



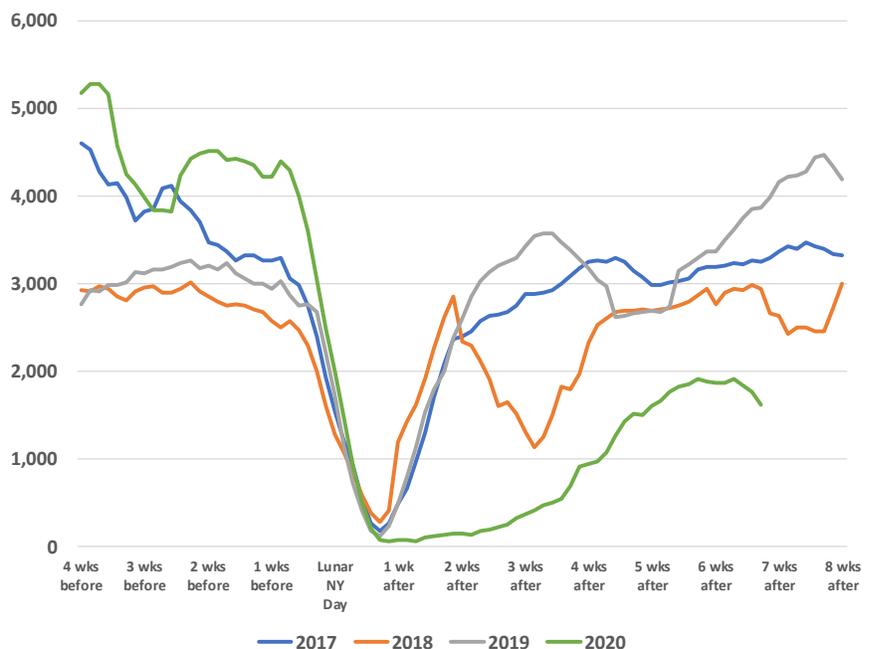
Timberland Flash Report

COVID-19 and Timber Markets— Impacts on Supply-Chain Disruptions

The dramatic spread of the COVID-19 virus in China and the more recent appearance of COVID-19 cases and fatalities in an increasing number of countries has sparked major corrections in global commodity and financial markets. Estimates of the possible scope and trajectory of the COVID-19 outbreak remain highly uncertain at this time, making it exceedingly difficult to quantify potential impacts on timber and forest products markets. However it is very clear that the duration and magnitude of market effects will vary dramatically between producing regions. Those timber supply regions which are more dependent on cross-border trade requiring ocean freight to deliver unprocessed logs, wood chips and forest products will be most vulnerable in the coming months.

Real Estate Transactions Stalled Following Lunar New Year in China

Chart 1. Chinese residential real estate transaction volumes, 7 day averages, by year (thousands)



Source: Macrobond March 8, 2020

China is the source-point for the COVID-19 outbreak and, so far, accounts for the majority of the cases (80,900 out of a global total of 150,000 cases, as reported on Sunday, March 8th).¹ China has taken very draconian measures to contain the spread of the virus, restricting travel and quarantining large segments of the population in affected regions. These measures have resulted in major disruptions in many manufacturing sectors, construction activity and the functioning of transportation and delivery systems (See Chart 1, page 1). Consequently, China is experiencing a pronounced slow-down in economic activity and obstacles to the flow of goods within the country.

At one point in February, provinces accounting for over two-thirds of China's economy were effectively in lockdown. *Capital Economics* is projecting that China's economy will contract by 2% year-over-year in the first quarter of 2020, and they have reduced their forecast for China's annual growth in GDP for 2020 from 5% to 2%.² In addition to the demand-side impacts in China of the COVID-19 outbreak, the highly calibrated logistics of global shipping have been upended, resulting in delayed and disrupted sailing schedules and major congestion and back-ups at Chinese ports.

China is the number one importer of timber and forest products in the world. Based on *FAO* data for 2018, China's imports as a share of total global trade was: 45% for softwood logs; 25% for hardwood logs; 20% for softwood lumber; 48% for hardwood lumber; 28% for wood chips; and 37% for market pulp.³ The severity of the initial impacts of the COVID-19 on any particular timber supply region will reflect the relative importance of exports to domestic demand for timber and forest products, and the degree of exposure to the China market.

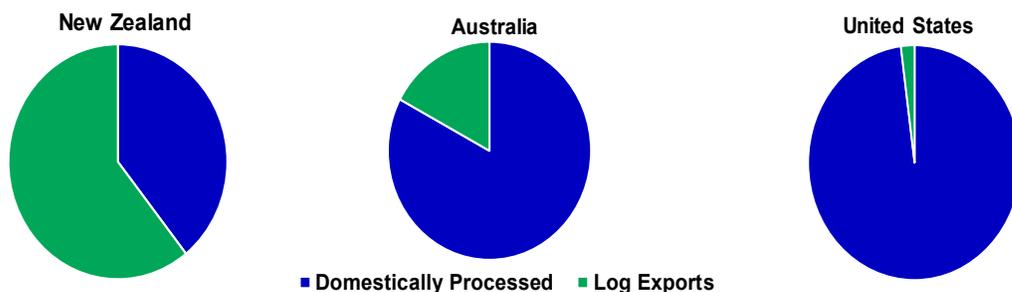
Given the time needed to reboot shipping logistics to normal functioning, virus-related impacts on New Zealand timber markets are likely to extend into the second and possibly third quarter of 2020.

New Zealand timber markets will be particularly vulnerable to the expected setback in Chinese economic and construction activity in the first half of 2020. Approximately 62% of New Zealand's plantation Radiata Pine timber harvest annually (as of December 2019) is exported as unprocessed logs, and China accounted for 80% of total New Zealand log exports in 2019, through September. In addition, New Zealand exports 41% of its lumber production, for which China is the number one destination (27% of total New Zealand lumber exports in 2019, through September).^{4,5}

In early 2020, many softwood lumber manufacturing plants in China that process softwood logs from New Zealand implemented extended shutdowns which were originally expected to last through the extended Chinese New Year celebration, which ended February 8th.⁶ Major reductions in processing activity have continued throughout February, and off-port log sales remain stalled entering March. Operations at Chinese ports have also suffered due to shortages of labor tied to quarantines and restrictions on travel. The full extent that log exports from New Zealand to China have been compromised will only become clear when trade statistics for the first quarter of 2020 are released later this year.⁷

New Zealand and Australia Timberland Have Greater Exposure to China Markets than U.S. Timberland

Chart 2. Share of timber production which is exported as logs (roundwood equivalents, percent)



Source: ABARES, December 2019; NZ Ministry of Agriculture and Forestry, December 2019, Fastmarkets RISI, January 2020

¹<https://www.statista.com/statistics/1043366/novel-coronavirus-2019ncov-cases-worldwide-by-country/>

²Capital Economics, March 2, 2020

³FAO, as of March 9 2020

⁴Random Lengths International, February 26, 2020

⁵New Zealand Ministry of Agriculture and Forestry, December 2019

⁶<https://chinesenewyear.net/calendar/>

⁷TPT and HNRG Research as of March 3, 2020

Shipments of logs and lumber from New Zealand to China are expected to rebound once the spread of the virus has slowed and the number of reported cases is clearly in retreat, allowing trade to normalize. However, the rate of recovery in trade will be limited by the volume of freight that can be shipped by boat due to finite seaport capacity. Given the time needed to reboot shipping logistics to normal functioning, virus-related impacts on New Zealand timber markets are likely to extend into the second and possibly third quarter of 2020.

Australia's timber producers are less vulnerable than New Zealand to the current COVID-19 crisis in China, but in fiscal year 2019, Australia exported close to 20% of its softwood log harvest, and nearly 90% of Australia's combined hardwood and softwood log exports were to China. Australia is also the second largest global producer of softwood chips, with just shy of 60% of Australia's fiscal year 2019's chip production exported to China.⁸

The degree of impact from the coronavirus on timberland properties will vary significantly between different timber producing regions, based on their exposure and dependence on exports to China

In the U.S., timber markets are dominated by domestic consumption of logs and forest products, and U.S. exposure to trade and the associated COVID-19 related timber supply-chain disruptions are reduced compared to New Zealand and Australia. Log exports represent a relatively small component of total timber demand. Even in areas such as the U.S. West Coast which have had periods of substantial trade in logs and lumber with China and other Asian destinations, offshore trade in timberland forest products has trended lower over the past decade, as domestic residential construction activity has improved. This trend was reinforced last year as trade disputes with China resulted in tariffs being placed on shipments of U.S. logs and forest products. In 2019, log exports accounted for 2% of U.S. timber production and lumber exports just 3% of U.S. lumber production.⁹

Demand for timber and building products in the U.S. may actually receive an indirect boost from the coronavirus outbreak as a result of the Federal Reserve easing monetary policy to protect the

economy from a potential economic slow down. The Federal Reserve cut the Fed fund rate by 50 bps on March 3, and 30 year mortgage rates are now approaching record lows near 3.0%.¹⁰ These lower mortgage rates combined with record low unemployment and rising wages should help support home construction in 2020 despite the negative impacts of COVID-19 on the overall economy.

For timberland operations in Latin American countries such as Brazil and Chile, the potential magnitude and duration of the impacts of the coronavirus outbreak are far from clear at this time. To date, only a few cases have been reported within the region (as of March 3, 2020). However, lower commodity prices and weaker global demand in general will negatively impact the domestic economies in the region. In the case of Chile where copper exports are a key component of the total economy (mining contributed 10% to Chile's GDP in 2019¹¹), lower prices and reduced copper shipments to China are expected to dampen overall economic growth in Chile in 2020 and moderate domestic consumption of lumber and other forest products. Brazil and Chile's export forest products sectors also have significant exposure to Chinese imports of pulp, wood chips, and lumber.

The COVID-19 crisis is impacting global timber markets through a combination of factors: depressed demand resulting from weaker economic growth; deferred consumption in a period of high uncertainty; and supply-shocks resulting from factory shutdowns, shipping delays and bottlenecks, travel bans, and quarantined workers. The degree of impact from the coronavirus on timberland properties will vary significantly between different timber producing regions, based on their exposure and dependence on exports to China. The timing and speed of China's recovery from the COVID-19 crisis will be a key determinant in the ability of timber markets in New Zealand, Australia and Latin America to bounce back from the challenges they are currently facing. In comparison, U.S. timberland properties, with their deep domestic markets and the rather limited exposure to China should be in a relatively better position to weather the virus-related challenges of 2020.

⁸ABARES 2019, Australian forest and wood product statistics

⁹Fastmarkets RISI as of February 11, 2020

¹⁰Washington Post, March 2, 2020

¹¹<https://www.statista.com/statistics/1056760/chile-mining-sector-contribution-gdp/>

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