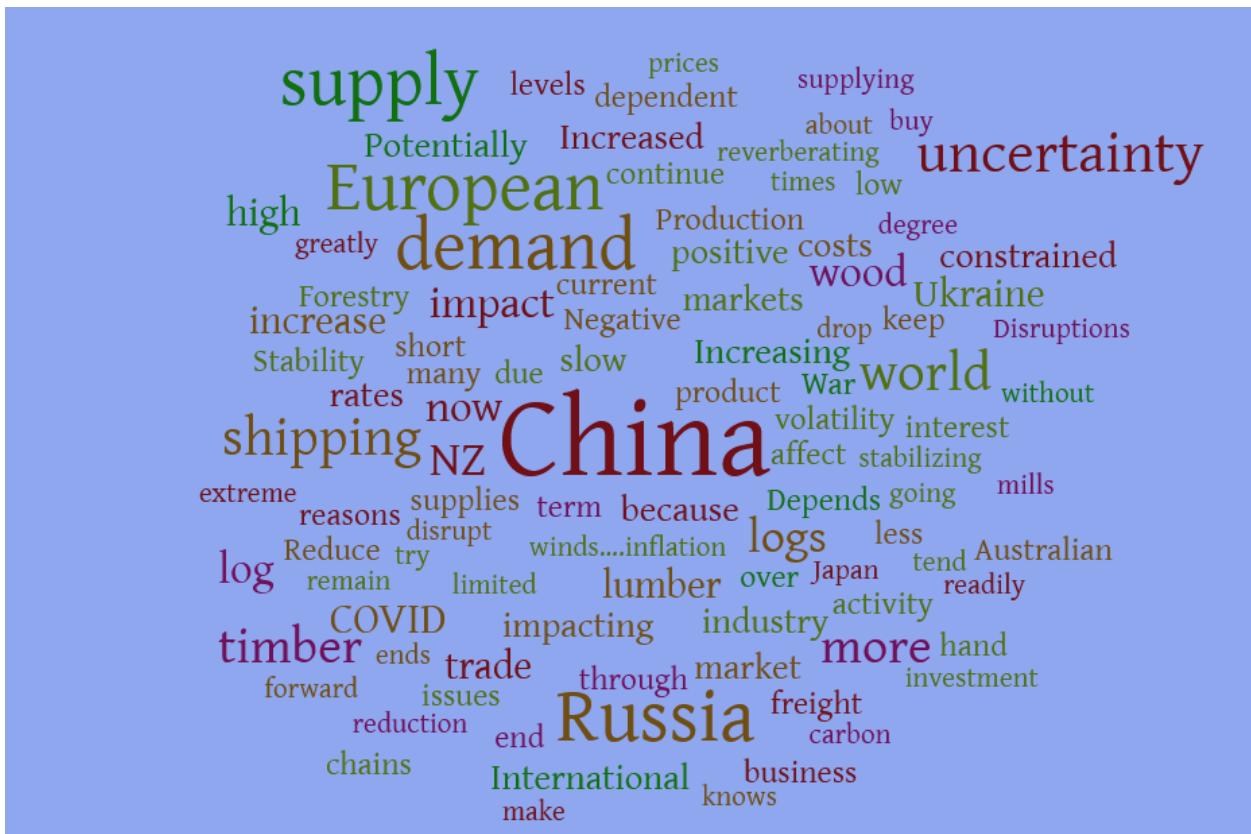


New Zealand Forestry Business Outlook – May 2022

By Karen Bayne and Melissa Welsh



Summary: Twenty-three people from various parts of New Zealand's domestic and international forest products supply chains participated in this outlook. These participants represent a large component of the NZ forestry industry. Log prices between the two reported grades show very divergent trends this quarter. Unpruned log prices have been highly volatile month to month, with May price for A grade landing at \$126/m³. Respondents anticipate a slight price fall over the coming quarter, and a steady recovery for the following nine months to \$131/m³ by May 2023. In contrast, pruned log price this quarter has remained relatively high, with a May price of \$173/m³. Respondents do anticipate a price decrease to \$161/m³ by August 2023 however, before rebounding to \$176/m³ by May 2023.

Business confidence has weakened, with 44% of respondents holding a negative outlook compared to 36% last quarter. Just 17% hold a positive outlook, down from 24% last quarter. Confidence has been shaken due to high levels of uncertainty within key markets, irregular and lumpy supply chains, high freight and roading costs, and the long tail of Omicron at home coupled with China's Covid woes.

The war in Ukraine appears to have potential for both positive and negative impacts for New Zealand producers, but which direction this will tip towards is still unclear. The two large questions are which way China will move with respect to political alignment, and bilateral trade agreements; and how fast Russian and European supply chains can adjust to the shift in trade conditions. This outlook provides some insight into respondents' views around likely impacts. We also report on the transition towards EDN as an alternative fumigant.

LOG PRICE OUTLOOK

Unpruned log prices (Fig 1) show the unexpected level of volatility in the market over the past quarter, after fairly stable prices in Q4 2021. An increase in March to \$132/m³ was followed by a sharp fall back to Q4 levels (\$104/m³) and a quick rebound to \$126/m³ in May 2022. Respondents forecast a slight reduction in log price to \$120/m³ by August 2023, and then a steadily increasing price trajectory back to \$131/m³ by May 2023.

Following a Q4 2021 price increase in pruned logs, the market has somewhat stabilised over the past quarter to within the \$170-185/m³ range for pruned (Fig 2). Respondents anticipate a price decrease to \$161/m³ by August 2023 however, before rebounding to \$176/m³ by May 2023.

Figure 1: Forestry business expectation outlook for unpruned wharf log price over the period May 2021 to May 2023
(A Grade is used as a general proxy)

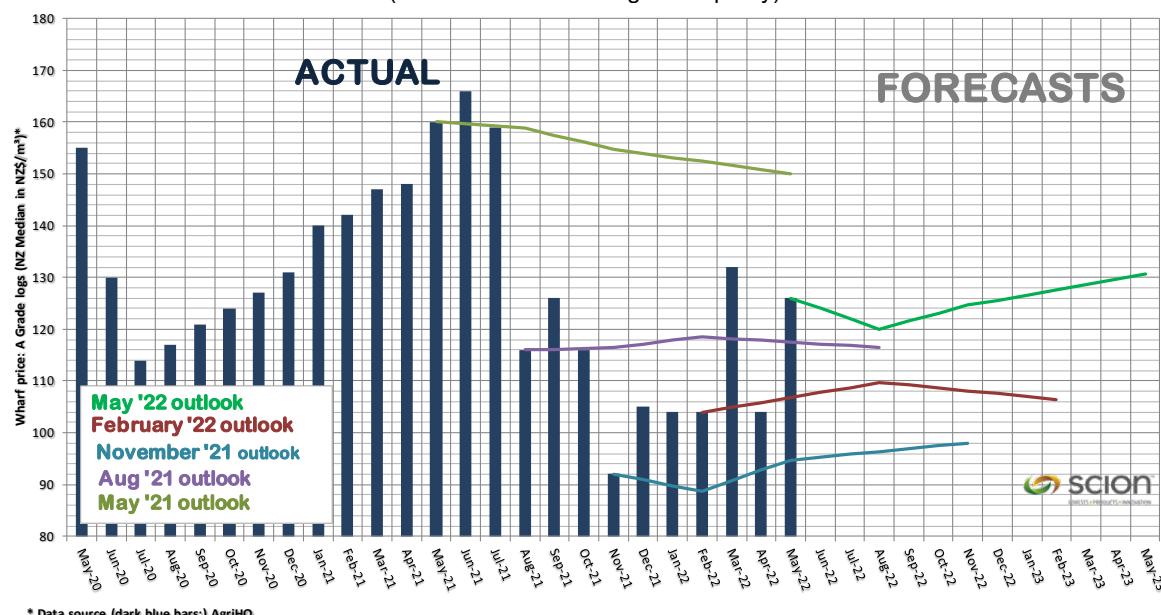
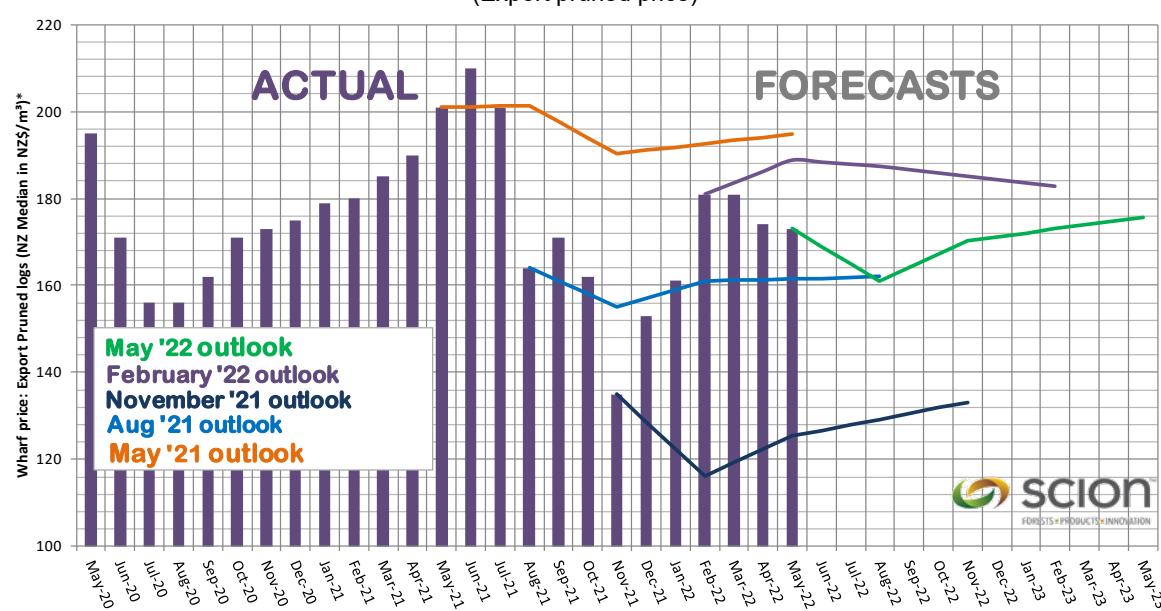


Figure 2: Forestry business expectation outlook for pruned wharf log price over the period May 2021 to May 2023
(Export pruned price)



This quarter's histograms (pg 6-7) provide a very wide range of viewpoints as to where prices will head over the coming year, reflecting ongoing uncertainty in the forest sector. In terms of export log volumes short term (3-6mth) forecasts from respondents provide a range of $\uparrow 30\%$ and $\downarrow 20\%$. Long term (12 month) estimates are even more diverse, with many individual views ranging from a 50% increase in volume to a 15% decrease. Overall respondents estimate an average 4% volume decrease for export logs in 3 months, a 1% volume increase in 6 months, and an 8% volume increase by May 2023.

Pruned log pricing reflects a similar broad range of views, though fewer individual viewpoints. Respondents anticipate steady or falling pricing in the next 3 months (range of views is $\uparrow 5\%$ to $\downarrow 30\%$), with more mixed views on pricing for 6 and 12 month forecasts (range of views is $\uparrow 15\%$ to $\downarrow 30\%$; and $\uparrow 15\%$ to $\downarrow 15\%$, respectively). In terms of domestic log volumes, compared to today these are anticipated to remain very steady overall, with a -1% average volume change in 3 months, and no change from today estimated by respondents for the 6 and 12 month forecasts. There is wider spread this quarter in individual views compared to previous quarters, with long term estimates (12 month) ranging from 10% increase in volume to 20% decrease in volume, on today's figures.

BUSINESS CONFIDENCE

Respondents remain pessimistic, and business confidence is not strong, with 44% holding a negative outlook compared to 36% last quarter, and just 17% holding a positive outlook down from 24% last quarter. A similar number (39%) feel there are stable conditions ahead. The weakened confidence is due to China's continued Covid elimination strategy and the ongoing conflict in Europe, coupled with changing fumigation requirements for access in key markets.

Respondents continue to report a constrained business environment, with the strong possibility of domestic recession and ongoing global uncertainties muddying the trade waters. However, markets remain strong with reasonable demand:

- “Stable with uncertainty.”
- “Strong market demand.”
- “The world in the short to medium term has too many head winds....inflation, interest rates and impending recessions. China is facing difficult times”

Reasons given for expecting a positive change to business include the opportunities from decarbonisation, particularly for forest investment and the better outlook for trade with China post the Covid lockdowns in that region:

- “Disruptions and supply crunches will lead to opportunities for investors also decarbonisation is impacting investment activity positively”
- “I believe after COVID lockdown in China, demand will surge whilst Russia will continue to be shunned as a supplying nation”

Reasons given for expecting steady and stable business include a delay in recession until first quarter 2023, and opening of borders:

- “Should be good through the end of 2022 but then recessionary factors should be in place for 2023Q1”
- “Now that borders are open and the economy stabilizing the expectation is that production from the Forestry Industry as a whole will settle. The proviso is if the Russia/Ukraine war escalates who knows what the outcome will be”

Those expecting a negative change in their business anticipate international instability, economic recession, freight charges due to shipping constraints, and continued Covid restrictions:

- “Forestry Production will be curtailed because of Indian Ban on NZ Logs and for similar reasons relating to current log fumigation issues China shipping will remain constrained for a number of reasons”
- “The degree of international instability is at very high level due to Covid, Ukraine War and Europe's struggles with that - potentially the world is heading into a depression so current forecasts aren't that positive”
- “Clouds over construction industry International freight and drop in World GDP Growth forecast”
- “Inflation is rampant and central banks will struggle to keep a lid on it. Increasing interest rates could create a severe recession. China is struggling to contain its COVID outbreak and lockdowns are affecting demand and logistics.”
- “China's continuing Covid eradication policy. Uncertainty regarding Russia and the Ukraine and very high freight rates.”

IMPACTS ON FORESTRY BUSINESS FROM SUPPLY CHAIN DISRUPTION

Once again, we asked respondents about disruptions due to upstream suppliers, and how these issues impacted their ability to provide customers service.

The largest impact related to **irregular and unreliable supply chains**. This led to delayed shipments, late payments and loss of customers. Producers are unable to shift stock and production has slowed as a result.

The second largest impact was **rising freight costs** followed closely by **domestic fuel costs** and delays in **export shipping**. Domestically, roading costs are impacting small grower harvesting decisions. Several respondents indicated harvesting had ceased due to rising cost or they have taken a 'time out' until economic conditions improve. Others continue to harvest at reduced grower returns.

Impacts from Covid, both on domestic production and international markets, was also a notable disruption. Skilled worker shortage is still apparent, along with constraints and demurrage at Chinese ports due to China's Covid elimination strategy.

Some continued delays in getting parts on time, and availability of parts was also noted, especially from Europe. There weren't many comments directly indicating an impact from the Russia-Ukraine conflict, although knock on effects from this war are causing a not in-substantial amount of the supply chain uncertainty and disruption globally.

We asked the question "On a scale of 1-10 (where 1 = very mild disruption; and 10 = very considerable disruption) how have shipping and transportation constraints impacted your business?"

The average score was 5.8 out of 10, compared to 5.9 out of 10 last quarter.

28% indicated very low impact (<3/10); 24% indicated medium impact (between 4 and 7 out of 10) and 48% indicated a large impact (>7/10).

- *"Change in shipping terms due to unavailability of door to door options"*
- *"Such uncertainty that many small owners choosing not to harvest"*
- *"We need to put prices up"*
- *"Unable to shift wood domestically on rail and road networks"*
- *"Slow down in production, unable to deliver on time"*
- *"...have had stock build in some items even though we have orders"*
- *"Difficult to plan ahead"*

RUSSIA-UKRAINE CONFLICT

Respondents were asked to reflect on the ways they saw this conflict impacting NZ international trade out to Dec 2022. The two large questions are which way China will move with respect to political alignment, and bilateral trade agreements; and how fast Russian and European supply chains can adjust to the shift in trade conditions.

Russia is now very dependent on China as a market. Most anticipated a Russian increase in volume into China, particularly plywood and softwood lumber. Much depends however, on China's continued acceptance of Russian forest supplies. China is currently bogged with Covid, so has yet to fully play its hand. Thus, the biggest uncertainty over the coming months is around Chinese demand for NZ softwood. This could be much reduced going forward if Russian supplies are increased, or if Europe finds alternative freight routes through to Asian markets.

However, other respondents anticipate an increased market opportunity for New Zealand timbers if European sawnwood supplies are reduced, alongside an inability to adequately move additional Russian supply into China. Russia's ability to switch supply chains from Europe to China may be limited. In addition, limited East-bound routes may stop or slow the supply of finished EU goods into China until new supply routes can be found. This could improve markets for finished product into EU markets, as well as increase the Japan and Korea log markets short term.

There could also be a big demand longer-term for industrial wood within Europe, particularly energy fuels to supply the European pellet demand. Russia had been increasing domestic panel production over the past

decade, but cannot absorb the residues produced from sawmilling, that have been used in EU pellet production, into these panel mills.

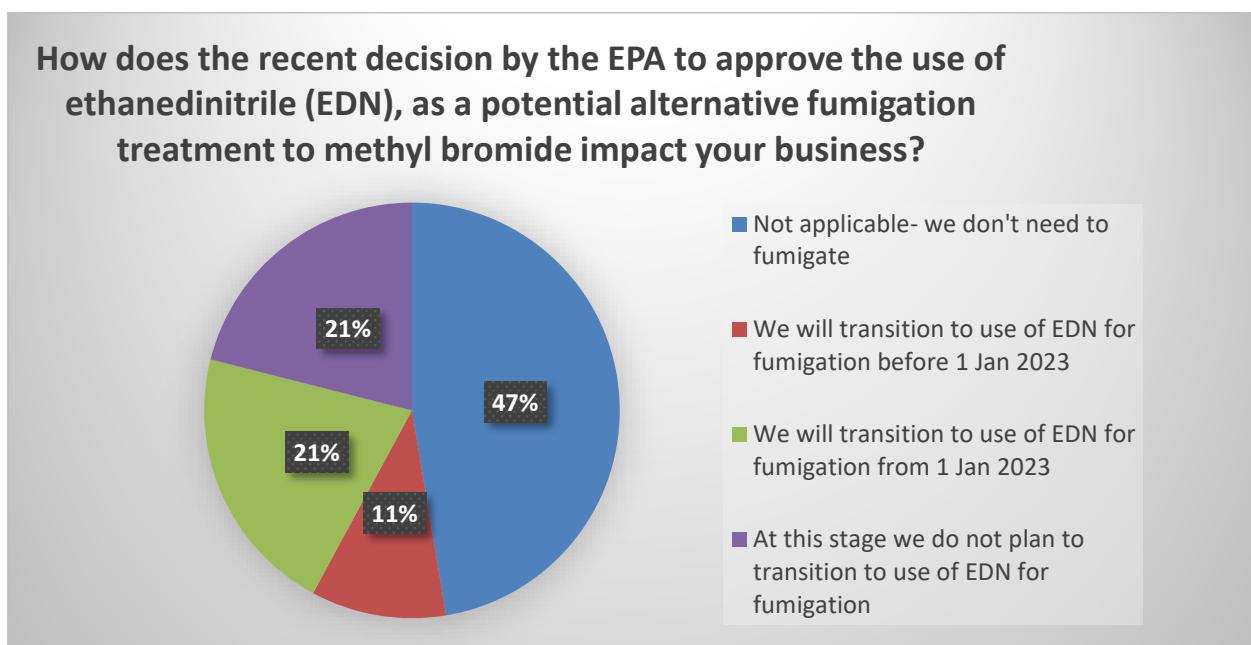
China may reduce demand for low-priced logs but could increase demand for higher grades due to reduced volumes from Europe to China, and no Australian supply. Other respondents saw a plentiful timber supply from Nordic and EU sources due to reduced Chinese demand, and little room for NZ in EU market growth.

Whether New Zealand can capitalise on these opportunities remains to be seen.

- *"Impact on projects we were about to start looking at in Russia for a client, that will still go ahead but without our involvement"*
- *"It will affect supply and demand in Europe and China which will impact world log and timber trade"*
- *"World timber supply is now readily available and we are now changing to a world wide International buyers market"*
- *"European supply crunch reverberating through industry impacting US and Australia in particular. Russian ability to switch supplies to China logically limited. Potentially positive for NZ."*
- *"Will alter the log trade and set new pricing levels. Will shift the Australian timber markets."*
- *"European salvage may be diverted to European mills previously dependent upon Russian wood."*
- *"On one hand China could buy more from NZ and on the other hand China may decide to try and increase log/timber purchases from Russia. China will prefer a steady supply so NZ will meet those requirements"*
- *"Will slow/stop the supply of European wood to China.... It will soften our European markets"*
- *"It will slow world trade."*
- *"More logs and lumber to China because access to timber and lumber from Ukraine and Russia will be constrained"*
- *"Not sure because global supply chains are a mess"*

FUMIGATION

Figure 3: Transition to use of EDN



Just over half of respondents (53%) need to fumigate logs for export markets. This breaks down as: 11% who will transition to EDN ahead of the 1 Jan 2023 timeframe, and 21% who plan transitioning from 1 Jan 2023, with a remaining 21% do not have plans to transition to EDN at this time.

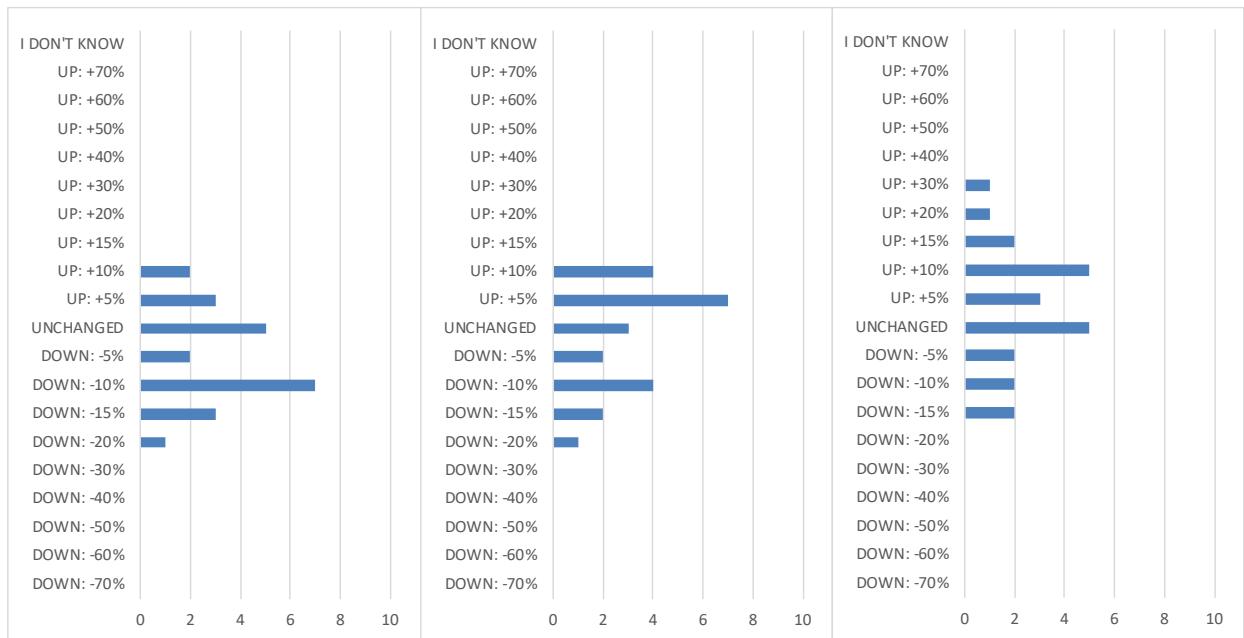
Unpruned Log Prices

Log Price as a % of prices in May 2022

3 Month Outlook

6 Month Outlook

12 Month Outlook

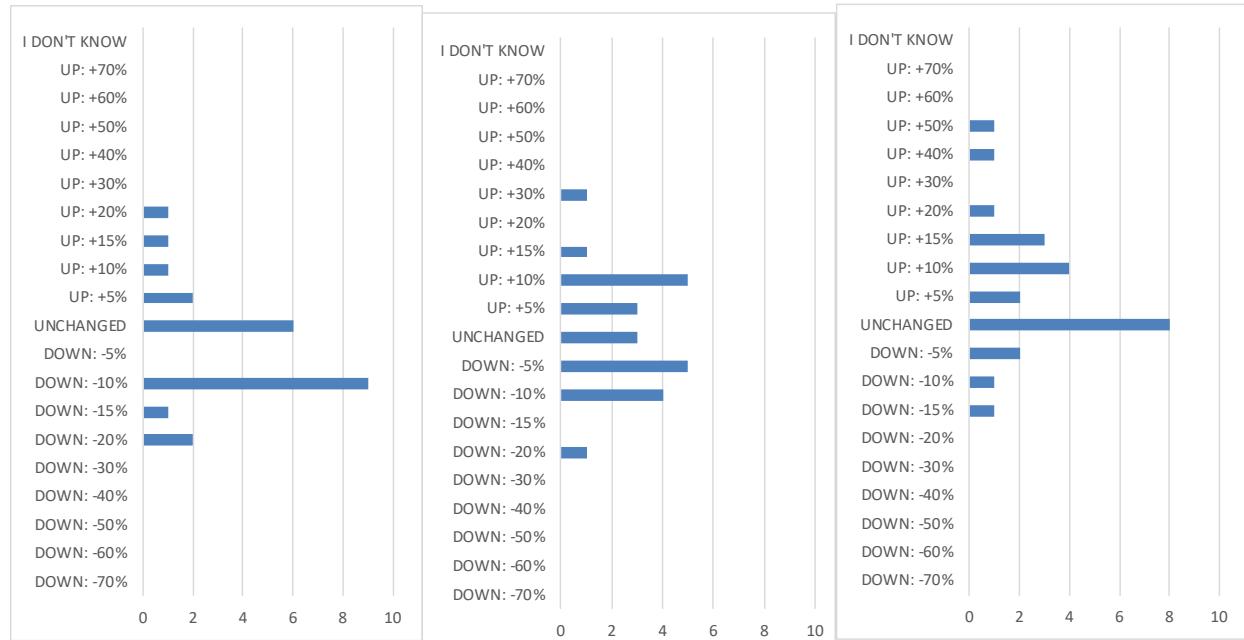


Export Log Volume as a % of May 2022

3 Month Outlook

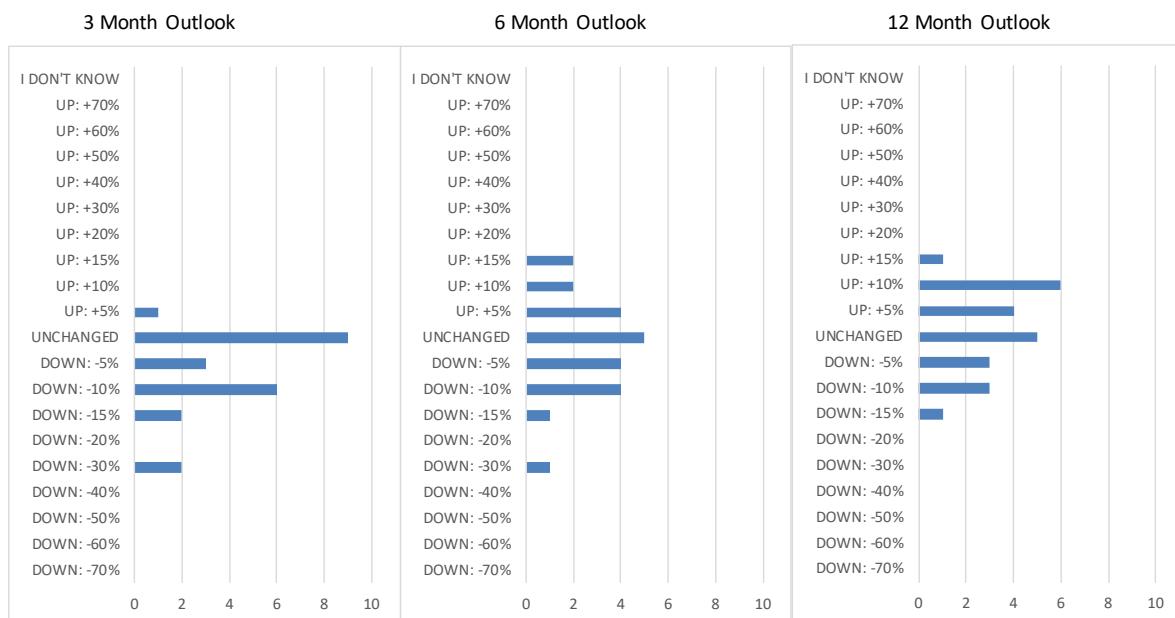
6 Month Outlook

12 Month Outlook

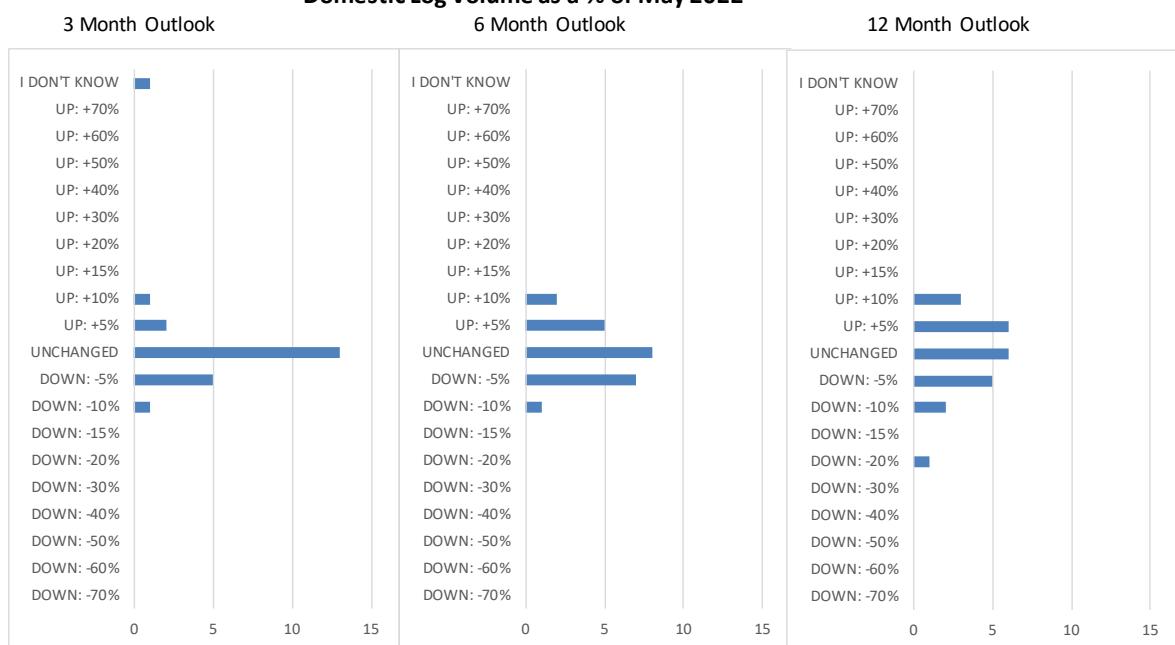


Pruned Log Prices

Log Price as a % of prices in May 2022



Domestic Log Volume as a % of May 2022



Acknowledgements

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To access previous outlook reports please visit this website:

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