FOREST360
GROWING YOUR FUTURE

July 2023 Market Update

Marcus Musson, Forest360 Director

Opinion Piece

Sentiment's a funny thing. A month ago, we were staring down the barrel of a long and protracted export market 'crash' as prices plummeted to double digits courtesy of lack of demand from China and an oversupply, or perceived oversupply from NZ. Most in the industry knew that the oversupply situation, perceived by Chinese buyers, was very short term and that once prices dropped below the magic $120/m3 level, supply would drop faster than the popularity of home-built submarines. This has played out as expected, however, supply from NZ has been artificially buoyed by the windthrow harvest in Taupo and the shutdown of the Pan Pac mill in Napier which are both short term anomalies.

Unsurprisingly, as port deliveries have reduced in the past month (especially in Gisborne and regions supplied by the woodlot sector), the sentiment of exporters has noticeably changed as supply dips under demand and looks to be low for a reasonable period. This is reflected in the increased pricing of July deliveries and the posturing for volume by exporters. While July pricing is barely above $100/m3 on an at wharf gate basis, and about as appealing to forest owners as a Kardashian singing karaoke, it is a signal that there is some flickering light at the end of the tunnel. Actual sales prices in China have only increased very slightly, and the July wharf gate increase is a result of this combined with lower shipping and demurrage costs, but we'll take any increase at this point.

This doesn't signal a change to the fundamentals of the Chinese real estate market which needs a serious dose of Prozac. You only need to look to the negative reports from the global steel industry to see that the consensus is that the Chinese building boom has had its run, a bit like Phar Lap, great while it lasted and ended unexpectedly. While there will be continued baseline log demand, it will very likely be below levels we have enjoyed for the last 15 years, which will necessitate lower supply to keep prices to acceptable (maybe not enjoyable) levels. We are currently in the Chinese slow construction season and port offtake is in the 65 -70,000m3 per day range which isn't horrible as NZ accounts for around 80% of total China softwood supply. On port log inventory has been reasonably static in the high 3Mm3 range and is expected to track down as NZ supply reduces.

There's plenty of stimulus getting thrown at the Chinese economy by central government, however, it will take a significant cut in the lending rates before consumers return to the property market. At this point, the growth in China's economy is centred around the service industry which uses a fraction of the raw materials of the real estate and construction sector.

Looking to the domestic sawmills to increase production to offset poor export returns isn't going to work as the domestic market has its own issues with timber inventory build. It appears that the magnitude of over ordering by timber merchants during the past few years to secure timber supply in a tight supply market was significantly higher than expected by sawmillers. This has led to several framing lumber-based sawmills reducing hours to minimize stock build.

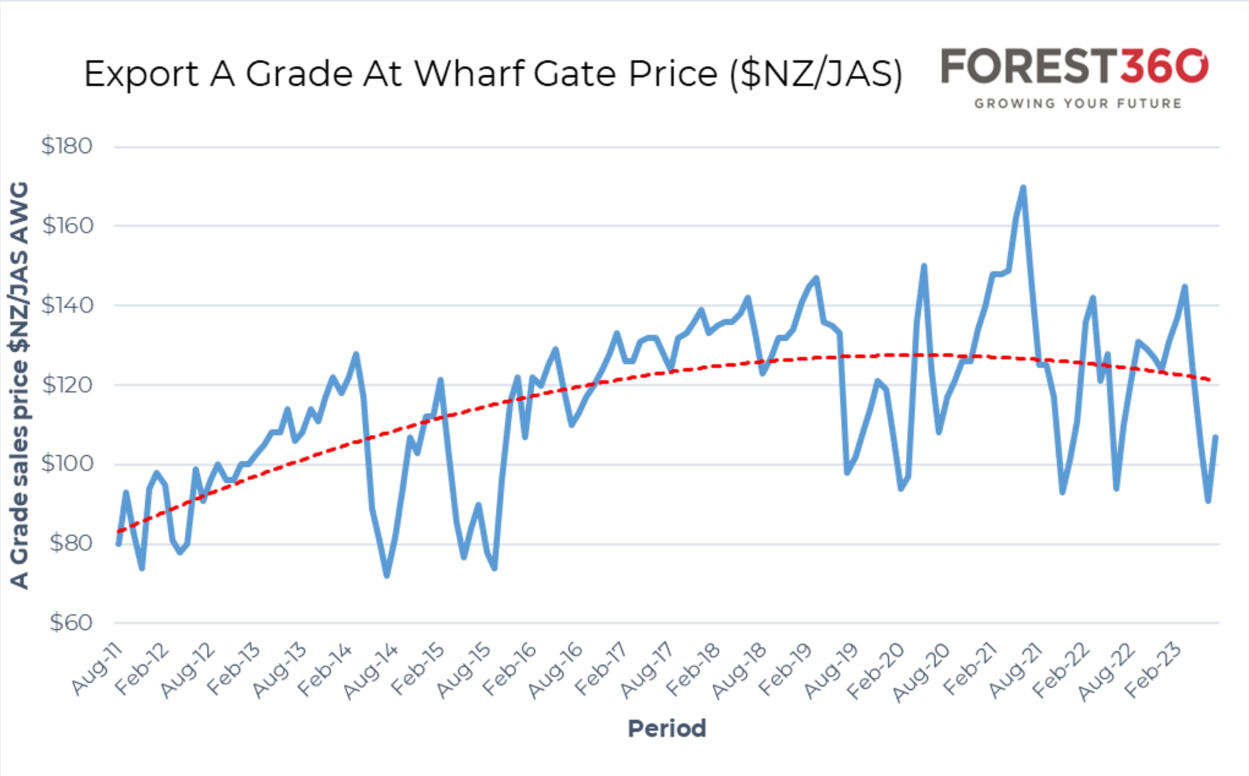
Those forest owners smarting about foregoing harvesting to enjoy the rewards of the ETS will have cancelled the holiday to the Maldives and booked into the Eketahuna Top10 as the carbon price has plummeted by 60% in the past 7 months. The cause of this drop is extremely frustrating and primarily centered around uncertainty of government policy. The current governments' brilliance in ignoring the Climate Change Commissions' recommendations, kicking off consultations around reviewing forestry's participations in the ETS and Nationals desire to minimize or eliminate farm conversions to exotics has wiped around 7.8 billion worth of value from the total NZU holdings. Looking back to the beginning of the year, you would have thought there was as much chance of the NZU value halving as a transport minister owning Auckland Airport shares, but it just shows

FOREST360 OFFICES NATIONWIDE
P 0800 366 700
E info@forest360.nz
www.forest360.nz

you that no investment is secure, especially one that is at the behest of government policy and opposition vote pandering.

It's been well publicised that many harvesting contractors are either out of work or out of business and it's hard to see those that have exited, re-entering the industry again. Even if they wanted to, there would be very little appetite from lenders to invest in any bit of machinery that goes anywhere near a tree for a reasonable period. This will help balance the longer-term supply and demand books but is a very bitter pill to swallow for those that have invested their lives into the industry, both mentally and financially.

So, where does this leave us going forward? We will likely see further increases in price in the coming months, albeit a soft bounce. With lower supply and depressed commodity markets, shipping will remain at lower levels and, provided the reserve bank governor doesn't do something stupid at the next OCR round (no guarantees there), the exchange rate should stay around current levels which means any increases in CFR sales price (sales price in China) should flow into forest owner returns. We don't want to see huge price increases as has happened historically as we're all aware that a race to the top is almost always followed by a race to the bottom (as shown in the graph). Although NZ will struggle to increase supply quickly in response, it would open the door for supply from other countries. In that sentiment, let's hope that this flicker of light in the tunnel doesn't turn out to be a blowtorch.



FOREST360 OFFICES NATIONWIDE
P 0800 366 700
E info@forest360.nz
www.forest360.nz