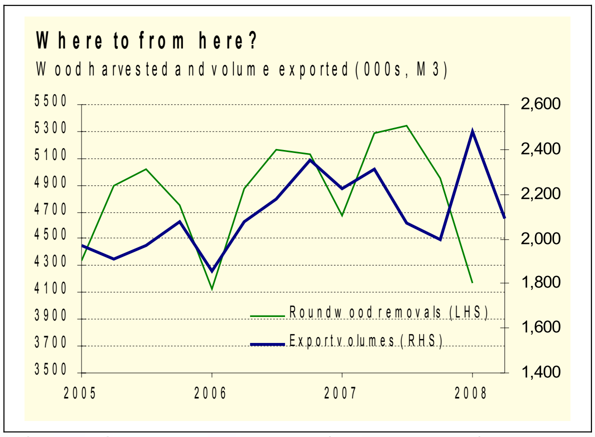
WHAT NOW FOR FORESTRY?

Although the emissions trading scheme (ETS) has hit its share of hurdles, it seems almost inevitable that it will be passed into law in some form. One feature of the ETS that the forestry industry has been aware of for some time is the liability imposed for deforestation.

Forest owners knew that from 2008 onwards they would face a carbon liability if they permanently cleared forestry land which was established prior to 1990. In the five years since the government indicated the possibility of this liability, an extra incentive has existed for forest owners to cut down their trees. There was evidence of a rush of felling activity in early 2007, when over 5.3 million cubic meters of roundwood were harvested in both the March and June quarters. The subsequent spike in export volumes suggests that some of the logs felled were transported to port at a later date. Export volumes finally dropped off in the June 2008 quarter, lagging the sharp drop in harvest volumes. June data is not yet available for roundwood removals, but harvest volumes are expected to take a permanent hit – given that the ETS now makes it more costly to fell trees. This will dampen the demand for transport services from the forestry industry over the near term.



Source: Statistics New Zealand (Export volumes) and MAF (roundwood removals). Note that MAF data is currently only available up to the March quarter 2008.

Lower prices have been working against forestry volumes and may have exacerbated the downturn triggered by the ETS. Log prices in Asia have actually improved over the last year but rising shipping costs, a strong New Zealand dollar, and a weak US construction industry is dampening US demand for New Zealand's logs. The softness in our own housing market will keep domestic demand for timber flat over the next year or so.

If New Zealand dollar log prices do improve, this will prop up activity in the forestry sector. However, the short term outlook for log prices remains soft, with no bottom in sight for the US construction industry, and falling Asian demand for timber following the Olympics. An expected near-term increase in the supply of wood from Russia (which had temporarily cut back production to focus on adding value) will also help to keep log prices lower than the forestry industry has been accustomed to.

With official interest rates looking likely to hit 7% as early as January, the question becomes just how far the exchange rate will fall. Rather than a return to the days of 40 US cents for our dollar, an exchange rate in the mid to low 60s is where we are more likely to be heading. If the Reserve Bank continues cutting rates as they have indicated, we could get there as soon as next year. A lower exchange rate will mean good news and bad news for transport operators, as it implies that fuel costs will be higher – but it will also lead to a lift in demand for transport services from exporters.

MAF projects that the harvestable volume of wood will remain stable or increase in most New Zealand regions over the next 10 years. In the medium term, as the New Zealand dollar depreciates and prices for logs improve in Asia, the volume of forestry harvested will begin to increase also. The downturn in residential construction in the US and back at home is making the Asian market increasingly important. Although China will face some form of slowdown in construction activity following the Olympics, the medium term outlook for the Asian market is healthy.

Many transport operators working in the forestry industry will already be feeling the slowdown triggered by the ETS. However, the medium to long term outlook remains positive for the forestry sector, following the short term drop we are experiencing. The demand for transport services from this industry is expected to steadily increase over the next five to ten years.

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