Forest 360 Export Log Market Update – www.WoodWeek.com

"Log markets never fail to repeat history." **25 August 2021**

(OPINION, Dan Gaddum, Forest 360) It is interesting that despite the headline of the article, some pundits started talking about such wishful thought patterns with comments on the recent bull run of log prices such as "It's a paradigm shift in export log demand and price" and "The macro fundamentals of the market have changed for the better". Sure enough, finding the people happy to admit they said such optimistic things is a bit like trying to find people to admit they voted for Labour.

Since September of 2020 forest owners who have managed to harvest their trees have unquestionably experienced the dairy equivalent of the land of milk and honey. Log prices have traded at record highs and some returns to stump have been off the charts. It used to be that a pruned stand close to the Port of Tauranga and a pruned log sawmill was the poster child of forestry returns. Up until July this year forests all over the country have been literal golden geese with returns consistently sitting between $40K - $60K per ha dependant on several different factors. These returns really shine a spotlight on the opportunity with marginal land in New Zealand … and I haven't even mentioned carbon yet.

Since July record prices and the fortunes that go with it have reversed as they inevitably do (ref fig 1).

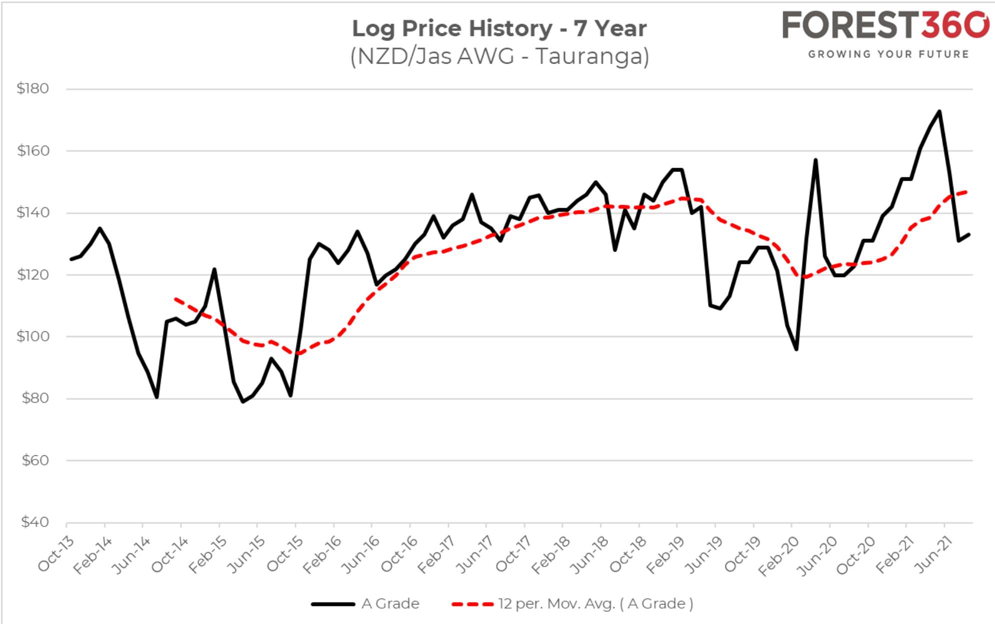

Figure 1 - TGA At Wharf Gate Price History

However, there is still a lot to be positive about – notwithstanding New Zealand's return to level 4 lockdown which will invariably change things again and probably not for the better in the short term. Although if the last lockdown is any judge of the future, the medium term is likely to surprise to the upside.

Record softwood log prices were primarily supported by sky-high US lumber prices, but this market has seen a 70% price reduction from peaks of $1700/mbf in May, but at close to $500/mbf remain above the long run average. At this level lumber supply will gradually return to China markets and start to fill the void that had driven log demand to record price levels.

So, what are we positive about?

The market pushed into USD CFR territory and more importantly Chinese RMB currency territory that hasn't been seen before – see figure 2.

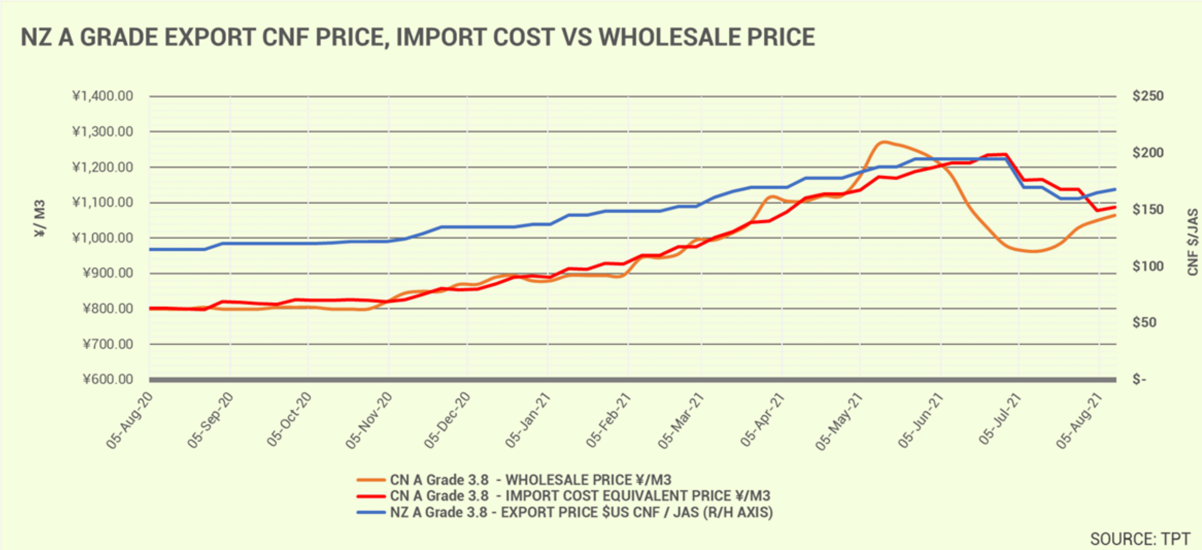

Figure 2 - NZ A Grade CNF, Import Cost and China Wholesale Price

This is great news for NZ Radiata as it proves that inevitable substitution is reasonably elastic; ie, the market can afford to pay premium prices before things unwind. The rider to this is that it appears this premium is somewhat overstated. This is evident by the fact that Chinese log buyers appeared (Fig 2) to be losing around $25 - $30 USD / m3 on the buy and sell price. So, despite the market topping out at $195 USD for A Grade, basic maths would suggest the price should have been around $165 USD / m3 to keep things moving and allow all supply chain participants to make a buck. Such is a commodity market and to all those people that thing single desk is a smart idea for logs – good luck with that!

So $30USD is a big gap and buyers' appetite to continue to lose in round terms $1m USD per ship eventually dried up. Not surprisingly this happened at about the time that inventory was starting to climb over 4.5m m3, daily sales rates were dropping and so the need for log buyers to do another deal and bleed red ink was also faltering. At this point the Mexican stand-off prevailed and because there is no other, we watched the very blunt instrument of price being used to bludgeon demand back. Unfortunately, this came with a mutual bludgeoning of our own back yard to find the bottom of the market and get things back on track.

Sounds all a bit grim but the reality of the situation needs context. Currently A grade CNF price levels are around USD$165 per m3. As you can see from figure 1, this is historically a very firm price and >$30USD / m3 above long run averages. The issue hampering NZD at wharf gate returns is that of shipping costs. We have seen daily hire rates for log vessels increase steeply since February 2021 (ref fig 3).

Figure 3 - Log Vessel Daily Hire Rates

Unfortunately, there is no sign at all that ocean freight rates are reducing, with only the occasional spot vessel negotiated favorably. The market firmly supports vessel owners for the time being, with options for alternate cargoes readily available.

Any gains on a CFR basis, if not eroded by high freight costs have the potential to be reversed by demurrage costs which are increasing. This is due to the combination of NZ berthing delays becoming the norm, lengthy China delays now exacerbated by Covid 19 restrictions on some major ports, and daily vessel hire rates at $25-$30k/day. As with headline freight rates it appears vessel delays and subsequently demurrage costs will be with us for some time yet, but lockdown induced supply restrictions may help here.

In a New Zealand context and looking at averages and history, it is not a disaster by any stretch. Current NZD AWG returns (excluding Gisborne which has been subjected to significant shipping issues and costs) are – for pruned stands - around $12 less than the 12-month average (which is has been a record) and $3-$4 less than 2-year and 5-year average prices.

Tauranga Prices (POS = AWG)	Pruned	A Grade	K Grade	KI	KIS	AVE	Diff from Spot
Current Price	$ 175.00	$ 131.00	$ 123.00	$ 113.00	$ 108.00	$ 134.80	
12 Mnth Ave Price	$ 187.00	$ 144.00	$ 136.00	$ 126.00	$ 119.00	$ 147.48	-$ 12.68
2 Year Ave Price	$ 175.00	$ 135.00	$ 127.00	$ 118.00	$ 111.00	$ 138.03	-$ 3.23
5 Year Ave Price	$ 175.00	$ 136.00	$ 128.00	$ 119.00	$ 112.00	$ 138.83	-$ 4.03

In summary there is almost certainly a bridge too far to entertain a return to A grade prices at the wharf of over NZD$175/m3 in the short term. However, the market is not all bad and there is a likelihood China will support CFR price increases from late August which should provide NZD AWG returns above the long run averages.

While there remains risk around the pace of price increase generating a market stall, escalating freight / demurrage costs, as well as widening Covid 19 restrictions within China, the market may yet surprise to the upside as it did following the last lockdown in New Zealand.