

NEW ZEALAND ECONOMICS ANZ AGRI FOCUS

JANUARY 2012

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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

Sharon Zöllner

Senior Economist

Telephone: +64 4 576 1062
E-mail: Sharon.Zollner@anz.com

Mark Smith

Senior Economist

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

ALL BETS ON THE DRAGON

FEATURE ARTICLE: KEY THEMES FOR 2012

We discuss seven key themes that we expect to play an influential role in determining NZ's economic prospects over the year ahead. They include: Deleveraging headwinds; Transitioning via differentiation; Sovereign risk; Economic tensions – the interaction of five shocks; Asia – with opportunity comes vulnerability; The grand finale – game theory at play; and Desynchronisation.

THE MONTH IN REVIEW

Mother Nature remains in a kind mood though not universally. The North Island has continued to receive good dollops of rain at regular intervals, and while there are issues with pasture quality there is plenty to go round. In the South, Otago and Southland have become dry following an excessively wet spring. On the other hand, Marlborough and Canterbury are similar to the North Island.

RURAL PROPERTY MARKET

Turnover of dairy and other livestock-aligned properties has increased to 75 percent of its 10-year average. As a lot more due diligence is being applied the strength in enquiries from the spring is only just showing up as properties go unconditional. A lack of high quality dairy properties is also seeing stronger pricing beginning to emerge for second tier dairy properties and convertible land. We expect further momentum for turnover into this autumn and pricing to consolidate at current levels.

KEY COMMODITIES AND FINANCIAL MARKET VARIABLES

In-market returns for most commodities remain strong and near all time highs in many instances for this time of the year. However, a seasonally stronger NZD and also weaker EUR has dampened returns back to the farm-gate. Lower headline inflation should help on the cost side of the ledger and keep shorter-term interest rates on hold for longer.

BORROWING STRATEGY

Carded rural fixed interest rates are little changed relative to where they were when we published our last edition of the Agri Focus. Fixed rates out to 3 years remain at or below the floating rate, which makes fixing reasonably attractive. With the RBNZ unlikely to cut the OCR again, the temptation to fix is very high, particularly for 2 years, where the rate is well below floating, and only a little higher than the cheapest rate. We broadly favour such a strategy, but would caution against fixing the whole lot for that period, as this heightens rollover risk.

EDUCATION CORNER: GLOBAL MILK SUPPLY

In this month's edition of *Education Corner* we take a look at different countries' milk supply. We look at who the main players are, who is on the move, and how competitive they are. The upshot is that while New Zealand will continue to be a key player in international dairy markets, other competitors will also respond to the surge in demand emanating from countries around the equator. Consequently, New Zealand needs to ensure it maintains its cost competitiveness, seeks out new innovations that add value to our raw milk, and plays to our differentiating strengths, including brand and food safety.

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ASSESSMENT

In this article we discuss seven key themes that we expect to play an influential role in determining New Zealand's economic prospects over the year ahead. They include: Deleveraging headwinds; Transitioning via differentiation; Sovereign risk; Economic tensions – the interaction of five shocks; Asia – with opportunity comes vulnerability; The grand finale – game theory at play; and Desynchronisation. The collection portends a repeat of 2010 and 2011, namely, sideways movements.

The farming sector cannot be divorced from wider economic developments, and we are at the whims of global forces. Prospects are linked. Our key aim in writing this article is to alert our readers to some of the wider economic forces at work, inherent tensions that exist within the economic system and what themes we see as influential over the year ahead. We've chosen seven key themes. They are by no means exhaustive. We'd need a book to cover the myriad of influences on the economy and farming sector. Rather we've decided to focus on what we consider the most relevant. The themes are:

- **Deleveraging (still);**
- **Transitioning via differentiation;**
- **Sovereign risk;**
- **Economic tensions: the interaction of numerous shocks;**
- **Asia – with opportunity comes vulnerability;**
- **Game theory at play – looking for a mandate to bite the bullet;**
- **Desynchronisation.**

THEME 1: DELEVERAGING HEADWINDS

Call it "that old chestnut", call it what you will. But don't dismiss it. **Deleveraging is certainly a familiar theme, but it still remains at the top of our list of key considerations.** Of course, we have been deleveraging for three years now, but it's far from over (NB: we define deleveraging as a drop in debt to income ratios as opposed to falling nominal debt levels). Our view is based on three simple considerations:

1. **We came to the end of a multi-decade leveraging supercycle across Western society in 2008.** Credit growth cannot expand by 2 to 3 times the rate of nominal GDP or income for a sustained period. Penance beckons. The consequences and necessary "healing" include: bank deleveraging in Europe; fiscal austerity; negative feedback effects on the real economy;

more regulation – without invoking unintended consequences; and social fallout. These consequences are only now starting to be felt.

2. **New Zealand was binging at the party** like a host of others. Hence the hangover.
3. **A sustained improvement in structural barometers is a precursor to sustained cyclical recovery.**

So where does NZ stand? It is worth summing up what we have seen in the past three years.

- After a recession and a tepid recovery, the **New Zealand economy is the same size as it was in 2007 in real terms.** In real per capita terms we are almost 5 percent smaller.
- **Commodity prices have lifted strongly since 2008,** giving a huge boost to rural incomes, and mitigating what could have been a nasty hit to heavily indebted parts of the rural sector.
- **House prices are around 2½ percent below their peak** in nominal terms. They've fallen, recovered, fallen and moved sideways, but not collapsed.
- **Rural property values are improving but remain 20 percent below their peak in nominal terms.** Turnover has increased to 75 percent of its 10-year average.
- **The household saving rate has improved** from -7.5 percent of disposable income in March 2007 to +2.8 percent in September 2011.
- **The current account deficit has fallen** from 8.9 percent of GDP at the end of 2008 to 4.3 percent as of September 2011.
- **Net external debt has fallen** from 84.7 percent of GDP in March 2009 to 72.9 percent of GDP as of September 2011.
- **Households and farmers have deleveraged.** Household debt to income has fallen from a peak of 154 percent in mid 2008 to 144 percent in September last year. Farmers' land value to net cash earnings ratio has improved from being virtually technically insolvent, to last year's meat and fibre measure being 28 versus the 20-year average of 41. In addition, the dairy measure is around 12, versus the 20-year average of 22.
- **We've seen tax and regulatory changes.**
- **The fiscal position has deteriorated markedly.**
- **Our credit rating has been downgraded** by both Fitch and Standard & Poor's.

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Although we can take heart from the improvement in many of these metrics, it has come at a cost. The retailing environment has been poor and trading is still tough. While the rural property market has stabilised and turnover has recovered, prices are still around 20 percent below the 2007 to 2008 period. If commodity prices had not provided an out, things could have been ugly for certain pockets within each sector.

Of course, the big question is, are we there yet? The short answer is no.

Where do we need to be to set the stage for the good times to roll again?

- **The global scene needs to stabilise.**
- **Net external debt needs to get below 60 percent of GDP.**
- **The household saving rate probably needs to be north of 5 percent of income.**
- **Commodity prices need to stay supportive of rural incomes. The cash rate of return needs to be comparable with the cost of borrowing.**
- **Fiscal deficits need to turn into surpluses.**
- **Housing affordability needs to improve further.**

There are a host of other dynamics that could assist. For instance a sustained lift in productivity growth would not go amiss. But turning the dial and trend here will take time.

2011 was dominated by a deleveraging headwind and we expect the same dynamic to be influential in 2012. As economists that means we're paying more attention to the structural indicators as opposed to the daily barrage of cyclical measures. It is progress in the former that will ultimately unlock a sustained lift in the latter. Until then, cyclical barometers will merely oscillate as opposed to trend upwards. This means we pay more attention to the profit and loss statement and balance sheet to see how the farming sector is progressing. Interest costs per unit of output need to come down in certain pockets of the farming sector to manage volatile commodity prices. Lower interest rates have helped but these can only do so much. There needs to be a strong focus on positive cash flow performance.

What about the intensity of the deleveraging dynamic? **We expect headwinds to be as intense as they were between 2009-2011, but with a couple of twists.**

- **There will be a shift in the mix.** Rural sector deleveraging is ongoing but lessening in intensity as the commodity price boom filters through and

rural land prices stabilise as turnover increases. Nominal business borrowing collapsed by more than 3 percent between April 2009 and July 2010, but has since recovered. Conversely, fiscal retrenchment is only beginning (there are huge lags) and households still need to get their finances in order.

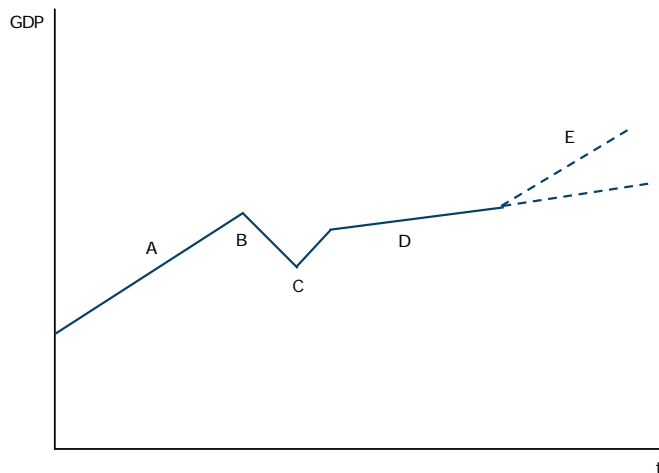
- **The intensity will be strongly influenced by the global scene** (as a driver of income generation).
- **We have to acknowledge that income growth needs to exceed cost (spending) growth for a sustained period.** If income slips, so too will prospects for spending and the converse applies. Our working assumption is that we need to see something akin to "negative jaws" of 2 percent; which means spending growth 2 percentage points below income generation. That's a big gap.

THEME 2: TRANSITIONING VIA DIFFERENTIATION

Last year we identified **five stages in the current economic cycle**, and they still apply. The first stage (A) was the "old normal", the 2002 (or even as far back as the early 1990s) to 2007 period, where growth **was driven by excessive borrowing** and risk-taking. This led to asset price bubbles and unsustainably high wealth-induced spending, or artificial wealth. **Stage B over 2008-09 saw the inevitable initial purging** that follows such excesses. **Stage C** was the healing or recovery process that we saw in late 2009 and first six months of 2010, helped by aggressive policy action and an inventory rebuild. "Healing" or "recovery" is probably a bit optimistic: more like **stabilisation** following capitulation, and a recoil off lows.

The New Zealand (and global) economy entered stage D – which we call "transition", around the middle of 2010. Normal pro-cyclical forces and drivers of the business cycle, such as consumer spending, failed to kick on and take the inventory rebuild into something of substance. That's because there's a debt "supercycle" and payback dynamic that is overwhelming the usual cyclical forces. This period is where the economy transitions on a number of levels, including **altering the mix of growth (rebalancing)** and also paying penance for prior sins, i.e. **lowering debt** as a share of GDP across Western society. This entails **a period of stuttering and "grumpy" growth (D)** as stylised below. In the final stage (E), trend growth rates (the slope) will be at least partly a reflection of the choices made in the transition stage.

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The economy is expected to remain in the transition stage for a number of years. We are not talking booms to busts, but rather a period of grumpy growth. Transition will involve a number of dynamics:

- **A capped rate of growth**, as a leveraging tailwind is replaced by a deleveraging headwind. Put simply, the slope of D is less than A.
- **A different mix to growth.** You can't borrow and spend your way out of a debt-induced jam. So spending sectors of the economy need to underperform and farming and other export-oriented sectors need to outperform.
- **The re-mobilisation of resources**, including labour and capital, across sectors, as a spend-centric model is replaced by a more balanced model for growth. Capital and labour does not respond instantaneously. It will be messy. As the hairdresser in Auckland does not necessarily want to milk cows in Southland.
- **Economic wobbles.** Time is the only true healer. We're in the hands of the politicians globally to make the tough decisions.

So what determines the rate of growth in the transition stage? **The weaker the balance sheet, the greater the deleveraging headwind** holding back near-term growth. NZ is somewhat saddled here by its sins of the past. Having more flexibility across your economy in areas such as the labour market and a floating currency can assist by allowing resources to adjust more readily. On this front, NZ stands strong.

Economists can probably point to 80-odd factors that determine growth. The problem is that it's difficult to disentangle the causality, for a lot of so-called growth determinants (such as investment) are key components of GDP themselves. We know that traditional dynamics such as population and productivity will of course be influential.

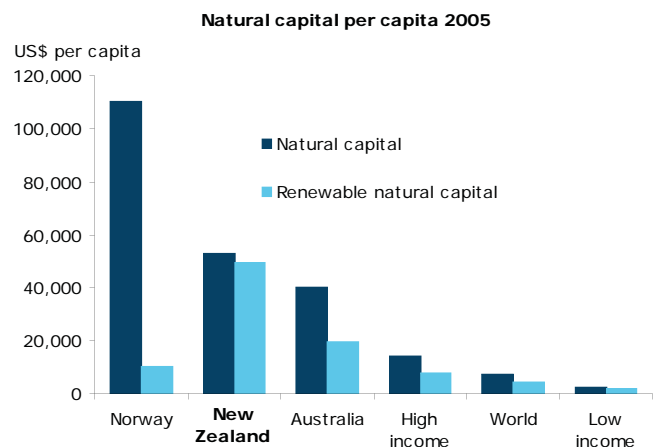
Depopulation in Christchurch, the allure of Australia and sub-par productivity performance are challenges for NZ.

Increasingly key for an indebted nation will be differentiation, i.e. convincing investors that you're on the right track. Nothing is a problem until markets think you are a problem, and as Ireland, Greece, Italy and other highly indebted countries will bear witness to, problems can turn exponentially ugly in a very short time. We see differentiation as a major factor determining both the rate of growth in the transition stage, and the volatility around it. Investors are eyeing the scene with confusion, and New Zealand is facing a marketing challenge of crucial importance.

We see differentiation occurring on a number of levels.

- **Natural endowment.** It is easier to transition if you have strategic areas of excellence, or areas of comparative advantage. This makes it possible to get debt to GDP down by raising GDP, a far preferable adjustment path to scrimping.

NZ ranks 8th in the per capita natural resources stakes globally, a few notches higher than Australia, who are often deemed the lucky country. And in terms of per capita renewable natural capital, we lead the world.



There are, however, tensions between some of our endowments. Unlocking them is not easy. You wouldn't want one area of strategic excellence such as mining or farming to undermine another such as tourism, so sensible regulatory heads are required. However, just like successful businesses need something in their offering that is "different" (whether that be brand, relationships, or a better service proposition), the same applies for a nation. New Zealand has this in spades and it's critical,

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for the more you pull an income-generating lever, the less pressure there is for austerity, and the better the prospects are for spending sectors of the economy.

- **The political framework.** New Zealanders tend to take their lack of corruption and well-functioning political system as a given. But it matters. And while democracy may be “the worst system of governance except for all the others” in that it rewards short-term thinking, we are encouraged by the consistency being shown across the political spectrum towards fiscal savings and responsibility. If you want to see political fragmentation and institutions that are conducive to gridlock, look no further than the US and Europe. Our system is not perfect but it’s better than most.
- **Evidence that society is “getting it”.** Leadership can only take you so far – habits have to change on the ground. Our economic performance, after all, reflects the decisions of 4 million individuals, whether that’s their borrowing, spending, or voting decisions. Japan’s lost decade epitomises a refusal to bite the bullet. It appears in New Zealand the critical mass is now tilting towards the necessary structural change. Witness the continued uptake of KiwiSaver despite reduced incentives, the focus on fiscal responsibility in the 2011 election, a refreshingly non-hysterical discussion of the possibility of raising the retirement age beyond the age of 65; such signals don’t guarantee that society is willing to do the hard yards but they flag that things are moving in the right direction.
- **Microeconomic reform.** Microeconomic issues are often overlooked when assessing the macroeconomy, but as stated, the economy is the summation of its parts. It is crucial to get the right incentives in place. Tax policy is a biggie here, as well as welfare policy design, the ease of starting a business, property rights, balancing public and private interests, and avoiding corruption and rent-seeking (moulding one’s economic activity around maximising returns from distortionary policies, rather than true economic profit). As a general rule NZ is pretty good in this area, whereas the real issue for a host of nations is microeconomic reform, and altering behaviour at the firm and individual level. Moreover, we’re seeing continued tweaks. Over time, the benefits will accrue.

These factors do not deliver nirvana. Nothing does. But in a world that is “transitioning”, differentiation through showing competency and maintaining confidence is key. **Such differentiation allows you to remain in control of your own destiny (and adjustment).** The alternative is the likes of Greece.

THEME 3: SOVEREIGN RISK

2008 was a credit crisis across the financial system, and unsustainable levels of debt to GDP were at the heart of the problem. Between 2008 and 2011 the private sector began to improve balance sheets. However, **the ratio of debt to GDP in most Western societies is now higher than in 2008.**

Country	Overall Score	Overall Rank	Prior Rank (mid 2011)
Norway	40%	1	1
Switzerland	30%	2	2
Australia	17%	3	3
Denmark	17%	4	5
Sweden	13%	5	6
Singapore	11%	6	4
Taiwan	11%	7	7
Luxembourg	10%	8	8
Canada	8%	9	9
NZ	2%	10	10
Korea	-1%	11	14
China	-1%	12	13
Czech Rep	-2%	13	15
Japan	-2%	14	12
Hong Kong	-3%	15	11
USA	-3%	16	16
Finland	-5%	17	17
Germany	-5%	18	18
Austria	-9%	19	19
Netherlands	-11%	20	20
Malaysia	-12%	21	22
Hungary	-12%	22	25
Thailand	-12%	23	24
Poland	-13%	24	21
Iceland	-15%	25	23
UK	-16%	26	26
India	-16%	27	27
Philippines	-18%	28	28
Vietnam	-21%	29	29
Indonesia	-22%	30	30
Belgium	-24%	31	32
Italy	-24%	32	31
France	-29%	33	33
Slovakia	-29%	34	34
Ireland	-30%	35	35
Spain	-38%	36	36
Portugal	-42%	37	37
Greece	-59%	38	38

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Private sector deleveraging has simply been replaced by sovereign and government leveraging. Some of this was a forced “socialisation” of the 2008 crisis. The average level of net government debt across the OECD rose from 43.9 to 62.5 percent of GDP between 2008 and 2011 and is expected to continue rising.

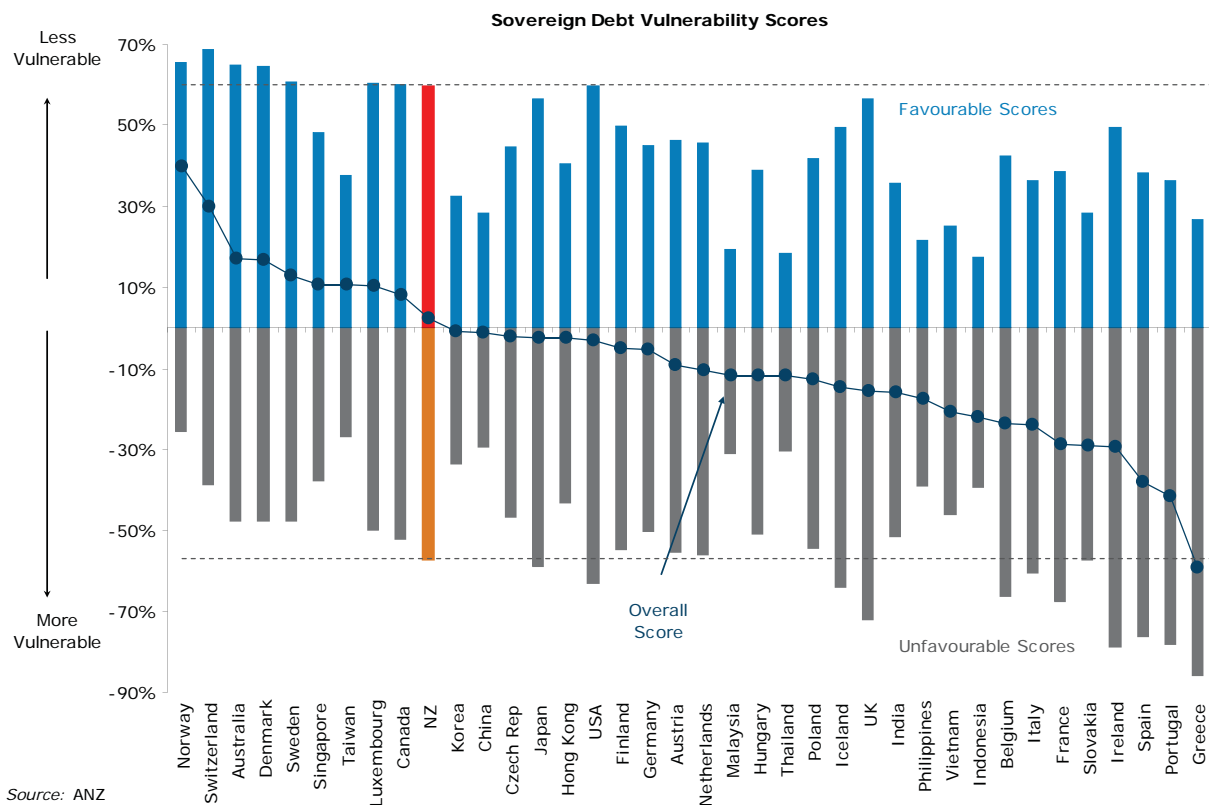
With attention now focused on sovereigns, two years ago we developed an indicator to assess sovereign debt vulnerability in an objective manner (sovereign risk was one of our key themes at the start of 2011). Without having the massive resources of a rating agency, we simply assess each country on the basis of two broad criteria. First, we looked at “bad” or “worry” variables – things like government debt, the fiscal balance, the current account, net external debt and the unemployment rate. But we also recognised that there would be offsets, and looked at things that may buy you a bit of time – GDP per capita, population, the existence of a floating exchange rate, political stability, competitiveness etc. By comparing one set of criteria against the other, we arrived at a “net” score giving a simple metric of vulnerability for key nations.

The table on the previous page summarises the results. Nations are ranked according to the overall score, which is the net of the unfavourable and favourable numbers. But remember, this is a peer group comparison, so if everyone improves their lot,

overall scores will improve. **Because investors have a choice as to where they invest, what matters most is a country’s overall placing on the table.**

Our rankings highlight several consistent points:

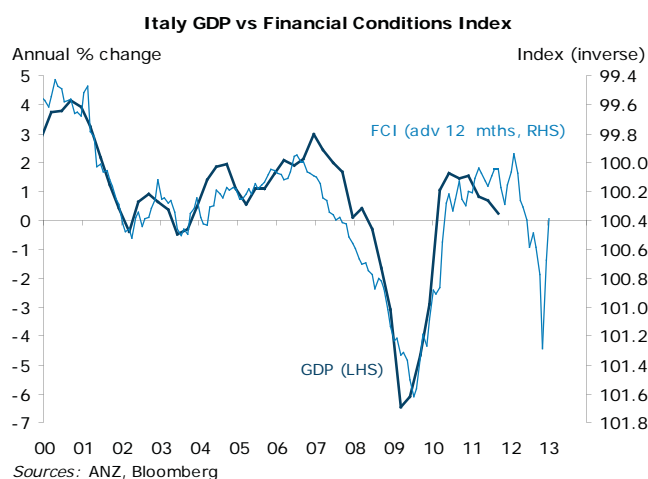
- **Europe continues to dominate the problem end of the spectrum** and it’s a reflection of both unfavourable and poor favourable characteristics. By contrast, Switzerland, Scandinavia, and the commodity countries dominate the top end. China and the more developed Asian economies are in the top half of the table.
- Big countries (like the US and UK) remain mid-table. They **have serious fiscal issues, but this is offset somewhat by positive factors.**
- There has been some minor position shifting in terms of rankings in the middle of the table, but those at the top and bottom have tended to stay put. **Those in the hock are still in the hock, and those that were never in it have not been dragged in.**
- **New Zealand remains reasonably placed.** It ranks below average (26th) for unfavourable characteristics, a reflection of a high net external debt position and fiscal blowout in 2011, but has an above-average ranking (9th) for favourable characteristics.



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All of this leaves us with a strong feeling that the situation has not improved. There has been much talk, and arguably more “muddling through”. But **at some stage, push will come to shove, and tough decisions will need to be made.**

The experience of Italy is demonstrative of how quickly a tailspin can develop. Once confidence is lost, borrowing costs rise, financial conditions tighten, and recessions beckon. This only lifts the debt burden further, forcing politicians to implement austerity measures, potentially plunging the country into a deeper recession, and confidence deteriorates further, and **before you know it the downward spiral is in motion.** Remember, Italy is the 8th biggest economy around the globe and at last count the third largest borrower in the bond market.



Italy, then, is a clear example when the market calls time; the game is up, hence the importance of policymakers being on their game. **In practice, this means putting our fate in the hands of politicians. Even with the best intentions, they may not be able to deliver the credible outcomes the market so desperately craves. It's not easy balancing the demands of the populous (who vote you in and out) with the market (which you depend on for financing).**

Although New Zealand ranks fairly well overall, we are not above scrutiny by global markets and can't be complacent. We are more “plugged in” to the global economy through trade and financial markets than ever. **The “Six C's” are crucial barometers for New Zealand – namely contagion risks (we need to be doing the basics well), confidence (growth), cost of credit (offshore borrowing), China (can it remain immune?), commodity prices (okay for now) and the currency (up and down like a yo-yo).** Witness, for example, swings in sentiment and pricing on all six of the C's that have occurred over the past year

as financial markets have swung from optimism to pessimism regarding Europe. **We are simply dreaming if we think a significant shock in Europe won't cause shock waves here. The six C's are metrics that bear watching closely.**

THEME 4: ECONOMIC TENSIONS – THE INTERACTION OF FIVE SHOCKS

The economic outlook is arguably more complicated than any time in New Zealand's economic history. Theme 1 detailed the **structural headwinds** the economy is facing. Restoring a modicum of health to the national balance sheet is a prerequisite to any sort of cyclical upturn taking hold. This is shock 1. That means any talk of a supply-demand imbalance, housing-led upturn, or borrowing and spending our way to nirvana is premature. On top of this we have a **weak and volatile global scene** to contend with (shock 2). We can add to that three other material shocks and tensions.

- **Rebalancing.** The economy remains lopsided, with excessive concentration in spendthrift activity, and this is at the expense of earning. Since 2004 activity in the tradable sector has gone backwards, and income growth has not kept up with spending. It will take years for resources (i.e. labour and capital) to respond to different price signals, for opportunities to be unlocked, and the DNA of society to change.
- **A positive income shock.** We're seeing structurally higher demand for commodities, which has seen our goods terms of trade hit a 37 year high. Asia is increasingly relevant for New Zealand as an export market, with Asia ex-Japan now accounting for a third of merchandise exports, versus a quarter a decade ago. We're getting better connected in regard to the Asian region, with a free trade agreement with India currently under negotiation. But we must add a note of caution here: with exposure to the upside of Asia's potential comes vulnerability to adverse turns. And there are plenty of pundits picking an adverse turn for China in the next 12 months (see Theme 5).
- **The Canterbury earthquakes.** The impact channels are endless. Relative to the size of the economy, the estimated cost (more than 10 percent of GDP) is unrivalled globally. A lot of wealth has been destroyed and we see it as accentuating the structural change in households' savings behaviour. Canterbury's population will not be the same, but the South Island needs it as a hub. We expect a net migration outflow from the region in 2012 but an inflow once the rebuild starts. There will be a massive construction

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response, but the ground needs to stop shaking first and Christchurch's events will alter building and insurance standards nationally. And in reality, much of what was lost cannot or will not be rebuilt, at least not in Christchurch. Nonetheless, we need to rebuild a lot of destroyed domestic capital at a time resources also need to be deployed to tradable-centric areas (refer above). This risks blowing out the current account deficit unless consumption as a share of GDP drops. Over time the costs of Canterbury will hit consumers' pockets via increased levies, higher insurance premiums and reduced government spending in other areas.

These shocks are complementary in some facets but opposing in others. Deleveraging is deflationary. Commodity income shocks and natural disasters are not (indeed, we'd put some of the current Auckland housing inflation down to earthquake migration). The income shock is helping New Zealand get its balance sheet back in order via income generation (by getting the debt to GDP ratio, the current account deficit, and the consumption to income ratio down). Conversely, rebuilding Canterbury will involve dedicating huge amounts of resources to rebuilding domestic capital (i.e. housing and infrastructure) at a time when we're also supposed to be investing in other regions and sectors to address our national indebtedness.

To put these shocks in perspective in terms of their significance, issues such as the leaky home/building crisis, which hasn't gone away and is hugely relevant, doesn't make our top five (deleveraging, the global scene and the three above). And if we were ranking economic developments by national significance, Psa – which is decimating the gold kiwifruit industry – would not even make the top ten. That is not to belittle the kiwifruit industry or those facing large leaky building repair bills. It's to underline **the mammoth scale of the forces buffeting the New Zealand economy** at present.

The interaction of these shocks will see **more volatility across the New Zealand business cycle than is normal, amidst a lower trend growth rate.** It will be difficult to get a steer on the true state of affairs. Data will be murky. A lot will have to be taken on faith. **Sectors across the economy will move up and down, depending on which shock is dominating at the time.** Probably the clearest trend will be a lack of one.

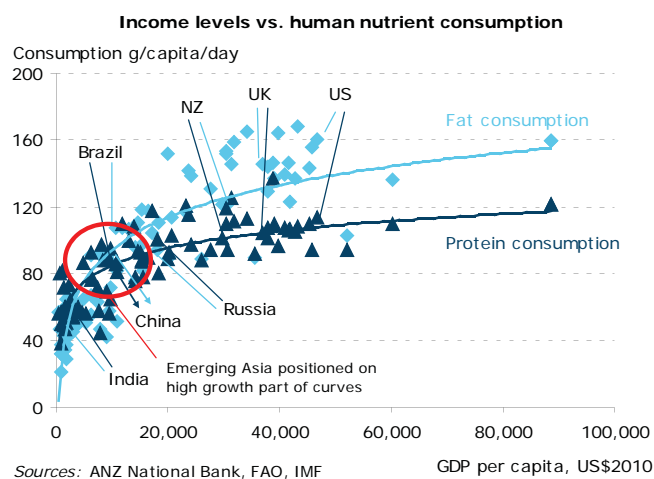
This also portends challenges for policymakers as they face off against voters with expectations based on a debt-accumulating world that no longer exists. Fine-tuning the supply-side capacity of the economy will take on particular importance. Things like rebuilding Christchurch and rebalancing require

at their core the remobilisation of resources, and getting the right incentives in place in areas such as education will be critical. There will be trade-offs in dealing appropriately with these shocks, and **a long-term view will be key to achieving the best outcomes.** Navigating numerous shocks simultaneously ups the ante on true leadership to prevail over populism. We hope cool heads prevail and that enough of society grasps the big picture.

THEME 5: ASIA – WITH OPPORTUNITY COMES VULNERABILITY

The economic opportunities in Asia and even a little further up the silk route in the Middle East are unprecedented for a number of sectors that New Zealand excels in. The "food story" of large populations increasing their protein and fat consumption, with limited key natural endowments to meet these needs, has been well documented. This is further energised by rising incomes in the middle class, urbanisation, and the modernisation of their food industries. The Asia-Pacific region now makes up 55 percent of New Zealand's total merchandise trade, up from 42 percent 10 years ago.

Tourism is another benefactor. Total tourism numbers from Asia (excluding Japan) have increased by 23 percent over the last 10 years.



Things such as rising connectivity, our close geographical position and the rise of e-commerce will continue to facilitate these prospects. An increasing number of bilateral agreements with key countries such as China have opened the door for New Zealand's wares. The countries with which New Zealand has a FTA cover 2 billion people (29 percent of global population), 16 percent of global GDP (in current prices), account for almost half of New Zealand's merchandise trade, and, importantly, have been growing at a much faster rate

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than global growth. The FTAs New Zealand now has under negotiation cover 1.8 billion people (26 percent of global population), 31 percent of global GDP and currently account for around 18 percent of our trade. If all of them prove successful, then New Zealand will have free access to 56 percent of the world's population, accounting for close to half of global GDP. This represents a big playground for a country of just 4.4 million people.

In many cases, we have been the first across the line, or in the lead, which allows us to establish a beachhead versus our competitors.

Country	GDP US\$bn in current prices	Population (millions)	Average real GDP growth past 10-years	% of NZ exports	% of NZ imports
FTA in force or about to be in force					
Australia	1,507	22.5	3.0	22.6	16.3
Singapore	266	5.3	6.3	1.7	4.8
Thailand	339	64.3	4.5	1.6	3.0
Brunei	16	0.4	1.4	0.0	0.9
Chile	243	17.4	4.1	0.1	0.1
China	6,988	1348.1	10.6	12.4	15.8
Myanmar	50	62.4	9.8	0.0	0.0
Philippines	216	95.8	5.0	1.6	0.3
Vietnam	122	89.3	7.2	0.9	0.6
Cambodia	13	14.4	7.7	0.0	0.0
Indonesia	834	240.5	5.5	1.9	1.3
Laos	8	6.6	7.5	0.0	0.0
Malaysia	248	28.7	5.1	1.8	3.3
Hong Kong	247	7.2	4.6	1.6	0.4
Total				46.3	46.8
FTA under negotiation					
Bahrain	26	1.1	5.6	0.1	0.1
Oman	67	3.1	4.5	0.1	0.8
Kuwait	171	3.7	6.0	0.2	1.2
Saudi Arabia	560	28.2	3.9	1.5	1.4
UAE	358	5.4	5.8	1.1	1.6
Qatar	173	1.8	14.4	0.1	1.8
Korea	1,164	49.0	4.2	3.5	3.2
India	1,843	1206.9	7.8	2.1	0.8
Russia	1,885	142.4	4.8	0.7	2.6
Belarus	58	9.4	7.5	0.0	0.0
Kazakhstan	180	16.5	7.6	0.0	0.0
Peru	168	30.0	6.3	0.2	0.1
US	15,065	312.9	1.6	8.3	11.1
Total				17.9	24.7

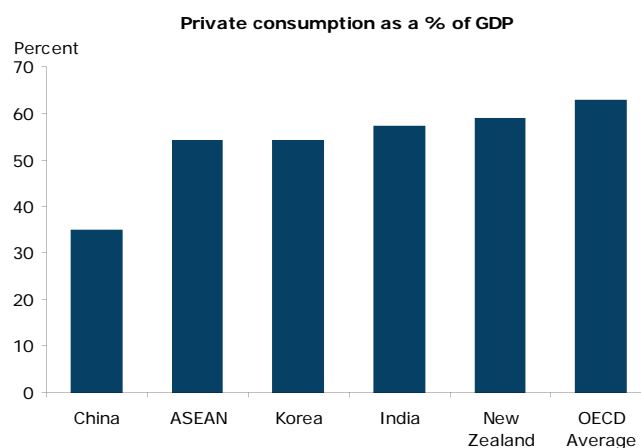
Sources: ANZ, IMF, Statistics NZ

However, while Asia has been a strong focus opportunity-wise for investors, particularly since 2008 and there are further opportunities to

exploit, Asia is not immune to what is happening elsewhere in the world. It is subject to business cycles, and countries such as China have their own unique structural economic issues that need to be addressed. With New Zealand more reliant on Asia, we are also increasingly susceptible to what happens there.

Key issues to keep an eye on in Asia in 2012 will be:

- Growth and trade.** The more open economies are more sensitive to changes in global growth and have greater downside risks. This means we can't divorce China *et al* from European developments.
- Private consumption.** Asia must progress towards more economic growth coming from private consumption instead of being reliant on the traditional export and investment model.
- Financial tail wags real dog.** Market turbulence lowers asset values, confidence, and growth. Our financial conditions measures for Asia have a high weight on asset prices; in some cases they are extreme. This high correlation in itself leaves us uneasy regarding how much of the Asia growth story may have gotten ahead of itself.
- Bank funding.** Financial systems that rely on wholesale funding (loan/deposit > 100 percent) are at risk if inter-bank flows dry up.



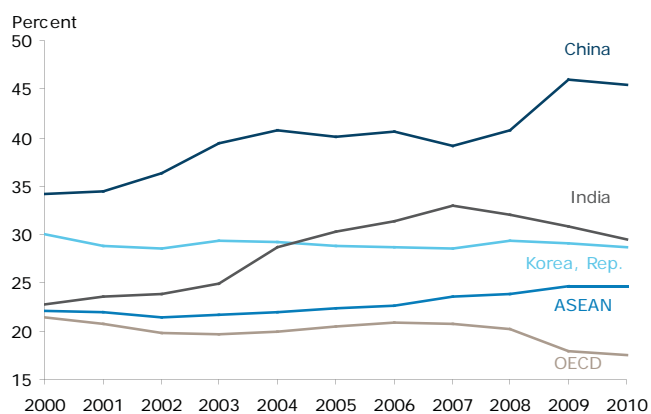
Sources: ANZ, National Bank, The World Bank

Many of the economies in Asia have been through a tightening of macro and fiscal policy over the last 12 months to dampen down inflationary flames. In many countries, monetary policy was "behind the curve" in 2011. **With growth in a cyclical downturn, inflation still persistent in some economies, and a deterioration in Europe's economic prospects (Asia's largest trade partner), walking the tightrope of keeping inflation under control but not overshooting the mark and choking off economic growth will be tricky.**

FEATURE ARTICLE: KEY THEMES FOR 2012

This is especially the case where the traditional model for growth in many cases has been export-led industrialisation, supported by weak currencies. It has produced high net export and fixed capital investment shares and a lower consumption share of GDP. The squeeze could come on very quickly should trading partner demand dry up, especially for those economies that are more open.

Gross Fixed Capital Formation as a % of GDP



Sources: ANZ, National Bank, World Bank

Longer-term, net exports, fixed capital investment and saving need to fall as a share of GDP, while private consumption needs to sharply rise. This is a particular issue for China but is also a familiar theme for many other ASEAN countries where private consumption as a percentage of GDP is well below the OECD average. The challenge of increasing private consumption before the investment boom turns into a bust cannot be overstated in countries such as China that are still heavily controlled by the State. **High saving rates and low private consumption are structural issues that will take years of politically difficult reform to change.**

If financial market turbulence and policy responses hit capital investment growth, this would have a disproportionate effect on growth in countries such as China and India. The lead indicator of such a change will be international prices for key hard commodities such as copper, iron ore, nickel and the like, with China now consuming 40-50 percent of global trade in these products. Late 2011 falls in these metals may be telling.

The other challenge that could possibly hurt the credit cycle and growth in some Asian economies is European banks massively contracting their balance sheets by calling in, or not rolling over, loans. In general, European banks' gross assets in Asian economies rarely exceed 10 percent of total outstanding domestic credit. Loan-to-deposit ratios in most of Asia are well under 100, implying low reliance on offshore wholesale funding.

However, India, Vietnam, Korea and Australia, despite recent improvements, are the most vulnerable if this were to occur.

THEME 6: THE GRAND FINALE – GAME THEORY AT PLAY

The challenges for the global economy are well documented. There is simply too much debt. A host of governments face solvency challenges. The global economy is unbalanced: excessive saving in the East is financing consumption largesse in the West. Governments have been on a borrowing bender.

Solutions are easy to identify; it is implementation that is difficult, for we are in the realm of politics and there is a group dynamic to it, as well as a host of considerations that go beyond pure economics. Witness trade tensions between the US and China; the furore over a financial transactions tax between the UK and France/Germany; uncertainty over pending bank regulation including Basel III; street protests against austerity measures; the rise of nationalist parties in Europe *et al.* These are non-trivial tensions that illustrate the difficulty getting a truly unified response.

The global economy is desperately looking for leadership. Probably the most important aspect of the leadership challenge is achieving significant fiscal austerity to demonstrate solvency.

Will politicians make the hard decisions? So far they have avoided them as much as possible. The Eurozone crisis unfolding at present, if left unchecked, could quickly engulf the US next. Doing nothing is not an option. But this does not necessarily mean the "right" thing will be done. **Rather than go into the ins and outs of the various challenges in a political sense – which are huge – we turn to game theory,** and in particular the prisoners' dilemma, which illustrates the **tension between group and self interest.** This dynamic is played out time and time again around the globe. Remember, global problems require truly global solutions.

This is how it works. Two men are arrested on suspicion of robbing a bank, but the police do not have enough evidence for a conviction. Following the separation of the two men, the police offer both the same deal – if one testifies against his partner (defects), and the other stays quiet (co-operates with his partner), the betrayer goes free and the co-operator receives the full 5 year sentence. If both remain silent, both are sentenced to only 6 months in jail on a minor charge. If each 'rats out' the other, each receives a 2 year sentence. Each prisoner must choose to either betray or remain silent; the decision of each is kept quiet. What should they do?

FEATURE ARTICLE: KEY THEMES FOR 2012

	Prisoner 2 stays silent (co-operates)	Prisoner 2 confesses (defects)
Prisoner 1 stays silent (co-operates)	Each serves 6 months in jail	Prisoner 1: 5 years Prisoner 2: goes free
Prisoner 1 confesses (defects)	Prisoner 1: goes free Prisoner 2: 5 years	Each serves 2 years

The best outcome for the prisoners is that they both stay silent or “co-operate” with each other, as this minimises their jail time. However, a closer look at the payoff matrix reveals a range of possible outcomes. Consider prisoner 2. They don’t know what prisoner 1 will decide. If prisoner 1 stays silent, they are best to confess, going free rather than serving 6 months. If prisoner 1 confesses, they are still best to confess (2 years rather than 5 years). Individually, the optimal strategy for both prisoners is therefore to confess, even though this leads to a worse outcome for both of them than staying silent.

Politicians face a similar situation when trying to agree on solutions to the global problems.

Where tension exists between a country’s own best interest and the group’s best interest, a less than optimal solution is highly likely. This is especially the case in Europe where the monetary union exacerbates the situation, limits the available solutions, and heightens the trade-offs between the optimal and actual outcomes of decisions. Each country is looking out for its own banking sector, its own export sector, and its own credit rating. Worse still, each politician is looking out for their own re-election chances. The UK’s recent decision to opt out of the EU-wide negotiations on a new fiscal treaty was a case where self-interest (avoiding curbs on London as a financial hub) trounced group interest (a unified front).

So how does the grand finale look? We are not sure. The *hope* is that enough will be done to head off problems before they arise. The *fear* is that a) the later you leave it the more exponentially difficult the decisions become (and for politicians there are no easy choices in 2012), and b) individual interest will dominate group interest, and the combination will lead to **an accident of sorts before mandates are given to make the hard choices – whether that’s a true political mandate, or sheer will forcing through the tough leadership solutions regardless of the damage it does to politicians’ re-election chances.** Upcoming elections (Finland, Greece, Russia, Slovakia, and France in the first half of this year alone) may be preventing politicians

from making the tough calls now, but they are also an opportunity. It’s easier for a new Government to implement unpopular measures and blame their predecessors for making it necessary.

Can an accident be averted? Yes. Theme 2 – “Transitioning via differentiation” applies. It’s about showing competency, confidence and credibility. Going back to our Prisoners’ Dilemma example and application of game theory, if the game is played repeatedly, players can ultimately end up with the “Pareto Optimal Solution”. Oil cartels succeed, even though everyone at any given time has an incentive to “defect” by increasing their production, because everyone is in it for the long haul. Arguably, the 2008 GFC should serve as the “lesson” regarding short versus long-term thinking. **Yet when we consider the cultural and attitude differences in the West and the East,** and prospects for Europe corralling 17 euro member nations (and 27 in the EU) into some sort of fiscal union, which is required for the euro to survive, well, **it just seems a bit of a stretch.**

THEME 7: DESYNCHRONISATION

As a baseline assumption we view the world as “coupled” in a growth sense, such is the strength of trade and financial linkages. Historically, Western economy business cycles have tended to be well correlated. The emergence of China as an economic powerhouse has added a twist to this – they were a key source of global stabilisation in 2009 – but has not fundamentally altered the core proposition of coupling.

However, we are also mindful of growing disparities in terms of growth prospects across key regions that point to the possibility of decoupling. **To give us a steer, we track financial conditions across an array of countries.¹**

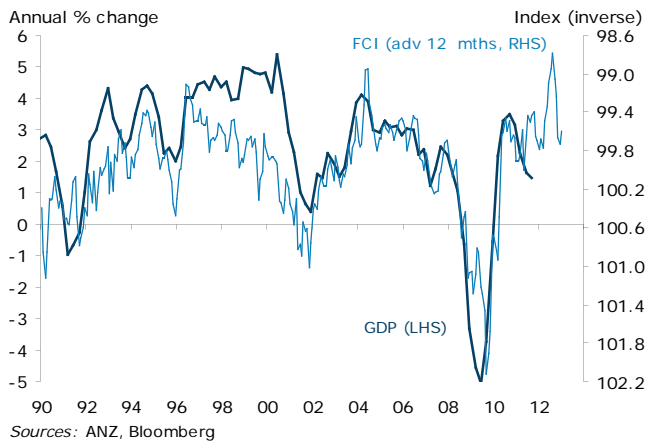
A quick look at our financial conditions measures across key regions highlights the disparities.

- **Prospects for the US look fairly solid.** The “level” of conditions has come back thanks to an unwind of the surge in M2 money supply (i.e. QE2), but they still point to growth of around 3 percent.

¹ Our financial conditions index summarises a range of financial variables into a single series that can be used to predict the future path of the economy. Where available, our FCI includes the currency adjusted for commodity prices or terms of trade movements, interest rates, asset prices, credit growth and proxies for the cost and availability of credit.

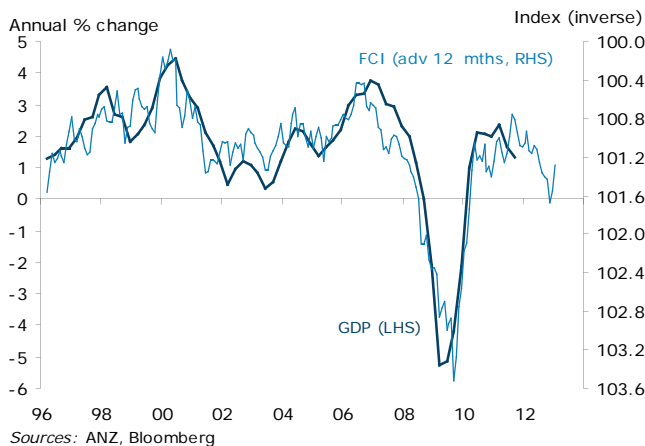
FEATURE ARTICLE: KEY THEMES FOR 2012

US GDP vs Financial Conditions Index



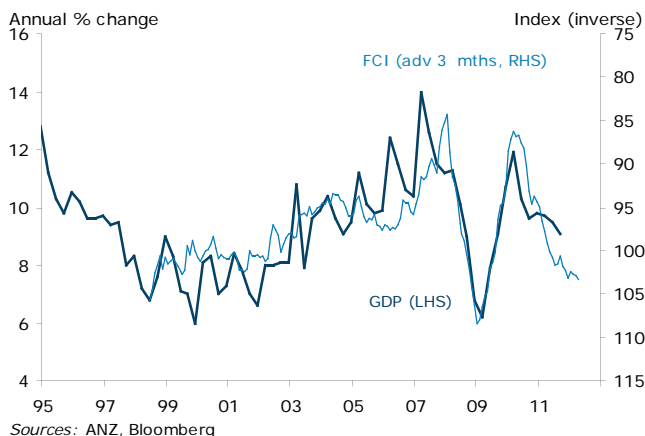
- By contrast, our Eurozone FCI is pointing to a sharp slowing in European growth, and the possibility (we would say inevitability) of recession.

Eurozone GDP vs Financial Conditions Index



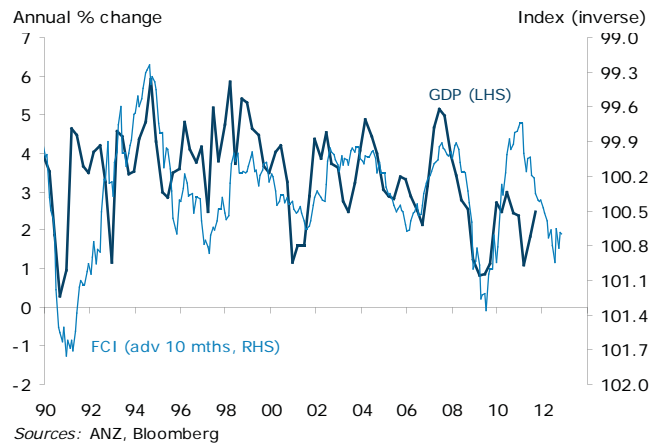
- Our FCIs are flagging a slowdown in China too, adding weight to fears that some moderation lies ahead

China GDP vs Financial Conditions Index



- Our FCIs also point to some moderation in Australia.

AU GDP vs Financial Conditions Index



We admit that indicators such as financial conditions have limitations. Our FCIs are simple, high-level, and do not capture all of the many influences on growth, but then again, what approach could, especially when confidence and risk appetite are such key drivers, and we are in the midst of a once in a generation structural realignment! **Our FCI measures should be interpreted as an indicator as to the direction for base momentum within an economy, as opposed to the general rate of growth itself.**

The messages across our financial conditions measures are simple.

- Regions face divergent prospects.
- Diverging prospects means more uncertainty.
- Beware nations that can't achieve 2 percent growth; a debt spiral may beckon. Debt and deleveraging will be a significant determinant of growth prospects. But you need sufficient growth (the denominator in debt/GDP) to keep the debt burden in check. Countries where prospects for nominal GDP are below borrowing costs are in a pickle.

THE UPSHOT

So what do all these themes in aggregate mean for the New Zealand economy and farming sector in particular?

- A bumpy year, particularly for the domestic economy and farming sector (Themes 1, 2, 3, 4). We've pencilled in 2 percent growth for the real economy and a solid cash performance for farming. It's enough to get by and help slowly push the unemployment rate lower.



FEATURE ARTICLE: KEY THEMES FOR 2012

- New Zealand will still perform better than most across the OECD (Themes 2, 3 and 5). Two percent growth is not stellar but relative to others New Zealand will look solid.
- There is still more downside risk than up (Themes 3 and 6). Where the world goes, NZ follows. We're in the hands of the European politicians.
- Fiscal policy (number 2 The Terrace) to supercede monetary policy (number 1 The Terrace) in importance (Themes 2, 3 and 5). We can remain masters of our own destiny to a degree. The NZ Treasury need to take a stronger role in the leadership space. Watch for more structural reform aimed at rebalancing the economy. In the farming sector this could include more extensive examination of RMA regulation, implementation of NAIT and the pursuit of more FTAs.
- A lack of clear trends across financial market variables (Themes 2, 4 and 7).
- Interest rates to remain lower for longer (Themes 1, 3 and 4).

THE MONTH IN REVIEW

ASSESSMENT

Mother Nature remains in a kind mood though not universally. The North Island has continued to receive good dollops of rain at regular intervals, and while there are issues with pasture quality there is plenty to go round. This is in stark contrast to the dry November/December period last year. In the South Otago and Southland have become dry following an excessively wet spring. On the other hand, Marlborough and Canterbury are similar to the North Island. But in general production is up strongly, and providing a buffer against easing prices.

Most parts of the North Island continue to operate near full soil moisture capacity after receiving regular rainfall over the last two months. But this comes with niggly factors. Pasture quality is now becoming an issue. It has also been reported as one of the worst years for thistles and weeds. There has been a lot of supplementary feed made to restock barns and silage pits after the tough 2010 spring and start of summer. The mild La Nina has meant moist humid conditions in many places. This has increased animal health, weed and pest issues. Faecal egg counts are on the rise and fly strike has increased. Cereal crops in the Manawatu have good plant population and yield potential but will need things to dry out to mature. Maize crops in the upper North Island and Manawatu have had a little too much rain limiting growth potential. We expect some big yields for most crops this season but spot prices will be under pressure from the large amounts of feed still standing in paddocks. Expect the moist and humid conditions to see more spent on animal health, weed and pest control.

In the South Island, Otago and Southland became very dry with little rain from December to mid January. However, 50-100mm of rain in mid January has helped relieve things for now. Crops in these regions were generally planted later than normal because of the markedly wet spring. This makes the growing season even shorter. Combined with crops being stressed this will no doubt have an impact on yields. In general, most other parts of the South Island seem to have dodged the dry and are having a bumper season thus far. This has seen a lot of lambs move north from Otago and Southland for finishing. Irrigation use in Canterbury prior to Christmas has been estimated at less than 50 percent of normal, which represents a large saving in direct costs. Irrigators are now reported as in full use so some catch-up might apply.

DAIRY

Since our last update, Fonterra revised its milk payout up from \$6.30 to \$6.50 per kgMS in line with our expectations. International dairy prices have stabilised since October and the NZD has been up, down and up but generally weaker than the first couple of months of the season. We still hold a weakening bias for international dairy prices over the next few months

but season-to-date pricing implies there still could be another \$0.10-0.20 per kgMS of upside to the farm-gate milk price.

Year-to-date milk production continues to run 9-10 percent ahead of last year in the North Island. In the South Island growth has moderated towards 7-8 percent ahead of last year. The dry in Otago and Southland region which represents around 17 percent of NZ's total milk solid supply has been offset by continued strong production in the other parts of the South Island. This leaves national production 9 percent ahead of last year. Milk production is unlikely to better last year's record autumn, leaving production up around 7 percent.

MEAT AND FIBRE

After a pretty slow start to the 2011-12 meat processing year, momentum has picked up since mid January. The divergence in weather conditions between regions has seen cattle offloaded in the bottom of the South Island earlier than in other regions. Year-to-date South Island export cattle slaughter is 2 percent ahead of last year, compared with 25 percent behind in the North Island. Part of the drop in the North Island is because the cull cow slaughter is 40 percent behind last year. Last year was dry in the early part of summer which saw some dairy farmers revert to once a day milking and offloading surplus cows earlier than normal. However, prime beef production is also well behind last year, with the steer, bull and heifer slaughter back 24, 19 and 14 percent respectively in the North Island.

National lamb slaughter is back around 6 percent on last year, versus industry expectations of a 7 percent increase this season. The North Island is back 14 percent and South Island is up 1 percent. Lamb slaughter in the South Island has accelerated in recent weeks as the schedule has softened and the dry has bitten, reducing the incentive to add more weight that had been driving the soft slaughter pattern prior to Christmas. National mutton slaughter is also 41 percent behind last year and store prices for breeding stock are at all-time highs, indicating some flock rebuilding in 2012-13. Year-to-date wool exports are back 8 percent. Chinese exports are up 20 percent by volume and have accounted for 50 percent of total export volumes, up from 37 percent for the same period last year. EU exports are back 17 percent on last year.

HORTICULTURE AND VITICULTURE

The spread of Psa seems to have slowed in recent months with the onset of summer. Twenty-eight percent of orchards and thirty seven percent of total area are now identified as infected. Production of gold kiwifruit will be badly affected but on a brighter note, it seems this year's green kiwifruit crop has grown through the disease.

RURAL PROPERTY MARKET

SUMMARY

Turnover of dairy and other livestock-aligned properties has increased to 75 percent of its 10-year average and has accounted for 90 percent of total sales in the three month period ended December 2011. As a lot more due diligence is being applied the strength in enquiries from the spring is only just showing up as properties go unconditional. A lack of high quality dairy properties is also seeing stronger pricing beginning to emerge for second tier dairy properties and convertible land. We expect further momentum for turnover into this autumn and pricing to consolidate at current levels.

COMMENT

The very good pasture conditions over most parts of New Zealand have added momentum to the very favourable financial conditions in livestock industries over the last 18 months. This has boosted the confidence of many farmers and added to the pool of buyers. Horticultural-aligned properties seem to have snapped out of their spring

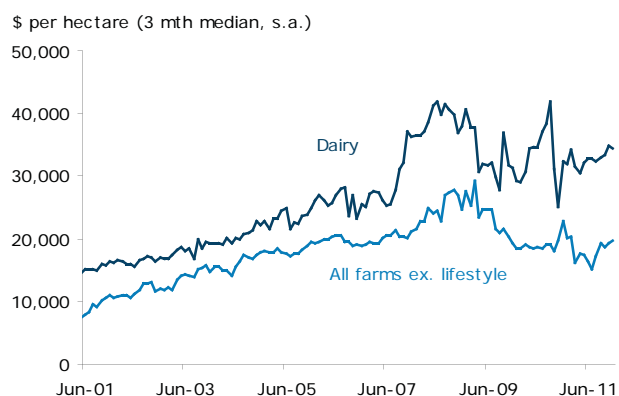
freeze.

The three month period ended December saw 352 farms change hands, continuing a tick-up in turnover that extends back nine months to March. Average prices are similar to this time last year but the big difference is the turnover of farms has increased by 70 percent this year. This is giving a more fundamental read on the underlying value of the rural property market and different farm types. **The average price sits 7 percent above the 10-year average.**

The tables and charts below show the official statistics from REINZ for the three month period ended December (i.e. October, November and December farm sales). The table is broken down into farm sales by each of the main farm types, both 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.

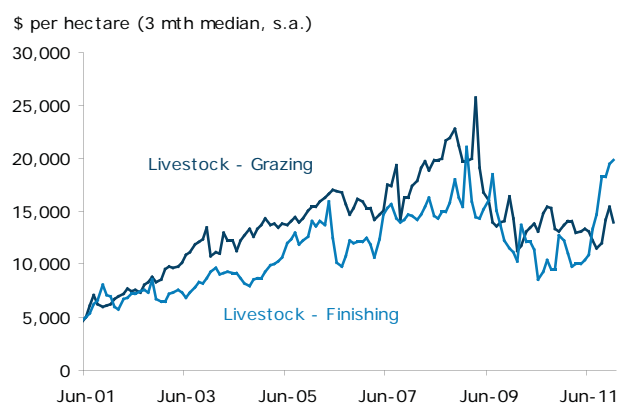
FARM SALES BY FARM TYPE								
3-Month Seasonally Adjusted		Current Period	Previous Period	Last Year	10-Year Average	Chg. P/P	Chg. Y/Y	Chg. P/10yr
Dairy	Number of Sales	43	41	37	84	↑	↑	↓
	Median Price (\$ per ha)	34,400	34,800	32,500	27,100	↓	↑	↑
Livestock – Finishing	Number of Sales	65	52	18	71	↑	↑	↓
	Median Price (\$ per ha)	19,900	19,500	12,200	11,600	↑	↑	↑
Livestock – Grazing	Number of Sales	196	190	87	249	↑	↑	↓
	Median Price (\$ per ha)	14,000	15,400	14,000	14,100	↓	↔	↓
Horticulture	Number of Sales	24	25	37	59	↓	↓	↓
	Median Price (\$ per ha)	120,500	93,400	157,600	142,900	↑	↓	↓
Arable	Number of Sales	17	16	13	20	↑	↑	↓
	Median Price (\$ per ha)	19,500	21,300	23,300	23,700	↓	↓	↓
All Farms ex. Lifestyle	Number of Sales	352	351	212	519	↑	↑	↓
	Median Price (\$ per ha)	19,600	19,300	22,800	18,400	↑	↓	↑
Lifestyle	Number of Sales	1,230	1,176	1,062	1,646	↑	↑	↓
	Median Price	463,000	448,000	433,000	372,000	↑	↑	↑

Farm Sales, Median Price



Sources: ANZ, National Bank, REINZ

Farm Sales, Median Price



Sources: ANZ, National Bank, REINZ

RURAL PROPERTY MARKET

Momentum in the rural property market has taken another step-up over the last few months as spring enquiries are turned into unconditional sales. We expect further momentum for turnover into this autumn and pricing to consolidate around current levels. The main difference between this year and last has been a 70 percent increase in the number of sales. Turnover of dairy and other livestock-aligned properties now sits at 75 percent of its 10-year average. A lot of renewed interest has come from owner-operators, which has added to the pool of institutional and overseas buyers. Listings have also started to respond, but a reported lack of quality and scale seems to have kept some of the larger buyers on the sidelines. However, the return of owner-operators looking to expand or buy the next-door neighbour's property seems to be improving pricing for second-tier properties. Renewed confidence from owner-operators has come on the back of very good seasonal conditions that almost every region has enjoyed since the autumn in 2011 and some of the best financial conditions since the early 2000's.

How much better can things get? All buyers and banks' lending criteria are heavily cash return focused. So expect the direction of land values for all farm types to be heavily governed by expectations of cash returns. Currently meat and fibre rates of return are expected to average around 2-3 percent and dairy 4-6 percent, suggesting land prices are still overvalued. While the top performers in both industries are doing considerably better than this, it is difficult to see how much further upside rates of return will have in 2012-13, with seasonal conditions and pricing looking to have topped out over the last 18 months. Therefore, while there may be some slight further improvement in financial conditions, through interest rates remaining lower for longer, the two big levers – production and prices received – look to have found top gear for now. At the other end of the spectrum, support for prices continues to emerge from "buyers" of the long-term agriculture story. Hence, our view is that pricing will consolidate rather than take off.

Looking at the components of the table on page 15 shows there has been a slow grind higher in farm sales since the middle of 2011. Monthly turnover during this period has increased by 3.6 percent per month. **The median price for all farm sales also moved higher over this period, increasing 4.6 percent per month.** However, it is distorted by a lift in the average price and turnover for finishing land during this period, which has been in high demand for dairy conversions. In total, 352 farms were sold in the three month period ended December 2011. After a lean end to 2010, the continued slow grind higher in the total number of farm sales and values over 2011 is encouraging and reflects the good space farmers are currently operating in.

The median price per hectare at the end of 2011 for dairy properties has crept up to the \$35,000

mark. This is 6 percent higher than the middle of the year and 3 percent up on the same period last year. **Recent sales have been weighted toward the traditional dairying areas of Waikato and Taranaki, where land values are higher.** The December month saw 27 dairy farms sold at an average sale value of \$34,125 per hectare and \$36 per kg MS. The average farm size was 159 hectares and the average production per hectare across all dairy farms sold in December was 961 kgs of MS. The forecast 2011-12 \$6.90-7.00 per kilogram of MS (in total) gives an investment multiple of between 5-5.5, which is in line with historical averages.

Anecdotal evidence suggests confidence in the dairy sector is spilling over into demand for dairy support blocks and land suitable for dairy conversions, especially in the South Island. The turnover of finishing and arable land in the three-month period ended December is just about back to its 10-year average and has tripled on the same period last year. Values have been stable for arable land around the \$19,000-20,000 per hectare mark over recent months. However, the star performer has been finishing land, with values jumping from \$10,000-12,000 per hectare to \$18,000-20,000 per hectare over the spring and early summer period. **Finishing sales have been heavily focused in the South Island with 70 percent of the national turnover in recent months.** Surprisingly, the Otago and Southland regions have accounted for the bulk of this activity despite there being plenty of noise from the local regional councils about new controls and regulation for dairying in the region.

Grazing land also seems to have moved up a notch or two into the \$14,000-\$15,000 per hectare mark. The distribution of sales across different regions has been more even though when compared with finishing properties. Nevertheless, this would seem perhaps the upper bound for this type of land, with projected meat and fibre returns of \$300 per hectare translating into only a 2 percent return, when not including livestock and plant & machinery. This is still well below the cost of borrowing.

Horticultural land values showed a bit of a bounce in the three-month period ended December, back to \$120,000 per hectare.

Green kiwifruit growing through Psa and several new varieties of gold showing resistance to the disease has no doubt helped confidence in the future of the industry. However, turnover of horticultural blocks is still running at only 40 percent of the 10-year average. Land values compared with the spring and early summer period last year are also 40 percent behind, but are better when compared with the 10-year average (-15 percent). We will have to wait and see whether this newfound confidence will continue, but it will probably be governed in the short term by the quality and size of the crops this season.

ECONOMIC INDICATORS

EXCHANGE RATES

	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
NZD/USD	0.80	0.77	0.77	↑	↑
NZD/EUR	0.61	0.58	0.57	↑	↑
NZD/GBP	0.51	0.49	0.49	↑	↑
NZD/AUD	0.77	0.76	0.77	↑	↓
NZD/JPY	62.3	59.9	63.2	↑	↓
NZD/TWI	70.0	68.4	68.7	↑	↑

NZD Buys USD

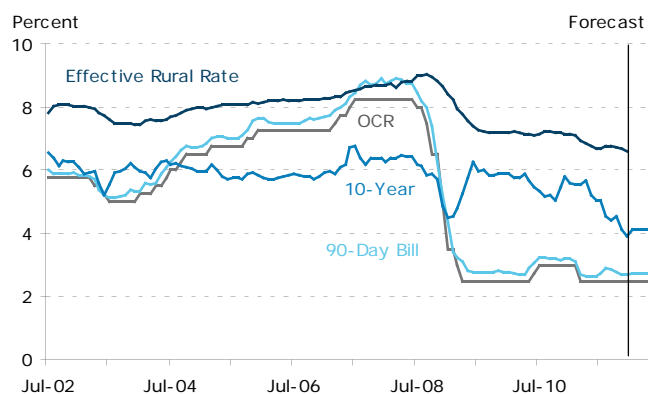


Sources: ANZ, National Bank, Bloomberg

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	2.72	2.69	3.19	↑	↓
1 yr	2.50	2.47	3.46	↑	↓
2 yr	2.55	2.57	3.80	↓	↓
3 yr	2.62	2.72	4.16	↓	↓
5 yr	3.13	3.16	4.77	↓	↓
10 yr	4.10	3.90	5.57	↑	↓
Effective Rural Rate	6.59	6.67	7.13	↓	↓
Agricultural Debt (\$b)	46.62	46.59	46.78	↑	↓

Key NZ Interest Rates



Sources: ANZ, National Bank, RBNZ

The NZD has rebounded over December and January, led by seasonal factors but also improved data out of the Chinese and US economies and expectations for an even longer period of low interest rates in the US.

Looking forward, the NZD remains the two-bit player at the international roulette table. On one side we have the European situation, which we characterise as a slow-moving train wreck. The ECB can alleviate short-term liquidity issues across the banking system, but the fundamental problems of excessive leverage, Government insolvency and macro inflexibility require a different policy prescription. So headwinds for the Euro (which the NZD has been correlated with) are substantial. This leads us to the other side and the USD. Data in the US has been better but the Fed's decision to flag interest rates remaining at pretty well zero until 2014 has upped the ante on the USD remaining a carry trade funding currency and has seen risk appetites pick up.

The euro and USD jockeying – which we are seeing via risk on and risk off – is really reflective of the battle between the fundamentals, which are poor globally, and massive liquidity being pumped into the system, which is positive for risk. One commentator summed it up nicely a few weeks ago: "I'm terrified I'm not long enough.... and terrified I'm too long if the apocalypse is coming in Europe". Our core house view sides more with the liquidity argument, which is NZD (and commodity) supportive, though we have a lot of sympathy for the fundamentalist view. A repeat of the NZD's oscillations in 2011 would not surprise.

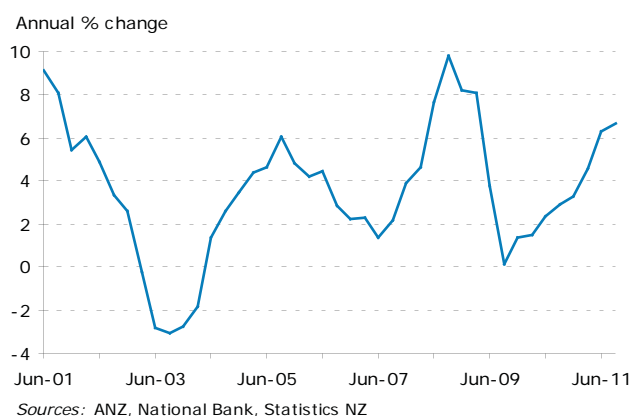
A slowing in economic activity and weaker than expected inflation data have diminished the possibility of an OCR hike in the near term, with the OCR set to remain on hold for longer. Nevertheless, barring global meltdown, the next move in the OCR will be up. The long end, by contrast, tends to be driven by investment flows, which are in turn a function of things like real yield, monetary and fiscal credibility, the need for diversification, and currency views. At the moment, New Zealand rates fairly well on these factors when compared with peers. What unites prospects for the short end and the long end is the outlook for Europe – for if things start to get ugly there, we may see OCR cuts here (though the hurdle is high), and an eagerness to invest in NZ bonds, driving long-term interest rates lower. Flattening the interest rate curve further and making fixing look even more attractive.

ECONOMIC INDICATORS

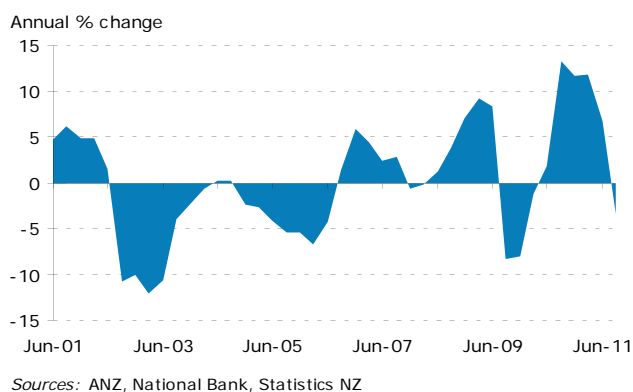
INFLATION GAUGES

Annual % change	Current Qtr	Last Qtr	Last Year	Chg. Q/Q	Chg. Y/Y
Consumer Price Index	1.8	4.6	4.0	↓	↓
Farm Input	6.7	6.3	2.9	↑	↑
Net Imp. Margins PPI	-3.3	6.8	13.3	↓	↓

Farm Input Inflation Gauge



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



The next reading of farm input inflation is due in February but is expected to moderate in line with headline inflation. Headline inflation fell 0.3 percent in the fourth quarter of 2011, which saw annual inflation fall to 1.8 percent y/y.

This was well below market and RBNZ expectations. The considerable drop from the last quarter's read of 4.6 percent y/y was a combination of the changes in the GST rate dropping out and weaker food, communication and household contents pricing.

There was clear evidence of the soft retail environment weighing on prices. Prices fell for furniture, kitchenware and appliances, which pushed down prices in the household contents grouping. Even prices for apparel and recreational and cultural equipment bucked the usual seasonal pattern and fell.

Cost pressures were generally restrained. There were several categories that will flow through to on-farm costs. Insurance costs increased at a more modest 0.7 percent q/q, following a 2.4 percent increase in the previous quarter. However, annual insurance costs are still running 4.5 percent y/y and are likely to have more upside after the Christchurch earthquakes and other recent natural disasters (Nelson flooding). Petrol was on the move up again (+0.9 percent q/q) courtesy of political tensions in the Middle East and a weaker NZD. Construction costs posted a 0.4 percent q/q increase and will rise further when the Christchurch rebuild takes hold. Electricity costs managed their second quarterly fall in a row (-0.5 percent q/q), to an annual rate of 2.4 percent y/y. This is now well below the annual rate experienced over the last 10 years, which should help irrigators.

The chart to the left measures the difference between the annual percentage change in prices received for rural outputs, and the annual percent change in costs of production (excluding labour costs and interest charges).

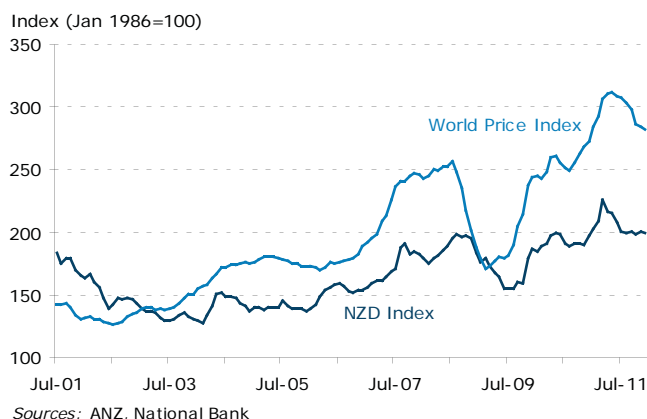
The softening in commodity prices since the first quarter of 2011 and the high NZD have seen the first decline in annual net margins since March 2010. The quarterly decline was largely on the output side, with dairy and forestry the weakest during this period. Dairy output prices were down 12.3 percent q/q and inputs were up 0.9 percent. Overall, the implied net margins for dairy declined 13.1 percent for the quarter. Forestry and logging output prices were down 7.4 percent q/q and inputs were up 0.6 percent. Overall, the implied net margins for forestry declined 8.0 percent. Net margins for horticulture and meat and fibre also decreased by 1-2 percent. Fishing and aquaculture was the only industry that experienced an increase in implied net margins of 3.8 percent on last quarter.

KEY COMMODITIES: OVERALL INDEX AND DAIRY

ANZ COMMODITY INDEX

	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
NZ Index	200	201	197	↓	↑
World Index	282	284	273	↓	↑

ANZ Commodity Price Index



The ANZ Commodity Price Index has continued its slow decline since May this year. The latest decrease of 0.8 percent in the month of December was the second smallest fall since May. Since the peak in the series the overall level of in-market prices has retreated 10 percent and 11.5 percent at the farm-gate. This has taken the series from extraordinarily elevated to extremely elevated.

Dairy markets have stabilised since October with oscillating moves around current price levels for the key dairy products. Pricing has remained remarkably resilient in the face of very strong seasonal milk production from most Southern Hemisphere producers. New Zealand production is forecast to finish the season up 7 percent, twice the average growth rate seen over the past 10 years. Australian production has picked up as the season has progressed (+3 percent). Prospects for the remainder of the season look very good with ample water storage for irrigation in Victoria (65% of total Australian milk production). Argentina (+14%), Brazil (+3%), Chile (+6.5%) and Uruguay (+19.5%) are also showing strong output this season so far.

The seasonal buying from China this season has not been as prominent as the last three years, but other markets such as ASEAN economies and South America seem to have picked up the slack. China's domestic milk production is forecast to grow by 4.7 percent in 2012, but remains 9 percent below its 2007 peak. The continued strengthening of food safety standards, production shifting from quantity to quality, solid economic growth, reduced trade barriers and moderating food inflation is expected to continue to be import growth friendly.

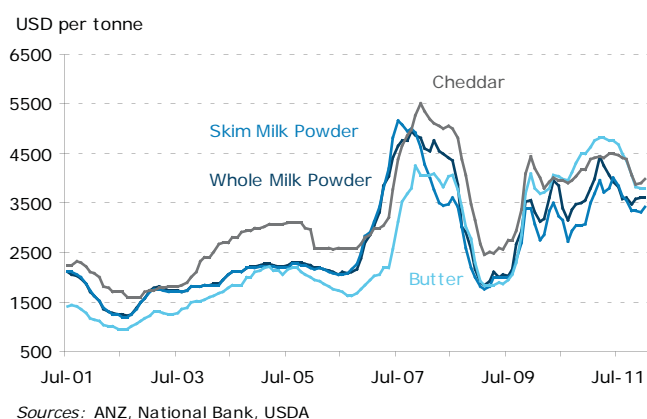
Russia's (the largest importer of fat based products) cheese and butter imports requirements are forecast to moderate in 2012 as domestic production stabilises. Cow numbers are stable after an 11 percent drop in 2010 as cows were culled following a widespread drought. The offset is that per cow production will lift slightly due to the use of more grain feeding, especially wheat, which is forecast to be more plentiful and cheaper in 2012.

On balance we still hold a weakening bias for fat based products but modest Chinese and US data could continue to see prices oscillate around current levels for powders. Most processors in New Zealand are reported as well forward sold so a reduction in product offered through the GlobalDairyTrade over and above normal seasonal variations could also be price supportive. Another key indicator to watch over the coming months will be new season dairy exports from Europe. Year-to-date EU exports are up 5.7 percent, with increased exports to Algeria and China.

OCEANIA DAIRY PRICE INDICATORS

USD per tonne	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
Whole Milk Powder	3,600	3,600	3,800	↔	↓
Skim Milk Powder	3,415	3,325	3,500	↑	↓
Butter	3,800	3,800	4,625	↔	↓
Cheddar	3,988	3,906	4,375	↑	↓
World Basket	3,701	3,658	4,075	↑	↓

Dairy Products - Oceania Export Market Prices



KEY COMMODITIES: BEEF AND LAMB

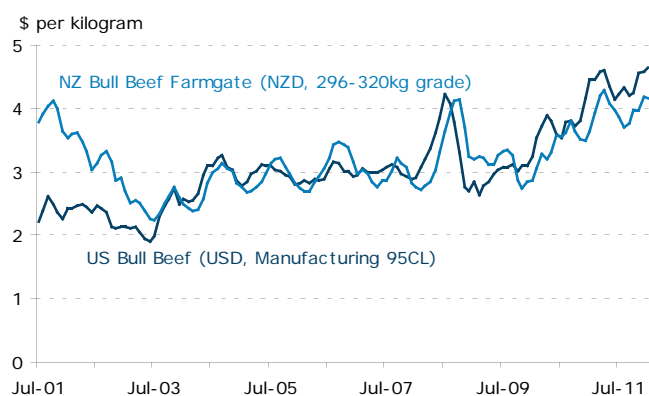
BEEF PRICE INDICATORS

\$ per kg	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
US Bull Beef ¹	4.65	4.58	4.45	↑	↑
NZ Bull Beef ²	4.17	4.19	3.65	↓	↑
NZ Steer ²	4.14	4.19	3.79	↓	↑
NZ Heifer ²	4.22	4.27	3.73	↓	↑

¹ USD, Manufacturing 95CL

² NZD, 296-320kg Grade Bull & Steer, NZD, 195-220kg Grade Heifer

Beef Indicator Prices



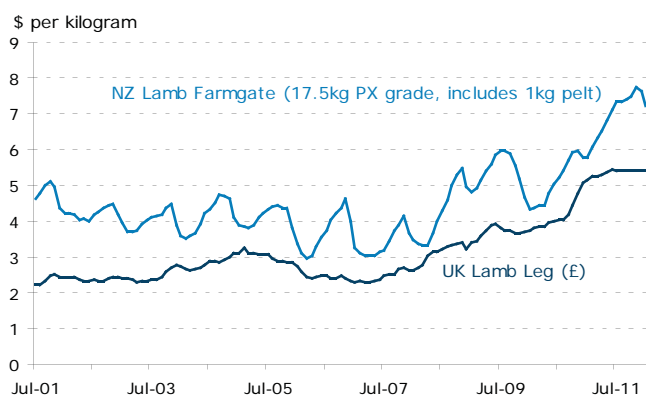
Sources: ANZ, National Bank, Agrifax

LAMB PRICE INDICATORS

\$ per kg	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
NZ Lamb ¹ (NZD)	7.22	7.65	5.76	↓	↑
UK Lamb Leg (£)	5.42	5.42	5.15	↓	↑

¹ 17.5kg PX grade, including 1kg pelt

Lamb Indicator Prices



Sources: ANZ, National Bank, Agrifax

The US beef market continues to push toward new highs, while renewed competition from the US has pushed down returns for prime cuts in Korea and Japan. There is reportedly good retail demand for ground beef in the US. Strong promotional activity for the Super Bowl in early February has been supportive for fresh domestic beef, which has a positive flow-on effect for frozen imported beef. Limited supplies from New Zealand (especially the North Island) also appear to be contributing to stronger frozen prices. However, US imports from Australia have risen sharply in the first couple of weeks of the New Year to help fill the import gap. There should be more upside to pricing in the first part of the year before the cull cow slaughter from New Zealand accelerates in the May-June period. The slaughter pattern for cull dairy cows is likely to be very condensed this year because of the good seasonal conditions. The prime beef market is in a comparatively poorer state, with Japan and South Korea not offering the returns hoped for. The flood of cheap prime US beef into these markets, aided by a favourable exchange rate and better market access, will continue to pose problems. Better US market access is coming via a FTA with Korea and the rumour is that the US will once again be able to export cattle that are up to 30 months of age to Japan.

Finally, it is important to keep in mind the global beef supply picture. **Key world beef exporters Brazil, Australia, Argentina, and Canada are in herd rebuilding mode.** While this will lead to higher beef supplies in 2013 to 2016, the coming year will likely continue to see limited global beef supply availability.

A grass market has been operating for lamb over December and January, but NZ meat processors have started to steadily pull farm-gate prices back to match in-market fundamentals. Easter falls relatively early this year and orders have to be filled by mid-February, two weeks earlier than in 2011. Until then processors will continue to pay good procurement premiums to ensure good stock flow and maximum returns from the lucrative Easter trade. In order to guarantee supply some processors had earlier offered fixed contracts in December at \$7.30 per kg. Most wholesalers and importers in Europe still have higher stock levels than they would like so are in no hurry to place new orders beyond Easter. Prices for frozen lamb legs are reported to be steadily easing each week and there is a general expectation they have further to go.

The question remains: how far schedules will pull back after the Easter trade is finished? Lamb production in NZ is forecast to increase 7 percent on last year but is currently running 6 percent behind last year. The average price decline from December to April over the last 5 years has been 10 percent. As the forecast extra lambs come forward it is anticipated lamb prices will dip toward \$6.50 per kg and the winter trade won't be as strong as last season. Heavier carcass weights will provide some offset for per head returns.

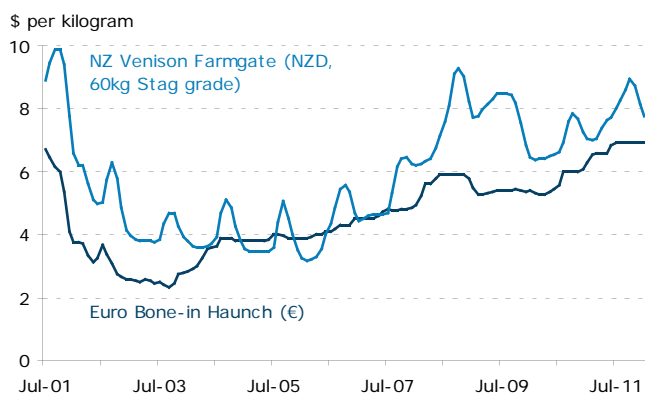
KEY COMMODITIES: VENISON AND WOOL

VENISON PRICE INDICATORS

\$ per kg	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
NZ Venison ¹	7.75	8.14	7.06	↓	↑
Euro Bone-in Haunch (€)	6.90	6.90	6.30	↔	↑

¹ 60kg Stag AP grade

Venison Indicator Prices



Sources: ANZ, National Bank, Agrifax

The farm-gate price for venison has reached its seasonal lull in an orderly fashion. This is despite a deterioration in its main markets in Europe since game season contracts finished in October. The recent strengthening in the NZDEUR is also providing another headwind. The average schedule price of \$7.75 per kg is the highest farm-gate price on record for January in the last 10 years, just beating January 2009. Expectations are that prices will drop another \$0.30-0.50 per kg before lifting again into October. The restaurant trade for middle cuts in Germany and other markets is struggling from both softer restaurant activity and its price competitiveness with other proteins and menu items. However, there is reportedly good demand and prices for legs and forequarter cuts from importers.

The velvet market remains stable with some small price improvement coming through from recent sales. The demand for mixes of both Korean (e.g. Super A, A, B) and China (C, D, RG, HV, Spiker etc) grades is strong. The mixing of the two is also prompting sales. Price indications for A grades are \$90-110 per kg and B/C grades is \$85-100 per kg.

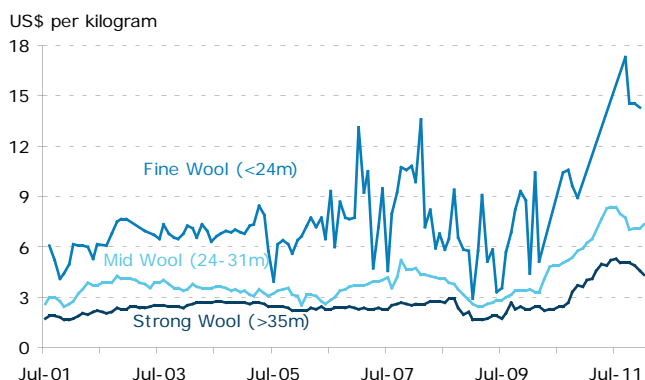
Wool prices continue to adjust lower as demand dries up in Europe and a higher NZD clips farm-gate returns. The wool market is being hit hard by developments in Europe. **Exports for the year-to-date to Europe have dropped 17 percent on the same period last year to 12,800 clean tonnes. The biggest drop has been in UK exports, back 30 percent on last year to 4,100 clean tonnes.** Germany has picked up some of the slack with export volumes increasing 4.8 percent. However, most other countries that import smaller amounts have dropped by up to 50 percent. China has picked up the slack, increasing its imports by 20 percent on the same period last year to 20,500 clean tonnes. **China has taken 50 percent of total New Zealand exports for the year-to-date, up from 37 percent last year.** Demand from China has reportedly slowed recently as it has become more difficult to market finished woollen products to Europe. With the US and Chinese data looking a little better this should add some support to prices in a low supply environment.

In-market prices have dropped by 5.2 percent for strong wool and 8.8 percent at the farm-gate. The finer end of the clip has been more stable with mid micron trading around \$8-10 per kg at the farm-gate and fine micron \$18-20 per kg. For the stronger end of the clip, supply has reportedly been better than expected with good seasonal conditions lifting fleece weights. However, the warmer, wet conditions have impaired the colour of the clip with a colour count of 6-7 quite common. This has also been a factor in the softer strong wool prices.

CLEAN WOOL INDICATOR PRICES

\$ per kg	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
NZ Fine Wool (>24m)	NA	18.55	NA	NA	NA
NZ Mid Wool (24-31m)	9.21	9.27	8.13	↓	↑
NZ Strong Wool (>32m)	7.37	7.14	6.22	↑	↑
USD Fine Wool (>24m)	4.33	4.57	4.04	NA	NA
USD Mid Wool (24-31m)	7.37	7.14	6.22	↑	↑
USD Strong Wool (>32m)	4.33	4.57	4.04	↓	↑

Wool Indicator Prices (Clean)



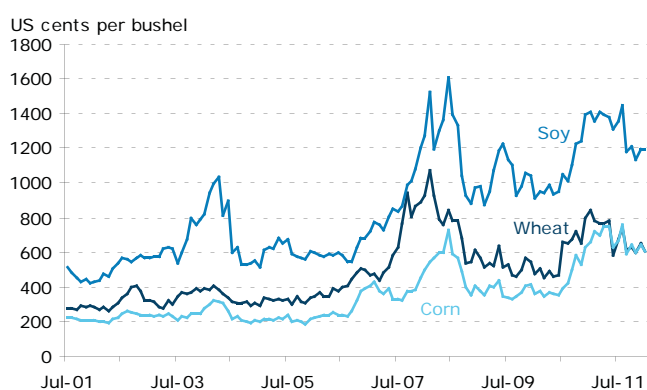
Sources: ANZ, National Bank, Beef + Lamb NZ, Wool Services

KEY COMMODITIES: GRAIN AND FERTILISER

GRAIN & OILSEED PRICE INDICATORS					
USD cents per bushel	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
Wheat	6.1	6.5	8.4	↓	↓
Soy	12.0	12.0	14.1	↓	↓
Corn	6.1	6.5	6.6	↓	↓
Australian Hard Wheat ¹	263	259	369	↑	↓

¹ NZD per tonne

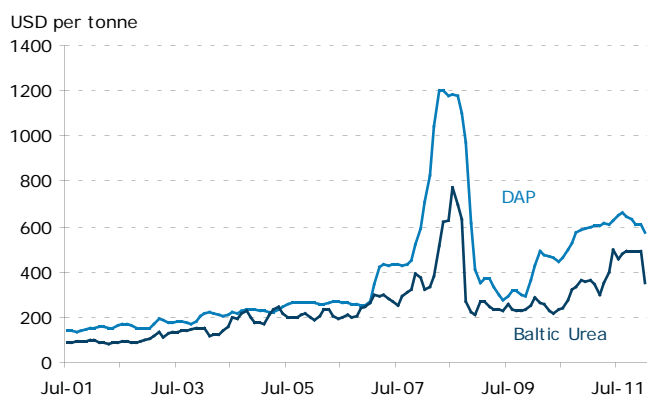
CBOT Future Grain & Oilseed Indicator Prices



Sources: ANZ, National Bank, Bloomberg

FERTILISER PRICE INDICATORS					
USD per tonne	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
DAP	635	643	588	↓	↑
Urea	490	490	366	↔	↑

Fertiliser Indicator Prices



Sources: ANZ, National Bank, Bloomberg

Markets have reacted negatively to the latest USDA report on grain stocks. Most were expecting December corn and residual stocks to be 9.4 billion bushels while the USDA reported stocks at 9.6 billion bushels. **The higher than expected stocks implied smaller feed use, since ethanol production has been particularly strong.** Most analysts estimate that feed corn and residual use for the September to November quarter was down 9 percent compared to last year, a considerable number given higher numbers of hogs and cattle on feed. It seems a larger supply of distiller's grain going to domestic supply rather than exports has been used in feed mixtures. US wheat is also more plentiful, with winter wheat plantings 12.4 percent higher than 2 years ago. The increase in US domestic wheat, combined with higher wheat supply in other markets, is expected to further pressure pricing toward long-term averages. The one offset to the US data has been unusual dryness across Argentina and Southern Brazil. The driest Brazilian states of Parana and Rio Grande do Sul account for 35 percent of Brazil's corn crop and 32 percent of soybean production. Argentina and Brazil are the second and third largest exporters of corn behind the US. While there has been recent rain, it looks a little too light in most areas and too late for the corn crop, but soybeans can still benefit.

Here in NZ domestic demand for feed grain is slow with only hand to mouth purchases from most buyers. Most large users seem to have their short-term requirements covered and are waiting to see where the market settles on price. There are good supplies of excellent quality new crop feed barley available, which could indicate a drop in the market as growers look to sell surplus tonnage for cash flow and storage space. The dryness in Southland and Otago held up South Island grain and palm kernel prices until recent rain. If more rain does not follow grain prices will be supported.

The underlying softer tone in commodity markets and continued gloomy tone for global growth has dragged fertiliser prices down. **Global benchmarks for nitrogen and phosphate have fallen significantly.** In most regions buying activity has been constrained by inventories being sufficient to cover short-term needs. Any run-down in inventories now could potentially see prices spike up as Northern Hemisphere planting gets underway in their spring. Another possible upside factor is the continued unrest in the Middle East which could disrupt supply. China has also imposed taxes of 110 percent on exports of phosphates and urea to keep a lid on domestic prices. However, phosphate supplies from Russia, Saudi Arabia and Russia seem to be sufficient and new urea manufacturing capacity is expected to soon come on line in Algeria and Qatar.

KEY COMMODITIES: HORTICULTURE

HORTICULTURE PRICE INDICATORS

	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
Kiwifruit (USD per kg)	2.5	2.5	2.1	↔	↑
Apples (Weighted Index)	180	180	172	↔	↑
Wine (USD per litre)	5.5	5.5	5.1	↑	↑

Kiwifruit Indicator Price



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

Apple Indicator Price Index



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

Wine Indicator Price



Sources: ANZ, National Bank, NZ Winegrowers.

It has been reported that seasonal conditions for pipfruit in the Hawke's Bay have been ideal. Hawke's Bay makes up approximately 60 percent of the national crop. **Recent rain has come at the right time to enhance the quality and size of fruit.** The recent rain has also reduced irrigation needs for this time of the season, helping the cost side of the ledger. The spring weather in the first 30 to 50 days after bloom was also very favourable which should support a good fruit population.

In the kiwifruit industry the focus remains on the effect of Psa-V on the 2012 crop. 2011 produced a record crop for the industry. **On the back of this the 2012 season is expected to produce a smaller crop for two reasons – seasonal variability and the impact of Psa-V.** Psa-V will have a material impact on the Gold volume, but it is too early to say exactly what that impact will be. A crop estimate will be made in February which will give some more certain numbers. Green volumes will be back to more normal levels compared to previous years, after last year's record crop.

The impact on revenue will not be the same as the impact on volume. This is due to several factors, including being able to optimise market mix and a shorter selling season, which means less fruit loss. **Based on this, Zespri expects revenue could be down by around 10 percent in 2012 compared to 2011.**

Just prior to Christmas there were 927 orchards with Psa-V. This is just under 30 percent of New Zealand's total number of orchards. **It is important to note that these orchards have varying levels of infection, from mild symptoms to being forced to cut out vines.** Zespri are currently working through a process to establish how many hectares have been cut out.

There are now over 80 research programmes underway, and in a parallel process over 300 different products being tested for efficacy against Psa. It is widely accepted that there will not be a "silver-bullet" cure for Psa; rather the industry will learn to manage in a Psa-environment through a combination of more resistant cultivars, new orchard management practices and new tools/products.

Based on both lab work and on-orchard observations it is clear there are differing levels of tolerance to Psa between different cultivars. The original ZESPRI Gold variety (Hort 16A) is at the less tolerant end of the spectrum, while the Green variety is more tolerant. Zespri's new varieties that were commercialised in 2010 (Gold varieties G3 and G9 and Green variety G14) sit between Hort 16A and Green on the scale of tolerance.

KEY COMMODITIES: OIL AND FREIGHT

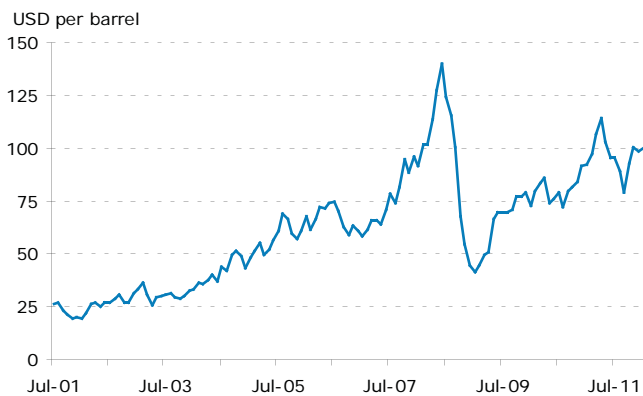
OTHER COST INDICATORS

	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
Crude Oil ¹	100	99	92	↑	↑
Ocean Freight ²	926	1,738	1,107	↓	↓

¹ USD per barrel, grade WTI

² Baltic Dry Index

Crude Oil Indicator Price (WTI)



Sources: ANZ, National Bank, Bloomberg

Ocean Freight (Baltic Dry Index)



Sources: ANZ, National Bank, Bloomberg

Political tensions between Iran and the West over its nuclear programme are driving the oil market higher. Europe has recently announced plans to formally adopt oil embargos and the US plans to further increase their sanctions. Arm-twisting from the US has also put Iran in a difficult position with China and Japan. **And according to reports, China, Iran's biggest trade partner, has cut its purchases of Iranian oil by more than half in January.**

US crude output is forecast to increase by 20 percent over the next decade to 6.7m bbls/day in 2020 due to a boom in shale oil production, according to the US Energy Information Administration (EIA). Shale oil production will account for 31 percent of output in the lower 48 states by 2035, up from 21 percent in 2010. The country will also become a net exporter of LNG in 2016. This puts pressures on oil and LNG prices, with energy companies now cutting production and slowing drilling. Chesapeake Energy, the No.2 US gas producer, announced an immediate production cut of 8 percent and will drop the number of rigs drilling at dry gas fields to about 24 by Q2 from 47 currently. Talisman Energy, Canada's fifth-largest oil explorer, said it has moved rigs away from the gas-rich Marcellus shale deposit in favour of other energy sources.

The Baltic Freight Index has fallen to a 3-year low and the overall index is down 50 percent for the month of January to 840 points at its latest reading. However, this is unlikely to give accurate signals about world economic conditions. Chinese New Year is very early this year (the earliest since 2004) and the freight index will not truly reflect the underlying demand until the first week of February at the earliest. In addition, Valemax ships have just started shipping recently. To put some context around what this means: these ships are 365m long and double the capacity of the Capesize carrier (the next largest bulk carrier). The good news is this will make freight costs cheaper for our major export industries.

BORROWING STRATEGY

SUMMARY

Carded rural fixed interest rates are little changed relative to where they were when we published our last edition of the Agri Focus. Fixed rates out to 3 years remain at or below the floating rate, which makes fixing reasonably attractive. With the RBNZ unlikely to cut the OCR again, the temptation to fix is very high, particularly for 2 years, where the rate is well below floating, and only a little higher than the cheapest rate. We broadly favour such a strategy, but would caution against fixing the whole lot for that period, as this heightens rollover risk.

OUR VIEW

Rural lending rates have held fairly constant over the past two months, offering borrowers similar choices to those available when we published our last edition of the Agri Focus. Back then, we noted that we favoured the 6 month fixed rate. This was largely on the basis that it was the cheapest rate at the time, and we felt interest rates would still be fairly low at the end of 6 months such that borrowers would still be able to roll over debt at low rates. **Broadly speaking, we remain of that view. However, with the passage of time, we are mindful that it may pay to extend the duration of hedges a little further.** This is because there is very little difference between, say, the 6 month rate (currently 6.6 percent) and the 2 year rate (currently 6.75 percent). For those who value certainty, such a small difference is unlikely to be a deterrent to extending the term of a fixed rate.

Of course, certainty is not the only consideration. We must also consider the flipside – flexibility. For one, we need to be confident that interest rates are unlikely to fall. At this juncture we are comfortable saying the hurdle to a rate cut is very high. While there is no guarantee they won't, particularly if things get really nasty overseas (think the European debt crisis, Greece and the euro, etc), this is not our core view, and in fact, we must admit that we have been pleasantly surprised at how constructively markets have handled major surprises recently, like news that Standard & Poor's had downgraded 9 European sovereigns.

Indeed, one could be forgiven for expecting the market to react badly, but it took it in its stride. **The point is; markets are expecting the worst already, so things have to get really ugly first if full blown panic is to set in, and for one to reasonably expect interest rates to fall.** We are also mindful of local considerations, and ironically, the very fact that fixed mortgage rates have fallen without the OCR coming down takes the heat off the RBNZ to cut the OCR. What's more, households continue to benefit en masse as historic fixed rate mortgage roll off and reset at new, lower rates.

We also need to be confident that if we do fix, we won't find ourselves having to roll over an expired fixed loan after interest rates have risen. And this is where flexibility is important. **If we knew when interest rates would eventually rise, we would simply fix for 6 months, and keep rolling over until just before rates rose,** at which time we'd fix for a longer term. **The problem is we don't know when it will be.** But as we do not see the economy being in recession forever, we do expect interest rates to eventually rise, and potentially to be much higher in 2 years. **So while choosing to fix for 2 years may be cheap now, the rate you roll into in 2 years could be much higher. Had it not been for this consideration, we'd have a clear preference for 2 years, but instead, we favour a blended strategy, as we discuss in the next paragraph.** Of course, you could choose to fix for longer, like 3 or 4 years. But those rates are higher still, and as our breakeven tables show, you'd need to see a fairly large rise in rates over the next 2 years for it to be worthwhile.

Another strategy would be to fix for a shorter term (like 6 months) now, with a view to fixing when that term expires. Not only is this cheaper in the interim, but so long as the rates in 6 months are lower than they are in the relevant column of the breakeven table, you'll be better off overall. And with the RBNZ likely to be on hold for the remainder of the year, we do not expect breakeven rates to be exceeded. But there is no guarantee that will be the case.

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%	6.60%	6.83%	7.38%	7.88%
1 year	6.60%	6.71%	6.90%	7.50%	8.00%
2 years	6.75%	6.94%	7.20%	7.75%	8.50%
3 years	7.00%	7.21%	7.47%	8.17%	
4 years	7.25%	7.53%	7.85%		
5 years	7.60%				

Given the level of interest rates, the extreme level of uncertainty in global markets, and our expectation that rates will remain low for a while yet before eventually rising, our preference is to spread borrowings over 6 months, 1 year and 2 years (and possibly 3 years for those who want more certainty). Such a mixture will deliver a cost of funds below the floating rate, and offers a good mix of flexibility and certainty.

EDUCATION CORNER: GLOBAL MILK SUPPLY

SUMMARY

In this month's edition of *Education Corner* we take a look at different countries' milk supply. We look at who the main players are, who is on the move, and how competitive they are. The upshot is that while New Zealand will continue to be a key player in international dairy markets, other competitors will also respond to the surge in demand emanating from countries around the equator. Consequently, New Zealand needs to ensure it maintains its cost competitiveness, seeks out new innovations that add value to our raw milk, and plays to our differentiating strengths, including brand and food safety.

One thing in life is certain, be it in sport, business or something else: you can never stand still, otherwise someone will pick you off. It is human nature and where there is a dollar to be made someone will be looking at how they can get their cut. While New Zealand's dairy sector is world class and the surge in demand from emerging economies with big populations has led to higher returns, competing producers are also eyeing up the prizes on offer. We therefore thought it would be relevant to look at the supply side of global milk, who the main players are, who is on the move, and how competitive they are. As they say; better the devil you know than the devil you don't.

From the rollercoaster ride that started for international dairy product prices back in late 2006, every time prices have gone up there has been a rapid supply response that has smoothed things out. The recent price cycle was a surge in prices in early 2011 as import demand outpaced available supplies and there were fears around Oceania supply. The result was an expansion in milk supply from all major producing countries, significantly increasing the supply of available exportable dairy products. Only about 6 percent of global milk production is traded. Consequently, in the middle six months of 2011 prices slipped 15 percent on average before stabilising over the last several months.

WORLD MILK PRODUCTION BY SPECIES OF ANIMAL (000 TONNES)					
Type of milk	2009	2010	2011p	Growth 10-11	CAGR 00-11
Cow	591,548	601,290	616,322	2.5%	2.1%
Buffalo	90,064	92,885	95,672	3.0%	3.3%
Goat	15,853	15,888	16,285	2.5%	2.2%
Sheep	9,234	9,272	9,318	0.5%	1.3%
Other	1,840	1,840	1,849	0.5%	2.2%
Total	708,539	721,175	739,447	2.5%	2.2%

Sources: ANZ, National Bank, IDFN

Total global milk supply is dominated by cow's milk, which makes up 83 percent of total milk production. Buffalo milk is second with a 13 percentage share. Buffalo milk has had the highest compound growth of all milk sources over the last 10 years at 3.3 percent, followed by goat's and cow's milk at 2.2 and 2.1 percent respectively. Buffalo milk is produced in only a few countries with India and Pakistan comprising 90 percent of total global supply.

TOP 20 COUNTRIES FOR DAIRY COW'S				
Rank	Country	Number of dairy cows (000)	Annual compound growth last 10 years	% share of total dairy cows globally
1	India	38,928	1.7%	15.3%
2	Brazil	22,999	2.5%	9.0%
3	Sudan	14,400	4.5%	5.6%
4	China	12,607	9.2%	4.9%
5	Pakistan	10,100	4.0%	4.0%
6	Kenya	9,350	7.1%	3.7%
7	USA	9,117	-0.1%	3.6%
8	Russia	8,800	-3.9%	3.5%
9	Tanzania	6,800	7.2%	2.7%
10	Ethiopia	6,500	4.1%	2.6%
11	Colombia	5,301	-0.8%	2.1%
12	New Zealand	4,680	3.0%	1.8%
13	Turkey	4,213	-2.2%	1.7%
14	Germany	4,182	-0.9%	1.6%
15	Iran	4,100	1.2%	1.6%
16	France	3,729	-1.1%	1.5%
17	Uzbekistan	3,536	4.4%	1.4%
18	Ukraine	2,772	-6.1%	1.1%
19	Poland	2,529	-1.8%	1.0%
20	Mexico	2,395	1.4%	0.9%
	Total	254,898	1.5%	69.5%¹

¹ Top 20 countries share of total cows milk globally

Sources: ANZ, National Bank, IDFN

In terms of number of cows milked the top 5 countries are India, Brazil, Sudan, China and Pakistan. New Zealand comes in twelfth for the number of dairy cows and fourteenth in the growth stakes over the last 10 years. The other high growth countries for herd expansion over the last 10 years are predominantly in Asia and Africa. The 10 year growth rate in China's dairy herd of 9.2 percent per annum is second, behind Turkmenistan. This is despite a decrease in cow numbers from food safety issues in 2008.

EDUCATION CORNER: GLOBAL MILK SUPPLY

Of course the number of cows in milk does not translate into who is the largest and most competitive producer. The yield of milk per cow and also the protein and fat content of the milk matter from a supply perspective. These vary substantially across geography, type of dairy farm (feed versus pasture) and the time of season. The three highest producing herds around the globe are Saudi Arabia, Israel and the US. Saudi Arabia is producing close to 15,000 litres of milk per cow per annum, or six times the global average. Israel and the US are second and third with 10,800 and 9,300 litres per cow per annum respectively. New Zealand ranks a distant 44th.

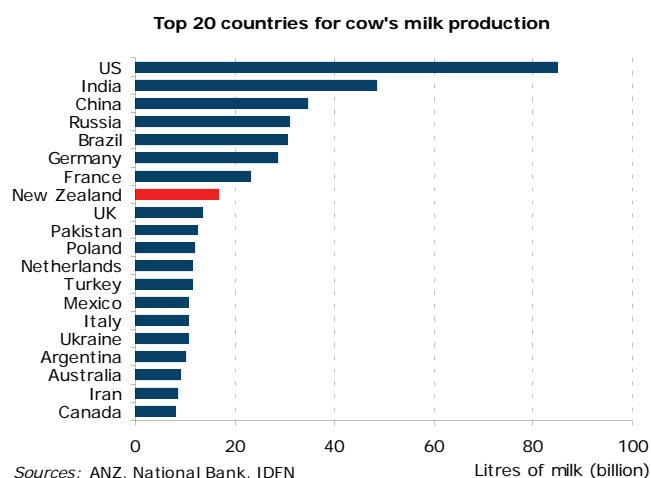
TOP 20 COUNTRIES FOR MILK PRODUCTION PER COW			
Rank	Country	Litres of milk per cow	Annual compound growth last 10 years
1	Saudi Arabia	14,476	5.8%
2	Israel	10,804	0.9%
3	USA	9,314	1.5%
4	Denmark	8,413	1.7%
5	Korea	8,351	-0.3%
6	Canada	8,347	1.9%
7	Sweden	8,088	0.6%
8	Finland	7,896	1.5%
9	Netherlands	7,839	0.9%
10	Japan	7,776	0.8%
11	UK	7,325	2.0%
12	Spain	7,238	3.7%
13	Luxembourg	6,986	1.8%
14	Portugal	6,902	2.5%
15	Czech Republic	6,891	3.7%
16	Germany	6,874	1.3%
17	Estonia	6,837	4.0%
18	Hungary	6,737	2.1%
19	Cyprus	6,669	1.2%
20	Switzerland	6,657	1.7%
	World	2,290	0.5%

Sources: ANZ, National Bank, IDFN

The farm systems employed by the top 20 countries for milk yields tend to be indoor/feed based systems. Over the last six years the countries that have been exposed to international prices at their farm-gate have tended to be able to quickly respond because they operate a feed-based system. In many cases the marginal price signal to produce more has been very strong as prices have risen, despite feed prices also being high. This compares quite differently with the pasture-based system in New Zealand, where good seasonal conditions are required to ramp-up per cow production quickly.

However, this is changing in certain regions of New Zealand as farmers have started to adopt mixed models to better manage seasonal conditions and respond more quickly to higher prices. In terms of milk production per cow New Zealand ranks forty fourth at 3,556 litres per cow, with yields flat-lining over the last 10 years, albeit with a few ups and downs during this period depending on seasonal conditions. But importantly, as we will discuss, yield per cow is not the best predictor of the cost of production per litre.

The fastest-growing countries for yield of milk per cow over the last 10 years have mainly been smaller players with yields that are on par to below the global average. Of note are China and Russia who are in the top 20 countries for milk yield growth over the last 10 years. China and Russia are the third and fourth largest milk producers globally but are also the largest importers of dairy products. Russia is the world's largest importer of butter/butteroil and cheese. China is the world largest importer of whole-milk powder. China's milk per cow growth has been 5.8 percent per annum and Russia's has been 4.0 percent per annum.



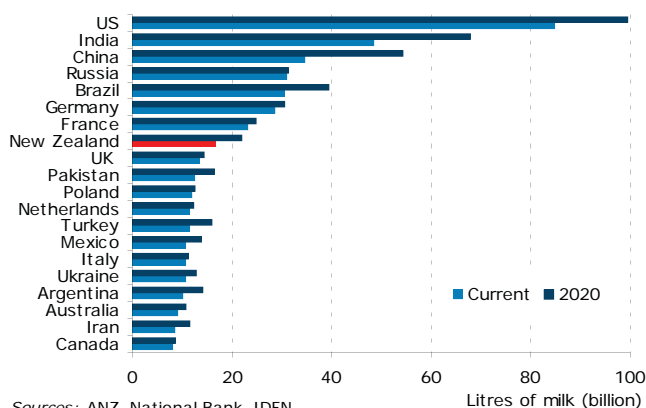
Putting the number of cows and yields together the top five producers of cows milk are the US, India, China, Russia and Brazil. Together these countries produce 40 percent of global supply. But they also account for 47 percent of the global population. New Zealand comes in at eighth, or 3 percent of global supply.

The fastest-growing country for total milk supply over the last 10 years is China at 15.6 percent per annum. However, as the focus moves from milk quantity to quality, annual growth is forecast to slow toward 5 percent per annum. This is not enough to keep up with domestic demand, which is forecast to double over the next

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5 years. Other high growth countries are Ecuador, Saudi Arabia and Kenya, which have averaged 8-10 percent per annum over the last 10 years. If buffalo milk is added to the equation India is a much larger player than the US, producing 109 billion litres of milk per year compared with 85 billion litres in the US. **Buffalo milk makes up 55 percent of India's total supply. Pakistan also leaps up the table under this calculation, replacing Russia at number four.**

Top 20 countries for cow's milk in 2020



Sources: ANZ, National Bank, IDFN, USDA, OECD, FAPRI

Longer-term, most forecasters believe global milk supply will grow around 2.0 percent per annum over the next 8 years. This is slightly above the growth rate of 1.6 percent per annum achieved over the last 10 years.

Consensus forecasts have China and India experiencing some of the fastest growth in milk supply over this period. However, this is not expected to be enough to knock the US off the top spot. Changes in the top 10 have Brazil moving into fourth spot, displacing Russia, and Pakistan and Turkey moving past the UK. Individual consensus forecasts for European countries are not available so the growth rate for Europe has been applied. It is likely once production quotas run out in 2015 there will be significant growth divergences between individual countries within Europe, which would alter these forecasts.

TOP 20 COUNTRIES FOR COW'S MILK				
Country	Milk production (litres million)	Current Ranking	2020 Ranking	% share of global cows milk supply
US	84,914	1	1	14.5%
India	48,544	2	2	8.3%
China	34,715	3	3	5.9%
Russia	30,966	4	5	5.3%
Brazil	30,486	5	4	5.2%
Germany	28,748	6	6	4.9%
France	23,301	7	7	4.0%
New Zealand	16,644	8	8	2.9%
UK	13,529	9	11	2.3%
Pakistan	12,530	10	9	2.1%
Poland	11,921	11	15	2.0%
Netherlands	11,593	12	16	2.0%
Turkey	11,569	13	10	2.0%
Mexico	10,712	14	13	1.8%
Italy	10,684	15	18	1.8%
Ukraine	10,657	16	14	1.8%
Argentina	10,308	17	12	1.8%
Australia	9,102	18	19	1.6%
Iran	8,641	19	17	1.5%
Canada	8,188	20	20	1.4%
Total	583,777			73.3%¹

¹ Top 20 countries share of total cows milk globally

Sources: ANZ, National Bank, IDFN, USDA, OECD, FAO, FAPRI

While most countries produce milk mainly to service their domestic market, there is also an increasing amount of cross border trade. This means New Zealand needs to be cognisant of what is happening to domestic supply in our main export markets but also of what is happening in the supply of milk and dairy products from other exporting nations. For now New Zealand, Europe, US and Australia continue to dominate cross border trade in dairy products accounting for 74 percent of global trade. **However, some of the smaller players such as Belarus (+14 percent) and Argentina (+4.1 percent) have had the fastest growth in exports over the last 10 years.** These countries have now reached critical mass and will become increasingly influential as they eye up some of our main markets in Asia, the Middle East and South America.

EDUCATION CORNER: GLOBAL MILK SUPPLY

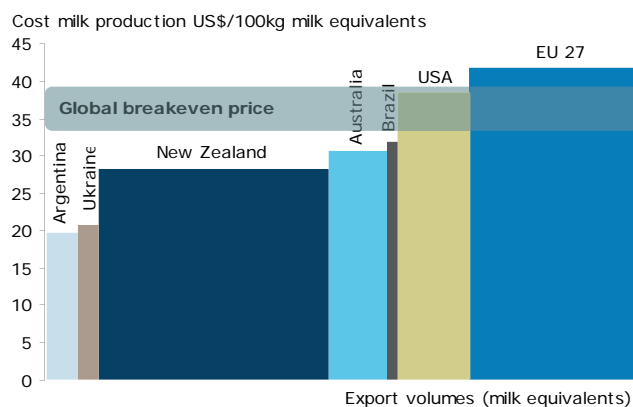
SELECTED COUNTRIES CONTRIBUTIONS TO TRADABLE DAIRY PRODUCTS

	Share of global dairy trade	Annual growth in exports last 10 years
New Zealand	30.8%	5.3%
EU 27	26.1%	-0.5%
Other	10.4%	3.7%
US	9.7%	7.2%
Australia	7.3%	-5.1%
Belarus	4.4%	14.0%
Argentina	3.6%	4.1%
Uruguay	1.9%	9.6%
Ukraine	1.5%	4.3%
Switzerland	1.4%	2.4%
Singapore	1.2%	15.9%
Brazil	0.1%	9.6%

Sources: ANZ National Bank, IDFN

The US and European farm systems have often allowed them to increase production quickly over the last six years to respond to high international prices. However, the price signal at the farm-gate in these countries has been heavily distorted by subsidies and other regulation. As fiscal austerity in these countries kicks-in and subsidies are slowly removed it will be interesting to see how competitive they continue to be. A current comparison of the cost of production for tradable dairy production has New Zealand reasonably well placed compared with Europe and the US. However, others such as Argentina and the Ukraine can produce more cheaply than us. We would also add Uruguay and Belarus to these countries but we do not have the supporting data. This highlights the importance of maintaining our cost competitiveness and continuing to be able to offer something different, be it better food safety, service, branding or different products.

Cost of production for tradable dairy production for selected countries



Sources: OECD-FAO, IFCN, DairyNZ Economics Group

UPSHOT

While New Zealand will continue to be a key player in international dairy markets, other competitors will also respond to any surge in prices and the burgeoning demand coming from a number of countries that border the equator. Some of the smaller players such as Belarus and Argentina have had the fastest growth in dairy exports over the last 10 years and have now reached critical mass. China, New Zealand's largest market, has, and will continue to have, one of the fastest growth rates of any countries for milk supply. With others such as Argentina and Belarus eyeing up the Chinese market, and their domestic production recovering from 2007, there will no doubt be plenty of competition. That means we cannot stand still. New Zealand will need to ensure it maintains its cost competitiveness in this and other markets. With grain prices high, we are well placed on this count against the big boys in the US and Europe. Other veins will also need to be tapped, such as new product innovations to create more value-add from our raw milk, and playing to our differentiating strengths, including brand and food safety.

KEY TABLES AND FORECASTS

FX RATES	ACTUAL			FORECAST (END MONTH)						
	Nov-11	Dec-11	30-Jan	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13
NZD/USD	0.810	0.770	0.824	0.80	0.83	0.86	0.89	0.90	0.90	0.90
NZD/AUD	0.768	0.794	0.774	0.80	0.79	0.78	0.81	0.82	0.82	0.82
NZD/EUR	0.583	0.570	0.624	0.58	0.59	0.61	0.61	0.62	0.62	0.62
NZD/JPY	62.73	57.75	63.20	60.0	59.8	61.9	64.1	63.0	63.0	63.0
NZD/GBP	0.504	0.497	0.524	0.51	0.52	0.53	0.55	0.55	0.55	0.55
NZ\$ TWI	70.3	68.4	72.4	70.3	71.3	72.8	74.8	75.4	75.4	75.4

INTEREST RATES	ACTUAL			FORECAST (END MONTH)						
	Nov-11	Dec-11	30-Jan	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13
NZ OCR	2.50	2.50	2.50	2.50	2.50	2.50	2.75	3.25	3.50	3.75
NZ 90 day bill	2.73	2.75	2.77	2.70	2.80	2.80	3.20	3.70	3.80	4.20
NZ 10-yr bond	4.02	3.81	3.92	4.10	4.10	4.20	4.40	4.40	4.60	4.80
US Fed Funds	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50
US 3-mth	0.53	0.58	0.55	0.35	0.35	0.35	0.35	0.35	0.35	0.60
AU Cash Rate	4.50	4.25	4.25	4.00	4.00	4.00	4.00	4.00	4.00	4.00
AU 3-mth	4.60	4.48	4.36	4.20	4.20	4.20	4.20	4.20	4.20	4.20

ECONOMIC INDICATORS	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13
GDP (% qoq)	0.8	0.6	0.2	0.5	0.7	1.0	0.9	0.7	0.7	0.6
GDP (% yoy)	1.9	2.2	1.7	2.1	2.0	2.4	3.1	3.3	3.3	2.9
CPI (% qoq)	0.4	-0.3	0.6	0.7	0.9	0.4	0.6	0.7	0.9	0.3
CPI (% yoy)	4.6	1.8	1.6	1.4	1.8	2.5	2.7	2.6	2.7	2.7
Employment (% qoq)	0.2	0.2	0.2	0.5	0.4	0.3	0.3	0.3	0.3	0.3
Employment (% yoy)	1.1	1.7	0.7	1.2	1.4	1.4	1.5	1.3	1.2	1.2
Unemployment Rate (% sa)	6.6	6.5	6.5	6.2	6.1	6.1	6.1	6.1	6.1	6.0
Current Account (% GDP)	-4.3	-3.8	-4.2	-4.4	-4.7	-5.0	-5.2	-5.4	-5.7	-5.9
Terms of Trade (% qoq)	-0.6	-0.4	-0.9	-0.9	-0.8	-0.8	-0.8	-0.6	-0.7	-0.7
Terms of Trade (% yoy)	3.4	2.1	0.5	-2.7	-2.9	-3.3	-3.2	-3.0	-3.0	-2.8

Figures in bold are forecasts. Quarter-on-Quarter yoy: Year-on-Year

NEW ZEALAND'S 20 LARGEST EXPORT MARKETS

NZ'S TOP EXPORT MARKETS FOR THE 12 MONTHS ENDED DECEMBER 2011

	Global Total	Australia	China	USA	Japan	Korea	UK	Germany	India	Taiwan	Malaysia	Indonesia	Singapore	Hong Kong	Philippines	Thailand	Saudi Arabia	Nether-lands	Canada	UAE	Venezuela
Sheepmeat	3,011	9	193	303	68	5	584	314		59	51		15	41	1	6	99	174	124	11	
Beef	2,059	19	12	799	186	172	39	23		133	14	102	47	38	40	7	7	38	120	21	
Other Meat	461	30	10	22	43	27	31	69		2	3	16	7	16	2	2	9	32	5		
Milk Powder	6,968	86	1,755	12	23	18			77	182	341	251	233	55	285	270	300	10		347	460
Butter	2,491	96	215	117	32	29			14	74	62	60	51	20	76	51	126	7	26	43	3
Cheese	1,366	261	73	6	322	115	37			38	25	49	9	19	54	17	37	23		19	12
Whey/Casein	1,750	64	205	724	208	47	5	119	4	13	18	28	51	6	25	2	22	2	28		6
Kiwifruit	1,074	64	90	29	301	76		229	3	75	12	8	9	29	1	6		1	2	4	
Apples	371			43			46	51	16	26	10	5	9	25	21			53	6	11	
Other Fruit/Vege	652	311	3	35	156	22	3	4	1	15	13	2	9	6	1	13		3	2		
Wine	1,135	356	23	235	11	2	294	7		2	1	2	1	14	19	1	1	28	64	5	
Wool	678	72	202		98	92			12	23	24	90	11		8	31					
Skins/Hides	795	40	374	26	-72	-69	68	44	58	-10	-19	-81	-11	46	-8	-15		1	4	1	
Logs	1,741		1,028		176	315			200	13					4						
Sawn Timber	1,078	328	124	157	93	51	2	2	8	35	15	26	5	1	47	33	15	3	1	7	
Fibreboard/Plywood	381	67	27	15	196				4	4	7	21	1		5	1	3		1		
Wood Pulp	678	72	202		98	92			12	23	24	90	11		8	31					
Fish/Seafood	1,478	272	281	156	119	42	14	26	1	9	9	2	36	146	6	25	2	8	13	4	
Crude Oil	2,410	2,360		23																	
Aluminium	1,242	94	31	71	665	124	56		21	2	1	3	1	11			84	3			
Remainder	15,924	6,273	1,041	1,249	696	517	363	157	508	183	262	181	303	321	204	224	72	158	199	83	5
TOTAL	47,743	10,873	5,890	3,999	3,440	1,677	1,545	1,046	938	899	875	856	813	798	756	732	691	625	598	557	486

NZ MERCHANDISE EXPORTS ANNUAL CHANGE BETWEEN THE 12 MONTHS ENDED DECEMBER 2011 AND A 12 MONTH SPAN A YEAR EARLIER

	Global Total	Australia	China	USA	Japan	Korea	UK	Germany	India	Taiwan	Malaysia	Indonesia	Singapore	Hong Kong	Philippines	Thailand	Saudi Arabia	Nether-lands	Canada	UAE	Venezuela
Sheepmeat	280	-5	73	42	10	2	-23	75		-1	-8		1	-19		3	-11	84	27	-4	
Beef	126	6	3	59	-23	27	11	8		17	1	-58	4	-2	5		-3	14	11	3	
Other Meat	35	11	3	5	4	5	-3	-1			-1	-9	1	-1	1	1		13	3		
Milk Powder	1,207	20	176	10	1	16			14	39	51	30	-15	28	10	26	87	7		131	24
Butter	317	6	109	24	28	9			-73	9	16	4	8	2	-17	14	19	7	13	9	-1
Cheese	-73	-53	5	-12	24	6	-1		-2	-3	-6	7	-2	-2	-5	6	-10	-4		-1	5
Whey/Casein	243	9	72	123	-21	11	2	41	-1	6	7	-5	14	4	3		1		-3		2
Kiwifruit	75	12	18	-2	3	12		10	1	12	1	3		6		1		1	-2	1	
Apples	31			-17			6	3	7	4	4	1	3	8				1			
Other Fruit/Vege	80	57		2	28	3	-1	1		1	-13	1	-4	-3		5					
Wine	46	24	9	-2			-6	1			-1	1		4				5	1	1	
Wool	-7	-15	17		1	8			-2	-8	-2	-14	10		-2	-2					
Skins/Hides	301	12	170	1	3	-3	13	13	-5	9	5	15	-10	1	2			1	1		
Logs	310		217		11	30			53	2								-2		-4	
Sawn Timber	-92	-12	-26	-33		8		-1	5	3			1		10	4	-15	-13		-3	
Fibreboard/Plywood	33	-3	-5	-1	40	-1			-2		2	4			1		-3			-1	
Wood Pulp	-7	-15	17		1	8			-2	-8	-2	-14	10		-2	-2					
Fish/Seafood	48	-13	121	-17	-5	-2	1	-15	1	-5	1	1	-4	-104	3	13	1	3		1	
Crude Oil	395	575		-64									-57			-65					
Aluminium	29	-27	6	10	17	19	9	-8	6	-1	-2	1		-5		-2		32	-4	-1	
Remainder	833	257	78	49	4	107	7	3	37	-18	44	-42	26	16	18	51	10	-17	55	8	-7
TOTAL	4,210	847	1,064	239	65	264	17	130	37	56	99	-75	-13	-68	27	53	76	132	101	141	22

NZ MERCHANDISE EXPORTS ANNUAL CHANGE BETWEEN THE 3 MONTHS ENDED DECEMBER 2011 AND A 3 MONTH SPAN A YEAR EARLIER

	Global Total	Australia	China	USA	Japan	Korea	UK	Germany	India	Taiwan	Malaysia	Indonesia	Singapore	Hong Kong	Philippines	Thailand	Saudi Arabia	Nether-lands	Canada	UAE	Venezuela
Sheepmeat	-27	-1	6	-18	1		-12	18		-1	-14			3		-1	6	12	5	-1	
Beef	-19	3	1		-1	-4	-1	1				-15	2	-1		-1	-1		-3		
Other Meat	12	6		2		1	-1	1				-1		-1	1			3			
Milk Powder	382	8	10	8		6			28	10	18	13	7	10	7	-3	1	5		62	58
Butter	-20	7	18	36	1	1			-27	-7	5	8	3		-10		-12	5	-3	-2	-1
Cheese	8	-5	4	-4	15	2	5		-2	-3	-1	1		-1	2	1	-5	-2		1	-2
Whey/Casein	107	5	23	51	-4	4	1	7		2	2	2	-2	3	2		-1	2	5		
Kiwifruit	21				4	4		2		5	1	1	1	1		1		1			
Apples	2																				
Other Fruit/Vege	39	28	-1	2	11	1	1	1		-1	-3		1			1					
Wine	13	2	2	3			-3						1					-1	3		
Wool	-8	-2	-17		15	1				-2	-1	-3	2								
Skins/Hides	65	1	63	1	-13	-2	2	1	-1	2	2	3	-1	-1		1					
Logs	-40		-49		-3	6			6							1				-1	
Sawn Timber	-22	-5	-10		2	1			-1	-5	1		2		1	1	1	-3			
Fibreboard/Plywood	11	-1	-1	-1	14	-1			-1			2			1		-2				
Wood Pulp	-8	-2	-17		15	1				-2	-1	-3	2			-1					
Fish/Seafood	5	-10	21	-7	-1	-1	-1	-5			1	1	5	-5	3	2		1		1	
Crude Oil	164	186											-7			-17					
Aluminium	-12	-4	2	-3	9	1	-2		-1									3	1		
Remainder	1,217	415	134	114	149	63	16	21	-56	-7	45	-36	15	50	32	24	-26	-2	35	61	50
TOTAL	1,889	629	189	185	215	86	7	48	-55	-8	53	-25	30	56	38	8	-38	24	43	121	104

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<http://www.anz.co.nz> e-mail nzeconomics@anz.com