

# Economic Bulletin.

23 July 2020



## Forestry: COVID impact and outlook – Re-enter the dragon.

- The COVID lockdown hit forestry hard.
- The hit has forced some downstream wood processors to close and (temporarily) hit forestry contractor incomes and employment.
- From here, we expect that export prices will rebound modestly as the Chinese economy and wood demand sparks back into life.
- This will see harvest and export activity rebound in 2021.
- However, wood processors' struggles will be ongoing.

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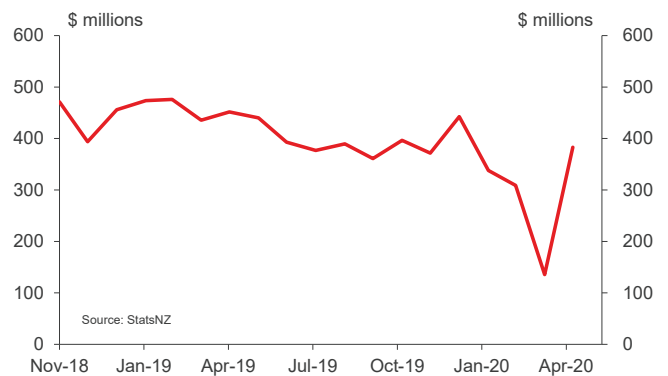
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### The thunderstorm.

The forestry sector battled a major storm over the first half of 2020. The impact of the COVID outbreak on forestry was as sharp as it was immediate. Logs were turned away at Chinese ports or at best delayed and stockpiled on wharfs. Export log prices, already relatively soft, slumped further, with export incomes plunging, particularly over April.

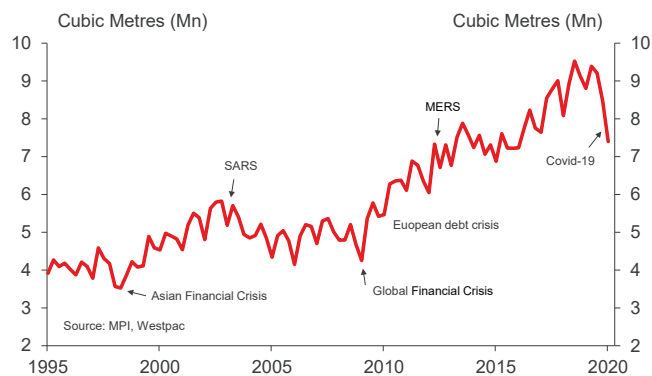
### Log and wood export values



The next hammer blow came as the Level 4 lockdown was imposed, during which forestry activity was classified as non-essential. The chart below highlights just how suddenly logging activity came to a halt. Indeed, the COVID impact has dwarfed that of past pandemics such as SARS in 2002/03 and MERS in 2012/13. Even the Global Financial Crisis in 2008/09 had only muted impacts in comparison.

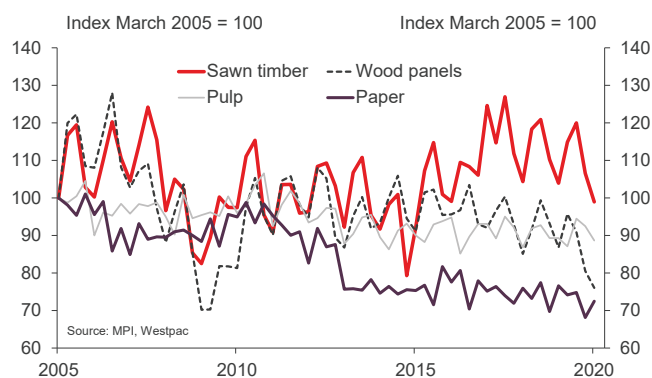


## Quantity of logs harvested, quarterly



Downstream wood processing was similarly affected, with exports of sawn timber, panel products, and wood pulp, each recording large falls during the lockdown period. The only exception was paper and paperboard, presumably because of an increase in online shopping, which will have boosted demand for packaging materials.

## Processed wood production, quarterly



Forestry contractors involved in harvesting activity and wood processors were among the first to feel the effects of the lockdown. Especially vulnerable were the many small operators that rely heavily on cash running through their books.

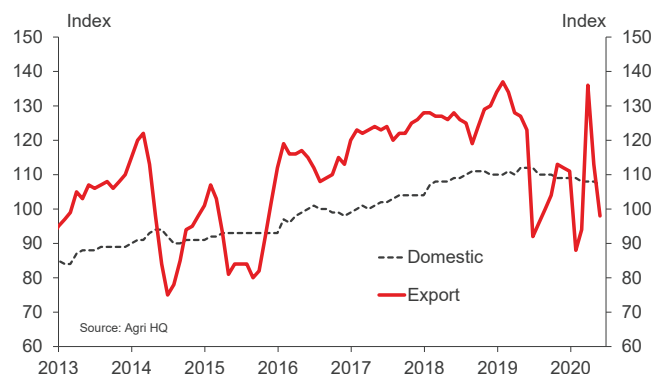
Some, that were already teetering on the edge before COVID, were forced to rejig their operations or close shop, resulting in jobs losses. Others tapped into the Government's wage subsidy scheme to buy themselves some time and weather the lockdown storm.

## The way of the dragon.

Then the picture changed. Both locally and in key forestry export markets, the COVID outbreak was contained. Crucially, the local move down the alert levels meant logging could resume and the supply chain could re-open. Global demand also began to resurface, with key ports accepting delivery once again.

Export log prices, while volatile, at least lifted off their lows. With the restart of logging, some laid-off workers returned to work. However, it remains to be seen if harvesting has fully recovered to pre-COVID levels. The sector's export income is currently still lower than pre-COVID and some of the income hit (in the vicinity \$200 million) won't ever be regained.

## Export and domestic log prices

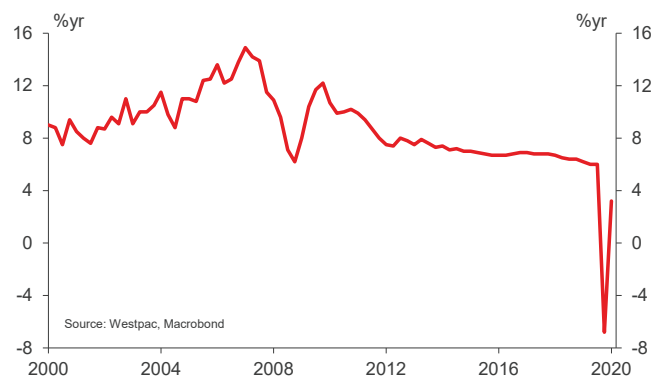


## The big boss.

We expect the second half of 2020 will be better than the first. In fact, we expect export log prices to lift as Chinese economic momentum builds and its construction sector sparks into life.

As always for export log prices, and for forestry more broadly, China is key. Recall that China accounts for nearly 60% of New Zealand's overall wood exports and more than 80% for log exports. After falling 10% in the March quarter, the Chinese economy is recovering both sooner and stronger than any other major global economy. Already, Chinese GDP has rebounded back above its pre-COVID level, following the 11.3% jump over the June quarter. We expect further growth over the September and December quarters of 3.5% and 1.7%, respectively, and then nearly 10% over the 2021 year. The economic recovery follows the successful containment of the outbreak. While there have been second waves, notably in Beijing, these outbreaks have been quickly contained.

## China real GDP



That general lift in Chinese economic activity is also beginning to translate into activity in the sectors that matter for forestry. The Chinese housing market is sparking to life and the construction pipeline is growing, and when we look at a range of indicators, like building permits, land sales, and house prices, they are lining up for a material pick up in (housing) construction, and thus demand for wood.

### China real estate – completed developments



### A walk in the spring rain.

On this basis, our central view is that we expect a lift in export log prices over the second half of 2020. If anything, we anticipate much of the lift will occur over the September quarter, noting that New Zealand harvest is at cyclical lows and it will take time for logging to respond to any price lift.

A lift in export prices would align forestry with other commodities. Over the Tasman, iron ore prices have lifted of late as Chinese demand has improved. Locally, we've also seen global dairy prices spike, with Fonterra noting that the price lift is largely due to firm Chinese demand.

Looking to late 2020 and early 2021, we expect harvest and contracting crews to be going closer to full capacity. As this dynamic plays out export log prices are likely to start to moderate through mid-2021.

Looking at other prices, we expect domestic log prices, sawn timber and wood panels to continue to trade largely sideways. Paper and paperboard prices are likely to prove an exception to this trend and remain firm as the ongoing switch to online shopping continues to boost demand for packaging materials.

With the outlook for domestic log prices largely flat, the market impact on downstream wood processors is likely to be limited. However, the ending of the wage subsidy and the balance sheet scarring associated with the lockdown could be a blow for already struggling firms.

### Infancy.

All of this is contingent on our assumption that COVID remains reasonably well-contained in China. If there is another outbreak in China, which the authorities cannot contain, then log export prices would step lower once again for the duration of any lockdown. China's past containment successes do not guarantee the same success going forward. The same principles would apply to a New Zealand lockdown, the event of which would see domestic prices also fall. In addition, global struggles with the pandemic may ultimately lead back to China and put pay to its economic rebound and thus its wood demand.

Time will tell and we will continue to regularly update our view. Nonetheless, as Bruce Lee once said "in the middle of chaos lies opportunity."

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