

## NEW ZEALAND ECONOMICS ANZ AGRI FOCUS

NOVEMBER 2011

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### THE GREEN FLUSH

**FEATURE ARTICLE: AGRICULTURAL PRICE PREVIEW**

We expect NZD commodity prices to remain elevated, supported by favourable supply-demand dynamics. However, a fickle global scene adds a considerable amount of downside risk, though the currency is acting as a buffer. We are bullish regarding the long-term trend for commodities but caution against banking on excessive gains. Sustainable commodity price trends will be more slow-moving.

**THE MONTH IN REVIEW**

The green flush of some pretty hefty cash flowing in the door in the livestock sectors and some of the best pasture conditions seen across the country has been the winning hand this spring. Despite a few one-off cold snaps here and there, the weather has been fairly kind since February, giving most a bit more of an armchair ride compared with usual. This was perfect timing to watch the All Blacks bring home the Webb Ellis Cup for the first time in 24 years!

**RURAL PROPERTY MARKET**

While we have heard a lot of noise about debt repayment from the good earnings in 2010-11, the reality looks like quite a bit of this extra cash has found its way into property. Thankfully, most investments have been strategic in nature and from those with strong balance sheets. This additional momentum has also started to lend some support to pricing, with murmurs of further upside over the coming 12 months. However, it does feel like *deja vu* given the uncertain economic environment and pockets of the livestock industry remaining over-leveraged.

**ECONOMIC INDICATORS AND KEY COMMODITIES**

Commodity prices have continued their slow decline since May this year. The latest decrease was 3.5 percent in October, the largest monthly decrease since prices started to ease. The on-going debt saga in Europe and forecast lower global growth has started to drag on consumption estimates. The recent weakening bias in the NZD has helped buffer against the declines in offshore prices.

**ECONOMIC BACKDROP**

Rather than focus on intra-weekly noise and "risk on" and "risk off" sentiment shifts around the globe, we prefer to focus on the underlying trends, namely heightened volatility, a downwards risk profile for the global economy, and slow growth across Western society. The New Zealand economy continues to display relative resilience in some areas, although we are now seeing more fragmentation across data outturns. Some of this reflects deep-rooted structural challenges, but a growing share looks to be related to the global scene. A slow grind for the New Zealand economy remains our core view.

**BORROWING STRATEGY**

Carded rural fixed interest rates have fallen since our last edition, having been cut following falls in wholesale interest rates. By contrast, the carded floating interest rate has not changed, largely because the OCR has not changed. With the RBNZ on hold for at least the next 6 months, and risks in Europe escalating, the 6 month rate is our preferred tenor. Not only is it the lowest rate, but it offers a good balance of cost, flexibility and certainty against the outlook, bearing in mind the considerable downside risks.

**EDUCATION CORNER: MONETARY POLICY IN NEW ZEALAND**

In our frequent travels around the country, we regularly hear gripes from the business and farming communities regarding New Zealand's monetary policy framework and the perceived collateral damage it delivers via the currency. This article takes a basic look at the framework and its evolution. While not a perfect system, and further tweaks could certainly improve things, it is better than the alternatives on offer. And we should remember that New Zealand has tried some of the alternatives that have been mooted before, with disastrous consequences.

## FEATURE ARTICLE: AGRICULTURAL PRICE PREVIEW

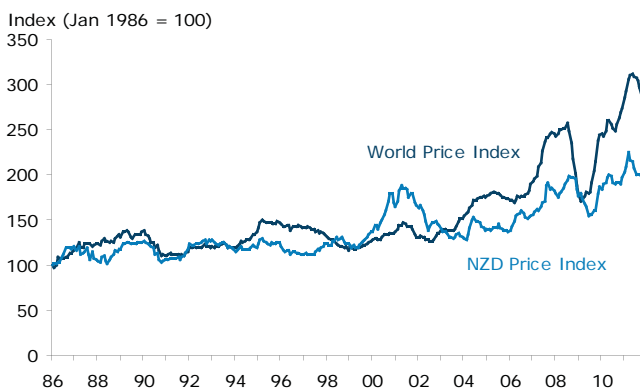
### ASSESSMENT

We expect NZD commodity prices to remain elevated, supported by favourable supply-demand dynamics. However, a fickle global scene adds a considerable amount of downside risk, though the currency is acting as a buffer. We are bullish regarding the long-term trend for commodities but caution against banking on excessive gains. Sustainable commodity price trends will be more slow-moving.

### BACKGROUND

The historical pattern has been for the commodity basket that New Zealand exports to the world to come under pressure during periods of global duress and uncertainty. Based on this you'd expect New Zealand's key commodity exports to be falling in price currently. Certainly the past few months we've seen commodity prices ease, but from extraordinary highs, and not as much as other markets. Simply eyeballing the ANZ soft commodity series, you can see a retreat in the level of world prices, but to a level that is still above previous peaks! The NZD has been more problematic over the last six months, taking the cream off world prices at the farm/orchard gate, but now looks to be playing ball, falling more of late than soft commodity prices. Relative to history, world prices for most commodities New Zealand exports are still either at historical records, or not too far off.

ANZ Commodity Price Index



### New Zealand's commodity prices have held up for several reasons.

- A weaker global scene is a clear risk, but not yet reality. Certainly we see Europe slipping into recession, but other pockets are trading okay. However, it is clear that the downside risks to the outlook are material.
- The main driver on the demand side has come from emerging market economies as they shift

to becoming net importers of protein and other key foodstuffs in many instances. This support is expected to continue.

- Worldwide cost of production is up on many fronts via land values, wages, increasing food safety and animal welfare standards, oil and energy prices flowing into transportation and packaging, and the introduction of new technology to increase efficiency and quality of products. These cost increases have been particularly prevalent in emerging countries.
- Weather events in some key producing areas, such as drought in the Southern US states.
- An increase in the global growing area of grains has been onto more marginal land, with a more volatile climate – there are good reasons why many areas have not been cropped prior to now. This increases the marginal cost of production and provides greater risk of failure.
- In many cases where there has been an increase in supply, this has been required to replenish inventory levels that were at historical lows and remain so.
- Government responses to high food inflation and the civil unrest it has caused in parts of the globe have been supportive of a softening in prices rather than an implosion, which has been the historical experience.

**Looking forward we've pencilled in for soft commodity prices to come off their highs** posted earlier in the year, but remain at elevated levels. There is still some way to go, and some will adjust faster than others, eg. dairy has fallen further than meat and fibre so far.

**Looking beyond cyclical turns, we are optimistic that the long-term trend for commodities is up. However, we would caution against excessive hype, with the trend likely to be slow moving.** There will be consumer price resistance, speculators entering and exiting the market, unfriendly government intervention, other substitutes becoming viable, and a supply-side response to strong prices. Belarus is a recent example emerging as a major supplier of dairy products. Its share of world cheese exports is now 7 percent and its growing skim milk powder (SMP) exports stand at 80,000 tonnes – or one-third of US SMP exports. All of these things can upset the apple cart.

## FEATURE ARTICLE: AGRICULTURAL PRICE PREVIEW

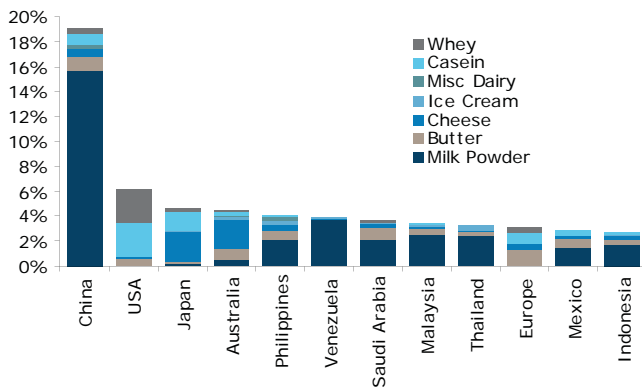
Seasonal Year	2008-09	2009-10	2010-11	2011-12f
<b>Dairy (\$ per kilogram of milksolid)</b>				
Fonterra Milk Price	4.72	6.10	7.60	6.50
Dividend per share after retentions	0.48	0.27	0.30	0.30
Total payout to a farmer 100% share backed	5.20	6.37	7.90	6.90
<b>Wool (\$ per kilogram greasy, whole of clip net of costs)</b>				
Fine (<24 micron)	9.10	8.30	11.05	12.00
Medium (25-31 micron)	4.70	4.90	6.15	5.90
Crossbred (>31 micron)	2.45	2.30	3.80	3.50
<b>Sheep (\$ per head, weighted averages, GST exclusive and net levies at farmgate)</b>				
Lamb (17.5 kg carcass)	89	82.	115	95
Mutton (24.5 kg carcass)	47	55	86	80
<b>Beef (\$ per kilogram of carcass weight, weighted averages, GST exclusive and net levies at farm gate)</b>				
Steer (296-320 kg carcass)	3.70	3.35	4.00	4.20
Heifer (195-220 kg carcass)	3.60	3.30	3.90	4.10
Bull (296-320 kg carcass)	3.50	3.15	3.80	4.00
M Cow (160-195 kg carcass)	2.40	2.15	2.90	3.00
<b>Deer (\$ per kilogram of carcass weight, weighted averages, GST exclusive and net levies at farm gate)</b>				
Stag (60 kg carcass)	8.30	7.25	7.35	8.10
Hind (50 kg carcass)	8.15	7.10	7.15	8.00
Velvet (\$ per kg)	60	100	95	95
<b>Grains (\$ per tonne, Agrifax prices grower bids delivered nearest store or mill, net levies and freight to this point)</b>				
Milling Wheat	340 to 420	340 to 420	355 to 460	350 to 450
Feed Wheat	280 to 310	280 to 310	295 to 330	310 to 380
Feed Barley	270 to 300	270 to 300	290 to 340	305 to 370
<b>Kiwifruit (\$ per tray OGR)</b>				
Zespri™ Green	3.70	3.70	4.21	3.65
Zespri™ Gold	5.40	7.73	8.89	7.40
<b>Apples (Weighted FAS returns \$ per TCE)</b>				
Braeburn	25.10	16.10	18.25	15-20
Royal Gala	22.20	21.10	22.90	19-23
Fuji	26.10	25.50	25.70	23-27
Jazz™	31.00	19.50	21.60	19-22
Pacific Rose	25.40	27.30	30.70	29-31
NZ Average	24.40	20.50	22.20	18-24
<b>Grapes (\$ per tonne, national average)</b>				
Sauvignon Blanc	1,636	1,194	1,070	1,000
Merlot	1,588	1,570	1,470	1,400
Pinot Noir	2,891	2,752	2,530	2,450
Chardonnay Mendoza	1,317	1,089	1,216	1,150
Chardonnay Other	1,362	1,070	1,130	1,130
Pinot Gris	1,687	1,419	1,240	1,200

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## THE BRIEF SPECIFICS

### DAIRY

Top 10 destinations for NZ dairy exports, 2011



Sources: ANZ, National Bank, Statistics NZ

**The flow of dairy exports continues to be increasingly towards high-growth countries such as China and petro-dollar economies such as Saudi Arabia and Venezuela, as their consumers move toward a westernised diet, energized by rising income levels and urbanisation.** At their current stage of development these countries are importing lower protein and value-add products, such as skim and whole milk powders. However, over the last 20 months growth in exports of products with higher milkfat content has also started to pick up, especially butter.

**China now takes approximately 20 percent of New Zealand's dairy supply, up from 5 percent in 2008, so is a very important market.** Several factors have held up demand in this market over the last 12 months and will continue to provide a level of support.

**1. Policy changes:** China has been struggling to quell inflation, with food inflation accounting for 70+ percent of total inflation and running at 12 percent year-on-year. To dampen inflation authorities have undertaken a range of policy responses that have involved letting their exchange rate appreciate against the USD, increasing reserve capital ratios, and raising interest rates. To directly target food prices they have been using some of their US\$3+ trillion in foreign reserves to import key foodstuffs, such as dairy products, and give these to low income families. This has also been to prevent civil unrest such as those seen in North Africa and parts of the Middle East. Other measures have included trying to directly cap the retail price of fresh milk and other key foodstuffs. In the main most of the changes are positive for more sustainable pricing and demand.

**2. New Zealand's free trade agreement (FTA)** in 2008 with China has opened up preferential access that is benefiting our dairy exporters over others. This has shown up in Chinese imports of whole milk powders (WMP), where NZ accounts for some 90 percent of the total volume China imports. Back in 2007-08, when food prices moved higher, a range of export taxes and quotas was implemented to combat high food prices, which was detrimental to New Zealand exports to these markets. However, the Chinese and others seem to have resisted such policies so far. The NZ-China FTA provides some level of protection against such measures going forward. The FTA also provides an incentive to purchase early in the year as a lower tariff rate applies to a limited volume of product. In 2011 the FTA limit was reached early in March, coincidentally the same time prices peaked. In 2012 a tariff of 5.8 percent will apply to the first 115,473 tonnes of milk powder imported by China from NZ. This has recently been reflected in the GlobalDairyTrade auctions with SMP and WMP results stabilising, providing a reasonable price guide for 2012.

**3. Increasing food safety standards:** China has increased food safety standards for local farmers and domestic milk manufacturers in response to several high-profile food safety incidents. This has resulted in China closing nearly a third of its milk processors in 2011 following a nationwide safety crackdown. Reportedly 426 out of 1,176 processors did not have their licenses to operate renewed, with a further 107 forced to suspend production until improvements are made. This is supportive of demand for imports and consumer trust will not be quickly regained either.

**Countries in the Middle East and other parts of Asia have also been implementing similar policies to China** by purchasing key foodstuffs from oil receipts and then providing these to lower income families to keep food inflation and civil unrest in check. This will continue to be supportive of demand for milk powders. Other countries have also reduced trade barriers by lowering tariffs and increasing quotas, an example being India recently sanctioning a major increase in SMP, butter and butter/oil imports in an attempt to control rising domestic prices as increasing national production is failing to keep up with surging demand.

### SUPPLY

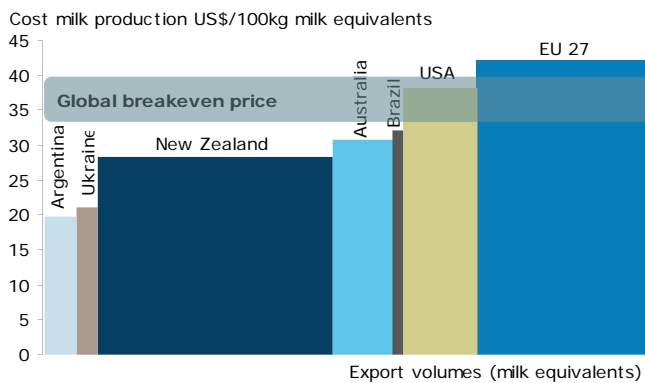
In response to the high prices in the back end of 2010 and first quarter of 2011 **there has been a strong supply response from just about every country that exports dairy products.** Global

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supply is forecast to increase by 2 percent in 2011-12, double last year's rise of 1 percent.

Recent work by Dairy NZ has shown how the break-even cost of production for countries that trade dairy products across borders has increased with higher grain prices. The chart below shows the share of tradable product for each country and their break-even cost of production. **With higher grain prices forecast to persist, this means the US and EU have the highest break-even cost of production at US\$3,800-\$4,200 per tonne.** This is compared with NZ at US\$2,800 per tonne. This research is supported by the recent slowing in US production in response to lower milk prices and higher grain prices. **Overall, if international prices fall below US\$3,500 per tonne then we are likely to see a contraction in supply from the US and EU.** Expansion in supply from Argentina will need to be watched over the longer term as their cost of production is considerably lower than most others and they have natural endowments that allow them to expand rapidly.

Cost of production for tradable dairy production



Sources: OECD-FAO, IFCN, DairyNZ Economics Group

Basket of NZ Dairy Products	Fonterra Milk Price Component Scenarios (NZ\$ per kg MS)				
	NZD/USD				
	USD	0.75	0.78	0.81	0.84
3350	6.20	5.97	5.75	5.55	
3450	6.39	6.14	5.92	5.71	
3550	6.58	6.33	6.09	5.88	
3650	6.76	6.50	6.26	6.04	
3750	6.95	6.68	6.44	6.21	
3850	7.14	6.86	6.61	6.37	
3950	7.32	7.04	6.78	6.54	

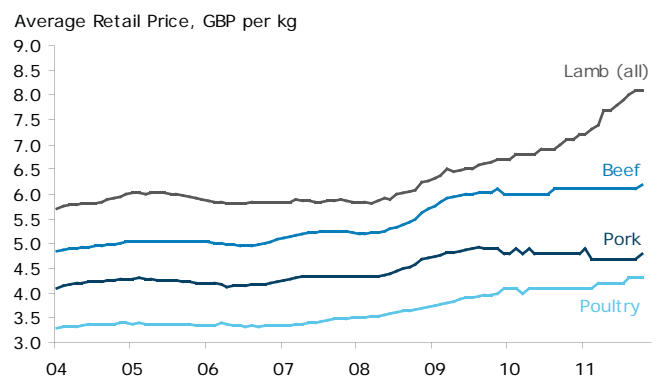
On season-to-date pricing and an effective currency conversion on dairy receipts of NZDUSD 0.78 we would still expect the milk price component of the

payout to be \$6.70 per kilogram MS. **However, given the weakening bias in international prices from increased supply and moderating food inflation in Asian/Middle East countries, along with a NZDUSD currency in the high 70s, a milk price outlook of \$6.35 to \$6.50 per kilogram MS looks more reasonable at this stage of the season.** Every 1-cent change in the NZDUSD is worth approximately 10 cents on the milk price payout, although this is not linear when there are large swings in the currency. Given the importance of the dairy sector to the New Zealand economy the currency will act as a natural hedge to normalise the farm-gate payout if international dairy prices fall too far.

## SHEEP

**The prospects for demand in the bellwether market of the UK and Europe looks a bit tough over the coming 12 months.** Recent events in global financial markets have highlighted the divergence in growth prospects for the region (see the last *Agri Focus* for a detailed synopsis). **With this as the backdrop, lamb prices face more challenges with retail and in-market prices having diverged from substitute meat products such as beef, pork and poultry.** This has driven down consumption, with UK retail sales of lamb during the past months down 20-25 percent compared with a year ago – and this was not due to product availability.

British retail meat prices Domestic and imported

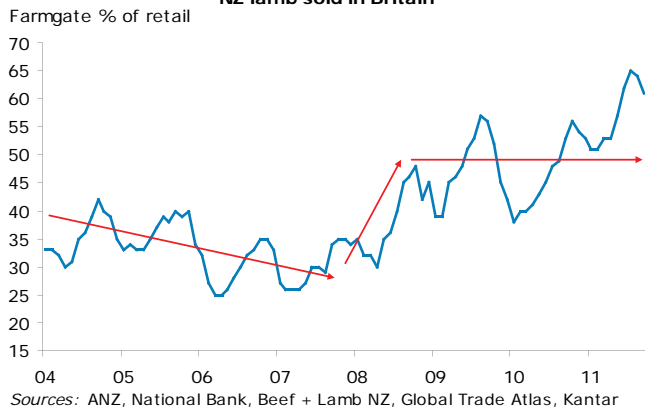


Sources: ANZ, National Bank, Beef + Lamb NZ, Kantar

**The retail price gap between NZ and other lamb sold in the UK (mainly domestic) has also closed completely over the past four months.** This is another sign that there will be limited further upside for retail prices of NZ lamb.

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**NZ farmer share of retail price of NZ lamb sold in Britain**



The tighter supply out of NZ and other markets has supported higher margins for farmers over the last three years. This has seen the farm-gate price as a percentage of the retail price increase from around 35 percent to 45-55 percent over the last several years (similar to local UK produce). These margins now look to have topped out around 60 percent late in the 2010-11 season, implying limited upside for wholesale prices. In addition, farm-gate prices in 2010-11 did not decrease to the extent they usually do during peak slaughter. This was due to a later Easter, more national holidays in Europe, good grass conditions in NZ, and farmers holding lambs for longer to add more weight because of reduced numbers. Easter is earlier this season and the reasonable lambing should see a return to a more normal seasonal slaughter pattern. This will mean a return to more seasonal pricing and reduce season average prices.

Co-product price prospects are mixed, with some products performing better than others because of reduced lamb supplies, mixed inventory levels and trading down supporting demand for "value" products. Pelt prices look strong courtesy of wool prices.

**Supply of tradable lamb is to remain significantly constrained but is expected to bounce off the lows of 2010-11.** An increase in New Zealand and Australian production is offset by a further decline in the EU.

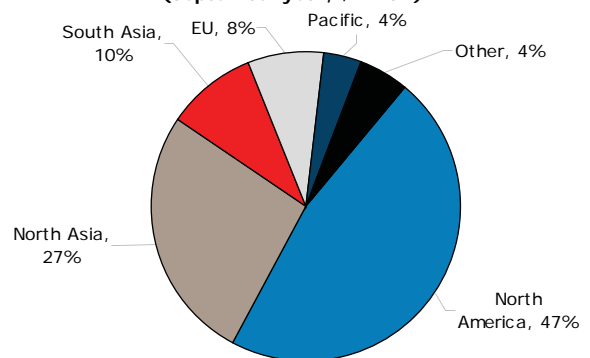
**Due to seasonality factors, our more bearish view of Europe, a bounce in supply and the unsustainable rise in the price of lamb versus other protein substitutes, with a correction imminent, we believe a \$95 per head season average price is more realistic.** Whether it gets this low may depend on grass conditions, how well Europe can hold together, and whether the bounce

in supply is sufficient to tip the market. This may be more a 2012-13 story.

Mutton prices are expected to remain more supported than lamb due to consumers trading down, limited supply as flock numbers stabilise in NZ, Australia and China, and continued demand from the Middle East and Asia. **Season average mutton pricing is forecast at \$80 per head, down 7 percent from last year.**

## BEEF

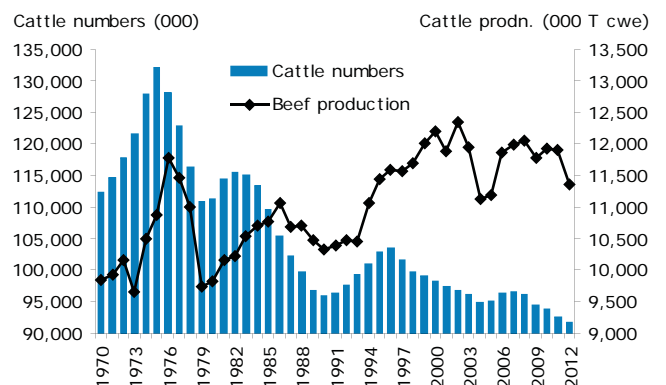
**NZ export beef markets 2010-11 (September year, \$m FOB)**



Sources: ANZ, National Bank, Beef + Lamb NZ

Despite fluctuating demand from importing countries, the export shares of NZ's main beef markets remained largely unchanged in 2010-11. North America continues to make up 47 percent of returns in 2010-11, followed by the likes of North & South Asia, which make up 37 percent of returns. Japan, Taiwan and South Korea continue to be the main markets within the Asian region. However, exports to surrounding countries also continue to expand, with Indonesia now an important alternative export destination for manufacturing beef.

**US cattle numbers (000 head, 1 January)**



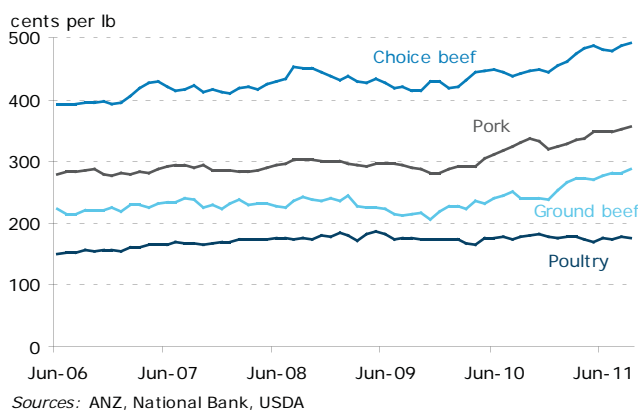
Sources: ANZ, National Bank, USDA, Informa Economics

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The recent focus in the US has been on the drought in Texas and surrounding states (which account for about 40 percent of the US beef cow herd). The situation has forced cow-calf producers to sell their feeder cattle to feedlots at lighter weights, and their beef cows to slaughter plants as they have dramatically reduced their herds. This has increased domestic supplies of US beef and put downward pressure on US manufacturing beef prices. While there are still more cattle on feedlots to be turned-off, the lighter entry weight and high cost of feed has meant they are being turned-off at lower weights than normal i.e. it is not economic to add the normal amount of extra weight. This has meant overall production has not been as high as would normally be expected and pricing has remained buoyant given the circumstances. The ultimate impact of this drought-induced liquidation will be further reductions in US production in 2012 and beyond – accentuating their import requirements and crimping their export ability for years to come.

The latest estimates from the USDA in fact forecast a 3 percent increase in imports in 2012, helping recover some of the estimated 12 percent fall in 2011. **The increase in imports for 2012 will be largely in response to an anticipated 5.0 percent decline in total beef production, as a near half-century low cattle herd starts to impact on throughput.** Exports are forecast to be stable in 2012, but they have increased by 20 percent over the past 12 months as they have regained access into Asia and the low USD has supported exports.

Retail meat price spreads in US



Meanwhile consumers in the US have traded down from eating choice cuts of beef (i.e. steaks) to more manufacturing beef. **The ongoing questions over the US economic recovery, high unemployment and faltering consumer confidence have acted as a major drag on wholesale prices and the ability of importers and retailers to be able to fully pass on higher wholesale prices to the**

consumer. So far, some of the higher wholesale prices have filtered through to retail beef and pork prices, but poultry has been flat over the last five years. **But pork and poultry producers have now cut production in response to low/negative margins over much of 2011. This will see lower poultry production next year and growth in pork production constrained.** This will provide a lift in poultry prices and help beef and pork prices move higher in 2012.

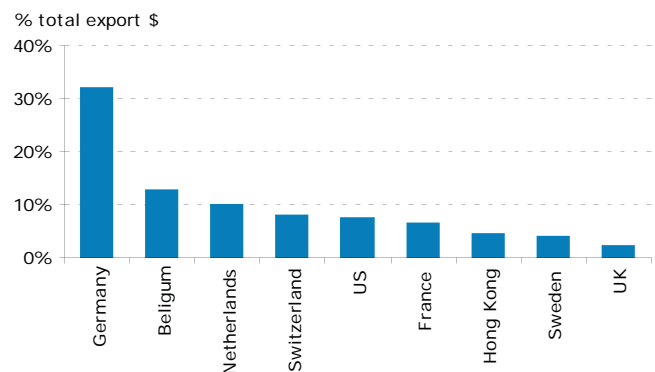
Elsewhere the main Asian markets remain fickle, with increased competition from the US introducing more price tension, but food safety issues with other protein sources helping support imports and demand for beef.

**Beef exports from South America continue to experience a period of short supply.** After booming during the mid 2000s, export supplies from this region have felt the effects of unsustainable slaughter and production, supported by fast growth in processing capacity, but more importantly, the growth in domestic consumption limiting the availability of product for export. There is solid evidence that the Australian cattle industry has entered a rebuilding phase, underpinned by the better seasonal conditions since the start of 2010.

**With a constrained outlook for supply, other protein prices set to move higher, and reasonable demand in the main markets, it is anticipated farm-gate prices will lift by 5 percent over the 2011-12 season.**

### VENISON

Destinations of NZ venison & co-products 2010-11



**The current sovereign debt issues in Europe are expected to weigh on demand for expensive food items such as venison.** However, this is within the context of a two-speed economy in the region, where some of NZ's main venison markets,

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such as Germany, Sweden, Switzerland and the Netherlands, are faring better.

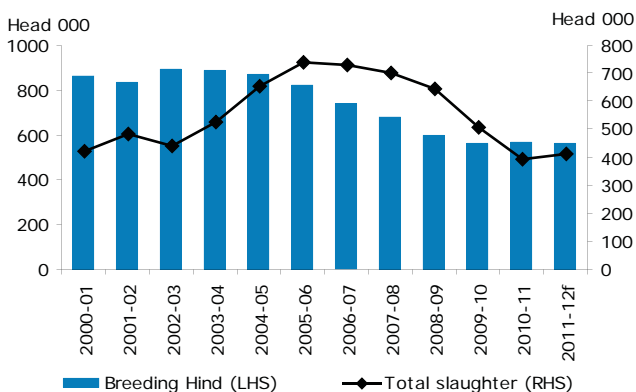
Over the last four years the industry seems to have finally stabilised supply, but also to have:

- improved marketing structures and partnerships with more contracted supply;
- built more trust between exporters and importers providing a sharing of risk; and
- started to slowly diversify markets into different food segments and products i.e. increased the proportion of product sold chilled to supermarkets.

These changes mean that venison is not as reliant as it was on the seasonal frozen game trade into Germany. This used to be a major cause of volatility in returns.

**However, despite having increased the size and diversity of the venison market over the past few years, 80 percent of NZ venison is still sold in euros.** The austerity measures being put in place by many European governments are likely to weigh on consumer spending for luxury proteins over the next couple of years. **Yet other protein prices, especially lamb and beef, have moved higher. This allows venison to maintain a higher price point without consumers trading down, or supply chain partners taking it off the menu, as has happened in the past.**

NZ breeding hind numbers & production



Sources: ANZ National Bank, Statistics NZ, DINZ

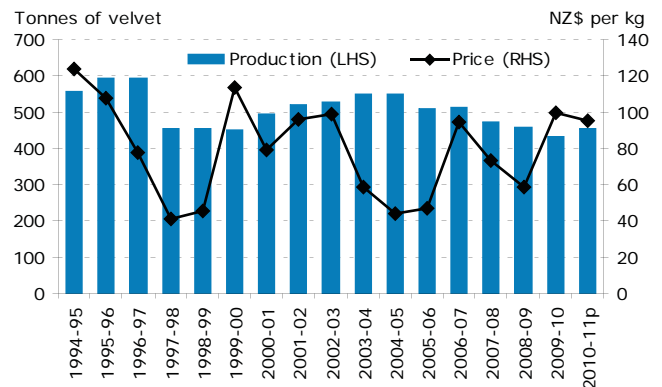
The retention of weaner hinds and a lower number of hinds processed indicates hind numbers are stabilising as replacement rates have normalised over the last two seasons. **With the herd stabilised at around 1.1 to 1.2 million, venison production of around 420,000 animals for the next few years can be expected.**

**On the back of this, we have forecast a season average 10 percent increase in pricing to \$8.10 per kg cwe for stags in 2011-12.** The main

downside comes from a stronger NZDEUR, rather than a decrease in in-market prices. Longer-term the changes the industry has undertaken to diversify their markets and product offering should lead to good returns and more stable pricing.

### VELVET

NZ Velvet Production vs. Price



Sources: ANZ National Bank, DINZ

Velvet prices continue to show signs of stability at higher levels, with reasonable sales over the last 12 months clearing most stock in New Zealand.

Some key forward indicators that look particularly positive are:

- relatively low velvet stocks in the global supply pipeline from lower production in New Zealand, Canada, Russia and China over the last three years;
- solid economic growth in Korea and China; and
- no substantiated reports of a significant build up of velvet stags in New Zealand, or in competing countries. Russian production has been forecast as flat at best, with ongoing climatic events affecting production. Chinese production is reported to be well back on historical levels. Chinese production systems are reliant on cheap grain, and as the price of grain has increased over the last several years their production system has become uncompetitive.

**As a result, we have forecast velvet prices to be unchanged in 2011-12 with solid in-market prices offset by the higher NZD.**

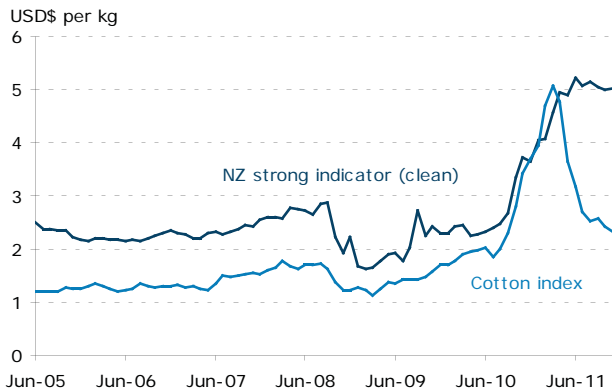
### WOOL

The farm-gate price for strong wool was 55 percent above the previous year in 2010-11 and has traded above \$6 per kilogram since March 2011. Overall, all wool types have shown substantial price increases. Some of these gains have been crimped back at the

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farm-gate by the high NZD, with in-market prices increasing 70 percent.

**Strong Wool Prices vs. Cotton Prices**



Sources: ANZ, National Bank

**One of the major factors that has underpinned stronger demand for New Zealand wool has been an improvement in the price competitiveness of wool relative to cotton and polyester, with cotton being the other major natural fibre that wool competes directly with.** Over the first three quarters of the 2010-11 season the Cotlook 'A' indicator price more than doubled, hitting a high of US\$5.0 per kg in March 2011. This was caused by supply constraints in major producing countries and inventories falling substantially as demand for apparel and textiles in the US and Europe picked up.

**However, since March cotton prices have tumbled back to US\$3.00 per kg and now look to be stabilising around this level.** While there was extra area planted in cotton in response to the higher prices, crop conditions and yields were mixed in major producing countries (especially in Texas, which supplies 43 percent of the US's cotton) and inventory levels remain low. However, end demand for yarn has not been as strong as implied by the price of cotton over 2010-11, with recent uncovering of yarn stockpiles in China and India. These elements make for a volatile picture over the next six months.

The current high wool prices have the potential to result in manufacturers changing blending ratios in textile and apparel production in favour of alternatives such as cotton and polyester. This will enable manufacturers to avoid a significant increase in the cost of production, with limited and acceptable implications for product characteristics for consumers, especially consumers who are going to be cost conscious. While this will help textile and apparel manufacturers maintain retail demand for wool blend products, it will lower wholesale demand for wool and affect pricing.

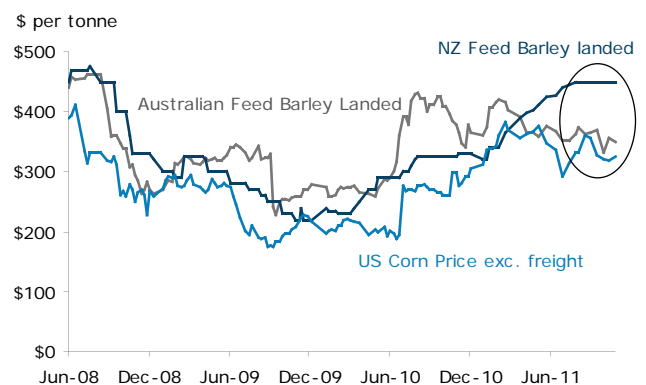
**Thus far wool prices seem to have been sheltered from the correction seen in other fibre prices. The only reason is lower supply, as many farmers in NZ and Australia took the money and ran earlier in 2011.** It seems some sort of correction in the price of wool is on the cards but it might be slower moving because of lower on-farm inventories and reduced supplies from fewer sheep.

**Therefore, a softening in strong and medium wool prices of 8 and 4 percent respectively is expected over the next 12 months.** Nevertheless, be warned the correction could happen more quickly and be a lot larger.

### GRAINS

**Domestic prices seem to have gone the opposite way to international grain prices over the past few months,** after playing catch-up during the first quarter of 2011. Demand for domestically produced grain has been relatively strong over the last several months from buyers wishing to secure supply for the spring. Inventory levels had been reported as low, which has helped maintain some momentum in prices. The spread to international prices now appears to be providing topside, along with the good pasture conditions being experienced in most parts of the country. The good pasture conditions should also allow more silage and baleage production, which will reduce feed grain demand this summer and autumn.

**New Zealand versus offshore – Barley Prices**

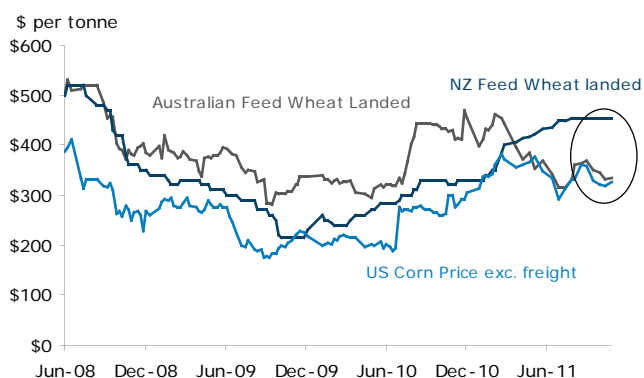


Sources: ANZ, National Bank, Agrifax, USDA

Global grain prices are expected to remain higher for longer on tight fundamentals. However, a higher NZD will ensure grain and palm kernel imports remain competitive with domestic product. This, along with better grass conditions heading into the summer, means feed grain prices have topped out for now and will probably start to soften over the first half of 2012.

## FEATURE ARTICLE: AGRICULTURAL PRICE PREVIEW

New Zealand versus offshore – Wheat Prices

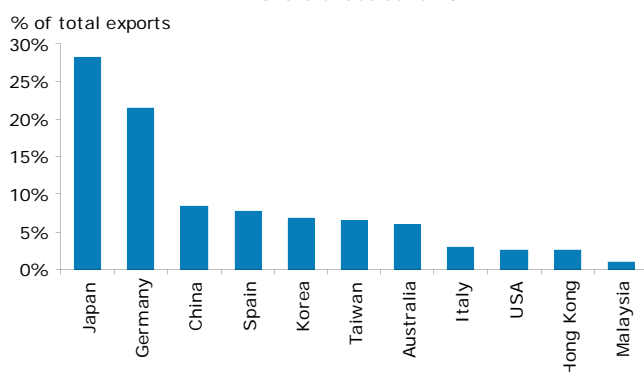


Sources: ANZ, National Bank, Agrifax, USDA

### KIWIFRUIT

Zespri has been sending cautious messages on demand for the 2011 crop. There have been food safety concerns in some markets and increased competition in others.

NZ's main Kiwifruit export markets  
12 months ended June 2011



Sources: ANZ, National Bank, Statistics NZ

Reported sales in Japan have been slow following the tsunami, and lower consumer spending has affected demand for large-sized kiwifruit, with demand shifting to smaller-sized fruit. However, ongoing food safety concerns around seafood and other local produce following the nuclear fall-out at Fukushima are expected to see food imports supported.

The E. coli outbreak in Germany earlier in the year had a major impact on fruit markets across Europe, eroding consumer confidence and spending on vegetables and fruit.

In Asia competition has been strong from Chilean producers. In Korea, cheap Chilean kiwifruit in the wholesale market provided strong competition along with high domestic fruit volumes. In Taiwan, the market for imported fresh fruit was strong following a food safety scare. In China, small volumes of

domestic kiwifruit and large stocks of Chilean kiwifruit have provided strong competition.

**Total kiwifruit export volumes are expected to reach 110 million trays in 2011-12, while export returns are forecast to reach above \$1 billion.**

**However, the identification and spread of PsA-V over the last 12 months has led to forecasts that the national crop will decline to below 95 million trays in 2012 and 75 million the year after. Gold is forecast to be most affected dropping from approximately 30 to fewer than 10 million trays.**

Overseas experience shows the disease affects Gold kiwifruit vines more than the traditional Green. Gold is the higher value crop.

**This kind of reduction in supply would lead to an increase in grower prices through a larger proportion of kiwifruit being sold to the higher paying markets.** This would lift average returns per tray for growers as a smaller proportion of fruit would go into lower paying markets. However, the expansion of Gold into other Asian markets would be severely curtailed by the large reduction in supply.

The other channel for an improvement in grower returns to compensate for lower yields would be via increased competition from packhouses for the reduced crop. This will reduce margins, leading to lower processing costs for growers. **This is likely to lead to some packhouses going out of business, or consolidating, rebalancing packhouse capacity with kiwifruit supply.**

**Even optimistic commentators believe it will be at least 3-5 years before a solution is found, and subsequently supply is expected to remain significantly constrained over this period.**

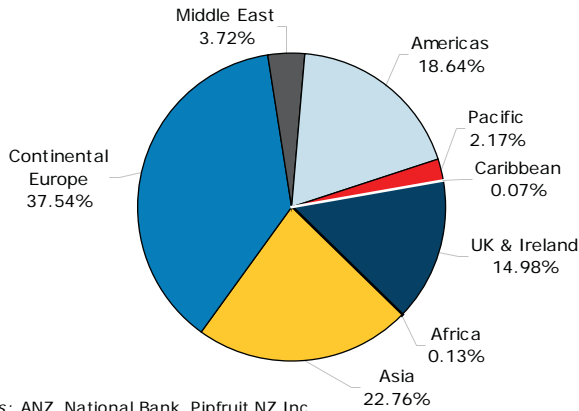
**An escalation in the disease is not expected to affect market access.** Fruit has been shipped to all major markets since the identification of the disease. But the increase in prices is unlikely to compensate for the reduced yields many growers will face. Therefore, orchard gate returns per hectare are expected to be well down on the last several years.

**The forecast reduction in supply is expected to see Gold prices over \$9.50 per tray over the 2012-2015 period. Green is expected to trade above \$4.50 per tray over this time.** As an example, a 25 percent reduction in yields per hectare for Gold, with a price of \$9 per tray, will lead to an average orchard gate return per hectare of \$68,000. This is 18 percent down on the average for the last two years.

# FEATURE ARTICLE: AGRICULTURAL PRICE PREVIEW

## APPLES

Export Production by Destination Region: 2010



The outlook is encouraging for the NZ apple and pear sector, with potential for market expansion in Australia and Asia, and an increasing proportion of new varieties planted to service these growing markets.

Exports to Asian and Middle Eastern markets have gone from 17 to 27 percent of export earnings over the last two years. Continued economic growth in these regions should see this trend extend over the next several years, with good demand for the Pacific series expected to be maintained.

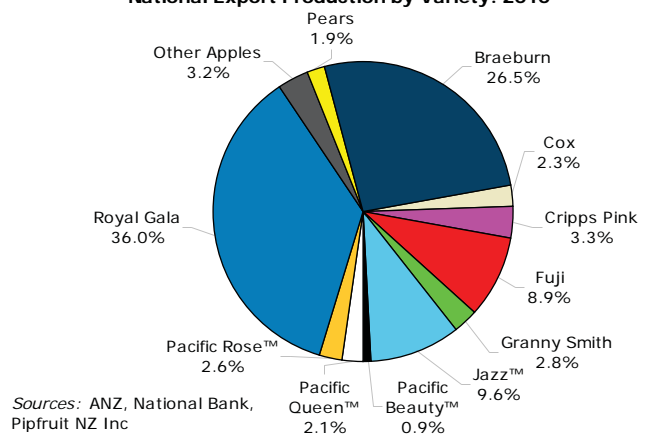
Nonetheless the traditional markets of Europe and North America still account for 70 percent of all export earnings. Prices are expected to be under pressure in continental Europe from the deteriorating economic situation and E. coli issues earlier in the season. The market potential for New Zealand apples in the US is likely to improve on last year as US stocks have cleared more rapidly than expected.

**To service the growing Asian and Middle Eastern markets a number of new varieties have been established over the last several years.** This has reduced reliance on traditional varieties such as Royal Gala and Braeburn, which are now 48 percent of total planted area, although they still constitute 62 percent of exports. Fuji and Jazz are now 11 percent of plantings each.

**Annual export volumes have settled into a band between 14 and 17 million cartons, with climatic conditions determining volumes within this range.**

Growers and exporters are working to better coordinate market supply with demand for the Braeburn variety, with export volumes likely to drop below 4 million cartons. Higher apple juice prices in 2011, owing to reduced global stocks, provided growers with income options for non-export quality fruit.

National Export Production by Variety: 2010

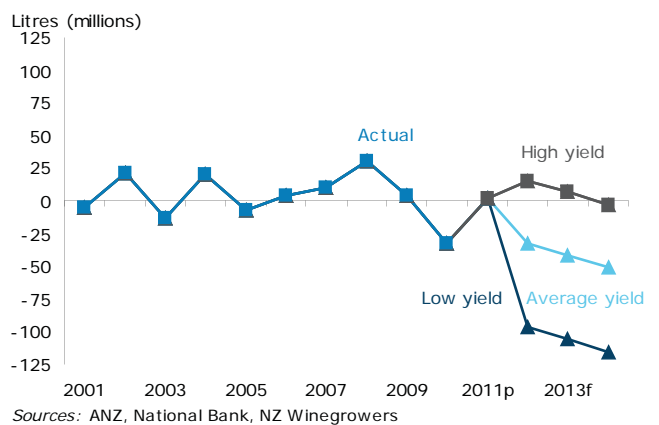


While it is a little difficult to source representative data on in-market prices for apples, reports have suggested reasonable to generally firmer prices during the main selling window in 2010-11. Stronger returns have been received for varieties that are more aligned with the Middle East and Asian markets, such as Fuji, the Pacific series and Envy.

The offset has been a stronger NZD, although this has depended on the specific market and the currency used to conduct trade. The NZDUSD from April to September was nearly 17 percent stronger than last year, whereas the NZDEUR was only 5 percent stronger. **Looking forward, prices are expected to remain in similar ranges to recent years, with slight improvements expected for varieties that are more aligned to Asian and Middle Eastern markets.**

## GRAPES

Supply and demand balance of NZ wine

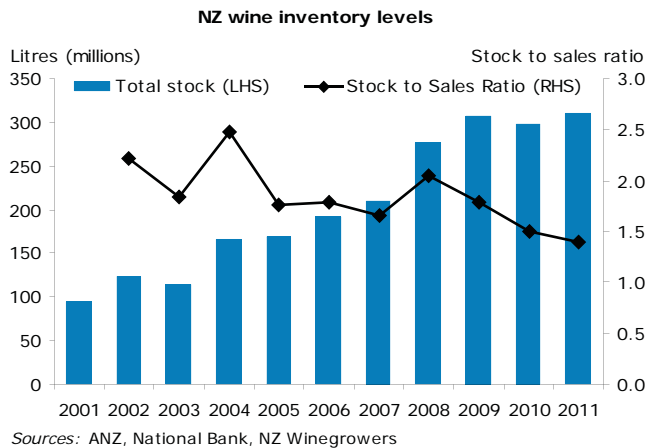


The chart above shows the impact of the large 2011 vintage, increasing the oversupply of wine by 2.3 million litres in 2011-12. This follows the 2008 to 2010 period where the difference between sales and

## FEATURE ARTICLE: AGRICULTURAL PRICE PREVIEW

supply had been slowly brought back into balance. This was due to strong export growth and yield caps. In 2010-11 a deficit of 27.2 million litres of Sauvignon Blanc was created due to flat production and a 14 percent increase in exports. However, in 2011-12 there is an estimated oversupply of 4.3 million litres of Sauvignon Blanc and 6.0 million litres of Pinot Noir. Other varieties have a net deficit of 8.7 million litres due to capped/normal yields, helping reduce the national average surplus to 2.3 million litres.

The persistent surpluses have created an inventory build-up over the last 10 years that needs to be reduced.



A 14 percent increase in export sales in 2010-11 and a slight decrease in the 2010 vintage has led to the first decline in inventory levels since 2003. Overall inventory levels were estimated to have decreased 3 percent from the previous year to 298 million litres.

If the industry continues to experience high yields then it is forecast that supply will continue to overshoot demand until well into 2014-15. However, in practice this is unlikely to be the case. Average yields would see the balance between sales and supply reached much sooner, which would help stabilise bulk exports and prices quickly, along with reducing inventory levels. Therefore, while there is expected to be a decent deficit between supply and demand in 2012, on par with 2010, **a required run down in stock, higher NZD and softer in-market prices for bulk wine are expected to keep downward pressure on average export prices and subsequently grape prices for most varieties over the next 12-18 months.**

## THE MONTH IN REVIEW

### ASSESSMENT

The green flush of some pretty hefty cash flowing in the door in the livestock sectors and some of the best pasture conditions seen across the country has been the winning hand this spring. Despite a few one-off cold snaps here and there, the weather has been fairly kind since February, giving most a bit more of an armchair ride compared with usual. This was perfect timing to watch the All Blacks bring home the Webb Ellis Cup for the first time in 24 years!

**The west coast of both islands and Southland have had a remarkable amount of rain through October and early November with most paddocks now at field capacity.** The downside to the moist conditions has been limited access to paddocks for heavy machinery. This has delayed the planting of summer crops, and silage and baleage making has been stop-start for many. Where crops have been planted, germination has occurred very quickly due to the good soil moisture and temperature conditions. Unfortunately, with Southland being a later lambing region some pockets were affected by larger lamb losses than normal. This is now the second year in a row that lamb production in the region has been affected by wet weather.

**The east coast of both islands was also wet, but not quite at field capacity. Spring conditions have been some of the best seen for years, which provides good momentum heading into the summer.** Crop establishment has also been stop-start in places. In Canterbury, favourable weather conditions have led to huge savings in irrigation costs. The development of mild La Nina conditions since April seems to be driving more favourable growing conditions. The momentum from the spring and forecast favourable climatic conditions should see cautious optimism continue into the first quarter of 2012.

### DAIRY

Fonterra revised back their milk price forecast for 2011-12 by 45 cents to \$6.30 per kg MS. Early season payments were left unchanged, with step ups later in the season reduced. Combined with last year's record payout and the strong start to milk production this season, this means there has been very good cash-flow this spring. While a downward revision was expected, the magnitude was probably larger than most had pencilled in. **The soft landing for the revenue line will be provided by better production and lower interest rates, but this won't make up the entire difference.**

Year-to-date milk production is up 10 percent, with the lower North Island and central and lower South Island leading the charge. The reported loss of 30-50 million litres of milk in the central and upper North Island region from the gas leak in the Maui pipeline

that shut down processing plants was not trivial. This shaved 2-3.5 percentage points off the growth in milk production in the North Island during October. It also reduced year-to-date milk production growth by 0.5-1.0 percentage points, implying there is very strong momentum in milk production heading into the summer. This could see milk production for the season finish as high as 8 percent ahead of last year, one of the largest annual increases since Fonterra's formation 10 years ago (discounting the bounce-back from drought in 2008).

### MEAT AND FIBRE

Official lambing results are due this week. **Anecdotally, most regions have had a better lambing than last year's shocker.** Better lamb survival has been cited as the main reason in most regions. More lambs, good pasture conditions and high early season prices should be seeing a deeper draft of prime lambs away at weaning. **So far we have not seen this in production statistics yet which are back 20 percent on last year, as farmers add more weight to lambs.** Carcass weights for the year-to-date are up 8 percent on this time last year. Anecdotally, lamb breeders have planted, or are intending to plant, more feed crops to add more value to their lambs. Combined with good pasture conditions across just about every region, this could suggest higher store prices as breeders hold on to lambs that are not sold prime at weaning, shorting the store market. A similar situation exists for store cattle. Total beef production is back 12 percent on last year, with bull beef back 27 percent.

Wool exports for the 2011-12 year-to-date are nearly 17 percent behind last year, despite prices being some 58 percent higher than this time last year. A smaller sheep flock, combined with most farmers selling down inventories last year, will see supply remain tight even though a lift in per head production is expected.

Venison production finished 7.9 percent ahead of last year at 415,000 head. Hind slaughter increased 10 percent and stag slaughter was 6.3 percent higher. Stable hind numbers and better-than-average fawning rates from the good autumn conditions during mating are expected to see production up 2 percent in 2011-12.

### HORTICULTURE AND VITICULTURE

**Psa is casting a lengthening shadow over the kiwifruit industry and Bay of Plenty region.** There are sizeable implications for the Bay of Plenty economy (with kiwifruit-related activity making up close to 20 percent of regional activity). A bleak kiwifruit outlook is likely to lead to many pack-houses going under or consolidating over the next 12 months, with transport, orchard and engineering services also hit.

# RURAL PROPERTY MARKET

## SUMMARY

While we have heard a lot of noise about debt repayment from the good earnings in 2010-11, the reality looks like quite a bit of this extra cash has found its way into property. Thankfully, most investments have been strategic in nature and from those with strong balance sheets. This additional momentum has also started to lend some support to pricing, with murmurs of further upside over the coming 12 months. However, it does feel like *deja vu* given the uncertain economic environment and pockets of the livestock industry remaining over-leveraged.

## COMMENT

**The spring flush has provided additional momentum to livestock-aligned properties but a moribund feeling in the horticultural sectors persists.**

The three month period ended October saw 328 farms change hands, continuing a tick-up in turnover

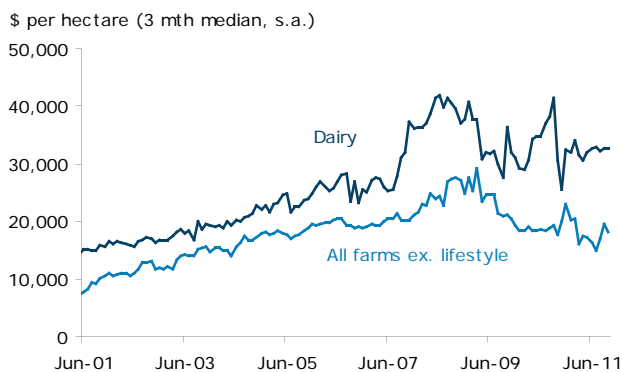
that extends back eight months to March. Average prices had moved around \$4,000 per hectare lower over the January to August period, but have taken a leap up this spring to be on par with this time last year. Grazing properties accounted for 56 percent of all farm sales in the three months to October, dairy properties 14 percent, finishing 17 percent, horticulture 7 percent, and arable 6 percent.

The tables and charts below show the official statistics from REINZ for the three month period ended October (i.e. August, September and October 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.

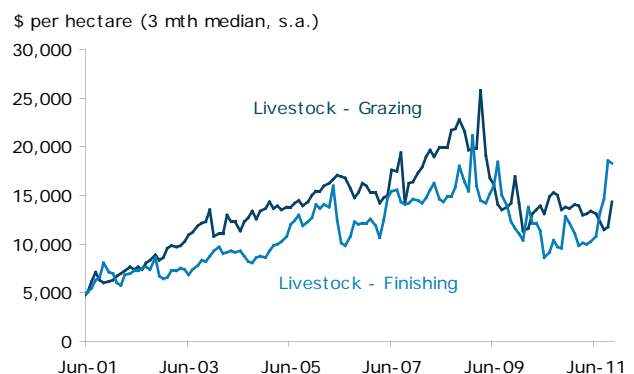
There has been a lot of noise made about debt repayment, but this is not showing up in the RBNZ

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	44	45	20	87	↓	↑	↓
	Median Price (\$ per ha)	32,700	32,800	30,600	26,800	↓	↑	↑
Livestock – Finishing	Number of Sales	54	49	14	72	↑	↑	↓
	Median Price (\$ per ha)	18,300	18,600	9,600	11,400	↓	↑	↑
Livestock – Grazing	Number of Sales	172	156	90	251	↑	↑	↓
	Median Price (\$ per ha)	14,300	11,700	13,000	13,900	↑	↑	↑
Horticulture	Number of Sales	21	19	4	60	↑	↑	↓
	Median Price (\$ per ha)	73,200	78,900	152,800	142,000	↓	↓	↓
Arable	Number of Sales	17	16	6	20	↑	↑	↓
	Median Price (\$ per ha)	19,400	19,600	32,400	23,500	↓	↓	↓
All Farms ex. Lifestyle	Number of Sales	328	317	168	527	↑	↑	↓
	Median Price (\$ per ha)	18,300	19,600	17,700	18,300	↓	↑	↔
Lifestyle	Number of Sales	1,180	1,250	1,038	1,651	↓	↑	↓
	Median Price	444,000	443,000	435,000	368,000	↑	↑	↑

Farm Sales, Median Price



Farm Sales, Median Price



## RURAL PROPERTY MARKET

credit figures. In fact, according to the RBNZ figures, aggregate gross agricultural debt has increased by nearly \$1 billion since April and \$300 million since the start of 2011. This is despite cash flow during this period being amongst the strongest ever experienced.

If we look at the average dairy farmer's cash available for reinvestment in 2010-11 there was **approximately \$175,000 extra cash for reinvestment after tax over and above the average of the last 10 years**. The average meat and fibre farmer's cash available for reinvestment after tax in 2010-11 was **\$40,000 over and above the average of the last 10 years**. Across all the commercial dairy and meat and fibre farmers in New Zealand, this adds up to a substantial \$2.57 billion extra for reinvestment over and above the average of the last 10 years (1.3 percent of GDP).

Looking at the June year RBNZ data it shows gross debt has been stable year-on-year, while deposits have increased by \$758 million. **So in effect there is probably an extra \$1.8 billion in cash available for reinvestment**. While the October milk cheque is yet to be reflected in the RBNZ data, and a good proportion of the meat and fibre and some of the dairy money would have been spent on deferred on-farm maintenance, a reasonable amount seems to have found its way into the rural property market over the last six months or so.

The average price per hectare for all farm sales in the three month periods ended October and September has now lifted by \$4,000 per hectare, compared with the March to August period. **Overall values are now in line with this time last year, but the big change has been in the number of farms changing hands**. The average number of sales in the three month periods ended October and September are up 75 percent on this time last year.

Anecdotally a lot of the recent activity has been from owner-operators with strong balance sheets who are looking to add to their business through strategic purchases that will strengthen their overall operation. In many cases strong equity positions have been available either through cash earnings from 2010-11, or existing balance sheets. This has added to the buyer side of the equation versus this time last year, where purchasers were institutions and/or offshore interests.

**The median price for a three month period for dairy properties continues to show stability around the \$32,000-33,000 per hectare mark**. While there is considerable variability around the median price month-to-month, depending on the quality of properties being sold and region, this has now been the median price for nine of the last twelve three month periods.

**The October month saw five dairy farms sold at an average sale value of \$34,046 per hectare and \$39 per kg MS**. The average farm size was 129 hectares and the average production per hectare across all dairy farms sold in October was 873 kgs of MS. There were 44 dairy farms sold in the three month period ended October. Turnover has shown remarkable consistency from the start of 2011.

The forecast 2011-12 \$6.75-6.85 per kilogram of MS (in total) gives an investment multiple of above 5.7, which is slightly above historical averages. While Fonterra has revised back the milk payout for 2011-12 to \$6.60 per kilogram MS, **the hit to the revenue line will be offset to some extent by better production and lower interest rates**.

For example, if production were to finish the season up 5 percent on last season this would be worth \$0.32 per kg MS for a farmer who is 100 percent share backed. The effective interest rate has also been lowered by 0.50 percent over the last 12 months. This lowers interest costs by \$0.11 per kg MS for the average dairy farmer with debt of \$22 per kg MS (or half a cent for every \$1 of debt per kg MS). **All up this means the average dairy farmer will probably receive at least a \$0.43 per kg MS lift from better production and lower interest rates**. This offsets a third of the decline in the payout from 2010-11 and will ensure momentum in the rural property market is maintained into the New Year.

The extra dosh has also flowed into grazing, finishing and arable land for dairy support and conversions. Grazing, finishing and arable land have all increased in both turnover and price in recent months. The grazing land price increased by 23 percent to \$14,000 per hectare in October. Finishing land increased to \$18,000 per hectare in September and October. **Turnover is also up 10 percent and nearly double last year for both grazing and finishing**. Arable land has increased back toward \$19,500 per hectare, but is still well below long-term averages. Turnover has tripled on this time last year but is off very low levels.

**Horticultural property values and turnover seem to have stabilised, but at very low levels**. The turnover in sales since the start of this year has halved and is now a third of the 10-year average. The average price per hectare plunged to \$75,000 in August and has stayed around this level in September and October. This provides evidence that August was not a one-off. The spring median prices per hectare have been half what they were this time last year. All indications are that the stresses in each sector will continue to hamper turnover and sale values.

## ECONOMIC INDICATORS

### EXCHANGE RATES

	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
NZD/USD	0.79	0.79	0.77	↔	↑
NZD/EUR	0.57	0.58	0.57	↓	↑
NZD/GBP	0.49	0.50	0.48	↓	↑
NZD/AUD	0.77	0.78	0.78	↓	↓
NZD/JPY	61.00	60.4	63.7	↑	↓
NZD/TWI	68.00	70.4	68.1	↓	↓

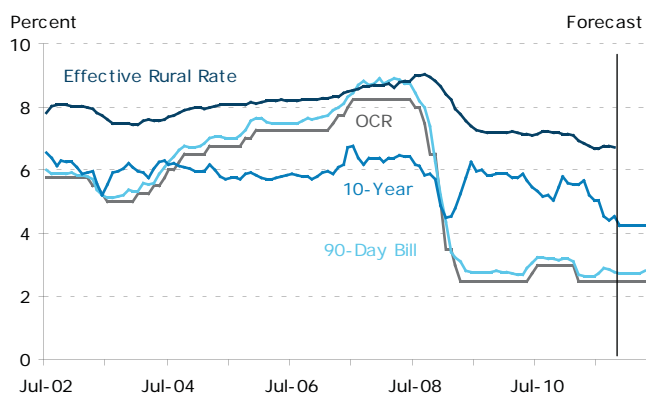
### NZD Buys USD



### 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	2.76	3.17	↓	↓
1 yr	2.70	2.72	3.57	↓	↓
2 yr	2.90	2.98	4.01	↓	↓
3 yr	3.25	3.25	4.34	↑	↓
5 yr	3.53	3.76	4.83	↓	↓
10 yr	4.26	4.53	5.48	↓	↓
Effective Rural Rate	6.70	6.78	7.20	↓	↓
Agricultural Debt (\$b)	46.89	46.79	47.01	↑	↓

### Key NZ Interest Rates



Since our last update the NZD has had a weakening bias. **The European debt crisis has been the focal point, with promises of solutions often shot down by political ineptitude and an inability to make hard decisions stick.** The situation has dragged on, creating the feeling of “Groundhog Day” and increasing the uncertainty regarding what the final outcome will be. Finding a solution seems increasingly unlikely as the “guys with the cash” (read BRICs) seem unwilling participants in any rescue. It seems that a Mexican standoff exists; “show me a plan and I will give you the money – give me the money and I will show you the plan”. The increasing length of the saga increases the odds of a disintegration of the euro (whether it is an orderly exit of the core or a disorderly break-up), posing significant downside risks to global growth, the NZD and interest rates.

**Elsewhere the USD has not had much frontline press lately but with the economy on the (slight) improve and a widening gap between economic performance in Europe and the US, watch this space.** While the global scene will continue to be the focus, more mixed data out of the domestic scene could add to uncertainty and volatility. We expect some more downside to the NZD, albeit with bouts of optimism now and then.

While a huge degree of uncertainty surrounds the outlook for the NZD, one thing is clear: **it is acting as an appropriate buffer against global risks.** This is helping support (and arguably inflate) NZD returns.

New Zealand interest rates have fallen dramatically since our last update on the European debt concerns. **Of concern is the possibility that falling risk appetite leads to a tightening in key funding markets which are so crucial for New Zealand.** Any increase in bank funding costs will only further delay OCR increases, the timing of which we characterise as “fluid”.

**With interest rates decreasing the opportunity cost of being fixed has too.** But the risks to the downside have increased as well, and as such we prefer to sit on the sidelines, and we suspect that what matters most now is not where interest rates are headed, but rather how the business environment looks.

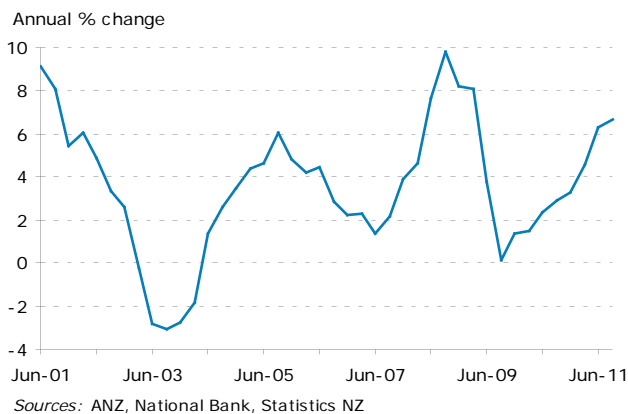
As mentioned in the rural property section, lower interest rates and a higher proportion of farmers on floating has help lower the **effective rural interest rate by 50 basis points over the last 12 months.** On current debt levels this means a lower interest bill of \$234 million, helping provide a level of support to offset lower commodity prices in 2011-12.

## ECONOMIC INDICATORS

### INFLATION GAUGES

Annual % change	Current Qtr	Last Qtr	Last Year	Chg. Q/Q	Chg. Y/Y
Consumer Price Index	4.6	5.3	1.5	↓	↑
Farm Input	6.7	6.3	2.9	↑	↑
Net Imp. Margins PPI	-3.3	6.8	13.3	↓	↓

### Farm Input Inflation Gauge



The Consumers Price Index (CPI) rose by 0.4 percent in Q3 2011, taking the annual rate of headline inflation to 4.6 percent. Excluding the direct impact of the GST increase the annual inflation rate was 2.5 percent. Cost increases (rather than strengthening demand) were the major culprit.

**There were several categories where substantial increases will flow through to on-farm costs.**

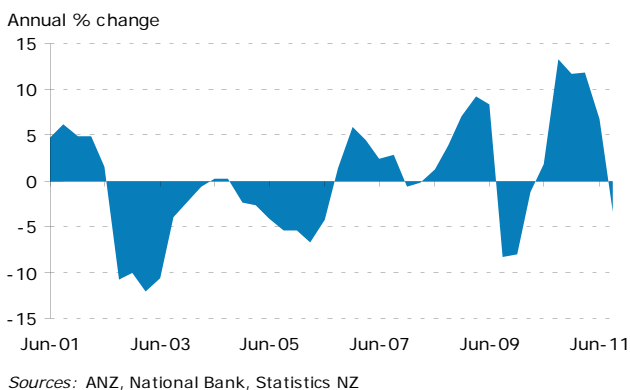
One category is local authority rates, which were up 4.1 percent. Typically, these make up 2.6 percent of total cash expenditure on the average dairy farm, and 3.5 percent on the average meat and fibre farm. For kiwifruit and viticulture growers rates are a higher proportion of total cash expenditure, at 2.7 and 4.2 percent respectively. The other area was insurance costs, with dwelling insurance (up 12 percent) and contents insurance (up 5.6 percent q/q) contributing to a 2.4 percent increase in insurance prices. On-farm the impact is larger for average-sized meat and fibre farmers, with insurance costs 2.1 percent of total cash expenditure. For the average dairy farmer insurance is 1.3 percent of total cash expenditure and typically 1.3-2.0 percent for horticultural businesses.

**Elsewhere the inflation picture was more benign.**

After a period of sizeable increases, electricity prices managed a small fall, the first since December 2009 and only the third quarterly fall in the past 10 years. Increased data caps for broadband plans and cheaper international calling rates contributed to a 3.5 percent fall in telecommunication services and petrol prices fell 3.3 percent.

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).

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



**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.**

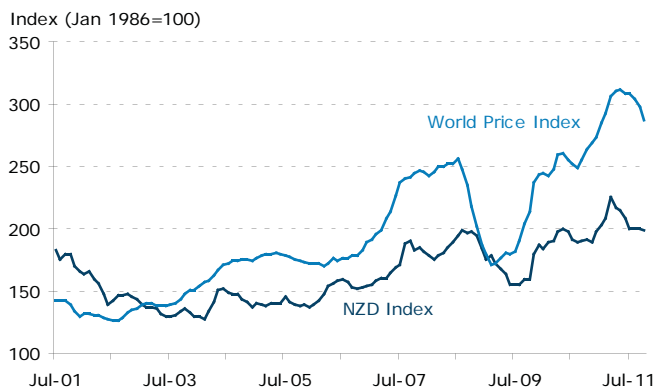
The quarterly decline was largely on the outputs side, with dairy and forestry the weakest during this period. Dairy output prices were down 12.3 percent q/q and inputs were up 0.9 percent. Overall, the implied net margins for dairy declined 13.1 percent for the quarter. Forestry and logging output prices 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. This was largely due to a 3.4 percent lift in output prices but was also helped by a 0.4 percent fall in input prices. This is likely to have been due to lower petrol prices.

## KEY COMMODITIES: OVERALL INDEX AND DAIRY

### ANZ COMMODITY INDEX

	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
NZ Index	199	200	192	↓	↑
World Index	287	298	263	↓	↑

### ANZ Commodity Price Index



The ANZ Commodity Price Index has continued its slow decline since May this year. The latest decrease was 3.5 percent in October, the largest monthly decrease since prices started to ease in May. The ongoing debt saga in Europe and forecast lower global growth have started to drag on consumption estimates, placing downward pressure on wholesale prices. The cumulative drop in the index since the May peak has been 7.9 percent. The adjustment so far has been remarkably orderly, but it probably still has some way to run. We have long said a 20 percent decrease from the peak would seem realistic. That said, November is likely to show a bounce as dairy and beef prices have been stronger and others have shown stability. However, the general sentiment is lower, but it looks like it will be an orderly adjustment.

In New Zealand dollar terms the cream at the start of the year was taken off the top of high world prices by the NZD, with a lot of pressure created when it ran above NZDUSD 0.80 over the June to August period. The recent weakening bias in the NZD has helped buffer against the declines in offshore wholesale prices. This one of the major benefits of a floating currency when things look flaky offshore.

**October prices for dairy markets have shown their first signs of stabilisation since March.**

Prices through GlobalDairyTrade have now increased by 3.4 percent since late September. The more profitable powders have shown better strength during this period, with WMP and SMP up 6.9 and 3.9 percent respectively.

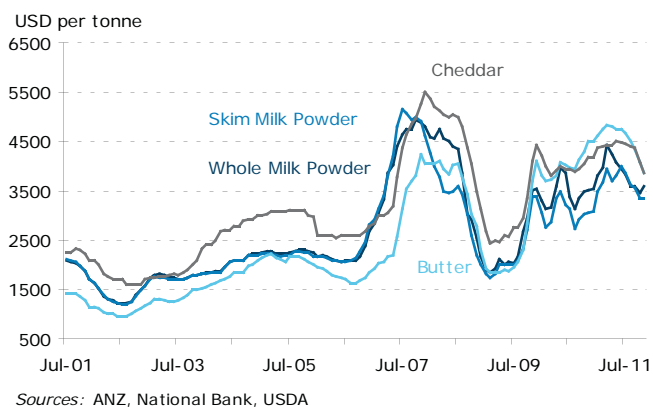
The bounce in prices has come later than anticipated largely due to China having a lot of excess inventories from the first half of the year. It seems these have been worked through, so some further strength into the New Year could be expected, before Northern Hemisphere production kicks in. Higher oil prices are also probably lending some support to buying from the Middle East and other oil exporters. The downward correction in higher milkfat content products had been more substantial than for powders. However, prices for higher milkfat content products bounced at the latest GlobalDairyTrade auction. This indicates there is still strong underlying demand, especially given the large increase in production of these products from the Northern Hemisphere since the start of this year.

All-in-all with just about every major dairy exporter continuing to produce more milk and global economic growth heading lower, prices have shown remarkable resilience. The key to prices over the first quarter is likely to be European dairy exports. With a high probability of a European recession on the horizon this will lower the EUR and negatively impact domestic consumption, leading to their new season's production spilling over onto the international market.

### OCEANIA DAIRY PRICE INDICATORS

USD per tonne	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
Whole Milk Powder	3,600	3,463	3,513	↑	↑
Skim Milk Powder	3,350	3,344	3,050	↑	↑
Butter	3,850	4,075	4,500	↓	↓
Cheddar	3,875	4,069	4,175	↓	↓
World Basket	3,669	3,738	3,770	↓	↓

### Dairy Products - Oceania Export Market Prices



## KEY COMMODITIES: BEEF AND LAMB

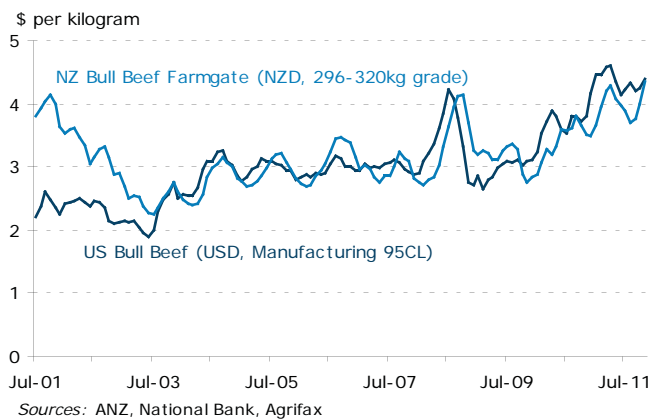
### BEEF PRICE INDICATORS

\$ per kg	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
US Bull Beef <sup>1</sup>	4.40	4.25	3.81	↑	↑
NZ Bull Beef <sup>2</sup>	4.35	3.98	3.51	↑	↑
NZ Steer <sup>2</sup>	4.40	4.19	3.77	↑	↑
NZ Heifer <sup>2</sup>	4.30	4.16	3.45	↑	↑

<sup>1</sup> USD, Manufacturing 95CL

<sup>2</sup> NZD, 296-320kg Grade Bull & Steer, NZD, 195-220kg Grade Heifer

### Beef Indicator Prices



The correction in the US beef market has come much sooner than most were expecting. Tight supplies of imports in recent years have seen the market become extremely sensitive to changes in supply. **The 95CL bull meat market in particular has quickly returned to being a sellers' market on softer weekly US production.** NZ production is also some 27 percent behind this time last year. Some buyers have been caught short of product during this period, and the slow start to New Zealand's slaughter season has them concerned about near-term supplies. The challenge in the US at the moment is predicting when the cattle turned-off on feedlots during the drought in Texas and surrounding states will reach market weight. Expect this to provide some downside pressure while these are worked through, before we see prices rebound.

Buyers in some Asian countries are now looking to start sourcing product for Lunar New Year celebrations in early February 2012. However, if cattle slaughter rates do not pick up quickly, exporters may not be able to meet demand, and therefore risk losing market share to Australia. **The pick-up seen in in-market prices has started to flow through to farmgate schedules but current pasture conditions and low stocking rates mean further procurement premiums will need to be offered to see farmers tempted.** Elsewhere, in a sign that South American beef exports are struggling, in January to September 2011 Argentina exported 18 percent less beef than in the corresponding period of 2010. The result was largely due to a decline in domestic production.

**Tight supply early in the season for lamb, with production back 20 percent on normal levels, has led to a build-up of procurement pressure, which has in turn resulted in a continuation of the exceptional farmgate prices above \$8.00/kg. However, these schedule prices are not indicative of the returns being achieved in-market, especially for frozen product. When lamb slaughter does pick up, and procurement pressure eases, expect to see a downwards correction in farmgate prices.**

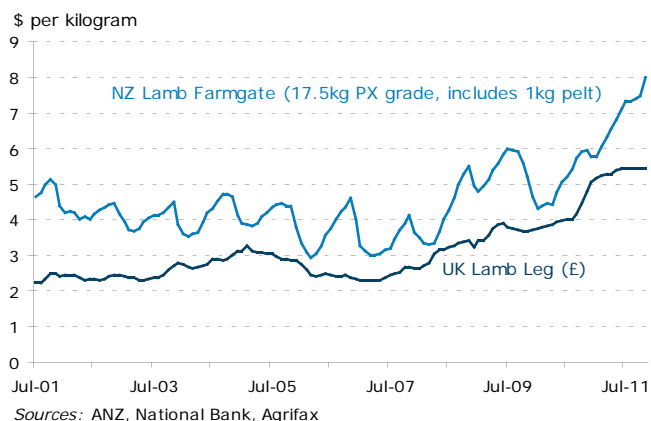
Good prices for chilled lamb for the Christmas trade continue in-market, but with only a portion of the meat produced able to be sold chilled, the majority will be exported frozen. The frozen market is still very quiet at the moment as importers struggle to work through existing stocks. As a result, interest in placing new orders is limited. Recently released data by Kantar shows the challenges that lamb consumption faces from higher retail prices and lower economic growth, with consumption in France down by 5 percent for the calendar year to date. Exporters will be hoping that the market picks up before lamb throughput starts to ramp up; otherwise stocks may start to build here. **This would extend the downward pressure on prices for the winter trade in 2012.**

### LAMB PRICE INDICATORS

\$ per kg	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
NZ Lamb <sup>1</sup> (NZD)	8.00	7.48	5.95	↑	↑
UK Lamb Leg (£)	5.42	5.42	4.78	↔	↑

<sup>1</sup> 17.5kg PX grade, including 1kg pelt

### Lamb Indicator Prices



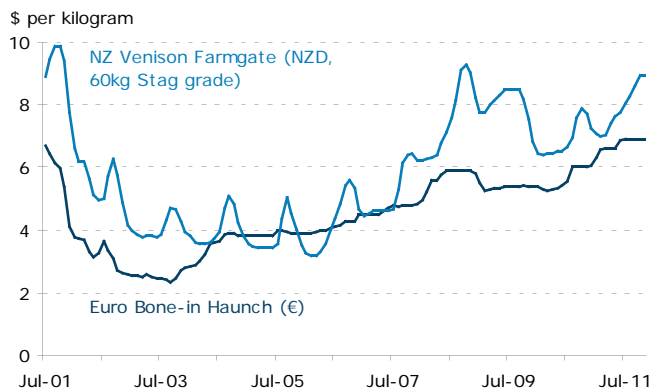
## KEY COMMODITIES: VENISON AND WOOL

### VENISON PRICE INDICATORS

\$ per kg	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
NZ Venison <sup>1</sup>	8.95	8.94	7.70	↑	↑
Euro Bone-in Haunch (€)	6.90	6.90	6.00	↔	↑

<sup>1</sup> 60kg Stag AP grade

### Venison Indicator Prices



Sources: ANZ, National Bank, Agrifax

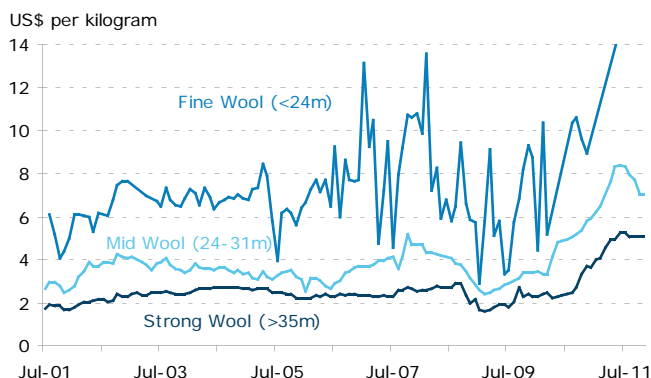
The chilled game season for New Zealand venison has been very successful, with farmgate prices above \$9.00 per kg of carcass weight for the first time since the GFC. The national average published venison schedule peaked at \$9.26 per kg carcass weight, (not including pool payments or QA premium), the third highest on record, and the fourth year in a row of good returns. But more important than the 'peak' which only lasts for a couple of weeks, is the average reported schedule for the chilled season (Aug to Oct) for 2011, which was near \$9.00 per kg carcass weight. This was 30 percent higher than the average of the past 10 years.

While Europe is the main destination for venison, and marketers are watching the deterioration in the political and economic indicators with concern, NZ's main markets are in northern European countries, including those not using the euro such as Switzerland and Sweden. These economies have continued to perform strongly. Currently the market is comfortable with stock levels on hand, with additional requests for airfreighted product before Christmas. There is certainly concern around restaurant spending in Belgium, France and parts of Germany, but we have not seen any major indication of weakening consumer demand yet.

### CLEAN WOOL INDICATOR PRICES

\$ per kg	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
NZ Fine Wool (>24m)	N/A	18.43	11.59	N/A	↑
NZ Mid Wool (24-31m)	8.90	8.90	7.48	↔	↑
NZ Strong Wool (>32m)	6.39	6.45	4.82	↓	↑
USD Fine Wool (>24m)	NA	14.54	8.96	N/A	↑
USD Mid Wool (24-31m)	7.02	7.02	5.78	↔	↑
USD Strong Wool (>32m)	5.04	5.09	3.73	↓	↑

### Wool Indicator Prices (Clean)



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

**The schedule is now on the normal downward trend as the chilled season ends.** Indications for the post Christmas schedule remain good. If the normal pattern is repeated and the 'trough' is around \$1.50 below the 'peak', producers may be looking at schedules in the mid \$7s before climbing again for the 5th year of solid returns from deer farming.

**Not much has changed in the wool marketplace with prices remaining very resilient in the face of a number of challenges. Strong wool continues to trade above \$6 per kg, and has been at this level since March.**

There are two contrasting forces at play. One is lower economic growth and consumption of wool products in key Western markets, namely the UK, US and Japan. The other is the rise of Chinese demand for wool products. **At the moment China is winning, taking 45 percent of New Zealand's wool exports from July to September, up from 34 percent compared with the same period last year.** It is a similar theme for Australia, with China now accounting for 50 percent of their wool exports. While economic growth is expected to be softer in China, the government is continuing to support development of the country's textile industry and marketing of wool products to Chinese consumers. **This is expected to increase per person wool consumption in key cities like Shanghai and Beijing.**

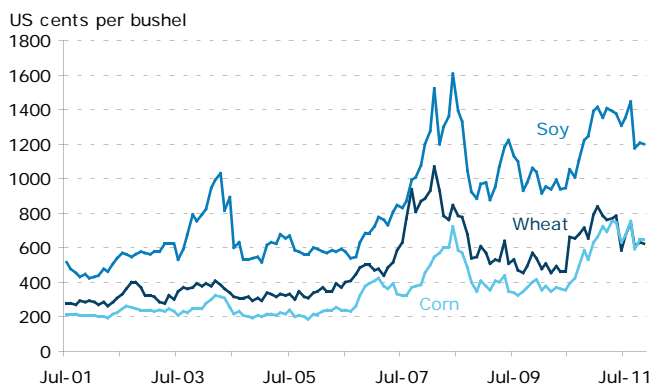
## KEY COMMODITIES: GRAIN AND FERTILISER

### GRAIN & OILSEED PRICE INDICATORS

USD cents per bushel	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
Wheat	6.2	6.3	6.5	↓	↓
Soy	12.0	12.1	12.4	↓	↓
Corn	6.5	6.5	5.3	↓	↑
Australian Hard Wheat <sup>1</sup>	288	280	321	↑	↓

<sup>1</sup> NZD per tonne

### CBOT Future Grain & Oilseed Indicator Prices



In the latest USDA's monthly crop production estimates there was a modest reduction in both yield and crop size for both corn and soybeans, but no accompanying higher price forecasts.

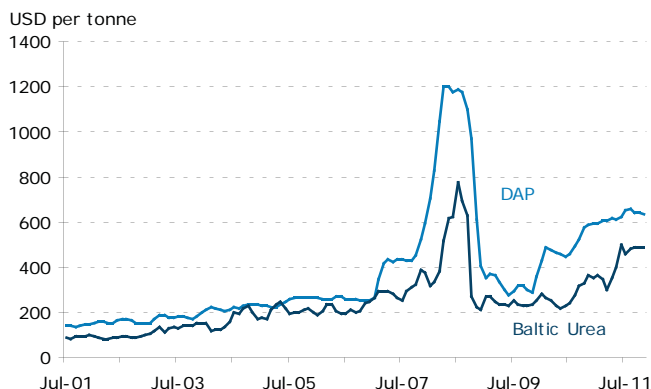
The corn yield was reduced by 1.4 bushels per acre to 146.7. This is 6.7 percent below the 1960-2010 trend yield and 9.1 percent below the 1996-2010 "biotech" era trend yield. The deviation from the longer-term trend is the largest since yields fell 7.8 percent short of the trend value in 2002. The deviation from the "biotech era" trend is the largest to date. Some expect the final January yield figure to be lower yet. Consumption estimates for feed and residual usage were further reduced, but ethanol and other usages were left unchanged. **All-in-all this led to a slight reduction in the year-end stocks-to-use ratio to 6.7 percent, and unchanged price ranges.**

For soybeans, yield estimates were reduced slightly (-0.2 bu/acre) to 41.3 bushels per acre. Projected year-end soybean stocks rose to 6.3 percent of total usage. That is significantly higher than last month's 5.1 percent, resulting in 55 cents per bushel off the price range. The 6.3 percent stock-to-use ratio is still among the lowest on record. But it marks the fifth straight year of stock-to-use ratios less than 7. Prior to the 2007-2008 crop year, this has happened only four times since the mid-1970s.

### 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



**Domestically the excellent pasture conditions are expected to see softer demand for feed grains and palm kernel imports.** To date it has been a little too wet to make extra silage and baleage, but this will change as summer conditions take hold. This will lower demand for supplementary feeds this summer with the duration of the impact depending on how long the good growing conditions persists. **The reduction in the milk payout from last season could also see some dairy farmers cutting input costs such as extra feed.**

That the price of the main fertilisers is not reducing substantially as buyers seasonally reduce their purchases is telling. There are ongoing issues with supply out of North Africa and parts of the Middle East. Production in Pakistan and China has been lower, reducing exports from China during their low tax export window, which has now closed for Urea and DAP. **International prices of nitrogen fertilisers such as Urea are likely to be firm next year due to production cuts in China and Pakistan and steady demand from importers, especially India, the world's largest importer. Prices for DAP are expected to be lower on increased production from Saudi Arabia.**

## KEY COMMODITIES: HORTICULTURE

### HORTICULTURE PRICE INDICATORS

	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
Kiwifruit (USD per kg)	2.5	3.1	2.2	↓	↑
Apples (Weighted Index)	180	180	187	↔	↓

The big focus in the horticultural sector is on the Kiwifruit industry and the spread of **Psa-V**. The latest update from KVH has **839 orchards identified as having the disease, or 25 percent of all orchards**. The epicentre is in the Bay of Plenty region where the average orchard size is larger than other regions. **The total infected area is 4,612 hectares, or 34 percent of total area**. Seventy-eight percent of New Zealand's production is now in a priority zone. **Gold is bearing the brunt of the disease with half of the total Gold crop now infected. A third of the Green crop is infected.**

Where to from here is the question. **It is going to be a very big struggle for Gold kiwifruit over the next few years**. This crop is one of New Zealand's key competitive advantages. From a profitability point of view it has the highest yield and receives a price premium at the orchard-gate nearly twice that of Green. In 2011-12 orchard-gate returns per hectare are forecast at \$87,100 for Gold and \$31,400 for Green. Until new Psa-V resistant Gold varieties can be bred, Gold exports are going to be severely constrained. Anecdotal reports have Green responding better to containment/management practices. **A better idea of the size of the 2012 crop will be gained in coming weeks, but we expected Gold to be well down on the 30 million trays from 2011.**

The latest in-market kiwifruit prices have fallen as is normal for this time of the year as Northern Hemisphere supply is underway. Chilean kiwifruit supply declined in most markets slightly earlier than last year, which provided some breathing space and better prices for New Zealand product.

Latest wine export volumes have increased by 10.3 percent to 166.6 million litres in the year to September 2011. Bottled wine shipment volumes remained flat, while bulk wine shipments increased to 37 percent of total volume for the period.

**The annual average unit value has declined further to FOB \$6.86 per litre in response to the higher proportion of bulk wine exports in the mix.** The price differential between what bottled/branded wine is being sold for versus bulk is distorting averages. In fact the price received for bottled export sales is not too different today from what it was back in 2007. In 2007 the average price per litre of bottle wine was \$9.30 compared with \$8.70 in 2011. Back then, bulk wine made up only 5 percent of total exports and the price ratio of bottle to bulk wine was only 1.5. In the 2011 financial year bulk exports were 30 percent of total exports and the price ratio of bottled to bulk wine grew to 3. This has left the national average price at \$7.07 per litre in 2011, compared with \$9.19 per litre in 2007.

Kiwifruit Indicator Prices



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

Apple Indicator Price Index



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

## KEY COMMODITIES: OIL AND FREIGHT

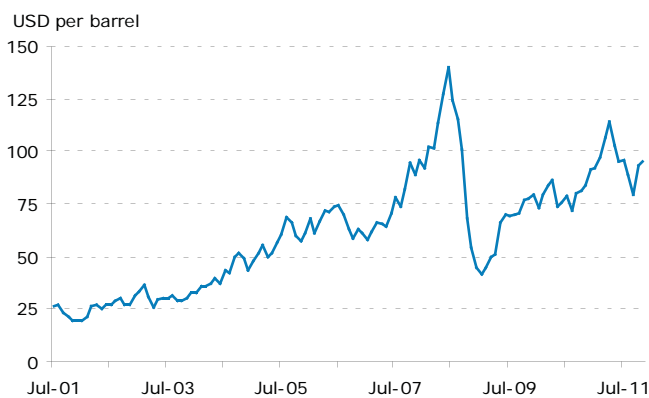
### OTHER COST INDICATORS

	Current Month	Last Month	Last Year	Chg. M/M	Chg. Y/Y
Crude Oil <sup>1</sup>	95	93	84	↑	↑
Ocean Freight <sup>2</sup>	1,835	1,965	2,099	↓	↓

<sup>1</sup> USD per barrel, grade WTI

<sup>2</sup> Baltic Dry Index

### Crude Oil Indicator Price (WTI)



Sources: ANZ, National Bank, Bloomberg

### Ocean Freight (Baltic Dry Index)



Sources: ANZ, National Bank, Bloomberg

**Global oil demand will grow slightly less than previously projected this year and next, the US Energy Information Administration (EIA) forecast in a report.** The EIA lowered its 2012 world oil consumption growth forecasts by 220kbbbls per day to 89.62mbbls per day. On the supply side, the EIA forecast 2012 OPEC production would be down by more than originally forecast, but non-OPEC supplies would help make up the difference.

**Russia, the world's largest producer of oil, increased oil production to a post-Soviet high of 10.34mbbls per day in October.** The key reason was cuts in export duties. Libya signalled it may not support Gulf Arab OPEC producers when the exporters' group meets in December, saying other countries should reduce output to make space for Libya's returning oil output. The pressure is beginning to build up again ahead of the December meeting, as consumers say prices above US\$100 per bbl are hurting the global economic recovery. However, those warnings are unlikely to be the main concern for Libya, which needs to maximise oil revenues to get fresh cash injections to rebuild infrastructure damaged by seven months of civil war. Libya's National Oil Corporation (NOC) expects crude exports to rise to 1.345mbbls per day by the fourth quarter of 2012, **indicating the OPEC member's oil is returning to the international market faster than expected.**

China's crude oil production in October fell 6.2 percent year-on-year to 3.93mbbls per day. Reports said the fall in processing rates may be a sign that domestic refiners are nearing maximum capacity. China cut retail prices for diesel and gasoline in early October, squeezing margins at state refineries and forcing many independent plants to cut or halt production. **The supply squeeze in China is expected to ease this month or next, suggesting prices will stay below \$100 per bbl in the near term.**

**The Baltic Exchange's main sea freight index is down 7 percent this month as a cargo slowdown on the larger capesize market continued to take its toll.** The overall index fell 130 point to 1,835 points. Rents for capesize ships that haul iron ore and coal slid 5.1 percent to \$25,300 per day, as the number of the vessels available for short-duration voyages jumped to 1 in 7 from 1 in 10. Ton-mile demand, or cargo volume multiplied by distance shipped, fell 23 percent. Such a combination of increasing tonnage supply and falling ton-mile indicators probably means lower freight rates for sometime to come.

## ECONOMIC BACKDROP

### SUMMARY

Rather than focus on intra-weekly noise and “risk on” and “risk off” sentiment shifts around the globe, we prefer to focus on the underlying trends, namely heightened volatility, a downwards risk profile for the global economy, and slow growth across Western society. The New Zealand economy continues to display relative resilience in some areas, although we are now seeing more fragmentation across data outturns. Some of this reflects deep-rooted structural challenges, but a growing share looks to be related to the global scene. A slow grind for the New Zealand economy remains our core view.

### OUR CORE ECONOMIC VIEW

**Global events continue to dominate the local scene.** Tail risks from a global slowdown remain prevalent, with continued concerns about the European debt situation pointing to a slowdown in trading partner growth. Deleveraging (debt reduction) has always been a precondition to the global economy returning to a sustainable recovery path. However, there is now **more debt in the global economy than prior to the 2008 event**, with lower private sector debt offset by a massive rise in government debt.

**International policymakers are of course trying to minimise downside risks but there is only so much they can do.** Fiscal policy is impotent given the huge amount of government borrowing already going on. Interest rates are near zero in most major OECD nations. A host of countries have instigated quantitative easing (so-called printing of money). In fact Japan has been doing it for 20 years. The US has done it not just once, but twice, and there is speculation is we could see a third crack. Sugar pill solutions haven't worked so we're not sure why they would suddenly gain traction.

**This is the harsh reality in which we now reside.** The news is not all downbeat. Some regions such as China continue to perform well, though cracks are appearing. However, as the RBNZ point out in their November Financial Stability Report, *“Risks to the New Zealand economy and financial system have increased...stresses created by weak growth and the overhang of substantial public and private debt have intensified”.*

**We continue to eye key transmission mechanisms to New Zealand**, including commodity prices, the currency, confidence and funding costs.

- Commodity prices are 8 percent off their May peaks, but remain elevated.
- The NZD is performing more somersaults than a gymnast but it's still moving in line with risk

sentiment. This means “risk-off” or nervousness pushes the NZD down, which, ironically, helps a small exporting nation out.

- Confidence has declined and we are starting to see more cautious tones, though the level remains solid. New Zealand appears somewhat lucky in that a large one-off event in the form of the Rugby World Cup provided feel-good support during a period of heightened uncertainty.
- Funding costs remain at elevated levels, but this “cost” is more theoretical than real for now.

**Against this backdrop the New Zealand economy is actually performing okay.** We're seeing growth, albeit somewhat patchy, a bit of debt is being paid down, some spending is going on and we're earning a bit more. It's respectable and orderly, though somewhat grumpy. Given the global scene doing “okay” is probably a sign of resilience.

**However, the tenor of New Zealand data is becoming more dichotomised.** While positive momentum remains, we are starting to see early signs of waning momentum in leading gauges. The Rugby World Cup appeared nicely timed to fill a hole in underlying momentum and keep confidence robust – though domestic retail is likely to be weaker in the RWC aftermath. Growth in early 2012 is likely to be sluggish, with a lull between the Rugby World Cup and the stepping up of earthquake reconstruction work. The labour market is holding up, with official unemployment benefit numbers lower than a few months ago, and hours worked and employment outside of Canterbury strengthened in Q3. However, official figures lag, and job ads are now declining – a worrying sign. **We continue to expect a sustained period of heightened volatility** and a subdued trend rate of growth for the New Zealand economy against the backdrop of cyclical support mechanisms facing off against structural headwinds.

A sustained improvement in key structural indicators is a prerequisite to an improvement in New Zealand's economy. This remains a key anchor behind our economic view. There remains a long way to go on this front. In the glass-half-full interpretation of current events, increased savings as a result of nervousness about the global situation would speed necessary structural adjustment, albeit at the cost of near-term growth. But the danger is that our income-generating capacity is slowed by lower commodity prices, making structural adjustment harder.

## BORROWING STRATEGY

### SUMMARY

Carded rural fixed interest rates have fallen since our last edition, having been cut following falls in wholesale interest rates. By contrast, the carded floating interest rate has not changed, largely because the OCR has not changed. With the RBNZ on hold for at least the next 6 months, and risks in Europe escalating, the 6 month rate is our preferred tenor. Not only is it the lowest rate, but it offers a good balance of cost, flexibility and certainty against the outlook, bearing in mind the considerable downside risks.

### OUR VIEW

Wholesale interest rates have fallen significantly over the past few weeks, **taking swap rates to all time lows across the entire yield curve.** This has paved the way for cuts in carded rural fixed interest rates ranging from 0.25 to 0.35 percent. However, **because the OCR has not fallen, the floating interest rate remains unchanged.** The carded floating interest rate is high at 7% (and notably higher than all fixed rates 3 years and less) and as such is a fairly unattractive proposition, especially given that the 6 month rate is lower, and as noted, we expect the RBNZ to be on the sidelines for at least the next 6 months.

**It seems clear then that the 6 month rate is more attractive than floating. But is it worthwhile fixing for a longer period – perhaps for 1, 2 or even 3 years? From a pure cost perspective, we are not entirely convinced.**

Fixed rates like the 1 year and 2 year are the same or similar to the 6 month rate, so the step-up is zero or negligible. However, if one does elect a longer fix, one might miss out on even better opportunities should fixed rates continue falling. These are, among other things, the considerations we discuss in what follows.

Although we do not expect the RBNZ to cut the OCR, the market is starting to shift to this view, and with the sovereign debt crisis in Europe escalating by the day, we may well see wholesale interest rates move lower yet. That said, as we **stress regularly – cost is only one part of the equation. Certainty has a value – and because the step up to fix has fallen, the cost of certainty has just dropped.**

If we ignore the benefit of certainty (which is qualitative and thus difficult to quantify), **we believe 3 things matter when it comes to the question of whether it is worthwhile fixing.** They are (1) the immediate cost; (2) the likely overall cost; and (3) the flexibility one gives up if one chooses to fix.

The first consideration is the easiest to answer. Indeed, **at the moment, the 6 month and 1 year borrowing rates are the cheapest. With the**

**OCR not likely to change in the next 6 months,** it is an easy choice to go for 6 months. But with no difference between the 6 month and 1 year interest rate, and only a small step up into 2 years, is it worth fixing for longer?

The best way to answer this is to ask what the overall cost is likely to be, and to consider how “hemmed in” one would be if one did fix. Without being able to perfectly predict the future, we cannot say for sure how costs will stack up. **But we can use breakeven analysis, as we do every month, and turn the question on its head. That is, we ask where interest rates need to go in order to make fixing beneficial,** and then compare those levels to our forecasts or expectations.

**What we find from our tables is that breakeven levels have fallen dramatically** when compared to our last edition – as the table below shows. Broadly speaking then, this suggests that the “hurdle” to fixing has fallen. **In other words, we wouldn’t need to see borrowing rates rise by as much to make fixing worthwhile.** The question is how much, and this is where things get tricky.

Rural Lending Rates		Breakeven rates in			
Term	Current	in 6mths	in 1yr	in 2 yrs	in 3 yrs
Floating	7.00%				
6 mths	6.55%	6.55%	6.70%	7.40%	8.00%
1 year	6.55%	6.63%	6.75%	7.55%	8.15%
2 years	6.65%	6.86%	7.15%	7.85%	8.58%
3 years	6.95%	7.19%	7.48%	8.23%	
4 years	7.25%	7.53%	7.86%		
5 years	7.60%				

Consider, for example, the 6 month and 1 year breakevens for each the short terms (i.e. 2yrs and less). All are subdued, and show that borrowing rates would not need to rise by much to make fixing worthwhile. But notice how they all step up quickly in 2 years and 3 years. This is not what we expect to happen. Indeed, we expect the OCR to remain on hold for the next 6 months, and to rise only gradually thereafter.

**What about flexibility? The main risk here is that borrowing rates fall after you fix, or your fixed rate expires just as borrowing rates are starting to rise.** There is no way to predict this, but it is probably obvious that the longer you fix for, the less flexibility you have. **And it is this consideration that has us favouring the 6 month rate over the other rates. Put simply, we expect the choices one has in 6 months time to still be attractive,** and by then we will have a better idea of the impact European travails will have on the NZ economy.

## EDUCATION CORNER: MONETARY POLICY IN NEW ZEALAND

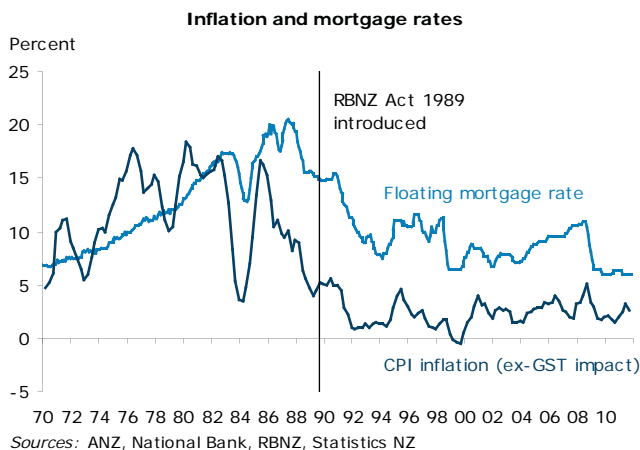
### SUMMARY

In our frequent travels around the country, we regularly hear gripes from the business and farming communities regarding New Zealand's monetary policy framework and the perceived collateral damage it delivers via the currency. This article takes a basic look at the framework and its evolution. While not a perfect system, and further tweaks could certainly improve things, it is better than the alternatives on offer. And we should remember that New Zealand has tried some of the alternatives that have been mooted before, with disastrous consequences.

### EVOLUTION OF MONETARY POLICY IN NZ

New Zealand has seen it all in terms of monetary policy: the gold standard; a fixed exchange rate; a freely floating exchange rate; capital controls on international money flows; money printing and its associated high inflation, and now inflation targeting.

In 1989 New Zealand was the first country in the world to introduce inflation targeting as a formal monetary policy framework, an interesting but untested academic idea at the time. Prior to that, monetary policy had been run by politicians, and the results were not good, with high inflation and floating mortgage rates over 15 percent. Most damaging of all, inflation and interest rates were extremely hard to predict, making economic planning for households, farmers and businesses extremely difficult.



The Reserve Bank Act of 1989 established price stability as the single objective for monetary policy, and also set out a governance structure. The most important thing the Act did was to make the operation of monetary policy independent from the Government of the day. Consistent with democratic principles, the Government was still responsible for setting the inflation target. However, the Reserve Bank was given operational independence in how it achieved those goals, divorcing monetary policy from the election cycle.

Early Policy Targets Agreements (PTAs) between RBNZ governors and Ministers of Finance focused heavily on inflation outcomes. After years of high inflation, it was very important to quickly build up inflation-fighting credibility. As the cartoon below from 1988 shows, the RBNZ had its work cut out for it.



Of course, stable inflation is not the be all and end all. There are trade-offs involved. As credibility has been won, the inflation targeting framework has gradually evolved to be less purely focused on CPI inflation outcomes and instead taking more account of the "costs" of inflation targeting. The current PTA strikes a balance: allowing a degree of flexibility while providing a medium-term discipline that helps keep inflation expectations broadly in check.

Compared to the original settings, the current PTA has a higher inflation target band (1-3 percent rather than a strict 0-2 percent); a longer timeframe in which to hit it ("on average over the medium term", as opposed to in real time); a requirement to "avoid unnecessary instability in output, interest rates and the exchange rate"; and a broader definition of "shocks" that might cause an acceptable short-term deviation from the inflation target. All these things are designed to reduce the short-term pain inflicted on the economy by inflation targeting, but this has come at the cost of gradually upward creeping inflation. If that trend continues, at some point, the RBNZ will have to get tough on inflation again. But at present, the upward drift is not sufficient to seriously endanger the credibility of the framework.

### DETAILS OF THE CURRENT FRAMEWORK

The essential ideas underlying inflation targeting as a monetary policy framework are threefold:

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- **Monetary policy cannot raise the trend rate of growth** in the economy (though if done poorly it can damage it, as NZ saw in the 1970s!).
- **A little inflation is good. A lot is bad.**
- **Most of the time, increases in CPI inflation reflect an economy that is overheating, and/or a rise in inflation expectations.** If this isn't the case, the causes will be clear, and short term in nature.

The idea, then, is that **if the central bank sees the economy lifting above sustainable rates of growth, or sees inflation rising, it responds by raising the Official Cash Rate (OCR).** They impose this rate on the market by standing ready to lend cash just below the OCR, and ready to borrow cash just above the OCR. This has the effect of sandwiching the market overnight cash rate at or very close to the OCR.

The overnight wholesale cash rate is of course not the rate that matters to people out in the street. They care about the retail interest rate, and very often usually for a term longer than one day (i.e. a fixed rate). **The influence the Reserve Bank has on wholesale rates wanes the further out along the "curve" one goes.** They have a very strong influence on 90-day rates, for example, which underlie floating mortgage rates, but little influence on, say, the 10 year wholesale interest rate, which will depend more on factors such as long term inflation expectations, country risk premium and global interest rates. **If a high proportion of mortgages are on floating or short-term rates, the Reserve Bank will get "more bang for its buck" when it raises the OCR.** On the other hand, a rush of mortgage fixing blunts the transmission mechanism.

If excess demand is the problem, increasing interest rates has the effect of killing two birds with one stone: dampening the economy's over-exuberance and the inflation bump at the same time. **Things get tricky when the observed or expected inflation reflects not excessive demand, but insufficient supply. For example, an oil price shock can cause inflation while the economy is in fact weak. In this case, monetary policy faces stark trade-offs between stabilising inflation or stabilising output. In practice, policymakers tend to "look through" such shocks as long as inflation expectations do not start to rise unduly.** The inflation targeting framework in New Zealand is yet to be seriously tested by a very large, persistent shock of this nature, as inflation expectations have remained well behaved on the whole. There will be no magic bullets when it is.

### PROS AND CONS

**The weight of international evidence and practice supports New Zealand's focus on maintaining low inflation through the use of a formal inflation target.** In recent years the number of countries adopting an inflation targeting approach to monetary policy has increased.

The current New Zealand framework has been acknowledged to be close to best practice globally.<sup>1</sup> However, inflation targeting is not the answer to everything. Indeed, **the Global Financial Crisis of 2008 and the current turmoil in Europe perhaps provide the most serious challenge to the inflation targeting framework since its inception.** It has raised serious questions, such as:

- **Does focusing on CPI inflation blind policymakers to crucial imbalances, such as asset price bubbles,** elsewhere in the economy?
- **Does the framework cope adequately with highly persistent supply shocks?** There are an increasing number of people who argue that the imported low inflation from China (a highly persistent positive supply shock) led to interest rates being kept too low for too long in both the US and Europe, fuelling housing bubbles that have damaged household balance sheets and banking sectors all around the world.
- **What is the "ideal" rate of inflation?** A little inflation greases the wheels of the economy by assisting real wage adjustment. Too low inflation expectations increase the risk of a "liquidity trap" such as the one Japan has languished in for decades. But unexpectedly high inflation rewards borrowing, punishes savers, and leads to inefficient resource allocation.
- **Is the OCR the best tool available? It is a very blunt instrument.** It whacks those with a mortgage or business loan hard, whereas savers benefit. And whether one is a saver or a borrower is largely to do with one's age. This arbitrary redistribution of wealth hardly seems fair.

### IMPACT ON THE EXCHANGE RATE

**A long-term concern in New Zealand, particularly within the rural sector, has been the impact of inflation targeting on the exchange rate. High interest rates encourage speculative activity and the so-called "carry trade" where people borrow in a low interest rate region and invest in a high one. However, it is**

<sup>1</sup> See <http://www.rbnz.govt.nz/monpol/review/index.html>

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**worth bearing in mind that some of the extreme movements in the NZD have not been interest rate driven** – the collapse in the NZDUSD to sub 40 cents in 2000 being an example. In that period of USD “irrational exuberance”, countries that raised interest rates, such as Australia, saw their currencies belted lower, as higher rates were seen as bad for growth! These sorts of peculiarities show just how fickle currency markets can be. And let’s not forget the NZD tends to move with commodity prices.

**Some have called for an exchange rate target to be explicitly included in the PTA. Unfortunately, it isn’t that simple.** If monetary policy tries to sit in two boats it will fall in the water between them. Economists talk about the “impossible trinity”: the exchange rate, interest rates, and free flow of money over the national border. Only two can be controlled at any one time. In short, if New Zealand wanted to both target inflation via manipulating interest rates, and fix the exchange rate, **we would have to impose stringent capital controls (the Chinese model)**. New Zealand’s experience with this kind of highly interventionist policy did not end happily, with a currency crisis resulting in 1984.

**In addition, if you wanted to peg or fix the currency, the inevitable question is to whom?** The AUD naturally springs to mind, but it is equally as volatile. And with a currency union comes monetary union. This would mean New Zealand’s OCR would be the same as Australia’s (4.5 percent at the moment), and we would not have the benefit of a lower NZDAUD cross rate to help out our exporters to Australia. Pegging to the USD might help us now, but how would NZ.Inc have fared when the USD was mighty against all and sundry in 1999 and 2000?

**In practice, the RBNZ has very limited ability to target the exchange rate using interest rates without creating additional volatility elsewhere in the economy.** Direct exchange rate intervention by the Bank is done rarely, with the aim being to reduce some of the cyclical extremes in the exchange rate cycle. **The most effective way to limit the exchange rate impact of inflation targeting is for policy to react promptly to signs that inflation pressure may be emerging**, particularly from the housing market. It is monetary policy that is “behind the 8 ball” that makes the currency seem a one-way bet to speculators.

### THE PATH FORWARD

The inflation targeting framework has evolved over time, and will continue to do so.

**The OCR is still acknowledged as the primary policy instrument, but there is a growing realisation that it needs to be reinforced to**

**increase its effectiveness.** One instrument means one target. It is mathematically impossible to target multiple variables with one instrument. So if we want to iron out extremes, we need more instruments or tools.

Either directly or indirectly, major swings in the NZD have been tied to extreme movements in asset prices. Consider the mid 1990s housing boom, the pot of gold at the bottom of the US dot.com rainbow in the lead-up to 2000, and the fabled credit bubble of the preceding decade. The global financial crisis has brought things to a head. **The consensus is now that you can’t separate macrofinancial stability and the soundness of the financial system (i.e. the formation of bubbles) from the outlook for the macroeconomy.**

Policymakers are naturally turning to prudential policy and greater regulatory oversight. It is inevitable that prudential policy will play an even greater role in the future. And it needs to be globally driven as opposed to merely New Zealand doing its part. **There are three main thrusts to prudential policy:**

- **stronger capital and liquidity standards for banks;**
- **managing system-wide risks using macroprudential tools;** and
- **improving the resolution framework for dealing with bank failures.**

**In New Zealand, the RBNZ has forced banks to hold more longer-term funding to reduce their exposure to fickle international funding markets.** This has pushed up longer-dated wholesale borrowing rates relative to shorter ones. **We’ve seen modified rules for rural lending** with banks needing to hold more capital (which means credit margins rise) **and tighter rules surrounding finance companies.**

**Regulation in the form of prudential oversight is like paying for a bit of insurance**, and it doesn’t come free. **So the downside to these types of tweaks is that someone ends up paying for it, and that someone tends to be the final borrower.** There is no free lunch! A bit of regulation is good. A lot is bad. It’s a fine line striking the correct balance between free-market principles and the nanny state.

**But there is an upside. Shifting the shape of the yield curve is encouraging borrowers onto floating or short-term fixed rates, meaning changes to the OCR have a faster impact on the economy.** Higher credit costs means the OCR shouldn’t need to go up as far. **The potential for another credit-fuelled housing bubble is**

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**reduced** by new liquidity rules, including the need to adhere to a minimum core funding ratio: if credit starts to ramp up again, banks will need more deposits or long-term funding, which means deposit rates will move up. And if deposit rates lift, so too will borrowing costs, acting as an effective handbrake.

**All these should be factors helping to keep the OCR lower than would otherwise be the case, thereby taking pressure off the currency.**

Macroprudential tools are designed to address risks across the financial sector, rather than overseeing each institution individually and assuming that if the parts are sound, then the sum is too. Further tools are in the pipeline. **One key idea is to try to smooth out the credit cycle – booms and busts in the availability of credit** that can have at least as large an impact on the economy as cycles in the costs of credit (i.e. interest rates). **Such measures could include things such as time-varying capital requirements, or restrictions on lending such as loan-to-value caps. Smaller cycles in credit availability would be helpful for monetary policy by dampening asset price cycles,** such as house price booms and busts.

**A key problem here is getting some uniform consistency across geographies.** We live in a world where capital moves at the touch of a button. Banking and credit is global whereas regulation tends to be local. The Europeans and Americans have divergent views on monetary and prudential policy. Just look at how they responded over the last three years. Getting agreement will not be easy.

In addition, **there is a shortage of savings across Western society and an excess across Asia.**

This is where the unbalanced nature of the global economy is still problematic in more ways than one. This money needs to find a home and there is a wall of it. **Tightening up local prudential measures will make little difference if this wall of cash is looking for opportunities, and decides to come knocking at your doorstep.**

### OTHER TWEAKS

What other changes could we envisage? How about a wider definition of price stability? **Rather than the narrow focus on inflation itself, we could target a broader definition that includes asset prices.** Though trying to determine when bubbles form will prove to be a tricky proposition, as we tend to only know after the fact.

Another area that would assist monetary policy is to get a degree of independence into fiscal policy, if it can assist in getting greater coordination between the two. **Imagine being able to tweak tax rates**

**and government spending as well as interest rates!** Then you would have numerous tools at your disposal and you'd be able to "target" more effectively, rather than relying on the blunt OCR instrument. If consumer spending was too hot, you could tweak the tax rate. Of course, introducing greater "independence" into fiscal policy is asking democratically elected politicians to cede their rights, so good luck with that! **Obviously this is a bridge too far,** but suffice to say the better the co-ordination between monetary and fiscal policy (which we are seeing of late), the more effective policy will be in terms of economic outcomes.

### THE UPSHOT

It is easy to point the finger at monetary policy. But too often this is because detractors expect too much from monetary policy, or do not understand its role. **Monetary policy cannot lift the trend growth rate of the economy** – it is designed to minimise the fluctuation of the economic cycle around the trend. **While monetary policy has a short-term influence on the exchange rate, there are ultimately wider forces at work which swing it around** – such as commodity prices and the fortunes of the USD. **Monetary policy is designed to deliver low and stable inflation, not help out exporters or deliver low interest rates for all.** You need other policies or changes in savings behaviour to address those issues.

What we do know is this:

- **The current framework is pretty good.** It has stood up to numerous reviews and you only need to look at New Zealand's economic performance from the onset of inflation targeting compared to prior decades to appreciate its value.
- **It is not perfect, and there are limitations. But there is no such thing as a magic policy bullet.** Monetary policy was designed to achieve stable inflation, and that is what it has delivered.
- **There will be tweaks and changes.** But we see the process of change as evolutionary as opposed to revolutionary.
- **Better the devil (or framework) you know than the devil you don't.** Beware people postulating massive changes to New Zealand's monetary policy framework. Some of the proposed solutions are snake oil.

And finally, we should remember that New Zealand has tried some of the alternatives that have been mooted before, with disastrous consequences.

## KEY TABLES AND FORECASTS

FX RATES	ACTUAL			FORECAST (END MONTH)						
	Sep-11	Oct-11	23-Nov	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13
NZD/USD	0.761	0.807	0.748	0.77	0.80	0.83	0.86	0.89	0.90	0.90
NZD/AUD	0.788	0.766	0.760	0.79	0.80	0.79	0.78	0.81	0.82	0.82
NZD/EUR	0.569	0.582	0.554	0.57	0.58	0.59	0.61	0.61	0.62	0.62
NZD/JPY	58.67	63.06	57.59	57.8	60.0	59.8	61.9	64.1	63.0	63.0
NZD/GBP	0.489	0.502	0.479	0.50	0.51	0.52	0.53	0.55	0.55	0.55
NZ\$ TWI	68.3	70.4	66.5	68.4	70.3	71.3	72.8	74.8	75.4	75.4

INTEREST RATES	ACTUAL			FORECAST (END MONTH)						
	Sep-11	Oct-11	23-Nov	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13
NZ OCR	2.50	2.50	2.50	2.50	2.50	2.75	3.00	3.00	3.25	3.50
NZ 90 day bill	2.86	2.73	2.66	2.70	2.70	3.00	3.25	3.25	3.70	3.75
NZ 10-yr bond	4.42	4.50	3.99	4.25	4.25	4.25	4.25	4.35	4.40	4.55
US Fed Funds	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
US 3-mth	0.37	0.43	0.42	0.35	0.35	0.35	0.35	0.35	0.35	0.35
AU Cash Rate	4.75	4.75	4.50	4.50	4.25	4.25	4.25	4.25	4.25	4.25
AU 3-mth	4.92	4.71	4.64	4.70	4.60	4.60	4.50	4.50	4.50	4.50

ECONOMIC INDICATORS	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13
GDP (% qoq)	0.9	0.1	<b>0.8</b>	<b>1.1</b>	<b>0.2</b>	<b>0.5</b>	<b>0.7</b>	<b>1.0</b>	<b>0.9</b>	<b>0.7</b>
GDP (% yoy)	1.7	1.5	<b>2.4</b>	<b>2.9</b>	<b>2.2</b>	<b>2.6</b>	<b>2.5</b>	<b>2.4</b>	<b>3.1</b>	<b>3.3</b>
CPI (% qoq)	0.8	1.0	0.4	<b>0.3</b>	<b>0.6</b>	<b>0.7</b>	<b>0.9</b>	<b>0.4</b>	<b>0.6</b>	<b>0.7</b>
CPI (% yoy)	4.5	5.3	4.6	<b>2.5</b>	<b>2.3</b>	<b>2.1</b>	<b>2.5</b>	<b>2.6</b>	<b>2.6</b>	<b>2.6</b>
Employment (% qoq)	1.2	0.0	0.2	<b>0.3</b>	<b>0.2</b>	<b>0.5</b>	<b>0.4</b>	<b>0.3</b>	<b>0.3</b>	<b>0.3</b>
Employment (% yoy)	1.8	2.0	1.1	<b>1.8</b>	<b>0.8</b>	<b>1.3</b>	<b>1.4</b>	<b>1.4</b>	<b>1.5</b>	<b>1.3</b>
Unemployment Rate (% sa)	6.5	6.5	6.6	<b>6.4</b>	<b>6.4</b>	<b>6.2</b>	<b>6.1</b>	<b>6.0</b>	<b>6.0</b>	<b>6.0</b>
Current Account (% GDP)	-3.6	-3.7	<b>-3.9</b>	<b>-3.3</b>	<b>-3.5</b>	<b>-3.6</b>	<b>-4.0</b>	<b>-4.4</b>	<b>-4.5</b>	<b>-4.5</b>
Terms of Trade (% qoq)	0.8	2.3	<b>1.5</b>	<b>2.1</b>	<b>-0.8</b>	<b>-0.8</b>	<b>-0.8</b>	<b>-0.8</b>	<b>-0.7</b>	<b>-0.7</b>
Terms of Trade (% yoy)	6.7	7.0	<b>5.5</b>	<b>6.8</b>	<b>5.1</b>	<b>2.0</b>	<b>-0.3</b>	<b>-3.1</b>	<b>-2.9</b>	<b>-2.9</b>

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 SEPTEMBER 2011**

	Global Total	Australia	China	USA	Japan	Korea	UK	Germany	India	Taiwan	Indonesia	Malaysia	Singapore	Hong Kong	Philippines	Thailand	Saudi Arabia	Nether-lands	Canada	UAE	Italy
Sheepmeat	3,040	10	187	321	67	5	595	296		60		66	14	38	1	6	94	162	119	13	36
Beef	2,078	16	11	799	187	176	40	22		132	117	14	45	39	41	8	8	38	123	20	22
Other Meat	449	24	10	20	43	26	32	68		2	18	3	7	17	2	2	8	29	5		3
Milk Powder	6,595	79	1,745	5	23	13			49	173	239	324	227	45	278	274	299	4		285	
Butter	2,511	90	197	81	31	28			41	80	52	57	48	21	86	51	138	2	29		45
Cheese	1,358	266	69	10	307	113	32		2	41	48	26	9	19	52	16	42	26		18	
Whey/Casein	1,643	59	182	673	211	43	4	112	4	11	25	16	53	4	23	2	23		23		35
Kiwifruit	1,053	64	90	28	298	72		227	3	69	7	12	9	28	1	5			2	4	32
Apples	369			43			46	51	16	26	5	10	9	25	20			53	6	11	
Other Fruit/Vege	613	282	4	32	145	21	3	3	2	16	2	16	9	6	1	13		3	2		1
Wine	1,122	354	21	231	11	1	297	6	1		1	2	13	19	1	1		29	61	5	1
Wool	686	74	219		83	90			12	25	93	25	10		8	32					
Skins/Hides	733	40	313	25	-59	-67	66	43	59	-12	-84	-21	-10	47	-8	-16		1	4	1	280
Logs	1,780		1,078		179	307			194	13					3					1	
Sawn Timber	1,100	333	135	157	91	49	2	2	8	40	26	14	4	1	46	31	14	6	1	7	1
Fibreboard/Plywood	370	67	28	16	181	1			4	4	19	7	1		4	2	5		1		
Wood Pulp	686	74	219		83	90			12	25	93	25	10		8	32					
Fish/Seafood	1,474	283	260	162	120	42	15	31	1	9	1	9	31	151	3	23	2	7	13	3	11
Crude Oil	2,239	2,168			23								7		17						
Aluminium	1,261	98	29	74	656	123	58		23	2	5	1		11			85	3			
Remainder	15,627	6,173	1,002	1,226	654	498	350	160	536	186	204	244	303	299	191	204	78	172	186	83	34
<b>TOTAL</b>	<b>46,790</b>	<b>10,555</b>	<b>5,798</b>	<b>3,905</b>	<b>3,333</b>	<b>1,633</b>	<b>1,541</b>	<b>1,022</b>	<b>965</b>	<b>904</b>	<b>871</b>	<b>849</b>	<b>798</b>	<b>770</b>	<b>738</b>	<b>730</b>	<b>712</b>	<b>617</b>	<b>577</b>	<b>497</b>	<b>455</b>

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

	Global Total	Australia	China	USA	Japan	Korea	UK	Germany	India	Taiwan	Indonesia	Malaysia	Singapore	Hong Kong	Philippines	Thailand	Saudi Arabia	Nether-lands	Canada	UAE	Italy
Sheepmeat	342	-2	76	76	12	2	-13	41		-5		17	1	-27		4	-20	80	20	-1	-2
Beef	225	4	2	60	-9	33	12	8		20	-28	1	2	1	6	1		17	30	4	4
Other Meat	20	4	6	3	6	4	-4	-8		-1	-6		1		1	-1	9	3			1
Milk Powder	1,402	15	386	2	3	9			-14	37	10	42	-3	21	16	78	119	-1		60	
Butter	649	3	106	-25	28	10		-1	-32	26	-3	16	8	5	3	25	61	1	23	16	
Cheese	-76	-53	5	-6	18	12	-15		2	4	9	-2	-2		-5	6	-5	-4		-2	
Whey/Casein	180	9	51	99	-1	7	2	40		5	-10	6	22	1	2	-3	4	-3	-12		6
Kiwifruit	52	15	15	-2	3	6		5	1	4	2	1	5		5	1			-2	1	
Apples	30			-17			6	3	7	4	1	5	2	8				1			
Other Fruit/Vege	53	37	1	2	14	3	-2	-1		3	1	-7	-4	-3		5		1			
Wine	64	21	4	5	1		10	1						6				7		2	
Wool	20	-13	77		-25	2				-7	-20	1	9		-2	-1					
Skins/Hides	302	8	103	1	30	4	15	15	-8	9	21	1	-10	3	2	-2			1	1	82
Logs	515		391		27	30			70	3								-2			-5
Sawn Timber	-35	6	-5	-46	4	11			5	12		1	-1	-1	11	7	-12	-9			-7
Fibreboard/Plywood	26		-5	-1	31	-1				-1	1	1					1				-1
Wood Pulp	20	-13	77		-25	2				-7	-20	1	9		-2	-1					
Fish/Seafood	90	5	118	-6	2		4	-5		-6		2	-9	-103	-2	12	1	2	1	-1	2
Crude Oil	156	436			-64									-186		-32					
Aluminium	121	-26	4	26	45	20	15	-8	11	-6	2	-3		-2				41	-4	-1	
Remainder	847	212	69	23	-15	122	-12	1	166	-12	-7	26	-113	7	11	43	31	2	50	14	-46
<b>TOTAL</b>	<b>5,002</b>	<b>669</b>	<b>1,480</b>	<b>194</b>	<b>84</b>	<b>278</b>	<b>19</b>	<b>93</b>	<b>211</b>	<b>81</b>	<b>-45</b>	<b>109</b>	<b>-273</b>	<b>-81</b>	<b>40</b>	<b>139</b>	<b>180</b>	<b>143</b>	<b>109</b>	<b>79</b>	<b>47</b>

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

	Global Total	Australia	China	USA	Japan	Korea	UK	Germany	India	Taiwan	Indonesia	Malaysia	Singapore	Hong Kong	Philippines	Thailand	Saudi Arabia	Nether-lands	Canada	UAE	Italy
Sheepmeat	122		11	8	2	1	15	24		6		-7		4		1	3	24	6		1
Beef	42	1	1	19	-16	4	3	1		2	9	-1	1	3	2	-1	-1	5	4	2	2
Other Meat	5	3	1				1	-6				-1		1				5	1		
Milk Powder	-1	5	-94	1	1	1			7	14	10	6	5	8	4	-10	15	2		6	
Butter	111	-4	26	6	7	3			-5	-2	4	2	7	2	-1	5	8	2	14	1	
Cheese	3	-25	-1	-4	20	-3	11				1	-2			4	2	3	6		-1	
Whey/Casein	22	1	15	-12	1	3		-1		1	-2	2	10		5			5			-2
Kiwifruit	58	9	6	-1	10	10		18		2	1	1		4						1	4
Apples	-3						-1	-1	1	-2			1	1		-2					
Other Fruit/Vege	29	30	1		6							-6				2					
Wine	29	16	4	-1			3	1					-1	1				1	2	1	
Wool	-2	-3	10		-4	2			-1	-2	-2	-2	4		1	-5					
Skins/Hides	76	-2	44		4	-3		3	3	2	2	3	-4	-3	-1	3					20
Logs	83		74		11				-1												-2
Sawn Timber	-41		-8	-12	-1	2		-1		1	-1	-1	-1		-1	1	-8	-5			
Fibreboard/Plywood	8		-2	-1	9				-1		2				2		-2				
Wood Pulp	-2	-3	10		-4	2			-1	-2	-2	-2	4		1	-5					
Fish/Seafood	-28	-4	15	-15	-6	3		-9		-1			-3	-37	1	5		1	-1		1
Crude Oil	160	199			-23											-17					
Aluminium		-7	4	-9	24	-11	-1	-1	3	-1	2			-2				14	-5		
Remainder	763	269	208	-33	-117	55	20	29	157		-7	46	56	-16	14	15	11	50	50	5	-72
<b>TOTAL</b>	<b>1,435</b>	<b>484</b>	<b>326</b>	<b>-53</b>	<b>-76</b>	<b>73</b>	<b>52</b>	<b>57</b>	<b>162</b>	<b>18</b>	<b>18</b>	<b>40</b>	<b>76</b>	<b>-35</b>	<b>32</b>	<b>-7</b>	<b>27</b>	<b>106</b>	<b>75</b>	<b>13</b>	<b>-45</b>

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