Over the Fence

7 June 2019

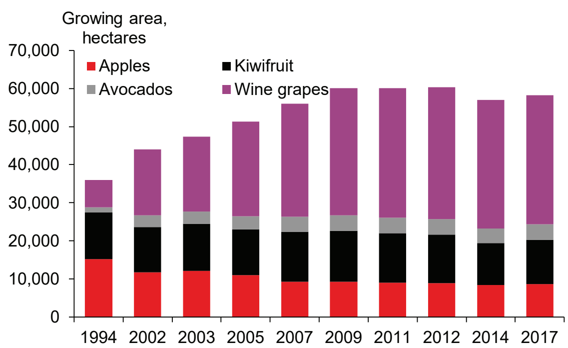
A is for Apple

- The pipfruit industry has enjoyed a strong run of late.
- Much of the success has been on the back of expanding exports of new apple varieties developed to meet the tastes of the growing Asian markets.
- Productivity improvements and advances in technology have also improved yields and the quality of fruit exported.
- While the future won't all be plain sailing, we are optimistic that the sector is well paced to harness recent momentum, take advantage of growing Asian demand and leverage New Zealand's international reputation for quality.

The pipfruit sector is the stalwart of New Zealand's horticulture industry. Like other parts of the horticulture sector, New Zealand pipfruit growers have been enjoying a strong run of late. In this month's issue of *Over the Fence*, we take stock of New Zealand's pipfruit industry and consider some of the opportunities and challenges the sector may face in the coming years.

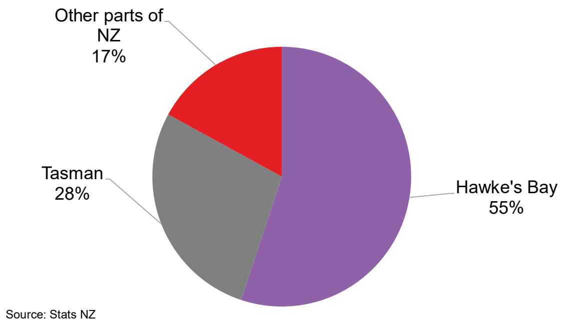
The pipfruit industry has had an important presence in New Zealand's agriculture sector for generations with the first apple exports reportedly departing from Christchurch in 1888, bound for Chile. Like other parts of New Zealand's agricultural sector, the pipfruit sector has certainly been through many ups and downs since then. One feature since deregulation in 2001 has been consolidation in the industry with larger growers and packers taking over smaller less efficient operators.

Selected NZ horticulture areas



New Zealand's pipfruit industry is concentrated in two regions, Nelson and the Hawke's Bay, and is dominated by apple production (although there is also a relatively small volume of pears produced and exported). Apple production has become even more concentrated in these regions over the last decade with little change in the area of land devoted to apple growing over the past decade.

Apple growing area by region

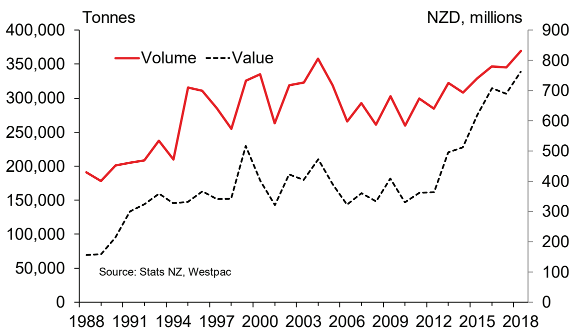


Yet despite little additional land being devoted to apple growing, export volumes have grown significantly over the last decade. The domestic market is also important for the industry with apples one of New Zealanders' favourite fruits. There is also a significant market for apples which are processed locally into juice, including growing demand from cider producers. Future demand growth, however, will rely heavily on increased exports.

In the decade to 2018, the volume of NZ apple exports has grown 40%, but the value of apple exports has grown much faster, up almost 130% over the same period. Growth has mostly been driven by increased exports to Asia, including strong growth in exports to China. In contrast, apple exports to more traditional destinations such as the EU have been pretty stable. Despite this strong growth in exports to Asia, apple export markets remain more diversified than other New Zealand agricultural products.

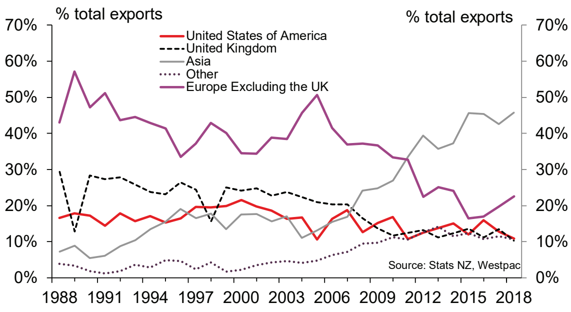
Export volumes are expected to continue growing over the next few years as recent plantings reach maturity, and the sector continues to improve its productivity. New Zealand Apples and Pears expects the apple (and pear) crop to be up 2.5% in 2019.

NZ apple exports



The growth in apple export volumes in recent years has been due to a combination of new plantings, particularly of recently developed varieties, and increased productivity in the sector.

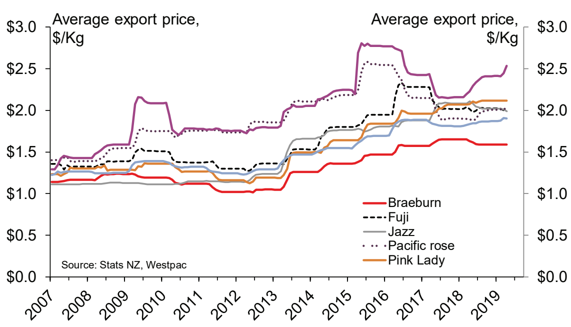
NZ Apple exports by selected destination



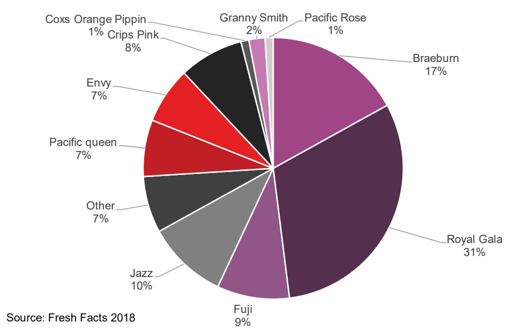
The New Zealand pipfruit sector has long had a reputation for innovation. Cornerstone varieties of New Zealand production, Royal Gala and Braeburn, had their origins in New Zealand. These varieties are still a mainstay of New Zealand apple exports and are mainly sold in Europe and North America. More recent additions such as Envy, Pacific Rose and Jazz apples have also been developed locally. These cultivars are trademarked, protecting the intellectual property that went into developing them. It is estimated that nearly half of all planted area in New Zealand is comprised of these “club” or trademarked varieties.

Newly developed apple varieties often command a significant price premium in comparison to more traditional apple exports. Indeed, many of the varieties that have enjoyed commercial success in recent years have been designed with the increasingly important Asian markets in mind. There, consumers often prefer higher colour, sweeter apples. This is a great example of the New Zealand horticulture sector improving productivity and adding value to their exports, while still making use of some of New Zealand’s key comparative advantages such as favourable climate and access to water.

Export price by apple type



NZ apple exports by variety



New Zealand is a relatively small player in the international apple trade, accounting for around 6% of global apple exports. That's well behind the likes of the EU, China, the United States and Chile who in 2018/19 are together estimated to account for around 65% of world apple exports. Often, New Zealand apples won't be the cheapest on offer, so success hinges on being able to differentiate the product and convince consumers to pay for a product that is of superior quality.

With just 10% of global apple production traded, domestic conditions in key export markets can be very important. For example, China is the world's biggest apple producer. While it only exports 3% of its production, it is the source of around half of global apple exports. In 2018 extreme weather conditions in key production regions led to a sharp drop in China's apple crop, pushing up apple prices in China and probably supporting demand for imports.

Challenges and opportunities

Globally, New Zealand is recognised as a high quality producer and has been named the most competitive apple industry for the last four years by the World Apple Review. The adoption of new growing strategies and technologies to improve productivity in the sector is seen as a particular strength, likewise the local industry's commitment to innovation and development of new apple varieties is an important way the industry has remained ahead of international competitors.

Despite these successes, the sector continues to face a number of challenges. In the near-term, perhaps the biggest challenge facing the sector is difficulty finding labour. The industry has traditionally relied on a mix of local and international labour to meet seasonal demand. Overseas workers have been sourced via the short term Regional Employer Scheme (which permits people from neighbouring Pacific countries to work in New Zealand for up to 7 months) and temporary arrivals on working holiday visas. But with demand for workers booming on the back of the combined success of a wide variety of horticulture produce, and New Zealand's unemployment rate near a cyclical low, many in the sector report that getting local workers is very difficult. What's more, labour costs are increasing quickly, in part due to big lifts in the minimum wage in the last couple of years.

The industry estimates it needs around 30,000 workers for short term, seasonal tasks such as harvesting and picking each year. About a third of these are foreign workers employed under the Regional Employer Scheme which has grown significantly since it was established in 2007. Initially set at 5,000 places, the cap on workers has been increasing, with the most recent cap set at 12,850 in December 2018. There have also been seasonal labour shortages declared during peak harvest periods, which allow visitors to NZ to work for up to 7 weeks. However, the Government has been reluctant to extend the RSE scheme further, in case it squeezes out demand for local labour.

One obvious solution for the sector is to reduce its reliance on labour and increase investment in technologies that allow greater automation in fruit picking and processing. While there are a number of practical challenges to overcome, feasibility of these types of solutions is improving. A recent example is an apple picking robot developed by T&G Global and US-based Abundant Robotics. The success of this type of technology however, relies on orchards being structured two dimensionally (with trees strung along wires) rather than the traditional three dimensional structure that currently exists in many orchards.

Growth in the sector has also put pressure on processing and storage capacity. There has been significant investment in this sector of late, with the development of new storage technologies improving quality of exports and new varieties and growing techniques lifting yields.

Like other agricultural industries, biosecurity risks are an ongoing concern for the sector. New Zealand benefits from being relatively pest and disease free. However, as we have seen in other sectors, increased cross-border flows of trade and people increase the risk that pests and disease will be brought to New Zealand from offshore. And countries can be quick to close their doors if they are concerned that imports of fresh fruit and vegetables could hurt their domestic industries. Indeed, Australia only opened the door to New Zealand apple exports in 2011 (under strict conditions) following a WTO ruling in New Zealand's favour.

More generally access to export markets will be crucial. The recent CPTPP could provide benefits in this respect, particularly by improving market access to Japan. This market is currently relatively small for New Zealand exporters, but with all tariffs on NZ apple exports to Japan due to be eliminated in 11 years, New Zealand producers will be able to compete on a level playing field with their Australian competitors.

Climate change also has the potential to impact New Zealand's pipfruit sector. While the sector has a much smaller carbon footprint than pastoral farming, access to water and irrigation is crucial for further growth. The sector will also be directly affected by climate change. Already researchers are considering how they might develop new varieties with favourable characteristics in hotter climates. Climate change may also impact where fruit can be grown, opening up the possibility of orchards in regions that previously have been unsuitable for apple growing. On the downside, more extreme weather events could also pose risks to production.

Looking forward, we expect New Zealand's pipfruit industry to continue to reap the rewards from recent innovation and productivity improvements in the sector. Many investments in the pipfruit sector have very long lead times, and decisions taken now will hopefully continue to benefit producers for some time to come. However, the sector can't afford to sit still. Other apple producers globally will no doubt be watching New Zealand's recent success and attempting to emulate it. Future success will continue to rely on the industry's ability to be nimble and keep meeting consumers changing tastes with innovative products – certainly no easy task given the length of time it can take to bring new varieties to market.

Success will also rely on preserving New Zealand's excellent reputation for quality and food safety. With an increasing focus amongst consumers globally about where their food comes from (including issues such as pesticide use), any slip up on this front could have serious consequences.

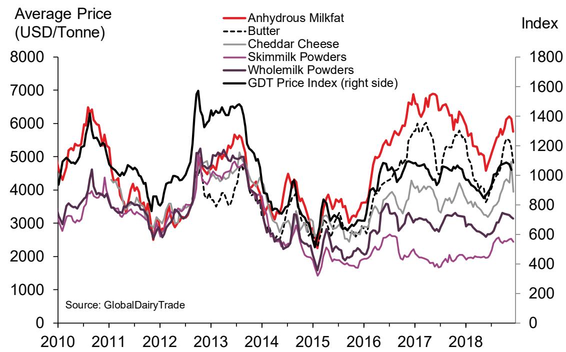
Undoubtedly the future won't all be plain sailing. However we are optimistic the sector is well placed to take advantage of recent momentum, rising consumer demand and income growth in Asia, increased demand for high quality and premium produce, and New Zealand's reputation as a high quality food producer.

Anne Boniface
Senior Economist

Beyond the farm gate

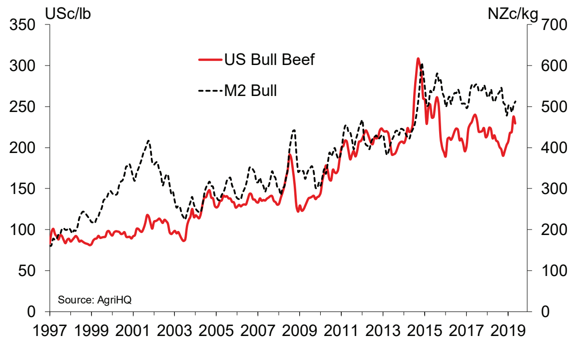
Dairy

Dairy prices have eased over the last month. Falls in whole milk powder prices have been more modest, with prices remaining comfortably above $3000/tonne level. Fonterra's opening forecast for the 2019/20 season was a little more conservative than our own take. They are forecasting a range of $6.25-7.25. Our own forecast remains at $7.20. We're happy to retain a slightly more optimistic view than Fonterra on the outlook for now. Our forecasts have long assumed a modest weakening in dairy prices over the second half of this year. The recent easing in prices has been a little earlier than this, introducing a little downside risk to our forecast. However, with the 2019/20 season only just underway, there is a long way to go before milk prices for the new season are finalised in September next year.



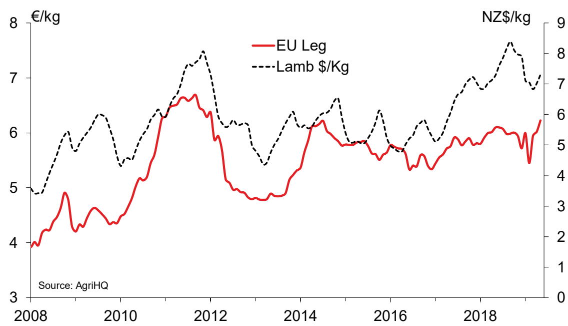
Beef

There was a sharp lift in US imported beef prices in April. However, prices moderated in May on the back of a lift in US domestic beef production. Strong demand from China remains a key feature of international markets, with the ongoing African Swine Fever outbreak in China likely to support demand for alternative proteins such as beef. This week Brazil, the largest supplier of beef to China, suspended exports to China on the back of the discovery of an atypical case of mad cow disease. For now, expectations are that the suspension will be lifted quickly, however it will be a development worth keeping an eye on.



Lamb

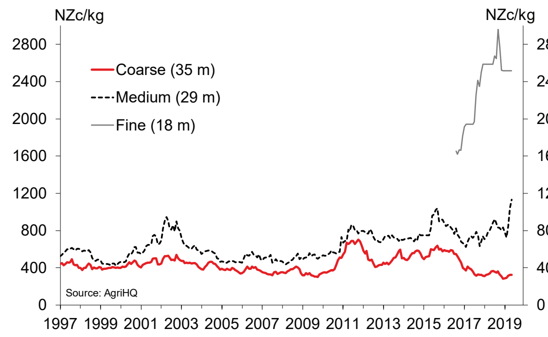
International lamb prices took a leg higher in May, as did mutton prices. Strong demand from China remains a key feature of international sheep meat markets, with China's outbreak of African Swine Fever likely to mean demand there remains strong in the coming months. Global supplies remain tight. Australian lamb production is forecast to be down 7% this year by Meat and Livestock Australia, with an even bigger fall expected in mutton production. Combined, this could see prices firm further in the coming months, despite ongoing Brexit uncertainty weighing on European demand.



Beyond the farm gate

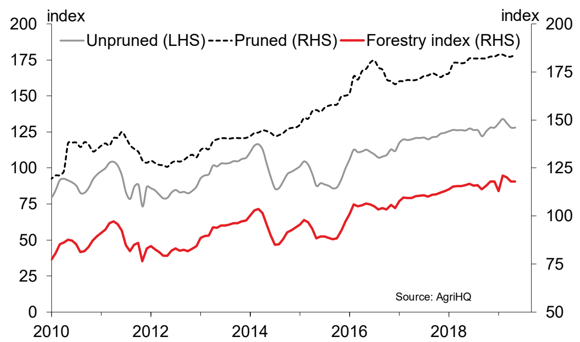
Wool

Most recent indications are that the lift in wool price seen earlier in the year has run out of steam, and this is likely to be reflected in price data in the coming months. One factor at play may have been China reopening the door to South African wool exports. More generally, there have also been anecdotes of soft Chinese demand at recent wool auctions. Concerns about the impact of the US-China trade dispute and subdued retail conditions in both mainland China and Europe are likely to have contributed to this weaker demand.



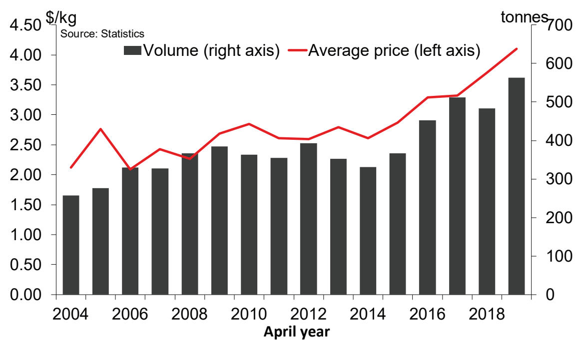
Forestry

Domestic log prices performed better than export prices in April. In China, log prices reportedly stabilised in May, however there remains ongoing nervousness about the impact of the US – China trade war and a weaker US dollar on the demand for NZ logs. Local log demand remains firm, with residential construction activity in New Zealand remaining strong, particularly in Auckland. There have been a number of announcements from the Government around the Emissions Trading Scheme (EST) in recent months. However, there remains considerable uncertainty around some key aspects of the design of the ETS and the accounting treatment around forestry.



Horticulture - Kiwifruit

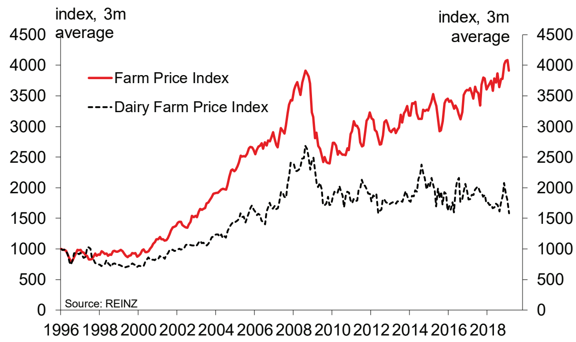
Zespri's annual report for the 2018/19 showed profits up 77% to $179.8 million as revenues benefitted from both strong kiwifruit sales and increased returns from licensing fees from gold kiwifruit. In the 2019 year Zespri sold licences for 700ha of SunGold kiwifruit via tender. It has previously announced it expects to release licences for the same area each year out until 2022 as growers looks to capitalise on the higher prices and improved yields on offer with gold kiwifruit (although this is subject to an annual review). At the margin, we would expect increased supply to put some modest downward pressure on prices achieved for gold kiwifruit over the coming years. However, this is something that Zespri is likely to remain mindful of, and they could adjust the pace of growth in supply if demand softened.



Beyond the farm gate

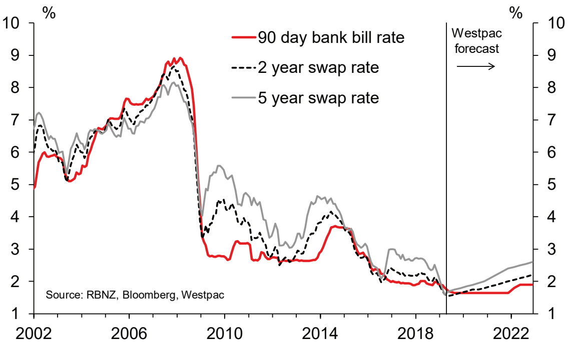
Farm prices

Rural real estate markets generally remain subdued. The REINZ farm price index was up 6% in the three months to April compared to the same period a year ago, however sales volumes remain weak. There are clear differences between farm types. REINZ's dairy farm price index (which attempts to adjust for location and farm size) was down 8% on a year ago. In contrast, demand is reported to be particularly strong for forestry land (or land that can be converted to forestry). This has been helped by a lower hurdle for offshore ownership of forestry land and government policies aimed at supporting forestry. Looking ahead, we could see some improvement in sentiment in rural property markets over the coming months on the back the Government's cancellation of its capital gains tax plans and also the recent sharp fall in interest rates.



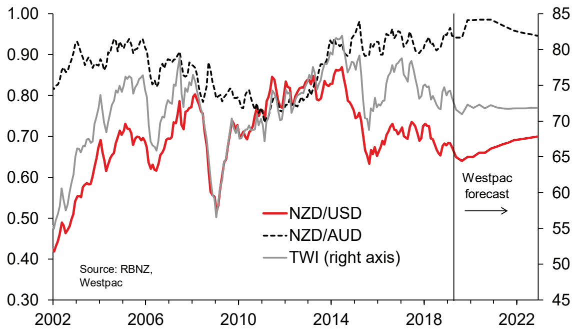
Interest rates

As expected, the RBNZ cut the OCR by 25 basis points in May. It is certainly possible that the RBNZ chooses to reduce the OCR further from here. But much will depend on how the data plays out. We expect the recent sharp drop in interest rates will be enough to stimulate the housing market and economy. If we're correct, this is likely to mean the RBNZ will be content to leave the OCR unchanged at 1.5%.



Exchange rate

For some time, our view has been that the NZ dollar would come under pressure due to a slowing economy, ongoing soft inflation and a dovish RBNZ. This view has largely come to pass, with the NZ dollar falling from above 70 cents a year ago to around 66 cents now. Through the back half of this year however, we expect this to change. We're forecasting the NZ dollar to start drifting higher, supported by a firm terms of trade, improving sentiment around the outlook for global growth and changing expectations for monetary policy.



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