

Monthly Market Report

April 2015



For the first time in a long time we are seeing a major correction in the market in China with prices falling rapidly, inventory continuing to build and cash in very short supply. The result of this almost perfect storm is a staggering US\$15 drop in price in 1 month. Most commentators are suggesting there is another US\$5 to \$10 of drops before the market basically bottoms out.

In this report I will focus on China since I have just been there and although a very sobering week, it has bought home the realities of something I predicted would happen 3 years ago. At that time I took a team of four other people from NZ who had interests spanning Government, corporate and medium scale forestry. At that time I suggested there would be dark days ahead when the China construction sector faltered.

Regrettably it has faltered, but it has come at a time when there are wide ranging factors that have contributed to the rapid and significant drop in price. Some are completely out of our (NZ) control. Some are not

To recap on some of the critical elements relating to current conditions in China.

- ▶ Current softwood log consumption is running at about 60,000 cubic metres per day across the China eastern seaboard
- ▶ Consumption compares to about 70,000 per day at the same time last year. The spring time is the major construction period before the onset of the hot summer.
- ▶ Current consumption is based on a 7 day working week so equates to 1.8mil cubic metres per month
- ▶ NZ remains the largest supplier with 60 - 65% of the total volume.
- ▶ Deliveries in February and March were each about 2.2 million tonnes (all countries)
- ▶ The Russian Rouble has reduced in value by 70% against the Yuan in 6 months resulting in a dramatic

increase in lumber and log volumes heading to China

- ▶ US and Canada Log volumes have declined slightly but lumber sales, ultimately heading to the same markets as Radiata pine, have remained unchanged.
- ▶ At least 70% of all softwood log and lumber sales are for making apartment construction plywood and lumber, basically to hold up concrete, until it dries.
- ▶ Inventory levels are heading well above 4.5 million cubic metres across all eastern seaboard ports. At the expected delivery rate for April, the inventory is likely to very quickly run close to 5 mil cubic metres or 3.0 months supply.
- ▶ Many China buyers and traders are in default. 3 major liquidations or cessation of involvement in the log trade have occurred in recent weeks
- ▶ Cash and credit is in short supply. Letter of Credit deposits for logs have gone from 20% required to at least 50% due to nervousness about default. There have been many instances of buyers walking away from the earlier 20% deposits.
- ▶ House prices appear to have bottomed out in Tier one cities but nationally house prices have fallen 5% year on year across the 70 major cities.
- ▶ The China Government have just announced a new construction and house purchase incentive programme including reducing interest rates for the second time in 4 months. We can expect at least a 2 month lag before this revised suite of policy starts to take effect.
- ▶ A 5mil inventory in effect means there is at least US\$3bil in cash not circulating in the log and lumber segment.
- ▶ The China Government have been focussing on reducing environmentally poor performing polluting industries. In the case of the wood sector this is seeing the forced closure of plywood operations particularly.

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- ▶ China buyers do not want any more logs. NZ sellers are therefore trying for sales at any level just to move cargo's. Heavy discounting thus becomes the order of the day.
- ▶ Most commentators are suggest this years growth in GDP will drop just below 7%, firmly ending a 30 year double digit run up until 2012.
- ▶ The speculative run on the housing sector has come to an abrupt end with the realisation there is a large number of apartments purchased for speculation rather than to ever live in. As a consequence there is a glut of unoccupied housing in many cities.

Available cash within the general population and from the investment sector has been very firmly heading toward the sharemarket. Exponential growth has been the order of the day with many companies experiencing a very strong bull run. Thus cash has been diverted from the housing sector contributing to stalled projects and construction company liquidations.

The only saviour for NZ in the current significantly difficult situation is for supply to slow down and inventory to reduce. And then we must remain at a reduced supply level to avoid a repeat this time next year. The only instrument available to reduce supply is to reduce price.

Based on the imposition of this very blunt instrument called price, and what we see of the market in the next quarter, we can expect the current situation to last at least until July. If demand wanes at all and supply does not decrease, it could last longer.

Despite this factual recount of the current situation there are many positives to consider. Consumption is running at 60,000 cubic metres per day and really that is not too shabby. Incentive programmes and a continuance of urbanisation policies should see a generally strong demand profile for the next 3 to 5 years.

On this latest trip I focussed on non traditional sectors and it was heartening to see more and more manufacturing in the softwood furniture, finishing and appearance sectors. Indeed there was a lot of comment that Chinese consumers were increasingly showing a preference for knotty grade furniture which they recognised as not coming from natural forests.

I also came home with a significant order for Eucalyptus logs which are increasingly being used for making the ply in Container floors. After several trial shipments, China manufacturers have found ways to use the Eucalyptus to replace the dwindling Tropical Rainforest hardwood supply.

It continues to be thoroughly important to remember the trees keep growing regardless and peoples of the world continue to need wood for wide ranging reasons. Thus, it has never been more timely, to remember the only way forward for climate, country and the planet is to get out there and plant more trees!

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