

Forestry Production Getting the Chop

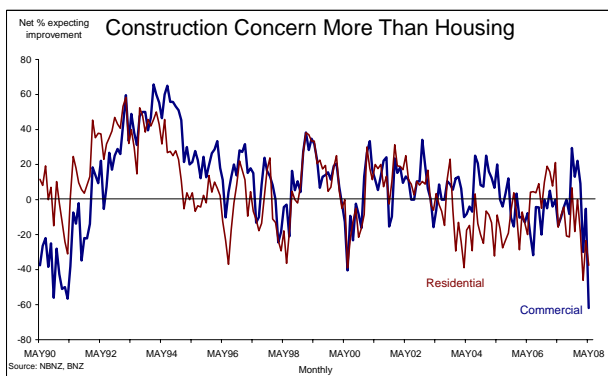
- Forestry sector looking as soft as any
- Production falling as construction contracts
- Still waiting for own commodity price boom
- While costs keep rising
- Pruning the theme for the meantime

In assessing the softest spots in the economy, spare a thought for forestry. While it's still waiting for global commodity boom benefits, it is surely looking as poorly as any sector right now, including the more widely noted, and severely squeezed, household sector.

This was certainly the signal from May's Performance of Manufacturing Index. It saw the wood and paper product sectors register a 37.8 result – the second-worst on record, and very deep into the contraction zone.

Yet this should not come as a big surprise. The forestry industry is facing a multitude of major headwinds.

For a start, it is highly exposed to the current downturn in the domestic construction industry. And while much of this is centred on the housing market – where an already marked pull-back is likely to continue for a while yet – there have also been signs that non-residential construction work is looking less robust, especially beyond the next six months or so.

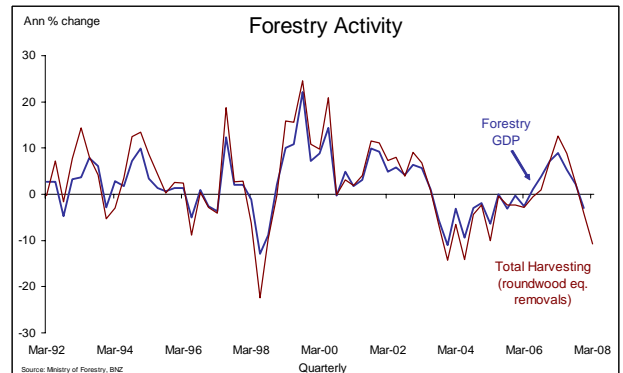


Onto this we can add the international housing and construction markets, which are either weak already, or about to become so inclined, in respect of New Zealand's traditional forestry export markets of Australia, North Asia and the United States. China would be the notable exception.

Adding to the production woes most recently has been the talked-about hangover from the harvesting that occurred last year in order to beat the Kyoto deforestation charges that kicked in on 1 January 2008.

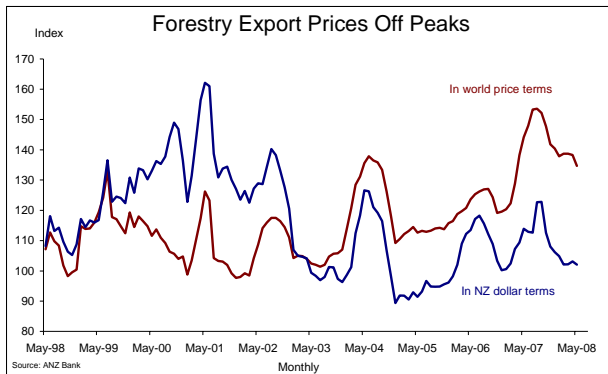
For the March quarter there were also reports of premature shut-downs because of the early-Easter, while fire risk, amid tinder-dry conditions, also hampered activity in some areas.

It has thus been little surprise to see total ("roundwood equivalent") harvesting in the March quarter of 2008 down 11% on a year ago. This is not only weaker than the -4% y/y result in the December quarter but implies a clear and further drop on a quarterly basis according to our seasonally adjusted estimates. This is likely to translate into negative impacts from forestry in the Q1 GDP accounts (due 27 June).



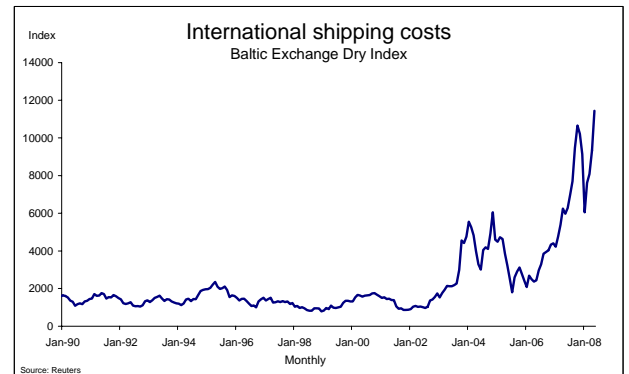
And it's not as though the forestry sector is enjoying higher prices to offset production weakness (the way the dairy sector is, for example, in light of the recent drought). Indeed, forestry product prices have, in the main, completely sidestepped the global commodity boom. Sure, the industry is hopeful of better returns later in the year, as fundamental demand-supply factors are seen tightening up. However, for the meantime, prices look subdued.

As an example of this we note May's ANZ world commodity price index for New Zealand's forestry product exports had fallen 12% from its August 2007 peak, to be 7% lower than in May 2007. And it gets softer when converting into Kiwi dollars. In these terms, forestry export prices declined 10% y/y, following their 17% drop since August.



It's not just international prices, however. We are also conscious of the potential for domestic prices to come under downward pressure, in line with the way housing demand has dried up, leaving builders under pressure to reassess their margins in order to get contracts and make sales.

All the while, input costs for the forestry sector continue to rise. One of the more noticeable of these has been fuel, which is always a big issue for a sector so reliant on the running of capital equipment. And in respect of the heavy transportation requirements for forestry, there are not only the higher internal costs to think about but also rising world freight charges to bear in mind.



As an indicator of the latter, we note the Baltic Dry bulk international shipping rate has nearly doubled since the start of the year, to be comparable to the highs seen around October of last year. Sure, this index might not be directly relevant to the forestry sector. But it certainly highlights the upward pressure in global shipping rates of late.

Rolling this all together, it's easy to see how difficult business has become in the forestry industry. It's no wonder, then, that firms in the field were as glum as they were in May's Performance of Manufacturing Index survey. It looks as though we're in for a period of pruning.

craig_ebert@bnz.co.nz

Contact Details

Bank of New Zealand Research



Stephen Toplis
Head of Research
+(64 4) 474 6905

Craig Ebert
Senior Markets Economist
+(64 4) 474 6799

Mark Walton
Markets Economist
+(64 4) 474 6923

Danica Hampton
Currency Strategist
+(64 4) 472 4767

Main Offices

Wellington
1 Willis Street
PO Box 2392
Wellington
New Zealand
Phone: +(64 4) 474 6145
FI: 0800 283 269
Fax: +(64 4) 474 6266

Auckland
125 Queen Street
PO Box 2139
Auckland
New Zealand
Phone: +(64 9) 976 5762
Toll Free: 0800 081 167

Christchurch
129 Hereford Street
PO Box 1461
Christchurch
New Zealand
Phone: +(64 3) 353 2219
Toll Free: 0800 854 854

NAB/nabCapital Research



Peter Jolly
Head of Research
+(61 2) 9295 1199

Alan Oster
Group Chief Economist
+(61 3) 8641 3464

Rob Henderson
Chief Economist, Markets
+(61 2) 9237 1836

John Kyriakopoulos
Currency Strategist
+(61 2) 9237 1903

Contact Phone Numbers

Wellington
Foreign Exchange +800 642 222
Fixed Income/Derivatives +800 283 269

Sydney
Foreign Exchange +800 9295 1100
Fixed Income/Derivatives +(61 2) 9295 1166

London
Foreign Exchange +800 333 00 333
Fixed Income/Derivatives +(44 20) 7796 4761

New York
Foreign Exchange +1800 125 602
Fixed Income/Derivatives +1877 377 5480

Hong Kong
Foreign Exchange +(85 2) 2526 5891
Fixed Income/Derivatives +(85 2) 2526 5891

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