support the market for imported beef.

The number of beef cows in the US was estimated at 29.4 million at the beginning of July, down 2.6% y/y. Canada's beef herd is also shrinking due to the drought affecting many parts of the country. While this is yet to translate into higher demand for imported beef, that is likely to occur in the future.

SOUTH AMERICAN BEEF EXPORTERS FOCUS ON CHINA

Brazil is the world's largest beef exporter, and changes in supply from this market have a huge impact on global markets. Brazil tends to export mainly to Asian markets but focuses heavily on China, which took nearly 60% of its beef exports in the first half of the year.

CHINA BEEF IMPORTS BY COUNTRY



Source: China Customs

Brazil's beef export volumes are about four times larger than New Zealand's. At present, a little more beef is coming out of Brazil, although this is partially offsetting reduced supply from Argentina and Uruguay. Both Argentina and Uruguay are heavily dependent on China, which takes about 80% of the Argentina's exports and well over half of Uruguay's.

Argentina has been slaughtering more cattle than usual, but as yet this hasn't hit global markets due to internal measures to limit beef export volumes. Argentina regularly controls exports to manage the price of beef (and other goods) in its domestic market. At this stage it isn't clear whether more will be exported from Argentina in the future or not.

AUSTRALIA BEEFS UP EXPORT VOLUMES

The quantity of cattle being slaughtered in Australia is running at elevated levels. Following several years of low slaughter volumes, numbers are back near the five-year average. This is resulting in more Australian beef being available for export.

This, combined with relatively weak demand from Asian markets, means Australia has started exporting more beef to the US. This extra supply is putting downward pressure on the price US buyers are prepared to pay. This situation is expected to continue and will keep pressure on export markets for some time.

DEER

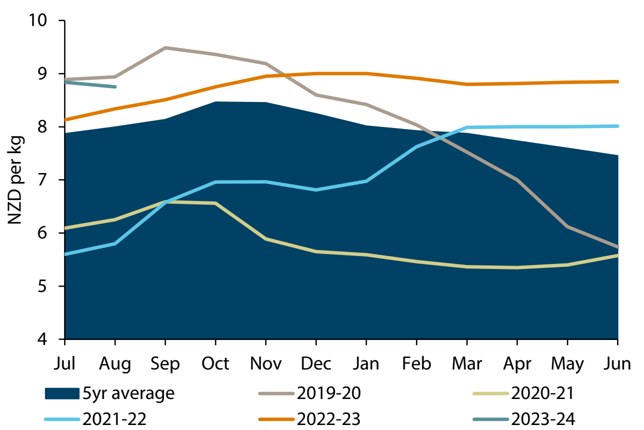
VENISON DOING OKAY

Farmgate prices are holding up better for venison than for most other forms of protein. What will really matter is where the schedule price sits as we move into the main processing season for young stags.

Venison's diversified market is helping returns. While the China market is challenging, the US market is proving more resilient from an economic point of view.

Farmgate prices for venison eased marginally in July and have been stable since. The current price is slightly stronger than it was a year ago. Exporters are making a concerted effort to stabilise farmgate returns to rebuild confidence in this market.

VENISON FARMGATE PRICES (BASED ON 60KG STAG)



Source: AgriHQ

The industry is working hard to connect with potential high-end consumers, with restaurant chefs demonstrating the qualities of venison. This strategy is gradually paying off, but it is taking time to bolster sales and meaningfully improve farmgate pricing. However, there are indications that confidence in the industry is rebuilding following a period of very low returns.

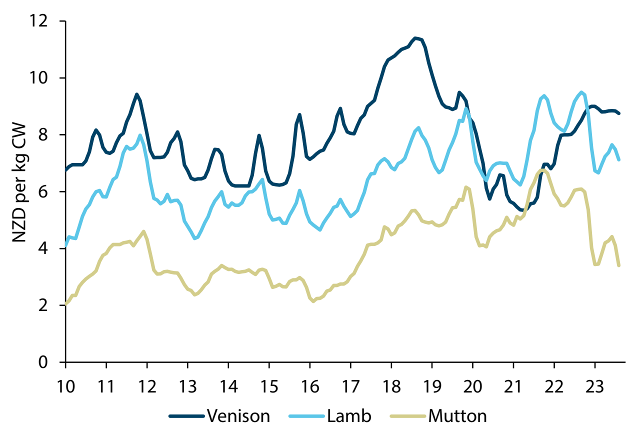
One area of concern is how environmental emissions for deer are managed. In terms of management, deer have their challenges as they like to wallow. Fencing to keep deer away from waterways is expensive and practically challenging.

Deer are ruminants so they also produce methane. The industry is working with government to ensure that legislation is feasible for the industry. Research is also being undertaken to work out how emissions can be reduced by changing on-farm policies. Potential changes include altering winter crops and pasture species, retiring some areas of land and offsetting through planting additional trees.

Many farmers are passionate about farming deer, but if returns are not high enough, or environmental legislation is too restrictive, the number of deer farmed in New Zealand could shrink.

At present the returns from deer are stacking up better than other species simply due to the recent sharp fall in farmgate prices for lamb, mutton and beef. Prices for venison are still below the level the industry would like them to be, but the fall in returns from the other industries will help many farmers justify retaining deer as part of their overall enterprise.

FARMGATE PRICES BY SPECIES



Source: AgriHQ

GRAIN

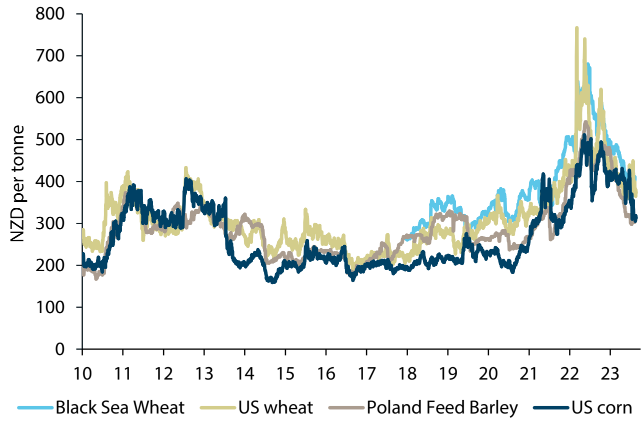
GLOBAL GRAIN SUPPLIES CONTRACTING

A high level of uncertainty continues to hang over global grain markets as transporting grain out of the Ukraine remains challenging.

Overall, global crop production is expected to ease in the season ahead and export volumes are expected to fall.

Locally, producers are focusing on getting ground prepared for spring planting, but this is likely to be later than normal in some regions due to excessively wet soil.

WORLD GRAIN PRICES



Source: CME Group, Polish Ministry of Agriculture & Rural Development, ANZ Research

SUPPLY CONCERNS AS RUSSIA PULLS OUT OF BLACK SEA DEAL

Global grain markets remain volatile. Wheat and corn production for the 2023-24 season is expected to be similar to the previous year, but the exportable volume is expected to fall by about a third, as it is now very challenging to ship grain from Ukraine.

On 17 July, Russia withdrew from the Black Sea Grain Initiative, set up a year earlier to allow the export of grain and other agricultural products from several of Ukraine's Black Sea ports. Wheat exported from Ukraine has tended to head into the Middle East/North Africa regions as well as to China and the EU. Corn exports have mainly moved into China and the EU. Attacks on ships in the Black Sea are limiting the volume of grain being moved from Ukraine to Turkey or into the Danube River system, which means Ukraine is having to move more grain overland into Europe. Grain from Ukraine is being exported via ports in both Romania (into the Black Sea) and Croatia (into the Adriatic Sea), which is helping alleviate pressure.

Global wheat production and export forecasts are lower for the 2023-24 season. Less wheat is expected to be produced in China, Europe, the US and Canada, while more wheat is forecast for Kazakhstan. But Russian export volumes are forecast to grow.

Many countries are avoiding trade with Russia, but China remains one of its major grain buyers. Unsurprisingly, Russian grain is slightly cheaper than product from other markets.

Global grain prices have consolidated a little in recent weeks, with prices in the most expensive markets – the US and Canada – easing, while the price of Russian and Australian wheat has increased.

COARSE GRAINS

Global corn production is expected to ease from the near record volumes achieved last season. China, Russia, the EU and the US are expected to produce less, while Canada and possibly Ukraine are expected to produce more.

Corn prices are trending down despite expectations of lower export volumes. We expect Brazil and the US to export less, which will be more than offset by the increase in exports forecast for the EU, Canada, Russia and Zambia.

GRAINS

AUSTRALIA EXPORTS MORE BARLEY TO SOUTH KOREA

South Korea relaxed its import restrictions on barley as it was worried about supply shortages following Russia's invasion of Ukraine. It increased the volume of its import quota from 40,000t to 250,000t in 2022. Australian exporters particularly welcomed the increased access to South Korea, given the country's record crop last year and its exclusion from the China market at the time. For 2023 South Korea set its barley import quota at 100,000t and this is expected to fall further next year. However, Australia has regained access to China's market, so is no longer as reliant on Korea.

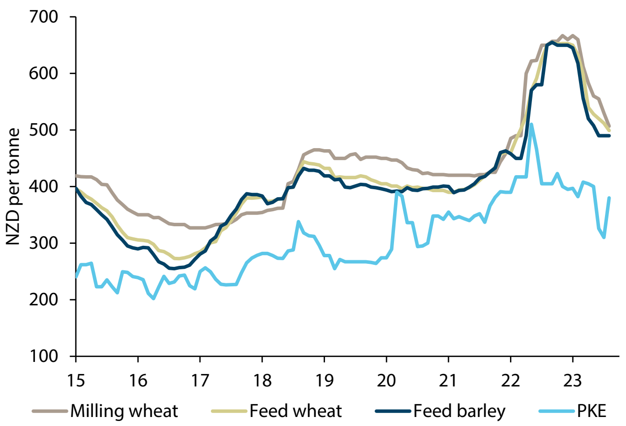
LOCAL MARKET

New Zealand's arable farmers are preparing land for spring planting. There are expected to be some delays to spring plantings due to soil being excessively wet in many regions.

There are concerns regarding how much grain the dairy industry is likely to purchase this season, given the sharp downturn in the forecast milk price.

The price of palm kernel expeller (PKE) has risen significantly and is now selling at about $400/t. This is not far below the spot price for domestic feed wheat and feed barley, which have a higher energy content and are more palatable feeds, as well as being perceived as a more ethical choice.

NEW ZEALAND GRAIN PRICES



Source: NZX

So, while we may see a reduction in the total quantity of feed purchased by dairy farmers, we are likely to see some farmers buying wheat or barley instead of PKE, which may mean overall demand for locally produced feed grains does not differ much this season from last.

Local flour mills are still showing an interest in contracting locally produced wheat this season, and contracts for feed wheat are still available.

Some growers have turned their backs on growing premium-grade wheat for local mills following problems with securing contracts in recent years. Some are opting to grow feed-grade wheat instead, in order to reduce costs. The disruption in supply in recent seasons means the current spot price for milling is $600/t, which is substantially higher than the spot price for feed wheat, which is currently as low as $450/t.

Pricing varies somewhat, with feed wheat and feed barley prices ranging up to $500/t in the South Island and even higher in the North Island. The price of maize grain has eased slightly but is still trading near $600/t in the spot market.

FORESTRY

LOG MARKETS UNDER PRESSURE

International markets for logs remain weak, and it is unlikely that this situation will improve soon.

New Zealand's supply of logs for export dropped over the winter, partly in response to lower returns but also due to wet conditions and damaged road access to forests that caused logistical challenges for harvesting.

The Emissions Trading Scheme (ETS) and the 'permanent forest' category are both under review. Demand for land to plant trees for carbon fell sharply over winter as did the volume of planting, due to uncertainty about proposed legislative changes.

GLOBAL DEMAND SUBSIDES

Pricing in international markets has stabilised recently but the pain is not yet over for log exporters. Prices have fallen 30% since March but have stabilised somewhat in recent weeks. That has prompted speculation that market fundamentals are now improving, but unfortunately this doesn't appear to be the case.

At current uptake levels, there is about 60 days worth of stock sitting on Chinese wharves. That is considerably more than normal, and underlying demand remains relatively weak.

Although New Zealand's supply of logs has dropped dramatically, China is importing logs from other sources, rapidly replenishing stocks.

In the current market – where the utilisation rate for logs is low – it seems unlikely that prices will lift substantially. The slowdown in China's property sector has lowered demand for logs for construction. Manufacturing has also slowed, lowering demand for timber for pallets and crates.

AUSTRALIA'S LOG EXPORTS TO CHINA TO RESUME

China banned the import of Australian logs in late 2020 after reporting bark beetles in some shipments. Tension between the two countries meant it has taken a long time to resolve this issue. Relations are improving and a meeting between the heads of the two countries is proposed for September. In May, China advised it would be lifting the ban on Australia logs.

In 2020, prior to the ban, Australia exported about 4 million tonne of logs to China, mainly pulp grade but about a third was higher-quality logs suitable for sawn timber.

It is unclear how many logs Australia will now export. Mills there have benefited from the closure of this major export market, and some market participants feel Australia should keep its high-quality timber resources for the local housing market and only export pulp-grade logs. Exports to China are expected to resume in the coming months, but it seems unlikely this will be at the level seen prior to the ban.

Aside from New Zealand and Australia, China imports softwood logs from Uruguay and large volumes of logs from Europe, Russia and North America. The supply of logs from Eastern Europe has waned since it surged in 2021 on the back of large-scale felling of forests to prevent the spread of bark beetles.

The supply of logs from Russia has also slowed this year, as China's demand for logs waned. The volume supplied by New Zealand hasn't dropped by nearly as much as supply from other countries, meaning it has increased its market share and is now supplying about 40% of China's imported logs.

Nonetheless, anecdotal evidence suggests low prices and weak international demand led to fewer shipments of logs leaving New Zealand in July. Pricing has now stabilised, and some market participants are reporting

FORESTRY

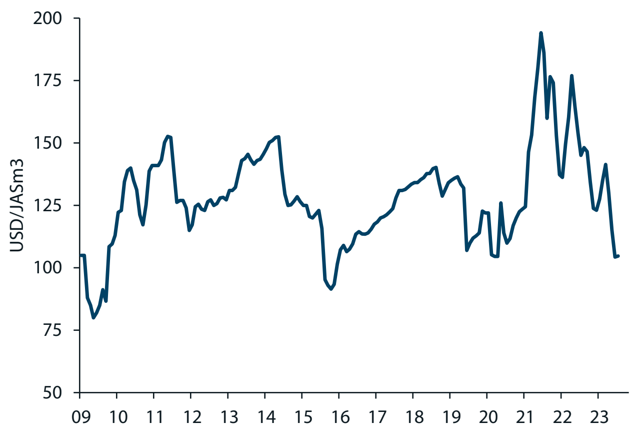
small increases in prices and export volumes. But any substantial rise in pricing is unlikely to occur soon given the state of China's economy and its property sector in particular.

LOWER SHIPPING COSTS PROVING BENEFICIAL

Shipping costs have been gradually falling, helped along by weaker overall demand.

Wharfgate prices have improved a little as a result of the stabilisation in-market prices and easing shipping prices. The NZD is yet to show any signs of strengthening, which is also assisting returns to exporters and growers.

UNPRUNED A-GRADE LOG PRICE



Source: AgriHQ

Wharfgate prices are now back above $100/JASm^3 in the North Island, but South Island prices are softer due to the additional cost of moving logs from the southern ports.

WET WEATHER BRINGS CHALLENGES

Extremely wet conditions plaguing many regions of New Zealand have hindered harvesting. On some sites, it is difficult to get machinery in and trees out due to damage to private forestry tracks and public roads.

EMISSIONS TRADING SCHEME CHANGES

Proposed changes to the ETS to increase incentives to reduce gross rather than net emissions are under consideration. The difference between gross and net is the reduction primarily given for sequestration, that is for planting extra trees.

Under current settings, emitters are tending to offset emissions by investing in forestry or purchasing carbon credit units (NZUs), rather than investing in technology or changing systems to reduce emissions.

Several of the proposed options would result in a lower price for NZUs generated from sequestration via trees than the price that emitters would normally pay, in order to tilt incentives towards gross emissions reduction.

The initial public consultation phase for the changes closed on 11 August, but any changes are expected to take time to be finalised. In addition to that potential change, the types of trees included in the 'permanent forestry' category are also under review.

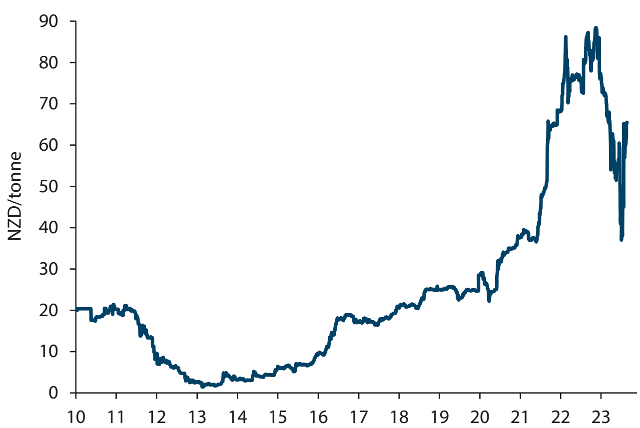
Changes have also been made to the National Environmental Standards for Plantation Forestry, which will allow councils to require landowners to apply for a consent to change land use to forestry.

These regulatory changes have caused uncertainty, resulting in a slowdown in farmland being sold for forestry and the amount of planting this winter.

CARBON MARKET BOUNCE

Carbon prices shot up in late July following the announced changes to the ETS settings for the current and subsequent years. When the settings were initially announced in December 2022 the market was surprised that they did not align with the advice from the Climate Change Commission (CCC). The settings had a considerably lower reserve price and there were more units available to auction than the much lower number the CCC deemed necessary to provide the necessary incentives for New Zealand to meet its climate change obligations.

NZ CARBON PRICE



Source: Bloomberg, ANZ Research

FORESTRY

Following a High Court ruling, the Minister of Environment announced on 25 July that the ETS settings would be changed to align with the CCC's recommendations. These settings won't apply until the final quarterly auction of NZUs for the year, scheduled for 6 December. At the next auction, on 6 September, the previous settings will still apply.

Following the High Court's announcement, the carbon price bounced back over \$60/t CO_2e and has since traded near this level. While the minimum price at which NZUs can trade at the 6 September auction is \$33.05, a confidential reserve price also applies that is linked to the price at which the NZUs have been trading in the secondary market in the lead-up to the auction. This means there is unlikely to be any bargain-price NZUs available at this event unless the carbon trading price plummets before the event.

HORTICULTURE

LOWER YIELDS SUPPORT PRICES

The common theme across horticultural sectors is of smaller yields, which is helping support prices.

Most kiwifruit and apple growers still face financial challenges. Wine growers have done a little better with the size of this season's harvest being referred to as ideal.

APPLES: REDUCED GLOBAL PRODUCTION

New Zealand is not the only country to have experienced a smaller apple harvest than usual. While the Hawke's Bay floods severely curtailed local production, harvests in several other countries have also been lower than normal. This reduced production is helping offset some of the price impact of weakening consumer demand.

Production in the main European apple-growing markets is forecast to be down 3.3% y/y in 2023. However, 2022 was a big harvest, so the current estimate is closely aligned with the longer-term average.

China, the world's largest apple grower, is expected to produce a crop of 37.2 million tonnes, about what it produced last year. Apple production in 2023 is expected to fall in the US by 3.6% y/y.

Excess heat across the Northern Hemisphere has contributed to the reduction in expected yields.

Pear production in Europe is also under pressure with this season's crop estimated to be 13% smaller, primarily due to a 63% drop in Italy due to flooding, but also smaller volumes from France and the Netherlands.

While New Zealand doesn't export pears, the reduction in global supply of both pears and apples is helping to support prices for its apple exports.

KIWIFRUIT: HARVEST

The kiwifruit harvest is now complete, with the total harvest estimated to be less than 140 million trays, 20% lower than the previous season.

While lower yields this season mean grower incomes will be down, this has been partially offset by stronger pricing. The real challenge will be how well prices can be maintained next season when volumes are forecast to lift substantially.

The industry continues to focus on fruit quality to ensure consumers have a good experience and remain or become loyal buyers of Zespri-branded fruit. Overall fruit quality has been considerably higher this season than last, although some organic green fruit in-market in the US was recalled.

Zespri reported on 10 August that it had already sold over 60% of this season's fruit, which is more than normal for this time of the year. Selling of Zespri Red was finalised in May. As the season progresses it becomes harder to obtain premium pricing for kiwifruit in the European markets, as summer fruit comes onto the market, making it harder to garner both shelf space and customer enthusiasm. Therefore Zespri is working to sell fruit as quickly as possible to achieve higher returns.

The stronger prices have allowed Zespri to revise up its forecast prices for the 2023-24 season towards the upper end of its previous guidance range.

HORTICULTURE

ORCHARD GATE FORECAST PRICES – AUGUST 2023

Kiwifruit variety	2023-24 per tray forecast	2023-24 per tray forecast range	2023-24 per ha forecast	2021-22 per ha forecast range
Green	$8.10	$7.80 - $8.60	$55,683	$54,000 - $60,000
Organic Green	$11.20	$10.70 - $11.70	$49,956	$48,000 - $52,000
SunGold	$11.50	$11.00 - $12.00	$130,908	$125,000 - $137,000
Organic SunGold	$13.10	$12.60 - $13.60	$101,076	$97,000 - $105,000
Sweet Green	$9.80	$9.30 - $10.30	$45,947	$44,000 - $48,000
RubyRed	$23.30	$22.80 - $24.80	$36,044	$35,000 - $38,000

Source: Zespri

In China, Zespri is awaiting the resolution of legal action regarding the vast area of unauthorised plantings of its Gold3 registered variety. At present, there are an estimated 7,850 hectares of unauthorised plantings in China, but the rate of new planting has slowed. While it may be difficult to achieve a resolution the action is at least helping to slow further plantings.

In August Zespri paid a final dividend of 18c per share for the 2023 financial year and an interim dividend of 66c per share relating to the 2024 financial year.

WINE HARVEST 'IDEAL' SIZE TO MANAGE

New Zealand's wine harvest resulted in a 6% lighter harvest than the record harvest in 2022. Total yield this harvest was 501,000t, down from 532,000t in 2022.

The size of this year's harvest is being referred to as "not too large and not too small". An extremely large harvest can be challenging to process and sell, whereas a very small harvest means some wineries may not have sufficient product to fulfil contracts.

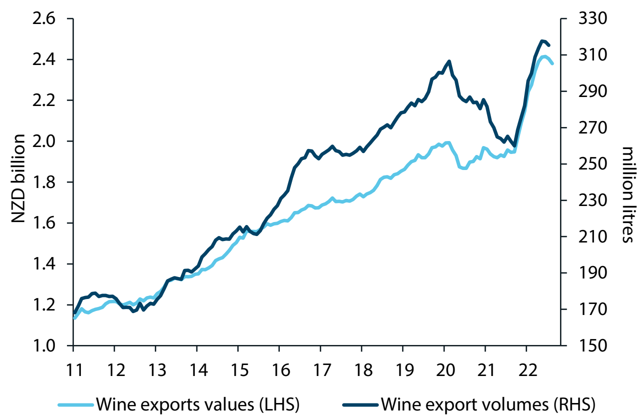
The quality of the grapes harvested can also be influenced by the yield, with smaller crops generally producing better-quality wines. This year's harvest is considered to be of high quality.

Yields in Marlborough, a region that accounts for more than 81% of the total harvest, were down 5%. Hawke's Bay's harvest was down only 4% on the previous year, despite a cyclone hitting during the harvest. But losses were very uneven: unfortunately, some growers in Hawke's Bay lost their entire harvest and several vineyards were obliterated.

Wine exports in 2023 have been strong to date, with sales earlier in the year relating to the previous year's harvest. Export volumes for the year to date are well ahead of 2022 but are forecast to be lower than last year in the latter half of 2023.

North American markets continue to pay the highest price for New Zealand wines, with the European and Australian markets paying lower prices per unit. This is influenced by the varieties being sold to the various markets and also by the format in which it is delivered. A lot of wine destined for the UK and EU is sold in bulk and bottled in-market, which lowers its per unit price but doesn't necessarily reduce profitability.

NZ WINE EXPORTS (12 MONTH ROLLING)



Source: Stats NZ

RURAL PROPERTY MARKET

INVESTOR CONFIDENCE WEAK

The spring market for rural properties is expected to remain soft. Investor confidence is weak as the risks of lower profits and more complex compliance requirements are priced into property values.

Investment in property is a long-term decision funded by profits generated over the next 20 years, yet in practice decisions are often heavily influenced by the current state of the market.

The downturn in commodity markets is squeezing incomes, while operating costs and interest rates remain relatively high. These factors are weighing on profits in the short term and challenging investor confidence.

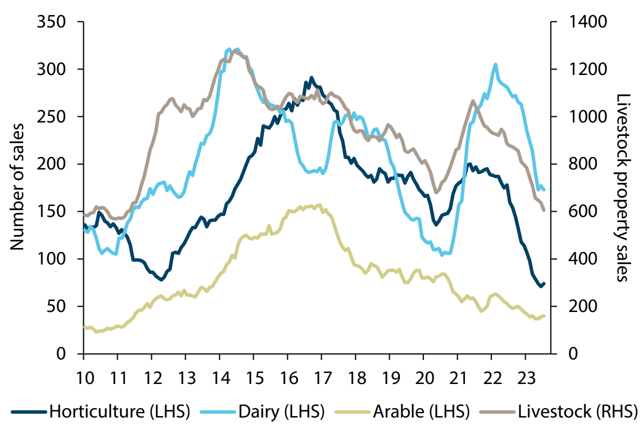
The rural property market is expected to be relatively subdued this spring as the recent reduction in farm incomes for most sectors is factored into long-term investment decisions.

Uncertainty associated with the changes to the ETS discussed in the Forestry section above has stalled investment in land for forestry conversion. This has effectively "pulled the rug out" from under land prices in the sheep and beef sector. While forestry owners are likely to still be rewarded for sequestration, there is uncertainty as to what the level of this will be and whether restrictions will be imposed on using Pinus Radiata for permanent forests.

Even prior to the recent downturn the rural property market was relatively subdued, with more listings than buyers. This trend is expected to only become clearer in the year ahead.

In the past year, the number of rural properties that changed hands fell by a third. Dairy properties traded fell 42%, livestock properties 29% and horticultural properties 60%.

SALES VOLUMES (12 MONTH ROLLING AVERAGE)



Source: REINZ

Falling sales numbers tend to indicate lower prices ahead. We are expecting market conditions to soften in the coming months due to the number of properties available and the lack of investor interest.

We anticipate that prices will fall for most sectors as higher interest rates take a toll on the viability of the investment, as well as the impact the current economic downturn is having on farm incomes.

Environmental regulations are also having an impact on how readily properties trade. Properties that hold all the necessary consents and are well placed to have these those renewed are a much more favourable investment option than those that carry risk of non-consent.

Buyers are spending a lot more time on due diligence on farm purchases. In the current market where there are more sellers than buyers, buyers are not feeling pressured to make a quick decision to secure a property.

RURAL PROPERTY MARKET

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	175	271	225	↓	↓
	Median price ($ per ha)	41,000	41,655	35,392	↓	↑
Livestock	Number of sales	606	877	978	↓	↓
	Median price ($ per ha)	19,950	22,283	19,149	↓	↑
Horticulture	Number of sales	74	160	192	↓	↓
	Median price ($ per ha)	395,875	436,333	247,154	↓	↑
Arable	Number of sales	40	50	93	↓	↓
	Median price ($ per ha)	37,150	37,367	39,315	↓	↓
Forestry	Number of sales	42	62	54	↓	↓
	Median price ($ per ha)	7,236	13,610	9,078	↓	↓
All farms	Number of sales	1,016	1,506	1,576	↓	↓
	Median price ($ per ha)	28,292	30,250	26,064	↓	↑

Source: REINZ

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Last updated: 18 April 2023

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