

NEW ZEALAND ECONOMICS ANZ AGRI FOCUS

JULY 2011

INSIDE

Feature Article	2
The Month in Review	8
Rural Property Market	9
Economic Indicators	11
Key Commodities	13
Economic Backdrop	19
Borrowing Strategy	20
Education Corner	21
Key Tables and Forecasts	27

CONTRIBUTORS

Cameron Bagrie
Chief Economist
Telephone: +64 4 802 2212
E-mail: Cameron.Bagrie@anz.com

Con Williams
Rural Economist
Telephone: +64 4 802 2361
E-mail: Con.Williams@anz.com

David Croy
Senior Interest Rate Strategist
Telephone: +64 4 576 1022
E-mail: David.Croy@anz.com

Mark Smith
Economist
Telephone: +64 4 802 2199
E-mail: Mark.Smith2@anz.com

THE GAME OF TWO HALVES

FEATURE ARTICLE: A CLOSER LOOK AT INDIA

We examine the upside potential of a Free Trade Agreement (FTA) between New Zealand and India. Our simple estimates suggest a bilateral FTA could provide a one-off boost to New Zealand exports of around \$2.3bn (1.2 percent of GDP), with agriculture one of the major beneficiaries. We view these as very conservative.

THE MONTH IN REVIEW

Winter seems to have been a game of two halves thus far. A superb autumn was followed up with a mild start to winter, but things then quickly reverted to business as usual after the shortest day with a decidedly more wintry feel in most regions.

PROPERTY MARKET

The rural property market continues to show signs of building momentum. The number of farms sold in the three months ended June has now ticked up to nearly 60 percent of the 10-year average and values have either stabilised, or increased slightly for all property types except horticulture.

KEY COMMODITIES AND FINANCIAL MARKET VARIABLES

Commodity prices have shown their first signs of peaking in the last two months. We expect them to come off their highs over the next six months, but remain at elevated levels. This, along with the NZD front footing New Zealand's economic recovery in recent weeks, provides challenges for farm/orchard gate returns over coming months.

ECONOMIC BACKDROP

The NZ economy is navigating four large shocks simultaneously: debt payback, rebalancing, the Christchurch earthquakes and record terms of trade. And this is against a fickle global backdrop. In cycling parlance, it is like having to climb three steep hills, but with a tailwind! The interaction of these shocks will create tensions for years to come.

BORROWING STRATEGY

Although we see the RBNZ lifting the OCR in September, which will have a knock-on impact on rural rates, it doesn't necessarily mean borrowers should be in a hurry to fix. Some fixing may be appropriate, but we do not favour getting carried away. This is largely because fixed rates already incorporate an expectation that the OCR will rise. Furthermore, the high NZD will limit the extent of the tightening cycle.

EDUCATION CORNER: EMERGING DEMAND – LESSONS ON THE BUILDING BLOCKS OF HUMAN NUTRITION

Everyone has talked at length about protein demand being a big driver for New Zealand agricultural exports and industries over the next decade or more. We believe that we need to broaden our horizons and think about other areas of opportunity. Examining the building blocks of human nutrition shows that some of the bigger opportunities might lie with fat and other base nutrients that make up the human diet.

FEATURE ARTICLE: A CLOSER LOOK AT INDIA

SUMMARY

We examine the upside a Free Trade Agreement (FTA) between New Zealand and India might bring. This follows on from our FTA article in the March edition of the Agri (Rural) Focus. This analysis highlighted the fact that New Zealand currently has FTAs in place with 29 percent of the global population and we are under negotiation with another 27 percent. India alone represents a huge proportion of that. Our simple estimates suggest a FTA with India could provide a one-off boost to New Zealand exports of around \$2.3bn (1.2 percent of GDP), with agriculture one of the major beneficiaries. We consider these estimates conservative. Longer-term given its demographic advantages, India looks set to become a bigger player on the world stage, though its low-income levels suggest it will be some time before India becomes as influential as China and reaches sufficient critical mass.

BACKGROUND

In March we detailed the progress New Zealand was making in regard to bilateral trade agreements, as distinct from multilateral progress, which is being stymied by the obvious political dynamics. The former represents a huge source of upside for the New Zealand economy. **While there is much penned about the key challenges facing the New Zealand economy (rebalancing, deleveraging, seismic events) we see another shock emerging at the same time, namely a huge income shock**, built around a) the emergence of Asia as a powerhouse, b) the consequential rise in commodity prices and c) rising connectivity between New Zealand and the Asian region with trade agreements a key platform.

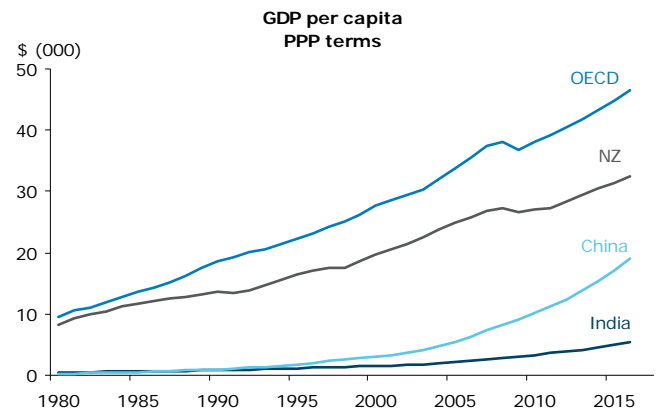
This note looks at some key metrics in regard to India, and attempts to map out some potential connections. The relevance is clear: India is a populous nation and trade negotiations look to conclude over the coming couple of years.

SOME KEY METRICS ON INDIA

India is a Sleeping Giant. With nearly 1.2 billion people it is the second most populous country in the world, the fourth largest global economy in terms of purchasing power parity (5.6 percent of world GDP), and the 10th largest in terms of nominal GDP (2.5 percent of nominal world GDP in USD terms). The structure of the Indian economy is predominantly services based, with agriculture, mining and manufacturing accounting for barely one quarter of GDP.

Some key metrics	New Zealand	India
Surface area (million km ²)	0.27	3.29
Population (million, 2010 est)	4.25	1,173
Income inequality (UN Gini coefficient)	36.2	37
Human Development Index (2010)	0.91 (3 rd)	0.52 (122 nd)
GDP (USD current prices, 2010)	140	1,651
GDP per-capita (PPP, 2010, International \$)	26,966	3,339
Export values (% GDP, 2010)	28	21
Import values (% GDP, 2010)	27	27
Merchandise Trade (US\$bn)	62	584

Sources: World Bank, UN, IMF, MFAT, ANZ, National Bank



Sources: ANZ, National Bank, IMF

Despite achieving average annual growth of around 6 percent since 1980, India is poor, with more than one third of the Indian population living below the poverty line (roughly US \$1 per day). Average USD per-capita incomes (US \$1,400 for 2011) are about 1/25th of New Zealand's. On a USD basis, per capita incomes in India were on par with China up until the early 1990s. A long period of out-performance has seen Chinese per-capita incomes now well above their Indian counterparts.

Measures of income inequality place India about middle of the pack – below China and the US, on par with New Zealand, but above Sweden¹. Of the 250 million Indian households, around 3 million have average household incomes of at least US \$38,000, with another 12 million households having annual household incomes above US \$12,500.

¹There are various metrics for categorising economies by their stage of development, but each has its own pitfalls. According to the UN Human Development Index (HDI), which combines life expectancy, literacy, education and standards of living, India is of medium development (122nd), versus China (91st) and New Zealand (3rd).

FEATURE ARTICLE: A CLOSER LOOK AT INDIA

TRADE PATTERNS

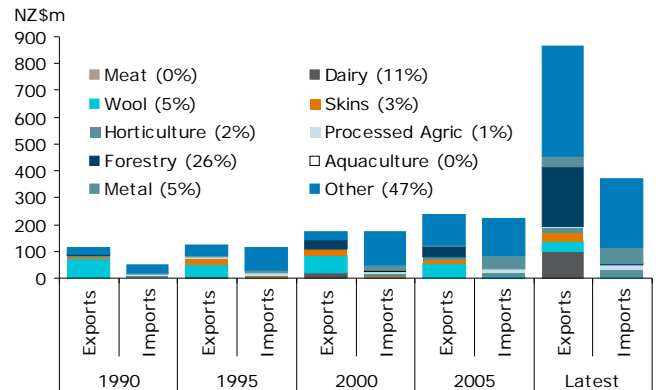
Merchandise trade

Previously a closed economy, successive moves to liberalise trade and lower tariffs over the last 15 or so years (India has been a WTO member since 1995) have seen India rapidly expand, with **India now accounting for around 2 percent of global trade**. India's total merchandise trade (exports and imports) reached US \$583bn in 2010 (about 35 percent of GDP). By comparison, this trade portion was only 14 percent of GDP in 1975.

India's major merchandise exports are mineral fuels, jewellery, clothing and manufacturing. Its major export destinations are the EU and US (which account for about 40 percent of total exports), although of late India has been sending an increasing portion of exports to oil rich or rapidly developing economies (such as the United Arab Emirates and China). **New Zealand's bilateral trade with India accounts for a small portion of Indian trade (about 0.2 percent of imports and 0.1 percent of exports)**. Relative to the mid 1970s, the share of Indian exports to New Zealand has been declining, whereas the import share has been increasing. India's major imports include mineral fuels, non-electrical machinery, iron, steel, precious stones and organic chemicals. In the main it sources these imports from China, US, Europe and UAE.

By virtue of its size, India is our 7th largest trading partner, accounting for \$864m of exports (1.9 percent of merchandise exports) with \$372m in imports (0.8 percent of merchandise imports) in the May 2011 year. With nearly 1.2 billion mouths to feed, and New Zealand being a food exporter, the natural area to target will be food. However, agriculture constitutes less than one quarter of our exports to India. Coal exports (categorised as 'Other' in the chart due to the confidential nature of coal exports) have led the increase in New Zealand trade with India in recent years, with forestry also a major growth sector; both now account for nearly three quarters of total merchandise exports. Dairy and wool are the two major agricultural exports, with the latter (an input into Indian carpets), declining in relative importance.

NZ's merchandise trade flow with India

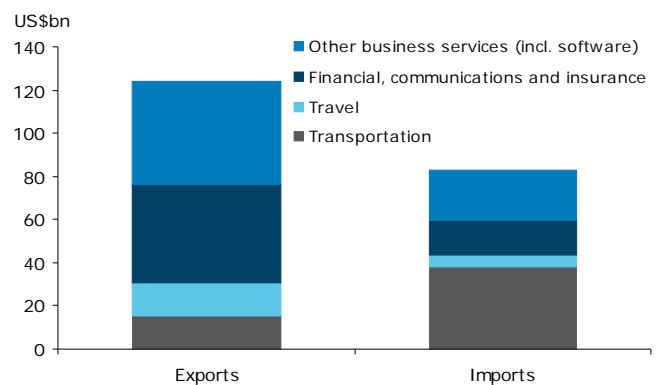


Sources: ANZ, National Bank, Statistics NZ

Services trade

India's trade in services is much smaller than goods (around one quarter of total trade) but is rapidly growing. By virtue of its low cost base, India is a growing hub for software development and lower value added financial services. The Indian outbound travel market has expanded steadily in recent years, rising from 4 million persons at the start of the millennium to above 10 million in 2010. The Indian film industry is multi-lingual and is the world's largest in terms of ticket sales and number of films produced, though much smaller than the US in terms of revenue.

India's services exports and imports 2010



Sources: ANZ, National Bank, UN

There has been steady growth in New Zealand's services trade with India, most notably in tourism and education. India is one of New Zealand's fastest growing education markets, now our fourth largest (after China, South Korea, and Japan), with around 10,000 Indian students in New Zealand. India is our 10th largest market for overseas visitors, with around 29,300 visitors in the

FEATURE ARTICLE: A CLOSER LOOK AT INDIA

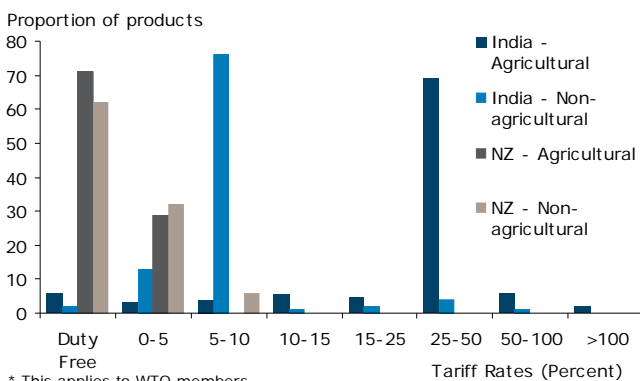
June 2011 year (around 1.2 percent of total overseas visitor arrivals). In 2000 this share was 0.4 percent.²

Trade liberalisation

A past impediment to greater trade has been protectionism, with high tariff rates and a multitude of non-tariff barriers (including quarantine restrictions) limiting market access to India. **Over the last 15 years, however, India's average applied tariff rate has reduced in line with its tariff policy and WTO commitments.**

There have also been increased bilateral efforts to bolster the trade and economic relationship, with a number of treaties in force between New Zealand and India. In 2007 New Zealand and India agreed to undertake a joint study into the benefits of a FTA, with the 2009 study³ finding considerable potential to substantially develop the trade and economic relationship. **Formal negotiations towards an FTA commenced at the start of 2010, and with four rounds of negotiations completed the target date for finalising negotiations is March 2012.** While there remains a large amount still to be done, both countries remain committed to meet this target.

Tariff Rates Most Favoured Nation Status*, 2009



India's average tariff rate is around 12 percent but tariffs differ markedly across sectors, with **considerably higher tariffs on agricultural products.** As an example, the average tariff rate on dairy products is around 34 percent, for animal products it is 33 percent and for fruit and vegetables 30 percent. Maximum tariff rates range from 60 to 150 percent for a range of foodstuffs. Free-trade negotiations with India are at an early stage, but there will be considerable emphasis by New Zealand

negotiators on reducing tariff rates for trade in agricultural goods. By contrast, the maximum tariff rate on coal is only 5 percent.

Under the General Agreement on Trade in Services (GATS), there have been multilateral negotiations to lower barriers on services. **Generally, tariffs on services are low in India.** On the bilateral front it is worth noting that:

- a bilateral Film Co-Production Agreement has just been signed that will encourage more cooperation between the New Zealand and Indian film industries and, it is hoped, greater tourism flows from India;
- despite a bilateral Air Services Agreement being in place, there is no direct air link between India and New Zealand. The majority of travellers transit through Singapore, Kuala Lumpur and Hong Kong; and
- there is also considerable scope for growth in services exports that are complementary to our comparative advantages, including building, environmental services, and services incidental to agriculture and forestry.

WHERE IS INDIA HEADED?

India represents a huge potential market for New Zealand, and a successful and comprehensive FTA deal could see exports there boosted. There is a long way to go before India becomes as important a market to New Zealand as China, but the potential is certainly there considering demographic advantages.

Demographics

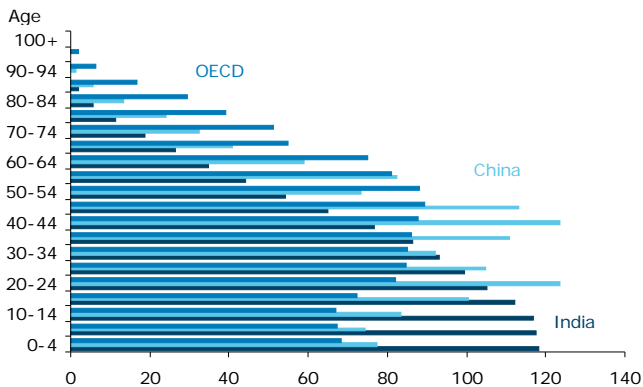
India has a young and rapidly growing population. Population growth has slowed from the 2 percent plus annual rate in the 1970s and 1980s to around 1.4 percent now. This is still well ahead of growth rates for OECD economies and China. The Indian population age structure is also very young: in 2011 about 30 percent of the Indian population was aged under 15 and two thirds under 35. There is also a shift towards greater urbanisation, with nearly one third of the Indian population now living in cities. The Census Bureau expects this proportion to trend higher.

² Average spend per Indian tourist (\$3,200 in 2008) were slightly above the nationwide average of \$3,000.

³ See www.mfat.govt.nz/Trade-and-Economic-Relations/2-Trade-Relationships-and-Agreements/India/index.php

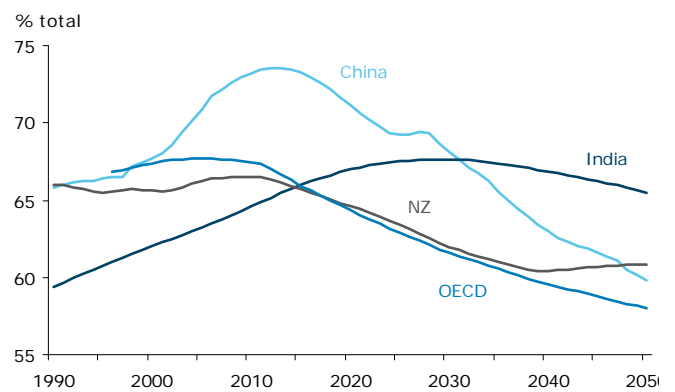
FEATURE ARTICLE: A CLOSER LOOK AT INDIA

Population age structure



Sources: ANZ, National Bank, US Census Bureau

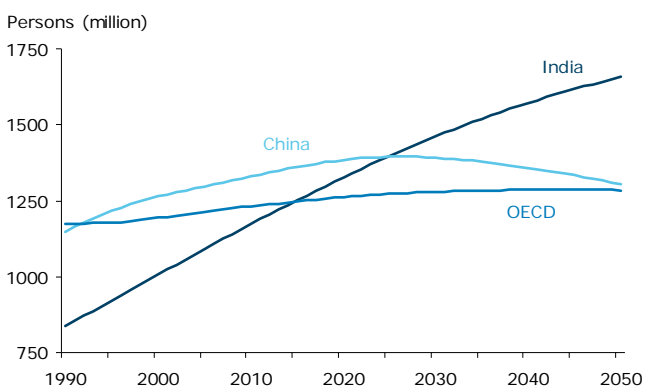
Population aged 15-65



Sources: ANZ, National Bank, US Census Bureau

The Indian population is set to rise from around 1.2 billion persons in 2011, to 1.46 billion persons in 2030 and 1.66 billion by 2050. By 2015 it will overtake the OECD (as currently defined) and by 2025 it will overtake China in terms of population. By 2050, the Indian population is projected to have 350 million more persons than either China, or the OECD.

Population projections



Sources: ANZ, National Bank, US Census Bureau

As well as having more people, the Indian population age structure is set to become more favourable from a labour supply and income generation point of view, with a rising proportion (until 2030 at least) in the key 15 to 65 age group.

Before we get too ahead of ourselves, we should note India's low starting point. It will not be until about 2028 that Indian per-capita incomes reach those of China at present, according to the International Monetary Fund. On a whole economy basis, Indian GDP will not surpass current Chinese GDP until 2024. Moreover, infrastructure demands are immense, and significant development would be needed to maintain high growth rates in GDP per-capita.

WHAT ARE THE PROSPECTS FOR OUR EXPORTS TO INDIA?

Trade liberalisation could yield significant benefits

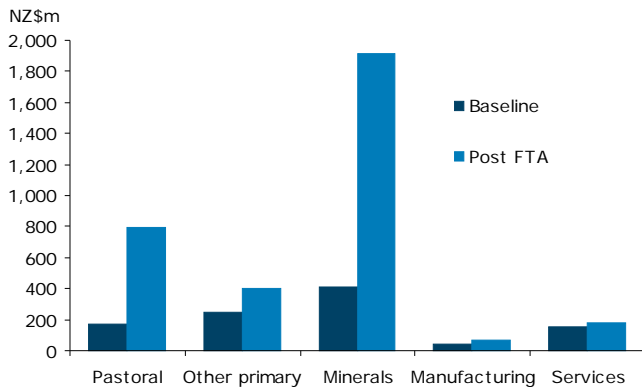
There is great potential to diversify exports, particularly through the FTA currently under negotiation which aims not only to eliminate tariffs but address a range of non-tariff barriers. The growth in New Zealand's merchandise exports shows the strongest growth has come from economies with either few trade barriers (such as Australia) and/or those experiencing rapid growth (such as China). India could potentially have both.

What would the scale of the benefits be? This would crucially depend on the extent to which lower final prices for Indian consumers would boost the demand for New Zealand goods and services. There would also be potential gains via the FTA in fostering greater trade facilitation between the two countries.

With higher tariff rates for agricultural goods there are sizeable one-off gains from an FTA with India. Proportionate gains, while significant, are not as large for manufacturing, seafood and forestry exports given the lower tariff structure currently in place. Gains for our services exports are lower still (perhaps 15 percent). While tariffs on coal are low, there are assumed to be significant trade facilitation benefits from a FTA with India.

FEATURE ARTICLE: A CLOSER LOOK AT INDIA

Potential gains to NZ exports to India from an FTA



Sources: ANZ, National Bank, Statistics NZ, MFAT

Applying MFAT estimates⁴ to the NZ export basket yields a **static one-off gain of around \$2.3bn from a FTA with India, around 1.2 percent of GDP and more than three times the current estimated value of our exports to India.**

Considering New Zealand's lower tariff structure, the static one-off gains for Indian merchandise exports would be quite limited from a FTA. MFAT estimates suggest this would translate into a 15 percent increase in merchandise imports from India (an additional \$50m or so). Greater trade facilitation and closer trade links could potentially provide a much larger boost to Indian services exports. In practise we consider such estimates very conservative. The experience of China shows how rapidly export growth can literally explode on completion of a FTA.

The longer term potential of the Indian market

Considering the growth potential of the Indian economy, it would be useful to examine its potential for New Zealand exports. Extrapolating forward export values by projections for Indian GDP implies Indian exports would rise from around \$1bn in current dollar terms in 2011, to around \$2.3bn by 2020, over \$4bn by 2030 and \$7bn by 2040. It is not likely to be until 2035 that the value of exports to India exceeds (in current dollar terms) the current value of exports to China today (2030 if we take account of the benefits of an India-NZ FTA).

In this month's edition of Education Corner we take a look at the longer term potential of protein and fat exports (dairy, lamb and seafood) to India and other emerging countries. The results suggest fat demand looks set to outpace protein demand from current levels. **Over the next 10 year period protein demand in India is projected to increase by 8.5 million tonnes, or 34 percent from current**

levels. Demand for fats is projected to increase by 11.1 million tonnes, or 52 percent from current levels.

While it is difficult to forecast the mix of products that might fill this gap, converting the figures to milksolid equivalents provide an idea of how many cows would be needed to meet this. Converting the fat and protein demand directly back to milksolid equivalents is tricky because the demand forecasts for fat and protein differ in composition to the proportion of a milksolid that is made up of protein and fat and there will be yield losses from farm-gate through to final form of consumption. But **simply taking each at face value shows that in order to fill protein demand of 8.5 million tonnes you would need 20 billion kilograms of MS, thirteen New Zealand dairy herds.** Doing the same calculations for fat demand of 11.1 million tonnes of fat, you would need 19.5 billion kilograms of MS, again thirteen New Zealand dairy herds. In current market prices, this translates to around \$130+bn worth of dairy exports. This of course translates into some very big numbers, which are equivalent to 200+ percent of our total exports, and 66 percent of our annual nationwide GDP.

Of course New Zealand does not have the resources to fill this and some of this higher demand will be met by an increase in domestic production in India and accessing other markets than New Zealand. It does, however, present a number of opportunities for New Zealand. One would be to focus on the speciality/boutique food market segments to extract as much value added as possible. Another opportunity would be to leverage more fully off our comparative advantage and boost the returns from our intellectual property and expertise in food production systems and food processing and manufacturing. The opportunities seem boundless and we would have first mover advantage. Remember, the figures are for the next 10 years also, not out to 2030 when things are forecast to really get going!

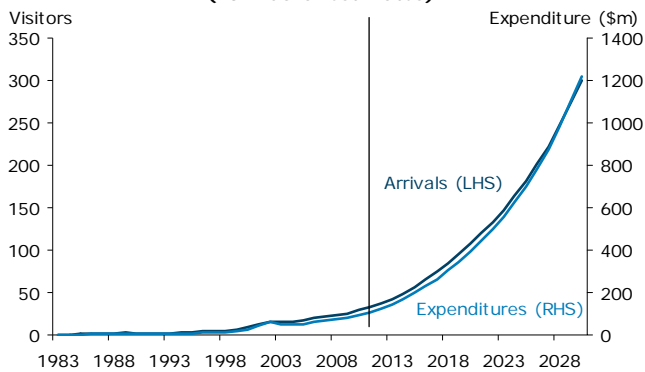
Tourism

With growth in tourism numbers from India having averaged 18 percent per annum since the early 1980s, the longer term potential of this market is huge also. Extrapolating forward tourism flows by also taking into account population and income projections suggest this market will continue to gain in importance.

⁴ See www.mfat.govt.nz/Trade-and-Economic-Relations/2-Trade-Relationships-and-Agreements/India/index.php

FEATURE ARTICLE: A CLOSER LOOK AT INDIA

Indian tourism arrivals to NZ and expenditures
(2011 dollar estimates)



Sources: ANZ, National Bank, Statistics NZ

Our projections suggest the number of Indian visitor arrivals will increase tenfold to around 300,000 visitors by 2030. In current dollar terms, total expenditures of tourists would increase from just under \$100m in 2011, to around \$1.2bn by 2030 (\$1.0bn assuming no change in spend per visitor). By comparison, annual visitor numbers from Australia and the UK are currently 1.1 million and 616,000 respectively in the June 2011 year, with Chinese visitor arrival numbers at 134,000 persons.

THE UPSHOT

India represents a huge potential market for New Zealand, and a successful and comprehensive FTA deal could boost exports to India.

One-off gains to exports could amount to around 1.2 percent of GDP. Although these will take a long time to accumulate, the China experience suggests the upside should never be understated. Given its demographic advantages India looks set to become a bigger player on the world stage, but its low income levels suggest it will be some time before India becomes as influential as other nations. Such dynamics need to be respected, as do infrastructure challenges. However, amongst all the doom and gloom around the globe, we thought it appropriate to point out some upside potential for NZ.Inc, which increasing connectivity with populous nations is bringing.

THE MONTH IN REVIEW

ASSESSMENT

Winter seems to have been a game of two halves thus far. A superb autumn was followed up with a mild start to winter, but things then quickly reverted to business as usual after the shortest day with a decidedly more wintry feel. The 2010–11 season will be remembered as one of the best: with good production despite the wild weather during the first 8 months of the season, and record farm–gate prices in many cases. The 2011–12 season has started in similar fashion to last, wet and cold. However, better feed supplies and stock condition means most are in a healthier position to withstand the wet and cold this time round. The wet weather over the last four weeks means much of the country's soils are now fully saturated for calving and the start of lambing.

DAIRY

The 2010–11 season finished with **record milk production, up some 7 percent on last year, to nearly 1.55 billion kilograms of milksolids.** The very good autumn conditions across many parts of the country meant farmers took advantage of the higher payout and good pasture conditions to milk cows for as long as possible. Nationally milk production during the February to May period was up a remarkable 18 percent on last year. 2010–11 production volumes were particularly strong in the Central and Upper North Island (+8.5 percent on last year), with volumes recovering from the drought affected autumn in 2010. The central South Island posted double-digit growth in milk production for 2010–11, up some 11 percent on last year. Good pasture conditions throughout the majority of the season and continued expansion of dairying in the region being the main drivers.

While there was some nervousness around empty rates heading into the 2011–12 season, due to the wet spring and poor cow condition during mating in 2010, these fears do not seem to have materialised. Therefore, better cow condition heading into 2011–12 should see production up again this season. While expectations are for some softening in farm–gate prices in 2011–12, reasonable production and a tight hold of the reins on expenditure should see good bottom lines continue in 2011–12, but not quite as good as 2010–11.

MEAT AND FIBRE

It is getting down to the business end of the season for lamb and beef production. Higher store prices for lambs and ewes and the wet weather has seen a drop-off in the kill figures over the last month. Mutton production was back 5 percent in June and has dropped-off even more in July. However, **overall mutton production is still likely to finish some 20 percent up on last season. This means opening ewe numbers are**

likely to be back 1–2 percent to around 21.5 million at 30 June 2011. North Island scanning results have been reported to be poor, with the February period when feed was only just starting to come away and ewe condition was only just lifting affecting contraception rates. Sub-clinical facial eczema and worm burdens may have also had a bigger influence than first expected. However, recent South Island scanning results have been better, providing an offset. As always, the weather during lambing will be the biggest factor. **Reasonable lambing conditions would see a lift in the total lamb crop by 2 million head (+8 percent), which would push export lamb production back towards 20.5 million head in 2011–12.** Expectations are for export lamb production in 2010–11 to finish at around 19 million head, down 11 percent on last season. Lamb weights are hitting new records, which are providing an offset to the lower number of lambs. The good autumn and low lamb production which is creating an unusual season kill pattern for prime lambs, meaning the national average lamb weight is likely to be finished around 18.2 kilograms this season. This is up 3 percent on last year and above 18 kilograms for the first time ever. Currently weights are running 2.2 percent ahead for the year–to–date, but nearly 10 percent ahead for this time of the season. Year–to–date wool exports for 2010–11 are back some 7.5 percent on last year to 114,000 tonnes. As farmers took the money and ran earlier in the season, export volumes have dropped off some 25–30 percent in recent months as lower sheep numbers come home to roost.

Higher cull dairy cows are driving beef production this season. Cow production has been tracking around 5–8 percent ahead of last year in both the North and South Island. Overall, beef production is on par with last season, as lower steer and heifer production has offset higher cull dairy cows. Steer and heifer production in the South Island has been particularly weak, back 25,000 head, or 10 percent year–to–date.

HORTICULTURE AND VITICULTURE

Apple production for most varieties is up on last year, although last year's crop was some 10 percent below average annual production from 2005 to 2009. **Grape production for the 2011 vintage has come in at 328,000 tonnes.** This was driven by very good yields from favourable pollination and growing conditions. This level of production is an all time high for NZ and up 25 percent on the 2010 vintage. A strong increase in exports to the US and UK markets has meant the sale of the 2011 vintage has started earlier than normal. Total kiwifruit production for the 2011 harvest **has been reported as 110 million trays, up from 102 million last season.**

RURAL PROPERTY MARKET

SUMMARY

The rural property market continues to show signs of recovering momentum. The number of farms sold in the three months ended June has now ticked up to nearly 60 percent of the 10-year average and values have either stabilised, or increased slightly for all property types except horticulture. The average length of time from listing to completion of a sale has doubled since the crash in late 2008. So while volumes are recovering, buyers look to be selective and are undertaking extensive due diligence.

COMMENT

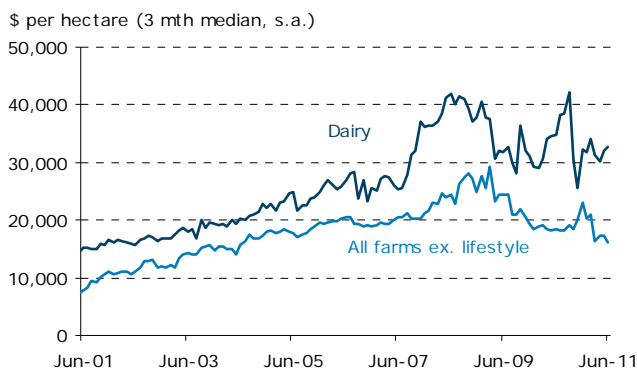
REINZ figures portray a rural property market that is recovering. The three-month period ended June saw 315 farms change hands, the highest number of sales since the global financial crisis at the end of 2008. Anecdotes suggest there is more to come over the next couple of months as conditional offers are finalised heading into the 2011–12 season.

This translates into a 10 percent increase in the number of farm sales in the three month period ended June (excluding lifestyle blocks). The median price for all farm sales moved 7 percent lower in the three-month period ended June. However, the types of farms sold overtly influences the median price. Grazing properties accounted for 59 percent of all farm sales in the three months to June, up from 40 percent at the end of last year. Dairy properties accounted for 15 percent, finishing properties 15 percent and horticulture properties 7 percent.

The tables and charts below show the official statistics from REINZ for the three-month period ended June (i.e. April, May and June farm sales). The table is broken down into farm sales by each of the main farm types, for the number of sales during the three-month period and the median price per hectare. The figures have also been seasonally adjusted and therefore the components may not necessarily add to the total. While the data is volatile, it is the best available regarding current market conditions.

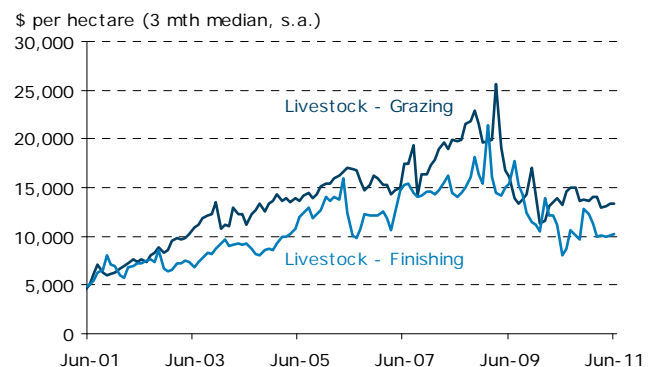
3-Month Seasonally Adjusted		Current Period	Previous Period	Last Year	10 - Year Av.	Chg. P/P	Chg. Y/Y	Chg. P/10yr
Dairy	Number of Sales	44	39	24	92	↑	↑	↓
	Median Price (\$ per ha)	32,700	31,900	34,700	26,200	↑	↓	↑
Livestock - Finishing	Number of Sales	44	41	29	77	↑	↑	↓
	Median Price (\$ per ha)	10,200	10,100	8,100	11,100	↑	↑	↓
Livestock - Grazing	Number of Sales	171	157	121	257	↑	↑	↓
	Median Price (\$ per ha)	13,300	13,400	13,000	13,700	↓	↑	↓
Horticulture	Number of Sales	20	22	43	62	↓	↓	↓
	Median Price (\$ per ha)	135,500	141,500	150,700	141,700	↓	↓	↓
Arable	Number of Sales	12	11	5	20	↑	↑	↓
	Median Price (\$ per ha)	20,700	24,000	19,300	23,200	↓	↑	↓
All Farms ex. Lifestyle	Number of Sales	315	286	245	544	↑	↑	↓
	Median Price (\$ per ha)	16,200	17,300	18,400	18,000	↓	↓	↓
Lifestyle	Number of Sales	1,339	1,214	1,078	1,657	↑	↑	↓
	Median Price	461,000	460,000	445,000	360,000	↑	↑	↑

Farm Sales, Median Price



Sources: ANZ, National Bank, REINZ

Farm Sales, Median Price



Sources: ANZ, National Bank, REINZ

RURAL PROPERTY MARKET

The \$30,000 per hectare mark now seems to be a firm base for dairy farms, although there is considerable variability around the median price from month to month, depending on the quality of the property being sold, size, region and whether or not shares are included. During the 2008–09 season when the milk payout collapsed from the previous season, the number of sales decreased to a quarter of what they were previously and the majority of sales that were transacted traded below the \$30,000 per hectare level. June saw 13 dairy farms change hands at an average sale value of \$24,100 per hectare, or \$35 per kg of MS (June was lower due to a larger property changing hands). The average production per hectare across these farms was 700 kgs of MS per hectare. May was a better month with 21 dairy farms sold at an average sale value of \$28,000 per hectare, or \$36 per kg of MS. The average production per hectare across these farms was 770 kgs of MS per hectare. In the regions, Waikato is showing stability around the \$40,000 per hectare level, Taranaki remains the most expensive dairy region at \$45,000+ per hectare. Canterbury dairy properties have been trading around the \$37,000 per hectare level over the last couple of months and Southland slightly less at \$31,000 per hectare.

Most of the action in the rural property market has been in the turnover of grazing, finishing and arable properties, where the number of farms changing hands has doubled since the end of 2010. This has largely been for dairy support, possible dairy conversion in the future and livestock finishing. So the Mexican standoff between buyers and sellers we had earlier in the year seems to have been broken, with buyers winning the shootout. **This is partly due to the values for grazing and finishing property dropping back around \$1,000 per hectare over the last 12 months. On the back of this, grazing land now seems to have found a base around \$13,000 per hectare and finishing \$10,000 per hectare.** We expect to continue to see an increase in sales at these values, but expect cash returns will continue to contain any price increases. Average cash returns are still too low to support significant amounts of debt and a tightening in financial conditions will reinforce conservative analysis and due diligence.

Horticultural sales continue to be hit hard by lower returns and confidence in the pipfruit and viticulture industry and PSA concerns in the kiwifruit industry. The total number of horticultural blocks to change hands has halved since the start of the year, leaving turnover running around a third of the 10-year average. The value paid per hectare has also dropped \$15,000 per hectare to \$135,000 (-10%)

over the same period. **We expect pressure to remain especially with the resolution of PSA and what it means long-term for the kiwifruit industry still some way off.**

A period of consolidation is expected over the next six months as financial conditions tighten.

This may seem a bit peculiar given that the market has only now moved forward off a pretty low base, cash-flows look strong and we are seeing strong offshore interest. Such forces are certainly relevant and will maintain a bid tone to the market. However, against this backdrop we are mindful that:

- Commodity prices are coming off their peaks.
- NZ dollar returns are being further reduced by a stubbornly high New Zealand dollar.
- New prudential rules such as the altered capital requirements for banks on rural lending are implicitly aimed at making sure the market does not get up a full head of steam.
- The OCR looks set to move up gradually, and there is core pressure on farm working expenditure from rising costs.

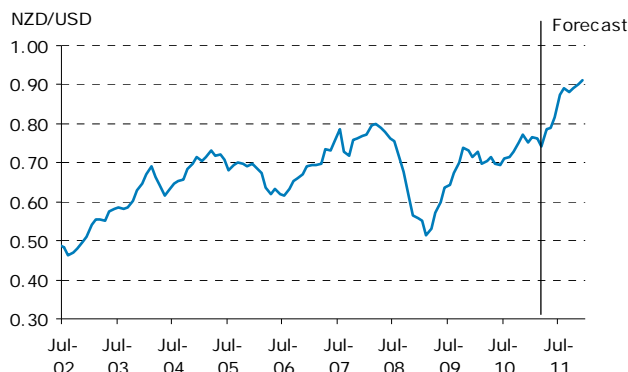
Such forces are expected to restrict new buyers from emerging soon – therefore reinforcing the criteria and mindset of current buyers.

ECONOMIC INDICATORS

Exchange Rates

	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
NZD/USD	0.84	0.82	0.71	↑	↑
NZD/EUR	0.59	0.57	0.56	↑	↑
NZD/GBP	0.51	0.50	0.47	↑	↑
NZD/AUD	0.78	0.77	0.81	↑	↓
NZD/JPY	67.2	65.6	62.4	↑	↑
NZD/TWI	73.0	71.2	67.5	↑	↑

NZD Buys USD

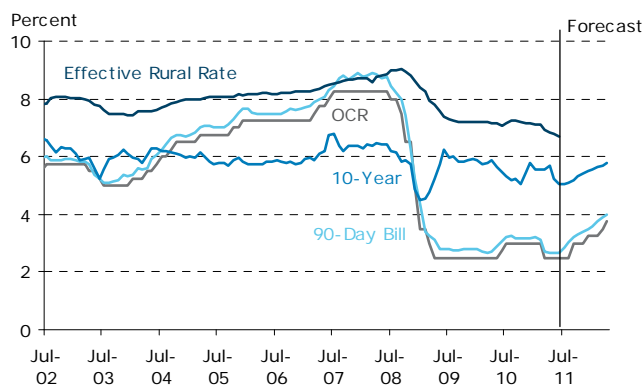


Sources: ANZ, National Bank, Bloomberg

NZ Interest Rates

	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
Official Cash Rate	2.50	2.50	3.00	↔	↓
90 Day Bill Rate	2.67	2.65	3.22	↑	↓
1 yr	2.92	2.92	3.62	↑	↓
2 yr	3.27	3.27	3.98	↑	↓
3 yr	3.62	3.66	4.29	↓	↓
5 yr	4.25	4.27	4.74	↓	↓
10 yr	5.17	5.04	5.33	↑	↓
Effective Rural Rate	6.68	6.79	7.08	↓	↓
Agricultural Debt (\$b)	46.12	46.54	45.99	↓	↑

Key NZ Interest Rates



Sources: ANZ, National Bank, RBNZ

The NZD looks to have started front footing New Zealand's economic recovery a little too prematurely in recent weeks. **A stronger NZDAUD and a dislocation with commodity prices (which have softened in recent weeks) could make for some challenging times for farm and orchard-gate returns over the coming months.**

NZ's economic story is one of a firmer footing, which a run of stronger than expected data (some of it quite historical) in recent weeks has confirmed. This contrasts significantly with the tone and performance of the global economy where it has been a battle for the headlines between the US and Europe. Both have issues with sovereign debt and need to come up with credible plans to resolve the difference between earning and spending. There should be some relief on the way, which will calm things down, but ultimately the outcomes are likely to see a lower economic growth path for both regions over the years to come. **So the relative performance of the NZ economy compared to others has been reflected in the NZD.** However, in recent times it looks to have gotten very extended and risks choking off the recovery before it gains a stronger footing.

Farmers continue to benefit from historically low interest rates and the proportion of debt on maturities of less than one year continues to increase, going from 37 percent last year to 60 percent now. However, this will change over the coming months as the RBNZ unwinds the emergency 50 basis points cut delivered in March. The firmer footing in NZ has led to interest rate markets finally factoring in a rise in the OCR in the next couple of months. Our view is the 50 basis point cut in March will be unwound in September.

While we are not talking about an aggressive increase in the OCR over the next couple of years, the emergency cuts delivered earlier in the year do need to be unwound. With global markets grappling with sovereign debt issues in the US and Eurozone this will mean longer-term rates will be lower for longer. The combination of these two events should see a flatter interest rate curve over the coming months and potentially create an opportunity for farmers to fix a proportion of debt.

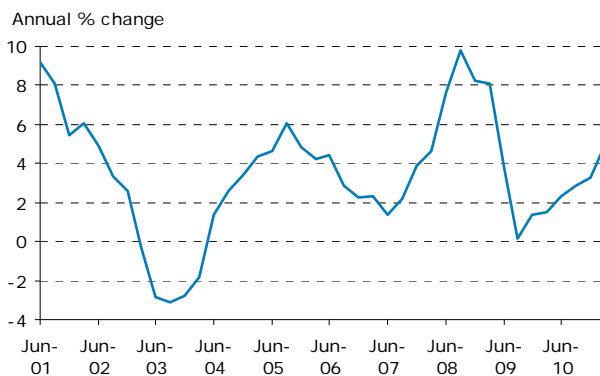
Fixing does offer certainty, but the cost of doing so are higher funding costs now. Our breakeven analysis shows that interest rates would have to move up at around the pace we expect them to in order for fixing to be worthwhile. **That being the case, the decision to fix or remain floating is something of a line call. The global economy still looks skittish and the NZ economy has a number of challenges to address, therefore expect interest rates to stay relatively low compared with history, but not as low as what they have been.**

ECONOMIC INDICATORS

Inflation Gauges

Annual % change	Current Qtr	Last Qtr	Last Year	Chg. Q/Q	Chg. Y/Y
Consumer Price Index	5.3	2.0	1.7	↑	↑
Farm Input	5.0	3.3	1.5	↑	↑
Net Imp. Margins PPI	11.7	11.7	-1.2	↓	↑

Farm Input Inflation Gauge



Sources: ANZ, National Bank, Statistics NZ

On-farm costs are on the march and will continue to do so over the coming months. Farmers need to ensure they maintain a tight hold of the reins to ensure profit margins are not squeezed too much in 2011–12.

The CPI rose by 1.0 percent in Q2 2011, taking the annual rate of headline inflation to 5.3 percent. While this includes the change in the GST rate last year, it is still the highest annual rate since the 7.6 percent increase recorded in Q2 1990, which included the rise in GST from 10 to 12.5 percent on 1 July 1989. If we exclude GST and other taxes from the headline rate, inflation is still 2.8 percent. Half of the increase in the CPI during the quarter was driven by higher prices for food (up 1.1 percent in the quarter), petrol (up 4 percent) and electricity (up 2.7 percent).

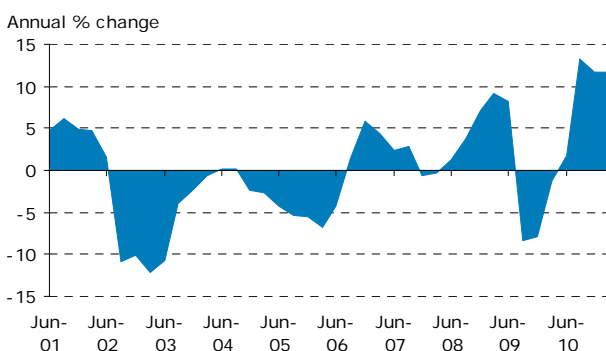
Fertiliser prices have also increased by various amounts during the last two months as international prices move up. Price increases have ranged from +\$50 per tonne for Urea to \$760, +\$55 per tonne for DAP to \$1,050 and +\$25 per tonne for Superphosphate to \$345. While most took advantage of the lower prices and good autumn conditions to apply catch-up maintenance applications, farmers need to ensure they get expert advice on which fertiliser blends will deliver them the most value. **Further inflationary pressure is likely to come via local authority rates as they factor in GST changes from last year and there remains further potential for insurance premiums to rise because of the earthquakes in Christchurch.**

Wage expectations from farm workers and service providers are another area of concern. These have increased because of the high commodity prices, higher inflation and a lack of skilled workers in some cases. Farmers will need to ensure performance is rewarded to keep skilled staff but should still maintain an element of conservatism as it is difficult to unwind higher wage costs.

The chart to the left measures the annual percentage change between the prices received for rural outputs and price changes in costs of production (excluding labour costs and interest charges). This provides a good proxy for the relative change in margins received for the primary goods produced and manufactured by the rural sector.

The sharp rise in commodity prices at the start of 2011 has outpaced the rise of input costs. Implied margins rose 11.7 percent in the March 2011 year. Margins are expected to narrow over the next six months as commodity prices come off their peak while costs increase. However, the level of margins is forecast to remain healthy throughout the 2011–12 season.

Net Implied Margins PPI Ag/Forestry/Fishing (Outputs - Inputs)



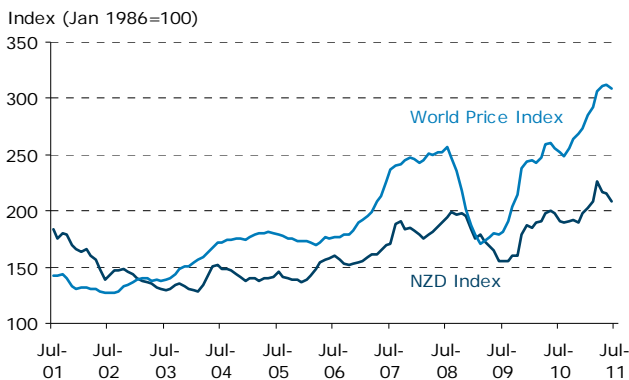
Sources: ANZ, National Bank, Statistics New Zealand.

KEY COMMODITIES

ANZ Commodity Index

	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
NZ Index	208	215	198	↓	↑
World Index	308	312	256	↓	↑

ANZ Commodity Price Index

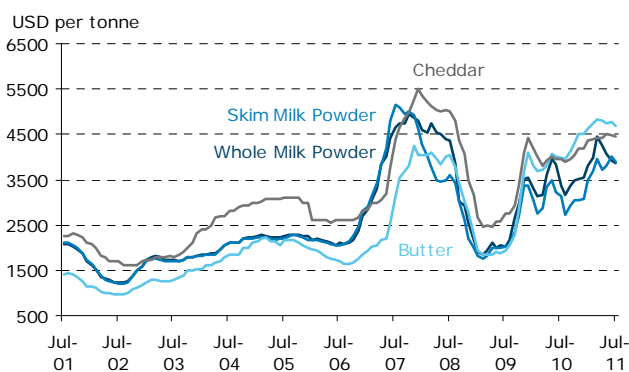


Sources: ANZ, National Bank

Oceania Dairy Price Indicators

USD per tonne	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
Whole Milk Powder	3,863	3,938	3,380	↓	↑
Skim Milk Powder	3,900	4,000	3,140	↓	↑
Butter	4,675	4,763	3,970	↓	↑
Cheddar	4,450	4,488	3,950	↓	↑
World Basket	4,222	4,297	3,610	↓	↑

Dairy Products - Oceania Export Market Prices



Sources: ANZ, National Bank, USDA

Commodity prices have shown their first signs of peaking in the last two months. We expect them to come off their highs over the next six months, but remain at elevated levels. It is not so much the level that prices have reached, but the speed at which they have got there. Many participants within the food supply chain have not had time to adjust their cost of production and margins to the higher prices and now there will be some unwinding.

China (a key source of growth in the demand for soft commodities) is also trying to cool their inflation rate by using a range of policies. Food price increases (up 14.4% per annum) have been a major cause of the lift in inflation in China over the last 12 months. These measures are expected to moderate further demand pressures from China in the near future.

On the other side of the ledger, there has been a supply response from farmers to the higher prices also. This will increase the supply of key soft commodities over the coming months. This is of course barring further weather related shocks in major producing countries. Inventory levels still remain low.

Dairy markets lacked a bit of direction in June but have picked up a softening tone recently. **It seems the price differential between milkfat products and powders over the back end of 2010 and first half of 2011 has encouraged a production mix of skim milk powders (SMP) and either butter, cheese or anhydrous milkfat over whole milk powder (WMP).** This has led to an increase in the production and export of milkfat products and SMP from NZ, the US and EU in recent months. This has also allowed milkfat inventory levels to be rebuilt from their low levels at the start of 2011. The US has doubled butter stocks since the start of 2011.

At this point it seems there will be **continued softening in SMP and milkfat prices over the coming months because of the increase in supply.** If these prices fall considerably it seems likely that WMP production will be ramped up.

WMP purchases from China have eased back over the past few months. Large quantities of product were imported during the first four months of 2011. The NZ-China FTA provides an incentive for purchases early in the year as a lower tariff rate applies to a limited volume of product. In 2011 the FTA limit was reached early in March. In 2012 a tariff of 5.8 percent will apply to the first 115,473 tonnes of milk powder imported by China from NZ. For additional product imported from NZ the general World Trade Organisation member rate will then apply. This has recently been reflected in the *GlobalDairyTrade* WMP results, with July contracts set for delivery in the first months of 2012 reflecting a price premium over near term contracts.

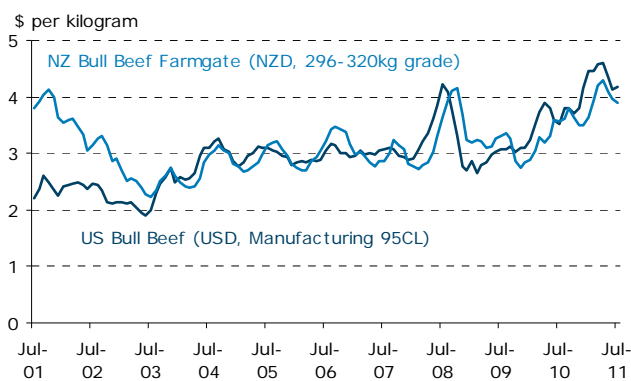
KEY COMMODITIES

Beef Price Indicators					
\$ per kg	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
NZ Bull Beef ¹	3.90	3.98	3.56	↓	↑
US Bull Beef ²	4.17	4.13	3.53	↑	↑
NZ Steer ¹	4.05	4.11	3.71	↓	↑
NZ Heifer ¹	4.00	4.08	3.62	↓	↑

¹ (NZD, 296-320kg Grade Bull & Steer) (NZD, 195-220kg Grade Heifer)

² (USD, Manufacturing 95CL)

Beef Indicator Prices



Sources: ANZ, National Bank, Agrifax

All the focus has been on the US beef market

recently. The drought in Texas and surrounding states (which account for about 40 percent of the US beef cow herd) is of historic scale – the third driest year ever (so far) – and pasture and water conditions continue to deteriorate. The situation forces cow-calf producers to sell their feeder cattle to feedlots, and their beef cows to slaughter plants as they drastically reduce herds. This has increased domestic supplies of US beef and led to a 9 percent decrease in US manufacturing beef prices since April. This has reduced NZ farm-gate returns by 9 percent over the same period. However, the NZD has appreciated by some 7 percent against the USD during this period, indicating better demand from Asia and Indonesia of late.

In Asia exports to Japan have increased 10 percent year on year. **Japanese demand has been very firm following the tsunami and nuclear disaster due to domestic supply disruptions, a reduction in seafood consumption and concerns about food safety following the disaster.** The banning of live beef exports from Australia to Indonesia has also lent support to NZ's lower quality cuts and manufacturing meat in recent weeks as import licences have come through.

Looking ahead, other meat protein sources (poultry & pork) have recently moderated production because of negative margins. This along with beef production from other US states not affected by the drought should start to lead to some stability in the US meat market. The main risk to NZD farm-gate returns in the near term seems to be where the NZDUSD might head.

There is growing evidence that in-market prices for lamb have peaked and there will be some softening heading into the 2011–12 season. In the bellwether market of the UK, retail sales of lamb during Easter declined 20 percent compared with a year ago and this was not due to product availability.

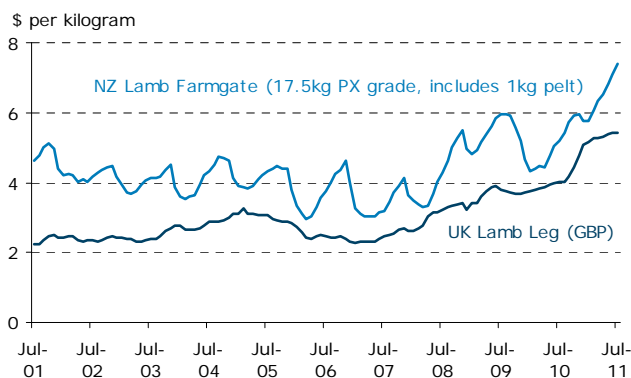
Recently the normal transition to Northern Hemisphere supply has taken place, along with Australian farmers offloading lambs in larger than expected numbers due to a good autumn. Prices to both British and Australian farmers have also declined, with Australian farm-gate prices now back to 2009–10 levels. The trading down of European consumers from eating out at restaurants to buying a leg of lamb at the supermarket and having friends/family around now seems to have run its course. Consumers are now starting to eye other meat protein sources in an effort to keep total food expenditure down.

As mentioned above, a slight increase in production from NZ and Australia in 2011–12, along with a stronger NZD is likely to lead to a season average price of \$90–95 per lamb in 2011–12. A season average price of \$115 per lamb is expected in 2010–11.

Lamb Price Indicators					
\$ per kg	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
NZ Lamb ¹ (NZD)	7.40	7.09	5.21	↑	↑
UK Lamb Leg (£)	5.42	5.44	4.02	↓	↑

¹ (17.5kg PX grade, including 1kg pelt)

Lamb Indicator Prices



Sources: ANZ, National Bank, Agrifax

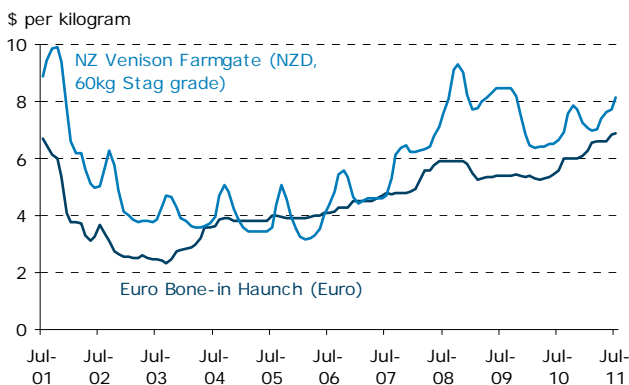
KEY COMMODITIES

Venison Price Indicators

\$ per kg	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
NZ Venison ¹	8.13	7.74	6.64	↑	↑
Euro Bone-in Haunch (EUR)	6.90	6.85	5.56	↑	↑

¹ (60kg Stag AP grade)

Venison Indicator Prices



Venison has become more of a niche meat protein in Europe over the last several years. Marketing it as a healthy meat choice seems to be paying dividends, with double-digit growth into the UK market last year. With reasonable economic growth in other major European markets, especially Germany, things look reasonably robust heading into the game season. Chilled contracts for this period are currently being negotiated at 10-15 percent ahead of last year. These stronger in-market prices have been reflected in contract prices offered by processors to farmers earlier this year.

NZ venison production for the year-to-date continues to be around 4 percent ahead of last year. The March to June period has seen an increase in hind slaughter compared with last season. This has probably been due to favourable autumn prices and some hangover of stock from the wet spring in 2010 when animals didn't reach target weights. However, inventory levels remain low.

With stable breeding numbers, a 5 percent increase in production is forecast in 2011-12. The only downside at the moment is from the weak Euro which is limiting NZD prices heading into the next game season. **Prices are still forecast to range up to \$9.0+ per kg cwt during this period.**

The recent jitters in the cotton market have not yet hit wool prices substantially but are expected to have some impact over the next 6-12 months. Cotton prices have come back from USD180-200 cents per pound earlier in the year to now trading just over USD100 cents per pound in July. While there has been extra area planted in cotton in response to the higher prices, crop conditions remain uncertain (especially in Texas which supplies 43 percent of the US's cotton) and inventory levels low. However, end demand for yarn has not been as strong as implied by the price of cotton, with recent uncovering of more and more yarn stockpiles in China and India. These elements make for a volatile picture over the next several months.

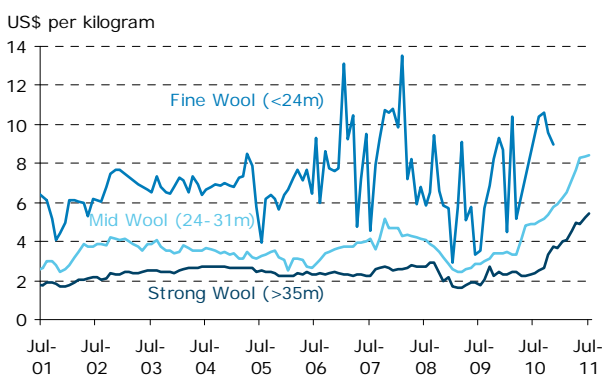
Wool prices seem to have been sheltered from this crash so far, as many farmers in NZ and Australia took the money and ran earlier in 2011. This has run down inventories and auction volumes as the season ended, holding up prices. However, the largest buyer over recent months has been China and reports of stockpiles of yarn do not bode well for 2011-12.

If prices do drop from current levels this could also encourage farmers to hold onto wool, as the current season enabled many to off load stock that had been kept on hand for some time. This, combined with lower sheep numbers, could potentially see a drop off in supply pretty quickly if prices drop too much.

Clean Wool Indicator Prices

\$ per kg	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
NZ Fine Wool (>24m)	N/A	N/A	0.00	↔	↑
NZ Mid Wool (24-31m)	10.00	10.26	6.91	↓	↑
NZ Strong Wool (>32m)	6.48	6.41	3.38	↑	↑
USD Fine Wool (>24m)	N/A	N/A	0.00	↔	↑
USD Mid Wool (24-31m)	8.40	8.36	4.92	↑	↑
USD Strong Wool (>32m)	5.44	5.22	2.41	↑	↑

Wool Indicator Prices (Clean)



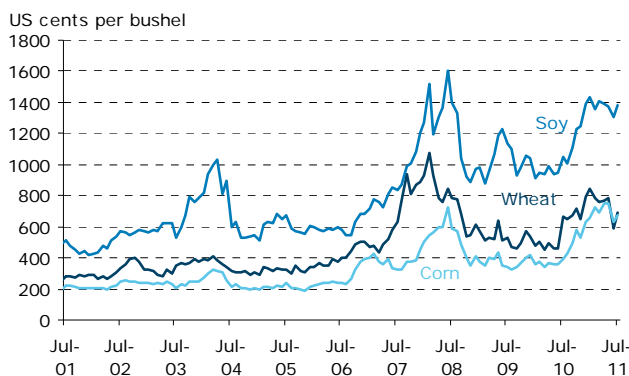
KEY COMMODITIES

Grain & Oilseed Price Indicators

USD cents per bushel	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
Wheat	6.9	5.9	6.6	↑	↑
Soy	13.9	13.1	10.5	↑	↑
Corn	6.8	6.3	3.9	↑	↑
Australian Hard Wheat ¹	312	330	287	↓	↑

¹ NZD per tonne

CBOT Future Grain & Oilseed Indicator Prices

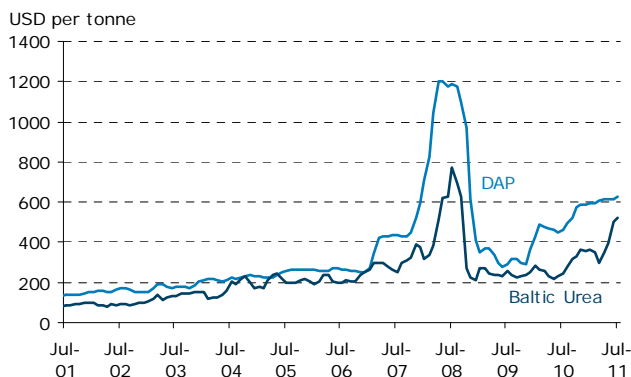


Sources: ANZ, National Bank, Bloomberg

Fertiliser Price Indicators

USD per tonne	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
DAP	630	617	461	↑	↑
Urea	525	500	243	↑	↑

Fertiliser Indicator Prices



Sources: ANZ, National Bank, Bloomberg

Global grain prices have topped out over the last several months, with wheat and corn prices declining around 10 percent since their peaks in April. Domestic prices seem to have gone the other way, playing catch-up from the start of the year and more recently with buyers wishing to secure supply going into the spring because of reports of low inventories in NZ.

Globally the grain markets remain sensitive to any supply shocks in the Northern Hemisphere despite an increase in the area of crop planted this season. The area planted in corn and wheat in the US has increased by 4.6 and 5.2 percent respectively on last year. More recently, focus has shifted to the hot and humid conditions in the Mid Western corn-growing States, with speculation end yields could be affected as crops are in the critical part of the growing season. While uncertainties remain around yields, prices are expected to remain up but fickle until more certainty is gained later in August.

Demand has also continued to be better than expected for corn to ethanol and feed demand from China and other parts of Asia. Much of the growth in US ethanol demand has been the result of government mandates for blending renewable fuels with gasoline. Under the mandate of the Clean Air Act, the EPA indicated that for 2011, a minimum of 13.95 billion gallons of renewable fuels (ethanol) would need to be consumed in the US. This translates roughly into 5 billion bushels of corn, or 38 percent of the US corn crop. With all the talk of removing refiner tax credits and import taxes, the matter of fact is that the ethanol mandate will not go away and corn prices are likely to continue increasing. The bottom-line is it will be a weather market for global corn and grains markets in the short term, while longer term, the demand drivers of ethanol and feed grain to Asia will dominate.

As mentioned above, global fertiliser prices are on the move higher in response to better demand from an increase in crop area planted globally.

Urea prices have now doubled from this time last year, with prices increasing some 75 percent over the last 5 months. While some of the increase has been seasonal, there has been strong underlying demand that has moved season average prices to a higher plane.

DAP benchmarks have increased at a more modest rate of 5 percent over the last five months but are up 37 percent on this time last year.

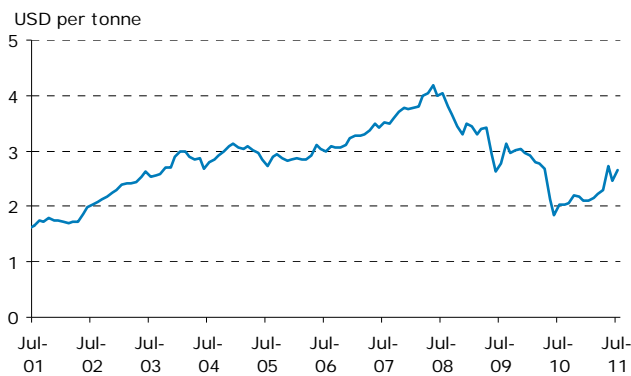
A continuation of good demand will continue in the short-term with high commodity prices. However, seasonal demand will come off. Longer-term higher production costs coupled with tight supply is forecast to lift season average pricing, but the real dampener for farm-gate prices in NZ is likely to be a higher NZD.

KEY COMMODITIES

Horticulture Price Indicators

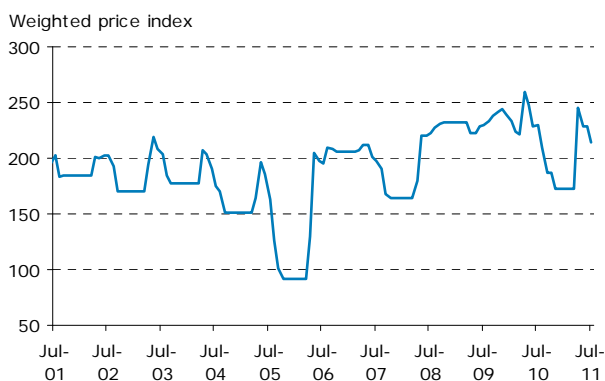
	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
Kiwifruit (USD per kg)	2.7	2.5	2.0	↑	↑
Apples (Weighted Index)	214	228	230	↓	↓

Kiwi Fruit Indicator Prices



Sources: ANZ, National Bank, Zentrale Markt- und Preisberichtsstelle

Apple Indicator Price Index



Sources: ANZ, National Bank, Zentrale Markt- und Preisberichtsstelle

The 2011 vintage has come in at 328,000 tonnes. This level of production is an all time high for New Zealand, up 25 percent on the 2010 vintage. The main driver of the big 2011 vintage was very good grape yields, with a national average yield of 9.8 tonnes per hectare, up 23 percent on last year. Together the UK, USA and Australia have accounted for 85 percent of our volumes and 80 percent of export returns over the last 12 months. While the substantial increase in the 2011 vintage will continue to pressure pricing, export sales to the US and UK have been strong over the last 12 months, albeit at reduced prices. Australia has also shown signs of an improvement, driven by a lower NZDAUD and better in-market prices.

Forecast export growth will not make-up for the large 2011 vintage, but a return to average yields in 2012 should see things come back into balance more quickly than most think. Indicative pricing for Sauvignon Blanc in 2011 has been \$1,100 per tonne, Chardonnay \$1,100-1,500 per tonne, Pinot Noir \$2,500 per tonne and Merlot \$1,500 per tonne.

Pipfruit and Kiwifruit markets are in full swing but added pressure has come from food safety concerns in some markets and increased competition in others. Early signs look challenging for both at the moment, especially when the high NZD is factored in.

Zespri's indicative ranges for the different types of kiwifruit remain unchanged at \$6.80 to \$7.40 per tray for green, \$8.30 to \$8.90 per tray for organic green and \$11.60 to \$12.20 per tray for gold. A 9 percent increase in organic green production and 28 percent for gold will put pressure on average market returns as more fruit will go into lower returning markets than previous years.

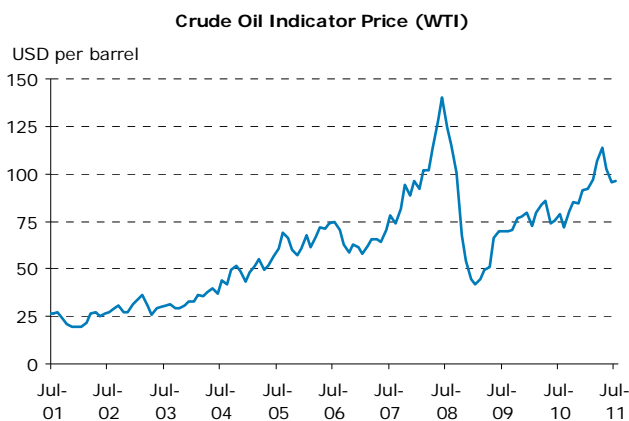
Japan has slipped back into recession following the tsunami and lower consumer spending has effected demand for large-sized kiwifruit, with demand shifting to smaller-sized fruit. The E. coli outbreak in Germany has had a major impact on fruit markets across Europe, eroding consumer confidence and spending on vegetables and fruit. In Asia and North America competition has been strong from Chilean producers.

KEY COMMODITIES

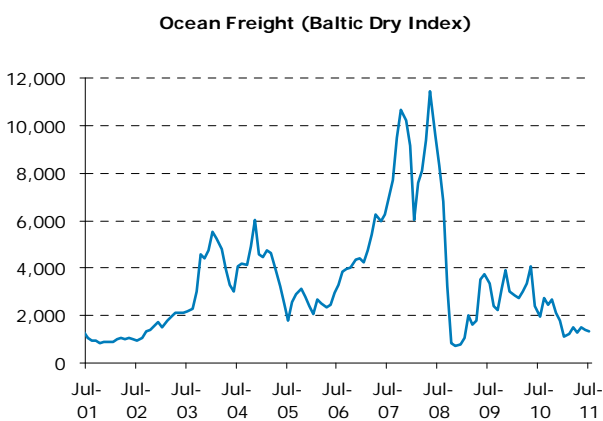
Other Cost Indicators					
	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
Crude Oil ¹	96	95	79	↑	↑
Ocean Freight ²	1,340	1,413	1,967	↓	↓

¹ (US\$ per barrel, grade WTI)

² (Baltic Dry Index)



Sources: ANZ, National Bank, Bloomberg



Sources: ANZ, National Bank, Bloomberg

The announcement by the international energy agency (IEA) in late June to release a total of 60 million barrels of oil from strategic reserves and Saudi Arabia's decision two weeks earlier to increase its daily production has taken the heat out of the oil market recently. The Saudi move came after the inability of OPEC members to reach any agreement on production quota increases at their early June meeting.

The IEA, a 28-nation agency of industrialised countries, was set up after the Arab oil embargo as a counterweight to OPEC. Historically, IEA has made two previous releases of the strategic inventories when global supply faced abrupt shortages: during the first Gulf War in 1991 and post Hurricane Katrina in 2005.

More recently, jitters around global growth and sovereign debt issues in Europe and US have weakened the near-term demand outlook and pricing. However, we remain bullish on the longer-term picture. With global economic growth continuing to drive world oil demand well in excess of the increases in non-OPEC production, the oil market will pull on inventories and OPEC spare capacity in order to balance demand and supply. Therefore it seems only a matter of time until inventories and OPEC spare capacity will become effectively exhausted, requiring higher oil prices to restrain demand.

The Baltic Exchange's main sea freight index, which tracks rates to ship dry commodities, rose in early June with cargo bookings on the larger capesizes driving market activity. Improved optimism, particularly for capesize vessels carrying coal, was forecast to offset pressure from fleet oversupply. But recent global growth concerns have taken over in the last several weeks.

More recently dry freight bulk vessel congestion at Australian, Brazilian, Indian and Chinese ports were reported as having risen to its highest level since the beginning of the year. The combined congestion of the dry bulk fleet at Australian, Brazilian, Indian and Chinese ports has risen above 59 million deadweight tonnes. This is the highest level seen since January and is equivalent to nearly 11 percent of the entire dry bulk fleet, marginally greater than the year-to-date average of 10.25 percent. Despite the news, freight markets still appear soft.

ECONOMIC BACKDROP

SUMMARY

The New Zealand economy is navigating four large shocks simultaneously: debt payback, rebalancing, the Christchurch earthquakes and record terms of trade. And this is against a fickle global backdrop. In cycling parlance, it is like having to climb three steep hills, but with a tailwind! The interaction of these shocks will create tensions for years to come. The long-term picture is about getting more out of the earnings pockets of NZ.Inc to pay our way and this makes the rural sector a critical part of the journey for the economy. We expect growth momentum to build over the coming months and four percent growth looks within reach. While welcome, it is after a torrid few years and our five-year picture remains one of only moderate growth, as we continue to pay for past excesses.

OUR CORE ECONOMIC VIEW

The New Zealand economy is navigating four large shocks.

- **Our national balance sheet remains weak.** Net external debt stands at 75 percent of GDP. We're running a trade surplus, but it's not enough to service our past accumulation of debt. Therefore, we have a current account deficit. The economy still needs to deleverage further. This crimps growth.
- **We still need to rebalance and tilt the economy** in favour of investing and earning, at the expense of spending. Changes to the tax system in 2010 are an example of getting the right incentives in place. So too are prudential measures the RBNZ is bringing in. But we are talking about changes to the DNA of society whom for years has favoured the joys of consumption and capital gain over the attractiveness of saving and cash-flow/yield.
- **Seismic events have destroyed a huge amount of capital.** At a time we need to be focused on reorientating and rebalancing the economy, we've got major housing and rebuilding issues to contend with. We're leaning on the Government balance sheet for now, but debt needs to be paid back and the RBNZ can't keep interest rates at extraordinary low levels forever. Brace for tensions across the economy for years to come.
- **We are experiencing a once in a generation income shock.** This is manifesting via changes in the mix of global growth as Asia becomes far more relevant, increasing connectivity with Asia (free-trade-agreements and the like) and booming commodity prices. All are on secular trends that

will be around for decades. They are helping NZ.Inc get on top of its balance sheet (i.e. lower debt to GDP) via raising the denominator.

This is amidst a fickle global scene. A banking crisis in 2008 risks being replaced by a potential sovereign equivalent. Financial crises have typically been long drawn out recovery processes as excesses of the past are paid for. This one will be no different. Greece is facing the realities of selective default. The worry is a domino dynamic could infect other parts of Europe. A game of political brinkmanship in the US between Democrats and Republicans is doing NZ.Inc no favours. It risks setting off a crisis in confidence, could lift global borrowing rates (US Treasury yields are a global borrowing benchmark) and is keeping the USD under pressure which keeps the NZDUSD elevated. It is simply untenable that the world's largest economy will not find a solution. Yet how much that solution is leadership (i.e. addressing the issues) versus populism (go for the quick fix) remains to be seen.

Despite this, we're becoming progressively upbeat on NZ's prospects over the coming year. We seem to have sufficient income generation and have made partial progress in repairing our national balance sheet, such that better times are around the corner. Four percent growth looks within reach – a rate of growth not seen for five plus years. While lofty, we need to remember that one-offs such as the Rugby World Cup and rebuilding Christchurch are very influential and the size of the economy in per capita terms, is still smaller than what it was in 2007. So the recovery is off lows, and when you bounce off lows it's easier to get a springboard style recovery.

Looking forward, the picture is brighter than it may look to the person in the street. There are the obvious short-term fillips coming from the Rugby World Cup. We expect residential related activity in Christchurch to pick up towards the end of the year, though strengthening non-residential activity is a mid-2012 story. Farmers are starting to spend, not en masse, but chequebooks are starting to come out. It is not just growth that we are after, but also the right mix.

Our five year prognosis is one of modest performance. We see the income generating shock accruing gradually over time. While less intense than seen over 2008-2010, headwinds such as deleveraging remain. As income growth expands, spending growth will pickup, but it's untenable for spending growth to outstrip income growth for years to come. The rebuild in Canterbury will be both growth supportive but also dilutive (i.e. it'll take resources from other endeavours). Welcome to grumpy growth.

BORROWING STRATEGY

SUMMARY

The rural floating rate has not changed since our last edition, but fixed rates are generally higher. As a result, the step up into fixed has increased, making the decision to fix trickier for those contemplating making a move. Although we see the RBNZ lifting the OCR in September, which will have a knock-on impact on rural rates, it doesn't necessarily mean borrowers should be in a hurry to fix. Some fixing may be appropriate, but we do not favour getting carried away. This is largely because fixed rates already incorporate an expectation that the OCR will rise. Furthermore, the high NZD will limit the extent of the tightening cycle.

OUR VIEW

With the economy having moved from recovery to expansion, the RBNZ's emergency rate cut in March following the Christchurch earthquake looks set to be unwound. There are of course risks to this outlook, particularly offshore, where financial markets have been spooked by the European sovereign debt crisis and US debt ceiling negotiations. Still, the domestic inflation outlook is now starting to look sufficiently "troubling" that the March insurance cuts will be reversed soon.

With the OCR set to rise, the question many farmers are now asking is; is now the time to fix, and if so, for how long? While the answer very much depends on individual circumstances, breakeven analysis can be of assistance, as it provides a framework to assess how quickly short-term rates would need to move up for it to still be worth taking a higher fixed rate. Indeed, the prospect of floating rates rising is not sufficient justification for jumping into a fixed rate.

Rural Lending Rates		Breakeven rates in			
Term	Current	in 6mths	in 1yr	in 2 yrs	in 3 yrs
Floating	7.00%				
6 mths	6.60%	7.70%	7.83%	8.60%	9.40%
1 year	7.15%	7.76%	8.05%	8.80%	9.60%
2 years	7.60%	8.10%	8.43%	9.20%	9.75%
3 years	8.00%	8.47%	8.82%	9.43%	
4 years	8.40%	8.79%	9.09%		
5 years	8.70%				

So what do breakevens tell us? As the table above shows, **future rates are assumed to be higher than current rates.** This has been the case for some time now, and is largely a function of the fact that the longer the term, the higher the rate. For example looking at the 1 year versus 3 year rates (7.15% vs. 8.00%), breakevens tell us the 1 year rate over the next two years has to be over 8.00 percent to make it worthwhile fixing now for three years. At the moment, the 1 year rate in two years time sits at 8.80 percent, which means it is a

pretty much a line call. This is because you can benefit from being on a lower rate by initially fixing for 1 year at 7.15 percent, then rolling onto another 1 year rate of 8.05 percent when this matures and another 1 year rate of 8.80 percent in year three. This strategy would average out at 8.00 percent for the three years versus fixing now for 8.00 percent.

What really matters then is when and how quickly rates might move up. We expect the RBNZ to increase the OCR by 50bps in September, but for further increases beyond that to be gradual over the next two years with increases of around 2 percent. That may seem swift, and it certainly marks a change of pace relative to the inaction of the past few years. But it's not a long way away from what is implied by breakevens. Furthermore, we see the OCR peaking at around 4.75%, well below historic norms. Not only does the high NZD reduce the extent to which the OCR needs to go higher, but so too do structural issues like deleveraging. Put simply, the sheer quantum of debt and the degree of exposure to floating rates is now that much higher that the economy cannot withstand significantly higher rates.

From a cost perspective, it is not clear that fixing will be beneficial. Doing so will protect you against the impact of rising floating rates, but it does come at a cost. Our view is simply that the pace at which rates would need to rise is too sharp to make fixing unequivocally more attractive. Moreover, we need to acknowledge global risks, and with that comes the risk of less RBNZ action.

That said, it is also **worth stressing that the decision to fix is not always purely about cost.** Many borrowers will place a value on certainty, and if that is the case, the fact that the pace at which rates are assumed to rise is similar to what we are forecasting may be a good enough reason to fix. And with the prospect of a higher OCR by the end of the year comes the prospect of higher fixed rates, which will inevitably move higher over time as the rate hike cycle evolves. So if there is an intention or need to fix, it makes sense to do it now before fixed rates rise further, which they will likely do over coming months if monetary policy follows the path we expect. Borrowers just need to be clear whether they are fixing because they think fixed rates are heading higher (i.e. they just want to be fixed, and to get it done before fixed rates rise), or whether they want to be fixed because they see floating rates rising (i.e. they are looking at the overall cost equation).

Given the likelihood that rates will rise, **we favour adding some fixed cover here in the 1 and 2 year maturities,** as these approximate our forecasts and provide certainty. But we still prefer a good degree of exposure to floating rates too, noting their low cost and global uncertainties.

EDUCATION CORNER: EMERGING DEMAND – LESSONS ON THE BUILDING BLOCKS OF HUMAN NUTRITION

ASSESSMENT

Everyone has talked at length about protein demand being a big driver for New Zealand agricultural exports and industries over the next decade or more. We believe that we need to broaden our horizons and think about other areas of opportunity. Examining the building blocks of human nutrition shows that some of the bigger opportunities might lie with fat and other base nutrients that make up the average human diet.

Diving into the detail actually shows that on average 25-40 percent of our daily energy requirements come from fats versus 10-12 percent from proteins. Overall, this means the average human consumes 95 grams of fats per day versus 85 grams of protein (fats provide more energy per gram). In emerging countries, the proportion of their daily energy requirements from protein is roughly similar to developed countries. However, the proportion of daily energy sourced from fats in emerging markets is often less than 25 percent, compared with 30-40 percent in developed countries. While the protein demand curve has obvious upside potential as incomes in emerging market economies rises, it is the fat demand curve where the stellar story could be delivered. It all adds up to a bigger demand profile for fats rather than proteins. Of course every food product has a mix of all the different types of nutrients, but this does influence the type of products we will need to offer customers in the future.

INTRODUCTION

Exporting 80-90+ percent of most agricultural goods we produce provides a number of challenges. We often have a reasonable understanding of supply and what our competitors are doing (i.e. are they producing more, or less of something) but one area where we need to increase our understanding is the future preferences of our future customers. Traditionally the majority of our agricultural goods have gone to like-minded countries such as Australia, United States, United Kingdom and other parts of Europe. These countries have similar food preferences, which are governed by a wide range of factors such as cultural beliefs, climate, cost, age, lack of time for food preparation, food industry sophistication and the list goes on. However, **the end markets for our agricultural goods are rapidly changing.** The growth in New Zealand's exports to China is a case in point. Exports to China have increased 25 percent per annum over the last 10 years and they now account for 12 percent of total merchandise export earnings in the 12 months ended June 2011.

As a country we have good statistics on exports, so we know what products we have sold, to what country and for what price. But in reality many of these statistics represent what we have sold to middlemen, who then go on to sell it to someone else in the same form, or in a slightly modified form to extract more money (add further value). So, while export statistics are the best and most robust information we have on the demand and food preference picture of our export destinations, ultimately these statistics are one, two, three, or more steps removed from the final consumer and point of consumption. Therefore, we miss what the final purchase price was, in what form it was consumed (think restaurants, fast-food outlets, or supermarkets for beef and lamb) and most importantly, how much someone paid to have the pleasure of eating New Zealand's fine produce.

Consequently, better understanding the end consumer of our products, and what they are willing to pay top dollar for is going to be critically important to maintain a competitive edge and meet our future consumers' wants and needs.

To try and better understand what the base demand might look like for New Zealand agricultural goods **we need to examine some of the basics of a human's diet and how income levels influence this.**

THE BASICS OF HUMAN NUTRITION

There are seven major classes of nutrients: carbohydrates, fibre, fats, minerals, protein, vitamins, and water.

These nutrient classes can be categorised as either macronutrients (needed in relatively large amounts) or micronutrients (needed in smaller quantities). **The macronutrients include carbohydrates, fats, fibre, protein, and water. The micronutrients are minerals and vitamins.**

The macronutrients (excluding fibre and water) **provide structural material and energy.** Some of the structural material can be used to generate energy internally, and in either case it is measured in joules or kilocalories (often called 'Calories'). Carbohydrates and proteins provide 17 kJ approximately (4 kcal) of energy per gram, while fats provide 37 kJ (9 kcal) per gram, though the net energy from either depends on factors such as absorption and digestive effort, which vary substantially from instance to instance. Vitamins, minerals, fibre, and water do not provide energy, but are required for other reasons. A third class of dietary material, fibre (i.e. non-digestible material such as

EDUCATION CORNER: EMERGING DEMAND – LESSONS ON THE BUILDING BLOCKS OF HUMAN NUTRITION

cellulose), is also required for both mechanical and biochemical reasons.

The table aside shows, for our main trading partners, the daily amount of calories consumed by the average person. It is no surprise that **the US is top of the list for calories consumed**, followed by other European countries such as Belgium, Italy, Germany and France. The more interesting aspect is **the proportion of these calories that come from fats, this being as high as 40 percent in Belgium and 38 percent in the US. This is versus protein that makes up just 10-12 percent of daily calorie in-takes.** Carbohydrates make-up the vast majority of the rest. The average daily calorie in-take for our main trading partners is 3,000 calories per day. This is made-up of 30 percent from fat sources, 11 percent from protein sources and the remainder from carbohydrates and other minor nutrients.

The proportion of daily calories from fats should probably be more like 25-30 percent to curb obesity levels, but ultimately, that comes down to individual choice at the end of the day. In emerging countries, roughly the same proportion of their daily energy requirements comes from protein as in developed countries. However, the proportion of daily energy sourced from fats in emerging countries is often less than 25 percent, compared with 30-40 percent in developed countries. So potentially there is a double whammy effect, as incomes continue to grow, emerging markets will eat more, which will increase their protein and fat consumption. But the double up for fat demand comes from the higher daily fat intake from emerging countries westernising their diets. This is implying that the proportion of emerging countries' diet that comes from fats will rise over time. So perhaps we should start talking about the growth in demand for fats instead of proteins, as this adds up to a bigger growth profile than proteins. Of course every food product has a mix of all the different types of nutrients in reality, but this does influence the type of products we will need to offer customers in the future.

Human nutrition of our main trading partners				
Country	Daily calories consumed (kcal)	Percentage of daily calories from:		
		Fats	Protein	Carbohydrates & other
New Zealand top 20 export destinations over last 20 years				
USA	3,748	38%	12%	49%
Belgium	3,694	40%	10%	49%
Italy	3,646	39%	12%	49%
Germany	3,547	37%	11%	52%
Canada	3,532	37%	12%	51%
France	3,532	42%	13%	45%
UK	3,458	38%	12%	50%
Netherlands	3,278	38%	13%	50%
Mexico	3,266	27%	11%	62%
Australia	3,227	40%	14%	47%
New Zealand	3,159	35%	12%	53%
Saudi Arabia	3,144	25%	11%	63%
Fiji	3,041	30%	10%	60%
Taiwan	3,034	29%	11%	61%
China	2,981	28%	12%	60%
Malaysia	2,923	25%	11%	64%
Korea	2,899	31%	10%	59%
Japan	2,812	29%	13%	58%
Venezuela	2,632	26%	12%	63%
Hong Kong	2,623	23%	10%	66%
Philippines	2,565	18%	9%	73%
Thailand	2,539	20%	9%	71%
Indonesia	2,538	19%	9%	72%
India	2,352	19%	10%	72%
Singapore	2,170	23%	10%	67%
Average	3,054	30%	11%	59%
Other countries of interest				
Russia	3,455	28%	13%	59%
Brazil	3,113	31%	11%	58%
Argentina	2,941	34%	13%	53%
European Union	3,466	37%	12%	50%
Net Food Importing Developing Countries	2,360	16%	10%	74%
Global Average	2,749	26%	11%	63%

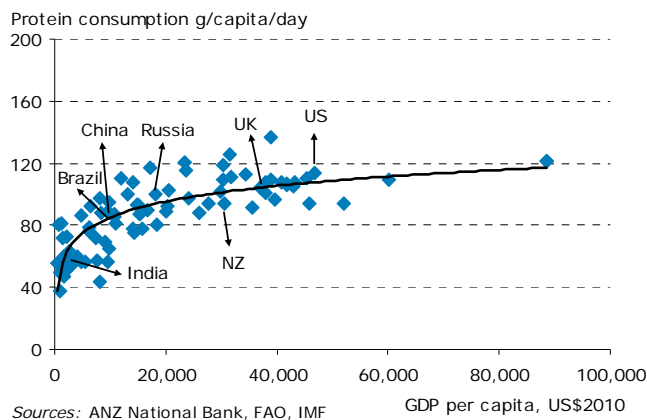
Sources: ANZ, National Bank, FAO

RELATIONSHIP BETWEEN INCOME LEVELS AND CONSUMPTION OF FATS & PROTEIN

Examining the relationship between income levels and protein consumption clearly shows a strong link between the two. In emerging countries, such as Brazil, Russia, India and China (BRICs), there has been rapid growth in protein consumption over the last 20 years as incomes have increased off low levels. In fact, protein consumption per person in China has more than doubled over the last 40 years, compared with the US and UK at 19 and 14 percent respectively. New Zealanders' protein consumption has actually decreased by 2 percent. Some might point out that the growth in protein consumption in emerging countries has been off a low base, but it has to be remembered we are talking about some of the most populous countries in the world.

EDUCATION CORNER: EMERGING DEMAND – LESSONS ON THE BUILDING BLOCKS OF HUMAN NUTRITION

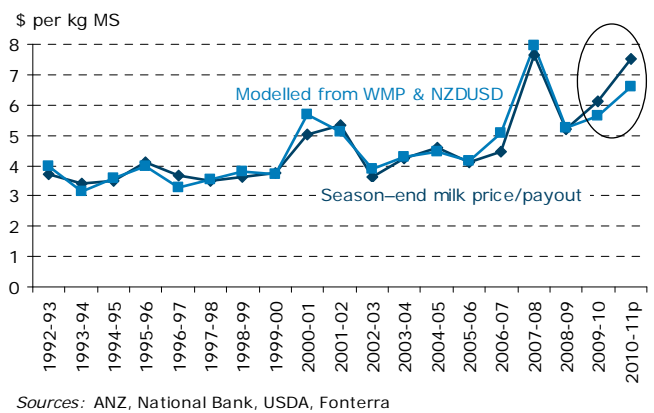
Income levels vs. protein consumption



As the growth in protein consumption has reached critical mass, many countries, especially those in the Asia-Pacific region, have recently moved to being net importers of protein and other key foodstuffs because local production has struggled to keep pace. This is one of the main factors why international dairy prices have shown a structural shift higher over the last four seasons. For example, China now makes up 17-19 percent of New Zealand's dairy export earnings, or \$1.35 out of the \$7.50 per kg MS received by dairy farmers in the 2010-11 season.

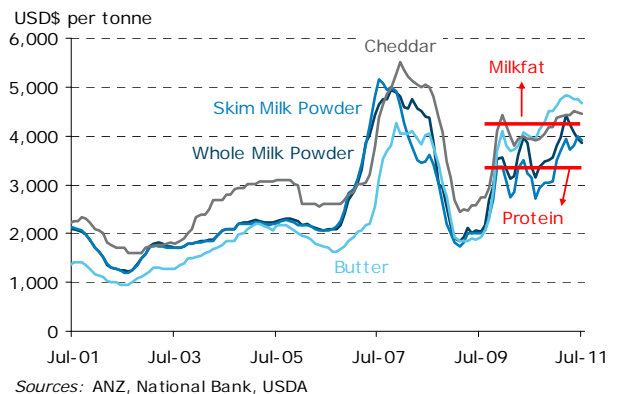
Historically international prices for skim and whole milk powders have been the main driver of the end milk price (payout prior to the last two seasons) dairy farmers received. The following chart shows a modelled milk price using Fonterra's effective currency conversion for all its sales (NZDUSD) and international prices for whole milk powders compared with season end farm-gate prices for the last 19 years. The long and short of the matter is that the modelled milk price explains 91 percent of the farm-gate price a NZ dairy farmer receives. However, a gap between the modelled and season end milk price has opened up over the last 12-18 months. While the final 2010-11 season milk price has yet to be determined, it will not be too far off the current \$7.50 per kilogram MS. Using an effective NZDUSD of 72 cents (spot NZD for 2010-11 season minus Fonterra's historical performance against spot NZD of 4-6 percent below) and the season average price for whole milk powder, indicates that this year's farm-gate milk price should be only \$6.60 per kilogram of MS. So where has the extra \$0.90 per kilogram MS come from?

Modelled vs. Actual Milk Price/Payout



We suspect a fair proportion is due to better prices from milk fat products such as cheese, butter and anhydrous milkfat. Some of the extra \$0.90 per kilogram MS might be slightly different end metrics, as we do not have all commercial information to hand, but this will be within the margin of error. This trend has extended back to the end of 2009 when dairy prices first rebounded after the global financial crisis and prices for milk fat products not decreasing to the same extent as powders during first quarter of the 2010-11 season.

Oceania international dairy product prices



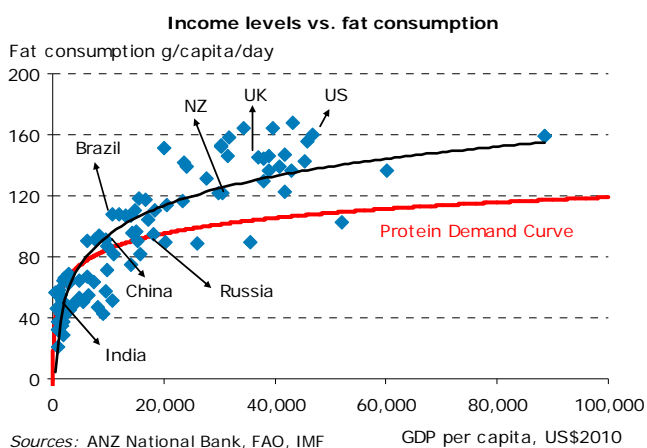
Examining the factors behind this reveals some other interesting trends that raise a number of worthy questions for the longer-term set-up of farming systems, animal genetics and dairy processing in New Zealand. The higher prices for milk fat products again are a demand story, but some of this has come via traditional markets. Butter demand has been strong in North America and Europe since the Global Financial Crisis, as households and consumers have traded down from eating out, to eating in and learning to cook again. You only have to switch on the television at night to see the proliferation of cooking shows! This has increased household's butter demand for use in home

EDUCATION CORNER: EMERGING DEMAND – LESSONS ON THE BUILDING BLOCKS OF HUMAN NUTRITION

cooking. New demand is also coming from non-traditional markets such as India and the Middle East, where they use a lot of butter (ghee) in their cooking of traditional cuisine. Ghee is clarified butter, made by simmering unsalted butter in a cooking vessel until all water has boiled off. In India it has a sacred role in Vedic and modern Hindu libation and anointment rituals. It is widely used in Indian cuisine and is traditionally prepared and served with rice.

Cheese is an interesting story with new demand being generated via quick service restaurant chains in China and other parts of Asia. Traditionally Asian consumers have not consumed cheese as a natural part of their diet, but as they urbanise and multi-nationals such as McDonald's and Burger King set-up shop, they are increasingly eating out more and consuming larger quantities of cheese, via more burgers and pizzas. Every slice of pizza has some type of cheese topping and most burgers have a slice of cheese, or two or three if you live in a developed country. Russia has also been a major buyer of butter and cheese over the last 12 months due to the drought they had in 2010.

Looking at income levels versus fat consumption shows a very similar relationship to protein consumption. However, on average a person will consume 95 grams of fats per day versus 85 grams of protein. However, the fat demand curve has a higher trajectory than the protein demand curve. This suggests it will be more about fat demand over the coming years as incomes grow in developing countries.



Currently Fonterra uses a valued component ratio (VCR) to set the relative price paid to Fonterra suppliers for milk fat compared to protein. This reflects the relative returns of each component in the milk on the international market. It has been calculated using the same method for 15 seasons and the price paid out each season is worked out over a three year rolling average. As you can see from the table below, the ratio varies every season but because prices being paid for milk fat have been strong in recent seasons, this has now moved through the rolling average method and the difference in the 2011-12 season is quite noticeable.

Dairy Season	Value Component Ratio
2001-02	0.42
2002-03	0.36
2003-04	0.35
2004-05	0.36
2005-06	0.39
2006-07	0.39
2007-08	0.36
2008-09	0.35
2009-10	0.33
2010-11	0.39
2011-12	0.49

Sources: ANZ, National Bank, Fonterra

For the 2010-11 season, the fat to protein ratio was 0.39 (i.e. milk fat value was 39 per cent of that for protein). The VCR to be applied in the 2011-12 season is 0.49 and therefore **the value of fat relative to protein has increased compared to the 2010-11 season.** While the value of protein is still double that of milk fat, in the past, protein has been closer to three times as valuable. **Strong international fat prices mean that farmers could reasonably expect to see another increase in the value of fat compared to protein in the VCR for the 2012-13 season.**

This has knock-on effects for animal genetics i.e. Jersey versus Holstein-Friesian and the input of supplementary feeds such as palm kernel extract, which increases the milk fat component of a milk solid. These trends also extend to the meat sectors, with Asia and the Middle East now consuming more meat protein, especially lower value cuts such as lamb flaps and other co-products such as tallow. In fact, the price of tallow has increased nearly 50 percent over the last 12 months as a result of some of these trends.

EDUCATION CORNER: EMERGING DEMAND – LESSONS ON THE BUILDING BLOCKS OF HUMAN NUTRITION

SO FATS OR PROTEINS? THE BILLION-DOLLAR PLUS QUESTION

Analysing individual countries and how they have moved along the consumption curve for protein and fat as income levels have grown over the last 40 years provides some interesting insights also. First, looking at the 1960's trend for protein and fat consumption to income levels shows the relationship for fat has not changed substantially over the last 40 years, while protein has increased slightly. Looking at movements of the individual countries over the last 40 years shows some of the largest per capita increases in fat consumption have been seen in European countries, China and Brazil. Increases in protein consumption have been more sporadic across regions but China heads the pack again, with a number of other Middle East countries following.

To get a feel for how much further protein and fat demand could grow from the BRIC countries in the next 10 years we have applied income growth figures to both the protein and fat demand curves. These forecasts have then been applied to population forecasts to show the total potential change in protein and fat demand over the next 10 years. There will of course be other drivers that influence food preferences, such as religious beliefs, climate and the like, but population and income growth will be two of the major influences.

The results show that fat demand is going to grow more than protein demand from current levels. Over the 10-year period the annual change in per capita protein demand for BRIC countries is forecast at 390 grams per year. This would be an

increase in protein demand of 19.9 million tonnes, or 25 percent from current levels for BRIC countries. The annual change in fat demand is forecast at 690 grams per person – 1.8 times that of protein. **This would mean total annual fat demand for the BRIC's would increase by 29.5 million tonnes, or 37 percent from current levels.** The largest change from status quo is for India, principally due to a bigger increase in their population compared to others. However, China still stands out and experiences a larger increase in per person fat and protein consumption primarily due to higher income growth. This perhaps creates more discerning customers willing to pay a premium for New Zealand's high quality agricultural goods.

How this increase in demand will be filled raises a number of questions when you eye metrics such as arable land per person, water per person, urban creep onto arable land and the like for China and India. While it is difficult to forecast the mix of products that might fill this gap, in reality it will be a mix of all food types. Converting the figures to milksolid equivalents shows you would certainly need a lot of cows to do it with dairy alone. Converting the fat and protein demand directly back to MS equivalents is tricky because the demand forecasts for fat and protein differ in composition to the proportion of a MS that is made up of protein and fat and there will be yield losses from farm-gate through to final form of consumption. But **simplistically taking each at face value shows that in order to fill protein demand of 19.9 million tonnes you would need 46.3 billion kilograms of MS, or 30 New Zealand dairy herds.** This would also create

	Units	Countries			
		Brazil	Russia	India	China
Average real GDP growth last 10 years		4.5	5.0	7.5	10.3
Current Protein Consumption	grams/capita/day	85.5	100.0	57.4	88.9
Forecast Protein Consumption in 10 years	grams/capita/day	92.0	107.7	66.2	104.1
Annual change Protein Consumption	kilograms/capita/year	0.24	0.28	0.32	0.56
Current Population	million head	201	140	1,216	1,341
Forecast Population in 10 years	million head	213	135	1,411	1,415
Current Protein Demand	tonnes protein	6,274,175	5,111,022	25,489,731	43,508,544
Protein Demand in 10 years	tonnes protein	7,154,014	5,306,398	34,078,704	53,760,518
% Change in Protein Demand		14%	4%	34%	24%

	Units	Brazil	Russia	India	China
Current Fat Consumption	grams/capita/day	107.6	94.4	48.4	91.7
Forecast Fat Consumption in 10 years	grams/capita/day	121.4	106.0	63.3	118.7
Annual change Fat Consumption	kilograms/capita/year	0.50	0.42	0.54	0.98
Current Fat Demand	tonnes fat	7,891,873	4,822,818	21,464,102	44,879,046
Fat Demand in 10 years	tonnes fat	9,438,823	5,222,393	32,574,393	61,282,072
% Change in Fat Demand		20%	8%	52%	37%

Sources: ANZ National Bank, FAO, IMF

EDUCATION CORNER: EMERGING DEMAND – LESSONS ON THE BUILDING BLOCKS OF HUMAN NUTRITION

26.4 million tonnes of milkfat, 90 percent of the total forecast increase in demand for the BRIC countries.

Doing the same calculations for fat demand of 29.5 million tonnes of fat, you would need 51.7 billion kilograms of MS which is equivalent to 33 New Zealand dairy herds. This would over supply protein by 11.6 percent though.

At current international dairy prices this of course translates into some very big numbers. For New Zealand's current basket of dairy exports we are receiving around NZ\$4,800-\$5,000 per tonne. Using these prices and New Zealand's current export mix of dairy products translates into a \$315-\$350 billion export market. This is around six times New Zealand's current exports.

UPSHOT

It is impossible to see New Zealand supplying the mass market for dairy and other commodities, with our land base and pastoral production system limiting how much we will be able to produce at a competitive price. The bigger opportunity lies in segmenting and owning the speciality/boutique food markets within these large, populous countries. Supermarkets in New Zealand now have product ranges of up to 700 different types of cheese as an example of the different market segments within a country of 4.4 million people. Think French racks, speciality yoghurts, ice creams, cheese, fine wine and the list goes on.

Food preferences will also be influenced by other trends such as urbanisation, religious beliefs, climate, cost, age, lack of time for food preparation, sophistication of the food industry and the list goes on. It is difficult to see the Indians eating too much meat anytime soon. This is because 80 percent of them are Hindu and a third practise vegetarianism, so largely do not eat meat for religious reasons. However, many of these trends also reinforce convergence in dietary patterns between developed and developing countries, which is again positive for protein and fat consumption.

If New Zealand agriculture wants to future proof its place in the global food chains of the next 20 years, we will need to allocate more capital, research, innovation and bodies further up the value/supply chain. History and academic research in fact shows some of the best performing business, in terms of cash returns and wealth creation, are those that are located closest to the end consumer of a product, and we have world class expertise here also. In agriculture this includes players such as supermarkets, importers, distributors and processors. While it is a little silly to imagine New

Zealand wanting to own too many overseas supermarkets, or restaurant chains, it is the intellectual property of being the number one supplier to these supermarkets and restaurant chains that will ensure a superior return. There is no big bang on how this is achieved, as it will be reliant on a number of initiatives.

As subsidies and other distortions to agricultural markets are ever slowly removed these trends and others will demand more value add if New Zealand wants to retain control of our agricultural intellectual property and further grow incomes and wealth at home. With good prices and reasonable profitability forecast for the coming 2011-12 season, it is an opportune time to start to think about how to do this. You only have to look in the local paper to see all the foreign acquisitions of agricultural companies, assets and land in nearly every other nation to see other countries are thinking exactly this too, but in reverse, because they have many mouths to feed.

KEY TABLES AND FORECASTS

FX RATES	ACTUAL			Forecast (end month)						
	May-11	Jun-11	28-Jul	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
NZD/USD	0.824	0.829	0.872	0.88	0.91	0.92	0.93	0.93	0.93	0.92
NZD/AUD	0.772	0.773	0.790	0.80	0.81	0.82	0.83	0.82	0.82	0.82
NZD/EUR	0.572	0.572	0.607	0.60	0.61	0.61	0.61	0.60	0.60	0.60
NZD/JPY	67.16	66.80	67.96	66.0	68.3	69.0	67.0	67.0	67.0	68.1
NZD/GBP	0.501	0.517	0.534	0.53	0.55	0.54	0.55	0.53	0.53	0.53
NZ\$ TWI	70.9	71.2	74.3	74.1	75.9	76.3	76.7	75.8	75.8	75.7

INTEREST RATES	May-11	Jun-11	28-Jul	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
NZ OCR	2.50	2.50	2.50	3.00	3.25	3.50	3.75	4.00	4.25	4.50
NZ 90 day bill	2.69	2.67	2.85	3.20	3.50	3.90	4.00	4.40	4.50	4.90
NZ 10-yr bond	5.11	5.07	5.05	5.20	5.50	5.70	6.00	6.20	6.10	6.20
US Fed funds	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.75
US 3-mth	0.25	0.25	0.25	0.35	0.35	0.35	0.35	0.35	0.60	0.85
AU Cash Rate	4.75	4.75	4.75	4.75	4.75	5.00	5.00	5.25	5.25	5.50
AU 3-mth	5.02	5.03	5.04	5.00	5.00	5.20	5.20	5.50	5.50	5.70

ECONOMIC INDICATORS	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
GDP (% qoq)	0.5	0.8	0.7	1.5	1.8	0.7	0.9	0.9	0.8	0.7
GDP (% yoy)	1.1	1.4	1.9	3.5	4.9	4.8	5.0	4.4	3.3	3.3
CPI (% qoq)	2.3	0.8	1.0	0.8	0.7	0.6	0.8	0.7	0.6	0.8
CPI (% yoy)	4.0	4.5	5.3	5.0	3.3	3.1	2.9	2.7	2.6	2.9
Employment (% qoq)	-0.4	1.4	0.2	0.4	0.6	0.7	0.5	0.5	0.4	0.4
Employment (% yoy)	1.3	1.8	2.2	1.6	2.6	1.9	2.2	2.3	2.1	1.8
Unemployment Rate (% sa)	6.7	6.6	6.4	6.0	5.9	5.5	5.4	5.2	5.2	5.2
Current Account (% GDP)	-4.1	-4.2	-4.2	-4.2	-3.6	-4.0	-4.2	-4.6	-4.9	-5.0
Terms of Trade (% qoq)	0.8	0.9	2.9	3.1	1.0	-0.8	-0.9	-0.8	-0.8	-0.8
Terms of Trade (% yoy)	12.3	6.8	7.8	7.9	8.0	6.2	2.3	-1.6	-3.2	-3.3

NEW ZEALANDS' 20 LARGEST EXPORT MARKETS

NZ's top EXPORT markets for the 12mths ended June 2011																					
	Global Total	Australia	China	USA	Japan	Korea	UK	Germany	Taiwan	India	Indonesia	Malaysia	Hong Kong	Singapore	Thailand	Philippines	Saudi Arabia	Netherlands	Canada	UAE	Italy
Sheepmeat	2,918	11	176	312	65	4	581	273	54			72	35	14	5	1	92	137	112	13	35
Beef	2,036	15	10	781	203	172	37	21	131		108	15	36	44	8	38	10	33	119	19	20
Other Meat	444	21	9	20	42	26	31	75	2		17	3	16	7	2	2	8	24	4		3
Milk Powder	6,597	74	1,839	3	22	11			158	43	229	318	37	222	284	274	284	2		279	
Butter	2,401	94	171	75	24	25			82	45	48	55	19	41	46	87	130		15	44	
Cheese	1,355	291	71	14	287	116	21		41	2	47	28	20	9	14	48	39	20		19	
Whey/Casein	1,621	58	167	685	211	39	4	113	9	5	27	15	3	43	2	18	23		18		37
Kiwi/fruit	995	55	84	29	288	62		209	67	3	6	10	24	8	5	1			3	3	28
Apples	372			43			47	52	28	15	5	9	25	8	23			53	6	11	
Other Fruit/Vege	584	252	3	33	138	21	3	3	16	2	2	22	6	12	11	1		3	1		1
Wine	1,094	338	17	232	11	1	294	5		1		2	18	14	1	1		27	59	4	1
Wool	688	77	209		87	88			27	13	96	27		6	37	7					
Skins/Hides	658	42	268	25	-64	-64	66	40	-14	55	-86	-24	49	-6	-19	-7		1	4		260
Logs	1,697		1,004		168	307			13	195					4					2	
Sawn Timber	1,141	334	142	168	92	47	2	3	39	8	26	15	1	5	31	47	21	11	1	6	1
Fibreboard/Plywood	362	67	30	17	172	1			4	6	17	6			2	3	7		2		
Wood Pulp	688	77	209		87	88			27	13	96	27		6	37	7					
Fish/Seafood	1,503	287	245	177	126	39	15	39	10	1	2	9	188	34	18	2	2	6	14	3	10
Crude Oil	2,071	1,962		46										7	34						
Aluminium	1,261	105	26	84	632	134	60	2	3	20	2	1	13	1	2			71	8		
Remainder	15,598	6,147	957	1,232	733	479	356	159	196	460	217	218	298	285	186	193	81	175	173	84	83
TOTAL	46,081	10,307	5,636	3,931	3,370	1,596	1,515	993	894	885	859	829	788	760	733	722	698	564	540	490	478

NZ merchandise EXPORTS annual change between the 12mths ended Jun 2011 and a 12mth span a year earlier																					
	Global Total	Australia	China	USA	Japan	Korea	UK	Germany	Taiwan	India	Indonesia	Malaysia	Hong Kong	Singapore	Thailand	Philippines	Saudi Arabia	Netherlands	Canada	UAE	Italy
Sheepmeat	108	-1	67	70	12	1	-61	-2	-10			28	-34	1	3		-35	51	8	-1	-9
Beef	214	4	1	48	11	31	7	7	17		-21	3	-1	5	2	3	5	11	22	1	-2
Other Meat	18	2	5	4	7	5	-7	1			-6		-3	2	1			1	2		1
Milk Powder	1,674	15	621	-1	1	7			23	-16	11	42	15	4	115	23	105	-2	-1	63	
Butter	654	18	78	-36	22	9			36	-27	-5	19	3	5	22	13	60		2	19	
Cheese	19	16	13	1	21	27	-30		4	2	8	2	1	-2	4	-10	-7	-5		2	
Whey/Casein	222	10	45	163	11	5	1	44	3	1	-8	3	1	13	-5	-5	5	-3	-23		5
Kiwi/fruit	-30	6	9	-3	16	-2		-51	-1	1	1	-1	1	-1	1	-1			-1		-9
Apples	38			-17			7	4	6	5		3	10	1	7						
Other Fruit/Vege	20	-1		3	6	2	-2	-1	3	1	1	3	-3		3			1			
Wine	53	11		20	2		-5					1	6	1				6		1	
Wool	27	-9	79		-30	3			-6	3	-28	5		6	9	-4					
Skins/Hides	272	12	58	5	37	3	17	14	9	-10	29	-4	4	-6	-7	4		-1	1		79
Logs	463		342		25	25			3	73					2			-2		-4	
Sawn Timber	72	24	12	-35	10	12		1	13	2	3	5	-2	1	9	18	7	1	1	-13	
Fibreboard/Plywood	27	5	-5	-1	28	-1			-1	3		1				-1	3			-2	
Wood Pulp	27	-9	79		-30	3			-6	3	-28	5		6	9	-4					
Fish/Seafood	158	8	115	19	6	-1	1	10	-5		1	2	-54	-3	7	-2		1	3	-1	1
Crude Oil	-169	219	-36		-44							-29		-280	3						
Aluminium	196	-20	-4	58	51	32	25	-5	-13	9	-2	-3	3		-10			30	6		
Remainder	1,345	349	51	78	140	113	-5	5	8	106	2	-7	15	-135	26	27	41	8	41	24	54
TOTAL	5,409	656	1,527	375	300	274	-51	26	80	159	-39	78	-38	-383	200	61	185	97	61	89	119

NZ merchandise EXPORTS annual change between the 3mths ended Jun 2011 and a 3mth span a year earlier																					
	Global Total	Australia	China	USA	Japan	Korea	UK	Germany	Taiwan	India	Indonesia	Malaysia	Hong Kong	Singapore	Thailand	Philippines	Saudi Arabia	Netherlands	Canada	UAE	Italy
Sheepmeat	175	-3	39	30	3	1	-7	32	-1			6	-11	1	2		6	33	-3	-2	4
Beef	21		1	5	-10	4	5	4	7		-34	2	-3	1	1	2		6	6		2
Other Meat	2	3	1		-1	2	-2				-6		-1		1	1		1	1		
Milk Powder	319	5	-62	1		8				-5	33	24	7	3	-16	16	35	2		30	
Butter	148	5	31	-2	5	3			5	-38	2	6	1	-1	4	-1	18		2	2	
Cheese	-26	-3	4	-3	-4	5	-9				-1	-3		-1	2	-1	-4	2		-1	
Whey/Casein	35	1	18	12	-10	1		22	1	-1		2	1	2		-3	4	-1	-11		7
Kiwi/fruit	18	2	12	-1	1	-3		2	4	1	1			-1					-2	1	-4
Apples	24			-15			4	6	3	6	1	2	7	1	4			-4		1	
Other Fruit/Vege	1	2		2	1	-1						-4		-2	2			0			-1
Wine	16	3	4	3			3						2					3			
Wool	-18	-2	9		-17	1			-5	-1	-5	-1		3	2	-2					
Skins/Hides	106	6	43		19	2	4	5	4	-5	5	1	2	-3	-4	2					18
Logs	128		94		9	18				9										-2	
Sawn Timber	-44	-14	-12	-17		3			3	1	-1				1	5	-8	-3		-1	
Fibreboard/Plywood	12		-3		15				-1								1				-1
Wood Pulp	-18	-2	9		-17	1			-5	-1	-5	-1		3	2	-2					
Fish/Seafood	34	2	38	-2	-1	-5	1	-5	-1				-25		5			1	-1		1
Crude Oil	50	96		-31											-17						
Aluminium	23	-9		9	8	7	1	-4	-1	2			1		-1			10			
Remainder	1,627	190	253	68	60	117	1	64	8	-41	-33	54	-58	43	4	17	66	43	24	33	28
TOTAL	2,634	282	479	90	30	165	0	123	23	-71	-41	89	-78	49	4	31	117	92	16	60	56

IMPORTANT NOTICE

NEW ZEALAND DISCLAIMER

This publication is for information purposes only. Its content is intended to be of general nature, does not take into account your financial situation or goals, and is not a personalised adviser service under the Financial Advisers Act 2008. It is recommended you seek advice from a financial adviser which takes into account your individual circumstances before you acquire a financial product. This publication does not constitute an offer to sell or solicitation to buy any security or other financial instrument. No part of this publication can be reproduced, altered, transmitted to, copied to or distributed to any other person without the prior express permission of ANZ National Bank Limited (the "Bank").

This publication is a necessarily brief and general summary of the subjects covered. The information contained in this publication is given in good faith, has been derived from sources perceived by it to be reliable and accurate and the Bank shall not be obliged to update any such information after the date of this publication. To the extent permitted by law, neither the Bank nor any other person involved in the preparation of this publication accepts any liability for the content of this publication (including the accuracy or completeness thereof) or for any consequences flowing from its use.

UNITED STATES DISCLAIMER

This publication is being distributed in the United States by ANZ Securities, Inc. (Member of FINRA [www.finra.org] and registered with the SEC) ("ANZ S") (an affiliated company of Australia and New Zealand Banking Group Limited ("ANZBG") and the Bank), which accepts responsibility for its content. Further information on any securities referred to herein may be obtained from ANZ S upon request. Any US person(s) receiving this publication and wishing to effect transactions in any fixed income securities referred to herein should contact ANZ S 277 Park Avenue, 31st Floor, New York, NY 10172 USA, Tel: 1-212-801-9160, Fax: 1-212-801-9163, not its affiliates.

This publication is issued on the basis that it is only for the information of the particular person to whom it is provided. This publication may not be reproduced, distributed or published by any recipient for any purpose. This publication does not take into account your personal needs and financial circumstances. Under no circumstances is this publication to be used or considered as an offer to sell, or a solicitation of an offer to buy.

In addition, from time to time ANZBG, the Bank, ANZ S, their affiliated companies, or their respective associates and employees may have an interest in any financial products (as defined by the Australian Corporations Act 2001), securities or other investments, directly or indirectly the subject of this publication (and may receive commissions or other remuneration in relation to the sale of such financial products, securities or other investments), or may perform services for, or solicit business from, any company the subject of this publication. If you have been referred to ANZBG, the Bank, ANZ S or their affiliated companies by any person, that person may receive a benefit in respect of any transactions effected on your behalf, details of which will be available upon request.

The information herein has been obtained from, and any opinions herein are based upon, sources believed reliable. The views expressed in this publication accurately reflect the author's personal views, including those about any and all of the securities and issuers referred to herein. The author however makes no representation as to its accuracy or completeness and the information should not be relied upon as such. All opinions and estimates herein reflect the author's judgement on the date of this publication and are subject to change without notice. No part of the author's compensation was, is or will be directly or indirectly related to specific recommendations or views expressed in this publication. ANZBG, the Bank, ANZ S, their affiliated companies, their respective directors, officers, and employees disclaim any responsibility, and shall not be liable, for any loss, damage, claim, liability, proceedings, cost or expense ("Liability") arising directly or indirectly (and whether in tort (including negligence), contract, equity or otherwise) out of or in connection with the contents of and/or any omissions from this communication except where a Liability is made non-excludable by legislation.

This document has been prepared by ANZ National Bank Limited. ANZ (part of ANZ National Bank Limited), Level 7, 1 Victoria Street, Wellington 6011, New Zealand Phone 64-4-802 2000 Fax 64-4-496 8639 <http://www.anz.co.nz> e-mail nzeconomics@anz.com